The 1981 Budget.

Review of Corporation Tax and Stock Relief.

PART 5.

ECONOMIC POLICY.

Part 1 : May 1979

Part 5 : Feb 1981.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~25-2-81~~		~~25.6.81~~					
~~[illegible]~~		~~2.7.81~~					
3-3-81.		10.7.81					
6-3-81		— Ends —					
~~[illegible]-3-81~~							
10.3.81							
~~[illegible]-3-81~~							

PREM 19/439

NB: Financial Statement & Budget Report
1981 - 82

and

Cmnd 8175: Govt's Expenditure Plans
1981-2 & 83-4

in Yellow folder at back of file

TREASURY & C.S. COMMITTEE 1980-81, REPORT ON
1981 BUDGET AND GOV EXPENDITURE PLANS 1981-82 & 1983-84

in yellow folder at Back of File

PART 5 ends:-

TL to Treasury 10.7.81

PART 6 begins:-

Treasury Chambers to P/S CDL

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(81) 10th Conclusions	10/03/81
CC(81) 17th Conclusions, Item 1	30/04/81
CC(81) 26th Conclusions, Item 1	02/07/81

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

Signed CWayland Date 26 August 2010

PREM Records Team

Published Papers

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

1. Financial Statement and Budget Report 1981-82
   Published by HMSO, 10 March 1981

2. House of Commons Hansard, 10 March 1981, columns 757-806
   "Budget Statement" and "Budget Resolutions and Economic Situation"

3. House of Commons Paper 232-I: 1981 Budget and Government's
   Expenditure plans 1981-82 to 1983-84
   Published by HMSO, 6 April 1981

4. House of Commons Hansard, 2 July 1981, columns 1007-8
   "Petroleum Duty (Derv)"

Signed OMWayland Date 26 August 2010

PREM Records Team

FILE

ds

Econ Pol

10 July 1981

Taxation of Benefits in Kind - Free Petrol

This is just to confirm that the Prime Minister is content with the Chancellor's proposals in his minute of 8 July.

T P LANKESTER

John Wiggins, Esq.,
HM Treasury.

Your Ref

with compliments

Alex Allan

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: Direct Line 01-233
Switchboard 01-233-3000

File A 54

Reference A54

30.3.81

Andrew

This is the 364. They use the expression 'present policies will deepen the depression'

TB.

Monetarism attacked by top economists

By David Blake
Economics Editor

Three hundred and sixty-four of Britain's leading academic economists have today published an outspoken attack on the Government's handling of the economy.

The group, which includes most of the men who have held the coveted post of Chief Economic Adviser to governments since the war, declares that present policies are eroding the industrial base, deepening the depression and threatening social and political stability.

The attack comes in the form of a statement which was circulated in Britain's universities just after the Budget. Copies have been sent to the Prime Minister and to the Chancellor of the Exchequer. Although uncompromising in tone, it has succeeded in attracting massive support from the community of academic economists.

Among the signatories are the president, nine vice-presidents and the director-general of the Royal Economic Society.

The statement says: "We, who are all present or retired members of the economic staffs of British universities, are convinced that:

There is no basis in economic theory or supporting evidence for the Government's belief that by deflating demand they will bring inflation permanently under control and thereby induce an automatic recovery in output and employment;

Present policies will deepen the depression, erode the industrial base of our economy and threaten its social and political stability;

There are alternative policies; and

The time has come to reject monetarist policies and consider urgently which alternative offers the best hope of sustained economic recovery."

Five men who have held the post of Chief Economic Adviser to the Government since the war have signed the statement. They are Professor James Meade, Lord Roberthall, Sir Alec Cairncross, Sir Bryan Hopkin and Sir Fred Atkinson.

Sir Donald MacDougall, at present at the Confederation of British Industry, and Sir Kenneth Berrill, who was until

Continued on page 15, col 4

University economists attack Tory policy

Continued from page 1

last year head of the Government "think tank", are the two former Chief Economic Advisers to the Government who have not signed the statement. But under Sir Donald's guidance, the CBI has been critical of Government policy.

The organizers say that the response from different universities throughout the country may have been influenced by the timing of the statement, which went out as term was ending. The biggest contingent, 54 in all, comes from Cambridge University, the original home of the statement. There are 47 signatories from the various colleges of London University, 13 from Oxford and 21 from Warwick.

The list includes 76 present or past professors. Thirty-six universities are represented.

The statement was organized by Professors Frank Hahn and Robert Nield at Cambridge.

The aim is to bury the controversy over whether the Government is right in its present policies and switch attention to what alternatives should be pursued instead. The organizers feel that the economics profession in Britain has never been convinced of the case for monetarism, but that this fact has never clearly been communicated to the country as a whole.

Monetarism's converts have been largely in the City, politics and in the Press, although there are some leading academic economists who do broadly subscribe to the monetarist viewpoint.

The statement aimed against monetarism comes from economists who could be loosely described as "Keynesian" in their views.

PRESS OFFICE

10 DOWNING STREET

PRIME MINISTER

You said you would like to write to Patrick Minford about his article in The Times (copy attached).

I attach a draft.

28 April 1981

ECONOMY

10 DOWNING STREET

THE PRIME MINISTER

I did mean to write to you before I left for India and the Gulf about your splendid article in The Times of 7 April in which you rebutted the 364 economists. This was a marvellous piece, and I am most grateful.

Patrick Minford, Esq.

Patrick Minford

A dangerous and dishonest game

The 364 " Keynesians " who signed last week's statement attacking the government's handling of the economy have forgotten some salient facts, which would not have escaped their master. The public sector accounts in 1932, the trough of the Great Depression, appear to have been in significant financial surplus when adjusted for the economic cycle (ie, after deducting the effects of the cycle on revenue and social expenditures). The money supply had grown at less than 1 per cent a year and prices had fallen by more than 2 per cent a year over the previous five years. So Keynes could rightly observe that the actual deficit could be increased with no threat to (indeed restoration of) price stability.

Today the public sector still has a massive borrowing requirement when adjusted for the cycle—in the fiscal year 1979-80 about 5 per cent of gross domestic product and in 1980-81 about 4 per cent. This has been sustaining high inflation. But the budget for 1981-82, if plans are fully carried out, will cut this percentage to about 1 per cent of gdp and lay the basis for permanently lower inflation, even eventual price stability.

While one can write pages of algebra and estimate scores of statistical relationships, the essentials of the inflationary process are simple. It starts when a government, unwilling to cover its expenditure by overt taxation, borrows from the public.

As interest rates rise, in order to induce the public to lend, political pressures develop to hold them down. Lending to the government from the public slows down and the central bank has to lend the difference, which, of course, it does by increasing the supply of money.

During the early stages output usually rises, as extra monetary demand is met by producers whose expectations of inflation have not yet altered and who therefore think that rising prices offer them higher real returns. Expected inflation will soon increase, however, as information both about the policies and actually rising prices becomes widely known. This causes prices to rise faster and output to fall back.

At some point the increase in the rate of growth of money supply and so of monetary demand is entirely accounted for by an equal increase in inflation and output has dropped right back to where it would have been.

This description is widely accepted by serious students of macroeconomics. True, there have been—and persist—differences of view in particular about time lags and the interaction of fiscal and monetary influences. These differences ironically have been as great

Last week a group of prominent economists published an attack on the Government's strategy In this article a leading monetarist argues that the critics are wrong

or even greater within the ranks of " monetarists " than between them and " Keynesians ". But the economists who have developed this general line of thinking include as many Keynesians as monetarists. Indeed, the mechanism is named after a Keynesian, A. W. Phillips, who taught at the London School of Economics in the fifties.

Yet part (A) of the statement by the 364, on which the other parts are essentially based, explicitly rejects this mechanism in stating that " deflating demand " will not " bring inflation permanently under control " and thereby induce " an automatic recovery in output and employment ". For, of course, that is precisely what the same mechanism asserts when the process of deficit and money creation is put into reverse, as the present Government is doing.

Charity dictates that we interpret this rejection by 364 economists as an unintentional lapse; otherwise it would make nonsense of their professional work.

To carry out this reversal of the inflationary process, to break the inflation psychology, political courage and determination of a high order are necessary because of the short-term pressures that are generated—the strong vested interests on the expenditure side, the unpopularity of higher taxes, the temporary misery of the initial recession. At a certain point in the process the siren voices murmuring easy options can become irresistible; the minds of Ministers, untrained in economics, can hardly be blamed for being easily seduced. But hard-headed professionals require our most severe censure if they back such nonsense.

One such suggestion is that [illegible] of reducing inflation we should [illegible] lize it as its existing level and [illegible] with it ". Yet recent studies have come up with very large costs for this option (e g, Feldstein in 1979 for the United States, G. W. Hilliard and myself in 1978 for the United Kingdom), costs which appear to be far higher than any transitional loss of output that could be involved in eliminating inflation.

The more popular easy options are reflation to increase output, with incomes policy to prevent inflation, a view usually backed by the glib assertion that the economy suffers from widespread " market failure ". This is the route both of some clever general equilibrium theorists and of others who are utterly ignorant of modern macroeconomics. But a convincing theoretical account of an economy which would respond as hoped to these policies has yet to be constructed.

The evidence is brutal. Incomes policies have broken down repeatedly since 1960, leaving no trace on the inflation rate. Reflation has been followed by inflation and output has continued to rise slowly, with the massive extra demand (e g, real disposal incomes rose by more than 7 per cent per annum from 1977 to 1979) going into imports.

The effects of counter-inflationary policies have been superimposed on the adjustment to North Sea oil and a world recession of broadly the severity of 1974-75. The strains on particular companies and industries in the international sector have been intense. But there is no evidence that those with sound long-term prospects are going to the wall. Instead, we have seen rationalization, the reduction of overmanning and a sharp reduction in wage settlements. Indeed, the stock market is now increasing the capitalization of even the hardest hit sectors.

In the short run, this process worsens unemployment. But, in the long run, unemployment by general agreement can only be eliminated by this and other improvements in competitiveness. Bitter experience has confirmed what monetary theory predicts—that devaluation and incomes policies are incapable of raising competitiveness for more than a brief period. It is likely, however, that union power, high labour, taxes and social security benefits and a heavily controlled housing market help to create serious unemployment and lower competitiveness.

Economic analysis can help to identify solutions. But the economist who downs tools to sign petitions for apparently political ends is playing a dangerous and dishonest game, even with 363 others.

The author is Professor of Applied Economics at the University of Liverpool.

cc. A Walters
A. Duguid
→ Press Office

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

Prime Minister
The principle of taxing free petrol was announced in the Budget - and of course approved by you. The Chancellor will announce tomorrow ~~today~~ the method: after consultations, he has decided on a 'scale' method. If a driver uses less petrol than the scale amount, he can apply for an individual assessment.
TL 9/7

Agreed MT

PRIME MINISTER

TAXATION OF BENEFITS IN KIND - FREE PETROL

In my minute of 6 March I explained the background to the proposal announced in my Budget Speech to bring petrol provided for higher-paid employees and directors driving company cars into charge to tax from April 1982. I should mention that there are currently two representative cases before the Commissioners on the question of liability in this field under the law as it now stands. In my speech I said that the Inland Revenue would be consulting over the various methods by which the various methods of taxing free petrol could be done. These consultations are complete and I can now inform you of what I propose.

... 2. A consultative document (of which a copy is attached) was issued in March canvassing three possible options: to tax petrol (a) on the basis of the actual amount provided for the employee's private use; (b) on the basis of some statutory formula eg so much per mile driven; or (c) by reference to a scale similar to those already used in relation to car benefits.

3. Those who responded to the consultative document were substantially in favour of a scale although some, notably the Association of British Chambers of Commerce and GEC, favoured the 'actual' method. The main factors which appear to have weighed with respondents are equity (or the lack of it); administrative simplicity; and experience with the car scales, which have of course fallen far below the true value of the benefit.

/There is no doubt

4. There is no doubt that in theory the actual method is the most equitable, and that there is very little equity about a scale system. However, the Inland Revenue experience up to 1976 in relation to cars was that the 'actual' charge degenerated into a sort of ad hoc scale. I am not therefore convinced that an 'actual' basis, if enacted, would necessarily lead to equity in the charge.

5. However, the most potent factor which persuades me in favour of a scale is the question of administrative costs. Tentative Revenue figures put a cost on an 'actual' charge of about 250 extra civil servants (against about 50 for a scale).

6. As you know, in relation to car benefits the Finance Bill contains a provision which enables employers to apply PAYE directly (without the need for the tax office to notify a change of code number). I propose to extend this provision to cover petrol benefits and it is this that should enable the job to be done at a relatively small cost to the Revenue.

7. I have therefore authorised the Inland Revenue to prepare an amended clause with schedule for the Finance Bill introducing a scale charge for petrol for use in company cars. This will remove the doubts which have existed about the present law and which might not be resolved even if the Revenue were successful in the 'representative' cases at present awaiting hearing. The scale, which would consist of three points, would be related solely to engine size and follow the bands already adopted for the car scales - up to 1300cc, 1301-1800cc, over 1800cc.

8. The scale would be a measure of rough justice and I propose that for 1982-83 (the first year) the level of the scale should match the first three points of the car scale proposed for that year - £270, £360, £540. These figures are, I hope sufficiently

/high to act as a

high to act as a deterrent where it has not hitherto been the practice of an employer to provide free petrol, but not so high that they can be regarded as punitive. For the 'tool of the trade' driver who does more than 18,000 business miles a year the scale would be halved, and where the employee pays for all private petrol the scale would be extinguished.

9. The original proposal as explained in the consultative document was for 'a single, unified system covering all directors and higher-paid employees'. In the course of the consultative process it became apparent however that, while a scale would work quite well in relation to cars provided by employers, there were severe problems in applying a scale to petrol provided for directors' and employees' own cars. The position there is that there has always technically been an 'actual' charge available, but there is scope for evasion. The Revenue will be tightening up their practice in that area.

10. Inevitably employers will object that as a result of these proposals the burden of operating the tax system is being transferred to them and that savings in the Revenue will have to be paid for by them. And, even with a scale system, employers will need to keep some sort of records of petrol provided and of reimbursements. Some complaint must therefore be expected against our decision to press ahead with such a system. But there can be no question of our drawing back now on the principle of the charge; we could not defend continued inaction in the face of the present situation. So we are only talking about the form of the action - and on that point the consultations showed the CBI and the Institute of Directors as favouring a scale.

11. I had hoped that it might have been possible to introduce the amended clause and schedule at Committee Stage but for technical reasons that we not possible, and they will now be introduced at Report and announced tomorrow (9 July).

postponed until Friday, 10 July

TL.

GH.

(G.H.)

8 July 1981

PETROL PROVIDED BY EMPLOYERS

METHODS OF BRINGING THE BENEFIT INTO TAX

A CONSULTATIVE DOCUMENT

1. The Chancellor announced in his Budget Speech that the benefit of free petrol for directors and higher paid employees for their private use, however provided, should be brought into charge to tax. This document outlines the various methods which might be employed to achieve this and is designed to elicit views on these methods, rather than the proposal itself. In particular, it canvasses the administrative problems likely to be thrown up by these methods for employers and employees, as well as for the Inland Revenue.

2. For the purpose of this document 'petrol' includes petrol, oil, diesel and other substances used as fuel for motor vehicles.

3. The Revenue's ability to raise a charge under the general Schedule E rules varies according to the method by which petrol is provided for an employee's private use; and the effects of the benefits legislation contained in the 1976 Finance Act (which applies only to sums not otherwise chargeable to tax) vary according to whether petrol is provided for use in the employee's own car or in a company car to which Section 64, Finance Act 1976 applies. It is proposed to introduce a single, unified system covering all directors and higher paid employees.

4. The method adopted could take one of three forms -

(i) Quantification of the benefit by reference to the actual cost incurred by the employer in supplying petrol to the extent that it is used for private, as distinct from business, purposes (the 'actual' method);

(ii) the use of formulae agreed locally for application to individuals or groups of employees receiving petrol from particular employers, (the 'formula' method); and

(iii) a scale, similar to the scale used for measuring the benefit from a company car (the 'scale' method).

<u>The 'actual' method</u>

5. This would involve the employer in keeping records for each employee concerned of the cost of petrol provided for him and returning the particulars to the Inspector after the end of the tax year. He could either be required to break down the total by reference to business and private use, or he could merely return the total, leaving it to the employee to claim for business use. The first approach would be more burdensome for employers, the second more burdensome for the Revenue and for employees; but they would both require records to be kept more extensively than is now the general practice.

<u>The 'formula' method</u>

6. The precise formula would be for negotiation with the Inspector, although there would be a general pattern into which the different formulae would fit. The employee would retain the right to claim expenses under the general Schedule E rules where

he considered that in his case this would produce a more favourable result. The formula might be based on actual expenditure in a sample period; or AA or other figures for petrol costs per mile for the type of car involved or an agreed proportion of the total mileage; or any other basis which gave a just and reasonable measure of the benefit for the groups of employees or individuals concerned.

The 'scale' method

7. This would be similar in principle to the scale used for car benefits. It would not depend directly on the amount of petrol provided. The scale could be graduated like the car scale, by reference to engine size and price of car, and might be set as a percentage of the car scale; or it could be at a flat rate unrelated to the type of car. The scale charge could simply be reduced to nil where the employee fully reimbursed his employer for the cost of petrol used privately. Alternatively, the charge might be reduced where the private mileage was very low. It could also be reduced if the employee made some payment to his employer specifically for the fuel provided for his private motoring. These modifications would require more elaborate record keeping than a simple scale but they would probably be administratively more convenient than the 'actual' method. A graduated petrol scale related to the car scale could present problems in its application to those provided with free petrol for use otherwise than in a company car.

Application of PAYE

8. Under the 'actual' method the tax on the benefit would ordinarily be recoverable through adjustments to the PAYE coding. Under the 'scale' method and under the 'formula' method the benefit could be treated as pay for PAYE purposes, so that the employer would apply PAYE to it directly month by month.

Conclusion

9. Views are invited on the methods examined in this document, and any other suggestions would be welcomed. Any representation should be made in writing to the Inland Revenue, Room 46, New Wing, Somerset House, if possible by 15 May 1981.

Board of Inland Revenue
March 1981

Kay

Yes. It is on our Budget file. Please return to me AD 10/7

File BK

10 DOWNING STREET

THE PRIME MINISTER

Alan Thanks

7 July 1981

CF to file Kay 13/7

CF Have you seen PM's letter of 8/6 pl? Kay 10/7

Dear Dr. Hammer,

Thank you for your letter of 3 July. I was so pleased to hear from you again.

Carol is in fact still in Australia and alas my diary for next week is appalling. I shall not, sadly, be able to get to the Royal Academy to see the Codex. I had hoped to be able to come but I have not even a quarter of an hour to spare.

With all best wishes and I hope you enjoy your visit to London.

Warm regards,

Yours sincerely

Margaret Thatcher

Dr. Armand Hammer

Claridge's
Brook St
W1

LPO

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

3rd July, 1981.

The Rt. Hon. Mrs. Margaret Thatcher, M.P.
Prime Minister and First Lord of the Treasury,
10 Downing Street,
London, W.1.

Dear Mrs. Thatcher,

Thank you for your kind and comprehensive letter of June 8th and for your unfailing courtesy to me in taking the trouble to explain the Government's position on the new tax structure.

As you know, I am very sorry that the Chancellor has taken the decision that he has. Thank you for your advice that we should present alternative proposals to the Treasury and we should be pleased to do so.

I do hope that you, Carol and Mr. Denis Thatcher will be able to see the Codex at the Royal Academy next week where I shall very much look forward to seeing you again.

With warmest regards.

Yours sincerely,

Armand Hammer

Armand Hammer.

CONFIDENTIAL

Econ Pol

SUBJECT.

cc. Master set

NOTE FOR THE RECORD

The Prime Minister held a meeting at 1015 pm last evening with the Chancellor of the Exchequer, the Chancellor of the Duchy, the Chief Secretary, the Financial Secretary and the Chief Whip. Mr. Gow, Mr. Murdo Maclean and I were also present. The meeting had been called to discuss the Chancellor of the Exchequer's proposal to announce his derv recoupment measures the following day.

The Prime Minister said that, while she had approved the recoupment measures in principle, she believed an announcement the following day would have a serious effect on the outcome of the Warrington by-election. The Tory candidate was going to do badly enough anyway; the announcement of a 3p increase on a packet of cigarettes plus the other minor measures could well mean the difference between his winning or losing his deposit. If he were to lose his deposit, this would seriously damage his prospects of finding another seat to fight; she herself had a personal interest because of his position in her own constituency Party. But it would also be damaging for the Party as a whole, and it would also affect market confidence. She was surprised that Treasury Ministers and their political advisers had apparently failed to take into account the by-election in deciding the timing of the announcement. If it could not be announced after the by-election, surely it could have been announced either before the by-election was even called or at least several weeks earlier?

The Chancellor of the Exchequer said that, admittedly, he and his colleagues had not considered the timing of the announcement in relation to Warrington. But he had consulted the Chief Whip on whether the announcement should be made during the Committee stage of the Finance Bill. The Chief Whip's advice had been that the addition of a new clause should be avoided because it would prolong the Committee's sitting; and the announcement could not have been made at the time the tobacco clause was taken because at that time the final decision on the recoupment measures had not been reached. From the Treasury's point of view, the Report

/Stage

CONFIDENTIAL

Stage of the Finance Bill could possibly be delayed until the week beginning 20 July, and the announcement could perhaps be made then - ie after the by-election which was on 16 July. But there were political risks in being seen to make the announcement so soon after the by-election, and he understood that the Parliamentary managers could find themselves in difficulty with other Bills.

In discussion the following points were made:

i) the Chancellor of the Duchy suggested that it might be possible to avoid the tax increase on tobacco altogether.

ii) The Chief Whip suggested that the non-tobacco measures - ie gaming and gambling - should be announced now and included in the Finance Bill, and that the increase in tobacco tax might be brought in by the regulator in the "overspill".

iii) The Chancellor of the Duchy said that, if the tobacco increase had to be in the Finance Bill, it would be a mistake to postpone the Report Stage. The Opposition already had a fairly clear idea that the Report Stage was going to be taken in the week beginning 13 July. To postpone it now would look like "gerrymandering". Mr. Gow added that, if the Government postponed the announcement until after the by-election, there would be allegations at future by-elections that the Government would be announcing some "bad news" immediately afterwards.

iv) The Chancellor of the Exchequer said that it would be very bad for confidence and the Government's credibility if he were to drop the recoupment measures. He therefore could not accept the Chancellor of the Duchy's suggestion. He was also strongly opposed to the idea of using the regulator in the autumn: that would look like a mini-budget.

/ v)

v) It was suggested that the recess could be put off by a week in order to allow the Report Stage to be taken in the week beginning 27 July: this would at least allow a week between Warrington and the announcement.

Summing up, the Prime Minister said she was still most unhappy, and she wished that the new measures had been announced during the Committee Stage. Before taking a final decision, the Chancellor of the Exchequer and the Chief Whip should sound out Lord Thorneycroft. Subject to that, she was reluctantly willing for an announcement to be made the following afternoon.

Postscript

The Chancellor and the Chief Whip saw Lord Thorneycroft this morning. Lord Thorneycroft was relatively relaxed about the announcement being made today. His view was that the Tory candidate at Warrington was likely to lose his deposit anyway. If anything, the extra 3p on tobacco would provide him with some excuse for his poor showing.

I passed this on to the Prime Minister, who confirmed that the announcement should go ahead.

R.

2 July 1981

Distribution: No. 10 Private Office only

SECRET

21

PRIVY COUNCIL OFFICE

WHITEHALL, LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

30 June 1981

Dear John

DERV DUTY REDUCTION AND COMPENSATING MEASURES: TIMING

Thank you for your letter of 26 June to David Heyhoe. in PM's box

I explained when we spoke this morning that the Chancellor of the Duchy had considered the timing proposals set out in your letter and had agreed that the Chancellor of the Exchequer should announce the increases in tobacco, gaming and betting duty by means of an arranged Oral Answer on Thursday, 2 July. Mr Pym has also noted that the Chancellor of the Exchequer's preferred course of action would be to introduce the reduction in DERV duty as soon as possible after the announcement of compensating measures, and that this would be given legislative force by means of an amendment to the Finance Bill on Report.

The present plan is for the Resolutions required to give effect to the increases in tobacco, gaming and betting duties to be taken on Monday, 6 July: the Chancellor of the Duchy's intention is to announce this in his reply to the Business Question on Thursday. As his reply will follow immediately after the Chancellor of the Exchequer's arranged Oral Answer, I would suggest that any reference in the Answer to the timing of the Resolutions on tobacco, gaming and betting duty should be to the effect that this would be announced by the Leader of the House of Commons very shortly in the usual way. The timing of the entry into force of these changes in duty is of course a matter for your Department.

I am copying this letter to Mike Pattison and Murdo Maclean.

Yours sincerely

Nick Huxtable

N P M HUXTABLE
Private Secretary

A J Wiggins Esq
Private Secretary to the
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

SECRET

Prime Minister [through ...]
Mr Pym is ready to settle for announcement by an arranged Oral Question at [Thursday] 3.30: his own business statement will follow, taking account of the need for the House to deal with the necessary resolutions next Monday.
Content?

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

26 June 1981

David Heyhoe, Esq.,
Chancellor of the Duchy of Lancaster's Office

Rang I discuss with Chancellor, not.

MP 30/vi

Dear David,

RECOUPMENT OF DERV DUTY REDUCTION : TIMING

Treasury Ministers have been considering the timing of the moves to bring into effect the reduction in the derv duty agreed at the Committee Stage of the Finance Bill on the Floor of the House on 30 April, and the offsetting increases in the tobacco and betting and gaming duties required to recoup the lost revenue.

Their first thought had been to make the changes more or less at the time the Finance Bill receives the Royal Assent. However, further examination has made clear that there would be a certain amount of disruption of the road haulage industry, and a great deal of public criticism, if there were a substantial period of notice of the effective date for the change in the derv duty. The problem is that firms and garages would seek to run down their stocks of derv in advance of the change, and there could be disruption both of deliveries of all kinds of goods, and also a physical shortage of supplies at the pumps. The oil companies would, of course, not be able to re-supply all their customers immediately the change took effect. Nor would a duty rebate scheme get over the problem; this would be a considerable administrative burden at the best of times, and it would have to be restricted to garages - so leaving out of the count the 80 per cent of derv deliveries which go directly to industrial customers.

Customs and Excise, in consultation with the industries mainly concerned, therefore conclude that the only way to avoid the complaint and disruption is to minimise the

/interval

interval between announcement of the timing of the change, and its actually coming into effect. The best timing would be announcement on one day, followed by debate on the Resolutions increasing the tobacco and betting and gaming duties the next day, with the derv reduction taking effect on the day of the debate and the increases at convenient times in the course of the following few days.

Treasury Ministers and the Chief Whip have contemplated that it would be essential for the Resolutions to have been taken in advance of the Report Stage of the Finance Bill, due in the week beginning 13 July. If the announcement were to be made - as hitherto contemplated - by an arranged Oral Answer on Thursday, 2 July, Customs' advice is that the latest tolerable time for the reduction to become effective would be the following Tuesday, 7 July, at 6 p.m. This would be consistent with taking all the Resolutions at 10 p.m. on Monday, 6 July. Alternatively - and perhaps better - the derv reduction might be brought into force at, say, 6 p.m. on Friday, 3 July, on the basis of a promise of a suitable amendment at Report to confirm this date. This would eliminate the need for a separate Resolution on derv. Some delay between announcement and coming into effect is required in any case for the tobacco duty, for practical reasons; it would be convenient if the increase took effect at midnight on Thursday, 9 July, thus leaving a little more time - consistently with a 2 July announcement - for the necessary Resolutions to be passed.

It would be possible to delay the preliminary announcement until the week beginning 6 July, although the convenient option of the arranged Oral Answer would not then be available. Corresponding timing constraints would then apply to both the derv reduction and the tobacco and other increases.

The Chancellor would be grateful if the Chancellor of the Duchy and the Chief Whip could consider how best these various changes can be fitted into the Parliamentary time-table. The Prime Minister has already agreed to the substance of the Chancellor's proposals for recouping the lost revenue, but she will wish to be aware of the precise timing, as well as the need for an appropriate announcement, whether by way of an arranged Oral Answer or - as would otherwise be required - by means of an Oral Statement. Accordingly I am sending copies of this letter to Tim Lankester and Murdo MacLean.

Yours sincerely

John Wiggins

A.J. WIGGINS

SECRET

File Eng

19

10 DOWNING STREET

Econ Pol

From the Private Secretary

25 June 1981

Dear John,

BANK TAX AND DERV DUTY CONCESSIONS

The Prime Minister has considered the Chancellor of the Exchequer's minute of 24 June.

This is just to confirm that she is content with his proposal that the Financial Secretary should announce later today a minor concession on the bank profits tax. She is also content with the decision that he has reached on how the loss of derv duty should be recouped; she notes that the Chancellor will be putting proposals to the Leader of the House and the Chief Whip on the timing and implementation of the recoupment measures.

I am sending a copy of this letter to Brian Norbury (Ministry of Defence) and Murdo Maclean (Chief Whip's Office).

Yours ever,

Tim Lankester.

John Wiggins, Esq.,
HM Treasury.

Prime Minister 18B 1

The Chancellor wishes the Financial Secretary to announce a minor concession on bank profits this afternoon - to help the smaller banks. He has also decided to go firm on his proposals for making up the DERV loss - i.e. 3p on cigarettes and £20m from gaming and betting. (You told the Chancellor that he should have the final say on this.)*

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

PRIME MINISTER

Agreed MT.

BANK TAX AND DERV DUTY CONCESSIONS

I have been considering possible changes to the bank tax in the light of the criticisms which have been made.

2. On our side most of the criticisms have focused on the precedent of raising extra taxation from a successful sector, and the alleged retrospection. There is nothing we can do on that. But there has also been criticism - right across the House - that in practice, for a variety of reasons, the tax bears particularly heavily on some of the smaller and medium-size banks. When the clause was debated on 12 May, we undertook to look again at their position.

TL. 25/6

*to be announced later.

3. After careful consideration, I have decided that it would be right to provide some help for these banks. I propose increasing the exempt slice of deposits from £10m to £15m, and reducing the charge on the first £200m deposits from 2½ to 2 per cent. These changes would provide some benefit for every bank - and so should be acceptable to the big clearing banks - but they will give proportionately more help to the small and medium-size banks.

4. The bank tax schedule will be taken in Standing Committee tomorrow (Thursday) and - if you agree - I see advantage in the Financial Secretary announcing the proposed changes then. He will also be mentioning that the Government have been having discussions with National Girobank, in their role as shareholders, about the effect of the tax on Girobank and how they might help with its capital requirements.

/These changes

5. These changes will cost some £25m - but I do not think we can do less. Because this is a new tax, there has always been some uncertainty about the precise yield. I think we can reasonably say, therefore, that, notwithstanding these changes, we see no reason to change the round figure estimate of £400m which we gave at the time of the Budget. On that basis, I would not seek to recover elsewhere the cost of these concessions.

6. I am however committed to recouping the revenue lost as a result of the derv duty reduction I announced on 30 April. I told the House at the time that the probable cost of the duty reduction would be £85 million in the current year. Since then I have established that some £10 million or so will be saved through lower levels of bus fuel grants at the new duty rates. The appropriate revenue target is therefore £75 million.

Flag A

7. I should like to proceed as follows. As foreshadowed in my minute to you of 19 May, I propose to secure an additional £20 million in 1981-82 from betting and gaming. I can achieve this by raising the "off course" rates of general betting duty from $7\frac{1}{2}$ per cent to 8 per cent and the bingo duty from $7\frac{1}{2}$ per cent to 10 per cent and by ad hoc increases in the gaming machine licence duty. The bulk of the additional revenue however - some £55 millions - I conclude will have to come from tobacco. This means a 3p increase on a packet of cigarettes, with commensurate increases on other tobacco products. I have considered carefully whether it would be possible to limit the increase on cigarettes to 2p. But this would reduce the revenue yield by almost £20 million and - especially in view of the concessions I am now making to the banks - I believe we should lose credibility if we were to announce proposals which fell well short of my declared intention to cover the cost of the derv duty reduction. As I explained in the course of a talk we had early this month, there is no other practicable alternative which could bridge the revenue gap.

/I shall

8. I shall be putting to the Leader of the House and the Chief Whip shortly proposals for the timing and implementation of the derv duty reduction and the recoupment measures.

9. I am copying this minute to Francis Pym and Michael Jopling.

(G.H.)
24 June 1981

File

TMP

cc: HMT Econ Pol.

CF bble

10 DOWNING STREET

THE PRIME MINISTER

8 June 1981

Dear Mr. Hamner

Thank you for your letter of 20 May and for sending me a copy of your letter to Sir Geoffrey Howe. Perhaps I could reply on behalf of both of us.

You know we appreciate the immense efforts and resources which the oil companies have put into the development of UK oil production. Its exciting growth is a tribute to what private enterprise can achieve given the right environment. But in forming our policies we have to remember the interests of the nation and secure a proper return on a national resource.

We gave very careful study to the economics of future development before deciding on the proposals in Sir Geoffrey's budget, and I believe that they leave the companies with a fair return and an adequate incentive to future exploration and development. We know we have to compete with other countries, but we believe that taking fiscal and other conditions together, the UK is still a good place for investment in oil development.

However, we have, as you know, invited the industry to put forward an alternative structure for North Sea taxes if they can find one. This is why we are only introducing SPD in the first instance for 18 months. I hope that you will contribute any suggestions you have on this exercise, which can of course include any changes to PRT reliefs which are appropriate.

/In the meantime

DSG

In the meantime, you suggest that we should withdraw the proposals to curtail the PRT "safeguard" relief in the current Finance Bill. I am afraid I do not think it would be right to do this. While it is true that the cost to the Exchequer would be relatively small this year (though much less so in a few years time), the PRT relief changes are not primarily intended to raise short-term tax revenues. The prime reason for them is to reduce distortions in the PRT system which could lead, as Sir Geoffrey explained in his letter to you of 8 April, to a serious distortion in the oil industry's efforts. The old PRT reliefs could give considerable encouragement to developments which in pre-tax terms would be of no or little benefit to the economy.

We do take your point that companies need to know where they stand and decisions to change the reliefs were not taken lightly. It was so that people should know where they stood that we thought it right to make the changes in PRT now rather than waiting until the immediate revenues at stake had become very large and companies had perhaps become committed to expenditure - expenditure which would not have been their first priority if it were not for the distorting effect of the PRT reliefs.

We will certainly be prepared to look in the review of possible alternative tax structures at any alternatives to Safeguard which meet both our revenue raising objective and the need to avoid distortions. But until we have seen an alternative which works I really do not feel we can withdraw the provisions in the current Finance Bill.

On the happier note in your letter, it was very kind of you to ask me and my family to see the Codex in July. We will certainly try to get to the Royal Academy if we can, and I look forward to hearing from you.

Yours sincerely

Margaret Thatcher

Dr. Armand Hammer

SUBJECT

SECRET

b.c. MR. WALTERS

cc Master

18A

10 DOWNING STREET

From the Private Secretary

3 June 1981

Dear John.

At their meeting yesterday evening, the Prime Minister and the Chancellor discussed the Chancellor's minute of 19 May on the steps he is proposing to take to recoup the £85 million of revenue lost as a result of the concession on DERV.

The Prime Minister expressed her misgivings about the proposal that there should be an extra 3p duty on a packet of cigarettes. Coming on top of the 14p increase already announced, she felt a further 3p might be difficult to sustain politically. She suggested a 2p increase, and some further increase in the duty on wines and spirits to make up the balance of lost revenue.

The Chancellor explained the difficulty of raising the duty on wine any further in terms of the problems we would be likely to run into with the European Community. He was also reluctant to increase the duty on spirits because the whisky industry was already in considerable difficulty - and more so than the cigarette industry. It was also relevant that the 14p increase on cigarettes already announced had been received in the House more or less without demur.

The Prime Minister said that she was still not altogether happy with the proposal, but she was prepared to leave it to the Chancellor to reach a final decision.

Yours ever,

Tim Lankester.

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

SECRET

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

2 June 1981

W. Rickett, Esq.,
Private Secretary,
10, Downing Street

Pl type for PM.
WR 4/6

Dear Willie,

You wrote to me on 22 May enclosing a letter the Prime Minister had received from Dr. Armand Hammer and asking for a draft reply which she might send Dr. Hammer on behalf of both of them.

.... I enclose the same.

Yours ever,

Richard Tolkien

R.I. TOLKIEN

DRAFT FOR PRIME MINISTER'S SIGNATURE

Dr Armand Hammer
Chairman & Chief Executive Officer
Occidental Petroleum Corporation
10889 Wilshire Boulevard
Suite 1500
Los Angeles
California 90024

Thank you for your letter of 20 May ~~enclosing~~ and for sending me a copy of your letter ~~of 18 May~~ to ~~Sir~~ Sir Geoffrey Howe. Perhaps I could reply on behalf of both of us.

~~We do~~ You know we appreciate the immense efforts and resources which ~~you and your company~~ the oil companies have put into the development of UK oil production. Its ~~speedy and successful~~ exciting growth is a tribute to what private enterprise can achieve given the right environment. ~~And I recognise the substantial orders your company has placed in Britain.~~ But in forming our policies we have to ~~have regard~~ remember to the ~~legitimate~~ interests of the nation ~~in~~ and ~~securing~~ secure a proper return on a national resource.

We gave very careful study to the economics of future development before deciding on the proposals in Sir Geoffrey's budget, and ~~we~~ I believe that they leave the companies with a fair return and an adequate incentive to future exploration and development. We know ~~very well~~ we have to compete with other countries, but we believe that taking fiscal and other conditions together, the UK ~~remains~~ is still a ~~favourable~~ good ~~environment~~ place for investment in oil development.

~~As you know~~ However, we have, invited the industry to put forward an alternative structure for North Sea taxes if they can find one ~~and~~. This is why we are only introducing SPD in the first instance for 18 months. I hope that ~~your company~~ you will contribute any suggestions you have this exercise, ~~and this~~ which can of course include any changes to PRT reliefs which are appropriate.

In the meantime, you suggest that we should withdraw the proposals to curtail the PRT "safeguard" relief in the current Finance Bill. I am afraid I do not think it would be right to do this. While it is true that

The cost to the Exchequer would be relatively small this year (though much less so in a few years time), the PRT relief changes are not primarily intended to raise short-term tax revenues. The prime reason for them is to reduce distortions in the PRT system which could lead, as Sir Geoffrey explained in his letter to you of 8 April, to a serious distortion in the oil industry's efforts. The old PRT reliefs could give considerable encouragement to developments which in pre-tax terms would be of no or little benefit to the economy.

We do take your point that companies need to know where they stand and decisions to change the reliefs were not taken lightly. It was so that people should know where they stood that we thought it right to make the changes in PRT now rather than waiting until the immediate revenues at stake had become very large, and ~~and~~ companies had perhaps become committed to expenditure – expenditure which would not have been their first priority ~~apart from the~~ if it were not for the distorting effect of the PRT reliefs.

We will certainly be prepared to look in the review of possible alternative tax structures at any alternatives to Safeguard which meet both our revenue raising objective and the need to avoid distortions. But until we have seen an alternative which works I really do not feel we can withdraw the provisions in the current Finance Bill.

On the happier note in your letter, it was very kind of you to ask me and my family to see the Codex in July. We will certainly try to ~~to try~~ ~~drop~~ get to the Royal Academy if we can, and I look forward to hearing from you.

PRIME MINISTER

Meeting with the Chancellor
Tuesday 2 June at 1720 hours

There are three issues you need to discuss:

i) Tax measures to offset the £85m lost by the decision on Derv (Flag A). The Chancellor wants to raise £20m from betting and gaming, and £55m from tobacco (another 3p on a packet of cigarettes). Your view has been that we should raise something extra from wine. I have mentioned this to the Treasury, who say that the Chancellor will argue very strongly against trying to go down this route: he thinks that, without increasing the tax further on beer, a tax increase on wine will simply be thrown out by the European Court, and that on the basis of a Court decision traders will be able to recoup the revenue. It also seems doubtful whether it would be worth having a row with the Community over such a relatively small issue (we would only be getting in another £10m or so at the most).

ii) Taxation of widows and single women, aged 60 - 64. You have disagreed with the Chancellor's advice on how he should respond to Jeff Rooker (Flag B). The issue here really comes down to whether the age allowance should be introduced at 60 for women generally or widows and single women. But this would presumably be very expensive.

iii) Progress on monetary control improvements. At Flag C are some notes by Alan Walters following a discussion last Friday, and also a draft letter which you might send to the Chancellor. I see little point in going into this in detail with the Chancellor, but you could mention your concern that the timetable seems to be slipping. I can then 'top and tail' Alan's draft letter for you to sign, and we can suggest a stocktaking seminar just before the summer recess.

Duty Clerk p.p. T. P. Lankester.

1 June 1981

jfh

27 May 1981

The Prime Minister has read the Chancellor's minute of 19 May about how he proposes to make good the revenue shortfall as a result of the concession on derv. As I told you, she will wish to discuss this with the Chancellor and we are arranging a meeting for next week.

TPL

Richard Tolkien, Esq.,
HM Treasury.

7/8

1/6

10 DOWNING STREET

From the Private Secretary

22 May 1981

Chase? Yes pl WW 2/6

Dr. Armand HAMMER

I enclose a letter to the Prime Minister from Dr. Armand Hammer of Occidental Petroleum. He expresses concern over the proposed changes in oil taxation and encloses a letter he has written to the Chancellor.

The Prime Minister has seen this letter and would like to reply to Dr. Hammer herself. I should be grateful if you could provide a suitable draft by Monday 1 June. We will deal with the personal point raised by Dr. Hammer in his penultimate paragraph.

WR

Richard Tolkien, Esq.,
HM Treasury.

TWP

jfh

22 May 1981

I am writing on behalf of the Prime Minister to acknowledge your letter of 20 May.

I have placed this before the Prime Minister and you will be sent a reply as soon as possible.

WR

Dr. Armand Hammer.

10 DOWNING STREET

1 Miss Stephens

2 Prime Minister

In the attached, Armand Hammer expresses concern over the proposed changes in oil taxation, and encloses a letter he has written to the Chancellor. He also suggests that you and your family go to see the "Codex Hammer" with him at the RA in the week of 6 July. I have asked Treasury to provide a passage for a reply you can send to Dr Hammer, covering his concerns on oil tax.

WR
21/5

It is the week of the PPB. but you could manage Friday 10 — but pl. remember what hell the last couple of weeks have been. CP.

We with Guy MR

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

20th May, 1981.

The Rt. Hon. Mrs. M. Thatcher, M.P.
Prime Minister and First Lord of the Treasury,
10 Downing Street,
London, SW1.

Dear Mrs. Thatcher,

I hope I may take advantage of our friendship to draw your attention one final time to the damaging effects to the British economy of the proposed changes in the Safeguard provisions of PRT contained in the Finance Bill.

not enclosed

I am advised that the bill becomes law at the end of next month. I am enclosing a copy of a letter I have sent to Sir Geoffrey Howe in a last minute effort to persuade him to make at least a modest concession to the oil companies who have created the North Sea oil industry and contributed much to British prosperity.

The bottom line fact is that Britain will gain no revenue whatever from his proposed change on Safeguard until the mid-1980's. The oil industry on the other hand, gain a massive disincentive to invest - some effects of which have already been seen - and a very serious impact on long term profitability.

On a happier note, I am expecting to be in London in the week beginning July 6th when in the spirit of our agreement earlier this year, I shall be exhibiting the Codex at the Royal Academy. Some of Her Majesty's Leonardo drawings will also be on joint display. I do hope that you and Mr. Denis Thatcher and your daughter, Carol, whom I so much enjoyed meeting in Washington, will be able to see this fascinating exhibition.

I will be in touch with you nearer the time.

With warmest regards.

Yours sincerely,

Armand Hammer

Armand Hammer.

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

18th May, 1981.

The Rt. Hon. Sir Geoffrey Howe, QC. MP.,
Chancellor of the Exchequer,
11 Downing Street,
London, SW1.

Dear Sir Geoffrey,

Thank you for your letter and for taking the trouble to put on paper your reasons for the introduction of SPD and for the change of PRT relief. I am grateful to you for the courtesy to me and for the careful consideration you are giving to this very serious problem.

But I must tell you candidly, the effects that your new tax policies, if put into law in their present form, will have on investment levels in the United Kingdom.

Britain is not an economic vacuum. The oil-industry is worldwide. Investment is competitive and the fact of life is that with your new tax policy, other countries are far more attractive investment propositions than Britain. You know that I want to invest in Britain. I have played as big a part as anyone in contributing to British prosperity. You make the point in your letter that your changes in Safeguard are not intended for tax gathering in the early 1980's. But surely jobs in shipbuilding, steel and construction in 1981 are as important as tax collection in 1985.

You say in your letter that you are changing the rules on Safeguard so that companies can make their long-term plans. Sir Geoffrey, we have already made our long-term plans on the basis of your previous long-term tax assessment. If you change the rules so severely in the middle of the life of the field, you create the most serious problems for companies like mine who have to make their investment forecasts and economic projections on the basis of the lifetime of the field.

Cont'd.

Sir Geoffrey Howe 18th May, 1981.

Even a modification of your changes of the rules on Safeguard would show goodwill towards the oil industry and would cost Britain no revenue whatsoever - a point which you make so clear in your letter.

I do hope you will be able to consider this point and make a gesture while there is still time during the committee stage of your bill.

With every personal good wish and my warmest regards to Lady Howe.

Sincerely yours,

Armand Hammer

Armand Hammer.

S E C R E T

Prime Minister 2

18 A

You will want to discuss this with the Chancellor.

cc Walters

Hoskyns

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

PRIME MINISTER

21/5

I have been considering the steps I shall need to take in order to recoup the £85 million of revenue lost as a result of the concession on derv that I announced on 30 April.

2. The right time to introduce the necessary amendments to the Finance Bill will be at Report Stage. This is likely to be in the second week of July. We shall have to make our intentions known a little sooner so that the necessary Ways and Means' Resolution(s) can be tabled and debated before the amendments are taken in the House. I shall need to discuss the precise timing with the Leader of the House and the Chief Whip. But I would hope that we could delay taking any action until shortly before Report Stage.

3. It follows that we do not need to take firm decisions now on the taxes that are to be increased to pay for the derv concession. As you are aware however from our previous discussions, the options open to me are extremely limited. In my view we have no alternative but to raise the money from the other excise duties. My provisional conclusion is that we should go for a combination of increases in the betting and gaming duties and a further increase in the tobacco duty.

4. A more substantial contribution from gambling would involve changing the structure of the taxes, which would be difficult, and, in any event, is simply not possible this year. But it would be possible to get another £20 million or so from betting and gaming this year by raising the "off course" rate of general betting duty from 7½ per cent to 8 per cent, the bingo duty from

/7½ per cent

S E C R E T

$7\frac{1}{2}$ per cent to 10 per cent and by ad hoc increases in the gaming machine licence duty. I believe that it would accord with the wishes of our supporters to obtain the maximum revenue that is available from these sources. And there is the further advantage that increases in the gambling taxes would not add to the RPI.

5. For tobacco, I have in mind an increase of 3p on a packet of cigarettes. This would raise £55 million this year, giving a total for 1981-82 of some £75 million. That is some £10 million short of the cost this year of the derv concession; but the revenue raised in a full year would be only £5 million short of the full year cost of the concession. The effect of the tobacco duty increase would be to add 0.15 per cent to the RPI.

6. The alternative to an increase of 3p on cigarettes would be to put another 1p on beer. This would raise approximately the same revenue at a marginally smaller cost of 0.10 per cent on the RPI. But it would be difficult politically to increase beer duty without at the same time increasing the duty on spirits. The balance of the arguments, including those of health policy, points in my view to concentrating the increases on tobacco.

7. Given that getting inflation down is one of our major policy aims, and having regard to the inevitable fragility of our success so far, it is of course most unwelcome that my proposal should add 0.15 per cent to the RPI. But I think we have to accept this. I have said publicly that the loss resulting from the concession on derv will have to be recovered, and in my view the course I propose is the best way of doing this. I should make it clear, of course, that the 0.15 per cent is within the margins of forecasting error on the RPI, and that I shall stand by my judgement made at the time of the Budget that inflation over the year to the fourth quarter of 1981 is expected to be 10 per cent.

8. I am sure it is right that we should insist that the cost of the derv concession be met by offsetting increases in other taxes. But I should wish to make equally plain to our colleagues that there are no easy options available for paying for additional public expenditure out of higher taxation. By way of illustration I may perhaps mention the measures to assist industrial energy prices which we are considering in MISC 56. These could cost up to £150 million this year. To find sums of that order from the excise duties, in addition to the £85 million needed to offset the derv concession, would require both an increase on beer (2p on a pint of beer with commensurate increases on other drinks would raise about £160 million this year) and a substantial increase on tobacco. Increases on that scale would add something like ½ per cent to the RPI. That would probably call for a revision of my Budget inflation forecast of 10 per cent and, as a consequence, raise the issue of a compensating adjustment of social security upratings. It would also begin to call in question the Budget judgement.

9. To embark on additional public expenditure financed through higher taxation would at one and the same time undermine two of our central policy objectives - the reduction of public expenditure and the reduction of taxation. Since we came to office circumstances have forced us to go in the wrong direction on both of these, and we must try to call a halt. This means in my view that any addition to public expenditure this year will either have to be matched by savings on other programmes or charged to the Contingency Reserve.

10. As you are aware, the position, on this year's contingency reserve is already tight. Very large additional requirements are in prospect for the nationalised industries, such as coal and British Telecoms, and a wide range of bids can already be foreseen in other areas. The totals involved represent a real

/threat to

threat to the reserve. In these circumstances we must take a very rigorous attitude towards any proposals for additional expenditure that cannot be met from offsetting savings.

11. I am sending this to you on a personal basis.

R.I. Tolkien

for, [Approved by the Chancellor and signed in his absence]

(G.H.)
19 May 1981

MORNING STAR
14 MAY 1981

£ million tax gift for ministers

Eight top Tories can make a budget killing

By BILL BROOKS

MILLIONAIRE Ministers, if not caught with their hands actually in the till, have been discovered to be loitering with intent.

Labour MP Jack Straw spotted no fewer than eight millionaires in the Tory Cabinet who, he said, could benefit collectively to the tune of around a million pounds from the tax concessions they were proposing for the rich.

Mr. Straw, discussing Clause 89 of the Finance Bill, which will replace the life-time accumulation of wealth with ten-year rule for capital transfer tax, said no ordinary members of the public would benefit.

Thatcher's husband missed out once —but never again

Despite furious opposition from Labour MPs, the clause was approved by 163 votes to 110 on Tuesday night.

Mr. Straw, opposition spokesman on Treasury and Economic Affairs, named names — including Mr. Dennis Thatcher.

He pointed out that the proposal would allow individuals to give away £50,000 every ten years, plus £3,000 each year, without being liable for capital transfer tax.

Mr. Thatcher had sold his £565,000 interest in Atlas Preservative Company in 1965.

Had he been able to "adopt the tactic" then, Mr. Straw suggested, he could have saved £95,000 on the deal.

Mrs. Thatcher was not in the Commons at the time — she was with the Queen — but no doubt seethed when she thought of what might have been.

However, Mr. Straw showed that the tax handout to the rich will enable Cabinet Ministers even wealthier than the Thatchers to benefit—millionaires like Home Secretary William Whitelaw, Industry Secretary Sir Keith Joseph and Leader of the House Francis Pym.

"There is Employment Secretary James Prior who, I am told, has farms and land valued at £700,000.

"There is the Lord Privy Seal (Sir Ian Gilmour) who is heir to his father's industrial estates in Scotland," said Mr. Straw, and "there is the Minister of Agriculture."

Of the latter — Mr. Peter Walker — Mr. Straw said he "sold his shareholding in Slater Walker in 1970 for £405,000 and sold an estate in 1976 for a further £250,000."

He named Environment Secretary Michael Heseltine — "has a majority shareholding in Haymarket Press"—and the Scottish Secretary George Younger.

He may one day become a viscount and, with preferment, maybe even a duke, and owns substantial interests in the family brewery, said Mr. Straw.

"If they play these rules—as no doubt they will be advised to play them—they will be saving around a million pounds," he concluded.

Two fingers to the poor from James Prior

Only the day before, th[e] Honourable Tory Members use[d] their majority to approve a ne[w] tax burden on the unemploye[d] and strikers.

It did not worry the robb[er] band who regard the work [of] shop stewards as criminal an[d] obscene.

20

Econ Pol 17

cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Ryrie
Mr. Middleton
Mr. Salveson
Mr. Cropper
Mr. A.H. Newton, MP
Mr. de Waal - Parl. Counsel
Mr. Lankester - 10 Downing Street

MR. BATTISHILL)
MR. FREEDMAN - C&E) Copy to each

MP

ROAD FUEL DUTIES ETC.

This is to record a few points from this morning's meeting.

2. The Chancellor reported the Prime Minister's concern that some of the revenue lost through the concession on derv should be recouped through higher duties on wine and gambling. It was noted, however, that the duty on wine could only be increased if there were also a parallel increase in the duty on beer, since an increase in the duty on wine alone would expose the UK to a high risk of infraction proceedings before the European Court. The possibility remained open, however, that increases in all the alcohol duties might be incorporated into the Finance Bill at the Report Stage. This would require new Budget resolutions in advance - but not too long in advance - of Report Stage; if it seemed appropriate, the resolutions could be delayed until immediately before the Report Stage. It was agreed that Customs and Excise should prepare a note exploring the scope for further revenue from gambling; even an extra £5-10 million from this source could be helpful, particularly if what would otherwise be a sensible package of offsetting increases in the revenue duties fell somewhat short of the cost of the concession on derv.

3. If the offsetting duty increases were to be concentrated on tobacco, it was noted that there was very little difference in the total revenue whether or

not the increases were applied to pipe tobacco and cigars. The Minister of State (C) undertook to discuss this issue further with Customs. The point was made that it would be desirable to restrict the increase to 4p on 20 cigarettes, rather than 5p, since the impact effect on the RPI would thus be restricted to 0.2 per cent.

4. It was agreed that the Chancellor should indicate on 30 April that the concession on derv would take effect "when the Finance Bill becomes law". An amendment would then be made to the Bill at Report Stage fixing as the operative date the Monday after the expected date of Royal Assent. Customs would meanwhile give further consideration to the impact of a possible duty relief scheme and how the costs could be minimised.

5. It was agreed that the Whips should indicate to Government backbenchers on 29 April that the Government would be ready to accept an amendment reducing the tax increase on derv by 10p a gallon with effect from early August. They would make clear at the same time that the Government would be proposing in due course offsetting measures to recoup the revenue loss. Arrangements would then be made for Mr. Skeet to move the amendment in question at the beginning of the debate, which the Chancellor would then accept, speaking second.

6. The Chancellor asked for speaking notes to be provided for this purpose. These could conveniently be in the form of summary notes rather than continuous prose, but complete forms of words should be provided on issues where the statements required particularly precise definition. I should be grateful if you would arrange for the necessary notes to be provided, covering the industrial and energy conservation

aspects, as well as the "rural" and "political" aspects.

7. The Chancellor also asked Customs, in consultation with Parliamentary Counsel to prepare a note on possible alternative timings of Budget resolutions and the subsequent debates, depending on which duties were to be increased and whether the Bill was to be amended in Committee or on Report.

JW

(A.J. WIGGINS)
28 April 1981

SECRET

BK

CC HMT 16

File

Econ Pol

10 DOWNING STREET

From the Private Secretary 28 April 1981

I understand that the Chancellor of the Exchequer has decided that the Government should agree to an amendment to Clause 4 of the Finance Bill reducing the tax on Derv by 10p a gallon to come into effect as from Royal Assent in early August. He has also decided that the revenue loss will have to be recouped, though precisely how will be for further consideration.

I have spoken to the Prime Minister about this, and she is content for the Chief Whip to sound out those backbenchers who have said they would vote against the petrol duty increase on what the Chancellor has decided.

I am sending a copy of this letter to John Wiggins (HM Treasury)

T. P. LANKESTER

Murdo Maclean, Esq.,
Chief Whip's Office

SECRET

N 010 15

Dm agreed

Prime Minister
The Chancellor has decided that the tax on derv be reduced by 10p from the date of Royal Assent, and that the revenue loss should be recouped – at this stage by unspecified measures. Do you want now like the Chief Whip to sound out the dissident back-benchers. Content?

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, HOUSE OF COMMONS AT 4.30 P.M. ON MONDAY 27 APRIL 1981

Present:

Chancellor of the Exchequer (in the chair)
Secretary of State for Industry
Chancellor of the Duchy of Lancaster
Secretary of State for Energy
Chief Secretary
Chief Whip
Mr. A.H. Newton, MP
Sir Douglas Lovelock (Customs & Excise)
Mr. Battishill
Mr. Cropper
Mr. de Waal (Parliamentary Counsel)
Mr. Guinness (Department of Energy)
Mr. MacLean (Chief Whip's Office)
Mr. Owen (Department of Industry)

ROAD FUEL DUTY AND ENERGY PRICES

Relationship with further measures on energy prices

The possible link between decisions on the level of the road fuel duties and decisions on further changes in energy prices was noted. The Secretary of State for Energy was circulating on 27 April a number of papers which he thought would chart a satisfactory way forward, and which he expected to be discussed at MISC 56 on 29 or 30 April. It was accepted, however, that there was no realistic prospect of reaching firm conclusions on energy prices in time for an announcement on 30 April; it would be most undesirable for the Government to enter into any commitments on energy prices before the precise details of any further measures had been worked out. Although it was recognised that action in response to the rural and energy price lobbies was to a degree complementary, so that action aimed at the one could be presented as helping to satisfy the other, it was recognised that there was no alternative to treating the two issues separately for the purposes of early discussions on the Finance Bill.

28/4

CHANCELLOR OF THE EXCHEQUER

Timing of the Finance Bill discussion

2. The possibility of moving the Finance Bill discussion of the road fuel duties from 30 April to, say, 13 May was briefly considered. This would perhaps have enabled Ministers to reach firm decisions on energy prices, so making it possible for changes in the road fuel duties to form part of a package with energy price changes and other changes in indirect taxes to offset the increase there would otherwise be in the PSBR. It was, however, generally felt that such a delay in discussion of Clause 4 of the Finance Bill would convey an impression of Government uncertainty, and would stoke up expectations of substantial changes. Moreover it would have the effect of delaying the announcement of the reduction in the duty on derv - which could have considerable electoral appeal - until after the County Council elections on 7 May. It was agreed, therefore, that the Procedure Motion to enable Clause 4 to be taken before Clause 1 on 30 April should be put down on 27 April.

Concessions on road fuel duties

3. The Chief Whip reported that there were 18 Conservative backbenchers who seemed unlikely in any circumstances to vote for the Budget increase of 20p a gallon on petrol. There were a further 13 who would only support the increase on petrol if there were a reduction in the duty on derv. In his judgement the reduction would have to be 10p a gallon; 5 of the 13 members who seemed likely to be "bought off" with a concession on derv had made it clear they thought 5p a gallon insufficient.

Nature of offsetting action and timing of announcement

4. Treasury Ministers had hitherto envisaged that, while a 5p reduction in the duty on derv - particularly if delayed until August - could be accepted without any action taken to offset it, a 10p reduction should be offset by a 1p increase in the duty on a pint of beer. If such an increase were to be made, it would require a new Budget Resolution to be debated and passed before Clause 1 of the Finance Bill was taken on the Floor of the House, probably on 5 May. In further discussion the point was made that it would be better to look for the additional revenue from tobacco rather than

alcohol; the Opposition were less rigorously opposed to increases in the duty on cigarettes, while they were expected to make a great fuss about the increase in the duty on beer. Moreover since tobacco was being taken upstairs in Committee, it would be unnecessary for the Government to move the Budget Resolution imposing the increase of 3p on 20 cigarettes necessary to offset the 10p derv reduction until well after 7 May. Once the Resolution was put down, the Opposition might well seek to move the debate on tobacco on to the Floor of the House; on balance, this seemed likely to be advantageous to the Government. It was noted that the Chancellor would need to give some general indication that it would be necessary to recoup in some way the cost of the 10p derv reduction; one possible course might be to indicate that the Government were giving further thought to possible measures on energy prices, and that they would in due course propose whatever measures were necessary to offset the costs of any moves on energy prices as well as that on derv.

Operative date for duty changes

5. The Chancellor of the Duchy suggested that it would be better for the reduction on derv to take effect on 1 May; a delay until the Finance Bill received the Royal Assent in early August would be very uncomfortable. Moreover this delay would give added force to demands for a duty relief scheme, which Customs thought most undesirable. On the other hand, the disadvantages of an early announcement on the offsetting measures were noted, and it was agreed on balance that it would be better if both the reduction in the derv duty and the offsetting increase in that on tobacco took effect after Royal Assent. It was noted that this course of action would enable the Government to accept an amendment to the Finance Bill put down by Mr. Skeet without making any prior announcement of their intentions; the insertion of the effective date and one other minor consequential amendment could then be dealt with at Report Stage. No new Budget Resolution would then be needed covering the position on derv, and no question would arise of Customs failing to collect all the duty required by the PCTA (a difficulty which would

arise if there were no new Budget Resolution, but the reduction were to have immediate effect).

Conclusions

6. The Chancellor said that the meeting had reached provisional conclusions as follows:-

(i) The road fuel duty clause should be taken first in Committee on the Floor of the House on 30 April.

(ii) The Government should agree to an amendment reducing the tax on derv by 10p a gallon.

Chancellor is consulting – eg. wine, gambling.

(iii) The revenue loss should be offset by an increase in the duty on cigarettes.

(iv) Both the reduction and the increase should take effect after Royal Assent.

(v) Treasury Ministers should indicate in general terms that the revenue loss on derv would need to be recouped. The necessary Resolutions. (The question how to meet the cost of any energy price changes would be considered separately.)

(vi) A modest subsidy to fuel oil used in horticulture, on the lines proposed by the Minister of Agriculture, should be announced on 30 April either separately or in the course of the debate on derv. Urgent discussions would be held with the Ministry of Agriculture.

(vii) Possible measures on energy prices would be discussed in MISC 56 on the basis of the papers provided by the Secretary of State for Energy.

JW

A.J. WIGGINS
28 April 1981

Distribution:
Those present
Minister of State (L)
Sir Douglas Wass

Mr. T.P. Lankester (No.10)
Mr. Ryrie
Mr. Middleton
Mr. Ridley
Mr Unwin
Mr. Wicks

C A Whitmore Esq

2.

Prime Minister

To see

that 23rd.

CLIVE

You will wat to see this

MS
22/4

CABINET OFFICE

With the compliments of
Sir Robert Armstrong KCB, CVO
Secretary of the Cabinet

Mtg record returned to Cabinet Office

70 Whitehall, London SW1A 2AS
Telephone: 01-233 8319

14 A.

SECRET AND PERSONAL

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref. A04741

21 April 1981

The Meeting of MISC 56 on 16 April discussed as its first item possible changes in the duty on derv. Since these were discussed in the context of other possible amendments to the Finance Bill, which could have the affect of changing other duties as well as the duty on derv, I have included only the briefest note of the discussion in the minutes as circulated. You may, however, like to have the attached full minutes as an aide-memoire for the Chancellor of the Exchequer.

I am sending copies of this letter and the enclosed minutes to Clive Whitmore.

ROBERT ARMSTRONG

A J Wiggins Esq

SECRET AND PERSONAL

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

2

Prime Minister

April 9, 1981

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

The Rt. Honorable Mrs. M. Thatcher MP
The Prime Minister and First Lord
of the Treasury
10 Downing Street
London

12/4

Dear Mrs. Thatcher:

Flag A

It was very good of you to take the trouble to write to me in response to my letter of March 13. I deeply appreciate your thoughtfulness.

Flag B

I am also very pleased that the Chancellor of the Exchequer has considered the detailed points I have made to you and I hope that these will be reflected in the Committee stage of the Finance Bill.

It is so important for the future of Great Britain and for the development of oil in the North Sea that some amelioration of the changes in the Safeguard be made.

I look forward to seeing you again soon and, in the meanwhile send my very warmest wishes.

Respectfully,

Armand Hammer

AH/fa

MAP has seen.

B

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

8 April, 1981

Dr Armand Hammer
Chairman & Chief Executive Officer
Occidental Petroleum Corporation
10889 Wilshire Boulevard
Suite 1500
Los Angeles
California 90024

Dear Dr Hammer

You wrote to David Howell on 13 March - with copies to the Prime Minister and myself - about my Budget oil taxation proposals particularly as they affect your company's Claymore Field Extension project. Perhaps I can reply on behalf of all three of us.

As you know, my PRT relief proposals - unlike the new Supplementary Petroleum Duty - are not primarily designed to raise revenue in the short-term, but rather to remove distortions and anomalies in the oil taxation system which have emerged in recent years. In particular, we were concerned that some further investment on fields already in production might secure a measure of PRT relief quite out of proportion to the economic merit of the expenditure. The result might have been not just a long-term loss of tax yield, but also potentially a serious distortion of the industry's exploitation effort.

In considering how best to remove these distortions I certainly did not want to discourage worthwhile new investment, either on new fields or on field extension. Despite what you say, I do not believe that the proposals will "kill all incentives for future investment", or that it discriminates against companies like your own. I do think there is advantage in putting the PRT structure right as soon as possible, before any company becomes deeply committed to projects which depend on excessive PRT relief for an acceptable post-tax return.

Turning to your own Claymore project, my officials and Department of Energy officials have studied the impact of the proposed changes on the project's economics using the figures you have submitted to the Department. They can see that there is a significant reduction in return below what could have been expected under the old PRT regime but the changes appear to leave the return around the same broad level as would have been achieved if there had been no North Sea taxes at all. In these circumstances I do not think that tax can be rendering an economically desirable project non-viable. I do appreciate you will wish to reappraise your plans in the light of the changed tax system but I would hope that if the project was worthwhile in the first place it will still be worthwhile under the new rules even if some changes in the technical approach or timing are necessary.

Yours ever,

Geoffrey Howe

GEOFFREY HOWE

010

BACKGROUND NOTE PMG 9/81

THE BUDGET ARITHMETIC : BACK TO FIRST PRINCIPLES

P2

The Government's economic policy is designed to defeat inflation and to restore the economy. At the heart of the Budget judgement lie the questions how much the Government is going to spend in the coming year and where it is going to find the money. The Government has no money of its own. It can only finance public spending by calling on the taxpayer and by borrowing. And higher borrowing means higher interest rates not only for the Government but for industry and home owners.

The arithmetic around which this year's Budget judgement had to be made is easy. In the coming year we will spend about £104 billion, in cash, not phoney prices. If we hadn't raised taxes in the Budget, government revenue would have provided about £90 billion of that, leaving £14 billion to be borrowed. We decided not to borrow more than £10½ billion, so taxes had to go up by enough to raise an extra £3½ billion.

Now it's clear that the arithmetic would be easier still if we started from somewhere else - from planning to spend only £100 billion, for instance. In fact we've had to make strenuous efforts to stop it going higher still, and we are already planning to spend £5 billion less than the previous administration planned. Getting it down below £104 billion for next year would have meant making quite unacceptable cuts in public services: but in later years, as we come out of the recession, we shouldn't need to spend so much on supporting our industries and employment and the level of public spending can come down.

So, given that we were stuck with £104 billion, why did we decide to base the budget arithmetic on borrowing £10½ billion? The reason is that this figure is the highest one at which we can aim if we are both to control the money supply, and so beat inflation, and also keep down the burden of interest rates on industry and others. Of course, the outturn will not be borrowing of £10½ billion precisely. But the Budget

Contd .....

sums must begin from a precise number and in this way £10½ billion is not the same as £11 billion, £11½ billion and so on.

The Chancellor chose to get his extra revenue in three ways: from those who could best afford it - which meant the oil companies and the banks, who have been doing well despite the recession: from duties that hadn't been keeping pace with inflation - which meant the old favourites like tobacco, alcohol, and petrol; and from those who are employed, since in the last two years they've done very well - so tax allowances were not indexed to keep pace with inflation. There are other ways of doing it; but the money had to be got from somewhere.

Of course, the Budget wasn't just about tax raising. The Chancellor made room for some help for those who most need it, too. There were imaginative new measures to encourage the growth of small businesses, where many of the new jobs must be found; and there was special help for families, pensioners and the disabled.

The only way to escape the logic of the Budget arithmetic is to cheat: to make two and two equal five by printing pound notes to make up the difference. But we all know that would lead us straight back to rising inflation. This Government has certainly faced up to the difficulties, and the depth of the world recession has been chief among them, but it has never lost its grip on the task of keeping inflation permanently under control.

Chancellor of the Duchy of Lancaster
and Paymaster General
Privy Council Office
68 Whitehall
LONDON SW1

Econ Pol.

2

CONFIDENTIAL

PRIME MINISTER

H.M. CUSTOMS AND EXCISE
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE
01-626 1515

More work needs to be done on this: no doubt it will be, in the light of this advice. MS 19/3

Mr Salveson

PA (cf file) MS

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Mr Ryrie
Mr Battishill
Mr Unwin
Mr Ridley
Mr Cropper
Mr Cardona
Mr de Waal

19 March 1981

CHANGES IN PETROL DUTY

1. We understand that No 10 has asked for a note on the legal position on the Budget Resolution covering the petrol duty increase. We have consulted Parliamentary Counsel. He has pointed out that we are in "uncharted waters" and cannot predict the views of the Courts with abolute certainty.

2. The Budget Resolution, having been passed by the House, has statutory effect up to Royal Assent unless "the provisions giving effect to it are rejected during the passage of the Bill containing them through the House" (or Parliament is dissolved or prorogued). Amendment of the clause at Committee or Report Stage so as to reduce the size of the increase to, say, 10p or 15p should not constitute "rejection" and should not abolish the statutory effect of the Resolution. Only a defeat of the motion that "the Clause stand part" should abolish the statutory effect of the resolution.

3. If the clause were to be amended the oil companies would be entitled after Royal Assent to reclaim the "excess" they had paid after 10 March between the 20p increase imposed under the Resolution and the "legal" rate finally enacted by the Finance Act. For this

Internal circulation:

CPS — Mr Jeddere-Fisher — Mr Leavett-Yeats
Mr Phelps — Mr McGuigan
Solicitor — Mr Howard

reason, the procedure followed in 1977 was to retain the Budget increase until 8 August and the increase was removed only from that date.

4. If the Government were to be defeated in Committee, the amendment would not have immediate statutory effect and strictly speaking Customs and Excise should charge the 20p increase until Royal Assent and repay the excess subsequently. One possibility would be for the Chancellor to authorise Customs in the interim to charge only the "revised" increase extra-statutorily (and to authorise the value for VAT on petrol to be reduced accordingly).

5. An amendment made during the passage of the Bill could be given immediate statutory effect only by the introduction of a new resolution setting out the new rate of duty and its operative date. Such a resolution could of course provide for the 20p Budget increase to be charged up to the date of the subsequent change; and repayment claims would then be inhibited if the provisions of the resolution were to be enacted by a Report Stage amendment. Such a resolution could not be moved more than 25 sitting days before the Report Stage amendment would be due to be debated in the House.

6. In practice there could be near-chaos if the Government were to be defeated at Committee Stage; and it would be virtually essential to have clear contingency plans if there is any possibility of such an event. The "cleanest" solution might be to try to ensure that any amendment debated at Committee Stage contains a future date for the change in the rate of duty - preferably after Royal Assent. Even then, it might be necessary to repeat the special provisions for the duty on the stocks of petrol in garages which were introduced in 1977.

CF

C FREEDMAN

hs

Econ Pol.

19 March 1981

I have shown your letter of 17 March to the Prime Minister, and she is content that the draft consultative paper on methods of bringing the petrol benefit into tax should be published.

M.A. PATTISON

Roy Warden, Esq.,
H.M. Treasury.

cc HMT

NJ

10 DOWNING STREET

THE PRIME MINISTER

19 March 1981

Dear Dr. Hammer.

Thank you for your letter of 13 March.

I am delighted to hear that you have now obtained an export licence for the Leonardo Codex. Thank you for your understanding over this.

You made your views on oil taxation clear when we met here in February. I am asking the Chancellor of the Exchequer to reply to the detailed points you have now made to us in your letter of 13 March. - He did consider your views very carefully indeed before reaching a decision.

All good wishes.

Yours sincerely

Margaret Thatcher

Dr. Armand Hammer

10 DOWNING STREET

From the Private Secretary

18 March 1981

B F 30/3/81

The Chancellor has received a copy of Dr. Armand Hammer's letter of 13 March to the Secretary of State for Energy, about the effect of the changes in PRT relief provisions announced in the Budget. The Prime Minister has sent a short personal acknowledgement, in view of the covering letter with which Dr. Hammer forwarded a copy of his letter to her. She believes that it would be appropriate for the Chancellor to reply to Dr. Hammer's letter on behalf of all three Ministers. I should be grateful if you could arrange this. May we please have a copy of the reply for our records in due course.

I am sending a copy of this letter to Geoff Dart (Department of Energy).

M. A. PATTISON

R.I. Tolkien Esq
HM Treasury

6

FILE

VLB

17 March 1981

I am writing on behalf of the Prime Minister to thank you for your letter of 13 March, which I shall place before her.

M A PATTISON

Dr. Armand Hammer

10 DOWNING STREET

From the Private Secretary 18 March 1981

B F 30/3/81

The Chancellor has received a copy of Dr. Armand Hammer's letter of 13 March to the Secretary of State for Energy, about the effect of the changes in PRT relief provisions announced in the Budget. The Prime Minister has sent a short personal acknowledgement, in view of the covering letter with which Dr. Hammer forwarded a copy of his letter to her. She believes that it would be appropriate for the Chancellor to reply to Dr. Hammer's letter on behalf of all three Ministers. I should be grateful if you could arrange this. May we please have a copy of the reply for our records in due course.

I am sending a copy of this letter to Geoff Dart (Department of Energy).

M. A. PATTISON

R.I. Tolkien Esq
HM Treasury

6

PRIME MINISTER

Dr. Hammer writes again about oil taxation, and takes the opportunity to confirm that all is now well over the Leonardo Codex. (I believe that the export licence was issued on Monday.)

Do you want to get involved in the correspondence about oil taxation, or do you prefer to leave this to Mr. Howell? If so, we will let you have a short courtesy reply.

MAP

I think a Treasury reply (preferably signed by the Chancellor) would be best.

MT.

17 March 1981

cc Wolfson ✓ 2
Walters ✓

PRIME MINISTER
Attached is the Inland Revenue draft consultative paper on methods of bringing the petrol benefit into tax. It merely sets out the options for taxing this benefit, and invites views. It should not cause any difficulty.

MINISTER OF STATE TREASURY

Treasury Chambers, Parliament Street, SWIP 3AG

TL 18/3

M A Pattison Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

17 March 1981

Dear Mike

In his Budget Statement last week, the Chancellor said that, in view of the growing practice of employers providing free petrol, action would be taken to ensure that tax was chargeable in all cases where petrol was provided for the private use of a higher paid employee or director. He added that the Inland Revenue would be consulting employers' organisations over the administrative implications of the various possible methods of achieving this.

I attach a copy of a consultative paper which the Inland Revenue intend to issue. As you will see, three methods are outlined:

(a) to attempt to be precisely accurate at the expense of imposing substantial record-keeping and checking burdens on employers and the Inland Revenue;

(b) to use formulae negotiated locally by Inspectors;

(c) to apply a scale on a similar basis as that used for company cars.

The Inland Revenue hope to begin consultations very quickly so as to complete them by mid-May so that an announcement can be made during the Committee Stage of the Finance Bill.

Yours ever,

Roy Warden

R WARDEN

Private Secretary

PETROL PROVIDED BY EMPLOYERS

METHODS OF BRINGING THE BENEFIT INTO TAX

A CONSULTATIVE PAPER

1 The Chancellor announced in his Budget Speech that the benefit of free petrol for directors and higher paid employees for their private use, however provided, should be brought into charge to tax. This paper outlines the various methods which might be employed to achieve this and is designed to elicit views on these methods, rather than the proposal itself. In particular, it canvasses the administrative problems likely to be thrown up by these methods for employers and employees, as well as for the Inland Revenue.'

2. For the purpose of this paper 'petrol' includes petrol, oil, diesel and other substances used as fuel for motor vehicles.

3. The Revenue's ability to raise a charge under the general Schedule E rules varies according to the method by which petrol is provided for an employee's private use; and the effects of the benefits legislation contained in the 1976 Finance Act (which applies only to sums not otherwise chargeable to tax) vary according to whether petrol is provided for use in the employee's own car or in a company car to which Section 64, Finance Act 1976 applies. It is proposed to introduce a single, unified system covering all directors and higher paid employees.

4. The method adopted could take one of three forms -

(i) Quantification of the benefit by reference to the actual cost incurred by the employer in supplying petrol to the extent that it is used for private, as distinct from business, purposes (the 'actual' method);

(ii) the use of formulae agreed locally for application to individuals or groups of employees receiving petrol from particular employers, (the 'formula' method); and

(iii) a scale, similar to the scale used for measuring the benefit from a company car (the 'scale' method).

The 'actual' method

5. This would involve the employer in keeping records for each employee concerned of the cost of petrol provided for him and returning the particulars to the Inspector after the end of the tax year. He could either be required to break down the total by reference to business and private use, or he could merely return the total, leaving it to the employee to claim for business use. The first approach would be more burdensome for employers, the second more burdensome for the Revenue and for employees; but they would both require records to be kept more extensively than is now the general practice.

The 'formula' method

6. The precise formula would be for negotiation with the Inspector, although there would be a general pattern into which the different formulae would fit. The employee would retain the right to claim expenses under the general Schedule E rules where he considered that in his case this would produce a more favourable result. The formula might be based on actual expenditure in a sample period; or AA or other figures for petrol costs per mile for the type of car involved; or an agreed proportion of the total mileage; or any other basis which gave a just and reasonable measure of the benefit for the groups of employees or individuals concerned.

The 'scale' method

7. This would be similar in principle to the scale

used for car benefits. It would not depend directly on the amount of petrol provided. The scale could be graduated like the car scale, by reference to engine size and price of car, and might be set as a percentage of the car scale; or it could be at a flat rate unrelated to the type of car. The charge might be reduced where the business mileage was very high. It could also be reduced if the employee made some payment to his employer specifically for the fuel provided for his private motoring. Alternatively, the scale charge could simply be reduced to nil where the employee fully reimbursed his employer for the cost of petrol used privately. These modifications would require more elaborate record keeping than a simple scale but they would probably be administratively more convenient than the 'actual' method. A graduated petrol scale related to the car scale could present problems in its application to those provided with free petrol for use otherwise than in a company car.

Application of PAYE

8. Under the 'actual' method the tax on the benefit would ordinarily be recoverable through adjustments to the PAYE coding. Under the 'scale' method and under the 'formula' method the benefit could be treated as pay for PAYE purposes, so that the employer would apply PAYE to it directly month by month.

Conclusion

9. Views are invited on the methods examined in this paper, and any other suggestions would be welcomed.

Inland Revenue
Somerset House
March 1981

A

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

13th March 1981

The Rt. Hon. Mrs. M. Thatcher MP.,
Prime Minister and First Lord
of the Treasury,
10, Downing Street,
London,
SW1

Dear Mrs. Thatcher,

Permit me to thank you for the help you have given to make it possible to obtain the export licence for the Leonardo Codex. I very much hope to have the opportunity of showing it to you when it comes to the Royal Academy in the Summer.

The award of the licence was well received by the press, as you no doubt have seen. At the press conference on the award of the Codex licence I was asked a question on the impact of the budget on Occidental's North Claymore development. This resulted in an article (copy attached) which appeared in Saturday's Financial Times. I did my best to soften the blow and only said that the PRT changes would cause a 'temporary hold up', but must in all fairness tell you that the policy of tampering with PRT in a discriminatory way, in addition to the introduction of SPD, affects the credibility of the U.K. as a country in which to invest, as I mentioned to you in Washington.

For your information I enclose a copy of my letter to Mr. Howell, regarding Occidental's position on the North Claymore project, following the budget. For the good of Britain I hope changes can be made and the position rectified so that the project can proceed.

With warmest regards.

Sincerely yours,

Armand Hammer

ARMAND HAMMER

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

13th March 1981

The Rt. Hon. D. Howell MP.,
Secretary of State for Energy,
Department of Energy,
Thames House South,
Millbank,
London,
SW1

Dear Mr. Howell,

In view of the past discussions that we have had with you and members of the Department of Energy staff regarding the Claymore Field Extension project, I am writing to advise you that the utilization of a floating production facility for the project is likely to be deferred and possibly cancelled. The reason for this decision is the changes in PRT relief provisions announced in the March 10, 1981 Budget. The preliminary economic calculations indicate that the elimination of uplift and reduction of the safeguard period now make this major investment unattractive. It is unfortunate that some of the increase in economic reserves and contracts to Britain that would have been the net result of such a facility will not now be realised. These tax changes will similarly impact reservoir extensions of other producing fields which have reached payout. We are disappointed that the Budget changes require us to reach this conclusion.

We realise the difficulties facing the U.K. We do not object to the introduction of SPD, certainly as it may be only a temporary tax to be lifted in June 1982. We also appreciate the need to increase the revenue from the North Sea. However, the discrimination against companies like Occidental which are willing to make hugh investments in developing marginal extensions to existing fields, by changing the rules in mid stream

Cont/...

will kill all incentives for future investment and, in my opinion, will hurt the U.K. more than the benefits derived from the tax changes. It is a little like killing the goose that is laying the golden egg.

With best regards.

Sincerely yours,

Armand Hammer

ARMAND HAMMER

cc. Rt. Hon. Mrs. M. Thatcher MP
Rt. Hon. Sir Geoffrey Howe MP

FINANCIAL TIMES

Saturday March 14 1981

Occidental says tax rise has delayed £250m oilfield development

BY RAY DAFTER, ENERGY EDITOR

OCCIDENTAL PETROLEUM has postponed the £250m development of its North Claymore field following the Government's Budget proposals for higher North Sea oil taxes, Dr. Armand Hammer, chairman of the U.S.-based oil group said yesterday. Other offshore operators are also reassessing their investment plans.

Occidental's move will come as a blow to British Shipbuilders and British Steel Corporation, which were hoping to win important orders.

Shipbuilders in the UK and four other countries have been asked to tender for one of the main contracts—worth around £50m—involving the construction of the hull of a proposed floating production platform. It is expected that Occidental will outline its revised plans for North Claymore at the end of April when it was due to award the hull contract.

The North Claymore project is the furthest advanced of three schemes, worth a total of £625m, that Dr. Hammer unveiled last September. The package of projects, including a refinery in the Thames Estuary and a chemicals plant in Scotland, was then welcomed by the Prime Minister.

Commenting on the Budget proposals yesterday, Dr. Hammer said that the tax changes, including the imposition of a Supplementary Petroleum Duty for the next 18 month, might make uneconomic some fields which could have been developed commercially. There would be a "temporary hold-up" in the exploitation of North Claymore, he said.

An additional £1bn in Government revenue is to be creamed off North Sea oil operations during the 1981-82 financial year, most of it through the new supplementary tax. But it is understood that commercial viability of the small North Claymore field has been more affected by planned changes in the existing Petroleum Revenue Tax.

Occidental and its partners—Allied Chemical, Getty, and the Thomson Organisation — had planned to use tax credits gained from the main Claymore Field development to help finance the neighbouring North Claymore project. But proposed changes in the "uplift" allowances and "safeguard" provisions will make Petroleum Revenue Tax conditions more

Continued on Back Page

Continued from Page 1

Occidental blames tax rise

onerous.

At present, an "uplift" allowance of 35 per cent on top of field development costs can be set against PRT. In future, this uplift will be restricted to expenditure incurred up to the time the field's operators begin to make a profit.

The safeguard provisions presently protect companies against Petroleum Revenue Tax payments where profits are less than 30 per cent of capital investment. Above this level, the PRT charge does not exceed 80 per cent of the profits over the 30 per cent return. In future these safeguard provisions will be restricted to a period half as long again as the time it takes companies to recover their development costs.

The UK Offshore Operators Association, which represents North Sea companies, has already warned that tax changes will hit the pace of both exploration and development. But Occidental is the first company to reveal changed plans.

North Claymore is a small field by North Sea standards. Recoverable reserves are thought to be about 50m barrels, just about sufficient to justify the development using a floating semi-submersible production unit capable of handling a flow of about 35,000 barrels a day.

Occidental has already positioned on the seabed a £250,000 eight-well drilling frame, fabricated by Blackwall Engineering, a British Shipbuilders subsidiary. Its first main North Claymore development contract, recently placed with contractors Brown and Root (UK) has already been terminated. Brown and Root had been asked to undertake the engineering and project management of the processing facilities.

HMT. 25 p.

Budget file

To describe the Government's policies as deflationary is absurd. It reflects two peculiar forms of myopia.

First, it considers one side of the fiscal account only. It is necessary to look at the whole fiscal stance. It is true that yesterday's Budget measures will increase net tax next year by some £3½ billion. But it is true also that the reason for this is that public spending next year will be much greater than originally planned. In fact in cash, around £6 billion more than planned a year ago. Now much of this, of course, is due to the recession (extra spending on special employment measures, support for industry, unemployment benefits, etc.). So to offset it all by tax increases would be too restrictive. The Chancellor made this clear yesterday. This is why we are not providing for the PSBR of £7½ billion which the Medium Term Strategy published last year suggested would be appropriate given the higher level of economic activity then assumed. What we are doing is to offset a reasonable part of the extra spending by tax increases and to provide for a PSBR of around £10½ billion which is actually higher than the PSBR for which we originally provided in the current year. It is absurd to describe this as deflationary. What it enables us to do is to keep the pressure on inflation, to get interest rates down, and to continue laying the foundatio for geniune and sustainable growth of output and jobs in the future.

/ The second

The second form of myopia is to put a particular set of measures under the microscope and treat them as if they have no relation to anything else and are divorced from the Government strategy as a whole. This is deliberate and mischievous misrepresentation. It wilfully ignores the fact that yesterday's Budget proposals form but one part of the Government's longer-term strategy for defeating inflation. Until we restore sound money and beat inflation there is no prospect of getting unemployment down and keeping it down. This Budget is a vital further step in that strategy. It is particularly absurd to abuse it as deflationary when the only alternative is not reflation but inflation.

9 Scottish Tories.

C of E: being confronted in a few minutes
by Scottish Members
angrily protesting etc.

MS 'PRIME MINISTER Worth reading: a good performance, in my view MS 13/3

CC. Mr Saunders. Econ Pol

CHANCELLOR - INTERVIEW ON BUDGET WITH JIMMY YOUNG

Transcript from BBC Radio 2, Jimmy Young Programme, 13 March 1981

✓ CF file (Budget) MS

YOUNG: ..... How can the Budget, which it is being said - I mean by the Treasury among other people - is likely to increase unemployment how can a Budget like that work do you think?

CHANCELLOR: Well the effect of it is to lay the foundations for getting unemployment coming down. And the most important foundation for that is getting inflation coming down. That's the centre piece of our policy, it has been ever since we came in. So if we're to do that we've got to make sure Government's not borrowing more than it can sensibly do. Putting it very simply, I have to balance the books in a sensible fashion if interest rat es are going to come down, if inflation is going to come down, if industry is going to be able to have the right chance to begin creating new jobs.

YOUNG: You see I suppose the question one has to ask is; why does it appear that the TUC, the CBI, a lot of your Back Benchers and so on, are all at odds with you? In other words, are you the only one in step?

CHANCELLOR: You will find that the overwhelming majority of our own parliamentary Party supports the strategy we're on very strongly. And it's my impression, talking to the great mass of ordinary folk up and down the country, that they also do so. They see very clearly that we've got to get on top of inflation, and that any sensible Government has got to balance its books. And that it isn't for the Government to begin spending us back to prosperity.

If you look at what's happened in Britain you see over recent years; there's been no shortage of cash or demand But for people's wages they have been rising very sharply, but imports have been going up and not output. What we've got to do is to get the balance of the thing right and I have to start right back here in the cetre of Government. To put it very simply; last year we had very big increases in pay for all those that work in the public sector. It cost the Government £2 billion or so. In the year ahead we're going to have big increases, as is right, in pensions. That's another cost of £2billion or so. That's £4 billion extra And it happens that those figures coincide pretty closely with the extra revenue I'm getting on taxes on alcohol, tobaco and petrol and the taxes that are going to come from leaving income tax thresholds where they are. Now it's that sort of arrangement. I have to get it back into that sort of balance. If I'd borrowed, as we would have been doing, £14 billion then interest rates would have been going up through the roof instead of coming down.

<u>YOUNG</u> : You've just mentioned the magic word petrol; can I ask you about that because that seems to have caused more comment that practically almost anything else you did in the Budget?

<u>CHANCELLOR</u>: Yes, it s a very sensitive, and understandably, a very sensitive subject because petrol is used by so many of us in our motoring for work as well as for pleasure. Though in fact it may be surprising to say so, the price of petrol per gallon after this Budget in terms of purchasing power is almost exactly the same as it was in 1970, or in 1950. But as inflation has happend the tax take on the gallon of petrol has fallen as a percentage of it. It went up last year ~~ax~~ as you remeber by 10p. In fact petro prices haven't moved since then at all really. And this additional tax we're now taking is going a very little further than is necessary to keep the Exchequer's share in line with inflation.

<u>YOUNG</u>: But surely it's bound to increase the cost of transporting goods about the country and therefore bound to cause problems?

CHANCELLOR: It makes a small contribution to additonal costs of that kind. The effect of it on the cost of living altogether is only just over half a percentage point because it's spread through so many different transactions. And looking at the other side of it, if I didn't get revenue from that quarter then I should be increasing my borrowing by more than another £1,000 and that would be likely to send interest rates again in the wrong direction.

YOUNG: Are you confident that you're going to get the full 20 p through?

CHANCELLOR: I think so yes. I think that when I've discussed it with colleagues in the parliamentary Party they do understand that this Budget, like so often in housekeeping, is an amalgam combination of many uncomfortable choices. While most of the taxes we're having to increase are unattractive, taxes are like that, but one's got to make the best of the choice one has. I think most people understand that.

YOUNG: But if pressed on the 20p for petrol would you be prepared to lessen it somewhat?

CHANCELLOR: No I don't think I've got any room to maneouvre. You see, it's more than a billion £'s the yeild from petro and other hydro carbon oils. And that's equivalent to well over a penny on income tax for example. And people I don't think want to see that rate going up again. The money has got to come from somewhere I quite beleive that after we've done this our petrol will still be cheaper than most of Europe. Because I think it's the exce ption of Germany and Holland.

INTERVIEWER : Would it be better perhaps to have put it on petrol but not to have put it on derv?

CHANCELLOR: That I think raises difficult complications. One of them is that the diesel engine car market in this country is a particularly sensitive one and we discussed that with industry. On the whole we think they should move in line with each other. Last year in our first Budget you may remember I did actually bring petrol up and hold derv steady to get them back into line, they'd got out of line. I think it's sensible to move in line now.

YOUNG: Let me ask you something that Peter Shore said a little while ago; he said in this spiral of decline with 90% of companies working under capacity, unemployment rising to over 3 million, it's in the interests of the country to increase spending on things like long term benefit investment by which I mean railway electrification, road programmes, replacing some of the rotting sewersand housing programmes. Is it not better in fact to pay people to work rather than pay people to not work?

CHANCELLOR It's obviously better to do that if you can. But that with which you pay them, whether it's to work or not to work is limited . This is the point. And the suggesting which Peter Shore puts forward that we can somehow solve this thing by increasing borrowing is not the way out because the money isn't there to increase borrowing in that way. You see what's been happening , and people need to be reminded of this so often, is that our actual personal living standards over the last 3 years and many years now have gone on going up while the resources of companies and the resources available for capital invesment by Government have gone on shrinking. . We've actually all been enjoying as individuals many of the benefits of North Sea oil already. Because that's keeping the £ up and everybody is able to buy things more cheaply round the rest of the world.

So people have been becoming better off and the resources that companies and businessses so desperately need haven't been there. Hence this Budget. Hence, I'm afraid higher taxes on people but lower interest rates for business

<u>YOUNG</u>: Now Peter Shore said quite categorically that he would borrow the money. And when you say the money isn't there to be borrowed he says well there are vast sums in collective savings, in pension funds and so on, which could be - and he used the word - persuaded to invest?

<u>CHANCELLOR</u>: The way in which they are persuaded to invest in a free society is by the <u>level of interest rates.</u> Because the money that the pension fudnds and insurance companies have doesn't belong to Peter Shore or any politician, it belongs to the pensioners present and future of this country. Many millions of people whose pensions depend upon those pension funds getting the interest to which they're entitled. Now if a socialist Government was to come along and say whatever you may think about the right interest rate pension funds we're going to coral your money and begin spending it though the State at unfair interest rates, that would be unfair to pensioners and a very very damaging thing to do. And I think that he doesn't actually recognise the reality of the world we live in. Interest rates now at 12% are well below the equivalent rates in the United States, they're below those in Germany or France. In a world at the time we're now living in interest rates have to be at a certan level if people are to be fairly compensated for investing their savings. The money in pension funds is the accumulated savings of pensioners.

<u>YOUNG</u>: Can we go back to something which we were talking about just now: would it not make sense in fact to be into projects like new roads

and railway investment and so on?

CHANCELLOR: I'm very much in favour of trying to find additional investment projects which can be sepearately financed with the private sector. Now one of the problems of our coutnry at present you see is the large chunk of it is blighted by having been taken into public ownership, having been nationalised. And it's very very difficult when you're dealing with some of those nationalised industries to identify separate profitable projects into which money can be put in that way. That's one of the reasons why we'removing as fast as we can on what we call privatising. That's why we were glad to get British Aerospace back to the private sector within the last few weeks, and thank heavens 9 out of 10 of the workers bought shares in it, which shows they've got some confidence in it. Now if we can get projects out into the private sector in that way being disciplined by profits depending upon success and rewarding the investor depending on success, how much better that would be. How much better off we would be if we hadn't got these gigantic industries like I'm afraid the steel corporation in public ownership.

YOUNG: Yes but you have got them haven't you?

CHANCELLOR: Of course we've got them and we're putting, because they belong to us at the moment, large chunks of money into them. Very large sums of money into those industries that are in public ownership. But when I think back on my life, my home town in South Wales in POrt Talbot that used to be called the city of steel that never sleeps, working as I did in my young days at the Bar throughout the steel industry in Wales. Those great private companies with pride and competitiveness all taken through a political thrust into public ownership and all now sadly thrown together in the BRitish Steel Corporation, I regret the mistake that was.

YOUNG: But however much you wanted to are you ever going to take those out of public ownership?

CHANCELLOR : Oh no indeed I mean we have after all recently taken British Aerospace back into private ownership, that's one example.

We've got some schemes already taking place with parts of the British Steel Corporation going back into joint private ownership. Parts of the railway operations, ferries and so on going into private ownershi And the interesting thing now is that whereas 5 or 10 years ago somebody like yourself would have said well what difference does it make Sir Geoffrey whether they're owned by this or that, most people in those industries now know that they will benefit by getting back into a relationship which is not dependent on the Government as their paymaster.

YOUNG: Coming back to the Budget. In your Ministerial broadcast on Tuesday you said if we're going to stop unempoyment going up we've got to keep inflation down. But you have also said that as a net result of the Budget will be a rise in prices of at any rate 2 pence(%). So what is that doing for jobs?

CHANCELLOR: No that's the immediate consequence of the indirect tax increases. It's one of the awkward features of inflation that if I'm merely to keep my share of rising prices the same I have to take with that kind of change in the tax on tobacco and cigarettes and so on. But it doesn't effect the long run prospect. Our forecast is that inflation by November will be down to 10% and going on coming down next year. We're increasing pensions so as to make sure they stay alongside inflation over the last 2 years. We're putting up child benfits to make sure they stay alongside inflation.

It's to maintain those benefits for people who are hardest pressed that we have to place a tax burden on the rest of us.

YOUNG: But with respect, you said our forecast is .... a year ago you forecast public spending at £7½ billion . Didn't quite turn out that way though did it?

CHANCELLOR: No, public spending is probably the most ~~id~~ difficult thing to control. But if we're to begin swapping forecasts a year ago I predicted a level of inflation that was actually 1% higher than it turned out. In other words we beat our inflation forecast by 1%. So some things do go the right way.

YOUNG: Another thing that Peter Shore said a little while ago, he said it's the role of Government in a time of recession to prime and pump the economy. What do you say to that?

CHANCELLOR: Well it's an attractive image of course. But even pump priming costs money and you have to know where to prime the pump. One of the things I think we've learned again from the experience over many years is that the politician is not very good at picking winne[rs]. The best way of ~~prim9 ng~~ priming the pump is by creating the conditions in which industry and enterprise can do it for itself. And that's why I think it's so important to regard the reduction of interest rates and the reduction of inflation as probably the best prize we can offer, the best way of priming the pump, ~~than~~ rather than any politically directed expenditure.

YOUNG: Now one of the main planks on which the Conservative Government was elected was the reduction of taxation. According to the Treasury this morning the total amount of taxation as a percentage of the GDP ~~xx~~ in 1980 was 44.5%. Is that the sort of percentage which you would hope to see?

CHANCELLOR: The burden of taxation as a percentage, as you rightly say, has been rising. That's not what we want. The total national

national production is not expanding. We're having to maintain very expensive programmes. I'm afraid it's inevitable that the burden will shift the wrong way. It's far worse to borrow the money than to raise it honestly by higher taxes. But we believe if we keep it in balance like that then we can get the economy growing (back into growing again and then the tax burden can begin to fall again.

YOUNG: Now it looks as though - I mean some Conservative back benchers David Crouch was on here yesterday for instance - looks as though they are fairly unhappy with the Budget and they might try to get it amended during the committee stage. What happens if they do that?

CHANCELLOR: Well the committee stage is about discussions on the shape of the Budget. So we shall hear as we always do a number of suggestions and criticisms for discussion. But I don't believe that the parliamentary party, or Parliament itself, is likely to disturb the shape of the Budget because it's a Budget which is founded on facts, facts founded on the options that we've got to face up to. You'll find that in most countries at the moment there are quite a lot of people who, are as you are saying, are quite unhappy. Because all the countries facing the consequences of the huge price rise in oil in the last 2 years are having to tighten their belts. And finance Ministers in every country round the world are having to face criticism for having to balance their Budgets. So of course it's tight, but I think that most people understand that and respect the need for getting the books right.

YOUNG: Now on the thorny subject of petrol. In 1977 you said of Jim Callaghan, on the subject of petrol you said, "This is a selective tax it's deliberately biased against those who have no option over the method by which they travel to work and it's deliberately biased against those in rural areas". I mean what's the difference in 1977 and 1981?

CHANCELLOR: Well at that time the tax package that had been adv...
was concetrated particularly on petrol price increases. What we are doing this time is in the context of a general increase in excise duty across the board. Part of sharing the burden. I think that probably some of the things that people say about the tax system are bound to be critical because it's uncomfortable. But I think that one has no option but to do this.

YOUNG: On Wednesday morning the Financial Times, following the Budget, said it would be ideal to pretend that the decisions announced ~~announced~~ in the Budget are anythng more than a defeat for the Goernment. Do you think that's a correct analysis?

CHANCELLOR: Yes that's the opening sentence of their leading article which went on, after analysing the Budget completely, to praise me for my dogged resolution, and say that I had no alternative but what I was doing.. So you pays your money and you takes your choice. That is the fact you see, if in fact our society is determined to maintain spending programmes on the size that it has, if it's determined to go on protecting the pensioner against inflation - and that's very understandable - if it's determined to go on maintaining a health service and we're expanding resources going into health, then we have to pay ~~fo~~ for it. And the fact is that the total of spending last year is going to be higher than it was last year and taxes have to go up to pay, to balance those books.

YOUNG: But the pensioners didn't get the full rise to which they were entitled of course?

CHANCELLOR: No, they did in fact. You see, it's because of the part I mentioned earlier on. Last year we actually got prices down a point below my forecast so they got a percentage point more than they were entitled to on that analysis. This year we're simply balancing that. We think inflation will go up by 10% and they're going

~~they're going~~ to get 9%.. So that over the two years they will be fully protected. And indeed I think it's something we can even be proud of because over the last 10 years or so the value of the pension the purchasing power of the pension has gone up by twice as much as the cost of living. So that under successive Governments we have stood by the pensioners even although the world we're living in is getting tougher and tougher.

YOUNG: Now just now when I made reference to the FT, you carried on the quote and you made reference to your dogged resolution, or indeed they made reference to your dogged resolution; does this mean then that this is the path and ~~yxxx~~ you're committed to it, there'll be no U-turns and no deviation and that When you talk to me this time next year we shall still be on the same course?

CHANCELLOR : That I think is what most people have rightly read as the message of this Budget. When we set out to regard inflation and the conquest of inflation as the first objective we meant that. And a Government that does mean that has got to remain resolute in pursuit of that objective. We are doing so. I think that people will see that that does lay the foundation for the long term ~~groth~~ growth and return to prosperity that we want . If we turn back from that, like every preceding Government has tended to do, then we'll find ~~fnd~~ inflation coming ~~co;m ing~~ back, we shall find unemployment coming back at an even higher level. It is bound to be tough ~~togh~~ to sustain this course but I think that most people want to see a Government ~~G-ernment~~ that actually has the guts to hang on to that objective as we're doing.

YOUNG: Even though that may mean 3 million, 4 million or however many millions unemployed?

hostage?

CHANCELLOR That is not the kind of figure that is in prospect and what you've got to remember the whole time , it's the lesson of economic history over many years, if we give up the pursuit of the fight against inflation then in fact unemployment would get higher still. That's the lesson of Governments in this country since 1960 onwards. Each of them left with a higher rate of inflation and a higher rate of unemployment(average rate) Each has been building if you like upon the failure of the last.

~~YOUNG: So in effect I mean t e~~

YOUNG: So in effect, and in a sentence, as far as you the Chancellor of the Exchequer and the Prime Minister is concerned it's we shall not be moved?

CHANCELLOR: We shall not be moved from our central objectives. Of course we understand that steering an economy and taking people like our own through economic difficulties of this kind is a difficult business. We are willing to respond as far as we possibly can to soften the edges of change and soften the edges of what is necessary for that policy. But from the central objective the British people would not wish us to move, it's their objective as well.

=

Econ Pol

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

11 March 1981

J D West Esq.
Private Secretary to the
Secretary of State for Energy

Dear Julian,

HEAVY FUEL OIL DUTY

In your Secretary of State's letter to the Chancellor of 3 March, he suggested two technical changes to the application of the heavy fuel oil duty to help, in particular, the steel and chemical industries. In his subsequent letter of 5 March he said that he did not wish to press the suggestion to abolish the tax on oil injected into blast furnaces. As he mentioned, officials of both Departments have discussed this and are agreed that it would be inappropriate to grant this relief.

The second propoal was to change our present rules so as to extend the relief granted in respect of fuel oil used in power plants associated with refineries. Such a change would be particularly welcome to ICI. The Chancellor has decided that this is one measure which we can take but he proposes that it should be announced not on 10 March but during the subsequent debate on the Budget. Officials here will be in touch with yours next week to explain the details of the new scheme.

I am copying this letter to Tim Lankester, Ian Ellison (Industry) John Wilson (Scottish Office) and Sir Robert Armstrong.

Yours ever

Peter

P.S. JENKINS
Private Secretary

the extra tax burden imposed on them. It is a matter of grave importance to the House and to the relationship between the House and the country.

The Opposition and, I believe, the country as a whole, are primarily concerned about the Budget, not only because of the tax rates which will be imposed. I have barely touched upon the range of increased indirect taxation that will impose its burden upon people. Overwhelmingly, the greatest issue facing the country is what is to happen to the level of unemployment. Both the Government and the Chancellor propose that we continue along the same course on which we were embarked. That means that there will be a serious increase in the level of unemployment that our people will have to encounter and overcome in the coming months and, indeed, years.

The Chancellor of the Exchequer has said that he will continue on the same course. That means the continuance of the appalling production figures that this country has endured throughout this period. Last year, GDP fell by 6.8 per cent., the index of industrial production by 13.2 per cent., the index of manufacturing production by 17.2 per cent., capital investment in all industries by 2.6 per cent. and in manufacturing by 3.6 per cent., investment in manufacturing by 12.6 per cent, and construction industry output by 9.2 per cent. Those figures add up to the massive unemployment that the country has had thrust upon it throughout this period.

The CBI put forward proposals for the right hon. and learned Gentleman to consider which at any rate would have avoided a fresh bout of deflation. The House and indeed the country should take note of what the CBI said about unemployment. These are the prophecies, not of the Labour Party, but of the CBI itself. The CBI calculates that if all the proposals outlined in the CBI plan were carried through—and certainly the Government have not come near to accepting any more than a few trifles from among them—by 1984 it might be possible to get the unemployment figures down to what they are today. The unemployment figures today are already record figures for this century.

The right hon. and learned Gentleman had to point out in his speech that huge totals must be added to the figure of 2½ million unemployed. There are 700,000 people working short time, sustained by the various schemes that have been introduced. There are hosts of other figures to be added. I hate to make prophesies about unemployment rising above 3 million, and I believe that one should be careful about doing so, but that is what the CBI has said.

This Budget will produce a total of more than 3 million unemployed in this country. It is a Budget of no hope for the people of this country.

"All hope abandon, ye who enter here"

is the inscription to be written above the monetarist Inferno in which the Government still believe. There is no hope for the one million people who have joined the ranks of the unemployed in the past year. There is no hope for the further half million who will join the queue in the coming year, and in years to come. There is no hope for the vast majority of people coming out of the youth schemes. Certainly, they are good schemes, but the people in them still have to find jobs at the end. There is no hope for the overwhelming majority of people who will have to bear a much heavier burden as a result of this Budget.

It is a no-hope Budget, introduced by a no-hope Chancellor. It is a Budget which can only inflict the most serious injury on our country as a whole in years to come. It will inflict serious injury upon individuals and their families and on communities in the coming weeks and months, and longer-term injury on our country. It results from a combination of the primitive morals of the monetarists and the practical incompetence of the broken-backed Cabinet that we see arrayed before us today.

How long will this country have to endure the combination of injury and insult to which we have been subjected from the Treasury Bench? How long will this continue? That is the question which echoes up and down this country. The sooner the electorate has the chance to finish this Government, the better for all concerned.

5.26 pm

Mr. J. Grimmond (Orkney and Shetland): Fifteen or 20 years ago, the Budget was considered to be the main instrument of economic policy in the Government's hands. Those days have departed. We do not now hear of demand management or fine tuning. The Budget now is a desperate attempt by the Government to cover at least a part of their own annual expenditure.

If that is how the Budget is to be viewed, i wish to make one point. Great importance is now attached to the public sector borrowing requirement. But that includes not only borrowing by the Government for unproductive purposes but also borrowing by the nationalised industries. If borrowing by the nationalised industries is for genuine investment, there is no reason why it should not be treated as such and taken out of the public sector borrowing requirement. I am sure that the real fear in the Government's mind is that it is not genuine investment but that it is largely wasted. If that is so, the Government should turn their attention to the running of the nationalised industries. In so far as it is genuine investment for productive purposes which earns a profit, however, there is no conceivable reason for one to be ashamed of it.

It has been said that the Government are not changing course, but in one respect they are changing course very rapidly. They promised continuing reductions in taxation. Apart from anyhing else, they are raising income tax levels this year by about 3p. There is no further reduction in taxation, so they have certainly changed course on that. However, it is not my business to deploy the main Liberal case on the Budget. That will be for my right hon. Friend the Leader of the Liberal Party tomorrow.

I wish to concentrate upon two aspects. First, there is the question of oil and petrol. I believe that the Government's policy on North Sea oil is disastrous. There is a strong case for issuing shares, to the public as has been suggested by Mr. Samuel Brittan. There is also a strong case for putting this income to investment. But there is no case for treating it largely as revenue when it should be treated as capital and allowing it to increase the value of the pound and provide no benefit to the economy. Today, we have again heard that the price of petro: is to rise 20p per gallon. This will be killing for agriculture. Already, farmers all over the country are complaining bitterly that their costs have far outstripped the prices that they obtain. Agricultural prices are falling. It will also be a further grave handicap on industry. In areas such as Orkney and Shetland, which I represent, the Isle of Wight, and other islands off the coast, where petrol is already 10p per gallon dearer than it is in London, this will be a further blow to the whole rural community. This continual raising of the tax on oil or petrol regardless of its effect on industry and

BUDGET FILE

MJS

12/3

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

THE BUDGET

recorded from transmission 2125 (BBC-1) 10th March, 1981

THE CHANCELLOR OF THE EXCHEQUER
THE RT.HON.SIR GEOFFREY HOWE, MP: Good evening. Yes, in many ways it's a tough Budget and times are tough for a lot of people I know because in the last year I've been to a lot of the places where people are suffering most from the recession. To Northern Ireland, South Wales, Clydeside and the North. And of course I've met the businessmen whose firms are being squeezed. The people in public services trying to keep up standards despite the cuts. And, worst of all, those who are looking for a job, some of them for quite a time.

So, if the Government understands how grim things are, the obvious question to ask is "what are we doing about it?". Well there are some things we can't do anything about. We can't, for example, cut ourselves off from the rest of the world. And at the moment a lot of other countries are finding things tough too.

Unemployment is going up in Germany, in France, in most Western countries -- even Japan. But we in Britain have been making things especially hard for ourselves and for quite a number of years. We've been pricing ourselves out of jobs. And in the last three years our pay's been rising nearly three times as fast as our foreign competitors. So it's been getting harder for us to sell our goods abroad and easier for other countries to sell their goods here.

The pay rises of recent years have caused a lot of to-day's unemployment and our problems have been getting worse for a long time. Under governments of both parties. The figures show that very clearly. Take inflation first. Under each new government, Labour or Conservative, prices have gone up faster than under the one before. Less than 3% a year at the end of the first Conservative government after the war. 4½% under Sir Harold Wilson's first Labour government of the 1960s. 9% under the last Conservative government and 15% under Mr.Callaghan.

Some people think we can choose between inflation and unemployment. Let inflation rise a bit, they say, to get unemployment down. But it doesn't work like that. The two go together. Higher inflation means higher unemployment. It's like an addictive drug. The more you have, the more you need and the more damage it does to you. The figures show that. They show that the average level of unemployment under each of those same governments has

BBH

been climbing steadily as well. 400,000 up to 1964. Half-a-million by 1970. Three-quarters of a million by 1974 and one-and-a-quarter-million under the last Labour government.

So the problem goes back twenty years. All this time we've avoided reality at the cost of rising prices and rising unemployment. This government is facing reality. That's why it's so important to defeat inflation. It isn't just theory. It's a fact. You can see the country was on a disaster course.

So if we are to stop unemployment going up we have to keep inflation coming down. It's painful for a while of course but it's got to be done. And on that we are making headway. Real progress. The inflation rate has been coming down month by month. Last April it was nearly 22%. Now it's around 13% and it's going to come down further. We expect it to be down to 10% before the end of the year.

I said last year that it would take more than one Budget, more even than two or three, to have a chance of getting inflation under control. That's why we can't let up now.

There's something else we need if industry is to have the chance to recover and to provide the jobs we so badly want. And that's lower interest rates. To-day we have cut the Minimum Lending Rate by 2% and that makes a fall since last summer of 5%. Our short-term interest rates are now lower than in Germany and substantially lower than in America. Lower interest rates help people with a mortgage.

But above all they help business to provide jobs. And the main reason why interest rates have been high is because governments have been borrowing too much. That's been my other big problem this year. If I'd done nothing about it, then government borrowing next year would have been up to a record £14,000m. And that level of borrowing would have made it more difficult to control inflation, not easier. And no reduction in interest rates. Even bigger burdens on industry. And so an even bigger risk to jobs.

I couldn't accept that so I've had to take action to get government borrowing down. And it's better to do that by taxing those least harmed by the recession than by cutting spending that's helping those who have been worst hit.

A lot of my Budget is about helping those who most need help. Pensions will go up in November by £2.45 for the single person and by £3.90 for the married couple. Child benefit will be going up too by 50p. That fully compensates for rising prices. And in this International Year of Disabled People we are giving some extra help to them too, especially to the blind. And we are taking special measures to help the unemployed, particularly the young people who haven't found a job.

BBH

Obviously these things have to be paid for and I've tried to place that burden on those who can afford it best. On the oil companies and the banks for example. They've been making good profits despite the recession but I've raised taxes for individuals as well because, while business has been getting worse off, most of us have had rather more to spend. That may come as a surprise but during the last three years earnings have gone up much faster than prices even after you allow for inflation. A real rise in living standards for those who have stayed in work;

What's suffered has been companies. Companies that need to be successful to provide tomorrow's jobs. It makes a worrying picture. Company income down 25% in the last three years. Personal income up 17% and output up only 2%. And that company income figure includes North Sea oil revenue. That's why I've had to ask individuals to pay more. That's why I've had to put up taxes on beer, whisky, cigarettes and the rest. And even, I'm afraid, on petrol.

I have been able to leave income tax rates as they were but I've not been able to raise the income tax allowances. I had to leave them as they were if I'm to help businesses and helping businesses means helping jobs. It's Britain's businesses that'll help Britain back to prosperity . And to-day I'm bringing more help for industry, public and private. Changes in stock relief. Lower prices for bulk users of gas and electricity. And, above all, by getting interest rates down.

But it's the new firms, the new businesses I want to help particularly. I've already done a lot for them in earlier Budgets and to-day I'm going further. We are launching what I've called the Business Opportunities Programme -- a whole package of tax reliefs and incentives to help and encourage people who want to start new businesses. And all the time I'm keeping up the battle against extravagence in government spending. Every penny the government spends has first had to be earned. And industry has been fighting very hard to survive.It's had to keep pay settlements right down. So must we in government. We can't pay more than the taxpayer or the ratepayer can afford.

I've said that our policies won't bring quick or easy results. But already there are encouraging signs. As you've seen, inflation is coming down. Exports have been doing well and one of the most encouraging things of all, new businesses are starting up. Of course things will stay difficult for a while yet. You don't reverse a twenty year decline overnight. To-day's Budget can't bring quick results. At the moment it is an uphill slog.

And uncomfortable as that may be, I am sure it's better to stick at that than to go back to the old downhill slide. Goodnight.

BBH

010

BUDGET BRIEF : 10 MARCH 1981

The following amendments should be made to the Budget Brief I circulated today.

Brief D7. The cross-reference in the heading should refer to Brief M9 and not N4.

Brief G6. I attach a revised version of G6 (Indexed Gilts) incorporating amendments received today from the Financial Secretary.

Brief K2. In factual (i), Inland Revenue tell me that their original estimate that 700,000 women will benefit is too high: please substitute "about half a million".

Brief M1. Inland Revenue tell me that the full year costs in factual (ii) should be £2,460 and not £2,450.

Brief M9. HF have suggested the following further defensive point :

> "It has been agreed that questions about the effects of the heavy fuel oil duty on gas price contracts should be referred to the Department of Energy Press Office".

Brief R4. I also attach some further defensive briefing by the Minister of State (L) on the roll over relief decision, which again arrived too late to be incorporated in the Brief.

12A

R I G ALLEN
EB
10 March 1981

G6 INDEXED GILTS

Factual

(i) Bank of England will announce on Budget day an issue of £1 billion of Indexed Gilt-Edged Stock with a maturity of 15 years and a coupon of 2 per cent.

(ii) Value of principal on repayment and of each half-yearly interest payment will be related to changes in the RPI. Eligibility to hold the stock is limited to pension funds, and life insurance companies and Friendly Societies in respect of their approved pension business in the UK. The issue is part paid, with £35 per cent payable on application and calls in April and May.

(iii) On the assumption that the first issue is successful it is intended to make further index-linked issues in the future.

(iv) Technical change to tax rules for life assurance companies proposed so that income and gains from indexed gilts attributed wholly to tax-exempt pension business of companies which also carry on taxable life business (IR Press Release gives details).

Positive

(i) Demonstrates Government's confidence in strategy of bringing inflation down. For a Government committed to bringing down inflation IGs promise to be a cheaper form of funding than long-dated fixed interest stock at current yields. A Government not wholeheartedly committed to reducing inflation would not wish to issue them.

(ii) Indexed borrowing should benefit both borrowers and lenders, by eliminating uncertainty in the market about future real yields.

(iii) Important advantages for monetary control. Addition of a new instrument, which will be sold by auction, offers more flexibility enabling Government to match preferences of investors more closely.

(iv) It will in due course be possible for pension funds and insurance companies to offer pension benefits in the private sector with an element of index-linking.

Defensive

(i) Government not institutionalising inflation. On contrary, reliance entirely on high fixed coupon long-dated stock gives the greatest incentive to a Government to let inflation rip, to reduce the real burden of debt interest.

(ii) There is no comparison between indexation of a long-term contract and indexation of social security benefits or wages where a level of real income is guaranteed. With indexed gilts return is determined by the market price. And only a lender holding the asset to maturity is guaranteed any particular return (which may or may not be positive). There is, of course, already a precedent in the National Savings area - Granny Bonds - which are widely regarded as acceptable.

(iii) Introduction has not been provoked by any inability to sell conventional gilts. Bank sold £15 billion gross in 1980-81.

(iv) The move has not been prompted by Scott report's recommendations and the planning of the issue was undertaken long before Scott reported. [IF PRESSED on Scott; Government wants to take account of reactions to Report's analysis and findings before making decisions]. Initiative should be seen rather in context of moves to improve our techniques of monetary control, though there may be benefits in pensions area.

Cont.

(v) Restrictions on holdings unfair to life insurance industry? Eligibility provisions are designed to ensure that indexed gilts will not stimulate unwanted inflows from abroad. Within this context intention has been to include Life Offices as far as possible, not to discriminate against them.

(vi) Effects on company sector? Government not using indexed gilts to increase total of debt raised. Don't expect a significant impact on equity prices, and companies should benefit from lower interest rates which should flow from improved funding methods. Companies could issue their own indexed debt. The consequences not necessarily insurmountable; Inland Revenue can give advice to interested companies.

(vii) Inflows of funds from abroad Eligibility restrictions mean that indexed gilts are not available to non-residents. No risk of attracting unwanted inflows.

Contact Point: H J Davies 233 4533

EXPLANATION ON ROLLOVER RELIEF FOR TRUSTS

We would defend our decision like this -

1. The rollover on gifts into settlement is an integral part of our proposals to facilitate [remove the obstacles from] lifetime giving: and it is so presented in the Budget Speech.

2. So far as gifts out of trust are concerned that is inextricably interwoven with what we do about settled property generally. Final decisions on that, including legislation, having been deferred until next year, obviously (!) we must defer decisions on rollover relief for property coming out of settlement until we know what the shape of the new settled property regime will be.

3. If someone then objects by asking how then can you deal with gifts going into settlement in advance of the new settled property regime, your answer is that virtually nobody (in fact only one person) has proposed the abolition of the CTT entry charge so that clearly there will be a continuing double charge on gifts going into settlement unless we provided rollover relief: and this is why we are doing it. But many, many people have proposed the abolition or modification of the exit charge. Until a decision has been taken on that point - and it won't now finally be taken until next year - we don't know whether there will be a double charge or the extent or incidence of it. Clearly therefore we cannot legislate on this point this year.

A.C.
9 March 1981

 vb

Econ Pol

9 March 1981

Public Expenditure in the Budget

The Prime Minister has seen and noted the Chancellor's minute of 5 March.

I am sending a copy of this letter to Julian West (Department of Energy).

TpL

CS

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

14aa

BUDGET SECRET

COPY NO. 1 OF 20 COPIES

Ch/Ex. Ref. No. B(81) 44

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

9 March 1981

T P Lankester Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Tim,

You suggested that it might be helpful if a note were to be drawn up of Ministers' statements on tax thresholds.

... I now attach notes, prepared by the Inland Revenue, on

(a) Statements made in Opposition

(b) Ministerial statements on the burden of direct taxation, and

(c) A comparison of tax thresholds and net income in 1978/79 and 1981/82.

It seems that no Minister has given anything which could be interpreted as a copper-bottomed guarantee since the Government took office that tax thresholds would not fall in real terms.

Yours ever,

Richard Tolkien.

R I TOLKIEN
Private Secretary

ANNEX A

MINISTERS' STATEMENTS ON TAX THRESHOLDS

STATEMENTS IN OPPOSITION

1. During 1978, the present Chancellor made a number of references to the importance of tax thresholds in speeches outside Parliament:

27 February 1978: an essential step in Conservative policy was "to raise tax thresholds more than enough to allow for inflation: they are still way below the poverty line" (Institute of Bankers in Southampton)

5 May 1978: "Our strategy - a higher starting point for every tax band" (Taxation seminar and later at the Welsh Conservative Conference)

4 July 1978: a "Conservative change of course - higher tax thresholds" (Address to the St Marylebone Conservative Association).

2. In a speech on 24 March 1979, to the Central Council Meeting of the National Union Conservative and Unionist Associations at Solihull, the Chancellor looked for solutions to the "Why Work?" problem, and said "First we need to raise tax thresholds, so as to let more low-income earners out of paying income tax. That we shall do, as far and as fast as resources allow."

3. The Conservative manifesto in 1979 declared the intention to "cut income tax at all levels" and to "tackle the poverty trap". On thresholds, it said "It is especially important to cut the absurdly high marginal rates of tax both at the bottom and top of the income scale ... Raising tax thresholds will let the low-paid out of the tax net altogether."

STATEMENTS IN GOVERNMENT

4. In the Budget statement of 12 June 1979 (Hansard Vol 968 Col 259), the Chancellor said "It is not only at the top of the income range that the burden of income tax is particularly oppressive. The same is true for those on the lowest taxable incomes, where the tax system can help to ensure that some people are actually better off out of work. That is the importance of tax thresholds."

5. In the 1980 Budget speech, the Chancellor gave the importance of increasing thresholds by the full indexation figure as one of the main reasons for abolishing the LRB and using it to finance full (18%) indexation. He said that the undesirable effects of falling below full indexation would be that:

> 'it would lower the starting point of income tax in real terms, compared with a year ago, it would increase the number of taxpayers, it would narrow the gap between tax thresholds and the main social security benefits, and it would impose particularly heavy burdens on those with the smallest incomes'.

(Mr Jeff Rooker and others put down an early day motion earlier this year quoting what the Chancellor had said - copy attached.)

6. Similarly, during the debates on last year's Finance Bill, the Financial Secretary referred to the decision to go for full indexation with the abolition of the lower rate band, rather than keeping the band with less than full indexation, as showing "the importance that the Government attach to maintaining the index value of the tax thresholds". He said "I think that we were wholly right to do that." He specifically made no commitment about future policy with respect to rates and thresholds, though he hoped that progress would be maintained. (See Committee Hansard, 10 June 1980, Col 306.)

118 *CHANCELLOR OF THE EXCHEQUER'S ADVICE TO THE HOUSE ON TAX THRESHOLDS*

Mr J. W. Rooker
Mr Frank Dobson
Mr Bob Cryer

☆ 3

That this House notes that Mr Chancellor of the Exchequer in his Budget Statement of 26th March 1980 at column 1474 listed four 'undesirable effects' of not fully raising personal income tax allowances in line with the rise in prices, namely—'it would lower the starting point of income tax in real terms, compared with a year ago, it would increase the number of taxpayers, it would narrow the gap between tax thresholds and the main social security benefits, and it would impose particularly heavy burdens on those with the smallest incomes'; considers these effects just as undesirable in 1981; and hopes that Mr Chancellor of the Exchequer, the Prime Minister and the rest of the Cabinet will think on these words especially when briefing the media about the effects of the forthcoming Budget.

ANNEX B

MINISTERS' STATEMENTS ON THE BURDEN OF DIRECT TAXATION

Statements about reducing taxation generally include:-

1. In the debate on the Address on 15 May 1979, the Prime Minister spoke of "a need to give an incentive all the way up the scale - to those on low incomes, those on differentials, and those on management earnings. ... The first important step in restoring incentives is to reduce the excessive burden of direct taxation. ... I give a firm assurance that we regard the reduction of income tax as an objective of highest priority." (Hansard 15 May 1979, Col 78.)

2. In the 1979 Budget statement, the Chancellor said that "These changes represent only the first stage in the major reduction in the burden of direct taxation that we are determined to make." (Hansard 12 June 1979, Col 262.)
The following day, the Financial Secretary described the tax cuts as "part of an essential economic strategy for this country" and "only the first step", and on 14 June the Minister of State talked of "a Budget which I dare say will be remembered for initiating a sustained programme of tax reform" but which was "only that first of a series of tax-cutting budgets". (Hansard 13 June 1979, Col 577; 14 June 1979, Col 749.)

3. In the 1980 Budget speech, the Chancellor referred to the previous year's measures as "an important start on reducing the oppressive burden of direct taxation" but said "I intend to do more in the future".

COMPARISONS OF 1978/79 TAX THRESHOLDS AND NET INCOME WITH 1981/82

1. Two tables are attached to illustrate the effect of the Budget on thresholds and net income in comparison with earlier years.

Thresholds

2. Table 1 shows how thresholds and allowances have increased in comparison with the retail prices index (RPI). Comparisons are shown both for price changes between financial years and changes over the preceding calendar year (the statutory indexation basis). For 1981/82 compared with 1978/79 there is not a large difference between the two calculations.

3. Allowances and the starting point for higher rates will be lower in 1981/82 in real terms than in 1978/79. Personal allowances are lower to a greater extent if the abolition of the lower rate band is converted to an equivalent reduction in allowances. Higher rate thresholds beyond the first and second have increased markedly in real terms.

Net Income

4. Table 2 shows figures for real net income and for tax as a percentage of earnings. The figures for 1981/82 are based on a broad estimate of average earnings (increased in line with prices) which need to be treated with caution (see the footnote to the table).

5. Despite the fall in the real value of thresholds, and the increase in NIC rates, real net income shows a modest increase between 1978/79 and 1981/82 at earnings levels up to average earnings and more substantial increases above average earnings. This reflects the increase in gross earnings in real terms over the period, together with the reduction in rates of tax, particularly for higher rate payers.

6. Roughly speaking, below average earnings tax increases as a percentage of earnings comparing 1981/82 with 1978/79, whilst above average earnings it has fallen.

Table i

BUDGET-SECRET

THRESHOLDS: 1978/79 compared with 1981/82

Indices, 1978-79 = 100

	1978/79	1979/80	1980/81	1981/82
RPI	100	116	135	148**
RPI at end of previous year (statutory formula)	100	108	127	146
Single Allowance	100	118	140	140
Married Allowance	100	118	140	140
Age Allowance Single	100	118	140	140
Age Allowance Married	100	118	140	140
Age Allowance income limit	100	125	147	147
Single Allowance + value of lower rate	100	111	118	118
Married Allowance + LR value	100	113	125	125
Age Allowance Single + LR value	100	112	123	123
Age Allowance Married + LR value	100	114	128	128
Higher Rate Thresholds 40%	100	125	141	141
45%	100	133	147	147
50%	100	150	167	167
55%	100	182	202	202
60%	100	200	222	222
65, 70, 75, 83%	100	*	*	*

* These rates of tax were abolished in 1979-80

** Assuming a 10% increase on 1980-81

Tab 6 2

		1978/79	1979/80	1980/81 (October 1980)	1981/82 (See note below)
Real net income after tax and NIC (Index 1978-79 = 100)					
Single	½ Average	100	103	105	102
	2/3rds Average	100	104	106	103
	Average	100	105	108	105
	1½ x Average	100	106	109	106
	2 x Average	100	107	110	105
	3 x Average	100	110	112	108
	5 x Average	100	123	124	120
Married	½ Average	100	102	104	100
	2/3rds Average	100	103	105	102
	Average	100	104	107	104
	1½ x Average	100	106	109	105
	2 x Average	100	106	109	105
	3 x Average	100	109	111	107
	5 x Average	100	121	123	118
Tax as % of earnings					
Single	½ Average	17.5	16.8	18.4	19.4
	2/3rds Average	21.3	20.1	21.3	22.1
	Average	25.2	23.4	24.2	24.7
	1½ x Average	27.8	25.6	26.3	26.5
	2 x Average	29.8	27.2	28.2	29.6
	3 x Average	37.5	33.1	34.5	35.8
	5 x Average	51.1	41.8	43.3	44.7
Married	½ Average	10.1	10.2	11.9	13.5
	2/3rds Average	15.8	15.1	16.4	17.6
	Average	21.6	20.1	21.0	21.8
	1½ x Average	25.4	23.4	24.0	24.5
	2 x Average	27.5	25.0	26.1	27.4
	3 x Average	35.3	31.3	32.7	34.2
	5 x Average	49.5	40.5	42.0	43.6

NOTE: For 1981-82 estimated earnings of £150 per week have been used, approximately 10% up on October 1980. This is a round figure, consistent with the figure used in Treasury briefing, since it would not be appropriate for ministers to quote too precise a forecast figure. It should be noted that a more precis[e] calculation would give a rather lower earnings figure and would reduce the real net income indices by about 1 point and the tax percentage figures by about 0.2 points.

RW

10 DOWNING STREET

From the Private Secretary

9 March, 1981

The Prime Minister has considered the Chancellor's minute of 6 March about free petrol. She agrees with his proposal to announce in the Budget Speech that this will be brought into charge to tax with effect from April, 1982.

T. P. LANKESTER

A J Wiggins, Esq
HM Treasury

Econ Pol. 14

R H

B/C: Mr Walters
Mr Wolfson

10 DOWNING STREET

From the Private Secretary

9 March, 1981

As you know, the Prime Minister held a meeting with the Chancellor, the Governor and Sir Douglas Wass on Friday evening to discuss whether, and by how much, MLR should be reduced on Budget Day. They agreed that the Chancellor should announce in his Budget Speech a reduction of 2%.

The Governor showed the Prime Minister the draft statement enclosed with this letter; the Prime Minister indicated that she was content with it.

I am sending a copy of this letter to Tim Allen (Bank of England).

T. P. LANKESTER

A J Wiggins, Esq
HM Treasury

Mran

BUDGET SECRET

The Bank of England announce that, with the approval of the Chancellor of the Exchequer, they have decided to reduce Minimum Lending Rate from 14% to 12%.

NOTE TO EDITORS

Information becoming available for February suggests that the lower trend of private sector borrowing from the banks is continuing. This, taken together with the fiscal action announced by the Chancellor in his Budget statement to-day, will help to slow the growth of £M3 and of the other measures of broad money. Furthermore, the rise in real interest rates as inflation has slackened and developments in the economy more generally confirm that policy has remained restrictive.

Against this background it has been decided that a reduction in Minimum Lending Rate can now be made.

10 March 1981

BUDGET CONFIDENTIAL

Prime Minister

Agree?

Yes ms.

TL

6/3

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

PRIME MINISTER

TAXATION OF BENEFITS IN KIND : FREE PETROL

In my minute of 3 February I told you of my proposals for changes in the taxation of fringe benefits. I deal here with a benefit which I did not refer to in that minute, the provision of free petrol.

2. The benefit of a company car is taxed by reference to a scale (which I propose to increase by 20 per cent with effect from April 1982). Where petrol is also provided free by the employer and used for private as well as business purposes, the value of the benefit may or may not be chargeable, depending upon the method used for providing it. The Revenue are advised that, where the employer contracts with a filling station to supply petrol to his employees (without the use of a voucher) or where he allows employees to use a pump on his premises, they cannot tax the value of the petrol. But, whatever the legal position, there is no doubt that - (a) the practice of providing free petrol has grown considerably over the past few years and (b) to tax it on the basis of the actual amount provided for the employee's private use would impose a substantial administrative burden on many employers and a heavy staff cost on the Revenue.

3. In my Budget Speech last year I referred to the growing practice of employers providing petrol and said that I should be bound to contemplate action this year if the practice continued to spread at anything like its present rate. There is certainly no evidence that the practice has diminished over the past year. It is estimated that of the employers who

provide company cars some two-thirds provide free petrol and that some 50 per cent of employees with company cars get their petrol free.

4. I do not think that we can allow this to continue unchecked. It is unfair to those who pay for their own petrol, and to leave it untaxed would be contrary to our declared intention to encourage employers to remunerate in cash rather than kind. I propose therefore that we should ensure that petrol provided for the private use of higher-paid employees and directors is brought into charge to tax with effect from April 1982. The Inland Revenue will in the meantime consult interested parties with a view to finding a method of achieving this, e.g. through some formula or scale, which will cause employers (and the Revenue) as little extra work as possible.

If you agree, I shall announce our intention in the Budget Speech.

(G.H.)

6 March 1981

010

Also copied to Econ Pol, Sept 80 Correspondence with Dr. Hammer

OCCIDENTAL PETROLEUM CORPORATION
10889 WILSHIRE BOULEVARD · SUITE 1500
LOS ANGELES, CALIFORNIA 90024
(213) 879-1700 · (213) 477-0066

ARMAND HAMMER
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

6 March 1981

The Rt Hon Sir Geoffrey Howe MP
Chancellor of the Exchequer
House of Commons
LONDON SW1

Brampton file

TL 6/3

Dear Chancellor,

As budget time approaches, it seems appropriate to mention to you again that one action that could be taken by your Government to promote significant additional investments in the United Kingdom would be to eliminate the so called "ring fence' provision in the Oil Taxation Act of 1975 insofar as Corporation Tax is concerned. This could encourage new "downstream" manufacturing and processing facilities which utilize crude oil or natural gas as the principal raw material and the relief could be limited to capital allowances expended for such energy investments. Large capital investments, such as our proposed Peterhead project, which would create considerable employment, would be made less risky due to an earlier write-off of such investments for Corporation Tax purposes.

The revenue loss to the Government is only a temporary loss not a permanent loss as the revenue foregone is recovered fully out of the profits produced by the new investments. The temporary loss could be controlled for Government purposes by limiting relief to projects which commence to trade after a pre-established date. This would provide equal opportunity for prospective future investments.

Tax incentives are a proven and accepted means of inducing and encouraging new investments and your favourable consideration of this recommended change could result in substantial additional investments in the United Kingdom over the near term.

Sincerely yours,

Armand Hammer

Armand Hammer

cc The Rt Hon Mrs Margaret Thatcher MP
The Rt Hon David Howell MP

SECRET

Econ Pol

13

01-211-6402

R 6/3

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

6 March 1981

with TL?

ENERGY AND THE BUDGET: HFO DUTY

Following my letter to you of 3 March, I understand our officials have been in contact about the two minor technical changes I proposed.

It is now clear in the light of consultations that a concession on blast furnace injection would benefit only BSC and I do not, therefore, press the suggestion.

The changes in the preponderance rule which Customs earlier had in mind are, however, of greater practical and presentational significance. They will provide relief to parts of the chemical sector and particularly ICI who can otherwise be expected to be among the more vocal critics of the duty decision and who have made clear in their various representations that this is their "fall back"bid.

I very much hope, therefore, that you will feel able, even at this late stage, to incorporate this limited, but tactically useful, concession.

Yours ever

David

D A R HOWELL

Prime Minister

2

This is all rather obscurely presented. But I am sure the higher figures for spending and the Contingency reserve are (unfortunately) correct.

TL 6/3

cc Mr Hoskyns

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

PRIME MINISTER

MG

PUBLIC EXPENDITURE AND THE BUDGET

I need to let you and David Howell know how I propose to handle the various energy related public expenditure proposals in relation to the Budget, and to the public expenditure planning totals.

2. As you know, the Contingency Reserve for 1981-82 in the White Paper is deliberately tightly drawn. It is £1,500 million in Survey prices, which is equivalent to £2,000 million cash. We are now faced with two large additional requirements for expenditure which were not foreseen at the time of that decision, namely:

You already agreed this TL

(i) the various proposals for increases in the National Coal Board's EFL, on which I commented to you in my minute of 2 March; and,

Flag A

See Nat Ind Coal

(ii) the increases of some £120 million in the EFLs for Electricity and British Gas to allow some adjustment in fuel prices for bulk supplies to industry.

3. It would not be realistic to charge both these additions to the Contingency Reserve, and then expect to hold that Reserve for the rest of the year. I therefore propose to increase the size of the Reserve by £200 million (cash).

4. I will say in the Budget Speech that this is to allow for developments since the White Paper went to press, including the decision to suspend the accelerated programme

of pit closures. This would avoid giving a specific figure for the National Coal Board, and be in line with the approach which David Howell is proposing in his paper E(81)25 which we are to discuss today. Whatever figure is eventually proposed for the increase in the NCB's EFL will then be a bid on the enlarged Reserve.

5. The changes in the EFLs in respect of fuel prices will be treated as a straight addition to programmes. Together these two changes add £320 million cash to public expenditure.

6. There are one or two other minor expenditure changes which I or Patrick Jenkin will be announcing, including a boiler conversion scheme and certain minor changes in social security. These are relatively small and can be treated as bids on the Contingency Reserve. As such they do not affect the planning total or the Budget arithmetic.

7. The total change in public expenditure will therefore be some £320 million cash. This will mean that there will now be a slight increase of expenditure between this year and next in volume terms as well as in cash. This is unfortunate. We should be deluding ourselves if we tried to avoid this by saying that the large items would be absorbed within the existing Contingency Reserve.

8. I should also mention that there will be a change in the nominal amount of the Contingency Reserve to reflect the switch onto a cash control basis, which Cabinet agreed last week. We have to allow for the fact that there will now be a wider range of bids for the Reserve. The most obvious, and probably the largest, will be the adjustment in the Defence cash limit to take account of whatever we may decide on armed forces pay, when the Review Board reports.

In the past, cash limit increases to pay for higher pay (or indeed prices) ~~would~~ did not count against the Contingency Reserve.

TL.

9. I am proposing to allow £300m for this widening in the basis of control. This brings the total of the Reserve to £2,500 million cash. This will not add to the public expenditure totals. The tighter control should reduce them.

10. I attach for your information the relevant paragraphs from the most recent draft of the Budget Speech.

11. I am sending a copy of this minute only to David Howell.

[signature]

for (G.H.)
5 March 1981

(Approved by the Chancellor & signed in his absence)

J4. This Government has not been alone in cutting planned and actual public expenditure. Our predecessors had repeatedly to do the same. Such reductions are necessary if the burdens on the rest of the economy are not to become intolerable. They are essential to the fight against inflation. This has been the recent experience of almost every other industrial democracy. In the United States, President Reagan has been obliged to propose cuts in almost every area of the budget. The Swedish, Dutch, Belgian and Danish authorities are all seeking substantial reductions in planned public spending. Japan too, has announced the lowest increase in public spending in cash terms for twenty-two years. A number of governments have already gone some way towards breaking the automatic indexation of much public expenditure. The economic conditions which call for lower public spending are a world-wide phenomenon.

J5. Our own White Paper shows a volume of public expenditure next year which would be much the same as this. Developments since the White Paper went to print, including the shelving of the plans for accelerated pit closures, mean it is prudent to increase the size of the Contingency Reserve. I shall also be announcing later in my speech additional expenditure of about £120 million to help with the fuel costs of some particularly hard pressed parts of industry. Together, these will add about one-third of a percent to the volume of expenditure next year. The resultant planning total is higher than we had intended. It will still be [nearly 5 per cent] less than our predecessors had planned - despite the much larger claims of employment support and of social security for the unemployed.

J6. Moreover our decisions for the future are firmly designed to ensure that the volume of spending falls after 1981-82. The Public Expenditure White Paper shows a planned fall of 4 per cent by 1983-84.

J7. Even so I must stress that the figures for later years - both for totals and individual programmes - must be regarded as provisional. They are upper limits rather than targets. Whether we shall be able to spend on that scale dpends on whether we can afford to do so. During the annual review later this year we shall be looking hard at the possibility of further reductions in those spending plans. Any further economies that can be achieved will reduce the risk of further tax increases or upward pressure of public sector financing on interest rates - to the benefit of

J17. We have decided to make a major shift in the planning and control of spending from volume to cash. The introduction of cash limits by the last Government paved the way for this change. We now need to go a great deal further down that road.

J18. In the first instance we shall, from the coming year onwards, change the way in which we operate the contingency reserve. This will now be a cash control. Previously only decisions which increased the volume of spending during the year were charged to the Reserve. Next year the control will be extended so that decisions to increase cash limits - in respect of pay or prices as well as in respect of volume - will be treated as a charge on the Reserve. The Reserve will be set at £2½ billion cash, about 2½ per cent of the total of programmes. This allows both for the wider coverage resulting from the switch to a cash basis, and for the increased provision, mentioned earlier, to allow for developments since the White Paper.

J19. Even more fundamental is the change we shall be making in the way we go about future annual reviews of public spending. In planning public spending for 1982-83 we shall from the outset conduct our examination and discussions in terms of the cash which will be available for that year. This will change the whole framework and spirit

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

CONFIDENTIAL

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London, SW1P 3AG

5 March 1981

Dear Geoffrey,

BRITISH AIRWAYS PILOTS

You will be aware that British Airways are reducing manpower numbers - as they must do if the airline is to remain competitive and therefore become profitable again in an increasingly difficult international market. However, reductions have to be achieved by natural wastage and voluntary redundancy because BA's management judge that resort to compulsory redundancies will damage the age structure of the airline's workforce, provoke disruption, and sacrifice the improvement in industrial relations that has been achieved over the past couple of years.

Pilots are at present causing a particular problem. Because of changes in the aircraft fleet and the depressed level of traffic BA have at present around 150 surplus pilots. Although it will be possible for these to be absorbed over time, I am sure that the Board would welcome a means of achieving an earlier reduction by agreement, in order to save wage costs.

As you know, Norman Tebbit still has a line of communication to his former pilot colleagues in BA, and he tells me that Mark Young, General Secretary of the British Airline Pilots Association, has a proposal which could assist here. Mr Young's idea is that BA's pilots should forgo a pay increase this year provided that the money saved is allocated to better redundancy terms for his members within the airline. However, he is concerned that the present limit for tax-free redundancy awards - which I understand is £20,000 - will stand in the way of the success of the proposal.

I find Mr Young's approach an enlightened one, and it seems to me to deserve consideration for a number of reasons:-

(i) A zero pay increase for BA pilots would react favourably on other pay negotiations in the public and private sectors.

(ii) The proposal would accelerate reductions in BA's manpower - a process I am very eager to encourage. (The effect might not be confined to pilots: Mr Young claims that BA's difficulty in shedding pilots is hindering staff reductions elsewhere in the airline.)

(iii) Through its effect both on pay levels and staff numbers the proposal would help BA to achieve the cost reductions they so badly need, and would thus favour our objective of privatisation.

(iv) It would also provide an example of a deal worthy of imitation by other industries both in the public and private sectors.

Inasmuch as the acceptability of Mr Young's scheme to the pilots depends on a relaxation of the £20,000 limit for tax-free awards, his approach does seem to me to merit an urgent and serious review of this limit. Whilst I realise that work on your Budget must now be well advanced I should nevertheless be grateful if you could look

From the Secretary of State

CONFIDENTIAL

into this. If you are favourably disposed towards the proposal but cannot accommodate it within the Budget statement itself, then presumably we could arrange for a suitable amendment to be tabled to the Finance Bill in due course.

I am copying this letter to the Prime Minister and to Jim Prior and Norman Tebbit.

Yrs

John Biffen

JOHN BIFFEN

12

BUDGET - SECRET

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

5 March 1981

ENERGY AND THE BUDGET

Thank you for copying to me your letter of 27 February to David Howell.

I have been assured that the structure of the new tariffs to be applied from 1 April by the Scottish Electricity Boards, which they will announce later this month, will be such as to ensure that the tariffs for large high load factor users in Scotland will broadly match those to be charged in England and Wales. There will, therefore, be no need for the Scottish Boards' EFLs to be increased for this purpose.

My officials have already cleared with yours the following sentence to be added to the proposed passage for the Budget Statement enclosed with your letter of 27 February:

> "My rt hon Friend the Secretary of State for Scotland will announce later today the action which is to be taken in this area by the Scottish Electricity Boards."

I am sending copies of this letter to the Prime Minister, the Secretary of State for Energy and the Secretary of State for Industry.

Approved by the Secretary of State
and signed in his absence

COVERING BUDGET SECRET 11a

COPY NO. 1 OF 20 COPIES

CH/EX. REF. NO. 9(81)35

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

4 March 1981

T. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

The Chancellor has asked me to send you, in advance of his talk with the Prime Minister, a short note on the distributional effects of the main changes in his Budget affecting people's incomes. This is enclosed, along with two tables showing the main figures on alternative bases. The first of these takes no account of rising prices and earnings; the second does.

Yours

John

A.J. WIGGINS

DISTRIBUTIONAL IMPLICATIONS OF THE BUDGET

This note examines the distributional implications of the Budget.

2. The main features affecting personal incomes are the increases in the indirect taxes on tobacco, alcohol and petrol etc; the absence of any increase this year in the income tax personal allowances and thresholds; and the 50p increase from November in the child benefit. These changes come on top of higher employee national insurance contributions which, though announced in November and not part of the Budget, take effect from 6 April.

3. The effects of the Budget can be analysed in simple static terms, ignoring increases in income and prices, or in dynamic terms which take these into account.

Static comparisons

4. This is the simplest approach and looks at the effects of the Budget on families in straightforward cash terms. It takes no account of inflation or of pay increases. The figures simply show how real disposable income goes up or down as a result of the Budget for any given level of gross earnings for 1981/82, all other factors ignored.

5. Table 1 shows the position on this basis. It ignores the increased national insurance contributions as not part of the Budget. The main points which emerge are as follows:-

(i) Everyones income is effectively reduced by the Budget measures. There are no cuts in income tax, but the increases in indirect taxes effectively put up prices by 2%.

(ii) The indirect tax increases are not spread evenly. Allowing for patterns of family expenditure, the effects are likely to be broadly proportional to income for single people.

(iii) For married couples the increases will hit those with lower incomes proportionately harder than those with higher incomes. This is the usual regressive effect from putting up the excise duties. Concentrating the increases particularly on petrol helps to dampen these effects but cannot do so completely.

(iv) Families with children do rather better than those without children because of the 50p increase in child benefit from November, fully in line with inflation. It is particularly helpful to families on low incomes, where it covers a larger proportion of the family budget.

6. No doubt comparisons will be made with the position as it would have been if the personal allowances and thresholds could have been increased this year in line with the statutory formula. This would have produced increases of around 15%. On that basis, a single person on average earnings would have had his income tax cut next year by £1.21p a week, an increase in net income of 1.2%. The cut in income tax for married couples would have been £1.90p, or 1.8%.

Dynamic comparisons

7. These try to take account of the effects of inflation in increasing the real burden of income tax, whilst reducing the real burden of the excise duties. The simplest approach is to look at families whose money incomes in the past year have gone up exactly in line with prices, so that they have the same real income as they did a year ago. Table 2 shows some figures calculated on this basis. They rest on the illustrative assumption that gross earnings have risen by 15.1%, the statutory formula for indexing the personal allowances. They are not the only basis for this kind of comparison, but they illustrate the broad effects.

8. On this approach, taxpayers at all income levels are seen to face an even bigger reduction in real net income. This is because, with a progressive tax system, the absence of any increase in the personal allowances and rate bands shows up as a real increase in income tax, and a cut in real take-home pay. This is the effect of fiscal drag. Although cuts are spread across the income scale, they are proportionately largest at the highest incomes. This is because the points at which the higher rates of tax apply are not being increased in line with inflation. Although the child benefit increase helps families with children, their relative position is less favourable on this basis of comparison.

Publicity

9. In past years, it has been usual to issue a press notice on Budget day illustrating the effects of income tax changes on people's net take-home pay. The tables have been issued on both the two bases described above. Since there are no income tax changes to show this year, the tables are unnecessary. No press notice will be issued.

TABLE 1 "STATIC" COMPARISON

Multiple of Average Earnings	2/3	1	1½	3	5
Earnings £ per week	100	150	225	450	750
SINGLE ADULT					
Net Income before Budget (£ per week)	71.18	102.80	154.29	277.56	403.28
Indirect Tax (£ per week)	-1.35	-1.98	-2.97	-5.49	-8.01
Net Income after Budget (£ per week)	69.83	100.82	151.32	272.07	395.27
% Change	-1.9%	-1.9%	-1.9%	-2.0%	-2.0%
MARRIED COUPLE					
Net Income before Budget (£ per week)	75.63	107.25	158.74	284.97	412.17
Indirect tax (£ per week)	-2.05	-2.35	-2.84	-4.06	-5.28
Net Income after Budget (£ per week)	73.58	104.90	155.90	280.91	406.89
% Change	- 2.7%	-2.2%	-1.8%	-1.4%	-1.3%
MARRIED COUPLE WITH 2 CHILDREN					
Net Income before Budget (£ per week)	84.18	115.80	167.29	293.52	420.72
Child Benefit (£ per week) [1]	+1.32	+1.32	+1.32	+1.32	+1.32
Indirect Tax (£ per week)	-1.86	-2.17	-2.65	-3.90	-5.16
Net Income after Budget (£ per week)	83.64	114.95	165.96	290.94	416.88
% Change	-0.6%	-0.7%	-0.8%	-0.9%	-0.9%

1 The November increase in Child Benefit of 50 pence is averaged over the year.

TABLE 2 "DYNAMIC COMPARISON

Multiples of Average Earnings	2/3	1	1½	3	5
Earnings £ per week	100	150	225	450	750
SINGLE ADULT					
Net income 1980-81 revalorised (1) (£per week)	72.28	104.00	153.80	285.50	418.90
Income tax change ie no revalorisation(£ per week)	-1.21	-1.21	-1.21	-10.10	-18.39
Indirect tax change (£ per week)	-0.64	-0.94	-1.41	-2.58	-3.79
Net Income after Budget (£ per week)	70.53	101.86	151.19	272.82	396.72
% Change	-2.6%	-2.1%	-1.7%	-4.4%	-5.3%
MARRIED COUPLE					
Net income 1980-81 revalorised (1) (£ per week)	77.49	109.11	158.91	294.02	429.12
Income tax change ie no revalorisation(£ per week)	-1.91	-1.91	-1.91	-11.25	-19.77
Indirect tax change (£ per week)	-1.02	-1.15	-1.34	-1.84	-2.34
Net income after Budget (£ per week)	74.56	106.05	155.66	280.93	407.01
% Change	-3.8%	-2.8%	-2.2%	-4.8%	-5.2%
MARRIED COUPLE, 2 CHILDREN					
Net income 1980-81, revalorised (1) (£per week)	87.33	118.95	168.75	303.86	438.96
Income tax change ie no revalorisation(£ per week)	-1.91	-1.91	-1.91	-11.25	-19.77
Child Benefit change(£per week)	+0.03	+0.03	+0.03	+0.03	+0.03
Indirect tax change(£per week)	-0.92	-1.07	-1.31	-1.91	-2.52
Net Income after Budget (£ per week)	84.53	116.00	165.56	290.73	416.70
% Change	-3.2%	-2.5%	-1.9%	-4.3%	-5.1%

(1) ie with full 15.1 revalorisation of allowances & thresholds (and Child Benefit)

BUDGET SECRET

11

01 211 6402

R.
4/3

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament St
SW1P 3AG

4 March 1981

Dear Geoffrey.

ENERGY AND THE BUDGET

Thank you for your letter of 27 February enclosing a first draft of a text on energy pricing for the Budget Statement.

As you will know, following publication of the NEDC Task Force's report, the Opposition have already been pressing today for an immediate statement on energy prices. In the circumstances I think there is a real danger that deferring substantive announcement of the measurers we are taking to a written answer will be seen as unnecessarily provocative.

I hope that you will feel able to expand on what you say in the Statement so as to convey to the House something of the substance of what we intend on electricity and gas prices. I enclose a suggested text. This avoids going into full detail, which becomes complex and which we shall stand ready to explain further through Press Releases etc and during the Debate.

I have written to you separately about the heavy fuel oil duty.

I am copying this letter to the Prime Minister, the Secretary of State for Industry and the Secretary of State for Scotland.

Yours ever

David

D A R HOWELL

BUDGET-SECRET

GAS AND ELECTRICITY PRICES

Another area of concern to industry has been energy prices. The National Economic Development Council discussed last Wednesday the report of their Task Force on Energy Prices. This showed that, while prices for the vast majority of industrial customers remain in line, a limited but important number of large users of electricity and gas are paying more for supplies than competitors in Europe.

In the light of this the electricity supply industry in England and Wales plans to introduce new flexibility in its tariffs and special agreements with customers.

The British Gas Corporation has offered to extend existing relaxation of its industrial pricing policy, already introduced last year, in order to give some further benefit to industrial customers. As a result, all renewals of contracts by industrial customers for gas will be held at their current levels until 1 December 1981 and the quarterly provisions for price increases in contracts for providing industrial gas on a firm and continuous basis will not be applied during this period.

These two moves represent a direct benefit to British industry worth some £120m in 1981/82. The Government has agreed to adjust the two industry's External Financing Limits accordingly.

Econ Pol

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

3 March 1981

Prm Min

A. Proud Esq
Department of Energy

Dear Alan

PRESS NOTICES RELATING TO THE BUDGET

I am afraid that since I wrote to you on 26 February, the Vote Office have increased their bid for copies of the press notices relating to the Budget. Departments issuing Budget Press Notices should now send 1,325 (instead of 1,175) copies to the Committee Section at the Treasury (Mr. A.W. Batchelor) in two separate bundles, one of 900 copies (to be collated and sent to the Vote Office) and one of 425 copies (mainly for distribution to the press). All other arrangements set out in my earlier letter, particularly the timing, remain unchanged.

I am copying this letter to the Private Secretaries of all Cabinet Ministers and of the Minister of State in the Civil Service Department.

Yours sincerely
Louise Birnie

MISS L.E. BIRNIE
Assistance Private Secretary

SECRET

106

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1

3 March 1981

Dear Geoffrey

ENERGY AND THE BUDGET

Thank you for your letters of 27 February and 3 March. I shall be writing separately to you about the handling of the Frigg point.

I am disappointed that you have decided against even a token 25% reduction in the HFO duty next year and the expenditure of an extra £25 million in order to defer price increases for both firm and interruptible gas at least until the end of 1981. I recognise that the reduction in the HFO duty is not the most cost-effective way of helping industry. But the political cost of refusing even a token 25% reduction would be out of all proportion to the revenue loss - some £40 million with a "Frigg cost" of £3 million in 1981/82. Such a reduction would lead automatically to reduced electricity and interruptible gas prices. I hope, however, that you will agree to make the technical changes in the way the duty is levied, which are spelt out in the annex to this letter. They have been discussed by our officials and would be particularly helpful to the steel and chemicals industries.

BGC have now had an opportunity to look in greater detail at the cost of maintaining their existing firm and interruptible gas prices for 9 months from 1 March and believe that this could be achieved through a relaxation of their EFL of £73 million for the full 9 months period. I also understand you will now not be having to find £5 million for Scottish electricity prices, I must therefore press you to agree to providing an extra £8 million to enable BGC to hold their present prices for a full 9 months from 1 March. Under your proposals BGC will only be able to hold their firm and interruptible prices at existing levels for some 6 months. This will be seen by industry and our supporters as an inadequate response to the

/findings....

findings on gas prices of the NEDO Task Force, which the CBI think in any case understate the disparity for large users. The whole argument could be reopened in the summer. The extra £8 million would make it possible for BGC to defer price increases for both firm and interruptible gas for 9 months thus allowing time for prices on the Continent to catch up with ours. I very much hope you will feel able to reconsider this point.

X

I remain uneasy about your proposal to defer announcement of our decisions until the Budget. This delay will mean that the disparities established by the Task Force will attract all the Press and industry attention between 4 and 10 March. Pressures for a large package will build up. However, if for wider reasons you think it essential to defer announcement to the Budget I will not press the point. But I believe this delay will make it all the more essential to offer more than you have in mind on gas prices so that the Government's response to the Task Force can be defended as at least the minimum needed to deal with the situation.

I am writing to you separately about the boiler substitution scheme. Sufficient to say here that I think it is an important element in our response to private industry's demands, particularly in view of strong current criticism that all the help is going to public sector industries. The fact that it also helps limit and head off other demands from the coal industry in the current tripartite talks should, I suggest, make it doubly attractive.

I am sending copies of this letter to the Prime Minister, Keith Joseph, George Younger and Sir Robert Armstrong.

Yours ever

David

D A R HOWELL

HFO Duty Technical Changes

If no change is made in the main HFO duty rate there are too minor changes in the application of the existing tax which have featured in the representations of important industrialists:

(a) abolition of the tax on oil injected into blast furnaces;

(b) a switch from "preponderance" to "proportionality" as the basis of taxing HFO use in refineries.

A. Blast furnace use

BSC and other steel industry representatives emphasise that, at least in Germany, HFO injected into blast furnaces is treated as a chemical feedstock and not taxed. They continue to press for comparable treatment.

B Preponderance v. proportionality

On the Continent it is usual for the HFO duty liability of a refinery to be based on the proportion of HFO used for heat-raising as opposed to feedstock purposes. In the UK if consumption for one purpose is preponderant all consumption is taxed accordingly. For historic reasons ICI is particularly affected by this administrative rule.

NOTE FOR THE RECORD

Just before the Prime Minister left for the United States last Wednesday, the Chancellor called on her and reported that he had changed his view on the income tax decision. He had come to the conclusion, having consulted his Ministerial colleagues in the Treasury, that it would be right to go for a somewhat more restrictive Budget than he had contemplated; and in particular, that he should plan on a PSBR of less than £11 billion on 1981/82. He had been influenced partly by the greater risks to public expenditure and PSBR resulting from the concessions to the coal-miners. In order to achieve this objective, he had decided that the right course would be to forgo any uprating of personal allowances. This, compared with his earlier intention to uprate by 7½ per cent, would raise nearly £1 billion; and he believed it would be politically more tolerable than a 1p increase in the basic rate.

He had also decided not to increase the thresholds on the capital taxes: to do otherwise, when income tax thresholds were being held, would be inequitable.

The Prime Minister said she was content.

T.L.

2 March 1981

BUDGET SECRET

COPY NO. 2 OF 22 COPIES

CH/EX. REF. NO. B(81)32

10

x spoke to Manzy. They say all energy industries have to be consulted, but they will try to keep the info. tight.

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

Prime Minister

27 February 1981

The Rt. Hon. David Howell, MP

Dear David

ENERGY AND THE BUDGET

Thank you for your letter of 24 February.

Gas and Electricity Prices
I accept that the Task Force's Report will cause us a real problem and that we will be under great pressure for reductions in electricity and gas prices beyond what is possible by the increase in the electricity supply industry's EFL of some £45 million and BGC's of up to £65 million in 1981-82. But PSBR constraints, which obviously have been made much tighter by our decisions on the miners, have made it impossible for me to find room for a relaxation in the two industries' EFLs beyond the £110 million, which I originally agreed. The additional £25 million for BGC referred to in your letter cannot therefore be accommodated.

As you say, it would be possible to announce the measures which the electricity supply industry and BGC are taking in a Parliamentary statement immediately after the NEDC meeting on 4 March. But as you know, I have always envisaged that the measures on energy prices would form an important part of the package of measures in the Budget which will benefit industry. A further reason for making the announcement in the Budget is that the expenditure involved would not come from the Contingency Reserve but would reflect a budgetary decision to increase the public expenditure totals. I attach therefore a first draft of what I might say in the Budget Statement about energy prices. If you have any comments, please could you let me know very quickly. You will see that the draft assumes that you will be announcing further details of the measures in a Written Answer later on Budget Day. Perhaps your officials could be in touch with mind about its drafting and about your Department's press notice. The nationalised industries too will need to be ready to answer questions.

Please do not let them have advance notice - the whole thing will leak.

/I am

BUDGET SECRET

I am sending a copy of this letter to George Younger in view of my officials' discussions with his about a small relaxation, of up to £5 million, for the two Scottish Electricity Boards which might be necessary if they are to take action on prices for large users on the lines agreed for users in England and Wales. I understand that the Scottish Boards' first reaction was that similar action was unnecessary in Scotland. Could he let me know the position urgently. Obviously we should avoid the addition to the industries' EFLs if at all possible. If there had to be an increase, I would want to be assured that it was to be passed entirely to the large users concerned and would not be used by the two Scottish Boards for other purposes.

Boiler Substitution Scheme
We discussed this in E Committee on 23 February and decided not to pursue it for the time being.

HFO Duty
I shall be writing to you separately about this.

I am sending a copy of this letter to the Prime Minister, the Secretary of State for Industry and the Secretary of State for Scotland.

GEOFFREY HOWE

Gas and electricity prices

Another area of concern to industry has been energy prices. The National Economic Development Council discussed last Wednesday the report of their Task Force on Energy Prices. Real concern was expressed on all sides about the report's evidence that some large industrial consumers are paying more for electricity and gas supplies than competitors in Europe. My rt hon friend the Secretary of State for Energy will give details in a Written Answer later today of positive action planned by the industries to respond to this concern. The Government has agreed to the consequent [£115m] increase in external financing limits for gas and electricity for 1981-82. This will represent a direct benefit to British industry in the coming financial year.

9a

CH/EX. REF. NO. B(81)27
COPY NO. 1 OF 22 COPIES

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

27 February 1981

Prime Minister

I thought you would like to see a summary of the budget decisions.

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

Dear Tim,

THE BUDGET

You asked for a brief statement of the Budget decisions which the Prime Minister could have on her return from the USA at the weekend.

TL 27/2

.... I attach a list of the main tax changes. As you can see, the overall increase in 1981-82 revenue, compared with present tax rates and allowances, is about £3.6 billion. This is net of the cost of the stock relief scheme for industry - worth about £180 million in 1981-82 and much more in the following year. (Measured against a base assuming revalorisation of direct or indirect tax rates and allowances, the net revenue increase is some £4.3 billion.)

Aside from the stock relief scheme the other item in aid of industry that carries a major 1981-82 PSBR cost is a scheme for relief of gas and electricity prices charged to certain industrial users. To make this possible, the Chancellor is agreeing with the Energy Secretary increases of about £115m in the 1981-82 EFLs of the nationalised industries concerned.

The economic forecast is still shaking down (including how far and in what way to take account of the costs of shelving the pit closures plan) but the published 1981-82 PSBR figure should be around £10½m, taking account of the Budget package. I am sure the Chancellor will also want to discuss with the Prime Minister next week his approach to presentation of the Budget and related issues. I hope this letter and the table attached will be a useful aide-memoire for the Prime Minister meanwhile.

Yours
John

A.J. WIGGINS

1981 BUDGET TAX MEASURES		Estimated 1981-82 revenue effects £billion
(i) income tax		
no change in rates or personal allowances		0
(ii) indirect taxes		
about double revalorisation overall of the specific duties with 2% impact effect on RPI.		+ 2.4
illustrative price changes:		
vehicle excise duty	£10	
beer	4p/pint	
tobacco	14p/packet of 20	
petrol and derv	20p/gallon	
spirits	60p/bottle	
wine	12p/bottle	
fortified wine	25p/bottle	
(iii) special tax on bank deposits		
$2\frac{1}{2}$% on non-interest bearing balances over £10m		+ .4
(iv) supplementary petroleum duty (North Sea, as outlined in November)		
20% rate		+ .93
(v) PRT relief changes (as foreshadowed in November)		+ .1

(vi) enterprise

(a) CTT: minor changes (no general increase in thresholds) (-.004, ie very small)

(i) 10 year cumulation instead of of lifetime cumulation

(ii) more generous rates and scales for lifetime transfers

(iii) annual exemption from £2,000 to £3,000

(b) CGT: changes in settlement rules, offset by anti-avoidance measures. negligible

-.02

(c) including Business Start-Up Scheme,

(d) CT small companies' rate limits,

(e) plus range of other measures, not all with a revenue cost.

(vii) stock relief for corporation tax -.18

(ix) construction

Development Land Tax minor changes	negligible
Capital allowances for industrial building - raised from 50 to 75%	negligible in 1981-82

(x) benefits in kind

various measures as explained in recent minutes from the Chancellor (e.g. 3 and 23 February) negligible

(xi) disabled and charities negligible

e.g. double income tax allowances for the blind (this relates to the special blind allowance, not the main personal allowances) VAT concessions for charities and equipment for the disabled; tax exemption for private health insurance provided to employees earning less than £8,500 a year; some minor public expenditure on restoration of previous 5% deduction from Invalidity Allowance.

BUDGET - SECRET

9

10 DOWNING STREET

MR. LANKESTER

12

27/2

26 February 1981

Budget - Secret

Dear Douglas,

BUDGET

I believe the clock has now stopped on the 1981 Budget. There is nothing more to be done.

I thought you ought to know, however, that essentially I have not changed my views. I have seen neither evidence nor arguments to suggest that the present proposals are not very much a case of too little and the wrong kind. The consequences are likely to appear in crisis measures after a few months.

I suppose, however, there is still room for some decisions about MLR. As you know, with this Budget I would think it desirable not to move MLR at all, except for the fact that the markets are expecting three or even four points reduction. If, therefore, it is to be reduced at all then I think the maximum of one point reduction is in order. I think three or four would be quite disastrous.

Yours

Alan

Sir Douglas Wass, GCB,
HM Treasury.

Mr Lyne
Mr Vernon

Econ Pol

JL
26/2

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

26 February 1981

A. Proud, Esq.,
Department of Energy

Dear Alan

PRESS NOTICES RELATING TO THE BUDGET

I am writing to seek your and copy recipients' co-operation in dealing with the press releases relating to the Budget. Separate guidance has been issued to Departments (PESC(N)(81)1 and corrigendum) on press notices relating to the Public Expenditure White Paper.

I should be grateful if you and other recipients of this letter could let me know by noon on Wednesday, 4 March

(a) what, if any Budget press notices are proposed by your Departments; and

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

Departments issuing Budget press notices should send 1175 copies of them to Committee Section at the Treasury (c/o Mr. A.W. Batchelor) in two separate bundles, one of 750 copies (to be collated and sent to the Vote Office) and one of 425 copies (mainly for distribution to the press). Copies should have a hole punched through the top left hand corner. Copies of press notices should reach Treasury Committee Section by 5.30 p.m. on Friday, 6 March.

As you will see, we are hoping to make use of the weekend before the Budget to relieve some of the strain (inevitably increased by simultaneous publication of the Public Expenditure White Paper) on our distribution facilities here. We would be grateful if Departments would co-operate to make this feasible. If, however, this timetable looks likely to cause acute problems anywhere, I wonder if we could discuss them with the Departmental contact point in question before 4 March. In particular, if you are unable to meet the deadline for sending material for the Vote Office to Committee Section here and need to send Press Notices direct to the House on Budget day please so advise the Treasury's Parliamentary Clerk (233 4749).

/As the

As the PESC(N)(81)1 paper says in relation to the press notices on the White Paper, the Treasury would be grateful if all press notices - on the White Paper and on the Budget - could be cleared in draft with the relevant Treasury divisions.

I am copying this note to the Private Secretaries of all Cabinet Ministers and of the Minister for the Civil Service.

Yours sincerely,

L E Birnie

MISS L.E. BIRNIE
Private Secretary

8a

COPY NO. 20 OF 24 COPIES

Ch/Ex. Ref. No. B(81) 21

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY ON WEDNESDAY, 25 FEBRUARY 1981 AT 9.30 A.M.

Present:

Chancellor of the Exchequer (In the Chair)
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Mr Burns
Mr Ryrie
Mr Middleton
Mr Unwin
Mr Ridley
Mr Cropper
Mr Cardona

THE FISCAL STANCE

The Chancellor expressed his renewed concern about the trend in the PSBR for 1981-82. It appeared that income tax revenue might fall below the level hitherto indicated by the Treasury forecasters, while there would be some further additions to expenditure, particularly in respect of the financing of the coal industry. As a result the PSBR seemed to be moving inexorably towards £12 billion. There was much criticism that the Government's strategy was being gravely damaged by spending £1 hundreds of millions in additional aid to the nationalised industries; but it appeared that there was no immediate scope for offsetting reductions in other areas of public expenditure. A fresh cash limit squeeze would have its main impact on private sector firms supplying public authorities, while a reduction in social security benefits could save relatively little in 1981-82. The Secretary of State for Industry and some of the Prime Minister's advisers favoured further taxation:

/was there not a

was there not a case for looking again at the possibility of increasing the basic rate of income tax?

2. The possibility was canvassed in discussion of waiting until the summer to see whether further action was required. If some kind of funding crisis materialised, there would be a better prospect of securing crash reductions in public expenditure. Equally, the indirect tax regulator powers would be available, and these could provide the Government with whatever additional revenue might be needed. Meanwhile an increase in the basic rate of income tax would not of itself provide sufficient of a safety margin to give Ministers a firm assurance that developments in the PSBR would not have an adverse impact on interest rates and funding at some stage.

3. It was noted, however, that the decision on the fiscal stance depended to a considerable extent on the Government's intentions about the movement of interest rates over the next three to four months. If reductions were to be made, then the risks of this course would be substantially increased with a PSBR approaching £12 billion. In these circumstances it would be increasingly difficult to make interest rate reductions credible.

4. Mr Unwin suggested that the margins of error in the figures were such that it would not be unreasonable for the Government to publish a PSBR forecast not far above £11 billion despite the difficulties with the miners. Some of the extra financing costs for coal might perhaps have to be found from the contingency reserve, although the balance of opinion was that it would not be possible to find the whole amount in this way. If it were decided not to change previous decisions on taxation, the fact that the contingency reserve would have been substantially pre-empted would constitute a strong argument for Treasury Ministers to resist any new claim

/from spending Ministers.

from spending Ministers. The question was also raised whether an increase in the basic rate would in practice be regarded with much favour by the financial markets. The disincentive effects, and the psychological damage to the Government's strategy would be considerable. On the other hand, it was generally felt that if no further fiscal action were taken, it would not be possible to reduce MLR by more than 1 per cent in the Budget; and there would then be little prospect of interest rates remaining on a downward trend thereafter. A further possibility suggested was to collect an additional 1p on the basic rate on a provisional basis, with the prospect that if things went well the Finance Bill might be amended in July to restore the basic rate to its present level; however, this would be administratively cumbersome, and it was doubtful whether the position would be clear enough for a new decision to be taken before the Finance Bill had completed its progress through Parliament.

5. Two further approaches to reducing the PSBR were canvassed: advancing the payment of VAT on imports, and a more radical approach to income tax involving full revalorisation of the thresholds and bands, coupled with a 3p increase in both basic and higher rates. The Chancellor thought that VAT on imports, quite apart from the adverse effect on industrial costs, would not represent a satisfactory response to a continuing problem; the containment of the 1981-82 PSBR would then be unduly dependent on once-for-all changes - the levy on the banks had the same characteristics. It was noted that the more radical approach to income tax would make the overall balance of the Budget less regressive, and would be better on the whole in relation to the "Why Work question" problem; but the effect on incentives was thought to be an overriding objection.

6. Mr Burns argued that the Budget as yet did not sufficiently

/confront the problem

confront the problem presented by the large increase in public expenditure as compared with previous plans; expenditure in cost terms in 1981-82 was now likely to be £6 billion higher than had been envisaged in the 1980 MTFS - but additional revenues would amount to only about £4 billion. Unless action were taken which offered a better prospect of a substantial reduction in interest rates, the Budget would mean disappointed expectations for industry as well as unpopular increases in taxes for the personal sector. Mr Ryrie and Mr Unwin, however, thought it would be better not to make the fiscal stance more restrictive; they suggested that a PSBR in the region £11¼-11½ should be shown, with the immediate reduction in MLR restricted to 1 per cent. This course would certainly involve some risks, but there was no entirely satisfactory way out of a difficult situation. To the extent that the exchange rate moved down somewhat, relatively higher interest rates would be less of a problem for UK industry.

7. Mr Burns again urged the case for action in the Budget rather than later; if monetary developments through the first half of 1981 proved adverse, there would be a risk of a resurgence in inflation, to which "regulator" increases in indirect taxes would not be an appropriate response, since they would increase both the RPI and the demand for money. On the other hand, if the PSBR could be reduced to about £10½ billion, Mr Burns thought it would be reasonable to make a 2 per cent reduction in MLR in the Budget.

8. The Minister of State (L) said he saw no circumstances in which it would be appropriate to increase the basic rate of income tax. If the Government had to have more revenue, it would be better to leave tax thresholds and bands where they currently were in money terms - despite sophisticated discussion in Parliament and the Press,

/people still saw

people still saw increases in tax thresholds as implying a reduction in tax, even if the reduction were not enough to offset the rising real burden due to inflation. If there were no revalorisation of income tax, the CTT thresholds would have to be left where they were, and it might be appropriate to look again at the level of child benefit. There would undoubtedly be a problem arising from the disappearance of clear water between benefit levels and tax thresholds, but this should not prove insuperable; the Inland Revenue could absorb a good deal of this by increasing their administrative tolerances. The Financial Secretary and Sir Douglas Wass agreed with the Minister of State (L) about the choice between tax thresholds and an increase in the basic rate; and it was noted that the Conservative Central Office had taken the same view.

9. In further discussion there was a wide measure of agreement among Ministers with the Minister of State (L)'s approach. Action now to contain the PSBR would put the Government somewhat less at risk from newly emerging public expenditure overruns; if, on the other hand, the situation were to deteriorate markedly following inadequate action in the Budget, then the remedial action which would be needed later would have to be greater and therefore more unpopular. In general the Budget would carry greater conviction if it included what would clearly be a harsh decision on income tax, and Treasury Ministers' hands would be strengthened in asking their spending colleagues for expenditure cuts.

10. The question was raised, if income tax and CTT thresholds were unchanged, what other elements of the business and enterprise package would also have to be omitted. The preliminary view was that the other CTT changes - the annual exemption, 10 year accumulation, life-time scale and the agricultural package - could probably be retained; there was relatively little revenue at stake in the near

/future, and the

future, and the agricultural changes incorporated useful measures against tax avoidance. Similarly it appeared that the CGT roll-over relief could be retained, on the basis that this was being presented as self-financing.

11. It was noted in further discussion that more thought would need to be given to the treatment of the additional financing for the coal industry, and the measures to reduce energy prices. On the face of things it would be odd to regard the energy price changes (up to £150 million), which were known with certainty, as a charge on the Contingency Reserve, while the extra costs of coal financing - which were not precisely known at this stage - were shown explicitly in the arithmetic as affecting the PSBR.

12. The Chancellor, summing up the discussion, said Treasury Ministers favoured leaving income tax and CTT thresholds and bands where they were, thus reducing the PSBR by approaching £1 billion. This course would offer a far better prospect of validating a 2 per cent reduction in MLR as part of the Budget. In effect this implied a trade off between 7½ per cent revalorisation of tax allowances and a further immediate reduction in interest rates of 1 per cent. In view of the urgent need to help the business sector, it seemed better to follow the course which gave a better prospect of lower interest rates.

13. Following the meeting the Chancellor discussed the new proposals on income tax and CTT with the Prime Minister. She gave her agreement to them.

JW

A J WIGGINS

25 February 1981

Distribution:

Those present
Sir A Rawlinson
Mr Battishill
Mr Bridgeman
Mr Britton
Mr Monck
PS/Inland Revenue
PS/Customs & Excise
Mr T P Lankester - No.10 (Personal)

8

Econ Pol

FCS/81/27

R
25/2

CHANCELLOR OF THE EXCHEQUER

Oil Taxation Proposals

1. Thank you for sending me a copy of your minute to the Prime Minister. I have just seen the Prime Minister's reply of 23 February agreeing to your proposals.

2. I note your judgement that the oil companies have accepted the justification for an increased tax revenue. The US companies do seem to face the prospects of special difficulties but I welcome the various ways in which you suggest you may be able to alleviate these. If I pick up any reactions to this during the Prime Minister's visit to the United States this week I will let you know.

3. I am sending copies of this minute to the Prime Minister and to David Howell.

C

(CARRINGTON)

Foreign and Commonwealth Office

25 February 1981

cc MR. LANKESTER -
MR. HOSKYNS
MR. WOLFSON

7

Econ Pol

10 DOWNING STREET

CHANCELLOR OF THE EXCHEQUER

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

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

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

25 February 1981

cc D. Wolfson
E Hoskyns
A. Walters.

file copy. 6B

10 DOWNING STREET

From the Private Secretary

24 February, 1981.

Dear John,

As you know, the Prime Minister had a further discussion with the Chancellor and Sir Douglas Wass this afternoon about the Budget.

Commenting on the Chancellor's minute of 23 February, the Prime Minister said she was dismayed at the prospect of a PSBR for 1981/82 of £11¾b. She doubted whether it would be possible to justify a reduction in MLR unless the PSBR was reduced to around £10½b. From a political standpoint, she thought it might now be possible to justify a 1p increase in the basic income tax rate on account of the increased spending on the NCB and BSC.

The Chancellor explained that he had mentioned an estimate for the PSBR of £11¾b at the meeting on 13 February. Although a PSBR at this level would certainly involve risks, he and his Ministerial colleagues remained of the view that an increase in the basic rate would be extremely difficult politically and would be very bad for business morale. He did not think that the increased spending on coal and steel would provide an adequate justification: on the contrary, many people would say that the Government was having to raise taxes on account of its own failures. It also had to be recognised that, even with a PSBR of £11¾b, many would criticise the Budget for being excessively deflationary. Sir Douglas Wass added that he was not as pessimistic as the Prime Minister appeared to be about the prospects of funding a borrowing requirement of £11¾b. - for example, the indexed gilt and the extension of Granny Bonds would be a considerable help; and he still believed that a 1% reduction in MLR could be justified.

The Prime Minister said that she remained concerned at the risks that the Chancellor was taking, but she was prepared to accept his political judgement that an increase in the basic rate was not possible.

There was a brief discussion about other possible measures of raising revenue, in addition to the indirect tax package already agreed. The Prime Minister suggested that revenue could be found from restructuring the ITV levy, and by applying VAT to all advertising. As regards the former, the Chancellor explained that, while the present levy was in need of improvement, nothing could be done in the Finance Bill. Discussions on a possible restructuring of the levy were taking place between the Treasury and the Home Office; if changes were to be made, separate legislation would be required.

As regards VAT on advertising, Sir Douglas Wass said that he believed that VAT already applied to all advertising except in newspapers; but he would look into this further. I have now heard from Tony Battishill that this is indeed the case, and that newspaper advertising has always been exempt from VAT both for political reasons and because it is thought that to tax classified ads would seriously damage the provincial newspapers. Imposing VAT on business advertising would not raise any revenue. (I will mention these points about advertising to the Prime Minister.)

The Chancellor told the Prime Minister that he had decided, after all, not to suspend the land development tax because he was afraid it might be wrongly exploited. But he still proposed to make certain minor changes in the tax.

Lu en.

Tim Lankester.

A.J. Wiggins, Esq.,
HM Treasury.

2

Mr Wolfson
cc Mr Duguid
Mr Walters

Prime Minister

This discussion with the TUC Economic Committee was on predictable lines. But the Treasury admitted that the TUC £6 bn package would lead to higher interest rates.

TL
26/2

MG.

NOTE OF A MEETING HELD AT 11, DOWNING STREET ON TUESDAY, 24 FEBRUARY, 1981 AT 5.30 P.M.

Present:

Chancellor of the Exchequer
Secretary of State for Employment
Chief Secretary
Mr. Unwin
Mr. Dixon
Mr. Burgner
Mrs. Gilmore
Mr. Mortimer
Mr. Ian Stewart, MP

Mr. Basnett)
Rt. Hon. Lionel Murray)
Mr. Cave)
Mr. Christopher)
Mr. Daly)
Mr. Drain)
Mr. Duffy)
Mr. Evans)
Mr. Fisher)
Mr. Gill)
Mr. Jackson)
Mr. Jenkins)
Mr. Parry)
Mrs. Patterson)
Mr. Sirs)
Mr. Whatley)
Mr. Willis)
Mr. Lea)
Mr. Callaghan)

BUDGET REPRESENTATION BY TUC ECONOMIC COMMITTEE

Mr. Basnett said that the TUC Economic Committee had sought a meeting with the Chancellor on reading the report of the February meeting of the NEDC. This had suggested that neither the Government nor the CBI appreciated the true scale and speed of the erosion of British industry, and that the Government had not seriously addressed itself to the proposed steps to recovery set out in the TUC's Economic Review. The TUC wished to take the opportunity also to indicate the immediate steps which in their view were needed in the Budget. There had been a catastrophic 14 per cent fall in manufacturing output, unprecedented even in the 1930s, and a reversal of all growth achieved since 1967. GDP had fallen 3 per cent last year, and 440,000 redundancies had been notified to the MSC in the first 11 months of 1980. All the forecasts, which the Government had not challenged, pointed to a continuation of these disastrous trends. At the meeting with the Prime Minister in October, the General Council had requested an urgent change in course of economic policy on the grounds that unemployment had reached the level of 2 million. It had increased by 23,000 per week since then, and of course these figures understated the real problem because of the large amount of unregistered unemployment. The total shortage of jobs was now around 3½ million. The forecast that employment would reach 5 million by the end of the 1980s, mentioned at the last NEDC meeting, had not been challenged by the Government. The TUC welcomed the belated signs of flexibility by the Government over the serious problems of the mining industry. There was joy in heaven after a sinner's repentance, but there were doubts whether the repentance went far enough or was for the right motives. If a change in course was not possible through mutual discussion and debate, without the threat of industrial force being used, there was bound to be a tendency for that threat to be brought into play. The TUC did not want this development, but had to consider whether there were other means of deflecting the Government from its present disastrous policies. As a careful reading of the Economic Review showed, the TUC did recognise the importance of competitiveness and the challenge that was presented by new technology. It was ready to react positively to proposals for the introduction of new technology when their implementation was by agreement; it should be remembered that it had been the CBI General Council, not the TUC, which had turned down the joint statement on technological change. The TUC did not believe that the problems of Britain could be easily solved. Instead they were calling for a long term policy for restructuring and modernising industry; specifically they suggested large investments in improving the transport and telecommunications systems. More

hardly !

generally their aim was to reverse the appalling waste of resources involved in unemployment. They calculated that each unemployed worker cost £7600 in lost output, so that the total bill was over £18 billion per year. The direct cost to the Exchequer of unemployment would outstrip the receipts of North Sea oil and gas in 1981-82. In short you could not lay waste an economy and claim to be solving its problems; this was what the Government appeared to be doing.

2. Mr. Murray said it was quite clear that the downward spiral was continuing. As he travelled round the country, and in particular to places such as the West Midlands, he found that the disastrous consequences of present policies were increasingly recognised by both trade unionists and employers. So far as the Budget was concerned, the first urgent need was for a reversal of the decision to increase employees' National Insurance contributions. A reduction of ½ per cent in the employers National Insurance Surcharge (costing £½ billion) would also be very desirable. The TUC was most concerned at the rumours circulating about the Government's intention not to allow full indexation of tax allowances; this would have damaging effects on purchasing power and would be inequitable. It was worth pointing out in passing that it favoured a far more open discussion of the possible content of the Budget in its preparatory stages so that it was not necessary to rely on leaks in newspapers.

3. The TUC Economic Review recommended a net stimulus of £6 billion to the economy. This sounded a lot of money, but it was really a very modest proposal which would do no more than prevent unemployment from rising further. It was intended as a stabilising package and should not be seen as large scale reflation. It had been criticised because it had amounted to a proposal to revert to old style demand management. The TUC firmly believed that it was essential to manage the economy in a positive way. They wanted a counter-cyclical stimulus for private sector investment as well as more investment in the nationalised industries. In many

parts of industry there were no signs of genuine adaptation to the problems of the 1980s and in areas such as training and technology the Government had a crucial part to play. There were bound to be arguments and differences about the means which should be used, but the important point to realise was that the situation we were in was not automatically self-correcting. It was no answer to the very real problems to play about with the minor variants of monetary policy. The TUC accepted that its measures would lead to an increase in the PSBR; but they argued that a net stimulus of the order proposed would in time lead to higher revenue, save much of the enormous expenditure currently going on unemployment, and generate new savings. The PSBR was only one half of the problem; there was also the financial deficit of the company sector, which was presently greatly inflated by companies borrowing to survive. The TUC also argued strongly the case for a rise in pensions, long term unemployment benefit and child benefit at least in line with inflation. It was wrong to say the TUC was not concerned about inflation - they had been extremely concerned at the effect of last year's VAT measures on inflation, and hoped that the Chancellor had nothing similar in mind. This was not the time for an increase in indirect taxes. Far too high a price was being paid for getting inflation down, in terms of the erosion of industrial production and the rise in unemployment. The question which the TUC wished to put was what level of unemployment needed to be reached before there would be a modification of present policy. He hoped that, as present signs seemed to indicate, the answer was that level had been reached. The TUC was offering the Government a viable alternative to its present policies. It accepted that there were some risks, but when compared to the risks which were already being taken it was clearly the better way.

4. <u>The Chancellor</u> said that the Government had not accepted and did not accept the unemployment figure of 5 million by the end of the 1980s mentioned at last meeting of NEDC. Nor did it accept the implication that recent events showed it had changed

its basic economic strategies; the MTFS had explicitly allowed for variations in response to changed circumstances. It had always been recognised that cyclical factors would operate to raise the PSBR, depending on the extent and depth of the recession. The Government was desperately concerned about rising unemployment, because of its social and economic consequences, and about the failure of the economy to grow; but it had to cope with the world as it was, not with how it would like it to be. Colleagues in Europe were facing very similar problems and recession and rising unemployment were worldwide phenomena. The impact of the succession of oil price increases had affected all countries and the present difficulties were not a consequence of Government policies. The TUC were asking for a stimulus to the economy of £6 billion, which would require additional borrowing on that scale. Did the TUC believe this could be achieved in present circumstances without severe upward pressure on interest rates? It was hard to see how a large increase in rates could be avoided if the PSBR rose to £17½ billion.

5. In reply, Mr. Murray said the UK was in a strong position internationally to give a lead in reducing interest rates and increasing demand. He recognised that there would be some upward pressure on interest rates from action to increase demand, but this would be counter-acted to some extent by the strong tendancy at present for rates to come down. There was also the argument that more growth in the economy would generate additional savings, which again would tend to counter-act any tendancy for interest rates to rise.

6. The Secretary of State for Employment said that he did not accept the view that unemployment was on an inexorable upward trend. The number of young people coming onto the labour market had now peaked, and there was a retirement bulge as those born in the population boom after the First World War reached retirement. Developments in technology inevitably meant some rundown in the number of people in manufacturing industry - the present level in the UK (32 per cent) compared with 25 per cent in the US.

On the other side there were opportunities for greater employment in service industries, in high technology industries. Further moves towards early retirement might also help. Of course there was room for debate about the rate of decline in the number of people in manufacturing industry, and for saying that it was too fast at present. There was evidence to show that when the upturn came increased demand would be met mainly by increased productivity, and that there would only be a relatively small increase in manufacturing employment. Mr. Prior hoped for a revival of investment intentions by the end of 1981; but the key to a better industrial performance was a reduction in unit labour costs relative to those of our international competitors - UK unit labour costs were still much too high.

7. The TUC commented that rising unemployment was an inescapable fact and that there was no real sign of present strong upward trend being halted let alone reversed. Public sector employment, office employment and employment in new technology were no longer expanding. Unless more money was injected into the economy to get industry off its back and for investment in the future, not only would there be no end to the recession, but we would be in serious trouble in years to come. They recognised the need to improve marketing, to increase competitiveness, to improve the quality of management and industrial relations, but substantial action was needed on aggregate demand. The idea that if you squeezed industry hard, this would squeeze inflation out, and achieve increased competitiveness was wholly wrong. Industrial investment was needed to improve competitiveness, and they sought a boost to demand to facilitate this.

8. The Chancellor pointed out that, even if the interest rate objection could be overcome, there was no guarantee that an injection of demand on the scale the TUC were requesting would produce the desired effects. The lesson of past attempts to reflate out of recession was that only a small proportion went to higher output, a larger proportion to imports, and by far the

largest proportion to renewed inflation. Nor was vast investment necessarily the answer - as the example of the steel industry indicated. Here large scale investment had produced a large unneeded capacity, and we were now having to face the cost of disinvestment. It was crucially important to improve competitiveness so that we could begin to create real wealth. This depended on getting inflation down and keeping it down, because only then would investment in industry increase, and by getting our unit labour costs down to the levels of our competitors. In short he had studied the TUC's Economic Review very carefully, and he understood the intellectual case it argued for a large injection of demand. In his view this was not the right way out of our difficulties and would be fraught with danger. The inevitable increase in interest rates, which the TUC had not sought to deny, would worsen the problems of industry because of the increase to the cost of borrowing and the further stimulus that would be given particularly if there were a substantial fall in the exchange rate. Finally, it was worth pointing out that the present picture was not one of unmitigated gloom. There was evidence that British firms were still getting orders and hanging onto markets that on the arithmetic they should be losing. This suggested that UK industry was more often able to compete on price and quality than was often realised.

PSJ

(P.S. JENKINS)

25 February 1981

BUDGET SECRET

10 DOWNING STREET

From the Principal Private Secretary

23 February 1981

Oil Taxation Proposals

The Prime Minister has seen the Chancellor of the Exchequer's minute of 20 February 1981 on the oil taxation measures to be taken in the Budget and agrees to the proposals in paragraph 18 of his minute.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office) and Julian West (Department of Energy).

C. A. WHITMORE

CS

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

BUDGET SECRET

BUDGET SECRET

Prime Minister.

6(a)

You have of course already agreed the Chancellor's proposals. If you are disposed to give weight to Mr Howell's concerns, we shall have to have a meeting after your return from Washington. / afternoon. He is tied up in the Enterprise meeting tomorrow.

KW 24.ii

MS

PRIME MINISTER

OIL TAXATION PROPOSALS

1. I have seen a copy of Geoffrey Howe's minute to you of 20 February. I am grateful to Geoffrey for keeping me in touch with his thinking and in drawing to your attention points on which we do not wholly agree. However, I felt I should explain slightly more fully my worries about his proposals.

2. First, I think that he somewhat overstates the case in saying that the industry generally accepts that his proposals are justified on the basis of current North Sea economics. Admittedly the industry is generally prepared to see us take an additional £1 billion from the North Sea next year, given our budgetary difficulties. However, they see it being taken as a temporary levy representing an advance payment of PRT; and I have seen little evidence that generally they accept there is a case for our taking additional revenues on a permanent basis. Certainly I do not think that we should put too much weight on Dr Hammer's views since his interests do not coincide with those of most companies active in the North Sea.

3. Second, I remain concerned about the proposal for the new tax to be paid on a monthly basis. This step will have an adverse effect on the cash-flow of companies and I do not think that the monetary policy arguments for it justify imposing this burden on them. Certainly they have said that they regard it as the last straw.

4. Third - and most important - I am very concerned about the proposal to press ahead with the changes to PRT as planned given the risk that, with these changes, PRT will no longer be creditable. If we did go ahead and the US subsequently ruled that PRT was no longer creditable the companies would take the view that we had decided on the new measures without having fully thought through the consequences: this would further erode their confidence in us and have in its turn a damaging effect on North Sea activity. Indeed their uncertainty as to whether the new measures would result in loss of creditability would in itself affect their North Sea activity. And the mere step of going ahead

BUDGET SECRET

without further consultation with the US authorities when we know that they are already taking a strong interest in the matter could encourage the US authorities to take a more critical line than they would otherwise have done.

5. I therefore believe that there is a case for introducing the changes at a later stage after further discussion with the US authorities. I recognise that it could take some time to secure a formal ruling from them. But at least this would give us a better chance of convincing them. And delay would have the presentational advantage of being seen by the companies as evidence of a willingness on our part to give them more time for consultation.

6. I recognise that by delaying we would not allow the longer term revenue gains to score in the MTFS this year and that there would be a loss of a small part of the additional revenue we are seeking in the interim. On the other hand, I do not think that companies would benefit from the delay by taking advantage of the distortions in the current regime given that the regime is under threat of change. All in all I think that there is little to be lost, and something to be gained, from a delay in introducing these changes.

7. I accept, of course, that these are very much matters of judgement. But I thought you should be aware of my concern.

8. I am copying this minute to Geoffrey Howe and Peter Carrington.

DH.

SECRETARY OF STATE FOR ENERGY
23 February 1981

Budget

2

PRIME MINISTER

MS 23/2

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

23 February 1981

Sir Jeremy Morse, KCMG
Chairman of the Committee of
London Clearing Bankers
10 Lombard Street
LONDON
EC2V 9AP

MS

Dear Jeremy

Thank you for your letter of 3 February, with which you sent me a copy of your letter to the Prime Minister and its enclosures. I have discussed what you say with her and she has asked me to reply.

We have, of course, already discussed your argument that a tax would have a damaging effect on your pay negotiations, and I am afraid that I continue to find it unconvincing. It can hardly be suggested that the unions concerned are unaware either of the level of banks' profits or of the bargaining value of that fact. Public recognition that you have high profits would surely not signal anything new to the unions. By contrast it could well be said that a tax or other form of contribution would give an added argument for standing firm in negotiations, on the grounds that it decreased ability to pay.

I note what you say about retransfer of export credit at present refinanced by the Government. As you know, neither we nor the previous Government have excluded such retransfers. However, the acquisition by the banks of what is really a form of gilt-edged security carrying a market-related interest rate can hardly be seen as a major benefit to public funds or an important sacrifice by the banks. I am afraid the interest charge fully offsets what you say about a discounted cash flow advantage. These retransfers do not meet the need for a real contribution.

In all the circumstances, I must express my very real disappointment that you and your colleagues have not felt able to respond more positively to the proposals for cost-sharing which Nigel Lawson put to you at the end of January.

Yours sincerely

Geoffrey

GEOFFREY HOWE

CONFIDENTIAL

10 DOWNING STREET

From the Principal Private Secretary 23 February 1981

Company Tax: Stock Relief

The Prime Minister has seen the Chancellor of the Exchequer's minute of 18 February 1981 about stock relief.

She agrees that he should legislate in the forthcoming Finance Bill for the new stock relief scheme in the form proposed in the Consultative Document but without a credit restriction at this stage and that he should announce his proposals in his Budget Statement.

I am sending copies of this letter to Ian Ellison (Department of Industry) and Stuart Hampson (Department of Trade).

C. A. WHITMORE

CS

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

CONFIDENTIAL

CONFIDENTIAL

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

Prime Minister.

Would you like to discuss this further with the Chancellor when he comes in tomorrow afternoon?

No

23/i

PRIME MINISTER

SEASON TICKETS

We spoke earlier in the week about taxing the benefit of season tickets provided by employers.

2. Over the past few years, there has been a great increase in the provision of season tickets by employers. Schemes are now advertised by British Rail and London Transport. Out of a commuter population of around 1 million, some 250,000 are now provided with season tickets by their employers. Of these 250,000, roughly half already pay tax on the benefit (including directors and employees earning above £8,500, and all who are provided with vouchers which they exchange for tickets or are reimbursed the cost of the ticket). It is only a minority (100,000 or so) who escape tax: these are employees earning less than £8,500 whose employers have entered into schemes which avoid tax (through a loophole in the law).

3. The minority escape tax, while the majority are either taxed on the benefit of the season ticket provided or pay for their travel from home to work out of taxed income. This is very unfair. It fuels the pressure for tax relief for travelling expenses from home to work (which would cost some £1 billion). Taxing all season tickets would to some extent reduce that pressure (or at least remove a source of grievance).

CONFIDENTIAL

4. It is our policy to encourage employers to reward in cash rather than in kind. A watertight tax on the provision of season tickets would be entirely consistent with this. And, by preventing avoidance through schemes drawn up for the purpose, it would end the preferential tax treatment enjoyed by a minority of commuters.

5. I am copying this minute to the Chief Whip.

(G.H.)

23 February 1981

6

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

COPY NO. 1 OF 26 COPIES

cc Walters
Hoskyns
Wolfson

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

PRIME MINISTER

THE BUDGET

Flag C

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

Flag D

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

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

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

5. The main tax proposals are:-

(i) Increasing the income tax thresholds and allowances by $7\frac{1}{2}$% rather than the 15% required by the statutory indexation formula. This will reduce the PSBR next year by some £0.9 billion compared with the forecast.

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

(iii) A once and for all bank levy of $2\frac{1}{2}$%. This will raise some £420 million next year and reduce the PSBR by only a little less.

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

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

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

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

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

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

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

R.I. Tolkien

, for ,

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

23 February 1981

ANNEX A

INDIRECT TAX PACKAGE

The major Excise duties

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

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

B

ANNEX B

Enterprise

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

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

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

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

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

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

Construction

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

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

ANNEX B (CONT)

Disability

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

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

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

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

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

5(B)

COPY NO. 1 OF 18 COPIES

CH/EX. REF. NO. OTP BS

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

PRIME MINISTER

Agreed MT.

OIL TAXATION PROPOSALS

1. You have asked for a note on this year's oil taxation measures. I have now, in consultation with David Howell, settled the broad lines of my proposed Budget changes; there are of course some points of detail yet to be settled.

BACKGROUND

2. You will recall that I announced my outline proposals at the time of the Industry Act Forecast last November under two heads:-

(i) a proposed new supplementary tax on gross revenues less a flat-rate oil allowance: for illustrative purposes, at a rate of 20 per cent with an allowance to 1m tonnes/year. The tax was to raise about £1 billion in 1981-82; and

(ii) a review of the PRT reliefs designed to improve their efficiency and economy in the face of changed North Sea economics. The detailed problems and possible solutions were outlined in a Revenue discussion paper issued just before Christmas.

3. The background to these proposals was set out in my letter to you of 14 November. I need not rehearse the arguments again here: nothing has happened - either to North Sea economics or to the wider economic picture - which substantially affects the conclusions we reached then.

Consultations with the industry

4. Since the November announcements Ministers and officials have had extensive discussions with the industry representative bodies and with individual companies. It is always difficult to assess the industry's response, but in my judgement the industry generally accepts that my proposals are justified on the basis of current North Sea economics. You will recall that Dr. Hammer agreed, and stressed that I was right to look for a large part of the revenue from fields which are not yet liable to PRT. The industry has however argued strongly that my objectives could be reached without introducing a permanent new tax: they suggest a "temporary levy" for 1981-82 off-settable against future North Sea tax, followed by discussions aimed at a radical reform of PRT. You will remember that this was Dr. Hammer's main point; and that he did not seriously, challenge our view of the taxable capacity of the North Sea.

5. US companies have argued this line particularly strongly in favour of a temporary levy since they believe - with some justification - that the new tax might exacerbate their existing problems in obtaining effective credit for PRT against US tax. They have also argued that any changes to the PRT reliefs of the kind I have in mind might prejudice the present US credit status of PRT under the double taxation treaty.

New tax

6. Since my November announcement, my officials and those of Department of Energy have reconsidered my new tax proposals on the basis of the latest North Sea economic indications and have analysed the industry's counter-proposals; they have also carried forward the review of PRT reliefs. In the light of their conclusions, and after consulting David Howell, I propose to introduce the new tax as first announced, at a rate of 20 per cent on gross revenues with an oil allowance of 1m tonnes/year. The tax will raise about an extra £1,000 million in 1981-82; somewhat less in later years.

7. You will know that we have been looking at ways of smoothing the PSBR over the year. As one contribution to this objective, I propose to provide for advance payment of the new tax in monthly instalments over the year. David is understandably concerned that this will substantially increase the cash flow impact of the new tax on the industry, but I believe there are overriding monetary policy arguments for starting the tax off on this footing. I have however told David that I agree that the advance payment machinery should be amended - after further discussion with the industry - to reduce the burdens on particularly hard cases. My officials are already considering possible ways to do this, short of changing the proposed pattern of payments. I also propose to invite the industry to discuss the possibility of smoothing PRT: it may well, however, be impossible to develop an acceptable scheme.

8. In response to the industry's call for a "temporary levy" I propose to introduce the new tax to apply in the first instance only to mid-1982. This will give the industry ample time to show how a "reformed PRT" might replace my proposals. And if, as I rather anticipate, they do not make out the case, then our present proposals can be put on a permanent basis.

?

9. As a further response to the industry's representations on the new tax, I propose to:

(i) exempt gas which is already exempt from PRT;

(ii) provide for the new tax to be repaid to fields which do not cover their development costs; and

(iii) relax the "PRT spreading" machinery - after further discussion with the industry - to ease the double taxation problem of US companies.

Review of PRT reliefs

10. My review was motivated by the belief that the PRT structure as it now exists has been overtaken by the radical changes in North Sea economics since PRT was introduced. In particular, the PRT reliefs do not now give adequate incentives to cost-effective investment. Apart from the risk of misdirection of the North Sea exploitation effort, this could lead to a substantial loss of tax in the longer run if not corrected now. More generally, the PRT reliefs in their present form are likely to give a degree of relief in the later years of some highly profitable fields that was never intended when PRT was introduced. Our consultations with the industry have, if anything, confirmed these conclusions.

11. I therefore propose the following changes to the PRT reliefs:

(i) "Uplift", which is given at 35 per cent as a proxy for interest relief, will no longer be given on expenditure incurred after a field is well into production. Such expenditure can be paid for out of current field cash-flow (to the extent that it is not paid for by immediate 100 per cent expenditure relief against CT and PRT): no proxy for interest is therefore justified;

(ii) "safeguard", which reduces the PRT charge by reference to the field's annual return on capital, will also be removed after the first few years of production. Safeguard mitigates the charge to PRT on fields which are slow to cover their costs, and insures fields generally against adverse changes in economics before the field has earned an acceptable return. There is no case on either ground for continuing the relief in later years of production long after the field has moved into profit.

I do not propose any changes to the remaining PRT relief, the oil allowance.

Yield

12. The whole package will raise about £1040 million in 1981-82 (in money-of-the-day) almost all from the new tax. This compares with a prospective yield of "about £1,000 million" announced last November. The net yield of the new tax will be substantially less than this in later years, but this fall will be partly offset by the effects of the changes to the PRT reliefs, especially in the longer term. The increased yield flowing from all these changes might be in the range £300 million to £500 million in 1983-84 (again in money-of-the-day) depending on the precise details of the PRT changes.

Industry response

13. The industry have made very little attempt to argue that my proposals are unjustified on grounds of "taxable capacity" and I do not think they will find it easy to mount such an argument after the Budget. They will no doubt continue to argue that my objectives could be better met some other way: introducing the tax initially for a limited period should effectively answer this. In the meantime, I can reasonably claim that my proposals have been significantly influenced by the industry's detailed representations.

14. I do, however, expect strong and continuing reaction from the US companies on the tax credit issues outlined in paragraph 5 above. So far as the ne w tax is concerned, I have considered the US companies' alternative - "advance PRT" - proposal carefully. But I conclude that it is distinctly inferior to the new tax, both in its immediate effects on cash flow for some fields, and in its longer-term usefulness as a tax instrument. Our response must be, I think, that any US tax credit problems are not, at bottom, of our making; they

cannot determine the shape of my proposals when the problems (which already exist) can reasonably be tackled some other way (i.e. by the "PRT spreading" provisions mentioned at paragraph 8(iii) above.

15. The US companies will also make much of the risk that the PRT relief proposals will put all PRT credit at risk: they have already enlisted the support of the State Department on this issue. There is a genuine risk that the US authorities will rule that PRT as amended is no longer a creditable tax: if and when they do so, we would be obliged to renegotiate the US/UK tax treaty, at some unquantifiable cost elsewhere.

16. David is concerned - as I am - about the possible political consequences of an adverse decision in due course (which might not be for some months) on PRT creditability from the US authorities. But I think it is clear that some quite radical changes in PRT are now unavoidable - even the industry agree on that - and therefore the credit status of PRT will inevitably come into question however we proceed. We have quite respectable arguments that the precise changes I propose do not change the basic structure of PRT. If we are to take this risk, as I think we should, the choice is between pressing ahead with legislation as planned, leaving it to the initiative of the US authorities to argue that PRT is no longer creditable; or putting the proposals formally to the US authorities for their views before any legislation, with no guarantee of a quick or favourable response.

17. David sees advantage in this latter course, with legislation - modified if necessary - following during the passage of the Bill. But I am doubtful whether the US authorities would respond in time for legislation this year; and if they gave an adverse response to my present proposals, I am not clear that it would be easy to modify them so as to retain creditability while still preserving the substance.

I therefore conclude that the alternative of immediate legislation is preferable, both because it will eliminate the distortions and loss of revenue we have identified that much sooner, and because it will allow the longer term revenue gains to score in the MTFS this year. If creditability of PRT does then become an issue we will - if the IRS rule against us - have to re-negotiate the tax treaty with the US Treasury, though possibly at a price.

Conclusion

18. I seek your agreement that we should introduce in this year's Finance Bill:-

(i) the new tax described at paragraphs 6 to 8 above, to have effect up to mid-1982 in the first instance; and

(ii) PRT relief changes on the lines set out in paragraph 11 above.

19. I am copying this to David Howell and - in view of the international implications - Peter Carrington.

P.S. Jenkin
for (G.H.)

20 February 1981
(Approved by the Chancellor and signed in his absence).

18/81

COPY NO. 1 OF 24 COPIES
Ch/Ex. Ref. No. B(81)14

(3)

5a

COPY No OF 17

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

20 February 1981

SECRETARY OF STATE'S OFFICE
TO Mr Guinness-1 MOS-2 PUSS/MR LAMONT-3 PUSS/MR MOORE-4 PUS-5 MR T P JONES-6 MR D JONES-7 MR TUCKER-8 MR SPAIN-9 MR PRIDDLE-10 MR MORPHET-11 MR HERZIG-12 MR PRICE-13 MR HOUSTON-14 15,16,17-P/O
FOR
DRAFT
APPROVAL
PLEASE BY: 11 a.m. 23/2/81

R 23/2

J.D. West Esq.,
Private Secretary
Department of Energy

Dear Julian,

ENERGY AND THE BUDGET

The Chancellor of the Exchequer has seen your Secretary of State's letter of 13 February and he has asked me to let you have his initial reactions.

(i) He agrees that the EFLs of BGC and the electricity supply industry should be raised by up to £65m and £45m for 1981-82 respectively. The consequent moderation in gas and electricity prices for large users will go some way to meet the inevitable outcry from industry following publication of the NEDC Task Force Report. But it seems most unlikely that the moderation in pricing policy will satisfy industry. Clearly the Government cannot accept a policy of pricing UK energy down to Continental levels regardless of economic pricing principles. We cannot sell electricity, for example, at a loss. But the Chancellor wonders whether there could be rather greater moderation in pricing policy, particularly in the case of electricity, for the industrial consumers referred to in the Task Force Report, if additional money could be found. He therefore would like your Secretary of State's views on, and suggestions for, a possible package for gas and electricity prices costing up to £200m. This sum would have to cover any consequential effects for electricity prices in Scotland. Could your officials be in touch with the Scottish Office in order to bring them up to date with developments.

(ii) The Chancellor is most reluctant to make any reduction in the HFO duty because of effects of the Frigg contract. But before coming to a final decision, he would like your Department to consult the Law Officers to confirm that there is no legal solution to the impasse.

Treasury officials have already warned your Department's officials about (i) and (ii) above.

/(iii) The Chancellor

(iii) The Chancellor understands that your Department sees problems in taking account in the Budget forecast for the PSBR £200m for certain Eighth Round licenses. The Chancellor, while recognising the uncertainties, hopes your Secretary of State can reconsider this and let him have a favourable reply. If £200m cannot be taken into account, the Chancellor considers that credit should be taken for at least £100m; this would make it much easier to go ahead with somewhat larger energy price reductions.

2. The Chancellor would be grateful for a response by 4.30 p.m. Monday 23 February.

Yours

John

A.J. WIGGINS

bc Mr. Wolfson

SUBJECT.

cc. Master set.

10 DOWNING STREET

From the Private Secretary

20 February 1981

Dear Tim,

Indirect tax package

As you know, the Prime Minister discussed the proposed indirect tax package (your letter of 19 February refers) with the Chancellor and Sir Douglas Lovelock this afternoon.

The Prime Minister raised the question of whether there might be some shift from the increase in petrol and Derv duty to VED. She thought that, for example, a duty change on petrol and Derv which would result in a price rise of 18p per gallon together with a VED increase of £15 might be more acceptable politically than the increases proposed.

The Chancellor explained that he had discussed the balance between petrol and Derv and VED with the Minister for Transport who had argued on political grounds that any shift to VED on the lines suggested by the Prime Minister would be more difficult. But he would consult him again if the Prime Minister wished.

The Chancellor did so consult Mr. Fowler subsequent to the meeting, and they both concluded that it would be better to stick with the existing proposal. I reported this to the Prime Minister who said that she was content.

Yours ever,

Tim Lankester.

A.J. Wiggins, Esq.,
H.M. Treasury.

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-233 3000
Direct Dialling 01-233 5728

T P Lankester Esq
10 Downing Street
London S.W.1.

20 February 1981

Dear Tim,

CBI: COMMENTS ON THE STOCK RELIEF DOCUMENT

I understand that the Prime Minister is seeing Sir Terence Beckett about lunchtime today.

2. You should be aware that the CBI will be publishining on Sunday a paper commenting on the Government's proposals on stock relief in extremely hostile terms. At points, they seem to call in question not only the Government's judgement but also its good faith.

3. I attach copies of the document, with some of the most difficult passages sidelined. (Since we saw this copy, I understand that the CBI have made a number of minor changes in the document - but not sufficient to alter its general impact.)

4. The Chancellor very much regrets the tone in which the CBI have commented. On the substance of the proposals, the Chancellor has already written to the Prime Minister; and as you know he does in practice intend to meet the CBI on the point of substance that worries them most - the credit restrictions, but the tone in which the CBI have commented makes all this much more difficult than it ever needed to be.

5. The Chancellor is arranging for the Press to be briefed on a number of the points in the CBI paper which are factually mistaken, misleading or self-contradictory.

6. The Chancellor is speaking to Sir Terence Beckett before he sees ~~you~~ the Prime Minister.

Yours

John

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

February 1981
£2.00

Report by CBI Taxation Committee

E 40 81

CBI PUBLICATIONS

A

THE REFORM OF STOCK RELIEF

THE REFORM OF STOCK RELIEF

INTRODUCTION

On 14 November 1980 a Consultative Document was issued by the Inland Revenue describing in some detail a new system of stock relief for businesses which the Government proposes to introduce in the 1981 Finance Bill. Since stock relief was first introduced in the UK in 1975 it has been an important feature of the way in which business profits are taxed, with major financial implications for business and Government: roughly, it has so far reduced the tax that would otherwise have been paid on profits by £10 billion. So the new proposals are of considerable importance in their own right for businesses, both incorporated and unincorporated.

But they have even wider implications than may appear at first sight. In paragraph 2.7 of the Consultative Document it is stated that

> "the Government see the scheme proposed ..... as consistent with the direction in which they would hope to see the corporation tax itself develop;"

a wide-ranging Green Paper on the structure of corporation tax is promised in due course. An appraisal of the new proposals therefore needs to examine not simply whether they add up to a system of stock relief that is clearly superior to the present one, but also whether the same sort of changes to other aspects of the taxation of business profits would be desirable.

Stock relief is a rather technical subject, and this review of the Government's proposals is inevitably rather technical too. It assumes on the reader's part some familiararity with the present system of business taxation and stock relief, and also with the proposals contained in the Consultative Document. Throughout the paper, references in brackets are to paragraph numbers in the Consultative Document.

CONTENTS

I THE PRESENT STOCK RELIEF SYSTEM

In its essentials the system of relief which was introduced in the 1975 Finance Act is extremely simple. It allows the individual business to deduct from the profits on which tax would otherwise be payable any increase in the book value of its stocks during the relevant accounting period, less a fraction of its trading profits after deducting capital allowances. For the business sector as a whole, "this (profit) restriction was designed as a rough and ready means of excluding the annual average increase in stock volume" from relief (CD 3.2). In other words the present stock relief was introduced as a means of removing from the tax base, for the business sector as a whole, the element of stock appreciation which is included in conventional historic cost profits when stocks are valued on a First In, First Out basis as in the UK.

The CBI is proud of the part which it played in the years 1974 and 1975 in pressing for and helping to design this system of relief. Admittedly it contains a number of anomalous features, which we shall look at shortly. But at the time British business faced a serious crisis of liquidity and profitability. In our view the inclusion of stock appreciation in the "profits" on which tax was payable was a major factor contributing to that crisis, and a quick and simple solution was needed. We recognised that improvements would need to be made to the original system. But we have always taken the view that relief, in one form or another, on stock appreciation should be a permanent feature of the system of taxation of business profits in the UK. We therefore welcomed the commitment made by the previous Government in 1978 that this would be so.

I.1 BROAD EFFECTS ON THE COMPANY SECTOR

Under the present system companies have received relief related to their stock appreciation in each calender year from 1973 onwards. Roughly speaking this relief has been obtained in the following financial year (April to March). The table below summarises our estimates - in some cases extremely rough - of how relief has been related to stock appreciation for the company sector as a whole during the first seven years of the scheme's operation. The table gives all figures at 1980 prices as well as in terms of "money of the day", since the purchasing power of the pound was about three times as great in 1973 as in 1980.

STOCK APPRECIATION AND STOCK RELIEF:
SUMMARY STATISTICS FOR INDUSTRIAL AND COMMERCIAL COMPANIES

		Current prices (£b)	1980 prices (£b)
Calendar years 1973-79:			
1	change in book value of stocks	36.4	63.1
2	of which, (a) volume change	5.7	9.8
3	(b) stock appreciation	30.6	53.3
Financial years 1974/5-1980/1:			
4	stock relief - (a) allowed for tax	18	31
5	(b) still being carried forward	10	10
6	(c) total	28	41
7	relief removed by the profit restriction	9	13

A number of important conclusions can be drawn from the rough figures shown in this table. First, in terms of current prices, the amount of relief allowed to companies and either already claimed against tax or carried forward (about £28b) has very nearly matched the relevant stock appreciation in the same period (£30.6b).

However, when a relief cannot immediately be claimed against tax it declines in value with inflation; and about one-third of the stock relief claimed by companies in this seven year period had not been set against tax by the end of the period. So in terms of a common unit of account the amount of relief allowed to companies has fallen short of their stock appreciation to a significant extent - by about £8b at 1980 prices. (As Appendix 2 of the Consultative Document shows, this erosion is not confined to stock relief: it also has a very serious effect on the relief that is given for capital expenditures.)

Finally, the table suggests that the extent to which companies' stock relief has been reduced by the profit restriction may well have been somewhat greater than the corresponding change in the volume of stocks, whether measured at current prices or at constant 1980 prices. Taken on its own this conclusion would suggest that the present 15 per cent profit restriction for companies should be reduced to about 10 per cent. But there is a good deal more than this to be put right with the present stock relief scheme.

I.2 PROBLEMS WITH THE SYSTEM

I.2a Arbitrary Incidence

The most obvious anomaly inherent in the present system is that, whatever may be the position for businesses taken together, the amount of relief that it gives to individual businesses often bears very little relation to the stock appreciation which they actually experience. Other things being equal, businesses with high trading profits (after deducting capital allowances) are denied relief not only on any change in their stock volume but also on some part of their stock appreciation. Conversely, other businesses receive relief on some part of a change in stock volume as well as on the full amount of their stock appreciation. So the scheme has come to be widely regarded as arbitrary and unfair in its incidence. A fundamental criterion in assessing any reform must be whether it would distribute relief more closely than at present in accordance with the stock appreciation experienced by individual businesses.

I.2b Effect on Stock Levels

The present system can encourage businesses in certain circumstances to engage in artificial transactions in order to secure a tax advantage. Such "manipulation" could take quite a wide variety of forms. For example, a simple purchase of stock at the end of an accounting period followed on the next day by a sale will attract relief on the full amount of the purchase (unless it falls foul of the profit restriction). Admittedly this relief would be recovered by the Inland Revenue in the next period, if the same manoeuvre were not repeated. But the business would nevertheless have benefitted from its interest-free use of the tax saved for one year. In general this kind of artificial stock manipulation has probably been on a very small scale, but it is clearly undesirable that businesses should be given an incentive to undertake it.

The basic reason for this particular feature of the present scheme is that it provides relief according to the position of a business on a single balance sheet date. A rather different sort of manipulation might be undertaken to exploit the arbitrary nature of the profit restriction. A business which expects its stocks to grow in value over a period of years could in principle vary the timing of its stock purchases to minimise the effect of the restriction on the stock relief which it is able to claim: usually, purchases of stock would be made more irregularly as a result.

Rather more importantly, it has often been suggested that the present stock relief scheme provides an inducement to businesses to build up stocks to a level that is higher than they would otherwise have chosen on a broad commercial judgment. This suggestion is repeated, rather uncritically, in the Consultative Document (CD 2.3).

It has been subjected to thorough professional analysis since the scheme was first introduced, and does not appear to be well-founded. Obviously, the incentive to hold stocks will be greater at present than it would be if tax were still to be levied on historic cost profits without deducting the element of stock appreciation. But such a tax system involves an artificial discouragement to business investment in stocks, to an extent that depends arbitrarily on the rate of inflation. Indeed a very important element in the case for stock appreciation relief in one form or another is the fact that it is necessary to remove this artificial discouragement.

I.2c "Clawback"

Under the present system relief given in past years is recovered when the business's stock value falls. This feature has created a number of difficulties, and several important modifications have been made to it (notably the provision in the 1980 Finance Act allowing businesses to defer a part of a recovery charge for one year in certain circumstances). But the reality of "clawback" charges remains. They are a particularly serious threat to many businesses in the present recession: on average, stock prices have risen little faster during the last year than the rate at which stock volumes have fallen, so average stock values have been stagnant; for a large number of businesses they have fallen very sharply.

In this situation, "clawback" of stock relief threatens to raise the effective rate of tax on business profits at precisely the stage in the economic cycle at which it is most desirable, from a macroeconomic standpoint, for funds to be left in businesses to sustain their investment programmes. Unless a satisfactory solution to this problem can be found the present recession will be quite unnecessarily accentuated by the tax system.

II THE GOVERNMENT'S PROPOSALS

It is most convenient to describe and analyse the proposals set out in the Consultative Document in two distinct parts. Each represents a radical departure from the present system.

The first part is what may properly be called the "basic relief." In essence it would be extremely simple. For each accounting period, the relief would amount to the opening value of stocks after the first £2,000 times the proportional change during the accounting period in a single index of the prices of business stocks - the "all stocks" index, which is now being prepared by the Government Statistical Service. This relief would only be recovered in subsequent years "where a business is discontinued or there is a permanent and substantial reduction in the level of trading" (CD 4.2d).

The second part of the proposals consists of a "credit restriction". The simple basic relief would be reduced, for companies or groups of companies with opening stocks exceeding a certain value, by the ratio of total borrowing to total assets as shown in the balance sheet of the company or group.

II.1 THE BASIC RELIEF

The sections that follow examine the extent to which the proposed basic relief would overcome the real problems that have been experienced with the present scheme.

II.1a Abitrary Incidence

The question that needs to be answered here is whether the proposed basic relief would correspond more or less closely than the present stock relief, at the level of the individual business, with its stock appreciation - or more strictly, its cost of holding stock.

At the outset one must recognise that the meaning of the phrase "the cost of holding stock" is not self-evident. How that cost should be measured is an issue that has been thoroughly debated by accountants and others, particularly during the last decade, and a wide variety of views has been expressed. This is not the place for a review of the debate, but some aspects of it are relevant. They can be illustrated by means of a simple example.

Suppose that a business held an item of stock at the beginning of an accounting period valued then at £100, that it holds an identical item of stock at the end of the accounting period, and that during the accounting period

(1) the general level of prices in the economy (as measured, for example, by the Retail Prices Index) rose by 10 per cent;

(2) the average price of business stocks rose by 20 per cent; and

(3) the replacement cost of the item in question rose by 50 per cent.

What then was the cost to the business of holding that item during the period?

Three answers might be suggested on the basis of the figures given in the example. The first answer - £10, based on the change in the general price level - would be given by advocates of Current Purchasing Power (CPP) accounting. This answer was thoroughly examined by the Government-appointed Sandilands Committee in the early 1970's and rejected in its report in 1974, for reasons that do not need repetition here. A possible second answer - £20, based on the change in the average price of stocks - is the basic relief that would be given under the Government's proposals, although this answer has not been seriously advocated by any participant in the debate. The third answer - £50, based on the actual change in the replacement cost of the item in question - is the one given by the Sandilands Committee and in March 1980 by the Accounting Standards Committee in its Statement of Standard Accounting Practice no. 16 on Current Cost Accounting.

Our question, then, is a simple one: for individual businesses, would a relief based on the Government's proposals tend to be a closer approximation than the present stock relief to what the ASC has now determined to be the true cost of holding stock?

Three separate points need to be made here in response to this question. The first is that the answer is not self-evident. It is remarkable that the Consultative Document gives no indication at all that the Government, which alone has the information on which to base a reasonably authoritative judgment, has even asked itself the question.

The second point is that our guess is that the answer to the question is probably, in most cases, "yes". On that unsatisfactory basis we judge that the Government's proposed basic relief is probably some improvement on the present stock relief.

But the third point is that this improvement could quite obviously be made very much greater if the relief were to be based, not on a single index, but on a variety of indices reflecting more closely the price movements of stocks held by individual sectors and industries in the economy. We accept the Government's judgment that the cost of holding stock as calculated according to SSAP16 is not, at least for the time being, a practical basis for the relief (CD 5.14). We also accept that a relief based on a variety of indices would be somewhat more complicated than a relief based on just one (CD 5.19). But a proper balance needs to be struck between complexity and fairness.

II.1b Effect on Stock Levels

On average the proposed basic relief would differ very little from the present scheme in its effect upon the incentive to hold stocks. At present when a business decides to increase the value of the stocks that it holds by a given amount it typically receives relief on that amount in the first period, and that is the end of the matter. With the proposed basic relief, it would instead receive a series of reliefs, depending on the behaviour of the all stocks index. If those expected future reliefs were to be discounted to the present at the rate of increase of the all stocks index, their sum would be about the same as the relief that is now obtained.

There would, however, be very significant effects on the incentive to hold different kinds of stocks. Compared with the present position, businesses would be discouraged from holding stocks that are expected to rise in price more rapidly than stocks in general: stocks of oil and some other primary commodities are examples. And they would be encouraged instead to hold stocks of things such as electrical goods which could reasonably be expected to rise in price more slowly than stocks in general. The reason for this is that the expected relationship between stock appreciation and relief obtainable would vary systematically between different kinds of stock under the proposed basic relief. This undesirable variation would of course be weakened to the extent that the relief could be based on more than one index of stock prices.

II.1c "Clawback"

Undoubtedly the main advantage that the proposed basic relief has over the present scheme is that it removes the threat of new recovery charges from businesses with accounting periods ending after 14 November 1980. As noted earlier, it does not remove "clawback" entirely, and the proposed retention of such charges in the event of liquidation or substantial reduction in business activity is rather odd: a relief for stock appreciation that is based on opening book value inevitably gives too little relief when book value rises and too much when it falls, but stock appreciation is not transformed into something else by a reduction in the scale of trading.

II.1d An Assessment

On balance our conclusion is that the basic relief proposed in the Consultative Document represents a very modest improvement over the present stock relief scheme, and that such benefits as are to be expected from this reform are particularly important at the present time when perverse clawback charges threaten many businesses. For this reason we welcome the Government's intention to introduce some reform along these lines in the coming Budget.

But the particular reform proposed, even if it is confined to the basic relief discussed so far, cannot be a long-term solution to the problems of stock relief. With a single index the reality of arbitrariness and unfairness would remain. Indeed, now that expectations of a better system have been raised, awareness of these problems will be intensified. As a long-term measure, such a reform would be judged a tragically wasted opportunity.

II.2 THE CREDIT RESTRICTION

When the opening book value of stocks held by a company or group of companies exceeds a certain figure - which the Consultative Document suggests might be £1.002 million (CD 6.16) - it is proposed that the maximum relief should be reduced by the ratio of total borrowing to total assets as shown in the balance sheet of the company or group. Virtually all the complexities contained in the Consultative Document, and the difficult questions which it raises but leaves unanswered, stem from this particular proposal: from the limited discussion of those questions it is clear that a very large number of extremely complicated provisions would be necessary to give practical effect to the proposal, in one form or another, in the context of groups of companies. We believe that the theoretical arguments used to justify the restriction are untenable and that such a restriction would have extremely damaging effects upon the business sector as a whole.

II.2a Theoretical Justification

Two arguments are advanced in the Consultative Document for relief to be restricted according to the extent to which stocks (and other assets) are financed by borrowing. They are both stated rather briefly, and deserve to be cited in full.

The first argument is stated twice, in the following terms:

> "Relief is given under the present scheme without regard to whether stock is being financed out of credit or other borrowings. Large amounts of relief have been available to businesses which have in practice financed their stocks by trade credit, including businesses in the retail trade which in some instances will even have sold their stocks before payment for them becomes due. In cases of this kind, businesses have been receiving relief for inflationary costs that they themselves have not had to bear." (CD2.4)

> "To the extent that a business finances its stocks by trade credit or some other form of borrowing it does not itself directly bear the effects of inflation on the value of those stocks. On the contrary, it benefits from the falling real burden of its debt." (CD 6.3)

This argument confuses a number of different questions, which need to be sorted out. To begin with, suppose that a retailer (R) pays its supplier (S) immediately on purchase and typically holds items in stock for three months, during which their replacement cost rises. In this example the case for stock appreciation relief to be given to R is straightforward and the Consultative Document does not call it in question.

Now suppose that R does not pay S until the items are finally sold. The same stock appreciation has taken place, and the case for allowing relief for tax remains unaffected. The question that arises however is whether relief should be given to R (as under the present scheme) or given instead to S (by extending the relief to trade debtors, and subtracting creditors). In other words, the issue is the distribution of relief for a given amount of stock appreciation, not the total amount of relief to be given - which is what would be altered by the proposed credit restriction.

The next question to be raised is whether this distributional issue is really a very important one. In practice one would expect in a competitive situation that the terms on which S extends credit to R in respect of a given amount of stock will fully reflect the tax treatment of that stock. There is a very close parallel here with leasing. Some years ago it was often asserted that lessors were "unfairly" benefitting from being able to claim 100 per cent first year allowances on plant and machinery which they were not themselves operating. By contrast, it is now recognised that virtually the whole of this "benefit" is passed to the users of the equipment in the leasing rate, and that the incentive for businesses to use equipment is therefore about the same - as it should be - whatever their present tax positions.

A third question, which at this stage of the argument is something of a red herring, is whether businesses really do "benefit" from a falling real burden of debt in times of inflation. Inflation certainly erodes any debt that is fixed in nominal terms. But borrowers are charged for this by means of nominal interest rates that are higher than they would otherwise be. With nominal interest rates now well above the current and expected future rate of inflation, it should be quite clear to Government - as it is to businesses - that there is no net "benefit" at all.

We must turn now to the second argument in the Consultative Document, which is slightly more sophisticated. It is expressed in the following terms:

> "There is an important link between the tax treatment of the effects of inflation on stocks (and other assets) and on interest. Under present tax rules, a business is allowed a deduction for the full cost of its interest payments, including not only the element which might be said to represent a "real" rate of interest, but also the excess which is attributable to inflation. It would be quite wrong in principle to allow the full amount of all interest as a deduction for corporation tax purposes while at the same time giving relief for the effects of inflation on stocks without any adjustment for credit or other borrowings. To do so would be to give relief twice for what in effect was the same inflationary cost." (CD 6.4)

The initial steps in this argument are unexceptionable. Excessive relief would indeed be given by the tax system if the appreciation of stocks (and other assets) and the nominal interest payments financing the holding of these assets were both fully deductible for tax, and that were the end of the matter. But that is not the end of the matter. At present lenders pay tax on their nominal interest receipts (including the element of repayment as well as "real" interest), and this unjustifiable liability roughly matches the excessive relief given to borrowers. Once again, the market system tends to adapt (in this case by an increase in market interest rates) in such a way as to cancel out the excessive relief on one side and excessive liability on the other.

What emerges is that one cannot separate discussion of the appropriate tax treatment of borrowing from that of lending, as the Consultative Document seeks to do. A fortiori one cannot argue that a questionable tax treatment of borrowing justifies a reduction in the amount of stock relief given, not just to individual businesses but to the business sector as a whole.

II.2b Practical Consequences

Under the Consultative Document proposals the extent to which a business would receive relief on stock appreciation (as measured by the all stocks index) varies rather dramatically at the margin, depending on the ratio between its total borrowing and total assets. For example, where this ratio is 40 per cent (which is probably around the average for business as a whole), the extent of the proposed stock appreciation relief on additional opening stocks is as follows:

up to £2000	:	0 per cent
£2000-£1.002m	:	100 per cent
£1.002m-£1.669m	:	0 per cent
over £1.669m	:	60 per cent

According to the Consultative Document, about 90 per cent of the amount of stock relief under the proposed scheme would be affected by the credit restriction and would thus receive relief at something less than the full rate (CD 6.17).

The implication of this extraordinary variation in the proposed marginal rates of relief is that the total amount of relief received by business on a given amount of stock appreciation would depend on the particular distribution of both stocks and borrowing between businesses. The result would be arbitrariness, unfairness and scope for manipulation out of all proportion to the scale of these problems under the present scheme.

A very large number of specific examples of these potential problems has been reported to us, and to the Government, by individual businesses. As just one example of the effects that the restriction would have, it may be noted that it would substantially increase the effective cost of borrowing for many businesses: when more is borrowed (say, to finance additional investment) the credit restriction would rise and less relief would therefore be received on a given amount of stock. With "real" interest rates at their present penal levels, it is very hard to see how such a change could be contemplated.

II.2c An Assessment

The proposed credit restriction is theoretically indefensible and would have extremely damaging practical consequences for the business sector. We made essentially these same points to the Government when it introduced a similar restriction into the Finance Act 1980 provisions allowing a partial deferment of stock relief recovery charges. It is sad that so little notice has been taken of these points.

II.3 FINANCIAL CONSEQUENCES FOR THE COMPANY SECTOR

The Consultative Document is remarkably vague about the financial consequences of the introduction of its proposals. Most of the information on which reasonably reliable judgments could be based is available at present only to Government. In the last few months we have made a number of formal and informal approaches to the Government in an effort to obtain information on which to base firm conclusions, but very little has been released: even the amount of stock relief allowed to businesses since the present system was introduced has had to be estimated indirectly, since the Government has chosen not to release the true figures. So the sections that follow will be almost as vague as the Consultative Document itself. Nevertheless there are some things that can be said confidently, and that need saying.

II.3a Aggregate Effects

The aggregate effects on companies are best considered in two stages - the immediate effects in the financial year 1981/2, and the longer term effects.

It has been reliably reported that the Government estimates that introduction of the Consultative Document proposals as they stand would reduce companies' tax bills in 1981/2 by very roughly £300 million. That estimate reflects the widespread de-stocking which occurred in 1980, which would entail recovery charges for large numbers of businesses (particularly in the Distribution sector) if no changes were to be made to stock relief in the coming Budget. That de-stocking is now past history, and £300 million seems to us a reasonable estimate of the aggregate benefit to companies in 1981/2.

It has also been suggested, informally, that companies could gain a similar amount from the new proposals in 1982/3. We believe that this suggestion is thoroughly misleading misleading and that it could not be defended in public as an estimate based on reasonable assumptions.

A much more important question, however, is what the aggregate financial effects would be for companies in the longer term, taking one year with another. One way of approaching this question, using the Inland Revenue's corporation tax computer model, would have been to compare the relief actually obtained by companies from the present scheme since it was introduced with what would have been obtained if relief had been based instead on the Consultative Document proposals. An alternative approach would have been to simulate the effects on the model of the present scheme and the new proposals using a variety of reasonable assumptions about the longer term behaviour of stock volumes and stock prices.

It is not clear from the Consultative Document that either of these exercises has in fact been carried out. But it is reasonably clear that they would show that in the longer term the company sector as a whole would obtain substantially less relief from the proposed new scheme than from the present one.

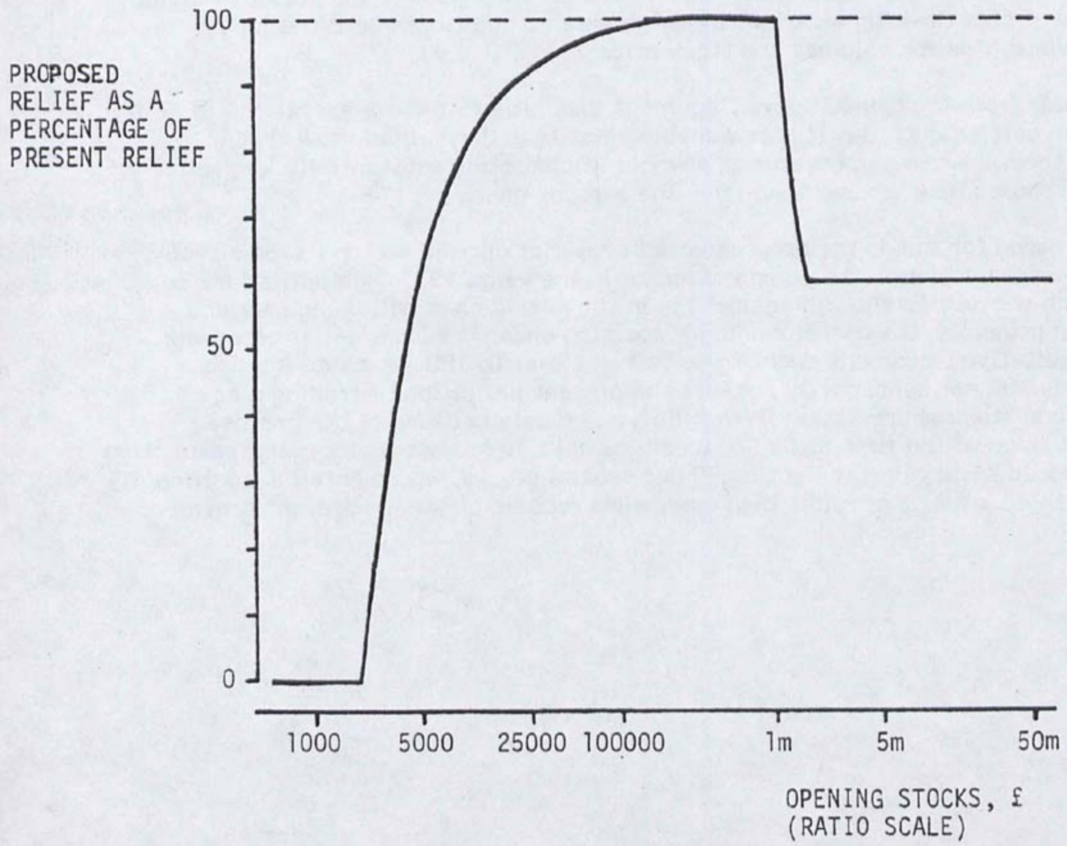
The main reason for this is the proposed credit restriction. As we have seen already, most stock appreciation in the company sector in the years 1973-79 qualified for relief, which was either allowed against tax in the period or is still being carried forward. In principle, the corresponding proportion under the basic relief proposed in the Consultative Document ought to be rather closer to 100 per cent - though not precisely 100 per cent, partly because the present definition of trading stock excludes some stock appreciation from relief, and partly because of the proposed further exclusion of the first £2,000 of trading stock. It follows that a major restriction of the proposed basic relief, affecting 90 per cent of stocks, would entail a significantly lower aggregate amount of relief than companies receive under the present scheme.

At this point it is appropriate to mention a further restriction that is suggested in the Consultative Document, though it seems wholly unrelated to the main thrust of the proposals - namely the cancellation of unused relief after six years (CD 5.33). The fact that relief is eroded by inflation when it has to be carried forward is a serious weakness of the present stock relief scheme, as it is of other important reliefs against corporation tax and income tax. To make the erosion complete after a certain length of time is not an answer to this problem.

II.3b Distribution of Relief Between Businesses

As well as reducing the scale of relief for the business sector as a whole in the longer term, the Consultative Document proposals would entail a significant redistribution of relief between individual businesses. We have already commented in general terms on some aspects of this redistribution. Insofar as it would achieve the object of aligning each business's relief more closely with its stock appreciation we welcome it in principle, even though some businesses must lose what others gain, and all must pay the price of an upheaval to the system. But there are some aspects of the proposed redistribution that require more specific comment.

First, it is proposed that relief should be redistributed, other things being equal, according to the value of stocks held - and in a rather peculiar way. Consider a business which is reasonably close to the average, in that the relief which it obtains under the present scheme corresponds to the amount of its stock appreciation, its stocks rise in price at the average rate, and its borrowing/asset ratio is 40 per cent. The diagram below illustrates the way in which the relationship between its present relief and that obtainable under the Consultative Document proposals will vary, depending on the value of its opening stocks.



It is clear from this diagram that the greatest losers from the Government's proposals, other things being equal, would be the smallest business as well as the largest - the latter because of the credit restriction, and the former because of the exclusion of the first £2,000 of trading stock. We do not believe that the case for a de minimis provision has been adequately made out (CD 5.26); certainly, a defensible provision would not be an exclusion applying to all businesses irrespective of their size, with the distributional consequences illustrated in the diagram.

The second distributional point to be made concerns the proposed transitional provisions. With any reform of this kind it is inevitable that some businesses will be better off and others worse off, given the way they behave after the proposals are announced. But under the Consultative Document proposals businesses could also be worse off as a result of the way that they behaved before the proposals were even published. For accounting periods straddling the 14 November 1980 publication date, it is proposed that companies be given a choice between the new relief, and relief under the present scheme for stock value changes up to that date less 25 per of the new relief. This restriction is said to be necessary "to avoid placing on either businesses or tax offices a disproportionate administrative burden "(CD 9.12). Those businesses affected would, we think, be content to bear some administrative burden to obtain a relief to which they can reasonably consider themselves entitled. This burden could be moderated more fairly by moving the introduction of a reformed scheme - as an alternative to the present scheme, in the transitional period - back to a more sensible starting date.

III CONCLUSIONS

The Consultative Document proposals are flawed in principle in two fundamental respects:

1 The credit restriction should be dropped.

2 The single index should be replaced by a variety of indices, so as to give a better balance between simplicity and fairness.

The other points in the proposals which need to be changed are as follows:

3 The exemption of the first £2,000 of trading stock should be removed, and replaced - but only if an adequate administrative case can be made out - by a fairer de minimis provision.

4 There should be no "clawback" of the new relief.

5 In the transitional period, the proposed reduction in the maximum relief obtainable under the present scheme by 25 per cent of that obtainable under the new scheme should be dropped.

6 Further measures - such as a back-dating of the start of the new scheme - should be introduced to ease the problems of the transition.

7 There should be no cancellation of unused relief.

8 There should in the forthcoming Green Paper on the future of corporation tax be a thorough consideration (among other things) of the appropriate treatment of borrowing and lending, which could justify an extension of the relief to trade debtors.

We are aware that some of these points are rather fundamental. That is inevitable: a proper discussion of the reform of stock relief could only take place in the wider context of a discussion of the future of corporation tax. We deplore the fact that the promised Green Paper has not yet appeared. Business is impatient to see what it contains. And when it appears, there must be an opportunity for the fullest possible consideration and public discussion. There must be no repetition of the present exercise on stock relief, in which a badly considered set of proposals has been put forward as a package, with wholly inadequate time allowed and information provided for analysis and considered response.

The future of corporation tax is important. It deserves to be taken as seriously by Government as by business.

4

20 February 1981

PRIME MINISTER

BUDGET STRATEGY

It is, of course, easy for us to prescribe a tough Budget, when we don't personally have the responsibility for presenting it. Nevertheless, we believe that a Budget which fails to intercept the ominous trend in PSBR will spell the end of the Government's economic strategy; while a Budget which succeeds is not unsaleable and would set us on the right road for the next Election. Some comments:

1. PSBR IS ALREADY LOOKING WORSE

1.1 When we discussed Budget strategy with you last week, the Treasury team agreed with our forecast that the "present assumptions" PSBR of over £13bn would continue to get worse.

1.2 Since last week, it already looks as if we shall need about £200m more for NCB, and another £400m-odd for British Steel, depending on the £-DM rate. Another £150m has just cropped up for BT in the current year, and we understand that this will also mean more for 1981-2. If we assume more bad news on Rolls Royce, British Rail, British Leyland, ICL, public services pay, unemployment, the numbers are going to keep on growing.

2. MID-YEAR FUNDING CRISIS: CATASTROPHE OR OPPORTUNITY?

2.1 Last week, you and Geoffrey argued that a mid-year funding crisis would be an opportunity, not a problem, because it would allow us to make further cuts which would not otherwise be possible. In other words, the worse the problem, the more surely it would solve itself. Does our experience of PSBR overshoot in 1980/81, and the last round of cuts, bear that out?

Hardly

2.2 We simply cannot see how a funding crisis could work out well in practice. Total failure of policy can't be good news. Colleagues will argue that your economic strategy, after three Budgets, has finally come unstuck. The choice will then lie between a further increase in MLR (leading to more bankruptcies, even higher unemployment and yet greater PSBR strains as a result); or letting money supply take the strain which would once again be quickly reflected in increasing interest rates, as the market discounted accelerating inflation (which would, of course, come through as the Election approached). Cabinet would choose the latter course, when your own credibility was at its lowest.

2.3 LET US BE BLUNT. A BUDGET THAT CAUSES A MID-YEAR CRISIS MEANS CERTAIN FAILURE. IT IS WISHFUL THINKING TO IMAGINE THAT IT COULD BE AN OPPORTUNITY. BECAUSE CERTAIN FAILURE IS "UNTHINKABLE", WISHFUL THINKING TAKES OVER.

We believe there is an alternative strategy for success.

3. IF A TOUGHER BUDGET IS RIGHT, IT MUST BE SALEABLE

3.1 It was the possibility of a hostile press reaction to a deflationary Budget which seemed to concern you most last week. But honest money requires an honest Budget. We believe that such a Budget would not be as difficult to sell as at first sight appears:

No

(a) It should be presented as an enterprise/employment/recovery package. Everyone in work contributes to meet the heavy costs of recession. Public service pay and nationalised industries should bear their share of the blame. Social security costs are heavy, but that is what the welfare state is for at a time of recession. The key to recovery is the reduction of interest rates and, hopefully, the exchange rate. That is the only way that the business sector - the only provider of jobs that create rather than consume wealth - can begin to recover.

(b) As you have already suggested, the withdrawal of the pit closure plan will inevitably affect the Budget. That is one of the pegs on which to hang a tougher Budget. It is a perfect opportunity - the opposite of a U-turn - for the Government to reassert authority and regain control of events. (Opinion research last summer showed that people do not regard sensible and necessary action as a U-turn. The only thing that would be seen as a U-turn, the research showed, would be deliberate increases in public spending to win electoral popularity.)

(c) The colleagues would have to accept a tough Budget, since they were not able to find more expenditure cuts, and they all know that industry must get lower interest rates and a lower exchange rate, if it is to recover.

(d) We know, from the 1979 Budget, the likely RPI effect on the pay round if we load too much onto indirect taxes. And we know the "tax net" effects of too big a cut in Rooker-Wise. Increases in direct tax rates should not only be "thinkable"; they will also be seen as fair and honest in hard times.

3.2 We should not underestimate the maturity and commonsense of the public, back-benchers and commentators. If we ensure that they understand the box into which world recession, nationalised industry performance and public service pay have driven the Government over the past year, then they should welcome a Budget which points a way out of that box; a Budget which may appear deflationary in terms of consumption, but which allows early fall in interest rates and the exchange rate, a consequent recovery of business activity and thus a gradual unwinding of the whole tangle of recession-linked problems. Do we seriously think that, after proper explanation, back-benchers would revolt and force an early Election?

3.3 If we believe that this is the right way out of the maze, surely we can explain it, and keep on explaining it, until the commentators are persuaded. If we don't think that this is the right way, then of course that is another matter, but this was not the conclusion we seemed to reach during our discussions. The conclusion we reached was that it was the right thing to do but that it was politically impossible to do it.

4. THE BUDGET IS THE TURNING POINT

4.1 We remain convinced that this Budget is the turning point. Whichever way we go, it will be a rapidly self-fulfilling prophesy. If the Budget fails to take care of the PSBR, we shall be locked almost immediately into a vicious circle from which there will be no escape.

If it succeeds in intercepting the PSBR, even to the extent of overkill, we shall be quickly into a virtuous circle of falling interest rates, restoration of confidence and renewed activity.

4.2 IN SHORT, WE BELIEVE THAT THE BUDGET PRESENTED ON 10 MARCH WILL LARGELY DETERMINE WHETHER WE WIN OR LOSE THE NEXT ELECTION.

We are copying this minute to Geoffrey and are, of course, available if you want to discuss it over the weekend.

ALAN WALTERS DAVID WOLFSON JOHN HOSKYNS

ECON POL

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1P 3AG

20 February 1981

TAXATION OF TOBACCO

I am writing to say that I share the view expressed by Patrick Jenkin in his letter of 12 February that there should be a substantial increase in tobacco taxation.

In terms of the incidence of smoking-related diseases Scotland's record is appalling and in some aspects the worst in the world. It is not surprising therefore that I am under constant pressure to secure some alleviation of the position. There is no doubt that price is an important factor affecting consumption of tobacco products and Patrick Jenkin's proposal therefore has my support.

I am copying this letter to our Cabinet colleagues and to Sir Robert Armstrong.

GEORGE YOUNGER

2

PRIME MINISTER

MJS 23/2

Y SWYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SWIA 2ER
Tel. 01-233 3000 (Switsfwrdd)
01-233 6106 (Llinell Union)

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SWIA 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)

Oddi wrth Ysgrifennydd Gwladol Cymru The Rt Hon Nicholas Edwards MP *From The Secretary of State for Wales*

cc A Walters
D. Wolfson

20 February 1981

MF

Dear Geoffrey

I have seen a copy of Patrick Jenkin's letter to you of 12 February in which he sets out the strong case that there is for a substantial increase in tobacco taxation on health grounds.

I fully realise that you will be weighing up many other considerations in devising your budget, but as a fellow Health Minister I would wish to support Patrick's proposals that there should be a substantial increase in tobacco taxation and particularly I would add on cigarettes this year.

/ I am copying this letter to our Cabinet colleagues and Sir Robert Armstrong.

Yours ever

Nick

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON

① Less on petrol more on VAT)
② More on wine possibly spirits not

BUDGET SECRET

3

1

COPY NO. 1 OF 5 COPIES
CH/EX. REF. NO. B(81)11

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

Prime Minister

cc Mr Walters
Mr Wolfson
Mr Hoskyns

19 February 1981

The Chancellor's indirect tax proposals. The petrol increase is going to cause problems, but it is hard to see how else he can raise the revenue. (Putting more on tobacco, for example, would have a disproportionate effect on the RPI).

TL
19/2

T.P. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

INDIRECT TAX PACKAGE

..... I attach a table which shows the implications in detail of the "twice revalorisation" package the Chancellor mentioned to the Prime Minister.

On the RPI effects, the table reflects the fact that, for each 0.1 per cent on the RPI, petrol yields £150 million, beer £100 million and tobacco £70 million.

The duty changes on beer and wine reflect the need to minimise the risk of infraction proceedings initiated by the European Commission; our objective is to secure their assent to our moving gradually towards a wine/beer duty relativity of 3 : 1 from the present 5 : 1 ratio.

The balance between road fuel duty and VED increases could still be adjusted at the margin (e.g. £15 on VED, and 18p on road fuel duty) - but there would be very little impact on the revenue change, and the RPI change would be the same.

Yours

John

A.J. WIGGINS

Prime Minister

It hardly needs saying, I know, but the problems Tim refers to above will not only be on the general premises of the effect on the RPI and the impact on industrial costs but ~~also~~ will also arise from the implications for the rural community (from which, of course, the Party draws a great deal of support).

[illegible] 19ii

BUDGET

SECRET

PACKAGE D (i)

2% on RPI, no VAT blocking

	Approx. price effects	Duty change	Revenue change 1981-2	Revenue change full year	Impact on industrial costs 1981-2	Impact on industrial costs full year	RPI impact effect
		%	£m	£m	£m	£m	%
Beer	4p/pint	36.8	385	395			0.4
Spirits	60p/bottle	14.5	60*1	60*1			0.1
Table wine	12p/bottle	18.3	30	30			neg
Fortified wine	25p/bottle	33.0	50	50			neg
Tobacco	14p/pkt 20	[29.7*2]	480	490			0.7
Petrol	20p/gallon	38.3	905	905	325	325	0.6
Derv	20p/gallon	38.3	265	265	265	265	nil
VED	£10	16.7	220	220	100	100	0.1
			2395	2415	690	690	2.0*2

NOTES:

*1 Reflects the average of alternative views about the price elasticity of demand

*2 Total taxation on cigarettes since 1980 Budget

2

SECRET

PRIME MINISTER

Treasury say they will be auctioned

T.

INDEXED GILTS

It is not clear how the indexed gilts are to be sold.

Since we have no idea of the appropriate price it is important that they be auctioned and not sold on tap at or near par.

AAW

19 February 1981

SECRET

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

19 February 1981

The Rt. Hon. Patrick Jenkin MP
Secretary of State for
Social Service
Alexandra Fleming House
Elephant and Castle
SE1

Dear Patrick

Thank you for your letter of 10 February about the taxation of alcoholic drinks. I have also seen Quintin Hailsham's letter of 13 February.

The points which you and Quintin make in your respective letters are well understood. You may be sure that I shall take all aspects of this question into account in drawing up my Budget proposals.

I am copying this letter to Quintin, to other Cabinet colleagues and to Sir Robert Armstrong.

GEOFFREY HOWE

010 2

CONFIDENTIAL

cc Mr. Walters
Mr. Wolfson.

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

Prime Minister

PRIME MINISTER

MT.

Content with these proposals? They seem to me to strike a reasonable balance, and one of the CBI's two main points (ie about the credit restrictions) has been met. (CBI's unfortunate document is at Flag A).

JL 20/2

COMPANY TAXATION: STOCK RELIEF

I have been considering the response to the Consultative Document on Stock Relief which we published last November.

Background

2. As you know, we saw 3 main defects in the old stock relief scheme.

3. First, it extended relief not only in respect of higher prices of stocks, but also in respect of higher physical volumes of stocks held.* This led in some instances to artificial stock building to secure a tax advantage.

4. Second, it gave relief where stock was being financed out of credit or other borrowings so that businesses were receiving relief for inflationary costs that they themselves had not had to bear.

5. Third, the old scheme withdrew relief - imposed a charge to tax ("clawback") - when the value of stocks held fell. This clawback charge became a major threat to the solvency of businesses which had been reducing stock in the current recession.

/The main

*subject to a rule that relief was given only to the extent that the stock increase exceeded 15 per cent of profits - the "profit restriction".

6. The main differences between the old scheme and the new proposals in the Consultative Document were:

a. relief to be given, by reference to the effects on profit of price rises on stock-holdings, irrespective of whether they are increasing or decreasing in total value

b. the relief to be given by reference to a general measure of inflation as it affects stocks (the "all stocks" index)

c. there is to be no profit restriction

d. clawback to disappear save in exceptional circumstances

e. relief to be restricted to the extent that stock is financed by borrowing, where stocks exceed £ml.

7. The new scheme would thus tackle the well-known abuses of the old stock relief scheme and at the same time virtually ending clawback and providing much needed relief to companies in present circumstances (up to £m300 in 1981/82, rising to perhaps £m500 in the following years), mainly to the benefit of manufacturing industry. (The figures are being up-dated in the light of the latest economic forecasts.)

Response to the Consultative Document

8. The initial response to the Consultative Document was largely favourable. But, there have been criticisms from representative bodies and others of certain specific aspects of the new proposals.

/Thus there has

Thus there has been some - though by no means universal - disappointment that it has not been possible to come closer to adopting the Accountants' new "Current Cost Accounting" rules for tax purposes, as they stand. And there has been much anxiety about the effects of the credit restriction - the rule restricting relief to the extent that stock is financed by borrowing.

Conclusions

9. I have discussed these representations with Arthur Cockfield, who has been deeply engaged at all stages in preparing the new scheme, and with my other Ministerial advisers. In the light of these discussions I remain persuaded that the new proposals represent a rational and constructive answer to the problems posed by the effects of inflation on business stocks. In particular the removal of the threat of clawback is of great benefit to industry. Subject to a few points of detail - and to the one major point which I discuss below - I intend therefore to legislate in the Finance Bill for the new stock relief in the form proposed in the Consultative Document.

10. The major question concerns the proposed new credit restriction. I have thought long and hard about this:

a. On the one hand, the representations have raised no new points which were not foreseen in drawing up the new proposals, or which call seriously in question the intellectual case for the credit restriction argued in the Consultative Document. In principle, we should not give tax relief for stocks financed by trade credit or other borrowings. The retail sector finances much

/of its stocks

of its stocks in this way (one aspect of the so-called "Tesco abuse"), and so do many other businesses.

b. On the other hand, I have to recognise that it is this aspect of the new proposals which has aroused most anxiety. Much of this can be attributed to industry's natural desire to extract the maximum value from any relief, and to reduce to a minimum the effect of any restriction on it. However, the credit restriction would be complex to legislate and administer, particularly as it affected company groups. It would also have a sharp - and it would be argued, arbitrary - impact on the tax relief available in some individual cases. The other elements in the new stock relief proposals - by excluding relief for increases in the volume of stocks - would in themselves cut out something like one-third or more of the stock relief which people like Tesco have enjoyed on average over the past 5 years or so.

11. The additional cost of withdrawing the credit restriction in present circumstances would be moderate: negligible in 1981/82, rising to perhaps £m100 a year in 2 years' time.

12. In all the circumstances, I have come to the conclusion that it would be wrong to risk jeopardising the favourable political impact of the new stock relief scheme on industry generally, or indeed to add to businesses' anxieties at this time. It would be a great pity if the whole effect of our most substantial relief to industry was marred by insistence on one arguable set-off. I propose therefore to legislate

/in this year's

in this year's Finance Bill for the new stock relief without a credit restriction at this stage. I would not, of course, concede the case which is well established in principle for the credit restriction and this would be for consideration again in the wider-ranging Green Paper on the future of corporation tax in due course.

14. The stock relief proposals will be an important part of my Budget Statement and I would not therefore propose to announce this decision, or the other minor detailed concessions which I have in mind, in advance of my Budget Statement.

15. I am sending copies of this minute to Keith Joseph and John Biffen.

(G.H.)

18 February 1981

1

u h hatters

Original filed on:-
Econ Pol : Domestic monetary Policy : Pt 7

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

PRIME MINISTER

INDEXED GILTS

When the Governor and I discussed indexed gilts with you, you invited us to consider the timing of the issue and to report back.

2. We are agreed that the Budget would be the best time to announce an indexed gilt. The Bank have tied up in advance over £500 million of funding for banking March which begins next Thursday, and hope to achieve further sales ahead of the Budget, particularly if the hopes of lower MLR, which were quashed last week, should revive. In any event the market will need longer than usual to digest the (complicated) prospectus and will be better able to assess the stock in the Budget context.

3. If we wished to issue before the Budget we should need to do so very soon, so as not to have a situation in which the period between issue and call included Budget day itself. An announcement in the next week or so might in any event be technically impracticable. On the other hand, we do not wish to delay the announcement any longer than necessary. The longer we do delay the greater the risks of a leak which could cause considerable damage to our conventional funding programme.

4. On balance, therefore, we think the Budget is the best time for an announcement, with the first call on 26 or 27 March.

5. You might wish to know that we would propose, in the first place, to issue a tranche of £1 billion with calls spread

over three months, with a 2 per cent real coupon and a maturity of 15 years.

6. I have proposed a solution to the eligibility problem to the Secretary of State for Trade.

7. I am copying this letter to Gordon Richardson.

(G.H.)
18 February 1981

File

ECON POL

10 DOWNING STREET

From the Private Secretary

18 February 1981

I have shown the Prime Minister the draft reply enclosed with your letter of 16 February, which is intended to be in response to Sir Jeremy Morse's letter of 2 February to the Prime Minister.

She is content that the Chancellor should reply in the terms suggested except that she would prefer the last sentence to be deleted.

TL

Richard Tolkien, Esq.,
HM Treasury.

PART 4 ends:-

TL to PM of 17/2/81.

PART 5 begins:-

TL to HMT of 18/2/81.