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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.

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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 7½% 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 2½%. 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 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 £1½ 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 £m	Full year £m	RPI impact effect %	Approximate price effects (including VAT)
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%.

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.