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CAB 128/11

MOST CONFIDENTIAL RECORD

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SUBJECT

cc(83) 2d Conclusions, Minutes
3 February 1983
ECONOMIC STRATEGY

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TO
CC(83) 3rd Conclusions, Minute 5
Thursday 3 February 1983

ECONOMIC
STRATEGY

The Cabinet considered a memorandum by the Chancellor of the Exchequer (C(83) 5) on economic strategy.

THE CHANCELLOR OF THE EXCHEQUER said that the background to the Budget, to be presented on 15 March, was one of expectations of modest growth in the world economy. Recovery had been delayed in 1982, partly because of the difficulties experienced by the United States and West German economies and partly because of retrenchment by major debtor countries such as Nigeria and Mexico. Inflation and interest rates were, however, declining; and real demand was likely to expand in 1983. There were two main uncertainties. First, the scale and speed of recovery would depend on developments in the United States economy: it would be necessary for the Administration to tackle convincingly the problem of the mounting federal budget deficit in order to improve confidence and allow scope for reductions in interest rates. Secondly, the future movement of oil prices was uncertain. A moderate decline in the price of oil would be broadly helpful to world economic activity and inflation, and had little effect on the United Kingdom's balance of payments and public revenue. A sharp decline could however have adverse effects.

The 1982 Budget had envisaged a Public Sector Borrowing Requirement (PSBR) in 1982-83 of about £9.5 billion; the outturn was likely to be less. For 1983-84, the Medium Term Financial Strategy suggested a PSBR of about £8 billion. A higher figure would have little effect on activity and employment in the short term, but could seriously impair confidence, especially in the present state of uncertainty in the markets. His preliminary view was that it would be a mistake to publish a forecast PSBR for 1983-84 of higher than £8 billion. A figure of £8 billion would allow some scope for tax reductions besides the revalorisation of allowances and bands assumed in the economic forecasts. On indirect taxes, he would be reluctant to forgo a substantial measure of revalorisation. Full revalorisation would yield some £600 million a year but add only about 0.5 per cent to the Retail Price Index. There might, however, be a case for limiting the increase in petrol tax in order to protect rural areas. To the extent that direct taxes were reduced, it would be necessary to decide between the claims of industry and the personal sector. The Confederation of British Industry (CBI) were pressing strongly for relief through the abolition of the National Insurance Surcharge (NIS). It was undoubtedly desirable to encourage improvements in competitiveness and the rebuilding of companies' profit margins. Companies were, however, already benefiting from the previous reductions in NIS, and from falls in interest rates and the exchange rate. There was a stronger case for increasing income tax thresholds beyond the amount needed for revalorisation. This would be welcome to many of the Government's supporters, and would be appropriate in view of the Government's inability to reduce the burden of

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direct taxation to the extent that it had hoped to be able to do when it took office. A significant increase in the thresholds could well bring benefits in wage bargaining, and would help alleviate the poverty and unemployment traps.

Finally, he hoped that the Budget could include, as in 1982, packages of smaller measures targeted to help particular areas of the industry or deserving groups. He would be in touch separately with the Ministers concerned.

The following main points were made in discussion -

a. The Chancellor of the Exchequer was to be congratulated on the steadiness with which he had maintained the course of the Government's financial and economic strategy. This was the main reason why the Government now had useful freedom of fiscal manoeuvre. It would be politically and economically disastrous if the Government appeared to be departing now from the course which had been set.

b. It could be argued that, without departing from the Government's underlying policies, it would be possible to allow the PSBR in 1983-84 to be rather higher than the Chancellor of the Exchequer had suggested. A PSBR of £8 billion would be low in comparison with the average of industrialised countries; and the previous forecasts which had included it had assumed a rather higher level of economic activity than now seemed likely. It was improbable that the markets would react adversely if the PSBR were kept below £9 billion. On the other hand, there were great uncertainties, as C(83) 5 brought out, in the economic forecasts and in the current economic situation. These and other considerations argued for erring on the side of caution in the Budget. It would be better to be cautious in the spring and relax if appropriate later, than to relax too far in the spring and be obliged to retrench later. A further consideration was that real interest rates were at an exceptionally high level. Reductions in them would encourage industrial investment and new housebuilding, which were the keys to sound economic growth. The level of mortgage interest rates was also of central importance to many families. All these arguments told in favour of a cautious policy in respect of the PSBR.

c. A few members of the Cabinet took the view that any reduction in taxation should mainly benefit industry. The United Kingdom's industrial base was still weak. Strengthening it, and improving competitiveness, was the only satisfactory long-term solution to the problem of unemployment, which was bound to assume increasing political and social importance. One possibility would be to make a further reduction in the rate of NIS, as an earnest of the Government's intention ultimately to abolish it. But there were grounds for believing that the CBI's arguments in favour of this course reflected their difficulties in reaching agreement among their members rather than the true needs and wishes of individual companies. Moreover the fall in the exchange rate was now helping to make industry more competitive. It might be better to devise schemes of increasing capital investment, particularly in the West Midlands and other parts of the country which had been particularly hard hit by unemployment.

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An alternative way of helping businesses, which could have some presentational advantage at relatively small cost, would be to reduce corporation tax.

d. Most members of the Cabinet, however, took the view that priority should be given to reductions in personal taxation, and to increasing income tax thresholds, rather than to reducing tax rates. Many workers on relatively low earnings paid surprisingly large amounts of income tax. Unless early action was taken to put this right the problem could become intractable for a long time. Raising tax thresholds would help to alleviate the problems of the poverty trap and the lack of incentive to take a job rather than rely on social security benefits. If possible, it would similarly be desirable to make a substantial increase in the rate of child benefit.

e. On this occasion it would be desirable to make a striking improvement in one major area of the tax system rather than dissipate the effect by spreading the reductions over several areas. It would also be important, however, to supplement the major measures with an imaginative package of minor measures such as had featured in the 1982 Budget. These need not cost much, but could have a stimulating effect out of all proportion to their cost. Attractive possibilities were developments of the Enterprise Allowance Scheme and the Small Engineering Firms Investment Scheme. The latter could be particularly helpful to firms in areas such as the West Midlands, which had suffered an extremely sharp decline in comparison to their previous history. It might also be desirable to devote resources to alleviating unemployment, which was certain to continue to increase for some time to come, through such measures as the Temporary Short-Time Working Compensation Scheme, the Job Release Scheme, and improved youth training. There should also be a more imaginative and helpful attitude to fiscal measures, such as stock-option schemes, designed to encourage entrepreneurship.

f. It was open to doubt whether it would be possible to mount a scheme to increase public investment, as had been suggested in discussion, which would be economically justified and have sufficiently early effects to be useful. It was however regrettable that the undershoot in the PSBR for 1982-83 was partly the result of an unintended shortfall in capital expenditure in the public sector. Every effort should be made to prevent this from happening again in 1983-84.

g. The reduction in the oil price might have serious effects on the profitability of marginal fields on the United Kingdom Continental Shelf. It might be necessary to adjust the relevant financial regime in order to ensure that marginal fields continued to be exploited and developed.

h. There was some concern about the price of petrol, particularly in rural areas, and this should be borne in mind in considering the revalorisation of the relevant duties. Limiting the increase in the duty on DERV could in particular have beneficial consequences for industrial and agricultural costs. On the other hand rural areas had benefited from the greater prosperity of agriculture, as compared with industry.

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i. Much attention had been given in the media to complaints about the rating of empty industrial and commercial premises. There were, for example, reports of roofs being removed from new buildings in order to avoid the payment of local rates. There might be scope for fiscal reliefs in this area. However, the factual basis for the reports was doubtful. The matter was under examination by the Secretary of State for the Environment and the other Ministers concerned.

THE PRIME MINISTER, summing up the discussion, said that there was general agreement on the assessment of the situation, on the outlook for the future and on the course to be followed.

The Cabinet -

Invited the Chancellor of the Exchequer to take account of the discussion in preparing his forthcoming Budget.

Cabinet Office

7 February 1983

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SUBJECT

CC(83) 7th Conclusions, Minute 5

3 March 1983

OTHER BUSINESS - Public Expenditure: (proposals of Pensions.
and Benefits.

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TO
CC(83) 7th Conclusions, Minute 5
Thursday 3 March 1983

OTHER
BUSINESS

Public
Expenditure:
Uprating of
Pensions and
Benefits

Previous
Reference:
CC(82) 6th
Conclusions,
Minute 2

THE PRIME MINISTER said that the Cabinet had previously endorsed the principle of recovering the excess provision for inflation in the November 1982 uprating of social security benefits, up to a maximum of 2½ per cent. The need to recover an excess had once again demonstrated the unsatisfactoriness of the method of uprating based on forecasts of inflation. That method had been introduced by the previous Labour Administration in order to produce a once-for-all saving in public expenditure at a time of temporarily declining inflation. In the event, outturn had rarely coincided with forecasts. When the outturn exceeded the forecast, the Government was expected to make good the shortfall; when outturn fell short of forecast, it was politically difficult for the Government to recover excess provision. She and the Ministers most closely concerned had therefore agreed, subject to the approval of the Cabinet, that future upratings should be based on the actual increase in the Retail Prices Index (RPI) in the twelve-month period ending in the May before each November uprating. This increase was announced in June. It was the latest figure which it was feasible to use both because of administrative constraints and because of the need to allow time for Parliamentary debate on the statutory instruments giving effect to the uprating. The necessary legislation would be announced in the Chancellor of the Exchequer's Budget Statement and introduced immediately thereafter. The present year was a favourable time for making the change from forecasts to actual figures as the basis of upratings. Although it was likely that the increase in the RPI between May 1982 and May 1983 would be less than the forecast increase between November 1982 and November 1983, it was no longer proposed that any part of the excess provision for inflation in the November 1982 uprating should be recovered. The use of actual figures, unadjusted for the past excess provision, was likely to be more favourable to beneficiaries than the use of a forecast with full or near-full adjustment. It was proposed that increases in public service pensions, which were linked by statute to increases in State retirement pensions, should be dealt with in the same way. This made it unnecessary to pursue the possibility, raised in the Cabinet's previous discussion, of breaking the statutory link between increases in public service pensions and increases in State pensions: the problem of excess provision for inflation, and consequent unintended increases in the real value of pensions, which had been the cause of the Cabinet's previous concern, could no longer arise if pensions increase were based on actual increases in the RPI rather than forecasts.

Although the proposals were entirely logical, they would need careful presentation both in the Budget Statement and subsequently. The Government would be criticised for changing from forecasts to actual figures as the basis of upratings at a time when this change, in isolation, seemed likely to be less favourable to beneficiaries; but such criticism could be rebutted if, as was proposed, no adjustment was made in November 1983 for the excess provision for inflation in November 1982. It was

helpful that several organisations representing pensioners, including the influential National Federation of Old Age Pensioners Associations, had pressed for the change.

In discussion, there was general agreement with the proposals outlined by the Prime Minister. The following main points were also made -

- a. Using actual increases in the RPI rather than forecasts as the basis of uprating social security benefits would reduce the attention given to the forecasts of inflation which had to be published at the time of the Budget by virtue of the provisions of the Industry Act 1975. It was particularly undesirable in the context of pay bargaining to draw excessive attention to such forecasts.
- b. Although there were persuasive administrative and other reasons for using the May RPI figures as the basis of upratings, it would be desirable for the proposed legislation not to prevent the use of later figures if that should at some stage prove feasible.
- c. The proposals were fully consistent with the Government's pledge to maintain the real value of State retirement pensions during the lifetime of the present Parliament; it was, however, likely that the Government would be pressed during the Budget debate to make clear its policy towards maintaining the real value of pensions and other benefits after expiry of the present pledges.

The Cabinet -

1. Approved the proposals described by the Prime Minister relating to the future uprating of social security benefits and public service pensions, and in particular agreed:
 - i. that the excess provision for inflation in the November 1982 uprating of State retirement pensions and other social security benefits should not be recovered;
 - ii. that legislation should be introduced to provide that the November 1983 uprating and subsequent upratings should be based on the actual increase in the Retail Prices Index in the twelve-month period ending in the previous May;
 - iii. that public service pensions should be treated in the same way as State retirement pensions.
2. Invited the Secretary of State for Social Services to consider whether the legislation to give effect to the proposals should permit the use of increases in the Retail Prices Index over a twelve-month period ending in a month later than May as the basis of future upratings of social security benefits and public service pensions, if that should in due course prove to be administratively and politically feasible.



3. Took note that the Prime Minister would discuss further with the Chancellor of the Exchequer and the Secretary of State for Social Services how the Government's decisions could best be presented in the Chancellor of the Exchequer's forthcoming Budget Statement and subsequently.

Cabinet Office

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SUBJECT

CC(83) 8th Conclusions, Minutes.

10 March 1983

FOREIGN AFFAIRS: Hong Kong

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TO
CC(83) 8th Conclusions, Minute 2
Thursday 10 March 1983

FOREIGN
AFFAIRS

Hong Kong

THE PRIME MINISTER said that during her visit to Peking in September 1982 Chairman Deng Xiaoping and the then Prime Minister of the Chinese People's Republic had agreed a communique, issued jointly with her, which committed the two sides to hold talks through diplomatic channels about ways of maintaining the future stability and prosperity of Hong Kong. Despite repeated approaches from the British side, these talks had not yet taken place. Instead, the Chinese were seeking to make cession of sovereignty over Hong Kong by the British Government a precondition for starting the talks; and there was evidence to suggest that the Chinese Government was intending to use the occasion of a meeting of the Chinese People's Congress in June 1983 to announce that its intentions for Hong Kong were to assume full sovereignty over the whole colony, which would thereafter be administered as a special autonomous region of China. This would be disastrous for confidence in Hong Kong. Unless satisfactory arrangements could be negotiated with China for maintaining British administration along with the present legal and economic system in Hong Kong, the economy of the colony would collapse. Sovereignty over 92 per cent of its territory would in any case revert to China in 1997 with the expiry of the lease of the New Territories - without which Hong Kong would cease to be viable. It was therefore vital to get talks with China started soon. Accordingly, after consultation with the Governor of Hong Kong, Sir Edward Youde, and HM Ambassador at Peking, Sir Percy Cradock, she proposed, subject to the agreement of the Cabinet, to write to Chairman Deng Xiaoping. Her letter, the proposed text of which the Prime Minister read to the Cabinet, would be delivered by HM Ambassador on his return to Peking within the next few days. It would express disappointment that talks had not started on the basis of the joint communique of last September, and would propose that they should start at once. The letter would go on to say, that provided that formal agreement could be reached on arrangements for maintaining the stability and prosperity of the colony which were satisfactory to the people of Hong Kong and to the British Government as well as to the Government of China, she would be prepared, subject to the agreement of the Cabinet, to recommend to Parliament that sovereignty over the whole of Hong Kong should be transferred to China. This would involve going one step further than the formula she had used with the Chinese Government in September 1982, when she had said that, in the circumstances described, she would be prepared to "consider" making such a recommendation to Parliament.

The Cabinet -

Agreed that the Prime Minister should write to Chairman Deng Xiaoping in the terms proposed.

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CC(83) 11th Conclusions.

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CC(83) 11th Conclusions
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FOREIGN
AFFAIRS

Hong Kong

Previous
Reference:
CC(83) 8th
Conclusions,
Minute 2

THE PRIME MINISTER said that her letter to the Chinese Prime Minister, the tenor of which the Cabinet had approved at their meeting on 10 March, had been delivered. The Chinese Prime Minister had indicated that he was not yet ready to receive the British Ambassador in Peking to discuss the letter. In the meantime the Chinese Government had cancelled a contract placed in Britain for the refit of their Luda destroyers, apparently out of a feeling that it was in principle wrong for Chinese destroyers to be refitted in foreign shipyards. A British firm had, however, won a contract for making board from rice straw. The Chinese Minister of Commerce would be arriving later in the day on a visit to this country, in the course of which she would meet the Prime Minister and the Secretaries of State for Industry and Trade.

The Cabinet -

Took note.

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CC (83) 18th Conclusions

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CC(83) 8th
Conclusions,
Minute 2

THE PRIME MINISTER reported that a reply had now been received from the People's Republic of China. The general tone of the Chinese letter was friendly. They proposed an early meeting in Peking to agree on the agenda for preparing discussions. These talks might start in May or June. In the discussions the United Kingdom and Chinese letters would both be on the table. Our position on a transfer of sovereignty was fully protected by the conditions which we had laid down, including the agreement of the British Parliament and the people of Hong Kong. The Chinese now seemed to recognise how complex this question was. In discussion it was pointed out that informal contacts with the Liberal and Social Democratic Parties (Mr Healey had not responded to the offer) had indicated that they expected the Government's position to be fully acceptable to the House of Commons.

The Cabinet -

Took note.

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CC(83)19th Conclusions

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CC(83) 19th Conclusions
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FOREIGN
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Hong Kong

Previous
Reference:
CC(83) 18th
Conclusions,
Minute 2

THE PRIME MINISTER said that negotiations with the Government of the People's Republic of China were continuing on the basis of the letter which she had sent, with the Cabinet's agreement, to the Chinese Prime Minister, Mr Zhao Ziyang, and the Chinese reply. The Chinese had allowed a distorted version of the contents of her letter to become public, but no great harm had been done. It was clear that they were now anxious to proceed expeditiously with the formal talks about the future of Hong Kong; negotiations were in progress about the agenda, and the Chinese had come some way to meet the British position by offering to relegate the question of a transfer of sovereignty to third place in their list. Her Majesty's Ambassador at Peking had now been instructed to communicate the British Government's view in the following terms:

"In order to meet the wish of the Chinese side for a broad agenda covering the whole course of the formal talks, the British side agree that, during the course of the talks, matters relevant to the future of Hong Kong should be discussed, in particular all the subjects mentioned in Mrs Thatcher's letter and Premier Zhao Ziyang's letter. These will include arrangements for Hong Kong after 1997, arrangements for Hong Kong between now and 1997, and matters relating to a transfer of sovereignty in that order. It is agreed that this agenda should remain strictly confidential."

The Hong Kong Executive Council had been consulted and had agreed that it would be right for the British Government to enter into talks on the foregoing basis. The concept that the final outcome would have to be acceptable to the British Parliament, to China and to the people of Hong Kong had not been made explicit, since it was judged that this would be rejected by the Chinese, but was implicit in the reference to her letter to the Chinese Prime Minister. The eagerness which the Chinese Government was now showing to begin the formal talks was an important development, and suggested the beginning of some understanding on the Chinese side of the need to avoid a collapse of confidence in Hong Kong; but the negotiations would be long, complicated and difficult and it would be important to discourage any expectation of an early result.

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CC(83) 21st Conclusions

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PARLIAMENTARY PAY AND ALLOWANCES

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CC(83) 21st Conclusions
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PARLIAMENTARY
PAY AND
ALLOWANCES

Previous
Reference:
CC(83) 17th
Conclusions,
Minute 2

THE PRIME MINISTER said that the Top Salaries Review Body (TSRB), in their Report No 20 on Parliamentary Pay and Allowances, had proposed that the salary of Members of Parliament should be increased by 31 per cent, from £14,510 to £19,000. The Report contained proposals on pensions, including an increase in the accrual rate from 1/60th to 1/50th and an increase in the contribution rate from 6 per cent to 8 per cent. It also proposed increases in allowances for Members of Parliament and Peers, and large increases in the salaries of Ministers. She had already made clear the Government's general attitude to the recommendations for Ministers; it was now necessary to consider those relating to Members of Parliament. The proposals on allowances and pensions were very generous and, together with previous pay increases, could justify a much smaller salary increase than the TSRB recommended. The 31 per cent proposed by the TSRB was quite unacceptable and would have a disastrous effect on other pay settlements. There were two options: to reject the Report altogether and suggest a figure similar to recent public sector settlements; or to propose as a compromise an increase of, say, 15 per cent, in which case the pensions contribution rate might be set at 9 per cent.

In discussion the following main points were made -

- a. A proposal by the Government that the salaries of Members of Parliament should be increased by 15 per cent would contrast unfavourably with the 3.7 per cent increase in the old age pension and with other pay settlements in the public sector, which had been in the region of 5 per cent and were expected to be even lower in the forthcoming pay round. From that point of view it might be better for the Government to propose a low increase, accept the risk of a defeat in the House of Commons, and be prepared to distance itself from the House's decision. It was by no means certain that such a proposal would in fact be defeated.
- b. If a low offer were made, emphasis could be placed on the other proposals in the TSRB Report, especially those on pensions, which were very favourable. It was also relevant that in the previous Parliament Members' pay had risen from £6,900 to £14,510.
- c. If the Government proposed a low figure and was defeated, the authority of the Leader of the House and the Chief Whip could be damaged. Some of the Government's supporters had no additional sources of income, and Members of Parliament, unlike other public servants, had no security of tenure. There was substantial support for the TSRB recommendations. From that point of view it might be preferable for the Government to propose the lowest figure that was likely to be accepted by Parliament.

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d. Whatever proposal the Government made, it was not clear how far it could distance itself from the final decision of the House of Commons. The size of the Government's majority could lead the public to associate the Government with whatever decision the House made.

e. The Government's attitude to the TSRB's recommendations on Ministerial salaries would be discussed in the following week. There would be difficulties, particularly for Parliamentary Secretaries, if the House approved a high increase for Members and if Ministerial salaries were not increased. A Member lost substantial tax allowances on becoming a Minister.

f. It was recognised that the question of Ministerial salaries in the House of Lords raised separate issues.

THE PRIME MINISTER, summing up the discussion, said that it would be necessary for the Chief Whip to take further soundings of opinion among the Government's supporters before a decision could be taken. An attempt should be made to influence them towards acceptance of a figure around 4 per cent, by pointing out the level of awards to pensioners and to others in the public sector, and of a pension contribution of 9 per cent (the equivalent of the 8 per cent effectively in force in the Civil Service). The value of the recommendations on pensions and allowances should also be stressed. It was clear that a high increase in the salaries of Members of Parliament could have an adverse effect on the Government's economic strategy.

The Cabinet -

1. Invited the Chief Whip to take further soundings of opinion among the Government's supporters, as indicated by the Prime Minister in her summing up of the discussion.

2. Agreed to resume their consideration of Reports No 19 and 20 by the Top Salaries Review Body at their meeting on 7 July 1983.

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CC(83) 28th Conclusions
Thursday 22 September 1983

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Previous :
Reference:
CC(83) 19th
Conclusions,
Minute 2

THE PRIME MINISTER said that the next round of talks with the Chinese Government about the future of Hong Kong, which were beginning that week, would be crucial and difficult. The United Kingdom was fortunate to have a skilful and experienced negotiator in Sir Percy Cradock. The Chinese were insisting not only on Chinese sovereignty but also on Chinese administration of the whole Colony from 1997 and had so far refused to take any account of the British contention that the link with the United Kingdom was essential to confidence and hence to Hong Kong's continued prosperity. Despite the confidential character of the talks, the Chinese were making their own position and intentions public, and this had precipitated serious falls in the value of the Hong Kong dollar and on the Hong Kong Stock Exchange. There was likely to be growing Parliamentary concern about how far the Government was taking account of the wishes of the population of Hong Kong, four million of whom were refugees from China for whom Britain had a particular moral responsibility. The Government was in fact in close touch with the Executive Council, the Legislative Council and with the elected District Councils in Hong Kong, as well as with other representative organisations in the Colony. A referendum would be able to be exploited by the Chinese in a way which would make a free expression of opinion impossible. The overwhelming majority of the population wanted the status quo maintained, but unfortunately senior members of the Hong Kong Chinese community were frightened to make this clear to the Chinese Government when they visited Peking. The Chinese authorities preferred to believe that Hong Kong would continue as before following a complete Chinese takeover. It was unclear how far, if at all, they understood the importance of the confidence factor (and hence of a continued administrative link with Britain) for Hong Kong's future prosperity: but Chinese national pride, combined with Communist non-comprehension of how a capitalist system worked, made it difficult for them to accept that Britain should have any rights in Hong Kong after 1997, whatever the economic consequences. Unfortunately British public opinion tended to over estimate British power and the extent of British leverage with the Chinese. The task of the British negotiators in the coming round would be to keep the Chinese in play on the question of confidence and continue to put across the British case without prompting them to break off the talks.

The Cabinet -

Took note.

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SUBJECT

CC(83) 33rd Conclusions,

Thursday 10 November 1983

ECONOMIC SITUATION AND PROSPECTS

No.	Contents	Date

MOST CONFIDENTIAL RECORD
TO
CC(83) 33rd Conclusions
Thursday 10 November 1983

ECONOMIC
SITUATION
AND
PROSPECTS

THE CHANCELLOR OF THE EXCHEQUER said that he would be making his Autumn Statement on Thursday 17 November. This would include the outline public expenditure programmes for 1984-85, reflecting the decisions taken by the Cabinet in their earlier discussion. It would also deal with National Insurance contributions (NICs) and the economic forecasts required by the provisions of the Industry Act. He had agreed with the Secretary of State for Social Services that there would be no change in the rate of either employers' or employees' NICs in 1984-85. The lower earnings limit, below which NICs were not charged, would be increased in line with the State Retirement Pension to £34 a week; the upper earnings limit, income above which was not subject to NICs, would be increased in line with earnings to £250 a week. The Exchequer supplement would be reduced from 13 per cent to 11 per cent. As a result of these changes, the surplus in the National Insurance Fund would be reduced; but it would still be well above the level which the Government Actuary had advised was necessary. The budgetary prospect which would be revealed in the Industry Act forecasts was not comfortable. The public sector borrowing requirement in 1983-84 was above the forecast made at the time of the Budget. This would increase the burden on debt interest in 1984-85. It also seemed that there would be little shortfall in that year in cash-limited expenditure programmes. Forecasts of revenue from North Sea oil were higher than before; and there was little change in the forecast yield of other Inland Revenue taxes; but because of lower inflation the forecast yield of Customs and Excise duties was lower. The net effect was that a small negative fiscal adjustment (that is, an increase in the real burden of taxation) would probably be required instead of the small positive adjustment forecast at the 1983 Budget. Such forecasts were, however, necessarily uncertain, since they depended on the difference between very large flows of revenue and expenditure. At the present stage the fiscal adjustment was an assessment of the prospect based on existing policies and assumptions and on the best available figures; it was not a budget judgment.

Inflation was forecast to be under 5 per cent by the end of 1984. The economy was expected to grow by up to 3 per cent in both 1983-84 and 1984-85. Much of this growth in 1983-84 was due to higher consumption. But in 1984-85 a higher proportion would come from growth in investment and exports, as our main export markets, such as West Germany, recovered: growth in exports was also being forecast by the Confederation of British Industry. The balance of payments was expected to be neutral.

The Cabinet -

Took note.