SEC
(Circulate under
notify REGISTRY

TREASURY

FILE BEGINS 29/10/87 ENDS 23/11/87

PO -CH /NL/0010

PART T

MISCELLANEOUS PAPERS
1987

PO -CH /NL/0010
PART T

FOR DISPOSAL ADVICE SEE INSIDE COVER

DISPOSAL DIRECTIONS	SIGNATURE	DATE
DESTROY AFTER 25 YEARS	C Dent	10/1/94
PRESERVE		

...ATION USE ONLY	REFER TO	DATE	REFER TO	DATE
	PA(23/11/87) PAR	10/1/94		

CLOSED
CONTINUED ON:-
PART U

FOR RECORDS SECTION USE ONLY

8265493, 6/93, C300, 2213/1, 15121, 04772

T.R.1.

CH/EXCHEQUER
REC. 29 OCT 1987 29/10
ACTION PMG
COPIES TO

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary 29 October 1987

Dear Simon

The Prime Minister has seen the Paymaster General's minute of 27 October with which he enclosed a 1986-87 Report on "Using Private Enterprise in Government". She has noted his suggestion that Ministers in charge of Departments should arrange to see personally the annual progress reports and forward targets prepared by their Departments before these are forwarded to the Treasury.

I am copying this letter to the Private Secretaries to Ministers in charge of Departments, Sir Robert Armstrong and Sir Robin Ibbs.

Yours ever

Andy

(P. A. BEARPARK)

Simon Judge, Esq.,
Paymaster General's Office,
HM Treasury.

CONFIDENTIAL

3FROM: J S HIBBERD
DATE: 30 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc : Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Byatt
Mr Cassell
Mr Monck
Mr H P Evans
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr Bottrill
Mr R I G Allen
Mr Melliss
Mr Mowl
Miss O'Mara
Mr S J Davies
Mr Pickford
Mr Cropper
Mr Tyrie
Mr Call

Nigel

LBS OCTOBER ECONOMIC OUTLOOK

The October issue of the LBS Economic Outlook will be released over the weekend. (It is embargoed until midnight Sunday, but details will appear before then in the Sunday Times). The detailed forecast was prepared before the stock market fall (SMF). However the LBS indicates how its forecast would differ if some allowance was made for the impact of the SMF.

The Outlook: LBS and IAF

2. Table 1 compares key features of the LBS outlook (pre-and post-SMF) with the IAF projections.

fst
lbs-oct87

Table 1: Outlook for 1988 (Growth, per cent)

	LBS Pre SMF	LBS Post SMF	IAF Rounded
GDP	2.8	2.5	2½
Consumption	3.9	3.7	4
Investment	7.1	6.3	4½
Exports	4.6	4.2	2
Imports	6.1	5.5	5
Average earnings of: whole economy	7.6	7.6*	7
: general economy	7.6	8.3	8
RPI(Q4)	4.0	4.0*	4½
Current account (£bn)	- 1.8	- 1.3	- 3½
Sterling index*	73	73*	72½
PSBR (£bn financial year)	2.9	3.6	1

* Taken from pre-SMF forecast.

3. The post-SMF projections of the LBS are broadly similar to the IAF, except for the following:

- LBS are more buoyant on business investment.

- LBS have a notably more optimistic outlook for UK exports of goods and services. This reflects the LBS's faster forecast growth in the major seven OECD countries and a more optimistic outlook for the balance of invisible trade.

- Mainly as a result of the better export prospect, the LBS have a more optimistic outlook on the current balance.

The impact of the stock market fall in the LBF Forecast

4. The LBS assume that there will be no general tightening of monetary conditions leading to a severe contraction of demand. The main impact of SMF will then be through demand effects associated with the contraction in financial wealth and increased cost of capital to industry. Comparable assumptions are made for the world economy. This is a similar philosophy to that underlying the recent adjustments to the figures made in the IAF. The effects assumed by the LBS are shown in Table 2.

Table 2: Assumed impact of stock market fall (per cent)

	LBS
GDP	- 0.3
Consumption	- 0.2
Investment	- 0.8
Export	- 0.4
Imports	- 0.6
Current account (£bn)	+ 0.5
PSBR (£bn, financial year)	+ 0.7
OECD GNP	- 0.5
OECD Industrial Production	- 0.9
World Trade	- 0.5

5. The lower consumption forecast is driven by the drop in personal sector wealth. Although it only falls by 0.2 per cent in 1988, the long run impact (sometimes beyond 1989) is likely to be a fall of 1 per cent - provided the stock market fall is sustained. The LBS have been cautious on the investment impact; the decline in growth is much less than current research in the LBS would suggest. Because the LBS assumes a slightly bigger drop in import growth than export growth, there is a marginal improvement to the current balance.

Future of the Louvre Accord

6. In the "Economic Viewpoint" section Alan Budd and Geoffrey Dicks examine the outlook for exchange rates and conclude that "the policy of holding the dollar is misguided". They argue that the present conjuncture (the article was presumably begun before the recent turmoil in financial markets) of interest rates and inflation points to further dollar depreciation.

7. Budd and Dicks note that a system of fixed exchange rates based on the dollar will only survive if US policies are consistent with low inflation for itself and for other participating countries. They consider that the size of the US budget deficit is inconsistent with exchange rate stability, and that Louvre Accord attempted to fix the dollar at an unacceptably high rate. As a result, substantial intervention has been required, boosting the growth of Japan and Germany and presenting them with a dilemma of exchange rate or domestic monetary stability, in which they are bound eventually to choose the latter.

8. Budd and Dicks consider that if there is a serious desire for exchange rate stability, this might best be achieved by a step depreciation of the dollar supported by measures to reduce the US budget deficit and the announcement of monetary policies to contain inflation. (They might modify the latter if the article had been written after the collapse in share prices.)

Is the economy overheating?

9. In a briefing paper, the LBS address the issue of whether the economy is overheating. On balance, they conclude that it is currently "hot but not overheating". Nor do they see it overheating over the next year or so.

10. Their argument goes as follows. **Productive potential** has increased fairly rapidly in manufacturing in recent years, but especially over the past twelve months, as a result of rising productivity. The authors note that CBI surveys show no indication of capacity constraints in manufacturing. Moreover, the capital stock in manufacturing has probably grown faster in the recent past than official CSO figures imply, because the latter do not reflect the accelerated scrapping of capital in the early 1980s. Labour productivity in the non-manufacturing sector has also risen faster than in the 1970s. While **final domestic demand** has increased sharply over the past twelve months, it has probably risen no faster than output itself (though still faster than trend output).

11. The main danger signal is the deterioration in the current account in 1987. But, even here, they are inclined to discount the evidence; incorrect seasonal adjustment may have adversely affected the August current account numbers and the large residual error in the National Accounts may mean that the current account surplus is understated. (They ignore the fact that the balancing item in the balance of payments for the first half of 1987 suggests that the current account may be overstated.)

12. The LBS admits that all these factors are open to alternative interpretation. But, what finally tips the balance for them is that CBI Survey evidence does not support the notion of current overheating. Specifically, they say ".... it is also evident that the strength of

the current recovery in no way compares with the boom conditions of 1973". This interpretation of recent developments is close to our own.

13. Over the medium term the LBS sees output growing at a sustainable 3 per cent per annum. The question then is the outlook for demand. Assuming cautious monetary policy, and what the LBS describe as neutral fiscal policy, they see little prospect for excessive demand growth. In their view, the personal sector savings ratio has probably bottomed out and is likely to increase slowly over the next few years. Consumption is thus likely to grow more slowly than real incomes. Increased personal savings are expected to make room for an expected faster growth in company spending than company income. (The LBS believes a new phase of the investment cycle is underway.) Against this background there is likely to be little or no change in the current account deficit.

14. All in all, therefore, the LBS sees little prospects of serious overheating in the next year. We would agree with this. Our own estimates of total productivity growth over the medium term is close to the LBS. (There are compositional differences; we see faster manufacturing productivity growth than the LBS but slightly slower growth of private non-manufacturing.) We foresee a worse current balance than the LBS next year, but this reflects slower world growth in the IAF. It does not, of itself, suggest serious overheating.

Line to take

It will not be possible to comment on the Treasury forecast until publication of the Autumn Statement on Tuesday afternoon. There is little difference between the LBS and IAF outlook for GDP growth in ~~1980~~ 1988. Allowance for stock market effects are inevitably uncertain but the LBS estimates seem reasonable.

15. On the question of overheating, we can welcome the LBS arguments.

Jim Hibberd

J S HIBBERD

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary 30 October 1987

Dear Simon

CENTRAL UNIT ON PURCHASING: PROGRESS REPORT TO THE PRIME MINISTER

Thank you for your letter of 29 October. The Prime Minister has approved the draft arranged PQ and I have now passed the papers to Sue Holt in our Parliamentary Questions branch to make the necessary arrangements.

I am copying this letter to the Private Secretaries to Ministers in charge of Departments, Trevor Woolley (Cabinet Office) and Kate Jenkins (Efficiency Unit).

Yours ever

Andy

P. A. Bearpark

S. P. Judge, Esq.
Paymaster General's Office.

CH/EXCHEQUER

REC.	30 OCT 1987 30/10
ACTION	PMG
COPIES TO	

CH/EXCHEQUER
REC. 4 NOV 1987 4/11
ACTION PMG
COPIES TO

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

3 November 1987

Dear Alastair

PROGRESS REPORT ON THE IMPLEMENTATION OF GOVERNMENT PURCHASING

The Prime Minister has seen, and noted without comment, the Chancellor of the Duchy of Lancaster's minute of 29 October on the above subject. I understand that the Paymaster General will be pursuing this directly with the Chancellor.

I am copying this letter to the Private Secretaries to Ministers in charge of Departments, to Simon Judge (Paymaster General's Office), Trevor Woolley (Cabinet Office), and Kate Jenkins (Efficiency Unit, Cabinet Office).

Yours ever

Andy

P. A. Bearpark

Alistair organ, Esq.,
Chancellor of the Duchy of Lancaster's Office.

Papers Pse
Flannigans minute of 28 ish Oct.

1/2917

PMP

PMP

FROM: A WILSON

DATE: 4 November 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Byatt
Mr Cassell
Mr Monck
Mr Burgner
Mr D Moore
Mrs Lomax
Mr Scholar
Mrs M Brown
Mr Houston
Mr Ilett
Mr Gray
Mr Bradley
Mr Inglis
Mr Wynn Owen
Mr Flanagan

Mr D Walker - BE
Mr Beighton - IR
Mr Finlinson - C&E

Ch/
Letter to issue?

MW 5/11

OK as

ACCOUNTING INITIATIVE

I believe the time is now ripe for you to write to Lord Young telling him about the Accounting Initiative which was put in hand some weeks ago. I have talked about the subjects set out in the annex to my earlier submission to you with Mr Walker at the Bank of England, and the Inland Revenue, and shall shortly take the views of Customs and Excise, although their interest will be more passive than that of the Inland Revenue.

2. There is now a need to tell DTI formally what is going on, and Lord Young's agreement to the procedure for carrying the exercise into its next stage is necessary in view of the many developments now taking place within DTI itself and in

the Accounting Standards Committee, as well as the institutes of accountants. Benefit will be obtained if these various strands can be harnessed and coordinated as soon as possible.

3. I attach a letter which you may wish to send to Lord Young, together with the attached draft list of current accounting issues which require consideration. The letter also deals with the small company audit and accounts issues raised in Lord Young's letter to you of 29 September to avoid you having to write separately about this.

4. You will see that I have indicated my willingness to coordinate the exercise, but I expect that Lord Young and his officials may see this as a trespass on their sponsorship role for the accountancy profession and companies' legislation; I have threfore drafted the attached letter as tactfully as I can, recognising the work which DTI officials are already doing in the field of the Initiative.

A WILSON

2911/004

~~DRAFT~~ New LETTER FROM THE CHANCELLOR TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

ACCOUNTING DEVELOPMENTS

I know that your officials and mine have been talking about various shortcomings in the present legislative and working background against which accounting principles are developed and it might be helpful if I tell you how we see the problems from here. I am also taking this opportunity to reply to your letter of 29 September on small firms accounts and audit.

Attached to this letter is a draft list of specific issues which we feel need to be tackled, which I believe coincides to a large extent with issues which your own officials are already addressing. Some of these points relate to work underway in the Accounting Standards Committee, which could usefully be supported by the Government. Other aspects might require legislation which could be included in a Companies Bill if you are able to secure room for it in the timetable. I see advantage in bringing together the various issues in a single note which, if you agree, could then serve as an agenda for continuing discussions between our officials, identifying the issues to be covered and possible solutions, and about which they should consult informally both with other parts of Government as well as external interested parties.

New para

I do not think that a formal inter-departmental working party should be established, for this would almost certainly extend the timescale for the exercise, but co-ordination of work on the several topics suggested will be necessary if real progress is to be achieved and our objectives met. Responsibility for such coordination could most sensibly ~~usefully~~ be placed, I believe, ~~if you agree~~, in the hands of Mr Anthony Wilson, the Head of the Government Accountancy Service ~~my Accountancy Adviser here in the Treasury, who is also head of the profession in Government~~. The immediate aims would be to reach early conclusions on objectives for action by the accountancy profession and to settle any provisions which might need to be included in legislation.

The amount of information which companies are expected to disclose in their accounts is a separate issue, and therefore it is not covered in the attached draft list of accounting matters. However, work on this, including the special concern of small firms mentioned in your letter of 29 September, could be carried forward by our officials as a separate exercise in parallel with what I have suggested above.

Turning to the other main point in your letter, I was interested to note that you now suggest removing the statutory audit requirement from companies with an annual turnover of less than £2 million, i.e. around 90 per cent of all businesses, rather than the £250,000 threshold you suggested when you were Employment Secretary. But I ~~do not think~~ am not yet persuaded that conditions have significantly changed since we decided on 14 May last year to retain the statutory audit. Opinion among interested parties still seems divided. You mention that the Institute of Chartered Accountants are in favour of abolition, but I understand that the certified accountants, who audit the accounts of many small companies, have come out strongly in favour of retaining the statutory audit, as it introduces an element of financial rigour which many small companies would otherwise lack.

I remain concerned about fraud. You will recall that your White Paper "Building Businesses...Not Barriers" said of the statutory audit: "The Government are determined to clamp down on fraud and have decided that removal of this first defence against fraud would be inappropriate". To go back on that decision now would be to send out quite the wrong signals even though fraud in small companies obviously has a lower profile than in larger ones.

You asked what the implication to the Inland Revenue would be of abolishing the audit requirements. At present, the Revenue feel that the discipline of statutory audit makes company tax returns more reliable. They therefore investigate about half the percentage of accounts from companies which they do for unincorporated (and therefore unaudited) businesses. To provide the same coverage of company accounts as for unincorporated business accounts would require several hundred new inspectors, which is not a realistic prospect. So the consequence of the change would be to put Exchequer revenues at risk.

These considerations suggest to me that the decision we reached last year was probably correct, and that it would certainly be unwise to adopt the very much more far-reaching exemption you now propose.

I am copying this letter to Douglas Hurd and John Cope.

DRAFT LIST OF CURRENT ACCOUNTING ISSUES WHICH REQUIRE CONSIDERATION

A number of issues to do with accounting requirements or practices are currently causing concern and need to be addressed. Accounting information provides an important influence on the way markets work, as well as the basis for sound economic decisions, and therefore attention must be paid to its quality

2. The main current issues are:

- the need for economic substance to prevail over legal form in the preparation of accounts and for unrestricted true and fair view requirements;

- off balance sheet financing;

- accounting for mergers and acquisitions;

- fair value and modified historical cost accounting;

- disclosure of R & D expenditure.

Substance over form and the true and fair view

3. The main purpose of accounts is to disclose corporate profitability and what may be distributed to shareholders, and the full state of affairs of the reporting group or company. Efficient markets require information about the true economic performance of companies at least as much as a statement of what may legally be distributed. Since the 4th EC Company Law Directive was reflected in UK legislation there has been a tendency for accounts to concentrate more on what is distributable than on economic performance. Furthermore the law now governs more aspects of accounts than it used to do and this seems to have led to an overlegalistic view of what is permissible in them and what is not. Some accounting shortcomings stem directly from the ability

of companies to hide behind restrictive legal interpretation of company law at the expense of showing a genuine "true and fair view".

4. The operation of the concept of a true and fair view has been restricted since the 1981 Companies Act and this has led to difficulties in developing accounting standards to cover such matters as what may be included in group balance sheets, and the related question of "off balance sheet finance", and what may be treated as a profit. The capacity of accounting to deal swiftly with new situations and abuses is gravely weakened if the requirement for accounts to show a true and fair view is restrained by the law.

Proposal

5. There is a case for considering change to legislation so that the requirement for accounts to show a true and fair view is reinforced (within the limitations of the 4th Directive) as overriding. The impact of the 7th Directive (group accounts) needs careful consideration to ensure that accounts are allowed to reflect the real composition of a group and the latter is not unduly restricted by statutory definition.

Off-balance sheet financing

6. Off-balance sheet financing takes a variety of forms designed to reduce disclosed gearing and to some extent, assets, thus improving the apparent rate of return on capital employed. It has arisen in part because of restrictive interpretation of company law by lawyers and merchant bankers. The technique of removing both assets and liabilities from company and group balance sheets conceals the true nature and extent of liabilities which the group may have underwritten, and improves the perceived rate of return on assets above its true level.

Proposal

7. The clarification of law on the supremacy of the true and fair view concept should prevent much of the abuse, but this needs to be bolstered by stonger accounting standards. The recent attempt by the accountancy profession to produce a solution was stopped in its tracks by legal quibbles. The objective must be to ensure that the true economic position of the group is reflected in accounts and that all the components of the group are included in them.

Mergers and acquisitions

8. More flexibility is given to the permissible accounting treatment of mergers and acquisitions in the UK than is the case in the US and some other developed countries. When the 7th EC Directive governing group accounts is translated into UK law, there will be an opportunity to revise the relevant provisions of the Companies Act.

9. The objectives of changes in this area are to improve disclosure of what has actually happened, (the price paid for acquisitions, their consequences and the accounting treatment adopted), and to reduce the number of accounting options available so as to improve the consistency and comparability of accounts, to make them easier to understand and to put a stop to some current abuses.

Proposal

10. The law should permit both merger and acquisition accounting as at present, but there is a case for considering prohibiting a currently popular hybrid of merger relief under the Companies Act and acquisition accounting. We should encourage the accounting profession to tighten up on the rules for disclosure, and narrow the range of circumstances when each form of accounting can be used, against a threat to legislate if the rules aren't strong enough. The Accounting Standards Committee review of the

composition and content of group accounts and the relevant Standards should be publicly encouraged and pressed forward.

Fair value accounting and regularity of revaluations

11. There has been a retreat from accounting for changing prices by the private sector and the Accounting Standards Committee is due to review the subject before the end of 1987. The decline in inflation and the cost of preparation of alternative forms of accounting information have been used to rationalise this retreat, (though many companies still use price level adjusted information in one form or another for management purposes). A more legitimate complaint is that the techniques tried have been oversophisticated and not appropriate for all types of business. Nevertheless, the main reason for retreat is undoubtedly still the fear of the effects of lower reported profits on share values as well as on profit related remuneration bases.

12. That said, the threat and practice of takeovers has led to increasing emphasis on modified historical cost accounts, incorporating updated valuations of significant assets, notably land and buildings. At present the UK law allows a choice of which, if any, assets to revalue and when, in contrast to other major countries such as the US and Germany, where revaluation is not an accepted accounting practice. This option distorts comparability of accounts. A requirement that there should be systematic, regular and consistent reassessment of fair values of all assets in company accounts, should achieve the benefit of price level adjustments without the complexities and dissent likely if more sophisticated methods of accounting were required.

Proposal

13. There may need to be a requirement in company legislation that revaluation of assets is comprehensive and regularly carried out using consistent principles or, as a minimum that this should be done where there is any departure from the historical cost

convention. The Accounting Standards Committee is already at work to develop a Standard in this area, but pressure is probably going to be needed to strengthen it.

Research and development

14. Considerable progress has been made with the accounting profession which is revisiting this subject. A new accounting standard is proposed in Exposure Draft 41, published in June 1987 which will require companies to disclose the level of research and development expenditure undertaken each year. This proposal should be publicly supported.

CH/EXCHEQUER
REC. 4 NOV 1987
ACTION FST
COPIES TO

4/11

PPS in

pmp

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SWIH 9AT

3 November 1987

Dear David,

SMALL COMPANIES ACCOUNTING AND AUDIT REQUIREMENTS

Thank you for copying to me your letter of 29 September to Nigel Lawson. I am grateful for the opportunity to consider at an early stage the implications of your proposals for charitable companies.

I see the need to reduce the burdens placed on small companies by the accounting and audit requirements of the Companies Act but I am concerned about any relaxation of the auditing requirements on charitable companies, particularly just at this time. Our officials have recently been considering the special position of charitable companies on the context of the proposed abolition of the auditing requirements of some aspects of the ultra vires rule. These consultations - to which Treasury Solicitors, the Inland Revenue and the Charity Commission were also party - have established the principle that (notwithstanding variations in the overall framework of company regulation) charitable companies do need a stricter treatment than other companies, if only because they must continue to fall under the jurisdiction of the High Court with regard to charities and, therefore, come within the supervisory remit of the Charity Commission.

We attach great importance to emphasising this now in the aftermath of the NAO Report on the Control and Monitoring of Charities and Sir Philip Woodfield's Efficiency Scrutiny of the Supervision of Charities. Both these reports noted the mounting public concern about the abuse of charitable status, were sharply critical of the existing arrangements for supervision and called for changes to tighten the statutory framework of control to enforce the law more effectively. The Woodfield report, in particular, recommended new legislation which would inter alia require all but very small charities to submit annual audited accounts to the Charity Commission.

Because we have yet to take decisions on the handling of the Scrutiny Report, I cannot at the moment rule out the possibility that we may have to put forward proposals for stricter controls on charities (including charitable companies) which, at least in respect of auditing requirements, could run counter to the relaxations you are contemplating for small companies generally.

One of our concerns is that, while an annual turnover of £2 million may define a "small" trading company, it is a large turnover for a charity. With the growing trend for charities to establish themselves as companies, your proposals would have the effect of placing large numbers of them beyond the requirement for audit just at the time when we are becoming only too aware that this is exactly where charitable fraud is particularly concentrated.

The Rt Hon The Lord Young of Graffham

/over....

You mention that the relaxation of the audit requirement might have resource implications for the Revenue. I should add that the position will be mirrored in the Charity Commission, which also has the task of examining accounts. I see less difficulty, however, over accounting information, though this will depend partly on the Statement of Recommended Practice on charity accounting which is being prepared by the Accounting Standards Committee.

My understanding is that the ultra vires discussions have cleared the way to distinguish charitable companies from other companies in legislation and to apply different requirements in each case. I am grateful for the progress which has been made on this and the way in which our interest in charitable companies has been taken into account. I hope that you can agree to extending this principle to auditing requirements and I have asked my officials to be in touch with yours to see what can be agreed.

I am copying this letter to Nigel Lawson, Norman Lamont and to John Cope.

Yours,

Douglas

2838/39c2

Papers Please

FROM: S J FLANAGAN

DATE: 28 October 1987

1. MR A WILSON agree 28/10

2. CHANCELLOR

C/ letter to issue?

CR 28/10

Phoned through

This submission is disgracefully late & in the crisis I am not prepared even to entertain it until to-day week. As I do not agree with the conclusion.

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Monck
Mr Burgner
Mr Scholar
Miss Sinclair
Mr Gray
Mr Inglis
Mr Wynn Owen
Mr Cropper
Mr Tryie
PS/IR
Mr L Beighton IR
Mr D L Shaw IR
Mr C Sullivan IR
Mr Arnold IR
Mr Holloway C+E

SMALL FIRMS ACCOUNTING AND AUDIT REQUIREMENTS

Lord Young wrote to you on 29 September, proposing that the statutory audit requirement should be removed for small firms (which he defined as those with an annual turnover of less than £2 million), and that discussions should be re-opened at official level on how to relax the accounting requirements for small firms. Mr Cope's letter of 12 October to Lord Young records his agreement with the proposal to remove the statutory audit.

2. I apologise for the delay in submitting this advice, which recommends that you write saying you wish to retain the statutory audit. On small firms' accounting requirements, it would be best to take this forward as a separate part of the accounting initiative suggested in Mr Wilson's minute to you of 21 September. He is already engaged in a series of meeetings with the Bank of England, Customs and Excise, and the Inland Revenue. But before positive recommendations for further relaxation in accounting disclosures can be made it will be necessary for Inland Revenue and DTI officials to agree what they should be. The DTI therefore needs to be made aware formally now of the accounting initiative. Mr Wilson will be minuting you separately with a draft letter.

Background

3. The possible abolition of audit requirement for small companies was discussed at a meeting you held on 14 May 1986. Lord Young, then Employment

Secretary, wanted to remove the requirement from companies with a turnover of £250,000 a year or less. His current proposal, from DTI, is more ambitious: to remove the audit requirement from companies with an annual turnover of £2 million or less (the maximum permitted by the EC). This would cover 90 per cent of UK companies.

4. It was decided at your May meeting to retain the audit requirement. The resulting White Paper "Building Businesses.. Not Barriers" stated: "The Government have decided to retain the requirement for small companies to have their accounts audited. The consultation revealed no strong balance of opinion in favour of abolition. The Government are determined to clamp down on fraud and have decided that removal of this first defence against fraud would be inappropriate".

5. It was also decided that the accounting requirements for small firms should be relaxed as far as EC law and Inland Revenue requirements allowed. There followed a period of consultation at official level between the Revenue, DTI and Treasury, which resulted in the proposed relaxations Lord Young rejects as not worth implementing.

AUDIT

6. It is difficult to establish how much of a burden on small businesses the audit requirement represents. There is no accurate assessment available of audit costs by themselves, but on such slender evidence as is available they represent only a small proportion - perhaps no more than 20 per cent - of the overall accountancy fees paid by smaller companies. This is because much of the accounting work that would have to be done anyway is performed in the course of an audit.

7. Opinion amongst concerned groups is divided. Lord Young mentions that the Insitutes of Chartered Accountants want the statutory audit removed and is himself apparently influenced by the situation in the USA where audit has always been voluntary except for listed companies. The Institutes may have been stirred by the likely high costs of monitoring audit performance by a large number of small firms, a procedure which will be required by the companies legislation enacting the EC 8th directive. But the Certified Accountants - who members audit many small companies - want the audit retained. The representations received on the Government's consultation paper "Accounting and Audit Requirements for Small Firms" were inconclusive either way.

8. The audit requirement serves two main purposes. Firstly, it is a deterrent to deliberate fraud. Secondly, it helps maintain accounting standards and corrects unintentional error: an important feature given the inadequate housekeeping in many small companies. Lord Young argues that the main area of public concern is with large-scale, particularly City, fraud. Such cases are certainly more dramatic and more likely to be reported in the press. But there is still good reason to protect creditors and shareholders of small companies from fraud and from failure of companies with inadequate business records - particularly when Lord Young's definition of "small" includes 90 per cent of businesses.

9. The greater reliability of audited accounts seems to be valued by private sector users. The Chartered Association of Certified Accountants' report "The Information Needs of Bankers Dealing with Large and Small Companies" found that audited accounts were much preferred. Although there is no firm evidence, it is a reasonable assumption that the additional checks which auditors have to make before certifying the accounts as true and fair provide a measure of reliability, and on that basis the Inland Revenue investigate a smaller percentage of companies than unincorporated (and therefore unaudited) businesses. To investigate the same percentage as they now do for unincorporated businesses would require another 350 to 400 fully trained inspectors. This is not a realistic option, so the consequence of dropping the audit requirement would be to put the Exchequer at considerable risk. Investigations into companies currently yield sums of the order of £50 million a year, and technical revision to tax computations yield more than ten times that much.

10. There are also problems associated with any threshold: companies near the £2 million (or any other) threshold would not know until late in the year whether they needed audited accounts, and might fluctuate either side of the threshold from year to year. Skilful fraudsters would doubtless make sure that they operated within the threshold, perhaps by setting up a string of small companies.

ACCOUNTING REQUIREMENTS

11. It was agreed at the meeting you held on 14 May 1986 with Lord Young and Mr Channon (then Secretaries of State for Employment and Trade and Industry respectively) and others that ways of reducing the burdens of accounting requirements on small companies should be examined. It would not be desirable to reduce the information required below the level needed by regular users - be they shareholders, banks, or the Inland Revenue. The information would then have to be sought by other routes, at a possibly greater cost to the small businessman than if he had included it in his audited accounts in the first place.

12. Discussions between officials produced a set of some 30 deletions and relaxations in information requirements which the Revenue judged were unlikely to cause undue difficulty - in particular serious prospects of increased abuse. Lord Young however, believes that these amendments would be virtually worthless and liable to do more harm presentationally than good. The Revenue think that to go further would increase the danger to the Exchequer, not just from fraud but also from failure to identify necessary technical adjustments.

13. Mr Wilson's minute to you of 21 September suggested a more general review by officials of accounting aspects of company law and professional practice. Ms Ryding's minute of 1 October noted that you welcomed this initiative but were a little concerned that there was nothing on small firms, and the need for simpler accounting requirements in their case.

14. There is now a need for speedy resolution of the problem of the amount of information to be disclosed in the accounts of small companies. This can be dealt with as a separate issue from the others contained within Mr Wilson's Accounting Initiative. Nor is there any further need for the existence of this initiative to be withheld from Lord Young. In fact, it would now be helpful for the DTI to be made aware of it formally so that talks can proceed at official level. Mr Wilson will be sending you separately a suitable draft letter for Lord Young.

15. In the meantime, the Financial Secretary will be attending the Ministerial Committee on deregulation, MISC 133, on Monday 2 November. It would be helpful if Lord Young had received a reply to his letter before then. The best option would therefore seem to be a fairly non-commital response. The draft letter attached takes that line.

S J FLANAGAN

DRAFT LETTER FROM THE CHANCELLOR TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

SMALL COMPANIES ACCOUNTING AND AUDIT REQUIREMENTS

Thank you for your letter of 29 September. I have also seen John Cope's letter to you of 12 October, registering his support for your proposal to abolish the statutory audit requirement for small companies.

Audit

2. I was interested to note that you now suggest removing the statutory audit requirement from companies with an annual turnover of less than £2 million, around 90 per cent of businesses, rather than the £250,000 threshold you suggested when you were Employment Secretary. But I do not think conditions have significantly changed since we decided on 14 May last year to retain the statutory audit. Opinion among interested parties still seems divided. You mentioned that the Institutes of Chartered Accountants are in favour of abolition, but I understand that the Certified Accountants, who admittedly have an interest in that they audit the accounts of many small companies, have come out strongly in favour of retaining the statutory audit, as it introduces on element of financial rigour which many small companies would otherwise lack.

3. I remain concerned about fraud. You will recall that your White Paper "Building Businesses ... Not Barriers" said of the statutory audit: "The Government are determined to clamp down on fraud and have decided that removal of this first defence against fraud would be inappropriate". To go back on that decision now would be to send out quite the wrong signals. Fraud in small companies obviously has a lower profile than in larger ones, but we should not expose creditors and shareholders of small companies, among others, to needless risk.

4. You asked what the implication for the Inland Revenue of abolishing the audit requirements would be. At present, the Revenue feel that the discipline of statutory audit makes company tax returns more reliable. They therefore investigate no more than about half the percentage of accounts from companies as they do for unincorporated (and therefore unaudited) businesses. Without the safeguard of audit, this lower proportion investigated would be hard to justify. To allow the same coverage of company accounts as unincorporated business accounts would require some hundreds of new inspectors, which is not a realistic prospect. So the consequence of the change would be to put Exchequer revenues at risk and signal that the Government were placing less emphasis on fraud.

5. In the light of these considerations. I do not think we should reverse the decision we reached last year.

Accounts

6. We are agreed that the burdens imposed on small companies by accounting information requirements should be eased. But there is little point removing information which is needed by regular users of the accounts. They will simply seek it by other routes. The burden on the small businessman will not be reduced. Indeed, it may even be increased if he has to respond separately to inquiries from his shareholders, his bank, and the Inland Revenue.

7. I recognise, though, that you are unhappy with the proposals produced by the exercise our officials undertook last year. I am looking into the best way of taking this forward, and will write again shortly.

8. I am copying this letter to Douglas Hurd and John Cope.

[N L]

SF/J/29

Department of Employment
Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 5949
Switchboard 01-213 3000

Minister of State

RECEIVED IN THE SECRETARY OF STATE FOR TRADE AND INDUSTRY'S OFFICE
14 OCT 1987

For Information
MR Hewes EDU
PS/CDL Mr Ewing
PS/FM Ms Darrell
PS/SBH
MR Liesner
MR Knighton
MR Headfield
MRS Ashmore
MS Morgan
Mr Loughead

Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

12 October 1987

Dear David

MINISTERIAL GROUP ON DEREGULATION

In your letter of 15 September to Norman Lamont about the new Ministerial Group, you invited initial thoughts before the first meeting.

One paper on the agenda will discuss principles of deregulation. While a primary aim must be to continue to seek to identify regulations which can be totally abolished, much remains to be done even where some form of regulation seems inevitable, and I should like us to consider an approach which takes into account the particular cost of regulation and bureaucracy for small firms. We have rightly stressed that industry as a whole suffers from too much regulation but I believe, and this is confirmed by the recent studies carried out by the Belmont centre and by Graham Bannock for the European Commission, that the costs fall especially heavily on small firms. Small firms do not have the specialist legal, accounts and other departments that ease the effect of bureaucracy.

Of course, we would not want to take any steps that might suggest a first and second class citizen divide. I am not suggesting that safety standards, for example, should be lower in small firms. But there are already areas where exemptions exist for small firms and we might look both at the case for raising these and for extending that approach elsewhere. A specific case where I believe a relaxation might be introduced for small firms concerns the requirement to file accounts at Companies House as suggested in your letter of 29 September to Nigel Lawson. I believe that for small firms the requirement is onerous and unfair and I should like to suggest that it is examined. Other areas of concern include the statutory audit for small companies which I know from your letter of 29 September you wish to review. I support you in this. You may also think it suitable to look at the effect of the Financial

Services Act, which I am sure you will have under review, and the effect of the Financial Services Act on independent intermediaries.

There are other areas that we can examine in particular but I should find it helpful for there to be a discussion first of the general point that we should aim, in our approach to deregulation, to alleviate the position of those on whom the effect - and it usually means a cost ultimately - is greatest.

I also think it is important to recognise that, while your new group will take the overall lead on deregulation, there will be complementary work going on elsewhere. I have in mind particularly the role of the Tourism Coordination Committee in relation to tackling barriers to development of the tourism industry. As the founding chairman of this committee you will know how useful it can be in allowing a range of issues important to the industry to be dealt with in the right context. The officials dealing with tourism here will continue to keep in close touch with the EDU on the progress and handling of these issues, and I am sure the tourism and deregulation thrusts can continue to reinforce one another.

I am copying this letter to the other members of the Group and to Sir Robert Armstrong.

Yours ever

John

JOHN COPE

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

BF 12/10

BF 21/10

29 September 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1P 3AG

CH/EXCHEQUER
REC. 01 OCT 1987 1/10
ACTION FST
COPIES TO

HM TREASURY – MCU
RECD. 1 OCT 1987
ACTION
SIGNATURE
REF. No.

Dear Nigel,

SMALL COMPANIES ACCOUNTING AND AUDIT REQUIREMENTS

I have been considering what further steps should be taken within my field of responsibility in this Department to reduce burdens on small companies. We already have a useful package of measures which I would hope to implement in the Companies Bill proposed for 1988/89, but I would also like to press forward with reducing the accounting and audit requirements which the Companies Act imposes on small companies. I am writing to you in view of the Treasury and Inland Revenue considerations which affected the decisions we took on these matters last year.

Audit

My first priority is the audit. We decided last year to retain the audit requirement for all companies primarily as a defence against fraud. I went along with that decision but, given the limitations of small company audits, I cannot really believe that any deterrent effect they may have outweighs the significant costs involved. I am clear, on the other hand, that the requirement to have an audit serves little useful purpose so far as the management of the business is concerned. I am reinforced in that view by the English and Scottish Institutes of Chartered Accountants which have both written to me in recent weeks pressing the case for abolition and arguing that the accountancy profession could do more to help small companies if the requirement for an independent audit were dispensed with.

JG2BRO

Given last year's decision, any relaxation of the audit requirement will need careful presentation. There must be a risk that our opponents will try to present it as evidence that we are going soft on fraud but our record on tackling fraud, particularly City fraud - the major area of public concern - is such that I am confident we could rebut any charge of that sort. We can also stress the benefits to all those who are concerned with the small company sector of freeing small companies from an unnecessary task and enabling them to get on with their business.

Last year, Revenue officials stressed that in their view audited accounts are inherently more reliable than unaudited accounts and that consequently the Revenue is able to justify devoting significantly less resources to investigation of company accounts than would otherwise be the case. I do not accept the basic argument - as I understand it such investigations as have been carried out suggest that there is no significant difference in standards of accuracy - but I do accept that the resource implications of abolition for the Revenue need to be taken into account. I would therefore welcome your views on that issue and generally on how far abolition should go. There is a case for limiting its scope, at least initially but my personal preference would be to abolish the requirement for all small companies with an annual turnover of less than £2 million except plcs, companies engaged in financial services business and members of groups with a combined turnover of more than £2 million.

<u>Accounts</u>

We agreed last year that the amount of information the Companies Act requires companies to produce for shareholders should be reduced so far as was consistent with the needs of the Revenue with a view to enabling small companies filing modified accounts to use the same set of accounts for shareholders, Revenue and filing purposes. Michael Howard subsequently made two separate announcements to this effect promising detailed proposals in due course but we have so far failed to discharge that commitment. You may recall that I was distinctly unhappy about the extent of the reductions which were worked out by DTI and Revenue officials and that it was agreed that officials should look at the position again before any final decisions were taken.

Since then, officials here have tried the proposed changes out on the major accountancy bodies and on the proposals as they stand are virtually worthless, will not significantly reduce costs and presentationally could well do more harm than good. Quite independently, the EDU has come to exactly the same conclusion. In

JG2BRO

the circumstances, I see no point in implementing the current package as it stands but it is clearly essential that we should deliver what we have promised.

I recognise that the Revenue attach importance to being able to use statutory accounts as sources of information but I must say that we still see considerable scope for reducing Companies Act requirements in this area without prejudicing Revenue needs. Our assessment is that some two thirds of the items on the current balance sheet are not necessary for company law purposes we need to be very sure therefore that any information over and above that is really necessary for tax purposes and needs to be included in the accounts themselves. I therefore propose that officials should re-open discussions with a view to achieving further significant reductions in the content of shareholders' accounts. I hope that you will give this objective your support.

I am copying this letter to Douglas Hurd in view of his interests in charitable companies, Norman Lamont, and to John Cope.

LORD YOUNG OF GRAFFHAM

JG2BRO

056231
MDHIAN 2794

RESTRICTED
FM WASHINGTON
TO IMMEDIATE FCO
TELNO 2301
OF 270125Z OCTOBER 87
AND TO PRIORITY CG NEW YORK
INFO SAVING OTHER CGS IN USA

US ECONOMY: REACTIONS TO DEVELOPMENTS ON WALL STREET

SUMMARY
1. UNPRECEDENTED VOLATILITY BLAMED ON TWIN DEFICITS AND PROGRAMME TRADING. CONSUMPTION AND INVESTMENT LIKELY TO BE DELAYED, LOWERING GROWTH NEXT YEAR. MANY SMALL AND POSSIBLY A FEW LARGE FINANCIAL BANKRUPTCIES EXPECTED. BANKING DEREGULATION LIKELY TO GO ON BACK BURNER. SILVER LININGS ARE PRESIDENT'S AGREEMENT TO DISCUSS BUDGET DEFICIT REDUCTION (BUT THIS MAY HAVE BEEN OVERSOLD), LIKELY INCREASE IN DOMESTIC SAVINGS AND LOWER INTEREST RATES. MARKET VOLATILITY LIKELY TO CONTINUE.

DETAIL
2. OVER THE LAST TEN DAYS THE STOCK MARKET HAS FALLEN BY 22 PER CENT ON THE DOW JONES INDEX. EQUITIES ARE NOW 26 PER CENT BELOW THE PEAK LEVEL REACHED ON 25 AUGUST BUT ARE STILL 142 PER CENT ABOVE THE TROUGH ATTAINED ON AUGUST 12, 1982 (COMMONLY REGARDED AS THE START OF THE BULL MARKET). THE DECLINE CONTINUED ON 26 OCTOBER (ANOTHER 157 POINTS). VOLATILITY HAS BEEN AT UNPRECEDENTED LEVELS AND TRADING VOLUME HAS BEEN FOUR TIMES HIGHER THAN USUAL.
3. THE DOMINANT VIEW HERE IS THAT THE FUNDAMENTAL CAUSES OF THE SLIDE ARE THE TWIN DEFICITS AND, TO A LESSER EXTENT, FEARS THAT THE FED WOULD HAVE TO RAISE INTEREST RATES TO COMBAT RISING INFLATIONARY EXPECTATIONS. KAUFMAN HAS ARGUED THAT THE BULL PHASE OF THE MARKET WAS ARTIFICIALLY PROLONGED BY COMPANIES BUYING THEIR OWN STOCK, THEREBY REDUCING THE SUPPLY OF SUCH SHARES AND PUSHING UP THEIR PRICE IN AN ATTEMPT TO WARD OFF HOSTILE TAKEOVERS. PROGRAMME TRADING IS BEING WIDELY BLAMED FOR INCREASING THE VOLATILITY OF, BUT NOT THE DECLINE IN, THE MARKET.
4. A NUMBER OF CONSEQUENCES AND CONCERNS ARISING FROM LAST WEEK'S EVENTS HAVE ALREADY EMERGED, THE MOST SIGNIFICANT BEING:
(I) A LASTING IMPRESSION OF THE TRUE RISKINESS OF EQUITIES WHICH WILL PROBABLY REDUCE THE SCALE OF DIRECT EQUITY INVESTMENT BY INDIVIDUALS FOR SOME TIME:

056231
MDHIAN [illegible]94

(II) THE REALISATION THAT FUTURES MARKETS AND, IN PARTICULAR, STOCK INDEX OPTIONS DO NOT OFFER MUCH HEDGING PROTECTION BUT APPEAR TO INCREASE VOLATILITY SIGNIFICANTLY. (IN THE YEAR TO DATE TRADING IN STOCK FUTURES HAS EXCEEDED TRADING IN ORDINARY STOCKS BY 50 PER CENT.) TRADING IN STOCK INDEX OPTIONS WAS BANNED AT TIMES LAST WEEK AND SOME COMMENTATORS ARE ARGUING THAT THEY SHOULD BE PERMANENTLY OUTLAWED:
(III) GROWING WORRIES ABOUT THE CONSEQUENCES OF FINANCIAL DEREGULATION. IT IS NOW MUCH LESS LIKELY THAT CONGRESS WILL TAKE RADICAL STEPS TO REFORM THE GLASS-STEAGALL ACT'S DIVISION BETWEEN BANKING AND SECURITIES DEALING. INDEED THERE ARE ALREADY MOVES TO CONSIDER IMPROVING THE REGULATION OF FINANCIAL MARKETS, IN PARTICULAR, THE FUTURES MARKETS:
(IV) INCREASING CONCERN ABOUT ATHE CAPITALISATION OF SECURITIES HOUSES. IN NEW YORK RUMOURS THAT MANY SMALL, AND SOME LARGE, HOUSES ARE IN TROUBLE ARE WIDESPREAD. E F HUTTON HAS BEEN MENTIONED AS A POSSIBLE LARGE CASUALTY, BUT MOST PEOPLE BELIEVE THE FED MAY ORGANISE TAKEOVERS RATHER THAN ALLOWING FIRMS TO FAIL:
(V) RISING OPTIMISM OVER THE PROSPECTS FOR BUDGET DEFICITS IN THE LIGHT OF THE PRESIDENT'S AGREEMENT TO DISCUSS A DEFICIT REDUCTION PACKAGE WITH CONGRESS (BUT SEE PARA 7 BELOW):
(VI) LOWER EXPECTATIONS OF ECONOMIC GROWTH NEXT YEAR. MOST ANALYSTS AGREE THAT INVESTMENT PLANS AND EXPENDITURE ON CONSUMER DURABLES AND HOUSES COULD WELL BE DELAYED FOR SOME TIME. THE FED'S MODEL SUGGESTS THAT A 20 PER CENT DROP IN EQUITY PRICES WOULD REDUCE REAL GNP GROWTH BY 0.75 PER CENT IN THE FOLLOWING YEAR, ALTHOUGH THE FED STAFF REGARD THIS ESTIMATE AS SOMEWHAT ON THE HIGH SIDE. PRIVATE SECTOR MODELS PRODUCE MUCH SMALLER EFFECTS. THE ADVERSE EFFECTS ON CONSUMPTION, INVESTMENT AND THE HOUSING SECTORS MAY BE OFFSET SOMEWHAT BY THE LARGE FALL IN INTEREST RATES. BUT THE INCREASED VOLATILITY OF INTEREST RATES WILL TEND TO OFFSET THE ADVANTAGES OF A REDUCTION IN THEIR LEVEL. THE ONE POSSIBLE SILVER LINING IS THAT DOMESTIC SAVINGS MAY RISE AS CONSUMPTION IS POSTPONED AND INCOMES REMAIN AT LEAST INITIALLY UNAFFECTED:
(VII) FEARS THAT 1987 COULD BE A REPEAT OF 1929. FEW BELIEVE THAT THE FED WILL MAKE THE MISTAKE OF TIGHTENING POLICY AS THEY DID IN 1929 AND GREENSPAN IS WIDELY PRAISED FOR INJECTING LIQUIDITY INTO THE SYSTEM IN A TIMELY FASHION. MANY COMMENTATORS HAVE USEFULLY POINTED OUT THAT 1929 WAS FOLLOWED BY SMOOT-HAWLEY WHICH WAS A MAJOR CAUSE OF THE GREAT DEPRESSION. THIS MAY SERVE TO STRENGTHEN THE ANTI-PROTECTIONISTS IN THEIR EFFORTS TO IMPROVE THE ATATADE BILL:

(VIII) WORRIES THAT THE DOLLAR MAY ALSO COME UNDER PRESSURE IN THE NEAR FUTURE. FOREIGN EXCHANGE ANALYSTS IN NEW YORK ARE ARGUING THAT THE FED DARE NOT RAISE INTEREST RATES TO DEFEND THE DOLLAR BECAUSE OF THE FRAGILITY OF ATE FINANCIAL SYSTEM. IF FOREIGNERS DECIDE TO TAKE THEIR INVESTMENTS OUT OF DOLLARS IT MAY THEREFORE NOT BE POSSIBLE FOR THE G7 COUNTRIES TO PREVENT A DECLINE IN THE DOLLAR UNLESS THERE IS CONCERTED INTERVENTION ON A MASSIVE SCALE, OR INTEREST RATES OVERSEAS ARE REDUCED. (ANALYSTS WILL REGARD THE EXTENT OF JAPANESE PARTICIPATION IN THE TREASURY'S QUARTERLY AUCTION, SCHEDULED FOR 3-5 NOVEMBER, AS A GOOD INDICATOR OF FOREIGN INTEREST IN DOLLAR SECURITIES.)

COMMENT

5. WALL STREET'S PROBLEMS SEEM FAR FROM OVER. THE MARKETS HAVE YET TO DIGEST FULLY THE POOR TRADE FIGURES CONTAINED IN THE PRELIMINARY THIRD QUARTER GNP REPORT RELEASED ON 23 OCTOBER. BOTH EXPORTS AND IMPORTS ARE ESTIMATED TO HAVE INCREASED IN VOLUME TERMS BY 16.5 PER CENT (ANNUAL RATE) IN THE THIRD QUARTER. SINCE IMPORTS ARE MUCH LARGER THAN EXPORTS, THE TRADE BALANCE DETERIORATED. THIS IS A BLOW TO ONE OF THE ADMINISTRATION'S MAIN ARGUMENTS ABOUT THE SLOWNESS OF THE J-CURVE EFFECT TO SHOW UP, NAMELY THAT EVEN IF IN DOLLAR TERMS THE GAP HAD NOT YET NARROWED, IN VOLUME TERMS THE SITUATION WAS IMPROVING.
THE RESILIENCE OF IMPORT VOLUMES DESPITE THE PRICE INCREASE OF 8.3 PER CENT (ANNUAL RATE) WILL PROVIDE AMMUNITION TO THOSE IN FAVOUR OF A TOUGHER TRADE BILL (THOUGH SEE ALSO PARA 4(VII) ABOVE). THE FALL IN THE STOCK MARKET IS EXPECTED TO WEAKEN CONSUMPTION AND INVESTMENT WHICH MAY HELP TO REDUCE IMPORTS. HOWEVER THE DECLINES IN OVERSEAS STOCK MARKETS MAY HAVE A SIMILAR DAMPENING EFFECT ON DEMAND FOR US EXPORTS.

6. THE PROSPECTS FOR AGREEMENT BETWEEN CONGRESS AND THE ADMINISTRATION ON A DEFICIT REDUCTION PACKAGE HAVE IMPROVED AS A RESULT OF THE UPHEAVALS IN THE STOCK MARKET. ON THE CONGRESSIONAL SIDE, THERE HAVE BEEN INCREASING SIGNS IN THE LAST FEW DAYS OF A MORE BIPARTISAN APPROACH. AND DESPITE DOUBTS ABOUT THE ABILITY OF A WEAKENED PRESIDENT TO PROVIDE THE NECESSARY LEADERSHIP TO CALM THE MARKETS, THE PRESIDENT'S NEW WILLINGNESS TO START NEGOTIATIONS WITH CONGRESS HAS HAD A POSITIVE PSYCHOLOGICAL EFFECT. SPRINKEL (CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS) SUGGESTED ON TV AT THE WEEKEND THAT THE PRESIDENT MIGHT ACCEPT MEASURES TO CLOSE LOOPHOLES AND REDUCE DEDUCTIONS AS PART OF A PACKAGE THAT INCLUDED SPENDING CUTS. THE RECONCILIATION BILLS PASSED BY THE HOUSE WAYS AND MEANS AND THE SENATE FINANCE COMMITTEES CONTAIN MEASURES OF THIS KIND WHICH WOULD RAISE AROUND DOLLARS 12 BILLION IN REVENUE. IT MAY

THEREFORE BE POSSIBLE TO AGREE A PACKAGE WHICH RAISES SUFFICIATNT REVENUE WITHOUT INCREASING TAX RATES (SOMETHING THE PRESIDENT STILL EVIDENTLY REFUSES TO ACCEPT). SPRINKEL SUGGESTED THAT A FREEZE OF CERTAIN SPENDING PROGRAMMES COULD BE A USEFUL PART OF AN OVERALL DEFICIT REDUCTION PACKAGE.

7. THE HOUSE RECONCILIATION BILL IS LIKELY TO BE VOTED ON (AND PROBABLY PASSED) LATER THIS WEEK. IT IS LIKELY THAT ANY MEASURES AGREED WITH THE PRESIDENT COULD BE INCLUDED IN ATE SENATE BILL, WHICH HAS NOT YET REACHED THE FLOOR. A CONFERENCE WILL BE NEEDED TO AGREE A COMPROMISE BILL, SO IT IS UNLIKELY THAT A DEFICIT REDUCTION PACKAGE WILL BE SIGNED INTO LAW MUCH BEFORE THE 20 NOVEMBER DEADLINE IMPOSED BY THE REVISED GRAMM-RUDMAN LEGISLATION. IF THERE IS NO AGREEMENT BY THEN, THE DOLLARS 23 BILLION SEQUESTRATION WILL BE IMPLEMENTED. TREASURY SECRETARY BAKER AND HOUSE WAYS AND MEANS COMMITTEE CHAIRMAN ROSTENKOWSKI HAVE EXPRESSED SCEPTICISM ABOUT THE POSSIBILITY OF AGREEING A PACKAGE INCLUDING LARGER CUTS THAT HAS THE SUPPORT OF SENATORS DOLE, BENTSEN AND CHILES. BUT IT IS LIKELY THAT THE OUTCOME OF THE TALKS BETWEEN CONGRESS AND THE ADMINISTRATION WILL MAINLY DETERMINE THE FORM OF DEFICIT REDUCTION, NOT THE AMOUNT. NEVERTHELESS THE MARKETS SEEM TO ATTACH IMPORTANCE TO THE WHITE HOUSE REACHING AGREEMENT WITH CONGRESS AND MAY REACT BADLY IF THE TALKS BREAK DOWN OR FAIL TO PRODUCE ANYTHING SIGNIFICANT. IT IS WORTH EMPHASISING THAT, EVEN WITH A DOLLARS 23 BILLION CUT, NEXT YEAR'S DEFICIT IS LIKELY TO BE CONSIDERABLY ABOVE THE FY 87 LEVEL, AS THE LATTER WAS REDUCED BY A NUMBER OF ONE-OFF FACTORS. THE CONGRESSIONAL BUDGET OFFICE HAVE ESTIMATED THAT THE DEFICIT WILL BE DOLLARS 156 BILLION IN FY 88 IF CUTS OF DOLLARS 23 BILLION ARE IMPLEMENTED (AS OPPOSED TO AN ESTIMATED DOLLARS 148 BILLION FOR FY 87).

8. FCO PLEASE ADVANCE TO PS/CHANCELLOR, SIR P MIDDLETON, SIR T BURNS, PERETZ, EVANS AND LOMAX (TREASURY),PS/GOVERNOR, GEORGE, WALKER AND GREEN (BANK), HILTON (DTI), AND RICHARDSON (ERD).

ACLAND

YYYY

056231
MDHIAN 2794

DISTRIBUTION 1

MAIN 1

FINANCIAL

NNNN

056231
MDHIAN 2794

RESTRICTED
FM WASHINGTON
TO IMMEDIATE FCO
TELNO 2301
OF 270125Z OCTOBER 87
AND TO PRIORITY CG NEW YORK
INFO SAVING OTHER CGS IN USA

US ECONOMY: REACTIONS TO DEVELOPMENTS ON WALL STREET

SUMMARY

1. UNPRECEDENTED VOLATILITY BLAMED ON TWIN DEFICITS AND PROGRAMME TRADING. CONSUMPTION AND INVESTMENT LIKELY TO BE DELAYED, LOWERING GROWTH NEXT YEAR. MANY SMALL AND POSSIBLY A FEW LARGE FINANCIAL BANKRUPTCIES EXPECTED. BANKING DEREGULATION LIKELY TO GO ON BACK BURNER. SILVER LININGS ARE PRESIDENT'S AGREEMENT TO DISCUSS BUDGET DEFICIT REDUCTION (BUT THIS MAY HAVE BEEN OVERSOLD), LIKELY INCREASE IN DOMESTIC SAVINGS AND LOWER INTEREST RATES. MARKET VOLATILITY LIKELY TO CONTINUE.

DETAIL

2. OVER THE LAST TEN DAYS THE STOCK MARKET HAS FALLEN BY 22 PER CENT ON THE DOW JONES INDEX. EQUITIES ARE NOW 26 PER CENT BELOW THE PEAK LEVEL REACHED ON 25 AUGUST BUT ARE STILL 142 PER CENT ABOVE THE TROUGH ATTAINED ON AUGUST 12, 1982 (COMMONLY REGARDED AS THE START OF THE BULL MARKET). THE DECLINE CONTINUED ON 26 OCTOBER (ANOTHER 157 POINTS). VOLATILITY HAS BEEN AT UNPRECEDENTED LEVELS AND TRADING VOLUME HAS BEEN FOUR TIMES HIGHER THAN USUAL.

3. THE DOMINANT VIEW HERE IS THAT THE FUNDAMENTAL CAUSES OF THE SLIDE ARE THE TWIN DEFICITS AND, TO A LESSER EXTENT, FEARS THAT THE FED WOULD HAVE TO RAISE INTEREST RATES TO COMBAT RISING INFLATIONARY EXPECTATIONS. KAUFMAN HAS ARGUED THAT THE BULL PHASE OF THE MARKET WAS ARTIFICIALLY PROLONGED BY COMPANIES BUYING THEIR OWN STOCK, THEREBY REDUCING THE SUPPLY OF SUCH SHARES AND PUSHING UP THEIR PRICE IN AN ATTEMPT TO WARD OFF HOSTILE TAKEOVERS. PROGRAMME TRADING IS BEING WIDELY BLAMED FOR INCREASING THE VOLATILITY OF, BUT NOT THE DECLINE IN, THE MARKET.

4. A NUMBER OF CONSEQUENCES AND CONCERNS ARISING FROM LAST WEEK'S EVENTS HAVE ALREADY EMERGED, THE MOST SIGNIFICANT BEING:
(I) A LASTING IMPRESSION OF THE TRUE RISKINESS OF EQUITIES WHICH WILL PROBABLY REDUCE THE SCALE OF DIRECT EQUITY INVESTMENT BY INDIVIDUALS FOR SOME TIME:

(II) THE REALISATION THAT FUTURES MARKETS AND, IN PARTICULAR, STOCK INDEX OPTIONS DO NOT OFFER MUCH HEDGING PROTECTION BUT APPEAR TO INCREASE VOLATILITY SIGNIFICANTLY. (IN THE YEAR TO DATE TRADING IN STOCK FUTURES HAS EXCEEDED TRADING IN ORDINARY STOCKS BY 50 PER CENT.) TRADING IN STOCK INDEX OPTIONS WAS BANNED AT TIMES LAST WEEK AND SOME COMMENTATORS ARE ARGUING THAT THEY SHOULD BE PERMANENTLY OUTLAWED:

(III) GROWING WORRIES ABOUT THE CONSEQUENCES OF FINANCIAL DEREGULATION. IT IS NOW MUCH LESS LIKELY THAT CONGRESS WILL TAKE RADICAL STEPS TO REFORM THE GLASS-STEAGALL ACT'S DIVISION BETWEEN BANKING AND SECURITIES DEALING. INDEED THERE ARE ALREADY MOVES TO CONSIDER IMPROVING THE REGULATION OF FINANCIAL MARKETS, IN PARTICULAR, THE FUTURES MARKETS:

(IV) INCREASING CONCERN ABOUT ATHE CAPITALISATION OF SECURITIES HOUSES. IN NEW YORK RUMOURS THAT MANY SMALL, AND SOME LARGE, HOUSES ARE IN TROUBLE ARE WIDESPREAD. E F HUTTON HAS BEEN MENTIONED AS A POSSIBLE LARGE CASUALTY, BUT MOST PEOPLE BELIEVE THE FED MAY ORGANISE TAKEOVERS RATHER THAN ALLOWING FIRMS TO FAIL:

(V) RISING OPTIMISM OVER THE PROSPECTS FOR BUDGET DEFICITS IN THE LIGHT OF THE PRESIDENT'S AGREEMENT TO DISCUSS A DEFICIT REDUCTION PACKAGE WITH CONGRESS (BUT SEE PARA 7 BELOW):

(VI) LOWER EXPECTATIONS OF ECONOMIC GROWTH NEXT YEAR. MOST ANALYSTS AGREE THAT INVESTMENT PLANS AND EXPENDITURE ON CONSUMER DURABLES AND HOUSES COULD WELL BE DELAYED FOR SOME TIME. THE FED'S MODEL SUGGESTS THAT A 20 PER CENT DROP IN EQUITY PRICES WOULD REDUCE REAL GNP GROWTH BY 0.75 PER CENT IN THE FOLLOWING YEAR, ALTHOUGH THE FED STAFF REGARD THIS ESTIMATE AS SOMEWHAT ON THE HIGH SIDE. PRIVATE SECTOR MODELS PRODUCE MUCH SMALLER EFFECTS. THE ADVERSE EFFECTS ON CONSUMPTION, INVESTMENT AND THE HOUSING SECTORS MAY BE OFFSET SOMEWHAT BY THE LARGE FALL IN INTEREST RATES. BUT THE INCREASED VOLATILITY OF INTEREST RATES WILL TEND TO OFFSET THE ADVANTAGES OF A REDUCTION IN THEIR LEVEL. THE ONE POSSIBLE SILVER LINING IS THAT DOMESTIC SAVINGS MAY RISE AS CONSUMPTION IS POSTPONED AND INCOMES REMAIN AT LEAST INITIALLY UNAFFECTED:

(VII) FEARS THAT 1987 COULD BE A REPEAT OF 1929. FEW BELIEVE THAT THE FED WILL MAKE THE MISTAKE OF TIGHTENING POLICY AS THEY DID IN 1929 AND GREENSPAN IS WIDELY PRAISED FOR INJECTING LIQUIDITY INTO THE SYSTEM IN A TIMELY FASHION. MANY COMMENTATORS HAVE USEFULLY POINTED OUT THAT 1929 WAS FOLLOWED BY SMOOT-HAWLEY WHICH WAS A MAJOR CAUSE OF THE GREAT DEPRESSION. THIS MAY SERVE TO STRENGTHEN THE ANTI-PROTECTIONISTS IN THEIR EFFORTS TO IMPROVE THE ATATADE BILL:

(VIII) WORRIES THAT THE DOLLAR MAY ALSO COME UNDER PRESSURE IN THE NEAR FUTURE. FOREIGN EXCHANGE ANALYSTS IN NEW YORK ARE ARGUING THAT THE FED DARE NOT RAISE INTEREST RATES TO DEFEND THE DOLLAR BECAUSE OF THE FRAGILITY OF ATE FINANCIAL SYSTEM. IF FOREIGNERS DECIDE TO TAKE THEIR INVESTMENTS OUT OF DOLLARS IT MAY THEREFORE NOT BE POSSIBLE FOR THE G7 COUNTRIES TO PREVENT A DECLINE IN THE DOLLAR UNLESS THERE IS CONCERTED INTERVENTION ON A MASSIVE SCALE, OR INTEREST RATES OVERSEAS ARE REDUCED. (ANALYSTS WILL REGARD THE EXTENT OF JAPANESE PARTICIPATION IN THE TREASURY'S QUARTERLY AUCTION, SCHEDULED FOR 3-5 NOVEMBER, AS A GOOD INDICATOR OF FOREIGN INTEREST IN DOLLAR SECURITIES.)

COMMENT

5. WALL STREET'S PROBLEMS SEEM FAR FROM OVER. THE MARKETS HAVE YET TO DIGEST FULLY THE POOR TRADE FIGURES CONTAINED IN THE PRELIMINARY THIRD QUARTER GNP REPORT RELEASED ON 23 OCTOBER. BOTH EXPORTS AND IMPORTS ARE ESTIMATED TO HAVE INCREASED IN VOLUME TERMS BY 16.5 PER CENT (ANNUAL RATE) IN THE THIRD QUARTER. SINCE IMPORTS ARE MUCH LARGER THAN EXPORTS, THE TRADE BALANCE DETERIORATED. THIS IS A BLOW TO ONE OF THE ADMINISTRATION'S MAIN ARGUMENTS ABOUT THE SLOWNESS OF THE J-CURVE EFFECT TO SHOW UP, NAMELY THAT EVEN IF IN DOLLAR TERMS THE GAP HAD NOT YET NARROWED, IN VOLUME TERMS THE SITUATION WAS IMPROVING. THE RESILIENCE OF IMPORT VOLUMES DESPITE THE PRICE INCREASE OF 8.3 PER CENT (ANNUAL RATE) WILL PROVIDE AMMUNITION TO THOSE IN FAVOUR OF A TOUGHER TRADE BILL (THOUGH SEE ALSO PARA 4(VII) ABOVE). THE FALL IN THE STOCK MARKET IS EXPECTED TO WEAKEN CONSUMPTION AND INVESTMENT WHICH MAY HELP TO REDUCE IMPORTS. HOWEVER THE DECLINES IN OVERSEAS STOCK MARKETS MAY HAVE A SIMILAR DAMPENING EFFECT ON DEMAND FOR US EXPORTS.

6. THE PROSPECTS FOR AGREEMENT BETWEEN CONGRESS AND THE ADMINISTRATION ON A DEFICIT REDUCTION PACKAGE HAVE IMPROVED AS A RESULT OF THE UPHEAVALS IN THE STOCK MARKET. ON THE CONGRESSIONAL SIDE, THERE HAVE BEEN INCREASING SIGNS IN THE LAST FEW DAYS OF A MORE BIPARTISAN APPROACH. AND DESPITE DOUBTS ABOUT THE ABILITY OF A WEAKENED PRESIDENT TO PROVIDE THE NECESSARY LEADERSHIP TO CALM THE MARKETS, THE PRESIDENT'S NEW WILLINGNESS TO START NEGOTIATIONS WITH CONGRESS HAS HAD A POSITIVE PSYCHOLOGICAL EFFECT. SPRINKEL (CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS) SUGGESTED ON TV AT THE WEEKEND THAT THE PRESIDENT MIGHT ACCEPT MEASURES TO CLOSE LOOPHOLES AND REDUCE DEDUCTIONS AS PART OF A PACKAGE THAT INCLUDED SPENDING CUTS. THE RECONCILIATION BILLS PASSED BY THE HOUSE WAYS AND MEANS AND THE SENATE FINANCE COMMITTEES CONTAIN MEASURES OF THIS KIND WHICH WOULD RAISE AROUND DOLLARS 12 BILLION IN REVENUE. IT MAY

THEREFORE BE POSSIBLE TO AGREE A PACKAGE WHICH RAISES SUFFICIATNT REVENUE WITHOUT INCREASING TAX RATES (SOMETHING THE PRESIDENT STILL EVIDENTLY REFUSES TO ACCEPT). SPRINKEL SUGGESTED THAT A FREEZE OF CERTAIN SPENDING PROGRAMMES COULD BE A USEFUL PART OF AN OVERALL DEFICIT REDUCTION PACKAGE.

7. THE HOUSE RECONCILIATION BILL IS LIKELY TO BE VOTED ON (AND PROBABLY PASSED) LATER THIS WEEK. IT IS LIKELY THAT ANY MEASURES AGREED WITH THE PRESIDENT COULD BE INCLUDED IN ATE SENATE BILL, WHICH HAS NOT YET REACHED THE FLOOR. A CONFERENCE WILL BE NEEDED TO AGREE A COMPROMISE BILL, SO IT IS UNLIKELY THAT A DEFICIT REDUCTION PACKAGE WILL BE SIGNED INTO LAW MUCH BEFORE THE 20 NOVEMBER DEADLINE IMPOSED BY THE REVISED GRAMM-RUDMAN LEGISLATION. IF THERE IS NO AGREEMENT BY THEN, THE DOLLARS 23 BILLION SEQUESTRATION WILL BE IMPLEMENTED. TREASURY SECRETARY BAKER AND HOUSE WAYS AND MEANS COMMITTEE CHAIRMAN ROSTENKOWSKI HAVE EXPRESSED SCEPTICISM ABOUT THE POSSIBILITY OF AGREEING A PACKAGE INCLUDING LARGER CUTS THAT HAS THE SUPPORT OF SENATORS DOLE, BENTSEN AND CHILES. BUT IT IS LIKELY THAT THE OUTCOME OF THE TALKS BETWEEN CONGRESS AND THE ADMINISTRATION WILL MAINLY DETERMINE THE FORM OF DEFICIT REDUCTION, NOT THE AMOUNT. NEVERTHELESS THE MARKETS SEEM TO ATTACH IMPORTANCE TO THE WHITE HOUSE REACHING AGREEMENT WITH CONGRESS AND MAY REACT BADLY IF THE TALKS BREAK DOWN OR FAIL TO PRODUCE ANYTHING SIGNIFICANT. IT IS WORTH EMPHASISING THAT, EVEN WITH A DOLLARS 23 BILLION CUT, NEXT YEAR'S DEFICIT IS LIKELY TO BE CONSIDERABLY ABOVE THE FY 87 LEVEL, AS THE LATTER WAS REDUCED BY A NUMBER OF ONE-OFF FACTORS. THE CONGRESSIONAL BUDGET OFFICE HAVE ESTIMATED THAT THE DEFICIT WILL BE DOLLARS 156 BILLION IN FY 88 IF CUTS OF DOLLARS 23 BILLION ARE IMPLEMENTED (AS OPPOSED TO AN ESTIMATED DOLLARS 148 BILLION FOR FY 87).

8. FCO PLEASE ADVANCE TO PS/CHANCELLOR, SIR P MIDDLETON, SIR T BURNS, PERETZ, EVANS AND LOMAX (TREASURY),PS/GOVERNOR, GEORGE, WALKER AND GREEN (BANK), HILTON (DTI), AND RICHARDSON (ERD).

ACLAND

YYYY

056231
MDHIAN 2794

DISTRIBUTION 1

MAIN 1

FINANCIAL

NNNN

MR 3/63

~~CONFIDENTIAL~~ UNCLASSIFIED

CHANCELLOR OF THE EXCHEQUER

FROM: CATHY RYDING

DATE: ~~4~~ 2 NOVEMBER 198~~6~~7

PARLIAMENTARY CLERK

cc: PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Scholar
Mr Turnbull
Mr A C S Allan
Mr ~~Culpin~~ RIG Allen
Miss O'Mara
~~Mr Hacche~~ Miss C Evans
~~Mr Hudson~~
~~Mr Pickering~~ Miss Wallace
~~Mr Kerley~~
Mr ~~Ross Goobey~~ Cropper
Mr Norgrove No.10 Mr Tyne

BOX ATTENDANCE - NOVEMBER ~~6~~3

I should be grateful if you would let the House authorities know that the following people ~~the names of those~~ who will be occupying the Official Box on 3 ~~6~~ November:-

~~2. The following list is for the Chancellor's opening speech in the Economic Debate, and for the Autumn Statement Oral Statement:-~~

1. Sir P Middleton
2. ~~Mr Scholar~~ Miss C Evans
3. Mr Turnbull
4. ~~Mr Culpin~~ Mr R I G Allen
5. Mr A C S Allan
6. Miss O'Mara
7. ~~Miss Rutter~~ Miss Wallace
8. ~~Mr Hudson+/Mrs Ryding*~~ Mrs Ryding
9. Mr ~~Ross Goobey~~ ~~Cropper~~ Tyne
10. Mr Norgrove - No.10

3 Gallery tickets:-
1. ~~JT~~ Miss Rutter
2. ~~Moira / Sarah~~ Mr Hudson
3. Mr Cropper
~~Mrs Lawson~~

Mr RIG Allen ~~Culpin~~ will not actually be sitting in the box, this is merely to give him the access he needs to officials.

~~* Oral Statement~~
~~+ Economic Debate~~

2. In addition, I should be grateful if you arrange for the following to have Gallery tickets:- 1. Miss Rutter 2 Mr Hudson 3 Mr Cropper

3. In addition, I should be grateful if you would arrange for the following names to be added to the box list for the remainder of the debate up to the Chief Secretary's speech at the end of the debate:-

1. Mr Pickering
2. Mr Hacche
3. Mr Kerley

4. The Chief Secretary's office will provide you with a list of officials they will require in the box for the Chief Secretary's closing speech.

5. If Sir T Burns and Mr Butler give a press conference after the Autumn Statement, they will listen to the Statement over the speaker in the IDT. However, in case the press conference does not take place could you arrange for Sir Terence to have a Gallery ticket for both the Oral Statement and the Chancellor's Speech in the Economic Debate. Mr Butler is content to listen in IDT in any event. In addition, Mr Hudson will require a Gallery ticket for the Oral Statement.

C.R

CATHY RYDING

CONFIDENTIAL

[redacted]ate of issue: NOVEMBER 1987

BUDGET STARTER: REFERENCE SHEET

TITLE: EXCISE: DUTY RATES

STARTER NUMBER: 1

CLASSIFICATION: A

Revenue £m* **cost(-)/yield(+)** 1988/89	1989/90 (Full year)	**Staff effect*** 1/4/89	1/4/90	**Length of legislation**
+590	+1425	Nil	Nil	2 pages plus 12 pages of schedule

Minister in lead	**Date instructions sent to Counsel**	**PCTA or equivalent resolution required**
Chancellor		Yes. Up to 8 separate resolutions

ORIGIN OF STARTER: Customs. (Treasury for Vehicle Excise Duty (VED))

BACKGROUND AND COMMENTS:

Revenue yield is based on revalorisation of all specific excise duties (including VED) by 4.0 per cent, the inflation rate assumed for the 12 months prior to December 1987. The 1989-90 yield is based on a further revalorisation of 4.75 percent.

The official Treasury (FP) has policy responsibility for VED. Of the estimated length of legislation, 1 page plus 11 pages of schedule are attributable to VED.

A submission on the excise duty rates will be made before Christmas.

OFFICIAL IN LEAD: P R H ALLEN **TELEPHONE** 2913 5023

OFFICIAL IN SUPPORT: MS A FRENCH **TELEPHONE** 2913 5059

FP CONTACT: **R G MICHIE** **TELEPHONE 270 4922**

***HEALTH WARNING:** The data reports the position at the time of issue of each Reference Sheet and will be updated only if the scope of the Starter changes significantly. Latest information for all items can be found on the Summary Sheets.

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest subm	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
1	Duty rates	NSM	-	+590	+1425	Nil	Nil	2 pages and 12 pages of schedules		1988-89 revenue yield is based on revalorisation of 4%. 1989-90 yield assumes a further revalorisation of 4.75%.
2	Duty differential for unleaded petrol	NSM	-	Variable		Nil	Nil	5 lines		Revenue cost of £0.6M per 1p tax differential for every percentage point of unleaded petrol market share
3	Definition of process of rendering wine or made-wine "sparkling"	UCM	4.11.87	Nil	Nil	Nil	Nil	10 lines		
4	Restructuring of wine and made-wine duties	UCM	4.11.87	Neg	Neg	Nil	Nil	2 pages		
5	Pool betting duty structure	NSM	-	Neg	Neg	Nil	Nil	31 lines		

CONFIDENTIAL

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest subm	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
6	Phased abolition of matches and mechanical lighters duties	NSM	-	-6	-12	Nil	-9	10 lines		
7	Abolition of minimum duty charge for beer	UCM	4.11.87	Neg	Neg	Nil	Nil	20 lines		
8	Power to assess beer, wine and cider duties	UCM	4.11.87	Neg	Neg	Nil	Nil	5 lines		
9	Remission of duty on spirits for medical or scientific use	UCM	4.11.87	Nil	Nil	Neg	Neg	15 lines		
10	Oil duties relief	UCM	20.11.87	Nil	Nil	Nil	Nil	23 lines		
11	Relief from duty of goods for testing	UCM	4.11.87	Nil	Nil	Nil	Nil	10 lines		

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest subm	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
30	Keith review	I	9.10.87	Neg	Neg	Nil	Nil	4-5 pages		Revenue cost of £5M in full year after 1990-91
31	Revalorisation of registration and deregistration thresholds	NSM	-	Neg	Neg	Nil	Nil	None	Not applicable	
32	Motor expenses	D*	9.11.87	Neg	Neg	Nil	Nil	5-10 lines		
33	Value of used goods	D	18.11.87	Nil	Nil	Nil	Nil	6-7 lines		
34	Tax on supply to be liability of person completing the tax invoice	I	13.11.87	+5	+5	Nil	Nil	5 lines		Revenue yield likely to increase if loophole becomes more widely exploited
35	Amendments to VAT Act 1983 Schedule 1	I	2.11.87.	Neg	Neg	Nil	Nil	10 lines		
36	Computer evidence (Scotland)	D	3.11.87.	Nil	Nil	Nil	Nil	1 line		

CONFIDENTIAL

CUSTOMS AND EXCISE BUDGET STARTERS: SUMMARY SHEETS

Date 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
No.	Description	Status	Date latest subm	Revenue £m cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date Inst. sent to Counsel	Other Comments
60	Disclosure of importers' details	NSM	-	Neg	Neg	Neg	Neg	1 page		
61	Search of persons	I	12.11.87.	Nil	Nil	Nil	Nil	35 lines		
62	Penalty for customs fraud	UCM	17.9.87.	Nil	Nil	Nil	Nil	12 lines		
63	Prosecution time limits	UCM	17.9.87.	Neg	Neg	Neg	Neg	6 lines		
64	CAP warehouse approval and control	UCM	20.11.87	Nil	Nil	Nil	Nil	12 lines		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest subm^n**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
100	Income tax: allowances, thresholds & rates	UCM	14.7.87	Depends on decisions		Depends on decisions		2/3		Cost of 3.7% indexation of thresholds (£1060m in a full year) included in forecast.
101	Independent taxation of husband & wife	UCM	16.9.87	Nil	Nil	+110	+770	25	3.11.87 (part)	Implementation in 1990/91. Full year cost £700m.
102	Additional personal allowance: conversion to social security provision.	UCM	3.9.87	Depends on decisions		Depends on decisions		1/4		
103	Minor personal allowances - abolition	I	9.10.87	+10		-75	-100	A few lines		
104	Benefits in kind - misc.	UCM	20.10.87	Depends on decisions		Depends on decisions		Depends on decisions		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 19

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
105	Benefits in kind - threshold	UCM	16.7.87	Depends on decisions		Depends on decisions		1/4		Cost & manpower effects depend on level of threshold and whether or not it includes car car fuel benefits.
106	Benefits in kind - car & car fuel benefits	I	22.10.87	Depends on decisions		Depends on decisions		Possibly up to 1/2		Changes to scale charges made by Treasury Order, but legislation may be necessary if changes to structure of car benefit scale to be made.
107	Benefits in kind - third party entertainment	I	16.7.87	Neg (-)	Neg (-)	Nil	Nil	6 (approx)	**18.11.87**	Exemption announced by FST on 25.9.87.

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	Description	Status	Date latest subm	Revenue £m cost(-)/yield(+)		Staff Effect		Length	Date inst. sent to Counsel	Other comments
				1988/89	1989/90	1/4/89	1/4/90			
108	Benefits in kind - car parking	UCM	30.7.87	Depends on decisions		Depends on decisions		1/2 - 1		Estimates of cost, manpower & length of legn will need to be altered if car parking only partially exempted. Estimate of cost & manpower take into account that very little of charge is currently collected.
109	Benefits in kind - luncheon vouchers	NSM			Estimates not yet available					It is not certain that legislation would be required.

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+)**		**Staff Effect**		**Legislation**		**Other comments**
				1988/89	**1989/90**	**1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	
110	Amendments to PRP legislation	UCM/ NSM	3.9.87	Not known (probably negligible cost and manpower effect).					22.9.87 19.10.87 (part) PMG pro.	Ministers have approved drafting one item. Submissions on others will be made as soon as possible, when early reactions to the new legislation and Revenue's recent Guidance Notes can be assessed.
111	Review of S79 Unapproved employee share schemes.	I	22.7.87	Neg		Neg		5	4.9.87	Draft clauses published 26.10.87. Important. No bad signs yet.
112	Employee priority shares in a public offer.	I	18.9.87	Neg		Neg		1/2	Drafted	

SECRET

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
				Limit £30,000						
113	Mortgage Interest Relief Limit for 1988-89	UCM	23.9.87	Nil	Nil	Nil	Nil	Few lines		
				Limit £35,000						
				-230	-320	-12	-10			
				Limit £40,000						
				-400	-550	-25	-20			
				Limit £30,000						
114	Mortgage Interest Relief: Residence Basis	UCM	23.9.87	April 1988 start				2 or 3		
				+10	+30	+25-30	+25-30			
				August 1988 start						
				+3	+20	+25-30	+25-30			
				Limit £35,000						
				April 1988 start						
				-220	-290	+25-30	+25-30			
				Alternative approach						
				April 1988 start						
				-260	-285	+25-30	+25-30			

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
115	Mortgage interest relief: restriction of relief for home improvements	UCM	27.10.87	+100	+250	-150	-200	1		
116	FA 1984 Employee Share Option Schemes: Restricted Shares	I	5.10.87	Neg		Neg		8 lines	Drafted	
150	Maintenance payments and covenants.	UCM	13.11.87	Depends on decisions		Depends on decisions		Depends on decisions		
151	Personal pensions - delay in commencement date.	I	24.8.87	+10	+10	To be assessed		1	21.10.87	
200	Close companies - apportionment of interest	D	5.11.87	Neg	Neg	Neg	Neg		--	
201	CT rate for FY 1988	NSM		+10	+350	Nil	Nil	2 lines		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest subm^{n}**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
202	Small companies rate of CT for FY 1988	NSM		Neg	+25	Nil	Nil	4-9 lines		
203	BES	NSM		N/K		N/K		N/K		
204	Capital allowances: pre-consolidation amendments	NSM		Depends on decisions but should be very small.		Negligible		say 6-10		
205	Capital allowances: transfers by exempt bodies.	I	12.10.87	Nil	Nil	Negligible		1/2		Potential revenue saving long-term, say, £540m (net present value).
206	Capital allowances: fire safety etc	NSM		Depends on decisions		Negligible		Up to 1/2		
208	Capital allowances: enterprise zones	D	21.10.87	Depends on decisions		Negligible		-	--	

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
				Revenue £m cost(-)/yield(+)		Staff Effect		Legislation		
No	**Description**	**Status**	**Date latest submn**	**1988/89**	**1989/90**	**1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
209	Capital allowances: assured tenancies	NSM		Depends on decisions		Negligible		Depends on decisions		Depends on developments in Housing Policy.
210	Exchange gains and losses	NSM		Depends on decisions		Negligible		say 20		Submission to Treasury Ministers by end-October 1987
211	Abolition of relief for business entertaining of overseas customers	UCM	11.11.87	N/K	N/K	Negligible saving		say 1/2		
212	Small advertising gifts	UCM	11.11.87	Increase to: £15 Nil £20 Nil £25 Nil	 -3 -4 -5	Negligible saving		Few lines		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
213	In-year assessment on Schedule D income	UCM	12.11.87	+60 to 70		Saving of at least 40		say 1/2		This starter would avoid what would otherwise be a once and for all revenue cost of £m60-70 and a continuing staff cost of at least 40, if the Courts uphold the Special Commissioners decision.
214	LLoyd's RIC leavers	UCM	19.11.87	Probably negligible		Probably small		3/4		Cost and staff effects depend on details of relief.
215	Lloyd's Special Reserve Fund (SRF)	UCM	17.11.87	Neg	-3 to -20	Neg	Nil to + or - 10	Up to 1		Cost, staff effects and length of legislation all dependent on nature of change - for discussion with Lloyd's.

SECRET

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
				Revenue £m cost(-)/yield(+)		**Staff Effect**		**Legislation**		
No	**Description**	**Status**	**Date latest submn**	**1988/89**	**1989/90**	**1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
216	Lloyd's - reform of assessment and collection system.	NSM		Neg	Neg	Neg	-20 to -50	Up to 2		Staffing effects and length of legislation dependent on details of changes - for discussion with Lloyd's.
217	Pension fund repayments	NSM		[-100]		Nil		1/2		
250	IHT - rates and bands	NSM		-25	-60	Indexation alone will add to staff needs (increase of 20% in caseload)		1/2		Costs reflect effect of automatic indexation and are already assumed in the forecast.
251	IHT - exemption for transfers to political parties	I	**9.11.87**	Nil	Nil	Nil	Nil	1/2		
252	CGT: main proposal	UCM	1.7.87	**Nil**	**Neg**	**Nil**	**Nil**	**25**	6.8.87 21.10.87 30.10.87 (part)	

SECRET

BUDGET STARTERS: SUMMARY SHEETS Date: 20 November 1987
INLAND REVENUE

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
253	CGT - husband and wife	I*	6.8.87	Nil	Nil	Nil	Nil	1/4	Drafted	Full year cost -£90m.
254	CGT - annual exempt amount	I		Nil	Nil	Nil	+15	Few lines	18.11.87	
255	CGT - definition of an investment trust.	I	17.7.87	Nil	Nil	Nil	Nil	1	Drafted	
256	CGT - extension of rollover relief to satellites and spacecraft	I	24.7.87	Yield effect fluctuates from year to year - in some years nil, in others could be several million.		Neg	Neg	11 lines	Drafted	
257	CGT - capital losses on building society and co-operative shares.	I	18.6.87	Impossible to quantify. Revenue at risk if no action taken.		Neg	Neg	1/3	Drafted	
258	CGT - indexation and groups.	I*	12.10.87	Substantial revenue at risk if no action taken.		Neg	Neg	Depends on decisions. Could be up to 2 pages.	4.11.87	

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
259	CGT - intra-group share exchanges	I*	21.9.87	Legislation is to prevent, for the future, both avoidance of tax and, in other cases, the charging of gains twice.		Nil	Nil	Up to 1/3	29.10.87	
260	CGT: milk and potato quota	I	23.9.87	Neg	-5 or less	Neg	Neg	1/2		Relief announced 29.10.87.
300	Stamp duty threshold:	**UCM**	**10.11.87**							
	(a) £30,000			Nil	Nil	+10	+10	Nil		
	(b) £40,000			-270	-360	-10	-10	1/3		
	(c) £50,000			-420	-580	-20	-20	1/3		
301	Stamp duty on shares	NSM		-480	-480	Nil	Nil	1/5		
302	Stamp duty - Channel Tunnel	I	21.9.87	Neg	Neg	Neg	Neg	1/3	22.10.87	
303	Abolition of Unit Trust Instrument Duty	NSM		-30	-30	Neg	Neg	1/3		Capital duty will also need to be considered

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest subm^{n}**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
350	PRT: Expenditure claims during safeguard periods.	UCM	13.11.87	Neg	Neg	Nil	Nil	2		Review announced on 7.8.87
351	PRT: Variations in assessments or determinations	NSM		Nil	Nil	Nil	Nil	2		Designed to protect revenue
352	PRT: Expenditure relief - tariffing arrangements	D	21.10.87	?+5	?+10	Nil	Nil	-	--	EST agreed that issues should be reviewed for FB 1989.
353	Oil licence gains: work programme farm outs	I	20.8.87	Neg	Neg	Nil	Nil	2		
354	North Sea Fiscal Regime Reviews	NSM	21.7.87 (work programme only - no options for decisions)	N/K	N/K	N/K	N/K	N/K		

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
400	Company residence and migration	**UCM**	**19.11.87**	Without S482 the loss of revenue could be large (the amount must be speculative but could exceed £150m).		Nil	Nil	10-15		
450	Tax appeals - General Commissioners for Northern Ireland	I*	14.7.87	Nil		Nil		1-2 Short clause and schedule of repeals	12.8.87 (part)	Consultative document was issued seeking views by 20.11.87. Final decisions not likely until late December.
451	Tax appeals - place of hearing by General Commissioners	UCM	20.10.87	Nil		15-20* (Inspector level)		1		**Measure avoids additional staff need. Consultative document issued 5.11.87**
452	Keith Committee administrative improvements	UCM	16.10.87	N/K	N/K	N/K	N/K	N/K		Non-controversial bit of Keith

SECRET

BUDGET STARTERS: SUMMARY SHEETS
INLAND REVENUE

Date: 20 November 1987

1	2	3	4	5	6	7	8	9	10	11
								Legislation		
No	**Description**	**Status**	**Date latest submn**	**Revenue £m cost(-)/yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Length**	**Date inst. sent to Counsel**	**Other comments**
453	Mr Monck's Working Group proposal	UCM	6.5.87	Nil	Neg	Negligible		2		
454	Shelters exercise	UCM	23.10.87	N/K	N/K	N/K	N/K	N/K		

BUDGET STARTERS: SUMMARY SHEETS

DEPARTMENT OF TRANSPORT

Date October 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest sub mn**	**Revenue £m Cost(-)/Yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Legislation Length**	**Date inst sent to Counsel**	**Other Comments**
600	VED: powers to Combat Under-Licensing	NSM		Neg+		Neg		6-8 lines		
601	VED: Changes to recovery vehicle tax class	UCM	1.10.87	Nil		Nil	Nil	About ¼ page		
630	Dishonoured cheques provision to claim duty for the period a void vehicle excise licence was held by an Offender	UCM	28.10.86	Neg	Neg	Neg	Neg	1 page		
631	Vehicle registration and licensing minor amendments	NSM		Nil		Nil		½ Page		
632	Redefinition of 'Community Service Bus' (previously 'playbus') to make these vehicles	D								

CONFIDENTIAL

BUDGET STARTERS: SUMMARY SHEETS

DEPARTMENT OF TRANSPORT

Date October 1987

1	2	3	4	5	6	7	8	9	10	11
No	Description	Status	Date latest sub mn	Revenue £m Cost(-)/Yield(+) 1988/89	1989/90	Staff Effect 1/4/89	1/4/90	Legislation Length	Date inst sent to Counsel	Other Comments
	eligible for restricted HGV rate of VED			-£0.3m	-£0.3m	Nil		3-4 lines		
633	Change in criterion for concessionary rate for vehicles 'registered' pre 1.1.47 to manu-factured pre 1.1.47	NSM		small		-	-	6-8 lines		
634	Ambulance and new welfare vehicle taxation classes	NSM		Neg Cost		Nil	Nil	1 page +4 lines		

41/5

CONFIDENTIAL

BUDGET STARTERS: SUMMARY SHEETS

TREASURY

Date October 1987

1	2	3	4	5	6	7	8	9	10	11
No	**Description**	**Status**	**Date latest sub mn**	**Revenue £m Cost(-)/Yield(+) 1988/89**	**1989/90**	**Staff Effect 1/4/89**	**1/4/90**	**Legislation Length**	**Date inst sent to Counsel**	**Other Comments**
650	Public Accounts & Charges Act 1891: technical amendment to Section 2(3)	UCM	-	Neg	Neg	Neg	Neg	Say 5-10 lines		Administrative simplification and avoiding illegality of present Treasury practice
651	GILTS REDEMPTION PROCEDURES	UCM	20/11	Neg	Neg	Nil	Nil	1-2 pages	EST wd include.	simplification of procedures for repaying gilts redemption moneys. Minor staff savings at Bank.
652	GILTS: SMALL ESTATES	UCM	20/11	Neg	Neg	Nil	Nil	1-2 pages		

7-17

FROM: MRS T C BURNHAMS
DATE: 23 NOVEMBER 1987

APS/CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Scholar
Mr Culpin
Miss Sinclair
Miss Evans
Mr Cropper
Mr Call
Mr Tyrie
PS/IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr Shaw - IR
PS/C&E Unwin Knox
Mr R Allen - C&E French
Mr Jenkins - Parliamentar
Counsel

MINOR BUDGET STARTERS

Further to my minute of 20 November you will wish to note that the Economic Secretary has now made decisions on the following starters

No		
5	Pool betting duty structure	) recommends
10	Oil duties relief	) dropping
351	PRT: variants in assessments or determinations	)
651	Gilts: redemption procedure	) recommends
652	Gilts: small Estates	) inclusion

In addition the following corrections to the minor Starters List should be made:

No	
6	the comment should refer to the MMC report
31	the comment should read - Primary legislation not required
35	the comment should read - EST agreed to include 11/11/87

Teresa Burnhams

T C BURNHAMS

COPY NO 2 OF 18

Inland Revenue

Policy Division
Somerset House

From: I R SPENCE
Date: 17 November 1987

S.R.F was very much a product of high marginal tax rates (in the 1950's) so it is essentially a matter of political judgement in the context of the 1988 Budget. But given the decision that there is to be no wholesale attack on shelters and that it would undoubtedly be helpful to minimise controversy while we try to get a more sensible basis of assessment and collection for Lloyds, there is a good case for letting SRF continue to wither.

1. MR PAINTER

2. FST

LLOYD'S SRF: STARTER 215

1. The conclusion in the attached notes on this starter (with a wider circulation) is that on merits

a. there seems a strong case <u>against</u> the radical changes proposed by Lloyds; and

b. there remains a case for complete abolition (though this would be controversial).

2. The income tax changes you are contemplating for the budget would reinforce the arguments against Lloyd's proposals and - we would think - any other action to make SRF more generous. Lloyd's argument for improving SRF is based on the proposition that Lloyd's need generous tax relief (via the SRF) because:

a. members cannot reasonably be expected to put reserves aside against future losses out of income taxed at 60%; and

---

cc Chancellor
Chief Secretary
Economic Secretary
Sir Peter Middleton
Mr Cropper
Mr Scholar
Miss Sinclair
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Painter
Mr McGivern
Mr Beighton
Mr Lewis
Mr Cayley
Mr Spence
PS/IR

b. generous relief through SRF is justified by the difference between the 60% rates paid by Lloyd's members and the 35% CT rate paid by insurance companies.

3. Even if these arguments have some validity now, they will be lost with higher rates of the level you are contemplating. And we would expect the steam to go out of Lloyd's campaign for improvements in SRF as soon as budget day is reached.

4. Abolition of SRF? On present income tax rates there is already a case (perhaps a strong one) for abolishing SRF entirely. The income tax package you are contemplating would strengthen the case for abolition on merits, and should strengthen it presentationally as well. So Ministers may well wish to keep this option open. But we think it has to be expected that Lloyds will find arguments for preservation of SRF so long as there is any gap between basic rate and higher rate. So some, at least, of the political difficulty of abolishing SRF would remain. And the revenue yield from abolition (already fairly small), would be further reduced by the reformed tax system. So there would be an argument for doing nothing, and leaving SRF to wither on the vine.

5. In essence, abolition of SRF would be a simple drafting operation. But if it is to be left as a live option, we will need to devote a bit of thought to transitional arrangements. Would you like us to go ahead with considering these points, and instruct Counsel on a contingency basis?

I R SPENCE

Inland Revenue

Policy Division
Somerset House

From: I R SPENCE
Date: 17 November 1987

I agree.
Alan Lord is coming to see me on Friday 20th - after your lunch - but on present indications I am not expecting any new arguments to emerge on SRF. I will report back if necessary.
P 17.11

1. MR PAINTER

2. FINANCIAL SECRETARY

LLOYD'S SPECIAL RESERVE FUND (SRF): STARTER 215

1. Mr Peter Miller's 6 November letter to the Chancellor (attached) seeks to enlist the Chancellor's "personal sympathy for a successful outcome to the discussions which will now commence with the Revenue" [on SRF]. Lloyd's have now put this at the top of the agenda for their lunch with you on Wednesday 18 November.

2. The attached note sets out the salient points of Lloyds (radical) proposals for improving SRF and give a preliminary assessment of the options as we see them now (ie before any discussion with Lloyd's on their proposals). On merits, there seems little to be said for Lloyd's own proposals. They would turn a small-scale anomaly (on Ministers' current view of SRF) into a substantial tax-break for Lloyd's members, with major Exchequer costs. At the other extreme, there remains a case (perhaps a strong one) for abolishing SRF entirely. At this stage, you may want to keep the abolition option open, despite the controversy that it is likely to involve. Alternative options are more modest improvements in SRF, or no change (and no legislation).

---

cc Chancellor
Chief Secretary
Economic Secretary
Sir Peter Middleton
Mr Scholar
Mrs Lomax
Mr Haigh
Mr Culpin
Miss Sinclair
Mr Cropper
Mr Jenkins (OPC)
Mr Battishill
Mr Isaac
Mr Painter
Mr Rogers
Mr Pollard
Mr Beighton
Mr McGivern
Mr Spence
Mr Skinner
Mr Newstead
Mr Bolton
Mr Templeman
Mr Walker
Ms McFarlane
PS/IR

3. <u>Your 18 November meeting with Lloyds</u>. You have made it clear all along (eg your 24 August letter to Mr Peter Miller) that the proposed Lloyds/Revenue discussions of SRF does not imply any commitment to legislation. Lloyd's cannot reasonably expect you to have examined the details of their proposals, given that discussions with the Revenue have not yet started. So there should be no difficulty in taking the line that you are there to listen and take note, so that you are in a better position to assess matters when you get the report-back on the outcome of the Lloyds/Revenue discussions.

4. It is a matter of political judgement whether you indicate that abolition of SRF is a live possibility. If you wish to do so you could take the line that:

a. a clear case for reviewing SRF. The original arguments for SRF in its present form (including near 100% maximum tax rate) belong to the distant past, and need re-appraisal. Apparent from Lloyd's representations that, in their view, it produces a lot of administrative hassle for relatively little benefit to Lloyd's members;

so

b. desirable to have a thorough review, to examine whether RIC should continue and - if so - whether it should be unchanged or radically re-structured (and made more generous) as Lloyds suggest.

5. <u>Reply to Mr Peter Miller's letter to the Chancellor</u> - we suggest this is left till after you have had your lunch with Lloyds.

Now on 20th November

6. <u>Next steps</u>. When we see Lloyds (we expect Alan Lord to ✓ lead for their side) we will listen noncommittally (probing where necessary) and report back. Legislation on the lines of

Lloyd's proposals would be a substantial undertaking and involve intensive discussions on a short time scale (given their delay in opening discussions). So if you reach a view after you lunch with Lloyds, and before we see them, on whether their proposals are a serious runner for the Finance Bill, it would be helpful to have a steer. If you think the Lloyd's proposals <u>are</u> a serious starter, we will need to press them for an early meeting, and start our detailed internal work straight away.

I R SPENCE

LLOYD'S SPECIAL RESERVE FUND: STARTER 215

THE PRESENT POSITION

1. SRF is a special tax relief for funds set aside by Lloyd's members to meet future losses. Payments into the fund are free of higher rate tax on up to £7,000 a year (or half the annual profits if less). The higher rate relief is clawed back when there are payments out of the fund to meet losses or on retirement. The income limit (£7,000) was last increased in 1972. At present only a third of Lloyd's members (perhaps less) have an SRF (and many of these now only have a few thousand pounds in their SRF). The number of participants, and the amount in their funds, have declined in recent, loss-making, years. The cost of the relief, in recent years years has probably been around £1 million a year (ie the cost of higher rate relief on payments into the fund, less clawback of higher rate relief when money is taken out to meet losses).

PREVIOUS MINISTERIAL CONSIDERATION AND CURRENT STATE OF PLAY

2. SRF was introduced shortly after the second World War to meet Lloyd's claim that members were unable to build up reserves to meet future losses with the prevailing high personal rates of tax (linked with the arguments that the corporate tax rate for insurance companies was much lower). Ministers have rejected claims for an increase in the £7,000 income limit since 1972 on the grounds that the case for having the SRF had lost most of its validity with the reduction in personal tax rates. After IIS was abolished Ministers considered abolishing SRF entirely, but did not raise the proposition with Lloyd's.

3. Lloyd's made representations for radical improvements in SRF in November 1986 (and since then there has been no detailed discussions of these representations). Ministers decided against any action in the 1987 Finance Bill. The Financial Secretary agreed in July 1987 that Lloyd's representations on SRF should be discussed with the Revenue, and then considered by Ministers. But it was made clear there was no commitment to legislation. Mr Peter Miller's 6 November letter to the Chancellor has re-launched Lloyd's proposals.

LLOYD'S REPRESENTATIONS

Lloyd's arguments for radical changes in SRF

4. Lloyds fiscal argument. Lloyd's say the present arrangements leave Lloyd's members at a significant disadvantage in building up reserves by comparison with insurance companies (CT rate of 35% against personal rates of up to 60%) and insurance company shareholders (where Lloyd's reasoning is obscure).

5. The practical argument. Lloyd's say the present SRF is too complex, and that this complexity (which is a deterrent to membership of SRF) means SRF does not fulfil its purpose.

6. Lloyd's commercial argument. Lloyd's say an adequate capital base is vital to Lloyd's, because Lloyd's reputation depends on its members meeting their obligations on losses

without fail. To strengthen this capital base Lloyd's need more members, more investment per member and bigger personal reserves per member. SRF in its present form does not meet this need. It needs to be made more attractive, so that members have an incentive to join Lloyd's and build up personal reserves.

7. Lloyd's main proposals for improvement are:

a. contributions into SRF - should be free of higher rate tax without any income limit (limit now £7,000 or half of profits);

b. income of the fund. Reinvested income should be free of higher rate tax without any income limit (currently the £7,000/50% of profits limit apply);

c. capital gains. Roll over relief for realised capital gains (no deferment at present) capital appreciation to be withdrawn free of tax (CG payable now);

d. withdrawal of losses - optional. (At present losses must be met from SRF until the fund is exhausted);

e. resignation. Value of funds subject to CGT (now taxed as income);

f. death - no IT or CGT charge (now a limited IT charge).

EFFECTS OF THE LLOYD'S PROPOSAL

8. Tax benefits to Lloyd's members. At present the fund gives deferment of higher rate tax on payments into SRF (on limited amounts), normal tax treatment while the income remains in the fund, and claw-back of the higher rate tax when losses materialise (when losses have to be met out of the fund).

9. Prima facie, Lloyd's proposal would turn SRF into a tax-free piggy bank. The whole of the Lloyd's profit could go into the fund free of higher rate tax. All higher rate tax would be deferred (including tax on the build up) until the member chose to take his money out - irrespective of when and if losses had occurred. CGT would be deferred until funds were taken out. If the member resigned, the higher rate deferment would turn into exemption - there would only be a CG charge. On death there would be complete exemption (apart from IHT).

10. Cost. The cost of Lloyd's proposals would be much more than the present (£1 million plus) annual cost of SRF. We have not yet done any detailed costing, and much would depend on Lloyd's profitability and on take-up (though it can be assumed that most members would contribute as much as possible, because the tax breaks are so substantial). At a guess, we would put the short term cost in the range of £5 million to £15 million, and the medium term cost - mid 90's - in the £15 million to £40 million range, or even higher.

11. Administrative/compliance effects. Lloyd's say the present system is excessively complex, for the Revenue and Lloyd's. We agree. The Lloyd's proposal would be an improvement for Lloyd's members, simply because it would remove all the conditions and

constraints (on payments in and payments out of SRF) which are the main source of the present difficulties. But we doubt whether it would produce any significant staff saving for the Revenue. Lloyd's proposal will have its own complications. Quite apart from this, a relatively simple system used by virtually all Lloyd's members (as we can expect) is likely to be as big an administrative problem for the Revenue as the current, complex, system used by only a third of Lloyd's members.

COMMENT

12. As we see it (without, of course, any discussion with Lloyd's) there is nothing in Lloyd's argument which calls in question the view Ministers have taken since 1972, viz:-

a. the existence of the SRF is an anomaly - there is no fiscal case for tax relief for general reserves for any taxpayer (over and above the relief available for properly deductible provisions/RIC premiums);

b. the original case for special treatment (a personal tax rate of up to 98%) has no real validity with the reduction in higher rates and the removal of IIS;

13. The comparison with insurance companies. This is the basis of Lloyd's case for maintaining/improving SRF. Neither insurance companies nor their shareholders get any tax relief for general reserves - nor does anyone else, apart from Lloyds. It is not self-evident that the difference between personal tax rates and corporate tax rates justifies continuing - let alone increasing - a special relief for Lloyd's members general reserve when other individual traders do not get it. Nor, at first sight, is there any relevance in the comparison with shareholders in insurance companies (or other companies). Lloyd's particular argument on SRF links in with the familiar general argument from Lloyds that their members are at a tax disadvantage compared with insurance companies and/or their shareholders (their point of comparison often varies according to the point at issue). There are, of course, swings and balances. The advantages to Lloyds (offsetting the difference between IT/CT rates) are summarised in the attached extract from the RIC note on Clause - Annex 1. Ministers have, so far, found Lloyd's arguments unpersuasive*. It remains to be seen whether Lloyds will produce any new arguments to strengthen their case when their detailed representations are discussed. At present we are sceptical.

---

* Extract from Chancellor's 27 February 1987 meeting on Lloyd's RIC: "The Governor's last point was that action was being taken only on one area where Lloyd's were at present treated advantageously, but not on other areas where Lloyd's were disadvantaged. Mr Painter said that this was a misrepresentation of the position. There were many other areas where Lloyd's were treated more advantageously than commercial companies, but where no proposals were now being made to level the playing field. The loss relief provisions for names was one good example. The Chancellor thought this was an important argument. Our defence could contain a hint of menace that other areas deserved attention too."

14. Lloyd's commercial arguments for improving SRF. These are still to be explored. On the arguments so far, their case for an improvement is not convincing. In particular, there is no evidence that improvements in SRF are necessary to attract members to Lloyds. Lloyd's membership has increased rapidly (over 30,000 now; 21,500 in 1983; 7,000 in 1973). This has happened despite the (alleged) unattractiveness of SRF and despite a succession of loss-making years (when most of the losses have come out of member's personal funds, rather than SRF). It may be that increasing membership is not a complete answer to Lloyd's concerns about the adequacy of its capital base. If so, the answer would be to increase the requirement for funds to be committed to Lloyd's, which could be automatically called on to meet losses. There is no evidence that a fiscal subsidy is justifiable/necessary for this. (If the SRF is important from this point of view, it is somewhat odd that Lloyd's current proposal undermines it, by removing the requirement that losses must be met out of SRF).

OPTIONS

15. We will report back when we have heard what Lloyds have to say in support of their representations. At this stage our view on options for the 1988 Finance Bill is as follows:

Option 1: Improve SRF on the lines suggested by Lloyd's. This does not seem an attractive proposition. If Ministers continue to take the view that SRF is an anomaly, accepting Lloyd's proposals would compound the anomaly on a major scale, (with major revenue costs). Lloyd's proposal, if conceded, would be prayed in aid by the lobby who are arguing that taxation on business income should be confined to what is taken out of the business and that profits left in the business should be exempted from tax.

Option 2 - limited improvements. Ministers could consider:

a. increase income limit for contributions? The £7,000 limit was set in 1972 (1987 equivalent would be over £50,000). Ministers could consider a modest improvement (doubling it might take the cost from its present £1 million plus to something approaching £5 million) but on merits the argument for any improvement seems weak.

b. administrative changes? If SRF is to remain, there is a good case for tidying up the present structure without making SRF more generous. But this is not a priority issue for legislation in its own right. It can - and we think should - be treated as a relatively minor aspect of the more general case for reform of the assessment and collection system, (on which we will be letting Ministers have a separate note).

Option 3: Abolish SRF entirely. On merits, there seems a fairly strong case for abolishing SRF. But this would be politically controversial - perhaps as controversial as the RIC legislation. And, compared with leaving things as they are, the revenue to be gained from abolition is fairly small.

Option 4: No change on the substance of SRF. This would be a continuation of the policy the Government has followed since the last increase in the SRF income limit in 1972, of rejecting demands for an improvement - but stopping short of abolition, and the controversy this would provoke. Ministers may find this the most attractive option.

I R SPENCE

Annex A.

BOARD OF INLAND REVENUE

(8) General tax position of Lloyd's Names

42. Wrong to look at RIC in isolation: Lloyd's members already at a disadvantage compared with insurance companies and shareholders in them.

a. Whatever the balance of advantage/disadvantage in other respects, there would be no justification for deferring action to remedy the current anomaly on reinsurance to close.

b. Comparisons. Lloyd's underwriters are in a unique commercial position, which makes comparisons with insurance companies and shareholders particularly difficult. There may be disadvantages in some respects for Lloyd's names. But there are also advantages for Lloyd's names, such as:

i. the Lloyd's Special Reserve Fund (which gives higher rate relief for contributions to a fund to meet future losses) - this is a unique benefit;

ii. Lloyd's capital gains are charged at personal rates, and with individual thresholds available - which contrasts with the position of insurance companies and other financial concerns;

iii. Lloyd's names get loss relief against other, non-Lloyd's, income (unlike insurance company shareholders). And the interaction of Lloyd's three-year accounting with the normal rules gives results which are, arguably, generous to Lloyd's.

iv. Lloyd's names pay their tax on average two and a half years later than corporate insurers.

43. ~~Why no action on Lloyd's other representations (eg for improvements in Special Reserve Fund)? Lloyd's representations were considered. The Government decided against legislation on them.~~

HM TREASURY — MCU
REC. - 9 NOV 1987
IR
CC APS/CHX, FST, Mr Ilett FIM2
CHX
27622/87

THE CHAIRMAN
PETER MILLER

C/W

Lloyd's

Lime Street, London EC3M 7HL

Telephone: 01-623 7100
INTERNATIONAL: +44 1 623 7100

TELEGRAPHIC ADDRESS: LLOYDS LONDON EC3
TELEX: 987321 LLOYDS G

6th November, 1987

Dear Chancellor

When we approached you a year ago with a request that the Lloyd's Special Reserve Fund rules should be re-considered, it quickly became clear that we had first to deal with the problems surrounding Lloyd's Reinsurance To Close. Now that that road-block has happily been removed, the Financial Secretary kindly agreed that we should proceed to discussions with the Revenue on the points raised in our note of 13th November, 1986 to yourself.

The purpose of this letter is to enlist your personal sympathy for a successful outcome to the discussions which will now commence with the Revenue.

Put briefly, the reason why we are pressing these proposals is that the Lloyd's Special Reserve scheme has not been looked at or altered since 1955.

The proposals which our Chief Executive will discuss with the Inland Revenue as a preliminary to a decision by yourself and the Treasury will be based on the following principles:-

a) Members should receive comparable treatment to an insurance company in the manner in which general reserves can be created and maintained.

b) Members should not be disadvantaged when compared with shareholders in an insurance company by virtue of the tax treatment of general reserves on resignation or death.

c) That the arrangements must be significantly simplified as compared with the existing Special Reserve Fund including the application of normal tax principles where appropriate.

The Council of Lloyd's as a regulator of our marketplace and the Department of Trade and Industry as our supervisors in this respect set great store by the solvency of the Lloyd's policy. The Special Reserve Fund has a vital role to play in that solvency, which role has been much diminished, not only by the passage of time since this matter was last looked at, but also because of the administrative inconveniences to all parties of the present system.

I have attached to this letter, for the use of your colleagues to whom it is being copied, a short resume of the proposed Special Reserve Fund comparing it with the existing Special Reserve Fund.

I would of course at any time be happy to discuss the whole matter with yourself. Meanwhile I hope that you will feel able to give a fair wind to our discussions and that eventually a proposal will emerge which you will be able to adopt next year.

Yours sincerely

Peter Miller

Enc.

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
London SW1P 3AG

ATTACHMENT

FEATURES OF PROPOSED NEW SPECIAL RESERVE FUND (SRF) AS COMPARED WITH EXISTING ARRANGEMENTS

	NEW PROPOSALS	COMPARISON WITH EXISTING ARRANGEMENTS
1. Transfers in	-Gross transfers limited only by "SRF profit".	- Limited to higher of £7000 or 50% of SRF profit.
	-Basic Rate tax liability only.	- No change.
	-Single annual notification by say 5.4.	- Single date but extended when syndicate accounts unagreed.
2. SRF profit	-defined as aggregate of:- a) Underwriting result and syndicate investment income agreed by I.R. during previous calendar year. b) Income from Lloyd's deposit, personal reserves and SRF. c) Less personal Lloyd's expenses.	- As with new proposal but Underwriting results related to single year of account only.
3. Assets/ Investments	-Range to be agreed. (Solvency purposes only).	- No Change.
	-Acceptable "personal" assets may be transferred in or withdrawn subject to valuation, but will not be treated as acquisition or disposal for capital gains tax purpose.	—
4. Income from fund	-Part of "SRF profit".	- No Change.
	-If re-invested in SRF, subject only to BR tax.	- Available only if within transfer limits.
5. Capital Appreciation/ Gain	-Realised gains within the fund calculated normally but tax subject to rollover.	- No deferral permitted.
	-Capital Appreciation may be withdrawn.	- Not available (except for CG Tax payable).
6. Withdrawal for losses	-Optional (losses may be funded from other assets).	- Mandatory withdrawal.
	-Grossed up withdrawals treated as taxed income.	- No Change.
	-Provisional withdrawals permitted.	- No Change.
7. Resignation	-Book value of fund subject to Capital Gains Tax.	- Taxed as income (Subject to higher rates).
8. Death	-No income or Capital Gains Tax charge.	- Complex arrangement for determining IT charge.
	-Assets subject to inheritance tax.	- No Change.

Task Force Stuff

CHANCELLOR OF THE EXCHEQUER

To ACIT – copies FST/PJC

& 20/11.

SOMETHING RADICAL CGT

Many thanks for your two contradictory suggestions of 19/11. One commending option 5(i) in Brian Mace's latest paper (a 24% basic rate) and the other advocating a 25% ~~single~~ flat rate for all income and capital gains. While the attractions of the latter are undeniable, the disadvantages you list are, I believe, greater than you appear to imply. Moreover there is a further, and in my opinion decisive, disadvantage. Your proposed flat rate would have a constraining finality about it.

[illegible]

you could not reintroduce the basic rate/higher rate distinction once you had abolished it. Nor, in practice, would it be justifiable to bring the flat rate (= top rate) down any further. All you could subsequently do would be to raise personal allowances. I would prefer to keep open the option of moving the basic rate down still further, with a target of 20% – which is what I take to be the attraction you see in the 24% proposal. This means that retention of the basic rate/higher rate distinction is important.

I am, incidentally, surprised at your estimate of only £1.3 billion for the cost of the 25% flat rate.

NL.

036/3648

TASK FORCE SECRET

Copy No 1 of 5

FROM: A G TYRIE

DATE: 19 NOVEMBER 1987

CHANCELLOR

cc Financial Secretary
Mr P Cropper

SOMETHING RADICAL

It is a luxury of advisers to peddle outrageous or radical suggestions. This is one.

Why not get rid of higher rates altogether and move to a flat rate of 25 pence for both income and capital gains? The additional cost would be £1.3 billion for the two. Not a King's ransom these days.

The main advantages would be:

- A dramatic act of simplification. You would be able to remove from the statute book an enormous number of provisions, complex anti-avoidance legislation, most averaging provisions, top slicing reliefs, shelters, simplification of MIR etc.

- There would be (NICs excepted) a level playing field for a vast range of personal and company financial decisions. (Investment income/composite rate, CGT etc).

- I expect that the supply side effects would be large, possibly dramatic. My guess is that there would be a substantial increase in small business and entrepreneurial activity. Most of my entrepreneur friends spend a large chunk of their time working out how to shelter their higher rate liability. (Is it the company I keep?.) Indeed, for some of them it is the key factor in deciding which business areas to get into. An enormous amount of time wasted on tax planning would, I think, be directed towards more fruitful activities. I would wager that much of the lost yield would be recouped.

On the supply side this would be a leap in the dark, but because of our considerable fiscal room for manoeuvre, not one in which we had to land on the other side of the bank.

- There would be substantial Revenue staff savings.

The main disadvantage would be that a single rate tax system would stir up the politics of envy in a way which even the reduction from 60 per cent to 35 per cent would not. (How would No. 10 react?)

Also Labour would sound credible when claiming that they could fund some of their promises from the rich. (This might matter in four years time.) But this argument holds for 35 pence almost as much as for 25 pence. The total yield of higher rates is £4.2 billion: we are already writing-off £3.1 billion with the current 35 per cent proposal.

Apparently there might be some transitional difficulties for the Revenue because the computerisation of PAYE (COP) was designed for lots of higher rates. I am told that having only one higher rate already poses difficulties! When I heard this I wondered whether we could redesign COP for a one rate system in a way that would make it impractical for a subsequent government to reintroduce higher rates until well into their term of office. Quite a bonus.

Worth a proper look?

AGT

A G TYRIE

042/3648

TASK FORCE SECRET

Copy No 1 . . Of 5

FROM: A G TYRIE

DATE: 20 NOVEMBER 1987

cc Financial Secretary
Mr P Cropper

CHANCELLOR

Ch/
E1 costs £1·5 billion in a full year compared with Option D. It is much more consistent with overall objectives. But it is (? 3 times) more expensive than an individual threshold of £30,000 on the basis we discussed yesterday.
AT 29/11

24 PENCE AND KINK LOSERS

I am delighted to see that a basic rate of 24 pence has now surfaced as an option (E1) in Brian Mace's interesting note of 17 November!

I incline towards 24 pence because:

- It would reduce kink losers in a way which conforms with our overall direct tax objectives (unlike, for example, the effects of a higher mortgage interest relief ceiling).

- 24 pence implies that, sooner or later, we would consider further reductions of the basic rate. I am not attracted to the apparent finality of the 25 pence/35 pence regime. But I can appreciate the neatness.

Although it is expensive 24 pence does reduce kink losers considerably. It takes out over 60 per cent of the losers compared with 25 pence option D. It also reduces the average size of the loss, from £161 to £135.

I attach a couple of tables showing the losers under E1 (which Brian, for brevity's sake, omitted from his note) and also a copy of the same table for Option D (25 pence). In the upper table, as you can see, the 24 pence option skews the remaining losers to the left, that is, reducing the amount of their loss.

On the lower table I think you only need bother with income ranges up to £30,000. The losers above that are higher rate taxpayers using shelters. They are just the sort of people we are trying to catch by abolishing the UEL!

One further point: these tables exclude the gainers from independent taxation, some of whom would be in the kink. Do you think it is worth asking Brian to see by how much the losers would be further reduced if the effects of independent taxation were included?

AGT.

A G TYRIE

LINE 190 COLUMN WRAP E1. 1988-89 compared w. IC 1987-88. HOL

TASK FORCE SECRET

24 pence : Option E1

Losers by range of income and amount of loss

Income range (lower limit) £000s	Amount of loss (£ per year) 0-50	50-100	100-200	200-300	300-400	400-500	>500	TOTAL
0	0	0	0	0	0	0	0	0
15	0	0	0	0	0	0	0	0
16	0	0	0	0	0	0	0	0
17	0	0	0	0	0	0	0	0
18	0	0	0	0	0	0	0	0
19	0	0	0	0	0	0	0	1
20	7	0	0	0	0	0	0	7
21	9	5	1	0	0	0	0	15
22	9	8	8	0	0	0	0	25
23	14	8	16	2	0	0	0	40
24	4	6	9	6	0	0	0	25
25	17	9	21	13	11	1	1	72
30	3	2	8	2	1	1	1	19
35	0	1	0	0	0	0	1	2
40	0	0	0	0	0	0	0	1
45	0	0	0	0	0	0	0	0
50	0	0	0	0	0	0	1	1
TOTAL	64	40	63	24	12	2	4	208

Losers ranged by total income (lower limit)

Range of total income £000s	Amount of loss £million	Number of losers 000s	Average loss £
0	0	0	0
15	0	0	0
16	0	0	0
17	0	0	0
18	0	0	0
19	0	1	61
20	0	7	19
21	1	15	46
22	2	25	79
23	4	40	92
24	3	25	130
25	12	72	164
30	3	19	186
35	1	2	480
40	0	1	385
45	0	0	0
50	2	1	1711
TOTAL	28	208	135

Option D (without phasing) 1988-89 : Losers compared with 1987-88

25pence

Losers by range of income and amount of loss (000s)

Income range (lower limit) £000s	Amount of loss (£ per year) 0-50	50-100	100-200	200-300	300-400	400-500	>500	TOTAL
0	0	0	0	0	0	0	0	0
15	0	0	0	0	0	0	0	0
16	0	0	0	0	0	0	0	0
17	0	0	0	0	0	0	0	0
18	7	0	0	0	0	0	0	7
19	32	11	1	0	0	0	0	43
20	24	20	18	0	0	0	0	62
21	14	19	30	3	0	0	0	66
22	12	9	24	16	1	0	0	62
23	7	8	23	17	10	0	0	66
24	8	7	12	12	8	3	0	49
25	16	17	32	22	19	14	8	128
30	8	4	7	6	9	2	3	37
35	1	1	1	0	0	0	1	5
40	1	1	1	0	0	0	1	4
45	0	0	0	0	0	0	0	1
50	0	0	0	0	0	0	1	1
TOTAL	130	97	149	77	48	19	13	533

Losers ranged by total income (lower limit)

Range of total income £000s	Amount of loss £million	Number of losers 000s	Average loss £
0	0	0	0
15	0	0	0
16	0	0	0
17	0	0	0
18	0	7	17
19	2	43	36
20	4	62	71
21	7	66	104
22	9	62	138
23	12	66	183
24	9	49	189
25	30	128	232
30	9	37	233
35	1	5	281
40	1	4	242
45	0	1	248
50	2	1	1331
TOTAL	86	533	161

Note: Estimates of gains/losses cover individuals only and exclude ACT, etc effects.

TASK FORCE SECRET

pp

COPY NO 4 OF 5 COPIES

FROM: J M G TAYLOR
DATE: 23 November 1987

MR TYRIE

cc PS/Financial Secretary
Mr Cropper

SOMETHING RADICAL/24 PENCE AND KINK LOSERS

The Chancellor has seen your minutes of 19 and 20 November. He has commented as follows: "Many thanks for your two contradictory suggestions of 19 November and 20 November, one commending option E1 in Brian Mace's latest paper (a 24 per cent basic rate) and the other advocating a 25 per cent flat rate for all income and capital gains. While the attractions of the latter are undeniable, the disadvantages you list are, I believe, greater than you appear to imply. Moreover there is a further, and in my opinion decisive, disadvantage. Your proposed flat rate would have a constricting finality about it. You could not reintroduce the basic rate/higher rate distinction once you had abolished it. Nor, in practice, would it be justifiable to bring the flat rate (=top rate) down any further. All you could subsequently do would be to raise personal allowances. I would prefer to keep open the option of moving the basic rate down still further, with a target of 20 per cent - which is what I take to be the attraction you see in the 24 per cent proposal. This means that retention of the basic rate/higher rate distinction is important. I am, incidentally, surprised at your estimate of only £1.3 billion for the cost of the 25 per cent flat rate."

JT

J M G TAYLOR

PH1/188

PLAIN PAPER

PMP.

FROM: A C S ALLAN

DATE: 20 NOVEMBER 1987

~~DRAFT~~ STATEMENT BY CHANCELLOR ON US BUDGET AGREEMENT

I welcome the news that agreement in principle has been reached on a package of measures to reduce the US budget deficit.

As I have all along made plain, this is an essential element both in the correction of the imbalances that have been plaguing the world economy, and in the restoration of confidence in the financial markets.

NP) Other major nations, particularly the surplus countries, will now need to prepare an appropriate response, with a view to a meeting as soon as practicable after the Congress has approved the package, so that a successful co-operative approach to current economic difficulties can be agreed.

Ch

I have kept a copy, so we can discuss any changes

AA

Boards of Governors

~~DRAFT STATEMENT BY CH/EX~~

I welcome the ~~fact~~ news that agreement in principle has now been reached on a package of measures to reduce the US Budget deficit.

~~As I made clear from the start~~

As I have all along made plain, this is an essential element both in the correction of the ~~im~~ imbalances that have been plaguing the world economy, and in the restoration of confidence in the financial markets.

~~It is now time for the other~~ Other major nations, particularly the surplus countries, will now need to prepare an appropriate response, with a view to a meeting as soon as practicable ~~at which a cooperative approach to the current e~~ after the Congress has approved the package, ~~at which~~ so that a successful co-operative approach to ~~[illegible]~~ ~~current the~~ current economic difficulties can be agreed.

mjd 1/4A

RESTRICTED

EARLIER **DRAFT STATEMENT BY CHANCELLOR ON US BUDGET AGREEMENT**

I am very glad to hear that an agreement has been reached in Washington on a deficit reduction package. That is a welcome step forward.

It demonstrates the ~~US'~~ United States' determination to carry forward the reductions in ~~there~~ their deficit which they have already secured in cutting the deficit from ~~$20~~ $220 billion in 1985/86 to $148 billion in 1986/87.

~~220~~ ?

~~Line for IDT on next steps~~

~~There will now need to be further urgent discussions on an appropriate response in other countries, with a view to an early meeting.~~

Preparations can now be set in hand for a meeting

PH1/188

Spare

STATEMENT BY CHANCELLOR ON US BUDGET AGREEMENT

I welcome the news that agreement in principle has been reached on a package of measures to reduce the US budget deficit.

As I have all along made plain, this is an essential element both in the correction of the imbalances that have been plaguing the world economy, and in the restoration of confidence in the financial markets.

Other major nations, particularly the surplus countries, will now need to prepare an appropriate response, with a view to a meeting as soon as practicable after the Congress has approved the package, so that a successful co-operative approach to current economic difficulties can be agreed.

ND

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF
Telephone Direct Line 01-213 6460
Switchboard 01-213 3000 GTN Code 213
Facsimile 01-213 5465 Telex 915564

David Norgrove Esq
Private Secretary
10 Downing Street
LONDON SW1

4 November 1987

Dear David

OUTLOOK FOR RPI

... I enclose a numbered copy of the latest DE note.

Copies also go to Alex Allan (Treasury), Sir Peter Middleton (Treasury), Timothy Walker (Trade and Industry), Ms A Large (CSO), John Footman (Bank of England), Chris Cloke (CO) and Sir Brian Hayes (Trade and Industry).

Beverley

BEVERLEY EVANS
Private Secretary

2

PERSONAL AND CONFIDENTIAL

OUTLOOK FOR RETAIL PRICES: OCTOBER AND NOVEMBER

1. The annual rate of inflation as measured by the 12 month change in the retail prices index for October is expected to increase to around 4½ per cent compared with 4.2 per cent for September. This is at the top end of the range anticipated last month.

2. Between September and October prices are expected to have risen by about ½ per cent, compared with a rise of 0.2 per cent recorded between the corresponding months last year. A few small price reductions were recorded for October, but there were rather more increases than expected last month across a large range of goods and services.

3. For November the annual rate of inflation is expected to fall again to around 4 per cent. There is likely to be an increase of between ⅓ and ½ per cent in the overall level of prices between October and November compared with the increase of 0.8 per cent recorded between the corresponding months last year, when mortgage interest rates rose from around 11 per cent to around 12¼ per cent.

4. This outlook is consistent with the forecast given yesterday by the Chancellor in his Autumn Statement for an average annual rate of increase of 4 per cent for the last quarter of 1987.

Percentage change in the RPI

	12 months	over 1 month	
	all items	all items	all excluding seasonal food
July	4.4	-0.1	0.1
Aug	4.4	0.3	0.3
Sept	4.2	0.3	0.4
FORECASTS			
October	4½	½	½
November	4	⅓–½	⅓–½

STATISTICS D

SEPTEMBER 1987

psl/63A

pwp

FROM: A C S ALLAN
DATE: 5 November 1987

CHANCELLOR

RPI PROFILE

In your Oral Statement you said:

> "Inflation may rise a little next year, reaching 4½ per cent in the fourth quarter, by which time it should be on a downward trend again."

2. Your statement was sent round for checking often enough, but only now have the forecasters queried this bit - see monthly profile attached.

3. I have discussed this with Terry. He suggests the following line (the question came up at the press briefing he and Robin gave).

Does this mean that interest rates will rise above 5 per cent before Q4?

Not our practice to publish forecasts for anything other than Q4. [IF PRESSED] Would not expect rate to rise significantly above 4½ per cent during next year.

ACSA

A C S ALLAN

Mr Sedgwick

These are the numbers.
I'll see you after lunch
about presentation.

[illegible]

Mr. Allen

These are provisional.
More work is being done on them
but this should
give a rough
idea of the pattern

FROM S PRICE

DATE 4 NOVEMBER

MR HIBBERD

Copy for Sir T. Burns

This may not be the final
version.

T.N.J. 4.XI

You asked for a monthly path for the RPI to end 1988 consistent with the Industry Act forecast. The figures follow.

MONTHLY PATH OF RPI

1° Percentage rates of change over previous 12 months.

		Total	Total excluding MIPs
1987	Sept	4.2	3.5
	Oct	4.3	3.6
	Nov	3.8	3.7
	Dec	3.7	3.7
1988	Jan	3.3	3.4
	Feb	3.3	3.4
	Mar	3.5	3.6
	April	3.7	4.0
	May	4.2	4.2
	June	4.2	4.1
	July	4.4	4.2
	Aug	4.4	4.3
	Sept	4.5	4.4
	Oct	4.5	4.4
	Nov	4.5	4.4
	Dec	4.5	4.3

1989 (for what it's worth)

QI	4.7
QII	4.3
QIII	4.0

99/11

VINSON

3976/39

10 PT.P

FROM: P J CROPPER
DATE: 6 November 1987

CHANCELLOR

cc Financial Secretary

LORD VINSON

We need to decide how to proceed with Nigel Vinson. Discuss briefly at Prayers? Nigel wrote to you with a list of tax suggestions on 17 September. I acknowledged formally on your behalf and said we would be replying. The FST then invited Nigel in for a chat: this resulted in a letter to Nigel dated 13 October. Copies attached.

2. Meanwhile, Nigel has engaged in a correspondence with me about the tax status of MPs, and why they are not classed as self-employed. With the help of the Revenue I have established the facts. Nigel does not like them, and is clearly set on pressing you for reclassification of MPs as self-employed. I have tried to argue that most people regard Schedule D as more attractive than Schedule E, and that it would not therefore be very sensible for MPs to legislate themselves selectively into this privileged position. No joy. Underlying it all is the familiar argument that people should be able to elect for Schedule D treatment if they want it, rather than the matter being decided "on the facts" as the Inland Revenue and DHSS contend. I attach the correspondence.

3. Both the general letters and the correspondence on MPs call for some sort of reaction. It seems to me that you have the choice between:

(i) seeing Vinson (and probably Philip Chappell) sometime before the Budget, as you did last year. This might be the easiest way, or

(ii) sending a shortish reply. (I attach a draft.)

PJC.

P J CROPPER

DRAFT REPLY CHANCELLOR TO LORD VINSON

Thank you for your letter of 17 September written on behalf of the CPS Wider Ownership Group. I found it most interesting and I gather that you have already had useful discussions with Norman Lamont.

I know you will not expect me to go into great detail about my thinking for the next budget. Tax reform is still ~~very much~~ on the agenda. We have already achieved a good deal, including abolition of four taxes, amelioration of the capital taxes, and substantial cuts in income tax rates. But there is more to do.

I fully share your yearning for lower income tax rates, and hope it will not be too long before we can meet the 25 per cent basic rate commitment. I also share your impatience with the bias that still exists in favour of institutional channels of saving and against personal saving. I am less sure about going the whole way with the Loi Monory: it would be very difficult to prevent the misuse of a front-end tax relief by resort to the re-cycling of existing savings.

It is encouraging to know that you approve of our personal pension scheme, and I note what you say about the need for a flow of suitably dated and priced indexed-linked Government Bonds. Since 1981, when the first index-linked gilt was issued, we have offered to the market substantial amounts of this kind of instrument at a wide range of maturities. There is at present just under £12 billion nominal index-linked gilts outstanding, and the longest maturity is 2024. We do not give undertakings about the specific sorts of gilt edged stock that will contribute to our future funding programme, and prices are of course set by the market. I can assure you however that our decisions on gilt issues will continue to take full account of market demand.

I am interested also that you think it would be right to set a ceiling on the tax relief available for pension contributions.

The frontier between Schedule D and Schedule E is something to which we have given a great deal of thought. Peter Cropper has kept me abreast of your correspondence on the tax status of Members of Parliament.

P J C

6/11/87

4556/007

CONFIDENTIAL

until 11.30 AM 9 NOVEMBER

MMP

FROM: P H BROOK

DATE: 6 November 1987

1. MR C W KELLY CWK 6.11

2. ECONOMIC SECRETARY

cc Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Peretz
Mr Sedgwick
Mr R I G Allen
Mr Grice
Miss Noble
Mr Hall

File: MAMC A5

DTI PRESS NOTICE ON CONSUMER CREDIT

(All figures are seasonally adjusted)

The attached DTI press notice on credit business in September will be published at 11.30 am on Monday 9 November. This includes the Q3 figures for bank loans on personal accounts not exceeding £10,000 (Table 2). The inclusion of these data on a quarterly basis was the main extension to the coverage of the DTI press notice when it was revised in August.

2. The increase in the amount of consumer credit outstanding in Q3 is slightly lower than that in Q2. There is nothing in the figures that necessitates any revision to the briefing lines on consumer credit included in the briefing for the September money supply figures circulated under cover of my minute of 27 October to Mr Cassell.

3. The figures <u>on credit outstanding available on a monthly basis</u> (Table 1) show an increase of £402 million (1.9 per cent) in September compared with £206 million (1 per cent) in August. The main reason for the increase is that bank credit card lending increased by £160 million in September, following a fall of £80 million in August. The annual growth rate to September fell to 17.6 per cent from 18 per cent to August.

4. The <u>amount outstanding on all consumer credit agreements</u> (Table 2) increased by £1,384 million (4.1 per cent) in Q3 compared with an

increase of £1,463 million (4.5 per cent) in Q2. Annual growth rates are not available as the full series only goes back to 1987 Q1.

5. New credit advanced amounted to £3,220 million in September continuing the gradual upward trend seen for most of this year.

P H BROOK

CONFIDENTIAL
UNTIL 11.30 HOURS
ON DAY OF RELEASE

DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 4471/4475
Out of hours: 01-215 7877

Number 87/685

9 November 1987

CREDIT BUSINESS IN SEPTEMBER

During September the change in **amounts outstanding on consumer credit agreements** with finance houses, other specialist credit grantors, building societies, retailers and on bank credit cards was £0.4 billion (see **Table 1**), an increase from the figure of £0.2 billion in August.

The increase in the latest three months, July to September, was £0.8 billion, below the corresponding figure of £1.0 billion in the previous three months. Within the total, the increase shown by finance houses, other specialist credit grantors and building societies was £0.6 billion in the most recent period compared with £0.7 billion in the previous one. Bank credit cards showed an increase of £0.2 billion in the latest three months, less than the increase of £0.3 billion in the previous period. The increase for retailers was £0.1 billion in both three month periods.

Bank loans on personal accounts showed an increase in amounts outstanding of £0.5 billion, a similar increase to that in the previous quarter (see **Table 2**). Including these loans and loans by insurance companies, figures for which are available only quarterly, gives a **total increase in consumer credit** in the July to September quarter of £1.4 billion, compared with £1.5 billion in the preceding quarter. At the end of September the total amount **outstanding on consumer credit agreements** was £35.1 billion, 4 per cent more than the total three months earlier.

MORE/...

New credit advanced to consumers in September by finance houses, other specialist credit grantors, building societies, retailers and on bank credit cards amounted to £3.2 billion, compared with a total of £3.0 billion in August (see **Table 3**). The total for the three months July to September was 8 per cent higher than that for the previous three months.

In September there was a **change in amounts outstanding on agreements** with businesses by finance houses, other specialist credit grantors and building societies of £0.1 billion (see **Table 1**). The total change in the latest three months was £0.4 billon, the same as for the preceding three months.

NOTES TO EDITORS

1 All figures are quoted after seasonal adjustment. The seasonal adjustments of bank loans on personal account and of credit card lending are subject to greater uncertainty than the seasonal adjustments of the other data owing to the shortness of the series.

2 **Table 1** covers amounts outstanding and changes in amounts outstanding to finance houses, other specialist credit grantors and building societies, retailers and on bank credit cards. Loans by retailers and on bank credit cards are mainly to consumers and are treated as consumer agreements. Loans by finance houses, other specialist credit grantors and building societies, are split into agreements with consumers and agreements with businesses and the two components are shown separately.

3 **Table 2** includes the same data as Table 1 on agreements with consumers. Also shown are figures for loans by banks (monetary sector institutions other than those included in finance houses and other specialist credit grantors) on personal accounts, where the amount outstanding does not exceed £15,000, and by insurance companies to individuals, excluding loans for house purchase and bridging finance. These figures are available only quarterly. This table covers all institutions providing finance for consumers and thus provides a quarterly series for total consumer credit.

4 **Table 3** shows new credit advanced by finance houses, other specialist credit grantors and building societies, retailers and on bank credit cards. The coverage is the same as for Table 1 except that dealer stock funding loans by finance houses to businesses are excluded. A high proportion of credit advances in certain types of agreements, notably on bank credit cards and by mail order houses, is repaid within a month, reflecting the use of such agreements as a method of payment rather than as a means of obtaining credit.

5 Unsecured loans by building societies, which are advanced under the terms of the Building Societies Act 1986, are included from January 1987. Amount outstanding on bank loans on personal accounts are available from end December 1986 only. Lending by finance houses and other specialist credit grantors where the group specialises in lending to other companies only are excluded from the statistics in this Press Notice.

6 Further definitions are given at the foot of the tables accompanying this Press Notice.

7 Full results of the inquiries which collect the monthly information on credit are published by H M Stationery Office in Business Monitor SDM6 - Credit business. This may be obtained on subscription (£17.50 per annum) from H M Stationery Office P O Box 569, London SE1 9NH. Individual copies are available, price £3.20 each from:

The Library,
Business Statistics Office,
Government Buildings,
Cardiff Road,
Newport, GWENT.
Telephone: Newport (0633) 222973.

8 Non-press calls to 01-215 3138

TABLE 1

CHANGES IN AMOUNTS OUTSTANDING TO FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTO
AND BUILDING SOCIETIES, RETAILERS AND ON BANK CREDIT CARDS. (SEASONALLY ADJUSTE

£ Million

	AGREEMENTS WITH CONSUMERS				AGREEMENTS WITH BUSINESSES	TOTAL AGREEMENTS
	TOTAL	RETAILERS (a)	BANK CREDIT CARDS	FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES ON AGREEMENTS WITH CONSUMERS	BUSINESSES	
	A=B+C+D	B	C	D	E	A+E
AMOUNTS OUTSTANDING AT END OF PERIOD						
1986	19,063	2,231	4,681	12,151	5,728	24,791
1987 AUG	21,500R	2,431	5,212	13,857R	6,387R	27,887R
SEP	21,902	2,461	5,372	14,069	6,516	28,418
CHANGES IN AMOUNTS OUTSTANDING (b)						
1986	2,437	94	891	1,452	596	3,033
1986 1st Qtr	855	39	221	595	214	1,069
2nd Qtr	346	3	213	130	34	380
3rd Qtr	792	107	356	329	193	985
4th Qtr	444	-55	101	398	155	599
1987 1st Qtr	952	67	248	637	5	957
2nd Qtr	1,038	56	260	722	373	1,411
3rd Qtr	849	107	183	559	410	1,259
1986 SEP	392	45	194	153	72	464
OCT	194	-81	86	189	127	321
NOV	-15	12	-113	86	-23	-38
DEC	265	14	128	123	51	316
1987 JAN	257	8	15	234	-17	240
FEB	296	27	97	172	24	320
MAR	399	32	136	231	-2	397
APR	410	20	113	277	66	476
MAY	294	20	19	255	141	435
JUN	334	16	128	190	166	500
JUL	241	52	103	86	149	390
AUG	206R	25	-80	261R	132R	338R
SEP	402	30	160	212	129	531
1987 APR-JUN	1,038	56	260	722	373	1,411
JUL-SEP	849	107	183	559	410	1,259

R = revised

NOTES

(a) Self financed credit advanced by clothing retailers, household goods retailers, mixed retail businesses (other than Co-operative societies) and general mail order houses only.

(b) Data were not collected on a consistent basis for all types of credit grantor prior to 1986. The following table gives figures for changes in amounts outstanding which are available:

£ Million

	1983	1984	1985
Retailers	132	116	195
Finance Houses etc.	2,286	2,180	2,541

TABLE 2

CHANGES IN AMOUNTS OUTSTANDING ON ALL CONSUMER CREDIT AGREEMENTS.

(SEASONALLY ADJUSTED)

£ Million

CONSUMER CREDIT AGREEMENTS

	TOTAL (a)	RETAILERS (b)	BANKS (c) CREDIT CARDS	BANKS (c) LOANS ON PERSONAL ACCOUNTS (d)	INSURANCE COMPANIES	FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES
AMOUNT OUTSTANDING AT END OF PERIOD						
1986	31,095	2,231	4,681	11,228	804	12,151
1987 1st Qtr	32,267	2,298	4,929	11,440	812	12,788
2nd Qtr	33,730	2,354	5,189	11,895	782	13,510
3rd Qtr	35,114	2,461	5,372	12,420	792	14,069
CHANGES IN AMOUNTS OUTSTANDING						
1986	2,496	94	891		59	1,452
1986 1st Qtr	858	39	221		3	595
2nd Qtr	360	3	213		14	130
3rd Qtr	806	107	356		14	329
4th Qtr	472	-55	101		28	398
1987 1st Qtr	1,172	67	248	212	8	637
2nd Qtr	1,463	56	260	455	-30	722
3rd Qtr	1,384	107	183	525	10E	559

——— indicates a break in the series

R = revised
E = estimated

NOTES

(a) Changes in amounts outstanding in 1986 exclude bank loans on personal accounts.

(b) Self-financed advances by clothing retailers, household goods retailers mixed retail businesses (other than Co-operative societies) and general mail order houses only.

(c) Monetary sector institutions other than those included in finance houses and other specialist credit grantors.

(d) Amounts outstanding on bank loans on personal accounts, not exceeding £15,000, excluding bridging loans and house purchase finance.

TABLE 3

NEW CREDIT ADVANCED BY FINANCE HOUSES,OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES,RETAILERS AND ON BANK CREDIT CARDS. (SEASONALLY ADJUSTED)

£ Million

	AGREEMENTS WITH CONSUMERS				AGREEMENTS WITH BUSINESSES	TOTAL AGREEMENTS
	TOTAL	RETAILERS (a)	BANK CREDIT CARDS	FINANCE HOUSES,OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES ON AGREEMENTS WITH		
				CONSUMERS	BUSINESSES (b)	
1986	28,026	4,834	12,916	10,276	3,489	31,515
1986 1st Qtr	6,549	1,146	2,926	2,477	826	7,375
2nd Qtr	6,875	1,191	3,115	2,569	864	7,739
3rd Qtr	7,349	1,267	3,395	2,687	874	8,223
4th Qtr	7,253	1,230	3,480	2,543	925	8,178
1987 1st Qtr	7,918	1,241	3,874	2,803	963	8,881
2nd Qtr	8,440	1,272	3,997	3,171	1,029	9,469
3rd Qtr	9,136	1,365	4,353	3,418	1,130	10,226
1986 SEP	2,555	431	1,220	904	315	2,870
OCT	2,437	413	1,152	872	322	2,759
NOV	2,360	420	1,129	811	275	2,635
DEC	2,456	397	1,199	860	328	2,784
1987 JAN	2,417	411	1,177	829	278	2,695
FEB	2,618	415	1,276	927	331	2,949
MAR	2,883	415	1,421	1,047	354	3,237
APR	2,766	416	1,289	1,061	314	3,080
MAY	2,697	414	1,268	1,015	335	3,032
JUN	2,977	442	1,440	1,095	380	3,357
JUL	2,944	447	1,410	1,087	359	3,303
AUG	2,972R	457	1,384	1,131R	376R	3,348R
SEP	3,220	461	1,559	1,200	395	3,615
1987 APR-JUN	8,440	1,272	3,997	3,171	1,029	9,469
JUL-SEP	9,136	1,365	4,353	3,418	1,130	10,266
Percentage increase over previous three months	8	7	9	8	10	8

R = revised

NOTES

(a) Self financed credit advanced by clothing retailers, household goods retailers, mixed retail businesses (other than Co-operative societies) and general mail-order houses only.

(b) Excluding dealer stock funding. These agreements are included in tables 1 and 2.

4373/33

SECRET and PERSONAL

FINANCIAL SECRETARY TO THE TREASURY

KB. M.

FROM: J J HEYWOOD
DATE: 9 November 1987

PS/FST
To
PS/CH
9.11.87

PS/CHANCELLOR

cc Sir P Middleton
Mr Monck
Mr D J L Moore

BRITISH STEEL CORPORATION

The Financial Secretary has read Mr Clarke's letter to the Prime Minister of 6 November. He has commented:

> The sooner this approach is adopted the better. Ravenscraig has become a totem pole out of all proportion to its real importance in the Scottish economy. Both this and the closure of Govan are long overdue and will help the Scots to concentrate on those parts of their economy that really matter."

J.H.

JEREMY HEYWOOD
Private Secretary

WORLD ECONOMY

CONFIDENTIAL
until 3 November 1987
then UNCLASSIFIED

pp

BB2 WORLD ECONOMY AND INTERNATIONAL COMPARISONS

[See also Industry Act forecast of UK economy (Brief B1), Balance of payments, oil and competitiveness (BB3), Employment and unemployment (BB4), Monetary policy (C3) and Interest and exchange rate developments (CC3)]

Factual

(i) Current position

(a) GDP growth in major 7

	Percentage changes on year before			
	1984	**1985**	**1986**	**1987 Q2**
United States	6.8	3.0	2.9	2.4
Japan	5.1	4.7	2.4	2.7
Germany	3.3	2.0	2.5	0.8
France	1.4	1.7	2.2	1.7
UK*	**2.5**	**3.7**	**3.1**	**3.8**
Italy	3.5	2.7	2.7	2.5
Canada	6.3	4.3	3.3	3.2
Major 7	5.2	3.2	2.8	2.3

* average estimate

Source: OECD, IMF, CSO

(b) Industrial production in major 7

	Percentage changes on year earlier		latest month		
	1985	**1986**	**change over 6 months**	**change over 12 months**	
United States	1.7	1.0	2.7	4.5	(Aug)
Japan	4.5	-0.3	2.9	3.9	(July)
Germany	5.0	1.9	1.0	-3.1	(Aug)
France	0.0	1.0	4.0	2.8	(June)
UK	**4.7**	**1.8**	**2.0**	**4.3**	**(Aug)**
Italy	1.4	3.0	3.6	1.1	(June)
Canada	5.2	1.3	3.0	4.1	(July)
Major 7	2.8	1.1	2.7	3.0	(June)

Source: OECD

Industrial production was depressed in other European countries early in 1987 but has now picked up. (See changes over last 6 months in table above.)

WPU

(c) Standardised unemployment rates

Percentage of labour force; seasonally adjusted

	1986		1987			
	Q3	**Q4**	**Q1**	**Q2**	**Latest**	
United States	6.8	6.8	6.6	6.1	5.9	(Aug)
Japan	2.9	2.8	2.9	3.0	2.7	(July)
Germany	6.9	6.8	6.8	6.9	7.0	(July)
France	10.6	10.6	10.9	11.0	10.9	(July)
UK	**11.2**	**10.9**	**10.7**	**10.3**	**9.8**	**(Aug)**

Source: OECD

(d) Consumer price inflation

Percentage change on year before

	Dec 1985	**Dec 1986**	**Latest**	
United States	3.8	1.1	4.3	(Aug)
Japan	1.8	-0.2	0.7	(Aug)
Germany	1.8	-1.1	0.5	(Sept)
France	4.7	2.1	3.5	(Aug)
UK	**5.7**	**3.7**	**4.2**	**(Sept)**
Italy	8.6	4.4	5.0	(Sept)
Canada	4.4	4.2	4.5	(Aug)
Major 7	3.8	1.2	3.4	(Aug)

Source: OECD

(e) Unit labour costs in manufacturing

Percentage changes on year before

	1984	**1985**	**1986**	**1987Q1**
United States	-0.6	0.6	-0.5	-1.1
Japan	-3.9	-2.4	2.6	-0.2
Germany	1.0	0.3	3.5	5.4
France	4.8	2.9	1.7	0.2
UK	**2.5**	**3.9**	**4.6**	**2.1**
G5 average	-0.1	0.6	1.4	0.4

Source: IMF

(f) Current account imbalances of three largest countries widened further in 1987H1 but remained about constant as percentage of GDP.

Current account balance ($ billion)*

	1985	1986	1987 H1 (annual rate)
US	-118 (-3)	-141 (-3½)	-156 (-3½)
Japan	49 (3½)	86 (4½)	92 (4)
Germany	14 (2¼)	37 (4¼)	43 (4)
France	1 (0)	4 (½)	-3 (-½)
UK	**4 (¾)**	**-1½ (-¼)**	**0 (0)**

* as percentage of GDP in brackets

Source: OECD, CSO

(g) Nominal and real short-term interest rates

per cent

	1984	1985	1986	latest (30 Oct 1987)
Nominal*				
US	10.4	8.1	6.5	7.5
Japan	6.2	6.5	5.0	3.9
Germany	5.9	5.5	4.6	4.1
France	11.5	10.0	7.8	8.2
UK	**9.7**	**12.3**	**11.0**	**9.1**
G5 average	9.0	8.0	6.5	6.5
Real**				
US	5.9	4.4	4.5	3.1
Japan	3.8	4.4	4.5	3.2
Germany	3.4	3.2	4.9	3.5
France	3.5	3.9	5.1	4.6
UK	**4.5**	**5.8**	**7.2**	**4.5**
G5 average	4.8	4.3	4.9	3.5

* Three month money market rates
** Deflated by change in consumer price index on year earlier

(h) GDP per head

	US $ 1985*
US	16,500
Japan	11,800
Germany	12,200
France	11,400
UK	**10,900**
Italy**	10,800
Canada	15,200

* OECD estimates at purchasing power parities
** OECD have used Italian national figures include allowance for black economy and are doubtfully comparable with others.

Source: OECD

(ii) Historical comparisons

(a) Average GDP growth

Annual average growth rate; per cent

	1960-70	1970-80	1980-86
US	3.8	2.7	2.6
Japan	10.5	4.6	3.7
Germany	4.5	2.7	1.4
France	5.6	3.6	1.6
UK	**2.8**	**1.8**	**2.2**
Italy	5.7	3.1	1.8
Canada	5.2	4.6	2.9

(b) Output per employee in manufacturing

Annual average growth rate; per cent

	1960-70	1970-80	1980-86
US	3.4	3.0	4.0
Japan	8.8	5.3	2.4
Germany	4.1	3.2	2.6
France*	4.8	3.0	2.7
UK	**3.0**	**1.6**	**5.1**
Italy*	6.7	3.1	2.4
Canada	4.0	3.2	3.4
Major 7	6.1	2.9	3.3

* whole industry, not just manufacturing

Source: OECD

(c) Real GDP per employee

Annual average growth rate; per cent

	1960-70	1970-80	1980-86
US	2.0	0.3	1.1
Japan	9.0	3.7	2.6
Germany	4.3	2.8	2.1
France*	5.0	3.1	1.8
UK	**2.6**	**1.6**	**2.6**
Italy*	6.2	2.5	1.1
Canada	2.5	1.5	1.2

* Calculated from average estimate of GDP.

Source: OECD

(d) Employment growth*

Average annual growth rate; per cent

	1963-70	1970-80	1980-85	1986
US	2.2	2.4	1.5	2.3
Japan	1.5	0.8	1.0	0.8
Germany	-0.1	-0.2	-0.6	1.0
France	0.9	0.5	-0.4	0.0
UK	**0.1**	**0.2**	**-0.7**	**0.8**
Italy	-0.4	0.5	0.2	0.5
Canada	3.0	3.1	1.1	2.9
Major 7	1.5	1.3	0.7	1.4

* Total civilian employment

Source: OECD

(e) Relative inflation

	Major 7 Inflation	EC(12) Inflation	UK Inflation	Difference UK/Major 7 (percentage points)	Difference UK/EC(12) (percentage) points)
Feb'74-Apr'79	9.0	11.0	15.5	6.5	4.5
May 1979	8.6	8.8	10.3	1.7	1.5
May'79-Aug'87	5.9	7.8	7.9	2.0	0.1
June'83-Aug'87	3.3	4.9	4.5	1.2	-0.4
August'87	3.2	3.4	4.4	1.2	1.0

Source: OECD

(b) Fixed investment

Percentage of GDP at market prices

	1960	1970	1980	1986
US	18.0	17.7	19.1	16.1
Japan	29.5	35.5	31.6	27.7
Germany	24.3	25.5	22.7	19.3
France	20.1	23.4	21.9	18.8
UK	**16.4**	**19.0**	**18.0**	**17.1**
Italy	22.6	21.4	19.8	20.1
Canada	21.9	21.5	23.5	19.6

(iii) Forecast

(a) Autumn Statement forecast for world economy broadly in line with latest assessment from outside forecasters (eg IMF, OECD):

	Per cent change on year earlier		
	1986	1987	1988
Major 7:			
Real GNP	2¾	2½	2
Real domestic demand	3¾	2¾	2
Industrial production	1	3	3¼
Consumer prices	2	2¾	2¾
World trade at constant prices			
Total	4¾	3½	3½
Manufactures	2	3¾	4

Source: Autumn Statement Table 1.1

3971/2

PMid
PST
McI
Hett
Sinclair

FROM: P CROPPER
DATE: 10 NOVEMBER 1987

PS/CHANCELLOR

c/ 5.30pm on Tuesday 8 Dec seems convenient
Content?

OK

Julie
12/11.

LORD VINSON †

At prayers yesterday, the Chancellor asked for Lord Vinson to be invited in to see him for a drink in mid-December. It would probably be 5.30-6-6.30 pm for half an hour. Lord Vinson would probably like to bring Mr Philip Chappell with him.

PJC

P CROPPER

† He can be telephoned at the Development Commission in Cowley Street (I think it is).

Barbara Yates.
222 9134.

PJC

November 10, 1987

Economic Indicators--United Kingdom

	1987	1988	1989	1990	1991
Real GDP (percentage change)	4.0	2.5	2.5	2.5	2.5
Real total domestic demand (percentage change)	4.0	3.5	2.3	2.3	2.6
Employment (percentage change)	1.3	0.6	0.6	0.5	0.5
Unemployment rate	10.2	9.7	9.2	8.7	8.2
GNP deflator (percentage change)	4.3	4.5	3.5	3.0	2.5
Consumer prices (percentage change) 1/	4.0	4.5	3.5	3.0	2.5
Current account (US$ bn)	-3.9	-5.7	-2.9	0.0	0.0
(percent of GNP)	-0.6	-0.8	-0.4	0.0	0.0
Trade balance, fob/fob (US$ bn)	-15.9	-19.4	-19.9	-19.4	-21.9
(percent of GNP)	-2.4	-2.8	-2.7	-2.5	-2.6
General government borrowing requirement balance (percent of GNP)	0.5	1.0	1.0	1.0	1.0
PSBR (percent of GNP) 2/	0.3	1.0	1.0	1.0	1.0
PSBR (percent of GDP) 3/	1.5	2.2	2.2	2.2	2.2
Monetary growth rate (MO) (percent)	4.0	3	2	2	2
Short-term interest rate (percent)	10.0	9.5	9.0	8.5	8.0
Long-term interest rate (percent)	...	...	...	...	...

1/ Retail Price Index, fourth quarter to fourth quarter.
2/ Including privatization receipts.
3/ Excluding privatization receipts.

PERSONAL AND CONFIDENTIAL

PMP

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213............................
Switchboard 01-213 3000 GTN Code 213
Facsimile 01-213 5465 Telex 915564

D Norgrove Esq
10 Downing Street
London
SW1A 2AA

11th November 1987

Dear David

RETAIL PRICES INDEX

I enclose a copy of our note and draft press release on the Index of Retail Prices due to be released at 11.30 am on Friday, 13 November.

Numbered copies also go to Alex Allan (Treasury), Sir Peter Middleton (Treasury), Timothy Walker (DTI), Rachel Passmore (CSO), John Footman (Bank of England), Chris Cloke (Cabinet Office) and Sir Brian Hayes (DTI).

Yours sincerely

Peter Baldwinson

Peter Baldwinson
Private Secretary

2

PERSONAL AND CONFIDENTIAL UNTIL 11.30 am ON FRIDAY 13 NOVEMBER 1987

184/87 November 13, 1987

GENERAL INDEX OF RETAIL PRICES

OCTOBER 1987

The general index of retail prices for all items for October 13, 1987 was 102.9 (January 13, 1987 = 100). This represents an increase of 0.5 per cent on September 1987 (102.4) and an increase of 4.5 per cent on October 1986 (388.4, January 1974 = 100).

The rise in the index between September and October was the result of price increases across a wide range of goods and services; most notably among food, alcoholic drink and tobacco.

The movements for the main groups in the index are shown in Table 2.

Table 1.

	All items				All items except seasonal food		
	Index Jan 13 1987 = 100	Percentage change over 1 month	6 months	12 months	Index Jan 13 1987 = 100	Percentage change over 1 month	6 months
1987							
May	101.9	+0.1	+2.6	+4.1	101.7	+0.1	+2.2
June	101.9	+0.0	+2.3	+4.2	101.8	+0.1	+2.1
July	101.8	-0.1	+1.8	+4.4	101.9	+0.1	+1.9
August	102.1	+0.3	+1.7	+4.4	102.2	+0.3	+1.9
September	102.4	+0.3	+1.8	+4.2	102.6	+0.4	+2.0
October	102.9	+0.5	+1.1	+4.5	103.1	+0.5	+1.5

TABLE 2

	Indices (13 January 1987 = 100)		Percentage change
	September 8, 1987	October 13, 1987	over the month
All items	102.4	102.9	+0.5
All items excluding food	102.8	103.3	+0.5
All items excluding housing	102.1	102.6	+0.5
Food	100.4	101.1	+0.7
Seasonal food	95.7	96.8	+1.1
Non seasonal food	101.2	101.8	+0.6
Catering	104.3	104.7	+0.4
Alcoholic drink	102.8	103.5	+0.7
Tobacco	99.7	100.5	+0.8
Housing	104.4	104.9	+0.5
Fuel and light	98.5	98.0	-0.5
Household goods	102.7	103.3	+0.6
Household Services	102.9	103.2	+0.3
Clothing and footwear	101.8	102.3	+0.5
Personal Goods and Services	101.9	102.6	+0.7
Motoring Expenditure	105.1	105.4	+0.3
Fares and Other Travel Costs	102.3	102.6	+0.3
Leisure Goods	101.9	102.6	+0.7
Leisure Services	101.9	103.3	+1.4

NOTES TO EDITORS

1 The General Index of Retail Prices (RP1) measures the average change from month to month in the prices of goods and services purchased by most households in the United Kingdom. The expenditure pattern on which the index is based is revised each year using information from the Family Expenditure Survey. The expenditure of certain higher income households and pensioner households, mainly dependent on state pensions and benefits, is excluded.

2 The index is compiled using a large and representative selection of more than 600 separate goods and services for which price movements are regularly measured in about 180 towns throughout the country. Approximately 130,000 separate price quotations are used each month in compiling the index.

3 The prices of some items of food show significant seasonal variation. A separate price index is compiled for these "seasonal foods", the expenditure on which accounts for around $2\frac{1}{2}$ per cent of household expenditure. The variation caused by these items is removed from the series of indices for 'all items except seasonal food'.

4 Rates of change of indices can be calculated over periods of any length. Rates calculated over long periods are slow to detect changes in trend while calculations over very short periods give rather volatile results. To help in assessing what is happening to prices, rates of changes in the all items index and the index for all items except seasonal food are shown in Table 1 over successive periods of one month, six months and twelve months.

5 Following the recommendations which the Retail Prices Index Advisory Committee made in its report submitted to the Secretary of State for Employment in July 1986, the index has been re-referenced to make January 1987 = 100. Calculations of movements in the index over periods of time which span January 1987 are made as follows:-

> The index for the later month (January 1987 = 100) is multiplied by the index for January 1987 (January 1974 = 100) and divided by the index for the earlier month (January 1974 = 100). 100 is subtracted to give the percentage change between the two months.
>
> Using the all items index for example: take the index for October 1987 (102.9) and multiply it by the January index (394.5) then divide by the October 1986 index (388.4). Subtract 100 from the result which gives 4.5 as the percentage change in the index over the twelve months to September.

6 The index for October 1987, if translated to the old reference date (January 1974 = 100) would be 405.9.

7 Other changes made to the index in 1987 are given in an article in the April edition of Employment Gazette.

8 The Retail Prices Index Advisory Committee was first established in 1946 and advises on the methodology used for compiling the RPI. Committee members include representatives of consumers, employees, employers, retailing organisations, academic experts, government departments and other official bodies. The Committee's latest report - 'Methodological Issues Affecting The Retail Prices Index' Cmnd 9848 HMSO £6.50 - was published on 15 July 1986. The Government announced at the same time that all its recommendations were to be accepted.

9 The housing costs of owner-occupiers are reflected in the index using an indicator which represents mortgage interest payments. A weighted average of building societies base mortgage interest rates is used in the calculation.

10 The index is given in full in the Employment Gazette.

PERSONAL AND CONFIDENTIAL

GENERAL INDEX OF RETAIL PRICES : OCTOBER 1987

The annual rate of inflation, as measured by the 12-month change in the retail prices index, rose to 4.5 per cent in October, from the 4.2 per cent recorded for September. This is at the top end of the range anticipated last month.

2. The overall level of prices was 0.5 per cent higher in October than in September, more than the increase of 0.2 per cent recorded between the corresponding months last year. Whilst a few price reductions were recorded for October there were price increases across a wide range of goods and services; most notably among food, alcoholic drinks and tobacco.

3. In November the 12-month rate is expected to fall back again to around 4 per cent. An increase of between 1/3 and ½ per cent in the overall level of prices between October and November is expected to replace, in the 12-month calculation, the increase of 0.8 per cent recorded between the corresponding months last year, when mortgage interest rates rose from around 11 per cent to around 12¼ per cent.

4. This outlook is consistent with the forecast given by the Chancellor in his Autumn Statement for an average rate of increase of 4 per cent for the last quarter of 1987. It is not certain that the rate will fall below 4 per cent for December if the pattern of price increases seen in October continues; unless, that is, other Building Societies follow the lead of the major society which has announced plans to reduce mortgage rates from December 1st.

Producer Prices

5. The annual change in the price index for home sales of manufactured products rose to 3.9 per cent for October; having remained virtually unchanged at around 3½ per cent for the previous six months. This rise was almost wholly attributable to increases in the prices of outputs from the food, drink and tobacco industries, which rose by 2.4 per cent in the year to October, after rising by only 1.6 per cent in the year to September. The annual rate of increase in the prices of other industries has been around 4¾ per cent since July. This suggests some upward pressure on retail prices.

6. Annual price inflation for materials and fuels purchased by manufacturing industry fell back to 5.1 per cent in October but remains above the rate of retail price inflation.

PERSONAL AND CONFIDENTIAL

Tax and Prices Index

7. The tax and prices index increased by 2.9 per cent in the year to October compared with 2.4 per cent recorded for September.

International comparisons

8. The latest 12-month percentage changes in consumer prices in the main OECD countries and the averages for all EEC and OECD countries are as follows:-

	UK	FRANCE	FEDERAL GERMANY	ITALY	NETHER-LANDS	JAPAN	USA	CANADA	OECD Averages	EEC Averages
1986										
Q2	2.8	2.4	-0.2	6.1	0.4	0.8	1.6	3.9	2.5	3.2
Q3	2.6	2.1	-0.4	5.4	-0.4	0.2	1.7	4.2	2.5	3.0
Q4	3.4	2.1	-1.1	4.4	-1.8	-0.5	1.3	4.3	2.1	2.9
1987										
Q1	3.9	3.2	-0.5	4.1	-1.2	-1.3	2.2	4.1	2.3	2.2
Q2	4.2	3.1	0.1	4.2	-1.0	-0.2	3.8	4.6	3.5	3.0
Q3	4.3	3.3	0.6	4.8	0.7	0.5	4.2	4.5	3.8	3.3
April	4.2	3.5	0.1	4.3	-1.1	-0.2	3.8	4.5	3.5	3.1
May	4.1	3.4	0.2	4.2	-1.1	-0.3	3.8	4.7	3.4	3.1
June	4.2	3.3	0.2	4.4	4.4	0.0	3.7	4.8	3.4	3.1
July	4.4	3.4	0.7	4.7	0.1	-0.4	3.9	4.7	3.5	3.3
August	4.4	3.4	0.8	4.5	0.2	-0.4	4.3	4.5	3.9	3.4
September	4.2	3.2	0.4	5.0	0.2	1.1	4.3	4.5	3.9	3.2
October	4.5									

STATISTICS DIVISON
DEPARTMENT OF EMPLOYMENT

11 November 1987

'A' Sir G Littler
cc = Sir T Burns
Mr H Evans
Mr Peretz

87 -11 12:57
262405 TRSY G
33141Z MIFI NL

CH/EXCHEQUER
REC. 11 NOV 1987
ACTION SIR G. LITTLER
COPIES TO SIR T. BURNS
MR H.P. EVANS
MR PERETZ

FROM : THE MINISTRY OF FINANCE
THE NETHERLANDS

TO HIS EXCELLENCY
RT. HON. NIGEL LAWSON, P.C. MP
CHANCELLOR OF THE EXCHEQUER
H.M. TREASURY
LONDON

DEAR COLLEAGUE,

IN MY CAPACITY AS CHAIRMAN OF THE INTERIM COMMITTEE OF THE IMF I AM WRITING TO YOU AND TO THE OTHER MEMBERS OF THE COMMITTEE WHO ARE ALSO PARTICIPANTS IN THE GROUP OF SEVEN-MEETINGS, TO EXPRESS MY GREAT CONCERNS ABOUT THE RECENT ADVERSE INTERNATIONAL FINANCIAL DEVELOPMENTS, PARTICULARY IN THE STOCK MARKETS AND IN THE FOREIGN EXCHANGE MARKETS. WE UNANIMOUSLY AGREED ON THE COMMUNIQUE ISSUED AFTER THE MEETING OF THE INTERIM COMMITTEE OF SEPTEMBER 28, 1987. I QUOTE THE FOLLOWING RELEVANT PHRASES FROM THIS COMMUNIQUE:

(PARAGRAPH 2):''.......PROGRESS HAS BEEN MADE IN REDUCING FISCAL AND PAYMENTS IMBALANCES IN REAL TERMS AMONG THE LARGE INDUSTRIAL COUNTRIES.......... THE PERSISTENCE OF LARGE CURRENT ACCOUNT IMBALANCES IN SOME OF THESE COUNTRIES IS A MATTER OF CONCERN......... THE IMPORTANCE OF A CONTINUED COORDINATED, COOPERATIVE APPROACH WAS STRESSED. THE IMPROVED ECONOMIC AND MONETARY COOPERATION BETWEEN THE MAJOR INDUSTRIAL COUNTRIES WAS WELCOMED. THE RESOLUTION OF DEBT DIFFICULTIES REMAINS CRUCIALLY DEPENDENT ON.........POLICIES IN INDUSTRIAL COUNTRIES THAT WILL SECURE STABLE WORLD FINANCIAL CONDITIONS AND OPEN AND GROWING MARKETS. THE FUND HAS A MAJOR RESPONSIBILITY THROUGH ITS SURVEILLANCE FUNCTION TO FOSTER THIS COMBINATION OF MUTUALLY REINFORCING POLICIES. COMMITTEE MEMBERS WELCOMED THE RECENT REDUCTION IN THE U.S. FISCAL DEFICIT. THIS PROGRESS SHOULD BE CARRIED FURTHER IN 1988 AND BEYOND TO FACILITATE EXTERNAL ADJUSTMENT WITHOUT HARMING CAPITAL FORMATION.......IT IS IMPORTANT, AT THE SAME TIME, THAT THE GROWTH OF DOMESTIC DEMAND EXCEED THAT OF GNP IN COUNTRIES WITH STRONG EXTERNAL SURPLUS POSITIONS, PRICE STABILITY, AND GOVERNMENT DEFICITS THAT ARE NOT TOO LARGE.....''

(PARAGRAPH 4):''......THE COMMITTEE NOTED THE IMPORTANCE OF STABLE EXCHANGE MARKET CONDITIONS AND WELCOMED THE PROGRESS MADE SINCE THE LOUVRE ACCORD.''

IT IS THE IMPRESSION OF MANY COLLEAGUES AND OBSERVERS - AND I SHARE THEIR VIEW - THAT DEVELOPMENTS SINCE OUR MEETING OF SEPTEMBER 28 FALL SHORT OF THE EXPECTATIONS RAISED ON THE BASIS OF OUR COMMUNIQUE. PARTICULARLY, THE GROUP OF SEVEN COUNTRIES WHO HAVE ASSUMED A SPECIAL RESPONSIBILITY FOR INTERNATIONAL FINANCIAL DEVELOPMENTS, APPEAR - JOINTLY OR INDIVIDUALLY - UNTIL NOW TO HAVE ACTED INSUFFICIENTLY TO CARRY OUT THE COMMITMENTS UNDERTAKEN ON SEPTEMBER 28.

I HOPE THAT - IN THE SPIRIT OF TRUE MULTILATERAL COOPERATION IN THE FRAMEWORK OF THE IMF - IT WILL BE POSSIBLE TO ACHIEVE WHAT WE HAD AGREED TO ACHIEVE, PARTICULARLY ''STABLE EXCHANGE MARKET CONDITIONS'', ''A CONTINUED COORDINATED, COOPERATIVE APPROACH'', AND ''POLICIES IN INDUSTRIAL COUNTRIES THAT WILL SECURE STABLE WORLD FINANCIAL CONDITIONS''.

I SEND A COPY OF THIS MESSAGE TO THE MANAGING DIRECTOR OF THE IMF WITH SPECIAL REFERENCE TO THE ABOVE QUOTED CONCLUSION OF OUR MEETING OF SEPTEMBER 28 THAT ''THE FUND HAS A MAJOR RESPONSIBILITY THROUGH ITS SURVEILLANCE FUNCTION TO FOSTER THIS COMBINATION OF MUTUALLY REINFORCING POLICIES''.

YOURS SINCERELY,

H. ONNO RUDING,
CHAIRMAN OF THE INTERIM COMMITTEE OF THE IMF

THE HAGUE, 11TH NOVEMBER 1987
NO: 387-10533
33141Z MIFI NL
26 05 TRSY G

CONFIDENTIAL

PWP

FROM: A A DIGHT

DATE: 11 November 1987

MR J S HIBBERD x6590

MONTHLY PATH FOR THE RPI

The Chancellor has seen and was very grateful for your minute of 10 November.

A A Dight

A A DIGHT

CONFIDENTIAL

Smith

FROM: J S HIBBERD
DATE: 10 NOVEMBER 1987

CHANCELLOR OF THE EXCHEQUER

Tony

Mary Rutter

cc : Sir Peter Middleton
Sir Terence Burns
Mr Sedgwick
Mr S Price
Mr R Deane

MONTHLY PATH FOR THE RPI

October RPI

Preliminary indications from DE suggest that the annual RPI inflation rate was **"around 4½ per cent"** in October. (The final numbers will be available to us on Wednesday 11 November and published on Friday 13 November.) DE's projection for November is 4.0 per cent. These estimates are a bit higher than the monthly RPI profile underlying the IAF.

2. We do not have the detail for the October RPI, but it seems likely that, as in September, the increases will be across the whole range of goods and services other than housing, food, nationalised industries and petrol. The products affected account for just over half the total RPI. As we noted in a minute to you of 9 November, **producer price inflation** also edged up again in October, to 4.8 per cent. There, thus seems to be increasing evidence of an upward creep in inflation this year.

Monthly path for RPI in IAF

3. We have **not** adjusted the Industry Act forecast in the light of the latest RPI estimates. The first column of Table 1 and the first two columns of Table 2 show the path for inflation to 1988 that is consistent with the Industry Act forecast.

The impact of recent interest rate and exchange rate changes on IAF forecast of RPI

4. As a purely mechanical and illustrative exercise, however, we have constructed an RPI forecast for next year (as a variant of the IAF path) to take account of recent interest rate and exchange rate movements, **assuming they are sustained throughout 1988.** The outlook for both interest rates and the exchange rate is of, course, uncertain.

cm
sp-mtgint

Mortgage interest rate effects

5. The IAF already took account of an expected cut of ½ per cent in mortgage interest rates, beginning on 1 January. To reflect recently announced cuts in mortgage interest rates, we imposed a cut of 1 point for December only and modified the existing IAF path down by a further ½ point through 1988. The mortgage interest rate cut works almost entirely through housing costs (there is some extremely small knock-on effect from the assumed revalorisation of duties in April 1988). The net effect of the changes is to take about 0.2 per cent off the total RPI. The quarterly path is shown in Table 1.

Exchange rate effects

6. We assumed an average effective exchange rate of 74.3 for 1987Q4 (an actual average of 73.4 for October-November 4, and 75 over the rest of 1987 and 1988). This is about 3 per cent higher for 1988 than in the IAF. This change has more widespread effects. Nationalised Industry prices (fixed by assumption), mortgage interest payments, rents and rates are assumed to remain as in the IAF. But food prices, other housing costs and, particularly, petrol are affected. Other retail prices are also affected, mainly driven by producer output prices. The combined effect of the exchange rate and interest rate changes is shown in table 1. By itself, the exchange rate effect reduces RPI inflation by about ¼ per cent in 1988Q1, building up to ½ per cent by 1988Q4. The combined impact of interest rate and exchange rate changes is to reduce RPI inflation by about ½ per cent throughout 1988

Table 1:

		Year on year percentage change in total RPI		
		IAF Forecast	Additional drop in interest rates	Exchange rate appreciation plus lower interest rate
1987	Q3	4.3	4.3	4.3
	Q4	3.9	3.8	3.8
1988	Q1	3.4	3.2	2.9
	Q2	4.0	3.8	3.4
	Q3	4.4	4.2	3.7
	Q4	4.5	4.4	3.9

Monthly RPI profile

6. The implications of these changes for the monthly path underlying the IAF forecast are shown in Table 2 below:

Table 2: Monthly RPI profile

Year on year percentage change

		IA forecast		Change interest rate		Change Exchange rate and interest rates	
		Total	Total excl. MIPs	Total	Total excl. MIPs	Total	Total excl. MIPs
1987	Sept*	4.2	3.5	4.2	3.5	4.2	3.5
	Oct	4.3	3.6	4.3	3.6	4.3	3.6
	Nov	3.8	3.7	3.8	3.7	3.8	3.7
	Dec	3.7	3.7	3.3	3.7	3.3	3.6
1988	Jan	3.3	3.4	3.1	3.4	2.9	3.2
	Feb	3.3	3.4	3.1	3.4	2.9	3.2
	March	3.5	3.6	3.3	3.6	2.9	3.2
	April	3.7	4.0	3.5	4.0	3.2	3.7
	May	4.2	4.2	4.0	4.2	3.6	3.8
	June	4.2	4.1	4.0	4.1	3.6	3.7
	July	4.4	4.2	4.1	4.2	3.6	3.7
	Aug	4.4	4.3	4.2	4.3	3.7	3.8
	Sept	4.5	4.4	4.3	4.4	3.8	3.9
	Oct	4.5	4.4	4.3	4.4	3.8	3.9
	Nov	4.5	4.4	4.3	4.4	3.8	3.9
	Dec	4.5	4.3	4.7	4.3	4.2	3.9

* Actual

The forecast for the reduction in MIPs alone is actually higher in December 1988 than in the IA forecast. This is because the effect of the 1 per cent fall in mortgage rates now drops out in December, compared to the January cut originally assumed in the IAF.

Tim Hibberd

J S HIBBERD

SECRET

COLMAN TO CH. 11.11.87

FROM: J G COLMAN
DATE: 11 November 1987

1. MR D J L MOORE DJLM 11/11
2. CHANCELLOR

cc Financial Secretary
Sir P Middleton
Mr Monck

BRITISH STEEL CORPORATION

This submission forms the briefing for the Prime Minister's meeting tomorrow.

2. Briefing on the substance of the BSC proposals was included in my submission of 8 October, and 26 October. That is unchanged. In general we agreed, throughout, as did you, with the line taken by Mr Clarke in his minute of 29 October to the Prime Minister, with the exception of his proposal on the timing of announcement.

3. You asked about the effects of the recent stock market fall on BSC's prospects. I attach a note by EA/PSF which concludes that there seems to be no reason to reject BSC's own optimistic view of its prospects provided that there is not a more serious fall in world and UK activity than assumed in the Autumn Statement. DTI have also discussed these issues with BSC and Mr Clarke will be briefed accordingly.

4. The remaining points at issue are the scale of the employment and training package proposed by Mr Clarke and those raised in Mr Rifkind's minute of 10 November.

Employment package

5. Mr Rifkind disputes the BSC's proposals and does not pick up the references in Mr Clarke's minute to a training and employment package. It may well be that the idea of such a package will not be discussed at the Prime Minister's meeting.

CONFIDENTIAL

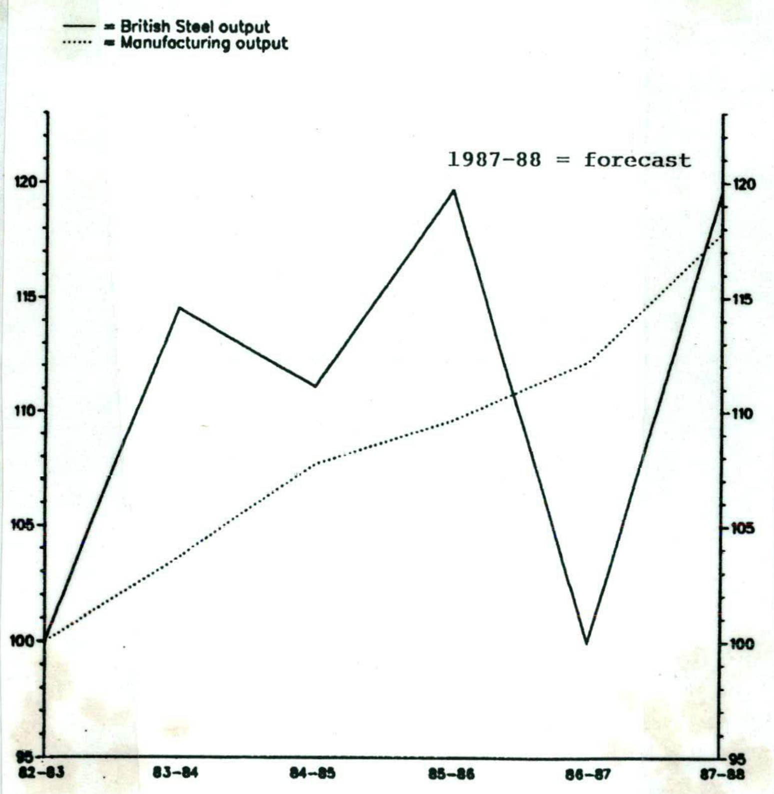
PROSPECTS FOR BSC: NOTE BY EA/PSF

This note examines the implications for British Steel of a possible slowdown in world and UK growth as a result of the stock market falls and of recent sharp changes in exchange rates. It has benefited from an extensive discussion with Mr Hood (PE).

BSC output

2. BSC's output (liquid steel production) has grown strongly over the past few years largely in response to growth in demand, particularly in the UK. Chart 1 illustrates the recent performance of the steel industry compared to the manufacturing sector as a whole. The fall in output in 1986-87 (and part of the subsequent recovery in 1987-88) reflects major maintenance at the Redcar blast finance.

CHART 1: MANUFACTURING & BRITISH STEEL OUTPUT 1982/83=100



3. Output is subject to an EC quota which is set quarterly on the basis of a projection of total EC steel demand. However in practice the quota system is a relatively loose constraint and BSC is heavily dependent on UK demand for steel: around

two-thirds of its output is sold within the UK, just over 10 per cent in the rest of the EC and about 5 per cent in the US.

4. The effect of the stock market fall on BSC output therefore depends on how the prospects for its main customers - roughly proxied by the UK manufacturing and construction sectors - have changed. The Autumn Statement forecast incorporated post stock market fall adjustments which had the effect of reducing world (G7) and UK GDP growth by about ½ percentage point in 1988. UK manufacturing output growth was similarly reduced by ½ percentage point to 3½ per cent. The outlook for construction may also have weakened a little, although reductions in interest rates will help sustain industrial and commercial building which has a relatively high steel content.

5. Table 1 compares the Autumn Statement forecast of manufacturing output with assumptions used by BSC in March and September 1987.

Table 1: Manufacturing output growth (per cent per annum)

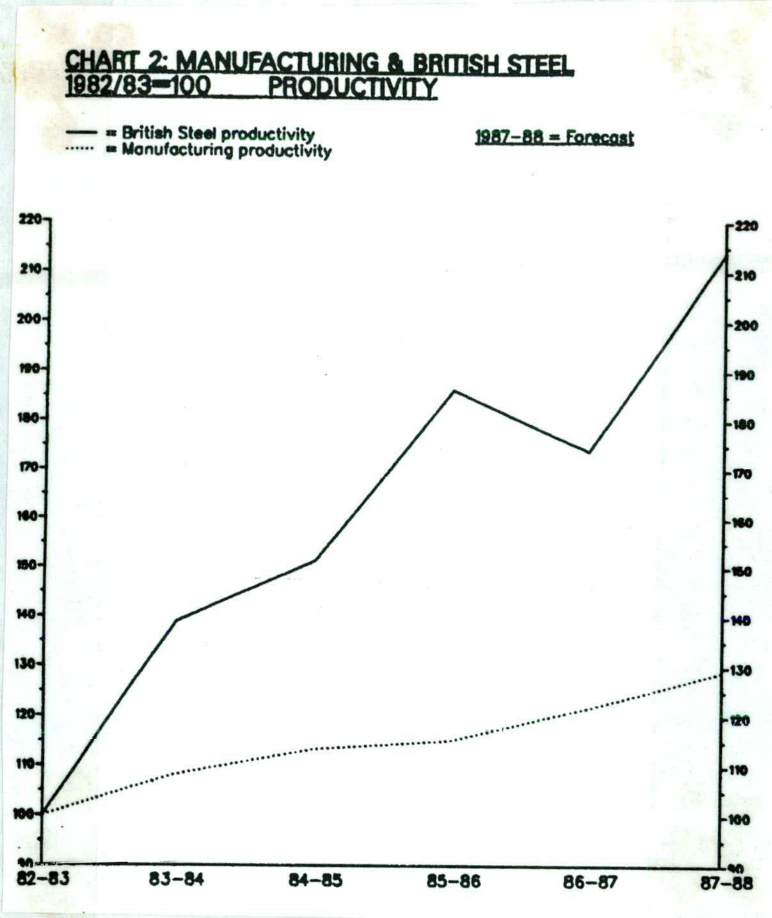
	Autumn Statement	BSC assumptions March 1987	BSC assumptions September 1987
1986	1	0.5	0.9
1987	5	2.5	4.2
1988	3½	1.5	2.5

Clearly, although we believe the prospects for manufacturing have deteriorated a little, they remain considerably brighter than BSC have been assuming. However further stock market falls or bigger effects from existing falls would worsen the prospects.

Productivity

6. Improved productivity has made an important contribution to the better profits performance over the past few years. In the past year this has almost entirely reflected output growth,

with employment fairly stable. Chart 2 compares BSC's productivity growth with the performance of the manufacturing sector as a whole.



7. In the short term at least, any slowdown in BSC output growth would probably be reflected in slower productivity growth.

Profit margins

8. In addition to productivity the other major influence on profit margins is the pattern of exchange rates. Material inputs - principally iron ore and coke - are priced on world markets in dollars so that, unless these prices fully adjust for changes in the dollar, a fall in the dollar against sterling will reduce BSC's costs. However the price of steel within the EC is fixed in Deutschemarks. Revenue would rise if the pound fell against the Deutschemark, and vice versa.

Table 2: $/£ and DM/£ exchange rates

	$/£		DM/£	
1984	1.34		3.79	
1985	1.30		3.78	
1986	1.47		3.19	
1987 1	1.54		2.83	
2	1.64		2.96	
3	1.62		2.97	
10 November	1.79		2.97	
Assumptions	**AS**	**BSC (Sept)**	**AS**	**BSC (Sept)**
1987	1.61	1.61	2.94	2.92
1988	1.68	1.60	2.94	2.85

9. Table 2 shows that between 1985 and 1986, movements in both exchange rates tended to boost BSC profit margins, although the rise of the pound against the DM during 1987 will have partly reversed these gains.

10. With rising profit margins and output, BSC profits have improved steadily over the past few years.

£ million

	1984-85	**1985-86**	**1986-87**	**1987-88***
Gross trading surplus	- 309	99	279	393

* 1987 PEWP

11. The Autumn Statement forecast assumed relatively stable bilateral exchange rates over the next year, with both the $/£ and DM/£ rates a little higher than assumed by BSC. However it was completed before the recent very sharp fall in the dollar. The present $/£ rate of 1.79 is 6½ per cent higher than the 1988 level assumed in the Autumn Statement and nearly 12 per cent higher than the latest BSC assumption. Against a background of slower world growth it seems unlikely that the weaker dollar will be significantly offset by higher dollar input prices. Consequently, if the present $/£ rate were to be sustained, BSC would benefit from a significant cost reduction, compared both to their own assumptions and those underlying the Autumn Statement.

12. Despite the fall in the dollar, the DM/£ rate has remained stable in recent weeks and there seems no reason at this stage to suppose that the rate will deviate very significantly from the Autumn Statement or BSC assumptions.

Conclusions

13. The effect of recent changes in financial markets on BSC profits is hard to judge, but seems unlikely to be large unless activity effects are much larger then assumed in the Autumn Statement. Any slowdown in the growth of UK manufacturing or construction would reduce the demand for steel somewhat, but profit margins will almost certainly have benefited from the recent fall in the dollar. Even after taking account of the stock market falls we believe the outlook for UK manufacturing is considerably brighter than assumed by BSC, so there seems no reason to reject BSC's own optimistic view of its prospects. A more serious fall in world and UK activity than assumed in the Autumn Statement would however, inevitably, damage these prospects.

But if it is, we have serious reservations about ideas which DTI have been developing, which involve a kind of joint venture between BSC Industry Ltd (BSCI) and British Shipbuilders Enterprise Ltd (BSEL). This new body would carry out similar activities to BSCI and BSEL, namely counselling, training, business start-ups, generating alternative employment opportunities, financial assistance, and provision of workspace.

6. These ideas are described further in Mr Clarke's paper on shipbuilding, for discussion at the Prime Minister's meeting on 19 November. So far as the steel side of DTI are concerned the package should be judged by its political effect rather than by its power to help those displaced by redundancy. In accordance with the remit given him by the Prime Minister, Mr Clarke's officials have discussed with us "the finance which might potentially be made available for an enterprise company in the Ravenscraig area". We have not proposed, still less agreed, any figure for this. The DTI proposals for the North East envisage £36m over 5 years, plus £60m for an industrial park, and they invite Mr Rifkind to consider something similar for Scotland. No doubt Mr King will make similar demands for Belfast.

7. We will brief in more detail for the meeting on shipbuilding, but our reservations about the DTI ideas are:

a. the proposed scale of activity ("a significant proportion" of BSC sale proceeds) is disproportionate to the job losses (400 at the hot strip mill, 2000 for BS in Glasgow, 30000 at Sunderland and an eventual - after 4, or possibly, even 7 years - 3000 at Ravenscraig);

b. the proposals are not based on any analysis of need but solely on a supposed political requirement to have a generous-sounding package;

c. in particular, there is little evidence that lack of factory space is a major constraint, so that DTI proposals for 6 million square feet of factory space are disproportionate;

d. similarly, DTI proposals for £11m per annum finance for enterprise would provide for 11000 job opportunities over 3 years, again disproportionate.

Line to take: Employment package

a. concede (as you are recorded as doing so in the record of the Prime Minister's meeting on 27 October) that some training and employment package is needed;

b. but package must be proportionate to scale of job losses;

c. discourage idea of spending "a significant proportion" of BSC sale proceeds. BSEL, set up to deal with 3500 redundancies has not yet been able to spend £5m. BSCI is now self-financing. Enterprise companies find it difficult to spend large sums quickly and effectively;

d. a single package should cover both steel and shipbuilding: can be settled only after decisions taken on both;

e. package should take account of all existing or proposed support for enterprise in the areas affected, for example the Scottish Development Agency will have a role to play;

top-up

f. look at possibility of financing within DTI or Scottish block budget.

8. If agreed, Mr Rifkind's proposal for an enterprise zone for Inverclyde would be a major concession for Scotland (there are to be no more for England) and would need to be given full weight in devising a package. We suggest that you do not mention the enterprise zone yourself, but that if it is raised use it as an important bargaining counter on the package.

Mr Rifkind's minute

9. We have a number of comments on Mr Rifkind's minute, as follows:

a. unrealistic to privatise BSC as early as November/December 1988 (paragraph 4)

Comment

No. Legislation of only medium length will be needed.

b. risk of accusation of bad faith (paragraph 5a)

Comment

The degree of opposition to the BSC proposals probably will lead to such accusations. Mr Rifkind uses this point to suggest BSC cannot be trusted to honour any commitments, but what was said at the time of the Gartcosh closure fell a long way short of the kind of formal commitment BSC are now willing to give. It is not true that Gartcosh was closed to help Ravenscraig.

c. closure of hot strip mill not necessary for privatisation (paragraph 5b)

<u>Comment</u>

That is not the reason why BSC are proposing closure. The reasons are commercial ones relating to capacity utilisation, as the Scholey letter makes clear.

d. EC negotiations do not require closure of hot strip mill (paragraph 5c)

<u>Comment</u>

Given that BSC have decided, as they have, on commercial grounds to close the hot strip mill, there is a good case for announcing closure before the next round of EC negotiations

- it will avoid the appearance of the closure resulting from the negotiations

- it will strenghten our position in the negotiation on <u>quota</u>

e. refurbishment of the Dalzell plate mill would be the least expensive way of meeting BSC's needs (paragraph 6)

<u>Comment</u>

The refurbishment option was looked at closely by BSC. It is true that it was the least expensive. It is not true that it meets BSC's needs. That is why BSC believe they will, in due course, need to have a new plate mill to secure production of plate of the required size range at lower costs than Dalzell can supply.

f. early decisions on the plate mill would be to BSC's commercial advantage (paragraph 8)

Comment

BSC have made no proposals for the timing of plate mill development. They must judge where their commercial advantage lies. If they were to take a decision now it is clear that it would not favour Scotland.

g. the savings from the closure of the hot strip mill would be minimal (paragraph 9a)

Comment

But £20m a year is a material proportion of BSC's profits: the **commercial** case for closure is very strong.

h. effect on privatisation of SSEB (paragraph 96)

Comment

We believe Ravenscraig takes about 1% of SSEB's output which is about 1 year's growth in that output. In the context of a closure over 4 years away, that is not likely to be material to SSEB's privatisation.

i. effect on unemployment in Lanarkshire (paragraph 9c)

Comment

Pressing Ravenscraig would increase the comparable unemployment figure for Scunthorpe (ie male unemployment) to **over** 30%.

10. Generally, Mr Rifkind wishes to substitute his judgement for BSC's own commercial view of whether steelmaking has a future in Scotland. That is just not compatible with privatisation. Both the merchant banks emphasised that BSC having and being seen to have freedom to manage will be crucial to the success of the privatisation.

Line to take

a. essential that decisions on steel are taken on commercial grounds;

b. no reason to question BSC's commercial judgement;

c. agree that an employment package may be necessary to deal with transitional problems.

J.G.C.

J G COLMAN

pmp.

Dewe Rogerson

News Release

Embargo: Not for publication before 2.30pm - 12 November 1987

"CENTRE FOR EXPLOITATION OF SCIENCE AND TECHNOLOGY"
TO BE ESTABLISHED IN MANCHESTER

A new £6 million national body aiming to improve Britain's exploitation of its scientific research and development is formally launched at a press conference today (12 November 1987). It will be based in Manchester.

The <u>Centre for Exploitation of Science and Technology</u>, which will operate as a completely independent body, is jointly funded by contributions from industry and Government. Some of the UK's leading companies in research and development are involved and have exceeded targets by contributing almost £5 million to the launch. The Government has given a further £1 million.

The steering committee of founding member companies - each of which will contribute £¼ million to the Centre - has been chaired by Sir Robin Nicholson, a Director of Pilkington plc, the world's leading glass company.

The Centre is to be located at the Manchester Science Park, which was the successful applicant among thirteen educational institutions to bid. Manchester Univerity led the bid which was based on a consortium including the Universities of Salford, Liverpool, Lancaster and UMIST; and the Polytechnics of Manchester, Liverpool and Lancashire.

Along with representatives from industry and commerce in the North West, the colleges will offer access to its resources and expertise to the Centre, which will be run by a Chief Executive (appointment pending) and core group of professional staff.

/More...

Dewe Rogerson Limited, 3½ London Wall Buildings, London Wall, London EC2M 5SY. Telephone: 01-638 9571. Telex: 883610. Fax: 01-628 3444.

Commenting on the Centre's launch today, Chairman Sir Robin Nicholson said:

"In recent decades no area of industry has remained untouched by scientific innovation, and there are no signs that this stream of advance is slowing down.

"Indeed, future progress in science and technology will radically affect product lines, manufacturing processes and in some cases the whole structure of industries.

"Britain has an excellent science and engineering base in the universities and colleges. Our new Centre will aim to develop networks throughout the academic, scientific and industrial communities to improve understanding and awareness in industry of advances in science and engineering.

"Our task is to encourage research in promising aspects of new technology where there are commercial opportunities which can be exploited for the national benefit."

Although the Centre's founder members are large companies from industry and finance, it is sensitive to the vital role smaller businesses play in the effective exploitation of scientific advances, and will involve them in the Centre's work.

The establishment of the Centre was recommended in a 1986 report from the Advisory Council for Applied Research and Development (ACARD), and having a central forum will bring the UK into line with many of our competitor nations.

The full text of Sir Robin's statement and list of founder members is attached.

- Ends -

For further information, please contact:

Sir Robin Nicholson on 0744-28882
or Sir Francis Tombs on 01-222-9020

Issued by Christopher Ashton-Jones,
Dewe Rogerson Ltd, 01-638-9571

==

CENTRE FOR EXPLOITATION OF SCIENCE AND TECHNOLOGY

STATEMENT BY SIR ROBIN NICHOLSON - CHAIRMAN OF STEERING COMMITTEE

==

1. National economic success and well being are built on the foundations of scientific knowledge and the ability of industry to develop and apply advances in science and technology quickly and effectively. In recent decades no industry has remained untouched by science-based innovation: radically new product lines have been introduced and traditional product lines have been changed and improved. In many cases, whole new industries have emerged and older industries completely restructured. There are no signs that the stream of scientific advance is slowing down, indeed the reverse may be true. There will therefore be further decades of major industrial change which offers opportunities to organisations which are technically alert and entrepreneurial and poses threats to those which are not.

2. The Centre for Exploitation of Science and Technology believes that industry in the UK is well placed to take advantage of science-led change. The UK has an excellent science and engineering base in our Universities and Colleges and we have a good output of well-trained scientists and engineers. Both industry and our society have shown an ability to recognise and respond to invention and innovation from the Industrial Revolution to the present day. Our industry is now profitable; management and workforce have shown themselves capable of bringing in radical change in product design, manufacturing processes and services.

3. The Centre aims to promote within the UK an awareness of advances in science and technology worldwide; to identify those advances likely to lead to new industrial and commercial opportunities; to provide research scientists and engineers with an awareness of these opportunities and to encourage basic research in areas of science and technology where such opportunities exist.

/more ...

4. Of course many individual companies already carry out similar activities in their own fields but the Centre believes its resources to be such as to provide a broader and more integrated approach (and one seen from a wider perspective of skills) which will be of significant national benefit.

5. The Centre is well placed to ensure that the results of its work are rapidly disseminated through a substantial part of the UK to the benefit of the national economy as the founder members represent a broad spectrum of manufacturing and science industries, and financial institutions, and are responsible for around half of the R & D carried on by industry in the UK.

6. The Centre welcomes further members, in particular it recognises the unique and important role played by small and medium sized businesses in the rapid and effective exploitation of advances in science and technology and will be making arrangements for these organisations to play a full and effective role in the Centre.

7. The Chief Executive and core group of professional staff of the Centre will be located in Manchester in the Manchester Science Park. The decision to locate the Centre there was taken after extensive consideration of a number of potential locations throughout the country. Invitations to bid were sent to nineteen Universities and Polytechnics and thirteen bids were considered. Manchester's bid was based on a North-West Consortium. This was led by the Manchester University and included the Universities of Salford, Liverpool and Lancaster, the University of Manchester Institute of Science and Technology, the Manchester Business School and the Polytechnics of Manchester, Liverpool and Lancashire. It also had very broad representation from industry and commerce in the North-West. The Centre will be an independent body but will be afforded access to expertise and resources in these organisations, all of whom share a strong commitment to its objectives. The founder members believe that the choice of Manchester gives the Centre a secure base with good access to industrial Britain as a whole.

/more ...

8. The Centre welcomes the participation of Government and the financial contribution which Government is making. The Centre will aim to influence the Government's approach to education in science and engineering and the amount and distribution of Government funding of applied R & D and science and engineering research in Universities and Colleges. The links with the Government will be mainly through the Advisory Council on Science and Technology (ACOST), the Advisory Board for the Research Councils (ABRC) and the Department of Trade and Industry. The Centre will develop networks throughout the academic, science and engineering communities through the Research Councils, Universities and Colleges and Learned Societies. Through these links it will aim to foster and promote new and promising aspects of science and technology and its exploitation for public benefit. The Centre also welcomes the participation of the Bank of England as further evidence of the importance the financial community attaches to the work of the Centre.

9. The Centre is currently being developed by a Steering Committee comprised of founder members (which I chair) who have a common goal - that UK industry should emerge from the process of future science and technology-led change stronger than it entered it and making a correspondingly larger contribution to the UK economy and society. The founder members have each agreed to contribute £250,000 over five years towards the cost of establishing and running the Centre for that period. Contributions from companies have so far reached £4,750,000 and Government has contributed £1,000,000. A Chief Executive is to be appointed. The success of the Centre will depend on getting the right person for this job. A thorough search has produced a substantial and high quality list of candidates. An early announcement is anticipated.

- Ends -

12 November 1987

MEMBERS

British Aerospace	Mr I Yates
British Gas plc	Mr G Clerehugh
The British Petroleum Co plc	Mr R Malpas
British Telecommunications plc	Dr A Rudge
The Committee of London & Scottish Bankers	Mr P Borrett
ESSO UK plc	Dr J Price
Glaxo Holdings plc	Dr D Jack
IBM United Kingdom Holdings Ltd	Dr G Robinson
Imperial Chemical Industries plc	Dr C Reece
Investors in Industry	Viscount Caldecote
Jaguar plc	Sir John Egan
Lucas Industries plc	Mr A K Gill
Nothern Engineering Industries plc	Mr T Harrison
Pilkington plc	Sir Robin Nicholson (Chairman)
Rolls Royce plc (and Advisory Council on Science & Technology)	Sir Francis Tombs
Shell United Kingdom Ltd	Dr H L Beckers
Smiths Industries plc	Mr F R Hurn
Thorn EMI plc	Dr K Gray
Advisory Board for the Research Councils	Prof Sir David Phillips
Cabinet Office	Mr J W Fairclough
Department of Trade and Industry	Dr R Coleman

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

(3x) 13 November 1987

CHANCELLOR OF THE EXCHEQUER VISITS INLAND REVENUE COMPUTER CENTRE

The Chancellor of the Exchequer the Rt Hon Nigel Lawson MP today visited the Inland Revenue Computer Centre in Telford.

The Chancellor attended the foundation stone laying ceremony for Matheson House. When completed it will be the largest building in Telford housing some 750 Inland Revenue staff working on the department's computerisation programme. The ceremony was performed by the Inland Revenue's Director of Information Technology Mr Steve Matheson after whom the building has been named.

The Chancellor of the Exchequer paid tribute to the "hard work and commitment" of all those involved in the Inland Revenue's computerisation programme. He said,

> "PAYE is now computerised throughout the country. By any standards, the computerisation programme is a major achievement. The records of 28 million taxpayers have been computerised. Some 27,000 visual display units have been installed in over 600 tax offices. More than 35,000 staff have been trained in the new techniques, and 11 regional computer centres have been set up.
>
> All this amounts to one of the biggest on-line computerisation projects in Europe."

The Chancellor pointed to the continuing process of computerisation: CODA, the computerisation of the taxation of the self-employed, which is already underway; the National Tracing System (NTS); and the new systems for Corporation Tax assessing, and the Collection Service, to follow. He commented:

> "The Revenue's Information Technology programme is one of the most extensive in the country today. This is the answer to those who, quite unfairly criticise the Inland Revenue as a staid institution populated by stick-in-the-muds who are resolutely opposed to a change of any kind. Nothing could be further from the truth. In fact the Revenue is changing at a very rapid rate indeed. What remains unchanged is the commitment to providing an efficient service to the public".

---

1. Notes for Editors

Notes for Editors

An Inland Revenue computerisation development team first came to Telford in 1981 with 140 staff. At that time work concentrated on the successful programme to computerise PAYE - known as COP. COP is being completed on time and within budget. It is one of the largest and most technically advanced on-line computer systems in Europe.

Further projects are being developed and a system to computerise the taxation of the self-employed is now being implemented - this is known as CODA. CODA will be completed in 1988. It will reduce delays which can occur in sorting out the self-employed's correct tax liability by speeding up communications between tax and accounts offices. It will also reduce arithmetical errors and give the taxpayer clearer information about how much tax has been paid and how much is owed.

When both COP and CODA are complete in 1988, the records of 31 million individuals and over one million employers will be held on computers in 11 Regional Processing Centres. 500 local offices are already linked to the computers under COP by over 21,000 VDUs on tax officers' desks. Including the associated CODA project, there are now some 27,000 VDUs in over 600 offices. Some 35,000 members of staff will have been trained to operate the computer systems.

Future projects include an on-line system for Corporation Tax and a new system for the Collection Service. In addition NTS will help identify the right home for correspondence on the minimum of information.

The Telford site now houses over 1,200 Inland Revenue staff and Matheson House will provide purpose designed accommodation for 750.

When completed Matheson House will be the largest building in Telford. Costing £12.1m it has been designed by the Property Service Agency; the main contractor is J Laing Construction Ltd. A Press Release issued today by the Property Services Agency gives technical details for Matheson House. (For copies or information please telephone 01-212-7584/4674).

---

p.264 Pl. fax immediate to Beverly Evans PS/SOS - Employment
Eamonn Kelly PS/MoS-SS DHSS
from: Jim Rutter PS/CST

BRIEFING ON SOCIAL SECURITY RATES ASPECTS OF RPI ERROR 11 DECEMBER

Most underpayments are very small and nobody has lost a large amount. Pence per week rather than pounds. There will be no gain to the Exchequer from the effects on social security expenditure.

The department will make special extra payments to National Insurance Retirement and Supplementary pensioners and severely disabled people. It is too early to give any details of how this will be done. Ministers will report to Parliament before Christmas.

We estimate that the total amount underspent for 1987-88 will be £35 million. At the rates set for 1988-89 there is an estimated underspend of £70 million. So the total underspend over both years is around £105 million.

You may say for guidance if pressed:

We estimate that a single retirement pensioner has been underpaid a total of £2.60 for the whole of 1987-88 and would be underpaid £5.20 for the year 1988-89. There are 9 ½ million retirement pensioners.

If pressed very hard:

The biggest underpayments could be around £30 in a full year. They would affect war and industrial pensioners on maximum pensions and additions.

There are approximately 275,000 war pensioners and 185,000 people getting industrial disablement benefit. Very few of these (tens of thousands) will have been underpaid as much as £30.

[To be used if pressed]

How much will the extra payment to pensioners be?

A retirement pensioner/single or married will have lost roughly £2.50 this year (1987-88) and would stand to lose roughly £5 next year (1988-89). The special payments will cover this loss.

when will the extra payment be made?

A.S.A.P.

Briefing agreed by H.M.T + DHSS

INDEXED-LINK DEBT

Background Brief

The Government issues some gilt-edged stocks and National Savings certificates whose redemption value (and interest) is linked to the RPI - thus providing the holder with protection against inflation.

Paragraph 5 of the attached prospectus shows the wording that has been used in these issues. The relevant number is the "index figure issued monthly and subsequently published in the London, Edinburgh and Belfast Gazettes".

For gilts the applicable figure (for administrative reasons) is the one for seven months precisely (for certificates the lag is one month). In fact no indexed gilts have yet reached redemption. The first issue to do so will be in March 1988 (for which the RPI for July 1987 will be relevant).

Several issues of indexed National Savings certificates have matured and many others will have been encashed ahead of maturity. But in all cases the amount repaid to the holder will have been calculated strictly in accordance with the terms of the prospectus.

The RPI for past months is of course not being changed by the correction announced today.

It is the <u>level</u> of the RPI that is relevant to the cash value of indexed securities. The correction of the error in the level will correspondingly increase the cash value of future redemptions of these securities. (But <u>NB</u> it will not affect the 1988 gilt maturity - because of the 7 months lag.)

a conventional stock

TENDERS MUST BE LODGED AT THE BANK OF ENGLAND, NEW ISSUES (B), WATLING STREET, LONDON, EC4M 9AA NOT LATER THAN 10.00 A.M. ON THURSDAY, 21ST FEBRUARY 1985, OR AT ANY OF THE BRANCHES OF THE BANK OF ENGLAND OR AT THE GLASGOW AGENCY OF THE BANK OF ENGLAND NOT LATER THAN 3.30 P.M. ON WEDNESDAY, 20TH FEBRUARY 1985.

ISSUE BY TENDER OF £400,000,000

$2\frac{1}{2}$ per cent INDEX-LINKED TREASURY STOCK, 2013

PAYABLE IN FULL WITH TENDER

INTEREST PAYABLE HALF-YEARLY ON 16TH FEBRUARY AND 16TH AUGUST

1. The Stock is an investment falling within Part II of the First Schedule to the Trustee Investments Act 1961. Application has been made to the Council of The Stock Exchange for the Stock to be admitted to the Official List.

2. THE GOVERNOR AND COMPANY OF THE BANK OF ENGLAND are authorised to receive tenders for the above Stock.

3. The principal of and interest on the Stock will be a charge on the National Loans Fund, with recourse to the Consolidated Fund of the United Kingdom.

4. The Stock will be registered at the Bank of England or at the Bank of Ireland, Belfast, and will be transferable, in multiples of one penny, by instrument in writing in accordance with the Stock Transfer Act 1963. Transfers will be free of stamp duty.

5. If not previously redeemed under the provisions of paragraph 14, the Stock will be repaid on 16th August 2013. The value of the principal on repayment will be related, subject to the terms of this prospectus, to the movement, during the life of the Stock, of the United Kingdom General Index of Retail Prices maintained by the Department of Employment, or any Index which may replace that Index for the purposes of this prospectus, such movement being indicated by the Index figure issued monthly and subsequently published in the London, Edinburgh and Belfast Gazettes.

6. For the purposes of this prospectus, the Index figure applicable to any month will be the Index figure issued seven months prior to the relevant month and relating to the month before that prior month; "month" means calendar month; and the Index ratio applicable to any month will be equal to the Index figure applicable to that month divided by the Index figure applicable to February 1985.

7. The amount due on repayment, per £100 nominal of Stock, will be £100 multiplied by the Index ratio applicable to the month in which repayment takes place. This amount, expressed in pounds sterling to four places of decimals rounded to the nearest figure below, will be announced by the Bank of England not later than the business day immediately preceding the date of the penultimate interest payment.

8. Interest will be payable half-yearly on 16th February and 16th August. Income tax will be deducted from payments of more than £5 per annum. Interest warrants will be transmitted by post.

9. The first interest payment will be made on 16th August 1985 at the rate of £1.2280 per £100 nominal of Stock.

10. Each subsequent half-yearly interest payment will be at a rate, per £100 nominal of Stock, of £1.25 multiplied by the Index ratio applicable to the month in which the payment falls due.

11. The rate of interest for each interest payment other than the first, expressed as a percentage in pounds sterling to four places of decimals rounded to the nearest figure below, will be announced by the Bank of England not later than the business day immediately preceding the date of the previous interest payment.

SECRET UNTIL 11.00 am

Inland Revenue

L J H Beighton

Somerset House
London WC2R 1LB

Telephone 01-438-~~6507~~ 7586

cc PPS Sent 11-12-87
Chief Secretary
Sir T Burns
Mr Anson
Mr Cassell
Mr Kemp
Mr Scholar
Mr Beastall
Mr Luce
Mr McIntyre

Private Secretary to Sir Michael Quinlan
Department of Employment
Caxton House
Tothill Street
SW1H 9NF

11 December 1987

Dear Ms Rutherford

Error in the retail prices index

I have not managed to raise anybody in your office or that of your Secretary of State to enquire what briefing if any he requires on the taxation aspects of this morning's statement. If any detailed questions on taxation arise if he will doubtless leave them to Treasury Ministers.

The major point to make if the question arises is that the compensation payment to retirement pensioners will not be taxable.

The Government will not be taking any action on the various indexation provisions in the taxation system. These will continue to run by reference to the previously published RPI figures. The Government's decision to limit corrective action to national insurance retirement pensions applies to the tax system as it does to all other areas involved.

I should be grateful if you would feed this into your Secretary of State I brief in whatever way he would find most convenient.

I am copying this letter to Sargent in Sir Peter Middletons office.

Yours sincerely

LJH Beighton

L J BEIGHTON

1-11-12

PERSONAL AND CONFIDENTIAL

FROM: S PRICE
DATE: 11 DECEMBER 1987

This is most unfortunate.
Jim Hibberd
11/12

1. **MR J S HIBBERD**
2. **CHANCELLOR OF THE EXCHEQUER**

Not shown to CTT
MPW.
11/12

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Paymaster General
Sir Peter Middleton
Sir Terence Burns
Miss Mueller
Mr Anson
Mr F Cassell
Mr Kemp
Mr N Monck
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Bottrill
Mr Hibberd
Mr S J Davies
Mr R I G Allen
Mr Gilhooly
Mr Mowl
Mr Pickford
Mr de Berker
Mr Patterson
Mr Cropper
Mr Tyrie
Mr Call

THE NOVEMBER RPI

The Department of Employment have told me this morning that, due to an error in the processing of the RPI, the November figures will **not** be released at the usual time of 11.30 this morning. Instead a ministerial statement will be made later today and detailed figures will be made available next week.

2. The errors concern some of the components of the RPI (we do not know which components) but, it appears, **the twelve-month RPI inflation figure for November will be unchanged.**

3. However, the figures quoted in my note to you on 10 December should **not be quoted** until we hear otherwise.

SIMON PRICE
EA1 DIVISION
EXT 5401

RETAIL PRICES INDEX: PERCENTAGE INCREASES OVER A YEAR EARLIER

	Annual Average	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec
1963	2.0	2.7	3.5	3.2	2.1	1.7	1.0	0.8	1.4	1.8	2.3	2.2	1.9
1964	3.3	2.0	1.2	1.5	2.0	3.0	3.4	4.0	4.7	4.4	4.1	4.6	4.8
1965	4.8	4.6	4.5	4.5	5.6	5.1	4.9	4.9	4.7	4.8	4.8	4.4	4.5
1966	3.9	4.4	4.5	4.3	3.6	3.9	3.9	3.5	3.9	3.6	3.8	4.0	3.7
1967	2.5	3.7	3.7	3.5	3.0	2.2	2.4	2.2	1.4	1.5	2.0	2.0	2.5
1968	4.7	2.6	3.0	3.4	4.4	4.6	4.6	5.3	5.7	5.9	5.6	5.2	5.9
1969	5.4	6.2	6.2	6.3	5.5	5.3	5.3	5.3	4.9	5.1	5.4	5.4	4.7
1970	6.4	5.0	4.9	5.1	5.6	6.1	5.9	6.7	6.8	7.0	7.4	7.9	7.9
1971	9.4	8.5	8.5	8.8	9.4	9.8	10.3	10.2	10.3	9.9	9.4	9.2	9.0
1972	7.1	8.2	8.1	7.6	6.3	6.1	6.1	5.8	6.6	7.0	7.9	7.6	7.7
1973	9.2	7.7	7.9	8.2	9.2	9.5	9.3	9.4	8.9	9.3	9.9	10.3	10.6
1974	16.1	12.0	13.2	13.5	15.2	16.0	16.5	17.1	16.9	17.1	17.1	18.3	19.1
1975	24.2	19.9	19.9	21.2	21.7	25.0	26.1	26.3	26.9	26.6	25.9	25.2	24.9
1976	16.5	23.4	22.9	21.2	18.9	15.4	13.8	12.9	13.8	14.3	14.7	15.0	15.1
1977	15.8	16.6	16.2	16.7	17.5	17.1	17.7	17.6	16.5	15.6	14.1	13.0	12.1
1978	8.3	9.9	9.5	9.1	7.9	7.7	7.4	7.8	8.0	7.8	7.8	8.1	8.4
1979	13.4	9.3	9.6	9.8	10.1	10.3	11.4	15.6	15.8	16.5	17.2	17.4	17.2
1980	18.0	18.4	19.1	19.8	21.8	21.9	21.0	16.9	16.3	15.9	15.4	15.3	15.1
1981	11.9	13.0	12.5	12.6	12.0	11.7	11.3	10.9	11.5	11.4	11.7	12.0	12.0
1982	8.6	12.0	11.0	10.4	9.4	9.5	9.2	8.7	8.0	7.3	6.8	6.3	5.4
1983	4.6	4.9	5.3	4.6	4.0	3.7	3.7	4.2	4.6	5.1	5.0	4.8	5.3
1984	5.0	5.1	5.1	5.2	5.2	5.1	5.1	4.5	5.0	4.7	5.0	4.9	4.6
1985	6.1	5.0	5.4	6.1	6.9	7.0	7.0	6.9	6.2	5.9	5.4	5.5	5.7
1986	3.4	5.5	5.1	4.2	3.0	2.8	2.5	2.4	2.4	3.0	3.0	3.5	3.7
1987		3.9	3.9	4.0	4.2	4.1	4.2	4.4	4.4	4.2			

PERSONAL AND CONFIDENTIAL

~~PMP~~

previous papers pse (X)

FROM: S PRICE
DATE: 12 NOVEMBER 1987

(X) Much as we warned in my minute of 10 November Jim Hibberd 12/11

1. MR J S HIBBERD
2. CHANCELLOR OF THE EXCHEQUER

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr F Cassell
Mr Kemp
Mr N Monck
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Bottrill
Mr Hibberd
Mr S J Davies
Mr Culpin
Mr Gilhooly
Mr Mowl
Miss O'Mara
Mr Pickford
Mr de Berker
Mr Patterson
Mr Cropper
Mr Tyrie
Mr Call

Not minuted

Nah.

E. What's [illegible]: [illegible] - [illegible] [illegible] this [illegible] forecasts?

N L [illegible]

THE OCTOBER RPI (to be published at 11.30 am on Friday 13 November)

The RPI rose from 102.4 to 102.9 between September and October. As forewarned in Mr Hibberd's minute to you of 10 November, the annual inflation rate was 4.5 per cent in October, a rise from 4.2 per cent in September. Excluding mortgage interest payments, the October figure was 3.9 per cent, 0.4 per cent higher than in September.

2. Part of the rise is due to higher food prices. The price of milk rose in October, along with seasonal food prices (compared to a fall in seasonal food prices in October last year). Otherwise, the increase was over a broad range of goods and services.

RPI
july87

3. Our forecast for October, consistent with the Industry Act forecast, was 4.3 per cent. The current forecast is that inflation will fall to about 4 per cent in November, followed by a further fall in December. If, as seems likely, mortgage interest rates fall by 1 per cent in December, this will reduce inflation by an additional 0.4 per cent. The recent strength of Sterling is unlikely to be significantly reflected in prices until next year.

4. In the City there is broad agreement about the expected change in prices between September and October 1987. Phillips and Drew, James Capel, Wood Mackenzie, Alexander Laing and Cruickshank and Warburg Securities all expect +0.3 per cent; the Nomura Research Institute expects a rise of 0.2 per cent. The correct figure is +0.5 per cent.

Simon Price

S PRICE
EA1 DIVISION
x 5388

Notes to editors

1. The purpose and methodology of the TPI were described in an article in the August 1979 issue of Economic Trends, and the series from January 1979 is published regularly in the Monthly Digest of Statistics. Figures from January 1976 are available from the CSO.

What the TPI measures

2. The TPI measures the increase in gross taxable income needed to compensate taxpayers for any increase in retail prices. The RPI measures changes in retail prices; the TPI also takes account of the changes to direct taxes (and employees' National Insurance contributions) facing a representative cross-section of taxpayers. It is thus an additional, more comprehensive, index.

3. The TPI increased by 2.9 per cent over the twelve months up to October 1987 while the RPI increased by 4.5 per cent. The increase in the TPI was smaller because of the increase in personal income tax allowances and the reduction in the basic rate of income tax in the 1987 Budget. The effect on the TPI of the changes in National Insurance contributions, which took effect in April 1987, was negligible.

4. When direct taxation or employees' National Insurance contributions change (usually at Budget time) the TPI will rise by less than or more than the RPI according to the type of changes made. Between Budgets the monthly change in the TPI is normally slightly larger than that in the RPI (a more than proportionate increase in gross income is needed to offset any rise in prices, since all the extra income is fully taxed). In fact because of rounding both the RPI and the TPI rose by 0.5 per cent between September and October 1987. However, the focus of attention should be the changes over twelve months.

Coverage and calculation of the TPI

5. Non-taxpayers and those with incomes over £22,415 a year at January 1987 are excluded from the TPI. Non-taxpayers are excluded because the RPI already provides a measure of the change needed to maintain the purchasing power of their incomes. Those with high incomes are excluded because the changes in their tax liabilities are not necessarily representative of the majority of tax-payers, and because broadly the same percentage (the top 4 per cent) is already excluded from the households on whose expenditure patterns the RPI is based. Otherwise everybody is included, whether working, unemployed or retired, so long as they pay tax.

6. The TPI reflects changes in people's tax and National Insurance contribution liabilities. If the index were instead to reflect actual payments it would be subject to highly erratic movements, which would be difficult to interpret and could be misleading.

7. The current composition and distribution of gross taxable incomes are estimated from Inland Revenue's Survey of Personal Incomes in 1984/85, updated by later aggregate data on incomes. With the exception of housing benefit, non-taxable income, (and in particular child benefit), is not covered. From February 1987 onwards, housing benefit is included in the income base for calculating the TPI because of changes made to the RPI as a result of the RPI Advisory Committee's recommendations. The RPI now reflects changes in gross housing costs which, for a substantial minority of tax-payers, are partially offset by receipts of housing benefit. After excluding those with high incomes, the sample comprises 32,037 tax units (single people or married couples). The change in tax and National Insurance contribution liability resulting from any uniform increase in gross incomes can be estimated from this. So the change in gross income needed to offset a particular RPI increase can be found.

PRESS AND INFORMATION SERVICE

CSO

CENTRAL STATISTICAL OFFICE
GREAT GEORGE STREET
LONDON
SW1P 3AQ
PRESS CALLS ONLY 01-270 6357
(AFTER 1800 HRS 01-270 3000
OTHER ENQUIRIES 01-270 6363/6364
COPY No. 3

CSO(87) 101

PERSONAL AND CONFIDENTIAL until release of
Press Notice at 11.30 a.m. on Friday 13 November — 13 November 1987
and thereafter unclassified.

TAX AND PRICE INDEX, OCTOBER 1987

The Tax and Price Index (TPI) for October was 100.9 based on January 1987 = 100. Over the twelve months to October the increase in the TPI was 2.9 per cent, compared with an increase of 4.5 per cent in the Retail Prices Index (RPI).

TAX AND PRICE INDEX

	TPI (Jan 1978=100)	TPI (Jan 1987 = 100)	Percentage change in TPI over 12 months	Corresponding change in RPI
1986				
January	192.9		4.4	5.5
February	193.7		3.9	5.1
March	194.0		3.0	4.2
April	192.5		1.2	3.0
May	192.9		0.9	2.8
June	192.8		0.6	2.5
July	192.1		0.4	2.4
August	192.9		0.6	2.4
September	194.0		1.2	3.0
October	194.3		1.5	3.0
November	196.3		2.2	3.5
December	197.1		2.4	3.7
1987				
January	198.0	100.0	2.6	3.9
February		100.5	2.7	3.9
March		100.7	2.8	4.0
April		99.7	2.5	4.2
May		99.8	2.4	4.1
June		99.8	2.5	4.2
July		99.7	2.8	4.4
August		100.0	2.6	4.4
September		100.4	2.4	4.2
October		100.9	2.9	4.5

NBPr @ End. Mr.

CHANCELLOR OF THE EXCHEQUER

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

pwp on RPI

Ch/
You will have seen that the TV news (and PA tapes) have been quoting some entirely unacceptable figures for the amounts pensioners will receive as compensation (eg "between £7 and £12, in some cases up to £30"). We have protested v strongly a number of times to DHSS, and demanded that they make sure the error is not repeated. They say they have done everything they can, but the error has been repeated in each of this evening's TV news programmes.

contd.

CHANCELLOR OF THE EXCHEQUER
HONI SOIT QUI MAL Y PENSE

Treasury Chambers, Parliament Street, SW1P 3AG
01-930 1234

Mr Fowler is said to be very irritated, as is Mr Norgrove. (It was at No 10's insistence that the range £5-£10 was explicitly quoted, so as to avoid giving the impression that there would be a jamboree for pensioners.)

We shall continue to press DHSS to

stamp on this error over the weekend. Shall we protest in writing on Monday?

Yes, the error repeated in Sunday papers. N.

MPW 11/12

PERSONAL AND CONFIDENTIAL

FROM: S PRICE
DATE: 12 NOVEMBER 1987

Much as we warned in my minute of 10 November
Jim Hibberd 12/11

1. MR J S HIBBERD
2. CHANCELLOR OF THE EXCHEQUER

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr F Cassell
Mr Kemp
Mr N Monck
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr Bottrill
Mr Hibberd
Mr S J Davies
Mr Culpin
Mr Gilhooly
Mr Mowl
Miss O'Mara
Mr Pickford
Mr de Berker
Mr Patterson
Mr Cropper
Mr Tyrie
Mr Call

PERSONAL

AA

PMP

This is really not very satisfactory briefing on what is an awkward and sensitive set of figures. Can we not do something to step up the briefing in future e.g. by asking EB to do it?

RA 13/11

THE OCTOBER RPI (to be published at 11.30 am on Friday 13 November)

The RPI rose from 102.4 to 102.9 between September and October. As forewarned in Mr Hibberd's minute to you of 10 November, the annual inflation rate was 4.5 per cent in October, a rise from 4.2 per cent in September. Excluding mortgage interest payments, the October figure was 3.9 per cent, 0.4 per cent higher than in September.

2. Part of the rise is due to higher food prices. The price of milk rose in October, along with seasonal food prices (compared to a fall in seasonal food prices in October last year). Otherwise, the increase was over a broad range of goods and services.

RPI
july87

264/11

3. Our forecast for October, consistent with the Industry Act forecast, was 4.3 per cent. The current forecast is that inflation will fall to about 4 per cent in November, followed by a further fall in December. If, as seems likely, mortgage interest rates fall by 1 per cent in December, this will reduce inflation by an additional 0.4 per cent. The recent strength of Sterling is unlikely to be significantly reflected in prices until next year.

4. In the City there is broad agreement about the expected change in prices between September and October 1987. Phillips and Drew, James Capel, Wood Mackenzie, Alexander Laing and Cruickshank and Warburg Securities all expect +0.3 per cent; the Nomura Research Institute expects a rise of 0.2 per cent. The correct figure is +0.5 per cent.

Simon Price

S PRICE
EA1 DIVISION
x 5388

b/f 18/11

pmp

Y VYDDFA GYMREIG
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switsfwrdd)
01-270 0538 (Llinell Union)
Oddi wrth Ysgrifennydd Gwladol Cymru

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-270 3000 (Switchboard)
01-270 0538 (Direct Line)
From The Secretary of State for Wales

The Rt Hon Peter Walker MBE MP

12 November 1987

SECRET

REGIONAL ASSISTANCE

I believe that we will be unable to delay an announcement of the ending of RDG until January. There is widespread and growing speculation that an early change is in prospect. Rumour has been less in Wales than elsewhere, but it is now gathering pace in the Principality and I am coming under mounting pressure from Welsh MPs. My officials are being asked by industry what credence is to be placed on these rumours. Continuing to stall is losing us credibility and handing the initiative to our critics. The opposition will make it a major issue in the Welsh Grand Committee next month and it will be utterly disingenuous to pretend that we have not decided what we have decided. In fact it would be downright dishonest.

More immediately, I am currently faced with the problem of having to prepare estimates with the WDA which, on the normal timetable, need to be with the Treasury in December. It is really not practicable to agree with the Agency how the additional money they will be getting is to be used if I cannot at the same time explain the implications of ending RDG for their plans.

While there is an advantage in an announcement in January, public discussion is now so widespread that I do not see that this is any longer a tenable position. It seems doubtful whether extending the period of notice by a few weeks will significantly add to the surge of applications we already expect in the period up to 1 April. In my view we should now act quickly to end the speculation and regain the initiative.

/ I am sending copies of this letter to the Prime Minister and to Nigel Lawson and Malcolm Rifkind.

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry

PERSONAL AND CONFIDENTIAL UNTIL 11 30 AM ON 13 NOVEMBER 1987

JO835 COPY NO 2

MR D NORGROVE
Prime Minister's Office

Ref: F1/18

INDEX OF OUTPUT OF THE PRODUCTION INDUSTRIES - SEPTEMBER 1987

The provisional index of the output of the production industries for September 1987 will be published at 11.30 am tomorrow, Friday 13 November. A copy of the Press Notice is attached.

Latest figures

The September 1987 index of the output of the production industries - energy and manufacturing - is provisionally estimated at 113.8 (1980=100, seasonally adjusted), a decrease of 1 per cent on August. For manufacturing the index was 111.2, a decrease of $\frac{1}{2}$ per cent on August (see also paragraph on bias adjustment below).

In the third quarter of 1987, the output of the production industries was $1\frac{1}{2}$ per cent higher than in the previous quarter; manufacturing output was 2 per cent higher. Some industry detail is given in the attached Table A.

Assessment

Manufacturing output reached a temporary peak in the second quarter of 1985 and then declined by 2 per cent by the first quarter of 1986. Since then manufacturing output has grown steadily with the exception of a slackening in growth in the first quarter of this year, which was largely a reflection of severe weather in January. The provisional figures for July and August show sharp rises compared with previous months but September shows a reduction on August. These figures are seasonally adjusted and it seems that in July and August manufacturers reduced their output by less than usual for this holiday period, leading to high figures for this time of year. As a result, in the third quarter, manufacturing output was 6 per cent higher than a year ago; but a fairer representation of the recent underlying growth rate in manufacturing would be slightly lower, perhaps 5 or $5\frac{1}{2}$ per cent per year. In the third quarter, manufacturing output was just above ($1\frac{1}{2}$ per cent higher than) the previous peak which was in the first half of 1979.

Trends in the **energy** sector are more difficult to determine. Oil extraction was low at the end of last year due to a pipeline leak and again this June due to an unusually high level of maintenance work. After allowing for these factors, energy output looks to be declining a little.

Since 1985 the output of **production industries** has grown steadily, reflecting the growth in manufacturing. (Published figures were almost flat between the third and fourth quarters of last year and depressed in June this year because of interruptions to oil extraction.) The provisional figures for July and August show sharp rises on June due to increases in both manufacturing and energy output, but both sectors show decreases in September. In the third quarter, the output of production industries was 3 per cent higher than a year ago, but this comparison is distorted a little by short-term fluctuations in oil extraction, and a fairer representation of the recent underlying growth rate in production industries would be about $3\frac{1}{2}$ per cent per year.

Bias adjustment for manufacturing output

In line with revised procedures introduced in January last year, figures for manufacturing output in the latest six months include adjustments to try to allow for underestimation in the provisional estimates. The overall size of the bias adjustment is dependent on the size of any discrepancy between the growth in the CSO raw figures and the growth implied by the CBI figures, while the historical month by month profile of the bias in the CSO figures contributes to the profile of the adjustment over the six month period for which it is applied. This profile is updated from time to time.

Figures for October 1987

Figures for October 1987 are scheduled for publication on Tuesday 15 December.

D C K Stirling
12 November 1987

Central Statistical Office

Table A

Copy No.

++ PERSONAL AND CONFIDENTIAL until release of Press Notice at 11.30 am on November 13 1987 and thereafter unclassified ++

Index of output of the production industries 1980=100

SUMMARY	Total production industries	Energy and water supply	Total manufacturing industries	Metals	Other minerals and mineral products	Chemicals and man-made fibres	Engineering and allied industries	Food, drink and tobacco	Textiles, footwear, clothing and leather	Other manufacturing
1985	108.1	120.1	103.7	112.7	94.6	119.2	104.0	101.0	101.9	99.0
1986	110.1	125.2	104.7	110.5	96.9	120.8	103.1	102.5	103.8	103.8
1986 2	109.7	125.6	104.0	109.6	97.0	119.1	102.6	101.6	104.1	102.4
3	110.9	127.4	105.0	108.5	97.9	120.9	103.3	102.8	103.2	104.9
4	111.1	121.2	107.4	115.0	99.4	124.9	105.4	104.6	104.8	107.6
1987 1	111.9	124.6	107.4	113.8	98.0	126.6	105.2	104.5	101.9	109.0
2	112.5	120.9	109.4	119.1	102.1	128.8	105.8	106.0	105.8	113.1
3	114.3	122.6	111.4	120.6	103.4	131.0	108.1	106.0	107.9	115.6
1987 J	114.2	122.9	111.1	120	103	132	107	106	108	116
A	115.0	123.9	111.8	124	104	131	108	106	109	116
S	113.8	121.0	111.2	118	104	131	109	105	107	115
Percentage change latest 3 months on:										
previous 3 months	+1.6	+1.4	+1.8	+1.3	+1.3	+1.7	+2.2	-	+1.9	+2.2
a year earlier	+3.1	-3.7	+6.1	+11.2	+5.7	+8.3	+4.7	+3.1	+4.5	+10.2
1st quarter 1981(a)	+20.2	+20.6	+20.1	+21.4	+16.0	+36.1	+20.5	+6.4	+18.4	+23.6
1st half 1979(b)	+6.9	+23.8	+1.4	-7.5	-4.1	+20.7	-1.5	+6.1	-10.0	+4.1

DETAILED ANALYSIS	Coal and coke	Extraction of mineral oil and natural gas	Mineral oil processing	Other energy and water supply		Metals	Other minerals and mineral products	Chemicals	Man-made fibres	Metal goods not elsewhere specified
1985	67.2	150.3	98.6	105.9		112.7	94.6	120.5	74.0	99.4
1986	79.3	153.1	99.9	111.7		110.5	96.9	122.4	67.9	97.6
1986 2	79.6	152.5	103.1	113.1		109.6	97.0	120.6	68.9	98.0
3	78.3	158.2	101.0	111.2		108.5	97.9	122.5	65.8	97.9
4	79.1	147.2	99.0	108.0		115.0	99.4	126.7	62.4	98.4
1987 1	75.9	153.0	95.7	112.1		113.8	98.0	128.6	59.4	97.6
2	75.5	147.8	98.9	107.9		119.1	102.1	130.6	65.7	99.6
3	76.6	147.8	104.3	111.6		120.6	103.4	133.1	61.0	102.9
1987 J	76	149	98	112		120	103	134	58	104
A	78	149	107	113		124	104	133	65	104
S	75	146	108	110		118	104	133	60	102
Percentage change latest 3 months on:										
previous 3 months	+1.4	-	+5.5	+3.4		+1.3	+1.3	+1.9	-7.1	+3.3
a year earlier	-2.2	-6.5	+3.3	+0.4		+11.2	+5.7	+8.6	-7.3	+5.1
1st quarter 1981(a)	-21.4	+37.8	+8.5	+15.4		+21.4	+16.0	+38.0	-32.3	+16.3
1st half 1979(b)	-19.8	+56.6	-7.6	+6.5		-7.5	-4.1	+23.6	-55.6	-16.3

DETAILED ANALYSIS continued	Mechanical engineering	Electrical and instrument engineering	Motor vehicles and parts	Other transport equipment	Food	Drink and tobacco	Textiles	Clothing, footwear and leather	Paper, printing and publishing	All other manufacturing
1985	91.8	131.0	87.4	94.4	103.9	95.0	98.3	104.9	98.3	99.8
1986	91.9	130.1	82.5	96.5	105.4	96.4	98.8	108.1	102.2	105.7
1986 2	93.6	126.8	81.9	96.0	104.1	96.4	99.2	108.4	101.3	103.8
3	91.1	131.5	81.3	97.9	105.7	96.6	97.7	108.0	102.4	107.7
4	91.6	136.2	85.6	97.8	108.1	97.5	100.1	108.8	105.9	109.6
1987 1	89.1	139.5	83.7	97.6	106.7	100.1	99.2	104.3	105.3	113.3
2	90.4	136.8	86.1	100.6	108.0	101.9	102.2	109.0	110.7	115.9
3	91.1	138.8	92.9	102.4	107.9	102.0	104.0	111.2	113.2	118.4
1987 J	91	138	90	102	108	102	104	111	113	119
A	91	140	91	103	109	101	105	113	114	119
S	91	139	97	102	107	103	103	110	113	117
Percentage change latest 3 months on:										
previous 3 months	+0.8	+1.5	+7.8	+1.8	-0.1	+0.2	+1.7	+2.0	+2.3	+2.1
a year earlier	-	+5.6	+14.2	+4.7	+2.1	+5.7	+6.4	+3.0	+10.5	+9.9
1st quarter 1981(a)	+4.3	+49.9	+20.8	-2.9	+9.3	+0.7	+14.8	+21.5	+19.2	+28.9
1st half 1979(b)	-17.3	+34.5	-24.7	+9.1	+8.3	+1.8	-16.7	-3.7	+6.0	+2.1

(a) Last trough for production industries (b) Last peak for production industries

Personal numbered copies of the minute and attachment to:

Treasury	(Principal Private Secretary (Sir Peter Middleton
Cabinet Office	(Mr Jack Hibbert
Department of Trade and Industry	(Private Secretary Secretary of State's Office
	(Private Secretary Chancellor of the Duchy of Lancaster and Minister for Trade and Industry
	(Private Secretary to Robert Atkins
	(Private Secretary to John Butcher
	(Sir Brian Hayes (Mr H H Liesner (Mr A Whiting (Mr N Harvey (Mr S W Treadgold
Bank of England	(Mr R Leigh-Pemberton

CONFIDENTIAL

FROM: S J FLANAGAN

DATE: 13 November 1987

Copy to Chancellor

NOTE FOR THE RECORD

cc PS/Financial Secretary
Mr Monck
Mr Burgner
Mr Gray
Mr Wynn Owen

Interesting!

g.

DEREGULATION: MEETING WITH EDU, 12 NOVEMBER

I attended the latest deregulators meeting at DTI at 2.15pm on 12 November. The meeting was chaired by Bob Hughes of the EDU, and sheds some light on what the EDU are looking for from the three "tax points" papers.

2. Much of the meeting was taken dividing up the future work programme agreed at MISC 133 on 2 November. When it came to the items on the impact of Value Added Tax systems on business, the interface between tax/NI arrangements, and the effect of tax/benefit systems on incentives on enterprise, I said that we were still working on the distinction between administrative and policy issues, which was far from clear, that we would have to get back to them. Mr Marshall of the Revenue stressed that it was very hard to find administrative issues which would not lead straight into policy. He asked whether EDU could outline any particular ideas they had in mind when they suggested these items for the work programme. Mr Hughes said that Lord Young had stressed he was not interested in impinging on "next year's budget". He fully accepted that issues such as tax rates were well outside his responsibility. Lord Young had claimed that he did not want to see MISC 133 becoming in any way a budget lobbying group. Even so, Mr Hughes went on to talk about the papers covering long term and background "problems and issues". Mr Marshall pointed out that there had been a Green Paper only last year. Mr Hughes did not seem to pay much attention to this, even suggesting that a summary of the Green Paper might form the basis of papers for discussion by MISC 133.

3. I was left with two clear impressions:

- EDU have only the vaguest idea what they want;

- but they are quite clearly not looking to be confined only by administrative issues. They may not want to influence next year's budget, but they certainly want to influence the year after's.

4. Much of the rest of the meeting was taken discussing the availability of CCAs. I did not take part in this, since central Treasury is not a major source of CCAs. The idea of providing the whole gamut of CCA s to the likes of the Institute of Economic Affairs was effectively squelched.

5. Following Mr Cope's letter of 9 November, there was some discussion of how the paper or papers on One Stop Shops should be presented at the next meeting of MISC 133. I will be minuting separately about this. Prior to the next meeting, Lord Young is also likely to write round about miscellaneous proposals put forward in Ministerial correspondence prior to MISC 133 which were not received in time for them to go on the Work Programme paper.

6. The meeting was also visited by Mr Francis Maude, who emphasised the necessity of getting deregulation principles embedded in Whitehall culture. His desire was to get them on a par with public expenditure considerations.

S J FLANAGAN

MISC 133
DEREGULATION

RJ4.68 CONFIDENTIAL

cf. for bilateral with LdY

FROM: J M G TAYLOR
DATE: 11 November 1987

17/11

PS/FINANCIAL SECRETARY

MISC 133: DEREGULATION AND TAX

The Chancellor was grateful for the Financial Secretary's minute of 10 November. He will raise these points with Lord Young when he sees him next week.

J M G TAYLOR

4373/40

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 10 November 1987

Ch, For your bilateral with Ld. Y.
25 10/11

CHANCELLOR

Yes. [illegible]

MISC 133: DERECULATION AND TAX

As you know, following my letter of 29 October, I spoke to David Young before MISC 133 on 2 November. I argued that it was not appropriate to discuss taxation matters in this forum. But his view, which was not surprisingly shared by colleagues, was that a distinction could be made between policy issues, which were budgetary matters, and purely administrative issues. In my view, the minutes of the meeting are remiss in not bringing out this distinction between administration and policy.

2. David summed up by proposing that I prepare papers for the group on the administrative aspects of three tax points

- the impact of the VAT system on business;
- the interface between tax/NI arrangements;
- the effect of the tax/benefit systems on incentives to enterprise.

3. However, it is clearly not possible to distinguish between policy and administrative questions. For example:

(i) on P11Ds, an area which has interested David in the past, many of the so called administrative arrangements have implications for revenue.

(ii) On the division between the self employed and the employed the argument against allowing people to decide their own status is not administrative but a revenue matter.

4. As far as the tax/NIC interface is concerned, we acknowledged in the Green Paper on Personal Taxation, that integration of income tax and employees NICs could have benefits for employers, but these need to be weighed against the substantial policy objections to such a change, including the damage to the contributory principle. It would not be useful for MISC 133 to look at one aspect of the integration option, without considering all the other angles - and that would obviously take it deep into budgetary territory.

5. Discussion of the effects of tax and benefits on incentives ranges even wider into the policy field. I am not clear what David envisages the group discussing under this heading. Again this issue was discussed in the Green Paper. The conclusion was that although integration of all benefits with tax was never likely to be either desirable or practical, partial or further steps towards integration might become both. But practicality largely depends on completing computerisation in both DHSS and the Inland Revenue. We are still some years away from this, so I do not see much point in MISC 133 looking now for candidates for integration.

6. The effect of the VAT system on businesses does not raise policy issues of the same order. But I wonder if MISC 133 has taken on board the extent of this year's Budget measures to help small businesses with VAT (despite the fact that these were described in an annex to my letter of 29 October to David Young). We are currently reviewing an unpopular aspect of the VAT system - namely the penalty regime - and will be proposing a number of easements. This, however, is a budgetary matter and you will not want it discussed in MISC 133. The level of the VAT threshold, which members of MISC 133 would doubtless like to see increased, is not a matter we in the UK can determine by ourselves.

7. I have considered whether there are any other purely administrative tax issues which we could propose that the group should consider. The difficulty is that on the obvious candidates, we have either just taken action, or are in the process of doing so; there is little or nothing MISC 133 could usefully discuss. David is likely to turn to two examples of administrative issues which earlier deregulation initiatives dealt with, but further and more radical action in either case will take us straight back to policy:

- arrangements for joint decisions by DHSS and Inland Revenue on employment/self employment status have been introduced, as have arrangements for joint audits of employers. For some small groups it is still the case that Inland Revenue rules and DHSS rules point in different directions as far as the self-employed/employed distinction is concerned. But this generally works to the benefit of the groups concerned, and in some cases (eg North Sea divers) legislation would be needed to change their status;

- the form P11D is being drastically simplified and wide publicity given to dispensation. The major real relaxation possible without radical restructuring would be to raise the current £8,500 limit. Alternative proposals are of course being pursued in this area.

8. As far as NICs are concerned, DHSS are working on a proposal to merge Class 2 and Class 4 NICs for self-employed, and for the Revenue to collect it. DHSS Ministers may be writing to Treasury Ministers about this. This might simplify compliance and streamline administration, though on the latter there are some difficult policy issues involved. But, as the DHSS are aware, it would not be possible for the Revenue to take this on until BROCS has been implemented ie. not before the mid 1990s. While the proposal is well worth pursuing, I see little point in MISC 133 involvement, especially given the timescale.

9. I suggest that when you see David you should emphasise that administrative questions can seldom be divorced from policy in the tax and benefits field. Perhaps in particular you could try to steer him away from the benefits in kind area.

10. You could also remind him of the Government's publicly stated position on both integration of income tax and NICs, and of tax and benefits. While there is no reason to object to MISC 133 looking at the impact of the VAT system on business, you could fairly ask what this is likely to achieve, coming hard on the heels of a review which led to the measures in your last Budget to help small businesses. Having warned of the real difficulties involved in discussion in this area, you could tell him that if MISC 133 could identify specific tax issues which were purely a question of administration, not policy, you would of course be prepared to see them discussed in a constructive fashion. But contact with the EDU at official level suggests that they have nothing precise in mind, rather a general fishing expedition.

11. We need to emphasise to David that we are fully committed to the deregulation initiative and to the work of MISC 133. But he does need to realise that it would not be a good use of the Committee's time to have partial discussions of tax issues, on which you are in the lead and on which you will take decisions based on a wider context than that available to MISC 133.

12. Naturally, in the normal way, if any budgetary issue has implications for colleagues' areas of responsibility their voices will not go unheard. But MISC 133 should not develop into a forum for Budget representations - it has plenty of more valuable work to do. There is also a danger of wasting a lot of effort on cases that, unknown to them, are already being considered.

NL.

NORMAN LAMONT

ps2/4R RESTRICTED

FROM: CATHY RYDING

DATE: 30 October 1987

NO

PS/FINANCIAL SECRETARY

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Monck
Mr P Gray
Miss Sinclair
Ms HayMr Michie
Mr Wynn Owen
Mr Flanagan

PS/IR
Mr J Marshall - IR
Mr W P Carr - IR

PS/C&E
Mr D Howard - C&E
Mr Trenett - C&E
Mr C J Holloway - C&E

DEREGULATION - MISC 133

The Chancellor has seen Mr Flanagan's minute to the Financial Secretary of 28 October and very much agrees that "the interface between tax/NI arrangements and the effect of tax/benefit systems on incentives on enterprise" seems to be going too far outside the Committee's remit and into budgetary matters.

CR

CATHY RYDING

33/4372

CC Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P. Middleton
Mr Monck
Miss Sinclair
Ms Hay
Mr P.R.C Gray
Mr Flanagan
Mr Michie
Mr Wynn Owen
PS/IR
PS/C+E

Treasury Chambers, Parliament Street, SWIP 3AG

The Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade & Industry
1-19 Victoria Street
London SW1H OET

29 October 1987

Dear David

DEREGULATION - MISC 133

You wrote to me on 15 September with an outline agenda for our first MISC 133 meeting on 2 November and inviting initial thoughts and suggestions from members of the Group.

The outline agenda you propose covers the essential ground we need to consider in getting this initiative off to a fresh start. In particular, I agree that we should identify outstanding commitments.

Both Customs and the Inland Revenue have been in the forefront of deregulation. Customs and Excise have already made a major contribution to the earlier deregulation initiative, with their VAT: Small Business Review, resulting in the introduction of cash accounting this year and annual accounting next year, and they will continue to make every effort to ease the burdens on small businesses wherever practicable across a wide range of measures. For instance, I note that EDU has launched its own study of export procedures and I imagine there could well be significant Customs involvement not only in the study, but in implementing any of its recommendations.

As for the Inland Revenue, the further reduction in tax rates in 1987 build on a large number of policy and legislative measures which have already helped small businesses since 1979, especially cuts in the rates of corporation tax and income tax. They also include the introduction of the Business Expansion Scheme, and, this year, Personal Pensions and Profit Related Pay. Earlier measures included Employee Share Options.

These measures represent important steps towards reducing the weight of taxation and provide encouragement to small businesses to help them increase their profitability and to expand. On the administrative side a major highlight is the continuing computerisation of the Revenue. Last month a further milestone was reached when the Computerisation of Pay As You Earn (COP) was extended to the last group of tax offices. Now all employees are dealt with by computer. This is producing benefits for both employers and employees by offering a faster and more efficient service.

You asked in your letter for progress made since "Encouraging Enterprise". Progress reports are attached. They extend to a number of measures and proposals. No one proposal stands out as a major new item, but taken together they represent a worthwhile addition to the continuing programme of deregulation. My officials are in regular touch with the Enterprise and Deregulation Unit and would be happy to elaborate on these summaries.

To date, I have seen separate responses to your letter from John Cope and Donald Thompson. I look forward to seeing suggestions from other colleagues, so that we are in a position, at our meeting on 2 November, to take a preliminary view on where priorities might lie.

I have now also seen the papers for Monday's meeting. I am concerned that some of the items proposed for future work go a good deal wider than is appropriate for a committee dealing with deregulation. In particular, it would not seem appropriate to tackle the interface between tax and National Insurance from this angle. The same consideration applies to the other tax items and possibly some of the more general ones too. John Cope, for example, may have views on the handling of finance for small businesses.

I am copying this letter to the other members of the Group.

Yours ever

Norman

NORMAN LAMONT

2832/38

We were always conscious of the danger of MISC 133 spreading its wings too widely, and I think X below would be worth doing.

FROM: S J FLANAGAN

DATE: 28 October 1987

Papers PSe

1. MR GRAY

2. FINANCIAL SECRETARY

RRG 28/10

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Monck
Miss Sinclair
Ms Hay
Mr Michie
Mr Wynn Owen
PS/IR
Mr J Marshall - IR
Mr W P Carr - IR
PS/C&E
Mr D Howard - C&E
Mr Trenett - C&E
Mr C J Holloway - C&E

V. much agree.

DEREGULATION - MISC 133

I attach a redraft of the letter attached to Mr Wynn Owen's minute of 23 October, using material provided by Mr Carr, along the lines you requested.

2. Since you asked for these changes, however, we have seen the papers for MISC 133 on Monday 2 November. There is a problem with the proposals for future work (MISC 133(87)4 attached) which include, inter alia, "the interface between tax/NI arrangements" and "the effect of tax/benefit systems on incentives on enterprise".

3. This seems to be going too far outside the Committee's remit and into Budgetary matters. Tax and National Insurance were, in any case dealt with in the recent Green Paper. One way of approaching this would be to argue strongly at Monday's meeting that these issues are too broad for MISC 133 to deal with. We will, of course, be providing full briefing. But it might be useful to get in a letter now, before the meeting is held, making your position clear. I have therefore added a paragraph to the end of the draft, keeping the tone fairly soft.

X

4. We also understand that DE are unhappy at the inclusion of finance for small businesses as on item on the work programme: again this seems to be an issue too broad for MISC 133. You might like to give Mr Cope a way in on this too.

Steven Flanagan

S J FLANAGAN

4306.2/001c3

DRAFT LETTER FROM THE FINANCIAL SECRETARY TO:

The Lord Young of Graffham
Secretary of State for Trade and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

DEREGULATION - MISC 133

You wrote to me on 15 September with an outline agenda for our first MISC133 meeting on 2 November and inviting initial thoughts and suggestions from members of the Group.

2. The outline agenda you propose covers the essential ground we need to consider in getting this initiative off to a fresh start. In particular, I agree that we should identify outstanding commitments. I look forward to hearing from colleagues not only of any new initiatives they may have in mind to further deregulation but also of practical measures they are taking to clear this backlog of outstanding commitments.

3. Both Customs and the Inland Revenue have been in the forefront of deregulation. Customs and Excise have already made a major contribution to the earlier deregulation initiative, with their VAT: Small Business Review, resulting in the introduction of cash accounting this year and annual accounting next year, and they will continue to make every effort to ease the burdens on small businesses wherever practicable across a wide range of measures. For instance, I note that EDU has launched its own study of export procedures and I imagine there could well be significant Customs involvement not only in the study, but in implementing any of its recommendations.

4. As for the Inland Revenue the further reduction in tax rates in 1987 build on a large number of policy and legislative measures which have already helped small businesses since 1979, especially cuts in the rates of corporation tax and

income tax. They also include the introduction of the Business Expansion Scheme, and, this year, Personal Pensions and Profit Related Pay. Earlier measures included Employee Share Options. These measures represent important steps towards reducing the weight of taxation and provide encouragement to small businesses, to help them increase their profitability and to expand. On the administrative side a major highlight is the continuing computerisation of the Revenue. Last month a further milestone was reached when the Computerisation of Pay As You Earn (COP) was extended to the last group of tax Offices. Now all employees are covered by COP. This is producing benefits for both employers and employees by offering a faster and more efficient service.

5. You asked in your letter for progress made since "Encouraging Enterprise". Progress reports are attached. They extend to a number of new measures and proposals. No one proposal stands out as a major new item, but taken together they represent a worthwhile addition to the continuing programme of deregulation. My officials are in regular touch with the Enterprise and Deregulation Unit and would be happy to elaborate on these summaries.

6. To date, I have seen separate responses to your letter from John Cope in DE and Donald Thompson in MAFF. I look forward to seeing suggestions from other colleagues in advance of our meeting on 2 November, so that we are then in a position to take a preliminary view on where priorities might lie.

7. I have now also seen the papers for Monday's meeting. I am concerned that some of the items proposed for future work go a good deal wider than is appropriate for a committee dealing with deregulation. In particular, it would not seem useful to tackle the interface between tax and National Insurance from this angle. The same consideration applies to the other tax items and possibly some of the more general ones too. John Cope, for example may have views on the handling of financce for small busineses.

8. I am copying this letter to the other members of the Group.

[N L]

INLAND REVENUE - PROPOSALS SINCE "ENCOURAGING ENTERPRISE"

Major administrative measures on deregulation include the introduction of a procedure whereby a business or an individual can ask the Revenue and the Department of Health and Social Security to give a joint decision as whether an individual is employed or self employed. This procedure has now been implemented. In addition all employers have been reminded that they may apply for dispensations relieving them of the obligations of completing P11D returns in certain circumstances.

ACTION SINCE "ENCOURAGING ENTERPRISE"

"Encouraging Enterprise" listed proposals for action on:

- publication of a consultative document on disincorporation;
- exemption of 200,000 documents from a fixed 50p stamp duty;
- publication of a Statement of Practice easing the conditions for the acceptance of computer printed returns and other forms and returned completed on photocopies of blank forms.

All these proposals have now been implemented:

- the consultative document on disincorporation was published on 2 July;
- draft clauses will shortly be published for comment;
- the stamp duty exemptions apply from 1 May 1987;
- the Statement of Practice on computer returns and photocopies was published on 15 June 1987.

DEPARTMENTAL STATEMENT

The Inland Revenue continue to place great emphasis on service to the taxpayer. They have, for the first time, prepared a full statement of the Department's aims and objectives. This has been circulated to all members of the Department. It includes, amongst its main objectives, the need to take account of compliance burdens on taxpayers and employers. This reiterates to all staff the positive message of the Taxpayer's Charter, that is to:

- deal with the taxpayer's affairs fairly, impartially and with strict regard for confidentiality;

- carry out their duties courteously, promptly and as helpful as possible;

- have regard to the impact of their activities on individuals, business and the economy.

FURTHER MEASURES

In addition the following measures have been introduced:

- relaxation on the Capital Allowance requirements for certain hotels;

- the setting up of a nationwide computer index for taxpayers. This is designed to reduce unnecessary communications with individuals and businesses where a tax record already exists.

PUBLICATIONS

Two helpful publications have been issued: a comprehensive guide for employers on Profit Related Pay and an up to date leaflet on the Business Expansion Scheme.

Advice

Advice to businesses and individuals has been further improved with the introduction of an enhanced travelling information service and the preparation of a video and information pack for school leavers.

INLAND REVENUE - FUTURE PROPOSALS

As part of the continuing programme to help small firms the following measures will provide a further contribution to the deregulation initiative:

- the introduction of a streamlined form P11D reduced from 4 to 2 pages and produced in a more easily understood format. The new form for the employer to report expenses and benefits will be brought into use in the Spring of 1988;

- the computerisation of Schedule D assessing will have considerable benefits for businesses. As the phased introduction gathers momentum it should ease considerably communications between local tax offices and the Accounts Offices. Looking further ahead the further computerisation of the Collection service will bring substantial additional benefits for businesses by streamlining and speeding up the flow of information between businesses and the Revenue;

- the Inland Revenue in conjunction with the Department of Health and Social Security and the Department of Trade and Industry have been assisting the National Computing Centre (NCC) and representative bodies over the design of an NCC scheme for testing and registering computer payroll software. The scheme is about to be launched. It will inform and help employers thinking of computerising their payrolls;

- two of the main Revenue leaflets aimed at helping businessmen are being rewritten in conjunction with the Enterprise and Deregulation Unit and the Department of Health and Social Security. They are:

  IR53 "Thinking of Taking Someone on" aimed at potential new employers.

  IR56 "Employed or Self Employed" a guide to help employers of individuals on employment status;

- the legislation on unapproved employee share schemes is being reviewed, with the aim of reducing restrictions. The review was announced in the 1987 Budget. Draft legislation was published for comment on 26 October;

- a joint review of the "Starter Pack", the PAYE material sent to new employers. This review is being carried out jointly with the Enterprise and Deregulation Unit and the Department of Health and Social Security.

CUSTOMS AND EXCISE - PROGRESS SINCE "ENCOURAGING ENTERPRISE"

VAT: Small Business Review

Cash Accounting: EC derogation was obtained, and scheme started on 1 October.

Annual Accounting: Will be introduced on 1 July 1988.

Requirements for record keeping and accounts: The report by Peat Marwick McLintock has been received and is being considered.

Rules for registration and deregistration: These were eased significantly in the 1987 Finance Act, in particular extending the time to register to 30 days. Customs are now looking at the rules for voluntary and intending trader registrations.

Retail schemes: Revised package now effective as reported in "Encouraging Enterprise" para 5.5.

Other C & E matters

Free Zones: Customs have completed their review of the practical operation of free zones, including the present VAT requirements, and their report is being considered by Ministers.

Review of the system of civil penalties, default surcharge and repayment supplement: As part of the review, Customs have sought the views of trade associations and professional bodies.

Joint visits with Inland Revenue: The outcome of the pilot exercise is under consideration in the Departments.

Paperwork for VAT on imports: No change from position described in "Encouraging Enterprise" para 5.13.

Use of a retailer's sale invoice for VAT free retail exports: Implementation agreed, but date difficult to forecast at current time.

Bad debt relief: As reported in "Encouraging Enterprise" para 5.16.

CAP exports: Flexibility now agreed for fixing the date on which goods are brought under customs control at premises; this date determines the rate of any refund or charge applicable so the provision will enable exporters to take advantage of beneficial rates.

Terminal market in platinum and palladium: A VAT free ring has been created for dealing in metals on the market.

Removal of 'Customs locks' from maturation warehouses: Businesses will now have access to their warehouses without the presence of a Customs officer.

CUSTOMS AND EXCISE - FUTURE PROPOSALS

Some important items in the deregulation field (eg the review of the system of Civil penalties) will come to fruition during the life of MISC 133.

Repayment of import VAT to Community Traders: Taxable persons established in other member states of the EC who incur VAT on business importations into the UK will be able to reclaim it.

Repayment of value added tax to taxable persons not established in the EC: From 1 January 1988, these businesses will be able to reclaim VAT on business purchases in the UK, provided that they are registered for VAT in their own countries.

Relief from VAT on imported goods: It is planned that relief from import VAT for goods imported by non-taxable persons, on which VAT has previously been paid and remains levied at the time of their importation, will be implemented in 1988.

Increase in the value of certain goods imported by post eligible for VAT reflief: The maximum value for such relief on a postal consignment of certain goods from other Member States of the EC will go up from £7 to £16.

Relief from car tax: It is proposed to extend the relief from car tax, currently enjoyed by traditional black London taxi-cabs, to all purpose built taxis.

SECRET AND PERSONAL until release of press notice on 24 November 1987 at 11.30 am and thereafter unclassified

pp

To Minister for Trade

Copy No. 3. (28)

From Peter Stibbard
US/S2
V/260 Ext. 4872

13 November 1987

OVERSEAS TRADE FIGURES FOR OCTOBER: EXPORTS

1 The value of exports in October, seasonally adjusted on a balance of payments basis, is estimated at £6.9 billion, £0.2 billion (2½ per cent) lower than in September. Exports of oil were little changed but exports of the erratic items rose by £0.1 billion. Excluding oil and the erratic items exports fell by 5½ per cent between September and October.

2 In the three months ended October the total value of exports increased by 4½ per cent compared with the previous 3 months; excluding oil and the erratic items the increase was also 4½ per cent.

3 In the three months ended October, total export volume was 4 per cent higher than in the previous three months and 6½ per cent higher than in the same three months a year ago. Excluding oil and the erratic items export volume rose, again by 4 per cent, to be 8 per cent up on a year earlier. The trend of non-oil export volume has been rising in recent months and is well above the high level reached at the end of last year.

4 Recent export figures are shown in the attached table; charts plotting the main aggregates are also attached. A note describing imports and the current account will be circulated on Thursday 19 November, a day later than that shown in the timetable circulated by Mr Boyd on 2 November, due to a slippage at Customs and Excise. The monthly press notice for October is schedule for release on Tuesday 24 November; to get it out on time we may have to shorten the time allowed for clearance by Ministers.

Revisions to earlier months

5 Figures for exports for the months April to August have now been revised to take account of the completion of processing by Customs and Excise of the backlog of documents delayed by industrial action earlier this year. The net revisions to previously published figures on a balance

of payments basis are shown below. They are relatively small. The biggest was for July, but it represents a downward revision of less than one per cent.

£ million

April	May	June	July	August
-2	+14	-5	-47	-18

6 There may be revisions to import figures for these months, which also will be reported next Thursday.

P J STIBBARD

SECRET and PERSONAL until release of press notice on 24 NOV 87 at 11.30am and thereafter unclassified

Copy No...( )

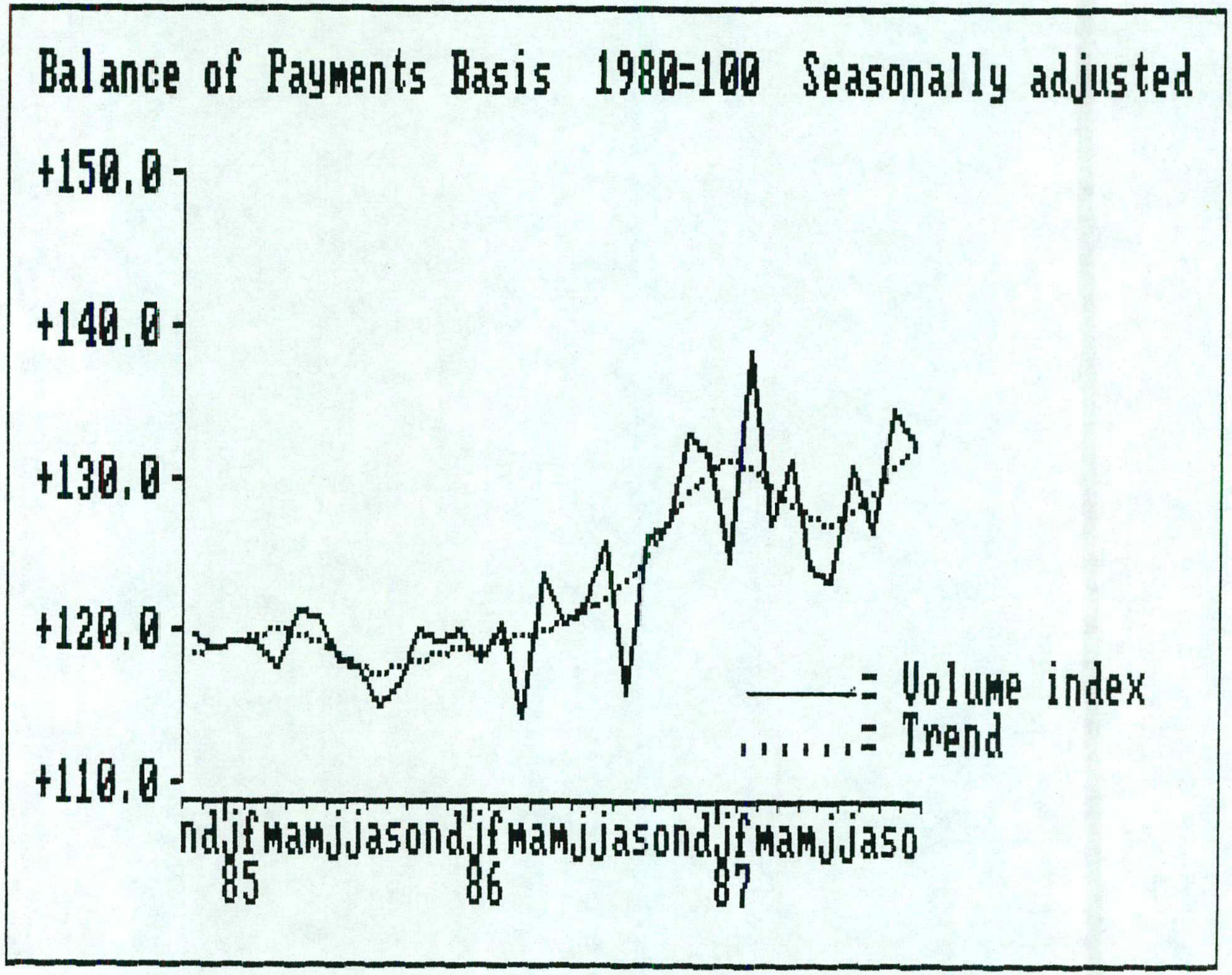
EXPORTS

(Balance of payments basis: seasonally adjusted)

		---TOTAL TRADE---		EXCLUDING --OIL & ERRATICS--	
		VALUE £m	VOLUME (1980=100)	VALUE £m	VOLUME (1980=100)
1986	Q3	17553	122.6	14839	118.5
	Q4	19340	130.5	15873	125.3
1987	Q1	19637	130.0	15899	124.4
	Q2	19388	126.3	15892	122.5
	Q3	20362	130.7	16808	129.3
1987	MAY	6386	124.2	5284	121.9
	JUN	6394	123.4	5298	122.0
	JUL	6762	130.9	5527	128.4
	AUG	6566	126.6	5424	124.9
	SEP	7034	134.6	5858	134.6
	OCT	6867	132.4	5546	127.8

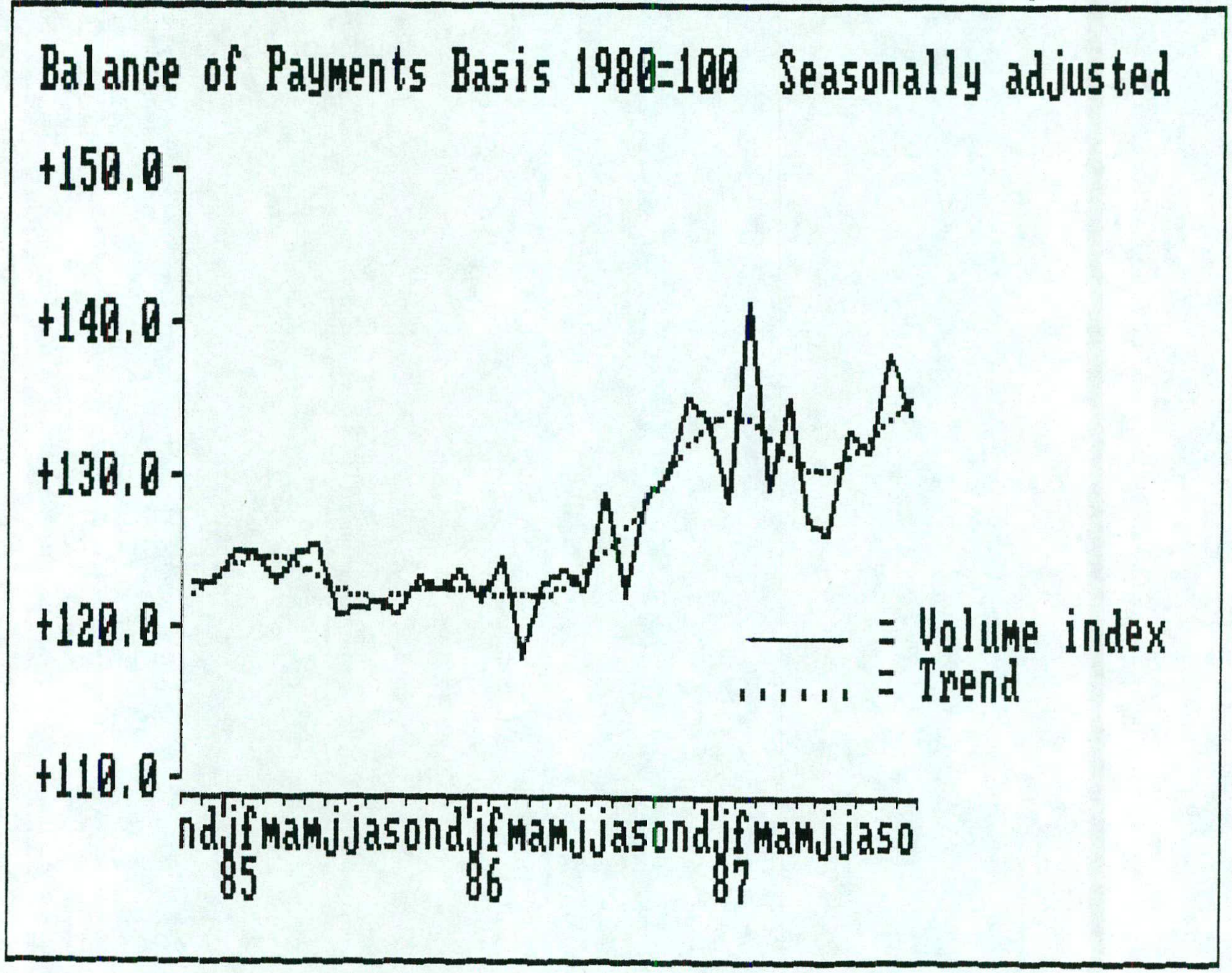
SECRET & PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 24.11.87

TOTAL EXPORTS



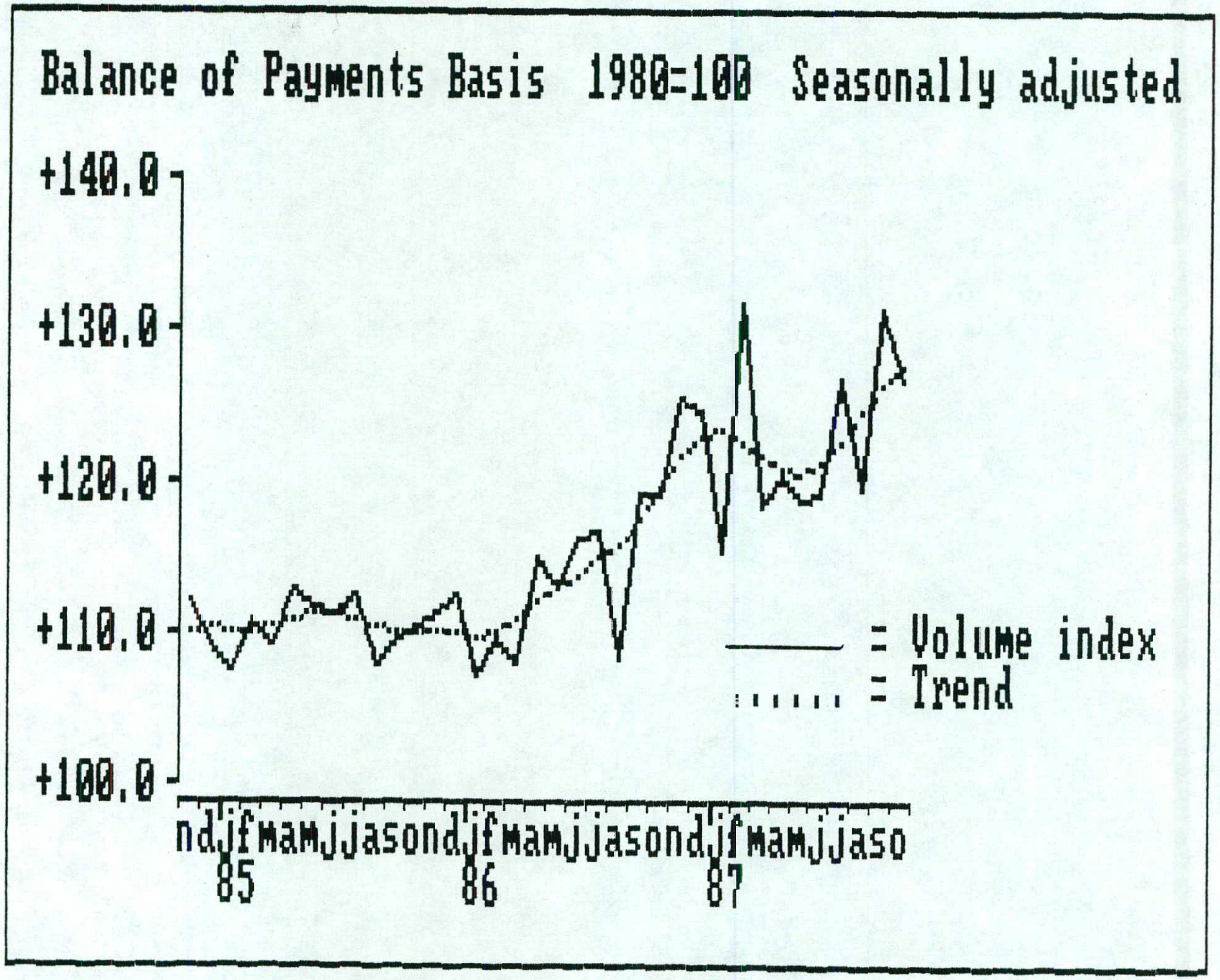
SECRET & PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 24.11.87

EXPORTS LESS ERRATICS (Ships,N Sea Rigs,Aircraft,Precious Stones & Silver)



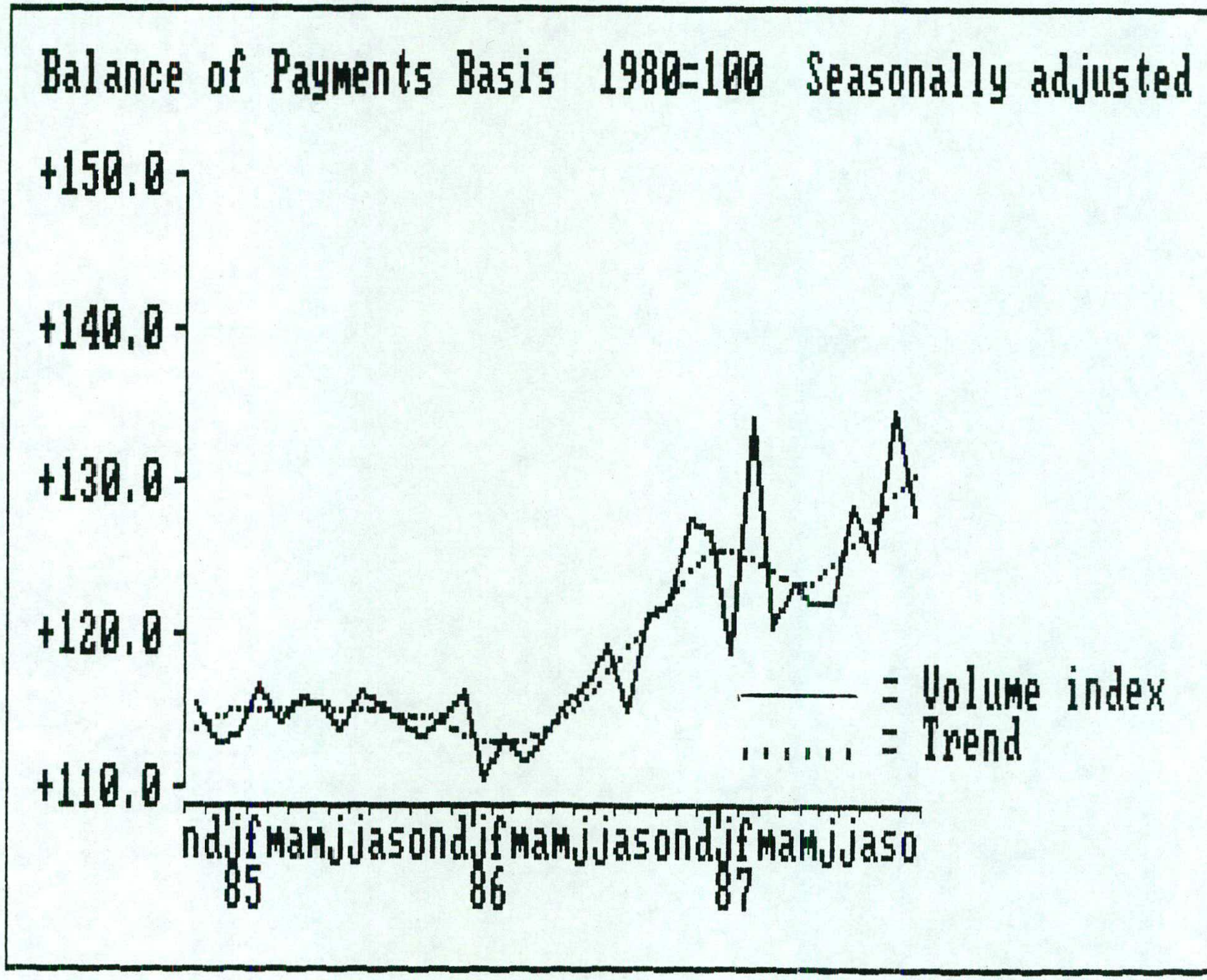
SECRET & PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 24.11.87

EXPORTS LESS OIL



SECRET & PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 24.11.87

EXPORTS LESS OIL & ERRATICS



CIRCULATION LIST

Copy No	1	Minister for Trade
	2	Prime Minister
	3	Chancellor of the Exchequer
	4	Secretary of State for Trade and Industry
	5	PUSS for Trade and Industry
	6	Sir Robert Armstrong (Cabinet Office)
	7	Sir Brian Hayes (Dept. of Trade and Industry)
	8	Sir Peter Middleton (HM Treasury)
	9	Governor of the Bank of England
	10	Chairman of the Board of HM Customs & Excise
	11	Mr J Hibbert (CSO)
	12	Mr Pratt (HM Customs & Excise)
	13	Mr B Buckingham (CSO)
	14	Mr Davies (HM Treasury)
	15	Mr Barrell (HM Treasury)
	16	Mr P Sedgwick (HM Treasury)
	17	Mr D Owen (HM Treasury)
	18	Mr A McIntyre (CSO)
	19	Mr D J Wilson (Dept of Energy)
	20	Mr Bottrill (HM Treasury)
	21	Mr H H Liesner)
	22	Mr P J Stibbard)
	23	Mr W E Boyd)
	24	Mr E J Wright) Dept of Trade and
	25	Mrs A Brueton) Industry
	26	Miss C Siddell)
	27	Miss H Chapman)
	28	Mr D Packer)

PRESS
AND
INFORMATION SERVICE

CSO

CENTRAL STATISTICAL OFFICE

GREAT GEORGE STREET
LONDON
SW1P 3AQ

PRESS CALLS ONLY 01-270 6357
(AFTER 1800 HRS 01-270 3000
OTHER ENQUIRIES 01-270 6363/6364

COPY No. 2

PERSONAL AND CONFIDENTIAL until release of Press Notice at 11.30 a.m. on 13/11/87 and thereafter unclassified

CSO(87)102
13 November 1987

INDEX OF OUTPUT OF THE PRODUCTION INDUSTRIES - SEPTEMBER 1987

Output of the production industries in the third quarter of 1987 is provisionally estimated to have increased by 1½ per cent from the level of the previous quarter; manufacturing output rose by 2 per cent.

Output of the production industries (to September 1987)

The September index of the output of the production industries - energy and manufacturing - is provisionally estimated at 113.8 (1980=100, seasonally adjusted). In the third quarter of 1987, production industries' output was 1½ per cent higher than in the previous quarter and 3 per cent higher than in the same period a year earlier.

Manufacturing output in the latest quarter was 2 per cent higher than in the previous quarter and 6 per cent higher than in the same period a year earlier (see also note 10 of Notes to Editors). Within manufacturing, between the latest two quarters, there were increases of 2 per cent in the output of the chemicals, engineering and allied, textiles and clothing and 'other manufacturing' industries, and 1 per cent increases in the output of the metals industry and other minerals. There was little change in the output of the food, drink and tobacco industries.

The output of the energy sector in the latest quarter was 1½ per cent higher than in the previous quarter but 3½ per cent lower than in the same period a year earlier.

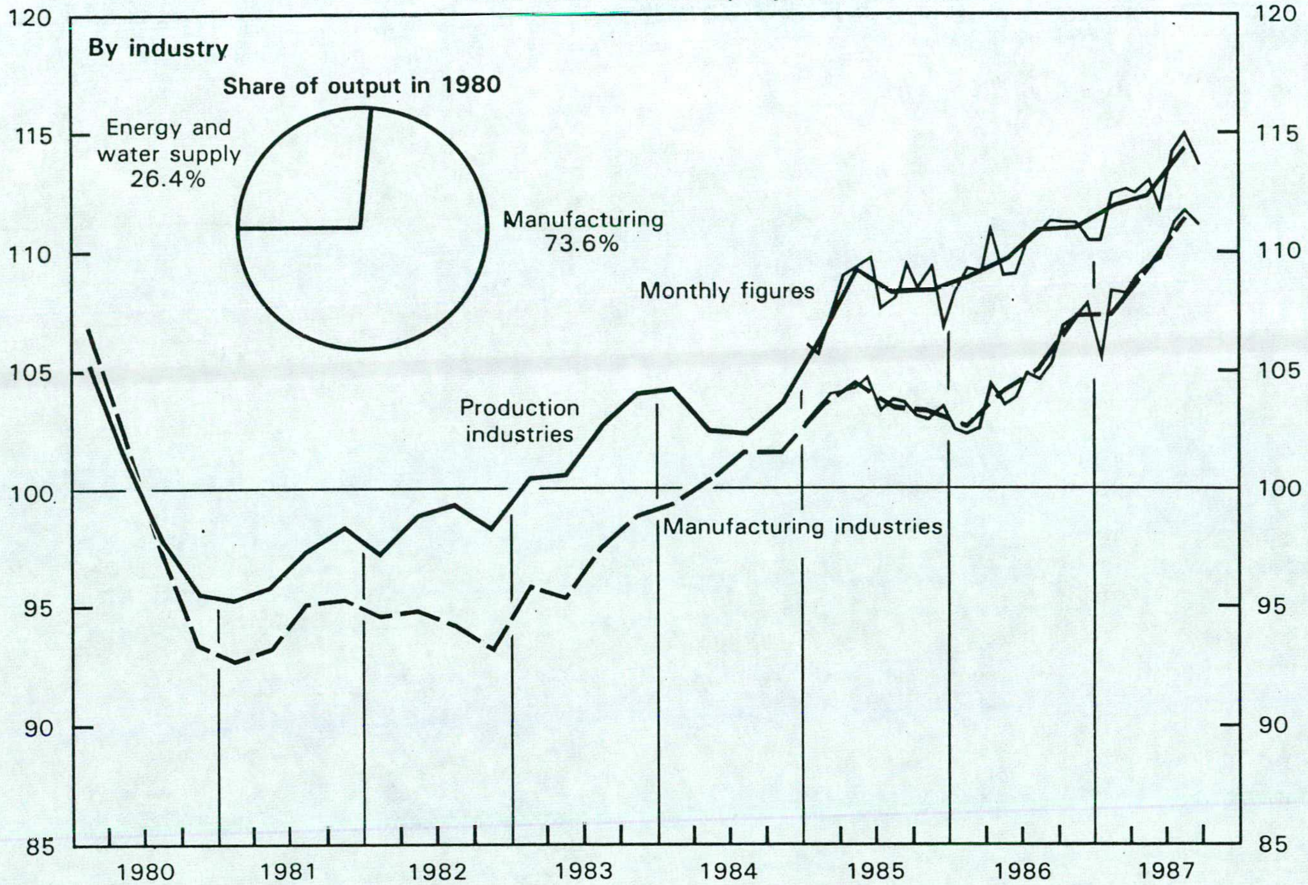
By market sector, the output of the investment goods industries increased by 2 per cent between the latest two quarters and that of both the consumer and intermediate goods industries by 1½ per cent.

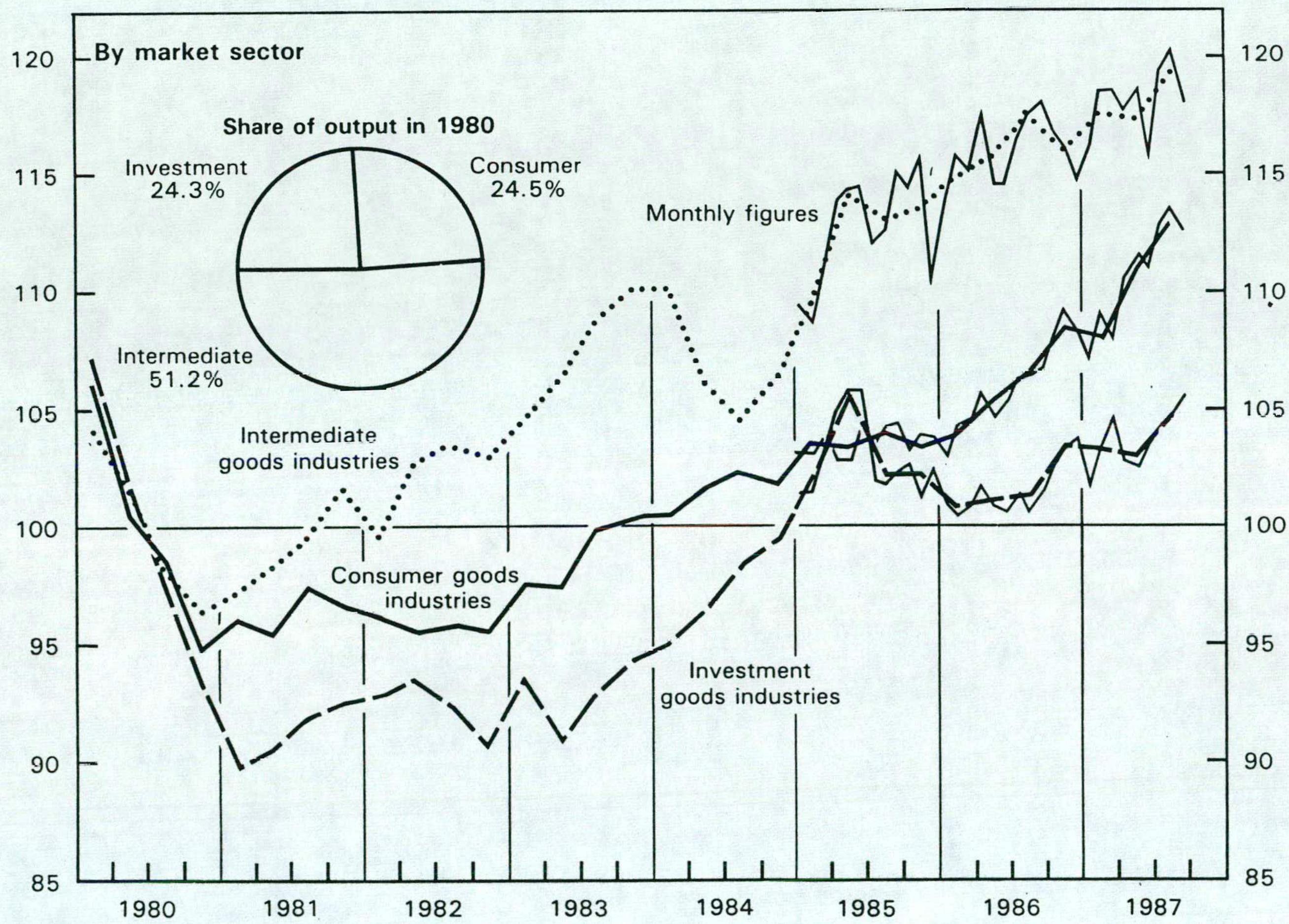
Output of the production and construction industries (to second quarter of 1987)

Output of the construction industry in the second quarter of 1987 is estimated to have been $3\frac{1}{2}$ per cent lower than in the previous quarter but 4 per cent higher than in the same period a year earlier; output of the production and construction industries in the second quarter was little changed from the previous quarter but 3 per cent higher than in the second quarter of 1986.

INDEX OF OUTPUT OF THE PRODUCTION INDUSTRIES

1980 = 100 Seasonally adjusted





OUTPUT OF THE PRODUCTION INDUSTRIES(1)

(1980=100)

TABLE 1

	Broad industry groups			Market sectors		
	Production industries Division 1-4	Energy(2) Division 1	Manufacturing Division 2-4	Consumer goods	Investment goods	Intermediate goods
Weights	1000	264	736	245	243	512
	DVIM	DVIN	DVIS	DVJP	DVJV	DVJZ
1981	96.6	103.8	94.0	96.4	91.3	99.2
1982	98.4	110.0	94.2	95.8	92.4	102.3
1983	101.9	115.0	96.9	98.8	93.0	107.6
1984	103.3	110.2	100.8	101.7	97.4	106.8
1985	108.1	120.1	103.7	103.6	103.0	112.6
1986	110.1†	125.2	104.7†	106.0	101.6†	116.0
Seasonally adjusted						
1981 4	98.3	106.6	95.3	96.7	92.7	101.7
1982 1	97.2	104.1	94.7	96.1	92.9	99.7
2	98.8	110.0	94.9	95.7	93.7	102.9
3	99.2	113.2	94.1	95.9	92.4	103.7
4	98.3	112.8	93.1	95.6	90.6	103.0
1983 1	100.4	112.8	95.9	97.7	93.6	104.7
2	100.5	114.9	95.4	97.4	90.9	106.6
3	102.8	117.4	97.6	99.9	93.0	108.9
4	104.0	118.3	98.9	100.4	94.4	110.2
1984 1	104.2	116.8	99.7	100.7	95.0	110.2
2	102.7	109.1	100.4	101.8	96.6	106.1
3	102.5	104.9	101.6	102.4	98.3	104.5
4	103.7	109.8	101.6	101.9	99.6	106.6
1985 1	106.4	114.9	103.4	103.6	102.2	109.6
2	109.3†	122.6†	104.6	103.4	105.6	114.1†
3	108.2	120.9	103.7	104.0	102.2	113.1
4	108.3	122.2	103.2	103.4	102.2	113.5
1986 1	108.9	126.7	102.5†	103.9	100.8†	114.9
2	109.7	125.6	104.0	105.3†	101.1	115.7
3	110.9	127.4	105.0	106.4	101.2	117.5
4	111.1	121.2	107.4	108.5	103.3	116.0
1987 1	111.9	124.6	107.4	108.1	103.2	117.8
2	112.5	120.9	109.4	111.1	103.0	117.5
3	114.3	122.6	111.4	113.0	104.9	119.3
1985 S	109.4†	125.0†	103.8	104.4	102.3	115.1†
O	108.6	123.8	103.1	102.4†	102.7	114.3
N	109.3	126.6	103.1†	104.0	101.3	115.8
D	106.9	116.2	103.5	103.9	102.5	110.4
1986 J	108.2	123.8	102.6	103.0	101.0†	113.9
F	109.4	128.8	102.4	104.2	100.6	115.7
M	109.2	127.6	102.6	104.5	100.9	115.1
A	111.0	129.0	104.6	105.8	101.8	117.7
M	109.0	124.2	103.6	104.8	100.9	114.7
J	109.1	123.7	103.9	105.2	100.7	114.7
J	110.5	126.2	104.9	106.2	101.4	116.8
A	110.8	127.9	104.7	106.4	100.7	117.5
S	111.4	128.0	105.4	106.7	101.6	118.1
O	111.3	123.2	107.0	108.0	102.7	116.9
N	111.3	122.3	107.4	109.1	103.3	116.2
D	110.6	118.2	107.9	108.3	103.9	114.9
1987 J	110.6	124.1	105.7	107.2	101.8	116.2
F	112.5	124.3	108.3	109.1	103.2	118.5
M	112.7	125.3	108.2	107.9	104.7	118.6
A	112.5	122.1	109.0	110.7	102.8	117.8
M	113.1	123.0	109.5	111.6	102.6	118.7
J	111.9	117.7	109.8	111.1	103.6	116.1
J	114.2	122.9	111.1	112.8	104.2	119.4
A	115.0	123.9	111.8	113.6	104.8	120.3
S	113.8	121.0	111.2	112.6	105.7	118.1
Percentage change latest 3 months on:						
1. previous 3 months	+1.6	+1.4	+1.8	+1.7	+1.8	+1.5
2. a year earlier	+3.1	-3.7	+6.1	+6.2	+3.6	+1.5

(1) Output index numbers include adjustments, as necessary, to compensate for the use of sales indicators (see Notes to Editors).
(2) Includes water supply.

An obelus in the table indicates that the data are new or have been revised. The period marked is the earliest in the table to have been revised.

OUTPUT OF MANUFACTURING INDUSTRIES

(1980=100)

TABLE 2

	Metals	Other minerals and mineral products(1)	Chemicals and man-made fibres	Engineering and allied industries	Food, drink and tobacco	Textiles, clothing footwear and leather	Other manufacturing
	Class 21-22	Class 23-24	Class 25-26	Class 31-37	Class 41-42	Class 43-45	Class 46-49
Weights	25	41	68	325	99	52	126
	DVIT	DVIU	DVIV	DVIY	DVJE	DVJH	DVJK
1981	106.0	89.0	99.5	91.8	98.3	92.7	93.2
1982	103.2	90.9	99.6	92.9	99.8	91.3	90.8
1983	104.7	93.9	107.1	94.9	100.9	94.7	93.8
1984	107.9	95.1	113.9	99.5	101.9	98.1	97.8
1985	112.7	94.6	119.2†	104.0	101.0	101.9	99.0
1986	110.5†	96.9	120.8	103.1†	102.5	103.8	103.8
Seasonally adjusted							
1981 4	113.3	88.6	101.4	93.6	98.5	94.3	92.9
1982 1	110.3	89.8	99.7	93.7	99.1	91.9	91.0
2	108.1	91.8	99.5	93.6	100.2	91.3	91.2
3	100.4	91.3	99.2	92.7	100.4	91.6	90.8
4	93.9	90.8	99.8	91.6	99.6	90.3	90.2
1983 1	98.6	93.0	103.8	94.8	99.9	92.7	92.9
2	104.8	91.4	106.5	93.1	98.7	93.4	92.8
3	105.6	95.6	108.5	95.1	103.0	95.2	93.7
4	109.9	95.4	109.8	96.7	101.9	97.4	95.7
1984 1	111.5	94.3	111.3	97.7	101.8	96.8	97.3
2	104.5	95.4	112.1	98.8	102.8	97.7	98.4
3	109.0	96.5	115.6	100.8	101.8	99.0	97.5
4	106.8	94.3	116.4	100.9	101.2	99.1	98.1
1985 1	109.6	93.0	120.4†	103.8	101.8	100.0	98.1
2	114.7	95.0	120.7	106.1	100.4	101.7	97.8
3	115.0	94.7	118.4	103.4	100.4	103.0	100.3
4	111.7	95.6	117.2	102.6	101.3	102.9	99.8
1986 1	109.1†	93.6	118.5	101.1†	100.9	103.1	100.4
2	109.6	97.0	119.1	102.6	101.6	104.1	102.4
3	108.5	97.9	120.9	103.3	102.8	103.2	104.9†
4	115.0	99.4†	124.9	105.4	104.6†	104.8†	107.6
1987 1	113.8	98.0	126.6	105.2	104.5	101.9	109.0
2	119.1	102.1	128.8	105.8	106.0	105.8	113.1
3	120.6	103.4	131.0	108.1	106.0	107.9	115.6
1985 S	113	95	119	103	101	103	100
O	112	96	117	103	102	100†	99
N	112	96	118	102	100	106	100
D	111	95	117	103	102	102	100
1986 J	110†	96	121	101†	99	102	100
F	107	92	119†	101	102	104	100
M	110	93	116	101	102	103	101
A	108	97	119	104	102	106	102
M	111	96	119	102	102	103	102
J	110	98	120	102	101	104	103
J	110	97	120	103	103	103	105
A	107	98	121	103	103	104	104
S	109	98	122	104	103	103	105
O	112	99	126	105	104	105	107
N	116	100†	123	105	105	106	108
D	117	100	126	106	105	103	108
1987 J	106	93	126	104	102†	103	108
F	120	100	127	105	107	102	110
M	115	101	127	107	104	101	109
A	115	101	131	105	105	106	113†
M	119	102	130	106	107	106	113
J	123	103	126	106	106	106	114
J	120	103	132	107	106	108	116
A	124	104	131	108	106	109	116
S	118	104	131	109	105	107	115
Percentage change latest 3 months on:							
1. previous 3 months	+1.3	+1.3	+1.7	+2.2	-	+1.9	+2.2
2. a year earlier	+11.2	+5.7	+8.3	+4.7	+3.1	+4.5	+10.2

(1) Mainly building materials

An obelus in the table indicates that the data are new or have been revised. The period marked is the earliest in the table to have been revised.

OUTPUT OF PRODUCTION AND CONSTRUCTION INDUSTRIES (1)

(1980=100)

TABLE 3

		Production and construction Division 1-5	Construction Division 5	Production industries Division 1-4	Energy(2) Division 1	Manufacturing Division 2-4	Oil and gas extraction Class 13
Weights (parts per thousand of GDP(0))		424	63	361	95	266	44
		DVJN	DVJO	DVIM	DVIN	DVIS	DVIP
1981		95.6	89.9	96.6	103.8	94.0	110.3
1982		97.4	91.6	98.4	110.0	94.2	125.6
1983		101.0	95.3	101.9	115.9	96.9	137.6
1984		102.6	98.5	103.3	110.2	100.8	147.1
1985		106.8	99.8	108.1	120.1	103.7	150.3
1986		108.9†	102.1	110.1†	125.2	104.7†	153.1†
Seasonally adjusted							
1981	4	96.6	86.9	98.3	106.6	95.3	114.5
1982	1	96.0	89.1	97.2	104.1	94.7	113.1
	2	97.6	90.6	98.8	110.0	94.9	126.6
	3	98.2	92.6	99.2	113.2	94.1	131.2
	4	97.7	94.3	98.3	112.8	93.1	131.6
1983	1	99.4	93.7	100.4	112.8	95.9	131.3
	2	99.3	92.1	100.5	114.9	95.4	132.6
	3	102.1	97.7	102.8	117.4	97.6	141.5
	4	103.1	97.8	104.0	118.3	98.9	145.2
1984	1	103.3	97.8	104.2	116.8	99.7	147.7
	2	102.1	98.3	102.7	109.1	100.4	146.1
	3	102.1	99.6	102.5	104.9	101.6	142.8
	4	102.9	98.2	103.7	109.8	101.6	151.8
1985	1	105.5	100.3	106.4	114.9	103.4	153.9
	2	107.9	99.5	109.3†	122.6†	104.6	152.3†
	3	106.8	98.7	108.2	120.9	103.7	145.4
	4	107.2†	100.8	108.3	122.2	103.2	149.6
1986	1	107.4	98.9	108.9	126.7	102.5†	154.4
	2	108.5	101.7	109.7	125.6	104.0	152.5
	3	109.7	102.8	110.9	127.4	105.0	158.2
	4	110.2	105.1	111.1	121.2	107.4	147.2
1987	1	111.6	109.8	111.9	124.6	107.4	153.0
	2	111.5	105.9	112.5	120.9	109.4	147.8
	3	-	-	114.3	122.6	111.4	147.8

(1) The long run series in column 3-5 are consistent with Table 1.
(2) Includes water supply.

An obelus in the table indicates that the data are new or have been revised. The period marked is the earliest in the table to have been revised.

NOTES TO EDITORS

1. The index numbers of output of the production and construction industries in this Press Notice are on the base 1980 = 100 and classified to the 1980 revision to the Standard Industrial Classification (SIC). These industries account for 42 per cent of gross domestic product; production industries alone accounts for 36 per cent. The index numbers were first published in this form in September 1983. The monthly index for the production industries covers only the energy (and water supply) Division 1 of the SIC, and manufacturing industries, Divisions 2 to 4 of the SIC. An index of production and construction broadly equivalent to the previously published "all industries' index of production" is available only quarterly. These changes were described in advance in March 1983 Economic Trends. A further article describing the effects of rebasing appeared in October 1983 Economic Trends.

2. The purpose of the index numbers is to measure changes in net output or value added (that is total outputs less total inputs) at constant (1980) prices. Conceptually, this should be estimated as the difference between outputs and inputs, each valued at the appropriate prices of the base year. However, this approach, known as double deflation, is difficult to apply reliably since it requires a great deal of information. In practice, movements in net output at constant prices are generally estimated by movements in gross output at constant prices. This yields satisfactory estimates, provided the ratio of gross to net output remains largely unchanged, as will generally be the case in the short-term. Further discussion of the concepts of measurement may be found in "Sources and Methods, Studies in Official Statistics No 37" (HMSO, 1985).

3. The index of production is a weighted average of 330 separate indicators, each of which describes the activity of a small sector of industry. These indicators are obtained monthly where possible but for a number of sectors, representing 17 1/2 per cent of activity, only quarterly data are available. Two Occasional Papers, one describing the weights and indicators and the other the sources used in compiling the index, are available.

4. Many of the basic series used to construct the index of production measure either final production or deliveries. Neither type of series takes account of changes in work in progress and series based on deliveries do not take account of changes in stocks of finished goods. All of the index numbers in this Press Notice have been adjusted where necessary, for estimated changes in stocks. An Occasional Paper describing these calculations is available.

5. More detailed tables on the index of production are published regularly in "British Business" and the "Monthly Digest of Statistics". The data in this Press Notice can be obtained in computer readable form via the CSO Databank service which provides macro-economic time series on magnetic tape. Details of the service offered and the Schedule of Charges may be obtained from the Database Manager, CSO Branch 9, Room 52/4, Government Offices, Great George Street, London SW1P 3AQ (telephone: 01-270-6386). CSO does not offer direct on-line access for these data, but a list of host bureaux offering such a facility is available on request from CSO.

6. Estimates of the output of the construction industry are compatible with those published by the Department of the Environment which are available only quarterly, one month in arrears of the corresponding quarters' estimates for the output of production industries. The aggregate index numbers no longer make use of preliminary estimates for the construction industry based, in advance of receipt of regular returns from the industry, on broad indicators of activity; they are thus delayed by one month but are better founded.

7. The index numbers in this Press Notice are all seasonally adjusted, to remove annually recurring month-to-month variations owing for example, to the incidence of holidays and other regular seasonal patterns of behaviour. The adjustments can only be derived from analysis of past data and may not be completely appropriate when holiday patterns change sharply. Unadjusted data may be obtained from CSO.

8. Estimates for the latest few months are always based on partial information and should be regarded as provisional and subject to revision as more complete data become available. During the lifetime of the 1975-based index, the average revision (regardless of sign) to the all-industries index for the latest month was one half of 1 per cent. It is recommended that, to obtain an assessment of short-term change, attention should be directed to the three-month-on-three month changes. The average revision to this latter measure was one quarter of a percentage point over the same period. An Occasional Paper is available from CSO describing the effects of revisions.

9. Occasional Papers (price £2.50 each) and off-prints of Economic Trends articles (price £1.50 each) are available from the Central Statistical Office.

10. Bias adjustments for the index of manufacturing output

In an attempt to allow for understatement in the provisional figures, an improved system of adjustments to manufacturing output was introduced in January last year. Some detail was included in note 12 of Notes to Editors in the January 1986 Press Notice and a fuller note on the methodology of the adjustment procedure is available on request from the CSO. The adjustment procedure makes use of smoothed monthly CBI figures on expectations of growth in output The overall size of the bias adjustment is dependent on the size of any discrepancy between the growth in the CSO raw figures and the growth implied by the CBI figures while the historical month by month profile of the bias in the CSO figures contributes to the profile of the adjustment over the six month period for which it is applied. This profile is updated from time to time. The bias adjustments, which are additive, included in the manufacturing figures this month are:

1987					
April	May	June	July	August	September
+0.1	+0.2	+0.4	+0.7	+1.0	+1.0

8:2/3a

PERSONAL AND CONFIDENTIAL
until 11.30am 13 November 1987
then UNCLASSIFIED

FROM: **PETER CURWEN**
DATE: 12 November 1987

1. ~~MISS~~ M O'MARA
2. **CHANCELLOR OF THE EXCHEQUER**

The manufacturing series has been behaving oddly so the latest monthly fall is nothing to worry about. The underlying annual growth rate remains at a very encouraging 5-5½ per cent.

Tony

cc Chief Secretary, Financial Secretary, Economic Secretary, Paymaster General, Sir Peter Middleton, Sir Terence Burns, Mr Cassell, Mr Monck, Mr Burgner, Mr Scholar, Mr Sedgwick, Mr R I G Allen, Mr Hibberd, Mr Gray, Mr Pickford, Mr Brooks, Mr Hudson, Mr Dyer (+1 for No 10), Mr Call, Mr Cropper, Mr Tyrie, Mr Stirling - CSO, HB/002

INDEX OF OUTPUT OF THE PRODUCTION INDUSTRIES - SEPTEMBER AND THIRD QUARTER 1987

This will be published at 11.30am on Friday 13 November.

2. The index of production fell by 1.0 per cent between August and September but in the third quarter as a whole was up 1.6 per cent on the previous quarter and up 3.1 per cent on the same period a year earlier.

3. Manufacturing output fell by 0.5 per cent between August and September, but in the third quarter as a whole was up 1.8 per cent on the previous quarter and up 6.1 per cent on the same period a year earlier.

4. The index of manufacturing output has been revised up for the two most recent quarters with some minor downward revisions to earlier months. These revisions have worked to boost the growth rate between the third quarter and the same period a year earlier but to subdue the growth rate between the second and third quarters.

5. **Recent movements**

percentage changes	1987Q3 on 1987Q2	1987Q3 on 1986Q3	September on August	1987Q3 on 1979H1
Index of Production within which:	+1.6	+3.1	-1.0	+6.9
Manufacturing	+1.8	+6.1	-0.5	+1.4
Energy and Water	+1.4	-3.7	-2.3	+23.8

6. Manufacturing output fell slightly between August and Setpember to a level marginally higher than in July. Little significance should be attached to the fall. The figures for manufacturing output have followed an unusual path in the third quarter, primarily because manufacturers reduced their output by less than usual during the holiday months of July and August, thereby producing unusually high seasonally adjusted figures for these months. As a consequence the CSO believe underlying growth in manufacturing is lower than recent figures suggest but still a very healthy 5-5½ per cent a year. Manufacturing output in the third quarter was 1.4 per cent higher than the 1979H1 peak, although the figure for September is 2.5 per cent below the 1979 monthly peak.

7. Energy sector output fell back in September after picking up in July and August. There were also significant downward revisions to recent months figures reflecting more information from the gas and electricity industries and an updated seasonal adjustment pattern for the oil industry. The CSO now believe that energy sector output is 'declining a little'. However, the fall over the past year is almost certainly an overstatement of the underlying movement as it is affected by fluctuations in North Sea oil production which contributed to an unusually high energy sector output figure for the third quarter of 1986.

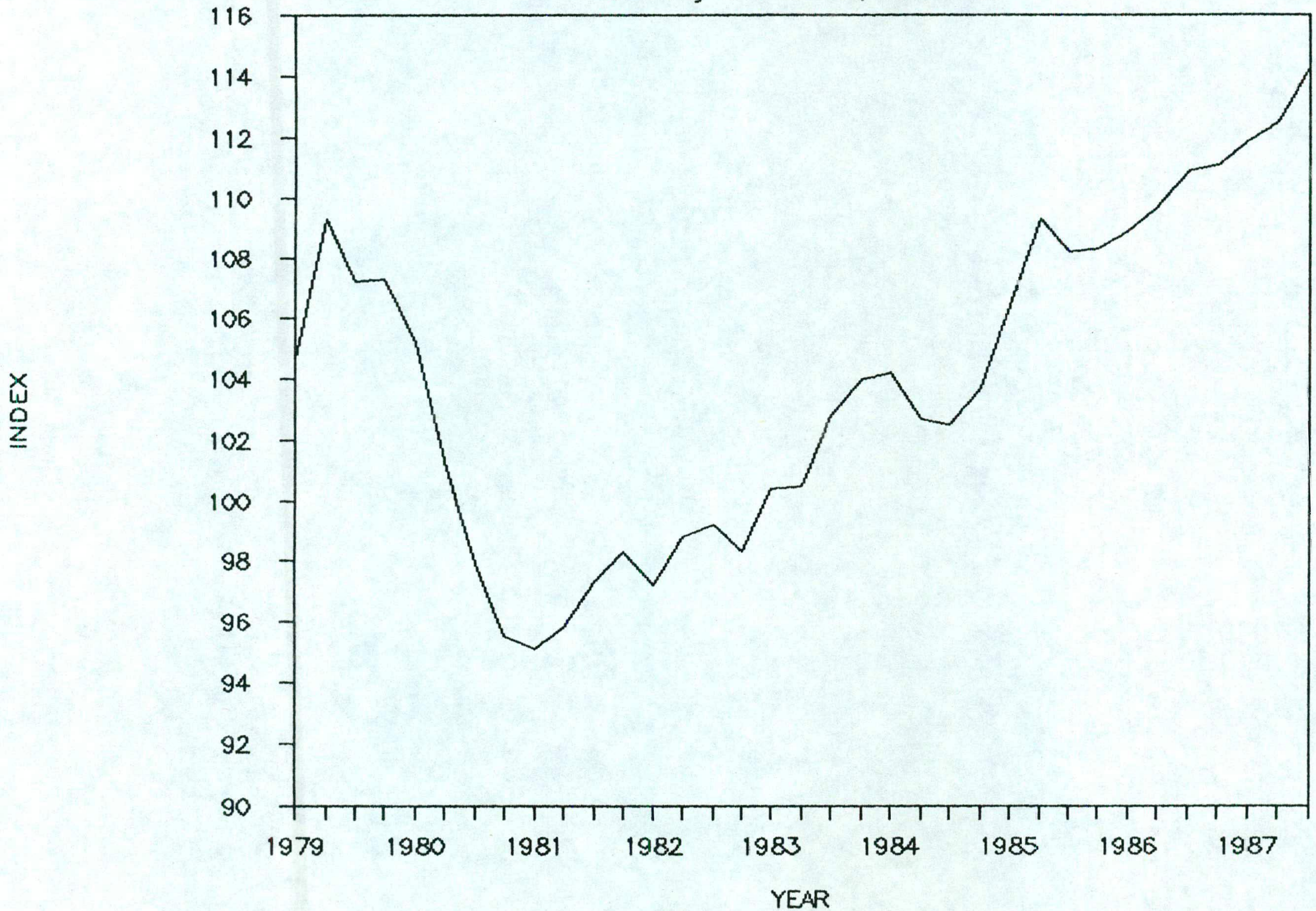
8. Following the increases of July and August, the index of production fell back in September. This reflects the unusual pattern of manufacturing output over the past 3 months and also the fluctuations in energy sector output. The CSO believe that a fair representation of recent underlying growth is about 3½ per cent.

Peter. S. Curwen

PETER S CURWEN

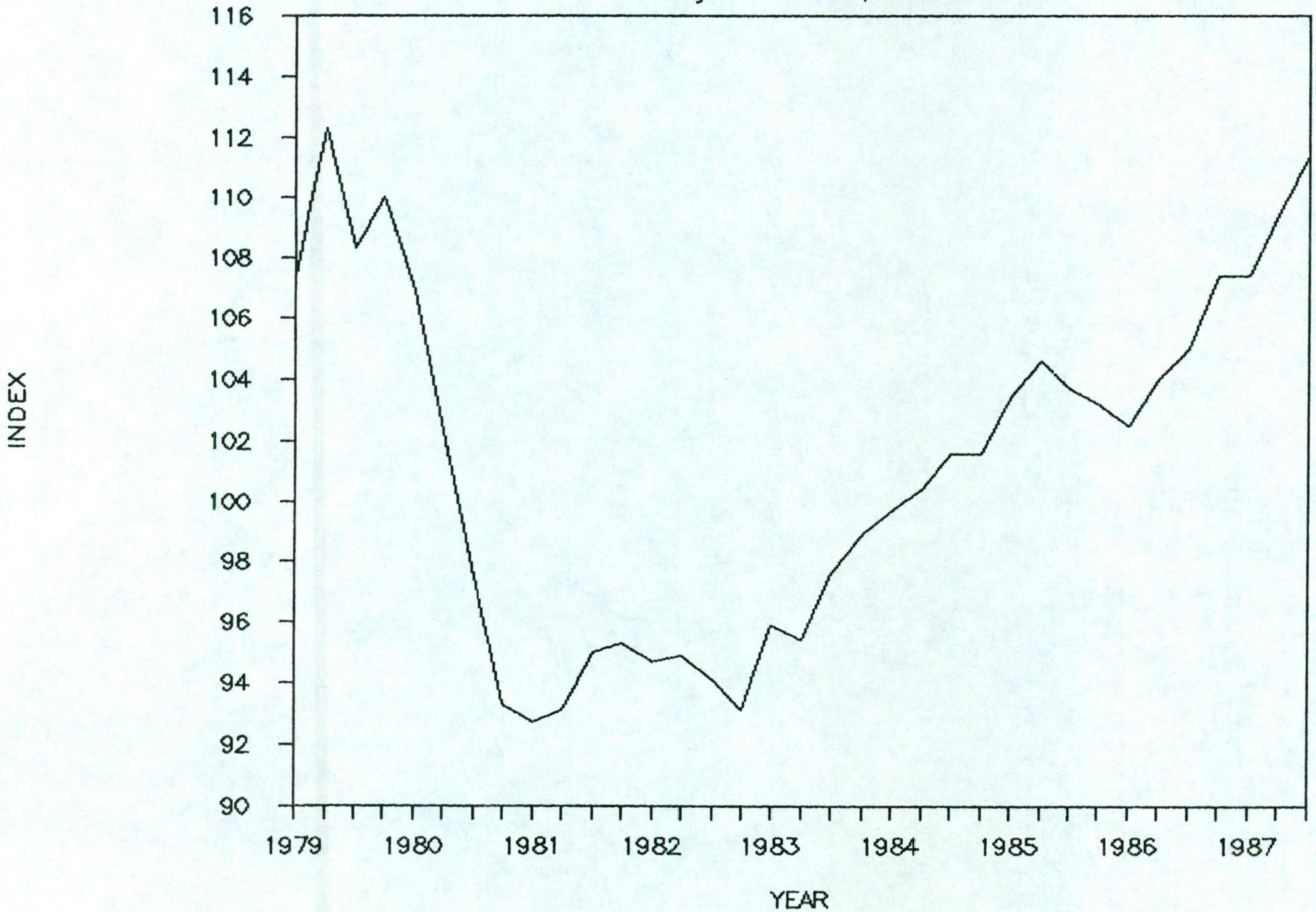
INDUSTRIAL PRODUCTION

Quarterly movements; 1980=100



MANUFACTURING OUTPUT

Quarterly movements; 1980=100



3890/002

SECRET

PMP

Many thanks. Re para 18, I am content with (i) & (ii). As to (iii) & (iv), I would like the EST first to consider X, which @ 1st sight has a gt deal to be said for it. As to (v), I am content that this can be done but I would rather the work was done @ an even lower visibility. Finally, I am v. concerned that we avoid Y [illegible] if humanly possible.

Ch
Issues for decision summarised in para 18.
AA

CHANCELLOR

FROM: C W KELLY

DATE: 13 November 1987

cc: Chief Secretary
Economic Secretary
Sir T Burns
Sir G Littler
Mr Anson
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Turnbull
Mr R I G Allen
Mrs M Brown
Mr Grice
Mr Mowl
Mr Watts
Mr M Williams
Miss O'Mara
Ms Goodman
Mr Cropper

FOREIGN CURRENCY BORROWING

The addition of a further \$6.7 billion to the reserves in October (\$8.2 billion if the forward book is included) has a number of implications for our foreign currency borrowing strategy.

2. Our assumption earlier this year was that we might expect a large part of the intervention which had then been undertaken to be reversed later in the year. That still remains a possibility. But the upward pressure on sterling has persisted for longer than most of us had, I think, anticipated; and there must now be a stronger probability that a substantial part at least of the \$16.7 billion we have amassed through intervention this calendar year will stick.

3. In the meantime, investing it has begun to pose something of a problem. There is a limit to the amount which can prudently be added to our bond portfolios in the current state of the markets. The great bulk has therefore been invested in fairly

KELLY TO CX 13 NOV

short-term instruments - Treasury bills, short-term paper, bank deposits and deposits with the BIS. The consequence is that our exposure to the banking system - and their dependence on us - is now much higher than we would ideally wish. Since mid-1986 it has risen from around $2½ billion to around $15 billion. We have also been driven into holding more and more of our assets in the form of Treasury bills and BIS deposits, both of which offer a return below the average cost of our borrowing.

4. The implications of this as we see them are three-fold.

5. First, we ought to reconsider whether we want to go ahead with the proposed sovereign note programme. The Bank have, as you will appreciate, been preoccupied with other things in recent weeks and have not yet produced the note on this commissioned at your meeting on 16 September.

6. Subject to seeing that, the sovereign note programme is in our view still an attractive proposition, because of the flexibility it would give us. And if we are going to set it up there is a lot to be said for doing so from an obvious position of strength. But the advice the Bank have received suggests that the programme would need to be rather larger than we had previously envisaged - at least $2 billion if we are to differentiate it sufficiently from other sovereign note programmes to extract the best terms. To undertake this scale of borrowing immediately no longer makes sense. We suggest keeping the possibility in reserve for the time being, perhaps reviewing the position in the spring.

7. Second, we can make further progress on prepaying existing debt. We have already made a start on this. We expect scheduled and early prepayments of debt together this quarter to amount to $900 million, compared with new borrowing which is unlikely to be more than between $250 and $300 million (and which we have reduced as much as possible without reneging on existing commitments). The intention had been to use the note issue to refinance both the scheduled repayments next year and around

$600 million or so of the $2 billion outstanding stock of relatively expensive bank debt. We could now accelerate this programme, to the extent of aiming to pay down all of the bank debt. Prepayment out of bank deposits would both produce interest savings and reduce our exposure on the asset side to banks.

8. Our original reasons for being more cautious were partly uncertainty about how much of the increment to the reserves would stick and partly not wanting to damage banking relationships unnecessarily if we thought it likely that we would want to put new bank credits in place in the foreseeable future. Neither argument now seems as strong as it did; and it seems unnecessarily perverse to worry too much about banking relationships at the same time as we are concerned about our exposure to the banking system on the asset side.

9. There is, however, one potential difficulty. Exchange cover scheme loans are treated in the hands of the nationalised industry borrowers as if they were NLF loans. Under the NLF rules, early repayment of loans at times when interest rates are lower than when the loans were taken out involves the payment of premia to us by the industries to leave them no better and no worse off. (The reverse happens when interest rates are higher). Prepayment of these bank credits will therefore mean small increases in the external financing requirements of the industries involved in the year they are prepaid (mainly 1987-88, but partly also 1988-89) matched by corresponding reductions in later years. We will need to pursue the implications of this with PE, and if necessary the Chief Secretary, on a case by case basis. Preliminary analysis suggests that the effects should be relatively small (perhaps around £20 million in total) and PE think that in the case of the energy industries at least they ought to be containable within existing EFLs.

10. We will want to continue to review the case for prepaying other forms of debt, depending upon how circumstances develop next year and on the progress made on bank credits. One possibility - and it is at present no more than that - is that

we could look at the first ($2½ billion) FRN which is callable for the first time in October 1988. It might make financial sense to exercise the option then, perhaps refinancing with a note programme. That could both produce cost savings and reduce what might otherwise be a fairly nasty hump in the repayment profile in 1992. There is, however, no need to take a view on this now.

11. In the meantime it would, however, make sense to think in terms of buying in part of one or both of the FRNs on investment grounds. The $2½ billion FRN is trading at around LIBID less 10 basis points to its call in October 1988; the $4 billion FRN is at around LIBID to its final maturity in 1996. Either offers a better return than we are getting on our current marginal assets, deposits with the BIS or US Treasury bills. The Bank's advice is that it might be possible to acquire $50-$100 million a month without too much difficulty and without moving the markets noticeably. For technical reasons, purchases would have to be held ex-reserves, but they could be financed by running down the forward book so that the level of the spot reserves would not be affected. We would not, of course, make public what we were doing and we would retain the option of disposing of our holdings, which are very liquid, if circumstances so demanded.

12. Third, we think it would be sensible to reconsider the decision not to announce the reduction in the attractiveness of the terms of the exchange cover scheme until we are ready to begin the sovereign note programme. You agreed in September to reduce the subsidy to borrowers from ½ per cent to 1/8 per cent and to introduce a minimum loan size of $25 million.

13. The reason for delaying the announcement had been concern that if we moved before the note programme the markets might wonder how we proposed to fill the gap that would be left by a lower level of exchange cover scheme borrowing, and draw their own conclusions. But the delay in announcement has made it difficult to turn down the stream of small loans from local

authorities and others which, under the old regime, would have gone through more or less automatically; and an announcement within the next few weeks could now be tied in with the new higher level of reserves following the October reserves announcement.

14. The alternative would be to wind up the scheme altogether, or to suspend it sine die. There is a case for doing this. But we are a little reluctant to do so yet. With the new arrangements there could still be occasions on which it is cost-effective for us to borrow indirectly rather than in our own name; and it does allow us to keep open channels which we might want to draw upon again at a later stage should circumstances change. Keeping it going on a minimal care and maintenance basis will, however, probably involve picking and choosing which of the potential borrowers we are prepared to use. We are checking with Treasury Solicitor that this is something we can do without causing problems. X

15. Whether it makes sense to think in terms next year of doing as much as the $400 million or so of indirect borrowing that I suggested in an earlier submission is, however, much more debatable.

16. One institution affected by this will be the European Investment Bank (EIB). We had told the EIB some while ago that we expected to reduce very significantly the amount we take from them by comparison with the $1 billion we are likely to draw this year. I have now told them that it seems unlikely that we can make any kind of commitment and do not expect to take other than modest amounts from them next year, though we will want to retain the option to do so depending upon circumstances. I have also told them that, although we will obviously have to have some transitional arrangements to deal with projects currently in the pipeline, these are now likely to be much more brutal than had at one time seemed possible. This will be a major blow to them. Though I think they understand our position, they can

be expected to make a great fuss, especially about the transitional arrangements. I am having a further meeting with them next week and the President of the bank will also expect to go through it with you when he visits you on 26 November.

17. There is one other very awkward implication of the lower level of foreign currency borrowing we now need of which you should be aware. One of our most assiduous recent borrowers has been British Nuclear Fuels Ltd (BNFL). BNFL are in an anomalous position, being 100 per cent government owned but classified to the private sector. The availability to them of exchange cover scheme borrowing has suited everybody, because it has avoided the need to face up to the possibility of BNFL borrowing in the sterling markets on terms worse than would have been available from the NLF, which might be difficult to justify to the PAC. This question will now have to be addressed. PE and GEP will be making a separate submission to the Chief Secretary shortly. But you should know now that the most defensible alternative to fill the gap left by lower foreign currency borrowing seems to be NLF loans <u>unless</u> it were to prove possible for BNFL to borrow in foreign currency and swap into sterling at better than NLF rates. The Bank are looking into this. The difficulty with NLF lending is that, as central government lending to the private sector, it would add to public expenditure and the PSBR. The effect would be something like an additional £100 million in 1987-88, and £200-£300 million a year thereafter. Y

<u>**Conclusion**</u>

18. There is a danger in making major changes in strategy in response to increases in the reserves which could prove to be transitory. But in the light of the persistence of the upward pressure on sterling, the size of the increment to the reserves which has now happened, and the implications of that for the manangement of reserve assets we do think that it makes sense to adjust the strategy in a number of ways. Specifically we would like:

i. To continue to plan on the basis of initiating a sovereign note programme, but perhaps begun rather later than we had initially thought.

ii. To step up the prepayment of other debt, particularly bank debt.

iii. To make an early announcement about the change in terms of the exchange cover scheme (as on previous occasion this would require a written PQ), pointing to the rise in the reserves as the reason for making the change.

iv. Depending upon circumstances, and subject to the difficult point about BNFL, to plan in terms of fairly minimal new borrowing under the exchange cover scheme once that already in the pipeline has gone through, with the implication that this could well mean reducing borrowing from the EIB to a fairly trivial level.

v. For as long as it continues to make sense and can be done discreetly, to be prepared to buy in small amounts ($50-$100 million a month) of one or both of our FRNs, to be held ex-reserves and financed out of the forward book.

19. These recommendations have been agreed with the Bank of England.

C W KELLY

cc: Mr George)
Mr Plenderleith) Bank of England
Mr Page)

FROM: A A DIGHT
DATE: 16 November 1987

MISS M O'MARA

INDEX OF OUTPUT OF THE PRODUCTION INDUSTRIES - SEPTEMBER AND THIRD QUARTER 1987

The Chancellor has seen and was grateful for your minute of 12 November.

A A Dight

A A DIGHT

NC/10
P.

Thanks: pse copy to Mins & officials.
I wd also like a draft reply – which need not be a point by point reply: gratitude for [illegible] [illegible] wd draft.
I wd also be grateful for a note on those pts which we have not already considered [illegible]

Chancellor

Nigel Vinson asked me to get this to you.

Do you want it copied to Ministers – and Officials?

To allay any suspicion, I have not talked to Vinson or Chappell about tax reform at all recently.

Shall I tell him to copy it to his Founders!

PJ.

E(A)/Mon 3/xx

C·P·S

CENTRE FOR POLICY STUDIES

8 Wilfred Street, London SW1E 6 PL. Tel: 01-828 1176

17 September 1987

The Chancellor of Exchequer,
The Treasury,
London SW1.

Dear Chancellor

VINSON → CH/EX 17/9

I hope you will welcome this letter from our Wider Ownership group and that it will reinforce your thinking on future tax strategy: the success of that programme to date provides the opportunity to take a radical new look at the fiscal barriers to personal ownership.

May we suggest that you now major on two themes. From many sources you are under pressure to introduce major tax reforms. You will need no convincing that the present tax system in inequitable, unnecessarily complex and discourages personal asset creation. We think it would be valuable for the Tory party clearly to nail its colours to the mast of tax reforms. Now that privatisation is broadly behind us, an unequivocal commitment to really major reform, would give the party an excellent philosophical base on which to fight the next election in some four years time.

Secondly, as part of the process of major tax reforms, could we urge you to stress constantly that one man's tax privilege is another man's tax rise. Currently the tax privileges given to institutions, are reycled back into the revenue net through privatisation sales; but when the programme is completed this will not be possible and meanwhile they are certainly not conducive to the cause of wider share ownership. These privileges, many of which in our view are wholly unnecessary, hugely erode the tax base. This will at some stage have to be put right and we think it would be valuable to begin to effect that process now.

However successful we may have been in spreading the number of shareholders you will know that in practice the proportion of listed shares owned by individuals continues to fall; personal wealth continues to be increasingly institutionalised.

Hence, we would like to suggest a number of interim measures that we believe would be useful steps down the road to wider tax reform. Of necessity we deal with these briefly but would be happy to argue them out at greater length and depth should you invite us to do so.

1. THE POVERTY TRAP. We urge you to couple any reforms of higher rate taxation with explicit action to relieve taxation at the bottom. A marginal rate of tax of 36% (including NICS) for a married man earning £100.00 a week is a positive disincentive to enter the workforce and a penalty on those that do. We must not be seen as the party that only favours the rich, however strong the arguments for reducing tax.

2. CAPITAL GAINS TAX. It may be in your mind - and we would agree with the desirability - of integrating capital gains with the basic system, and rate, of income tax. Meanwhile, however, the complexity of the existing tax calculations not only discourages the personal holding of shares but also locks individuals into existing holdings. The failure to index pre-1982 gains means in effect we still have a Tory wealth tax. We would like to suggest that indexation be progressivly backdated and currently to at least 1975. You could keep up your sleeve further backdating for future budgets.

3. PENSION DEDUCTIBILITY. Pending wholesale reform of pension privilege we think you should begin to illustrate the inequities of the present concession. There is no better example of one man's tax break being another man's tax rise than the fact that those on higher salaries can attract tax allowable pension provision which can be worth as much as £25,000 a year tax free for a man earning £100,000 per year; these are just the people who are perfectly able to save in their own right.

3. (Cont'd.) In the same way that there is a ceiling on mortgage relief, we believe that there should be a ceiling on pension relief. We suggest that relief should be limited to a maximum of pension provision equivalent to a salary of £30,000 a year - ie just under three times the national average wage and a figure that happens to coincide with the figure for mortgage relief. Obviously there would be nothing to stop companies providing higher pension provision but it should not be tax relieved at any stage. Incidentally, there are not many votes lost on this one and the administration would not be complex.

It might be argued that the Exchequer gain from this would be fairly small - but it would be a useful presentational offset against enhanced indexation of capital gains and we see it signalling an end to unlimited pension relief, just in the same way as you have rightly limited the amount of lump sum commutation.

Furthermore, it would not only seem to be fair but it would be part of a process of encouraging individuals at this level of income to develop their own personal savings and move into self-employment or contracted employment.

4. SELF-EMPLOYMENT. PAYE Introduced an inflexibility into the labour market and an entirely irrational and artificial tax division between being "employed" and being "self-employed". The labour market is changing and there is likely to be a rapid growth in part-time jobs and multiple employment.

continued ... page 4

Is the jobbing gardener who works for four different people during the week self-employed or does he work for the first one? The fact is it should not matter and the tax system must become more flexible so as to allow more people to drift between self-employment, full-time employment, and a variety of part-time jobs. The aim should be to tax all economic activity equitably. The forthcoming introduction of computerised tax returns will enable individual assessment on a much wider scale without extra cost.

As part of the Tory philosophy for encouraging the enterprise ethic, we must make the labour market more mobile and flexible and we would like to see you commit the party to equality of tax treatment and assessment for all forms of earned income.

5. PERSONAL EQUITY PLANS. You know we welcomed these but were sorry they were not structured so as to give tax concessions on entry. We urge you to look again at this "Loi Monory" approach and at the same time allow investment in unquoted stocks and consider simplification of the procedural arrangements, the costs of which personally erode so much of the benefits.

6. PERSONAL PENSION PLANS AND INDEX-LINKED GILTS. We welcome all you have done to encourage personal pension provision and the direct ownership of shares. As part of the process of recycling pension savings, and in order to give comparable investment security as to those in guaranteed pension schemes and in the public sector, a flow of suitably dated and priced index-linked Government Bonds will be necessary. We would like to see the undertaken given that these will be regularly offered as part of the Government's funding and refunding programme.

For the longer term, Chancellor, we know how much has already been achieved by the measures you have introduced but we urge you to proclaim that major tax reform is one of the basic tenets of Tory party political philosophy. We continue to be concerned at the ever increasing institutionalisation of financial assets, which is partly a by-product of the present tax system. It is illogical and nonsensical that we should proclaim the advantages of Shareholding for Everyman - but at the same time continue to give tax privileges to institutional ownership.

We urge you now to go down the road of a fundamental shift in taxation policy. There are many options but the basic structure should, we believe, be based on two principles:-

- firstly by widening the tax base through the removal of privileges currently given in so many directions - and not least to retirement relief. We believe the full extent of pension privileges, costing up to £10 billion per annum has never been fully understood or debated. Not least substantial overfunding means the tax base is eroded quite unnecessarily.

- secondly, to balance the removal of privileges we would like to see you move towards a single, lower rate of income tax, abolishing all higher rates, and hopefully, integrating income tax with NICS. Many of the existing fiscal privileges - such as interest-free national savings, the tax deductibility of the business expansion scheme and many other besides would naturally wither on the vine if a single, low rate of tax were introduced.

It should be stated again and again that our philosophy depends on our belief that individuals separately make better decisions than the State collectively: all forms of taxation introduce distortions, in varying degrees, to that personal freedom of choice.

We hope the proposals in this letter will encourage you to redouble your efforts and we will be delighted to have the opportunity to meet you and to expand on them if you felt that this would be worthwhile.

LORD VINSON

RJ5.59

C/ Would you like anyone with you at this meeting? Julie 17/11

N 4/10 T

FROM: MRS JULIE THORPE

DATE: 17 November 1987

PS/INLAND REVENUE

cc PS/Financial Secretary
PS/Sir P Middleton
Mr Ilett
Mr McIntyre
Miss Sinclair
Mr Cropper

FST
Mr Cropper
Mr Taylor

CHANCELLOR'S MEETING WITH LORD VINSON ON TUESDAY 8 DECEMBER AT 5.30PM

The Chancellor has agreed to see Lord Vinson for drinks at 5.30pm on Tuesday 8 December. He may bring Mr Philip Chappell with him.

2. I would be grateful if you could provide briefing by close of play on Friday 4 December. Please could Mr Cropper also provide a note on current issues from his side.

Julie Thorpe

MRS JULIE THORPE

DEPARTMENT OF THE
ENVIRONMENT
NEWS RELEASE

pp

470 17 November 1987

DOMESTIC RATES TO BE ABOLISHED IN MOST AREAS OF ENGLAND IN 1990

The Government has decided to introduce the Community Charge in one go on 1 April 1990 in all local authorities in England, except for the highest spending areas in London, Environment Secretary Nicholas Ridley told the House of Commons today.

In a small number of areas where spending is highest, either as a result of the Inner London Education Authority, or the Borough, or both, the Community Charge will be phased in over four years between 1990-1994.

For those high-spending areas every adult will pay a £100 Community Charge in 1990/1991 if spending is unchanged compared with the previous year. At the same time, households in those areas will pay a proportion of their rates. The proportion will decline steadily to zero over the following four years while the Community Charge will increase. For all other areas Community Charge will be introduced fully on 1 April 1990.

As previously announced there will also be a safety net, phased out over four years to limit the effects of the move to the new grant and business rate systems on Community Chargepayers and ratepayers. It is now proposed, however, that there will be a maximum contribution to the safety net of £75 per adult in any area.

In a written answer to a Parliamentary Question from Jeff Rooker MP (Perry Barr), Mr Ridley said:

2 MARSHAM STREET · LONDON SW1P 3EB · TELEPHONE 01 · 212 3434

"The Government has given careful consideration to the arrangements for introducing the Community Charge in England in 1990/91, in the light of the many representations that have been made. There are two elements: the introduction of the community charge and abolition of domestic rates within each area; and the phasing -in of the impact of changes in grant and non-domestic rates on individual areas (safety netting).

"We have decided that the vast majority of areas should introduce the full, safety netted Community Charge in 1990/91; domestic rates will be abolished in those areas from 31 March 1990. However, in some areas where spending is particularly high either as a result of the Inner London Education Authority, or the Borough, or both, it would be too disruptive to introduce the new system in full in one go. That was the reason for our initial phasing-in proposals. In the light of comments on these proposals we have now decided to concentrate the phasing-in on these particular areas only. This will give them more time to adjust their spending, while ensuring that the benefits of the new system will flow through more quickly elsewhere.

"In areas where local authorities have budgeted to spend more than £130 per head above their Grant Related Expenditure assessments in 1987/88, we propose that the Community Charge should therefore be introduced only partially in 1990/91 at £100 (assuming unchanged spending). Domestic rates there will be phased out and the full Community Charge phased in between 1990/91 and 1994/95. On this basis, the phasing-in would only apply throughout inner London, and in the London Borough of Waltham Forest.

"The safety net which we have already announced, will enable the effect on domestic taxpayers of changes in the grant and non-domestic rate arrangements to come through gradually. In 1990/91 the safety net will ensure that there is no change in the distribution of grant and non-domestic rates between areas, except that we now propose that contributions will be limited to a maximum of £75 per adult in any area. This will slightly reduce the extent to which areas are able to gain from the safety net. The safety net will be phased out in equal steps between 1991/92 and 1994/95."

"I have today placed in the Library tables illustrating the impact of these proposals on each local authority area, on the basis of 1987/88 spending."

NOTES TO EDITORS

Phasing out rates determines the speed at which the cost of paying for local services shifts between individuals in the same area (from, for example, single pensioner homeowners to those living in households with several adults). The phasingin of these grant and non-domestic rate changes determines how quickly changes in the overall amounts of domestic taxation (from domestic rates and the Community Charge combined) should occur.

The safety net will ensure that the grant and nondomestic rate changes are phased in over four years, rather than immediately, thus cushioning the impact of the new arrangements for areas which would otherwise have to raise more in total from their residents. So some authorities will benefit from the safety net, while others will contribute towards its cost. However, the maximum contribution which any authority must make to the safety net will be limited to £75 per adult. The attached tables show what these decisions mean for the residents of each local authority.

The Government has announced that certain people will be exempt from the Community Charge. They are: the severely mentally handicapped, old people living in homes, patients living in hospitals, and those in prison. For those on low incomes, there will be rebates of up to 80 per cent. Income support will assist those on the lowest incomes in paying the 20 per cent contribution. Students will pay 20 per cent of the charge in their college town.

Transitional arrangements for business rates were announced on 6 May 1987 (Press Notice No 212) and are not affected by today's announcement. The changes result from the revaluation of property and the introduction of the uniform business rate. The Government had initially proposed that the Community Charge should be phased in over four years throughout England, from 1 April 1990 (Press Notice 309, 30 July 1987).

In Scotland and Wales the Community Charge will be introduced in one go in all authorities - on 1 April 1989 in Scotland and on 1 April 1990 in Wales.

Press Enquiries: 01 212 3496/7539/8236/5113
(out of hours: 01 212 7132)
Public Enquiries: 01 212 3434
(ask for Public Enquiries Unit)

----0000----

Community charge : Illustrative figures for local authority areas in England (assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
GREATER LONDON			
Camden	£ 100	£ 321	£ 782
Greenwich	£ 100	£ 343	£ 608
Hackney	£ 100	£ 274	£ 691
Hammersmith and Fulham	£ 100	£ 236	£ 465
Islington	£ 100	£ 189	£ 483
Kensington and Chelsea	£ 100	£-18	£ 370
Lambeth	£ 100	£ 240	£ 547
Lewisham	£ 100	£ 302	£ 677
Southwark	£ 100	£ 277	£ 570
Tower Hamlets	£ 100	£ 326	£ 639
Wandsworth	£ 100	£ 218	£ 435
Westminster	£ 100	£-75	£ 396
Barking and Dagenham	£ 213	£ 8	£ 221
Barnet	£ 297	£-75	£ 222
Bexley	£ 212	£-1	£ 211
Brent	£ 326	£-44	£ 283
Bromley	£ 217	£-44	£ 173
Croydon	£ 219	£-60	£ 158
Ealing	£ 301	£-23	£ 278
Enfield	£ 226	£-28	£ 199
Haringey	£ 340	£-11	£ 329
Harrow	£ 276	£-52	£ 223
Havering	£ 208	£-19	£ 189
Hillingdon	£ 239	£-18	£ 221
Hounslow	£ 205	£-35	£ 170
Kingston-upon-Thames	£ 252	£-40	£ 212
Merton	£ 222	£-48	£ 173
Newham	£ 309	£-5	£ 304
Redbridge	£ 208	£-38	£ 171
Richmond-upon-Thames	£ 291	£-58	£ 233
Sutton	£ 262	£-39	£ 224
Waltham Forest	£ 100	£ 9	£ 365

Footnotes

1. Local authorities in inner London and Waltham Forest will raise the remainder of their domestic taxation by levying a domestic rate.

2. A minus sign in Column 2 indicates a contribution to the safety net.

Community charge : Illustrative figures for local authority areas in England (assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
GREATER MANCHESTER			
Bolton	£ 202	£ 0	£ 202
Bury	£ 254	£-10	£ 244
Manchester	£ 261	£ 12	£ 272
Oldham	£ 184	£ 18	£ 201
Rochdale	£ 199	£ 38	£ 236
Salford	£ 238	£ 4	£ 243
Stockport	£ 238	£-54	£ 183
Tameside	£ 203	£ 30	£ 233
Trafford	£ 218	£-62	£ 156
Wigan	£ 216	£ 29	£ 245
MERSEYSIDE			
Knowsley	£ 256	£ 11	£ 267
Liverpool	£ 263	£ 37	£ 301
St Helens	£ 225	£ 18	£ 243
Sefton	£ 242	£-32	£ 210
Wirral	£ 280	£-34	£ 246
SOUTH YORKSHIRE			
Barnsley	£ 173	£ 91	£ 264
Doncaster	£ 210	£ 71	£ 280
Rotherham	£ 189	£ 63	£ 252
Sheffield	£ 195	£ 53	£ 248
TYNE AND WEAR			
Gateshead	£ 197	£ 67	£ 263
Newcastle upon Tyne	£ 259	£ 34	£ 292
North Tyneside	£ 239	£ 27	£ 265
South Tyneside	£ 188	£ 66	£ 254
Sunderland	£ 200	£ 62	£ 262
WEST MIDLANDS			
Birmingham	£ 249	£-63	£ 186
Coventry	£ 239	£-20	£ 219
Dudley	£ 240	£-46	£ 203
Sandwell	£ 200	£-25	£ 175
Solihull	£ 238	£-75	£ 163
Walsall	£ 222	£-31	£ 191
Wolverhampton	£ 254	£-50	£ 205
WEST YORKSHIRE			
Bradford	£ 196	£ 42	£ 238
Calderdale	£ 176	£ 83	£ 259
Kirklees	£ 172	£ 74	£ 246
Leeds	£ 182	£ 22	£ 204
Wakefield	£ 195	£ 59	£ 254

Community charge : Illustrative figures for local authority areas in England
(assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety* net Col 3
AVON			
Bath	£ 209	£ 15	£ 224
Bristol	£ 227	£ 10	£ 237
Kingswood	£ 209	£-3	£ 206
Northavon	£ 223	£-3	£ 221
Wansdyke	£ 217	£-14	£ 204
Woodspring	£ 243	£-24	£ 219
BEDFORDSHIRE			
North Bedfordshire	£ 262	£-21	£ 241
Luton	£ 293	£-54	£ 239
Mid Bedfordshire	£ 255	£-22	£ 233
South Bedfordshire	£ 292	£-55	£ 236
BERKSHIRE			
Bracknell	£ 219	£-75	£ 144
Newbury	£ 226	£-75	£ 151
Reading	£ 210	£-43	£ 168
Slough	£ 208	£-60	£ 149
Windsor and Maidenhead	£ 239	£-75	£ 164
Wokingham	£ 224	£-75	£ 149
BUCKINGHAMSHIRE			
Aylesbury Vale	£ 250	£-60	£ 191
South Bucks	£ 281	£-75	£ 206
Chiltern	£ 286	£-75	£ 211
Milton Keynes	£ 266	£-45	£ 221
Wycombe	£ 276	£-75	£ 201
CAMBRIDGESHIRE			
Cambridge	£ 263	£-74	£ 190
East Cambridgeshire	£ 191	£-10	£ 182
Fenland	£ 187	£-1	£ 185
Huntingdon	£ 206	£-25	£ 181
Peterborough	£ 231	£-17	£ 214
South Cambridgeshire	£ 242	£-75	£ 167
CHESHIRE			
Chester	£ 230	£-36	£ 194
Congleton	£ 214	£-27	£ 187
Crewe and Nantwich	£ 214	£-22	£ 192
Ellesmere Port and Neston	£ 239	£-23	£ 216
Halton	£ 197	£-4	£ 194
Macclesfield	£ 258	£-75	£ 183
Vale Royal	£ 208	£-19	£ 189
Warrington	£ 204	£-12	£ 192

Community charge : Illustrative figures for local authority areas in England
(assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
CLEVELAND			
Hartlepool	£ 215	£ 53	£ 268
Langbaurgh	£ 252	£ 18	£ 270
Middlesbrough	£ 252	£ 24	£ 277
Stockton-on-Tees	£ 250	£-1	£ 250
CORNWALL			
Caradon	£ 163	£-5	£ 158
Carrick	£ 170	£-4	£ 166
Kerrier	£ 153	£ 9	£ 162
North Cornwall	£ 168	£-6	£ 162
Penwith	£ 169	£-5	£ 164
Restormel	£ 165	£-4	£ 161
CUMBRIA			
Allerdale	£ 180	£ 73	£ 252
Barrow in Furness	£ 164	£ 93	£ 257
Carlisle	£ 201	£ 63	£ 264
Copeland	£ 168	£ 90	£ 258
Eden	£ 179	£ 65	£ 243
South Lakeland	£ 226	£ 26	£ 252
DERBYSHIRE			
Amber Valley	£ 225	£ 12	£ 237
Bolsover	£ 205	£ 61	£ 266
Chesterfield	£ 227	£ 19	£ 246
Derby	£ 263	£-26	£ 237
Erewash	£ 233	£ 4	£ 237
High Peak	£ 219	£ 26	£ 245
North East Derbyshire	£ 239	£ 12	£ 252
South Derbyshire	£ 236	£-4	£ 232
West Derbyshire	£ 247	£-11	£ 236
DEVON			
East Devon	£ 193	£-26	£ 167
Exeter	£ 164	£-5	£ 159
North Devon	£ 152	£ 23	£ 175
Plymouth	£ 174	£-9	£ 165
South Hams	£ 201	£-23	£ 178
Teignbridge	£ 178	£-3	£ 175
Mid Devon	£ 157	£ 16	£ 173
Torbay	£ 205	£-28	£ 177
Torridge	£ 139	£ 41	£ 180
West Devon	£ 163	£ 6	£ 168

Community charge : Illustrative figures for local authority areas in England
(assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
DORSET			
Bournemouth	£ 214	£-48	£ 165
Christchurch	£ 241	£-75	£ 166
North Dorset	£ 176	£-20	£ 156
Poole	£ 237	£-75	£ 162
Purbeck	£ 187	£-33	£ 154
West Dorset	£ 176	£-19	£ 157
Weymouth and Portland	£ 170	£-4	£ 165
Wimborne	£ 248	£-75	£ 173
DURHAM			
Chester-le-Street	£ 184	£ 30	£ 214
Darlington	£ 205	£ 41	£ 245
Derwentside	£ 181	£ 83	£ 264
Durham	£ 176	£ 48	£ 224
Easington	£ 148	£ 50	£ 198
Sedgefield	£ 174	£ 79	£ 253
Teesdale	£ 134	£ 60	£ 194
Wear Valley	£ 155	£ 92	£ 247
EAST SUSSEX			
Brighton	£ 226	£-50	£ 176
Eastbourne	£ 248	£-75	£ 173
Hastings	£ 204	£-35	£ 169
Hove	£ 235	£-61	£ 174
Lewes	£ 247	£-75	£ 172
Rother	£ 251	£-75	£ 176
Wealden	£ 224	£-49	£ 175
ESSEX			
Basildon	£ 325	£-65	£ 259
Braintree	£ 219	£-42	£ 177
Brentwood	£ 355	£-16	£ 339
Castle Point	£ 261	£-75	£ 186
Chelmsford	£ 256	£-75	£ 181
Colchester	£ 211	£-43	£ 168
Epping Forest	£ 259	£-75	£ 184
Harlow	£ 321	£-5	£ 315
Maldon	£ 254	£-75	£ 179
Rochford	£ 252	£-75	£ 177
Southend-on-Sea	£ 259	£-75	£ 184
Tendring	£ 240	£-56	£ 184
Thurrock	£ 274	£-31	£ 242
Uttlesford	£ 258	£-75	£ 183

Community charge : Illustrative figures for local authority areas in England (assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
GLOUCESTERSHIRE			
Cheltenham	£ 231	£-51	£ 180
Cotswold	£ 230	£-50	£ 180
Forest of Dean	£ 167	£ 24	£ 191
Gloucester	£ 187	£-4	£ 183
Stroud	£ 204	£-12	£ 192
Tewkesbury	£ 215	£-42	£ 173
HAMPSHIRE			
Basingstoke and Deane	£ 208	£-45	£ 163
East Hampshire	£ 238	£-57	£ 181
Eastleigh	£ 221	£-45	£ 176
Fareham	£ 237	£-58	£ 179
Gosport	£ 206	£-37	£ 169
Hart	£ 259	£-74	£ 185
Havant	£ 229	£-61	£ 168
New Forest	£ 219	£-37	£ 181
Portsmouth	£ 181	£ 6	£ 187
Rushmoor	£ 194	£-12	£ 182
Southampton	£ 182	£-7	£ 176
Test Valley	£ 207	£-37	£ 171
Winchester	£ 233	£-53	£ 180
HEREFORD AND WORCESTER			
Bromsgrove	£ 209	£-74	£ 135
Hereford	£ 157	£-8	£ 149
Leominster	£ 149	£-3	£ 146
Malvern Hills	£ 207	£-57	£ 150
Redditch	£ 210	£-57	£ 153
South Herefordshire	£ 147	£-13	£ 133
Worcester	£ 206	£-56	£ 150
Wychavon	£ 223	£-73	£ 150
Wyre Forest	£ 200	£-34	£ 166
HERTFORDSHIRE			
Broxbourne	£ 250	£-56	£ 194
Dacorum	£ 273	£-75	£ 198
East Hertfordshire	£ 257	£-60	£ 196
Hertsmere	£ 287	£-75	£ 212
North Hertfordshire	£ 272	£-75	£ 197
St Albans	£ 279	£-75	£ 204
Stevenage	£ 287	£-54	£ 233
Three Rivers	£ 280	£-75	£ 205
Watford	£ 263	£-57	£ 206
Welwyn Hatfield	£ 299	£-74	£ 225

Community charge : Illustrative figures for local authority areas in England
(assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
HUMBERSIDE			
Beverley	£ 240	£-21	£ 219
Boothferry	£ 170	£ 54	£ 224
Cleethorpes	£ 201	£ 28	£ 229
Glanford	£ 196	£ 23	£ 219
Great Grimsby	£ 188	£ 32	£ 219
Holderness	£ 199	£ 16	£ 215
Kingston upon Hull	£ 187	£ 61	£ 248
East Yorkshire	£ 185	£ 44	£ 230
Scunthorpe	£ 214	£ 47	£ 261
ISLE OF WIGHT			
Medina	£ 201	£ 7	£ 209
South Wight	£ 216	£-1	£ 215
KENT			
Ashford	£ 178	£-30	£ 148
Canterbury	£ 170	£-17	£ 152
Dartford	£ 151	£-2	£ 149
Dover	£ 151	£-7	£ 144
Gillingham	£ 156	£-6	£ 150
Gravesham	£ 177	£-25	£ 152
Maidstone	£ 170	£-23	£ 147
Rochester upon Medway	£ 157	£-26	£ 131
Sevenoaks	£ 189	£-38	£ 151
Shepway	£ 201	£-41	£ 160
Swale	£ 152	£ 1	£ 153
Thanet	£ 182	£-28	£ 154
Tonbridge and Malling	£ 166	£-13	£ 152
Tunbridge Wells	£ 177	£-25	£ 152
LANCASHIRE			
Blackburn	£ 149	£ 57	£ 206
Blackpool	£ 193	£ 1	£ 194
Burnley	£ 147	£ 92	£ 239
Chorley	£ 185	£ 5	£ 190
Fylde	£ 209	£-20	£ 189
Hyndburn	£ 142	£ 70	£ 212
Lancaster	£ 167	£ 23	£ 190
Pendle	£ 137	£ 75	£ 212
Preston	£ 178	£ 23	£ 201
Ribble Valley	£ 176	£ 23	£ 199
Rossendale	£ 164	£ 64	£ 228
South Ribble	£ 180	£ 9	£ 189
West Lancashire	£ 215	£-25	£ 190
Wyre	£ 190	£-1	£ 189

Community charge : Illustrative figures for local authority areas in England (assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
LEICESTERSHIRE			
Blaby	£ 222	£-33	£ 189
Charnwood	£ 231	£-36	£ 195
Harborough	£ 239	£-42	£ 196
Hinckley and Bosworth	£ 210	£-25	£ 185
Leicester	£ 189	£ 31	£ 220
Melton	£ 224	£-20	£ 204
North West Leicestershire	£ 213	£-3	£ 210
Oadby and Wigston	£ 232	£-38	£ 194
Rutland	£ 208	£-13	£ 195
LINCOLNSHIRE			
Boston	£ 158	£-5	£ 152
East Lindsey	£ 158	£-1	£ 157
Lincoln	£ 157	£ 1	£ 158
North Kesteven	£ 160	£-5	£ 155
South Holland	£ 158	£-2	£ 155
South Kesteven	£ 169	£-15	£ 154
West Lindsey	£ 160	£ 5	£ 166
NORFOLK			
Breckland	£ 165	£-19	£ 147
Broadland	£ 187	£-36	£ 152
Great Yarmouth	£ 175	£-9	£ 166
North Norfolk	£ 170	£-18	£ 152
Norwich	£ 183	£-11	£ 172
South Norfolk	£ 186	£-36	£ 149
King's Lynn and West Norfolk	£ 154	£-1	£ 154
NORTHAMPTONSHIRE			
Corby	£ 202	£-13	£ 189
Daventry	£ 265	£-33	£ 232
East Northamptonshire	£ 177	£-18	£ 158
Kettering	£ 192	£-6	£ 186
Northampton	£ 224	£-36	£ 188
South Northamptonshire	£ 228	£-57	£ 171
Wellingborough	£ 195	£-14	£ 180
NORTHUMBERLAND			
Alnwick	£ 177	£ 37	£ 215
Berwick-upon-Tweed	£ 178	£ 28	£ 206
Blyth Valley	£ 212	£ 39	£ 252
Castle Morpeth	£ 219	£-4	£ 215
Tynedale	£ 186	£ 31	£ 217
Wansbeck	£ 180	£ 70	£ 251

Community charge : Illustrative figures for local authority areas in England
(assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
NORTH YORKSHIRE			
Craven	£ 159	£ 25	£ 184
Hambleton	£ 182	£-3	£ 179
Harrogate	£ 207	£-1	£ 206
Richmondshire	£ 155	£ 29	£ 184
Ryedale	£ 164	£ 17	£ 181
Scarborough	£ 170	£ 22	£ 192
Selby	£ 165	£ 35	£ 200
York	£ 141	£ 32	£ 173
NOTTINGHAMSHIRE			
Ashfield	£ 168	£ 41	£ 209
Bassetlaw	£ 189	£ 49	£ 238
Broxtowe	£ 203	£-0	£ 202
Gedling	£ 206	£-5	£ 201
Mansfield	£ 191	£ 45	£ 237
Newark	£ 191	£ 17	£ 209
Nottingham	£ 195	£ 12	£ 207
Rushcliffe	£ 229	£-23	£ 205
OXFORDSHIRE			
Cherwell	£ 228	£-28	£ 201
Oxford	£ 235	£-15	£ 220
South Oxfordshire	£ 254	£-52	£ 202
Vale of White Horse	£ 243	£-50	£ 193
West Oxfordshire	£ 227	£-22	£ 205
SHROPSHIRE			
Bridgnorth	£ 192	£-19	£ 172
North Shropshire	£ 175	£ 2	£ 177
Oswestry	£ 170	£ 13	£ 183
Shrewsbury and Atcham	£ 205	£-17	£ 188
South Shropshire	£ 168	£ 8	£ 176
The Wrekin	£ 209	£-7	£ 203
SOMERSET			
Mendip	£ 188	£-10	£ 178
Sedgemoor	£ 198	£-7	£ 191
Taunton Deane	£ 187	£-6	£ 181
West Somerset	£ 203	£-22	£ 181
South Somerset	£ 186	£-8	£ 178

Community charge : Illustrative figures for local authority areas in England
(assuming 1987/88 budgeted expenditure)

	1990/91 community charge Col 1	Contribution to/from safety net Col 2	Full CC no safety net Col 3
STAFFORDSHIRE			
Cannock Chase	£ 192	£-6	£ 186
East Staffordshire	£ 184	£-7	£ 177
Lichfield	£ 232	£-58	£ 174
Newcastle-under-Lyme	£ 189	£-3	£ 186
South Staffordshire	£ 234	£-61	£ 172
Stafford	£ 203	£-25	£ 177
Staffordshire Moorlands	£ 189	£-5	£ 184
Stoke-on-Trent	£ 173	£ 14	£ 187
Tamworth	£ 211	£-28	£ 183
SUFFOLK			
Babergh	£ 202	£-29	£ 173
Forest Heath	£ 172	£-3	£ 169
Ipswich	£ 215	£-23	£ 192
Mid Suffolk	£ 187	£-10	£ 177
St Edmundsbury	£ 183	£-22	£ 161
Suffolk Coastal	£ 222	£-44	£ 178
Waveney	£ 189	£-14	£ 175
SURREY			
Elmbridge	£ 314	£-75	£ 239
Epsom and Ewell	£ 257	£-75	£ 182
Guildford	£ 235	£-75	£ 160
Mole Valley	£ 244	£-75	£ 169
Reigate and Banstead	£ 258	£-75	£ 183
Runnymede	£ 211	£-60	£ 151
Spelthorne	£ 221	£-43	£ 179
Surrey Heath	£ 215	£-75	£ 140
Tandridge	£ 228	£-54	£ 173
Waverley	£ 249	£-75	£ 174
Woking	£ 215	£-75	£ 140
WARWICKSHIRE			
North Warwickshire	£ 217	£-9	£ 208
Nuneaton and Bedworth	£ 219	£-19	£ 200
Rugby	£ 222	£-42	£ 180
Stratford on Avon	£ 249	£-75	£ 174
Warwick	£ 251	£-75	£ 176

pp

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch

I gather from Tim that Acland is still pretty bruised about how he was treated by the Treasury.

Case for writing as below?

Yes - shortly

AP

psl/2A

PERSONAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

17 November 1987

His Excellency Sir Antony Acland GCMG GCVO
Ambassador Extraordinary and Plenipotentiary
British Embassy
3100 Massachusetts Avenue N.W.
Washington DC 20008
USA

Dear Antony

I was very glad to hear that you were now content with the proposals for the new Economic Minister at your Embassy. I am sure you will find Frank Cassell an outstanding holder of that important post, and a valuable colleague. I am also grateful to you for releasing Tim Lankester for promotion to his new job here.

I look forward to seeing you at the Spring Meetings - or, if you are in London before then, do drop in to No.11 for a chat.

Please tell Jenny that I have taken her advice and Emily will start at Francis Holland next term.

Yours ever,

Nigel

NIGEL LAWSON

029/3648

Pps please INP?

CONFIDENTIAL

FROM: A G TYRIE
DATE: 18 NOVEMBER 1987

PS/CHANCELLOR

pmp

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr A Wilson
Mr N Monck
Mr M Scholar
Mr T Burgner
Mr S Flanagan
Mr P Cropper

Ch
Also a minute from Mr Cropper behind. You have already written supporting retention of requirement.
MPW 20/11

not quite - see X. Meanwhile, I suggest further Mr Wilson's comments on these 2 minutes.

SMALL COMPANIES ACCOUNTING AND AUDITING REQUIREMENTS

The Audit Requirement

I have now had a chance to consider Mr Flanagan's minute of 28 October. I think we should consider removing the audit requirement from companies with a turnover of less than £2 million and that we can probably do this without risking a significant increase in fraud.

Lord Young has floated two ideas: the creation of a £250,000 threshold for audit, and lifting the threshold to £2 million. He would justify these on the same grounds but his thinking seems muddled. His first proposal, of removing the requirement from companies with a turnover of £250,000 a year or less, would not reduce the burden on close companies at all. Companies of that size have their accounts both prepared and audited by the same accountant. There is normally only a token extra fee to produce the audit since almost all the work has already been done in the preparation of the accounts.

It is only when companies are big enough to employ a book-keeper/accountant of their own that there would be a saving. This is the attraction of this £2 million proposal. The book-keeper/accountant prepares the accounts before submission for the audit. In these cases the auditing firm often retraces many of the steps already taken by the book-keeper/accountant. This duplication can cost a company a substantial fee. This is the 'burden' we would be lifting.

Fraud

I think we could keep a similar level of protection against fraud. The Revenue could retain the power, without having to give any reason, to demand that a particular company submit its accounts for audit. The Inspectors would examine company accounts in the normal way, and demand an audit wherever something struck them as suspicious. This would reduce the burden on the, say, 90 per cent of companies who were not asked to produce an audit each year. Companies would still be required to submit full accounts to the Revenue. They would have a considerable incentive to build up a reputation for submitting 'true and fair' accounts, just as accountancy firms do now. That way they would be able to avoid the Audit cost and possibly a time-consuming and costly investigation as well.

Accounting Requirements

I also think it is worth looking at the detailed requirements under the Companies Act for the provision of accounting information. Most accounts, even for very small companies, are 10 or 12 pages long. Clearly a balance sheet, profit and loss account, and Director's report is needed. But what about all the reams of accompanying notes? I am not an expert I can imagine there is scope for improvement.

AGT.

A G TYRIE

TASK FORCE SECRET

Copy No ..1. of 9

Postscript

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr M Scholar

SMALL COMPANIES AUDITING REQUIREMENTS AND THE BUDGET PACKAGE

1. In view of the budget proposals on top rates I cannot see much advantage, from the Revenue's point of view, in retaining a compulsory audit for very small firms. In the long-run I think the Revenue are likely to be faced largely with unincorporated traders' accounts at these low levels of turnover anyway.

2. This is because the 35 per cent top rate proposed in the budget package would, I suspect, remove the incentive to incorporate for many small firms. A NIC incentive to stay unincorporated would be created, although it would be very small at the higher income tax rate.

3. For many companies with a small turnover (where the Director/owner may well be a basic rate tax payer) there could be a strong incentive to try and disincorporate. (The tax rates are only one of several factors in the 'incorporate/don't incorporate' decision).

4. I am making a fairly big assumption about small business

behaviour. Assuming I am right, even if my suggestion of an Inland Revenue option to call for audited accounts on companies up to the £2 million threshold turns out to be unworkable, I would see little point in blocking Lord Young's £250,000 threshold proposal. The Revenue would lose little. The small firms would gain nothing (they would have to go to an accountant anyway) but Lord Young would be the happier!

M May

pp A G TYRIE

18 November 1987

3976/54

FROM: P J CROPPER
DATE: 13 November 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr A Wilson
Mr Monck
Mr Scholar
Miss Sinclair
Mr Burgner
Mr Flanagan
Mr Tyrie
PS/IR

SMALL COMPANIES ACCOUNTING AND AUDIT REQUIREMENTS

I see that the DTI is trying, again, to eliminate the auditing of accounts of smaller companies.

2. The Home Secretary's letter to David Young concerning Charity Companies is surely a salutary corrective to David's recent denial of the utility of audit:

> "Last year, Revenue officials stressed that in their view audited accounts are inherently more reliable than unaudited accounts and that consequently the Revenue is able to justify devoting significantly less resources to investigation of company accounts than would otherwise be the case. I do not accept the basic argument - as I understand it such investigations as have been carried out suggest that there is no significant difference in standards of accuracy....".

3. I must say I find it hard to believe that it would make no difference to the efficiency with which revenue might be collected, whether or not the accounts of smaller companies were audited. It seems to me too obvious to be even worth stating, that if an unquoted company's accounts are not going to be audited there will be an added temptation to understate profits and underpay tax.

P J CROPPER

Tony D - ~~this~~ has this been done? M.

PSE copy to Mr Tyrie, then PMP.

MPW

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

10 November 1987

Rt Hon Douglas Hurd MP
Home Office
Queen Anne's Gate
London SW1H 9AT

CH/EXCHEQUER
REC. 10 NOV 1987 10/11
ACTION FST
COPIES TO

Dear Douglas,

SMALL COMPANIES ACCOUNTING AND AUDIT REQUIREMENTS

Thank you for your letter of 3 November commenting on my proposals for reducing accounting and audit requirements for small companies.

I appreciate your concerns about charitable companies but, as you say, the considerations which apply to them do not apply to the generality of companies. Subject to Nigel Lawson's comments on my letter of 29 September, I would therefore intend to press ahead with my proposals but making such special provisions for charitable companies as may be necessary in advance of any new charities legislation you may decide to bring forward. I suggest that our officials get together to consider the possibilities.

I am grateful for your comments on ultra vires. The fact that officials have been able to work out arrangements which strengthen controls over charitable companies without undermining the benefits of the proposed reforms is very satisfactory from every point of view.

I am copying this letter to Nigel Lawson, Norman Lamont and John Cope.

Yours,
David

LORD YOUNG OF GRAFFHAM

JG7ACQ

CT/11/mjd

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Byatt
Mr Cassell
Mr Monck
Mr Burgner
Mr D Moore
Mrs Lomax
Mr Scholar
Mrs M Brown
Mr Houston
Mr Ilett
Mr Gray
Mr Bradley
Mr Inglis
Mr Wynn Owen
Mr Flanagan

Mr D Walker - BE
Mr Beighton - IR
Mr Finlinson - C&E

pmp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

The Rt Hon Lord Young of Graffham
Secretary of State for Trade
and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

9 November 1987

Dear David

ACCOUNTING DEVELOPMENTS

I know that your officials and mine have been talking about various shortcomings in the present legislative and working background against which accounting principles are developed and it might be helpful if I tell you how we see the problems from here. I am also taking this opportunity to reply to your letter of 29 September on small firms accounts and audit.

Attached to this letter is a draft list of specific issues which we feel need to be tackled, which I believe coincides to a large extent with issues which your own officials are already addressing. Some of these points relate to work underway in the Accounting Standards Committee, which could usefully be supported by the Government. Other aspects might require legislation which could be included in a Companies Bill if you are able to secure room for it in the timetable. I see advantage in bringing together the various issues in a single note which, if you agree, could then serve as an agenda for continuing discussions between our officials, identifying the issues to be covered and possible solutions, and about which they should consult informally both with other parts of Government as well as external interested parties.

I do not think that a formal inter-departmental working party should be established, for this would almost certainly extend the timescale for the exercise, but co-ordination of work on the several topics suggested will be necessary if real progress is to be achieved and our objectives met. Responsibility for such coordination could most sensibly be placed, I believe, in the hands of Mr Anthony Wilson, the Head of the Government Accountancy Services. The immediate aim would be to reach early conclusions on objectives for action by the accountancy profession and to settle any provisions which might need to be included in legislation.

The amount of information which companies are expected to disclose in their accounts is a separate issue, and therefore it is not covered in the attached draft list of accounting matters. However, work on this, including the special concern of small firms mentioned in your letter of 29 September, could be carried forward by our officials as a separate exercise in parallel with what I have suggested above.

Turning to the other main point in your letter, I was interested to note that you now suggest removing the statutory audit requirement from companies with an annual turnover of less than £2 million, ie around 90 per cent of all businesses, rather than the £250,000 threshold you suggested when you were Employment Secretary. But I am not yet persuaded that conditions have significantly changed since we decided on 14 May last year to retain the statutory audit. Opinion among interested parties still seems divided. You mention that the Institute of Chartered Accountants are in favour of abolition, but I understand that the certified accountants, who audit the accounts of many small companies, have come out strongly in favour of retaining the statutory audit, as it introduces an element of financial rigour which many small companies would otherwise lack.

I remain concerned about fraud. You will recall that your White Paper "Building Businesses...Not Barriers" said of the statutory audit: "The Government are determined to clamp down on fraud and have decided that removal of this first defence against fraud would be inappropriate". To go back on that decision now would be to send out quite the wrong signals even though fraud in small companies obviously has a lower profile than in larger ones.

You asked what the implication to the Inland Revenue would be of abolishing the audit requirements. At present, the Revenue feel that the discipline of statutory audit makes company tax returns more reliable. They therefore investigate about half the percentage of accounts from companies which they do for unincorporated (and therefore unaudited) businesses. To provide the same coverage of company accounts as for unincorporated business accounts would require several hundred new inspectors, which is not a realistic prospect. So the consequence of the change would be to put Exchequer revenues at risk.

These considerations suggest to me that the decision we reached last year was probably correct, and that it would certainly be unwise to adopt the very much more far reaching exemption you now propose.

I am copying this letter to Douglas Hurd and John Cope.

Yours
Nigel

NIGEL LAWSON

2911/3

DRAFT LIST OF CURRENT ACCOUNTING ISSUES WHICH REQUIRE CONSIDERATION

A number of issues to do with accounting requirements or practices are currently causing concern and need to be addressed. Accounting information provides an important influence on the way markets work, as well as the basis for sound economic decisions, and therefore attention must be paid to its quality

2. The main current issues are:

- the need for economic substance to prevail over legal form in the preparation of accounts and for unrestricted true and fair view requirements;

- off balance sheet financing;

- accounting for mergers and acquisitions;

- fair value and modified historical cost accounting;

- disclosure of R & D expenditure.

Substance over form and the true and fair view

3. The main purpose of accounts is to disclose corporate profitability and what may be distributed to shareholders, and the full state of affairs of the reporting group or company. Efficient markets require information about the true economic performance of companies at least as much as a statement of what may legally be distributed. Since the 4th EC Company Law Directive was reflected in UK legislation there has been a tendency for accounts to concentrate more on what is distributable than on economic performance. Furthermore the law now governs more aspects of accounts than it used to do and this seems to have led to an overlegalistic view of what is permissible in them and what is not. Some accounting shortcomings stem directly from the ability

of companies to hide behind restrictive legal interpretation of company law at the expense of showing a genuine "true and fair view".

4. The operation of the concept of a true and fair view has been restricted since the 1981 Companies Act and this has led to difficulties in developing accounting standards to cover such matters as what may be included in group balance sheets, and the related question of "off balance sheet finance", and what may be treated as a profit. The capacity of accounting to deal swiftly with new situations and abuses is gravely weakened if the requirement for accounts to show a true and fair view is restrained by the law.

Proposal

5. There is a case for considering change to legislation so that the requirement for accounts to show a true and fair view is reinforced (within the limitations of the 4th Directive) as overriding. The impact of the 7th Directive (group accounts) needs careful consideration to ensure that accounts are allowed to reflect the real composition of a group and the latter is not unduly restricted by statutory definition.

Off-balance sheet financing

6. Off-balance sheet financing takes a variety of forms designed to reduce disclosed gearing and to some extent, assets, thus improving the apparent rate of return on capital employed. It has arisen in part because of restrictive interpretation of company law by lawyers and merchant bankers. The technique of removing both assets and liabilities from company and group balance sheets conceals the true nature and extent of liabilities which the group may have underwritten, and improves the perceived rate of return on assets above its true level.

Proposal

7. The clarification of law on the supremacy of the true and fair view concept should prevent much of the abuse, but this needs to be bolstered by stonger accounting standards. The recent attempt by the accountancy profession to produce a solution was stopped in its tracks by legal quibbles. The objective must be to ensure that the true economic position of the group is reflected in accounts and that all the components of the group are included in them.

Mergers and acquisitions

8. More flexibility is given to the permissible accounting treatment of mergers and acquisitions in the UK than is the case in the US and some other developed countries. When the 7th EC Directive governing group accounts is translated into UK law, there will be an opportunity to revise the relevant provisions of the Companies Act.

9. The objectives of changes in this area are to improve disclosure of what has actually happened, (the price paid for acquisitions, their consequences and the accounting treatment adopted), and to reduce the number of accounting options available so as to improve the consistency and comparability of accounts, to make them easier to understand and to put a stop to some current abuses.

Proposal

10. The law should permit both merger and acquisition accounting as at present, but there is a case for considering prohibiting a currently popular hybrid of merger relief under the Companies Act and acquisition accounting. We should encourage the accounting profession to tighten up on the rules for disclosure, and narrow the range of circumstances when each form of accounting can be used, against a threat to legislate if the rules aren't strong enough. The Accounting Standards Committee review of the

composition and content of group accounts and the relevant Standards should be publicly encouraged and pressed forward.

Fair value accounting and regularity of revaluations

11. There has been a retreat from accounting for changing prices by the private sector and the Accounting Standards Committee is due to review the subject before the end of 1987. The decline in inflation and the cost of preparation of alternative forms of accounting information have been used to rationalise this retreat, (though many companies still use price level adjusted information in one form or another for management purposes). A more legitimate complaint is that the techniques tried have been oversophisticated and not appropriate for all types of business. Nevertheless, the main reason for retreat is undoubtedly still the fear of the effects of lower reported profits on share values as well as on profit related remuneration bases.

12. That said, the threat and practice of takeovers has led to increasing emphasis on modified historical cost accounts, incorporating updated valuations of significant assets, notably land and buildings. At present the UK law allows a choice of which, if any, assets to revalue and when, in contrast to other major countries such as the US and Germany, where revaluation is not an accepted accounting practice. This option distorts comparability of accounts. A requirement that there should be systematic, regular and consistent reassessment of fair values of all assets in company accounts, should achieve the benefit of price level adjustments without the complexities and dissent likely if more sophisticated methods of accounting were required.

Proposal

13. There may need to be a requirement in company legislation that revaluation of assets is comprehensive and regularly carried out using consistent principles or, as a minimum that this should be done where there is any departure from the historical cost

convention. The Accounting Standards Committee is already at work to develop a Standard in this area, but pressure is probably going to be needed to strengthen it.

Research and development

14. Considerable progress has been made with the accounting profession which is revisiting this subject. A new accounting standard is proposed in Exposure Draft 41, published in June 1987 which will require companies to disclose the level of research and development expenditure undertaken each year. This proposal should be publicly supported.

SECRET AND PERSONAL until release of press notice at 11.30 am on 24 November 1987 and thereafter unclassified

pmp

To: MINISTER FOR TRADE

Copy No. (3) 28

From: Peter Stibbard
US/S2
V/260 Ext. 4872

19 November 1987

OVERSEAS TRADE FIGURES FOR OCTOBER 1987

THE CURRENT ACCOUNT

In October, the value of exports was £6.9 billion and imports £7.7 billion, so that visible trade, seasonally adjusted on a balance of payments basis, shows a deficit of £0.9 billion compared with the deficit of £0.6 billion in September.

The Central Statistical Office project a surplus on invisibles of £0.6 billion for months in the fourth quarter so that the current account is provisionally estimated to have been in deficit by £0.3 billion, compared with a provisional estimate close to zero in September.

TABLE 1: CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES
(Table 2 of Press Notice)

Seasonally adjusted
Balance of Payments
Basis
£ million

	Current Account Balance	Visible Trade Balances: Total	Oil	Non-oil	Invisibles Balance
1985	+2919	-2178	+8104	-10282	+5097
1986	- 980	-8463	+4056	-12519	+7483
1987 May-July	- 722A	-2780	+ 898	- 3677	+2058A
Aug-Oct	-1206A	-3006	+1044	- 4050	+1800A
1987 Aug	- 907A	-1507	+ 372	- 1879	+ 600A
Sept	- 17A	- 617	+ 286	- 903	+ 600A
Oct	- 282A	- 882	+ 386	- 1268	+ 600A
1987 Jan-Oct	-1053A	-7447	+3529	-10976	+6394A

A = Projection or part projection

999 80

SECRET AND PERSONAL until release of press notice at 11.30 am on 24 November 1987 and thereafter unclassified

In the three months ended October there was a deficit on visible trade of £3.0 billion - a surplus on trade in oil of £1.0 billion, offset by a deficit in non-oil trade of £4.0 billion. Between the three months ended July and the latest three months, the visible trade deficit increased by £0.2 billion; the surplus on oil rose by £0.1 billion while the deficit on non-oil rose by £0.4 billion.

EXPORTS

The value of exports in October was £167 million (2½ per cent) lower than in September. Exports of oil increased by £41 million between the two months and exports of the erratic items increased by £104 million. Excluding oil and the erratic items, exports fell by 5½ per cent between September and October.

In the three months ended October, total export volume was 4 per cent higher than in the previous three months and 6½ per cent higher than in the same period last year. Excluding oil and the erratic items, export volume increased by 4 per cent between the three months ended July and the latest three months to stand 8 per cent up on a year ago. The underlying level of non-oil export volume has been rising for over six months and is well above that reached at the end of last year.

TABLE 2: EXPORTS BY VALUE AND VOLUME (Tables 1, 4 and 7 of Press Notice)

Bop Basis, Seasonally Adjusted

	VALUE (£m)		VOLUME (1980 = 100)	
	Total	Total Less Oil and erratics	Total	Total less Oil and erratics
1985	78111	57685	118.7	114.9
1986	72843	59238	123.1	117.7
1987 May-July	19542	16109	126.1	124.1
Aug-Oct	20467	16828	131.2	129.1
1987 Aug	6566	5424	126.6	124.9
Sept	7034	5858	134.6	134.6
Oct	6867	5546	132.4	127.8

By value, exports of manufactures during the three months ending October were 6 per cent up on the previous three months; the rises were fairly evenly spread across the main commodity categories.

Also by value, total exports rose by 4½ per cent between the three months ended July and the latest three months. The rise in exports to the developed countries was 7 per cent - within which exports to the rest of the European Community and to North America rose by 7½ per cent and 5 per cent respectively.

IMPORTS

The value of imports in October was £98 million (1½ per cent) higher than in September. Imports of oil fell by £59 million while imports of the erratic items increased by £138 million between the two months. Excluding oil and the erratic items, imports were little changed between September and October.

In the three months ended October, total import volume was 5 per cent higher than in the previous three months and 8 per cent higher than in the same period last year. Excluding oil and the erratic items import volume rose by 5½ per cent in the latest three months to stand 12 per cent up on a year ago. The underlying level of non-oil import volume continues to rise following the slight fall at the beginning of the year.

TABLE 3: IMPORTS BY VALUE AND VOLUME (Tables 1, 4 and 7 of Press Notice)

Bop Basis, Seasonally Adjusted

	VALUE (£m)		VOLUME (1980 = 100)	
	Total	Total less oil and erratics	Total	Total less oil and erratics
1985	80289	68719	126.0	142.8
1986	81306	73491	134.2	150.9
1987 May-July	22321	20283	143.9	164.6
Aug-Oct	23473	21432	151.4	173.8
1987 Aug	8073	7404	155.1	178.5
Sept	7651	7004	150.1	172.1
Oct	7749	7024	149.1	170.7

By value, imports rose by 5 per cent between the three months ended July and the latest three months. Increases over that period in the main categories of manufactures were in the range 5-10 per cent.

Again in value terms, imports from the developed countries rose by 6 per cent over the latest three months, with arrivals from the European

Community countries up by 5 per cent, from North America up by 9½ per cent and from the other developed countries by 8½ per cent. Imports from the developing countries increased by 20 per cent between the two three months periods.

TRADE IN MANUFACTURES

Figures showing trade in manufactures on a balance of payments basis will be published in the December edition of the Monthly Review of External Trade Statistics following the release of the press notice. On present estimates they show a deficit in the three months ended October of £2.3 billion compared with a deficit of £2.1 billion in the previous three months. The deficit on trade in manufactures in the first ten months of this year stands at £5.5 billion compared with a deficit of £4.1 billion in the first ten months of 1986.

TABLE 4: TRADE IN MANUFACTURES (SITC 5-8) (Table 16 of Press Notice, quarterly data only)

£ million
Seasonally Adjusted
Balance of Payments Basis

	Exports	Imports	Balance
1985	52271	55273	-3002
1986	54486	59977	-5491
1987 May-July	14985	17040	-2055
Aug-Oct	15657	17928	-2270
1987 Aug	4926	6181	-1254
Sept	5485	5767	- 282
Oct	5246	5980	- 734

COMPARISON BETWEEN AUTUMN STATEMENT FORECAST AND OUTTURN TO DATE

The table below compares the current account for the year to date with the projections for 1987 in Table 1.3 of the Chancellor's Autumn Statement.

£ billion

	Non oil goods: Manufactures	Non oil goods: Other	Oil	Invisibles	Current balance
1987 Jan-Oct (inc)	-5½	-5½	+3½	+6½	-1
1987 year (Partly forecast)	-7½	-6½	+4	+ 7½	-2½

SECRET AND PERSONAL until release of press notice at 11.30 am on 24 November 1987 and thereafter unclassified

REVISIONS TO EARLIER MONTHS

Figures for visible trade for the months April to August have now been revised to take account of the latest estimates by Customs and Excise of the effect of the delay in processing documents due to industrial action earlier this year. The net revisions to previously published figures on a balance of payments are shown below. They are relatively small.

£ million

	April	May	June	July	August
Exports	-2	+14	-5	-47	-18
Imports	-1	+26	+3	-	-
Net Adjustment	-1	-12	-8	-47	-18

In addition to the revisions shown above, figures for the third quarter of 1987 on a balance of payments basis, have been revised to reflect the usual quarterly update of balance of payments adjustments.

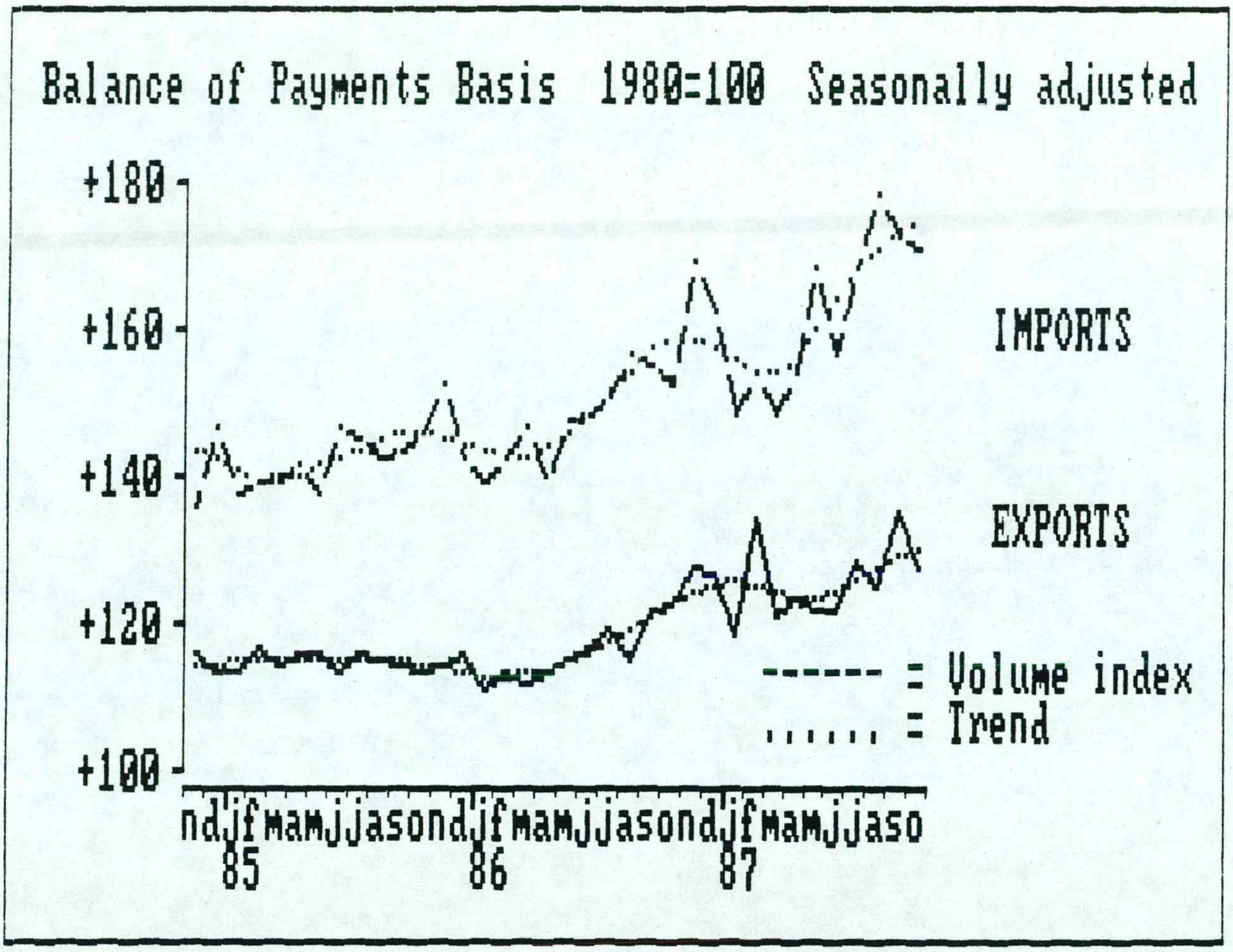
PUBLICATION

The press notice containing the October figures is scheduled for release on Tuesday 24 November 1987.

P J STIBBARD

SECRET & PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 24.11.87

VOLUME INDICES EXCLUDING OIL AND THE ERRATIC ITEMS



CIRCULATION LIST

Copy No	1	Minister for Trade
	2	Prime Minister
	3	Chancellor of the Exchequer
	4	Secretary of State for Trade and Industry
	5	PUSS for Trade and Industry
	6	Sir Robert Armstrong (Cabinet Office)
	7	Sir Brian Hayes (Dept. of Trade and Industry)
	8	Sir Peter Middleton (HM Treasury)
	9	Governor of the Bank of England
	10	Chairman of the Board of HM Customs & Excise
	11	Mr J Hibbert (CSO)
	12	Mr Pratt (HM Customs & Excise)
	13	Mr B Buckingham (CSO)
	14	Mr Davies (HM Treasury)
	15	Mr Barrell (HM Treasury)
	16	Mr P Sedgwick (HM Treasury)
	17	Mr D Owen (HM Treasury)
	18	Mr A McIntyre (CSO)
	19	Mr D J Wilson (Dept of Energy)
	20	Mr Bottrill (HM Treasury)
	21	Mr H H Liesner)
	22	Mr P J Stibbard)
	23	Mr W E Boyd)
	24	Mr E J Wright) Dept of Trade and
	25	Mrs A Brueton) Industry
	26	Miss C Siddell)
	27	Miss H Chapman)
	28	Mr D Packer)

SECRET

CC - CX, FST, MR ANSON
MR KEMP, MR MONCK
MR BURGNER, MR TURNBULL
MR GIEVE, MR A WHITE
MR WALKER, MR FYFE
MR CALL

Treasury Chambers. Parliament Street, SW1P 3AG

The Rt Hon Peter Walker MBE MP
Secretary of State for Wales
Welsh Office
Gwydyr House
Whitehall
London
SW1A 2ER

19 November 1987

Dear Peter,

REGIONAL ASSISTANCE

You sent Nigel Lawson a copy of your letter of 12 November to David Young. I have now seen David's reply of 16 November.

As far as an early announcement is concerned, I very much share David's view that an early announcement would be undesirable. Presentionally it is very important that the announcement of the end of RDG should be accompanied by details of the other policy changes which, as David indicates, still need further work before they can be presented to Parliament. I therefore think it is essential that we stick firmly to the public line set out in paragraph 3 of David's letter.

That said, I recognise that the timetable for submission of Main Estimates for the WDA may cause you some problems. However, I understand that it would be possible for your department to provide your currently intended WDA Estimate in December as usual but to submit amended figures by the end of the first week in February. This would mean that you could hold Estimates discussions with the WDA after the regional policy changes are announced in mid-January with the results of these discussions being reflected in the 1988-89 Main Estimates. I hope this relaxation of the Estimates timetable will be helpful to you.

I am sending copies of this letter to the Prime Minister, David Young and Malcolm Rifkind.

Yours Ever,
John

JOHN MAJOR

CONFIDENTIAL

From: Sir G.Littler
Date: 20 November 1987

CHANCELLOR

c.c. Sir P.Middleton
Sir T.Burns
Mr Cassell
Mr Huw Evans
Mr Odling-Smee
Mr Sedgwick
Mr Matthews
Ms Symes

a
OK?

INDICATORS

I apologise for inflicting on you this boring and unreal subject at the present time, but I have to commit us on the next stage very shortly and need to know whether you are content with what I propose.

<u>The Venice Decision</u>

2. The public Venice Declaration noted in particular on this subject (as agreed at the lunch which you attended):

> "the commitment by each country to develop medium-term objectives and projections for its economy, and for the group to develop objectives and projections, that are mutually consistent individually and collectively; and
>
> "the use of performance indicators to review and assess current economic trends and to determine whether there are significant deviations from an intended course that require consideration of remedial actions".

A list of key indicators had been agreed at the Louvre and modified slightly at the April Washington G7, comprising:

> "growth, domestic demand, inflation, current account balances, budget performance, monetary conditions and exchange rates".

3. Since that time you have publicly (Annual Meetings) cast doubt on further development of this <u>national</u> surveillance and urged the need to develop indicators for the group as a whole, but there has been no further G7 discussion or agreement.

CONFIDENTIAL

Proposed Implementation

4. Mulford has of course been pressing hard for implementation on the basis that we must have the system agreed at Venice up and running for 1988. With varying degrees of enthusiasm the rest of us have accepted this, but there has been a lot of argument about the basis of the figures.

5. I was driven off the line of "IMF figures only" when all the others accepted that the various 1987 agreements in effect ask countries to develop projections, etc. We then argued about the coverage. I insisted that we could not and would not offer U.K. figures beyond (in effect) what we make public - nor could we necessarily convert or 'normalise' our figures to suit somebody else's definitions. Gyohten originally backed me up well though he seems latterly to be weakening (while I suspect regarding the exercise as something of a waste of time).

? could do this

6. At our last argumentative session (in Washington after you had left), we eventually agreed that the IMF should carry out by early December (when we planned another meeting of Deputies) a dry run operation:

- to collect from us individually the most they could get out of us;
- to annotate as necessary any reasons for gaps or vagaries worth noting on numbers which were offered;
- themselves to construct by intelligent extrapolation some numbers to fill the gaps, and try in bilateral discussion whether they could get us to 'agree not to challenge them for the purpose of this exercise'.

CONFIDENTIAL

The IMF Operation

7. One of the senior IMF staff came to London a fortnight ago and has now produced a table for the U.K. attached at Annex A. There are several points in this we cannot accept. At Annex B is an alternative which I should like to propose.

8. Points which you will want to consider - for the exercise itself but more importantly for your own interest against risk of any leakage - are:

- I believe we must delete unemployment and interest rate lines: not part of the agreed list of indicators and we do not predict them;
- For the same reason (even if the figures are less sensitive) I would also drop the employment line;
- The figures to left of the dividing line are understood to have been provided by the U.K. (in fact drawn from the Autumn Statement and, for later years where available, from the last MTFS); those to the right of the line are the IMF extrapolations; we insist that the presentation should make the distinction clear (as we have done by drawing the dividing line on the tables);
- We have corrected a minor mistake by the IMF in the line for PSBR excluding privatisation receipts - otherwise all their 'U.K. figures' are as agreed with them and drawn from published sources as indicated above.

Conclusions and Recommendations

9. This is supposed to be a trial run - a basis for a further talk among Deputies next month to see whether the format is right.

CONFIDENTIAL

I think it is not a very satisfactory format at present. Moreover the actual figures at this stage will be a mess, not least because the U.K. figures are based on a post-crash update while all the others reflect September or earlier views! I may need to consult you again before the discussion among Deputies.

10. For immediate purposes I should like, subject to your agreement, to write to the IMF as in the attached draft letter - enclosing Table B and insisting on all the amendments we have made to the IMF version - and also repeating our interest in having IMF independent forecasts available on a consistent basis (they have in fact done a post-October revised projection) and in having further work done to develop some global G7 indicators as proposed in your Washington speech.

11. Mr Evans has very sensibly suggested that it could help us to influence the shape of future developments if we prepared and circulated to my Deputy colleagues some notes on how we would see the exercise developing. At some stage Ministers will have to address this question. Mr Evans will work on a draft which we shall want to show you later.

(Geoffrey Littler)

DRAFT LETTER FROM LITTLER TO FRENKEL, IMF

Thank you for your letter of 10 November and attachments.

We have looked carefully at your table and notes and I attach a revised version of your table and a commentary on the detailed changes we have made.

There are two important points among these changes on which some further comment may be helpful:

- we want to avoid risks of confusion by delineating very carefully the distinction between official U.K. figures and IMF projections: I think the line we have drawn is a helpful way of doing this - your bold/normal shading gets lost on copies and is in any case less clear;
- I must insist on cutting the lines for unemployment and employment and short- and long-term interest rates: we do not regard these as appropriate indicators; they were not in any list agreed in our G7 discussions earlier this year; and we would challenge <u>any</u> figures you put in (except of course retrospective interest rate figures).

I should like also to register two related points which came up in discussions here with Andrew Crockett. First, I hope the IMF will stand ready to offer its own forecasts on a consistent basis: I frankly continue to feel that IMF figures offered independently but after discussion with countries are the best basis for the kind of discussion we want. Secondly, I was disappointed that you seem not to share our interest in exploring global G7 indicators - a point we believe to be important and one which the Chancellor emphasised in his speech at the Annual Meetings this year. I shall want to revert to this.

Also: add memo G&P

20b/5

FROM: **MRS M HENSON**
DATE: 23 November 1987

CHANCELLOR'S OFFICE	12/2
CST OFFICE	36/2
FST OFFICE	43A/2
EST OFFICE	52/2
SIR P MIDDLETON	78A/2
MR SCHOLAR	90/1
MR PICKFORD	97/2
MR P SEDGWICK	83/G
MR R I G ALLEN	93/2
MISS SINCLAIR	89/1
MISS O'MARA	109/G
MR S BROOKS	43/3
MR A HUDSON	13/2
MS C EVANS	44/1
MR PATTERSON	98/2
MISS SIMPSON	99/2
	95/2
MR J CARR	112/G
MR B S KALEN	98/3
MR MILLS	42/3
MR P BROOKS	110/G
MR CURWEN	98/2
MR S PRICE	41/3
MR BUCKLEY	90/2
MS HATTER	112/2
MR CROPPER	17/2
MR TYRIE	15A/2
MR M CALL	117/2
THE DUTY CLERK	10 DOWNING STREET
MR S SHERBOURNE	10 DOWNING STREET
MR J R CALDER	I/R SOMERSET HOUSE
MR D H ROBINSON	DEPT OF FINANCE AND PERSONNEL ECONOMICS DIVISION RM 249A STORMONT BELFAST 3S15
MR P MAKEHAM	DTI Rm 601c 1-19 VICTORIA STREET LONDON SW1
MR GROOMBRIDGE	RM 536A, DHSS, NEW COURT, CAREY STREET, LONDON

PNP.

RELEASE DATES FOR ECONOMIC STATISTICS IN DECEMBER

I attach the release dates for economic statistics in December.

2. Any enquiries please contact Mrs Henson on 5212, 99/2 HM Treasury.

Meena Henson
MEENA HENSON

62a/5

RELEASE DATES FOR ECONOMIC STATISTICS IN DECEMBER

WEEKS 1 & 2

Wed	2	11.30	UK official reserves (Nov)
Thurs	3	11.30	Housing starts and completions (Oct)
"	"	21.00	Employment Gazette
Mon	7	11.30	Retail Sales (Oct-final)
	"	"	Credit business (Oct)
Thurs	10	11.30	CBI/FT Survey of distributive trades (Nov)
Fri	11	11.30	Tax and Price index (Nov)
"	"	"	Retail price index (Nov)
"	"	"	Construction output (3rd qtr-prov)

WEEK 3

Mon	14	00.30	CBI monthly Trends Enquiry [illegible]ec)
"	"	11.30	Retail Sales (Nov-prov)
"	"	"	Producer price index numbers (Nov-prov)
Tues	15	11.30	Index of output of the production industries (Oct)
2	"	"	UK balance of payments (3rd qtr)
Wed	16	11.30	Public Sector Borrowing Requirement (Nov)
Thurs	17	11.30	Capital expenditure by the manufacturing and service industries (3rd qtr-rev)
"	"	"	Labour market statistics: unemployment and unfilled vacancies (Nov-prov); average earnings indices (Oct-prov) employment, hours, Productivity and unit wage costs; industrial disputes
"	"	"	Investment intentions of the manufacturing and service industries
Friday	18	11.30	Building societies monthly figures (Nov)
"	"	"	Gross Domestic Product (3rd qtr-prov)
"	"	"	Provisional estimates of monetary aggregates (Nov)

WEEK 4

Mon	21	11.30	Cyclical indicators for the UK economy (Nov)
"	"	"	Manufacturers' and distributors' stocks (3rd qtr-rev)
Wed	23	11.30	Balance of Payments current account and overseas trade figures (Nov)
"	"	"	Construction - new orders (Oct)
Thurs	31	11.30	UK banks' assets and liabilities and the money stock (Nov)

Mrs M Henson
HM Treasury
1 Parliament Street
LONDON SW1P 3AG
01-270 5212

3692/4/sh

SECRET

FROM: J G COLMAN

DATE: 23 NOVEMBER 1987

CHANCELLOR

Ch/ Mr Colman does not know, of course, about today's meeting. CST will tell you about this tomorrow (I understand that it was agreed to go ahead with privatisation, to press for Mr Clarke's new option, to turn down flat the idea of a separate Scottish co., and to be rather more open about the (poor) future of the hot strip mill. But CST will amplify) 25 23/11

cc FST
Sir P Middleton
Mr Monck
Mr D J L Moore

BRITISH STEEL CORPORATION

The Prime Minister is holding a further meeting on 24 November. The meeting will discuss Mr Clarke's minute of 19 November. We also expect Mr Rifkind to circulate a further note. now enclosed

COLMAN TO CX 23 NOV

Mr Clarke's proposals

2. Mr Clarke's minute explains how he would proceed towards privatisation of BSC on the basis discussed at the Prime Minister's previous meeting. That envisaged no major closures before privatisation in November 1988, but giving BSC freedom after privatisation to close operations whenever the company wished to do so.

3. We agree with Mr Clarke that the approach is a second-best, but feasible, route to early privatisation if Mr Rifkind's concerns really must over-ride Mr Clarke's earlier proposals. You should note, however, that very great care will be required both in Government and in BSC to preserve the point that no closures will be announced until after privatisation. Great care will be needed because the intention to close, say, the hot strip mill, would be a material decision, and would need to be disclosed in the prospectus if such an intention had been formed at the time of the sale. Hence, to avoid an announcement in the prospectus BSC must avoid forming intentions prior to the sale.

Mr Rifkind's views

4. We understand that Mr Rifkind will be raising two main points:

a. the problem of making Parliamentary time for the requisite privatisation Bill;

b. the justification for not forming a Scottish Steel Corporation.

These are, indeed, his main points.

5. As to the Bill, Mr Rifkind believes that whatever its length (which we and DTI expect to be medium) it will be highly contentious and therefore time consuming. To fit such a Bill in the present Session will require other important Bills to be dropped. Yet no mention of a steel privatisation Bill was made in the Queen's Speech nor in the election manifesto. What justification could be given for introducing such contentious legislation at such short notice?

6. We, of course, do not know why steel privatisation was not mentioned in the manifesto, but both before and since then it has been stated policy to privatise BSC as soon as practicable. BSC's excellent performance this year is a genuine and new reason for believing that privatisation next year is practicable, and a genuine reason for making room for legislation.

7. As to a Scottish steel corporation, we agree entirely with Mr Clarke (paragraphs 5-7). Mr Clarke's minute does not, however, refer to another possibility, which has recently received publicity in the Glasgow Herald. Sir Ian MacGregor seems to be behind it. That is the idea of selling Ravenscraig to a foreign purchaser outside the EC, or establishing Ravenscraig as an independent producer with long-term contracts to supply foreign demand for slab steel. This idea was looked at by Samuel Montagn. The problems are that no such long-term contracts exist: they would have to be negotiated from, as it were, a standing start. There is also, no evidence that any foreign purchaser would buy at prices which would cover Ravenscraig's full costs. (When Sir I MacGregor was Chairman of BSC, he pursued such deals but at prices covering marginal costs only.) If Mr Rifkind wanted the question to be looked into again, that would guarantee delay.

Employment measures

8. If Mr Clarke's new proposals are agreed, there is no urgency about employment measures, and quite possibly no need for any in respect of the steel industry. (The hot strip mill closure, if it occurs after privatisation, would be very small, and other major closures some years away).

Line to take

- Support for Mr Clarke: if no decisions on closures before privatisation agree could sell on basis that BSC would have commercial freedom in the private sector.

- Next year's opportunity for sale of BSC should be grasped: will be a major success to return UK steel industry to the private sector.

- There are good reasons for our change of views on possible timing of sale: not necessary to feel need to give excuses, it is good news that BSC is doing well.

- Separating Scottish steel puts whole privatisation at risk, will be seen as commercially unsound.

- Content for announcement of planned privatisation to be made soon, as Mr Clarke proposes.

J.G.C.

J G COLMAN