PO-CH/NL/0108

PARTA

CONFIDENTIAL

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PO -CH /NL/0108

PART A

FINANCIAL SECTOR
BORROWING REQUIREMENTS
AND BUDGET PACKAGING1988

DD'S 25 years NA&LJ 11/8/95

PO -CH /NL/0108
PART A

11.3.88

FROM: A P HUDSON

DATE: 15 February 1988

MISS SINCLAIR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Mr Cropper
Mr Tyrie
Mr Call
Mr Mace - IR
PS/IR

10

FSBR CHAPTER 4: INDEPENDENT TAXATION

For the record, the Chancellor said, in the course of a discussion about Budget Day pamphlets, that he thought there was a strong case for including a section on Independent Taxation in Chapter 4 of the FSBR, setting out a clear summary account of the reform in reasonable detail. Please could you include something in the next draft, for him to look at?

APH

A P HUDSON

mjd 1/68A

BUDGET CONFIDENTIAL

FROM: A C S ALLAN

DATE: 18 February 1988

MR ODLING-SMEE

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Monck
Mr Scholar
Mr Culpin
Mr Turnbull
Miss Sinclair
Miss C Evans

TREATMENT OF EXPENDITURE MEASURES IN FSBR

The Chancellor was grateful for your minute of 17 February. He agrees that the expenditure changes should be charged to the Reserves. And he is generally content with your recommendations about how they should be shown in the FSBR.

2. However, he feels that an alternative presentation in table 1.1 should be used. This would be retain the title 'The Budget Measures', but would delete the side-heading 'Tax Proposals', and would not have a separate side-heading for 'Expenditure Measures'. Instead, the figures for covenants and maintenance and for forestry would be shown net, with a footnote on the lines 'Figures are net of consequential increases in public expenditure'. The grouping of the various items in table 1.1 has, of course, yet to be decided.

ACSA

A C S ALLAN

REDRAFT OF 2-19

RE-DRAFT OF 2.19

Continued restraint in total public spending is a vital element of the Government's economic strategy. Reductions in borrowing & hence in the burden of debt interest, coupled with strong economic growth, have enabled the Government to increase spending on priority programmes while at the same time achieving its objective of reducing public expenditure as a proportion of national income. This in turn has created room for reductions in ~~[the burden of]~~ taxation, helping to improve further the performance of the supply side of the economy. Public expenditure is considered more fully in Chapter 5.

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch

2 comments from Terry.

AA

Thanks: Good points.

Mr Allan,
I prefer version B.
2 drafting suggestions below so that
(i) we hint at last year's 1% without making too much of it
(ii) we take credit for gradualism

2.16 The Government has decided not to reduce taxes on this scale this year. This cautious approach takes account of the uncertainties in the revenue forecasts and minimises the risk of tax increases being required later on if revenues prove less buoyant than expected. The PSBR for 1988-89 is set at -[ ] billion, equal to -[ ] per cent of GDP, little changed from the expected outturn in 1987-88. Thereafter the PSBR is projected at zero, a balanced budget, which is equivalent to the objective of 1 per cent of GDP after adding back privatisation proceeds. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Version B of paragraphs 2.15 and 2.16

If privatisation proceeds are added back it is only 1 per cent of GDP

2.15 The PSBR is now assumed to be zero over the medium term: a balanced budget. This is a prudent and cautious level and can be maintained over the medium term. In practice, there are likely to be fluctuations around this level from year to year. // The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of [over £7 billion] in 1988-89. Continuing the gradualist approach which has always been a characteristic of the MTFS only part of this room for tax reductions has been used.

2.16 The PSBR for 1988-89 is set at [ ], little changed from the expected outturn in 1987-88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Assumptions

2.17 For the period to 1990-91, the public expenditure projections in Table 2.4 use the figures for the public expenditure planning total shown in the public expenditure White Paper (Cm 288); gross debt interest payments are lower than projected in the White Paper, reflecting lower government borrowing while other adjustments are a little higher. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1991-92. Decisions on expenditure in 1991-92 will be taken in the 1988 Survey.

~~2.09~~ (~~M...~~ 40)

Subject to section B of 2:15, I would also like to change 2:13 as indicated. Chart 2:3 is now there for historical purposes; there is no reference to it in the text.

1. SIR PETER MIDDLETON

2. CHANCELLOR

Many thanks. I am content with 3/1/2. I have also made a few changes to the text, & some comments on the pictures. N.

FROM: S J DAVIES
DATE: 23 February 1988

COPY NO 1 OF 20

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr Grice
Ms Turk
Mr Cropper
Mr Tyrie
Mr Call

S.J. DAVIES 23/2

FSBR CHAPTER 2: MTFS TEXT AND FISCAL PROJECTIONS

The purpose of this note is to seek provisional decisions on the medium term fiscal projections to be included in the MTFS and on the MTFS text. A draft of the whole MTFS is attached.

MTFS text

2. The early part of the text (up to paragraph 2.13) has been revised following your meeting of 18 February. The later sections on fiscal policy and the conclusion are new. There are virtually no numbers in the fiscal tables, and the text is provisional. Tables will be filled in and the text revised in the light of your comments and reactions to the fiscal projections. The preferred versions of the various charts are included in the text. Alternative versions are attached at the end. Points to note on the text include:

i) paragraph 2.09 does not refer to the pre-Christmas G7 agreement : to do so would take another sentence.

ii) the words in square brackets in paragraph 2.11 and 2.12 are possible additions to the draft you suggested.

iii) in paragraph 2.13 you deleted the word "desirable" in the second sentence; we have suggested "right" as a replacement.

iv) we have as agreed deleted the last sentence of the previous version of paragraph 2.13, which allowed for the case where there was heavy intervention towards the end of a financial year, which it would not be sensible to seek to sterilise immediately. We will need to make it clear in the budget briefing that the statement on this last point in last year's Mansion House speech still stands. We are also hoping that we will be able to include a more complete and detailed description of funding policy in the planned EPR article we are writing, though this will not be published until April.

(v) two alternative versions of paragraphs 15-16 are offered. The first version makes use of the argument that a zero PSBR is equal to the Government's long term objective of 1 per cent of GDP adjusted for privatisation proceeds.

Fiscal projections

3. We have prepared fiscal projections with the help of the revenue departments over the last week. These projections are still provisional, but the issues that they raise are fairly firmly established.

4. The prospects for 1987-88 and 1988-89 were discussed in Mr Sedgwick's submission to you of 18 February, and are subject to change as further information arrives. The current submission takes account of your objectives for the PSBR in 1988-89 ie it assumes revenue lower than in Mr Sedgwick's submission. Final decisions on the later years will have to wait until the details of the 1987-88 and 1988-89 revenue numbers have been settled.

below.

(a) General government expenditure

5. As agreed at your meeting of 4 February, the expenditure figures show the planning total as published in the PEWP for financial years 1988-89 and 1990-91. For 1991-92, the planning total is assumed to increase by 1½ per cent, giving a rise of about 1 per cent in general government expenditure.

6. Combining planning total figures as in the PEWP with the higher money GDP growth adopted in the MTFS implies a bigger fall in the ratio of general government expenditure to GDP than that shown in the PEWP (and also a bigger fall than likely to be achieved in practice). In addition, using planning total figures as in the PEWP in conjunction with revenue figures based on a higher rate of growth of money GDP can cause the prospect for tax cuts to be overstated.

7. We can alleviate both of these problems to some extent by shading up the components of general government expenditure that are outside the planning total: debt interest and other adjustments. But there is a limit to what we can do given our need to be able to justify in public any changes since the PEWP.

8. The expenditure figures shown in the PEWP were:

£ billion	1987-88	1988-89	1989-90	1990-91
1. Planning total	147.3	156.8	167.1	176.1
2. Debt interest	17.8	18.0	18.0	18.0
3. Other adjustments	7.5	8.0	8.0	8.0
4. General government expenditure	172.6	183.0	193.2	202.1
Memo: Implied unrounded sum of 2+3	25.3	26.2	26.1	26.0

9. The table below shows the broad implications for debt interest of revising the PSBR path from the flat +£1 billion a year that underlies the PEWP figures.

£ billion	1987-88	1988-89	1989-90	1990-91
New PSBR path	[-3]	[-3]	0	0
Cumulated change in borrowing from PEWP (end year)	-4	-8	-9	-10
Implied reduction in debt interest	-0.1	-0.5	-0.8	-0.9

10. Taking account of the implication of lower borrowing, we are thinking in terms of the following rounded expenditure figures for the MTFS:

(£ billion)	1988-89	1989-90	1990-91	1991-92
1. Planning total	157	167	176	184
2. Debt interest	18	17 18?	17 -1	17
3. Other adjustments	8	8	9 +1	9
4. General government expenditure	183	193	201	209

only if on the CMS adds up!

2+3 26 25 26

11. In rounded terms the general government expenditure figures are unchanged from the PEWP in 1988-89 and 1989-90, but £1 billion lower in 1990-91. They imply the following ratios of GGE excluding privatisation proceeds to GDP (to be published in Chapter 5 for the period up to 1990-91):

	1988-89	1989-90	1990-91	1991-92
GGE excluding privatisation proceeds as percentage of GDP*	41(42)	40½(41¾)	40(41¼)	39½

*PEWP ratios shown in brackets.

The ratio for 1987-88 is now put at 41½, compared with 42½ in the PEWP; thus this path of expenditure gives a fall in the ratio in each year from 1987-88 to the end of the MTFS.

(b) **Revenue**

12. After taking account of the Budget package (as in the scorecard of Thursday 18 February), and also of:

(i) an assumed PSBR path flat at zero after 1988-89

(ii) forecasts of likely expenditure levels, given MTFS economic assumptions

(iii) central forecasts of revenue, given MTFS assumptions,

our current projections of general government revenue and expenditure, and of the available fiscal adjustments are:

(£ billion)	1987-88	1988-89	1989-90	1990-91	1991-92
General government expenditure	171.6	183.4	192.0	201.5	211.9
General government receipts (pre fiscal adjustment)	174.0	187.3	198.3	207.0	217.7
Public corporations' market and overseas borrowing	-0.9	-1.2	-0.5	-0.1	0
Cumulated fiscal adjustment	-	-	6.8	5.6	5.8
PSBR	-3.4	-5.1	0	0	0

The implied annual fiscal adjustments are (to the nearest £1 billion) :

1989-90	1990-91	1991-92
7	-1	0

The implied non-North Sea tax burden is as follows:

Non-North Sea taxes as percentage of non oil GDP

	1987-88	1988-89	1989-90	1990-91	1991-92
pre-package	37.5	38.9	39.3	39.0	39.2
post-package	37.5	38.1	38.1	37.5	37.6

13. The large underlying rises in the tax burden between 1987-88 and 1989-90 reflect the effect of real fiscal drag on income tax payments, very strong growth in corporation tax receipts, and also large increases in local authority rates. Thereafter the pre-Budget tax burden is projected to be static: although real fiscal drag continues to boost income tax, sluggish profits and rising depreciation allowances cause corporate tax receipts to weaken. Adjusted so as to remove the effect of tax cuts in successive budgets, the non-oil tax burden can be seen to have shown strong underlying growth since 1985-86:

Non-oil tax burden at constant tax rates

1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
35.5	35.6	35.4	35.9	36.6	38.1

(NB the adjustments made to derive the tax burden at constant tax rates are only approximate.)

14. Your decisions on the PSBR to be shown in 1988-89 mean that the revenue total published for that year will be below the forecasters' central estimate. Taking that adjustment on into later years will reduce published revenue in those years, and will also reduce the projected fiscal adjustments. On the other hand, using the PEWP planning total figures, rather than realistic forecasts of expenditure, tends to raise the projected fiscal adjustments, particularly in the later years of the MTFS.

excellent!

15. The net effect of taking on both the adjustment to revenue and the PEWP planning total path (with the upward adjustment to other components of expenditure discussed in paragraph 7) is to reduce substantially the annual fiscal adjustment projected for 1989-90, and to raise the annual fiscal adjustments shown for later years. The cumulative fiscal adjustment over the three years to 1991-92 is the same as the forecast fiscal adjustments shown in paragraph 12. The annual fiscal adjustments and tax burdens (pre and post package) are shown below:

Fiscal adjustment and tax burden with adjusted revenue and PEWP planning total

	1988-89	1989-90	1990-91	1991-92	
Annual fiscal adjustments		4	1 0	1 2	better.
Non oil tax burden: pre package	38.5	38.9	38.5	38.7	
post package	37.6	37.6	37.0	37.1	

16. Reducing the annual fiscal adjustment in 1989-90 and raising that in 1990-91 so that both lie within the £1-3 billion range we might normally expect to show in the MTFS will require only a limited amount of smoothing of revenues. Taking the MTFS period as a whole we will not want to "hide" revenue (beyond the adjustment to revenue made in 1988-89).

17. It is worth noting that adopting last year's MTFS assumption about revenues - that post-Budget non-North Sea revenues would grow in line with non-North Sea GDP - will not be helpful this year:

- as the tax burden figures in paragraph 1~~4~~5 imply, a flat tax burden gives a very high (£4 billion) fiscal adjustment in 1989-90.

- a flat tax burden over the whole MTFS period will give a rather high cumulative fiscal adjustment - some £2-3 billion above what we would actually forecast.

18. If we want to describe the revenue projections as an assumption, a variant on last year's practice would be to assume that pre-budget non oil revenues rise in line with non-oil money GDP. This gives the following path for the fiscal adjustment and the non-oil tax burden.

	1988-89	1989-90	1990-91	1991-92
Annual fiscal adjustments		2	1	1
Non-oil tax burden: pre package	38.5	38.5	38.5	38.5
post package	37.6	37.2	37.0	36.9

The disadvantages with this are:

- the cumulative fiscal adjustment is on the low side (although it could be shaded up to £5 billion rather than 4 by marginal changes to the expenditure projections)

- it will permit approximate calculations to be made of the third and fourth year effects of the package.

19. Last year was the first time the MTFS revenue projections were described as an "assumption", and there is no need to describe them as such again this year. Relatively small amount of smoothing of the forecast path of revenue would leave us with a run of fiscal adjustments of

1989-90	1990-91	1991-92
3	1	2

This would imply a small (0.2 percentage point) fall in the tax burden (post-package) in 1989-90. It would not be too difficult to explain this in terms of the published second year revenue effects of the package.

20. In order to proceed further with the fiscal projections it would help if you can give your views on the following:

- Do you want to the revenue path to be derived as an "assumption" this year?

- If not, should we work towards a fiscal adjustment path of 3, 1, 2?

3, 1, 1
or 4, 1, 1 ?

SJD

S J DAVIES

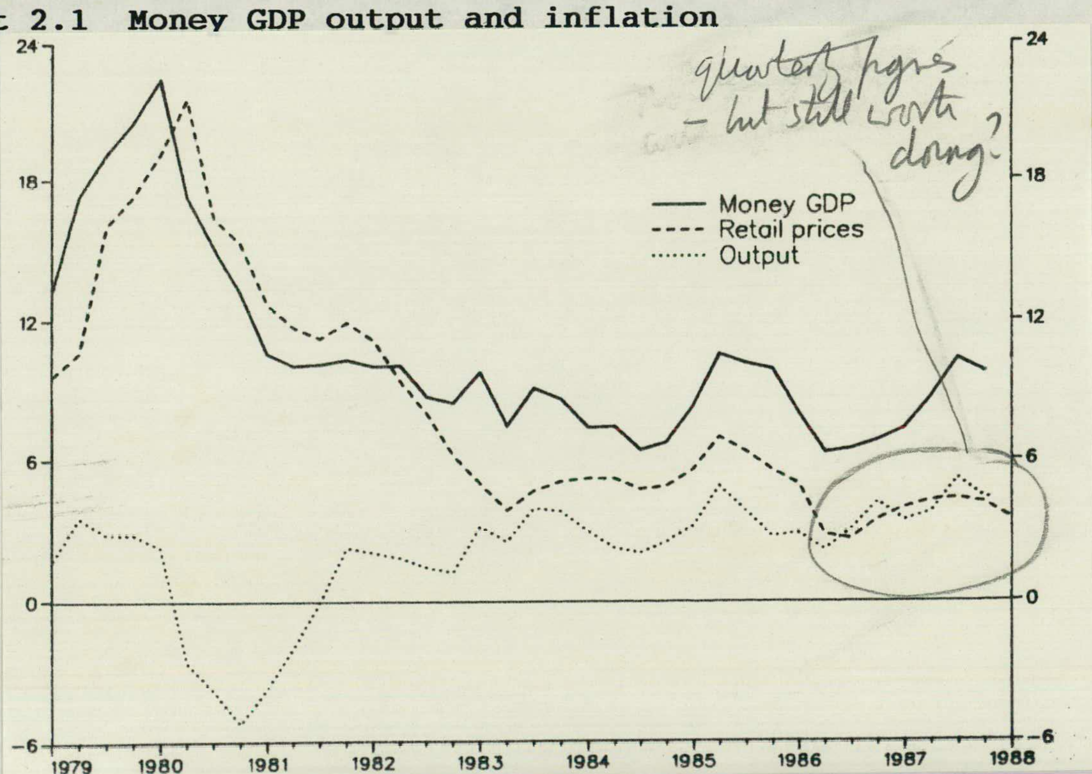
MEDIUM TERM FINANCIAL STRATEGY

2.01 The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980.

2.02 It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. Accordingly, economic policy is set in a nominal framework. Monetary and fiscal policies are designed to keep the growth of money GDP on a downward trend over the medium term. The MTFS is complemented by policies to improve the working of markets and the supply side of the economy. By encouraging enterprise, efficiency and flexibility, these policies improve the division of money GDP growth between output growth and inflation, thus assisting the creation of jobs.

2.03 Money GDP growth has come down from over 20 per cent at the start of 1980 to under 10 per cent last year. At the same time inflation has fallen from over 20 per cent at its peak in 1980 to around 4 per cent last year. In real terms the economy has grown steadily at around 3¼ per cent a year on average since 1983, and is set for a further year of growth at around 3 per cent, with inflation remaining around 4 per cent.

Chart 2.1 Money GDP output and inflation



Objectives and the framework of policy

2.04 Policy is directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term. Table 2.1 shows the intended medium term path for money GDP, although there will inevitably be fluctuations around it in the short term.

Table 2.1: **Money GDP Growth***

1987-88	1988-89	1989-90	1990-91	1991-92
9¾	7½	6½	6	5½

* Per cent change on previous financial year. See Table 2.3 for assumptions on output and inflation. The figure for 1988-89 is a forecast; the figures for subsequent years describe the Government's broad medium term objectives.

2.05 Money GDP growth is expected to be around 9¾ per cent in 1987-88, higher than forecast in last year's FSBR. The main reason for this was substantially stronger real growth, which is currently estimated at 1½ per cent above last year's forecast; inflation (as measured by the GDP deflator) is also estimated to have been a little higher in 1987-88 than was forecast last year.

2.06 For 1988-89, money GDP growth is forecast to be 7½ per cent. Real growth is forecast to slow down from its 1987-88 level, but to remain higher than projected in last year's FSBR. The current forecast for the increase in the GDP deflator in 1988-89 is similarly a little above the projection in last year's MTFS.

2.07 For the later years, the growth of money GDP is projected to decline at the same rate as envisaged last year. The medium term growth projection for the economy as a whole is unchanged from last year's MTFS, as is the medium term decline in inflation.

2.08 A declining path for money GDP growth, as in Table 2.1, requires firm monetary policy supported by prudent fiscal policy. Fiscal policy is reviewed each year at budget time. Short-term interest rates, which are varied more frequently, are used to keep monetary conditions on track.

Monetary Policy

2.09 As the Chancellor made clear at the Mansion House last year, the Government is committed to maintaining a stable exchange rate, with the rate against the deutschemark being of particular importance. This provides an important financial discipline, and is also helpful to industry. ~~There was an extended period of general currency stability following the agreement between the major industrial nations at the meeting in Paris in February 1987. Despite the subsequent fall in the dollar towards the end of 1987, and despite significant market pressure at times, sterling has been [kept] broadly stable against the deutschemark over the whole of the past year.~~ ~~Maintaining~~ a stable exchange rate ~~this stability in future will~~ provides the ~~basis~~ for the declining path for money GDP growth and inflation.

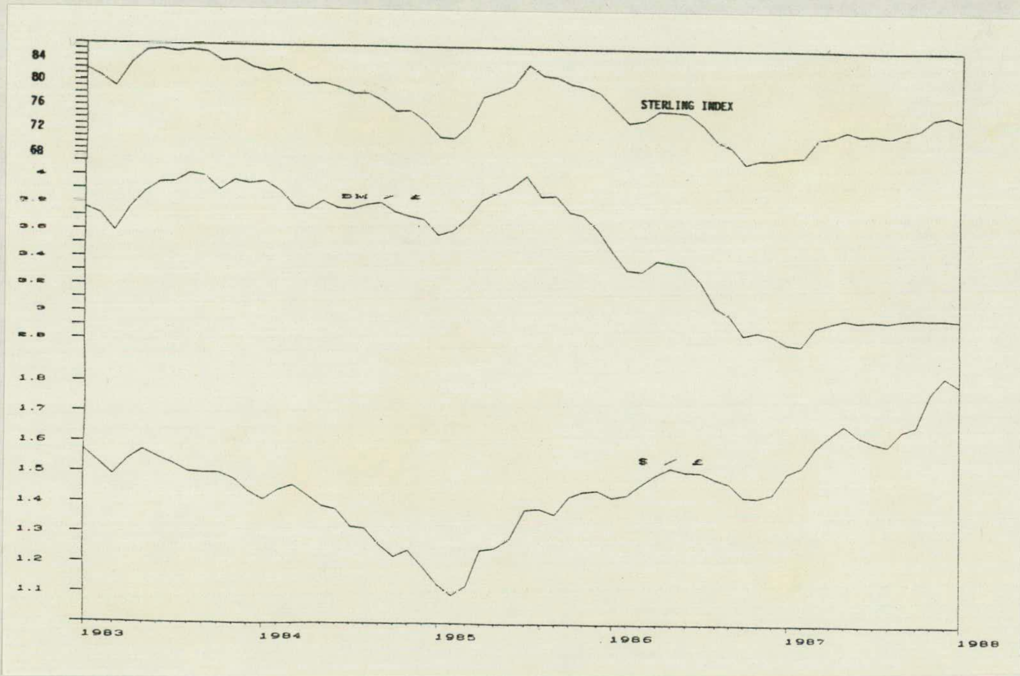
Sterling has remained stable against the Deutschemark throughout the last year, following the Louvre accord in February 1987.

underpinning

The discipline of

This won't do at all. Pse speak

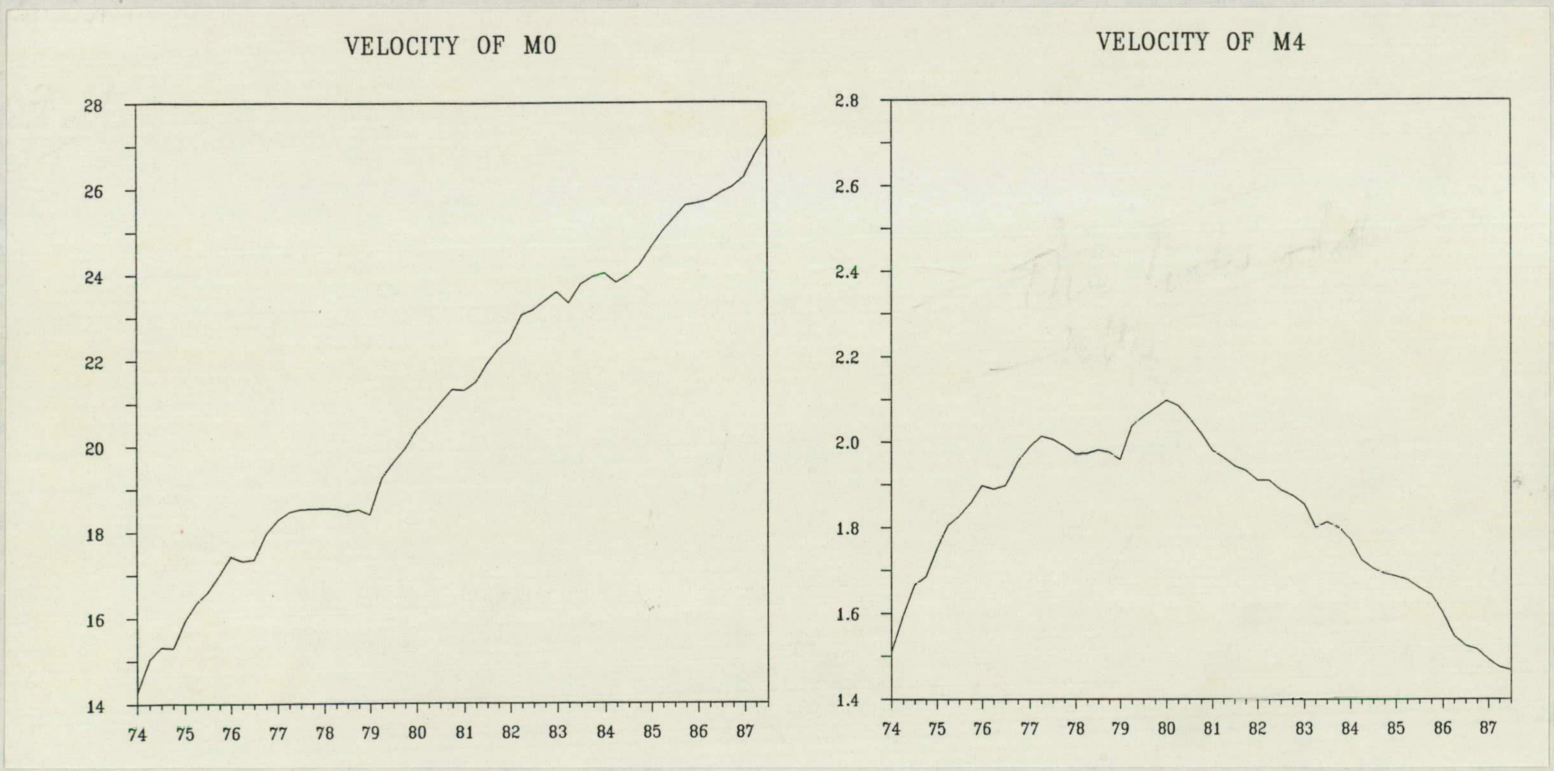
Chart 2.2 Sterling exchange rates



2.10 Achieving these objectives implies a reduction in monetary growth over the medium term. For MO, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988-89 of 1-5 per cent [2-6 per cent]. This is the same as indicated in last year's MTFS. [This is the same as last year's range.] The ranges given in Table 2.2 for later years are illustrative, but show a steady fall consistent with the declining path for money GDP growth.

2.11 Interest rate decisions are based on a continuous and comprehensive assessment of ~~[all the indicators of]~~ monetary conditions so as to ensure that inflationary pressures are not accomodated. This means, in particular that increases in domestic costs will not be accommodated by a decline in the exchange rate.

Chart 2.3 Velocity of monetary aggregates



These cd be much better as a single graph with 2 lines

Looks a bit odd, but maybe OK

this cd be dropped altogether if we have space problems

Table 2.2: **Growth of MO***

1987-88	1988-89	1989-90	1990-91	1991-92
5	[1-5]	1-5	0-4	0-4

* Per cent change on previous financial year. 1987-88 is a forecast. 1988-89: target range. 1989-90 onwards: illustrative ranges.

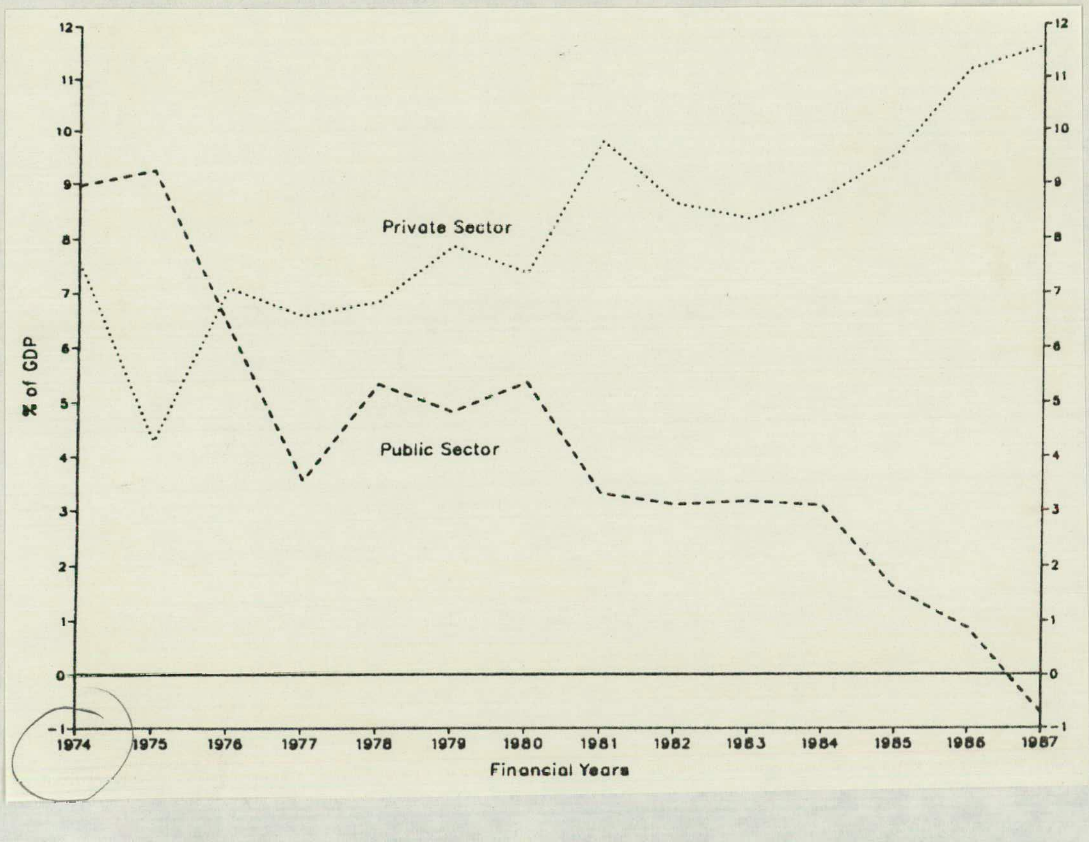
continues to

2.12 While, as last year, there is no explicit target range for broad money, the assessment of monetary conditions take~~s~~ ~~[the behaviour of]~~ broad money, or liquidity, into account.

2.13 With the increasing overlap between activities of banks and building societies, it is sensible to concentrate on measures of broad money, such as M4, that include deposits held with both. ~~Nor is it [right] in funding policy to distinguish between sales of debt to banks and sales to building societies.~~ Equally ~~So~~ the authorities will seek ~~[in 1988-89]~~ to fund the total of maturing debt, the PSBR, and any net increases in foreign exchange reserves resulting from market ~~intervention~~ transactions, by sales of debt outside the banking and building society sectors.

PEM's amendments

Chart 2.4 Private and public sector borrowing



BUDGET SECRET: TASK FORCE LIST

Fiscal policy

Even if there had been no

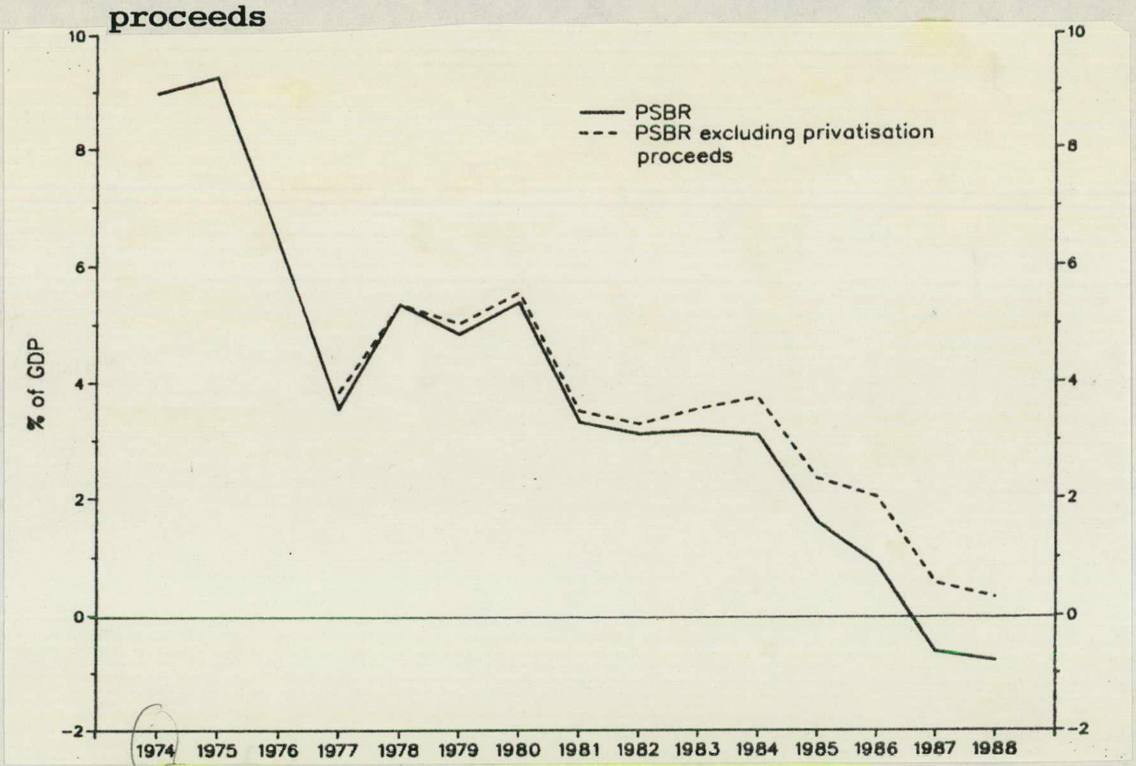
2.14 It is now expected that there will be a net repayment of public debt in 1987-88, compared with a borrowing requirement of around 1 per cent of GDP forecast a year ago. This is only the [~~first~~ second] time since the War that there has been a budget surplus [~~since 1969-70~~]. The borrowing requirement after adding back privatisation proceeds will be equal to under ½ per cent of GDP, smaller ~~in relation to GDP~~ than in any year since 1969-70.

at all the PSBR would have been under

Chart 2.5 Public sector borrowing requirement and privatisation proceeds

See alternatives @ X

I agree: take back to 1971



Version A of paragraphs 2.15 and 2.16

The PSBR path 2.15 The Government's long term objective for the PSBR is for it to equal 1 per cent of GDP. The recent strength of the economy and the buoyancy of government revenues have already reduced borrowing well below this level; and on present forecasts tax reductions of [over £7 million] would have been needed in order to achieve a PSBR of 1 per cent of GDP after adding privatisation proceeds.

Don't like this version

2.16 The Government has decided not to reduce taxes on this scale this year. This cautious approach takes account of the uncertainties in the revenue forecasts and minimises the risk of tax increases being required later on if revenues prove less buoyant than expected. The PSBR for 1988-89 is set at -[ ] billion, equal to -[ ] per cent of GDP, little changed from the expected outturn in 1987-88. Thereafter the PSBR is projected at zero, a balanced budget, which is equivalent to the objective of 1 per cent of GDP after adding back privatisation proceeds. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

It also provides a clear and simple rule, with a good historical pedigree. In

Version B of paragraphs 2.15 and 2.16

Better

2.15 The PSBR is now assumed to be zero over the medium term: a balanced budget. This is a prudent and cautious level and can be maintained over the medium term. In practice, there are likely to be fluctuations around this level from year to year. /P The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of [over £7 billion] in 1988-89. [add TB sentence here]

On the basis of current privatisation plans, a PSBR of zero implies that, without any privatisation proceeds, it would be only 1 per cent GDP.

2.16 The PSBR for 1988-89 is set at [ ], little changed from the expected outturn in 1987-88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Assumptions

2.17 For the period to 1990-91, the public expenditure projections in Table 2.4 use the figures for the public expenditure planning total shown in the public expenditure White Paper (Cm 288); gross debt interest payments are lower than projected in the White Paper, reflecting lower government borrowing while other adjustments are a little higher. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1991-92. Decisions on expenditure in 1991-92 will be taken in the 1988 Survey.

2.18 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.3. They are consistent with the figures for money GDP growth in Table 2.1. Oil prices are assumed to ~~remain close to recent levels~~ in 1988-89 and thereafter to remain broadly unchanged in real terms.

or $15

average $15 a barrel

Table 2.3	Output and inflation assumptions				
	Percentage change on previous financial year				
	1987-88	1988-89	1989-90	1990-91	1991-92
Real GDP					
Non North Sea	5	3	3	3	3
Total	4½	2½	2½	2½	2½
Inflation					
GDP deflator	5	4½	4	3½	3

Public expenditure

continuation total

2.19 ~~The Government's objective is to reduce public spending as a proportion of national income. With a balanced budget, this reduction in public expenditure will create room for reductions in the burden of taxation, helping to improve further the supply side of the economy. Public expenditure is considered more fully in Chapter 5.~~

much better | See redraft

Table 2.4	General government expenditure					
	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Public expenditure planning total[1]						
Gross debt interest						
Other adjustments						
General government expenditure[2]						
of which Privatisation proceeds[3]						
General government expenditure excluding privatisation proceeds						

[1] For 1986-87 to 1990-91, the figures are taken from Table 5.1.

[2] General government expenditure, and its components, are rounded to the nearest £1 billion from 1987-88 onwards. General government expenditure is assumed to grow by 1% in real terms in 1991-92.

[3] See the public expenditure White Paper (Cm 288), Table 1.8. Proceeds are assumed to be the same in cash terms in 1991-92 as in 1990-91.

Revenue

2.20 The growth in government revenues [~~in cash terms~~] over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, [general government receipts are expected to increase somewhat less than money GDP. Government revenues from the North Sea are projected to decline as oil output falls. Non-North Sea revenues are projected to grow at around the rate of growth of non oil money GDP.]

Table 2.5 **General government receipts**

	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Taxes on incomes, expenditure and capital						
National insurance and other contributions						
Interest and dividends						
Other receipts						
General Government receipts[1]						
of which North Sea tax[2]	4.8	5	4	4	3	3

[1] General government receipts, and its components, are rounded to the nearest £1 billion from 1987-88 onwards.

[2] Royalties, petroleum revenue tax (including advance payments) and corporation tax from North Sea and gas production (before advance

corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 3 to Table 6B.3.

Public sector borrowing

2.21 The projections of government expenditure and receipts are brought together in Table 2.6 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.22 Changes since the 1987 MTFS are discussed in the Annex to this chapter.

Table 2.6 **Public sector borrowing**[1]

	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
General government expenditure						
General government receipts						
Fiscal adjustment from previous year[2]						
Annual fiscal adjustment[2]						
GGBR						
Public corporations' market and overseas borrowing						
PSBR	3.4	-[ ]	-[ ]	0	0	0
Money GDP at market prices	387	426	457	487	516	545
PSBR as per cent of GDP	0.9	-[ ]	-[ ]	0	0	0

[1] Rounded to the nearest £1 billion from 1987-88 onwards. Further details for 1987-88 and 1988-89 are provided in Tables 1.2 and 6.7.

[2] Means lower taxes or higher expenditure than assumed in lines 1 and 2.

Conclusion

2.23 [~~Money GDP growth has been higher than forecast over the last year, with real growth in the economy substantially above expectations. Both nominal and real GDP growth are forecast to decline over the next year. The assumptions on which the medium-term projections are based may have to be modified in the light of events. But the government remains committed to reducing money GDP growth over the medium term, and to reducing the ratio of public expenditure and taxation to GDP. The MTFS provides the financial framework within which the policies to achieve these objectives are set.~~]

Use ms version

The strength of the economy ~~and of Government revenues in particular~~ coupled with fiscal prudence has enabled the Government to achieve a balanced budget ~~substantially earlier than had previously seemed possible~~ on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress towards lower inflation, ~~and~~ lower taxes and lower public spending as a share of GDP in the medium term. The MTFS provides the financial framework within which the policies to achieve these objectives are set.

ANNEX TO CHAPTER 2

Changes since the 1987 MTFS

Money GDP

2A.1 The growth rate of money GDP is expected to be higher in both 1987-88 and 1988-89 than envisaged in last year's MTFS, with growth in the GDP deflator ½ percentage point higher in both years. Thereafter inflation is projected to decline at the same rate as last year. The projection of output growth over the medium term in the whole economy is unchanged from last year's MTFS.

Table 2A.1 **Money GDP growth**

Differences from 1987 MTFS projections, percentage points

1987-88	1988-89	1989-90	1990-91
+2¼	+1	+½	+½

Monetary aggregates

2A.2 The growth in MO in 1987-88 has been within its target range throughout the year. The target range for 1988-89 [is the same as the illustrative range given last year]. The illustrative ranges for subsequent years are [also] the same.

Table 2A.2 **The growth of MO**

	Per cent changes on a year earlier			
	1987-88	1988-89	1989-90	1990-91
1988 MTFS	5	[1-5]	1-5	0-4
1987 MTFS	2-6	1-5	1-5	0-4

Fiscal projections

2A.3 Table 2A.3 shows changes in the fiscal projections since the 1987 FSBR. Additional information on 1987-88 is given in Chapter 6.

Expenditure

2A.4 The expected undershoot on the planning total in 1987-88 is described in Chapter 5. General government expenditure is also lower in 1987-88 than projected last year, reflecting the lower planning total. The planning total for 1988-89 onwards is as in the public expenditure White Paper (Cm 288), which incorporates higher figures than assumed last year. The general government expenditure figures for the future have also been revised up; but to a lesser extent than the planning total, as the lower path now adopted for the PSBR implies substantially lower debt interest payments.

Receipts

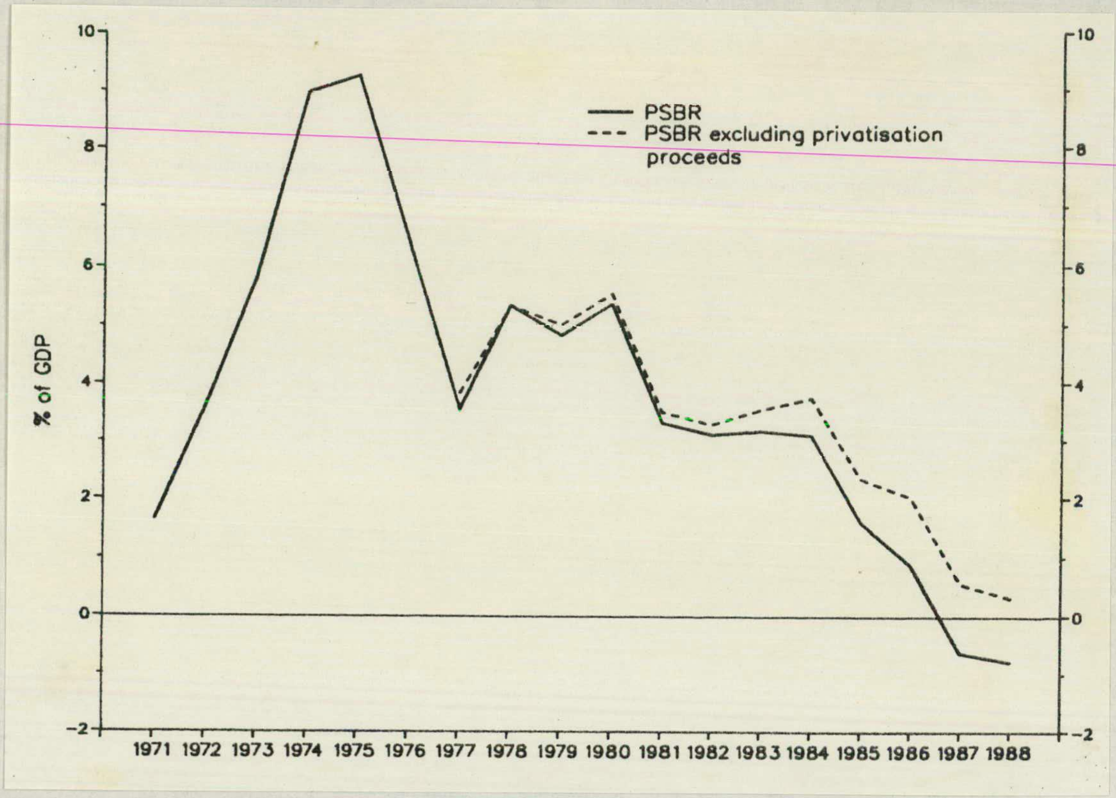
2A.5 Revenues in 1987-88 have been much higher than forecast, in large part reflecting higher money GDP growth in both 1986-87 and 1987-88. Because of the lag between accruals and payments of taxes on corporate profits, the buoyancy of the economy over the last year will still be contributing to the growth of revenues in 1988-89. North Sea revenues in 1987-88 were slightly higher than forecast, as the oil price for much of the year was well above the assumed level of $15 a barrel. On the assumption that oil prices remain close to recent levels, oil revenues in 1988-89 are now forecast to be much as projected a year ago.

Table 2A.3

Revenue and expenditure

	Changes from 1987 MTFS projections £billion				
	1986-87	1987-88	1988-89	1989-90	1990-91
Expenditure					
1 Planning total	-1	-2½			
2 Other	+1	+½			
3 General government expenditure	0	-2			
Receipts					
4 North Sea taxes	0	+½			
5 Other taxes and contributions	+½	+4			
6 Other	+½	+1			
7 General government receipts	+1	+5½			
8 Implied cumulative fiscal adjustment	-	-			
9 Public corporations' market and overseas borrowing	0	0			
10 PSBR	-1	-7½			

Chart 2.5 taken back to 1971



I vote for this one

Chart 2.5 Bar chart back to 1974

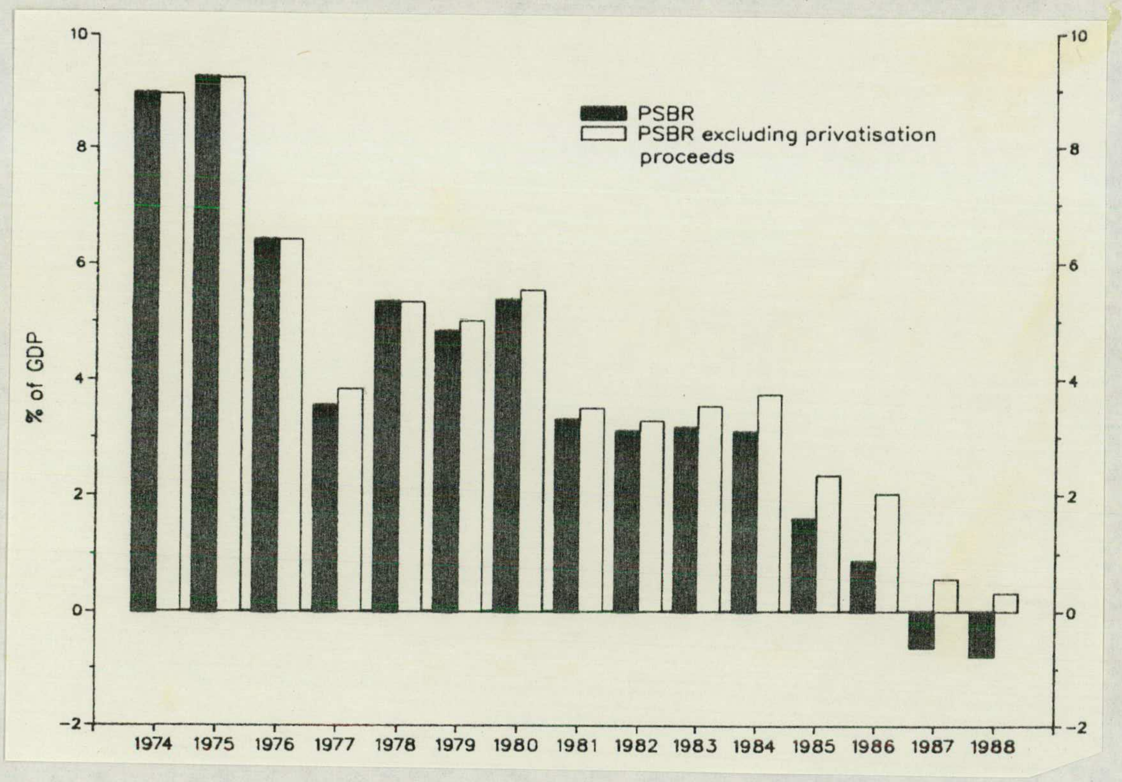


Chart 2.5 Bar chart back to 1971

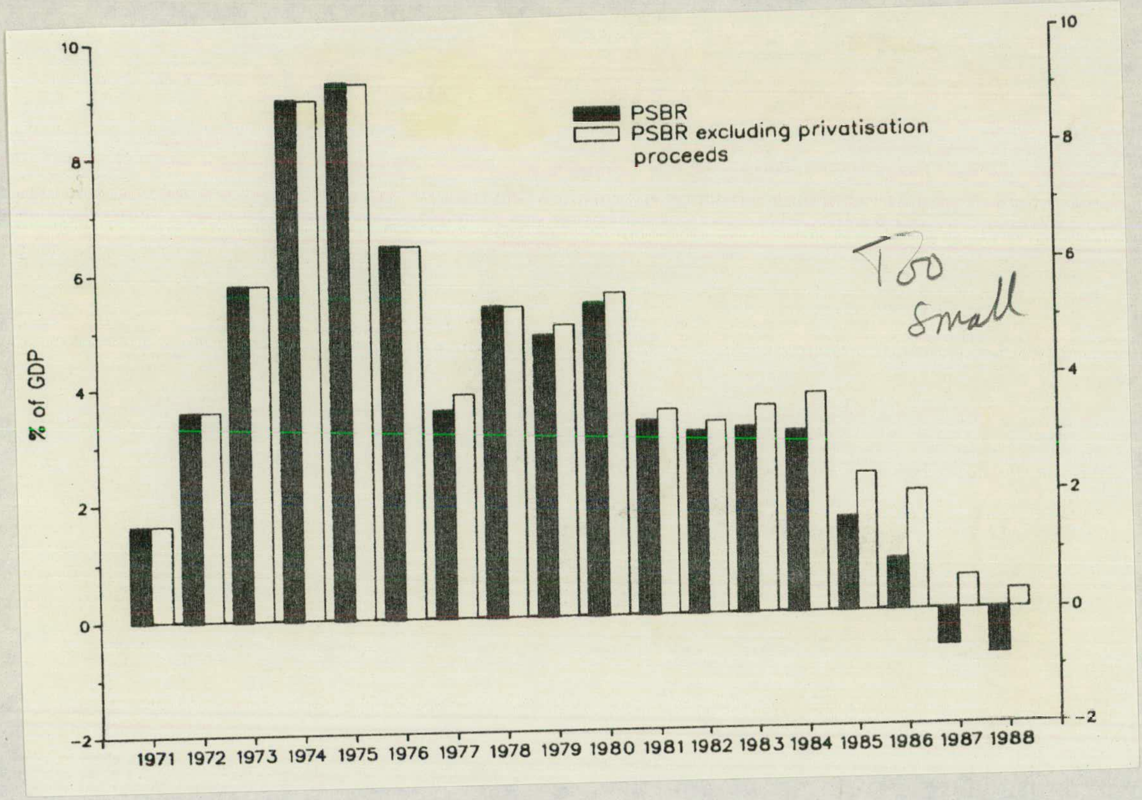
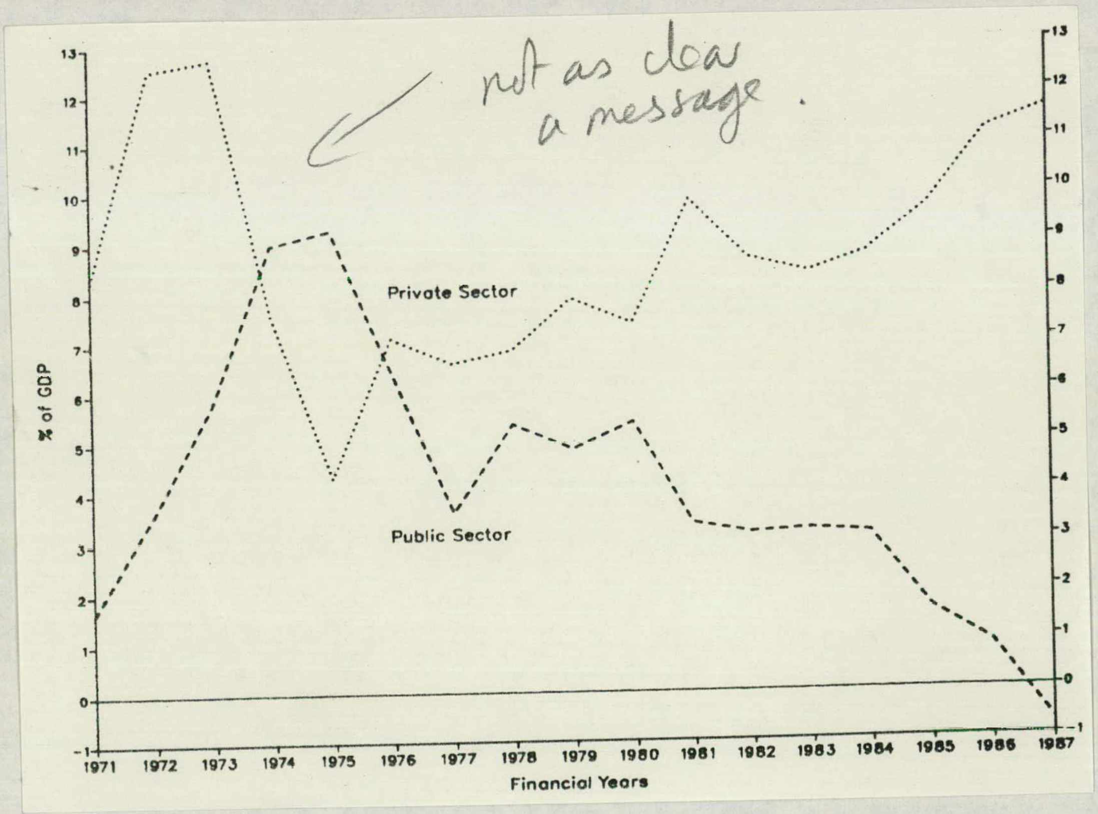


Chart 2.4 Back to 1971



31/952

Covering BUDGET CONFIDENTIAL

The precise wording of paragraph 5.05 will need some further revision in the light of our continuing discussions with the departments concerned. But this does not affect the rest of the Chapter.

FROM: MRS R J BUTLER
DATE: 24 February 1988

1. MR ~~ANSON~~ A 24/2

Copies attached for:
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton

2. CHANCELLOR OF THE EXCHEQUER

cc Sir T Burns
Mr Hayden Phillips
Mr Scholar
Mr Sedgwick
Mr Odling-Smee
Mr Turnbull
Mr S Davies
Mr Mowl
Miss C Evans

FSBR: CHAPTER 5

The attached draft of the public expenditure chapter for the FSBR has been prepared on the same lines as last year's version.

2. A stronger link to the rest of the FSBR has been included in the first paragraph and the explanation of the differences between the planning total and GGE has been omitted.

3. The structure of the tables is also unchanged apart from some modifications to Table 5.1 where the ratio of public spending to GDP is given in terms of general government expenditure excluding rather than including privatisation proceeds and the real terms figures relate to GGE excluding privatisation proceeds rather than to the planning total. We have reverted to the 1986 FSBR listing of departments and included those spending over £10 billion and the territories because the 1987 FSBR selection, chosen after various exchanges of view, did not have much coherence and included a very large block for "other departments". We could, if you wished, go further and include the other two programmes of over £5 billion in 1988-89, namely Home Office and legal departments and Transport. This reduces the "other departments" from 22 per cent to 14 per cent of public expenditure.

I remember having heated arguments with Andrew Turnbull.

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4. The figures for the estimated outturn for the 1987-88 planning total are based on GEP's February assessment and will, of course, continue to change over the next few weeks. As last year, GEP will send a submission to the Chief Secretary giving him the results of an early March re-assessment of the estimated outturn asking him to clear a planning total for publication in the FSBR. The figures for and references to individual departments will be cleared with departments nearer the time. The figures for debt interest, national accounts adjustments and GGE will also continue to change as the Budget figuring is finalised.

5. We are sending Chapter 5 to the printer on Friday. It would therefore be helpful to have your comments as soon as possible.

RJButler

MRS R J BUTLER

2/959

Covering BUDGET CONFIDENTIAL

DRAFT
24/2/88

1988 FSBR

5. PUBLIC EXPENDITURE

5.01 ~~As discussed~~ explained ~~in Chapter 2 the Government's objective is to keep the growth of public expenditure below that of the economy as a whole.~~

ADD PARA 5.02 FROM NEXT PAGE

Public spending ~~plans~~ trends

5.0~~2~~3 ~~General government spending as a percentage of GDP has fallen from around 47 per cent in 1982-83 to below 42 per cent and it is planned that this decline should continue.~~

The reductions in the burden of debt interest, in unemployment and in subsidies to industry have helped make room for these increases while maintaining the Government's policy of reducing the share of national income taken by public expenditure. General government spending excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982-83 to below 42 per cent now. This fall is planned to continue.

~~5.03 The detailed plans, providing the basis for the Supply Estimates, cash limits and other spending controls for 1988-89, were set out in the 1988 public expenditure White Paper (Cm 288-I and II). These plans are summarised in Table 5.1.~~

Acc. to Table 5.1, the 42 has gone down to 41½, & there is a year's pause before the fall continues. Some redrafting looks necessary.

The Government's expenditure plans were set out in the 1988 Public Expenditure White Paper (Cm 288). These plans are summarised in Table 5.1. The Budget makes ~~not~~ no change to these ~~proposals~~ plans, apart from two consequentials of the tax proposals, described in paragraph 5.05.

Table 5.1 Public expenditure

Probably OK this year
Last year we identified
Home Office and Employment,
but not territories.

	£ billion				
	1986-87 Outturn	1987-88 Estimated outturn	1988-89 Plans	1989-90 Plans	1990-91 Plans
Department					
DHSS - social security	44.4	[46.3]	48.5	51.1	53.6
DHSS - health and personal social services	17.9	[19.7]	20.7	21.7	22.7
Defence	18.1	[18.7]	19.2	20.0	20.6
Education and science	15.7	[17.1]	18.0	18.6	19.2
Scotland, Wales and Northern Ireland	15.4	[16.4]	17.1	17.5	17.9
Other departments	32.0	[33.2]	34.9	36.2	36.7
Privatisation proceeds	-4.4	[-5.0]	-5.0	-5.0	-5.0
Reserve			3.5	7.0	10.5
Public expenditure planning total	**139.2**	**[146.4]**	**156.8**	**167.1**	**176.1**
General government gross debt interest*	17.6	[17.5]	[17.5]	[17]	[17]
Other adjustments*	8.0	[8.1]	[8.4]	[8]	[9]
General government expenditure*	**164.8**	**[171.6]**	**[183.0]**	**[193]**	**[201]**
General government expenditure excluding privatisation proceeds					
In real terms (base year 1986-87)	**[169.2]**	**[168.2]**	**[171.4]**	**[173.5]**	**[174.4]**
As a percentage of GDP	**[43¾]**	**[41½]**	**[41¼]**	**[40¾]**	**[40]**

*1989-90 and 1990-91 figures rounded to the nearest £1 billion

Changes since previous Budget

5.0~~1~~2 Since the last FSBR, extra resources have been allocated to priority services such as health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also been increased.

Budget measures

5.05 Two of the Budget measures have consequences for public expenditure. In parallel with the abolition of tax relief on new covenants between individuals, including covenants to students - see paragraph 4.A, the parental contribution scale is being revised ~~reduced by [*] per cent~~ for those starting their studies ~~courses~~ from the 1988-89 academic year onwards. This will cost some £20 million in 1988-89, rising to £80 million in 1991-92. In parallel with the change in the tax treatment of forestry - see paragraph 4.B, there will be an increase in grants to forestry estimated to cost about £x million in 1989-90 rising to £y million in 1991-92. The expenditure arising from these changes will be charged to the Reserve ~~within~~ and will not add to the Planning Totals.

1987-88 outturn

5.06 The latest estimates for the outturn for the planning total in 1987-88, which are still ~~, which still remain~~ subject to some uncertainty, suggest that it ~~the planning total outturn in 1987-88~~ is likely to be about £[146.4] billion, £[2.2] billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £[0.9] billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2.

What this means, I take it, is that of the £3½bn reserve provision, only £1.3bn is now thought to be required. This point is worth making.

~~5.07 The plans included an unallocated Reserve of £3.5 billion. This is higher than the net additions to departmental programmes which amount to only £[1.4] billion.~~

Table 5.2 Comparison of plans and estimated outturn for 1987-88

	1987-88 £ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government[2]	108.3	[109.5]	[+1.2]
Local authority[2]	40.2	[41.0]	[+0.8]
of which:			
relevant expenditure	31.0	[32.2]	[+1.3]
other current	4.9	[5.1]	[+0.1]
capital	4.3	[3.7]	[-0.6]
Nationalised industries and other public corporations	1.6	[1.0]	[-0.6]
Privatisation proceeds	-5.0	[-5.0]	
Reserve	3.5		[-3.5]
Public expenditure planning total	**148.6**	**[146.4]**	**[-2.2]**

[1]Plans from The Government's Expenditure Plans 1987-88 to 1990-91, Cm 56, adjusted for classification changes.
[2]Excluding finance for nationalised industries and other public corporations

5.08 The major changes between plans and estimated outturn for particular programmes are

a net increase of £[1.2] billion in central government expenditure mainly due to an increase in expenditure by DHSS on Health and Personal Social Services of £[0.6] billion and higher net payments to the European

(reflecting the cost of the 1987 nurses and doctors and dentists pay settlements), Communities (£[0.8] billion) offset by lower payments by the Intervention Board for Agricultural Produce (£[0.3] billion);

an ~~increase~~ overspend of £[1.4] billion ~~in~~ on the plans for local authority current expenditure

~~an increase of £[0.4] billion in gross capital expenditure more than offset by higher than expected capital receipts of local authorities £[1.0] billion~~

a net underspend of £[0·6] billion on local authority capital expenditure, reflecting £[0·4] billion higher gross spending, more than offset by £[1·0] billion higher capital receipts. The net underspend is £[ ] billion greater than that shown in the public expenditure White Paper.

better ~~than expected~~ results for nationalised industries and other public corporations, by £[0.6] billion, due principally to higher profitability of British Steel and increased capital receipts from New Towns £[0.2] billion

expenditure by DHSS on social security is now estimated to be £[ ] billion above last year's plans; this is £[0·2] billion below the estimate in the public expenditure White Paper.

~~5.09 The main changes contributing to the drop of £[0.9] billion since the 1988 public expenditure White Paper are~~

~~a decrease of £230 million in expenditure by DHSS-Social Security due to lower unemployment~~

~~a decrease of £130 million in Ministry of Defence spending~~

~~a decrease of over £100 million on housing expenditure by the Department of the Environment~~

~~a decrease of £70 million in local authority capital expenditure~~

Table 5.3 Public expenditure by spending authority

£ billion	1986-87 Outturn	1987-88 Estimated outturn	1988-89 Plans	1989-90 Plans	1990-91 Plans
Central government*	104.6	[109.5]	114.2	120.2	124.7
of which:					
Voted in Estimates	73.4	[77.0]	81.0	84.6	87.6
other	31.2	[32.6]	33.2	35.6	37.1
Local authorities*	37.9	[41.0]	42.6	44.0	45.2
of which:					
relevant expenditure	29.4	[32.2]	33.2	34.3	35.4
other current	4.8	[5.1]	5.4	5.7	5.9
capital	3.7	[3.7]	4.0	4.0	3.9
Nationalised industries	0.4	[0.4]	0.7	0.0	-0.4
Other public corporations	0.8	[0.6]	0.8	1.0	1.0
Privatisation proceeds	-4.4	[-5.0]	-5.0	-5.0	-5.0
Reserve			3.5	7.0	10.5
Public expenditure planning total	**139.2**	**[146.4]**	**156.8**	**167.1**	**176.1**

*Excluding finance for nationalised industries and other public corporations

Public expenditure by spending authority

5.10 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social security payments paid out of the National Insurance Fund. Spending by local authorities accounts for about one quarter of public expenditure. Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

Supply Estimates

5.11 For 1988-89, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1988-89 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1988-89 are published in a series of booklets on 15 March 1988 with a Summary and Guide (Cm [ ]) which explains the Supply procedure and summarises the Estimates. It also explains how they relate to the public expenditure planning total.

5.12 Of the £[108.3] billion included in the Supply Estimates, £[83.0] billion is direct public expenditure. The remaining £[25.3] billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public expenditure. [Nearly 60] per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion			
	1986-87		1987-88	1988-89
	Expected outturn in 1987 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	99.1	99.1	[104.5]	[108.3]
Supplementaries and net underspending	2.8	2.4	[1.2]	
Total Supply expenditure	**101.9**	**101.5**	**[105.7]**	
(public expenditure element)	(77.3)	[(77.1)]	[(79.7)]	

Paragraph 5.01. Delete. Replace with: "The Government's expenditure plans were set out in the 1988 Public Expenditure White Paper - Cmd 288. These plans are summarised in table 5.1. The Budget makes no change to these proposals, apart from two consequentials of the tax proposals, described in para 5.05."

Paragraph 5.02 As present paragraph 5.04

Paragraph 5.03 : Public expenditure "trends" (as last year): ~~text~~ Redraft:

"The reductions in the burden of debt interest, in ~~the~~ unemployment and in subsidies to industry have helped make room for these increases while maintaining the Government's policy of reducing the share of national income taken by public expenditure. GGE excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982-3 to below 42 per cent now. This fall is planned to continue."

Paragraph 5.05 : Insert at the start: "Two of the ~~tax~~ Budget measures have consequences for public expenditure. ~~Insert in last sentence~~ Last sentence "... charged to the Reserve and will not add to the Planning Totals."

§ Paragraph 5.06. This does not make it clear right away that we have switched from talking about GGE ex privatisation proceeds to the planning total. Reorder: "The latest estimates for the outturn of the planning total which are ~~are~~ still subject to some uncertainty ..."

Paragraph 5.07. Very unclear what this means. Either redraft to clarify, or delete.

Paragraph 5.08 and 5.09. ~~This is~~ The presentation is very unclear here. Could these paragraphs not be edited to ~~show the~~ bring out where necessary the changes from the PEWP (there is no

FINANCIAL TIMES

David Waller looks at Trusthouse Forte's renewed interest in Savoy Hotel group

Share split is still main barrier

25

"...the Savoy, which combines grandeur with homeliness, luxury with simplicity, and good taste and comfort so skilfully that it may be called the best-loved hotel in the world."

So wrote Compton Mackenzie in 1953, the year in which the compelling charms of the Savoy group of hotels – which include Claridge's, the Connaught and the Berkeley – first attracted the attentions of an unwelcome predator.

As events this week show, the group's charms to predators – in this case, Trusthouse Forte – are not much diminished many years later.

On Monday night, THF received an affidavit from the Savoy, which in turn prompted a caustic response from THF. The details of the exchange are obscure – partly because the affidavit has not been published, partly because of the complexity of the issues at stake – but out of the mist of speculation it emerged that Sir Hugh Wontner is to retire from the Savoy board after more than 47 years as a director, 36 of which were as chairman.

"Why they chose to reveal this in an affidavit, I do not know," said THF chief executive, Rocco Forte, yesterday. "It will be interesting to see whether he gives up his apartment at Claridge's. If he did, the company would benefit to the tune of £500,000 a year."

THF's pique is wholly understandable. In apparent defiance of the fundamental principle of capitalist society, that ownership should be wedded to control. THF owns 69½ per cent of Savoy's equity capital and yet has absolutely no influence on the management of the group. The reason is that THF owns only 42½ per cent of the Savoy's high-voting 'B' shares.

The split of the company's share capital into 'A' and 'B' shares must rank as one of the most effective defence manoeuvres in UK corporate history. The original split took place in 1955 at Sir Hugh's initiative, and from that time on the company has been able to preserve its independence against all comers.

The move was a belated response to separate takeover attempts from Mr Charles Clore and Mr Harold Samuel some two years earlier. Then, as now, it was a battle between the Establishment and the Outsider. Clore – the Brunel of financial engineering – and Samuel made an assault on the sensibilities, as well the watering-holes of the English upper classes. The Establishment rallied to its own.

In time, the pair would be absorbed into polite society: as chairman of Land Securities, Mr Samuel was to become the post-war property world's most prominent figure, and Mr Clore was to acquire wealth, and respectability, in proportion as the Sears Group grew in size.

But in the autumn of 1953, City gentlemen were scandalised at Samuel's plan to turn the Berkeley Hotel in Piccadilly into an office block.

Sir Hugh – then just plain Mr Wontner – responded with an ingenious plan whereby ownership of the Berkeley was to be removed from the publicly quoted company and vested in

Sir Hugh Wontner: director of the Savoy

charitable trust. Later ruled as a "an invalid use of management power" by a Board of Trade inspector, the so-called "Worcester Buildings" scheme was never implemented.

But it was enough to deter Mr Samuel from proceeding with a full bid. He sold his 20 per cent holding to the Savoy board at £3.2s6d a share, a substantial premium to the average price of £2 a share he paid when accumulating his stake.

One of the enduring mysteries of the affair is how the Savoy board managed to raise the £1,346,000 required to buy him out, and how it managed to obtain the permission to do so from the Bank of England at a time of strict controls over lending.

Cazenove, the blue-blooded stockbroker, was retained to find a way of avoiding any further close shaves: the upshot of the consultation was the issue of 85,000 new 'B' shares which carried 850,000 votes. The same number of votes was carried by all the 850,000 'A' shares, with the result that the 'A' shares represented 97.7 per cent of the company's equity and carried only half the vote.

There was no jiggery-pokery: the 'B' shares were issued pro-rata to one's holding of 'A' shares so that shareholders'proportional voting rights were maintained; however, the new shares could be sold independently of the 'A' shares and the Savoy board and friendly trusts swiftly snapped up any loose 'B' shares. They now have 50½ per cent of the total voting rights.

By the 1970's, a new predator appeared on the scene in the form of Victor Matthews of Trafalgar House; after numerous lunches with Sir Hugh, he passed his sizeable stake on to Maxwell Joseph of Grand Metropolitan, who saw the folly of seeking control and sold out to Rothschild Investment Trust, which in turn sold the block on to the Kuwaiti Investment Office.

In 1981, THF made its £58m. bid. Just as Samuel had pointed to the declining profitability of the Berkeley (it made £114,000 in 1945, and only £6,000 in 1954), Lord Forte hit out at the Savoy's trading record and what it claimed was the "mutilation" of its capital base.

Although Forte planned nothing quite so heretical as the conversion of the Berkeley, his offer met with the contempt that had once been turned towards Harold Samuel. Although ennobled, Forte encountered the patrician froideur afforded to one who had started life running a milk bar in Regent Street.

THF's strategy was to accumulate a majority of the 'A' shares, then press for control at separate meetings of the two classes of shareholders. The courts ruled this out, and THF is now fighting a war of attrition.

The legal action started last year is designed to disenfranchise a 5.77 per cent block of 'B' shares issued in 1970 when the Savoy bought the Hotel Lancaster Hotel in Paris.

Owned through convoluted channels by supporters of the Savoy Board, the removal of the stake would leave the Savoy directors with 44½ per cent of the votes against THF's 42½ per cent. THF hopes it could then clinch control through market purchases.

Thursday, February 18, 1988

17/5

separate table comparable to S.2 for PEWP estimate and current estimate. A suggested redraft might be:

~~5.08~~ ~~a net~~ .... are:

a net increase of [£1.2bn] in central govt. expenditure mainly due to ~~£0.6 bn~~ an increase of [£0.6bn] in ~~central gov~~ expenditure on the health service [largely reflecting ~~the~~ to the cost of the 1987 nurses and doctors and dentists pay settlements and ... ~~higher~~ [reference to net change to Social Security spending] and MoD]

~~local au~~ an overspend on ~~the planned to~~ plans for local authority current expenditure of £1.4bn (meaningless to talk of an increase in this connexion)

a net underspend of ~~on~~ [£] on LA capital, reflecting higher gross expenditure of [£0.4bn] more than offset by higher than expected capital receipts of [£1.0bn]; this is [ ] greater than the underspend shown in the White Paper

better results for nationalised industries ...

Thursday, February 18, 1988

Daily Telegraph

Ritblat's walk on the safe side

19

JOHN Ritblat is leaving no one in any doubt about his views on the DTI investigation into British Land. Last week he despatched a press release containing an outright denial of any involvement in insider dealing and disapproval of the DTI's conduct.

The property mogul then wrote to a number of friends, shareholders and agents, hammering home the point. Enclosed was another copy of the release and a handwritten letter restating his position just in case anyone was still harbouring any improper thoughts.

FINANCIAL TIMES

Societies planning to become plcs could face big tax bills

44

BY DAVID BARCHARD

BUILDING SOCIETIES planning to convert themselves into public companies could face huge bills for capital gains tax and stamp duty unless there are changes in the law.

Individual societies' total tax liabilities would probably be greater than a single year's profits.

The Building Societies Association has raised its concerns with the Treasury and Inland Revenue and is now awaiting a response.

"We are reasonably hopeful that the Inland Revenue will agree to some changes as the present situation means that the cost of conversion would be too great," the association said yesterday.

The Revenue is understood to have told societies that it has considered the issue and put it to ministers.

At present, building societies have mutual status, which bars them from seeking equity capital and means they are subject to restrictions on their activities imposed by the Building Societies Act 1986. The same act gave them the option of converting to public limited companies.

Such a move is now being contemplated by several leading societies. If they go ahead they would cease to exist as mutual bodies and be succeeded by limited companies, with assets, including premises and goodwill, transferred from the old legal entity to the new one.

As the law stands, the new companies would be liable to capital gains tax of 35 per cent on the indexed gain on the market value of their business premises and goodwill. They would probably also have to pay stamp duty of 1 per cent as well as capital duty on the issue of new shares for the company.

One City accountant said yesterday that he believed the Halifax, the biggest UK society with gross assets of about £31bn, would probably face a tax bill of about £360m if it converted.

The main problem would be the definition of the societies' tax liabilities for their goodwill as going business concerns. One way of defining goodwill might be to assess it as their earnings over several years.

Tax liabilities could be lessened if building societies were to transfer their assets to an existing company, perhaps a subsidiary created in advance to succeed them.

Mr David Gilchrist, general manager of the Halifax, said yesterday that the society had not yet worked out what its tax liability would be if it became a limited company.

He said: "The income tax treatment of members' deposits held with us would not change as the same composite rate applies now to both banks and building societies."

Leeds Permanent floating rate note doubled, Page 31

Daily Mail

Counting the cost of Black Monday...

36

THE body count in the City's post-Crash jobs massacre is going to get worse.

Chris Chaitow of Morgan Grenfell Securities calculates gloomily that the City earned at best £1.75m a day in January in daily client commissions in the equity market.

That is a dramatic slump on his earlier £2.85m estimate but small punters, who pay some five times as much per bargain as the institutions, have since fled the market.

Miserable

And January looked almost rosy compared to stock market turnover so far this month. That miserable £1.75m tally is just 45pc of estimated daily commissions last year.

Stephen Lewis, director of economic research at Phillips & Drew, reckons the industry's total costs run at £750m a year. At the current rate equity commissions generate just £437m. And gilts business, corporate finance and market making will be hard put to fill the gap.

The City will slim down more during Lent.

NICK GILBERT

FINANCIAL TIMES

Equitable Life cuts 1987 reversionary bonus rates

BY ERIC SHORT

10

EQUITABLE Life Assurance Society, the world's oldest mutual life assurance company, has surprised the life assurance industry by reducing its reversionary bonus rates for end-year 1987.

It has done so on both its with-profit life and its pension contracts.

All other life companies that have to date reported their end-year bonus rates have maintained their reversionary bonus rates.

Under a traditional with-profit life and pensions contract the overall profits from the underlying fund are given to policyholders in the form of bonus additions to the benefits determined by the company-appointed actuary.

Bonuses come in two main forms: a reversionary bonus which is added to the contract benefits each year and a terminal bonus added when a contract matures or becomes a death claim.

Reversionary bonuses reflect the underlying return on the funds and are linked to the interest rates. As such, they are inherently stable. Terminal bonuses, on the other hand, reflect the underlying capital appreciation and tend to be more volatile.

Actuaries have held reversionary bonus rates steady over the past five years, relying on higher equity returns and the ample reserves held by the funds to offset the fall in interest rates.

Various actuaries have for some years warned that reversionary bonus rates could not be held at current levels indefinitely in the face of falling interest rates. Until now, no appointed actuary had taken the decision to reduce bonus rates in the face of marketing pressures.

Mr Roy Ransom, assistant general manager and joint actuary of Equitable Life, said the decision to cut rates was part of the company's long-term strategy. It had not been influenced by the stock market fall last October and did not reflect a decline in underlying investment performance.

The aim was to provide consistently good returns for all policyholders reflecting the underlying performance. He had no intention of using up reserves to hold up an unsupportable bonus level.

Mr Ransom said policyholders should concentrate on the whole bonus package, not a single item. Pay-outs on policies maturing now were still slightly higher than corresponding pay-outs a year ago.

He said Equitable Life still occupied a high position in the with-profit performance tables – in individual pensions contracts it is a leader.

Nevertheless, it is doubtful if it could have cut its rates when other companies were keeping theirs steady if it relied on independent intermediaries for business.

But the company is one of the very few that does not pay commission to third parties. It relies on its own sales force for its business.

Mr Ransom claims that the field staff have accepted the situation and do not see any "negative points" in the bonus structure. To date, inquiries for policyholders have been related to seeking information rather than complaining over the cuts.

17/4

ACSA
FSBR
CHP. 2
29/2

FROM: A C S ALLAN
DATE: 29 February 1988

MR S J DAVIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr Grice — Ms C. Evans
Ms Turk
Mr Cropper
Mr Tyrie
Mr Call

FSBR CHAPTER TWO: MTFS TEXT AND FISCAL PROJECTIONS

The Chancellor was grateful for your minute of 23 February, and the ... draft of Chapter 2. I attach a marked up copy of those pages on which he had comments.

2. He saw no need to derive the revenue path as an "assumption" this year, and was content for you to work towards a fiscal adjustment path of 3, 1, 2.

ACSA

A C S ALLAN

REDRAFTS OF 2.19 AND 2.23

2.19 Continued restraint in total public spending is a vital element of the Government's economic strategy. Reductions in borrowing and hence in the burden of debt interest, coupled with strong economic growth, have enabled the Government to increase spending on priority programmes while at the same time achieving its objective of reducing public expenditure as a proportion of national income. This in turn has created room for reductions in taxation, helping to improve further the performance of the supply side of the economy. Public expenditure is considered more fully in Chapter 5.

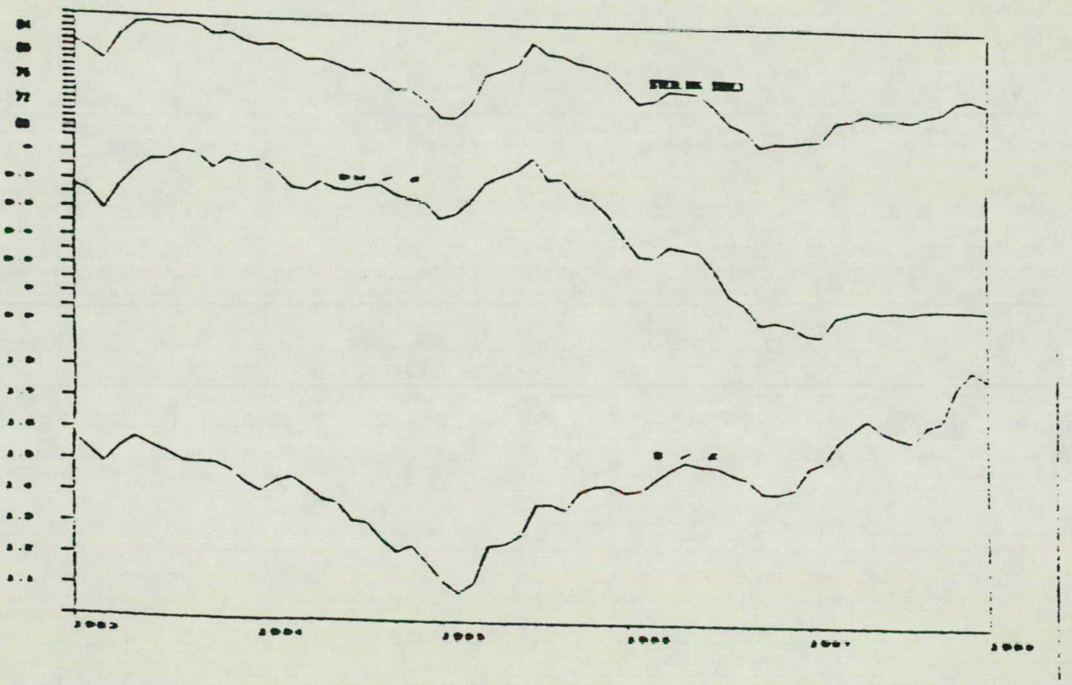
2.23 The strength of the economy coupled with fiscal prudence has enabled the Government to achieve a balanced budget on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress towards lower inflation, lower taxes and lower public spending as a share of GDP in the medium term. The MTFS provides the financial framework within which the policies to achieve these objectives are set.

2.08 A declining path for money GDP growth, as in Table 2.1, requires firm monetary policy supported by prudent fiscal policy. Fiscal policy is reviewed each year at budget time. Short-term interest rates, which are varied more frequently, are used to keep monetary conditions on track.

Monetary Policy

2.09 As the Chancellor made clear at the Mansion House last year, the Government is committed to maintaining a stable exchange rate, with the rate against the deutschemark being of particular importance. This provides an important financial discipline, and is also helpful to industry. Sterling has remained stable against the Deutschemark throughout the past year, following the Louvre accord in February 1987. ~~There was an extended period of general currency stability following the agreement between the major industrial nations at the meeting in Paris in February 1987. Despite the subsequent fall in the dollar towards the end of 1987, and despite significant market pressure at times, sterling has been [kept] broadly stable against the deutschemark over the whole of the past year. Maintaining this stability in future will~~ The discipline of a stable exchange rate provides the ~~basis~~ underpinning for the declining path for money GDP growth and inflation.

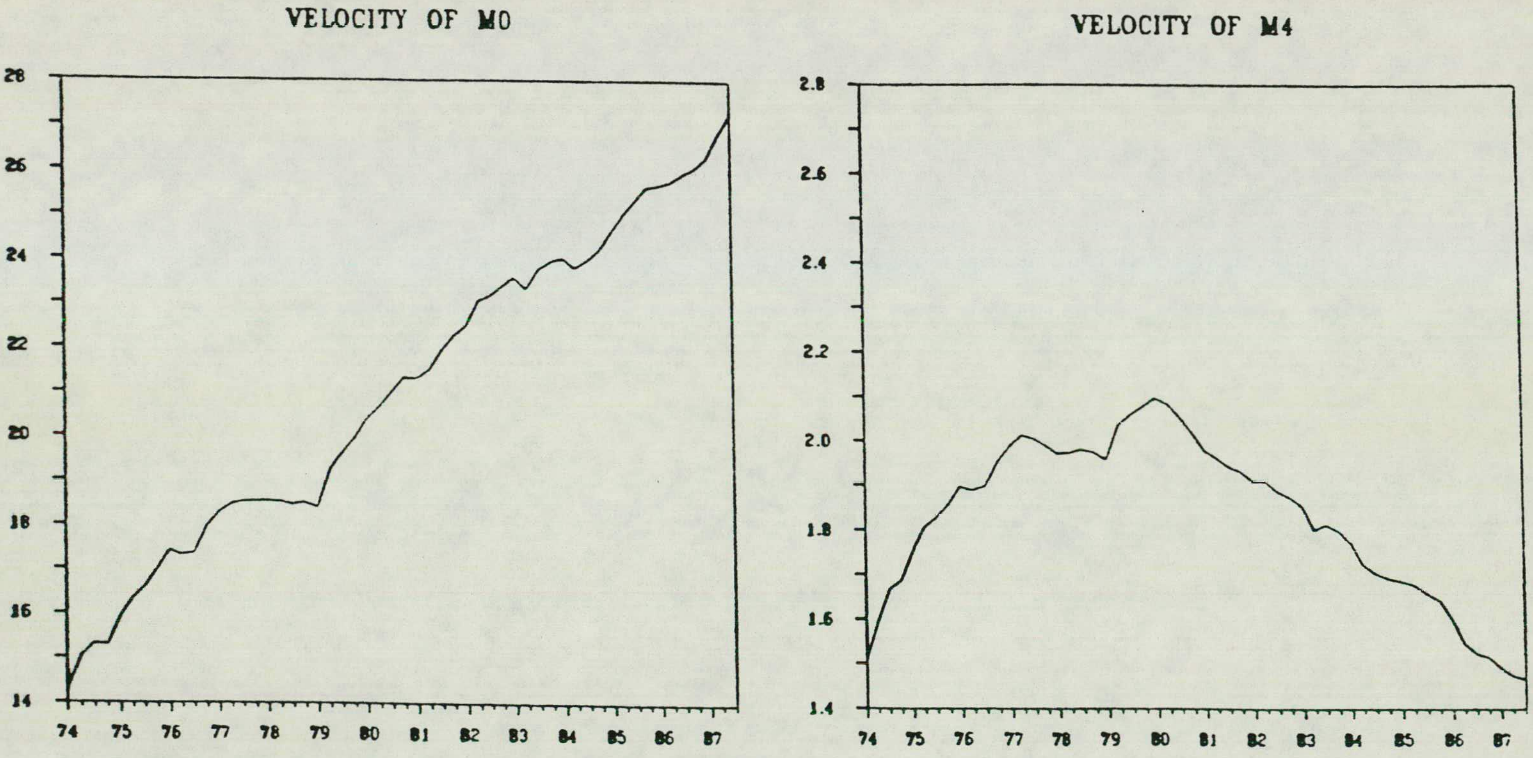
Chart 2.2 Sterling exchange rates



2.10 Achieving these objectives (also requires) ~~implies~~ a reduction in monetary growth over the medium term. For M0, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988-89 of 1-5 per cent [2-6 per cent]. This is the same as indicated in last year's MTFS. [This is the same as last year's range.] The ranges given in Table 2.2 for later years are illustrative, but show a steady fall consistent with the declining path for money GDP growth.

2.11 Interest rate decisions are based on a continuous and comprehensive assessment of ~~[all the indicators of]~~ monetary conditions so as to ensure that inflationary pressures are not accomodated. This means, in particular that increases in domestic costs will not be accommodated by a decline in the exchange rate.

Chart 2.3 Velocity of monetary aggregates



These would look much better as a single graph with two lines, though could be dropped altogether if we have space problems.

Table 2.2: **Growth of M0***

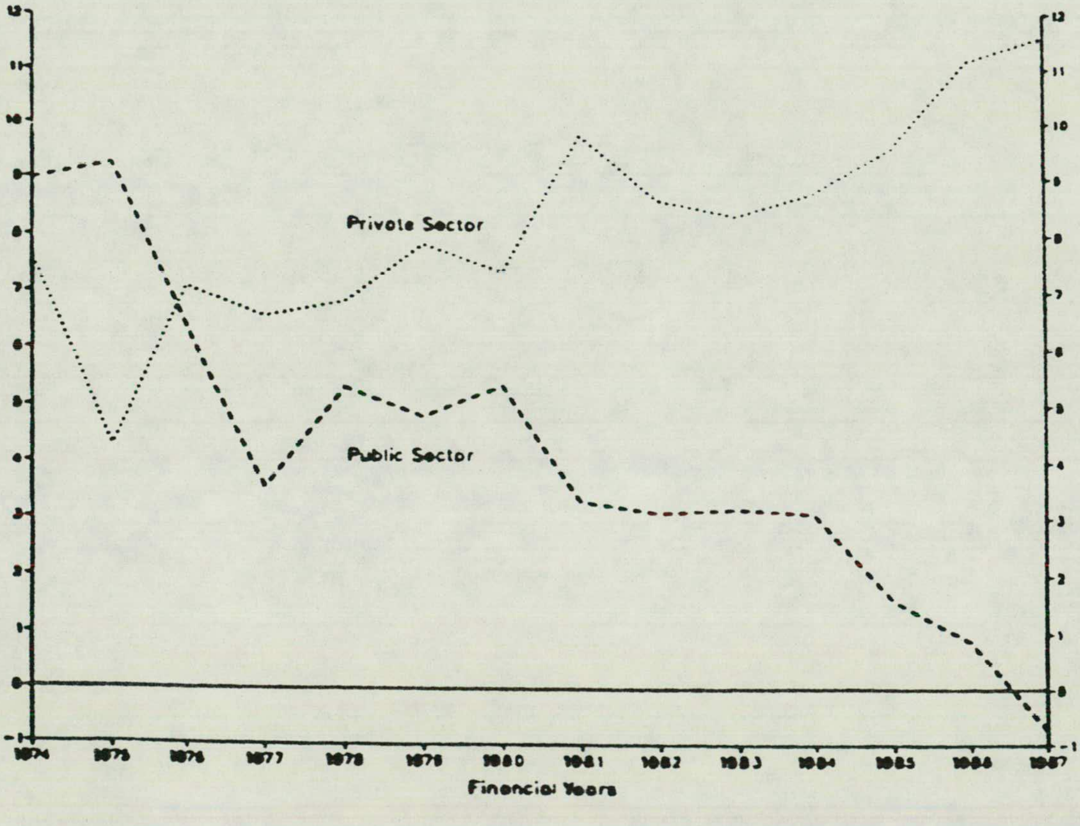
1987-88	1988-89	1989-90	1990-91	1991-92
5	[1-5]	1-5	0-4	0-4

* Per cent change on previous financial year. 1987-88 is a forecast. 1988-89: target range. 1989-90 onwards: illustrative ranges.

2.12 While, as last year, there is no explicit target range for broad money, the assessment of monetary conditions continues to take~~s~~ the behaviour of broad money, or liquidity, into account.

2.13 With the increasing overlap between activities of banks and building societies, it is sensible to concentrate on measures of broad money, such as M4, that include deposits held with both. [~~Nor is it [right] in funding policy to distinguish between sales of debt to banks~~] and ~~sales to building societies. So~~ Equally, the authorities will seek ~~in 1988-89~~ to fund the total of maturing debt, the PSBR, and any net increase in foreign exchange reserves resulting from market ~~intervention~~ transactions, by sales of debt outside the banking and building society sectors.

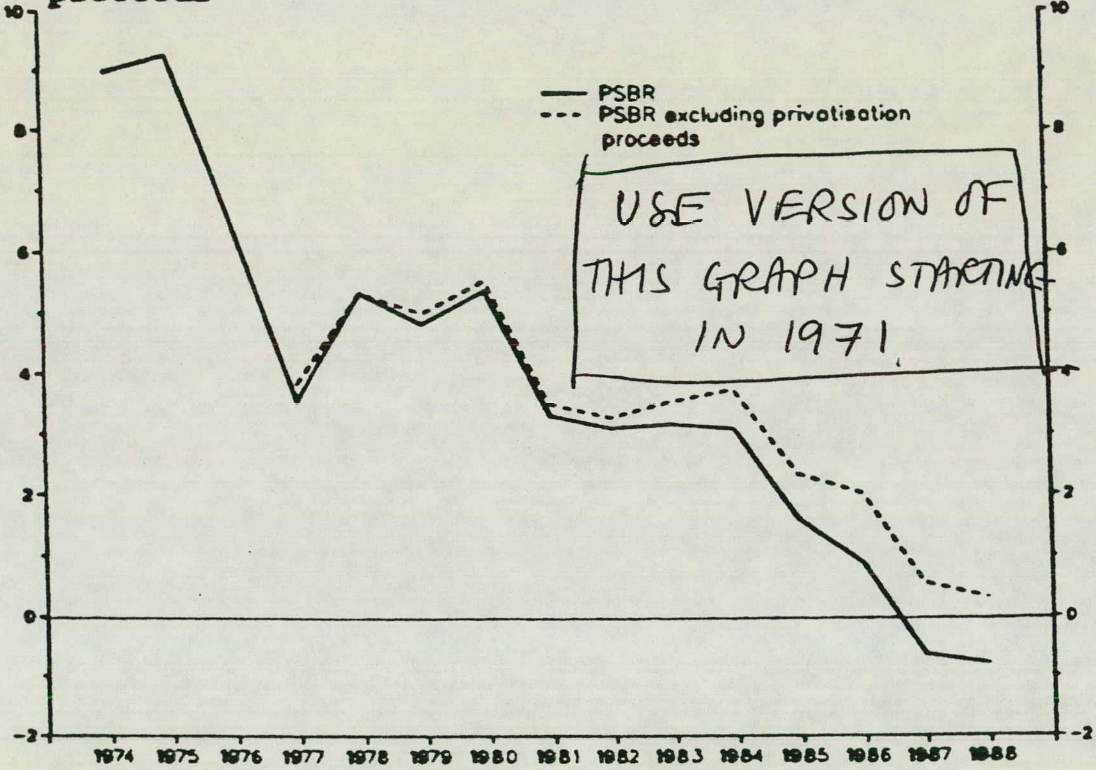
Chart 2.4 Private and public sector borrowing



Fiscal policy

2.14 It is now expected that there will be a net repayment of public debt in 1987-88, compared with a borrowing requirement of around 1 per cent of GDP forecast a year ago. This is only the ~~first~~ second time since the War that there has been a budget surplus ~~since 1969-70. The borrowing requirement after adding back privatisation proceeds will be equal to under~~ Even if there had been no privatisation proceeds at all, the PSBR would have been under ½ per cent of GDP, smaller ~~in relation to GDP~~ than in any year since 1969-70.

Chart 2.5 Public sector borrowing requirement and privatisation proceeds



<u>Version A of paragraphs 2.15 and 2.16</u>

The PSBR path 2.15 The Government's long term objective for the PSBR is for it to equal 1 per cent of GDP. The recent strength of the economy and the buoyancy of government revenues have already reduced borrowing well below this level; and on present forecasts tax reductions of [over £7 million] would have been needed in order to achieve a PSBR of 1 per cent of GDP after adding privatisation proceeds.

~~2.16 The Government has decided not to reduce taxes on this scale this year. This cautious approach takes account of the uncertainties in the revenue forecasts and minimises the risk of tax increases being required later on if revenues prove less buoyant than expected. The PSBR for 1988-89 is set at -[ ] billion, equal to -[ ] per cent of GDP, little changed from the expected outturn in 1987-88. Thereafter the PSBR is projected at zero, a balanced budget, which is equivalent to the objective of 1 per cent of GDP after adding back privatisation proceeds. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.~~

<u>Version B of paragraphs 2.15 and 2.16</u>

2.15 The PSBR is now assumed to be zero over the medium term: a balanced budget. This is a prudent and cautious level and can be maintained over the medium term. It also provides a clear and simple rule, with a good pedigree. In practice, there are likely to be fluctuations around this level from year to year.

On the basis of current privatisation plans, a PSBR of zero implies that, even without any privatisation proceeds, it would be only 1 per cent of GDP.

[NEW PARA] The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of [over £7 billion] in 1988-89. Continuing the gradualist approach which has always been a characteristic of the MTFS, only part of this room for tax reductions has been used.

2.16 The PSBR for 1988-89 is set at [ ], little changed from the expected outturn in 1987-88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Assumptions

2.17 For the period to 1990-91, the public expenditure projections in Table 2.4 use the figures for the public expenditure planning total shown in the public expenditure White Paper (Cm 288); gross debt interest payments are lower than projected in the White Paper, reflecting lower government borrowing while other adjustments are a little higher. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1991-92. Decisions on expenditure in 1991-92 will be taken in the 1988 Survey.

2.18 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.3. They are consistent with the figures for money GDP growth in Table 2.1. Oil prices are assumed to ~~remain close to recent levels~~ average $15 a barrel in 1988-89 and thereafter to remain broadly unchanged in real terms.

Table 2.3 Output and inflation assumptions

	Percentage change on previous financial year				
	1987-88	1988-89	1989-90	1990-91	1991-92
Real GDP					
Non North Sea	5	3	3	3	3
Total	4½	2½	2½	2½	2½
Inflation					
GDP deflator	5	4½	4	3½	3

Public expenditure

SEE REDRAFT ATTACHED

~~2.19 The Government's objective is to reduce public spending as a proportion of national income. With a balanced budget, this reduction in public expenditure will create room for reductions in the burden of taxation, helping to improve further the supply side of the economy. Public expenditure is considered more fully in Chapter 5.~~

Table 2.4 General government expenditure

	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Public expenditure planning total[1]						
Gross debt interest						
Other adjustments						
General government expenditure[2]						
of which Privatisation proceeds[3]						
General government expenditure excluding privatisation proceeds						

1. For 1986-87 to 1990-91, the figures are taken from Table 5.1.

2 General government expenditure, and its components, are rounded to the nearest £1 billion from 1987-88 onwards. General government expenditure is assumed to grow by 1% in real terms in 1991-92.

3 See the public expenditure White Paper (Cm 288), Table 1.8. Proceeds are assumed to be the same in cash terms in 1991-92 as in 1990-91.

Revenue

2.20 The growth in government revenues [~~in cash terms~~] over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, [general government receipts are expected to increase somewhat less than money GDP. Government revenues from the North Sea are projected to decline as oil output falls. Non-North Sea revenues are projected to grow at around the rate of growth of non oil money GDP.]

Table 2.5 General government receipts

	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Taxes on incomes, expenditure and capital						
National insurance and other contributions						
Interest and dividends						
Other receipts						
General Government receipts[1]						
of which North Sea tax[2]	4.8	5	4	4	3	3

1 General government receipts, and its components, are rounded to the nearest £1 billion from 1987-88 onwards.

2 Royalties, petroleum revenue tax (including advance payments) and corporation tax from North Sea and gas production (before advance

Conclusion

2.23 Money GDP growth has been higher than forecast over the last year, with real growth in the economy substantially above expectations. Both nominal and real GDP growth are forecast to decline over the next year. The assumptions on which the medium-term projections are based may have to be modified in the light of events. But the government remains committed to reducing money GDP growth over the medium term, and to reducing the ratio of public expenditure and taxation to GDP. The MTFS provides the financial framework within which the policies to achieve these objectives are set.

SEE RE-DRAFT

CHANCELLOR OF THE EXCHEQUER

Ch

The attached marked-up copy reflects the Chief Secretary's comments (based on comments Jill & I fed in to him).

This is 2nd proof of Chapter 6.

A few comments & changes.

AA

4482/47/PN

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COPY 2 OF 27

FROM: MISS C E C SINCLAIR
DATE: 22 February 1988

CHANCELLOR

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Mr Riley
Miss Evans
Mr A Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Issac
Mr Calder - IR
Mr Painter

Mr Unwin - C&E
Mr Knox

NB Missing pages detached & used in minute of 26/2 to Miss Sinclair

Please ~~Destroy~~ or return to Miss Sinclair, as appropriate

FSBR CHAPTER 4

I attach a draft Chapter 4 of the FSBR, plus Table 4.1 and the Annex.

2. It would be very helpful to know if you are content with the narrative section. This describes in summary form the significant tax changes. You will see that in the case of covenants and forestry the reader is referred to Chapter 5 for details of the parallel public expenditure measures. Non-tax and non-public expenditure measures - such as disclosure of importers' details - will not be mentioned in the FSBR.

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3. You asked us to include a section on independent taxation, setting out a clear summary account of the reform in reasonable detail (Mr Hudson's minute of 15 February). This is currently at the end of the narrative section. The printers should be able to get it all on to one page. If you wished, it could be put in a box, or all printed in heavy type, in either case without paragraph numbers. We think it comes most naturally at the end of the narrative.

4. You will want to note that we have shortened and revised the first part of the introduction to the Annex to Table 4.1. We have moved away from suggesting that the Inland Revenue and Customs and Excise adopt different approaches to costing tax changes. The new formula on all taxes other than VAT and excise duties is designed to leave you maximum freedom of maneouvre to include, or not include, assumptions about behavioural response in the FSBR.

5. The attached draft of Table 4.1 takes behavioural effects into account in costing the CGT changes and independent taxation (both the effects on income tax and CGT receipts). This is explained in the accompanying notes. Behavioural assumptions have also been made in the case of the BES costings, although these are largely guesswork. They are not explained in the notes, which simply say that the cost depends on take-up and is highly uncertain.

6. Papers will be coming forward this week on the behavioural effects which may be expected as a result of other tax changes, such as increasing the car scales and abolishing relief for home improvement loans. We shall offer you advice on whether these should also be taken into account and explained in the FSBR, though on the whole we doubt if they warrant this.

CAROLYN SINCLAIR

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Independent taxation for married couples

The present system of taxing husbands and wives, under which a married woman's income is treated in law as if it belonged to her husband, has been unchanged since the earliest days of income tax. Green Papers published in 1980 and 1986 have considered how the system might be reformed. There is general agreement that the present law is no longer acceptable, and wide support for an early change to a new and more up-to-date system.

A major reform of the system is therefore proposed to give husbands and wives independence and privacy in their tax affairs and remove the tax penalties on marriage which can occur under the present system. The new system will be introduced from 6 April 1990 to give the Inland Revenue time to make the necessary preparations.

From 6 April 1990, husbands and wives will be taxed independently on their income and chargeable capital gains. This will mean that:

husband and wife will become independent taxpayers each with their own allowances and rate-bands to set against their own income (from whatever source); each will be responsible for handling their own tax affairs with the Inland Revenue;

every taxpayer will be entitled to a personal allowance, equivalent to the existing allowance for single people;

there will be a new married couple's allowance (equal to the difference between the present married allowance and the single allowance). This will be set first against the husband's income, but any unused amount may be transferred to the wife;

married women will qualify in their own right for the higher levels of personal allowance for taxpayers aged 65-79 and those aged 80 or over. Higher levels of married couples allowance will apply where either partner in a couple is aged 65-79 (or aged 80 or over).

there will be transitional protection for the small number of couples whose allowances would be reduced as a result of the change to the new system;

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a husband's and wife's capital gains will be taxed independently; each spouse will be entitled to the same exempt amount as a single person;

the existing exemptions from capital gains tax and inheritance tax on transfers of capital between husband and wife will continue;

the new system will mean that a number of provisions, including the wife's earnings election and separate assessment, can be abolished.

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million — Estimated effect on receipts in: 1988-89: Changes from a non-indexed base	1988-89: Changes from an indexed base	1989-90: Changes from an indexed base
	Vehicle excise duty			
86	No change in VED on car, light van and main lorry rates	-	-100	-105
87	Increase in certain other VED rates	~~+15~~ +20	~~+15~~ +20	+20
88	New VED class for exceptional loads	*	*	*
	Other			
89	Bus fuel grants	-5	*	-5
	TOTAL VED AND OTHER	+10	-85	-90
	TOTAL CHANGES IN TAXATION	-4185	-3870	-6020

* = Negligible   - = Nil

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Annex to Chapter 4

How the figures in Table 4.1 have been calculated

Table 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million.

The direct effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rate of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

Use same wording as last year

In the case of VAT and the excise duties the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980. First round behavioural responses are also taken into account in the case of some direct taxes.

Table 4.1 shows the expected change in receipts of tax resulting from the Budget proposals. Additional information is provided in the commentary below for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1988-89 or 1989-90; or where the impact of the proposal is expected to build up over a period of years.

The figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1988-89. Budget proposals are compared with a non-indexed base - that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1987-88 levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1988-89, measured against an indexed base. The indexed base for 1988-89 is obtained by increasing 1987-88 allowances, thresholds and rates of duty by 3.7 per cent, the increase in the RPI over the year to December 1987.

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The figures in the third column show the direct effect on receipts in 1989-90, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1988-89 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1987 and 1988 (shown in Table 3.13).

The estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact of the tax change on the PSBR. The base for the post-Budget forecast of each tax (given in Table 6B.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

Is this necessary

Table 4.1 does not include certain measures announced and implemented before Budget day. These are the tax treatment of entertainment and gifts costing £100 or less provided for an employee by someone other than his employer, and the correction to the treatment for capital gains tax of losses incurred in a personal equity plan. [Other possibilities.] These measures are reflected in the baseline for costing the effect of tax changes in the Budget.

The remainder of this annex provides a commentary on the Budget proposals in Table 4.1. The paragraph numbers refer to the lines in this table.

Income tax

1 and 2. The basic rate will be reduced to 25 per cent and there will be a single higher rate of 40 per cent.

The cost figures in the table for items 1 and 2 assume that the changes in items 3-8 have been made first. Item 1 includes the saving in public expenditure on mortgage interest relief to those below the tax threshold. The effect of the consequential change in the rate of advance corporation tax (ACT) is shown in line [4~~8~~9] of Table 4.1.

3 to 7. The increases in the main income tax personal allowances are twice those due under statutory indexation (based on the increase of 3.7 per cent on the RPI in the year to December 1987).

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25. The administrative arrangements for the assessment and collection of tax from members of Lloyds will be reformed. [The legislation will first take effect for the Lloyd's 1986 Account, which closes at the end of 1988].

26. ~~[The entitlement of discretionary share option schemes to approval and to the associated tax relief will be denied and existing approvals will be withdrawn in cases where the company concerned has not introduced an approved all-employee share scheme and does not operate it to the required extent.]~~

27. Changes will be made to the rules (Section 79 Finance Act 1972) governing unapproved employee share schemes. The present charge (to income tax) on the whole of any growth in value of certain employee-acquired shares is to be replaced in most cases with a new, more narrowly targeted charge that will arise only if and to the extent

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that value is shifted preferentially into the employee shares. This relaxation will also apply to shares in "qualifying" subsidiaries. These changes will take effect from 26 October 1987 when draft Clauses incorporating the proposed changes were published for consultation.

28. Subject to certain conditions, employees will be exempt from tax on any benefit resulting from priority in applying for public offers of shares given to them by virtue of their employment. The change will apply from 23 September 1987.

29. The legislation relating to approved discretionary share option schemes will be changed to enable employees to enter into certain loan arrangements regarding the shares they have under option without prejudicing their eligibility for the tax relief associated with such schemes.

30. The limit below which redundancy and certain other lump sum payments are exempt will be increased from £25,000 to £30,000. The reduced rates of tax which apply to the next £50,000 of such payment will be abolished.

31. Legislation will be introduced to ensure that the Inland Revenue continue to have power to make an income tax assessment, on certain types of income assessable on the "current year" basis, in the course of the year in which the income is received.

32. The "top-slicing" relief which applies to the tax charged on premiums for leases and certain other payments will be withdrawn.

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36. Schedule B will be abolished with effect from 1988-89. With effect from 15 March 1988 (subject to transitional provisions extending to 5 April 1992) the right of occupiers of commercial woodlands to elect to be assessed to tax on their profits or losses under Schedule D will be abolished. The eventual net annual saving is estimated at [£10 million]. [Provision for increased forestry grants will be introduced as from [ ], building up over this period to an annual increase of £10 million.]

37. [Changes will be made to the tax rules for personal pensions relatingto the payment by DHSS of contracting-out rebates.]

38. The rate of tax on refunds of employee pension contributions will be increased from 10 per cent to 20 per cent.

39. Minor amendments are to be made to the 1987 legislation which dealt with exploitation of pensions tax reliefs.

40. Interest will be charged where an employer or contractor delays payment to the Inland Revenue of amounts deducted under the PAYE or subcontractor deduction schemes beyond 19 April immediately following the deduction year. This interest charge will not be introduced before 1992.

41. ~~From expenditure after 15 March 1988 the ceiling above which capital allowances and lease rental payments for cars are restricted will be increased from £8,000 to [£10,000] and the maximum annual writing-down allowance will be increased from £2,000 to £2,500. The cost could build up to £50 million in 1990-91, and to £60 million in 1991-92.~~

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58. The capital gains tax annual exempt amount for 1988-89 will remain at £6,600 for individuals, and £3,300 for most trusts.

59. Retirement relief currently exempts business gains up to £125,000, subject to certain qualifying conditions. From 6 April 1988, half of any business gains between £125,000 and £500,000 will also be exempt, subject to the same conditions.

60. From 4 July 1987, disposals of shares in Building and Co-operative Societies will not qualify for indexation relief.

61. From 6 April 1988, the capital gains tax exemption for homes provided for dependent relatives will cease to be available. There will be special provisions to ensure that exemption continues where a dwelling would have qualified for this exemption on a disposal before 1988-89.

62. The PRT oil allowance for Southern Basin and onshore fields given development consent on or after 1 April 1982 is to be reduced to 100,000 tonnes per chargeable period, with a cumulative total of 2 million tonnes. The yield figures in table 4.1 relate to this proposal only. At the same time, it is proposed to abolish royalty on these fields. These two measures have cumulative cost of around [£40 million] in the first five years [in part because it is estimated that they will accelerate certain developments], but in the long run they are expected to be broadly revenue neutral.

63. For disposals of oil licences in undeveloped areas where the consideration includes a work programme or another licence interest, that work programme or other licence interest will be deemed to have a nil value.

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64. All tariff-related expenditure incurred by an asset owner will be allowed against his PRT liability on tariff income arising from third party use of those assets, even though his principal field has ceased production. No cost will arise until after fields owning assets used by others cease production.

65. The estimated cost of the proposed rate structure in paragraph 4 for 1990-91 is £210 million, measured against the indexed base. For 1991-92 it is £230 million. The estimated full year cost attributable to transfers in 1988-89 is £200 million.

66. The £100,000 exemption limit on transfers to political parties made on or within one year of death is abolished from Budget day.

67. Changes are proposed to stamp duties and the reserve tax on shares in a UK and a non-UK company where the shares are paired and can only be transferred as a unit.

Value added tax

68. Amendments will be made to the civil penalty system so that

- from 16 March, the rate of penalty for late registration will relate to the length of the delay;

Do we really need to go into such detail?

- default interest (to be introduced in late 1989) will not be charged on tax which is also subject to late registration penalty;

- a penalty for a regulatory offence will only be imposed following issue of a warning letter;

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81. The duty on leaded petrol will be increased by [5.5] per cent or [5.6p] a gallon (inclusive of consequential VAT). The duty on unleaded petrol will remain unchanged so that the tax differential in favour of unleaded petrol will rise to [10.6p] a gallon.

82. The duty on derv will be increased by [5.7] per cent, equivalent to [4.9p] a gallon (inclusive of consequential VAT).

83. There will be no change in the rates of duty on gas oil and fuel oil.

84. The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by [3.7] per cent or [3.4p] a packet of 20 cigarettes and [1.9p] a packet of 5 small cigars (both inclusive of consequential VAT).

85. There will be no change in the duty on pipe tobacco.

Vehicle excise duties

86. There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

87. From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

88. From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable fo carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1,600. These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£130).

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From: S D H SARGENT

Date: 29 February 1988

MR ODLING-SMEE

cc PPS
Sir T Burns
Sir G Littler
Mr S Davies

not copied to us

SARGENT FSBR: MTFS TEXT 29/2

FSBR: THE MTFS TEXT

Sir Peter Middleton was grateful for your minute of 26 February in which you set out Mr Davies' suggested revision of paragraph 2.05 to provide more explanation for the money GDP overshoot in 1987-88. Sir Peter has himself slightly revised Mr Davies' version; the paragraph would now read as follows:

> "Money GDP growth is expected to be around 9¾% in 1987-88, higher than forecast in last year's FSBR. The division of money GDP growth between output growth and inflation was better than forecast, a further sign of improvement in the supply performance of the economy. Output growth is currently estimated at 1½ points above last year's forecast; inflation (as measured by the GDP deflator) is estimated to have been about ½ point higher than forecast."

CL
This seems a bit defensive
AA

S

S D H SARGENT
Private Secretary

GOV.
BoE
→ CH/EX
MTFS
29/2

SECRET

Bank of England

The Governor

London EC2R 8AH

29 February 1988

29/2

CH/EXCHEQUER
REC. 29 FEB 1988
ACTION PS/CST, PS/EST
Sir P Middleton
COPIES TO
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr R G Allen
Mr Grice
Mr Cropper

F1

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

Dear Nigel,

MEDIUM-TERM FINANCIAL STRATEGY

We have now seen the draft of the monetary policy section of this year's medium-term financial strategy, which we are to discuss at our meeting with you on Wednesday morning. There is only one point of any substance that we would wish to raise, namely the position of the DM exchange rate target. Because this is, of course, central to the approach, I thought that you might find it helpful to have, ahead of our meeting, the attached note setting out our considerations.

Yours ever,

Robin

MEDIUM TERM FINANCIAL STRATEGY

1 The present draft of the MTFS (paragraph 2.09) elevates stabilty of the exchange rate, in particular against the DM, to the position of the over-riding intermediate objective of monetary policy. There are subsequent references to "interest rate decisions being based on a continuous and comprehensive assessment of monetary conditions" (2.11), and to monetary indicators being a part of that process (2.10 in relation to M0 and 2.12 in relation to broad money). But the text as a whole, despite a reference to the need for "a reduction in monetary growth over the medium term" makes it clear that other indicators are subordinate, and that in resolving any conflict in the short term, priority would be given to the exchange rate objective.

2 This further reformulation of the monetary policy framework effectively completes the process of moving from a situation in which the exchange rate was in principle disregarded, through one in which it was accepted as one <u>indicator</u> of monetary conditions, to one in which it has become not simply <u>an</u> intermediate objective of policy but the over-riding objective.

3 We see a danger in going as far as this for two reasons. First, there are a number of different - and not implausible - scenarios in which an over-riding DM3 objective could become inappropriate, in either direction, ie it is too simple a rule. And secondly, we think it possible to have most of the benefit of a commitment to exchange stability against the DM without targetting it so explicitly and unequivocally: this would reduce the embarrassment and damage to the credibility of policy if the DM3 target <u>should</u> in practice become inappropriate.

4 There are at least three scenarios in which this might happen -

(i) <u>An intensification of the present conflict with domestic policy considerations</u>.

Tactically, the proposed policy framework means that, in circumstances - like now - when the other evidence points to the need for tighter monetary conditions, monetary policy is put in baulk by the DM3 ceiling. Of course we understand the argument which says that this is simply a short-term situation and that, provided the policy is persisted in, it will all come out in the longer-term wash. But the longer the domestic/external conflict persists, and the more intense the conflict, the harder that position is to sustain. It is at least conceivable that domestic cost pressures will develop a momentum in the initial phases of the policy which will make it very difficult to sustain in the longer run - without severely damagingly restrictive policies - when the exchange rate pressure finally reverses.

(ii) <u>A steep rise or fall in the dollar</u>

In a sense we have been fortunate that the dollar fell as it did in the latter part of last year. This meant that sterling's effective rate rose despite the DM3 cap, so that some part at least of the upward pressure on the exchange rate was allowed to come through as an influence restraining domestic cost pressures. But this was pure chance. The dollar's recovery since the end of the year has meant that exchange rate influences overall have contributed to an easing of monetary conditions, despite sterling's stability against the DM. It is possible that the dollar's recovery may go further, which, with sterling's rate against the DM effectively fixed, would mean an additional inflationary impulse from the exchange rate. More likely the dollar will weaken - perhaps substantially - in which case the exchange rate will tend to support the domestic counter-inflationary ultimate objective of policy; but it is not difficult in present circumstances to envisage a situation where the upward movement in sterling's effective exchange rate was excessive in terms of its implications for competitiveness and the balance of payments. The point is that the overall outcome with one exchange rate relationship fixed, is essentially unpredictable; and we may well find that we are, for considerable periods at least, deprived of the freedom to offset, if necessary, the overall exchange rate influence on monetary conditions through changes in domestic influences - notably interest rates.

(iii) <u>A steep rise or fall in the oil price</u>

An over-riding DM target could similarly constrain our ability to adjust domestic monetary policy and the effective exchange rate to large and protracted movements in the oil price, as we were able to do very successfully in 1986.

5 It will no doubt be argued that the draft MTFS approach need not preclude adjustment of the DM target - up or down - if that were called for by a fundamental change in circumstances; and that is no doubt true. But in market terms, except in rather extreme circumstances, this would now be seen as a failure on the basis of the obviously deliberate change in the MTFS language (more so than if we joined the EMS explicitly because the EMS arrangements clearly provide for such adjustment), and because of this, and because of its inevitable "one-step" nature, such adjustment will tend to be delayed.

6 Some of these potential difficulties might be overcome, without necessarily sacrificing the pursuit of a stable exchange rate against the DM, by describing the policy framework along the following lines -

(a) The aim of policy will continue to be to maintain monetary conditions which produce sustained, gradual, downward pressure on inflation;

(b) monetary conditions will be assessed in the light of domestic indicators, including both narrow and broad money, as well as the exchange rate;

(c) within that overall framework we will continue - as in the past year - to aim to maintain a stable exchange rate, in particular against the DM.

The effect of this presentation would be to make a DM target an intermediate objective of policy, but not the sole or over-riding objective. It need not limit our ability to pursue the exchange rate objective. Nor, in our judgment, would it weaken perceptions - either in the market or the wider economy - of our intention to adhere to the DM3 target, but it would help to reduce the damage to confidence if there are good reasons for departing from that target.

7 Ultimately, of course, it is not what we say about the policy framework, but what we do about policy itself, that matters. That is not the immediate issue; but we are concerned that what is said about the framework should not inhibit timely action when it is agreed that policy adjustment is necessary.

RA7.62

REF NO ACSA/21

COPY NO 1 OF 17

FROM: A C S ALLAN

DATE: 29 February 1988

MR ODLING-SMEE

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Turnbull
Miss Sinclair
Miss C Evans
Mr Cropper
PS/IR
Mr P R H Allan - C&E

FSBR CHAPTER ONE

The Chancellor was grateful for your note of 25 February, and the ... draft of Chapter 1. I attach a marked-up copy of the pages on which he had comments, together with a redraft of table 1.1.

2. The Chancellor agreed with you that the order of rates and allowances should, in this table, follow the Scorecard order. This could be followed in table 4.1, but that would mean that there would be an unhappy juxtaposition of the abolition of the higher rates with the abolition of minor personal allowances. He would be grateful for views.

ACSA

A C S ALLAN

RA7.61

RE-DRAFT OF TABLE 1.1

Income tax	
personal allowances	-1395
basic rate	-2500
higher rate thresholds	- 300
higher rates	- 835
car scales	+ 230
P11D limit	- 50
home improvement loans	+ 80
covenants & maintenance (3)	-
Independent taxation	*
Capital gains tax	
rebasing	-
rates	+ 70
Inheritance tax	- 110
Corporation tax	
capital gains	- 25
small companies rate	*
Excise duties	
oils	+ a
VED	+ b
tobacco	+ c
alcohol	+ d
Other tax changes (3)	+75
	-4210

1. THE BUDGET

1.01 The objective of the Government's economic policy is to defeat inflation and to maintain a vigorous ~~dynamic~~ and enterprising economy, ~~and hence the conditions for~~ with sustained growth of output and employment.

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium-Term Financial Strategy (MTFS); describes developments in the economy over the past year; provides forecasts to mid-1989; sets out the tax proposals in the Budget; summarises the Government's spending plans; and gives forecasts for ~~shows the position of~~ the public finances for the year ahead.

The Medium Term Financial Strategy

1.03 Chapter 2 describes the MTFS which provides the framework for the Government's economic policy. Monetary and fiscal policies are designed to keep the growth of money GDP on a downward trend over the medium term, so bringing down inflation. The MTFS is complemented by supply side policies, including new measures in the Budget, designed to encourage enterprise, efficiency and flexibility and thus the growth of output and employment.

The economy

1.04 Chapter 3 describes the main developments in the economy in 1987 and the prospect until mid-1989. The economy grew strongly in 1987, ~~and unemployment fell at a post-war record rate.~~ with the largest fall in unemployment since the War. GDP is forecast to grow by a further 3% in 1988, with particularly strong growth in business investment. ~~growing by 8½%.~~ Inflation should remain low and unemployment continue to fall.

Tax measures

1.05 Chapter 4 sets out the tax proposals in the Budget. They continue the Government's programme of tax reduction and reform. They include ~~the~~ and the introduction in 1990-91 of independent taxation of husband and wife, ~~an~~ an increase in personal allowances, a reduction of 2p in the basic rate of income tax, the abolition of all higher rates of income tax above 40% ~~[and an increase in the higher rate threshold, the alignment of the rates of capital gains tax with income tax rates, the removal of the tax liability on inflationary capital gains before 1982, and the abolition of some income tax reliefs]~~. Other measures include reforms of capital gains tax, inheritance tax and the tax treatment of maintenance & covenants. The measures are summarised in Table 1.1.

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, as set out in the public expenditure White Paper. This Chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1987-88. ~~Public expenditure is planned over the medium term to grow less rapidly than the economy as a whole, permitting some further reduction in the burden of taxation.~~

Public sector finances

1.07 Chapter 6 presents the complete financial picture for the public sector. ~~The budget~~ There is expected to be ~~show~~ a budget surplus of £3 billion in 1987-88, the first surplus since 1969-70. A further surplus of £3 billion is ~~also forecast~~ envisaged for 1988-89. This takes account of the tax proposals in the Budget which are expected to reduce ~~revenues~~ taxation by £4 billion, ~~over and above~~ after adjusting for the net cost of indexing direct and indirect tax rates and allowances. Table 1.2 shows the main components of general government receipts and expenditures.

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FROM: A C S ALLAN

DATE: 29 February 1988

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr H Phillips
Mr Scholar
Mr Sedgewick
Mr Odling-Smee
Mr Turnbull
Mr S Davies
Mr Mowl
Miss C Evans

FSBR: CHAPTER FIVE

The Chancellor was grateful for your minute of 24 February and the
... draft of Chapter 5. I attach a copy with the Chancellor's and Chief Secretary's comments marked (only those pages on which they had comments).

ACSA

A C S ALLAN

2/959

Covering BUDGET CONFIDENTIAL

DRAFT
24/2/88

CHANCELLOR'S AND CHIEF SECRETARY'S COMMENTS MARKED.

1988 FSBR

5. PUBLIC EXPENDITURE

~~5.01 As discussed in Chapter 2 the Government's objective is to keep the growth of public expenditure below that of the economy as a whole.~~ explained

5.01 The Government's expenditure plans were set out in the Public Expenditure White Paper (Cm 288). These plans are summarised in Table 5.1. The Budget makes no change to these plans, apart from two consequentials of the tax proposals, described in paragraph 5.05.

→ ADD PARA 5.02 FROM NEXT PAGE

Public spending ~~plans~~ trends

5.03 ~~General government spending as a percentage of GDP has fallen from around 47 per cent in 1982-83 to below 42 per cent and it is planned that this decline should continue.~~

The reduction in the burden of debt interest, in unemployment and in subsidies to industry have helped make room for these increases while maintaining the Government's policy of reducing the share of national income taken by public expenditure. General government spending excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982-83 to [41½ per cent] now. This fall is planned to continue.

~~5.03 The detailed plans, providing the basis for the Supply Estimates, cash limits and other spending controls for 1988-89, were set out in the 1988 public expenditure White Paper (Cm 288-I and II). These plans are summarised in Table 5.1.~~

Table 5.1 Public expenditure

	£ billion				
	1986-87 Outturn	1987-88 Estimated outturn	1988-89 Plans	1989-90 Plans	1990-91 Plans
Department					
DHSS - social security	44.4	[46.3]	48.5	51.1	53.6
DHSS - health and personal social services	17.9	[19.7]	20.7	21.7	22.7
Defence	18.1	[18.7]	19.2	20.0	20.6
Education and science	15.7	[17.1]	18.0	18.6	19.2
Scotland, Wales and Northern Ireland	15.4	[16.4]	17.1	17.5	17.9
Other departments	32.0	[33.2]	34.9	36.2	36.7
Privatisation proceeds	-4.4	[-5.0]	-5.0	-5.0	-5.0
Reserve			3.5	7.0	10.5
Public expenditure planning total	**139.2**	**[146.4]**	**156.8**	**167.1**	**176.1**
General government gross debt interest*	17.6	[17.5]	[17.5]	[17]	[17]
Other adjustments*	8.0	[8.1]	[8.4]	[8]	[9]
General government expenditure*	**164.8**	**[171.6]**	**[183.0]**	**[193]**	**[201]**
General government expenditure excluding privatisation proceeds					
In real terms (base year 1986-87)	**[169.2]**	**[168.2]**	**[171.4]**	**[173.5]**	**[174.4]**
As a percentage of GDP	**[43¾]**	**[41½]**	**[41¼]**	**[40¾]**	**[40]**

*1989-90 and 1990-91 figures rounded to the nearest £1 billion

Changes since previous Budget

5.0~~1~~ 2 Since the last FSBR, extra resources have been allocated to priority services such as health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also been increased.

TO PREVIOUS PAGE

Budget measures

Two of the Budget measures have consequences for public expenditure.

5.05 In parallel with the abolition of tax relief on new covenants between individuals, including covenants to students - see paragraph 4.A x the parental contribution scale is being revised ~~reduced by [*] per cent~~ for those starting their studies ~~courses~~ from the 1988-89 academic year onwards. This will cost some £20 million in 1988-89, rising to £80 million in 1991-92. In parallel with the change in the tax treatment of forestry - see paragraph 4.B x there will be an increase in grants to forestry estimated to cost about £x million in 1989-90 rising to £y million in 1991-92. The expenditure arising from these changes will be charged to the Reserve ~~within~~ and will not add to the Planning Totals.

1987-88 outturn

5.06 The latest estimates for the outturn for the planning total in 1987-88, which are still ~~which still remain~~ subject to some uncertainty, suggest that it ~~the planning total outturn in 1987-88~~ is likely to be about £[146.4] billion, £[2.2] billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £[0.9] billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2. Of the Reserve of £3.5 billion, only £[1.4] billion was therefore required to meet additions to departmental programmes.

~~5.07 The plans included an unallocated Reserve of £3.5 billion. This is higher than the net additions to departmental programmes which amount to only £[1.4] billion.~~

Table 5.2 Comparison of plans and estimated outturn for 1987-88

	1987-88 £ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government[2]	108.3	[109.5]	[+1.2]
Local authority[2]	40.2	[41.0]	[+0.8]
of which:			
relevant expenditure	31.0	[32.2]	[+1.3]
other current	4.9	[5.1]	[+0.1]
capital	4.3	[3.7]	[-0.6]
Nationalised industries and other public corporations	1.6	[1.0]	[-0.6]
Privatisation proceeds	-5.0	[-5.0]	
Reserve	3.5		[-3.5]
Public expenditure planning total	**148.6**	**[146.4]**	**[-2.2]**

[1]Plans from The Government's Expenditure Plans 1987-88 to 1990-91, Cm 56, adjusted for classification changes.
[2]Excluding finance for nationalised industries and other public corporations

5.08 The major changes between plans and estimated outturn for particular programmes are

a net increase of £[1.2] billion in central government expenditure mainly due to an increase in expenditure by DHSS on Health and Personal Social Services of £[0.6] billion (reflecting the cost of the 1987 nurses and doctors and dentist pay settlements), and higher net payments to the European

Communities (£[0.8] billion) offset by lower payments by the Intervention Board for Agricultural Produce (£[0.3] billion);

expenditure by DHSS on social security is now estimated to be £[ ] above last year's plans; this is £[0.2] billion below the estimate in the public expenditure White Paper.

an ~~increase~~ overspend of £[1.4] billion ~~in~~ on the plans for local authority current expenditure

~~an increase of £[0.4] billion in gross capital expenditure more than offset by higher than expected capital receipts of local authorities £[1.0] billion~~

a net underspend of £[0.6] billion on local authority capital expenditure, reflecting £[0.4] billion higher gross spending, more than offset by £[1.0] billion higher capital receipts. The net underspend is £[ ] greater than that shown in the public expenditure White Paper.

better ~~than expected~~ results for nationalised industries and other public corporations, by £[0.6] billion, due principally to higher profitability of British Steel and increased capital receipts from New Towns £[0.2] billion

~~5.09 The main changes contributing to the drop of £[0.9] billion since the 1988 public expenditure White Paper are~~

~~a decrease of £230 million in expenditure by DHSS Social Security due to lower unemployment~~

~~a decrease of £130 million in Ministry of Defence spending.~~

~~a decrease of over £100 million on housing expenditure by the Department of the Environment~~

~~a decrease of £70 million in local authority capital expenditure.~~

Table 5.3 Public expenditure by spending authority

£ billion					
	1986-87 Outturn	1987-88 Estimated outturn	1988-89 Plans	1989-90 Plans	1990-91 Plans
Central government*	104.6	[109.5]	114.2	120.2	124.7
of which:					
Voted in Estimates	73.4	[77.0]	81.0	84.6	87.6
other	31.2	[32.6]	33.2	35.6	37.1
Local authorities*	37.9	[41.0]	42.6	44.0	45.2
of which:					
relevant expenditure	29.4	[32.2]	33.2	34.3	35.4
other current	4.8	[5.1]	5.4	5.7	5.9
capital	3.7	[3.7]	4.0	4.0	3.9
Nationalised industries	0.4	[0.4]	0.7	0.0	-0.4
Other public corporations	0.8	[0.6]	0.8	1.0	1.0
Privatisation proceeds	-4.4	[-5.0]	-5.0	-5.0	-5.0
Reserve			3.5	7.0	10.5
Public expenditure planning total	**139.2**	**[146.4]**	**156.8**	**167.1**	**176.1**

*Excluding finance for nationalised industries and other public corporations

Public expenditure by spending authority

5.10 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament

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Pg

FROM: D L C PERETZ

DATE: 1 March 1988

CHANCELLOR

cc Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Mr R I G Allen
Mr Grice
Miss O'Mara
Mr Cropper

Cl
New draft below
AA

1988-89 M0 TARGET RANGE

We have so far left over a decision on whether to go for a 1-5 per cent or 2-6 per cent M0 target range next year. It may be sensible to try to make a decision at tomorrow's meeting with the Governor.

2. We now have more or less final M0 figures for February - where the outturn was distorted downwards by below normal bankers' balances and Northern Irish notes. I am attaching a note showing the recent figures, together with our latest forecast for M0 growth over 1988.

3. The forecast has 12 month M0 growth at around 6 per cent in March and April. This is now fairly certain. The seasonally unadjusted 12 month growth rate in March is likely to be even higher, because of the timing of Easter this year and last.

4. The forecast has the rate falling below 5 per cent by July. That is less certain, and reflects the slowdown of consumer spending which is in the FSBR forecast.

5. The arguments for 2-6 per cent, the same as this year, are:

- we are more likely to stay within it; and in the early part of the year it is less likely to be in conflict with the exchange rate objective

- arguably it is more consistent with the money GDP path, in the short run, which for 1988-89 is 1 per cent higher than envisaged in the 1987 MTFS.

6. The arguments for 1-5 per cent, the illustrative range for 1988-89 indicated last year, are:

- even if we are above the range in the first few months of the year, sticking to 1-5 per cent is a statement of intent not to accommodate inflationary pressures, and is arguably more consistent with the medium-term aspirations for money GDP and inflation

- we have said in the past that if outside the range we will act on interest rates <u>unless</u> other indicators clearly suggest this is not needed. So being outside the 1-5 range early in the year would (correctly) increase the presumption that we will raise interest rates if external factors permit. This applies whether exchange rate stability is taken as a constraint, or simply as a factor given very heavy weight in setting policy.

7. Treasury and Bank officials agree that the arguments in paragraph 6 are more convincing. So our advice is to go for 1-5 per cent rather than 2-6 per cent.

DLCP

D L C PERETZ

cc: Mr E A J George - B/E

FACTORS UNDERLYING THE M0 FORECAST

The underlying forecasts for M0 are made on an end-quarterly basis and the monthly profile shown in Table 1 derived by interpolation. End-quarterly forecasts for M0 in this year's FSBR projections are as follows:

M0 Projections : 1988 FSBR

		Growth Rates (%)	
	Level (£m s/a)	**On One Year Previously**	**Annualised Quarterly Rate**
1988 Q1	15960	5.8	3.5
Q2	16051	4.8	2.3
Q3	16179	3.6	3.2
Q4	16262	2.7	2.1
1989 Q1	16427	2.8	4.1

2. Of the factors affecting M0, the main influences are:

(i) interest rates

(ii) non-durable consumer spending

(iii) consumer prices

3. It is possible to analyse the reduction in the year-on-year growth rate so as to attribute it to the effects of changes in each of these items. Doing so and interpolating to a monthly basis yields the following breakdown:

Contributions to M0 Growth (expressed as percentage year-on-year growth, seasonally adjusted)

			Contribution of:-			
		M0	Interest Rates	Non-durable Consumption	Consumer Prices	Financial Innovation/ unexplained
1988	Mar	6.0	1.0	4.3	3.5	- 2.8
	Apr	5.8	1.0	4.2	3.7	- 3.1
	May	5.5	1.0	4.1	3.9	- 3.5
	Jun	5.5	1.0	4.1	4.2	- 3.8
	Jul	4.3	1.0	4.1	4.2	- 5.0
	Aug	4.3	0.9	3.6	4.1	- 4.3
	Sep	3.9	0.7	3.2	4.0	- 4.0
	Oct	3.4	0.6	2.8	3.7	- 3.7
	Nov	3.3	0.5	2.7	3.4	- 3.3
	Dec	2.5	0.4	2.6	3.0	- 3.5
1989	Jan	2.9	0.4	2.4	2.8	-2.7
	Feb	2.9	0.3	2.5	3.0	- 2.8
	Mar	2.8	0.2	2.4	3.2	- 3.0

4. It seems clear that the main reason for the declining year-on-year growth in M0 is the projected deceleration in non-durable consumption in the course of 1988. From the second half of 1988 onwards both lower increases in consumer prices and the effects of the recent increase in interest rates also help to produce slower M0 growth. (No great attention should be paid to the apparent increased effect of financial innovation and the unexplained item in 1988 Q3. This reflects only erratic behaviour in the unexplained component a year before in 1987 Q3.)

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TABLE 1: MO FORECAST

Seasonally adjusted

	LEVELS £ MILLION			% CHANGE ON PREVIOUS MONTH		% CHANGE ON YEAR EARLIER	
	Notes and coin	Bankers' Deposits	MO	Notes and coin	MO	Notes and coin	MO
ACTUAL							
1988 January	15,620	181	15,801	- 0.3	- 0.3	4.5	4.6
February	15,658	122	15,780	+ 0.2	- 0.1	5.7(6.0)	5.3(5.7)
FORECAST							
March	15,750	190	15,940	+ 0.6	+ 1.0	6.3(6.6)	6.0(6.2)
April	15,810	190	16,000	+ 0.4	+ 0.4	6.0	5.8
May	15,830	190	16,020	+ 0.1	+ 0.1	5.6	5.5
June	15,855	190	16,045	+ 0.2	+ 0.2	5.2	5.5
July	15,875	190	16,065	+ 0.1	+ 0.1	4.7	4.3
August	15,920	190	16,110	+ 0.3	+ 0.3	4.3	4.3
September	15,970	190	16,160	+ 0.3	+ 0.3	3.9	3.9
October	16,000	190	16,190	+ 0.2	+ 0.2	3.5	3.4
November	16,030	190	16,220	+ 0.2	+ 0.2	3.3	3.3
December	16,060	190	16,250	+ 0.2	+ 0.2	2.5	2.5
1989 January	16,070	190	16,260	+ 0.1	+ 0.1	2.9	2.9
February	16,130	190	16,320	+ 0.4	+ 0.4	3.0	2.9
March	16,190	190	16,380	+ 0.4	+ 0.4	2.8	2.8

* Last month's forecast in brackets.

COPY NO 1 OF 22

FROM: S J DAVIES
DATE: 1 March 1988

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr Grice
Ms C Evans
Ms Turk
Mr Cropper
Mr Tyrie
Mr Call

FSBR CHAPTER TWO

I attach a new version of FSBR Chapter 2, revised to take on your comments on the previous version. The Bank of England have seen this revised version (up to paragraph 2.13 only).

2. Changes from the amended copy returned to me yesterday are sidelined.

3. Paragraph 2.05 has been redrafted as proposed in [Sir Peter Middleton's minute to you of 1 March.] Simon Sargent's note to Oddler of 29 February.

4. In paragraph 2.06 the words "but to remain higher than projected in last year's FSBR" have been deleted at the end of the second sentence. This corrects an error in the draft circulated last week: while non-North Sea output is projected to grow faster than in last year's MTFS (by ¼ per cent a year) the growth of the whole economy has not been revised up (except for 1988).

5. The second sentence of paragraph 2.14 has been amended to say that 1987-88 "is only the second time since the early 1950s that there has been a budget surplus" rather than "since the War". Although PSBR figures are not available for the early paost-war period, the public sector ran a financial surplus in each of the three years from 1948 to 1950.

6. Small amendments have been made to paragraphs 2.19. In the second sentence "are helping" has been substituted for "have enabled". The reason for the change is that it is not only reductions in debt interest, but also reductions in spending on other programmes in relation to GDP, that have permitted the Government to increase spending on priority programmes etc.

SJD

S J DAVIES

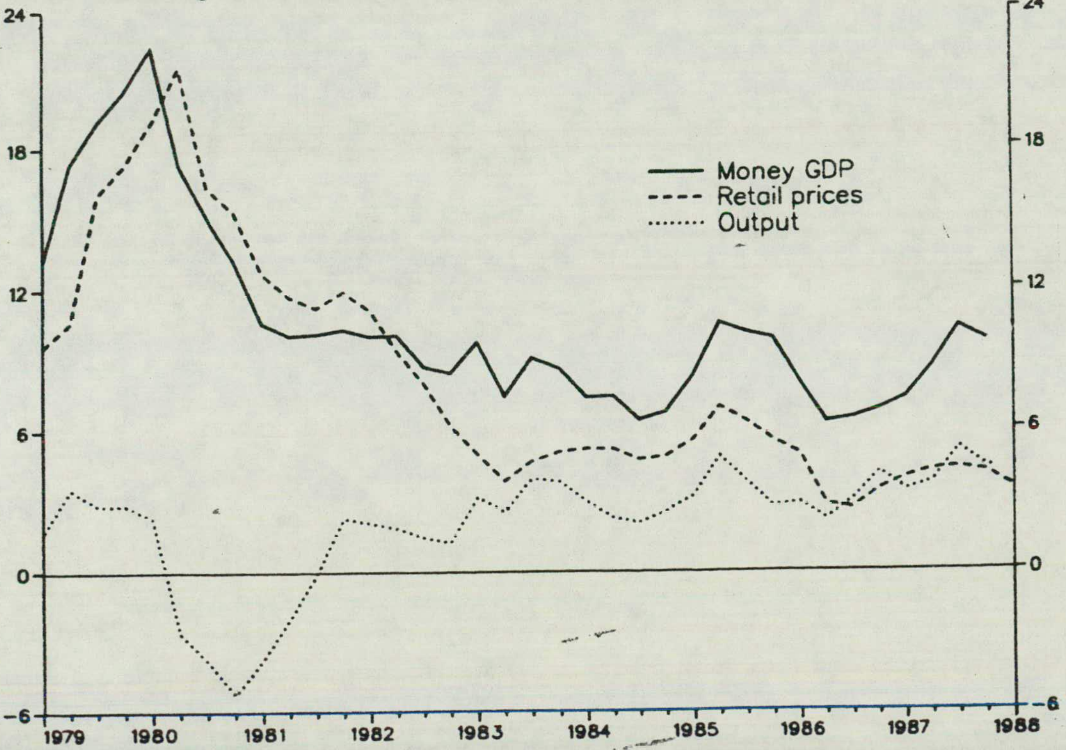
MEDIUM TERM FINANCIAL STRATEGY

2.01 The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980.

2.02 It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. Accordingly, economic policy is set in a nominal framework. Monetary and fiscal policies are designed to keep the growth of money GDP on a downward trend over the medium term. The MTFS is complemented by policies to improve the working of markets and the supply side of the economy. By encouraging enterprise, efficiency and flexibility, these policies improve the division of money GDP growth between output growth and inflation, thus assisting the creation of jobs.

2.03 Money GDP growth has come down from over 20 per cent at the start of 1980 to under 10 per cent last year. At the same time inflation has fallen from over 20 per cent at its peak in 1980 to around 4 per cent last year. In real terms the economy has grown steadily at around 3¼ per cent a year on average since 1983, and is set for a further year of growth at around 3 per cent, with inflation remaining around 4 per cent.

Chart 2.1 Money GDP output and inflation



Objectives and the framework of policy

2.04 Policy is directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term. Table 2.1 shows the intended medium term path for money GDP, although there will inevitably be fluctuations around it in the short term.

ng

Table 2.1: **Money GDP Growth***

1987-88	1988-89	1989-90	1990-91	1991-92
9¾	7½	6½	6	5½

* Per cent change on previous financial year. See Table 2.3 for assumptions on output and inflation. The figure for 1988-89 is a forecast; the figures for subsequent years describe the Government's broad medium term objectives.

I prefer original

2.05 Money GDP growth is expected to be around 9¾ per cent in 1987-88, higher than forecast in last year's FSBR. The division of money GDP growth between output growth and inflation was better than forecast, a further sign of improvement in the supply performance of the economy. Output growth is currently estimated at 1½ points above last year's forecast; inflation (as measured by the GDP deflator) is estimated to have been about ½ point higher than forecast.

2.06 For 1988-89, money GDP growth is forecast to be 7½ per cent. Real growth is forecast to slow down from its 1987-88 level. The current forecast for the increase in the GDP deflator in 1988-89 is a little above the projection in last year's MTFS.

2.07 For the later years, the growth of money GDP is projected to decline at much the same rate as envisaged last year. The medium term growth projection for the economy as a whole is unchanged from last year's MTFS, as is the medium term decline in inflation.

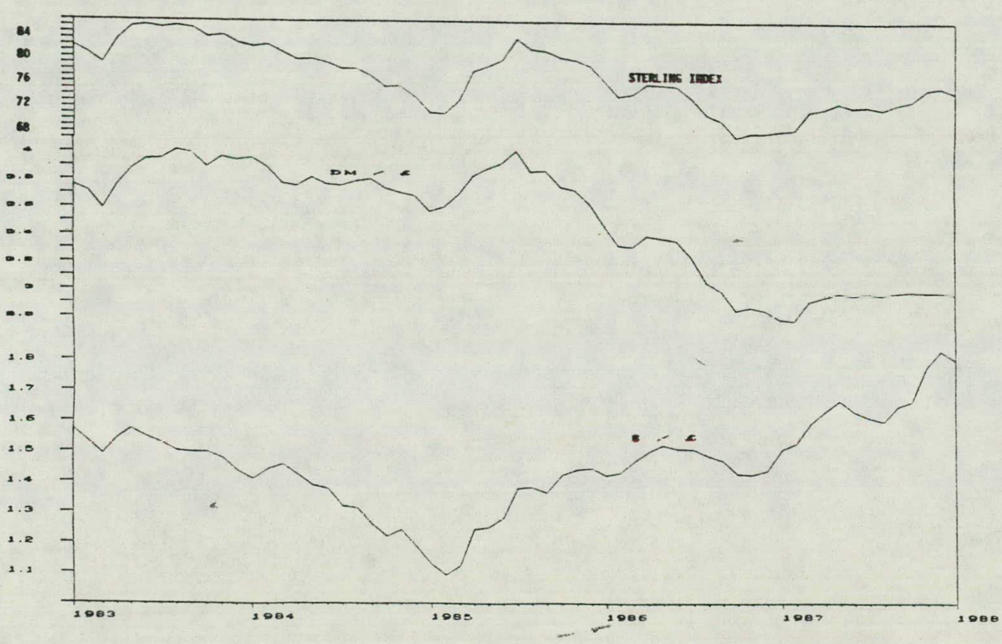
2.08 A declining path for money GDP growth, as in Table 2.1, requires firm monetary policy supported by prudent fiscal policy. Fiscal policy is reviewed each year at budget time. Short-term interest rates, which are varied more frequently, are used to keep monetary conditions on track.

Monetary Policy

attaches particular importance

2.09 [As the Chancellor made ~~clear at~~ the Mansion House last year,] The Government [~~is committed~~] to maintaining a stable exchange rate, ~~with~~ notably the rate against the deutschemark, [~~being of particular importance~~.] This provides an important financial discipline, and is also helpful to industry. Sterling has remained stable against the deutschemark throughout the past year, following the Louvre accord in February 1987. The discipline of a stable exchange rate provides the underpinning for the declining path of money GDP growth and inflation.

Chart 2.2 Sterling exchange rates



2.10 Achieving these objectives ~~implies~~ also requires a reduction in monetary growth over the medium term. For M0, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988-89 of 1-5 per cent [2-6 per cent]. This is the same as indicated in last year's MTFS. [This is the same as last year's range.] The ranges given in Table 2.2 for later years are illustrative, but show a steady fall consistent with the declining path for money GDP growth.

2.11 Interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure that inflationary pressures are not accommodated. This means, in particular that increases in domestic costs will not be accommodated by a decline in the exchange rate.

Chart 2.3 Velocity of monetary aggregates

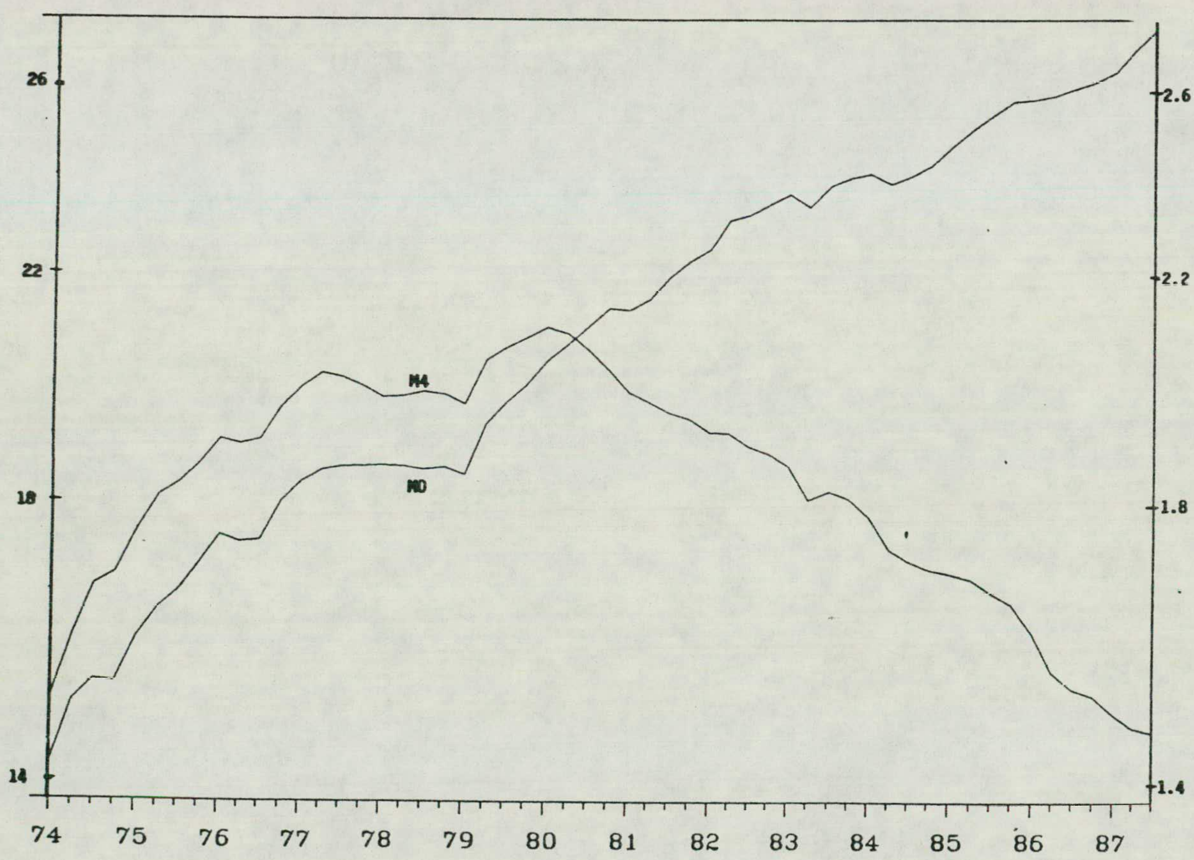


Table 2.2: Growth of MO*

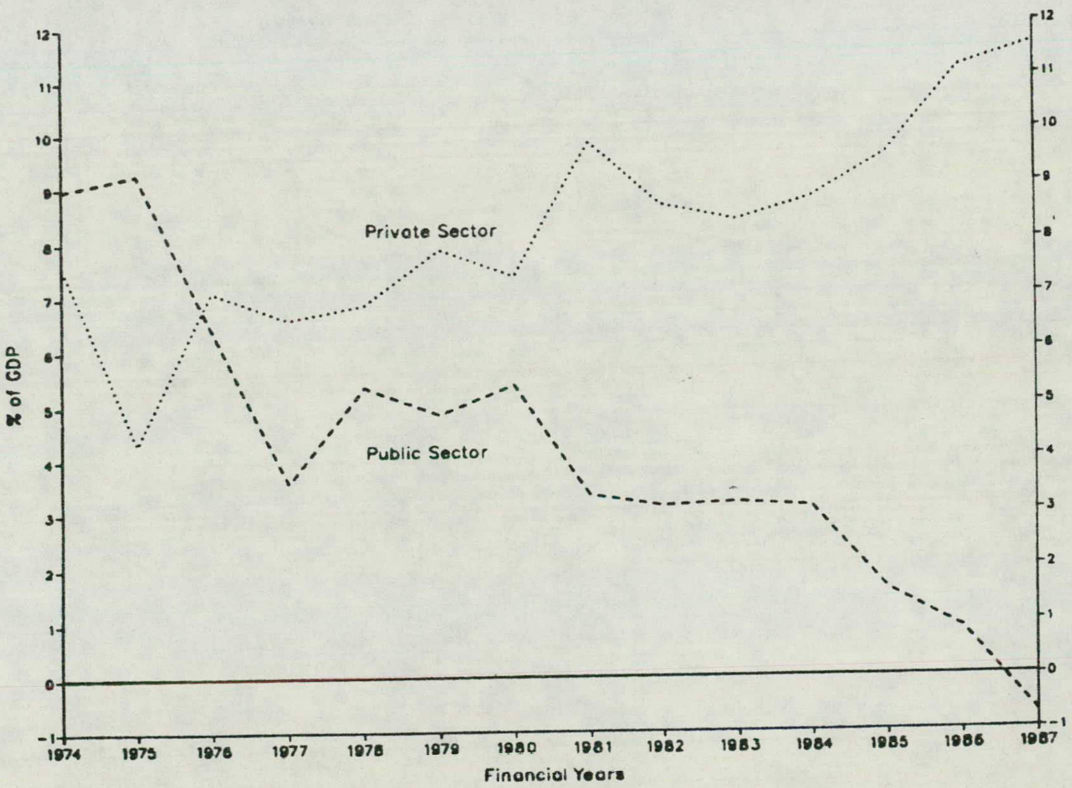
1987-88	1988-89	1989-90	1990-91	1991-92
5	[1-5]	1-5	0-4	0-4

* Per cent change on previous financial year. 1987-88 is a forecast. 1988-89: target range. 1989-90 onwards: illustrative ranges.

2.12 While, as last year, there is no explicit target range for broad money, the assessment of monetary conditions continues to take broad money, or liquidity, into account.

2.13 With the increasing overlap between activities of banks and building societies, it is sensible to concentrate on measures of broad money, such as M4, that include deposits held with both. Equally, the authorities will seek to fund the total of maturing debt, the PSBR, and any net increase in foreign exchange reserves resulting from market transactions, by sales of debt outside the banking and building society sectors.

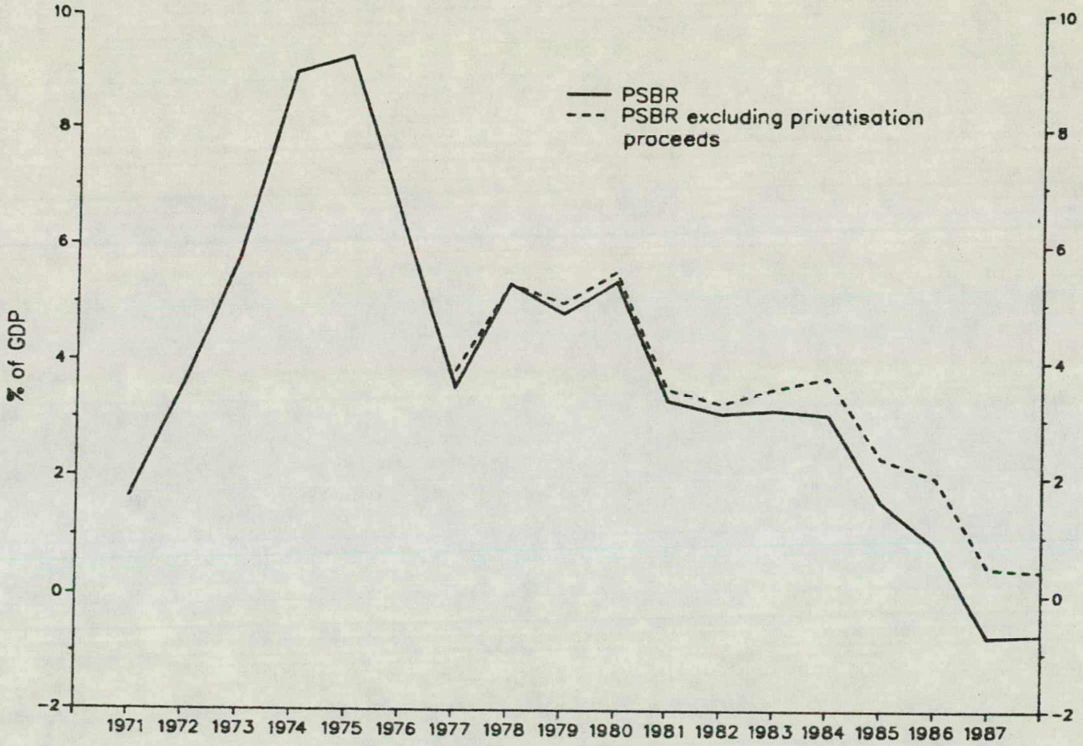
Chart 2.4 Private and public sector borrowing



Fiscal policy

2.14 It is now expected that there will be a net repayment of public debt in 1987-88, compared with a borrowing requirement of around 1 per cent of GDP forecast a year ago. This is only the second time since the early 1950s that there has been a budget surplus. Even if there had been no privatisation proceeds at all, the PSBR would have been under ½ per cent of GDP, smaller than in any year since 1969-70.

Chart 2.5 **Public sector borrowing requirement and privatisation proceeds**



The PSBR path **2.15** The PSBR is now assumed to be zero over the medium term: a balanced budget. This is a prudent and cautious level and can be maintained over the medium term. It also provides a clear and simple rule, with a good historical pedigree. In practice, there are likely to be fluctuations around this level from year to year. On the basis of current privatisation plans, a PSBR of zero implies that, even without any privatisation proceeds, it would be only 1 per cent of GDP.

2.16 The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of [over £7 billion] in 1988-89. Continuing the gradualist approach which has always been a characteristic of the MTFS, only part of this room for tax reductions has been used. The PSBR for 1988-89 is set at [ ], little changed from the expected outturn in 1987-88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Change here seems to be merging two paragraphs

Assumptions

2.17 For the period to 1990-91, the public expenditure projections in Table 2.4 use the figures for the public expenditure planning total shown in the public expenditure White Paper (Cm 288); gross debt interest payments are lower than projected in the White Paper, reflecting lower government borrowing while other adjustments are a little higher. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1991-92. Decisions on expenditure in 1991-92 will be taken in the 1988 Survey.

2.18 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.3. They are consistent with the figures for money GDP growth in Table 2.1. Oil prices are assumed to average $15 a barrel in 1988-89 and thereafter to remain broadly unchanged in real terms.

Table 2.3 **Output and inflation assumptions**

	Percentage change on previous financial year				
	1987-88	1988-89	1989-90	1990-91	1991-92
Real GDP					
Non North Sea	5	3	3	3	3
Total	4½	2½	2½	2½	2½
Inflation					
GDP deflator	5	4½	4	3½	3

Public expenditure

2.19 Continued restraint in total public spending is a vital element of the Government's economic strategy. Reductions in borrowing and hence in the burden of debt interest, coupled with strong economic growth, are helping the Government to increase spending on priority programmes while at the same time achieving its objective of reducing public expenditure as a proportion of national income. This in turn is creating room for reductions in taxation, helping to improve further the performance of the supply side of the economy. Public expenditure is considered more fully in Chapter 5.

Table 2.4 **General government expenditure**

£ billion cash

	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Public expenditure planning total[1]						
Gross debt interest						
Other adjustments						
General government expenditure[2]						
of which Privatisation proceeds[3]						
General government expenditure excluding privatisation proceeds						

[1] For 1986-87 to 1990-91, the figures are taken from Table 5.1.

[2] General government expenditure, and its components, are rounded to the nearest £1 billion from 1987-88 onwards. General government expenditure is assumed to grow by 1% in real terms in 1991-92.

[3] See the public expenditure White Paper (Cm 288), Table 1.8. Proceeds are assumed to be the same in cash terms in 1991-92 as in 1990-91.

Revenue

2.20 The growth in government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, [general government receipts are expected to increase somewhat less than money GDP. Government revenues from the North Sea are projected to decline as oil output falls. Non-North Sea revenues are projected to grow at around the rate of growth of non oil money GDP.]

Table 2.5	General government receipts					
	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
Taxes on incomes, expenditure and capital						
National insurance and other contributions						
Interest and dividends						
Other receipts						
General Government receipts[1]						
of which North Sea tax[2]	4.8	5	4	4	3	3

[1] General government receipts, and its components, are rounded to the nearest £1 billion from 1987-88 onwards.

[2] Royalties, petroleum revenue tax (including advance payments) and corporation tax from North Sea and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 3 to Table 6B.3.

Public sector borrowing

2.21 The projections of government expenditure and receipts are brought together in Table 2.6 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.22 Changes since the 1987 MTFS are discussed in the Annex to this chapter.

Table 2.6 Public sector borrowing[1]

	£ billion cash					
	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92
General government expenditure						
General government receipts						
Fiscal adjustment from previous year[2]						
Annual fiscal adjustment[2]						
GGBR						
Public corporations' market and overseas borrowing						
PSBR	3.4	-[ ]	-[ ]	0	0	0
Money GDP at market prices	387	426	457	487	516	545
PSBR as per cent of GDP	0.9	-[ ]	-[ ]	0	0	0

[1] Rounded to the nearest £1 billion from 1987-88 onwards. Further details for 1987-88 and 1988-89 are provided in Tables 1.2 and 6.7.

[2] Means lower taxes or higher expenditure than assumed in lines 1 and 2.

Conclusion

go back to your draft

2.23 The strength of the economy coupled with fiscal prudence has enabled the Government to achieve a balanced budget on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress in the medium term towards lower inflation, [and] lower taxes and lower public spending as a share of GDP. The MTFS provides the financial framework within which the policies to achieve these objectives are set.

ANNEX TO CHAPTER 2

Changes since the 1987 MTFS

Money GDP

2A.1 The growth rate of money GDP is expected to be higher in both 1987-88 and 1988-89 than envisaged in last year's MTFS, with growth in the GDP deflator ½ percentage point higher in both years. Thereafter inflation is projected to decline at the same rate as last year. The projection of output growth over the medium term in the whole economy is unchanged from last year's MTFS.

Table 2A.1 Money GDP growth

Differences from 1987 MTFS projections, percentage points

1987-88	1988-89	1989-90	1990-91
+2¼	+1	+½	+½

Monetary aggregates

2A.2 The growth in MO in 1987-88 has been within its target range throughout the year. The target range for 1988-89 [is the same as the illustrative range given last year]. The illustrative ranges for subsequent years are [also] the same.

Table 2A.2 The growth of MO

	Per cent changes on a year earlier			
	1987-88	1988-89	1989-90	1990-91
1988 MTFS	5	[1-5]	1-5	0-4
1987 MTFS	2-6	1-5	1-5	0-4

Fiscal projections

2A.3 Table 2A.3 shows changes in the fiscal projections since the 1987 FSBR. Additional information on 1987-88 is given in Chapter 6.

Expenditure

2A.4 The expected undershoot on the planning total in 1987-88 is described in Chapter 5. General government expenditure is also lower in 1987-88 than projected last year, reflecting the lower planning total. The planning total for 1988-89 onwards is as in the public expenditure White Paper (Cm 288), which incorporates higher figures than assumed last year. The general government expenditure figures for the future have also been revised up; but to a lesser extent than the planning total, as the lower path now adopted for the PSBR implies substantially lower debt interest payments.

Receipts

2A.5 Revenues in 1987-88 have been much higher than forecast, in large part reflecting higher money GDP growth in both 1986-87 and 1987-88. Because of the lag between accruals and payments of taxes on corporate profits, the buoyancy of the economy over the last year will still be contributing to the growth of revenues in 1988-89. North Sea revenues in 1987-88 were slightly higher than forecast, as the oil price for much of the year was well above the assumed level of $15 a barrel. On the assumption that oil prices remain close to recent levels, oil revenues in 1988-89 are now forecast to be much as projected a year ago.

Table 2A.3

Revenue and expenditure

Changes from 1987 MTFS projections £billion

	1986-87	1987-88	1988-89	1989-90	1990-91
Expenditure					
1 Planning total	-1	-2½			
2 Other	+1	+½			
3 General government expenditure	0	-2			
Receipts					
4 North Sea taxes	0	+½			
5 Other taxes and contributions	+½	+4			
6 Other	+½	+1			
7 General government receipts	+1	+5½			
8 Implied cumulative fiscal adjustment	-	-			
9 Public corporations' market and overseas borrowing	0	0			
10 PSBR	-1	-7½			

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BUDGET

COPY NO 1 OF 31

FROM: MISS C E C SINCLAIR
DATE: 2 March 1988

CHANCELLOR

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Mr Riley
Miss Simpson
Miss Evans
Mr A Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Isaac
Mr Painter - IR
Mr J Calder

Mr Unwin
Mr Knox - C&E
Mr P R H Allen

SECRET

Missing pages used in note to Miss Sinclair

B.L.O.

FSBR: CHAPTER 4

I attach the first printer's proof of Chapter 4. It has been amended to take account of the decisions at Monday's Overview.

2. You will see that we have also taken on board the vast majority of the comments you made on the first draft (Mr Allan's minute of 26 February). But there are one or two points where we would like to offer you further advice:

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(a) You asked whether the car parking exemption should be mentioned in the narrative. We think it is too minor to warrant this (it will, of course, appear in Table 4.1 and the Annex).

(b) You wanted to refer to the cost of entertaining overseas businessmen rather than customers. The Revenue feel that this is not sufficiently accurate: the relief currently extends to (and is thus being withdrawn from) the cost of entertaining the agent of an overseas Government or public authority. Would you be content with customers?

(c) You asked if it was essential to include a reference in the narrative (para 4.30) to the fact that there will be an increase in grants for forestry. While not essential, this is in line with the treatment of covenants (para 4.10). If we were to take out the cross-reference to Chapter 5 from the narrative, would you want it to go in the Annex? Or do you want the only mention of the parallel public expenditure changes on forestry and covenants to be made (possibly) in a footnote to Table 1.1, and in Chapter 5 (para 5.04)?

(d) You asked if we could drop the paragraph in the narrative on the easements to the VAT penalty regime. It has been omitted from the printer's proof, but Customs see a case for including a shortened entry in the narrative, viz.

"The VAT civil penalty system, introduced in 1985, has been reviewed and amendments are proposed."

(e) You asked if we could show unleaded petrol in a separate line in Table 4.1, disaggregated from the change in duty on leaded petrol. The resulting figures would be as follows:

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£m

	1988-89 Non-indexed	1988-89 Indexed	1989-90 Indexed
Increase in duty on leaded petrol	+110	- 85	-495
No change in duty on unleaded petrol	+165	+165	+545
[Net effect]		[+ 80]	[+ 50]

These figures would look rather odd among the other excise figures in Table 4.1. Yet explaining them in the Annex would require something to be said about the assumptions on changes in market share. You might prefer to avoid this.

(f) You asked if we should say somewhere that the MIR limit will remain at £30,000. The limit is mentioned in paragraph 4.09. We do not normally confirm the status quo in Chapter 4, though we can do so if you wish.

(g) You asked what note 51 in the Annex was about. Last year's Finance Act abolished part of the definition of an investment trust by mistake (in the context of changing the taxation of companies' capital gains). In a PQ answered on 23 July, Ministers undertook to restore the relevant provision in the 1988 Finance Bill with effect from 17 March 1987.

3. The ordering of the income tax items in the narrative and in Table 4.1, and their costing, are consistent with those in Mr Eason's submission of today's date.

4. The costings for home improvements loans and car scales now take account of the behavioural responses discussed in Mr Riley's submission of 23 February . This fact is flagged up in the notes in the Annex.

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5. We need to return the proof to the printers on **Friday, 4 March.** It would be very helpful to have your comments on the morning of that day.

CAROLYN SINCLAIR

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4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1.

Income tax

4.02 The basic rate of income tax will be reduced to 25 per cent.

4.03 There will be a single higher rate of income tax of 40 per cent, which will apply to taxable income over £19,300.

4.04 The main income tax personal allowances will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3.7 per cent in the RPI in the year to December 1987). This will mean that:

the single person's and wife's earned income allowances will rise by £180 from £2,425 to £2,605;

the married allowance will rise by £300 from £3,795 to £4,095;

the age allowance for those aged 65 to 79 will rise by £220 from £2,960 to £3,180 (single) and by £360 from £4,675 to £5,035 (married);

the age allowance for those aged 80 or over will rise by £240 from £3,070 to £3,310 (single) and by £360 from £4,845 to £5,205 (married);

the income limit for age allowance will rise by £800 from £9,800 to £10,600;

the additional personal allowance and widow's bereavement allowance will rise by £120 from £1,370 to £1,490.

4.05 The dependent relative allowance of up to £145, the housekeeper allowance of £100 and the allowance for the services of a son or daughter of £55 will be abolished.

4.06 From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

Life assurance premium relief

4.07 The rate of premium relief for life assurance policies taken out before 14 March 1984 will be reduced to 12½ per cent from 6 April 1989.

Benefits in kind

4.08 Car benefit scale charges for 1988–89 will be set at twice their 1987–88 levels.

Mortgage interest relief

4.09 For loans taken out from 1 August 1988, tax relief will be limited to the interest on £30,000 per residence, regardless of the number of borrowers. Relief on new loans for home improvements will be abolished from 6 April 1988. So will relief on new loans for the purchase of residences for dependent relatives and divorced or separated spouses.

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Independent taxation for married couples

The present system of taxing husbands and wives, under which a married woman's income is treated in law as if it belonged to her husband, has been unchanged since the earliest days of income tax. Green Papers published in 1980 and 1986 have considered how the system might be reformed. There is general agreement that the present law is no longer acceptable, and wide support for an early change to a new and more up-to-date system.

A major reform of the system is therefore proposed to give husbands and wives independence and privacy in their tax affairs and remove the tax penalties on marriage which can occur under the present system. The new system will be introduced from 6 April 1990 to allow time for the necessary preparations.

From 6 April 1990, husbands and wives will be taxed independently on their income and chargeable capital gains. This will mean that:

husband and wife will become independent taxpayers each with their own allowances and rate-bands to set against their own income (from whatever source); each will be responsible for handling their own tax affairs with the Inland Revenue;

every taxpayer will be entitled to a personal allowance, equivalent to the existing allowance for single people;

there will be a new married couple's allowance (based on the difference between the present married allowance and the single allowance). This will be set first against the husband's income, but any unused amount may be transferred to the wife;

married women will qualify in their own right for the higher levels of personal allowance for taxpayers aged 65–79 and those aged 80 or over. Higher levels of married couples allowance will apply where either partner in a couple is aged 65–79 (or aged 80 or over).

{there will be transitional protection for the small number of couples whose allowances would be reduced as a result of the change to the new system;}

a husband's and wife's capital gains will be taxed independently; each spouse will be entitled to the same exempt amount as a single person;

the existing exemptions from capital gains tax and inheritance tax on transfers of capital between husband and wife will continue;

the new system will mean that a number of provisions, including the wife's earnings election and separate assessment, can be abolished.

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Table 4.1 Direct effects of changes in taxation—*continued*

	£ million		
	Estimated effect on receipts in: 1988–89		1989–90
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Excise duties—*continued*			
78 ~~79~~ Increase in rate of duty on leaded petrol etc	+275	+80	+50
78 ~~80~~ Increase in rate of duty on derv	+75	+25	+30
79 ~~81~~ No change in rates of minor oil duties	—	−5	−10
80 ~~82~~ Increase in rates of duties on cigarettes, hand-rolling tobacco and cigars	+100	—	—
81 ~~83~~ No change in rate of duty on pipe tobacco	—	*	−5
TOTAL CUSTOMS AND EXCISE	**+565**	**+110**	**+75**
Vehicle excise duty			
82 ~~84~~ No change in VED on car, light van and main lorry rates	—	−100	−110
83 ~~85~~ Increase in certain other VED rates	+20	+20	+20
84 ~~86~~ New VED class for exceptional loads	*	*	*
TOTAL VED	**+20**	**−80**	**−90**
Other			
85 ~~87~~ Bus fuel grants	−5	*	−5
TOTAL CHANGES IN TAXATION	~~−4280~~	~~−3985~~	~~−6300~~
	~~−4305~~	~~−4010~~	~~[illegible]~~
	−4305	−4005	~~[illegible]~~
			−6250

* = Negligible — = Nil

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for existing maintenance arrangements, in 1988–89 the present rules will continue to apply except that a divorced or separated spouse will be exempt from tax on the first £1,490 of maintenance received (after grossing up at the basic rate where tax has been deducted by the payer). From 1989–90, all payments will be made gross; and relief for the payer will be limited to the amount which qualified for relief in 1988–89; ~~and~~ the tax liability on the recipient will be limited to the amount taxable in 1988–89; and a divorced or separated spouse will be exempt from tax on an amount up to the difference between the single and married allowances.

(Usual letters) **The changes are estimated to ~~cost~~ yield £[~~15~~ 5] million in 1990–91 and £[~~10~~ 15] million in 1991–92, and ~~to [yield £20~~ [235] million] eventually.**

21 See paragraph 4.1~~6~~7

22 See paragraph 4.~~28~~15. ~~[The legislation will first take effect for the Lloyd's 1986 Account, which closes at the end of 1988.]~~

23 The legislation on Lloyd's reinsurance to close (RIC) will be modified so that it will not apply to Lloyd's members who ceased membership of a syndicate at the end of the underwriting year, and are therefore not members of the syndicate to which the relevant RIC premium is paid. [The legislation will first take effect for the Lloyd's 1985 Account, which closed at the end of 1987. This is the first year to which the 1987 legislation on Lloyd's RIC will apply.]

24 Changes will be made to the rules (Section 79 Finance Act 1972) governing unapproved employee share schemes. The present charge (to income tax) on the whole of any growth in value of certain employee-acquired shares is to be replaced in most cases with a new, more narrowly, targeted charge that will arise only if, and to the extent that, value is shifted preferentially into the employee shares. This relaxation will also apply to shares in "qualifying" subsidiaries. These changes will take effect from 26 October 1987 when draft clauses incorporating the proposed changes were published for consultation.

25 From 23 September 1987, any benefit resulting from priority in applying for a public offer of shares given to employees by virture of their employment will be exempt from income tax.

26 Changes will be made to approved discretionary share option legislation to enable employees to borrow to purchase their option shares without losing tax relief.

27 Legislation will be introduced to ensure that the Inland Revenue continue to have power to make an income tax assessment, on certain types of income assessable on the "current year" basis, in the course of the year in which the income is received.

28 The limit below which redundancy and certain other lump sum payments are exempt from income tax will be increased from £25,000 to £30,000. The reduced rates of tax which apply to the next £50,000 of such payment will be abolished.

29 The "top-slicing" relief which applies to the tax charged on premiums for leases and certain other payments will be withdrawn.

30 The new system of independent taxation for husbands and wives will apply from 1990–91. The revenue costs in 1990–91 and 1991–92 (based on the existing distribution of income between husbands and wives) are estimated at £[630] and £[970] million respectively for income tax. For capital gains tax, the prospect of independent taxation may lead some couples to defer disposals until the new

BUDGET SECRET
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RESTRICTED
Covering BUDGET CONFIDENTIAL

FROM: MRS R J BUTLER
DATE: 2 March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr S Davies
Mr Mowl
Mr Pickford
Mr R I G Allen
Miss Simpson
Miss Hudson
Miss Evans

Cl
A few small points
AA

I have marked a few, too. But should we not make some reference for 5.04 – perhaps on to the consequential PX saving resulting from the increased personal allowances (following the introduction of the soc. sec. reforms)?

FSBR: CHAPTER 5

I attach a copy of the amended proofs of Chapter 5 of the FSBR which take on board the comments made by you and the Chief Secretary last week.

2. The figures to be shown for 1987-88 estimated outturn for the planning total will be cleared with the Chief Secretary early next week and the figures for GGE and GDP have yet to be settled. The final figures will be incorporated next week.

3. These proofs have to be returned to the printers on Friday so I would be grateful for any further comments you may have by noon on Friday.

MRS R J BUTLER

~~BUDGET SECRET—BUDGET LIST ONLY~~ BUDGET CONFIDENTIAL

RJButler 2/3/88

30/88/3

5 Public expenditure

5.01 The Government's expenditure plans were set out in the Public Expenditure White Paper (Cm 288). These plans are summarised in Table 5.1. The Budget makes no change to these plans, apart from two consequen~~tials~~ces of the tax proposals, described in paragraph 5.04.

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Scotland, Wales and Northern Ireland	15·4	[16·4]	17·1	17·5	17·9
Other departments	32·0	[33·2]	34·9	36·2	36·7
Privatisation proceeds	−4·4	[−5·0]	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**139·2**	**[146·4]**	**156·8**	**167·1**	**176·1**
General government gross debt interest*	17·6	[17·5]	[17·5]	[17]	[17]
Other adjustments*	8·0	[8·1]	[8·4]	[8]	[9]
General government expenditure*	**164·8**	**[171·6]**	**[18~~3·0~~]** 2·8	**[193]**	**[201]**
General government expenditure excluding privatisation proceeds:					
(a) in **In real terms (base year 1986–87)** [Not bold]	**[169·2]**	**[168·2]**	**[171·4]**	**[17~~3·5~~]** 4	**[174·~~4~~]**
(b) as **As a percentage of GDP**	**[43¾]**	**[41½]**	**[41¼]**	**[40¾]**	**[40]**

* *1989–90 and 1990–91 figures rounded to nearest £1 billion.*

BUDGET CONFIDENTIAL * 0174

~~BUDGET SECRET—BUDGET LIST ONLY~~

delete this line

R J Butler
2/3/88

Public spending trends are helping to

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Consequentials

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lc lc

1987–88 outturn

8·4

5.05 The latest estimates for the outturn for the planning total in 1987–88, which are still subject to some uncertainty, suggest that it is likely to be about £[146.[] billion, £[2·2] billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £[0·9] billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2. Of the Reserve of £3·5 billion, only £[1·4] billion ~~was therefore~~ has been required to meet additions to departmental programmes.

Table 5.2 Comparison of plans and estimated outturn for 1987–88

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Local authority[2]	40·2	[41·0]	[+0·8]
of which:			
relevant expenditure	31·0	[32·2]	[+1·3]
other current	4·9	[5·1]	[+0·1]
capital	4·3	[3·7]	[−0·6]
Nationalised industries and other public corporations	1·6	[1·0]	[−0·6]
Privatisation proceeds	−5·0	[−5·0]	
Reserve	3·5		[−3·5]
Public expenditure planning total	**148·6**	**[146·4]**	**[−2·2]**

[1] *Plans from The Government's Expenditure Plans 1987–88 to 1990–91, Cm 56, adjusted for classification changes.*

[2] *Excluding finance for nationalised industries and other public corporations.*

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RJ Butler
3/2/88

5.06 The major changes between plans and estimated outturn for particular programmes are:

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a net increase of £[1·2] billion in central government expenditure ~~mainly due to~~ an increase of £[0·6] billion in expenditure by DHSS on Health and Personal Social Services (principally reflecting the cost of the 1987 nurses and doctors and dentists pay settlements), and higher net payments to the European Communities (£[0·8] billion) are expected, partly offset by lower payments by the Intervention Board for Agricultural Produce (£[0·3] billion); expenditure by DHSS on social security is now estimated to be £[ ] above last year's plans though ~~but~~ this is £[0·2] billion below the estimate in the 1988 public expenditure White Paper;

Do underlined in italics or similar

an overspend of £[1·4] billion on the plans for local authority current expenditure;

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better results for nationalised industries and other public corporations, by £[0·6] billion, due principally to higher profitability of British Steel and increased capital receipts from New Towns £[0·2] billion.

Table 5.3 Public expenditure by spending authority

£ billion	1986–87 Outturn	1987–88 Estimated outturn	1988–89 Plans	1989–90 Plans	1990–91 Plans
Central government*	104·6	[109·5]	114·2	120·2	124·7
of which:					
Voted in Estimates	73·4	[77·0]	81·0	84·6	87·6
other	31·2	[32·6]	33·2	35·6	37·1
Local authorities*	37·9	[41·0]	42·6	44·0	45·2
of which:					
relevant expenditure	29·4	[32·2]	33·2	34·3	35·4
other current	4·8	[5·1]	5·4	5·7	5·9
capital	3·7	[3·7]	4·0	4·0	3·9
Nationalised industries	0·4	[0·4]	0·7	0·0	−0·4
Other public corporations	0·8	[0·6]	0·8	1·0	1·0
Privatisation proceeds	−4·4	[−5·0]	−5·0	−5·0	−5·0
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5.07 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social

RJButler
3/2/88

security payments paid out of the National Insurance Fund. Spending by local authorities accounts for about one quarter of public expenditure. Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

Supply Estimates

5.08 For 1988–89, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1988–89 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1988–89 are published in a series of booklets on 15 March 1988 with a Summary and Guide (Cm [ ]) which explains the Supply procedure and summarises the Estimates. It also explains how they relate to the public expenditure planning total.

5.09 Of the £[108·3] billion included in the Supply Estimates, £[83·0] is direct public expenditure. The remaining £[25·3] billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public expenditure. [Nearly 60] per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion			
	1986–87		1987–88	1988–89
	Expected outturn in 1987 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	99·1	99·1	[104·5]	[108·3]
Supplementaries and net underspending	2·8	2·4	[1·2]	
Total Supply expenditure	**101·9**	**101·5**	**[105·7]**	
(public expenditure element)	(77·3)	[(77·1)]	[(79·7)]	

psl/3A

BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 4 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr H Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr S Davies
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Miss C Evans

FSBR: CHAPTER 5

... The Chancellor was grateful for your minute of 2 March. I attach a copy of the text with his comments marked.

ACSA

A C S ALLAN

DJ Butler 2/3/88

30/88

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(a) in **General government expenditure excluding privatisation proceeds:** not bold					
not bold **In real terms (base year 1986–87)**	**[169·2]**	**[168·2]**	**[171·4]**	**[17~~5·5~~] 4**	**[174·[illegible]]**
(b) as **As a percentage of GDP**	**[43¾]**	**[41½]**	**[41¼]**	**[40¾]**	**[40]**

delete line

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R J Butler 2/3/88

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8·4

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R J Butler 3/2/88

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psl/3A BUDGET CONFIDENTIAL

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DATE: 4 March 1988

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Sir T Burns
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FSBR: CHAPTER 5

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30/88

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RJButler 2/3/88

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Central government*	104·6	[109·5]	114·2	120·2	124·7
of which:					
Voted in Estimates	73·4	[77·0]	81·0	84·6	87·6
other	31·2	[32·6]	33·2	35·6	37·1
Local authorities*	37·9	[41·0]	42·6	44·0	45·2
of which:					
relevant expenditure	29·4	[32·2]	33·2	34·3	35·4
other current	4·8	[5·1]	5·4	5·7	5·9
capital	3·7	[3·7]	4·0	4·0	3·9
Nationalised industries	0·4	[0·4]	0·7	0·0	−0·4
Other public corporations	0·8	[0·6]	0·8	1·0	1·0
Privatisation proceeds	−4·4	[−5·0]	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**139·2**	**[146·4]**	**156·8**	**167·1**	**176·1**

*Excluding finance for nationalised industries and other public corporations.

Public expenditure by spending authority

5.07 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social

0176

RA7.86 BUDGET - CONFIDENTIAL

FROM: A C S ALLAN

DATE: 4 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Mowl
Mr Pickford
Miss Simpson
Miss C Evans

FSBR: CHAPTER 5

The Chancellor had one further point on Chapter 5: should not some reference be made - probably in 5.04 - to the consequential public expenditure saving resulting from the increased personal allowances (following the introduction of the social security reforms)?

ACSA

A C S ALLAN

covering BUDGET SECRET : TASK FORCE LIST

MR A. ALLAN

XSPAW

FSBR Chapter 2.

I have noticed that one figure in Table 2.6 was incorrect in the version of Chapter 2 circulated last night. Could you please substitute the attached corrected version

A

With you

AA

Table 2.5 General government receipts

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
Taxes on incomes, expenditure and capital	119.6	132	141	149	157	165
National insurance and other contributions	26.7	29	31	34	36	38
Interest and dividends	6.0	6	6	5	5	4
Other receipts	6.9	6	7	7	7	7
General government receipts [1]	160.0	173	185	195	205	214
of which North Sea tax[2]	4·8	5	4	4	3	3

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1987–88 onwards.*

[2] *Royalties, petroleum revenue tax (including advance payments) and corporation tax from North Sea oil and gas production (before advance corporation tax set-off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 3 to Table 6B.3.*

Public sector borrowing

2.21 The projections of government expenditure and receipts are brought together in Table 2.6 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.22 Changes since the 1987 MTFS are discussed in the Annex to this chapter.

Table 2.6 Public sector borrowing[1]

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
General government expenditure	164.8	172	183	193	202	210
General government receipts	160.0	173	185	195	205	214
Fiscal adjustment from previous years[2]	–	–	–	–	3	4
Annual fiscal adjustment[2]	–	–	–	3	1	1
GGBR	4.8	−2	−2	1	1	1
Public corporations' market and overseas borrowing	−1.5	−1	−1	−1	−1	−1
PSBR	3·4	−~~(~~3~~)~~	−~~(~~3~~)~~	0	0	0
Money GDP at market prices	387	426	45~~7~~8	48~~7~~8	51~~6~~8	54~~5~~6
PSBR as per cent of GDP	0·9	−~~(~~3/4~~)~~	−~~(~~3/4~~)~~	0	0	0

[1] *Rounded to the nearest £1 billion from 1987–88 onwards. Further details for 1987–88 and 1988–89 are provided in Tables 1.2 and 6.7.*

[2] *Means lower taxes or higher expenditure than assumed in lines 1 and 2.*

Conclusion

2.23 The strength of the economy coupled with fiscal prudence has enabled the Government to achieve a balanced budget on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress in the medium term towards lower inflation, and lower taxes and public spending as a share of GDP. The MTFS provides the financial framework within which the policies to achieve these objectives are set.

0386

25/952

CONFIDENTIAL

I wd settle for "two-thirds [illegible]"

FROM: MRS R J BUTLER
DATE: 4 March 1988

MR ANSON

cc Chancellor
Chief Secretary
Sir Peter Middleton
Sir T Burns
Mr Phillips
Mr Scholar
Miss Peirson
Mr Turnbull
Mr Saunders
Mr Mowl
Mr R I G Allen

Ch
If it's 300/475, what's wrong with "principally" AA

FSBR: CHAPTER 5

As requested in your minute of today's date I have discussed the position on central government expenditure by DHSS on health and personal social services and they have agreed that we should adopt your wording on the pay settlements ie "(including £0.3 billion following the 1987 nurses' and doctors' and dentists' pay settlements)".

2. The overall figure for the change in central government DHSS-HPSS expenditure between plans and estimated outturn shown in the FSBR will be £0.5 billion (not £0.6 billion as shown in the earlier draft). The underlying figure is £475 million and arises from announced increases of about £300 million for pay awards, £109 million for special increases (£65 million from the pre-Christmas announcement and £44 million for the special carryover), about £30 million each for AIDS, prescriptions and the FPS and £13.5 million for storm damage, partly offset by a small measure of underspending.

RJ Butler

MRS R J BUTLER

FSBR

BUDGET CONFIDENTIAL

FROM: J. ANSON
4th March, 1988.

MRS. R. J. BUTLER

c.c. Chancellor
Chief Secretary
Sir Peter Middleton
Sir T. Burns
Mr. Phillips
Mr. Scholar
Mr. Turnbull
Mr. Mowl
Mr. R. I. G. Allen

FSBR: CHAPTER 5

In the version of Chapter 5 attached to your minute of 2nd March, paragraph 5.06 describes the increase of £[0.6] billion in expenditure by DHSS on Health and Personal Social Services as "principally reflecting" the cost of the nurses and doctors and dentists pay settlements.

2. The draft briefing on the Summary and Guide to the Main Estimates puts the increase in the cash limit on this account as £316 million. Assuming the £[0.6] billion is correct, "principally reflecting" is not quite right. I am not quite clear where the rest of the increase comes from; it is not fully accounted for by the announcement of extra money for the NHS before Christmas. Subject to clarification of that, it might be better to say "(including £[0.3] billion following the 1987 nurses' and doctors' and dentists' pay settlements)". Could you please consider this with ST?

JA.

J. ANSON

RA7.85

REF ACSA 27

COPY NO OF 18

FROM: A C S ALLAN

DATE: 4 March 1988

MISS SINCLAIR

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Mr Riley
Miss Simpson
Miss C Evans
Mr Cropper
PS/IR
Mr P R H Allen - C&E

FSBR: CHAPTER 4

... The Chancellor was grateful for your minute of 2 March. I attach a copy of the relevant pages with his comments marked.

2. He had a few comments on the points in your covering note:

(i) He will want to consider further the best formulation for the withdrawal of relief for entertaining overseas businessmen/customers.

(ii) On the public expenditure implications, he feels that for both covenants and forestry the best treatment is to mention the expenditure measures in the annex to Chapter 4 and in Chapter 5 only (ie not in Table 1.1 and not in Chapter 4 apart from the annex).

(iii) He is considering further the presentation of the unleaded petrol impact.

(iv) He is content not to refer to the MIR limit remaining at £30,000.

... 3. On maintenance, I attach a redraft: the Chancellor would be grateful if this could be checked for accuracy and clarity.

ACSA

A C S ALLAN

REDRAFT OF PARAGRAPH 4.12

4.12 The tax treatment of maintenance payments will be reformed. People who receive maintenance payments under new arrangements entered into after Budget day will not be liable to tax on their receipts; the person making the maintenance payments will get tax relief only for payments to a divorced or separated spouse, up to a limit of £1490. Special provisions will be introduced for existing maintenance arrangements no-one will get less tax relief on their payments or will pay more tax on their receipts than they do now; and all divorced or separated spouses will be able to receive up to £1490 free of tax.

Covenants

4.10 The tax treatment of covenants will be reformed and simplified. Non-charitable covenants made by individuals on or after Budget day will no longer attract tax relief, and income from such covenants made after Budget day will not be taxable in the hands of the recipient. ~~There will be parallel changes in the student grant system (see paragraph 5.04).~~ Covenants to charities will not be affected, nor will non-charitable covenants made before Budget day

X

Charitable giving

4.11 The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be doubled from £120 to £240 a year from 1988–89.

Maintenance payments

SEE REDRAFT

4.12 The tax treatment of maintenance payments will be reformed. ~~Under~~ new maintenance arrangements recipients will not be liable to tax on the payments; relief for those making payments will be ~~restricted~~ available only for to payments to a divorced or separated spouse, up to a limit of ~~[~~£1,490~~]~~. ~~Transitional~~ Special provisions will be introduced ~~to protect~~ for existing maintenance arrangements.

Personal equity plans

4.13 The annual limit on investment in a personal equity plan will be increased from £2,400 to £3,000.

Employee share schemes

4.14 Following consultation last year, the income tax charge on unapproved employee share schemes under Section 79 of the 1972 Finance Act will be eased.

Lloyd's

4.15 Changes will be made to the present administrative arrangements for taxing members of Lloyd's.

4.16 The legislation on Lloyd's reinsurance to close will be modified to give relief to Lloyd's members who leave syndicates at the end of the underwriting year.

Trusts

X

4.17 The additional rate of income tax charged on discretionary and accumulation trusts will be reduced from 18 per cent to 10 per cent. ~~for 1988–89.~~

Capital gains

4.18 The base date for capital gains will be brought forward from 6 April 1965 to 31 March 1982; gains accrued before that date will no longer be liable to tax. The present indexation provisions will continue to apply to gains accruing from 31 March 1982. This proposal will also apply to companies' gains.

4.19 Gains, after deduction of the exempt amount and allowing for rebasing to 1982 and indexation, will be added to income and taxed at income tax rates (as if they were the marginal slice of income).

4.20 The capital gains tax annual exempt amount will be reduced to £5,000 in the case of individuals and £[2,500] in the case of most trusts.

4.21 From 6 April 1988, 50 per cent of any gains between £125,000 and £500,000 will qualify for retirement relief, subject to the general conditions for the relief.

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4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1.

Income tax

4.0~~2~~5 The basic rate of income tax will be reduced to 25 per cent.

X

4.0~~3~~6 There will be a single higher rate of income tax of 40 per cent. ~~which will apply to taxable income over £19,300.~~ and the limit of the basic rate band

4.0~~4~~2 The main income tax personal allowances will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3.7 per cent in the RPI in the year to December 1987). This will mean that:

the single person's and wife's earned income allowances will rise by £180 from £2,425 to £2,605;

the married allowance will rise by £300 from £3,795 to £4,095;

the age allowance for those aged 65 to 79 will rise by £220 from £2,960 to £3,180 (single) and by £360 from £4,675 to £5,035 (married);

the age allowance for those aged 80 or over will rise by £240 from £3,070 to £3,310 (single) and by £360 from £4,845 to £5,205 (married);

the income limit for age allowance will rise by £800 from £9,800 to £10,600;

the additional personal allowance and widow's bereavement allowance will rise by £120 from £1,370 to £1,490. 5

the basic rate limit will rise from £17,900 to £19,300 of taxable income.

4.0~~5~~3 The dependent relative allowance of up to £145, the housekeeper allowance of £100 and the allowance for the services of a son or daughter of £55 will be abolished.

4.0~~6~~4 From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

Life assurance premium relief

4.07 The rate of premium relief for life assurance policies taken out before 14 March 1984 will be reduced to 12½ per cent from 6 April 1989.

Benefits in kind

4.08 Car benefit scale charges for 1988–89 will be set at twice their 1987–88 levels.

Mortgage interest relief

4.09 For loans taken out from 1 August 1988, tax relief will be limited to the interest on £30,000 per residence, regardless of the number of borrowers. Relief on new loans for home improvements will be abolished from 6 April 1988. So will relief on new loans for the purchase of residences for dependent relatives and divorced or separated spouses.

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VAT **4.3~~4~~** 5 From 16 March 1988 the registration limits will become £22,100 per annum and £7,500 per quarter.

4.3~~5~~ 6 The provision for applying VAT to confectionery will be amended with the main effect of taxing all cereal bars at the standard rate.

Excise duties **4.3~~6~~** 7 The duties on beer and wines will rise by the equivalent of 1p on a typical pint of beer, just under 4p on a bottle of table wine, and just over 6p on a bottle of sherry (all inclusive of VAT). The dut~~ies~~y on spirits will remain unchanged. The minimum duty charge for beer will be abolished and provision will be made for restructuring the duties on low strength mixed drinks.

under 6p **4.3~~7~~** 8 The duty on leaded petrol will be increased by the equivalent of [just ~~over 5½p~~] a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged~~, so that the duty differential in its favour vis-à-vis leaded petrol will be increased~~. The duty on derv will rise by the equivalent of [just under 5p] a gallon.

X

just **4.3~~8~~** 9 The specific duties on cigarettes, hand-rolling tobacco and cigars will rise by the equivalent of [over 3p] on a packet of 20 cigarettes and [nearly 2p] on a packet of 5 small cigars. The duty on pipe tobacco will remain unchanged.

Tax administration **4.~~39~~** 40 The VAT civil penalty system, introduced in 1985, has been reviewed and various easements are proposed. 4.41 In the light of recommendations by the Keith Committee, changes will be made:

to encourage people to notify the Inland Revenue if they are liable to tax;

~~to introduce a tax-geared penalty for failure to notify liability~~;

to improve the information powers of the Inland Revenue;

to charge interest where payment to the Inland Revenue of income tax deducted by employers is delayed beyond the end of the tax year. ~~(the interest charge will be implemented when the necessary Inland Revenue computer systems are in place).~~

×

Stamp duties 4.34 Capital duty & unit trust instrument duty will be abolished with effect from Budget Day

Independent Taxation 4.41 A new system of taxation for married couples will be introduced in 1990. The details are set out in the box on the next page.

Inheritance tax

4.22 From Budget Day the threshold for inheritance tax will be increased from £90,000 to £110,000. Chargeable transfers above this amount will be taxed at a ~~single~~ flat rate of 40 per cent. The £100,000 limit on the amount that can be given to a political party without incurring inheritance tax will be abolished.

Business tax

4.23 The small companies' rate of corporation tax will be reduced to 25 per cent for the financial year 1988.

4.24 The rate of advance corporation tax (ACT) for 1988–89 will go down automatically to 1/3rd as a consequence of the reduction in the basic rate of income tax.

4.25 The main rate of corporation tax for the financial year 1988 will be 35 per cent.

SEE COVER NOTE

4.26 In common with other business entertainment, the cost of entertaining overseas ~~businessmen~~ customers will no longer be an allowable business expense for tax purposes. This change will take effect from Budget Day, except for commitments entered into before that date. From 1 August 1988 the VAT paid by businesses on this entertainment will no longer be deductible.

4.27 A number of changes will be made to prevent tax charges arising on the conversion of building societies into public limited companies.

Business Expansion Scheme

4.28 Investment in private rented housing will be encouraged by extending the Business Expansion Scheme to give relief on investment in companies ~~letting on the new assured tenancy basis.~~ providing rented housing under the new assured tenancy scheme.

4.29 A general limit of £500,000 will be set on relief under the Business Expansion Scheme for total investment in any one company in any period of twelve months, with a higher limit of £~~10~~5 million for investment in qualifying companies providing private rented housing [or ~~shipping~~]. chartering.

Forestry

4.30 Income from the occupation of commercial woodlands will be removed from the scope of Income Tax and Corporation Tax. ~~(See paragraph 5.04 for details of the proposed increase in grants for forestry.)~~ ~~There will be a parallel increase in forestry planting grants (see paragraph 5.04).~~

Oil taxation

4.31 The ~~Oil~~ oil allowance for Petroleum Revenue Tax (PRT) will be reduced to ~~100,000~~ tonnes per chargeable period for all Southern Basin and onshore fields given development consent on or after 1 April 1982. (At the same time the Secretary of State for Energy proposes to abolish royalty payments for these fields.)

4.32 A new capital gains relief will be provided for disposals of oil licence interests in undeveloped areas wherever the consideration includes a work programme or another licence interest.

UK incorporated companies wishing to move their business abroad, or non UK incorporated companies moving their residence abroad, may do so without consent if they pay ~~their~~ the due tax (including tax on capital gains)

Company residence and migration

purposes

4.33 [~~On Royal Assent~~,] Section 482(1) (a) and (b) of the Taxes Act will be repealed with effect from Budget Day. In future companies will be resident for tax in the United Kingdom if incorporated here or centrally managed and controlled here. ~~They will no longer need Treasury consent to move their residence abroad [and the criminal penalty for non-compliance will cease]. Companies will be able to migrate if they pay their tax liability, including liability on accrued gains.~~

0027

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Table 4.1 Direct effects of changes in taxation—*continued*

	£ million Estimated effect on receipts in: 1988–89		1989–90
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Capital gains tax			
42 ~~44~~ Rebasing capital gains of individuals and trusts to March 1982	—	—	~~–75~~ –70
43 ~~45~~ Charging gains of individuals and trusts at income tax rates	+70	+70	~~+60~~ +80
44 ~~46~~ Annual exempt amount	—	—	~~+10~~ +15
45 ~~47~~ Retirement relief	—	—	–10
46 ~~48~~ Building and Co-operative society shares	*	*	*
47 ~~49~~ Homes provided for dependent relatives	—	—	*
Corporation tax			
48 ~~50~~ Reduction in rate of ACT to 1/3rd of the amount of the distribution	–380	–380	–200
49 ~~51~~ Reduction in small companies' rate to 25 per cent	*	*	–50
50 ~~52~~ Company residence and migration—new rules	—	—	—
51 ~~53~~ Definition of an investment trust	—	—	—
52 ~~54~~ Indexation allowance—intra-group transactions	—	—	—
53 ~~55~~ Intra-group share exchanges	—	—	—
54 ~~56~~ Capital allowances—assured tenancies relief	—	—	—
Corporation tax and capital gains tax			
55 ~~57~~ Rollover relief for satellites, spacecraft, milk quotas and potato quotas	*	*	–5
Income tax, corporation tax and capital gains tax			
56 ~~58~~ Keith Committee administrative changes	+10	+10	+20
Income tax, corporation tax, capital gains tax and stamp duties			
57 ~~59~~ Conversion of building societies into public limited companies —changes in tax rules	—	—	—
Oil taxation			
58 ~~60~~ Reduction in PRT oil allowances for certain fields	+30	+30	+30
59 ~~61~~ New capital gains relief for certain oil licence disposals	–5	–5	–5
60 ~~62~~ Petroleum revenue tax relief for certain tariff related costs	—	—	—
Inheritance tax			
61 ~~63~~ Increase of £20,000 in threshold and change to 40 per cent flat rate	–120	–100	–200
62 ~~64~~ Abolition of limit on gifts to political parties	*	*	*
Stamp duties			
63 Abolition of capital duty & unit trust instrument duty	–100	–100	–125
64 ~~65~~ Stamp duty and reserve tax on paired shares	—	—	—
TOTAL INLAND REVENUE	**–4 860**	**–4 015**	**–6 280**
CUSTOMS AND EXCISE			
Value added tax			
65 ~~66~~ Change in liability of certain confectionery	+5	+5	+10
66 ~~67~~ Keith Committee—review of civil penalties	*	*	*
67 ~~68~~ Increase in registration limits	*	*	*
68 ~~69~~ Revised registration requirements	*	*	*
69 ~~70~~ Revision of approved self-billing arrangements	+5	+5	+5
70 ~~71~~ Revised treatment of business entertainment for overseas customers	*	*	*
Excise duties			
71 ~~72~~ No change in rate of spirits duty	—	–25	–25
72 ~~73~~ Increase in rate of beer duty	+80	+20	+15
73 ~~74~~ Abolition of minimum duty charge for beer	*	*	*
74 ~~75~~ Increase in rate of duty on cider and perry	+5	+5	*
75 ~~76~~ Increase in rate of duty on light wine and made-wine duties	+20	+5	+5
76 ~~77 No change in rates of duty on fortified wines~~ ? Increase in rates of duty on fortified wines	~~—~~	~~–5~~	~~*~~
77 ~~78~~ Revised duty regime for low strength mixed drinks	*	*	*

* = Negligible — = Nil

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Table 4.1 Direct effects of changes in taxation

See Annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1988–89 Changes from a non-indexed base	 Changes from an indexed base	 1989–90 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Increase in single allowance of £180 and married allowance of £300	−1 245	−620	−810
2 Increase in additional personal allowance and widow's bereavement allowance of £120	−15	−5	−10
NEW 3 Increase in age allowance of £220 (single) and £360 (married) for those aged 65 to 79	−90	−45	−55
ORDER 4 Increase in age allowance of £240 (single) and £360 (married) for those aged 80 and over	−15	−10	−10
5 Increase in income limit for age allowance of £800	−10	−5	−10
9 ~~6~~ Reduction of 2p in basic rate	~~−2 060~~ −2170	~~−2 060~~ −2,170	~~−2 860~~ −2970
6 ~~7~~ Increase in basic rate limit of £2 100 to ~~£20 000~~ £19,300	~~−295~~ −170	~~−215~~ −85	~~−400~~ −150
10 ~~8~~ Abolition of higher rates of income tax above 40p	~~−1 015~~ −1055	~~−960~~ −995	−~~2 050~~ −2150
7 ~~9~~ Abolition of minor personal allowances	+10	+10	+10
8 ~~10~~ Restriction on additional personal allowance for unmarried couples	—	—	+5
11 Reduction in relief on life assurance premiums	—	—	+70
12 Fringe benefits—car benefit scales	~~+230~~ +290	~~+230~~ +290	~~+280~~ +360
~~13 Fringe benefits—earnings threshold (P11D limit)~~	~~50~~	~~50~~	~~50~~
13 ~~14~~ Fringe benefits—car parking space	−5	−5	−5
14 ~~15~~ Mortgage interest relief ceiling applied to residence	+5	+5	+20
15 ~~16~~ Abolition of tax relief on new home improvement loans	~~+80~~ +60	~~+80~~ +60	~~+200~~ +170
16 ~~17~~ Abolition of tax relief on new loans for homes for dependent relatives, ~~&~~ and divorced and separated spouses	*	*	*
17 ~~18~~ Abolition of tax relief on new non-charitable covenants	+45	+45	+105
18 ~~19~~ Payroll giving to charities—increase in donation limit to £240 a year	*	*	*
19 ~~20~~ Change in rules for maintenance payments	−10	−10	−5
20 ~~21~~ Change in additional rate on discretionary trusts	−5	−5	−10
21 ~~22~~ Lloyds: reform of administrative arrangements	—	—	*
22 ~~23~~ Lloyd's reinsurance to close—relief for leavers	*	*	*
23 ~~24~~ Unapproved employee share schemes: relaxation of charge	*	*	*
24 ~~25~~ Employee priority in public offer of shares	*	*	*
25 ~~26~~ Approved FA 1984 employee share option schemes—restricted shares	*	*	*
26 ~~27~~ Assessing procedure for Schedule D	—	—	—
27 ~~28~~ Redundancy payments: change to scale of charge	*	*	*
28 ~~29~~ Withdrawal of "top-slicing" relief for tax charged on premiums for leases, etc	*	*	*
Income tax and capital gains tax			
29 ~~30~~ Independent taxation of income and chargeable capital gains of husband and wife from 1990–91	*	*	−30†
30 ~~31~~ Business Expansion Scheme—limit on relief	*	*	+25
31 ~~32~~ Business Expansion Scheme—private rented housing	*	*	−40
32 ~~33~~ Personal Equity Plans—increase in limit	*	*	−5
Income tax and corporation tax			
33 ~~34~~ Forestry—removal of commercial woodlands from scope of tax	—	—	*
[~~35 Personal pensions—minor changes~~	−10	−10	−5]
34 ~~36~~ Refunds of employee pension contributions	+15	+15	+15
35 ~~37~~ Occupational pensions—minor amendments	—	—	—
36 ~~38~~ End of year interest on PAYE and subcontractors deductions	—	—	—
37 ~~39~~ Capital allowances—exempt persons	—	—	—
38 ~~40~~ Capital allowances—safety at sports grounds (being considered)	*	*	—
39 ~~41~~ Capital allowances—abolition of quarantine premises relief	*	*	*
40 ~~42~~ Withdrawal of relief for business entertainment of overseas [businessmen]	*	*	+5
41 ~~43~~ Rebasing capital gains of companies to March 1982	−25	−25	−235

* = Negligible — = Nil † Allows for some postponement of realisation of gains by married couples (see annex note ~~30~~ 29).

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Annex to Chapter 4

How the figures in Table 4.1 have been calculated

Table 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million.

The direct effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rate of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

For Inland Revenue taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre- and post-Budget tax regimes to the same tax base. This base is the post-Budget base—that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where these [~~behavioural~~] changes can be directly attributed to the change in tax.

For example, the estimate of the cost or yield of the capital gains tax changes allows for the likely effects on the volume & timing of disposals.

For Customs and Excise taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

Table 4.1 shows the expected change in receipts of tax resulting from the Budget proposals. Additional information is provided in the commentary below for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1988–89 or 1989–90; or where the impact of the proposal is expected to build up over a period of years.

The figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1988–89. Budget proposals are compared with a non-indexed base—that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1987–88 levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1988–89, measured against an indexed base. The indexed base for 1988–89 is obtained by increasing 1987–88 allowances, thresholds and rates of duty by 3·7 per cent, the increase in the RPI over the year to December 1987.

The figures in the third column show the direct effect on receipts in 1989–90, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1988–89 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1987 and 1988 (shown in Table 3.13).

The estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact of the tax change on

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the PSBR. The base for the post-Budget forecast of each tax (given in Table 6B.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

The remainder of this annex provides further details on the Budget proposals in Table 4.1. The paragraph numbers refer to the lines in this table.

(et seq) Revert to past practice of referring briefly to what is proposed, rather than referring back to earlier paragraphs

Income tax **1** to ~~**5**~~ 6 See paragraph ~~4.04.~~ 4.02

~~**6**~~ 7 See paragraph 4.0~~2~~5. This item includes the saving in public expenditure on mortgage interest relief to those below the tax threshold. The effect of the consequential change in the rate of advance corporation tax (ACT) is shown in line [50] of Table 4.1

8 See paragraph 4.06
~~**7** The basic rate limit will rise~~ by £2,100 from £17,900 to £19,300.

9 ~~**8**~~ See paragraph 4.0~~3~~6

10 ~~**9** See paragraph 4.05~~ See paragraph 4.04

~~**10** See paragraph 4.06.~~

11 Following the reductions in the basic rate of income tax in successive Budgets, the rate of relief for life assurance premiums on policies taken out before 14 March 1984 will be reduced ~~to~~ from 15 per cent to 12·5 per cent from 6 April 1989. The starting date is to allow life offices time to make the necessary preparations.

(under consideration) ×

12 For 1988–89 the scale for taxing car benefits for directors and for "higher paid" employees will be double the 1987–88 levels. [The previously announced scales for 1988–89 will not apply.] ~~Yields are measured from these previously announced scales. No change is proposed for 1988–89 and 1989–90 to the scale charges for car fuel benefit also used for VAT purposes.~~ The estimated yield is based on the difference between the tax payable on the new scales & the tax payable if 1987-88 scales had applied.

~~**13** See paragraph 4.09.~~

13 ~~**14**~~ The provision of a car parking space for the use of directors or higher-paid employees will be exempt from tax from 6 April 1988.

(") ×

14 to 16 ~~**15** to **17**~~ See paragraph 4.~~10~~09. Relief for loans for the purchase on improvement of let property is not affected.

17 ~~**18**~~ See paragraph 4.1~~1~~0. The change is estimated to yield £160 million in 1990–91, £175 million in 1991–92, and £[210] million eventually. ~~These figures do not include the effect on public expenditure of the parallel change in the student grant system.~~ There will be compensating changes in the student grant system (see paragraph 5·04)

15 ~~**19**~~ See paragraph 4.12 1

19 ~~**20**~~ The new tax regime for maintenance payments in paragraph 4.13 2 will mean that:

for payments under new maintenance arrangements, relief will be restricted to payments to a divorced or separated spouse, up to a limit ~~equal to [1,490]~~. £1,490, being the difference between the married & single allowances.
Recipients will not be liable to tax on maintenance payments;

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, and

arrangements are in place ~~and from 1990–91 onwards, couples may transfer assets between them where one spouse has unused annual exempt amount or basic rate band.~~ The figure for 1989–90 in Table 4.1 reflects ~~the deferral of disposals~~ this. Costs for capital gains tax in 1990–91 and 1991–92 are each estimated at £60 million; ~~These~~ the estimates ~~which allow for changes in taxpayers' behaviour~~ are subject to a high degree of uncertainty.

~~31~~ 30 and ~~32~~ 31 See paragraphs 4.~~26~~ 8 and 4.~~27~~ 9. The estimated revenue effects depend on take up and are highly uncertain.

~~33~~ 2 The annual limit on investment in a PEP will be raised from £2,400 to £3,000. At the same time the amount which may be held in cash will be increased from £240 ~~and~~ to £300 (or, in each case, 10 per cent of total market value of a plan). [And the amount which may be invested in a unit trust or investment trust will rise from £420 to £xxx (or, if greater, 25 per cent of total investment).] The changes will apply from calendar year 1988.

~~34~~ 3 Schedule B will be abolished with effect from 1988–89. With effect from 15 March 1988 (subject to transitional provisions extending to 5 April 1992) the right of occupiers of commercial woodlands to elect to be assessed to tax on their profits or losses under Schedule D will be abolished. The eventual net annual saving is estimated at £[10] million. ~~[Provision for increased forestry grants will be introduced as from [ ].~~ ~~These figures do not include the effect on forestry~~

There will be compensating changes in the forestry grants system (see paragraph 5.04)

~~35 [Changes will be made to the tax rules for personal pensions relating to the payment by DHSS of contracting-out rebates.]~~

~~36~~ 4 The rate of tax on refunds of employee pension contributions will be increased from 10 per cent to 20 per cent.

~~37~~ 5 Minor amendments are to be made to the 1987 legislation (which dealt with exploitation of pensions tax reliefs).

~~38~~ 6 Interest will be charged where an employer or contractor delays payment to the Inland Revenue of amounts deducted under the PAYE or subcontractor deduction schemes beyond 19 April immediately following the deduction year. This interest charge will not be introduced before 1992.

~~39~~ 7 The rules for calculating industrial buildings allowance following a sale and those for transfers of machinery or plant between connected persons will be amended to prevent excessive relief where one person is not chargeable to tax in the United Kingdom. These changes will prevent a potential Exchequer loss of up to £150 million in 1991–92 with a diminishing effect in later years.

~~40~~ 38 The legislation relating to capital allowances for safety expenditure at sports grounds will be amended from 1 January 1988 to take account of changes to the Safety at Sports Grounds Act 1975.

~~41~~ 39 Capital allowances on expenditure at certain quarantine premises will be abolished from 16 March 1988.

~~42~~ 40 See paragraph 4.~~24~~ 6. The yield from the VAT change is shown separately at item 71.

~~43~~ 41 and ~~44~~ 42 See paragraph 4.~~17~~ 8. The total cost of rebasing will build up to a peak of some £850 million in 1991–92, of which the amount attributable to companies' gains is about three-quarters. The figures take account of the likely effect of this measure on the volume and timing of disposals; and, to individuals and trusts, are additional to the effect on item ~~45~~ 3.

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3 ~~45~~ See paragraph 4.~~18~~ 9. Until the introduction of independent taxation in 1990–91, the gains of married couples will be taxed as the marginal slice of the husband's income. The revenue yield in 1990–91 is estimated at £40 million and in 1991–92 at £85 million. The figures take account of the likely effect of taxing gains at income tax rates on the volume and timing of disposals.

4 ~~46~~ See paragraph 4.1~~9~~. 20

5 ~~47~~ See paragraph 4.2~~0~~ 1. Retirement relief currently exempts business gains up to £125,000, subject to certain qualifying conditions.

6 ~~48~~ From 4 July 1987, disposals of shares in Building and Co-operative Societies will not qualify for indexation relief.

7 ~~49~~ From 6 April 1988, the capital gains tax exemption for homes provided for dependent relatives will be abolished ~~cease to be available~~. There will be special provisions to ensure that exemption continues where a dwelling would have qualified for this exemption on a disposal before 1988–89.

48 ~~50~~ and 49 ~~51~~ See paragraphs ~~4.22~~ 4.23 & 4.24. The reduction in ACT will be balanced by an increase in the subsequent liability to mainstream corporation tax.

50 ~~52~~ See paragraph 4.33.

1 ~~53~~ The Finance (No 2) Act 1987 repealed part of the definition of an investment trust. The full definition will be reinstated, and the legislation will include provision to ensure that the repeal was never effective.

2 ~~54~~ The indexation allowance will be denied or restricted on disposal of certain intra-group debts and shareholdings. This provision counters use of the indexation allowance to create large artificial capital losses which could cause a significant loss of tax.

3 ~~55~~ As a result of a recent court ruling, share exchanges by companies in the same group can now give rise to capital gains or losses being taxed or allowed more than once. The legislation will be amended so as to remove that anomaly.

4 ~~56~~ Capital allowances in respect of properties let on assured tenancy terms by "approved bodies" will come to an end when the Housing Bill takes effect. Changes will be made to the capital allowances legislation to ensure that relief for past years is not withdrawn and to provide transitional arrangements in respect of expenditure already incurred.

5 ~~57~~ Rollover relief will be extended to satellities and spacecraft from 28 July 1987 and to milk quotas and potato quotas from 30 October 1987.

6 ~~58~~ **(a)** The present flat rate penalty for failure to notify liability to tax will be replaced by a fully mitigable penalty up to the amount of tax unpaid.

(b) The Revenue's power to call for returns of information will be extended to details (where relevant for tax) of payments for services by Government Departments, grants or subsidies paid out of public funds and the names of licence holders.

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(c) The Revenue's power to call for documents relating to taxpayers suspected of avoidance or evasion will be extended to include the Department of National Savings, and, in order to identify taxpayers suspected of serious default, to documents relating to taxpayers whose identity is not known to the Revenue.

(d) The Revenue will be allowed the same access to records held on computer as it is allowed to records held on paper.

[Used letters]

The estimated yield of these measures is based on the unreported tax liabilities which will be uncovered.

~~59~~ 7 Changes in the tax rules concerning the conversion of building societies into public limited companies are necessary in order to prevent unintended tax charges arising.

~~60~~ 58 See paragraph 4.31. The PRT oil allowance for Southern Basin and onshore fields given development consent on or after 1 April 1982 is to be reduced to 100,000 tonnes per chargeable period, with a cumulative total of 2 million tonnes. The yield figures in Table 4.1 relate to this proposal only. At the same time, it is proposed to abolish royalty on these fields. These two measures have cumulative cost of around £~~[~~40~~]~~ million in the first five years ~~(~~in part because it is estimated that they will accelerate certain developments~~)~~, but in the long run they are expected to be broadly revenue neutral.

~~61~~ 59 See paragraph 4.32. For disposals of oil licences in undeveloped areas where the consideration includes a work programme or another licence interest, that work programme or other licence interest will be deemed to have a nil value.

~~62~~ 60 All tariff-related expenditure incurred by an asset owner will be allowed against his PRT liability on tariff income arising from third party use of those assets, even though his principal field has ceased production. No cost will arise until after fields owning assets used by others cease production.

~~63~~ 1 and **~~64~~** 2 The estimated cost for 1990–91 of the proposed rate structure for inheritance tax in paragraph 4.~~21~~ is £240 million, measured against ~~the~~ an indexed base. For 1991–92 it is £270 million. The estimated full year cost attributable to transfers in 1988–89 is £220 million. To qualify for exemption, transfers to political parties must be made on or within one year of death.

X 63 Capital duty will not be payable on transactions done after 15 March 1988. Unit trust instrument duty will not be payable on instruments executed after 15 March 1988, nor on property put into an existing trust after that date.

~~65~~ 4 Changes are proposed to stamp duties and the reserve tax on shares in a UK and a non-UK company where the shares are paired and can only be transferred as a unit.

Value added tax

~~66~~ 5 See paragraph 4.~~40~~. 36

~~67~~ 6 Amendments will be made to the civil penalty system including the introduction of a time-related penalty for late registration; the halving of daily penalties; changes to the rules about eligibility to repayment supplement; and changes to the rules for persons who persistently misdeclare their liability.

~~68~~ 7 See paragraph 4.~~38~~. 35

~~69~~ 8 The rules for registration of voluntary and intending traders will be simplifed and restrictions and conditions removed.

~~70~~ 69 From ~~1 [~~ Royal Assent, where a taxable person issues himself with an invoice under the terms of an approved self-billing arrangement, he will be responsible for determining the correct VAT liability.

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71 See paragraph 4.26. The change will bring the treatment of VAT incurred by businesses on entertaining foreign businessmen into line with the treatment of other business entertainment.

Excise duties

72 See paragraph 4.41. 37

73 The duty on typical beer will be increased by 4·7 per cent, equivalent to 1p a pint (inclusive of VAT).

74 From 1 October 1988, beer duty will be charged on the basis of £0·90 a hectolitre for every degree by which the original gravity of the beer exceeds 1000°.

75 The duty on cider and perry will be increased by 9·7 per cent or 1p a pint (inclusive of ~~consequential~~ VAT).

76 The duties on wine and made-wine will be increased by 4·5 per cent, equivalent to 3·8p on a 75cl bottle of still wine, 5·9p on a 70cl bottle of sparkling wine and 6·1p on a bottle of sherry (all inclusive of VAT).

~~**77** See paragraph 4.41.~~

78 Lower strength mixed drinks, not exceeding 5·5 per cent alcohol, will be dutied according to their alcoholic strength on a scale proportionate to table wine duty. This will bring duties on wine-based and similar mixed drinks into line.

79 The duty on leaded petrol will be increased by 5·5 per cent or 5·6p a gallon (inclusive of ~~consequential~~ VAT). The duty on unleaded petrol will remain unchanged, so that the tax differential in favour of unleaded petrol will rise to 10·6p a gallon.

80 The duty on derv will be increased by 5·7 per cent, equivalent to 4·9p a gallon (inclusive of ~~consequential~~ VAT).

81 There will be no change in the rates of duty on gas oil and fuel oil.

82 The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by 3·8 per cent or 3·4p a packet of 20 cigarettes and 1·9p a package of 5 small cigars (both inclusive of ~~consequential~~ VAT).

5.3p on a 25 gram packet of hand rolling tobacco

~~**83** See paragraph 4.43.~~ 34

Vehicle excise duties

84 There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

85 From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

86 From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable of carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1,600. These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£130).

87 There will be no change in bus fuel grant.

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COPY NO 1 OF 13

FROM: A C S ALLAN

DATE: 3 March 1988

MR MOWL

cc PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr R I G Allen
Miss C Evans

FSBR CHAPTER 6

... The Chancellor was grateful for your minute of 2 March. I attach a copy of the pages on which he had comments.

2. He would not wish to insist on showing no increase in the non-oil tax burden in 1988-89: it is desirable, though not essential.

3. He still thinks it looks a bit odd that a Financial deficit and a Budget surplus are both shown as negative: while he agrees that this is correct, he feels a footnote might help, if a neat one could be devised.

ACSA

A C S ALLAN

6 The public sector's finances

The scope of this chapter

6.01 This chapter brings together revenue (discussed in Chapter 4) and spending (in Chapter 5), and provides an analysis and forecast of the public sector's finances in 1988–89 together with estimates of outturn in 1987–88. It also comments on the main features of the public sector's finances in those two years, including the most important changes that have taken place since last year's projections. Table 6.1 is a summary.

repayment of debt

Table 6.1 Public expenditure, receipts and borrowing

	£ billion 1986–87 Outturn	1987–88 1987 Budget	1987–88 Latest estimate	1988–89 Forecast
General government expenditure	164·8	173·5	171·6	182·8
General government receipts	160·0	168·8	173·5	184·7
General government borrowing requirement	4·9	4·7	−2·0	−1·9
Public corporations' market and overseas borrowing	−1·5	−0·8	−0·9	−1·2
Public sector borrowing requirement	**3·4**	**3·9**	**−2·9**	**−3·1**

comma, no dash

~~implying net repayment of debt~~

6.02 There is now estimated to be a negative public sector borrowing requirement, ie. a budget surplus, of about £3 billion in 1987–88, This compares with the forecast of a ~~PSBR~~ borrowing requirement of £4 billion made a year ago. This would be the first budget surplus since 1969–70 and only the second since 1952, the earliest year for which PSBR figures ~~were~~ are available. A budget surplus of about £3 billion is ~~also~~ forecast ~~in~~ for 1988–89.

Public sector's finances: three-fold analysis

6.03 The public sector's finances can be analysed in a number of different ways: by type or activity, by sector and by economic category. The rest of this chapter sets out these three analyses in detail.

Public sector's finances: analysis by type or activity

6.04 Table 1.2 analyses the public sector's finances by type or activity. The main receipts of general government (ie central plus local government) are grouped according to the kind of activity which gives rise to them, while spending is shown by department, as in Chapter 5 and in the public expenditure White Paper. Its bottom line, the PSBR, is derived from those two totals. This derivation is repeated in Table 6.1.

Receipts

6.05 General government receipts in 1987–88 are now projected to exceed the 1987 Budget forecast by about £4¾ billion. As Table 1.2 shows, most components of general government receipts are likely to be higher than originally forecast. The main contributors to the extra receipts are income tax (£1 billion), VAT (£1 billion), and North Sea Revenues (£¾ billion).

6.06 Additional income tax receipts are mainly the result of the stronger growth of the economy and higher incomes. VAT receipts have increased by more in 1987–88 than would have been expected from the recorded increase in total consumer spending: this implies either that the proportion of total spending which goes on goods and services subject to VAT has increased, or that estimates of consumer spending in 1987 may be revised up later. The higher than expected oil revenues in 1987–88 are largely the result of a higher dollar oil price than assumed last year.

6.07 General government receipts are forecast to rise by 6½ per cent in 1988–89, following an estimated 8½ per cent increase in 1987–88. This is a little less than the rate of growth forecast for money GDP. Without the Budget measures however forecast growth in receipts would be about 1½ percentage points above that of money GDP.

will average $15 a barrel over the year ahead.

6.08 Oil revenues, which in the event in 1987–88 were only slightly below the 1986–87 level, are forecast to fall by about £1 billion in 1988–89 as a result of both a lower average oil price and lower production. The forecast assumes that North Sea oil prices [~~remain close to recent levels~~]. As last year, Oil production is assumed to fall in 1988 to a level close to the centre of the Department of Energy's range. A $1 a barrel difference in the oil price in 1988 would change revenues by about £2~~5~~70 million in 1988–89 and £3~~0~~30 million in a full year. A change of 1 million tonnes in oil production in 1988, spread evenly across fields, would alter revenues by about £~~40~~ 35 million in 1988–89 and £45 million in a full year.

6.09 Non-oil receipts are forecast to rise by 7 per cent in 1988–89. As can be seen from Table 1.2 there is within this overall increase:

a 1½ per cent increase in income tax receipts. Without the Budget measures the forecast increase would have been 10 per cent;

a further rise of 24 per cent in receipts of corporation tax (including ACT but excluding North Sea mainstream corporation tax). This reflects continued growth in company profits in 1987.

a 16 per cent rise in capital taxes, mainly reflecting rising asset ~~prices in~~ STET earlier years;

an 8 per cent increase in VAT, in line with the forecast increase in consumers' expenditure;

a 5½ per cent increase in the excise duties on petrol, tobacco and alcohol, a little below the increase in consumers' expenditure reflecting the trend decline in the share of these items in the total;

a small fall in stamp duty following the fall in stock market [~~prices and~~] turnover.

6.10 Table 6.2 shows taxes (including rates) and national insurance contributions as a percentage of GDP. Non-oil taxes have risen slightly as a percentage of non-oil GDP in each of the last two years, and [a further marginal increase] is forecast for 1988–89. Without the Budget measures the 1988–89 figure would have been ~~about one~~ almost a full percentage point higher.

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Table 6.2 Taxes and national insurance contributions (NICs) as a percentage of GDP

	1982–83	1983–84	1984–85	1985–86	1986–87	1987–88 Latest estimate	1988–89 Forecast
Total taxes and NICs as a share of total money GDP	38·9	38·5	39·1	38·5	37·8	37·7	37·8
Non-oil taxes and NICs as a share of non-oil money GDP	38·2	37·8	37·8	37·0	37·3	37·5	37·6

Expenditure

6.11 General government expenditure is now forecast to be about £171½ billion in 1987–88, £2 billion lower than in the 1987 Budget forecast. The outturn for the planning total is expected to be £2½ billion lower than in the original plans, and gross debt interest payments nearly £½ billion lower than forecast. ~~Partly offsetting these is an increase in other national accounts adjustments.~~

x

6.12 General government expenditure is expected to rise by 6¾ per cent in 1988–89, to £183 billion. The planning total, at £156·8 billion, is as published in the public expenditure White Paper (Cm 288). General government gross debt interest payments in 1988–89 are now forecast to be lower than projected in the White Paper as a result of the marked reduction in the PSBR.

about

Borrowing

6.13 The difference between general government receipts and expenditure is the general government borrowing requirement (GGBR), as shown in Table 6.1. As general government lending to public corporations is included in general government expenditure, the GGBR together with public corporations' market and overseas borrowing gives the PSBR.

x

6.14 There was a substantial budget surplus in the first [ten] months of 1987–88. Excluding privatisation proceeds the PSBR was some £[5½] billion lower than in the same period of 1986–87. This reduction in borrowing was almost entirely due to lower central government own account borrowing. Local authority borrowing has been higher than in 1986–87 and public corporations' borrowing little changed. Taking into account the well established pattern of relatively high borrowing in the final two months of the year, the forecast for 1987–88 as a whole is a budget surplus of about £3 billion, or ¾ per cent of GDP.

6.15 A further budget surplus of £3 billion, or ¾ per cent of GDP, is forecast for 1988–89.

again, although only

Trends in receipts and expenditure

6.16 Chart 6.1 shows trends in taxes and expenditure as percentages of GDP. Revenues from non-oil taxes and national insurance contributions fell as a percentage of non-oil GDP between 1981–82 and 1985–86, but since then it has been rising. [It is forecast to rise marginally in 1988–89.] The ratio of general government expenditure (excluding privatisation proceeds) to GDP has fallen every year since 1982–83 except for a small rise in 1984–85 as a result of the miners' strike; it is forecast to fall again in 1988–89.

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BUDGET CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 3 March 1988

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Monck
Mr Culpin
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Call
Mr Jenkins (OPC)

Mr Painter IR
Mr McGivern IR
Mr Reed IR
PS/IR

BES: CEILING - START DATE

The Chancellor has seen Mr Reed's minute of 2 March.

2. He has commented that, whatever option we go for, there seems a clear need for a repetition of the 19 March 1986 warning.

JT

J M G TAYLOR

psl/4A

RETNO ACSA/28

COPY NO. 1 OF 12

FROM: A C S ALLAN

DATE: 4 March 1988

MISS C EVANS

cc PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin
Mr Odling-Smee
Miss Sinclair
Mr R I G Allen
Mr Pickford

FSBR: CHAPTER 1

... The Chancellor was grateful for your minute of 3 March. I attach a copy with his comments marked.

ACSA

A C S ALLAN

1 The Budget

1.01 The objective of the Government's economic policy is to defeat inflation and to maintain a vigorous and enterprising economy, with sustained growth of output and employment.

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS); describes developments in the economy over the past year; provides forecasts to mid-1989; sets out the tax proposals in the Budget; summarises the Government's spending plans; and gives forecasts for the public finances for the year ahead.

The Medium Term Financial Strategy

1.03 Chapter 2 describes the MTFS, which provides the framework for the Government's economic policy. Monetary and fiscal policies are designed to keep the growth of money GDP on a downward trend over the medium term, so bringing down inflation. The MTFS is complemented by supply side policies, including new measures in the Budget, designed to encourage enterprise, efficiency and flexibility and thus the growth of output and employment.

The economy

1.04 Chapter 3 describes the main developments in the economy in 1987 and the prospect until mid-1989. The economy grew strongly in 1987, with the largest fall in unemployment since the war. GDP is forecast to grow by a further 3 per cent in 1988, with particularly strong growth in business investment. Inflation should remain low and unemployment continue to fall.

Tax measures

X

1.05 Chapter 4 sets out the tax proposals in the Budget. They continue the Government's programme of tax reduction and reform. They include a reduction of 2p in the basic rate of income tax, an increase in personal allowances, the abolition of all higher rates of income tax above 40 per cent, and the introduction in 1990–91 of the independent taxation of husband and wife. Other measures include reforms of capital gains tax, inheritance tax and the tax treatment of maintenance and covenants. The measures are summarised in Table 1.1.

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, as set out in the public expenditure White Paper. This chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1987–88.

Public sector finances

1.07 Chapter 6 presents the complete financial picture for the public sector. There is expected to be a budget surplus of £3 billion in 1987–88, ~~the first surplus since 1969–70~~. A further surplus of £3 billion is envisaged for 1988–89. This takes account of the tax proposals in the Budget which are expected to reduce taxation by £4 billion, after adjusting for the net cost of indexing direct and indirect tax rates and allowances. Table 1.2 shows the main components of general government receipts and expenditures.

only the second such surplus since the early 1950s.

[please check for accuracy & consistency]

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REF NO ACSA/24

COPY NO 24 OF 24

FROM: A C S ALLAN

DATE: 2 March 1988

MR CULPIN

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Miss Sinclair
Mr Riley
Miss C Evans
Mr Hudson
Miss Simpson
Mr Cropper
Mr Tyrie
Mr Call
PS/IR
Mr P R H Allen - C&E

BUDGET: PACKAGING

The Chancellor has been considering further the packaging suggestions attached to Miss Simpson's note of 17 February; he has also seen (and agrees with) Mr P R H Allen's minute of 23 February.

... 2. I attach an annex with his revised packaging.

3. He commented that we should not put independent taxation in a simplification package: this, like the CGT rebasing, remedies an injustice. On balance, he felt that there was not a useful separate category of "simplication", over and above reform.

ACSA

A C S ALLAN

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ANNEX

BUDGET PACKAGES

1. Reform

Independent taxation
Higher rate restructuring
Maintenance & Covenants
Mortgages - residence basis
Mortgages - home improvement loans
CGT package
IHT package
Minor reforms/simplifications
- Minor personal allowances
- Lloyd's
- Top slicing relief

2. Reducing Burdens

Income tax rates & allowances
CGT package
IHT changes
North Sea changes

3. Removal of unjustified tax breaks

Car benefits etc
Forestry
Home improvement reliefs
APA for cohabiting couples
Top slicing
Keith

4. Business

CT rates & rebasing
Importers' details
Business entertainment
Capital duty
Building societies incorporation

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Employee share schemes
Lloyd's
Section 482
VED/DERV rates

5. Small Business

BES
VAT threshold
Small companies' CT rate
IHT package
CGT retirement relief

6. Supply side measures

Private rented housing
Importers' details
Employee share schemes
CGT retirement relief
IHT
- and practically everything else!

7. Housing

BES for building for private rent
Assured tenancies
Mortgages - residence basis
Mortgages - home improvement relief

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psl/3A

BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 4 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr H Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Mowl
Mr Pickford
Miss Simpson
Miss C Evans

FSBR: CHAPTER 5

... The Chancellor was grateful for your minute of 2 March. I attach a copy of the text with his comments marked.

ACSA

A C S ALLAN

PJ Butler 2/3/88

30/88 2/3

5 Public expenditure

5.01 The Government's expenditure plans were set out in the Public Expenditure White Paper (Cm 288). These plans are summarised in Table 5.1. The Budget makes no change to these plans, apart from two consequen~~tials~~ces of the tax proposals, described in paragraph 5.04.

Changes since previous Budget

5.02 Since the last FSBR, extra resources have been allocated to priority services such as health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also been increased.

Table 5.1 Public expenditure

	£ billion				
	1986–87 Outturn	1987–88 Estimated outturn	1988–89 Plans	1989–90 Plans	1990–91 Plans
Department					
DHSS – social security	44·4	[46·3]	48·5	51·1	53·6
DHSS – health and personal social services	17·9	[19·7]	20·7	21·7	22·7
Defence	18·1	[18·7]	19·2	20·0	20·6
Education and science	15·7	[17·1]	18·0	18·6	19·2
Scotland, Wales and Northern Ireland	15·4	[16·4]	17·1	17·5	17·9
Other departments	32·0	[33·2]	34·9	36·2	36·7
Privatisation proceeds	−4·4	[−5·0]	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**139·2**	**[146·4]**	**156·8**	**167·1**	**176·1**
General government gross debt interest*	17·6	[17·5]	[17·5]	[17]	[17]
Other adjustments*	8·0	[8·1]	[8·4]	[8]	[9]
General government expenditure*	**164·8**	**[171·6]**	**2·8 [18~~3·0~~]**	**[193]**	**[201]**
(a) in **General government expenditure excluding privatisation proceeds:** not bold					
not bold ~~In~~ **real terms (base year 1986–87)**	**[169·2]**	**[168·2]**	**[171·4]**	**4 [17~~5·5~~]**	**[174·~~4~~]**
(b) as ~~As~~ **a percentage of GDP**	**[43¾]**	**[41½]**	**[41¼]**	**[40¾]**	**[40]**

delete line

** 1989–90 and 1990–91 figures rounded to nearest £1 billion.*

R J Butler 2/3/88

Public spending trends 5.03 The reduction in the burden of debt interest, in unemployment and in subsidies to industry are helping to ~~have helped~~ make room for ~~these~~ ~~increases~~ while priority services maintaining the Government's policy of reducing the share of national income taken by public expenditure. General government spending excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982–83 to [41½ per cent] now. This fall is planned to continue.

Budget ~~measures~~ consequentials 5.04 Two of the Budget measures have consequences for public expenditure. In parallel with the abolition of tax relief on new covenants between individuals, including covenants to students—see paragraph 4.~~A~~10 the parental contribution scale is being revised for those starting their studies from the 1988–89 academic year onwards. This will cost some £20 million in 1988–89, rising to £80 million in 1991–92. In parallel with the change in the tax treatment of forestry—see paragraph 4.~~B~~30 there will be an increase in grants to forestry estimated to cost about £x million in 1989–90 rising to £y million in 1991–92. The expenditure arising from these changes will be charged to the Reserve and will not add to the Planning Totals. lc lc

1987–88 outturn 5.05 The latest estimates for the outturn for the planning total in 1987–88, which are still subject to some uncertainty, suggest that it is likely to be about £[146.] 8.4 billion, £[2·2] billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £[0·9] billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2. Of the Reserve of £3·5 billion, only £[1·4] billion has been ~~was therefore~~ required to meet additions to departmental programmes.

Table 5.2 Comparison of plans and estimated outturn for 1987–88

	1987–88 £ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government[2]	108·3	[109·5]	[+1·2]
Local authority[2]	40·2	[41·0]	[+0·8]
of which:			
relevant expenditure	31·0	[32·2]	[+1·3]
other current	4·9	[5·1]	[+0·1]
capital	4·3	[3·7]	[−0·6]
Nationalised industries and other public corporations	1·6	[1·0]	[−0·6]
Privatisation proceeds	−5·0	[−5·0]	
Reserve	3·5		[−3·5]
Public expenditure planning total	**148·6**	**[146·4]**	**[−2·2]**

[1] *Plans from The Government's Expenditure Plans 1987–88 to 1990–91, Cm 56, adjusted for classification changes.*

[2] *Excluding finance for nationalised industries and other public corporations.*

0175

RJ Butler
3/2/88

5.06 The major changes between plans and estimated outturn for particular programmes are:

: there has been

are expected, partly

though

a net increase of £[1·2] billion in central government expenditure ~~mainly due to~~ an increase of £[0·6] billion in expenditure by DHSS on Health and Personal Social Services (principally reflecting the cost of the 1987 nurses and doctors and dentists pay settlements), and higher net payments to the European Communities (£[0·8] billion) offset by lower payments by the Intervention Board for Agricultural Produce (£[0·3] billion); expenditure by DHSS on social security is now estimated to be £[ ] above last year's plans ~~but~~ this is £[0·2] billion below the estimate in the 1988 public expenditure White Paper;

an overspend of £[1·4] billion on the plans for local authority current expenditure;

bits underlined should be in italics or similarly emphasised

L]

a net underspend of £[0·6] billion on local authority capital expenditure, reflecting £[0·4] billion higher gross spending, more than offset by £[1·0] billion higher capital receipts. [The net underspend is £[0·1] billion greater than that shown in the 1988 public expenditure White Paper;]

better results for nationalised industries and other public corporations, by £[0·6] billion, due principally to higher profitability of British Steel and increased capital receipts from New Towns £[0·2] billion.

Table 5.3 Public expenditure by spending authority

	£ billion				
	1986–87 Outturn	1987–88 Estimated outturn	1988–89 Plans	1989–90 Plans	1990–91 Plans
Central government*	104·6	[109·5]	114·2	120·2	124·7
of which:					
Voted in Estimates	73·4	[77·0]	81·0	84·6	87·6
other	31·2	[32·6]	33·2	35·6	37·1
Local authorities*	37·9	[41·0]	42·6	44·0	45·2
of which:					
relevant expenditure	29·4	[32·2]	33·2	34·3	35·4
other current	4·8	[5·1]	5·4	5·7	5·9
capital	3·7	[3·7]	4·0	4·0	3·9
Nationalised industries	0·4	[0·4]	0·7	0·0	−0·4
Other public corporations	0·8	[0·6]	0·8	1·0	1·0
Privatisation proceeds	−4·4	[−5·0]	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**139·2**	**[146·4]**	**156·8**	**167·1**	**176·1**

**Excluding finance for nationalised industries and other public corporations.*

Public expenditure by spending authority

5.07 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social

psl/7A

REF. ACSA /32

COPY NO. 1 OF 20 .

FROM: A C S ALLAN
DATE: 7 March 1988

MR S J DAVIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mrs R Butler
Mr Mowl
Mr Pickford

FSBR: CHAPTER 2

... The Chancellor was grateful for your minute of 3 March. I attach a copy of the pages on which he had comments.

ACSA

A C S ALLAN

2 The Medium Term Financial Strategy

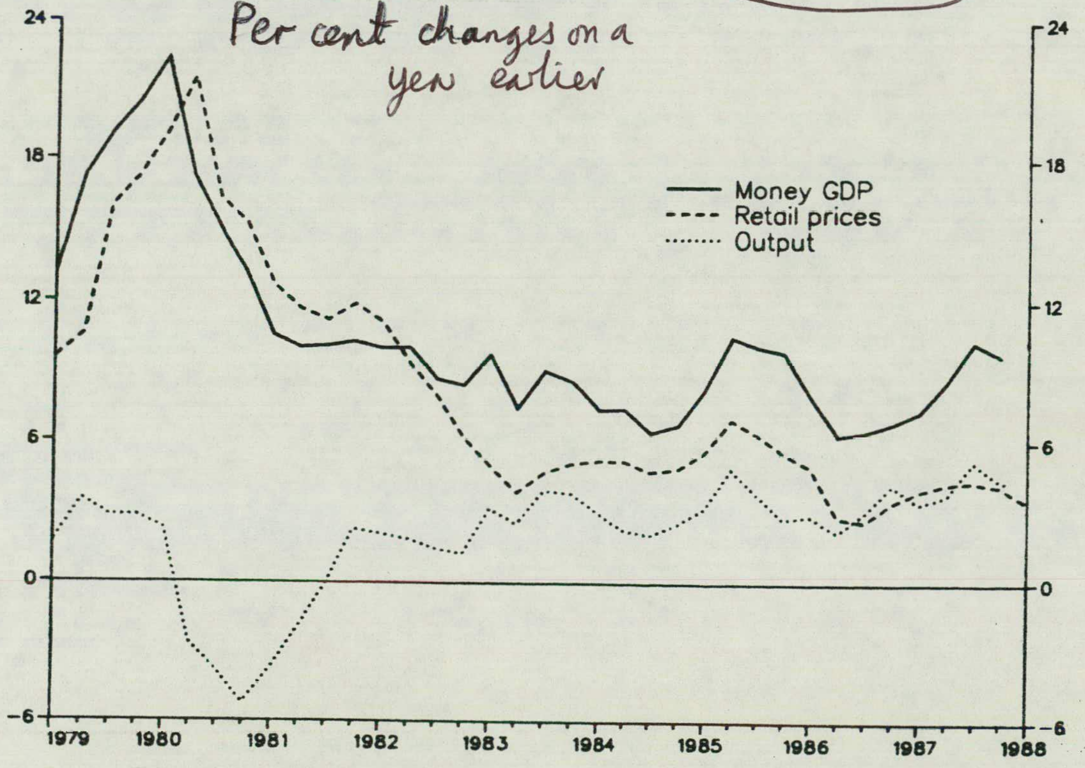
2.01 The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980.

2.02 It is intended to bring inflation down further over a period of years, and ultimately to achieve price stability. Accordingly, economic policy is set in a nominal framework. Monetary and fiscal policies are designed to keep the growth of money GDP on a downward trend over the medium term. The MTFS is complemented by policies to improve the working of markets and the supply side of the economy. By encouraging enterprise, efficiency and flexibility, these policies improve the division of money GDP growth between output growth and inflation, thus assisting the creation of jobs.

2.03 Money GDP growth has come down from over 20 per cent at the start of 1980 to under 10 per cent last year. At the same time retail price inflation has fallen from over 20 per cent at its peak in 1980 to ~~around~~ 4 per cent last year. In real terms the economy has grown steadily at ~~around~~ $3\frac{1}{4}$ per cent a year on average since 1983, and is set for a further year of growth at around 3 per cent, with inflation ~~remaining~~ ~~around~~ ~~near~~ approaching 4 per cent.

Chart 2.1 Money GDP, output and inflation

Per cent changes on a year earlier



Objectives and the framework of policy

2.04 Policy is directed at maintaining monetary conditions that will bring about a gradual reduction in the growth of money GDP over the medium term. Table 2.1 shows the intended medium term path for money GDP, although there will inevitably be fluctuations around it in the short term.

Table 2.1 **Money GDP Growth***

l.c.

1987–88	1988–89	1989–90	1990–91	1991–92
9¾	7½	6½	6	5½

**Per cent change on previous financial year. See Table 2.3 for assumptions on output and inflation. The figure for 1988–89 is a forecast; the figures for subsequent years describe the Government's broad medium term objectives.*

2.05 Money GDP growth is expected to be around 9¾ per cent in 1987–88, higher than forecast in last year's FSBR. The division of money GDP growth between output growth and inflation was better than forecast, a further sign of improvement in the supply performance of the economy. Output growth is currently estimated at 1½ points above last year's forecast; inflation (as measured by the GDP deflator) is estimated to have been about ½ point higher than forecast.

2.06 For 1988–89, money GDP growth is forecast to be 7½ per cent. Real growth is forecast to slow down from its 1987–88 level. The current forecast for the increase in the GDP deflator in 1988–89 is a little above the projection in last year's MTFS.

2.07 For the later years, the growth of money GDP is projected to decline at much the same rate as envisaged last year. The medium term growth projection for the economy as a whole is unchanged from last year's MTFS, as is the medium term decline in inflation.

2.08 A declining path for money GDP growth, as in Table 2.1, requires firm monetary policy supported by prudent fiscal policy. Fiscal policy is reviewed each year at budget time. Short-term interest rates, which are varied more frequently, are used to keep monetary conditions on track.

Monetary policy

Bring (X) forward to here

2.~~09~~10 ~~As the Chancellor made clear at the Mansion House last year, t~~The Government ~~is committed~~ attaches particular importance to maintaining a stable exchange rate, ~~with~~ notably the rate against the deutschemark ~~being of particular importance~~. This provides an important financial discipline ~~[and is also helpful to industry]~~. Sterling has remained stable against the deutschemark throughout the past year, following the Louvre accord in February 1987. The discipline of a stable exchange rate provides the underpinning for the declining path of money GDP growth and inflation. ~~[Y here]~~

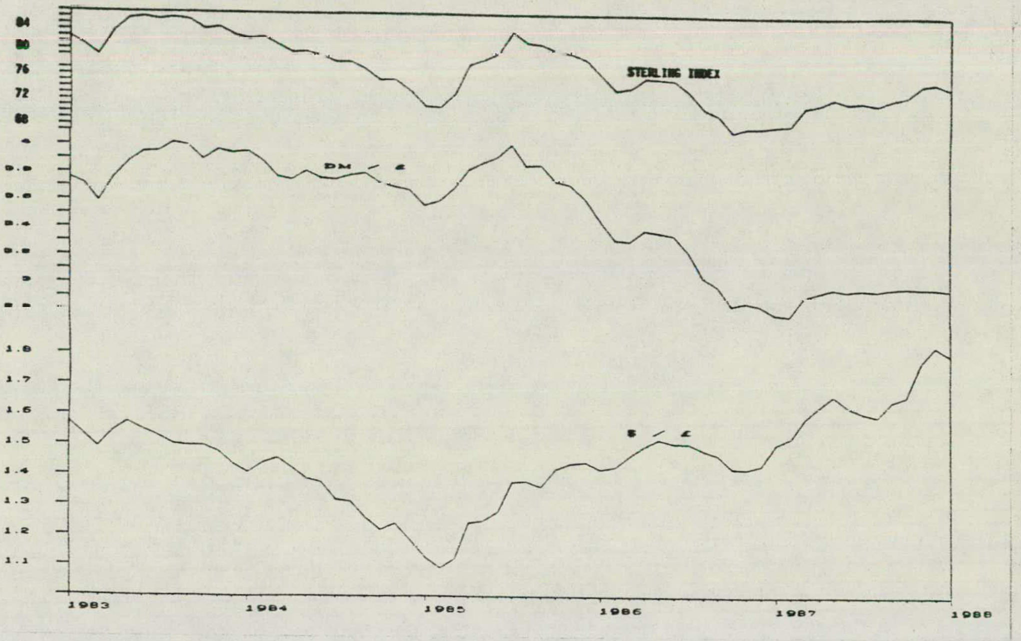
add (Y) here

2.1~~0~~1 Achieving these objectives ~~implies~~ also requires a reduction in monetary growth over the medium term. For M0, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988–89 of 1–5 per cent ~~[2–6 per cent]~~. This is the same as indicated in last year's MTFS. ~~[This is the same as last year's range.]~~ The ranges given in Table 2.2 for later years are illustrative, but show a steady fall consistent with the declining path for money GDP growth.

MOVE THIS PARA BETWEEN CHARTS 2.2 AND 2.3

0381

Chart 2.2 Sterling exchange rates

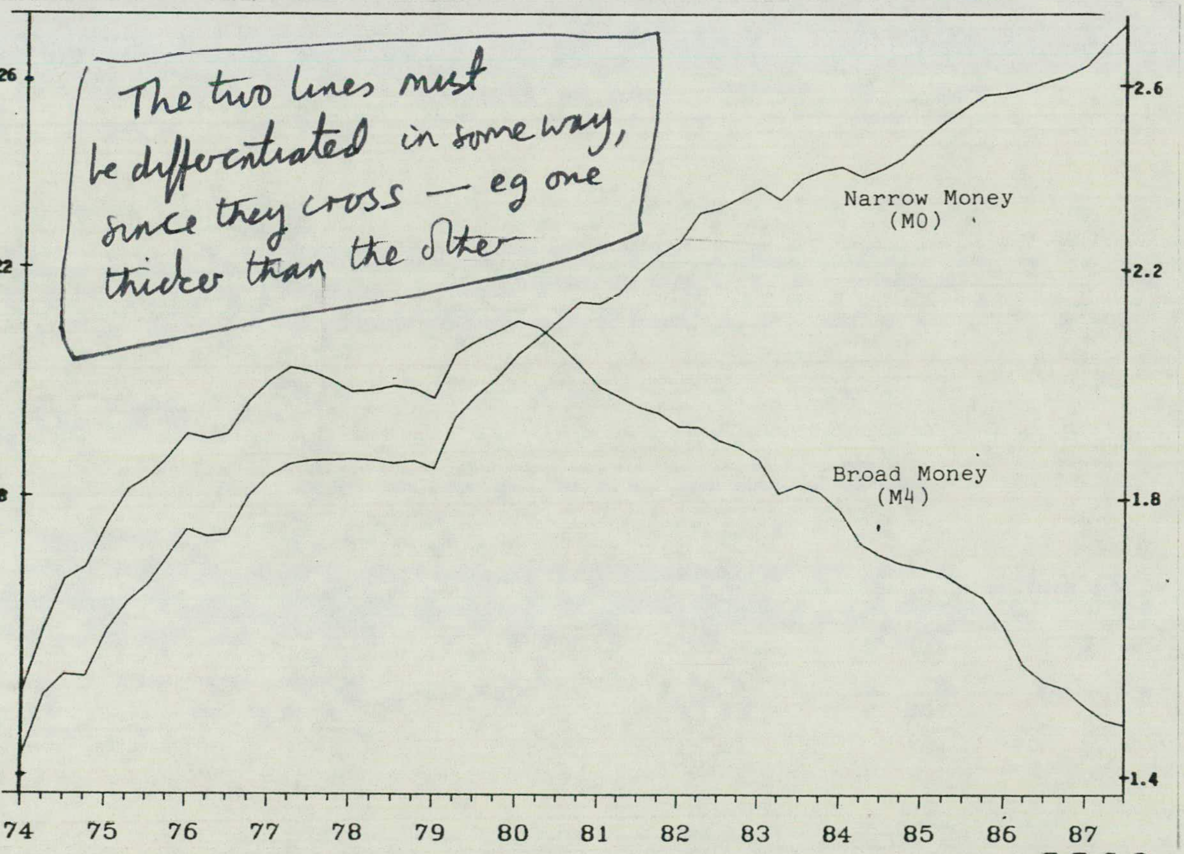


(X) — Bring forward

2.~~11~~09 Interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure that inflationary pressures are not accommodated. ~~This means, in particular, that~~ since increases in domestic costs will not be accommodated by a decline in the exchange rate.

(Y) Bring forward

Chart 2.3 Velocity of monetary aggregates

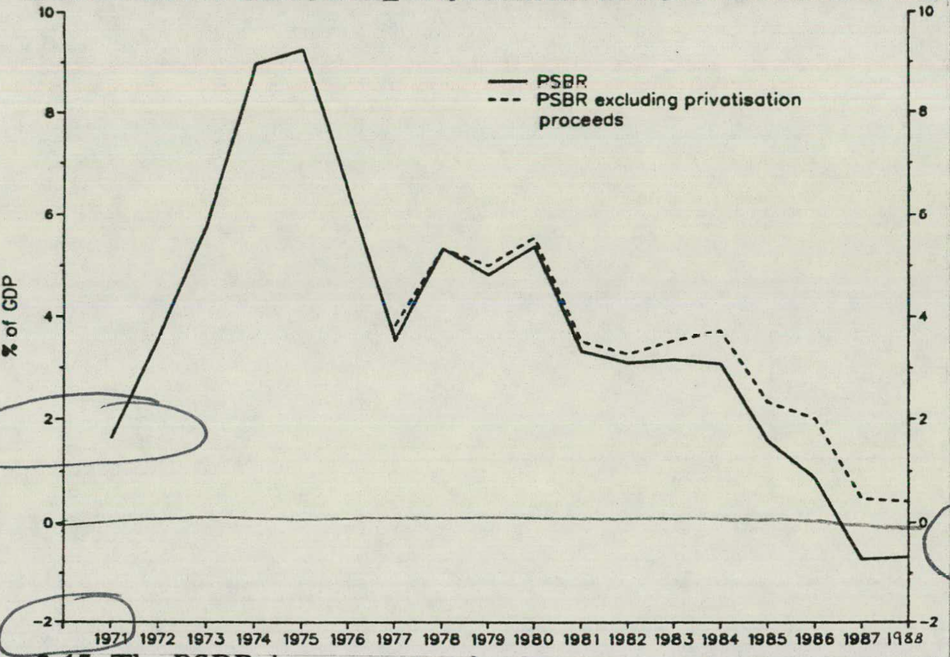


The two lines must be differentiated in some way, since they cross — eg one thicker than the other

0382

ADD ZERO LINE AND START AT LEFT-HAND AXIS

Chart 2.5 Public sector borrowing requirement and privatisation proceeds



The PSBR path 2.15 The PSBR is now assumed to be zero over the medium term: a balanced budget. This is a prudent and cautious level and can be maintained over the medium term. It also provides a clear and simple rule, with a good historical pedigree. In practice, there are likely to be fluctuations around this level from year to year. On the basis of current privatisation plans, a PSBR of zero implies that, even without any privatisation proceeds, it would be only 1 per cent of GDP.

2.16 The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of ~~over~~ some £7 billion in 1988–89. Continuing the gradualist approach which has always been a characteristic of the MTFS, only part of this room for tax reductions has been used. The PSBR for 1988–89 ~~is~~ has been set at £3 billion, ~~little changed from~~ the same as the expected outturn in 1987–88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Assumptions 2.17 For the period to 1990–91, the public expenditure projections in Table 2.4 use the figures for the public expenditure planning total shown in the public expenditure White Paper (Cm 288); gross debt interest payments are lower than projected in the White Paper, reflecting lower government borrowing, while other adjustments are a little higher. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1991–92. Decisions on expenditure in 1991–92 will be taken in the 1988 Survey.

2.18 The assumptions about output growth and inflation that underlie the revenue projections are shown in Table 2.3. They are consistent with the figures for money GDP growth in Table 2.1. Oil prices are assumed to average $15 a barrel in 1988–89 and thereafter to remain broadly unchanged in real terms.

0384

Table 2.5 General government receipts

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
Taxes on incomes, expenditure and capital	119.6	132	141	149	157	165
National insurance and other contributions	26.7	29	31	34	36	38
Interest and dividends	6.0	6	6	5	5	4
Other receipts	6.9	6	7	7	7	7
General government receipts [1]	160.0	173	185	195	205	214
of which						
North Sea tax[2]	4·8	5	4	4	3	3

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1987–88 onwards.*

[2] *Royalties, petroleum revenue tax (including advance payments) and corporation tax from North Sea oil and gas production (before advance corporation tax set off). This does not correspond exactly to tax receipts in the same financial year in respect of North Sea production. See footnote 3 to Table 6B.3.*

Public sector borrowing

2.21 The projections of government expenditure and receipts are brought together in Table 2.6 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.22 Changes since the 1987 MTFS are discussed in the Annex to this chapter.

Table 2.6 Public sector borrowing[1]

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
General government expenditure	164.8	172	183	193	202	210
General government receipts	160.0	173	185	195	205	214
Fiscal adjustment from previous years[2]	–	–	–	–	3	4
Annual fiscal adjustment[2]	–	–	–	3	1	1
GGBR	4.8	−2	−2	1	1	1
Public corporations' market and overseas borrowing	−1.5	−1	−1	−1	−1	−1
PSBR	3·4	−{3}	−{3}	0	0	0
Money GDP at market prices	387	426	458	488	518	546
PSBR as per cent of GDP	0·9	−{3/4}	−{3/4}	0	0	0

[1] *Rounded to the nearest £1 billion from 1987–88 onwards. Further details for 1987–88 and 1988–89 are provided in Tables 1.2 and 6.7.*

[2] *Means lower taxes or higher expenditure than assumed in lines 1 and 2.*

Conclusion

2.23 The strength of the economy coupled with fiscal prudence has enabled the Government to achieve a balanced budget on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress in the medium term towards lower inflation, coupled with ~~and~~ lower taxes and public spending as a share of GDP. The MTFS provides the financial framework within which the policies to achieve these objectives are set.

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Annex to Chapter 2

Changes since the 1987 MTFS

Money GDP

2A.1 The growth rate of money GDP is expected to be higher in both 1987–88 and 1988–89 than envisaged in last year's MTFS, with growth in the GDP deflator ½ percentage point higher in both years. Thereafter inflation is projected to decline at the same rate as last year. The projection of output growth over the medium term in the whole economy is unchanged from last year's MTFS.

Table 2A.1 Money GDP growth

Differences from 1987 MTFS projections, percentage points

1987–88	1988–89	1989–90	1990–91
+2¼	+1	+½	+½

Monetary aggregates

2A.2 The growth of M0 in 1987–88 has been within its target range throughout the year. The target range for 1988–89 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

Table 2A.2 The growth of M0

	Per cent changes on a year earlier			
	1987–88	1988–89	1989–90	1990–91
1988 MTFS	5	1–5	1–5	0–4
1987 MTFS	2–6	1–5	1–5	0–4

Fiscal projections

2A.3 Table 2A.3 shows changes in the fiscal projections since the 1987 FSBR. Additional information on 1987–88 is given in Chapter 6.

Expenditure

2A.4 The expected undershoot on the planning total in 1987–88 is described in Chapter 5. General government expenditure is also lower in 1987–88 than projected last year, reflecting the lower planning total. The planning total for 1988–89 onwards is as in the public expenditure White Paper (Cm 288), which incorporates higher figures than assumed last year. The general government expenditure figures for the future have also been revised up; but to a lesser extent than the planning total, as the lower path now adopted for the PSBR implies substantially lower debt interest payments.

Receipts

2A.5 Revenues in 1987–88 have been much higher than forecast, in large part reflecting higher money GDP growth in both 1986–87 and 1987–88. Because of the lag between accruals and payments of taxes on corporate profits, the buoyancy of the economy over the last year will still be contributing to the growth of revenues in 1988–89. North Sea revenues in 1987–88 were slightly higher than forecast, as the oil price for much of the year was well above the assumed level of $15 a barrel. On the assumption that oil prices remain close to recent levels, oil revenues in 1988–89 are now forecast to be much as projected a year ago.

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COPY NO 15 OF 15

FROM: A C S ALLAN

DATE: 7 March 1988

MR HIBBERD

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr R I G Allen
Miss Simpson
Mr Hudson
Mr Allum
Miss C Evans

CHAPTER 3 OF THE FSBR: THE INDUSTRY FORECAST

... The Chancellor was grateful for your minute of 4 March. I attach a copy of the pages on which he had comments.

2. He would be grateful to know why, if domestic demand for oil fell in 1987, it is expected to rise (albeit "modestly") in 1988? Is this a stocks point?

3. He also asked when, on the basis of the forecast for growth in manufacturing output (ie 5 per cent in 1988), do we regain the 1973 peak?

ACSA

A C S ALLAN

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3 The economy: recent developments and prospects to mid 1989

Summary

significantly

3.01 1988 should see growth of 3 per cent, the average rate over the last six years, but ~~appreciably~~ below the $4\frac{1}{4}$ per cent growth in 1987. Inflation is expected to remain low and there are good prospects for a further fall in unemployment.

Assumptions

3.02 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. As last year, it assumes that North Sea oil prices will [average $15 a barrel] over the year ahead, and that the exchange rate will remain close to its current level.

Demand and activity

3.03 The economy grew strongly in 1987, with GDP growth of $4\frac{1}{4}$ per cent and manufacturing output growth of $5\frac{1}{2}$ per cent. Domestic demand grew by just under 4 per cent, the same as in 1986. It is expected to grow at a similar rate in 1988, with slightly lower growth of consumer spending being offset by markedly faster growth of investment. GDP is forecast to grow by 3 per cent ($3\frac{1}{2}$ per cent for non-oil GDP).

Inflation

averaged

3.04 RPI inflation ~~was~~ just over 4 per cent in 1987. It fell to $3\frac{1}{4}$ per cent in January 1988, but ~~may edge up~~ to 4 per cent ~~by~~ the fourth quarter of 1988.

is forecast to return in

Labour market

3.05 Employment has risen strongly over the past year, with unemployment falling by half a million—the largest decline since the war. ~~With non-oil GDP growing at close to 3 per cent during 1988,~~ Unemployment should continue to fall.

~~the current buoyancy of activity,~~

World economy

3.06 GNP in the main industrial economies grew by about 3 per cent last year. Some slackening in growth is likely in 1988 particularly in the United States, and growth in the main industrialised countries in aggregate could ease slightly to $2\frac{1}{2}$ per cent. Industrial production picked up strongly during 1987. Associated with this were faster growth in trade in manufactures and some recovery in industrial materials prices. World trade in manufactures appears to have grown by about $5\frac{1}{2}$ per cent in 1987 and should grow by a similar amount this year.

UK trade and current account

3.07 Both export and import volumes grew rapidly last year: some moderation in growth is likely in 1988. Following recent revisions to the surplus on invisibles the current account is now estimated to have been in deficit by £1 billion in 1987. A deficit of [£3] billion ($\frac{3}{4}$ per cent of GDP) is forecast for 1988.

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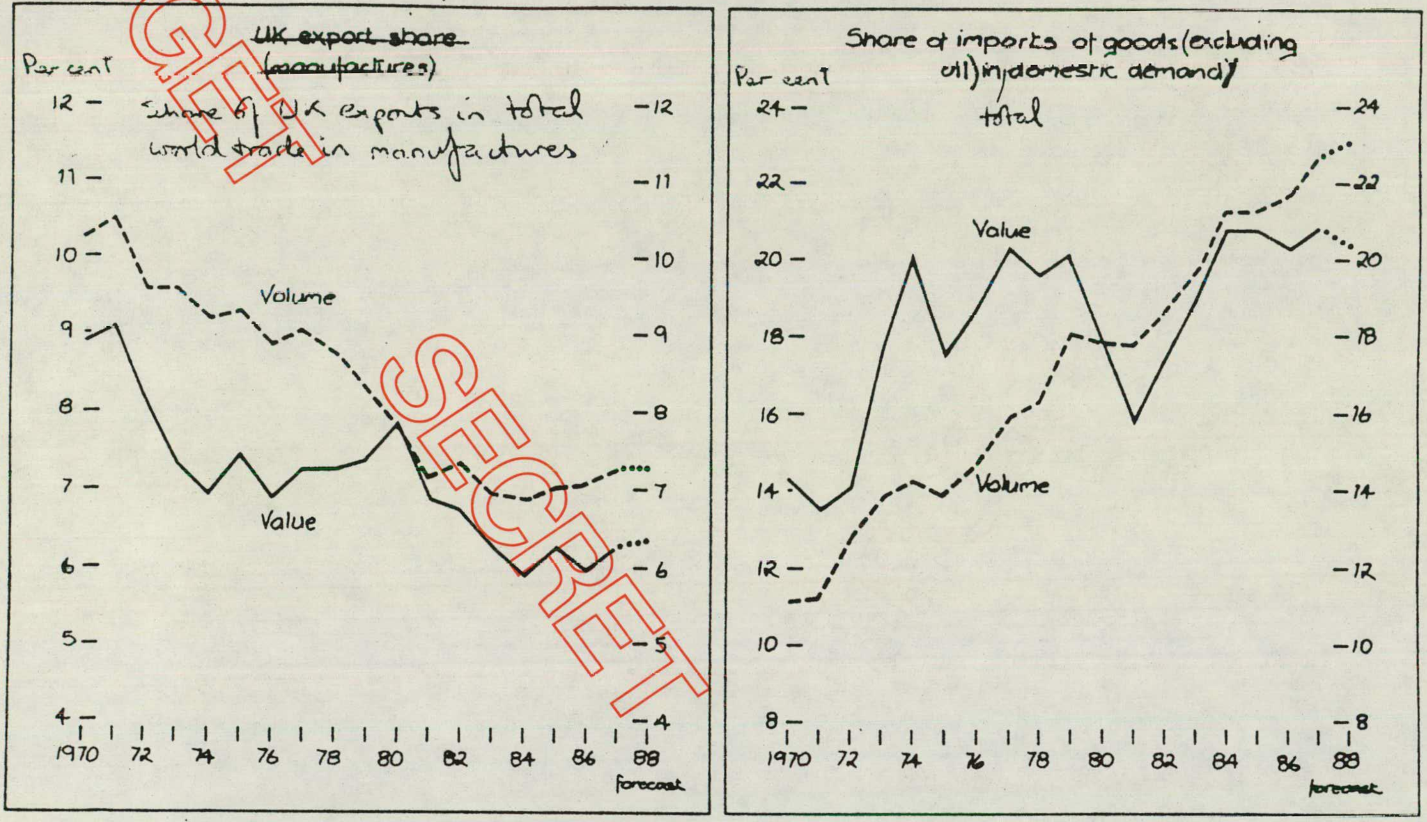
Chart 3.5 Export shares and import penetration



Oil trade

3.26 There was a surplus in oil trade of £4 billion in 1987, little changed from 1986. Higher oil prices and a fall in domestic demand for oil more than offset a decline in North Sea production. In 1988 oil production is likely to decline further and be close to the centre of the Department of Energy's range while domestic demand for oil may rise modestly. The oil trade surplus is expected to fall by £1½ billion, to about £2½ billion

Trade prices and the terms of trade

3.27 The terms of trade, which fell in 1986 as oil prices declined, improved again in 1987 as oil prices firmed and as sterling's appreciation offset some rise in world commodity prices in the latter part of the year. Little further change in the terms of trade is ~~expected~~ assumed during the rest of 1988.

Invisibles and overseas assets

3.28 The latest estimate for the surplus on invisibles in 1987, at £8½ billion, is as forecast in last year's FSBR. This is the same as the outturn in 1986, with increased transfers to the European Community offset by higher net earnings from services and from the UK's net overseas assets. The invisible surplus seems likely to rise in 1988 partly because of lower net payments abroad by North Sea oil companies.

3.29 The value of the UK's stock of net overseas assets is estimated provisionally to have been about £90 billion at the end of 1987, some £20 billion down on end-1986. This decline is largely due to the fall in world equity markets and in the sterling value of UK assets in North America following the fall in the US dollar.

Current account

3.30 The current account deficit is estimated to have been £1 billion in 1987, the improvement over the forecast in last year's FSBR being due to the unexpected strength of exports of manufactures. A deficit of

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Table 3.5 Gross fixed domestic capital formation

	£ billion at 1980 prices	Per cent changes on a year earlier		
				Forecast
	1986	1986	1987	1988
Business[1]	29·8	−3	4½	8½
of which (i) non-oil business	27·8	−2	6½	8½
(ii) manufacturing	7·1	−5½	3½	11½
Private dwellings[2]	9·6	6½	5	2
X General government	7·0	5½	−1½	~~2~~ 1
Total fixed investment	**46·4**	**0**	**3½**	**6**

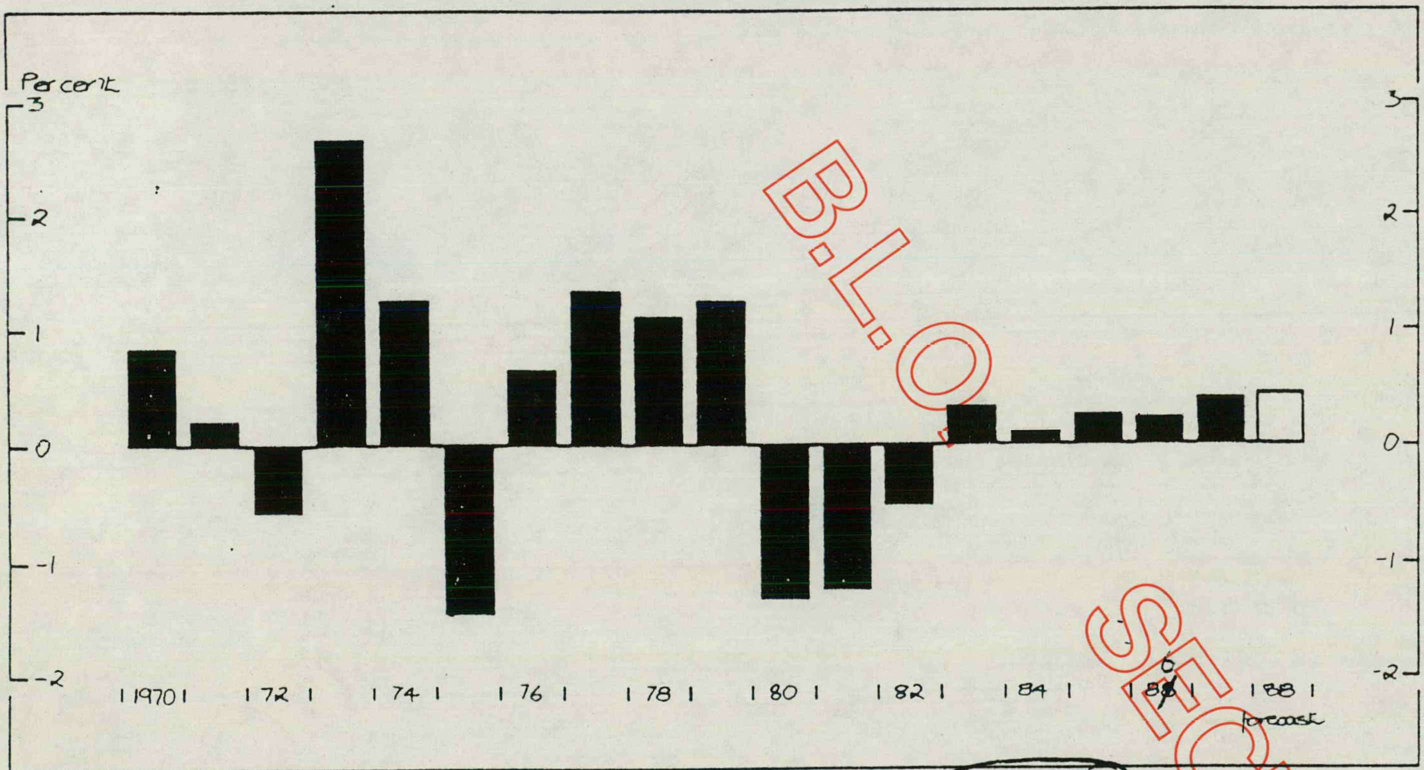
[1] *Includes investment by public corporations.*

[2] *Includes purchase less sales of land by persons, companies and public corporations, other than purchases of council houses.*

X

3.37 Despite a rise in stocks in 1987, stock-output and stock-sales ratios continued their trend decline of the last eight years. These downward trends are expected to continue in 1988, though, as last year, there is still likely to be modest stockbuilding.

Chart 3.8 Stockbuilding as a share of GDP



Prospects for demand and activity

3.38 GDP growth is likely to moderate to around 3 per cent (3½ per cent excluding oil) in 1988, close to the 1981–87 average ~~between 1981 and 1987~~. Domestic demand is forecast to rise at around the same rate in 1988 as in 1987; some slowdown in consumer spending should be offset by buoyant investment prospects. But declining North Sea output (and lower oil exports) may reduce GDP growth by around ~~½–¾~~ per cent, rather more than in 1987. Manufacturing output is expected to rise faster than non-oil GDP in 1988, as it did in 1987.

x x

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they did in 1986. Over the longer term, high profitability should lead to continued growth in investment, capacity and productivity. Together these should enhance prospects for controlling industrial costs.

3.44 Inflation has come down during the first quarter of 1988, aided by lower import costs and recent cuts in mortgage interest rates. It may edge up a little partly as a result of the Budget proposals and the effects of local authority rate increases. There will also be some real increases in nationalised industry prices following a decline in real terms over the past three years. The RPI is forecast to rise by 4 per cent in the year to the fourth quarter of 1988. With substantial cuts in income tax, the tax and price index (TPI) is likely to rise more slowly than the RPI during 1988. By the fourth quarter of 1988 it is likely to be [ ] per cent higher than a year earlier?

Table 3.8 Retail prices index

	Per cent changes on a year earlier			
	Weight in 1987	1987 Q4	Forecasts 1988 Q4	Forecasts 1989 Q2
Food	16½	3½	2[illegible]	~~2½~~ 3
Nationalised industries	6	2¼	6½	5~~¼~~ 3/4
Housing	15	7	~~7¼~~ 6	~~8~~ 7½
Other	62½	3¾	3~~¼~~ ½	3~~¼~~ ½
Total	**100**	**4**	**4**	**4**

3.45 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output. It does not include import prices. The GDP deflator at market prices is ~~forecast~~ estimated to rise by 5~~¼~~ per cent in 1987–88 (a little faster than expected in the Autumn Statement), following an increase of 3~~¼~~½ per cent in 1986–87. The higher rate of increase in 1987–88 is accounted for by a recovery in North Sea profits, which had fallen by over 50 per cent in 1986–87 following the sharp fall in oil prices. The GDP deflator is now forecast to rise by 4½ per cent in 1988–89.

Productivity and the labour market

3.46 Preliminary estimates suggest that the employed labour force in Great Britain rose sharply during 1987; in the year to September 1987 it is estimated to have risen by 45~~1~~3,000. Self-employment has grown particularly strongly, as many more people have taken advantage of the opportunities offered by the buoyant economic climate. Total employment has now risen by over 1½ million since March 1983.

Table 3.9 Employment

	Thousands, change in GB seasonally adjusted				
	Employees in employment: Male	Employees in employment: Female	Self-employed	HM Forces	Employed labour force
September 1984 to September 1985	+55	+200	+90	−3	+343
September 1985 to September 1986	−8~~1~~2	+150	+71	−3	+136
September 1986 to September 1987	+2~~4~~5	+225	+207*	−~~3~~4	+453

* *Figures for self-employment after June 1987 are projections based on self-employment growth over the previous ~~five~~ six years.*

0628

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3.47 Productivity has also been growing strongly. In 1987 manufacturing productivity rose by almost 7 per cent. In the year to 1987Q3 (the latest period for which comparable data are available) UK manufacturing productivity rose faster than in any other major industrial country. It has now risen by an average of 4 per cent per annum since 1979. Underlying growth in labour productivity in manufacturing industry may now be higher than in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this, as a result of the large rise in part-time employment.

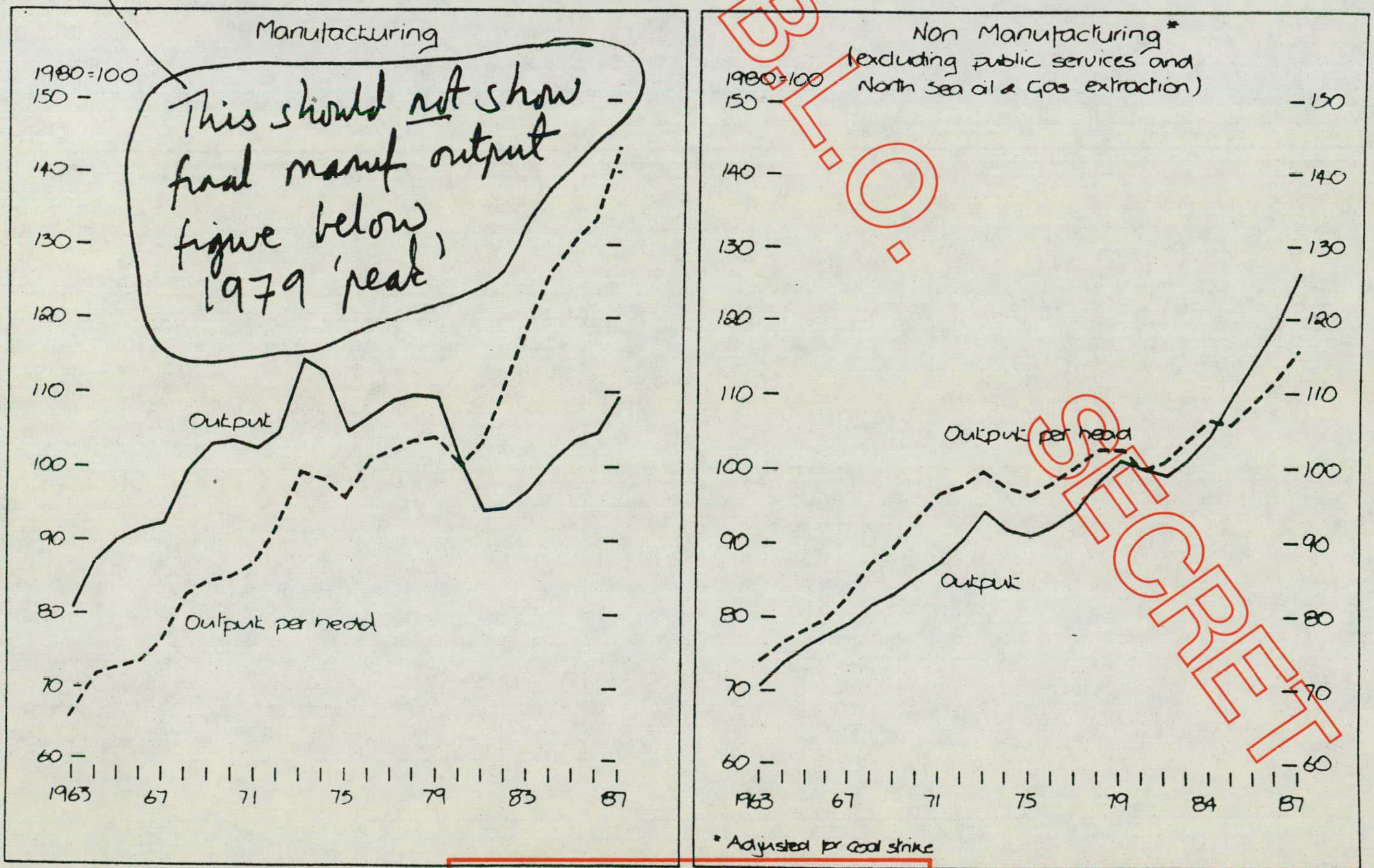
Table 3.10 Output per head of the employed labour force

Per cent changes

	Annual averages 1964–73	1973–79	1979–87	1984 Q4 to 1985 Q4	1985 Q4 to 1986 Q4	1986 Q4 to 1987 Q4[2]
Manufacturing	3¾	¾	4	2¼	6½	6¼
Non-manufacturing[1]	3	½	1½	3½	3½	~~3½~~ 3¾
Whole economy	2¾	1¼	2	2¼	3¼	3¼
Non-North Sea economy	2¾	½	2	2½	3¾	3½

[1]*Excludes public services and North Sea oil and gas extraction.* [2]*Partly forecast.*

Chart 3.11 Output and productivity



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Unemployment

~~Provided pay settlements are moderate~~ STET

3.48 Seasonally adjusted adult unemployment in the UK has fallen in each of the last eighteen months. It has now come down by almost 650,000 since July 1986. Over the same period long term unemployment (over one year's duration) has fallen by around 250,000. The improved trend in unemployment has been mainly the result of strong growth of output and employment. ~~U~~nemployment should continue to fall in the year ahead. ~~But~~ STET excessive pay settlements could threaten further progress.

Forecast and outturn

3.49 Table 3.11 compares the main elements of the forecast published in the 1987 FSBR with the outturn or latest estimate.

Table 3.11 Forecast and outturn

	1987 FSBR forecast	Latest estimate/ forecast	Average errors from past forecasts
Total gross domestic product; per cent change between 1986 and 1987	3	4¼	¼
RPI: per cent increase between the fourth quarters of 1986 and 1987	4	4	1½
Money GDP, per cent change between 1986–87 and 1987–88	7½	9¾	1½
Current account of the balance of payments in 1987, £ billion	−2½	−1	3
PSBR, financial year 1987–88, £ billion	4		5

3.50 Inflation in the fourth quarter of 1987 was in line with the forecast made a year ago while the current account deficit is now estimated to have been rather smaller than forecast. Although the data on which the latest estimates of GDP in 1987 are based are still very uncertain, it is clear that both money and real GDP growth have been stronger than forecast. The PSBR in 1987–88 is likely to turn out about £[ ] billion lower than last year's forecast. This error—which is slightly higher than average errors on past forecasts—reflects a combination of lower than expected general government expenditure and, in particular, higher than forecast tax revenues.

3.51 This year's forecast is summarised in Table 3.12.

Risks and uncertainties

3.52 No forecast is complete without an indication of error margins. Table 3.12 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about [£200] billion; and for the current account of the balance of payments exceed £[150] billion.

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37

BUDGET SECRET: TASK FORCE LIST

Many thanks. I would rather stay where we are for the present. If there are difficulties (or if I have 2nd thoughts when I see the weekend's press) we may find this alternative useful. Much will depend on market developments [illegible] 3.08, or [illegible] over the w/e [illegible] 3.08; so it's too soon to go firm. What is

Copy No 1 of 4 Copies

From: SIR PETER MIDDLETON
Date: 7 March 1988

CHANCELLOR

cc Sir T Burns

PART 2

I have been thinking further about parts 2:9 and 2:10 of the MTFS. An alternative presentation might go as follows:

> "Interest rate decisions are taken on a comprehensive assessment of monetary conditions so as to maintain downward pressure on inflation. Increases in domestic costs will not be accommodated either by monetary expansion or by depreciating the exchange rate.
>
> Exchange rate stability plays a central role in both domestic monetary decisions and international co-operative arrangements. In this context, the Government attaches particular importance to the exchange rate against the Deutschmark."

the absolute deadline for these 2 paras?

2. I do not think this loses anything from the presentation we have at the moment, but it might fit a little easier with market developments and the views in No 10.

PEM

P E MIDDLETON

37/952

BUDGET CONFIDENTIAL

FROM: MRS R J BUTLER
DATE: 7 March 1988

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Mowl
Mr Pickford
Miss Simpson
Miss C Evans

Cl
OK?
OK
AA

FSBR: CHAPTER 5

I have tried to contact you to discuss your minute of 4 March about the possible inclusion in Chapter 5 of a reference to the consequential public expenditure saving resulting from the increased personal allowances. As you are very tied up I thought I had better put pen to paper.

2. There are usually a number of Budget measures which have consequences for public expenditure but we have not consistently sought to present Budgets after taking account of all second round effects. Most Budgets have increases in indirect taxes, eg higher petrol duty but their expenditure consequences have hardly ever been mentioned. The savings from the reductions in NIS in 1983 and 1984 were mentioned. In 1984, the extension of VAT was mentioned as a source of increased costs but it was stated that these would be absorbed within existing programmes wherever possible. Reductions in rates of income tax reduce the cost of LAPR and MIRAS but these have never been mentioned.

3. The issue seems, therefore, to have been resolved pragmatically. ST estimate the saving to social security from any tax changes to be only about £20-25 million, well within any margin of error on the social security programme. You will want to consider whether you want to go out of your way to highlight how little people in low-paid work will gain from

your Budget. DHSS have not been consulted. They may come up with a somewhat different costing though they also would probably be unenthusiastic about giving prominence to the figure.

4. I have just received your note of today's date about the comment on DHSS spending which I will happily incorporate into paragraph 5.06. Unfortunately it reached me too late to be incorporated into the draft which I gave Mr Richardson to append to his minute on 1987-88 outturn this morning but I will pick the point up when I next amend the proofs. You may also wish to note that the MOD underspend will be shown as £0.1 billion rather than £0.2 billion - the figure was havering close to £150 million and the balance has just tipped the other way when all the details were worked through. This makes no difference to the overall assessment of outturn.

RJ Butler

MRS R J BUTLER

RA7.93

CONFIDENTIAL

pig-

FROM: A C S ALLAN

DATE: 7 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr H Phillips
Mr Scholar
Miss Peirson
Mr Turnbull
Mr Saunders
Mr Mowl
Mr R I G Allen

FSBR: CHAPTER 5

The Chancellor has seen Mr Anson's minute to you of 4 March about the increase in DHSS spending referred to in paragraph 5.06; he has also seen your reply of the same date.

2. He feels, given the figures of £300 million for the pay awards out of a total of £475 million, that the wording should say "two-thirds of which reflects the 1987 nurses' and doctors' and dentists' pay settlements".

ACSA

A C S ALLAN

mjd 1/97A

REF No. ACSA/40

COPY NO. OF 24

FROM: A C S ALLAN

DATE: 8 March 1988

MR CULPIN

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Miss Sinclair
Mr Riley
Miss C Evans
Mr Hudson
Miss Simpson
Mr Cropper
Mr Tyrie
Mr Call
PS/IR
Mr P R H Allen C&E

BUDGET: PACKAGING

The Chancellor has seen the Financial Secretary's and Economic Secretary's comments on the revised packaging. In the light of these and on further reflection, he has revised the
... packaging as attached.

ACSA

A C S ALLAN

ANNEX

BUDGET PACKAGES

1. Reform and simplification

Independent taxation
Higher rate restructuring
Maintenance & Covenants
Mortgages - residence basis
Mortgages - home improvement loans
CGT package
IHT package
Capital duty
Minor reforms/simplifications
- Minor personal allowances
- Lloyd's
- Top slicing relief
- Minor perks (car parking and 3rd party entertainment)

2. Reducing Burdens

Income tax rates & allowances
CGT package (including CT on company gains)
IHT changes

3. Removal of unjustified tax breaks

Car benefits etc
Forestry
Mortgages - residence basis
APA for cohabiting couples
Top slicing
Keith

4. Business

CT rates & rebasing
Importers' details
Business entertainment
Building societies incorporation
North Sea changes

Employee share schemes
Lloyd's
Section 482
Importers' details

5. <u>Small Business</u>

BES
VAT threshold
Small companies' CT rate
IHT package
CGT retirement relief

6. <u>Housing</u>

BES for building for private rent
Assured tenancies
Mortgages - residence basis
Mortgages - home improvement relief

7. <u>Other</u>

Excise duties
Payroll giving
PEPs

12/952

RESTRICTED
Covering BUDGET CONFIDENTIAL

FROM: MRS R J BUTLER
DATE: 9 March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Sir T Burns
Mr Anson
Mr Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr A Allan
Mr S Davies
Mr Mowl
Mr Pickford
Mr R I G Allen
Miss Simpson
Mr Hudson
Miss Evans
Mr Cropper

a
A few comments. See also separate folder on social security consequentials
AA

FSBR: CHAPTER 5

I attach a copy of the amended proofs of Chapter 5 of the FSBR which take on board the estimated outturn figures for 1987-88 which you and the Chief Secretary agreed yesterday.

2. There may be further changes to the GDP figures and the GDP deflator which could affect the last two rows of Table 5.01.

3. At Mr Odling-Smee's request, I have not emboldened the spending authorities in the sub-paragraphs of paragraph 5.06 as this would, apparently, be out of line with the general editorial style of the document.

4. These proofs have to be returned to the printers tomorrow (Thursday) and this is the last opportunity for substantive amendments. I would be grateful for any further comments you may have by noon tomorrow.

R J Butler

MRS R J BUTLER

~~BUDGET SECRET—BUDGET LIST ONLY~~

G Butler 9/3

4[redacted]8/9/3

5 Public expenditure

5.01 The Government's expenditure plans were set out in the public expenditure White Paper (Cm 288). They are summarised in Table 5.1. The Budget makes no change to these plans, apart from two consequences of the tax proposals, described in paragraph 5.04.

Changes since previous Budget

5.02 Since the last FSBR, extra resources have been allocated to priority services such as health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also been increased.

this doesn't follow your comment of adding (a) & (b), but I think that's an editorial point. Don't press!

Table 5.1 Public expenditure

£ billion	1986–87 Outturn	1987–88 Estimated outturn	1988–89 Plans	1989–90 Plans	1990–91 Plans
Department					
DHSS – social security	44·4	46·3	48·5	51·1	53·6
DHSS – health and personal social services	17·9	19·7	20·7	21·7	22·7
Defence	18·1	18·6	19·2	20·0	20·6
Education and science	15·7	17·1	18·0	18·6	19·2
Scotland, Wales and Northern Ireland	15·4	16·3	17·1	17·5	17·9
Other departments	32·0	33·0	34·9	36·2	36·7
Privatisation proceeds	−4·4	−5·0	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**139·2**	**146·0**	**156·8**	**167·1**	**176·1**
General government gross debt interest*	17·6	~~[~~17·5~~]~~	~~[~~17·~~4]~~5	~~[~~17~~]~~	~~[~~17~~]~~
Other adjustments*	8·0	~~[~~8·~~1]~~3	~~[~~8·~~4]~~5	~~[8]~~9	~~[~~9~~]~~
General government expenditure*	**164·8**	~~**[**~~**171·~~6]~~8**	~~**[**~~**182·~~6]~~8**	~~**[**~~**193~~]~~**	~~**[**~~**202~~]~~**
General government expenditure excluding privatisation proceeds:					
in real terms (base year 1986–87)	[169·2]	[168·2]	[171~~·4~~] 0·5	[17~~4~~] 3	[174]
as a percentage of GDP	**[43¾]**	**[41½]**	**[41~~¼~~]**	**[40~~¾~~]** ½	**[40]**

* *1989–90 and 1990–91 figures rounded to nearest £1 billion.*

BUDGET CONFIDENTIAL

~~BUDGET SECRET—BUDGET LIST ONLY~~

1146

RJ Butler 9/3

Public spending trends

5.03 The reductions in the burden of debt interest, in unemployment and in subsidies to industry are helping to make room for priority services while maintaining the Government's policy of reducing the share of national income taken by public expenditure. General government spending excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982–83 to [41½ per cent] now. This fall is planned to continue.

your consequentials

Budget ~~consequences~~

5.04 Two of the Budget measures have consequences for public expenditure. In parallel with the abolition of tax relief on new covenants between individuals, including covenants to students (see paragraph 4.~~A~~ 10) the parental contribution scale is being revised for new students. ~~those starting their studies from the 1988–89 academic year onwards~~. This will cost some £~~20~~ 15 million in 1988–89, rising to £~~80~~ 60 million in 1991–92. In parallel with the change in the tax treatment of forestry (see paragraph 4.~~B~~ 30) there will be an increase in planting grants for commercial woodlands ~~to forestry~~ estimated to cost about £~~x~~ 4½ million in 198~~9~~8–~~90~~ 89 rising to £~~y~~ 7 million in 1991–92. The expenditure arising from these changes will be charged to the Reserve and will not add to the planning totals.

1987–88 outturn

5.05 The latest estimates for the outturn for the planning total in 1987–88, which are still subject to some uncertainty, suggest that it is likely to be £~~[146]~~ 146·0 billion, £~~[2·2]~~ 2·6 billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £~~[0·9]~~ 1·3 billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2. Of the Reserve of £3·5 billion, only £~~[1·4]~~ 0·9 billion has been required to meet additions to departmental programmes.

Table 5.2 Comparison of plans and estimated outturn for 1987–88

	1987–88 £ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government[2]	108·3	109·2	+0·8
Local authority[2]	40·2	40·9	+0·7
of which:			
relevant expenditure	31·0	32·2	+1·2
other current	4·9	5·1	+0·1
capital	4·3	3·7	−0·6
Nationalised industries and other public corporations	1·6	1·0	−0·6
Privatisation proceeds	−5·0	−5·0	
Reserve	3·5		−3·5
Public expenditure planning total	**148·6**	**146·0**	**−2·6**

[1] *Plans from The Government's Expenditure Plans 1987–88 to 1989–90 (Cm 56), adjusted for classification changes.*

[2] *Excluding finance for nationalised industries and other public corporations.*

1147

RJ Butler 3/3

BUDGET CONFIDENTIAL

5.06 The major changes between programme plans and estimated outturn for the different spending authorities are:

a net increase of £0·8 billion in central government expenditure: higher net payments to the European Communities (£0·8 billion) are expected, and there ~~have~~ has been an ~~increases~~ increase in DHSS expenditure of £0·5 billion on health ~~and personal social services~~ ~~(including £0·3 billion following~~ two-thirds of which reflects the 1987 nurses' and doctors' and dentists' pay settlements ~~and £[0·3] billion on social security~~, partly offset by lower payments by the Intervention Board for Agricultural Produce (£0·3 billion); ~~and lower than planned expenditure by the Ministry of Defence (£0·1 billion)~~

OMIT?

an overspend of £1·3 billion on the plans for local authority current expenditure;

a net underspend of £0·6 billion on local authority capital expenditure, reflecting £0·4 billion higher gross spending, more than offset by £1·0 billion higher capital receipts;

an improvement of £0·6 billion in the figures for nationalised industries and other public corporations, due principally to higher profitability of British Steel (£0·4 billion) and the effect of increased capital receipts from new towns (£0·2 billion).

Table 5.3 Public expenditure by spending authority

	£ billion				
	1986–87 Outturn	1987–88 Estimated outturn	1988–89 Plans	1989–90 Plans	1990–91 Plans
Central government*	104·6	109·2	114·2	120·2	124·7
of which:					
Voted in Estimates	74·0 ~~73·4~~	76·6	81·0	84·6	87·6
other	30·6 ~~31·2~~	32·5	33·2	35·6	37·1
Local authorities*	37·9	40·9	42·6	44·0	45·2
of which:					
relevant expenditure	29·4	32·2	33·2	34·3	35·4
other current	4·8	5·1	5·4	5·7	5·9
capital	3·7	3·7	4·0	4·0	3·9
Nationalised industries	0·4	0·4	0·7	0·0	−0·4
Other public corporations	0·8	0·6	0·8	1·0	1·0
Privatisation proceeds	−4·4	−5·0	−5·0	−5·0	−5·0
Reserve			3·5	7·0	10·5
Public expenditure planning total	**139·2**	**146·0**	**156·8**	**167·1**	**176·1**

**Excluding finance for nationalised industries and other public corporations.*

Public expenditure by spending authority

5.07 Central government spending makes up about three-quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social security payments paid out of the National Insurance Fund. Spending by local authorities accounts for about one quarter of public expenditure.

BUDGET CONFIDENTIAL 1148

RJ Butler 9/3

Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

Supply Estimates

5.08 For 1988–89, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1988–89 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1988–89 are published in a series of booklets on 15 March 1988 with a Summary and Guide (Cm 328) which explains the Supply procedure and summarises the Estimates. It also explains how they relate to the public expenditure planning total.

5.09 Of the £108·3 billion included in the Supply Estimates, £83·0 is direct public expenditure. The remaining £25·3 billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public expenditure. About two-thirds ~~Nearly 60 per cent~~ of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion			
	1986–87		1987–88	1988–89
	Expected outturn in 1987 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	99·1	99·1	104·5	108·3
Supplementaries and net underspending	2·8	2·4	0·9	
Total Supply expenditure	**101·9**	**101·5**	**105·3**	
(public expenditure element)	(77·3)	(7~~7·1~~) 6·9	(79·5)	

1149

FROM: A C S ALLAN
DATE: 10 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr H Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr Pickford
Miss Simpson
Miss C Evans
Mr Cropper

FSBR: CHAPTER 5

The Chancellor was grateful for your minute of 9 March. He had the following comments on the text:

(i) The side heading for paragraph 5.04 should read "Budget consequentials".

(ii) The first sentence of paragraph 5.04 ("Two of the Budget measures have consequences for public expenditure") should be deleted.

(iii) The first indent of paragraph 5.06 should be redrafted to read: "a net increase of £0.8 billion in central government expenditure: higher net payments to the European Communities (£0.8 billion) are expected, partly offset by lower payments by the Intervention Board for Agricultural Produce (£0.2 billion); and there has been an increase of £0.5 billion in DHSS expenditure on health, two-thirds of which reflect the 1987 nurses' and doctors' and dentists' pay settlements;" (the references to MOD expenditure should not be included).

ACSA

A C S ALLAN

RA7.106 CONFIDENTIAL

FROM: A C S ALLAN

DATE: 10 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
Mr Anson
Mr H Phillips
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr Pickford
Miss C Evans

FSBR: CHAPTER 5

The Chancellor was grateful for your minute of 7 March, and is content not to include any references to social security consequentials.

ACSA

A C S ALLAN

CHANCELLOR OF THE EXCHEQUER

Ch

FSBR Chapter 5

Carolyn Sinclair wants to delete first sentence of 5.04. Other Budget measures (eg petrol VED & hs fuel grants) have consequences for public expenditure.

[signature]

OK -

EJ Butler 3/3

Public spending trends 5.03 The reductions in the burden of debt interest, in unemployment and in subsidies to industry are helping to make room for priority services while maintaining the Government's policy of reducing the share of national income taken by public expenditure. General government spending excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982–83 to [41½ per cent] now. This fall is planned to continue.

Budget consequences 5.04 [Two of the Budget measures have consequences for public expenditure.] In parallel with the abolition of tax relief on new covenants between individuals, including covenants to students (see paragraph 4.~~11~~ 10) the parental contribution scale is being revised for new students. ~~those starting their studies from the 1988–89 academic year onwards.~~ This will cost some £~~20~~ 15 million in 1988–89, rising to £~~80~~ 60 million in 1991–92. In parallel with the change in the tax treatment of forestry (see paragraph 4.~~12~~ 30) there will be an increase in planting grants for commercial woodlands ~~to forestry~~ estimated to cost about £~~2~~ million in 198~~9–90~~ 8–89 rising to £~~4~~ 7 million in 1991–92. The expenditure arising from these changes will be charged to the Reserve and will not add to the planning totals.

1987–88 outturn 5.05 The latest estimates for the outturn for the planning total in 1987–88, which are still subject to some uncertainty, suggest that it is likely to be £[146·0] billion, £[2·~~2~~ 6] billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £~~[0·9]~~ 1·3 billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2. Of the Reserve of £3·5 billion, only £~~[1·4]~~ 0·9 billion has been required to meet additions to departmental programmes.

Table 5.2 Comparison of plans and estimated outturn for 1987–88

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of which:			
relevant expenditure	31·0	32·2	+1·2
other current	4·9	5·1	+0·1
capital	4·3	3·7	−0·6
Nationalised industries and other public corporations	1·6	1·0	−0·6
Privatisation proceeds	−5·0	−5·0	
Reserve	3·5		−3·5
Public expenditure planning total	**148·6**	**146·0**	**−2·6**

[1] *Plans from The Government's Expenditure Plans 1987–88 to 1989–90 (Cm 56), adjusted for classification changes.*

[2] *Excluding finance for nationalised industries and other public corporations*

psl/18A

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COPY NO OF 15

FROM: A C S ALLAN

DATE: 10 March 1988

MR HIBBERD

cc Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr R I G Allen
Mr Pickford
Miss Simpson
Mr Hudson
Mr Allum
Miss C Evans

CHAPTER 3 OF THE FSBR: THE INDUSTRY ACT FORECAST

The Chancellor was grateful for your minute of 9 March. He was content with the various points in your cover note, except that he wishes paragraph 3.08 to begin "Sterling has shown considerable stability against the Deutschmark over the past year".

2. On further reflection, and after seeing the briefing on the Q4 balance of payments figures, he now wishes to show a current account deficit of £4 billion in 1988, based on a smaller invisibles surplus, of £8½ billion. This will mean consequential amendments to paragraphs 3.07 and 3.30 and to Tables 3.4 and 3.12. The deficit should be described as "less than 1 per cent of GDP".

... 3. I attach a copy of the pages on which he had drafting comments.

ACSA

A C S ALLAN

3 The economy: recent developments and prospects to mid-1989

Summary

3.01 Growth should be around 3 per cent in 1988, close to the average rate over the last six years, but significantly below the $4\frac{1}{4}$ per cent growth in 1987. Inflation is expected to remain low and there are good prospects for a further fall in unemployment.

Assumptions

3.0~~2~~1 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. It assumes that North Sea oil prices and ~~sterling~~ the exchange rate remain close to recent levels.

Demand and activity

3.0~~3~~2 The economy grew strongly in 1987, with GDP growth of $4\frac{1}{4}$ per cent and manufacturing output growth of $5\frac{1}{2}$ per cent. Domestic demand ~~grew~~ rose by just under 4 per cent, the same as in 1986. It is expected to ~~grow~~ rise at a similar rate in 1988, with slightly slower growth of consumer spending being offset by markedly faster growth of investment. GDP is forecast to grow by 3 per cent ($3\frac{1}{2}$ per cent for non-oil GDP).

Inflation

3.0~~4~~3 RPI inflation averaged just over 4 per cent in 1987. It fell to $3\frac{1}{4}$ per cent in January 1988, but is forecast to return to 4 per cent in the fourth quarter of 1988.

Labour market

3.0~~5~~4 Employment has risen strongly over the past year, with unemployment falling by half a million—the largest decline since the war. Unemployment should continue to fall this year.

World economy

3.0~~6~~5 GNP in the main industrial economies grew by about 3 per cent last year. Some slackening in growth is likely in 1988 particularly in the United States, and growth in the main industrialised countries in aggregate could ease slightly to $2\frac{1}{2}$ per cent. Industrial production picked up strongly during 1987. Associated with this were faster growth in trade in manufactures and some recovery in industrial materials prices. World trade in manufactures appears to have grown by about $5\frac{1}{2}$ per cent in 1987 and should grow by a similar amount this year.

UK trade and current account

3.0~~7~~6 Both export and import volumes grew rapidly last year: some moderation in growth is likely in 1988. Following recent revisions to the surplus on invisibles the current account is now estimated to have been in deficit by £$1\frac{1}{2}$ billion in 1987. A deficit of ~~£$3\frac{1}{2}$ billion ($\frac{3}{4}$ per cent of GDP)~~ £4 billion (less than 1 per cent of GDP) is forecast for 1988.

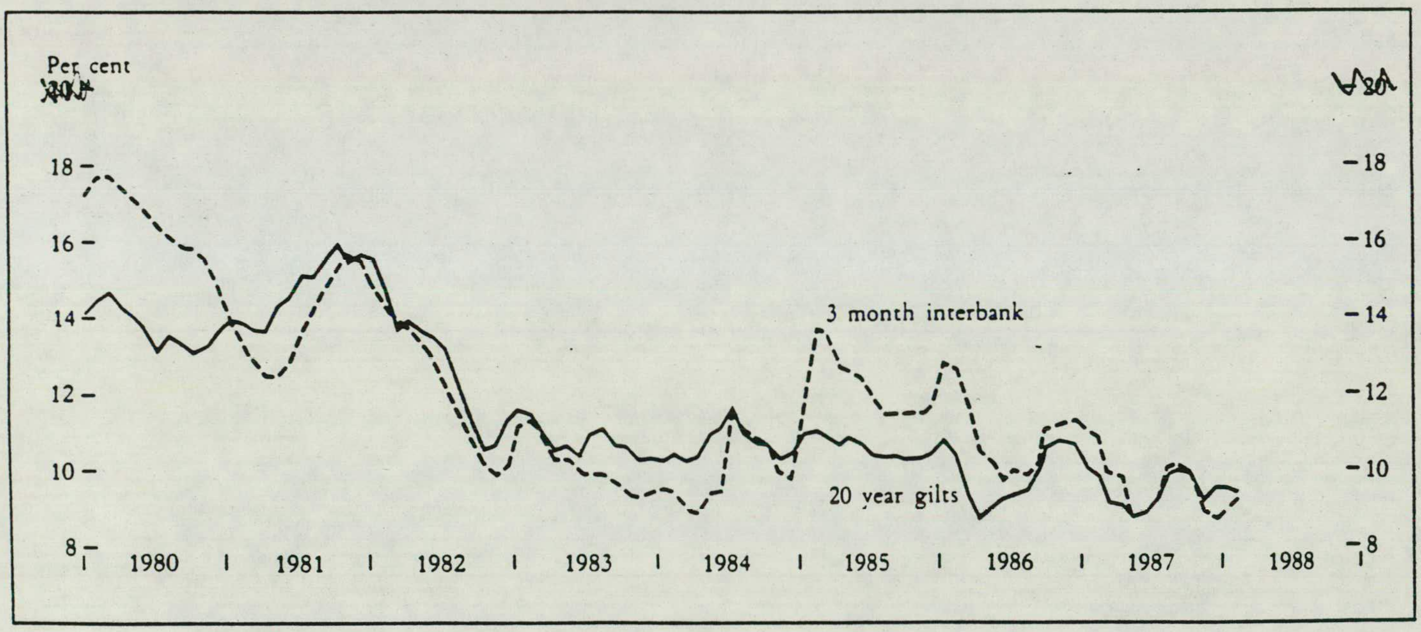
shown considerable stability

Financial conditions

Exchange rates **3.08** Sterling has ~~been stable~~ broadly against the ~~d~~ Deutschemark over the past year. There was an inflow of \$20 billion into the reserves in the year to February. Following the Louvre accord the dollar remained stable against the major currencies for much of 1987, before falling further towards the end of the year. It has risen slightly in the early months of 1988, in the wake of the G7 statement just before Christmas and improved US trade figures.

Interest rates **3.09** Short-term interest rates in the UK fell from 11 per cent at the beginning of 1987 to 9 per cent in July. They rose to 10 per cent in August, but came down again to 8½ per cent in the immediate aftermath of October's stock market collapse. Following the restoration of more settled markets earlier this year short-term interest rates returned to around 9 per cent. Longer term interest rates have followed a similar profile to short-term rates, but with smaller fluctuations. In recent weeks they have been ~~around~~ a little over 9½ per cent.

Chart 3.1 Interest rates in the UK



Narrow money **3.10** M0 growth ~~over the previous year~~, which fell in early 1987, rose rapidly in the summer reflecting lower interest rates. It may move to the top of or outside its 1-5 per cent target range in the early part of the financial year ~~but should be within the 1–5 per cent range later in the year.~~ before coming back within it.

Broad money **3.11** M4, which includes the liabilities of both banks and building societies, has grown at close to 16 per cent over the past year. As in recent years there has been a sharp fall in its velocity.

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be helped by stronger commodity prices, and hence export earnings. Total world trade in 1988 is forecast to continue to grow at close to the rate experienced in 1987.

In the

UK trade and the balance of payments

Relative costs and prices

3.22 UK unit labour costs in manufacturing rose only slightly in 1987, at a similar rate to the average in the other major economies, with rapid productivity growth largely offsetting a continuing high level of pay increases. Despite some appreciation of sterling ~~against the dollar~~ the UK's cost competitiveness remains clearly more favourable than in 1984 and 1985 before the fall in world oil prices. The maintenance of competitiveness in the year ahead will depend on success in continuing to restrain unit cost increases.

Table 3.2 The exchange rate and cost competitiveness

	Sterling index (1975 = 100)	Relative unit labour costs[1] (1980 = 100)
1985 Q4	80	88
1986 Q4	68	71
1987 Q4	75	80

(Centre over numbers)

[1] *Ratio of UK manufacturing sector's costs to those overseas.*

Trade volumes (goods other than oil)

3.23 Non-oil export volumes rose by 7 per cent in 1987. Manufactured exports rose particularly strongly, reflecting renewed growth in world trade and the UK's strong competitive position. Non-oil export volumes are forecast to rise in 1988 by a further 5 per cent.

(Chart 3.5)

3.24 The UK increased its share of world trade in manufactures slightly in 1987. Its volume share has remained broadly stable since 1981, in marked contrast to the previous long-term decline. This improved performance is forecast to continue in 1988.

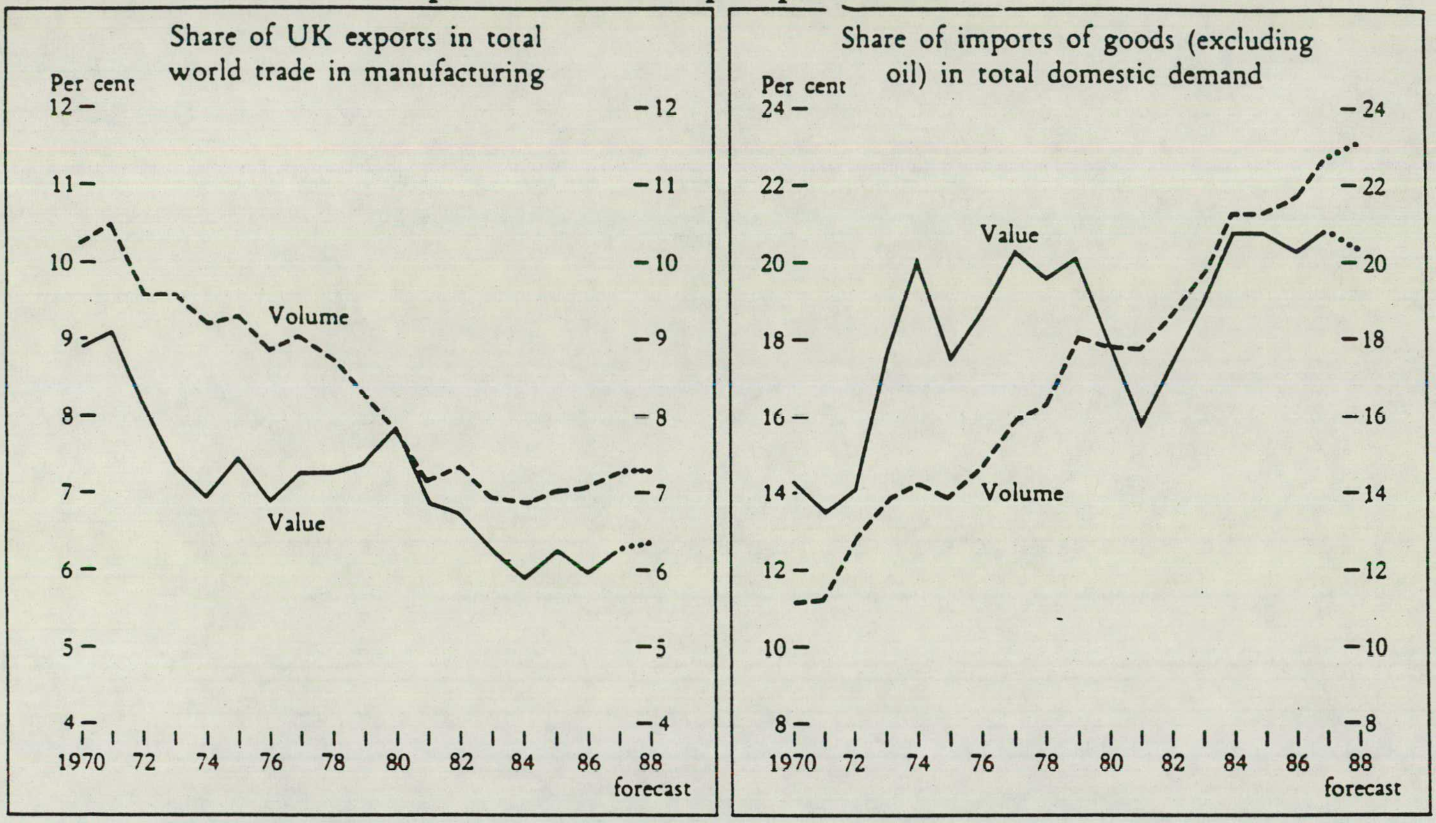
Table 3.3 Visible trade

	Per cent changes on previous year					
	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade[1]	Export volume	Import volume	Terms of trade[1]
1986	$3\frac{1}{2}$	$6\frac{1}{2}$	−5	4	6	$-\frac{1}{2}$
1987	$5\frac{1}{2}$	$7\frac{1}{2}$	1	7	$8\frac{1}{2}$	1
1988 Forecast	$3\frac{1}{2}$	$6\frac{1}{2}$	$\frac{1}{2}$	5	$6\frac{1}{2}$	1

[1] *Ratio of UK export average values to import average values.*

3.25 Non-oil import volumes fell unexpectedly in early 1987, but rose during the rest of the year, and were $8\frac{1}{2}$ per cent higher than in 1986. The increases were widespread, with higher imports of materials and capital goods reflecting the strong growth of UK production, stocks and investment. Consumer goods imports also rose in response to the rise in consumer spending. The volume of imports is forecast to rise less rapidly through the year ahead as output growth slows.

Chart 3.5 Export shares and import penetration



Oil trade **3.26** There was a surplus in oil trade of £4 billion in 1987, little changed from 1986. Higher oil prices and a fall in domestic demand for oil more than offset a decline in North Sea production. In 1988 oil production is likely to be below its 1987 level and close to the centre of the Department of Energy's projected output range while domestic demand for oil may rise modestly. The oil trade surplus is expected to fall by £1½ billion, to about £2½ billion.

Trade prices and the terms of trade **3.27** The terms of trade, which fell in 1986 as oil prices declined, improved again in 1987 as oil prices firmed and as sterling's appreciation offset some rise in world commodity prices in the latter part of the year. Little further change in the terms of trade is assumed during the rest of 1988.

Invisibles and overseas assets **3.28** The latest estimate for the surplus on invisibles in 1987, at £8 billion, is slightly below the outturn in 1986, with increased transfers to the European Community only partly offset by higher net earnings from services and from the UK's net overseas assets. The invisible surplus seems likely to rise in 1988 partly because of lower net payments abroad by North Sea oil companies.

3.29 The value of the UK's stock of net overseas assets is estimated provisionally to have been about £90 billion at the end of 1987, some £20 billion down on end-1986. This decline is largely due to the fall in world equity markets and in the sterling value of UK assets in North America following the fall in the US dollar.

Current account **3.30** The current account deficit is estimated to have been a little over £1½ billion in 1987, the improvement over the forecast in last year's FSBR being due to the unexpected strength of exports of manufactures. A deficit of £4 billion (less than 1 per cent of GDP) is forecast for 1988, largely as a result of the projected decline in the oil surplus. The deficit on non-oil trade is forecast to show little further change from the level in the second half of 1987.

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Table 3.4 Current account

	£ billion				
	Manufactures	Oil	Other goods	Invisibles	Current balance
1986	−5½	4	−7	8½	0
1987	−6½	4	−7½	8	−1½
1988 Forecast	−8½	2½	−6½	~~9~~ 8½	~~−3½~~ −4

Demand and activity

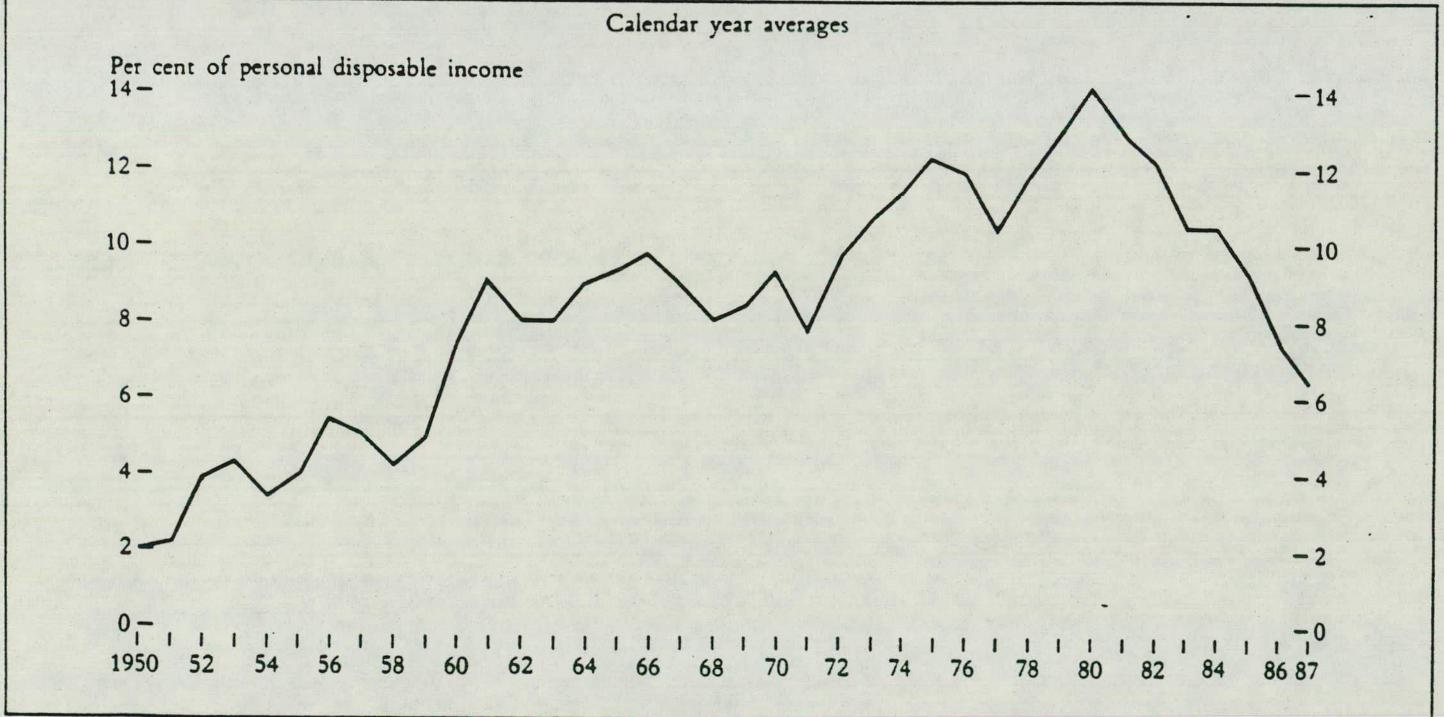
3.31 The UK economy grew by 4¼ per cent in 1987. Growth was strong throughout the economy: manufacturing output rose by 5½ per cent, construction output by 8 per cent and output of the service industries by 5½ per cent.

Personal sector expenditure

3.32 Consumers' expenditure is now estimated to have risen by 5 per cent in 1987, slightly less than in 1986. ~~The growth in consumer spending~~ This was faster than the 3½ per cent growth in real personal disposable income, and the savings ratio once again fell.

3.33 A number of factors could account for the decline in the savings ratio in recent years. Inflation has been at a low level not experienced since the 1960s. Recent increases in real house prices and in equity prices up to October 1987 may also have contributed. ~~Finally,~~ And many employers have taken so-called "holidays" on their contributions to employees' pension funds; ~~which~~ these score as reduced personal saving.

Chart 3.6 Personal savings ratio



3.34 Personal borrowing rose further during 1987, in large part reflecting increased mortgage borrowing. But personal financial assets showed a larger increase, despite the October share price fall (Chart 3.7)

IF AT ALL POSSIBLE, IT WOULD BE BETTER IF THIS PARA COULD COME ABOVE CHART 3.7

1250

3.37 Current estimates suggest that manufacturing investment grew by 6 3½ per cent last year, while total non-oil business investment grew by ~~7~~ per cent. The latest DTI Investment Intentions Survey indicated ~~suggested~~ a strong pick-up in manufacturing investment growth, to about 11 per cent in 1988. The January CBI Industrial Trends Survey, the first full enquiry since the fall in share prices, confirms that prospect, with a near record balance of manufacturing firms expecting to increase investment. On the basis of the DTI Survey, further steady growth, of about 6 per cent, is expected in non-manufacturing business investment. This outlook for company investment is consistent with the recent and prospective buoyancy in output, real profitability, and company finances, and it will add to industrial capacity. North Sea investment fell by about £½ billion in 1987 and is expected to show little change in 1988.

Table 3.5 Gross fixed domestic capital formation

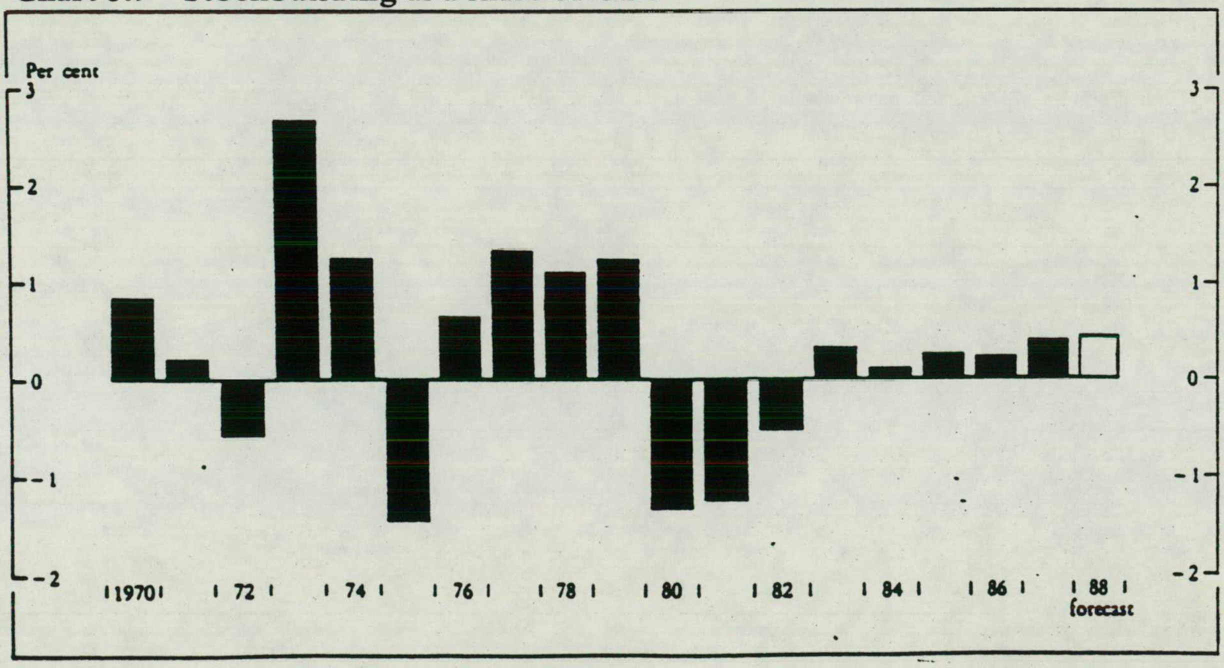
	£ billion at 1980 prices	Per cent changes on previous year		
	1986	1986	1987	Forecast 1988
Business[1]	29·8	−3	4½	8½
of which (i) non-oil business	27·8	−2	6½	8½
(ii) manufacturing	7·1	−5½	3½	11½
Private dwellings[2]	9·6	6½	~~8~~ 6½	2
General government	7·0	5½	2 ~~1½~~	1
Total fixed investment	**46·4**	**0**	**3½**	**6**

[1] *Includes investment by public corporations.*

[2] *Includes purchase less sales of land by persons, companies and public corporations, other than purchases of council houses.*

3.38 Despite a rise in stocks in 1987, stock–output and stock-sales ratios continued their trend decline of the last eight years. These downward trends are expected to continue in 1988, though, as last year, there is still likely to be modest stockbuilding.

Chart 3.9 Stockbuilding as a share of GDP



Prospects for demand and activity

1981-87

3.39 GDP growth is likely to moderate to around 3 per cent (3½ per cent excluding oil) in 1988, close to the 1981-87 average ~~rate since 1981~~. Domestic demand is forecast to rise at around the same rate in 1988 as in 1987; some slowdown in consumer spending should be offset by buoyant investment. But declining North Sea output (and lower oil exports) may reduce GDP growth by just over ~~½~~ per cent, rather more than in 1987. Manufacturing output is expected to rise faster than non-oil GDP in 1988, as it did in 1987.

Table 3.6 Domestic demand and GDP

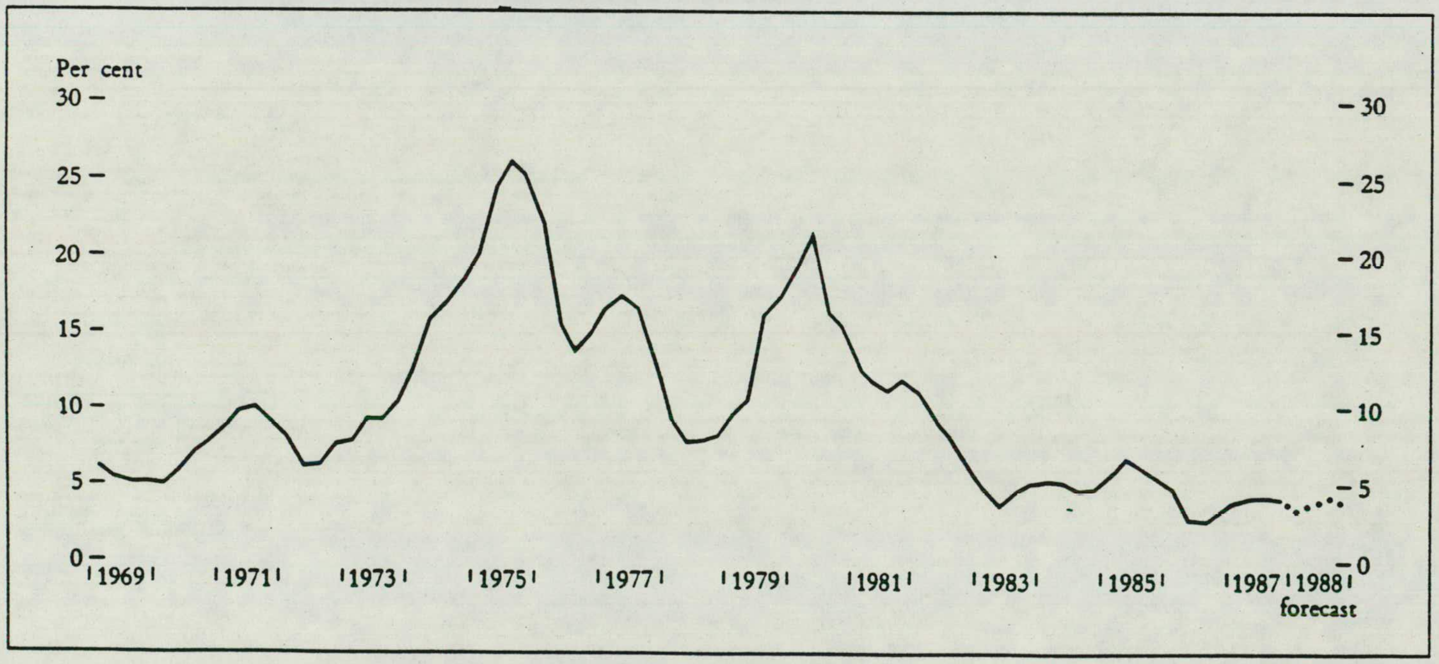
	Per cent changes on a year earlier		
		Forecasts	
	1987	1988	1989 H1
Domestic demand	4	4	2½
Exports of goods and services[1]	5½ (6½)	3 (4)	2~~½~~ (~~4~~) 3½
Imports of goods and services[1]	7½ (8½)	6½ (6)	5½ ~~4½~~ (~~4½~~) 5½
GDP[1,2]	4¼ (4¾)	3 (3½)	2½ (3)
Manufacturing production	5½	5	2½

[1] *Non-oil shown in brackets.*
[2] *Average measure.*

Inflation

3.40 The annual rate of inflation as measured by the RPI was 4·1 per cent in 1987Q4, in line with the forecasts in the 1987 FSBR and Autumn Statement. The average rate for 1987 as a whole was 4·2 per cent. Last year was the first time in 23 years that inflation was lower than the growth ~~in~~ of GDP, which is now estimated at 4·3 per cent.

Chart 3.10 Annual increases in the RPI



3.41 Pay settlements in manufacturing industry recorded by the CBI show a fall of about 1 percentage point between the 1985–86 and 1986–87 pay rounds. There was a similar picture in the services sector. Average earnings, boosted by record overtime working in manufacturing, rose by 8 per cent. But unit labour costs in manufacturing were broadly unchanged in 1987, reflecting a sharp increase in labour productivity.

Chart 3.11 **Unit labour costs in manufacturing**

on

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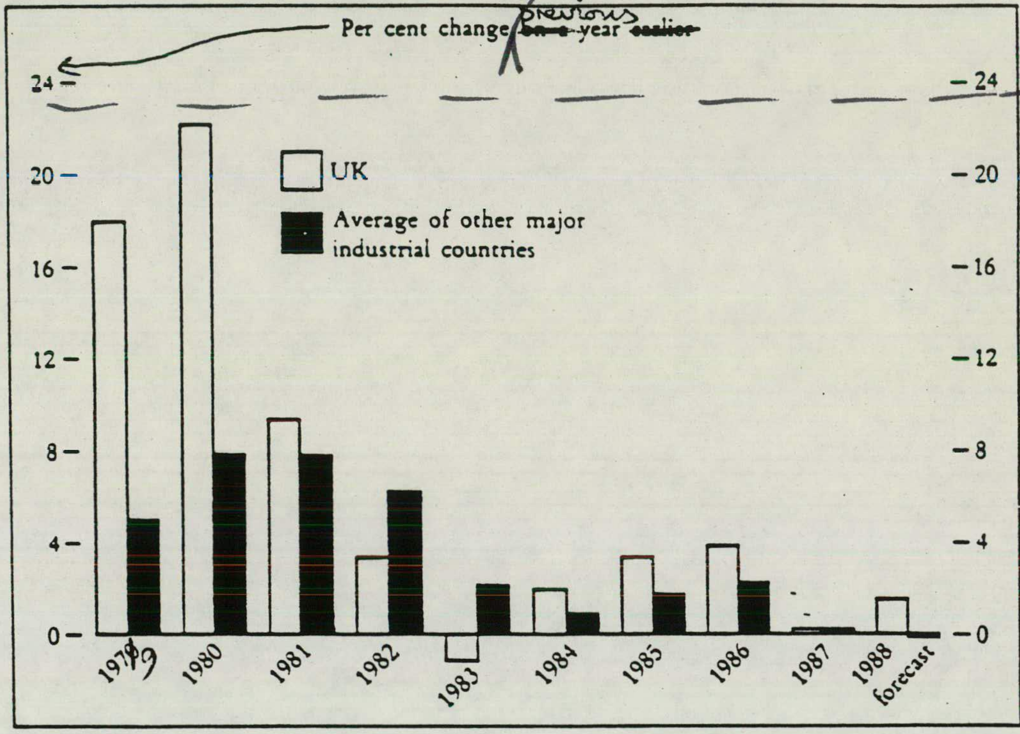

Prospects **3.42** It is difficult to discern a reliable trend in recent private sector pay settlements. They have been markedly lower than the ~~recent~~ high growth in earnings, which reflects record overtime working and bonus payments. Recent data suggest that settlements may turn out a little higher in 1988 than in 1987, but overtime working (and overtime earnings) should fall as economic growth moves back closer to trend.

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3.43 In 1987 rapid growth in productivity meant that manufacturing unit labour costs rose only fractionally, in line with other major industrial countries. Continued growth in underlying productivity should mean that manufacturing unit labour costs grow only slowly in 1988, though in other major industrialised countries no unit labour cost growth at all is forecast.

Table 3.7 **Costs in manufacturing**

Per cent changes on ~~a~~ previous year

	Unit labour costs	Cost of materials and fuel[1]	Estimated total unit costs[2]	Output prices[1]
1986	4	−11	−½	4½
1987	~~0~~ ½	5	1½	4½
1988 Forecast	2	~~0~~ −2½	1~~½~~	4½

[1] *Producer prices excluding food, drink and tobacco industries.*
[2] *Including costs of bought-in services.*

3.44 Manufacturers' profit margins rose significantly in 1987 for the third year in succession. There may be further increases in 1988 if producers take some advantage of falling import costs to raise profits, as they did in 1986. Over the longer term, high profitability should lead to continued growth in investment, capacity and productivity. Together these should enhance prospects for controlling industrial costs.

3.45 Inflation has come down ~~during~~ in the first quarter of 1988, aided by lower import costs and recent cuts in mortgage interest rates. It may edge up a little, partly as a result of the Budget proposals and the effects of local authority rate increases. There will also be some real increases in nationalised industry prices following a decline in real terms over the past three years. The RPI is forecast to rise by 4 per cent in the year to the fourth quarter of 1988. With substantial cuts in income tax, the tax and price index (TPI) is likely to rise more slowly than the RPI during 1988. By the fourth quarter of 1988 it is likely to be [1¾] per cent higher than a year earlier.

Table 3.8 Retail prices index

		Per cent changes on a year earlier		
			Forecasts	
	Weight in 1987	1987 Q4	1988 Q4	1989 Q2
Food	16½	3½	2	~~3~~ 2½
Nationalised industries	6	2¼	6½	5¾
Housing	15	7	6 3/4	~~7½~~ 8¼
Other	62½	3¾	3½	3½
Total	**100**	**4**	**4**	**4**

3.46 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output. It does not include import prices. The GDP deflator at market prices is estimated to have risen by 5 per cent in 1987–88 (a little faster than expected in the Autumn Statement), following an increase of 3½ per cent in 1986–87. The higher rate of increase in 1987–88 is accounted for by a recovery in North Sea profits, which had fallen by over 50 per cent in 1986–87 following the sharp fall in oil prices. The GDP deflator is ~~now~~ forecast to rise by 4½ per cent in 1988–89.

Productivity and the labour market

3.47 Preliminary estimates suggest that the employed labour force in Great Britain rose sharply during 1987; in the year to September 1987 it is estimated to have risen by 453,000. Self-employment has grown particularly strongly, as many more people have taken advantage of the opportunities offered by the buoyant economic climate. Total employment has now risen by over 1½ million since March 1983.

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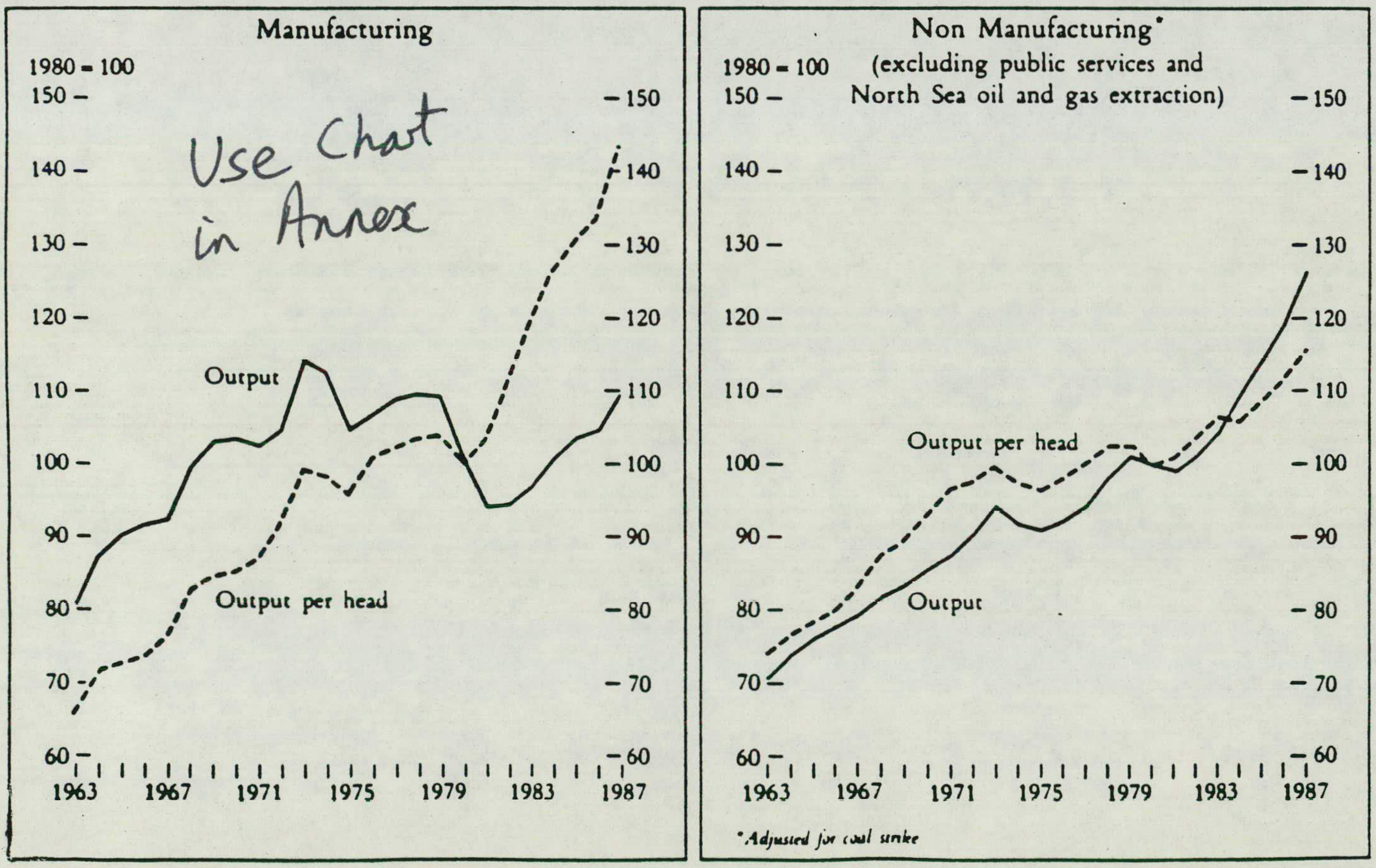
Table 3.9 Changes in Employment

	Thousands, ~~change in~~, GB, seasonally adjusted				
	Employees in employment		Self-employed	HM Forces	Employed labour force
	Male	Female			
September 1984 to September 1985	+55	+200	+90	−3	+343
September 1985 to September 1986	−82	+150	+71	−3	+136
September 1986 to September 1987	+25	+225	+207[1]	−4	+453

[1] *Figures for self-employment after June 1987 are projections based on self-employment growth over the previous six years.*

3.48 Productivity has also been growing strongly. In 1987 manufacturing productivity rose by almost 7 per cent. In the year to 1987Q3 (the latest period for which comparable data are available) UK manufacturing productivity rose faster than in any other major industrial country. It has now risen by an average of 4 per cent per annum since 1979. Underlying growth in labour productivity in manufacturing industry may now be higher than in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per man hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this, ~~as a result of~~ reflection the large rise in part-time employment.

Chart 3.12 Output and productivity



*Adjusted for coal strike

USE UNADJUSTED FIGURES

Table 3.10 Output per head of the employed labour force

	Per cent changes					
	Annual averages			1984 Q4[3] to 1985 Q4	1985 Q4 to 1986 Q4	1986 Q4 to 1987 Q4[2]
	1964–73	1973–79	1979–87			
Manufacturing	3¾	¾	4	2¼	6½	6¼
Non-manufacturing[1]	3	½	1½	~~3½~~ 3/4	3½	3¾
Whole economy	2¾	1¼	2	~~2¼~~ 3/4	3¼	3¼
Non-North Sea economy	2¾	½	2	~~2½~~ 1	3¾	3½

[1]*Excludes public services and North Sea oil and gas extraction.* [2]*Partly forecast.*

[3] Figures for 1984Q4 are adjusted for the estimated effect of the coal strike

Unemployment **3.49** Seasonally adjusted adult unemployment in the UK has fallen in each of the last eighteen months. It has now come down by almost 650,000 since July 1986. Over the same period long term unemployment (over one year's duration) has fallen by around 250,000. The improved trend in unemployment has been mainly the result of strong growth of output and employment. Unemployment should continue to fall in the year ahead. But excessive pay settlements could threaten further progress.

Forecast and outturn

3.50 Table 3.11 compares the main elements of the forecast published in the 1987 FSBR with the outturn or latest estimate.

Table 3.11 Forecast and outturn

	1987 FSBR forecast	Outturn or latest estimate ~~/forecast~~	Average errors from past forecasts
Total gross domestic product (per cent change between 1986 and 1987)	3	4¼	¾
RPI (per cent increase between the fourth quarters of 1986 and 1987)	4	4	1½
Money GDP (per cent change between 1986–87 and 1987–88)	7½	9¾	1½
Current account of the balance of payments ~~in~~ (1987, £ billion)	−2½	−1½	3
PSBR ~~, financial year~~ (1987–88, £ billion)	4	~~1~~ 1-3	~~3~~ 4

3.51 Inflation in the fourth quarter of 1987 was in line with the forecast made a year ago while the current account deficit is now estimated to have been rather smaller than forecast. Although the data on which the latest estimates of GDP in 1987 are based are still very uncertain, it is clear that both money and real GDP growth have been stronger than forecast. The PSBR in 1987–88 is likely to turn out about £[7]billion lower than last year's forecast. This error—which is rather ~~slightly~~ higher than average errors on past forecasts—reflects a combination of lower than expected general government expenditure and, in particular, higher than forecast tax revenues. This is discussed in more detail in Chapter 6.

3.52 This year's forecast is summarised in Table 3.12.

Table 3.12 The prospects: summary

	Forecast		Average errors from past forecasts[1]
	1986 to 1987	1987 to 1988	
	per cent changes		percentage points
Output and expenditure at constant 1980 prices			
Domestic demand	4	4	1
of which:			
consumers' expenditure	5	4	1
general government consumption	0	~~2~~ 1½	1
fixed investment	3½	6	2¼
change in stockbuilding (as per cent of level of GDP)	~~½~~ 0	0	½
Exports of goods and services	5½	3	1¾
Imports of goods and services	7½	6 ½	2¼
Gross domestic product: total	4¼	3	¾
manufacturing	5½	5	1½
Inflation			
Retail prices index	per cent changes		
1987 Q4 to 1988 Q4	4		1¼
1988 Q2 to 1989 Q2	4		1¾
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987–88	5		¾
Financial year 1988–89	4½		1¾
Money GDP at market prices	£ billion[2]		
Financial year 1987–88	424 (9¾)		1
Financial year 1988–89	45~~7~~6 (7½)		1½
Balance of payments on current account	£ billion		
1988	~~−3½~~ −4		3½
1989 first half (at an annual rate)	~~−3½~~ −4		4½
PSBR	£ billion[3]		
Financial year 1987–88	−3		1 (¼%)
Financial year 1988–89	−3		4 ~~3~~ (~~1¼~~%) 3/4

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn over the last ten years.*

[2] *Per cent change on previous financial year in brackets; average error shown relates to the forecast of the percentage change.*

[3] *Per cent of GDP at market prices shown in brackets.*

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REF: ACSA/45

COPY NO. OF 18.

FROM: A C S ALLAN
DATE: 10 March 1988

MISS SINCLAIR

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Mr Riley
Miss Simpson
Miss C Evans
Mr Hudson

PS/IR
MR P R H Allen - C&E

FSBR: CHAPTER 4

The Chancellor was most grateful for your minute of 9 March, and ... agrees with the points in your covering note. I attach a copy of the pages on which he had comments.

2. He had a few separate comments on the redrafted paragraphs on CGT (paragraphs 30-32 in the Annex).

(i) Do the costings in paragraph 31 assume annual indexation of the exempt amount? They should.

(ii) It looks odd to give figures for 1990-91 and 1991-92 for the measures in paragraphs 31 and 32, but not for the measure in paragraph 30. Do we need these figures at all?

(iii) He feels it is absurd to include the sentence "Estimates of cost take account of the likely effect of this measure on the volume and timing of disposals." <u>three</u> times - especially in the context of the reduction in the exempt slice. He feels it should be included just once, to govern the entire CGT package.

pp A C S ALLAN

4 The Budget tax proposals

4.01 The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1.

Income tax

4.02 The main income tax personal allowances and the limit of the basic rate band will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3·7 per cent in the RPI in the year to December 1987). This will mean that:

the single person's and wife's earned income allowances will rise by £180 from £2 425 to £2 605;

the married allowance will rise by £300 from £3 795 to £4 095;

the additional personal allowance and widow's bereavement allowance will rise by £120 from £1 370 to £1 490;

the age allowance for those aged 65 to 79 will rise by £220 from £2 960 to £3 180 (single) and by £360 from £4 675 to £5 035 (married);

the age allowance for those aged 80 and over will rise by £240 from £3 070 to £3 310 (single) and by £360 from £4 845 to £5 205 (married);

the income limit for age allowance will rise by £800 from £9 800 to £10 600.

4.03 The dependent relative allowance, ~~of up to £145~~, the housekeeper allowance ~~of £100~~ and the allowance for the services of a son or daughter ~~of £55~~ will be abolished.

4.04 From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

~~**4.05**~~ the basic rate limit will rise from £17 900 to £19 300 of taxable income.

4.06 The basic rate of income tax will be reduced to 25 per cent.

4.07 There will be a single higher rate of income tax of 40 per cent.

Life assurance premium relief

4.08 The rate of premium relief for life assurance policies taken out before 14 March 1984 will be reduced to 12½ per cent from 6 April 1989.

Benefits in kind

4.09 Car benefit scale charges for 1988–89 will be set at twice their 1987–88 levels.

Mortgage interest relief

4.10 For loans taken out from 1 August 1988, tax relief will be limited to the interest on £30 000 per residence, regardless of the number of borrowers. Relief on new loans for home improvements will be abolished from 6 April 1988. So will relief on new loans for the purchase of residences for dependent relatives and divorced or separated spouses.

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7

Covenants 4.11 The tax treatment of covenants will be reformed and simplified. Non-charitable covenants made by individuals on or after Budget day will no longer attract tax relief, and income from such covenants ~~made after Budget day~~ will not be taxable in the hands of the recipient. Covenants to charities will not be affected, nor will non-charitable covenants made before Budget day.

Charitable giving 4.12 The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be doubled from £120 to £240 a year from 1988–89.

(why only 'most'?)

1.c. d

Maintenance payments 4.13 The tax treatment of maintenance payments will be reformed. People who receive maintenance payments under [most] new arrangements entered into on or after Budget Day will not be liable to tax on their receipts; the person making the maintenance payments will get tax relief only for payments to a divorced or separated spouse, up to a limit of £1 490. ~~Special provisions will be introduced to preserve~~ relief for existing maintenance arrangements will be preserved, and ~~to allow~~ all divorced or separated spouses will be able ~~to~~ receive up to £1 490 of existing maintenance payments free of tax.

B.L.O. SECRET

Personal equity plans 4.14 The annual limit on investment in a personal equity plan will be increased from £2 400 to £3 000.

Employee share schemes 4.15 Following consultation last year, the income tax charge on unapproved employee share schemes under Section 79 of the 1972 Finance Act will be eased.

Lloyd's 4.16 ~~Changes will be made to~~ The present administrative arrangements for taxing members of Lloyd's, ~~will be~~ simplified.

4.17 The legislation on Lloyd's reinsurance to close will be modified to give relief to Lloyd's members who leave syndicates at the end of the underwriting year.

Is this really necessary?

Trusts 4.18 The additional rate of income tax charged on discretionary and accumulation trusts will be reduced from 18 per cent to 10 per cent.

In general only gains or losses accrued since 1982 will be brought into account for tax.

Capital gains 4.19 The base date for capital gains will be brought forward from 6 April 1965 to 31 March 1982; ~~gains accrued before that date will no longer be liable to tax~~. The present indexation provisions will continue to apply to gains accruing from 31 March 1982. This ~~proposal~~ change will also apply to companies' gains.

4.20 Gains, after deduction of the exempt amount and allowing for rebasing to 1982 and indexation, will be added to income and taxed at income tax rates (as if they were the marginal slice of income).

4.21 The capital gains tax annual exempt amount for 1988–89 will be reduced to £5 000 in the case of individuals and £2 500 in the case of most trusts.

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4.22 From 6 April 1988, 50 per cent of any gains between £125 000 and £500 000 will qualify for retirement relief, subject to the general conditions for the relief.

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l.c. **Inheritance tax** 4.23 From Budget ~~D~~ d ay the threshold for inheritance tax will be increased from £90 000 to £110 000. Chargeable transfers above this amount will be taxed at a flat rate of 40 per cent. The £100 000 limit on the amount that can be given to a political party without incurring inheritance tax will be abolished.

Business tax 4.24 The small companies' rate of corporation tax will be reduced to 25 per cent for the financial year 1988.

4.25 The rate of advance corporation tax (ACT) for 1988–89 will go down automatically to 1/3rd as a consequence of the reduction in the basic rate of income tax.

4.26 The main rate of corporation tax for the financial year 1988 will be 35 per cent.

%[ ]
l.c.

4.27 In common with other business entertainment, the cost of entertaining overseas (customers) will no longer be an allowable business expense for tax purposes. This change will take effect from Budget Day, except for commitments entered into before that date. From 1 August 1988 the VAT paid by businesses on this entertainment will no longer be deductible.

4.28 A number of changes will be made to prevent tax charges arising on the conversion of building societies into public limited companies.

Business Expansion Scheme 4.29 Investment in private rented housing will be encouraged by extending the Business Expansion Scheme to give relief on investment in companies providing rented housing under the new assured tenancy scheme.

4.30 A general limit of £500 000 will be set on relief under the Business Expansion Scheme for total investment in any one company in any period of twelve months, with a higher limit of £5 million for investment in qualifying companies providing private rented housing or ~~ship chartering.~~ letting ships on charter.

Forestry 4.31 Income from the occupation of commercial woodlands will be removed from the scope of Income Tax and Corporation Tax.

Oil taxation 4.32 The oil allowance for Petroleum Revenue Tax (PRT) will be reduced to 100 000 tonnes per chargeable period for all Southern Basin and onshore fields given development consent on or after 1 April 1982. (At the same time the Secretary of State for Energy proposes to abolish royalty payments for these fields.)

4.33 A new capital gains relief will be provided for disposals of oil licence interests in undeveloped areas wherever the consideration includes a work programme or another licence interest.

Company residence and migration 4.34 Section 482(1) (a) and (b) of the Taxes Act will be repealed with effect from Budget day. In future companies will be resident for tax purposes in the United Kingdom if incorporated here or centrally managed and controlled here. UK ~~UK~~ incorporated companies wishing to move their ~~business~~ assets abroad, or non-UK incorporated companies moving their residence abroad may do so without consent if they pay the tax due (including tax on accrued capital gains).

%,

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Stamp duties **4.35** Capital duty and unit trust instrument duty will be abolished with effect from midnight on Budget day

VAT **4.36** From 16 March 1988 the registration limits will become £22 100 per annum and £7 500 per quarter.

4.37 The provision for applying VAT to confectionery will be amended with the main effect of taxing all cereal bars at the standard rate.

Excise duties **4.38** The duties on beer and wines will rise by the equivalent of 1p on a typical pint of beer, just under 4p on a bottle of table wine, and just over 6p on a bottle of sherry (all inclusive of VAT). The duty on spirits will remain unchanged. The minimum duty charge for beer will be abolished and provision will be made for restructuring the duties on low strength mixed drinks.

5½

4.39 The duty on leaded petrol will be increased by the equivalent of ~~5~~5p a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged. The duty on derv will rise by the equivalent of just under 5p a gallon (inclusive of VAT).

4.40 The specific duties on cigarettes, hand-rolling tobacco and cigars will rise by the equivalent of just over 3p on a packet of 20 cigarettes and nearly 2p on a packet of 5 small cigars (inclusive of VAT). The duty on pipe tobacco will remain unchanged.

Tax administration **4.41** The VAT civil penalty system, introduced in 1985, has been reviewed and various easements are proposed.

4.42 In the light of recommendations by the Keith Committee, changes will be made:

to encourage people to notify the Inland Revenue if they are liable to tax;

to improve the information powers of the Inland Revenue;

to charge interest where payment to the Inland Revenue of income tax deducted by employers is delayed beyond the end of the tax year.

Independent taxation

4.43 A new system of taxation for married couples will be introduced in 1990. The details are set out in the box on the next page.

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million — Estimated effect on receipts in: 1988-89 — Changes from a non-indexed base	1988-89 — Changes from an indexed base	1989-90 — Changes from an indexed base
	INLAND REVENUE			
	Income tax			
1	Increase in single allowance of £180 and married allowance of £300	-1245	-625	-810
2	Increase in additional personal allowance and widow's bereavement allowance of £120	-15	-5	-10
3	Increase in age allowance of £220 (single) and £360 (married) for those aged 65 to 79	-90	-45	-55
4	Increase in age allowance of £240 (single) and £360 (married) for those aged 80 and over	-15	-10	-10
5	Increase in income limit for age allowance of £800	-10	-5	-10
7 ~~6~~	Abolition of minor personal allowances	+10	+10	+10
8 ~~7~~	Restriction on additional personal allowance for unmarried couples	-	-	+5
6 ~~8~~	Increase in basic rate limit of £1,400 to £19,300	-155	-75	-125
9	Reduction of 2p in basic rate	-2190	-2190	-3000
10	Abolition of higher rates of income tax above 40p	-1025	-965	-2070
11	Reduction in relief on life assurance premiums	-	-	+70
12	Fringe benefits - car benefit scales	+260	+260	+310
13	Fringe benefits - car parking space	-5	-5	-5
14	Mortgage interest relief ceiling applied to residence	*	*	+25
15	Abolition of tax relief on new home improvement loans	+80	+80	+200
16	Abolition of tax relief on new loans for homes for dependent relatives and divorced or separated spouses	*	*	*
17	Abolition of tax relief on new non-charitable covenants	+45	+45	+105
18	Payroll giving to charities - increase in donation limit to £240 a year	*	*	*
19	Change in rules for maintenance payments	-10	-10	-5
20	Change in additional rate on discretionary trusts	-5	-5	-10
21	Lloyd's - reform of administrative arrangements	-	-	*
22	Lloyd's reinsurance to close - relief for leavers	*	*	*
23	Unapproved employee share schemes - relaxation of charge	*	*	*
24	Employee priority in public offer of shares	*	*	*
25	Approved FA 1984 employee share option schemes - restricted shares	*	*	*
26	Assessing procedure for Schedule D	-	-	-
27	Redundancy payments - change to scale of charge	*	*	*
28	Withdrawal of "top-slicing" relief for tax charged on premiums for leases, etc	*	*	*
29	Amendment to tax treatment of overseas interest and ~~securities~~ dividends	*	*	*
	Capital gains tax			
30	Rebasing capital gains of individuals and trusts to March 1982	*	*	-55
31	Annual exempt amount reduced to £5000	*	*	+15
32	Charging gains of individuals and trusts at income tax rates	+70	+70	+65
33	Retirement relief	*	*	-10
34	Building and Co-operative society shares	*	*	*
35	Homes provided for dependent relatives	-	-	*

* = Negligible — = Nil

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for existing maintenance arrangements, in 1988–89 the present rules will continue to apply except that a divorced or separated spouse will be exempt from tax on the first £1 490 of maintenance received (after grossing up at the basic rate where tax has been deducted by the payer). From 1989–90, all payments will be made gross; and relief for the payer will be limited to the amount which qualified for relief in 1988–89. The tax liability on the recipient will be limited to the amount taxable in 1988–89; and a divorced or separated spouse will be exempt from tax on an amount up to the difference between the single and married allowances.

L, 97 and ordinary type

The changes are estimated to yield £5 million in 1990–91, ~~and~~ £15 million in 1991–92, and £35 million eventually.

The full year cost is £15 million.

20 The additional rate of income tax charged on the income of discretionary and accumulation trusts will be reduced from 18 per cent to 10 per cent ~~from~~ for 1988–89 L

21 The administrative arrangements for the assessment and collection of tax from members of Lloyd's will be reformed. The legislation will first take effect for the Lloyd's 1986 Account, which closes at the end of 1988.

22 The legislation on Lloyd's reinsurance to close (RIC) will be modified so that it will not apply to Lloyd's members who ceased membership of a syndicate at the end of the underwriting year, and are therefore not members of the syndicate to which the relevant RIC premium is paid. The legislation will first take effect for the Lloyd's 1985 Account, which closed at the end of 1987. This is the first year to which the 1987 legislation on Lloyd's RIC will apply.

23 The rules (Section 79 Finance Act 1972) governing unapproved employee share schemes will be relaxed with effect from 26 October 1987 (when draft clauses were published for consultation).

97,

24 Any benefit resulting from priority in applying for a public offer of shares given to employees by virtue of their employment / will, subject to certain conditions, be exempt from income tax.

25 Changes will be made to the approved discretionary share option legislation to enable employees to borrow to purchase their option shares without losing tax relief.

26 Legislation will be introduced to ensure that the Inland Revenue continue to have power to make an income tax assessment, on certain types of income assessable on the "current year" basis, in the course of the year in which the income arises.

27 The limit below which redundancy and certain other lump sum payments are exempt from income tax will be increased from £25 000 to £30 000. The reduced rates of tax which apply to the next £50 000 of such payments will be abolished.

28 The "top-slicing" relief which applies to the tax charged on premiums for leases and certain other payments will be withdrawn.

29 The definition of a recognised clearing system will be amended and the deduction of tax rules will be extended to collecting agents obtaining payment of overseas interest and dividends in the UK.

insert CGT section here

inevitably

Income tax and capital gains tax

L,

~~30~~ The new system of independent taxation for husbands and wives will apply from 1990–91. For income tax, the revenue costs in 1990–91 and 1991–92 (based on the existing distribution of income between husbands and wives) are estimated at £500 million and £1 billion respectively. For capital gains tax, the prospect of independent taxation may lead some couples to defer disposals until the new arrangements are in place; and the figure for 1989–90 in Table 4.1 reflects this. Costs for capital gains tax in 1990–91 and 1991–92 are estimated at £50 million and £~~60~~ 45 million respectively. The estimates are subject to ~~a high degree of~~ uncertainty.

considerable

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move up

see redraft at Annex

31 ~~44~~ From 1988–89, the capital gains of individuals and trusts will be taxed at income tax rates, that is as if they formed the marginal slice of income. The revenue yield in 1990–91 is estimated at £75 million and in 1991–92 at £120 million. The figures take account of the likely effect of taxing gains at income tax rates on the volume and timing of disposals. Until the introduction of independent taxation in 1990–91, the gains of married couples will be taxed as the marginal slice of the husband's income.

32 ~~45~~ The capital gains tax annual exempt amount will be reduced to £5 000 in the case of individuals and £2 500 in the case of most trusts. The revenue yield in 1990–91 is estimated at £35 million and in 1991–92 at £50 million. The figures take account of the likely effect of this measure on the volume and timing of disposals. The costs of allowing separate exempt amounts for husband and wife from 1990–91 are not included in these figures but at item 30.

33 ~~46~~ Retirement relief currently exempts business gains up to £125 000, subject to certain qualifying conditions. From 6 April 1988 half of any business gains between £125 000 and £500 000 will also be exempt, subject to the same conditions.

34 ~~47~~ From 4 July 1987, disposals of shares in Building and Co-operative Societies will not qualify for indexation relief.

35 ~~48~~ From 6 April 1988, the capital gains tax exemption for homes provided for dependent relatives will be abolished. There will be special provisions to ensure that exemption continues where a dwelling would have qualified for this exemption on a disposal before 1988–89.

Corporation tax

49 The small companies' rate of corporation tax for the financial year 1988 will be reduced to 25 per cent.

50 As a consequence of the reduction in the basic rate, the rate of advance corporation tax (ACT) for 1988–89 will be 1/3rd of the amount of the distribution. The reduction in ACT will be balanced by an increase in the subsequent liability to mainstream corporation tax.

in the UK

requiring Treasury

51 The rules for company residence and migration will be changed. In future companies will be resident for tax purposes if they are incorporated or are centrally managed and controlled here. UK incorporated companies will be able to transfer their assets abroad and non-UK incorporated companies will be able to transfer their residence abroad—in both cases without consent—on providing for the payment of any tax due, including tax on capital gains.

accrued

52 The Finance (No 2) Act 1987 repealed part of the definition of an investment trust. The full definition will be reinstated, and the legislation will include provision to ensure that the repeal was never effective.

53 The indexation allowance will be denied or restricted on disposal of certain intra-group debts and shareholdings. This provision counters use of the indexation allowance to create large artificial capital losses which could cause a significant loss of tax.

54 As a result of a recent court ruling, share exchanges by companies in the same group can now give rise to capital gains or losses being taxed or allowed more than once. The legislation will be amended so as to remove that anomaly.

55 Capital allowances in respect of properties let on assured tenancy terms by "approved bodies" will come to an end when the Housing Bill takes effect. Changes will be made to the capital allowances legislation to ensure that relief for past years is not withdrawn and to provide transitional arrangements in respect of expenditure already incurred.

Corporation tax and capital gains tax

56 Rollover relief will be extended to satellites and spacecraft from 28 July 1987 and to milk quotas and potato quotas from 30 October 1987.

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Income tax, corporation tax and capital gains tax

57(a) The present flat rate penalty for failure to notify liability to tax will be replaced by a fully mitigable penalty up to the amount of tax unpaid.

(b) The Revenue's power to call for returns of information will be extended to details (where relevant for tax) of payments for services by Government Departments, grants or subsidies paid out of public funds and the names of licence holders.

for

(c) The Revenue's power to call for documents relating to taxpayers suspected of avoidance or evasion will be extended to include the Department ~~of~~ National Savings, and, in order to identify taxpayers suspected of serious default, to documents relating to taxpayers whose identity is not known to the Revenue.

(d) The Revenue will be allowed the same access to records held on computer as it is allowed to records held on paper.

normal lettering

The estimated yield of these measures is highly uncertain.

Income tax, corporation tax, capital gains tax and stamp duties

58 Changes in the tax rules concerning the conversion of building societies into public limited companies are necessary in order to prevent unintended tax charges arising.

Oil taxation

59 The PRT oil allowance for Southern Basin and onshore fields given development consent on or after 1 April 1982 is to be reduced to 100 000 tonnes per chargeable period, with a cumulative total of 2 million tonnes. The yield figures in Table 4.1 relate to this proposal only. At the same time, it is proposed to abolish royalties on these fields. These two measures have a cumulative cost of around £~~40~~ million in the first five years (in part because it is estimated that they will accelerate certain developments), but in the long run they are expected to be broadly revenue neutral.

50 =

Can we find another way of putting this? Sounds too much like CTT.

60 For disposals of oil licences in undeveloped areas where the consideration includes a work programme or another licence interest, that work programme or other licence interest will be deemed to have a nil value.

61 All tariff-related expenditure incurred by an asset owner will be allowed against his PRT liability on tariff income arising from third party use of those assets, even though his principal field has ceased production. No cost will arise until after fields owning assets used by others cease production.

Inheritance tax

62 The estimated full year cost attributable to transfers in 1988–89 is £220 million measured against ~~an~~ indexed base.

63 The £100 000 exemption limit on transfers to political parties made on or within one year ~~after~~ death is abolished ~~from~~ Budget day.

Stamp duties

64 Capital duty will not be payable on transactions completed after 15 March 1988. Unit trust instrument duty will not be payable on instruments executed after 15 March 1988, nor on property put into an existing trust after that date.

65 Changes are proposed to stamp duties and the reserve tax on shares in a UK and a non-UK company where the shares are paired and can only be transferred as a unit.

Value added tax

66 The taxing provision relating to confectionery will be amended, with the main effect of taxing all cereal bars at the standard rate.

67 Amendments will be made to the civil penalty system including the introduction of a time-related penalty for late registration; the halving of daily penalties; changes to the rules about eligibility to repayment supplement; and changes to the rules for persons who persistently misdeclare their liability.

68 From 16 March 1988 the registration limits will become £22 100 per annum and £7 500 per quarter.

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69 The rules for registration of voluntary and intending traders will be simplifed and restrictions and conditions removed.

70 From ~~Royal Assent~~ where a taxable person issues himself with an invoice under the terms of an approved self-billing arrangement, he will be responsible for determining the correct VAT liability.

71 From 1 August 1988 VAT incurred by businesses on entertaining foreign customers will no longer be deductible, bringing it into line with the treatment of VAT on other business entertainment.

Excise duties

72 There will be no change in the rate of duty on spirits.

73 The duty on typical beer will be increased by 4·7 per cent, equivalent to 1p a pint (inclusive of VAT).

74 From 1 October 1988, beer duty will be charged on the basis of £0·90 a hectolitre for every degree by which the original gravity of the beer exceeds 1 000°.

75 The duty on cider and perry will be increased by 9·7 per cent or 1p a pint (inclusive of VAT).

76 The duties on wine and made-wine will be increased by 4·5 per cent, equivalent to 3·8p on a 75cl bottle of still wine, 5·9p on a 70cl bottle of sparkling wine and 6·1p on a 70cl bottle of sherry (all inclusive of VAT).

77 Lower strength mixed drinks, not exceeding 5·5 per cent alcohol, will be dutied according to their alcoholic strength on a scale proportionate to table wine duty. This will bring duties on wine-based and similar mixed drinks into line.

78 The duty on leaded petrol will be increased by 5·5 per cent or 5·5p a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged so that the tax differential in favour of unleaded petrol will rise to 10·6p a gallon.

79 The duty on derv will be increased by 5·5 per cent, equivalent to 4·7p a gallon (inclusive of VAT).

80 There will be no change in the rates of duty on gas oil and fuel oil.

81 The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by 3·7 per cent or 3·4p on a packet of 20 cigarettes, 5·3p on a 25 gram packet of hand-rolling tobacco and 1·9p on a packet of 5 small cigars (all inclusive of VAT).

82 The duty on pipe tobacco will be unchanged.

Vehicle excise duties

83 There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

84 From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

85 From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable of carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1 600. ~~These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£130).~~

~~86~~ Bus fuel grants to certain bus service operators will automatically be increased to compensate them for the increase in duty on derv.

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FROM: A C S ALLAN
DATE: 10 March 1988

MRS R J BUTLER

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr H Phillips
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr R I G Allen
Mr Pickford
Miss Simpson
Miss C Evans
Mr Cropper

FSBR: CHAPTER 5

The Chancellor was grateful for your minute of 9 March. He had the following comments on the text:

(i) The side heading for paragraph 5.04 should read "Budget consequentials".

(ii) The first sentence of paragraph 5.04 ("Two of the Budget measures have consequences for public expenditure") should be deleted.

(iii) The first indent of paragraph 5.06 should be redrafted to read: "a net increase of £0.8 billion in central government expenditure: higher net payments to the European Communities (£0.8 billion) are expected, partly offset by lower payments by the Intervention Board for Agricultural Produce (£0.2 billion); and there has been an increase of £0.5 billion in DHSS expenditure on health, two-thirds of which reflect the 1987 nurses' and doctors' and dentists' pay settlements;" (the references to MOD expenditure should not be included).

ACSA

A C S ALLAN

BUDGET CONFIDENTIAL

FROM: A C S ALLAN
DATE: 11 March 1988

MISS SINCLAIR

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr R I G Allen
Mr Pickford
Mr Riley
Miss Simpson
Miss Evans
Mr Hudson

PS/IR
Mr Calder IR

Mr P R H Allen C&E

FSBR: CHAPTER 4

The Chancellor was grateful for your minute of 11 March. On the questions in your paragraph 12:

(a) he is, reluctantly, content for yields for 1990-91 (only) to appear in notes 31 and 32. His reluctance is because, although the absence of 1991-92 helps, we have a package which involves a net cost, yet the only figures we show are yields. It looks pretty rum.

(b) He thinks the simple answer looks to be to delete "most", but also to delete "on or" in paragraph 4.13 and note 19, leaving the text as "people who receive maintenance payments under new arrangements entered in to after Budget day will not be liable to tax on their receipts etc". (As you say, the FSBR is not a legal document).

(c) He was content to retain the words "in general" in paragraph 4.19.

ACSA

A C S ALLAN

mjd 2/11Jn

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REF: JMGT/51

COPY NO 25 OF 25

FROM: J M G TAYLOR
DATE: 11 March 1988

MR ODLING-SMEE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Pickford
Mr Riley
Miss Sinclair
Miss C Evans
Mr Cropper
Mr Tyrie
Mr Call

NOTE FOR THE QUEEN AND OVERSEAS POSTS

The Chancellor was grateful for your minute of 8 March, and the enclosed draft note.

2. The Chancellor has reworked the opening section (to paragraph 14), and I attach his redraft. I also attach the rest of your draft, with his preferred changes marked.

J M G TAYLOR

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1987 BUDGET: SUMMARY OF MAIN POINTS

The background to this year's Budget is an extremely favourable one. The economy is growing strongly, unemployment is falling rapidly, while inflation remains low. The public finances are exceptionally strong. This year's Budget will help the economy to continue this excellent progress, by improving incentives and encouraging enterprise, against the background of sound financial policies.

2. The main points are:

- a Budget <u>surplus</u> of £3 billion in both 1987-88 and 1988-89, and the prospect of a balanced budget over the medium term;
- major reform and simplification of personal taxation;
- income tax allowances raised by twice as much as inflation, the basic rate reduced to 25p in the £, and all higher rates above 40 per cent abolished;
- a completely new system of taxation for married couples,to take effect in 1990, which will, for the first time ever, give married women privacy and independence and end tax penalties on marriage.

<u>**Economic Background**</u>

3. The strength and durability of the economic upswing in Britain has now exceeded all post War records. The UK is about to enter its eighth successive year of sustained growth, and the sixth in which this has been combined with low inflation. It has now seen the longest period of steady growth, at a rate averaging 3 per cent a year, for half a century. During the 1960s and the 1970s, Britain's growth rate was the lowest of all the major European economies; during the 1980s, it has been the highest.

4. In 1987, total output grew by 4½ per cent, substantially stronger than forecast a year ago, while inflation averaged 4¼ per

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cent. Unemployment fell by half a million, more than in any other year since the War, in every region of the country, and faster than in any other major nation. The substantial fall in long-term unemployment is particularly encouraging.

5. Manufacturing industry performed particularly well in 1987. Manufacturing output rose by 5½ per cent, and there was a further large improvement in manufacturing productivity: in the 1980s, output per head in manufacturing industry has risen faster in Britain than in any other industrial country.

6. After seven successive years of surplus, the current account of the balance of payments is now estimated to have been in deficit last year by a little over £1½ billion. This is a smaller deficit than forecast in last year's Budget, thanks to a better than expected performance on visible trade, with exports of manufactured goods up by 8½ per cent.

7. The Chancellor expects 1988 to be another year of healthy growth with low inflation; and there is every prospect that unemployment will continue to fall, although probably not as rapidly as last year. The pace of growth is likely to ease somewhat, returning to the underlined trend of the past few years. Output for 1988 as a whole is forecast to be 3 per cent higher than in 1987, with the non-oil economy up by 3½ per cent. Business investment is forecast to grow particularly strongly, with a rise of 8½ per cent. As last year, inflation is forecast end the year at 4 per cent.

8. With growth in the UK likely to continue to outpace that of most other major countries, particularly in continental Europe, and with the oil surplus falling as North Sea production declines, the current account of the balance of payments is forecast to remain in deficit in 1988, by some £4 billion, equivalent to less than 1 per cent of GDP. The forecast assumes that the oil price will remain close to recent market levels.

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Budget Strategy

9. The medium term financial strategy continues to provide the framework for the Government's economic policy, as it has done since 1980. It is designed to reduce the growth of total spending power in the economy steadily over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further sustained economic growth.

10. Interest rate decisions are based on a continous and comprehensive assessment of monetary conditions so as to ensure downward pressure on inflation. Industry has benefitted from the greater stability of exchange rates over the past year, and the Government will continue to pursue a policy of exchange rate stability, with the rate against the deutschemark being of particular importance. The Chancellor is setting a target range of 1 to 5 per cent for narrow money in 1988-89; like last year, there will be no explicit target for broad money.

11. One of the Government's main objectives, since it first took office in 1979, has been to bring down Government borrowing. It has been reduced from $5\frac{1}{4}$ per cent of national income in 1978-79 to only three-quarters of one per cent in 1986-87. In 1987-88, it now looks as if the outturn will be a Budget surplus - something previously achieved on only one isolated occasion since 1952. [Check]

12. The Chancellor believes that a balanced budget is a valuable discipline for the medium term, and intends that a zero borrowing requirement should be the norm from now on, though there are bound to be fluctuations on either side from year to year. For 1988-89, the Chancellor has decided that it is prudent to budget for a surplus of £3 billion, the same size as expected as in 1987-88. This is after allowing for the substantial increases in public expenditure announced in last November's Autumn Statement, including additional spending of over £1 billion on health.

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Taxation

13. The Chancellor is introducing major reforms in personal taxation, designed to sharpen incentives and provide a further boost to the supply-side of the economy.

14. [Continue as in Odling-Smee draft.]

Summary [DN: Goes at end of text]

47. The Budget continues the economic policies which have brought about the renewed strength of the British economy. It introduces major reforms of personal taxation including: new arrangements for taxing husbands and wives which will give married women privacy and independence in their tax affairs for the first time; an end to the taxation of inflationary gains; and the elimination of all personal tax rates over 40 per cent. The Chancellor has reduced the basic rate of income tax to 25 per cent, and set a new target of 20 per cent. And he has done this within the context of a balanced budget.

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Income tax

14. The Chancellor is raising the main personal allowances by twice the amount needed to compensate for inflation - that is, by roughly 7½ per cent. This includes the special age allowance for pensioners. It also applies to the upper limit for the basic rate band (i.e. the point at which the higher rates of tax begin).

15. He is reducing the basic rate of income tax by 2p in the £, to 25p. This meets the Government's manifesto commitment. He is also announcing a new target for the basic rate, of 20p in the £, to be reached as and when it is prudent.

16. The Chancellor is radically reforming the higher rates of tax. ~~taxation of higher incomes.~~ He is abolishing all ~~of~~ the higher rates ~~of tax~~ above 40p. Income tax will thus be reduced from a six rate to a two rate system; and the higher ~~top~~ rate (reached at a taxable income of £19,300) will be one of the lowest (top rates) in the world.

17. The income tax changes will benefit all 25 million taxpayers. A ~~The~~ married man on average earnings will gain nearly £5 a week.

18. At the same time ~~These big reductions enable~~ the Chancellor is reducing ~~to reduce~~ some of the special reliefs in the income tax system. ~~which are hard to justify. First, the Chancellor is raising the valuation of company cars for income tax purposes. (They are taxed in the hands of recipients under PAYE.) At present, they are valued for income tax at only a quarter of what they are worth. The Chancellor is doubling that with effect from 1988-89.~~

19. First ~~Second~~, he is ending the tax shelter for forestry, which has been widely criticised, and switching to an improved system of grants. ~~for forestry, which will maintain the Government's planting objective and encourage in particular the planting of broad-leaved trees.~~ Support through grants will be better targeted, e.g. to encourage better balance between broad-leaved trees and conifers. There is no change in the Government's planting aim.

20. Second ~~Third~~, he is abolishing the tax relief on home improvement loans, most of which are small and finance minor improvements such as double-glazing, rather than extensions or ~~loft~~ conversions, and which have been widely abused. This concentrates mortgage interest relief on its primary purpose: house purchase.

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He is also doubling the income tax liability on company cars, which have long been taxed at substantially less than they were worth.

~~21. In line with the reduction in the basic rate of tax, the relief on pre-1984 life assurance premium payments is coming down to 12½ per cent. It is traditionally set at half the basic rate.~~

Excise duties

22. The Chancellor is raising the excise duties, as a whole, broadly in line with inflation. However:

a. there is no change in the tax on unleaded petrol: this means that the differential between leaded and unleaded will double to just over 10p a gallon;

b. there is no change in the tax on spirits or pipe tobacco, or in the main rates of vehicle excise duty: the cost of keeping VED unchanged will be financed from the increased petrol ~~tax~~ duty, which will go up by ~~up~~ nearly 6p a gallon;

c. so as to encourage switching, particularly by the young, from high-alcohol to low-alcohol drinks there are reductions in the taxation of some low alcohol drinks; and

~~d. the Chancellor is introducing a higher VED charge on one group of juggernauts which exact a considerable toll on the road system.~~

Capital gains tax

23. Since 1982, capital gains tax has been charged only on 'real' gains. ~~if they have been made since then:~~ the paper gains which simply reflect inflation are no longer taxed. But these arrangements do not apply to gains made before 1982. This means that there are people and companies who have held assets since the 1960s or 1970s, or even earlier, who cannot realise them without paying substantial tax on purely paper gains made before 1982.

24. The Chancellor proposes to rectify this by exempting from tax all gains made before 1982. There will then be no taxation of ~~paper~~ inflationary gains whatever.

25. The real gains which are subject to tax will be charged at the same tax rates as income - 25 per cent and 40 per cent. This will reduce the incentive to convert income artificially into capital, and to invest for speculative gain rather than income. (Companies' gains are already taxed at the same rate as their profits: this change was made in the last Budget.)

26. The annual exempt amount of gains which individuals can make without paying tax is being reduced from £6,600 to £5,000. The present high level of the exemption was introduced explicitly to compensate for the fact that paper gains made before 1982 were, until now, subject to tax. The need for such compensation falls away under the Chancellor's reforms.

27. At the same time the Chancellor is increasing the amount of relief from capital gains tax which is available to a small businessman selling his business on retirement.

Inheritance tax

28. The Chancellor is raising the threshold for inheritance tax from £90,000 to £110,000. This will reduce by a quarter the number of estates which are taxed. In particular, it will allow ordinary people to pass on their homes without being taxed.

29. The Chancellor is also reducing the tax from four rates to one (having reduced it from seven last year). The new flat rate will be
X 40 per cent. For many family businesses passing from one generation to another, this means the effective rate will be only 20 per cent, because there is 50 per cent business relief.

Taxes on business

30. The main Corporation Tax rate remains at 35 per cent. The small companies' rate is reduced from 27 per cent to 25 per cent, in line with the basic rate of tax.

31. The VAT threshold is being increased by the maximum permitted
X under EC law, to ~~It will be~~ £22,100.

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32. Capital Duty, the 1 per cent tax paid by companies which raise new capital is being abolished, as is the ¼ per cent duty paid on all property put into a unit trust.

33. The special tax reliefs for entertaining foreign customers are also being abolished, so that the entertainment of foreign business contacts is put on the same footing as domestic ones.

34. There will be a change in the rules affecting the small number of companies which wish to change their country of residence for tax purposes. At present the rules require an application to the Treasury for formal consent, and are backed up by criminal sanctions. New rules, similar to those which exist in ~~a good many~~ MBF other countries, will be introduced to allow companies to migrate if they wish, provided they pay the tax due to the UK Exchequer first. The rules will be based on objective criteria and will no longer involve either an application to the Treasury for consent, or criminal sanctions.

Business Expansion Scheme

34. The Chancellor is extending the Business Expansion Scheme, under which investors obtain immediate tax relief for investment in new businesses in particular ~~high risk companies,~~ to include investment in companies providing housing for rent. This extension will last for five years. It is designed to help revive the private rented sector, in conjunction with the deregulation of rents. These measures should make it easier for people seeking work to find accommodation for themselves and their families. ~~at a price they can afford.~~

Share ownership

35. The Chancellor is increasing the limit on the amount which can be invested by individuals in Personal Equity Plans from £2,400 to £3,000, and relaxing some of the restrictions on shares owned by employees in the companies in which they work.

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Maintenance and Covenants

36. The Chancellor proposes to reform the taxation of maintenance and covenant payments, other than covenants to charity which are untouched. The present arrangements are complex and involve unnecessary work for both taxpayers and the Revenue.

37. Most maintenance payments are made by divorced men to their ex-wives or children. At present the Inland Revenue taxes the recipients, and returns the money to donors in tax relief. The Chancellor proposes instead that future recipients should be freed from tax on their maintenance. Donors will still be able to enjoy tax relief on payments to separated or divorced wives, but only up to a limit, ~~defined as~~ set equal to the difference between the married allowance and the single allowance. In 1988-89 this will be £1,490. Existing arrangements will be protected, and existing recipients will be freed from tax on the first £1,490 of their maintenance.

38. ~~In the case of~~ For covenants between individuals, the Chancellor is again making the income tax free in the hands of recipients. Tax relief for donors is being abolished. The largest single group affected will be students and their parents: covenants have simply become a convoluted way of getting State support into the hands of students, in a way that shelters the parents' income from tax. There will be a broadly compensating reduction in the parental contribution to student grants at mandatory rates.

Charities

39. As well as leaving tax relief on covenants to charity unchanged, the Chancellor is doubling the amount which people can give to charities free of tax under the payroll-giving scheme.

Independent taxation

40. The Chancellor is announcing in the Budget that a major reform of the taxation of married couples will take effect in 1990, the earliest practicable date. The present system, which dates back 180

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years, taxes the income of a married woman as if it belonged to her husband. ~~This~~ It can also lead to a tax penalty on marriage, ~~where~~ with married couples ~~pay~~ paying more tax simply because they are married. ~~It also~~ This denies privacy and independence to married women.

41. Under the new system a husband and wife will be taxed independently, on all their income. Married women will pay their own tax on their own income, and be responsible for their own tax return if one is necessary. All tax payers, male or female, married or single, will be entitled to the same personal allowance.

42. The tax system will continue to recognise marriage. Married couples will get a married couple's allowance equal in value to the difference under the present system between the single allowance and the married man's allowance.

Tax penalties on marriage

43. The new system will remove a number of the tax penalties on marriage. The most common penalty, the taxation of a married woman's savings income at her husband's marginal ~~tax~~ rate, will disappear altogether; and husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each instead of one between them. Transfers of capital between husband and wife will continue to be free of tax.

44. The Chancellor is abolishing two other tax penalties on marriage, ahead of Independent Taxation. First, ~~mortgage interest relief.~~ Under the present system of mortgage interest relief an unmarried couple can get twice as much relief ~~(on loans up to £60,000)~~ as a married couple ~~(limited to £30,000)~~. From August 1988 the limit of £30,000 will be applied to the house or flat, so that married and unmarried couples will get the same amount of relief. Existing borrowers will not be affected.

45. The second penalty arises because an unmarried couple with children can each claim an Additional Personal Allowance, giving them more tax relief than a married couple in the same position. In future unmarried couples will be entitled to only one Additional Personal Allowance.

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46. Thus the Chancellor is abolishing, for all practical purposes, all [illegible]e tax penalties which, under the present system, can arise on marriage.

<u>Summary</u>

[47 (above)]

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