PO-CH/NL/0119
PART B

Part B.

Begins: 17/3/87.
Ends: 17/3/87.

PO -CH /NL/0119
PART B

Chancellor's (Lawson) Papers:

1987 BUDGET BRIEF

Disposal Directions: 25 Years

17/8/95.

PO -CH /NL/0119
PART B

BB8 EMPLOYMENT AND UNEMPLOYMENT

[Department of Employment issuing Press Notice on Budget Day giving revised employment figures.]

[See also Industry Act forecast of UK economy (Brief B1), World economy (BB2), International economic comparisons (BB3), Pay (BB7), North/South divide (BB9), Manufacturing industry in UK (BB10), Outside forecasts (BB11), Inter-government comparisons (BB12), Fiscal policy (C4) and Alternative budgets (CC4)]

Factual

NB New manufacturing employment and unemployment figures to be published on 19 March.

(i) GB employed labour force rose:

- by 999,000 between June 1983 and September 1986 (services +1,290,000, manufacturing -227,000);
- by 136,000 over year to September 1986 - compared with 330,000 in year to September 1985 and 406,000 in year to September 1984;
- and by 59,000 between June and September 1986.

(September 1986 most recent data available but figures incorporate revisions published on 17 March.)

(ii) Inter-government comparison of employment changes: See BB12.

(iii) Growth in labour force: Labour force rose by 192,000 between 1984 and 1985, following rise of 512,000 between 1983 and 1984.

(iv) Unemployment

- Adult seasonally adjusted total little changed in January: small rise of 300 following five consecutive monthly falls. Level 3,119,000; 11.3 per cent.
- Over past six months seasonally adjusted total has fallen on average by 17,000 a month. Over last three months fallen by approaching 16,000 a month.
- Effect of employment measures on count estimated to have risen by about 5,000 a month for more than year.
- Headline total rose by 68,000 in December to 3,297,000; 11.9 per cent of working population.
- Long term unemployment fell 7,000 between October and January to 1.33 million, second successive quarterly fall.
- Youth unemployment rate fallen from around 20 per cent in 1983 to 18 per cent in January 1987.

- Recent falls in unemployment spread across all regions except Scotland.

(v) Unemployment rates at Budget* time (and six months later)

seasonally adjusted unemployment rates

1979	4.2 (4.2)
1980	4.5 (6.0)
1981	7.9 (9.0)
1982	9.5 (10.1)
1983	10.6 (10.9)
1984	10.9 (11.2)
1985	11.2 (11.3)
1986	11.6 (11.6)

* count date closest to Budget Day
(Information given in Written Answer to Clare Short (OR vol 112, No 69, col 126).)

(vi) Stock of unfilled vacancies: Little changed in January at 210,000, following fall in December. Rose steadily between January and November 1986.

(vii) Unemployment duration: 25 per cent leave register within 1 month, 50 per cent within three months, over 60 per cent within six months and 80 per cent within year.

(viii) Inter-government comparison of unemployment changes: See BB12.

(ix) International comparisons of unemployment and employment growth: See BB3.

(x) Select Committee on Employment:

- First Report (1985-86) recommended £3.3 billion (net) package to eliminate long term unemployment (ie over 1 year) by creating ¾ million jobs. Included building improvement programme, more health and social services jobs and £40/week recruitment subsidy. Said measures should: create additional jobs at lowest feasible cost to Exchequer; produce regular jobs; involve private sector as much as possible. Claimed it cost £47,000 to create job through tax cuts, £26,00 through infrastructure spending and only £3,300 through special measures.

- Endorsed by Labour Party, SDP/Liberals, Employment Institute and Charter for Jobs.

- Government response published in Committee's Third Report (1985-86). Rejected proposals as less practicable and cost-effective than Government's own approach.

- Third Report proposed interim scaled-down package of £1 billion to help those unemployed for over 3 years (not spelt out in detail), with pilots to test feasibility of original proposals.

(xi) Opposition policies to reduce unemployment: See CC4.

(xii) New employment measures announced by Secretary of State for Employment, 28 January 1987 (OR vol 109 no 40 cols 337-339):

- extension of new Job Training Scheme to 110,000 places;
- Restart interviews available to all those unemployed over 6 months; regular 6 monthly interviews for at least first three years of unemployment;
- guaranteed place on Youth Training Scheme (YTS) for all unemployed 17 year old school leavers;
- 10,000 extra entrants on Enterprise Allowance Scheme (EAS) to provide for annual rate of 110,000 entrants by April 1988.

Costs absorbed within existing public expenditure totals.

(xiii) Opposition estimates of cost of unemployment: £22 billion according to Bryan Gould MP (OR 18 February vol 110 no 55 col 938).

(iv) Increase in national output with lower unemployment: SDP/Liberals' "The Time Has Come, published 26 January, claims that national output would be £25 billion higher if unemployment reduced to 1979 levels.

Positive

(i) - Adult unemployment (seasonally adjusted) fell by 104,000 in six months to January - largest 6 month fall for thirteen years.

- Unemployment trend still downward. Average fall 17,000 a month in last six months.

(ii) Long term unemployment fallen in last six months. Now lower than year ago. Training and counselling measures announced and implemented over past year helping long term unemployed in particular.

(iii) Youth unemployment rate below EC average and falling. (Fallen 80,000 in year to January 1987; 120,000 in two years to January 1987.)

(iv) Vacancies in last three months at highest level for seven years; 30 per cent up on year earlier.

(v) Employment increase in 1986Q3 fourteenth consecutive quarterly increase - longest period of continuous employment growth for almost 30 years.

(vi) One million more jobs created since June 1983; more than whole of rest of Community in same period. Growth over 5 times as fast as under Labour Government. (See also BB3 and BB12.)

(vii) UK's 'employment rate' is highest of major EC countries.

(viii) Self employment risen in every year since 1979. Total increase of 750,000, up 40 per cent.

(ix) Employment/unemployment prospects: See B1.

(x) Surest route to more jobs is slower wage growth. 1 per cent lower real wages could lead to 110,000 to 220,000 new jobs over time as firms are encouraged to expand output and employ more men rather than machines. (See also BB7.)

(xi) Strike record: Number of strikes around lowest level for almost 50 years; current number of working days lost lowest for almost 20 years.

(xii) Employment measures

- Planned expenditure on employment, training and related measures £3.1 billion in 1987-88; almost £3.4 billion in 1989-90 - five times (cash) and more than double in real terms 1978-79 expenditure.
- Over three million people helped by major measures (excluding Restart) since inception.
- Over one million opportunities available on measures in 1986-87 and more than 1.3 million people unemployed over one year will get help from Restart.
- Government spending about £1.3 billion a year to help long term unemployed find real jobs.

(xiii) Government has developed its employment and training programmes on scale which no other country can match.

Defensive

(i) Budget does nothing to reduce unemployment? No.

- Government's prudent management of nation's finances has secured favourable economic climate, enabling 1 million new jobs to be created since last election, with unemployment now on downward trend.
- Income tax package carefully designed to sharpen incentives and so improve employment prospects throughout economy.
- Government encouraging pay flexibility necessary to defeat unemployment through tax relief on profit related pay schemes.
- In 1987-88 spending on employment, training and related measures more than double 1978-79 level in real terms.
- Best hope of all for unemployed lies in continuing vigour of economy.

(ii) Higher infrastructure spending more effective than tax cuts at stimulating employment: See C4.

(iii) Fiscal adjustment better spent on more employment measures. See C4.

(iv) Higher PSBR would help employment. See C4.

(v) Unemployment no longer falling: Too much should not be read into one month's figures. Unemployment fallen more than 100,000 in last six - largest six monthly fall since December 1973. (February figures published on 19 March.)

(vi) Fall in unemployment total just due to Restart, availability testing and employment measures: No. Change in trend reflects success of Government's sound financial and economic policies which have contributed to creation of one million new jobs since 1983.

(vii) Cost of current level of unemployment: Unemployment benefit and supplementary benefit paid to unemployed estimated to be £6.16 billion in 1986-87 (£7.42 billion including housing benefit). Opposition calculations, giving far bigger numbers, absurd: not possible to know what income those unemployed would earn if they became employed and so not possible to assess revenue consequences.

(viii) National income £25 billion higher if unemployment reduced to 1979 levels: Measures designed to raise national income by £25 billion would have dire inflationary consequences with all they imply for slower growth and fewer jobs. MTFS ensures adequate level of nominal demand, with plenty of scope for jobs to be created, provided wages adjust.

(ix) Employment growth stagnating: Increase in 1986Q3 of 60,000 was largest quarterly rise for over a year. Recent monthly figures for manufacturing employment point to further pick up in total employment growth in Q4.

(x) Since 1979 Britain has lost more jobs than all other EC countries. See BB3.

(xi) Manufacturing employment fallen under this Government. See BB10.

(xii) Employment growth mainly in service sector. Shift of industrial pattern away from traditional 'smoke stack' manufacturing industries. Common to most industrialised countries. Employment growth simply reflects this.

(xiii) US employment record: See BB2 and BB3.

Contact point: G Hacche (EB) 270 5207

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until release of revised
employment figures at
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BB9 NORTH/SOUTH DIVIDE

[See also Employment and unemployment (Brief BB8)]

Factual

NB New figures for employment and unemployment to be published on 17 and 19 March respectively.

(i) GDP per capita

UK less Continental Shelf=100

	1974	1979	1983	1985*
South East	113.2	115.2	114.7	114.8
East Anglia	92.7	93.8	99.7	100.8
South West	93.0	92.7	95.5	93.8
West Midlands	100.5	95.5	89.7	92.3
East Midlands	95.9	96.1	97.6	95.7
Yorks & Humberside	94.7	93.1	93.5	91.8
North West	96.5	96.6	94.6	96.0
North	91.0	91.4	93.8	92.9
Wales	86.4	88.4	87.7	88.8
Scotland	96.1	95.5	98.5	97.3
Northern Ireland	78.2	76.2	75.0	74.8

* latest available data

(ii) Unemployment rates by region

per cent

	May 1979	June 1983	January 1986	July 1986*	January 1987
South East	2.7	7.8	8.3	8.6	8.2
East Anglia	3.3	8.4	8.7	9.0	8.7
South West	4.2	8.9	9.9	10.2	9.7
West Midlands	4.2	13.6	13.5	13.6	13.1
East Midlands	3.5	10.0	10.9	11.1	10.8
Yorks & Humberside	4.4	12.0	13.0	13.3	12.9
North West	5.4	13.7	13.9	14.2	13.6
North	6.9	15.4	16.6	16.4	15.9
Wales	5.9	13.3	14.2	14.2	13.4
Scotland	6.1	12.6	13.3	13.7	13.9
GREAT BRITAIN	4.2	10.7	11.3	11.5	11.1
Northern Ireland	8.0	16.2	17.7	18.7	18.9
UNITED KINGDOM	4.3	10.8	11.4	11.7	11.3

* unemployment peak

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BB9

(iii) Employment changes by region (incorporates revisions published 17 March)

Changes in civilian employed labour force

'000 (percentage changes)

	June 1979-June 1983		June 1983-June 1986		June 1979-June 1986	
South East	-312	(-3.8)	+407	(5.2)	+95	(1.2)
East Anglia	+1	(0.1)	+54	(6.9)	+55	(7.0)
South West	-16	(-0.9)	+116	(6.7)	+100	(5.7)
West Midlands	-263	(-11.0)	+100	(4.7)	-163	(-6.8)
East Midlands	-88	(-5.3)	+109	(6.9)	+21	(1.3)
Yorks & Humberside	-204	(-9.5)	+84	(4.3)	-120	(-5.6)
North West	-364	(-12.6)	+4	(0.2)	-360	(-12.5)
North	-177	(-13.4)	+34	(3.0)	-143	(-10.8)
Wales	-143	(-12.4)	0	(0.0)	-143	(-12.4)
Scotland	-184	(-8.1)	+20	(1.0)	-164	(-7.3)
GREAT BRITAIN	-1,750	(-7.1)	+927	(4.1)	-822	(-3.4)

NB Mid year figures used because seasonally adjusted data unavailable.

(iv) Shares of total GB employment by region

	1974	1979	1983	1986
South East	33.2	33.2	34.4	34.7
East Anglia	3.1	3.2	3.4	3.5
South West	7.0	7.1	7.6	7.8
West Midlands	9.9	9.7	9.3	9.4
East Midlands	6.6	6.8	7.0	7.2
Yorks & Humberside	8.9	8.8	8.5	8.6
North West	12.1	11.8	11.1	10.7
North	5.5	5.4	5.1	5.0
Wales	4.5	4.7	4.5	4.3
Scotland	9.2	9.2	9.1	8.9

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(v) Net public expenditure on regional incentives GB (current prices)

	1986 PES	1987 PES	Difference
			£ million
1986-87			
RDG*	390	491	+101
RSA+	172	166	-6
TOTAL	**562**	**657**	**+95**
1987-88			
RDG	201	197	-4
RSA	182	222	+40
TOTAL	**383**	**419**	**+36**
1988-89			
RDG	213	174	-39
RSA	187	245	+58
TOTAL	**400**	**419**	**+19**
1989-90			
RDG	not app	192	-26
RSA	not app	217	+26
TOTAL	**not app**	**409**	**not app**

* Regional Development Grants
\+ Regional Selective Assistance

- Prime Minister's written reply on 21 January (OR vol 108 no 35 col 466) showed fall in RDG from £396 million in 1986-87 to £188 million in 1987-88 (both at 1986 prices).

- Chancellor stated in Economic Debate on 20 January (OR vol 108 no 34 col 777) that provision for regional expenditure had been increased.

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(vi) Regional expenditure on employment and training measures

Approximate spend per head of labour force(1) on Manpower Services Commission (MSC) programmes: 1986-87

MSC Region	£
South East	59
London	66
South West	121
Midlands	116
Yorkshire and Humberside	129
North West	131
Northern	179
Wales	161
Scotland	143
GREAT BRITAIN	107

(1) Labour force includes employed and self-employed, and unemployed who are available for work.

Positive

(i) Unemployment rate fallen fastest over last 12 months in Wales and North. In these regions fall in long term unemployment over past year has also been greatest (in percentage terms).

(ii) Youth unemployment fallen in every region over last three years. Fallen proportionately faster in Wales, North, North West and West Midlands.

(iii) Since last election, employment has risen in every region except Wales where unchanged. Of 1 million new jobs since last election over a third have arisen in 'the North' (defined as GB less South East, South West and East Anglia).

(iv) 'North's' share of unemployment fallen (from 69 per cent to 66 per cent) since 1979.

(v) All regions have seen improvements under this Government eg greater proportion of households in all regions possess central heating and deep freezes than in 1978-79.

(vi) Government measures to help 'the North':

- Regional incentives (RDGs/RSA). Since 1979 RSA and new RDG (introduced in November 1984) worth almost £1.7 billion in offers with £14 billion associated project costs and 620,000 associated jobs; plus further £3½ billion payments of old RDG. Spending now better targeted on jobs.

- Urban Development Grants: Since 1982 (when grants introduced) £100 million paid to 200 projects (England and Wales); £423 million associated private funds and 22,800 jobs supported.

- Urban Development Corporations: Of 6 operating or planned, 5 are in 'North'.

- 23 of 25 Enterprise Zones and 5 of 6 designated Freeports in UK located in 'North'.

- Expenditure on wide range of MSC programmes, including employment and training measures, heavily skewed towards 'North'. Expenditure per head estimated to be three times greater in Northern region than in South East.

- Rate Support Grant redistributes about £1 billion from 'South' to 'North'.

(vii) Infrastructure spending

- Roads: Since April 1985 8 schemes costing approximately £40 million have been completed in NE and NW. 45 schemes costing £482 million are in forward programme.

- NHS: In NE/NW 31 major hospital buildings since 1985, 25 under construction and 26 approved.

Defensive

(i) North/South: Not simply matter of North and South. Prosperous areas in North (eg Macclesfield) and areas of high unemployment in South (eg Thanet).

(ii) Larger fall in employment/rise in unemployment in North than in South since 1979: Not surprising, given concentration of traditional heavy industry in 'North'. Employment risen in all regions since last election, except Wales and there unchanged.

(iii) Rate at which people find a job does not vary markedly from region to region: 82 per cent of newly unemployed cease to be unemployed within a year in South East, 79 per cent in Scotland, 78 per cent in Yorkshire and Humberside and 77 per cent in North West.

(iv) Big reduction in spending on regional incentives: Reduction between 1986-87 and 1987-88 reflects run down of old, costly and inefficient RDG scheme. 1987 PEWP shows provision for regional incentives for next year up 9 per cent (cash) on 1986 plans.

(v) Government policies have led to relative impoverishment of regions. Under this Government, GDP per capita of rest of country has grown faster than that of South East; reverse of position under Labour Government when per capita GDP grew faster in South East.

(vi) Scottish unemployment still increasing: Mainly reflects difficulties in oil related sectors, where around 20,000 jobs lost in last year. Similar adverse effects on unemployment in eg Texas and Alaska. Without oil factor, Scotland might well have experienced halt to rising unemployment trend.

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BB10 MANUFACTURING INDUSTRY IN UK

[See also Industry Act forecast of UK (Brief B1), UK economy: recent developments (BB1), International economic comparisons (BB3), Balance of payments and competitiveness (BB4), Employment and unemployment (BB8) and Inter-governmental comparisons (BB12)]

Factual

(i) Manufacturing output

NB Incorporates new figures to be published on 17 March.

(a) Recent movements

percentage changes

3 months to Jan 1987 on previous three months	3 months to Jan 1987 on same period year earlier	3 months to Jan 1987 on 1983Q2	3 months to Jan 1987 on 1981 H1 trough	3 months to Jan 1987 on 1979 H1	1974H1 to 1979H1
+0.5	+2.2	+10.5	+13.7	-4.0	-2.5

(b) Inter-government comparisons: See BB12.

(c) Industry Act forecast: 4 per cent growth in 1987. (See B1.)

(ii) Manufacturing employment

NB January figures published on 19 March.

average monthly changes ('000s)

1986 Sept to 1986 Dec	1985 Dec to 1986 Dec	1983 June to 1986 Dec	1979 March to 1986 Dec	1974 March to 1979 March
-1,000	-10,000	-7,000	-21,000	-10,000

(iii) Manufacturing productivity

NB January figures to be published on 19 March.

(Table consistent with FSBR which takes account of revisions to manufacturing output to be published on 17 March.)

(a) UK

percentage change at annual rate

1985Q4 to 1986Q4	1983Q2 to 1986Q4	1979H1 to 1986Q4	1974H1 to 1979H1
4 ¾	4 ½	3 ¾	1 ¼

(b) International comparison of productivity growth: See BB3.

(iv) Manufacturing investment (including leased assets)

NB Revised figures to be published on 19 March.

(a)

percentage change

1985 to 1986*	1983Q2 to 1986*	1979H1 to 1986*	1974H1 to 1979H1
-4 ½	+21 ½	-19 ½	+7

* Average 1986 level; quarterly path in 1986 distorted as result of 1984 corporate tax reform.

(b) DTI's Investment Intentions Survey indicates rise of around 2 per cent in 1987. Preliminary indications are for faster growth in 1988 than in 1987.

(v) Manufacturing trade and competitiveness

(a) UK went into manufacturing deficit for first time ever in 1983. Deficit of £6 billion in 1986 and £9 billion forecast for 1987.

(b) Manufactures: trade volumes

NB February trade figures to be published on 26 March.

percentage change

	3 months to Jan 1987 on previous three months	3 months to Jan 1987 on year earlier	3 months to Jan 1987 on 1983Q2	3 months to Jan 1987 on 1979H1	1979H1 on 1974H1
Exports	2.5	5.8	28.6	22.1	10.6
Imports	2.0	9.5	37.7	66.3	38.9

(See also BB1 and BB4.)

(vi) Manufacturing profitability: Net real rate of return in 1985 (7 per cent) highest since 1973 (8 per cent).

(vii) Unit wage and salary costs in manufacturing

NB January figures to be published on 19 March.

(Table consistent with productivity data used in FSBR.)

12 month percentage changes

		Growth in unit wage and salary costs	Productivity growth	Average earnings growth
1985		5½	3½	9¼
1986		5½	2¼	7¾
1986	Q1	8	0	8
	Q2	6¾	¼	7½
	Q3	4	3¼	7¼
	Q4	3	4¾	8

(For international unit labour costs comparison, see BB3.)

(viii) Manufacturing employment: Fell by only 4,000 in 1986Q4, following fall of 126,000 in first three quarters (and fall of 44,000 in 1985). (For inter-government comparison, see BB12.)

(ix) Share of manufacturing in total output: Manufacturing as share of total output fallen from over 29 per cent in 1979 to 25 per cent in 1985. (Also fell slightly from 30 per cent to 29 per cent between 1974 and 1979.)

(x) CBI February Trends Enquiry: Balances on total order books, export order books and volume of output all up sharply. But further increase in balance of firms expecting to raise average prices.

Positive

(i) Manufacturing productivity growth: Since 1979 manufacturing productivity increased by over 3½ per cent a year - growth fastest of all major industrialised countries. (See also BB3.) Underlying growth seems to be back to rate experienced in 1960s.

(ii) Manufacturing profitability highest since 1973. Up from 4½ per cent in 1979: contrasts with no overall change between 1974 and 1979.

(iii) UK manufactured export volumes appear to have increased in line with developed countries' exports in 1986. Reinforces previous evidence that declining trend over years up to 1981 has ended. No previous five year period in recent history in which UK manufacturing exporters have been so successful. Since last election, export volumes up about 30 per cent. (See also BB4.)

(iv) Manufacturing output up over 10 per cent since last election. Forecast to rise further 4 per cent in 1987.

(v) Manufacturing investment growth in 1987 indicated by both DTI Investment Intentions Survey and CBI forecast. (See also B1.)

(vi) February CBI Trends Enquiry: Sharp improvement in order books, export order books and output series. Further evidence that growth in manufacturing output set to continue.

Defensive

(i) Manufacturing output below 1979 levels

- Fall since 1979 peak not unique - shared by France and Italy since 1979 and 1980 peaks respectively.
- Output also declined under Labour Government.
- Output recovered in recent years: 14 per cent above 1981 trough and up over 10 per cent since 1983 election.
- Forecast is for 4 per cent growth in 1987.

(ii) Share of manufacturing in total output: Declining since early 1960s under Labour and Conservative Governments alike. Similar experience in all Western industrialised countries.

(iii) Role of manufacturing in economy: Important that manufacturing thrives and is profitable. But UK needs, at least as much, strong service sector which now contributes more than twice as much to output and nearly three times as much to employment.

(iv) Manufacturing investment down under this Government: While fell during recession, up over 20 per cent since last election.

(v) Fall in manufacturing investment in 1986: Poor figures reflect earlier sluggish behaviour of output which has now picked up. CBI forecast is for manufacturing investment growth of 4 per cent in first three quarters of 1987 (period covered by their forecast). December DTI Investment Intentions Survey indicates rise of 2 per cent in 1987.

(vi) Manufacturing trade deficit large and expected to remain: Increased trade deficit in manufactures since 1979 reflects many factors, not least balance of payments adjustment required following increased oil production. Other countries also experiencing rising trend in import penetration. Since 1981, UK manufacturing's export volumes have grown on average at least as fast as those of other developed countries, after decades of relative decline. (See also BB4.)

(vii) Trade deficit important indicator of manufacturing performance: Ignores good performance of output, profitability, productivity and exports.

(viii) Manufacturing competitiveness: See BB4.

(ix) UK's share of world market in manufactures well down since 1979: See BB4.

(x) Manufacturing employment down under this Government: See BB12.

(xi) Slower growth in unit wage costs: Recent fall welcome but improvement attributable to faster productivity growth rather than slower earnings growth. High rate of productivity growth should contain growth in manufacturing unit labour costs to around 1½ per cent in 1987. But lower pay settlements vital to improved employment prospects.

Contact point: G Hacche (EB) 270 5207

BB11 OUTSIDE FORECASTS

[See also Industry Act forecast of UK economy (Brief B1)]

Factual

(i) Summary comparison at Annex.

(ii) Average outside forecast is for growth of 2¾ per cent in 1987.

(iii) Outsiders forecast current account deficit of around £2¾ billion in 1987; but forecasts may be revised in light of CSO's downward revision to invisibles surplus, published 5 March.

(iv) On average, forecasters expect

- unemployment to fall to a little under 3 million by 1987Q4;
- employment growth of around 1 per cent forecast for 1987.

(v) On average, outsiders expect PSBR outturn of £6¼ billion in 1986-87, rising to £7¼ billion in 1987-88, with assumption of £2½ billion fiscal adjustment on average.

(vi) On average, outsiders forecast inflation rate of 4¾ per cent in 1987Q4.

Positive

(i) Outside forecasters expect GDP growth to continue through 1987, taking UK into seventh successive year of sustained growth.

(ii) Outsiders expect employment growth to be sustained through 1987.

(iii) Unemployment expected to fall through 1987.

Defensive

(i) Outsiders predict higher inflation for 1987 than Industry Act forecast. Over past year or two, outsiders have tended eventually to come into line with Treasury on inflation. 1986 FSBR forecast spot on for inflation in 1986Q4.

(ii) Government providing no unemployment forecast: Follows long-established practice of both Labour and Conservative Governments. (See also B1.)

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SECRET
until after Budget Speech on 17.3.87
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BB11

ANNEX

SUMMARY COMPARISON OF INDUSTRY ACT FORECAST (IAF) AND OUTSIDE FORECASTS

(Except where specified, figures are percentage changes on previous year)

	IAF (Mar'87)	NIESR (Feb'87)	LBS (Feb'87)	Phillips & Drew (Mar'87)	Outside* Average (Feb'87)
GDP					
1987	3 (A)	2.8 (0)	3.2 (0)	2.7 (A)	2.8
1987H1-1988H1	2½ (A)	2.2 (0)	2.9 (0)	2.1 (A)	2.4
Current Account					
£ billion 1987	-2½	-2.6	-2.3	-2.3	-2.7
1988H1 at annual rate	-2	-3.9	-1.2	-3.6	-2.4
PSBR (£ billion)					
1987-88	4	8.6	6.0	7.6	7.2
1988-89	not app	6.3	5.8	9.0	7.2
Retail Prices Inflation					
1987Q4	4	4.5	3.9	4.9	4.8
1988Q2	4	5.5	3.6	5.2	5.0
Consumers' Expenditure					
1987	4	4.3	3.9	3.9	3.8
1987H1-1988H1	3½	3.9	2.9	2.3	2.9
Fixed Investment					
1987	4	2.8	5.1	3.2	3.2
1987H1-1988H1	3	4.8	4.5	1.4	3.3
Exports of Goods and Services					
1987	4	3.3	4.5	3.2	4.1
1987H1-1988H1	2	1.1	3.8	2.0	2.5
Imports of Goods and Services					
1987	6	8.0	4.9	6.3	6.1
1987H1-1988H1	2½	5.1	3.6	2.9	3.4

*Outside average derived from simple average of major independent forecasters; outsiders are NIESR, LBS, Phillips and Drew, Goldman Sachs, Henley, Cambridge Econometrics, Liverpool, Oxford, CBI, OECD and EC. 1987 and 1988H1 averages not strictly comparable since some forecasters only provide annual forecasts.

(A) average measure
(O) output measure

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BB12 INTER-GOVERNMENT COMPARISONS

[See also UK economy: recent developments (Brief BB1), International economic comparisons (BB3), Balance of payments and competitiveness (BB4), Prices (BB6), Pay (BB7), Employment and unemployment (BB8), Manufacturing industry in UK (BB10) and Effects of tax and National Insurance contribution changes on living standards (D3)]

Factual

(i) GDP and its components

NB 1986Q4 figures to be published on 20 March.

	annualised percentage changes		
	1974H1 to 1979H1	1979H1 to 1986Q3	1983Q2 to 1986Q3
GDP(A)	2	1½	2¾
GDP (A) excluding oil	1	1	2¾
Fixed investment	½	1	4½
Consumers' expenditure	2	2	3¾
Exports of goods and services	3¼	2¼	5½
Imports of goods and services	1¾	3¾	6¼

(ii) Recoveries compared

NB 1986Q4 figures to be published on 20 March.

	annualised percentage increases	
	1975H2 to 1979H1	1981H1 to 1986Q3
GDP (A)	3	2½
GDP (A) excluding oil	1¾	2¼
Consumers' expenditure	3	3
Fixed investment	1¼	4
Exports of goods and services	5¼	4
Imports of goods and services	4¾	7

(iii) Manufacturing

	percentage changes		
	1974H1 to 1979H1	1979H1 to 3 months to January 1987	1983Q2 to 3 months to January 1987
Output	-2½	-4	10½
Productivity (annual* average)	1¼	3¾	4½

*Includes 1986 Q4 (consistent with FSBR but unpublished until 19 March).

(See also BB10.)

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(iv) External account

(a) Current account: See BB4.

(b) Non-oil exports and imports*

per cent annualised

	1974H1 to 1979H1	1979H1 to 3 months to January 1987	1983Q2 to 3 months to January 1987
Exports	2½	3	7½
Imports	5	5½	8½

* excluding more erratic items

(c) Overseas assets: See BB4.

(v) Employment changes (incorporates revisions published on 17 March)

'000s

	March 1974 to March 1979	March 1979 to September† 1986	June 1983 to September† 1986
Manufacturing employment*	-608	-1,992 (Dec)	-293 (Dec)
Services employment*	+934	+1,005	+984
Employees in employment	+328	+1,420	+566
o/w Females part time	+384	+333	+369
Self employment	-101	+749	+432
Employed labour force**	+192	-662	+999

† latest data available
* excludes self-employed
** includes employment in armed forces

(See also BB8 and BB10.)

(vi) Unemployment

NB February figures to be published on 19 March

	'000s February 1974 to May 1979	May 1979 to January 1987	June 1983 to January 1987
Change	+639	+1,967	+233
Change per month	+10	+22	+5

(vii) Unit wage and unit labour costs in manufacturing: See BB3 and BB10.

(viii) Real earnings growth

NB January figures to be published on 19 March.

	per cent annualised		
Government	**Earnings**	**Prices**	**Real earnings**
Feb 1974 - April 1979	15.9	15.5	0.4
May 1979 - Dec 1986	10.6	8.2	2.4
June 1983 - Dec 1986	7.6	4.7	2.9

(ix) Real take home pay: See D3.

(x) Inflation

NB February figures to be published on 20 March.

	February 1974 to April 1979	**May 1979 to January 1987**	**June 1983 to January 1987**
Average	15.5	8.2	4.7
Lowest	7.4 (June '78)	2.4 (July/Aug '86)	2.4 (July/Aug '86)
Highest	26.9 (Aug '75)	21.9 (May '80)	7.0 (May/June '85)

(a) 10.3 per cent and rising in May 1979.

(b) 3.7 per cent and rising in June 1983.

(c) Averaged 3.4 per cent in 1986.

(See also BB6.)

(xi) Company profitability (net real rates of return)

	annual averages				
	1974 to 1979	1979	1979 to 1985*	1983	1985*
Manufacturing	4½	4½	4½	5	7
Non-oil companies	5½	6	5¼	5	7½
All companies	6	7½	8½	9½	12

* latest data available

(See also BB1 and BB10.)

Positive

(i) Inflation

- Government inherited rate of over 10 per cent and rising. Average for 1986 3.4 per cent.
- Since May 1979 annual rate has averaged a little over 8 per cent, compared with over 15 per cent under Labour Government.
- Since 1983 election has averaged under 5 per cent, compared with over 15 per cent under Labour Government.
- Highest 12 month rate since June 1983 lower than lowest Labour Government achieved.

(See also BB6.)

(ii) Money GDP

- Between 1974 and 1979, up by around 19 per cent a year, of which 17 per cent frittered away in higher inflation, with real growth of only 2 per cent a year.
- Since 1983 election, money GDP growth reduced to around 7½ per cent a year, with real GDP having grown by nearly 3 per cent a year and inflation averaging about 4½ per cent.

(iii) Now entering seventh year of balanced growth. In present upswing investment risen faster than consumption (and twice as fast as EC average). Reverse of position during 1975-79 upswing under Labour Government.

(iv) Manufacturing productivity growth since 1979 three times that 1974-79.

(v) In this Parliament:

- GDP growth averaged nearly 3 per cent a year;
- fixed investment growth averaged 4½ per cent a year;
- total employment grown by 1 million.

(vi) Self employment risen in every year since 1979. Fell under Labour Government.

(vii) Company profitability

- Now 12 per cent. Highest rate since 1964 and three times rate in 1975.
- Since 1979 averaged over 8 per cent - only 6 per cent under Labour Government.
- Manufacturing profitability also up to highest level since 1973.

Defensive

(i) GDP growth less since 1979 than under Labour Government: Little in it. Non-oil GDP grown at same rate. Since 1983 election both grown faster.

(ii) Manufacturing output below 1979 level: Output also fell under Labour Government. (See BB10.)

(iii) Manufacturing employment down much more since 1979 than under Labour Government: But since 1983 election, fall has averaged only 7,000 a month, compared with 10,000 a month under Labour Government. (See BB8.)

(iv) For other manufacturing comparisons, see BB10.

(v) Unemployment much worse than under Labour Government: But large rise in unemployment after 1979 due to shedding of labour. Overmanning ("hidden unemployment") rife under previous Government and productivity stagnant. World recession starting in 1979 forced firms to become more efficient. Since June 1983 monthly increase half that under Labour Government.

(vi) Much of increase in employment since 1983 part-time jobs for women: Nothing wrong with that - shows flexibility of this type of employment. Under Labour Government employment growth solely result of increase in part-time female workers, as against contribution of just over one third since last election.

(vii) Current account: See BB4.

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CC1 INTEREST AND EXCHANGE RATES

[See also Industry Act forecast of UK economy (Brief B1), UK economy: recent developments (BB1), World economy (BB2), International economic comparisons (BB3), Balance of payments and competitiveness (BB4), Prices (BB6), Inter-government comparisons (BB12), Fiscal policy (C4), Monetary policy (C5) and Repeal of Exchange Control Act 1947 (C6)]

A INTEREST RATES

Factual

(i) Policy: Short-term interest rates essential instrument of monetary policy. Will be maintained at levels necessary to keep downward pressure on money GDP and hence inflation, but no higher.

(ii) Recent UK nominal rates

	Base rate	3 month interbank	10 year gilt	20 year gilt
Current rates (13 March 1987)	10½	9 15/16	9.2	9.3
6 November 1986 (Autumn Statement)	11	10 15/16	10.9	10.5
18 March 1986 (Budget Day)	12½	11 5/8	10.7	9.4

(iii) Recent base rate movements

	per cent
8 January 1986	12½
17 March	11½
8 April	11
18 April	10½
22-23 May	10
14 October	11
9 March 1987	10½

Historical movements

	per cent
1974 (10 October)	11½
1979 (3 May)	12
1983 (9 June)	10

(iv) Real interest rates in UK compared with those elsewhere: Exact figures cannot be given since depend on future inflation. No uniquely right way of getting at this. Using current pre-tax short interest rates deflated by RPI implies real rates of around 5.8 per cent (post-tax real rates generally lower) compared with around 8 per cent in October 1986. Using this measure, real rates currently higher in UK than in rest of major seven and during 1986 at highest levels since before Second World War.

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(v) Comparison of Labour and Conservative Government interest rate records

		Interest rate				**Mortgage rate(1)**	
		Short Term(2)		**Long Term(3)**			
		High	**Low**	**High**	**Low**	**High**	**Low**
L	1974	13	11½	16.3	13.3	11	11
A	1975	11¼	9¾	15.1	12.2	11	11
B	1976	15	9	15.7	12.1	12¼	10½
O	1977	14¼	5	14.1	10.3	12¼	9½
U	1978	12½	6½	13.1	10.6	11¾	8½
R	1979 (to May)	14	12	13.8	11.4	11¾	11¾
C							
O							
N	1979 (from May)	17	12	15.0	11.7	15	11¾
S	1980	17	14	14.9	13.1	15	14
E	1981	16	12	16.3	13.7	15	13
R	1982	14	9	15.9	10.7	15	10
V	1983	11	9	11.9	10.7	11¼	10
A	1984	12	8½	12.4	10.7	12.9	10.25
T	1985	14	10½	11.7	10.5	14	11.9
I	1986	12½	10	11.3	8.7	12.75	11
V	1987	11	10½	10.4	9.1	12.25	12.25
E							
Labour high/low		15	5	16.3	10.3	12¼	8½
Conservative high/low		17	8½-8¾	16.3	8.7	15	10
Labour average(4)		10.7(5)		13.0		10¾	
Conservative average(4)		12.2(5)		12.2		12¼	

(1) Monthly average from November 1984 when cartel ended.
(2) Minimum Lending Rate (MLR) until 1980; base rate 1981 onwards.
(3) Monthly average of 10 year gilt yields, apart from 1987 daily close.
(4) Average inflation rate: Labour Government 15.5 per cent, Conservative Government 8.2 per cent.
(5) Based on 3 month interbank rates.

(vi) Factors reflected in level of UK real interest rates include

- high private sector borrowing, including heavy corporate demand for investment finance in recent years;
- premium needed to cover market's fear of Labour Government (Chancellor in Economic Debate 6 November, OR vol 111 no 61 col 1119);
- freeing of financial system from various inefficient and unfair controls (eg corset for banks, exchange controls, mortgage rationing);
- continuing high level of pay settlements in UK (Chancellor in Economic Debate 6 November, OR vol 111 no 61 col 1119).

(vii) International comparisons: See BB3.

Positive

(i) Interest rate policy: Short-term interest rates will be held at whatever level necessary to keep downward pressure on inflation, but no higher. Will not take risks with inflation.

(ii) Link between wage rises and interest rates: If management succeeds in moderating pace of wage rises, then prospects for lower interest rates and higher employment will be much improved.

(iii) Labour Party's policy: With one breath accuse Government of engineering consumer credit boom; with next claim cut in interest rates delayed for political purposes. As usual, do not know whether they are coming or going.

(iv) Long term gilt yields in 1986-87 in single figures for first time since early 1970s. Private sector borrowers recently able to raise long-term funds at lowest yields for many years.

(v) Base rates 2 per cent lower than at 1986 Budget.

Defensive

(i) Why were interest rates lowered on 9 March? Because Government viewed ½ per cent reduction as appropriate and prudent. No wish to maintain interest rates higher than consistent with inflation objectives. Without cut, recent strengthening of pound would, other things being equal, have caused excessively tight monetary conditions.

(ii) When will interest rates be lowered again? When prudent to do so.

(iii) Interest rates used simply to hold pound. No. Government's first priority remains defeat of inflation. Exchange rate certainly important factor taken into account in assessing conditions but by no means only one.

(iv) UK nominal rates out of line with international competitors: Level reflects number of factors, including fact that UK inflation still higher than in main competitor countries. Reductions in interest rates will only be made when justified by monetary conditions. (See BB3.)

(v) UK real rates out of line with international competitors/historically high? Real rates depend on status of borrower/lender and expectations of future inflation. No uniquely right way of calculating them and evidence not all in one direction.

(vi) Real interest rates higher now than under last Labour Government: Real rates only negative under last Labour Government because inflation accelerating. Fuelled inflation further and cheated savers. This Government's sound monetary policy brought inflation in 1986 to lowest levels for almost 20 years and rekindled incentive to save and invest.

(vii) Effect of positive real interest rates on savers: Positive real rates benefit millions of savers cheated under Labour Government's inflationary policies. Each interest rate percentage point earns over £1½ billion for savers in full year.

(viii) High real interest rates bad for industry: Company liquidity and profitability remain strong. (See BB1.) Relaxation of monetary policy, fuelling inflation, far greater threat to industry than current levels of interest rates.

(ix) High real interest rates damaging investment prospects? Key to increased investment is to maintain stable, non-inflationary growth. Investment risen at average of 4 per cent a year since beginning of upswing - twice as fast as EC average and 3 times as fast as under Labour Government's recovery. Prospects for future investment remain good. (See B1, BB3, BB12.)

(x) Comparative cost of wage rises and interest rates: Over full year, industry has at least 4 times as much to gain from 1 per cent off pay rises than from 1 per cent off interest rates.

(xi) Banks (building societies) making killing out of high rates? What matters to institutional lenders is margin between lending and borrowing rates, not absolute level. (Margins being cut by new high interest cheque and premium accounts.)

(xii) Mortgage rates: Matter for banks and building societies. (At present ½ per cent lower than at time of 1986 Budget.) House purchase remains worthwhile aspiration - one which Labour Party would seek to deny to many.

(xiii) Mortgage rate assumption: See BB6.

(xiv) Interest rate assumptions underlying PSBR forecast: Not practice to reveal. Market sensitive.

(xv) Effect on Budget on interest rates: Short-term interest rates will continue to be set at levels consistent with inflation objectives.

(xvi) Market should set interest rates. Base rates and interbank rates reflect commercial judgement of banks and market. But Government cannot stand aside, since interest rates essential instrument of monetary policy.

(xvii) Paris Accord: Agreement not about interest rates.

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B EXCHANGE RATE

Factual

(i) Exchange rate movements

per cent change to 13 March since

	1979 (3 May)	All time £ low point against $ (26 Feb 1985)	Plaza agreement (20 Sept 1985)	2 Dec 1985 (oil $30)	18 March 1986 (Budget)	Nov 1986 Autumn Statement	Paris Accord (20 Feb 1987)
Sterling							
£ ERI	-18	+2	-13	-12	-4	+3	+4
$/£	-24	+52	+15	+6	+7	+10	+3
DM/£	-26	-19	-25	-22	-12	-1	+5
Dollar							
$ effective	+9	-34	-25	-18	-11	-7	0
$/DM	+2	+87	+53	+36	+21	+11	-1
$/Yen	+47	+72	+56	+33	+15	+7	+1

(ii) Sterling all-time lows: ERI 67.1 (October 1986), $1.03½ (26 February 1985), DM 2.73½ (January 1987).

(iii) Recent £ highs

ERI	84.7	(26 July 1985)
$	1.60	(11 March 1987)
DM	4.09½	(10 July 1985)

(iv) Exchange rate comparisons

		Highs		Lows	
Labour					
(March 1974- April 1979)	ERI	109.9	(May 1974)	74.2	(October 1976)
	$/£	2.43	(March 1975)	1.57	(October 1976)
	DM/£	6.24	(March 1974)	3.62	(October 1978)
Conservative					
(May 1979 and following)	ERI	105.7	(January 1981)	67.1*	(October 1986)
	$/£	2.45	(November 1980)	1.035*	(February 1985)
	DM/£	5.07	(January 1981)	2.735*	(January 1987)

* all time low

(v) Reserves and official debt comparisons

		Gross reserves		Total official debt	
Labour		$ billion			
(March 1974- April 1979)	High	21.9	(March 1979)	25.5	(December 1977)
	Low	4.1	(December 1976)	8.7	(March 1974)
Conservative					
(May 1979 to date)	High	28.5	(March 1981)	22.0	(May 1979)
	Low	14.0	(May 1985)	11.0	(September 1984)

- Current total official debt around $19 billion.
- Reserves in February: Underlying rise of $287 million, total rise of $305 million, giving level of $22.3 billion at end-February.

(vi) Plaza Agreement: G5 agreed in September 1985 that to help improve economic fundamentals in member countries, orderly appreciation of main non-dollar currencies against dollar desirable.

(vii) Paris Accord: G6 agreed on 22 February that substantial exchange rate changes since Plaza Agreement had brought currency values within ranges broadly consistent with underlying economic fundamentals. Further substantial exchange rate shifts could damage growth and adjustment prospects. Period of stability desirable. G6 therefore agreed to cooperate closely to that end.

(viii) UK exchange rate policy: Chancellor said publicly after Paris meeting that while he did not want sterling to fall further, neither did he want to see substantial rise. Period of stability desirable.

(ix) Role of exchange rate in monetary policy: See C5.

(x) UK membership of ERM: Government views stated fully on many occasions. Chancellor said (on Radio 4 'Today' programme, 10 October) that many of arguments against ERM membership had weakened in force but Government had decided time was not right for UK to join ERM.

(xi) Opposition Parties' views of ERM:

- SDP/Liberals strongly in favour of UK participation.

- Labour Party used to be opposed. But Roy Hattersley MP said in speech on 15 October 1986 now in favour on certain conditions: sustainable exchange rate to encourage exports, policy co-ordination between members to cut unemployment, more use to be made of pooled currency reserves and less use of competitive increases in interest rates to defend currencies.

(xii) Exchange rate assumption for Budget forecast: Forecast assumes sterling remains close to present level in effective terms.

(xiii) Institute of Fiscal Studies' study on capital controls (published 11 February) concludes Labour Party's proposals for fiscal penalties on overseas investment difficult to operate and police. Confirms Government view that National Investment Bank unnecessary.

Positive

(i) G5 agreed 18 months ago that exchange rates out of line. Have cooperated to help move them in right direction. Big success.

(ii) Period of stability now desirable. Over-shooting in no-one's interest. G6 agreed to cooperate to achieve this. Going with grain of market.

(iii) Strong productivity growth and present pattern of exchange rates offer industry best selling opportunity abroad for years, provided pay costs controlled. (See BB4.)

(iv) February fourth successive month of underlying rise in reserves.

Defensive

(i) Exchange rate target: No exchange rate target but Chancellor repeated at time of G6 meeting that did not want sterling to fall further, and added that no wish to see substantial rise either. Period of stability desirable. Paris Accord entirely consistent with that.

(ii) Implications of Paris Accord for role of exchange rate in monetary policy: No change in policy. Accord is pragmatic international agreement specifically to deal with current circumstances (see C5).

(iii) Support for sterling at present levels: Paris Accord applies to all six currencies. All agreed on present broad pattern of exchange rates and stand ready to intervene. Chancellor has stressed value of period of stability.

(iv) What value is Paris Accord to UK? As major trading nation, UK has at least as much to gain as anyone from anything which lessens international trade tensions and pressures for protectionism.

(v) Delay in cutting interest rates costly: No. Real cost would come from discarding prudent monetary policies.

(vi) Intervention costly: No. Smoothing intervention tends to be profitable over time.

(vii) UK membership of ERM: Matter kept under review. Have always said arguments both in favour and against joining system and that UK would only join when satisfied that balance clearly favours doing so.

(viii) Sterling's lower exchange rate with DM gives UK opportunity to join ERM at favourable rate. Not prepared to speculate on what rates might or might not be appropriate. In any case, not merely matter of achieving appropriate rate; number of technical questions also need to be considered.

(ix) Difference between specific agreement and target zone: Pragmatic judgement made about current circumstances that will last as long as necessary: agreement that current levels of exchange rates broadly acceptable and worth trying to consolidate. Paris Accord is Plaza II.

(x) What happens if exchange rates depart from acceptable levels? G6 stand ready to use all available instruments, including co-ordinated intervention.

(xi) Automatic policy adjustments: Purpose of agreement to avoid substantial exchange rate movements. For policy commitments, see BB2, C4.

(xii) Can agreement be implemented in practice? Does not solve all problems but communique contains clear declarations of political will. All G6 agree that, with policies in communique, present pattern of exchange rates reflects economic fundamentals.

(xiii) Government forecasting exchange rate stability: Made conventional assumption that effective rate will remain close to current level, not forecast.

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CC2 PUBLIC SECTOR BORROWING: HISTORIC TRENDS AND INTERNATIONAL COMPARISONS

[See also MTFS: Strategy (Brief C1), MTFS: expenditure, revenue and borrowing (C2), PSBR: 1986-87 and 1987-88 (C3) and Fiscal policy (C4)]

A HISTORIC TRENDS

Factual

(i) PSBR in cash and as percentage of GDP:

	PSBR			PSBR excluding privatisation proceeds		PSFD[1]	
	Cash (£ billion)	Real terms (1985-86 prices) (£ billion)	Ratio to GDP (per cent)	Cash (£ billion)	Ratio to GDP (per cent)	Cash (£ billion)	Ratio to GDP (per cent)
1968-69	0.4	2.1	¾	0.4	¾	0.4	¾
1969-70	-0.6	-3.3	-1¼	-0.6	-1¼	-0.8	-1¾
1970-71	0.8	4.0	1½	0.8	1½	-0.2	-½
1971-72	1.0	4.5	1¾	1.0	1¾	0.7	1¼
1972-73	2.4	10.5	3½	2.4	3½	2.0	3
1973-74	4.3	17.5	5¾	4.3	5¾	3.5	4¾
1974-75	8.0	27.0	9	8.0	9	6.0	6¾
1975-76	10.3	27.6	9¼	10.3	9¼	8.1	7¼
1976-77	8.3	19.7	6½	8.3	6½	7.4	5¾
1977-78	5.4	11.2	3½	5.9	4	6.6	4½
1978-79	9.2	17.4	5¼	9.2	5¼	8.5	5
Average 1974-75 to 1978-79	8.2	20.6	6¾	8.3	6¾	7.3	5¾
1979-80	10.0	16.1	4¾	10.4	5	8.2	4
1980-81	12.7	17.2	5½	13.1	5½	11.9	5
1981-82	8.6	10.7	3¼	9.1	3½	5.7	2¼
1982-83	8.9	10.2	3¼	9.3	3¼	8.4	3
1983-84	9.8	10.8	3¼	10.9	3½	12.2	4
1984-85[2]	10.2	10.8	3	12.3	3¾	13.9	4¼
1985-86[2]	5.8	5.8	1½	8.5	2¼	8.4	2¼
1986-87 (Budget forecast)[3]	4.1	4.0	1	8.5	2¼	11.0	3
Average 1979-80 to 1986-87	8.8	10.7	3¼	10.3	3¾	9.9	3½
1987-88 (Budget forecast)	3.9	3½	1	8.9	2¼	9.4	2¼

(1) Public Sector Financial Deficit.
(2) If adjusted for coal strike, PSBR and PSFD ratios to GDP roughly 0.9 per cent lower in 1984-85 and 0.3 per cent lower in 1985-86.
(3) Outturn to February £0.1 billion.

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(ii) Error on PSBR forecasts for year ahead: Average absolute error on past PSBR forecasts made at Budget time

- over last 10 years: about 1¼ per cent of GDP, equivalent to around £5 billion in 1987-88;

- over last 5 years: about ¾ per cent of GDP, equivalent to around £3 billion in 1987-88. Also no sign of bias-overshoots broadly offset by undershoots.

	FSBR*	Outturn+	Difference	As percentage of GDP
1975-76	9.1	10.6	+1.5	+1.4
1976-77	11.9	8.5	-3.3	-2.6
1977-78	9.5	5.6	-3.9	-2.6
1978-79	8.6	9.2	+0.6	+0.3
1979-80	7.6	10.1	+2.5	+1.2
1980-81	8.5	13.3	+4.8	+2.0
1981-82	10.6	9.0	-1.6	-0.6
1982-83	10.5	9.4	-1.1	-0.4
1983-84	6.9	10.2	+3.3	+1.1
1984-85	7.2	10.2	+3.0	+0.9
1985-86	7.1	5.8	-1.3	-0.4
1986-87	7.1	4.1 (f)	-3.0	-0.8

* after adjusting for in-year policy changes

\+ up to 1983-84, PSBR outturns based on definition then in use (slightly different from current definition).

(f) forecast

(iii) PSBR (real terms and ratio to GDP) less than one-fifth level of mid-1970s in 1986-87 and 1987-88.

(iv) Effect of privatisation proceeds on PSBR/GDP ratio now around one per cent each year.

(v) Net public debt/GDP ratio: About 60 per cent in March 1975, 51 per cent in March 1979 and 45 per cent (estimated) in March 1986.

(vi) PSBR (excluding privatisation proceeds) and PSFD (as ratios to GDP) under one-half levels of mid-1970s in 1986-87 and 1987-88.

(vii) No PSBR figures available for years before 1952 but PSBR lower as percentage of GDP than 1987-88 forecast in only 2 years since then (1968-69 and 1969-70). Record of PSBR less privatisation proceeds less good but still impressive.

(viii) PSFD, unlike PSBR, is not wholly measure of cash transactions because certain components are measured on an accruals basis. PSFD figures also less timely and more subject to revision. PSFD higher in recent years than PSBR mainly because PSFD excludes privatisation proceeds, but these can easily be removed from PSBR figures if necessary.

Positive

(i) PSBR/GDP historical ratios:

(a) In each of years 1981-82 to 1986-87, PSBR/GDP ratio lower as percentage of GDP than in any year under previous Labour administration, when ratio peaked at 9¼ per cent (1975-76).

(b) Same comparison holds true of PSBR excluding privatisation proceeds (with same peak in 1975-76).

(c) Marked reduction in 1985-86 compared with earlier years: Further reduction in 1986-87 and maintained in 1987-88 (see C4).

(ii) PSBR/GDP ratios in 1986-87 and 1987-88

(a) PSBR/GDP ratio including privatisation proceeds

- 1986-87: Expected 1 per cent. Lowest for 17years (small net surplus in 1969-70).
- Has been as low as this on only two occasions since early 1950s (1968-69 and 1969-70).
- 1987-88: Forecast 1 per cent.

(b) PSBR/GDP ratio excluding privatisation proceeds

- 1986-87 (expected 2¼ per cent) and 1985-86 (2¼ per cent).
- Lower than in any year under Labour Government.
- About one third of average level under Labour Government.
- Lowest since 1971-72.

(c) Marked downward trend in both ratios since 1980-81: See C4.

(iii) Expected PSBR in 1986-87 compared with 1985-86: See C3.

(iv) 1975-76 ratio of PSBR to GDP (9¾ per cent) would imply:

- 1986-87 PSBR of over £35 billion.

- 1987-88 PSBR of around £38 billion.

Defensive

(i) Comparisons based on other measures (TCSC report on 1986 Autumn Statement alleged PSFD far more relevant and useful figure than PSBR): No single best measure of fiscal stance. But whether look at PSBR, PSBR excluding privatisation proceeds or PSFD, currently well below ratios to GDP achieved in any years of last Labour Government. (See also C4.)

(ii) Public debt/GDP ratio fell much more rapidly under previous administration. Nothing to boast about. Simply result of rapid growth in money GDP in late 1970s, stemming from high inflation which this Government has brought under control.

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B INTERNATIONAL COMPARISONS

Factual

NB International comparisons of public sector financial balances and borrowing requirements made difficult by differences in coverage of public sector accounts. Usually comparisons employ general government (central and local government and social security funds) but even these require caution.

(i) General government financial balances as percentage of GDP (deficit shown as minus)

	1974	1976	1979	1985	1986(1)	1987(1)
US(2)	-0.2	-2.1	0.6	-3.4	-3.4	-2.3
Japan(2)	0.4	-3.7	-4.8	-1.4	-1.5	-1.4
West Germany(2)	-1.4	-3.4	-2.6	-1.1	-1.0	-0.9
France	0.6	-0.5	-0.7	-2.6	-2.9	-2.5
Italy	-8.1	-9.0	-9.5	-14.0	-12.5	-11.8
Canada(2)	1.9	-1.7	-1.8	6.6	-5.4	-5.3
UK	**-3.8**	**-4.9**	**-3.5**	**-2.6**	**-3.1**	**-3.3**
Total of above countries (G7)	-0.8	-2.9	-1.7	-3.4	-3.4	-2.7
EC(3)	-2.1	-3.9	-3.6	-4.7	-4.5	-4.2
Total OECD(4)	-0.5	-2.7	-1.8	-3.5	-3.4	-2.8

(1) OECD estimates and forecasts from OECD 'Economic Outlook', December 1986. Note that outturn figures for UK general government deficit in 1986 will almost certainly be less than 3.1 per cent of GDP. Estimate for 1987 consistent with FSBR will also be below OECD's December forecast.

(2) As percentage of GNP. (NB general government ratio for US is lower than often quoted Federal deficit ($5\frac{1}{4}$ per cent in fiscal 1986) because of state government surpluses. Ratio for Japan also understates central government deficit because of surplus of social security funds.)

(3) Excludes Luxembourg and Portugal.

(4) Covers 18 of 24 members.

Source: OECD 'Economic Outlook,' December 1986 and OECD 'Economic Studies', Autumn 1984

(ii) Net general government debt as percentage of GDP*

	1975	1979	1982	1985+
US	25	20	22	28
Japan	-2	15	23	26
Germany	1	12	20	23
France	11	10	11	17
Italy	60	66	71	96
Canada	4	12	20	34
UK	**58**	**49**	**47**	**48**
G7 average	20	22	26	32

* rounded to nearest 1 per cent
+ latest year for which full comparison can be made

Source: OECD

Positive

(i) Germany and Japan have lowest government deficits as percentage of GNP. Also countries with lowest interest and inflation rates.

(ii) UK deficit of general government (as percentage of GDP)

- Now around average of our competitors.
- In 1979 UK deficit double that of competitors.

(iii) Competitors' budget deficits have tended to rise on average in 1980s but not in UK.

Defensive

(i) US budget deficit higher than in UK and employment performance better: See BB2.

(ii) Little fall in UK general government deficit in 1980s: Deficit of other countries tended to rise in 1980s, while UK's shows slight fall. Now at lower level than in 1970s.

(iii) Low UK debt income ratio implies room for fiscal expansion: See C4.

Contact points: J A Clark (PSF) 270 5030 (PSBR)
A M Dolphin (IF2) 270 5546 (International comparisons)

CC3 BURDEN OF TAXATION

[See also MTFS: strategy (Brief C1), MTFS: expenditure, revenue and borrowing (C2), PSBR: 1986-87 and 1987-88 (C3), Fiscal policy (C4), Effects of tax and National Insurance contribution changes on living standards (D3) and International tax comparisons (LL1)]

Factual

(i) (a) Budget reduces taxation in 1987-88 by £2.63 billion compared with indexed base. Comprises £2.27 billion reduction in direct taxes; £0.36 billion reduction in indirect taxes.

(b) Total tax and National Insurance contributions (NICs) expected to be slightly lower as percentage of GDP in 1987-88 than in 1986-87 (see Table 1).

(c) Non-North Sea tax and NICs expected to be marginally higher as percentage of non-North Sea GDP in 1987-88 than in 1986-87 (see Table 2).

(ii) Position in 1987-88 compared with 1986-87

(a) Total tax and NICs risen by £3½ billion in real terms.

(b) No change in balance of direct and indirect taxes.

(c) Personal income tax and employees' NICs as percentage of total taxes and NICs fallen by 0.7 percentage points.

(d) Taxes on expenditure as percentage of total taxes and NICs lower by 0.3 percentage points.

(e) Corporation tax (non-North Sea) as percentage of total taxes and NICs risen by over 1 percentage point.

(iii) Following Budget, position in 1987-88 compared with 1978-79

(a) Total tax and NICs:

- risen by over 4 percentage points as percentage of GDP;

- risen by over £34½ billion in real terms.

(b) Direct taxes as percentage of total taxes and NICs fallen by 1.4 percentage points; indirect taxes risen by 1.4 percentage points.

(c) Income tax as percentage of total tax and NICs fallen over 5 percentage points through reduced tax rates and about 22 per cent real terms increase in thresholds.

(iv) Following Budget, position in 1987-88 compared with 1982-83

(a) Total tax and NICs:

- fallen by over 1 percentage point as percentage of GDP;
- risen by over £16½ billion in real terms.

(b) Direct taxes as percentage of total taxes and NICs fallen by 1.7 percentage points; indirect taxes risen by 1.7 percentage points.

(c) Income tax as percentage of total tax and NICs fallen by 1.8 percentage points.

(d) Expenditure taxes and stamp duties as percentage of total tax and NICs risen 3.3 percentage points.

(e) North Sea taxes as percentage of total tax and NICs fallen by 4.6 percentage points.

(f) Employers' NICs and National Insurance Surcharge (NIS) as percentage of total tax and NICs fallen by 1.4 percentage points.

(g) Non-North Sea corporation tax as percentage of total tax and NICs risen by 4 percentage points.

(v) Following Budget, burden of tax on individuals in 1987-88 compared with indexed 1978-79 regime

		£ billion
(a)	Income tax	-12
(b)	Employees' NICs	+4¼
(c)	Indirect taxes on persons (excl LA rates)	+11
(d)	**Total**	**+3¼**

(vi) G6 Paris communique (22 February) included statement by UK Government "The share of public expenditure in the economy will continue to fall and the burden of taxation will be reduced, while public sector borrowing is maintained at a low level". (See also C4.)

(vii) Shift in burden of taxation

- Sir G Howe in 1979 Budget Statement: "We made it clear in our manifesto that we intended to switch some of the tax burden from taxes on earnings to taxes on spending. This is the only way that we can restore incentives and make it more worthwhile to work; and at the same time increase the freedom of choice of the individual. We must make a start now." (OR 12 June 1979 vol 968 cols 249-250.)

- Present Chancellor in 1984 Budget Statement: "The broad principle was clearly set out in the manifesto on which we were first elected in

1979. This emphasised the need for a switch from taxes on earnings to taxes on spending. My predecessor made an important move in this direction in his first Budget, and the time has come to make a further move today." (OR 13 March vol 56 col 301.)

(viii) Personal Tax Green Paper Cmnd 9756 March 1986 said: "The Government regard it as of major importance to reduce the burden of income tax. .... the Government believe that people should be left to spend their own money as they wish. This maximises their freedom of choice. It gives incentives to effort and enterprise. And it produces an economy that is responsive to changing tastes and circumstances. For all these reasons taxes must be kept as low as possible, and their incidence made as fair and efficient as it can be."

(ix) Neil Kinnock MP claimed Government has increased burden of tax on individuals by about 18 per cent since 1979 ('This Week, Next Week' BBC1, 11 January).

(x) Chancellor stated in 1987 Budget Speech prudent fiscal policy "diminishes scope for reducing burden of taxation, which of course remains major objective of Government policy".

(xi) Dr Owen claimed in speech to SDP Party Conference, 17 September, that reductions in basic rate since 1979 offset by increased NICs.

(xii) Burden of tax over medium term: See C2.

(xiii) International comparisons: See LL1.

Positive

(i) In 1987 Budget

- direct taxes reduced by £2.3 (£2.27) billion
- indirect taxes reduced by £0.4 (£0.36) billion
- total taxes reduced by £2.6 (£2.63) billion

in 1987-88, compared with indexed base.

(ii) Balance of direct and indirect taxation

- Since 1978-79, deliberate shift from taxes on personal income to taxes on personal spending.
- 1987 Budget maintains 1986-87 balance of direct and indirect taxation as share of total taxes and NICs.
- No uniquely right balance between different taxes. In 1987 Government has concentrated tax package on income tax cuts to improve incentives and allow people to choose what they do with their own income.

(iii) Income tax fallen as proportion of total taxation from 1978-79: If rates had remained at 1978-79 levels (ie including reduced rate band) and allowances merely indexed, total yield would be £12 billion higher. Equivalent to over £10.50 a week for family on average earnings (all family types).

(iv) Since 1978-79 employers' NICs and NIS fallen in real terms by £1.9 billion. Reduces cost of employing labour. Good for jobs. Abolition of NIS saves private sector over £4 billion in 1987-88, compared with 3½ per cent rate Government inherited in 1978-79.

Defensive

(i) No reduction in non-North Sea tax burden in 1987-88: Overall tax burden does fall slightly, but bigger tax cuts this year would not have been prudent. Government remains firmly committed to significant reduction in burden over medium-term.

(ii) Increase in tax burden since 1979: Increase to 1981-82 necessary to reduce PSBR to levels consistent with reduction of inflation. Level more or less stabilised in recent years. Over half of increase comes from higher taxes on expenditure; remainder from corporation tax, North Sea taxes and local authority rates.

(iv) Excise duties standstill means reversal of policy of shifting burden to indirect taxes? No. Budget maintains 1986-87 balance of indirect and direct taxes. If Budget had simply indexed main thresholds and excise duties but left basic rate at 29p, share of direct taxes in total would have increased. Policy remains to shift burden from income to spending. Individual, not state, should decide how own money to be spent.

(iii) Direct tax cut since 1978-79 outweighed by increases in indirect tax: Indirect taxes have certainly increased; some people will be paying more tax overall. But Government's policy has been to switch taxes from earnings to spending in order to give people greater freedom of choice.

(v) UK burden too high - much higher than US, Japan: Yes. Government's aim remains to reduce burden of tax. But scope for reduction constrained by need to maintain prudent economic strategy. (See also C2, LL1.)

(vi) Burden on consumers relatively high: Taxes on goods and services certainly higher than US, Japan. But about average for EC. Government's policy to switch taxes from earnings to spending to give greater freedom of choice.

(vii) Burden of CT increased since 1978-79: Reflects improved profit performance of UK companies. Increase in corporation tax yield partially offset by reduction in yield from employers' NICs and NIS.

(viii) Burden of tax on individuals increased by about 18 per cent? Figure wildly exaggerates increase in burden on individuals. For virtually everyone earning between ¾ and 1½ average earnings, burden of income tax, NICs and indirect taxes has increased since 1978-79. (For married man, 2 children, on average earnings from 32.0 per cent to 33.8 per cent.) But for everyone in this group, real take home pay has increased by about 20 per cent since 1978-79.

(ix) Income tax reductions offset by increased burden of employees' NICs? Compared with 1978-79 indexed tax regime, income tax reduction (down by £12 billion) far outweighs increase in employees' NICs.

Contact point: Miss C Evans (FP) 270 5170

ANNEX

Table 1: Total taxation (including local authority (LA) rates) and NICs as percentage of GDP (at market prices)

	Excluding North Sea taxes	North Sea[1] taxes	Total, incl. North Sea taxes
1970-71	36.2	0	36.2
1974-75	35.7	0	35.7
1978-79	33.5	0.3	33.8
1979-80	34.0	1.1	35.1
1980-81	34.8	1.7	36.4
1981-82	36.9	2.5	39.4
1982-83	36.4	2.8	39.2
1983-84	35.8	2.9	38.6
1984-85	35.5	3.6	39.2
1985-86	35.4	3.1	38.6
1986-87 (est)	36.9	1.3	38.2
1987-88 (est)	37.0	1.0	38.0

(1) Includes North Sea corporation tax before ACT set off.

Table 2: Total non-North Sea taxation and NICs as percentage of non-North Sea GDP

1970-71	36.2
1974-75	35.7
1978-79	34.1
1979-80	35.2
1980-81	36.2
1981-82	38.8
1982-83	38.4
1983-84	37.9
1984-85	37.8
1985-86	37.2
1986-87 (est)	37.7
1987-88 (est)	37.8

Table 3: Breakdown as percentage of GDP (at market prices)

	1978-79	1982-83	1986-87	1987-88
Income tax	11.1	10.8	10.0	9.7
Employees' NICs	2.4	3.3	3.4	3.4
Sub-total	13.4	14.0	13.4	13.1
Corporation tax (non-North Sea)	2.2	1.8	2.9	3.3
North Sea taxes(1)	0.3	2.8	1.3	1.0
Other(2)	-	-	-0.3	-0.2
Capital taxes	0.5	0.5	0.7	0.8
Employers' NICs and NIS	4.8	4.2	3.6	3.6
LA rates	3.4	4.3	4.1	4.1
Taxes on expenditure(3)	9.3	11.5	12.5	12.4
Total	**33.8**	**39.2**	**38.2**	**38.0**

(1) Includes North Sea corporation tax before ACT set off.
(2) Includes North Sea ACT set off and royalties accruals adjustment.
(3) Includes stamp duty.

Table 4: Balance of taxation

	Per cent of total taxes and NICs			
	1978-79	1982-83	1986-87	1987-88(est)
Income tax	32.8	27.5	26.3	25.6
Employees' NICs	7.0	8.3	8.8	8.9
Sub total	39.8	35.8	35.2	34.5
Corporation tax (Non-north sea)	6.5	4.7	7.6	8.7
North Sea taxes(1)	1.0	7.1	3.3	2.5
Other(2)	0.0	0.1	-0.8	-0.5
Capital taxes	1.4	1.3	1.9	2.1
Total direct	**48.6**	**48.9**	**47.2**	**47.2**
Employers' NICs and NIS	14.1	10.8	9.3	9.4
Taxes on expenditure(3)	27.4	29.3	32.9	32.6
LA rates	9.9	11.0	10.6	10.8
Total indirect	**51.4**	**51.1**	**52.8**	**52.8**

(1) Includes North Sea corporation tax before ACT set off.
(2) Includes North Sea ACT set off and royalties accruals adjustment.
(3) Includes stamp duty.

Table 5: Taxes in real terms

£ billion, 1985-86 prices

	1978-79	1982-83 (est)	1986-87	1987-88 (est)
Income tax	36.1	35.3	37.2	37.2
Employees' NICs	7.7	10.7	12.5	12.8
Sub-Total	43.9	45.9	49.7	50.0
Non-North Sea Corporation tax	7.1	6.0	10.8	12.6
North Sea taxes(1)	1.1	9.1	4.7	3.6
Other(2)	-	0.1	-1.2	-0.7
Capital taxes	1.6	1.6	2.6	3.0
Employers' NICs and NIS	15.6	13.9	13.2	13.6
LA rates	10.9	14.1	15.0	15.6
Taxes on expenditure(3)	30.2	37.6	46.5	47.2
Total	**110.3**	**128.3**	**141.4**	**145.0**

(1) Includes North Sea corporation tax before ACT set off
(2) Includes ACT set off and royalties accruals adjustment
(3) Includes stamp duties

CC4 ALTERNATIVE BUDGETS

[See also Industry Act forecast of UK economy (Brief B1), Pay (BB7), Employment and unemployment (BB8), Fiscal policy (C4), Income tax: main changes (D1), National Insurance contributions (DD5), Inheritance Tax (IHT): details (EE1), Wider share ownership (including Personal Equity Plans) (EE3), Business taxation: other provisions (FF2), Business Expansion Scheme (BES) (FF3), VAT and small businesses: details (FF4), Industrial research and development (FF5), VAT: tax avoidance (principally partial exemption) (HH4), Labour Party proposals (J1) and SDP/Liberal Party proposals (J2)]

Factual

(All costings, employment effects and forecasts are organisations' own. 1987-88 unless otherwise stated.)

CBI

Published Budget representations on 19 January.

(i) Proposed 'enterprise package':

(a) expand 'Support for Marketing Initiative' (£10 million);

(b) allocate 1 per cent of major spending Departments' R&D budgets to small firms;

(c) 100 per cent capital allowance on investment up to £25,000 for firms paying lower rate of corporation tax (£375 million, average annual cost over five years);

(d) extend Business Expansion Scheme (BES) to give relief for 'connected persons' (£20 million; £50 million full year);

(e) extended Business Asset Relief for IHT to 10 per cent (£20 million; £65 million full year);

(f) exemptions from VAT penalties and full relief on bad debts (not costed).

Total cost of enterprise package: £50 million 1987-88; £500 million full year.

(ii) Wanted increased infrastructure spending (£300 million 1987-88 and full year).

(iii) Proposed 5 per cent real increase in personal allowances (£850 million 1987-88; £1.1 billion full year).

(iv) Total cost of Budget proposals (net of unexplained 'feedback effect') £1.6 billion, to be financed within limits set by Medium Term Financial Strategy.

TUC

(i) Wanted increased public expenditure (over and above Autumn Statement provision):

(a) NHS and local authorities' health and social services (£600 million).

(b) Education (£1,000 million).

(c) Aid to industry:

- to exporters (£140 million);
- local economic development and encouraging co-operatives (£100 million);
- regional policy (£300 million);
- adult training (£170 million);
- employment measures, including raising payments to those on Community Programme (CP) and Youth Training Scheme (YTS) (£500 million);
- increased public sector infrastructure and repairs spending (£2.4 billion).

Total expenditure (less CP and YTS increases, see below): £4.85 billion.

(ii) Proposed tax and benefit package:

Spending on:

(a) increased child benefit by £3 a week and increased single parent allowance by £2 (£1,200 million);

(b) increased invalid care allowance by £8 (£20 million);

(c) extended long-term supplementary benefit (£400 million);

(d) increased state retirement pension (£5 a week, single person, £8 married couples) (£1,450 million).

NB TUC classified CP and YTS increases at (i)(c) as 'benefits'. Whole 'benefits' package costed at £3.4 billion.

Taxation

(a) restore investment income surcharge (£395 million);

(b) reduce threshold of capital gains tax (CGT) in line with income tax thresholds; abolish CGT relief for gifts and exemptions on life assurance policies (£320 million);

(c) introduce IHT on lifetime transfers and not index IHT (£95 million);

(d) restrict mortgage interest relief to basic rate (£379 million);

(e) increase advance corporation tax (£460 million);

(f) abolish BES (£75 million);

(g) increase resources devoted to detecting tax evasion (£130 million revenue).

Total revenue from tax package; £1,890 million.

(iii) Budget expansion of £6.5 billion would be financed from borrowing.

(iv) TUC forecast unemployment register would fall by well over 500,000, from effects of first year of measures. Estimated inflation would rise by less than 2 per cent. (Both figures based on assumption Britain reflates alone: figures slightly more favourable if part of internationally co-ordinated expansion).

Labour Party

Issued "Investing in People" (14 October) which included summary of major economic policies. Proposals also reiterated frequently in speeches by Shadow Cabinet (eg Mr Kinnock (2 October) and Mr Hattersley (30 September) at Labour Party Conference). Latest version in "Programme of National Renewal", published 11 March. (See also J1.)

(a) 5 year Medium Term Employment Strategy (MTES) (with 10 year 'planning horizon' designed to promote industrial reconstruction and increase employment);

(b) target of reducing unemployment (by creation of 1.2 million jobs) by one million within two years of taking office through jobs package:

- aid to industry, including reducing employers' National Insurance contributions (NICs) (250,000 jobs);
- infrastructure and public sector capital spending (250,000);
- training measures (300,000);
- increased expenditure on various services (300,000);

(c) in first year of office, increase PSBR by £6 billion, primarily to finance jobs package;

(d) increase taxation of 'richest 5 per cent' by £3.6 billion to restore tax reductions since 1979. (See J1 for details and programme designed to finance);

(e) priority areas for increasing public expenditure (usually not costed by Labour Party) include health, social security (including pensions), education, job creation and infrastructure investment;

(f) increased 'social ownership' including re-nationalisation of utilities and support for municipal and co-operative enterprise. (See also EE3.)

SDP/Liberal Party

Published "The Time has Come", 26 January, (see also J2) which included summary of economic policies. Also frequently re-iterated by spokesmen (eg Dr Owen MP at SDP conference on 17 September, David Steel MP at Liberal Assembly on 26 September, Roy Jenkins MP at London Business School on 22 January). Alternative budget published 10 March.

Main proposals included:

(a) incomes policy, including rebate on employers' National Insurance contributions when settlements below inflation; 'inflation tax' kept in reserve if that incentive fails and use of comparative studies of public and private sector pay rates in negotiation of former's pay;

(b) join Exchange Rate Mechanism of European Monetary System as soon as possible (eg favoured joining at exchange rates prevailing in September 1986);

(c) increase PSBR by £2.1 billion;

(d) priority areas for increased public expenditure (usually not costed by SDP/Liberal Party) include employment measures, public sector capital spending (by £1 billion a year for 3 years), social security (including pensions), health, education and housing;

(e) Shadow Treasury spokesmen reported in May 1986 as telling their Parliamentary colleagues calls for increased public expenditure to be limited to total £10 billion in full year.

Positive

(i) Firm financial framework, has brought inflation to lowest levels for 20 years, creating conditions for growth of (just under 3) per cent a year since 1981 and million new jobs since 1983 election.

(ii) Many of Labour Party/TUC and SDP/Liberal Party proposals would create distortions and rigidities in economy, damaging prospects for jobs and growth.

(iii) Labour Party proposals would be highly inflationary. As inflation and interest rates rose, jobs would be destroyed in longer term.

Defensive

(i) Allocate 1 per cent of major Departments' R&D to small firms: See FF5.

(ii) Capital allowances for firms on lower CT rate: See FF2.

(iii) Extend BES to 'connected persons': See FF3.

(iv) Extension of Business Asset Relief from IHT: See EE1.

(v) CBI VAT proposals: See HH6.

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(vi) Increased infrastructure/public sector capital spending: Government finding room for worthwhile public sector capital projects, within framework of MTFS, which is best way to encourage sustained growth and investment in economy as whole. (See also B1.)

(vii) Personal allowances: See D1.

(viii) Fiscal boost needed: See C4.

(ix) Public expenditure better than tax cuts for cutting unemployment: See C4.

(ix) Increased NHS/social services spending: NHS spending up 26 per cent in real terms between 1978-79 and 1986-87. Spending by local authorities on personal social services increased by over 20 per cent in real terms over same period.

(x) Increased education spending: Education shows largest increase for any programme for 1987-88 on previous year. Spending per pupil at record level. Record 123,300 graduates in 1985.

(xi) Help for exporters: Export Credit Guarantee Department's fixed rate export finance estimated to support flow of exports of up to £2½ billion a year to 1989-90.

(xii) Regional policy/local economic development: Regional policy reformed in 1984 to make incentives much more cost effective in achieving main target of creating jobs. Expenditure on new Regional Development Grants expected to rise by some 30 per cent (in cash terms) between 1986-87 and 1989-90. Recent falls in unemployment spread across most regions.

(xiii) Why no action on unemployment measures in Budget? See BB8.

(xiv) Labour Party proposals for increasing public services employment: Simple to create non-jobs by hiring more public sector employees indiscriminately. Government believes in helping to create conditions for more real jobs in economy.

(xv) Social ownership: Really renationalisation under another name. Bound to mean Government interference in management, with heavy costs in terms of efficiency and performance.

(xvi) Reduce employers' NICs: See DD5.

(xvii) Incomes policy, inflation tax and public sector comparability: See BB7.

Contact point: A Tyrie (Special Adviser) 270 4529

DD1 BLIND PERSON'S ALLOWANCE

Factual

(i) Allowance for blind increased by £180 from £360 to £540. Where husband and wife are both blind, allowance goes up from £720 to £1,080.

(ii) Allowance £180 in 1978-79 (same since 1975-76). Last increased in 1981 (when also raised by £180).

(iii) Estimated revenue cost: £2 million in 1987-88 and 1988-89.

(iv) Staff cost: Negligible.

(v) About 45,000 blind people benefit.

Positive

(i) Gives substantial benefit to blind, including working blind.

(ii) Real value of allowance now higher than at any time since mid 1970s.

(iii) (a) Since 1978-79 benefit expenditure for long term sick and disabled has risen by 75 per cent in real terms to 1986-87.

(b) In cash terms, spending on long term sick and disabled has increased from around £2 billion in 1978-79 to nearly £6 billion in 1986-87.

Defensive

(i) Why not introduce specific cash benefit for blind?

(a) Need to consider case for social security blindness allowance alongside other claims for extra resources for disabled. Successive Governments have sought to concentrate resources on provisions that help all disabled people.

(b) DHSS undertaking major survey of disabled to provide comprehensive and up-to-date information about numbers, circumstances and needs of disabled people. Will provide basis for reviewing overall provision for all disabled.

(c) Blind people will qualify for disablement premium under new income support scheme.

(ii) Why not extend allowance to other disabled people? Tax system not designed to cope with defining and identifying wide range of categories of disablement. Blind allowance exception: goes to small, readily identifiable group (registered blind). Social security system generally more effective way of targeting help on disabled.

(iii) Why not increase each year? All personal allowances reviewed each year. Changes depend on Budget priorities.

Contact point: B A Mace (Inland Revenue) 2541 6546

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DD2 INCOME TAX: OTHER CHANGES

[See also Income tax: main changes (Brief D1)]

Brief contains:

A TAXATION OF INCOME SUPPORT FOR UNEMPLOYED AND STRIKERS

B DEDUCTION OF TAX FROM ANNUITIES, INTEREST ETC

C COMPOSITE RATE (CR)

D CONSTRUCTION INDUSTRY TAX DEDUCTION SCHEME: RATE OF DEDUCTION

E VISITING ENTERTAINERS AND SPORTSMEN

F EFFECT ON COVENANTS

G ADDITIONAL RATE ON TRUSTS

A TAXATION OF INCOME SUPPORT FOR UNEMPLOYED AND STRIKERS

Factual

(i) Supplementary Benefit (SB) paid to unemployed and strikers for their families taxable since 1982. SB to be replaced from April 1988 by Income Support (IS). Legislation in 1987 Finance Bill to make similar payments of IS taxable.

(ii) Staff cost and yield: Negligible. Intended to maintain present tax treatment so far as differences in two benefits allow. Estimated yield from taxing benefits (SB and unemployment benefit) paid to unemployed £400 million in 1986-87.

(iii) Opposition speakers in 1981 Finance Bill debates confirmed principle of taxation of short-term benefits agreed (OR 11 May 1981 vol 4 col 492 et seq).

Positive

(i) Unemployment benefit (UB) taxable. Fair that IS paid in lieu of UB should also be taxable.

(ii) Similarly, if IS paid to unemployed taxable, only fair should be taxable when paid to strikers.

(iii) If not taxable, person whose income includes benefit would pay less tax than person with same income, all from earnings.

Defensive

(i) Government attack on unemployed and strikers: Legislation on IS will simply preserve existing tax treatment of SB.

WPU

(ii) Taxing strikers' benefit vindictive: Successive Governments have supported principle that income replacement benefits (such as UB) should be taxable. If unemployed's is taxable, only fair that striker's also taxable.

(iii) Does Government intend to bring invalidity benefit into tax? Principle not in dispute. Still considering timing. Depends on general taxation policy and also on staffing and operational considerations.

Contact points: J D Farmer (Inland Revenue) 2541 7652
I Fraser (Inland Revenue) 2541 7763

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B DEDUCTION OF TAX FROM ANNUITIES, INTEREST ETC

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Where right or obligation to deduct tax at basic rate from annuities, other annual payments (eg alimony), interest, royalties etc, rate at which deduction to be made reduced to 27 per cent after 5 April 1987. For majority of taxpayers deduction of basic rate tax at time of payment finalises basic rate tax liabilities of both payer and recipient.

(ii) For UK Government securities and foreign dividends paid in UK, deductions at 29 per cent permitted for one month after passing of Resolution, but over-deduction to be adjusted later by tax office on production of evidence of over-deduction.

(iii) For annuities, annual payments (including alimony), royalties and other annual interest, payer must make good any over-deduction.

(iv) When Provisional Collection of Taxes Act Resolution giving statutory effect to basic rate of 27 per cent has been passed, Inland Revenue will issue circular (available from tax offices) outlining details.

Contact point: B O'Connor (Inland Revenue) 2541 6218

WPU

C COMPOSITE RATE (CR)

Factual

(i) CR is rate banks, building societies, licensed deposit-takers and local authorities pay to Inland Revenue as tax deducted from interest paid to depositors.

(ii) Rate based on tax rates and tax status of investors in 1986-87. For transitional period up to 1988-89, pending full survey of depositors in banks and other deposit taking institutions, rate calculated by reference to evidence of interest paid by building societies and estimates of movements in components of personal incomes.

(iii) CR for 1987-88: 24.75 per cent (25.25 per cent in 1986-87). Fixed by Statutory Instrument (SI 1986 No 2147), 17 December 1986.

(iv) Section 26 Finance Act 1984 provides for CR to be fixed on preceding year basis.

(v)
- Benefit of 1986-87 basic rate cut reflected in CR 1987-88.
- Benefit of 1987-88 basic rate cut will work through to CR in 1988-89.

Positive

Preceding year basis introduced in 1984 at request of banks.

Defensive

(i) Why not further reduce CR to match basic rate cut? Benefit of basic rate cut will feed through in 1988-89. CR at 24.75 per cent still well below 27 per cent basic rate.

(ii) Why CR set on preceding year basis? To meet operational requirements of banks operating CR scheme.

(iii) Remove CR from children's and other non-taxpayers' savings accounts. CR introduced to bring bank and building society interest into line. Building society interest subject to CR for many years. CR is reduced rate which reflects fact that some depositors liable to tax and others not. Because of disadvantage to non-taxpayers, Government decided to exclude Department of National Savings from CR coverage to retain means by which interest could be paid gross.

Contact point: B O'Connor (Inland Revenue) 2541 6218

D CONSTRUCTION INDUSTRY TAX DEDUCTION SCHEME: RATE OF DEDUCTION

Factual

(i) Under special tax deduction scheme for construction industry, payments to sub-contractors who do not hold exemption certificates must be made under deduction of sum on account of tax.

(ii) With effect from 2 November 1987, rate to be fixed at 27 per cent, in line with basic rate.

(iii) Until 1 November 1987, deductions should continue to be made at 29 per cent.

(iv) Guidance and new ready-reckoners will be sent to all contractors in the industry before change in rate takes effect.

(v) Cost: Reduction in yield of £15 million in 1987-88; £45 million in 1988-89; for following years £30 million a year.

Positive

(i) No automatic connection between basic rate of income tax and construction industry rate but convenient for industry. Basic rate and construction industry rate have remained in step for last five changes of rate.

(ii) Any reduction in rate of deduction is help at margin to cash flow of uncertificated sub-contractors.

Defensive

(i) Why time lag (April to November)? Matches timetable for last four changes of rate. Necessary because of need to have instructions and literature printed and distributed. (Every contractor notified individually.)

(ii) Would be possible to take statutory power to operate new rate from earlier date - but industry has become used to November change. Earlier implementation would not be universally popular.

Contact point: C D Sullivan (Inland Revenue) 2541 6401

E VISITING ENTERTAINERS AND SPORTSMEN

Inland Revenue issued Press Notice on 13 March.

Factual

(i) Finance Act 1986 introduced framework for new rules to withhold tax at source from UK earnings of non-resident entertainers and sportsmen. Detailed scheme to be contained in regulations.

(ii) Timetable

- Draft regulations issued 19 December 1986.
- Comments requested by 16 February 1987.

(iii) Announcement by Financial Secretary on 13 March (in reply to arranged Question) that regulations will be laid on 26 March and scheme will come into effect on 1 May 1987.

(iv) Financial Secretary's statement also indicated that

- payments received from sale of records would be excluded from scope of regulations;
- de minimis limit below which withholding tax need not be deducted will be increased to £1,000 (as compared with £500 in draft regulations);
- number of other changes would be made to administrative arrangements affecting new scheme.

(v) Withholding will apply to payments connected with performer's appearance in UK; covering endorsements and sponsoring payments as well as fees and prizes.

(vi) Yield: About £75 million 1987-88; about £100 million in 1988-89.

(vii) Representations: 61 representations received (broadly, one third from record industry, one third from professional advisers, one third from other interested parties).

(viii) Those affected: About 10,000 people within new scheme - including tennis players, golfers, motor racing drivers, pop and film stars, actors and musicians.

Positive

(i) Stops major tax loophole. Current yield of £2 million from this source.

(ii) Most other major countries (eg US, Canada, France, West Germany) already have withholding tax scheme.

(iii) Regulations take account of representations received, together with Ministerial and official meetings with number of representative bodies.

Defensive

(i) Singling out entertainers and sportsmen: Many countries, and OECD as whole, recognise this group calls for special rules. Often earn huge amounts in very brief visits.

(ii) Disincentive for performers to visit UK? Most other major countries already have withholding tax. Scarcely affects UK as cultural and sporting centre. Double taxation agreements often mean little or no overall impact on tax bill of individual performer.

(iii) Financial burden on arts and film industry: Accept additional compliance cost on payers. Layman's guide to be issued shortly. Provision for arrangements on level of withholding tax alleviates burden on payers.

Contact point: J P B Bryce (Inland Revenue) 2541 6372

F EFFECT ON COVENANTS

Inland Revenue issuing Press Notice on Budget Day.

[See also Budget and charities (Brief KK1)]

Factual

(i) Basic rate tax deducted from covenant payments; repayable to recipient where appropriate.

(ii) Basic rate reduction means

(a) for "gross" covenants, covenantor has to increase net payment (eg if covenant is to pay £100 less tax, has to increase net payment from £71 to £73);

(b) for "net" covenants, covenantor continues to pay same net sum (eg £71 if covenant is to pay £71 after tax at current rate) but tax repayment available to recipients (eg charities) slightly reduced because net payment grossed up at 27 per cent rather than 29 per cent.

Positive

Cut in basic rate increases individual's net income, so more available for charitable giving if he wishes. 1986 Budget tax changes encourage this. Payroll giving scheme starts 6 April 1987. (See KK1.)

Defensive

(i) People with gross covenants have to increase net payment. Yes, since less tax to deduct. But they pay correspondingly less tax on their own income.

(ii) Charities lose out on net covenants. Repayment is reduced slightly but inevitable result of basic rate reduction. General tax reduction and 1986 special incentives for charitable giving will encourage donors to give more.

Contact points: C Stewart (Inland Revenue) 2541 7414
Mrs E Fletcher (Inland Revenue) 2541 7784

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G ADDITIONAL RATE ON TRUSTS

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Additional rate (in addition to basic rate) charged on income of discretionary and accumulation trusts; 16 per cent 1986-87; 18 per cent 1987-88. Rate goes up because it is fixed automatically by legislation as difference between basic rate and second higher rate (45 per cent).

(ii) Beneficiaries get credit for basic and additional rate tax when income distributed to them.

Defensive

(i) Wrong to increase rate on trusts: Additional rate charge broadly represents higher - not basic - rate liability. Higher rates not being reduced.

(ii) Charge unfair on eg orphans' trusts, small trusts: When income distributed, beneficiaries get full credit for tax paid by trustees. Can claim repayment of additional rate tax if basic rate taxpayers, plus basic rate tax if non-taxpayers.

Contact points: C Stewart (Inland Revenue) 2541 7414
Mrs E Fletcher (Inland Revenue) 2541 7784

DD3 TAXATION OF BENEFITS IN KIND

A CARS AND CAR FUEL

Inland Revenue issuing Press Notice on Budget Day.

[See also Excise duties (Brief G1)]

Factual

(i) Scale charges announced year in advance. Added to recipient's income and taxed at marginal tax rate.

(ii) Car benefit scale charge to be increased by 10 per cent for 1988-89. Policy is to increase scale charge gradually until it reflects true benefit.

(iii) Cash breakpoints (ie thresholds at which higher scale charges apply) for expensive cars and cars without engine rated in ccs to remain unchanged. Scale charges for these cars increased by 10 per cent.

(iv) Car fuel scale charges: No change for 1988-89.

(v) Announced in 1986 Budget that from 1987-88 car fuel scale also to be used for VAT scale charge (used to assess VAT payable on petrol used for private journeys in business cars) where fuel provided from business resources for private motoring by registered traders and their employers.

(vi) Special rules remain without change for 1988-89.

- Car and car fuel charges halved where car used for 18,000 or more business miles in tax year.

- Car scale charges increased 50 per cent where car is second company car or does less than 2,500 business miles in tax year.

(vii)
- Separate and lower car scale charges where car more than 4 years old. Scale charges for older cars about one third lower than for newer cars.

- No change in relativity for 1988-89.

(viii) Main scales proposed for 1988-89 (1987-88 in brackets)

(a)

Cars	**Scale charge/£**		**Tax payable (1988-89)* £ Year**	**Week**
1,400cc & below	580	(525)	156.60	3.01
1,401cc - 2,000cc	770	(700)	207.90	3.99
over 2,000cc	1,210	(1,100)	326.70	6.28
Original market value				
£19,250 - £29,000	1,595	(1,450)	430.65	8.28
over £29,000	2,530	(2,300)	683.10	13.13

(b) **Car fuel**	**Scale charge/£**		**Tax payable (1988-89)* £ Year**	**Week**
1,400cc & below	480	(480)	129.60	2.49
1,401cc - 2,000cc	600	(600)	162.00	3.11
over 2,000cc	900	(900)	243.00	4.67

* assuming basic rate (ie 27 per cent) taxpayer

(ix) Changes made by Treasury Order to be laid around June, giving time for details to be fully absorbed. No legislation needed in Finance Bill.

(x) - Extra yield (excluding VAT): £30 million in 1988-89.

- Total yield (excluding VAT) from taxing car and car fuel benefits: £460 million in 1987-88; £530 million in 1988-89.

(xi) In terms of tax, average company motorist driving 1,600cc car less than 4 years old will pay about £4 a week in tax for his car (assuming basic rate for 1988-89 of 27p) compared with £3.63 in 1987-88. He will pay further £3.11 a week if gets fuel too.

(xii) Car scale engine-size breakpoints changed with effect from 1987-88 to align with EC Directive. Will help UK motor industry to adapt to new emissions requirements.

Positive

(i) Car benefit scale charges increased by 10 per cent for fourth year in succession. Further modest step towards taxing benefit on realistic basis. Scale charges still well below true value of benefit.

(ii) Total tax payable in 1988-89, by basic rate employee, on benefit of 1,600cc company car (eg Sierra) available for private use plus free petrol only £7.10 per week. (Half if car does high business mileage.)

(iii) Applying fuel scale charge to VAT scale charge simplifies previous arrangements for restricting amount of input tax that can be offset against VAT where fuel provided for private use.

Defensive

(i) Car benefit increase too high: Car scales fall far short of cost to individual of running own car. Basic rate taxpayer would have to earn around additional £3,000 gross to compensate if benefit withdrawn, if running 1,600cc car. By contrast tax charge (car and fuel) only £370.

(ii) Increases

- For 1,600cc car user (assuming taxed at 27 per cent basic rate) increase over 1987-88 only 36p per week in tax paid.
- For cars less than 1,400cc, increase 29p per week.
- For cars over 2,000cc, increase 57p per week.

And no increase in car fuel charge for 50-60 per cent of company car users who also get free fuel.

(iii) Further increases in future: Aim to arrive at realistic figures gradually but no specific target in view.

(iv) Change hits real business motorist. Scales halved for those driving 18,000 or more business miles a year.

(v) Should be lower charge for diesel cars. Scale charges designed for simplicity. Each band covers broad range and many diesel cars now in same band as equivalent (in terms of performance) (lower cc) petrol driven cars. Already substantially under-taxed.

(vi) No increase in car fuel scale charges: Recognises level of charge already broadly reflects real value of benefit at current petrol prices. Petrol prices little changed since 1986 Budget.

(vii) No increase in cash breakpoints for expensive cars. Until 1986, cash breakpoints increased at same rate as scale charges. Scale charges have increased at more than rate of inflation - eg 10 per cent for last 3 years - so breakpoints have become too generous. As result, benefit of more expensive cars under-taxed relative to less expensive cars. Freezing breakpoints helps correct this.

(viii) Increase £8,500 earnings threshold for taxing benefits: Benefits in kind just as much form of remuneration as pay. Present earnings threshold therefore anomalous. Raising threshold would perpetuate anomaly.

Contact point: Miss A M Rhodes (Inland Revenue) 2541 6303
Mrs J D Tournoff (Inland Revenue) 2541 7764

B TAX RELIEF FOR TRAINING COSTS

Inland Revenue issuing Press Notice on Budget Day.

[See also Employment and unemployment (Brief BB8)]

Factual

(i) By law

- employee liable to pay tax on cost of external training course (ie not run by firm in question) paid for by employer;
- cost of training paid for by employee not deductible for tax;
- costs paid by employer generally deductible in calculating taxable profits.

(ii) But by extra-statutory concession

- cost of job-related course paid for by employer is not treated as benefit in kind in hands of employees earning over £8,500 and directors or emoluments in hands of employees earning below £8,500;
- under 21s do not pay tax on some general training paid for by employer;
- cost of job-related training course paid for by employee is deductible.

(iii) Budget contains proposals to

- extend current relief further by exempting employees from tax on benefit they receive from provision of training for new job provided by employer for employees about to leave (or who have already left) current job;
- ensure that costs of this kind of training will always be deductible in calculating employer's profits.

(iv) Exemption will only be granted where course intended solely to provide skill or knowledge employee needs for new job or business. Details will be contained in Finance Bill.

(v) Cost: No firm estimate but likely to be small.

(vi) Relief effective from 6 April 1987, available to people already on training courses on that date.

(vii) Redundancies just over 50,000 in 1986Q3 and on falling trend.

(viii) No firm estimate of how much industry spends on this type of training but unlikely to exceed £5 million.

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Positive

(i) Training and retraining vital to flexible and competitive economy. Tax system already provides relief in practice for training for present or prospective job with same employer. New relief removes a disincentive for employer to provide retraining for people having to change jobs and for employee to undertake such training.

(ii) Provides incentive for people to move into new expanding areas of economy, to acquire new skills for new jobs.

(iii) Improves opportunities for people facing redundancy.

Defensive

(i) Concessionary reliefs should be made statutory. Agree but main priority to provide new relief for people having to change jobs. This cannot be done by extra statutory concession. Concessionary reliefs can be made statutory when time and space permit.

(ii) Duplication of Manpower Services Commission (MSC) provision? No. Encourages greater training by removing tax disincentive. Complements MSC's efforts.

(iii) Relief should be available where employee pays. Large deadweight cost - perhaps up to £50 million - and administratively cumbersome: to deal with claims would require 900 staff. Would be very difficult to prevent relief for purely recreational courses.

(iv) Help predominantly for public sector employers? No, although some public sector employers (eg British Coal) already provide this help, relief will encourage all employers to do so.

(v) Exempt other benefits: All benefits form of remuneration. Right they should be taxed as such. Special treatment justified in this limited area because of importance of encouraging retraining for improved job opportunities.

(vi) Comparison with employer subsidised nurseries (ESN):

(a) ESN are form of remuneration and should be taxed as such. Benefit of subsidised place can be worth up to £3,000 a year. Exemption would help only favoured few (about 2,000 places) and be unfair to great majority who have to pay for child care out of taxed income.

(b) Tax for ESN not sought for back years in view of past misunderstandings of correct tax treatment. Now everyone knows benefit taxable and tax due from 6 April 1985.

(c) Training has special importance to economy.

Contact points: Miss A M Rhodes (Inland Revenue) 2541 6303
S S Wilcox (Inland Revenue) 2541 7211

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DD4 MORTGAGE INTEREST RELIEF

Inland Revenue issuing Press Notice on Budget Day.

[See also Interest and exchange rates (Brief CC1), Income tax: main changes (D1), Miscellaneous savings measures (EE4), Green Paper on personal tax reform (H3), Labour Party proposals (J1) and SDP/Liberal Party proposals (J2)]

Factual

(i) - Mortage interest relief limit to be £30,000 for 1987-88.

- Unchanged since 1983-84 increase from £25,000.

(ii) Cost: £5 billion in 1987-88.

(iii) Statutory indexation does not apply to mortage interest relief ceiling; has to be re-set each year (otherwise would be no limit on relief).

(iv) Indexation in line with RPI increase since 1978-79 would produce ceiling of £48,000; since last increase (1983 Budget) £36,000.

(v) MIRAS: Deduction of mortgage interest relief at source.

- For most taxpayers, mortgage interest relief now given at source rather than through tax codes. Minor lenders outside scheme altogether; lenders within scheme required from April 1987 to bring all new loans, including those over limit, within scheme.

- Higher rate relief not given through MIRAS but by tax offices.

(vi) - From 6 April 1987, income tax deducted from mortgage by lender under MIRAS to be at new basic rate of 27 per cent (see D1).

- Net payments of interest will increase slightly as result by £2 for every £71 payable now.

- But in some cases lender may consider short extension of repayment period rather than increase in monthly payments.

(vii) Cost of housing

- Average price of homes in UK purchased through building society £37,900. (1986Q4)

- Average new mortgage £26,400 (1986Q4).

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(viii) Effect on average mortgage holder within MIRAS scheme: Will generally be small increase in interest payments to be made eg on home purchase loan of £20,000 at rate of interest of 12.25 per cent:

	£ per month
Gross interest payable	204.16
net monthly interest at 29 per cent	144.95
net monthly interest at 27 per cent	149.03

(ix) **[NOT TO BE VOLUNTEERED:** About 500,000 non-taxpayers who have mortgages will face increased mortgage payments but will not benefit from Budget tax cuts but fall in mortgage rate of 0.35 per cent sufficient to offset this.]

(x) Between 1978-79 and 1986-87 mortgage interest relief increased by £3.4 billion from £1.1 billion to £4.5 billion. About £2 billion attributable to growth in average mortgage outstanding; remaining £1.4 billion attributable to increased number of mortgagors, after taking account of increased value of average mortgages. (Since 1983-84 cost includes cost of relief for mortgages previously under option mortgage scheme.)

(xi) Prime Minister given several public assurances mortgage interest relief will be retained eg:

> "The Conservative Party and the Government are now the only people who do not want to limit in any way the present system of mortgage interest tax relief for home buyers." (5 February 1987 OR vol 109 no 46 col 1139.) (See also 30 October 1986 OR vol 103 no 166 col 446.)

(xii) Labour Party

- Policy brief issued on 4 February stated Labour Party propose to limit mortgage interest relief to basic rate relief only.
- Dr McDonald MP said "We wish to limit mortgage tax relief to the standard rate .... Higher rate taxpayers do not need to receive this relief at the higher rate .... we should not continue relief at the higher rate." (17 July 1986 OR vol 101 no 152 col 1259).

(See also J1.)

(xiii) SDP/Liberals' 'The Time Has Come", published 26 January, stated "Mortgage tax relief has assisted millions of people to buy their own homes and we will retain it. We do not believe, however, that the present situation, whereby the better off benefit most from this relief is fair. We would therefore confine mortgage rax relief to the basic rate of tax." (See also J2.)

(xiv) Other views:

- TUC want to retain relief at basic rate and abolish relief at higher rates.

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DD4

- Housing Associations' report, published July 1985, chaired by Duke of Edinburgh, suggested relief should be phased out and replaced by "needs related housing allowance".

- Duke of Edinburgh repeated view in article in 'The Times', 7 October.

- Relief also criticised in Church of England report "Faith in the City", December 1985.

- Michael Heseltine MP reported in 'Independent', 29 October, as stating in speech to National Housing and Town Planning Council that mortgage tax relief should be phased out for second-and third-time house buyers but desirable to continue with relief for first-time buyers.

(xv) Restricting relief to basic rate only would save about £350 million of total cost of £5 billion.

(xvi) Limits on supplementary benefit help with mortgage interest: Government now meeting only 50 per cent of mortgage interest for under-60s in first 16 weeks of claim. Regulations announced 10 December by PUSS DHSS (OR vol 107 no 21 col 341). Change implemented from 26 January. DHSS criticised by Opposition and some Conservative backbenchers. SB claimants used to receive 100 per cent help with mortgage interest from beginning of claim.

(xvii) Approximately £1 billion current revenue subsidy for public sector housing. Gross capital expenditure on public sector housing in 1987-88 about £3½ billion.

Positive

(i) Mortgage interest relief helps over 8 million home-owners.

(ii) Government fully committed to retention of relief.

(iii) Owner occupation at highest ever level: 63 per cent of all dwellings in UK.

Defensive

(i) Why no increase in limit? Limit reviewed every year; need to balance relief for home-owners against competing claims. 89 per cent of outstanding mortgagors at 1 April 1987 still within it.

(ii) Why repayments increasing? Reduction in income tax basic rate means less tax relief. But repayments to be made out of net income which for most mortgagor has increased as result of lower tax rate.

(iii) Position of non-taxpayers: [**IF PRESSED:** True will face increased mortgage payments without benefit of Budget tax cuts. But many will get increased supplementary benefits to compensate.]

(iv) Relief should be given at basic rate only. No. £30,000 provides limit to relief.

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(v) Relief should be abolished entirely. Relief shows Government commitment to encouraging home ownership. Withdrawal would adversely affect many households.

(vi) Relief distorts housing market. Many other factors also affect house prices. Relief reflects Government's commitment to encourage owner occupation.

(vii) Why has cost of relief increased from 1986-87 to 1987-88? Mainly reflects increase in stock of mortgages eligible for relief (not increase in house prices).

(viii) Government limits on supplementary benefit help with mortgage interest sentence thousands of unemployed to homelessness? Nonsense.

- Most vulnerable groups (over-60s, those out of work over 6 months) still to receive 100 per cent help. After 16 weeks claimants affected can claim interest on arrears which will assist lenders to reschedule loans.

- Proposals will create room for individuals to help themselves eg through taking out mortgage protection policies against short-term interruption of earnings. Not fair that taxpayer should have to underwrite these forms of support from first day on benefit.

- Important to keep in perspective: estimated that changes might affect 75,000 claimants at any one time, out of 6 million borrowers from building societies.

(ix) Stop couples living together getting double relief. See H3.

Contact point: B O'Connor (Inland Revenue) 2541 6218

WPU

DD5 NATIONAL INSURANCE CONTRIBUTIONS (NICs)

[See also Pay (Brief BB7), Profit related pay (PRP) (D2) and Effects of tax and National Insurance contribution changes on living standards (D3)]

Factual

(i) Government announced in Autumn Statement on 6 November (OR vol 103 no 171 col 1085-6) following limits and reduced bands for those contracted in to National Insurance scheme during 1987-88:

Weekly earnings	Employee's rate per cent	Employer's rate per cent
Below £39 (LEL)(1)	0	0
£39 - £64.99	5	5
£64.99 - £99.99	7	7
£100 - £149.99	9	9
£150 - £295	9	10.45
Above £295 (UEL)(2)	9 on £295	10.45

(1) lower earnings limit
(2) upper earnings limit

(ii) Opposition Parties' NIC proposals

(a) Labour Party

- abolish UEL for employees ("Social Security and Taxation");
- cut employers' NICs ("New Jobs for Britain").

(b) SDP/Liberals

- "cut of 25 per cent in.... unemployment blackspots through reduced employers' NICs" ("More Jobs in a Fairer Britain");
- integrate employees' NICs with income tax ("The Time Has Come");
- reduce employers' NICs for new employees in first year with firm ("The Time Has Come");
- use of NIC rebates as pay roll incentive ("The Time Has Come") (see BB7).

(iii) NIC trust exemption

- Minister for Social Security announced on 5 February steps to abolish NIC exemption for payments made to employees through trust funds (OR vol 109 no 47 (part II) col 876) to end abuse.

- Draft regulations to be considered by Social Security Advisory Committee.

- To take effect from 6 October 1987 for trusts set up after 1985 Budget (when UEL on employers' NICs abolished); pre-1985 trusts given 3 years' grace to April 1990.

Positive

(i) Main Class 1 rates at same level as in April 1983 despite continuing increase in social security benefit expenditure (up 43 per cent in real terms 1978-79 to 1986-87 and 17 per cent since 1982-83).

(ii) Government has also abolished National Insurance Surcharge (NIS) which would have cost private sector over £4 billion in 1987-88 at 3½ per cent rate Government inherited in 1979.

Defensive

(i) Why not cut employees' rates? Employees' contributions earn benefit rights. Benefit expenditure has increased and employee contribution income of National Insurance Fund must help cover this.

(ii) Why not reduce employers' rate further to help create more jobs? Government has done much already

- NIS abolished.

- 1985 Budget changes will reduce employers' costs at lower end of wage scale by £1,055 million in full year.

- 1987 increase in earnings limits worth £150 million to employers.

But key to reduced costs is moderate pay settlements. (See BB7.) Cannot expect taxpayer to support excessive increases.

(iii) Why not abolish UEL for employees?

- UEL also provides ceiling for additional pension payable under State Earnings Related Pension Scheme (SERPS) and for guaranteed minimum pensions paid by contracted-out occupational pension schemes. If abolished, contracted-out employers would have to pay much greater guaranteed pensions and Government would also have to pay pensions based on very high earnings.

- All those earning above £15,340 a year would pay up to an extra 9p on every £1 earned.

- Someone earning eg £20,000 a year would pay up to £8 per week more.

(iv) Why not make LEL a threshold as for income tax allowance (so no payment in respect of earnings below that level)? Would cost about £6½ billion. 1985 Budget changes to NIC rate structure already help low paid.

(v) Why not raise LEL further? LEL linked to level of retirement pension by statute. Taking people out of NICs means depriving them of contributory benefits (eg retirement pension, unemployment benefit etc).

(vi) Abolishing NIC exemption for trusts will hit some existing PRP schemes. Most trusts set up since 1985 Budget are blatant devices to avoid effect of UEL abolition for employers' NICs and have nothing to do with PRP. If ignored, this loophole would have resulted in substantial revenue loss. **IF PRESSED:** Some trusts are used for profit sharing schemes (eg John Lewis Partnership). Trusts set up before 1985 Budget being given 3 years' grace to April 1990 to adjust or modify rules to qualify for new PRP income tax relief.] (See also D2.)

(vii) Why not use NIC system to encourage pay restraint? Incomes policies of all kinds ineffective and introduce distortions into economy. Use of NICs in this context would blur contribution principle too. (See also BB7.)

Contact point: M Gibson (ST1) 270 5053

DD6 EFFECTS ON INCENTIVES AND TRAPS

[See also Income tax: main changes (Brief D1), Effects of tax and National Insurance contribution changes (D3) and National Insurance contributions (NICs)(DD5)]

Factual

(i) Poverty trap

(a) Situation where working families face high effective marginal tax rates (ie increases in gross earnings produce small increases or even decreases in net income) as result of combined effect of income tax, National Insurance contributions (NICs) and withdrawal of income-related benefits.

(b) Families with children receiving Family Income Supplement (FIS) and housing benefit (HB) and paying income tax and NICs would face marginal rates of up to 111 per cent in absence of Budget changes (up from 109 per cent in 1986-87 because of steepening in HB rent taper from April 1987).

(c) Families receiving HB alone and paying tax and NICs could face rates of up to 84 per cent in absence of Budget changes (up from 80 per cent in 1986-87).

(d) - Latest published DHSS estimate is that about 300,000 working families (less than 2 per cent) had marginal tax rates of over 70 per cent in November 1985 (OR 14 January 1986 vol 89 no 36 cols 593-4) compared to about 90,000 in 1979.

- Number likely to have fallen since then mainly because real earnings growth will have floated some families off benefits.

(ii) Unemployment trap

(a) Situation where net income out-of-work close to or even greater than net income in-work. Conventional measure of this is ratio of out-of-work to in-work net income: "replacement ratio".

(b) - Several ways of estimating replacement ratios (depending on assumptions as to period out-of-work and, for those currently unemployed, as to their in-work income).

- But latest DHSS estimate is about 200,000 working families (excluding self-employed) had ratios of over 90 per cent in November 1985 and about 750,000 had ratios of over 80 per cent. Number likely to have fallen since then because of real earnings growth and indexation of out-of-work benefits in line with prices.

(iii) Effect on incentives

(a) Marginal rates

- High marginal rates may encourage people to work fewer hours or to reject better paid jobs. But little evidence. Some studies (eg Treasury funded research by Professor Brown placed in House of Commons Library 18 December (OR vol 110 no 51 col WA 182)) show little short run effect of income tax changes on hours worked. But these do not investigate longer term effects of taxes (eg on enterprise and risk-taking, willingness to train etc) or efficiency losses from high taxation.

- Quoted high rates for those in poverty trap may overstate problem because:

  (1) FIS award runs for whole year, so FIS withdrawal does not affect incentive to earn more in short run.

  (2) Most real world decisions are not about whether to earn small amount more but involve discrete choices eg taking different job or wife going out to work. With large increases in earnings, family may be able to jump clear of trap.

(b) Replacement ratios

- Highest replacement ratios faced by married men with children. But most research evidence suggests their decisions to accept work not very responsive to replacement ratios.

- Other groups (eg juveniles) more strongly affected, even though their replacement ratios generally lower.

- But empirical evidence not clear-cut and some (eg Professor Minford) argue disincentive effects of high replacement ratios are stronger.

(iv) Effects of Budget

(a) Marginal tax rates

- Cut in basic rate will reduce marginal income tax rates by 2 percentage points for 20.8 million basic rate taxpayers of working age (94 per cent of total).

- Increase in income tax allowances will take about 270,000 people of working age out of tax, reducing their marginal rates by 29 percentage points (although earnings growth will mean that number of taxpayers will be greater in 1987-88 than in 1986-87).

- Cut in basic rate means that maximum effective marginal rate in 1987-88 will be 109 per cent for those on FIS and HB (same as in 1986-87) and 82 per cent for those on HB only (up by 2 percentage points from 1986-87).

(b) Replacement ratios

- Increase in allowances and cut in basic rate will raise in-work incomes, reducing replacement ratios for most working families. (In practice, replacement ratios will be further reduced as result of growth in real earnings, since out-of-work benefits indexed in line with prices).

Positive

(i) Cut in marginal rates: Basic rate cut will reduce marginal tax rates by 2 percentage points for 20.8 million taxpayers of working age.

(ii) Unemployment trap: Faster growth of net income in-work as result of income tax cuts will reduce replacement ratios for most working families.

Defensive

(i) Tackling traps not given sufficient priority: Should not overestimate size of problem eg less than 2 per cent of working families have marginal tax rates of over 70 per cent. Unemployment trap eased since 1978-79 by withdrawal of earnings related supplement to unemployment benefit, taxation of unemployment benefit and by more generous in-work benefits (especially FIS).

(ii) Number in poverty trap has increased since 1978-79. True, but partly reflects more generous FIS. Cannot be more generous to low income families through targeted benefits without increasing their marginal tax rates.

(iii) Increased allowances preferable to basic rate cut

- Spending same amount on increasing allowances would only have raised married man's allowance by about £8.50 a week. Very few families in poverty trap (only about 10,000) would have been taken out of tax by such an increase.

- New structure of social security benefits to be introduced in April 1988 with withdrawal based on net income will reduce difference between rate cuts and allowance increases in terms of effects on number in traps.

- Cut in basic rate will reduce marginal tax rates by 2 percentage points for 20.8 million taxpayers of working age; allowance increase would only reduce rates for 800,000 taken out of tax.

- Increases in allowances increase replacement ratios for some people (eg because those out of work for short period may still pay tax and hence receive same cash benefit from allowance increase as those who stay in work). (See also D1.)

(iv) Treasury funded research shows no incentive effects from tax cuts? Study concerned with short run effects on hours people wish to work in existing jobs. Does not consider wider effect of taxes on economic performance on which supply side case for tax cuts based.

Contact point: R P Short (ETS) 270 4977

EE1 INHERITANCE TAX (IHT): DETAILS

Inland Revenue issuing Press Notice on Budget Day.

[See also Capital taxes: main changes (Brief E2)]

A RATES AND THRESHOLDS

B BUSINESS RELIEF

C INTEREST IN POSSESSION TRUSTS

D HERITAGE MAINTENANCE FUNDS

E ACCEPTANCE IN LIEU

A RATES AND THRESHOLDS

Factual

(i) Threshold to be increased from £71,000 to £90,000 from Budget Day.

(ii) From Budget Day, number of rates of tax to be reduced from 7 to 4 to give following scale:

Band of chargeable value £'000s	Tax rate (per cent)
0 - 90	NIL
90 - 140	30
140 - 220	40
220 - 330	50
over 330	60

(iii) Estimated to be around 26,000 taxpaying estates in 1987-88, compared with 38,000 if threshold increased only in line with RPI to £74,000. Around 38,000 in 1978-79.

(iv) Changes since 1979

1980 threshold doubled by abolishing bottom four rate bands

1981 10-year cumulation* introduced (in place of donor's whole lifetime)

1982 threshold indexed

1984 lifetime rates half death rates throughout wealth range

* Process by which chargeable transfers charged as top slice of aggregate of chargeable transfers within certain period. Capital transfer tax (CTT) as introduced cumulated all chargeable transfers in person's lifetime.

1986 change from CTT

- complete exemption for outright gifts between individuals made more than 7 years before donor's death;

- further reduction of cumulation period from 10 to 7 years.

(v) CTT/IHT yield:

	£ million
1985-86	895
1986-87	990 (1986 Budget forecast 910)
1987-88 (estimated)	1,100

Rising yield due to continuing increase in asset values, especially house and share prices.

(vi) Costs of changes above statutory indexation (£74,000 threshold)

	£ million
1987-88	75
1988-89	170
Full year	220

Positive

(i) Substantial increase in threshold: £16,000 more than required by statutory indexation.

(ii) Number of taxpaying estates reduced by around a third - 12,000 fewer than with statutory indexation.

(iii) Increase in threshold gives greatest percentage reductions to smallest estates, which are least likely to have gained from abolition of lifetime charge in 1986.

(iv) Simplification of scale gives worthwhile reductions at all levels.

Defensive

(i) Give away to wealthy: See E2.

(ii) Rate scales still harsher in real terms than 1975 scales: See E2.

(iii) 100 per cent business relief needed? See E2.

(iv) Tax now payable on modest house in London and South East? Starting point for paying tax increased by 27 per cent in 1987 Budget and at highest ever level in real terms. Tax on £100,000 estate only £3,000 now, and payable by 10 annual instalments to extent attributable to land, including housing.

(v) Government only put up threshold because of rising house prices: If assets in estates rise faster than RPI, indexation of IHT threshold in line with RPI will increase number of taxpayers. This has happened - homes and shares are over half IHT tax base. So right to give priority this year to substantial rise in threshold to take 12,000 smaller estates out of tax.

Contact point: J P Battersby (Inland Revenue) 2541 6459

B BUSINESS RELIEF

Factual

(i) Purpose of relief to assist with problems in paying tax on assets which are not readily liquid or marketable (see eg Minister of State OR Standing Committee G, 10 June 1986 col 397).

(ii) Rate of relief increased from 30 to 50 per cent for minority holdings of more than 25 per cent in unquoted companies to concentrate relief on assets which do not provide funds to meet tax, or which could provide funds only at risk of damaging the business. Relief only available where holding has been more than 25 per cent for at least 2 years preceding transfer.

(iii) Unlisted Securities Market (USM) Companies

- Shares in companies quoted on USM to be treated from Budget Day like shares in companies with full listing: no relief for minority holdings.

- If taxpayer owns 30 per cent of unquoted company and dies, tax is due. If only way to pay tax is to sell shareholding, could damage continued operation of business. But if company is USM, shares are already marketable, so same argument does not apply.

(iv) From Budget Day, rates of relief for shares in qualifying companies will be

- 50 per cent for controlling holdings in any company.

- 50 per cent for holding of more than 25 per cent in unquoted (excluding USM) company.

- 30 per cent for minority holding of 25 per cent or less in unquoted (excluding USM) company.

(v) Pre-Budget Day

- 50 per cent for controlling interest in any company.

- 30 per cent for minority interest in unquoted, including USM.

(vi) Rates of agricultural relief remain at 50 per cent for land farmed by owner and 30 per cent for tenanted land. Where dual eligibility, agricultural relief takes priority over business.

(vii) Costs: Negligible.

(viii) Numbers of losers (minority holdings of USM shares) and gainers (minority holdings of more than 25 per cent in unquoted) probably in hundreds and roughly equal.

(ix) Representations: Institute of Directors (IOD), CBI and others have urged same rate of relief for majority and minority holdings in unquoted companies. IOD and CBI wanted 100 per cent.

Positive

(i) Purpose of changes to improve targeting of relief on assets which not readily marketable, or where disposal to meet tax might damage business. Helps small businesses in particular.

(ii) Substantial (more than 25 per cent) minority holdings in unquoted companies can be largest shareholding, and in any event often as important to running of business as majority holdings. So two should have equal relief.

(iii) Meets representations from number of sources.

Defensive

(i) Why withdraw relief from substantial minority holdings in USM companies? Purpose of relief to assist with problems in paying tax on assets which are not readily liquid or marketable. Development of USM since start in 1980 means that such shares now have ready market and no longer justify relief on same basis as for other unquoted companies with no such market.

(ii) Is intention to treat USM like quoted companies for all tax purposes? Some recent provisions like Business Expansion Scheme already treat USM like quoted. Those which treat USM differently kept under review, but no need yet for general change. (Would not all be to taxpayer's advantage.) IHT change justified by specific aims of business relief.

(iii) Majority shareholdings should now have 100 per cent relief?

- Case for equal treatment for majority and substantial minority holdings argued by representative bodies.

- 100 per cent relief not needed in view of other changes in 1987 (reductions in tax) and 1986 Budget (abolition of lifetime charge). Would require reappraisal of whole purpose of relief.

(iv) Why no corresponding increase in 30 per cent rate of agricultural relief? Same arguments do not run. Relief at 30 per cent for agricultural landlords specific measure to encourage tenanted sector. Generous: no relief for other landlords. Higher rate of relief for land farmed by owner, where risks greater and value higher than where land farmed by tenant.

Contact point: J P Battersby (Inland Revenue) 2541 6459

C INTEREST IN POSSESSION TRUSTS

Factual

(i) In 1986, lifetime charge abolished for outright gifts between individuals made more than seven years before donor's death.

(ii) Transfers involving trusts remained taxable when made, at half full rates.

(iii) 1987 Budget extends 1986 abolition to gifts involving trust property with interest in possession (one under which individual has right either to use and enjoyment of trust property or to income arising from that property eg trust with life interest to individual).

(iv) Proposal applies to transfers made on or after 17 March 1987.

(a) Transfers into trust

No immediate lifetime charge on gift made by individual

- if gift is into trust under which another individual has beneficial interest in possession in gifted property; or

- if gift increases value of trust property in which another individual has beneficial interest in possession.

(b) Transfers out of trust

No immediate lifetime charge on disposal or termination of individual's beneficial interest in possession in trust property if on that event

- another individual becomes beneficially entitled to property in which interest subsisted, or to interest in possession in that property; or

- that property becomes subject to accumulation and maintenance trust, or trust for disabled; or

- value of another individual's estate is increased.

(v) Takes effect on Budget Day.

(vi) Cost: Negligible.

(vii) Representations from all major professional bodies (eg Law Societies, Institute of Chartered Accountants, Institute of Taxation) and representative bodies (eg IOD, National Farmers' Union, Unquoted Companies Group, Landowners' Group, Historic Houses Association).

Positive

(i) Meets representations from wide spectrum of bodies. Should be welcomed as further help to family businesses and family farms - often held in trust to secure orderly succession.

(ii) Builds on 1986 reforms and provides further encouragement to lifetime giving.

Defensive

(i) Abolish charge on discretionary trusts: No. Necessary to protect charge on death. Discretionary trusts do not die and if not taxed could be used to shelter assets from charge on death of individual.

(ii) Will facilitate tax avoidance. No. Protective measures to be included in 1987 Finance Bill. Await publication.

(iii) Government volte face on trust transfers: No. Marks extension, not reversal, of 1986 reforms.

Contact point: H B Thompson (Inland Revenue) 2541 6334

D HERITAGE MAINTENANCE FUNDS

Factual

(i) Heritage maintenance fund is trust for maintenance, repair, preservation of qualifying heritage property (historic houses, contents and supporting amenity land; historic, scientific or scenic land).

(ii) Pre-Budget position: Gifts to heritage maintenance funds exempt from IHT, subject to special tax charge where distributions made from fund for non-heritage purposes (which is permitted after 6 years). Charge based on cumulated chargeable transfers of settlor. If he is dead, distribution is taxed as if it was top slice of his death estate - at full death rate if property went to fund on his death, and if not, at half death rate. If he is still alive, distribution taxed as top slice of his chargeable transfers in preceding seven years.

(iii) 1987 Budget proposals

(a) Interest in possession (IIP) (see subsection C) trust property to be exempt from IHT on death of life tenant if (by post-death re-arrangement) goes to maintenance fund within two years of death (three years if Court Order needed).

(b) Where maintenance fund property derived from IIP trust, special tax charge (applying where distribution made for non-heritage purposes) in (ii) above to be based on cumulated chargeable transfers of former life tenant instead of settlor (because it is tax on transfer by life tenant that was given up when property entered fund).

(c) - Changes in (a) to take effect for deaths on or after Budget Day.

- Changes in (b) to take effect for charges arising on or after Budget Day.

(iv) Court Order may be needed for re-arrangement of trust if some beneficiaries are minors or untraceable.

(v) Cost: Negligible, unless several large cases (cf Calke Abbey) arise in same year; then several millions.

(vi) Representations: Made on this issue by Historic Houses Association and English Heritage.

Positive

(i) Proposal meets representations fully.

(ii) Gives for IIP property exemption already available for property in absolute ownership or in discretionary trust.

(iii) Could obviate time-consuming and expensive action by parties while life tenant alive.

(iv) Improves protection of heritage by helping creation of maintenance funds that might not be established without this aid. Thereby reduces risk of expensive rescue calls on National Heritage Memorial Fund.

Defensive

Another hand out to rich: No. Natural extension/rounding-off of existing rules. Could obviate more expensive rescue calls on National Heritage Memorial Fund.

Contact points: H B Thompson (Inland Revenue) 2541 6334
D Denton (Inland Revenue) 2541 6583

E ACCEPTANCE IN LIEU

Factual

(i) Outstanding "heritage" property (land, buildings, objects of pre-eminent national, scientific, historic or artistic interest) can be accepted in lieu of IHT, CTT, Estate Duty and interest on other property.

(ii) Acceptance at discretion of Inland Revenue with agreement of Environment/Arts Ministers (who take expert advice on quality).

(iii) Property accepted is itself exempted from IHT.

(iv) Tax satisfied (amount deemed to have been paid) is market value of item less tax given up on that item plus "douceur" (25 per cent of tax given up on objects, 10 per cent of tax given up on land/buildings).

(v) Currently, market value is agreed value as at date on which property is to be accepted. Tax due bears interest until that date.

(vi) Interest rate 8 per cent per annum, ie below interest rate for other direct taxes.

(vii) 1987 Budget proposes to allow offeror option of using market value at date of offer, with interest until that date only. "Douceur" arrangement will still apply.

(viii) Cost: Negligible.

Positive

(i) Meets representations from Historic Houses Association, National Trust and others.

(ii) Avoids loss to offeror when negotiations protracted and property value does not rise by more than interest rate.

(iii) Removes a psychological barrier to offers in lieu.

(iv) Improves protection of national heritage (see also subsection D).

Defensive

(i) Little value at time of rapid rise in prices? Perhaps. But worthwhile if value of item falls or remains static.

(ii) Delays: Negotiations necessarily protracted: assessment of quality of item, agreement of values. Interest rate for IHT recognises delays often inevitable: thus rate (currently 8 per cent) 1½ percentage points below interest rate for other direct taxes. Relief given by remission if maladministration occurs.

(iii) Too generous? Offeror can scarcely lose? Why not retain value at date of acceptance and remit interest from date of offer? Offeror retains use of property and benefit of value increase until date of acceptance. Interest merely commercial restitution (at special low rate) for period. Exchequer otherwise out of pocket. If interest stops at date of offer, only right that Exchequer should have benefit if later value rises.

Contact point: H B Thompson (Inland Revenue) 2541 6334
D Denton (Inland Revenue) 2541 6583

EE2 CAPITAL GAINS TAX (CGT): DETAILS

Inland Revenue issuing Press Notice on Budget Day.

[See also Pensions (Brief E1), Capital taxes: main changes (E2) and Effects of Budget on small and unincorporated businesses (G3)]

Brief contains:

A COMPANIES

B ANNUAL EXEMPT AMOUNT

C RETIREMENT RELIEF

D OVER THE COUNTER (OTC) OPTIONS AND FUTURES

A COMPANIES

Factual

(i) Current position: Indexed gains of companies liable to corporation tax (CT) at effective rate of 30 per cent, with no Advance Corporation Tax (ACT) set-off.

(ii) For disposals after midnight preceding Budget Day:

(a) indexed gains liable at normal CT rates - 35 per cent or 27 per cent small companies' rate (but 37 per cent in taper band - gradually withdrawing benefit of small companies' rates - from £100,000 to £500,000);

(b) ACT can be set against gains.

(iii) Yield: Negligible in 1987-88; £60 million in 1988-89; £100 million in full year.

(iv) Will not affect authorised unit trusts and approved investment trusts: these exempt on gains (individual investors liable to CGT tax when they sell their holdings).

(v) Gains on farm-outs (transfers of North Sea licence interests) kept within CT ring-fence (see FF1) for purposes of ACT set-off.

Positive

(i) Reduces burden on small companies (see also G3).

(ii) ACT set-off helps companies with surplus ACT and those which distribute gains, meeting regular complaint.

(iii) Simplifies rules.

(iv) With mainstream CT rate on income reduced to 35 per cent (from 52 per cent before 1984 changes), case for differential lower rate on gains very much weaker.

Defensive

(i) Companies more heavily taxed on gains than individuals who will still be liable at 30 per cent. Small companies will pay at 27 per cent. And companies, unlike individuals, can (and often do) set trading losses against gains.

(ii) Should tax individuals' gains at basic rate (equivalent to change for small companies). Under present structure no obvious link between basic rate and rate on individuals' gains. Many individuals making gains are higher rate taxpayers.

(iii) Change puts life assurance companies at competitive disadvantage: will pay tax at 35 per cent on gains while unit/investment trusts exempt. Impact on life companies relatively marginal. In any case will benefit from improvements in pensions relief (see E1).

(iv) Making change effective from midnight preceding Budget Day is retrospective. Necessary to prevent forestalling - companies could otherwise make large disposals in late afternoon/evening Budget Day. Government announced in 1986 that some future Budget changes might be effective from start of Budget Day for just this reason (then Financial Secretary, in Budget Debate 19 March 1986 (OR vol 94 no 81 cols 377-78); Inland Revenue press release 20 March 1986).

(v) Why not allow capital losses to be set against income? Major erosion of tax base with potentially high revenue cost. Would give scope for avoidance through manufacture of capital losses. (Similar ring-fencing of capital losses in US.)

Contact points: M F Cayley (Inland Revenue) 2541 7427
P A Michael (Inland Revenue) 2541 7571

B ANNUAL EXEMPT AMOUNT

Factual

(i) Increased in line with RPI increase in year to December 1986.

- For individuals from £6,300 to £6,600.
- For most trusts from £3,150 to £3,300.

In accordance with statutory indexation requirements (Section 80 of Finance Act 1982).

(ii) Cost above statutory indexation: Nil in 1987-88 and 1988-89.

Positive

(i) Evidence of Government commitment (stated in eg Conservative Party Manifesto 1983) to keep down burden of capital tax.

(ii) Keeps out some 10,000 taxpayers who would otherwise come into CGT.

Defensive

Increase in already generous threshold

(a) Does no more than maintain real value.

(b) In accordance with statutory indexation requirement.

(c) Provides most effective simplification - gains clearly below exempt amount do not have to be calculated; taxpayers not required to make full returns for CGT purposes if gains not over exempt amount and aggregate proceeds from disposals in year do not exceed twice exempt amount.

Contact points: M F Cayley (Inland Revenue) 2541 7427
P A Michael (Inland Revenue) 2541 7571

C RETIREMENT RELIEF

Factual

(i) Relief applies when businessman retires at or after 60 or on ill health grounds.

(ii) Current position: Exempts gains up to £100,000.

(iii) 1987 Budget proposes ceiling raised to £125,000 for disposals on or after 6 April 1987.

(iv) Cost: Nil in 1987-88; negligible in 1988-89; £5 million (full year).

Positive

(i) Extra help to small businessmen who fall within scope.

(ii) Since 1984, ceiling raised from £50,000 to £125,000 - very much more than rate of inflation.

Defensive

(i) Should extend retirement relief to agricultural landlords. Relief designed for those with close everyday involvement in business. Landlords usually in slightly different position.

(ii) Why not increase other limits for CGT reliefs? Relief for small part disposals of land (proportion of holding of land which can be sold without charge to CGT) already made more generous in 1986.

(iii) Increase too generous: Necessary to ensure that CGT does not act as deterrent to small businessmen (from retiring at sensible age) and reinvestment of funds in business.

Contact points: M F Cayley (Inland Revenue) 2541 7427
P A Michael (Inland Revenue) 2541 7571

BUDGET SECRET
until after Budget Speech on 17.3.87
then UNCLASSIFIED

D OVER THE COUNTER (OTC) OPTIONS AND FUTURES

Factual

(i) At present profits on transactions in OTC options and futures in some circumstances taxed as income rather than capital gains. OTC market can offer options and futures tailor-made to particular customers instead of standardised product offered by recognised exchanges.

(ii) In future will always be taxed as capital gains except where arise in course of trading.

(iii) Brings treatment into line with rules for traded options and for futures transactions on recognised exchange. Affects options and futures in hands of non-dealers (ie not trading). Beneficiaries will include banks and other financial institutions.

(iv) Other technical changes to bring tax regime for OTC options in line with that for traded options.

(v) Commencement date for changes to be set by secondary legislation: will tie in with date of introduction of regulatory framework of Financial Services Act, at end of 1987.

(vi) Cost: Negligible.

Positive

(i) OTC market expanding fast to meet demand for tailor-made (as opposed to off-the-peg) options and futures. Once proper regulatory framework in place for tailor made OTC options, no reason why tax treatment should be less favourable than that of transactions on recognised exchanges.

(ii) Helps City compete for international options and futures business. Increases institutions' flexibility to hedge.

Defensive

(i) Why not introduce change immediately? Better to wait until regulatory framework in place. Definition of options and futures concerned much easier if linked with legal concepts of Financial Services Act. These do not yet have legal force (will be brought in by DTI secondary legislation).

(ii) Tax perk for City: No. Measure recognises increasing importance of over the counter market and rationalises tax rules. Does not provide opportunity for tax avoidance.

Contact points: M F Cayley (Inland Revenue) 2541 7427
C Gordon (Inland Revenue) 2541 6739

EE3 WIDER SHARE OWNERSHIP (INCLUDING PERSONAL EQUITY PLANS)

Inland Revenue issuing 2 employee share scheme Press Notices on Budget Day (one covering consultative document on Section 79, Finance Act 1972).

Treasury issuing Press Notice on share ownership survey on 18 March.

[See also Fiscal policy (Brief C4), Pensions (E1), Capital taxes: main changes (E2), Inheritance tax (IHT): details (EE1), Capital gains tax (CGT): details (EE2) and Miscellaneous savings measures (EE4)]

Factual

(i) Extent of adult shareownership: Joint Treasury/Stock Exchange survey carried out to estimate number of adult shareholders in January/February 1987 before BA privatisation showed

- 8.4 million adult shareowners
- 19½ per cent of adult population own shares
- 11 per cent own shares in more than one company.

(ii) Other surveys of share ownership

- Target Group Index (TGI) estimated that 7 per cent (3 million) of adult population owned shares in 1979.
- Recent surveys by Dewe Rogerson for 'Observer' and National Opinion Polls for BA confirm results of Treasury/Stock Exchange survey.
- New York Stock Exchange estimates 20 per cent of total US population own shares (including unit trusts).

(iii) Chancellor promised at Party Conference, 9 October, to double again number of people who directly own shares, in next Parliament.

(iv) Employee share schemes

Numbers of different types of approved employee share schemes in operation:

- 622 all-employee profit sharing schemes (Finance Act 1978);
- 607 all-employee SAYE-related share option schemes (Finance Act 1980);
- 2,080 discretionary share option schemes (Finance Act 1984).

(v) 1987 Budget changes to employee share schemes

(a) Amendments proposed to Finance Act 1980 and Finance Act 1984 to make it possible, in event of takeover, for participants in approved scheme to exchange existing share options for options over shares in acquiring company. (Negligible cost 1987-88 and 1988-89.)

(b) As announced in 13 November 1986 Press Notice, technical changes being made to "material interest" provisions which - among other things - determine whether directors and employees may participate in schemes. (Negligible cost in 1987-88 and 1988-89.)

(c) Unapproved employee share schemes: Proposed to invite representations and review anti-avoidance provisions in Section 79, Finance Act 1972. Inland Revenue issuing consultative document on Budget Day. Responses requested by 31 May. (Section charges to income tax gains on shares acquired by employees outside approved schemes.) Will review scope for improvement and simplification, consistent with provisions underlying objectives.

(vi) Labour Party policy: Roy Hattersley MP advocated employee share ownership scheme along lines of US Employee Stock Option Plans (ESOPs) at Personnel Management Conference at Harrogate on 16 October 1985.

(vii) Personal Equity Plans

(a) Introduction of Personal Equity Plans from 1 January 1987. Allows investment of up to £2,400 a year in equities with reinvested dividends free of income tax and realised gains free of capital gains tax when held for one year.

(b) Figures to end-January show:

- 70,000 Personal Equity Plans taken out, worth around £112 million.

- 58 per cent of holders have subscribed maximum of £2,400. Average £1,600.

- 170 Plan Managers registered to run PEPs by 13 March.

(c) Labour Party policy: Mr Hattersley said Labour Government would scrap relief on PEPs because money "going to the rich": would replace PEPs with greater incentives for employees to invest in companies they work for (reported in 'Financial Times' and 'Daily Telegraph', 21 February).

(viii) Plan Managers' charges

	Cheapest	**Typical**
Initial	1% (minimum £10)	3-5%
Annual	0.5% (Equitable Life)	0.75% (Barclays, Midland, Nat West)
Attending AGMs	Free (Barclays/Nat West)	Wide variation (£5 to £120)

(ix) Some pressure for introduction of US "Employee Stock Option Plan" (ESOP) reliefs in UK, notably tax incentives to borrow to purchase shares to pass on to employees. Such changes would require removal of limits on tax relief for UK employee share schemes, and would involve grafting benefits of ESOPs onto UK schemes, without imposing restrictions.

Positive

(i) Treasury/Stock Exchange survey shows trebling of shareholders since 1979.

(ii) More than 5 million new shareholders created since 1979.

(iii) Level of direct share ownership in UK fast approaching US level.

(iv) Increase in share ownership widely spread, in all sections of community and geographically, with most marked increases since 1979 among ordinary working people.

(v) Benefits of share ownership

- gives personal stake in success of British companies;
- increases money for investment and so creates/saves jobs.

(vi) Measures to promote wider share ownership

(a) Privatisation

- 16 share sales since 1979 giving individuals chance to own shares.
- British Telecom attracted 1 million new investors. British Gas further 2 million.
- 430,000 employees have become shareholders - 9 out 10 employees in privatised companies floated on stockmarket.

(b) Employee share schemes

- 1,229 all-employee share schemes (involving over 10,000 companies) now in operation, against 30 in 1979.
- 1½ million employees given stake in companies worth over £2 billion.
- Discretionary schemes give incentives to key employees to stay in Britain.
- Legislation introduced in 7 of last 8 Budgets.

(c) Personal Equity Plans

- Simple and cheap method of owning shares. Involves no contact with Inland Revenue.
- Over 2,000 PEPs a day taken out in first month.
- Barclays have estimated 23 per cent of their PEP holders new shareowners.

Defensive

(i) Privatisation selling off national assets at discount: Over 6 million now have direct stake in privatised companies, including 430,000 employees.

(ii) Use of privatisation proceeds: See C4.

(iii) Employee share scheme take-up slackening: Take-up of 1984 schemes strong. No sign of slackening in 1978 and 1980 all-employee schemes - number risen 40-fold since 1979.

(iv) Discretionary employee share schemes should be restricted to companies with all-employee schemes. No. Must safeguard key talents. Many companies could not afford to run both types of schemes.

(v) Should adopt US-type ESOPs: Reliefs for employee share ownership already generous. 1978 Finance Act rules give employees more tax relief than under US plans.

(vi) Limits should be raised on employee share schemes. No evidence current levels under all-employee schemes too low. (Average contributions well below maxima.) Discretionary scheme limits already very generous.

(vii) Government should have acted more boldly to encourage wider share ownership in 1987 Budget. Already done great deal through privatisation, employee share schemes and PEPs. Privatisation programme will carry on. PEP scheme only been in place for 3 months; must have time to settle down.

(viii) PEP shares too risky: No. PEP gives opportunity to spread risk. Measures encourage direct stake in success of British companies, often those in which shareholders work. But planholders must appreciate that shares can go down as well as up.

(ix) PEPs charges too high: No. Number of applicants to manage PEPs - 170 - indicates competition will keep charges down. In some schemes annual charges not much more than cost of couple of small share transactions in Stock Exchange.

(x) PEPs benefit higher rate taxpayers only. No. Income tax relief benefits all taxpayers. With benefits building up over time, encouraging sustained commitment to share ownership.

(xi) Give immediate tax relief for investment in PEPs (cf Loi Monory or US Individual Retirement Account)? No. PEPs designed to encourage long term share ownership. Loi Monory approach means:

- complex rules to stop or penalise early disposals
- high initial cost
- more Inland Revenue manpower.

Over 10 year period, income tax relief from PEPs likely to be more favourable than Loi Monory relief.

(xii) PEPs rules should be extended to include higher proportion of unit trusts. No. Designed to encourage direct ownership of shares. Already sufficient scope to spread risk.

(xiii) Scheme restricts choice of shares. PEPs open to all listed and Unlisted Securities Market shares. Potential investors should shop around to find plan manager providing best combination of choice and changes.

(xiv) Treasury survey shows share ownership thinly spread? True that many individuals have bought shares for first time in recent privatisations. But this is necessary first stage in creating share owning democracy. Next stage is to deepen share ownership - what PEPs designed to do.

Contact points: M Neilson (FIM2) 270 4502 (Wider share ownership and PEPs)
J P McIntyre (PE2) 270 4777 (Privatisation)
Miss D Green (Inland Revenue) 2541 6457 (Employee share schemes)

EE4 MISCELLANEOUS SAVINGS MEASURES

Brief contains:

A STAMP DUTIES

B CONSEQUENCES OF FINANCIAL SERVICES ACT

- I UNIT TRUSTS
- II DEFINITION OF STOCK EXCHANGE

C FRIENDLY SOCIETIES: TAX EXEMPT LIFE AND ENDOWMENT BUSINESS

D TRADE UNION PROVIDENT BENEFITS

A STAMP DUTIES

[See also Mortgage interest relief (Brief DD4)]

Factual

(i) No change to stamp duty rates or thresholds in 1987 Budget which remain at:

Sales duty	
Shares	0.5%
House etc	1%
Threshold for houses etc	£30,000
Capital duty	1%
Leases	1%-24%
Life Insurances	0.05%
Unit Trusts	0.25%

(ii) 1987 Finance Bill to contain proposals for detailed technical changes to both stamp duty and reserve tax (new tax introduced in 1986 to apply half per cent rate to share deals which escape stamp duty). None of these proposals is being announced on Budget Day (but some indicated by Ways and Means Resolutions).

(iii) £30,000 threshold fixed in 1984. Home prices risen 36 per cent since then. Average house price:

	March 1984	January 1987
National	£28,121	£38,335
London	£36,459	£57,723

Source: Building Societies Association

(iv) 1986 Budget introduced higher rate of duty (eventually fixed at 1½ per cent) on conversion of UK shares into depositary receipts, such as American Depository Receipts (ADRs) (certificates by American banks that shares have been deposited).

(v) International comparison of dealing costs commission, tax and spread

(£500,000 buy/sell)

	March 1986	March 1987
UK	2.5 per cent	1.25 - 1.65 per cent
Japan	1.55 per cent	1.55 per cent
US	0.5 per cent	0.5 per cent

Source: Bank of England

Positive

(i) Revenue from stamp duties buoyant.

- Yield £1,230 million in 1985-86.
- Estimated outturn for 1986-87 £1,840 million (compared with 1986 Budget forecast of £1,430 million).
- Forecast for 1987-88 £2,100 million (140 per cent higher in real terms than in 1978-79).

(See also C3.)

(ii) 1986 rate cutting package for shares did not result in loss of revenue - Opposition doubts proved wrong. (Dynamic effect forecast by joint Treasury/Bank paper published October 1985.)

(iii) Activity booming in financial markets helped by reduction in stamp duty in 1986. Cut in transaction costs helping City to consolidate London's international competitive position. Stock Exchange turnover in equities more than doubled since Big Bang; dealing by investors up 50 per cent.

(iv) New reserve tax operating smoothly and bringing in forecast revenue.

BUDGET SECRET
until after Budget Speech 17.3.87
then UNCLASSIFIED

Defensive

(i) Increase stamp duty threshold for houses: House buyers benefited substantially in 1984 from cut in stamp duty rate from 2 per cent to 1 per cent and increase in threshold from £25,000 to £30,000 to bring in line with mortgage interest ceiling. (See DD4.)

(ii) Abolish stamp duty: Very costly: £2.1 billion - equivalent to nearly 2p cut in income tax basic rate.

(iii) Abolish stamp duty on shares? Following Big Bang, London's competitive position much stronger. Abolition would cost £890 million plus some loss of duty on real estate resulting from sales of shares in single property companies. Americans considering introducing 0.5 per cent tax on share deals ('Wall Street Journal' 3 March).

(iv) Tax on depositary receipts (eg ADRs) should be dropped. Still needed to protect revenue from duty on shares. 1½ per cent rate not inhibiting ADR market in New York or British companies from getting shares quoted in this market, despite concern expressed initially.

(v) When will details of technical changes be announced? Details to be announced when 1987 Finance Bill published. Ways and Means Resolutions indicate that Finance Bill will contain stamp duty and reserve tax charges.

Contact points: D G Draper (Inland Revenue) 2541 6646
N J B Adderley (Inland Revenuc) 2541 6605

B CONSEQUENCES OF FINANCIAL SERVICES ACT (FSA)

I UNIT TRUSTS

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Financial Services Act 1986 (FSA) provides new investor protection regime for unit trusts:

(a) authorised unit trusts (AUTs)

- marketable to general public;
- currently restricted to investment in securities;
- post FSA can diversify also into property, commodities, futures and options.

(b) unauthorised unit trusts (UUTs)

- not marketable to general public (used only by professional investors, especially institutions);
- no restriction on types of investment;
- post-FSA will be more widespread (including new types of generally marketable schemes eg single property schemes).

New FSA regime for unit trusts expected to come into force late autumn 1987.

(ii) Current tax treatment

(a) AUTs

- capital gains exemption for trustees (but unit holders pay capital gains tax (CGT) on disposal of units);
- trustees treated as investment companies (paying corporation tax on income);
- units treated as shares; unit holders' income treated as dividend.

(b) UUTs

- no special tax rules: normally trustees pay income tax on trust income; unit holders pay income tax on distributions with credit for tax paid by trustees.

(iii) 1987 Budget

- preserves existing tax treatment of AUTs. Only minor adjustments needed to cope with new-style AUTs investing in property, commodities etc;
- sets up specific tax code for UUTs based on existing practice;
- allows individual schemes to be excluded from new UUT code by regulation.

(iv) Cost: Nil.

(v) Budget Resolutions (Nos 37 and 51) to be moved at end of Budget debate. No 51 normal Ways and Means Resolution to enable Parliamentary consideration of general Unit Trust changes. Resolution 36 technical consequential, necessary to cater for wider range of investment opprotunities open to AUTs in new FSA regime.

Positive

(i) Updates tax rules in parallel with FSA changes.

(ii) New-style AUTs inherit same treatment as existing AUTs, including capital gains exemption.

(iii) All unit trusts (UUTs as well as AUTs) now have clear tax rules. Gives certainty for trusts, unit holders, the market, Inland Revenue and designers of new types of unit trusts permitted by FSA.

Defensive

(i) Existing AUTs will suffer. No. Present rules continue.

(ii) Wrong to give Treasury regulatory powers. No.

- Regulations measures only apply to UUTs not AUTS.
- Detailed FSA regulations on unit trusts yet to appear. Need ability to adjust unauthorised unit trust tax treatment quickly to keep in line. New regulations can be made at any time.
- FSA definition of unit trust very wide. Need ability to exclude individual schemes quickly where unit trust tax treatment inappropriate. When assets not pooled and right to tax investor on income from his assets rather than proportional share of all assets in scheme.

(iii) Single property schemes (which utilise single buildings like office blocks) should be excluded from unit trust tax treatment. Cannot be judged until precise form of scheme known. Legislation has necessary flexibility to implement eventual decision on any scheme.

(iv) Investment trust companies' capital gains exemption should be extended in parallel with AUT (to cover property, commodity etc investment). Will consider any representation. (None made pre-Budget.)

Contact point: A J Bolton (Inland Revenue) 2541 7517

II DEFINITION OF STOCK EXCHANGE

[See also Inheritance Tax (IHT): details (Brief EE1)]

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) FSA provides for establishment of new "recognised investment exchanges" (RIEs).

(ii) Term "stock exchange" used for great variety of purposes in Taxes Acts (eg Business Expansion Scheme relief not given on shares quoted on stock exchange.

(iii) At present, in UK this can only mean "The Stock Exchange"; new RIEs cannot be accommodated in existing law.

(iv) 1987 Budget proposes legislation to allow new RIEs (by regulation) to be treated as equivalent to Stock Exchange for purposes of income tax/corporation tax/capital gains tax.

(v) Cost: Nil.

Positive

(i) Ensures fair treatment can be given to securities dealt with on new exchanges: anomalous advantages and disadvantages can be avoided ("level playing fields").

(ii) Consistent with philosophy of FSA.

(iii) Avoids tax rules driving business off-shore (especially huge Eurobond market).

Defensive

(i) Why use regulations? Only sensible course. Need:

(a) quick response to adjust tax rules as soon as new RIE appears;

(b) flexibility to mesh tax provisions with new RIE's rules.

(ii) Stock Exchange itself (including Unlisted Securities Market and third-tier market) unaffected by this legislation.

Contact point: A J Bolton (Inland Revenue) 2541 7517

C FRIENDLY SOCIETIES: TAX EXEMPT LIFE AND ENDOWMENT BUSINESS

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Current position: Profits from life and endowment business of Friendly Societies exempt from tax subject to following limits

- for assurance policies, £750 gross sum assured. For such policies to be "qualifying" for tax purposes, this sum must be at least 75 per cent of total premiums payable and premiums must be payable evenly over at least 10 years. Changed limit exactly equivalent to existing one in respect of 10-year endowment policy (for mainly investment purposes) which has been main product marketed by newer commercial societies;

- for annuities, £156 a year.

(ii) 1987 Budget proposes replacing limit for assurance policies. Individual will be able to invest up to £100 a year in tax-exempt, "qualifying" life or endowment assurance with friendly society. Qualifying policies do not normally attract tax charge when they mature. New limit to be based on annual premiums of £100. No change in present limit for annuities.

(iii) Change designed to help traditional societies (writing long-term insurance to cover funeral expenses or to provide modest benefit on retirement) rather than newer, commercial societies (which sell 10 year endowments for investment).

(iv) New limit will apply to insurance contracts made on or after 1 September 1987 (earliest feasible date for implementation).

(v) Where premiums are payable more often than once a year, 10 per cent of premium may be disregarded in applying £100 limit. This will enable friendly societies to issue tax-exempt policies with premiums of, for example, £2 a week or £9 a month.

(vi) Cost: Below £1 million a year.

(vii) Report by Professor Morgan commissioned by National Conference of Friendly Societies published November 1986. Recommended raising tax-exempt limit to £5,000 gross sum assured and other (non-tax) changes in friendly society legislation.

(viii) 1984 Finance Act reduced tax-exempt limit from £2,000 to current figure of £750.

Positive

(i) New premium-based limit

- allows older, traditional, friendly societies to issue long-term policies. Annual premiums required to assure gross sum of £750 over 30 years or more much lower than £100 and, in consequence, so is society's per capita premium income. So these policies are not currently attractive for many older societies;

- encourages less well-off to make long-term provision for retirement and death benefits. For example, £100 per annum would typically provide a man aged 30 with an endowment policy (excluding bonuses) of around £4,500 gross sum assured over a 35 year term;

- achieves fiscal neutrality between traditional and commercial societies (current limit based on sums assured means that 10 year endowments can have premiums of £100 a year whereas annual premiums on longer-term policies must be lower);

- leaves position of tax-efficient, commercial societies effectively unchanged;

- equivalent of very substantial increase in old limit for policies.

(ii) 1 September 1987 commencement date gives societies ample time to adapt to restructured limit.

Defensive

(i) Proposal admission that 1984 Finance Act measures wrong. No. Main aim of 1984 changes to curb exploitation of tax exemption on commercial scale. Proposal will not increase scope for commercial exploitation.

(ii) Raise tax-exempt limit on sums assured No. Would benefit newer commercial societies (who specialise in 10-year endowment assurance) more than traditional societies.

(iii) Raise tax-exempt limit to £5,000. No. Would seriously distort tax treatment of savings generally and bias relief towards commercial societies.

(iv) Professor Morgan's report studied very carefully by Government. Many of recommendations not tax matters and not for Finance Bill.

(v) Inconsistent with Government view that market should dictate pattern of business: Any tax exemption for friendly societies distorts market. Change keeps exemption at modest level and continues recognition of traditional, 'self-help' role of small societies.

Contact point: C S McNicol (Inland Revenue) 2541 7237

D TRADE UNION PROVIDENT BENEFITS

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Trade unions get tax relief on income and capital gains from funds used to pay provident benefits eg to member during sickness or to family after his death. To qualify, benefits must not exceed certain limits.

(ii) Present limits: £2,400 (lump sums) and £500 (annuities). Last fixed 1982.

(iii) 1987 Budget proposes increasing limits to £3,000 (lump sums) and £625 (annuities) in line with inflation since 1982. New limits apply from Budget Day.

(iv) Cost: Insignificant.

(v) Limits under Labour Government

	lump sums	£ annuities
pre 1975	500	104
1975-80	1,000	208

Positive

(i) Small but useful additional relief to help trade unions in assisting members.

(ii) Limits increased in 1980 and 1982 in line with inflation. 1987 increases maintain indexation since 1980.

Defensive

(i) Too little? Increases restore 1982 value of limits.

(ii) If cost insignificant, why not do every year? Government does not change most monetary limits each year (adds to complexity and confuses people).

Contact point: J H Reed (Inland Revenue) 2541 6442
D J Huffer (Inland Revenue) 2541 6257

FF1 NORTH SEA TAXATION: DETAILS

Inland Revenue issuing Press Notice on Budget Day.

[See also Effects of Budget on North Sea companies: main points (Brief F2)]

Brief contains

A PETROLEUM REVENUE TAX (PRT) CROSS FIELD ALLOWANCE (CFA)

B PRT TREATMENT OF CERTAIN RESEARCH EXPENDITURE

C OIL ALLOWANCE

D SET OFF OF SURRENDERED ACT AGAINST RINGFENCE PROFITS

E RING FENCE ADVANCE CORPORATION (ACT) ON PREFERENCE SHARES

F PRT VALUATION AND PRICING

A PRT CROSS FIELD ALLOWANCE (CFA)

Factual

(i) At present, PRT relief for expenditure in developing oil field allowable only in that field against PRT liability on income from that field (the field basis").

(ii) Thus expenditure only effectively relieved when income stream begins, and then only if income sufficiently high to give rise to PRT liability. Early expenditure on new fields will thus not enjoy relief for some time.

(iii) 1987 Finance Bill will include relaxation of field basis rules, so that participator in an oil field can elect for up to 10 per cent of expenditure in developing certain new fields, until fields reach payback, to be set immediately against his PRT liabilities in another field(s). ("New field": one which had not yet received development consent on 17 March 1987 (and which is not onshore or in Southern Basin).) Payback reached when cumulative field income first exceeds cumulative outgoings ie allowable expenditure and uplift - supplement of 35 per cent.

(iv) New rules effective for expenditure on or after Budget Day.

(v) Cost: £5 million in 1987-88; £15 million in 1988-89. Builds up to £40 million in 1989-90 and £80 million in 1990-91.

(vi) Representations: Oil industry (both as individual companies and their representative bodies: UK Offshore Operators Association, UK Oil Industry Taxation Committee, BRINDEX (Association of British Independent Oil Exploration Companies), Scottish Development Agency, BRIT) and other offshore supplies industry representatives requested relaxation of PRT field basis on these lines.

Positive

(i) New relief will improve post-tax economics of certain new developments, and should encourage companies to proceed with them sooner than might otherwise be case.

(ii) Will generate opportunities for offshore supplies industry, currently suffering as result of trough in orders.

(iii) Will help to keep together carefully nurtured capability in UK offshore industry.

(iv) Helps meets some of representations from industry.

Defensive

(i) Breaches field basis of PRT? Limited measure to encourage some developments to go ahead now, rather than waiting for oil price to recover further. Not to be seen as precedent for further erosion of field basis.

(ii) 10 per cent not enough: True that industry seeking 15-20 per cent CFA or more but higher amounts could result in post-tax returns being higher than pre-tax returns. Little justification for singling out oil industry for special help of this kind.

(iii) Does not apply to Southern Basin developments. CFA only applies to new offshore fields developed outside Southern Basin. No sign extra fiscal relief needed to encourage new developments in Southern Basin. Several development consents for new developments there already announced in 1986 eg V Block, Ravenspurn.

Contact point: Mrs C B Hubbard (Inland Revenue) 2541 6576

B PRT TREATMENT OF CERTAIN RESEARCH EXPENDITURE

[See also Industrial research and development (R & D) (Brief FF5)]

Factual

(i) Field basis of PRT (see subsection A) means that expenditure generally only allowable for PRT against income of field for purposes of which expenditure incurred. (Exception for exploration and appraisal expenditure incurred before field receives development consent: relief for that available immediately under Section 5A Oil Taxation Act (OTA) 1975, against income from field of participator's choice.)

(ii) Some research expenditure of so general nature (eg into coating of pipelines) that cannot be shown to be specifically for purposes of given field. Thus outside PRT relief rules. Nevertheless is (wholly or in part) for purposes of UK and UK Continental Shelf (UKCS) oil extraction activities.

(iii) 1987 Finance Bill will include provision to allow such research expenditure against participator's liability in any field if, 3 years after incurred, has not yet become allowable for any given field.

(iv) Provision effective for expenditure on or after Budget Day.

(v) Cost: Nil in 1987-88 to 1989-90; in 1990-91 will cost about £30 million.

(vi) Representations: Oil industry, both as individual companies and UK Oil Industry Taxation Committee and BRINDEX, have sought immediate PRT relief for non-specific research.

Positive

(i) Research often into more cost-effective methods of producing oil from North Sea. Will help to keep momentum of North Sea development going, especially at time of lower oil price. Keeps research teams together.

(ii) Brings PRT treatment of this expenditure more closely into line with that for corporation tax.

(iii) Meets industry's representations.

Defensive

(i) Why 3 year delay? Do not want to breach normal field basis rules. Wait to see first whether expenditure will qualify in a field without this relief. Do not want to treat non-field specific research more favourably than research for purpose of given field. But companies can plan, on expectation they will get relief on their expenditure.

(ii) Why single out oil industry for help in research but no general concession to industry on research and development? This measure simply brings PRT treatment more closely into line with treatment for corporation tax, where relief already available for any research related to company's trade. (See also FF5.)

Contact point: Mrs C B Hubbard (Inland Revenue) 2541 6576

C OIL ALLOWANCE

(i) Oil allowance gives quarter of million tonnes of oil (double for post 31 March 1982 offshore fields outside Southern Basin) per chargeable period (6 months) free of PRT, subject to cumulative total of 5 million tonnes per field (10 million tonnes for post 31 March 1982 fields).

(ii) Oil allowance given to each participator in same ratio as share of oil lifted in each period. If profit too small to use all share of oil allowance, balance carried forward, but for whole field, not for participator.

(iii) In last period for which oil allowance due (when reaches cumulative total), provision (Section 8(6) OTA 1975) to rectify imbalances in use of oil allowance. But one period's allowance may not be enough to correct imbalance.

(iv) 1987 Finance Bill will include provision to increase flexibility to reallocate oil allowance both in final and penultimate period for which due.

(v) Will apply for chargeable periods ending on or after 30 June 1987. Earlier problems have been dealt with in other ways eg cash equalisation payments among participators. But could be rare future case where two periods not enough.

(vi) Cost: Negligible in 1987-88 and full year (cumulative total of oil allowance unchanged).

(vii) Representations: UK Oil Industry Taxation Committee and BRINDEX both requested relaxation (although would prefer much greater flexibility).

Positive

(i) Goes long way to meeting industry representations and should provide complete solution for all known cases.

(ii) Remedies defect in existing legislation.

Defensive

Why not unlimited flexibility? Risk of abuse, by means of effective sales of certain expenditure relief, if participators able to reallocate oil allowance as they wish, rather than in line with their shares of oil won and saved. Two periods should be enough to redress imbalance in virtually all cases.

Contact point: Mrs C B Hubbard (Inland Revenue) 2541 6576

D RING FENCE ADVANCE CORPORATION TAX (SECTION 16 OTA 1975)

Factual

(i) Section 16 prevents group with non-ring fence losses from importing those losses, indirectly through general ACT rules, within ring fence.

(ii) Practical effect of Section 16 is that subsidiary ring fence company can get ACT set against its CT liability on ring fence income only via surrender from its parent.

(iii) This inhibits dividend flexibility because surrendered ACT cannot be carried back to earlier years. Effect is that where dividends are paid out of past profits companies can be left with "stranded" ACT which can be carried forward only.

(iv) 1987 Finance Bill will allow, subject to certain conditions, including monetary limits, carryback of surrendered ACT for up to 6 years.

(v) Finance Bill will also make clear that carry-back of ACT cannot give rise to repayments of ACT under certain repealed provisions.

(vi) Applies to dividends paid on or after Budget Day.

(vii) Consortia: 1987 Finance Bill will also allow surrender of ACT on dividends paid on or after Budget Day to ring fence company owned by 50/50 joint venture (current rule permits surrender only to 51 per cent subsidiary).

(viii) Cost: Carryback of surrendered ACT will cost £20 million in both 1987-88 and 1988-89. No immediate cost for measure on consortia.

(ix) Representations: UK Oil Industry Taxation Committee (UKOITC) and BRINDEX both requested carryback of surrendered ACT to meet Section 16 anomaly, and UKOITC requested surrender of ACT to consortium company.

Positive

(i) Goes long way to meet industry representations.

(ii) Goes long way to removing unintended side effect of existing legislation.

Defensive

Why impose monetary limits? Cost of allowing carryback of surrendered ACT would otherwise be prohibitive.

Contact point: Mrs C B Hubbard (Inland Revenue) 2541 6576

E RING FENCE ADVANCE CORPORATION TAX (ACT) ON PREFERENCE SHARES

Factual

(i) Sections 13-19 OTA 1975 erected ring fence around income from UK and UK Continental Shelf oil extraction activities, to prevent erosion of revenues from exploitation of national resource by offset of losses and charges from other activities. Section 15 prevents deduction for interest unless borrowing used to finance ring fence expenditure.

(ii) Capital (for any purpose) can be raised from banks by issue of preference shares, rather than loan, in which case ACT on resulting dividends can be set against CT liability on ring fence income unless dividend paid to associated company (Section 16 OTA 1975).

(iii) Thus ring fence for interest can be breached by raising capital (for non-ring fence purposes) by preference shares to banks, instead of loan.

(iv) 1987 Finance Bill will prevent this ACT set-off against ring fence CT unless preference share capital can be shown to have been raised for ring fence purposes.

(v) Applies to dividends paid on or after Budget Day.

(vi) Yield: Nil in 1987-88; £15 million in 1988-89. Figure uncertain, but device could have cost Exchequer tens of millions of pounds if it became widespread.

Positive

(i) Necessary to protect revenues from UK oil extraction activities against erosion by deduction for financing costs which have nothing to do with North Sea development.

(ii) Will not affect any financing arrangement genuinely for UK or UKCS oil extraction activities.

Defensive

(i) Ring fence no longer necessary? Although large overhang of downstream losses and charges may have been reduced, still risk of extraneous losses substantially reducing Government's take from national resource.

(ii) Cannot hypothecate capital for different purposes. Capital raised from banks by preference shares usually for given project. Should be possible for oil companies to show whether genuinely for North Sea development purposes: already apply such test to interest on borrowing.

Contact point: Mrs C B Hubbard (Inland Revenue) 2541 6576

F PRT VALUATION AND PRICING

Factual

(i) On 18 November Government announced intention to include in 1987 Finance Bill legislation on PRT valuation and pricing (OR vol 105 no 6 cols 176-77).

- On valuation, aim to reflect present market circumstances;

- On pricing, to protect return to Exchequer in current markets.

(ii) Subsequent consultation with industry on details of proposals.

(iii) In light of consultation, Government announced on 9 February amended approach on PRT pricing (OR vol 100 no 48 WA cols 29-30).

(iv) To ensure actual sale proceeds taxed to PRT, company may nominate - within specified time limits - deals which relate to oil it has produced itself.

(v) Changes on valuation effective from 1 January 1987, and on pricing from 1 March 1987.

(vi) Costs: Changes not part of 1987 Budget. (Any tax effects already taken into account in Budget and FSBR baseline.) In any case, revenue effects very difficult to predict as depend on degree of volatility in future oil markets.

(vii) Operation of 1975 valuation rules gave rise to uncertainty in present markets; 1975 pricing rule not able to prevent companies choosing low prices as basis of PRT.

Positive

(i) Valuation change designed to reflect how market now works, removing uncertainty inherent in applying old - 1975 - rule to present market conditions.

(ii) Pricing change should ensure nation receives full share of return from profits of producing North Sea oil.

(iii) Industry endorsed Government's aims on both changes and welcomed opportunity to consult on detail of proposals. In both cases Finance Bill legislation will take account of comments made.

Defensive

(i) Increasing tax take when industry already hit by price fall. Not structural changes designed to increase tax take: aim simply to remedy defects in existing rules. Companies will pay more tax only when hitherto have taken advantage of these defects.

(ii) Adversely affect oil (Brent) market: No part of Government's object to influence market itself. No complaint made that current proposals unreasonably constrain companies trading as commercial considerations dictate.

(iii) Retrospective taxation? No so. Government clearly signalled intentions in November 1986 and initiated consultation with those affected by proposed change. Finance Bill legislation will reflect comments made.

Contact point: Miss M A Hill (Inland Revenue) 2541 6018

FF2 BUSINESS TAXATION: OTHER PROVISIONS

[See also Effects of Budget on business (Brief F1)]

Brief Contains:

A CORPORATION TAX (CT) RATES

Inland Revenue issuing Press Notice on Budget Day.

[See also Industry Act forecast of UK economy (Brief B1), PSBR: 1986-87 and 1987-88 (C3), International tax reform (HH1), Corporation tax payment dates (Brief HH8) and International tax comparisons (LL1)]

Factual

(i) 1987 Budget sets rates for financial year 1987 (ie year ended 31 March 1988) at 35 per cent.

(ii) Before 1984, rates set in arrears. So not essential to set rate for financial year 1987 until 1988 Budget.

(iii) Rates last set in 1984 Finance Act when major reform announced to reduce distortions. Elements of reform:

(a) Phased reduction in main CT rate

Financial year	Main CT rate
1982	52 per cent
1983	50 per cent
1984	45 per cent
1985	40 per cent
1986	35 per cent

(b) Phased abolition of incentive first year allowances for plant and machinery and incentive initial allowances for industrial buildings:

Financial year	First year allowance	Initial allowance
	per cent	
1983 (up to and including Budget Day 1984)	100	75
1984 (and after Budget Day 1984)	75	50
1985	50	25
1986	Nil	Nil

Instead of first year and initial allowances, expenditure on plant and machinery and industrial building given writing down allowance against company's taxable profits. For 1987-88 remains at same levels as for 1986-87

- 25 per cent a year for plant and machinery. Reducing balance basis applies to allowance for any year at 25 per cent of cost, less allowances already given (effectively exhausted in 8 years.)
- 4 per cent a year for industrial buildings. Straight line basis applies to allowance at 4 per cent a year over 25 years. (So allowance continues for 25 years.)

(c) Immediate abolition of stock relief for accounting periods beginning on or after Budget Day 1984.

(iv) Revenue neutrality of 1984 CT reform: Asserted in 1984 reform would be broadly neutral over transitional period. (NB transitional period never specified, nor made clear whether claimed neutrality referred to direct effects only.)

(v) Yield

In 1978-79	£ 3,940 million
In 1985-86	£10,700 million
In 1986-87	£13,400 million
In 1987-88	£15,000 million

(vi) Rate of Advance Corporation Tax (advance payment of CT where companies pay dividends) reduced in line with income tax from 6 April 1987. Shareholders receiving dividends get tax credit of equivalent amount which accounts for their basic rate income tax liability.

Positive

(i) Announcing main CT rate in advance provides companies with certainty. Allows them to plan ahead. Many requests for advance announcement.

(ii) UK's main CT rate one of lowest of any major industrial country. (NB From 1 July 1987 US rate lower than UK's CT main rate, at 34 per cent.) (See also HH1, LL1.)

(iii) Lower level of CT, together with changes in capital allowances, gives incentive to better quality investment by removing distortions which subsidised unprofitable investment and were biased against employment; profitable projects and enterprise rewarded.

Defensive

(i) Revenue neutrality of 1984 CT reform:

- Profits have grown faster than expected in 1984. So benefit of reduced CT rate to profit-making companies is higher than expected. But previously unprofitable companies may have turned into tax paying companies faster than assumed in 1984.

- Increasingly difficult to disentangle effect of 1984 reforms from other factors affecting both profitability and CT paid on those receipts. CT reform one of number of measures to increase efficiency and dynamism of corporate sector.

- In longer run, when reform worked through, will mean reduction in tax burden borne by companies.

(ii) 1984 reforms have led to fall-off in investment. Industrial investment in 1985 at record levels in real terms. Expected to show slight fall-off in 1986 (partly because some investment brought forward to benefit from first year allowances finally withdrawn). But investment expected to rise by around 6 per cent in 1987 and by similar amount in 1988 (DTI Investment Intentions Survey). (See also B1, BB1.)

Contact points: J H Reed (Inland Revenue) 2541 6442
D A Carr (Inland Revenue) 2541 6390

B CT: SMALL COMPANIES

Inland Revenue issuing Press Notice on Budget Day.

[See also Income tax: main changes (Brief D1) and Effects of Budget on small and unincorporated businesses (F3)]

Factual

(i) Small companies' corporation tax rate reduced to 27 per cent for Financial year 1987 (ie year ended 31 March 1988) in line with income tax basic rate. (See D1.)

(ii) Profits limits used to determine entitlement to relief remain at present levels of £100,000 and £500,000 (unchanged since Financial year 1982). (But 37 per cent in taper band - gradually withdrawing benefit of small companies rate - from £100,000 to £500,000, but average rate always below 35 per cent.)

(iii) Cost: Negligible in 1987-88; £45 million in 1988-89.

Positive

(i) Further evidence of Government's determination to encourage small businesses.

(ii) Small companies' rate reduced by 11 percentage points to 27 per cent (Financial year 1987) in five years.

Defensive

(i) Why not bigger cut in small companies' rate? Not right to reduce rate for companies below rate borne by most unincorporated businesses (basic rate).

(ii) Increase profits limits: No need for change in limits over period when have been substantial reductions in main and small companies' rates of CT. Over 80 per cent of companies still qualify for small companies' rate.

Contact points: J H Reed (Inland Revenue) 2541 6442
D A Carr (Inland Revenue) 2541 6390

C OFFSHORE FUNDS

Factual

(i) Introduction of Inland Revenue discretion to certify offshore fund as distributing fund (one which distributes at least 85 per cent of its income and satisfies certain investment criteria). Will be possible to extend time limit for making distributions and to ignore inadvertent breach of investment conditions.

(ii) Certification means investor chargeable to capital gains tax on gain on disposal of his interest; otherwise, gain chargeable to income tax.

(iii) Effective for accounting periods ending after 1987 Finance Bill receives Royal Assent.

(iv) Cost: Negligible in 1987-88 and 1988-89.

(v) Representations: Law Society pressed for greater Inland Revenue discretion. British Bankers' Association (BBA) have pressed for more radical amendments.

Positive

(i) Response to representations. Proposed changes discussed with BBA.

(ii) Provides more equitable regime for investors since failure of fund to qualify in one year results in income tax charge on investor's gain over whole period of investment.

Defensive

(i) Does not go far enough? Meets case where failure to qualify due to inadvertence. Fund which deliberately flouts present rules not deserving of sympathy. Risk of manipulation - and significant cost - if more radical changes (eg income tax charge applying only to gains of years of non-certification) adopted.

(ii) Why help investors in overseas funds? Proposed change intended neither to help nor hinder investment overseas; meets legitimate concern of funds about drastic consequences for investors of inadvertent breach of rules.

(iii) Handout to rich? Gains made by UK residents from investment in offshore funds remain fully liable to tax; proposed change will apply in relatively few cases and although generally beneficial, effect will depend on circumstances of each case.

Contact point: J P B Bryce (Inland Revenue) 2541 6372

D CAPITAL ALLOWANCES: ASSURED TENANCIES

Inland Revenue issuing Press Release on Budget Day.

Factual

(i) Capital allowances introduced in 1982 for costs of constructing property for letting on assured tenancies to cover expenditure incurred in 5 years ending 31 March 1987, to encourage private rented sector.

(ii) Availability of writing down allowances extended further 5 years to 31 March 1992 in 1987 Budget.

(ii) Rate of allowance same as for industrial buildings.

- Expenditure on or before Budget Day 1984 attracted initial 75 per cent allowance plus annual writing down allowance of 4 per cent on unrelieved balance. (See subsection A.)

- Following 1984 reforms, now normally 4 per cent a year straight line.

(iv) Cost: Negligible in 1987-88 and 1988-89; long term cost unlikely to exceed £5 million a year.

(v) Assured Tenancy (AT) scheme introduced in Housing Act 1980. Approved landlords may let homes on assured tenancies provided built after 8 August 1980 and not lived in other than on assured tenancy terms. Rents freely negotiated between landlord and tenant. Tenant has security of tenure and right to renewal of lease.

(vi) AT scheme extended under Housing and Planning Act 1986 to cover substantially repaired or improved properties as well as "new build". Extension applies to lettings made from January 1987 but expenditure on improvements etc can have been incurred at any time in 2 years preceding lettings.

(vii) Capital allowances for AT properties wholly exceptional. Other residential property normally specifically excluded from benefit of capital allowances. Nor do capital costs of erecting fabric of commercial buildings (other than those in enterprise zones and certain hotels) qualify for relief.

Positive

(i) Extension of relief for further 5 years broadly coincides with extension of AT scheme to include letting of substantially repaired or improved property.

(ii) Represents small but important measure to encourage new private investment in housing for rent in line with Government's objective of creating healthy market in privately-owned rented property.

Defensive

(i) Return to more generous pre-1984 regime: Under 1984 business tax reforms initial allowances phased out generally. AT scheme not exempted from changes designed to create more neutral tax system based on lower rates of tax and allowances for depreciation at more realistic rates. AT allowances therefore stepped down in line with those for industrial buildings. To reintroduce incentive allowances would be inconsistent with underlying corporate tax strategy. Nevertheless, AT scheme does attract 4 per cent writing down allowances, which other non-industrial buildings do not.

(ii) Why renew availability of capital allowances when AT scheme itself not success? Scope of AT scheme recently widened to include substantially repaired or improved properties. Continued availability of capital allowances for further 5 year period will contribute to future success of enlarged scheme.

(iii) Scheme a failure: Limited success, but private sector generally doing well recently: about 180,000 private sector housing starts in 1986, higher than in any year 1974-85.

Contact points: P J A Driscoll ((Inland Revenue) 2541 6287
G A A Elmer (Inland Revenue) 2541 7505

E APPORTIONMENT OF INCOME ETC OF CLOSE COMPANIES

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Apportionment is process by which income of closely-controlled company (broadly, one controlled by five or fewer people) can be attributed to participators (broadly, shareholders) who are charged to tax on it at higher rates of income tax. Prevents higher rates being avoided by accumulating income within close company (where taxed at CT rate) instead of distributing it.

(ii) Since Finance Act 1980 apportionment not applied to trading income of close company, but still applies to investment income.

(iii) Existing legislation says Inspector may apportion. Inland Revenue's legal advice is that Inspector obliged to make apportionments. Court of Appeal held in 1986 Inspector had discretion (case involving covenanted payments to charity made by Lansing Bagnall Ltd).

(iv) Inspector's discretion to be removed for accounting periods beginning on or after Budget Day. So Inspector obliged to apportion except, in practice, for 'de minimis' amounts.

(v) For earlier periods Inspectors will exercise discretion using Inland Revenue guidelines, to be published on Budget Day as Statement of Practice.

(vi)
- Apportionment may also apply to covenanted payment to charity by close company.
- In past, necessary to prevent avoidance of £10,000 limit on higher rate relief for such payments made by individuals. Limit abolished 1986 (except where charity itself fails to meet conditions for tax exemption).
- So apportionment (on covenanted payments to charity) now applies only to extent that charity itself fails to qualify for relief (individuals would get no relief for such convenanted payments).
- Again, Inspector will be obliged to apportion, exempt for 'de minimis' amounts.

Positive

(i) Future application of apportionment legislation more certain.

(ii) Position restored to what always intended. Wrong that Inspectors should have discretion whether or not to charge tax (except on 'de minimis' grounds).

Defensive

(i) Right to retain discretion: No. Unsatisfactory to have this sort of unfettered discretion in tax legislation.

(ii) Court's decision overturned: Only for future. Court disliked unfettered discretion - but felt obliged to decide this because of terms of legislation.

(iii) Will discretion for pre-Budget cases produce inconsistencies? Inland Revenue guidelines will reduce risk. But impossible to eliminate this when Inspector given unfettered discretion. To remove this discretion would require retrospection.

(iv) Implications for other tax provisions? So far Inland Revenue have not identified any provisions which require similar amendment (but review of tax legislation continuing).

Contact points: J H Reed (Inland Revenue) 2541 6442
D J Huffer (Inland Revenue) 2541 6257

F BUILDING SOCIETIES: CT ON GAINS

[See also Miscellaneous savings measures (Brief EE4)]

Factual

(i) Special rules apply to transactions between companies that are members of same group. Broadly, rules treat group of companies as single entity so that assets can be transferred between group members without immediate tax consequences. Tax charge arises when company which has received asset from another group member leaves group within 6 years of receiving it.

(ii) Provisions do not apply to building society and its subsidiaries because building society not "company" for these purposes. Only significant since Building Societies Act 1986 made it possible for building societies to form groups and have subsidiaries.

(iii) Proposed to put building societies and their subsidiaries on same footing as other groups of companies with effect from Finance Bill Royal Assent.

(iv) Cost: Negligible.

Positive

Building Societies and their subsidiaries will be in exactly same position as other groups of companies.

Defensive

(i) Tax concession for building societies? No. Provides tax deferral, not exemption, for intra-group transfers. Assets disposed of to outsiders chargeable in normal way.

(ii) Tightening up? No. Purely technical consequential of Building Societies Act.

Contact points: M F Cayley (Inland Revenue) 2541 7427
P A Michael (Inland Revenue) 2541 7571

G EXCHANGE RATE FLUCTUATIONS

Factual

(i) Not part of Budget as such.

(ii) Inland Revenue issued Statement of Practice (SP) and Press Notice 17 February setting out views on tax treatment of exchange rate fluctuations under current law. SP takes account of comments made by representative bodies following publication of provisional SP in January 1985.

(iii) Current law allows traders to deduct exchange losses on long-term currency liabilities only so far as liabilities 'matched' with currency assets, on which there is corresponding exchange gain. Even where matching recognised for purpose of computing trading (Case I) profits, gain on currency asset may still give rise to chargeable gain liable to capital gains tax (CGT), with no corresponding deduction for loss on liability. This 'tax fragmentation' has been attacked as asymmetrical and illogical.

(iv) Ministers invited detailed representations on possible law reform to be sent to Inland Revenue.

Positive

(i) SP useful and practical guide for traders and their advisers to current law.

(ii) Ministers recognise limitations of present system: possibility of major legislative reform not ruled out. Hence invitation to submit proposals for reform.

(iii) Government not acting hastily but undertaking wide consultation.

Defensive

(i) SP does not meet companies' needs. Statement goes as far as possible within existing law. Representative bodies' wider demands could be met only by new legislation.

(ii) Why no legislation in 1987 Finance Bill? Widely recognised as formidably complex problem. SP on current law runs to 13 pages. Wrong to rush into legislation without full examination of all possible solutions. No consensus in industry/commerce on what is 'right' solution.

(iii) Government not serious about introducing legislation: Complex subject and possible that solution could be very expensive. So Government cannot undertake in advance to reform law. But wants to examine carefully and positively whether effective solution possible without entailing risk of unacceptable cost to Exchequer.

Contact points: P J A Driscoll (Inland Revenue) 2541 6287
D A Carr (Inland Revenue) 2541 6390

H SECTION 482 TAXES ACT 1970 (COMPANY MIGRATIONS ETC)

Factual

(i) Section 482 of Taxes Act 1970 makes unlawful certain transactions (eg company migrations) where carried out without Treasury consent. Five general consents cover situations where no clearance needed. Criminal penalty.

(ii) Government announced in 1986 Budget that it had concluded, after review of representations from business, inappropriate to make substantial changes to Section 482 at present time.

(iii) But representations invited on general consents (automatic let-outs for company migration etc) and case for removing criminal penalty for non-compliance would be examined against background of Keith.

(iv) 'Daily Mail' case (in which Treasury consent to emigrate was not given) referred to European Court in February.

Positive

(i) Considering representations on general consents (most not received until December). Statement will be made shortly on any changes to be made.

(ii) Criminal penalty being considered together with other penalties for tax offences referred to by Keith Committee (up to end October 1987).

(iii) Section 482 prevents substantial tax losses.

Defensive

(i) Section 482 should be abolished. Government announced a year ago after full consultation that inappropriate to make changes, and still remains its view.

(ii) General consents should be widened. Accept case exists for widening. Statement on this will be made shortly. Widening would reduce number of occasions when applications for specific consents have to be made.

(iii) When will changes in general consents be announced? Expected in April/May.

(iv) Criminal penalty not appropriate: Keith Committee did not formally recommend that criminal penalty should be abolished. Merely recorded its view in favour of principle of making penalty civil one.

(v) Government defeated by 'Daily Mail'/Treaty on Rome bars application of Section 482 to migrations to other EC countries: Subjudice but judge said arguments balanced and therefore right that question should be referred to European Court.

Contact point: P W Fawcett (Inland Revenue) 2541 6497
Mrs C Smyth (Inland Revenue) 2541 6015

FF3 BUSINESS EXPANSION SCHEME (BES)

Inland Revenue issuing Press Notice on Budget Day.

[See also Inheritance Tax (IHT): details (Brief EE1) and effects of Budget on small and unincorporated businesses (F3)]

Factual

(i) BES offers income tax relief to individuals investing up to £40,000 a year in new full risk equity of certain unquoted UK trading companies with which not connected. Most trades eligible but some exceptions.

(ii) Scheme introduced 1983 as successor to Business Start-up Scheme (introduced 1981) for four years but extended indefinitely 1986. 1986 Finance Act also provided that:

- BES shares issued after Budget Day 1986 exempt from capital gains tax;

- companies with substantial property backing or carrying on trades holding investment goods (eg fine wines) excluded;

- scheme extended to ship chartering companies.

- plus various other changes including allowing BES company to have overseas subsidiaries.

(iii) 1987 Budget contains proposals to reduce effect of bunching of investment towards last quarter of tax year and to improve effectiveness of scheme for film production companies.

(iv) Bunching:

- Investment under Scheme concentrated in last quarter of tax year; little in first half. Said to be caused by individual's unwillingness to invest until has good idea of how much money he has available (may depend on amount of spare capital and tax position for year). Difficult for companies to attract funds in first half of tax year.

- Change designed to encourage earlier investment. For investments made in first half of tax year, investor will be able to claim part of relief against income of previous year. Carryback subject to maximum of £5,000 in respect of total BES investments made in first half of tax year.

(v) Film production.

- Scheme extended to film production companies in 1984 Finance Act. But little take up partly owing to some difficulties in meeting qualifying condition that company must produce films throughout 3 year qualifying period.

- Condition relaxed so can be met by company distributing films produced during qualifying period.

- Change designed to encourage greater use of Scheme by bona fide film production companies. In practice this will help company set up to produce single film where production is likely to take less than three years.

(vi) Cost of changes: Uncertain but perhaps £5 million a year.

(vii) TUC wanted to abolish BES (Budget representations).

(viii) Neil Kinnock MP welcomed Chancellor's 1986 decision to extend BES indefinitely and exclusions announced then. (OR 18 March 1986 vol 94 no 80 col 185)

Positive

(i) Proposal to encourage investment earlier in tax year should give companies better chance of attracting BES finance at any time of year.

(ii) Film production companies will be able to compete freely for BES finance with new certainty that conditions can be met.

(iii) Scheme great success, as illustrated by take-up figures

- 1983-84: 715 companies raised £105 million.

- 1984-85: 807 companies raised £148 million.

- 1985-86: Investment expected to have been higher. Preliminary figures suggest about £165 million will be raised.

- 1986-87: 1986 restrictions seem not to have reduced investment greatly.

(iv) Study by Peat Marwick in 1985 showed

- almost half investment would not have been raised in any form without Scheme;

- over 70 per cent would not have been raised as equity.

Defensive

(i) Proposal to reduce effect of year-end bunching does not go far enough. Should be considerable help. Doubt other possibilities more effective and might need difficult transitional rules to avoid new distortions.

(ii) Introduce ceiling on investment in any one company. Large companies also face difficulties raising equity capital. Proposal would effectively exclude eg ship chartering companies but Scheme only extended to them in 1986 on grounds that ship chartering was kind of risky trade for which BES intended (two public offers this tax year seeking total of £20 million).

FF4 VAT AND SMALL BUSINESSES: DETAILS

Customs and Excise issuing Press Notices on Budget Day

[See also Effects of Budget on small and unincorporated businesses (Brief F3) and Keith Report (HH2)]

Factual

(i) Package of changes in VAT accounting and record-keeping procedures to assist small businesses. Follows up consultation document, "VAT: Small Business Review", issued October 1986, with some improvements to benefit of taxpayer.

(ii) Main features

- Cash accounting: Subject to necessary derogation from EC law (formal application made on Budget Day), businesses with turnover up to £250,000 to have option of accounting for VAT on basis of cash paid and received. (Improves on consultation document proposal of turnover limit of £100,000.) Automatic bad debt relief will be obtained by businesses using cash accounting.

- Annual accounting: Businesses with turnover up to £250,000 to have option of making one VAT return a year, instead of four at present; payments to be made on account during year. (Proposal turnover limit again increased from £100,000 proposal in consultation document.)

- Registration and deregistration: VAT registration threshold to be increased from £20,500 to £21,300 (3.9 per cent) indexation based on real value, £5,000, at April 1973 when VAT introduced; time limit for notification of liability to register to be increased from 10 days to 30 days. Also other technical changes.

- Special schemes for retailers: Package of changes to retail schemes to make them simpler for small and medium sized businesses; use of retail schemes to be withdrawn from certain non-retailers, eg solicitors, estate agents and in other cases to be limited to genuinely retail supplies.

(iii) Two proposals from consultation document dropped in response to representations. Now

- no compulsory deregistration of traders below VAT threshold;

- no withdrawal of standard method of calculating gross takings by retailers.

(iv) Independent consultant currently examining VAT record-keeping and preservation requirements as affect small businesses; due to report by end May 1987.

(v) Registration threshold: Proposal maximum compatible with existing EC law. More flexibility sought on EC law. EC Commission has produced draft Small and Medium-sized Enterprises Directive, proposing optional maximum of 35,000 ecus (about £26,000).

(vi) Dates of introduction

- Cash accounting on 1 October 1987, subject to EC agreement.
- Annual accounting in summer 1988.
- Registration limits Change effective midnight 17 March 1987 (consequential changes in deregistration limits effective for technical reasons from 1 June 1987).
- Time limit for notification of liability to be registered: Royal Assent to Finance Bill.
- Special schemes for retailers: Changes effective autumn 1987.

(vii) Delay of third phase of VAT "Keith" measures: Priority to be given to computer re-programming so that facility of annual accounting can be offered to small businesses at earliest practicable date. (See HH2.)

(viii) Costs

- Cash accounting: Once-and-for-all revenue cost of £100 million in 1987-88. Continuing annual cost of about £10 million a year.

(NB Over 800,000 VAT registered traders who are net payers of tax have turnover of less than £250,000. But about 60 per cent of these already use retail schemes or other special accounting arrangements. Figures assume that about two-thirds (200,000) of eligible businesses will take up cash accounting option.)

- Time limit for notification of liability to be registered: £15 million in 1987-88; £25 million in subsequent years.
- Postponement of Keith Phase III: £25 million in 1988-89; some £50-£75 million in 1989-90.
- Other proposals: Nil or broadly neutral.

(ix) Representations

- 192 responses to consultation paper from trade and professional associations, accountancy firms and individual businesses, together with 1,256 completed questionnaires from small businesses.
- CBI wanted cash accounting for all businesses eventually, but initially for businesses up to £1 million turnover.
- Some respondents to consultation exercise recommended turnover limits for cash accounting and annual accounting in range £500,000 to £2 million or even no limit at all.

Positive

(i) Consultation exercise generally welcomed by most respondents.

(ii) Increase in turnover limits proposed for cash accounting and annual accounting from £100,000 to £250,000 demonstrates Government's concern to make these options widely available, taking account of constraints of EC law and of cost and revenue control considerations.

(iii) Response to consultation exercise suggests that (with those turnover limits) cash accounting likely to be taken up by about two-thirds of 300,000 eligible businesses; annual accounting by some 150,000. (Take-up could be up to one-third greater than with £100,000 limit, - large proportionate increase because population not much higher.)

(iv) Dropping of two consultative document proposals demonstrates value of consultation exercise and Government's willingness to take careful account of representations received.

(v) Postponement of Keith Phase III demonstrates concern that annual accounting should be introduced as quickly as consistent with necessary computer programming.

(vi) Government will consider independent consultant's report on record-keeping requirements as matter of urgency when received. Recognises concern of many small businesses about this perceived burden.

(vii) Proposals generally consistent with EC law. For cash accounting Government acting urgently by applying to EC Commission on Budget Day for necessary legal derogation, with proposed operative date of 1 October 1987.

Defensive

(i) Turnover limits for cash accounting and annual accounting too low: Not so. Proposed limit of £250,000 represents considerable improvement of consultation document proposals for £100,000, at significant once-for-all cost. Impracticable to go further in light of EC and revenue control considerations.

(ii) Bring in proposals more quickly: Not possible. Cash accounting will be introduced from 1 October: delay necessary for legislation, discussion with EC and detailed preparation of scheme. Annual accounting in summer 1988 as soon as major redesign of VAT accounting section of Customs and Excise computer system can be undertaken.

(iii) Need much higher VAT registration threshold. £21,300 is maximum compatible with existing EC law. Government has sought greater flexibility. EC Commission now produced draft Directive proposing optional maximum of about £26,000. Government seeking further improvement.

(iv) Urgent need to reduce VAT record-keeping burden on small businesses: As proposed in October 1986 consultation document, independent consultant currently studying. Report expected by end May 1987. Government will reach decisions on recommendations as soon as practicable thereafter.

(v) Proposals affecting large businesses inappropriate to "Small Business Review": Section on retail schemes contained balanced package of 15 proposals: 11 of direct benefit to small businesses. Appropriate trade associations were consulted and had opportunity of making representations. End result: proposal to withdraw standard method of reckoning gross takings, which would have affected mainly mail order (larger) businesses, dropped from Budget package.

(vi) Abolition of VAT on credit transactions between registered traders would be radical improvement in system. No. Has been reviewed again. But little comment in response to consultation exercise. Far from offering simplification, Government believes it would complicate tax while endangering revenue. In any case, unlikely EC would accept what would in effect be retail sales tax. "Silent majority" clearly accepts these arguments.

Contact point: C J Holloway (Customs and Excise) 2913 5339

FF5 INDUSTRIAL RESEARCH AND DEVELOPMENT (R&D)

[See also UK economy: recent developments (Brief BB1) and North Sea taxation: details (FF1)]

Factual

(i) No relevant policy changes on Budget Day.

(ii) UK and competitors' R&D spending as percentage of GDP in 1984 (latest comparable data available)

	UK	US	Japan	W Germany	France
Total Govt R&D	1.4	1.2	0.5	1.1	1.5
Govt civil R&D	0.7	0.4	0.5	1.0	1.0
Govt R&D on industrial development	0.10	0.003	0.03	0.13	0.16
Private sector R&D(1)	0.9	1.5	2.0	1.5	0.8

(1) 1983 (latest available data)

(iii) UK Government R&D spending

£ million

	DTI R&D expenditure(1)	Total civil	Total(3)
1978-79	106	1,069	2,097
1986-87 (plan)	383 (2)	2,256	4,666
1987-88(plan)	412	2,232	4,726

(1) includes support for innovation, Section 8 support, aerospace, space and research establishments but not launch aid

(2) estimated outturn

(3) including defence

(iv) Progressive change in pattern of DTI R & D support announced 25 March 1985 (OR vol 76 col 38):

- greater emphasis on collaborative research, advisory services and schemes for encouraging best practice and improving key skills;
- less support for individual firms;
- criteria for support tightened.

(v) Opposition Parties promise major increases in Government industrial R&D spending. Not quantified, except SDP/Liberals' pledge of immediate £85 million increase in science budget ("Jobs and Competitiveness", March 1986). SDP/Liberals would also set up New Technology Enterprise Corporation within British Technology Group to stimulate new technologies ("More Jobs in a Fairer Britain", 10 March). Labour Party propose to increase research staff in universities and higher education generally, and also to increase Government support for industrial R&D, hence creating 30,000 research jobs ("New Jobs for Britain", 11 March).

(vi) Representations

- CBI Budget representations included proposal to allocate 1 per cent of major Departments' R & D spending to small firms.

- Electronic Engineering Association proposed increased tax incentives for R & D in August 1986.

- House of Lords Report (see below) recommends Government study of feasibility of extra tax incentives.

(vii) New LINK initiative (announced 10 December 1986 OR vol 107 no 22 cols 160-161) means Government can support up to half cost of collaboration between scientific community, industry and Departments, to enhance commercial exploitation of publicly - funded research. Should also stimulate private sector R & D spending. Government funding up to £210 million over 5 years. Other collaborative research programmes continuing in association with LINK.

(viii) Eureka (European Research Coordinating Agency), established early 1985, supports industry-led collaborative projects to exploit R & D commercially. Strong UK backing. Over £2 billion spent on 109 projects involving 41 UK firms.

(ix) House of Lords Select Committee on Science and Technology

- Report on civil R & D, published 8 January, said UK R & D underfunded by public and private sectors. Called for greater co-ordination of Government-funded R & D including Cabinet Minister responsible for science and technology aspects of policy and promotion of national R & D effort.

- Debated in House of Lords on 19 February.

- Government response due by Summer Recess.

Positive

(i) Total Government R&D spending about 1.4 per cent of GDP, very similar to other major countries and much higher than for Japan (0.5 per cent of GDP). Planned total public expenditure on R&D in 1987-88 is £4.7 billion.

(ii) Split of Government spending: Government civil R&D running at £2¼ billion a year (47 per cent of total Government R & D spending in 1987-88).

DTI R&D spending	£ million	as percentage of total DTI budget
1978-79	106	9
1986-87 (estimated outturn)	383	30
1987-88 (plan)	412	38

(iii) UK Government-funded civil R&D (0.7 per cent of GDP) well above levels in US and Japan (0.4 per cent and 0.5 per cent respectively).

(iv) Government civil R&D targeted to produce widest possible benefit for economy with emphasis on programmes which spread technology and encourage collaboration. Support provided in clear cases of market failure but generally for companies themselves to respond to market opportunities.

(v) Survey, published 27 February in "British Business", shows encouraging 14 per cent increase (cash) in UK private sector R&D from £4.2 billion in 1983 to £4.8 billion in 1985.

Defensive

(i) Government civil R&D spending less than for major competitors? Government funding for civil R&D as proportion of GDP varies considerably between major countries but UK proportion well above US and Japan. Main problem has been lower R&D spending by industry than among major competitors.

(ii) Industry needs fiscal encouragement to spend more on R&D? Industry now highly profitable (see BB1), thanks to Government's efforts to create right climate (low inflation, sustained growth, deregulation etc). Well placed to increase own spending on R&D and has done so.

(iii) 100 per cent capital allowances for scientific equipment should be extended? 100 per cent relief specially aimed at research not development. But capital spending on development plant and buildings receives normal allowances (25 per cent and 4 per cent respectively). Also, extra benefit in case of short-life plant (4-5 years) which can be written off over useful life of plant. Little evidence of any R&D project not going ahead because allowance applies too narrowly.

(iv) Government should increase tax relief for R&D? Substantial relief already available

- 100 per cent first year scientific research allowances for capital spending;
- allowances for capital spending on development plant and buildings;
- most R&D is current spending and therefore fully deductible in calculating taxable profits.

Alternative methods of providing relief kept under review, but studies of schemes overseas (US, Canada, Sweden etc) suggest tax allowances for R&D not very cost-effective way of stimulating R&D. Such allowances very expensive and run counter to 1984 corporate tax reforms. Important to look at all aspects of tax system (eg UK corporation tax rate one of lowest in industrialised world). Government also provides substantial grants for R&D (over £400 million planned by DTI in 1987-88).

(v) Compulsory disclosure of R&D in company accounts? Government strongly favours disclosure of R&D in company accounts. Best if this can be achieved through voluntary agreement by Accounting Standards Committee (ASC) but mandatory requirement not ruled out.

(vi) Why does Budget single out oil industry but not other sectors for help in research? See FF1.

(vii) Government lacks overall R&D strategy? Government taken steps to improve co-ordination of R&D across Departments, to maximise R & D contribution to efficiency, competitiveness and innovative capacity of economy.

- Actively reviewing all its R & D programmes and has established Assessment Office on Science and Technology in Cabinet Office to help in this. Will work with Departments and advise Ministers collectively on relative priorities between R&D programmes.

- Advisory Board for Research Councils (ABRC) currently undertaking strategy exercise (consulting University Grants Committee) on priorities for science budget.

- New LINK initiative is major step towards greater co-ordination of UK R&D expenditure by bringing together industry, publicly funded scientists and Government Departments on collaborative basis.

But ultimately for industry itself to decide level of own R&D investment.

(viii) Government's civil R&D spending falling in 1987-88 onwards? Civil R&D budget £2¼ billion in 1987-88, broadly same as 1986-87 and higher than in all previous years. Government continuing to focus on improving value for money through larger contribution to UK competitiveness.

(ix) Government underfunding EC R&D?

- UK Government, with other member states, arguing for 1987-91 Framework substantially below extravagant proposals from Commission and other member states. But result likely to be significantly higher pro rata than 1984-87 programme.

- Essential to secure value for money on EC R & D programmes at least equal to domestic R & D spending. Not clear has been case (eg Joint Research Centre).

- Government has pressed rigorously and with success for 1987-91 Framework to be far more geared to improving industrial competitiveness than before. (Past Framework heavily weighted to energy-related research.)

- Medical research programme (prevention/detection of major diseases eg AIDS, cancer; and rehabilitation) and RACE telecommunications programme (Research into Advanced Communications for Europe) programmes still under discussion and not in state to be adopted. UK supports research in both areas.

- Government committed to EUREKA programme for stimulating European industry-led collaborative projects to exploit R&D commercially. 109 projects announced, 41 involving UK firms, with total investment of over £2 billion.

<u>**Contact points:**</u> T U Burgner (IAE) 270 4449
D Bartlett (IAE2) 270 4658

GG1 VEHICLE EXCISE DUTY

Department of Transport issuing Press Notices on Budget Day.

[See also Excise duties (Brief G1) and Labour Party proposals (J1)]

Factual

(i) No change in duty rates, except:

- concessionary rates on farmers' heavy goods vehicles increased by between 5 per cent and 34 per cent (from 18 March);

- rates for trade licences which allow motor traders and vehicle testers to use unlicensed vehicles temporarily in their possession, to be increased by 21 per cent (from 1 January 1988);

- new tax class introduced for recovery vehicles (currently mainly used under trade licences): rate £50 per year (from 1 January 1988).

(ii) VED enforcement measures (from 1 October 1987):

- Increase in back duty payment on conviction for VED evasion: courts will be required to order payment of all back duty due from owner from expiry of last licence or date of acquisition of vehicle, without regard for any non-use of vehicle during that period;

- Increase in maximum penalty for failure to surrender tax disc when paid for by cheque which subsequently dishonoured.

(iii) RPI impact of VED changes: Nil.

(iv) Yield from Budget changes: About £5 million in 1987-88 and £10 million 1988-89. Preferable not to give breakdown.

[IF PRESSED: Figures below are rough estimates and should be used only if essential:

	1987-88	**1988-89**
Farmers' heavy goods vehicles	£2.5 million	£ 2.5 million
Trade licences	£1 million	£ 1.5 million
Recovery vehicles	£0.5 million	- £ 0.5 million
Increase in back duty payments	£2 million	£ 5 million
Increase in maximum penalty in cases of dishonoured cheques	negligible	negligible]

(v) - Total yield of VED: £2,500 million in 1987-88.

- If all VED rates revalorised, would have given £95 million in 1987-88 (£76 million from cars and light vans; £19 million from other vehicles).

(vi) In 1987-88 estimated that

- lorries' share of road track costs (cost of building, maintaining and policing roads) will be £1,120 million;

- share of total motoring taxation will be £1,015 million fuel duty and £460 million VED;

- excess taxation of £355 million in 1987-88 compares with excess of £305 million in 1986-87.

(vii) Scale of VED evasion: 4 per cent of total revenue (Department of Transport Survey, December 1984) (equivalent to £100 million in 1986-87). In 1985-86 850,000 offence reports followed up; 190,000 offenders prosecuted; revenue from enforcement £23 million.

(viii) - Labour Party has suggested ("Fresh Directions", transport policy document, published 12 February) abolition of VED on private cars and recoupment from petrol duty. Now estimated would require 39p increase in price of gallon of petrol (not 20p as Labour Party suggested). (See J1.)

- Government position is that would not abolish VED unless benefits clearly outweigh disadvantages. Then Financial Secretary said (24 October 1985 OR vol 84 col 488) "Possible alternative forms of taxation have been examined but none has been found preferable to the form that we have, even with its acknowledged disadvantages".

(ix) Farmers enjoyed until 1984-85 concessions on their goods vehicles of up to 84 per cent of general rates. Farmers' mileage on average only 40 per cent below average. Duty rates increased in 1985 and 1986 as first two stages of bringing concession down to 40 per cent. 1987 increase final stage.

(x) Trade licensing scheme modernised, broadened and made easier to enter in Finance Bill 1986 following consultation exercise. Benefit of trade licence, recognised by trade, reassessed simultaneously. Department of Transport Press Notice said that benefit best reflected by setting rate at ordinary car rate - would move in stages towards it.

Positive

(i) No increase in most rates.

(ii) Second year of standstill for most vehicles.

(iii) Standstill on lorry VED will help contain industrial costs.

(iv) Standstill for heaviest lorries may help hauliers in obtaining international business in face of foreign competition.

(v) All groups of lorries continue to cover their allocated road track costs.

(vi) Standstill in car VED and petrol duty will help private motorists.

(vii) Introduction of new tax class for recovery vehicles should be broadly welcomed in trade (who have been fully consulted). Clarifies definition of such vehicles and also of trade licensing.

(viii) Increase in back duty payments designed to make it impossible for evaders to gain financially from evading; expected to encourage more voluntary relicensing. With increased penalties in cases of dishonoured cheques, will strengthen VED enforcement.

Defensive

(i) Increases in rates for farmers' goods vehicles unfair?

- Farmers' mileage only 40 per cent below average.
  So right that concession be reduced to standard 40 per cent.

- To mitigate hardship, increase in duty spread over three years from 1984-85.

- Action in 1987 Budget final step of process.

(ii) Farmers' concession wholly unjustified? Concession now brought into line with actual mileage done.

(iii) Increase in trade licence rates? Benefits of trade licences recognised by trade - Government view that best reflected by setting rate at ordinary car rate. 1987 is second stage in increasing rate to that level.

(iv) Why has excess of lorries' tax (VED and derv duty) over road track costs increased? Because of increases in estimated traffic and fuel consumption.

(v) Why should there be any excess tax? Policy is that tax (VED and fuel duty) should at least cover track costs; sets no ceiling. Excess reflects social and environmental factors as well as fiscal considerations.

(vi) Lorries should be taxed more. Every group of lorries more than covers its track costs in fuel duty and VED. Social and environmental costs reflected in margin of excess taxation over road track costs.

(vii) VED widely evaded; better abolished.

- Government takes VED evasion seriously (although estimated scale lower than previously thought - £100 million or 4 per cent of total VED revenue).

- Already dealing vigorously with problem by local enforcement campaign, streamlining enforcement operation.

- Now taking further action to deal with evasion by eg new measures to increase back duty payable on conviction for VED offences, increased penalties in cases of dishonoured cheques.

- Replacement of VED with higher petrol duty would mean increase of 39p per gallon, raising costs of essential high mileage business users.

(viii) Will Government abolish VED? No present plans to abolish VED. Would not do so, unless benefits clearly greater than disadvantages.

(ix) New tax class for recovery vehicles: Large proportion of recovery vehicles clearly do not come into category of vehicles temporarily in licence-holder's possession. Trade fully consulted about proposed change. Rate of duty for new tax class set at concessionary level but envisaged that will eventually equate to that for cars and light vans.

(x) Labour Party plans: See J1.

Contact point: K Romanski (FP) 270 4922

GG2 BETTING AND GAMING DUTIES

Customs and Excise issuing Press Notice on Budget Day.

[See also Excise duties (Brief G1)]

Factual

(i) Duty on on-course betting (horse and greyhound racing), currently 4 per cent, abolished, with effect from 29 March.

(ii) No change in off-course betting duty (8 per cent), gaming licence duty (on casino gaming), rate of bingo duty or rate of pool betting duty.

(iii) Gaming machine licence duty (last increased 1982 Budget) raised with effect from 1 June 1987:

> (a) in pubs, arcades etc, previous rates of £120 and £300 replaced by new charges of £150 for 5p machines (25 per cent increase) and £375 for 10p machines (25 per cent increse);
>
> (b) in clubs, previous rates of £300 for 5p machines and £750 for 10p machines increased to £375 (25 per cent increase) and £960 (28 per cent increase) respectively.

(iv) Revenue effect of changes: Overall neutral 1987-88 (£20 million loss from abolition of on-course betting duty recouped from increase in gaming machine licence duty).

(v) RPI impact effect: Nil.

(vi) Total yield from all betting and gaming duties: £800 million in 1987-88.

(vii) Betting offices off-course benefited from change in law 1986 (allowing televised racing in betting shops and shortly-to-be introduced satellite information services etc).

(viii) Neil Kinnock MP promised to abolish on-course duty (quoted in 'Sporting Life,' 21 March 1984).

(ix)
- Horse-race attendances down from 4.5 million in 1974 to under 4 million in 1986 (but 1986 5 per cent up on 1985).
- Betting turnover halved in real terms 1974 to 1986, though slightly up in 1986.
- Greyhound racing attendances down from 7.6 million in 1974 to 4.7 million in 1986.
- Totalisator turnover down 60 per cent in real terms, but slight increase in 1986.

(x) Home Office approved higher prize limits for gaming machines from 1 January 1987. (Pubs up from £3 to £4; clubs up from £100 to £150.)

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Positive

(i) Abolition of on-course duty will stimulate attendances at racecourses and dog-tracks and help both sports. Meets representations of eg Jockey Club, British Greyhound Racing Board, Horserace Betting Levy Board, Horserace Advisory Council, Horserace Totalisator Board, National Association of Bookmakers.

(ii) On-course market sets odds; off-course (much larger market) follows. If on-course market weak, odds can be manipulated. Increased attendances will strengthen on-course betting market.

(iii) - In 1986, change in legislation benefited off-course betting.

- In 1987 Government help directed to where races take place.

(iv) Abolition from 29 March makes change simple for traders and Customs (accounting period ends 28 March), and prevents confusion resulting from immediate abolition. Also in time for Grand National on 4 April when bookmakers' business brisk.

Defensive

(i) Abolition of on-course betting duty will lead to upsurge in illegal betting (by misdescription of off-course bets as on-course). No. Customs will continue to exercise controls at tracks and retain certain record-keeping requirements to protect off-course duty. But much onus on racing and betting industries to ensure that duty-free on-course betting not abused.

(ii) Why no corresponding decrease in off-course betting duty?

- Expensive: Each one per cent reduction in off-course rate would cost around £30 million. Most unlikely that revenue would be recouped by increased turnover.

- Not justified: No evidence that present (8 per cent) rate of duty unduly onerous. Off-course turnover up over 6 per cent (in cash terms) in calendar 1986.

(iii) Tax-break for idle rich? Nonsense. Vast majority of on-course punters ordinary working people.

(iv) Government prepared to forgo revenue here but not make funds available for [whatever deserving cause]. Helps British racing and bloodstock industries (on which many jobs depend).

(v) Why increase in gaming machine licence duty so high? Duty not increased since 1982 Budget. Full indexation from 1982 would have required 27.2 per cent increase, so duty on most licences still lower in real terms (three rates rounded down to 25 per cent, one rate (top) up to 28 per cent: achieves sensible rounded figures).

(vi) Better to raise gaming machine licence duty steadily than in single large step.

- Annual increases would be small but awkward (for trade and Customs because of need to allow for sensible part-year rates).
- Modest increase at intervals better than tiny annual steps.
- 1987 good time to restore value of duty because Home Office has approved increases in monetary prize limits: increased prizes should result in increased turnover and profits .

(vii) Why no increase in other betting and gaming duties? Apart from gaming machine licence duty, all other duties ad valorem, so real value maintained automatically. Increases could harm industry and could drive some gambling underground.

(viii) Abolition of on-course betting will only encourage compulsive gamblers: Most unlikely. Tend to be found more at gaming machines, where duty increased.

Contact point: W F McGuigan (Customs and Excise) 2913 5101

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GG3 VAT ON TOUR OPERATORS' SERVICES

Customs and Excise issuing Press Notice on Budget Day.

[See also VAT and car tax: main points (Brief G2)]

Factual

(i) As foreshadowed in 1986 Budget, special scheme will be introduced for applying VAT to part of tour operators' gross margins.

(ii) 1987 Finance Bill will contain clause enabling scheme to be introduced with effect from 1 April 1988.

(iii) Scheme required under Community law (Article 26 of Sixth VAT Directive).

(iv) Sales of package tours to places within European Community will bear small element of UK VAT for first time.

(v) Sales of package tours to places outside Community will remain free of all UK VAT.

(vi) Sales of tours to places within UK already liable to VAT, although scheme will alter way in which tour operators have to account for tax.

(vii) Yield: £20 million in 1988-89.

Positive

(i) Holiday packages to other member states of Community will no longer entirely escape UK VAT, as do at present to disadvantage of UK resorts and holiday centres.

(ii) Long lead-in time (intention announced in 1986 Budget) has allowed tour operators ample period to adjust their records to scheme's requirements and and to fix prices accordingly.

Defensive

(i) Tax will make little difference to prices payable by public. VAT charge will probably amount to about 1 per cent for most holidays to other EC member states.

(ii) Chancellor promised no further extension in base of VAT in 1985 (see G2). That was in context of switching areas of zero-rating to 15 per cent. Scheme for taxing part of tour operators' added value required under Community law; Chancellor made clear at time UK had to be bound by EC treaty obligations.

(iii) Scheme too complicated: Inevitably complex because only part of each transaction will be taxed. Details worked out in consultation with Association of British Travel Agents (ABTA).

(iv) Why exempt non-EC holidays? Required under EC law. UK disagrees with distortion and argues against it when under discussion by Community.

Contact point: J W Tracey (Customs and Excise) 2913 5369

HH1 INTERNATIONAL TAX REFORM

[See also World economy (Brief BB2), MTFS: strategy (C1), Burden of taxation (CC3), briefs in Section H, other briefs in Section HH and International tax comparisons (LL1)]

A GENERAL

Factual

(i) - Many developed countries implementing or planning reforms.

- Generally following UK lead in reducing rates of direct tax (especially top rates) and broadening tax base by removing or reducing tax reliefs and shelters which distort decisions.

(ii) (a) Top rates of income tax already reduced or being reduced

	Previous top rate (per cent)	New top rate (per cent)
US	50	28
France	65	58
Australia	60	49
New Zealand	66	48
Ireland	60	58
UK	**98****	**60**

** Including investment income surcharge

(b) Proposed reductions

	Previous top rate (per cent)	Proposed top rate (per cent)
Japan	70	50
Italy	62	56
W Germany	56	53

* local taxes excluded above

(iii) Some countries (eg Japan, New Zealand) following UK lead by switch from direct to indirect taxes.

B INDIVIDUAL COUNTRIES

(i) US

(a) Comprehensive Tax Reform Act passed 1986.

(b) Overall revenue neutral; but switch in burden from individuals (down 6.1 per cent on average) to companies.

(c) 15 tax brackets for individuals reduced to two (15 per cent and 28 per cent). But system more complex than appears on surface. Above $71,900, personal exemption and lower rate reduced by effective 33 per cent rate. Also state taxes on top eg California 8 per cent.

(d) Corporation tax down from 46 per cent to 34 per cent.

(e) Capital gains chargeable at rates applying for income (both companies and individuals).

(f) Many reliefs removed or cut back: Investment credits abolished, deductions for interest, deductions for state sales taxes and medical expenses, individual retirement accounts cut back.

(g) But remaining reliefs still extensive compared to UK: No action on pensions; mortgage interest available without limit on two houses.

(h) Complex minimum taxes on both individuals and companies tightened up. (Alternative tax computation at lower rate but allowing fewer deductions.)

(ii) Japan

Reforms proposed in 1987 to bring down top rate of tax, reduce reliefs for savings accounts, introduce VAT-type tax.

(iii) Canada

Restructuring of corporate tax proposed very recently, reducing allowances for depreciation and reducing federal corporation tax rate to 33 per cent (ie below US and UK). Minimum tax introduced for both individuals and corporations.

(iv) Australia

Reforms introduced 1986. Income tax rates reduced, new tax on fringe benefits, capital gains taxed at full income tax rates, imputation (reducing double taxation of distributed profits) system for corporate taxation introduced.

(v) New Zealand

Rates of income tax being reduced; tax on fringe benefits, new value added type of tax being introduced.

(vi) W Germany

Top and bottom income tax rates being reduced and cuts in corporation tax being proposed. But unlike most other countries, depreciation rules being made more generous in special package for small and medium-sized businesses. Overall direct taxes being reduced; only partly offset by indirect tax increases.

(vii) France

Top rates being reduced; some depreciation allowances reduced and corporation tax cut to 45 per cent (may come down to 42 per cent). Wealth tax abolished.

(viii) Ireland

Series of reports by Commission on Tax Reform. None implemented to date. Outgoing Government published consultative document on introduction of self-assessment in place of PAYE.

Positive

(i) UK started first: 1979 switch from direct to indirect tax; 1984 business tax reform; successive Budgets have reduced rates, removed distorting reliefs.

(ii) US still has more shelters in some areas than UK eg mortgage interest on first and second homes without limit.

Defensive

(i) Comprehensive US type package only effective method of reform: US needed comprehensive reform because so many likely losers if done piecemeal. Have achieved great deal in UK by programme of reform over two Parliaments. Upheaval of comprehensive package can impose uncertainty and serious learning costs on Government, taxpayer and advisers. Starting from different point in UK. "Root and branch" approach not necessarily best.

(ii) UK should follow US example of cutting rates and shelters. UK Government already cut rates and made clear would like to do more. But UK does not have substantial shelters which US reform removes.

- US reform switches burden from individuals to companies; inappropriate for UK where see industry as source of higher employment.

- Has to be borne in mind that quoted US figures would refer to Federal tax rates only.

- US reform revenue neutral overall. But better priority would be to use tax receipts to reduce budget deficit (as UK did). (See C1, BB2.)

Contact point: M A Johns (Inland Revenue) 2541 6768

HH2 KEITH REPORT

Inland Revenue issuing Press Notice on Budget Day.

[See also Corporation tax payment dates (Brief HH8) and Staffing implications of Budget (LL2)]

Brief contains:

A BACKGROUND

B CORPORATION TAX (CT) PAY AND FILE

C PAYE AND SUB-CONTRACTORS

D VAT

A BACKGROUND

(i) Independent Committee, chaired by Lord Keith of Kinkel, set up by Government in July 1980 to review tax enforcement powers of Inland Revenue and Customs and Excise. Report (Volumes 1 and 2 - on income tax, capital gains tax, corporation tax, VAT), published March 1983, made far-reaching recommendations for future administration of tax and compliance and enforcement regimes.

- Bulk of VAT recommendations implemented in Finance Act 1985.

- Vol 3 (Development land tax, petroleum revenue tax, capital transfer tax, stamp duties) published January 1984: taxes are or will be subject of continuing consultation.

- Vol 4 (covering excise, customs, car tax), published February 1985, followed by public consultation. Government response (probably by White Paper) not before November 1987.

(ii) Consultation

(a) Ministers invited comments by end 1983.

(b) Discussions with interested parties 1983 to present (continuing throughout 1987).

(c) VAT recommendations subject of two consultative exercises, second involving exposure clauses.

(d) Inland Revenue consultation document, including draft exposure clauses, published 12 December 1986:

- comments on priority proposals (ie corporation tax (CT) Pay and File and PAYE/subcontractors measures) invited by 13 February 1987;

- comments on non-priority proposals (ie those not in 1987 Budget) invited by 31 October 1987.

(iii) Representations taken into account in formulating proposals.

B CT PAY AND FILE

Factual

(i) Package of proposals paving way for reform of administration of company tax.

(a) Companies to estimate and pay CT on normal due date without need for Inland Revenue to make estimated assessment.

(b) Interest to be paid on tax overpaid or charged on tax underpaid for whole period tax over- or underpaid. Current restrictions denying interest for first year and to non-residents removed.

(c) Companies to make returns within 12 months.

(d) Automatic penalties for late returns, increasing from £100 for delays of less than 3 months to £200 and 20 per cent of tax unpaid for delays of more than 1 year.

(e) Interest rates to be set individually.

(f) Simplified procedure for charging penalties.

(ii) Commencement: Not before early 1992.

(iii) Yield/cost: Nil; package fiscally neutral.

(iv) Staffing: Small short term increase; long term saving up to 140. (See also LL2.)

(v) In 1986, Inland Revenue made some 650,000 corporation tax assessments, of which some 420,000 or 65 per cent had to be estimated and against some 400,000 of which appeals were lodged.

Positive

(i) Result of wide and lengthy consultation with professional bodies and companies both before and after consultative document. Reflects their comments.

(ii) Overwhelming support for proposals, eg "sensible modernisation" Institute of Chartered Accountants (11 February), "the Revenue ought to be congratulated on the alternative developed" Arthur Young, 'Business View' Winter 1986-87.

- Out of 39 responses only 2 expressed any reservations about overall scheme.

(iii) Introduction of PAYE part of wider programme of modernising and streamlining tax collection, which includes major developments in Inland Revenue's computer systems. Pay and file:

- Simplification of tax system for companies.

- Greater efficiency for Inland Revenue.
- Eliminates need for large number of estimated assessments and appeals.

(iv) Compatible with eventual self assessment, if wanted in due course.

(v) Interest on all repayments. Removes present restrictions denying interest for first year and to non-residents.

(vi) Length of period before implementation allows companies and practitioners plenty of time to adapt to new system: new office procedures, computer changes, education of clients, clearing arrears etc.

Defensive

(i) Why legislate now for implementation in early 1990s? Allows time for Inland Revenue to develop and install computer systems and for taxpayers and accountants to adapt procedures, as representations requested.

(ii) Why prescribe contents of tax returns by regulation? Primary legislation insufficiently flexible - unsuitable for detailed, administrative matters of this sort.

(iii) Returns to be made within 12 months (Keith Committee recommended 6 or 7 months): Adopts view of representative bodies.

(iv) No mitigation of penalties

(a) No penalty if reasonable excuse for delay.

(b) Penalty adjusts automatically to seriousness of offence, increasing with length of delay and amount of tax unpaid.

(c) Mitigation by Inland Revenue would involve executive discretion. Removal of executive discretion central theme of Keith Report: preferred automatic penalties as being fair to taxpayer through equality and certainty of treatment.

(d) Mitigation would add to administrative costs. Automatic penalties geared to seriousness of offence achieve same result, but simpler and cheaper to administer.

(v) Penalties charged by assessment: Essential simplification for collection of automatic penalties. Does not alter taxpayer's right of appeal to independent Commissioners.

(vi) Different interest rates for payments and receipts: At present no (unless abuse).

(vii) Pre-1965 companies: Transitional provisions in Budget proposals on payment dates will be completed before Pay and File implemented. All companies will be on same due date. (See also HH8.)

(viii) Package favours Inland Revenue too much: Modernisation, streamlining, simplification have advantages to taxpayers as well as Inland Revenue.

(ix) Why remove current restrictions on interest repayments? Package puts taxpayer and Exchequer on equal footing. Will get commercial interest repayments for use of their money.

(x) Prelude to Pay and File for individual taxpayers? Modernisation, streamlining, simplification desirable in long term for all taxpayers - could take similar form.

(xi) Why treat as priority item? Long lead time to implementation is necessary for Inland Revenue to computerise and taxpayers' accountants to revise their procedures and clear their arrears. Later legislation would mean later implementation.

Contact points: D L Shaw (Inland Revenue) 2541 6300
Miss M A Barlow (Inland Revenue) 2541 6690

C PAYE AND SUB-CONTRACTORS

[See also Income Tax: other changes (Brief DD2)]

Factual

1987 Budget provides

(a) PAYE

- end-year interest charge where PAYE paid late following formal assessment; effective from April 1988.
- technical clarification of when remuneration paid for PAYE purposes (eg PAYE due when director's remuneration voted by shareholders, if not before, such as when drawn on account; measures would also stop deferral of PAYE by artificial fetters on drawing of remuneration credited).

(b) sub-contractors

- end-year interest charge where amounts formally assessed that should have been paid by contractor under deduction;
- companies with 714 "C" sub-contractor certificate to notify Inland Revenue of change of company control;
- new right for Inland Revenue to require production of contractor's records;
- new appeal right against Inland Revenue cancellation of sub-contractor certificate;
- new taxpayer safeguards for some circumstances where contractors mistakenly pay sub-contractors without deduction;

[**IF PRESSED:** Reduction of sub-contractor rate consequential of basic rate cut, not action following Keith recommendation (subcontractor and basic rates traditionally kept in line) (see DD2).]

(ii) Yield: 1987-88 £5 million; 1988-89 £45 million.

[**IF PRESSED.** Largely cash flow effect as companies render returns for, and pay, prior years' PAYE to avoid interest charge.]

(iii) Keith Committee recommended further penalty and interest measures to improve PAYE/subcontractors' compliance. These being further considered.

Positive

(i) Proposals in line with specific Keith Committee recommendations.

(ii) PAYE proposals clarify law, reduce opportunities for eg company directors to delay their PAYE.

(iii) Sub-contractor proposals reduce risk of abuse, while providing more safeguards for taxpayer.

(iv) Proposals contained in 12 December 1986 consultative document "The Inland Revenue and the Taxpayer" and discussed with representative bodies.

Defensive

(i) Legislation in consultative document just more regulation-making power for Inland Revenue: PAYE and sub-contractor schemes in themselves work by regulations under enabling powers.

(ii) Consultation on contents of regulations: Government happy to discuss details of material to be included.

(iii) Why not go further down Keith interest/penalty road for PAYE? Consultation period for general penalty proposals still open. Smooth working of PAYE depends on employers; so hesitate before increasing compliance burdens.

(iv) More far-reaching revision of PAYE/sub-contractor schemes? Would go far outside remit of implementing Keith Committee recommendations.

(v) Why act now if general penalty proposals still out at consultation? Proposals not concerned with penalties but incentives - primarily concerned to encourage, by interest charged, payment of tax due. Where tax nevertheless paid late, would give Exchequer measure of commercial recompense.

(vi) Implications for ordinary taxpayer? None. Will principally affect directors' operation of PAYE on themselves.

(vii) Why treated as priority? Acts on areas of manipulation. Companies who fail to operate PAYE (or subcontractor scheme) properly gaining unfair advantage over competitors. Proposals adopt Keith Committee taxpayer safeguards.

(viii) Why any yield 1987-88 when proposals start later? Assumes small effect as employers bring previous years successively up to date.

Contact point: C D Sullivan (Inland Revenue) 2541 6401
E Green (Inland Revenue) 2541 6590

D VAT

[See also VAT and small businesses: details (Brief FF4) and PSBR: 1986-87 and 1987-88 (C3)]

Factual

(i) Bulk of VAT recommendations implemented in Finance Act 1985.

- All VAT offences, except serious fraud, to be decriminalised and system of financial penalties, surcharge and interest to be introduced progressively.

- Powers to require information clarified; inconsistencies and anomalies removed.

- Taxpayer protected by right of appeal and by recognition of "reasonable excuse" for default.

(ii) Commencement

- Financial penalties for regulatory type offences implemented 25 July 1985.

- Default surcharge to be applied to persistent late payers and repayment supplement (when Customs delay payment) introduced 1 October 1986.

(iii) Revenue effect Chancellor in 1985 Budget Speech (OR 19 March 1985 vol 75 col 797) "... expected to bring in extra revenue of about £50 million in 1985-86. By 1988-89 there will have been a cumulative once-for-all revenue gain of about £600 million."

(iv) No further action in 1987 Budget. (Minor technical extension in 1986.)

(v) Third phase of measures (serious misdeclaration penalty and interest on inaccuracies in VAT returns) deferred from 1 July 1988 to autumn 1989 to allow earliest possible introduction of annual accounting. (See FF4.)

Positive

(i) 1985 provisions designed to combat twin problems of VAT enforcement: late returns and payments, and under-declarations of tax. Offer prospect of revenue and administrative benefits (halving outstanding VAT debt by 1988-89; penalties, surcharges and interest adding to yield). Already indications of cashflow improvement.

(ii) More certainty for taxpayer: particular defaults now incur known penalties at fixed rates.

(iii) Taxpayer protected by right of appeal to independent VAT Tribunal; will avoid penalties if reasonable excuse for default.

(iv) Conscientious businessman accounting for tax accurately and on time has nothing to fear from provisions.

(v) Penalties, surcharge and repayment supplement to be reviewed before 1988 Budget (promised in White Paper: "Building Businesses not Barriers" Cmnd 9794, published May 1986) after full year's experience.

Defensive

(i) Enforcement powers of Customs and Excise "draconian". No.

- Based on recommendations of Keith Committee.

- Need effective powers to ensure compliance with legal requirements of VAT.

- Measures include civil penalties and surcharges which apply in respect of various defaults.

- Great care taken to provide protection for taxpayer. Where taxpayer can show "reasonable excuse" for default, should be no liability for penalty or surcharge.

(ii) Customs and Excise and VAT Tribunal should have power to mitigate penalties.

- Mitigation would destroy philosophy of fixed and certain penalties.

- No penalty if "reasonable excuse" for default. Customs have extra-statutory powers to prevent injustice or financial hardship.

- Mitigation would encourage every penalised trader to appeal with substantial increase in Customs and Excise and Tribunal resources when Government seeking to reduce costs.

(iii) Deferment of third phase of Keith: Priority to be given to computer reprogramming, so facility of annual accounting can be offered to small businesses at earliest practicable date. (See also FF4.)

(iv) Small businesses likely to be affected by surcharges on late payments

- Surcharge system (introduced 1 October 1986) carefully geared to apply only to persistent late payers, after warnings; will affect all late payers, large as well as small. No surcharges yet imposed (because of warnings, will not be applied before May 1987), but already marked increase in timely submission of VAT returns and in VAT receipts.

- Small businesses helped in 1987 Budget by VAT package (See FF4)

(v) Revenue in line with 1985 Budget Speech: Expect £600 million by 1988-89.

Contact points: B J Orr (Customs and Excise) 2019 7129

HH3 LLOYD'S: REINSURANCE TO CLOSE (RIC)

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) Lloyd's RIC is payment of insurance premiums by Lloyd's syndicates (in order to close year of account) to members of syndicate for following year who assume outstanding liabilities. Membership for both years is usually largely same. Tax deductibility for payer (the bigger the RIC, the bigger the tax relief).

(ii) Government proposals will apply to RIC normal tax principles governing tax deductibility of provisions for outstanding liabilities by insurance companies and by Lloyd's syndicates where accounts are not closed.

(a) Provisions for known claims and for claims incurred but not reported are tax deductible if based on adequate evidence or computed by reference to acceptable statistical methods

but

(b) general reserves not tax deductible.

Similar tax rules apply to provision by other traders (eg banks for outstanding debts and bad debts generally).

(iii) Will be consultation with Lloyd's on details of legislation.

(iv) Legislation

- First effective for premiums payable at close of Lloyd's 1985 Account (closed at end-December 1987) as result of Lloyd's 3-year accounting convention.
- Tax assessed for 1985-86 (hence terms of Budget Resolution No 31).
- But assessments not made until late 1988.

Tax not payable till January 1989 (basic rate) or July 1989 (higher rate).

(v) Legislation necessary because

- Lloyd's legal advice is that Inland Revenue cannot adjust RIC for tax purposes if amount of premium determined by syndicate agent in accordance with Lloyd's own rules.
- Inland Revenue's own legal advice confirms little prospect of successful challenge in Courts.

So if no action taken, Lloyd's RIC will be tax deductible in full, regardless of normal rules for tax liability of provision for outstanding liabilities.

(vi) Yield will depend on details of legislation (ie after consultation). No yield figure therefore published in FSBR.

(vii) Other Lloyd's special tax arrangements: No change.

(viii) 1985 Central Settlement: Lloyd's centrally paid £42 million in satisfaction of "names'" tax liabilities for tax underpaid for 1981 Account and previous Accounts.

Positive

(i) Unacceptable - to Exchequer and other taxpayers - that particular group should be in position to determine amount of tax deduction without review and, where appropriate, adjustment by Inland Revenue on principles which apply to other provisions. If no action taken, Lloyd's would be unique among taxpayers in being able themselves to determine what can be offset against their tax liability.

(ii) Need for effective Inland Revenue scrutiny of RIC became apparent during investigation of other irregularities at Lloyd's, leading to 1985 Central Settlement (for £42 million).

(iii) Terms of Central Settlement made it explicit that Inland Revenue maintained right to examine critically RIC for 1983 or any later Account.

Defensive

(i) Lloyd's tax deductions for RIC not excessive: If so Lloyd's have nothing to fear. New legislation simply gives Inland Revenue right to check that tax deductions claims are not excessive on normal tax rules - and to adjust any that are excessive.

(ii) Why conceal yield figures? Yield cannot sensibly be estimated until details of legislation settled, following consultation with Lloyd's.

(iii) Why consult with Lloyd's? Complex issue. Equitable solution important. Need to consider Lloyd's view of impact of legislation on individual "names". But consultation only on details.

(iv) Wrong to override legal position that RIC is insurance contract: Substance of position same as for other insurance companies making provisions for outstanding liabilities and for Lloyd's syndicates making provisions where account is not closed ("run-off" syndicates", where business not passed on to new syndicate at year end).

(v) Wrong to treat arm's length (ie on full commercial terms, subject to open market rules) reinsurance contract like insurance company's provision. In substance, RIC not arm's length contract because great majority of members of syndicate paying RIC premium are same as members of successor syndicate receiving premiums.

(vi) Provisions basis unfair to those who leave syndicate (because, unlike continuing "names," he suffers disallowance of taxable receipt in next year). Proposed tax rules follow Lloyd's own RIC practice - no differentiation between those who leave syndicate at year end and those who remain in successor syndicate.

(vii) Proposals mean Inland Revenue will be second-guessing Lloyd's judgement of prudential level of reserves. No. Syndicate agents still free to fix level of RIC on their own judgement of prudential considerations - as are corporate insurers etc. Adjustment only for tax purposes - as for corporate insurers etc.

(viii) Retrospective taxation to charge tax for 1985-86 (and 1986-87) on new basis: No retrospection: no effect on RIC premiums already fixed or paid. Change for 1985-86 follows from Lloyd's 3 year accounting convention.

- Lloyd's 1985 Account assessed for 1985-86 but RIC for 1985 not determined until after December 1987 (and tax for that Account not payable until January/July 1989).

- 1986 Account assessed 1986-87 but RIC not fixed until after December 1988 (and tax payable January/July 1990).

- No reason why Lloyd's three year accounting should give them two years immunity from tax changes compared with other taxpayers.

(ix) Legislation "retrospective" because will claw back "excessive" tax relief given for provisions before 1985? [**ONLY IF PRESSED:** No. Not retrospective taxation.

- Legislation does not apply to years before 1983 Account, for which liabilities have been settled. Nor does it apply to 1983 and 1984 Accounts, for which liability has not yet been settled (though year of Account has closed).

- True that RIC for 1985 Account may reflect excessive provisions of earlier years. But legislation only applies to amount of provision which is tax deductible (ie to amount of tax deferred) for 1985-86, on which 1985 Account assessed.

- No revision of assessments and tax valuations for earlier years.

- Unfair to other taxpayers - and Lloyd's competitors - for "names" to retain benefit of excessive tax provisions from past years.]

(x) Why not apply new legislation to 1983 and 1984 Accounts? True that Inland Revenue said in Central Settlement they would examine RIC critically for 1983 or any later Account. Also true that closing RIC not yet been fixed for 1983 and 1984 Accounts. But since transactions for these Accounts have been governed by existing law, Government's view that would be retrospective to apply legislation to 1983 and 1984 Accounts.

(xi) Opening adjustment for 1985 Account? (to meet 'retrospection' allegation) [**FOR USE ONLY IF PRESSED:** All representations will be considered.]

(xii) Hardship for "names": No reason to think so.

(xiii) Economic damage to Lloyd's? No. Lloyd's membership has been expanding rapidly (17,000 in 1980, 30,000 in 1986), despite heavy underwriting losses in some recent years. Reduction in post-tax return from RIC legislation likely to be small compared with yearly fluctuations in income of Lloyd's members.

(xiv) Lloyd's members at disadvantage already compared with insurance companies and shareholders: Lloyd's members are in favourable position in many respects - eg Special Reserve Fund (unique to Lloyd's), capital gains charged at individual rates and with individual thresholds available (unlike insurance companies and other financial traders), availability of loss relief against other income (unlike insurance company shareholders) for up to five years back (because of 3-year accounting).

(xv) Why no action on other Lloyd's representations eg for improvement in Special Reserve Fund (higher rate relief for contributions to fund to meet future losses; £7,000 ceiling on annual contributions - unchanged since 1972): Ministers fully considered representations. Decided no change called for this year.

Contact point: I Spence (Inland Revenue) 2541 6252

HH4 VAT: TAX AVOIDANCE (PRINCIPALLY PARTIAL EXEMPTION)

Customs and Excise issuing Press Notices on Budget Day.

Factual

(i) Package of measures to eliminate various sources of VAT avoidance. Follows from consultation document issued 7 August 1986.

(ii) Chancellor announced in Parliament 19 December measures he intended to introduce (OR vol 107 no 27 cols 742-745).

(iii) Activities affected: Trading activities which are exempt for VAT purposes, mainly in finance, insurance, property. Also groups of companies, where individual companies properly exempt are able to profit from taxable activities of rest of group.

(iv) Purpose of changes: Designed to limit VAT avoidance, which distorts competition and produces revenue loss, by amending rules on deduction of input tax (and consequential changes).

(v) Pressure for change: Customs conscious of revenue losses from abuse. Subject raised by Tony Blair MP in Standing Committee, 1986 Finance Bill (OR, Standing Committee G, Second Sitting 15 May 1986, cols 88 to 92). Minister of State gave assurance to Committee Government would keep under review and consult before legislating.

(vi) Main features: Change in right to deduct input tax (VAT on business purchases):

(a) Limits recovery of input tax to that incurred in making of taxable supplies. Prevents recovery of tax related to

- future exempt supplies
- activities which do not result in making of any supplies
- most supplies outside scope of UK VAT (see (c) below for exceptions).

(b) Provides for regulations to determine fair and reasonable attribution of input tax to taxable supplies; and to lay down 'de minimis' rules which will remove small businesses from partial exemption net completely.

(c) Allows recovery of input tax attributable to

- supplies made outside UK which are outside scope of UK VAT but which would have been taxable if had taken place in UK, eg if UK trader buys goods in USA and sells them on to customer in USA, that transaction is outside scope of UK VAT. But UK trader may incur some overhead expense in UK relating to transaction and any VAT thereon will be recoverable;
- supplies of warehoused goods disregarded for VAT purposes under provisions of Section 35 of VAT Act 1983 (ie no VAT

charged) eg purchase and sale of whisky in bond is not supply liable to VAT, not zero rated, simply 'disregarded'.

(vii) Related features

(a) Registration provisions

- Businesses with UK establishment but who make no taxable supplies within UK will be allowed to register for VAT (to claim input tax referred to at (vi)(c) above). Registration to be on request but subject to Customs approval.

- Zero-rating provisions to be repealed: Transfer of goods and services from UK by person carrying on business both inside and outside UK to place of business outside UK will no longer be zero-rated but 'disregarded' for VAT purposes. Businesses currently registered for this zero-rating may be eligible for continued registration as above and allowed to continue to deduct related input tax as before.

(b) Transfer of going concern: New charging provision whereby partly-exempt group of companies registered as such for VAT can be required to account for VAT on acquisition of business assets or transfer of business (or part of business) as going concern.

(c) Value of exempt supplies to be determined for VAT purposes in same way as taxable supplies - ie value is consideration paid, if no connection between parties; otherwise open market value. (Consideration: what given - money or payment in kind - in exchange for supply.)

(d) "Capital issues: Underwriting of and making arrangements for capital issues (eg equity shares, Eurobonds) to be exempt (formerly standard-rated). New input tax rules ((vi)(a) above) would mean that tax incurred in connection with capital issues no longer deductible. This would increase costs ("sticking tax") for businesses seeking to raise capital. To mitigate impact, some services connected with capital issues to be exempt: should eliminate substantial part of additional tax burden on issuers. But other services (eg legal and accountancy advice) still taxable, so will still be some increase in costs for businesses making capital issues.

(viii) Dates of introduction: All changes effective from 1 April except registration provisions (effective from Royal Assent).

(ix) Legislative changes: Changes to be made both in primary law (eg VAT Act 1983 Section 15) and in Regulations to be made and laid immediately after Budget debates.

(x) Revenue yield from total package estimated to be £300 million in 1987-88; £400 million in 1988-89.

(xi) Closer alignment of UK law with EC law on input tax.

(xii) Representations

- Brewers concerned about financial impact on tied house operations.
- CBI concerned about compliance and 1 April start.

(xiii) Other changes

- Section 7 of VAT Act 1983 to be amended from 1 April to apply to certain services imported by exempt UK businesses; such businesses will be required to register and account for VAT when value of imported services (and any taxable supplies) exceeds registration limit.
- Revenue yield: Negligible in 1987-88; £5 million in 1988-89.

Positive

(i) Necessary package of reforms to reduce scope for VAT avoidance and consequential revenue loss.

(ii) Prevents distortion of competition: Certain businesses with substantial exempt supplies were, by virtue of VAT grouping provisions, able to recover VAT incurred on inputs related to those exempt supplies. Traders operating in same market should now be able to compete on equal terms.

(iii) Helpful to small businesses: Around 2,000 of smallest partly exempt traders will cease being treated as partly exempt: ie will be freed from task of having to calculate deductible input tax; proportion of input VAT they can recover will increase. (But around 6,000 large and very large traders will become partly exempt for first time.)

(iv) Exemption for managing and underwriting capital issues: Will afford partial relief of tax burden on companies raising capital. Brings UK closer into line with EC VAT law on financial services.

(v) Imported services: Blocks loophole that, since newspaper advertising made taxable in 1985, latter increasingly used by sizeable businesses in exempt financial sector. Placed orders for VAT-free advertising and other specialist services with overseas and Channel Island traders to detriment of UK traders who charge 15 per cent VAT.

Defensive

(i) Administrative and financial burden

- Proposals aim to strike fair balance between prevention of serious tax loss and reasonable interests of business.
- New 'de minimis' rules devised to be as generous and simple as possible without being open to manipulation and substantial revenue loss.

- Where partial exemption calculations have to be made, rules lay down 'standard method' but Customs will allow alternative methods. Criteria for alternative methods simply that they should be practical, accurate and fair. In past, Customs and Excise able to agree most methods which utilise existing system, thereby minimising compliance costs.

- Only about 13,500 of total 1.5 million VAT traders will be required to restrict recovery of input tax: less than 1 per cent.

(ii) 'De minimis' limits too low

- Allow up to £40,000 of standard rated expenditure (£6,000 VAT) to be attributed to exempt activities before partial exemption restrictions begin to apply.

- Overgenerous 'de minimis' provisions would result in trade distortion.

- Simplification rules will greatly restrict number of traders who will be required to apply 'de minimis' rules.

(iii) Customs failed to use existing powers adequately. Not true that all avoidance schemes could be stopped simply by restricting VAT grouping.

(iv) Tightening of rules governing input tax deduction represents back door way of raising taxation. No. Underlying principle governing deduction of VAT input tax not changed: businesses still entitled to recover VAT incurred in making taxable supplies. But in recent years principle has become increasingly undermined by businesses in financial and property spheres. Changes intended to protect intention of original legislative provisions.

(v) Basis for estimate of revenue yield: Best estimate based on revenue control information and assessment of number of traders brought into partial exemption net for first time. Not possible to break figures down.

(vi) 1 April too soon to start

- Those involved known since August 1986 (publication of consultative document) that changes on way.

- Many are well advanced with arrangements and Customs will agree provisional methods of calculation for those finding April deadline too tough.

- Longer delay would increase revenue loss because consultation process highlighted weaknesses of existing rules which now open to wider exploitation. Also unfair on traders applying existing rules correctly.

(vii) Exemption for capital issues does not go far enough (heavy burden of "sticking tax" from taxation of legal and accounting services): No. Proposed exemption will limit increase in tax incurred by companies making capital issues. Exemptions go as far as EC law allows. Cost of these services currently ranges typically from 0.1 per cent to 4 per cent of capital raised: additional cost of sticking tax will be 15 per cent of that, ie 0.015 per cent to 0.6 per cent.

(viii) Exemption for capital issues will drive underwriting business off-shore (fears expressed by British Bankers' Association and others): Has not happened in past (although financial sector already suffers restriction of input tax). If business moved offshore would cause problems of organisation/communications etc for businesses. But matter will be kept under review.

(ix) Brewers' tied properties: Agreement reached between Customs and Brewers' Society on special partial exemption method for calculating deductible input tax in relation to tied properties. Reflects unusual features of brewers' tied house arrangements. [**IF PRESSED:** Without special method would risk distortions between brewers with tied houses and those with managed houses.] Customs indicated willingness to enter into trade agreements with other representative bodies to minimise administrative burdens.

(x) Oil companies: Customs negotiating arrangements for tied petrol stations similar to those agreed with Brewers' Society.

(xi) New rules could lead to disputes with Customs over calculation methods. Legislative provision has been made for partly exempt businesses to have right of appeal to VAT Tribunal concerning use of partial exemption method. (This right not previously available.)

(xii) New charging provision will lead to possible double taxation or valuation problems for partly exempt VAT group transactions.

- Provision will not apply if Customs satisfied assets acquired by transferor more than 3 years before transfer.

- Customs will have power to abate some or all of tax due to prevent double taxation if VAT group produces satisfactory evidence to show that input tax not fully recovered by transferor in purchasing assets.

- Exclusions (of goodwill, interests in land) from charging provisions will greatly reduce valuation problems.

Contact point: R G Michie (Customs and Excise) 2913 5351

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HH5 DUAL RESIDENT COMPANIES (DRCs)

Factual

(i) DRCs are companies which simultaneously satisfy residence rules of two countries (most resident in UK and US).

(ii) Set up as finance vehicles by multinationals and raise funds for multinational group by borrowing.

(iii) Interest payments they make create tax losses relieved in both countries.

(iv) 1987 Budget proposes denying relief for such losses to non-trading DRCs but not to genuine trading companies.

(v) Proposals follow consultative document of December 1986 and similar US legislation 1986.

(vi) Companies in future have to be UK residents and only UK residents, not to be within scope of provision (unless trading DRCs).

Positive

(i) Right to stop multinationals getting two tax reliefs for one expense.

(ii) Desirable that UK should complement US legislation (most DRCs operate UK/US).

(iii) Only area in which UK has followed US corporate tax reform.

Defensive

(i) Why worry if another country gives second relief? Right to take action when DRCs exploit interaction of two countries' tax systems. No reason why their losses should get double relief. Wrong to assume that other country involved, not UK, is always loser from DRC abuse. Once relief available in only one country, some companies will restructure so that relief given only in US.

(ii) Why UK legislation when US has already legislated? Because not exclusively UK/US problem. In any case right to join with US to ensure one relief whether investment international or domestic. (But likely that some yield would come from US legislation alone.)

(iii) Problem should be dealt with by tax treaty. Impossible: tax treaties only give relief; cannot deny it.

(iv) DRCs often set up for good commercial reasons. Only trading companies could claim this and they are excluded from proposals.

(v) Will damage inward UK investment. Unlikely with both US and UK legislating. Legislation removes fiscal distortion.

(vi) Will proposal lose business for UK? No. DRCs tax vehicles, not main economic activity of multinational groups.

(vii) Will companies be able to choose in which country they can take relief? Await Bill (for this and other points of detail on legislation).

Contact points:

P W Fawcett	(Inland Revenue)	2541 6497
P H Linford	(Inland Revenue)	2541 6362

HH6 DOUBLE TAXATION RELIEF: BANKS: FOREIGN WITHHOLDING TAXES

Inland Revenue issuing Press Notice on Budget Day.

[See also Miscellaneous savings measures (Brief EE4)]

Factual

(i) Double taxation relief, in form of credit for foreign tax suffered, available to UK banks and UK branches of foreign banks trading in UK in respect of tax withheld by non-resident borrower out of interest he pays to them. Relief given either under terms of double taxation agreement (DTA) or unilaterally. Prevents same income being taxed by both foreign and UK Exchequers.

(ii) Relief similarly available for tax "spared" overseas (ie tax deemed to be paid, but not actually withheld in accordance with overseas incentive legislation) but only for UK resident banks and under DTAs.

(iii) Present rules allow credit against corporation tax (CT) on banks' profits as whole.

(iv) As result, some banks have been able to reduce interest rates on overseas loans at expense of UK Exchequer.

(v) Since 1982, amount of foreign tax on interest which may be credited against banks' UK tax liability limited to 15 per cent of gross interest, whether relief due under DTA or unilaterally.

(vi) Where tax credit includes tax spared, amount of foreign tax spared, like tax withheld and similarly limited to 15 per cent of gross interest, is added to interest received in computing banks' income for UK tax purposes.

(vii) In future, looking at each loan separately, banks will be able to offset tax credit relief for foreign withholding tax paid on interest they receive against CT on profit only on that loan.

(viii) More precisely, 1987 Budget contains proposals:

(a) to close loophole by introducing further restriction to limit tax credit relief to amount of UK CT on net profit from loan transaction. Net profit to be defined as "turn" after deducting from interest received direct costs of borrowing to fund loan. Where actual costs difficult to quantify, costs to be arrived at on "just and reasonable" basis;

(b) to take power to make by statutory instrument procedural rules about factors to be taken into account in applying "just and reasonable" basis so as to determine direct funding costs;

(c) apart from changes above to preserve existing rules on tax credit relief set out at (v) and (vi).

(ix) New measure applies

- for new loans from 1 April 1987;

- but for existing loans only to interest received on or after 1 April 1988.

(x) Yield from new restriction depends on future pattern of lending to non-residents and is sensitive to movements in costs of borrowing. Using illustrative 6 per cent dollar London inter-bank offer rate ($LIBOR), could be £20 million in 1988-89, rising to £60 million by 1990-91.

Positive

(i) Closes loophole which has resulted in significant loss of UK tax by ending relief of profits, including purely UK domestic business profits, which have nothing to do with overseas loan in question.

(ii) Removes what amounts to capricious subsidy by UK taxpayer towards overseas lending.

(iii) Consistent with and represents further step towards same objective as 1982 legislation.

(iv) Change in UK tax rules makes them more nearly comparable to those in other countries.

Defensive

(i) Why change needed now? Cost of subsidy growing. 1982 restriction has had some success but any increased yield from 1982 restriction more than balanced by further tax loss arising from subsequent increase in overseas lending undertaken from UK.

(ii) Some evidence of foreign banks artificially routing loans through UK branches or subsidiaries to get benefit of unduly generous UK tax credit relief.

(iii) Compliance costs for banks (in being required to calculate and allocate direct borrowing cost to each overseas loan): To be kept to minimum by provision of detailed procedural rules in regulations supplementary to proposed Finance Bill measure. Rules themselves will be drawn up in consultation with bodies representing banks.

(iv) How can new loan agreements be drawn up adequately before regulations published? Although legislation will take effect before regulations finalised, consultations will show banks what is envisaged and enable new agreements to be drawn up without serious delay.

(v) Existing loans: Most loan agreements cover banks and borrowers against changes in system of tax credit relief. One year's grace (to 1 April 1988) allows ample time for renegotiation.

(vi) Weakens London's competitive position: Main attractions of London as international banking centre non-fiscal. After new measure taken effect, UK will remain in strong competitive position. Most other countries do not offer tax reliefs which would attract banks away from London. Even if some foreign banks moved overseas lending business from London, unlikely to have significant effect on London's position or on employment.

(vii) Puts up cost of borrowing? Only foreign borrowers directly affected. No need for taxpayers to subsidise.

Contact points: J B Shepherd (Inland Revenue) 2541 7019
M C Sharp (Inland Revenue) 2541 6348

HH7 INTEREST PAYMENTS BETWEEN COMPANIES

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) In various circumstances (eg when paid by cheque which is posted) interest (or certain other payments) may be treated for tax purposes as received by lender on date different from treated as paid by borrower.

(ii) Proposed to align dates for tax purposes where payment between companies within group or under common control.

(iii) Measure effective for interest payments made on or after Budget Day.

(iv) Change needed because of avoidance device: interest paid in one accounting period (and tax deduction given) not charged to tax in hands of recipient until next accounting period. Result: tax deferral.

(v) Ordinarily, company paying yearly interest to another should deduct tax from payment and pay this to Inland Revenue (recipient given credit for tax deducted). Deferral advantage small here. But within groups of companies, interest can be paid without deduction: so advantage greater.

Positive

(i) Change will prevent avoidance where substantial risk of abuse with large potential cost. Will cause no significant difficulties for companies.

(ii) Change does not affect position of companies not under common control: continue to be taxed on interest only when received.

Defensive

(i) Rule should be extended to interest payments between any companies. Risk of abuse by those not under common control minimal. Device more complex for unrelated companies to operate.

(ii) Why change now? Some avoidance already. Inland Revenue lost case on appeal (to Special Commissioners) in 1986 which may stimulate more use of device.

(iii) Creates work and confusion for companies? Should not. Companies concerned are under common control so payment date should be easy to establish. Change needed to prevent abuse.

Contact points: J H Reed (Inland Revenue) 2541 6442
D A Carr (Inland Revenue) 2541 6390

HH8 CORPORATION TAX PAYMENT DATES

Inland Revenue issuing Press Notice on Budget Day.

[See also UK economy: recent developments (Brief BB1) and Business taxation: other provisions (FF2)]

Factual

(i) Proposed to standardise time corporation tax (CT) payable by companies (and building societies): after transitional period, CT due 9 months after end of company's accounting period.

(ii) Measure to be effective for accounting periods beginning on or after Budget Day.

(iii) Companies' accounting periods usually end on either 31 December or 31 March, but can end on any date.

(iv) For most companies, CT already payable 9 months after end of accounting period. But companies trading before CT introduced in 1965 retained payment interval they had under old income and profits tax system: could be up to 21 months, although 12 months most common interval. Many of these companies have accounting periods ending on 31 December and pay tax on 1 January one year later.

(v) Companies with long payments intervals would face tax bills for two financial years very close together if change introduced immediately. Transitional arrangements will spread change over three years eg for companies with accounting periods coinciding with financial year:

Accounting period	Payment interval
31 March 1987	existing payment interval (up to 21 months)
31 March 1988	interval reduced by one-third
31 March 1989	interval reduced by further one-third
31 March 1990	interval of 9 months

Transition will vary slightly for other company accounting periods but no less generous.

(vi) Main effect of movement of date is to move some of January peak of payments to October (though January still forecast to remain a little higher than October).

(vii) Payment dates for building societies also to be brought into line with companies. Those with payment intervals of more than 9 months will have same transitional arrangements as companies. But many building societies taxed on special basis and generally pay tax on 1 January of tax year in which accounting period ends (eg if ends on 31 December, pay CT next day). Some societies pay before accounting period ends. For these transitional arrangements will be

Accounting period ending in tax year	Payment interval
1989-90	interval extended to two months (if otherwise shorter)
1990-91	interval of 9 months

(viii) Yield for companies and building societies combined: Negligible 1987-88; £100 million 1988-89. Yield over following three years depends on level and incidence of profits. Yield should average £100 million for each year. After 1991-92 all companies on 9 months payment interval.

(ix) Effect of change on PSBR profile: Smoother flow of CT receipts over year will help management of PSBR.

Positive

(i) Change consistent with business tax reform: Distortion which favours pre-1965 trading companies cannot be justified.

(ii) Putting building societies on same basis as companies consistent with policy of "levelling playing field" between societies and other financial sector companies. Benefits most large building societies. (See FF2.)

(iii) Change blocks off avoidance device which puts large part of CT yield seriously at risk (companies with short intervals can acquire companies with longer intervals and transfer activities to them so as to delay payment of CT).

Defensive

(i) Why not simply formulate rules to counter avoidance?

- Not primarily anti-avoidance measure. Designed to remove distortion.

- In any case anti-avoidance rules alone would be complex and not entirely effective.

- Abuse highlighted fundamental distortion resulting from transition to CT in 1965. Special rules for pre-1965 companies outlived usefulness.

(ii) Why make change in 1987? Good year: profit and cash flow position of most companies healthy (see BB1).

(iii) Imposes burden on companies: Transitional arrangements reduce burden. Companies affected have benefited since at least 1965 from delay in paying CT. Time come to rationalise system on more equitable basis.

(iv) Building societies' transitional arrangements should be advanced. Bringing forward changes for building societies would have substantial net Exchequer cost because more building society CT would be deferred out of first year of transition than company CT advanced into that year. Transitional arrangements for companies and building societies designed to avoid cost to Exchequer in any single year.

(v) Different building societies affected differently: Yes. But discrepancies already exist. Now right to put all building societies on equal footing.

Contact points: J H Reed (Inland Revenue) 2541 6442
D A Carr (Inland Revenue) 2541 6390

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HH9 FOREIGN PARTNERSHIPS

Inland Revenue issuing Press Release on Budget Day.

Factual

(i) 1987 Budget proposes that partner of foreign partnership who is resident in UK be charged to tax in respect of his share of profits of partnership, notwithstanding that under any double taxation relief arrangements, profits of such partnership may be exempt from UK tax.

(ii) Reverses decision of High Court in case of Padmore v Commissioners of Inland Revenue in December 1986.

(iii) Proposal has retrospective effect (ie 6 years back). But will not affect Court decisions before 17 March.

Positive

(i) Right that UK residents who are partners in foreign partnerships should pay tax like other UK residents.

(ii) Padmore case surprising decision; proposal puts law back to what it was thought to be.

(iii) Purpose of retrospection to prevent windfall benefit of tax relief for 6 years back which would otherwise be available under Court decision.

Defensive

(i) Not right for Government to tinker with Court decisions. Desirable to have early legislation to restore previous general understanding of law. As result, UK residents who are partners in foreigh partnerships will continue to pay tax in same way as other UK residents.

(ii) Retrospection wrong: Does no more than restore general understanding of law. Does not charge tax for 6 years back which taxpayers were not expecting to pay. Merely prevents claims to windfall relief (refunded tax which taxpayers have paid and always expected to pay).

(iii) Legislation overrides tax treaties. Does not interfere with rights of treaty partners; merely protects UK's rights to tax same income. Treaty partners will be consulted, with aim of amending treaties in due course (but inevitably over long period).

Contact points: P W Fawcett (Inland Revenue) 2541 6497
P H Linford (Inland Revenue) 2541 6362

HH10 CONTROLLED FOREIGN COMPANIES (CFCs)

Factual

(i) Amendment to 1984 legislation to prevent CFCs avoiding UK charge to tax on dividends paid to UK shareholders.

(ii) CFC charge - levied on UK companies with interests in companies in low tax territories - is not levied if overseas company pays adequate dividend ("acceptable distribution" test). Intention is that dividends should be subject to UK tax but this can be avoided by moving residence of CFC to UK before payment of dividend, since dividends paid by one UK company to another can escape tax. Company could then set up another CFC to repeat manoeuvre.

(iii) Significant amount of tax (up to £40 million) at risk if device were to be widely exploited. Amendment will make clear that acceptable distribution test is satisfied only where dividend paid when paying company not resident in UK.

(iv) Will apply to dividends which are paid on or after Budget Day; existing cases will be challenged in Courts.

Positive

(i) Carefully targeted legislation to stop indefensible avoidance device.

(ii) No element of retrospection: Cases where dividends have already been paid unaffected by proposed change.

Defensive

(i) Other unsatisfactory features of CFC legislation should be dealt with at same time? Present measures restore intended effect of provisions. Could be substantial loss of tax if allowed to continue. CFC legislation will remain under close review; not aware of other aspects on which immediate action is required.

(ii) Hits genuine trading companies? Genuine trading companies not within CFC legislation. Device is solely tax saving measure which few would seek to defend.

Contact point: J P B Bryce (Inland Revenue) 2541 6372

KK1 BUDGET AND CHARITIES

Customs and Excise issuing Press Notice on Budget Day.

[See also Income tax: other changes (Brief DD2)]

Factual

(i) Measures in 1987 Budget

(a) VAT zero-rate reliefs extended from 1 April 1987 to cover

- installation or adaptation of any bathroom, washroom and lavatory facilities for handicapped in charity residential homes (Group 14, Schedule 5 VAT Act 1983). Extends existing extra-statutory concession for individual facilities in these homes;
- drugs and chemicals directly used by charity engaged in medical research (Group 16, Schedule 5);
- welfare vehicles (with 6 to 50 seats) for use by hospices for transporting terminally ill (Group 16, Schedule 5);
- specialised location and identification equipment for use by charitable rescue and first aid services (Group 16, Schedule 5).

(b) Provision also being made to give legislative cover to existing extra statutory concession for goods donated for export by charity established for relief of distress.

(ii) Costs: Total cost of package unlikely to exceed £5 million in 1987-88 and 1988-89. Preferable not to give breakdown.

[IF PRESSED VERY STRONGLY: Figures shown below are very much guesstimates and should be used only if essential:

	Revenue costs £ million	
Item	**1987-88**	**1988-89**
Bathrooms etc in charity residential homes	1-2	1-2
Drugs and chemicals	2	2
Welfare vehicles	negligible	negligible
Mountain and other rescue equipment	negligible	negligible
Donated goods for export	negligible	negligible]

(iii) New payroll giving scheme announced in 1986 Budget begins 6 April 1987.

- Employees get tax relief on gifts to charity deducted from pay.
- Original limit (Section 27 Finance Act 1986) £100. Chancellor announced 16 December 1986 (OR vol 107 no 25 col 499 WA) increase in limit to £120 a year. Provision will be made in 1987 Finance Bill.
- Cost of increase depends on take up but expected to be negligible.
- Several agencies already approved to run schemes eg Charities Aid Foundation, Dr Barnardo's, and others have applied for authorisation. Many employers known to be interested or in touch with agencies.

(iv) Earlier tax concessions to charity by this Government: Large number made since 1979 eg

- reduction from 7 to 4 years in minimum period for charitable covenants for tax relief
- introduction of higher rate income tax relief for charitable covenants (and £10,000 limit abolished in 1986)
- corporation tax relief for single donations by companies (except close companies) to charities
- various extensions of VAT zero-rating to charities.

(v) Budget representations: Many representations for further VAT relief for charities. Charities VAT and Tax Reform Group (CVTRG) set out shopping list of charities' main priorities for particular reliefs:

- drugs for medical research;
- all equipment used by medical research charities;
- all purchases by social welfare charities or at least relief on building alterations and associated professional fees;
- building work necessitated by statutory requirements;
- all building alterations designed to improve access by disabled;
- bathroom and lavatory facilities in residential homes for handicapped;
- welfare vehicles for hospices;
- wireless for bedridden;
- laundry and catering equipment used in provision of medical care;
- charity fund raising events.

General VAT relief for charities remains ultimate aim but not being pressed.

Underlined requests met, plus relief granted on location and identification equipment used by charitable search and rescue organisations.

Positive

(i) Worthwhile extension of reliefs to broad range of charities slanted towards those caring for sick and handicapped or engaged in medical research. Worth about £5 million in 1987-88. Meets one of major requests put forward by CVTRG and two other items.

(ii) Relief for drugs and chemicals used in research will significantly benefit charities looking for cure for cancer and AIDS; extends 1986 relief for medicinal products.

(iii) Zero-rating for bathroom and lavatory facilities extended to communal (as well as individual) facilities in charity residential homes for handicapped; will reduce VAT bill for building alterations.

(iv) Relief for welfare vehicles for transporting terminally ill helps hospice movement; extends relief given last year for vehicles for deaf, blind or mentally handicapped.

(v) Relief ror specialised location and identification equipment for charitable rescue and first aid services covers some of most expensive items in these charities' expenditure; should particularly benefit mountain rescue work.

(vi) Payroll scheme will give further fillip to personal giving. Widespread interest in press and among charities hoping to benefit. Several agencies preparing to run it.

(vii) Increase in payroll giving limit

- allows round sum donations: £10 a month or £2 a week;
- meets representations from MPs in 1986 Finance Bill debates and from charity organisations.

(viii) 1986 charity reliefs warmly and widely welcomed.

- "This is the most exciting and imaginative Budget for charities there has ever been" (Institute of Fund-raising Managers).
- "I think [the effect of the new concessions will] be quite dramatic" (Michael Brophy, Charities Aid Foundation).
- "In many ways the 1986 Budget will prove to be a notable landmark for charity in this century. All three tax relief concessions are to be welcomed but the payroll deduction scheme is perhaps the most exciting in terms of its huge potential" (Charities Aid Foundation Newsletter).
- "The best charity Budget we've ever had" (Tim Yeo MP).

(ix) Government support for charities

- Direct grants to charities by central Government more than doubled in cash terms since 1979: £268 million in 1985-86.

- Total of grants and payments to voluntary organisations by all Government agencies in excess of £1,000 million.

(x) Total direct tax reliefs for charities increased since 1979 to about £500 million a year. Cost of new reliefs introduced in 1986 estimated to be £60 million, depending on public response.

(xi) Recorded giving to charities doubled in real terms since 1979.

Defensive

(i) 1987 Budget should have done more to help charities. 1986 Budget most substantial package of reliefs for charities ever. Widely welcomed. Chancellor made clear in 1986 Budget Speech that VAT measures were exceptional. Even so some limited further reliefs in 1987.

(ii) No general VAT relief for charities. Carefully and sympathetically considered by Government on many occasions. But

- would bear no necessary relationship to popular support for charities, as would benefit whole range of charities according to their expenditure on taxable goods and services (contrast direct tax reliefs which are mostly related to giving, so that benefit reflects popular support);

- would be contrary to obligations under EC Sixth VAT Directive. No other EC country gives general relief from VAT to its charities;

- system of general relief on charities' non-business purchases would involve making refunds to at least 100,000 charities;

- very costly both in terms of revenue (£140 million to £160 million) and administration.

(iii) No relief for social welfare charities (although providing services comparable to those provided by statutory authorities) (on CVTRG list).

- Costly in revenue terms (roughly £10 to £15 million).

- Would put social welfare charities in uniquely privileged position; strong pressure from other charities for similar treatment.

- Also pressure for same treatment from non-charities performing functions on behalf of state .

(iv) No relief for charities' building alterations and extensions (on CVTRG list).

- High revenue costs: £25 million for all charities; £6-10 million for social welfare residential care alone. Even higher if relief applied to repairs as well as alterations (for which would be strong pressure).

- Also pressure for corresponding relief for all building alterations for disabled in own homes (where policy is to help with grant aid, not costly VAT relief).

- But relief extended to any bathroom, washroom and lavatory facilities in charity residential homes for handicapped.

(v) No relief for wireless for bedridden (on CVTRG list) and hospital radio (separate campaign).

- Present relief (extended in 1986) confined to recording equipment used by blind. Equipment for recording talking books and equipment for blind relieved by analogy with zero-rating for books and newspapers (which bedridden, like others, already enjoy).

(vi) Industrial laundry and catering equipment used by hospitals and social welfare charities (on CVTRG list)

- Would lead to repercussive claims for relief on normal automatic equipment used by hospitals and residential homes and private individuals caring for handicapped and sick at home, and ultimately to all general purpose equipment used by sick, elderly and other disadvantaged groups. Problem of drawing borderline between worthy causes.

- Present relief is confined to medical, scientific, computer, video or refrigeration equipment used in medical research, treatment or diagnosis.

(vii) No relief for fund raising events (on CVTRG list).

- Not necessary because high level of UK registration threshold (increased to £21,300 in 1987 Budget) (see FF4) means small scale activities excluded.

- No strong evidence that existing rules not working satisfactorily.

- In any case, EC only permits exemption if fund raising events do not cause distortion of competition.

(viii) £120 payroll giving limit too low: Cost of scheme about £20 million, depending on take-up. £120 generous donation for most employees.

(ix) Payroll giving scheme will jeopardise deeds of covenant. Aim to bring new donors into regular giving - not replace existing routes.

(x) Will civil service participate in payroll giving scheme from April 1987? Chancellor said on 16 December at press conference "The Government has decided to participate in the payroll giving scheme itself as an employer. This means that all civil servants will be able to take part. And the scheme will also be introduced in the Armed Forces". Civil service will participate as soon as they and charity agencies have made necessary arrangements. Treasury has approached registered agencies on behalf of 216,000 civil servants paid through Chessington payroll centre.

(xi) Effect of basic rate cut on giving by covenant: See DD2.

Contact points: D E Barrett (Customs and Excise) 2913 5387
I R Monk (Customs and Excise) 2913 5390
C Stewart (Inland Revenue) 2541 7414
Mrs E Fletcher (Inland Revenue) 2541 7784

LL1 INTERNATIONAL TAX COMPARISONS

[See also Burden of taxation (Brief CC3), Income tax: main changes (D1), National Insurance contributions (DD5), VAT and car tax: main points (G2) and International tax reform (HH1)]

Warning

International comparisons can be misleading because:

(a) statistics hide different underlying tax systems and economic conditions, and different-sized public sectors, and in difference countries;

(b) countries can be selected to support virtually any argument;

(c) OECD statistics used in some tables in this brief not necessarily comparable with classifications used in other briefs.

A OVERALL BURDEN AND BALANCE OF TAXATION

Factual (See Tables 1, 2 and 3 at Annex.)

(i) Total UK burden of tax and social security contributions as percentage of GDP

- comparable with West Germany and Italy;
- well below France, Denmark, Netherlands and Sweden;
- but much higher than US and Japan.

(Table 1.)

(ii) Indirect taxes as proportion of total tax in UK just above EC average (Table 3).

(iii) On make-up of total burden

- UK taxes on household incomes about EC average; employees' SSCs below EC average.
- UK taxes on corporate income above average (but UK figures distorted by North Sea tax receipts; employers' SSCs below average).
- Taxes on goods and services just below EC unweighted average but well above US and Japan (Table 3).

Positive

(i) UK tax burden less than EC unweighted average; significantly lower than France, Netherlands, Denmark.

(ii) Tax burden on industry (tax on corporate incomes plus employers' SSCs) as proportion of tax lower than most major industrial countries.

(iii) UK's main corporation tax rate (35 per cent) one of lowest of any major industrial country. (From 1 July 1987 US rate lower than CT main rate, at 34 per cent) (see FF2).

Defensive

(i) UK burden too high - much higher than US, Japan. See CC3.

(ii) Burden on consumers relatively high: Taxes on goods and services certainly higher than US, Japan. But about average for EC. Government's policy to switch taxes from earnings to spending to give greater freedom of choice. (See CC3.)

B INCOME TAX AND SOCIAL SECURITY CONTRIBUTIONS

Factual (See Tables 4, 5 and 6 at Annex.)

(i) UK thresholds

- in middle of range compared with other developed countries;
- single and married thresholds higher than eg West Germany, Italy (for married only), Denmark;
- but lower than US, France;
- similar to Japan, Netherlands (Table 4).

(ii) UK starting rate: After 2 point cut in basic rate

- still higher than all countries in table except Denmark;
- but combined tax/SSC rate nearer average (Table 4).

(iii) UK maximum rate

- below average since top rates cut substantially in 1979 (Table 5);
- but top rates in several OECD countries due to fall eg US 28 per cent (plus state tax in most states eg California 8 per cent); Australia 49 per cent (see HH1).

(iv) At UK (male) earnings level: Marginal rate of tax and tax plus SSC in line with other countries (Table 6).

Positive

(i) Basic rate cut brings starting rate of tax and marginal rate at average income more into line with overseas competitors.

(ii) UK tax thresholds compare favourably with number of countries (eg West Germany, Italy, Netherlands).

Defensive

(i) High UK starting tax rate

- Accept still too high by international standards.
- Objective to reduce basic rate further when circumstances permit.
- Basic rate band very wide (marginal rate for 95 per cent UK taxpayers): low starting rates in other countries often marginal rate for very few taxpayers.
- UK SSC rates low: at average earnings, combined burden in UK about average.

(See also D1.)

(ii) Introduce reduced rate. See D1.

(iii) UK penalises those with children (because some other countries have child tax allowances). UK about average when SSCs (low in UK) and child benefit (high in UK) taken into account (Table 6).

(iv) High UK rates will lead to "brain drain". Recognise problem. But right in 1987 Budget to concentrate resources on basic rate cut which helps overwhelming majority of taxpayers. Chancellor said in 'Financial Times' (5 January 1987) "We may well need to bring the top rate down further" (in next Parliament). (See also D1.)

C VAT AND EXCISE DUTIES

Factual (See Table 7 at Annex.)

(i) Excise duty and VAT on premium petrol at 9 March 1987. Total tax (duty and VAT) as percentage of retail selling price lower than all countries except Luxembourg.

(ii) Excise duty and VAT on derv at 9 March 1987: Total tax (duty and VAT) as percentage of retail selling price about average for EC.

(iii) Other countries with tax differential in favour of unleaded petrol: West Germany, Denmark, Netherlands, Austria, Switzerland, Finland, Norway and Sweden. Differentials range from 7p (Sweden) to 19p (Finland) per gallon (including VAT or equivalent internal tax).

(iv) Excise duty on beer, wines and spirits at 2 March 1987: Duty on beer in UK is higher than in all countries except Denmark and Ireland. Same is true of duty on table wine, fortified wine and spirits.

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(v) Excise duty and VAT on cigarettes at 2 March 1987: Duty second highest (after Denmark). Total tax (duty and VAT) on 20 cigarettes in most popular category as percentage of retail selling price is same as Ireland and higher than all other countries except France and Denmark.

Positive

(i) Standard rate of VAT in UK lower than most in EC (Table 7).

(ii) UK (with Ireland) has zero-rates on wide variety of goods and services.

Defensive

UK duties generally higher than rest of EC. Yes, but VAT relatively low.

Contact points: R P Short (ETS) 270 4977 (balance and burden)
A J Walker (Inland Revenue) 2541 6302 (direct tax)
J Bone (Customs and Excise) 2913 5028 (indirect tax)

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Table 1 Total taxes and social security contributions as proportion of GDP

	1984	1985[2] (provisional)
Denmark	48.0	49.4
France	45.5	45.6
West Germany	37.7	38.0
Italy	41.2	not available
Netherlands	45.5	44.8
EC average[1]	41.9	not available
Sweden	50.5	50.6
US	29.0	not available
Japan	27.4	not available
UK	**38.5**	**38.6**

(1) Unweighted average, excluding Spain and Portugal (not members in 1984).

(2) Latest available figures.

Source: OECD Revenue Statistics and National Accounts.

Table 2: Breakdown of taxes and social security contributions (SSCs) as percentage of GDP at market prices, 1984 (latest available year)

	UK	France	Japan	West Germany	US
Household incomes	**10.3**	6.0	6.7	10.5	10.2
Employee's SSCs (incl self-employed)	**3.5**	7.0	4.0	6.5	3.4
Corporate incomes[1]	**4.4**	1.9	5.8	2.0	2.1
Property (excl rates and stamp duty)	**0.2**	0.5	0.3	0.6	0.3
Total direct	**18.4**	**15.4**	**16.8**	**19.6**	**16.0**
Employers' SSCs and payroll taxes	**3.9**	14.0	4.2	7.2	5.0
Goods and services	**11.7**	13.1	4.1	10.2	5.3
Other (incl rate and stamp duties)	**4.5**	3.0	2.4	0.7	2.7
Total indirect	**20.1**	**30.1**	**10.7**	**18.1**	**13.0**
Total	**38.5**	**45.5**	**27.5**[2]	**37.7**	**29.0**

(1) Including North Sea taxes.

(2) Due to rounding.

Source: OECD Revenue Statistics and National Accounts

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Table 3: Breakdown of taxes and social security contributions (SSCs) as percentage of total taxes and SSCs 1984 (latest available year)

	UK	Denmark	France	West Germany	Italy	EC average(1)	US	Japan
Household incomes	26.7	50.3	13.3	27.9	26.3	27.2	35.3	24.5
Corporate incomes(2)	11.5	6.0	4.1	5.4	9.8	6.9	7.2	21.1
Employees' SSCs (incl self-employed)	9.0	1.9	15.3	17.2	10.0	13.3	12.0	14.5
Property (excl rates and stamp duties)	0.6	0.8	1.2	1.5	0.2	1.2	0.8	1.1
Total direct	**47.8**	**59.0**	**33.9**	**52.0**	**46.3**	**48.6**	**55.3**	**61.2**
Employers' SSCs and payroll taxes	10.2	2.5	30.7	19.1	24.0	16.4	17.1	15.2
Goods and services	30.5	35.1	28.7	27.1	26.1	31.0	18.2	15.1
Other (incl rates and stamp duties)	11.6	3.4	6.6	1.8	3.5	3.8	9.5	8.6
Total indirect	**52.3**	**41.0**	**66.0**	**48.0**	**53.6**	**51.2**	**44.8**	**38.9**
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

(1) Unweighted average, excluding Spain and Portugal.

(2) Including North Sea taxes.

Source: OECD Revenue Statistics and National Accounts

WPU

Table 4[1]: Starting tax rate, combined tax/social security contribution (SSC) rate, and threshold 1987

Single person

	Tax rates per cent	Tax and SSC rate per cent	Threshold £
Denmark[2]	49	49	1,770
France	26	36	3,940
West Germany	22	36	1,820
Italy	12	19	2,530
Netherlands	15	32	2,530
Japan[2]	15	24	2,580
US[2]	11	18	2,540
UK 1986-87	**29**	**34**	**2,335**
1987-88	**27**	**32**	**2,425**

Married without children

	Tax rates per cent	Tax and SCC rate per cent	Threshold £
Denmark[2]	49	49	3,390
France	19	31	6,070
West Germany	22	36	3,180
Italy	12	19	3,425
Netherlands	16	33	4,650
Japan[2]	15	24	3,530
US[2]	11	18	4,320
UK 1986-87	**29**	**36**	**3,655**
1987-88	**27**	**34**	**3,795**

(1) Figures for 1987, except France, Italy and Japan (1986), and take account of minimum deductions for expenses and other flat rate reliefs. Thresholds converted using purchasing power parities (PPP): better measure than exchange rates which can be volatile. (See BB3.) Income of married couple treated as wholly of husband.

(2) Includes local income tax or typical rates (for Japan, rates applying in most areas; for Denmark, Copenhagen; for US, California).

Source: Inland Revenue

Table 5(1): Maximum tax rate on employment income and threshold 1987

Single person

	Tax rate per cent	**Tax and SSC rate per cent**	**Threshold £**
Denmark(2)	68	68	11,930
France	58	61	49,600
West Germany	56	56	31,140
Italy	62	65	281,190
Netherlands	72	72	59,970
Japan(2)	84	84	223,750
US(2)	45	45	34,760
UK 1986-87	**60**	**60**	**43,535**
1987-88	**60**	**60**	**43,625**

Married without children

	Tax rate per cent	**Tax and SCC rate per cent**	**Threshold £**
Denmark(2)	68	68	15,405
France	58	61	50,220
West Germany	56	56	61,900
Italy	62	65	281,190
Netherlands	72	72	61,235
Japan(2)	84	84	224,640
US(2)	45	45	57,965
UK 1986-87	**60**	**60**	**44,855**
1987-88	**60**	**60**	**44,995**

(1) See footnote (1) to Table 4.

(2) Including local income tax.

Source: Inland Revenue

Table 6(1): Marginal rate of tax, and tax plus SSC, on employment income of £11,000(2)

Percentage rate

	Income tax			**Income tax plus SSCs**		
	Single	**Married**	**Married 2 children**	**Single**	**Married**	**Married 2 children**
Denmark(3)	57	51	51	57	51	51
France	26	16	10	32	23	18
West Germany	43	24	22	60	41	39
Italy	27	27	27	33	33	33
Netherlands	32	32	32	56	56	56
Japan(3)	23	20	17	32	29	17
US(3)	15	15	15	22	22	22
UK 1986-87	**29**	**29**	**29**	**38**	**38**	**38**
1987-88	**27**	**27**	**27**	**36**	**36**	**36**

Notes

For married with 2 children, child tax allowance, where applicable, taken into account. (Not possible to include child benefits in marginal rate calculations).

(1) See footnote (1) to Table 4.

(2) Rounded estimate of UK male full-time earnings 1986-87.

(3) Including local income tax.

Source: Inland Revenue

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Table 7: VAT rates for UK and other EC countries at 2 March 1987

(per cent)

	Standard rate	Increased luxury or higher rate	Reduced(4) rates	Covering of zero-rating
Italy	18	38	2,9	Minimal
Luxembourg	12	-	3,6	(2)
West Germany	14	-	7	(2)
Netherlands	20	-	6	(2)
Belgium	19	25,33 (3)	6,17	Minimal
Ireland	25	-	10	Wide variety of goods and services
France	18.6	33 1/3	5.5,7	(2)
Denmark	22	-	-	Minimal
Greece	18	36	6	Information not available
Spain	12	33	6	(2)
Portugal	16,12(5)	30,21(5)	8,6(5)	Variety of goods and services
UK	**15**	-	-	**Wide variety of goods and services (1)**

(1) Zero-rate applies to goods and services amounting to about 25 per cent of consumers' expenditure.

(2) No zero-rate applying to consumer expenditure.

(3) Higher rate includes 8 per cent luxury tax and applied to restricted selection of goods including, inter alia, jewellery, arms, furs, perfumes and cosmetics.

(4) Most commonly applied to eg food, books and newspapers, some aids for handicapped, public transport.

(5) Portugal obliged to apply common VAT system from 1 January 1989. Lower rates apply in Azores and Madeira.

Source: "VAT in Europe" - International Bureau of Fiscal Documentation

LL2 STAFFING IMPLICATIONS OF BUDGET

[See also Pay (Brief BB7), Profit related pay (PRP) (D2), Pensions (E1) and Capital taxes: main changes (E2)]

Factual

(i) Customs and Excise: Staffing effects expected to be broadly neutral in 1987-88. Effects in later years will be taken into account in 1987 Public Expenditure Survey (PES).

(ii) Inland Revenue: Staff needs partly covered by existing provision. But overall requirement increased by about 115 (1 April 1988) and 300 (1 April 1989). Main components

- income tax: work loads increased due to growth in earnings (see BB7);
- profit related pay: new task (see D2);
- pensions: (mostly for personal pensions) new task (see E1);
- capital taxes: growth in asset values and increased market activity mean more individuals cross capital gains tax threshold, higher stamp duty volumes. Offset by higher inheritance tax exempt band (so fewer taxable estates) (see E2).

(iii) Inland Revenue sent 'Taxes Clerical Work Measurement programme' to civil service unions January 1987: document examines how to measure clerical performance in tax offices.

Positive

(i) 583 more staff for Customs in 1986 PES by 1 April 1988, including 460 on customs work - mainly prevention of drug smuggling.

(ii) Increased Inland Revenue staff requirement partly to cover new services - wider pension choice, new incentive for profit related pay.

(iii) Inland Revenue staff needs contained by successful implementation of PAYE, Schedule D computerisation ('COP/CODA'). On target for 4,600 savings from COP by April 1989; further 1,700 from CODA by April 1990.

Defensive

(i) Inland Revenue work state: Workstate initiative considerable success on post arrears, but still some way to go in other areas (eg clearance of Schedule E cases).

(ii) More staff for Inland Revenue: Budget only one of many factors bearing on staff requirement. Requirement at April 1989 due to 1987 Budget less than 0.5 per cent of total manpower provision. Budget and all other relevant factors will be taken into account in forthcoming Public Expenditure Survey in normal way.

(iii) Budget erodes Inland Revenue staff savings/Chancellor no longer interested in cutting Civil Service numbers. Total staff reductions in Inland Revenue between April 1979 and April 1987 about 16,000.

(iv) 'Taxes Clerical Work Measurement Programme' shows Inland Revenue already understaffed. Results now under consideration by Inland Revenue management; will be taken into account in 1987 PES. Illustrative figures are for 1985-86 and based on exercise of judgement. Recommendations on certain adjustments diverge from civil service wide-standards.

Contact points: D Battle (Customs & Excise) 2913 5431
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CONFIDENTIAL

FROM: M C SCHOLAR
DATE: 11 MARCH 1987

CHANCELLOR OF THE EXCHEQUER 12/2

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Culpin
Miss Noble
Miss O'Mara
Miss Sinclair
Miss Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Isaac - IR
Mr Lewis - IR
Mr Mace - IR

PUBLIC LINE ON GREEN PAPER ON PERSONAL TAXATION

At your meeting on 9 February you asked us to work out what should be said about the Government's intentions on transferable allowances following consultations on the Green Paper on Personal Taxation. You said that the aim should be to focus on objectives rather than specific measures, and said that the line should perhaps be that "measures would be introduced in the next Parliament to address the problems of independence and privacy for married women identified in the Green Paper."

2. You have decided to say nothing in the Budget Speech. But Treasury Ministers and the Press Office are likely to be asked soon after the Speech what the Government's assessment is of the responses to the Green Paper, whose consultation period ended over five months ago, and whether or not you are going ahead with transferable allowances.

3. One option would be to stick to the present position, pointing to the Manifesto as the occasion on which the Government might be expected to declare its thinking. The line would be to say that the

Green Paper consultations showed that the majority of those expressing a preference support the introduction of transferable allowances; that the Government is still considering its response; wait for the Manifesto.

4. This is perhaps the safest course. But it is very weak.

5. It would be possible to go beyond this, and say that the consultations showed that there was a broad measure of agreement on the need to tackle the lack of privacy and independence in tax affairs for married women: and that the Government accordingly intends to press forward and deal with these problems, introducing new measures in the next Parliament.

N.B. The Wife's Income Election, the easiest of the interim measures, only gives privacy + independence to those who elect, who will be the better off.

6. This line carries the implication that the introduction of transferable allowances has been postponed, or that they will come later in time than the measures on privacy and independence. I think it likely that we will be asked point-blank at some stage, probably soon, if this is the case. Given the decisions which have been taken we could not say that transferable allowances have not been postponed.

7. When this cat is let out of the bag we will clearly need a line to explain the postponement. I suggest that this should be that, in the light of the Green Paper consultations, the Government has decided to take action first on the most pressing problems it identified - privacy and independence; then to convey the implication that transferable allowances are further away, given the need for a very wide measure of understanding and acceptance of a major reform of this kind which affects every taxpayer in the land. This line would cause the more friendly commentators to say that the Government had decided that there was insufficient consensus at this stage to proceed with this major reform now: so perhaps this should be part of our line from the start.

Timing

8. Would it be best to hold back this new line until the Manifesto, or until such time before then as close questioning draws it out, or

to come out with it straight after the Budget, say, in the Financial Secretary's wind-up speech in the Budget debate? My inclination would be to take the initiative, avoid a rather damaging period in which the Government looks indecisive and on the defensive, and take the opprobium, such as there will be, of deferring transferable allowances now rather than later. But this is, clearly, very much a matter of judgement for you and your colleagues: you have to strike a balance between the advantages of decisiveness and the disadvantages of a more prolonged period for probing of the new line.

9. We do not think that it would be right for officials to go beyond the present line, in paragraph 3, without cover of a Ministerial pronouncement in the House. So our Budget brief for the time being must be constructed on these very thin lines. But if you decided to take the initiative and deploy the approach in paragraph 7 above we envisage a brief on the lines of Annex A; and a section in the Financial Secretary's speech (or in some other Parliamentary utterance) on the lines of Annex B.

10. If you decide to adopt this approach you will presumably wish to inform in advance No 10 and your colleagues who were most closely involved in the discussions of the Green Paper (Mr Tebbit, Lord Whitelaw and Mr Fowler).

MCS

M C SCHOLAR

Green Paper on Personal Tax

Factual

Green Paper

(i) "The Reform of Personal Taxation" (Cmnd 9756), published Budget Day 1986, outlined possible system of independent taxation with transferable allowances.

(ii) Under proposed system of transferable allowances no-one would lose in cash terms from abolition of married man's allowance.

(iii) Period of public consultation ended 30 September 1986. Majority of those expressing preference supported introduction of transferable allowances.

Opposition proposals on taxation of husband and wife

(v) Labour and SDP/Liberals have proposed:

- independent taxation of men and women;
- abolition of married man's allowance;
- improved benefits (not always specified or costed) for some of those who would otherwise lose from abolition of married man's allowance.

Positive

(i) All major parties agree taxation of husband and wife needs to be reformed.

(ii) Outcome of Green Paper consultations - majority of those expressing preference supported introduction of transferable allowances. But Government has decided not sufficient broadly-based support at this stage to proceed with such a major reform immediately; in any event long lead-times and computerisation mean that transferable allowances could not be introduced quickly, as the Green Paper explained.

(iii) General agreement on need to give married women independence and privacy in tax matters. Government will bring forward measures addressing this problem in next Parliament.

(iv) Greater independence for married women in tax matters still consistent with move to transferable allowances at later stage.

Defensive

(i) Is Government dropping transferable allowances?

No. Still optimal solution for longer term. But wrong to rush into major change of system before benefits have been widely understood and accepted. Aim to deal first with most pressing problems identified in Green Paper, namely lack of independence and privacy for married women.

(ii) Government has been forced to accept that transferable allowances are unworkable/too costly/unpopular with married women?

No. System of transferable allowances described in the Green Paper carefully worked out and costed. No doubt of its viability. Cost could be reduced by phasing if necessary. Response to Green Paper showed majority of women's organisations responding to transferable allowances.

(iii) Surely the Government has by now, after 5 months, assessed responses to Green Paper?

Majority of respondents expressing preference supported transferable allowances. Will take account of all responses in designing measures for next Parliament.

(iv) More delay? When is Government going to introduce legislation?

No more delay. Legislation will be introduced in the lifetime of the next Parliament.

(v) How is Government going to tackle problems of privacy and independence for married women?

By introducing a system which would allow married women to take responsibility for their own tax affairs.

(vi) Why not act now to give married women privacy and independence in tax matters?

Personal tax changes have wide-reaching effects. Further work required on detailed measures.

(vii) Mandatory separate taxation with cash benefits?

Government view remains that mandatory separate taxation is unacceptable. Opposition proposals have not been properly thought out or costed. Likely to result in a substantial number being worse off. Many on low incomes could be brought into tax or taxed more heavily.

(viii) Will you publish a summary of responses to Green Paper?

It is for those who sent us their views to publish them if they wish to do so. Have already given (20 November 1986 WA col 17) list of organisations who have responded.

ANNEX B

Possible section in a Parliamentary Speech

"The consultation showed there is general agreement that action is needed to deal with the present lack of privacy and independence for married women in their tax affairs. We intend to deal with these problems by introducing new measures in the next Parliament. It would be open to move to transferable allowances thereafter but, although the majority of those expressing a preference in the Green Paper consultation supported transferable allowances, the Government does not feel the support was sufficiently broadly based at this stage to go ahead now with that major reform."

TRANSFERABLE ALLOWANCES

Tony!

PS/MST TO CROPPER 5/3

FROM: S P Judge

DATE: 5 March 1987

MR CROPPER

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Hudson
Mr Ross Goobey
Mr Tyrie

Illuminating

TRANSFERABLE ALLOWANCES

The Minister of State has seen your note of 4 March to the Chancellor, and has commented that Ms Lait is the Chairman of one of his constituency branches. She lives at the top of one of the Barbican tower blocks, with an Englishman who works in American bank. She used to cover the Parliamentary work of the Chemical Industries' Association for scme years, and how runs her own firm.

S P J

S P JUDGE
Private Secretary

2812/32

FROM: J J HEYWOOD
DATE: 5 March 1987

PS/FST
TO
CROPPER
5/3

MR CROPPER

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Hudson
Mr Mace IR
Mr Ross Goobey
Mr Tyrie

TRANSFERABLE ALLOWANCES

The Financial Secretary has seen your note of 4 March. On your speculation in paragraph 8, the Financial Secretary has commented: "Perhaps. But our promise would have to be vague as there are various ways of doing it and different lead-in times."

J.H.

JEREMY HEYWOOD
Private Secretary

3219/3

6/3

FROM: P J CROPPER
DATE: 4 MARCH 1987

CHANCELLOR

& PSC whether to have another mtg with ladies on all this:

PRAYERS

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Hudson
Mr Mace IR
Mr Ross Goobey
Mr Tyrie

CROPPER TO CH/EX 4/3

TRANSFERABLE ALLOWANCES

When the Financial Secretary and I went to meet the ladies of the CWNC at Central Office the other day to talk about the Green Paper, I was struck by Jacqui Lait's obvious grasp of the subject. She is a sensible girl, eight years a civil servant, partly in Scotland, before becoming a candidate.

2. Hence, or otherwise, I took her out to lunch last week. I wanted to find out exactly why she lines up so firmly with Judith Chaplin against transferable allowances.

3. The essence of it is that she does not think that ordinary people will be able to work the system of transferable allowances without a lot of hassle, that it will exacerbate frictions wherever they are already latent in a marriage, and that nobody will thank us except the better off stay-at-home wives and the women with significant investment income of their own (often the same people). So it will be seen as evidence of the upper class bias of the Tory Party.

4. There is a touch of the paternalistic (or maternalistic) in this. "We know what will be good for the ordinary people and what will not be good for them." However it is very clear that the CWNC women who are against transferable allowances are far more assertively against them than are those who find themselves hesitantly on the other side. As Jacqui put it, the ladies of the CWNC are intensely loyal to the Party line, but that is about all that is keeping them in the transferable camp.

5. When it came to discussing the alternatives, I am afraid that carers' benefits and larger child benefit were taken for granted. The difficulty of defining a carer had been considered, but it was felt that existing DHSS definitions would generally suffice.

6. Jacqui was also quite strong on the cases of mother and daughter, brother and sister, and friend and friend living together. She did not find very persuasive the argument that Conservatives should go for transferable allowances because of a belief in marriage. It was not only couples living in sin, who would be better served by MST than by transferable allowances.

7. Finally, Jacqui was very anxious that the Manifesto should say something definite about our intentions on this front. She foresaw difficulties if we set out for the hustings with only a vague promise to introduce "a fair system of taxation for women and the family".

8. One wonders whether the best next step might not be simply to promise independent taxation of savings income. Jacqui did not think there would be any significant political back-lash against such a proposal: everybody was now agreed that it was daft to treat women's savings income as if it were their husbands'.

?

P J CROPPER

PLWP

NOTE OF A MEETING HELD IN HM TREASURY ON

MONDAY 9 FEBRUARY 1987

Present Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Isaac - IR
Mr Lewis - IR
Mr Mace - IR
Mr Dyall - IR

NOTE OF MEETING 9/2

GREEN PAPER ON PERSONAL TAXATION

Papers: Mr Isaac to Chancellor, 2 February.

1. The Chancellor said that reform of the taxation of married couples was particularly difficult, because it combined the usual difficulties of major tax reform with a very long lead time, which allowed maximum time for complaints to build up. In the preparation of the Green Paper, colleagues in spending departments had argued that the resources required for transferable allowances could be better spent on other things, and the Prime Minister had always been sceptical of the merits of the reform. Unfortunately, the response to the Green Paper had not been sufficiently positive to overcome this scepticism. Progress could not therefore be made with transferable allowances at present; we would have to wait for a more propitious moment. The practical question was whether we simply said as little as possible in the meantime, or whether some interim action should be taken.

2. There was some discussion of the interim measures assessed in Mr Isaac's minute: the "Lorna Bourke" scheme (LB); and the Wife's Income Election (WIE).

3. The following points were made about the LB scheme.

(a) It met the objectives of independence and privacy for married women, and helped to tackle the tax penalty on marriage, but did not improve the cost-effectiveness of increases in tax thresholds.

(b) Much of the benefit would go to high income families with investment income, though it might be introduced alongside other measures benefiting other families.

(c) It might be difficult to present LB as a measure arising out of the Green Paper, because the Green Paper argued the case for more tax relief for one-earner couples, whereas LB tended to help two-earner couples. In some ways, LB could even be seen as a stalking horse for mandatory separate taxation, though proper presentation could minimise this risk.

(d) It was doubtful whether LB would make it easier to get to transferable allowances. Once action was taken on privacy and the tax penalties on marriage, there might be less pressure for further reform. Indeed, transferable allowances would offer less privacy than LB. And LB would bring forward much of the benefit to the elderly, which was an attraction of transferable allowances. The remaining arguments for transferable allowances would be that they were a more cost-effective way of raising thresholds, and that the married man's allowance was anomalous.

4. The following points were made about the Wife's Income Election (WIE).

(a) WIE emerged more naturally from the present system, and kept more options open than LB.

(b) It only gave privacy and independence to the better off couples who would make the election. But these tended to be the people who complained most about the present system.

(c) Most of the benefit went to the well off, and WIE would do nothing for wives with a small nest egg, which was one of the main sources of grievance about the present system.

(d) WIE could be announced in the 1988 Budget, and could be effective for the 1988-89 tax year, provided that elections were made after the end of that year, and the tax reductions given through repayments in 1989. Prompt implementation was attractive, because it reduced the time available for criticism to build up.

5. It was noted that both schemes would tend to benefit the well off, and the Chancellor asked for a distributional analysis comparing the two. Opponents would find it hard to criticise the principle of giving independence to married women, but there would be added pressure for increases in child benefit.

Tax penalties on marriage

6. Mr Cassell said that it would not be easy to tackle the other tax penalties on marriage, though the Chief Secretary pointed out that they aroused a lot of resentment. The Chancellor said that, on mortgage interest relief, it would be difficult not to level upwards, and give married couples two slices of relief, because increasing numbers of young single people, including, for example, brother-and-sister couples as well as those "living together", were sharing the costs of buying a home. Mr Ross Goobey suggested that the limit could be applied on a residence basis for new mortgages

only. The Chancellor thought this was attractive, and asked for figures for the costs of the various options and the numbers affected.

Conclusion

7. The Chancellor said that no more resources should be put into work on transferable allowances at this stage - we would have to wait for the right moment to make further progress.

8. The Chancellor said that, in any public statements, the aim should be to focus on objectives rather than specific measures, perhaps along the lines "measures would be introduced in the next Parliament to address the problems of independence and privacy". He asked Mr Scholar to suggest a precise form of words.

9. The Chancellor asked the Financial Secretary to consider after the Budget the options for the next Parliament.

APH

A P HUDSON

9 February 1987

Distribution

Those Present
PS/Minister of State
Sir P Middleton
Mr Byatt
Miss Noble

PS/IR

RP

COPY 2 NO OF 21 COPIES

FROM: M C SCHOLAR
DATE: 13 MARCH 1987

CHIEF SECRETARY

cc Chancellor of the Exchequer
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Culpin
Miss Sinclair
Miss O'Mara
Miss Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Hudson

CHIEF SECRETARY'S SPEECH IN THE BUDGET DEBATE

... I attach the pieces you requested in your minute to me of 6 March.

(a) Fruits of success - No mention here of unemployment - I suggest we wait to see what Thursday's figures will be before finally deciding what to say. My inclination would be simply to add "unemployment is falling" somewhere in paragraph 1. On reflection I have dropped the 'trinity' in favour of the 'triple'.

(b) Income tax (piece by Mr Sinclair), covering your pay point.

(c) short defensive piece on excise duties and prescription charges.

MW

M C SCHOLAR

Fruits of economic success

1. My rt hon friend the Chancellor set out yesterday a remarkable catalogue of success - successes achieved in recent years and successes still to come. Six years of steady growth already under our belts, a seventh about to begin. Four years in which that steady growth has gone together with low inflation, and another year of low inflation ahead. Productivity, exports, manufacturing output all performing well, or very well; and every prospect that this sustained improvement in our economic performance is continuing and will continue.

2. All this has been plain enough for some time now - except of course to the rt hon gentleman for Sparkbrook and his colleagues, for whom it spells gloom and disaster. I understand that, and understand why it leads them to deny the truth which is staring them in the face. But there is one aspect of our success which has taken even the impartial commentators somewhat by surprise - the extraordinary strength of the public finances.

3. There is, Mr Speaker, nothing new or surprising about that strength. It is the strength which has enabled my rt hon friend, and before him

the present Foreign Secretary, to reduce public sector borrowing progressively to its present very low level and at the same time to cut taxes in each of the past six Budgets. It is the strength which has grown out of a strong economy, prudently and steadily managed. It is a strength sustained now over many years, durable enough to withstand two whirlwinds - the collapse of our oil revenues and a long and costly coal strike. It is a strength upon which we may rely in the time to come.

4. How has all this been brought about? What is it which has enabled the government to secure this triple achievement - at one and the same time to keep borrowing, and inflation, low; to allow a modest increase in overall public spending, sufficient to make room for our high priorities - health, education and the rest; and to cut taxes year after year?

5. The answer to these questions is clear, and should, by now, be uncontroversial. From the outset, in 1979, the Government set out a clear, medium-term, prospectus for sound, steady finances, together with a whole bank of measures to improve the performance of the economy and to release its energies and its enterprise. Year after year my rt hon friend and his predecessors have pursued these policies, steadily and without deviation.

Luck, or good fortune, have had nothing to do with it. Yesterday's Budget is the latest instalment, both of sound financial policies and in our programme of action to galvanise the economy.

6. I turn first to the income tax changes ...

INCOME TAX REDUCTIONS

Lower rates of income tax are good for incentives and stimulate enterprise. In this Budget we have brought down the basic rate, the marginal rate for 95 per cent of taxpayers, to 27 per cent - an important milestone on the road to our goal of 25 per cent.

We have deliberately designed the income tax package so that it benefits as many people as possible, but we have limited the benefits for those paying the highest rates of tax. All income tax rates need to come down if we are to remain competitive with those countries which are making substantial reductions in their top rates. But we have thought it right this year to give priority to reducing the marginal rate for the largest number of taxpayers.

There are those who say that it is not worth cutting the basic rate of income tax. But cuts in basic rate certainly have an effect on living standards. This year's income tax changes are equivalent to a 2.8 per cent pay increase for a married man on average earnings. I do not think this can be described as not worth it.

People have been getting steadily better off since 1979. Following the Budget changes, real take home pay for a married man on average earnings will be up 21½ per cent. It will be up over 17½ per cent for the same man on half average earnings.

If we had kept the previous Labour Government's tax regime and simply adjusted it for inflation, the man on average earnings would be paying 2.1 per cent more of his income in tax and NICs. This means he is around £250 a year better off than under an inflation-adjusted Labour regime. The man on half average earnings would be paying 0.8 per cent more of his income in tax and NICs. So much for the policies of the Honorable Members opposite who say that their concern is with the less well off.

Fortunately we have not kept Labour's tax regime. And this Budget is continuing the process of leaving more of the taxpayer's money in his or her pocket. At all levels. A nurse on £155 a week will be £2.67 better off. If she is married to a primary school teacher, on a joint income of £435 a week, the couple will be £7.59 better off. But the Rt Hon Member for Sparkbrook proposes to take this away. I do not think he will get the chance.

We have recognised that those over eighty can have special needs. The increase in age allowance for this group is worth over £100 a year either to a single person or to a married couple on an income of £5,000. We also thought it right to make a significant increase in the blind allowance, from £360 to £540.

Apart from reducing the income tax burden for most taxpayers this Budget introduces a specific income tax relief to encourage the spread of profit related pay. My Rt Hon Friend the Minister of State will be speaking more fully about this later. I believe that the Government's initiative will, over time, help to tackle the problems in the nature and balance of our labour market. Those firms who already have profit related pay schemes generally believe that they have worked well. In addition to allowing a more flexible response to changing market conditions, they give employees a greater personal interest in the success of the companies for which they work. There is a lot of evidence that firms which can create a sense of unified effort fare better than those who are stuck with ossified ideas about "management" and "workers". The profit related pay scheme is another Government measure designed to make the economy work more efficiently.

Excise Duties

1. The rt hon gentleman for Sparkbrook regrets that we have not increased taxes on motoring, drinking and smoking. That doesn't surprise me in the least. Like other members on the benches opposite he always seeks every occasion to put taxes and prices up, whenever and wherever he can. The House perfectly understands his reason: he needs the money to finance the huge, extravagant and self-defeating expenditure commitments his colleagues have foisted upon him.

2. (vs prescription charges) These two issues have nothing to do with one-another, and he knows that. Prescription charges are charges for a service, and they have increased as the cost of providing that service has increased. Excise duties are taxes, and totally different considerations apply as to whether to raise or lower taxes. The rt hon gentleman always wants to raise taxes ... etc etc

MR 11/108

BUDGET SECRET No 18 of 18 Copies

RP

FROM: CATHY RYDING
DATE: 16 March 1987

PS/FINANCIAL SECRETARY

cc: PS/CST
PS/EST
PS/MST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss O'Mara
Mr Culpin
Mr Hudson
Mr Cropper
Mr Tyrie

Mr Ross Goobey
PS/IR
Mr Mace - IR

BUDGET DEBATE: FINANCIAL SECRETARY'S WIND-UP SPEECH

The Chancellor has seen Mr Scholar's minute to the Financial Secretary of 13 March.

2. The Chancellor suggests that the last three lines of the first paragraph of the contribution on the Green Paper on the Reform of Personal Taxation should be amended to read

> "Government does not yet feel that there is sufficient support to take a decision now to go ahead with so far reaching a reform."

The Chancellor thinks this is an important amendment.

3. The Chancellor agrees that it would be courteous to circulate these paragraphs (as ammended) for information. He suggests this is done first thing on Wednesday morning.

CR

CATHY RYDING

BUDGET SECRET

Inland Revenue

Policy Division
Somerset House

FROM: B A MACE

DATE: 16 MARCH 1987

PS/CHIEF SECRETARY

COPY NO 2 OF 25

CHIEF SECRETARY'S SPEECH IN BUDGET DEBATE

1. Mr Heywood showed me a copy of the draft contribution on income tax for the Chief Secretary's Speech which was attached to Mr Scholar's note of 13 March.

2. There are a number of factual points on this.

3. In the third paragraph, the statement should be that the income tax changes are equivalent to a 2.7 per cent pay increase. (I have agreed this figure with Treasury ETS who will make the necessary changes in Budget Brief D3).

4. In the forth paragraph, first sentence, it would be better to say "People are now substantially better off than in 1979". There has not been a "steady" improvement because of the effect of the decision not to raise allowances in cash terms in 1981. The figures in the next sentence need checking depending on what the Chief Secretary wants to say. (The figures are 22 1/2 per cent and 18 per cent respectively for a married man without children. For married men with two children or less it would be possible to say "over 21 1/2 per cent" and "17 1/2 per cent" (but not "over 17 1/2") respectively.)

---

cc PS/Chancellor of the Exchequer
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Scholar
Mr Culpin
Miss Sinclair
Miss O'Mara
Miss Evans
Mr Cropper
Mr Scotter
Mr Ross Goobey
Mr Tyrie
Mr Hudson
Mr Isaac
Mr Beighton
Mr Lewis
Mr Mace
PS/IR

5. In the seventh paragraph the second sentence should be reworded:

"For this group the Budget income tax changes are worth over £100 per year ...". The increase in age allowance alone for those aged 80 and over is not worth as much as £100.

B A Mace

B A MACE

PWP

FROM: CATHY RYDING
DATE: 16 March 1987

PS/FINANCIAL SECRETARY

cc: PS/CST
PS/EST
PS/MST
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Scholar
Miss O'Mara
Mr Culpin
Mr Hudson AH
Mr Cropper
Mr Tyrie

Mr Ross Goobey
PS/IR
Mr Mace - IR

BUDGET DEBATE: FINANCIAL SECRETARY'S WIND-UP SPEECH

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The Chancellor thinks this is an important ammendment.

3. The Chancellor agrees that it would be courteous to circulate these paragraphs (as ammended) for information. He suggests this is done first thing on Wednesday morning.

CR

CATHY RYDING

ps2/25R

CONFIDENTIAL

FROM: CATHY RYDING
DATE: 19 March 1987

MR CROPPER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Ross Goobey
Mr Tyrie

FURTHER BUDGET BRIEFING

The Chancellor was grateful for your minute of 18 March. He would be grateful to see in draft the mini-Backbench Brief mentioned in your paragraph 3. He also thought the "Zipcard" on Small Business mentioned in your paragraph 4 was a good idea.

CR

CATHY RYDING

5-3

MC/0119.

BUDGET SECRET

COPY NO 2 OF 18 COPIES

FROM: M C SCHOLAR
DATE: 13 MARCH 1987

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Miss O'Mara
Mr Culpin
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Ross Goobey
PS/IR
Mr Mace - IR

C/ content for FST to proceed as at X

CR 16/3

I have made an emphatic amendment to the line – see X. I agree that No 10 etc be content to circulate paras 1 & 2 (as amended) for information. I suggest this is done first thing on Wed AM.

BUDGET DEBATE: FINANCIAL SECRETARY'S WIND-UP SPEECH

... I attach, as requested, pieces on

(i) lower taxes and higher revenues

and (ii) transferable allowances, in the light of the discussion with the Chancellor this morning.

2. One matter raised in my minute to the Chancellor was not covered this morning - whether No 10 and interested Ministers on the Prime Ministers' ad hoc group should be told in advance of what you are planning to say. I think it would be courteous to do so, and - subject to the views of the Chancellor - suggest that you simply circulate, for information, an extract from your speech to, say, No 10, Lord Whitelaw, Mr Tebbit and Mr Fowler early next week.

X

MCS

M C SCHOLAR

BUDGET SECRET

1. Since 1979 it has been a cardinal element in the government's policy that tax reduction is the single most effective measure available to it to stimulate enterprise and release wealth-creating energies throughout the economy. That is why we cut the basic rate of income tax in 1979, last year and this year, from 33 to 27 pence in the pound, and reduced higher rates from their penal levels under the Labour Government: why we abolished the National Insurance Surcharge, Capital Transfer Tax, the Investment Income Surcharge, Development Land Tax; and reduced the burden of most of the remaining direct taxes, including halving stamp duty on shares.

2. Hon Members opposite, of course, found much to criticise in all this, and have ceaselessly advocated higher public expenditure rather than cuts in taxation. I believe that it is now clear that they have been posing a false dilemma. The fact is that the revenue yield from non-oil taxation has been and is remarkably buoyant, notwithstanding - and, some would say, because of the tax cuts which we have made. This is the final vindication of our policy - lower tax rates and higher revenue, coming from an increasingly vigorous and profitable economy.

1. Last year on Budget day, my Rt Hon Friend published a Green Paper on the Reform of Personal Taxation The Government invited comments from organisations, representative bodies and members of the public on the ideas discussed in the Green Paper. I have to tell the House that the response to the Green Paper has been disappointingly thin Although the majority of those who responded to the Government's invitation expressed themselves in favour of [the approach in the Green Paper] transferable allowances, the Government ~~is clear~~ does not yet feel that there ~~was not~~ is sufficient support to take a decision now to go ahead with so far-reaching a reform.

Y

X

2. Nevertheless the Government considers it important both that the tax system should give women a fair deal; and that the tax penalties on marriage should be removed. We will therefore be considering the matter further and will be exploring whether there is any satisfactory halfway house to the approach in the Green Paper

Nigel (or anyone who feels inclined,) pl

FROM: S P Judge

DATE: 23 March 1987

MR HUDSON

cc Miss O'Mara

BUDGET DEBATE: 23 MARCH: FRENCH REGIONAL UNEMPLOYMENT

The Minister of State asked me to draw the attached chart to the Chancellor's attention (extracted from Paris Saving Telno 8 of 16 March - "France Economic Report for February 1987").

The Minister thought this might be useful to repulse the likely Opposition thurst in today's debate - ie the fate of the periphery. I hope your French is good enough.

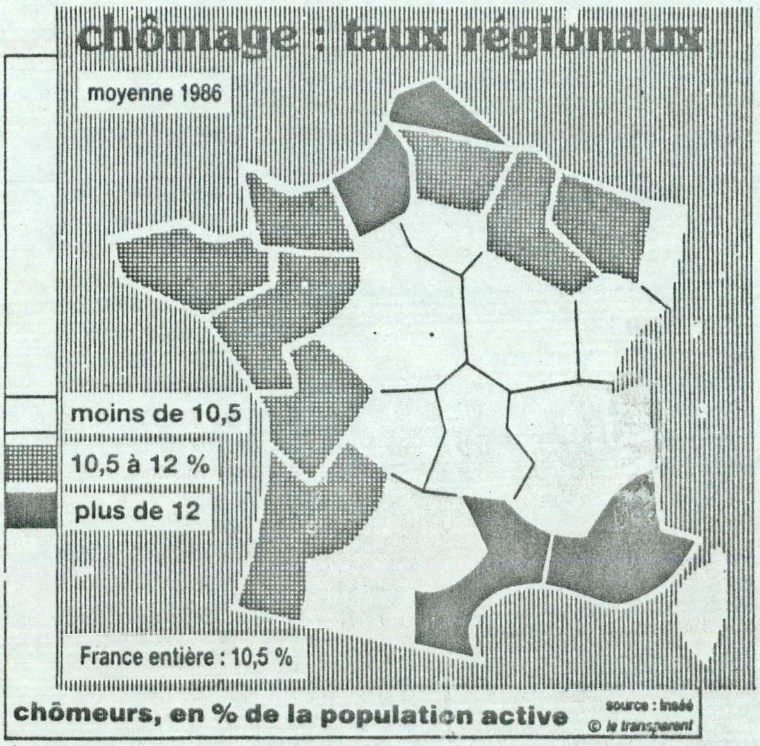
SPJ

S P JUDGE
Private Secretary

21. The fall in youth unemployment reflects the success of the government's parafiscal (social security) incentives for the employment and training of young people. 109,872 young people benefitted from the plan in January, bringing the total since 1 May to 947,565, of whom half took up industry based training courses. (The Social Affairs Ministry claims that there has not been any significant substitution of young people for adults as a result of the scheme.) A further 266,000 young people benefitted from the community programme equivalent (TUC) over the same period.

22. An analysis of the regional distribution of unemployment in 1986 published by INSEE showed that the highest rates (over 12%) were concentrated in North and South East France. The annual average in the West and North East was over 10.5%.

~~Tha~~ You made the point on 20 Jan that regional disparities were not a uniquely British phenomenon.



SW France!

The worst affected region was Languedoc Roussilan - 13.9%, the least, Alsace - 7.8%. Disparities between regions had increased since the last study in 1980, when the difference between Alsace and the region then worst affected, the Nord - Pas de Calais was only 4.1 percentage points.

/23.

23. INSEE has forecast that unemployment will continue to rise, by 15-20,000 a month in the first half of 1987, to reach 2,650,000-2,700,000 by mid-year, and that there will be a slight improvement in the second half of the year. The Employment Minister, Philippe Séguin, has described another INSEE forecast that unemployment will rise to 3.4 million by 1991 as 'optimistic'. He has announced a series of new measures, to help the long-term unemployed and redundant workers: Extension of the offer of 5 months retraining leave to all redundant workers, including those whose employer becomes bankrupt has attracted particular comments. The measures will be financed from 7.5 billion francs savings to be found from Ministers' 1987 budgets.

24. Employment in the non-agricultural trading sector, which rose by an estimated 50,000 (0.4%) in 1986 is forecast by INSEE/ by 30,000 (0.2%) in the first half of 1987. Drastic reduction in coal, steel cars and shipbuilding are expected.

25. A rise in the national minimum wage (SMIC) was triggered by the January inflation figures: it goes up 2.4% to 27.52 francs an hour with effect from 1 March.

26. The news on inflation gave rise to renewed calls for 'safeguard' (catch-up clauses) in this year's pay settlements. But major settlements continued to be in line with the government's 2%-3% guidelines. An imposed settlement in the banking sector will raise pay by 1% on 1 May 1987 and 0.7% on 1 December. Guaranteed minimum pay rates in the road transport industry go up by 1% with effect from 1 February following an agreement on 17 February to 4,445 francs a month (169 hours) for manual workers, 5,012 francs monthly for first-time supervision and 92,899 francs for managers. Civil servants received first stage of the 1987 pay settlement on 1 March: minimum monthly pay for a single person in the Paris region is now 4,995.93 francs.

27. The hourly pay of manual workers rose by 0.5% during the last quarter of 1986, bringing the rise over the year to 3.2%, according to provisional results of the Employment Ministry's quarterly survey. Average weekly hours worked fell to 38.95 for manual workers, 38.8 for white collar workers over the quarter.

28. The primary school teachers dispute was interrupted by the two week February holiday.

SOCIAL SECURITY AND UNEMPLOYMENT BENEFIT

29. The social security system continued to give rise to concern. The general fund had a deficit of F20.9 billion in 1986, where spending on medicine was up by 10.3% compared with 1985 and on hospital care by 13.9%. Deficits for all main funds are expected at the end of 1987: 25 billion francs for the health care fund. In spite of all this, measures to extend and increase prescription

/charges

C3/001

UNCLASSIFIED

FROM: A LYONS
DATE: 25 March 1987

PS/MINISTER OF STATE

BUDGET DEBATE: 23 MARCH: FRENCH REGIONAL UNEMPLOYMENT

The Chancellor has seen and was grateful for your minute dated 23 March.

A Lyons

A LYONS

CE2

FROM: MISS C EVANS
DATE: 26 MARCH 1987

MR SCHOLAR
MR ODLING-SMEE
MR PERETZ
MR TURNBULL
MR SEDGWICK

cc Chancellor of the Exchequer
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monck
Mrs Lomax
Mr Culpin
Miss O'Mara

TCSC ENQUIRY INTO THE BUDGET: OFFICIALS' EVIDENCE

... I attach the transcript of yesterday's hearing. I should be grateful if you could return your copies to me with amendments marked clearly in red by close on Monday 30 March please.

Carys Evans

MISS C EVANS
ext 5190 93/1

1925/035

FROM: S J PICKFORD
DATE: 23 March 1987

PS/CHANCELLOR

cc: Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Culpin
Miss O'Mara

papers please (i.e. first part)

POST-BUDGET PRESS BRIEFING

I attach the second and final part of the transcript of the Chancellor's press briefing for economic correspondences on Wednesday 18 March.

Stephen Pickford

S J PICKFORD

QUESTION: .... does that mean you are now equally resistant to a rise as to a fall or is there the same preference for a rise rather than a fall ....?

CHANCELLOR: No, to the extent that the exchange rate has risen since Paris my remarks now would be less lopsided.

QUESTION: On that question of interest rates could you tell us whether a new savings certificate is imminent or are you going to wait and see what the building societies do?

CHANCELLOR: I think we'll have to wait and see.

QUESTION: Going back to the EMS, where now does the chief focus now lie whereas before it was not this side .... where is the chief focus now ...?

CHANCELLOR: I'm afraid I can't give you a very helpful answer. The fact is that we continually keep it under review and all factors are taken into account.

QUESTION: There's not any particular ...... ?

CHANCELLOR: No, all factors are taken into account.

QUESTION: If Britain is going to grow at a faster rate than practically any other major industrial country isn't there a worry that imports are going to be sucked in at an even faster rate than anticipated in your current account balance of payments forecast?

CHANCELLOR: No, because we're growing at a perfectly acceptable rate. We're not doing the sort of unsustainable rate that happened in the United States that happened in '84 when it was at a ridiculous rate. It happened of course in the UK in '73 and it was a totally unsustainable rate, no nothing like that. This is a perfectly, 3% I believe is a perfectly sustainable rate or thereabouts, you know a fraction. And I think British industry is better placed to take advantage of this prospect than it ever has been. Indeed it was that kind of question that I had in mind when I said in my Budget forecast last night, I don't know if you saw it, that in this country the curious thing is we seem to be terribly embarassed and ashamed and awkward about success. For years and years we've been worried about our rate of growth being the slowest and now it's the fastest we worry about that.

QUESTION: .... a bit confused Chancellor because last autumn the £ was under pressure, interest rates were going up and there was no money for tax cuts and 6 months later it's all rosy. Now 6 months down the line is it still going to be rosy or are we going to be back under siege?

CHANCELLOR: No, in the autumn the comment at the time was really rather absurd and that is why I resisted very vigorously the pressure for a 2% rise in interest rates because it seemed to me to be wholly unwarranted and I waited until the pressure had abated and then put interest rates up by 1%. .... at that time sterling was under pressure and MO you know, was rising and looking to break out at the top of the range. Now we have sterling strong, there has been a reassessment in overseas markets of the British economy, a favourable reassessment and we see MO back safely in the middle of its range. And so the monetary conditions are all right, perfectly all right and we can have these two half % cuts perfectly consistent with keeping monetary policy where it should be. As for the room .... for tax cuts in fact what I said at that time was that there would not be much room for tax cuts. .

QUESTION: You were ...... weren't you - the situation changed rather dramatically?

CHANCELLOR: Well I always believe in being cautious. I expected the PSBR to undershoot. I didn't think it would undershoot by as much as it has, but I expected it to undershoot. On the other hand, the official forecasters at the Treasury at the time were forecasting an overshoot, which was clearly ridiculous. And so in the Autumn Statement what I stuck to was the £7 billion figure which I'd said at the time of the Budget, that seemed to be a sensible thing to do, you know, the forecasters were up the pole. But I expected an undershoot for the reasons that are clear. Although I have to say I didn't expect it to be as big as it has turned out.

QUESTION: .... that your Chancellorship is not anything like your predecessor in the sense that you've made no further progress in reducing inflation and it's quite likely that you'll go into the election in the autumn or whatever with a higher inflation rate than you inheritted from Sir Geoffrey Howe. Does that suggest that you're objectives in this period have changed, that you're really not able any longer to reduce inflation, so that you replaced the strategy , the medium term strategy, ...?

CHANCELLOR: No I don't accept that at all. The underlying rate of inflation, the average rate of inflation in 1983, you can't look at just one month, the average rate of inflation in 1983 was 4.6%. In fact because of the pattern of mortgage reliefs I think the underlying rate of inflation then was 5% at that time, the time of the last election. We chose to go at a time when because of the mortgage rate effect it was particularly low, it was pretty well the low point. But the underlying rate then was 5%. The underlying rate now is 4%. So that I haven't brought the underlying rate of inflation down a lot certainly, but it has come down and I trust it will continue to come down.

QUESTION: ~~What~~ One per cent every 5 years would be your sort of aim?

CHANCELLOR: No, no, we don't have a specific ..aim..... But obviously it takes longer to get from 5 to zero than it takes to get from 10 to 5.

QUESTION: Worry that £ will rise too far?

CHANCELLOR: I don't think that we need allow that to happen.

QUESTION: What do you think of the reaction to the Budget, it seems much more a Budget of the sort of Treasury's knights than your previous Budgets where you sort of - even with a limited scope for tax cuts - you certainly produced some ingenious things on reform of taxes or whatever? This one seems a Budget sort of scripted by Treasury officials and your delivery, which was perhaps a little faltering, reflects that you weren't so enthusiastic about this Budget?

CHANCELLOR: No, the Budget was entirely by me, I can assure you, like all the previous Budgets. I can't think of anything off hand, there must have been something in it which the Treasury knights contributed, but I can't off hand think of anything but I'm sure there was something. I think that the faltering delivery ..... because I lost a page in the middle of the speech which was slightly off putting. But I discovered it later on and I did the last part of a sentence which was at the top part of the page from memory and fortunately got it right. And the rest of the missing page I read when it turned up. I don't think the unplanned change of order really made any difference to the Budget. The speech could just as well have been written in that order because it happened during the shockingest part of the speech. But it did slightly cause me to falter because it was a new experience for me. I've not actually before delivered a Budget speech and lost page. It's slightly disconcerting when you turn over a page and it's missing.

QUESTION: I mean relative to your other Budgets you don't think this was sort of, if you like, a boring Budget? It was sort of, apart from the cut in the PSBR and the 2p cut in interest rate there were all these maybe important technical things, but there was no I suppose

Lawson surprise or Lawson sort of ingenuity there?

CHANCELLOR: ..... No, I think that what you're grasping for is to say there was nothing in the way of tax reform. There wasn't much. I think that there was a certainly cleaning up of the treatment of corporate capital gains but that's a minor matter. But it was something which was left over from the main corporation tax reform in tune with .... capital gains. But, you know, the fag end of a parliament - whenever the election is imminent ...., the fag of a parliament is not a time to embark on tax reforms, nobody does that. I mean I concentrated it in my first Budget. It is the beginning of parliament, that's when to do it. You look at the Americans, they waited until the Presidential election was over and that was when Treasury I' was revealed to astonished world. I mean it's the sensible way to do it.

QUESTION: But you said earlier that ....?

CHANCELLOR: No on the particular question of - this was on a particular question of transferrable allowances. There is a lot more (end of tape) .....

...(tape continued).....

QUESTION: Looking beyond the fourth quarter of the year, of that inflation figure of 4%, what are the factors that are going to cause inflation to be on a downward trend in 1988?

CHANCELLOR: The anti inflationary policy is well known, it's the same policy as we've had from '79.

QUESTION: You seem to have a pronounced shifts from one year to another, a higher inflation rate 2 years ago than the previous year and your trend ......?

CHANCELLOR: You don't ever get inflation coming down in a straight line. What you get is fluctuations. What we've had we've had fluctuations in the past in the '50s and the '60s. But what was happening in the '50s and the '60s, sorry the '60s and '70s, what was happening in the '60s and '70s was that each peak, inflationary peak, was higher than the previous peak, each trough was higher than the previous trough. We're now on ......, we still have fluctuation but each peak is lower than the previous peak and each trough is lower than the previous trough.

QUESTION: But for 1988 are you confident that the inflation rate will actually be going down , that the peak and the trough ...?

CHANCELLOR: We don't make a forecast beyond the second quarter of '88 , which the forecast is 4%.

QUESTION: What's your explanation for British interest rates being considerably higher now, they're still ...., why should they be at the level they are now ....?

CHANCELLOR: I think there are a number of reasons for ..... this. It's difficult to attach .... weights to them. But one of them undoubtedly is the fact that not only do ~~they~~ we have a highly financial market, much more highly developed than most I should imagine, but we have also freed it up tremendously and therefore the control on credit, borrowing, lending and all that, has to rest in this very free market that we ~~and~~ have has to rest entirely on the interest rate, there is no other - we have it and I think that makes it a much more efficient market. And I think that it is one of the reasons too why London is one of the 3 world financial centres, even though we are not one of the 3 biggest economies in the world. And I think London may well become the most important of the 3 financial centres. That's one reason. Another reason I think is that we have a Labour Party in this country with policies that would be very damaging for the economy and that leads to a constant fear. And I think that the third reason is that compared with many of these countries we do not have as long a track record of low inflation. There's no doubt at all that track record records are very important and the longer we have a track record the more confidence that there will be and the less room there will be for interest rates to be higher than those of other countries.

QUESTION: Economy suffering from high interest rates?

CHANCELLOR: In what sense?

QUESTION:

CHANCELLOR: Yes, I don't think that the economy is suffering to any great extent as the result of the present level of interest rates, you're thinking of investment. If you look at what's happened to investment it's a very good story. We had admittedly a pause in 1986 which was a combination of 2 things. It was a combination of the growth pause which happened worldwide as a result of the oil shock and the fact that the corporation tax reforms of 1984 brought a lot of the investment forward into '84 and '85 and there was always likely to be a some kind of a dip anyway in '86. In fact it was far less, despite the oil ..... price fall super imposed on it, than the CBI and others were predicting at the time of the corporation tax reform. But now all the forecasts of investment for 1987 are very very bouyant. And that's on the basis of current levels of interest rates. One thing I must draw your attention to incidentally, ..., because we had the first actual photograph ever taken of crowding in, which is on page 11. What .... I call the 'frog chart', because if you ignore the first few years it's, you know, it's rather like a frog. You know, you see the legs coming out at the end. But it is actually a remarkable example, as I say, the first known photograph of crowding in.

QUESTION: Given that you knew last November that the PSBR was going to be lower and given that you estimated that the petroleum price, the oil price, would only be $15 and it was $18 yesterday, are you in your heart of hearts aiming for an even lower PSBR than £4 billion so that you can get an even nicer ~~growth~~ 'frog chart'?

CHANCELLOR: Well we've now undershot. I mean I've had 3 years of the completed results that I inheritted in 1983 Budget - 1984-5 we overshot only because of the coal strikecost. It would have been about I thin where we said. It was very difficult to estimate the coal strike cost but it would have been there or thereabouts. IN the 1985-6, 1986-7 we had two successive undershoots and it could well be that we have a third. I don't know. But I certainly always believe in being cautious and the $15 oil price assumption is a cautious basis for budgeting. It's not meant to be a prediction of what the oil price would be.

QUESTION:

CHANCELLOR: No I wouldn't look at it that way. Interest rates are not an objective for us, as I've said on a number of occasions. Interest rates are an instrument. Indeed they're the only real instrument you have in a free economy for conducting monetary policy. In this Budget I was faced with the choice as to how much to reduce tax by, having of course increased public expenditure in the Autumn Statement budget substantially, but how much come March to reduce taxes by and how much to reduce borrowing by. . Now we have an objective for getting borrowing down. And it seemed to me that it was worth - that the best mix was the mix I had of roughly £2 1/2billion of tax cuts and letting ...... which would allow the PSBR to go down to the level that I think is an appropriate level so it doesn't need to go down any further. That part of the policy is now achieved Now there may be certain interest rate consequences from that. But that is the way round, not that I set myself say how can we get interest rates down.

QUESTION:

CHANCELLOR: Yes, but then, as I say, there's the gradualism point. I mean how much - you know I think it's a good idea to be reducing taxes a little bit you know each year, year in year out and doing that way rather than overdoing it in one year. Whereas getting the borrowing requirement down to the level that I think you can safely stay at, which is you know 1% of GDP which means that related to what I said about in my Lombard speech about how to set the PSBR, what is the right figure for the economy. This is a .... which would mean that even on a zero inflation you would have a declining ratio of debt to GDP.

QUESTION: If you are Chancellor in a new tax reforming parliament what would you like to see happening to VAT?

CHANCELLOR: I think we will have to see what is the right balance between direct and indirect taxes, which involves VAT, which involves the excise duties as well. And I haven't any preconceived views on that. What is clear however, and you see this from the fiscal adjustments which are pencilled in ...., is that we envisage taxation coming down further and successfully over all the MTFS years. And so the idea which has been put about, somehow that everything that has been reduced by way of income tax is going to be clawed back by increased VAT is ridiculous because the tax burden will be reduced, it wont be increased. And there are other parties who are offering that in their ...... because they say that tax cuts are not popular, they're not what the people want. Now I'm sure they're right but I believe that a Government should do what is right for the country, what is right for the economy even though it may be unpopular. that is how this Government has conducted its policies for 8 years now and that's how it should continue them.

QUESTION: When as a percentage of GDP - you said in 1984 I think it would take a long time to get taxation as a share of GDp, overall taxation, back to the level of the early 70s and I think you said it Would mean holding public spending qunatities in real terms back 10 years to get back. Do you see some point upon the horizon taxation as a share of GDP gets bck to the early 70s?

CHANCELLOR: Well clearly the process is going to be a slow one. You'll see that taxation for example as a percentage of GDP has been trapped ... sixth year, it goes down only very slightly from - including national contributions - between 38.2% in '87 to a forecast 38.0% in 87-8. It's only very gradually going down. Undoubtedly of course because of the north sea oil tax revenues but it's still above what it was in the early '70s. It'll take time, it'll take a long time. But as public expenditure continues to decline as a proportion of GDP there will be continuing progress on that and at the same time of course the mix and pattern of taxation will be greatly improved. That's the whole point of tax reform. And there have already been great improvements.

QUESTION: Tax reform before next Parliament?

CHANCELLOR: I very much doubt it. I think we'll have to wait and see.

QUESTION: Do youexpect revenues to be less bouyant in the coming financial year than it has been in the past ....?

CHANCELLOR: What we're assuming is that over the coming year, I think it's a cautious assumption but I think it's right to make a cautious assumption, what we are assuming is that tax revenues rise in, non oil tax revenue, rise in line with non oil GDP. Oil tax revenues will be down a bit as a proportion of GDP; therefore total tax revenues will be down slightly as a proportion of GDP. But of course the important thing is not just the rate of growth in the year, but the base from which you start. And the significant thing is we start 87-8 from a very much higher base than was previously imagined.

QUESTION: Aim for 15% basic rate?

CHANCELLOR: Well that's very ambitious, leave that to the Americans. No, Geoffrey Howe said no more than 25% in 1979 so for the time being I'm perfectly happy to stick to his formulation.

QUESTION: What is the next priority, it's assuming that that....... ...., what is the priority once you've met 25p?

CHANCELLOR: The new target, the new aim, will be released when we have achieved the old one.

QUESTION: You have now said that you want the PSBR as 1% of GDP as the present level of the PSBR, do you have a target or appropriate level for the PSFD ...?

CHANCELLOR: No I don't think there's any particular merit in looking at the public sector financial deficit. Because most of the ...., with the exception of privatisation. I think there is sense in looking at it added the privatisation proceeds.

QUESTION: But you have no target for PSBR plus privatisation.

CHANCELLOR: Well it's the same thing, it's the same thing. That's why there will be this constant 1% with this lovely row of 1s you see. Whether it'll actually mean a declining figure, a gradually declining figure, for PSBR plus privatisation proceeds. But privatisation proceeds have reached a peak of 5 and 5 itself is a declining share of GDP and then eventually you will get to a point some years out when of course privatisation proceeds start to decline, that will be the general line but they will eventually. So that the steady 1% of GDP implies clearly a decline, gradual decline, of PSBR plus privatisation proceeds.

QUESTION: Nothing left to sell off?

CHANCELLOR: No no, I'm talking about the long term after the second phase of the privatisation programme. The privatisation programme won't I don't think go above £5 billion a year. In my opinion because , perhaps .... .., but I mean there will be a second stage privatisation programme. But I mean eventually, I'm not talking about now I'm talking about eventually, we shall have privatised all we wish to privatise. And I am talking about that period.

QUESTION: On the current scale of privatisation what years are we looking at as far as when ....?

CHANCELLOR: Well I think that there will be a substantial privatisation programme running right through the next parliament. I'm not quite sure what the profile willbe in the parliament after next

QUESTION: Raise mortgage relief limit or cut basic rate?

CHANCELLOR: No I mentioned .... earlier. But first of all we are pledged to retain mortgage interest relief so that's not a live issue. But even if one were engaged in - because we always keep our pledges - if this were an academic discussion even then I think people exaggerate greatly the benefits that would come from the abolition of mortgage interest relief and I think that they understate, underestimate, the tremendous practical problems and I believe upheavals there would be in ....

QUESTION: ..... lower tax rates, if it dropped to 15p .... because it wouldn't be worth very much?

CHANCELLOR: You're quite right, it would be worth less.

QUESTION: ...(privatise electricity?)

CHANCELLOR: Well we, I mean it depends how you privatise it. ...... depends on the ....

QUESTION: It's too big to give away in the methods that have been used up to now?

CHANCELLOR: I deeply resent the suggestion that anything has been given away. I think if anything had been given away we should immediately and properly been censured by the Public Accounts Committee and that has not happened. So clearly nothing has been given away. No, I think we are always very anxious to get a proper price for what we privatise.

QUESTION: Chancellor if this is your last Budget, you're practically over your period as Chancellor, what is the achievement you're really proud of, ...?

CHANCELLOR: I'll save that for my memoirs.

QUESTION: Do you have a time scale at all for the electricity industry, I mean will it begin during the next term, the electricity industry, privatisation?

CHANCELLOR: It's one of the issues which we are considering at the present time.

QUESTION: You said earlier that you thought the City might become actually the most important of the 3 major financial centres of the world, why do you think that?

CHANCELLOR: I think that it has - I'm trying to be dispassionate ..... - but I think it has two obvious advantages. First of all, it is in the right time zone. Secondly, it is the most international, the most genuinely international of the 3. It has to be of course, it has to be, but it is and I think that's a great plus.

QUESTION: Do you regard the recent strengthening of £ as 'significant'?

CHANCELLOR: I am perfectly content with the present level of the exchange rate. As to what exchange rate I would be discontent that is something which I was asked before in different terms and I choose not to reply.

QUESTION: You said it was conceivable you had a sort of private informal target range, does that mean you have?

CHANCELLOR: No it means it's conceivable.

QUESTION: Strengthen City regulation?

CHANCELLOR: I think we do have to consider as to whether anything needs to be done to strengthen the take over panel. I think that's the weak link in the - has been the weak link in the present set up.

QUESTION: Do you expect that to be solved?

CHANCELLOR: I don't know, it will be under discussions which we have.

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UNCLASSIFIED

FROM: N G FRAY
DATE: 23 MARCH 1987

MR PICKFORD

POST-BUDGET PRESS BRIEFING

The Chancellor has seen and was grateful for your minute of 20 March.

N G FRAY

1925.035

— Nigel

From : S J PICKFORD
Date : 20 March 1987

PS/CHANCELLOR

Thanks.

cc Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Culpin
Miss O'Mara

POST-BUDGET PRESS BRIEFING

I attach a transcript of the Chancellor's press briefing for economic correspondents on Wednesday 18 March.

2. The transcript is not yet complete. I will circulate the final part on Monday morning.

Stephen Pickford

S J PICKFORD

CHANCELLOR - POST-BUDGET PRESS BRIEFING FOR ECONOMIC CORRESPONDENTS

Transcript from: tape recording of briefing at No 11, 18 March 1987

CHANCELLOR: May I just start by reassuring the representative of The Times that there's nothing whatever wrong with mystate of health. A most extrordinary comment. Rodney will you please procure a formal apology.

CULPIN: After this private communication with the Times newspapers the rest of it is on the record.

CHANCELLOR: Right, who's going to start?

QUESTION:

CHANCELLOR: By the way, I don't know whether this happened while you were on the way here, but two of the clearers have reduced their base rates by half a point.

QUESTION: Policy for sterling?

CHANCELLOR: It means what it says and I think that unless you're part of a formal exchange rate mechanism, which we are not, then tactics in the foreign exchange market are assisted if you don't try and be too precise. And that is why I say that I believe that, as I said at the press conference which you among others attended, Phillip, following the Paris meeting of the G5, 6, 7 whatever it was, that I didn't want to see sterling fall further which I'd said some time back. I mean there's nothing new about that but what I added at that was that I didn't want to see it rise substantially either. And that was the position at that time and remains the position. We'd like to see sterling stay round about where it now is and that was reflected in the Red book.

QUESTION: Deal with Bundesbank?

CHANCELLOR: No, we don't comment on things of that kind as you know.

QUESTION: Switch from indirect to direct taxes?

CHANCELLOR: If you look at what has happened over a period of years you will see, and if you look at just what's happened while I've been Chancellor, that tobacco tax has gone up by something like 18% more than the RPI in my period as Chancellor, ..., and beer has gone up by 1 1/2% more than the rate of inflation. It's true that because of the court judgement and the beer/wine .... thing wine's gone down a bit. Of course I also did deliberately I've been pursuing a policy deliberately of keeping the whiskey duty down because the corporation taxreforms in 1984 involved the abolition of stock relief, which is a particular problem for the whisky industry. And I felt therefore that it was necessary to offset .... by going easy on the spirits , which I can't under Community law you see do something for whisky which I don't do for other spirits. But beer, which is the main one actually has despite the standstill gone up slightly in real terms and tobacco very considerably gone up in real terms. And so that over a period, over a period, I would expect that we will at least revalorise and clearly the shifting of the emphasis from direct tax to indirect tax - from taxes on income to taxes on spending - will continue because all the room for reductions in taxation will I would imagine be on the side of direct taxes and in particular income tax.

QUESTION: Excise duty standstill to lower inflation?

CHANCELLOR: No, but you see I had a slight problem. I mean there were two things, there were a number of factors which came together. There was the fact of course that tobacco tax did indeed go up very, very steeply in the last Budget and if one's going to do anything .... to give them a pause now , I mean one obviously wants to extend it more fully. There is the fact that we are just it seems getting some kind of a breakthrough in the sense of pay settlements coming down. And it would be foolish just at that time to risk knocking that on the head by adding a blip in the RPI which might have a bad effect. And then the third thing is that because of the lunatic behaviour of the RPI advisory committee - and the Government is in an enlightened minority - they insist on keeping the mortgage rate in the index. And that means every time that the basic rate of income tax is cut because that reduces the value of mortgage interest relief the RPI goes up. And in fact I had to accept a .15% increase in the RPI simply as a result of the tuppence off the basic rate. And so that was a further reason for not adding further to that by by the excise.

QUESTION: ½% interest rate cut sufficient?

CHANCELLOR: I think that it is right to be cautious and careful and prudent and I don't think there's any need to rush anything. And I think that this isa prefectly reasonable response and then we'll see how things go from there assessing the situation in the light of financial markets following, and other indicators, following this half point off.

QUESTION: Another ½ point to come?

CHANCELLOR: I don't think we should rush anything.

QUESTION: RPI vs TPI.

CHANCELLOR: Oh no, no. The TPI, which people should have had, because that is a closer measure of the cost of living in the way that ordinarily you understand it, the TPI I would think would be around something like 2%, something like that. No, no, the TPI would be, wouldn't it be something like - I didn't give a figure in the Budget speech - be something of the order of 2%

QUESTION: It would be 2% as against 4?

CHANCELLOR: That's right, that's right.

QUESTION: It's a pity people don't look at it?

CHANCELLOR: Yes, yes, you can draw their attention to it can't you.

QUESTION: Want to get top income tax rates down?

CHANCELLOR: Well I gave an interview to the Financial Times at the turn of the year, which I think was published early in the New Year as far as I can rembmer, 5 January, in which I was asked you know looking ahead to the next Parliament what is there to do in the next Parliament. And Phillip will correct me if I .... . And what I said is that one of the things I think that we are going to have to look at in the next Parliament is the question of the top rate of income tax, that the Americans by 1988 will have theirs down substantially to 28/33 plus of course there are state taxes on top of that then it sounds more co;mplicated. But anyhow they'll get theirs down that low and other countries seem likely to be moving in the same direction. And I think that we cannot be uneffected by that. So I will just repeat the answer I gave to the Financial Times.

QUESTION: Have you any forecasts for the level of interest rates by the end of this year?

CHANCELLOR: No we never forecast interest rates.

QUESTION: Revenue effect of measures for Lloyd's?

CHANCELLOR: I can't at the moment because it depends on the precise details of the legislation. It's an extremely complex area. I was absolutely certain that action needed to be taken and that's why I stated firmly in the Budget action will be taken. The details of the legislation ..... necessary to consult. But I didn't want to consult in advance of the commitment to legislate. But there will now be full consultation between lawyers and the Inland Revenue. But I didn't want to consult in advance of the statement because that might have led Lloyd's to think that the consultations might be about the question of whether to do anything at all and the consultations were not of that nature. The consultations are precisely about precisely what to do.

QUESTION:

CHANCELLOR: Well as I say, it depends on the details of the legislation and I think it's best to leave it there. But you know what the problem is. The problem is that under the the present system they can in effect make any provisions which are liable against tax they like and they cannot be challenged by the Revenue. And that is clearly unsatisfactory. No ordinary insurance company can do that because in so far as it does, if it provides, then there is a clawback the following year, ... But of course in the case of Lloyd's a syndicate comes to an end technically and then a new sysndicate is born. So it isn't possible for there to be the subsequent adjustment. Now Lloyd's maintain that they don't over provide. If anything they under provide. But that doesn't alter the point of principle that you cannot have a system in which people can as it were write their own tax reliefs. So we have to get this sorted out but it'll be sorted out by consultation and sorted in a way that will not be damaging to Lloyd's. It'll just mean that the appropriate amount of tax is taken.

QUESTION: Last Budget before election?

CHANCELLOR: I don't know if this'll be the last Budget before the election. I think it is more likely, it's not for me to decide, it's for the next door neighbour. I think it's more likely that there will be an election this year than in the sort of period between March and

June 1988. But I don't know. I mean all the options are open and I think this Budget has helped to keep all the options open.

QUESTION: But what about yourself, would you like this to be your last Budget?

CHANCELLOR: I am reasonably relaxed.

QUESTION: Preference for full term?

CHANCELLOR: I think there are arguments both ways. I think that in many - ideally I would like the full term. I think that in an ideal world I think that there is a danger that once it starts getting shorter it will get shorter and shorter and shorter and it will seem that the term is no longer 5 years but 4 years then you'll have the election fever starting up after 3 years and the whole thing would be completely impossible. As I say, I think that to establish, I think if we could establish 5 years as a norm and in only exceptional circumstances would one go earlier that would be much healthier than what is .... seems to be happening establishing 4 years as a norm. On the other hand, looking at how things actually are/thought of this absurd pre-election fever going on all the time from now - this is what March 87 - through to June 88 is pretty appalling. So I don't know.

QUESTION: High starting rate for tax?

CHANCELLOR: Yes it is quite a big, it is indeed quite a big jump. And of course I did ease the way in 1985 by having lower rates of national insurance at the contribution end. But the one interesting thing is that the Labour Government did introduce a reduced rate band, remember because of that very fact, a reduced rate band of 25% which was a pretty silly thing - it was only the first £750 of taxable income. Well we're very near the state of ..... when everybody will be on a reduced rate band by Labour's standards.

QUESTION: Do yousee the possibility at some stage of a reduced rate band below 25p?

CHANCELLOR: I think that it's something we could look at when we've got the Revenue computerised, which will be quite soon now. But I don't think it's necessarily the most important thing to do. .... it is also something which when it was in force small businessmen, small employers, complained about because it's much easier for them to do their PAYE if everybody is on the same rate than if there are two differentrates. You know, I'm not convinced that this is the most important objective but we can certainly look at it once we get the computerisation fully run in. At the moment we couldn't administratively do it if we want to with the existing manpower.

QUESTION: Green Paper?

CHANCELLOR: Norman Lamont will be saying a little bit about that in his wind up speech today. I mean the short answer - and you'd better see precisely what he says - but the short answer of it is that we have not at this stage made up our minds about what we shall be doing.

QUESTION: Are you convinced now that Britain will not enter the EMS mechanism until after the election?

CHANCELLOR: I think it's most unlikely that we'll go into it before the election, no.

QUESTION: Just one other question on the summit, what will be achieved at the June summit in Venice, what are your hopes for that, the economic summit?

CHANCELLOR: To tell you the truth I haven't given a great deal of thought to the Venice summit. So far as Finance Ministers are concerned the meetings of Finance Ministers alone, ..., whether they à cinq or à sept or even à six as we were in Paris, are rather more valuable than these summits which are largely there for the benefit of the Prime Ministers and Presidents.

QUESTION: Unemployment forecasts?

CHANCELLOR: Well we never had targets and I think that that it is sensible. And I think it is extremely difficult to say and I think that - do you in the CD what do you call yourselves, the SDP - do you have an answer to that, where you would want to stop?

QUESTION: Well there is an aim for reducing it, I gather that you don't have that Chancellor?

CHANCELLOR: No, well we have reduced it of course. It's reduced by 100,000 over the past 6 months, which is quite a rapid rate and I would expect it to continue.

QUESTION: Beyond this year?

CHANCELLOR: Well we'll have to see. I mean I don't know, there are all sorts of uncertainties. I mentioned in my Budget statement uncertainties about the world economy and we can't be immune to that. But the combination of the very substantial and I think very well designed and well targeted measures that we now have in place, both for the young and increasingly for the long term unemployed, the combination of those and the steady growth of the economy should be bringing unemployment and certainly I believe will be bringing unemployment down during the course of this year.

QUESTION: There was a very instructive piece in the Financial Times recently suggesting that the entire fall in unemployment since last summer is exactly paralleled by decline in the labour force as a result of the Restart scheme, ...?
Does that really suggest that the fall in unemployment is due to improvements in the underlying job situation?

CHANCELLOR: I think not for the first time the Financial Times is mistaken.

QUESTION: ...... thinking behind mortgage interest rate, failure to raise ceiling?

CHANCELLOR: I thought there was a conspicuous consistency, it is precisely what has happened in each of my previous Budgets.

QUESTION: Can you just elaborate on that, what is your philosophy ?

CHANCELLOR: I think that this is a sleeping dog which we can let lie.

QUESTION: .... the opportunity's gone to raise it for another year though, I mean can it only be done at Budget time or can it be done at any time?

CHANCELLOR: What the ceiling for mortgage interest rate? Yes it would only be done in a Finance Bill which is normally announced in a Budget or not at all, that's right.

QUESTION: Does this mean that you would like to see mortgage interest relief phased out by inflation?

CHANCELLOR: There's not much inflation, I mean it's a pretty slow process I'm glad to say.

QUESTION: .... inflation in house prices ...?

CHANCELLOR: No, no, that's not - well I think that - I mean house prices fluctuate a bit don't they. No I think that you know the policy that I've been pursuing is to leave it where it is and as I said, that is a policy I've consistently pursued now in 4 Budgets.

QUESTION: Do you want to abolish mortgage relief?

CHANCELLOR: What, mortgage interest relief? No I think that people exaggerate tremendously the benefits which it is alleged would follow from the abolition of the mortgage interest relief. And I think they underestimate the enormous upheaval and problems that would be caused by abolishing it.

QUESTION: .... you said that as far as tactics are concerned

these are assisted if you're not too precise in your objectives [on sterling].
Does this mean that if you're not too precise publicly in your objectives, say you have some private objectives which are not publicised, or does it mean that you don't really have any precise objectives internally inside the Treasury?

CHANCELLOR: What I'm talking about is certainly what one says publicly and of course everything I say to you is public.

QUESTION: So you could, it's feasible, that you could have some private objectives which are more precise?

CHANCELLOR: It's certainly conceivable.

QUESTION: .... Come back to this question of unemployment and inflation because it strikes me that the failure to raise excise duties is actually a sign that you are worried about the rise in inflation ....?

CHANCELLOR: It's coming down again at the end of the year, there will be a blip, rather like the blip we had in 1985 although not as pronounced. I mean that as you recall went up to 7 and it came quite sharply down.

QUESTION: But as you say, that would obviously come at a very unhelpful point, ... the start of a new wage round?

CHANCELLOR: That's right, that's right.

QUESTION: This question of the level of unemployment at which earnings begin to accelerate again , and surely that is not entirely academic, what is the level that you believe - since unemployment in your view is falling - what is the level at which we can safely go to without a new resurgence of wage inflation ......?

CHANCELLOR: Well I don't beleive it's as simple as that. If you look at the United States, I mean really what we're trying to do is that I indicated you know various things that would change how the labour market in this country behaves. That's what really important and that's the significance of profit related pay, the significnce of trying to get management to think in rather different terms. If you look at the United States you will find that unemployment - difficult to make faircomparisons - unemployment, which is undoubtedly lower than unemployment in Europe, they don't have this wages going up. Indeed wages have gone up far less, over a long period they haven't gone up at all in real terms. And the connection is, you know, as it were the other way round I think. It is that if you have pay going up too fast that leads to unemployment. And I think that a lot of people are mistaken when they look at the effect on pay of a particular level of unemployment. That's not the way I am looking at it. What I am looking at is the effect of unemployment at a particular level of pay.

QUESTION: Surely both ...?

CHANCELLOR: Yes but ;it's a question of which is the more important.

QUESTION: Why no broad money target?

CHANCELLOR: The reason is set out pretty fully in the Governor's Loughborough lecture.

QUESTION: That was only about £M3, not broad money?

CHANCELLOR: No it isn't, it was about broad money generally if you read it.

QUESTION: Did you consider at any stage reducing income tax to 25p ....?

CHANCELLOR: I considered that this was right in economic terms, that this was the right balance. And I think it happens to be the right balance politically too, incidentally. But I thought it was the right balance in economic terms.

QUESTION: Worried about overheating / balance of payments?

CHANCELLOR: I think that in general, in economic management, and this is it's really the very idea of the medium term financial strategy, I think that in economic management gradualcy is always best. I think that the economy has difficulty in adjusting to abrupt changes of any kind whether they're oil shocks or whether they're wage shocks or even if they're tax shocks. So I think that gradualism and steadiness should be the keynotes of economic policy. That's what I've sought to base my policy on.

<u>QUESTION:</u> You've repeatedly stressed the possibility of international factors affecting Britain's economy, twice in the Budget and now again this morning, is that just a general ...... on your tongue or is there anything spe cific looming on the horizon?

<u>CHANCELLOR:</u> There's not anything specific which I haven't mentioned at some or other time and which you're not well aware of. But I think that there is a peculiar problem, again it's very close to what we've been saying. We have had there an exchange ....., in a remarkably short space of time there's been a dramatic change between the $ on the one hand and the Yen and the Deutchmark on the other. It had to happen because of course the $ had overshot so absurdly before it. So there had to be an adjustment, but the economies of both the United States on the one hand and of Germany and Japan on the other are having difficulty in adjusting sufficiently rapidly to this rapid change in the exchange rate. And that is, you know, that is an object lesson in how much better it'd have been if the thing had been started earlier and been much more gradual. And while there are these difficulties of adjustment, difficulties with the United States to make its economy more export orientated, there's a danger of protectionist pressures there getting strong and I'm glad to see that the Democratic leadership in the ~~e centre~~ Senate is becoming more responsible now, it is becoming more responsible now than it was in the utterances before

the Senate elections. In Japan and Germany again, particularly in Japan, they have great difficulty in adjusting their economy and making it more home market orientated. And of course that means that therefore there is a danger of, in both these countries, growth rates slipping, in all 3 countries, the growth rate slipping and a world recession being engendered. And I hope that the agreements we reached in Paris will help prevent that.

QUESTION: Are you confident that there are growing prospects for lower interest rates in Tokyo and Germany ....?

CHANCELLOR: I don't think there's much scope for lower interest rates. I would have thought much likelier rather than lower interest rates in Tokyo, there may be more scope in Frankfurt and Washington. But the Japanese are I mean politically they've already removed, in the process of removing, the tax incentive for small savings, which is very large in aggregate, certainly personal savings. They've already reduced the interest rate, I think it's the lowest it's ever been in Japan. And I think that politically they would find it - they've already had difficulties in getting their Budget through for a variety of reasons, I think that politically they would find it very very difficult to knock the saver ~~(sala?)~~ even further. I mean to say, you have to remember that Japan is slightly different from in this country where on the whole the politics in this country is the politics of the borrower and therefore it is politically popular when interest rates come down. In Japan the politics tends to be the politics of the saver and it's unppopular when interest rates come down.

MR 4/109

PWP

Treasury Chambers, Parliament Street, SW1P 3AG
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The Editor
Official Report
House of Commons
LONDON SW1A 0AA

27 March 1987

Dear Sir,

CHANCELLOR'S SPEECH IN BUDGET DEBATE, 23 MARCH

The Chancellor was grateful for the prompt reporting of his speech on Monday.

I attach a copy of the Hansard, with a few amendments marked. I should be grateful if you could take these in for the Bound Volume.

Yours sincerely,

Andrew Hudson

A P HUDSON

revenues? What happened to the billions of pounds that [illegible] secured by selling off the taxpayers' assets? What happened to the increased revenues from the increased tax burden that he piled on ordinary people, including hidden taxes, such as the forced increases in electricity and gas charges? Where have all those billions of pounds gone? They have slipped through the Chancellor's fingers, and there is nothing to show for them. He has spent that money at the rate of £20 billion a year on financing unemployment. Now, this prudent Chancellor invites the nation to float itself over the general election hump on a tide of imported consumer goods, financed by record family borrowing and fuelled afresh by the irresponsible tax cuts that he has offered in the Budget.

Oddly enough, it is not only the Opposition who have argued the case for public spending as a more responsible alternative to tax cuts. A document, presumably addressed to the Chancellor, from the Tory Reform Group—the patrons of that august body include the Secretaries of State for Energy and for Education and Science, the Paymaster General—who is present—and the Home Secretary—states:

"We believe that the extra resources available to the Government should not be used to increase the real spending power of those fortunate enough to be in work, but rather to create jobs for those out of work."

It goes on to say:

"This is not the year to boost consumer spending."

The Paymaster General will no doubt endorse that, and so do we. We believe that that would have been the responsible thing to do. The Chancellor had nearly £6 billion to spend, and he gave almost half of it in irresponsible tax cuts and reduced borrowing, unnecessarily and damagingly, by a further £3 billion to keep the City sweet. He could have taken the action that was necessary in the interests of our economic future—action that we spelt out in "New Jobs for Britain", our programme for reducing unemployment by 1 million in two years. As it happens, by a happy coincidence, our programme cost exactly the £6 million which the Chancellor has frittered away. It is on that that we should have been spending the money.

There is just one thing to be said for the Budget. In all its futility and irresponsibility, it offers the British people a clear choice between another five years of Tory Government, with all their wasted decay, irresponsibility, carelessness and incompetence, and investing in our economic future, our industrial base, our infrastructure, the training and skill of our people, our economic future and the quality of life. It is a choice between destructiveness and investment. That is the choice which the British people will make come a general election. That is why there will be a Labour Government after that general election.

9.36 pm

The Chancellor of the Exchequer (Mr. Nigel Lawson): We have had an interesting debate, enlivened for the past 25 minutes by the complete fantasy of the hon. Member for Dagenham (Mr. Gould). I congratulate the hon. Member for Truro (Mr. Taylor) on his maiden speech. He has not wasted much time. I do not know whether that betrays a certain nervousness about the duration of his tenure here, but he certainly carried the whole House with him in his sincere and well-merited tribute to David Penhaligon, whom we all miss so much.

The debate was interesting, too, for the opportunity that it has given to the right hon. and learned Member for Monklands, East (Mr. Smith) and the hon. Member for Dagenham to compete for the moderate candidature in the battle for the labour leadership, which cannot now be long postponed. Although the hon. Member for Dagenham is rather flashier—

Mr. John Smith: Get on with the Budget.

Mr. Lawson: I have been told to get on with the Budget, but we did not hear a single word about Labour's plans from the hon. Member for Dagenham. He was purporting to say what the choice was for the nation. I shall give a word of advice to the Opposition. Although the hon. Member for Dagenham is undoubtedly rather flashier, I would go for the right hon. and learned Member for Monklands, East. He is very canny; he has seldom, if ever, said anything, and certainly not today. The hon. Member for Dagenham has said a great deal, most of it highly critical of the Labour party and all of which we have carefully kept on file for future use. The hon. Gentleman is also a little careless. I read in *The Observer* the weekend before the Budget that he

"was given the task of drawing up the employment programme in preference to the pugnacious Prescott who is employment spokesman. (Gould did, though, get his sums wrong, meaning that the appendices had to be left out of the original document.)"

Mr. Gould: I am grateful to the Chancellor for giving way because this gives me an unforeseen opportunity to place on the record that that statement in *The Observer* profile, about which I do not generally complain, is plainly wrong.

Mr. Lawson: I do not know what happened to those appendices, but the hon. Gentleman certainly got his sums wrong today.

Today's debate takes place on a very important anniversary, for it was exactly 10 years ago today that the Lib-Lab pact was signed. The right hon. Member for Cardiff, South and Penarth (Mr. Callaghan), in the days when he had some influence over the Labour party's policies, succeeded in resisting a Conservative motion of no confidence by striking a deal with the right hon. Member for Tweeddale, Ettrick and Lauderdale (Mr. Steel). This deal ensured that the right hon. Gentleman's Government would die a slow and lingering death, rather than a quick one. By the same token, it delayed the return to sanity in the nation's finances.

It is interesting to recall what some luminaries in our political life were doing then—a sort of "Where were they then?" rather than "Where are they now?" The right hon. Member for Plymouth, Devonport (Dr. Owen) was Labour's Foreign Secretary. That very model of a modern Labour moderate, Mrs. Shirley Williams, was Education Secretary, in between appearances on the Grunwick picket line.

The right hon. Member for Birmingham, Sparkbrook (Mr. Hattersley) was Minister for Prices—a job in which he first established Hattersley's law: whatever the right hon. Gentleman predicts, the precise opposite will come to pass. Indeed, of the leading lights of the Opposition today, only two were absent from the ranks of Government then. The right hon. Gentleman the Leader of the Opposition had, we are told, refused offers of a

[Mr. Lawson]

Ministerial job. I only hope he is not regretting his decision, because it is daily becoming clearer that he is most unlikely to get another opportunity of office.

The right hon. Member for Glasgow Hillhead (Mr. Jenkins) had already left the sinking ship for the flesh pots of Brussels. Of course, the right hon. Member is back with us now, as joint economic spokesman for the SDP and its subsidiary, the Liberal party. The right hon. Gentleman's "Who's Who" entry reminds us that he is a member of the Athenaeum, of Brooks's, of Pratts, and of the Reform Club. He is, par excellence, someone who believes that the solution to any problem is to join a club, whether it is the European Monetary System or OPEC. Talking of clubs, let me take this opportunity of wishing the right hon. Gentleman well in his new and exalted post of Chancellor of Oxford university.

Mr. Jack Straw (Blackburn) *rose*——

Mr. Lawson: I shall not give way. The hon. Member for Dagenham did not give way, and nor shall I.

The right hon. Member for Hillhead owes that victory, in equal measure, to the first-past-the-post electoral system and his seminal address to the students of Oxford university a few years ago. In that address, he said:

"There has been a lot of talk about the formation of a new centre party . . . I find this idea—"

[Interruption.]

Mr. Speaker: Order.

Mr. Lawson: I shall be coming to the Budget in due course, have no fear. In his address to the students of Oxford university, the right hon. Gentleman said:

"There has been a lot of talk about the formation of a new centre party . . . I find this idea profoundly unattractive. I do so for at least four reasons.

First, I do not believe that such a grouping would have any coherent philosophical base. The idea that my views are closer to the campaign attitude of the Liberal candidate in Chester-le-Street than to those of Mr. Giles Radice is manifest nonsense."

He concluded:

"Fourth, and more personally, I cannot be indifferent to the political traditions in which I was brought up and in which I have lived my political life. Parties are not to me a religion, but the Labour Party is and always has been an instinctive part of my life.

[Interruption.] I am coming to the end.

Mr. Speaker: Order. I think that this is a preamble.

Mr. Lawson: He went on:

"I therefore have no desire to seek new combinations. I remember an old piece of doggerel about someone:

'Playing on his fuddled fiddle
Somewhere in the muddled middle.'"

I could not have put it better myself.

As for the right hon. Gentleman's contribution to this debate, it was, of course, the same speech as he has made in all our previous economic debates—rather like some fine antique piece of furniture, the polish improving as the utility diminishes.

This year's Budget has been warmly welcomed—*[Interruption.]*—I see by the Opposition, and it has also been warmly welcomed by British industry, on whose performance our future prosperity depends.

Interest rates, which had fallen ½ per cent. in anticipation of the Budget, have since fallen a further ½ per cent., and the building societies have now given notice of a 1 per cent. fall in the mortgage rate. The pound remains firm. This means, incidentally, that, taking the income tax cut and the mortgage rate reduction together, the Budget is worth an extra £5 or more a week in take home pay to a typical married couple buying their home on a mortgage.

As for the fall in interest rates generally, this of course reverses the 1 per cent. increase in interest rates in October. The House will recall that during the period of foreign exchange market turbulence which followed the somewhat inconclusive G5 and G7 meetings at the end of September, I authorised the Bank of England to intervene unusually heavily in order to buy a breathing space that would enable me to confine the interest rate rise to 1 per cent. rather than the 2 per cent. the market was then pressing for.

The reward for this was to be accused by the Opposition parties of having wasted vast sums of money. *[Interruption.]* I hear Opposition Members say that we did. I can now tell the House that the dollars that were sold from the reserves in September and October have subsequently all been repurchased—at a profit of some tens of millions of pounds. So much for wasting the taxpayer's money.

All Budgets are exercises in balance. What has surprised some, both inside and outside the House on this occasion, is that in striking the balance I leaned very heavily in the direction of prudence, limiting the reduction of taxation to what was compatible with a public sector borrowing requirement of only £3·9 billion, or 1 per cent. of gross domestic product.

A PSBR of this size, which we look to have secured for the first time this year, represents an important achievement. In his very cogent speech my right hon. Friend the Member for Worthing (Mr. Higgins) asked, "Why 1 per cent.?" I believe that it is necessary to get the PSBR down to a level which, even with zero inflation, would prevent public debt growing as a percentage of GDP. One per cent. does that. We are there, and from now on it is a matter of consolidation.

But this Budget is not just a matter of having achieved the spring double of significant tax cuts—including 2p off the basic rate—and a sharp reduction in planned public borrowing. With the autumn statement, in which I announced a sizeable increase in public spending, concentrated on the priority areas of health and education, it represents an unprecedented autumn and spring treble.

Meanwhile, the Opposition parties have been vying with each other as to how they would have used the money that was available to me. For £3 billion, the Leader of the Opposition informed the House, in his somewhat rambling reply to the Budget speech, I could have obtained a computer for every secondary school child. Maybe I could, but the real point is this. Had they been in office, with their policies, they would never have been in that position in the first place. The money would not have been there; the resources would not have been there; there would have been no chance whatever.

For there is nothing fortuitous about it. It is the reward of years of vigorous, healthy growth with low inflation. And that is what is set to continue, assisted not merely by sticking to the overall economic strategy that has brought us this success but by the new measures contained in the Budget.

I cannot, inevitably, mention all the measures in the Budget. I noted that my hon. Friend the Member for Woking (Mr. Onslow) and a number of my other hon. Friends referred to the capital gains of life assurance companies. We shall certainly be debating that matter in Committee. However, let me mention three important proposals among the others. The first is profit-related pay, to which my right hon. Friend the Secretary of State for Trade and Industry devoted, quite rightly, a large part of his opening speech. That offers great hope for the future of our country. The second is the development of personal pensions, to which my right hon. Friend the Secretary of State for Social Services referred more fully in a major speech outside the House a few days ago. The third proposal relates to the measures to help small businesses, in particular the option for businesses with a turnover of up to £250,000—more than half of all traders registered for VAT—to switch to cash accounting. That is a most important change. In his speech on Wednesday the right hon. Member for Sparkbrook referred to this and said:

"We equally welcome the changes in VAT that the Chancellor proposed for small businesses. However, we must confess to bias because we proposed them all in last year's Finance Bill, but the Government voted them down."—[*Official Report,* 18 March 1987; Vol. 112, c. 948.]

I have to tell the House that there is not a shred of truth in that assertion. I challenge the right hon. Gentleman to provide chapter and verse for it. While he is thinking about it, I remind him that the Budget resolution covering cash accounting for VAT is Budget resolution No. 1, which I understand the Opposition propose to vote against tonight. Small businesses will be well aware of what the Opposition are doing.

There is, of course, an irreconcilable difference between the Government's economic policy and that of the Opposition parties. They would spend more, borrow more and tax more than we believe is compatible with a healthy economy and a free people. The main difference between the Opposition parties is that the Labour party, whether wisely or not, has been a great deal more specific.

As my right hon. Friend the Chief Secretary has revealed during the debate, the Labour party's firm spending pledges now amount to an extra £34 billion a year of public expenditure. All that would have to be financed somehow. If from income tax, it would require the basic rate of tax to be more than doubled. A lot of it, it seems, would be financed by higher borrowing—some £6 billion more, according to the right hon. Member for Sparkbrook. That would be damaging enough, but it still——

Mr. Gould *rose*——

Mr. Lawson: Does the hon. Member for Dagenham dispute the £6 billion figure?

Mr. Gould *rose*——

Mr. Lawson: I have not given way. I shall give way in a moment. The hon. Member for Dagenham disputed that the Labour party is planning to borrow an extra £6 billion. Let me tell the House that the right hon. Member for Sparkbrook said that he believed that there should be a public sector financial deficit of some 4 per cent. of GDP. That is £16 billion—*[Interruption.]* GDP is over £400 billion, so 4 per cent. is a £16 billion public sector financial deficit. The public sector financial deficit in the Red Book is £9½ billion, so the difference is £6½ billion and I challenge the hon. Member for Dagenham to wriggle out of that.

Mr. Gould: It is interesting that the Chancellor was extremely anxious not to be answered on the question that he put to me and tried to wriggle out of the subject.

Let me make it clear. Our jobs programme costs a net annual amount to the Exchequer — the Chancellor wanted an answer, so let him listen to it—of £6 billion. I believe that even the Chancellor can work out that that is quite a different question from how that money is to be provided. The fact is—*[Interruption.]*

Mr. Speaker: Order.

Mr. Gould: The Chancellor's Budget strategy and speech clearly show that it is possible to raise £6 billion for an investment programme of the kind that we propose without having to borrow anything like £6 billion.

Mr. Lawson: The hon. Gentleman has got his sums wrong again. It is clear that *The Observer* was right after all.

The Opposition could not have shown their hand more clearly than by their pledge, if given the chance, to take back the tax cuts I have been able to make in the Budget as a prelude to still more——*[Interruption.]*

Mr. Gould *rose*——

Mr. Lawson: They have chosen that battleground and in the weeks and months ahead we shall be more than X happy to fight on it. But let me return for a moment to the overall framework of economic policy. Over the past seven years there has been a vigorous debate in this country about the conduct of fiscal and monetary policies—in particular whether it was possible to have a sustained recovery of output without a fiscal stimulus. Para

The post-war neo-Keynesian approach was to try to stimulate economic performance by expansionary fiscal policy and accommodating monetary policy whenever there was any sign of weakening growth. In practice it provided at best short-term gains to output at the cost of long-term trouble: rising inflation and a succession of financial crises. That is why we turned our back on that approach.

Our critics have constantly changed their ground as events have confounded all their gloomy predictions. Initially, they said that it was quite impossible to reduce inflation by the policies we were pursuing, and then we did reduce inflation. They then said that inflation was falling only because we were in a self-perpetuating downward spiral and that as soon as growth resumed inflation would rise again. Growth has now been going on for the past six years and inflation has stayed low. When growth did begin they said that it was a flash in the pan and would soon peter out. It has not petered out, it has gone on for six successive years. Year after year, we were told that although growth this year might be better than expected, next year it would slow down. And so it went on. But what has been the outcome? Sustained growth against a background of falling inflation.

The debate about monetary and fiscal policy should now be over. Given the historically low Budget deficits of the past two years, there can be no clearer evidence of the bankruptcy of our critics' case than the suddenness with which those who accused us of starving the economy of demand now turn round and accuse us of generating excessive demand. They were wrong then, they are wrong now.

The plain fact is that ours is now the fastest growing major economy in Europe and it is continuing to grow ahead of the rest. Moreover, growth in this upswing has been balanced between consumption and investment

[Mr. Lawson]

whereas, under the Labour party it was consumption that was growing fast, so far as anything was growing at all, and investment was growing at a mere fraction of the rate of growth during this Government.

Para

Fixed investment has gone up nearly 4 per cent. in the upswing under this Government, twice the average for the European Community as a whole and far ahead of the $1\frac{1}{4}$ per cent. that Labour achieved. The picture of a healthy flourishing economy emerges not only from the official statistics but from the CBI's industrial trends survey and from that of the Association of British Chambers of Commerce, and all the other surveys, which show, too, that it is throughout the country, not just in the south-east.

Throughout the country, too, unemployment is falling. Indeed, the unemployment rate has fallen fastest over the past 12 months in Wales and the north. The same is true for long-term unemployment. Youth unemployment has fallen in every region over the past three years, again, fastest in Wales, the north, the north-west and the west midlands. That is where unemployment has been falling fastest. The job pages of the regional newspapers bear that out.

To say that the Budget does nothing about unemployment, as the hon. Member for Dagenham said, is to miss the point completely. The solution to unemployment is a vigorous economy, and this Budget is reinforcing the vigorous economy that we have in this country. That is why unemployment is coming down and why it will continue to come down for the rest of this year. The plain fact is that British manufacturers, too, have an outstanding opportunity in 1987 with exports growing fast and a highly competitive pound.

The economy is now as sound and strong as it has been for a generation. It is the strength of the economy that has enabled us to announce in one and the same year higher spending on priorities, lower public borrowing, and lower taxation. Many Governments have been able to achieve one or even two out of the three, but no previous Government for decades has succeeded in all three. I commend the Budget to the House.

Question put:—

The House divided: Ayes 351, Noes 202.

Division No. 122] **[10.00 pm**

AYES

Adley, Robert
Aitken, Jonathan
Alexander, Richard
Alison, Rt Hon Michael
Amess, David
Ancram, Michael
Arnold, Tom
Ashby, David
Aspinwall, Jack
Atkins, Rt Hon Sir H.
Atkinson, David *(B'm'th E)*
Baker, Rt Hon K. *(Mole Vall'y)*
Baker, Nicholas *(Dorset N)*
Baldry, Tony
Banks, Robert *(Harrogate)*
Batiste, Spencer
Beaumont-Dark, Anthony
Bellingham, Henry
Bendall, Vivian
Bennett, Rt Hon Sir Frederic
Benyon, William
Best, Keith
Bevan, David Gilroy
Biffen, Rt Hon John
Biggs-Davison, Sir John
Blackburn, John
Blaker, Rt Hon Sir Peter
Bonsor, Sir Nicholas
Bottomley, Peter
Bottomley, Mrs Virginia
Bowden, A. *(Brighton K'to'n)*
Bowden, Gerald *(Dulwich)*
Boyson, Dr Rhodes
Braine, Rt Hon Sir Bernard
Brandon-Bravo, Martin
Bright, Graham
Brinton, Tim
Brittan, Rt Hon Leon
Brooke, Hon Peter
Brown, M. *(Brigg & Cl'thpes)*
Browne, John
Bruinvels, Peter
Bryan, Sir Paul
Buchanan-Smith, Rt Hon A.
Buck, Sir Antony
Budgen, Nick
Bulmer, Esmond
Burt, Alistair
Butcher, John
Butler, Rt Hon Sir Adam
Butterfill, John
Carlisle, John *(Luton N)*
Carlisle, Rt Hon M. *(W'ton S)*
Carttiss, Michael
Cash, William
Chalker, Mrs Lynda
Channon, Rt Hon Paul
Chapman, Sydney
Chope, Christopher
Churchill, W. S.
Clark, Hon A. *(Plym'th S'n)*
Clark, Dr Michael *(Rochford)*
Clark, Sir W. *(Croydon S)*
Clarke, Rt Hon K. *(Rushcliffe)*
Cockeram, Eric
Colvin, Michael
Conway, Derek
Coombs, Simon
Cope, John
Cormack, Patrick
Couchman, James
Critchley, Julian
Crouch, David
Currie, Mrs Edwina
Dickens, Geoffrey
Dicks, Terry
Dorrell, Stephen
Douglas-Hamilton, Lord J.
Dover, Den
Dunn, Robert
Durant, Tony
Dykes, Hugh
Edwards, Rt Hon N. *(P'broke)*
Eggar, Tim
Emery, Sir Peter
Eyre, Sir Reginald
Fairbairn, Nicholas
Fallon, Michael
Farr, Sir John
Favell, Anthony
Fenner, Dame Peggy
Finsberg, Sir Geoffrey
Fookes, Miss Janet
Forman, Nigel
Forth, Eric
Fowler, Rt Hon Norman
Fox, Sir Marcus
Franks, Cecil
Fraser, Peter *(Angus East)*
Freeman, Roger
Fry, Peter
Gale, Roger
Galley, Roy
Gardiner, George *(Reigate)*
Gilmour, Rt Hon Sir Ian
Glyn, Dr Alan
Goodhart, Sir Philip
Goodlad, Alastair
Gorst, John
Gow, Ian
Gower, Sir Raymond
Grant, Sir Anthony
Greenway, Harry
Gregory, Conal
Griffiths, Peter *(Portsm'th N)*
Grist, Ian
Ground, Patrick
Grylls, Michael
Gummer, Rt Hon John S
Hamilton, Hon A. *(Epsom)*
Hamilton, Neil *(Tatton)*
Hampson, Dr Keith
Hanley, Jeremy
Hannam, John
Harris, David
Harvey, Robert
Havers, Rt Hon Sir Michael
Hawkins, C. *(High Peak)*
Hawkins, Sir Paul *(N'folk SW)*
Hayes, J.
Hayhoe, Rt Hon Sir Barney
Heathcoat-Amory, David
Heddle, John
Henderson, Barry
Heseltine, Rt Hon Michael
Hickmet, Richard
Hicks, Robert
Higgins, Rt Hon Terence L.
Hill, James
Hind, Kenneth
Hirst, Michael
Hogg, Hon Douglas *(Gr'th'm)*
Holland, Sir Philip *(Gedling)*
Holt, Richard
Hordern, Sir Peter
Howard, Michael
Howarth, Alan *(Stratf'd-on-A)*
Howarth, Gerald *(Cannock)*
Howe, Rt Hon Sir Geoffrey
Howell, Ralph *(Norfolk, N)*
Hubbard-Miles, Peter
Hunt, David *(Wirral W)*
Hunt, John *(Ravensbourne)*
Hunter, Andrew
Hurd, Rt Hon Douglas
Irving, Charles
Jackson, Robert
Jenkin, Rt Hon Patrick
Jessel, Toby
Johnson Smith, Sir Geoffrey
Jones, Gwilym *(Cardiff N)*
Jones, Robert *(Herts W)*
Jopling, Rt Hon Michael
Joseph, Rt Hon Sir Keith
Kellett-Bowman, Mrs Elaine
Kershaw, Sir Anthony
Key, Robert
King, Roger *(B'ham N'field)*
Knight, Greg *(Derby N)*
Knight, Dame Jill *(Edgbaston)*
Knowles, Michael
Knox, David
Lamont, Rt Hon Norman
Lang, Ian
Latham, Michael
Lawler, Geoffrey
Lawrence, Ivan
Lawson, Rt Hon Nigel
Lee, John *(Pendle)*
Leigh, Edward *(Gainsbor'gh)*
Lennox-Boyd, Hon Mark
Lester, Jim
Lewis, Sir Kenneth *(Stamf'd)*
Lightbown, David
Lilley, Peter
Lloyd, Sir Ian *(Havant)*
Lloyd, Peter *(Fareham)*
Lord, Michael
Luce, Rt Hon Richard
Lyell, Nicholas
McCrindle, Robert
McCurley, Mrs Anna
Macfarlane, Neil
MacGregor, Rt Hon John
MacKay, Andrew *(Berkshire)*
MacKay, John *(Argyll & Bute)*
Maclean, David John
McLoughlin, Patrick
McNair-Wilson, P. *(New F'st)*
McQuarrie, Albert
Madel, David
Major, John
Malins, Humfrey
Malone, Gerald
Maples, John
Marlow, Antony

oil revenues? What happened to the billions of pounds that he secured by selling off the taxpayers' assets? What happened to the increased revenues from the increased tax burden that he piled on ordinary people, including hidden taxes, such as the forced increases in electricity and gas charges? Where have all those billions of pounds gone? They have slipped through the Chancellor's fingers, and there is nothing to show for them. He has spent that money at the rate of £20 billion a year on financing unemployment. Now, this prudent Chancellor invites the nation to float itself over the general election hump on a tide of imported consumer goods, financed by record family borrowing and fuelled afresh by the irresponsible tax cuts that he has offered in the Budget.

Oddly enough, it is not only the Opposition who have argued the case for public spending as a more responsible alternative to tax cuts. A document, presumably addressed to the Chancellor, from the Tory Reform Group—the patrons of that august body include the Secretaries of State for Energy and for Education and Science, the Paymaster General—who is present—and the Home Secretary—states:

> "We believe that the extra resources available to the Government should not be used to increase the real spending power of those fortunate enough to be in work, but rather to create jobs for those out of work."

It goes on to say:

> "This is not the year to boost consumer spending."

The Paymaster General will no doubt endorse that, and so do we. We believe that that would have been the responsible thing to do. The Chancellor had nearly £6 billion to spend, and he gave almost half of it in irresponsible tax cuts and reduced borrowing, unnecessarily and damagingly, by a further £3 billion to keep the City sweet. He could have taken the action that was necessary in the interests of our economic future —action that we spelt out in "New Jobs for Britain", our programme for reducing unemployment by 1 million in two years. As it happens, by a happy coincidence, our programme cost exactly the £6 million which the Chancellor has frittered away. It is on that that we should have been spending the money.

There is just one thing to be said for the Budget. In all its futility and irresponsibility, it offers the British people a clear choice between another five years of Tory Government, with all their wasted decay, irresponsibility, carelessness and incompetence, and investing in our economic future, our industrial base, our infrastructure, the training and skill of our people, our economic future and the quality of life. It is a choice between destructiveness and investment. That is the choice which the British people will make come a general election. That is why there will be a Labour Government after that general election.

9.36 pm

The Chancellor of the Exchequer (Mr. Nigel Lawson): We have had an interesting debate, enlivened for the past 25 minutes by the complete fantasy of the hon. Member for Dagenham (Mr. Gould). I congratulate the hon. Member for Truro (Mr. Taylor) on his maiden speech. He has not wasted much time. I do not know whether that betrays a certain nervousness about the duration of his tenure here, but he certainly carried the whole House with him in his sincere and well-merited tribute to David Penhaligon, whom we all miss so much.

The debate was interesting, too, for the opportunity that it has given to the right hon. and learned Member for Monklands, East (Mr. Smith) and the hon. Member for Dagenham to compete for the moderate candidature in the battle for the labour leadership, which cannot now be long postponed. Although the hon. Member for Dagenham is rather flashier—

Mr. John Smith: Get on with the Budget.

Mr. Lawson: I have been told to get on with the Budget, but we did not hear a single word about Labour's plans from the hon. Member for Dagenham. He was purporting to say what the choice was for the nation. I shall give a word of advice to the Opposition. Although the hon. Member for Dagenham is undoubtedly rather flashier, I would go for the right hon. and learned Member for Monklands, East. He is very canny; he has seldom, if ever, said anything, and certainly not today. The hon. Member for Dagenham has said a great deal, most of it highly critical of the Labour party and all of which we have carefully kept on file for future use. The hon. Gentleman is also a little careless. I read in *The Observer* the weekend before the Budget that he

> "was given the task of drawing up the employment programme in preference to the pugnacious Prescott who is employment spokesman. (Gould did, though, get his sums wrong, meaning that the appendices had to be left out of the original document.)"

Mr. Gould: I am grateful to the Chancellor for giving way because this gives me an unforeseen opportunity to place on the record that that statement in *The Observer* profile, about which I do not generally complain, is plainly wrong.

Mr. Lawson: I do not know what happened to those appendices, but the hon. Gentleman certainly got his sums wrong today.

Today's debate takes place on a very important anniversary, for it was exactly 10 years ago today that the Lib-Lab pact was signed. The right hon. Member for Cardiff, South and Penarth (Mr. Callaghan), in the days when he had some influence over the Labour party's policies, succeeded in resisting a Conservative motion of no confidence by striking a deal with the right hon. Member for Tweeddale, Ettrick and Lauderdale (Mr. Steel). This deal ensured that the right hon. Gentleman's Government would die a slow and lingering death, rather than a quick one. By the same token, it delayed the return to sanity in the nation's finances.

It is interesting to recall what some luminaries in our political life were doing then—a sort of "Where were they then?" rather than "Where are they now?" The right hon. Member for Plymouth, Devonport (Dr. Owen) was Labour's Foreign Secretary. That very model of a modern Labour moderate, Mrs. Shirley Williams, was Education Secretary, in between appearances on the Grunwick picket line.

The right hon. Member for Birmingham, Sparkbrook (Mr. Hattersley) was Minister for Prices—a job in which he first established Hattersley's law: whatever the right hon. Gentleman predicts, the precise opposite will come to pass. Indeed, of the leading lights of the Opposition today, only two were absent from the ranks of Government then. The right hon. Gentleman the Leader of the Opposition had, we are told, refused offers of a

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Ministerial job. I only hope he is not regretting his decision, because it is daily becoming clearer that he is most unlikely to get another opportunity of office.

The right hon. Member for Glasgow Hillhead (Mr. Jenkins) had already left the sinking ship for the flesh pots of Brussels. Of course, the right hon. Member is back with us now, as joint economic spokesman for the SDP and its subsidiary, the Liberal party, The right hon. Gentleman's "Who's Who" entry reminds us that he is a member of the Athenaeum, of Brooks's, of Pratts, and of the Reform Club. He is, par excellence, someone who believes that the solution to any problem is to join a club, whether it is the European Monetary System or OPEC. Talking of clubs, let me take this opportunity of wishing the right hon. Gentleman well in his new and exalted post of Chancellor of Oxford university.

Mr. Jack Straw (Blackburn) *rose*——

Mr. Lawson: I shall not give way. The hon. Member for Dagenham did not give way, and nor shall I.

The right hon. Member for Hillhead owes that victory, in equal measure, to the first-past-the-post electoral system and his seminal address to the students of Oxford university a few years ago. In that address, he said:

"There has been a lot of talk about the formation of a new centre party . . . I find this idea—"

[Interruption.]

Mr. Speaker: Order.

Mr. Lawson: I shall be coming to the Budget in due course, have no fear. In his address to the students of Oxford university, the right hon. Gentleman said:

"There has been a lot of talk about the formation of a new centre party . . . I find this idea profoundly unattractive. I do so for at least four reasons.

First, I do not believe that such a grouping would have any coherent philosophical base. The idea that my views are closer to the campaign attitude of the Liberal candidate in Chester-le-Street than to those of Mr. Giles Radice is manifest nonsense."

He concluded:

"Fourth, and more personally, I cannot be indifferent to the political traditions in which I was brought up and in which I have lived my political life. Parties are not to me a religion, but the Labour Party is and always has been an instinctive part of my life.

[Interruption.] I am coming to the end.

Mr. Speaker: Order. I think that this is a preamble.

Mr. Lawson: He went on:

"I therefore have no desire to seek new combinations. I remember an old piece of doggerel about someone:

'Playing on his fuddled fiddle
Somewhere in the muddled middle.'"

I could not have put it better myself.

As for the right hon. Gentleman's contribution to this debate, it was, of course, the same speech as he has made in all our previous economic debates—rather like some fine antique piece of furniture, the polish improving as the utility diminishes.

This year's Budget has been warmly welcomed — *[Interruption.]*—I see by the Opposition, and it has also been warmly welcomed by British industry, on whose performance our future prosperity depends.

Interest rates, which had fallen ½ per cent. in anticipation of the Budget, have since fallen a further ½ per cent., and the building societies have now given notice of a 1 per cent. fall in the mortgage rate. The pound remains firm. This means, incidentally, that, taking the income tax cut and the mortgage rate reduction together, the Budget is worth an extra £5 or more a week in take home pay to a typical married couple buying their home on a mortgage.

As for the fall in interest rates generally, this of course reverses the 1 per cent. increase in interest rates in October. The House will recall that during the period of foreign exchange market turbulence which followed the somewhat inconclusive G5 and G7 meetings at the end of September, I authorised the Bank of England to intervene unusually heavily in order to buy a breathing space that would enable me to confine the interest rate rise to 1 per cent. rather than the 2 per cent. the market was then pressing for.

The reward for this was to be accused by the Opposition parties of having wasted vast sums of money. *[Interruption.]* I hear Opposition Members say that we did. I can now tell the House that the dollars that were sold from the reserves in September and October have subsequently all been repurchased—at a profit of some tens of millions of pounds. So much for wasting the taxpayer's money.

All Budgets are exercises in balance. What has surprised some, both inside and outside the House on this occasion, is that in striking the balance I leaned very heavily in the direction of prudence, limiting the reduction of taxation to what was compatible with a public sector borrowing requirement of only £3·9 billion, or 1 per cent. of gross domestic product.

A PSBR of this size, which we look to have secured for the first time this year, represents an important achievement. In his very cogent speech my right hon. Friend the Member for Worthing (Mr. Higgins) asked, "Why 1 per cent.?" I believe that it is necessary to get the PSBR down to a level which, even with zero inflation, would prevent public debt growing as a percentage of GDP. One per cent. does that. We are there, and from now on it is a matter of consolidation.

But this Budget is not just a matter of having achieved the spring double of significant tax cuts—including 2p off the basic rate—and a sharp reduction in planned public borrowing. With the autumn statement, in which I announced a sizeable increase in public spending, concentrated on the priority areas of health and education, it represents an unprecedented autumn and spring treble.

Meanwhile, the Opposition parties have been vying with each other as to how they would have used the money that was available to me. For £3 billion, the Leader of the Opposition informed the House, in his somewhat rambling reply to the Budget speech, I could have obtained a computer for every secondary school child. Maybe I could, but the real point is this. Had they been in office, with their policies, they would never have been in that position in the first place. The money would not have been there; the resources would not have been there; there would have been no chance whatever.

For there is nothing fortuitous about it. It is the reward of years of vigorous, healthy growth with low inflation. And that is what is set to continue, assisted not merely by sticking to the overall economic strategy that has brought us this success but by the new measures contained in the Budget.

I cannot, inevitably, mention all the measures in the Budget. I noted that my hon. Friend the Member for Woking (Mr. Onslow) and a number of my other hon. Friends referred to the capital gains of life assurance companies. We shall certainly be debating that matter in Committee. However, let me mention three important proposals among the others. The first is profit-related pay, to which my right hon. Friend the Secretary of State for Trade and Industry devoted, quite rightly, a large part of his opening speech. That offers great hope for the future of our country. The second is the development of personal pensions, to which my right hon. Friend the Secretary of State for Social Services referred more fully in a major speech outside the House a few days ago. The third proposal relates to the measures to help small businesses, in particular the option for businesses with a turnover of up to £250,000—more than half of all traders registered for VAT—to switch to cash accounting. That is a most important change. In his speech on Wednesday the right hon. Member for Sparkbrook referred to this and said:

"We equally welcome the changes in VAT that the Chancellor proposed for small businesses. However, we must confess to bias because we proposed them all in last year's Finance Bill, but the Government voted them down."—[*Official Report,* 18 March 1987; Vol. 112, c. 948.]

I have to tell the House that there is not a shred of truth in that assertion. I challenge the right hon. Gentleman to provide chapter and verse for it. While he is thinking about it, I remind him that the Budget resolution covering cash accounting for VAT is Budget resolution No. 1, which I understand the Opposition propose to vote against tonight. Small businesses will be well aware of what the Opposition are doing.

There is, of course, an irreconcilable difference between the Government's economic policy and that of the Opposition parties. They would spend more, borrow more and tax more than we believe is compatible with a healthy economy and a free people. The main difference between the Opposition parties is that the Labour party, whether wisely or not, has been a great deal more specific.

As my right hon. Friend the Chief Secretary has revealed during the debate, the Labour party's firm spending pledges now amount to an extra £34 billion a year of public expenditure. All that would have to be financed somehow. If from income tax, it would require the basic rate of tax to be more than doubled. A lot of it, it seems, would be financed by higher borrowing—some £6 billion more, according to the right hon. Member for Sparkbrook. That would be damaging enough, but it still——

Mr. Gould *rose*——

Mr. Lawson: Does the hon. Member for Dagenham dispute the £6 billion figure?

Mr. Gould *rose*——

Mr. Lawson: I have not given way. I shall give way in a moment. The hon. Member for Dagenham disputed that the Labour party is planning to borrow an extra £6 billion. Let me tell the House that the right hon. Member for Sparkbrook said that he believed that there should be a public sector financial deficit of some 4 per cent. of GDP. That is £16 billion—*[Interruption.]* GDP is over £400 billion, so 4 per cent. is a £16 billion public sector financial deficit. The public sector financial deficit in the Red Book is £9½ billion, so the difference is £6½ billion and I challenge the hon. Member for Dagenham to wriggle out of that.

Mr. Gould: It is interesting that the Chancellor was extremely anxious not to be answered on the question that he put to me and tried to wriggle out of the subject.

Let me make it clear. Our jobs programme costs a net annual amount to the Exchequer — the Chancellor wanted an answer, so let him listen to it—of £6 billion. I believe that even the Chancellor can work out that that is quite a different question from how that money is to be provided. The fact is—*[Interruption.]*

Mr. Speaker: Order.

Mr. Gould: The Chancellor's Budget strategy and speech clearly show that it is possible to raise £6 billion for an investment programme of the kind that we propose without having to borrow anything like £6 billion.

Mr. Lawson: The hon. Gentleman has got his sums wrong again. It is clear that *The Observer* was right after all.

The Opposition could not have shown their hand more clearly than by their pledge, if given the chance, to take back the tax cuts I have been able to make in the Budget as a prelude to still more——*[Interruption.]*

Mr. Gould *rose*——

Mr. Lawson: They have chosen that battleground and in the weeks and months ahead we shall be more than happy to fight on it. But let me return for a moment to the overall framework of economic policy. Over the past seven years there has been a vigorous debate in this country about the conduct of fiscal and monetary policies—in particular whether it was possible to have a sustained recovery of output without a fiscal stimulus.

The post-war neo-Keynesian approach was to try to stimulate economic performance by expansionary fiscal policy and accommodating monetary policy whenever there was any sign of weakening growth. In practice it provided at best short-term gains to output at the cost of long-term trouble: rising inflation and a succession of financial crises. That is why we turned our back on that approach.

Our critics have constantly changed their ground as events have confounded all their gloomy predictions. Initially, they said that it was quite impossible to reduce inflation by the policies we were pursuing, and then we did reduce inflation. They then said that inflation was falling only because we were in a self-perpetuating downward spiral and that as soon as growth resumed inflation would rise again. Growth has now been going on for the past six years and inflation has stayed low. When growth did begin they said that it was a flash in the pan and would soon peter out. It has not petered out, it has gone on for six successive years. Year after year, we were told that although growth this year might be better than expected, next year it would slow down. And so it went on. But what has been the outcome? Sustained growth against a background of falling inflation.

The debate about monetary and fiscal policy should now be over. Given the historically low Budget deficits of the past two years, there can be no clearer evidence of the bankruptcy of our critics' case than the suddenness with which those who accused us of starving the economy of demand now turn round and accuse us of generating excessive demand. They were wrong then, they are wrong now.

The plain fact is that ours is now the fastest growing major economy in Europe and it is continuing to grow ahead of the rest. Moreover, growth in this upswing has been balanced between consumption and investment

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whereas, under the Labour party it was consumption that was growing fast, so far as anything was growing at all, and investment was growing at a mere fraction of the rate of growth during this Government.

Para

Fixed investment has gone up nearly 4 per cent. in the upswing under this Government, twice the average for the European Community as a whole and far ahead of the $1\frac{1}{4}$ per cent. that Labour achieved. The picture of a healthy flourishing economy emerges not only from the official statistics but from the CBI's industrial trends survey and from that of the Association of British Chambers of Commerce, and all the other surveys, which show, too, that it is throughout the country, not just in the south-east.

Throughout the country, too, unemployment is falling. Indeed, the unemployment rate has fallen fastest over the past 12 months in Wales and the north. The same is true for long-term unemployment. Youth unemployment has fallen in every region over the past three years, again, fastest in Wales, the north, the north-west and the west midlands. That is where unemployment has been falling fastest. The job pages of the regional newspapers bear that out.

To say that the Budget does nothing about unemployment, as the hon. Member for Dagenham said, is to miss the point completely. The solution to unemployment is a vigorous economy, and this Budget is reinforcing the vigorous economy that we have in this country. That is why unemployment is coming down and why it will continue to come down for the rest of this year. The plain fact is that British manufacturers, too, have an outstanding opportunity in 1987 with exports growing fast and a highly competitive pound.

The economy is now as sound and strong as it has been for a generation. It is the strength of the economy that has enabled us to announce in one and the same year higher spending on priorities, lower public borrowing, and lower taxation. Many Governments have been able to achieve one or even two out of the three, but no previous Government for decades has succeeded in all three. I commend the Budget to the House.

Question put:—

The House divided: Ayes 351, Noes 202.

Division No. 122] **[10.00 pm**

AYES

Adley, Robert
Aitken, Jonathan
Alexander, Richard
Alison, Rt Hon Michael
Amess, David
Ancram, Michael
Arnold, Tom
Ashby, David
Aspinwall, Jack
Atkins, Rt Hon Sir H.
Atkinson, David *(B'm'th E)*
Baker, Rt Hon K. *(Mole Vall'y)*
Baker, Nicholas *(Dorset N)*
Baldry, Tony
Banks, Robert *(Harrogate)*
Batiste, Spencer
Beaumont-Dark, Anthony
Bellingham, Henry
Bendall, Vivian
Bennett, Rt Hon Sir Frederic
Benyon, William
Best, Keith
Bevan, David Gilroy
Biffen, Rt Hon John
Biggs-Davison, Sir John
Blackburn, John
Blaker, Rt Hon Sir Peter
Bonsor, Sir Nicholas
Bottomley, Peter
Bottomley, Mrs Virginia
Bowden, A. *(Brighton K'to'n)*
Bowden, Gerald *(Dulwich)*
Boyson, Dr Rhodes
Braine, Rt Hon Sir Bernard
Brandon-Bravo, Martin
Bright, Graham
Brinton, Tim
Brittan, Rt Hon Leon
Brooke, Hon Peter
Brown, M. *(Brigg & Cl'thpes)*
Browne, John
Bruinvels, Peter
Bryan, Sir Paul
Buchanan-Smith, Rt Hon A.
Buck, Sir Antony
Budgen, Nick
Bulmer, Esmond
Burt, Alistair
Butcher, John
Butler, Rt Hon Sir Adam
Butterfill, John
Carlisle, John *(Luton N)*
Carlisle, Rt Hon M. *(W'ton S)*
Carttiss, Michael
Cash, William
Chalker, Mrs Lynda
Channon, Rt Hon Paul
Chapman, Sydney
Chope, Christopher
Churchill, W. S.
Clark, Hon A. *(Plym'th S'n)*
Clark, Dr Michael *(Rochford)*
Clark, Sir W. *(Croydon S)*
Clarke, Rt Hon K. *(Rushcliffe)*
Cockeram, Eric
Colvin, Michael
Conway, Derek
Coombs, Simon
Cope, John
Cormack, Patrick
Couchman, James
Critchley, Julian
Crouch, David
Currie, Mrs Edwina
Dickens, Geoffrey
Dicks, Terry
Dorrell, Stephen
Douglas-Hamilton, Lord J.
Dover, Den
Dunn, Robert
Durant, Tony
Dykes, Hugh
Edwards, Rt Hon N. *(P'broke)*
Eggar, Tim
Emery, Sir Peter
Eyre, Sir Reginald
Fairbairn, Nicholas
Fallon, Michael
Farr, Sir John
Favell, Anthony
Fenner, Dame Peggy
Finsberg, Sir Geoffrey
Fookes, Miss Janet
Forman, Nigel
Forth, Eric
Fowler, Rt Hon Norman
Fox, Sir Marcus
Franks, Cecil
Fraser, Peter *(Angus East)*
Freeman, Roger
Fry, Peter
Gale, Roger
Galley, Roy
Gardiner, George *(Reigate)*
Gilmour, Rt Hon Sir Ian
Glyn, Dr Alan
Goodhart, Sir Philip
Goodlad, Alastair
Gorst, John
Gow, Ian
Gower, Sir Raymond
Grant, Sir Anthony
Greenway, Harry
Gregory, Conal
Griffiths, Peter *(Portsm'th N)*
Grist, Ian
Ground, Patrick
Grylls, Michael
Gummer, Rt Hon John S
Hamilton, Hon A. *(Epsom)*
Hamilton, Neil *(Tatton)*
Hampson, Dr Keith
Hanley, Jeremy
Hannam, John
Harris, David
Harvey, Robert
Havers, Rt Hon Sir Michael
Hawkins, C. *(High Peak)*
Hawkins, Sir Paul *(N'folk SW)*
Hayes, J.
Hayhoe, Rt Hon Sir Barney
Heathcoat-Amory, David
Heddle, John
Henderson, Barry
Heseltine, Rt Hon Michael
Hickmet, Richard
Hicks, Robert
Higgins, Rt Hon Terence L.
Hill, James
Hind, Kenneth
Hirst, Michael
Hogg, Hon Douglas *(Gr'th'm)*
Holland, Sir Philip *(Gedling)*
Holt, Richard
Hordern, Sir Peter
Howard, Michael
Howarth, Alan *(Stratf'd-on-A)*
Howarth, Gerald *(Cannock)*
Howe, Rt Hon Sir Geoffrey
Howell, Ralph *(Norfolk, N)*
Hubbard-Miles, Peter
Hunt, David *(Wirral W)*
Hunt, John *(Ravensbourne)*
Hunter, Andrew
Hurd, Rt Hon Douglas
Irving, Charles
Jackson, Robert
Jenkin, Rt Hon Patrick
Jessel, Toby
Johnson Smith, Sir Geoffrey
Jones, Gwilym *(Cardiff N)*
Jones, Robert *(Herts W)*
Jopling, Rt Hon Michael
Joseph, Rt Hon Sir Keith
Kellett-Bowman, Mrs Elaine
Kershaw, Sir Anthony
Key, Robert
King, Roger *(B'ham N'field)*
Knight, Greg *(Derby N)*
Knight, Dame Jill *(Edgbaston)*
Knowles, Michael
Knox, David
Lamont, Rt Hon Norman
Lang, Ian
Latham, Michael
Lawler, Geoffrey
Lawrence, Ivan
Lawson, Rt Hon Nigel
Lee, John *(Pendle)*
Leigh, Edward *(Gainsbor'gh)*
Lennox-Boyd, Hon Mark
Lester, Jim
Lewis, Sir Kenneth *(Stamf'd)*
Lightbown, David
Lilley, Peter
Lloyd, Sir Ian *(Havant)*
Lloyd, Peter *(Fareham)*
Lord, Michael
Luce, Rt Hon Richard
Lyell, Nicholas
McCrindle, Robert
McCurley, Mrs Anna
Macfarlane, Neil
MacGregor, Rt Hon John
MacKay, Andrew *(Berkshire)*
MacKay, John *(Argyll & Bute)*
Maclean, David John
McLoughlin, Patrick
McNair-Wilson, P. *(New F'st)*
McQuarrie, Albert
Madel, David
Major, John
Malins, Humfrey
Malone, Gerald
Maples, John
Marlow, Antony