PO-CH/NL/0141
PART B

Part. B.

SECRET
(Circulate under cover and notify REGISTRY of movement)

Begins: 6/1/87.
Ends: 13/1/87.

PO -CH /NL/0141
PART B

PO -CH /NL/0141
PART B

Chancellor's (Lawson) Papers:

CHEVENING 1987

Disposal Directions: 25 Years

[signature]

23/8/95.

FROM: J ODLING-SMEE
DATE: 6 JANUARY 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Riley
Mr Allan
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Mr Battishill (I/R)
Sir A Fraser (C & E)

POLICY BACKGROUND TO THE 1987 BUDGET

You asked for Chart B.1 in Sir Terence Burns' paper to be redrawn to cover the 1980s only. I attach a blown-up version.

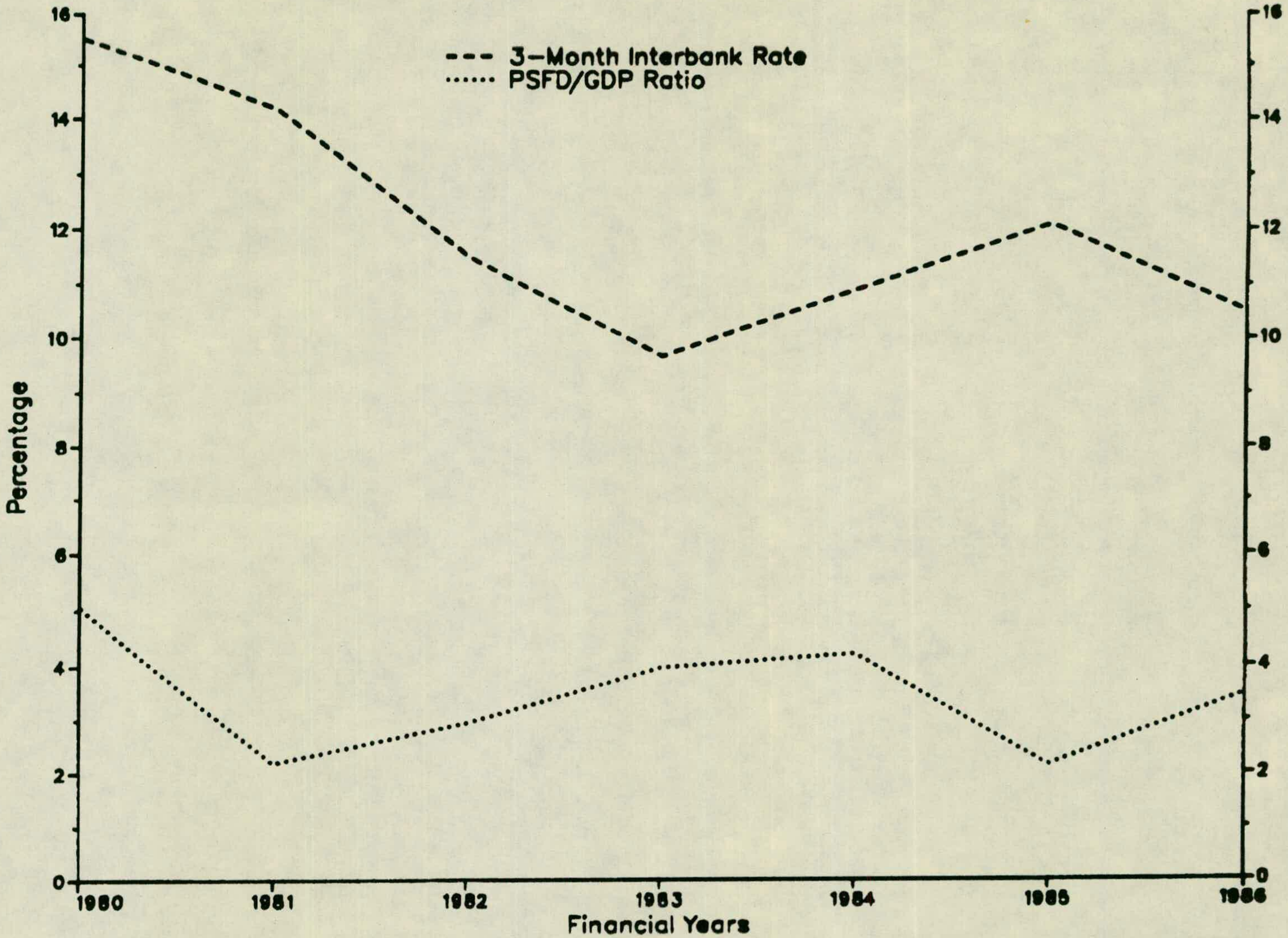
2. The answers to the other questions you raised will come later.

JOL 01

J ODLING-SMEE

ENC

Chart B1



MARK.DEBTGRA

FROM: CATHY RYDING
DATE: 7 January 1987

MR ODLING-SMEE

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Riley
Mr Allan
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Battishill (I/R)
Sir A Fraser (C&E)

POLICY BACKGROUND TO THE 1987 BUDGET

The Chancellor was grateful for your minute of 6 January attaching a redrawn version of Chart B.1.

2. The Chancellor would be grateful if the Chart could be re-done on a quarterly basis, in time for Chevening.

CR

CATHY RYDING

113/1/152

CONFIDENTIAL

FROM: C J RILEY
DATE: 8 JANUARY 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr F E R Butler
Sir G Littler
Sir T Burns
Mr Cassell
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Allan
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Mr Battishill - IR
Sir A Fraser - C&E

POLICY BACKGROUND TO THE 1987 BUDGET

You raised some specific points on Sir Terence Burns' paper for Chevening (Cathy Ryding's minute of 2 and 7 January).

Paragraph 70

2. An international comparison of public sector financial deficits is given in table J2 of Annex J. It shows that all the major countries currently have larger deficits than in the late 1960s.

Annex B

3. A quarterly version of Chart B1 from 1980 to the present is attached.

Annex C

4. The model used for the simulations was essentially the 1986 published version of the model, released in January last year. Results were reported for the four years 1986-1989. Generally the model was estimated using data for the last 15 years or so, but the determination of the exchange rate, and hence interest rates and other variables, is dominated by the experience of the 1980s.

Annex D, paragraph 2

5. The difference between the January 1986 internal forecast of money GDP growth and the path in the MTFS is shown below, alongside the corresponding figures for the October forecast. Although the January forecast was based on an oil price of $20/ barrel, this would have had a relatively small effect on money GDP growth over the period as a whole.

Money GDP growth (% per annum)

	1986-87	1987-88	1988-89
MTFS	6.8	6.4	6.0
January forecast	6.7	6.8	7.0
October forecast	5.5	7.3	8.0

6. In comparing the January forecast and the MTFS it is difficult to disentangle changes of judgement by the forecasters and adjustments required to achieve the assumed paths for money GDP, output and inflation. The main adjustments were to earnings, interest rates, expenditure and trade. But quite a lot of work would be required to obtain an estimate of their scale because the assumed paths are imposed on the projections after the first year of the MTFS (in this case 1986-87), and as the budget approaches the distinction between judgement and adjustment becomes increasingly blurred.

7. The differences in the money GDP paths suggest prima facie that adjustments to the January forecast may have been quite large in relation to the change between the MTFS and the October forecast - perhaps around a half. Allowing for the change in the oil price assumption between January and March, which would probably have depressed money GDP growth in 1986-87 and raised it in 1988-89, would reduce the difference between the January and October forecasts.

Annex G, paragraph 4

8. The adjustments made for essentially capital transactions - known as "Riley adjustments" in some quarters, hence the footnote - were first set out in the paper "Public Expenditure and the Fiscal Stance" which I submitted to you on 21 December 1984. This is attached (top copy only) for ease of reference; the adjustments are described in paragraphs 13-16 and annex B. Details of the present figures are set out in the attached table; they are probably not fully consistent with the PEWP, though the differences should be small.

Table J3

9. The figures in this table were taken from an OECD working paper published in May 1986.* As far as we are aware the figures for France are correct given the definitions employed; the OECD may subsequently have updated them, but we do not have any further information on this. Corresponding figures for gross debt are shown below.

General Government Gross Debt

(per cent of GDP/GNP at market prices)

	1974	1979	1984	1985
US	40.1	37.8	44.4	46.6
Japan	17.9	47.0	67.4	67.2
Germany	19.6	30.7	41.8	41.9
France	24.7	26.2	31.8	33.4
UK	69.6	55.7	55.6	54.4
Italy	57.7	70.4	91.1	95.9
Canada	44.4	46.9	63.4	67.3

pp. C J RILEY

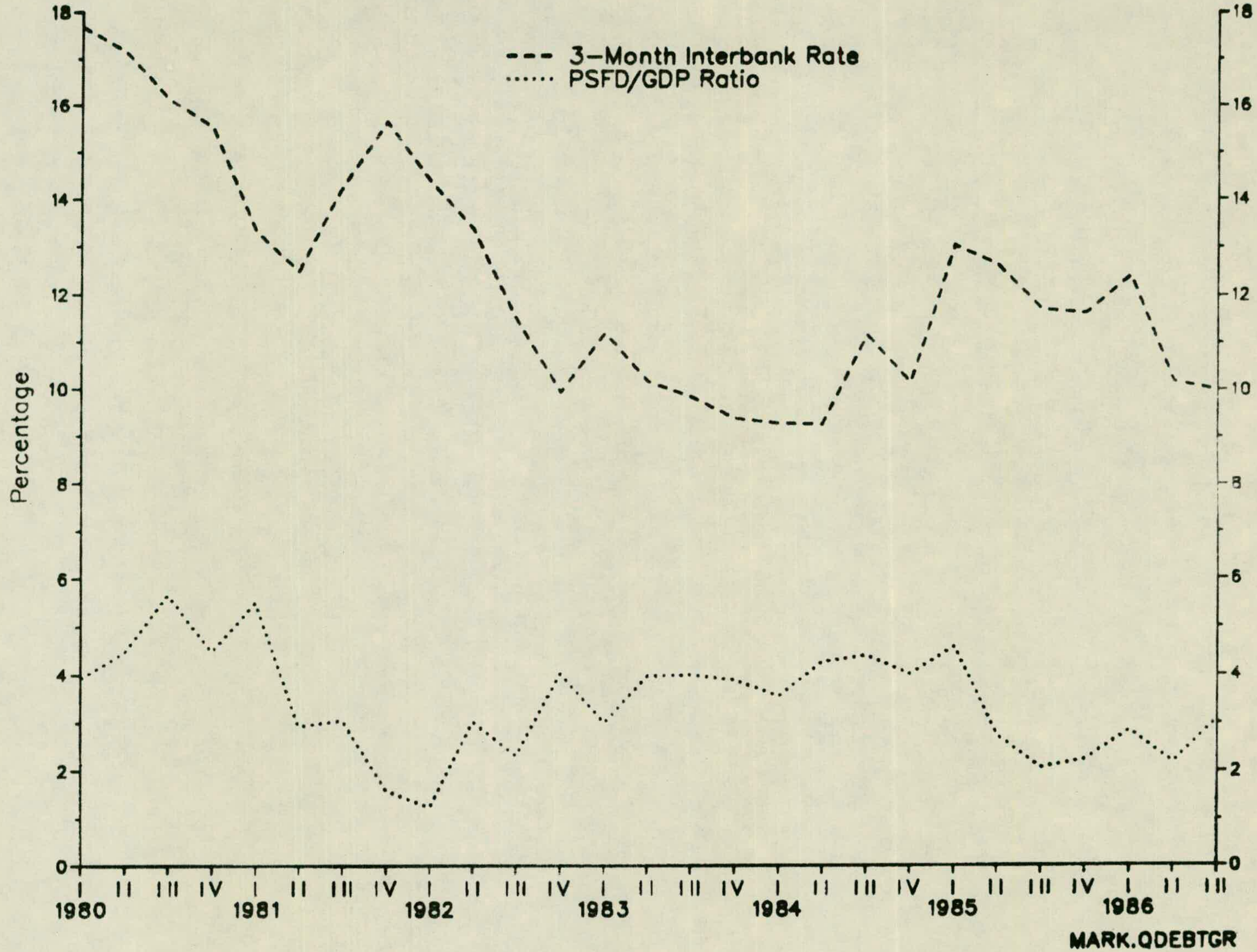
* "Public Debt in a Medium-Term Context and its implications for Fiscal Policy" by Chouraqui, Jones and Montador.

ESSENTIALLY CAPITAL TRANSACTIONS

£m cash	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	1989-90
Privatisation proceeds	370	405	494	488	1142	2132	2702	4750	5000	5000	5000
Sales of vehicles plant and machinery	1	3	3	4	7	15	17	23	17	20	20
Sales of land and buildings (net)	402	845	1735	2345	2001	1978	2022	1897	1678	1550	1570
Net lending to private sector:											
- Home shipbuilding refinance	30	31	48	23	47	25	76	-	-	-	-
- LA mortgages and other housing	-390	-274	-419	-230	269	387	338	308	280	230	230
- Other	-113	-287	-351	-358	136	72	57	-89	-74	-50	-50
Net lending to overseas											
- Export credit refinance	407	629	467	293	144	1	70	-	-	-	-
TOTAL	707	1352	1976	2566	3746	4610	5281	6889	6901	6750	6770

6 January 1987

Chart B1


3-Month Interbank Rate
PSFD/GDP Ratio
Percentage
0
2
4
6
8
10
12
14
16
18
I II III IV I II III IV I II III IV I II III IV I II III IV I II III IV I II III
1980
1981
1982
1983
1984
1985
1986
MARK.QDEBTGR

FROM: **S J DAVIES**
DATE: 8 JANUARY 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Cassell
Mr Monck
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Bottrill
Mr Matthews
Mr Mowl
Mr Riley
Mr Cropper
Mr Ross-Goobey
Mr Tyrie

Mr Battishill - I/R
Sir A Fraser - C/E

WINTER FORECAST : PRELIMINARY INDICATIONS

As the winter forecast is under way EA and PSF have prepared the attached note to serve as a background to your Chevening discussions.

2. The note concentrates on the new information that has become available since the completion of the October and Autumn Statement forecasts and on the main changes we expect in the prospect for 1987. It deals in turn with the world and domestic economies and public sector finances.

SJD

S J DAVIES

WORLD ECONOMY

RECENT DEVELOPMENTS

The note on "World Economic Developments" sets out the most recent world economic indicators.

(a) Activity and demand: In the third quarter of 1986 G5 domestic demand was nearly 4 per cent higher than a year earlier (mainly as a result of buoyant consumers' expenditure), while real GNP had grown by a more modest 2½ per cent. Large terms of trade changes have resulted in G5 import volumes rising considerably faster than their exports. Industrial production, always sensitive to export growth, continued to grow more slowly than GNP, and has remained flat in each of the three major countries - the US, Japan and Germany.

(b) Trade: Data on world visible trade for the second half of 1986 are sparse. A rebuilding of oil stocks in industrial countries may have temporarily inflated total world import volumes, which were perhaps 4-4½ per cent higher than a year earlier in the first half of 1986. OPEC and other oil producers' imports probably continued to fall. Trade in manufactured goods appears to have increased more slowly, by only 2½-3 per cent over the same period.

(c) Current accounts: The current account surpluses in Japan and Germany have continued to grow. The US deficit may have ceased rising.

(d) Inflation: Consumer price inflation in the G5 has levelled out at a little over 1 per cent, with negative inflation in Japan and Germany. Real commodity prices have failed to recover as expected when completing the Autumn Statement.

(e) Oil prices: The Brent price was within the \$14-\$15½ range in the autumn, but rose in late-December in response to OPEC's agreement to make further production cuts, and is now just over \$18. Markets at the moment seem confident that the OPEC agreement will substantially achieve its aims over the next few months.

PROSPECTS

2. No major changes in <u>policy</u> are yet in prospect. The German Parliament has passed a restrictive budget for 1987, and interest rates are unlikely to fall soon. The new Japanese budget has also been described as being "austere". In the US we still expect significant overshooting of the Gramm Rudman Federal deficit targets.

3. Our provisional conclusions on the prospect for 1987 are as follows.

(a) **Activity:** Growth of G5 domestic demand may be a little lower in 1987 than 1986. Growth in G5 GNP is likely to be about 3 per cent, a little above the likely outcome for 1986 of 2½ per cent. G5 industrial production should grow rather faster than in 1986 as exports to non-oil developing countries stop falling.

(b) **Trade:** In 1987 the prospect is for growth of total world trade to be slightly lower than in 1986, but for world trade in manufactures to grow more strongly at 3-4 per cent.

(c) **Inflation:** The outlook for 1987 is for another year of very low consumer price inflation. Real commodity prices are expected to rise less than expected at the time of the Autumn Statement.

THE UK

RECENT DEVELOPMENTS

4. Monitoring recent developments is complicated by large discrepancies between the CSO's estimates of the various measures of GDP in the third quarter of 1986. The output measure of GDP probably gives a better idea than the present estimate of average GDP of what the CSO will eventually record for the average measure. In other words the expenditure and income measures are likely to be revised up as the CSO acquire more information. Bearing this in mind there is evidence of a strong growth in activity occurring during 1986, while the current account moved into deficit, and inflation behaved much as envisaged in the Autumn Statement.

(a) **Activity and domestic demand:** Growth in both GNP and manufacturing output since the spring of 1986 has been more vigorous than was apparent a few months ago. The behaviour of the output measure of GDP suggests that growth in 1986 now seems likely to turn out between 2½ and 3 per cent; not far, after all, below the FSBR forecast. The recorded growth of domestic demand in the UK in the first three quarters of 1986 has been a little below what was expected at the time of the Budget, but we suspect the CSO's figures understate the actual growth of demand. The volume of consumer spending in recent months seems to be running a little higher than forecast in the Autumn Statement, investment spending lower, and both export and import volumes significantly higher.

(b) **Money GDP:** Money GDP growth in 1986-87 may not after all significantly undershoot the $6^3/4$ per cent growth envisaged in the 1986 MTFS.

(c) Inflation: Both RPI and producer price inflation may currently be slightly above the path consistent with the Autumn Statement forecast. The last two CBI surveys have shown some rise - above what can be accounted for entirely by seasonal factors - in the proportion of firms expecting to raise prices. The RPI figures for the last two months have shown a perceptible upward shift in the trend increase in prices of some consumer goods.

(d) Pay: Pay settlements monitored by the Department of Employment in manufacturing industry have fallen by about a point so far in this pay round. However, as in other respects, manufacturing appears to be behaving differently from other sectors of the economy. There has so far been only a marginal fall in settlements in the rest of the private sector. The fall in settlements in the private sector as a whole has been no greater than that allowed for in the internal October forecast, and less than was implicit in the Autumn Statement forecast.

(e) The exchange rate and competitiveness: The depreciation of the exchange rate during 1986 has been accompanied by a marked improvement in competitiveness. The exchange rate is currently a little above the value assumed in the Autumn Statement forecast for early 1987.

(f) The current account: The current account has been in deficit in recent months with a steep increase in the volume of imports more than offsetting the strong recovery in exports through most of 1986. The surplus on invisibles rose sharply during 1986. Our best guess is that the current account deficit for 1986 was close to £½ billlion. Given the somewhat confused signals on the behaviour of world trade in 1986 it is not clear whether the recent strong growth in UK exports reflects principally an upsurge in world demand, or whether there has been an increase in the UK's share of world trade, possibly in response to improved competitiveness.

PROSPECTS

5. The new forecast is not showing any major change to the prospects for activity and inflation in 1987 as compared with our view in the autumn, although the outlook for the current account has worsened.

(a) Activity: For 1987 the prospect is still for GDP growth of around 3 per cent as envisaged in the Autumn Statement. The forecast for consumer spending is little changed, with growth in spending at around 4 per cent. Business fixed investment should rise by more than envisaged two months ago given the encouraging December Intentions Survey. Investment in non manufacturing industry and services (especially in distribution) and residential investment look likely to be particularly strong in 1987. The relative weakness of manufacturing investment this year and next reflects the recent pattern of output growth which since early 1985 has been weighted towards the other three quarters of the economy.

(b) Inflation and pay: The increase in the RPI over the year to 1987 (4) is likely to be a little higher than in the Autumn Statement. On the basis of no change in mortgage rates during 1987 (as assumed in the Autumn Statement) total RPI inflation could be a little over 4 per cent in the fourth quarter of 1987 after a period earlier in the year when it is rather higher than this. Recent evidence on pay settlements seems to confirm the view that we took on earnings growth in the October forecast: there should be a small fall in underlying earnings growth over the next year to around 7 per cent.

(c) The exchange rate and current account: The improved level of competitiveness should help to restrain the growth of imports and encourage exports during 1987. Nevertheless the prospect of buoyant UK demand compared with more modest growth in markets abroad suggests that the trade deficit may continue to widen. The forecast for the current account as a whole in 1987 is likely to show a larger deficit than the £1½ billion forecast in the Autumn Statement. For the moment we are working on the assumption that there will be no significant further decline in sterling over the year: the forecast widening in the current account deficit is probably no greater than markets currently anticipate, and we expect the present large real interest differential to persist.

(d) The oil price: The forecast has been constructed on the basis of the oil price averaging $15 over the next year. If the oil price were to remain at its present level of $18 a barrel for the rest of 1987, government revenues from the North Sea would be about £1-1¼ billion higher in 1987-88. The current account deficit in 1987 might be £½-3/4 billion lower with an unchanged exchange rate; but the improvement would be less than this to the extent that the exchange rate appreciated in response to the higher oil price. RPI inflation might be about 1/3 percentage point higher at the end of 1987.

(e) Monetary conditions: In the light of M0's recent behaviour and the prospect of continued strong growth of personal income and consumers' expenditure it could prove difficult to keep it within the range for 1987-88 set out in the 1986 MTFS. The prospect is for money GDP growth clearly above the MTFS rate. If something else went seriously wrong, for example if there were a run of trade figures that were much worse than expected, a deterioration of expectations in financial markets could pose a serious problem. However we are currently assuming that interest rates will remain at their current levels, at least until the end of 1987.

PUBLIC FINANCES

1986-87 TO DATE

6. Figures for the CGBR to December are now available. The provisional December outturns for the LABR and PCBR, and therefore the PSBR as a whole, will be available on Friday, January 9.

7. The central government story has not changed much in recent weeks.

(a) **Non-oil taxes** to December are £2¼ billion above the Budget profile. VAT and corporation tax (CT) more than account for this excess. Little of this unexpected buoyancy can be explained, on current data at least, in terms of what has happened to consumer spending and past profits. We suspect however that the profits data will in time be revised upwards. Upward revisions to consumer spending are also possible, but the more likely explanation is that 1986-87, like 1985-86, will be a year in which VAT has grown significantly faster than consumer spending. It does look therefore as if the effective rates of tax on consumers' expenditure and profits have risen. For CT one possibility is that the sustained rise in profits over a number of years has brought down the proportion of tax exhausted companies faster than expected.

(b) Most of the £1 billion shortfall on **oil taxes** compared with the Budget profile reflects an oil price in the first half of 1986-87 below $15 a barrel.

(c) Little, if any, of the £½ billion additional **national insurance contributions** (NICs) is thought to reflect higher than expected wages and salaries. This fits in with the experience on PAYE, which is roughly on track.

(d) An overrun of £3/4 billion on **supply and other expenditure** compared with the Budget profile is largely accounted for by social security (£0.5 billion) and net EC payments (£0.3 billion).

(e) Central government debt interest payments net of receipts are broadly on track.

(f) The timing of **privatisation proceeds** in the Budget profile is fairly arbitrary and departures from profile are not particularly meaningful. The annual target may be just missed however. (See below.)

8. At end December the **CGBR(O)** was about £1 billion below the Budget profile, with higher expenditure and lower oil taxes more than offset by higher non-oil taxes and NICs.

9. Both the **LABR** and **PCBR** are below profile. Information on LA's and PC's accounts is patchy. On the LA side higher than expected capital receipts from council house sales and the delay in the teachers settlement could account for some

of the shortfall. In the case of public corporations lower capital spending is a more likely explanation than higher profits.

1986-87 AS A WHOLE

10. Forecasts for 1986-87 as a whole are still subject to significant margins of error. Average errors on internal January forecasts of the PSBR over the last ten years have been equivalent to £1½ billion. Although in recent years the error has been less there has been a tendency to overpredict the outcome, by about £3/4 billion on average. A relatively large margin of uncertainty will remain right up to, and including the Budget because of the possibility of very large receipts and payments switching between the end of March and the beginning of April.

11. The latest forecast for 1986-87 assumes

(a) privatisation proceeds of £4.6 billion (ie just below the previous assumed total of £4 3/4 billion);

(b) expenditure on Rover (repayment of debt) of £650 million (only £100m was allowed for as a contingency in the Autumn Statement).

The forecast is consistent with a public expenditure planning total of £140.5 billion This is the same as in GEP's December assessment, but our figuring here assumes slightly lower privatisation proceeds offset by lower central government current expenditure than GEP assumed.

12. The PSBR in 1986-87 is now forecast to be about £6 billion, 1.6 per cent of GDP, the same as last year's ratio. The downward revision to the PSBR since the Autumn Statement is due to higher receipts, especially for CT. The present forecast assumes mainstream CT receipts of no less than £4 billion in January alone, not far off total receipts for a whole year only a few years back.

1987-88

13. We are still assessing the prospects for 1987-88, which are very uncertain at this stage of the forecasting exercise. At present the picture in broad terms is as follows.

(a) The forecast envisages overspending on programme plans in 1987-88 arising mainly from continued higher than planned take-up of social security benefits (partially offset by lower unemployment than the plans assume) and higher than assumed inflation, including public sector pay (other than the teachers). If in addition some allowance is made for genuine contingencies, such as Airbus launch aid and Space, a small total overspend on the planning total of £½ billion is suggested.

(b) If the oil price averages $15, **North Sea revenues** could be a little higher than projected in the FSBR. There is a new possibility of a higher price for at least some of the year. (The oil price for calendar 1987 will determine oil revenues for financial year 1987-88.)

(c) Although the buoyancy of **non-oil taxes** in 1986-87 is by no means fully understood it seems sensible to assume that a good deal of the buoyancy in 1985-86 and 1986-87 will carry forward into later years.

(d) On the assumption of a PSBR ratio of $1^3/4$ per cent of GDP, the prospect is for a **fiscal adjustment** in 1987-88 possibly twice as large as projected in the 1986 MTFS. However, the upward revision to the fiscal adjustment will probably not carry over to later years of the MTFS period to anything like the same extent.

SECRET

PROSPECTS FOR THE DOMESTIC ECONOMY

	FSBR MARCH 1986	AUTUMN STATEMENT NOVEMBER 1986	PRELIMINARY VIEW JANUARY 1987
GDP			
1986	3	2½	2¾
1987	2½ (first half)	3	3
Money GDP			
1986-87	6¾	5½	6½
1987-88	6½	7	7½
Current balance, £ billion			
1986	3½	0	-½
1987	1½*	-1½	-2 - -4
RPI			
1986)change over previous)year to the fourth	3½	3¼	3½
1987)quarter	3¼**	3¾	4¼
Short-term interest rates ** (per cent)			
1986 Q4	11	11	11
1987 Q4	9½	10½	11
MO **			
1986-87)financial)year	2½	4	4½
1987-88)averages	4	4	6

* First half of 1987 at annual rate

** not published

time equivalents were previously estimated to rise by ¼ per cent a year and are now expected to rise by ¾ per cent a year;

(ii) an increase in the provision for discretionary additions to programmes such as launch aid and space (£200-300 million);

(iii) an increased estimate of the central government paybill (£200-300 million).

Again, given the margins of error, not too much significance should be attached to these changes.

AT

A TURNBULL

SECRET

FROM: A Turnbull
DATE: 9 January 1987

CHIEF SECRETARY

cc Chancellor
Sir T Burns
Mr F E R Butler
Mr Mowl
Mr Gieve
Mrs R Butler

CHEVENING: PROSPECTS FOR PUBLIC EXPENDITURE

Mr Davies' note of 8 January reports on the latest position on the forecast. You might like an additional comment on the reference to public expenditure.

<u>1986-87</u>

2. The forecasters put the outturn for this year at £140.5 billion. This is the same as set out in GEP's monthly note for December (Mr Pratt's submission of 19 December) and is very close to the £140.4 billion which was published in the Autumn Statement and will be repeated in the White Paper. The figures are insignificantly different given the margin of uncertainty remaining.

<u>1987-88</u>

3. In October the forecasters' estimates for the planning total was £0.5 billion lower than eventually settled in the Survey (£148.1 billion against £148.6 billion). Another way of expressing this is that only £3.0 billion of the £3.5 billion Reserve might be used.

4. In the current exercise, which the note explains is still at a preliminary stage, the estimate of the outcome on the planning total moved from about £0.5 billion under the plans to perhaps £0.5 billion over - a change of the order of £1 billion.

5. The main reasons for the change from one forecast to the next are:

(i) higher local authority paybill (£200-300 million), principally on account of higher numbers. Full-

4-18a

COVERING SECRET

FROM: M C SCHOLAR
DATE: 9 JANUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Geoffrey Littler
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Allan

Mr Battishill - IR
Sir Angus Fraser - C/E

CHEVENING: AGENDA

... I attach an annotated agenda for the weekend discussions.

MCS

M C SCHOLAR

152/1/153

SECRET

CHEVENING 10-11 JANUARY 1987

PAPERS

1. Policy background to the 1987 Budget

   Sir T Burns/Chancellor of 19 December

   Also relevant:

   Winter forecast: preliminary indications
   Mr S J Davies/Chancellor of 8 January

2. Tax issues

   Mr Scholar/Chancellor of 19 December

3. World Economic Background

   Sir G Littler/Chancellor of 19 December

1. THE POLICY BACKGROUND TO THE 1987 BUDGET
(References are to Sir T Burns' paper)

Introduction and policy framework

(i) Should the objective of macro-economic policy continue to be to bring inflation down and provide the conditions for further growth of output and employment - and to that end to reduce the growth of money GDP over the medium term? (paras 18, 26)

(ii) Is the general analysis in the paper (para 25 and following) of the roles of monetary policy and fiscal policy in bringing this about accepted?

(iii) In particular, is it accepted that different combinations of interest rates and fiscal policy can deliver the same outcome for money GDP, but with different effects on the balance of the economy, and on the current account of the balance of payments?

The current position

(iv) How plausible is the forecast of a bounce-back in money GDP growth in 1987-88 and 1988-89? Does this and other evidence suggest that the overall stance of policy should be tightened? (Paras 49-62)

(v) If so what are the strengths and weaknesses of the case for tighter fiscal policy and the case for tighter monetary policy? (Paras 63-71)

Policy assessment

(vi) What are the implications for the PSBR in 1987-88 and beyond? Table 9 in paragraph 76 sets out some illustrative paths.

2. **TAX ISSUES**

General Approach

(i) What scope is there for income tax cuts? Do they need to be financed in part by a new tax on credit cards, over-indexation of excise duties, an increase in the VAT standard rate or anything else?

(ii) Will we be able to present the Budget convincingly as a continuation of the process of reforming the tax system?

(iii) Should we set an overall limit on the impact of the Budget on the RPI (the 1986 Budget increased the RPI by 0.6%)?

(iv) Given the anti-avoidance starters in play will we wish to make fairness a Budget theme, perhaps in the context of a reduction in the tax on individuals?

(v) Is the overall impact of the Budget on the financial sector likely to be acceptable?

Tax Reform
Personal tax Green Paper

(vi) Is it agreed that transferable allowances are the right approach in principle?

(vii) Would partially transferable allowances be worth pursuing?

(viii) Is there sufficient support now to go ahead with transferable allowances?

(ix) How could more support be built up?

- A questionnaire, or some other means of testing opinion more widely?
- Presenting the measure in a different way, or in a broader context, eg more as part of the tax reduction programme than as a measure for women?

(x) Would it be best to freeze the issue until after the Election? If so, what would be said in public, and what would be the effect on the Inland Revenue?

Income tax/CGT reform (paras 9-16)

(xi) Is it accepted that any reduction in income tax this year should take the form of a reduction in basic rate, plus simplification of the higher rates?

(xii) Is the CGT package feasible without a reduction in 60% rate? Does the present shape of the package look promising - generally, and for hard cases?

(xiii) What cut in the basic rate, if any, should we be aiming for?

Inheritance tax

(xiv) Is it agreed that the aim should be to increase the threshold by more than statutory indexation?

(xv) In addition to raising the threshold in real terms, should the aim be to stretch out and simplify the rate structure?

Other Personal Tax Issues

(xvi) Is any move on the mortgage interest relief ceiling likely?

(xvii) Should action be taken to reform taxation of members of Lloyds in 1987?

Widening the tax base

(xviii) Does a 15% tax on interest on credit cards look plausible for 1987, with the aim of moving in 1988 to a wider-based consumer credit tax to be applied to interest on consumer credit across the board (including mortgages)? What should the ultimate net revenue target be (£1½ billion, as Customs suggest)?

Company tax

(xix) Should all companies (including building societies) be moved on to a nine months' basis for CT?

(xx) Should we continue to set CT rates in advance? Should the mainstream rate of Corporation Tax remain 35%?

(xxi) Should we legislate for Pay and File in this Budget?

(xxii) Should the Budget have anything on BES; and anything to promote wider share ownership?

Excise duties and VAT (paragraphs 33-37)

(xxiii) Should the aim be to raise excise revenue equivalent to the yield from revalorisation; or more?

(xiv) Should the standard rate of VAT be increased?

Action against labour market rigidities

(xxv) Do we proceed with profit-related pay?

(xxvi) Should proposals on pensions cover free-standing AVCs, together with proposals to prevent abuse of pension tax relief by well-paid employees?

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(references are to Sir G Littler's paper)

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perhaps
- Mr Tebbit
- Lord Young (again?)
- Mr Fowler
- Mr Channon
- Mr Ridley
- Mr Moore

(iv) Any other points?

SUMMARY

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6 Candidates for inclusion in next year's Finance Bill:

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(a) to (d) are strong candidates: (e) and (f) are more uncertain.

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Details two ideas which Lord Young "is likely to emphasise in our submission".

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3. **Lord Young - Department of Employment - 16 and 17 December**

Does not want any major increase in expenditure on traditional employment measures. Resources should be concentrated in two main areas - schemes (eg Enterprise Allowance Scheme) which promote the growth of new, permanent jobs; and programmes (eg Restart) which are self-financing.

Various detailed proposals. On employment:

(a) Extension of the Enterprise Allowance Scheme by September next year to a total of 130,000 entrants a year.

(b) Extend the YTS guarantee to all 17 year old school leavers.

(c) A further extension of the Restart programme of compulsory interviews for the long term unemployed.

(d) Extension of the new Job Training Scheme which the MSC are now piloting.

On enterprise:

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(j) Business Expansion Scheme: rule changes to encourage small firms and new enterprises by allowing BES investments in companies running small units of less than 1250 sq.ft.

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(m) Claims and elections: changes to various time limits.

(n) CGT roll-over relief: two technical recommendations to improve the operation.

(o) Deregulation of P11D: simplification to reduce compliance costs.

You discussed the employment measures proposals with Lord Young on 16 December.

4. **Mr Jopling - Ministry of Agriculture Fisheries and Food - 30 December**

Will be writing further. Letter of 30 December to give advance warning of one particular area where measures required "to demonstrate the Government's recognition of the difficulties now confronting our farmers".

Seeks special consideration for the introduction of a new 100 per cent first year allowance on say the first £30,000 of expenditure on plant and machinery. Such an arrangement would assist the smaller family farm but applying generally would also provide further encouragement in the growth of all small business.

4. **Mr Channon - Department of Trade and Industry - 18 December**

Welcomes any moves to continue the process of reducing the burden of personal taxation. But specifically would like thresholds for higher tax rates to at least receive the benefit of full indexation this year.

Detailed points cover:

(a) Corporation tax: there should be no increase in the present rate of 35 per cent and hopefully some decrease. Would like to see rate of corporation tax for 1987/88 announced and a clear indication of intentions for subsequent years. In addition, would like extension of tax relief to expenditure incurred by a consortium on R&D before trading begins and for the clarification of the definition of research used for the Scientific Research Allowance.

(b) Stamp duty: there remains a strong case for complete abolition on securities transactions but recognises that revenue loss would be significant and therefore seeks a further reduction of ¼ per cent. Also wants a pro rata reduction, to ¾ per cent, in the new tax on the transfer of shares for the purpose of creating depository receipts and the halving of stamp duty reserve tax.

(c) Unit trust instrument duty: requests you look again at the ¼ per cent duty.

(d) Life insurance: two suggestions - removal of the stamp duty of 50 pence per £1000 and in particular the application of this duty to the reassurance in the UK of life policies written abroad.

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(h) VAT: increase turnover threshold for registration at least in line with inflation. Also would welcome the early introduction of an option for smaller traders to account for VAT on a cash basis. Seeks reconsideration of the suggestion that firms with a turnover below the registration threshold should no longer have the option of registering.

(i) Matches and mechanical lighters: opposes abolition in the coming Budget.

time equivalents were previously estimated to rise by ¼ per cent a year and are now expected to rise by ¾ per cent a year;

(ii) an increase in the provision for discretionary additions to programmes such as launch aid and space (£200-300 million);

(iii) an increased estimate of the central government paybill (£200-300 million).

Again, given the margins of error, not too much significance should be attached to these changes.

AT

A TURNBULL

SECRET

FROM: A Turnbull
DATE: 9 January 1987

CHIEF SECRETARY

cc Chancellor
Sir T Burns
Mr F E R Butler
Mr Mowl
Mr Gieve
Mrs R Butler

CHEVENING: PROSPECTS FOR PUBLIC EXPENDITURE

Mr Davies' note of 8 January reports on the latest position on the forecast. You might like an additional comment on the reference to public expenditure.

<u>1986-87</u>

2. The forecasters put the outturn for this year at £140.5 billion. This is the same as set out in GEP's monthly note for December (Mr Pratt's submission of 19 December) and is very close to the £140.4 billion which was published in the Autumn Statement and will be repeated in the White Paper. The figures are insignificantly different given the margin of uncertainty remaining.

<u>1987-88</u>

3. In October the forecasters' estimates for the planning total was £0.5 billion lower than eventually settled in the Survey (£148.1 billion against £148.6 billion). Another way of expressing this is that only £3.0 billion of the £3.5 billion Reserve might be used.

4. In the current exercise, which the note explains is still at a preliminary stage, the estimate of the outcome on the planning total moved from about £0.5 billion under the plans to perhaps £0.5 billion over - a change of the order of £1 billion.

5. The main reasons for the change from one forecast to the next are:

(i) higher local authority paybill (£200-300 million), principally on account of higher numbers. Full-

4-18a

COVERING SECRET

FROM: M C SCHOLAR
DATE: 9 JANUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Geoffrey Littler
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Allan

Mr Battishill - IR
Sir Angus Fraser - C/E

CHEVENING: AGENDA

... I attach an annotated agenda for the weekend discussions.

MCS

M C SCHOLAR

SECRET

CHEVENING 10-11 JANUARY 1987

PAPERS

1. Policy background to the 1987 Budget

   Sir T Burns/Chancellor of 19 December

   Also relevant:

   Winter forecast: preliminary indications
   Mr S J Davies/Chancellor of 8 January

2. Tax issues

   Mr Scholar/Chancellor of 19 December

3. World Economic Background

   Sir G Littler/Chancellor of 19 December

1. THE POLICY BACKGROUND TO THE 1987 BUDGET

(References are to Sir T Burns' paper)

Introduction and policy framework

(i) Should the objective of macro-economic policy continue to be to bring inflation down and provide the conditions for further growth of output and employment - and to that end to reduce the growth of money GDP over the medium term? (paras 18, 26)

(ii) Is the general analysis in the paper (para 25 and following) of the roles of monetary policy and fiscal policy in bringing this about accepted?

(iii) In particular, is it accepted that different combinations of interest rates and fiscal policy can deliver the same outcome for money GDP, but with different effects on the balance of the economy, and on the current account of the balance of payments?

The current position

(iv) How plausible is the forecast of a bounce-back in money GDP growth in 1987-88 and 1988-89? Does this and other evidence suggest that the overall stance of policy should be tightened? (Paras 49-62)

(v) If so what are the strengths and weaknesses of the case for tighter fiscal policy and the case for tighter monetary policy? (Paras 63-71)

"Balanced tightening" is in fact big step in 1987-88 & little thereafter

Policy Assessment

(vi) What are the implications for the PSBR in 1987-88 and beyond? Table 9 in paragraph 76 sets out some illustrative paths.

2.7 0.3

2. TAX ISSUES

General Approach

VAT avoidance

(i) What scope is there for income tax cuts? Do they need to be financed in part by a new tax on credit cards, over-indexation of excise duties, an increase in the VAT standard rate or anything else?

(ii) Will we be able to present the Budget convincingly as a continuation of the process of reforming the tax system?

(iii) Should we set an overall limit on the impact of the Budget on the RPI (the 1986 Budget increased the RPI by 0.6%)?

(iv) Given the anti-avoidance starters in play will we wish to make fairness a Budget theme, perhaps in the context of a reduction in the tax on individuals?

(v) Is the overall impact of the Budget on the financial sector likely to be acceptable?

Consumer Credit
CGT on life assurance companies.
VAT avoidance on banks etc

— separate folder

Tax reform
Personal
tax Green
Paper

(vi) Is it agreed that transferable allowances are the right approach in principle?

(vii) Would partially transferable allowances be worth pursuing?

(viii) Is there sufficient support now to go ahead with transferable allowances?

(ix) How could more support be built up?

- A questionnaire, or some other means of testing opinion more widely?

- Presenting the measure in a different way, or in a broader context, eg more as part of the tax reduction programme than as a measure for women?

(x) Would it be best to freeze the issue until after the Election? If so, what would be said in public, and what would be the effect on the Inland Revenue?

Income
tax/CGT
reform
(paras 9-16)

(xi) Is it accepted that any reduction in income tax this year should take the form of a reduction in basic rate, plus simplification of the higher rates?

(xii) Is the CGT package feasible without a reduction in 60% rate? Does the present shape of the package look promising - generally, and for hard cases?

Will probably want to spend more time on this

(xiii) What cut in the basic rate, if any, should we be aiming for?

Inheritance tax

(xiv) Is it agreed that the aim should be to increase the threshold by more than statutory indexation?

(xv) In addition to raising the threshold in real terms, should the aim be to stretch out and simplify the rate structure?

Arithmetic 82 versus Econometric 82

Other Personal Tax Issues

(xvi) Is any move on the mortgage interest relief ceiling likely?

(xvii) Should action be taken to reform taxation of members of Lloyds in 1987?

Widening the tax base

(xviii) Does a 15% tax on interest on credit cards look plausible for 1987, with the aim of moving in 1988 to a wider-based consumer credit tax to be applied to interest on consumer credit across the board (including mortgages)? What should the ultimate net revenue target be (£1½ billion, as Customs suggest)?

Customs submission

Company tax

(xix) Should all companies (including building societies) be moved on to a nine months' basis for CT?

(xx) Should we continue to set CT rates in advance? Should the mainstream rate of Corporation Tax remain 35%?

(xxi) Should we legislate for Pay and File in this Budget?

(xxii) Should the Budget have anything on BES; and anything to promote wider share ownership?

Oil taxation [arguments for dec's pass station 88-9]

Excise duties and VAT (paragraphs 33-37)

(xxiii) Should the aim be to raise excise revenue equivalent to the yield from revalorisation; or more? or less?

(xiv) Should the standard rate of VAT be increased?

Action against labour market rigidities

(xxv) Do we proceed with profit-related pay?

Cost of pensions proposals?

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W? -

(i) Matches and mechanical lighters: opposes abolition in the coming Budget.

3215/11

FROM: P J CROPPER
DATE: 9 January 1987

CHANCELLOR

PRE-CHEVENING FIGURES

I am not quite sure whether these figures have appeared in the briefing:

	Direct Revenue Cost £m	
	1987-88	Full Year
Abolish 60% and 55% Income Tax rates, against indexed base. (Top rate becomes 50%)	200	380
Abolish 60% and 55% IHT rates, against indexed base. (Top rate becomes 50%).	25	70

PJC

P J CROPPER

Rule: Pls put on Chevening file.

C.

TAX BURDEN

1. You asked about Mr Hattersley's remarks ~~..~~ about the tax burden on "The World This Weekend".

2. The table below, from the Chevening tax issues paper, shows tax and NIC as a percentage of income for 1978-79, 1986-87, and the main options for next year. Basically, anybody on ¼ average earnings, and anybody to the right of the blue lines pays less tax and NIC as a proportion of income than in 1978-79.

3. I have asked Michael Scholar what would be needed to reduce everybody's burden below the 1978-79 level.

See note below.

AH

6.1.

SECRET

TABLE 5: TAX AND NIC AS PERCENTAGE OF INCOME

Multiples of average earnings

	¼	½	¾	1	1½	2	3	4	5	10
Single										
1978-79	11.1	23.5	28.9	31.5	33.3	33.7	39.8	46.5	52.2	67.5
1986-87	9.6	25.8	29.9	31.9	32.9	33.3	38.0	42.1	45.6	52.8
1987-88										
Indexation	10.3	26.1	30.1	32.1	32.8	33.5	38.3	42.6	46.0	53.0
Option (a) 1p off basic rate	10.1	25.6	29.4	31.3	32.0	33.4	37.3	42.2	45.7	52.9
Option (b) 2p off	9.9	25.0	28.6	30.5	31.1	32.7	36.8	41.8	45.4	52.7
Option (c) 13% on thresholds	7.2	24.6	29.1	31.3	32.7	33.6	37.4	42.1	45.7	52.9
Married										
1978-79	6.5	16.0	23.8	27.8	30.8	31.4	37.5	44.5	50.5	66.5
1986-87	5.0	18.9	25.3	28.4	30.6	30.9	36.0	40.3	44.2	52.1
1987-88										
Indexation	5.0	19.5	25.7	28.7	30.6	31.2	36.4	40.8	44.7	52.3
Option (a) 1p off BR	5.0	19.1	25.1	28.1	29.8	30.9	35.6	40.4	44.3	52.2
Option (b) 2p off BR	5.0	18.8	24.5	27.4	29.0	30.1	35.1	40.1	44.0	52.0
Option (c) 13% on thresholds	5.0	17.1	24.0	27.5	29.8	30.7	35.4	40.2	44.2	52.1

SECRET

TAX BURDEN

4-19

SECRET

FROM: M C SCHOLAR
DATE: 9 JANUARY 1986

MR HUDSON cc Mr Scotter

Your note of 6 January.

2. Low-earners have lost most, proportionately, from the abolition of the reduced rate band, and gained relatively little from the basic rate cuts (and real earnings have of course risen even faster than the 22 per cent real increase in allowances). Because there may be some rogue losers at around 45 per cent of average earnings, to ensure that everyone has a lower income tax and NIC burden than in 1978-79 means either reintroducing a reduced rate band, further NIC reductions, or a very expensive overall increase in allowances/cut in basic rate.

3. Mr Scotter's note (attached) calculates that a 23 per cent increase in allowances or 13p cut in the basic rate would be needed. We have checked with the Revenue that these numbers are of the right order of magnitude.

MCS

M C SCHOLAR

C.

1. You asked about ~~the~~ Hattersley's claim that people on low & middle incomes were now paying a higher tax burden. What would be necessary to bring ~~it~~ everybody down below 1978-79 levels?

2. Unfortunately, the amounts are unrealistic. Not worth pursuing.

AH
9.1.

SECRET

FROM: I SCOTTER
DATE: 8 JANUARY 1986

MR SCHOLAR

TAX BURDEN

The Chancellor asked what would be necessary to reduce the tax and NIC burden for everybody below that in 1978-79 (Mr Hudson's minute of 6 January).

2. Most taxpayers face a reduced income tax burden because of lower basic rates and increased allowances, but there are some on low incomes (around half average earnings) who lost more from the abolition of the reduced rate band than they have gained from the tax cuts.

3. The main cause of the increase in the tax and NIC burden is the increase in the main NIC rate from 6½ per cent to 9 per cent, for someone not contracted in to SERPs. For those above 1½ times average earnings, income tax cuts have outweighed this increase but at lower earnings the NIC increases have been larger than tax cuts. (There is also an element of real fiscal drag.)

4. The most direct way to bring everyone's income tax and NIC burden below its 1978-79 level would therefore be to reduce the NIC rate by 2½ points, back to its 1978-79 level, in combination with a modest increase in personal allowances above indexation. This would cost about £5 billion in a full year although the cost could be reduced by the extension of reduced rate NIC bands.

5. For changes which could take effect from April, we are left with reductions in income tax. There are many possibilities here with combinations of allowance increases and basic rate cuts as well as differential increases in single and married allowances.

6. The following measures would ensure no working income tax payer had a higher tax burden than in 1978-79 are:

(a) a 23% increase in personal allowances above indexation, costing £4 billion in 1987-88;

(b) a 13p cut in the basic rate to 16p in the pound, costing £14 billion in 1987-88;

(c) a reduced rate of income tax at 16p in the pound on the first £2,500 of taxable income, costing about £7 billion.

7. The alternative way of comparing the tax and NIC burden with 1978-79 is to compare with an indexed 1978-79 tax regime at current income levels. The 1986 Budget meant that in 1986-87 nearly everyone had a lower burden on this comparison. We are not yet in a position to produce 1987-88 comparisons with an indexed regime (the December RPI is not yet available) but expect that comparison to hold. Any of the Chevening options are likely to show a reduced burden on this basis.

I doubt it. 8. Mr Hattersley was probably referring to the burden of income tax, NIC and indirect taxes. This is up by about 2 points for everyone between ¾ and 1½ times average earnings, and probably even more for those on half average earnings. None of the measures discussed here would be sufficient to bring that burden down for everybody. That would need reductions in indirect taxes or very large income tax or NIC concessions for those on low incomes.

IAN SCOTTER

Covering CONFIDENTIAL

FROM: R P SHORT
DATE: 8 JANUARY 1987

cc: As attached list

MANUAL OF ILLUSTRATIVE TAX CHANGES

I attach the 1987 edition of the tax and national insurance ready-reckoner. This provides information on the main taxes and gives estimates of the revenue effects of illustrative tax changes.

2. The estimates are based on the Autumn Statement forecast. An illustrative rate of inflation of 3¼ per cent has been used to show the effects of indexation and revalorisation. A revised edition will be issued once the actual figure for the December RPI becomes available.

3. The sections of the ready-reckoner have been prepared by the departments responsible for each tax. Detailed enquiries about the figures and requests for estimates of the costs of particular packages (as opposed to changes of individual taxes) should be addressed to the relevant department.

RPShort

R P SHORT
ETS DIVISION

MANUAL OF ILLUSTRATIVE TAX CHANGES

1/17

MANUAL OF ILLUSTRATIVE TAX CHANGES

Circulation List: Revenue Pages

HM Treasury

1.	Chancellor of the Exchequer			12/ 2
2.	Chancellor's Principal Private Secretary	-	A C S ALLAN	12/ 2
3.	Chancellor's Second Private Secretary	-	A W KUCZYS	12/ 2
4.	Chief Secretary			36/2
5.	Financial Secretary			43A/2
6.	Economic Secretary			52/2
7.	Minister of State (Revenue)			49/2
8.	Permanent Secretary	-	SIR PETER MIDDLETON	78A/2
9.	Second Permanent Secretary	-	F E R BUTLER	120/2
10.	Second Permanent Secretary	-	J G LITTLER	113/2
11.	Chief Economic Adviser	-	SIR TERENCE BURNS	119/2
12.	Deputy Chief Economic Adviser	-	I C R BYATT	73/2
13.	Deputy Secretary Public Finance Sector	-	F CASSELL	87/2
14.	Under Secretary Economics EA	-	P N SEDGWICK	39/3
15.	Under Secretary Economics MP	-	J ODLING-SMEE	45/2
16.	Under Secretary FIM	-	MRS R LOMAX	82/G
17.	Under Secretary FP	-	M C SCHOLAR	90/1
18.	Under Secretary MG	-	D L C PERETZ	84/G
19.	Senior Economic Adviser ET	-	G P SMITH	117/1
20.	Senior Economic Adviser EA1	-	S J DAVIES	36A/3
21.	Senior Economic Adviser MP1	-	C J RILEY	91/3
22.	Senior Economic Adviser MP2	-	C MELLISS	114/3
23.	Assistant Secretary FP	-	MISS C E C SINCLAIR	89/1
24.	Assistant Secretary EB	-	MISS M O'MARA	97/2
25.	Economic Adviser ET	-	I SCOTTER	116/1
26.	Economic Adviser ET	-	R P SHORT	116/1
27.	Economic Adviser EA1	-	P F L ALLUM	36/3
28.	Economic Adviser EA2	-	R J BARRELL	33/3
29.	Economic Adviser PSF	-	A W RITCHIE	88/4
30.	Economic Adviser MP1	-	H BREDENKAMP	88/3
31.	Statistician PSF	-	S J W BRISCOE	89/4
32.	Principal FP	-	K ROMANSKI	93/1
33.	Principal FP	-	M HAIGH	92/1
34.	Principal FP	-	MS C EVANS	126/2
35.	Principal ST1	-	M GIBSON	24/2

36.	Special Adviser	-	A ROSS GOOBEY	117/2
37.	Special Adviser	-	P CROPPER	17/2

Inland Revenue

38.	Chairman to the Board	-	A M BATTISHILL
39.	Deputy Chairman	-	T J PAINTER
40.	Deputy Chairman	-	A J G ISAAC
41.	Director Central Division	-	L J H BEIGHTON
42.	Under Secretary Policy Division 1	-	P LEWIS
43.	Director Statistics Division	-	J CALDER
44.	Senior Economic Adviser Central Division	-	R WEEDEN
45.	Chief Statistician Company Incomes	-	F A FITZPATRICK

46.	Chief Statistician Budgetary Support and Forecasting	-	R EASON
47.	Chief Statistician Capital and Wealth	-	W GONZALEZ
48.	Assistant Secretary Policy Division 1	-	B A MACE
49.	Statistician Statistics Division 1	-	G KEENAY
50.	Assistant Secretary Central Division 2	-	M JOHNS

Customs and Excise

51.	Deputy Chairman	-	B H KNOX
52.	Chairman's Private Secretary	-	MR L RAILTON
53.	Commissioner for Internal Taxation	-	P JEFFERSON SMITH
54.	Assistant Secretary DPU	-	P G WILMOTT
55.	Economic Adviser DPU	-	MRS L HAMILL
56.	Statistician DPU	-	B SEXTON
57.	Principal Planning Unit	-	J BONE

MANUAL OF ILLUSTRATIVE TAX CHANGES

CONTENTS

HM TREASURY
ETS Division
JANUARY 1987

1. INCOME TAX

INDEXED LEVELS OF INCOME TAX ALLOWANCES AND THRESHOLDS

Allowances	1986-7 Current Levels £	1987-8 Indexed Levels(1) £
Single and wife's earned income allowances	2,335	2,415
Married allowance	3,655	3,775
Additional personal and widow's bereavement allowance	1,320	1,360
Single age allowance	2,850	2,950
Married age allowance	4,505	4,655
Aged income limit	9,400	9,800

Rates per cent	Bands of taxable income 1986-7 Current Levels £	1987-88 Indexed Levels(1) £
29	0 - 17,200	0 - 17,800
40	17,201 - 20,200	17,801 - 20,900
45	20,201 - 25,400	20,901 - 26,300
50	25,401 - 33,300	26,301 - 34,500
55	33,301 - 41,200	34,501 - 42,700
60	over 41,200	over 42,700

(1) Indexed by 3.25 per cent consistent with the Autumn Statement and following the rounding rules laid down in the Finance Act 1980.

Cost of 3.25 per cent indexation at 1987-88 and 1988-89 income levels

	1987-88 Revenue effect	1988-89 Revenue effect
	£m	£m
£80 increase in the single person's and wife's earned income allowance	250	325
£120 increase in the married man's allowance	280	355
£40 increase in the additional personal and widow's bereavement allowance	5	6
£100 increase in the Single Age allowance	24	31
£150 increase in the Married Age allowance	35	43
£400 increase in the Aged Income Limit	7	11
£600 increase in the Basic Rate Limit	51	93
Increase in the further higher rate thresholds	37	75
Total cost of indexation	690	940

GENERAL NOTE: The costs are based on the levels of allowances etc shown in the preceding table, and are estimated on the basis of the Autumn Statement NIF. The changes are cumulative, eg the cost of the increase in the aged income limit is on top of the increase in both the ordinary and age allowance immediately above. The estimates of the effects in 1988-89 assume the the 1987-88 indexed levels of allowances and thresholds continue to apply in 1988-89.

INDEPENDENT CHANGES	1987-88 Revenue effect £m	1988-89 Revenue effect £m
Rates		
Change basic rate by 1p [1]	1100	1450
Change all higher rates by 1p	65	140
Allowances		
Change single and wife's earned income allowance by £100	295	380
Change married allowance by £100	245	310
Change single age allowance by £100	23	31
Change married age allowance by £100	23	29
Change aged income limit by £200	4	6
Higher Rate Bands		
Change all higher rate thresholds by 1% of basic rate band:		
increase (cost)	22	43
decrease (yield)	23	44
Change all higher rate thresholds by 1%:		
increase (cost)	23	46
decrease (yield)	24	47
Change all higher rate thresholds by 10% of basic rate band:		
increase (cost)	200	390
decrease (yield)	265	495
Change all higher rate thresholds by 10%:		
increase (cost)	210	410
decrease (yield)	270	520

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Costs of tax changes over and above indexation at 1987-88 and 1988-89 income levels

PACKAGES	1987-88 Revenue effect £m	1988-89 Revenue effect £m
1% above indexation on all statutory allowances	175	230
1% above indexation on all statutory allowances and thresholds	200	275
10% above indexation on all statutory allowances	1735	2235
10% above indexation on all statutory allowances and thresholds	1935	2645

GENERAL NOTES: All absolute changes are calculated on top of the indexed levels of allowances and thresholds shown in table 1.1. Percentage changes unless otherwise stated are based on 1986-87 levels. Costs are based on the Autumn Statement NIF. Please refer to Inland Revenue for exact costs of packages and information on taxpayer numbers and staffing effects.

The estimated revenue effects are in most cases shown to the nearest £5 million (to avoid undue magnification of rounding errors when considering large changes), but the figures should not be assumed to be accurate to this degree.

(1) The effect would be smaller if introduced at the same time as an increase in one or more thresholds, but these amounts are broadly correct for rate changes on top of allowance increases up to 5 per cent above indexation. The costs include the effect of the change of receipts of Advance Corporation Tax and on consequent liability of Mainstream Corporation Tax; this effect is £15 million in a full year, £140 million in 1987-88 and £65 million in 1988-89.

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2. CORPORATION TAX

The 1984-85 Finance Act set a rate of 35 per cent for profits arising in the year 1986-87.

Advance corporation tax under the imputation system is due at the rate of 29/71 in respect of distributions made by companies during the year to 31 March 1987.

The estimated yield for 1986-87 is £12400 million (including £600 million on gains and £4100 million ACT).

The effect on corporation tax receipts of a reduction in the rates by 2 per cent to apply to profits arising in the 1986-87 financial year is estimated as:

£ million

	First Year 1987-88	Second year 1988-89
Main corporation tax rate	420	780
Small companies rate	40	80

Most of this change would affect tax payable on 1 January 1988 and paid for the most part in the following two months.

For the effect of a change in the rate of ACT see Section 1 (page 1.4).

The quarterly path of a 2 per cent change in the planned rate of Corporation Tax (including small companies rate)[1] from 1 April 1986 is estimated to be:

£ million

	Q2	Q3	Q4	Q1	Total
1987-88	5	25	110	320	460
1988-89	90	90	170	510	860
1989-90	110	100	180	570	960

A GREENSLADE
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(1) These figures ignore any possible associated change in the imputation system.

3. CAPITAL GAINS TAX

There is a liability to tax, under CGTA 1979 and subsequent Finance Acts, on capital gains realised on the disposal of assets. Tax payable by companies is accounted for within corporation tax. Capital Gains Tax only comprises payments for individuals and trusts.

2. There are various types of exemptions and reliefs from the tax. Examples are:

Exemption of gains arising on the disposal of

- a person's only or main residence;
- gilt edged securities and qualifying corporate bonds;
- National Savings Certificates and such like;
- Chattels which are wasting assets, or whose value is less than £3,000 on disposal;
- life assurance policies.

Exemption of:

- gains accrued but unrealised on death;
- compensation or damages for wrong or injury;
- gains of approved pension schemes, charities, authorised unit trusts and investment trusts, other specified types of organisations.

Reliefs include:

- "rollover" reliefs eg on reorganisation of share capital, where gains are used to replace business assets, for various gifts (including transfers out of trust);
- deduction of up to £100,000 on disposal of a family business on retirement.

Capital losses (including such losses brought forward) can be offset against realised gains. Companies can offset trading losses against capital gains.

3. In calculating chargeable gains, acquisition costs are indexed (using the Retail Prices Index) from March 1982, or from the date of aquisition if later.

4. The rate of tax on net chargeable gains is 30 per cent.

5. For individuals and trusts, tax is calculated on the extent to which the net chargeable gains in any financial year exceed an indexed annual exemption - as follows:

Gains realised in	**Exemption for**	
	Individuals	**Trusts**
1985-86	£5900	£2950
1986-87	£6300	£3150
1987-88 (if fully indexed)	£6600	£3300

6. Estimated yields in 1987-88 are:

	£m
Capital Gains Tax (individuals and trusts)	1150 [1]
Company gains (within corporation tax)	825 [1]

7. For Capital Gains Tax (ie on individuals and trusts) the liability on gains realised during any financial year becomes payable, at the earliest, on 1st December of the following year. For practical reasons, however, assessments in respect of any year are finalised only over several subsequent years so that receipts "for" a particular year are slow (and receipts "in" a year are in respect of gains made in several preceding years).

8. In estimating the "full year" effects of changing CGT rules, the FSBR convention (see FSBR 1981-82, page 9, note 2) is to apply an estimated proportionate cost (derived from estimates of the eventual yield for the first year to which the change applies fully) to the forecast yield in the year in which the Finance Act containing the change is enacted. On this basis, if selected changes were enacted during 1987-88, revenue effects would be:

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[1] Not for publication at this stage.

Change	Estimated "full year" effect			Effect in 1987-88		1988-89
Annual exemption increased to £7,000 (from £6,600)	CGT cost		£20 m	nil		£ 8 m cost
There is no annual exemption for companies						
Rate changed ± 5 per cent (ie to 35 per cent or 25 per cent)	CGT yield	±	£190 m	nil	±	£75 m
	CT yield	±	£140 m	nil	±	£80 m

R V S QUINN
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Ext 6314

4. STAMP DUTIES

Stamp Duty is charged under numerous heads. The most important covers the ad valorem duty on conveyances of real property which is a straight 1 per cent (with low value transfers up to £30,000 subject to a nil rate), and transfers of stocks and shares, where the rate is now ½ per cent.

2. Estimated yield in 1987-88: £1750 million(1). The main components are:

		£m
(a)	Conveyances (1 per cent) of which duty on residential property £590 million	755
(b)	Transfers of stocks and shares (½ per cent)	660
(c)	Leases (various rates)	65
(d)	Companies' Share Capital Duty (1 per cent)	170
(e)	Other	105

3. Because of the effect on demand, doubling the duties itemised in paragraph (2) would in general less than double the yield shown in a full year; similarly halving the rates would not reduce the yield by as much as a half.

The cost of raising by £5,000 the threshold for exemption from duty for small conveyances would be £110 million in a full year. If the new thresholds took effect from March 1987 the cost in 1987-88 would be around £100 million.

4. Any increase in stamp duties on conveyances of property or transfers of shares will lead to some reduction in yield of capital gains tax partly since stamp duties are an allowance expense against capital gains tax but also because of the demand effects.

Note

(1) Not for publication

G A PAPE
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Ext 6236

5. INHERITANCE TAX

Inheritance tax is charged, broadly, on transfers which reduce the value of the transferor's estate. The main occasions of charge are on death, and on events involving trusts and companies. The rate of tax on any transfer depends on the cumulative total of chargeable transfers made within the preceding 7 years. There are two scales of rates - one for transfers on death or within 3 years of death and another for lifetime transfers. The scales of rates applicable to chargeable transfers made on or after 13 March 1985 and those scales adjusted in line with statutory indexation are:

Bands of chargeable value 1985-86 £'000	1986-87 £'000	Indexation at 3½ per cent inflation	Rate on death per cent	Lifetime rate per cent
0 - 67	0 - 71	0 - 74	Nil	Nil
67 - 89	71 - 95	74 - 99	30	15
89 - 122	95 - 129	99 - 134	35	17½
122 - 155	129 - 164	134 - 170	40	20
155 - 194	164 - 206	170 - 213	45	22½
194 - 243	206 - 257	213 - 266	50	25
243 - 299	257 - 317	266 - 328	55	27½
over 299	over 317	over 328	60	30

2. The main exemptions are:

(i) all transfers of property between spouses (unless the recipient is not domiciled in the United Kingdom);

(ii) lifetime gifts made more than seven years before death;

(iii) gifts not exceeding £3,000 in a tax year;

(iv) gifts to any one person in a tax year up to a value of £250;

(v) gifts in consideration of marriage (up to certain limits);

(vi) lifetime gifts for the maintenance of children and dependent relatives;

(vii) gifts and bequests to political parties (up to certain limits);

(viii) gifts and bequests to charities and certain bodies concerned with the national heritage.

3. Relief of 50 per cent is given on business assets except for minority holding unlisted shares and loaned assets for which the relief is 30 per cent. There is also

50 per cent relief on agricultural assets held by working farmers and 30 per cent relief on let agricultural land owned by landlords.

4. Estimated yield in 1987-88 assuming statutory indexation of the scale: £1120 million[(1)]
of which tax on transfers on death: £1090 million [(1)]
The cost of statutory indexation in a full year is: £50 million (£17 million in 1987-88; £35 million in 1988-89).

Note

(1) Not for publication

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6. REVALORISATION

Full year revenue effects and price changes[1]

	VAT inclusive price change (p)	£m yield in[2] 1987-88	1988-89	RPI effect %
Beer				
(1 pint)	0.7	60	60	0.04
Spirit				
(75cl bottle of whisky)	17.7	25	30	0.02
Table Wine				
(EEC table wine) per 70cl bottle)	2.6	15	15	0.02
Fortified Wine				
- (Harvey's Bristol Cream per 70cl bottle)	4.4)			
- (Cockburn's Special Reserve per 70cl bottle)	) 5.1)	5	5	neg
Tobacco - specific duty only				
(20 King sized cigarettes)	3.0	90	95	0.09
Petrol				
(1 gallon of 4-star)	3.3	170	185	0.08
Derv				
(1 gallon)	2.8	45	45	neg(3)
Rebated oil				
(gallon of fuel oil)	0.2[2]	15	15	neg

Notes

(1) Revalorisation of specific duties for 1987-88 in line with assumed 3.25 per cent inflation for December 1986 on December 1985.

(2) Assuming implementation on 1 April 1987

(3) Fuel oil is not liable to VAT.

(4) Derv to be included in the RPI from January.

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Ext 5044

7. TOBACCO DUTY

Tobacco Products duty is paid at the following rates:

	Present rate
Cigars	£47.05) per kg on manufactured weight of tobacco
Hand-rolling tobacco	£49.64)
Pipe tobacco	£24.95)
Cigarettes	Ad valorem tax: 21 per cent of recommended retail price including VAT. Specific tax: £30.61 per 1000

VAT is also paid at 15 per cent (three twenty-thirds of retail pice).

Effective burden

On a packet of 20 king size cigarettes retailing at 150p the total tax burden is: 112.3p

Estimates	£m 1986-87	£m 1987-88	£m 1988-89
Duty (excluding revalorisation)	4650	4745	4865
VAT on tobacco	980	1010	1050

Specimen change

	Full year (including VAT)		
Price Increase	£m 1986-87	£m 1987-88	£m 1988-89
1p on an average packet of cigarettes*	30	30	30

(This increase can be achieved by several combinations of changes in the rates of individual tobacco taxes).

First Year Effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one-twelfth of full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effect of a change on the Retail Price Index

1p on a packet, 0.03 per cent*.

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* These figures assume equivalent increases on other tobacco products.

Business Costs

The incidence of tobacco duty on businesses is negligible.

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8. BEER AND CIDER DUTIES

Present Rates

Beer - the present duty rate for beer is £25.80 per hectolitre plus 86p for each degree of original gravity in excess of 1030^{o} (the average strength of a pint is approximately 1037^{o}).

Cider - £15.80 per hectolitre on cider of a strength of less than 8.5 per cent of alcohol by volume. Cider of a strength of 8.5 per cent or more is chargeable with made-wine duty.

VAT is also paid at 15 per cent (three twenty-thirds of retail price).

Effective Burden

Beer - Duty 18.1p per pint on beer of average strength. On a pint costing 78p, 10.2p of VAT is also paid.

Cider - Duty 9.1p per pint. On a pint costing 83p, 10.8p of VAT is also paid.

Estimates **Beer**	**£m** **1986-87**	**£m** **1987-88**	**£m** **1988-89**
Duty (excluding revalorisation)	2010	2060	2115
VAT on beer	1130	1190	1260

Cider and perry	**£m** **1986-87**	**£m** **1987-88**	**£m** **1988-89**
Duty (excluding revalorisation)	50	50	50
VAT on cider	75	80	85

Price increase		**Full year (including VAT)**	
	£m **1986-87**	**£m** **1987-88**	**£m** **1988-89**
1p on an average pint	85	85	90

First Year effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one-twelfth of full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effect of change on the Retail Price Index

1p on an average pint 0.06 per cent.

Business Costs

2 per cent of total beer duty receipts are assumed to be paid by businesses.

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9. WINE AND MADE WINE DUTIES

Excise duty rates on wine and made-wine -	Present rate Duty per hectolitre
Less than 15 per cent alcohol by volume	£ 98.00
15 per cent and over but not exceeding 18 per cent	£169.00
Exceeding 18 per cent but not exceeding 22 per cent	£194.00

Customs duty is also paid on non-EEC imported wine. VAT is also paid at 15 per cent (three twenty-thirds of retail price).

Effective burden

	Price (p)	Size (cl)	Strength band	Duty (p)	VAT (p)	Total effective burden (p)
EEC Table Wine "Hirondelle"	225	70	less 15%	68.6	29.3	97.9
"Harvey's Bristol Cream"	380	70	15% - 18%	118.3	49.6	167.8
"Cockburn's Special Reserve"	575	70	18% - 22%	136.4	75.0	211.4

Estimates	£m 1986-87	£m 1987-88	£m 1988-89
Duty (including made wine but excluding revalorisation)	700	765	840
VAT on wine	435	490	560

Specimen Change **Price increase**	Full year (including VAT) £m 1986-87	£m 1987-88	£m 1988-89
5p on a bottle (70 cl, NE 15^{o}) and equal percentage changes in the other strength bands, including made-wine	35	35	40

About 60 per cent of the extra revenue would come from light wine (ne 15 per cent) of fresh grape.

First Year effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one twenty-fourth of the full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effect of a change on the Retail Price Index

5p on a 70 cl bottle (NE 15^{o}) and equal percentage changes in the other rates, 0.04 per cent.

Business Costs

8 per cent of wine duty is assumed to be paid by businesses.

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10. SPIRITS DUTY

Present rate

Excise rate on mature and immature spirits is £15.77 per litre of alcohol. VAT is also paid at 15 per cent (three twenty-thirds of retail price).

Effective burden

£4.73 duty on a 75 cl bottle of domestically produced spirits at 70° (equivalent to 40 per cent alcohol by volume). On a bottle costing £7.90 (off-licence), £1.03 of VAT is also paid so that the total burden is £5.76 per bottle.

Estimates	**£m 1986-87**	**£m 1987-88**	**£m 1988-89**
Duty (excluding revalorisation)	1520	1600	1700
VAT on spirits	555	595	650

Specimen changes

Price Increase		**Full year (including VAT)**	
	£m 1986-87	**£m 1987-88**	**£m 1988-89**
30p on a 75 cl, 70° bottle	40	45	45

First Year effect of a change

Close to full year effect multiplied by the fraction of the financial year remaining less one twenty-fourth of the full year effect, but for a detailed estimate reference should be made to HM Customs and Excise.

Effect of a change on the Retail Price Index

30p on a bottle 0.04 per cent.

Business costs

8 per cent of spirits duty is assumed to be paid by businesses.

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11. OIL DUTY

(A) PETROL

Present rate

19.38p per litre. VAT is also paid at 15 per cent (three twenty-thirds of retail price). Petroleum substitutes and LPG are taxed at a related rate.

Effective burden

88.1p per gallon.

On a gallon of four-star petrol costing £1.69, VAT of 22.2p is also paid, and the effective burden for the private motorist is 110p. VAT is reclaimed on business use, which accounts for about a third of petrol consumption.

Estimates	**£m 1986-87**	**£m 1987-88**	**£m 1988-89**
Duty (excluding revalorisation)	5720	6010	6310
VAT on petrol*	950	1015	1085

* Not including VAT reclaimed on business use

Specimen change

Duty increase	**Full year (including VAT)**		
	£m 1986-87	**£m 1987-88**	**£m 1988-89**
2p on a gallon (including VAT)	100	105	110

First Year effect of a change

As for spirits (page 10.1).

Effect of change on the Retail Price Index

2p on a gallon: immediate efect 0.05 per cent.

Business costs

About a third of petrol duty is assumed to be paid by businesses.

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OIL DUTY

(B) DIESEL ENGINED ROAD VEHICLE FUEL (DERV)

Present rate

16.39p per litre. VAT is also paid at 15 per cent (three twenty-thirds of retail price) but this can be reclaimed by registered traders. The use of DERV by private motorists is negligible.

Effective burden

74.5p per gallon (the private motorist pays a further 20p in respect of VAT on a gallon of DERV selling at £1.53 (a VAT exclusive price of £1.33)).

Estimates	**£m 1986-87**	**£m 1987-88**	**£m 1988-89**
Duty (excluding revalorisation)	1430	1500	1580

Specimen change

Duty increase	**Full year (excluding VAT)***		
	£m 1986-87	**£m 1987-88**	**£m 1988-89**
2p on a gallon (including VAT)*	30	30	30

First Year effect of a change

As for spirits (page 10.1).

Effect of change on the Retail Price Index

DERV is to be included in the RPI from January.

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Ext 5044

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* DERV is normally purchased by registered traders who can reclaim any VAT charged as input tax, so the effective price increase to them would be 1.74p.

OIL DUTY

(C) REBATED OILS

Present rate

0.77p per litre. The duty on aviation kerosene and most lubricating oils was abolished in the 1986 Budget. The duty on kerosene used other than as aviation fuel was abolished in the 1984 Budget. All rebated oils are zero-rated except for lubricating oils which are chargeable at the standard rate of VAT.

Effective burden

3.5p on a gallon of fuel oil costing 37p.

Estimates	**£m 1986-87**	**£m 1987-88**	**£m 1988-89**
Duty (excluding revalorisation)	160	170	175

Specimen change

Duty increase	**Full year**		
	£m 1986-87	**£m 1987-88**	**£m 1988-89**
1.0p on a gallon on all rebated oil	45	45	50

First Year effect of a change

As for spirits (page 10.1).

Effect of a change on the Retail Price Index

1p on a gallon of all rebated oil. Immediate effect negligible.

Business costs

Over 90 per cent of rebated oil duty is assumed to be paid by businesses.

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12. BETTING AND GAMING

Present Rates

General Betting Duty	- Off-course	8 per cent on stakes
	- On-course	4 per cent on stakes
Pool Betting Duty		42½ per cent on stakes (33 1/3 per cent for charity pools)

Taxes are also levied on Bingo Halls, Casinos and Amusement Arcades.

Estimates	**£m 1986-87**	**£m 1987-88**	**£m 1988-89**
General Betting duty	335	365	395
Pool Beting Duty	250	270	295
Gaming Duties	195	210	230
All Betting and Gaming	780	845	920

Specimen Changes

An increase in the general betting duty may give a stimulus to the existing incentive for illegal betting posed by the current combined rates of duty and racing levy. It is not known by how much the revenue gain from increasing the rates would be eroded.

First Year effect of a change

This will depend on the date of operation of the change in rate and is complicated by the seasonality of the yield and the payment arrangements. Detailed estimates should be obtained from the Customs and Excise department.

Effect of change on the Retail Price Index

Negligible.

(No betting activity appears directly in the RPI. The effect of changes in pool betting duty on the price of admissions to football matches is expected to be negligible).

MRS L HAMILL
HM Customs and Excise
Ext 5044

13. VALUE ADDED TAX

Present rate

15 per cent

Zero-rated Items

Most foods; water supplies; books, newspapers etc; fuel and power (excluding road fuels); some building work; certain services to overseas traders; most commercial ships and aircraft; passenger transport (except taxis); residential caravans and houseboats; certain supplies of gold; bank notes; drugs and medical supplies on prescription; exported goods; certain supplies by certain charities; young children's clothing and footwear.

Exemptions

Land; insurance; postal services; sweepstakes and lotteries; financial services; most educational services; doctors, dentists and opticians; burial and cremation services; sports competitions.

For more detailed information on the zero-rated and exemption schedules see Customs and Excise Notice No 701. ("VAT Scope and Coverage")

Estimates	**£m 1986-87**	**£m 1987-88**	**£m 1988-89**
1. Full year yields (accruals)	21300	23100	25150
2. Receipts	21300	23100	25050

Specimen change

		Full year effect	
	£m 1986-87	**£m 1987-88**	**£m 1988-89**
% change in rate including compounding on tobacco* +1 per cent (15 per cent to 16 per cent)	955	1040	1135

(exclusive of Central Government and Local Authorities)

First Year effect

This is affected by the pattern of collection. Customs and Excise will provide the estimates for specific times of change.

Effect of a change on the Retail Price Index

± 1 per cent change in rate =±0.5 per cent change in the RPI

Business Costs

VAT on inputs, other than cars and business entertainment, can be reclaimed by registered traders.

MRS L HAMILL
HM Customs and Excise
Ext 5044

* The tobacco products duty on cigarettes has ad valorem and specific elements. The ad valoren duty is levied on the VAT inclusive recommended selling price which will change if the VAT rate is changed.

14. CAR TAX

Present rate

10 per cent on the wholesale price of all new cars and motor cycles.

Effective burden

VAT is also paid at 15 per cent on the retail selling price, so taxes total about 19.7 per cent of the selling price of a new car.

Estimates

	Car tax			VAT on new cars		
	£m 1986-87	£m 1987-88	£m 1988-89	£m 1986-87	£m 1987-88	£m 1988-89
Accruals	1010	1105	1250	1965	2150	2430
Receipts	975	1080	1215	1895	2100	2365

Specimen change

	Full year (including VAT) £m 1986-87	£m 1987-88	£m 1988-89
10 per cent to 12½ per cent	250	275	310

First Year effect

This is affected by the pattern of collection. Customs and Excise will provide estimates for specific times of change.

RPI effect

There is no direct effect on the RPI as the price index for all cars is based on the prices of second-hand cars. A change in car tax would be expected to affect the price of second-hand cares indirectly, however, so that there would be some eventual impact on the RPI.

Business Costs

About two-thirds of car tax duty is assumed to be paid by businesses.

MRS L HAMILL
HM Customs and Excise
Ext 5044

15. REGULATOR POWERS FULL YEAR REVENUE EFFECTS

EXCISE DUTIES

Group[1]		Change in price due to 10% Regulator p	Yield from Regulator 1986-87 £m	Yield from Regulator 1987-88 £m	Yield from Regulator 1988-89 £m	Change in Retail Price Index %
A	Tobacco 150p (20 king size) cigarettes) Full Regulator	13.1	375	385	395	0.40
	10 per cent specific tax regulator only	9.3	265	275	280	0.28
B	Beer 78p (1 pint of beer)	2.1	175	180	185	0.12
	Spirit 775p (bottle of whisky off licence)	54.4	70	75	85	0.08
	Wine 225p (EEC Table wine per 70 cl bottle	7.9)				
	(Harvey's Bristol Cream per bottle) 380p	13.6)	50	55	65	0.06
	(Cockburn's Special Reserve per bottle) 575p	15.7)				
C	Road Fuel (Gallon of 4-star) 169.6p	10.1[2]	495	520	550	0.24
	(Gallon of Derv) 153.3p	7.5[3]	125	130	135	nil
C	Rebated Oil (Gallon of fuel oil) 37p	0.35	15	15	15	neg

NOTES

(1) Under the provisions of the 1982 Finance Act the taxes on each of the items in a group may now be changed by different proportions. The maximum changes are illustrated here.

(2) The business user who deducts VAT will in effect pay only 8.8p.

(3) For the business user; that is, excluding VAT. The private motorist would pay an extra 8.6p.

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VAT[1]

Total Revenue Yield from 25 per cent Regulator, Full Year.

1986-87 £m	1987-88 £m	1988-89 £m	Change in RPI %
3530	3810	4170	1.9

NOTE

(1) The figures quoted are exclusive of Central Government and Local Authorities.

MRS L HAMILL
HM Customs and Excise
Ext 5044

16. MOTOR VEHICLE DUTIES ETC

		UK
		£pa
Present Rates		
Motor Cars and light goods vehicles		100
Illustrative Table		
Goods general taxed according to gross weight and wheel plan		
	Gross Weight (Tonnes)	
Rigid (without trailer):		
2 Axles	13	410
"	16 ½	1,030
Articulated (excluding concessionary rates)		
2 Axled tractive unit with any semi-trailer	16	590
	23	1,000
	32 ½	2,450
	38	3,100
3 axled tractive unit with any semi-trailer	16	440
	23	620
	32½	2,450
	38	2,730

Estimated Yield - United Kingdom 1987-88
(assumed current tax rates)

	UK £m	GB £m	NI £m
By class of vehicle:			
Cycles	20	20	-
Private, Light Goods Vehicles (including cycles)	2069	2020	49
Heavy Goods Vehicles	461	448	13
Tractors & Agricultural etc machines	8	8)	neg
Hackneys	10	10)	neg
Trade Licences	6	6)	neg
Grand Total	**2574**	**2512**	**63**
* Other receipts	13.9		
Driving Licence Receipts	18.8		

Specimen Changes

	£m
For each £5 Private Light Goods Licence	103.5
For 5 per cent change in Goods licence	23.0
For 5 per cent change in Tractors, etc	0.4
For 5 per cent change in Hackneys	0.5
For 5 per cent change in cycles	1.0

* Includes mitigated penalties and fees for retention of cherished registration numbers, duplicate registration documents and duplicate licences.

DVL ACS

18 December 1985

ESTIMATED VED YIELD AND VEHICLE NUMBERS - UK

1. Breakdown by Vehicle Category

		1986-87 Yield £m	Number of Vehicles Licensed September 1986 '000
Schedule 1:	Cycles	21	1223
Schedule 2:	Hackneys	9	127
Schedule 3:	Haulage Machines	2	6
	Agric Machines	6	383
		8	**389**
	HGV (Farmers)	7	28
	Other HGV	448	544
		455	**572**
Schedule 5:	Private/Light Goods	2018	19055
	Light Goods Farmers and Showmen	4	44
		2022	**19099**
	Trade Licences	**4**	**92**
	GRAND TOTAL	**£ 2519**	**21502**

D J HALSTEAD
Dept of Transport
Ext 6414

DVL ACS

18 December 1985

17. NATIONAL INSURANCE CONTRIBUTIONS

There are four classes of NICs:

Class 1 (Employees) - If an employee earns more than the lower earnings limit (£39 per week in 1987-88) they pay primary Class 1 contributions and their employer pays secondary contributions. The rates of contribution in 1987-88 are at the following percentages of gross weekly earnings up to the upper earnings limit (£295 per week in 1987-88):

Not contracted-out

		Paid by employee	Paid by employer	Total
Normal :	Earnings £39 to £64.99	5%	5%	10%
:	Earnings £65 to £99.99	7%	7%	14%
:	Earnings £100 to £149.99	9%	9%	18%
:	Earnings £150 to £295	9%	10.45%	19.45%
Opted out married women		3.85%	As in normal schedule	
Persons over pensionable age		-	As in normal schedule	

For earnings above the upper earnings limit employer's contributions remain at 10.45 per cent of gross weekly earnings. However for employee s there is a maximum contribution of £295 x employee rate (at not contracted-out rates = £295 x 9 per cent = £26.55).

Where the employee is contracted-out the percentage rates are reduced by 2.15 per cent (primary/employee) and 4.1 per cent (secondary/employer) on the slice of earnings between the lower earnings limit and the upper earnings limit.

Class 2 (self-employed) - Flat-rate payment of £3.85 in 1987-88 by all self-employed persons over the age of 16 with earnings above £2,125 per annum.

Class 3 (Voluntary) - Voluntary flat-rate contributions may be paid by persons 16 and over to enable them to qualify for certain benefits. The rate is £3.75 in 1987-88.

Class 4 (Self-employed) - Earnings related contributions for the self-employed. They are paid if earnings are above the lower profits limit of £4,590 (in 1987-88) at the rate of 6.3 per cent of earnings above the LPL. There is no contribution payable on earnings above the upper profits limit of £15,340.

Specimen changes

1. Contribution rates in 1988-89

Yield of an additional 1 per cent on contribution rates:

			GB	UK
Standard rate employees:				
	Weekly earnings:	£ 40 - £ 65	44	45
		£ 65 - £100	79	82
	(UEL £305)	£100+	1561	1594
Reduced rate employees:			56	57
Employers:				
	Weekly earnings:	£ 40 - £ 65	53	54
		£ 65 - £100	91	93
		£100 - £155	295	303
		£155+	1430	1458
Self-employed: (Class 4)			72	73

Yield of an additional £1 on flat-rate contributions

Self-employed:	(Class 2)	109	112
Voluntary:	(Class 3)	7	7

These are contributions due in respect of the tax year+ (full year effect) and exclude Treasury Supplement*.

A 1 per cent increase is assumed for all contributors including those groups (eg HMF) paying at special rates.

2. Earnings ceilings for contributors

The effect on contributions in respect of 1988-89 of abolishing the upper earnings limit for employees (although retaining it for the calculation of contracted-out rebate) and the upper profits limit for the self-employed from their assumed levels of £305 pw and £15860 pa is:

National Insurance Fund

£m

	Employees		Self-employed	
	GB	UK	GB	UK
Excluding Treasury Supplement	945	955	230	235
Including Treasury Supplement	1010	1020	245	250

3. Rate of SSP+

The effect on contributions in respect of 1988-89 of increasing the main rate of SSP by £1, with proportionate change for the other rate, is to reduce contribution income to the National Insurance Fund by £15.8 million (£16.3 million for the UK). This excludes the effect of additional contributions payable by employees and the Treasury Supplement payable thereon; together these would amount to at most £1.4 million (£1.5 million for the UK).

4. Rate of SMP+

The effect on contributions in respect of 1988-89 of increasing the rate of SMP by £1 is to reduce contribution income to the National Insurance Fund by £6.5 million (£6.7 million for the UK). This excludes the effect of additional contributions payable by employees and the Treasury Supplement payable thereon; together these would amount to at most £0.6 million.

Notes

+ Class 1 contributions are collected with PAYE income tax. There is an initial delay of some six weeks before changes in contribution rates are reflected in receipts. There are longer delays in the collection of contributions from the self-employed and voluntary contributions.

* There is an automatic Treasury Supplement of 7 per cent of the total contributions paid to the National Insurance Fund. Contributions used are after adding back estimated contracted-out rebates and SSP and SMP reimbursement to employers but exclude state scheme premiums.

E I BATTERSBY
Government Actuary's Department
Ext 337

18. PROJECTED INCOME OF NATIONAL INSURANCE FUND

GB (£ million)

CONTRIBUTIONS	April 1987 Rates and Limits		New Limits*	
	1987-88		1988-89	
	Receipts	Contributions in respect of tax year	Receipts	Contributions in respect of tax year
Employees	10935	11032	11760	11866
Employers	12680	12785	13751	13892
Self-employed	645	672	696	739
Voluntary	21	21	20	21
Premiums$^{\phi}$	325	325	346	346
Total	24606	24835	26573	26864
SSP and SMP	888	916	989	996
Net Total	23718	23919	25584	25868
Treasury Supplement^{+} Fund	2032	2051	2160	2179
Total NI Fund	25750	25970	27744	28047

(1) the figures shown in the table are on the basis of average numbers of employees in employment (including members of HMF) and the average earnings summarised below:

	Average gross earnings of employees in employment (£pa)	GB Employees in employment (000s)
1985-86	7937	21334
1986-87	8532	21410
1987-88	9087	21680
1988-89	9587	21734

It is the movement of these quantities since 1985-86 which is important rather than their absolute magnitudes, since our estimates are normalised on the actual 1985-86 contributions. Class 1 contributions are very nearly proportionate to the number of employees.

(2) The effect on contributions in respect of the tax years shown of average earnings 1 per cent higher or lower than has been assumed, with no effect on numbers, is:

	£m 1987-88
National Insurance Fund	
Excluding Treasury Supplement	245
Including Treasury Supplement	265

Because Class 4 contributions in respect of a tax year depend on earnings in a previous period it is assumed that self-employed contributions are unaffected except for those who have earnings from employment and are affected by the upper limit on contribution liability.

(3) The effect on contributions in respect of the tax year shown of $\pm$ 100,000 unemployed in GB, excluding school leavers and students, which would effect the number of employees in employment, is:

	£m 1987-88
National Insurance Fund	
Excluding Treasury Supplement	140
Including Treasury Supplement	150

Notes to the tables

* From April 1988 Class 1 lower and upper earnings limits are assumed to rise to £40 and £305 pw from their 1987-88 values of £39 and £295 pw. The earnings limits which determine the bands on which lower rates are paid are assumed to rise from £65, £100 and £150 pw to £65, £100 and £155 pw. Class 1 contribution rates are assumed to remain unchanged.

Where the employee is contracted out, the percentage rates of contributions in 1988-89 are assumed to be reduced by 1.85 per cent (primary/empoyee) and 3.55 per cent (secondary/employer) on the slice of earnings between the lower earnings limit and the upper earnings limit.

Classes 2 and 3 contributions are assumed to rise to £3.99 and £3.89pw respectively with the range for Class 4 contributions changing from £4590/£15340 to £4762/£15860 pa. The Class 4 rate is assumed to remain unchanged.

The standard rate of SSP is assumed to increase to £48.95 pw with a proportionate increase for the lower rate. The rate of SMP is assumed to increase to £34.10 pw.

\+ 7 per cent of contributions excluding state scheme premiums but before deducting contracting-out rebates.

ø for premiums the convention is adopted that contributions in respect of a tax year are the same as the receipt in the same period.

E I BATTERSBY
Government Actuary's Department
Ext 337

19. NATIONAL INSURANCE BENEFITS

Announced rates of benefit (from 6 April 1987)

1. National insurance flat rate retirement pension:

	£
single	39.50
married	63.25

Pensioners over 80 receive an extra 25p age addition

Pension is increased for each dependent child by:	8.05

A person who does not retire on reaching pensionable age becomes eligible for increased pension when they do retire. No further increase can accrue after the age of 70 (men) or 65 (women).

Since April 1979 pensions have been in two parts. As well as the flat-rate pension there is an earnings-related additional component (AC) based on contributions on earnings above the basic level in the relevant years. (Widows benefit and invalidity pension similarly attract an additional component).

2.	Widow's allowances	55.35
	Widowed mother's allowance	39.50
	Widow's pension (50+)	39.50
	Invalidity pension: single	39.50
	Dependency increase for wife of invalidity pensioner:	23.75
	Dependency increases for children:	8.05

Invalidity allowance is payable if age of onset of illness is less than 60 (55 for women). The rate of invalidity allowance depends on the age of onset of illness.

3.	Sickness, and maternity benefit: single	30.05
	Dependency increases for wife:	18.60

4.	Unemployment benefit: single	31.45
	Dependency increase for wife:	19.40

Earnings related supplement was abolished in January 1982

COST IN 1988-89 OF A 1 PER CENT UPRATING IN APRIL 1988

GREAT BRITAIN **£ MILLION**

Benefits uprated	NI Fund	Non means tested Non NI fund benefits	Supplementary Benefit	Housing Benefit (Rents only)	Net Cost
Retirement pensions only	180		-40	-13	127
Retirement pensions, supplementary pension and housing benefit for pensioners	180		5	negligible	185
Long term benefits +(1)	220	17	32	-14	255
Short term benefits +(2)	18	6	52	-1	75
Additional component (3)	6.4				6.4
All benefits except child benefit, FIS, supplementary benefit and housing benefit	241	28	-52	-14	203
All benefits except child benefit and FIS	241	28	78	7	354

Effect of a £1 increase in Child Benefit and One Parent Benefit in April 1988

GREAT BRITAIN **£ MILLION**

		1988-89	1989-90
Cost	Child Benefit	615	635
	One parent benefit	35	35
Savings	Child Dependency Additions		
	- retirement pension only	2	2
	- long term benefits - NI fund (1)	20	20
	Non-fund	0.5	0.5
	Supplementary Benefits	140	150

\+ Excludes housing benefit

(1) Comprising: NI Fund: (RP (excluding AC), WB (excluding AC), IVB (excluding AC), Dis Ben, IDB,II old cases.
Non means tested, non NI Fund benefits: NCRP, AA, ICA, SDA, War Pensions Supplementary benefit: Supplementary pensions and long term allowances

(2) Comprising: NI Fund: UB, SB, MA
Non means tested, non NI Fund: Mob A
Supplementary benefit: Supplementary allowance - basic scale

(3) AC payable with RP IVB and WB

Effect of change in the number of wholly unemployed (GB)

£ million

	April 1987 rates		April 1988 rates 3¾ per cent uprating
	1987-88	**1988-89**	**1988-89**
± 100,000 in 1987-88 and 1988-89			
Supplementary benefit/housing benefit	120	155	160
Unemployment benefit	95	65	70
± 100,000 in 1988-89 only			
Supplementary benefit/housing benefit		120	125
Unemployment benefit		95	100

P H HAMSHARE
DHSS
Ext 4202 (Friars House: GTN 2916)

SECRET

SCHOLAR To CH/EX 9/1

FROM: M C SCHOLAR
DATE: 9 JANUARY 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Geoffrey Littler
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Miss Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Mr Battishill - IR
Sir A Fraser - C&E

CHEVENING 1987: TAX ISSUES

You had a number of questions on the paper attached to my minute of 19 December (set out in Mr Kuczys' minute to me of 2 January).

2. (i) You asked whether an increase in the mortgage interest relief ceiling could be confined to the basic rate for existing loans. The Revenue think that in principle it could be so confined and will minute separately when they have thought through the implications.

(ii) The yield estimates given in paragraph 20 for the credit card and consumer credit taxes were not on the 15 per cent on interest basis. You will by now have seen Mr Knox's minute of 8 January, which shows a gross revenue yield on this basis of around £90m in 1987-88 (assuming card tax only implemented on 1 May) building up to a maximum full year gross yield for an across-the-board tax of some £6 billion.

(iii) The range of costs shown in Annex 2B for free-standing AVCs was £75-100m. This was based on an illustrative assumption of a 500,000 take-up. If, allowing instead for some build-up over time, we assumed take-up in 1988-89 of up to 250,000, the estimated cost would become up to £50m in that year. You also asked what the savings might be from tightening-up measures in this field. The Revenue's conjecture, if a range of measures were in effect in 1988-89, is that the savings involved might be of the order of £10m or so.

(iv) The figure for "families" in Table 1 of Annex 3 are figures for "tax units" (this is explained in the text of the annex but not, unfortunately, in the table itself): so they cover single people and pensioners as well as families in the normal sense of the word. I attach a table with figures for single persons. The 'average' column is no more than the average gain across all income bands in the previous columns. It shows how the gains at different income levels compare with the average (and permits a rough and ready comparison with the analysis by different family compositions in Table 2 of Annex 3). The average figures for one-earner couples with children are higher than those for all tax units because the latter include low average gains for eg pensioners and lone parents. "Annual gross income" in this table (and in the National Accounts) means income including benefits but before income tax and NICs.

(v) I am afraid that there have been revisions to some of the numbers in our tax issues paper. I attach a revised version of several pages of the paper and of Annex 2.

3. I would be grateful if (private) secretaries would transcribe these changes onto the texts you have read: I apologise for this.

MCS

M C SCHOLAR

CONFIDENTIAL

prof

RECORD OF DISCUSSIONS ON OVERSEAS MATTERS AT CHEVENING ON SUNDAY, 11 JANUARY

The Chancellor noted he would have to go to Brussels that afternoon for a Ministerial meeting on the EMS realignment. The details of the precise exchange rate changes in prospect were not of great importance to the UK: they involved at most 1 per cent movements in the minor currencies. But it was possible the French would use the opportunity to try to launch a new accord on intervention to support the dollar; a strong deutschmark and weak dollar almost inevitably brought pressure on the French franc within the EMS. The Germans would not be keen on massive intervention in which they would inevitably have to take the lead, but on the other hand would not want to see the dollar falling all that much further. The Chancellor asked for views on where our interests lay.

2. Sir T Burns said that he could not see it as in our interests to encourage a new initiative on intervention. He thought the problem was differences of policy stance. It would help us more if the Germans cut interest rates or else expanded their fiscal policy. The main pressure towards this came from the strength of the deutschmark and the weakness of the dollar, and so we should not take steps to get them off that particular hook. Sir P Middleton agreed, and commented that it was important to try to get the Americans to focus on problems with Japan as well as on problems with Europe. It was a disturbing development that the US seemed to regard its bilateral problems with Japan as solved, and to be concentrating on problems with Europe, on monetary, fiscal and trade policy. These views were widely shared by others present.

3. On another point, the Chancellor asked what work was in hand on allocating or reducing the world current account deficit (the 'global deficit'). Sir T Burns said that he had been pursuing this

in conjunction with the CSO; but he agreed that an approach via the IMF might carry greater weight. If we took action on our own it might be seen as fiddling the figures, but if the IMF did something for all countries, there could be genuine presentational gains. The Chancellor asked that work on this should be accorded a high priority.

ACSA

A C S ALLAN

Distribution

PS/EST
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Lavelle
Mr J P Evans
Mr Peretz
Mr Sedgwick
Mr Bottrill
Mr C W Kelly
Mr Ross Goobey

RA3.12

pwp

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

13 January 1987

Captain J D W Husband OBE RN
Chevening House
Sevenoaks
Kent
TN14 6HG

Dear Captain Husband

I am writing on behalf of my wife and myself, and all who took part in the Treasury seminar at Chevening last weekend, to thank you for co-ordinating the arrangements made for us. I was sorry I had to dash away to Brussels before lunch on Sunday, but despite that we managed to get through all we had planned. As usual, everything ran very smoothly.

I should be grateful if you could pass on my thanks to all who contributed to making the seminar a success.

Yours ever

Nigel

NIGEL LAWSON

RA3.12

please type for Ch's signature

~~DRAFT~~ LETTER FROM CHANCELLOR TO

Captain J D W Husband OBE ~~RN~~
Chevening House
Sevenoaks
Kent
TN14 6HG

+ Brussels before lunch

Stet

I am writing on behalf of ~~my wife~~ and myself, and all who took part in the Treasury seminar at Chevening last weekend, to thank you for co-ordinating the arrangements made for us. I was sorry I had to dash away ~~early~~ on Sunday, but despite that we managed to get through all we had planned. As usual, everything ran very smoothly.

I should be grateful if you could pass on my thanks to all who contributed to making the seminar a success.

NIGEL LAWSON

~~OK w~~

5.5

cc Eliz — NBX
Sir P. Middleton

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

includes you, I take it!
D 28/1

21 January 1985

1986 letter elusive

Major General J D C Graham CB CBE
Chevening House
SEVENOAKS
Kent
TN14 6HG

1985

Dear General Graham

Once again I write on behalf of my wife and myself, and all who took part in the Treasury seminar at Chevening, to thank you for co-ordinating the arrangements made for us. I am happy to say that despite the weather everything ran very smoothly!

X I should be grateful if you could pass on my thanks to all who contributed to making the seminar a success.

Yours sincerely
Nigel Lawson

NIGEL LAWSON

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