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PO -CH /NL/0365

PART B

1988 BUDGET FINANCIAL SECTOR BORROWING REQUIREMENTS

DD's 25 years NA&S 30/11/95.

PO -CH /NL/0365

PART B

7.3.88

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BUDGET

FROM: A C S ALLAN
DATE: 26 February 1988

MR MOWL

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Miss C Evans

FSBR CHAPTER 6

The Chancellor was grateful for your minute of 24 February and the draft of Chapter 6. I attach a marked-up copy of the pages on which he had comments.

The other points he made were:

i. He could not reconcile the last sentence of your paragraph 6 (saying that the forecast for 1988/89 has non oil taxes and NTCs adjusted for Budget change increasing by 2½ points more than non-oil GDP) with the figures in the table in your paragraph 5. The figures there seem to be 2.9% <u>before</u> Budget changes, and 0.4% after Budget changes.

ii. He would wish if at all possible to publish a figure for the non-North Sea tax burden in 1988-89 identical to that in 1987-88. This would mean shading the present provisional forecast for 1988-89 down from 37.6 to 37.5; at the same time it would be helpful to shade down the forecast of the total tax burden in 1988-89 from 37.8 to 37.7, the same as in 1987-88. Alternatively, but no doubt more problematic, would be to shade up the 1987-88 estimates.

iii. He was grateful for the charts on the tax burden and ratio of GGE to money GDP; he prefers the version starting in 1978-79.

iv. He agrees with your proposed change to the sign convention in table 6.7. But he felt some explanation was

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needed of the convention that a financial surplus is shown as negative and a financial deficit as positive, which is counter-intuitive.

v. He did not feel he wanted to carry through to the FSBR the term 'public sector net debt repayment' (PSDR).

vi. On chart 6.2, why does the proportion of expenditure on debt interest not come down between 1978/79 and 1988-89 (it is shown as 10% in both years)? He also wonders whether the figures for health (growing from 10% to 11%) may not cause confusion, since we have used figures on a different basis (ie as proportions of departmental spending) quite widely in other contexts - eg chart 1.10 of the PEWP.

ACSA

A C S ALLAN

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The scope of this chapter

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

Table 6.1 Public expenditure, receipts and borrowing

	£ billion			
	1986-87	1987-88		1988-89
	Outturn	1987 Budget	Latest estimate	Forecast
General government expenditure	164.8	173.5	171.6	182.8
General government receipts	160.0	168.8	173.5	184.7
General government borrowing requirement	4.9	4.7	- 2.0	- 1.9
Public corporations' market and overseas borrowing	- 1.5	- 0.8	- 0.9	- 1.2
Public sector borrowing requirement	**3.4**	**3.9**	**- 2.9**	**- 3.1**

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

Public sector's finances: three-fold analysis

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

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Public sector's finances: analysis by type or activity

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

Receipts

6.05 General government receipts in 1987-88 are now projected to exceed the 1987 Budget forecast by about £4¾ billion. As Table 1.2 shows, most components of general government receipts are likely to be higher than originally forecast. The main contributors to the extra receipts are income tax (£1 billion), VAT (£1 billion), ~~and~~ North Sea Revenues (£¾ billion), and corporation tax (£3/4 billion).

6.06 Additional income tax receipts are mainly the result of the stronger growth of the economy & higher incomes. ~~higher aggregate wages and salaries~~. VAT receipts have increased by more in 1987-88 than would have been expected from the recorded ~~currently estimated~~ increase in total consumer spending: this implies either that the proportion of total spending which goes on goods and services subject to VAT has increased, or that estimates of consumer spending in 1987 may ~~will~~ be revised up later. ~~as happened last year.~~ The higher than expected oil revenues in 1987-88 are largely the result of a higher dollar oil price than assumed last year. ~~dollar oil price. Although non-North Sea corporation tax receipts are estimated to be higher than in the 1987 Budget forecast, they are lower than forecast in the 1987 Autumn Statement.~~

6.07 General government receipts are forecast to rise by 6½ per cent in 1988-89, following an estimated 8½ per cent increase in 1987-88. This is a little less than the rate of growth

forecast for money GDP. Without the Budget measures however forecast growth in receipts would be about 1½ percentage points above that of money GDP.

6.08 Oil revenues, which in the event in 1987-88 were only slightly below the 1986-87 level, are forecast to fall by about £1 billion in 1988-89 ~~due to~~ as a result of both a lower average oil price and lower production. The forecast assumes that ~~sterling and~~ oil prices [remain close to recent levels.] Oil production is assumed to fall in 1988 to a level close to the centre of the Department of Energy's range. A $1 a barrel difference in the oil price in 1988 would change revenues by about £250 million in 1988-89 and £300 million in a full year. A change of 1 million tonnes in oil production in 1988, spread evenly across fields, would alter revenues by about £40 million in 1988-89 and £45 million in a full year.

(to be discussed)

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

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

a further rise of [ ] per cent in receipts of corporation tax (including ACT but excluding North Sea mainstream corporation tax). ~~[The 1988-89 increase reflects a provisional estimate of a 25 per cent increase in profits in 1987.]~~

This reflects continued growth in company profits in 1987.

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

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

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

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

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

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

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88 Latest estimate	1988-89 Forecast
Total taxes and NICs as a share of total money GDP	38.9	38.5	39.1	38.5	37.8	37.7	37.8
Non-oil taxes and NICs as a share of non-oil money GDP	38.2	37.8	37.8	37.0	37.3	37.5	37.6

Expenditure

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

6.12 General government expenditure is expected to rise by 6¾ per cent in 1988-89, to £183 billion. The planning total, at £156.8 billion, is ~~the same~~ as published in The public expenditure

White Paper (Cm 288). General government gross debt interest payments in 1988-89 are now forecast to be lower than projected in the White Paper as a result of the marked reduction in the PSBR. ~~lower borrowing and to be at much the same level as expected for 1987-88.~~

Borrowing

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

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

6.15 A ~~PSDR~~ further budget surplus of £3 billion, or ¾ per cent of ~~money~~ GDP, is ~~also~~ forecast for 1988-89.

Trends in receipts and expenditure

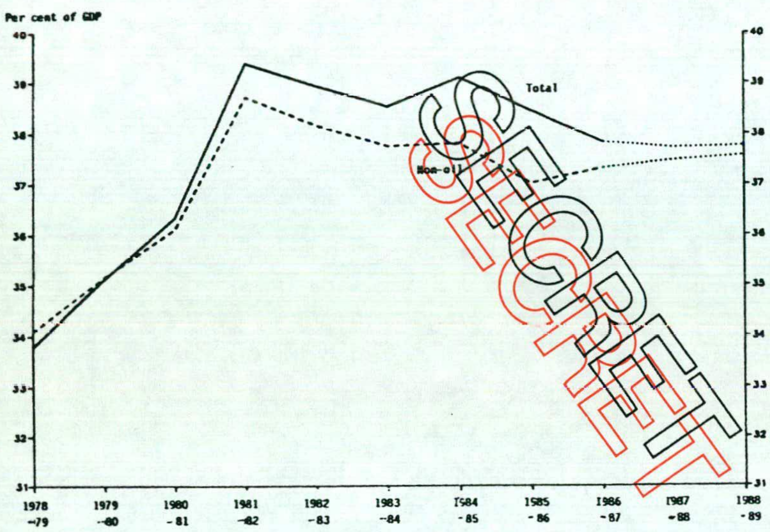
6.16 Chart 6.1 shows trends in taxes and expenditure as percentages of ~~money~~ GDP. ~~The percentage for~~ Revenues from non-oil taxes and national insurance contributions fell as a percentage of non-oil GDP between 1981-82 and 1985-86, but since then it has been rising. ~~rose slightly in 1986-87 and again in 1987-88.~~

to be further discussed — [It is forecast to rise marginally in 1988-89.] ~~to a level below~~

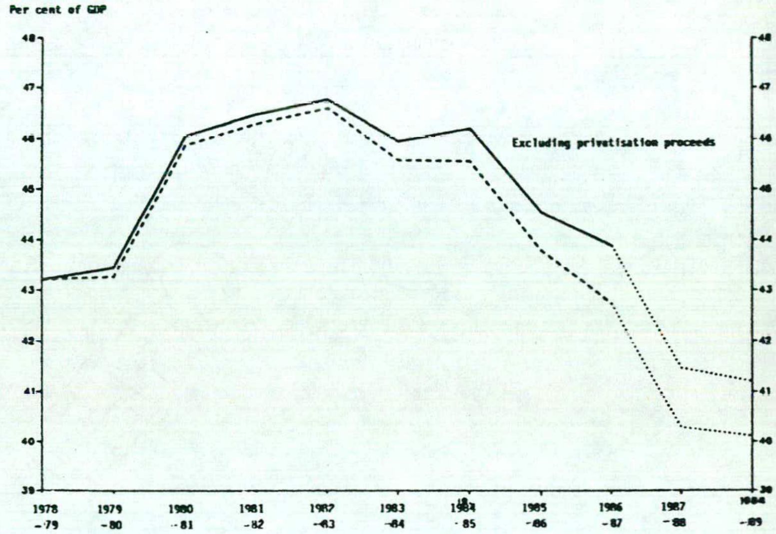
~~its~~ The ratio of general government expenditure (excluding privatisation proceeds) to GDP has fallen ~~every year but one~~ every year since 1982-83 ~~and~~ except for a small rise in 1984-85 as a result of the miners' strike; it is forecast to fall again in 1988-89.

Chart 6.1 Taxes and expenditure ~~relative to~~ as a percentage of GDP

Taxes and national insurance contributions



General government expenditure



6.17 Chart 6.2 shows the significant changes in the structure of general government receipts and expenditure which have taken place since 1978-79.

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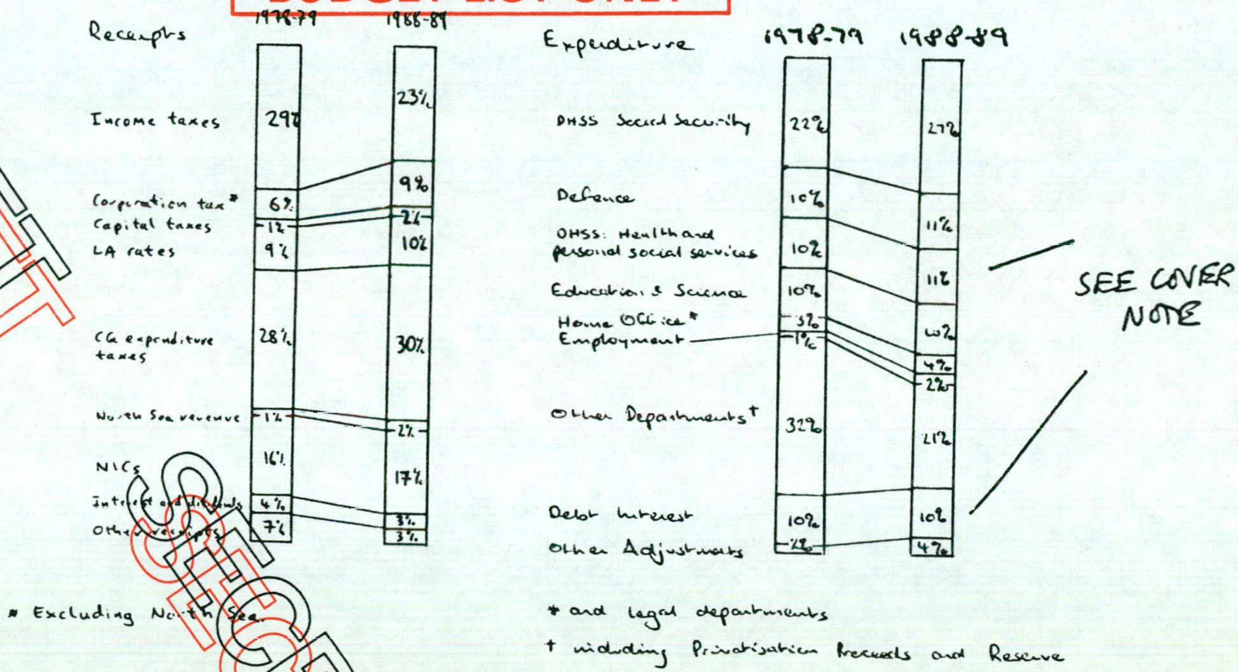
Chart 6.2 The structure of receipts and expenditure



Public sector's finances: analysis by sector

6.18 Table 6.3 shows ~~which authorities or sectors are repaying debt or undertaking~~ net borrowing in 1986-87 and 1987-88, by central government, local authorities and public corporations.

Table 6.3 Public sector borrowing requirement

	£ billion 1986-87 Outturn		1987-88 Latest estimate	
1 **Central government borrowing on own account**	4.5		- 2.8	
2 Local authority borrowing from central government		5.9		5.2
3 Local authority borrowing from market and overseas		- 5.6		- 4.0
4 **Total local authority borrowing**	0.2		1.1	
5 Public corporations' borrowing from central government		0.1		- 0.3
6 Public corporations' borrowing from market and overseas		- 1.5		- 0.9
7 **Total public corporations' borrowing**	- 1.4		- 1.2	
8 **Public sector borrowing requirement**	3.4		- 2.9	
Memorandum item:- Central government borrowing requirement (lines 1+2+5)	10.5		2.1	

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6.19 Tables 6.4 to 6.6 show estimated outturns and forecasts of receipts and expenditure in 1987-88 and 1988-89 for each of the three sectors. These tables include some of the analysis by economic category in Table 6.7. Expenditure in 1988-89 does not include an allocation of the Reserve, although the forecast of the PSBR assumes that the Reserve is fully spent.

Central government

6.20 Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Tables 6.5 and 6.6.

Table 6.4 Central government transactions

	£ billion		
	1986-87 Outturn	**1987-88 Latest estimate**	**1988-89 Forecast**
Receipts			
Tax and royalties	104.4	115.2	121.7
National insurance and other contributions	26.7	28.8	31.6
Other	10.4	11.2	11.3
Total receipts	**141.4**	**155.2**	**164.5**
Expenditure			
Current expenditure on goods and services	49.4	53.0	55.7
Current grants and subsidies	77.3	80.7	82.8
Interest	16.5	16.9	17.4
✓ Net lending,[1] capital expenditure, and cash expenditure on company securities	2.7	1.8	2.6
✓ **Total expenditure**	**146.0**	**152.5**	**158.4**[2]

✓ [1] Excluding lending to local authorities and public corporations
✓ [2] Excluding any allocation from the Reserve

[for consistency]

Local authorities

6.21 Local authority receipts consist primarily of rate income plus grants from central government. The forecast increase in rate income (net of rate rebates) between 1987-88 and 1988-89

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takes account of available information about rate decisions by local authorities, additions to rateable value, and changes to the system of rate rebates introduced by the Social Security Act 1986.

6.22 The local authority borrowing requirement (LABR) fell sharply in 1986-87 to £¾ billion, from £1¾ billion in 1985-86. The LABR in the first ten months of 1987-88 was higher than in the same period of 1986-87 and it seems likely that borrowing in the year as a whole will be above that in 1986-87, although still well below the levels of ~~the~~ earlier years, ~~immediately prior to that~~. The estimates of local authority receipts and expenditure do not fully explain the LABR in 1986-87 and 1987-88 (other receipts in table 6.5 and miscellaneous financial transactions in table 6.7 include a balancing item).

Table 6.5 Local authority transactions

	£ billion		
	1986-87 Outturn	1987-88 Latest estimate	1988-89 Forecast
Receipts			
Rates (net of rate rebates)[1]	15.6	17.0	19.2
Rate support grant	11.8	12.6	13.3
Other grants from central government	11.0	12.1	12.2
Other	6.3	5.2	5.6
Total receipts	**44.7**	**46.9**	**50.4**
Expenditure			
Current expenditure on goods and services	31.1	34.1	35.2
Current grants and subsidies	5.4	5.8	6.0
Interest	4.1	4.4	4.5
Net lending and capital expenditure	4.2	3.8	4.4
Total expenditure	**44.8**	**48.1**	**50.1[2]**
1 Memo: Rate rebates	1.7	1.8	1.4

2 Excluding any allocation from the Reserve

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Public corporations

6.23 Table 6.6 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations) their net external finance, ie. their borrowing plus subsidies and grants, is included in the public expenditure planning total. Public corporations' net external financing requirement, and not their borrowing requirement (PCBR), is the best measure of the public corporations' total contribution to the PSBR, because it ~~also~~ includes, in addition ~~as well as~~ borrowing, subsidies and grants provided by the central government which have to be financed from taxation or central government borrowing.

Table 6.6 Public corporations' transactions

	£ billion		
	1986-87 Outturn	1987-88 Latest estimate	1988-89 Forecast
Receipts			
Gross trading surplus (including subsidies)	7.4	7.0	7.4
Other	2.9	2.1	2.2
Total receipts	**10.3**	**9.1**	**9.6**
Expenditure			
Interest, dividends and taxes on income	3.3	3.1	3.8
Net lending and capital expenditure	5.5	4.7	5.7
Total expenditure	**8.8**	**7.9**	**9.5**[1]
Memo: nationalised industries' external finance	0.4	0.4	0.7
other public corporations' contribution to the planning total	0.8	0.6	0.8

1 Excluding any allocation from the Reserve

6.24 Changes in public corporations' income and expenditure from one year to another are affected by privatisations which

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COPY NO 15 OF 22

FROM: A C S ALLAN
DATE: 29 February 1988

MR S J DAVIES

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

FSBR CHAPTER TWO: MTFS TEXT AND FISCAL PROJECTIONS

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

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

ACSA

A C S ALLAN

PPS oops

I ought to point out that I am not on the Task Force List.

JWG

1.3.88

1/58

REDRAFTS OF 2.19 AND 2.23

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

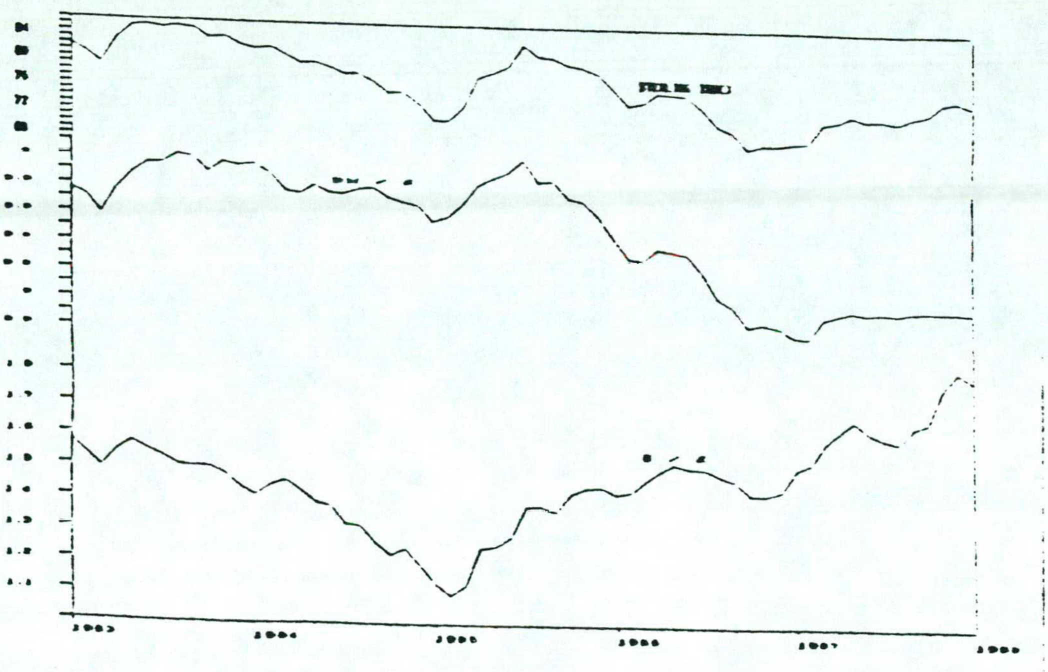
2.23 The strength of the economy coupled with fiscal prudence has enabled the Government to achieve a balanced budget on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress towards lower inflation,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

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

Monetary Policy

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

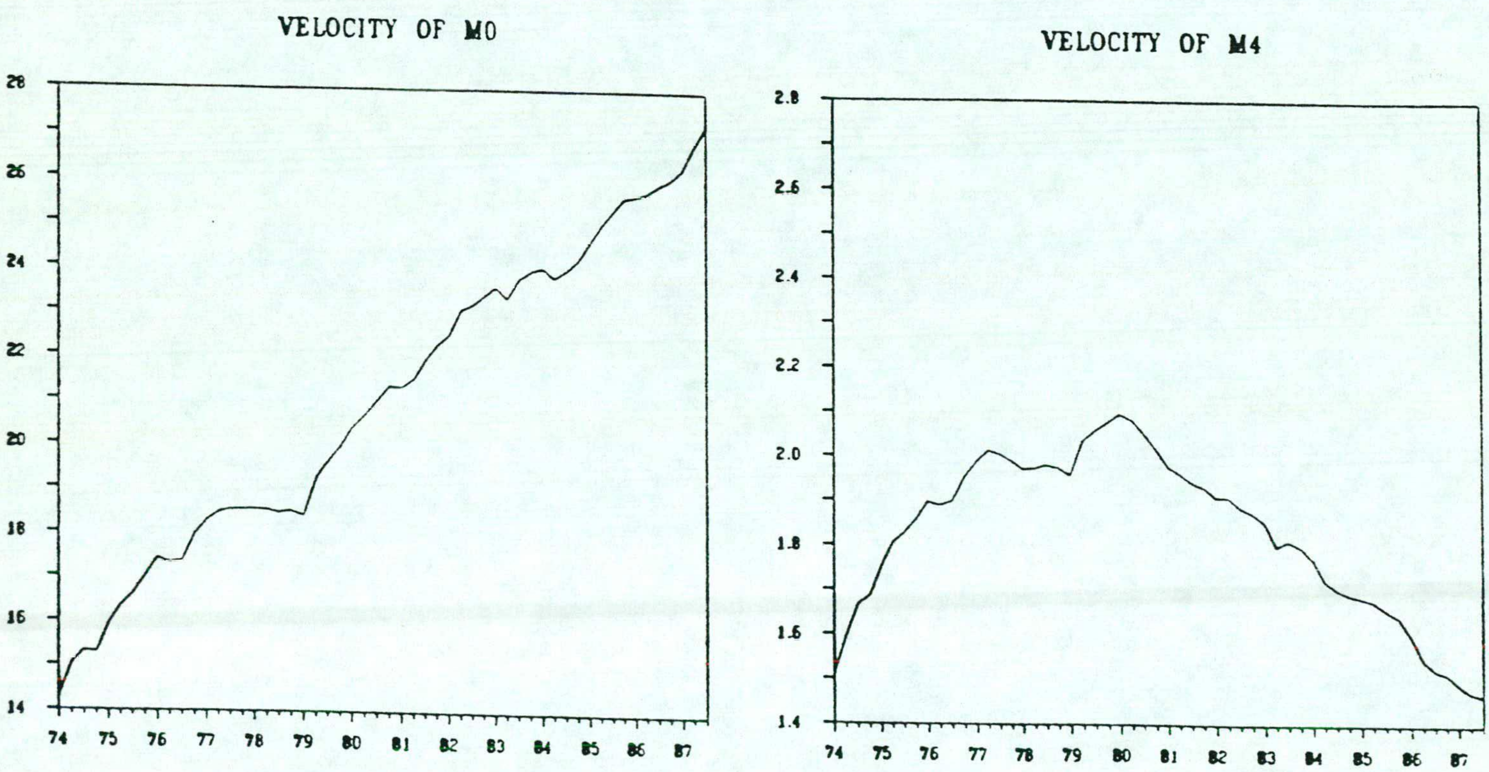
Chart 2.2 Sterling exchange rates



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

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

Chart 2.3 Velocity of monetary aggregates



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

Table 2.2: Growth of M0*

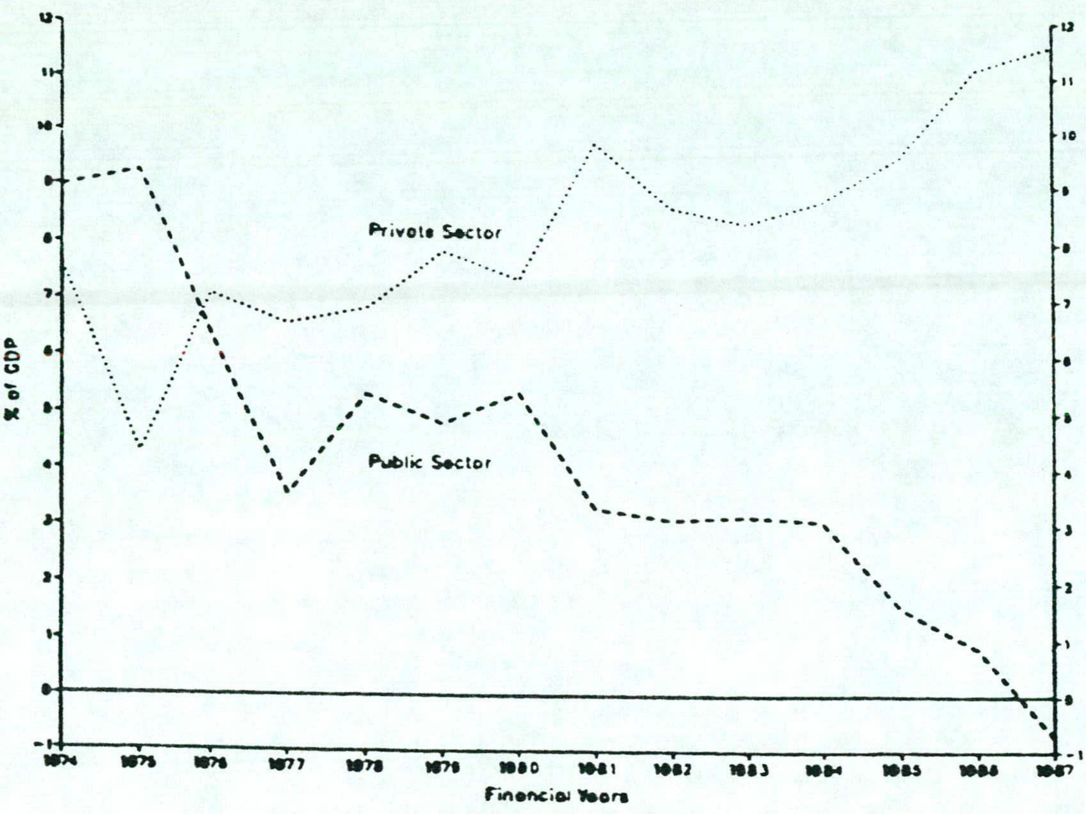
1987-88	1988-89	1989-90	1990-91	1991-92
5	[1-5]	1-5	0-4	0-4

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

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

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

Chart 2.4 Private and public sector borrowing

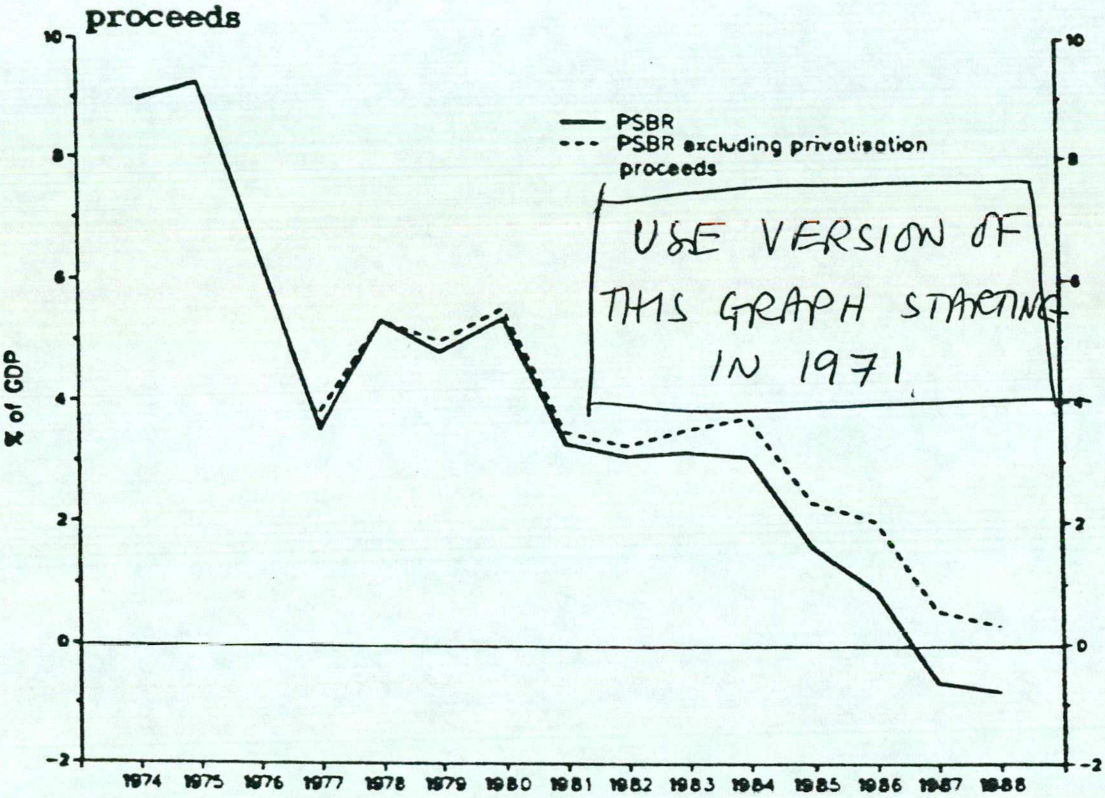


Fiscal policy

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

Even if there had been no privatisation proceeds at all, the PSBR would have been under

Chart 2.5 Public sector borrowing requirement and privatisation proceeds



X

Version A of paragraphs 2.15 and 2.16

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

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

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

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

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

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

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

Assumptions

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

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

Table 2.3 Output and inflation assumptions

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

Public expenditure

SEE REDRAFT ATTACHED

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

Table 2.4 General government expenditure

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

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

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

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

Revenue

X

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

Table 2.5 General government receipts

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

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

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

Conclusion

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

SEE RE-DRAFT

ph85

SECRET AND PERSONAL

FROM: A C S ALLAN
DATE: 29 FEBRUARY 1988

MR BOTTRILL

cc Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Sedgwick
Miss C Evans
Mr Hudson
Mr Owen

FSBR: CURRENT BALANCE OF PAYMENTS FORECAST

The Chancellor was most grateful for your minute of 26 February. He will want to consider the issues further befor taking a final decision on the FSBR forecast for the current account.

2. He notes that the new estimate for invisibles in 1987 is precisely what was forecast in last year's FSBR, and that the improvement in the current account to -£1 billion (cf our FSBR forecast of -£2½ billion) is entirely due to improved visible trade, and exports in particular.

3. He also noted that the roundings in our table 2 made the trends difficult to follow. For example, the balances on each of services, IPD and transfers are the same in 1987 and 1988, yet the total improves by £1 billion.

ACSA

A C S ALLAN

RA7.62

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REF NO ACSA/21

COPY NO 16 OF 17

FROM: A C S ALLAN

DATE: 29 February 1988

MR ODLING-SMEE

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

FSBR CHAPTER ONE

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

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

ACSA

A C S ALLAN

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RE-DRAFT OF TABLE 1.1

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

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BUDGET SECRET

B.L.O. SECRET

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1. THE BUDGET

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

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

The Medium Term Financial Strategy

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

The economy

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

Tax measures

and the introduction in 1990-91 of

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

Other measures include reforms of capital gains tax, inheritance tax and the tax treatment of maintenance & covenants.

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, ~~Public expenditure is planned over the medium term to grow less rapidly than the economy as a whole, permitting some further reduction in the burden of taxation.~~

as set out in the public expenditure White Paper. This Chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1987-88.

Public sector finances

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

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REF NO ACSA/21

COPY NO 17 OF 17

FROM: A C S ALLAN
DATE: 29 February 1988

MR ODLING-SMEE

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

FSBR CHAPTER ONE

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ACSA

A C S ALLAN

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RE-DRAFT OF TABLE 1.1

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covenants & maintenance (3)	-
Independent taxation	*
Capital gains tax	
rebasing	-
rates	+ 70
Inheritance tax	- 110
Corporation tax	
capital gains	- 25
small companies rate	*
Excise duties	
oils	+ a
VED	+ b
tobacco	+ c
alcohol	+ d
Other tax changes (3)	+75
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BUDGET

1. THE BUDGET

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SECRET

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B.L.O.

The economy

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

SECRET

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Tax measures

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

Public expenditure

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

Public sector finances

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

FROM: A C S ALLAN
DATE: 29 February 1988

MR S J DAVIES

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

FSBR CHAPTER TWO: MTFS TEXT AND FISCAL PROJECTIONS

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

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

ACSA

A C S ALLAN

REDRAFTS OF 2.19 AND 2.23

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

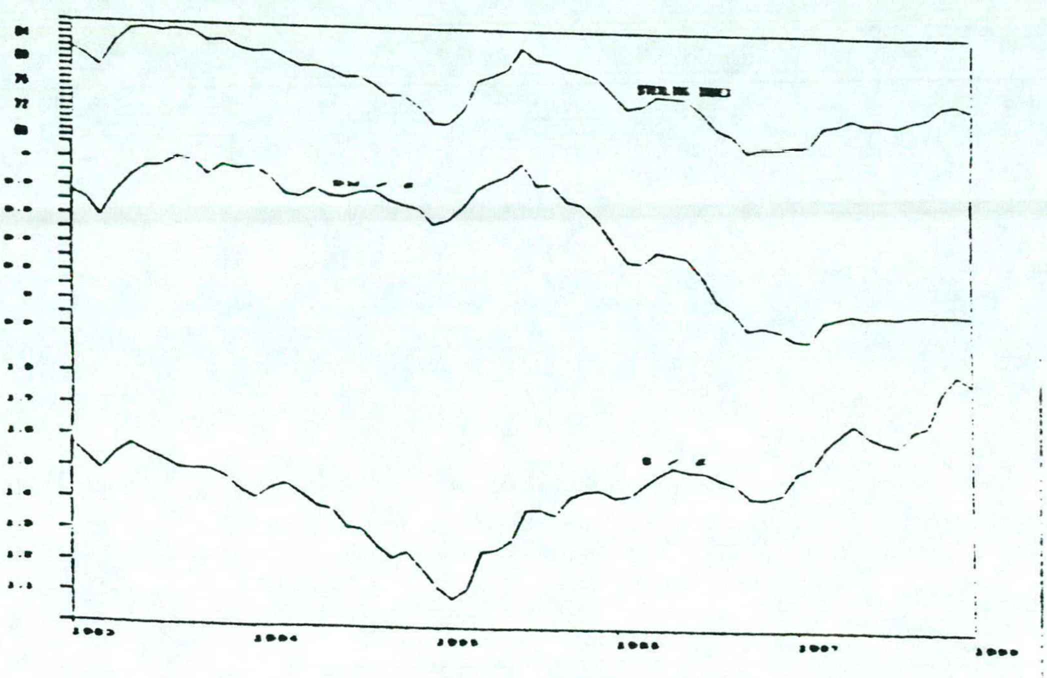
2.23 The strength of the economy coupled with fiscal prudence has enabled the Government to achieve a balanced budget on a sustainable basis. The Government remains committed to continuing with the policies which have helped to bring this about, and to maintaining the progress towards lower inflation,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

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

Monetary Policy

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

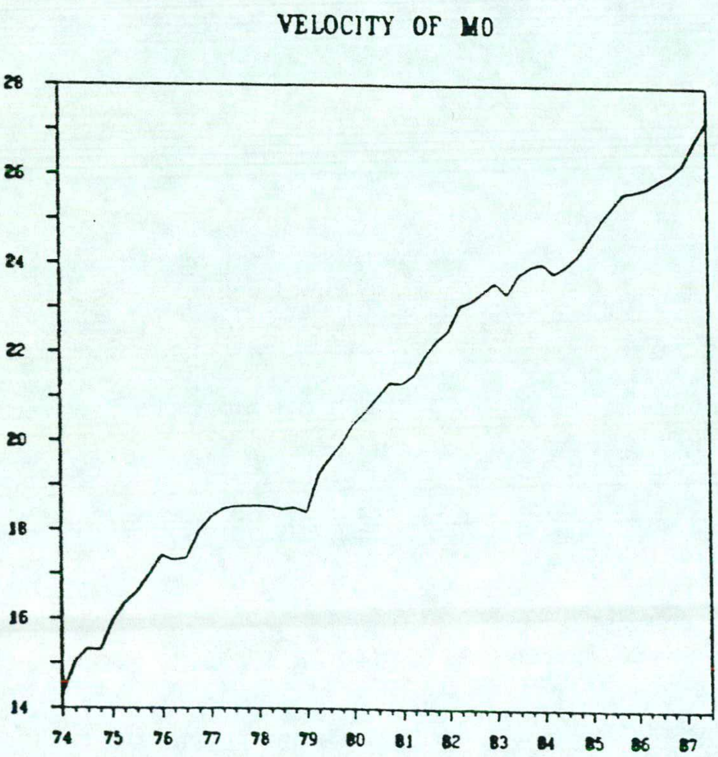
Chart 2.2 Sterling exchange rates

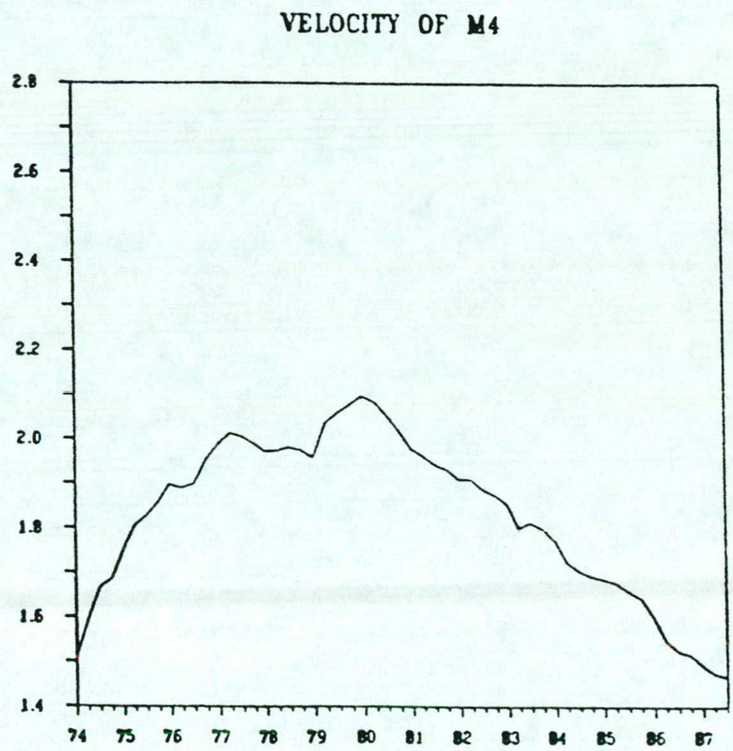


2.10 Achieving these objectives implies a reduction in monetary growth over the medium term. For M0, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988-89 of 1-5 per cent [2-6 per cent]. This is the same as indicated in last year's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

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

Chart 2.3 Velocity of monetary aggregates





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

Table 2.2: Growth of MO*

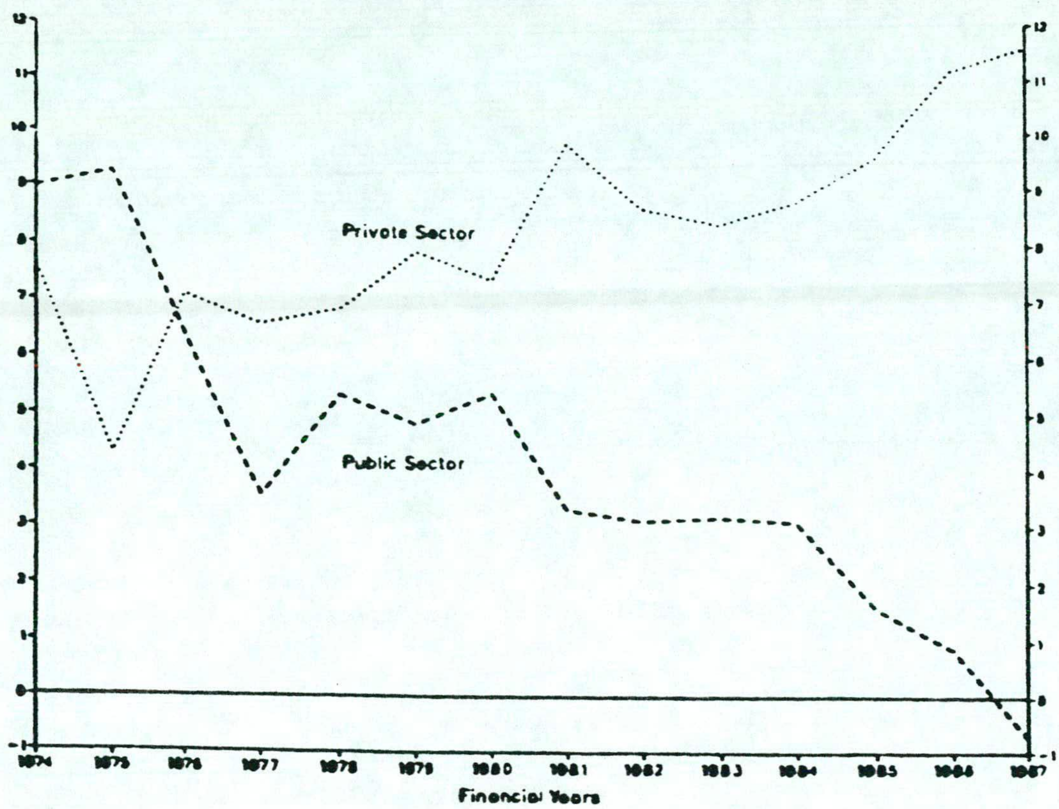
1987-88	1988-89	1989-90	1990-91	1991-92
5	[1-5]	1-5	0-4	0-4

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

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

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

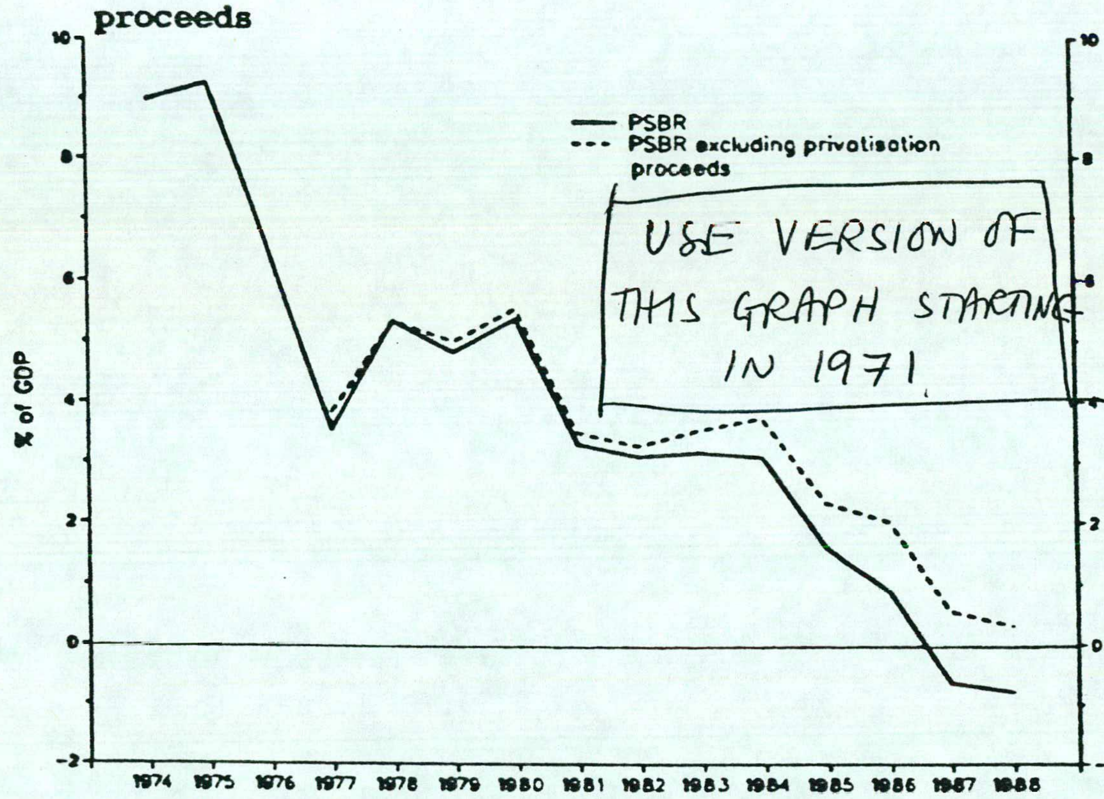
Chart 2.4 Private and public sector borrowing



Fiscal policy

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

Chart 2.5 Public sector borrowing requirement and privatisation proceeds



X

Version A of paragraphs 2.15 and 2.16

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

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

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

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

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

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

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

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

Assumptions

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

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

Table 2.3 Output and inflation assumptions

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

Public expenditure

SEE REDRAFT ATTACHED

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

Table 2.4 General government expenditure

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

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

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

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

Revenue

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

Table 2.5 General government receipts

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

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

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

Conclusion

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

SEE RE-DRAFT

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COPY NO 2 OF 31

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

CHANCELLOR

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

Mr Battishill
Mr Isaac
Mr Painter - IR
Mr J Calder

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

a/
A few points marked ✓
AA

I have commented on Miss Sinclair's para 2 pts (see over) & made a number of other changes etc passim. R

B.L.O.

FSBR: CHAPTER 4

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

SECRET

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

(! delicately phrased!

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

Agreed

(b) You wanted to refer to the cost of entertaining overseas <u>businessmen</u> rather than <u>customers</u>. The Revenue feel that this is not sufficiently accurate: the relief currently extends to (and is thus being withdrawn from) the cost of entertaining the agent of an overseas Government or public authority. Would you be content with <u>customers</u>? — No, but I will consider the dr. formulation.

This completely misses the point. Try "customer or supplier"

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

For both covenants & forestry, best treatment is Annex to Ch 4 and Ch 5 only (ie not Table 1.1 & not Ch 4 apart from annex)

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

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

~~I'd still be inclined to leave in Annex only~~

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

£m

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

Indeed.

But description should say "Increase in duty on leaded petrol; no change in duty on unleaded petrol".

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

(f) You asked if we should say somewhere that the MIR limit will remain at £30,000. The limit is mentioned in paragraph 4.09. We do not normally confirm the status quo in Chapter 4, though we can do so if you wish. — no need

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

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

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

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

CAROLYN SINCLAIR

BUDGET SECRET
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4 The Budget tax proposals

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

Income tax

Two points here: (1) even though we've changed the order in the table do we want to change it here? (2) should we now have a separate "basic rate limit double-rationalised" item?

4.02 5 The basic rate of income tax will be reduced to 25 per cent.

4.03 6 There will be a single higher rate of income tax of 40 per cent~~, which will apply to taxable income over £19,300~~.

4.04 2 The main income tax personal allowances and the limit of the basic rate band will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3·7 per cent in the RPI in the year to December 1987). This will mean that:

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

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

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

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

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

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

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

4.05 3 The dependent relative allowance~~ of up to £145~~, the housekeeper allowance~~ of £100~~ and the allowance for the services of a son or daughter ~~of £55~~ will be abolished.

4.06 4 From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

Life assurance premium relief

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

Benefits in kind

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

Mortgage interest relief

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

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

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

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

see re-draft attached.

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

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

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

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

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

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

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

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

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

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flat

Inheritance tax

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

Business tax

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

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

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

See covo note

I am consulting further

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

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

Business Expansion Scheme

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

Is this correct? yes

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

Forestry

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

The

Oil taxation

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

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

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

— and unnecessary?

Company residence and migration

purposes

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

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VAT 5 **4.34** From 16 March 1988 the registration limits will become £22,100 per annum and £7,500 per quarter.

6 **4.35** The provision for applying VAT to confectionery will be amended with the main effect of taxing all cereal bars at the standard rate.

Excise duties 7 **4.36** The duties on beer and wines will rise by the equivalent of 1p on a typical pint of beer, Just under 4p on a bottle of table wine, and just over 6p on a bottle of sherry (all inclusive of VAT). The duties on spirits will remain unchanged. The minimum duty charge for beer will be abolished and provision will be made for restructuring the duties on low strength mixed drinks.

8 **4.37** The duty on leaded petrol will be increased by the equivalent of [just over 5½p] under 6p a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged~~, so that the duty differential in its favour vis à vis leaded petrol will be increased~~. The duty on derv will rise by the equivalent of [just under 5p] a gallon.

9 **4.38** The specific duties on cigarettes, hand-rolling tobacco and cigars will rise by the equivalent of just [over 3p] on a packet of 20 cigarettes and [nearly 2p] on a packet of 5 small cigars. The duty on pipe tobacco will remain unchanged.

Tax administration 40 **4.39** The VAT civil penalty system, introduced in 1985, has been reviewed and various easements are proposed. 4.41 In the light of recommendations by the Keith Committee, changes will be made:

- to encourage people to notify the Inland Revenue if they are liable to tax;
- ~~to introduce a tax-geared penalty for failure to notify liability;~~
- to improve the information powers of the Inland Revenue;
- to charge interest where payment to the Inland Revenue of income tax deducted by employers is delayed beyond the end of the tax year ~~(the interest charge will be implemented when the necessary Inland Revenue computer systems are in place)~~.

leave for Annexe?

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

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

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Independent taxation for married couples

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

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

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

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

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

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

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

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

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

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

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

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33/34

Table 4.1 Direct effects of changes in taxation

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

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

being [illegible]

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

Case for putting this section after income tax?

Leave as is

	£ million Estimated effect on receipts in: 1988–89 Changes from a non-indexed base	 Changes from an indexed base	 1989–90 Changes from an indexed base
Capital gains tax			
42 ~~44~~ Rebasing capital gains of individuals and trusts to March 1982	—	—	~~−75~~ −70
43 ~~45~~ Charging gains of individuals and trusts at income tax rates	+70	+70	~~+60~~ +80
44 ~~46~~ Annual exempt amount reduced to £5000	—	—	~~+10~~ +15
45 ~~47~~ Retirement relief	—	—	−10
46 ~~48~~ Building and Co-operative society shares	*	*	*
47 ~~49~~ Homes provided for dependent relatives	—	—	*
Corporation tax			
48 ~~50~~ Reduction in rate of ACT to 1/3rd of the amount of the distribution	−380	−380	−200
49 ~~51~~ Reduction in small companies' rate to 25 per cent	*	*	−50
50 ~~52~~ Company residence and migration—new rules	—	—	—
51 ~~53~~ Definition of an investment trust	—	—	—
52 ~~54~~ Indexation allowance—intra-group transactions	—	—	—
53 ~~55~~ Intra-group share exchanges	—	—	—
54 ~~56~~ Capital allowances—assured tenancies relief	—	—	—
Corporation tax and capital gains tax			
55 ~~57~~ Rollover relief for satellites, spacecraft, milk quotas and potato quotas	*	*	−5
Income tax, corporation tax and capital gains tax			
56 ~~58~~ Keith Committee administrative changes	+10	+10	+20
Income tax, corporation tax, capital gains tax and stamp duties			
57 ~~59~~ Conversion of building societies into public limited companies —changes in tax rules	—	—	—
Oil taxation			
58 ~~60~~ Reduction in PRT oil allowances for certain fields	+30	+30	+30
59 ~~61~~ New capital gains relief for certain oil licence disposals	−5	−5	−5
60 ~~62~~ Petroleum revenue tax relief for certain tariff related costs	—	—	—
Inheritance tax			
61 ~~63~~ Increase (of £110,000) in threshold and change to (40 per cent) flat rate	−120	−100	−200
62 ~~64~~ Abolition of limit on gifts to political parties	*	*	*
Stamp duties			
63 Abolition of capital duty & unit trust instrument duty	−100	−100	−125 eh?
64 ~~65~~ Stamp duty and reserve tax on paired shares	—	—	—
TOTAL INLAND REVENUE	**−4 860**	**−4 015**	**−6 280**
CUSTOMS AND EXCISE			
Value added tax			
65 ~~66~~ Change in liability of certain confectionery	+5	+5	+10
66 ~~67~~ Keith Committee—review of civil penalties	*	*	*
67 ~~68~~ Increase in registration limits	*	*	*
68 ~~69~~ Revised registration requirements	*	*	*
69 ~~70~~ Revision of approved self-billing arrangements	+5	+5	+5
70 ~~71~~ Revised treatment of business entertainment for overseas customers	*	*	*
Excise duties			
71 ~~72~~ No change in rate of spirits duty	—	−25	−25
72 ~~73~~ Increase in rate of beer duty	+80	+20	+15
73 ~~74~~ Abolition of minimum duty charge for beer	*	*	*
74 ~~75~~ Increase in rate of duty on cider and perry	+5	+5	*
75 ~~76~~ Increase in rate of duty on light wine and made-wine duties	+20	+5	+5
~~76 77 No change in rates of duty on fortified wines~~ Increase in rates of duty on fortified wines	~~—~~	~~−5~~	~~*~~
76 77 ~~78~~ Revised duty regime for low strength mixed drinks	*	*	*

* = Negligible — = Nil

0031

BUDGET SECRET—BUDGET LIST ONLY

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

	£ million Estimated effect on receipts in: 1988–89 Changes from a non-indexed base	 1988–89 Changes from an indexed base	 1989–90 Changes from an indexed base
Excise duties—*continued*			
78 ~~79~~ Increase in rate of duty on leaded petrol etc	+275	+80	+50
78 ~~80~~ Increase in rate of duty on derv	+75	+25	+30
79 ~~81~~ No change in rates of minor oil duties	—	−5	−10
80 ~~82~~ Increase in rates of duties on cigarettes, hand-rolling tobacco and cigars	+100	—	—
81 ~~83~~ No change in rate of duty on pipe tobacco	—	*	−5
TOTAL CUSTOMS AND EXCISE	**+565**	**+110**	**+75**
Vehicle excise duty			
82 ~~84~~ No change in VED on car, light van and main lorry rates	—	−100	−110
83 ~~85~~ Increase in certain other VED rates	+20	+20	+20
84 ~~86~~ New VED class for exceptional loads	*	*	*
TOTAL VED	**+20**	**−80**	**−90**
Other			
85 ~~87~~ Bus fuel grants	−5	*	−5
TOTAL CHANGES IN TAXATION	~~−4 280~~ ~~−4305~~ −4305	~~−3 985~~ ~~−4010~~ −4005	~~−6 300~~ ~~[illegible]~~ ~~[illegible]~~ −6250

* = Negligible — = Nil

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2 The Medium Term Financial Strategy

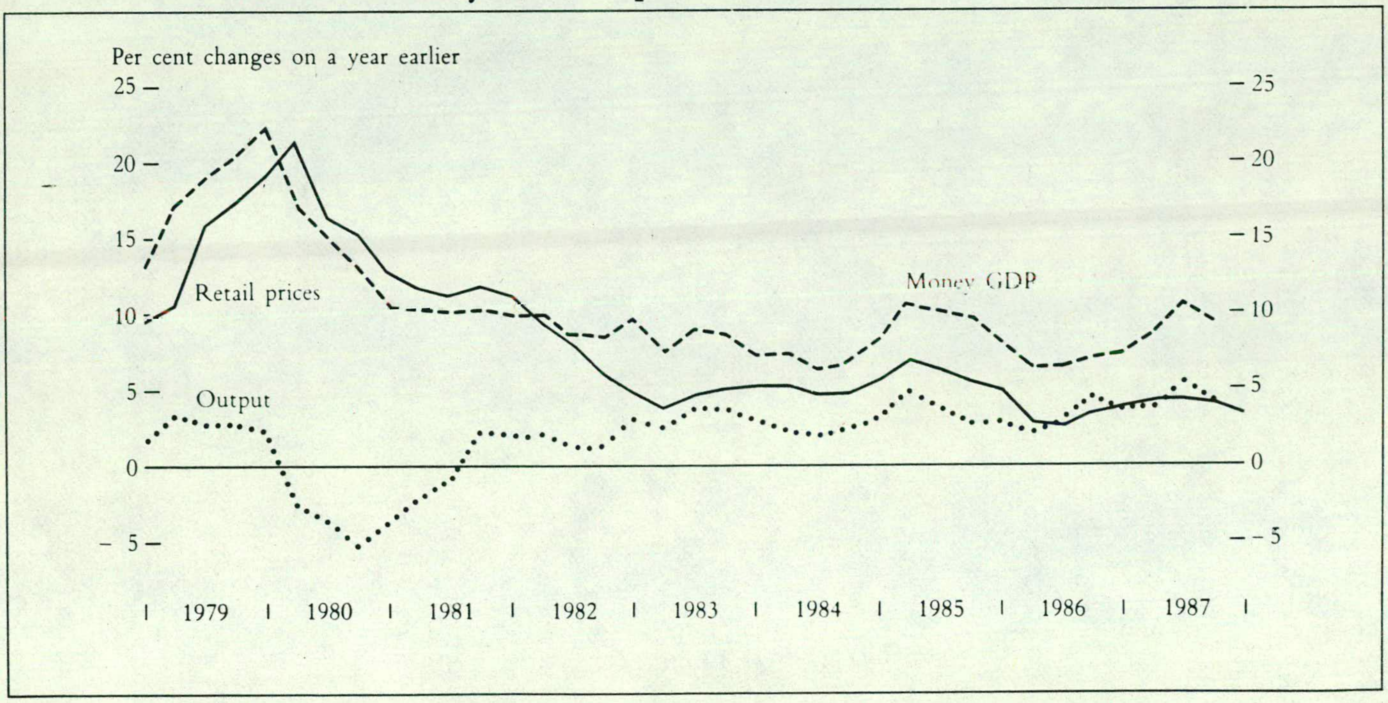
See pp 11, 12.

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

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

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

Chart 2.1 Money GDP, output and inflation



Objectives and the framework of policy

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

Table 2.1 Money GDP growth[1]

1987–88	1988–89	1989–90	1990–91	1991–92
$9\frac{3}{4}$	$7\frac{1}{2}$	$6\frac{1}{2}$	6	$5\frac{1}{2}$

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

2.05 Money GDP growth is expected to be around $9\frac{3}{4}$ per cent in 1987–88, higher than forecast in last year's FSBR. The division of money GDP growth between output growth and inflation was better than forecast, a further sign of improvement in the supply performance of the economy. Output growth is currently estimated at $1\frac{1}{2}$ percentage points above last year's forecast; inflation (as measured by the GDP deflator) is estimated to have been about $\frac{1}{2}$ percentage point higher than forecast.

2.06 For 1988–89, money GDP growth is forecast to be $7\frac{1}{2}$ per cent. Real growth is forecast to slow down from its 1987–88 level. The current forecast for the increase in the GDP deflator in 1988–89 is a little above the projection in last year's MTFS.

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

A declining path for money GDP growth

Monetary policy

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

Table 2.2 Growth of M0[1]

1987–88	1988–89	1989–90	1990–91	1991–92
5	1–5	1–5	0–4	0–4

[1] Per cent changes on previous financial year.
1987–88: forecast. 1988–89: target range. 1989–90 onwards: illustrative ranges.

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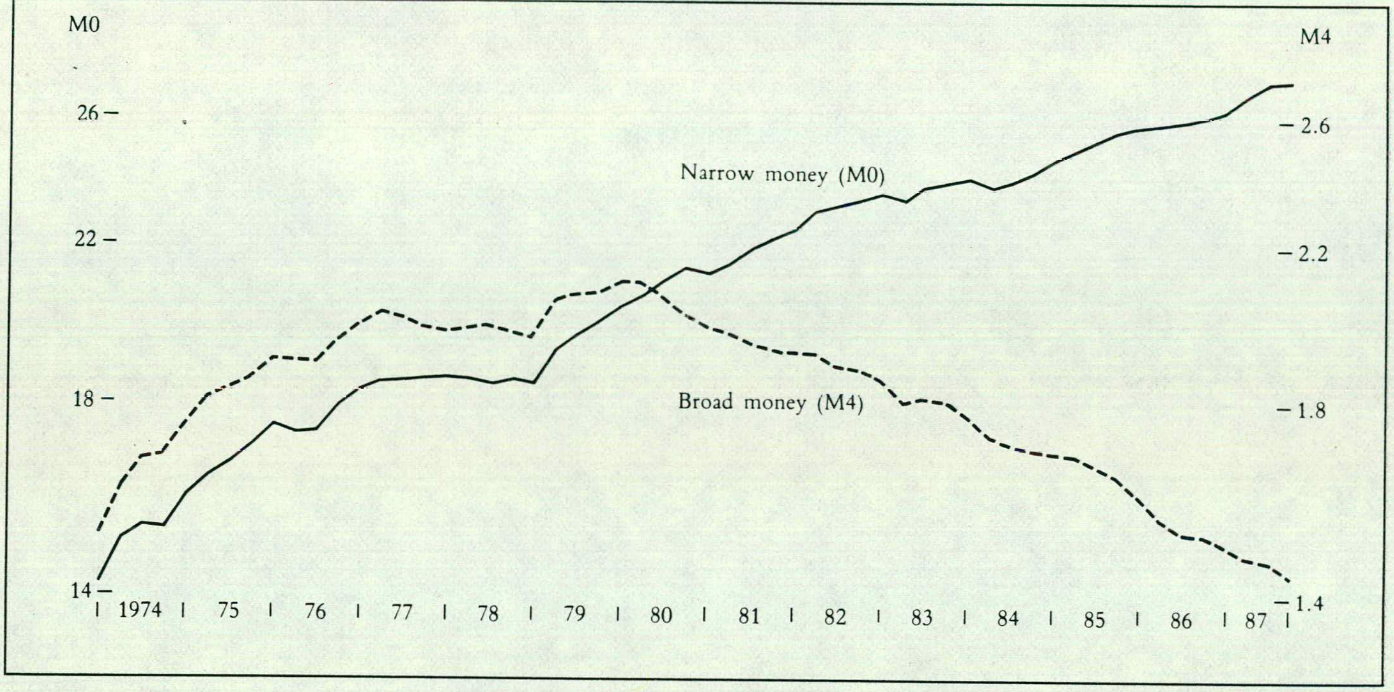
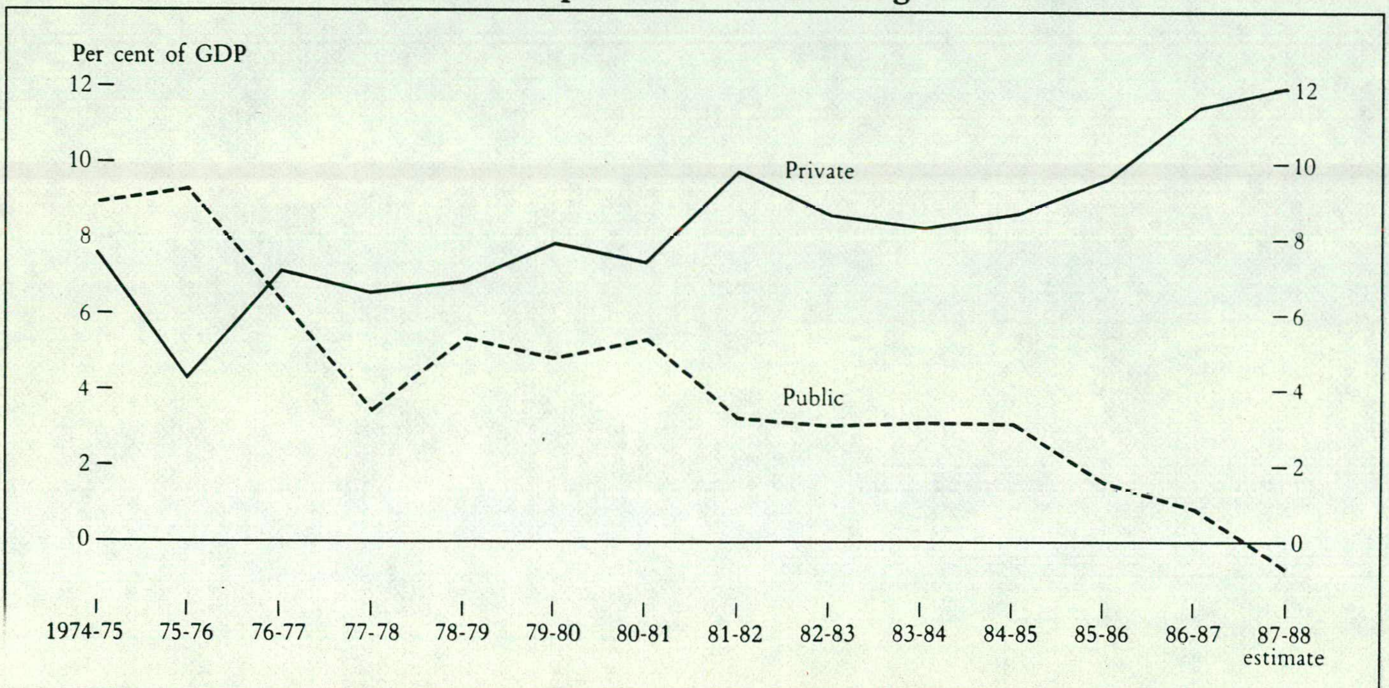
2.09 While, as last year, there is no explicit target range for broad money, the assessment of monetary conditions continues to take broad money, or liquidity, into account.

Chart 2.2 Velocity of monetary aggregates



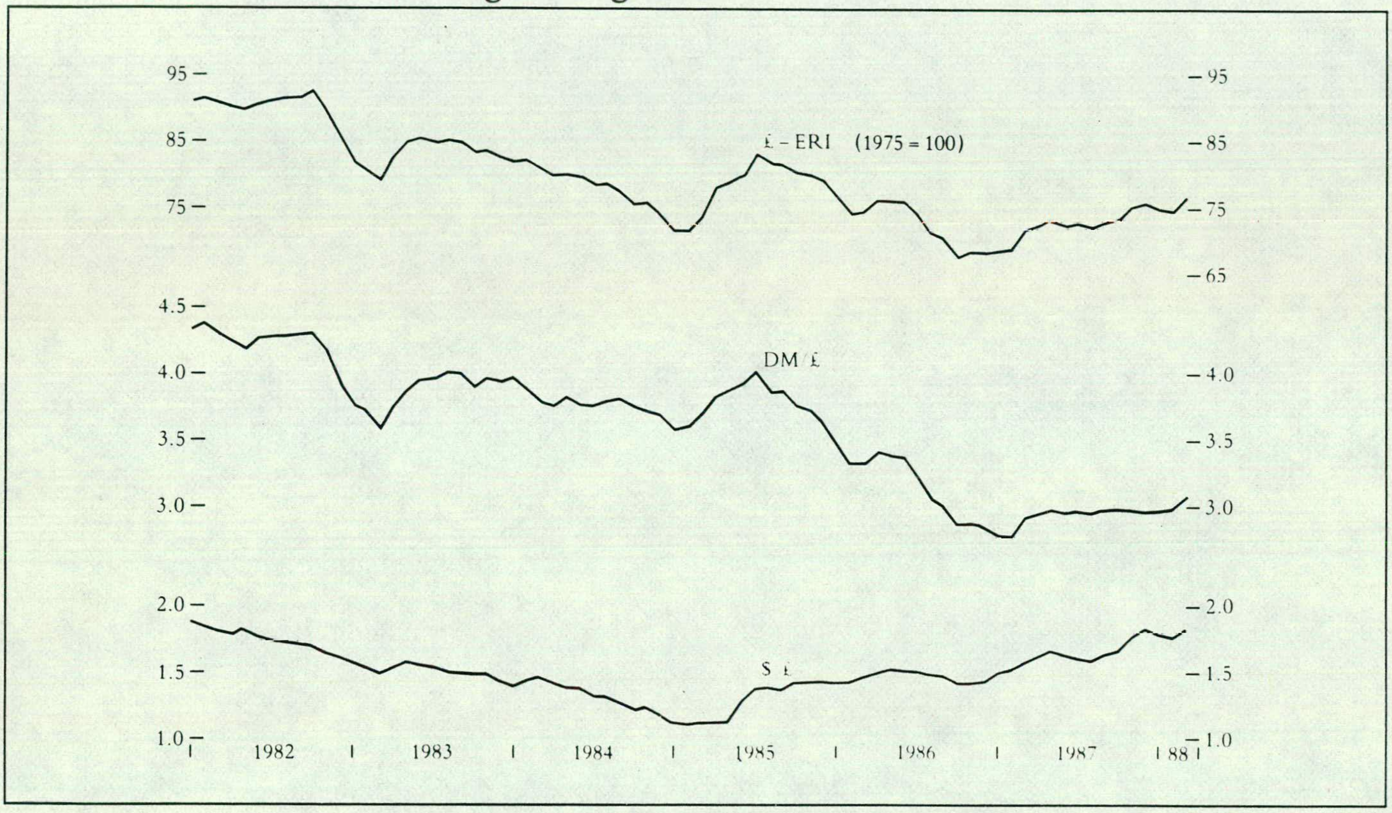
2.10 With the increasing overlap between activities of banks and building societies, it is sensible to concentrate on measures of broad money that include deposits held with both. The authorities will seek to fund the net total of maturing debt, the PSBR, and any underlying change in foreign exchange reserves, by sales of debt outside the banking and building society sectors.

Chart 2.3 Private and public sector borrowing



2.11 Interest rate decisions are based on a comprehensive assessment of monetary conditions so as to maintain downward pressure on inflation. Increases in domestic costs will not be accommodated either by monetary expansion or by exchange rate depreciation. Exchange rates play a central role in both domestic monetary decisions and international policy co-operation. In their communique of 23 December the Finance Ministers and Central Bank Governors of the seven major industrialised countries re-emphasised their common interest in more stable exchange rates.

Chart 2.4 Sterling exchange rates



Fiscal policy

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

The PSBR path

2.13 The PSBR is now assumed to be zero over the medium term: a balanced budget. This is a prudent and cautious level and can be maintained over the medium term. It also provides a clear and simple rule, with a good historical pedigree. In practice, there are likely to be fluctuations around this level from year to year. A PSBR of zero on the basis of current privatisation plans implies a PSBR of only 1 per cent of GDP in the absence of privatisation proceeds.

2.14 The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current

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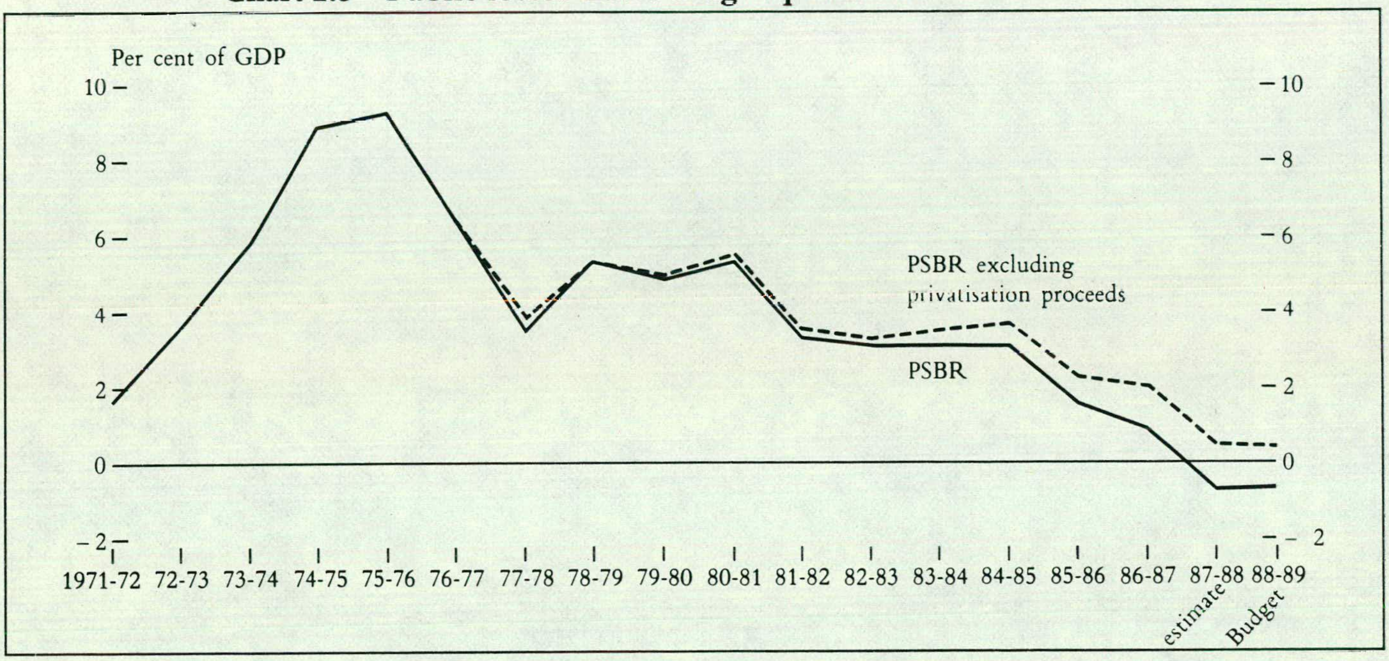
forecasts, a surplus of some £7 billion in 1988–89. Continuing the gradualist approach which has always been a characteristic of the MTFS, only part of this room for tax reductions has been used. The PSBR for 1988–89 has been set at −£3 billion, the same as the expected outturn in 1987–88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

Chart 2.5 Public sector borrowing requirement



Assumptions

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

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

Table 2.3 Output and inflation assumptions

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

Public expenditure

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

Table 2.4 General government expenditure

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
Public expenditure planning total[1]	139·2	146	157	167	176	184
Gross debt interest	17·6	17	17	17	17	16
Other adjustments	8·2	8	9	9	9	9
General government expenditure[2]	**165·0**	**172**	**183**	**193**	**202**	**210**
Privatisation proceeds	4·4	5	5	5	5	5
General government expenditure excluding privatisation proceeds	**169·4**	**177**	**188**	**198**	**207**	**215**

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

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

Revenue

2.18 The growth in government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. On the unchanged policy assumptions set out above, general government receipts are expected to increase somewhat less than money GDP. Government revenues from the North Sea are projected to decline as oil output falls. After taking account of the tax reductions announced in the Budget, non-North Sea revenues are projected to grow at a little under the rate of growth of non-oil money GDP.

in 1988-89

(as appears [illegible] throughout)

Table 2.5 General government receipts

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
Taxes on incomes, expenditure and capital	120·1	132	141	150	158	165
National insurance and other contributions	26·6	29	32	34	36	38
Interest and dividends	6·0	6	6	5	5	4
Other receipts	7·5	6	6	7	7	7
General government receipts[1]	**160·1**	**174**	**185**	**195**	**205**	**214**
of which North Sea tax[2]	4·8	5	3	3	3	3

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

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

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Public sector borrowing

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

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

Table 2.6 Public sector borrowing[1]

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
General government expenditure	165·0	172	183	193	202	210
General government receipts	160·1	174	185	195	205	214
Fiscal adjustment from previous years[2]	—	—	—	—	3	4
Annual fiscal adjustment[2]	—	—	—	3	1	1
GGBR	**4·9**	**−2**	**−2**	**1**	**1**	**1**
Public corporations' market and overseas borrowing	−1·5	−1	−1	−1	−1	−1
PSBR	**3·4**	**−3**	**−3**	**0**	**0**	**0**
Money GDP at market prices	386	424	456	486	516	545
PSBR as per cent of GDP	**0·9**	**−¾**	**−¾**	**0**	**0**	**0**

[1] *Net borrowing: positive; net debt repayment: negative. Rounded to the nearest £1 billion from 1987–88 onwards. Further details for 1987–88 and 1988–89 are provided in Tables 1.2 and 6.7.*

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

Conclusion

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

Annex to Chapter 4

How the figures in Table 4.1 have been calculated

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

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

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

estimate of the ~~cost~~ cost or yield of the capital gains tax changes allows for the ~~...~~ likely effects on the volume and timing of disposals.

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

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

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

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

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

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

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

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

Income tax

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

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

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

This is new. Any reason not to repeat info? Otherwise people who read Table 4.1 refer to these notes & there get re-referred to another para

I agree. Revert to past practice.

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

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

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

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

12 For 1988–89 the scale for taxing car benefits for directors and for "higher paid" employees will be double the 1987–88 levels. The previously announced scales for 1988–89 will not apply. ~~Yields are measured from these previously announced scales. No change is proposed for 1988–89 and 1989–90 to the scale charges for car fuel benefit also used for VAT purposes.~~ The estimated yield is based on the difference between the tax payable on the new scales & the tax payable if 1987–88 scales had applied. ~~It also takes account of behavioural effects changes which are expected as a direct consequence of the increased car scales.~~

consequential
result.

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

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

~~**15** to **17**~~ 14 to 16 See paragraph 4.~~10~~09. Relief for loans for the purchase on improvement of let property is not affected. ~~The estimated yield (for item 15) takes account of consequential changes in the level of borrowing.~~

~~**18**~~ 17 See paragraph 4.1~~1~~0. The change is estimated to yield £160 million in 1990–91, £175 million in 1991–92, and £[210] million eventually. ~~These figures do not include the effect on public expenditure of the parallel change in the student grant system.~~ There will be compensating changes in the student grant system (see paragraph 5.04).

~~**19**~~ 18 See paragraph 4.1~~2~~1

The difference between the married and single allowances.

~~**20**~~ 19 The new tax regime for maintenance payments in paragraph 4.1~~3~~2 will mean that:

for payments under new maintenance arrangements, relief will be restricted to payments to a divorced or separated spouse, up to a limit equal ~~to~~ of ~~[1,490]~~, being (£1,490), Recipients will not be liable to tax on maintenance payments;

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

Not Bold [Usual letters]

~~The changes are estimated to cost £[15] million in 1990–91 and~~ £[10] million in 1991–92, and to [yield £20 million] eventually.

21 See paragraph 4.16.

22 See paragraph 4.28. [The legislation will first take effect for the Lloyd's 1986 Account, which closes at the end of 1988.]

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

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

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

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

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

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

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

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

0098

, and

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

~~31~~ 30 and **~~32~~ 31** See paragraphs 4.2~~6~~8 and 4.2~~7~~9. The estimated revenue effects depend on take up and are highly uncertain.

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

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

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

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

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

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

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

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

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

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

~~42~~ 40 See paragraph 4.2~~4~~6. The yield from the VAT change is shown separately at item 71.

~~43~~ 41 and **~~44~~ 42** See paragraph 4.1~~7~~8. The total cost of rebasing will build up to a peak of some £850 million in 1991–92, of which the amount attributable to companies' gains is about three-quarters. The figures take account of the likely effect of this measure on the volume and timing of disposals; and, ~~to~~ for individuals and trusts, are additional to the effect on item 4~~5~~3.

3 9
45 See paragraph 4.18. Until the introduction of independent taxation in 1990–91, the gains of married couples will be taxed as the marginal slice of the husband's income. The revenue yield in 1990–91 is estimated at £40 million and in 1991–92 at £85 million. The figures take account of the likely effect of taxing gains at income tax rates on the volume and timing of disposals.

4
46 See paragraph 4.19. 20

5 1
47 See paragraph 4.20. Retirement relief currently exempts business gains up to £125,000, subject to certain qualifying conditions.

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

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

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

50
52 See paragraph 4.33.

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

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

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

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

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

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

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

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

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

[usual letters]

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

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

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

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

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

63 and **64** The estimated cost for 1990–91 of the proposed rate structure for inheritance tax in paragraph 4.21 is £240 million, measured against ~~the~~ an indexed base. For 1991–92 it is £270 million. The estimated full year cost attributable to transfers in 1988–89 is £220 million. To qualify for exemption, transfers to political parties must be made on or within one year of death.

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

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

Value added tax

66 See paragraph 4.40.

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

68 See paragraph 4.38.

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

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

0101

0
72 See paragraph 4.26. The change will bring the treatment of VAT incurred by businesses on entertaining foreign ~~businessmen~~ into line with the treatment of other business entertainment.

Customers

Excise duties

1
~~72 See paragraph 4.41.~~

2
73 The duty on typical beer will be increased by [4·7 per cent], equivalent to [1p] a pint (inclusive of VAT).

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

4
75 The duty on cider and perry will be increased by [9·7] per cent or [1p] a pint (inclusive of ~~consequential~~ VAT).

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

~~77 See paragraph 4.41.~~

6
78 Lower strength mixed drinks, not exceeding 5·5 per cent alcohol, will be dutied according to their alcoholic strength on a scale proportionate to table wine duty. This will bring duties on wine-based and similar mixed drinks into line.

7
79 The duty on leaded petrol will be increased by [5·5] per cent or [5·6p] a gallon (inclusive of consequential VAT). The duty on unleaded petrol will remain unchanged, so that the tax differential in favour of unleaded petrol will rise to [10·6p] a gallon.

78
80 The duty on derv will be increased by [5·7] per cent, equivalent to [4·9p] a gallon (inclusive of ~~consequential~~ VAT).

79
stet ~~81 There will~~ be no change in the rates of duty on gas oil and fuel oil.

80
82 The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by [3·8] per cent or [3·4p] a packet of 20 cigarettes and [1·9p] a package of 5 small cigars (both inclusive of ~~consequential~~ VAT).

5.3p on a 25 gram packet of hand rolling tobacco

1
~~83 See paragraph 4.43.~~

Vehicle excise duties

2
84 There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

3
85 From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

4
86 From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable of carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1,600. These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£130).

5
87 There will be no change in bus fuel grant.

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BUDGET

COPY NO. 1 OF 27

FROM: COLIN MOWL
DATE: 2 March 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Sedgwick
Mr Turnbull
Mr Culpin
Mr S J Davies
Mr A C S Allan
Mr Pickford
Mr R I G Allen
Mr Ritchie
Ms C Evans
Ms Simpson
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Calder - IR
Mr P R H Allen - C&E

Thanks.
I don't want to insist on X: it is
desirable, tho' not essential.
It still looks a bit odd that
a financial deficit and a
budget surplus are shown as negative: while
I ~~accept~~ agree that this
is conventional, a footnote
might ~~help~~ if a
[illegible] one can [illegible]
devised. I have
[illegible] a fn
other than changing.

SECRET

B.L.O.

FSBR CHAPTER 6

I attach a first proof of FSBR chapter 6.

2. It incorporates all your comments on the draft submitted on 24 February with two exceptions:

paragraph 6.05 - we have not included in the last sentence the reference to corporation tax (CT) in 1987-88 being £¾ billion higher than forecast in the 1987 FSBR. Your suggestion was based on table 6B.3 which shows CT £800 million higher than forecast. Paragraph 6.05 is however a commentary on table 1.2 (not available to you at that time). This shows non-North Sea CT only £500 million higher than forecast and we had advance warning from Inland Revenue that this overshoot was likely to be revised down to

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£300 million. Compared with table 6B.3, the table 1.2 definition excludes North Sea CT and CT on gains (included in capital taxes in table 1.2).

paragraph 6.14 - central government own account borrowing is not hyphenated in other official publications.

3. In addition we have made two alterations, to paragraphs 6.02 and 6.11, suggested by Sir Peter Middleton. In paragraph 6.02 the idea of debt repayment is introduced without giving it a formal title such as the PSDR. The final sentence of paragraph 6.11 is deleted because it is not very interesting and not essential.

4. We have also brought the description of the oil price assumption in paragraph 6.08 into line with that agreed for chapter 3. There are also some small changes to the oil ready reckoners.

5. Finally we have made a minor change to table 6.7 in light of your comment that we need to clarify the convention of showing the PSFD as negative. (on reflection, I think your earlier comment was wrong: deficits are -ve)

6. All the forecast numbers for 1987-88 and 1988-89 are the same as in the previous draft. The revenue departments are still working on the post-Budget forecasts of tax receipts, taking on board revised costings of the Budget measures and changes to the economic assumptions. Moreover we shall want to look again at all the figures when we have the provisional outturn for the PSBR in February next Wednesday. At that point we shall be giving you a final assessment of the PSBR in 1987-88 and 1988-89. In the meantime we feel that it is not worth changing the numbers piecemeal. We note your wish to show no increase in the non-oil tax burden in 1988-89, rather than the 0.1 point increase in the proofs, and shall do our best to accommodate this.

X

7. You were quite right in saying that there was an inconsistency in my covering minute of 24 February. On figures currently proposed for publication, which may change, non-oil

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taxes and national insurance contributions are forecast to increase before Budget changes by 2.9 percentage points more than non-oil money GDP, as implied by the table in the minute, and not by 2½ points more as in my paragraph 6.

8. We do not yet have the professionally produced charts, so the proof employs our lower quality in-house efforts. You had two points on chart 6.2 showing the structure of receipts and expenditure. First you asked why the proportion of expenditure on debt interest does not come down between 1978-79 and 1988-89. As a percentage of GDP general government gross debt interest payments rose from 4¼ per cent in 1978-79 to 5¼ per cent in 1981-82. Although they have since fallen back, they are forecast in 1988-89 to be 4 per cent, only ¼ per cent below the 1978-79 level. By contrast, GGE, the denominator for chart 6.2, has fallen from 43¼ per cent of GDP in 1978-79 to a forecast 40¼ per cent in 1988-89.

9. Secondly you wondered whether the figures for health may not cause confusion since we have used figures on a different basis (ie. as proportions of departmental spending) quite widely in other contexts. GEP's view is that the risk of confusion is small and that people wanting to conduct a serious analysis of the composition of expenditure will look in the PEWP rather than the FSBR. The limited objective of chart 6.2 is to illustrate trends in the composition of general government receipts and expenditure as shown elsewhere in the FSBR, in table 1.2 for example. (The FSBR does not include a breakdown of departmental spending by function.) But we can minimise the risk of confusion by inserting "general government" in the heading for the chart. This should distinguish it from departmental spending.

Conclusion

10. The proof of chapter 6 is due to be returned to the printer on Friday 4 March. We should be grateful for further comments therefore by lunch-time on that day.

Colin Mowl

COLIN MOWL

6 The public sector's finances

The scope of this chapter

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

net repayment of debt

borrowing requirement

Table 6.1 Public expenditure, receipts and borrowing

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

implying net repayment of debt —

This

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

PEM addition (a bit over the top to have 3 descriptions?)

Public sector's finances: three-fold analysis

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

Public sector's finances: analysis by type or activity

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

~~Corporation tax receipts were also £¼ billion higher than the 1987 Budget forecast, and showed a [25] per cent increase on 1986-87.~~

Receipts

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

0237

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

6.07 General government receipts are forecast to rise by $6\frac{1}{2}$ per cent in 1988–89, following an estimated $8\frac{1}{2}$ per cent increase in 1987–88. This is a little less than the rate of growth forecast for money GDP. Without the Budget measures however forecast growth in receipts would be about $1\frac{1}{2}$ percentage points above that of money GDP.

May need changing ~~yet~~ back again!

will average $15 a barrel over the year ahead.

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

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

a $1\frac{1}{2}$ per cent increase in income tax receipts. Without the Budget measures the forecast increase would have been 10 per cent;

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

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

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

a $5\frac{1}{2}$ per cent increase in the excise duties on petrol, tobacco and alcohol, a little below the increase in consumers' expenditure reflecting the trend decline in the share of these items in the total;

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

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

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

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

Expenditure

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

x

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

about

Borrowing

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

x

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

This will, of course, need to change to cover the 1st 11 months of 1987-88

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

again, although only

Trends in receipts and expenditure

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

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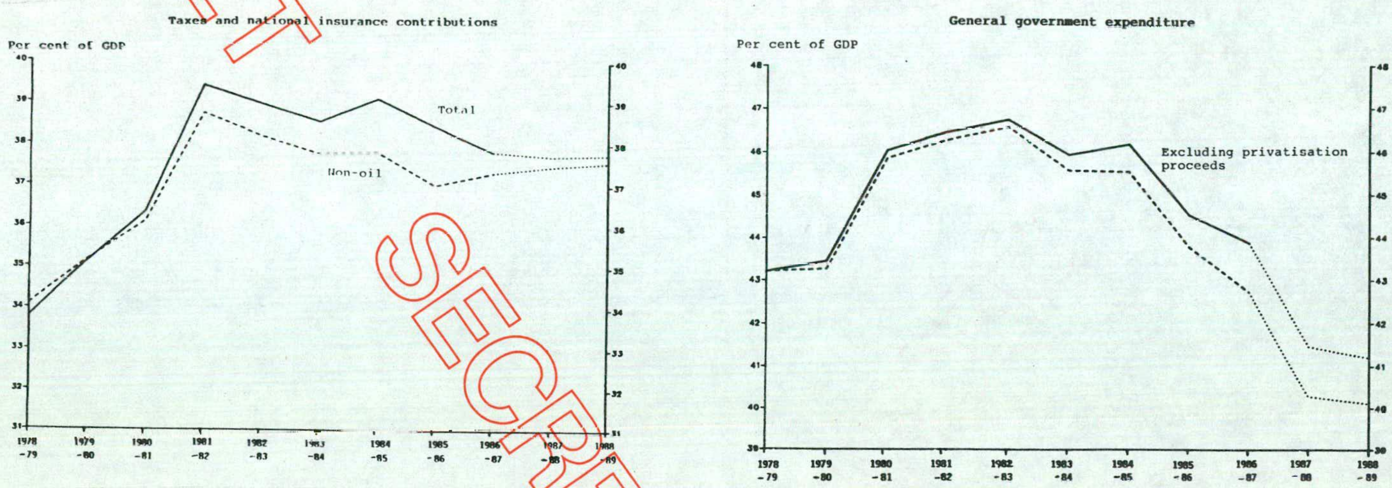
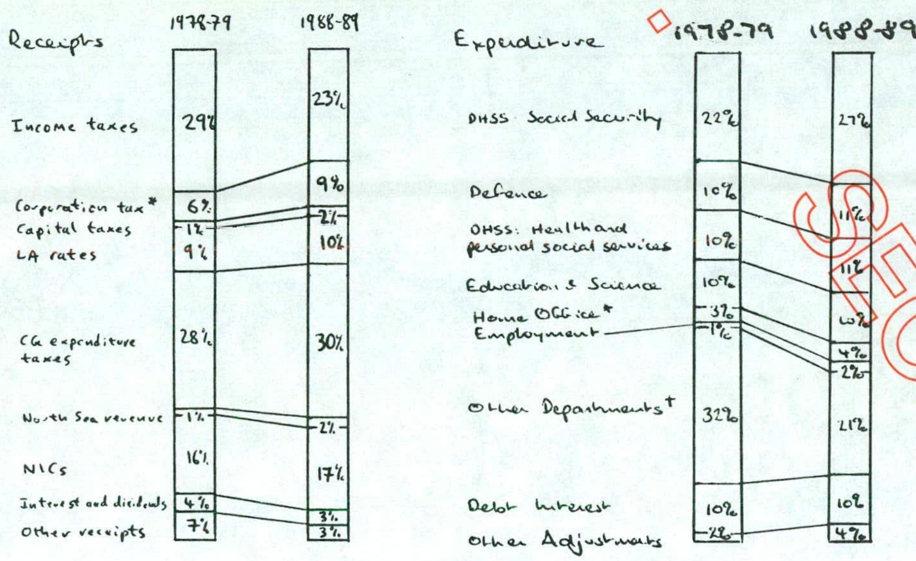
Chart 6.1 Taxes and expenditure as a percentage of GDP



6.17 Chart 6.2 shows the significant changes in the structure of general government receipts and expenditure which have taken place since 1978–79.

Chart 6.2 The structure of receipts and expenditure



* Excluding North Sea.

* and legal departments
† including Privatisation Proceeds and Reserve

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Public sector's finances: analysis by sector

6.18 Table 6.3 shows net borrowing in 1986–87 and 1987–88 by central government, local authorities and public corporations.

Table 6.3 Public sector borrowing requirement

	£ billion			
	1986–87 Outturn		1987–88 Latest estimate	
1 Central government borrowing on own account	**4·5**		**−2·8**	
2 Local authority borrowing from central government		5·9		5·2
3 Local authority borrowing from market and overseas		−5·6		−4·0
4 Total local authority borrowing	**0·2**		**1·1**	
5 Public corporations' borrowing from central government		0·1		−0·3
6 Public corporations' borrowing from market and overseas		−1·5		−0·9
7 Total public corporations' borrowing	**−1·4**		**−1·2**	
8 Public sector borrowing requirement	**3·4**		**−2·9**	
Memorandum item:—				
Central government borrowing requirement (lines 1+2+5)	10·5		2·1	

6.19 Tables 6.4 to 6.6 show estimated outturns and forecasts of receipts and expenditure in 1987–88 and 1988–89 for each of the three sectors. These tables include some of the analysis by economic category in Table 6.7. Expenditure in 1988–89 does not include an allocation of the Reserve, although the forecast of the PSBR assumes that the Reserve is fully spent.

Central government

6.20 Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Table 6.5 and 6.6.

Table 6.4 Central government transactions

	£ billion		
	1986–87 Outturn	1987–88 Latest estimate	1988–89 Forecast
Receipts			
Taxes and royalties	104·4	115·2	121·7
National insurance and other contributions	26·7	28·8	31·6
Other	10·4	11·2	11·3
Total receipts	**141·4**	**155·2**	**164·5**
Expenditure			
Current expenditure on goods and services	49·4	53·0	55·7
Current grants and subsidies	77·3	80·7	82·8
Interest	16·5	16·9	17·4
Net lending[1], capital expenditure, and cash expenditure on company securities	2·7	1·8	2·6
Total expenditure	**146·0**	**152·5**	**158·4**[2]

1 *Excluding lending to local authorities and public corporations*
2 *Excluding any allocation from the Reserve*

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Local authorities

6.21 Local authority receipts consist primarily of rate income plus grants from central government. The forecast increase in rate income (net of rate rebates) between 1987–88 and 1988–89 takes account of available information about rate decisions by local authorities, additions to rateable value, and changes to the system of rate rebates introduced by the Social Security Act 1986.

6.22 The local authority borrowing requirement (LABR) fell sharply in 1986–87 to £¼ billion, from £1¾ billion in 1985–86. The LABR in the first ten months of 1987–88 was higher than in the same period of 1986–87 and it seems likely that borrowing in the year as a whole will be above that in 1986–87, although still well below the levels of earlier years. The estimates of local authority receipts and expenditure do not fully explain the LABR in 1986–87 and 1987–88 (other receipts in Table 6.5 and miscellaneous financial transactions in Table 6.7 include a balancing item).

Table 6.5 Local authority transactions

	£ billion		
	1986–87 Outturn	1987–88 Latest estimate	1988–89 Forecast
Receipts			
Rates (net of rate rebates)[1]	15·6	17·0	19·2
Rate support grant	11·8	12·6	13·3
Other grants from central government	11·0	12·1	12·2
Other	6·3	5·2	5·6
Total receipts	**44·7**	**46·9**	**50·4**
Expenditure			
Current expenditure on goods and services	31·1	34·1	35·2
Current grants and subsidies	5·4	5·8	6·0
Interest	4·1	4·4	4·5
Net lending and capital expenditure	4·2	3·8	4·4
Total expenditure	**44·8**	**48·1**	**50·1[2]**
[1] *Memo: Rate rebates*	*1·7*	*1·8*	*1·4*

[2] *Excluding any allocation from the Reserve*

Public corporations

6.23 Table 6.6 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations) their net external finance, ie their borrowing plus subsidies and grants, is included in the public expenditure planning total. Public corporations' net external financing requirement, and not their borrowing requirement (PCBR), is the best measure of the public corporations' total contribution to the PSBR, because it includes, in addition to borrowing, subsidies and grants provided by the central government which have to be financed from taxation or central government borrowing.

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Table 6.6 Public corporations' transactions

	£ billion 1986–87 Outturn	1987–88 Latest estimate	1988–89 Forecast
Receipts			
Gross trading surplus (including subsidies)	7·4	7·0	7·4
Other	2·9	2·1	2·2
Total receipts	**10·3**	**9·1**	**9·6**
Expenditure			
Interest, dividends and taxes on income	3·3	3·1	3·8
Net lending and capital expenditure	5·5	4·7	5·7
Total expenditure	**8·8**	**7·9**	**9·5** ~~*~~ 1
Memo: nationalised industries' external finance	*0·4*	*0·4*	*0·7*
other public corporations' contribution to the planning total	*0·8*	*0·6*	*0·8*

1 ~~*~~ *Excluding any allocation from the Reserve*

6.24 Changes in public corporations' income and expenditure from one year to another are affected by privatisation which involve re-classifying privatised industries from the public corporation to the private sector in the national accounts. For example, although Table 6.6 shows a fall in gross trading surplus in 1987–88, the gross trading surplus of those industries remaining in the public sector rose strongly in 1987–88. The underlying buoyancy of the gross trading surplus is a major reason why the PCBR is estimated to have risen only slightly between 1986–87 and 1987–88, despite the inclusion in the 1986–87 figures of negative net borrowing by corporations now in the private sector.

Public sector's finances: analysis by economic category

6.25 The full analysis of receipts and expenditure by economic category is shown in Table 6.7, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment) shows the derivation of the public sector financial deficit. The financial deficit, unlike the PSBR, is not wholly a measure of cash transactions because certain items above line 24 in Table 6.7, for example some taxes included in lines 1 and 2, are measured on an accruals basis. An accruals adjustment is accordingly made in line 28.

6.26 The unallocated Reserve is assumed to be used up by spending on current items or physical capital formation ie. in transactions that fall above the financial surplus/deficit line. In practice allocations from the Reserve can affect financial transactions (lines 25 to 29).

Table 6.7 Public sector transactions by sub-sector and economic category

£ billion[1]

1987–88 Latest estimates

	Line[1]	General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector
Current and capital receipts						
Taxes on income, and oil royalties	*1*	59·2	—	59·2	−0·1	59·1
Taxes on expenditure	*2*	52·4	17·0	69·4	—	69·4
Taxes on capital	*3*	3·6	—	3·6	—	3.6
National insurance and other contributions	*4*	28·8	—	28·8	—	28·8
Gross trading surplus	*5*	−0·6	0·5	−0·1	7·0	6·9
Rent and miscellaneous current transfers	*6*	0·3	3·0	3·4	0·5	3·9
Interest and dividends from private sector and abroad	*7*	3·2	0·9	4·1	0·7	4·8
Interest and dividends within public sector	*8*	5·8	−3·7	2·1	−2·1	—
Imputed charge for non-trading capital consumption	*9*	1·2	1·6	2·7	—	2·7
Capital transfers from private sector	*10*	—	—	—	0·1	0·1
Total receipts	*11*	**154·0**	**19·3**	**173·2**	**6·1**	**179·4**
Current and capital expenditure						
Current expenditure on goods and services	*12*	53·0	34·1	87·1	—	−87·1
Subsidies	*13*	5·2	1·0	6·2	—	6·2
Current grants to personal sector	*14*	48·2	4·7	53·0	—	53·0
Current grants paid abroad	*15*	3·6	—	3·6	—	3·6
Current grants within public sector	*16*	23·7	−23·7	—	—	—
Debt interest	*17*	16·9	0·6	17·5	0·6	18·1
Gross domestic fixed capital formation	*18*	3·6	3·8	7·4	4·5	11·9
Increase in stocks	*19*	−0·1	—	−0·1	0·1	–
Capital grants to private sector	*20*	1·9	0·6	2·5	0·1	2·6
Capital grants within public sector	*21*	1·7	−1·0	0·7	−0·7	—
Total expenditure	*22*	**157·7**	**20·2**	**177·9**	**4·6**	**182·4**
(+) Unallocated Reserve	*23*	—	—	—	—	—
Financial surplus/deficit (−)	*24*	**−3·7**	**−0·9**	**−4·6**	**1·6**	**−3·0**
Financial transactions						
Net lending to private sector and abroad	*25*	−0·1	0·6	0·5	−0·1	0·4
Cash expenditure on company securities (net) (including privatisation proceeds)	*26*	5·4	—	5·4	—	5·4
Transactions concerning certain public sector pension schemes	*27*	0·6	—	0·6	—	0·6
Accruals adjustments	*28*	0·1	0·1	0·1	—	0·1
Miscellaneous financial transactions	*29*	0·6	−0·9	−0·3	−0·2	−0·6
Borrowing requirement	*30*	**−2·8**	**1·1**	**−1·6**	**−1·2**	**−2·9**

[1] *Relationship between lines: (24) = (11) − (22) + (23)*
(30) = −(24 to 29)

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£ billion[1]

1988–89 Forecasts

Line[1]	General government: Central government	Local authorities	Total	Public corporations	Public sector	
						Current and capital receipts
1	62·0	—	62·0	−0·7	61·3	Taxes on income, and oil royalties
2	55·6	19·2	74·8	—	74·8	Taxes on expenditure
3	4·2	—	4·2	—	4·2	Taxes on capital
4	31·6	—	31·6	—	31·6	National insurance and other contributions
5	−0·1	0·5	0·5	7·4	7·9	Gross trading surplus
6	0·4	3·0	3·4	0·6	3·9	Rent and miscellaneous current transfers
7	3·0	0·9	3·8	0·7	4·5	Interest and dividends from private sector and abroad
8	6·1	−4·1	2·0	−2·0	—	Interest and dividends within public sector
9	1·2	1·6	2·8	—	2·8	Imputed charge for non-trading capital consumption
10	—	—	—	0·2	0·2	Capital transfers from private sector
11	**163·8**	**21·1**	**184·9**	**6·1**	**191·0**	**Total receipts**
						Current and capital expenditure
12	55·5	35·2	90·7	—	90·7	Current expenditure on goods and services
13	4·6	0·9	5·6	—	5·6	Subsidies
14	50·5	5·0	55·5	—	55·5	Current grants to personal sector
15	2·9	—	2·9	—	2·9	Current grants paid abroad
16	24·7	−24·7	—	—	—	Current grants within public sector
17	17·4	0·2	17·6	0·9	18·5	Debt interest
18	3·9	4·0	8·0	5·4	13·4	Gross domestic fixed capital formation
19	—	—	—	0·1	0·1	Increase in stocks
20	1·9	0·7	2·6	0·1	2·6	Capital grants to private sector
21	1·5	−0·8	0·7	−0·7	—	Capital grants within public sector
22	**163·0**	**20·6**	**183·6**	**5·8**	**189·4**	**Total expenditure**
23					3·5	Unallocated Reserve
24					**−1·9**	**Financial surplus/deficit (−)** (+)
						Financial transactions
25	−0·5	0·3	−0·2	−0·1	−0·3	Net lending to private sector and abroad
26	5·0	—	5·0	—	5·0	Cash expenditure on company securities (net) (including privatisation proceeds)
27	0·6	—	0·6	—	0·6	Transactions concerning certain public sector pension schemes
28	−0·1	—	−0·1	—	—	Accruals adjustments
29	0·3	−0·5	−0·2	−0·2	−0·3	Miscellaneous financial transactions
30					**−3·1**	**Borrowing requirement**

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Annex to Chapter 6

Part A: relationship between tables in Chapter 6, and with Table 1.2; and outturn data

Relationship between tables

6A.1 Table 6.7 is based on the definitions used to compile the national accounts. In order to show the financial deficit for each sector, lending and other financial transactions are separated from the analysis of receipts and expenditure in lines 1–23 and shown in lines 25–29. These lines show the relationship between the financial deficit (line 24) and the borrowing requirement for each sector (line 30).

6A.2 Tables 6.4–6.6 are summary versions of the sectoral columns of Table 6.7. The information in Table 6.7 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.7, lines 16 and 21) appear as receipts in Table 6.5. Interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.7, line 8) appears as expenditure in Table 6.5. Finally, lending and other financial transactions (lines 25–29 of Table 6.7) are included in the receipts and expenditure of Tables 6.4–6.6.

6A.3 Table 1.2 in Chapter 1 uses the same information as Table 6.7, but again rearranges it. To derive general government expenditure, it starts by giving a departmental breakdown of the public expenditure planning total: that includes not only general government expenditure items in the third column of Table 6.7 (including the "financial transactions" in lines 25–26), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.7 and the national accounts adjustments already included in Table 6.7, and deducting public corporations' borrowing from the market and from overseas.

6A.4 Alternatively, general government expenditure in Table 1.2 (and Table 2.4) can be obtained as the sum of lines 22, 23, 25 and 26 (third column) in Table 6.7 and on-lending to public corporations in Table 6.3.

6A.5 To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.7 (lines 11, 27, 28 and 29) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.7) plus oil royalties. The sub total "total taxes and royalties" is the same as the first line of Table 2.5 in Chapter 2.

Outturn data

6A.6 Outturns for the PSBR and the statutory central government accounts (as in Tables 6B.1–4 in Part B of the Annex) are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in Tables 2.5 and 3.12 and 3.16 of the following issue of Financial Statistics. Details of the PSBR on national accounts definitions, as in Table 6.7, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

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6A.7 The first outturn for the PSBR in 1987–88 will accordingly be published on April 20. The first national accounts outturns for 1987–88 will appear in the June issue of Financial Statistics ~~including supplementary Table 13 which is based on Table 6.7~~.

Part B: central government transactions

Commentary on the tables

6B.1 The tables in Part B of this Annex are confined to central government transactions, and are based on the statutory funds and accounts. Their relationship to the accounts of central government on a national accounts basis (as in Table 6.4) is described in the Financial Statistics Explanatory Handbook (1987 edition, p38). The receipts and payments in the Part B tables are all shown on a cash basis, not accrued. Table 1.2, however, shows the main categories of taxes on an accrued basis as in the national accounts: for instance the item "income tax" in Table 1.2 differs slightly from "income tax" in Table 6B.3.

Table 6B.1 Summary of central government transactions

	£ billion 1987–88 latest estimate
Consolidated Fund	
Revenue (Table 6B.3)	123·0
Expenditure (Table 6B.2)	121·2
National Loans Fund (Table 6B.4)	
Receipts	16·7
Payments	21·6
Surplus transferred from Consolidated Fund	1·8
Total net borrowing by the National Loans Fund	3·1
Surplus on other funds and accounts (net)	1·0
Central government borrowing requirement[1] (Table 6.3)	**2·1**

[1] *Including borrowing for on-lending to local authorities and public corporations.*

Table 6B.2 Consolidated Fund expenditure

	£ million 1987–88 latest estimate
Supply issues[1]	105 190
Standing services	
Payment to the National Loans Fund in respect of service of the national debt	9 800
Northern Ireland—share of taxes etc.	2 220
Payments to the European Communities	3 890
Other services	100
Total standing services	16 010
Total Consolidated Fund expenditure	**121 200**

[1] *Supply Issues are monies paid from the Consolidated Fund to departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.4) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.*

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Table 6B.3 Consolidated Fund revenue

	£ million		
	1987–88		1988–89
	1987 Budget	Latest estimate	Forecast
Inland Revenue			
Income tax[1]	39 900	41 250	41 730
Corporation tax[2 3]	15 000	15 800	19 420
Petroleum revenue tax[4]	1 680	2 210	1 340
Capital gains tax	1 300	1 350	1 790
Development land tax	20	25	10
Inheritance tax[5]	1 100	1 070	970
Stamp duties	2 100	2 450	2 200
Total Inland Revenue	**61 100**	**64 150**	**67 460**
Customs and Excise			
Value added tax	23 300	24 300	26 220
Petrol, derv etc.	7 800	7 700	8 370
Cigarettes and other tobacco	4 800	4 800	4 930
Spirits, beer, wine, cider and perry	4 300	4 300	4 400
Betting and gaming	800	780	860
Car tax	1 100	1 100	1 210
Other excise duties	20	20	20
EC own resources[6]			
Customs duties, etc.	1 350	1 440	1 480
Agricultural levies	230	190	200
Total Customs and Excise	**43 800**	**44 630**	**47 670**
Vehicle excise duties[7]	2 600	2 720	2 770
Gas levy	490	520	500
Broadcasting receiving licences	1 030	1 030	1 140
Interest and dividends	1 020	1 080	680
Other[8]	7 600	8 930	7 050
Total Consolidated Fund revenue	**117 500**	**123 040**	**127 270**

[1] *See paragraph 6B.1.*

[2] *Includes advance corporation tax (net of repayments)*	*4 700*	*4 900*	5 *~~4~~590*
[3] *North Sea corporation tax*	*1 400*	1 *~~2~~360*	*1 500*
of which satisfied by setting off ACT	*800*	*630*	*780*

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore and offshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

[4] *Includes advance payments of petroleum revenue tax.*

[5] *Includes estate duty and capital transfer tax.*

[6] *Customs duties and agricultural levies are accountable to the European Communities as 'own resources'; actual payments to the Communities are recorded in Table 6B.2.*

[7] *Includes driving licence receipts.*

[8] *Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, privatisation proceeds and oil royalties (see Table 1.2).*

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Table 6B.4 **National Loans Fund receipts and payments**

	£ million 1987–88 Latest estimate
Receipts	
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 920
Service of the National Debt—balance met from the Consolidated Fund	9 800
Total receipts	**16 720**
Payments	
Service of the National Debt:	
interest	16 550
management and expenses	170
Total service of the National Debt	16 720
Loans to:	
nationalised industries	−320
other public corporations	−160
local authorities	5 190
private sector and within central government	180
x Total National Loans Fund lending*1	4 890
Consolidated Fund surplus	1 840
Total payments	**20 610**

x 1 *On-lending to local authorities and public corporations in Table 6.3 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6B.2).*

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BUDGET

COPY NO 1 OF 4 COPIES

33/2

FROM: MISS C EVANS
DATE: 2 MARCH 1988

Use Version 3 as amended!

MR CULPIN

cc Mr Sparkes

(PS see also footnotes changes)

TABLE 1.1

... I attach 5 versions:

Version 1	as proposed by Chancellor updated to include cgt annual exemption and delete P11D threshold
Version 2	1 more component (capital duty) than Version 1, summary explanation of components, except excise duties
Version 3	As Version 2 but fuller explanations
Version 4	As 3 but with explanation of duties
Version 5	as previously submitted, ie more components (BES, forestry) and more explanation of car scales and maintenance and covenants

SECRET

2. Versions 1-3 have Independent Taxation before cgt; in Versions 4 and 5 it comes after - reflecting the fact that Independent Taxation includes both IT and cgt measures.

3. The notes are the same for all versions.

B.L.O.

J. Sparkes
pp MISS C EVANS

~~OK?~~ cl

AA

Chancellor

We haven't got this right yet.

5 is much too cluttered.

1 is too uninformative: you can't use it as a summary ∵ it doesn't say what you're doing.

Can we compromise on 2, as amended? R 3/3

SECRET

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FP20k

VERSION 1

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BUDGET SECRET

B.L.O.

Table 1.1 The Budget measures[1]

This is essentially last year's

	£ million		yield(+)/cost(-)
	1988-89		1989-90
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Income tax			
personal allowances	-1375	-685	-895
basic rate[2]	-2440	-2440	-3060
basic rate limit			
higher rates			
car scales			
home improvement loans	+80	+80	+200
covenants and maintenance[3]	+35	+35	+100
Independent taxation[4]	*	*	-30
Capital gains tax			
annual exemption			
rates			
rebasing			
Inheritance tax	-120	-100	-200
Corporation tax			
capital gains	-25	-25	-235
small companies' rate	*	*	-50
Excise duties			
oils	+350	+100	+70
VED	+15	-80	-95
tobacco	+100	*	-5
alcohol	+105	*	-5
Other tax changes[3]			
Total			

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Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(-)
	1988-89		1989-90
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Income tax			
personal allowances up 7½%	-1375	-685	-895
[2p off] basic rate[2] ...t by 2p	-2440	-2440	-3060
basic rate limit up 7½%			
~~higher rates reduced~~ [top] single higher rate of 40%			
car scales doubled			
home improvement ~~loans~~ relief abolished	+80	+80	+200
covenants and maintenance[3]	+35	+35	+100
Independent taxation[4]	*	*	-30
Capital gains tax			
annual exemption reduced to £5000			
taxed at income tax rates, of 25% and 40%			
rebased to 1982			
Inheritance tax			
[flat] single 40% rate [over] on above £110,000 threshold	-120	-100	-200
Single rate of 40% threshold raised £110,000			
Corporation tax			
capital gains rebased	-25	-25	-235
[2p off] small companies' rate cut by 2p	*	*	-50
Capital duty abolished			
Excise duties			
oils	+350	+100	+70
VED	+15	-80	-95
tobacco	+100	*	-5
alcohol	+105	*	-5
Other tax changes[3]			
Total			

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Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(-)
	1988-89		1989-90
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Income tax			
personal allowances double indexed	-1375	-685	-895
basic rate reduced to 25p[2]	-2440	-2440	-3060
basic rate limit double indexed			
higher rates above 40p abolished			
car benefit scales doubled			
~~relief on new~~ home improvement loans relief abolished	+80	+80	+200
covenants and maintenance ~~simplified~~[3]	+35	+35	+100
Independent taxation ~~of husband and wife~~[4]	*	*	-30
Capital gains tax			
annual exemption reduced to £5,000			
gains charged at income tax rates			
~~capital gains~~ tax rebased to 1982			
Inheritance tax			
~~single~~ flat rate of 40% above threshold ~~of~~ £110,000	-120	-100	-200
Corporation tax			
tax on capital gains rebased to 1982	-25	-25	-235
small companies' rate reduced to 25p	*	*	-50
Capital duty ~~and unit trust investment duty~~ abolished			
Excise duties ~~(revalorised in overall revenue terms)~~			
oils	+350	+100	+70
~~VED~~ vehicle excise duty	+15	-80	-95
tobacco	+100	*	-5
alcohol	+105	*	-5
Other tax changes[3]			
Total			

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VERSION 4

Table 1.1 The Budget measures[1]

	£ million 1988-89 Changes from a non-indexed base	Changes from an indexed base	yield(+)/cost(-) 1989-90 Changes from an indexed base
Income tax			
personal allowances double indexed	-1375	-685	-895
basic rate reduced to 25p[2]	-2440	-2440	-3060
basic rate limit double indexed			
higher rates above 40p abolished			
car scales doubled			
relief on new home improvement loans abolished	+80	+80	+200
covenants and maintenance simplified[3]	+35	+35	+100
Independent taxation of husband and wife[4]	*	*	-30
Capital gains tax			
annual exemption reduced to £5,000			
gains charged at income tax rates			
capital gains rebased to 1982			
Inheritance tax			
single rate of 40% above threshold of £110,000	-120	-100	-200
Corporation tax			
capital gains rebased to 1982	-25	-25	-235
small companies' rate reduced to 25p	*	*	-50
Capital duty and unit trust investment duty abolished			
Excise duties (illustrative price changes in brackets)			
oils (unleaded petrol unchanged; leaded petrol up 5½p a gallon)	+350	+100	+70
VED (most rates unchanged)	+15	-80	-95
tobacco (cigarettes up 3½p for twenty; pipe tobacco unchanged)	+100	*	-5
alcohol (table wine up 4p a bottle; beer and cider up 1p a pint; spirits unchanged)	+105	*	-5
Other tax changes[3]			
Total			

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Table 1.1 The Budget measures[1]

	£ million 1988-89		yield(+)/cost(-) 1989-90
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Income tax			
personal allowances double indexed	-1375	-685	-895
basic rate reduced to 25p[2]	-2440	-2440	-3060
basic rate limit double indexed			
higher rates above 40p abolished			
life assurance premium relief reduced	-	-	+70
valuation of company cars for tax purposes doubled			
£30,000 mortgage interest relief ceiling applied to residence	+5	+5	+20
relief on new home improvement loans abolished	+80	+80	+200
relief on new non-charitable covenants abolished[3]	+45	+45	+105
changes in rules for maintenance payments	-10	-10	-5
Capital gains tax			
annual exemption reduced to £5,000			
gains charged at income tax rates			
capital gains rebased to 1982			
Independent taxation of husband and wife[4]	*	*	-30
Inheritance tax			
single rate of 40% above threshold of £110,000	-120	-100	-200
Corporation tax			
capital gains rebased to 1982	-25	-25	-235
small companies' rate reduced to 25p	*	*	-50
Business expansion scheme			
investment ceiling of £½ million per company	*	*	+25
extension to private rented housing	*	*	-40
Forestry removed from income/corporation tax[3]	-	-	*
Capital duty and unit trust investment duty abolished			
Excise duties (illustrative price changes in brackets)			
oils (unleaded petrol unchanged; leaded petrol up 5½p a gallon)	+350	+100	+70
VED (most rates unchanged)	+15	-80	-95
tobacco (cigarettes up 3½p for twenty; pipe tobacco unchanged)	+100	*	-5
alcohol (table wine up 4p a bottle; beer and cider up 1p a pint; spirits unchanged)	+105	*	-5
Other tax changes			
Total			

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1 These measures and the basis of the costings shown are described in detail in Chapter 4.

2 Figures include the effect of the consequential change in the rate of advance corporation tax.

~~3 Chapter 5 gives details of the expenditure increases to be implemented in parallel with this tax measure.~~

4 The cost of independent taxation, which is introduced in 1990-91, is shown in the Annex to Chapter 4.

- = nil. * = negligible.

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NOTE OF A MEETING IN THE CHANCELLOR'S ROOM HM TREASURY

AT 11.30AM ON WEDNESDAY 2 MARCH

Present	Chancellor	Governor
	Financial Secretary	Deputy Governor
	Economic Secretary	Mr George
	Sir P Middleton	Mr ~~Flemming~~ Fleming
	Sir T Burns	Mr Coleby
	Sir G Littler	
	Mr Anson	
	Mr Scholar	
	Mr Odling-Smee	
	Mr Peretz	
	Mr S J Davies	

The Governor said that his concerns about the draft had been alleviated by the amendments which had already been made to the second half of paragraph 2.09. But he was still concerned about the use of the words "the Government is committed to maintaining a stable exchange rate". He recognised that this was a quote from the Mansion House speech, but would much prefer something on the lines "the Government attaches particular importance to maintaining a stable exchange rate". He felt that use of the word "committed" in the MTFS could constrain monetary policy in a way that might be counter-productive. The Chancellor thought that the differences between his position and the Governor's were very slight. He was concerned that a departure from the Mansion House text might be seen as a weakening of the Government's anti-inflationary policies. He was prepared to accept the amendment proposed by the Governor, providing it was agreed that if there were any questions about whether there had been a change of policy since the Mansion House speech, the answer would be "no"; the Governor agreed.

... 2. After some further discussion, the attached redraft of paragraphs 2.09 to 2.13 was agreed, subject to final polishing.

ACSA

A C S ALLAN

2 March 1988

Distribution

Those present
PS/Chief Secretary
Mr R I G Allen

BUDGET CONFIDENTIAL

My redraft.

REDRAFT OF PARAGRAPHS 2.09 TO 2.13 OF THE MTFS

2.09 Interest rate decisions are based on a continous and comprehensive assessment of monetary conditions so as to ensure that inflationary pressures are not accommodated.

2.10 The Government attaches particular importance to maintaining a stable exchange rate, notably the rate against the deutschemark. This provides an important financial discipline, ~~and is also helpful to industry~~. Sterling has remained stable against the deutschemark throughout the past year, following the Louvre accord in February 1987. The discipline of a stable exchange provides the underpinning for the declining path of money GDP growth and inflation. ~~This means, in particular, that~~ since increases in domestic costs will not be accommodated by a decline in the exchange rate.

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

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

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

ce6

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COPY NO 1 OF 32

From: MISS C EVANS
3rd March 1988

CHANCELLOR OF THE EXCHEQUER

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Anson
Sir Terence Burns
Mr Scholar
Mr Odling-Smee
Mr Culpin
Mr Sedgwick
Mr Turnbull
Mrs Butler
Mr S Davies
Mr Mowl
Miss Sinclair
Mr R I G Allen
Mr Pickford
Miss Simpson
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill)
Mr Isaac) IR
Mr Painter)

Mr Unwin)
Mr Knox) C&E

a

Only one minor comment

AA

Not further chg'n v. (ask PSR check for accuracy & consistency)

SECRET

B.L.O.

FSBR CHAPTER 1

I attach the first proof of Chapter 1 of the FSBR. This takes on board your amendments to Mr Odling-Smee's draft of 29th February. It does not include Table 1.1, which you are thinking about.

2. We need to return this to the printer on Monday 7th March, so it would be very helpful to have your amendments on Monday morning.

SECRET

C Evans

MISS C EVANS

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1 The Budget

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

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

The Medium Term Financial Strategy

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

The economy

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

Tax measures

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

✓ To align with order in tables etc.

Public expenditure

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

Public sector finances

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

Only the seems such surplus since the early 1950s.

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Table 1.2 The finances of the public sector[1]

	£ billion				£ billion		
	1987–88		1988–89		1987–88		1988–89
	1987 Budget[2]	Latest estimate	Forecast		1987 Budget[2]	Latest estimate	Forecast
RECEIPTS				**EXPENDITURE**			
Income tax	40·0	41·0	41·8	DHSS—social security	46·0	[46·3]	48·5
Corporation tax excluding North Sea[3]	13·5	14·0	17·3	DHSS—health and personal social services	19·1	[19·7]	20·7
Capital taxes	3·3	3·6	4·2	Defence	18·8	[18·7]	19·2
Expenditure taxes:				Education and science	16·6	[17·1]	18·0
VAT	23·3	24·3	26·2	Scotland, Wales and Northern Ireland	16·0	[16·4]	17·1
local authority rates	16·9	17·0	19·2	Other departments	33·6	[33·2]	34·9
petrol, derv, etc.	7·8	7·7	8·4	Privatisation proceeds	−5·0	[−5·0]	−5·0
spirits, beer, wine, etc.	4·3	4·3	4·4	Reserve	3·5	—	3·5
cigarettes and other tobacco	4·9	4·8	4·9				
stamp duties	2·1	2·5	2·2	**Public expenditure planning total**	**148·6**	**[146·4]**	**156·8**
other	8·5	8·8	9·5				
Total expenditure taxes	67·8	69·4	74·8				
North Sea revenues:							
North Sea corporation tax[4]	1·4	1·4	1·5				
petroleum revenue tax	1·7	2·2	1·3				
oil royalties	0·8	1·0	0·7				
Total North Sea	3·9	4·6	3·5	General government gross debt interest	17·9	[17·5]	[17·5]
Other[5]	−0·8	−0·6	−0·7	Other adjustments	7·0	[8·1]	[8·5]
Total taxes and royalties	**127·8**	**131·9**	**140·9**				
National insurance and other contributions	28·5	28·8	31·6				
Interest and dividend receipts	5·7	6·2	5·8				
Gross trading surpluses and rent	3·3	3·0	3·6				
Other	3·5	3·7	~~3·0~~ 2·8				
General government receipts	**168·8**	**173·6**	**184·~~9~~ 7**	**General government expenditure**	**173·5**	**[171·6]**	**[18~~3·0~~] 2·8**

Expenditure, receipts and borrowing

	£ billion		
	1987–88		1988–89
	1987 Budget[2]	Latest estimate	Forecast
General government expenditure	173·5	171·6	18~~3·0~~ 2·8
General government receipts	168·8	173·6	184·~~9~~ 7
General government borrowing requirement	4·7	−2·0	−1·9
Public corporations' market and overseas borrowing	−0·8	−0·9	−1·2
Public sector borrowing requirement	**3·9**	**−2·9**	**−3·1**

[1] *In these and other tables, constituent items may not add up to totals because of rounding.*
[2] *On current definitions.*
[3] *Including advance corporation tax but excluding ~~corporation tax on~~ capital gains.*
[4] *Before advance corporation tax set off. See footnote* to Table 6B.3.
[5] *Adjustments for advance corporation tax set off against North Sea corporation tax plus accruals adjustment.*

BUDGET CONFIDENTIAL
covering
BUDGET SECRET: TASK FORCE LIST

COPY NO 1 OF 20

FROM: S J DAVIES
DATE: 3 March 1988

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mrs R Butler
Mr Mowl
Mr Pickford
Mr Kelly
Ms Turk

a
A few comments
plus more (some v. important). N.
AA

FSBR: CHAPTER 2

I attach a copy of the proofs of Chapter 2 of the FSBR amended in manuscript to bring the drafting into line with what was agreed with the Governor on 2 March.

2. I have also filled in the expenditure, revenue, and borrowing projections in Tables 2.4-2.6, and in Annex Table 2.A3. These figures are still provisional; we have a further discussion with revenue departments tomorrow. The projections include an annual fiscal adjustment path of:

(£ billion)	1989-89	1990-91	1991-92
	3	1	1

This differs from the run of fiscal adjustments that I proposed in my submission on fiscal projections of 23 February - and which you agreed - in that it has an annual fiscal adjustment of £1 billion, rather than £2 billion, in the final year. This change reflects a lower estimate of post-budget tax revenue.

(why?)

3. On the general government expenditure figures, I should point out one notable change from my previous submission: the gross debt interest figure for 1991-92 has been reduced from £17 billion (rounded) to £16 billion. Thus the series of gross debt interest figures now proposed is:

(£ billion)	1987-88	1988-89	1989-~~89~~ 90	1990-91	1991-92
	17.6	17	17	17	16

This compares with PEWP figures of:

(£ billion)	1987-88	1988-89	1989-89	1990-91
	17.8	18	18	18

4. The revisions since the PEWP reflect the repayment of public debt now projected: cumulated net borrowing at end 1990-91 is £10 billion lower in the MTFS than in the figures underlying the PEWP.

5. The final sentence of paragraph 2.20 has been amended to say: "After taking account of the tax reductions announced in the Budget, non-North Sea revenues are projected to grow at a little under the rate of growth of non-oil money GDP." Our current estimates, consistent with the revenue projections proposed for publication, show a fall of around ¼ percentage point in the non-North Sea tax burden between 1987-88 and the end of the MTFS period; all of the fall comes in the last two years of the period.

6. The proofs have to be returned to the printers on Monday 7 March, so I would be grateful for further comments by noon on Monday.

SJD

S J DAVIES

2 The Medium Term Financial Strategy

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

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

retail price

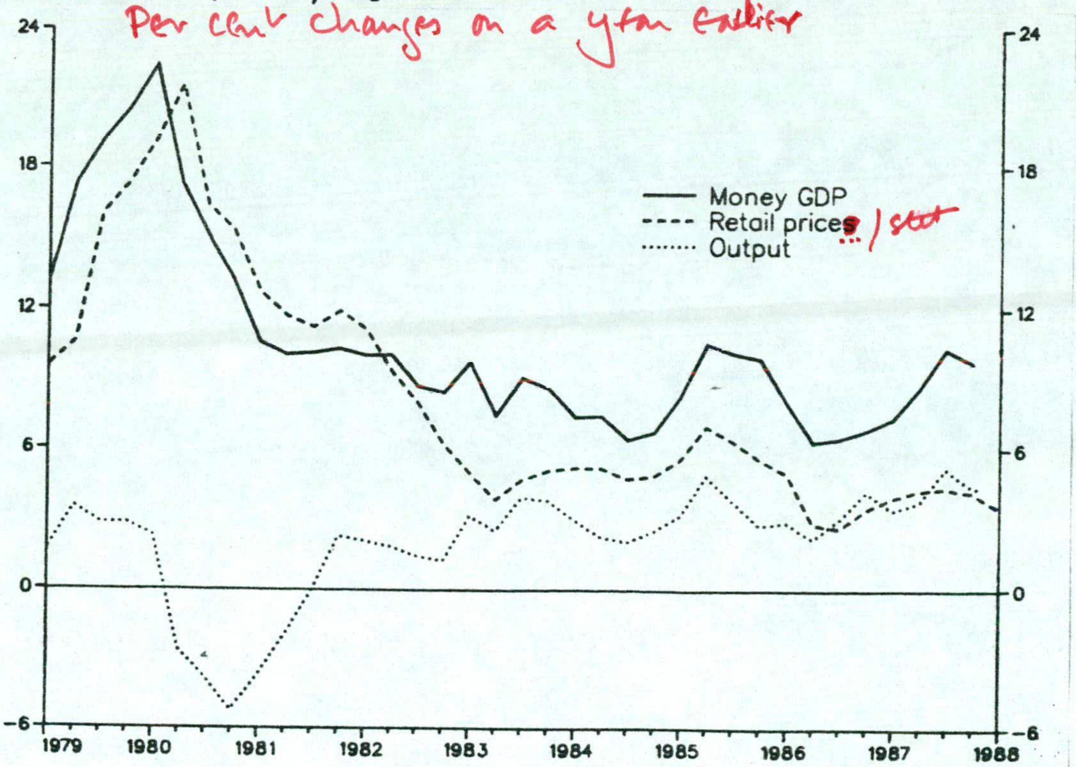
~~near~~

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

approaching

Chart 2.1 Money GDP, output and inflation

Per cent changes on a year earlier



Objectives and the framework of policy

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

Table 2.1 Money GDP Growth*

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

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

This is PEM's redraft, which you accepted

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

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

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

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

Monetary policy

Bring X forward to here

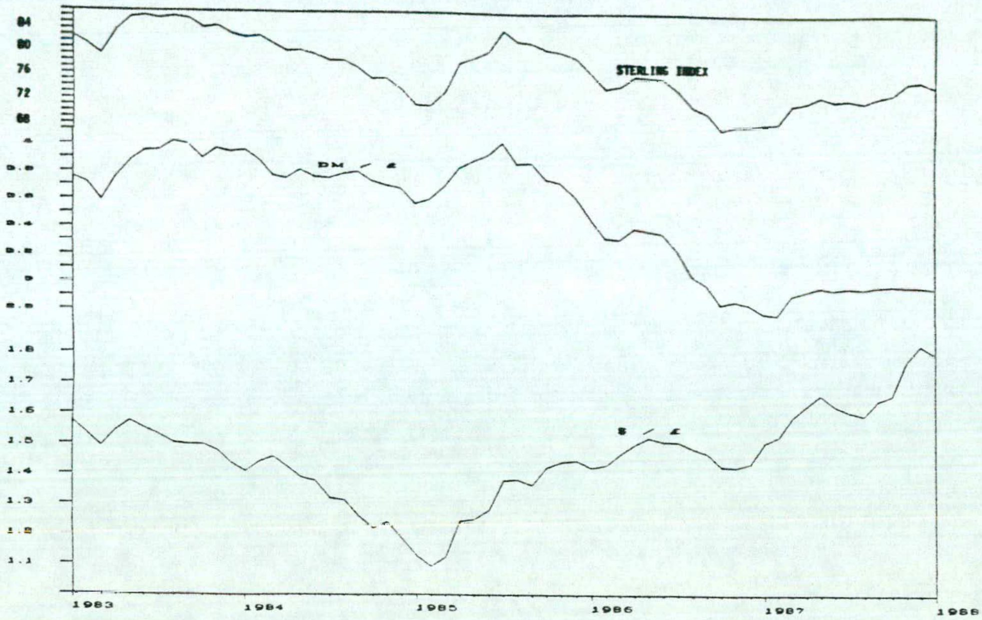
2.~~09~~10 ~~As the Chancellor made clear at the Mansion House last year, t~~The Government ~~is committed~~ attaches particular importance to maintaining a stable exchange rate, ~~with~~ notably the rate against the deutschemark ~~being of particular importance~~. This provides an important financial discipline, ~~and is also helpful to industry.~~ Y here Sterling has remained stable against the deutschemark throughout the past year, following the Louvre accord in February 1987. The discipline of a stable exchange rate provides the underpinning for the declining path of money GDP growth and inflation. ~~Y here~~

2.1~~0~~1 Achieving these objectives ~~implies~~ also requires a reduction in monetary growth over the medium term. For M0, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988–89 of 1–5 per cent ~~[2–6 per cent]~~. This is the same as indicated in last year's MTFS. ~~[This is the same as last year's range.]~~ The ranges given in Table 2.2 for later years are illustrative, but show a steady fall consistent with the declining path for money GDP growth.

This para will need to be moved between Charts 2.2 & 2.3

0381

Chart 2.2 Sterling exchange rates

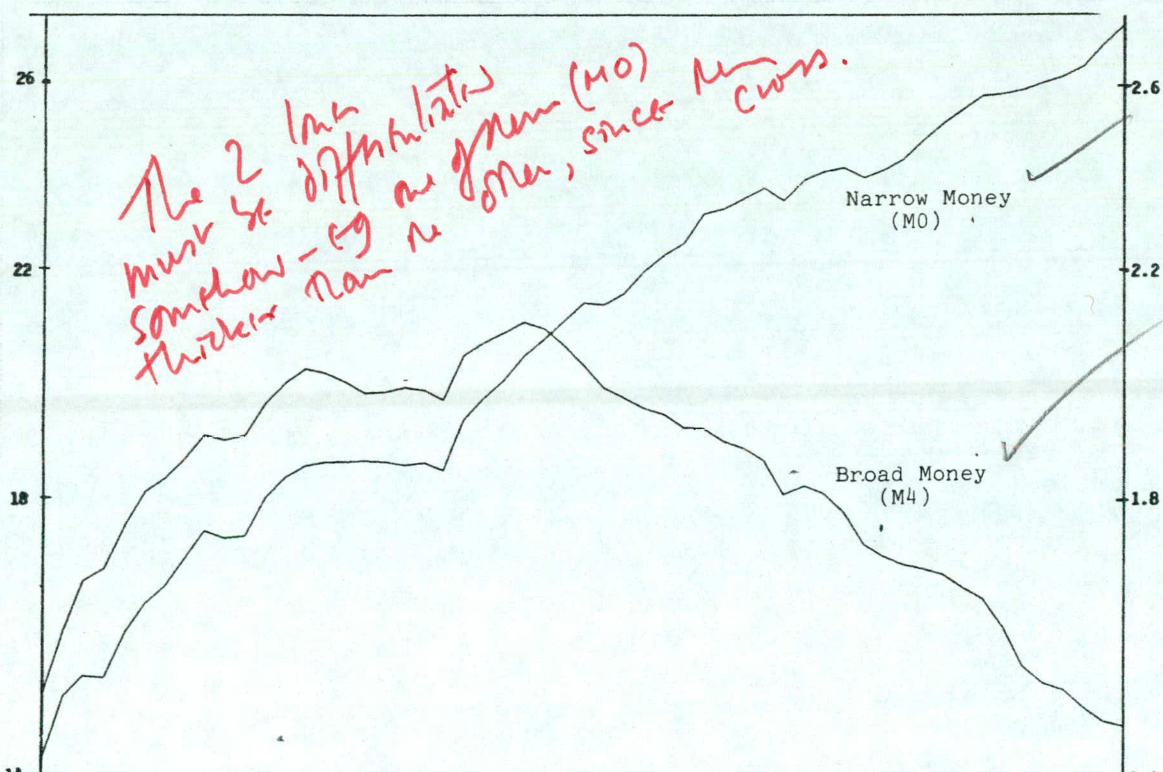


X – Bring forward

2.~~11~~09 Interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure that inflationary pressures are not accommodated. ~~This means, in particular that~~ since increases in domestic costs will not be accommodated by a decline in the exchange rate.

Y Bring forward

Chart 2.3 Velocity of monetary aggregates



The 2 lines must be differentiated somehow – eg one green (M0) thicker than the other, since they cross.

0382

Table 2.2 Growth of M0*

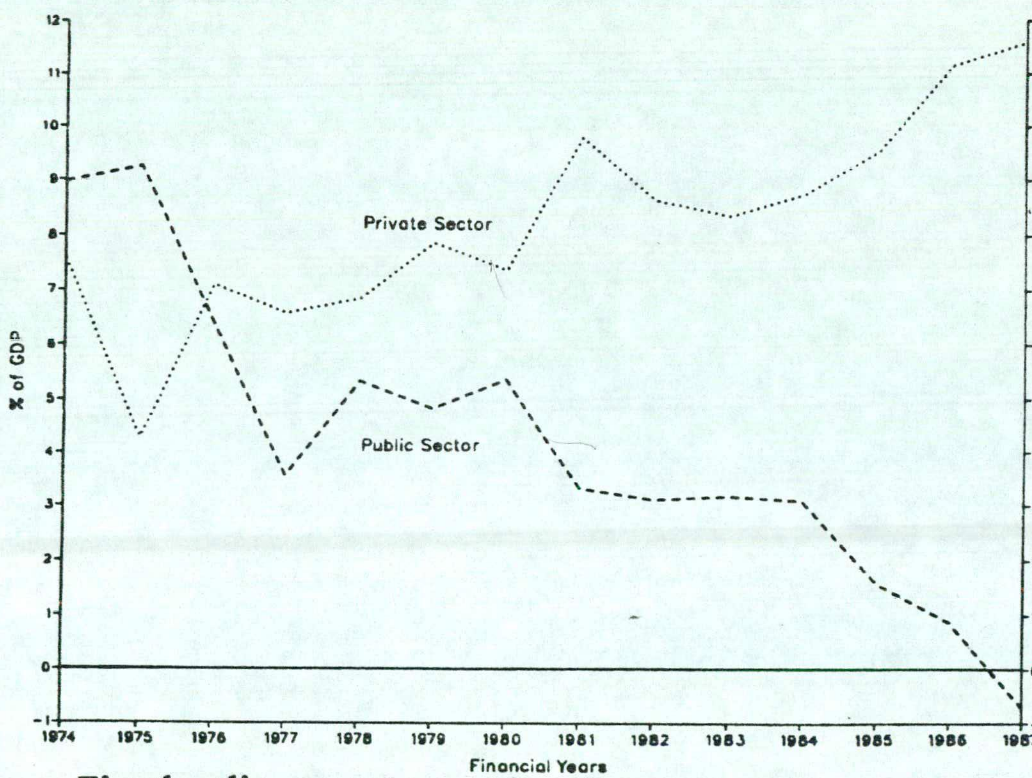
1987–88	1988–89	1989–90	1990–91	1991–92
5	1–5	1–5	0–4	0–4

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

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

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

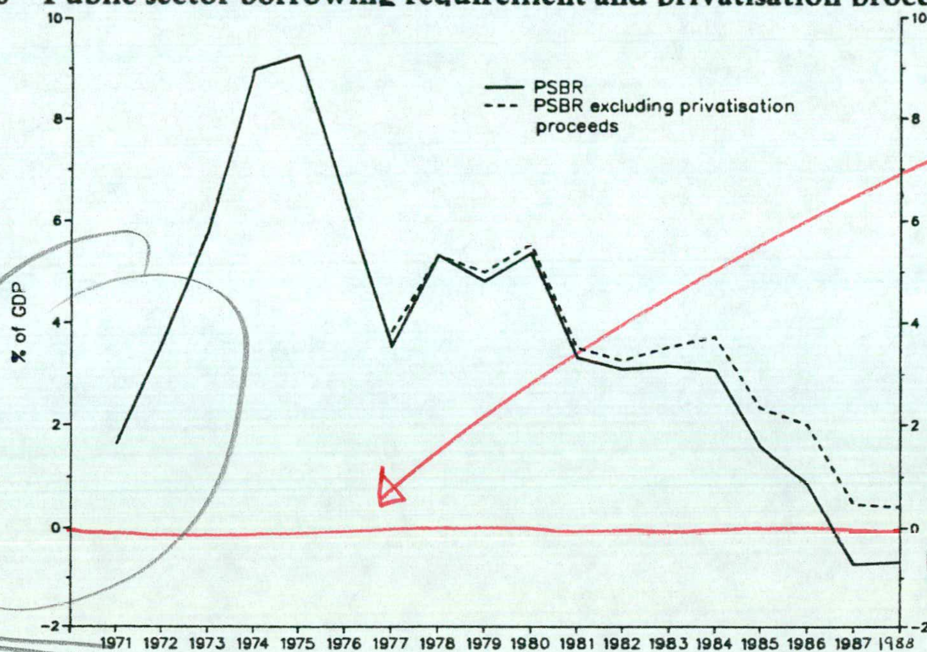
Chart 2.4 Private and public sector borrowing



Fiscal policy

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

Chart 2.5 Public sector borrowing requirement and privatisation proceeds



Surely this should start @ left axis

zero line must always be drawn

space needed

historical

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

2.16 The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of ~~lower~~ some £7 billion in 1988–89. Continuing the gradualist approach which has always been a characteristic of the MTFS, only part of this room for tax reductions has been used. The PSBR for 1988–89 ~~is~~ has been set at ~~[X]~~ £3 billion, ~~little changed from~~ the same as the expected outturn in 1987–88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

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

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

0384

Table 2.3 Output and inflation assumptions

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

Public expenditure

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

Table 2.4 General government expenditure

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
Public expenditure planning total[1]	139.2	146	157	167	176	184
Gross debt interest	17.6	17	17	17	17	16
Other adjustments	8.0	8	8	9	9	9
General government expenditure[2]	164.8	172	183	193	202	210
~~of which~~						
Privatisation proceeds[3]	4.4	5	5	5	5	5
General government expenditure excluding privatisation proceeds	169.2	177	188	198	207	215

[1] *For 1986–87 to 1990–91, the figures are taken from Table 5.1.*
[2] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1987–88 onwards. General government expenditure is assumed to grow by 1% in real terms in 1991–92.*
[3] *See the public expenditure White Paper (Cm 288), Table 1.8. Proceeds are assumed to be the same in cash terms in 1991–92 as in 1990–91.*

Revenue

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

0385

Table 2.5 General government receipts

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

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

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

Public sector borrowing

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

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

Table 2.6 Public sector borrowing[1]

	£ billion, cash					
	1986–87	1987–88	1988–89	1989–90	1990–91	1991–92
General government expenditure	164.8	172	183	193	202	209
General government receipts	160.0	173	185	195	205	214
Fiscal adjustment from previous years[2]	–	–	–	–	3	4
Annual fiscal adjustment[2]	–	–	–	3	1	1
GGBR	4.8	−2	−2	1	1	1
Public corporations' market and overseas borrowing	−1.5	−1	−1	−1	−1	−1
PSBR	3·4	−{3}	−{3}	0	0	0
Money GDP at market prices	387	426	458	488	518	546
PSBR as per cent of GDP	0·9	−{¾}	−{¾}	0	0	0

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

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

coupled with

Conclusion

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

0386

Annex to Chapter 2

Changes since the 1987 MTFS

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

Table 2A.1 Money GDP growth

Differences from 1987 MTFS projections, percentage points

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

Monetary aggregates 2A.2 The growth of M0 in 1987–88 has been within its target range throughout the year. The target range for 1988–89 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

Table 2A.2 The growth of M0

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

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

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

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

Oil price assumptions for revenues: that formulation & that in 2.18 will need to be the same

Table 2A.3 Revenue and expenditure[1]

	Changes from 1987 MTFS projections £ billion				
	1986–87	1987–88	1988–89	1989–90	1990–91
Expenditure					
1 Planning total	−1	−2½	+2½	+5½	+8
2 Other	+1	+½	−½	−1	−2
3 General government expenditure	**0**	**−2**	+2	+4½	+6
Receipts					
4 North Sea taxes	1	+½	−½	−1	−½
5 Other taxes and contributions	+½	+~~1~~3½	+5½	+8	+8½
6 Other	+½	+10	+½	+½	+½
7 General government receipts	**+1**	**+~~5½~~4½**	6	8	8
8 Implied cumulative fiscal adjustment	—	—	−3	−1½	−3
9 Public corporations' market and overseas borrowing	0	~~0~~ −½	0	+½	+½
10 PSBR	**−1**	**−7~~½~~**	−7	−5	−5

[1] Rounded to the nearest £½ billion.

[2] Includes changes in debt interest and other items

[3] The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set off. See footnote 3 to Table 6B.3

[4] Line 8 = lines 10 − 9 − 3 + 7

[5] Public corporations' market and overseas borrowing is included in the planning total and in the PSBR, but not in general government expenditure. Changes in it are therefore deducted in line 2 and added back in line 9.

0446

COPY NO 13 OF 13

FROM: A C S ALLAN
DATE: 3 March 1988

MR MOWL

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

FSBR CHAPTER 6

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

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

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

ACSA

A C S ALLAN

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6 The public sector's finances

The scope of this chapter

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

repayment of debt

Table 6.1 Public expenditure, receipts and borrowing

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

[comma, no dash]

This

~~underlying net repayment of debt~~

borrowing requirement

for

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

Public sector's finances: three-fold analysis

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

Public sector's finances: analysis by type or activity

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

Receipts

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

0237

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

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

will average $15 a barrel over the year ahead.

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

As last year, North Sea

xx
xx
λ 35

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

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

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

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

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

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

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

X

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

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

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

Expenditure

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

x

about

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

Borrowing

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

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

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

again, although only

Trends in receipts and expenditure

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

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REF NO. ACSA/28

COPY NO. 12 OF 12

FROM: A C S ALLAN

DATE: 4 March 1988

MISS C EVANS

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

FSBR: CHAPTER 1

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

ACSA

A C S ALLAN

1 The Budget

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

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

The Medium Term Financial Strategy

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

The economy

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

Tax measures

X

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

Public expenditure

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

Public sector finances

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

only the second such surplus since the early 1950s.

[please check for accuracy & consistency]

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BUDGET

COPY NO 17 OF 18

FROM: A C S ALLAN
DATE: 4 March 1988

MISS SINCLAIR

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

SECRET

FSBR: CHAPTER 4

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

B.L.O. SECRET

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

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

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

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

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

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

ACSA

A C S ALLAN

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RA7.84

REDRAFT OF PARAGRAPH 4.12

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

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4 The Budget tax proposals

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

Income tax

5 ~~**4.02**~~ The basic rate of income tax will be reduced to 25 per cent.

X

6 ~~**4.03**~~ There will be a single higher rate of income tax of 40 per cent ~~which will apply to taxable income over £19,300.~~

2 ~~**4.04**~~ The main income tax personal allowances and the limit of the basic rate band will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3.7 per cent in the RPI in the year to December 1987). This will mean that:

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

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

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

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

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

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

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

3 ~~**4.05**~~ The dependent relative allowance of up to £145, the housekeeper allowance of £100 and the allowance for the services of a son or daughter of £55 will be abolished.

4 ~~**4.06**~~ From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

Life assurance premium relief

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

Benefits in kind

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

Mortgage interest relief

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

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

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

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

SEE REDRAFT

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

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

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

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

B.L.O.

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

X

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

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

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

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

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Inheritance tax

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

Business tax

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

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

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

SEE COVER NOTE

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

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

Business Expansion Scheme

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

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

Forestry

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

X

X **Oil taxation**

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

UK incorporated companies wishing to move their business abroad, or non UK incorporated companies moving their residence abroad, may be so with consent if they pay ~~their~~ the due tax (including tax on capital gains)

X

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

Company residence and migration

X

purposes

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

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VAT ~~4.34~~ 5 From 16 March 1988 the registration limits will become £22,100 per annum and £7,500 per quarter.

~~4.35~~ 6 The provision for applying VAT to confectionery will be amended with the main effect of taxing all cereal bars at the standard rate.

Excise duties ~~4.36~~ 7 The duties on (just under) beer and wines will rise by the equivalent of 1p on a typical pint of beer, 4p on a bottle of table wine, and just over 6p on a bottle of sherry (all inclusive of VAT). The ~~duties~~ duty on spirits will remain unchanged. The minimum duty charge for beer will be abolished and provision will be made for restructuring the duties on low strength mixed drinks.

~~4.37~~ 8 The duty on leaded petrol will be increased by the equivalent of ~~just over $5\frac{1}{2}$p~~ under 6p a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged. ~~so that the duty differential in its favour vis à vis leaded petrol will be increased~~. The duty on derv will rise by the equivalent of ~~just under 5p~~ a gallon.

~~4.38~~ 9 The specific duties on cigarettes, hand-rolling tobacco and cigars will rise by the equivalent of just ~~over 3p~~ on a packet of 20 cigarettes and ~~nearly 2p~~ on a packet of 5 small cigars. The duty on pipe tobacco will remain unchanged.

Tax administration ~~4.39~~ 40 The VAT civil penalty system, introduced in 1985, has been reviewed and various easements are proposed. (4.41) In the light of recommendations by the Keith Committee, changes will be made:

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

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

to improve the information powers of the Inland Revenue;

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

Stamp duties 4.39 Capital duty and unit trust instrument duty will be abolished with effect from Budget Day.

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

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Table 4.1 Direct effects of changes in taxation

See Annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1988–89 Changes from a non-indexed base	Changes from an indexed base	1989–90 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Increase in single allowance of £180 and married allowance of £300	−1 245	−620	−810
2 Increase in additional personal allowance and widow's bereavement allowance of £120	−15	−5	−10
NEW ORDER 3 Increase in age allowance of £220 (single) and £360 (married) for those aged 65 to 79	−90	−45	−55
4 Increase in age allowance of £240 (single) and £360 (married) for those aged 80 and over	−15	−10	−10
5 Increase in income limit for age allowance of £800	−10	−5	−10
9 ~~6~~ Reduction of 2p in basic rate	~~−2060~~ −2170	~~−2060~~ −2170	~~−2860~~ −2970
6 ~~7~~ Increase in basic rate limit of £2 100 to ~~£20 000~~ £19,300	~~−295~~ −170	~~−215~~ −85	~~−400~~ −150
10 ~~8~~ Abolition of higher rates of income tax above 40p	~~−1 015~~ −1055	~~−960~~ −995	~~−2050~~ −2150
7 ~~9~~ Abolition of minor personal allowances	+10	+10	+10
8 ~~10~~ Restriction on additional personal allowance for unmarried couples	—	—	+5
11 Reduction in relief on life assurance premiums	—	—	+70
12 Fringe benefits—car benefit scales	~~+230~~ +290	~~+230~~ +290	~~+280~~ +360
~~13 Fringe benefits—earnings threshold (P11D limit)~~	~~50~~	~~50~~	~~−50~~
13 ~~14~~ Fringe benefits—car parking space	−5	−5	−5
14 ~~15~~ Mortgage interest relief ceiling applied to residence	+5	+5	+20
15 ~~16~~ Abolition of tax relief on new home improvement loans	~~+80~~ +60	~~+80~~ +60	~~+200~~ +170
16 ~~17~~ Abolition of tax relief on new loans for homes for dependent relatives & and divorced and separated spouses	*	*	*
17 ~~18~~ Abolition of tax relief on new non-charitable covenants	+45	+45	+105
18 ~~19~~ Payroll giving to charities—increase in donation limit to £240 a year	*	*	*
19 ~~20~~ Change in rules for maintenance payments	−10	−10	−5
20 ~~21~~ Change in additional rate on discretionary trusts	−5	−5	−10
21 ~~22~~ Lloyds: reform of administrative arrangements	—	—	*
22 ~~23~~ Lloyd's reinsurance to close—relief for leavers	*	*	*
23 ~~24~~ Unapproved employee share schemes: relaxation of charge	*	*	*
24 ~~25~~ Employee priority in public offer of shares	*	*	*
25 ~~26~~ Approved FA 1984 employee share option schemes—restricted shares	*	*	*
26 ~~27~~ Assessing procedure for Schedule D	—	—	—
27 ~~28~~ Redundancy payments: change to scale of charge	*	*	*
28 ~~29~~ Withdrawal of "top-slicing" relief for tax charged on premiums for leases, etc	*	*	*
Income tax and capital gains tax			
29 ~~30~~ Independent taxation of income and chargeable capital gains of husband and wife from 1990–91	*	*	−30†
30 ~~31~~ Business Expansion Scheme—limit on relief	*	*	+25
31 ~~32~~ Business Expansion Scheme—private rented housing	*	*	−40
32 ~~33~~ Personal Equity Plans—increase in limit	*	*	−5
Income tax and corporation tax			
33 ~~34~~ Forestry—removal of commercial woodlands from scope of tax	—	—	*
[~~35 Personal pensions—minor changes~~	−10	−10	−5]
34 ~~36~~ Refunds of employee pension contributions	+15	+15	+15
35 ~~37~~ Occupational pensions—minor amendments	—	—	—
36 ~~38~~ End of year interest on PAYE and subcontractors deductions	—	—	—
37 ~~39~~ Capital allowances—exempt persons	—	—	—
38 ~~40~~ Capital allowances—safety at sports grounds	*	*	*
39 ~~41~~ Capital allowances—abolition of quarantine premises relief (being considered)	*	*	*
40 ~~42~~ Withdrawal of relief for business entertainment of overseas [businessmen]	*	*	+5
41 ~~43~~ Rebasing capital gains of companies to March 1982	−25	−25	−235

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

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

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

* = Negligible — = Nil

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Annex to Chapter 4

How the figures in Table 4.1 have been calculated

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(under consideration) ×

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

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

(") ×

14 to 16
~~**15** to **17**~~ See paragraph 4.1~~0~~04. Relief for loans for the purchase on improvement of let property is not affected.

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

18
~~**19**~~ See paragraph 4.12

19
~~**20**~~ The new tax regime for maintenance payments in paragraph 4.1~~3~~2 will mean that:

for payments under new maintenance arrangements, relief will be restricted to payments to a divorced or separated spouse, up to a limit ~~equal to [1,490]~~.

£1,490, being the difference between the married & single allowance.

Recipients will not be liable to tax on maintenance payments;

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, and

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

~~31~~ 30 and ~~32~~ 31 See paragraphs 4.2~~6~~8 and 4.2~~7~~9. The estimated revenue effects depend on take up and are highly uncertain.

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

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

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

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

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

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

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

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

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

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

~~42~~ 40 See paragraph 4.2~~4~~6. The yield from the VAT change is shown separately at item 71.

~~43~~ 41 and ~~44~~ 42 See paragraph 4.1~~7~~6. The total cost of rebasing will build up to a peak of some £850 million in 1991–92, of which the amount attributable to companies' gains is about three-quarters. The figures take account of the likely effect of this measure on the volume and timing of disposals; and, ~~to~~ for individuals and trusts, are additional to the effect on item 45.

~~45~~ 3 See paragraph 4.1~~8~~9. Until the introduction of independent taxation in 1990–91, the gains of married couples will be taxed as the marginal slice of the husband's income. The revenue yield in 1990–91 is estimated at £40 million and in 1991–92 at £85 million. The figures take account of the likely effect of taxing gains at income tax rates on the volume and timing of disposals.

~~46~~ 4 See paragraph 4.~~19~~ 20.

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

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

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

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

~~52~~ 50 See paragraph 4.33.

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

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

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

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

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

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

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

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

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

[used letters]

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

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

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

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

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

63 and **64** The estimated cost for 1990–91 of the proposed rate structure for inheritance tax in paragraph 4.21 is £240 million, measured against ~~the~~ an indexed base. For 1991–92 it is £270 million. The estimated full year cost attributable to transfers in 1988–89 is £220 million. To qualify for exemption, transfers to political parties must be made on or within one year of death.

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

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

Value added tax

66 See paragraph 4.40. 36

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

68 See paragraph 4.38. 35

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

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

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~~72~~ 70 See paragraph 4.26. The change will bring the treatment of VAT incurred by businesses on entertaining foreign businessmen into line with the treatment of other business entertainment.

Excise duties

~~72~~ 71 See paragraph ~~4.41~~. 37

~~73~~ 72 The duty on typical beer will be increased by 4·7 per cent, equivalent to 1p a pint (inclusive of VAT).

~~74~~ 73 From 1 October 1988, beer duty will be charged on the basis of £0·90 a hectolitre for every degree by which the original gravity of the beer exceeds 1000°.

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

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

~~77 See paragraph 4.41.~~

~~78~~ 6 Lower strength mixed drinks, not exceeding 5·5 per cent alcohol, will be dutied according to their alcoholic strength on a scale proportionate to table wine duty. This will bring duties on wine-based and similar mixed drinks into line.

~~79~~ 7 The duty on leaded petrol will be increased by 5·5 per cent or ~~5·6p~~ 5·5p a gallon (inclusive of ~~consequential~~ VAT). The duty on unleaded petrol will remain unchanged, so that the tax differential in favour of unleaded petrol will rise to 10·6p a gallon.

~~80~~ 78 The duty on derv will be increased by ~~5·7~~ 5·5 per cent, equivalent to ~~4·9p~~ 4·7p a gallon (inclusive of ~~consequential~~ VAT).

~~81~~ 79 There will be no change in the rates of duty on gas oil and fuel oil.

~~82~~ 80 The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by 3·8 per cent or 3·4p a packet of 20 cigarettes, 5·3p on a 25 gram packet of hand rolling tobacco and 1·9p a package of 5 small cigars (both inclusive of ~~consequential~~ VAT).

~~83 See paragraph 4.43.~~ 81 34

Vehicle excise duties

~~84~~ 82 There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

~~85~~ 83 From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

~~86~~ 84 From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable of carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1,600. These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£130).

~~87~~ 85 There will be no change in bus fuel grant.

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COPY NO 2 OF 10

From: J ODLING-SMEE

4th March 1988

MISS SINCLAIR

cc Principal Private Secretary
PS/Financial Secretary
Sir Peter Middleton
Mr Scholar
Mr Culpin
Ms Evans

Mr Calder - IR

FSBR: CHAPTER 4

I have a couple of editorial points, in addition to the minor points I mentioned on the telephone.

2. First, I do not think that the text of the box on independent taxation should be in bold print. This would be the only place in the whole of the FSBR where text, as opposed to headings and some rows in tables, was in bold print. It would therefore completely alter the character of the document, and we would have to consider whether it made sense to have other bits of text in bold print as well. Anyway, I understand that it was a mistake that the bold print appeared here in the first place.

3. Secondly, I suggest that the heading of the annex should be: "Explanatory notes to Table 4.1". The present heading ("How the figures in Table 4.1 have been calculated") is no longer strictly accurate since some of the notes describe the measures rather than the figures.

J ODLING-SMEE

REF ACSA 27

COPY NO 18 OF 18

FROM: A C S ALLAN

DATE: 4 March 1988

MISS SINCLAIR

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

FSBR: CHAPTER 4

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

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

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

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

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

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

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

ACSA

A C S ALLAN

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REDRAFT OF PARAGRAPH 4.12

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

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4 The Budget tax proposals

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

Income tax

4.02 5 The basic rate of income tax will be reduced to 25 per cent.

4.03 6 There will be a single higher rate of income tax of 40 per cent ~~which will apply to taxable income over £19,300.~~ and the limit of the basic rate band

X

4.04 2 The main income tax personal allowances will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3.7 per cent in the RPI in the year to December 1987). This will mean that:

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

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

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

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

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

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

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

4.05 3 The dependent relative allowance of up to £145, the housekeeper allowance of £100 and the allowance for the services of a son or daughter of £55 will be abolished.

4.06 4 From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

Life assurance premium relief

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

Benefits in kind

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

Mortgage interest relief

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

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

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

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

SEE REDRAFT

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

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

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

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

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

X

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

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

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

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

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Inheritance tax

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

Business tax

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

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

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

SEE COVER NOTE

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

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

Business Expansion Scheme

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

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

Forestry

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

Oil taxation

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

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

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

Company residence and migration

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

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VAT ~~4.34~~ 4.35 From 16 March 1988 the registration limits will become £22,100 per annum and £7,500 per quarter.

~~4.35~~ 4.36 The provision for applying VAT to confectionery will be amended with the main effect of taxing all cereal bars at the standard rate.

Excise duties ~~4.36~~ 4.37 The duties on (just under) beer and wines will rise by the equivalent of 1p on a typical pint of beer, 4p on a bottle of table wine, and just over 6p on a bottle of sherry (all inclusive of VAT). The duties on spirits will remain unchanged. The minimum duty charge for beer will be abolished and provision will be made for restructuring the duties on low strength mixed drinks.

~~4.37~~ 4.38 The duty on leaded petrol will be increased by the equivalent of ~~just over 5½p~~ under 6p a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged. ~~so that the duty differential in its favour vis à vis leaded petrol will be increased~~. The duty on derv will rise by the equivalent of just under 5p a gallon.

~~4.38~~ 4.39 The specific duties on cigarettes, hand-rolling tobacco and cigars will rise by the equivalent of just over 3p on a packet of 20 cigarettes and nearly 2p on a packet of 5 small cigars. The duty on pipe tobacco will remain unchanged.

Tax administration ~~4.39~~ 4.40 The VAT civil penalty system, introduced in 1985, has been reviewed and various easements are proposed. (4.41) In the light of recommendations by the Keith Committee, changes will be made:

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

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

to improve the information powers of the Inland Revenue;

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

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

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

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Table 4.1 Direct effects of changes in taxation

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

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

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TABLE 4.1 (2/3)

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

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

* = Negligible — = Nil

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Annex to Chapter 4

How the figures in Table 4.1 have been calculated

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

~~10 See paragraph 4.06.~~

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

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

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

(under consideration) ×

~~13 See paragraph 4.09.~~ ~~[illegible]~~

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

~~15~~ 14 to ~~17~~ 16 See paragraph 4.1~~0~~9. Relief for loans for the purchase on improvement of let property is not affected. ~~[illegible]~~

(") ×

~~18~~ 17 See paragraph 4.1~~1~~0. The change is estimated to yield £160 million in 1990–91, £175 million in 1991–92, and £[210] million eventually. ~~These figures do not include the effect on public expenditure of the parallel change in the student grant system.~~ There will be compensating changes in the student grant system (see paragraph 5.04)

~~19~~ 18 See paragraph 4.12 1

~~20~~ 19 The new tax regime for maintenance payments in paragraph 4.1~~3~~2 will mean that:

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

, and

arrangements are in place ~~and from 1990–91 onwards, couples may transfer assets between them where one spouse has unused annual exempt amount or basic rate band~~. ~~T~~ t he figure for 1989–90 in Table 4.1 reflects ~~the deferral of disposals~~ this. Costs for capital gains tax in 1990–91 and 1991–92 are each estimated at £60 million; ~~T~~ t hese estimates ~~which allow for changes in taxpayers' behaviour~~ are subject to a high degree of uncertainty.

~~31~~ 30 and ~~32~~ 31 See paragraphs 4.2~~6~~8 and 4.2~~7~~9. The estimated revenue effects depend on take up and are highly uncertain.

~~33~~ 32 The annual limit on investment in a PEP will be raised from £2,400 to £3,000. At the same time the amount which may be held in cash will be increased from £240 ~~and~~ to £300 (or, in each case, 10 per cent of total market value of a plan). [And the amount which may be invested in a unit trust or investment trust will rise from £420 to £xxx (or, if greater, 25 per cent of total investment).] The changes will apply from calendar year 1988.

~~34~~ 33 Schedule B will be abolished with effect from 1988–89. With effect from 15 March 1988 (subject to transitional provisions extending to 5 April 1992) the right of occupiers of commercial woodlands to elect to be assessed to tax on their profits or losses under Schedule D will be abolished. The eventual net annual saving is estimated at £[10] million. ~~[Provision for increased forestry grants will be introduced as from [ ].]~~ ~~These figures do not include the effect on forestry~~

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

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

~~36~~ 34 The rate of tax on refunds of employee pension contributions will be increased from 10 per cent to 20 per cent.

~~37~~ 35 Minor amendments are to be made to the 1987 legislation (which dealt with exploitation of pensions tax reliefs).

~~38~~ 36 Interest will be charged where an employer or contractor delays payment to the Inland Revenue of amounts deducted under the PAYE or subcontractor deduction schemes beyond 19 April immediately following the deduction year. This interest charge will not be introduced before 1992.

~~39~~ 37 The rules for calculating industrial buildings allowance following a sale and those for transfers of machinery or plant between connected persons will be amended to prevent excessive relief where one person is not chargeable to tax in the United Kingdom. These changes will prevent a potential Exchequer loss of up to £150 million in 1991–92 with a diminishing effect in later years.

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

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

~~42~~ 40 See paragraph 4.2~~4~~6. The yield from the VAT change is shown separately at item 71.

~~43~~ 41 and ~~44~~ 42 See paragraph 4.17. The total cost of rebasing will build up to a peak of some £850 million in 1991–92, of which the amount attributable to companies' gains is about three-quarters. The figures take account of the likely effect of this measure on the volume and timing of disposals; and, ~~to~~ for individuals and trusts, are additional to the effect on item 45.

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~~45~~ 3 See paragraph 4.1~~8~~9. Until the introduction of independent taxation in 1990–91, the gains of married couples will be taxed as the marginal slice of the husband's income. The revenue yield in 1990–91 is estimated at £40 million and in 1991–92 at £85 million. The figures take account of the likely effect of taxing gains at income tax rates on the volume and timing of disposals.

~~46~~ 4 See paragraph 4.~~19~~ 20

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

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

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

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

~~52~~ 50 See paragraph 4.33.

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

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

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

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

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

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

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

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

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

[used letters)

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

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

58
~~60~~ See paragraph 4.31. The PRT oil allowance for Southern Basin and onshore fields given development consent on or after 1 April 1982 is to be reduced to 100,000 tonnes per chargeable period, with a cumulative total of 2 million tonnes. The yield figures in Table 4.1 relate to this proposal only. At the same time, it is proposed to abolish royalty on these fields. These two measures have cumulative cost of around £~~[~~140~~]~~ million in the first five years ~~(~~in part because it is estimated that they will accelerate certain developments~~)~~, but in the long run they are expected to be broadly revenue neutral.

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

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

1 2
~~63~~ and ~~64~~ The estimated cost for 1990–91 of the proposed rate structure for inheritance tax in paragraph 4.21 is £240 million, measured against ~~the~~ an indexed base. For 1991–92 it is £270 million. The estimated full year cost attributable to transfers in 1988–89 is £220 million. To qualify for exemption, transfers to political parties must be made on or within one year of death.

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

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

Value added tax

5
~~66~~ See paragraph 4.~~40~~ 35. 36

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

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

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

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

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~~72~~ 70 See paragraph 4.26. The change will bring the treatment of VAT incurred by businesses on entertaining foreign [businessmen] into line with the treatment of other business entertainment.

Excise duties

~~72~~ 71 See paragraph ~~4.41~~. 37

~~73~~ 72 The duty on typical beer will be increased by [4·7 per cent], equivalent to [1p] a pint (inclusive of VAT).

~~74~~ 73 From [1 October 1988, beer duty will be charged on the basis of £[0·90] a hectolitre for every degree by which the original gravity of the beer exceeds 1000°.

~~75~~ 74 The duty on cider and perry will be increased by [9·7] per cent or [1p] a pint (inclusive of ~~consequential~~ VAT).

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

~~77 See paragraph 4.41.~~

~~78~~ 76 Lower strength mixed drinks, not exceeding 5·5 per cent alcohol, will be dutied according to their alcoholic strength on a scale proportionate to table wine duty. This will bring duties on wine-based and similar mixed drinks into line.

~~79~~ 77 The duty on leaded petrol will be increased by [5·5] per cent or [~~6·6~~ 6·5p] a gallon (inclusive of ~~consequential~~ VAT). The duty on unleaded petrol will remain unchanged, so that the tax differential in favour of unleaded petrol will rise to [10·6p] a gallon.

~~80~~ 78 The duty on derv will be increased by [~~5·7~~ 5·5] per cent, equivalent to [~~4·9p~~ 4·7p] a gallon (inclusive of ~~consequential~~ VAT).

~~81~~ 79 There will be no change in the rates of duty on gas oil and fuel oil.

~~82~~ 80 The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by [3·5] per cent or [3·4p] a packet of 20 cigarettes, 5·3p on a 25 gram packet of hand rolling tobacco and [1·9p] a package of 5 small cigars (both inclusive of ~~consequential~~ VAT).

~~83 See paragraph 4.43.~~ 34

Vehicle excise duties

~~84~~ 82 There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

~~85~~ 83 From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

~~86~~ 84 From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable of carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1,600. These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£150).

~~87~~ 85 There will be no change in bus fuel grant.

0102

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COPY NO 2 OF 12

FROM: J HIBBERD
DATE: 4 March 1988

P.N.S
4.iii

1. MR SEDGWICK
2. CHANCELLOR

a
A few comments
AA

— And a few more from me ~

cc: Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Pickford
Mr R I G Allen
Miss Simpson
Mr Hudson
Mr Allum
Ms C Evans

CHAPTER 3 OF THE FSBR: THE INDUSTRY ACT FORECAST

I attach the first proof of Chapter 3 of the FSBR, which takes account of the comments you made on the draft submitted on 26 February. We will be returning the proofs to the printers on Monday 7 March so it would be helpful to have your comments on this draft during Monday morning.

New data

2. We will receive the final estimates of the 1987 current account from the CSO early next week. We will then resubmit revised versions of the relevant sections of Chapter 3.

3. We will be discussing with the CSO in the middle of next week the final estimates for GDP and domestic demand in the fourth quarter and for 1987 as a whole. These will, hopefully, be incorporated in the version submitted to you on Thursday. For the moment we have not changed any of the main numbers in the draft, though some of the details have been updated.

Drafting changes

4. The following changes have been made to the text since you last saw it.

(i) As you requested a paragraph on inflation (3.04) has been added to the summary section.

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(ii) A proposed amendment to the final sentence of paragraph 3.05, on prospects for unemployment, is marked in manuscript. The forecast shows growth in non oil GDP of 2½-3 per cent over the next year, broadly in line with estimated growth of 2¾ per cent in non-oil productive potential. Despite more modest growth we still expect some further fall in unemployment, but largely because of the lagged effects of high growth which has already occurred. The revised draft removes the link between the prospects for unemployment and future growth.

means through the year I presume

(iii) The chart of personal sector financial assets and liabilities which you requested is attached. We propose to insert it, as Chart 3.7, after the new paragraph 3.34, which discusses the chart. I am afraid the version of this chart attached to Mr Owen's minute of 26 February showed an incorrect series for 'gross financial liabilities'. The corrected chart makes the point even more strongly that gross assets have been rising faster than gross liabilities. The estimates shown for 1987 now incorporate our forecast of the effect of the stock market crash in the fourth quarter. Although data are only available to the third quarter it might be regarded as misleading not to make some allowance for the effect of the crash.

Very true!

(iv) The first sentence of the old paragraph 3.35 has been amended to include a more explicit indication of the rate of profits growth in 1987 which the CSO will be showing in their March 18 press notice. (Profits growth in 1987 has, not surprisingly, turned out to be greater than in 1986.)

(v) As agreed, a sentence on the TPI has been added to paragraph 3.44.

Other issues

Wait

5. The reference to the oil price assumption in paragraph 3.02 is in line with your suggestion. However, in view of the recent oil price fall, we could describe the assumed $15 oil price as 'close to recent levels' and maybe also remove the reference to last year.

6. US trade figures for January will be published on 11 March. If they turn out to be bad we will need to consider removing the references to improved US trade figures in paragraphs 3.08 and 3.16.

7. Mr Allan's minute of 29 February raised two other issues.

(i) You asked why the forecast of investment in dwellings slows to 2-2½ percent in 1988. For new dwellings, it reflects a return to a more "normal" growth rate relative to income. (New dwellings investment rose exceptionally fast in 1986, after falling in 1985.) Expenditure on improvements (about half of all new personal dwellings investment) has been broadly flat since the second half of 1986 and is expected to remain sluggish. This reflects the general slowdown in personal spending as well as the Budget proposal to withdraw tax relief on mortgage funded improvements, which, by itself, reduces improvement spending by about 1½ per cent in 1988.

Still not v convincing

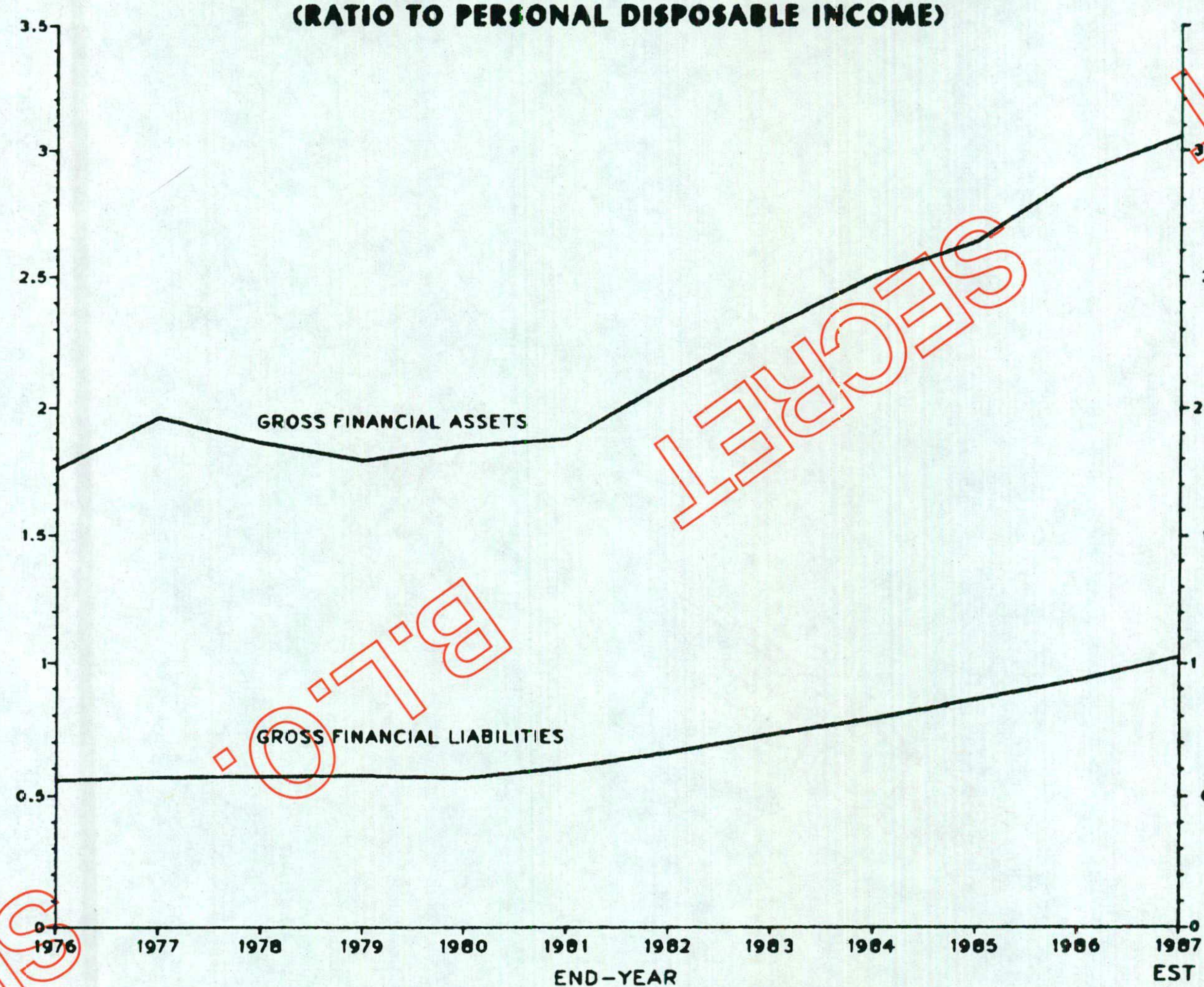
(ii) We will let you know the updated forecast of manufacturing production in 1989H1, and its relationship with projected GDP growth, when we have the new GDP data next week.

Jim Hibberd

J HIBBERD
EA1

Chart 3.7

PERSONAL SECTOR FINANCIAL ASSETS AND LIABILITIES
(RATIO TO PERSONAL DISPOSABLE INCOME)



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3 The economy: recent developments and prospects to mid 1989

Summary

significantly

3.01 1988 should see growth of 3 per cent, the average rate over the last six years, but ~~appreciably~~ below the 4¼ per cent growth in 1987. Inflation is expected to remain low and there are good prospects for a further fall in unemployment.

?

Assumptions 3.02 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. As last year, it assumes that North Sea oil prices will average $15 a barrel over the year ahead, and that the exchange rate will remain close to its current level.

recomnder later ✓

Demand and activity 3.03 The economy grew strongly in 1987, with GDP growth of 4¼ per cent and manufacturing output growth of 5½ per cent. Domestic demand grew by just under 4 per cent, the same as in 1986. It is expected to grow at a similar rate in 1988, with slightly lower growth of consumer spending being offset by markedly faster growth of investment. GDP is forecast to grow by 3 per cent (3½ per cent for non-oil GDP).

averaged

Inflation 3.04 RPI inflation ~~was~~ just over 4 per cent in 1987. It fell to 3¼ per cent in January 1988, ~~but may edge up to~~ 4 per cent ~~by~~ the fourth quarter of 1988.

and is forecast to return to — in

Labour market 3.05 Employment has risen strongly over the past year, with unemployment falling by half a million—the largest decline since the war. With ~~non-oil GDP growing at close to 3 per cent during 1988,~~ ~~unemployment~~ should continue to fall. in 1988

the current buoyancy of activity,

Unemployment

World economy 3.06 GNP in the main industrial economies grew by about 3 per cent last year. Some slackening in growth is likely in 1988 particularly in the United States, and growth in the main industrialised countries in aggregate could ease slightly to 2½ per cent. Industrial production picked up strongly during 1987. Associated with this were faster growth in trade in manufactures and some recovery in industrial materials prices. World trade in manufactures appears to have grown by about 5½ per cent in 1987 and should grow by a similar amount this year.

UK trade and current account 3.07 Both export and import volumes grew rapidly last year: some moderation in growth is likely in 1988. Following recent revisions to the surplus on invisibles the current account is now estimated to have been in deficit by £1 billion in 1987. A deficit of £3 billion (¾ per cent of GDP) is forecast for 1988.

To Mr [illegible]

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Financial conditions

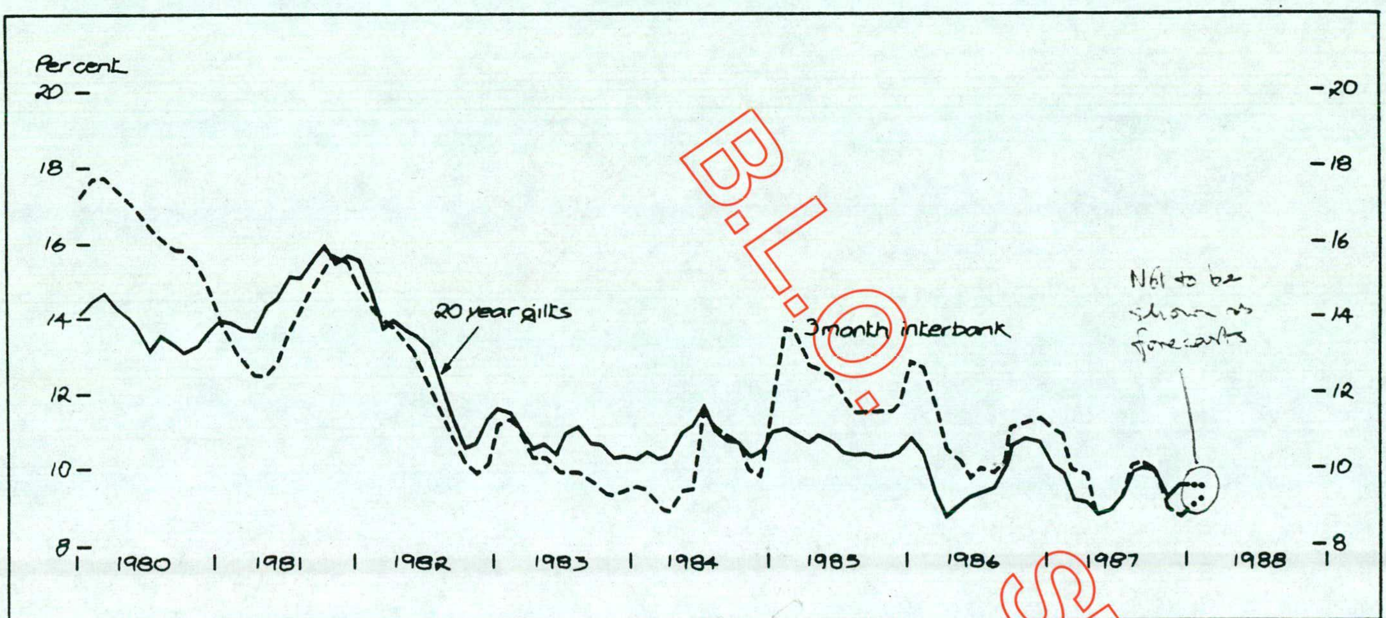
Exchange rates **3.08** Sterling has been stable against the Deutschemark over the past year. There was an inflow of $[20] billion into the reserves in the year to February. Following the Louvre accord the dollar remained stable against the major currencies for much of 1987, before falling further towards the end of the year. It has risen slightly in the early months of 1988, in the wake of the G7 statement just before Christmas and improved US trade figures.

XX later

This will need waiting until the last minute

Interest rates **3.09** Short-term interest rates in the UK fell from 11 per cent at the beginning of 1987 to 9 per cent in July. They rose to 10 per cent in August, but came down again to 8½ per cent in the immediate aftermath of October's stock market collapse. Following the restoration of more settled markets earlier this year short-term interest rates returned to around 9 per cent. Longer term interest rates have followed a similar profile to short-term rates, but with smaller fluctuations. In recent weeks they have been around 9½ per cent.

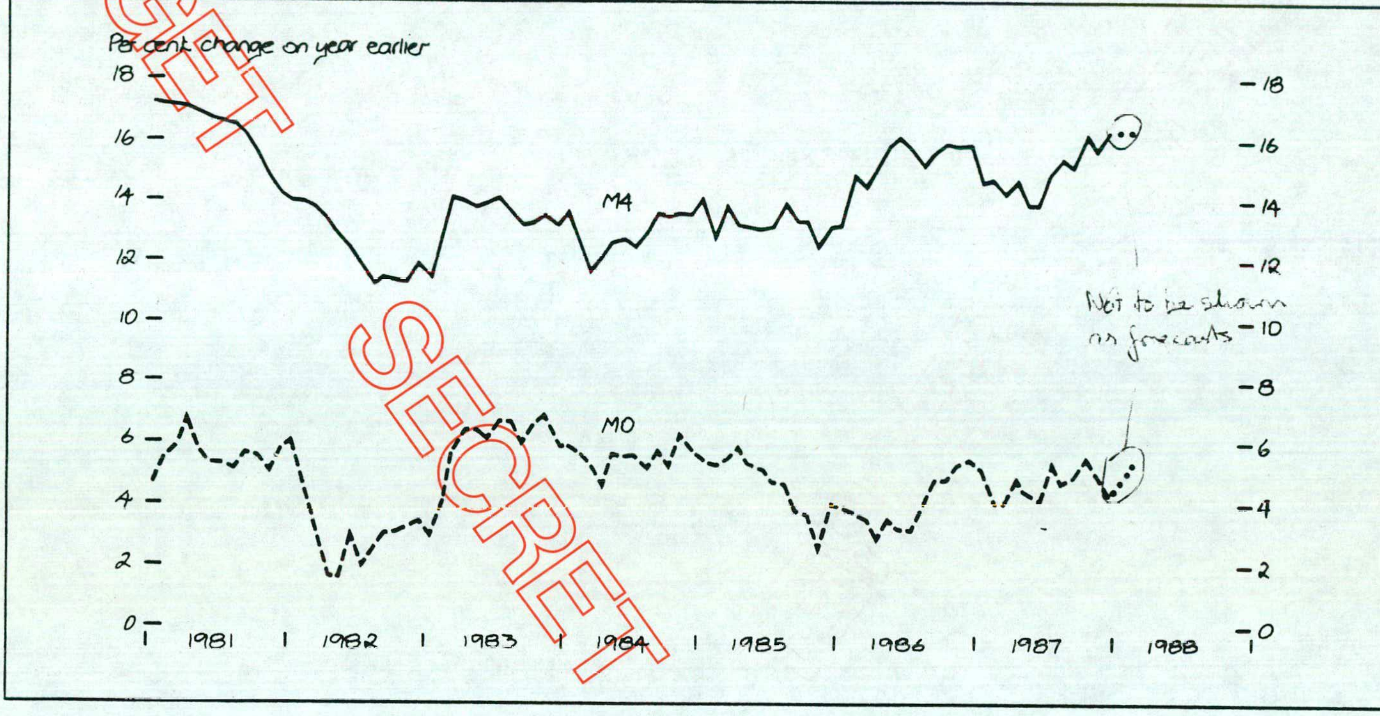
Chart 3.1 **Interest rates in the UK**



Narrow money **3.10** M0 growth, which fell in early 1987, rose rapidly in the summer reflecting lower interest rates. It may move to the top of or outside its target range in the early part of the financial year but should be within the [1–5] per cent range later in the year.

Broad money **3.11** M4, which includes the liabilities of both banks and building societies, has grown at close to 16 per cent over the past year. As in recent years there has been a sharp fall in its velocity.

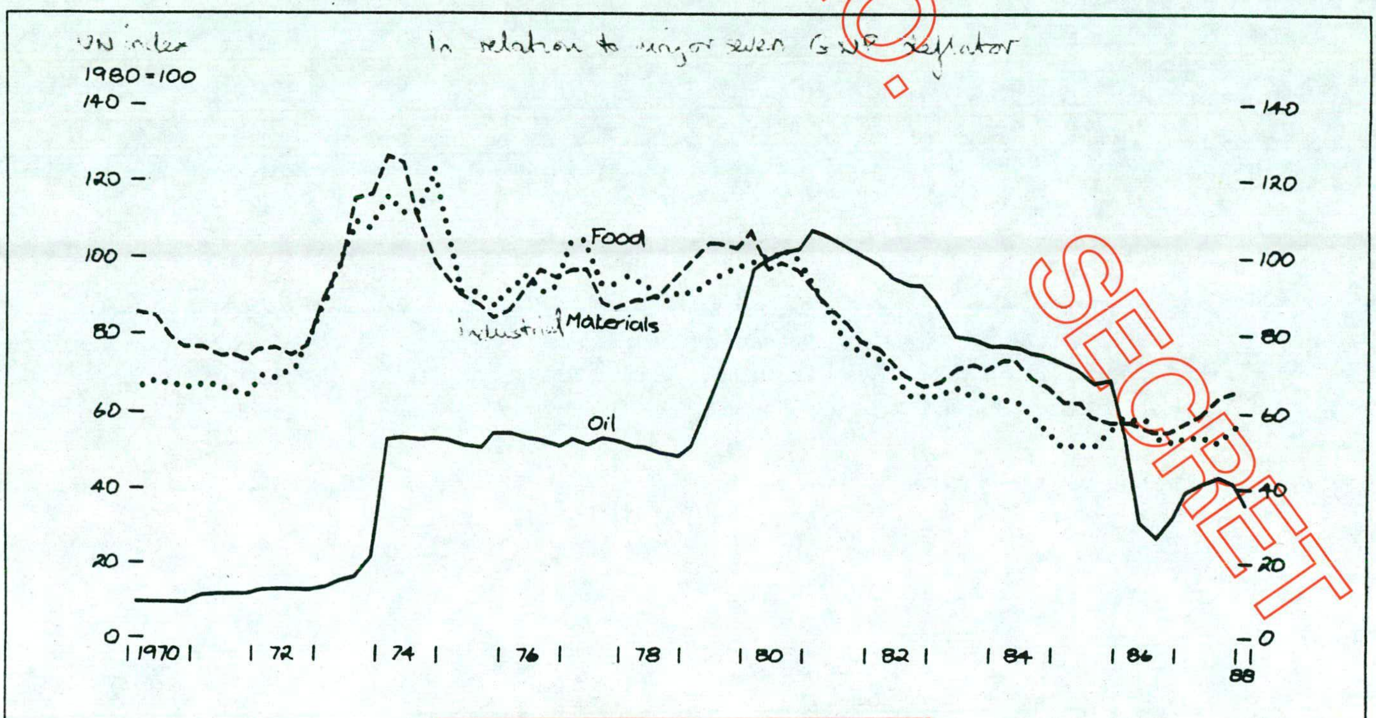
Chart 3.2 Growth rates of monetary aggregates



World economy

Recent developments 3.12 Output growth in the industrialised countries strengthened in the second half of 1987, particularly in North America and Japan. Real GNP in the major seven OECD countries is estimated to have increased by 3 per cent in 1987, marginally faster than in 1986.

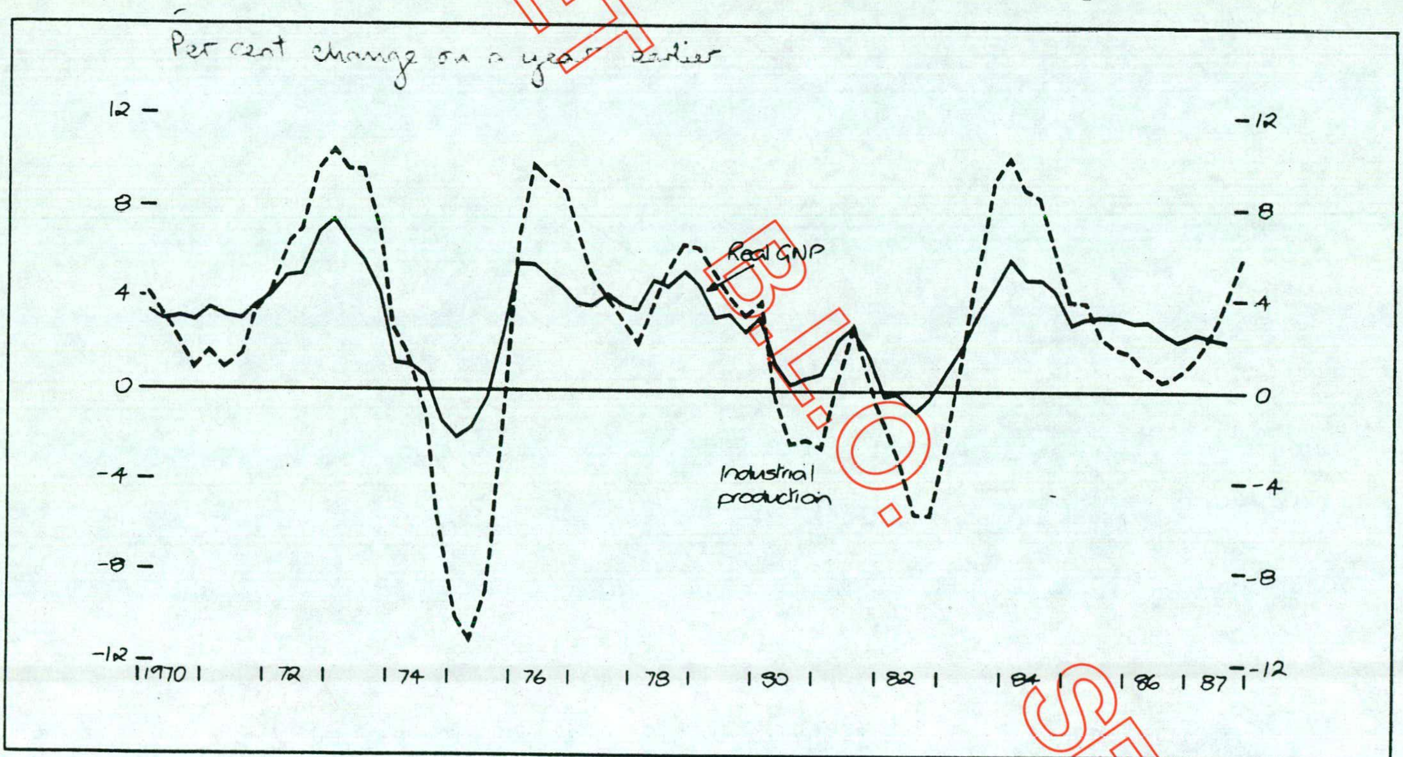
Chart 3.3 Real commodity prices



3.13 Part of the substantial falls in import prices in 1986—notably for oil, but also for many other primary commodities—were reversed in 1987. Oil prices recovered from their low point of the summer of 1986, but have weakened ~~a little~~ in recent months. Prices of other industrial materials rose as world activity picked up. Nevertheless, consumer price inflation in the major economies has remained low. In Japan and Germany the appreciation of their currencies meant that inflation was close to zero. But in the US, consumer price inflation rose to 4½ per cent at the end of 1987.

3.14 The improved terms of trade for developing countries boosted the exports of the major industrialised countries and helped to strengthen business investment. This more than offset some slowdown in the growth of real personal incomes and in consumer spending. As a result industrial production has been particularly buoyant; output in the major seven OECD economies was over 5 per cent higher in December 1987 than a year earlier.

Chart 3.4 Major seven economies' real GNP and industrial production



3.15 Equity prices in the US and most other countries continued to rise in the first part of 1987, reaching an all-time high in a number of countries around mid-year. In large part the subsequent fall in equity prices can be seen as a correction, even though the scale and sharpness of the fall in October were unprecedented. Prompt action by the monetary authorities in the major countries to reduce interest rates and provide sufficient liquidity helped to prevent a major collapse of confidence.

3.16 In the United States domestic demand growth, which had averaged 5½ per cent a year between 1983 and 1986, slowed to 2½ per cent in 1987; as a

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result the growth of import volumes has also slowed. US export volumes are now responding strongly to the massive depreciation of the dollar from its 1985 peak; by the fourth quarter of last year they were 17 per cent higher than a year earlier. These favourable movements in trade volumes were, for much of 1987, offset in money terms by the effects of the dollar's fall. But more recent figures have suggested some decline in the US trade deficit.

3.17 A two year phase of relatively slow growth in Japan ended in the spring of 1987 as exports stopped falling and domestic demand picked up sharply. But in Germany both real domestic demand and GNP grew slowly in 1987. The current account surpluses of both Japan and Germany fell slightly in relation to their GNP in 1987, with that of Japan falling rather faster.

3.18 World import volumes are estimated to have grown by more than 4 per cent in 1987. This is slightly lower than in 1986, when there was a substantial rise in oil trade as stocks were rebuilt. The growth of trade in manufactures in 1987—provisionally estimated at about 5½ per cent—picked up substantially, helped by the continued buoyancy of domestic demand in the major seven countries and by increased demand from the rest of the world.

Prospects

3.19 Table 3.1 shows the forecast for activity and inflation in the major seven OECD countries, and for world trade. In aggregate real GNP in the major seven countries is expected to grow a little less strongly in 1988 than in 1987, though industrial production should remain buoyant. Inflation is likely to stay low.

Table 3.1 World economy

	Per cent changes on a year earlier			
		Estimate	Forecasts	
	1986	1987	1988	1989 H1
Major seven countries[1]:				
Real GNP	2¾	3	2½	2
Real domestic demand	3¾	3	2½	2
Industrial production	1	3½	4½	~~2¾~~ 3
Consumer prices	2	2¾	3	3
World trade, at constant prices				
Total imports	5	4¼	4¼	3¼
Trade in manufactures	2	5½	5	3¼

[1] *US, Japan, Germany, UK, France, Italy and Canada.*

3.20 As a result of the continued strength of industrial activity, some further modest rise in non-food commodity prices is expected during 1988. Food prices, however, are likely to be held down by continued over-supply, encouraged by high levels of support in many OECD countries. The forecast is based on the assumption that North Sea oil prices will average $15 a barrel in 1988.

3.21 Imports by industrial countries are expected to grow less rapidly than in 1986 and 1987. However, imports by non-oil developing countries will

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be helped by stronger commodity prices, and hence export earnings. Total world trade in 1988 is forecast to continue to grow at close to the rate experienced in 1987.

UK trade and the balance of payments

Relative costs and prices

3.22 UK unit labour costs in manufacturing rose only slightly in 1987, at a similar rate to the average in the other major economies, with rapid productivity growth largely offsetting a continuing high level of pay increases. Despite some appreciation of sterling against the dollar the UK's cost competitiveness remains clearly more favourable than in 1984 and 1985 before the fall in world oil prices. The maintenance of competitiveness in the year ahead will depend on success in continuing to restrain unit cost increases.

Table 3.2 The exchange rate and cost competitiveness

	Sterling index (1975 = 100)	Relative unit labour costs* (1980 = 100)
1985 Q4	80	88
1986 Q4	68	71
1987 Q4	75	~~79~~ 80

X

** Ratio of UK manufacturing sector's costs to those overseas.*

Trade volumes (goods other than oil)

3.23 Non-oil export volumes rose by 7 per cent in 1987. Manufactured exports rose particularly strongly, reflecting renewed growth in world trade and the UK's strong competitive position. Non-oil export volumes are forecast to rise in 1988 by a further 5 per cent.

3.24 The UK increased its share of world trade in manufactures slightly in 1987. Its volume share has remained broadly stable since 1981, in marked contrast to the previous long-term decline. This improved performance is forecast to continue in 1988.

Table 3.3 Visible trade

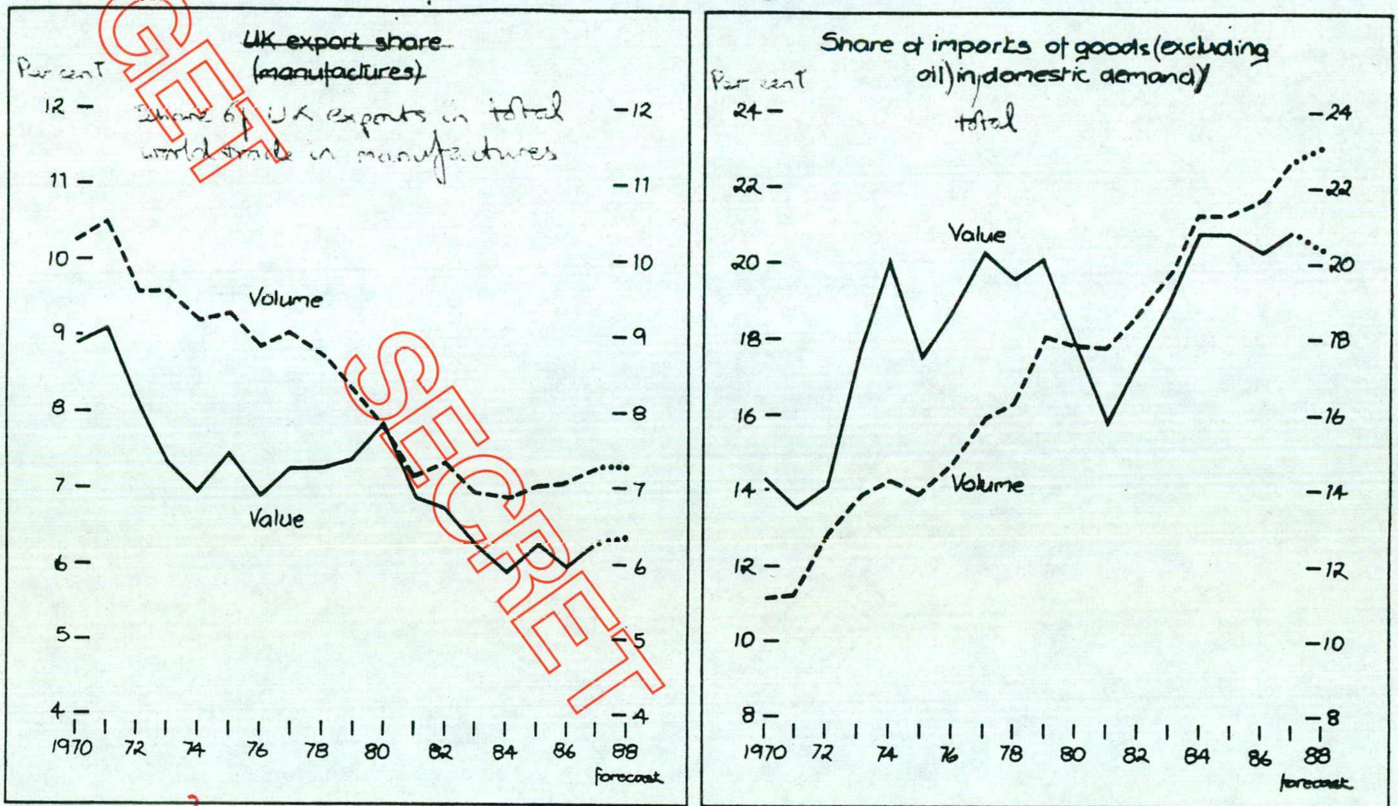
Per cent changes on previous year

	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade*
1986	3½	6½	−5	4	6	−½
1987	5½	7½	1	7	8½	1
1988 Forecast	3½	7	1	5	6½	1½

**Ratio of UK export average values to import average values.*

3.25 Non-oil import volumes fell unexpectedly in early 1987, but rose during the rest of the year, and were 8½ per cent higher than in 1986. The increases were widespread with higher imports of materials and capital goods reflecting the strong growth of UK production, stocks and investment. Consumer goods imports also rose in response to the rise in consumer spending. The volume of imports is forecast to rise less rapidly through the year ahead as output growth slows.

Chart 3.5 Export shares and import penetration



Oil trade

3.26 There was a surplus in oil trade of £4 billion in 1987, little changed from 1986. Higher oil prices and a fall in domestic demand for oil more than offset a decline in North Sea production. In 1988 oil production is likely to decline further and be close to the centre of the Department of Energy's range while domestic demand for oil may rise modestly. The oil trade surplus is expected to fall by £1½ billion, to about £2½ billion

domestic
Why, if demand for oil fell in 1987, is it expected to not fall (actually 'increase') in 1988? Is this a stocks pt?

Trade prices and the terms of trade

3.27 The terms of trade, which fell in 1986 as oil prices declined, improved again in 1987 as oil prices firmed and as sterling's appreciation offset some rise in world commodity prices in the latter part of the year. Little further change in the terms of trade is ~~expected~~ assumed during the rest of 1988.

Invisibles and overseas assets

3.28 The latest estimate for the surplus on invisibles in 1987, at £8½ billion, is as forecast in last year's FSBR. This is the same as the outturn in 1986, with increased transfers to the European Community offset by higher net earnings from services and from the UK's net overseas assets. The invisible surplus seems likely to rise in 1988 partly because of lower net payments abroad by North Sea oil companies. check fig

3.29 The value of the UK's stock of net overseas assets is estimated provisionally to have been about £90 billion at the end of 1987, some £20 billion down on end-1986. This decline is largely due to the fall in world equity markets and in the sterling value of UK assets in North America following the fall in the US dollar.

Current account

3.30 The current account deficit is estimated to have been £1 billion in 1987, the improvement over the forecast in last year's FSBR being due to the unexpected strength of exports of manufactures. A deficit of check fig

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check fig

£3 billion (¾ per cent of GDP) is forecast for 1988, largely as a result of the projected decline in the oil surplus. The deficit on non-oil trade is forecast to show little further change from the level in the second half of 1987.

Table 3.4 Current account

£ billion	Manufactures	Oil	Other goods	Invisibles	Current balance
1986	−5½	4	−7	8½	½
1987	−6½	4	−7½	8½	−1
1988 Forecast	−8½	2½	−6½	9½	−3

Demand and activity

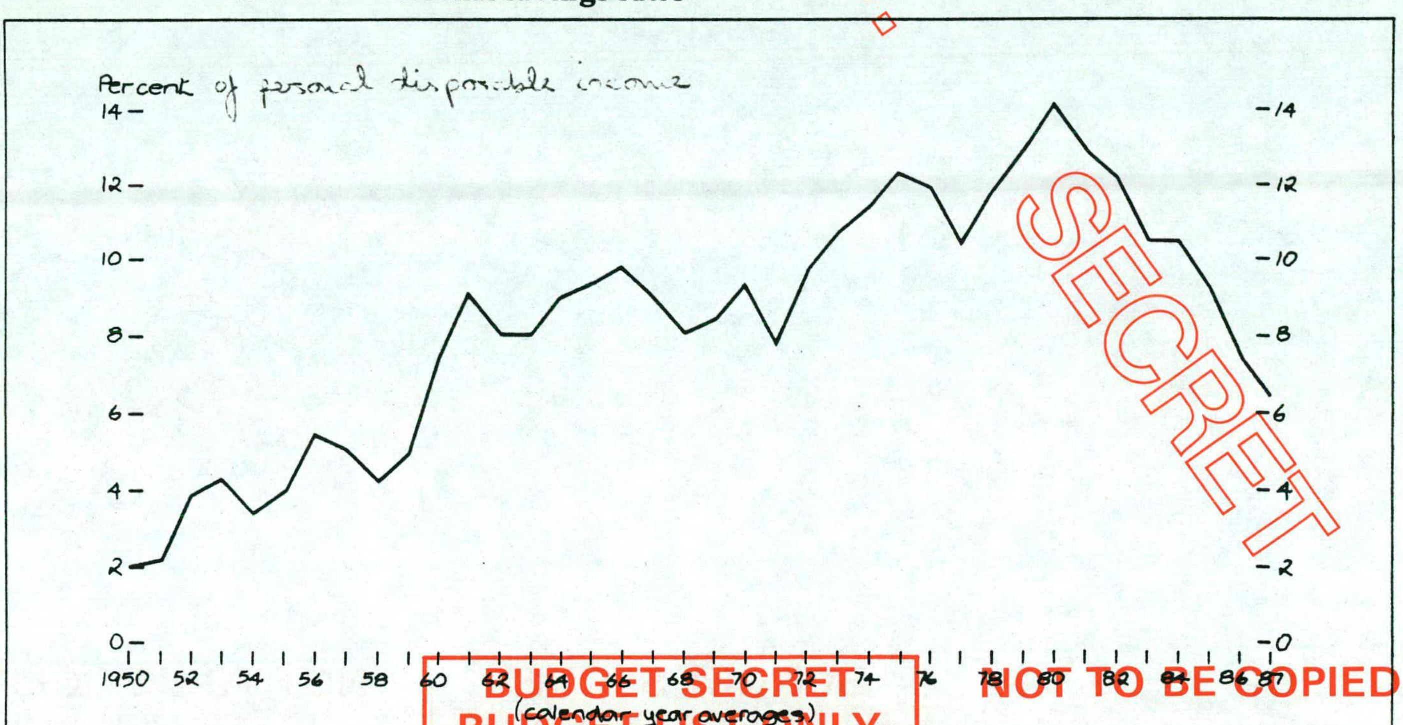
3.31 The UK economy grew by 4¼ per cent in 1987. Growth was strong throughout the economy; manufacturing output rose by 5½ per cent, construction output by 8 per cent and output of the service industries by 5½ per cent.

Personal sector expenditure

3.32 Consumers' expenditure is now estimated to have risen by 5 per cent in 1987, slightly less than in 1986. The growth in consumer spending was faster than the 3½ per cent growth in real personal disposable income, and the savings ratio once again fell.

3.33 A number of factors could account for the decline in the savings ratio in recent years. Inflation has been at a low level not experienced since the 1960s. Recent increases in real house prices and in equity prices up to October 1987 may also have contributed. Finally, employers have taken so-called "holidays" on their contributions to employees' pension funds, which score as reduced personal saving.

Chart 3.6 Personal savings ratio



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3.34 Personal borrowing rose further during 1987, in large part reflecting increased mortgage borrowing. But personal financial assets again showed a larger increase, despite the October share price fall.

Insert Chart 3.7 : Personal sector financial assets and liabilities

Chart attached

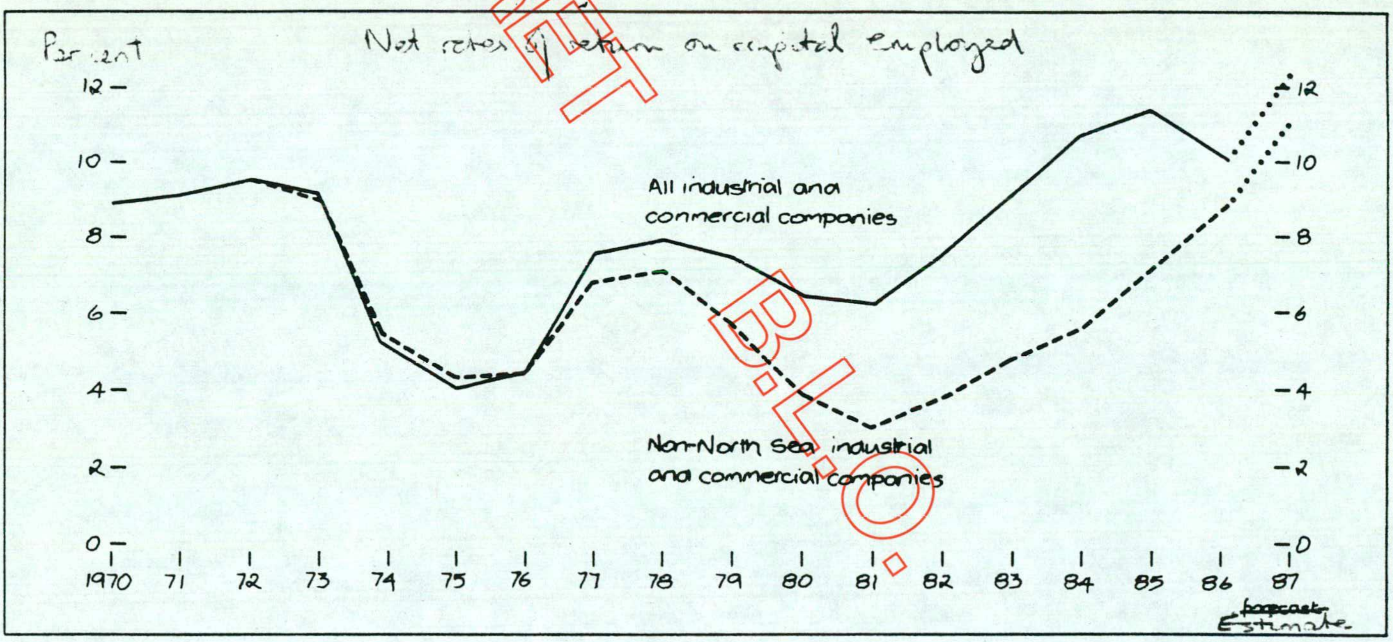
3.~~34~~5 Consumers' expenditure is forecast to increase by 4 per cent in 1988 and the savings ratio is expected to bounce back a little. Private investment in new dwellings could rise by around 2½ per cent in 1988, rather more slowly than over the last two years.

Non-North Sea industrial and commercial companies' profits rose strongly in 1987, probably at a faster rate than the [20] per cent recorded for 1986.

Company incomes and expenditure

3.35 ~~Company profitability improved sharply again in 1987~~. For the year as a whole the rate of return of non-North Sea industrial and commercial companies was probably 10–11 per cent—the highest level for about 20 years. Manufacturing profitability grew particularly strongly.

Chart 3.~~7~~8 Companies' real rates of return



3.36 ~~Preliminary~~ Current estimates suggest that manufacturing investment grew by 3½ per cent last year, while total non-oil business investment grew by 7 per cent. The latest DTI Investment Intentions Survey suggested a strong pick-up in manufacturing investment growth, to about 11 per cent in 1988. The January CBI Industrial Trends ~~Enquiry~~ Survey, the first full enquiry since the fall in share prices, confirms that prospect, with a near record balance of manufacturing firms expecting to increase investment. The DTI Survey also indicated further steady growth, of about 6 per cent, in non manufacturing investment. This outlook for company investment is consistent with the recent and prospective buoyancy in output, real profitability, and company finances, and it will add to industrial capacity. North Sea investment has fallen sharply since 1984, but is expected to recover a little in 1988.

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Table 3.5 Gross fixed domestic capital formation

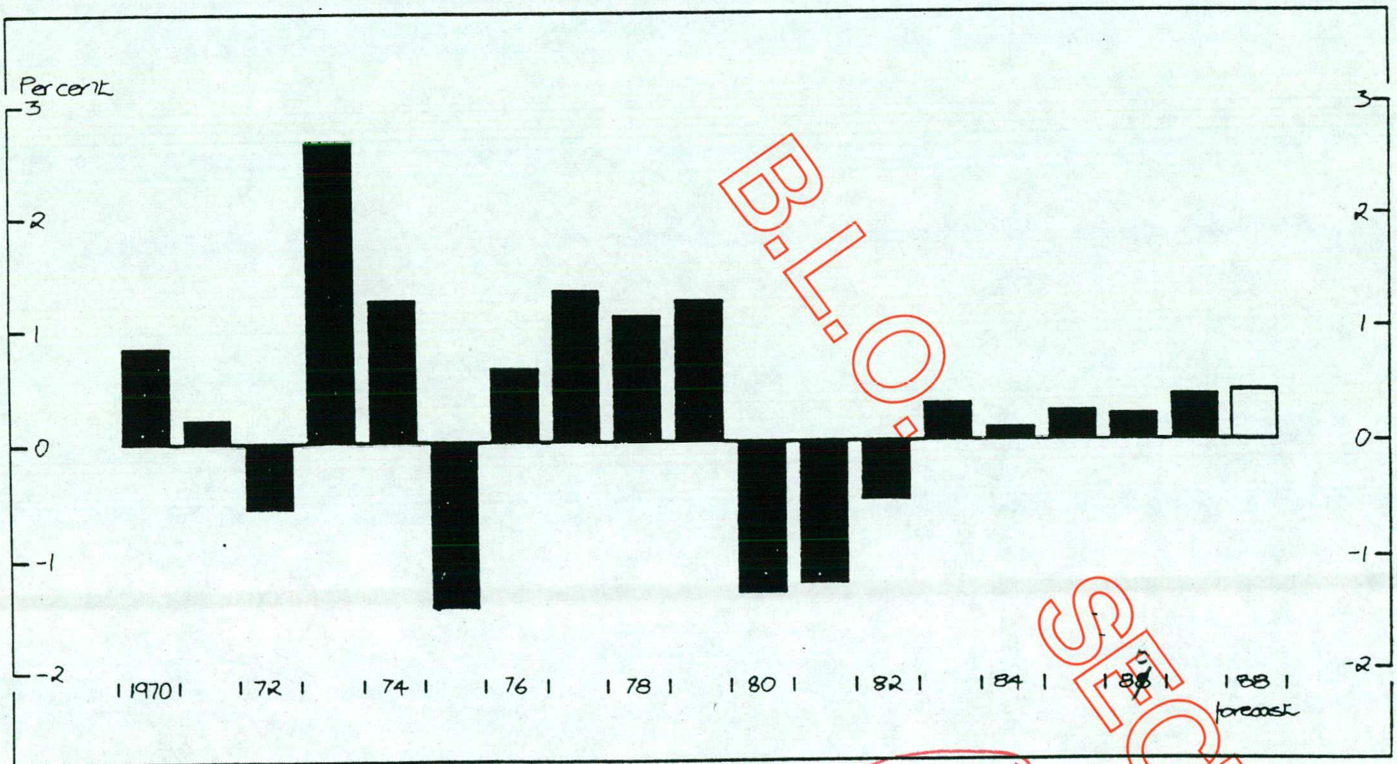
	£ billion at 1980 prices 1986	Per cent changes on a year earlier 1986	1987	Forecast 1988
Business[1]	29·8	−3	4½	8½
of which (i) non-oil business	27·8	−2	6½	8½
(ii) manufacturing	7·1	−5½	3½	11½
Private dwellings[2]	9·6	6½	5	2
General government	7·0	5½	−1½	~~2~~ 1
Total fixed investment	**46·4**	**0**	**3½**	**6**

[1] *Includes investment by public corporations.*

[2] *Includes purchase less sales of land by persons, companies and public corporations, other than purchases of council houses.*

3.37 Despite a rise in stocks in 1987, stock-output and stock-sales ratios continued their trend decline of the last eight years. These downward trends are expected to continue in 1988, though, as last year, there is still likely to be modest stockbuilding.

Chart 3.8 Stockbuilding as a share of GDP



Prospects for demand and activity

3.38 GDP growth is likely to moderate to around 3 per cent (3½ per cent excluding oil) in 1988, close to the average ~~between 1981 and 1987~~ 1981–87. Domestic demand is forecast to rise at around the same rate in 1988 as in 1987; some slowdown in consumer spending should be offset by buoyant investment prospects. But declining North Sea output (and lower oil exports) may reduce GDP growth by around ½–¾ per cent, rather more than in 1987. Manufacturing output is expected to rise faster than non-oil GDP in 1988, as it did in 1987.

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Table 3.6 Domestic demand and GDP

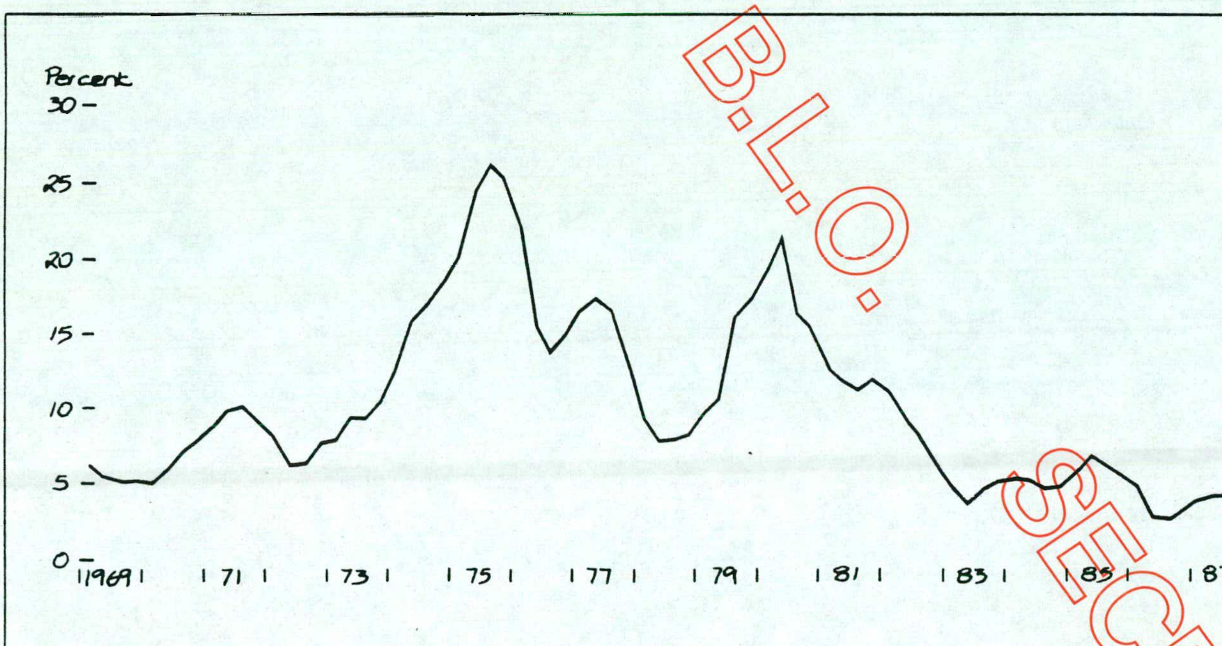
	Per cent changes on a year earlier		
		Forecasts	
	1987	1988	1989 H1
Domestic demand	4	4	2½
Exports of goods and services[1]	5½ ~~(7)~~ (6½)	3 (4)	2½ (4)
Imports of goods and services[1]	7 ~~(8)~~ (7½)	6½ (6)	4½ (4½)
GDP[1,2]	4¼	3 (3½)	2½ (3)
Manufacturing production	5½	5	2½

[1] *Non-oil shown in brackets.*
[2] *Average measure.*

Inflation

3.39 The annual rate of inflation as measured by the RPI was 4·1 per cent in 1987Q4, in line with the forecasts in the 1987 FSBR and Autumn Statement. The average rate for 1987 as a whole was ~~also~~ 4·~~1~~ 2 per cent. Last year was the first time in [23] years that inflation was lower than the growth in GDP, which is now estimated at 4·3 per cent.

Chart 3.9 Annual increases in the RPI



3.40 Settlements in manufacturing industry recorded by the CBI show a fall of about ~~½~~ 1 percentage point between the 1985–86 and 1986–87 pay rounds. There was a similar picture in the services sector. Average earnings, boosted by record overtime working in manufacturing, rose by 8 per cent. But unit labour costs in manufacturing were ~~probably~~ broadly unchanged in ~~the year to the fourth quarter of~~ 1987, reflecting a sharp increase in labour productivity.

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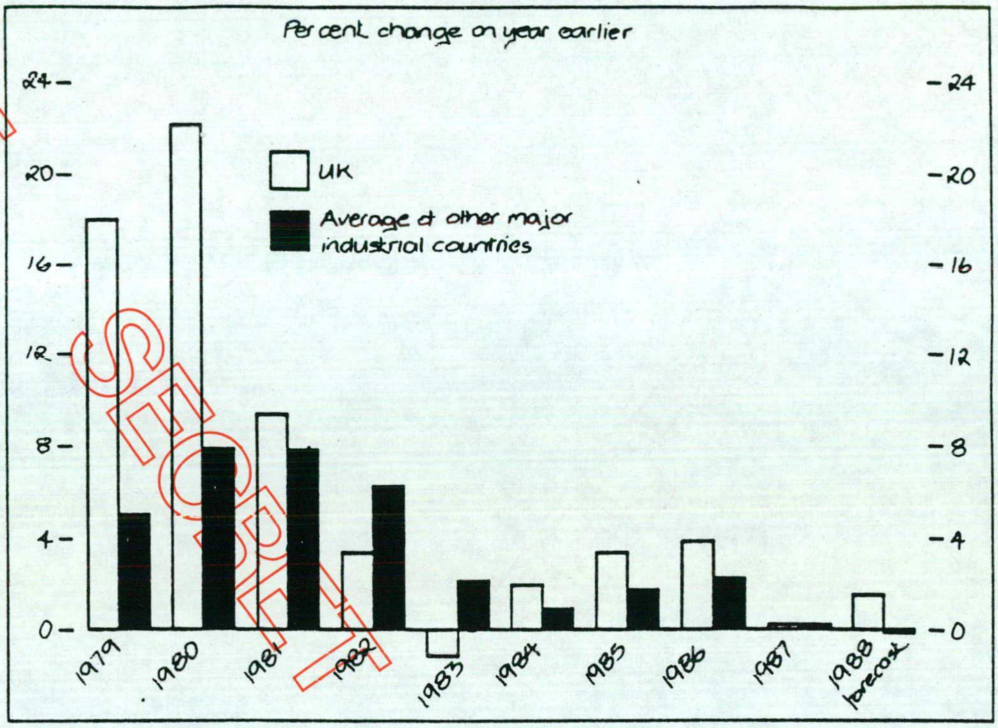
Chart 3.10 Unit labour costs in manufacturing



Prospects **3.41** It is difficult to discern a reliable trend in recent private sector pay settlements. They have been markedly lower than the recent high growth in earnings, which reflects record overtime working and bonus payments. Recent data suggest that settlements may turn out a little higher in 1988 than
× in 1987, but overtime working (and overtime earnings) should fall as economic growth moves back closer to trend.

3.42 In 1987 rapid growth in productivity meant that manufacturing unit labour costs rose only fractionally, in line with other major industrial countries. Continued growth in underlying productivity should mean that manufacturing unit labour costs grow only slowly in 1988, though in other major industrialised countries no unit labour cost growth at all is forecast.

Table 3.7 Costs in manufacturing

	Per cent changes on a year earlier			
	Unit labour costs	Cost of materials and fuel[1]	Estimated total unit costs[2]	Output prices[1]
1986	4	−11	−½	4½
1987	0	5	1½	4½
xxx 1988 Forecast	~~1½~~ 2	0	1½	~~4½~~

[1] *Producer prices excluding food, drink and tobacco industries.*
[2] *Including costs of bought in services.*

3.43 Table 3.7 shows that manufacturers' profit margins rose significantly in 1987 for the third year in succession. There may be further increases in 1988 if producers take some advantage of falling import costs to raise profits, as

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they did in 1986. Over the longer term, high profitability should lead to continued growth in investment, capacity and productivity. Together these should enhance prospects for controlling industrial costs.

3.44 Inflation has come down during the first quarter of 1988, aided by lower import costs and recent cuts in mortgage interest rates. It may edge up a little partly as a result of the Budget proposals and the effects of local authority rate increases. There will also be some real increases in nationalised industry prices following a decline in real terms over the past three years. The RPI is forecast to rise by 4 per cent in the year to the fourth quarter of 1988. (With substantial cuts in income tax, the tax and price index (TPI) is likely to rise more slowly than the RPI during 1988. By the fourth quarter of 1988 it is likely to be [ ] per cent higher than a year earlier.

Table 3.8 Retail prices index

	Weight in 1987	Per cent changes on a year earlier: 1987 Q4	Forecasts: 1988 Q4	Forecasts: 1989 Q2
Food	16½	3½	2~~¼~~	~~2½~~ 3
Nationalised industries	6	2¼	6½	5~~¼~~ 3/4
Housing	15	7	~~7¼~~ 6	~~9~~ 7½
Other	62½	3¾	3~~¼~~ ½	3~~¼~~ ½
Total	**100**	**4**	**4**	**4**

3.45 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output. It does not include import prices. The GDP deflator at market prices is ~~forecast~~ estimated to rise by 5~~¼~~ per cent in 1987–88 (a little faster than expected in the Autumn Statement), following an increase of 3~~¼~~ ½ per cent in 1986–87. The higher rate of increase in 1987–88 is accounted for by a recovery in North Sea profits, which had fallen by over 50 per cent in 1986–87 following the sharp fall in oil prices. The GDP deflator is now forecast to rise by 4½ per cent in 1988–89.

Productivity and the labour market

3.46 Preliminary estimates suggest that the employed labour force in Great Britain rose sharply during 1987; in the year to September 1987 it is estimated to have risen by 45~~4~~3,000. Self-employment has grown particularly strongly, as many more people have taken advantage of the opportunities offered by the buoyant economic climate. Total employment has now risen by over 1½ million since March 1983.

Table 3.9 Employment

Thousands, change in GB seasonally adjusted

	Employees in employment: Male	Employees in employment: Female	Self-employed	HM Forces	Employed labour force
September 1984 to September 1985	+55	+200	+90	−3	+343
September 1985 to September 1986	−8~~1~~ 2	+150	+71	−3	+136
September 1986 to September 1987	+2~~4~~ 5	+225	+207*	−~~3~~ 4	+453

** Figures for self-employment after June 1987 are projections based on self-employment growth over the previous ~~five~~ six years.*

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3.47 Productivity has also been growing strongly. In 1987 manufacturing productivity rose by almost 7 per cent. In the year to 1987Q3 (the latest period for which comparable data are available) UK manufacturing productivity rose faster than in any other major industrial country. It has now risen by an average of 4 per cent per annum since 1979. Underlying growth in labour productivity in manufacturing industry may now be higher than in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this, as a result of the large rise in part–time employment.

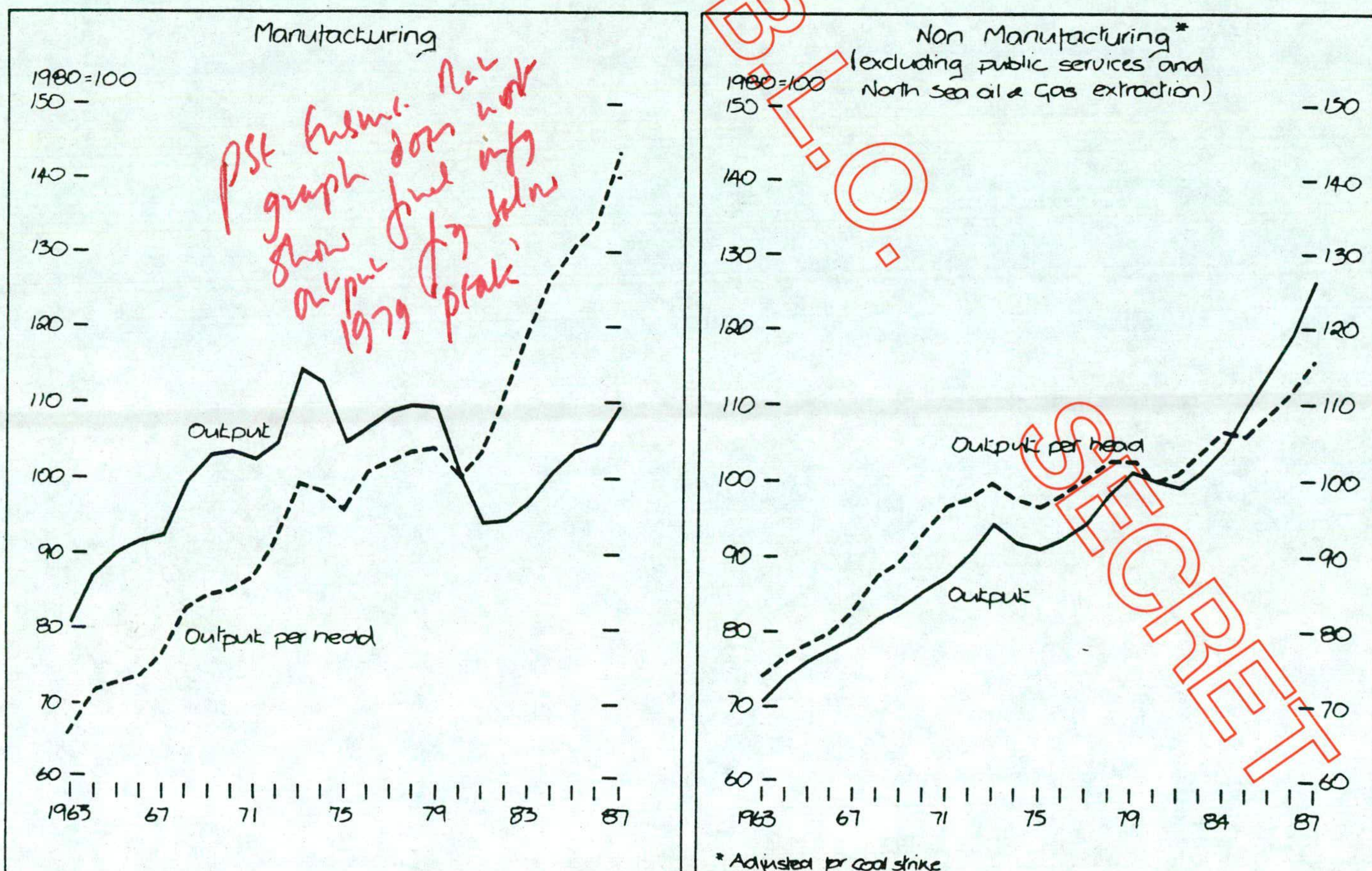
Table 3.10 Output per head of the employed labour force

Per cent changes

	Annual averages 1964–73	1973–79	1979–87	1984 Q4 to 1985 Q4	1985 Q4 to 1986 Q4	1986 Q4 to 1987 Q4[2]
Manufacturing	3¾	¾	4	2¼	6½	6¼
Non-manufacturing[1]	3	½	1½	3½	3½	3~~½~~ ¾
Whole economy	2¾	1¼	2	2¼	3¼	3¼
Non-North Sea economy	2¾	½	2	2½	3¾	3½

[1]Excludes public services and North Sea oil and gas extraction. *[2]Partly forecast.*

Chart 3.11 Output and productivity



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Unemployment

3.48 Seasonally adjusted adult unemployment in the UK has fallen in each of the last eighteen months. It has now come down by almost 650,000 since July 1986. Over the same period long term unemployment (over one year's duration) has fallen by around 250,000. The improved trend in unemployment has been mainly the result of strong growth of output and employment. Unemployment should continue to fall in the year ahead. ~~But~~ excessive pay settlements could threaten further progress.

[Provided pay settlements are moderate]
Prefer original
agree

Forecast and outturn

3.49 Table 3.11 compares the main elements of the forecast published in the 1987 FSBR with the outturn or latest estimate.

Table 3.11 **Forecast and outturn**

	1987 FSBR forecast	Latest estimate/ forecast	Average errors from past forecasts
Total gross domestic product; per cent change between 1986 and 1987	3	4¼	¾
RPI: per cent increase between the fourth quarters of 1986 and 1987	4	4	1½
Money GDP, per cent change between 1986–87 and 1987–88	7½	9¾	1½
Current account of the balance of payments in 1987, £ billion	−2½	−1	3
PSBR, financial year 1987–88, £ billion	4		5

3.50 Inflation in the fourth quarter of 1987 was in line with the forecast made a year ago while the current account deficit is now estimated to have been rather smaller than forecast. Although the data on which the latest estimates of GDP in 1987 are based are still very uncertain, it is clear that both money and real GDP growth have been stronger than forecast. The PSBR in 1987–88 is likely to turn out about £[ ] billion lower than last year's forecast. This error—which is slightly higher than average errors on past forecasts—reflects a combination of lower than expected general government expenditure and, in particular, higher than forecast tax revenues.

3.51 This year's forecast is summarised in Table 3.12.

Risks and uncertainties

3.52 No forecast is complete without an indication of error margins. Table 3.12 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about [£200] billion; and for the current account of the balance of payments exceed £[150] billion.

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Table 3.12 The prospects: summary

	Forecast 1986 to 1987	Forecast 1987 to 1988	Average errors from past forecasts[1]
	per cent changes		percentage points
Output and expenditure at constant 1980 prices			
Domestic demand	4	4	1
of which:			
consumers' expenditure	5	4	1
general government consumption	[½]	[2]	1
fixed investment	3½	6	2¼
change in stockbuilding (as per cent of level of GDP)	½	0	½
Exports of goods and services	5½	3¼	1¾
Imports of goods and services	7	6 ½	2¼
Gross domestic product: total	4¼	3	¾
manufacturing	5½	5	1½
Inflation			
Retail prices index	per cent changes		
1987 Q4 to 1988 Q4	4		1¼
1988 Q2 to 1989 Q2	4		1¾
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987–88	5¼		¾
Financial year 1988–89	4½		1¾
Money GDP at market prices	£ billion[2]		
Financial year 1987–88	424 (9¼)		1
Financial year 1988–89	457 (7½)		1½
Balance of payments on current account	£ billion		
1988	−3		3½
1989 first half (at an annual rate)	−3		4½
PSBR	£ billion[3]		
Financial year 1987–88			1 (¼%)
Financial year 1988–89			5 (1¼%)

[1] *The errors relate to the average differences (on either side of the central figure) between forecast and outturn over the last ten years.*

[2] *Per cent change on previous financial year in brackets; average error shown relates to the forecast of the percentage change.*

[3] *Per cent of GDP at market prices shown in brackets.*

on basis of this forecast, when do we regain 1973 peak?

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Table 3.13 Constant price forecasts of expenditure, imports and gross domestic product*

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	**Total final expenditure**	*Less* imports of goods and services	*Less* adjustment to factor cost	*Plus* statistical adjustment	**Gross domestic product at factor cost**	GDP index (average estimate) 1980 = 100
1983	144·4	50·6	41·6	64·4	0·7	**301·7**	62·6	31·6	0·2	**207·7**	104·0
1984	147·6	51·0	45·0	68·8	0·3	**312·7**	68·7	32·7	1·3	**212·7**	106·5
1985	153·3	51·0	46·4	72·7	0·6	**324·0**	70·5	33·8	0·6	**220·3**	110·3
1986	162·9	51·4	46·4	74·9	0·6	**336·3**	75·1	35·4	1·3	**227·1**	113·7
1987	171·3	51·6	48·1	79·2	0·8	**351·1**	80·3	37·3	3·4	**236·8**	118·6
1988	178·2	52·5	51·1	81·8	1·0	**364·6**	85·4	38·8	3·6	**244·1**	122·2
1986 H1	80·3	25·7	22·8	36·6	0·4	**165·8**	36·1	17·4	0·4	**112·7**	112·9
H2	82·6	25·8	23·6	38·3	0·2	**170·4**	38·9	18·0	0·9	**114·4**	114·6
1987 H1	84·1	25·6	23·7	38·9	−0·2	**172·1**	38·4	18·3	1·5	**116·9**	117·0
H2	87·2	26·0	24·4	40·4	1·3	**179·0**	41·9	19·0	1·9	**119·9**	120·1
1988 H1	88·6	26·2	25·2	40·7	0·6	**181·3**	42·2	19·3	1·8	**121·7**	121·9
H2	89·6	26·3	25·9	41·0	0·5	**183·3**	43·1	19·5	1·8	**122·4**	122·6
1989 H1	91·1	26·5	26·2	41·6	0·4	**185·7**	43·6	19·7	1·8	**124·2**	124·4
Per cent changes											
1985 to 1986	6½	1	0	3	—	**3½**	6½	4½	—	**3**	3
1986 to 1987	5	½	3½	5½	—	**4½**	7	5½	—	**4½**	4½
1987 to 1988	4	2	6	3½	—	**4**	6	4	—	**3**	3
1988 H1 to 1989 H1	3	1	4½	2	—	**2½**	3½	2	—	**2½**	2½

** GDP figures in the table are based on "compromise" estimates of gross domestic product, reflecting, for the past, average movements in constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to half per cent. Figures for 1988 H1 and beyond are forecasts. Figures for periods up to the end of 1987 are based mainly on the national accounts published earlier (covering periods up to 1987 Q3) and incorporate some revised and later data and forecasts. A full set of national accounts, to end 1987, will be published by the CSO on 18 March.*

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FROM: A C S ALLAN
DATE: 7 March 1988

MR HIBBERD

cc PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr R I G Allen
Miss Simpson
Mr Hudson
Mr Allum
Miss C Evans

SECRET

CHAPTER 3 OF THE FSBR: THE INDUSTRY FORECAST

... The Chancellor was grateful for your minute of 4 March. I attach a copy of the pages on which he had comments.

2. He would be grateful to know why, if domestic demand for oil fell in 1987, it is expected to rise (albeit "modestly") in 1988? Is this a stocks point?

B.L.O.

3. He also asked when, on the basis of the forecast for growth in manufacturing output (ie 5 per cent in 1988), do we regain the 1973 peak?

ACSA

A C S ALLAN

SECRET

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3 The economy: recent developments and prospects to mid 1989

Summary

3.01 1988 should see growth of 3 per cent, the average rate over the last six years, but significantly ~~appreciably~~ below the 4¼ per cent growth in 1987. Inflation is expected to remain low and there are good prospects for a further fall in unemployment.

Assumptions

3.02 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. As last year, it assumes that North Sea oil prices will [average $15 a barrel] over the year ahead, and that the exchange rate will remain close to its current level.

Demand and activity

3.03 The economy grew strongly in 1987, with GDP growth of 4¼ per cent and manufacturing output growth of 5½ per cent. Domestic demand grew by just under 4 per cent, the same as in 1986. It is expected to grow at a similar rate in 1988, with slightly lower growth of consumer spending being offset by markedly faster growth of investment. GDP is forecast to grow by 3 per cent (3½ per cent for non-oil GDP).

Inflation

3.04 RPI inflation averaged ~~was~~ just over 4 per cent in 1987. It fell to 3¼ per cent in January 1988, but is forecast to return ~~may edge up~~ to 4 per cent in ~~by~~ the fourth quarter of 1988.

Labour market

3.05 Employment has risen strongly over the past year, with unemployment falling by half a million—the largest decline since the war. ~~With non-oil GDP growing at close to 3 per cent during 1988,~~ ~~[the current buoyancy of activity,]~~ Unemployment should continue to fall.

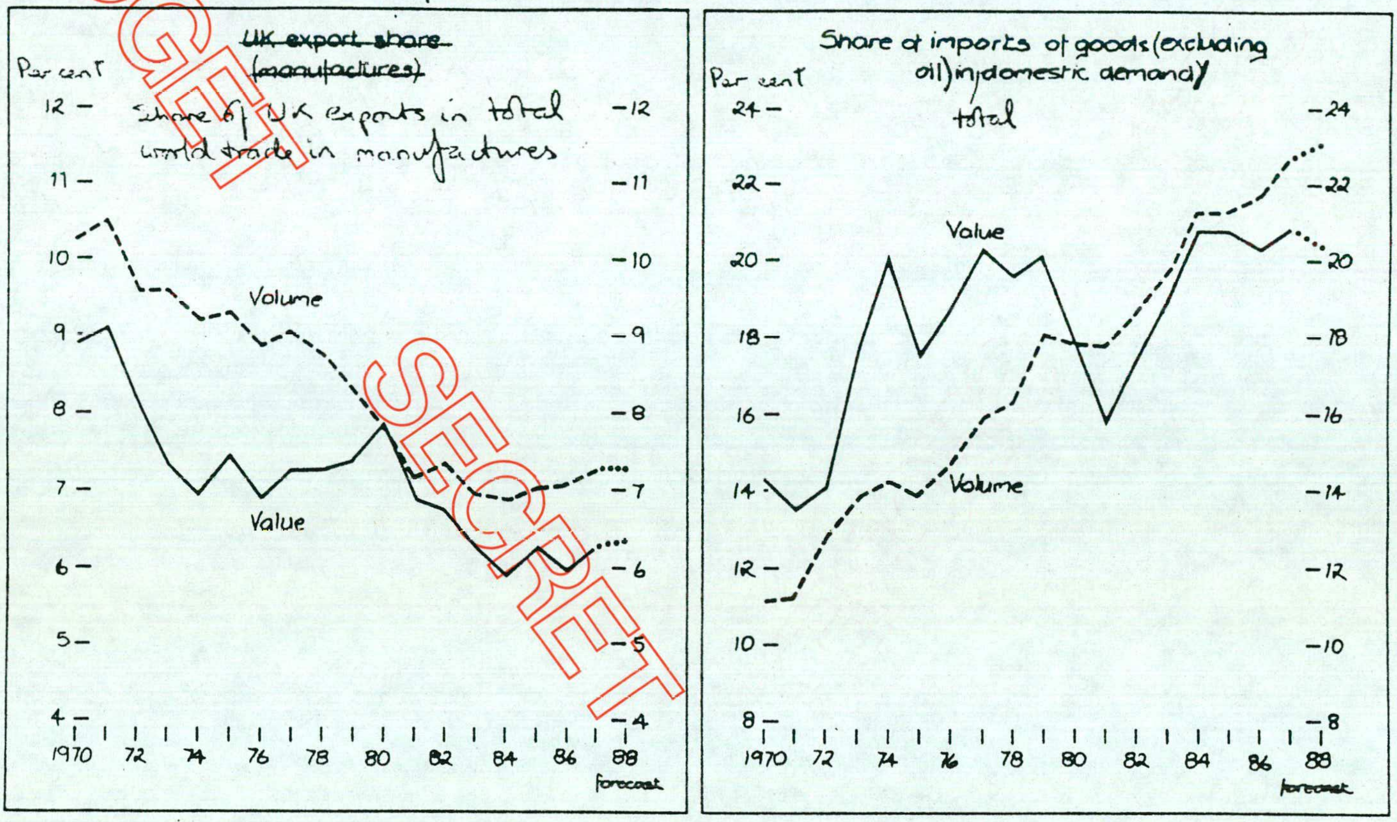
World economy

3.06 GNP in the main industrial economies grew by about 3 per cent last year. Some slackening in growth is likely in 1988 particularly in the United States, and growth in the main industrialised countries in aggregate could ease slightly to 2½ per cent. Industrial production picked up strongly during 1987. Associated with this were faster growth in trade in manufactures and some recovery in industrial materials prices. World trade in manufactures appears to have grown by about 5½ per cent in 1987 and should grow by a similar amount this year.

UK trade and current account

3.07 Both export and import volumes grew rapidly last year: some moderation in growth is likely in 1988. Following recent revisions to the surplus on invisibles the current account is now estimated to have been in deficit by £1 billion in 1987. A deficit of £3 billion (¾ per cent of GDP) is forecast for 1988.

Chart 3.5 Export shares and import penetration



Oil trade

3.26 There was a surplus in oil trade of £4 billion in 1987, little changed from 1986. Higher oil prices and a fall in domestic demand for oil more than offset a decline in North Sea production. In 1988 oil production is likely to decline further and be close to the centre of the Department of Energy's range while domestic demand for oil may rise modestly. The oil trade surplus is expected to fall by £1½ billion, to about £2½ billion

Trade prices and the terms of trade

3.27 The terms of trade, which fell in 1986 as oil prices declined, improved again in 1987 as oil prices firmed and as sterling's appreciation offset some rise in world commodity prices in the latter part of the year. Little further change in the terms of trade is ~~expected~~ assumed during the rest of 1988.

Invisibles and overseas assets

3.28 The latest estimate for the surplus on invisibles in 1987, at £8½ billion, is as forecast in last year's FSBR. This is the same as the outturn in 1986, with increased transfers to the European Community offset by higher net earnings from services and from the UK's net overseas assets. The invisible surplus seems likely to rise in 1988 partly because of lower net payments abroad by North Sea oil companies.

3.29 The value of the UK's stock of net overseas assets is estimated provisionally to have been about £90 billion at the end of 1987, some £20 billion down on end-1986. This decline is largely due to the fall in world equity markets and in the sterling value of UK assets in North America following the fall in the US dollar.

Current account

3.30 The current account deficit is estimated to have been £1 billion in 1987, the improvement over the forecast in last year's FSBR being due to the unexpected strength of exports of manufactures. A deficit of

Table 3.5 Gross fixed domestic capital formation

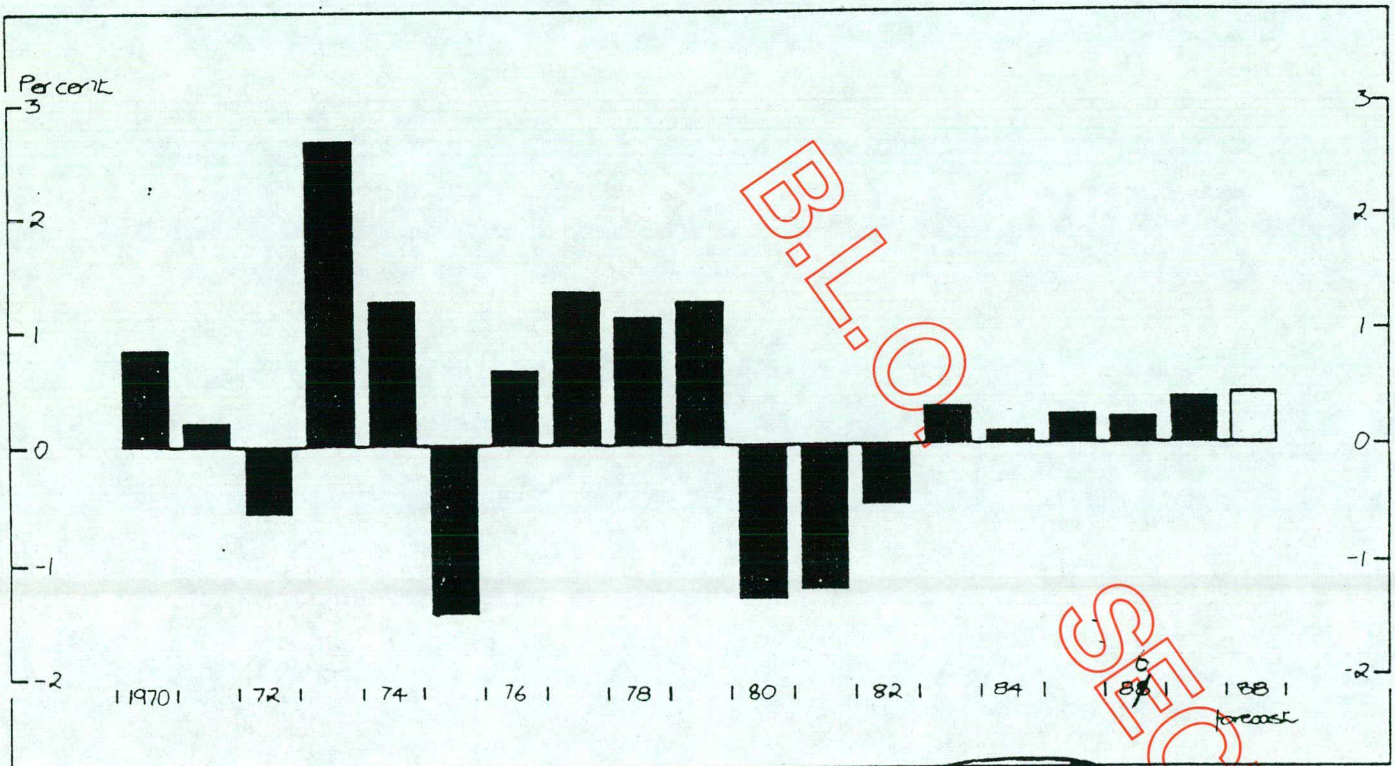
	£ billion at 1980 prices	Per cent changes on a year earlier		
	1986	1986	1987	Forecast 1988
Business[1]	29·8	−3	4½	8½
of which (i) non-oil business	27·8	−2	6½	8½
(ii) manufacturing	7·1	−5½	3½	11½
Private dwellings[2]	9·6	6½	5	2
X General government	7·0	5½	−1½	~~2~~ 1
Total fixed investment	**46·4**	**0**	**3½**	**6**

[1] *Includes investment by public corporations.*

[2] *Includes purchase less sales of land by persons, companies and public corporations, other than purchases of council houses.*

x **3.37** Despite a rise in stocks in 1987, stock-output and stock-sales ratios continued their trend decline of the last eight years. These downward trends are expected to continue in 1988, though, as last year, there is still likely to be modest stockbuilding.

Chart 3.8 Stockbuilding as a share of GDP



Prospects for demand and activity

3.38 GDP growth is likely to moderate to around 3 per cent (3½ per cent excluding oil) in 1988, close to the 1981-87 average ~~between 1981 and 1987~~. Domestic demand is forecast to rise at around the same rate in 1988 as in 1987; some slowdown in consumer spending should be offset by buoyant investment prospects. But declining North Sea output (and lower oil exports) may reduce GDP growth by around ½–¾ per cent, rather more than in 1987. Manufacturing output is expected to rise faster than non-oil GDP in 1988, as it did in 1987.

xx

they did in 1986. Over the longer term, high profitability should lead to continued growth in investment, capacity and productivity. Together these should enhance prospects for controlling industrial costs.

3.44 Inflation has come down during the first quarter of 1988, aided by lower import costs and recent cuts in mortgage interest rates. It may edge up a little partly as a result of the Budget proposals and the effects of local authority rate increases. There will also be some real increases in nationalised industry prices following a decline in real terms over the past three years. The RPI is forecast to rise by 4 per cent in the year to the fourth quarter of 1988. With substantial cuts in income tax, the tax and price index (TPI) is likely to rise more slowly than the RPI during 1988. By the fourth quarter of 1988 it is likely to be [ ] per cent higher than a year earlier.

Table 3.8 Retail prices index

	Weight in 1987	Per cent changes on a year earlier: 1987 Q4	Forecasts: 1988 Q4	Forecasts: 1989 Q2
Food	16½	3½	2~~¼~~	~~2¼~~ 3
Nationalised industries	6	2¼	6½	5~~½~~ 3/4
Housing	15	7	~~7¼~~ 6	~~8~~ 7½
Other	62½	3¾	3~~¼~~ ½	3~~¼~~ ½
Total	**100**	**4**	**4**	**4**

3.45 The GDP deflator measures the price of domestic value added—principally unit labour costs and profits per unit of output. It does not include import prices. The GDP deflator at market prices is ~~forecast~~ estimated to rise by 5~~¼~~ per cent in 1987–88 (a little faster than expected in the Autumn Statement), following an increase of 3~~¼~~½ per cent in 1986–87. The higher rate of increase in 1987–88 is accounted for by a recovery in North Sea profits, which had fallen by over 50 per cent in 1986–87 following the sharp fall in oil prices. The GDP deflator is now forecast to rise by 4½ per cent in 1988–89.

Productivity and the labour market

3.46 Preliminary estimates suggest that the employed labour force in Great Britain rose sharply during 1987; in the year to September 1987 it is estimated to have risen by 45~~4~~3,000. Self-employment has grown particularly strongly, as many more people have taken advantage of the opportunities offered by the buoyant economic climate. Total employment has now risen by over 1½ million since March 1983.

Table 3.9 Employment

Thousands, change in GB seasonally adjusted

	Employees in employment: Male	Employees in employment: Female	Self-employed	HM Forces	Employed labour force
September 1984 to September 1985	+55	+200	+90	−3	+343
September 1985 to September 1986	−8~~1~~2	+150	+71	−3	+136
September 1986 to September 1987	+2~~4~~5	+225	+207*	−~~3~~4	+453

* *Figures for self-employment after June 1987 are projections based on self-employment growth over the previous ~~five~~ six years.*

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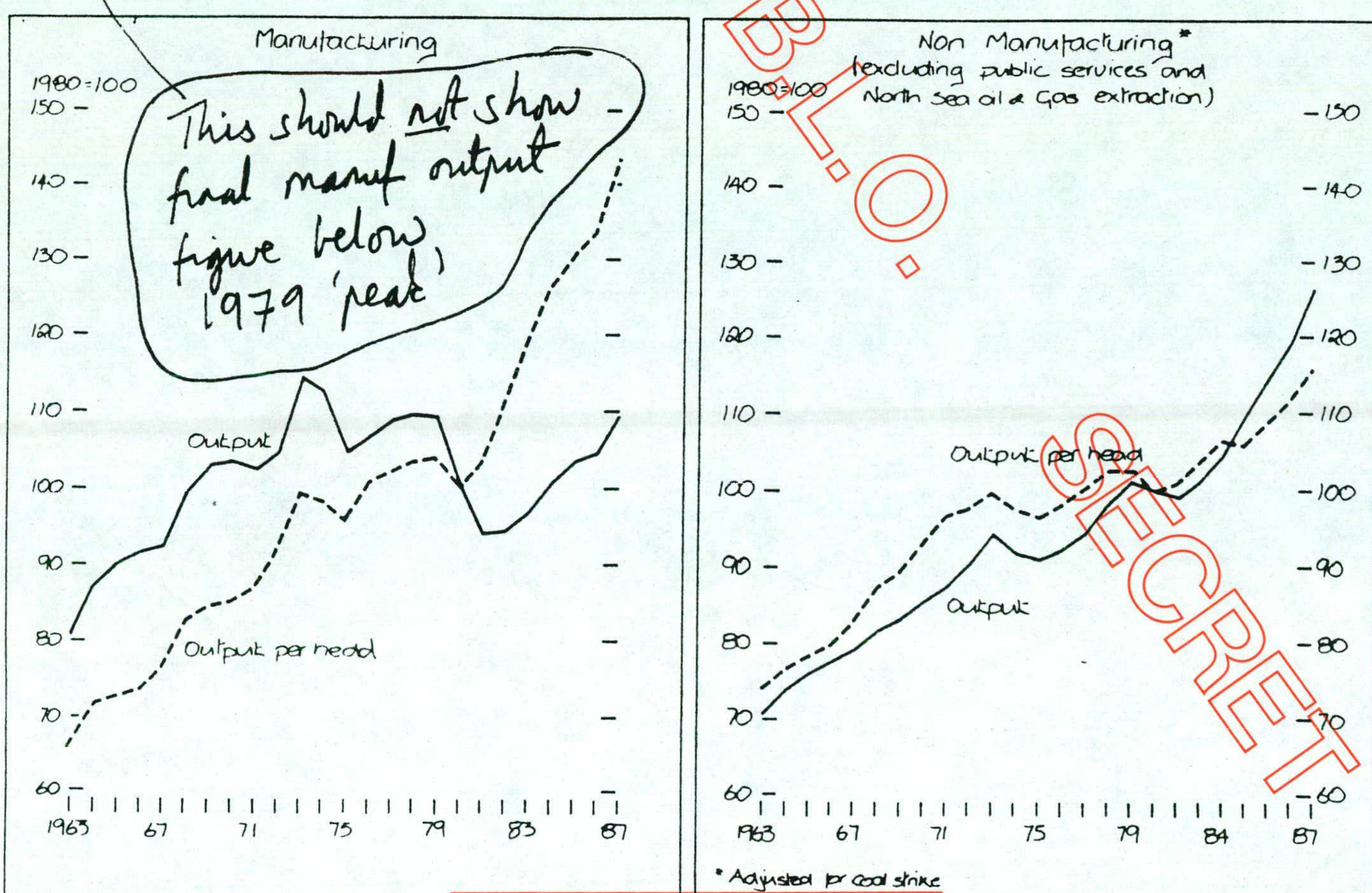
3.47 Productivity has also been growing strongly. In 1987 manufacturing productivity rose by almost 7 per cent. In the year to 1987Q3 (the latest period for which comparable data are available) UK manufacturing productivity rose faster than in any other major industrial country. It has now risen by an average of 4 per cent per annum since 1979. Underlying growth in labour productivity in manufacturing industry may now be higher than in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this, as a result of the large rise in part–time employment.

Table 3.10 Output per head of the employed labour force

	Per cent changes					
	Annual averages			1984 Q4 to	1985 Q4 to	1986 Q4 to
	1964–73	1973–79	1979–87	1985 Q4	1986 Q4	1987 Q4[2]
Manufacturing	3¾	¾	4	2¼	6½	6¼
Non-manufacturing[1]	3	½	1½	3½	3½	3~~½~~¾
Whole economy	2¾	1¼	2	2¼	3¼	3¼
Non-North Sea economy	2¾	½	2	2½	3¾	3½

[1]*Excludes public services and North Sea oil and gas extraction.* [2]*Partly forecast.*

Chart 3.11 Output and productivity



Unemployment

3.48 Seasonally adjusted adult unemployment in the UK has fallen in each of the last eighteen months. It has now come down by almost 650,000 since July 1986. Over the same period long term unemployment (over one year's duration) has fallen by around 250,000. The improved trend in unemployment has been mainly the result of strong growth of output and employment. Unemployment should continue to fall in the year ahead. ~~But~~ STET excessive pay settlements could threaten further progress.

~~Provided pay settlements are moderate~~ STET

Forecast and outturn

3.49 Table 3.11 compares the main elements of the forecast published in the 1987 FSBR with the outturn or latest estimate.

Table 3.11 Forecast and outturn

	1987 FSBR forecast	Latest estimate/ forecast	Average errors from past forecasts
Total gross domestic product; per cent change between 1986 and 1987	3	4¼	¾
RPI: per cent increase between the fourth quarters of 1986 and 1987	4	4	1½
Money GDP, per cent change between 1986–87 and 1987–88	7½	9¾	1½
Current account of the balance of payments in 1987, £ billion	−2½	−1	3
PSBR, financial year 1987–88, £ billion	4		5

3.50 Inflation in the fourth quarter of 1987 was in line with the forecast made a year ago while the current account deficit is now estimated to have been rather smaller than forecast. Although the data on which the latest estimates of GDP in 1987 are based are still very uncertain, it is clear that both money and real GDP growth have been stronger than forecast. The PSBR in 1987–88 is likely to turn out about £[ ] billion lower than last year's forecast. This error—which is slightly higher than average errors on past forecasts—reflects a combination of lower than expected general government expenditure and, in particular, higher than forecast tax revenues.

3.51 This year's forecast is summarised in Table 3.12.

Risks and uncertainties

3.52 No forecast is complete without an indication of error margins. Table 3.12 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about [£200] billion; and for the current account of the balance of payments exceed £[150] billion.

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COPY NO. 19 OF 20.

FROM: A C S ALLAN
DATE: 7 March 1988

MR S J DAVIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mrs R Butler
Mr Mowl
Mr Pickford

SECRET

FSBR: CHAPTER 2

B.L.O.

... The Chancellor was grateful for your minute of 3 March. I attach a copy of the pages on which he had comments.

ACSA

A C S ALLAN

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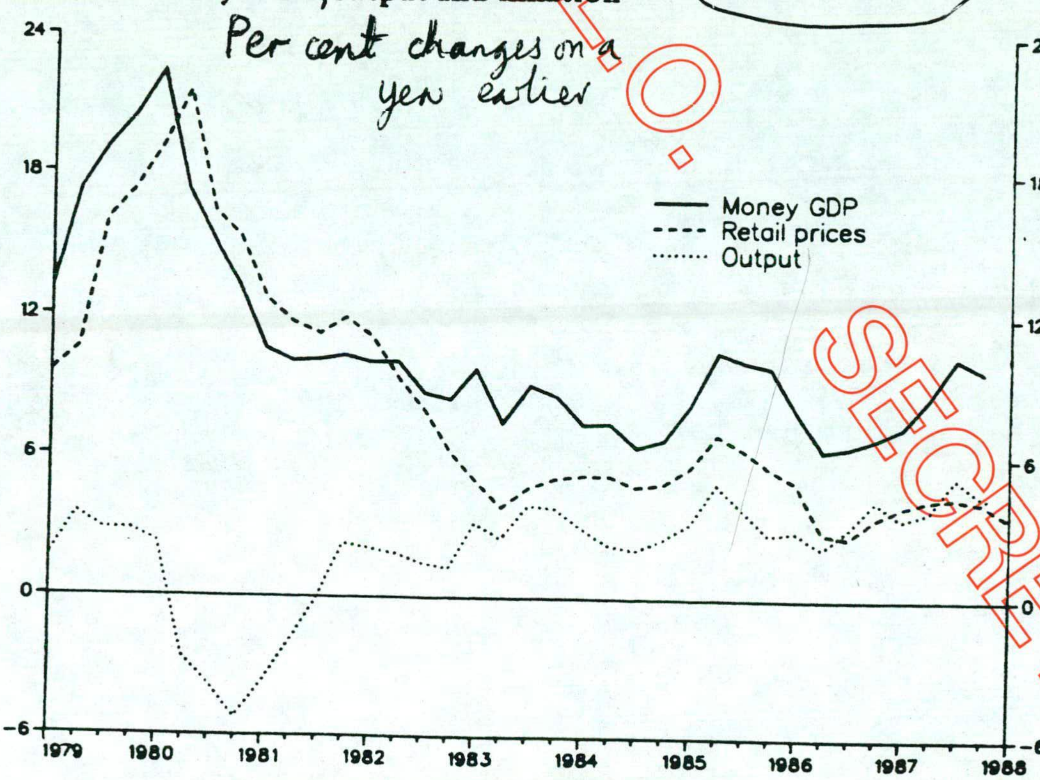
2 The Medium Term Financial Strategy

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

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

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

Chart 2.1 Money GDP, output and inflation



Objectives and the framework of policy

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

Table 2.1 **Money GDP Growth*** (l.c.)

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

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

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

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

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

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

Monetary policy

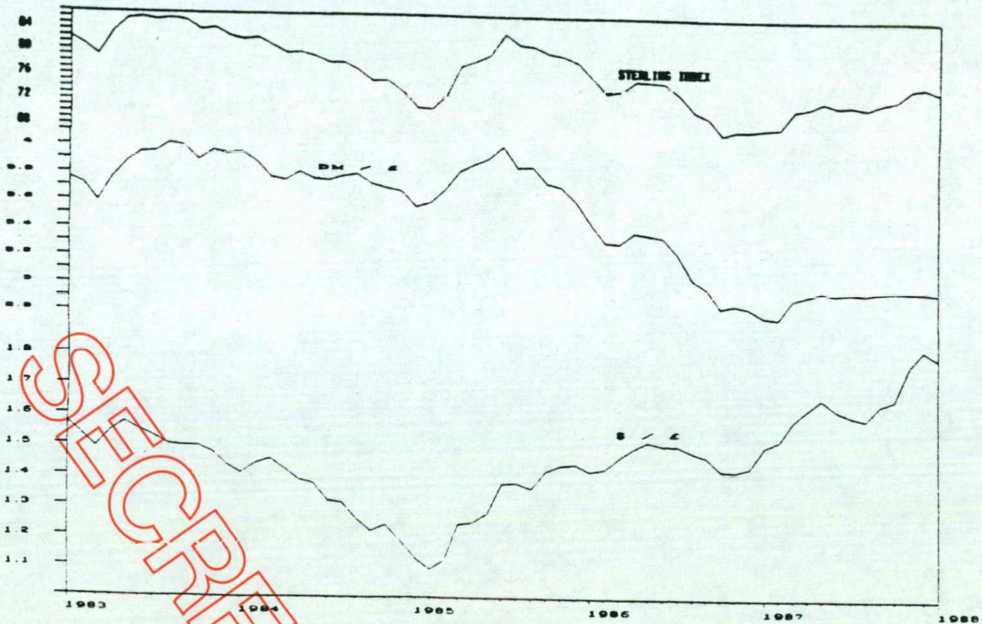
Bring (X) forward to here

~~2.09~~ 10 ~~As the Chancellor made clear at the Mansion House last year,~~ The Government ~~is committed~~ attaches particular importance to maintaining a stable exchange rate, ~~with~~ the rate against the deutschemark ~~being of particular importance~~ notable. This provides an important financial discipline. ~~and is also helpful to industry.~~ add (Y) here Sterling has remained stable against the deutschemark throughout the past year, following the Louvre accord in February 1987. The discipline of a stable exchange rate provides the underpinning for the declining path of money GDP growth and inflation. ~~(Y) here~~

2.1~~0~~ Achieving these objectives ~~implies~~ also requires a reduction in monetary growth over the medium term. For M0, which has continued to be a reliable indicator of monetary conditions, the Government is setting a target range for 1988–89 of 1–5 per cent ~~[2–6 per cent]~~. This is the same as indicated in last year's MTFS. ~~[This is the same as last year's range.]~~ The ranges given in Table 2.2 for later years are illustrative, but show a steady fall consistent with the declining path for money GDP growth.

MOVE THIS PARA BETWEEN CHARTS 2.2 AND 2.3

Chart 2.2 Sterling exchange rates



X — Bring forward —

2.~~11~~ 09 Interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure that inflationary pressures are not accommodated. ~~This means, in particular that~~ since increases in domestic costs will not be accommodated by a decline in the exchange rate.

Y Bring forwa

Chart 2.3 Velocity of monetary aggregates

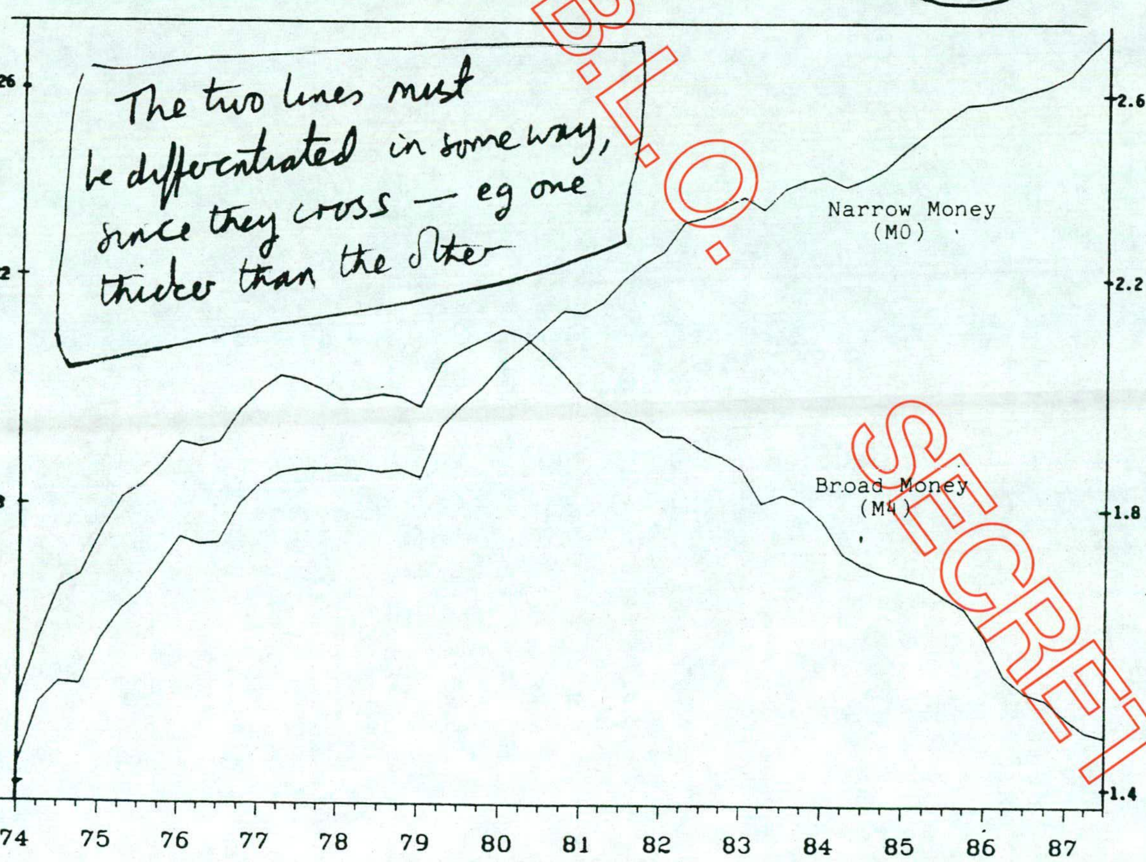


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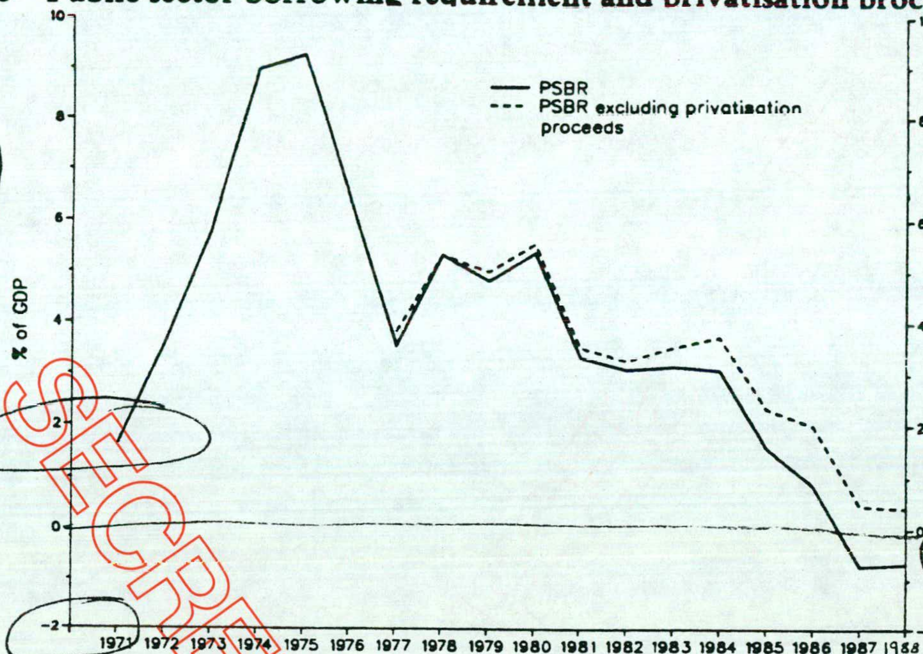
Chart 2.5 Public sector borrowing requirement and privatisation proceeds

ADD ZERO LINE AND START AT LEFT-HAND AXIS



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

2.16 The recent strength of the economy and the buoyancy of government revenue have led to a budget surplus over the last year; and without the tax reductions announced in the Budget there would have been, on current forecasts, a surplus of ~~over~~ some £7 billion in 1988–89. Continuing the gradualist approach which has always been a characteristic of the MTFS, only part of this room for tax reductions has been used. The PSBR for 1988–89 ~~is~~ has been set at ~~X~~ £3 billion, ~~little changed from~~ the same as the expected outturn in 1987–88. The PSBR to be set in future Budgets will as usual be reviewed in the light of circumstances at the time.

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

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

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Table 2.5 General government receipts

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

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

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

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Public sector borrowing

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

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

Table 2.6 Public sector borrowing[1]

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

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

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

B.L.O.

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Conclusion

coupled with

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

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Annex to Chapter 2

Changes since the 1987 MTFS

Money GDP

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

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

Differences from 1987 MTFS projections, percentage points

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

Monetary aggregates

2A.2 The growth of M0 in 1987–88 has been within its target range throughout the year. The target range for 1988–89 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

Table 2A.2 **The growth of M0**

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

Fiscal projections

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

Expenditure

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

Receipts

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

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From: S D H SARGENT
Date: 7 March 1988

BUDGET

MR HIBBERD

cc Chancellor
Sir T Burns
Mr Odling-Smee
Mr Sedgwick
Mr Pickford
Mr R I G Allen
Miss Simpson
Mr Hudson
Mr Allum
Miss C Evans

SECRET

CHAPTER 3 OF THE FSBR: THE INDUSTRY ACT FORECAST

Sir Peter Middleton has seen your note of 4 March covering the first proof of Chapter 3 of the FSBR. He has suggested that we need to consider whether the first sentence of paragraph 3.08 is still correct. We might need to talk instead about stability against the Deutschmark over most of the past year.

B.L.O.

S D H SARGENT
Private Secretary

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From: S D H SARGENT

Date: 7 March 1988

BUDGET

MISS C EVANS

cc PPS
PS/Financial Secretary
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr Culpin
Mr Sedgwick
Mr Mowl
Miss Sinclair
Mr R I G Allen
Mr Pickford

Ch
OK?
AA

OK as amended

of 2p

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FSBR CHAPTER 1

Sir Peter Middleton has seen the first proof of Chapter 1 of the FSBR circulated under cover of your minute to the Chancellor of 3 March. In paragraph 1.05 he has suggested that the third sentence should begin "They include a reduction in the basic rate of income tax to 25p ...".

2. With regard to the tables he has asked whether we need a footnote to explain the sign convention, now that we have negative borrowing. He thinks this would help in a number of the tables in the FSBR including 6.1, despite the textual change in paragraph 6.02 which is now very good.

B.L.O.

a point you've also made in relation to PSD/PSBR

S D H SARGENT
Private Secretary

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