

PO - CH/NL/0409

PART D

Part D.

SECRET

(Circulate under cover and
notify REGISTRY of movement)

Begins : 17/3/88
Ends : 31/3/88



PO -CH /NL/0409



PART D

Chancellor (Lawson's) Papers:

THE RETAIL PRICE INDEX,
RESERVES AND THE
GOVERNMENT'S ECONOMIC
PROGRAMME OF 1988

PO -CH /NL/0409
PART D

DD's : 25 Years

9/1/96.

DR. GERHARD STOLTENBERG
BUNDESMINISTER DER FINANZEN

5300 Bonn 1, 17. März 1988

Graurheindorfer Straße 108
Postfach 1308
Telefon: (0228) 682-4240

Nigel Lawson
Chancellor of the Exchequer
Parliament Street
London SW 1 P 3 AG

Großbritannien

CH/EXCHEQUER	
REC.	21 MAR 1988 213
ACTION	Mr H Evans
COPIES TO	RS/EST, Sir P Middleton
	Sir T Burns, Sir G Little
	Mr Lankester,
	Mr Scholas, Mr Odling-Smee
	Mr Peretz, Mr Matthews

(translation behind)

Sehr geehrter Herr Kollege,

in den letzten Monaten hat die Diskussion über die künftige Weiterentwicklung der währungspolitischen Zusammenarbeit in Europa durch einige Vorschläge, vor allem auch aus dem Kreis der Finanzminister, neue Impulse erfahren. Nachdem ich auch selbst bei verschiedenen Anlässen zu diesen Fragen Stellung genommen habe, lege ich nun ein Memorandum vor, in dem ich meine Einschätzung der währungspolitischen Aufgaben und Ziele zusammenfasse und für die Meinungsbildung in der Bundesregierung darlege.

Ich würde mich freuen, wenn meine Überlegungen dazu beitragen, die Diskussion über die währungspolitische Zusammenarbeit in Europa ein Stück weiterzuführen.

Mit freundlichen Grüßen

Jürgen Drewitz

**TRANSLATION OF LETTER FROM STOLTENBERG TO CHANCELLOR:
17 MARCH 1988**

Dear Colleague,

In recent months the discussion about the future development of European co-operation on exchange rate matters has been given a new impetus by a number of suggestions, mainly emanating from the circle of Finance Ministers. As I myself have now expressed my views on these questions on various occasions, I am now circulating a memorandum which was written to further the process of opinion forming in the Federal Government, and in which I set out my assessment of our tasks and objectives in the field of exchange rate policy.

I shall be glad if my remarks serve to take forward the debate about European co-operation on exchange rate policy.

... G Stoltenberg

15 March 1988

The further development of monetary cooperation
in Europe

Several proposals have recently been made concerning the further development of monetary cooperation in Europe with differing timescales and objectives.

I. Opinion of the Federal Government

The Federal Government has repeatedly endorsed the strengthening of monetary cooperation in the context of its policy of economic integration within the Community. The Government's concept on further development was most recently presented in a Cabinet resolution of 3 February 1988 (in response to the Major Interpellation by the SPD parliamentary group on the state of the world economy).

"The creation of a unified European economic area calls for steady convergence of economic and monetary policies of Member States on the basis of price stability and for the strengthening of the European Monetary System. The full liberalisation of capital movements will be a decisive step. The conditions for increased use of the ECU have been created now that its private use is permitted in the Federal Republic of Germany. The longer-term goal is Economic and Monetary Union in Europe, in which an independent European Central Bank committed to maintaining price stability will be able to lend effective support to a common economic and monetary policy."

II. Basis for further development

The specific points of departure for the further development of monetary cooperation are as follows:

1. The cooperation between Member States within the European Monetary System (EMS) has been increasingly strengthened and intensified over the past few years. Together with a reorientation of economic and monetary policy in some Member States, this cooperation has largely contributed towards enhancing price and exchange rate stability in Europe, on the basis of growing consensus between Member States on fiscal and monetary policy.
2. In the statement by central bank governors of September last year, noted and endorsed by the finance ministers, the well-tried cooperation between central banks was extended with the aim of strengthening the exchange rate mechanism. The goal of price stability was accepted by all as a point of reference for cooperation on monetary policy and for financing interventions within the agreed exchange rate margins.
3. The completion of the internal market is the prime objective. An essential condition is the freedom of capital movements stipulated as early as 1957 in Article 67 of the EEC Treaty. The draft directives submitted by the EC Commission some months ago aim to liberalise capital movements as soon as possible and thus to reduce

potential exchange rate distortions. The liberalisation of capital movements from all controls and restrictions will be the most important step in monetary reform during the period ahead of us.

4. The completion of economic and monetary union is the major objective. This will require a longer transition period for transferring economic and monetary policy responsibilities to the European level. With the revision of the EEC Treaty by the Single European Act (Chapter on economic and monetary union), the sequence of steps was laid down. First of all, the Member States are to cooperate with the aim of ensuring the necessary convergence, taking account of the experience acquired within the EMS and in developing the ECU, while respecting existing powers in this field. When further development requires institutional changes, amendments must be made to the Treaty with the consent of all national parliaments.

III. Tasks for the near future

1. Liberalisation of capital movements

The most immediate task during the German presidency is to bring about a fundamental decision on the irrevocable liberalisation of capital movements in the Member States of the Community. The freedom of capital transactions is of crucial significance for the continuing integration of European economies and for enhancing their growth potential. It enables the most efficient use to be made of scarce capital resources and

at the same time eliminates the causes of distortions within the exchange rate system. After decades of little or no progress, even repeated reversals, the time has now come for far-reaching decisions to meet the Treaty obligation existing since the end of the transitional period in the sixties. The proposals submitted by the EC Commission are a sound basis. The full liberalisation of capital transactions, however, will also require the current two-tier foreign exchange market in Belgium and Luxemburg to be discontinued.

In liberalising capital transactions the Community must not, in its own interests, set up external barriers or, still worse, wall itself off from other countries. The same freedom of capital movements as within the Community must therefore also apply to capital transactions with third countries.

Any transitional arrangements required by some of the new Member States must be of limited duration.

To give common assistance to Member States in temporary balance-of-payments difficulties, the Community already has various substantial financial assistance mechanisms of differing duration. We are prepared to consider how the existing mechanisms can be adapted to meet the new requirements.

The prior harmonisation of supervisory regulations for financial institutions and of capital revenue taxation is, in our view, neither

necessary nor appropriate. The endeavours to achieve harmonisation in these areas require intensive discussion and will thus take time; we are prepared to cooperate constructively. However, we feel that decisions on the liberalisation of capital transactions should not be made dependent on progress being achieved in these areas, a view shared by the EC Commission.

2. Operation and further strengthening of the EMS

a) Further improvement of convergence

The progress made in recent years in improving the convergence of economic and monetary policies and of the economic fundamentals of all countries participating in the exchange rate system will have to be secured and enhanced. In important areas such as budget deficits and current account balances, but also as regards inflation differentials, convergence is still neither satisfactory nor is it sufficiently secured for the future. Some Member States, for example, have high budget deficits which in the medium term could place considerable strains on the stability of the EMS. We therefore urge that the agreed new consultation and cooperation mechanisms should be fully applied and used, both bilaterally and at Community level.

b) Cooperation of the central banks within the exchange rate system

The agreements reached by the central banks in the autumn of last year have widened the scope for monetary cooperation. The proposal

put forward on that occasion that the agreed exchange rate margins should be used to a greater extent than in the past in order to increase the risk involved in exchange rate speculations has now been taken up. The new option to finance intramarginal interventions with the aid of extended credit facilities of the central banks of strong-currency countries has already been applied.

Indications made by other countries that the burden sharing mechanism of the existing exchange rate system of the EMS was unduly favouring the Deutsche Mark (so-called asymmetry) do not properly reflect the actual situation. The Deutsche Mark has developed into the most important intervention and reserve currency in Europe because of its inherent stability and attractiveness, and not because of any unilateral or multilateral decisions. This also reflects the assessment of our partner countries.

Market confidence in the currencies of other members of the EMS has now increased as well; we welcome this development. A continuation of this trend can make a decisive contribution to redress the balance within the EMS.

c) Full participation of Member States and dismantling of special regimes

The EMS will only become fully effective, both at European and international level, if all Member States with the economic and monetary qualifications join the system and abide by the same rules.

It would be desirable for the development of the EMS if

- all countries which are in a position to do so were to join the exchange rate system as soon as possible and thus also assume all rights and obligations involved;
- the special regime for wider margins of 6 per cent were reduced to the normal margin of 2.25 per cent.

Any suggestions to generally widen the fluctuation margins within the EMS would in our view be a step in the wrong direction.

d) Use of the ECU

The acceptability limit which used to be in effect for the official ECU (used only in transactions between central banks) has been lifted for a period of two years under the agreement reached between the central banks in the autumn of last year. The central banks have agreed to review in the light of experience the rules on the official ECU when this period has expired.

The private ECU is not a component of the EMS agreement. It has developed independently in the market and follows the definition of the official ECU; so far its main purpose has probably been to reduce exchange risks. The Deutsche Bundesbank's general authorisation of last year created the legal basis for

increased use of the private ECU in the Federal Republic of Germany. All Member States should now quickly dismantle restrictions on capital movements in order to make possible the international use of the private ECU as well. The private ECU would then be on an approximately equal footing when competing with national currencies. We feel it would be unjustifiable to grant it a privileged position.

From a monetary policy standpoint it is also important that the two circuits of the official and of the private ECU should not be linked, since this would pave the way for uncontrollable money creation.

IV. Economic and Monetary Union as a long-term goal

The long-term goal is the creation of an Economic and Monetary Union. This goal, however, goes beyond the liberalisation of capital movements and the completion of the internal market planned for 1992. As an enduring community based on solidarity, smoothing out differences in economic and monetary development, and with a common currency or irreversible exchange rates (with no margins), it must be founded above all on a far-reaching political and institutional reorganisation of the Community towards a more comprehensive union. As was already stated in the Werner Report of 1970, a lasting Economic and Monetary Union requires the creation or reshaping of Community bodies and the transfer of extensive powers from national to Community level going beyond mere monetary policy. Without this political and institutional evolution of the Community and without a transfer of authority

embracing basic national economic and monetary policies, a common currency would not be sufficiently protected against tensions which could result from differing economic and monetary decisions by Member States.

An Economic and Monetary Union also includes a European Central Bank, which in our opinion should meet in particular the following criteria:

- It must be committed to the goal of price stability.
- In fulfilling its task it must be independent of instructions from member governments or other Community bodies.
- The decision-making process must strike the proper balance between central and federative elements.

Careful consideration should be given to the question of whether intermediate steps towards a European Central Bank are possible and useful, and if so, what such steps would be. In any case a condition is that in the transitional period the central banks of all Member States should be enabled to give priority to the goal of price stability and to take decisions independently of instructions from governments. This would decisively promote the convergence of monetary policy needed for the further development of the EMS, and at the same time facilitate future integration into a European central bank system.

MR SEGAL
HM Treasury

17/3/88

As requested, a few quotes from the Italian press on the Budget, informal translation.

Corriere della Sera 16 March 1988

"For the first time in twenty years, the British Economy is no longer "the sick man of Europe"."

"An Italian observer would have had to struggle yesterday against a deep feeling of envy while the Chancellor of the Exchequer, Nigel Lawson presented his Budget to the House of Commons."

"The proceeds of privatisation have certainly helped but the explanation lies in the strengthening of the entire economy which was "the sick man of Europe" in the 60s and 70s and which today has begun to function again."

Il Sole 24 Ore 16 March 1988

"To the Italian observer, the feature of the balance sheet which stands out most clearly, in stark contrast to the facts of our own case, is the public sector surplus of £3 billion."

Il Sole 24 Ore 17 March 1988

Headline: "The Chancellor of Gold"

Sub-headlines: "With the new Budget, Lawson has sanctioned the political triumph of Thatcher"

"The successes of the economy make criticisms of the large tax cuts and the cuts in social spending difficult."

"But it is on the political level that the fifth Lawson Budget represents the essence of the Thatcher philosophy and has probably set in on the way to its most important success."

"Lawson enjoyed reminding the Opposition that the Labour Governments of Australia and New Zealand were already moving in the direction of cuts in contributions."

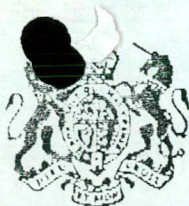
Italia Oggi 17 March 1988

"But the City reacts with unexpected scepticism; it awaits clarification on monetary policy. The Stock Market loses ground, Labour declares war."

I hope these may serve your purpose.

A L McGUFFOG
Labour Attache
17 March 1988

British Embassy
ROME



Britische Botschaft

Presseabteilung

53 Bonn Friedrich-Ebert-Allee 77

Fernschreiber 0886 887 Fernspr Sammel Nr 234061

FAX: 0228/234070

FACSIMILE LEADER

DATE..... 17.3.88

DOCUMENT CONSISTS OF ..1.....PAGES PLUS LEADER

FROM:..... C P BURROWS

TO:..... MOIRA WALLACE, CHANCELLOR'S OFFICE..... ~~004412705589~~ FAXNO:.....

..... TREASURY or 004418392029

THE BUDGET: THE GERMAN PRESS

Further to David Bell's fax of 16 March, I attach a copy of a press summary produced today covering further comment in the FRG press on the Chancellor's Budget speech.

Best wishes,

CP Burrows

GERMANY

UNCLASSIFIED

172664
MDHIAN 2499

UNCLASSIFIED

FM BONN

TO IMMEDIATE FCO

TELNO 251

OF 171155Z MARCH 88

AND TO IMMEDIATE WASHINGTON, PARIS, ROME, TOKYO, OTTAWA, UKDEL OECD

(CULL)

FRG REACTIONS TO UK BUDGET

SUMMARY

1. CHANCELLOR'S BUDGET SPEECH RECEIVES GENERALLY FAVOURABLE COMMENT IN TODAY'S FRG PRESS. PRAISE FOR GOVERNMENT'S INCENTIVES FOR INDUSTRY. STRENGTH OF ECONOMY NOTED. SOME REPORTING ON MIXED REACTIONS IN UK.

DETAIL

2. CHANCELLOR'S BUDGET SPEECH CAME TOO LATE TO MEET MOST OF YESTERDAY'S NEWSPAPER DEADLINES, BUT THERE HAS BEEN FACTUAL COVERAGE AND COMMENT IN TODAY'S EDITIONS.

3. HANDELSBLATT (LIBERAL), PRAISES THE GOVERNMENT'S CONSIDERABLE INDUSTRIAL INCENTIVES OVER THE PAST 9 YEARS WHICH HAVE RELEASED FORCES THROUGH WHICH THE UK CAN TAKE ON THE ROLE OF ECONOMIC PIONEER. "THE ONCE SICK MAN OF EUROPE HAS BECOME THE MOST DYNAMIC ECONOMIC NATION IN EUROPE". DIE WELT (CONSERVATIVE) PRAISES TAX REFORMS, AND THE INCENTIVES DESIGNED TO PUSH INDUSTRY FORWARD. THE KOELNER STADT-ANZEIGER (LIBERAL) SUGGESTS THAT GERMAN INDUSTRY WILL SEE BRITISH TAX REFORMS AS A MODEL. BRITAIN IS A "SHINING EXAMPLE", WITH STATE REVENUE HIGHER THAN EXPENDITURE. THE FRANKFURTER ALLGEMEINE (CONSERVATIVE) STATED THAT INCOME TAX REFORM SHOWS THE PRIME MINISTER'S AND CHANCELLOR'S TRUST IN THE PUBLIC WILLINGNESS TO RESPOND TO INCENTIVES.

4. THE SUEDEUTSCHE ZEITUNG (LIBERAL) SOUNDS A MORE CAUTIOUS NOTE. IT IS TOO EARLY TO ASSESS THE ABOVE AVERAGE ECONOMIC GROWTH OF THE PAST FEW YEARS AS IRREFUTABLE PROOF OF CONSERVATIVE POLICIES. DIE WELT ALSO REPORTS THE "CAUTIOUS" REACTIONS OF THE CITY. IN A REPORT ENTITLED "CHAMPAGNE FOR THE RICH, MORE MISERY FOR THE POOR" THE FRANKFURTER RUNDSHAU (LEFT OF CENTRE) FOCUSSES ON THE OPPOSITION'S RESPONSE TO THE BUDGET SPEECH.

UNCLASSIFIED

17704
MDHIAN 2499

WILLIAMS

YYYY

DISTRIBUTION

178

MAIN

178

FINANCIAL

WED

NNNN

FROM: R I G ALLEN
DATE: 17 MARCH 1988

PRINCIPAL PRIVATE SECRETARY

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Mr Anson
- Mr Scholar
- Mr Culpin
- Mr Hudson
- Mr Cropper
- Mr Tyrie
- Mr Call

Chancellor

cc this page
Sir T Burns
Mr Sewell
Mr RIG Allen

Page 13. The
2 million whose
marginal rate goes up are not all
in the bank. Some are higher rate taxpayers
(unless, of course, you cut the top rate to 31%).

PRESS BRIEFING FOR ECONOMIC/FINANCIAL CORRESPONDENTS, 16 MARCH

Re 18/3

I attach a transcript of yesterday's Press Conference.

2. I regret that there are one or two gaps and oddities arising from the poor quality of the tape recording.

3. You might like to consider whether we should make a copy available to those who attended the briefing. I see no objection to this, indeed some advantage, as the proceedings were on the record and (particularly in sensitive areas such as exchange rate/interest rate policy) it is important to get your words absolutely straight so as to avoid misquotations and misunderstandings.

RIG
 He didn't require that.
 What is the rate? is it 35%?
 No 40% rate to 30%
 50% to 40% and about 45% to 35%
 55% to 60%
 I think it was
 people on the
 bank?
 actually in the bank?

R I G ALLEN

CHANCELLOR'S PRESS CONFERENCE ON THE BUDGET

Transcript from a tape recording, Treasury, 16 March 1988

RICHARD ALLEN: Morning. This will be on the record today. We have about 45 minutes.

CHANCELLOR: Yes, as a maximum, so I think probably the best thing is I listen to your questions today.

QUESTION: The Mansion House speech made clear your policy of maintaining sterling stable against the Deutschemark. Are you prepared to restate that policy today?

CHANCELLOR: I made my statement on the exchange rate in the economic section of the Budget speech. I don't think I have anything to add to that. You remember we're committed to the G7 agreement of 23 December which we signed.

QUESTION: But has the policy changed?

CHANCELLOR: No. There's been no change in policy. As I say, we remain committed to that agreement.

QUESTION: What would be the range against the Deutschemark?

CHANCELLOR: I have never answered that question and I don't propose to.

QUESTION: Has there been a change in the sense of paying more attention to interest rates than the exchange rate?

CHANCELLOR: I've said time and time again, in almost the same words, that interest rates are the essential instrument of monetary policy.

QUESTION: If you are not prepared to repeat the words of the Mansion House speech, does it indicate that the Prime Minister's views have triumphed?

CHANCELLOR: I think it is sensible to see how policy is conducted. This is very market sensitive area as you know. And I think statements about it are seldom helpful for that reason. And therefore my statements on that subject are few and far between and very carefully considered when they are, I think the rest of the time it is sensible just to say very little and to see what happens. Actions, you know, are more important than words.

QUESTION: Is it still the intention to join the EMS when the time is right?

CHANCELLOR: The Government's position hasn't changed at all.

QUESTION: The aim of policy last year was to provide public reassurance to industry on the exchange rate. If you are now saying that industry has to guess where the exchange rate will be, does that not represent a change?

CHANCELLOR: Well - do come and join us Sarah - on the basis that it's what happens that matters. I mean if you look at the past 12 months you'll see that there's been a greater degree of stability than any previous 12 month period for a very long time.

QUESTION: Will the next 12 months see a similar degree of stability?

CHANCELLOR: I'm not making any predictions. But clearly I think that it was the considered view of the Group of 7 Finance Ministers and central Bank Governors, which we signed up to (and which we remain signed up to) and which was published on 23 December as a Christmas present to you all, that a greater degree - and continuation - of stability was desirable.

QUESTION:

CHANCELLOR: I wouldn't accept your characterisation - I think that it's rather more that the currency which has been slightly out of step over a period of months was the Dollar. And there were conflicting [stories] in Washington and so, and for a period following the collapse of the Stock Market there was uncertainty about the Dollar. But the Dollar now seems to have settled down and I think that the Americans are far happier now with the greater degree of stability. I think that's probably enough about that subject. I think we ought to get on to the Budget now.

QUESTION: Would you expect increased revenue from higher rate taxpayers to compensate for the cost of the reductions in tax?

CHANCELLOR: Yes I think that it is likely that there will be that effect. Certainly if you read for example the analysis that Professor Lyndsay has done. And certainly the evidence that we have is very dramatic. If you look at the top 5 per cent of taxpayers, they paid under the Labour regime in 78/79 24 per cent of the total income tax take. The top 5 per cent this year, we reckon, will pay 29 per cent of the tax take, and even with the cuts in this Budget, in 1988/89 (the coming financial year) it'll be down to 27 per cent. As I say, 27 per cent compared with 24 per cent under Labour, a substantially higher proportion. And even more striking I think is what has happened if you look at the income tax take in real terms. The income tax take in real terms has risen since 78/79 because, of course, incomes have risen in real terms so much more than the amount by which rates have been cut. But that increase in the tax take in real terms, has been entirely from the top 5 per cent. The top 5 per cent are paying one third as much again as they did in real terms in 78/79. The other 95 per cent pay the same as they did in real terms in 78/79. Now it's the whole of the increase that has come from the top 5 per cent and I think that's quite striking and indicative, and I would expect over time the same sort of effect from this reduction. We haven't shown any of that I may say though you will find it buried away in the footnotes in the Red book. We haven't shown any behavioural effects of the higher rate cuts. The assumption is made that there are none. Not because we believe there to be none but because it is really so difficult to put a figure on them. And, also, even if you have a view of the order of magnitude, you don't know the speed at which it's going to come through. We have made assessments of behavioural effects but they come through very quickly on the capital gains tax changes; and that capital gains tax reform was a very important reform indeed. And of course we always make assessments of the behavioural effects of the excise duty changes because it's

a simple matter of elasticities and easy to calculate. On income tax we assume zero behavioural effect but that is not what we actually believe is going to happen.

QUESTION: Do you have figures for the top 5 per cent which take account of the differential impact of excise duty charges?

CHANCELLOR: I haven't the figures. I'm sure the Treasury Press Office would be happy to, or the Customs and Excise - or perhaps Treasury probably better.

QUESTION: The 95 per cent who are paying the same in real terms in income tax as they were in 1979 - is that before or after the Budget?

CHANCELLOR: That is before this Budget, I'm pretty sure. I will certainly see that that is checked Sarah - but I'm pretty sure that what I was giving you was the comparison between 87/88 and 78/79. In other words.....

QUESTION: Hasn't the increases in tax take from the top 5 per cent arisen from a higher than average increase in such incomes due to the effects of increased benefits and the loosening of incomes policy, rather than a supply side push.

CHANCELLOR: I think there are a number of factors and you can't really disentangle them all. I mean, logically, quite apart from the difficulty of assigning weights to them. There was this egalitarian incomes policy under the last Labour Government. Now that clearly had a profound disincentive, you know, most people not bothered and prepared to take risks and so on - why should they? - and they go for the quiet life. It also made them look for all sorts of means of rewarding themselves other than in cash income. So that links up with the incentive effect

of reducing tax rates. As I say, it is a matter partly of dynamism because these are people who not only have the ability to change their work patterns much more than people lower down the scale but have also the ability to create jobs for other people. But, also, they have the ability through their accountants and so on to shelter income a great deal more. And one of the reasons for bringing tax rates down and one of the reasons why it does produce so much revenue is that it does reduce the attractiveness of tax shelters. And if at the same time, as I did in this Budget, you actually take positive measures to reduce the attractiveness of shelters that reinforces it.

QUESTION: Professor Lindsay said that his work should not be taken to apply in the UK.

CHANCELLOR: No, his study was certainly in the United States. But I think he - and he is a very careful academic - wouldn't therefore claim it applies beyond where he studied. But I think it can be applied to the United Kingdom too. And as for Brown, I was very concerned with the Brown study because the Treasury disapproves of other Departments wasting money and I therefore felt rather embarrassed that we'd wasted - although it wasn't anything to do with me - money on this shoddy and absurd exercise. All that he found, it can be summed up very quickly in a nutshell, is that ordinary people in 1980/81 didn't respond to the income tax cuts by working more overtime. Well there was a very simple reason for that: there was a recession on and there wasn't any overtime work available. That's the sum of Professor Brown's study. And we had to pay for that. As I say, I was very embarrassed. As someone with responsibility for the control of public expenditure I was very embarrassed.

QUESTION: How would you like industry and the consumer, with much more money in his pocket, to respond to your Budget?

CHANCELLOR: Well we have had a remarkable response by British industry to the policy we had been pursuing hitherto. That's why I think it is reasonable to suppose this will happen if

you carried that policy further, which is all this is. It's a continuation of a policy we've been pursuing for a very long time. And I think that having seen the very positive response of industry to the earlier instalments there will be a positive one to this. And that is certainly, I think, the view of the CBI too.

QUESTION: Chancellor, the CBI also said it wanted lower interest rates and a lower exchange rate. Do you support that too?

CHANCELLOR: Well we shall have to see. I think that what they have said all the time is that, on exchange rates, they value stability. And they have had, as I said, over the past year a greater degree of stability than in previous years, and I think they have valued that. And, as for interest rates I think they can fully understand the position, although of course people who borrow money like to pay less for it. That's not a remarkable discovery. I think they do understand that interest rates have to be adjusted as necessary in order to keep downward pressure on inflation because the last thing they want to see is an upsurge in inflation.

QUESTION: How quickly do you expect the top rate tax cuts to pay for themselves, by the end of the Parliament?

CHANCELLOR: I don't know. I think that you will be seeing the results of this before the end of this Parliament. We've been very patient - I'm sorry I'll come to you in a moment Anne. Don't forget that Geoffrey Howe, reduced the top rates in 1979, and he and I together have waited 9 years before making a further move down, during which time evidence of the beneficial effects of the cutting of top rates has been accumulating.

QUESTION: The FSBR was presumably finalised several weeks ago. Have recent events changed the forecasts?

CHANCELLOR: Oh my goodness me no. We're very much on the ball. No, no, we produce our up to date figures and forecasts; it

goes to bed very late.

QUESTION: Do you think in the light of what's happened to sterling - the slightly higher £ - that there is anything that you would want to change.

CHANCELLOR: No, we publish forecasts on the basis of assumptions which are clearly stated in the Red Book. We never state what the forecast might be if the assumptions were different.

QUESTION: Are you confident the PSBR forecast will be any better this year than the last couple of years?

CHANCELLOR: I think that it's difficult to be confident about that because the PSBR - PSDR as it now is - being this difference between two huge magnitudes, the margin or error is necessarily very large. And so I can't be confident that it'll be more accurate than it's been on average over the past few years. For this year now ending of course it's been conspicuously inaccurate and I would have thought that a difference of that scale is unlikely to occur again this year. I am always - and always have been as you probably know - very cautious in my forecasting.

QUESTION: Is there anything you are looking forward to doing in your next Budget?

CHANCELLOR: I've only just delivered this one. It's far too soon to think about the next Budget.

QUESTION: People have been saying that it's your last.

CHANCELLOR: People are always speculating.

QUESTION: Would you like to do another one?

CHANCELLOR: I think it is far too soon, far too soon, far too soon, for me to start thinking about that. I've got this Budget to get out, to get through the Budget debate let alone the Finance Bill.

QUESTION: In the 1987 Budget you settled on 1 per cent PSBR. Are there any particular reasons for now going for a balanced Budget?

CHANCELLOR: Well it was always possible to argue that - what I referred to in front of the Treasury Select Committee last year as the modern equivalent of the balanced Budget - should have been adjusted because it didn't take account of privatisation receipts. I wasn't too fussed about that because privatisation proceeds will go on at this level for many, many years to come. But nevertheless there was that objection. But I felt, you know, reviewing these affairs that the old fashioned doctrine of the balanced Budget really had a lot to commend it and that we should - it would be a very useful, clear and easily understandable rule - stick to that as a norm.

QUESTION:

CHANCELLOR: Well it'll vary from year to year as I said in the Budget speech. It'll inevitably tend to fluctuate from year to year - and that was of course what was always intended even by, for example, the authors of the Full Employment White Paper in 1944. I don't know whether any of you came to that Keynes conference, where I quoted Keynes. He was a very strong balanced Budget man and believed that it was only in most exceptional circumstances, such as the 30s, that you should depart from it. And it's only the sort of Keeganites who have departed from that.

QUESTION: Are we then all Keynesians?

CHANCELLOR: No, because the Keynesians have got nothing to do with Keynes. I mean they took off into a bizarre world of their own which led to total disaster.

QUESTION: Are you a true Keynesian?

CHANCELLOR: I'm a true eclectic.

QUESTION: How volatile is the balance of payments forecast.

CHANCELLOR: It's our best guess. The balance of payments current account is, for the same reason as the PSBR, extremely difficult to forecast because it is the difference between two enormous magnitudes. But our track record in forecasting has not been a bad one and there has been, as far as I'm aware, no systematic error one way or the other. In fact, last year as you know, we forecast 2 1/2 and it's come out at closer to 1 1/2. But the forecast for 1988 is the best guess of the Treasury forecasting team.

QUESTION: Did you apply your political judgement to it?

CHANCELLOR: Most certainly no. Absolutely not. There's no point in it, what would be the point? My judgement is part of the input, just as the chief economic forecaster's judgement is part of the input. But that is our judgement based on our deep experience of these matters.

QUESTION:

CHANCELLOR: No I think this is the forecast, this is the Treasury forecasters' best guess of the current account deficit within a very wide margin of error, which is published in the FSBR. I can't remember what it is but it's, what is it, the margin of error is 3% or is it 3 billion.

QUESTION: When - and how - will the forecast slowdown occur?

CHANCELLOR: I think that it is going to slow down naturally. You don't get these surges of consumer spending going on indefinitely. So consumer spending I think is likely to ease off. Investment is going to go up faster but consumer spending

is likely to ease off. Also, of course, there has been a tightening of monetary financial conditions. And if you look at the effective exchange rate and you look at interest rates you will see that combined there's clearly been a tightening of financial conditions. But I think that, particularly to the extent that consumer spending is financed by credit, you do get these cycles. And what this boils down to I believe, as Christopher Smallwood was about to say, is that what we are forecasting is a slower growth in consumption. The savings ratio having come down very markedly (though it's level is not unprecedented as you will see from the chart in the FSBR), to the lowest level for a very long time, we think it's likely to pick up in the future.

QUESTION: Since savings behaviour is so uncertain isn't the trade balance likely to be at greater risk than implied by a forecast £4 billion deficit.

CHANCELLOR: This is a supply side tax reform Budget. I see Gavin Davies described it yesterday as Reganomics without the red ink. I think that's rather a good description. And that's what matters. We can cope with the current account deficit without any difficulty in the markets. There wouldn't be the strength of the currency in the markets if they were worried about it. We can cope with the current account deficit whether it happens to be this figure that we forecast or something either side.

QUESTION: Did you assume high interest rates in the FSBR?

CHANCELLOR: I keep interest rates at wherever they need to be.

QUESTION: (did you think about taxing credit?)

CHANCELLOR: Sorry, which of you first?

QUESTION Inflation is now where it was when you became

Chancellor. What are the prospects for reduction?

CHANCELLOR: I'd like it to come down lower. It's been slightly lower. Inflation in 1983 reached 4.6 per cent as a whole and it's been under that for the last couple of years, and it'll be below that in 88. So it has come down. And it's come down - quite remarkably - at a time of outstandingly vigorous growth. It is always harder to get inflation down during a period of very strong growth than it is during a period of recession. We will get it down further but it'll be a gradual process.

QUESTION: When will it be possible to get income tax down to 20p?

CHANCELLOR: I don't know. It's worth recording that the 25p target, which was in terms of not more than 25p - was enunciated first by Geoffrey Howe in 1979 when he got it down to 30 and it has taken us 9 years to get it down to 25. Now that we have got the economy so much stronger and healthier, I think we'll do it in less than 5 years.

QUESTION: Why did you not change the burden of National Insurance to assist the lower paid?

CHANCELLOR: What do you mean, at the bottom?

QUESTION: Yes, the people at the bottom have a higher marginal rate of tax than anybody else in the system with National Insurance, or very nearly?

CHANCELLOR: Well that's nothing to do with National Insurance. The so called marginal rate at the bottom end is because means tested benefits are targetted on the poorest and neediest people and families. And that means that as they earn more there's a withdrawal^a of those benefits and that is where the high so called marginal rate, or poverty trap or what have you, comes in. It's nothing to do with the tax system.

QUESTION: If you get over £35 or £37 you start paying National Insurance not on every extra £ but on all of your income. So if the threshold is £37 and you then earn £38 you pay National Insurance on £38.

CHANCELLOR: Yes, there are certain steps. Because of the way the National Insurance contribution is paid, you first go into the thing at 5 per cent and then you step up to 7, and then up to 9. Through those little steps you get a very high marginal rate. But that is a tiny number of people who are actually at those points.

QUESTION: We now have a very bizarre tax system: you start off at a basic rate which is 25 + 9 national insurance contribution, 34p, then down to 25p, then up to 40p. What's the rhyme or reason behind that?

CHANCELLOR: Well the reason is that the national insurance contribution is levied on the basis that it is, and that is how it has always happened. But I don't think, although it offends the tidy minded, that it does any other violence. There has been a lot of talk about abolishing the UEL and all that, and that is obviously one of the options that I looked at very thoroughly. But if I had gone down that route it would have been a markedly inferior reform package. First of all, although I know some are sceptical about even that, what matters is what the marginal rate of tax is. I believe that does matter and I've got that top marginal rate down to 40 per cent. I don't think that what the mathematicians would call the second differential has any economic significance at all. I mean whether the step is from 25 to 40 or 30 to 40 or from 35 to 40 it doesn't make a ha'porth of difference. What matters is what the marginal rate of tax is, that's what has an economic effect. And I've got the benefits of bringing that down. Now if I'd abolished the upper earnings limit what that would have meant is that over 2 million people, [the people who are in that kink on the graph] would have seen a significant increase in their marginal rate which would undoubtedly have been economically damaging

and I see no virtue in that. It would also have meant, incidentally, that their average rate would have risen. And if these people had been hard hit, many with company cars, it would have been quite impossible in any Budget to double the scale of charges for company cars at the same time. You couldn't have done that. And I believe, again, that the economic benefits of reducing that distortion are infinitely greater than anything which is gained by having a tidy line on the graph. So, as I say, having looked at the 2 options side by side there was no doubt which was the economically superior.

QUESTION: What about the bottom end of National Insurance scales, I mean you obviously think there are some ill effects from that - you made some changes in it a few years ago - after that you seem to have abandoned that route.

CHANCELLOR: Well what I was concerned at that time to do was to attack a particular problem which was the problem of rising unemployment among the least skilled members of the workforce. Therefore, as you recall, I acted on both sides: not just the employees' national insurance contributions but also the employers at the bottom. And I think that did help at that time. We now see unemployment going down very fast and I think it will continue to go down but not as rapidly as it has been over the past 12 months. Therefore there isn't that particular problem to be addressed and it is more important now to take measures which I believe will lead to a more dynamic, more enterprising, and more successful economy which will benefit people at all levels.

QUESTION: National insurance: is there an occasion when the whole interaction between national insurance and tax might be reviewed or is this a completely closed subject?

CHANCELLOR: There are a lot of other difficulties in marrying up the two which I won't go into now, but which were exposed in a very fair and open way in the 1986 Green Paper, that chapter of the 1986 Green Paper on reform of personal taxation. No,

some future Chancellor may well be attracted to that.

QUESTION: But not you?

QUESTION: Is this your last word on the reform of personal taxation just as you said, for example, on corporation tax?

CHANCELLOR: Yes it's a very very substantial reform. If you go over the reforms and simplification of income tax; capital gains tax reform - which I don't think anybody was expecting and certainly not in its entirety - which is a very fundamental reform; reform of covenants and maintenance; independent taxation; the continuation of the inheritance tax reform; quite substantial changes on the mortgage interest front where the cost has gone down considerably by the combination of the home improvement loans no longer being given tax relief and the rates of tax coming down so much. It is a very, very substantial reform Budget and I went over all the possibilities and I put in this Budget what I think it is sensible to do.

QUESTION: Is there any change of a future look at allowances. These make the completion of tax returns very complicated.

CHANCELLOR: Well I did abolish 3 of the minor allowances in order to simplify a little bit further. But I think you can make a case for having the allowances much lower. I don't see that that's likely to happen.

QUESTION: Are there any plans to go even further, to a single rate of tax?

CHANCELLOR: No, as I said in the Budget speech, I think what we've set is a perfectly acceptable and reasonable rate of tax for higher earners to pay.

QUESTION: What remains that deserves a reformer's attention.

CHANCELLOR: If anything occurs to me I will certainly turn

my attention to it in the systematic and analytical way which you know is my forte. But there's nothing really that immediately springs to mind.

QUESTION: Have you given up on the pensions?

CHANCELLOR: I've said that if I was to do anything on taxation of savings, which means pensions in particular, then I would publish a Green Paper first and I obviously stick by what I said. That is a possible area, although it's interesting that what is happening in the tax system at the present time is some redressing of the balance between the institutions and the individuals which is what I think one is concerned with. Because companies are making so much profit, they are paying more tax and individuals are paying less. Now the burden of company taxation basically falls on the shareholders of the company, the owners of the company, and those are overwhelmingly the institutions and pension funds in particular. So the burden is going on them and off the individual. So, we're getting by that route, some switch of the kind that I think is desirable.

QUESTION: Likely developments on the international scene?

CHANCELLOR: I don't think there's much happening on the international scene. We've had a discussion about exchange rate and I don't see the point in spending any more time on it, except to say that there's unlikely to be much more happening on the international scene until the American Presidential election is over and the new administration has sorted out where it stands. Because obviously the United States is crucial to where any international agreement.

QUESTION: How many people have been taken out of the tax net. That figure was not in the Budget speech as it usually is.

CHANCELLOR: No I didn't, I didn't mention it but it's a little over $\frac{3}{4}$ of a million people taken out of tax, I think to be precise 780,000.

QUESTION: Does that include the change over and above indexation.

CHANCELLOR: It is the total change, which is half and half. I didn't mention it because it's so complicated. It's a question of are you doing it on an unindexed or indexed basis, so which figure do you give, and then how many of them will be back in the tax system by the end of the financial year and so on. So I thought it better not to give it. But as of 6 April, 780,000 taxpayers will be taken out of the income tax net.

QUESTION: Confirming figures for top tax take.

CHANCELLOR: That's right. Another figure - I must go in a moment really, two more questions - another interesting figure I gave in the speech, but I think there was a certain amount of noise in the House of Commons, what that of the total cost of the income tax package: 3/4 in 1988 is represented by the reduction in the basic rate and in the increase in the allowances.

QUESTION:

CHANCELLOR: Well on credit there's a great deal of exaggeration of the place of credit cards and all that in consumer credit. As you know, they represent less than 5 per cent of total personal credit. I felt that the removal of tax relief on home improvement loans, double glazing, porches and patios and so on which was generating a substantial amount of abuse as the PAC had reported, was obviously a much more effective way of dealing with that. On the question of the restricting mortgage relieve to the basic rate once you've got -

QUESTION: Also personal allowances?

CHANCELLOR: Do you mean pensions?

QUESTION: Single persons allowance etc.

CHANCELLOR: What, restricting that?

QUESTION: Yes.

CHANCELLOR: That's a perfectly good possibility. But I don't think any great advantage would accrue from that. Taking mortgage interest relief, now you've got a simple tax system of 2 rates - and you assume that everybody on the higher rate has their ration of £30,000 mortgage interest relief - then confining it to the basic rate simply has the effect of lowering the higher rate threshold. That's all it does. It brings more people into the higher rate of tax and you can have exactly the same effect by reducing the higher rate threshold. I don't think there's any great benefit in that. Arguably the higher rate threshold ought to be, if anything, rather higher than it has been. Over the years we've been in office it hasn't gone up by as much as the basic rate.

QUESTION: Rich man's budget?

CHANCELLOR: 3/4 of the tax relief in 88/89 is accounted for by the basic rate cut and the increase in personal allowances. And furthermore and perhaps rather more important the purpose of this Budget is to improve the performance of the British economy and that is something from which everybody benefits. The tax system should be collecting the amount of tax that needs collecting in a way that does least damage to the economy and that is what I have sought. Most of the people who are complaining about this being a rich man's Budget incidentally are rich men themselves. They can always send the money back if they don't like it.

QUESTION: It appears that the Budget was designed to encourage marriage or was that a side effect?

CHANCELLOR: It was certainly meant to be a Budget that removed the discouragement of marriage and the tax penalties on marriage. But a very nice attractive Scottish make-up girl who covered up my beard before I did the Budget broadcast last night said* 'a very good Budget, I think I'd better get married' So maybe it will. But that was not the purpose.

QUESTION: Full year cost of high rate tax charges showing in PSBR.

CHANCELLOR: It's not the full year it's year 2.

QUESTION:

CHANCELLOR: No that's not a full year. That is the second year. But that, of course, is without any other changes that there might be for 89/90 which could be introduced in the 89 Budget.

QUESTION:

CHANCELLOR: The reason why there's a big difference is quite clearly because large numbers of higher rate taxpayers are not on PAYE. Obviously a large number are but there are a lot that are not on PAYE and therefore the tax gets paid. This is done on a receipts basis as you know. But as I say the 89 line is incomplete because there may well be changes in the 89 Budget which will affect 89/90.

QUESTION:

CHANCELLOR: I don't think that is likely. If you look at the MTFs you'll see that the prognosis is quite encouraging.

QUESTION:

CHANCELLOR: No the point is it's absolutely clear and accurate.

QUESTION: On tax reform is this a sort of two bites at the cherry, or do you think you've done your bit and you're happy with it?

CHANCELLOR: Well you know I want certainly to see the results coming through. And I'm confident they will.

QUESTION: I don't think she was suggesting you were going to emigrate?

CHANCELLOR: How perceptive you are.



FROM: J M G TAYLOR
DATE: 18 March 1988

Php

PS/CHIEF SECRETARY

cc Mr Anson
Mr Monck
Mr Burgner
Mr Hawtin
Mr D J L Moore
Mr Turnbull
Mr Instone
Mr Waller
Mr Call

**SUNDERLAND SHIPBUILDING CLOSURES -
DECLARATION OF AN ENTERPRISE ZONE**

The Chancellor has seen Mr Ridley's letter of 15 March to the Chief Secretary. He has also seen your manuscript note of the same date recording a conversation with Mr Gray.

2. The Chancellor is glad that Mr Gray has told DOE to hold off pressing this while shipbuilding discussions are going forward. He has also commented that, as and when this Enterprise Zone does come, it will need to be the last.

J

J M G TAYLOR

ishment. He was released from prison in 1959.

He headed East Germany's atomic research centre near Dresden from 1974 until he retired in 1979.

Fuchs was born in a suburb of Frankfurt on December 29, 1911. His father, Professor Emil Fuchs, was a professor of theology and a Quaker who opposed the Nazi regime and was sent to a concentration camp.

Klaus Fuchs flirted briefly with the Social Democrats before joining the Communist Party in 1930.

He worked in the anti-Nazi underground movement for two years before he was forced to flee to France and later to England where he arrived in 1934.

In Britain, he studied physics at Edinburgh University.

In December 1986, when he was 75, the East German leader, Mr Erich Honecker, praised Fuchs for his "consistent struggle for the peaceful use of nuclear energy".

Mr Honecker added that Fuchs had been "one of the first scientists to recognise clearly the role and responsibility of the scientist in the atomic age".

Tory's "hidden agenda to disband the health unions" and a denial of democracy.

He said the November semi-

British people are being led round every zig-zag by a completely confused government."

TUC sheers away from strike call, page 3

Trade figures worsen

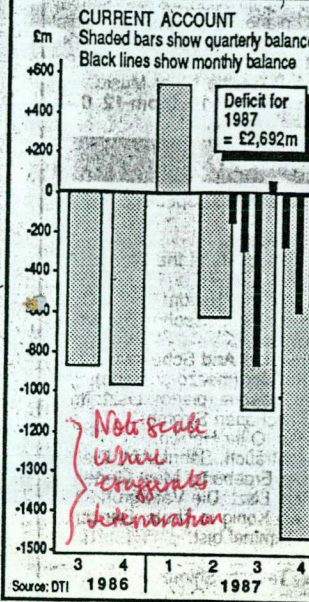
continued from page one

The overall rise in export volume (excluding oil and erratics) in 1987 was 7.7 per cent compared with an equivalent 9.6 per cent rise in imports, which a Treasury spokesman said was a good performance given that Britain had grown quickly compared with other countries.

However, the trade performance also reflected the sharp devaluation of sterling during 1986, which has been substantially reversed during 1987. Taking the fourth quarter compared with a year before, export volume is up only 4.6 per cent against a 10.6 per cent rise in imports.

The December figures showed that exports fell back £66 million to £6,885 million. Imports dropped by £79 million to £8,067 million. Excluding oil and erratics, exports volume rose by 1.5 per cent.

BALANCE OF PAYMENTS



DEAR

□ We recall how George "Wimpo" Bush, second most powerful man in the USA, embarked on a new career the other day as a macho man who slaps down rude TV pundits, with a prime-time victory on 10 points over Dan Rather of CBS. But it was short-lived glory. US columnist Jack Anderson has just answered the question that America has been asking since President Ronald Raygun went into hospital for cancer surgery: Just what did George Bush do during the historic 474 minutes that Ronnie was under anaesthetic and he was US President? (Gary Trudeau's Doonesbury mocked Wimpo's finest hour, attributing to him a boast that "not a single country fell to the Communists during my watch.") It emerges that, anxious not to repeat General Al Haig's "I'm in charge" gaffe during the 1981 assassination attempt, Bush lay low — literally. Playing some aggressive tennis, Bush overreached for a high ball, fell and banged his head. Said an aide who was present: "We all leaned forward and the same thing flashed through our minds: What if the Ruskiies attack now?" Officials in Washington are now being asked to confirm whether Bush was unconscious before he staggered off court to recover with the help of a glass of lemonade.

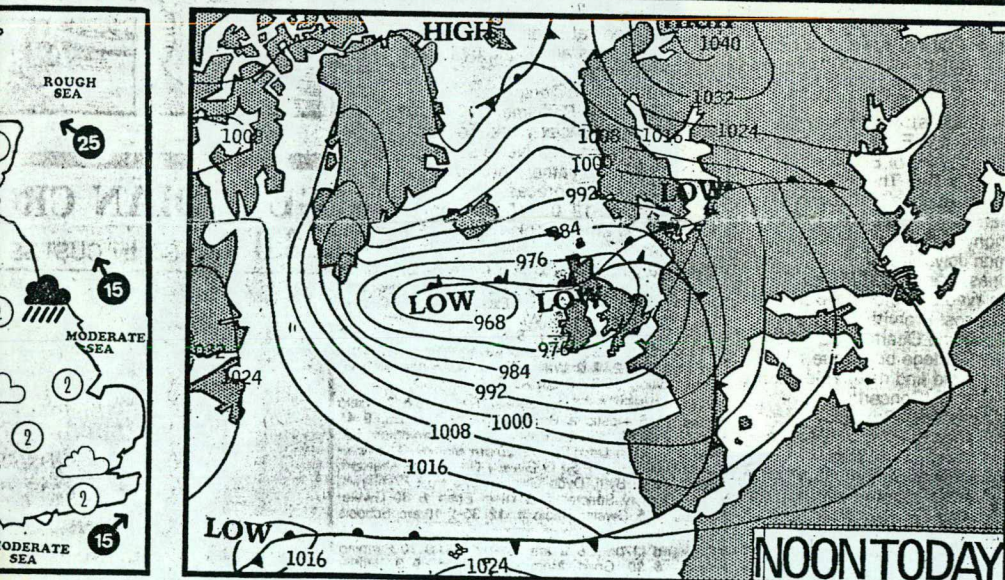
□ Robert Alexander QC is reputed to be the highest paid silk in the country. Since the foundation of the SDP, it has been assumed by most of its members that he was among the founders of their luckless organisation — he's a member of the SDP lawyers group, was enthusiastic about the project at its outset, and is a valued friend of the party's top brass. So he raised a few eyebrows with his eloquent defence of the Government's case against Spycatcher, and by deploying his advocacy skill to get unions banned at GCHQ. He fought Jeffrey Archer's libel action against the Star, and acted for Ken Livingstone. Well, we are able to dispel a myth: it transpires that our learned friend has, after all, been a paid-up member of the Conservative Party in Buckinghamshire for years ("I honestly can't remember how many"). He describes himself as "in favour of some (Government) policies and not in favour of others." Mr Alexander, now chairman of the City takeover panel, adds: "I certainly wouldn't suggest that I was an active working member of the party."

□ The prospect that the anti-gay Clause 28 of the Local Government Bill may soon become law seems to be having



"The beach ju obvious pla

of spreading the characterises of days. The Great forum sent out a warning that we homosexual art like James Bald Hockney might legal challenge. reason not to ma magazine Educa Training, a jour matters MSC-rel document was re mag's editor, De FCIS, with a fou unambiguously suggestion that t wasting his time. □ Meanwhile, th up at the London Gay Centre on Tennessee Willie Menagerie were disappointment. Wingfield was to man in drag — b French, the com administers the V threatened legal production went centre counted t backed down. W course, one of the celebrated gay pl □ While MPs det world health buff the last three day summit in the Queen Elizabeth centre (just across the Commons), d memory of Benj On the wall of the chamber is a plac the composer, spe affectionate term relationship with Pears.



AROUND BRITAIN

Report for the 24 hours ended 6 pm yesterday:

	Sun-shine hrs	Rain in	Max temp C	Weather (day)
ENGLAND				
Birmingham	24	4	39	Sleet am
Bristol	15	8	46	Shwrs pm
Cardiff	5.2	6	43	Bright
London	58	9	48	Rain
Manchester	5	4	41	Dull
Newcastle	14	02	5	41 Sleet am
Norwich	20	5	41	Sleet am
Nottingham	06	3	37	Sleet
Plymouth	0.2	66	11	52 Showers
Loss-on-Wye	39	5	41	Rain
EAST COAST				
Scarborough	01	5	41	Dull
Stridington	5	4	41	Cloudy
Kegness	14	4	39	Rain
Junstanton	17	4	39	Rain am
Promer	42	4	39	Rain
Lowestoft	24	6	43	Rain
Wick	05	60	7	45 Rain am
Southend	1.04	8	46	Dull
Fargate	4	9	48	Rain pm
Merne Bay	0.6	53	9	48 Rain
SOUTH COAST				
Wolkestone	37	9	48	Rain pm
Wasting	0.3	53	10	50 Showers
Wastbourne	51	9	48	Rain
Wrighton	66	9	48	Showers
Worthing	65	9	48	Rain
Littlehampton	38	9	48	Showers
Worner Regis	38	9	48	Rain
Worthingsea	0.1	17	10	50 Rain pm
Wandown	22	9	48	Rain
Wanklin	32	9	48	Rain
Wentnor	0.1	31	9	48 Rain
Wormemouth	61	9	48	Rain
Wool	72	10	50	Showers
Wantage	63	10	50	Showers
WEST COAST				
Newquay	1.4	45	12	54 Rain
Ilfracombe	45	10	50	Showers
Minehead	57	8	46	Rain
Weston-s-Mare	63	10	50	Showers
Southport	5	4	41	Rain pm
Blackpool	0.2	5	41	Cloudy
Morecambe	1.4	5	41	Cloudy
Douglas	5	4	41	Cloudy pm
WALES				
Anglesey	0.4	8	46	Cloudy
Cardiff	53	7	45	Rain
Swansea	29	8	46	Showers
SCOTLAND				
Aberdeen	0.6	4	39	Showers
Aviemore	3	3	37	Snow
Edinburgh	0.5	5	41	Cloudy
Edinburgh	3.3	5	41	Sunny am
Glasgow	0.1	5	41	Rain pm
Kinloss	0.9	01	3	37 Shwrs pm
Lerwick	0.7	3	37	Snow am
Leuchars	1.4	03	6	43 Sleet am
Prestwick	4	3	39	Cloudy
Stornoway	0.8	4	39	Bright
Tiree	5	4	41	Cloudy
Wick	1.4	05	5	41 Hail am
NORTHERN IRELAND				
Belfast	0.1	5	41	Rain pm

THE GUARDIAN

119 Farringdon Road
London EC1R 3ER
Telephone: 01-278 2332
Telex: 8811746
(Guard G)
Fax: 01-837 2114.

In Manchester:
164 Deansgate
Manchester M60 2RR
Telephone: 061-832 7200
Fax: 061-832 5351.

Telephone Sales:
London: 01-430 1234
Manchester: 061-832 7200

© Published by Guardian Newspapers Limited at 119 Farringdon Road, London EC1R 3ER, and at 164 Deansgate, Manchester M60 2RR. Printed at the Guardian Press Centre, 2 Millharbour, London E14 9NG; 164 Deansgate, Manchester M60 2RR; News Centre, Hilsa, Portsmouth PO2 8SX; and Northampton Mercury Co Ltd, Upper Mounts, Northampton NN1 3HR, for and on behalf of the Guardian

LONDON READINGS

From 6pm Wednesday to 6am yesterday:

Sun-shine hrs	Rain in	Max temp C	Weather (day)
24	4	39	Sleet am

MANCHESTER READINGS

From 6pm Wednesday to 6am yesterday:

Sun-shine hrs	Rain in	Max temp C	Weather (day)
65	10	50	Rain

BIRTHDAYS

Dr Robin Alston, bibliographer, 55; Malcolm Binns, pianist, 52; Tony Blackburn, disc jockey, 45; Sacha Distel, singer, guitarist, 55; John Forsythe, 70; Victor Mature, 73, actors; Germaine Greer.

OBITUARY

Sheckter, former G driver, 38; Tonyandy, former the House of Common

Klaus Fuchs
died in 1989,
aged 76.

Mr. Allen

18/3/88

py

You will
enjoy this.

We could employ
the same technique
in reverse in the
FSBR!

J.
4

SECRET

*Burns on 18 March 1988, see
I have a number of papers with 1 SW
~~parts~~ like to discuss with Sir TB on
Gives. Meanwhile, I SW
for materials to me with also
has more further work to do
concluded from 18/3 on that. v.*

FROM: SIR T BURNS
DATE: 18 MARCH 1988

CHANCELLOR

cc Sir P Middleton
Sir G Littler
Mr Scholar
Mr Odling-Smee

EXCHANGE RATE POLICY

I attach a synopsis of a paper on exchange rate policy. It is still very rough and I have been unable to make much progress on the final section. I will look at it further over the weekend but would be grateful for comments on this outline.

T BURNS

ENC

*with a complex world,
possible } advantages
opposites }
- also value factors and
how when they are
| Chart / table show
how IR change
have not value
to XP trend*

EXCHANGE RATE POLICY

SynopsisMonetary Policy and the Role of the Exchange Rate

1. The aim of monetary policy is to control inflation. Brought down from average rate of 15 per cent in the 1970s to 3½ per cent today.

2. Progress in recent years has been less rapid. Mortgage rate changes introduce spurious fluctuations. Excluding them makes clear that the trend has been downwards:

Inflation

	<u>RPI</u> <u>Total</u>	<u>RPI</u> <u>excluding mortgage payments</u>
1983	4.6	5.2
1984	5.0	4.4
1985	6.1	5.2
1986	3.4	3.6
1987	4.2	3.7
1988 FORECAST	3.8	4.0

3. Other important points:

- lower oil prices helped other countries much more than UK as sterling fell during that adjustment period;
- the UK has experienced a number of years of sustained rapid growth: rare for inflation to fall in those circumstances; indeed usually goes up: [figs]

4. Conduct of monetary policy has been difficult; partly because of changes to financial system:

- broad money has been a particularly poor indicator;

- narrow money (M0) has been better and has a good record. But on its own it is not enough. It does not carry much market credibility; and it only gives a short lead, if at all, to inflationary trends.

5. The exchange rate has been a major complicating factor; it has shown substantial fluctuations: eg sterling and dollar. Very often the fluctuations are reversed; but not until they have gone a long way and had substantial direct and indirect effects.

6. Exchange rate changes have important impact on monetary conditions:

- appreciation will tighten monetary conditions (and vice versa). Direct effect on import prices; and squeezes profits of UK manufacturers by constraining ability to raise prices;

- and can generate second round effects through impact on inflationary expectations and wage negotiation.

7. Therefore in some respects a higher exchange rate can be seen as a substitute for higher interest rates. But important difference. As compared with higher interest rates, tightening monetary policy through a higher exchange rate puts more pressure on exporters as well as those supplying goods at home who have to compete with cheaper imports; and less on the non-trading sector, particularly construction.

8. Because of the importance of exchange rate fluctuations for monetary conditions we have given a substantial weight to exchange rates in monetary policy decisions for many years. In successive editions of the MTFs the importance of exchange rate behaviour has been emphasised.

9. For example in Budget speech of 1985 - following the sharp fall of sterling against the dollar - Chancellor said:

"There are those who argue that if we stick to sound internal policies the exchange rate can be left to take care of itself. In the long run that may well be true. But significant movements in the exchange rate, whatever their causes, can have a short-term impact on the general price level and on inflationary expectations. This process can acquire a momentum of its own, making sound internal policies harder to implement. So benign neglect is not an option".

10. The approach to giving the exchange rate a substantial weight in monetary policy decisions is not unique to the UK. Increasingly other countries are giving exchange rates a major weight in the conduct of policy. And for the same reasons: the difficulty of interpreting domestic monetary indicators at a time of structural change; and the important effect on inflation, activity and the balance of payments.

The Nature of the Foreign Exchange Market

11. In deciding the most effective way of taking the exchange rate into account it is necessary to consider the nature and characteristics of the foreign exchange market.

12. The gyrations of exchange rates stem from the global 24-hour markets; turnover has increased dramatically, but only a small part is related to commercial transactions.

13. In the long run the foreign exchange markets adapt to fundamentals but in the short run they do not. There are insufficient speculators who take a long view. Fluctuations away from levels consistent with fundamentals can take place for long periods; and they can be very large. *eg \$ (gold?)*

14. These fluctuations can be very damaging:

- scarce management time in business is taken up with currency fluctuations;

- swings of exchange rates dislocate businesses as profit rates and selling prices fluctuate;

- and because of the uncertainty companies take low risk decisions and are averse to investing where they fear they might find themselves uncompetitive later on.

15. Although the Government cannot control exchange rates precisely they can give a lead and keep exchange rates closer to fundamentals. They are not all powerful; but neither are they impotent.

16. It is simply not true that the exchange rate is determined by the markets and the authorities cannot influence the outcome. Their influence stems from the size and importance of Government; they have the power to intervene as a big market player; and they influence some of the most important factors determining exchange rates - the budget deficit and interest rates. Not surprisingly the markets give weight to what they interpret as the authorities' preferences in developing their own market strategy.

17. Market expectations are not independent of Government behaviour. Markets are constantly trying to find out the Government's policy for this reason. It means that it is simply impossible to have a complete hands-off policy.

Instruments of Policy

18. Interest rates are the key instrument of monetary policy. They are also the Government's most important instrument for influencing the exchange rate. Operation in the foreign exchange market compare expected returns on currencies. The total return to holding a currency is the interest rate plus the expected appreciation or depreciation of the currency. A higher interest rate will raise the return. It may also increase the chance of a return through appreciation although if the higher interest rate reflects higher inflation it could go the other way.

Explanation

Explanation. Social int. if it's a

(or capital)

(or policy instrument)

with book p 4

19. If sterling is rising for speculative reasons, and an appreciation appears to be unjustified on fundamental grounds, it is possible to exercise some restraint through lower interest rates. The strengthening of the exchange rate will tend to tighten monetary conditions while the lower interest rate will mean easier monetary conditions. By adjusting interest rates in the face of fluctuations of sterling it is possible to reduce the volatility of exchange rates without monetary conditions becoming too loose or too tight.

20. Intervention also has a role to play in helping the Government to counteract potentially damaging short-term movements in exchange rates. Although the total flows across the foreign exchanges are enormous in relation to the funds that Government can deploy to meet its objectives many of the private sector flows are offsetting transactions as market participants hedge positions. In net terms even quite modest sums deployed in intervention can have a useful effect. This is especially true if intervention is co-ordinated.

21. Intervention is particularly useful in conditions of sudden surges of demand (and vice versa). If action is limited to interest rates it could lead to unnecessary large interest rate changes. Intervention can avoid unnecessary interest rate volatility which is undesirable in itself and in any event can look incompetent.

22. The impact of intervention upon monetary conditions is often misunderstood. Obviously if, in the absence of intervention, the exchange rate would have been higher or lower, there will be some effect on inflationary pressures. But there need be no longer-term consequences. In the UK system the Bank of England immediately offsets any effect of the intervention upon the monetary base by its own market operations. And over time we have had a policy of offsetting any effect it might have upon liquidity by funding. Even over the past year when intervention has been very high we have succeeded in fully funding it. As a result there have been no monetary effects.

23. The profitability of intervention is ~~a useful guide~~ but this has to be evaluated over a medium-term perspective. Because the swings away from fundamentals can exist for some time the benefits of intervention will only become apparent over the medium term. Looking at the swings in the sterling exchange rate there clearly have been many opportunities for profitable intervention that would only become apparent after several years.

24. This suggests that although intervention should not become a way of life, and can only be a subsidiary instrument, it is necessary at times and can play an important part. It would be a mistake to have a policy of never using it; but equally it must be used in a controlled way.

with limits of its effectiveness.

Experience over the past year

25. Although the exchange rate has played an important role in monetary policy decisions for many years it has had a greater weight over the past year. There have been a number of reasons:

- in the Autumn of 1986 sterling had been under considerable downward pressure. Interest rates were raised by 1 per cent to halt the slide. The Chancellor made clear ~~he did not want~~ any further depreciation; *with the intention.*

- in the Louvre agreement the major 7 industrialised countries agreed to co-operate to foster increased exchange rate stability whilst working to correct the fundamental reasons for the trade imbalances. In February the Chancellor made clear that he was more content for sterling to rise than to fall. This was expressed in terms of the DM rate as this is the single most important currency for UK manufacturing industry;

- in the run-up to the General Election in June there was a clear case for restraining the use of sterling to avoid a speculative bubble emerging that could be very inconvenient for the conduct of policy during the election;

- in the aftermath of the share price crash on October 19 there was a premium in maintaining as much stability as possible whilst confidence was restored.

26. The apparent importance of the 3DM rate grew out of these events. Once the market had seen some resistance at 3DM it hesitated to push very hard. And the longer sterling was maintained within the 2.90-3.00 range the more reluctant we were to see it breached. There were clear gains to industry from stability; and benefits to faster expectations of the likely scale of exchange rate fluctuations. ?

27. The cumulative scale of the intervention was greater than would normally be desirable. But it has done no damage to monetary policy because it has been offset by funding. And it has helped to establish the feasibility of limiting the scale of fluctuation. In future it should be possible to achieve a similar result with much less intervention; and there would be less of a case for defending a particular rate so firmly as credibility is enhanced.

28. It became clear on March 4 that the scale of exchange rate pressure was greater than could be coped with by intervention. And there was no scope for reducing interest rates as we already had concluded that, if anything, monetary conditions were on the easy side.

29. Since then the exchange rate has risen but because there have been tighter monetary conditions it has been possible to reduce interest rates by $\frac{1}{2}$ per cent.

30. In reflecting on the events of the past year it is important to recognise that the present situation is very different from 1980-81 when sterling rose so sharply. There is no inconsistency between what was allowed to happen then and what we would prefer now. The circumstances then were very different: inflation was almost 20 per cent; North Sea oil was having a big impact; it was

important to assert credibility for a non-accommodating policy stance; there was a need for a shock to expectations generally; and it was impossible to be sure for several months that broad money was giving the wrong signals. British industry is in much better shape now. What it needs is [more investment].

Options

31. The discussion in this paper suggests that:

- the Government must continue to give exchange rates a substantial weight in the conduct of monetary policy;
- in the process it is desirable to have an explicit objective for greater exchange rate stability.

32. There are three main alternative approaches:

- taking the exchange rate "into account" in the conduct of monetary policy;
- an explicit statement about the desire for stability combined with a notional but unpublished range (managed floating);
- full membership of EMS.

33. Taking the exchange rate "into account" was the presentation used for much of the 1980s. It means setting interest rates in a purely judgemental way in the light of the behaviour of a range of indicators, including the exchange rate. This should have some effect in curbing excessive swings of sterling and gives maximum flexibility. But markets will constantly press for a more explicit statement about exchange rate policy. And we lose some of the gain of stabilising speculation that we might get if our markets accepted greater stability.

34. "Managed floating" is a more formalised approach. This might involve:

- an explicit statement about the desire for stability;
- a notional, unpublished range;
- interest rates adjusted to keep exchange rates within range, supported by some intervention;
- periodic change to range if pressure is sustained so that interest rates too low (or high), intervention too great, or MO growth too fast (or too slow).

There are various degrees of formality, depending on: width of range; frequency of changing range; extent to which change range; amount of intervention before changing range.

35. **Advantages:**

- mechanism for reducing exchange rate volatility;
- maintaining appropriate degree of disinflationary pressure;
- using all instruments available;
- unpublished range and therefore ease of changing.

36. **Disadvantages:**

- testing to find range;
- less certainty for business.

37. Membership of EMS

? Under of
9/1/77

JAPAN

88年 3月18日 午後 5時58分

; # 1



British Embassy
No 1 Ichiban-Cho Chiyoda-ku Tokyo

Telex J22755 (A/B PRODRGME)
Telephone 265-5511
Fax No.: 265-5580

Please send by
facsimile to The Treasury
Facsimile No. 01-270-525-44
Originator A T MacDermott
Confirmed sent

Gregory Segal Esq
The Treasury
[by Fax]

Your reference
Our reference
Date 18 March 1988

UK BUDGET: JAPANESE PRESS REACTION

1. Summary: The Japanese media has reported fully and in detail the content of the budget. The recovery of the British economy gets wide reference. The budget surplus, falling inflation and rising economic growth rate are all mentioned. References to unemployment and the gap between rich and poor and the expansion of the trade deficit also appear, but comment has been generally favourable, and the budget has had a good reception.
2. The following are the major points picked up by the main Japanese newspapers:
 - (a) Asahi: The introduction of a two-stage tax rate.
 - (b) Nihon Keizai: The simplification of the tax system and the 4 billion pound income tax reduction.
 - (c) Yomiuri: The budget as a sign of the recovery of the UK economy.
 - (d) Mainichi: The simplification of the tax system and the prospects for a cut in the basic tax rate to 20%.
3. Comments have referred to "the Thatcher miracle" (Yomiuri), "a budget too bold for the Japanese Government" (Asahi). The influential Nihon Keizai, the Financial Times equivalent, refers to the changing image of Britain as now being a country of individual enterprise rather than cradle to grave welfare. All media coverage suggests that the Japanese Government, in considering their own tax reform plans, should study the British budget.

A T MacDermott
A T MacDermott
First Secretary
(Information)



BRITISH EMBASSY

35, rue du Faubourg Saint-Honoré - 75383 Paris Cedex 08

Telephone : 42 66 91 42

Ms Moira Wallace

APS/Chancellor of the Exchequer

Your reference

Our reference

Date 18 March 1988

Dear Moira,

1988 BUDGET: FRENCH PRESS COVERAGE

*pl cc Mr RIG Allen
Mr G Segal
and return
(Translations on request!)
mpw*

1. I sent you with my letter of 16 March that day's cuttings from the French press about the budget. I now attach cuttings which have appeared subsequently, including Le Monde that appeared that afternoon, and yesterday's cuttings from Le Figaro, La Tribune de L'Expansion and Les Echos.

2. I shall send you any cuttings from the weekly press early next week.

Yours sincerely,

Michael Jay

M H Jay
Counsellor (Financial & Commercial)

Pour la fortune

M. NIGEL LAWSON, le chancelier de l'Echiquier britannique, a bien de la chance. Les recettes tirées des privatisations et d'importantes rentrées fiscales lui ont permis de présenter au pays mardi 15 mars, un budget en or, réalisant le rêve impossible de tout ministre des finances : l'équilibre entre dépenses et recettes, doublé d'une baisse importante des impôts qui prend les apparences d'une petite révolution fiscale.

Le budget - 1987-1988 - qui s'achève est déjà la preuve de la clémence des dieux. Voté l'an dernier en léger déficit (4 milliards de livres, soit 42 milliards de francs) grâce à quelque 5 milliards de privatisations (52 milliards de francs) qui gommant autant de charges publiques - telle est la méthode anglaise, - l'exercice se soldera dans quelques jours (1) par un excédent de 3 milliards de livres (31 milliards de francs). Le budget 1988-1989, qui va commencer à s'appliquer au début d'avril, prévoit un excédent de quelque 3 milliards de livres également. Telle est, désormais, la règle, a pu dire en toute simplicité M. Lawson.

Peu de grands pays industrialisés peuvent se vanter d'un pareil résultat. Même si cela prête à interrogation : l'Etat vend ses entreprises, la forte croissance britannique pourvoyeuse de rentrées fiscales est menacée à terme par le déséquilibre des comptes extérieurs. Enfin, le pétrole de la mer du Nord (4 milliards de livres, soit 42 milliards de francs) est une ressource fragile...

Il n'empêche. Voilà la Grande-Bretagne, ou plus exactement les conservateurs, qui réalise un vieux rêve : réduire fortement l'impôt sur le revenu, et bien sûr l'impôt des plus fortunés. Le barème, qui avait déjà été sensiblement allégé lorsque M^{me} Thatcher était arrivée au pouvoir en 1979 - le taux le plus élevé d'imposition à 83 % avait alors été supprimé, - ce barème-là est proprement bouleversé.

Des six taux existants, qui s'évaluaient de 27 % à 60 %, n'en subsisteront plus que deux : 25 et 40 %. Qui dit mieux ? Bien sûr cette réforme extrême va d'abord favoriser les plus riches de la nation, et l'opposition, quand elle a appris la nouvelle, a littéralement accusé M. Lawson, l'accusant d'injustice scandaleuse. Difficile de démontrer le contraire.

Le chancelier n'en a pas moins sa logique, qui est de stimuler l'appétit du gain dans un pays où le dynamisme économique faisait singulièrement défaut il n'y a pas si longtemps encore. Logique qui doit également aboutir à faire baisser la fraude, comme on le constate dans la plupart des pays où les taux sont faibles. Logique, enfin, qui devrait aboutir à accroître l'épargne puisque ce sont les contribuables les plus aisés qui alimentent en priorité le marché des actions et des obligations si nécessaires aux financements des entreprises.

Reste que ni M^{me} Thatcher ni M. Lawson ne semblent se soucier le moins du monde de ce qui va être la grande affaire des pays européens : le marché unique de 1993. Rien n'est prévu en effet pour harmoniser les taux de TVA.

ALAIN VERNHOLES.

(1) L'exercice budgétaire britannique va du 1^{er} avril au 31 mars de l'année suivante.

La présentation du budget britannique

Important allégement de l'impôt sur le revenu

En présentant, mardi 15 mars, son projet de budget pour 1988-1989, M. Nigel Lawson, le chancelier de l'Échiquier, a provoqué des réactions extrêmement vives : enthousiasme du patronat, satisfaction mêlée d'inquiétude des boursiers, interrogation des économistes, colère de l'opposition et des syndicats. Le président du patronat britannique, le CBI, M. David Nickson, a immédiatement déclaré : « C'est le budget que nous attendions. Il permettra de conforter la reprise économique et de relancer la confiance des milieux industriels. » Le CBI s'est d'autre part félicité de la reconnaissance par le chancelier de la nécessité de taux de change stables.

L'ampleur des allégements fiscaux accordés au contribuable (près de 4 milliards de livres) a été accueillie avec satisfaction, mais sans plus, à la Bourse, qui s'attendait à moins de largesse et craint maintenant une accélération de l'inflation. Le Stock Exchange a terminé mardi en hausse modérée, mais d'après certaines informations, la Banque d'Angleterre serait intervenue en vendant des livres sterling pour ralentir la hausse de la monnaie britannique.

Le budget britannique pour la période 1^{er} avril 1989 - fin mars 1989 comporte de très importants changements de la fiscalité, des changements que M. Nigel Lawson, en les rendant publics le mardi 15 mars, n'a pas hésité à qualifier de « réforme radicale ». Cette réforme,

qui porte essentiellement sur l'impôt sur le revenu, aboutit à une réduction de la fiscalité de 4 milliards de livres, soit environ 42 milliards de francs.

L'impôt sur le revenu comporte actuellement six tranches, imposées à 27 %, 40 %, 45 %, 50 %, 55 % et 60 %. Ces taux avaient été abaissés en 1979, lorsque M^{me} Thatcher avait succédé aux travaillistes : le taux le plus bas de 33 % avait été porté à 27 % ; le taux le plus élevé, de 83 %, avait été porté à 60 %.

Les conservateurs, qui s'étaient toujours fixé comme objectif principal de réduire très sensiblement l'impôt sur le revenu, récidivent. Le budget 1988-1989, qui commencera à s'appliquer au début d'avril, prévoit deux taux seulement d'imposition : 40 % pour le plus élevé ; 25 % pour le plus bas. Dans ce barème extrêmement simplifié - l'un des plus simplifiés du monde, - quatre taux ont donc disparu.

C'est aussi dire que la tranche d'imposition maximum revient de 60 % à 40 %, alors que la tranche la plus basse - dans laquelle se situent 19,9 millions de contribuables sur 21 millions - n'est que légèrement diminuée (de 27 % à 25 %).

Cependant, M. Lawson a promis que le taux de 25 % serait ramené à 20 % « dès que possible ».

Autre allégement fiscal non négligeable : les abattements à la base sont relevés de 7,5 %, soit deux fois plus que l'inflation. Les célibataires

M. Neil Kinnock, leader de l'opposition travailliste, a déclaré que le discours de M. Lawson, en particulier la suppression des tranches d'imposition supérieures « engendre la colère » devant « une immense injustice ». « M. Lawson a donné beaucoup d'argent à ses amis et rien aux pauvres », a-t-il déploré.

La présentation du budget fera date dans l'histoire parlementaire et politique de la Grande-Bretagne. Jamais un tel brouhaha n'avait eu lieu. Les députés de l'opposition travailliste ont sifflé, hué les principales mesures de la réforme fiscale, la réduction de 60 % à 40 % de la tranche supérieure de l'impôt sur le revenu. Une telle mesure en faveur des plus riches a choqué les députés d'opposition, qui l'ont fait savoir. « Quelle honte ! quelle honte ! » ont-ils crié. Le tollé était tel que le président de la Chambre des communes a dû, à deux reprises, suspendre la séance.

La livre, mercredi matin, après une brève poussée à la hausse, était revenue à son niveau antérieur.

ne seront plus imposés au-dessous de 2 605 livres de revenus annuels (2 270 F par mois environ), les hommes mariés au-dessous de 4 095 livres (3 570 F par mois environ).

Le régime d'imposition des femmes mariées, qui n'avait guère changé depuis le dix-neuvième siècle, est, lui aussi, modifié. L'épouse pourra désormais être totalement indépendante sur le plan fiscal, tandis que certaines dispositions qui privilégiaient les couples en union libre par rapport aux couples mariés sont supprimées (régime de détaxation des prêts au logement).

Incitation à l'épargne

L'abattement fiscal sur les successions est relevé à 110 000 livres, contre 90 000 livres (115 000 F, contre 950 000 F environ). Le barème des droits de succession comporte un taux unique à 40 %, contre un taux maximum de 60 % jusqu'à présent. La taxe sur les plus-values est corrigée : le calcul de la plus-value imposable ne prendra plus en compte les hausses dues à l'inflation des années avant 1982.

Les avantages fiscaux à l'épargne sont améliorés. Le montant d'actions que le contribuable peut acheter dans l'année en bénéficiant d'une exonération des dividendes est relevé de 2 400 à 3 000 livres (25 000 F à 31 000 F environ).

17 MAR

Le budget 1988-1989 de M^{me} Thatcher

Fortes réductions d'impôts pour les Britanniques

La présentation du budget britannique, mardi 15 mars, par le chancelier de l'Echiquier, M. Nigel Lawson, a provoqué de vives réactions de la part de l'opposition. Le patronat, en revanche, s'est montré satisfait d'un projet de budget qui est présenté en excédent et comporte de sérieuses réductions d'impôt sur le revenu.

Le projet de budget pour 1988-1989, présenté mardi 15 mars par le chancelier de l'Echiquier, comporte deux caractéristiques principales. D'une part, il est en excédent de 3 milliards de livres (31 milliards de francs), ce qui est inhabituel, ces derniers temps, pour les pays industrialisés ; d'autre part, il prévoit d'importants allègements fiscaux par le biais d'une réforme qui porte principalement sur l'impôt sur le revenu. Celui-ci ne comportera désormais que deux tranches, l'une à 25 %, l'autre à 40 %, ce qui revient à diminuer de 20 points la tranche supérieure de l'impôt. L'allègement pour les contribuables équivaut à 42 milliards de francs.

Parallèlement, les abattements à la base sont relevés de 7,5 %,

très nettement au-dessus de l'inflation. D'autres mesures concernant l'imposition des femmes mariées, les droits de succession et les avantages liés à l'épargne complètent la réforme proposée par M. Nigel Lawson.

Le chancelier de l'Echiquier, s'il a été applaudi par les membres de la majorité, a essuyé en revanche un tollé de l'opposition, celle-ci lui reprochant de n'avoir pris cette mesure d'allègement que pour favoriser les contribuables les plus fortunés. La séance a dû être interrompue à deux reprises à la Chambre des Communes, tant furent vives les réactions de l'opposition.

(Lire page 3 l'article
d'ALAIN VERNHOLES)

Le miracle raisonnable de M. Lawson

On attendait Kohl, ce fut Thatcher. Alors que, de tous côtés, gouvernements et experts exhortent depuis de longs mois l'Allemagne fédérale à réduire les taux d'imposition pour stimuler l'activité, c'est le chancelier de

PAR JEAN-JACQUES ROSA

l'Échiquier qui crée l'événement fiscal. En s'inspirant de la réforme américaine de 1986, Nigel Lawson a doté la Grande-Bretagne de l'impôt sur le revenu le plus simple et le moins pénalisant d'Europe, avec deux tranches seulement aux taux respectifs de 25 % et de 40 %. Que de chemin parcouru depuis le barème de 1979 qui affichait un taux maximal de 83 % !

La baisse, il est vrai s'est effectuée en plusieurs étapes et avec prudence. Jointe à la progression de la pression fiscale globale, elle semble bien donner raison aux théoriciens de l'offre : une diminution des taux marginaux d'imposition stimulerait tellement la croissance que le manque à gagner en recettes serait plus que compensé, à terme, par l'élargissement du revenu imposable. C'est l'interprétation que retient M. Lawson, et c'est celle qui est reprise par l'éditorialiste du « Wall Street Journal ».

Fermeté et constance

Il est douteux qu'elle traduise fidèlement la séquence des événements. Il apparaît au contraire que l'allègement de l'impôt direct — aussi souhaitable qu'il puisse être en termes d'efficacité économique — intervient principale

ment comme une conséquence et non comme une cause de la plus grande aisance des finances publiques. Cette dernière provient de l'accroissement des recettes de l'État, consécutif au rythme plus soutenu de l'expansion depuis la fin de 1982. Elle résulte aussi de l'alourdissement de la TVA qui rapproche la Grande-Bretagne des systèmes fiscaux du continent, dans la perspective de 1992. Enfin les revenus reçus sur les capitaux qu'ont apportés au Trésor les privatisations, revenus non négligeables en raison du niveau élevé des taux d'intérêt outre-Manche, ont aussi favorisé l'équilibrage des finances publiques en permettant de limiter le recours à l'emprunt.

Le gouvernement britannique donne ainsi l'exemple de la fermeté et de la constance dans la stratégie fiscale de moyen terme tout en manifestant une grande souplesse

dans sa mise en œuvre, en fonction des circonstances politiques et de la conjoncture économique. Il n'est pas certain en effet que cette réforme aurait pu attendre. Une discrète tension inflationniste fait sentir ses effets

tandis que la croissance du produit national qui, de sensiblement inférieure à celle du reste de l'Europe en 1979-1982 est devenue nettement supérieure à compter de 1982, donne aujourd'hui quelques signes d'essoufflement. Et la poursuite de l'allègement des taux marginaux présente le triple avantage de stimuler l'activité, de renforcer l'efficacité du système fiscal, tout en évitant le gonflement des dépenses publiques.

La décrue du chômage

Ne pas croire à un « miracle lafférien » de la politique de l'offre en Grande-Bretagne ne revient pas pour autant à nier l'existence ou l'efficacité d'une telle politique. Mme Thatcher a même courageusement appliqué trois politiques de stimulation de l'offre depuis 1979. Tout d'abord en mettant un terme, par les réformes de 1982 et 1984, à l'irresponsabilité de syndicats très minoritaires qui pouvaient impunément paralyser par la grève la plupart des entreprises britanniques. Ensuite en soumettant à la concurrence du grand large, par la déréglementation du Big Bang, l'industrie financière de la City, si importante pour l'économie du Royaume-Uni. Enfin en refusant, lors de la profonde récession de 1979-1982, le moindre « accommodement » macroéconomique aux entreprises.

Mis au pied du mur devant l'envol des coûts salariaux, l'effondrement de la productivité, et le ralentissement de l'activité, les chefs d'entreprise durent procéder, contraints et forcés, à une réorganisation radicale qui se traduisait par le licenciement de près de 25 % des salariés de l'industrie.

Ce sont ces trois pressions conjuguées sur les partenaires dans l'entreprise qui ont déterminé la bonne performance de croissance des cinq dernières années. C'est ainsi qu'a pu être amorcée, à la mi-1986, la décrue du chômage, et non par le seul pouvoir d'une recette miracle fiscale. En macroéconomie, comme ailleurs, il n'y a pas de repas gratuit.

J.-J. R.

Après l'annonce d'importants allègements fiscaux

Le budget britannique est jugé un peu trop laxiste

Qualifiées de profondément injustes par l'opposition travailliste, les réductions d'impôt annoncées mardi par Nigel Lawson devraient avoir un impact légèrement expansionniste. Au moment où l'on craint la surchauffe, certains économistes s'en inquiètent

■ La présentation, mardi, du budget britannique a suscité des réactions aussi vives que variées dans les milieux politiques et économiques londoniens.

Côté politique, les députés travaillistes crient évidemment au scandale. « *C'est une immense injustice* », « *C'est une honte* », « *M. Lawson (chancelier de l'Échiquier) a donné beaucoup d'argent à ses amis et rien aux pauvres* »,... sont quelques-unes des exclamations poussées par le leader de l'opposition travailliste, Neil Kinnock, à la Chambre des communes. De fait, même si les réductions fiscales consenties aux faibles et moyens revenus excèdent celles bénéficiant aux revenus les plus élevés (3,2 milliards contre 2), les relèvements de taxes indirectes venant partiellement compenser le

cadeau fiscal touchent naturellement beaucoup plus les revenus modestes.

On espérait en outre que l'abaissement spectaculaire des tranches supérieures de l'impôt serait contrebalancé par un relèvement des cotisations sociales sur les salaires les plus élevés. Il n'en a rien été, alors que le financement des dépenses de santé est l'objet outre-Manche d'un débat passionnel. Enfin et surtout, la ponction fiscale sur les revenus supérieurs à 60.000 £ par an (630.000 F) sera réduite d'un montant équivalent à 10 % et plus de ces revenus, tandis que, dans le même temps, les contribuables les plus modestes (moins de 52.000 F par an) ne verront leurs revenus disponibles n'augmenter que de 1 %.

Au plan économique, les réactions sont également mitigées. Si pour David Nickson, président du CBI (patronat), « *ce budget permettra de conforter la reprise économique et la confiance des milieux industriels* », d'autres manifestent quelques inquiétudes. Nombreux sont les économistes qui considèrent ainsi le budget trop laxiste à un moment où l'économie britannique frise la surchauffe. Chez certains, la déception est de constater que l'on a préféré diriger l'argent économisé vers la consommation plutôt que vers l'épargne.

Pour Christopher Potts (Indosuez) : « *On aurait pu aller plus loin dans la neutralité budgétaire et la simplification de l'ensemble du système en supprimant un certain nombre d'abattement et de privilèges fiscaux.* » Selon lui, même si la réduction de l'impôt sur les revenus élevés ne devrait avoir que peu d'incidence sur la consommation, l'impact global du budget devrait faire sentir des effets expansionnistes sur la demande à partir du mois de juin. Pour diminuer ces effets, le gouvernement paraît en fait tabler sur le maintien du sterling à son niveau actuellement élevé. « *Le danger, estime C. Potts, est qu'en cas de reflux du sterling les autorités procèdent à un nouveau relèvement des taux d'intérêt.* »

Jacques Plassard (directeur de l'IPE-CODE) n'est pas loin de partager cette analyse : « *On va jouer sur la flexibilité du sterling.* » Toutefois, il n'est pas trop inquiet en ce qui concerne l'inflation dont « *le facteur numéro un est le dérapage des salaires ; l'allègement des impôts directs n'a pas d'incidence à cet égard* ». Jacques Plassard pense cependant que le budget de Nigel Lawson risque d'aggraver le déficit extérieur en venant s'ajouter aux effets de la livre forte.

DANIEL VIGNERON

Budget britannique

Accueil perplexe des milieux financiers

LE PATRONAT s'est félicité du budget présenté mardi, de nature « à conforter la reprise économique ».

Mais les milieux financiers britanniques étaient quelque peu désorientés et s'interrogeaient sur les conséquences des mesures annoncées par Nigel Lawson.

La Bourse a exprimé sa préoccupation en affichant la baisse dès l'ouverture. Un analyste de Barclays - De Zoete Wedd - estimait toutefois qu'il était coutumier que les investisseurs renversent, le mois suivant, la tendance affichée au lendemain de la présentation d'un budget et que le Stock Exchange retrouverait la confiance à partir d'avril. L'indice FT était en baisse de 1 % en fin d'après-midi.

Hier, les boursiers reprochaient au chancelier de ne pas avoir donné d'indications précises sur la politique monétaire, alors que la livre est au-dessus des 3,08 deutsche Mark. Ils s'attendaient à une « mise au point » après la confusion engendrée la semaine dernière par les propos divergents tenus sur la livre par M. Lawson et Margaret Thatcher. Or le chancelier s'est contenté d'insister sur la lutte contre l'inflation.

Les boursiers estimaient aussi que M. Lawson avait peut-être mis un peu trop d'argent dans les poches des Britanniques par ses largesses fiscales, notamment une réduction de 60 % à 40 % du taux maximal d'impôt sur le re-

venu. Ils redoutaient une surchauffe de l'économie et une aggravation du déficit de la balance des paiements courants. Certains analystes n'hésitaient pas à trouver optimiste la prévision officielle d'un déficit de 4 milliards de livres cette année. Les importations devraient d'ailleurs augmenter deux fois plus vite que les exportations, selon les prévisions officielles.

Le patronat a, en revanche, salué un budget qui « permettra de conforter la reprise économique » et s'est félicité des prévisions pour 1988 faisant état d'une croissance encore assez forte (3 %), malgré la crise boursière

et d'une inflation quasi stable. Toutefois, certaines entreprises comme ICI ont estimé que le chancelier avait fait bien peu pour stimuler l'industrie et ses exportations menacées par la fermeté de la livre.

Le comportement de la livre va bien sûr être, dans les prochains jours, déterminant. Le sterling a été « sage » hier sur le marché des changes. Elle a terminé légèrement au-dessus de 3,08 DM. L'annonce d'un excédent budgétaire avait été anticipée, mais l'ampleur des concessions fiscales (près de 4 milliards) a visiblement troublé le marché.

Pascale GOMMARD.

FRANCE

UNCLASSIFIED

176712

MDADAN 0168

ADVANCE COPY

UNCLASSIFIED

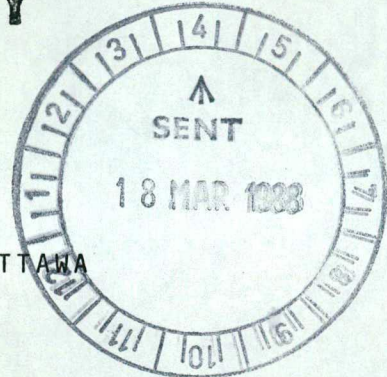
FM PARIS

TO IMMEDIATE FCO

TELNO 295

OF 181442Z MARCH 88

INFO PRIORITY BONN, WASHINGTON, ROME, TOKYO, OTTAWA



FRENCH REACTIONS TO UK BUDGET

SUMMARY

1. WIDESPREAD AND ALMOST WHOLLY POSITIVE INITIAL COVERAGE, WITH THE EMPHASIS ON RADICAL TAX REFORM AND A BALANCED BUDGET AGAINST A FAVOURABLE ECONOMIC BACKGROUND. SUBSEQUENT COMMENT TOUCHES ON THE BUDGET'S EFFECT ON INFLATION AND BALANCE OF PAYMENTS. YESTERDAY'S INTEREST RATE CUT WIDELY NOTED.

DETAIL

2. THE FRENCH DAILIES ON 16 MARCH GAVE WIDESPREAD AND ALMOST WHOLLY FAVOURABLE COVERAGE TO THE BUDGET (CUTTINGS AND PRELIMINARY ANALYSIS FAXED ON 16 MARCH TO CHANCELLOR'S OFFICE). THE EMPHASIS WAS ON RADICAL TAX REFORM, ESPECIALLY OF INCOME TAX, AND THE BALANCING OF THE BUDGET AGAINST A FAVOURABLE ECONOMIC BACKGROUND. LE FIGARO (RIGHT WING) SPOKE OF 'INCOME TAX REFORM WITHOUT PARALLEL IN THE WEST' AND 'OF BOLDNESS RARE IN EUROPE', TRIBUNE DE L'EXPANSION (CENTRE, FINANCIAL DAILY) OF 'THE MOST AMBITIOUS FISCAL REFORM IN THE WESTERN WORLD.... THANKS TO THE EXCEPTIONAL PERFORMANCE OF THE BRITISH ECONOMY'. LIBERATION (CENTRE LEFT) SPOKE OF 'THE MOST FUNDAMENTAL AND MOST DARING BUDGET SINCE MARGARET THATCHER CAME TO POWER' AND OF 'THE EXCEPTIONAL DYNAMISM OF THE BRITISH ECONOMY', WHILE REFERRING TOO TO CRITICISMS THAT TOO LITTLE WAS DONE TO HELP THE NHS. LE MONDE (CENTRE LEFT) SPOKE OF 'A GOLDEN BUDGET, REALISING THE IMPOSSIBLE DREAM OF EVERY FINANCE MINISTER: A BALANCE OF RECEIPTS AND EXPENDITURE, COMBINED WITH MAJOR TAX REDUCTIONS', WHILE NOTING BOTH THE WELCOME GIVEN BY INDUSTRY AND THE CRITICISMS OF THE OPPOSITION.

3. COMMENT YESTERDAY AND TODAY HAS CONTINUED LARGELY FAVOURABLE, THOUGH WITH SOME QUESTIONING OF THE BUDGET'S EFFECT ON INFLATION AND THE BALANCE OF PAYMENTS. YESTERDAY'S DROP IN INTEREST RATES IS WIDELY NOTED, AND ATTRACTS COMMENT (EG IN THIS AFTERNOON'S LE MONDE) ON THE DIFFICULTY OF BALANCING AN ANTI-INFLATIONARY POLICY WITH THE NEED TO AVOID TOO HIGH AN EXCHANGE RATE.

UNCLASSIFIED

176712
MDADAN 0168

4. FCO PLEASE PASS TREASURY AND BANK OF ENGLAND.

FERGUSSON

YYYY

DISTRIBUTION

5

ADVANCE 5

HM TRSY
B/ENG
HD/WED

HD/NAD
HD/FED

NNNN

SECRET AND PERSONAL until release of press notice on 25 March 1988
at 11.30 am and thereafter unclassified

To: MINISTER FOR TRADE

Copy No. (3) 29

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

21 March 1988

OVERSEAS TRADE FIGURES FOR FEBRUARY 1988

THE CURRENT ACCOUNT

In February, the value of exports was £6.2 billion and imports £7.5 billion, so that visible trade, seasonally adjusted on a balance of payments basis, shows a deficit of £1.3 billion compared with the deficit of £1.4 billion in January.

At the end of this note is an appraisal of the factors which may have influenced the figures, in particular the very low export figures for January and February 1988.

The Central Statistical Office continue to project a surplus on invisibles of £0.6 billion for months in the first quarter of 1988 so that the current account is provisionally estimated to have been in deficit by £0.7 billion, compared with a provisional estimate of £0.8 billion in January.

TABLE 1: CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES
(Table 2 of Press Notice)

	Current Account Balance	Visible Trade Balances			Invisibles Balance
		Total	Oil	Non-oil	
1986	+ 46	-8463	+4056	-12519	+8509
1987	-1679	-9625	+4184	-13809	+7946
Sept-Nov 1987	- 797	-2672	+1037	- 3709	+1875
Dec-Feb 1988	-2005A	-3774	+1023	- 4797	+1769A
1987 Dec	- 441	-1010	+ 346	- 1356	+ 569
1988 Jan	- 844A	-1444	+ 361	- 1805	+ 600A
Feb	- 720A	-1320	+ 316	- 1636	+ 600A

Seasonally adjusted
Balance of Payments
Basis
£ million

A = Projection or part projection

SECRET AND PERSONAL until release of press notice on 25 March 1988
at 11.30 am and thereafter unclassified

In the three months ended February there was a deficit on visible trade of £3.8 billion - a surplus on trade in oil of £1.0 billion, offset by a deficit in non-oil trade of £4.8 billion. Between the three months ended November and the latest three months, the visible trade deficit increased by £1.1 billion; the surplus on oil was little changed while the deficit on non-oil trade also rose by £1.1 billion.

EXPORTS

The value of exports in February was £29 million ($\frac{1}{2}$ per cent) lower than in January. Exports of oil decreased by £51 million between the two months and exports of the erratic items increased by £124 million. Excluding oil and the erratic items, exports fell by 2 per cent between January and February.

In the three months ended February, total export volume was $3\frac{1}{2}$ per cent lower than in the previous three months and 1 per cent lower than in the same period last year. Excluding oil and the erratic items, export volume was again $3\frac{1}{2}$ per cent lower than in the previous three months but $\frac{1}{2}$ per cent up on the same three months a year ago. The low export figure for February lends more weight to the view that there has been a change in export trends at the turn of the year.

TABLE 2: EXPORTS BY VALUE AND VOLUME (Tables 1, 4 and 7 of Press Notice)

Bop Basis, Seasonally Adjusted

	VALUE (£m)		VOLUME (1980 = 100)	
	Total	Total Less Oil and erratics	Total	Total less Oil and erratics
1986	72678	59098	123.3	118.0
1987	79622	65200	130.4	126.6
Sept-Nov 1987	20646	16895	133.7	130.5
Dec-Feb 1988	19208	16214	129.1	125.7
1987 Dec	6817	5699	137.1	133.1
1988 Jan	6210	5309	126.4	123.8
Feb	6181	5206	123.7	120.2

By value, exports of manufactures during the three months ending February were 7 per cent down on the previous three months; within manufactures, passenger motor vehicles fell by 19 per cent.

*Not for
Press
Notice*

SECRET AND PERSONAL until release of press notice on 25 March 1988
at 11.30 am and thereafter unclassified

Also by value, total exports fell by 7 per cent between the three months ended November and the latest three months. The fall in exports to the developed countries was $9\frac{1}{2}$ per cent - within which exports to the rest of the European Community fell by 13 per cent while exports to North America rose by $3\frac{1}{2}$ per cent.

IMPORTS

The value of imports in February was £153 million lower than in January. Imports of oil were little changed while imports of the erratic items increased by £109 million between the two months. Excluding oil and the erratic items, imports fell by $3\frac{1}{2}$ per cent between January and February.

In the three months ended February, total import volume was unchanged compared with the previous three months and 11 per cent higher than in the same period last year. Excluding oil and the erratic items import volume rose by $\frac{1}{2}$ per cent in the latest three months to stand 13 per cent up on a year ago. It appears that the upward trend in imports has flattened out since the autumn.

TABLE 3: IMPORTS BY VALUE AND VOLUME (Tables 1, 4 and 7 of Press Notice)

Bop Basis, Seasonally Adjusted

	VALUE (£m)		VOLUME (1980 = 100)	
	Total	Total less oil and erratics	Total	Total less oil and erratics
1986	81141	73346	134.6	151.6
1987	89247	81125	144.6	164.9
Sept-Nov 1987	23318	21227	160.3	172.9
Dec-Feb 1988	22982	21173	161.2	177.7
1987 Dec	7827	7202	154.9	177.0
1988 Jan	7654	7114	151.0	175.8
Feb	7501	6857	147.0	168.8

By value, imports fell by $1\frac{1}{2}$ per cent between the three months ended November and the latest three months. Imports of passenger motor cars rose by 13 per cent but imports of other consumer goods fell by $9\frac{1}{2}$ per cent.

Leave out of Press Notice

SECRET AND PERSONAL until release of press notice on 25 March 1988
at 11.30 am and thereafter unclassified

Again in value terms, imports from the developed countries fell by 1 per cent over the latest three months, with arrivals from the European Community countries up by $\frac{1}{2}$ per cent, from North America down by 5 per cent and from the other developed countries up by $2\frac{1}{2}$ per cent. Imports from the developing countries decreased by $4\frac{1}{2}$ per cent between the two three month periods.

TRADE IN MANUFACTURES

Figures showing trade in manufactures on a balance of payments basis will be published in the April edition of the Monthly Review of External Trade Statistics following the release of the press notice. On present estimates they show a deficit in the three months ended February of £3.0 billion compared with a deficit of £1.8 billion in the previous three months.

TABLE 4: TRADE IN MANUFACTURES (SITC 5-8) (Table 16 of Press Notice, quarterly data only)

	£ million Seasonally Adjusted Balance of Payments Basis		
	Exports	Imports	Balance
1986	54927	60233	-5307
1987	61556	68097	-6542
Sept-Nov 1987	16218	18037	-1819
Dec-Feb 1988	15087	18096	-3009
1987 Dec	5319	5959	- 640
1988 Jan	4854	6153	-1299
Feb	4914	5984	-1070

QUALITY OF THE FIGURES

With the low figure for February exports, following that for January, suspicion will remain amongst analysts of the trade figures that the changes to Customs' administrative procedures on 1.1.88 have had some distorting effect on the macro-economic statistics that are derived from them. HM Customs view is that the introduction of the administrative changes in the UK was smoother than expected, that the system of deriving trade statistics remains fundamentally the same and the overall value of trade is being recorded as accurately as before 1.1.88. HM Customs' monitoring procedures have not shown up any serious distortions that would affect the way that the basic information is recorded by traders.

**SECRET AND PERSONAL until release of press notice on 25 March 1988
at 11.30 am and thereafter unclassified**

However, in view of the special concern over the figures, they are taking particular care to check that the associated documentary procedures are completed and that all relevant information is included.

The documents analysed in the February accounting period generally cover goods shipped in the period mid-January to mid-February. For the latter half of that period the **ferry operators' strike at Dover** was in progress but HM Customs' analyses of trade through individual ports suggest that much of the Dover traffic has been diverted to Ramsgate and other nearby ports. The **Ford** strike (from 8-21 February) would only have had a negligible effect on total exports (about £5 million). The **Land Rover** strike did not begin until 22 February and therefore could not have affected exports recorded as February trade.

We are searching for corroborative evidence on low UK exports in January. Because of the volatile nature of monthly figures, the difficulty of matching figures from different sources and the delays in compiling other figures, it will probably be several weeks or even months before any firm conclusions can be drawn. We are looking at:-

- **other countries' trade figures** (ie imports from the UK). Generally their figures generally come out later than our own, even in normal times, and because of the 1.1.88 Customs changes most countries were unable to produce their January figures according to the normal timetable. Bilateral reconciliations, especially on a monthly basis, are difficult for definitional and timing reasons. Nevertheless we have asked overseas posts to send us the figures for major overseas markets when they become available to see if we can detect any reliable evidence that supports the pattern of trade shown by the UK export figures for January. The fall in January exports was almost entirely concentrated in exports to Europe (and the lower level of exports to Europe seems to have continued into February) and we will be looking particularly at these markets.

- **monthly enquiries of domestic production** conducted by the Business Statistics Office (BSO). Nowadays only large firms in the engineering industry are asked to separate export sales from home sales; this industry accounts for about one quarter of total UK exports. Some figures are available for January, and will be finalised and published in mid-April; those for February will be available about four weeks later. Again there are definitional, coverage and timing reasons why the production figures do not match trade figures, especially on a monthly basis. Our work so far does not show any firm

SECRET AND PERSONAL until release of press notice on 25 March 1988
at 11.30 am and thereafter unclassified

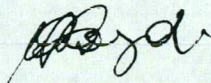
evidence that the December/January change in export figures is recorded by Customs was significantly different from that recorded in the BSO figures.

Conclusion

The DTI took an agnostic view of the meaning of the January figures, stating in the press notice that "It would be prudent to wait the figures for February and probably later months, before deciding whether or not there was any distortions in the monthly pattern of trade". This point will be repeated, perhaps less strongly, in Friday's press notice, a draft of which will be circulated to Ministers tomorrow. However, the low export figure for February does lend more weight to the view that there has been a real change in export trends at the turn of the year. Customs will continue with their special checks on the figures and we, as far as it is available, will be looking for corroborative evidence from other sources.

PUBLICATION

The press notice containing the February figures is scheduled for release on Friday 25 March 1988.

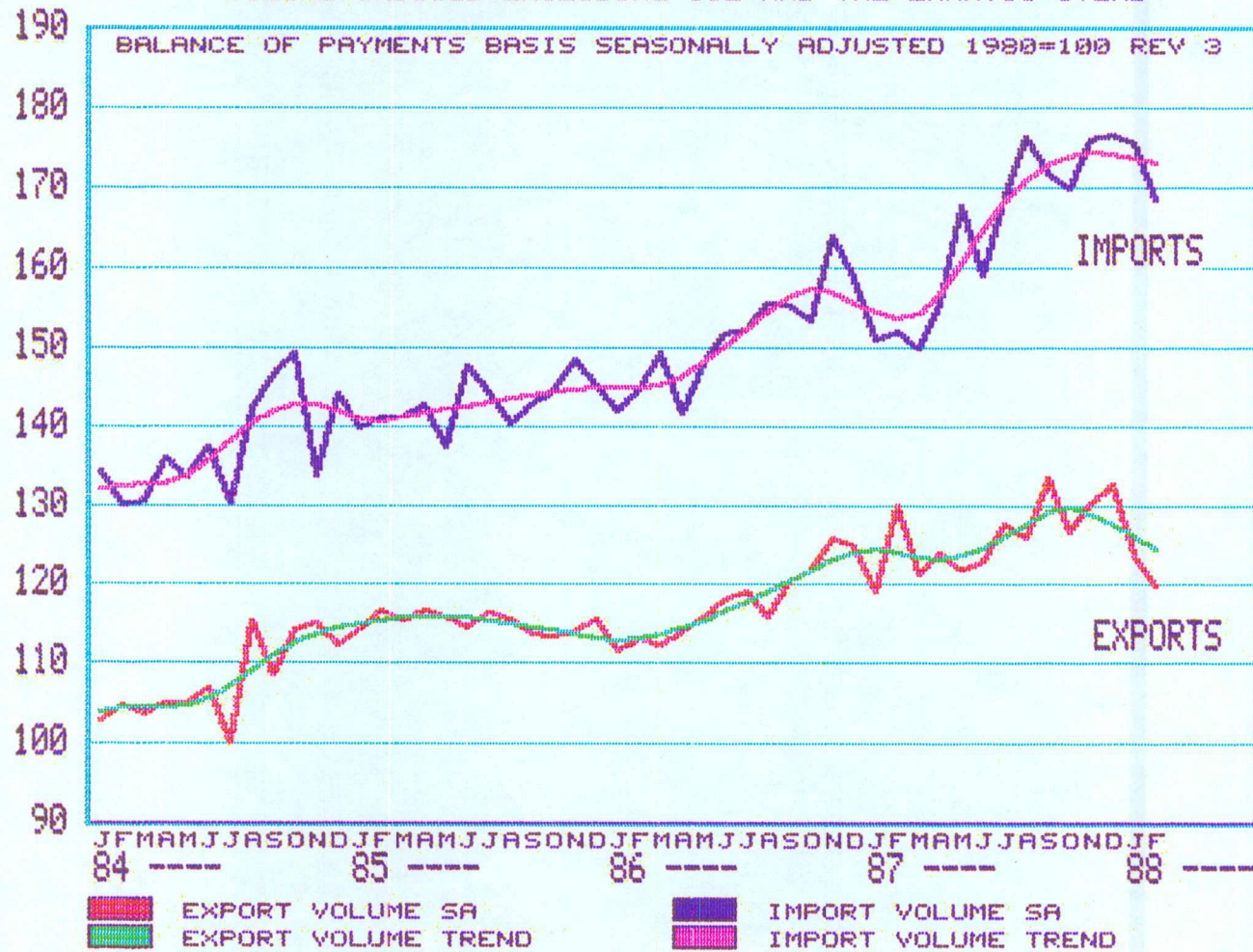


P J STIBBARD

(Signed in his absence)

SECRET AND PERSONAL UNTIL THE RELEASE OF THE PRESS NOTICE ON 25.3.88

VOLUME INDICES EXCLUDING OIL AND THE ERRATIC ITEMS



CIRCULATION LIST

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



Budget - Secret

HOUSE OF COMMONS
LONDON SW1A 0AA

Tuesday March 21

Dear Nigel,

You were kind enough to take me into your confidence about some of your budget proposals.

I find I am due to address a lunch gathering of 100 top figures in the Construction Industry on the Thursday immediately following Budget Day. Clearly, some of your proposals will be of more than passing interest to that audience. I cannot of course disclose to any of my people what you told me, so that any

(2)

preparations for that speech cannot embody your proposals.

Could I, I wonder, ask if you could commission a speaking note on which I could draw, and which would not need to be in my possession until after you had sat down?

You told me that in your view, the combined effect of your proposals upon the construction industry would leave them, on balance, better off. The Note should spell out that case as cogently as possible.

One fear which the industry always voices is that changes in the

(3)



fiscal / monetary / planning etc environment
will lead to a gaping hiatus in
orders — see for instance their
representations against the E.C.
with to see VAT imposed on new
construction.

Could the Note set out reasons
why there should be no reason
to fear any such hiatus following
the budget proposals — e.g. because
of phasing, etc.?

Changes in the fiscal etc en-
vironment affecting the industry almost
always do so in different ways for
different parts of the industry — i.e. for
volume housebuilders, civil engineering contractors,

(4)

commercial developers, overseas contractors,
building material producers,
small jobbing builders, etc etc.

Could the Note include an assessment
of the likely impact on the main
sections of the industry?

The lunch will be an excellent
opportunity to sell this part of
the Budget, and answer the critical
criticisms, fears, etc which the
budget might provoke. But I
will need your people's help if I
am to ~~to~~ make the most of
the opportunity.

Yours
Patrice

MAIN PAPER

CONFIDENTIAL

pur

EVANS
EXCHANGE
RATE
SYSTEMS
21/3

hpe12/14.3

FROM: HUW EVANS
DATE: 21 MARCH 1988

*Ballmer
Goschen
Stark's
Stark's
Stark's*

CHANCELLOR

cc

- Sir Peter Middleton
- Sir Terence Burns
- Sir Geoffrey Littler
- Mr Lankester
- Mr Scholar
- Mr Odling-Smee
- Mr Peretz
- Mr Grice
- Mr Matthews
- Miss O'Mara
- Mr Dolphin
- Mr Hood
- Ms Symes
- Mr Cropper
- Mr Tyrie
- Mr A Allan
- Mr A Hudson

*Ch
It's not a v good time
to be having any substantive
discussion. A what you might
be saying - Washington (!) But
this is a useful occasion to pull
together what's going on
internationally on all
this.*

EXCHANGE RATE SYSTEMS

AA

In your speech to the Annual Meetings last September, you outlined an approach to exchange rates. This minute and attachments written in IF2, and discussed with Sir Terence Burns and Sir Geoffrey Littler, include:

- (i) the main points of the speech;
- (ii) a reminder of the different views on how exchange markets work;
- (iii) the costs of misalignments;
- (iv) the various notions of sustainability of the US current account deficit and the dollar;
- (v) reasons for making exchange rates the focal point of policy co-operation.

2. The last year has seen a strong revival of interest in both the international monetary system and greater stability of exchange rates. The work of the Committee of Twenty is being dusted off. The French, not surprisingly, are leading the pack. But continued US reluctance when setting monetary policy to give

much weight to stabilising the dollar (particularly in advance of the Presidential election) as well as increased domestic sensitivities make this not the time for developing in public ideas for a future exchange rate system.

The September Annual Meetings speech

3. Before outlining "a regime for the future" you made a number of points about the nature of the world in which the major countries are attempting to manage exchange rates. Differences in the assumptions about the way the world works - in particular the way that foreign exchange markets operate - underlie the gap between supporters and opponents of more managed exchange rates. The principal points were:

- (a) Floating exchange rates are subject to large medium term swings and misalignments.
- (b) Exchange rate misalignments are costly.
- (c) Circumstances are now more propitious for managed exchange rates than in the 1970s and early 1980s:
 - inflation in the countries co-operating on exchange rate management is low and inflation differentials are small;
 - these countries are similarly committed to using their macroeconomic policies to keep inflation down and they pursue market-orientated micro policies.
- (d) The size of current account deficits and surpluses of the US, Japan and Germany (and other imbalances in the world economy) are compatible with more active management of exchange rates.
- (e) Exchange rates should be the focal point of policy co-ordination. This view was stated explicitly in January speech in the debate on the Autumn Statement.

(f) Countries are prepared to give significant weight to exchange rates in the conduct of their monetary policy. Experience since Plaza and Louvre suggests that countries will tend to take account of exchange rates only when it suits them.

(g) Governments are willing to use intervention, as well as monetary policies, to support an exchange rate agreement.

4. You then went on to sketch a "regime for the future", covering central rates, fluctuation bands, flexibility, global indicators (on which some progress is being made: they are now in an extra table in the IMF's paper on indicators), discretion etc. This left open a number of questions, which we have not attempted to deal with here.

Exchange rate determinants

5. Annex A reminds us of the major differences in the theories of exchange rate determination, and uses the dollar in the period 1983-6 as an example. The central question is: how far do exchange markets reflect fundamentals - monetary and fiscal policies, trade performance, rates of return on capital and so on - and how far do they reflect speculative bubbles, irrational market sentiment etc.

Costs of misalignments

6. Annex B sets out the various costs of misalignments. Medium term swings in exchange rates, which cannot be adequately hedged in forward markets, create uncertainty, damage investment, reduce the responsiveness of trade volumes to exchange rate changes, and so lead to resource misallocations and unsustainable trading patterns. In turn, protectionism is encouraged.

Sustainability

7. We frequently hear the current account imbalances of the three largest economies being described as unsustainably large.

What does this mean and how should we define an unsustainable situation? We have looked at a range of factors to see what insights they provide on this question:

- (a) present and prospective current balances in relation to historical experience;
- (b) reasons why structural shifts in national saving and investment balances could produce changes in 'equilibrium' current account positions;
- (c) the consequences of imbalances for net external asset and liability positions and hence for the creditworthiness of the countries' concerned;
- (d) on the sustainability of current exchange rates, we have compared present real exchange rates with past experience.

8. Annex C gathers together a variety of projections of the US current account deficit: virtually all show a reduction over the next two years. This is followed by little change, or even some worsening, as the effects of dollar depreciation come to an end and US growth of domestic demand comes back to a rate close to that of its GNP. We have looked at assumptions about US saving and trade propensities more favourable to greater adjustment of the balance of payments. It is possible to get a US current account close to balance by the early 1990s, without a further depreciation of the dollar, but this requires a combination of relatively favourable factors. This is not inconceivable, but could involve a transitional period of weaker growth in the rest of the world.

9. Annex D looks at the various measures of US real exchange rates: on most measures of relative prices and costs, the US is already very competitive by the standards of the last decade and a half, though there are concerns that non-price factors (such as the level of technology) are less favourable.

10. Annex E looks at the main considerations relevant to the financing of US deficits. The conclusions are:

(i) In a world of mobile capital, different savings/investment propensities and different returns on capital, countries should not aim for balanced current account positions; indeed given the uncertainties over measurement and forecasting, this could be a very foolish medium-term objective (pace the current account as a performance indicator).

(ii) The ratio of US net external debt to its GNP, although growing rapidly, is still very low compared with countries like Canada and Sweden.

(iii) A given level of debt will be more easily financed if:

(a) borrowing goes to finance additional profitable investment;

(b) the proportion of government debt is not too large;

(c) the US government gives a high weight to sound financial policies, especially the need for a stable dollar;

(d) the US government is prepared to issue liabilities in foreign currencies.

(iv) A sustainable position in the long run is possible with continuing current account deficits (as long as nominal GDP continues to grow). But as net interest payments abroad grow, the scope for a continuing deficit on trade declines, and ultimately - say within the next decade - the US trade deficit will need to decline to close to zero.

11. Conclusions on sustainability, looking at all this evidence, depend on the relative weight attached to the different pieces of evidence. It is tempting to conclude that, with US competitiveness now strong, with the US able to accumulate liabilities on a substantial scale, and with current account forecasts (especially over the medium term) notoriously uncertain, sustainability is a reasonable assumption. But the persistence of trade deficits in nearly all projections, the substantial improvements in performance that have to be made to most models in order to bring about a continued strong decline in the deficit, should make for caution. Perhaps most of all, the fact that currently US imports of goods are around 60 per cent higher than US exports is an indication of the size of the gap that sooner or later will have to be closed.

12. So we should continue to be cautious, arguing for a period of stability in the dollar and against the proposition that dollar depreciation alone will help, rather than asserting that the dollar is necessarily at or below a sustainable level in a longer term sense.

Exchange rates as the focal point of policy co-ordination

13. Annex F develops some of the practical and analytical arguments set out in your speech on January 14. These could be restated for an international audience.

Spring Meetings

14. Perhaps we could discuss at your meeting on Wednesday setting in hand some drafts for your intervention at the Interim Committee.

HPE

H P EVANS

EXCHANGE RATE DETERMINANTS

Strong disagreements about the role of governments in exchange markets largely reflect different views about how these markets work. Among the first and most fundamental questions that we need to ask ourselves are what determines exchange rates and why have rates varied so much over the past decade and a half of floating?

2. We can see, with the benefit of hindsight, that circumstances in the 1950's and 1960's were unusually propitious for exchange rate stability. Inflation was low and taking one year with another the policies of the major countries (including especially the US) were directed at keeping it low, inflation differentials between countries were relatively small, financial markets were comparatively undeveloped and exchange controls impeded capital flows between countries. When generalised floating started in the 1970's, it was widely expected to facilitate necessary changes in rates (which the Bretton Woods' system of adjustable pegs was blamed for delaying unduly). It was also argued that rates would, assuming appropriate macro policies were pursued, remain relatively stable, since speculative capital flows would need to be stabilising, if they were to be profitable in the long-term.

3. In practice, not only has there been substantial day-to-day and week-to-week volatility of exchange rates, but also large medium-term swings in exchange rates - the latter being potentially much more serious, since it is difficult for exporters and importers to hedge against them.

Explaining Exchange Rate Variability: The Role of Asset Markets

4. A number of theories have been developed to try to explain the variability of floating rates. A key element of most of them is that the supply of and demand for domestic and overseas assets are the main determinants of exchange rates in the short-run. This accords with such observable facts as the huge size of asset stocks and the potential capital flows (compared with trade flows) that can be generated in the short-term by portfolio adjustments; the increased mobility of capital which improved communications and the relaxation of exchange controls have produced; and so on.

5. In an asset-view of exchange markets the demand of financial market operators for the existing stocks of domestic and foreign currency assets will be a principal determinant of exchange rates in the short-run. As financial markets are likely to be forward-looking and to react quickly to news this provides considerable scope for exchange rate volatility. Indeed, overshooting of exchange rates in response to changes in government policy, external shocks etc is an integral part of many such exchange rate theories.

6. Where wages and goods' prices are relatively sticky, but asset prices respond quickly, a piece of news such as, say, an unexpected one-off rise in money supply would lead to an immediate depreciation in the exchange rate. This would initially overshoot the new long-run equilibrium and be followed by a real appreciation (as domestic prices responded to the money supply increase) bringing the exchange rate back to its new equilibrium. Other "shocks" or "news" such as changes in oil prices and in fiscal policy could similarly generate overshooting in the short-term, before rates return to their new long-term equilibrium (which will be determined by such factors as relative money supplies, purchasing power parity and a sustainable current account balance).

Exchange rate movements and "fundamentals": the dollar 1980-85

7. How far can exchange rate variability in the real world be explained by changes in "fundamentals" such as fiscal and monetary policies producing short-run overshooting? Some movements in exchange rates can clearly be traced back to such fundamentals. For instance, part of the appreciation of the dollar from 1980 to 1983 can be attributed to a rise in real interest differentials (particularly at the long end) in favour of the US, which in turn reflected a combination of tight monetary and expansionary fiscal policies. But this can realistically account for only part of the appreciation. Moreover, after 1983 the interest differential in favour of the US declined, while the dollar went on rising until February 1985.

8. Another puzzle is why did it take so long for the dollar to respond to such "fundamentals" as the growing US current account deficit? On average the US current account in the 1950's, 1960's and 1970's was close to a zero balance and the long-term equilibrium rate for the dollar in the 1980's might be expected to be broadly consistent with this. The growing current account deficit thus pointed (ceteris paribus) to an exchange rate below rather than substantially above this equilibrium rate.

9. These developments make it difficult to believe that the forward-looking expectations of financial market operators have consistently been based on a correct assessment of fundamentals. Nor do the views of academic economists, who argue that markets are efficient and their expectations rational, come out well from the more systematic and rigorous econometric tests to which they have also been subject and whose results, while not conclusive, offer little to support them.

10. In an effort to square the circle the possibility of rational speculative bubbles has been raised. On this view, while the bubble is expected to continue in the short-run, markets recognise that there is a chance that it will burst and the exchange rate fall back toward its equilibrium. They would need, however, over periods such as 1982-85 to have been compensated for this risk by a higher interest differential in favour of the dollar. Yet from 1983 onwards this differential fell, and the dollar continued to rise.

Other explanations of exchange rate variability

11. It is difficult not to draw the conclusion that the dollar, particularly in 1984-85, has been driven by market sentiment which is not based on considerations of fundamentals. Various explanations for this are possible. One important factor is that the time horizons of foreign exchange market traders are notoriously short and may ignore current account effects, which build up only with a lag - indeed, exchange rate appreciation may initially improve the current account (i.e. a J-curve effect).

12. It is also possible that those arguing, on the basis of fundamentals, that the dollar would fall were increasingly ignored, as events proved them wrong and the "chartists" right. Another possibility is that with the rate so far from equilibrium, market participants no longer knew what a realistic exchange rate would be, and, being mostly risk-averse, acted as if the current level were likely to continue.

Policy implications

13. This view of a foreign exchange market dominated by chartists, and with no clear view of the correct long-term equilibrium rate to anchor its expectations, points to a much more active role for the authorities. They can not only guide the market toward more appropriate exchange rates, but can achieve this, at least in part, by public statements and official intervention e.g. the Plaza Agreement.

14. However, even though market operators' expectations are not always grounded in fundamentals, this does not necessarily mean that the markets always ignore such factors. The authorities thus cannot hope to maintain, by announcement effects supported by intervention alone, a set of exchange rates which is at variance with their macroeconomic policies, and with sustainable current account balances. This points to a continuing need to support exchange rate agreements with credible and consistent fiscal and monetary policies.

COSTS OF EXCHANGE RATE MISALIGNMENT

Floating exchange rates have been subject to not only substantial day-to-day and week-to-week volatility, but also to large medium-term swings. The 1980's have seen an appreciation of some 40 per cent in the dollar's effective rate followed by a depreciation of similar dimensions. Some of the movements in bilateral exchange rates have been even greater.

2. Financial markets have evolved to help traders cope with the variability of exchange rates. For the main currencies, hedging against short-run volatility by using the forward exchange markets is relatively straightforward and inexpensive.

3. Coping with large medium-term swings is another matter. If exporters and importers know with certainty what their foreign currency receipts and expenditures will be over the next few years, they may be able to hedge (e.g. by making deposits or borrowings in foreign currency for the appropriate term). In practice the overwhelming majority of traders are not in this happy position. Investing in new plant and equipment or developing an export market are medium to long-term propositions involving considerable uncertainty about the actual scale of sales receipts or production outlays. This obviously makes it very difficult for a firm to protect itself against currency fluctuations.

4. Arguments that floating exchange rates are freely determined by market forces and must therefore be "optimal" miss the point. They are based on a static view of market efficiency, which ignores uncertainties and many other features of the real world. Far from improving the price mechanism floating which leads to large medium-term swings in exchange rates actually degrades it.

5. Adjustments which are inappropriate in the long-term are encouraged, with firms being forced to move out of markets where they have a genuine long-term comparative advantage. A persistent

overvaluation squeezes sales and profitability, so firms scrap capacity and, when the overvaluation is eventually corrected, they are unable readily to regain their markets. Similarly, undervalued currencies encourage firms to direct their energies towards products that in the longer term are not competitive on world markets. Investment in plant, in marketing, in people is wasted.

6. Companies in all countries find it harder to plan for the future. Uncertainty about large future exchange rate swings can create paralysing inaction, even in the face of profitable new opportunities. Not knowing in which country to locate a new plant may reduce the overall level of world investment.

7. Over time some firms (particularly large, financially strong, diversified corporations) may learn to "cope" with medium-term exchange rate swings, and do not attempt to adjust to every exchange rate change. Developing a market can be a gradual business and once a satisfactory market share has been obtained, this investment is not lightly thrown away, so that, if exchange rates move unfavourably, a firm may be prepared to accept substantial reductions in its profit margins in the expectation that exchange rates will eventually move back the other way.

8. This may be desirable at a micro level, but unhelpful at a macro level. The responsiveness of trade volumes to exchange rate changes is diminished and, with floating rates, the size of the eventual movement needed to correct current account imbalances is amplified. Large corporations may be able to devise strategies to cope with this, but, if so, the adjustment costs imposed on small and medium-size enterprises may be even greater.

9. Those countries with the most flexible markets, particularly labour markets, are likely to find it hardest to adjust to exchange rate fluctuations, so structural unemployment persists longer. But in all countries the resource misallocations and unsustainable trading patterns caused by misaligned exchange rates take time to reverse.

10. Consumers may also suffer from exchange rate fluctuations as the implications for domestic prices prevent a steady expansion in living standards.

11. Perhaps most serious, if unchecked, are the protectionist pressures that emerge as industries become less competitive in the short run and uncertain about their long term future. Persistent misalignment threaten the open multilateral trading system.

MEDIUM-TERM PROJECTIONS OF THE US CURRENT ACCOUNT

This note sets out the most recent medium-term forecasts/projections of the US current account from each of these sources:

- i. The WEP model - 1988 FSBR forecast.
- ii. The IMF - March 1988 WEO forecast and medium-term projections.
- iii. The OECD - February 1988 projections.
- iv. Private forecasters - Bryant and Holtham's analysis of projections prepared for a Brookings conference.

All suggest that if no changes are made to "current policies" and if the real exchange rate of the dollar does not fall, the US current account deficit will decline only moderately over the next few years. By the early 1990s it is expected to be still close to or over 2 per cent of GNP. This would mean that the US external debt:GNP ratio would still be rising.

2. There are various ways in which smaller US current account deficits might be brought about. The effects of a recovery in US saving (which might come about through a combination of increased household saving and a smaller Federal Budget deficit) and a better US trade performance are examined below. A combination of these events could come close to eliminating the US current account deficit by 1991 without further exchange rate adjustments. But there would still be substantial transitional costs for the rest of the world economy, as well as the US.

Recent projections

3. Recent medium-term projections of the US current account have been made by the IMF, the OECD, several private forecasting groups and by ourselves using the WEP model. Direct comparisons between these projections are difficult because they are based on differing assumptions about domestic policies (especially in the

US) and about exchange rates (some assume constant real exchange rates, others constant nominal exchange rates). Nonetheless, there is broad agreement about likely developments in the US current account, as Table 1 illustrates.

Table 1: Projections of the US current account (% of GNP)

	1987	1988	1989	1990	1991	1992	1993
WEP-FSBR	-3.6	-3.3	-2.9	-2.5	-2.2		
IMF		-2.9	-2.5			-2.1	
OECD		-2.8	-2.1	-2.0	-2.0	-1.9	-1.9
Average of private forecasters		-2.6	-2.2	-2.1	-2.3		

4. All the projections show some significant improvement in the US current account in 1988 and 1989, mainly reflecting the lagged effects of gains to competitiveness from the dollar's fall between 1985 and 1987. After 1989, however, little improvement is expected, except in the WEP forecast, which is based, inter alia, on the assumption of a tightening of US policy in 1989 and 1990, with a consequent slowdown in the growth of domestic demand and imports.

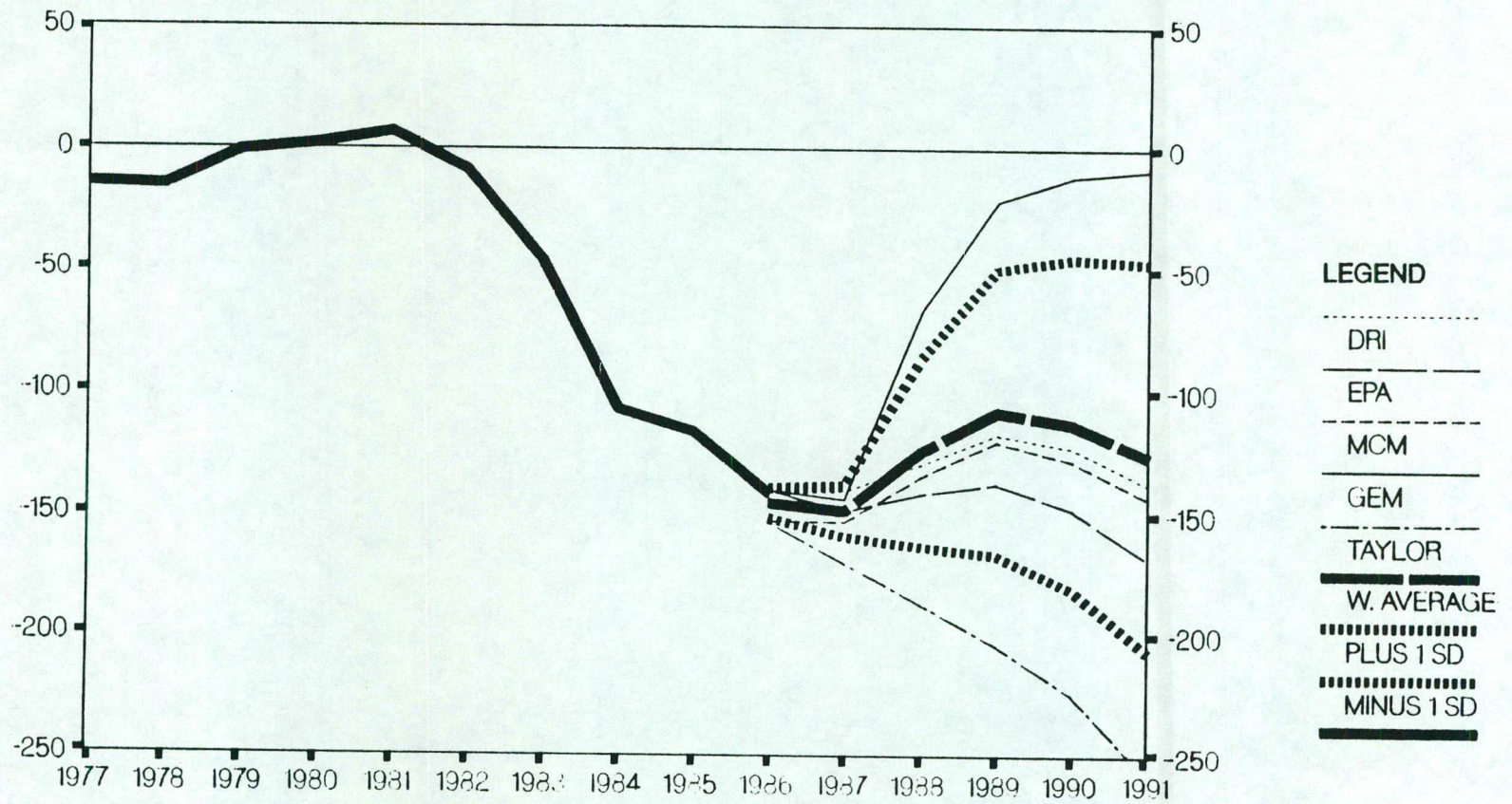
5. Even on OECD's projections of current balances, the external debt of the US rises from 8.3 per cent of GNP in 1987 to 16.3 per cent by 1993. And it will still be rising in 1993.

6. The "private forecasters" projection is based on Ralph Bryant's update of the current account projections prepared for a January 1987 Brookings Conference by the users of five world economic models. The average shown in Table 1 masks a range of views (see attached chart). One of the models (the National Institute's GEM) forecasts a current account deficit close to zero by 1991, while another expects it to be over \$250 billion.

CURRENT ACCOUNT BALANCE

History 1977-1986 and Conditional Projections for 1987-1991

Billions of Current U.S. Dollars



Sensitivity analysis of projections

7. That the projections cited above are subject to a substantial margin of error is illustrated by the divergent views of the private forecasters. The models may be an imperfect representation of how the world economy actually works and they may make incorrect assumptions about policies. We have therefore investigated with the assistance of the WEP model how the US current account might evolve if US saving were higher and trade performance better.

8. To simulate the effects of higher US saving the following changes from the WEP FSBR forecast are assumed:

- i. an exogenous increase in US household saving building up to the equivalent of 2 per cent of disposable income (1.3 per cent of GNP) by the end of 1989,
- ii. cuts in government dissaving (achieved via lower government expenditure) equivalent to 1 per cent of GNP in both 1990 and 1991.

No changes in interest rates or exchange rates are assumed. The simulation is thus rather partial in that important channels through which crowding in of other US expenditures might occur in response to these changes are in effect blocked off.

9. The result is much slower growth of US domestic demand (0.5 per cent a year between 1987 and 1991 compared to 1.6 per cent in FSBR forecast), fewer imports and a markedly better outlook for the current account (see table 2).

Table 2: US current account with higher US saving

	1987	1988	1989	1990	1991
Current account (\$bn)	161	147	127	107	82
Current account (% GNP)	3.6	3.1	2.6	2.1	1.5

The 'cost' of this adjustment is lower growth of real GNP both in the US, where it is just under 1 per cent a year lower than in the FSBR forecast, and in the major seven, where it is just under $\frac{1}{2}$ per cent a year lower.

10. On the WEP model the US trade equations have price elasticities that are similar to those of the other countries' trade equations, but income/market elasticities that are very different. Thus, the income elasticity in the US import equation ($2\frac{1}{4}$) is the highest on the WEP model, while the markets elasticity in the US export equation ($\frac{1}{2}$) is the lowest. To stimulate the effects of more favourable trade elasticities both these elasticities have been changed to 1. The results of this exercise are shown in Table 3.

Table 3: US current account with more favourable trade elasticities

	1987	1988	1989	1990	1991
Current account (\$bn)	161	152	124	88	45
Current account (% GNP)	3.6	3.2	2.5	1.6	0.8

11. The main benefit to the US current account comes from lower imports (the present level of imports is higher than the level of exports and the adjustment to the import elasticity is larger). There will be significant offsets to the better US trade performance in the rest of the world. This will mean a worse trade performance and lower growth in surplus countries such as Japan, Germany and the SE Asian NICs. But it will also mean a worse trade performance for many Latin American countries - e.g. Mexico, Brazil, Argentina - for which the United States is an important market for their exports.

12. The results of these two variants, as shown in Table 2 and 3, cannot be simply added together to give the effect on the US current account of higher US saving and more favourable trade elasticities. If the US import elasticity is much lower (1 instead of $2\frac{1}{4}$) then the benefits from higher US saving, which come through lower spending and thus fewer imports, will obviously also

be lower. Nonetheless, a combination of higher saving and a better trade performance would be sufficient to come close to eliminating the US current account deficit by 1991.

13. The simulated changes in saving are regarded as plausible. Household saving in the US has fallen well below its historical average level and could recover again, and the US Federal budget deficit was cut by the equivalent of 2 per cent of GNP in 1987, so cuts of the magnitude assumed here are within the bounds of recent experience. On the other hand there is no evidence to support the view that US trade performance could improve as simulated. During 1987 the main reason the US current account continued to grow - in dollar terms - was the continued strength of imports despite a slowing down of domestic demand and competitiveness losses. This suggests the income elasticity of imports remains high. Overall, therefore, it remains very unlikely that these factors alone will combine to eliminate the US current account deficit by 1991.

THE REAL EFFECTIVE DOLLAR EXCHANGE RATE

*(What about
US share of world
trade?)*

The attached chart shows measures calculated by the IMF of cost and price competitiveness for the US manufacturing sector from 1972. The comparison is with sixteen industrialised OECD economies, with Japan, Canada, and the EC countries the most important competitors included. The measures all relate to manufactured goods. Values for 1987Q4 and 1988Q1 are estimates based on actual changes in nominal effective exchange rates.

2. With the exception of relative export unit values, all the competitiveness indices show a similar picture. Relative actual unit labour costs perhaps provide the best guide to the underlying competitiveness of the manufacturing sector and are currently lower than at any time in the period of 1972-87, including the previous low point of 1978. The fall in the index (improvement in competitiveness) since the 1985 peak has been more than 40 per cent.

3. The export price competitiveness measure (relative export unit values) has fallen less (by 30 per cent) since the 1985 peak, and remains close to the average for the period 1972-87. The smaller fall in this series suggests that US manufacturing exporters have been able to rebuild profit margins squeezed by the high nominal exchange rates of 1983-85, while exporters to the US have tried to keep down their prices in dollar terms (by cutting their domestic currency prices) in order to try to remain competitive in the US market. This may, though, be a transitional situation and if present levels of cost competitiveness are maintained, exporters may have to adjust their prices further.

4. From early 1985 to early 1988, all the indices show that the competitive position of US manufacturing has changed dramatically, from very weak to average or stronger than average. Various arguments have nevertheless been put forward suggesting that this will be insufficient to correct the US current account deficit and further depreciation will be necessary:

(a) comparison with the average exchange rate for 1972-87 is inappropriate, since the US has lost its technological leadership over Europe and Asia, and that the real exchange rate needs to be lower than before 1980 to compensate for this;

(b) the US has accumulated substantial external debts over the past five years and will have to run a better net trade surplus than in the past in order to finance higher i.p.d. payments;

(c) that a period of overvaluation may have to be followed by a period of undervaluation because of hysteresis effects in trade;

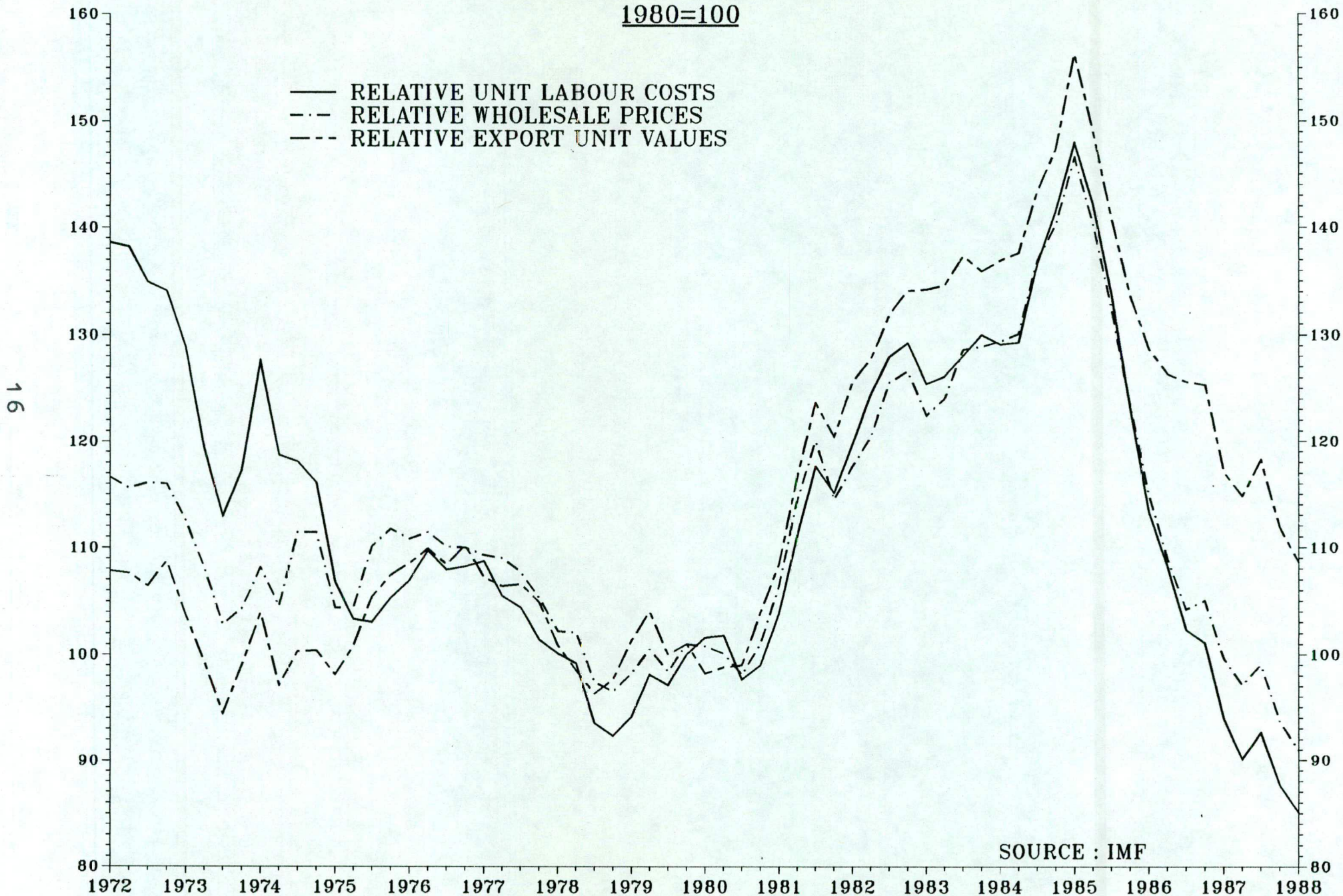
(d) the growth of US oil imports will require greater exports of manufactures than in the past and hence a better average level of competitiveness;

(e) secular declines in world food prices and weak growth in the United States' traditional Latin American markets since the start of the debt crisis may also point to a need for more exports of manufactures and hence for still greater competitiveness.

5. These arguments, however, do no more than qualify the clear message of the chart that the US now has a very strong competitive position.

U.S. REAL EXCHANGE RATES

1980=100



1982
uses data for: January (avg)
February (avg)
March 16

THE SUSTAINABILITY OF THE DOLLAR

The question of dollar sustainability is essentially whether the path of current account deficits to which the present level of the dollar gives rise are in some sense feasible. If it is infeasible, then the dollar must fall. There are two senses in which the level or path of the current account might be infeasible. Both are related to the ability to finance the deficits, but they differ in the time horizon over which financibility is considered.

"Long-term" sustainability

2. A path for the current account will be ultimately unsustainable if it gives rise to overall levels of external debt which are too large to be financed. In the case of the US, such a position might arise when overseas debt becomes so large relative to GNP that fears emerge amongst foreign lenders about the willingness of the US to service and ultimately to repay the debt. In these circumstances, the US government gradually loses control of its monetary policy, with the exchange rate and US interest rates increasingly determined by overseas creditors.

3. There is an important distinction to be made here between overseas borrowing by the private sector and by the government. To the extent that borrowing is undertaken willingly by the private sector in order to finance investment with a high rate of return, foreign investors have little to fear from an increase in debt. Also, to the extent that the debt is distributed through the economy amongst many individual debtors, the risk of widespread default is minimised.

4. Overseas borrowing by the government, particularly if it is undertaken in order to finance its own current expenditure, is very different from the lenders' point of view. On the one hand, the government is able at the end of the day to raise taxes to repay the debt. On the other hand, the US government is a large individual borrower and has the ability to reduce the burden of debt without defaulting on it through a deliberate policy of inflation and devaluation. For this reason, government debt is

likely to look riskier as the overall debt/income ratio increases. Foreign investors are thus likely to be concerned at the overall level of a country's overseas debt when the burden of that debt reaches high levels, but they will also look at the distribution of the debt and the extent to which it is being used to finance productive assets as against current consumption.

5. It is instructive to look at the overseas debt position of the US compared with that of some other countries. Figures for countries' net overseas liabilities are notoriously unreliable, and it is generally accepted that those for the US underestimate (to an unknown extent) the value of US assets abroad. Hence the published figures overestimate the net liability position of the US. Some commentators even suggest that the US may still be a net creditor. The figures employed here are the IMF's latest estimates.

6. On this basis, the table below shows how US net external liabilities as a proportion of GNP and exports of goods and services compare with two other high debtor countries in the OECD (Canada and Sweden) and with two "problem debtors" (Brazil and Mexico).

	US	Canada	Sweden	Brazil	Mexico
Net external liabilities/ GNP (%)	10	37	25	40	80
Net external liabilities/ exports of goods and services (%)	150	150	100	400	400

In terms of external liabilities as a proportion of GNP, the US has a long way to go to reach the levels of any of these countries. It is interesting to note that Canada has maintained its overseas debt at between 30 and 40 per cent of GNP at least since 1970. As a proportion of exports of goods and services, the US external debt is at least as high as Canada's and Sweden's but well behind Brazil's and Mexico's. As most US borrowing is denominated in dollars, however, this latter measure has less relevance to the US. Looking to the future, most forecasts of the

US current balance, including the WEP, imply a continuing rise in the US debt/GNP ratio of over 2 percentage points per year into the medium-term (ignoring revaluation effects), although the OECD projects only a further 8 percentage point deterioration in the ratio between 1987 and 1993, compared with a 12 point worsening from 1983 to 1987.

7. The above discussion raises the question of the maximum sustainable level of the US external debt/GNP ratio. It could be argued that foreign investors would be prepared to support a higher ratio for the US than that for other debtors, because of the dominant position of the US (and the dollar) in the world economy, and because the US government would be perceived as having both the incentive and the necessary political will to avoid an international debt crisis seen as caused by the US itself and involving the status of dollar assets.

8. On the other hand, most of the US assets held by foreigners are currently denominated in dollars. Although the risk of loss arising from the possibility of default is relatively small, the possibility of dollar depreciation as the overhang of dollar liabilities rises is likely to be a deterrent to investment at an earlier stage in the build-up of debt than would be the case if borrowing were undertaken in other currencies. Secondly, the portfolio position of foreign investors may become a constraint. The US current deficit in 1987 is estimated to have absorbed over 15 per cent of total net saving in the rest of the OECD. Because of the scale of US borrowing, foreign investors may become saturated with claims on the US at a point before they become concerned about ability to repay or risk of default. Thirdly, large scale US borrowing would put the position of the dollar as principal reserve asset of the world financial system under question, and this might deter investors. For all of these reasons, there is likely to be a need for increased borrowing in foreign currencies by the US as the level of debt increases.

9. It is impossible to estimate precisely a sustainable ratio of net external US debt to GNP, although a ratio substantially higher than the present one is likely to be sustainable. On this criterion, there is no reason to believe that the US current

balance must fall to zero very quickly, or indeed at all, as long as nominal GNP continues to rise. It can be shown that the ratio of the current balance to GNP which is sustainable in the long run - in the sense that the external debt/GNP ratio does not rise indefinitely - must be equal to the external debt/GNP ratio times the growth rate of nominal GNP. If for example the sustainable debt/GNP ratio for the US were 30 per cent and nominal GNP continued to grow at 7 per cent, the US could run a permanent current account deficit of about 2 per cent of GNP.

10. This is not to say that a continuing trade deficit would necessarily be sustainable, however. If the US were to run a current account deficit of this size, it would find that a larger and larger proportion of it would be accounted for by payments of interest on the external debt, leaving progressively less and less scope for a deficit on trade account. It can be shown that if the nominal interest rate payable on the external debt is greater than the growth of nominal GNP, a trade surplus would ultimately be necessary. If on the other hand the growth of GNP is greater than the interest rate, then a trade deficit is possible, but this would have to be relatively small. To take a very favourable example, if the interest rate were as much as 2 percentage points lower than nominal GNP growth, and the sustainable debt/GNP ratio 30 per cent, a trade deficit of no more than 0.6 per cent of GNP would be required to prevent the debt/GNP ratio from rising further.

11. The conclusion to be drawn is that while there is no immediate need for drastic action by the US to cut its current account deficit let alone eliminate it on long-term financing grounds, the trade deficit will need to be reduced over a number of years to close to zero as net interest payments abroad rise. The time period over which this adjustment must take place depends on what is thought to be the ratio of US external debt to GNP which is sustainable in the sense of being acceptable to the US authorities and financible by foreign holders of US assets. That level is likely to be considerably higher than the current level of (up to) 10 per cent, but on current forecasts of the US balance of payments and GNP growth with unchanged policies, the debt/GNP

ratio is likely to rise by around 2-3 percentage points each year, and could reach a level which would be difficult to finance on a long-term basis before the turn of the century.

"Short-term" sustainability

12. In addition to the previous discussion of sustainability in relation to the stock of assets and liabilities, there is the question of whether the current account deficits forecast for the next two or three years can be financed on a flow basis at interest rates and exchange rates which are compatible with growth and inflation objectives in the US and the rest of the world. The key to the financing of the US deficits over the next few years will lie with the Japanese, whose outflow of long-term capital accounted for 80-90 per cent of the US current account deficit in 1986 and 1987.

13. The size of the US deficit appears now to be declining in nominal terms, and on most forecasts is expected to continue declining, at least as a proportion of GNP, over the next two or three years. Furthermore, large gross and net capital outflows from Japan are likely to continue. The Japanese current account is expected to remain in substantial surplus and the corresponding private sector capital outflows from Japan are likely to remain high given the high Japanese saving ratio and the low propensity to import. On the other hand, the US current account deficit in 1987 was partly financed by very large quantities of official intervention which cannot be sustained for long without unacceptable consequences. To replace these flows, private sector flows must increase. This will require an improvement in the relative rate of return to investment in the US compared with that prevailing in 1987.

14. It is not clear whether the US will remain the most favoured destination for Japanese capital flows. There are several relevant factors:

- i. it is often argued that Japanese investors are relatively unsophisticated and cautious, with the result that they are unwilling to switch to new and unfamiliar markets despite

higher yields. In addition, some institutional investors may have doubts about the liquidity of European markets and hence their ability to handle the very large transactions which such investors prefer. It is difficult to evaluate these arguments. They are unlikely to hold over a long period in the face of persistently higher yields elsewhere, though they may hold over the short-term;

- ii. the US economy continues to offer a wide range of profitable investment opportunities, and returns to investment are high relative to other OECD economies (outside Japan);
- iii. now that the dollar is low relative to its recent experience, US assets are cheap to Japanese (and indeed other) investors;
- iv. the relative risk of dollar depreciation is now less than it has been over the past three years. Japanese investors continued to invest massively in the US during 1986 and 1987 despite both an exchange rate for the dollar which was falling rapidly and widely expected (until the Louvre accord) to continue to fall and an interest differential which was not on average markedly higher than it is now;
- v. the reluctance of the US authorities to give a high priority to stabilising the dollar - preferring to give a higher weight to maintaining an easy monetary policy - puts financing by Japanese and other inflows at risk.

EXCHANGE RATE THE FOCAL POINT FOR POLICY CO-ORDINATION

Historical examples:

- (i) Bretton Woods
- (ii) EMS
- (iii) Louvre Accord

2. In all these, policy co-ordination centred on exchange rates, with rules for exchange rate bands, a degree of agreement on who intervenes when, and a commitment to give weight to exchange rates in setting monetary policy.

3. Explicit co-ordination has always been needed to set up an exchange rate system; and then close co-ordination on intervention and monetary policy. There has been much less explicit co-ordination over fiscal policy which must be consistent with the needs of exchange rate and monetary policies. Hence policy co-ordination has often included references, and sometimes commitments, to fiscal policy.

4. Attempts to make fiscal policy deals the centrepiece of policy co-ordination have, however, been few and generally not successful. Bonn I (1978) produced a fiscal expansion in Germany and Japan which was ill-timed and inadvisable in the light of:

- (i) the rate of expansion of the world economy, and of those two countries in particular, in 1978; and
- (ii) the 1979 and subsequent rise in oil prices and in inflation.

5. Fiscal policy co-ordination has often carried the flavour of global demand management, without full recognition of the many difficulties. Moreover, the setting of fiscal policy in a medium term framework - e.g the MTFS - does not require fiscal policy co-ordination.

6. Not surprising that fiscal co-ordination is much more difficult than exchange rate co-ordination:

(i) Exchange rates are a point at which economies interact; not so fiscal policies.

(ii) With institutional arrangements varying greatly between countries, e.g on the extent of the powers and coverage of central government and local authorities, important practical difficulties in Finance Ministers signing up to policy changes in their country in exchange for policy changes elsewhere, e.g the difficulty of estimating budget balances at the start of the fiscal year and hence forecasting correctly what the stance of fiscal policy will be - recent experience of the US, Japan and UK provides ample evidence on this;

(iii) The links between fiscal policy changes and the aims of policy co-ordination are both ill understood and not robust. The effects of changes in budget balances on the economy and current account will depend on how domestic saving and investment react, which can be hard to predict, e.g the fall in the US Federal budget deficit in FY1987 was offset by a fall in private saving and so did not produce a commensurate fall in the current account deficit.

6. With regard to fiscal policy we should not seek to go beyond the usual multilateral surveillance discussions and the sort of commitment in G7 statements to date. In the end, fiscal policy has to be left to each individual country to implement in the light of overall objectives.

FROM: A BOTTRILL

DATE: 21 March 1988

SIR PETER MIDDLETON

cc: PPS

Sir T Burns
Sir G Littler
Mr Sedgwick
Mr P Davis

A handwritten signature in black ink, possibly 'PPS', with a red checkmark to its left.

FEBRUARY TRADE FIGURES

In view of the poor trade figures for February which are to be published on 25 March, I went down to Southend on Friday for a detailed discussion with Customs statisticians about the quality of the data. A major concern is that the introduction of new Customs procedures on 1 January may have affected the recording of trade flows adversely in the early weeks of the year. The figures for January and February - taken together - show a 9 per cent fall in the value of exports since the fourth quarter of last year while imports have fallen by 3 per cent.

2. The export figures in particular are difficult to reconcile with other evidence. The CBI survey for January for example reported a positive balance of firms planning to increase export deliveries in the current period. Exporters also reported order books at above average levels. Manufacturing output in the period November to January rose by 1 per cent over the previous three months which hardly seems consistent with a sharp fall in exports.

3. Data for exports reach Customs in three ways. The most reliable is perhaps the information entered directly by traders to the Customs computer or sent periodically by tape. These cover only 10 per cent of total exports but show the value of exports on average in January and February some 12 per cent higher than a year earlier. No significant problems with the new procedures have been reported.

4. The bulk of exports, however, are still recorded through pre-shipment documents collected at the ports and sent to Customs. These account for about two-thirds of exports. Errors in these documents were exceptionally high in early January causing some delays to shipments but Customs sorted out the errors and all documents were processed in both the January and February accounting months. Nevertheless, exports recorded in this way were about 4 per cent lower on average in January and February than a year earlier and it is possible that there was some backlog of shipments. Customs, however, can find no firm evidence. We have asked DTI to check with freight-forwarders.

5. The final method of collecting export data is from post-shipment documents, which cover about 25 per cent of total exports. Under this system, traders are allowed to ship goods on the basis of a summary document but have to send Customs full documentation within 14 days. Exports recorded by this method were some 14 per cent lower in January and February than a year earlier. We have asked Customs to check urgently on the extent to which pre-shipment forms have been fully matched by post-shipment documents and any delays in receiving these.

6. At Customs statistical office in Southend, processing of the raw data caused keying difficulties initially for computer operators because of the poor design of the new SAD form. These were tackled, however, by overtime working and the employment of extra staff so that all documents were processed on time. Validation and credibility checks on the data showed a sharp rise in errors in January but these were all tackled, and the error rate fell back in February. Customs officials are confident that any remaining errors are probably small and affect mainly the detailed classification of commodities rather than the global value of exports.

7. Apart from any difficulties with the new Customs procedures, it is possible that exports have been delayed by a number of other factors so far this year. These included gales in January, the ferry stoppages in February and the renewed ferry disputes in the most recent period. We have no quantification of any of these but have asked Customs to investigate fully at the ports and DTI to question their industry contacts.

8. At this stage it is possible only to speculate that the introduction of the new Customs procedures, gales and strikes may all have contributed in some measure to the low export figures but it is also possible that the underlying export picture is sluggish. The FSRB forecast, for example, already projected a small fall in exports in the first quarter of 1988 followed by a very flat path through the rest of the year. This reflected partly falling oil exports but also a relatively flat prospect for other exports as a result of modest world trade growth and lost competitiveness.

9. Any effect of the new Customs procedures on the recording of imports seems likely to have been less severe than on exports since 85 per cent of import information is entered to the Customs computer either directly by traders or by tape. Only 15 per cent is recorded by manual documentation. Customs have had some minor validation and credibility problems with imports but these have apparently been solved satisfactorily.

10. Any effect on the import figures, therefore, is likely to have stemmed more from difficulties at Continental ports rather than here in the UK. French and Dutch Customs apparently had computer problems but we cannot quantify any effect on the UK. Imports will have suffered like exports from gales in early-January. They may also have been affected by the ferry disputes in early-February and in the latest period. All these factors, however, would point to the underlying level of imports being higher rather than lower than recorded in January and February taken together.

11. I am sorry that this does not amount to a clearer picture of underlying trade trends. It seems likely that the monthly export and import figures may remain distorted at least up to April, and it may be June or July before we can be confident of our true performance in the early part of the year. We are to see Customs and DTI again tomorrow, and will report any further information in the normal monthly briefing note for the Chancellor.

AB/Anu

A BOTTRILL



HP-

Treasury Chambers, Parliament Street, SW1P 3AG

01-930 1234

Ch/ Mixed reactions in the French press,
varying from "un budget en or, réalisant
le rêve impossible de tout ministres des
finances" (Le Monde) via "un miracle
raisonnable" (Le Figaro) to worries of
overheating in La Tribune de l'Expansion
and Les Échos.

BSK
Le Monde
for me. 2/3
HP



**PRESS
AND
INFORMATION SERVICE**

BE 23/3 Janp
THE PRIVATE SECRETARY
TO THE
CHANCELLOR OF THE
EXCHEQUER

CENTRAL STATISTICAL OFFICE

GREAT GEORGE STREET
LONDON
SW1P 3AQ

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

CSO (88) 24

22 March 1988

RELEASE DATES OF ECONOMIC STATISTICS IN MARCH AND APRIL

This is issued by the CSO on behalf of the Government Statistical Service and other organisations as a guide to the publication dates of major economic series in **April**. It also includes the release dates for the remainder of **March**. Exceptionally there may be some delays due to unavoidable statistical problems. Enquiries about the release of individual series should be made to the source named.

Publication Date	Series	Method and time of release	Source
MARCH Mon 21	Manufacturers' and distributors' stocks (4th qtr - rev)	PN (11.30)	DTI
Tues 22	Cyclical indicators for the UK economy (Feb)	PN (11.30)	CSO
Wed 23	Construction - new orders (Jan - prov)	PN (11.30)	DOE
Thurs 24	Personal income and expenditure (4th qtr)	PN (11.30)	CSO
	Industrial and commercial companies (4th qtr)	PN (11.30)	CSO

PN = Press Notice



020

Publication Date	Series	Method and time of release	Source
MARCH (Cont'd)			
Fri 25	Engineering indices of production and orders (Jan)*	BB (00.30)	DTI
	Balance of payments current account and overseas trade figures (Feb)	PN (11.30)	DTI/CSO
	Tax and price index (Feb)	PN (11.30)	CSO
	Retail prices index (Feb)	PN (11.30)	DE
Mon 28	CBI Monthly Trends Enquiry (March)	PN 00.30	CBI
	Food facts (4th qtr)	PN 00.01	MAFF
Tues 29	London sterling certificates of deposit (Feb)	PN (11.30)	Bank of England
	Bill turnover statistics (Feb)	PN (11.30)	Bank of England
	UK banks' assets and liabilities and the money stock (Feb)	PN (11.30)	Bank of England
	Sterling commercial paper (Feb)	PN (11.30)	Bank of England
Wed 30	New vehicle registrations (Feb)	PN (11.30)	DTp
Thurs 31	Energy trends (Jan)	PN (11.30)	Dept of Energy

PN = Press Notice

BB = British Business

* = Not announced in previous diary.

Publication Date	Series	Method and time of release	Source
APRIL Tues 5	Retail sales (Feb - final)	PN (11.30)	DTI
	Credit business (Feb)	PN (11.30)	DTI
Wed 6	UK official reserves (March)	PN (11.30)	HMT
	Advance energy statistics (Feb)	PN (11.30)	Dept of Energy
	Housing starts and completions (Feb)	PN (11.30)	DOE
	Capital issues and redemptions (Mar)	PN (14.30)	Bank of England
	Detailed analysis of employment unemployment, earnings, prices and other indicators	EG (21.00)	DE
Fri 8	Finished steel consumption and stock changes (4th qtr-final)	BB (00.30)	DTI
	Import penetration and export sales ratios for manufacturing industries (3rd qtr-final, 4th qtr-prov)	BB (00.30)	DTI
Mon 11	Producer price index numbers (Mar-prov)	PN (11.30)	DTI
Tues 12	Quarterly analysis of bank advances (Feb)	PN (11.30)	Bank of England
Thurs 14	Institutional investment * (3rd qtr)	PN (11.30)	Bank of England
	Provisional figures of vehicle production (Mar)	PN (11.30)	DTI

PN = Press Notice
BB = British Business
EG = Employment Gazette

* = provisional

Publication Date	Series	Method and time of release	Source
APRIL (Cont'd)			
Fri 15	Usable steel production (Mar)	PN (00.30)	BSC/BISPA
	Labour market statistics : unemployment and vacancies (Mar-prov); average earnings indices (Feb-prov); employment, hours, productivity and unit wage costs; industrial disputes	PN (11.30)	DE
	Tax and price index (Mar)	PN (11.30)	CSO
	Retail prices index (Mar)	PN (11.30)	DE
	Index of output of the production industries (Feb)	PN (11.30)	CSO
Sun 17	National Savings monthly progress report (Mar)	PN (00.30)	Dept for National Savings
Mon 18	CBI/FT Survey of distributive trades (Mar)	PN (00.30)	CBI
	Retail sales (Mar - prov)	PN (11.30)	DTI

PN = Press Notice

Publication Date	Series	Method and time of release	Source
APRIL (Cont'd)			
Tues 19	Building societies monthly figs (Mar)	PN (11.30)	BSA
Wed 20	Index of production and construction for Wales (4th qtr)	PN (10.30)	Welsh Office
	Public Sector Borrowing Requirement (Mar)	PN (11.30)	HMT/CSO
Thurs 21	London and Scottish banks monthly statement (Mar)	PN (11.30)	CLSB
	Cyclical indicators for the UK economy (Mar)	PN (11.30)	CSO
	Provisional estimate of monetary aggregates (Mar)	PN (11.30)	Bank of England
Fri 22	Building societies monthly figures (Mar)	PN (11.30)	BSA
	Preliminary estimate of consumers' expenditure (1st qtr-prov)	PN (11.30)	CSO
Tues 26	CBI Industrial Trends Survey (2nd qtr)	PN (11.30)	CBI
Wed 27	Construction - new orders (Feb)	PN (11.30)	DOE
	Bricks and cement production and deliveries (1st qtr-prov)	PN (11.30)	DOE

PN = Press Notice

Publication Date	Series	Method and time of release	Source
APRIL (Cont'd)			
Thurs 28	Quarterly house purchase finance statistics (1st qtr)	PN (11.30)	CLSB
	Energy trends (Feb)	PN (11.30)	Dept of Energy
	New vehicle registrations (Mar)	PN (11.30)	DTp
Fri 29	Engineering indices of production and orders (Feb)	BB (00.30)	DTI
	Balance of payments current account and overseas trade figures (Mar)	PN (11.30)	DTI/CSO
	London sterling certificates of deposit (Mar)	PN (11.30)	Bank of England
	Bill turnover statistics (Mar)	PN (11.30)	Bank of England
	UK banks assets and liabilities and the money stock (Mar)	PN (11.30)	Bank of England
	Sterling commercial paper (Mar)	PN (11.30)	Bank of England

BB = British Business

PN = Press Notice

FROM: **MRS M HENSON**

DATE: 23 MARCH 1988

CHANCELLOR'S OFFICE	12/2	
CST OFFICE	36/2	
FST OFFICE	43A/2	
EST OFFICE	52/2	
SIR P MIDDLETON	78A/2	
MR SCHOLAR	87/2	
MR CULPIN	90/1	
MR PICKFORD	97/2	
MR P SEDGWICK	39/3	
MR J ODLING-SMEE	45/2	
MR R I G ALLEN	93/2	
MISS SINCLAIR	89/1	
MISS O'MARA	109/G	
MR S BROOKS	43/3	
MR A HUDSON	13/2	
MS C EVANS	44/1	
MR PATTERSON	98/2	
MISS SIMPSON	99/2	
MR H BUSH	95/2	
MR J CARR	112/G	
MS S WALKER	97/3	
MR MILLS	42/3	
MR N HOLGATE	110/G	
MR CURWEN	98/2	
MR S PRICE	41/3	
MR BUCKLEY	90/2	
MS HATTER	112/2	
MR CROPPER	17/2	
MR TYRIE	15A/2	
MR M CALL	117/2	
THE DUTY CLERK	10 DOWNING STREET	
MR J WHITTINGDALE	10 DOWNING STREET	
MR J R CALDER	I/R SOMERSET HOUSE	
MR D H ROBINSON	DEPT OF FINANCE AND PERSONNEL ECONOMICS	
	DIVISION RM 249A STORMONT BELFAST 3S15	
MR P MAKEHAM	DTI Rm 601c 1-19 VICTORIA STREET LONDON SW1	
MR T BIRD	RM 536A, DHSS, NEW COURT, CAREY STREET,	
	LONDON SE1	
MR N BAXTER	DEPT. OF EMPLOYMENT EPA1 LEVEL 5 CAXTON	
	HOUSE TOTHILL STREET LONDON SW1	

pp

RELEASE DATES FOR ECONOMIC STATISTICS IN APRIL

I attach the release dates for economic statistics in April.

- Any enquiries please contact Mrs Henson on 270-5212, 99/2 HM Treasury.

Meena Henson
MEENA HENSON

RELEASE DATES OF ECONOMIC STATISTICS IN APRIL 1988WEEKS 1 & 2

Tuesday	5	11.30	Retail Sales (Feb-final)
"	"	"	Credit business (Feb)
Wednesday	6	11.30	UK official reserves (March)
"	"	"	Housing starts and Completions (Feb)
"	"	21.00	Employment Gazette
Monday	11	11.30	Producer Price index numbers (Mar-prov)
Friday	15	11.30	Labour Market Statistics: unemployment and vacancies (Mar-prov); average earnings indices (Feb-prov); employment hours, Productivity and unit wage costs; industrial disputes
"	"	"	Tax and Price index (Mar)
"	"	"	Retail Price Index (Mar)
"	"	"	Index of output of the production industries (Feb)

WEEK 3

Monday	18	11.30	CBI/FT Survey of distributive trades (Mar)
"	"	"	Retail Sales (Mar-prov)
Wednesday	20	11.30	Public Sector Borrowing Requirements (Mar)
Thursday	21	11.30	Cyclical indicators for the UK economy (Mar)
"	"	"	Provisional estimate of monetary aggregates (Mar)
Friday	22	11.30	Building Societies monthly figures (Mar)
"	"	"	Preliminary estimate of consumers' expenditure (1st qtr-prov)

WEEK 4

Tuesday	26	11.30	CBI Industrial Trends Survey (2nd qtr)
Wednesday	27	11.30	Construction - new orders (Feb)
Friday	29	11.30	Balance of Payments Current account and overseas trade figures (Mar)
"	"	"	UK banks assets and liabilities and the money stock (Mar)

Mrs M Henson
 HM Treasury
 1 Parliament Street
 London SW1P 3AG
 01-270-5212

BF 2913
2013
FROM: MISS M P WALLACE

DATE: 23 March 1988

MR CULPIN

cc Sir T Burns
Mr Scholar
Mr R I G Allen**PRESS BRIEFING FOR ECONOMIC/FINANCIAL CORRESPONDENTS, 16 MARCH**

The Chancellor has seen your manuscript note on Mr Allen's minute of 17 March. He has pointed out that, if the UEL were to be removed, it would not be necessary to cut the top rate to 31 per cent to avoid higher marginal rates for higher rate taxpayers - it would simply require cutting the 40 per cent rate to 30 per cent, 45 per cent to 35 per cent, 50 per cent to 40 per cent, and abolishing the 55 per cent and 60 per cent rates. He thinks it may have been something like this that his questioner had in mind. A propos of this, he has asked how many people there actually are in the kink.

A handwritten signature in cursive script, appearing to read 'mpw.'.

MOIRA WALLACE

RESTRICTED



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

24 March 1988

Stephen Ratcliffe
PS/Secretary of State
Department of Trade and Industry
1-19 Victoria Street
London SW1

Dear Stephen,

LINE ON EXCHANGE RATES ETC

Thank you for your letter this morning. The Chancellor feels strongly that your reformulation will not do: both your first and third paragraphs would lead to a further series of hugely damaging press stories and headlines.

2. If the original was too long, the Chancellor feels that ... Lord Young could omit the sentences marked on the attached copy.

*Yours
Alex*

A C S ALLAN

LINE ON EXCHANGE RATES ETC

Exchange rate policy

The UK, along with other major industrial countries, is committed to seeking greater exchange rate stability. [~~Instability in exchange rates is damaging for British industry, and for exporters in particular.~~] But exchange rate stability does not mean immobility, and adjustments are needed from time to time. The Government never comments on exchange market tactics.

Industry has welcomed the greater exchange rate stability over the past year. But it is important that it also accepts the financial discipline inherent in this policy. The Government is not prepared to accommodate increases in domestic costs by allowing the exchange rate to depreciate. [~~Firm financial policies are needed to keep downward pressure on inflation. The greatest threat to output and employment would come if the Government relaxed its anti-inflationary stance.~~]

Interest rate policy?

Interest rates are set at the level necessary to ensure downward pressure on inflation. There is no evidence whatever that the present level of interest rates is damaging British industry: DTI's Investment Intentions Survey indicates 11 per cent growth in manufacturing investment in 1988, and this prospect is confirmed by recent CBI Surveys.

Competitiveness

The consistent trend of the 1980s has been that British manufacturers have maintained their share of an expanding world trade, after decades during which Britain's share was steadily declining. This is the crucial test of competitiveness.



the department for Enterprise

RESTRICTED

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

Alex Allan Esq
Principal Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street SW1P 3AG

Department of
Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Ch
*This is either sabotage
or incredible naivety*

AA

("too long & technical")

Direct line 215 5422
Our ref DC4AIJ
Your ref
Date 24 March 1988

Dear Alex,

LINE ON EXCHANGE RATES ETC

We spoke this morning about your letter of 23 March to Jeremy Godfrey when I explained that Lord Young did not feel the suggested line to take you had proposed entirely fitted the bill. He was especially concerned about this given that he is to appear on 'Any Questions' tomorrow with Tony Blair MP.

We have tried our hand at a possible line to take here and I am attaching this for your comments. It would be helpful if we could have these by close of play tonight.

Yours ever

Step Ratcliffe.

STEPHEN RATCLIFFE
Private Secretary

** RM ① & ②
dynamics & how
word is a further
step of
press stories
& headlines*

** This is 20 RTI forward
* unknown
to unacceptably
by mistake to accept
the form of words I gave
him. If he says he
can't see the
RTI A-13*

Points on exchange rate policy

1. Exchange rate policy has to be shrouded in a certain amount of mist anyway - markets can react strongly to evident government intervention - and even to Ministerial statements - and so undermine the policy.]

2. Government recognises industry's desire to avoid [wild] fluctuations in the value of the pound - that is why we are working with other governments to keep the value of our currencies more stable.

3. But government cannot guarantee a stable pound - its value inevitably reflects what world markets think about such things as the strength of the UK economy and the level of our interest rates.]

2. Stability does not mean immobility and adjustments are needed from time to time. It is best for market tactics to be shrouded in a certain amount of mist.

3. Government is fully committed to defeating inflation, & that requires firm financial policies. Greatest threat to industry would come if Government relaxed anti-inflationary stance.

Economist Commodity Price Indices

1985=100

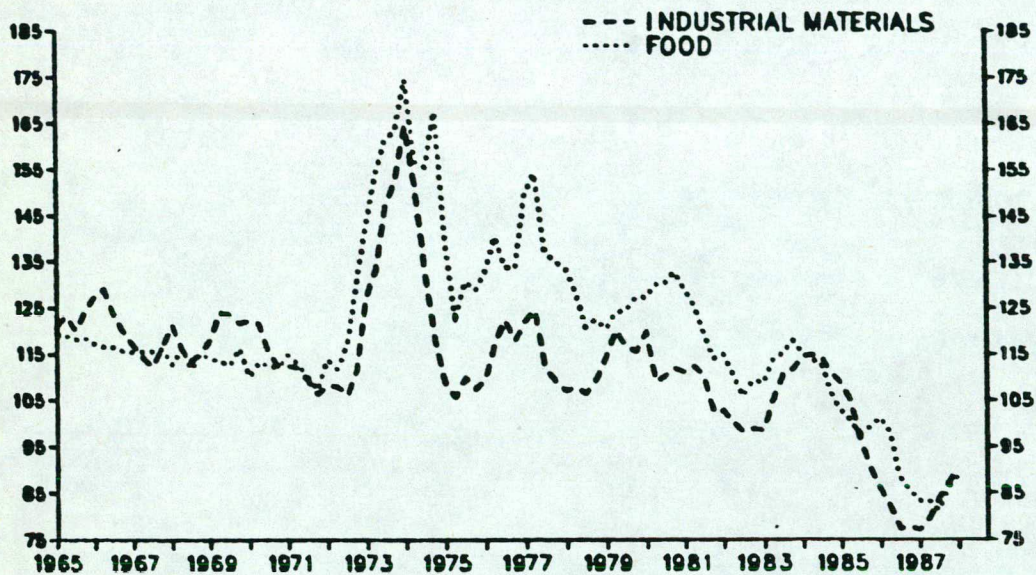
Annual	<u>All items indices</u>				<u>SDR indices</u>		
	SDR	Dollar	Sterling	Real*	Food	Nfa**	Metals
1980	104.4	133.7	74.0	115.6	96.7	106.2	118.6
1981	99.3	115.2	73.5	105.3	93.7	104.7	106.2
1982	91.8	99.9	73.4	94.3	89.3	96.0	93.8
1983	107.2	112.7	95.7	110.4	102.0	116.6	110.1
1984	110.3	111.5	107.2	113.1	112.3	111.6	106.2
1985	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1986	89.8	103.7	90.6	86.4	92.4	89.9	85.4
1987	87.4	111.5	87.1	82.2	73.0	103.3	100.6
<u>Quarterly</u>							
1986 Q3	84.6	100.2	86.2	81.8	85.1	85.5	83.1
Q4	84.2	100.1	89.5	80.2	82.2	91.0	82.8
1987 Q1	81.0	100.8	83.5	76.5	73.2	95.2	84.3
Q2	84.9	108.2	84.4	80.0	73.2	102.6	92.1
Q3	90.2	113.4	90.0	83.8	70.7	111.9	108.0
Q4	93.4	123.7	90.3	88.4	74.7	103.3	117.9
1988 Q1	99.8	134.6	95.9	94.6	77.6	105.5	133.4
Q2	115.5	155.7	108.8	107.6	84.0	115.1	169.1
<u>Monthly</u>							
June	86.7	109.7	86.3		73.4	105.9	95.7
July	89.3	111.5	88.9		71.9	109.4	104.4
August	91.4	114.2	91.8		69.6	115.0	111.7
September	90.1	114.5	89.3		70.7	111.4	107.9
October	93.5	119.3	92.3		74.2	106.8	117.0
November	91.3	121.3	88.1		74.2	101.4	113.3
December	94.8	129.1	90.5		75.6	102.1	122.4
January	97.4	132.2	94.1		78.1	102.7	126.6
February	98.2	131.2	95.6		78.0	106.5	126.7
March	103.8	140.3	98.0		76.8	107.3	147.0
April	106.4	144.9	99.1		77.3	110.5	152.8
May	113.4	153.8	105.7		80.9	114.1	168.2
June (prov)	126.6	168.4	121.6		93.9	120.8	186.4
<u>Weekly</u>							
April	12	106.6	144.3	99.9	77.6	110.4	153.3
	19	103.1	140.8	95.3	76.9	110.6	142.0
	26	105.0	143.0	97.8	77.6	111.8	146.5
May	3	104.9	142.6	97.7	77.0	111.2	147.7
	10	109.6	149.2	101.6	79.0	111.3	160.5
	17	116.6	158.3	108.9	81.4	112.4	179.4
	24	115.7	156.8	107.6	82.8	115.7	171.5
	31	120.4	161.9	112.8	84.1	120.0	182.1
June	7	128.1	172.1	121.8	90.0	120.3	198.4
	14	124.3	166.8	119.8	89.1	119.1	187.8
	21	131.5	174.6	125.3	97.6	121.5	196.3
	28(prov)	122.6	160.1	119.4	99.0	122.1	163.1
% change on one year		+41.2	+46.5	+37.5	+36.5	+13.7	+69.1

* In relation to prices of manufactured exports. Recent figures are estimated.

** Non-food agriculturals.

CHART A : REAL COMMODITY PRICES *

UN INDEX, 1985=100

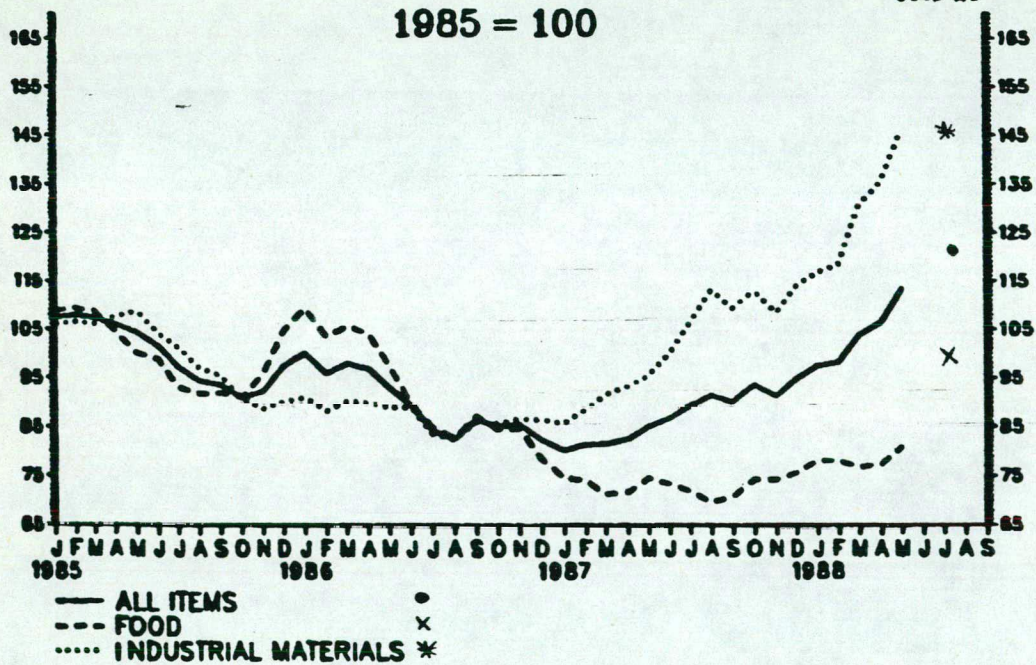


* IN RELATION TO PRICES OF MANUFACTURES

CHART B : ECONOMIST SDR COMMODITY PRICE INDICES

1985 = 100

JUNE 28



Economist Commodity Price Indices

1985=100

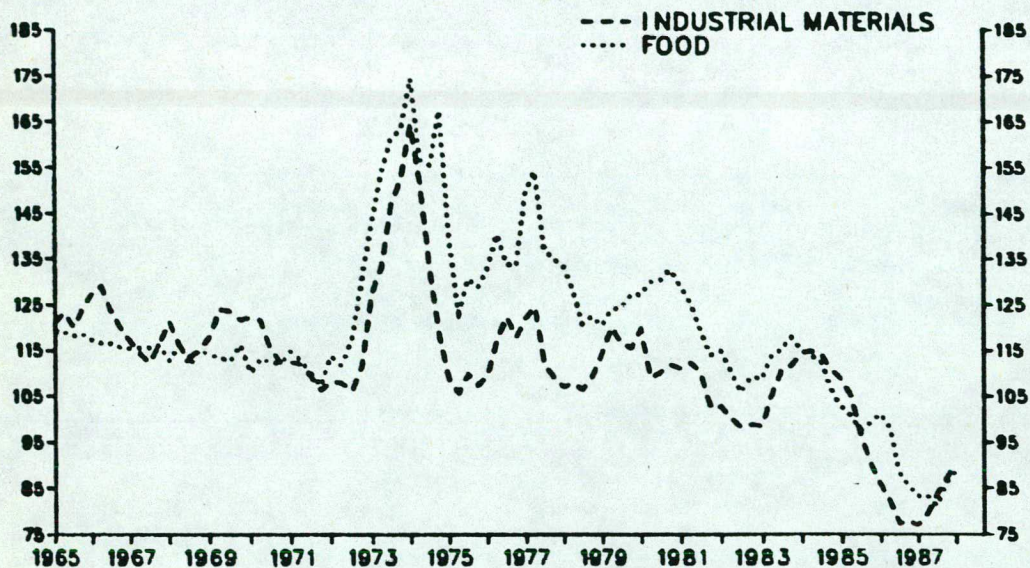
Annual	<u>All items indices</u>				<u>SDR indices</u>		
	SDR	Dollar	Sterling	Real*	Food	Nfa**	Metals
1980	104.4	133.7	74.0	115.6	96.7	106.2	118.6
1981	99.3	115.2	73.5	105.3	93.7	104.7	106.2
1982	91.8	99.9	73.4	94.3	89.3	96.0	93.8
1983	107.2	112.7	95.7	110.4	102.0	116.6	110.1
1984	110.3	111.5	107.2	113.1	112.3	111.6	106.2
1985	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1986	89.8	103.7	90.6	86.4	92.4	89.9	85.4
1987	87.4	111.5	87.1	82.3	73.0	103.3	100.6
<u>Quarterly</u>							
1986 Q3	84.6	100.2	86.2	81.8	85.1	85.5	83.1
Q4	84.2	100.1	89.5	80.2	82.2	91.0	82.8
1987 Q1	81.0	100.8	83.5	76.5	73.2	95.2	84.3
Q2	84.9	108.2	84.4	80.0	73.2	102.6	92.1
Q3	90.2	113.4	90.0	85.3	70.7	111.9	108.0
Q4	93.4	123.7	90.3	87.0	74.7	103.3	117.9
1988 Q1	99.8	134.6	95.9	93.3	77.6	105.5	133.4
<u>Monthly</u>							
June	86.7	109.7	86.3		73.4	105.9	95.7
July	89.3	111.5	88.9		71.9	109.4	104.4
August	91.4	114.2	91.8		69.6	115.0	111.7
September	90.1	114.5	89.3		70.7	111.4	107.9
October	93.5	119.3	92.3		74.2	106.8	117.0
November	91.3	121.3	88.1		74.2	101.4	113.3
December	94.8	129.1	90.5		75.6	102.1	122.4
January	97.4	132.2	94.1		78.1	102.7	126.6
February	98.2	131.2	95.6		78.0	106.5	126.7
March	103.8	140.3	98.0		76.8	107.3	147.0
April	106.4	144.9	99.1		77.3	110.5	152.8
May	113.4	153.8	105.7		80.9	114.1	168.2
<u>Weekly</u>							
April	5	110.9	151.6	103.4	77.0	109.2	169.6
	12	106.6	144.3	99.9	77.6	110.4	153.3
	19	103.1	140.8	95.3	76.9	110.6	142.0
	26	105.0	143.0	97.8	77.6	111.8	146.5
May	3	104.9	142.6	97.7	77.0	111.2	147.7
	10	109.6	149.2	101.6	79.0	111.3	160.5
	17	116.6	158.3	108.9	81.4	112.4	179.4
	24	115.7	156.8	107.6	82.8	115.7	171.5
	31	120.4	161.9	112.8	84.1	120.0	182.1
June	7	128.1	172.1	121.8	90.0	120.3	198.4
	14	124.3	166.8	119.8	89.1	119.1	187.8
	21	131.4	174.4	125.2	97.6	120.8	196.3
% change on one year		+51.6	+60.5	+43.8	+33.8	+13.1	+105.4

* In relation to prices of manufactured exports. Recent figures are estimated.

** Non-food agriculturals.

CHART A : REAL COMMODITY PRICES *

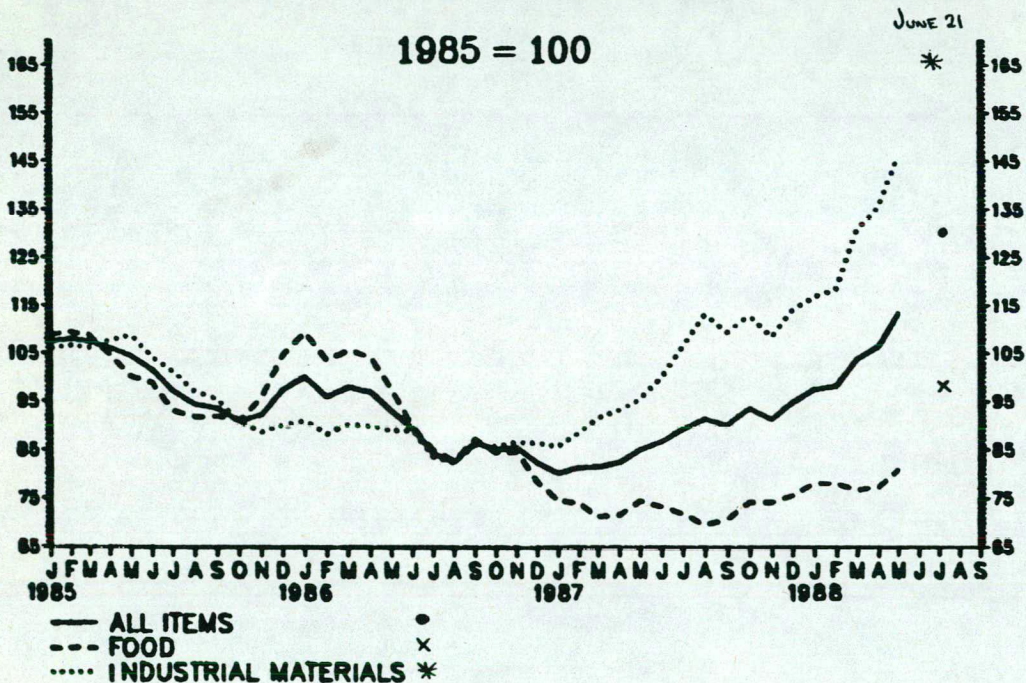
UN INDEX, 1985=100



* IN RELATION TO PRICES OF MANUFACTURES

CHART B : ECONOMIST SDR COMMODITY PRICE INDICES

1985 = 100



covering SECRET

pus

FROM: MISS M O'MARA

DATE: 24 March 1988

PRINCIPAL PRIVATE SECRETARY

cc Sir P Middleton
Sir T Burns
Mr Peretz

MG BRIEFING PACK

As requested, I attach a briefing pack covering:

*(ht
is useful
material)*

- (i) exchange rate movements;
- (ii) interest rate movements;
- (iii) monthly changes in the monetary aggregates;
- (iv) intervention by UK and others;
- (v) currency composition of UK reserves;
- (vi) funding.

MOM

MISS M O'MARA

12 Month growth rates of monetary aggregates, unadjusted.

Date	M0	NIBM1	M1	M2	M3	M4	M5
Feb 87	4.1	10.4	21.2	12.0	18.9	13.9	13.3
Mar	3.5	10.2	22.5	12.2	18.9	13.9	13.5
Apr	5.3	11.7	23.1	12.4	20.4	14.6	14.1
May	4.4	11.9	23.5	12.4	18.9	13.7	13.4
Jun	4.2	13.4	23.6	11.9	19.1	13.8	13.5
Jul	5.3	12.3	22.6	10.5	20.9	14.9	14.4
Aug	4.5	12.2	23.7	10.7	22.1	15.6	14.9
Sep	5.2	6.0	20.3	10.0	19.5	14.9	14.4
Oct	5.5	11.9	24.7	9.6	22.4	15.8	15.2
Nov	4.9	10.6	21.8	10.8	21.4	15.2	14.7
Dec	4.2	10.5	22.8	10.4	22.8	16.3	15.8
Jan 88	4.8	11.9	21.7	11.7	22.4	16.6	16.3
Feb	5.3	12.0	20.5	12.7	20.4	16.0	15.5

MONEY
SUPPLY

SECRET

UK MARKET INTERVENTION (SPOT AND FORWARD) 1987 TO
CLOSE MARCH 24 1988

	<u>Spot</u>	<u>Forward</u>	<u>\$ million equivalent</u> <u>Total</u>
<u>1987</u>			
January	+ 538	- 2	+ 536
February	+ 523	- 2	+ 521
March	+ 4348	-	+ 4348
April	+ 5071	-	+ 5071
May	+ 7633	-19	+ 7614
June	+ 36	-	+ 36
July	+ 1077	-	+ 1077
August	- 515	- 9	- 524
September	+ 1560	- 2	+ 1558
October	+ 8316	- 4	+ 8312
November	+ 115	+63	+ 178
December	<u>+ 4905</u>	<u>-</u>	<u>+ 4905</u>
1987 Sub-Total	+33607	+25	+33632
<u>1988</u>			
January	- 7	-	- 7
February	+ 49	- 2	+ 47
March 1-close on 24	<u>+ 2790</u>	<u>-</u>	<u>+ 2790</u>
1988 Sub-Total to date	<u>+ 2832</u>	<u>- 2</u>	<u>+ 2830</u>
Grand Total	<u><u>+36439</u></u>	<u><u>+23</u></u>	<u><u>+36462</u></u>

UK
INTER-
VENTION

SECRET

SECRET AND PERSONAL

FUNDING : FINANCIAL YEAR POSITION 1987/88

23/3/88

£ million

FUNDING

	FORECAST ----- Financial Year 87/88	OUTTURN ----- April 87 - Feb 88	RESIDUAL ----- March 88
PSBR AND FUNDING TARGET			
1 PSBR excl asset sales	1370	-2321	3691
2 Asset sales (sales-)	-5070	-5078	8
	-----	-----	-----
3 PSBR	-3700	-7399	3699
FINANCED BY:			
4 OPS debt sales to nbps (sales-)	1444	1294	150
5 National Savings (sales-)	-2000	-1837	-163 * -163
6 CTDs (sales-)	91	41	50
7 Treasury bills etc (sales-)	-73	-73	0
8 Intervention (reserves inc+)	11530	10030	1500
9 Public sector externals excl intervention and gilts (inc-)	464	464	0
	-----	-----	-----
10 NET GILT SALES TO NBPS & OVERSEAS NEEDED FOR FULL FUND (sales+)	7756	2520	
11 Adjustment for 1986/87 underfund	318		
12 OVER(-)/UNDER(+) FUNDING	-318	-5693	5375
GILT SALES:			
13 Net purchases by nbps and overseas (purchases+)	8074	8213	-139
14 Net purchases by monetary and other public sector (purchases+)	-632	-532	-100
15 Maturities	6950	5460	1490
	-----	-----	-----
16 GROSS OFFICIAL SALES	14392	13141	1251
17 Monthly average gross gilt sales	1199	1195	1251

* average per month

Relationship between lines:

$$\begin{aligned}
 3 &= 1 + 2 \\
 10 &= 3+4+5+6+7+8+9 \\
 12 &= 10 + 11 - 13 \\
 16 &= 13 + 14 + 15
 \end{aligned}$$

Note

Gross gilt sales in
March so far £0.3bn

giving underfund for
financial year of £0.9bn
if no further sales.

CONFIDENTIAL

Chancellor

c. Sir P Middleton
 Mr Sedgwick
 Mr Hibberd
 Mr Price

FROM: S PRICE

DATE: 25 March 1988

You will be interested to look at this
 review of last year's forecasts.

SIR TERENCE BURNS

cc Mr Sedgwick
 Mr Hibberd

MONTHLY PATH OF THE RPI

You asked me for a brief review of the various profiles of the RPI sent to the Chancellor over the past year. The attached table sets out all those sent up since this time last year.

2. The Chancellor also receives a one-month ahead forecast when the RPI is released each month. It is normally the practice to specify a figure rounded to the nearest $\frac{1}{4}$ per cent, although this is not always the case. These one-month forecasts are given in the final column of the table.

3. It is difficult to discern a systematic pattern of short run errors. The one-month forecast error has fallen into a range of ± 0.3 per cent since April 1986. There does not appear to be a systematic negative or positive bias. Over this period, our forecasts have been correct (within the rounding of $\frac{1}{4}$ per cent) about half the time.

4. Over a longer period, the average forecast error is generally negative, as the bottom row in the table shows. However, this does not necessarily indicate that our forecasts are subject to a downward bias, although this may be the case. Much of the new information that arrived in 1987 was likely to reduce inflation - lower oil prices, firmer exchange rates, higher productivity than expected.

Simon Price

SIMON PRICE

518/3/110

+ = forecast too high
 - = forecast too low

MONTHLY PROFILES OF THE RPI
 PERCENTAGE INFLATION

	Actual	Post Budget 1987	23 March 1987	June Forecast 1987	10 August 1987	October Forecast 1987	Autumn Statement 1987	January Forecast 1988	Post Budget 1988	One-month ahead forecast
1987 March	4.0	4.1 +.1								4
April	4.1	4.3 +.2	4.0 -.1							4
May	4.1	4.2 +.1	3.8 -.3							no-figure
June	4.2	4.6 +.4	4.1 -.1	4.5 +.3						4½
July	4.4	4.6 +.2	4.2 -.2	4.6 +.2	4.5 +.1					4½
August	4.4	4.4 -	4.2 -.2	4.5 +.1	4.3 -.1					no-figure
September	4.2	4.1 -.1	4.0 -.2	4.2 -	4.0 -.2					no-figure
October	4.5	4.2 -.3	4.0 -.5	4.3 -.2	4.2 -.3	4.3 -.2	4.3 -.2			4½
November	4.1	3.6 -.5	3.5 -.6	3.6 -.5		3.8 -.3	3.8 -.3			4
December	3.7	3.5 -.2	3.3 -.4	3.5 -.2		3.7 -	3.7 -			3½
1988 January	3.3					3.9 +.6	3.3 -	3.6 +.3	3.3	3½
February	3.3					3.9 +.6	3.3 -	3.4 +.1	3.3	3½
March						4.1	3.5	3.3	3.3	3½
April						4.5	3.7	3.3	3.6	
May						4.9	4.2	3.7	3.9	3.9
June						5.1	4.2	3.7	4.2	
July						5.2	4.4	3.8	4.2	
August						5.3	4.4	4.0	4.3	4.2
September						5.5	4.5	3.9	4.2	
October						5.4	4.5	4.0	4.0	4.0
November						5.3	4.5	3.8	3.8	
December						5.3	4.5	4.2	4.2	
Average error	-	- 0.0	- 0.3	- 0.1	- 0.1	+ 0.1	- 0.1	+ 0.2	0.0	-

Handwritten notes in red ink:
 3.3 }
 3.3 } -3.3
 3.3 }
 3.9 }
 4.2 }
 4.0 }
 4.0 }
 3.8 }
 4.2 }

43/3

FROM: S D KING
DATE: 21 MARCH 1988

~~PRICE~~

cc Mr Sedgwick
Mr Hibberd

MONTHLY PATH OF THE RPI IN 1988

Sir Terence Burns has seen a copy of your minute to the Chancellor of the Exchequer of 18 March. He would be grateful for a brief review of the various profiles of the RPI sent to the Chancellor over the past year.



S D KING
Private Secretary



**PRESS
AND
INFORMATION SERVICE**

aj
THE PRIVATE SECRETARY
TO THE
CHANCELLOR OF THE
EXCHEQUER

CENTRAL STATISTICAL OFFICE

GREAT GEORGE STREET
LONDON
SW1P 3AQ

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

CSO (88) 31

25 March 1988

**AMENDMENT TO RELEASE DATES OF ECONOMIC STATISTICS
(MARCH AND APRIL 1988)**

The following amendment should be made to Press Notice CSO (88) 24 of 22 March giving release dates of economic statistics in March and April 1988.

DELETION: The entry under Tuesday 19 April "Building societies monthly figures for March" was included in error and should be ignored.

The correct entry for this series is included under Friday 22 April 1988.

mp



Britische Botschaft
Presseabteilung
53 Bonn Friedrich-Ebert-Allee 77

Fernschreiber 0886 887 Fernspr Sammel Nr 234061 FAX: 0228/234070

FACSIMILE LEADER

DATE..... 25.3.88

DOCUMENT CONSISTS OF PAGES PLUS LEADER

FROM:..... D M Bell

TO:..... MOIRA WALLACE, TREASURY FAXNO: 00441270 5589

AND..... R Barnett Esq, WED, FCO

M Cole Esq, LCS, COI

THE BUDGET: GERMAN PRESS COMMENT

You may be interested to note that the German press continue to comment most favourably on the Budget and on the economic situation in Britain. I attach an extract from our Guide to the German Press summarising major articles which appeared in two "heavy" weekly newspapers. Our Economic Section will be reporting in more detail on these and other recent reports. If you, or your Press Department, would like copies of the articles or full translations of them, please let me know. Both were written by their respective newspaper's London correspondents. Herr Kratz of Die Zeit (circ. 460,000) attended the post-Budget briefing given by the Midland Bank on 16 March organised through the London Correspondents' Service of the COI. His article may therefore incorporate some feedback from this meeting.

2. Die Zeit is the Federal Republic's leading intellectual weekly, edited in Hamburg. Its political views are liberal, its economic tendency more conservative. It remains one of the FRG's major fora for debate and discussion. Herr Kratz's article will be read widely in leading economic circles here.

3. The Rheinischer Merkur (circ. 114,000) is Germany's oldest weekly which now takes an independent/conservative line. Recent changes in its editorial team are beginning to have some effect on its readership.

Dr Bell
25/3

GUIDE TO THE GERMAN PRESS

Friday 25 March 1988

2] British affairs: Budget: For the outside world, especially GB's European neighbours, it is interesting that GB has joined the countries with low top-rate income tax. After a discussion on the Budget among German managers in London, one participant summed up: It is worth working in the UK now. Lord Young heard complaints from the BDI during his last visit to Bonn that more and more firms were leaving the FRG and moving to the UK because of high taxation in W.Germany. The term "economic miracle" is now being applied in connection with Britain; the press responded enthusiastically to recent praise of UK by Japanese Ambassador. In the past, the German model was praised in an almost embarrassing manner and compared with GB's bad example, now it is the other way around [Kratz in Zeit p.33]. Rulf in RM: 10 years ago UK's economy was still Europe's problem child; today it has moved to the top of European countries as far as growth rate is concerned. In view of the budget surplus of £ 3bn, Governments & Finance Ministries in the rest of the world, above all in Washington, and also in Bonn, are facing almost a miracle. Return of trust in the economy is reflected in growing investments. As polls show, the public thought the Budget lacked an espousal of principles of social security and drastic measures to help the NHS. Government does not want to neglect its duties here but does not conduct any successful PR work in this sector. An increase in NHS expenditure is planned for financial year 1988/89. Lawson's policy was confirmed by another report of success this week: unemployment dropped in Feb. by almost 57,000, is now at lowest level since Aug.1981 (p.10).

mp



Britische Botschaft
Presseabteilung
53 Bonn Friedrich-Ebert-Allee 77

Fernschreiber 0886 887 Fernspr. Sammel Nr 234061 FAX: 0228/234070

FACSIMILE LEADER

DATE..... 25.3.88

DOCUMENT CONSISTS OF PAGES PLUS LEADER

FROM:..... D M Bell

TO:..... MOIRA WALLACE, TREASURY FAXNO: 00441270 5589

AND..... R Barnett Esq, WED, FCO

M Cole Esq, LCS, COI

THE BUDGET: GERMAN PRESS COMMENT

You may be interested to note that the German press continue to comment most favourably on the Budget and on the economic situation in Britain. I attach an extract from our Guide to the German Press summarising major articles which appeared in two "heavy" weekly newspapers. Our Economic Section will be reporting in more detail on these and other recent reports. If you, or your Press Department, would like copies of the articles or full translations of them, please let me know. Both were written by their respective newspaper's London correspondents. Herr Kratz of Die Zeit (circ. 460,000) attended the post-Budget briefing given by the Midland Bank on 16 March organised through the London Correspondents' Service of the COI. His article may therefore incorporate some feedback from this meeting.

2. Die Zeit is the Federal Republic's leading intellectual weekly, edited in Hamburg. Its political views are liberal, its economic tendency more conservative. It remains one of the FRG's major fora for debate and discussion. Herr Kratz's article will be read widely in leading economic circles here.

3. The Rheinischer Merkur (circ. 114,000) is Germany's oldest weekly which now takes an independent/conservative line. Recent changes in its editorial team are beginning to have some effect on its readership.

Dr. All
2/7

GUIDE TO THE GERMAN PRESS

Friday 25 March 1988

2] British affairs: Budget: For the outside world, especially GB's European neighbours, it is interesting that GB has joined the countries with low top-rate income tax. After a discussion on the Budget among German managers in London, one participant summed up: It is worth working in the UK now. Lord Young heard complaints from the BDI during his last visit to Bonn that more and more firms were leaving the FRG and moving to the UK because of high taxation in W.Germany. The term "economic miracle" is now being applied in connection with Britain; the press responded enthusiastically to recent praise of UK by Japanese Ambassador. In the past, the German model was praised in an almost embarrassing manner and compared with GB's bad example, now it is the other way around [Kratz in Zeit p.33]. Rulf in RM: 10 years ago UK's economy was still Europe's problem child; today it has moved to the top of European countries as far as growth rate is concerned. In view of the budget surplus of £ 3bn, Governments & Finance Ministries in the rest of the world - above all in Washington, and also in Bonn, are facing almost a miracle. Return of trust in the economy is reflected in growing investments. As polls show, the public thought the Budget lacked an espousal of principles of social security and drastic measures to help the NHS. Government does not want to neglect its duties here but does not conduct any successful PR work in this sector. An increase in NHS expenditure is planned for financial year 1988/89. Lawson's policy was confirmed by another report of success this week: unemployment dropped in Feb. by almost 57,000, is now at lowest level since Aug.1984 (p.10).

FROM: SUSIE SYMES
DATE: 28 March 1988

CHANCELLOR

cc: Sir P Middleton
Sir G Littler
Sir T Burns
Mr Byatt
Mr H P Evans
Mr Mountfield
Mr Burgner
Mr Bonney

Ch. Content to write as proposed?

OK

*25
28/3*

URUGUAY ROUND: AGRICULTURE

Following receipt of US Treasury Secretary Baker's letter of 18 March, you asked for advice on the state of play in GATT negotiations on agriculture, and on the latest US developments relating to agricultural protection. A draft reply to the letter is attached.

The GATT Negotiations

2. The GATT negotiations are well into their second year, and are due to finish by end 1990. A Ministerial Mid Term Meeting (MTM) on the Round as a whole, including agriculture, is fixed for December 1988. Attention is now focusing on what could be achieved at this MTM, with the OECD Ministerial (18-19 May) and the Toronto Economic Summit (19-21 June) being important for keeping up political momentum but not places for reaching detailed agreement.

3. In public the UK, as others, says that the Round has got off to a good start on agriculture. Agriculture was always going to be contentious, and certainly progress has been better than old GATT hands anticipated. Nevertheless, after nearly eighteen months the negotiations proper are not underway: the negotiating group has yet to agree how negotiations should be conducted, over what policies and products, and with what final objective in mind.

4. All the major parties have submitted initial proposals; all note the need to reduce all forms of support, not just trade measures. But there are important differences. The US zero-2000

proposal is the most radical, calling for complete elimination of all support and protection over ten years (apart from income aids not linked to production). The Canadian and Cairns Group - 13 major exporters, principally Argentina, Australia, New Zealand and Canada itself - proposals share the same long-term objective as the US, without specifying by when. Unlike the US they call for short-term measures, including a major progressive reduction of all subsidies and barriers to access over some 5 years. Japan and the Nordics, which are less than self sufficient in food production but give a high level of support to agriculture, want to focus on surplus production and export subsidies in order to divert attention from their own significant import protection.

5. The EC proposals are less stone-walling than the Japanese, with long-term reductions in support as the ultimate aim (but size and timing of reductions is not specified, and emphasis is on keeping basic CAP mechanisms of import protection and export subsidy). They include proposals for short-term measures, but of a highly interventionist market-sharing nature which are likely to increase rather than remove distortions. Overall, disappointing to the UK. We can let you have further information on UK views if you wish.

6. All proposals tabled so far, except that of Japan, endorse the potential usefulness of an aggregate measure of support (such as the OECD Producer Subsidy Equivalent - PSE - or a Canadian variant, the Trade Distortion Equivalent - TDE). Many technical - and not so technical - issues remain to be explored. The EC, US and Canada have submitted papers on this issue, although in Geneva last week the US were surprisingly reluctant to support further work by the Secretariat on how such measures might be used in negotiations.

7. The main questions still to be addressed are:

- the nature of any long-term agreement within the Round;
- the means of measuring present levels of support and reductions to be made;

- what short-term measures can be agreed upon;
- areas for agreement at the December 1988 MTM, covering elements of the above.

EC and UK views on the US approach

8. The EC see the US as looking for too much, too fast. And perhaps not being able to deliver if this tough negotiating bluff were called. US officials at all levels continue to assert bipartisan support for the Administration's proposals, but threaten that if substantive progress is not made in the Round this will strongly affect legislation next year when the current support legislation expires.

9. The US are beginning to show some flexibility on the question of short-term measures, provided - and we would agree - that they move in the same direction as long-term reform and are not a substitute. Cairns Group countries regard some such 'downpayment' as essential, and this seems the best prospect for bridging the gap between the US and the EC.

US views on the EC proposals and action so far

10. The US say the Europeans are doing far too little and that it would take far too long to show results. They are sceptical about claims made for the effectiveness of the European Council agreement, although Mr MacGregor corrected some misunderstandings during his recent visit to the US. In private the US have also expressed concern that the UK may share the somewhat complacent attitudes of the rest of the community. Mr MacGregor made it clear that the UK Government does not share this view.

11. The US are pushing hard, will be looking for UK support at the Toronto Summit, and go so far as to threaten that if there is no substantive progress on agriculture at the MTM then they would not facilitate progress in other areas such as services. As Whitehall preparations for the Summit progress, the Treasury may need to wield the Ten Principles to ensure that the progress made on budgetary matters in the Community does not obscure the need for longer-term, market-oriented reform.

Latest US Developments on Agricultural Support and Protection

12. The OECD will be submitting to the Ministerial meeting in May a Monitoring Report on progress in agricultural reform in the light of the 1987 Ministerial Communique principles. As currently drafted it is - partly through UK pressure - a frank assessment of disappointing progress by all countries. The US has done little although it might claim credit for:

- cutting the support price for milk by 9 per cent between 1986 and 1988;
- 3.4 per cent cut this year in cereals prices, combined with substantial land set aside of 69 million acres (although this may fall as low as 40 million next year);
- successful reduction in support expenditure which peaked in 1986 at \$25.8 billion, fell to \$22.4 billion in 1987 and is forecast at \$17.7 billion for 1988. This contrasts with EC - FEOGA Guarantee expenditure rising from \$21.8 billion in 1986, to \$31.7 billion in 1987 and forecast at \$32.0 billion for 1988 (provisional draft budget, as amended).

13. Such price cuts may cut the rate of increase in surplus production but are unlikely to get rid of surpluses altogether. Budgetary expenditure does not capture all forms of support and incentives to produce. That is why the PSE measure is so important. The percentage PSE, or value of all agricultural support as a percentage of farm incomes, has risen from 16 per cent in 1979-81 to around 35 per cent in 1986 (compared with a rise from 37 per cent to 50 per cent for the EC, and from 57 per cent to 75 per cent for Japan).

Susie Symes

SUSIE SYMES

Pre by you for M. G.

DRAFT LETTER FROM CHANCELLOR TO SECRETARY BAKER

Thank you for your letter of 18 March on agricultural reform. I share your analysis: interventionist agricultural policies distort trade and lead to inefficient use of resources and substantial costs to consumers and taxpayers. I am convinced that agriculture must be made much more open to market forces. We will continue to work towards significant reductions in overall agricultural support and protection world wide.

We have, of course, been in the forefront of international pressure for agricultural reform, in discussions at the 1986 Tokyo Summit, at successive IMF/IBRD Development Committees, and at the 1986 and 1987 OECD Ministerials. We have led the way in pressing for more market related policies in the Community.

Progress has been made in Europe, most recently at the February European Council. The Community has now agreed to set binding limits to the growth of agricultural spending and has agreed on stabilisers to control spending on support for the major agricultural products. In recent years support prices for most commodities have been cut in real terms. The UK will continue to work to ensure further reform of the CAP and effective budgetary discipline in the Community.

All countries still have much more to do. There is certainly no room for complacency. In the GATT, we have to build on the

level of agreement already reached between the main parties. An aggregate PSE-type measure of support is still in our view the best way of focusing negotiations on the totality of aggregate support and protection. I hope that the United States will fully support the necessary technical groundwork under way in Geneva to explore how such measures could be deployed.

We must maintain the momentum of agricultural reform in the GATT in our discussions and communiquees over the next few months and so take full advantage of the Mid-Term Meeting in order to make real progress. There is much common ground in the wide range of proposals tabled in Geneva. We now need to clarify where progress can be made. While agreement on a long term framework for negotiations is an essential step, it will need to be backed up by a clear multilateral commitment to early action to reduce agricultural support within that framework.

NL

FROM: J P MCINTYRE
DATE: 28 March 1988

1. MR ANSON
2. CHIEF SECRETARY

cc Mr Byatt
Mr Phillips
Mr Turnbull
Miss Peirson
Mr Culpin
Miss Sinclair
Mr Macpherson
Mr Scotter
Mr Cropper
Mr Tyrie
Mr Call
Mr Mace (IR)

Copies attached for:
Chancellor
Sir P Middleton

CHILD BENEFIT

We and DHSS have completed the first round of work on the options for reform. This is set out in the attached paper, which is also being submitted to Mr Moore. This minute is to seek your views on the options which should be pursued in further work and on the handling of the issue with Mr Moore and other colleagues.

2. The paper reviews six options:

- A. Means test at twice average earnings.
- B. Means test at average earnings.
- C. Abolition, with additional Family Credit.
- D. Reduction in rate.
- E. Pay according to size of family.
- F. Taxation through PAYE.

A summary table showing the savings, the number of families affected, and the earliest date of implementation is as at Annex A to this minute. All options would require primary legislation.

Options A and B - Means Test

3. There are of course many different thresholds at which means testing might be applied. The two illustrated in the paper are £25,000 (Option A, equivalent of twice average earnings) and £12,500 (Option B, average earnings). In fact, it is proposed that the income assessment be done on the basis of gross taxable income rather than gross earnings. So these figures correspond to rather higher thresholds in terms of gross earnings.

4. For each of these Options, there are several sub-options, depending on whether benefit is withdrawn completely when the income threshold is reached or tapered off. A further variation is a "stepped withdrawal", which would increase the threshold for withdrawal or taper according to the number of children in the family (eg a two child family would not lose CB until taxable income reached £14,000 under Option B, if we allowed an extra £1,500 for the second child.)

5. The big public expenditure savings (broadly, £1½-2½ billion) are obviously in Option B. Over 3 million families, out of the 7 million or so now getting CB, would be affected. By contrast, Option A would save us around £300-400 million and affect only ¼ million families.

6. The case for Option A is that it would stand a better chance of getting accepted and so establishing the means testing principle. We might hope to increase the savings in later years by freezing the threshold or increasing it in line with prices rather than earnings, so that more people would be caught by the means test. The case against Option A is that, if we are to go through the trauma of a major reform, we should perhaps set our sights on a more ambitious savings target, commensurate with the importance of the change. A threshold at the equivalent of 1½ times average earnings (£18,750) for example, would yield £700-900 million, affecting over 1 million families. This would also have the advantage of being pitched in the income band affected by the "kink" where people face a marginal tax rate of 25 per cent rather

than the 34 per cent rate at average earnings or the 40 per cent rate faced by those above twice average earnings.

7. The case for the taper and/or stepped withdrawal is stronger if we were to apply the means test at average or $1\frac{1}{2}$ times average earnings. An abrupt cut-off of benefit, with no account taken of family size, would be damaging to incentives at these income levels. However, at gross taxable incomes of £25,000 and above, this consideration may be less important - far fewer people would be affected; they would be much better placed to absorb the loss; and the size of their pay increases (taking them over the threshold and beyond) would tend to be larger in relation to the CB loss than for those lower down the income scale. Administrative simplicity would also point to complete withdrawal, if the twice average earnings option were chosen.

8. We have considered whether the higher rate tax point might be a suitable peg for a means test. This would have an attractive simplicity in presentational terms. But there would be disadvantages. If the threshold for the higher rate were to go up, we might not want the number of people eligible for CB to increase in line. And under Independent Taxation, we would be able to withdraw CB only if either partner became liable to higher rate tax; this would leave unaffected families with neither partner paying higher rate tax but combined incomes well over the higher rate tax point, which would be difficult to defend.

9. Apart from the threshold, the key features of a means testing system are:

i. Payment to the mother.

ii. Gross combined taxable income for the previous tax year as the basis for assessment.

iii. Self assessment, with sample checking of, say, 5 per cent of cases.

- iv. Opting in (ie people would have to apply in the first instance) rather than opting out (ie allowing all existing claimants to stay on the books unless they confess to incomes exceeding the threshold.)
- v. CB awards to run for a year (or possibly 2 years for families well below the cut-off point on initial application).
- vi. System to be run by Child Benefit Centre of DHSS at Washington (as now) rather than local offices. Additional administrative costs would be £2-7 million a year depending on which option is chosen, except for Option C (abolition), which would save £25 million a year.

with a general

10. The use of combined gross taxable income might be seen as at odds with Independent Taxation. But joint incomes are of course the basis for assessment in the social security system generally, and it would be difficult to argue that only the mother's income should be relevant in the case of CB but not in the case of, for example, family credit.

11. The other objection to use of gross taxable income as the basis for assessment is that it would encourage people to maximise their tax reliefs and allowances in order to retain their CB. This would be particularly relevant if the cut-off point were high, so that those crossing the threshold were relatively sophisticated in managing their financial affairs e.g they might think it worthwhile to invest in a BES or take out an AVC. On the other hand, the use of combined gross earnings as the basis for assessment would allow wealthy families with lots of investment income and low earnings to retain CB, unless we were to introduce a capital rule as well.

12. As far as administration is concerned, the overriding concern is to keep it simple so as to minimise costs for DHSS and hassle for the claimants, though there may well have to be some compromise of this objective with the need to produce a scheme

that can be reasonably defended as equitable. For example, we may well need to allow applications by mothers whose family incomes have fallen below the threshold since the previous tax year, perhaps because they have stopped work to have children.

13. As the paper mentions, Australia has just introduced a means test. It is of the stepped withdrawal/taper variety with the initial threshold set at about £23,000. This is encouraging. And indeed the general international comparison (Annex C to the paper) shows that the untaxed universal child benefit is not the norm eg there is some means testing in Germany and Italy, while the French pay nothing for the first child. On the other hand, help is provided through the tax system in most countries.

Option C - abolition

14. This has been included at the suggestion of DHSS officials. You may recall that we consulted you about this when the terms of reference for the review were being drawn up. You said (Miss Rutter's minute of 20 October) that it was not worth raising the possibility of abolition. But DHSS officials believe the option has sufficient merit to justify putting it to their Ministers. We have not passed on your views or commented at all.

15. The savings would of course be large (up to £3 billion). Those on income-related benefits would be compensated automatically. We would therefore be building on the existing means testing machinery instead of creating a new system, as under Options A and B. We might also use some of the savings to put in a sweetener, such as a cut in the family credit taper from 70 per cent. But there would be drawbacks in relying more heavily on the existing means-tested benefits (see para 34 below), while sweetening the package by making income-related benefits more generous would have disadvantages in adding still more to the numbers dependent on these benefits. In any case, you may still feel that it is not a realistic option in political terms.

16. However, there are wider considerations which may point to keeping this option in play, at least for the moment. The health review might produce very large bids which Mr Moore might be asked

to offset by a big reduction in CB expenditure. And on the social security side, we may also get large bids for pensioners and the disabled, if not in this year's Survey then in 1989. Against this background, abolishing CB looks less unreasonable.

Option D - Reduction in Rate

17. This would be harder to defend in terms of the targeting objective than means testing, though again income-related benefits would adjust automatically.

18. The great attraction of this option is that it could get us substantial savings more simply and a little earlier than the means testing options eg a 25 per cent cut, reducing CB from £7.25 to £5.45, would save us £800 million, net of additional income-related benefits. And it could be done for April 1990. (April 1989 would, in the DHSS view, be feasible only if there were a special Bill this Session.)

Option E - Pay according to size of family

19. There is a wide range of possibilities. The paper looks at:

- i. no payment for 1st child;
- ii. payment for first 2 children only;
- iii. full rate for 1st child and $\frac{1}{2}$ rate for subsequent children.

20. One difficulty with this option is that, whichever variant we chose, critics could argue that we should have done it differently. If we were to pay nothing for the first child, we would hit families at the time when the mothers' earnings are first reduced or forgone; the marginal cost of the first child is also higher than that of later children. On the other hand, variants on the lines of (ii) and (iii) above would be criticised for attacking the larger family. We would have to rely on means-tested benefits compensating the poorer large families, as with Options C and D, with the same drawbacks.

21. For these reasons, I would see this as among the least attractive of the options.

Option F - Taxation through PAYE

22. DHSS are aware that you are opposed to this, and we hope Mr Moore will be prepared to drop it, albeit on the basis that any report to the PM and colleagues should show that it has been considered. Independent Taxation has strengthened the case against it, because we would no doubt have to tax CB against the mother's income. Apart from drastically reducing the yield, this would result in non-working wives getting CB in full (being able to set their personal allowance against it) while working wives would be taxed on it. Targeting would therefore be poor.

Timetable for Implementation

23. There are three factors which will influence the timing of implementation:-

- (i) the timing of Ministers' decision and its announcement;
- (ii) the need to prepare and put through a Social Security Bill;
- (iii) the administrative preparations, particularly for means testing.

In addition, as none of the options look likely to be feasible before 1990 or 1991, timing of implementation in relation to the timing of the next election may also be a factor. The introduction of the Community Charge and of Independent Taxation in April 1990 also need to be kept in mind.

24. DHSS have Cabinet agreement for a Social Security Bill in the next Session. But DHSS officials are strongly of the view that this Bill, even if given Royal Assent by February, would not be in place in time for any of the options to take effect in April 1989. Even abolition, they say, would not be feasible until 1990 because of the need for policy decisions and legislation to deal

with the consequences of abolition for the rest of the benefit system e.g the need to find alternatives to CB as evidence of responsibility for children, such as for paying the widowed mother's allowance. The future of one parent benefit would also need to be considered.

25. I am not entirely convinced that abolition would be impossible by April 1989, if an early decision were taken and the Bill could be got through quickly. But Mr Moore would need to crack the whip in his Department.

26. Of the other options, a simple reduction in the rate does, on the face of it, look feasible by April 1989. But the problem here is the six months needed to put nearly 7 million order books onto the new rate. This is why DHSS say that only a special Bill in the current Session would be in time to enable a start in April 1989. (New order books containing the lower rate could not be issued until after Royal Assent.) The CB rate could, in theory, be cut sometime during 1989-90, but this would trigger an in-year reassessment and uprating of all families' claims to income-related benefits, which would be expensive in administration and hard to justify.

27. So, unless we pressed for an early decision to abolish or for a Bill this Session to cut the rate, we are probably stuck with implementation in April 1990 at the earliest. Options C, D, and E could all be introduced in April 1990.

28. The DHSS view is that October 1990 would be the earliest date for means testing with a high cut-off point (like Option A), assuming a decision were taken this Summer. Their assessment is that the minimum period between announcement of a decision to means test and implementation would be 18 months; a further 2 months would be needed if Ministers wanted one of the more sophisticated variants, involving a taper and a stepped withdrawal. They say that this 20 month period allows no contingency margin for unexpected problems in designing the system, programming etc; April 1990 would therefore be high risk, even if a decision were taken this Summer.

29. The other practical argument for October rather than April is that, if people are to rely mainly on their P60s to fill in the claim forms, an April 1990 start would mean an assessment based on incomes in the 1988-89 tax year. This is because P60s for 1989-90 would not be sent out until the Spring/Summer of 1990, too late for means testing to begin in April. So if we wanted to use 1989-90 incomes as the basis for assessment, October 1990 would be the earliest start date.

30. For means testing with a much lower cut-off point (like Option B), DHSS say implementation would not be feasible until 1991. Although fewer families would be claiming CB, the assessment system would have to be more sophisticated, because the cut-off point would be in a much denser area of the income distribution. Thus, for example, arrangements to cope with in-year falls in income might have to be more extensive than for Option A. But if they were pushed very hard, because Ministers preferred 1990 to 1991, I suspect that DHSS might be able to compress their timetable.

31. As mentioned above, DHSS regard a Summer 1988 decision (rather than Autumn) as necessary to deliver the earliest implementation dates shown in Annex A. Their other argument for a Summer decision is that it would be dangerous to leave preparation of the Bill until October, allowing only a few weeks for instructions to Counsel and drafting before introduction in November or December. All the options, and particularly A, B, and C, would have consequences for other parts of the social security system and these would complicate the legislation.

32. To sum up the DHSS position on the timetable, they see:-

June/July 1988: Decision/announcement

Nov/Dec: Introduction of Bill

April 1990: Implement Option C, D, or E

October 1990: Implement Option A

October 1991: Implement Option B

Comparing the Options

33. You may find it helpful to look at Annex E of the paper which shows how some typical families would be affected by the various options.

34. An important difference between Options A and B and the other options is that A and B leaves the existing CB entitlement of a large number of families unaffected. Even A would not affect the poor or those on modest incomes. By contrast, D and E would involve an across the board cut affecting families irrespective of their means, and C would mean abolition. Under C, D, and E those on income-related benefits would be automatically compensated. But there would be problems:-

- i. More people would be floated on to these benefits, as their net incomes fell below the threshold for entitlement as a result of the CB reduction. Over 100,000 would be floated on by a 25 per cent in the rate, and nearly $\frac{1}{2}$ million by abolition. (The current family credit population is about 450,000.)
- ii. In the case of Income Support, the compensation would often go to fathers rather than mothers.
- iii. Take-up of the income-related benefits is significantly lower than for CB. Not everyone would be compensated.
- iv. Around 200,000 families on low incomes do not get income-related benefits e.g because they do not work long enough hours to qualify for family credit.

35. If targeting is a key consideration. A, B, and C are the best options. C is best if the main aim is to concentrate help on the poorest. A is best if the emphasis is to be on taking it away from the better off.

36. In terms of simplicity, D is best. CB would remain a universal benefit, avoiding significant consequences for the rest

of the social security system and the expense and complexity of means testing.

Handling

37. As you know, our strategy up to now has been to play this issue long so as to get the decision taken in the Autumn as part of the Survey. In your letter of 24 September 1987 to Mr Moore, you said that CB was one of four issues for consideration "in the next Survey". You envisaged "a joint approach to senior colleagues". Mr Moore replied (25 September) that all of these items "would need extensive consideration in the political context and hence as matters to be pursued with colleagues over coming months, rather than as proposals linked explicitly to the Survey process". You effectively agreed to differ on the handling. But there is a case for reconsidering our approach:

- i. An Autumn decision would leave little time to prepare the necessary provisions for the Bill.
- ii. DHSS argue that even a relatively simple means testing option requires a Summer 1988 decision to ensure implementation in October 1990 rather than 1991. Their view is that only Option D could be implemented in 1990 if a decision were delayed to the Autumn.
- iii. Mr Moore's bids on the social security side seem likely to be much smaller than last year, partly because of lower unemployment. If this is right, our case for major savings in this year's Survey (looking at social security alone) will be weaker. (Bids for pensioners and the disabled are more likely in 1989.) For this reason, we could not rely on being able to exert sufficient pressure in the Survey to get a favourable decision.
- iv. The Budget might create a climate - among colleagues as well as the public - favourable (or at least less hostile) for action on CB, particularly for the options which could be clearly presented as taking it away from

the better off. By the Autumn, some of this effect may have worn off.

38. Taken together, these considerations argue for the issue to be brought to a head in the early Summer rather than the Autumn. We could still present the discussion in a Survey context, in the sense that we would know Mr Moore's bids (on health as well as social security), though we would not have had the July Cabinet. And the future pressures on the programme (elderly, disabled) not reflected in the bids could be referred to, without implying any Treasury acceptance that these would be accommodated at any particular level. CB would be presented as the only area in social security offering substantial scope for savings to offset other likely claims on the programme in the medium term.

39. The early Summer might be preferable to late Summer to avoid the very heavy period of business which tends to occur just before the Recess.

40. The case for taking the decision in the Autumn, as part of the normal Survey process, is that it would be difficult to announce reform of CB in isolation from other public expenditure decisions, not only on social security but on health and other programmes. Indeed, we might want to link more money for the NHS with the CB decision (though if the CB decision had to be announced in October as part of the general uprating statement, sometime ahead of the Autumn Statement, this link might not be easy to establish).

41. More generally, it might be asked why a decision on CB was being announced in the Summer, when we have been saying that the Autumn Statement is the time for public expenditure announcements. The answer to this would have to be that an earlier announcement was essential to enable preparations to go ahead for the Bill and for implementation in 1990.

42. This is a difficult choice. Mr Moore is likely to press for the issue to be taken to the PM fairly soon and for a Summer decision. If you are not persuaded, you may want to explore with

him the possibility of agreeing on one or two leading options which could be worked up further and then taken to colleagues in the Autumn. But there would be a limit to the amount of preparation which could be done without a decision or an announcement, and the timetable for the Bill preparation would be extremely tight.

Conclusions

43. You are asked to:

- i. agree that further work be done on Options A, B, C and D, and that we also work up another variant of means testing, starting at gross taxable income within the "kink".
- ii. agree that Options E and F be discarded.
- iii. indicate whether you are content with the way in which the four remaining options are shaping up and if you have any views on the batting order.
- vi. say whether an October 1990 (or 1991) implementation date would be a serious disadvantage for Options A and B or that we could live with it if we cannot get any change out of DHSS on the time needed for preparation.
- v. comment on the proposal that we aim to bring the issue to a head with colleagues in the early Summer rather than in the Autumn as part of the normal Survey timetable.

44. You may wish to discuss.

Jm

J P MCINTYRE

ANNEX ASummary comparison of Options

OPTION	net PE savings (£ billion)	No of families losing (million) (1)	DHSS assessment of earliest implementation date (2)
A: means test at twice av. earnings	0.3 to 0.4	0.5	October 1990
B: means test at av earnings	1.6 to 2.3	2.7-3.3	Apr/Oct 1991
C: abolition, with additional family credit	3.0	5.2	April 1990
D: reduced rate	0.7 to 1.0	5.2	April 1990 ⁽²⁾
E: pay according to size of family	0.3 to 1.9	upto 5.2	April 1990
F: taxation	none (2)	5.2	April 1991

Notes:

- (1) The estimates do not include those who would lose some child benefit but be compensated through higher income-related benefits. 6.8 million families are expected to claim CB in 1988-89.
- (2) In each case, DHSS have assumed a decision by Ministers in June/July 1988.
- (3) Unless a special Bill were passed in current session, enabling implementation in April 1989.
- (4) Additional tax revenue of £300-400 million, and a small increase in pe on income-related benefits.



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

28 March 1988

Sir James Cleminson MC DL
British Overseas Trade Board
1-19 Victoria Street
LONDON SW1H 0ET

Thank you for your letter of 9 March. I can assure you that I appreciate the points you make - and the strength of feeling behind them - and I shall continue to bear these considerations in mind.

NIGEL LAWSON

UNCLASSIFIED



FROM: MISS M P WALLACE

DATE: 28 March 1988

MR R I G ALLEN

OVERSEAS PRESS REACTIONS TO THE BUDGET

The Chancellor would like to have a select anthology of overseas comments on the Budget (and the UK economy in the light of the Budget) which he could distribute to the Prime Minister and Cabinet colleagues. He would be grateful if you could undertake this.

MOIRA WALLACE

BF 30/3

SECRET

FROM: J. ANSON
29th March, 1988.

CHIEF SECRETARY

c.c. Chancellor
Sir P. Middleton
Mr. Byatt
Mr. Phillips
Mr. Turnbull
Miss Peirson
Mr. Culpin
Miss Sinclair
Mr. McIntyre
Mr. Macpherson
Mr. Scotter
Mr. Cropper
Mr. Tyrie
Mr. Call
Mr. Mace (IR)

CHILD BENEFIT

I attach a submission by Mr. McIntyre on the outcome of the first round of work in this review. The questions posed to you and Mr. Moore are set out in paragraphs 13-17 of the joint DHSS/Treasury paper; and the options are further examined in Mr. McIntyre's covering minute. His analysis is very clear and I assume that you will wish to discuss it with us after Easter. At this stage I should like just to add the following comments.

2. Given the public commitments recited in Annex B of the joint paper, any substantial proposal for change will need to be justified by the need for a basic rethink of priorities in this and related programmes. That suggests that it should (a) incorporate a better targeting of the benefit, and (b) be presented as enabling some other, higher priority, service to be improved.

3. From the targeting standpoint, Options C and D would be difficult to sustain, especially in the aftermath of the Budget, even though those on income-related benefits

would be compensated. Option F (taxation), which you anyway did not favour, also scores less well on targeting following the announcement of Independent Taxation, and can probably now be relegated to the side-lines. Option E does not have much merit from a targeting standpoint on its own, but might be a useful adjunct of one of the others (see below).

4. As regards other worthy causes, the most closely related area might be the disablement review. If (as seems likely) there will anyway be pressure to announce a substantial package for the disabled, a well-targeted removal of child benefit from the better-off might be presented as an appropriate offset. But it is not yet clear when Mr. Moore will be ready to bring forward proposals on the disabled, as the results of the fieldwork will not have been written up till the late summer.


5. Another possible area is the NHS, with the change being presented as a switch of priorities within DHSS programmes. This would be more difficult to sustain politically, since the Opposition would no doubt argue that the Government was depriving families with children in order to finance a universal service which they should have been financing anyway. But if the conclusion of the NHS Review was that substantially more funds are needed in the short-term, pending longer-term reforms, I do not think we should rule out the possibility of fairly radical changes in child benefit in order to help finance it.

6. At this stage, there is some merit therefore in keeping some variant of Option C or D formally on the table, especially as Option C was paraded at the suggestion of the DHSS. To be viable at all, these would need to be combined with some improvement to the coverage and/or amount of family credit (though this could add substantially to the numbers caught in the poverty trap).

7. The more practical options, however, are A and B, or some variant between these two with a different cut-off point. An intermediate cut-off point which might be worth examining would be one where the taper of child benefit falls into the "kink" where the effective rate of tax/NIC drops to 25%. This might also be combined with some version of Option E, eg by limiting the means test to the first two children, in order to avoid having some very large losers (like families with 6 children just above the cut-off point). You will see from Annex C to the paper that this kind of formula is not unprecedented in other industrial countries. It would be a bit like the French model, although in France the means test only affects the first child.

8. The other main question is that of timing, which is discussed in the second half of Mr. McIntyre's minute. Mr. McIntyre suggests that we should aim for an early decision in order to get the earliest practicable date for implementation, and because of the need to prepare appropriate provisions for the Social Security Bill to be introduced in November or December. I can see the force of that argument, but it would run counter to our general line that expenditure decisions should be taken in the Survey; and I am doubtful if you could get a satisfactory outcome in the summer, in isolation from the other issues which will come to the crunch in the Survey.

9. On the other hand, the subject is one which might require quite prolonged collective discussion, and if this were not opened up till after the summer holiday there might be insufficient time to resolve it before the Autumn Statement. The ideal might therefore be to have some ground-clearing discussions in a fairly restricted group in June/July, but avoid reaching any final conclusion until towards the end of the Survey.


J. ANSON

CHANCELLOR

FROM: ROBERT CULPIN
DATE: 29 March 1988

cc: Sir T Burns
Mr Scholar
Mr R I G Allen

ABOLISHING THE UEL

Miss Wallace's note below.

2. You are of course quite right; and there are other possibilities too. Here is a do it yourself kit, in round numbers.

(a) This year there are probably more than 1½ million people in the kink, adding together employees and the self-employed. (I don't know how many more than 1½ million, because the Revenue have not updated the estimate for this year since they revised their earnings assumptions.)

(b) Next year there may be very nearly 2 million, on the assumptions underlying the FSBR;

(c) and nearly 3 million, in all, who have earnings or profits above the UEL and UPL.

3. So:

(d) If you were to abolish the UEL and UPL and make precisely offsetting reductions in the higher rates (the option in Miss Wallace's note), you would raise marginal rates for about 2 million people (but not necessarily "over" 2 million).

*Thanks. Safe to
state to about 2 million
which implies to (a) -
then focus on the
direct or the
people in the kink,
and when new
comes in as
again.*

(e) If you were to abolish the UEL and UPL without any compensation at all on the higher rates, you would raise marginal rates for about 3 million people.

(f) If you were to abolish the UEL and UPL with some but not absolutely complete compensation on the higher rates - and most options, including Mervyn King's, fall into this category - you would raise marginal rates for over 2 million people.

4. When you use the general formula that abolishing the UEL would raise marginal rates for over 2 million people, as you did very reasonably at your press conference, I think it better to relate this implicitly to proposition (f) then explicitly to proposition (d). That is the only small quibble I was registering. The general formula seems robust for a wide range of options, and readily defensible.

5. I stress that all the figures are approximate anyway, and subject to a margin of error. And I should add that the numbers affected seem to go up every time I ask. That is partly because top people's earnings have been rising more than the average, and partly because the Budget will widen the kink next year, by overindexing income tax but not national insurance.



ROBERT CULPIN



FROM: MISS M P WALLACE

DATE: 23 March 1988

MR CULPIN

cc Sir T Burns
Mr Scholar
Mr R I G Allen**PRESS BRIEFING FOR ECONOMIC/FINANCIAL CORRESPONDENTS, 16 MARCH**

The Chancellor has seen your manuscript note on Mr Allen's minute of 17 March. He has pointed out that, if the UEL were to be removed, it would not be necessary to cut the top rate to 31 per cent to avoid higher marginal rates for higher rate taxpayers - it would simply require cutting the 40 per cent rate to 30 per cent, 45 per cent to 35 per cent, 50 per cent to 40 per cent, and abolishing the 55 per cent and 60 per cent rates. He thinks it may have been something like this that his questioner had in mind. A propos of this, he has asked how many people there actually are in the kink.

A handwritten signature in dark ink, appearing to read 'mpw.'.

MOIRA WALLACE

CONFIDENTIAL

~~BRW HUSA~~
7/4
Pmg

PCC(88)13th MEETING

HER MAJESTY'S TREASURY
POLICY CO-ORDINATING COMMITTEE

Minutes of a meeting held at 9.30 am on Tuesday,
29 March 1988 in Sir Peter Middleton's room, HM Treasury

PRESENT

Sir Peter Middleton
Mr Anson
Sir Terence Burns
Sir Anthony Wilson
Mr Byall
Mr Lankester
Mr Monck
Mr Phillips
Mr Scholar
Mr Odling-Smee
Mr R I G Allen
Mr A C S Allan

30/3/88.

SECRETARIES

Mr Sargent
Miss Evans

CONTENTS

	Page
I. CURRENT DEVELOPMENTS	1-3

CONFIDENTIAL

CURRENT DEVELOPMENTS

1. Sir Peter Middleton reported on the Governor's evidence to the Treasury Committee the previous day. The Chancellor would be appearing on Wednesday.
2. Sir Terence Burns said that the CBI survey published the previous day was encouraging.
3. Mr Scholar said that the financial markets' attention was currently focussing on the dollar which had fallen to 1.23 yen, its lowest level since early January. Equity markets were nervous.
4. Mr Lankester reported on preparations for the Washington spring meetings. The Chancellor would suggest that there should be a central bank governors' study of the Balladur proposals for exchange rate management. There was to be a meeting that afternoon on the international debt questions likely to be raised in Washington: the middle income debtor countries and sub-Saharan African debt. The Brazilian debt rescheduling negotiations had reached a critical stage with the Brazilians looking for a further loan of \$6 billion. There was an expectation that the UK would take a leading role in responding to the Nigerian debt problem which was also acute. He would be suggesting that the Chancellor write to the Nigerian Minister of Finance emphasising the need for the reforms proposed by the IMF.
5. Sir Peter Middleton mentioned that he had attended a Foreign Office seminar at Wilton Park on various foreign policy and economic issues. The other participants were the ODA, DTI and MAFF. There had been much discussion of the implications of the 1992 deadline for the single European market. The Chief Secretary was very concerned about the justification for Lord Young's proposals for expensive advertising to increase public awareness of the single European market. It was not clear what practical difference 1992 would make to UK firms and what they were supposed to do in preparation for it. Mr Lankester agreed to provide a paper giving an overview of the implications of the single market for the UK for discussion at PCC on 19 April.

CONFIDENTIAL

6. Mr Phillips reported on the review of the NHS. ST were preparing a paper on opting out. The Prime Minister's lunch with doctors at Chequers the previous Sunday had been reasonably constructive. There had been some complaints about the Treasury's guidelines on the use of private sector capital which were thought to be inhibiting capital investment in the NHS. GEP had produced a very helpful draft speech for the Financial Secretary which would help to explain the Treasury's policy on this. The Home Secretary was planning emergency steps to respond to the acute shortage of prison accommodation, including looking harder for non-custodial alternatives. E(LF) had asked the Secretary of State for the Environment to do some further work on his proposals for changes in local authority housing finance. The Committee felt that it was not possible to take decisions on housing revenue accounts without formulating a clear policy on rents. His proposals for reforming local authority capital were thought to be tough on the shire counties. The view was also taken that stronger incentives were needed to encourage the private sector to take over local authority housing.

7. Mr Anson said that the Prime Minister had agreed that Treasury officials should discuss the proposals for redefining the planning total with departments.

8. Sir Peter Middleton mentioned that he would be talking to Sir Robin Butler about the role of the COI with the aim of clarifying whether it had an advisory role in relation to for example the propriety of advertising or whether it was simply an executive agency like the CCTA. Mr Anson said that we should be ready to respond if the National Audit Office pursued their enquiry into Lord Young's advertising budget and broadened it to enquire about the organisation of official advice in relation to the Chief Secretary's co-ordinating role on government publicity.

9. Mr Monck said that the discussions on nationalised industry board pay had concluded that pay increases not justified by recruitment and retention considerations should be within the rate of inflation. PE would be submitting shortly a paper on the options for the timing of the electricity and water privatisations. The

CONFIDENTIAL

Secretary of State for Trade and Industry would be announcing that afternoon the Government's approval of a takeover of Rover Group by BAe. This would involve a net government cash injection of over £600 million. This was very likely to provoke criticism from the Opposition and was likely also to lead to an investigation by the PAC. The deal was subject to EC approval which was unlikely to be received until June.

10. Sir Anthony Wilson said that the Secretary of State for Trade and Industry was re-organising the DTI accountants to integrate them more closely with the rest of the department, along the lines that he had been proposing. Work on the Companies' Bill was proceeding satisfactorily; the DTI were consulting about the proposals for reducing the audit requirements on small companies.

11. Mr Byatt said that the EC Economic Policy Committee had agreed a report on tax approximation which would be put to ECOFIN in April and informal ECOFIN in May. He had submitted his note on pensions to the Chancellor and work was in hand on the taxation of savings.

12. Sir Peter Middleton mentioned that PCC next month would need to consider divisions' work programmes for the coming year.

30/3/88.

CB prep

1. I have read these papers & considered
the matter v. carefully.

2. Options A & B in Mr McIntyre's paper (or when an
Other System of Grounds means that of CB) are
simple not a.

3. The reasons are implicit in Mr Isaac's note of 30 March,
& in paras 3 & 4 (~~the~~ / No work suggests in para 5

may also produce pretty discouraging results). The

attempts of para 10 give McIntyre's paper will

work: exist ~~but~~ social stems means that average
offer, a typical, a tiny minority of the population ~~the~~

as (in the only case where no unions is suitable, HB,

we still argue that it is an ~~error~~ to thin it back).

What is suggested here is a parallel notion of income that

we offer a large proportion of the ~~or~~ families with children.

4. Moreover, we already have a means-tested form of child

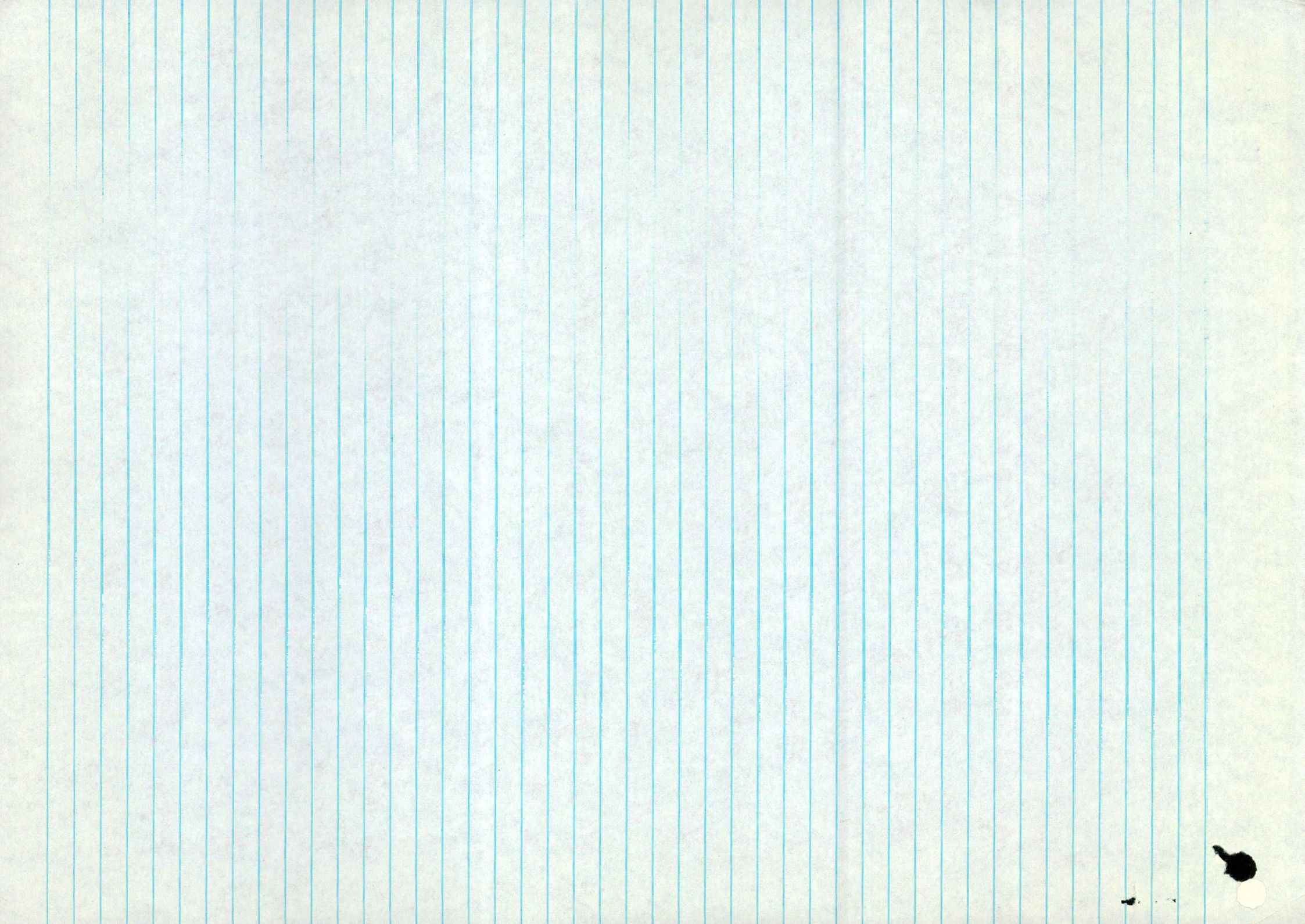
support in the shape of Family Credit. It follows that

we all rational income a means-test, must consist of

convey further what we did thus far - to shift

No further families from CB to H.

(over)



5. Thus attention shifts to engine & variants (a combination) of C, S & V. (Since there are no other options)

Real price in April 1990 start date, that is price (just a word.)

6. The ~~best~~ ^{least radical} option will be to

postpone when we did this year: 12 to freeze CB & use some of the money then saved to increase

FE. This has much to commend it. A more

radical option will be to engine CB to No just

child only* (is not OPS child, effectively on the

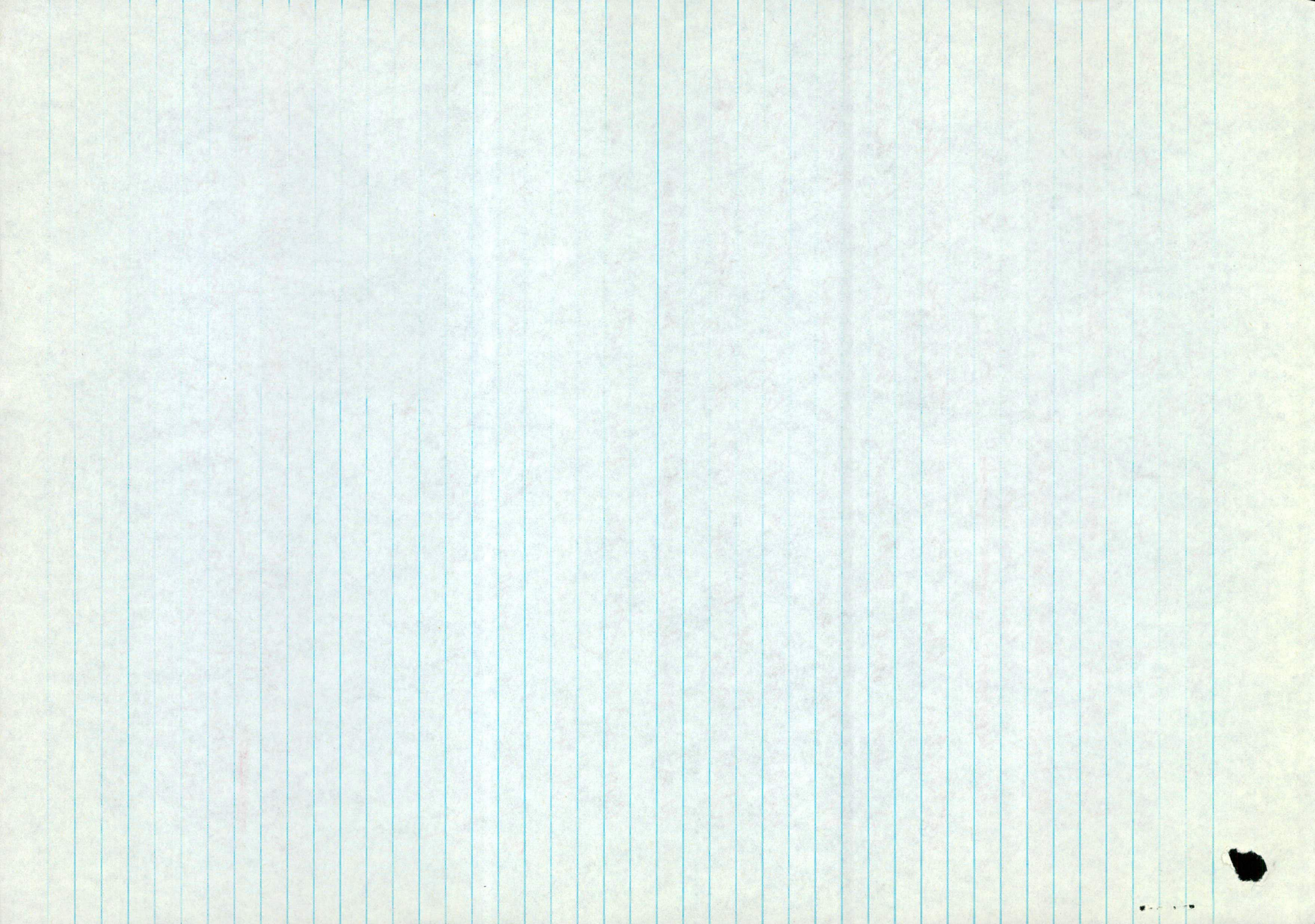
same? - just check) coupled with more generous FE

arrangements for poor parents with a large number of children.

7. I shall be happy to have a reply on this if further discussion is desired.

ME.

* It is to widen young CB as a last resort for mothers with young children, irrespective of the number of children. It is worth exploring this as we may have public opinion in support of large families.





FROM: A J G ISAAC
30 March 1988

CHIEF SECRETARY

CHILD BENEFIT

1. We have been following with interest the discussions leading up to Mr McIntyre's submission to you of 28 March. If I may say so, we welcome the conclusion that PAYE does not offer a promising vehicle for means testing child benefit.

2. The main remaining issues are very much for Treasury and DHSS. However, I think that I ought perhaps to note very briefly three or four points which have rather broader - if perhaps difficult - implications for tax.

3. First, I think we have to recognise that a good many outside commentators - for example the IFS - would raise their eyebrows

below

cc Chancellor of the Exchequer
Sir P Middleton
Mr Anson
Mr Byatt
Mr Phillips
Mr Turnbull
Miss Peirson
Mr Culpin
Miss Sinclair
Mr McIntyre
Mr Macpherson
Mr Scotter
Mr Cropper
Mr Tyrie
Mr Call

Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Lewis
Mr Mace
Mr J C Jones
PS/IR

if Ministers introduced a new system which required large numbers of people to submit returns of taxable income to DHSS, quite separately and independently of the tax system. The practical arguments could be explained, including the exacting timetable for Independent Taxation. It could be explained that the proposed new system seeks to minimise the number of people who have to submit full returns of income (rather than certify that they are above or below the marginal bands). At least for the more radical options, it could be explained that under the present system the Revenue does not need, and therefore does not have, information about the total income of the large majority of taxpayers and any system of means testing child benefit would therefore require a new system of income returns, whether run by DHSS or by IR. Nevertheless, the thing would look counter-intuitive. The larger the number of people concerned - and the wider the band of income over which the system would call for full returns of income - the more that I (at least) would expect people to question whether it made sense for the tax and benefits systems to continue to ask for separate statements of income. (I remember that we had some considerable discussion of this with the present Social Services Secretary, when he was Financial Secretary, looking forward to the possible future means testing of child benefit.)

4. Second, Mr McIntyre's paper notices the awkward interface with independent taxation. Obviously, the thing is easier if it is a DHSS matter, rather than a Revenue matter. Nevertheless, the point of substance remains. As Mr McIntyre says, any sensible means test must be based on combined family income, not just the independent income of the mother (or for that matter the father). But that does seem to me to weaken one of the main planks of Independent Taxation - the claim that for the first time it gives married women the right to privacy in their financial dealings with the authorities. Again, the larger the number of people affected by the means test - and by contrast with paragraph 3, this can in principle affect people whose total

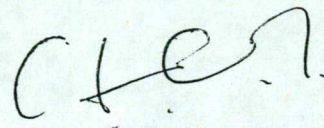
family income is outside the marginal bands - the more troublesome I see this conflict.

5. Finally, you may wish to commission some further detailed work in due course on the combined tax/benefit withdrawal rates implied by these changes and their distributional implications. For Option A (withdrawal at around twice average earnings) we might, for example, begin by looking at a family with gross taxable income somewhere in the region of £20,000 to £25,000 with two children, one at school and one at university. The main factors might be the sum of one or more of:-

- a. tax and NIC: marginal rates ranging from 25% to 49%;
- b. withdrawal of child benefit 50%;
- c. withdrawal of student grants 15%-18%.

For tax and NIC as at a. you will be well aware that - by contrast with the pretty graphs that sometimes appear in the newspapers - the "kink" is not a simple fixed amount. It varies from individual to individual. For over 3 million people in the kink, it varies from the very wide to the very narrow; and at the extreme (for the 300,000 or so people in the reverse kink) we have the marginal tax/NIC rate of 49%, rather than 25% - though few of those seem likely to meet the full combination of tax/benefit withdrawal rates.

6. For some of the other options - for example where child benefit might be withdrawn at around average or one-and-a-half times average earnings - you might want to look at the interaction with the means tested benefits more directly related to income support, including in particular housing benefit and family credit.



A J G ISAAC

papers

*Ch/ I would have thought
this should be much
shorter - eg the highlighted
selection? (would fit on 2 pages)*

FROM: R I G ALLEN
DATE: 30 MARCH 1988

PS/CHANCELLOR

Could circulate tomorrow if you are content.

cc Mr Pickford
Mr Hudson
Mr Segal
Mr Cropper

*mgn
30/3*

OVERSEAS PRESS REACTIONS TO THE BUDGET

In response to your minute of 28 March, I attach a select anthology of overseas comments on the Budget.

*Thanks. I think it's all
OK except for the 1st quote,
which says '...'.
On the 1st quote, however, psc
calculate to PM (copy to
only to the 1st quote. (copy to
with cover was from psc)*

R I G ALLEN



pay

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

31 March 1988

Paul Gray, Esq
No.10 Downing Street
London SW1

Dear Paul,

OVERSEAS PRESS REACTIONS TO THE BUDGET

X The Chancellor thought the Prime Minister might be interested to see the enclosed anthology of overseas comments on the Budget, and on the UK economy in the light of the Budget.

I am copying this letter to Simon Judge in the Paymaster General's office here.

*Yours
Alec*

A C S ALLAN



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

31 March 1988

Paul Gray, Esq
No.10 Downing Street
London SW1

Dear Paul,

OVERSEAS PRESS REACTIONS TO THE BUDGET

The Chancellor thought the Prime Minister might be interested to see the enclosed anthology of overseas comments on the Budget, and on the UK economy in the light of the Budget.

I am copying this letter to Simon Judge in the Paymaster General's office here.

Yours
Alec

A C S ALLAN

Journal of Commerce 16.3.88

"Buoyant revenues generated by a booming economy enabled Chancellor of the Exchequer, Nigel Lawson, to slash the top rate of income tax and lower the lowest income tax bracket"

Wall Street Journal 16.3.88

" the British Chancellor, Nigel Lawson, introduced what surely will go down as a historic tax reform for Mrs Thatcher's government."

"The winners will be the British people, at all levels of income, and in all regions of the country."

"Britain has returned to the lead in the global swing toward free economics and pro-growth policies based on individual initiative."

Washington Times 24.3.88

" the most sweeping tax reform and tax reduction in British history."

The Christian Science Monitor 27.3.88

" ... the most radical change in Britain's tax structure since World War II."

" a personal triumph for Lawson, who, during five years as Chancellor has simultaneously reduced inflation to 3.3 per cent and cut taxes."

Business Week 28.3.88

"With Britain now in the seventh year of a powerful recovery that's becoming the envy of the globe "

" Thatcher is taking over from a flagging West Germany the job of helping keep the world economy on an even keel as the US slows."

Newsweek 28.3.88

"Since Margaret Thatcher became Prime Minister in 1979, Britain has been transformed from the sick man of Europe to an economy of enviable vitality."

" Lawson's Budget was probably a landmark in Britain's postwar fiscal history - and perhaps that of Europe as well."

WEST GERMANY

Handelsblatt 16.3.88

"The once sick man of Europe has become the most dynamic economic nation in Europe."

Die Zeit

"The term 'economic miracle' is now being applied in connection with Britain."

"In the past, the German model was praised in an almost embarrassing manner and compared with Great Britain's bad example. Now it is the other way around."

Rheinischer Merkur

"Ten years ago the UK's economy was still Europe's problem child; today it has moved to the top of European countries as far as growth rate is concerned. In view of the Budget surplus of the £3bn, Governments and Finance Ministries in the rest of the world, above all in Washington, and also in Bonn, are facing almost a miracle."

FRANCE

Liberation 16.3.88

"The most fundamental and most daring Budget since Margaret Thatcher came to power."

" ... the exceptional dynamism of the British economy."

Le Figaro 16.3.88

"[Mr Lawson] introduces an income tax reform without parallel in the West."

"The Thatcher government has, once again, shown a boldness rare in Europe."

Tribune de l'Expansion 16.3.88

"Great Britain has won the fiscal jackpot."

"Nigel Lawson outline the most ambitious fiscal reform in the western world ... thanks to the exceptional performance of the British economy."

Les Echos 16.3.88

"A radical reforming budget."

Le Monde 16.3.88

"... a gold Budget realising the impossible dream of every finance minister: a balance of receipts and expenditures, combined with major tax reductions."

Le Figaro 17.3.88

"The British Government provides an example of firmness and constancy in its medium-term fiscal strategy while demonstrating great flexibility in execution"

Corriere Della Sera 16.3.88

"For the first time in twenty years, the British economy is no longer 'the sick man of Europe'."

"An Italian observer would have had to struggle yesterday against a deep feeling of envy while the Chancellor of the Exchequer, Nigel Lawson, presented his Budget to the House of Commons."

"The proceeds of privatisation have certainly helped but the explanation lies in the strengthening of the entire economy which was 'the sick man of Europe' in the 60s and 70s and which today has begun to function again."

Il Sole 24 Ore 16.3.88

"To the Italian observer, the feature of the balance sheet which stands out most clearly, in stark contrast to the facts of our own case, is the public sector surplus of £3 billion."

JAPAN

Yomiuri

" ... the Thatcher miracle."

Asahi

" ... a budget too bold for the Japanese government."

Nihon Keizai

" the changing image of Britain a country of individual enterprise rather than cradle to grave welfare."

UNITED STATES

New York Times 16.3.88

"As architect of five previous Thatcher budgets, Mr Lawson has won a reputation as a budgetary genius for his ability to cut taxes while reducing inflation to the current annual rate of 3.3 per cent and giving Britain its first balanced budget in almost two decades."

Journal of Commerce 16.3.88

"Buoyant revenues generated by a booming economy enabled Chancellor of the Exchequer, Nigel Lawson, to slash the top rate of income tax and lower the lowest income tax bracket"

Wall Street Journal 16.3.88

" the British Chancellor, Nigel Lawson, introduced what surely will go down as a historic tax reform for Mrs Thatcher's government."

"The winners will be the British people, at all levels of income, and in all regions of the country."

"Britain has returned to the lead in the global swing toward free economics and pro-growth policies based on individual initiative."

Washington Times 24.3.88

" the most sweeping tax reform and tax reduction in British history."

The Christian Science Monitor 27.3.88

" ... the most radical change in Britain's tax structure since World War II."