



Treasury Chambers, Parliament Street, SW1P 3AG
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Paul Gray Esq
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Dear Paul,

THE BUOYANCY OF TAX REVENUES

... I attach a note about the buoyancy of tax revenues, which the Chancellor said he would send the Prime Minister.

Yours
Alex

A C S ALLAN
Principal Private Secretary

THE BUOYANCY OF TAX REVENUES

We now estimate that the "non-oil tax burden" (the ratio of non-North Sea taxes to non-oil GDP) would rise by 1.7 percentage points over the next four years if there were no further changes to tax rates and allowances beyond simple indexation (see table 1). This amounts to £7¼ billion in today's prices or almost £2 billion a year. In practice the profile is unlikely to be smooth and we expect most of the projected rise to be concentrated in the first half of the period.

2. There are two main reasons for the buoyancy of non-oil tax revenues (see table 2).

3. Income tax tends to rise faster than incomes when allowances and bands are indexed in line with prices but earnings are increasing faster than that. The faster the growth of earnings relative to prices, the more significant this effect becomes. Over the next four years income tax accounts for about half of the buoyancy of non-oil tax revenues.

4. Secondly, corporation tax payments by non-North Sea companies are expected to rise strongly next year - continuing the pattern of recent years - and this accounts for the remainder of the tax buoyancy. This is mainly due to the sharp growth of profits in 1987 (over 25 per cent for non-North Sea industrial and commercial companies as a whole). In addition with several years of high profits growth it is likely that an increasing proportion of companies have ceased to be "tax exhausted".

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5. The 1984 corporation tax reforms, which reduced the value of allowances in return for a lower corporation tax rate, may have augmented this effect. During the transition the annual level of allowances has been running at an unusually low rate. But as the years go by the annual level of allowances will build up again. This helps to explain the fall in non-North Sea corporation tax receipts as a share of GDP after 1989-90 (table 2).

6. The result is that it will require tax "reductions" of approaching £8 billion (at today's income levels) over the next four years merely in order to stop the overall non-North Sea tax burden from rising. This is slightly more than the effect of the Budget package. Taking account of the proposed Budget package, we therefore project a post-Budget non-oil tax burden for 1991-92 that is slightly above the figure we estimate for 1987-88 (see table 1).

7. As the ratio of public expenditure to GDP declines gradually over the medium term there should be further scope for tax reductions while still maintaining a balanced Budget.

4 March 1988

Table 1

Non-North Sea taxes in relation to non-North Sea
GDP

	Non-oil tax burden (pre-budget)	Non-oil tax burden (post-budget)
1983-84	37.8	37.8
1984-85	37.8	37.8
1985-86	37.0	37.0
1986-87	37.3	37.3
1987-88E	37.5	37.5
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1988-89F	38.6	37.7
1989-90F	39.1	37.8
1990-91F	39.3	37.8
1991-92F	39.2	37.6

E: Estimate

F: Forecast

Table 2Pre-budget share of non-oil taxes in non oil GDP

	Income tax	Non North Sea CT	NICs	LA rates*	Other indirect taxes	Stamp duties and capital taxes
1983-84	10.9	1.9	7.3	4.2	11.8	1.0
1984-85	10.8	2.2	7.3	4.2	12.3	0.9
1985-86	10.4	2.4	7.1	4.0	12.2	1.0
1986-87	10.2	3.0	7.0	4.1	12.0	1.2
1987-88E	9.8	3.4	6.9	4.1	11.8	1.5

1988-89F	10.2	4.0	7.0	4.3	11.6	1.5
1989-90F	10.4	4.0	7.0	4.4	11.6	1.5
1990-91F	10.6	3.9	7.1	4.4	11.6	1.6
1991-92F	10.7	3.7	7.0	4.4	11.5	1.7

E: Estimate

F: Forecast

* including national non-domestic rate and Community Charge.