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PART A

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PART A

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PART A

1986 BUDGET PROFIT SHARING AND BUDGET STATEMENT

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28-2-86

CLOSED

CONTINUED ON:-

PART B

FINANCIAL SECRETARY TO THE TREASURY

FROM: VIVIEN LIFE
DATE: 20 December 1985

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Kemp
Mr Byatt
Mr Monck
Mr Cassell
Mr Burgner
Mr Odling Smee
Mr G White
Mr Riley
Mr Gilhooly
Mr H J Davies
Mr Cropper
Mr Lord
Mr Isaac IR
PS/IR

Ch
You discussed this with FST last week. Content to let this one drop?
AWK 23/12

No: I must remain on the Chairman's menu

PROFIT SHARING

1. At his meeting on 4 October the Chancellor asked Mr Isaac, consulting Mr Monck and reporting to the Financial Secretary, to look at a possible scheme, offering a tax incentive for profit sharing.

2. Mr Isaac's minute of 12 December represents the outcome of this work, for which the Financial Secretary is very grateful.

3. He is clear that the scheme follows the principles that Ministers had in mind. But having considered the proposal with some care, he has concluded that he is not attracted to the idea of pursuing this further. His fundamental concern is the high revenue cost - £250m - compared with the very uncertain benefits.

VL

VIVIEN LIFE

CONFIDENTIAL

FROM: A J G ISAAC

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

12 December 1985

ISACC → FST 12/12

FINANCIAL SECRETARY

PROFIT SHARING

1. As agreed at your meeting on 1 November, the attached note seeks to outline a possible scheme, offering a tax incentive for "profit sharing" on Weitzman lines. I am sorry that this response has been so long delayed. It has, in particular, taken a lot of work to agree with the Treasury the basic algebra of the proposed profit sharing formula (the Annex to this note). And, as you will see, it still has some traps for the unwary.

NATURE OF THE SCHEME

2. The outline scheme has three outstanding features. First and foremost, I hope that you will forgive me if I emphasise again the extent to which it is an act of faith. Second, it is shorter and simpler than such things can be

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cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Sir T Burns
Sir P Middleton
Mr Kemp
Mr Byatt
Mr Monck
Mr Cassell
Mr Burgner
Mr Odling-Smee
Mr G White
Mr Riley
Mr Gilhooly
Mr H J Davies
Mr Cropper
Mr Lord

Chairman
Mr Isaac
Mr Painter
Mr Blythe
Mr Lewis
Mr Weeden
Mr Farmer
PS/IR

(though I do not promise that our most heroic efforts could produce a scheme that the layman perceives as "short and simple" tout court - or that the legislation would be short or appear simple). Third, both the structure and administration are independent of the rest of the tax system.

An act of faith

3. The essential objective is to break the present rigidity in the wages market. For those within the scheme, take-home pay would fluctuate - upwards or downwards - in response to movements in company profits. As a result, employers would be under less pressure to lay off workers in a bad year, and have more incentive to take on additional workers in a good year. For this purpose, employees' remuneration is (very briefly) basic pay (not more than 80 per cent of the total at the outset) negotiated in the normal way; and the "profit share" (not less than 20 per cent) varying with movements in the employer's profits from year to year.

4. For those within the scheme, 10 per cent of total pay (basic pay plus profit share) is free of tax.

5. For the scheme to achieve its objectives

- The "profit share" must in practice respond to genuine movements in employers' profits.

- The "basic pay" must not become a kind of balancing factor: for example, if in any individual year the "profit share" is falling, annual negotiations on the "basic wage" must not yield a higher-than-normal increase, so as to insulate total take-home pay from the effects of the fall in the employer's profits.

- The tax incentive must not just be used to increase employees' take-home pay.

- Employees themselves must resist the temptation (because of the effect on their take-home pay) to oppose the hiring of additional workers.

6. Everyone who has looked at the scheme is agreed that in practice <u>none</u> of these conditions can in practice be enforced effectively, if at all. The realistic objective would be that the scheme would help, in a more or less general way, to create an industrial climate more responsive to market forces, and a labour market less committed to its present rigidity.

<u>Simple - within limits</u>

7. The tax relief and the conditions for its operation must clearly be plausible, and this could mean some fairly detailed rules in the legislation. This apart, however, as paragraph 6 explains, it is impossible to police effectively the main features of the scheme. A balance has therefore to be struck between those rules and definitions which would be needed to present a coherent, convincing (and potentially expensive) tax relief, and other provisions which might be unnecessary given the lightness of control envisaged.

8. Two constraints in particular would be essential, to limit the scope for blatant abuse:

- Tax relief should be given as a percentage of <u>total remuneration</u> from the employment in question - not as a percentage of the "profit share" within total remuneration. (This is because there will be the normal commercial constraints on the <u>total</u> amount of remuneration which an employer is willing to pay. But there is no practical way of policing the amount of the "profit share" - within that total - or the extent to which it is in practice dependent on genuine movements in the employer's profits.)

- There should also be an upper limit - say £2,000 a year - on the total remuneration wages which an employee may enjoy tax free under the scheme. (This is because there is no effective way of ensuring that total remuneration under the scheme is in practice responsive to movements in the employer's profits, and because otherwise there would be scope for companies to pay directors or other favoured employees tax-free bonuses of £20,000 a year and upwards for going through a mere charade of profit sharing.)

Outside the tax system

9. The scheme is designed so that it can be run independently of the rest of the tax system. At no point need it involve Inspectors of Taxes or tax offices. As presently designed, it need not even involve collection offices (or, if DHSS were to make difficulties about NI contributions, involve collection offices to an absolute minimum). The working assumption is that the scheme would be administered by the Inland Revenue. In principle, however, the work could be done by the Department of Industry or the Department of Employment.

PRESSURE POINTS

10. The main areas, which we and the official Treasury have so far identified as likely to give rise to pressure or criticism, are value for money, the self-employed, and administration.

Value for money

11. We all find it very difficult to guess how attractive the scheme could be, and therefore to guess the likely level of take-up. On the one hand, negotiators in this country are notoriously cautious and conservative - particular when faced, as they would be here, with a pretty complex proposition. On the other hand, the incentive - "up to £2,000 a year tax free" - could just possibly capture the public's imagination. However that may be, there is the risk that, in the final event, the lion's share of the tax relief could end up just as an increase in employees' take-home pay, with little or no significant impact on market rigidities. Ordinary shareholders and the Investment Protection Committees could be antagonistic. We can see circumstances in which many companies could find the scheme decidedly unattractive to investors and perhaps discouraging to capital investment. This is one important aspect of the "act of faith".

12. A serious practical problem could arise with smaller businesses whose profits for year 1 may not be established until year 3 has started. Because of this time lag the link between pay and profits could be somewhat attenuated, and the purpose of the scheme frustrated.

The self-employed

13. The scheme assumes that all employers would be eligible: large companies, small companies, subsidiary companies (whether the parents are quoted or unquoted) and unincorporated businesses. With your strong agreement, we assume that it would be politically unacceptable to discriminate in any way against small employers in general.

14. Thus, those excluded from the scheme would be the self-employed, to the extent that they were working on their own account, or were members of a partnership (and also public sector employees and those working for other non-profitmaking organisations).

15. Some of us see this as a major area of pressure.

16. On the one hand, there would on the face of it be no purpose in extending the scheme to the self-employed (and so to one-man companies and controlling directors). Their income is already wholly (or, in the case of directors, largely) dependent on the profits of the business. For them, the relief would simply provide that the first 10 per cent - or £2,000 - of Schedule D income and directors' remuneration would be tax free, without conditions. This would, at a stroke, add anything up to £600 million to the cost of the scheme - for nothing in return. It would also very seriously aggravate the present problem at Schedule D/Schedule E borderline. For all these reasons, you were clear that any scheme would have to exclude the self-employed on their own account (together with partners and controlling directors).

17. However, the result would appear to discriminate against the self-employed and be very difficult to reconcile with the Government's general strategy.* Thus, at least one main purpose of the scheme would be to involve employees more closely with the profitability of the business, and to make them more "entrepreneurial" and more responsive to market forces. On this basis, would it be defensible to exclude the genuine "entrepreneurs", whose whole income (not

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* Contrast, for example, the well-publicised proposal from the Institute of Directors that the self-employed should have an additional £5,000 of income tax free, over and above the normal tax threshold available to employees.

just 20 per cent) depends on their own exertions? Could Ministers defend the position in which an employee earning £15,000 a year gets tax relief on £1,500; but if he leaves his employer and sets up on his own account (earning the same income) he suffers a "tax penalty" of £450 a year, solely because he has become self-employed?

Administration

18. In earlier discussions people envisaged that a scheme might be confined, in the first instance, to the larger employer. 450,000 employers - 45 per cent of the total - employ 90 per cent of the workforce. But this could exclude over half a million small employers.

19. For familiar reasons, the scheme envisages that administration would be done by a central office, right outside the tax system. The uncertainty about take-up poses a problem here. We clearly do not want to set up a large office, which might be left idle. But if the response were good, a very small office could be swamped with applications, leading to delays and natural criticism.

20. The problems could be reduced, to the extent that the rules required standard documentation, based on self-certification and self-assessment - with a minimum of vetting by the central office, backed by relatively small monitoring/audit effort after the event. The uncertainties here will need further study, in the light of Ministers' decisions.

21. At the earlier discussion, you noted one technical, but important, implication of this approach. It is in the nature of a self-certified/self-assessed scheme that the subsequent "audit" will identify some employers as having given too much tax relief to their

employees. There would have to be provisions to recover the excess tax relief, together with interest and penalties. On administrative grounds, the scheme assumes that there could be no question of trying to recover from the employees. The tax, interest and penalties would therefore need to fall on the employer.

COST

22. With over 14 million employees in the private sector, a tax relief of the kind discussed which was fully taken up could theoretically cost more than £3 billion in a full year. As I have said, the likely actual take-up is difficult to assess. A better measure may be the calculation that for each one million employees on average earnings covered by profit-sharing contracts the revenue cost in a full year might be of the order of £250 million.

C.L.

OUTLINE OF A POSSIBLE TAX INCENTIVE FOR PROFIT SHARING

1. Nature and purpose of tax incentive. An income tax incentive for employees who agree to accept part of their remuneration as dependent on their employer's commercial performance. By encouraging employees to enter into such agreements, employers could more easily be able to secure greater flexibility in the remuneration of employment. By reducing their fixed labour costs, their propensity to engage additional employees would be increased.

2. Conditions. Conditions to be met if the tax incentive was to operate might include:

    - Inland Revenue approval of a scheme agreed between employer and employees providing for

        - the employer's freedom to engage additional labour

        - at least 20 per cent of every employee's remuneration at the outset to be liable to fluctuate subsequently and during the currency of the scheme in line with changes to the employer's profits (these to be defined in the scheme and to be unalterable subsequently)

        - the formula by which fluctuations in profits are to be reflected in such "share income"

        - the means of determining both remuneration for new employees and the effect on continuing employees of changes in total workforce

- <u>all employees</u> (full and part-time, but not casuals) to be covered by the scheme. Controlling directors to be excluded

- the scheme to operate for a minimum of [3 years]. Provisions to cover such events as takeover of the company, amalgamations, windings up.

3. <u>Eligible employers</u>. By definition a scheme would be operated only by employers. Employers eligible would <u>include</u> quoted companies, unquoted companies (including subsidiaries of quoted or unquoted companies), unincorporated businesses. Each would be entitled to introduce and operate its own scheme even though it might be a member of a group or associated with others; but group schemes would be permitted.

   Public services, state industries and non-profit-making organisations would be <u>excluded</u> (absence here of the need for means to encourage employment and/or the lack of performance measurements of the profit variety).

4. <u>Extent of tax relief</u>. Employees participating in a scheme would enjoy relief from income tax on 10 per cent (up to a maximum of say £2,000 pa) of their total remuneration (excluding benefits in kind?) from the employment in question for as long as the scheme continued. Measures to prevent avoidance of the limit would be necessary eg to exclude directors or to prohibit participation in more than one scheme.

5. Operation of the scheme. At the outset, at least 20 per cent of employees' remuneration would be converted to share income. This figure would also be used to define the fraction of profits plus share income used during the currency of the scheme to calculate share income in later periods. However, because of the inevitable delay in obtaining profit figures the fraction would be applied to profits plus share income for the latest period for which profits information was available. Share income per employee would depend on the figure of total share income and the number of eligible employees, which depends on average employment during the period. A worked example and commentary on this formula is attached.

6. Operation of the tax relief. Inland Revenue resource constraints dictate their minimum involvement in operation and control of the tax relief. The optimum mechanism would be a net pay arrangement, requiring "scheme" employers to operate income tax on only 90 per cent (or more in the case where the £2,000 limit on unrelieved share income applies) of gross pay. Any mechanism short of sophisticated arrangements involving substantial Revenue commitment will mean imperfect effects in some cases, eg low paid workers close to the tax threshold, employees participating in two or more schemes, employees with two or more sources of income.

7. Sanctions on employers. Impractical, and in some cases unreasonable, that employees who were wrongly given the benefit of the tax relief by their employers should be liable to repay it. Circumstances include unapproved changes in the scheme (eg a switch from one profit measure to another), premature abandonment of the scheme,

incorrect calculation of relief. Recovery, together possibly with penalties, should be possible from the employer - subject to appeal procedures.

8. <u>Inland Revenue commitment</u>:

Centrally:

i. approve schemes

ii. spot checks on operation of schemes

iii. recovery from employers where necessary

iv. receive annual returns from scheme operators

Locally:

Possibly - if it cannot be avoided in the exceptional case - clarify any problems arising from difference between figure for pay on individuals' returns and employer returns.

THE PROFIT SHARING FORMULA

1. The following worked example illustrates how the scheme might work. In the table the fraction used is 0.5 (= 20/40) and is obtained from the line of "converted figures" obtained when the scheme is set up initially. This coefficient is applied in later periods to the latest available figure for profits plus share income (final column) which here is assumed to be the figure for the previous period. The figures in brackets in the profits column are profits figures assuming that no conversion takes place (wages remain at 100).

	Total employee remuneration	Total employee share income	Total profits	Total profits plus share
Initial figures	100	-	20	20
Converted figures	80	20	20	40
Scheme:				
Period 1	80	20	40 (40)	60
Period 2	80	30	30 (40)	60
Period 3	80	30	-20 (-10)	10
Period 4	80	5	5 (-10)	10

2. The mathematics of the scheme implies the following points:

i. At levels of share income plus profits above initial levels, and assuming employment is unchanged, employees gain relative to companies/shareholders, as illustrated by the figures for periods 2 and 3. The opposite may be the case where the figures fall persistently (period 4). But the scheme encourages companies to employ extra workers which depresses profits per head but raises total profits, so that, other things being equal, companies/shareholders might be expected to gain in practice. It is this factor that justifies directing the tax relief towards employees rather than companies.

ii. There is an inevitable one period lag that elapses before share income adjusts to the "correct" figure. This can lead to windfall profits or losses for the company when profits vary markedly, which are amplified by the value of the fraction used to calculate share income. Companies will wish, therefore, to set up a scheme when profits are high relative to wages, or alternatively use a broader rather than a narrower definition of profit.

iii. There will be circumstances when it would not be sensible to set up a scheme at all eg when profits initially are negative.

iv. Assuming that a condition of the scheme is that share income would not decline below zero the minimum pay received by the employee is 80.

bf 3/1

DAVIES 2/1

FROM: H J DAVIES
DATE: 2 JANUARY 1986

CHANCELLOR

cc CST
FST
MST
EST
Sir P Middleton
Sir T Burns
Mr Kemp
Mr Byatt
Mr Monck
Mr Cassell
Mr Burgner
Mr Odling-Smee
Mr G White
Mr Riley
Mr Gilhooly
Mr Cropper
Mr Lord

Mr Isaac - IR
PS/IR

I have already decided that this should remain on the agenda for Chevening, where HJD will be able to deploy his case. (Sir LA will, inevitably, be better ~~[illegible]~~ briefed on the economics of it.)

PROFIT SHARING

I was disappointed to see that the Financial Secretary (Ms Life's minute of 20 December) had recommended that the idea of offering tax incentives for profit sharing schemes should not be pursued further.

2. I continue to believe that a scheme on the lines sketched out in Mr Isaac's minute of 12 December could make long-term economic sense, and has short and long-term political attractions.

3. Since we last discussed the subject, in October, the problem of excessive pay settlements has assumed more, rather than less, importance in public debate on the economic prospect. It takes various forms, from CBI breast-beating to Sam Brittan's Layard-type ideas for employment-related NIC holidays. Some critics exaggerate the problem, some draw wrong conclusions about the way in which policy should be adjusted as a result. Others attack the government on the basis that its rhetoric about the danger of high pay settlements is not backed up by action.

4. This criticism is unfair, since we have been careful not to argue that unions should ask for less, rather that employers should take a longer-term view of their companies interests in pay negotiation. But however unjust the criticism, I think there is little doubt that the reception of your Budget will be affected by the way it is seen to relate to the problem of pay. Not, perhaps, the reception of the man in the street. But of those commentators who might be inclined to give the Government the benefit of the doubt if they saw some acknowledgment of the need to spread the benefits of growth more broadly.

5. At present, as Mr Monck's Chevening paper makes clear, we have no strong runners in this area. The NIC proposals look unattractive for various reasons. This leads me to think that a profit-sharing initiative could pay large presentational dividends.

Objections to the Scheme

6. I see three major objections to going ahead.

7. First, that a profit-sharing scheme such as the one the Inland Revenue have developed is not, and would not be seen to be, significant enough to influence opinion one way or the other.

8. Second, that it is costly, for uncertain benefits (the Financial Secretary's point).

9. And third, that any scheme tolerable from the Treasury's perspective would exclude and therefore upset, the self-employed (the Chief Secretary's point).

Insignificance

10. It would certainly be wrong to present a profit-sharing scheme as the Government's answer to excessive pay settlements and continued labour-shedding. But you would not need to do this for it to be interpreted as an attempt to offer employers and unions an opportunity to strike a new type of deal which offered a greater

prospect of both wage flexibility and increased aggregate employment. No-one could forecast accurately the extent of take-up. But I doubt if you could be accused of over-timidity if the carrot of 10% of pay tax-free were offered.

11. I think you would wish to say that the scheme was a method of increasing the identification of the workforce, particularly of major companies, with the fortunes of their employers. It would allow this to happen where, so far, employee share schemes had not been widely established. If both sides of industry were able, as a result, to strike deals which favoured increases in output and employment, then that would be a bonus.

12. I see little downside here, in presentational terms, at least for a year or two - even if no new-style deals were established at all. However complicated the algebra the fundamental proposition is quite straightforward, and easy to explain.

Cost

13. The Financial Secretary's "fundamental concern is the high revenue cost - £250m - compared with the very uncertain benefits."

14. As I understand it, £250 million is the full-year cost for each one million employees on average earnings. The actual cost in year one, or any year, could be zero, or considerably higher. As for the benefits, they are uncertain at two levels. First, the take-up. At that level, though, there would be no cost unless there were benefits. So the concern must be that even where profit-sharing deals were struck within the terms of the scheme, there wouldbe no benefits. (Of course one cannot simultaneously argue that no-one will take up the offer so why bother to make it, and that the key provisions will be easy to circumvent in a costless fashion.) To some extent this is an empirical question. Can we envisage circumstances in which qualifying deals might be struck which did not increase downward flexibility in wages, and did not result in any increase in employment levels, above what they would otherwise have been?

15. Mr Isaac argues that we cannot hope to police the scheme in a foolproof manner. I am sure he is right. But the rules the Revenue have devised look quite tight to me. And given, as Mr Isaac describes it, the cautious and conservative nature of our wage bargainers, the uncertainty seems to lie more in the size of the take-up, and if the take-up is low, then so is the cost.

The Self-Employed

16. At the October meeting we identified this as a key political problem. The Revenue paper does not offer any new solutions. But I do not agree that the exclusion of the self-employed "is difficult to reconcile with the Government's general strategy" (para 17). Though we may wish to encourage self-employment we do not do so at any price. And we do so because of the economic benefits, not because we prefer self-employment per se. The tax and NIC benefits already enjoyed by the self-employed can be justified in relation to the labour market benefits brought by an expansion in their numbers. A profit-sharing scheme for employees can be justified in a very similar way.

17. No doubt there would be objections. But the self-employed lobbyists object to anything the Government does short of exempting them from tax altogether, and (as "How Britain Votes" shows us) their clients still vote Conservative in overwhelming majority.

Conclusion

18. I see a profit-sharing scheme on the lines developed by officials as potentially an exciting and radical feature of the Budget, and one which could contribute to securing a favourable reception to the principal tax proposals.

19. It would be a partial response to those who argue that the pay problem is the most important issue of economic management we now face, and one to which we have no answer. It also fits well into the theme of ownership which the Prime Minister has been developing further in recent weeks, showing that we are prepared to support extensions of the principle well beyond the ranks of the individual shareholder.

Come off it!

J. Smith

pp H J DAVIES

CONFIDENTIAL

bf with HJ Davies note 3/1 ~~ca~~ att.

FROM: P WYNN OWEN

DATE: 2 January 1986

PS/FINANCIAL SECRETARY

cc: PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Kemp
Mr Byatt
Mr Monck
Mr Cassell
Mr Burgner
Mr Odling Smee
Mr G White
Mr Riley
Mr Gilhooly
Mr H J Davies
Mr Cropper
Mr Lord

PS/IR

WYNN OWEN → PS/FST 2/1

PROFIT SHARING

The Chancellor has seen your minute of 20 December and Mr Isaac's minute of 12 December. He notes the Financial Secretary's views but would like the subject to remain on the Chevening menu.

Nigel Fray

pp. **P WYNN OWEN**

SECRET AND PERSONAL: CMO

PS/Chancellor

To be seen by: Mr F.E.R. Butler

RUP

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

2 October 1986

Dear Jill,

PUBLIC EXPENDITURE

The Prime Minister held a short meeting yesterday evening with the Lord President and the Chief Secretary to discuss public expenditure. Professor Brian Griffiths and Mr. Brian Unwin were also present.

The Chief Secretary outlined the position reached so far in discussion of public expenditure bids. The Prime Minister commented that the presentation of the decisions would need very careful consideration. It would be right to put a large share of the blame on local authority mismanagement.

There was some discussion of the social security up-rating to be announced following publication of the September RPI on 17 October. The Prime Minister and the Lord President saw political attractions in an increase in the single pension of £1 or more (with the equivalent for a married couple) as against the 75p which would result from an increase in line with the RPI. However, this would cost £135 million and it was not easy to see where the money could be found: a decision not to uprate unpledged benefits would not provide enough even if that were itself politically acceptable.

In a discussion of other bids, the Prime Minister commented that she was not over-sympathetic towards bids for more resources for health: all the evidence showed increasingly the great scope for improving efficiency.

The Chief Secretary said he had drawn two conclusions from this year's discussions: the Government would need at some stage to take further major action towards changing social security, though without the brouhaha which had surrounded the social security review, and secondly, thought would need to be given to how local authority expenditure was scored in the planning total.

It was agreed that the Chief Secretary should refer at Cabinet today to the bilaterals and setting up of the Star Chamber. Public reference to the Cabinet discussion should be avoided if at all possible.

It was also agreed that the Star Chamber would comprise the Lord President, the Chancellor of the Duchy of Lancaster, the Lord Privy Seal, the Paymaster General and the Chief Secretary. The Secretary of State for Wales might be invited to become a member of the Star Chamber if his programme was settled in time after his return from the United States on 12 October.

I am copying this letter to Joan MacNaughton (Lord President's Office) and to Michael Stark (Cabinet office).

Yours,

David.

DAVID NORGROVE

Miss Jill Rutter,
Chief Secretary's Office,
H.M. Treasury.

SECRET AND PERSONAL

SCORECARD
Copy No. 1 of 15

FROM: COLIN MOWL
DATE: 10 October 1986

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Sir T Burns
Mr Anson
Mr Monck
Mr Cassell
Mr Sedgwick
Mr Turnbull
Mr Gray
Mr Darlington
Mr Tyrie

Thanks. This would indicate that for 1987-88 we shd be thinking in terms of putting a £3 bn rather than a £3½ bn reserve, & a smaller lower planning total. Indeed, we will need to lower PX as a declining % of GDP. For 1988-89, however, there will need to be a bigger reserve & the show. I shd be interested in Mr Butler's comments on the v. big discrepancy between the PSF & GEP for that year. L

PUBLIC EXPENDITURE: COMPARISON OF OCTOBER FORECAST WITH LIKELY SURVEY OUTCOME

The Economic Forecast reports circulated today (Treasury Economic Forecast - Mr Sedgwick; Public Finances - Mr Mowl) compare the forecasters' assessment of the likely outcomes for the public expenditure planning total with the 1986 PEWP. This minute compares the forecast planning totals with GEP's assessment of the likely outcome of the current survey, as set out in the Scorecard of 6 October.

2. The main difference of principle between the GEP assessment and the forecast is that the latter attempts to take account, not only of net additions to programme plans during the current survey, but also claims on the Reserve during 1987-88 and 1988-89 and likely additions to plans in the 1987 survey. (The forecast does not go beyond 1988-89). The table attached summarises GEP's latest view of the likely additions to the 1986 programme baseline during the current survey and the additions implied by the forecast. It uses the breakdown of spending used to compile the forecast, rather than the more familiar departmental classification in the survey.

3. The total difference between GEP and the forecast, shown in row 10 of the table, gives an idea of the Reserve which, according to the forecast, would be required in the Autumn Statement to accommodate the overspends. The required reserve is £3 billion in 1987-88, a little below GEP's current working assumption, and £8 billion in 1988-89, some £3 billion above GEP's working assumption.

4. The table shows where the overspends are expected to occur. In every case the forecast has higher overspending. The main factors are:

Social security - greater take-up of non-contributory benefits; differences in economic assumptions reduce the overspend compared with GEP - although the benefit upratings are higher in the forecast, unemployment in 1988-89 is lower.

CG employment (wages+salaries) - larger pay increases;

CG other current - GEP's figures imply a fall in real terms; the forecast has, based on past trends, rising real spending and more inflation.

LA relevant current - rising manpower and pay increases in line with the private sector (the forecast assumes the authorities will be prepared to finance this with rate increases consistently well above RPI inflation).

Nationalised Industries - forecast assessment of industries' trading prospects suggests substantial overspending in 1988-89.

Other programmes - a heterogeneous category but the main additions are on subsidies and EC contributions. Differences are mainly due to differences in economic assumptions and the forecast judgement that overspending on certain programmes will continue.

5. An alternative presentation of the overall picture is shown below:

£ billion

	1987-88		1988-89	
	GEP	**Forecast**	**GEP**	**Forecast**
Programme baseline	142.6	142.6	145.6	145.6
Additions to programmes	7.5	10.5	8.1	16.1
Privatisation	-5.0	-5.0	-5.0	-5.0
Assumed Reserve	3.5	-	5.0	-
Projected planning totals	148.6	148.1	153.7	156.7

6. The conclusion is therefore that while a £3½ billion reserve might prove adequate in 1987-88, there is a real risk that £5 billion would be too low for 1988-89.

Colin Mowl

COLIN MOWL

SECRET AND PERSONAL

ADDITIONS TO PROGRAMMES RELATIVE TO SURVEY BASELINE - £ billion

		1987-88			1988-89		
		Likely Survey Outcome (GEP)	October Forecast (PSF)	Difference (Claims on Reserve)	Likely Survey Outcome (GEP)	October Forecast (PSF)	Difference (Claims on Reserve)
1.	Social Security (UK, excl. admin.)	1.4	1.8	0.4	1.5	2.3	0.8
2.	CG employment	0.6	0.7	0.1	0.6	1.8	1.2
3.	CG other current	0.2	0.7	0.5	0.2	1.8	0.6
4.	LA relevant current	4.0	4.7	0.7	5.1	7.2	2.1
5.	LA capital	0.6	0.7	0.1	0.2	0.7	0.5
6.	Nat. industries	0.4	0.6	0.2	0.3	1.2	0.9
7.	Other programmes	0.3	1.2	0.9	0.2	1.1	0.9
8.	Total additions to programmes	7.5	10.5	3.0	8.1	16.1	8.0
9.	Privatisation	-0.3	-0.3	0.0	-0.3	-0.3	0.0
10.	Forecast of required Reserve			3.0			8.0

LD/088

SECRET AND PERSONAL

SCORECARD
COPY NO 17 OF 17

1 ~~Alex~~
2 PWP.

FROM: CATHY RYDING
DATE: 13 OCTOBER 1986

MR MOWL

cc Chief Secretary
Sir P Middleton
Mr F E R Butler
Sir T Burns
Mr Anson
Mr Monck
Mr Cassell
Mr Sedgwick
Mr Turnbull
Mr Gray
Mr Darlington
Mr Tyrie

PUBLIC EXPENDITURE: COMPARISON OF OCTOBER FORECAST WITH LIKELY SURVEY OUTCOME

The Chancellor was grateful for your minute of 10 October.

2. The Chancellor has commented that this would indicate that for 1987-88 we should be thinking in terms of publishing a £3 billion rather than a £3½ billion reserve, and a similarly lower planning total. Indeed, we will need to in order to have public expenditure as a declining percentage of GDP. For 1988-89, however, more thought will need to be given to the right reserve to show. The Chancellor would be interested in Mr Butler's comments on the very significant disparity between the GEP and PSF figures for that year.

C.R.

CATHY RYDING

Forecast

PWP

FERB → CH/EX 14/10

SECRET AND PERSONAL

FROM: F. E. R. BUTLER
14th October, 1986.

CHANCELLOR OF THE EXCHEQUER

Ch
The action from this minute — level of the Reserves in future years — is perhaps best taken @ a later meeting, not tomorrow.
AA

357

c.c. Chief Secretary
Sir P. Middleton
Sir T. Burns
Mr. Anson
Mr. Monck
Mr. Cassell
Mr. Sedgwick
Mr. Turnbull
Mr. Gray
Mr. Darlington
Mr. Tyrie

PUBLIC EXPENDITURE: COMPARISON OF OCTOBER FORECAST WITH LIKELY SURVEY OUTCOME

You asked for my comments on the disparity between GEP's forecast outcome of the Survey for 1988-89 and the short-term forecast figures for that year.

2. Perhaps I can first comment on 1987-88. As you have remarked, the forecast indicates that we only need a reserve of £3 billion for that year. In this respect the forecasters' judgement is still the same as it was in June, although the components have changed considerably and the margin of error is very large. To take just two examples, the capital restructuring of British Rover which the forecasters have put in 1986-87 could very easily fall in 1987-88, and there is scope for the outcome on teachers' pay to be significantly worse than the forecasters have assumed. Even if the forecasters are right, the question is whether a reserve of £3 billion would carry conviction with the markets, when we will be publishing an overspend of £1½-2 billion for the current year despite a reserve of £4½ billion.

3. For 1988-89 the forecasters have increased their view of the likely outcome by £1.3 billion compared with June. Again, there are a number of ups and downs in the individual components and the margin of error is very large.

4. There is of course nothing surprising in a difference between the forecast of the Survey outcome on <u>programmes</u> and the forecasters' view of the overall outturn, particularly when the

forecasters have incorporated higher inflation and earnings than departments are expecting. The figure for programmes is the result of a negotiating process, in which we try to set control totals which exert a downward pressure on expenditure. Even for demand-led expenditure, where the negotiating factor is not present, the Government's natural reluctance to project inflation rates and unemployment rates which are higher than its objectives also introduces a downward bias.

5. The question which arises is whether we should set higher reserves to cover the possibility of later increases. This raises a dilemma. The forecasts suggest that, rather than a pattern of reserves of 3.5/5.0/6.5, we need one of 3/8/and perhaps 11. If we do not provide reserves of this size and the forecasters are right, we face the prospect of having to increase the planning totals again in next year's Survey (though we must, of course, remember that we have at least some discretion to take policy action to ensure that the forecasters are not right!).

6. But if we have higher reserves in 1988-89 and 1989-90, it follows that the planning totals would also be higher; and this would not only mean even bigger increases in the Autumn Statement and give an undesirable signal to local authorities, departments, pay bargainers etc. but it would also show public expenditure representing a higher proportion of GDP than we actually expect. This is because the forecasters' view of public expenditure incorporates a higher figure for inflation than we will be incorporating in the forecast of GDP. I attach a table which shows that, with reserves of 3.5/5.0/6.5, the outcome of the Survey as a percentage of the GDP in the published forecast will be close to what the forecasters really expect, although in fact the forecasters expect both the numerator and the denominator to be higher.

7. I do not think therefore that it would be sensible to incorporate reserves of 3, 8 and 11. But the question which the forecasters' exercise raises is whether we should, as we approach the end of the public expenditure exercise, shade down the reserve for 1987-88 and shade up the reserve for the two later years.

F.E.R.B

F. E. R. BUTLER

SECRET

GGE AS A PROPORTION OF GDP

	1985-86	1986-87	1987-88	1988-89	1989-90
1. GGE as per forecast	158.7	165.3	173.1	182.6	195.3
2. GGE as per GEP	158.7	165.3	173.8	181.5	187.2
3. GDP as per forecast	360.5	380.2	408.0	440.7	475.8
			(7.3)	(8.0)	(8.0)
4. GDP as per MTFS	360.5	380.2	406.8	431.2	454.9
			(7.0)	(6.0)	(5½)
5. 1÷3	44.0	43.5	42.4	41.4	41.0
6. 2÷4	44.0	43.5	42.7	42.1	41.2
7. 2÷3	44.0	43.5	42.6	41.2	39.3
8. 1÷4	44.0	43.5	42.6	42.3	42.9
9. Adjustment to remove effect of privatisation proceeds%	+0.7	+1.2	+1.2	+1.1	+1.1

SECRET

SECRET AND PERSONAL

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER
REC. 21 OCT 1986 ✓21/10
~~ACTION~~ SIR P. MIDDLETON
COPIES TO SIR T. BURNS
MR FER. BUTLER
MR KEMP
MR TURNBULL
MR GILHOOLY

From the Private Secretary

20 October 1986

Dear Alex,

PUBLIC EXPENDITURE AND TEACHERS' PAY

The main discussion at yesterday's Seminar at Chequers is recorded separately.

Y On public expenditure, the only point worth recording is that the Prime Minister expressed concern over the effect that maintaining electricity prices constant in real terms would have on the prospects for inflation during the coming year.

Teachers' pay was also discussed. The main points are recorded on the sheet attached, which was prepared as an aide memoire for use by the Prime Minister and Lord Whitelaw at today's meeting of Misc 122.

I am copying this letter and enclosure to Jill Rutter (Chief Secretary's Office, HM Treasury).

Yours,

David.

(DAVID NORGROVE)

Alex Allan, Esq.,
HM Treasury

SECRET AND PERSONAL

POINTS OF CONCERN ON THE EDUCATION MINISTERS' PROPOSALS ON TEACHERS' PAY

1. Cost. The increase in public expenditure to be announced in the Autumn Statement risks a very damaging effect on the markets. To announce a huge increase in spending on teachers' pay before the Autumn Statement would compound that. This points to refusing to go beyond the "£1$^1/_4$ billion". (Option (iii) in the paper costs less than £1$^1/_4$ billion.)

2. Conditionality. Mr. Baker would pay 8.2% now, on existing pay scales. More of the money should be kept back to be used to finance the new pay structure and to give more inducement to the teachers to agree to the new terms and conditions.

3. Legality. There is a risk that the proposal to legislate to abolish Burnham but to make the effect of the legislation retrospective to the date of the announcement would be overturned by a judicial review. The Attorney General will be advising. How difficult would it be to get the legislation through the House of Lords?

4. Enforcement. The Government may have to secure a right to bring actions against disruptive teachers. The Government could become a party to the contract under the second of Mr. Baker's two bills, but that may be too slow.

5. Tactics. MISC 122 has throughout not felt able to hijack the ACAS process, and the public perception is that the Government is in favour of the Coventry process. It would be a great shock and cause antagonism if the Government announces imposition of Main on Thursday. It may be better to wait until the public begin to perceive that Coventry is actually breaking down. Tuesday 4 November would be a possible date for the announcement.

1. Cathy
2. MISC 130 folder ?
PMP

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

21 October 1986

PUBLIC EXPENDITURE

The Prime Minister this afternoon discussed with the Lord President, the Chancellor of the Exchequer and the Chief Secretary the position reached so far in the Star Chamber. Sir Robert Armstrong and Mr. Unwin were also present. The meeting discussed in turn each of the major programmes which have not so far been settled.

Please handle this letter with particular care.

Scotland

The Lord President and the Chief Secretary explained that Mr. Rifkind and Mr. Edwards were adamant in refusing as a matter of principle to accept any overt reduction in the full consequentials of the local authority settlement in England. Mr. Edwards was prepared to accept a reduction of £8 million on the grounds of relative population changes. The counterpart reduction in Scotland would be over £130 million in the first year and Mr. Rifkind was not willing to accept that. There was also a Northern Ireland dimension. Mr. King had accepted less than the full consequentials from the English local authority settlement. If Wales and Scotland were to receive the full amount he might seek to reopen the settlement in Northern Ireland, and he could also ask for more money on the grounds of population changes.

It was agreed that the Star Chamber should seek to win the largest concessions possible from Mr. Edwards, including the reduction on account of population changes. They should do the best deal they could. This would establish the principle of the population adjustment which could then be used against Scotland. The Star Chamber should open by seeking the full population adjustment in Scotland, though it might be necessary to accept some reduction in this. Mr. Rifkind should be left the freedom to decide how to justify the reduction in public. Any request from Mr. King to reopen the settlement in Northern Ireland should be firmly refused. The Lord President would be willing to see him if necessary.

No 10 To Ld Pres 21/10

Social Security

It was agreed:

(i) the decision that people on supplementary benefit should meet their mortgage interest payments in their first six months on benefit should stand;

(ii) it would certainly be worth considering whether 16 to 18 year olds could be denied the right to supplementary benefit; this would also probably save on payments of housing benefit because the people concerned would then not set up independent homes; no guarantee of a YTS place should be given;

(iii) extension of the period for which the voluntary unemployed could be denied social security was certainly worth considering; withdrawal of the 25p payment for over 80s was not;

(iv) the least difficult way of finding the required savings in 1988/89 and the bulk of the savings in 1989/90 would be to begin the new social security system with lower rates of payment in April 1988;

(v) it would be important to agree figures for reductions with Mr. Fowler which he was prepared to accept without too much reluctance; this would reduce the risk that he would seek to open up a discussion in Cabinet.

It was recognised that to agree global reductions with Mr. Fowler, rather than specific measures would reduce the risk of damaging leaks though it would in turn increase the risk that when specific proposals were put forward later they would be rejected and the savings lost.

Health

It was agreed that the Star Chamber should work very hard to achieve a settlement which involved no more than a two per cent increase in health spending in real terms in 1987/88 and one per cent in each of the two following years.

Overseas aid

It was recognised that Sir Geoffrey Howe was unlikely to reach agreement with the Star Chamber. The Prime Minister would see him, with the Lord President, the Chancellor and the Chief Secretary, after the Star Chamber had met him.

Electricity

It was noted that the effect of achieving the Treasury's objective of a three per cent nominal increase in electricity prices in the first year would put a shade under 0.1 per cent on the RPI for a reduction of £$^1/_4$ billion in public expenditure. It should be perfectly possible to ensure that the increase was put into effect. Indeed three per cent amounted to a reduction in real terms and was less tough than the agreement which had been reached for electricity in Scotland in the first year.

It was agreed that Mr. Walker should be presented with the choice of finding savings of this order in the first year in his own way or by an increase in electricity prices. If this failed to achieve a settlement the matter would have to be brought to the Prime Minister.

It was agreed that a further meeting with the Lord President, the Chancellor and the Chief Secretary would be held early next week to take stock of the position then reached by the Star Chamber.

I am copying this letter to Alex Allan (H.M. Treasury), Jill Rutter (Chief Secretary's Office), Trevor Woolley (Cabinet Office) and Brian Unwin (Cabinet Office).

Yours,

David.

DAVID NORGROVE

Miss Joan MacNaughton,
Lord President's Office.

REC. 24 OCT 1986
ACTION Mr Turnbull
COPIES TO CX Sir Peter Middleton
Mr Butler
Mr Gray

LORD PRESIDENT OF THE COUNCIL

PRIME MINISTER

PUBLIC EXPENDITURE: STAR CHAMBER

I thought I should let you have for the weekend a brief report on where matters stand following our discussion on Tuesday.

2. Since we met, I have had further discussions in the Star Chamber with Norman Fowler, Nicholas Edwards, Malcolm Rifkind, Peter Walker, Geoffrey Howe and Richard Luce. The outcome is broadly as follows:

i. Social Security and Health: I have asked Norman Fowler to make further large reductions in the Social Security programme in the two later years (£100 and £250 million respectively) and to consider the implications of keeping within a profile of real increases of 2 per cent, 1 per cent and 1 per cent on the hospital and community health services current programme. He is due to report back to me by tonight and I very much hope that we shall be able to reach a settlement. There are indications that this may be possible;

ii. Scotland and Wales: I have reached a conditional agreement with Nicholas Edwards on Wales, in which he is prepared to accept the adjustment for relative population change since 1979 (£8 million) provided Malcolm Rifkind does also. We are still, however, far from agreement on Scotland. I am pressing hard for acceptance of at least a substantial part of the population change effect there (the full amount would be £133 million in 1987-88) and I plan to see Malcolm Rifkind again in the Star Chamber next Tuesday;

Ld Pres to PM 24/10 STATE OF PLAY

iii. Electricity: This is so far the most difficult, and most important, outstanding issue. Peter Walker has offered further modest savings, which would reduce his bid for an extra £1,048 million over the three years by some £250 million. He is adamant that he cannot do more. The Star Chamber have, however, made it clear to him that this is not an acceptable offer, and I have asked him to consider the possibilities further and let me have his reaction before the weekend. Subject to that, I plan to invite him to come to the Star Chamber again next Tuesday. As you know, the crucial issues are price increases and the target rate of return for the industry. To increase the present assumed rate of return of 2.75 per cent in the last year to 3.75 per cent would yield around another £350 million, which would make a crucial difference;

iv. Overseas Aid: I saw Geoffrey Howe yesterday and made it clear that we saw no case at all for going beyond maintenance of the programme in real terms, which would mean rejecting his bids except for the addition of £6 million in the last year. He will reflect on this, and I think there is just a possibility that he may accept it;

v. Arts and Libraries: Although the amounts are small, there remains a significant gap between the Group and Richard Luce, with whom, however, negotiations are still continuing.

3. As indicated above, I hope to see Norman Fowler, Malcolm Rifkind and Peter Walker - and if necessary Geoffrey Howe - again in the Star Chamber next Monday and Tuesday. I suggest, therefore, that it might be more sensible if I were to postpone

seeing you for a further round up discussion until Wednesday, when I believe you may have time in your diary in the afternoon. I shall then be in a better position to advise you on the overall position and in particular to discuss with you which of our colleagues it might then be advisable for you to consider seeing yourself. I shall, of course, continue to do what I can to achieve the toughest possible settlements within the Star Chamber, but the overall position is still very difficult indeed and there are some hard nuts to crack.

4. I am sending a copy of this minute to the Chief Secretary.

J McNaughton

(Approved by the Lord President
and signed in his absence)

Privy Council Office
24 October 1986

5 Public Expenditure

Public spending trends

5.01 The public expenditure planning total is the measure on which the Government's spending controls are based. Table 5.1 and Chart 5.1 show the path of the planning total in cash and in real terms ie after adjusting for the rate of inflation as measured by the GDP deflator. (The updated GDP deflator assumptions and money GDP figures are given in Chapter 2.)

Table 5.1 Public expenditure

£ billion

	1984–85	1985–86	1986–87	1987–88	1988–89
Department					
DHSS – Social security	38·1	41·3	42·9	44·4	45·9
Defence	17·2	18·0	18·5	18·8	19·0
DHSS – Health and personal social services	15·8	16·7	17·7	18·5	19·1
Scotland, Wales and Northern Ireland	13·7	14·5	15·0	15·0	15·2
Education and science	14·0	14·3	14·3	14·4	14·5
Other	33·0	31·7	31·2	31·3	31·7
Privatisation proceeds	−2·1	−2·6	−4·8	−4·8	−4·8
Reserve			4·5	6·3	8·0
Adjustments			−0·4[1]		
Public expenditure planning total	**129·6**	**133·9**[2]	**139·1**	**143·9**	**148·7**
General government gross debt interest	16·1	17·7	18·2	~~18½~~ 19	19
Other adjustments	4·3	6·2	6·1	~~6½~~ 7	7
General government expenditure [still provisional]	**150·0**	**157·6**	**163·4**	~~**169**~~ 170	~~**174½**~~ 175
Planning total in real terms (base year 1984–85) [still provisional]	**129·6**	**127·4**	**126·9**	**126·7**	**126·4**
General government expenditure as percentage of GDP	**45½**	**44½**	**43**	**42**	**41**

[1] *Includes external finance of −£400 million for nationalised industries to be privatised in 1986–87.*

[2] *~~The Treasury's~~ Latest estimate of outturn.*

5.02 The latest estimates suggest that the planning total outturn in 1985–86 is likely to be slightly below the figure set at the time of the 1985 Budget. Even after allowing for the effects of the miners' strike, spending in real terms in 1985–86 should be below the level of 1984–85, the first time since 1977–78 that there has been no increase in real terms. For the three following years the expenditure plans in cash terms are as set out in the 1986 Public Expenditure White Paper (Cmnd. 9702). In real terms the planning total is expected to fall slightly in 1986–87, and then to remain broadly constant over the period to 1988–89.

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5.03 Table 5.1 and Chart 5.1 also show that general government expenditure as a percentage of GDP is projected to continue the downward trend established since 1982–83, with a substantial further fall over the next three years. By 1988–89 the percentage is expected to be the lowest since 1972–73. This would be the case even without any proceeds from privatisation.

Chart 5.1 Trends in public expenditure 1978–79 to 1988–89

5.04 General government expenditure covers spending by central government and local authorities. It is the definition of government spending used in the national accounts, the forecasts and the MTFS. The main difference between general government expenditure and the planning total is general government gross debt interest, amounting to some £18·2 billion in 1986–87. There are also a number of other definitional differences and adjustments which are described in Part 7 of the 1986 Public Expenditure White Paper, paragraph 42. In 1986–87, these adjustments account for a further £6 billion.

Employment measures

5.05 The Budget speech included public expenditure measures to assist further enterprise and employment. The gross cost of these measures for the UK as a whole will be £195 million in 1986–87, £290 million in 1987–88 and £320 million in 1988–89. The net public expenditure cost after allowing for reduced expenditure on social security benefits will be £100 million in 1986–87, £165 million in 1987–88 and £180 million in 1988–89. These net costs will be charged against the Reserves provided in the White Paper, and thereby met within unchanged planning totals. Summer Supplementary Estimates will be presented to Parliament in due course for the extra resources required by the Department of Employment, the Manpower Services Commission, and Northern Ireland Departments in 1986–87.

5.06 The counselling scheme for the long term unemployed, and the Job Start scheme, also for the long term unemployed, both of which

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were introduced in January 1986 on a pilot basis, are to be extended nationwide as soon as possible. The costs of this extension will be £100 million in 1986–87 and £70 million in 1987–88.

5.07 The number of places on the Community Programme, which is also targeted at long term unemployed adults, is being raised to 255 000 from the existing level of nearly 200 000 places. Extra provision for this and for an increase in the average wage limit to £67 will be £60 million in 1986–87 and £120 million in 1987–88.

5.08 The Enterprise Allowance Scheme for those unemployed who set up in business on their own account is to be expanded to an annual rate of 100 000 entrants by April 1987, as against the current rate of 65 000. The cost of this will be about £5 million in 1986–87 and about £35 million in 1987–88.

5.09 A new scheme has been announced to help 18–20 year olds to find jobs. This scheme, the New Workers Scheme, will provide for an allowance of £15 per week for employers taking on 18 to 19 year olds on earnings of £55 per week or less and 20 year olds on earnings of £65 per week or less. The cost of this scheme is expected to be £25 million in 1986–87 and £50 million in 1987–88.

Loan Guarantee Scheme

5.10 The loan guarantee scheme, under which the Government guarantees 70 per cent of qualifying loans to small businesses is being extended for a further three years, with revised rules. The premium is being halved to 2½ per cent, and there are ceilings on the portfolio of loans covered of £90 million in 1986–87 and £130 million in the two subsequent years. The cost will be about £5 million in 1987–88.

Supply Estimates

5.11 For 1986–87, the plans set out in the Public Expenditure White Paper have now been translated into detailed control totals. The Supply Estimates set out the sums that the Government asks Parliament to vote for most expenditure by Government departments and certain other bodies. The main Estimates for 1986–87 are published on 18 March 1986 with a Summary and Guide (Cmnd. 9742) which summarises the Estimates and explains how they relate to the public expenditure planning total. Of the £99·1 billion included in the Supply Estimates, £74·6 billion is direct public expenditure in line with the plans published in the White Paper for public expenditure to be voted in Estimates. Nearly 60 per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.2 Supply expenditure

	£ billion			
	1984–85		1985–86	1986–87
	Expected outturn in 1985 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	90·4[1]	90·4[1]	96·0	99·1
Supplementaries and net under-spending	3·4	3·2	2·0	—
Total Supply Expenditure	**93·8**	**93·6**	**98·1**	**—**
(public expenditure element)	(70·6)	(70·6)	(4·9)	

[1] *Adjusted for abolition of NIS.*

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5 Public Expenditure

PS/ ask CST to check all figs: I have confirmed myself to th. HxL.

Public spending trends **5.01** The public expenditure planning total is the measure on which the Government's spending controls are based. Table 5.1 and Chart 5.1 show the path of the planning total in cash and in real terms ie after adjusting for the rate of inflation as measured by the GDP deflator. (The updated GDP deflator assumptions and money GDP figures are given in Part 2.)

Table 5.1 The public expenditure planning total and general government expenditure

£ billion	1984-85	1985-86	1986-87	1987-88	1988-87
Department					
DHSS - Social security	38.1	41.3	42.9	44.4	45.9
Defence	17.2	18.1	18.5	18.8	19.0
DHSS - Health and personal social services	15.8	16.7	17.7	18.5	19.1
Scotland, Wales and Northern Ireland	13.7	14.5	15.0	15.0	15.2
Education and science	14.0	14.1	14.3	14.4	14.5
Other	33.0	31.6	31.2	31.3	31.7
Privatisation proceeds	-2.1	-2.6	-4.8	-4.8	-4.8
Reserve			4.5	6.3	8.0
Adjustments			-0.4[1]		
Public expenditure planning total	129.6	133.6[2]	139.1	143.9	148.7
General government gross debt interest	16.1	17.7	18.2	18½	19
Other adjustments	4.3	6.2	6.2	6.4	6.6
General government expenditure	150.0	157.5	163.5	168.9	174.3
Planning total in real terms (base year 1984-85)	129.6	127.8	126.7	126.7	127.1
General government expenditure as percentage of GDP	46	44	43	42	40½

[1] Includes external finance of -£400m for nationalised industries to be privatised in 1986-87

[2] The Treasury's latest estimate of outturn

5.02 The latest estimates suggest that the planning total outturn in 1985-86 is likely to be £0.6 billion below the figure set at the time of the 1985 Budget. Of ~~this~~ £0.4 billion is accounted for by teachers' back pay which, as a result of the delay in ratifying the pay settlement, will slip from 1985-86 into 1986-87. Even after allowing for this and the effects of the miners' strike spending in real terms in 1985-86 should

PS/ let us know latest figure

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be below the level of 1984–85, the first time since 1977–78 there has been no increase in real terms. For the three following years the expenditure plans in cash terms are as set out in Cmnd. 9702. In real terms the planning total is expected to fall slightly in 1986–87, and then to remain broadly constant over the period to 1988–89.

5.03 Table 5.1 and Chart 5.1 also show that general government expenditure as a percentage of GDP is projected to continue the downward trend established since 1982–83, with a substantial further fall over the next three years. By 1988–89 the percentage is expected to be the lowest since 1972–73. ~~[These trends remain valid however one treats privatisation proceeds.] This will free an increasing share of the nation's resources to the private sector, and provide the basis for further reductions in the tax burden~~.

This would be no case even without any proceeds from privatisation.

Chart 5.1 Trends in Public expenditure 1978–79 to 1988–89

5.04 General government expenditure covers spending by central government and local authorities. It is the definition of government spending used in the national accounts and forecasts and the MTFS. The main difference between general government expenditure and the planning total is general government gross debt interest, amounting to some £18·5 billion in 1986–87. There are also a number of other definitional differences and adjustments which are described in Part 7 of Cmnd. 9702 (paragraph 42). In 1986–87, these adjustments account for a further £[6] billion.

~~Enterprise and~~ [Employment measures

5.05 Included in the announcements in the Budget speech was provision for further enterprise and employment measures. The gross cost of these measures will be £195 million in 1986–87 and £290 million in 1987–88. The net public expenditure cost after allowing for reduced

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expenditure on unemployment and supplementary benefit will be £100 million in 1986–87 and £165 million in 1987–88 as shown in Table 1.1. The net cost to public expenditure of these measures will be charged against the Reserves provided in Cmnd. 9702, and thereby met within unchanged planning totals. Summer Supplementary Estimates will be presented to Parliament in due course for the extra resources required by the Department of Employment and the Manpower Services Commission in 1986–87.

5.06 ~~Two pilot schemes to help the long term unemployed were introduced in January 1986.~~ ~~The aim of the~~ These counselling scheme has been to help the long term unemployed through an in-depth interview. Interviewees may for instance be submitted for jobs, offered places on employment or training schemes or in a Jobclub, offered a specially designed Restart training course, as appropriate. The Job Start scheme provides an allowance of £20 per week to long term unemployed ~~people who take a full-time job earning less than £80 per week.~~ ~~The schemes will be extended nationwide as soon as possible.~~ ~~[An intensive programme of counselling, offering interviews to a significant proportion of the long term unemployed, will be carried out in 1986–87.]~~ The costs of this extension will be £95 million in 1986–87 [and £70 million in 1987–88].

The counselling scheme for the long-term unemployed, and ~~also~~ the JOB Start scheme, also for the long-term unemployed, both ~~of which~~ which were introduced in January 1986 on a limited pilot scheme basis, are ~~to be~~ to be extended nationwide as soon as possible.

5.07 The number of places on the Community Programme, which is also targeted at long term unemployed adults, is being increased to 255 000 from the existing level of nearly 200 000 places. The cost of this will be £60 million in 1986–87 and £120 million in 1987–88. ~~The programme offers jobs to the long term unemployed for up to a year on projects of benefit to the community. When the expansion is complete, the scheme will be helping over 330 000 of the long term unemployed every year.~~

Extra provision for this and for an increase in the average wage limit to £67

5.08 The Enterprise Allowance Scheme is to be expanded to allow for 100 000 entrants a year [by April 1987], as against 65 000 previously provided for. ~~This scheme is intended to encourage enterprise and self-employment amongst those previously unemployed.~~ Total cost

~~designed to help~~ for those unemployed ~~to~~ to set up in business on their own account.

~~Another scheme to help small business and enterprise is~~ The Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying loans to small businesses, is to be extended for a further three years. The rules of the scheme will be revised, with the premium reduced from 5 per cent to ~~3~~ 2½ per cent, and a ceiling on the portfolio of loans covered of £90 million in 1986–87 and £130 million in the two subsequent years. ~~These two measures together will cost about £10 million in 1986–87 and £45 million in 1987–88.~~

Separate side-head for: Loan Guarantee Scheme

5.09 A new scheme has been announced to help 18–20 year olds to find jobs. This scheme, the New Workers Scheme, will provide for an allowance of £15 per week for employers taking on 18 to 19 year olds on earnings of £55 per week or less and 20 year olds on earnings of £65 per week or less. The cost of this scheme, ~~minor changes to Department of Employment programmes [including any offsetting savings]]~~ is expected to be £25 million in 1986–87 and £50 million in 1987–88.

5.10

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5.11 X

Supply Estimates ~~5.10~~ For 1986–87, plans have now been translated into detailed control totals. The Supply Estimates set out the sums that the Government asks Parliament to vote for most expenditure by Government departments and certain other bodies. The main Estimates for 1986–87, are published on 18 March 1986 with a Summary and Guide (Cmnd. 9742) which summarises the Estimates and explains how they relate to the public expenditure planning total. Of the £99 billion included in the Supply Estimates, £74·6 billion is direct public expenditure in line with the plans published in Cmnd. 9702 for public expenditure to be voted in Estimates. Nearly [60] per cent of the money voted in Estimates is subject to cash limits which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.2 Supply expenditure

£ billion

	1984-85 Expected outturn in 1985 Budget	1984-85 Final outturn	1985-86 Expected outturn	1986-87 Provision
Main Supply Estimates	90.4 [1]	90.4 [1]	96.0	99.1
Supplementaries and net under-spending	3.4	3.2	2.0	-
Total Supply Expenditure	93.8	93.6	98.1	
(public expenditure element)	(70.6)	(70.6)	(74.9)	

[1] Adjusted for abolition of NIS

1/959

Chapter 5

Wording will change due in place (B. Spch pt)

5. PUBLIC EXPENDITURE

The Government's strategy

5.01 The Government's expenditure plans are drawn up within the framework of the Green Paper, The Next Ten Years (Cmnd 9189) published in 1984, and the medium term financial strategy (MTFS). Spending must be contained within the available financial resources, and directed to where it will achieve the best value for money.

5.02 The 1985 Public Expenditure Survey took as its starting point the 1985 MTFS published a year ago. The Survey was successfully completed within that framework. The broad results were set out in the the 1985 Autumn Statement and full details were given in the 1986 public expenditure White Paper (Cmnd 9702) published on 15 January. This described the public spending plans for the period up to 1988-89.

Public expenditure planning total and general government expenditure

5.03 The public expenditure planning total is the measure on which Government spending controls are based. General government expenditure covers spending by central government and local authorities. It is the definition of government spending used in the national accounts and forecasts and the MTFS.

5.04 The main difference between general government expenditure and the planning total is general government gross debt interest, amounting to some £18.5 billion in 1986-87. There are also a number of other definitional differences and adjustments which are described in Part 7 of Cmnd 9702 (paragraph 42). In 1986-87, these adjustments are expected to add a further £[6] billion to the planning total.

Public spending trends

5.05 Chart 5.2 shows the path of the planning total in cash and in real terms ie after adjusting for the rate of inflation as measured by the GDP deflator. It also shows general government expenditure as a percentage of GDP. (The updated GDP deflator assumptions and money GDP figures are given in part 2).

5.06 The latest estimates suggest that the planning total outturn in 1985-86 is likely to be £[ ] below the figure set at the time of the 1985 Budget. [Comment on latest view including teachers' pay.] In real terms spending in 1985-86 should be below the level of 1984-85 even after allowing for the effects of the miners' strike, the first time since 1977-78 that the upward trend in public expenditure has been halted. For the three following years the expenditure plans in cash terms are as set out in Cmnd 9702. In real terms the planning total is expected to fall slightly in 1986-87, and then to remain broadly constant over the period to 1988-89.

figs pub^n?

Table 5.1 The public expenditure planning total and general government expenditure

£ billion

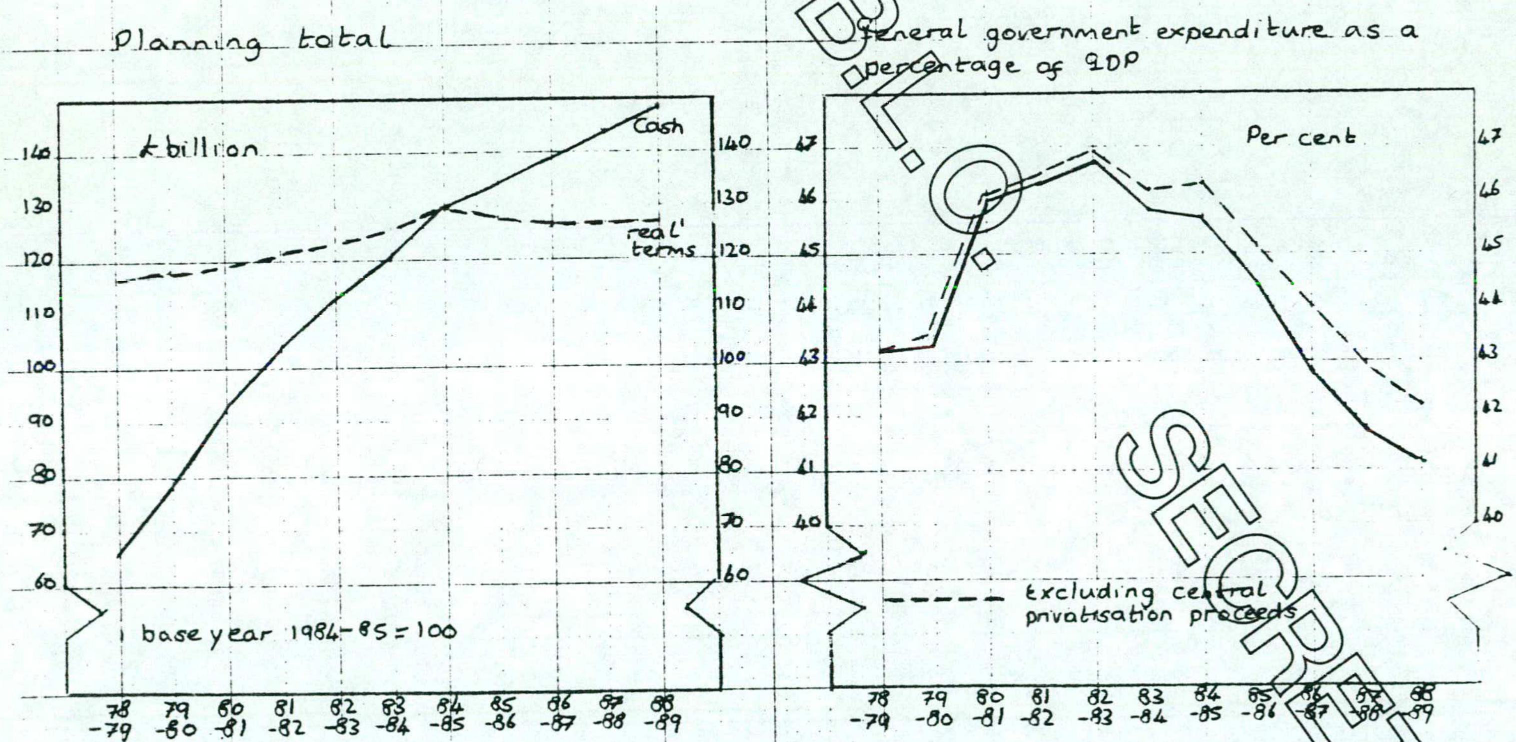
	1984-85	1985-86	1986-87	1987-88	1988-89
Department					
DHSS - Social security	38.1	41.2	42.9	44.4	45.9
Defence	17.2	18.2	18.5	18.8	19.0
DHSS - Health and personal social services	15.8	16.7	17.7	18.5	19.1
Scotland, Wales and Northern Ireland	13.7	14.4	15.0	15.0	15.2
Education and science	14.0	14.5	14.3	14.4	14.5
Other	33.0	32.0	31.2	31.3	31.7
Central privatisation proceeds	-2.1	-2.6	-4.8	-4.8	-4.8
Reserve			4.5	6.3	8.0
Adjustments(1)		-0.2	-0.4		
Public expenditure planning total(2)	**129.6**	**134.2**	**139.1**	**143.9**	**148.7**
General government gross debt interest	16.1	18.0	18.5	18.5	19.0
Other adjustments	4.3	6.2	6.2	6.4	6.8
General government expenditure	**150.0**	**158.2**	**163.6**	**168.9**	**174.7**
Planning total in real terms (base year 1984-85)	**129.6**	**127.8**	**126.7**	**126.7**	**127.1**
General government expenditure as percentage of GDP	**45½**	**44½**	**43**	**41½**	**41**

(1)[Estimated outturn in 1985-86 includes a general allowance for shortfall and] the 1986-87 planned figure includes external finance of -£400m for nationalised industries to be privatised in that year.

(2)The Treasury's latest estimate of outturn.

5.07 General government expenditure as a percentage of GDP is projected to continue the downward trend established since 1982-83, with a substantial further fall over the next three years. By 1988-89 the percentage is expected to be the lowest since 1972-73. These trends remain valid however one treats privatisation proceeds. This will free an increasing share of the nation's resources to the private sector, and provide the basis for further reductions in the tax burden.

Charts 5.1 Trends in Public expenditure 1978-79 to 1988-89



Enterprise and employment measures

5.08 ~~Included in the~~ announcements in the Budget speech was provision for further enterprise and employment measures. The gross cost of these measures will be £205m in 1986-87 and £550m in 1987-88. The net public expenditure cost after allowing for reduced expenditure on unemployment and supplementary benefit will be £110m in 1986-87 and £206m in 1987-88 as shown in Table 1.1. The net cost to public expenditure of these measures will be charged against the Reserves provided in Cmnd 9702, and thereby met within unchanged planning totals. Summer Supplementary Estimates will be presented to Parliament in due course for the extra resources required by the Department of Employment and the Manpower Services Commission in 1986-87.

5.09 Two pilot schemes to help the long term unemployed were introduced in January 1986. The aim of the counselling scheme has been to help the long term unemployed through an in-depth interview. Interviewees may for instance be submitted for jobs, offered places on employment or training schemes or in a Jobclub, offered a specially designed Restart training course, as appropriate. The Job Start scheme provides an allowance of £20 per week to long term unemployed people who take a full-time job earning less than £80 per week. The schemes will be extended nationwide as soon as possible. [An intensive programme of counselling, offering interviews to a significant proportion of the long term unemployed, will be carried out in 1986-87.] The costs of this extension will be

£110 million in 1986-87 [and £95 million in 1987-88.]

5.10 The number of places on the Community Programme, which is targetted at long term unemployed adults, is being increased to 250,000 from the existing level of nearly 200,000 places. The cost of this will be £ million in 1986-87 and £ million in 1987-88. The programme offers jobs to the long term unemployed for up to a year on projects of benefit to the community. When the expansion is complete, the scheme will be helping over 330,000 of the long term unemployed every year.

5.11 The Enterprise Allowance Scheme is to be expanded to allow for 130,000 entrants a year [by 1987], as against 80,000 previously provided for. This scheme is intended to encourage enterprise and self-employment amongst those previously unemployed. Another scheme to help small business and enterprise is the loan guarantee scheme, under which the Government guarantees 70 per cent of qualifying loans to small businesses with effect from [ ]. The rules of the scheme will be revised, with the premium reduced from 5 per cent to 3 per cent, and a ceiling on the portfolio of loans covered of £90m in 1986-87 and £130m in the two subsequent years. These two measures together will cost about £20 million in 198687 and £100 million in 1987-88.

5.12 A new scheme has been announced to help 18-20 year olds to find jobs. This scheme, the New Workers Scheme, will provide for an allowance of £15 per week for employers taking on 18 or 19 year olds on earnings of £55 per week or less and 20 year olds on earnings of £65 per week or less. The cost of this scheme, [along with other minor changes to Department of Employment programmes [including any offsetting savings]] is expected to be £25 million in 1986-87 and £50 million in 1987-88.

Supply Estimates

5.13 For 1986-87, plans have now been translated into detailed spending control totals. The Supply Estimates set out the sums that the Government asks Parliament to vote for most expenditure by Government departments and certain other bodies. The main Estimates for 1986-87, are published on 18 March 1986 with a Summary and Guide (Cmnd 9742) which summarises the Estimates and explains how they relate to the public expenditure planning total. Of the £99 billion included in the Supply Estimates, £74.6 billion is direct public expenditure in line with the plans published in Cmnd 9702 for public expenditure to be voted in Estimates. Nearly [60] per cent of the money voted in Estimates is subject to cash limits which provide the Government with greater control over its cash expenditure during the financial year.

44/952

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Table 5.1 Supply expenditure

£ billion

	1984-85 Expected outturn in 1985 Budget	1984-85 Final outturn	1985-86 Expected outturn	1986-87 Provision
Main Supply Estimates	90.4[1]	90.4[1]	96.0	98.9
Supplementaries and net underspending	3.4	3.2	2.2	
TOTAL SUPPLY EXPENDITURE	93.8	93.6	98.2	
(public expenditure element)	(70.6)	(70.6)	(75.0)	

[1] Adjusted for abolition of NIS.

Chief Secretary

DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon the Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
68 Whitehall
LONDON
SW1A 2AT

28 October 1986

Dear Willie

SS/DHSS to LD Pres 28/10 SOCIAL SECURITY

PUBLIC EXPENDITURE SURVEY 1986: SOCIAL SECURITY

At our meeting yesterday you offered to settle the social security programme for the years 1988/89 and 1989/90 on the basis that I make savings of £100 million and £250 million in these two years. I undertook to consider this, and having done so I am prepared to accept your offer subject to the following provisos.

What does this mean?

First, for 1988/89, I agreed to find savings of £100 million provided that the necessary primary legislation can be passed in time. I made clear I was not prepared to reduce the rates for the new income-related schemes to be introduced in April 1988. We agreed that fraud savings would count towards this total provided that the third year total was accepted. Although I would like to retain some flexibility over the precise measures, the savings I have in mind are:

(i)	the carry-through of not uprating in April 1987 the limits for ordinary board and lodging in the supplementary benefit scheme	- £5 million
(ii)	increased anti-fraud activity made possible by using on this work some of the staff released when we have brought in the new schemes	- £30 million
(iii)	with effect from April 1988, the extension to 26 weeks of the maximum period of disqualification for voluntary unemployment	- £30 million

E.R.

(iv) measures to be put through in a Bill in the 1987/88 session, to include tighter NI contributions conditions - £10 million

No!

(v) and the abolition of the 25p addition for retirement pensioners over the age of 80 - £23 million. !!!

Provided that such legislation is introduced in November or December 1987, or possibly January 1988, I see no difficulty in reaching the £100 million total. If, however, the Bill has to be introduced later in 1988 it would have the effect of reducing the savings from the measures requiring primary legislation and would mean that the total would have to be reduced to £75 million.

Secondly, for 1989/90 there will be the knock-through effect of the savings for 1988/89, about £90 million. The further savings will also require primary legislation, which in my view should be included in the Bill described above. However, I would emphasise that the commitment is to achieve total savings of £250 million rather than to particular specified measures to achieve them. !!

Thirdly, I would want my offer on supplementary benefit payments for mortgage interest to be accepted as part of this settlement. Having discussed this further with my Ministers I am entirely convinced that, in the face of an extremely hostile report from the Social Security Advisory Committee, some change to the original proposal is required if we are to pass this measure satisfactorily. As you know, I propose that the period of restriction should be reduced from 6 to 4 months; this cuts the savings by £7 million, which I shall make good by not uprating the ordinary board and lodging limits next April.

Subject to these provisos, I am prepared to accept your offer, in spite of the obvious difficulties which it presents for me.

I am copying this letter to the other members of MISC 130.

Yours ever,
Norman

NORMAN FOWLER

JT

276/003

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COPY NO 1 OF 30

FROM: M C SCHOLAR
DATE: 14 February 1986

CHANCELLOR OF THE EXCHEQUER

cc: Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir P Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr F E R Butler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Pratt
Mr Cropper
Mr Lord
Mr H J Davies

Sir Lawrence Airey-IR
Mr Battishill-IR
Mr Isaac-IR

Sir Angue Fraser-C&E
Mr Knox-C&E

BUDGET STATEMENT OUTLINE

I attach a first outline of your Budget Statement, mainly the work of the Central Unit, FP, MP and Mr Monck.

2. The outline is necessarily a little rough at this stage. As you agreed, it is written on the basis of Budget 'B' only, and there are still one or two gaps (nothing, for example, on a minimum tax yet).

3. It would be useful to spend a little time on it next week, perhaps at the Overview meeting if people have had time to look at it, so that you can give us guidance before we begin the serious drafting (the first proper draft is due to be submitted to you at the end of next week).

MCS

M C SCHOLAR

BLO enclosure pages

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BUDGET

BUDGET STATEMENT OUTLINE

Introduction

Economic Background

The MTFS

Monetary Policy

Borrowing

Employment and Enterprise

Taxation

Peroration

Positive all Cty

Income tax & Pretaxation rates

CP
YTS
XIRS

SECRET

[Record so far - since '79 - the Past!]

(recap some of last yr's measures)
(also coal recap)

B.L.O.

Oil & the Economy
Savings & Investment
Employment & Enterprise
The responsible society
~~Tax reform~~ Expenditure
The Future

* Big problem: what comes @ the end - what climax?
[GH & 1981 and w with B.85]

Pledge and all that

Unemployment Stat: - 8% 1985 span

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Introduction

- This Budget addresses the two vital economic issues of our time: the defeat of inflation; and the creation of conditions for falling unemployment and sustained growth.

- But, this year, the Budget takes place against a background of particular uncertainty, which arises from the fall in the oil price. The Budget has to take account of the impact of these events on the world economy, on oil-producing and oil-consuming countries alike; and of their likely effects on our own economy.

- But I do not come to House today with excuses about being blown off course. Our sound policies and the new strength of the economy have stood us in good stead during recent turbulent weeks. The Government's strategy is on course and I reaffirm our resolve to hold to it.

- In my Statement today, I shall begin by reviewing the economic background to the Budget. I shall then come to the Medium Term Financial Strategy, monetary policy and fiscal prospects. I will then turn to employment and finally the measures the Government proposes to take to maintain sound finances, and to improve further the strength, efficiency and competitiveness of the economy.

- Reference to press releases.

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Economic Background

- 1985 another year of steady growth and improvement in the underlying strength of the economy.

as forecast

- Confidence strengthened following the Budget and the end of the coal strike. For year as a whole output 3½ per cent higher than in 1984, with a strong export performance in world markets. Another large surplus on current account of the balance of payments despite the effects of the coal strike. Another substantial rise in manufacturing output.

- Both for the UK and the world economy, 1985 very much as predicted in last year's Budget Statement. In world economy, expansion slowed to a more sustainable pace, with inflation again coming down. Indications by end of year that major world imbalances - debt, US deficits etc - beginning to improve.

[illegible]!

- Said in last year's Budget Statement this a time for strong nerves and sound policies. Both needed, in double measure, in 1986, with falling oil prices the major economic event. But oil price fall provides great opportunity for better performance of world economy - both higher output and lower inflation. Should provide scope for lower interest rates in major oil importers, especially Germany and Japan, without inflationary risks.

- Contrast with recessions and need for restrictive policies following 1973-74 and 1979-80 increases in oil prices.

- Risks and uncertainties. Major changes - even favourable ones - have to be handled carefully, with the right policies, to ensure that opportunity not wasted. Inevitably considerable uncertainty at this stage about how governments will react and world economy evolve over next year or two.

- UK in different position as net oil exporter. Will benefit from more buoyant world economy and lower world inflation. But current account surplus will fall initially and exchange rate ~~may~~

was forecast

has

~~weaken.~~ Net effect on inflation of lower oil price, lower world prices and lower exchange rate may be little changed. Our policies are putting downward pressure on inflation. I expect 4 per cent by end of year. Given paramount importance of maintaining declining inflation path, much caution here especially indicated (I shall return to this later).

- Output also little changed. I expect another year of steady growth in output at 3 per cent. Different groups gain from oil price fall to different extent.

    - Consumers and business, especially in traded goods/services, gain

    - Oil companies and government lose.

    - Manufacturing (I shall return to this in employment section)

- Government's response to oil price fall needs to be especially careful.

    - Monetary policy: need to avoid excessive downward movement in exchange rate - some fall consistent with money GDP/inflation objectives, and part of process of balance of payments adjustment.

    - Fiscal policy: details later, but say now that have no doubt that problem can be managed without difficulty. Intend to pursue cautious/prudent line so as to be in a strong position to cope with any further adverse developments.

- Finally let us note this. Our economy now in a much improved position to take advantage of new opportunities and withstand new shocks. Evidence of this new strength: for example

    - Faster growth than the US, last year, and we will soon be entering sixth year of expansion of output, accompanied by major improvements in productivity (expand).

    - Investment growth at 4 per cent a year for 5 years now.

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- Strong export performance in 1984 and 1985; for once we took full advantage of strength of overseas markets improving market share while world trade was growing.

- [Lowest number of strikes for 50 years.]

- Another sizeable current account surplus and rise in overseas assets - further evidence of growing strength of external position (good use of oil revenues).

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The MTFS

- Two key elements of economic policy: financial strategy designed to bring down inflation, and supply side policy designed to improve the adaptability and competitiveness of the economy. These policies have been the key to the strong economic performance that I have described.

- Crucial importance of MTFS especially clear this year. Major fall in oil price, turbulence in foreign exchange market and shortfall in oil revenues of x% in 1985-86 and more in 1986-87 would have severely rocked the economy in past years. No doubt that MTFS can keep money demand on stable path, with downward pressure on inflation.

- MTFS provides firm framework which provides assurance to markets and permits businesses to plan. At same time it permits flexibility to allow economy to adjust to major disturbances, without jeopardising ultimate objectives. Critics who say that MTFS is ineffective or has been abandoned miss point. We have achieved what really mattered: lower inflation and sustained output growth. The split between output growth and inflation in the growth of money GDP has improved substantially - more so than was expected. By exercise of careful judgement Government has kept the path of money GDP on track.

- MTFS will remain centrepiece. Described in Budget red book published today. Will continue to be directed at gradually reducing money GDP growth and inflation. Monetary and fiscal policies set accordingly.

- MTFS framework accommodates oil price fall without unnecessary disruption. Lower oil prices and slower pay growth have similar effects. Energy and labour key factors in production process. Lower prices for them provide scope for higher output and employment for given money GDP. Extended version of NEDC pledge: MTFS guarantee against inadequate money demand that might otherwise follow fall in oil prices or pay restraint.

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- Both monetary and fiscal policies affect money GDP. Balance between them must be struck, taking account of implications for Government's taxation objectives, interest rates, external factors and balance of the economy.

- Fiscal policy set in Budget; monetary policy main instrument for adjusting to changes between Budgets. PSBR may change even without changes in fiscal policy: for example, more buoyant economy will automatically lower PSBR - would not wish to offset this. General objective in considering policy responses to unexpected developments is to keep money GDP on track.

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Monetary Policy

- The Government's medium term objectives for the growth of money demand are set out in the MTFS. Shall continue to meet these, as in the past.

- Money demand does not, however, provide a useful guide to operation of policy within the year. Figures for money GDP only available with a considerable lag; and in any event contain little information about likely future developments.

- In operating policy, the aim will be to control the growth of money; maintain the monetary conditions necessary to keep inflation coming down; and to achieve the MTFS objectives.

- [Section on the monetary targets for 1986-87.]

- No single monetary aggregate, however, encapsulates monetary conditions as a whole. In operating policy it is necessary to pay attention to a range of other evidence. Movements in the exchange rate can be particularly important, depending to some degree however on their cause. We also take account of the evidence from a range of other indicators, including movements in asset and commodity prices, and real interest rates.

need to adhere to 1985 formula

no

- This requires a continuous exercise of judgement in assessing monetary conditions. Not an easy task, and requires skill, but a judgement has to be made: no simple rule or mechanistic formula to follow. As in the past policy will be operated so as to take no risks with inflation. Not hesitate to act to change interest rates if necessary to keep monetary conditions sufficiently tight to achieve the Government's aims.

Much can do [illegible]

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Borrowing

as forecast (1st time since when?)

- PSBR estimated outturn in 1985-86. Despite lower oil prices, ~~below level forecast a year ago.~~ Buoyant non-North Sea revenues reflecting growth of personal and company incomes and expenditure.

- Last year's MTFS indicated continued decline in PSBR over medium term, with 2% of GDP in 1986-87. Broad picture still relevant but, as always, need to take into account monetary/fiscal policy mix and special factors.

- High real interest rates at world level suggest need to reduce total government borrowing in world as a whole. Welcome support of US Administration for deficit reduction programme. They have a long way to go; vitally important for the rest of the world that they succeed.

- In the UK, too, we need a policy mix consistent with fall in interest rates over medium term. Most important special factor in 1986-87 is oil price. Projections for 1986-87 in Red Book based on assumption of oil price of £[ ] less than projected a year ago.

no

- How much of North Sea revenue shortfall should be made up by raising extra revenue elsewhere and how much by extra borrowing? A matter for fine judgement. Case for some extra borrowing is that when oil revenues were higher, borrowing was lower than it otherwise would have been. Case for extra taxation is that some of benefits from high oil revenues have been taken in lower taxes than could be afforded on a sustainable basis.

- Shall return to taxation in a moment. But my judgement is that strain of lower oil revenues should be spread over both higher PSBR and higher non-oil revenues.

- Another special factor is privatisation proceeds. Now expected to be £[ ] billion more a year than projected a year ago. Some - eg TCSC - have argued that privatisation proceeds should not

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count as negative public expenditure; instead they prefer to describe them as a financing item. Do not accept that approach. Nevertheless privatisation puts an additional demand on financial markets even though it is in the form of equities rather than gilts. In the circumstances it is only prudent to rein back to some extent the demands we make upon the financial markets from the sale of gilt edged securities.

- Taking lower oil revenues, higher privatisation proceeds and overall balance of monetary and fiscal policies together, judge that should aim at PSBR in 1986-87 of ~~£[6.9]~~ billion, [1¾] % of GDP.

or £7 bn?

- [This represents a deliberately cautious fiscal policy, which is essential given oil price uncertainty. Had we known for sure that assumed oil price would rule throughout 1986-87, would have contemplated higher PSBR. But this way, can take a still lower oil price in our stride.

- If, on the other hand, oil price turns out higher, options - both fiscal and monetary - exist for action within the year if this proves desirable. Although monetary policy is the main instrument available to the government in between Budgets, could use regulator.]

Discuss

- Beyond 1986-87 envisage gradually declining PSBR relative to GDP for rest of MTFS period. Slightly lower level than in 1985 MTFS reflects higher privatisation proceeds and need to stake out cautious course given oil price uncertainty. Will, of course, be reviewed next year.

Explain

No room for tax cuts this year (but a lot of work for next year)

Employment and Enterprise

- Improving the prospects for jobs is at the heart of the Government's strategy.

- Limit to Government action. Cannot overrule the effect of workers pricing themselves out of jobs. Cannot overturn the inevitable result of excessive pay settlements. Wage costs still rising faster than competitors.

- But Government can help. Removing burdens to enterprise. Encouraging freer and more effective working of markets; and development of work force with the right skills, adaptable, well-motivated, and identified with the success of the enterprise for which they work.

- Have made progress. Effects coming through. Signs of more flexible labour market.

- Fall in oil prices and exchange rate will help tradeables, especially manufacturing, and hence full-time jobs for men. Labour supply not growing so fast.

- Last year's Budget included substantial measures. Bulk of benefits still to come through. NIC restructuring for employees and employers came into effect last Autumn. CP expansion going well but has some way to go. Two year YTS a structural improvement in our training arrangements - starting later this year. Tribute to support from employers and unions. Hope employers will take increasing share of cost over time. Also announced switch to engineering in higher education, reform of Wages Councils and employment protection.

- Package of that range and scale obviously cannot be repeated every year. But still scope for useful measures.

Enterprise

- Enterprise Allowance already has good success rate, reflected in rise of self-employed. Will now be reinforced by further expansion and adding training.

- Secondly, decided to extend Loan Guarantee Scheme not on a short-term basis but for 3 years. We will also reduce premium. Expect take-up to start rising again. Improved appraisal and monitoring by banks will help to reduce failure rate and to increase numbers of jobs in businesses helped by this scheme. Three-year extension will encourage banks to commit themselves to selling the scheme and making it work better than it did at first.

- Small businesses have gained from the rapid growth in the supply of venture capital. The Business Expansion Scheme has contributed to this and I have decided to extend it as I shall be explaining later.

Employment

- Also schemes to help the groups hit hardest by unemployment. First the young - those who have completed or are no longer eligible for YTS. New Workers Scheme giving subsidy to employers taking on 18 and 19 year olds at pay of £55 per week or less. This is the age group which has the highest rate of unemployment. I expect [ ] places in the coming year.

- An increasing proportion of the unemployed have been without a job for more than a year. My RhF announced pilot schemes at the time of the Autumn Statement targeted on the long-term unemployed. The results of these schemes. Decided to extend counselling ...

- The take-up of Jobstart has been smaller than my RhF expected ... we are not extending it [or doing so on a limited basis].

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Profit sharing

\- Although some encouraging evidence of greater labour market flexibility, more progress is needed to improve economic performance and long-term job prospect. Already done a lot through tax system and privatisation to promote employee shareholding and hence greater identification of employees with profitability of business. Would like to do more (more on this to come later in my Statement) and have in mind need to stimulate new thinking and further extension of profit sharing. Not easy and cannot legislate this year. But propose to issue Green Paper proposing tax relief for employees who agree to convert a proportion of their total remuneration into a share of profits. If response is favourable, propose to legislate [for a limited life scheme] in 1987 Finance Bill.

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Taxation

- I turn now to taxation.

- This Budget carries forward theme of tax reform charted in its two predecessors. Two objectives of reform
    - simplicity and evenhandedness
    - to improve our economic performance

Green Paper

- A Green Paper is being published today on the reform of personal taxation.

- Present system has defects:
    - Married woman's income treated as her husband's for tax purposes. Lack of privacy for married women.
    - Tax penalties on marriage: aggregation of investment income and capital gains, APA, MIR.
    - Allowances high when both partners are at work, low when only one is at work, although that is generally when family responsibilities are greatest.
    - Poverty and unemployment traps. Biggest single group in each of these consists of one earner couples. Dealing with them by increasing allowances expensive.

- Green Paper discusses system of transferable allowances. Everybody to have same allowance, but unused portion could be transferred to the other partner in a marriage. Would deal with these defects by:
    - Giving married women equality of treatment and opportunity for privacy in their tax affairs.
    - Tax penalties on marriage could be removed.
    - Allowances same whether both partners work or only one, hence do not fall when family responsibilities increase.

- Help to deal with poverty and unemployment traps, one-earner couples are so important to them. And future threshold increases will be better targetted.

- Green Paper discusses how new system could be introduced. Two points important. First, nobody would suffer a reduction in tax allowances. For most people they would rise in cash terms.

- Secondly, system could be introduced in stages. Speed of introduction would be decided in light of circumstances at the time. But this must be seen as part of Government's policy of reducing tax burden.

- Green Paper also discusses longer-term possibilities of tax system: moves towards closer working with benefits system, non-cumulation, self-assessment.

- Government will study response to Green Paper before deciding how to proceed. If it decided on a system of transferable allowances, legislation would be introduced.

<u>Taxation of business and enterprise</u>

- I have a number of other important proposals for tax reform to announce today. These are designed to encourage enterprise and improve our competitiveness.

- First, <u>stamp duty</u>. At present level is 1%, threatens to make London uncompetitive in world markets. Examples of comparative dealing costs in London and elsewhere.

- Stamp duty also suffers from defect that it applies to some financial transactions but not others. This is inconsistent with level playing-field approach.

- But reduction in duty expensive. Decided to introduce changes on a revenue-neutral basis. Therefore propose to reduce duty to ½%, but extend it to transactions now exempt: ADRs, intra-account dealing, takeovers, loan stock, renounceable letters. [Changes, if any, in stamp duty on houses.]

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- Next, Business Expansion Scheme. BES reaches end of its initial 5-year period next year. Future of the scheme has as promised been reviewed, with help of report from Peat Marwick, being published [today].

  - Scheme has been remarkably successful in encouraging investment that would not otherwise have taken place. Statistics from Peat Marwick report, and on take-up of scheme in 1985-86, and since its inception.

  - Therefore propose to extend it without further time limit.

  - But there have been some cases of abuse of the Scheme by using it for investment in activities with high asset backing. Purpose of scheme is to encourage risk investment that would not otherwise have taken place. Therefore propose restrictions on investment in land and property, and other assets likely to increase in value. Also propose power to exclude specific activities from the scheme by order.

  - With low risk investment therefore taken out of the scheme, it would be right to provide further encouragement to risk investment. Therefore propose to exempt BES shares issued after [today] from CGT.

- BES proposals a key element in my proposals for stimulating enterprise, and thus improving output and employment prospects. Buttressed by other measures with the same objectives.

  - New <u>measures to encourage equity savings.</u> Description of Share Purchase Yearly Plan.

  - Also propose amendment of <u>car and car fuel benefit scales</u>, in response to representations and to help our motor industry. The breakpoints, now 1300cc and 1800cc, are different from those in the EC directive on exhaust emission, which are 1400cc and 2000cc. Keeping separate breakpoints would hamper competitiveness of our industry. Therefore from April 1987 will bring them into line and make adjustment to scales to ensure revenue neutrality. The new scales will then be increased by 10%.

wrong place

  - Finally, <u>employee share schemes</u>. Profit sharing and share options schemes have had remarkable success in increasing the commitment of employees to the success of the companies for which they work. But some restrictions remain, especially in the case of co-operatives and employee controlled companies. Details of relaxations to help such companies.

- Come now to <u>pension funds.</u> Much interest recently in size of surpluses accumulated by many funds. These surpluses raise two questions. First, whether it is right for the very generous tax treatment given to pensions to be used to build up surpluses rather than for payment of pensions. Secondly, need to provide pension funds and companies with a clearly defined option which is not now available, and for which there is a legitimate demand, to reduce these surpluses.

- Therefore propose development of existing Revenue rules. Details of new rules. Emphasise that method by which surpluses are to be reduced is to be at funds' discretion. If method is refund to employer, this is to be ring-fenced for Corporation Tax purposes and employer to be subject also to surcharge of [10%]. This is to

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ensure that no advantage is taken by companies of very favourable tax treatment of funds to park money in them.

- Emphasise that this change will not reduce security of funds. Indeed, involves a new standard for the calculation of surpluses, on most secure funding basis, more secure than that generally used by the funds. So future pensions not at risk. Funds dispersed under new rules will be available to employers, employees and pensioners.

- Finally, <u>Capital Transfer Tax.</u> This was introduced by the Labour Government in 1974. It includes a charge on lifetime gifts as well as gifts at death. In practice, this charge has acted as a deterrent to lifetime giving and so discouraged mobility of assets. Propose to abolish lifetime charge on gifts between individuals. The regime for trusts will be kept broadly unchanged. The death charge will be protected by a tapered charge on gifts made within 7 years of death.

- With this (and other changes made by us earlier) CTT not recognisably same tax as that introduced in 1974. I have accordingly decided to rename the tax "inheritance tax". Abolition of CTT lifetime charge will mean that 4 unwanted taxes have been abolished in the last 2 years.

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Taxes on spending

- Have had to consider proposals for taxes on spending against background set out earlier in speech. Explained earlier excellent inflation prospect - balance between lower oil price and lower exchange rate effects. Have decided that it would be wrong to put this prospect at risk by making general increase in indirect taxation this year. Have accordingly framed my proposals for taxes on spending with the aim of minimising impact of Budget on the price level. But I judge that two duties require special attention:-

  - Recent developments in the oil market have substantially reduced revenue from direct taxation, and reduced the price to the consumer. Think it right therefore to increase excise duty on petrol this year by [9p] a gallon. This still leaves it well below the level just after last year's Budget. Figures to demonstrate this. [There will be a proportionate increase in the lower level of duty on derv.]

  - Secondly, cigarettes. Have decided that, because of their implications for health, there should be an increase in tobacco duty greater than required by indexation. Increase will be equivalent to [9p] on a packet of 20 cigarettes. [But no increase in duties on cigars and pipe tobacco.]

- For the other duties propose no increase at all. This applies to beer, wine, spririts, [VED on cars and VED on lorries].

- In line with assurances given last year, also propose no major changes in VAT, but have in mind a number of concessions to charities, to which shall return.

- Statement of total extra revenue raised by indirect tax changes (comparison with what would be raised by straight indexation). Overall effect of my proposals on spending is to increase RPI by no more than would be caused by an-across-the-board price indexation of these taxes.

Direct tax

- Will deal first with position of charities. Government anxious to encourage charitable giving. Reminder of past concessions made. Now propose further major changes, to provide substantial additional encouragement:

  - Abolition of limit on higher rate relief, but with measures to prevent increased abuse.

  - Tax relief for donations made through payroll deduction schemes.

  - [Tax relief for single donations by companies.]

  - A number of VAT reliefs: on newspaper advertising by charities, and on supply of medicines, donated medical equipment, welfare vehicles and recording equipment for the blind.

- Now turn to main income tax proposals. Against the background already explained, have decided that this year can make no change other than price indexation of basic allowances and thresholds. All basic allowances and thresholds will therefore be increased by 5.7%.

- Effective for PAYE on [date].

- Cost. [Total reduction in taxation of £m in 1986-87 and £m in 1987-88.]

PERORATION

?? Theme A forward-looking Budget

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

See my comments on MCS Draft. NL

Ch.

This weekend is too soon for detailed drafting. I suggest you focus on:-

- structure - not quite right especially at the beginning - and needs to come earlier; paragraph 1 merely, with more work Chambers might be at the end

- balance - some bits need more writing up eg. stamp duty, chambers; the Green Paper is too long.

- flow of the argument in particular sections. I consider though we've got the content of the employment & enterprise measures right. The indirect tax section is an unhappily assorted (& there is a presentational problem on ~~fags~~ fags & booze too). The "Savings & environment" section lacks a coherent thread - as well as being deficient in its parts too. The lead up to the Budget judgement doesn't work. And I have marked a number of other points throughout.

Michael will need to coordinate on the draft. But you might get Terry & the advisers busy on some sections this week.

(Perhaps Terry could attend to the first half; Howard might be able to do something with Savings & Investments, & maybe Peter Lopper could do something on charities).

I expect the other Ministers will want to know what you've had a go at yourself. But you'll want to spend some time at Rayners discussing presentational issues to prepare yourself for next weekend.

RL.

21/2.

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JT

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COPY NO 2 OF 32

FROM: M C SCHOLAR
DATE: 21 February 1986

CHANCELLOR OF THE EXCHEQUER

cc: Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir P Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr H J Davies
Mr Lord
Sir Lawrence Airey-IR
Mr Battishill-IR
Mr Isaac-IR
Sir Angus Fraser-C&E
Mr Knox-C&E

Many thanks. A useful 1st draft. I agree with 95% of your (RL's) comments & have made a number of my own. I have also suggested (on contents page) a slightly revised order, & given the components for each section.
I should particularly (grateful if Sir TB) would have a go at (new-style) sections B–F; and – under the general supervision of Mr Scholar – if Mr Davies could have a go at G, H & I, & Mr Cropper at L. Mr Scholar (following a chat with me) might do himself the next draft of J & K. NL.

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BUDGET STATEMENT: FIRST DRAFT

As you asked, I am sending you with this minute a first draft of the Budget Statement. This follows generally the outline you saw last weekend and takes account of the points you made about it on Monday afternoon.

2. One or two points of detail:-

(a) The structure you suggested seems to me to work well. But you may think that the section on oil and the economy would come better earlier on. I agree

(b) I have included nothing on further action, fiscal or monetary, which might need to be taken in-year,

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JT

if circumstances change. It seems to me better to wait a while yet before attempting to draft what little you may decide to say on this.

(c) But I have, as you suggested, included a section on cuts in the basic rate of income tax (paragraphs 118-119); and some words on the fiscal prospects for 1987-88 and beyond (paragraph 46).

doesn't work where it is. (or at that length)

(d) There is a short new section on business taxation which, following the 1984 rather than the 1985 precedent, contains the piece on car benefit scales.

(e) The short piece on Plaza you suggested is not very comfortably housed where I have it (paragraph 27). But I cannot see a better home.

Indeed no.

(f) I have not included anything on overseas travel expenses. If you wish to say something about these we could fit in a short paragraph in the taxes on income section.

3. This draft is, as always at this stage, the work of many hands. In the short time available there has been little time for editing or clearance, and I am afraid there are some inconsistencies and probably some errors too. The drafting still requires a good deal more work. But I hope that this first version will give you a feel for the shape of the Statement and provide a basis for further work next week.

4. Last year you spoke for about 1 hour 15 minutes (about 9,900 words). The present draft is about the same length as that.

MCS

M C SCHOLAR

DC

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BUDGET SPEECH

B.L.O.

Revised Order

A. Intro
B. Economic background
C. Oil
D. MTFS
E. Monetary policy & the Exchange Rate
F. Public Sector Borrowing
G. Employment [All L. Young package except Loan Guarantee Scheme]
H. Business & Enterprise [Agric Bldgs, MOWA, BES, Loan Guarantee Scheme, CTT]
I. Savings & Investment [Pension Surpluses, Stamp Duty, Emp Share Scheme, Savings Plan]
J. Personal Taxes: taxes on Spending [the package, @ gtr length]
K. Personal Taxes: taxes on Income [thresholds, basic rate, Green Paper, Employers' NICs]
L. Charities

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21 February 1986

A. INTRODUCTION

(I will redo)

1. This Budget addresses the two vital economic issues of our time: the defeat of inflation; and the creation of a permanently more vigorous and enterprising economy which will generate sustained growth and falling unemployment over the years ahead.

2. This year the Budget takes place against a background of particular uncertainty, which arises from the fall in the oil price. The Budget has to take account of the impact of these events on the world economy, on oil-producing and oil-consuming countries alike; and of their likely effects on our own economy. and public finances

defeatist

3. But I do not come to the House today with corrective measures, forced upon us by these recent events, and needed to restore calm in the markets. The Government's sound policies and the strength of the economy have stood us in good stead during the uncertainties of the past few months. Our strategy is on course and I reaffirm our resolve to hold to it.

4. I shall begin by reviewing the economic background to the Budget. I shall then come to the Medium Term Financial Strategy, monetary policy, and the fiscal prospects. I will then turn to the wider implications of the oil price fall; then to employment; and finally to the measures the Government proposes to take to maintain sound finances, and to improve further the strength, efficiency and competitiveness of the economy.

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5. As usual, the Financial Statement and Budget Report and a number of press releases filling out the details of my proposals will be available from the Vote Office as soon as I have sat down.

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B. ECONOMIC BACKGROUND

6. 1985 proved to be, as I indicated at this time last year, another year of steady growth and improving economic performance. Confidence strengthened following the Budget and the end of the coal strike.

7. In the world economy, expansion slowed to a more sustainable pace. With a strong performance in world markets, UK exporters made a major contribution to the 3½ per cent growth in total output in the UK. There was a similar rise in manufacturing output and a £4 billion overall surplus on the current account of the balance of payments. Inflation ended the year at around 5½ per cent, close to expectations.

8. Indeed, over the past three years, the economy has consistently demonstrated both its underlying strength and its resilience to shocks.

9. This strength shows up in output growth averaging about 3 per cent a year, a 20 per cent rise in investment by manufacturing industry, a 10 per cent rise in manufacturing productivity, a 17 per cent rise in manufactured exports, a cumulative £8 billion surplus on the balance of payments and a rise of some 50 per cent in the profitability of industrial and commercial companies outside the North Sea.

10. The improvement in productivity is particularly striking. In the six years between 1973 and 1979 the United Kingdom was at the bottom of the league of major industrial countries, with manufacturing productivity growth of 1 per cent a year. In the six years between 1979 and 1985 we moved to second place in the table, below only Japan, with growth of 3¾ per cent a year, and above France, Germany and the United States.

11. [I am confident that this new strength in the economy is now an established and permanent feature of the scene.] I expect 1986 to be another year of steady growth and falling inflation, with further gains in productivity.

12. Yet all these achievements - both those of the past and those in prospect - take place against the background of a series of shocks which in earlier times would have thrown the economy very seriously off course.

13. The first of these - the year-long coal strike - left in its wake a trail of destruction. At its peak, it cost the nation over 1 per cent of national output, it damaged sterling, and raised interest rates; in total it cost nearly £4 billion of unnecessary and wholly avoidable extra public expenditure.

14. This damaging dispute at last came to an end, and we are now reaping some benefit from the way it was resolved: high productivity in the coal industry, improved industrial relations in the economy at large, and an enhanced reputation for our ability to cope with major shocks of this kind.

21 February 1986

C. THE MTFS

18. There are two key elements to the Government's economic policy: the medium-term financial strategy designed to bring down inflation, and supply side policies which will improve the adaptability and competitiveness of the economy. These policies have played a vital part in the strong economic performance that I have described.

19. The MTFS has brought about a fall in the growth of money GDP from nearly 20 per cent six years ago to around 8 per cent. This is broadly in line with the assumptions underlying successive versions of the MTFS. Moreover, the proportion of money GDP growth that is accounted for by price inflation alone has fallen substantially. Since 1979-80 inflation has declined faster than the growth of money GDP, leaving room for a higher rate of output growth.

20. The MTFS has succeeded because it provides a predictable framework within which companies and markets can conduct their business. But it also leaves room for the economy to adjust to disturbances, without jeopardising our ultimate objective of non-inflationary sustainable growth.

21. The crucial importance of having a firm framework for financial policy is especially clear this year. The large fall in the world oil price, the associated turbulence in the foreign exchange

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market and a shortfall in oil revenues could have severely rocked the economy. But the existence of the MTFS assures markets that we shall keep money demand on a stable path, with downward pressure on inflation. It also ensures that monetary and fiscal policies will be consistent with each other and with the objectives for money GDP, despite the loss of oil revenues.

22. Similarly, the framework provided by the MTFS ensures that pay restraint will be translated into more output and employment. In particular, it ensures that slower growth of pay will not restrict real demand in the economy, as some people have argued. As I said to the House a year ago, the MTFS is as much a guarantee against inadequate money demand as it is against excessive demand.

23. The MTFS remains, of course, the centrepiece of the Government's macro-economic policies. I am rolling it forward one year today, and the details can be found in the Red Book. It will continue to be directed at gradually reducing money GDP growth and inflation. Both monetary and fiscal policies will be set consistently within this framework.

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D. MONETARY POLICY AND THE EXCHANGE RATE

24. Within the MTFS, monetary policy provides the framework for operational decisions on interest rates. For it is by maintaining sound financial conditions that the Government ensures that the medium term aims for inflation and the growth of money GDP are achieved.

25. As in last year's Budget, I am setting targets for the coming year for the growth of both narrow and broad money. The details are set out in the Red Book.

26. No monetary aggregate, however, encapsulates monetary conditions as a whole. In operating policy, therefore, it will continue to be necessary to pay attention to a range of other evidence about monetary conditions, including the exchange rate.

27. A significant movement in the exchange rate, even when it has its origins in events abroad, can affect prices and inflationary expectations, particularly if it is allowed to gather a momentum of its own. Last September's Plaza agreement between the Finance Ministers of the five major free economies has moved the world towards a more sustainable pattern of exchange rates. Since Plaza the dollar has fallen by 16 per cent against the major currencies; the deutschemark has risen by 24 per cent and the yen by 34 per cent against the dollar. Sterling, influenced by oil price movements, has risen by only 6 per cent against the dollar. These moves are already bringing benefits to the world economy, and reducing the pressures for protectionism.

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28. As I explained in October of last year, the operation of monetary policy requires a continuous exercise of judgement in assessing monetary conditions, striking a balance between the growth of the monetary aggregates, the exchange rate, and other evidence. This is not an easy task, and requires skill. But a judgement has to be made. There can be no simple or mechanical formula. As in the past, in making decisions on interest rates the Government will take no risks with inflation. I will not hesitate to act, if that is necessary, to keep monetary conditions sufficiently tight to continue to bring inflation down.

DC

— The Saudi-bashing here.

21 February 1986

— This is all written as if we knew what was going to happen to oil prices. More emphasis on uncertainty — to help with prudence.

E. OIL AND THE ECONOMY

29. The major economic event of 1986 is, of course, the fall in the world oil price. The big increases in oil prices in the 1970s and early 1980s themselves reduced real demand; in addition the restrictive policies that were necessary to prevent the higher prices becoming established as a higher rate of inflation also added to the downward pressures on economic activity.

30. It is salutary to recall how grim the prospects were after those big increases in oil prices. My predecessor said in his Budget Statement six years ago that ...

> "The rise in the oil price has had severe effects on the world prospect generally. The outlook in the coming year is for a significant slowdown in growth and a worsening of inflation everywhere ... Every major country is demonstrating its determination to resist this inflation by adopting a firm monetary and fiscal policy. The inevitable immediate result is lower output and higher interest rates. Since early last summer rates have risen by six percentage points, on average, in the major industrial countries."

Not complete mirror image: distortion caused problems both ways

31. By contrast, we now can expect a considerably better performance of the world economy in 1986 and 1987 than previously seemed likely. There should be both higher output and lower inflation. The major oil importers, especially Germany and Japan

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which already have very low inflation rates, should be able to reduce their interest rates without risk of inflation.

32. There will, of course, be difficulties. Change in itself can carry with it some cost. Major changes, even favourable ones, can have unpredicted effects. There is also uncertainty about where the oil price will settle, and how the world economy will evolve over the next year or two. Moreover, a few oil producers may face severe difficulties as their total revenues fall sharply.

33. But on balance the effects of the oil price fall will be beneficial for the industrialised countries as a whole. [At worst, it will prevent any tendency for the present recovery to slow down, and it will keep inflation moving downwards. At best, it may propel the world economy on to a higher growth path, approaching that of the 1950s and 1960s, without rekindling inflation.]

34. Turning to Britain, we will benefit from the more buoyant world economy and lower world inflation. But the value of our net oil exports has fallen, and the exchange rate has weakened. The combined effect of all these things is likely to be that both economic activity and inflation will not be very different from what they would have been without the fall in oil prices.

35. This may surprise some people, especially those who only a few months ago were predicting disaster when the oil runs out. What they overlooked is that oil production is only a relatively small part of the economy: in 1985 5 per cent or 6 per cent of national income, 5 per cent of investment, 8 per cent of exports, and 8 per cent of

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government revenues. The non-oil producing part of the economy is sufficiently flexible to adjust to this kind of change.

HoL + oil price fall [Robinson piece)

36. Far from being a disaster, these developments present a great opportunity for manufacturing industry and other sectors producing traded goods and services. Manufacturers not only benefit from lower fuel costs. Their price and cost competitiveness has also improved markedly. Since the autumn of 1985 the exchange rate has fallen by some 8 per cent against the average of all currencies and by 14 per cent and 20 per cent against the mark and the yen respectively. If only they can control their labour costs, this should provide manufacturers with a strong incentive and a unique opportunity to increase their exports and reduce import penetration in the home market.

easy. higher import costs; higher Chan[illegible]) [illegible]

37. But it is not only non-oil businesses which gain from the fall in the world oil price. Consumers also benefit through lower petrol prices and the moderation in other price increases as manufacturers and others pass on the lower fuel costs.

38. Of course, not everyone can gain, since the country as a whole is initially worse off through the reduction in the income earned on a major export. Oil companies obviously suffer from the loss of income, and so [- as I am only too painfully aware -] does the Exchequer.

Perhaps more against history at beginning of this one [illegible] experience with MTFS. Also need to play up [illegible].

39. The Government's response has to be especially careful. On the monetary side we have seen a significant fall in the exchange rate. But this has reflected the change in oil prices and is part of the

1st thought needs reconciling with EL monetary above; 2nd half fits better with HoL (above)

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process whereby the balance of payments will adjust to the loss of earnings from oil.

Borrowing I will have to redo

40. On the fiscal side, the Government's response must be prudent and cautious. Last year's MTFS envisaged that following the end of the coal strike the public sector borrowing requirement would resume its planned downward path, falling as a percentage of gross domestic product from $3\frac{1}{4}$ per cent of GDP in 1984-85 to 2 per cent in 1986-87.

41. The latest estimate of the PSBR for the current year is £7 billion. This is the same figure as was given in the Budget a year ago; but a number of its components have changed, some of them significantly. Oil revenues are some £2 billion lower than expected at this time last year. But this reduction is offset by buoyant non-North Sea revenues, reflecting the growth of personal and company incomes and expenditure; ~~and by a small underspend in the public expenditure planning total.~~

why?

spend as planned in cash

Do we need this here (see where it leads)

42. In spite of this significant reduction in public sector borrowing as a proportion of GDP, real interest rates have been at a high level throughout 1985. These high real rates have not, of course, been confined to sterling: very high real interest rates have prevailed in other major countries during this period. It is clear that a reduction in the totality of government borrowing across the world as a whole is needed, in order to bring down these high interest rates. I therefore welcome the United States Administration's support for the

nothing to do with borrowing: rather an awful place at all, part of [illegible] bridge

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Congress' deficit reduction programme. There is a long way to go in this; it is vitally important for the rest of the world that they succeed.

43. ~~In the UK, too, we need to frame our policies consistently with a fall in interest rates over the medium term.~~ Last year's MTFS projected a PSBR of £7½ billion for 1986-87, and looked forward to a fiscal adjustment of £3½ billion.

44. There have been significant changes in the composition of the PSBR since last year. Privatisation proceeds are up by £2½ billion. It is necessary to take full account of these and other factors in deciding at what level the PSBR should be set.

45. If the oil prices [settle at] in the year as a whole averages around [$15] a barrel - the figure assumed in this year's Red Book - oil revenues will have been reduced by around [£5½] billion compared with the 1985 MTFS assumption. There must, inevitably, be much uncertainty about what will happen to the oil price. We cannot be sure that there will be no further slide.

'settling' is most unlikely

all year.

and if there B....?

46. In the face of such uncertainties, I am clear that we must proceed very cautiously, setting our policies so as to ensure that we remain as invulnerable to the unexpected as it is possible to be. I have accordingly decided to set the PSBR at £7 billion (1¾ per cent of GDP), a little below the level envisaged in the 1985 MTFS. This will require no overall net increase in taxation: indeed it permits a very small overall reduction in 1986-87; and offers the hope that significant reductions in taxation may be possible in 1987-88 and later years.

-- or £7½ bn: see last yr's forecast

If you're going to leave this so late - at least this build up. Take more credit for not having to raise taxes.

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21 February 1986

F. EMPLOYMENT AND ENTERPRISE

47. It has been my over-riding objective, in this as in the last two Budgets, to put forward measures, within the framework of the medium-term financial strategy, which will improve the prospect for employments. And over the last ~~2½~~ 3 years our economy has done much better than the rest of Europe in creating jobs. Since June 1983 nearly 700,000 people in work jobs have been created, much more than in the whole of the rest of the Community. I share the OECD's view that the UK will out-perform Europe again in 1986.

as in Budget broadcast – it's sticking to strategy not particular Budget that promotes employment

48. Despite this rapid growth employment has not risen fast enough to absorb the rising numbers who want to work. That depends on improving business performance and competitiveness, both in terms of unit costs and of quality. The high level of unemployment owes much to the fact that unit labour costs are still rising faster than those of our major competitors. Productivity has been growing rapidly but not enough to offset the average growth of earnings.

Growing awareness of this – see CBI

49. The Government does not have the power to put that right. But I pay tribute to the recognition by the CBI during the past year that it is employers' responsibility - and their self-interest - to control costs more effectively.

I would like this; (it looks like "Don't blame me")

50. There are other promising pointers to the future. First there are encouraging signs of movements towards greater labour market

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flexibility. Demarcation and other barriers between different groups of workers are being removed. And recent flexibility agreements often differ from the productivity deals of the 1970s or earlier in one key respect. They involve a general commitment to flexibility in whatever form is necessary, and are not limited to removing specific named rigidities. Plant level bargaining has in some cases replaced national agreements. Of course much greater change is needed if unemployment is to be turned round and put on a firmly falling trend.

BR line is better (we're getting there)

51. The second helpful factor is the slow-down in the growth of the labour supply. I expect that over the next 3 years the labour force will grow by just over 100,000 a year, compared with the record increase of 500,000 in 1984.

52. Third, the fall in oil prices and the exchange rate will, as I have said, help tradeable goods and services, especially manufacturing, and hence the prospects for both full and part-time jobs.

The question is whether we believe this (it concedes some of the arguments we've denied in recent years)

53. Apart from maintaining prudent macro-economic policies and acting responsibly itself as an employer, the contribution which Government can make here is limited. But the major measures I announced in last year's Budget show the kind of action which can sensibly be taken.

(as above) during lead in

54. The bulk of the benefits of these measures is still to come. The restructuring of national insurance contributions for employees, employers and the self-employed came into effect in October. The two-year Youth Training Scheme, which will be starting in April, is a major structural improvement in the hitherto inadequate training

better where this is a third (or 4th) reason why life should get better (otherwise why aren't you sensibly taking more action of this kind again this year)

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arrangements. Our aim is that employers should invest more of their own resources in Youth Training Scheme and indeed in training generally, as the new scheme gets into its stride. The Community Programme, too, was greatly expanded. There was also a reform of employment protection and of Wages Councils, which, at present, restrict the terms on which young people can get jobs. These announcements brought together measures taken by several of my Rt Hon Friends. They demonstrated the importance which this Government attaches to doing everything that governments can sensibly do to improve the prospect for lasting jobs.

More about justification

55. This year I shall be announcing a number of further measures: <u>employment measures</u> designed to improve the labour market and to help specific groups of the unemployed: and <u>enterprise measures</u> which will stimulate the vigour and energy of businesses, and will encourage employees to identify more closely with the success of the businesses in which they work.

<u>Employment Measures</u>

56. Amongst the unemployed two groups require special consideration: the long-term unemployed, who make up an increasing proportion of the total; and the young - those who have completed or are no longer eligible for the Youth Training Scheme.

57. In November my rt hon and noble Friend the Secretary of State for Employment and my Rt Hon Friend the Paymaster General announced two pilot schemes to help the long-term unemployed which came into effect in January this year. The initial results are encouraging.

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Under the Counselling Scheme, X thousand or [ ] per cent of the total long-term unemployed in the pilot scheme areas have so far received invitations to an interview and [ ] per cent have attended for counselling. Most of those who came have welcomed the invitation. They have been offered a variety of opportunities. For example 20 per cent have put in for Community Programme places and [ ] per cent joined a Job Club. The aim of the scheme has been to help those of the unemployed who were genuinely seeking work or training. It has also identified people counted as unemployed who were either already earning or not genuinely available for work. The latter group were significant in size but far outweighed by those who have benefited from the scheme.

58. The second pilot scheme is a valuable complement to the first. It provides a £20 grant for long-term unemployed people taking a job earning less than £80 per week. The aim is to provide an extra incentive to those facing a relatively small margin between out of work benefits and the pay they could take home by taking a job. Experience of this pilot too has been encouraging.

Has it?
(CHBLK)

59. This is an imaginative new set of measures. In view of the indications already that it is proving a success I have agreed with my Rt Hon Friends that the schemes should be extended nationwide [as soon as possible]. This will add £110 million to the Department of Employment's public expenditure programme for 1986-87.

60. The Community Programme also benefits the long-term unemployed. It provides places for 18-24 year olds who have been unemployed for six months or more and other adults unemployed for

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over a year. It is currently providing nearly 200,000 places. I have agreed to make funds available to continue the expansion so that there will be 250,000 places by the end of this year. [I have also agreed that the average wage limit for this scheme, which pays the rate for the job, should be raised from £63 to £[ ] from [1 April/June/October]. This should give sponsors of the schemes confidence in their ability to fill places. The additional cost will be [£ million] in 1986-87 and [£ million] in 1987-88.

What is the justification for NWS. This makes it sound like a variant of CP. Can't we have a workers type rationale (helping people to price themselves into work)

61. The Community Programme provides many places for young people. But I have also agreed to provide resources for a new scheme to help those in the 18-20 year old group - an age group which has a very high unemployment rate. This scheme, which will be called the New Workers Scheme, will provide for a payment of £15 per week to employers taking on 18 or 19 year olds at pay of £55 per week or less; and a payment of £20 for 20 year olds earning £60 or less. I expect [ ] places in a full year. The scheme should provide a major direct incentive for employers to create jobs for young people and will also give a further boost to job prospects by exercising a downward pressure on wage settlements. It will cost £25 million in 1986-87 and £50 million in 1987-88.

Enterprise Measures

Link to enterprise

62. The Enterprise Allowance Scheme has been extremely popular and successful. It makes payments of £40 per week for up to a year to help unemployed people set up businesses. Survey evidence shows that on average for every 100 businesses helped, 68 extra new jobs have been created within 15 months of setting-up. I have agreed to

EAS is an employment measure, not (despite its name) an enterprise measure

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provide resources for the annual rate of entry to be raised from 64,000 to 130,000 by January 1987. The cost to the Department of Employment Vote will be about £20 million in 1986-87 and £90 million in 1987-88.

63. As its name implies, this scheme is as much designed to promote enterprise as it is to create employment. Its success has contributed to the strong growth of self-employment - one of the very encouraging features of the labour market in recent years. It is one element in the Government's drive to help the formation and growth of small businesses.

more to be said on this earlier

ENTERPRISE

64. Another such element is the Loan Guarantee Scheme. New lending under this scheme has fallen sharply in the last year, partly because of the high level of premium charged. The Scheme is at present due to run out at the end of this financial year. We have reviewed it and decided to relaunch it on new terms. It has led the banks to pay more attention to small businesses and to improve their capacity both to appraise proposals from borrowers and to monitor their progress. The scheme will be extended for three years. Its success will require the banks to commit themselves to selling the scheme and to running it in a way that brings the failure rate below the level of the past five years. The guarantee will cover 70 per cent of the loan, as now, but the premium rate will be reduced from 5 per cent to 3 per cent. The cost to the Department of Employment Vote will be negligible in 1986-87 but could be nearly £10 million in 1987-88.

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65. The total cost of all these public expenditure measures will be [£200 million] in 1986-87 and [£330 million] in 1987-88. These gross costs will be partly offset by social security benefit savings. The net public expenditure cost which will be financed from the Reserve, will be £105 million in 1986-87 and [£200 million] in 1987-88.

66. There are also two tax measures which form part of this enterprise package.

67. First Capital Transfer Tax. Introduced by the Labour Government in 1974, CTT taxes lifetime gifts as well as transfers on death. This tax - which was designed to pursue the taxpayer from the cradle to the grave - has deterred lifetime giving, locking in assets - and particularly the ownership of family businesses - and preventing them being used to best advantage. The yield on these gifts - only £35 million - demonstrates this clearly enough. It is harder to put a figure on the damage this vindictive tax has done to business and enterprise. The remedy I propose is the abolition of the lifetime charge on gifts between individuals. As with Estate Duty there will be a tapered charge on gifts made within seven years of death and provisions to charge so-called gifts in relation to which the "donor" may continue to enjoy a benefit. The regime for trusts, which is primarily a protection for the death charge, will be kept broadly unchanged.

68. With this (and the other changes made by us earlier) the character of the tax will be far removed from the indiscriminate tax introduced in 1974. I have accordingly decided to rename it the

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"Inheritance Tax". Three unwanted taxes have been abolished in the last two years. The abolition of the lifetime charge adds a fourth.

69. Next the Business Expansion Scheme. Next year this Scheme will reach the end of its initial four year life. I have reviewed the Scheme with the help of a report from Messrs Peat, Marwick and Mitchell. I should like to thank them for their valuable work. Their report is being published today, and I will place a copy in the Library of the House.

70. The Business Expansion Scheme has been conspicuously successful in its aim of attracting new equity capital into unquoted companies. Some £135m was invested last year - up 35 per cent on the year before - and we expect further growth this year. Peats found that about half this money would not have been raised at all but for the Scheme; and that getting for on one half of the remainder would not have been raised as equity. In the one hundred companies which they surveyed alone, £100m of extra turnover could be attributed to the Scheme in just one year.

71. I therefore propose to extend the life of the Scheme indefinitely.

72. But in some cases the investment has not met the purposes of the Scheme. Our objective is to encourage risk investment in both manufacturing and in the service industries. But the Scheme was not intended to encourage investment in companies with the security of a substantial proportion of assets safely tied up in land and buildings. Or in companies whose main purpose is to invest in objects such as

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pictures or fine wines whose value may be expected to rise over the years. I propose therefore to introduce changes, which will come into force for shares issued after today, to target the Scheme more precisely on the kind of businesses for which it was introduced. I propose also to take power to make further changes by Order.

Employee share ownership. Growth market, Law [illegible] what we are doing. Also selling a Scheme + [illegible]

73. I come now to the next element in my package of enterprise measures, profit sharing. The Government has already done much to promote profit sharing through the employee share schemes and through ensuring that employees are offered shares when nationalised industries are returned to the private sector. The advantage of these schemes is that they help employees to identify more closely with the profitability of their employers' business. They give employees a direct if modest interest in the action that will lead to higher profits.

74. All these schemes continue to enjoy remarkable success. The number of option schemes open to all employees has increased from about 30 in 1979 to over 1,000 now. They have provided over a million employees with shares or interests in shares worth over £1bn. In addition large numbers of discretionary share option schemes have been approved under the Finance Act 1984 legislation. These schemes have made a significant contribution to the improvements in labour market flexibility which I have mentioned.

75. I am proposing a number of detailed improvements to the existing tax reliefs to build on this success.

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76. I am also determined to stimulate new thinking and further advance in this whole area. I propose therefore to issue a consultative document later in the year setting out proposals which will build on existing schemes, but go well beyond them.

77. The object of such proposals would be to extend profit sharing and to increase the importance of the profit share in the total remuneration of those who took part. As now, it would be entirely a matter for employers and employees to reach agreement on pay and conditions. The new element under this proposal would be that tax relief would be available for employees if the Inland Revenue were satisfied that the agreements reached in the normal way fulfilled certain conditions.

78. The principal condition would be that a large majority of employees should be covered by an agreement under which a significant proportion of total remuneration would be share income, fluctuating with the profits of business. The tax relief would apply to some fraction of total remuneration, with a ceiling on the absolute amount of income to which tax relief could apply. The exemption would not vary with the actual proportion of share income to total remuneration.

79. Such a scheme might further increase employees' sense of identification with the fortunes of the enterprise for which they work; and there might be a useful demonstration effect for wage flexibility, as employees' remuneration rose and fell with the profitability of their firms. If the response to such a scheme were favourable I would propose to legislate for a limited life scheme in the 1987 Finance Bill.

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80. Finally, I have agreed with my Rt hon Friend the Secretary of State for Social Services to make further changes in the structure of national insurance contributions with effect from October 1986. These will enhance the benefits of the major reforms I announced a year ago to the lower paid. The contribution rates of 9 million employees paying the present rate of 5, 7 and 9 per cent will each be reduced by one per cent to 4, 6 and 8 per cent respectively. Employers rates will remain unchanged. The cost in 1986-87 will be [£150m].

Business Taxation

81. I turn now to business taxation.

82. British industry is already benefiting from the new and improved system of business taxation introduced in my 1984 Budget. As from next month ~~In 1986-87~~ the rate of Corporation Tax will be 35 per cent - one of the lowest rates in any major industrial country. I took further steps last year, notably to improve the treatment of short life machinery and plant and to continue 100 per cent allowances for scientific research. My proposals this year in two remaining areas will complete these reforms.

83. First I propose to introduce balancing adjustments on the disposal or destruction of an agricultural building, but only where the taxpayer chooses. This will ensure a full measure of tax depreciation for short life agricultural buildings, without introducing additional complexity for farmers.

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84. Second, the present code of allowances for certain mining and oil production expenditure is badly in need of bringing up to date. My proposals will do that. Taken overall, they will provide a net benefit for the industries concerned. I am also taking the opportunity to extend the code to cover sources of geothermal energy. The reforms will be broadly on the lines of the proposals published in a consultative document last July. Apart from that, I have only minor technical changes in the taxation of North Sea oil to propose this year to remove certain anomalies.

85. I am continuing to keep the economies of incremental investment under review and shall not hesitate to introduce at the earliest opportunity any changes which should prove necessary to the fiscal regime.

86. I propose, too, to restructure the car and car fuel benefit scales, in response to representations from the motor industry. The present engine-size breakpoints are different from those in the new EC directive on exhaust emissions. Keeping separate breakpoints would hamper the competitiveness of our industry. I therefore propose, from April 1987, to bring the breakpoints into line with those for the EC directive. I propose to increase [both] the restructured scales by 10 per cent. NB also VAT changes.

Savings and Investment

87. In my 1984 Budget I introduced a number of reforms of the taxation of savings and investment to improve the direction and quality of both. I am making today proposals to carry forward this reform a stage further.

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needs more of a lead in - to build up for renaissance in City

87a Financial markets in Britain have always been ready to meet new challenges: to adapt and change in order to succeed. This is why the City of London has remained pre-eminent in international finance. The changes I am proposing are designed to build on the City's strengths.

importance of City to economy, employment etc (hence for City lead)

88. First, stamp duty. The cost of buying shares in London is higher than in many other markets around the world. These costs must be reduced if the United Kingdom is to win a major share of the global equity market. The changes the Stock Exchange is making - which have become known as Big Bang - and those that will follow from the Financial Services Bill, will help to bring costs down. But they will not achieve the full effect, and London will not be fully competitive with stamp duty at the existing rate.

argue that City should contribute to tax. But doesn't mean that it's least damaging to competitiveness. Means broad base (level playing field) and low rate (could even describe it as restructuring)

89. But there is, in my judgement, no case for reducing the overall amount of tax paid on financial transactions. I propose therefore to reduce stamp duty on shares from 1 per cent to [½ per cent] in the autumn to coincide with Big Bang; and to finance the costs of this reduction by widening the scope of the duty: first by withdrawing a number of specific exemptions that have been introduced over the years, and second by taxing certain share deals which currently escape stamp duty.

90. The cut in duty in the new stock market conditions will significantly strengthen the liquidity of the market, and encourage a healthy growth in the volume of market transactions. This itself will significantly reduce the cost of the cut in the rate.

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91. Some of these changes will take effect immediately; others will come in in the autumn.

92. I turn now to the question of pensions. The Social Security Bill - currently before Parliament - proposes important and far-reaching changes in this field. I intend to bring forward legislation next year on the consequential tax provisions. Something positive about private pension provision

93. Meanwhile, I am aware of the concern which has been expressed about the surpluses which have built up in many pension schemes. On the one hand, the continued existence of these surpluses have been criticised in some instances as a misuse of the very generous tax treatment of pensions. On the other, there is genuine worry about the uncertainty facing many schemes as to how best they can reduce their surpluses to an acceptable level within the present tax rules.

but positive change. (leverage on tax scheme to tax abuse left)

Not quite; present IR approach is discretionary; and some companies waiting to make refunds

94. I see some force in both these criticisms - although I believe that the overall surpluses, if calculated on a proper and prudent basis, would be much less than the £50 billion which I have seen mentioned.

Need to make clear no change in taxation (or non-taxation) of PFs

95. In order to meet these legitimate anxieties, I propose the following new arrangements.

96. Objective guidelines will be published for determining for tax purposes the amount of any surplus in a fund. These guidelines will set a new standard for the calculation of surpluses, on a secure funding basis. There will be clear rules on eliminating surpluses.

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97. Funds will be free to choose how they will reduce excessive surpluses. Some will choose a contribution holiday, to the benefit of present employees. Others will choose to improve existing or future pensions to the benefit of present or future pensioners. Others will choose to make a refund to the employer.

A matter for the trustees

98. In order to ensure that the tax reliefs previously given are recovered, there will be a free-standing charge, at the rate of 45 per cent, on the employer in respect of any surplus which is refunded to him. This charge will take effect from [midnight tonight].

On the whole presentation might be better if there [illegible] yield.

99. I estimate that these changes will result in additional tax of about [£25m] in 1986-87, with larger amounts in subsequent years as the new measures take effect.

More positive — aid of Govt's aims to promote wider share ownership / [illegible] / privatisation etc

100. I turn now to the tax treatment of savings. There has been considerable concern - which I share - about the fiscal distortions in our tax system which favour some types of savings and investment at the expense of others.

101. One effect of those distortions has been to discourage direct investment in equities, while encouraging investment through institutions. As a result, the proportion of shares in British companies which is owned by individuals has reduced substantially over the years. I do not regard that as a healthy trend.

102. The changes made in my 1984 tax reform package for savings did much to redress this imbalance. Other measures we have introduced since 1979 mean that many more people now own shares for the first time. But more can be done.

103. I have therefore considered the case for a specific tax relief for direct investment in equities. I know that there is some support for a relief on the lines of the French 'Loi Monory'. I see that a relief on these lines could appear attractive. But it has its drawbacks. By front-loading the relief, it becomes extremely expensive. Almost by definition, it locks people into their investments for a significant stretch of years. But, unless it is to be an explicit subsidy, it requires tax to be imposed when the proceeds of the investment are withdrawn. This is always unpopular, and it requires complex rules for enforcement.

better to mention this later – say what you are doing & shares some of this making [illegible] to better. (This is rather negative now)

possibly glancing ref to Loi Monory, then

104. I prefer an alternative approach under which investment is made out of taxed income, but the proceeds of the investment - income as well as capital gains - are free of tax. I propose, therefore, to introduce a new tax relief for direct investment in equities, with effect from 1 January 1987, under which individuals will be able to subscribe up to £2400 a year in shares. Provided the shares are retained for a specified minimum period which may be as little as 12 months, no tax will be payable. If the income and gains are reinvested, the investment will continue to accumulate free of tax.

105. Investment will be in yearly plans, a little like National Savings schemes, and will be managed through authorised dealers in shares. But the important point is that investors will choose the shares they wish to buy; will retain the ownership of, and voting rights in, their

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selected shares, and will be free to switch their investments if they wish.

106. This Equity Savings Scheme is an exciting new prospect. It will attract many new investors to take a personal stake in British industry. It will encourage and reward share ownership. And it will allow the ordinary saver to share in the big changes which are taking place in the City, and on preferential terms.

107. All this adds up to a substantial package of measures to reform the taxation of savings and investment, which I am sure the whole House will welcome.

This section shd also have employee share scheme changes

Normally taxes on spending first: why the U-turn?

21 February 1986

G. PERSONAL TAX: TAXES ON INCOME

108. I turn now to the taxation of personal income and spending.

As I promised last year

109. I am publishing today a Green Paper on the reform of personal taxation.

This section not right: Green Paper section lastly & thresholds section claims too much. Finally, employee NICs belong in the section (if they are in the Budget at all). Try this order: Thresholds, Basic rate, Green Paper, NICs

110. Since 1979 we have reformed many aspects of the tax system with the aim of creating a simpler and fairer tax structure and one that is more favourable to enterprise and the prospects for growth and employment. But we have not yet tackled the personal income tax system which remains essentially as it emerged after the War forty years ago. The Green Paper I am publishing today considers a number of possible developments to the personal tax system which would be opened up by the computerisation of PAYE.

111. In recent years there has been growing dissatisfaction with the existing structure of personal income tax. The responses to the Green Paper on The Taxation of Husband and Wife, published in 1980, showed that there are some features of the system which are almost universally seen as unfair and indefensible. In particular, the fact that a wife's income is deemed to be that of her husband's for tax purposes is widely resented by married women. This rule gives rise to a number of tax penalties which discriminate against marriage and the family. In addition, the structure of the present system means that tax allowances are high when both partners in a marriage are in

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paid employment but low when there is only one earner even though that is generally when the family responsibilities are greatest. Raising tax thresholds is expensive so it is vital that the structure of the system should enable future increases to be targeted in the most cost-effective way.

112. Against that background the Green Paper describes a new system of transferable allowances under which everyone would have a tax allowance in their own right. Where one partner in a marriage had little or no income of their own, and so could not make full use of their allowance, they could, if they wished, transfer the unused balance to their spouse. Such a system would be better attuned to the life cycle of families. There would no longer be discrimination against married couples where, for whatever reason, the wife is not in paid employment. Transferable allowances would ensure that a couple's total allowances would remain the same and not fall when one partner leaves paid work.

113. By raising the tax threshold for couples where the wife is either not earning at all or earns very little, transferable allowances would enable future increases in thresholds to be directed more effectively at those families who are most affected by the poverty and unemployment traps. A move to transferable allowances would complement the proposals which we announced in the White Paper on the Reform of Social Security and which are currently before the House in the Social Security Bill.

114. The Green Paper also describes other changes to the tax system which might go hand in hand with a move to transferable allowances

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and which would be designed, in particular, to ensure privacy and independence for married women in tax matters and to end the tax penalties on marriage. These include the independent taxation of investment as well as earned income.

115. The Green Paper considers how a system of transferable allowances could be introduced if it were decided to do so. The aim would be to ensure that no-one would suffer a reduction in their total tax allowances during the change. For most people allowances would rise in cash terms. This means that in practice the change would be likely to be made in stages over a period of years. The speed at which a change might be introduced would of course depend on the circumstances at the time. But it is the Government's firm intention to reduce the burden of taxation as and when resources permit and a move to a system of transferable allowances would fit in with that process.

116. The Green Paper also considers how the tax system might develop in the longer term and in particular the relationship between the tax and social security systems. It also looks at the scope for integrating income tax and National Insurance Contributions and the implications of moving to a non-cumulative system of PAYE, combined possibly with self-assessment.

117. The Government will consider the responses to the Green Paper very carefully before deciding how to proceed. We are particularly anxious that there should be the widest possible response from the general public most of whom would, in one way or another, be affected by any changes.

Very long section.

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eh?

These 2 paras are a clear - with this leadin

118. I turn now to my main income tax proposals. The Government's policy is, as it has been since 1979, that tax reductions should be made both by increases in allowances and by reductions in rates. If, therefore, with the introduction of transferable allowances, substantial increases in allowances were to be possible in the early 1990s, the case for a cut before then, if resources allow, in the basic rate of income tax becomes all the stronger.

If you want some of this (almost all) keep more than a sentence or 2 - it needs to be welded in to the GP section - perhaps around para 115 - or even earlier

119. That case is, in any event, a strong one. The government has already done much to improve incentives by reducing the burden of tax both for those at the very top of the income scale, and for those right at the bottom. A cut in the basic rate would improve incentives for 14 million taxpayers, 95 per cent of the total; it would help those in the middle of the income scale, like the unmarried nurse on £140 a week, by more than an increase in the allowances costing the same amount; and it would reduce the marginal rate of tax not only for all these people but also for the vast majority of unincorporated businesses and for the self-employed.

120. But this year, with the tight financial background I have described, I fear that I have not needed to choose between different ways of carrying out a reduction in income tax. I have decided in this Budget to make no changes in income tax at all other than those which are necessary to meet the requirements of statutory indexation.

121. Under the statutory indexation formula the main thresholds for 1986-87 would rise in line with the increase in the RPI over the year to December 1985 which was 5.7 per cent. Accordingly, I propose to

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This needs the completely redone - I will do it.

21 February 1986

H. PERSONAL TAXATION: TAXES ON SPENDING

Wrong formula. (we also 'at the present time...')

126. Against the economic background I have described - with falling oil prices and a lower exchange rate - I have framed my proposals for taxes on spending with particular regard to the inflation prospect. It would be wrong to jeopardise the very good prospect for prices by making a real increase in indirect taxation this year. Accordingly, my proposals for the spending taxes are designed to minimise the impact of this Budget on prices.

127. But, within that overall objective I judge that there are two areas of indirect taxation which merit special treatment. Recent developments in the oil market have substantially reduced revenues from this source. At the same time they have reduced the price of road fuels to the consumer. I consider it right therefore to alter the balance of taxation on the motorist. Firstly, Vehicle Excise Duty on cars will remain unchanged at £100 a year. Similarly, VED for lorries will not be increased.

better after 'petrol duty' - draw more of it

128. On the other hand, to compensate for the loss of revenue from VED, I am proposing to increase excise duties on petrol and derv by about half as much again as is required simply to keep pace with inflation.

after you've said what would be happening to oil spending prices

129. So far oil companies have yet to pass on to the consumer the full benefit of lower oil prices; indeed they appear to have increased

Can't we say how much petrol prices could have fallen by, if oil price fully passed through.

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their margins by [10-12] pence a gallon. There is, therefore, more than enough room for them to absorb some or all of the duty increases I am proposing. If the increase in duties were passed on to the consumer - as I hope they will not be - prices (including VAT) would rise by about [8 pence per gallon] for petrol and a little under [7 pence for derv], leaving them still about 7 pence lower than after last year's Budget. The duty changes will take effect from 6 o'clock this evening.

not right

130. I propose, too, to alter the balance between the remaining duties on tobacco and alcohol. My intention is to maintain an overall level of revenue and an overall effect on the RPI broadly equivalent to that which would result from straight revalorisation of all duties. I have been further impressed by the arguments of those who have pressed for real increases in tobacco duties on health grounds. And so I have decided to increase duty on cigarettes and hand rolling tobacco by the equivalent of (including VAT) 11 pence on a packet of 20 cigarettes. This extra revenue that the tobacco duties will yield makes it unnecessary for me to raise the duties on any alcoholic drinks.

I think this is weird. Why? What possible arguments are there for changing the balance (this time?)

131. I propose no change in the standard rate of VAT and, in accordance with the assurance which I gave the House last year, I propose no major change in the VAT base.

Can we think of some good reasons for a standstill other than RPI and avoid the dubious implication that smoking is a greater social/health hazard than booze?

132. Taken together, the extra revenue from these changes will be £785 million and the RPI effect will be around half of one per cent. Since these effects are broadly in line with those of straight revalorisation they have already been taken into account in the forecast which I gave the House earlier of inflation by the end of the year.

above broadly fractions

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raise the single person's allowance by £130 to £2,335 and the married man's allowance by £200 to £3,655. The single age allowance will rise by £160 to £2,850 and the married age allowance will go up by £250 to £4,505.

122. Statutory indexation will also apply to the higher rate thresholds and bands. The first higher rate of 40 per cent will be reached at taxable income of £17,200 and the top rate of 60 per cent will apply to taxable incomes over £42,700.

123. These increases mean income tax cuts for most single people of at least 75p per week and for most married couples of at least £1.15. Some [560,000] people on low incomes - [70,000] of them widows - who would have paid tax if thresholds had not been increased will pay no tax at all in 1986-87.

124. The changes I have announced will take effect under PAYE on the first pay day after [17 May]. They will mean a total reduction in taxation of [£1,135 million] in 1986-87 and [million] in 1987-88 [compared with existing levels of allowances]. [Nil cost compared with indexed base.]

125. Increasing thresholds in line with statutory indexation means that the basic allowances will remain some 20 per cent higher in real terms than they were in 1978-79.

we have earlier

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21 February 1986

State what we have done since 1979 — & explain why

I. CHARITIES

[That conclusion the [illegible] I have proposed this year. But...

133. I have one last proposal to make. The Government has been much pressed to help charities, notwithstanding the substantial improvements we have made since 1979 to the existing reliefs, which are already very generous.

because philosophy needed — (therefore is a strong reason to have assured [illegible] PEX [illegible] programme with his own [illegible], as well as getting some political mileage out of it) Shouldn't the mini measures come first?

134. I am, however, anxious to go further than we have so far gone. I am proposing, therefore, three major income tax and corporation tax changes to encourage further giving by both individuals and businesses; and a series of reliefs from Value-Added Tax for charities.

135. First, there will be an entirely new relief for certain companies in respect of single donations to charities. Relief will be allowed up to the equivalent of 2 per cent of a company's dividends in the year.

136. Second, the present limit of £10,000 on higher rate relief convenanted contributions by individuals will be removed, and the apportionment of close company charitable covenants abolished.

Order of changes should all work: put them in crescendo, not a diminuendo

137. Third, I intend to introduce a scheme for tax relief for donations made by individuals through deduction from their wages and salaries. Relief will be available on donations of up to £100 a year, and the scheme will be open to all employers on a voluntary basis. I envisage that the relief will run from April 1987. But there

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will be early consultations with employers' representatives and charity agencies about the practical arrangements required.

138. Alongside these measures, I propose to take further action which will help the majority of charities and those who generously support them. And I intend to curb the growing abuse whereby a minority of unscrupulous people manipulate the charity reliefs to avoid tax and enrich themselves.

139. These abuses threaten to undermine the position of genuine charities. My objective is to direct tax reliefs and exemptions in future towards money which is actually spent on genuine charitable purposes.

140. I have also decided to relieve charities from VAT on fund-raising or educational advertisements, and to relieve them, too, from VAT on medicinal products where they are engaged in the treatment or care of people or animals or in medical research.

141. I also propose to relieve certain items of equipment of importance to the handicapped and the charities caring for them. The supply of vertical lifts and distress alarm systems in the home of a handicapped person, or to a charity caring for the handicapped, will be zero rated; as will the supply of welfare vehicles to a charity caring for the blind, deaf or mentally handicapped. The existing relief for equipment used to make recordings such as talking newspapers for the blind is presently restricted to specialist equipment; I propose to lift this restriction and additionally to zero rate the supply of cassette records to a charity for free loan to the

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blind. Finally, I propose to add refrigeration and video equipment to the list of relevant goods that may be zero rated when supplied to a charity or other eligible body when purchased with donated funds.

the grand climax!

142. The total cost of all these new reliefs will depend on the public response to the more generous incentives I am proposing. But I estimate the likely cost in total at about [£60m] in 1987-88. This will be partly offset by the yield from the measures I am proposing against abuse.

Absolutely essential that charities section sd conclude with an encomium of the extra giving. The changes are bound to stimulate

PERORATION

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CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Ch.

Overall a great improvement.

It rather loses its way in the middle, but the general ordering works quite well.

Specific comments

Introduction: needs a complete rewrite

B. Economic Background: rather bitty & complacent. Needs a longer term perspective. Emphasis should be on soundness & durability of economic growth (as set out for best section on oil). Could well start with something like 1st sentence of para 15. "The strength and durability of the current economic upswing...."

I'd pare down the reference to

Good strike to the bare announcement.

C. Govt and the Economy Good.

I'd speak out a bit more how UK is different from other developed countries (para 26 is rather compressed). Para 31 is the right place to end up.

D MTFS I liked this.

E. Monetary Policy and the Exchange Rate. Twin of understanding - though it deserves to be much longer. What is missing is the "proof of the pudding" theme you used in your Mansion House Speech.

F. Borrowing para 47 needs

improving. The final
sentence is wasted – too
compressed (what does it mean?)

G. Employment and Enterprise

The main lecture theme is
a reasonable start – but rather
undermined by going straight onto
SAM's. Perhaps better to have
chunk on employment next.
Then put last year's measures closer
to this year's. Is it worth
including NIC's in this section?
Section is on long side

, Enterprise & Business Taxation

A bit of a ragbag, & rather long &
boring. Engine's break points
but overdone. I suppose we must have

a section on banking
tax.

CTT needs more justification as
an enterprise [illegible] measure

H. Savings & Investment

Need for stamp duty package needs
more writing up - including
speed with which NY & Tokyo
markets are developing, the
threat to London's importance
as an international centre, &
the economic significance of the
City. I wonder-if make a general
statement about the need for revenue
from stamp duty; you may well
have to abolish it next year.
Best to justify revenue neutral
package by small size of this
year's Budget package.
Do you need to make it clear that
stamp duty on housing is unchanged.

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

<u>Pension Surpluses</u>:-

Need to make it clear that large surpluses are potentially an ~~avenue~~ area of tax abuse - & IR has always seen it this way.

Say something nice about Govt's commitment to private pension provision

More justification needed for recovery charge: <u>only</u> applies to refunds, which are <u>entirely</u> voluntary. Only recoups past tax relief (isn't really that)

<u>Profit sharing</u> - too long & rather too committal

<u>Savings</u> - need something up, with name of scheme at an earlier stage.

I Personal Taxes – Spending

Needs more work.

The punch line comes a bit early (para 110)

Changes in oil duties need to be related to oil prices, ~~to~~ as you want to draft so your spring a pleasant surprise. ~~If the new oil duties in with petrol~~ ~~down~~.

I mean the VAT lollipops were in the right place here.

But VAT registration threshold is missing.

J. Taxes on Income

~~As~~ Far too much on the Green Paper. I'd make the presentation a cut in the marginal rate for all earning < £140 more boldly in the NICs section

RL 28/2.

FLO

JT

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276/003

COPY NO 1 OF 32

FROM: M C SCHOLAR
DATE: 28 February 1986

CHANCELLOR OF THE EXCHEQUER

cc: Principal Private Secretary
Chief Secretary (2)
Financial Secretary (2)
Economic Secretary (2)
Minister of State (2)
Sir P Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr H J Davies
Mr Lord

Sir Lawrence Airey-IR
Mr Battishill-IR
Mr Isaac-IR

Sir Angus Fraser-C&E
Mr Knox-C&E

BUDGET STATEMENT: SECOND DRAFT

I attach a further draft of the Budget Speech.

2. The structure follows the slightly revised order you suggested last weekend (Mrs Lomax's minute to me of 24 February). The present draft itself is the work of Sir Terence Burns (Sections B-F), Mr Cropper (Section K), Mr Davies (Sections G and H) and myself (Sections A, I and J). I am also responsible for the overall editing.

3. I have tried to take in the comments sent to me by copy addressees this week; but one or two may have fallen through the net and will need to be taken in for the next draft.

MCS

BLO enclosure pages

M C SCHOLAR

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Budget Statement

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773/47 BUDGET CONFIDENTIAL COVERING BUDGET LIST ONLY F9

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cc as below

CHANCELLOR

It is perhaps worth considering whether a distributional analysis covering both direct and indirect tax changes should be published on Budget Day. This has not been done before, although a draft press release was prepared in 1984, and dropped only because of the last minute changes in that Budget.

2. The arguments for volunteering such information are that an analysis along these lines is usually provided by the IFS; that we would gain some credit with TCSC and perhaps others for providing new information; and that the general picture shown is reasonably satisfactory.

3. The arguments against are that there are no fundamental changes in indirect tax (such as were being considered in 1984, in the form of extensions to the VAT base); that there is no great pressure for the change; and that the figures show that the indirect tax changes taken by themselves are regressive, mainly because of the over-indexation of tobacco.

4. The analyses in this submission are rather different from the dynamic tables which are usually published on Budget Day and will show changes in net income after tax and NIC between 1985-6 and 1986-7 assuming a given percentage increase in gross earnings. If you were interested in the idea of publishing information about direct and indirect tax changes we should need to consider further how it could best be presented.

G W MONGER

Ch/
I wouldn't favour this — especially since they don't want to publish figures for ½ and x2x average earnings. It is particularly tricky this year, & would set a precedent.
RL. 28/2

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BUDGET SECRET

FROM: G P SMITH
DATE: 28 FEBRUARY 1986

Minute
Geo
28/2

1. MR MONGER
2. CHANCELLOR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Scholar
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Isaac - IR
Mr Battishill - IR

Sir Angus Fraser - C&E
Mr Knox - C&E

B.L.O. SECRET

CHANGES IN PERSONAL TAX - DISTRIBUTIONAL EFFECTS

The Chancellor has asked for the analysis in my note of 20 February to be extended to cover families at ½ and twice average earnings. (Mrs Lomax's minute of 24 February to Mr Monger.) These are in Tables 1, 2 and 3. (The figures take account of the latest decisions on indirect tax and provisionally assume indexation of income tax allowances and bands, and a 1% reduction in employee NIC at earnings below £140/wk.)

2. For a number of reasons we are not confident about indirect tax figures at ½ and twice average earnings and would prefer not to go public on them. (We have always refused to publish figures outside the ¾-1½ range.)

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3. Indirect tax payments especially vary greatly among families of a given type and at a given income level. This variation is not captured in a 'specimen family' analysis. We have, therefore, included some additional analysis (Table 4) showing the distribution of overall net increases and decreases in tax and NIC payments relative to indexation. Unlike the hypothetical 'specimen family' figures, these relate to the actual families covered by the 1983 Family Expenditure Survey. The figures are grossed up to population levels, but the sample is a relatively small one and the numbers are not precise.

4. The main points are:

(a) for all groups, the average net effect is little different from indexation. For 70 per cent of families the difference is within 50p a week (either way);

(b) about 45 per cent of families pay more than under indexation. But only 1½ per cent pay over £1 a week more;

(c) about 10 per cent of families gain £1 a week or more compared with indexation (mostly due to lower NIC payments);

5. **Average earnings** - The Chancellor also asked about the definition of average earnings. In our tables this refers to full time adult males (all occupations, earnings unaffected by absence). This is the standard general purpose definition we and Revenue use for PQs, general briefing etc.

6. Most of our questions about representative families include married couples and couples with children. This points to taking an earnings figure for adults, and for most purposes, for adult males rather than all adults.

7. The effective choice is therefore between an all occupations figure and some subgroup such as manual workers. In general there is no particular reason for excluding non-manuals (45-50% of adult male employees) though of course we would use figures for manual workers if specifically asked. The all occupations figures are more convenient to use - in particular we have constructed a reasonably consistent time series going back to 1945-46. We do not have a comparable series for manual workers.

8. All this assumes that only one definition is needed for any one question. It would, for instance, be possible to have a separate average for single people (who have lower average earnings because they are younger workers). But this gets complicated. Where the use of an adult male average is clearly inappropriate eg for the pensioners in our tables, we do of course use a more sensible figure eg the average income for single pensioners and pensioner couples (see notes to tables).

9. Some distributional analysis can of course be done in terms of income ranges without relating these to averages of any kind (as in Table 4). But for published work we are not going to be able to drop the analysis in terms of averages altogether.

10. The Chancellor also mentioned in this connection the correspondence initiated by Mr Lord last November and suggesting an 'all adults' average for general use. This was, however, mainly concerned with the possible presentational advantages from the pay point of view of using a lower earnings figure and one which had increased less in 1984 and 1985 (though not in some earlier years) than the adult male figure. The arguments in paragraphs 5-9 above are of course specific to our distributional concerns and do not necessarily carry over into the wider field.

G.P.S.

G P SMITH

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TABLE 1: CHANGES IN TAX AND NIC PAYMENTS FROM UNINDEXED BASE

20.2.86

£/wk

	Multiples of full time male average earnings				
	½ (106.90)	¾ (160.35)	1 (213.80)	1½ (320.70)	2 (427.60)
Single					
Income tax	-0.75	-0.75	-0.75	-0.75	-3.72
NIC	-1.07	0	0	+1.80	+1.80
Indirect taxes	+0.46	+0.52	+0.59	+0.73	+0.87
TOTAL	-1.36	-0.23	-0.16	+1.78	-1.05
Married Couple (one earner)					
Income tax	-1.15	-1.15	-1.15	-1.15	-3.46
NIC	-1.07	0	0	+1.80	+1.80
Indirect taxes	+0.68	+0.77	+0.86	+1.05	+1.25
TOTAL	-1.54	-0.38	-0.29	+1.70	-0.41
Married Couple + 2 Ch					
Income tax	-1.15	-1.15	-1.15	-1.15	-3.46
NIC	-1.07	0	0	+1.80	+1.80
Indirect taxes	+0.70	+0.76	+0.83	+0.96	+1.10
TOTAL	-1.52	-0.39	-0.32	+1.61	-0.56
Single Pensioner					
Income tax			-0.92		
Indirect taxes			+0.19		
TOTAL			-0.73		
Pensioner Couple					
Income tax			-1.44		
Indirect taxes			+0.55		
TOTAL			-0.89		

NOTE: Indirect tax payments show first round effects on households with average spending patterns. They do not allow for changes in spending pattern as a result of price changes. Estimates are based on the 1983 Family Expenditure Survey. Pensioners are assumed to have average incomes for pensioner households. (£65/wk and £130/wk respectively.)

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TABLE 2: CHANGES IN TAX AND NIC PAYMENTS FROM INDEXED BASE

20.2.86

£/pw

	Multiples of full time male average earnings				
	½ (106.90)	¾ (160.35)	1 (213.80)	1½ (320.70)	2 (427.60)
Single					
Income tax	0	0	0	0	0
NIC	-1.07	0	0	+0.12	+0.12
Indirect taxes	+0.06	+0.02	-0.03	-0.12	-0.22
TOTAL	-1.01	+0.02	-0.03	0	-0.10
Married Couple (one earner)					
Income tax	0	0	0	0	0
NIC	-1.07	0	0	+0.12	+0.12
Indirect taxes	+0.19	+0.15	+0.11	+0.02	-0.07
TOTAL	-0.88	+0.15	+0.11	+0.14	+0.05
Married Couple + 2 Ch					
Income tax	0	0	0	0	0
NIC	-1.07	0	0	+0.12	+0.12
Indirect taxes	+0.14	+0.13	+0.12	+0.10	+0.08
TOTAL	-0.93	+0.13	+0.12	+0.22	+0.20
Single Pensioner					
Income tax			0		
Indirect taxes			+0.04		
TOTAL			+0.04		
Pensioner Couple					
Income tax			0		
Indirect taxes			+0.03		
TOTAL			+0.03		

NOTE: Indirect tax payments show first round effects on household with average spending patterns. They do not allow for changes in spending patterns as a result of price changes. Estimates are based on the 1983 Family Expenditure Survey. Pensioners are assumed to have average incomes for pensioner households. (£65/wk and £130/wk respectively.)

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TABLE 3: CHANGE IN PAYMENTS OF INDIRECT TAXES

20.2.86

£/wk

	Single			Married No Children			Married with 2 Children		
	Petrol & Derv	Tobacco	Total	Petrol & Derv	Tobacco	Total	Petrol & Derv	Tobacco	Total
Multiples of av. earnings									
Cash									
½	+0.11	+0.35	+0.46	+0.13	+0.55	+0.68	+0.14	+0.56	+0.70
¾	+0.19	+0.33	+0.52	+0.21	+0.56	+0.77	+0.22	+0.54	+0.76
1	+0.28	+0.31	+0.59	+0.29	+0.57	+0.86	+0.31	+0.51	+0.83
1½	+0.46	+0.27	+0.73	+0.45	+0.60	+1.05	+0.50	+0.46	+0.96
2	+0.64	+0.23	+0.87	+0.63	+0.62	+1.25	+0.69	+0.41	+1.10
Pensioner	+0.06	+0.13	+0.19	+0.21	+0.34	0.55	-	-	-
Relative to revalorisation									
½	+0.03	+0.20	+0.06	+0.04	+0.31	+0.19	+0.04	+0.31	+0.14
¾	+0.06	+0.19	+0.02	+0.06	+0.31	+0.15	+0.06	+0.30	+0.13
1	+0.08	+0.17	-0.03	+0.08	+0.32	+0.11	+0.09	+0.29	+0.12
1½	+0.13	+0.15	-0.12	+0.13	+0.34	+0.02	+0.14	+0.26	+0.10
2	+0.18	+0.13	-0.22	+0.18	+0.35	-0.07	+0.20	+0.23	+0.08
Pensioner	+0.02	+0.07	+0.04	+0.06	+0.19	+0.03	-	-	-

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TABLE 4: DISTRIBUTION OF GAINS AND LOSSES RELATIVE TO INDEXATION BY FAMILY TYPE

(thousands of tax-units)[1]

£ per week	(Reduced tax/NIC payments) Over 2	1.5 to 2	1 to 1.5	0.5 to 1	0 to 0.5	(Increased tax/NIC payments) 0 to 0.5	0.5 to 1	1 to 1.5	1.5 to 2	Over 2	Average increase/decrease (£ per week)
Non-Pensioners											
Single	50	250	1620	2020	3620	3770	260	*	-	-	-0.34
Married no children	140	200	510	580	1460	1160	450	130	20	-	-0.27
Married with children	80	140	520	700	2320	2200	750	140	20	20	-0.11
Lone parents	-	-	70	110	310	680	110	-	-	-	-0.03
Pensioners											
Single	-	*	*	30	750	2120	60	-	*	-	+0.02
Married	*	20	30	130	940	980	170	20	*	*	+0.01
TOTAL	**270**	**610**	**2760**	**3560**	**9400**	**10900**	**1790**	**300**	**40**	**20**	**-0.20**

1 Numbers rounded to nearest 10,000; * indicates less than 10,000

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