PO-CH/NL/0364 PART A

SECRET

(Circulate under cover and notify REGISTRY of movement)

PO -CH /NL/0364

PART A

1988 BUDGET BRIEF

PO -CH /NL/0364

PART A

DD'S ~~A~~ 25 years NAGS 30/11/95.

9-3-88

CLOSED

CONTINUED ON:-

PART B

phl:76

pmp!

FROM: S J PICKFORD
DATE: 5 FEBRUARY 1988

MR BUSH (+ 7 copies)

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Paymaster General
Sir P Middleton
Mr Scholar
Mr Odling-Smee
Mr Culpin
Mr Sedgwick
Mr R I G Allen
Miss Sinclair
Ms Evans
Mr Hudson
Mr Patterson
Miss Simpson
Mr Cropper
Mr Tyrie
Mr Call
PS/Inland Revenue
Mr Walker - IR
PS/Customs & Excise
Ms French - C&E
A/014

PRE-BUDGET BRIEFING 1988

I attach the pre-Budget brief.

2. We are copying the brief in its entirety to Ministers' offices purely for reference. (It supplements, rather than overlaps with, the Budget Brief). It has been designed primarily for use in IDT.

Stephen Pickford

S J PICKFORD

phl:77

PRE-BUDGET BRIEF 1988

INDEX

BRIEF A

A INCOME TAX

[See also Reform of Personal Taxation Green Paper (Brief B), Profit-Related Pay (Brief J) and Wider Share Ownership (Brief V).]

Yield

£ billion

		Nominal	Real 1986-87 Prices
(i)	1978-79	18.7	37.3
(ii)	1986-87	38.5	38.5
(iii)	1987-88 Autumn statement forecast	40.5	38.8

Personal allowances in 1987-88

		£
-	single (and wife's earned income relief)	2,425
-	married man	3,795
-	additional personal allowance (mainly for single parents)	1,370
-	age allowance, single (for over 65s)	2,960
-	age allowance, single (for over 80s)	3,070
-	age allowance, married (for over 65s)	4,675
-	age allowance, married (for over 80s)	4,845
-	age allowance, income limit	9,800

Rates of tax

(a) 1978-79

Bands of taxable income: actual £	Bands of taxable income: indexed to 1987-88 £	per cent tax rate
0 - 750	0 - 1,600	25 (lower rate band)
751 - 8,000	1,601 - 16,700	33 (basic rate)
8,001 - 9,000	16,701 - 18,800	40
9,001 - 10,000	18,801 - 20,900	45
10,001 - 11,000	20,901 - 23,000	50
11,001 - 12,500	23,001 - 26,200	55
12,501 - 14,000	26,201 - 29,400	60
14,001 - 16,000	29,401 - 33,600	65
16,001 - 18,500	33,601 - 38,900	70
18,501 - 24,000	38,901 - 50,400	75
over 24,000	over 50,400	83

(b) **1987-88**

Bands of taxable income £	Per cent tax rate
0 - 17,900	27
17,901 - 20,400	40
20,401 - 25,400	45
25,401 - 33,300	50
33,301 - 41,200	55
over 41,200	60

Statutory indexation

- 1980 Finance Act Section 24 provides that main personal allowances (single, married and age allowances), higher rate thresholds and income limit for age allowance should be increased each year by increase in Retail Prices Index (RPI) during previous calendar year (December to December), unless Parliament decides otherwise. This section superseded less comprehensive indexation provision in 1977 Finance Act (so-called 'Rooker-Wise' provision).

- Statutory indexation does not apply to ceiling for mortgage interest relief (see below).

- Increase in RPI in year to December 1987 was 3.7 per cent.

Personal allowances with statutory indexation

	1987-88 £	Indexed 1988-89 £
- single	2,425	2,515
- married man	3,795	3,945
- additional personal allowance	1,370	1,430
- age allowance, single (over 65)	2,960	3,070
- age allowance, single (over 80)	3,070	3,190
- age allowance, married (over 65)	4,675	4,855
- age allowance, married (over 80)	4,845	5,025
- age allowance income limit	9,800	10,200

Indexation of higher rate thresholds

Bands of taxable income

1987-88 £	Indexed 1988-89 £	Per cent tax rate
0 - 17,900	0 - 18,600	27
17,901 - 20,400	18,601 - 21,200	40
20,401 - 25,400	21,201 - 26,400	45
25,401 - 33,300	26,401 - 34,600	50
33,301 - 41,200	34,601 - 42,800	55
over 41,200	over 42,800	60

Cost of indexation

Compared with maintaining 1987-88 levels, indexation of allowances and of higher rate thresholds would have revenue cost of £840 million in 1988-89 and around £1370 million in 1989-90 (Autumn statement Estimates.) By convention, this does not enter Budget arithmetic but is incorporated in base.

Each 1 percentage point increase in allowances and thresholds above indexation would cost about £215 million in 1988-89 and £295 million in 1989-90.

About 79 per cent of 1989-90 costs relate to raising personal allowances; remainder to higher rate thresholds. 1988-89 84 per cent.

Effect of indexation on tax paying population

Indexation would take about 250,000 out of tax. [NOT TO BE VOLUNTEERED: rather larger number will have been drawn into income tax as result of rise in money incomes since 1987 Budget.]

Basic rate

1 percentage point reduction in basic rate would cost £1,250 million in 1988-89 and £1,600 million in 1989-90. (Autumn Statement Estimates).

Action in previous Budgets

(i) (June) 1979 Budget

- Basic rate reduced by 3 points to 30 per cent.
- Top rate reduced from 83 per cent to 60 per cent on earned income.
- Two tier rate for IIS replaced with single rate of 15 per cent, with £5,000 threshold (1978-79 surcharge 10 per cent on investment income £1,701-£2,250; 15 per cent above £2,250).
- Main personal allowances increased by 18.2 per cent, double amount required by statutory indexation provision.

- Higher rate threshold increased by 25 per cent.

(ii) <u>1980 Budget</u>

- Main personal allowances increased by 18 per cent, in line with then indexation provision.

- Higher rate threshold increased by 12.5 per cent.

- Threshold for IIS raised to £5,500.

- Lower rate band (25 per cent on first £750 of taxable income) abolished.

(iii) <u>1981 Budget</u>

- <u>No</u> increase in personal allowances or thresholds. Indexation would have required 15.1 per cent increase.

(iv) <u>1982 Budget</u>

- Allowances etc increased by 14 per cent, 2 percentage points more than required by statutory indexation.

(v) <u>1983 Budget</u>

- Allowances and thresholds increased by 14 per cent, 8.5 percentage points more than required by statutory indexation.

(vi) <u>1984 Budget</u>

- Main allowances and thresholds increased by 12½ per cent, 7 percentage points more than required by indexation.

- Age allowances indexed.

- Investment Income Surcharge (IIS) of 15 per cent on investment income above threshold (£7,100 in 1983-84) abolished.

(vii) <u>1985 Budget</u>

- Basic allowances increased by around 10 per cent, 5 percentage points more than required by indexation.

- Same <u>cash</u> increase for age allowance.

- Higher rate thresholds indexed.

- Tax relief for profit related pay introduced - one half of PRP to be free of income tax up to lower of £3,000 or 20 per cent of total pay. (See Brief J.)

- New tax rules for personal pensions.

(viii) 1986 Budget

- Basic rate reduced from 30 per cent to 29 per cent.
- Main personal allowances increased in line with indexation.
- Threshold for first higher rate also increased in line with indexation but widths of bands for subsequent higher rates kept at 1985-86 levels (all higher rate thresholds thus rose by £1,000).

(ix) 1987 Budget

- Basic rate reduced from 29 per cent to 27 per cent.
- Main personal allowances increased in line with indexation.
- New higher level of age allowance for over 80s.
- First higher rate (40 per cent) threshold indexed (increase of £700); second higher rate (45 per cent) threshold increased by £200; other thresholds kept at 1986-87 levels.

Mortgage interest relief

(i) Statutory indexation does not apply to ceiling for mortgage interest relief; has to be set each year.

(ii) Ceiling is currently £30,000, following increase from £25,000 in 1983 Budget. (£25,000 limit introduced by Labour Government in 1974.)

(iii) Indexation in line with RPI increase since June 1979 would produce ceiling of £50,000 [since June 1983 -£38,000]

(iv) Average price of houses in UK bought with building society mortgage is £41,400 and average new mortgage is £27,900 (1987Q3 figures).

(v) For most taxpayers, mortgage interest relief now given at source (MIRAS) rather than through tax codes. Cost in 1987-88 estimated at £4.75 billion.

(vi) Government has given number of public assurances that mortgage interest relief will be retained eg

> "We will keep the present system of mortgage tax relief" (Conservative manifesto 1987).

See also OR 446 30 October 1986.

Cars and other benefits in kind

(i) Benefits in kind to directors and higher-paid employees taxed since 1948.

(ii) Earnings threshold for 'higher-paid' employment £8,500 since 6 April 1979.

(iii) Estimated 1.75 million (1987-88) directors and employees liable to tax on expenses and benefits in kind.

(iv) Provisional revenue yield 1987-88 £680 million; 1986-87 £610 million; 1978-79 £100 million.

Cars and car fuel

Scale charges announced year in advance. Scales for 1988-89, announced 1987 Budget and confirmed by Treasury Order laid 17 November 1987. (Scale charges added to recipients' income and charged at marginal income tax rate.)

- Scale charges for car benefits will be increased by 10 per cent for fourth year in succession.

- Car fuel scale charges will be at 1987-88 level.

1988-89 scales (1987-88 in brackets):

	£
(a) Cars	
Up to 1,400cc	580(525)
1,401cc to 2,000cc	770(700)
Over 2,000cc	1,210(1,100)
Original market value £19,250 - 29,000	1,595(1,450)
Over £29,000	2,530(2,300)
(b) Fuel	
Up to 1,400cc	480(480)
1,401cc to 2,000cc	600(600)
Over 2,000cc	900(900)

Provisional yield 1987-88 £480 million, 1986-87 £420 million (cars and fuel). (Comparable figures not available for 1978-79.)

Employee share ownership (See also Brief V)

Three separate tax incentive schemes to encourage introduction and operation of employee share schemes.

Finance Act 1978: All-employee profit-sharing schemes

- Annual profit-sharing limit greater of £1,250 and 10 per cent of salary (subject to £5,000 ceiling). Share retention period (necessary to qualify for full IT relief on disposal) 5 years.

Finance Act 1980: All-employee savings-related share option schemes (subsequently amended to increase monthly savings limit)

Finance Act 1984: Discretionary share option schemes (Company can offer participation to any or all of its full-time directors or employees)

Schemes must be approved by Inland Revenue to gain tax relief. In each case shares must be part of ordinary share capital of company either listed on Stock Exchange, controlled by non-close listed company or not controlled by another company.

Only 30 approved all-employee schemes in existence in May 1979. Now over 1,400 all-employee schemes (711 profit-sharing, 693 savings-related share option) and 2,767 discretionary share option schemes. All-employee schemes have benefited over 1½ million employees.

Unapproved employee share schemes

The Government recently completed a review of the anti-avoidance provisions relating to unapproved share option schemes which had been criticised as applying too widely. Major changes have now been proposed to Section 79 Finance Act 1972 designed to help companies and employees by targetting more closely on abuses at which provisions are aimed. Draft legislation has been published for consultation. Legislation to be included in 1988 Finance Bill.

Profit Related Pay

(See Brief J).

Keith Committee proposals

i. Revenue consultative document "Inland Revenue and the Taxpayer" published 13 December 1986. Contained detailed proposals in response to income tax, capital gains tax recommendations of Keith Committee. Deadline for comments on "priority" items - CT Pay and File, subcontractors' scheme and PAYE - was 13 February 1987 and legislation included in 1987 Finance (No 2) Act.

ii. 31 October closing date for comments on other items:-

- notification of liability to tax
- information powers
- privacy
- business records
- penalites
- re-opening of assessments

iii. Detailed consultation on responses now taking place between Revenue and representative bodies.

iv. Of the recommendations requiring no legislative change, all but a handful have been, or are being, implemented.

Contact point: Miss M Hay (FP) 270 4918

B "REFORM OF PERSONAL TAXATION" GREEN PAPER

Green Paper

"The Reform of Personal Taxation" (Cmnd 9756), published Budget Day 1986, outlined possible system of independent taxation of husband and wife with a standard personal allowance fully transferable between spouses. These arrangements would have subsumed the married man's allowance.

Present position

Financial Secretary announced in the 1987 Budget Debate (OR vol 112 no 75 col 1012, 18 March) that "... The response to the Green Paper has been disappointingly thin. Although the majority of those who responded expressed themselves in favour of transferable allowances, the Government do not yet feel that there is sufficient support to take a decision now to go ahead with so far reaching a reform. Nevertheless, the Government consider it important both that the tax system should give women a fair deal and that the tax penalties on marriage should be removed, so we will be exploring whether there is any satisfactory halfway house to the approach in the Green Paper."

Chancellor said at Party Conference (October1987) that tax treatment of married women no longer acceptable and must change.

No announcement yet made about future action.

Mortgage Interest Relief

Green Paper suggested ending present system, where unmarried couples can obtain relief on double sum (£60,000) available to married couples (£30,000), by linking relief to property not to borrower. No announcement made about future action. (Press speculation that this anomaly is to be abolished.)

Contact point: Miss R A Dyall (IR) 2541 7349

C. NATIONAL INSURANCE CONTRIBUTIONS

Changes taking effect on 6 April 1988

Social Security Act 1975 requires Secretary of State for Social Services to review National Insurance contributions rates and limits annually. Main decisions for 1988-89 given in Chancellor's oral statement on 3 November 1987, repeated in Chapter 3 of published Autumn Statement. Necessary orders for changes in National Insurance contributions will be laid shortly and also Report by Government Actuary showing effect on National Insurance Fund.

(i) **Class 1 rates** for employers and employees - no change.

(ii) **Lower Earnings Limit (LEL)** to rise from £39 to £41 per week (in line with basic pension, as required by statute). NICs payable on all earnings once earnings above LEL.

(iii) **Upper Earnings Limit (UEL)**, ceiling for employees' contributions to rise from £295 to £305 per week, maximum permitted by law. (NB. No ceiling on employers' contributions.)

(iv) **Limits for reduced rate bands** to be increased from £65, £100 and £150 per week to £70, £105 and £155.

(v) **Treasury Supplement** (taxpayers' contribution to National Insurance Fund) cut from 7 per cent in 1987-88 to 5 per cent in 1988-89 (cut worth £650 million).

(vi) **Contracted-out rebate** to decrease from 4.1 per cent to 3.8 per cent for employers and from 2.15 per cent to 2 per cent for employers (the rebate is reviewed every 5 years).

Gives following structure of Class 1 contracted-in NICs:

Weekly earnings	**Percentage NIC rate on all earnings**	
	Employees	**Employers**
Below £41	(No NICs payable)	
£41 to £69.99	5	5
£70 to £104.99	7	7
£105 to £154.99	9	9
£155 to £305	9	10.45
Above £305	9 on £305	10.45

(vii) Employment Protection Allocation (EPA) (element of NIC allocated to Redundancy Fund) reduced from 0.07 per cent for employees and 0.06 per cent for employers to zero.

(viii) National Health Service Allocation (element of NIC allocated to NHS) increased from 0.85 per cent to 0.95 per cent for employees, and from 0.7 per cent to 0.8 per cent for employers. NICs will contribute £3.3 billion to NHS in 1988-89.

Employees' and employers' burden

(i) For those earning between £41 and £295 per week, no increase for either employee or employer for those contracted in.

(ii) For those earning between £41 and £295 per week, maximum increase of 42p per week for employees and 84p per week for employers for those contracted out.

(iii) Some lower paid employees will pay up to £2.10 per week less. Their employers will pay up to £2.25 per week less.

(iv) For employees earning above £295 per week, maximum increase is 90p per week for those contracted in, £1.12 per week for those contracted out.

(v) Income from employers' contributions expected to be £1,290 million higher than in 1987-88 (Autumn Statement Table 3.1). Increase solely due to higher earnings and employment. Uprating of limits reduces burden by £110 million.

(vi) Income from employees' contributions expected to be £1,010 million higher than in 1987-88 (Autumn Statement Table 3.1). Increase due primarily to higher earnings and employment. Uprating of earnings limits (including UEL) increases burden by only £40 million (net).

1988 benefit uprating

4.2 per cent increase in most National Insurance benefits from April 1988.

Employees' and employers' NIC rates 1979-88 (contracted in)

	Employees	**Employers**
1978-79	6.5	10.0 (1)
1979-80	6.5	10.0
1980-81	6.75	10.2
1981-82	7.75	10.2
1982-83	8.75	10.2
1983-84	9.0	10.45
1984-85	9.0	10.45
6.4.85 - 5.10.85	9.0	10.45
6.10.85 - 5.4.86	(5.0/7.0/9.0) (2)	(5.0/7.0/9.0/10.45)
6.4.86 - 5.4.87	(5.0/7.0/9.0)	(5.0/7.0/9.0/10.45)
6.4.87 - 5.4.88	(5.0/7.0/9.0)	(5.0/7.0/9.0/10.45)
6.4.88f	(5.0/7.0/9.0)	(5.0/7.0/9.0/10.45)

Notes

(1) In addition employers had to pay National Insurance Surcharge until abolition on 1 October 1984. Rates were

From	6.4.77	5.10.78	2.8282	6.4.83	1.8.83	1.10.84
Rate	2.0	3.5	2.0	1.5	1.0	-

(2) Reduced rate bands since introduction on 6 October 1985:

Employees	6.10.85 - 5.4.86	£55/£90
	6.4.86 - 5.4.87	£60/£95
	6.4.87 - 5.4.88	£65/£100
	6.4.88f	£70/£105
Employers	6.10.85 - 5.4.86	£55/£90/£130
	6.4.86 - 5.4.87	£60/£95/£140
	6.4.87 - 5.4.88	£65/£100/£150
	6.4.88f	£70/£105/£155

Contact point: M Gibson (ST1) 270 5053

D CAPITAL TAXES

Inheritance Tax

Inheritance tax replaced capital transfer tax (CTT) in 1986 Budget. Main change

- complete exemption for lifetime transfers between individuals (and, since 1987 Budget) those involving interest in possession trusts) provided donor survives 7 years

- and 7 year cumulation of chargeable transfers instead of 10.

About 26,000 tax-paying estates in 1987-88.

Yield (CTT and IHT)

(i) 1978-79 yield £369 million (including £46 million residual estate duty).

(ii) 1986-87 yield £995 million.

(iii) 1987 FSBR forecast 1987-88 yield of £1,100 million.

Bands and rates

(a) Before 10 March 1981 top rate of 75 per cent applied to both death and lifetime transfers.

(b) Before 13 March 1984 top rate 75 per cent at death and 50 per cent lifetime.

(c) 1987 Budget simplified rate schedule reducing number of rates from 7 to 4. Current rates.

Band of chargeable value (£000)	Rate on or within 7 years of death (%)
0-90	0
over 90-140	30
over 140-220	40
over 220-330	50
over 330	60

Statutory indexation of threshold and rate bands introduced from 1983-84 (ie indexation implemented unless Finance Act contains provision to contrary). Indexation would produce following bands in 1988-89:

Band of chargeable value (£000)	Rate on or within 7 years of death (%)
0-94	0
over 94-146	30
over 146-229	40
over 229-343	50
over 343	60

Certain lifetime transfers (eg transfers into most discretionary trusts) remain taxable when made and are chargeable at half full rates.

Cost of indexing all bands would be

	(£ million)
1988-89	**1989-90**
25	55

Exemptions and reliefs

Following transfers are exempt

- lifetime transfers between individuals by way of outright gift, transfers into trust for children and disabled, and (from 1987) those involving interest in possession trusts, provided that made more than 7 years before donor's death
- lifetime transfers up to £3,000 each tax year;
- small transfers and gifts out of income;
- transfers between spouses (exemption limited for foreign-domiciled spouses);
- transfers to charities;
- heritage assets (conditional on maintenance and public access).

50 per cent relief given for

- interests in unincorporated businesses;
- majority shareholdings;
- minority shareholdings exceeding 25 per cent in unquoted (excludes USM) companies (1987 Budget)
- agricultural property with vacant possession.

30 per cent relief for

- let agricultural property;
- other minority shareholdings in unquoted companies;
- assets owned by a partner or controlling shareholder and used in partnership or company business.

(i) Tax on illiquid assets payable over 10 years, interest-free for agricultural and business property.

(ii) Transfers are cumulated over 7 years (over whole life to 26 July 1981; over 10 years from 27 July 1981 to 17 March 1986; over 7 years from 18 March 1986).

(iii) Rate of tax on any transfer depends on cumulative total.

Capital Gains Tax (CGT)

Yield

(i) 1978-79 yield £353 million (plus £100 million from corporation tax (CT) on companies' chargeable gains).

(ii) 1986-87 yield £1064 million (plus £650 million on companies' chargeable gains).

(iii) 1987 FSBR forecast 1987-88 yield of £1,300 million (plus £800 million on companies' chargeable gains included largely within CT).

- Rate 30 per cent for individuals and trusts (no change since 1979).

- Annual exempt amount £6,600 (£1,000 in 1979) is indexed (1982 Finance Act). Straight revalorisation for 1988-89 would increase exempt amount to £6,900 at cost of £20 million.

- Now about 200,000 individuals and trusts within charge to tax.

- 1982 Finance Act introduced provisions to index gains; extended in 1985 Finance Act. All gains accruing after March 1982 are fully indexed, whenever asset was acquired.

- Following 1987 Budget changes companies gains charged at marginal CT rates (27 per cent or 35 per cent with ACT set-off).

Development Land Tax (DLT)

(i) Abolished in 1985 Budget.

(ii) Removed impediment to availability of land for development and 200 pages of complex legislation.

(iii) Full year revenue cost of abolition about £50 million.

Stamp duty

(i) 1986-87 yield £1,860 million. About 40 per cent each from transfers of houses and shares. Balance from capital duty and minor duties.

(ii) 1987 FSBR forecast 1987-88 yield of £2,100 million.

Previous Budgets

1984 Budget

Rate reduced from 2 per cent to 1 per cent and threshold for houses raised from £25,000 to £30,000.

1985 Budget

(a) Duty on gifts abolished also various nominal duties. Relief for share exchange on takeovers provided.

(b) Significant simplification of stamp duty law.

1986 Budget

(a) rate on share transactions reduced to 0.5 per cent at a 1986-87 cost of £70 million. £30,000 threshold for houses unchanged.

(b) Scope widened and now includes

- takeovers (subect to new exemption for company reconstruction);
- letters of allotment;
- share dealings in same Stock Exchange account;
- conversion of shares into depositary receipts and transfer of shares to certain clearing houses (special 1.5 per cent rate applies to both).

(c) Package as whole designed to be revenue-neutral.

1987 Budget

No change to rates or thresholds.

Contact point: M Hay (FP) 270 4918

E BUSINESS TAXATION

[See also Small businesses (Brief F) and North Sea taxation (G)]

Corporation tax (CT)

CT applies to taxable profits, derived from commercial historic cost profits.

Yield

(i) In 1978-79 £3,940 million.

(ii) In 1986-87 £13,495 million.

(iii) 1987 Autumn Statement forecast 1987-88 yield of about £15¾ billion.

1984 Reform package

1984 Budget announced major reform to reduce distortions; cut CT rates. Main components in 1984 Finance Act:

(i) Phased abolition of incentive first year allowances for plant and machinery by 1986-87

Expenditure instead given writing down allowance. Remains at 25 per cent a year. Reducing balance basis applies, so allowance for any year 25 per cent of cost, less allowances already given.

(ii) Phased abolition of incentive initial allowances for industrial buildings by 1986-87

Expenditure instead allowed over 25 years at 4 per cent a year (straight line basis). Rate of this "writing down" allowance unchanged.

(iii) Immediate abolition of stock relief for accounting periods beginning on or after Budget Day 1984. (Increase in value of stocks previously relieved by reference to movement in "all stocks" price index.)

(iv) Phased reduction in main corporation tax rate

- 52 per cent 1982-83
- 50 per cent 1983-84
- 45 per cent 1984-85
- 40 per cent 1985-86
- 35 per cent 1986-87

Since April 1986 UK's main CT rate one of the lowest of any major industrial country.

(v) (a) Immediate reduction from 38 per cent to 30 per cent in small companies' rate from 1983-84 onwards where profits did not exceed £100,000.

(b) "Taper" rate on profits over £100,000 brought average tax rate to level at (iv) where profits exceeded £500,000.

(vi) Revenue-neutrality of package

1984 corporation tax reforms intended to be revenue-neutral over transitional period. [NOTE: transitional period has never been specified.] 1986-87 and 1987-88 CT receipts buoyant largely because company profits grew strongly in 1985-86 and 1986-87.

1985 Finance Act:

Implemented consequential changes resulting from, and refinements to, 1984 reform package, including:

(i) Changes to secondary capital allowances

- agricultural buildings: 20 per cent initial allowance abolished from 1986; writing down allowance reduced from 10 per cent to 4 per cent (straight line);

- dredging: 15 per cent initial allowance abolished from 1986; writing down allowance remained at 4 per cent (straight line);

- patents/know how: writing-down allowance standardised at 25 per cent (reducing balance) from 1986;

- hotels: 20 per cent initial allowance abolished from 1986; writing-down allowance remained at 4 per cent (straight line).

(ii) "De-pooling" for short-life assets, allowing assets with rapid depreciation to be left out of main capital allowance pool, with balancing allowance if disposed of at less than written down value within 5 years.

(iii) Scientific Research Allowance continued at 100 per cent, with minor changes to scope.

(iv) Shipping: "free depreciation" (up to 25 per cent reducing balance figure) to apply to writing-down allowances for new ships from 1984 and secondhand ships from 1985.

(v) Writing-down allowances for plant and machinery to be given when expenditure "incurred" (not when asset brought into use); also technical change to bring date expenditure incurred into line with usual accountancy practice.

1986 Finance Act

Further refinements to reform package:

(i) Mines and Oil Wells Allowances (MOWA) code brought more closely into line with post-1984 capital allowance regime following consultation document on proposals issued July 1985. (See also Brief G.)

(ii) Agricultural Buildings Allowance restructured from 1986 to provide system of balancing adjustments when an agricultural building is sold etc. enables capital allowances to be brought into line with actual depreciation suffered.

(iii) Leasing machinery or plant: several mainly technical changes to modify earlier legislation following phasing out of first year allowances.

(iv) Small companies' rate of corporation tax reduced to 29 per cent 1986-87 (in line with income tax basic rate).

1987 Finance Acts

(i) Small Companies' CT rate reduced to 27 per cent 1987-88 (in line with income tax basic rate cut) and corresponding reduction in advance corporation tax rate.

(ii) Corporation Tax payment dates harmonised at 9 months after end of accounting period, subject to transitional arrangements.

(iii) Companies' capital gains to be charged at normal Corporation Tax rates, with Advance Corporation Tax set-off (instead of straight 30 per cent rate).

(iv) Streamlining: enabling powers for streamlined "Pay and File" system for corporation tax. Under these provisions, companies will be required to pay tax by a fixed date, whether or not an assessment has been made. Interest due on tax will be calculated from fixed date also. System to be implemented in 1990s when new Inland Revenue computer system now being developed becomes operational.

Autumn Statement ready reckoner

Revenue effects at forecast 1987-88 income levels:

- 1 percentage point change in main CT rate: £360 million in 1988-89, £560 million in 1989-90

- 1 percentage point change in small companies' rate: £25 million in 1988-89, £45 million in 1989-90.

National Insurance Surcharge

(i) 1978-79 3½ per cent on earnings (subject to lower and upper earnings limits as for NIC).

(ii) 2 August 1982 reduced to 2 per cent;

6 April 1983 reduced to 1½ per cent;

1 August 1983 reduced to 1 per cent.

(iii) NIS abolished in 1984 Budget

- from 1 October 1984 for private sector and most public sector;
- from 6 April 1985 for local authorities (and related bodies).

Compared with 3½ per cent rate in 1979, private sector now benefiting by about £4.5 billion a year (at 1987-88 income levels).

Non-domestic rates

Estimated GB yield

£ billion

	1978-79	**1986-87**	**1987-88**
Industrial property and public utilities	1.1	2.5	2.9
Commercial property	1.6	4.7	4.8
Other	0.7	1.9	2.0
Total	**3.4**	**9.1**	**9.7**

Exemptions

- Agricultural property is exempt from rates.
- Property in Enterprise Zones (EZ) is exempt for 10 years from setting up of EZ. Crown Property is exempt but Crown pays contributions in lieu of rates.

Local Government Finance Bill

Published 4 December 1987. Non-domestic rates to remain: poundage set uniformly across England and (separately) Wales, and proceeds redistributed by population. Annual increase less than increase in RPI. Planned introduction in England and Wales 1990.

Abolition of Domestic Rates etc (Scotland) Act 1987 introduces similar reform in 1989. No national rate, but limits increase to no more than increase in RPI.

Representations

CBI proposed a 25 per cent cut in non-domestic rate bills, costing around £2.5 billion at 1987-88 values; and business in each locality should pay rates towards only (part of) some local services (eg refuse collection).

International business

1985 Finance Act included provision (S.54) for withdrawal of tax credits from certain overseas companies resident in states imposing unitary taxation. But in light of progress towards resolving unitary tax issues, UK Government not proposing to take action under S.54 at present. Equally, in view of need for further progress, Government does not intend to repeal S.54 (WA by FST 18 December 1986; OR vol 107 no 26 col 669).

1987 Finance (No 2) Act contained measures to remove unjustified tax breaks involving:

- international groups using dual resident companies;
- banks (through action on tax credit relief for tax withheld on foreign loans);
- controlled foreign companies to prevent avoidance of UK tax on dividends paid to UK shareholders.

Company profits and investment

- Non-North Sea industrial and commercial (ICC) company profits rose by 16 per cent between 1985/86 and 1986/87.
- Non-North Sea ICCs' profitability in 1986 at highest level since 1973 - net real rate of return 9 per cent.
- Industrial investment in 1986 12½ per cent above 1979 level in real terms. Manufacturing investment expected to rise by 6 per cent in 1987 and 11 per cent in 1988 (DTI Investment Intentions Survey (Dec). [NOTE survey conducted before stock market fall).]

Contact point: R G Michie (FP) 270 4922

F SMALL BUSINESSES

[See also Capital taxes (Brief D) and Business taxation (E)]

Overall policy

Stimulation of more vigorous enterprise culture and development of small businesses. Recognised that small firms need much same climate as bigger firms eg low and stable inflation; rates of taxation which enable retention of more rewards of success. But Government also designed measures aimed to help small firms overcome disadvantages arising from their size eg difficulty in raising finance.

Measures

(i) Loan Guarantee Scheme (LGS), introduced 1981, intended to provide access to loan finance not otherwise available. Under present terms, Government guarantees 70 per cent of loan advanced by bank and borrower pays 2½ per cent premium on guaranteed part. Current scheme due to expire end March 1989. To end-December 1987, Government assisted in 18,517 loans worth £614 million. Average loan £33,200. Just over half of LGS lending to new businesses.

(ii) Business Expansion Scheme (BES)

- **introduced 1983,** aims to improve flow of equity finance to small companies by offering individual taxpayers opportunity to offset value of new equity investments of up to £40,000 per year in unquoted companies against their top marginal rate of tax.

- **1986 Budget** extended life of scheme indefinitely; brought ship chartering companies and companies with overseas subsidiaries within its scope; excluded companies with substantial property backing or trading in investment goods and exempted gains on BES investment from CGT.

- **1987 Budget** included measures to reduce "bunching" of finance at end of tax year.

- **1985-86 £157 million** invested in 670 companies - 40 per cent increase over sum invested in 1983-84.

(iii) Enterprise Allowance Scheme (EAS), introduced 1982, assists people who have been unemployed and receiving benefit for at least 8 weeks to start their own business. £40 per week in lieu of benefits paid for one year. EAS entrants up 70 per cent from 65,000 in 1985-86 to 110,000 in 1987-88, in line with developing plans.

(iv) Local Enterprise Agency Grant Scheme (LEAGS), introduced 1986 for five years, provides financial assistance for agencies initially on 1:1 basis with private sector contributions, reducing to 1:3 by end of Scheme. Aim of Scheme to create network of viable, self supporting agencies, largely funded by private sector, providing advice, training etc to small firms.

(v) Deregulation central to small firms policy: recognised that administrative and legal burdens divert energies of businesses away from task of wealth creation. White Papers 'Lifting The Burden' (Cmnd 9571), and "Building Business ... Not

Barriers (Cmnd 9784), set out proposals for change. Much progress made on these. Report "Encouraging Enterprise described further measures. Departments now monitor compliance costs of new regulations to business.

(vi) Local grants to small employers

- in 1987-88 over £25 million provision for **local training grants** to employers to train current or new staff for hard-to-fill vacancies caused by eg new technology; also over £1.5 million for **local consultancy grants** for companies undergoing change;

- Under Managing Company Expansion (MACE) MSC provide money to smaller firms with potential. MSC mounted 120 pilot projects from April 1986 - now being evaluated;

- **redundancy rebates** now targetted; under 1986 Wages Act only available to firms with under ten employees.

(vii) Small Firms Service provides inexpensive access to information and advice. Dealt with 265,000 enquiries and arranged 38,000 business counselling sessions in 1987-88.

(viii) Training for enterprise and self-employed provided by MSC has increased in volume and range. 70,000 places available in 1987-88.

(ix) Access to Government contracts improved by simplification of tendering and approval procedures for contracts under £10,000 and explanatory publications issued by Departments.

(x) DTI-the department for Enterprise White Paper, January 1988, laid out detailed plans to assist small businesses including:

- **Business development initiatives** assisting small firms with use of private sector consultants in key areas - eg marketing, design, quality etc.

- **Business Reviews** of two days by experienced counsellors free to firms considering initiatives.

- **Export services** of BOTB will be reorganised to assist small companies better.

- **Innovation grants** for small companies in Development Areas, plus encouragement through Small Firms Merit Award for Research and Technology (SMART).

(xi) Reductions in taxation since 1979 have increased incentives for small firms (see also Brief E):

- National Insurance Surcharge abolished in 1984;

- unincorporated businesses benefited from basic rate cut to 27 per cent and increase in tax thresholds in 1987 Budget;

- "small companies rate" of corporation tax reduced to 27 per cent in 1987 Budget in line with basic rate. Stood at 42 per cent in 1979;

- Inheritance Tax exemption for lifetime gifts helps growing family firms (see also Brief D);

- Capital Gains Tax burden reduced over life of Government; exemption limit increased to £6,600; retirement reliefs extended (see also Brief D).

(xii) 1987 Budget VAT changes to help small businesses included introduction of cash accounting and annual accounting and increase in registration threshold to £21,300 (see Brief K).

(c) **Growth of small firms**

(i) On basis of VAT registrations, business starts exceeded stops on average by over 500 per week between end of 1979 and of 1986.

(ii) Company registrations up by 5 per cent in 1987 on 1986 to reach record level.

(iii) Evidence indicates that between 1982 and 1984 self-employment and employment in small firms rose by around 1 million (no more recent figures available).

Contact point: S J Flanagan (IAE3) 270 4472

G NORTH SEA TAXATION

[See also Balance and burden of taxes (including NICs) on income and spending (Brief N) and Public sector borrowing: historic trends and international comparisons (T)]

Three tiers of taxation

- royalties
- Petroleum Revenue Tax (PRT)
- corporation tax

Tax regime is fine-tuned to give fair return to Government but maintain incentives. Kept constantly under review in light of changes in oil field economics.

(a) **Royalties**

- Generally charged at 12½ per cent on gross value of oil or gas produced (less, in case of early offshore licences, certain conveying and treating costs).
- Royalties abolished in 1983 for "new" oil fields (ie offshore fields outside Southern Basin given development approval by Department of Energy after March 1982).
- Special royalty regime for onshore fields.

(b) **Petroleum Revenue Tax (PRT)**

- Charged at 75 per cent on landed value of oil from each field, less cost of exploration, extraction and putting it in saleable condition.
- Royalties are deductible for PRT.
- PRT paid shortly after oil extracted - mainly through provisions for monthly instalments (based on 75 per cent of previous chargeable period's liability and starting 2 months after beginning of chargeable period).

Special PRT reliefs

(i) Oil allowance exempts first ½ million tonnes of oil a year, up to limit of 5 million tonnes per field (these amounts are doubled for "new" oil fields).

(ii) Interest not directly allowable but 35 per cent uplift given on most capital expenditure incurred prior to "pay back" (which is broadly the point at which cumulative cash flow from yield first exceeds cumulative expenditure).

(iii) In early years, "safeguard" limits any PRT liability to 80 per cent of gross profits above 15 per cent of capital expenditure to date, designed to ensure no tax payable if certain levels of return on investment not reached.

[Doesn't this mean a ceiling, rather than a floor? How can it eve result in no tax being payable?]

(c) **Corporation tax**

Royalties, PRT and usual capital allowances are deducted in computing profits for corporation tax. "Ring fence" around profits attributable to extraction of oil or gas prevents losses, allowances and deductions for interest attributable to other activities being set against these profits.

Marginal tax rates

- Taking account of royalties, PRT and corporation tax, top marginal rate on oil and gas income 85.78 per cent from 1986-87. (NB Corporation tax paid at 35 per cent.)

- Top marginal rate on "new" oil fields 83.75 per cent. (Pay no royalties.)

- Average marginal rate 67 per cent.

Changes in North Sea tax regime

(i) 1986 APRT Act provied for immediate repayment of about £300million Advance Petroleum Revenue Tax (APRT) which would otherwise not have become repayable for another 3 years.

(ii) Finance Act and Finance No 2 Act 1987 introduced number of measures affecting oil companies:

PRT Cross Field Allowance (CFA) allows up to 10 per cent of cost of developing new oil field to be set immediately against PRT liability in another oil field. (Under normal rules, development expenditure only effectively relieved when income stream from field begins, and then only if income sufficiently high to give rise to PRT liability.)

PRT Treatment of Certain Research Expenditure allows research expenditure which is not specific to a given field against a participator's liability to PRT in any oil field after three years.

Reallocation of Oil Allowance allows greater flexibility in allocating oil allowance to redress imbalances between participators in field.

Ring Fence Advance Corporation Tax

- relax rules in relation to surrendered ACT (which can normally only be carried forward), allowing limited carry-back, and to permit surrender of ACT to a ring fence company owned by a 50/50 joint venture;

- anti-avoidance measure which prevents set-off against ring fence profits of ACT in respect of dividends on preference shares where capital was not used for ring fence purposes.

PRT Valuation and Pricing PRT Nomination Scheme enables companies to nominate, within a short time of deal being struck, those deals which will relate to oil company has produced itself. Other technical changes to valuation rules, likewise designed to reflect present market circumstances.

Capital Gains: Rollover Relief and Oil Licences clarifies that oil licences are not within class of assets which qualifies for rollover relief.

(iii) Capital Gains: Rollover Relief Goverenment announced during Summer Finance Bill Debates (on 16 July 1987, OR Vol 119 no 20, col 1320) that Government would consider in consultation with oil industry, possibility of allowing capital gains relief for certain disposals of oil licences made at the exploration stage.

(iv) PRT Safeguard and Deferred Expenditure Claims Government announced (on 16 December 1987 - OR Vol 124 No 66 col 531) that it would not, in current situation in oil market, be bringing forward legislation in 1988 Finance Bill to prevent extra relief (which was not originally intended to be available from being obtained by means of deferring expenditure claims during periods where safeguard relief reduces or cancels liability.

(v) PRT Nomination Scheme Government announced (on 4 December - OR Vol 123 No 58 col 731) that Revenue would consult with oil industry whether changes were needed to treatment under Nomination Scheme of oil taken to refining. While consultation proceeding, Government has given assurance that current transactions will be protected from any additional charge under Paragraph 5 of Schedule 8 Finance (No 2) Act 1987.

Effect of changes in oil price

Royalty and PRT receipts in 1987-88 depend on oil prices and production in calender 1987. Corporation tax receipts depend on prices and production in earlier years.

1987 FSBR forecast of effects as North Sea revenues (not updated in Autumn Statement):

		£ million
	1987-88	**Full year**
$1/ barrel difference in oil price on average in 1987 (assuming other things, including exchange rate, unchanged)	350	400
1 million tonnes difference in production in 1987, assuming change spread evenly across fields	45	50

Yield

See Annex

Contact points: Miss M A Hill (IR) 2541 6018 (structure of North Sea tax regime, PRT revenues, royalties)
Mrs C B Hubbard (IR) 2541 6576 (corporation tax and PRT relief)

ANNEX

Actual and forecast yields:

£ billion

	78-79	**79-80**	**80-81**	**81-82**	**82-83**	**83-84**	**84-85**	**85-86**	**86-87**	**FSBR**	**1986-87 Autumn Statement**
Royalties	0.3	0.6	1.0	1.4	1.6	1.9	2.4	2.1	0.9	0.8	
SPD[1]	-	-	-	2.0	2.4	-	-	-			No breakdown of fore-cast published
PRT	0.2	1.4	2.4	2.4	3.3	6.0	7.2	6.4	1.2	1.7	
CT											
- Mainstream	0.1	0.2	0.2	0.4	0.3	0.4	1.2	1.8	1.6	0.8	
ACT set-off[2]	0.0	0.1	0.1	0.3	0.2	0.4	1.2	1.1	1.1	0.6	
Total[3]	0.6	2.3	3.7	6.5	7.8	8.8	12.0	11.3	4.8	3.9	4.5
As per cent of GDP (at market prices)	0.3	1.1	1.6	2.5	2.8	2.9	3.7	3.1	1.2	0.9	1.1

(1) Supplementary Petroleum Duty, abolished from 1 January 1983

(2) estimated

(3) before ACT set-off

Forecasts for 1988-89 and later years will be published at time of Budget.

H. PENSIONS

Occupational pension schemes

Tax approved occupational pension schemes attract following exemptions and reliefs:

- employee contributions tax deductible up to 15 per cent earnings;
- no limit on deductible employer contributions (except that they should not exceed what is necessary to fund promised benefits);
- pension scheme investment income and capital gains tax free. Not tax exempt on trading or other non-investment activities.

Pension Fund Surpluses

(a) 1986 Budget introduced new rules for dealing with pension scheme surpluses. For purposes of new rules, pension fund assets and liabilities valued on pre-determined actuarial basis prescribed in Regulations. Where on this basis surplus exceeds 5 per cent, pension fund trustees should reduce surplus by:

- contribution reductions/holidays
- benefit improvements
- payments to employers, subject to 40 per cent free-standing income tax or corporation tax charge;
- any combination of the above.

(b) **Tax Yield on payments to employers**

1986/87 (actual) £26m
1987/88 (estimate) £50m

1987 Reform package

Major pensions reform package (see also Personal Pensions) covering

(a) free-standing additional voluntary contributions (AVCs);

(b) anti-exploitation measures;

(c) administrative streamlining

Cost of overall package will depend on take-up, but provisionally estimated as £65 million in 1988-89.

(a) **Free-standing AVCs**

Occupational pension scheme members can, from 26 October 1987, pay AVCs to their own plan, up to tax approval limits. Previously confined to AVCs to employer's scheme only. Can also vary amount and timing of such payments if they think fit. Basic rate tax relief given at source.

(b) **Anti-exploitation measures**

Changes in tax rules to counter exploitation of reliefs, particularly by high earners:

(1) limit of £150,000 on tax-free lump sums. Maximum lump sum benefit for which someone with final remuneration of £100,000 could qualify;

(2) tighter definition of 'final salary' for pension purposes (eg to exclude share options);

(3) less generous "uplift": maximum 'two-thirds final salary' benefits possible only after 20 years (previously 10 years);

(4) change in tax-free lump sums rules to prevent maximisation at expense to taxable pension.

Changes apply from 17 March 1987 for new schemes/new members only except for (2) which applies generally for all retirements on or after 17 March 1987.

(c) **Administrative streamlining**

- Present legislation (Finance Act 1970) amended to clear up detailed points concerning tax approval of occupational schemes.

- Changes in Inland Revenue administrative procedures and some simplications in existing practice being discussed with pensions bodies, for later implementation;

- new, simplified, 'no frills' occupational schemes. Detailed guidance to be published shortly, including standard scheme documentatation.

Personal Pensions (PPs)

(a) Consultative document: "Improving the Pensions Choice" November 1986 proposed new tax rules

- tax regime for PPs similar to present retirement annuities ('money purchase') benefits; contribution - not benefit - limits; tax free lump sums;

- but improvement (eg to allow contributions by employers, within overall limits; higher contribution limits for over 50s);

- PPs open to all employees (including public sector) and self-employed;

- greater transferability of pension rights.

(b) New tax regime giving effect to consultative document enacted in 1987 Finance No 2 Act. Tax rules include further relaxations in light of comments on consultative document.

- people can have more than one current PP;

- simpler certification procedure for employers (to ensure individual is employee but is not in employer's pension scheme);

- simpler rule for tax-free lump sums (25 per cent of fund).

(c) **Contribution limits**

Age	% of earnings
50 or less	17.5
51-55	20
56-60	22.5
61-75	27.5

(d) Original start date (4 January 1988) postponed to 1 July 1988 due to delays in implementing Financial Services Act. Provisions to be included in 1988 Finance Bill to give effect to new start date. Will replace present retirement annuities from 1 July 988.

(e) **Basic rate tax relief at source** for employees. Same rules as now for self-employed (ie claim tax relief in end of year tax returns).

Contact point: J D Hinton (IR) 2541 7565

J PROFIT RELATED PAY (PRP)

Profit Related Pay (PRP) is part of employees' pay which varies in relation to movement in profits of business or part of business in which they work.

(i) History

Chancellor floated idea of income tax relief for PRP in 1986 Budget Speech; Green Paper (Cmnd 9835) issued in July 1986 describing benefits of PRP and illustrating possible tax relief.

Tax relief introduced in 1987 Budget - Sections 1 to 17 and schedule 1 of Finance No.2 Act 1987 (Royal Assent July 1987) gives legal basis.

Inland Revenue Guidance Notes (PRP2) and HM Treasury introductory leaflet issuedin September 1987. Additional Notes to be issued by Inland Revenue in February 1988.

(ii) Tax Relief

(a) Form of relief:

- One half of any payment of PRP (up to limit) exempt from tax, provided paid under scheme satisfying conditions and registered in advance with Inland Revenue;
- No limit on total amount of PRP an employee can be paid under a registered scheme. But amount attracting tax relief in a year limited to 20 per cent of an employee's total pay, or £3,000 whichever is the lower. So up to 10 per cent of total pay, or £1,500 if less, can be exempt from tax in any one year.

(b) Main conditions

To be registered by Inland Revenue schemes must:

- make at least 80 per cent (with certain exceptions) of employees in "employment units" eligible to receive PRP;
- ensure profit and loss account produced for the employment unit;
- provide that prospective amount of PRP to be paid out in first year - if profits in that period unchanged compared with base year - at least equal to 5 per cent of standard pay of eligible employees.

(c) Introduction of PRP

Employers free to choose how to introduce PRP into business - whether by converting part of existing pay, as part of pay settlement, or otherwise.

Cost of setting up and running a PRP scdheme deductible in calculating profits for tax purposes.

(d) Revenue cost

Depends on take up. Likely to be negligible in 1987-88. Will build up substantially in later years as relief becomes payable on more schemes and PRP becomes higher proportion of pay.

(iii) **Benefits of PRP**

A major problem of UK economy is inflexible pay setting arrangements, based on "going rate" instead of what business can afford. Although pay systems ultimate responsibility of management, Government concerned to help over longer term if possible with measures to encourage labour market flexibility. Benefits of PRP are:

- makes pay flexible in face of changing business conditions - essential if labour market to work more efficiently and unemployment to be reduced;

- in times of falling profits, reduced risk of job losses because employers have option of temporary pay reductions.

- can improve industrial relations and activity by encouraging employee identification with success of business.

(iv) **Interest in PRP**

By 31 December 1987, Profit Related Pay Office (PRPO) had registered 430 schemes covering over 70,000 employees.

40,000 copies of Guidance Notes issued to end 1987. Clear that availability of tax relief has stimulated widespread debate amongst employers, employees and advisers at all levels about need to break rigidities of the British pay system.

Contacts:

Guidance Notes available from:

Profit Related Pay Office
Inland Revenue
St Mungo's Road
Cumbernauld
GLASGOW G67 1YZ

Officials:	Mr Wynn Owen	270 4473
	Mr Fray	270 5683
	Mr Fraser - IR	438 (GTN 2541) 7763
	Mr Annys - IR	438 (GTN 2541) 6591

K INDIRECT TAXES

[See also International comparisons of taxation (Brief P) and small businesses (Brief E).]

Yield

(Includes VED but excludes Customs duties etc.)

£ billion

		Nominal	Real at Sept 87 values
(i)	1978-79	13.9	27.9
(ii)	1986-87	42.2	43.7

(iii) FSBR forecast yield 1987-88 £44.8 billion. Autumn Statement indicated VAT yield might be £½ billion higher than FSBR forecast.

Historical comparison

	Level of duty post-Budget 1978	Current level of duty	Real change (per cent)*
Beer (pint)	7.7p	18.6p	+20.5
Wine (bottle of table wine 75cl)	53.6p	73.5p	-31.6
Spirits (bottle 75cl)	£ 3.13	£ 4.73	-24.6
Tobacco (20 king size cigarettes)	34.5p	94p	+36.0
Petrol (gallon)	30.0p	88.1p	+46.5
Derv (gallon)	31.0p	74.5p	+6.2
VED (cars and light vans)	£ 50	£100	-0.2

*Based on increase in RPI from average of 1978-79 to September 1987.

Specific duties, taken together, have increased in real terms by about 35 per cent since 1978-79.

Revalorisation

Effect of revalorisation at 3.7 per cent (ie increase in RPI over 12 months to December 1987) would be:

	Current level of duty	Price change inc VAT (pence)	Revenue 1988-89 (£ million)	Revenue 1989-90 (£ million)
Beer (pint)	18.6p	0.8	65	65
Wine (bottle of table wine 75cl)	73.5p	3.1	20*	20*
Spirits (bottle 75cl)	£4.73	20.1	25	30
Tobacco (20 kingsize cigarettes)	94p	3.4	100≠	110≠
Petrol (gallon)	88.1p	3.7	195	220
Derv (gallon)	74.5p	3.2	45	45
VED (cars and light vans)	£ 100	£3.70	80	80

* all wines

≠ includes hand-rolling tobacco

Across the board revalorisation by 3.7 per cent would yield about £550 million in 1988-89 and £590 million 1989-90. Would raise RPI by 0.28 per cent.

Revalorisation not statutory, but assumed in Autumn Statement forecast.

Illustrative tax changes

	Price change including VAT	Actual % change in duty	Revenue £ million 1988-89°	Revenue £ million 1989-90
Beer	1p	4.7	75	85
Wine	5p	6.3	30*	35*
Spirits	10p	1.8	15	15
Tobacco	1p	1.1	25≠	30≠
Petrol	1p	1.0	55	60
Derv	1p	1.2	15	15
VED (cars and light vans)	£1.00	1.0	20	25
VAT 1 per cent change in rate		na	940	1,310

* all wine

≠ all tobacco

o assumes implementation on 1 April.

Value added tax

(i) Rate 15 per cent. Raised and amalgamated in June 1979 Budget: previously standard and higher rates of 8 per cent and 12½ per cent.

(ii) Reliefs apply to some basic necessities, accounting for just under half of total consumer expenditure, and make tax mildly progressive:

(a) zero-rate (applied to most foods, heating and lighting, public transport, books and newspapers, new construction, young children's clothes, sewerage and water, exports etc);

(b) exemptions (applied to land, insurance, finance, education, health etc).

(iii) Estimated yield in FSBR £23.3 billion in 1987-88; increased in Autumn Statement by about £½ billion.

(iv) Registration limit raised from £20,500 to £21,300 from 18 March 1987. EC constraints on changes in limit, but draft Directive on VAT and Small and Medium-Sized Enterprises would permit increase to £25,000 if adopted in present form. UK pressing for progress on Directive.

(v) Finance Act 1987

- Introduction of package of changes in VAT accounting and record-keeping procedures to assist small businesses. These include:

(a) Cash accounting scheme introduced on 1 October 1987 giving businesses with turnover up to £250,000 option to account for VAT on basis of cash paid and received (reducing yield by about £100 million in 1987-88, £10 million in future years);

(b) annual accounting scheme to be introduced in summer of 1988 enabling businesses with turnover up to £250,000 to make one VAT return a year, with payments on account (reducing yield by about £25 million in 1988-89);

(c) time allowed to notify for registration extended to 30 days, and deregistration made easier;

(d) changes introduced on 1 October 1987 to improve and simplify special schemes for retailers.

- Package of measures to eliminate various sources of VAT avoidance introduced from 1 April 1987. Measures include: strengthening rules on right to deduct input tax for partly exempt traders; and making of arrangements for, and underwriting of, capital issues to be exempt. Expected to produce increase in yield of about £300 million in 1987-88.

- Gross margins earned by tour operators on sales of tours within EC brought within scope of VAT with effect from 1 April 1988.

- Relief for charities extended to installation or adaptation of bathroom, washroom or lavatory facilities for the handicapped in charity residential homes; drugs and chemicals directly used by a charity in medical research; certain vehicles for use by hospices for transporting the terminally ill; certain special location and identification equipment for use by charitable rescue and first aid services; goods donated for export by charity for relief of distress or animal welfare. Will reduce yield by about £5 million in 1987-88.

(vi) Pledges on VAT zero-rates

During election campaign, Prime Minister gave specific undertaking not to extend VAT to food, gas, electricity or young childrens' clothing and footwear. (Commitments confirmed at Prime Minister's Question Time: OR 16 July vol 119 No 20 col 1270 and 1271).

Commission proposals to "approximate" tax rates: On 16 November Chancellor made it clear to Council of Finance Ministers that UK would not agree to any proposals that in any way conflict with pledges the Government had given on UK zero rates. (Or 26 November col 369).

(vii) EC Infraction proceedings - concern interpretation of existing EC law in relation to certain areas of zero-rating (eg construction). [By contrast approximation proposals would involve the passing of new laws .] Advocate General published Opinion on 2 December but only advisory and not binding on Court. Cannot speculate what judgement will be, though Government is confident of strength of case which it has vigorously argued before Court.

(viii) <u>VAT Keith</u>

- <u>Bulk of VAT recommendations implemented in Finance Act 1985</u>

  - All VAT offences, except serious fraud, to be decriminalised and system of financial penalties, surcharge and interest to be introduced progressively.

  - Powers to require information clarified; inconsistencies and anomalies removed.

  - Taxpayer protected by right of appeal and by recognition of "reasonable excuse" for default.

- <u>Commencement</u>

  - Financial penalties for regulatory type offences implemented 25 July 1985.

  - Default surcharge to be applied to persistent late payers and repayment supplement (when Customs delay payment) introduced 1 October 1986.

- <u>Revenue effect</u> Chancellor in 1985 Budget Speech (OR 19 March 1985 vol 75 col 797) "... expected to bring in extra revenue of about £50 million in 1985-86. By 1988-89 there will have been a cumulative once-for-all revenue gain of about £600 million".

- <u>No further action</u> in 1987 Budget. (Minor technical extension in 1986.)

- Third phase of measures (serious misdeclaration penalty and interest on inaccuracies in VAT returns) <u>deferred</u> from 1 July 1988 to autumn 1989 to allow earliest possible introduction of annual accounting.

- Ministerial undertaking given to <u>review</u> system of civil penalities, including reasonable excuse, before 1988 Budget.

<u>Oil</u>

(all figures duty only - ie <u>exclude</u> VAT on duty)

(i) <u>Rates</u>

(a)	Petrol, other light hydrocarbon oils and petrol substitutes (For unleaded petrol see (iv) below)	88.10p per gallon
(b)	Derv	74.51p per gallon
(c)	Rebated heavy hydrocarbon oils	
	- fuel oil	3.5p per gallon
	- gas oil	5.0p per gallon
(d)	Liquified petroleum gas for use as road fuel	44.05p per gallon

(e) AVGAS (aviation gasolene) 44.05p per gallon

(ii) Reliefs

Oil used in fishing boats and lifeboats; heavy oil for ships and certain horticultural purposes; oil used in manufacturing other products (other than as fuel or lubricant).

(iii) Estimated yield £7,770 million in 1987-88 (petrol £6,080 million; derv £1,520 million; rebated oil £170 million).

(iv) Finance Act 1987

Duty differential in favour of unleaded petrol introduced. Equivalent to a little over 4p a gallon -5p a gallon including VAT).

Tobacco

(all figures duty only - ie exclude VAT on duty)

(i) Rates

(a) Cigarettes - 21 per cent of retail price + £30.61 per 1,000 (typical duty per packet of 20 - 94p).

(b) Handrolling tobacco - 124.1p per 25 gram packet.

(c) Cigars - 44.0p per packet of 5 (small). (No change in last three Budgets.)

(d) Pipe tobacco - 62.4p per 25 gram packet. (No change in last five Budgets.)

(ii) Estimated yield £4,850 million in 1987-88.

(iii) Finance Act 1987

Taxation of cigarettes, and other tobacco products unchanged.

Alcohol

(all figures duty only - ie exclude VAT on duty)

(i) Spirits

(a) Rate/incidence - £4.73 per bottle of whisky at 40 per cent by volume (£15.77 per litre of alcohol).

(b) Reliefs - spirits used for industrial, medical or scientific purposes.

(c) Estimated yield - £1,530 million in 1987-88.

(ii) Beer

(a) Rate/incidence - 18.6p per pint (£25.80 per hectolitre at 1030°).

(b) Estimated yield - £2,010 million in 1987-88.

(iii) Wine and made wine

(a) Rates

- still wine and made-wine £98.00 to £194.90 per hectolitre according to bands of alcoholic strength;

- sparkling wine £161.80 per hectolitre.

(b) Incidence - 74p to 146p per 75cl bottle, depending on alcoholic strength.

(c) Estimated yield - £750 million in 1987-88.

(iv) Cider and perry

(a) Rates/incidence - 9.0p per pint (£15.80 per hectolitre).

(b) Estimated yield - £55 million in 1987-88.

(v) Finance Act 1987

No change in duty rate on any alcoholic drink.

(vi) Wine/beer infraction proceedings

EC Commission began formal infraction proceedings against UK in 1978, alleging that UK rates of excise duty on beer and wine provided indirect protection for the industry contrary to Treaty of Rome. In July 1983 European Court delivered adverse judgment against UK. This resulted in wine duty reduction in 1984 Budget.

After 1987 Budget wine/beer ratio stands at 2.9988:1, fractionally below limit of 3:1 set by Court.

Matches and mechanical lighters

(all figures duty only - ie exclude VAT on duty)

(i) Rates

(a) matches - £1.15 per short standard (7,200 matches);

(b) mechanical lighters - 50p each.

(ii) Estimated yield £20 million in 1987-88.

(iii) Finance Act 1987

No change in duties on matches and mechanical lighters (negligible revenue effect).

Betting and gaming duties

(i) Consist of general betting, pool betting, gaming licence, gaming machine licence and bingo duties.

(ii) Estimated yield £800 million in 1987-88.

(iii) Finance Act 1987

Duty on on-course betting abolished with effect from 29 March 1987. Gaming machine licence duty increased as follows to offset revenue lost from on-course betting with effect from 1 July 1987:

- amusement-with-prizes machines: 5p machines now £150 a year and 10p machines now £375 a year;

- jackpot machines: 5p machines now £375 a year and 10p machines now £960 a year;

Car tax

(i) Rate 10 per cent of wholesale value: charged on purchase of new cars, motorcycles, mopeds and scooters in addition to VAT.

(ii) Estimated yield £1,100 million in 1987-88.

Vehicle excise duty

VED charged annually on all vehicles used on public roads.

(i) Rates

(a) £100 pa on cars and light vans (up to 1.525 tonnes unladen weight).

(b) £130 pa on goods vehicles up to 7½ tonnes gross weight.

(c) £290 pa on goods vehicles from 7½ to 12 tonnes gross weight.

(d) £320 to £3,100 pa on heavier goods vehicles.

(e) £52.50 (plus £1.05 for each seat over 20) pa on buses, coaches, and taxis.

(f) £10 to £40 pa for motorcycles.

(g) £50 pa on recovery vehicles (new class created in 1987 Finance Act).

(ii) Exemptions and reliefs

Certain exemptions eg electric vehicles, disabled drivers. Concessionary rates available for farmers' and showmen's goods vehicles and for vehicles first registered before 1947.

(iii) Estimated yield £2,600 million in 1987-88.

(iv) Finance Act 1987

(a) No change in rate of VED for cars and light vans, taxi, buses, coaches, motorcycles and most lorries.

(b) VED rates for farmers' goods vehicles increased by varying amounts. Last of three annual steps to move towards rates which are broadly proportionate to mileage which farmers' vehicles cover on roads by comparison with average lorry.

(c) In 1987-88, lorries expected to pay about £1,405 million in VED and derv duty, compared with road track costs of £1,095 million. Every class of lorry continues to cover its road track costs.

(v) Total effect of all VED changes was to increase yield by £5 million in full year.

(vi) If VED abolished (with no registration fee put in its place), estimated that 38p of extra tax (duty and VAT) required on gallon of petrol to make good lost revenue.

Customs duties etc

(i) Accountable to EC as 'own resources'.

(ii) Estimated yield £1,580 million in 1987-88.

Contact point: R G Michie (FP) 270 4922

L HISTORICAL RECORD ON INCOME TAX, EMPLOYEE NICS, CHILD BENEFIT

[See also Income tax (Brief A) and National Insurance contributions (C)]

Changes since 1978-79

(i) Income tax

(a) Basic rate down from 33p to 27p.

(b) 25p reduced rate band withdrawn in 1980 Budget.

(c) Higher rates considerably reduced: top rate down from 83p to 60p.

(d) Level of taxable income at which:

40 per cent rate starts - over 10 per cent up in real terms since 1978-79

60 per cent rate starts - over 60 per cent up in real terms since 1978-79

(e) Personal tax allowances up around 22 per cent in real terms between 1978-79 and 1987-88. Married man's allowance highest level in real terms since 1945.

(f) Investment income surcharge abolished in 1984 Finance Act.

(g) Mortgage interest relief ceiling raised from £25,000 in 1978-79 to £30,000 (1983 Budget).

(h) Income tax receipts fell from 11.1 per cent of GDP in 1978-79 to 9.7 per cent in 1987-88.

(ii) National Insurance contributions (NICs)

(a) New reduced rate bands with rates of 5 and 7 per cent for low earners (2.85 and 4.85 per cent for contracted-out) introduced in October 1985.

(b) For those earning above lower bands up to Upper Earnings Limit:

	contracted-in	contracted-out
1978-79	6.5	4
1987-88	9	6.85

(See also Brief C.)

(c) Employees' NICs rose from 2.4 per cent of GDP in 1978-79 to 3.4 per cent in 1987-88.

(d) Contracted out rates up by 0.15 per cent to 3, 5 and 7 per cent already announced for 1988-89.

(iii) Child benefit

- Child benefit in May 1979 was £4.00

- Child benefit since April 1987 is £7.25

Child benefit will remain at £7.25 from April 1988.

Child support (taking account of child tax allowances in 1978-79) 13 per cent higher in real terms in 1987-88 than in 1978-79 for basic rate taxpayer on average earnings with two children under 11 (6 per cent if children are both between 11 and 15; unchanged if both over 16).

Average tax rates

Income tax and employee NIC as percentage of gross earnings

Multiples of Male average earnings[1]	Income Tax					Income tax and NIC				
	½	¾	1	1½	2	½	¾	1	1½	2
Single										
1973-74	14.2	19.5	22.1	24.7	26.0	21.0	25.6	28.0	29.2	29.4
1978-79	17.0	22.4	25.0	27.7	29.5	23.6	28.9	31.5	33.3	33.7
1987-88	16.0	19.7	21.5	23.3	26.4	25.0	28.7	30.5	31.1	32.2
Married										
1973-74	9.4	16.3	19.7	23.1	24.8	16.2	22.5	25.6	27.6	28.2
1978-79	9.5	17.3	21.3	25.2	27.2	16.0	23.8	27.8	30.8	31.4
1987-88	9.9	15.6	18.4	21.3	23.9	18.9	24.6	27.4	29.0	29.7
Married + 2 children - taking account of child benefit										
1973-74	-2.5	8.3	13.7	19.2	21.9	4.3	14.5	19.6	23.6	25.2
1978-79	-4.1	8.1	14.4	20.6	23.7	2.5	14.6	20.9	26.2	27.9
1987-88	-2.7	7.2	12.1	17.1	20.8	6.2	16.2	21.1	24.8	26.5

(1) Average weekly earnings of full time adult males (all occupations) £229.80 (assuming 7.5 per cent growth on 1986-87.)

Main points

(a) All family types at and above 75 per cent of average earnings now pay smaller share of earnings in income tax (less child benefit) than in 1978-79.

(b) All family types at and above 75 per cent of average earnings paid smaller proportion of earnings in income tax and NIC (less child benefit) in 1973-74 than in 1978-79 and 1987-88. Also true at 50 per cent average earnings between 1973-74 and 1987-88.

Real take home pay

	Per cent change in real take-home pay			
Multiples of average earnings(1)	½	1	2	5
Single				
1973-74 to 1978-79	-1.0	-2.8	-4.1	-18.5
1978-79 to 1987-88	+20.9	+25.1	+26.1	+39.5
1973-74 to 1987-88	+19.7	+21.7	+21.2	+13.8
Married				
1973-74 to 1978-79	+2.5	-0.9	-2.4	-17.0
1978-79 to 1987-88	+19.2	+23.9	+26.4	+38.1
1973-74 to 1987-88	+22.2	+23.0	+23.6	+14.8
Married with 2 children including CB				
1973-74 to 1978-79	+4.2	+0.6	-1.4	-16.9
1978-79 to 1987-88	+18.6	+22.9	+25.6	+36.5
1973-74 to 1987-88	+23.6	+23.8	+24.0	+13.8

(1) Full time adult males (all occupations)

April 1979 to April 1987	**Percentage increase in gross earnings** (real terms)	**Percentage increase in real take home pay**		
		single	married	married + 2 children including CB
All occupations(1)				
Bottom decile	5	5	5	4
Median	14	13	13	12
Top decile	28	28	28	26
Average earnings	20	18	18	16
Average manual earnings(1)	8	8	8	7

(1) Full time adult males

	Tax thresholds at constant prices (1978-79 = 100)		Tax thresholds as percentage of average earnings(1)	
	Single	Married	Single	Married
1967-68	92	92	23.3	36.1
1973-74	126	105	26.4	34.3
1978-79	100	100	20.4	31.8
1987-88	122	123	20.5	32.1

(1) Full time adult males (all occupations)

Main points

(a) All family types whose earnings have risen at least as fast as national average now have real take-home pay at least 18½ per cent higher than in 1978-79.

(b) Increases in real take-home pay have been much larger for those on higher earnings since 1978-79, but not over whole period since 1973-74.

(c) Some lower paid have had only small increase in their real take-home pay, owing to slower growth of their gross earnings as well as income tax and NIC changes. Average gross earnings of manual workers have gone up less than average for all occupations.

(Note: figures for real take-home pay leave out of account means-tested benefits (FIS, HB etc) to which those at lower end of earnings scale would be entitled. These have been uprated by more than inflation since 1978-79.)

(d) Despite real increases in personal allowances since 1978-79, income tax still starts at much lower proportion of average earnings than 20 years ago.

Contact point: I J Scotter (ETS) 270 4981

M TAX REFORM

[See also Income tax (Brief A), "Reform of Personal Taxation" Green Paper (B), National Insurance contributions (C), Capital taxes (D), Business taxation (E), Pensions (H), Profit-related pay (J) and Indirect taxes (K)]

General Aims

Financial Secretary said in "Taxation" October 1987:

"Tax is not simply a matter of raising the revenue needed to fund essential public services. The overall burden of tax and the way it is collected have a major impact on the way individuals behave and thus on the overall performance of the economy. For this reason tax reform is a fundamental part of the Government's overall economic strategy.

"Our major theme is tax reduction ... helping markets to work effectively is the next vital element ... We are also reducing the burden of bureaucracy on businesess so that they can devote more energy to the business of making money and less to the chore of form filling."

The Government's Record

Income tax

- Main personal allowances increased by 22 per cent in real terms since 1978-79. Helps poverty and unemployment traps by boosting take-home pay (particularly at bottom of pay scale) and by taking some taxpayers out of tax altogether (so cutting their marginal 'tax' rates).

- Top tax rates cut from 83 per cent on earned income and 98 per cent on investment income to 60 per cent on both. Increases incentives to effort and enterprise, encourages saving and wealth-creation.

- Basic rate cut from 33 per cent to 27 per cent. Cuts tax burden for all taxpayers; reduces marginal rate and improves incentives for those - the large majority - liable at basic rate only. (But NB 25 per cent reduced rate band abolished).

  Stated aims:

- In 1987 Autumn Statement interview Chancellor said "Our policy is very clear. It is to cut taxes, particularly income tax, and get the basic rate of income tax down to 25 pence in the pound as soon as it is prudent to do so."

- Chancellor said at October Conservative Party Conference that tax treatment of married women no longer acceptable and must change. Green Paper published in 1986; Financial Secretary told House in April "I hope that the time will not be long delayed before we can make further progress".

(See also Briefs A and B)

Profit Related Pay (PRP)

- New relief introduced in 1987 for PRP. Will give work force a more direct interest in their company, encourage greater pay flexibility and so help prevent unemployment.

(See also Brief J)

Share Ownership and Retirement

- Employee share ownership encouraged by two new share option schemes and extension of existing tax reliefs.

- Personal Equity Plans introduced to encourage direct investment in shares by individuals.

- Government's privatisation programme created 3½ million new shareholders

- Wide - ranging review of pension provision included new tax regime for personal pensions and for additional contributions. Will expand freedom of choice and make it easier to keep pension rights when changing jobs.

(NB Chancellor said in 1985 Budget Speech, (OR vol 75 to 33 cols 794-5) that "the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested ..... There is a case for changing the tax treatment of pension funds, as part of a thorough going reform of the tax treatment of savings generally. Any fundamental reform of this kind would, in the same way, need to be preceded by the publication of a Green Paper".)

(See also Brief H and V)

Capital gains tax (CGT)

- Threshold increased more than three times in real terms to £6,600 since 1978-79. Cuts tax burden and simplifies system by taking people out of CGT altogether.

- Indexation introduced in 1982, extended in 1985. Now no tax on inflationary gains from 1982 onwards.

(See also Brief D)

Inheritance tax and Capital transfer tax

- Abolition in 1986 of tax on lifetime gifts more than 7 years before death. Encourages giving and wider spread of wealth. Particularly helpful for small and family businesses - gives opportunity for succession to next generation entirely free of tax.

- Other changes include real increase in tax threshold, top rates cut, rate scale simplified, business and agricultural reliefs improved.

(See also Brief D)

Business tax

- Major reform of corporation tax in 1984; rate reduced in stages from 52 per cent to 35 per cent; stock relief withdrawn; initial allowances replaced by writing down allowances.

- National Insurance Surcharge reduced in 1982 (twice) and abolished in 1984. Completed removal of Labour Government's "tax on jobs".

- Companies' capital gains taxed at same rate as their income from 1987.

- Small companies' rate reduced in stages from 42 per cent to 27 per cent, limit increased to £100,000 and limit for marginal relief increased to £500,000.

- Business Expansion Scheme introduced to assist small companies to raise venture capital.

1984 reform aimed to

- reduce tax-induced distortion of investment decisions

- improve quality of business investment

- encourage enterprise and efficiency by reducing marginal tax rate on company profits

- ensure that companies as a whole pay a lower effective tax rate for any given level of profit and investment; these benefits now being felt and will increase

(See also Brief E)

Development Land Tax

- Abolished 1985. Removed impediment to development; helpful to building industry and employment. Simplified system by removing complex tax with high collection costs for Inland Revenue, high compliance costs for taxpayers.

Stamp duties

- Rate on shares halved to 1 per cent in 1984 and again to ½ per cent in 1986. By reducing dealing costs, boosted market liquidity, prepared for "Big Bang" and promoted wider share ownership.

- Maximum rate on land and buildings halved to 1 per cent in 1984; since 1984 no duty on transfers below £30,000. Assists first time buyers in particular.

- Many minor duties abolished in 1985.

National Insurance contributions

- Rates increased to meet higher spending on NI benefits: 1988-89 contracted-in rates: 9 per cent for employees, 10.45 per cent for employers compared to 6.5 per cent and 10 per cent in 1978-79. But NIS also payable in 1978-79 and reduced rates (see below) are available now.

- Reduced rate bands introduced for lower-paid employees and their employers. Benefits those on less than £105 a week in 1987-88 (for current rates, see Brief C). Lower rates increase take-home pay, and hence incentive to work, of employees and reduce cost to employers of employing low paid workers, thus improving employment prospects.

- Employers' NIC extended to earnings above Upper Earnings Limit to offset cost of reduced rate bands.

- Tax Relief for Self-Employed NICs on half their Class 4 contributions introduced to put them on more even footing with employers.

(See also Brief C)

Indirect taxes

- Customs and Excise revenue, plus vehicle excise duty, increased from 38 to 43 per cent of total central government tax revenues since 1978-79. Reflects Government's shifting of burden from direct to indirect taxation to "restore incentives and make it more worthwhile to work; and at the same time increase the freedom of choice of the individual". (Sir Geoffrey Howe, 1979 Budget Statement, OR 12 June vol 968 cols 249-250).

Major changes include:

1979 - single VAT rate of 15 per cent replaced rates of 8 and 12½ per cent: shifted burden from direct to indirect tax and simplified structure of VAT.

1984 - VAT extended to building alterations and hot take away food as part of shift from direct to indirect taxes. Reduced distortions.

1985 - VAT extended to advertising in newspapers and periodicals, to extend tax base and end anomaly (other forms of advertising already subject to VAT).

1987 - VAT package for small businesses to reduce administrative burden of VAT.

Other measures include:

1984 - abolition of duty on paraffin, to help pensioners.

1986 - abolition of duty on aviation turbine kerosene (AVTUR) and most lubricating oils, to simplify tax system.

1987 - introduced tax differential in favour of unleaded petrol to encourage its use and abolished on-course betting duty.

(See also Brief K)

Charities

- Substantial package of reliefs in 1986 Budget to encourage charitable giving. Included relief for company donations, abolition of limit on higher rate relief for individual donations, new Payroll Giving Scheme and extension of VAT concessions for charities. Several other measures since 1979 to assist charities. Payroll Giving Scheme came into effect in April 1987; described by then Economic Secretary as "one of the most exciting developments in charitable giving for many years. It is a simple way for ordinary people to give regularly to their favourite charities and to do so with the aid of tax relief."

Contact point: D I Sparkes (FP) 270 5666

N BALANCE AND BURDEN OF TAXES (INCLUDING NICS) ON INCOME AND SPENDING

[See also Historical record on income tax, employee NICs, child benefit (Brief L) and International comparisons of taxation (P)]

(i) **Total tax burden**

Per cent of GDP at market prices

	Total taxes (incl LA rates) plus NICs		North Sea taxes and royalties(1)
	incl North Sea	excl North Sea	
1970-71	36.2	36.2	-
1974-75	35.7	35.7	-
1978-79	33.8	33.5	0.3
1979-80	35.1	34.0	1.1
1980-81	36.3	34.7	1.6
1981-82	39.4	37.0	2.4
1982-83	38.9	36.2	2.7
1983-84	38.5	35.8	2.7
1984-85	39.1	35.8	3.3
1985-86	38.5	35.7	2.8
1986-87	37.9	36.9	1.0
1987-88(est(2))	38.0	37.1	0.9

(1) After ACT set-off

(2) Based on Autumn Statement forecast

Breakdown as percentage of GDP (at market prices)

	1978-79	1987-88	Change Absolute	Change %
Income tax	11.1	9.7	-1.4	-13
Employees' NICs	2.4	3.4	1.0	+42
	13.5	13.0	-0.5	-4
Corporation tax (non-North Sea)	2.2	3.4	1.2	+55
North Sea taxes and royalties(1)	0.3	0.9	0.6	+200
Employers' NICs and NIS	4.8	3.6	-1.2	-26
Capital taxes	0.5	0.8	0.3	+60
LA rates	3.4	4.0	0.6	+18
Expenditure taxes and stamp duties	9.3	12.3	3.0	+32
Total	**33.8**	**38.0**	**4.2**	**+12**

(1) Includes North Sea corporation tax after ACT set-off.

Main points

(a) Sharp rise in burden 1978-79 to 1981-82 (to highest ever level), reflecting recession and need to reduce PSBR.

But

(b) Burden broadly stable since 1981-82 excluding North Sea; has fallen including North Sea.

(c) Income tax and employees' NICs together have fallen slightly as proportion of GDP since 1978-79.

(d) Corporate taxes have risen as a proportion of GDP since 1978-79, reflecting rising profitability of UK industry.

(e) Expenditure taxes up by one third (mainly owing to VAT increase).

(ii) **Taxes in real terms**

		£ billion 1986-87 prices	
	1978-79	1987-88 (est[1])	Change
Income tax	37.3	38.8	+1.5
Non-North Sea corporation tax	7.4	13.7	+6.3
North Sea taxes and royalties[2]	1.0	3.6	+2.6
Capital taxes	1.6	3.0	+1.4
Employees' NICs	8.0	13.4	+5.4
Employers' NICs	12.0	14.3	+2.3
NIS	4.1	-	-4.1
LA rates	11.3	16.2	+4.9
Taxes on expenditure and stamp duties	31.1	49.5	+18.4
Total	114.1	152.5	+38.4

(1) Based on Autumn Statement forecast

(2) After ACT set-off

Change in taxes on persons in 1987-88 compared to indexed 1978-79 regime

	£ billion
Income tax	-12
Employees' NICs	+4 ¼
Indirect taxes on persons (excl LA rates)	+11
Total	+3 ¼

Main points

(a) Taxes up by around £38 billion in real terms since 1978-79 as economy has grown.

(b) Taxes on persons £3 ¼ billion higher than under indexed 1978-79 regime.

(c) Income tax burden £12 billion lower than under indexed 1978-79 regime.

(d) Increase in NICs due to need to finance pensions and benefits to unemployed.

(e) Increase in indirect taxes reflects explicit Government objective to switch taxation from earnings to spending to encourage enterprise and increase freedom of choice.

(iii) **Balance of taxation**

	Per cent of total taxes and NICs 1978-79	1987-88 (est[1])
Income tax	32.7	25.4
Employees' NICs	7.0	8.8
Non-North Sea corporation tax	6.5	9.0
North Sea taxes and royalties[2]	0.9	2.4
Capital taxes	1.4	2.0
Total direct	48.7	47.6
Employers' NICs and NIS	14.1	9.4
Expenditure taxes and stamp duties	27.3	32.4
LA rates	9.9	10.6
Total indirect	**51.3**	52.4

(1) Based on Autumn Statement forecast.

(2) After ACT set-off.

Main points

(a) Direct tax share of total tax and NICs fallen since 1978-79.

(b) Share of taxes on personal incomes fallen since 1978-79.

(c) Share of taxes on expenditure risen since 1978-79.

(iv) **Burden on representative families**

	Per cent of gross earnings taken in all taxes and NICs					
	Single		Married no children		Married with two children	
Multiples of average earnings(1)	**1978-79**	**1987-88**	**1978-79**	**1987-88**	**1978-79**	**1987-88**
75 per cent						
Income tax (less CB) plus NICs	28.9	28.7	23.8	24.6	14.6	16.2
CG indirect taxes	11.5	12.9	12.6	13.6	12.5	13.6
LA rates	3.4	4.1	3.4	4.0	3.4	4.0
Total	43.8	45.7	39.8	42.2	30.5	33.8
100 per cent						
Income tax (less CB) plus NICs	31.5	30.5	27.8	27.4	20.9	21.1
CG indirect taxes	10.8	12.4	11.7	13.0	11.1	12.9
LA rates	3.1	3.8	2.9	3.5	3.0	3.6
Total	45.4	46.7	42.4	43.9	35.0	37.6
150 per cent						
Income tax (less CB) plus NICs	33.3	31.1	30.8	29.0	26.2	24.8
CG indirect taxes	10.2	12.1	10.9	12.7	9.8	12.4
LA rates	2.8	3.4	2.5	3.0	2.6	3.2
Total	46.3	46.6	44.2	44.7	38.6	40.4

(1) Average weekly earnings of full time adult males (all occupations) £229.80 in 1987-88 (assuming 7.5 per cent growth on 1986-87).

Main points:

(a) Overall tax burden (ie income tax and NICs, plus indirect taxes) increased between 1978-79 and 1987-88 for single people and couples for earnings levels between 75 and 150 per cent of average earnings. (Indirect tax figures not available outside this range.)

(b) Overall effect of taxes progressive (ie higher earners pay higher proportion of their income in tax).

(c) Need to take account of growth in real earnings as well as change in tax burden: real take-home pay has risen for all those whose earnings have increased in line with national average. (See Brief L.)

Contact point: Ms A Munro (ETS) 270 4977

P INTERNATIONAL COMPARISONS OF TAXATION

[See also Balance and burden of taxes (including NICs) on income and spending (Brief N)]

Warning

Statistical comparisons should be treated with caution because of differences in tax systems, sizes of public sector, and economic conditions. Figures below based on OECD classification which differs from that used for UK in Brief N.

(i) **Burden of taxation**

Total taxes and social security contributions as per cent of GDP at market prices

	1985	**1986 (provisional)**
UK	**38.1**	**39.1**
France	45.6	45.1
Netherlands	45.0	46.1
West Germany	37.8	37.4
Italy	34.7	not av
Canada	33.1	33.9
US	29.2	not av
Japan	28.0	not av
EC unweighted average	39.5	not av
G7 unweighted average	35.2	not av

Source: OECD Revenue Statistics (tables 1, 109)

Breakdown of taxes and social security contributions as percentage of GDP at market prices, 1985[1]

	UK	France	West Germany	Italy	EC Average[2]	Canada	Japan	US
Taxes on personal income	**9.9**	5.8	10.8	9.5	11.0	11.9	6.9	10.4
Employees' social security contributions (incl self employed)	**3.3**	7.0	6.7	3.4	5.2	1.7	4.1	3.6
Corporate Taxes[3]	**4.9**	1.9	2.3	3.3	3.0	2.8	5.9	2.1
Wealth and Inheritance Taxes	**0.2**	0.4	0.5	0.1	0.4	0.3	0.3	0.2
Total direct	**18.4**	15.1	20.3	16.3	19.6	16.6	17.3	16.3
Employers' social security contributions and payroll taxes	**3.4**	13.8	7.2	8.8	7.0	2.8	4.3	5.1
Goods and services	**12.0**	13.4	9.7	8.8	12.2	10.4	3.9	5.2
Other Indirect Taxes (incl rates and stamp duties)	**4.3**	3.0	0.6	0.8	1.5	3.1	2.5	2.7
Total indirect	**19.7**	30.2	17.5	18.4	20.7	16.3	10.7	13.0

(1) Latest year for which international comparisons available.

(2) Unweighted average excluding Portugal for which figures are insufficiently disaggregated.

(3) Including North Sea taxes and ACT.

Source: OECD Revenue Statistics.

Main points

(a) UK burden significantly higher than US and Japan but below EC average.

(b) UK direct taxes as percentage of GDP higher than US, Japan and France but below Germany and the EC average.

(c) UK indirect taxes as percentage of GDP higher than US, Japan and Germany but below EC average and well below France.

(ii) **Balance of taxation**

Percentage of total taxes and social security contributions 1985(1)

	UK	France	West Germany	Italy	EC Average(2)	Canada	Japan	US
Taxes on personal income	26.0	12.7	28.7	27.4	26.8	36.0	24.8	35.7
Employees' social security contributions (incl self-employed)	8.6	15.4	17.6	10.0	12.7	4.9	14.7	12.0
Corporate Taxes(3)	12.9	4.3	6.1	9.4	7.3	8.3	21.0	7.1
Wealth and Inheritance Taxes	0.6	0.8	1.3	0.2	1.0	1.2	1.2	0.8
Total direct	48.2	33.2	53.7	47.0	47.9	50.4	61.7	55.6
Employers' social security contributions and payroll taxes	8.9	30.3	19.0	25.4	18.0	8.5	15.4	17.3
Goods and services	31.6	29.4	25.6	25.4	30.4	31.5	14.0	17.7
Other Indirect Taxes (incl rates and stamp duties)	11.3	6.6	1.7	2.3	3.7	9.5	8.8	9.3
Total indirect	51.8	66.3	46.3	53.1	52.1	49.5	38.2	44.3

(1) Latest year for which international comparisons available.
(2) Unweighted average, excluding Portugal.
(3) Including North Sea taxes and ACT.

Source: OECD Revenue Statistics

Main points

(a) Direct tax share of total tax take in UK average for EC but below US and Japan.

(b) Taxes on personal incomes as share of total tax take in UK about average for EC but below US.

(c) Taxes on corporate incomes as share of total tax take in UK above US and EC average (mainly due to North Sea) but below Japan.

(d) Social security contributions and payroll taxes share of total tax take in UK is low.

(e) Taxes on goods and services as share of total tax take in UK about average for EC but well above US and Japan.

(iii) **Income tax: rates and thresholds (1987)**

Single person

	Tax rate(1) %	Income tax as % of APW(2) earnings %	Threshold(3) £	Threshold as % of APW(2) earnings %
UK (1987-88)	**27**	**20**	**2,425**	**25**
Denmark	51	44	1,900	18
France (1986)	26	8	4,070	57
West Germany	22	20	1,930	20
Italy	12	15	2,460	37
Japan	15	8	2,740	35
Netherlands	15	13	2,635	28
US	11	15	2,540	21

Married without children

	Tax rate(1) %	Income tax as % of APW(2) earnings %	Threshold(3) £	Threshold as % of APW(2) earnings %
UK (1987-88)	**27**	**17**	**3,795**	**39**
Denmark	51	38	3,455	33
France (1986)	19	2	6,330	89
West Germany	22	12	3,370	34
Italy	22	13	3,565	48
Japan	11	5	4,590	51
Netherlands	16	7	4,840	51
US	11	10	4,320	36

(1) Starting rate of tax on employment income. Tax rates are sum of national and local income taxes.

(2) APW = average production worker

(3) Thresholds converted using purchasing power parity. Local income tax thresholds may differ from the national thresholds above.

Source: Board of Inland Revenue 'International Comparisons of Direct Tax on Employment Income', December 1987. Does not include Canada.

Main points

(a) UK's starting rate of tax well above US, Japan and Germany but below Denmark.

(b) UK tax threshold as percentage of earnings of average production worker about average for developed countries.

(c) Income tax paid by average production worker in UK higher than in US, Japan, France, and Netherlands, but lower than in Denmark.

(iv) **Income tax and social security contributions**

Starting rate of tax and social security contributions on employment income (per cent) 1987

	Single	Married no children
UK (1987/8)	**32**	**32**
Denmark	51	51
France (1986)	36	31
West Germany	36	36
Italy	19	28
Japan	24	20
Netherlands	33	33
US	18	18

Income tax and social security contributions less child benefits as percentage of gross earnings of average production worker 1987

	Single	Married no children	Married with 2 children
UK (1987/8)	**29**	**26**	**18**
Denmark	46	38	35
France (1986)	22	16	7
Germany	38	29	22
Italy	23	20	12
Japan	19	16	13
Netherlands	38	32	24
US	22	17	15

Source: Board of Inland Revenue 'International Comparisons of Direct Tax on Employment Income', December 1987.

Main points

(a) UK starting rate of tax plus social security below Denmark and West Germany and similar to France and Netherlands but above US, Japan and Italy.

(b) Income tax plus social security contributions paid by average production worker in UK lower than in Germany, Denmark and the Netherlands but above US, Japan, France and Italy.

(v) **Indirect Taxes**

(1) VAT

	EC rates as at 1 January 1988				
	Standard Rate (%)	Luxury/ higher rate(s) (%)	Reduced rate(s) (%)	Coverage of zero-rating	Effective VAT rate 1985(4) (5)
UK	**15**	-	-	**wide variety of goods and services(1)**	10.0
Belgium	19	25,33 (3)	6,17	Minimal	11.6
Denmark	22	-	-	minimal	18.1
France	18.6	33 1/3	5.5, 7	(2)	13.8
West Germany	14	-	7	(2)	10.5
Greece	16	36	6	Information not available	n/a
Ireland	25	-	10	wide variety of goods and services (1)	14.2
Italy	18	38	2,9	minimal	9.5
Luxembourg	12	-	3,6	(2)	11.2
Netherlands	20	-	6	(2)	12.4
Spain	12	33	6	minimal	n/a

(1) Zero-rate applies to goods and services amounting to about 25 per cent of consumers' expenditure

(2) No zero-rates applying to consumer expenditure.

(3) Higher rate includes 8 per cent luxury tax and applies to restricted selection of goods including, inter alia, jewellery, arms, furs, perfumes and cosmetics.

(4) Total Value Added Taxes as percentage of private final consumption expenditure.

(5) Latest year for which international comparison available.

Main points

(a) UK overall effective rate of VAT one of the lowest in EC.

(b) UK coverage of VAT narrower than other EC countries. Only UK and Denmark have single positive rate.

(2) Petrol

Excise duty and VAT on premium petrol: 4 January 1988[1]

	Factor cost (pence)	Duty (pence)	VAT[2] (pence)	Retail Selling Price (RSP) (price)	Total tax as % of RSP
UK	**59**	**88**	**22**	**169**	**65**
Denmark	56	147	45	248	77
France	49	130[3]	33	212	77
Germany	51	81	18	150	66
Italy	59	181	43	283	79
Netherlands	57	115[3]	34	206	72

(1) Rates of exchange as at 4 January 1988.

(2) VAT on petrol is fully blocked (ie non-deductible) in Denmark, France and Italy.

(3) Includes parafiscal taxes and/or supplementary levies.

Sources: EC Excise Duty Tables
HM Customs and Excise
Department of Energy

Main point

Total tax as percentage of retail selling price lower in UK than in France, Italy, Denmark and Netherlands; about same as Germany.

(3) Cigarettes

Excise duty and VAT on 20 cigarettes in most popular price category:[1]

	Retail Selling Price (pence)	Factor cost (pence)	Total Duty (pence)	VAT (pence)	Total tax (pence)	Total tax as % of RSP
UK	**155**	**41**	**94**	**20**	**114**	**74**
Denmark	221	28	153	40	193	87
France	49	13	24	12	36	73
Germany	134	37	80	17	97	72
Italy	73	21	41	11	52	71
Netherlands	102	29	56	17	73	72

(1) Prices and rates of exchange as at 4 January 1988

Sources: EC Excise Duty Tables
HM Customs and Excise

Main point

Total tax as percentage of retail selling price in UK about average for EC, although considerably lower than Denmark.

Contact point: Chris Ford (ETS) 270 4323

Q INCENTIVES AND POVERTY/UNEMPLOYMENT TRAPS

[See also Historical record on income tax, employee NICs, child benefit (Brief L)]

Poverty trap

(i) **What is it?**

Situation where working families with low incomes face high effective marginal tax rates (ie increases in gross earnings produce small increases or even decreases in net income) as result of combined effect of income tax, NICs and withdrawal of means-tested benefits.

Under the current system, families with children receiving Family Income Supplement (FIS) and housing benefit (HB) can face marginal rates of up to 109 per cent.

Implementation of Social Security Act 1986 in April 1988 will reform structure of social security; Family Credit will replace FIS and Income support will replace Supplementary Benefit. There will be much closer alignment of rules for main income-related benefits; entitlement to Family Credit, Housing Benefit and Income Support will all be based on net income. The maximum effective marginal rate under the new system will be 97p.

(ii) **Numbers**

Working families with effective marginal tax rates over 50 per cent 1988-89, Great Britain

Total marginal rate of deduction (per cent) per £1 gross earnings	Pre-reform system 1988-89	Reformed system 1988-89
50 - 60p	50,000	0
60 - 70p	90,000	*
70 - 80p	0	95,000
80 - 90p	160,000	380,000
90 - 100p	45,000	70,000
100 and over	70,000	0

(* means less than 5000)

Notes

1. Heads of tax units only

2. Assumes 27 per cent basic rate of tax and 1988-89 personal tax allowances raised in line with inflation

3. Assumes employees' NIC is 9 per cent; no allowance made for lower contracted-in rates of 5 per cent and 7 per cent, or contracted-out rates; so estimates are overstated.

Source: OR 30 November 1987 Vol 123 WA 464

Main points

(a) Under the reformed system marginal rates exceeding 100 are eliminated.

(b) Proportion of working families with high marginal rates low - only about 4 per cent have rates of over 70 per cent under the reformed system.

(c) Number of families with high marginal rates increased since 1978-79 under the old system. Reasons include:

(1) switch from child tax allowances to child benefit which lowered tax threshold for families with children;

(2) increasing numbers entitled to FIS because of generous uprating;

(3) steepening of HB tapers - rates at which benefit is withdrawn as income rises.

(d) Under the reformed system, numbers with high marginal rates increase because of

(1) generosity of Family Credit - more families entitled

(2) Steepening of tapers for withdrawal of benefits.

(iii) **Effect on incentives**

(a) High marginal rates may discourage people from working extra hours and taking better paid jobs. But econometric evidence far from conclusive. Some studies (eg Brown) show little short run effect of taxes on hours worked. But these do not investigate wider effects of taxes (eg on enterprise and risk taking, willingness to train etc).

(b) Quoted marginal rates may overstate problem because:

(1) Family Credit awards run for 6 months, and Housing Benefit for a year, so withdrawal of these benefits does not affect incentive to earn more in short run;

(2) most real world decisions are not about whether to earn a small amount more but involve discrete choices eg taking different job or wife going out to work. With larger increases in earnings, family may be able to jump clear of trap.

Unemployment trap

(i) **What is it?**

Situation where net income out-of-work is close to or even greater than net income in work. Conventional measure of this is ratio of out-of-work to in-work net income - "replacement ratio".

High ratios reflect level of out-of-work benefits and fact that those in work pay tax at low earnings levels and have income-related benefits withdrawn quite rapidly as income rises.

(ii) **Numbers**

Difficult to measure precisely because of need to measure potential earnings of those currently unemployed. DHSS estimate that about 60,000 working families (excluding self-employed) had ratios of over 100 per cent in November 1985, about 200,000 had ratios of over 90 per cent and about 750,000 had ratios of over 80 per cent. No up-to-date figures for unemployed or of trend over time. But

(a) Replacement ratios have been reduced by:

(1) abolition of earnings related supplement to Unemployment Benefit (UB) in June 1982;

(2) real increases in FIS (which goes to working families);

(3) taxation of UB;

(4) introduction of lower rate NIC bands for those on low earnings in October 1985.

(5) lower tax rates/higher allowances

(b) They have been raised by:

real increases in rent and rates.

(iii) **Incentive effects**

(a) Most facing high replacement ratios are married men with children, but some research evidence suggests their decisions to accept work may not be very responsive to their replacement ratios.

(b) Other groups (eg juveniles) more strongly affected, even though their replacement ratios generally lower.

(c) But empirical evidence not clear-cut and some (eg Minford) argue disincentive effects of high replacement ratios are stronger.

Tax policy and incentives

Changes since 1978-79 (see also Brief L):

(a) Basic rate of income tax down from 33p to 27p.

(b) Higher rates considerably reduced and bands widened: top rate down from 83p to 60p.

(c) Level of taxable income at which 40p rate starts to be paid now over 10 per cent higher in real terms than in 1978-79; for 60p rate starting point over 60 per cent higher.

(d) Real increase of around 22 per cent in allowances has cut marginal rates for those taken out of tax.

But

(e) 25p reduced rate band withdrawn in 1980.

(f) For those with earnings above lower bands, employee's contracted-in NIC rate up from 6½ to 9 per cent (from 4 to 6.85 per cent for those contracted-out).

Contact point: Ms A Munro (ETS) 270 4977

R EVOLUTION OF MTFS AND MONETARY POLICY

Background

MTFS - Provides framework for Government's economic policy; introduced in 1980 Budget; updated each year in FSBR.

- Designed to achieve lower inflation, and ultimately price stability, through firm monetary policies supported by low public sector borrowing.

- Policy set in nominal framework in which money GDP growth gradually reduced by monetary and fiscal policy, so exerting steady downward pressure on inflation.

- Monetary and fiscal policies complemented by policies to promote enterprise, efficiency and flexibility. Role of macroeconomic policy is to reduce inflation and microeconomic policy to improve functioning of markets (Chancellor's 1984 Mais Lecture).

- Together these policies improve division of money GDP between output growth and inflation, creating conditions for sustained growth in output and employment.

- Statement in FSBR has set out:

  a. Medium term objectives for money GDP and assumptions for output and inflation;

  b. Instruments of policy and methods of assessing monetary conditions;

  c. Monetary targets for the year ahead and illustrative ranges for medium term;

  d. Factors relevant for setting PSBR with illustrative PSBR path for medium term;

  e. Consistent projections of public expenditure, revenue and implied fiscal adjustment.

Developments since 1980

Strategic objective of progressively reducing inflation, and consequent commitment to firm fiscal and monetary policies, has remained unchanged. But means of implementing policy, including PSBR path, revised in accordance with circumstances.

a. Monetary policy

Government has always taken account of wide range of indicators in assessing monetary conditions. Developments in financial system reflected in changes in specification of target monetary aggregates and ranges, and changes in emphasis on other indicators of monetary conditions:

- 1980 and 1981 MTFS: Target ranges for broad money (£M3)

- 1982 MTFS: Target ranges for £M3 growth raised following relatively rapid growth of £M3 but sharp deceleration in money GDP growth (ie falling velocity). Same ranges applied to PSL2 and narrow M1 measure. Explicit statement that other indicators, including exchange rate, taken into account in interpreting monetary conditions.

- 1983 MTFS: Same target aggregates and ranges. Role of other indicators maintained.

- 1984 MTFS: Target range for narrow money applied to MO, replacing M1. £M3 ranges not revised. Target range for PSL2 dropped, but PSL2 still taken into account. Broad and narrow money given equal importance in assessment of monetary conditions. As in past all available evidence taken into account, including exchange rate.

- 1985 MTFS: Same target ranges maintained for MO and £M3, but no special role for PSL2. Emphasised interpretation of monetary conditions to include assessment of appropriate combination of monetary growth and exchange rate necessary to keep financial policy on track. But no mechanistic formula.

- 1986 MTFS: Target range for MO unchanged. £M3 target range raised reflecting rapid fall in velocity, but no illustrative ranges for future years because of excessive uncertainty surrounding velocity trend. Role of other indicators, especially exchange rate, maintained.

- 1987 MTFS: Same target range for MO maintained, but formal target for broad money dropped because of difficulty of interpreting movements in face of pervasive changes in financial practices. Broad money still taken into account in assessing monetary conditions, along with all other available indicators, especially exchange rate. Aim to strike balance between exchange rate and domestic monetary growth consistent with inflation objectives. Desirability of exchange rate stability emphasised, following Louvre Accord.

Currently, if underlying growth of MO threatened to move significantly outside target range (2-6 per cent growth for 1987-88 over previous financial year), presumption that action taken on interest rates unless other indicators clearly suggest monetary conditions satisfactory. G7 statement (23 December 1987) reaffirmed common interest in more stable exchange rates. Government continues to pursue policy of seeking stability for sterling with sterling/deutschemark rate of particular importance. What industry wants and also serves as anchor against inflation. Evidence of firm adherence to monetary discipline obvious from achievements of MTFS (see below).

b. Fiscal policy and PSBR

Aim to support monetary policy with PSBR that can be financed in way that does not add to inflation, implying low PSBR as percentage of GDP. Appropriate PSBR path reappraised in successive MTFSs:

- Always recognised that composition of PSBR important as well as level. Profile of privatisation proceeds (which have little influence on monetary conditions and interest rates) and pattern of North Sea revenues figured explicitly in 1985 MTFS move to lower PSBR path.

- Cyclical position of economy also relevant. PSBR path revised in 1981 MTFS because of recession.

1987 MTFS path for PSBR

	1986-87	1987-88	1988-89	1989-90	1990-91
£ billion	4	4	4	5	5
as per cent of money GDP	1	1	1	1	1

Holding PSBR to no more than 1 per cent of GDP will meet important objective of ensuring ratio of public debt to GDP, and burden it imposes, do not rise, even when prices stable (implies falling debt/income ratio until price stability achieved). Hence represents sustainable fiscal position over longer term given zero inflation objective.

1987 Autumn Statement

- Forecast for PSBR in 1987-88 (£1 billion) £3 billion lower than in MTFS. Reduction largely result of higher growth, producing higher revenue.

- Autumn Statement forecast constructed on assumption that PSBR for 1988-89 will be similar to forecast outturn for 1987-88 (¼ per cent of GDP). PSBR for 1988-89 will be set in 1988 Budget in light of prevailing circumstances. But Chancellor said in evidence to Treasury and Civil Service Select Committee (TCSC Report on 1987 Autumn Statement) certainly would not like to see PSBR any higher than 1 per cent of GDP.

Achievements of MTFS

i. Money GDP growth

Strategic objective of lower money GDP growth achieved, much as envisaged. (NB Recognised that short term fluctuations from MTFS money GDP path inevitable. Aim is to avoid substantial departures in either direction in medium term.) Growth in money GDP was about 20 per cent in 1979-80. Autumn Statement forecast shows growth averaging about 7¾ per cent in 1987-88 and 1988-89.

MTFS projections of money GDP annual growth rates and latest estimates (per cent)

	1980 MTFS	1981 MTFS	1982 MTFS	1983 MTFS	1984 MTFS	1985 MTFS	1986 MTFS	1987 MTFS	Latest[1] Outturn
1979-80	17½								19¾
1980-81	17	13							14
1981-82	12	10½	10½						10
1982-83	9½	9½	9¾	8¼					9¼
1983-84	10¾	9¾	9¾	8	8				8¼
1984-85			9 ½	8½	8	6¾			7¼(8½)
1985-86				7½	6¾	8½	9½		9½(8¼)
1986-87					6	6½	6¾	6	6¾
1987-88					5½	5¾	6½	7½	8½[2]
1988-89					5¼	5	6	6½	7¼[2]
1989-90							5½	6	
1990-91								5½	

1 Figures in brackets adjusted for coal strike
2 1987 Autumn Statement forecast

(ii) Inflation and output

- Inflation in 1986 at lowest level for almost twenty years, having fallen from peak of over 20 per cent in first half of 1980. Inflation has remained at low level in 1987.

- Low inflation within declining money GDP growth path has left room for sustained increase in output. Now well into seventh successive year of steady output growth at average rate in excess of 3 per cent a year.

- Since end 1982-83 steady growth has been combined with low inflation (averaging about 4½ per cent a year).

Inflation - output split and monetary aggregates

per cent		Money GDP growth[1]		Inflation GDP Deflator	Inflation RPI	Output growth[1]		Monetary Aggregates[2] MO growth	Monetary Aggregates[2] M3 growth
Annual Average	1968-73	11.0		7.5	7.5	3.1		6.6	13.4
	1973-79	17.7		16.0	15.6	1.4		12.6	11.5
	1979-80	19.9		16.6	15.8	2.8		11.9	13.0
	1980-81	13.9		18.6	16.3	-3.8		7.1	16.2
	1981-82	10.1		9.8	11.5	0.5		5.3	16.8
	1982-83	9.2		7.1	7.1	1.9		3.2	12.4
	1983-84	8.1	(8.3)	4.7	4.7	3.3	(3.5)	6.0	12.7
	1984-85	7.2	(8.5)	4.5	5.1	2.5	(3.7)	5.5	9.5
	1985-86	9.6	(8.2)	5.9	5.9	3.5	(2.2)	4.3	13.1
	1986-87	6.7	(6.6)	3.2	3.2	3.2	(3.1)	4.0	19.4
Autumn Statement Forecast	1987-88	8½		4¼	4[3]	4[4]		2-6[5]	-
	1988-89	7¼		4½	4½[3]	2½[4]		1-5[6]	-

1 Figures in brackets adjusted for coal strike.
2 Percentage change on previous year of average stock outstanding.
3 Annual growth to 1987Q4 and1988Q4. Outturn to 1987Q4 was 4.1 per cent
4 Calendar year forecasts for 1987 and 1988
5 1987 MTFS target range.
6 1987 MTFS illustrative range.

Contact point: C M Kelly (MP1) 270 5508

S PUBLIC SPENDING: HISTORICAL TRENDS AND INTERNATIONAL COMPARISONS

(a) Historical trends

(i) General government expenditure and planning total in cash and real terms

	Planning total(1)		General government expenditure		General government expenditure (excluding privatisation proceeds)	
	Cash (£ billion)	Real terms(2) (£ billion)	Cash (£ billion)	Real terms(2) (£ billion)	Cash (£ billion)	Real terms(2) (£ billion)
1963-64	9.9	73.0	11.3	83.6	11.3	83.6
1964-65	10.8	76.3	12.3	86.5	12.3	86.5
1965-66	12.0	81.2	13.6	91.7	13.6	91.7
1966-67	13.3	86.0	15.1	97.2	15.1	97.2
1967-68	15.5	97.6	17.5	109.7	17.5	109.7
1968-69	16.1	96.5	18.2	109.1	18.2	109.1
1969-70	17.0	96.9	19.3	110.0	19.3	110.0
1970-71	19.1	100.2	21.6	113.6	21.6	113.6
1971-72	21.4	103.2	24.4	117.2	24.4	117.2
1972-73	24.8	110.6	27.6	123.2	27.6	123.2
1973-74	29.3	121.8	31.9	132.9	31.9	132.9
1974-75	39.3	137.2	42.8	149.4	42.8	149.4
1975-76	48.8	135.6	53.7	149.1	53.7	149.1
1976-77	54.4	133.5	59.5	145.8	59.5	145.8
1977-78	56.8	122.4	63.7	137.2	64.2	138.4
1978-79	65.7	127.9	74.8	145.5	74.8	145.5
1979-80	77.6	129.1	89.8	149.4	90.1	150.1
1980-81	92.6	130.1	108.4	152.3	108.8	152.8
1981-82	104.0	133.0	120.5	154.1	121.0	154.7
1982-83	113.5	135.4	132.5	158.0	133.0	158.6
1983-84	120.3	137.2	140.1	159.8	141.3	161.1
1984-85	129.8	141.8	150.2	164.0	152.3	166.4
1985-86	133.7	137.7	158.2	163.0	160.9	165.8
1986-87	139.2	139.2	164.8	164.8	169.3	169.3
1987-88(3)	147.3	141.3	172.6	165.6	177.6	170.4
1988-89(4)	156.8	143.9	183.0	168.0	188.0	172.6
1989-90(4)	167.1	148.2	193.2	171.3	198.2	175.7
1990-91(4)	176.1	151.6	202.1	174.0	207.1	178.3

Source: HM Treasury, using CSO data for historical figures on general government expenditure (GGE) and GDP. (See Table 5.1, Volume 1 of 1988 PEWP).

(1) Figures from 1973-74 are on current definition of public expenditure. Figures up to and including 1972-73 do not include market and overseas borrowing by public corporations (including nationalised industries).

(2) Cash figures adjusted to 1986-87 price levels by excluding effect of general inflation as measured by GDP deflator.

(3) Estimated outturn.

(4) Planning total and GGE in cash as in 1988 public expenditure White Paper (PEWP) (Cm 288); GDP figures are those underlying 1988 PEWP. GGE rounded to nearest £0.1 billion, although this does not imply accuracy to this degree.

(ii) General government expenditure: as percentage of GDP

GGE as percentage of GDP

	Including Privatisation proceeds	Excluding Privatisation proceeds		Including Privatisation proceeds	Excluding Privatisation proceeds
1963-64	35 ¾	35 ¾	1977-78	42 ¼	42 ½
1964-65	35 ½	35 ½	1978-79	43 ¼	43 ¼
1965-66	36 ¾	36 ¾	1979-80	43 ¼	43 ½
1966-67	38 ½	38 ½	1980-81	45 ¾	46
1967-68	42	42	1981-82	46 ¼	46 ½
1968-69	40 ½	40 ½	1982-83	46 ¾	46 ¾
1969-70	40	40	1983-84	45 ¾	46
1970-71	40 ½	40 ½	1984-85	45 ½	46 ¼
1971-72	41	41	1985-86	43 ¾	44 ½
1972-73	40 ¾	40 ¾	1986-87	42 ¾	44
1973-74	42 ½	42 ½	1987-88	41 ¼	42 ½
1974-75	48	48	1988-89	40 ¾	42
1975-76	48 ½	48 ½	1989-90	40 ¾	41 ¾
1976-77	46	46	1990-91	40 ¼	41 ¼

Source: Table 5.1, Volume 1 of 1988 PEWP

(iii) Annual growth rates in general government expenditure and planning total (in real terms)

	1968-69 to 1978-79	1978-79 to 1982-83	1982-83 to 1986-87	1986-87 to 1990-91
GGE excluding privatisation proceeds	**2.9**	**2.2**	**1.6**	**1.3**
GGE including privatisation proceeds	2.9	2.1	1.1	1.4
Planning total excluding privatisation proceeds	2.9	1.5	1.4	2.1
Planning total including privatisation proceeds	2.9	1.4	0.7	2.2

(b) International comparisons

Expenditure of general government as percentage of GDP:

	OECD figures							EC figures (forecast)		
	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
United States	32	34	34	37	37	36	37	not app	not app	not app
Japan	32	33	34	34	34	33	33	not app	not app	not app
Germany	48	48	49	49	48	48	47	47	47	47
France	46	46	49	51	52	53	52	52	52	51
United Kingdom	**44**	**46**	**49**	**48**	**48**	**49**	**48**	**44**	**43**	**42**
Italy	46	46	51	55	57	57	58	51	50	50
EC	45	47	49	50	51	51	51	49 (1)	49 (1)	48 (1)
Total OECD	38	40	40	42	42	41	41	not app	not app	not app

(1) Excluding Greece , Ireland, Portugal and Spain.

Source: 1980-85: OECD "Economic Outlook" 42, December 1987
1986-88: "European Economy", November 1987

OECD and EC figures broadly comparable but EC figures exclude money spent by member countries on behalf of EC. Definition of GGE in UK national accounts broadly in line with OECD and EC definitions but, following IMF practice, includes some financial transactions (dealing in company shares and net lending). Planning total concept is unique to UK.

Contact points: G C White (GEP3) 270 5639 (Historical trends)
D R Deaton (GEP3) 270 5337 (International comparisons)

T PUBLIC SECTOR BORROWING: HISTORICAL TRENDS AND INTERNATIONAL COMPARISONS

(a) **Historical trends**

	PSBR			PSBR excluding privatisation proceeds		Public Sector Financial Deficit (PSFD)	
	Cash £ billion	Real terms (1986-87 prices) £ billion	Ratio to GDP (per cent)	Cash £ billion	Ratio to GDP (per cent)	Cash £ billion	Ratio to GDP (per cent)
1948	not av	not av	not av	not av	not av	-0.3	-2¼
1949	not av	not av	not av	not av	not av	-0.3	-2½
1950	not av	not av	not av	not av	not av	-0.4	-2¾
1951	not av	not av	not av	not av	not av	0.2	1½
1952	0.8	8.2	5	0.8	5	0.6	3½
1953	0.6	5.9	3½	0.6	3½	0.7	4
1954	0.4	3.7	2	0.4	2	0.4	2½
1955	0.5	4.5	2½	0.5	2½	0.4	2
1956	0.6	5.1	2¾	0.6	2¾	0.5	2½
1957	0.5	4.2	2¼	0.5	2¼	0.5	2½
1958	0.5	4.1	2	0.5	2	0.4	2
1959	0.6	4.6	2¼	0.6	2¼	0.6	2¼
1960	0.7	5.7	2¾	0.7	2¾	0.7	2¾
1961	0.7	5.5	2½	0.7	2½	0.7	2¾
1962	0.5	4.1	1¾	0.5	1¾	0.5	1¾
1963	0.8	6.1	2¾	0.8	2¾	0.8	2¾
1963-64	1.0	7.7	3¼	1.0	3¼	1.1	3¼
1964-65	0.9	6.4	2¾	0.9	2¾	0.8	2¼
1965-66	0.9	6.4	2½	0.9	2½	0.6	1¾
1966-67	1.1	7.4	3	1.1	3	1.0	2¾
1967-68	2.0	12.7	4¾	2.0	4¾	1.7	4¼
1968-69	0.4	2.2	¾	0.4	¾	0.4	¾
1969-70	-0.6	-3.4	-1¼	-0.6	-1¼	-0.8	-1¾
1970-71	0.8	4.1	1½	0.8	1½	-0.2	-½
1971-72	1.0	4.7	1¾	1.0	1¾	0.7	1¼
1972-73	2.4	10.9	3½	2.4	3½	2.0	3
1973-74	4.3	18.1	5¾	4.3	5¾	3.5	4½
1974-75	8.0	28.0	9	8.0	9	6.0	6¾
1975-76	10.3	28.5	9¼	10.3	9¼	8.1	7¼
1976-77	8.3	20.4	6½	8.3	6½	7.5	5¾
1977-78	5.4	11.6	3½	5.9	4	6.6	4¼
1978-79	9.2	18.0	5¼	9.2	5¼	8.3	4¾
1979-80	10.0	16.7	4¾	10.4	5	8.0	3¾
1980-81	12.7	17.9	5¼	13.1	5½	11.7	5
1981-82	8.6	11.1	3¼	9.1	3½	5.2	2
1982-83	8.8	10.6	3	9.3	3¼	8.3	3
1983-84	9.7	11.1	3¼	10.9	3½	11.5	3¾
1984-85(1)	10.2	11.1	3 [2.1]	12.3	3¾ [2.9]	13.1	4 [3.1]
1985-86(1)	5.8	5.9	1½ [1.3]	8.5	2¼ [2]	8.2	2¼ [2]
1986-87	3.4	3.4	1	7.8	2	9.2	2½
1987-88 (AS forecast)	1.0	1.0	¼	6.0	1½	6.1	1½

(1) Figures in brackets are adjusted for coal strike.

(i) At ¾ per cent of GDP, Autumn Statement forecast represents lowest level of public sector borrowing at any time since beginning of 1950s, with single exception of 1969-70.

(ii) Excluding privatisation proceeds at 1½ per cent of GDP, expected to be lowest level since 1970-71 and lower than at any time since beginning of 1950s, except for 3 years from 1968-69 to 1970-71.

(b) **PSBR in 1987-88**

(i) Provisional PSBR for first nine months of 1987-88 surplus of £0.4 billion

(ii) PSBR excluding privatisation proceeds for first nine months of 1987-88, £4.6 billion, £2.8 billion lower than first nine months of 1986-87.

(iii) Further forecast of PSBR for 1987-88 will be given in Budget. Provisional 1987-88 outturn will be published on 20 April. January and February PSBR figures for 1987-88 will be published on 16 February and 16 March respectively.

(iv) Privatisation proceeds in first three-quarters of 1987-88 £5.1 billion. Autumn Statement had privatisation receipts in 1987-88 as whole of £5 billion. Cost of privatisations offset against gross privatisation proceeds so quite feasible that total for year as a whole could be lower than cumulative to December.

(v) PSBR in 1987-88 currently about £4¾ billion lower than for first nine months of 1986-87. Factors accounting for difference include:

CGBR(O) £5.7 billion lower, mainly because of buoyant tax revenues, but also because privatisation proceeds £1.8 billion higher.

LABR £0.9 billion higher.

(vi) Tax revenues buoyant so far in 1987-88. Outturn figures for 9 months, April-December (latest available data):

	% change on year earlier April-December outturn	**FSBR forecast for 1987-88**
Inland Revenue receipts	+11	+7½
Customs and Excise receipts	+7½	+6½

Within Inland Revenue receipts, income tax, corporation tax and PRT receipts have been particularly buoyant. Within Customs and Excise receipts, VAT receipts have been particularly buoyant.

(vii) Comparison between AS and 1987 FSBR

PSBR 1987-88 **£ billion**

	1987 Budget forecast	Autumn Statement forecast	Difference
Taxes on income, expenditure & capital	127.8	130.1	2.3
National insurance and other contributions	28.5	28.9	0.4
Interest and other receipts	12.6	12.3	-0.3
Accruals adjustment	0.0	-0.2	-0.2
General government receipts	**168.8**	**171.1**	**+2.3**
of which: North Sea revenues	3.9	4.5	+0.6
General government expenditure	**173.5**	**172.8** (1)	**-0.7**
Public corporations' market & overseas borrowing	-0.8	-0.7	+0.1
PSBR	**3.9**	**1.0**	**-2.9**

(1) £172.6 billion in PEWP.

PSBR in 1988-89

Chancellor told TCSC (on 9 December), "The PSBR could be lower than 1 per cent of GDP next year; or it may be that 1 per cent is appropriate. I certainly would not like to see it any higher than that".

(d) **International comparisons**

NB International comparisons of public sector financial balances and borrowing requirements made difficult by differences in coverage of public sector accounts. Usually comparisons employ general government (central and local government and social security funds) but even these require caution.

General government financial balances as percentage of GDP (deficit shown as minus)

	1979	1980	1981	1982	1983	1984	1985	1986	1987(1)	1988(1)
US(2)	0.5	-1.3	-1.0	-3.5	-3.8	-2.8	-3.3	-3.5	-2.4	-2.4
Japan(2)	-4.7	-4.4	-3.8	-3.6	-3.7	-2.1	-0.8	-0.9	-1.2	-1.1
Germany(2)	-2.5	-2.9	-3.7	-3.3	-2.5	-1.9	-1.1	-1.2	-1.7	-2.3
France	-0.7	-0.0	-1.9	-2.8	-3.2	-2.7	-2.9	-2.9	-2.8	-2.7
Italy	-10.1	-8.5	-11.5	-11.3	-10.7	-11.5	-12.3	-11.2	-10.3	-10.0
Canada(2)	-2.0	-2.8	-1.5	-5.9	-6.9	-6.6	-7.0	-5.5	-4.4	-3.3
UK	**-3.3**	**-3.5**	**-2.8**	**-2.3**	**-3.6**	**-3.9**	**-2.9**	**-2.6**	**-2.1**	**-1.9**
G7	-1.7	-2.5	-2.5	-3.9	-4.1	-3.3	-3.3	-3.2	-2.7	-2.6
EC(3)	-3.7	-3.8	-5.3	-5.5	-5.3	-5.3	-5.2	-4.7	-4.4	-4.4
OECD(4)	-1.8	-2.5	-2.7	-4.0	-4.2	-3.4	-3.4	-3.3	-2.7	-2.7

Source: OECD 'Economic Outlook,' December 1987, OECD 'Economic Studies' Autumn 1984 and EC Annual Economic Report, November 1987

(1) OECD estimates and forecasts on present policies: UK figures are probably too high

(2) As percentage of GNP.

(3) EC(8) before 1980. EC(12) after 1980.

(4) Covers 18 of 24 members.

NB: General government ratio for US is lower than often quoted Federal deficit (3.4 per cent in fiscal 1987) because of state government surpluses.

Japan's general government deficit is also much lower than its central government deficit because of a surplus on social security funds.

For UK, PSBR is lower than general goverment financial deficit, partly because of asset sales.

Contact points: H F Chapman (PSF) 270 5030 (PSBR)
D Savage (IF2) 270 5546 (International comparisons)

U SUPPLY SIDE

[See also Income tax (Brief A), National Insurance contributions (C) Business taxation (E), Small businesses (F), Tax reform (M), Incentives and poverty/unemployment traps (Q) and wider share ownership(V)]

Overall policy

While macroeconomic policy designed to reduce inflation, growth and employment prospects depend on improved performance of supply side, stimulated by microeconomic measures. Supply side policy emphasises:

- encouraging labour market flexibility and improving incentives to work;

- increasing competition and deregulation;

- encouraging enterprise and small businesses.

Measures

(i) Labour market

(a) Wages Act 1986 reformed Wages Councils: removed under-21s from Councils' coverage and allowed Councils to set only basic and overtime rates for adult workers. Should improve job prospects, particularly for young and unskilled.

(b) Trade union reform.

(c) Labour mobility facilitated by:

- Social Security Act 1986: removed barriers in pension arrangements to occupational mobility;

- easier house moving: council house exchange agencies; competition in conveyancing; reduced stamp duty; legislation before Parliament designed to encourage supply of more rented private accomodation.

(d) Self-employment encouraged by Enterprise Allowance Scheme (EAS) - entrants up 70 per cent between 1985-86 and 1987-88, changes in Manpower Services Commission training schemes, changes in National Insurance contributions (see Brief C). Self employment risen in every year since 1979 and in total by more than ¾ million.

(e) Greater emphasis on training

- for jobs in schools, especially new City Technology Colleges, and adult education. New two year Youth Training Scheme (YTS) introduced April 1986; Technical and Vocational Education Initiative, designed to stimulate provision of technical and vocational education for 14-18 year olds in full time education, extended into national scheme in 1987.

- for employers through improved management development and for teachers in schools through better school/employer links - eg will work with employers towards objectives of 10 per cent of teachers having opportunity to gain some personal experience of the world of business every year (see White Paper "DTI - the department for Enterprise, January 1988).

- Non-advanced further education (NAFE) initiative by MSC has led to improved Local Education Authority (LEA) planning in context of local labour market requirements.

(f) Measures to ease path of long term unemployed back into labour market: major expansion of Community Programme since 1985; Restart offers all unemployed over 6 months individual help and advice towards getting back to employment; Job Training Scheme offering practical training on and off job to over 200,000 young people unemployed over six months. New programme starting autumn 1988, subsuming existing programmes for long term unemployed, including Community Programme and new Job Training Scheme, announced 18 November 1987: will offer up to 12 months' training for those out of work for more than 6 months.

(g) Incentives to work sharpened by:

- basic and higher tax rate reductions and higher thresholds (see Briefs A and Q);

- taxation of unemployment benefit and abolition of earnings related benefits;

- Jobstart allowance;

- 1985 Budget NICs restructuring: reduced rate NIC bands have improved employee incentives while reducing employer labour costs; improving employment prospects of the low paid;

- Social Security Act 1986 measures eg family credit which will reduce incidence of working families being worse off in work than on benefit (see Brief Q).

(h) Much greater emphasis since 1979 on contracting-out services previously done in-house in Civil Service, local government, NHS.

(i) Profit Related Pay (PRP) (See Brief J)

(ii) Financial institutions/wider share ownership (see also Brief V)

(a) Wider share ownership promoted by privatisation, employee share schemes (see Brief A), Personal Equity Plans. Enlarges sources of finance for industry.

(b) Reduction in stamp duty from 2 to ½ per cent cuts cost of raising equity in UK.

(c) Powers granted by Building Societies Act 1986 enables building societies to offer wider range of services and will increase competition with other sectors, including clearing banks. Review now being undertaken on rules about role of Building Societies under the Act.

(d) Financial Services Act 1986 provides self-regulation with statutory backing, to protect investors, while maintaining London's position as main financial centre in European time-zone.

(iii) Competition/controls

(a) Deregulation:

- long distance coach services under Transport Act 1980;
- local bus services under Transport Act 1985;
- more liberal bilateral agreements with EC countries on aviation and road haulage;
- competition on domestic air routes introduced by Civil Aviation Act 1980.

(b) Abolition of exchange controls (1979); pay, price and dividend controls (1979); corset on bank lending (1980); hire purchase controls (1982) all abolished.

(c) Results of major review of mergers and restrictive trade practices (RTP) legislation foreshadowed in DTI White Paper "DTI - the department for Enterprise," January 1988. Brown and Green Paper due shortly on Mergers and RTP respectively.

Mergers: Competition now primary consideration in deciding whether to refer to MMC. Two major legislative changes will be sought to enable merger control process to operate more efficiently and effectively:- a formal though non-mandatory, pre-notification procedure; and a new function for Director General of Fair Trading to obtain undertakings from parties in cases where it is possible in this way to remove potential threat to competition without need for MMC investigation.

RTP: Green Paper will contain proposals for fundamental changes in RTP Act. These would prohibit agreements with anti-competitive effects, and provide stronger powers for investigation and punishment of suspected illegal cartels. There may be exemption for agreements which are on balance beneficial.

(d) Competition encouraged in various professional services

- solicitors' near-monopoly of conveyancing ended;
- more competition on architects' and surveyors' fees;
- removal of restrictions on advertising by various professions;
- opticians' monopoly of spectacles supply ended.

(e) Privatisation programme: around one third of state owned commercial sector in 1979 already transferred to private sector. 16 major businesses privatised with 655,000 employees.

(f) Changes to regional policy in DTI White Paper "DTI - the department for Enterprise" will concentrate resources on small firms and those where projects would not otherwise take place.

Contact point: S J Flanagan (IAE3) 270 4472

V. WIDER SHARE OWNERSHIP (INCLUDING PERSONAL EQUITY PLANS)

(i) Extent of adult shareownership: Joint Treasury/Stock Exchange survey carried out to estimate number of adult shareholders in January/February 1987 showed

- 8.4 million adult shareowners

- 19½ per cent of adult population own shares

- share ownership has trebled since 1979 (Target Group Index (TGI) estimated that 7 per cent (3 million) of adult population owned shares in 1979.)

- more than 5 million new shareholders since 1979.

(ii) Other surveys of share ownership

- surveys by FRS (September 1987), although on different definition suggests numbers of shareholders little changed since HMT survey.

- What evidence there is on post - stock market falls is that small investors have not been selling out (eg Stock Exchange data on transactions since October shows purchases are predominantly small bargains; Valin Pollen survey detected no sign that small investors attitudes had been affected by stock market falls)

- New York Stock Exchange estimates 20 per cent of total US population own shares (including unit trusts).

(iii) Privatisation

- 16 major businesses privatised since 1979 giving individuals chance to own shares.

- HMT survey showed 3½ million new shareholders created by privatisation (or TSB flotation). 6½ million own privatisation (or TSB) shares.

- British Telecom attracted 1 million new investors. British Gas further 2 million.

- 470,000 employees have become shareholders - 9 out of 10 eligible employees in privatised companies floated on stockmarket.

- Autumn Statement commitment to £5 billion privatisation proceeds in each of next 3 years. Announced privatisation of steel, electricity and water, but timings not yet announced.

(iv) Employee share schemes (See also Brief A)

Approximately 1½ million employees have benefitted from all employee share schemes with initial market value of £2 billion.

Numbers of different types of approved employee share schemes approved:

- 711 all-employee profit sharing schemes (Finance Act 1978); (compared to 30 in 1979)

- 693 all-employee SAYE-related share option schemes (Finance Act 1980);

- 2,767 discretionary share option schemes (Finance Act 1984).

(v) Personal Equity Plans (PEPs)

(a) Personal Equity Plans introduced from 1 January 1987. Allow investment of up to £2,400 a year in equities (of which £420 or 25 per cent maximum in unit trusts/investment trusts) with reinvested dividends free of income tax and realised gains free of capital gains tax when plan held for one full calender year.

(b) Figures to end-November show:

- 235,000 Personal Equity Plans taken out.

- £415 million invested, with average subscription of £1,760.

- 183 Plan Managers registered to run PEPs.

(vi) Plan Managers' charges

	Cheapest		Typical	
Initial	1%	(minimum £10)	3-5%	
Annual	0.5%	(Equitable Life)	0.75%	(Barclays, Midland, Nat West)

(vii) Recent PEPs changes
Chancellor announced, 28 October, changes to PEP schemes, which came into effect on 1 January 1988. Main changes - plan holders can opt not to receive annual reports rather than receiving them automatically; discretionary plan managers to provide 6-monthly statements of investment strategy.

(viii) Representations for change

- income tax relief on subscriptions to plans (along lines of French Loi Monory).

- increase unit/investment trust limit, or remove it altogther.

Contact points: M Neilson (FIM2) 270 4502
R Bent (PE2) 270 4777 (Privatisation)

BUDGET SECRET - BUDGET LIST ONLY

D

THE BUDGET IN BRIEF

1988 should be the eighth successive year of sustained growth and the sixth in which this has been combined with low inflation. Unemployment is falling fast. These successes are the result of sound monetary and fiscal policies, coupled with reforms to make the economy work better. The Budget builds on these policies.

The Main Features

2. The Chancellor announced:

- a balanced budget;
- substantial further tax reforms; and
- reductions in income tax at all levels.

3. The main tax changes (see table 1) include:

- double indexation of tax thresholds;
- a reduction in the basic rate of income tax to 25p;
- abolition of all higher rates of income tax above 40p;

- a new system of independent taxation for husbands and wives, to take effect in 1990;

- a major reform of Capital Gains Tax;

- a major simplification of the tax treatment of covenants and maintenance payments; and

- higher threshold and flat rate for Inheritance Tax.

The Economic Background

4. Since 1981, total national output has risen steadily at an average annual rate of about 3 per cent a year. At the same time, inflation has been brought down and remains low (see chart 1). Over the 1980s, the UK has grown faster than any other major country in the European Community (see table 2). This is in sharp contrast to the 1960s and 1970s, when the UK was bottom of the European growth league. Living standards have been rising strongly: a married man with two children on average male earnings is better off by well over 20 per cent since 1979 (see chart 3).

5. The British economy has in this way outperformed both its competitors and and earlier expectations, despite the coal strike in 1984, the oil price collapse in 1986 and the fall in world equity prices in October 1987. Total output is estimated to have risen 4¼ per cent last year, the best performance since 1973. For the first time in a generation, real growth slightly exceeded the rate of price inflation. Employment continued to rise strongly and unemployment fell by half-a-million in 1987 - the biggest annual fall since the war.

6. The strength of the economy has been reflected in rising tax receipts and strong public sector finances. In 1987-88, a budget surplus of around £[3] billion is expected, only the

second surplus since the early 1950s. For 1988-89 the Chancellor has already announced very substantial increases in public spending on the National Health Service and other priority areas. He has now been able both to provide for a further budget surplus of £3 billion and to reduce taxes.

The Medium Term Financial Strategy

7. The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980. The main features of the MTFS (in tables 2 and 3) are:

- The broad aim of policy will be steadily to reduce inflation, over the medium term,by reducing the growth of total spending power in the economy, as measured by the cash value of our national output (money GDP);

- the Government will aim to keep the growth of narrow money, as measured by M0, within the range 1-5 per cent in 1988-89, as indicated in last year's Budget;

- interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure downward pressure on inflation;

- the Government will continue to pursue a policy of exchange rate stability with the rate against the Deutschemark being of particular importance;

- a balanced budget will be the norm, for the medium term.

The Economic Forecast

8. Despite continuing uncertainties in the world economy, the UK economy is expected to grow by a further 3 per cent in 1988. Excluding the North Sea oil sector, growth will be faster - about 3½ per cent. Consumer spending is likely to grow a little more slowly than in

1987, but investment should grow much faster. Inflation is forecast to remain low, at around 4 per cent, and there are good prospects for a further fall in unemployment. The balance of payments on current account is likely to be in deficit by £4 billion, equivalent to less than 1 per cent of GDP.

9. The forecast is summarised in table 4 below.

Tax Measures

10. In addition to setting a budget surplus of £3 billion in 1988-89, the Chancellor has been able to reform personal taxes and reduce tax rates. But as a proportion of national output, total taxes and National Insurance contributions will remain broadly unchanged between this year and next.

Income Tax: Rates and Allowances

11. The Government believe that incentives for enterprise and effort should be improved and people should be left free to spend or save more of their own money - lower tax economies work better than higher tax economies. The Budget is therefore one of tax reductions as well as of tax reform.

12. The main changes are:

- a $7\frac{1}{2}$ per cent increase in the main personal allowances, double the inflation rate;

- a reduction in the basic rate of income tax to 25 per cent, in line with the Government's pledge; and

- a single higher tax rate of 40 per cent for taxable incomes over £19,300.

13. These changes will benefit some 25 million income tax payers. They will:

- increase the starting point for tax for everyone;

- bring down the marginal rate for the vast majority of taxpayers;

- be worth nearly £5 per a week extra for a married man on average earnings;

- create a simple, two rate tax system with a top rate among the lowest in the world, as our corporation tax rates already are.

14. The Chancellor also announced a new goal: that the basic rate of income tax should be reduced to 20p in the £ as and when it is prudent to do so.

15. Table 5 summarises the main changes.

Independent Taxation

16. The present system for taxing married couples goes back 180 years. It taxes a married woman's income as if it belonged to her husband. This is no longer acceptable.

17. The Chancellor therefore announced a completely new system for taxing married couples, providing:

- independent taxation for husbands and wives;

- complete privacy and independence for married women in their tax affairs; and

- an end to the tax penalties on marriage (see also section on maintenance payments).

18. The new system will be fully introduced at the earliest practicable date, April 1990, though some of the tax penalties on marriage will be removed before then.

19. Under the new system, a husband and wife will be taxed independently, on all of their income. All taxpayers, male or female, married or single, will be entitled to the same personal allowance, which will be available against income of all kinds, whether from earnings or savings.

20. In addition, there will be a married couple's allowance, equal to the difference under the old system between the married man's allowance and the single allowance. This will go to the husband in the first instance, but he will be able to transfer the unused portion of it to his wife.

21. Husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each, instead of one between them, as now. Transfers of capital between husband and wife will continue to be entirely free of to tax.

22. Two further tax penalties on marriage will be abolished:

- for new mortgages, after 1 August 1988, the £30,000 limit on mortgage interest relief will be related to the house or flat concerned, irrespective of the number of borrowers: an unmarried couple will no longer be able to get twice as much relief as a married couple;

- from April 1989, unmarried couples with children will be entitled to only one Additional Personal Allowance so that they can no longer get more tax relief than a married couple.

Income Tax: Other Changes

23. The Chancellor announced a number of proposals to tighten the existing system of allowances and reliefs, and to remove some unjustifiable tax breaks. In particular:

- tax relief on all new home improvement loans will be ended. This will concentrate relief where it is intended, on the purchase of a house or flat;
- the tax charge for company cars will be doubled;
- commercial woodlands will be taken out of the income tax system entirely, but there will be a parallel increase in planting grants.

24. The Chancellor also announced a major simplification of the tax arrangements when income is transferred between individuals. This reforms the complicated and anomalous system of taxing payments made under deeds of covenants and maintenance payments.

Covenants

25. For all new covenants, those receiving the payments will not be liable to tax on them and those making the payments will get no tax relief on them. The largest single group of people affected will be parents of students, and there will be a parallel reduction in the scale of in parental contributions to the maintenance grant.

Maintenance

26. For new maintenance arrangements, separated or divorced spouses receiving maintenance payments will not have to pay any tax whatever on them. Those making these payments will in future get only limited tax relief, up to an amount equal to the difference between the married allowance and the single allowance, and only for payments to separated or divorced spouses.

Business Taxation

27. Since the 1984 Corporation Tax reforms, company profitability has recovered to its highest level for some 20 years. The structure and main rate of Corporation Tax will be unchanged in 1988-89. Companies will benefit substantially from the rebasing of capital gains to 1982 (see below).

28. The small companies' rate of Corporation Tax will be cut to 25 per cent in line with the basic rate of income tax, and there are a number of other measures to encourage small and new businesses:

- better targetting of the (BES);

- an extension of Capital Gains Tax retirement relief; and

- an increase in the VAT threshold to £22,100, the maximum permitted under existing EC law.

29. The Business Expansion Scheme (BES) will be extended to companies specialising in the letting or property for assured tenancies: an important supply side measure.

30. There are a number of other measures affecting businesses, including the abolition of Capital Duty.

Charities

31. Tax relief for payroll giving to charity will be made more generous with a doubling of the limit from £120 to £240 a year.

Taxes on Spending

32. There will be minor changes in VAT arrangements. Excise duties as a whole will be

creased in line with inflation, but there will be some adjustments within the total: see table 6. The duty on unleaded petrol remains unchanged, raising the tax differential in its favour to over 10p a gallon. There will be no change in the tax on spirits or pipe tobacco. The main rates of Vehicle Excise Duty are unchanged..

Share Ownership

33. The Chancellor announced the results of a joint Treasury/Stock Exchange survey showing that, despite last year's stock market fall, the number of shareholders had risen slightly to around 9 million. He announced two further proposals to encourage share ownership:

- a raising of the annual limit for Personal Equity Plans from £2,400 to £3,000;

- a relaxation of the rules relating to some employee share schemes..

Capital Gains Tax

34. The Chancellor announced a major reform consisting of three elements.

35. First, the base date for the tax will be brought forward from 1965 to 1982: thus, any capital gain arising before April 1982 will be exempt from tax altogether, for individuals and companies alike. This will:

- end once and for all the injustice of taxing inflationary gains;

- benefit the economy by unlocking assets which have been frozen because of the penal tax that would have arisen on resale; and

- help many small businessmen and farmers in particular.

36. Second, the annual exempt slice will be reduced to £5,000 for individuals and £2,500 for most trusts.

37. Third, capital gains tax will be aligned with income tax. Although the taxation of gains will continue to benefit from existing indexation Provisions real gains will in future be taxed at the same two rates - 25 per cent and 40 per cent - as income..

Inheritance Tax

38. The Budget simplifies this tax still further by increasing the threshold from £90,000 to £110,000 which will reduce the number of estates liable to tax by a quarter, and levying a flat rate of 40 per cent on the rest.

Summary

39. The budget reaffirms the prudent policies that have brought a long and continuing period of strong economic growth, combined with low inflation. The Budget has been balanced. Tax rates have been substantially reduced. And some major tax reforms have been introduced. This will improve incentives and further strengthen strengthen the economy.

PMP

CHANCELLOR OF THE EXCHEQUER

Ch/

Fairly soon we shall have to start thinking about the allocation of gallery seats for Budget day. But in advance of that, we have been asked by COI whether we could allocate a ticket to Dr Saleh Al Omahir, Saudi Arabian Vice Minister of Finance, who will be in UK on official visit. Regrets?

Regrets.

phoned to P Edwards MPW

27/1

pvp

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

Thanks

cc

Anne Segall

~~N Atty~~ deposite has emerged. She tried to speak to CST in margins of TCSC but he strode off; she did speak to both Richard Allen & Phillip Worland — Phillip told Richard he had said he expected the Budget to be "prudent", & Richard has warned him off commenting on Budget in future. Richard may conceivably have been source for "prudent" also, though

over

he said he didn't talk about Budget itself (or certainly not about 25p). I spoke to Peter & he has spoken to Richard to make sure he knows the form.

AA

THE GUARDIAN Friday February 5 1988

Research suggests tax cut fears are baseless

32/1

By Christopher Huhne
Economics Editor

Treasury research suggests that even a large package of tax cuts in the budget would worsen the trade deficit much less than most economists fear, despite the attempts by officials yesterday to lower the high expectations of goverment munificence on March 15.

Officials were yesterday letting it be known that the economic data which prompted the half point rise in base rates on Monday — including the December trade deficit — also implied a cautious budget. The wilder City rumours of up to £11 billion to hand out in March were said to be wide of the mark.

However, the attempt to play down the Chancellor's room for manoeuvre is a "heads I win, tails you lose" option for the Treasury which seasoned observers treat with due scepticism.

Low expectations for tax cuts will mean little disappointment if the Chancellor does decide to be cautious, but a particularly rosy reaction if he decides that he can hand out tax cuts after all.

The Treasury's internal research, incorporated in the latest versions of its computer model, suggests that he may take the plunge with a bold budget, because it shows that tax cuts do not have anything like the adverse effects on the balance of payments that other economists suggest.

According to the Treasury's model, tax cuts help to ease earnings growth, and therefore improve international price competitiveness, offsetting the impact of higher imports as tax cuts boost consumers' spending.

A large package of tax cuts with several pence off the basic rate could cut earnings growth to less than 5 per cent a year, the model says.

However, such effects of income tax cuts in stalling wage growth are fiercely controversial among economists, and the Treasury's claims of the beneficial effects of tax cuts on wage growth are currently under investigation by the macro-economic modelling bureau at Warwick University, where researchers note that the evidence is 'very dubious'.

There is also no doubt that the Chancellor's advisers have been watching pay settlements and the current unrest in the health service and other parts of the public sector with concern, and that this will tend to weaken their confidence in the beneficial supply-side effects of tax cuts.

High on the Chancellor's agenda are still a reform of the personal taxation of husbands and wives.

One option is the abolition of the married man's allowance, independent taxation with individual, personal allowances, but a partially transferable element of those allowances from a spouse who does not work.

The Treasury was also saying yesterday that tax reforms affecting husbands and wives could be phased in over a period of time. This would be one way of limiting the overall size of the boost to personal consumption.

30 THE DAILY TELEGRAPH, FRIDAY, FEBRUARY 5, 1988

Treasury predicts 'prudent' Budget will cut tax rates

30

By Anne Segall, Economics Correspondent

SENIOR Treasury sources confirmed yesterday that Mr Lawson, the Chancellor, will unveil a "prudent" Budget on March 15 but denied this would mean sacrificing the Government's objective of reducing the basic rate of income tax by 2p to 25p.

Mr Lawson is understood to be worried about inflationary pressures within the economy but is still determined to increase incentives and introduce radical reforms.

He has long made it clear that he sees lower taxes as the key to a more efficient economy and would like to bring down top rates as well as the basic rate.

He also believes the tax system should be reformed to give greater financial independence to women.

But the Budget could contain some nasty surprises. The Chancellor believes the time has come to remove some of the more obvious tax breaks which help the rich but do little to promote economic efficiency.

At the top of his list for reform are reliefs for farming and forestry and the cumulative benefits of Business Expansion Schemes.

The Bank of England is adding its voice to those urging the Chancellor to err on the side of caution. In a quarterly bulletin due out next week it will call for a relatively "tight" fiscal stance.

Specifically, the Bank would like the Government to devote part of its surplus revenues to repaying the National Debt.

It is usually careful not to become involved in politically-sensitive issues, so the decision to air its concern is significant.

The Bank's belief that the economy is in danger of overheating received support on two fronts yesterday. Ford workers voted to reject the weekend pay deal agreed by union negotiators and Britain's biggest building society, the Halifax, reported that house prices are still rising strongly, with the stockmarket crash having failed to dampen demand.

According to the Halifax, the cost of property rose by an average of 16.3 per cent last year, a record, with house prices up by a third in East Anglia and a quarter in the London area.

Treasury sources suggest the Bank is taking too alarmist a view of developments in the economy. "We think there are signs that the economy is beginning to slow down," a senior official said yesterday.

In the City, economists say the Chancellor can aim for a Budget surplus without sacrificing tax cuts. They estimate he will have more than £3 billion available, providing ample scope for a 2p cut in the basic rate and reductions of 10p in all the higher rate bands.

According to Mr Bill Martin, chief economist at Phillips and Drew, "the Chancellor needs to be cautious but that does not mean he cannot cut taxes."

The contents of this publication are subject to copyright and may not be reproduced in any manner whatsoever without the prior consent of the copyright holder, nor may this publication be resold without the publishers prior consent
Prepared and printed on behalf of McCarthy Information Limited by Lincoln Hannah Limited. Published by McCarthy Information Limited. Errors and omissions excepted

42/2.BTW.4366/56

CC: PS/Chancellor
Mr. Culpin
Mr. Cropper
Miss. Rhodes IR
PS/IR.

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

R J Howard Esq
Group Personnel Manager
Higgs and Hill PLC
Crown House
Kingston Road
NEW MALDEN
Surrey
KT3 3ST

February 1988

Dear Mr Howard

LUNCHEON VOUCHERS

Thank you for your letter of 1 February.

I can assure you that your representations will be carefully considered in the run-up to the Budget. However, I hope you will understand that it would be inappropriate for me to comment further at this stage.

Yours sincerely

Norman Lamont

NORMAN LAMONT

670/25

FROM: R I G ALLEN
DATE: 5 FEBRUARY 1988

CHANCELLOR

Thanks. OK. I v. much endorse X.

Ch/ content? MPW 5/2

cc Chief Secretary
Financial Secretary
Economic Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Bush
Miss Evans
Miss Edwards
Mr Cropper
Mr Tyrie
Mr Call

EPR SUPPLEMENT/BUDGET IN BRIEF

I promised you a note on where things stand.

2. You will recall that last year we published an EPR Supplement on the Budget (copy attached). This was part of the Budget day package for journalists, etc, and was distributed to the usual EPR readership. It was also sold, on a limited and experimental basis, to commuters on Waterloo Station, with a separate masthead entitled "Budget in Brief".

3. You responded favourably to the experiment, noting that "this should go even better next year [ie 1988] if we put the Budget measures on the front page, in even plainer language." The TCSC also encouraged us to extend the experiment. We have had some discussions with the distributors (W H Smiths) and, subject to your agreement, I would propose to go ahead on the following basis this year:

(i) to aim to sell the "Budget in Brief" to some 4-5 outlets, at a price of 25p (the same as last year). This should enable us to sell around 2,000 copies (last year we sold nearly 500). We will get a share of the revenue from sales (last year, Smiths kept it as an incentive to try the pilot). If successful, we could consider an even wider distribution next year.

(ii) We should dispense with the dual-masthead approach, printing the document with the single heading "Budget in Brief". But we would propose, as usual, to send the document to all those on the EPR circulation list (involving a print run of about 70,000).

(iii) I would intend to write the document, as Robert Culpin did last year and, as noted above, try to summarise the main measures on the first page. If necessary, we have established that the printers could cope with a longer document than last year's (ie 8 pages instead of 4 pages), and you may think this is worthwhile this year. But it will be harder to describe this as a "Budget in Brief" and, if we go for a longer piece, it would require us to get the final text to the printers by the morning of the Thursday prior to the Budget (ie 10 March). There could also be risks of the print timetable slipping if the FSBR is running late. So, on balance, I would advise sticking to the 4-page format, if at all possible.

X

(iv) Even with the restructured "Budget in Brief", there will still be a need for the Budget "Snapshot": journalists find this document particularly useful.

RGA

R I G ALLEN

From: Robin Maxwell-Hyslop, M.P.

Jonathan,

1. [illegible] have a [illegible] up & [illegible]
2. I [illegible] greatest [illegible] a quick [illegible] 1st [illegible] / 2 suggestions [illegible]

HOUSE OF COMMONS
LONDON SWIA OAA

9 February 1988

Dear Nigel,

There are two aspects of tax relief which I think you should embody in this Budget:

1. To increase the upper limit on the tax-free status of terminal payments by an employer to an employee on retirement from £25,000 to (say) £35,000. Not only has the present figure been eroded by inflation, but unless you do so this year, you may find yourself in the embarrassing position of having to do it in a year when Members of Parliament will themselves benefit from such an alteration, i.e. when Members' pay reaches the figure of £25,000 a year, as it is likely to do by January 1991. It is always better to avoid occasions of acting ad hominem, but you would clearly be under immense pressure not to bring retired Members' "resettlement grant" into tax, thus greatly reducing its value.

2. Increase the maximum percentage of a person's final earned income that the Inland Revenue will accept for tax allowable contributions from the present 66⅔% to (say) 80%.

I understand it to be the Government's policy to encourage people to make better provision for their own retirement. Most people do not have the benefit of an index linked non-State pension. The effect of 10 years' inflation at 4% p.a. on top of the 66⅔% rule is that 10 years after retirement people will only have about 40% of the purchasing power that they had before retirement.

I am pressing these two relaxations upon you, not only on their own merit, but because I have not seen them discussed in the press, nor was either of them raised when you came to our Party Finance Committee.

Yours sincerely,

[signature]

The Rt.Hon. Nigel Lawson, M.P.
Chancellor of the Exchequer
H.M. Treasury

c.c. Rt.Hon. Cranley Onslow, M.P.

ps2/4M UNCLASSIFIED

pmp

FROM: MISS M P WALLACE

DATE: 9 February 1988

MR R I G ALLEN

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Bush
Miss C Evans
Miss Edwards
Mr Cropper
Mr Tyrie
Mr Call

EPR SUPPLEMENT/BUDGET IN BRIEF

The Chancellor was grateful for your minute of 5 February. He is content with what you propose, and very much agrees with your advice that we should stick to a four page format if possible.

MPW.

MOIRA WALLACE

BUDGET SECRET

Copy No 1 of 12 Copies

FROM: P J CROPPER
DATE: 29 February 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
PS/Permanent Secretary
Mr Scholar
Mr Culpin
Mr Tyrie
Mr Call

BACKBENCH BUDGET BRIEF

I attach the framework to which I am working this year and, for reminder, a copy of last year's Budget brief.

2. We normally circulate a draft to Ministers in the middle of the week before the Budget, but it cannot be finalised until the Speech is complete and a line has been drawn under the figuring. This usually means that copies are run off on the Monday evening. Arrangements are then made for copies to be released from locked brief cases in the Whips' Office when you sit down. Copies also go out in the Cabinet Ministers packs on the Tuesday morning.

P J CROPPER

BUDGET SECRET

BUDGET 1988

V2720.17

BUDGET SECRET: TASK FORCE LIST

Copy No. 2 of 2
FROM: ROBERT CULPIN
DATE: 1 March 1988

MR TYRIE

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Odling-Smee
Mr Turnbull
Mr Gieve
Mr Pickford
Mr Riley
Miss Sinclair
Miss Evans
Mr Cropper
Mr Call

* Mr Culpin So most helpful with this analysis questions: I share the gut feeling there is now tends to be fairness & Equality (tense) answers - on particular to the key question (& it is the key question) " why prefer tax cuts to a ~~...~~ 50/50 mixture of tax cuts & ~~£~~ NHS spend - ?" people understand the virtues the motivation & won't not support more than a ffl for package. They many from support my judgement that ffl for 'rigour'. But what Ken will have understand — unless we explain it to them —

THE BUDGET AND PUBLIC EXPENDITURE

I am glad you are consolidating a line on why the Budget has nothing for health. Many people will think it the most important question. Can I make two unhelpful points?

2. First, the question is not just: why prefer tax cuts to spending? It is: why prefer a large surplus to spending, when

(a) you could have tax cuts and higher spending and still have some surplus;

(b) no-one except the Chief Economic Adviser cares whether that surplus is (say) £3 billion or £2 billion;

(c) you're admitting that you can't count the thing to within £7 billion; and

(d) you seem to be suggesting that a balanced budget is sufficient for the future.

Which will apply the arithmetic of incentives — 100% tax cuts, 0% NHS spend v. ...

(the comparison)

3. Second, the question is not just: why no increase in spending? It is: why reductions, compared with the White Paper you published only a few weeks ago? This year:

(a) you are spending a lot less than planned in cash; and

(b) it is worth still less in real terms, because inflation is higher.

In the future:

(a) the planning totals are worth less in real terms, because inflation is higher;

(b) GGE is lower even in cash, because you have reduced debt interest and not allocated the proceeds; and

(c) you are showing that public expenditure will take roughly 1 per cent less of the national income than suggested in your own White Paper.

R

ROBERT CULPIN

mjd 1/90A

BUDGET SECRET: TASK FORCE LIST

COPY NO. 4. OF 4

BF 7/3

FROM: A C S ALLAN
DATE: 2 March 1988

MR CULPIN

cc Mr Tyrie

THE BUDGET AND PUBLIC EXPENDITURE

The Chancellor has seen your minute of 1 March to Mr Tyrie, with its helpful list of awkward questions. He would be grateful if you could now bend your mind to divising equally terse answers -in particular to the key question (and it is the key question) "Why prefer tax cuts to a 50/50 mixture of tax cuts and NHS spending?" People understand the virtues in moderation, and will not expect more than a £4 billion package. They may even respect the Chancellor's judgement that £4 billion is "right". But what they will <u>not</u> understand -unless we explain it to them - is the composition, which will appear the antithesis of moderation: 100% tax cuts, 0% NHS spending.

ACSA

A C S ALLAN

3977/61

CONFIDENTIAL

Thanks: Stet 'form'. One or two deletions, otherwise. N.

FROM: P J CROPPER
DATE: 2 March 1988

CHANCELLOR

cc Mr Culpin

with you.

BACKBENCH BUDGET BRIEF

I refer to the framework I put up to you on 29 February, and the packaging you have proposed to Mr Culpin in your BLO of 2 March.

2. I am making gradual headway with the backbench brief along the lines of my own framework. If you do want me to re-jig it along Culpinic lines, please speak now - or "forever hold your peace".

P J CROPPER

P.S. I note your use of the term "Removal of unjustified tax breaks". I take it that that is for bold use, generally.

PJC

Yes, wherever appropriate.

3975/1

BUDGET SECRET

BUDGET 1988

SECTION PAGE

jc16

BUDGET SECRET - TASK FORCE LIST

COPY NO 2 OF 24

From: J ODLING-SMEE
3rd March 1988

MR CULPIN

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mr S Davies
Mr Gieve
Mr Pickford
Mr Riley
Miss Sinclair
Miss Evans
Mr Kelly
Mr Cropper
Mr Tyrie
Mr Call

THE BUDGET AND PUBLIC EXPENDITURE

You might be interested in the answers which are being prepared for the main Budget briefs on the MTFS, fiscal policy and public expenditure to questions similar to those in your exam paper for Mr Tyrie. I have grouped the attached answers under two questions about the size of the PSBR and taxes versus expenditure. But it is easy to see how much the same answers can be given to slightly different questions (eg why not a higher PSBR and more expenditure?). The answers are deliberately condensed but the points being made should be clear.

2. There are a number of related points which are not raised here, such as: why a balanced budget rather than the 1% of GDP in last year's MTFS? how does the PSBR path relate to inflation and money GDP objectives? Answers to these and other questions will, of course, appear in the Budget brief.

3. It would be helpful to have comments by Monday morning.

JO-S

J ODLING-SMEE

jc16

BUDGET SECRET - TASK FORCE LIST

Why budget surplus of £3 billion?

- cautious, prudent and sustainable
- balanced budget sensible for medium term, but prudent policy is to move back to it gradually:
  - sudden move would require £7 billion tax cuts or expenditure increases (irresponsible, unpredictable consequences)
  - in three out of last four years have similarly only used part of fiscal adjustment suggested by PSBR in previous MTFS
  - room for manoeuvre in event of shocks
- budget surplus prudent when private sector financial surplus unusually small
- no need for still bigger surplus (smaller tax cuts):
  - tax cuts only just offset buoyancy of revenues, not irresponsible
  - £3 billion surplus provides room for private sector to borrow, invest and grow
  - current account deficit reflects private sector behaviour and strong growth in 1987, not fiscal laxity, so will correct itself in time
- cannot claim £3 billion <u>precisely</u> right, but in Chancellor's judgement better than £2½ or £3½ billion.

Why not use some of £4 billion for expenditure increases?

- government's objective is to reduce tax burden and GGE ratio over medium term: budget measures only just offset tendency for tax burden to rise

- objective is to give people more opportunity to spend own money

- virtuous circle: reductions in taxation stimulate private sector and create resources for more public services in medium term (balanced budget also creates room for more spending on services through lower debt interest burden)

- tax decisions made in Budget, expenditure reviewed in Survey in light of MTFS

- GGE/GDP ratios not precise targets: objective is to reduce ratio over medium term

- should not adjust medium-term spending plans because of faster output growth in one year (1987) when not expected to continue

- short-term impact of expenditure increases and tax cuts on economy (eg balance of payments and unemployment) not important: government has medium-term objectives for spending and taxes; balance of payments and unemployment will sort themselves out as private sector adjusts and supply side improves further.

BNM15

BUDGET SECRET: TASK FORCE LIST

COPY NO 1 OF 17 COPIES

FROM: MISS M HAY
DATE: 3 MARCH 1988

I must tell Culpin I did not say I wanted to write to LdY, which I never do on Budget measures. Nor, incidentally, is it true! I did see him a fortnight before the Budget last time and told him the outline. I will have a further bilateral at which I will show him an aide-memoire. It will have to be very much shorter than this — one page of notes, not five pages, at this stage. This way will have to be fixed soon, since as soon as ... will miss the Budget.

1. **MR CULPIN** note below

2. **CHANCELLOR OF THE EXCHEQUER** cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Mr Monck
Mr Scholar
Miss Sinclair
Miss Evans
Mr Cropper
Mr Tyrie
Mr Call
Mrs Smyth - IR
PS/IR

Ch/ Mr Culpin (his ms. note below) suggests a meeting rather a letter. This seems sensible, for the reasons he gives. Shall we set one up later this week?
AF 7/3

You have said that you wish to write to Lord Young in advance of the Budget informing him of those proposals which may have implications for areas for which DTI have responsibility.

2. I attach a draft letter outlining in general terms your proposed changes to the company residence and migration rules (S482), the business expansion scheme - including your decision to bring private renting within the scope of the scheme - and the taxation of members of Lloyd's.

3. It would not seem to be necessary to spell out the details of the proposed changes at this stage. These will be published in Inland Revenue Press Releases on Budget Day. Copies will be sent to DTI.

4. You may also want to tell Lord Young about your proposal to double the car scales (at your bilateral meeting you told him that you intended to make a 'swingeing' increase). I have included a paragraph in square brackets in case you decide to do this. X!

I am nervous about a letter. If the proposals on s. 482 were to leak, companies could take pre-emptive action, by rushing in applications under the present rules. Could you perhaps see Lord Y, near the Budget, hand him an aide-memoire based on this, & take it back again?
RC 4/3

MA

MISS M HAY

DRAFT

The Rt Hon Lord Young of Graffham
Department of Trade & Industry
1 Victoria Street
LONDON SW1H OET

I am writing to give you advance notice of Budget proposals which will affect the residence and migration of companies, the Business Expansion Scheme and the taxation of members of Lloyd's [and to inform you of my final decision on the levels of the car scales].

Company residence and migration (Section 482)

I propose to introduce changes to the provisions governing company residence and migration. The current rules are contained mainly in Section 482 Sub-section 1(a) and (b) of the Income and Corporation Taxes Act 1970. They involve the use of discretionary powers by the Treasury - whose approval must be obtained before a company may migrate - and criminal sanctions where the procedures are not followed. These provisions are meant to prevent tax avoidance but they are ~~their form is now regarded as~~ anachronistic and have been widely criticised.

I propose ~~therefore~~ to replace them ~~the existing discretionary provisions~~ with straightforward, objective rules governing residence and migration. These will be very similar to the provisions in a large number of other countries. The changes will involve a new test of ~~for~~ residence for tax purposes. In future a company will be deemed to be resident here if it is incorporated in the UK, or in the case of the foreign incorporated company, if it is centrally managed or controlled in the UK. There is, however, a five year transitional period for companies incorporated in the UK but not resident under the current rules.

UK incorporated companies wishing to move their business abroad, or non UK incorporated companies moving their residence abroad, will be able to do so without applying for Treasury approval provided they pay their accrued tax (including tax on capital gains) first. This will prevent companies moving offshore in order to avoid tax on gains accrued in the UK. You may recall that this is the point at issue in the Daily Mail case which is due to come before the European Court later this year.

The Daily Mail were not given consent, under the Section 482 rules, to move to the Netherlands because it was judged that their main objective was to avoid paying capital gains tax on assets in this country which they intended to realise. The Daily Mail have appealed to the European Court on the grounds that the relevant parts of Section 482 are contrary to the Treaty of Rome. We have a reasonable chance of winning this case but if we do, the ruling is likely to be unsatisfactory in a number of ways. This is a further factor in my decision to legislate now to put our arrangements broadly on all fours with those obtaining in other EC countries (and more widely).

In addition, in the light of consultation on the other provisions of Section 482 (Sub-Section 1(c) and (d) which cover transactions by UK companies in connection with non-resident subsidiaries whereby, for example, profits are brought into the UK in non-taxable form), I intend to make revisions to the general consents which should reduce the compliance burden.

Business Expansion Scheme

As you know, the BES scheme is intended to help smaller, riskier companies to attract equity finance. When we came into office in 1979, the venture capital industry in this country was very small and unquoted companies of even a moderately large size could have difficulty in raising equity finance. We now have a thriving venture capital industry which can supply unquoted companies wanting to raise relatively large amounts of equity finance. There is therefore no longer a need to continue to give BES relief for companies making relatively large (often public) issues. I have received a number of representations calling for the exclusion of larger issues from the scope of BES relief so that relief can be focussed on the smaller riskier companies who have most difficulty in raising equity finance. I propose to meet these representations by imposing a ceiling of £½ million on the total investment in any one company which may attract BES relief in any year.

This ceiling will not apply to investment in companies specialising in ship chartering, however. Such investment was brought within the scope of BES in 1986 with the aim of stimulating private risk investment in the UK shipping industry. I believe that relief for this industry is still justified in the current economic climate and I therefore propose a much higher ceiling of £5 million on investment in such companies.

[I also propose a small change to the rules governing relief for investment in an approved BES fund. Investors will be given relief by reference to the closing date of the fund rather than the (later) date when the fund invests in companies. This will allow funds wishing to take advantage of the ~~size~~ surge of BES investment which takes place in February and March more time for investment appraisal.]

BES relief for private renting

I have decided to make one other major change to the BES scheme. I have been considering with Nicholas Ridley the possibility of giving a ~~K~~kick-~~S~~start, via tax relief, to the deregulation of the private rented sector. The familiarity and success of the Business Expansion Scheme, and the fact that it gives immediate relief, makes it a good vehicle for this purpose. I therefore propose that, from Royal Assent, BES relief should be available for investment in companies specialising in letting residential accommodation on the basis of the new-style assured tenancies which will be brought in by the Housing and Housing (Scotland) Bills. A ceiling of £5 million will be imposed on BES investment in any such company in any year. This ~~particular~~ extension of the BES will run for 5 years. ~~as it is intended to help change attitudes rather than subsidize the provision of private rented accommodation on a continuing basis.~~

Lloyd's Reinsurance

I propose to modify the 1987 Reinsurance to Close (RIC) legislation to give relief from the effects of that legislation to Lloyd's members who leave a syndicate at the end of an underwriting year, and to produce more equitable treatment for those continuing in syndicate membership. The proposals, which have been discussed with Lloyd's, will take effect for the 1985 underwriting year (ie the first year for which the RIC legislation has effect). The general rules for determining the amount of RIC premiums which are tax deductible will not be affected. (The rules restrict tax deductibility to premiums which are "fair and reasonable".)

I also propose to make several changes to the administrative arrangements for assessing and collecting tax from members of Lloyd's. The current arrangements are complex and costly for both taxpayers and the Revenue, and can lead to delay in the collection or repayment of tax. The proposed package of measures follows extensive discussions with Lloyd's and we shall be consulting further on the detail. The revised arrangements will apply from the 1986 underwriting year.

[Finally, I mentioned to you at our recent meeting that I had it in mind to make a swingeing increase in the level of car scales (which measure the value of cars as a benefit in kind for income tax purposes). I have now decided that the levels of car scales for 1988-89 will be double the current levels. (This increase will subsume the 10 per cent increase I announced last year).]

I feel that it is only right that you should have prior knowledge of these proposals but I must ask you to observe the rules of Budget security and not divulge them further without contacting my office first.

ps2/6M BUDGET CONFIDENTIAL

MP

FROM: MISS M P WALLACE
DATE: 4 March 1988

MR CROPPER cc Mr Culpin

BACKBENCH BUDGET BRIEF

The Chancellor was grateful for your minutes of 29 February and 2 March. He has commented that the framework seems fine, although he would delete "Business Entertaining, (LVs)" in point 5, and "Payroll Giving" at point 9. He has commented that you are right in thinking that the term "Removal of unjustified tax breaks" is "for bold use", wherever appropriate.

MPW.

MOIRA WALLACE

063/3651

BUDGET SECRET: TASK FORCE LIST

Copy No 1 Of 13

Burden of tax. Lot people opp?

FROM: A G TYRIE

DATE: 4 MARCH 1988

CHANCELLOR

Ch
Could be toned down a bit
AA

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Culpin
Mr Scholar
Mr Turnbull
Mr Hudson
Mr Cropper
Mr Call

(received after boxes closed on Friday, but may want to see before Prayers)

THE NHS AND THE BUDGET

I attach a first cock-shy at lines to take on the NHS in the budget. It benefits from suggestions from Messrs Culpin, Turnbull and Hudson. I thought it might also be useful to set out three general bull points in this area which Ministers should try and say, whatever they are asked.

Although it is disingenuous, I find the last question I have set myself the most difficult.

There are also answers to Mr Culpin's quiz. Although they look difficult I don't think they're a big problem. Most people wouldn't understand them and so rather than answering the question, I think Ministers may well be able to get away with peddling the bull points.

I have tried to avoid refering to the Reserve and to the emergency £100 million we blew a few months ago. I think mentioning the Reserve would lead to an invitation to allocate it. That doesn't get you far. The £100 million invites the question: 'if you could dip in for £100 million only a short while back, why not £500 million now?'

AGT.

A G TYRIE

THE NHS AND THE BUDGET: BULL POINTS

Standardise a figure (? £4½ bn on programmes)

i. The strong economy we have created is generating extra money. We have used £3 billion of this to increase public spending. This year we also announced the biggest ever cash increases for the NHS (over the three year period etc).

We have also put some of the extra cash generated by the strong economy to tax and borrowing reductions. That is an essential investment for the future. It will help sustain a virtuous circle of lower taxation and borrowing and higher spending.

We will stick with the policies which for two years in succession have brought us a hat-trick of higher spending, lower taxation and lower borrowing.

somewhere (perhaps in supplementaries) we want 'tax cuts? what tax cuts?' line - 37.5% & all that.

ii. Cutting taxes is a principled thing to do:

- We are not giving money away, we are giving it back to the people who have earned it.

- Lower taxes sharpen incentives, keep doctors, ? entrepreneurs and people with skills in this country.

- Cutting taxes give people more freedom to choose for themselves, how to spend or save.

- Lower taxation, by fostering the enterprise culture, is by far an away is the most effective means of creating the resources for better public services.

iii. We have increased health spending by over 30% in real terms since we came to office. That is the equivalent of forgoing a cut of 3p in the basic rate of income tax [although superficially attractive there is a big downside to this last point: do we want directly to link the trade off between tax cuts and health spending in this way?]

BUDGET SECRET: TASK FORCE LIST

THE NHS AND THE BUDGET: DEFENSIVE LINES TO TAKE

i. Why, in a budget containing £4 billion of tax cuts and a budget surplus of £3 billion has no extra money at all been found for the NHS?

- That is not what budgets are for. In the budget the Chancellor sets out how he intends to raise the money he needs. It is about taxation and borrowing, not spending. Spending will be considered, as usual, in the annual survey during the Summer and Autumn.

- Each November the Chancellor announces the results of the survey of public spending and last year he announced the largest ever cash increase (over a 3 year period) for the NHS.

- The Government is undertaking a thorough-going review of the health service which will report as soon as possible. It would be absurd to try and solve problems by throwing money at them before we have the results to hand.

ii. Why don't you tell the health authorities that the Government will fund the nurses pay body review recommendations in full?

- No responsible Government would sign a blank cheque on recommendations that had not yet been received or studied.

- For this year we have minimised uncertainty by announcing that the Government will take its decisions on the pay body review reports before the end of April.

- For future years we are bringing forward the timetable for the review body reports so that decisions can be made well before the beginning of the financial year. This will remove uncertainty for future years.

iii. Isn't it immoral to give money away in tax cuts when the NHS is in need?

- We are not giving money away, we are giving money back to people who are earning it.

- Tax cuts benefit the whole economy. They sharpen incentives, and help keep people with skills, be they surgeons or entreprenuers, in this country.

- We are reviewing NHS funding etc.

iv. The red book shows that public expenditure will take 1% less of national income than set out in your own White Paper. If you are achieving you objectives faster than you anticipated (ratio of public expenditure/GDP) why can't you find more for health?

- We are achieving our goal of reducing public expenditure as a proportion of GDP while at the same time protecting real increases in public expenditure for the health service.

- It is those very reductions of spending as a proportion of GDP which are creating the conditions in which the economy can grow faster and provide greater resources for health and other spending. We have achieved a virtuous circle of higher spending, and lower taxation and borrowing. We intend to stick with the policies which have brought these healthy conditions about.

v. Why are you spending £3 billion on debt repayment, rather than allocate even only say, £1 billion of this on the NHS, when for every subsequent year you are judging that a balanced budget is adequate? Would it make a scrap of difference if only £2 billion was allocated to debt repayment and the NHS spending was increased by £1 billion?

- The economy is growing above trend this year. This has enabled me to do more than I anticipated on taxation and also enabled me to provide substantial increases in spending last November. It would be imprudent to do more.

- I have judged it important this year to adopt this cautious fiscal stance.

- (If in an interview with John Smith etc.) The economy is now strong enough to get to grips with reducing the accumulated profligacy of the last Labour government.

vi. Rather than give money away in tax cuts, which will suck in imports and worsen the balance of payments, wouldn't it have been better to spend it on the NHS which would have had virtually no effect on the balance of payments?

- Tax cuts, together with the other reforming measures we are taking, is the way to a better functioning economy, and one which will enable us to meet our promises on public spending (unlike Labour who reneged on their spending promises, eg capital spending etc).

- The small deficit on the current account forecast in the red book should pose no financing problem. I expect it to decline as the rates of growth overseas come back into line.

- Our prudent fiscal policy, a reduction in borrowing of £7 billion on last year's red book, combined with prudent monetary policies will help ensure that the modest deficit is not a problem.

vii. Why can't we carry forward even a little of the £2½ billion by which you have underspent last year?

- We have not reduced spending one penny on what we planned last year. The £2½ billion difference to which you refer is accounted for by higher receipts (in council house sales etc).

- You can't spend last year's money this year.

COPY NO. 2 OF 37

FROM: C J RILEY
DATE: 4 MARCH 1988

CHANCELLOR — cc Principal Private Secretary
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Monck
Mr Scholar
Mr Culpin
Mr Odling-Smee
Mr Sedgwick
Miss Sinclair
Mr Bredenkamp
Mr Courtney
Miss C Evans
Mr Hughes
Ms Munro
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call
<u>Inland Revenue</u>
Mr Battishill
Mr Isaac
Mr Painter
Mr Lewis
Mr I Stewart
<u>Customs and Excise</u>
Mr Unwin
Mr Knox

CARS AND HOUSES: BEHAVIOURAL EFFECTS

You asked what is the expected effect on M4 of the abolition of home improvement loan relief (Mr Taylor's minute of 25 February).

2. The answer is that the effect should be trivial - a reduction in the stock of less than 0.1%, spread over 4 years or so. The attached minute by Mark Courtney explains why.

CJR

C J RILEY

FROM: M M COURTNEY

DATE: 2 March 1988

MR RILEY

cc: Mr Bredenkamp

HOUSING : EFFECTS OF CHANGES IN MIR

I was asked to look at the possible effects on M4 of the proposed withdrawal of mortgage interest relief on home improvement loans.

2. The revenue gains already assumed, before allowing for behavioural effects are:

	1988-89	1989-90	1990-91	1991-92
£m	80	200	300	400

Assuming a 10% gross interest rate, the stock of relevant home improvement loans is:

£bn	3.2	8.0	12.0	16.0

3. Two behavioural effects are assumed.

(i) forestalling, which reduces the new loans without MIR.

(ii) switching from loans for home improvement to higher house purchase loans.

These reduce the revenue gains and relevant stock of loans to:

Gain	1988-89	1989-90	1990-91	1991-92
Revenue £m	60	170	260	340
Stock of relevant loans £bn	2.4	6.8	10.4	13.6

4. Both of these should be allowed for before considering the third behavioural effect, which is what gives rise to any long-term effect on M4, namely.

(iii) a reduction in borrowing for home improvement. The assumed interest rate semi-elasticity of investment is -1.75 (ie a 1 percentage point increase in interest cost reduces investment eventually by 1.75%). Assume an interest rate of 10% and neglecting any additional benefit to higher rate taxpayers of MIR, interest costs rise by 2.5 percentage points on withdrawal of MIR. This gives a long-run reduction in the stock of loans for home improvement of £1.36bn x 0.0175 x 2.5 = £0.595 bn.

5. This represents a reduction in credit to the personal sector for home improvements of about £0.6 bn. There may however be offsets among the credit counterparts.

(i) Increased borrowing for other purposes - this might apply particularly for the 20% of home improvement loans assumed to be for other purposes.

(ii) Some loans for home improvements might come from non-banks, non-building societies (but the proportion is less than the 12% assumed for loans for house purchases, and these new mortgage lenders are themselves largely bank financed.)

(iii) Some of the decreased funding requirements for banks and building societies might be met by a reduction in borrowing from the overseas sector (eg fewer Eurosterling bonds take up by foreigners).

(iv) There will be some very slight tendency for interest rates to weaken in response to the drop in demand for home improvement loans, stimulating some additional borrowing for other purposes.

6. None of these offsets is likely to be very significant. Thus one can say that the reduction in the stock of private sector credit by 1992 is likely to be £0.6 bn or somewhat less.

7. By 1992 Q1 the stock of M4 is forecast to be £512 bn. Thus the stock of M4 by then is likely to be about 0.1% less than it otherwise would be. Over the four years to 1992 the average annual rate of growth of M4 would be lower by about 0.03 percentage points then it otherwise would have been.

Mark Courtney

M M COURTNEY

MC2.71

FROM: MARK CALL
DATE: 7 MARCH 1988

MR TYRIE

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Turnbull
Mr Culpin
Mr Hudson
Mr Cropper

THE NHS AND THE BUDGET

At Prayers this morning the Chancellor asked us to let you have comments on your minute of 4 March.

2. In your second bull point, which argues the principled case for tax reduction, we should not talk about giving money away. We are talking about the proportion of someone's earnings it is right for the State to take in the first place.

3. Bull point iii. The idea of tax cuts forgone in the past compared to historical public expenditure, is quite confusing and will be difficult to get across. Instead, after referring to the 30% increase in real terms in health spending since 1979, I would refer to the £1 billion increases planned in each of the next two years. If we want to make a link with income tax cuts, it would be best to express these planned increases as forgone tax cuts.

4. Defensive lines iv. A small point, but the first tiret is too defensive. I would replace "protecting" by "making".

5. Defensive lines v. I would expand the second tiret to read:

"In the light of the uncertainties in the world economy following the stock market crash, I have judged it important this year to adopt this cautious fiscal stance." Whatever the case for tax cuts, world economic uncertainty could be a useful explanation of the decision to run a surplus.

6. It may be worth including something along the lines of the point made by the Economic Secretary at Prayers this morning. "Private spending on health care forms a smaller proportion of total spending in the UK than in any other European country with the exception of Sweden. The boost to disposable income given by the tax cuts in the Budget, will allow people to spend more on health care."

MC

MARK CALL

BUDGET SECRET: TASK FORCE LIST

Copy No 1 of 13 Copies

FROM: P J CROPPER
DATE: 7 March 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Culpin
Mr Scholar
Mr Turnbull
Mr Hudson
Mr Tyrie
Mr Call

THE NHS AND THE BUDGET

I refer to Andrew Tyrie's draft of 4 March.

If we are intending to point to the fact that the Tax/GDP percentage is not going down (as discussed this morning), it becomes more difficult to claim credit for "giving people their own money back". I wonder whether the time has come to devise a ratio for Personal Tax/GDP. Or, alternatively, a percentage for Non-oil-non-corporation tax/GDP?

2. It may somewhere in the presentation be worth drawing attention to the difference between the Tax/GDP ratio, which has not gone down, and the Public Expenditure/GDP ratio which has. The difference is, of course, explained by the disappearance of the "£40,000 million" borrowing of 1975-76.

3. In detail:

Bull Points P1 (ii). Rather than "We are not giving money away, we are giving it back to the people who have earned it", I would say "We are not giving money away, we are leaving it with the people who have earned it".

Also, second item, I would say: "Lower taxes sharpen incentives, keep doctors, entrepreneurs and people with skills in this country. Lower taxes make it worth tackling the difficult jobs." (Implicit comparison between being a surgeon and running an antique shop.)

Defensive Lines. P4 (iii) Again: "We are not giving money away, we are allowing people to keep the money they have earned."

(iv) Indent 1. Place to refer to difference between Expenditure/GDP and Tax/GDP?

(v) Indent 1. "The economy is growing above trend this year. This has boosted revenue and enabled me to do more than I anticipated on taxation. It has also.....".

(vii) Indent 1. Do we not want to link lower spending with lower unemployment? And I doubt whether we want to get into the business of negative spending - council house receipts and all that.

PJC

P J CROPPER

MC2.70

CONFIDENTIAL

pp.

FROM: MARK CALL
DATE: 7 MARCH 1988

CHANCELLOR'S MORNING MEETING   25TH MEETING

NOTE FOR THE RECORD

Present: Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Mr Lennox-Boyd, MP
Mr Forman, MP
Mr Cropper
Mr Tyrie
Mr Call

1. APOLOGIES were received from the Paymaster General.

2. PARLIAMENTARY BACKGROUND

The stance taken by the SSEB on coal prices was discussed. While this was almost certain to come up during the debate on electricity privatisation, it would not dominate the debate.

3. NHS AND THE BUDGET

The Chancellor referred to Mr Tyrie's minute of 4 March, and asked for comments from those on the copy list. The following points could be added to the briefing. Firstly, that while the burden of taxation had been rising over the past 3 years, spending on health as a proportion of GDP had also risen. Secondly, in response to those who said more should be spent on health, we could say that we have given them the opportunity to do that by increasing prescription ~~introducing dental and optical~~ charges. This had been done in a way which protected the poorest. While this may be more of a House

Commons point, and would certainly need careful wording, there should be a point in the brief which aimed to expose the hypocrisy of those who simply wanted to spend other people's money.

The Economic Secretary felt something could be made of the fact that under Labour the cost of Government borrowing had always exceeded total spending on the NHS.

The Financial Secretary noted that the proportion of total health expenditure taken up by State spending in the UK was the second highest in Europe (the highest being Sweden).

4. STRENGTH OF STERLING

The Chancellor said that in the light of the worst ever trade figures and a falling oil price, the fact that sterling had been stable against the deutschemark for almost 12 months was a measure of the confidence in the UK economy. While the normal response to the recent strengthening of sterling would be to reduce interest rates, he was not proposing to do so at the present time in order to give priority to the anti-inflation policy.

5. NHS REVIEW

The Chief Secretary would deal with the matters raised by Mr Phillips and Mr Saunders.

6. BUDGET DEBATE: MANNING OF THE BENCH

The Wednesday was a Treasury day, and there would need to be a bench roster (Paymaster General's office please note) of Treasury Ministers. Mr Lennox-Boyd would confirm that it is the responsibility of the Departments whose Minister was speaking in the debate to ensure coverage. If that was so, the Chancellor would remind Mr Fowler and Mr Clarke when inviting them formally.

MC

MARK CALL

4370/39

FINANCIAL SECRETARY TO THE TREASURY

Copy No. 1 of 9

PS/CHANCELLOR

FROM: J J HEYWOOD

DATE: 7 March 1988

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Culpin
Mr Turnbull
Mr Cropper
Mr Tyrie

Ch/ You have Tyrie of 4/3, I understand

MPW 7/3

THE NHS AND THE BUDGET

The Financial Secretary has now seen Mr Tyrie's minute of 4 March and Mr Cropper's of 7 March.

2. The Financial Secretary thinks that a key point is the fact that a Budget Surplus now means that in future the burden of debt interest is lower and, within the spending constraints, more money can go on priority areas and less on servicing the stock of Government debt (much of which was inherited).

3. The Financial Secretary did not like Andrew Tyrie's third bull p oint. He thinks it contradicts the whole analysis that there is in some sense a choice at each point in time between a cut in tax or an increase in spending.

4. On Peter Cropper's minute, the Financial Secretary has commented that he is not too worried about the Tax/GDP percentage. His answer would be "Of course we want lower taxes". He thinks the central attack will not be "Why no tax cuts?".

J.H.

JEREMY HEYWOOD
Private Secretary

CHANCELLOR OF THE EXCHEQUER

Ch

The attached Prayers minutes record the earlier discussion of NHS & the Budget

ADB

[illegible]

2718/7

BUDGET SECRET
TASK FORCE LIST

Copy no 3 of 5

FROM: ROBERT CULPIN
DATE: 7 March 1988

MR R I G ALLEN

cc: Mr Pickford
Mr Hudson

BUDGET IN BRIEF

Your draft is fine.

2. I should add:

- no tax rate more than 40 per cent
- payroll giving
- unleaded petrol.

3. I should delete:

- minor allowances (paragraph 20)
- raising the benefits in kind threshold (we aren't - paragraph 24)
- redundancy payments and probably Keith (paragraph 24).

4. In paragraph 2:

- the tense doesn't work for the first indent
- I should say "reduce" rather than "remove" in the third, and
- the fourth looks a bit weak.

5. The increase in allowances should probably be added to paragraph 3, and might perhaps come first in paragraph 20.

6. In paragraph 8, the fourth indent should clearly say "up to a point".

7. In paragraph 18, the reference to the APA is a bit condensed, but that may be OK.

8. At the end of praragraph 21, I am not sure whether our income tax rates - plural - will be amongst the very lowest in the world.

9. In paragraph 25, "within families" won't quite do, unless you count divorced couples as families. And in paragraph 28, "in future" isn't quite precise enough. (You might, incidentally, make the last two sentences of that paragraph sound more positive by saying simply that "those making payments to separated or divorced spouses will ... single allowance".)

10. In the very last sentence (paragraph 38) you might substitute "real" for "such", to rub in the point.

RC

ROBERT CULPIN

4369/030

CONFIDENTIAL

FROM: J J HEYWOOD
DATE: 8 March 1988

MR CALL

Ch/ you have papers

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Turnbull
Mr Culpin
Mr Hudson
Mr Cropper
Mr Tyrie

8/3

NHS AND THE BUDGET

The Financial Secretary has seen your note of 7 March.

2. On paragraph 6, he has commented that the point is that in the UK health care is financed out of taxation to a larger extent than in any other European country except Sweden.

J J HEYWOOD
Private Secretary

jc6

BUDGET SECRET - TASK FORCE LIST

COPY NO 2 OF 14

From: J ODLING-SMEE

8th March 1988

MR TYRIE

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Scholar
Mr Culpin
Mr Turnbull
Mr Hudson
Mr Cropper
Mr Call

NHS AND THE BUDGET

A few comments on your notes of 4th March.

2. **Bull points i:** I suggest that we do not round £2.6 billion to £3 billion for the increase in public spending in 1988-89. This is a very unusual rounding, and the costs of using it probably exceed the benefits. Secondly, you could add "on programmes" at the end of the second paragraph.

3. **Defensive i.** The most hostile form of this question will refer to a reduction in borrowing of £7 billion rather than a budget surplus of £3 billion.

4. **Defensive iii.** An additional answer would be that we are not in fact reducing the overall tax burden, just preventing it from rising. I have not seen the latest figures, and so am unsure whether the non-North Sea tax burden is flat or falls slightly.

5. **Defensive iv.** An additional answer might be that the reduction in the public expenditure/GDP ratio is faster in some years, but may be slower in others. Our objectives for public expenditure and the tax burden are medium-term ones, not figures that have to be achieved year by year.

6. **Defensive v.** An additional answer here might be that it is prudent to return to the medium-term norm of a balanced budget gradually rather than suddenly, from this year's outturn of a surplus. Tax cuts and expenditure increases combined of more than £4 billion, over and above the expenditure increases already announced, would be irresponsible. In three out of the last four Budgets, the tax cuts have been less than they could have been without exceeding the PSBR published in the previous Red Book. This illustrates our gradualist approach. (The text of the MTFS refers to gradualism.)

7. **Defensive vi.** We should avoid suggesting that growth in other countries has been especially slow, because that is not true of 1987. Your second indent would be better ending as follows:

> "I expect it to decline as the gap between our growth and that elsewhere moves back towards its long-term trend."

8. Also on **defensive vi**, an additional point is that the balance between taxes and expenditure is a matter for the medium term, and not something to adjust because of short-term developments in the economy.

9. **Defensive vii.** Is it really true that higher receipts accounts for all the £2½ billion difference?

J ODLING-SMEE

 Mr Tyrie

(1) pl. do asap
(2) pl. + say CX would like comments by tomorrow.

A redraft of (vii). Could you copy the redraft to Odling Smee & Grice who are both working on material in the same area

vi. Rather than give money away in tax cuts, which will suck in imports and worsen the balance of payments, wouldn't it have been better to spend it on the NHS which would have had virtually no effect on the balance of payments?

KT 7/3

- Tax cuts, together with the other reforming measures we are taking, is the way to a better functioning economy, and one which will enable us to meet our promises on public spending (unlike Labour who reneged on their spending promises, eg capital spending etc).

- The small deficit on the current account forecast in the red book should pose no financing problem. I expect it to decline as the rates of growth overseas come back into line.

- Our prudent fiscal policy, a reduction in borrowing of £7 billion on last year's red book, combined with prudent monetary policies will help ensure that the modest deficit is not a problem.

vii. Why can't we carry forward even a little of the £2½ billion by which you have underspent last year?

- Object of policy is not to spend up to a particular limit but to get spending and hence taxes and borrowing down. Much of underspend eg local authority receipts and MOD carryforward under end year flexibility will be available for spending next year.

- ~~We have not reduced spending one penny on what we planned last year. The £2½ billion difference to which you refer is accounted for by higher receipts (in council house sales etc).~~

- ~~You can't spend last year's money this year.~~

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

jc11

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

COPY NO 1 OF 25

From: J ODLING-SMEE
8th March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton

Sir Terence Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Pickford
Mr Riley
Miss Sinclair
Miss C Evans
Mr Cropper
Mr Tyrie
Mr Call

Ch
The early part of this is v wooden (I can volunteer a complete redraft if you think that would be helpful). The tax stuff seems broadly OK – I suspect Robert wrote much of it – but it's in a very odd order.
AA
(comments by Anson & Tyrie, & last year's piece are below).

NOTE FOR THE QUEEN AND OVERSEAS POSTS

I attach a note prepared with the help of FP. I suggest that, as last year, the same note should be used for both purposes. The attached draft is a little longer than last year because there are more tax changes, and some of them are rather complicated. It would, however, be possible to shorten it a bit if you felt it was necessary.

2. It would be helpful to have your comments tomorrow, so that we can prepare a final draft by Friday. We shall need to check the numbers after you have decided about the PSBR; and also the text in the light of the final version of the MTFS.

JOS

J ODLING-SMEE

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

queen

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

1987 BUDGET: SUMMARY OF MAIN POINTS

The background to this year's Budget is an exceptionally favourable one. The economy has been growing strongly and unemployment has fallen by around half a million over the last year. Inflation has remained low, while the public finances have been much stronger than forecast. This year's Budget should (will) help the British economy to continue this excellent progress; the tax reductions it contains will contribute by (improving incentives and) encouraging enterprise and efficiency. (against a background of sound financial policies.)

2. The main points of the Budget are:

- tax reductions of £4 billion in 1988-89
- income tax (the) basic rate reduced to 25p in the £, (and) higher rates above 40 per cent abolished, and allowances raised by twice as much as inflation
- (a major) reform and simplification of the tax system
- a budget surplus of £3 billion in 1988-89, the same as 1987-88, and a balanced budget over the medium term
- monetary and fiscal policies set to reduce the growth of money GDP over the medium term and so bring down inflation.

Economic background

3. The economy grew by 4¼ per cent in 1987, substantially faster than forecast a year ago, and in marked contrast to the sluggish performance of other major European economies. This has led to a further large rise in the number of jobs: the total increase in jobs since 1983 is now over 1½ million.

and the total fall since then is now 650,000.

4. Unemployment has been falling since July 1986; up to January of this year, it had fallen by 647 thousand (650,000). Unemployment (it) is still far

BUDGET SECRET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

too high, and there is no call for complacency about what has been achieved in the last eighteen months; but the fall in long term unemployment (about [¼ million] over the last year) is particularly encouraging.

Tyrie: x%

5. Inflation has been fluctuating around 4 per cent. It averaged 4.1 per cent in 1987, and so was below the rate of economic growth - the first time growth has been higher than inflation since 1964. Although pay increases have been [too] high, they have been offset by [exceptional] the very rapid growth in productivity [improvements].

6. Both exports and imports grew rapidly last year. The latest statistics show a current account deficit for 1987 of just over £1½ billion - below both the forecast made a year ago and earlier provisional estimates.

SECRET

7. The Chancellor expects growth to moderate somewhat in 1988, to about 3 per cent. This will be close to the average recorded since 1981, and again better than that expected in most other industrial countries. Investment is expected to be particularly strong this year. Unemployment should continue to fall, although perhaps at a more moderate rate than in the last year. Inflation in the final quarter of the year is likely to be at about the same level as at the end of last year, ie 4 per cent.

Tyrie

B.L.O. SECRET

8. As the UK will continue to grow faster than most other major industrial countries there is likely to be some increase in the current account deficit [on the current account of the balance of payments.] But at around £[4] 3½ billion, about 1 per cent of GDP, it [is] will still be small relative to [net overseas assets] the current account imbalances elsewhere in the world. Given the strength of the economy, there will not be any difficulty about financing it. The forecast assumes that the oil price will be $14 a barrel, close to recent market levels.

Budget strategy

9. The Medium Term Financial Strategy continues to provide the framework for the Government's economic policy, as it has done since

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

1980. It is designed to reduce the growth of total spending power in the economy steadily over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further sustained economic growth.

of 1-5 per cent

10. The Chancellor is setting a target range for narrow money in 1988-89; like last year, there will be no target for broad money, as its behaviour remains difficult to interpret. In operating policy the Government takes into account a range of evidence about monetary conditions; it

will continue to pursue a policy of

[attaches particular importance to continuing to maintain] exchange rate stability, [notably] against the Deutschemark being

with the rate

of particular importance.

11. At the time of the 1987 Budget, the Chancellor forecast a Public Sector Borrowing Requirement (PSBR) of £4 billion for 1987-88. It is now clear there will have been no net borrowing requirement at all in 1987-88; instead there has been net debt repayment of [debt. While there is still some uncertainty over the final figure, the Budget will show an estimated surplus of] some £3 billion.

12. The Medium Term Financial Strategy this year will cover the period up to 1991-92, and for the years 1989-90 to 1991-92 will show the budget in balance - the PSBR at zero. To set the PSBR at zero in 1988-89, however, would require tax cuts of about £7 billion given the buoyancy of revenues. Tax cuts on this scale would run counter to the Government's approach to economic policy, which is to make smooth, gradual adjustments rather than violent changes which may have to be reversed later. The Budget package therefore includes tax cuts costing some £4 billion in 1988-89, leaving a budget surplus of some £3 billion, the same as the estimated outturn for 1987-88.

Taxation

13. [On the tax side, the Chancellor's main objectives are to reduce income tax rates further, and to carry forward the process of tax reform.]

The Chancellor is introducing major reforms to personal taxation, designed to sharpen incentives and provide a further boost to the supply side of the economy.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET B.L.O. SECRET

Income tax

14. The Chancellor is raising the main personal allowances by twice the amount needed to compensate for inflation - that is, by roughly 7½ per cent. This includes the special age allowance for pensioners. It also applies to the upper limit for the basic rate band (ie the point at which the higher rates of tax begin).

15. He is reducing the basic rate of income tax by 2p in the £, to 25p. This meets the Government's long-term ~~manifesto~~ commitment. He is also announcing a new target for the basic rate, of 20p in the £, to be reached as and when it is prudent.

16. The Chancellor is radically reforming the higher rates of tax. ~~taxation of higher incomes.~~ He is abolishing all ~~of~~ the higher rates ~~of tax~~ above 40p. Income tax will thus be reduced from a six rate to a two rate system; and the higher ~~top~~ rate (reached at a taxable income of £19,300) will be one of the lowest top rates in the world.

17. The income tax changes will benefit all 25 million taxpayers. A ~~The~~ married man on average earnings will gain nearly £5 a week.

18. At the same time, ~~These big reductions enable~~ the Chancellor is ~~to~~ reducing some of the special reliefs in the income tax system. ~~which are hard to justify. First, the Chancellor is raising the valuation of company cars for income tax purposes. (They are taxed in the hands of recipients under PAYE.) At present, they are valued for income tax at only a quarter of what they are worth. The Chancellor is doubling that with effect from 1988-89.~~

19. First, ~~Second,~~ he is ending the tax shelter for forestry, which has been widely criticised, and switching to an improved system of grants. ~~for forestry, which will maintain the Government's planting objective and encourage in particular the planting of broad-leaved trees.~~ take in X (Anson)

Take Anson redraft (below)

20. Second, ~~Third,~~ he is abolishing the tax relief on home improvement loans, most of which are small and finance minor improvements such as double-glazing, rather than extensions or ~~loft~~ conversions, and which have been widely abused. This concentrates mortgage interest relief on its primary purpose: house purchase.

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

21. He is also doing the income tax liability on company cars, which have long been ~~substantially under taxed~~ taxed at substantially less than they are worth.

21. In line with the reduction in the basic rate of tax, the relief on pre-1984 life assurance premium payments is coming down to 12½ per cent. [It is customarily ~~traditionally~~ set at half the basic rate.]

(Too detailed)

Excise duties

22. The Chancellor is raising the excise duties, as a whole, broadly in line with inflation. However:

a. there is no change in the tax on unleaded petrol: this means that the differential between leaded and unleaded will double to just over 10p a gallon;

b. there is no change in the tax on spirits or pipe tobacco, or in the main rates of vehicle excise duty: the cost of keeping VED unchanged will be financed from the ~~a large~~ increased petrol ~~tax~~ duty, which will go up by ~~nearly~~ 6p a gallon;

c. so as to to encourage switching, particularly by the young, from high-alcohol to low-alcohol drinks there are reductions in the taxation of some low alcohol drinks; and

d. the Chancellor is introducing a higher VED charge on one group of juggernauts which exact a considerable toll on the road system.

Capital gains tax

23. Since 1982, capital gains tax has been charged only on 'real' gains~~: if they have been made since then~~: the paper gains which simply reflect inflation are no longer taxed. But these arrangements do not apply to gains made before 1982. This means that there are people and companies who have held assets since the 1960s or 1970s, or even earlier, who cannot realise them without paying substantial tax on purely paper gains made before 1982.

24. The Chancellor proposes to rectify this by exempting from tax all gains made before 1982. There will then be no taxation of ~~paper~~ inflationary gains whatever.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET

25. The real gains which are subject to tax will be charged at the same tax rates as income - 25 per cent and 40 per cent. This will reduce the incentive to convert income artificially into capital, and to invest for speculative gain rather than income. (Companies' gains are already taxed at the same rate as their profits: this change was made in the last Budget.)

26. The annual ~~exempt~~ amount of gains which individuals can make without paying tax is being reduced from £6,600 to £5,000. The present high level of the exemption was introduced explicitly to compensate for the fact that paper gains made before 1982 were, until now, subject to tax. The need for such compensation falls away under the Chancellor's reforms.

27. At the same time the Chancellor is increasing the amount of relief from capital gains tax which is available to a small businessman selling his business on retirement.

Inheritance tax

28. The Chancellor is raising the threshold for inheritance tax from £90,000 to £110,000. This will reduce by a quarter the number of estates which are taxed. In particular, it will allow ordinary people to pass on their homes without being taxed.

B.L.O.

29. The Chancellor is also reducing the tax from four rates to one (having reduced it from seven last year). The new flat rate will be 40 per cent. For many family businesses passing from one generation to another, this means the effective rate will be only 20 per cent, because there is 50 per cent business relief.

Taxes on business

SECRET

30. The main Corporation Tax rate remains at 35 per cent. The small companies' rate is reduced from 27 per cent to 25 per cent, in line with the basic rate of tax.

31. The VAT threshold is being increased by the maximum permitted under EC law, to ~~It will be~~ £22,100.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

32. Capital Duty, the 1 per cent tax paid by companies which raise new capital is being abolished, as is the ¼ per cent duty paid on all property put into a unit trust.

33. The special tax reliefs for entertaining foreign customers are also being abolished, so that the entertainment of foreign business contacts is put on the same footing as domestic ones.

34. There will be a change in the rules affecting the small number of companies which wish to change their country of residence for tax purposes. At present the rules require an application to the Treasury for formal consent, and are backed up by criminal sanctions. New rules, similar to those which exist in ~~a good many~~ most other countries, will be introduced to allow companies to migrate if they wish, provided they pay the tax due to the UK Exchequer first. The rules will be based on objective criteria and will no longer involve either an application to the Treasury for consent, or criminal sanctions.

Business Expansion Scheme

34. The Chancellor is extending the Business Expansion Scheme, under which investors obtain immediate tax relief for investment in new businesses in particular, ~~high risk companies,~~ to include investment in companies providing housing for rent. This extension will last for five years. It is designed to help revive the private rented sector, in conjunction with the deregulation of rents. These measures should make it easier for people seeking work to find accommodation for themselves and their families ~~at a price they can afford~~.

Share ownership

35. The Chancellor is increasing the limit on the amount which can be invested by individuals in Personal Equity Plans from £2,400 to £3,000, and relaxing some of the restrictions on shares owned by employees in the companies in which they work.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET B.L.O. SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Maintenance and Covenants

36. The Chancellor proposes to reform the taxation of maintenance and covenant payments, other than covenants to charity which are untouched. The present arrangements are complex and involve unnecessary work for both taxpayers and the Revenue.

37. Most maintenance payments are made by divorced men to their ex-wives or children. At present the Inland Revenue taxes the recipients, and returns the money to donors in tax relief. The Chancellor proposes instead that future recipients should be freed from tax on their maintenance. Donors will still be able to enjoy tax relief on payments to separated or divorced wives, but only up to a limit, [~~defined as~~] set equal to the difference between the married allowance and the single allowance. In 1988-89 this will be £1,490. Existing arrangements will be protected, and existing recipients will be freed from tax on the first £1,490 of their maintenance.

38. For [~~In the case of~~] covenants between individuals, the Chancellor is again making the income tax free in the hands of recipients. Tax relief for donors is being abolished. The largest single group affected will be students and their parents: covenants have simply become a convoluted way of getting State support into the hands of students, in a way that shelters the parents' income from tax. There will be a broadly compensating reduction in the parental contribution to student grants at mandatory rates.

Charities

39. As well as leaving tax relief on covenants to charity unchanged, the Chancellor is doubling the amount which people can give to charities free of tax under the payroll-giving scheme.

Independent taxation

40. The Chancellor is announcing in the Budget that a major reform of the taxation of married couples will take effect in 1990, the earliest practicable date. The present system, which dates back 180

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

years, taxes the income of a married woman as if it belonged to her husband. ~~This~~ it can also lead to a tax penalty on marriage, ~~where~~ with married couples ~~pay~~ paying more tax simply because they are married. ~~It also~~ ~~This~~ This denies privacy and independence to married women.

41. Under the new system a husband and wife will be taxed independently, on all their income. Married women will pay their own tax on their own income, and be responsible for their own tax return if one is necessary. All tax payers, male or female, married or single, will be entitled to the same personal allowance.

42. The tax system will continue to recognise marriage. Married couples will get a married couple's allowance equal in value to the difference under the present system between the single allowance and the married man's allowance.

Tax penalties on marriage

43. The new system will remove a number of the tax penalties on marriage. The most common penalty, the taxation of a married woman's savings income at her husband's ~~tax~~ marginal rate, will disappear altogether; and husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each instead of one between them. Transfers of capital between husband and wife will continue to be free of tax.

44. The Chancellor is abolishing two other tax penalties on marriage, ahead of Independent Taxation. First, ~~mortgage interest relief.~~ Under the present system of mortgage interest relief an unmarried couple can get twice as much relief ~~(on loans up to £60,000)~~ as a married couple ~~(limited to £30,000)~~. From August 1988 the limit of £30,000 will be applied to the house or flat, so that married and unmarried couples will get the same amount of relief. Existing borrowers will not be affected

45. The second penalty arises because an unmarried couple with children can each claim an Additional Personal Allowance, giving them more tax relief than a married couple in the same position. In future unmarried couples will be entitled to only one Additional Personal Allowance.

BUDGET SECRET
B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET B.L.O. SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

46. Thus the Chancellor is abolishing, for all practical purposes, all the tax penalties which, under the present system, can arise on marriage.

BUDGET SECRET

Summary

(typed version towards top of string)

The Budget continues the economic policies which have brought about the renewed strength of the British economy. It introduces major reforms of personal taxation, including completely new arrangements for taxing husbands and wives which will give married women privacy and independence in their tax affairs for the first time; an end to the taxation of inflationary gains; and the elimination of all personal tax rates of over 40 per cent. The Chancellor has reduced the basic rate of income tax to 25 per cent, and set a new target of 20 per cent. And he has achieved a balanced Budget.

BUDGET SECRET
B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

B2:21ph

BUDGET SECRET - BUDGET LIST ONLY

COPY NO. 2 of 51.

FROM: S J PICKFORD
DATE: 8 MARCH 1988

CHANCELLOR OF THE EXCHEQUER

cc As on attached list

1988 BUDGET BRIEF: DRAFT

I attach a full draft of the Budget Brief.

2. As last year the briefing has been produced in two parts. The main brief attached covers only the major Budget elements. We have also produced background briefing on the economy and the smaller Budget measures which we are distributing more selectively to those who need the detail.

3. We have tried to include the most positive points (and to cover all the most difficult questions) in the summary briefs A1 (Economic Strategy) and A2 (Tax Strategy). You will therefore want to look at those in detail. In particular you may have comments on the way we have treated:

(i) the Budget arithmetic. At the moment we are following last year's presentation of 'how the sums add up' and the hat-trick. This shows £4 billion tax cuts, £2½ billion increased public spending, and £7 billion lower PSBR.

(ii) why no more money for health. Defensive (i) in A1 suggests a summary line.

(iii) public expenditure. Difficult questions arise from the underspend in 1987-88, downward revisions to debt interest, and revisions to the GDP deflator and money GDP.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

(iv) the PSBR path, in particular the assumption of a zero PSBR in later years, following two years of surplus.

4. Of the other briefs, we suggest you may like to concentrate on:

B1 Industry Act forecast on the UK economy
C1 MTFS: strategy
C3 Fiscal policy
C4 Fiscal projection
C5 PSBR: 1987-88 and 1988-89
C6 Public expenditure
D1 Income Tax: rates and allowances
D2 Independent Taxation

although you may well want to glance at others.

5. We are sending out a first draft of the supplementary brief tomorrow. Ministers' offices may find this useful as they consider the presentation of different aspects of the Budget. Whenever possible, historical details have already been provided in the pre-Budget brief, of which all Ministers' offices have a copy, and there is more material, of course, in the Treasury Weekly Brief.

6. The briefs will have various gaps and square brackets, and many of the numbers are still subject to change. Also we may not yet have achieved full consistency between the various briefs. But we aim to rectify these in the next day or so.

7. Strategic briefs will, of course, need to reflect your further work on the speech. But we should also be grateful for any amendments from you and others by Friday lunchtime.

Stephen Pickford

S J PICKFORD

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET
SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

DISTRIBUTION LIST FOR SECOND ~~AND THIRD~~ DRAFT BUDGET BRIEF: MAIN

BUDGET SECRET

py No	Job title and number of copies where more than one		Official address	Name of present incumbent
1-3	Chancellor (3 copies)		14/2	
4-5	Chief Secretary (2 copies)		36A/2	
6-7	Financial Secretary (2 copies)		42/2	
8-9	Economic Secretary (2 copies)		52/2	
10-11	Paymaster General (2 copies)		48/2	
12	Permanent Secretary		78A/2	Sir P Middleton
13	Second Permanent Secretary	Public Services	120/2	Mr Anson
14	Second Permanent Secretary	Overseas Finance Sector	113/2	Sir G Littler
15	Second Permanent Secretary	Civil Service Management and pay	77/2	Dame A Mueller (only sections that is not BLO)
16	Chief Economic Adviser		119/2	Sir T Burns
17	Deputy Secretary	Public Finance	87/2	Mr Scholar
18	Deputy Secretary	Industry	46/2	Mr Monck
19	Under Secretary	FP	90/1	Mr Culpin
20	Under Secretary	EA	39/3	Mr Sedgwick
21	Under Secretary	MP	45/2	Mr Odling-Smee Turnbull
22	Assistant Secretary	FP	89/1	Miss Sinclair
23	Head of Division	IDT	93/2	Mr R I G Allen
24	Senior Economic Adviser	MP1	91/3	Mr S J Davies
25	Assistant Secretary	EB	97/2	Mr Pickford
26	Senior Economic Adviser	ETS	118/1	Mr C J Riley
27	Assistant Secretary	PSF	111/4	Mr Mowl
28	Economic Adviser	EB	98/2	Mr Patterson
29	Principal	EB	99/2	Miss Simpson
30	Principal	FP	44/1	Miss C E Evans
31	Principal	FP	93/1	Miss Hay
32	Principal	FP	93/1	Mr Michie
	~~Economic Adviser~~	~~ETS~~	~~116/1~~	~~Ms A Munro~~ Curwen
34	Senior Information Officer	IDT	89/2	Mr R K C Evans
35	EO	EB	99/2	Ms Hooson
36	AO	EB	99/2	Mrs Henson
37	Special Adviser		17/2	Mr Cropper
38	Special Adviser		15A/2	Mr Tyrie
39	Special Adviser		117/2	Mr Call

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

0-45 Principal CD2 Division (6 copies)	Inland Revenue	Rm 42 New Wing Somerset House, Strand	Mr A J Walker
46 Permanent Secretary	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Mr B Unwin
47 Deputy Chairman & Director-General Internal Taxation Group	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Mr Knox
48 Assistant Secretary Departmental Planning Unit	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Mr P R H Allen
49 Principal Branch 1 Dept Planning Unit	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Ms A French

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET B.L.O. SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

ph:86

A STRATEGY AND KEY ISSUES

A1 Economic Strategy
A2 Tax Strategy
A3 Summary of main points

B ECONOMIC BACKGROUND

B1 Industry Act forecast of UK economy

C MONETARY AND FISCAL POLICY

C1 MTFS: strategy
C2 Monetary policy and funding
C3 Fiscal policy
C4 Fiscal projections
C5 PSBR: 1987-88 and 1988-89
C6 Public expenditure

D TAXES ON PERSONAL INCOME

D1 Income tax: rates and allowances
D2 Independent taxation
D3 Mortgages
D4 Maintenance and covenants
D5 Benefits in kind
D6 Forestry
D7 Effects of tax, National Insurance Contribution changes on Social Security reforms on living standards

E CAPITAL TAXES

E1 Capital Gains Tax
E2 Inheritance tax
E3 Unit trust and capital duty

F BUDGET AND BUSINESS

F1 Effects of Budget on business

G TAXES ON SPENDING

G1 Excise duties
G2 VAT and car tax: main points

BUDGET SECRET
B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

B2:21ph

BUDGET

BUDGET SECRET - BUDGET LIST ONLY

COPY NO. 1 of 51.

A number of points!
M

FROM: S J PICKFORD
DATE: 8 MARCH 1988

CHANCELLOR OF THE EXCHEQUER

cc As on attached list

CX
For tonight I've only got through A1 & A2 attached - will let you have rest tomorrow. Small meeting with Stephen, Robert, Andrew, Richard?
AA

SECRET

1988 BUDGET BRIEF: DRAFT

I attach a full draft of the Budget Brief.

2. As last year the briefing has been produced in two parts. The main brief attached covers only the major Budget elements. We have also produced background briefing on the economy and the smaller Budget measures which we are distributing more selectively to those who need the detail.

3. We have tried to include the most positive points (and to cover all the most difficult questions) in the summary briefs A1 (Economic Strategy) and A2 (Tax Strategy). You will therefore want to look at those in detail. In particular you may have comments on the way we have treated:

B.L.O.

(i) the Budget arithmetic. At the moment we are following last year's presentation of 'how the sums add up' and the hat-trick. This shows £4 billion tax cuts, £2½ billion increased public spending, and £7 billion lower PSBR.

You've got Tyrie note etc

(ii) why no more money for health. Defensive (i) in A1 suggests a summary line.

(iii) public expenditure. Difficult questions arise from the underspend in 1987-88, downward revisions to debt interest, and revisions to the GDP deflator and money GDP.

SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET
SECRET
B.L.O.
SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

~~BUDGET SECRET - BUDGET LIST~~ ONLY

this is not v diff.

(iv) the PSBR path, in particular the assumption of a zero PSBR in later years, following two years of surplus.

4. Of the other briefs, we suggest you may like to concentrate on:

B1	Industry Act forecast on the UK economy
C1	MTFS: strategy
C3	Fiscal policy
C4	Fiscal projection
C5	PSBR: 1987-88 and 1988-89
C6	Public expenditure
D1	Income Tax: rates and allowances
D2	Independent Taxation

although you may well want to glance at others.

5. We are sending out a first draft of the supplementary brief tomorrow. Ministers' offices may find this useful as they consider the presentation of different aspects of the Budget. Whenever possible, historical details have already been provided in the pre-Budget brief, of which all Ministers' offices have a copy, and there is more material, of course, in the Treasury Weekly Brief.

6. The briefs will have various gaps and square brackets, and many of the numbers are still subject to change. Also we may not yet have achieved full consistency between the various briefs. But we aim to rectify these in the next day or so.

7. Strategic briefs will, of course, need to reflect your further work on the speech. But we should also be grateful for any amendments from you and others by Friday lunchtime.

Stephen Pickford

S J PICKFORD

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

DISTRIBUTION LIST FOR ~~SECOND AND THIRD~~ DRAFT BUDGET BRIEF: MAIN

py No	Job title and number of copies where more than one		Official address	Name of present incumbent
1-3	Chancellor (3 copies)		14/2	
4-5	Chief Secretary (2 copies)		36A/2	
6-7	Financial Secretary (2 copies)		42/2	
8-9	Economic Secretary (2 copies)		52/2	
10-11	Paymaster General (2 copies)		48/2	
12	Permanent Secretary		78A/2	Sir P Middleton
13	Second Permanent Secretary	Public Services	120/2	Mr Anson
14	Second Permanent Secretary	Overseas Finance Sector	113/2	Sir G Littler
15	Second Permanent Secretary	Civil Service Management and pay	77/2	Dame A Mueller (only sections that is not BLO.)
16	Chief Economic Adviser		119/2	Sir T Burns
17	Deputy Secretary	Public Finance	87/2	Mr Scholar
18	Deputy Secretary	Industry	46/2	Mr Monck
19	Under Secretary	FP	90/1	Mr Culpin
20	Under Secretary	EA	39/3	Mr Sedgwick
21	Under Secretary	MP	45/2	Mr Odling-Smee Turnbull
22	Assistant Secretary	FP	89/1	Miss Sinclair
23	Head of Division	IDT	93/2	Mr R I G Allen
24	Senior Economic Adviser	MP1	91/3	Mr S J Davies
25	Assistant Secretary	EB	97/2	Mr Pickford
26	Senior Economic Adviser	ETS	118/1	Mr C J Riley
27	Assistant Secretary	PSF	111/4	Mr Mowl
28	Economic Adviser	EB	98/2	Mr Patterson
29	Principal	EB	99/2	Miss Simpson
30	Principal	FP	44/1	Miss C E Evans
31	Principal	FP	93/1	Miss Hay
32	Principal	FP	93/1	Mr Michie
	~~Economic Adviser~~	~~ETS~~	~~116/1~~	~~Ms A Munro~~ Curwen
34	Senior Information Officer	IDT	89/2	Mr R K C Evans
35	EO	EB	99/2	Ms Hooson
36	AO	EB	99/2	Mrs Henson
37	Special Adviser		17/2	Mr Cropper
38	Special Adviser		15A/2	Mr Tyrie
39	Special Adviser		117/2	Mr Call

BUDGET SECRET

B.L.O.

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

40-45 Principal CD2 Division (6 copies)	Inland Revenue	Rm 42 New Wing Somerset House, Strand	Mr A J Walker
46 Permanent Secretary	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Mr B Unwin
47 Deputy Chairman & Director-General Internal Taxation Group	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Mr Knox
48 Assistant Secretary Departmental Planning Unit	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Mr P R H Allen
49 Principal Branch 1 Dept Planning Unit	Customs & Excise	New King's Beam House, 22 Upper Ground London SE1	Ms A French

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

ph:86

BUDGET

A STRATEGY AND KEY ISSUES

A1 Economic Strategy
A2 Tax Strategy
A3 Summary of main points

B ECONOMIC BACKGROUND

B1 Industry Act forecast of UK economy

C MONETARY AND FISCAL POLICY

C1 MTFS: strategy
C2 Monetary policy and funding
C3 Fiscal policy
C4 Fiscal projections
C5 PSBR: 1987-88 and 1988-89
C6 Public expenditure

SECRET

D TAXES ON PERSONAL INCOME

D1 Income tax: rates and allowances
D2 Independent taxation
D3 Mortgages
D4 Maintenance and covenants
D5 Benefits in kind
D6 Forestry
D7 Effects of tax, National Insurance Contribution changes on Social Security reforms on living standards

B.L.O.

E CAPITAL TAXES

E1 Capital Gains Tax
E2 Inheritance tax
E3 Unit trust and capital duty

F BUDGET AND BUSINESS

F1 Effects of Budget on business

SECRET

G TAXES ON SPENDING

G1 Excise duties
G2 VAT and car tax: main points

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDG

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

A1

A1

A1 ECONOMIC STRATEGY

Factual

(i) Objective of Government's economic policy unchanged.

- to defeat inflation
- to maintain vigorous, enterprising economy which will continue to generate steady, sustained growth and increased employment.

(ii) 1988 Budget consolidates and builds on progress to date.

- More than Achieves balanced budget and announces negative PSBR, ~~repayment~~ of £3 billion, for 1988-89; same as expected outturn for 1987-88. ~~which was £7 billion lower than forecast in 1987 MTFS.~~

i.e. budget surplus,

- Monetary and fiscal policies set to reduce growth of money GDP over medium term and so bring down inflation further.
- major reform of personal taxation with Proposes overall cut in taxes of £4 billion in 1988-89 (compared with indexed base). Basic and higher rates of income tax cut, allowances and basic rate limit increased, plus ~~tax reform package.~~ Encourages enterprise, efficiency and flexibility, ~~improving prospects for output and jobs.~~

~~this implies IT cuts not tax reform.~~

(iii) Further balanced growth forecast:

- 3 per cent growth in 1988 (3½ per cent non-oil), close to average rate of growth between 1981 and 1987, but significantly lower than 4½ per cent growth in 1987.
- Good prospects for further fall in unemployment.
- Current account deficit of ~~only~~ [¾] [?] per cent of GDP, in 1988. ~~same as forecast in Autumn Statement~~

£4 billion, or 1 on Man!

- Inflation by end 1988 close to 4 per cent, and set to stay low.

re-do in light of FSBR Ch2 (v. imp)

(iv) Government sticking to firm monetary policy based on continuous and comprehensive assessment of monetary conditions:

- particular importance attached to ~~stable exchange rate~~ exchange rate stability, notably against deutschemark;
- target range for MO of 1-5 per cent for 1988-89 (as in 1987 MTFS);
- continue to take account of broad money ~~and~~ or liquidity.

(vii) Prudent fiscal stance to buttress monetary policy:

- balanced budget a valuable discipline for medium term;

WPU

BUDGET SECRET

BUDGET SECRET

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

BUDGET

- sound, consistent policies set up <u>virtuous circle</u>: lower borrowing and lower tax rates create room for private sector to expand, generating higher revenues and in turn allowing yet lower borrowing and tax rates;

- lower borrowing reduces <u>debt interest</u> burden, allowing more spending on programmes for given public spending total.

(viii) <u>How the sums add up for 1988-89</u>

SECRET

	£ billion
Higher estimate of general government receipts (<u>before</u> Budget package)	10 ½
<u>less</u> increase in general government expenditure (announced in Autumn Statement)	-2 ½
<u>plus</u> fiscal adjustment in 1987 MTFS	+3
Fiscal adjustment available pre-Budget	11
<u>less</u> Budget package	-4
Budget reduction in PSBR	7

<u>Positive</u>

(i) Government's policies of sound money and free markets bearing fruit. 1988 Budget setting <u>more favourable</u> than for very many years.

- about to enter eighth ~~completing seventh~~ successive year of growth; ~~averaging around 3 per cent a year~~ - longest period of ~~such growth since war~~; 1981-1987 ~~to~~ already steadiest growth, averaging 3 per cent a year, for half a century

- ~~fifth~~ year in which steady growth combined with low inflation;

about to enter sixth

- 1987 first year since 1964 when inflation lower than output growth;

- public finances sound and strong;

- unemployment falling fast.

Economic strength puts UK in best possible position to withstand any shocks.

SECRET

(ii) <u>International league:</u>

- UK output growth faster than any other major European country in 1980s, whereas bottom of league in 1960's and 1970s;

- and UK growth in 1987 faster than all these countries, plus US and Japan too;

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

- UK growth of manufacturing productivity since 1980 faster than all other major industrialised countries; whole economy productivity growth similar to Japan's and faster than all others;

- UK employment growth since 1983 greater than rest of EC combined

(iii) Government's past prudent policies now permit

- £4 billion package of tax cuts and reforms

- £2½ billion increase in public spending, making possible higher provision for priority areas

and

- £7 billion reduction in PSBR

Hat-trick repeated for second successive year.

economy

(iv) Outlook

- Growth sustainable and balanced in 1988 and beyond, with ~~consumption~~ growing at healthy rate and investment faster than 1987.

- Investment and manufacturing output to grow significantly faster than economy as whole.

- Growth of 3½ per cent in non-oil economy in 1988, thoroughly satisfactory performance achieved only once in whole of 1970s.

- Good prospects for further fall in unemployment.

- Inflation to remain low.

(v) Stable Government policies, low inflation, rapidly rising productivity and high profitability present British industry with outstanding opportunity.

(vi) Remains prime Government objective to keep inflation on underlying downward trend, with ultimate objective of price stability.

(vii) Government continues to attach highest priority to sound money. Domestic cost increases will not be accommodated by decline in exchange rate.

(viii) Budget surplus in 1987-88 reflects real growth of economy. Surplus not seen since beginning of 1950s, with single exception of 1969-70.

(ix) Budget surplus repeated in 1988-89 even after Budget tax cuts of £4 billion. Balanced budget projected throughout MTFS period.

SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

(x) Major package of tax reforms

(xi) Budget gives priority to reducing income tax. Sharpens incentives, and leaves people free to spend or save more of their own money. Lower tax economies work better than higher tax economies.

(xii) Budget tax cuts increase real take home pay for family man with two children on average male earnings by almost £5 a week. Will have risen over [ ] per cent under this Government (1978-79 to 1988-89).

Defensive

(i) Spend more on health rather than cut taxes/reduce borrowing:

- Government already announced in Autumn Statement substantial increases in spending on health in 1988-89 and 1989-90, made possible by faster growth in economy (while still reducing total public spending as share of GDP.) Upward revisions to plans for NHS (England) in 1988 PEWP largest net cash increase ever.

- [Continued restraint in public expenditure in medium term vital to achieve balanced budget and lower tax rates. Lower taxation essential element in developing enterprise culture, which is far and away most successful way to create resources for better public services, as well as raising living standards generally.]

- Anyway, Budget is for decisions on taxation. Spending decisions already made in Autumn Statement, details published in PEWP in January. Will be reviewed in next public expenditure survey.

This is general PX point, not a health point

* I will want to work on this further, but await later version

(ii) Planning total underspent in 1987-88 - more money for NHS? Spending on health, education not below plans. Underspend because of faster economic growth (producing lower unemployment) and success of council house sale programme. ~~[illegible]~~ Reserve not fully spent

(iii) Faster inflation means public expenditure falling in real terms this year, even before taking account of RPE. Statistical revision to GDP deflator after the event does not change eg nurses' pay settlement last April. So does not cut resources already spent. Anyway unrealistic to plan expenditure in real/volume terms. Cash planning gives spending authorities stable base for their own plans.

(iv) GGE/GDP ratio falling faster - more scope for expenditure increases in next survey Reducing ratio is medium term aim. Planning totals will be reviewed in coming Survey in normal way. [But no presumption they will be changed - larger reserves incorporated within totals this year.]

(v) 1988-89 fiscal stance too tight? No. Domestic demand buoyant and money GDP growth strong (mainly higher real growth, but also higher inflation). Lower PSBR than in 1987 MTFS result in part of faster economic growth. In [three out of last four] years ~~some~~ much of scope for tax cuts used to cut borrowing - prudent policy.

Fall entirely due to lower ~~[illegible]~~ debt interest in real terms. No fall in planning total (excluding privatisation proceeds) in real terms.

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

In practice

BUDG

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

A1

Right to set balanced Budget as the norm {though there may be fluctuations around it}

(vi) Why go from £3 billion surplus next year to zero thereafter? 1988-89 PSBR a forecast based on Budget judgement, thereafter illustrative projections. Level for 1989-90 set in 1989 Budget, not before, in light of circumstances then. ~~But balanced budget the norm in medium-term.~~

(vii) No longer aiming at PSBR/GDP ratio of 1 per cent? Economic performance excellent. No apologies for balancing the budget, which ~~is appropriate norm in medium-term. Achieved already. [Consistent with 1987 MTFS which indicated 1 per cent was appropriate long run destination for policy.]~~ Balanced budget in any case equivalent, excluding privatisation proceeds, to PSBR/GDP ratio of 1%.

has good historical pedigree.

(viii) MTFS revised too often to remain credible element in strategy: Approach of MTFS vindicated by successful performance of economy.

(ix) Why reduce borrowing rather than cut tax burden? Government's policy of reducing public sector borrowing as proportion of GDP has brought steady, balanced growth, rising employment and low inflation at levels not seen for almost 20 years. Right to continue prudent fiscal stance - best guarantee for future that taxes will be cut further and that past reductions will not be reversed. Bigger tax cuts this year would ~~be irresponsible and~~ inconsistent with gradualist approach of MTFS.

~~Fractionally~~

(x) Tax burden still rising? Broadly stable. ~~Bigger tax cuts this year not prudent. Buoyant revenues reflect economic success of this Government - higher real earnings and profitability.~~ But with a strong & healthy economy a constant burden of taxation implies a reduction in tax rates.

(xi) Irresponsible to cut taxes when current account moving into deficit: No. Despite longer term commitment, Government has not reduced tax burden in 1988-89 because of overriding concern to maintain prudent fiscal stance. Cuts in tax rates produce supply-side benefits which improves trade performance in longer term. Should be no problem financing current account deficit ~~in short-term~~ given international confidence in UK and massive net overseas assets.

less than 1

(xii) Opposition fears of balance of payment crisis well founded. Emergence of temporary deficit unsurprising, given above trend growth in UK. But represents less than ½ per cent of GDP in 1987 and ~~only about~~ [¾] per cent in 1988, following cumulative current account surplus of £20 billion between 1979 and 1986. Deficit reflects fast growth of UK economy relative to ~~all~~ most other major economies~~; no reason to suppose will not decline as growth rates converge.~~

little over

Coupled with sharp ~~decline~~ fall in oil exports as production declines. A temporary phase.

(xiii) Growth forecast to slow down in 1988: Growth in 1987 above trend, thus not surprising some moderation in 1988. But still close to average rate since 1981, and growth of non-oil economy of 3½ per cent thoroughly healthy performance, achieved only once in whole of 1970s.

(xiv) Growth based on consumption boom: No. Forecast shows balanced growth with consumers' expenditure and fixed investment set to rise at similar rates in 1988.

(xv) Collapse in share prices worldwide means world recession: No sign of this happening and no reason why it should given pursuit of appropriate policies, within context of international cooperation.

WPU

BUDGET SECRET

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET

NOT TO BE COPIED

~~BUDGET SECRET - BUDGET LIST ONLY~~
~~until after Budget Speech on 15.3.88~~
then UNCLASSIFIED

BUDGET LIST ONLY

A1

BUDGET

(xvi) Budget does nothing to help unemployment. ~~No.~~ Stet

- Unemployment now on sharp downward trend thanks to Government's prudent management of nation's finances. Favourable economic climate enabling more than 1½ million new jobs to be created since 1983.

- Tax reform package carefully designed to sharpen incentives, encourage enterprise and so improve employment prospects throughout economy.

(xvii) Rising inflation demonstrates failure of MTFS: No. No sign of inflation rising. Under Labour Government, money GDP growth averaged 19 per cent a year but annual output growth only 2 per cent. Since 1983 money GDP growth averaged about [ ] per cent a year and annual output growth about 3 per cent. Government has no intention of relaxing grip on inflation. Remains committed to objective of stable prices.

Despite rapid growth.

Inflation in 1988 as a whole likely to be lower than in 1987.

(xviii) Inflation on upward trend: No. Small rise in retail price inflation between now and 1988Q4 reflects 1988 Budget proposals (ie increase in specific duties following non-revalorisation in 1987 and rise in mortgage interest component as result of tax rate reduction), ~~local authority rate increases~~ and need for real increases in nationalised industry prices in 1988 (following decline in real terms over past three years) to improve profitability and help finance increased investment. Short term fluctuations inescapable but remains Government's prime objective to keep inflation on underlying downward trend. ~~Inflation in~~

(xix) Stock market fall will sour future privatisation programme: Nonsense. Privatisation enormous success; swept world. Already 3 times as many shareholders as in 1979, and if anything number risen again over last year. Government committed to further privatisation and wider share ownership.

? add already in tag for 88-89

(xx) Budget for rich? No.

- Basic rate cut improves incentives - marginal rate for around 95 per cent of working age taxpayers.

- Double indexation of allowances also gives real benefit to lower-paid.

- Three-quarters of total cost of income tax reductions due to above 2 measures.

- ~~Some Budget measures~~ (eg forestry) specifically directed towards removing unjustified 'perks' for those on high incomes. Stet

- Absolutely right to improve incentives for entrepreneurs and managers who create wealth and jobs.

- Top 5 per cent of taxpayers pay [ ] more tax in real terms than in 1978-79, and higher share of total tax burden.

BUDGET SECRET

Contact point: S J Pickford (EB) 270 4549
P L Patterson (EB) 270 5207

WPU

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

B2:13ph

A2A

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

CONFUSING!

A2 TAX STRATEGY

A. OVERALL STRATEGY

Factual

(i) Tax reform integral part of Government's economic strategy. Increasing incentives and improving efficiency key to economic success.

(ii) Corporate tax system already radically reformed. Improved company sector performance - supply response, profitability, productivity - clearly shows benefits of reforms.

(iii) This Budget concentrates on reform of personal taxes.

Budget Reforms (for comprehensive list see Annex)

(i) Reducing tax rates and increasing allowances and basic rate limit encourages enterprise culture by improving incentives, and increases economic efficiency:

- basic rate cut by 2p to 25p;
- all higher rates above 40p abolished; leaving simple 2-rate structure (25/40)
- basic rate limit and main allowances increased by twice as much as indexation;
- small companies' corporation tax rate cut in line with basic rate;
- inheritance tax (IHT) structure simplified to single rate of 40p;
- capital gains tax (CGT) aligned with income tax; all inflationary gains removed from tax.

covenants & maintenance?

Reforms mean no personal tax rate above 40p.

(and tax breaks
looking continually at tax reliefs to see if still justified; as a result:

(ii) ~~Continuing process of reducing and removing unjustified tax breaks including:~~

- car scales doubled;
- forestry regime rationalised;
- home improvement loan relief removed;

BUDGET SECRET

B.L.O.

BUDGET

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

B2:13ph

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

- married couples restricted to one additional personal allowance;
- top slicing relief for redundancy payments etc abolished;
- implementation of further Keith Committee recommendations .

(iii) Removing injustices from tax system in particular giving fair ~~treatment~~ deal for married women:

- Independent Taxation introduced from 1990;
- tax penalties on marriage removed.

(iv) Making tax system simpler for taxpayers:

Do we want a simplification section? no harm

- income tax higher rates cut from 5 to 1;
- inheritance tax rates cut from 4 to 1;
- ? simpler system for maintenance and covenants;
- reform of capital gains tax, ~~especially rebasing to 1982;~~ with pre-1982 gains taken out of tax altogether
- Capital Duty abolished. Fifth (non-minor) tax abolished in last five Budgets.

Defensive

(i) Why do all changes benefit rich? All taxpayers benefit from higher allowances and lower basic rate. And specific action to remove unjustified tax breaks (forestry, cars) hits ~~rich~~ most. Absolutely right to improve incentives for entrepreneurs and managers who create wealth and jobs. Following cuts in higher rates in 1979, top 5 per cent of taxpayers now pay bigger share of tax burden. Other 95 per cent pay less in absolute terms.

better off

(ii) Why overall burden of tax/NICs still rising? ~~Not rising: constant~~ Remains Government's objective to reduce burden. But strong economy boosting tax revenues. Not prudent to cut taxes more than in Budget.

(iii) Why more taxpayers next year? Strength of economy and steady growth mean real earnings likely to rise, so despite real rise in allowances more people brought into tax.

(iv) Wasted opportunity for more radical reform? Nonsense. Achieved in this one Budget:

- ~~achieved~~ goal of 25p basic rate
- complete restructuring of taxation of husband and wife;
- complete reform of ~~taking~~ maintenance and covenants ~~out of the tax system;~~
- ~~rationalisation of higher income tax rates and IHT;~~ — major reform of higher rates
- radical reform ~~restructuring~~ of CGT and IHT

Most thorough overhaul of personal tax system ~~since [ ]~~ for many years.

(v) Why no tax measures for NHS? Review of whole financing of NHS currently in progress. Wrong to prejudge.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET
B.L.O. SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET

B2:15ph

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

also by twice indexation.

A2B

B. INCOME TAX

Factual

(i) Main allowances increased by twice as much as indexation. Basic rate limit increased.

(ii) Basic rate cut to 25p. All higher rates above 40p abolished.

(iii) Unjustified allowances and reliefs removed or reduced:

- forestry taken out of income or corporate tax altogether - will increase tax yields. Parallel increase in planting grants;

- car scales doubled; still leave benefit of company cars undertaxed;

- home improvement loan interest relief abolished on new loans from April 1988.

SECRET

(iv) Reform and simplification of tax regime for maintenance and covenants:

- maintenance payments under future court orders to be free of tax for divorced or separated wives; in future those making maintenance payments no longer qualify for tax relief, except up to limit of additional personal allowance for payments to separated or divorced spouses;

- transitional arrangements for existing agreements;

- new covenants (except to charities) taken out of tax altogether; existing covenants and covenants to charities unaffected;

- offsetting reduction in parental contribution to student grants.

B.L.O.

Positive

(i) Income tax reduced in each of last six Budgets - first time ever.

(ii) Lower marginal rates produce substantial supply-side benefits by increasing incentives and improving efficiency. Top 5 per cent now pay [ ] more tax in real terms than in 1978-79, and will contribute higher proportion of total income tax even after Budget package (up from 24 per cent in 1978-79 to [27] per cent in 1988-89). UK rates now amongst the ~~very~~ lowest in world.

(iii) Pledge of 25p basic rate redeemed. New aim to reduce it to 20p as soon as prudent to do so.

and stable

(iv) Allowances up [25] per cent in real terms since 1978-79. Married man's allowance highest in real terms since [before the war]. [ ] million taken out of tax altogether compared with indexed 1978-79 regime.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

(v) [Three-quarters] of cost of income tax package accounted for by raising allowances and cutting basic rate.

(vi) Married man on average earnings better off by nearly £5 a week.

(vii) Forestry regime could no longer be justified. ~~encouraged wrong people to plant wrong trees in wrong places.~~ Removing from tax closes tax shelter, simplifies tax system, increases revenue, improves environment, including more broad-leaved trees and fewer conifers.

(viii) Company cars massively under-taxed.

(ix) Mortgage interest relief to be focussed on main objective, encouraging house purchase. Home improvement loans little more than cheap consumer credit for double glazing etc. Also substantial scope for abuse.

overstated

(x) Maintenance changes ~~great~~ simplification; also help less well-off, improve incentives, and remove tax penalty on marriage.

(xi) Covenants changes remove unnecessary tax shelter, simplify tax system, and improve incentives. Charities unaffected, and most students protected.

Defensive

(i) Budget for the rich (See Section A).

potential

Environmental

(ii) Giving more to forestry in grants than taken away in taxes? [Net effect broadly neutral.] But changes give better balance: ~~more to farmers, less to pop stars;~~ more to broad-leaved trees, less for conifers; [more for small plantations on farms, less for forests in Flow Country].

(iii) Car scale changes hit British car industry? Little effect on industry. Anway car industry, like all others, better off with strong, low-tax economy rather than protected by special back-door subsidies. Last year car exports up by [ ] per cent and import penetration down.

(iv) Why not remove mortgage relief altogether, or restrict to basic rate? Government committed to keeping present system of mortgage tax relief. Right to encourage home ownership. Restricting relief to house purchase targets support better on this objective.

(v) Maintenance changes hit single parents, wives? Most divorced or separated wives better off under new system. Also simpler for them (no involvement with tax man), and because full personal allowance available against earnings removes disincentive to work.

(vi) Covenants only reformed in order to raise revenue? Tax shelter unnecessary now tax rates reduced.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET - BUDGET LIST ONLY
until after Budget Speech on 15.3.88
then UNCLASSIFIED

C INDEPENDENT TAXATION AND MARRIAGE

Factual

(i) Independent Taxation for husband and wife of all income (including investment income, capital gains) from April 1990.

(ii) Each taxpayer gets own personal allowance, and separate basic rate limit. In addition married couple's allowance.

(iii) Ending other tax penalties on marriage:

- mortgage interest relief restricted to residency from August 1988;
- unmarried couples with more than one child only get one additional personal allowance fom April 1989;
- individual CGT exempt allowances for husband and wife from April 1990.

Positive

(i) Reform gives real privacy and independence to married women for first time [since 1805].

(ii) New system continues to recognise marriage.

(iii) Independent Taxation will benefit in particular many married women who are elderly or on low incomes. [Figures]

(iv) New system in place by 1990, considerably sooner than many other possible reforms could have been.

(v) Ending of all tax penalties on marriage.

Defensive

(i) Why not abolish married man's allowance and increase child benefit. Right that tax system should recognise marriage, [which MST does not.] Also help for low income families better targetted by Family Credit/Income Support than higher child benefit.

(ii) Why not transferable allowances (as in Green Paper)? Broad consensus that something needed to be done about current outmoded system, and quickly. TAs could not be introduced until 1993, and then would have had to be phased; Independent Taxation in place by 1990.

(iii) Why not partially transferable allowances? Worst of all worlds. PTAs would take longer to implement and would not be as good.

(iv) Why give married allowance to rich couples who currently do not receive it? Natural consequence of Independent Taxation.

(v) Massive staff and revenue cost? Justified to give fair deal at last to married women.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

B2:16ph

BUDGET SECRET

BUDGET SECRET - BUDGET LIST ONLY
~~Until~~ after Budget Speech on 15.3.88
then UNCLASSIFIED

all fully indexed.

D CAPITAL TAXES

(i) Capital gains tax (CGT) rebased to 1982. Effect is to exempt all gains pre-1982 from tax. ~~Indexation remains for~~ post-1982 gains. ~~Brings to an end taxation of inflationary gains.~~

(ii) CGT exemption reduced to £5,000 (but from 1990 separate allowances for husband and wife).

(iii) Capital gains taxed as income, at marginal income tax rate.

(iv) CGT retirement relief increased (see Section E).

(v) Inheritance tax (IHT) threshold raised from £90,000 to £110,000. Number of rates cut from 4 to single rate at 40 per cent.

[(vi) Annual investment limit for Personal Equity Plans raised from £2,400 to £3,000.]

Positive

(i) CGT rebasing ends unjust taxation of inflationary paper gains, and unlocks assets.

(ii) Alignment of CGT with income tax makes tax system more neutral, reducing distortions and discouraging avoidance. Present system perverse - means basic rate taxpayers pay higher rate on gains than income, higher rate taxpayers vice versa.

(iii) IHT changes significant simplification with no taxpayer worse off, even compared with indexation of all thresholds. Higher threshold takes modest estates out of tax altogether (number of estates liable to tax reduced by one-quarter). For family businesses with 50% business relief effective rate of 20 per cent, one of lowest in industrialised world.

[(iv) PEPs already significant success - over ¼ million investors in 1987 invested total of nearly £½ billion. Higher limit gives further encouragement.]

Defensive

far bigger

(i) Why not get rid of CGT entirely (as you have effectively done pre-1982)? Right to tax real gains, otherwise simply creates incentive, purely for tax purposes, to switch income into capital gains. But no practicable way to extend indexation provisions pre-1982.

(ii) Raising tax burden on capital gains? Rebasing cuts tax liabilities. Small gains still exempt. But no reason to tax capital gains and income at different rates - a distortion, and encourages avoidance industry. Even new rates well below US rates [under most circumstances] because of indexation provision and exempt allowance.

(iii) Why indexation for capital gains when no indexation for income? Annual indexation of income tax allowances and basic rate limit effectively the same as taxing only real increases.

(iv) Raising burden of IHT? No losses under new system, and significant simplification.

BUDGET SECRET

BUDGET SECRET

A2D

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

B2:17ph

BUDGET SECRET - BUDGET LIST ONLY
until Budget Speech on 15.3.88
then UNCLASSIFIED

E SPENDING TAXES

Factual

(i) VAT rate unchanged, and no significant changes to coverage.

(ii) Duty for unleaded petrol unchanged.

(iii) VED held unchanged (apart from for largest juggernauts) by increasing petrol and derv duty slightly more than inflation.

(iv) Alcohol and tobacco duties generally revalorised, but some restructuring in favour of low alcohol drinks, pipe tobacco.

Positive

(i) Unleaded petrol should sell for no more than 2-star petrol. Considerable environmental benefits from positive encouragement for motorists to switch.

(ii) Encouragement for low alcohol drinks - 'coolers' and low alcohol beer.

(iii) Real duty on cigarettes maintained. Tax on cigarettes risen by over 50 per cent in real terms since 1979.

(iv) Very large and heavy vehicles, which cause substantial wear and tear on roads, will pay something closer to the costs they impose.

(v) Real burden on motorist largely unchanged by Budget measures.

Defensive

(i) Why no increase for spirits? Important not to harm whisky industry in Scotland when already facing severe international competition.

(ii) Why no more increase in cigarette duty? Real duty up over 50 per cent since 1979. Fell (by 7 per cent) in real terms between 1974 and 1979.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

B2:18ph

BUDGET SECRET - BUDGET LIST ONLY
until Budget Speech on 15.3.88
then UNCLASSIFIED

F BUSINESS TAXES

Factual

(i) Corporation tax (CT) rate unchanged at 35 per cent. Small companies' rate cut to 25 per cent, in line with basic rate.

(ii) Help for small businesses:

- BES ceiling of £½ million (£5 million for shipping);
- extending BES to companies letting residential property on assured tenancies also subject to £5 million ceiling;
- CGT retirement relief: half of gains between £125,000 and £500,000 free of CGT;
- VAT threshold raised to £22,100.

Is this a "small business" measure. Ch Sec!

A2F

(iii) Capital duty and unit trust instrument duty abolished.

(iv) Oil royalties abolished, (though separate legislation), PRT oil allowances cut for Southern Basin and onshore fields.

(v) Tax charges on building societies' incorporation removed.

(vi) Change to Lloyd's RIC charge, and simplified administrative arrangements.

[(vii) Business entertainment for overseas customers no longer tax-deductible.]

(viii) Section 482 (company migration provision) abolished. In its place new residence test - companies deemed to be resident if incorporated, or centrally managed and controlled, in the UK. Companies resident will be able to migrate, on payment of tax liabilities (including accrued CGT liability).

(ix) Importers' disclosure.

Positive

(i) CT regime unchanged. Gives stability for companies. Main CT rates lowest of any major European country. Benefits of 1984 reform evident from greatly improved profitability and performance of company sector.

(ii) Abolishing capital duty reduces burden on companies, and ends discrimination against risk capital.

(iii) Additional valuable supply-side measures: help for assured tenancy sector will encourage labour mobility; disclosure of importers' details improves information; change to oil regime will encourage oil and gas [exploration].

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET
BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

B2:18ph

BUDGET SECRET - BUDGET LIST ONLY
until Budget Speech on 15.3.88
then UNCLASSIFIED

(iv) Further help for small businesses.

(v) VAT threshold raised to maximum permitted by EC.

(vi) Section 482 changes introduce simple and objective test of residence, in place of Treasury discretion. Ends criminal penalties. Right that companies should not be able to avoid tax liabilities by emigration.

(vii) Useful minor simplification and tidying up of tax system.

~~Burden ...~~

Defensive

odd answer!!

(i) Tax burden on company sector increasing? ~~Not true. Since early 1980 taxes on companies fallen as a proportion of total taxes. Now lower than in all major countries except [ ].~~

(ii) BES limit will restrict finance for small companies. Larger companies already have access to thriving venture capital sector. Limits will target BES more effectively on smaller,newer and riskier companies (especially outside the South-East) who generally do not have access to venture capital or other sources of finance.

(iii) BES for assured tenancies gives tax relief to property speculators? Assured tenancy scheme valuable supply-side measure. Will help people to move to where new jobs are. Right to give special incentive to encourage process in early years.

(iv) Importers' disclosure [and business entertainment clampdown] will worsen trade deficit? No. Importers' disclosure provides good opportunity for UK firms to find new markets. [Business entertainment changes simply remove anomaly.]

Contact point: S J Pickford (EB) 270 4549
Miss J Simpson (EB) 270 5211

greatly improved profitability etc.

Companies in industry pay more tax ~~on~~ profits following sharp and welcome improvement in profitability. Receipts of the tax still well up. And companies pay a smaller share of GDP in tax than in most other industrial countries.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

B2:20ph

BUDGET SECRET - BUDGET LIST ONLY
until Budget Speech on 15.3.88
then UNCLASSIFIED

A2

ANNEX

1988 BUDGET TAX REFORMS

SECRET

Independent Taxation for husband and wife (D2)

Restructuring of income tax higher rates (D1)

Reform of the system for maintenance and covenants (D4)

Mortgage interest relief for house purchase loans on residence basis (D3)

Home improvement loans no longer qualify for interest relief (D3)

Capital gains tax radically reformed:

- rebased to 1982, so no pre-1982 gains liable to CGT;
- retirement relief significantly expanded (E1)

Inheritance tax sunstantially simplified - rates cut from 4 to 1 (E2)

B.L.O.

Minor reforms and simplification

- minor personal allowances abolished (DD3)
- changes to Lloyd's RIC, and administration of tax regime for Lloyd's simplified (FF8)
- top slicing relief simplified for redundancy payments and leases (DD5 and FF10).

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET - BUDGET LIST ONLY

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

COPY NO. / of 24.

FROM: R I G ALLEN
DATE: 8 MARCH 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Monck
Mr Odling-Smee
Mr Sedgwick
Mr Culpin
Mr Turnbull
Mr Peretz
Miss C Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

PS/IR
Mr P R H Allen - C&E

SECRET

B.L.O.

Ch
This arrived last night with a page missing - hence delay. Richard may mention @ [illegible] - but comments can wait.

BUDGET IN BRIEF

I attach a draft: tables to follow.

2. The draft may need some further work, and a little pruning to fit into the four page format. We need to deliver copy to the printers by 4.00pm on Thursday, so it would be helpful to have comments by first thing on Thursday morning.

SECRET

[signature]

R I G ALLEN

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET: BUDGET LIST ONLY

BUDGET SECRET

THE BUDGET IN BRIEF

The UK economy is now entering its sixth successive year of steady growth combined with low inflation. Unemployment is falling fast. These successes are the result of sound monetary and fiscal policies, coupled with reforms to make the economy work better. The Budget builds on these policies.

The Main Features

Chancellor announced:

2. The [Budget]:

- a balanced Budget

- [introduces] substantial further tax reforms;

- [leaves] no personal tax rate higher than 40 per cent;

- [maintains a Budget surplus;]

the reduction or elimination of

- [removes] some unjustified tax breaks; [and]

- [will help improve economic performance.]

3. The main tax changes include:

B.L.O. SECRET

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET

- a 7½ per cent increase in personal allowances and the basic rate limit;

2p

- a reduction in the basic rate of income tax to 25p;

- abolition of all higher rates of income tax above 40p;

- a new system of independent taxation for husbands and wives;

- a major simplification of the tax treatment of covenants and maintenance payments.

- a 40 per cent flat rate of Inheritance Tax; and

- a major reform of Capital Gains Tax.

The Economic Background

steadily

4. Since 1981, total national output has risen at an average annual rate of about 3 per cent, a year. with little variation from year to year. At the same time, inflation has been brought down and remains low (see chart 1). Over the 1980s, the UK has grown faster than any other major country in the European Community (see table 1). This is in sharp contrast to the 1960s and 1970s, when Britain was bottom of the European growth league. Living standards have been rising strongly: a the married man with two children on average male earnings is better off by over 20 per cent since 1979 (see chart 2).

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

5. The economy is weathering the storm of the world-wide collapse in equity markets in October 1987, just as it coped successfully with the coal strike (1984-85) and the collapse in world oil prices (1985-86). In 1987 the economy built on the strong and steady performance of previous years. Total output is estimated to have risen by some [4-4½] per cent last year, the best performance since 1973. For the first time in a generation, real growth slightly exceeded the rate of price inflation. Employment continued to rise strongly and unemployment fell by half-a-million - the biggest fall since the war. Both export and import volumes grew rapidly with the current account of the balance of payments in deficit by [£1½] billion.

6. The strength of the economy has been reflected in rising tax receipts and strong public sector finances. In 1987-88, the expected the budget surplus is expected to be in is around by £[3] billion, only the second surplus since the early 1950s. For 1988-89 the coming year, the Chancellor has been able to both plan for a further budget surplus of £3 billion and to reduce taxes. In later years, the objective is to maintain a balanced budget which should allow for further reductions in taxation.

The Medium Term Financial Strategy

7. The Medium Term Financial Strategy (MTFS) will continues to provide the framework for the Government's economic policy, as it has done since 1980. The Budget includes a revised MTFS, the main features of the MTFS which are summarised in tables 2 and 3.

8. The main points are:

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

- 5 The broad aim of policy will be steadily to reduce, over the medium term, the growth of total spending power in the economy, as measured by the cash value of our national output (money GDP);

- 3 [particular importance is attached to maintaining a stable exchange rate, notably the rate against the deutschemark];

Reorder

- 4 broader measures of money supply, [particularly M4], and liquidity will continue to be taken into account in assessing monetary conditions;

SECRET

- 1 the Government will aim to keep the growth of narrow money, as measured by M0, within the range 1-5 per cent in 1988-89, as indicated in last year's Budget;

B.L.O.

- 2 short term interest rates will continue to be held at the levels needed to keep downward pressure on inflation;

already covered

- [the Chancellor has planned for a budget surplus of £3 billion in 1988-89;]

- the MTFS projects a balanced budget in 1989-90 and subsequent years.

SECRET

The Economic Forecast

9. Despite continuing uncertainties in the world economy, the UK economy is expected to grow by a further 3 per cent in 1988.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

Excluding the North Sea oil sector, growth will be faster - about 3½ per cent. Consumer spending is likely to grow a little more slowly than in 1987, but investment should grow faster. Inflation is forecast to remain low, at around 4 per cent, and there are good prospects for a further fall in unemployment. The balance of payments current account is likely to continue in small deficit, equivalent to [½-¾] abt 3/4 per cent of GDP.

10. The forecast is summarised in table 4 below.

Tax Measures

11. In addition to setting a budget surplus of £3 billion in 1988-89, the Chancellor has been able to reduce taxes by about £4 billion. As a proportion of national output total taxes and National Insurance contributions will remain broadly unchanged between this year and next. Table 5 summarises and costs the Budget measures.

Income Tax: Rates and Allowances

12. The Government believe that incentives for enterprise and effort should be improved and people should be left free to spend or save more of their own money - lower tax economies work better than higher tax economies. The Budget therefore gives priority to reducing income tax.

13. The main changes are:

- a 7½ per cent increase in the main personal allowances, double the inflation rate;

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

- a reduction in the basic rate of income tax to 25 per cent, in line with the Government's pledge; and

- a single higher tax rate of 40 per cent [for taxable incomes over £19,300].

14. These changes will benefit all 25 million income tax payers. They will:

- increase the tax free allowance for practically everyone;

- bring down the marginal rate for the vast majority of taxpayers;

- be worth about £5 per week extra for a married man on average earnings;

- create a simple, two rate tax system with a top rate among the [very] lowest in the world, as our corporation tax rates already are.

15. The Chancellor also announced new goal: that the basic rate of income tax should be reduced to 20p in the £ as soon as is prudent.

16. Table 6 summarises the main changes.

Independent Taxation — Worth a separate box?

17. The present system for taxing married couples goes back 180 years. It taxes a married woman's income as if it belonged to her husband. This is no longer acceptable.

BUDGET SECRET
B.L.O.
BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET

18. The Chancellor therefore announced a completely new system for taxing married couples, providing:

- independent taxation for husbands and wives;

- complete privacy and independence for married women in their tax affairs; and

- an end to the tax penalties on marriage.

SECRET

some tax penalties ended before then

19. The new system will be introduced at the earliest practicable date, April 1990.

20. Under the new system, a husband and wife will be taxed independently, on all of their income. All taxpayers, male or female, married or single, will be entitled to the same personal allowance, which will be available against income of all kinds, whether from earnings or savings.

B.L.O.

21. In addition, there will be a married couple's allowance, equal to the difference under the old system between the married man's allowance and the single allowance. This will go in the first instance to the husband, but he will be able to transfer any unused portion to his wife.

22. Husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each, instead of one between them, as now. Transfers of capital between husband and wife will continue to be entirely free of to tax.

SECRET

23. Two further tax penalties on marriage will be abolished:

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET
SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET

- for new mortgages, after 1 August 1988, the £30,000 limit on mortgage interest relief will be related to the house or flat concerned, irrespective of the number of borrowers: an unmarried couple will no longer be able to get twice as much relief as a married couple;

- from April 1989, unmarried couples will be entitled to only one Additional Personal Allowance; this will stop them getting more generous [giving them the same relief as] than a married couple.

Income Tax: Other Changes

24. The Chancellor announced a number of proposals to tighten the existing system of allowances and reliefs, and to remove some unjustifiable tax breaks. [These include:]

- the scales for company cars will be doubled;

- forestry will be taken out of the tax system entirely, but there will be a parallel increase in planting grants. [This will end an increasingly blatant form of tax avoidance and enable the Government to secure its forestry objectives with a proper regard for the environment;]

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

- tax relief on all new home improvement loans will be ended. This will concentrate relief where it is intended, on the purchase of a house or flat.

Covenants and maintenance

25. The tax system for covenants and maintenance payments is very complicated and produces a host of anomalies. The Chancellor announced a major reform.

26. For all new non-charitable covenants, those receiving the payments will not be liable to tax on them and those making the payments will get no tax relief on them. The largest group of people affected will be parents of students, and there will be compensatory adjustments in parental contributions to the maintenance grant.

shortening

[27. The reform will remove a wholly unneccessary complication from the tax system while retaining the same overall levels of support for students.]

28. For new maintenance arrangements, separated or divorced spouses receiving maintenance payments will not have to pay any tax whatever on them. Those making these payments[, however,] will get tax relief only for payments to a separated or divorced spouse, up to a limit equal to the difference between the married allowance and the single allowance. [There will no longer be tax relief at all for maintenance payments other than to separated or divorced spouses.]

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Business Taxation

29. The structure and main rates of Corporation Tax will be unchanged. The system established by the 1984 reforms is a crucial part of an environment in which company profitability has recovered to its highest level for some 20 years. Companies will benefit substantially from the rebasing of capital gains to 1982 (see below).

30. The small companies' rate of Corporation Tax will be cut to 25 per cent in line with the basic rate of income tax.

31. The Chancellor announced three proposals benefitting businesses in particular sectors:

- changes in the North Sea oil regime which will abolish royalties on all future fields and relate future tax liability more closely to profitability;

associate these two

- changes to remove the existing tax penalty on building societies wishing to convert into companies;

- improvements in the tax arrangements for Lloyds.

32. The Budget also includes measures to:

- change the definition of company residence in the UK and to simplify the arrangements for companies wishing to migrate overseas;

and a range of measures to encourage small and new business including:

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

- better targetting of the Business Expansion Scheme (BES) and an extension of BES to companies specialising in the letting residential property for assured tenancies;

- an extension of Capital Gains Tax retirement relief;

- an increase in the VAT threshold to £22,100, the maximum permitted under existing EC law;

- abolition of Capital Duty and the Unit Trust Instrument Duty.

not small business relief

BUDGET SECRET B.L.O. SECRET

Charities

33. The scheme for tax relief on donations to charity under payroll giving arrangements will be made more generous with a doubling of the limit on qualifying donations from £120 to £240 a year.

Taxes on Spending

34. There will be only one minor change in VAT: to clarify the legal definition of confectionery. Excise duties as a whole will be increased in line with inflation, but there will be some adjustment within the total. In particular, the duty on unleaded petrol remains unchanged, raising the tax differential in its favour to over 10p a gallon. Alcohol duties have been restructured in favour of low-alcohol drinks. These changes are shown in table 7 below.

Share Ownership

35. The Chancellor announced the results of a joint Treasury/Stock Exchange survey showing that, despite last year's stock market fall,

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

the number of shareholders had risen slightly to around 9 million. He announced two further proposals to encourage share ownership:

- a raising of the annual limit for Personal Equity Plans from £2,400 to £3,000;

- a relaxation of the rules relating to some employee share schemes..

Capital Gains Tax

36. The Chancellor announced a major reform consisting of three elements.

37. First, the base date for the tax will be brought forward from 1965 to 1982: thus, any capital gain arising before April 1982 will be exempt from tax altogether, for individuals and companies alike. This will:

- end once and for all the injustice of taxing inflationary gains;

- benefit the economy by unlocking assets which have been frozen because of the penal tax that would have arisen on resale; and

- help many small businessmen and farmers in particular.

38. Second, the annual exempt slice will be reduced to £5,000 for individuals and £2,500 for most trusts. This is because there is no longer a need to compensate taxpayers for non-indexation.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

39. Third, the taxation of gains will continue to benefit from existing indexation arrangements but will be brought closer to that of income. In future, real gains will be taxed at a taxpayers' marginal income tax rate.

Inheritance Tax

40. The Budget simplifies this tax still further by levying it at a flat rate of 40 per cent, compared to the current four rates. The threshold will be increased from £90,000 to £110,000, reducing the number of estates liable to tax by a quarter. For a family business, enjoying 50 per cent business relief, the effective rate of Inheritance Tax can now never exceed 20 per cent, one of the lowest rates in the industrialised world.

Summary

41. The budget reaffirms the prudent policies that have brought a long and continuing period of strong economic growth, combined with low inflation. The Budget has been balanced. Tax rates have been substantially reduced. And further major reforms have been introduced to improve incentives and strengthen the economy.

BUDGET SECRET
B.L.O. SECRET

BUDGET SECRET
B.L.O. SECRET

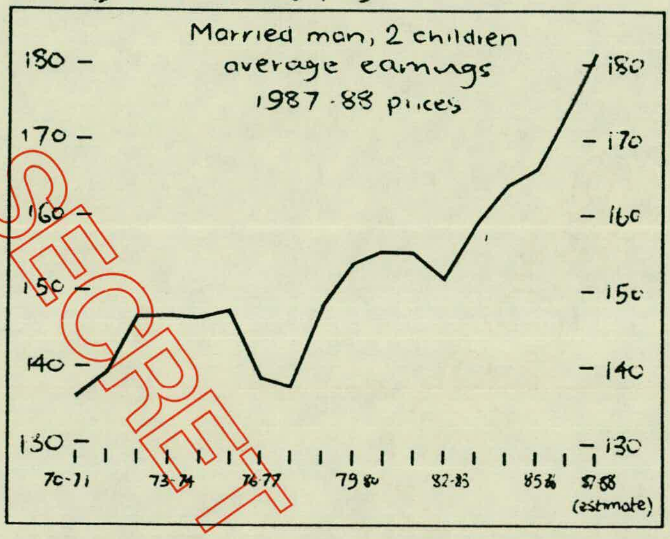
BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

Chart 2

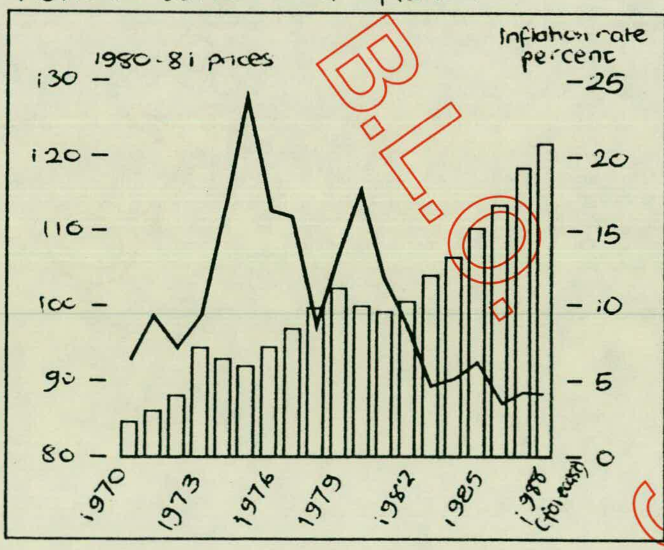
Weekly take home pay



SECRET

Chart 1

National output and inflation



B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

REF: RIGA/42

COPY NO 2 OF 25 COPIES

FROM: R I G ALLEN
DATE: 8 MARCH 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Anson
Mr Scholar
Mr Monck
Mr Odling-Smee
Mr Sedgwick
Mr Culpin
Mr Turnbull
Mr Peretz
Mr Pickford
Miss C Evans
Mr Hudson
Mr Cropper
Mr Tyrie
Mr Call

PS/IR
Mr P R H Allen - C&E

BUDGET IN BRIEF

Draft tables attached. Comments by first thing tomorrow please.

D. Crane

pp R I G ALLEN

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 1

EUROPEAN GROWTH LEAGUE

1960s	1970s	1980s
Italy	France	**UK**
France	Italy	Italy
Belgium	Netherlands	France
Netherlands	Belgium	West Germany
West Germany	West Germany	Netherlands
UK	**UK**	Belgium

Source: OECD

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Table 2

Money GDP, money supply and the PSBR

	87–88	**88–89**	**89–90**	**90–91**	**91–92**
Money GDP[1]	9¾	7½	6½	6	5½
Mo[2]	5	1-5	1-5	0-4	0-4
PSBR[3]	-3	-3	0	0	0
PSBR as % GDP	-¾	-¾	0	0	0

1 Percentage change on previous financial year. The figure for 1988-89 is a forecast; and in subsequent years describe the Government's broad medium term objectives.

2 1987-88: forecast. 1988-89: target range. 1989-90 onwards: illustrative ranges.

3 £ billion, cash.

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 3

Output and inflation assumptions

	87-88	88-89	89-90	90-91	91-92
	percentage change on previous financial years				
Real GDP					
Non-North Sea	5	3	3	3	3
Total	4½	2½	2½	2½	2½
Inflation					
GDP deflator	5	4½	4	3½	3

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

Table 4 = **Table 3.12 of FSBR**

minus first and final columns

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BNM7

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

Table 5

Budget Measures

(£ billion)	Estimated effect on receipts in **1988-89**	1989-90
Income tax		
changes in allowances	-675	-885
2p off basic rate	-2170	-2970
higher rate changes	-1080	-2300
Capital gains tax	+70	+265
Corporation tax	-380	-250
North Sea oil taxes	+25	+25
Inheritance tax	-100	-200
Stamp duties	-100	-125
VAT	+15	+15
Excise duties	+5	-5
Other changes	+390	+400
Total	-4000	-6270

SECRET

B.L.O.

Check numbers

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Table 6

Proposed changes in Personal Allowances and Rates

(1) Personal Allowances

	1987-88 £	1988-89 Proposed level £
Single person's allowance and wife's earned income allowance	2,425	2,605
Married man's allowance	3,795	4,095
Additional personal allowance and widow's bereavement allowance	1,370	1,490
Single age allowance (age 65-79)	2,960	3,180
Married age allowance (age 65-79)	4,675	5,035
Single age allowance (age 80 and over)	3,070	3,310
Married age allowance (age 80 and over)	4,845	5,205
Age allowance income limit	9,800	10,600

(The dependent relative allowance, the housekeeper's allowance, and the son's and daughter's services allowances are to be abolished.)

(2) Rates and Rate bands

Rate of tax per cent	1987-88 taxable income £	1988-89 proposed taxable income £
25	-	0-20,000
27	0-17,900	-
40	17,901-20,400	Over 20,000
45	20,401-25,400	-
50	25,401-33,300	-
55	33,301-41,200	-
60	Over 41,200	-

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Table 7

Proposed changes to Excise Duties

Product	Unit	Duty increase (per cent)	Price increase (pence)
Beer	Pint	4.7	1.0
Cider	Pint	9.7	1.0
Table wine	75cl	4.5	3.8
Sparkling wine	70cl	4.7	6.1
Sherry	70cl	nil	nil
Spirits	75cl	nil	nil
Cigarettes	20KS	3.7	3.4
Cigars	5 whiffs	3.7	1.9
Pipe tobacco	25 grams	nil	nil
Petrol (leaded)	Gallon	5.5	5.5
Petrol (unleaded)	Gallon	nil	nil
Derv	Gallon	5.5	4.7
VED (cars)	-	nil	nil
VED (other)	-	nil	nil
Gas oil	Litre	nil	nil
Fuel oil	Litre	nil	nil

BUDGET SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Qu

BUDGET SECRET

FROM: J. ANSON
9th March, 1988.

MR. ODLING-SMEE

c.c. PPS
PS/CST
Mr. Monck
Mr. Scholar
Mr. Culpin
Mr. Turnbull
Mr. R. Allen
Mr. Call

NOTE FOR THE QUEEN

I have had a word with Mr. Monck about paragraph 19, on forestry. It might be worth clarifying this a little, as I suspect it is a subject in which the Queen might be interested. In place of lines 3-5, I suggest:

"...grants. Support through grants will be better targeted, eg to encourage better balance between broad-leaved trees and conifers. There is no change in the Government's planting aim." X

2. On paragraph 38, some amendments are needed to bring it into line with the latest version of the Speech. In the third sentence, delete all after the colon; this is too rhetorical for this document and duplicates the second sentence of 36. The last sentence should read: "There will be a parallel reduction in the scale of parental .....".

JA

J. ANSON

003/3652

BUDGET SECRET: TASK FORCE LIST

Copy No 2 of 24

FROM: A G TYRIE

DATE: 9 MARCH 1988

MR ODLING-SMEE

cc Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgewick
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Pickford
Mr Riley
Ms Sinclair
Ms Evans
Mr Cropper
Mr Call

CRIB SHEET FOR THE QUEEN

I have a few suggestions.

Paragraph 4. (Penultimate line.) I would describe the fall in long term unemployment as x% of the total long term unemployed (is it about 20%?), rather than a fall of 'about ¼ million over the last year'.

Paragaph 7. (Line 3.) I suggest 'and again better than expected for almost all other industrial countries'.

It's there implicitly already

Paragraph 8. Should we not add the point that the balance of payments deficit is in part the consequence of poor growth performance by our competitors, reducing demand for our exports?

Paragraph 13. I would add a sentence along the lines: 'Tax cuts improve the supply side performance of the economy by sharpening incentives and assisting better allocation of resources'.

NO. The shelter against the income is being ended.

Paragraph 19. I think it's wrong to say that we are 'ending the tax shelter for forestry'. We are reforming it. Forestry will remain tax exempt.

Paragraph 20. I would add a clause at the end 'and which has also led to abuse'.

Paragraph 21. (Line 3.) Suggest replace 'traditionally' with 'customarily'.

Paragraph 26. It might be worth adding after the first sentence: 'Married persons will each get a £5,000 exemption instead of the present £6,600 shared between them.

only to Queen.

Paragraph 34. I don't know how far this is being copied before budget day but if it is at all widely circulated I suggest the complete deletion of paragraph 24. ?

Paragraph 44. I would add a sentence 'existing mortgage arrangements by sharers will be unaffected'.

pp RCJ.
A G TYRIE

psl/14A

BUDGET CONFIDENTIAL

pmp

FROM: A C S ALLAN
DATE: 9 March 1988

MR TYRIE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Culpin
Mr Scholar
Mr Turnbull
Mr Hudson
Mr Cropper
Mr Call

THE NHS AND THE BUDGET

The Chancellor was most grateful for your minute of 4 March and the various comments on it. In the light of this, he has prepared the ... attached line.

2. He commented that there are a number of other good points raised by Ministers and Advisers; but it is necessary to concentrate on a clear and simple story, and that is what he has done in his line. Section D of the Budget Speech is also relevant.

ACSA

A C S ALLAN

THE NHS AND THE BUDGET

The question is, why, when you are in such a strong financial position, with so much money to give away, are you spending it all on tax cuts and none on the NHS, which is starved of funds.

2. The answer should make the following points:

(i) we are not giving money away, we are taking less than we would otherwise have done;

(ii) as it is, the burden of tax (tax etc. as a percentage of GDP) has not been reduced in this Budget at all: without the measures it would have increased;

(iii) it is only the policies of sound public finance (eliminating Government borrowing) and stimulating enterprise (income tax cuts crucial here) that have given us the strong economy that creates the resources in the first place;

(iv) that is why, unlike like Labour we have been able to afford a substantial further <u>increase</u> in spending on the NHS. It was announced, not in the Budget, but last November (give key figures);

(v) but although spending on the NHS has risen substantially both in real terms and as a share of total public expenditure, all is clearly far from well with the NHS. That is why we have set up a fundamental review, and will be announcing our conclusions as soon as we are in a position to do so;

(vi) meanwhile, the reduction in debt interest as a result of our prudent policies will clearly leave more money to be spent on public expenditure programmes in general, and the NHS in particular.

The NHS and the Budget

The question is, why, ~~as you~~ when you are in such a strong financial position, with so much money to give away, are you spending it all on tax cuts and ~~starving~~ none on the NHS, which is starved of funds?

The answer should make the following points.

① We are not giving money away, we are taking less than we would otherwise have done

② As it is, the burden of tax (tax etc as % of GDP) has not been reduced in this budget ~~[illegible]~~ at all: without the measures it would have risen.

③ It is only the policies of sound public finance ~~[illegible]~~ (eliminating Govt borrowing) and stimulating enterprise (income tax cuts crucial here) that have given us the strong economy that creates the resources in the 1st place

④ That is why, unlike Labour we have been able to afford a substantial further increase in spending on the NHS. It was announced, not in the Budget, but last November. (Give key figs)

⑤ But altho' spending on the NHS has risen substantially both in real terms and as a share of total PX, ~~these are clearly~~ all is clearly far from well with the NHS. That is why we have set up a fundamental review, and will be announcing our conclusions as soon as we are ~~in~~ in a position to do so.

(6) Meanwhile, the reduction in debt interest as a result of our prudent policies will clearly leave more money to be spent on PX programmes in general, and the NHS in particular.

There are a number of other good pts, which Mins and advisers have raised. But we need to concentrate on a clear and simple story, and that is what I have done above.

PS See also relevant section of Budget speech.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

45/B.rj.2189/033

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Copy 6 of 8

FROM: N MONCK
DATE: 9 March 1988

MR R I G ALLEN

cc PS/Chancellor
Sir P Middleton
Mr Scholar
Mr Odling-Smee
Mr Hudson

BUDGET IN BRIEF

I wonder if it would be more consistent with the treatment of forestry in the Speech to include it, rather low down, in the income tax reform part of para 3. A possible form of words might be:

> "- a radical change in the tax treatment of commercial woodlands [and a parallel increase in planting grants]"

Leaving out the square brackets would match your treatment of covenants.

2. In the second indent to paragraph 24 could you substitute "commercial woodlands" for "forestry" and "maintain its forestry policies" for "secure its forestry objectives". You could add at the end "for example by improving the balance between broadleaved trees and conifers".

NM

N MONCK

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET—BUDGET LIST ONLY

yuk!

Nineteen eighty-eight should be the eighth successive year of sustained growth and the sixth in which this has been combined with low inflation. Unemployment is falling fast. These successes are the result of sound monetary and fiscal policies, coupled with reforms to make the economy work better. The Budget builds on these policies.

The Main Features

The Chancellor: announced

- a balanced budget;
- substantial further tax reforms; and
- reductions in income tax at all levels.

The main tax changes (see table 1) include:

- double indexation of tax thresholds;
- a reduction in the basic rate of income tax to 25p;
- abolition of all higher rates of income tax above 40p;
- a new system of independent taxation for husbands and wives, to take effect in 1990;
- a major reform of capital gains tax;
- a major simplification of the tax treatment of covenants and maintenance payments; and
- a higher threshold and flat rate for inheritance tax.

The economic background

Since 1981, total national output has risen steadily at an average annual rate of about 3 per cent a year. At the same time, inflation has been brought down and remains low (see chart 1). Over the 1980s, the UK has grown faster than any other major country in the European Community (see table 2). This is in sharp contrast to the 1960s and 1970s, when the UK was bottom of the European growth league. Living standards have been rising strongly — a married man with two children on average male earnings is better off by well over 20 per cent since 1979 (see chart 2).

The British economy has in this way outperformed both its competitors and earlier expectations, despite the coal strike in 1984, the oil price collapse in 1986 and the world-wide fall in world equity prices in October 1987. Total output is estimated to have risen by 4¼ per cent last year, the best performance since 1973. For the first time in a generation, real growth slightly exceeded the rate of price inflation. Employment continued to rise strongly and unemployment fell by half-a-million in 1987 — the biggest annual fall since the war.

The strength of the economy has been reflected in rising tax receipts and strong public sector finances. In 1987–88, a budget surplus of around £3 billion is expected, only the second surplus since the early 1950s. For 1988–89 the Chancellor has already announced very substantial increases in public spending on the national health service and other priority areas. He has now been able both to provide for a further budget surplus of £3 billion and to reduce taxes.

Ch

This is the page proof – not checked. Some cuts almost certainly will be required but I won't know how many until the copy has been pasted up.

RA.
11/3

Comment based on pasted-up version.

BUDGET SECRET—BUDGET LIST ONLY

The Medium Term Financial Strategy

The Medium Term Financial Strategy (MTFS) continues to provide the framework for the Government's economic policy, as it has done since 1980. The key points of the MTFS (see tables 3 and 4) are:

- The broad aim of policy will be steadily to reduce inflation, over the medium term, by reducing the growth of total spending power in the economy, as measured by the cash value of our national output (money GDP);
- the Government will aim to keep the growth of narrow money, as measured by M0, within the range 1–5 per cent in 1988–89, as indicated in last year's Budget;
- interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure downward pressure on inflation;
- the Government will continue to pursue a policy of exchange rate stability, with the rate against the Deutschemark being of particular importance;
- a balanced budget will be the norm, for the medium term.

exchange rates play a central role in both domestic monetary conditions and international policy cooperation

The Economic Forecast

Despite continuing uncertainties in the world economy, the UK economy is expected to grow by a further 3 per cent in 1988. Excluding the North Sea oil sector, growth will be faster—about 3½ per cent. Consumer spending is likely to increase a little more slowly than in 1987, but investment should grow much faster. Inflation is forecast to remain low, at around 4 per cent, and there are good prospects for a further fall in unemployment. The balance of payments on current account is likely to be in deficit by £4 billion, equivalent to less than 1 per cent of GDP.

The forecast is summarised in table 5 below.

Tax Measures

In addition to setting a budget surplus of £3 billion in 1988–89, the Chancellor has been able to reform personal taxes and reduce tax rates. But as a proportion of national output, total taxes and National Insurance contributions will remain broadly unchanged between this year and next. Table 6 shows the sources and uses of public money in 1988–89.

Income Tax: Rates and Allowances

The Government believe that incentives for enterprise and effort should be improved and people should be left free to spend or save more of their own money—lower tax economies work better than higher tax economies. The Budget is therefore one of tax reduction as well as of tax reform.

The main changes are:

- a 7½ per cent increase in the main personal allowances, double the inflation rate;
- a reduction in the basic rate of income tax to 25 per cent, in line with the Government's pledge; and
- a single higher tax rate of 40 per cent for taxable incomes over £19,300.

A 2p

BUDGET SECRET—BUDGET LIST ONLY

These changes will benefit some ~~£~~25 million income tax payers. They will:

- increase the starting point for tax for everyone;
- bring down the marginal rate for the vast majority of taxpayers;
- be worth [nearly] almost £5 [per] a week extra for a married man on average earnings;
- create a simple, two-rate tax system with a top rate among the lowest in the world, as our corporation tax rates already are.

The Chancellor also announced a new goal: that the basic rate of income tax should be reduced to 20p in the £ as and when it is prudent to do so.

Table 7 summarises the main changes.

Independent Taxation

The present system for taxing married couples goes back 180 years. It taxes a married woman's income as if it belonged to her husband. This is no longer acceptable.

The Chancellor therefore announced a completely new system for taxing married couples, providing:

- independent taxation for husbands and wives;
- complete privacy and independence for married women in their tax affairs; and
- an end to the tax penalties on marriage (see also section on maintenance payments).

The new system will be fully introduced at the earliest practicable date, April 1990, though some of the tax penalties on marriage will be [removed] before then. ended

Under the new system, a husband and wife will be taxed independently, on all of their income. All taxpayers, male or female, married or single, will be entitled to the same personal allowance, which will be available against income of all kinds, whether from earnings or savings.

In addition, there will be a married couple's allowance, equal to the difference under the old system between the married man's allowance and the single allowance. This will go to the husband in the first instance, but he will be able to transfer the unused portion of it to his wife.

Husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each, instead of one between them, as now. Transfers of capital between husband and wife will continue to be entirely free of tax.

Two further tax penalties on marriage will be abolished:

- for new mortgages, after 1 August 1988, the £30,000 limit on mortgage interest relief will be related to the house or flat concerned, irrespective of the number of borrowers. An unmarried couple will no longer be able to get twice as much relief as a married couple;
- from April 1989, unmarried couples with children will be entitled to only one additional personal allowance so that they can no longer get more tax relief than a married couple.

BUDGET SECRET—BUDGET LIST ONLY

Income Tax: Other Changes

The Chancellor announced a number of proposals to tighten the existing system of allowances and reliefs, and to remove some unjustifiable tax breaks. In particular:

- tax relief on all new home loan improvement loans will be ended. This will concentrate relief where it is intended, on the purchase of a house or flat;
- the tax charge for company cars will be doubled;
- to end tax avoidance on forestry, commercial woodlands will be taken out of the income tax and corporation tax system entirely, but there will be a parallel increase in planting grants.

The Chancellor also announced a major simplification of tax arrangements when income is transferred between individuals. This reforms the complicated and anomalous system of taxing payments made under deeds of covenants and maintenance payments.

Covenants

non-charitable

For all new covenants, those receiving the payments will not be liable to tax on them and those making the payments will get no tax relief on them. The largest single group of people affected will be parents of students, and there will be a ~~parallel~~ broadly compensatory reduction in the scale of parental contributions to the maintenance grant. Covenants to charity will not be affected in any way by these changes.

Maintenance

For new maintenance arrangements, separated or divorced spouses receiving maintenance payments will not have to pay any tax whatever on them. Those making these payments will in future get only limited tax relief, up to an amount equal to the difference between the married allowance and the single allowance, and only for payments to separated or divorced spouses.

Business Taxation

Since the 1984 corporation tax reforms, company profitability has recovered to its highest level for some 20 years. The structure and main rate of corporation tax will be unchanged in 1988–89. Companies will benefit substantially from the rebasing of capital gains to 1982 (see below).

The small companies' rate of corporation tax will be cut to 25 per cent in line with the basic rate of income tax, and there are a number of other measures to encourage small (colon) and new businesses.

- better targeting of the Business Expansion Scheme (BES);
- an extension of capital gains tax retirement relief; and
- an increase in the VAT threshold to £22 100, the maximum permitted under existing EC law.

The BES will be extended to companies specialising in the letting of property for assured tenancies: an important supply side measure.

There are a number of other measures affecting businesses, including the abolition of capital duty.

Charities

Tax relief for payroll giving to charity will be made more generous with a doubling of the limit from £120 to £240 a year.

BUDGET SECRET—BUDGET LIST ONLY

Taxes on Spending

There will be minor changes in VAT arrangements. Excise duties as a whole will be increased in line with inflation, but there will be some adjustments within the total: see table 8. The duty on unleaded petrol remains unchanged, raising the tax differential in its favour to over 10p a gallon. There will be no change in the tax on spirits or pipe tobacco. The main rates of Vehicle Excise Duty are unchanged.

Share ownership

The Chancellor announced the results of a joint Treasury/Stock Exchange survey showing that, despite last year's stock market fall, the number of shareholders had risen slightly to around 9 million. He announced two further proposals to encourage share ownership:

- a raising of the annual limit for Personal Equity Plans from £2,400 to £3,000; and
- a relaxation of the rules relating to some employee share schemes.

Capital gains tax

The Chancellor announced a major reform consisting of three elements.

First, the base date for the tax will be brought forward from 1965 to 1982. Thus any capital gain arising before April 1982 will be exempt from tax altogether, for individuals and companies alike. This will:

- end once and for all the injustice of taxing inflationary gains;
- benefit the economy by unlocking assets which have been frozen because of the penal tax that would have arisen on resale; and
- help many small businessmen, and farmers in particular.

Second, the annual exempt slice will be reduced to £5,000 for individuals and £2,500 for most trusts.

Third, capital gains tax will be aligned with income tax. Although the taxation of gains will continue to benefit from existing indexation provisions, real gains will in future be taxed at the same two rates—25 per cent and 40 per cent—as income.

Inheritance tax

The Budget simplifies this tax still further by increasing the threshold from £90,000 to £110,000 (which will reduce the number of estates liable to tax by a quarter) and levying a flat rate of 40 per cent on the rest.

Summary

The Budget reaffirms the prudent policies that have brought a long and continuing period of strong economic growth, combined with low inflation. The Budget has been balanced. Tax rates have been substantially reduced. And some major tax reforms have been introduced. This will improve incentives and further strengthen the economy.

Table 1 The Budget measures

	£ million 1988–89 Changes from an indexed base	yield(+)/cost(−) 1989–90 Changes from an indexed base
Income tax		
personal allowances double indexed	−690	−895
basic rate limit double indexed	−75	−125
basic rate reduced to 25p	−2 570	−3 200
higher rates above 40p abolished	−965	−2 070
car benefit scales doubled	+260	+310
home improvement loans relief	+80	+200
covenants and maintenance	+35	+100
Capital gains tax		
tax rebased to 1982	*	−55
annual exemption reduced to £5 000	*	+15
gains charged at income tax rates	+70	+65
Independent taxation	*	−20
Inheritance tax		
flat rate of 40% above £110 000	−100	−200
Corporation tax		
tax on capital gains rebased to 1982	−25	−235
small companies' rate reduced to 25p	*	−50
Capital duty abolished	−75	−80
Excise duties	+20	−40
Other tax changes	+50	+115
Total	**−3 985**	**−6 165**

* = negligible.

Table 2 European Growth League

1960s	1970s	1980s
Italy	France	**UK**
France	Belgium	Italy
Netherlands	Italy	France
Belgium	Netherlands	West Germany
West Germany	West Germany	Netherlands
UK	**UK**	Belgium

Source: OECD

Table 3 Money GDP, money supply and the PSBR

	1987–88	1988–89	1989–90	1990–91	1991–92
Money GDP[1]	9¾	7½	6½	6	5½
M0[2]	5	1–5	1–5	0–4	0–4
PSBR[3]	−3	−3	0	0	0
PSBR as per cent of GDP	−¾	−¾	0	0	0

[1] Percentage change on previous year. The figure for 1988–89 is a forecast; and in subsequent years describe the Government's broad medium term objectives.

[2] Percentage change on previous year. 1987–88: estimated outturn. 1988–89: target range. 1989–90 onwards: illustrative ranges.

[3] £ billion, cash.

Table 4 Output and inflation assumptions

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

Table 5 Summary of Economic Prospects

	1987	1988 forecast
	per cent changes on a year earlier	
Output and expenditure at constant 1980 prices		
Consumers' expenditure	5	4
General government consumption	0	1½
Fixed investment	3½	6
Change in stockbuilding (as per cent of level of GDP)	0	0
Exports of goods and services	5½	3
Imports of goods and services	7½	6½
Gross domestic product:		
total	4¼	3
manufacturing	5½	5
Inflation		
Retail prices index[1]	4	4
Deflator for GDP at market prices[2]	5	4½
	£ billion	
Balance of payments on current account	−1½	−3½

[1] Changes shown are to the fourth quarter of 1987 and 1988.
[2] Financial years.

Table 6 Public money 1988–89

Pence in every £1[1]

Reciepts		Expenditure	
Income taxes	23	DHSS: social security	27
National insurance contributions etc.	17	DHSS: health and personal social services	11
Value added tax	14	Defence	11
Local authority rates	10	Education and science	10
Road fuel, alcohol and tobacco duties	10	Scotland, Wales and Northern Ireland	9
Corporation tax[2]	9	Other departments	19
Capital taxes	3	Interest payments	10
Interest, dividends	3	Other	3
North Sea taxation	2		
Other taxation	10		
Borrowing[3]	−1		
Total	100		100

[1] Rounded to the nearest penny
[2] Excluding North Sea
[3] By central and local government

Table 7 Proposed changes in Personal Allowances and Rates

Personal Allowances	1987–88 £	1988–89 £	
Single person's allowance and wife's earned income allowance	2,425	2,605	(+180)
Married man's allowance	3,795	4,095	(+300)
Additional personal allowance and widow's bereavement allowance	1,370	1,490	(+120)
Single age allowance (age 65–79)	2,960	3,180	(+220)
Married age allowance (age 65–79)	4,675	5,035	(+360)
Single age allowance (age 80 and over)	3,070	3,310	(+240)
Married age allowance (age 80 and over)	4,845	5,205	(+360)
Age allowance income limit	9,800	10,600	(+800)

(The dependent relative allowance, the housekeeper allowance, and the son's or daughter's services allowances are to be abolished.)

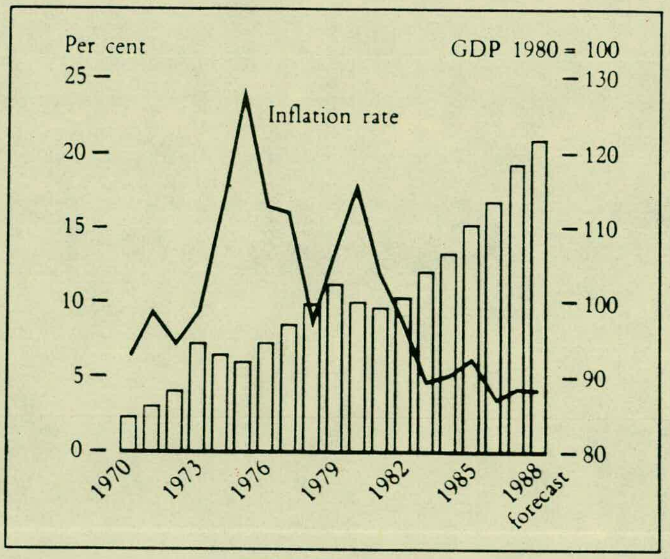
Rates and Rate bands

1987–88 Rate of tax (per cent)	1987–88 Taxable Income (£)	1988–89 Rate of tax (per cent)	1988–89 Taxable income (£)
27	0—17,900	25	0—19,300
40	17,901—20,400	40	Over 19,300
45	20,401—25,400		
50	25,401—33,300		
55	33,301—41,200		
60	Over 41,200		

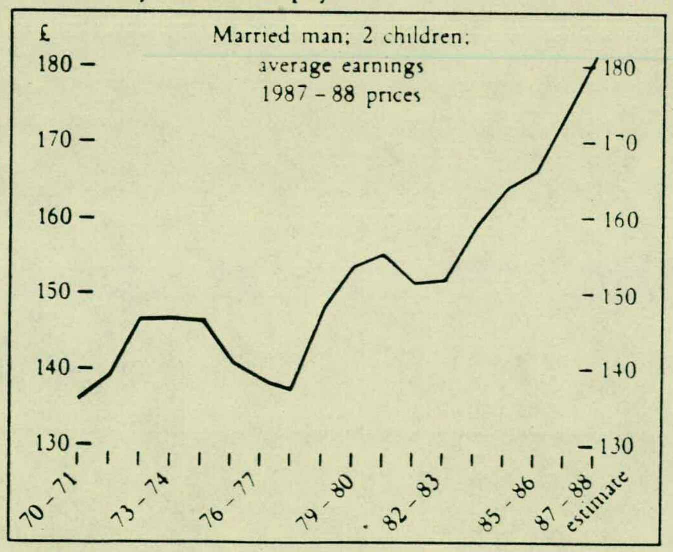
Table 8 Proposed changes to Excise Duties

Product	Unit	Duty increase (per cent)	Price increase (pence)
Beer	Pint	4·7	1·0
Cider	Pint	9·7	1·0
Table wine	75cl	4·5	3·8
Sparkling wine	70cl	4·7	6·1
Sherry	70cl	nil	nil
Spirits	75cl	nil	nil
Cigarettes	20KS	3·7	3·4
Cigars	5 whiffs	3·7	1·9
Pipe tobacco	25 grams	nil	nil
Petrol (leaded)	Gallon	5·5	5·5
Petrol (unleaded)	Gallon	nil	nil
Derv	Gallon	5·5	4·7
VED (cars)	—	nil	nil
VED (other)	—	nil	nil
Gas oil	Litre	nil	nil
Fuel oil	Litre	nil	nil

National output and inflation Chart 1



Real weekly take home pay Chart 2



BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

B2:12ph

DRAFT

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Chancellor

Please see my suggestions.

In addition please can we have PSBR Table 1.2 somewhere? And can we not show FSBR Table 1.1 on the front page - it after all summarise the tax measures in the Budget?

MCS 10/3

BUDGET SECRET: BUDGET LIST ONLY

THE BUDGET IN BRIEF

[8 better than 6]

The UK economy is now entering its ~~sixth~~ eighth successive year of ~~steady~~ sustained ~~growth~~ and the sixth in which this has been combined with low inflation. Unemployment is falling fast. These successes are the result of sound monetary and fiscal policies, coupled with reforms to make the economy work better. The Budget builds on these policies.

The Main Features

2. The ~~Budget:~~ Chancellor announced:

- a balanced Budget

- ~~introduces~~ substantial further tax reforms; and

~~cuts tax rates and~~

- ~~[leaves no personal tax rate higher than 40 per cent;~~ reductions in income tax at all levels; ~~and~~

- ~~maintains a Budget surplus;~~

~~the~~

- ~~removes some unjustified tax breaks; and~~

- ~~will help improve economic performance.~~

3. The main tax changes include:

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
B.I.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

- a 7½ ~~per cent increase in personal allowances and the basic rate limit~~; tax thresholds, double the inflation rate

- a reduction in the basic rate of income tax to 25p;

- abolition of all higher rates of income tax above 40p;

- a new system of independent taxation for husbands and ~~wives;~~ wives, to take effect in 1990;

- a major simplification of the tax treatment of covenants and maintenance payments.

- a ~~40 per cent~~ higher threshold and flat rate for Inheritance Tax; and

- a major reform of Capital Gains Tax,

Change these round

SECRET

The Economic Background

B.L.O.

4. Since 1981, total national output has risen at a steady average annual rate of about 3 per cent a year~~, with little variation from year to year.~~ At the same time, inflation has been brought down and remains low (see chart 1). Over the 1980s, ~~the UK~~ Britain has grown faster than any other major country in the European Community (see table 1). This is in sharp contrast to the 1960s and 1970s, when Britain was bottom of the European growth league. Living standards have been rising strongly: ~~the~~ a married man with two children on average male earnings is better off by well over 20 per cent since 1979 (see chart 2).

SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET
B.L.O.
SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

[a bit strained – two "collapses"]

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

5. ~~The economy is weathering the storm of the world-wide collapse in equity markets in October 1987, just as it coped successfully with the coal strike (1984-85) and the collapse in world oil prices (1985-86). In 1987 the economy built on the strong and steady performance of previous years.~~ Total output is estimated to have risen by some [4-4½] per cent last year, the best performance since 1973. For the first time in a generation, real growth slightly exceeded the rate of price inflation. Employment continued to rise strongly and unemployment fell by half-a-million in 1987 - the biggest annual fall since the war. ~~Both export and import volumes grew rapidly with the current account of the balance of payments in deficit by [£1½] billion.~~

"The British economy has in this way outperformed both its competitors' and earlier expectations despite ~~of [the storms it has had to weather]~~ [~~a number of potentially destabilising events~~] the coal strike in 1984, the oil price collapse in 1986 and the world-wide fall in equity prices in October 1987."

6. The strength of the economy has been reflected in rising tax receipts and strong public sector finances. In 1987-88, ~~the expected~~ a budget surplus is expected, of around ~~around~~ £[3] billion, only the second surplus since the early 1950s. For ~~the coming year,~~ 1988-89, the Chancellor has been able to both ~~plan~~ to provide for a further budget surplus of £3 billion and to reduce taxes. ~~In later years, the objective is to maintain a balanced budget which should allow for further reductions in taxation.~~

or ["set"]

already announced very substantial increases in public spending on the National Health Service and other priority areas. He has now

The Medium Term Financial Strategy

7. The Medium Term Financial Strategy (MTFS) ~~will~~ continues to provide the framework for the Government's economic policy, as it has done since 1980. The ~~Budget includes a revised MTFS, the~~ main features of ~~which~~ the MTFS are summarised in tables 2 and 3.

8. The ~~main~~ key points are:

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O.

BUDGET SECRET B.L.O. SECRET

- The broad aim of policy will be steadily to reduce, inflation over the medium term, (by reducing) the growth of total spending power in the economy, as measured by the cash value of our national output (money GDP);

- [particular importance is attached to maintaining a stable exchange rate, notably the rate against the deutschemark]; 3

- broader measures of money supply, [particularly M4], and liquidity will continue to be taken into account in assessing monetary conditions; 4

- the Government will aim to keep the growth of narrow money, as measured by M0, within the range 1-5 per cent in 1988-89, as indicated in last year's Budget; 1

- short term interest rates will continue to be held at the levels needed to keep downward pressure on inflation; 2

- a balanced budget will be the norm for the medium term,

- the Chancellor has ~~planned~~ provided for a budget surplus of £3 billion in 1988-89, and a balanced budget thereafter*.

- ~~the MTFS projects a balanced budget in 1989-90 and subsequent years.~~

Re-do to make consistent with revised MTFS (see Peretz 10/3) and FSBR Chapter 2 esp. [illegible]

Also, re-order as indicated

<u>The Economic Forecast</u>

9. Despite continuing uncertainties in the world economy, the UK economy is expected to grow by a further 3 per cent in 1988.

* NB Chapter 1 of FSBR doesn't mention the balanced budget! Insert "with a balanced budget thereafter" at end of 3rd sentence of 1.07?

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Excluding the North Sea oil sector, growth will be faster - about 3½ per cent. Consumer spending is likely to grow a little more slowly than in 1987, but investment should grow much faster. Inflation is forecast to remain low, at around 4 per cent, and there are good prospects for a further fall in unemployment. The balance of payments on current account is likely to ~~continue in small~~ be in deficit, ~~to the tune of £4~~ ~~equivalent to ½-¾ per cent of GDP~~. by £4 billion, equivalent to less than 1 per cent of GDP.

10. The forecast is summarised in table 4 below.

Tax Measures

11. In addition to setting a budget surplus of £3 billion in 1988-89, the Chancellor has been able to reduce taxes by about £4 billion. But ~~As~~ a proportion of national output, total taxes and National Insurance contributions will remain broadly unchanged between this year and next. Table 5 summarises and costs the Budget measures.

Income Tax: Rates and Allowances

12. The Government believe that incentives for enterprise and effort should be improved and people should be left free to spend or save more of their own money - lower tax economies work better than higher tax economies. The Budget is therefore ~~gives priority to reducing income tax~~. one of tax reduction as well as of tax reform.

13. The main changes are:

- a 7½ per cent increase in the main personal allowances, double the inflation rate;

BUDGET SECRET
B.L.O. SECRET
SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

- a reduction in the basic rate of income tax to 25 per cent, in line with the Government's pledge; and

- a single higher tax rate of 40 per cent for taxable incomes over £19,300.

14. These changes will benefit ~~all~~ some 25 million income tax payers. They will: [not all]

- increase the ~~tax free allowance for practically~~ starting point for tax for everyone;

- bring down the marginal rate for the vast majority of taxpayers;

- be worth ~~about~~ almost £5 ~~per~~ a week extra for a married man on average earnings;

- create a simple, two-rate tax system with a top rate among the ~~very~~ lowest in the world, as our corporation tax rates already are.

SECRET

B.L.O.

15. The Chancellor also announced a new goal: that the basic rate of income tax should be reduced to 20p in the £ as ~~soon as~~ and when it is prudent to do so.

16. Table 6 summarises the main changes.

~~Independent Taxation~~ — wd be better as a separate box

17. The present system for taxing married couples goes back 180 years. It taxes a married woman's income as if it belonged to her husband. This is no longer acceptable.

SECRET

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET

18. The Chancellor therefore announced a completely new system for taxing married couples, providing:

- independent taxation for husbands and wives;
- complete privacy and independence for married women in their tax affairs; and
- an end to the tax penalties on marriage.

19. The new system will be fully introduced at the earliest practicable date, April 1990, though some of the tax penalties on marriage will be ended before then.

20. Under the new system, a husband and wife will be taxed independently, on all of their income. All taxpayers, male or female, married or single, will be entitled to the same personal allowance, which will be available against income of all kinds, whether from earnings or savings.

B.L.O. SECRET

21. In addition, there will be a married couple's allowance, equal to the difference under the old system between the married man's allowance and the single allowance. This will go to the husband in the first instance, but he will be able to transfer any unused portion of it to his wife.

22. Husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each, instead of one between them, as now. Transfers of capital between husband and wife will continue to be entirely free of to tax.

23. Two further tax penalties on marriage will be abolished:

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O.

- for new mortgages, after 1 August 1988, the £30,000 limit on mortgage interest relief will be related to the house or flat concerned, irrespective of the number of borrowers: an unmarried couple will no longer be able to get twice as much relief as a married couple;

- from April 1989, unmarried couples with children will be entitled to only one additional personal allowance, ~~giving them the same relief as~~ so that they can no longer get more tax relief than a married couple.

Income Tax: Other Changes

24. The Chancellor announced a number of proposals to tighten the existing system of allowances and reliefs, and to remove some unjustifiable tax breaks. ~~These include:~~ In particular:

This? X for next page

- the ~~scales~~ tax charges for company cars will be doubled;

- to end tax avoidance on forestry, commercial woodlands will be taken out of ~~the tax system entirely~~ income tax and corporation tax altogether, but there will be a parallel increase in planting grants. ~~This will end an increasingly blatant form of tax avoidance and enable the Government to secure its forestry objectives with a proper regard for the environment;~~

[as drafted this is inaccurate - much too sweeping. The experts want 'commercial woodlands' not 'forestry', so I've tried to get round it as above]

and they don't like the "ending tax avoidance" because it's not an artificial device. I don't agree.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

to previous page

- tax relief on all new home improvement loans will be ended. This will concentrate relief where it is intended, on the purchase of a house or flat.

Covenants and maintenance

25. The tax system for covenants and maintenance payments is very complicated and produces a host of anomalies. The Chancellor announced a major reform.

26. For all new non-charitable covenants, those receiving the payments will not be liable to tax on them and those making the payments will get ~~no tax~~ relief on them. The largest single group of people affected will be parents of students, and there will be a broadly compensatory ~~adjustments~~ adjustment in the parental ~~contributions~~ contribution to the maintenance grant.

[want to keep notion of compensation, but to make it global]

~~27. The reform will remove a wholly unnecessary complication from the tax system while retaining the same overall levels of support for students.~~

28. For new maintenance arrangements, separated or divorced spouses receiving maintenance payments will not have to pay any tax whatever on them. Those making these payments~~, however,~~ will in future get only limited tax relief, up to ~~a limit~~ an amount equal to the difference between the married allowance and the single allowance, and only for payments to separated or divorced spouses. ~~There will no longer be tax relief at all for maintenance payments other than to separated or divorced spouses.~~

BUDGET SECRET
BUDGET LIST ONLY NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Business Taxation

29. The structure and main rates of Corporation Tax will be unchanged in 1988-89. ~~The system established by~~ Since the 1984 Corporation Tax reforms ~~is a crucial part of an environment in which~~ company profitability has recovered to its highest level for some 20 years. Companies will benefit substantially from the rebasing of capital gains to 1982 (see below).

30. The small companies' rate of Corporation Tax will be cut to 25 per cent in line with the basic rate of income tax, and there are a number of other measures to ~~help~~ encourage small and new businesses!

~~31. The Chancellor announced three proposals benefitting businesses in particular sectors:~~ insert from next page

~~31. Other measures~~

SECRET

- changes in the North Sea oil regime which will abolish royalties on all future fields and relate future tax liability more closely to profitability;

- changes to remove the existing tax penalty on building societies wishing to convert into companies;

B.L.O.

- improvements in the tax arrangements for Lloyds.

32. The Budget also includes measures to:

- change the definition of company residence in the UK and to simplify the arrangements for companies wishing to migrate overseas;

SECRET

and a range of measures to encourage [~~small and new~~] business & UTID? including:

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET
SECRET
B.L.O.
SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

to previous page

- better targetting of the Business Expansion Scheme (BES) and an extension of BES to companies specialising in the letting residential property for assured tenancies;

- an extension of Capital Gains Tax retirement relief; and

- an increase in the VAT threshold to £22,100, the maximum permitted under existing EC law.

- ~~abolition of Capital Duty and the Unit Trust Instrument Duty.~~

31/32. There are a number of other measures affecting business, including the abolition of Capital Duty.

Charities

33. ~~The scheme for~~ Tax relief ~~on donations to charity under~~ for payroll giving ~~arrangements~~ to charity will be made more generous with a doubling of the limit ~~on qualifying donations~~ from £120 to £240 a year.

Taxes on Spending

34. There will be only one minor change in VAT arrangements. ~~: to clarify the legal definition of confectionery.~~ Excise duties as a whole will be increased in line with inflation, but there will be some adjustment~~s~~ within the total. ~~In particular,~~ The duty on unleaded petrol remains unchanged, raising the tax differential in its favour to over 10p a gallon. ~~Alcohol duties have been restructured in favour of low-alcohol drinks.~~ These changes are shown in table 7 below.

There will be no change in the tax on spirits or pipe tobacco. The main rates of Vehicle Excise Duty are unchanged.

Share Ownership

35. The Chancellor announced the results of a joint Treasury/Stock Exchange survey showing that, despite last year's stock market fall,

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET
B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET
SECRET
B.L.O.
SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET NOT TO BE COPIED
BUDGET LIST ONLY

BUDGET

the number of shareholders had risen slightly to around 9 million. He announced two further proposals to encourage share ownership:

- a raising of the annual limit for Personal Equity Plans from £2,400 to £3,000;

- a relaxation of the rules relating to some employee share schemes..

SECRET

Capital Gains Tax

36. The Chancellor announced a major reform consisting of three elements.

37. First, the base date for the tax will be brought forward from 1965 to 1982: thus, any capital gain arising before April 1982 will be exempt from tax altogether, for individuals and companies alike. This will:

B.L.O.

- end once and for all the injustice of taxing inflationary gains;

- benefit the economy by unlocking assets which have been frozen because of the penal tax that would have arisen on resale; and

- help many small businessmen and farmers in particular.

SECRET

38. Second, the annual exempt slice will be reduced to £5,000 for individuals and £2,500 for most trusts. ~~This is because there is no longer a need to compensate taxpayers for non-indexation~~ of inflatn paper gains.

BUDGET SECRET NOT TO BE COPIED
BUDGET LIST ONLY

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET

39. Third, [Capital gains tax will be ~~[more closely]~~ aligned with income tax. Although] the taxation of gains will continue to benefit from the ~~existing~~ indexation ~~arrangements~~ provisions, ~~but will be brought closer to that of income. In future,~~ real gains will in future be taxed at ~~a taxpayers' marginal income tax rate.~~ the same two rates - 25% and 40% - as income.

Inheritance Tax

40. The Budget simplifies this tax still further by increasing ~~levying it at a flat rate of 40 per cent, compared to the current four rates.~~ The threshold ~~will be increased~~ from £90,000 to £110,000, which will reduce ~~reducing~~ the number of estates liable to tax by a quarter, and levying a flat rate of 40 per cent on the rest. ~~For a family business, enjoying 50 per cent business relief, the effective rate of Inheritance Tax can now never exceed 20 per cent, one of the lowest rates in the industrialised world.~~

SECRET

Summary

41. The budget reaffirms the prudent policies that have brought a long and continuing period of strong economic growth, combined with low inflation. The Budget has been balanced. Tax rates have been substantially reduced. And ~~further~~ some major tax reforms have been introduced ~~to~~ This will improve incentives and further strengthen the economy.

B.L.O.
SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

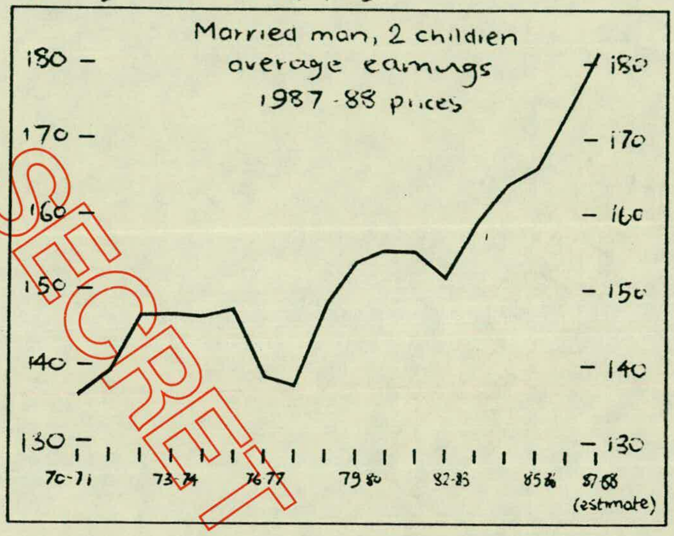
BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

Chart 2

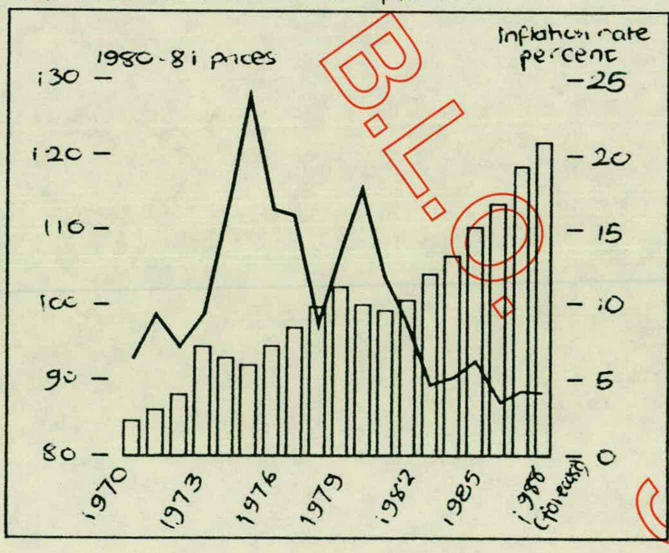
Weekly take home pay



SECRET

Chart 1

National output and inflation



B.L.O. SECRET

not clear that inflation is going down output up.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 1

EUROPEAN GROWTH LEAGUE

1960s	1970s	1980s
Italy	France	**UK**
France	Italy	Italy
Belgium	Netherlands	France
Netherlands	Belgium	West Germany
West Germany	West Germany	Netherlands
UK	**UK**	Belgium

Source: OECD

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED
BUDGET SECRET
B.L.O.
SECRET
BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Table 2

Money GDP, money supply and the PSBR

	87-88	88-89	89-90	90-91	91-92
Money GDP[1]	9¾	7½	6½	6	5½
Mo[2]	5	1-5	1-5	0-4	0-4
PSBR[3]	-3	-3	0	0	0
PSBR as % GDP	-¾	-¾	0	0	0

1 Percentage change on previous financial year. The figure for 1988-89 is a forecast; and in subsequent years describe the Government's broad medium term objectives.

2 1987-88: forecast. 1988-89: target range. 1989-90 onwards: illustrative ranges.

3 £ billion, cash.

BUDGET SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 3

Output and inflation assumptions

	percentage change on previous financial years				
	87-88	**88-89**	**89-90**	**90-91**	**91-92**
Real GDP					
Non-North Sea	5	3	3	3	3
Total	4½	2½	2½	2½	2½
Inflation					
GDP deflator	5	4½	4	3½	3

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

<u>Table 4</u> = Table 3.12 of FSBR

minus first and final columns

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 5

Budget Measures

(£ billion)	Estimated effect on receipts in 1988-89	1989-90	
Income tax			
changes in allowances	-675	-885	
2p off basic rate	-2170	-2970	
higher rate changes	-1080	-2300	
Capital gains tax	+70	+265	
Corporation tax	-380	-250	
?— North Sea oil taxes	+25	+25	NO
Inheritance tax	-100	-200	
Stamp duties	-100	-125	
VAT	+15	+15	
Excise duties	+5	-5	
Other changes	+390	+400	
Total	-4000	-6270	

B.L.O.

Should be
PSBR 1.1.
— and should be
prominent, on front page.

(agree –

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 6

Proposed changes in Personal Allowances and Rates

(1) Personal Allowances

Make this prominent

	1987-88 £	1988-89 Proposed level £
Single person's allowance and wife's earned income allowance	2,425	2,605
Married man's allowance	3,795	4,095
Additional personal allowance and widow's bereavement allowance	1,370	1,490
Single age allowance (age 65-79)	2,960	3,180
Married age allowance (age 65-79)	4,675	5,035
Single age allowance (age 80 and over)	3,070	3,310
Married age allowance (age 80 and over)	4,845	5,205
Age allowance income limit	9,800	10,600

(The dependent relative allowance, the housekeeper's allowance, and the son's and daughter's services allowances are to be abolished.)

(2) Rates and Rate bands

Rate of tax per cent	1987-88 taxable income £	~~1988-89 proposed taxable income £~~
~~25~~	~~-~~	~~0-20,000~~
27	0-17,900	-
40	17,901-20,400	Over 20,000
45	20,401-25,400	-
50	25,401-33,300	-
55	33,301-41,200	-
60	Over 41,200	-

B.L.O.

Not the way to do it. Show comparable scale for 1987-88; & then say for 1988-89 the first £19,300 of taxable income will be taxed at 25% and the rest at 40%.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET B.L.O. SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

Table 7

Proposed changes to Excise Duties

Product	Unit	Duty increase (per cent)	Price increase (pence)
Beer	Pint	4.7	1.0
Cider	Pint	9.7	1.0
Table wine	75cl	4.5	3.8
Sparkling wine	70cl	4.7	6.1
Sherry	70cl	nil	nil
Spirits	75cl	nil	nil
Cigarettes	20KS	3.7	3.4
Cigars	5 whiffs	3.7	1.9
Pipe tobacco	25 grams	nil	nil
Petrol (leaded)	Gallon	5.5	5.5
Petrol (unleaded)	Gallon	nil	nil
Derv	Gallon	5.5	4.7
VED (cars)	-	nil	nil
VED (other)	-	nil	nil
Gas oil	Litre	nil	nil
Fuel oil	Litre	nil	nil

B.L.O.

SECRET

Where is Table 1.2 from FSBR
– we've ~~always~~ had it before in the
EPR / Budget in brief, and it is
my favorite table in the whole thing!

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED