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PART C

1989 BUDGET
FINANCIAL SECTOR ~~AND~~
BORROWING REQUIREMENTS

8-3-89

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SECRET

From : D L C Peretz
Date : 2 March 1989

MR A ALLAN

cc Mr Scholar
Mr Riley
Mr S Davies
Mr Grice

(I have suggested compromise formulation.

MTFS : PARAGRAPH 2.24

Your minutes of the Chancellor's meeting on 28 February suggest that it was agreed to delete the words "in taking account of costs" at the beginning this paragraph. Neither Mr Grice nor I recall this being discussed at the meeting.

2. It is in fact more than a drafting change. As paragraph 2.23 explains, we take account of a variety of factors in adjusting the structure of Government debt : improving the quality, smoothing the profile of redemptions, as well as costs. The words "In taking account of costs" at the beginning of paragraph 2.24 indicate that this paragraph is only discussing how account is taken of the cost factor, and is not therefore a complete description of how the Government chooses which maturity of debt to purchase. If it were, the reverse auction (dealt with in paragraph 2.23) would look rather odd.

3. So I would much rather leave the words in, or something like them.

True: you had marked it on your copy but did not mention it @ the meeting. I took the short cut of including it in meeting record!

DLCP

D L C PERETZ

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FROM: S J DAVIES
DATE: 2 March 1989

CHANCELLOR (additional copy)

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mr Pickford
Mr Barrie
Mr Savage
Miss Simpson
Mr Call
Mr Chaplin
Mr Tyrie

Thanks. A number of comments attd, passim.

a

A few comments. The fiscal policy section clearly won't do as drafted.

AA

Really? What does this imply for non-oil GDP in 1989-90? And what is forecast quarterly path?

1989 FSBR : CHAPTER 2

I attach a copy of the proofs of Chapter 2 of the FSBR amended to take on board your comments on the previous draft and changes agreed at the meeting with the Bank of England.

?

2. Provisional decisions on the short term forecast for 1989 mean an upward revision to real growth in financial year 1989-90; this is now 2½% rather than 2%. As a result of this, money GDP growth in 1989-90 has been revised up to 8%. The money and real GDP growth paths are thus now:

	1988-89	1989-90	1990-91	1991-92	1992-93
Money GDP	10¾	8	6	6	5½
Real GDP	4	2½	2	2¾	2¾
Deflator	6½	5½	4	3	2½

Are you content with this?

Funny profile, but I suppose point is [illegible] is improving.

3. In accordance with the timetable, I would be grateful for comments by noon on Friday 3 March.

Told him Monday

S J D

S J DAVIES

2 The Medium Term Financial Strategy

Development of the MTFS

2.01 This is the tenth occasion on which the Government has set out its Medium Term Financial Strategy (MTFS).

2.02 Since its inception in 1980 the MTFS has provided a nominal framework within which the Government pursues its objective of bringing down the rate of inflation. The MTFS has been complemented by policies designed to improve the working of markets and the supply performance of the economy. The objectives of the MTFS and the central role of monetary policy in reducing inflation have remained unchanged throughout the 1980s; but the precise form in which the nominal framework has been expressed and the indicators used in the assessment of monetary conditions have changed as the economy has itself evolved.

2.03 The original version of the MTFS specified the nominal framework in terms of broad money—the aggregate known at the time as £M3 and now simply as M3—which had shown a stable relationship with money GDP in the second half of the 1970s. M3 initially had two roles: it was used to describe the Government's strategic objective for growth of nominal magnitudes in the medium term; and to act as a target in the short term, and thus as a guide to setting interest rates. However, following the abolition of exchange controls and other measures of financial liberalisation the earlier relationship between broad money and money GDP changed. It became necessary to give more attention to money GDP itself and to take account of other monetary indicators in setting interest rates.

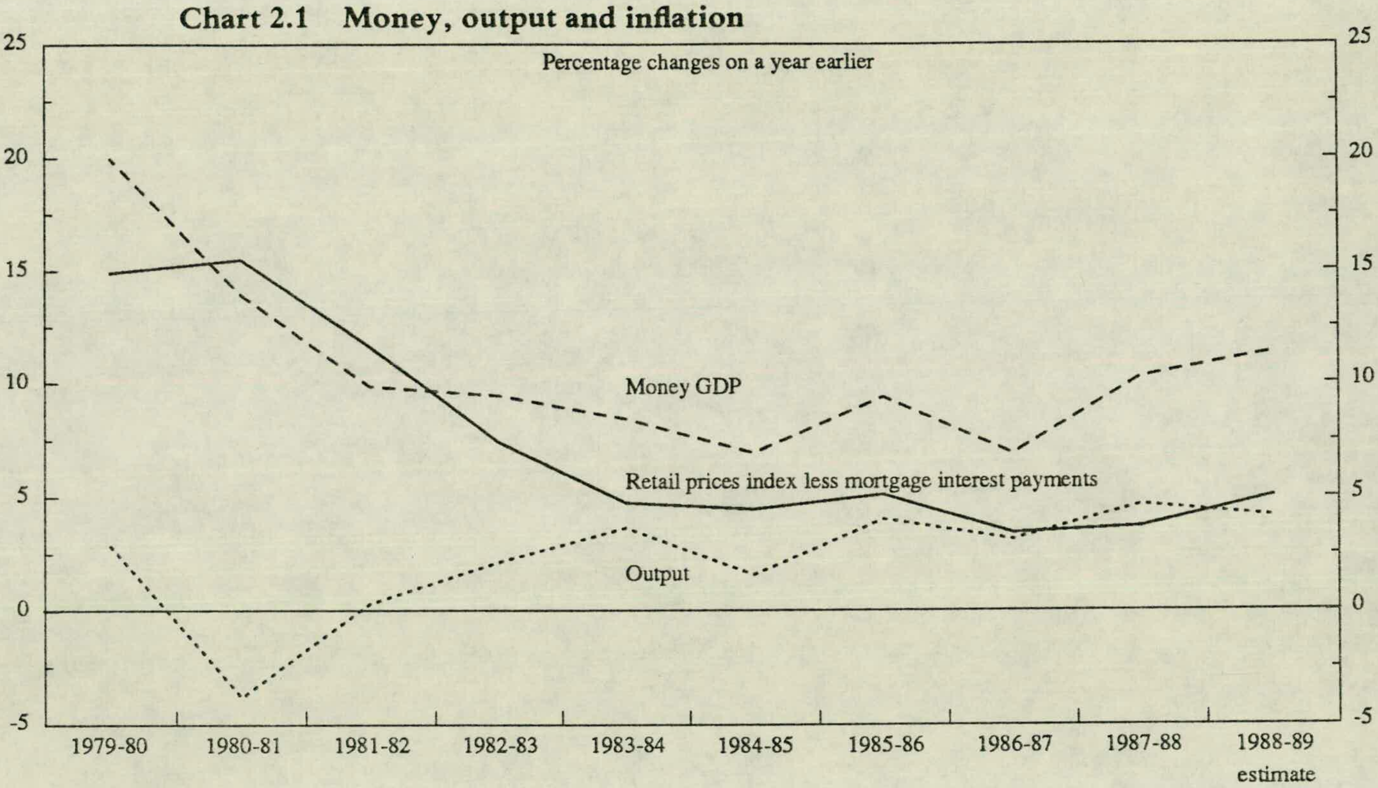
2.04 The nominal framework has been expressed in essentially its present form for the past six years. A medium term path for money GDP has been shown in all versions of the MTFS since 1982. M0 was introduced as a target aggregate in 1984, initially alongside M3, and since 1987 has been the only monetary aggregate for which a target range is given. The importance of the exchange rate in the assessment of monetary conditions was discussed in the 1982 MTFS, and restated regularly in subsequent versions.

2.05 Since the introduction of the MTFS, objectives for fiscal policy have been described in terms of the public sector borrowing requirement (which has now become a public sector debt repayment). With the PSBR at almost 5 per cent of GDP in 1979–80, a major reduction in the deficit was an essential component of the strategy in the early years of the MTFS. Since then, the public finances have been transformed and are now in substantial surplus; this has allowed the Government to move from a medium term
x objective of deficit reduction/ to a long term objective of a balanced budget.

Economic performance since 1980

2.06 As a result of ~~continuing~~ sound financial policies coupled with supply side reforms, substantial economic progress has been made during the 1980s. Inflation in recent years has been brought back to levels not experienced since the 1960s. The increase in the RPI excluding mortgage interest payments is likely to have averaged about 5 per cent in 1988–89, compared with over 15 per cent in the first year of the MTFS. The growth of GDP has averaged around 3 per cent a year since 1980–81, while productivity performance has improved sharply compared both with the UK's record in the second half of the 1970s and with the performance of other industrial countries. Latest figures put the workforce in employment [almost 700 000] above its 1980–81 level and at an all time high. Industrial profitability has recovered to levels not seen for ~~25~~ 20 years. The UK has acquired one of the largest stocks of net overseas assets in the world.

Chart 2.1 Money, output and inflation



2.07 The early years of the MTFS saw a sharp decline in money GDP growth. Output fell in the first year but started to recover in 1981; as output accelerated money GDP growth settled down between about 7 and 9½ per cent a year. Since 1986, the growth of money GDP has risen somewhat, with higher output growth matched by an upward movement in inflation.

2.08 As in other industrial countries, recent growth of demand in the UK has been much stronger than expected; here this has occurred in the face of high real interest rates and a substantial tightening of fiscal policy. Private sector investment has surged—growing by perhaps 25 per cent over the past two years. And several years of rising asset prices and increased consumer borrowing have helped to stimulate household expenditure. The collapse of stock market prices in October 1987 did not dampen demand in the way that had been widely expected.

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Objective for money GDP

2.09 The Government's intention remains to bring down inflation further over a period of years and ultimately to achieve price stability. To this end, it plans to reduce the rate of growth of money GDP over the medium term; monetary policy will be directed to achieving this. Money GDP growth in 1988–89 is estimated to have overshot the path published in last year's MTFS by ~~some~~ over 3~~½~~ percentage points; but current prospects, discussed in Chapter 3, are for a substantial slowdown in demand in 1989 and the first half of 1990, in part the result of the tightening of policy during 1988. Money GDP growth in 1989–90 is forecast to be about ½ percentage point higher than envisaged in last year's MTFS.

Why is the 1991-92 growth of money GDP ½ % under than in the 1988 MTFS?

2.10 It is the Government's policy not to accommodate inflationary impulses. To the extent that faster money GDP growth reflects supply side improvements it is sensible to raise the money GDP objective to accommodate the faster potential growth; but to the extent that faster growth of money GDP reflects only higher demand with no supply side improvement, the Government will take action designed to return to its planned path for money GDP growth over the medium term.

2.11 As compared with last year the Government has revised its view of the likely real growth rate over the medium term, taking account of a slower projected decline in oil output. The medium term trend in output growth consistent with declining inflation is now put at 2¾ per cent, compared with 2½ per cent assumed last year; the medium term trend in non-North Sea output growth consistent with declining inflation is put at 3 per cent.

2.12 Table 2.1 sets out the Government's revised objectives for money GDP. The aim is to get back by 1991–92 onto the path implied by last year's money GDP objectives, after allowing for the higher trend output growth now assumed. The new path is intended to be consistent with reducing inflation to 3 per cent by 1991–92, as ~~assumed~~ envisaged in last year's MTFS. There will inevitably be some fluctuation around ~~this~~ the path for money GDP ~~path~~. ~~For any particular year~~, Moreover the ~~precise~~ split between output and inflation implied by it ~~achievement of the money GDP path shown in Table 2.1~~ is ~~inevitably~~ subject to unavoidable uncertainty; illustrative assumptions are shown in ~~the table~~ Table 2.1. Following two years of rapid growth, output is likely to grow somewhat less than trend in the next two years.

Table 2.1 Money GDP growth, output and inflation[1]

		1988–89	1989–90	1990–91	1991–92	1992–93
Money GDP		**10¾**	~~7½~~ 8	**6**	**6**	**5½**
Real GDP:	non-North Sea	5	2½	2¼	3	3
	total	4	2½	2	2¾	2¾
Inflation:	GDP deflator	6½	5½	4	3	2½

[1] Percentage changes on previous financial year. The figures for 1989–90 are forecasts; the figures for subsequent years show the Government's medium term objectives for money GDP and consistent assumptions for output and inflation. The projections in the table make no allowance for any effect of the replacement of local authority rates by the Community Charge on recorded growth in money GDP or the GDP deflator.

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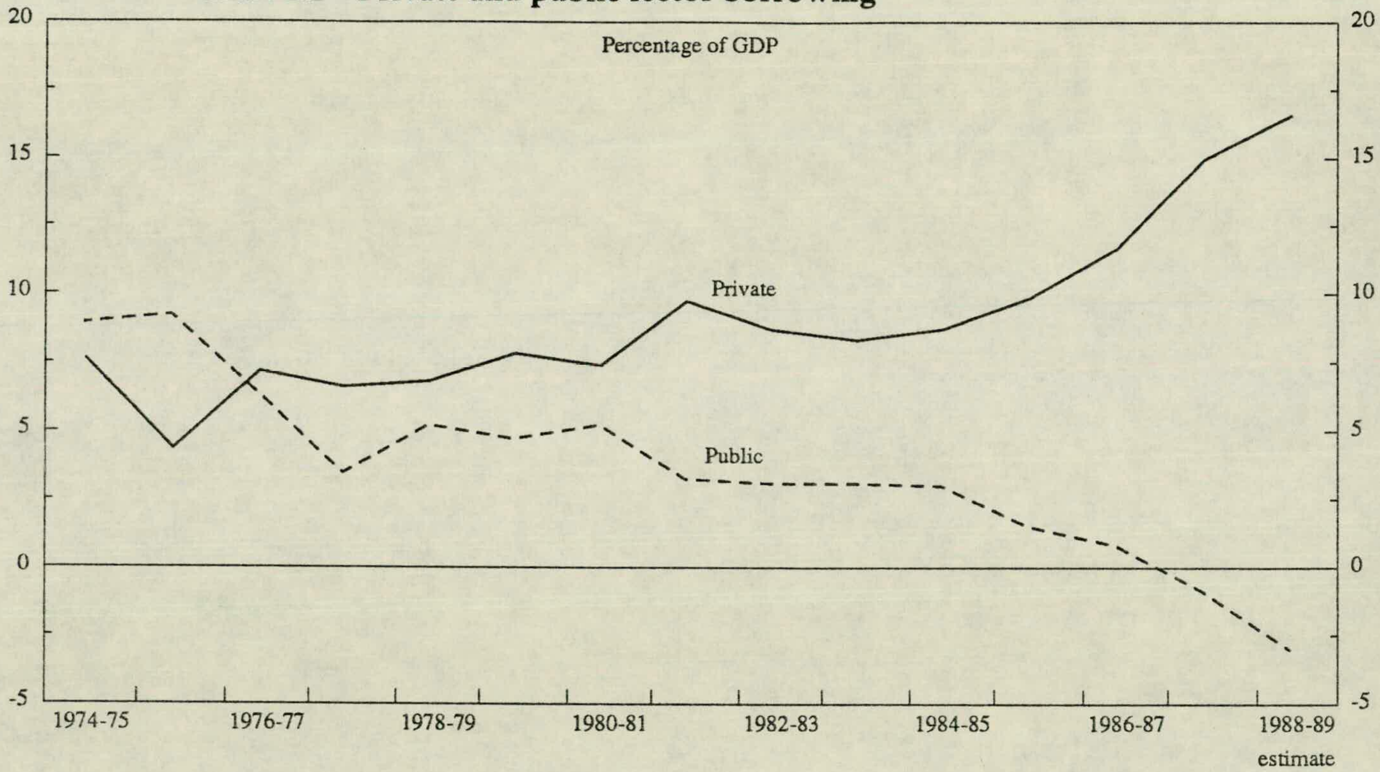
and these

2.13 The flows of saving and investment in the economy over the medium term are also uncertain; ~~the~~ inherent uncertainties are compounded at present by the discrepancies in the macroeconomic statistics discussed more fully in Chapter 3. In recent years the private sector as a whole appears to have moved from large surplus into substantial deficit, and this has led to the balance of payments current account moving into deficit despite the public sector's move into surplus. It seems likely that these trends will reverse themselves over the medium term, and the private sector's financial position is likely to move closer to balance. In particular, the personal debt/income ratio, which has been rising fast, should tend to stabilise, as borrowers and lenders become more cautious about allowing further increases: this will imply higher net personal saving.

Chart 2.2 Private and public sector borrowing



Monetary policy

2.14 The task of exerting downward pressure on inflation falls to monetary policy, conducted within a sound fiscal framework. Experience in the UK and elsewhere has shown that direct quantitative controls, once thought to be a possible instrument of monetary control, are not only inefficient and distortionary, and so undesirable, but also ineffective in today's sophisticated financial markets. Even a decade ago, markets were learning quickly how to circumvent such controls; their proficiency in doing so would be much greater now. The further liberalisation announced today, including the abolition of the Control of Borrowing Order (see box), removes one of the last vestiges of post-war controls on capital markets.

, with its antecedents,

wp

Further Measures Liberalising the Financial Markets

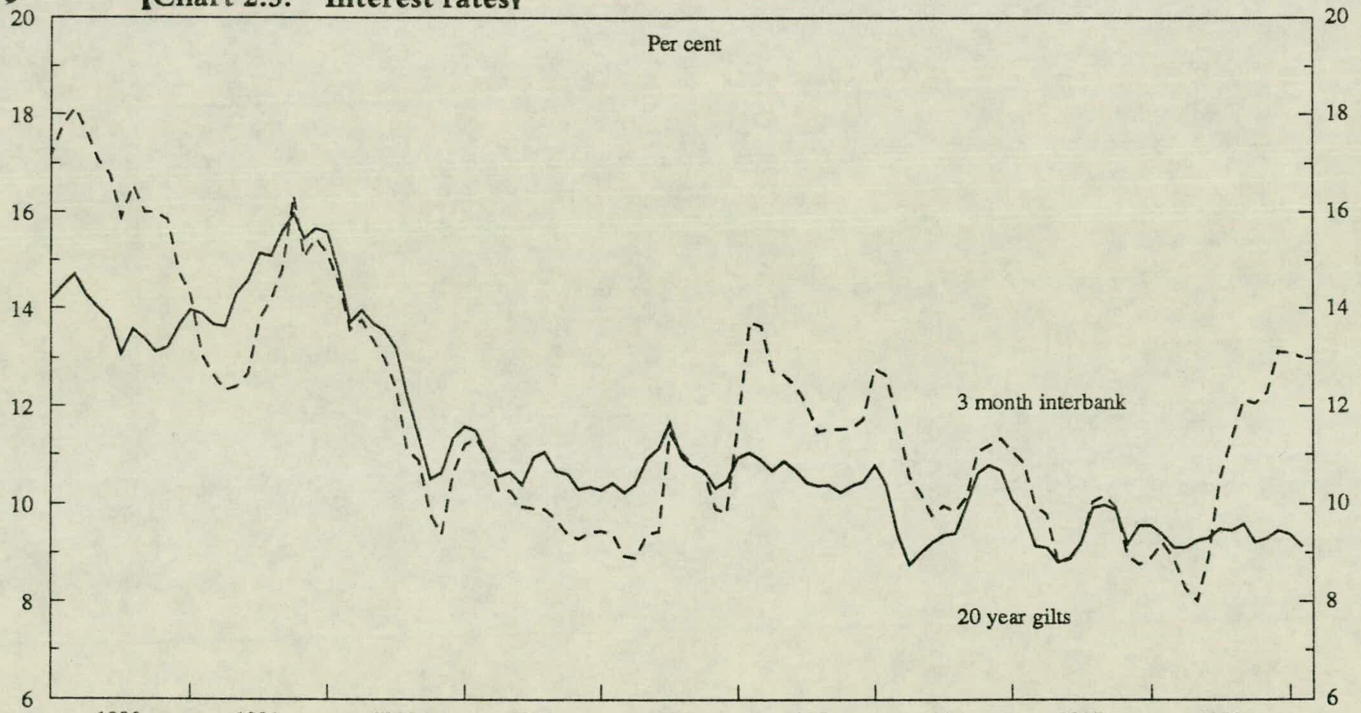
The removal of controls in financial markets since 1979 has contributed to greater competition and efficiency in the allocation of capital. Further liberalisation was announced in the Budget. The Control of Borrowing Order (COBO), which, with its antecedents, goes back to the immediate post-War period, ~~will now apply only to local authorities.~~ ~~This~~ The ~~means that from [today] the~~ Bank ~~of England~~ will no longer operate a new issues queue in the equity and bond markets. The regulatory regime for sterling commercial paper and short-term corporate bonds is also to be significantly liberalised, creating a single regime for sterling paper with an initial maturity of 0 to 5 years. In addition, the restrictions preventing certain organisations, including foreign sovereigns and private companies, from making sterling issues in this maturity range will be removed.

is to be revoked and its parent legislation repealed. A General Consent has been issued by the Treasury which means that it will no longer be necessary for new issues (other than local authorities) to obtain the Bank of England's consent to the timing of their issues.

COBO itself will remain in ~~force~~ place, solely for local authorities, only until new controls on their borrowing, contained in the Local Government and Housing Bill, come into force.

2.15 Here, as in other countries, monetary policy is implemented by changing the level of short-term interest rates. The process of financial liberalisation has increased the power of interest rates as a policy instrument. They can now fulfil their function as the price of money and credit unhampered by quantitative controls. At the same time, the rise in borrowing and holdings of liquidity, which followed liberalisation, means that interest rates now act on a wider base.

Chart 2.3: Interest rates



2.16 Decisions about interest rates are made on the basis of a comprehensive assessment of monetary conditions. The evidence of a range of indicators has to be appraised and balanced. But the assessment gives particular weight to

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, Seasonally adjusted,

the behaviour of narrow money in relation to its target range and to the exchange rate. Attention is also paid to the behaviour of broad money ~~and~~, or liquidity. Short-term interest rates fell from 9 per cent in early 1988 to touch 7½ per cent for a fortnight in May. Thereafter, they were raised steadily to reach 13 per cent by the end of November, where they have remained. ~~Longer term interest rates have scarcely moved, generally fluctuating between 9 and 9½ per cent throughout the past year. Currently they stand at just over 9 per cent.~~

2.17 Longer term interest rates have been stable despite the rise in short rates. 20 year gilts ~~yts~~ yields have fluctuated between around 9 and 9½ percent throughout the past year and currently stand near the middle of this range. This relative stability has been a feature of recent years. Since the sharp decline in 1982, the trend in long rates has been gently downwards, with only minor fluctuations.

2.18 Narrow money, as measured by M0, has continued to have a reliable and predictable relationship with money GDP. Reflecting the higher growth of money GDP, the 12 month growth rate of M0 has been above the target range throughout 1988–89. M0 grew particularly rapidly between March and September last year, but has slowed sharply since the autumn in response to the higher interest rates in the second half of 1988. Its ~~estimated~~ annualised growth over the last six months is [under 3 per cent], the lowest since the middle of 1987.

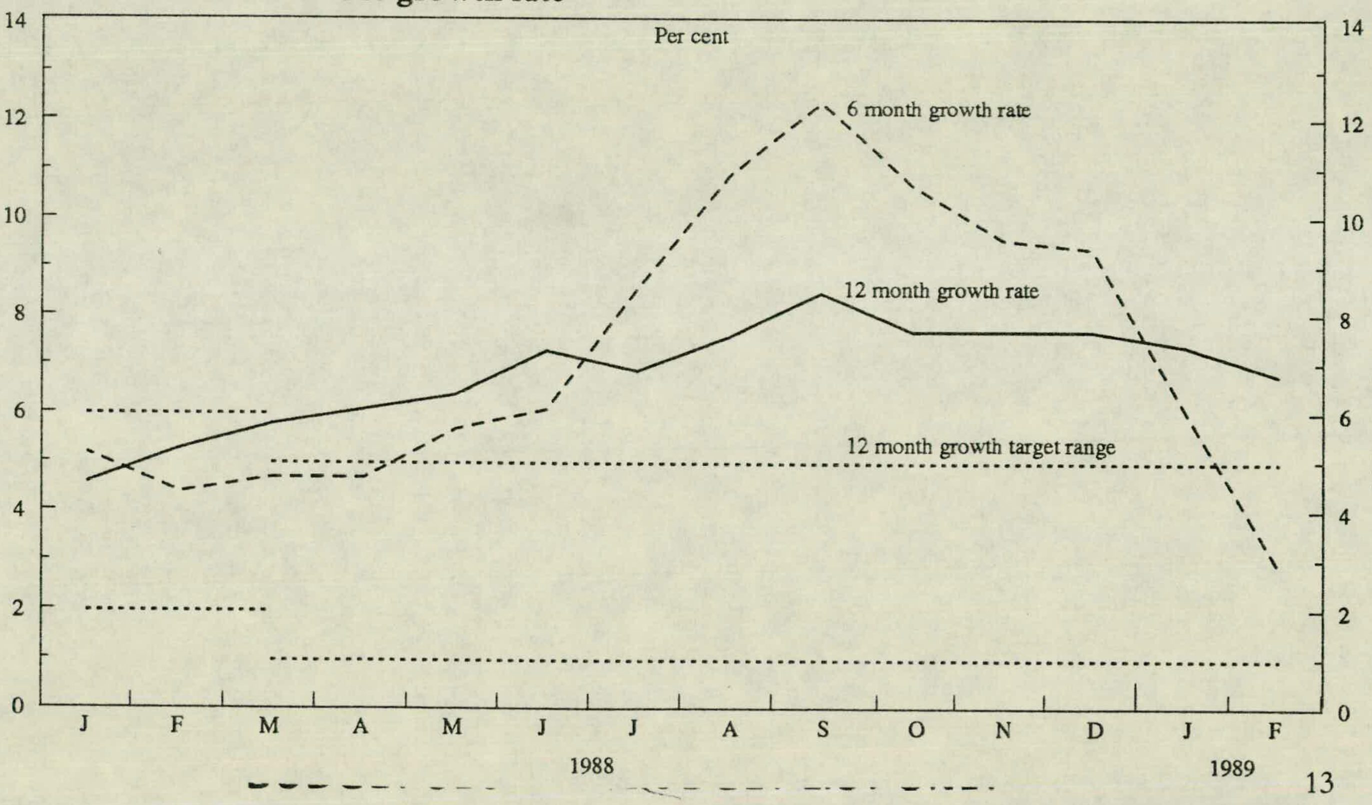
2.19 For 1989–90, a target range for M0 of 1–5 per cent has been set, the same as the illustrative range for that year in last year's MTFS. Measured by the 12 month growth rate, it is likely to begin the year above the target range. But as the deceleration over recent months continues, it will come back within it. The ranges given in Table 2.2 for later years are illustrative and show a steady fall consistent with the declining path for money GDP growth.

Table 2.2 Growth of M0[1]

1988–89	1989–90	1990–91	1991–92	1992–93
7½	1 to 5	0 to 4	0 to 4	−1 to 3

[1] 1988–89: forecast per cent change on previous financial year;
1989–90: target range for 12 month growth rate; 1990–91 onwards: illustrative ranges.

Chart 2.4 M0 growth rate

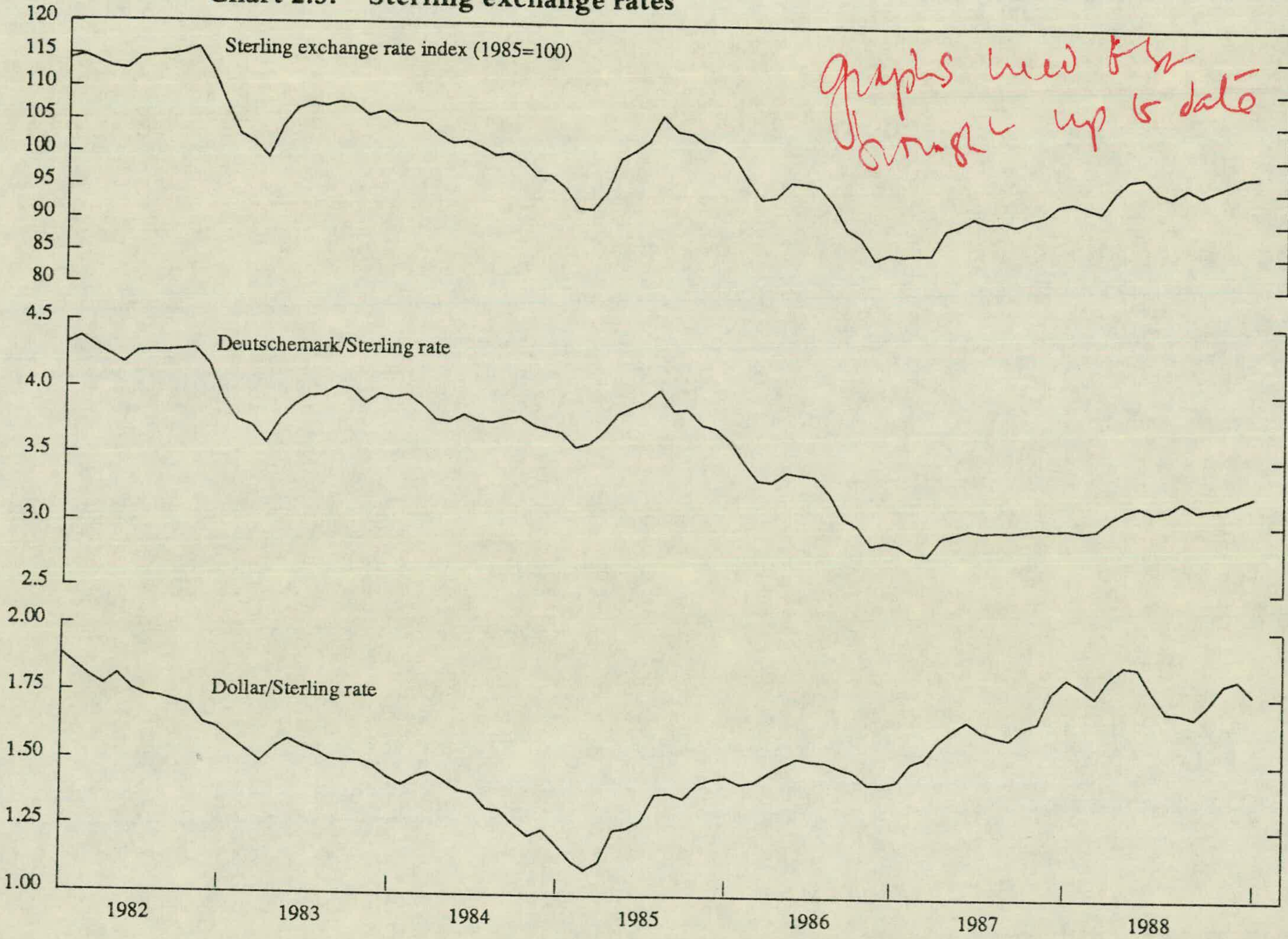


slightly

2.~~19~~ 20 The exchange rate is a key influence upon, and a key indicator of, monetary conditions. It has to be considered together with all the evidence of domestic indicators in making monetary policy decisions. Monetary policy has the overriding task of defeating inflation: the Government is accordingly not prepared to accommodate increases in domestic costs by exchange rate depreciation. Sterling has risen slightly against the deutschemark over the past year. The dollar has also risen against the deutschemark, though it has shown little change against the yen.

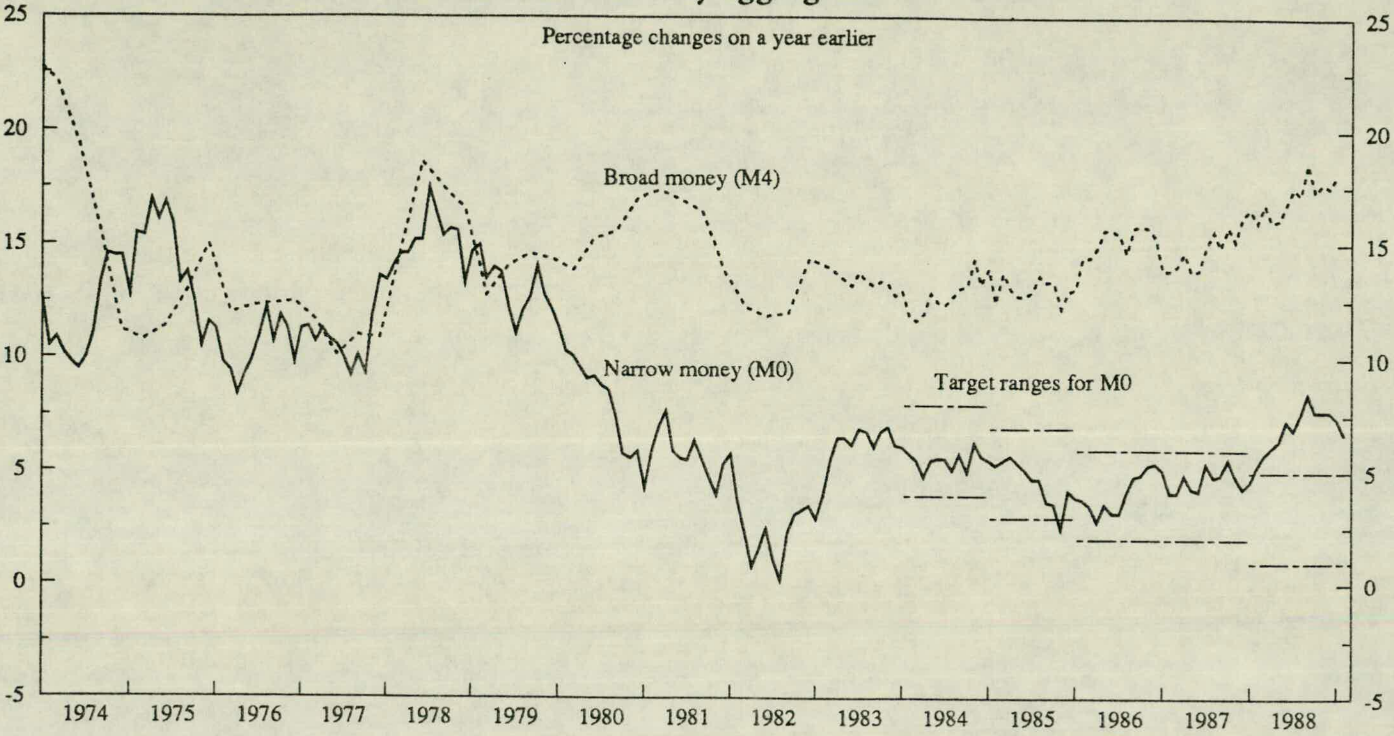
2.~~20~~ 21 Exchange rates are also important in international economic relationships. The improved co-operation between the G7 countries, who share a common counter-inflationary objective, has been clearly beneficial to the international community.

Chart 2.5: Sterling exchange rates



2.~~21~~ 22 In assessing monetary conditions, the interpretation of broad money, or liquidity, requires considerable judgment. There have been significant changes in the relationship between broad money and spending ~~in recent~~ over the years. Because it is used as a store of value as well as for transactions purposes, what matters, so far as subsequent inflationary pressure is concerned, is not its growth rate alone but the extent to which people are prepared to hold interest-bearing money balances rather than to spend them.

Chart 2.6: Growth rates of money aggregates



Funding policy

2.22 [3] The Government will continue to conduct its own financial affairs so as to have a broadly neutral impact on liquidity. That (is) embodied in the policy of funding the net total of maturing debt, the PSBR, and any underlying increase in the foreign exchange reserves, by sales of debt outside the banking and building society sectors. Should this total be negative, then 'unfunding' will be required, that is, the authorities will make purchases of debt. Gilts bought in by the Bank of England are normally held in its Issue u/c department. The Government is taking powers, in this year's Finance Bill, to enable the National Loans Fund to acquire these gilts for cancellation.

2.23 [4] Now that the public sector is repaying ~~the~~ debt, it is possible to devote more attention to the structure of the remaining debt, both to secure lower expected servicing costs and to improve the quality of debt by reducing reliance on borrowing in the form of liquid instruments. Attention will also be paid to smoothing the profile of redemptions. The reverse auction conducted in January 1989, the first of its kind, enabled the authorities to make substantial purchases of gilts maturing in 1989–90, a year when maturities will be particularly heavy. [The gilts which the authorities purchased were also becoming increasingly liquid.]

See Peck, note below

2.24 [5] ~~In taking account of costs,~~ In general, however, ~~The~~ the Government ~~will decide~~ decides what types and maturity of debt to repurchase or issue, depending on current relativities and expected future yields. In 1988–89, the Government took the view that, on this criterion, its longer term debt looked relatively expensive borrowing ~~to service~~. Accordingly, much of the buying-in of conventional gilts required by the full fund policy was of longer maturity issues, so as to secure greater future debt interest savings. The fact that the Government has been a net repurchaser of long term debt and the emergence of a downward sloping yield curve have created favourable conditions for longer term borrowing by the private sector. The increasing volume of fixed rate sterling borrowing by companies has been a welcome development.

0362

particularly

e/c

Reverse order of 1st 2 sentences

6

2.25 In circumstances when the Government believes it will reduce inflation in a way that is not yet fully reflected in market yields, index-linked borrowing becomes attractive to the Government as compared with conventional gilts. ~~In addition,~~ indexed debt has the advantage of reducing uncertainty, to both the Government and investors, about future real yields. Net sales of indexed gilts continued in 1988–89, despite the reduction in total gilts outstanding, and about one eighth of ~~the~~ all gilts outstanding are now in indexed form.

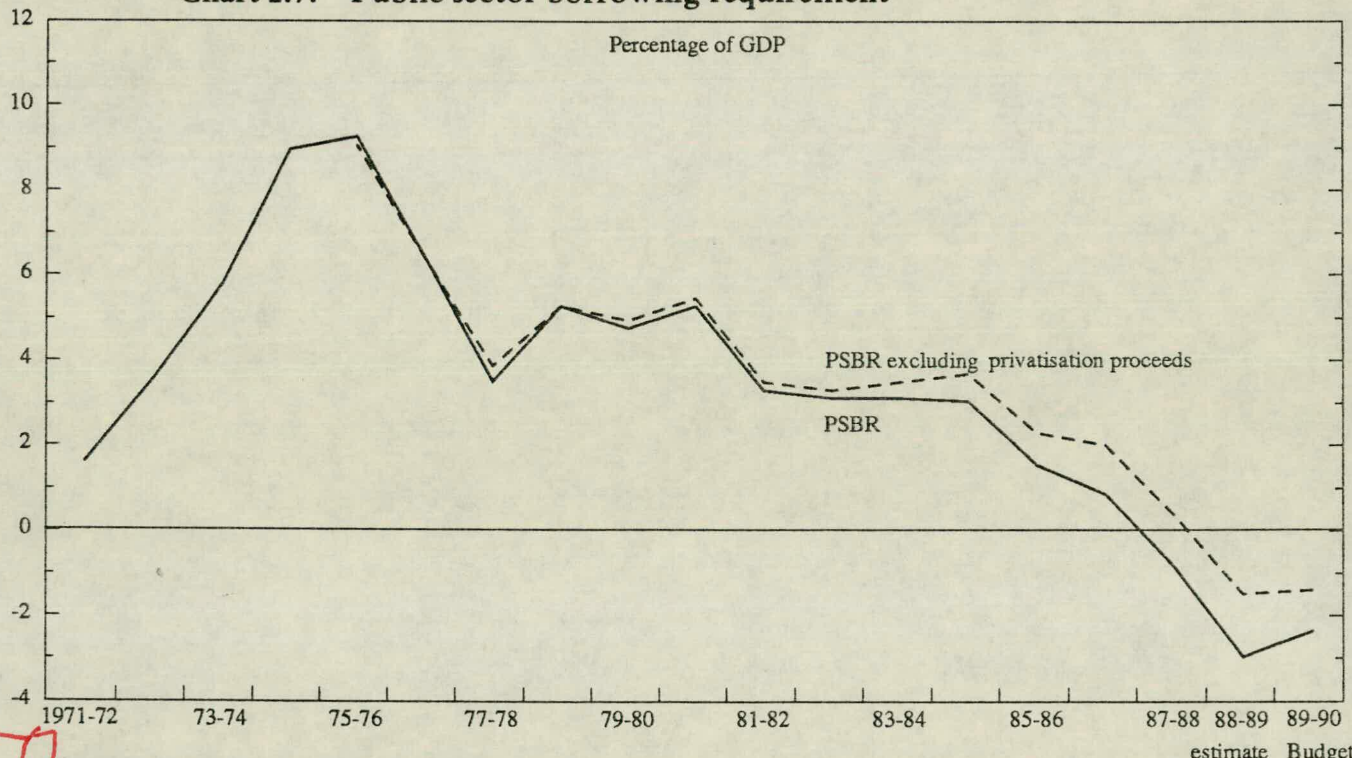
X X

Fiscal policy

7

2.26 It is now expected that the net repayment of debt in 1988–89 will total about £[14] billion ([3] per cent of GDP), compared with a forecast in last year's Budget of £3 billion. Even allowing for the fact that privatisation proceeds are now expected to be some £2 billion higher than forecast a year ago, this means that the fiscal stance has been considerably tighter than planned, reflecting in large part the strength of economic activity which has both boosted tax revenues and depressed public expenditure.

Chart 2.7: Public sector borrowing requirement



?

1 Negative values indicate a public sector debt repayment.

8

2.27 The long term objective of fiscal policy remains a balanced budget. This helps to ensure that the state is making no claim on the flow of the nation's saving or on flows from overseas. It reduces the burden of debt servicing, making room for lower taxes and higher public expenditure on priority services, and it also helps to secure confidence in sterling and in the financial stability of the economy.

On reflection, this justification won't do: it would apply a fortiori to a budget surplus & certainly doesn't explain why we want a balanced budget.

I have redrafted the para: attached.

2.28 The long-term objective of fiscal policy remains a balanced budget. This provides a clear and simple rule, with a good historical pedigree. It ~~provides~~ constitutes a firm buttress for monetary policy in the struggle against inflation, while enabling the burden of public debt, and with it debt interest, steadily to diminish as a ~~share~~ proportion of ~~GDP~~ the economy as a whole. And it means that as public expenditure declines as a share of GDP, so too can the burden of taxation.

§ gradually

u/c

2.~~28~~ 29 The Government intends to move gradually from the present surplus towards a balanced budget ~~[gradually/progressively]~~ over the medium term. The PSDR for 1989–90 has been set at £12 billion; this is equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The projected PSDR path thereafter is shown in Table 2.7. As usual, the PSDR to be set in future Budgets will be reviewed in the light of circumstances at the time; as tax rates are set on the basis of medium to longer term objectives the PSDR will tend to be increased by GDP growth above trend, and to be reduced by below trend GDP growth.

Public expenditure

Firm control of public expenditure coupled with

to fall

has caused

2.~~29~~ 30 The Government's objective for expenditure is to maintain a downward trend over the medium term in the ratio of general government expenditure to GDP. ~~Partly as a result of~~ the strength of economic activity the ratio of GGE excluding privatisation proceeds to GDP ~~has fallen~~ by 7 percentage points since 1982–83. This is the largest and most sustained fall since the immediate post-war period and it has brought the ratio back to levels not experienced since the ~~late~~ 1960s. The Government is determined to build on this achievement.

§

Table 2.3: General government expenditure (excluding privatisation proceeds) as a percentage of GDP[1]

1963-64	36 1/4				
1964–65	36	1974–75	48¼	1984–85	46¼
1965–66	37¼	1975–76	48½	1985–86	44½
1966–67	38¾	1976–77	46	1986–87	43¾
1967–68	42¼	1977–78	42¾	1987–88	41½
1968–69	41	1978–79	43¼	1988–89	39¼
1969–70	40¼	1979–80	43½	1989–90	39¼
1970–71	40¾	1980–81	46	1990–91	39
1971–72	41	1981–82	46½	1991–92	38¾
1972–73	41	1982–83	46¾	1992–93	38
1973–74	42¾	1983–84	45¾		

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 onwards: MTFS projections.*

Is there no typographical convention for distinguishing the future from the past? (eg ~~italics~~ figures in italics)

Shd contain July | not attractive Can't we get 88-89 up

2.3~~0~~1 Projections of government expenditure are shown in Table 2.4. For the period to 1991–92, they incorporate the public expenditure plans shown in the public expenditure White Paper (Cm 601–621); the projections of gross debt interest payments and other adjustments are consistent with the latest economic projections and assumptions. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1992–93. Decisions will be taken in the 1989 Survey.

Table 2.4 General government expenditure[1]

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Public expenditure planning total	145·7	150 ~~151~~·6	167	179	192	200
Gross debt interest	17·8	18·3	16·5	15	14·5	14
Other adjustments	8·3	9·9	10	10·5	9·5	9·5
General government expenditure[2]	**171·~~8~~ 7**	**178·8**	**194**	**205**	**216**	**223**
Privatisation proceeds	5·2	7·0	5	5	5	5
General government expenditure excluding privatisation proceeds	**177·0**	**185·8**	**199**	**210**	**221**	**228**

[1] *For 1987–88 to 1991–92, the figures are taken from Table 5.1.*

[2] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1989–90 onwards* ; except for debt interest and other adjustments which are rounded to the nearest ~~£~~ £0.5 billion. *General government expenditure is assumed to grow by 1% in real terms in 1992–93.*

A Riley
Paun

Revenue

2.3~~1~~2 The growth in government revenues over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. Government revenues from the North Sea are projected to decline relative to money GDP as oil output falls. After taking account of the tax reductions announced in the Budget, non-North Sea revenues are also projected to grow at a little under the rate of growth of non-oil money GDP.

Table 2.5 General government receipts

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Taxes on incomes, expenditure and capital						
National insurance and other contributions						
Interest and dividends						
Other receipts						
General government receipts [1]						
of which						
North Sea tax[2]						

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1988–89 onwards.*

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

Table 2.6: Non-oil taxes and national insurance contributions as a percentage of non-oil money GDP[1]

1963-64	29				
1964–65	29½	1974–75	35¾	1984–85	37¾
1965–66	31¼	1975–76	36¼	1985–86	37
1966–67	32	1976–77	36	1986–87	37½
1967–68	33¼	1977–78	35	1987–88	37¾
1968–69	35¼	1978–79	34¼	1988–89	37½
1969–70	36¾	1979–80	35½	1989–90	[37½]
1970–71	36¼	1980–81	36¼	1990–91	[36½]
1971–72	34¾	1981–82	38¾	1991–92	[36½]
1972–73	32½	1982–83	38¼	1992–93	[35½]
1973–74	33¼	1983–84	37¾		

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 MTFS onwards: MTFS projections.*

Same comment as per Table 2.3, but perhaps even more desirable.

Public sector borrowing

2.3~~2~~3 The projections of government expenditure receipts are brought together in Table 2.7 to provide projections of the general government borrowing requirement (GGBR), the PSBR and the fiscal adjustment.

2.3~~3~~4 Changes since the 1988 MTFS are discussed in the annex to this chapter.

Table 2.7 Public sector debt repayment[1]

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
General government expenditure						
General government receipts						
Fiscal adjustment from previous years[2]						
Annual fiscal adjustment[2]						
GGDR						
Public corporations' market and overseas debt repayment						
PSDR						
Money GDP at market prices						
PSDR as per cent of GDP						

[1] *Rounded to the nearest £1 billion from 1988–89 onwards. Further details for 1988–89 and 1989–90 are provided in Tables 1.2 and 6.9*

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

Conclusion

2.3~~4~~5 This tenth issue of the MTFS has reviewed the greatly improved economic record of the 1980s. It has reaffirmed the Government's commitment to reducing inflation and to the policy of lower taxes and lower public spending as a share of GDP. The MTFS provides the financial framework within which the policies to achieve the Government's objectives are set.

Annex to Chapter 2

Changes since the 1988 MTFS

Money GDP

2A.1 The growth rate of money GDP is expected to be higher in both 1988–89 and 1989–90 than envisaged in last year's MTFS, with growth in the GDP deflator 2[illegible] percentage points higher in 1988–89 and 1½ points higher in 1989–90. Inflation is projected to get back to last year's path by 1991–92. The projected trend in output growth over the medium term in the whole economy is ½ percentage point higher than in last year's MTFS, reflecting a slower decline in oil output.

Table 2A.1 **Money GDP growth**

Differences from 1988 MTFS projections, percentage points

1988–89	1989–90	1990–91	1991–92
+3¼	+1½	0	+½

Monetary aggregates

2A.2 M0 has moved above its target range during 1988–89 but it has been growing more slowly since the autumn. The target range for 1989–90 is the same as the illustrative range given last year. The illustrative ranges for subsequent years are also the same.

Table 2A.2 **The growth of M0**

	Per cent changes on a year earlier			
	1988–89	1989–90	1990–91	1991–92
1989 MTFS	7½	1–5	0–4	0–4
1988 MTFS	1–5	1–5	0–4	0–4

Fiscal projections

2A.3 Table 2A.3 shows changes in the fiscal projections since the 1988 FSBR. Additional information on 1988–89 is given in Chapter 6.

Expenditure

2A.4 The undershoot on the planning total in 1988–89 is described in Chapter 5. The planning total for 1989–90 onwards is as in the public expenditure White Paper (Cm 601–621), which incorporates higher figures for 1990–91 and 1991–92 than assumed last year. The general government expenditure figures for the future have also been revised up since last year; but to a lesser extent in 1990–91 and 1991–92 than the planning total, as the path for PSDR now assumed implies lower debt interest payments.

Receipts

2A.5 Revenues in 1988–89 have been much higher than forecast, in large part reflecting higher money GDP growth in both 1987–88 and 1988–89. Because of some lag between the accruals and payments of taxes, the buoyancy of the economy over the last year will still be contributing to the growth of revenues in 1989–90. In spite of the effect of the Piper Alpha and other accidents on oil output, North Sea revenues in 1988–89 were almost exactly as forecast. The accidents are likely to have their major revenue impact in 1989–90 and ~~the~~ revenue forecast for 1989–90 ~~has been reduced~~ since last year ~~partly because of the effect of the Piper Alpha disaster and other recent accidents~~.

XX account for most of the reduction in the oil

Table 2A.3 Revenue and expenditure[1]

	Changes from 1989 MTFS projections, £ billion			
	1988–89	1989–90	1990–91	1991–92
Expenditure				
1 Planning total				
2 Other[2,5]				
3 General government expenditure				
Receipts[3]				
4 North Sea taxes				
5 Other taxes and contributions				
6 Other[2]				
7 General government receipts				
8 Implied cumulative fiscal adjustment[4]				
9 Public corporations' market and overseas debt repayment[5]				
10 PSDR				

[1] *Rounded to the nearest £½ billion. Classification changes since the 1988 FSBR are included but their effects on both expenditure and receipts is small.*
[2] *Includes changes in debt interest and other items.*
[3] *The allocation of tax receipts between North Sea and other is affected by the treatment of advance corporation tax set off.*
[4] *Line 8 = lines 9 − 10 − 3 + 7.*
[5] *Public corporations' market and overseas debt repayment is deducted from the planning total, and included in the PSDR, but not in general government expenditure. Changes in it are therefore added to line 2 and subtracted in line 9.*

chex.md/aa/19 BUDGET SECRET ACSA/BS/89/7

COPY NO 24 OF 24

FROM: A C S ALLAN
DATE: 2 March 1989

MR MACPHERSON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Gilhooly
Mr Matthews
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill IR
Mr Calder IR

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

FSBR CHAPTER 4

The Chancellor was grateful for your minute of 1 March. He had the following comments on your covering note and on the redraft of chapter 4.

(i) He does not understand why we cannot publish a "mature" yield from the life assurance package: surely the detailed work done on the costings provides a reliable basis? He would be grateful for further advice from FP and the Revenue on this.

(ii) He was content with your redraft of the second age allowance indent in paragraph 4.02.

(iii) Throughout the draft, you will need to take on board any changes that maybe made to the final package.

(iv) He was content with your neat solution of including the pensioners earnings rule as a National Insurance measure.

(v) He would prefer the final sentence of paragraph 4.31, on VAT on non-domestic construction, to be joined together so that it reads "VAT will also be applied from 1 April 1989 to protective boots and helmets supplied to employers, and to news services; and from 1 July 1990 it will be applied to fuel and power supplied to businesses, and to water and sewerage services supplied to industry.

(vi) The first two sentences of paragraph 4.37, on NICs, should be redrafted to read "From 2 October, the structure of employees' National Insurance contributions will be reformed. Employees will pay Class 1 contributions equal to 2 per cent of earnings up to the lower earnings limit....."

(vii) He was content with the Financial Secretary's redraft of paragraph 4.35, on Keith, subject to two small changes: amend the end of the first indent to read "...and provide the taxpayer with greater safeguards"; and amend the end of the third indent to read "....greater protection for the taxpayer".

(viii) Amend the manuscript addition to paragraph 9 of the annex to read "Tax yield of these measures will eventually be of the order of £100 million...."

ACSA

A C S ALLAN

COPY NO: 1 OF 15 COPIES

FROM: COLIN MOWL
DATE: 2 March 1989

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Riley
Mr Gieve
Mr Pickford
Mr S J Davies
Mr Patterson
Mrs Chaplin

Thanks. I await further submission promised para 15. But looks [illegible] as far [illegible] sensible & shows same PSBR in 1989-90 as estimated outturn for 1988-89 despite lower privatisation proceeds. (This still provides some flexibility; [illegible] we have flexibility over what we estimate for 1988-89 outturn). N

Ch
The message at the end (+ Feb CGBR figures) make it look v likely we'll have higher PSDRs all the way through. AA

PSDR IN 1989-90

You asked for a note on why outside forecasts of the PSDR are coalescing around a higher figure than our own (Mr Allan's minute to me of 28 February).

2. The table below compares our best forecast with five recent outside forecasts. Four of the five have higher pre-Budget PSDRs than our own, the exception being Hoare-Govett whose forecast is £½ billion lower than ours.

£ billion

	1988-89	1989-90		
	PSDR	Post-Budget PSDR	Fiscal Adjustment	Pre-Budget PSDR
Treasury*	14.5	13.5	2.0	15.5
Hoare-Govett	11.8	13.5	1.5	15.0
IFS/Goldman Sachs	12.4	15.5	1.5	17.1
LBS	12.9	15.7	1.3	17.0
NIESR	12.6	16.2	3.0	19.2
Phillips & Drew	14.1	18.2	2.0	20.2

* Mowl to Chancellor 17 February ("PSDR in 1989-90 with NICs Reform") — these are so-called "best estimates"

3. The IFS/Goldman Sachs and Hoare-Govett forecasts were completed before the January outturn for the PSDR was published. Although the LBS and NIESR forecasts were only published in the last week we believe that most of the detailed figuring also preceded the January figures. The Phillips and Drew forecast probably does take account of January.

4. It is always difficult to explain why our forecasts of the PSDR differ from those of outsiders because the outside forecasts typically report very little detail (in some cases this reflects the way they construct their forecasts). Of the forecasts in the table this is particularly true of Hoare-Govett and Phillips and Drew (P & D). The two model based forecasters, the LBS and NIESR, give a certain amount of detail along the lines of table 6.7 from last year's FSBR. The IFS/Goldman Sachs Green Budget is the most detailed, being in the form of FSBR table 1.2. Hoare-Govett has the least detail and is not discussed further in this minute.

5. All the outside forecasts have higher money GDP growth than that underlying our PSDR forecast.

1989-90 - % increase on previous year

	Treasury[1]	IFS/GS	LBS	NIESR*	P & D
Money GDP	7.4	8½	8.4	8.0	10.0
GDP deflator	5.1	5½	5.3	6.1	7.4
Real GDP	2.2	3	3.1	1.8	2.6

[1] figures since revised

* factor cost

The composition, as well as the level, of money GDP affects the PSDR, particularly in the short run. But other things equal the higher the growth of money GDP the higher the PSDR. If the higher money GDP growth is the result of higher real growth, as appears to be the case with the LBS and the IFS, receipts would be higher and expenditure lower. If it is the result of higher inflation, as is the case with NIESR and P & D, receipts would be higher. There would however be upward pressure on expenditure, but if cash limits generally hold, as seems to be implicit in all the outside forecasts, cash expenditure might be largely unchanged.

6. Our standard ready reckoner show that 1 per cent on money GDP from higher real growth increases the PSDR by £1¼ billion in the first year: the effect could be bigger. Thus differences in money GDP assumptions might explain a good deal of the difference between our PSDR forecast and those of the LBS and IFS.

7. We do not have any up to date inflation ready reckoners but the arguments above suggest that the effect on the PSDR of 1 per cent more money GDP from higher prices might be a little less than the effect of extra money GDP from higher real growth. It is possible therefore that the difference on money GDP might account for up to half of the difference between our PSDR forecast and that for P & D. The difference in money GDP explains very little of the difference between our PSDR forecast and that of NIESR. There are however other explanations in the case of NIESR (see paragraph 11 below).

8. This sort of aggregate analysis can be no more than indicative. A given forecast of total money GDP may be consistent with a wide range of outcomes for the PSDR. The rest of this minute considers some of the specific differences between our forecast of the PSDR and those of the outsiders which provide supporting detail, namely the LBS, IFS/Goldman Sachs and NIESR.

<u>LBS</u>

9. The LBS's forecast for 1988-89 has not yet caught up with the latest privatisation proceeds figure. Taking this on board would bring their PSDR for this year up to about £14 billion. Their PSDR forecast for 1989-90 is £1½ billion higher than ours. As already noted most of this may be due to a higher forecast of money GDP. The £1½ billion PSDR difference is more than accounted for by higher taxes on income and expenditure in the LBS forecast. Much of the former is from higher taxes on companies. Although the LBS has smaller <u>growth</u> of corporate taxes in 1989-90 than in our forecast they are starting from a 1988-89 level which, latest information suggests, is much too high.

10. There are some oddities on the expenditure side of the LBS forecast. They claim that their forecast is very close to the PEWP figures and indeed their quoted figures for the planning total and GGE are each only £½ billion different from the PEWP. But within GGE they have a debt interest forecast nearly £2 billion above, and other national accounts adjustments £2¾ billion below, the PEWP.

IFS/Goldman Sachs

11. The IFS take the PEWP figures for public expenditure including the figure for debt interest. As the prospects are now for lower debt interest than in the PEWP the IFS have higher GGE than in our forecast. It follows therefore that their £1½ billion higher PSDR is more than accounted for by higher receipts. Within receipts the main difference is on corporation tax where the IFS figures are £1½ billion and £3 billion higher than ours in 1988-89 and 1989-90 respectively. Clearly there is a lot of uncertainty about the outlook for CT especially when the profits and investment data for 1988 are so fragile. But the IFS explicitly acknowledge that any "surprises" on CT receipts in January this year could alter their forecast for next year. They would therefore almost certainly revise their CT forecast for 1989-90 down in light of the latest information.

NIESR

12. The NIESR forecast is a most curious one. Despite higher money GDP than in our forecast their forecast of receipts is £2 billion lower than ours. Their higher PSDR is more than accounted for by a lower forecast of public expenditure, which, on a national accounts basis, is over £7 billion below ours. The difference is spread across the range of expenditure with lower current and capital spending and lower current grants (eg. social security). Their debt interest forecast however is £1 billion higher than ours. While of course it is possible that there will be another undershoot on expenditure, the size of NIESR's (implied) undershoot is very large given the economic background.

Assessment and risks

13. The margins of error in this area are large. A major area of difficulty is in assessing how much the recent strength of the public finances is due to the buoyancy of the economy, rather than the underlying strength of revenue and tight public expenditure control. The average error on Budget forecasts over the past then years is equivalent to £4¾ billion and recent errors have been larger than average. Much of the difference between our latest PSDR forecast and those of outsiders can be attributed to differences in economic assumptions. Some of the remaining difference can be explained by our earlier access to the latest information on the

current year, particularly corporation tax receipts in January. For many components of the fiscal outlook outsiders tend to follow our view once it is published.

14. There are risks and uncertainties, but in both directions:

- perhaps the main downside risk to the PSDR is the possibility of a sharper cyclical slowdown than currently forecast, coupled with a possible tendency to underestimate cyclical effects on the PSDR.

- one upside risk is the possibility of another undershoot on public expenditure. LA capital receipts and privatisation proceeds could again turn out considerably higher than planned. The underlying growth of social security expenditure might not pick-up as forecast. And the removal of grant penalties may not boost local authority current spending as much as the forecasts assume.

- another upside risk is that the buoyancy of revenues is more due to their underlying strength and less due to the buoyancy of activity than we have assumed.

- corporation tax is again a major uncertainty, but the risks here go in both directions.

Our latest view

15. As Mr Sedgwick's note on chapter 3 (to be circulated tomorrow morning) points out there are some changes to the economic prospects for 1989-90 that chapter 3 of the FSBR will describe. Money GDP growth is now 8-8¼ per cent compared with 7½ per cent when we last put a PSDR forecast to you. We shall be reviewing the implications of this revised GDP forecast for the PSDR and reporting back to you next week. At that point we shall also have taken on board the revenue departments' latest views and the CGBR outturn for February. But it would not be necessarily correct to anticipate a significant upward revision to our PSDR forecast for 1989-90 because much of the extra GDP is from higher profits which will only generate tax receipts from 1990-91 onwards.

Colin Mowl

COLIN MOWL

chex.ul/aa/2.28.2

BUDGET CONFIDENTIAL

BF 6/3

FROM: A C S ALLAN
DATE: 28 FEBRUARY 1989

MR MOWL

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr Riley
Mr Gieve
Mr Pickford
Mrs Chaplin

PSDR IN 1989-90

The Chancellor has noted with concern the way that outside forecasters seem to be coalescing around a PSDR forecast for 1989-90 of £17 billion or more. The LBS have a PSDR of this size "on unchanged policy" (and £15.7 billion after a 1p cut in the basic rate); the National Institute have a PSDR of £16¼ billion after income tax cuts of about £3 billion; and Phillips and Drew have a PSDR of £18 billion after tax cuts of £2 billion..

2. Why are these figures so much higher than ours? Are they based on different assumptions? Or on different forecasts of GDP growth etc? Or do they not take on board latest information (eg on Corporation Tax)? The Chancellor would be grateful for a quick note on these and other forecasts.

ACSA

A C S ALLAN

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FROM: COLIN MOWL
DATE: 17 February 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mrs Lomax
Mr Sedgwick
Mr A Allan
Mr S Davies
Miss Simpson
Mr Patterson
Ms Chaplin
Mr Tyrie
Mr Call

PSDR IN 1989-90 WITH NICs REFORM

Mr Sedgwick's minute of 16 February (The PSDR in 1988-89 and 1989-90) set out the post-Budget fiscal prospect assuming the Budget package in the Scorecard of 16 February. This minute summarises the prospect on the assumption that NICs reform with a direct revenue cost in 1989-90 of £1 billion is added, giving a package with a total cost of £2 billion.

Best Estimates

2. The NICs reform is assumed to be implemented from 1 October 1989 and to involve changes to employee NICs only (eg. option 4 in Mr McIntyre's minute of 16 February). The aggregate tax burden, as conventionally defined, measures some major taxes such as income tax, VAT and NICs, on an accruals basis. We have assumed that the direct effect of the reform on NIC accruals is £1.3 billion in 1989-90, more than the £1 billion direct receipts cost because of payment lags.

	1988-89	1989-90
PSDR excluding privatisation proceeds - £ billion		
£1 billion package	7.5	9.5
£2 billion package with NICs		8.5
PSDR excluding privatisation proceeds - % of GDP		
£1 billion package	1.6	1.9
£2 billion package with NICs		1.7
Non-oil tax burden - %		
£1 billion package	37.2	37.4
£2 billion package with NICs		37.1

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3. The addition of the NIC package reduces the PSDR in 1989-90 by £1 billion, the same as the direct revenue cost - the offsetting tax flowbacks are negligible in the first six months. On our best estimate the PSDR excluding privatisation proceeds in 1989-90 is £1 billion higher than 1988-89 with the NIC package. It barely changes between the two years as a share of GDP. With the NIC package the non-oil tax burden falls marginally.

Presentation in the FSBR

4. Were the larger package adopted the safety margins discussed in Mr Sedgwick's minute of 16 February would be lower for a given published PSDR. On the assumption that a PSDR of £14 billion were published for 1988-89 and that the PSDR in 1989-90 were the same as a percentage of GDP as in 1988-89, there would be a safety margin of only £1 billion.

PSDR (including privatisation proceeds) - £ billion	1988-89	1989-90
Best estimate with £2 billion package	14.5	13.5
Possible published figure	14.0	12.5
Safety margin	0.5	1.0

(Privatisation proceeds fall by £2 billion in 1989-90 and the PSDR excluding privatisation proceeds needs to rise by £½ billion to keep it unchanged as a percentage of GDP).

Colin Mowl

COLIN MOWL

mp.pc/docs/021

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FROM: S J DAVIES
DATE: 2 March 1989

CHANCELLOR

Thanks. The annual FA path and the final path is OK. And the PSDR path is clear an improvement on the previous submission's. But equally clearly we cannot yet take a final decision on the figs are still moving around. When ...

Ch

This is still all very provisional until forecasts settle down.

AA

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mr Pickford
Mr Barrie
Mr Savage
Miss Simpson
Mr Call
Mr Chaplin
Mr Tyrie

1982 FSBR : CHAPTER 2

This note updates yesterday's submission on MTFS fiscal projections to take account of revisions to the Budget package and a proposed PSDR path of 12.1/9/6/3.

A. <u>General government receipts</u>

2. The projection of Government revenues and the tax burden (tables 1 and 2) have been revised upwards to reflect the new package. The "Budget-adjusted" tax burden (second row of table 2) is unchanged.

We will also need to keep a close eye on the tax burden in 1989-90 & also on that of 1988-89; & also the PX ratio path.

Table 1: General government receipts

£ billion, cash

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
Taxes on incomes, expenditure and capital	133.2	144.8	156.3	165.0	173.2	182.4
National insurance and other contributions	25.0	32.8	34.5	35.8	37.8	39.9
Interest and dividends	6.1	6.8	6.9	6.7	6.3	5.6
Other receipts	5.7	6.5	6.7	6.2	6.5	7.0
General government receipts	173.5	190.9	204.4	213.6	223.8	234.9
Of which North Sea tax	4.7	3.2	2.7	2.4	2.7	2.6

i.e with 1989 package but nothing thereafter

Table 2: Non-oil tax burden before post 1989 fiscal adjustments

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
Projected	37.7	37.5	37.6	37.2	37.0	36.9
Before 1988 and 1989 Budget changes	37.7	38.4	39.2	39.2	39.2	39.2

B. <u>General government expenditure</u>

3. Table 3 shows our central projections of general government expenditure, given MTFS assumptions on output, inflation etc. This is virtually unchanged from yesterday.

Not yet, presumably, updated to take account of higher money GDP growth forecast for 1989.

Table 3: General government expenditure

£ billion, cash

	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
Public expenditure planning total	145.7	150.6	167.2	180.9	195.0	205.7
Gross debt interest	17.7	18.3	17.0	15.2	13.9	13.0
Other adjustments	8.3	9.9	9.8	9.5	8.6	8.5
General government expenditure	**171.8**	**178.8**	**194.1**	**205.6**	**217.5**	**227.2**
Privatisation proceeds	-5.2	-7.0	-5.0	-5.0	-5.0	-5.0
General government expenditure excluding privatisation proceeds	**177.0**	**185.8**	**199.1**	**210.6**	**222.5**	**232.2**
GGE excluding privatisation proceeds (per cent of GDP)	41.6	39.4	39.2	39.0	39.0	38.6

4. Table 4 compares the projections of GGE with those in the White Paper:

Table 4: Comparison of paths for GGE excluding privatisation proceeds

	1988-89	1989-90	1990-91	1991-92	1992-93
£ billion					
Projections as in table 3	185.8	199.1	210.6	222.5	232.2
White Paper*	186.9	198.7	210.0	221.0	
per cent of GDP					
Projections as in table 3	39.4	39.2	39.0	39.0	38.6
White Paper	39¾	39¼	39	38¾	

* rounded for 1990-91 onwards

C PSDR and fiscal adjustment

5. Bringing together the fiscal projections considered in sections A and B, table 5 shows a central estimate of the fiscal adjustment available in 1990 and later years for the new assumption on the PSDR (12.1/9/6/3).

Table 5: PSDR path and central projection of fiscal adjustment

	1989-90	1990-91	1991-92	1992-93
previously		*8*	*4*	*0*
PSDR (£ billion)	12	9	6	3
PSDR (% of GDP)	2½	1¾	1	½
previous		*0*	*1*	*5*
Annual fiscal adjustment		0	0	4
Cumulative fiscal adjustment		0	0	4
Non-oil tax burden after fiscal adjustment (per cent)		37.3	36.9	36.0

6. Assuming we publish cash GGE figures that are in line with the PEWP (and so marginally lower than our central projection of expenditure in 1990-91 and 1991-92), we will need to make only very small adjustments to the revenue projections to get annual fiscal adjustments of £1 billion in both 1990-91 and 1991-92. But note that this would mean revising up the cumulative fiscal adjustment over the first two years by a total of £2 billion relative to our central forecast.

7. Assuming we want a cumulative fiscal adjustment by 1992-93 that is the same as our central projection, we would have to adjust revenues down in the final year by around £4 billion (because the 1 per cent real GGE growth assumption for 1992-93 is rather below our forecast). This would give the following path for the annual fiscal adjustment:

Possible annual fiscal adjustment for publication (£ billion)

1990-91	1991-92	1992-93
1	1	2

S J DAVIES

mp.pc/Riley/083

BUDGET SECRET

COPY NO. 1 OF 29 COPIES

FROM: C J RILEY
DATE: 1 March 1989

CHANCELLOR

A Pls fix an urgent mtg with PDM, TB & MCS.

Ch

This note is excuse for meeting with Peter & Terry (? & Michael Scholar).

AA

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Sedgwick
Mr Gieve
Mr Grice
Mr MacAuslan
Mr Mowl
Mr Pickford
Mr Davies
Mr Barrie
Mr Savage
Miss Simpson
Miss Wallace
Mr Call
Mrs Chaplin
Mr Tyrie

MTFS FISCAL PROJECTIONS

Stephen Davies's submission sets out where we have got to on the fiscal projections for the MTFS. I have to say that at this stage the numbers are more than usually provisional, and may be subject to substantial change when we get revised projections back from the Revenue departments. The uncertainty arises primarily because we have just made major changes to the national accounts data for 1987 and 1988, notably profits and investment, which our corporation tax model especially finds difficult to handle. Further changes are likely at the end of the week when we get new figures from the CSO.

2. However, despite the uncertainty, it is possible to discern the essential message coming out of the projections for the years 1990-91 onwards.

(i) In the two years 1988-89 and 1989-90, we estimate that the non-oil tax burden would have risen considerably as a consequence of real fiscal drag had it not been for tax cuts in the 1988 and 1989 Budgets. But there are good reasons for thinking that, at given tax rates, we may see the tax burden flattening off - perhaps even falling - in the early 1990s.

(ii) The pre-Budget rise in the tax burden in 1989-90 is due largely to the lagged effect of buoyant profits in 1988 on CT receipts. By contrast, profits are projected to fall as a share of GDP in 1989, while at the same time investment allowances build up rapidly. With output and spending still growing below trend in 1990-91, we would not expect any underlying rise in the tax burden. And with the effect of the 1984 CT reform building up in the later years, a progressive decline in the effective rate of CT is likely to offset broadly the real fiscal drag in the rest of the tax system.

(iii) Meanwhile, the revenue effects of the 1988 and 1989 budgets continue to build up. In 1990-91 we have independent taxation coming in, the abolition of stamp duty, and the full year effect of the NICs package. Budget effects reduce the tax burden in that year by about £3½ billion - 0.6% of GDP.

(iv) With GGE falling only very slightly as a share of GDP, no underlying increase in the tax burden due to real fiscal drag, and a small fall in other receipts, it therefore seems likely that the PSDR will have to come down quite sharply - from £12 billion in 1989-90 to perhaps £8 billion in 1990-91 - in order to avoid having to raise taxes. With some further build up in budget effects, the situation also looks very tight in 1991-92.

(v) In 1992-93, however, the projections show the situation considerably improved. With GDP now growing on trend, a moderate fiscal adjustment (£1 billion) would appear to be available even with no reduction in the PSDR.

(vi) All this suggests going for a PSDR path which shows a fairly rapid return to budget balance, given the present package. Unadjusted numbers might look as follows:

£ billion	1989-90	1990-91	1991-92	1992-93
PSDR	12	8	4	0
Annual fiscal adjustment	-	0	1	5
	2½	1¾	1	¼

(vii) But we would want to adjust the figures for publication. The cash figures for GGE can be brought down to those given in the PEWP, with 1% real growth in 1992-93, without doing undue violence to the projection of debt interest; the differences are fairly small until the last year. Smoothing the profile of taxes in a not implausible way might then leave the path of the fiscal adjustment as follows:

1990-91	1991-92	1992-93
1	1	4

3. As I have already said, there is a good deal of uncertainty surrounding these numbers. But I have no reason to believe that when we get more considered projections from the Revenue departments, this will dramatically change the picture. If the economy develops broadly as we have assumed, and on a reasonably conservative assessment of the extent to which recent revenue buoyancy is cyclical, the position in the next year or two could

be very tight given the present package. Of course it is possible that we are continuing to understate the underlying strength of revenues. But our record if anything suggests that this is a cyclical phenomenon; we have typically underestimated the responsiveness of the fiscal position to the cycle, and if this pattern is repeated the errors could begin to go the other way over the next two years.

4. In terms of presentation, the prospect as we now see it has both advantages and disadvantages. The main advantage is that, to the extent that we show substantial reductions in the PSDR in 1990-91 and 1991-92 while at the same time showing little scope for fiscal adjustment, this is likely to reduce the pressures on public expenditure. The perception of a large pot of money available is shown to be mistaken. On the other hand, to the extent that it is necessary to bring back the PSDR rapidly towards zero because the money has already been given away in the form of tax cuts, this makes it more difficult to present the present Budget package as prudent and cautious.

5. There is, of course, some scope for further adjusting the figures. I doubt that the projections would be seriously questioned if we chose to show some continuing rise in the underlying tax burden in the medium term, a lower path for GGE, and a slower decline in the PSDR, while at the same time some remaining scope for fiscal adjustment. But there are obviously greater risks with this approach. It would reduce the chances that you will be able to do better in the event than the published projections imply, as you have done in recent years. And it is by no means impossible that the situation could turn out tighter even than our central projection suggests.

6. We will advise you further on all this next week, after we have taken on board the latest projections from the Revenue departments and further revisions to the national accounts.

CJR

C J RILEY

FROM: A C S ALLAN
DATE: 2 March 1989

MR MOWL

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Sedgwick
Mr Riley
Mr Culpin
Mrs Lomax
Mr S J Davies
Mr Hibberd
Mrs R Butler
Mr Pickford
Mr Gieve
Mr Patterson
Mrs Wright
Mrs Todd
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Calder IR
Mr Vernon C&E

FSBR CHAPTER 6

The Chancellor was most grateful for your minute of 1 March. He had only a few comments:

(i) He was content with the formulation of the comments on the stock of Government debt in paragraph 6.04.

(ii) He prefers the first version of chart 6.4, which makes it easier to see the overall income tax/expenditure tax switch. He felt the setting of "capital taxes" in the chart of receipts was clumsy. It would be better to widen the band slightly (so long as it remains narrower than the 3 per cent band for interest and dividends): the figures tell the story.

(iii) As he indicated on the earlier draft, he would be grateful for confirmation that company profits in 1987 have been revised down from the figures available at the time of the last Budget.

(iv) He noted that the figures for the non-oil tax burden in 1988/89 and 1989/90 w~~h~~ere not consistent with those in Mr Davies' note of 1 March on MTFS fiscal projections.

(v) He thought the new version of chart 6.3, showing debt interest payment as a percentage of GDP, was much improved.

(vi) The beginning of paragraph 6.24 should be redrafted to read "Local authority receipts consist primarily of rate income (and, in Scotland, community charge income) plus grants from central Government. The forecast increase in income (net of rebates)....".

A C S ALLAN

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FROM: C J RILEY
DATE: 3 March 1989

CHANCELLOR

cc
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)
Mr Isaac) IR
Mr Painter)
Mr Calder)

Mr Unwin)
Mr Jefferson Smith) C&E
Mr Allen)

a/ OK?

FSBR CHAPTER 1

I attach amended proofs of Chapter 1, which takes on board your comments and those of Sir Peter Middleton on the draft I circulated last week. It also reflects the latest decisions on the package; table 1.1 is in line with the Scorecard circulated today. The figures in table 1.2 will need amending in the light of the changes to the package and further information from the Revenue departments.

2. I would be grateful if comments could reach me by noon on Monday.

C J RILEY

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Financial Statement and Budget Report 1989-90

Return to an Order of the House of Commons dated 14 March 1989: for

Copy of Financial Statement and Budget Report 1989-90
as laid before the House of Commons by
the Chancellor of the Exchequer when opening the Budget

Treasury Chambers
14 March 1989 } Norman Lamont

Ordered by the House of Commons to be printed 14 March 1989

HER MAJESTY'S STATIONERY OFFICE LONDON

£[ ]

House of Commons No. 235

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0369

Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(−)
	1989–90		1990–91
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
National Insurance			
~~reform~~ employee contributions reformed and reduced	−98~~3~~0	−98~~3~~0	−~~2785~~ 2805
~~reduce self-employed contributions~~	~~−50~~	~~−50~~	~~−150~~
Income Tax			
personal allowances and basic rate limit indexed	−1 465	—	—
car benefit scales increased	+~~155~~ 160	+~~155~~ 160	+~~185~~ 200
new basis of assessment for Schedule E	− 80	− 80	− 60
Excise duties			
petrol, derv etc	—	−545	−580
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−~~30~~ 40	−~~30~~ 40	−~~25~~ 100
vehicle excise duty	+40	−150	−170
tobacco	—	−235	−250
alcohol	—	−255	−280
Value Added Tax			
non-domestic construction etc	+315	+315	+540
~~bad debt relief, reform of registration rules etc~~	~~−105~~	~~−105~~	~~−270~~
~~Stamp duty on shares abolished~~	~~+10~~	~~+10~~	~~−900~~
Life assurance ~~business'~~ tax regime reformed	−20	−20	+45
Corporation Tax			
small companies' rate threshold increased	*	*	−35
Other tax changes	−75	−40	+~~40~~ 25
Pensioners' earnings limit abolished[2]	—	—	—
Total	−~~2235~~ 2145	−~~1945~~ 1870	−~~4710~~ 3470

include in 'Other tax changes'?

yes

Is this correct terminology?

? should be ...

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

[2] Public expenditure cost of £~~125~~ 190 million in 1989–90 and £~~235~~ 375 million in 1990–91 will be met from the Reserve. See Chapter 5.

* = Negligible

— = Nil

B.L.O.

/ otherwise chapter 80

1 The Budget

Why?

higher

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

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS); describes developments in the economy over the past year; provides forecasts to mid-1990; sets out the tax proposals in the Budget; summarises the Government's spending plans; and gives forecasts for the public finances for the year ahead.

and national insurance

The Medium Term Financial Strategy

1.03 Chapter 2 describes the MTFS, which provides the framework for the Government's economic policy. The objectives of the MTFS and the central role of monetary policy have remained unchanged throughout the 1980s, a period of substantial economic progress. Monetary policy is designed to reduce money GDP growth and thus inflation over the medium term, with the ultimate objective of achieving stable prices; in this year's MTFS money GDP growth falls to around 5½ per cent over the next four years. Monetary policy is buttressed by a sound fiscal policy, with a substantial budget surplus in both 1988–89 and 1989–90; ~~a~~ gradual ~~return to~~ a balanced budget is projected over the medium term, with both taxes and public expenditure declining as a share of GDP. The MTFS is complemented by policies designed to improve the working of markets and the supply performance of the economy.

movement towards

STET original?

yes

The economy

1.04 Chapter 3 describes the main developments in the economy in 1988 and the prospect until mid-1990. In recent years economic trends have become increasingly difficult to interpret because of inconsistencies within the national and sectoral accounts; adjusted figures that reduce (but do not eliminate) these inconsistencies are used throughout the FSBR. The economy grew strongly again in 1988, with the largest fall in unemployment since the war. GDP is forecast to grow by a further 2½ per cent in 1989, on the basis of growth through the year lower than this. Inflation is forecast to be on a downward trend in the second half of 1989.

Tax and National Insurance measures

1.05 Chapter 4 sets out the tax and National Insurance proposals in the Budget. They include reform and reduction of employee National Insurance contributions, indexation of the main income tax ~~allowances~~ thresholds, ~~abolition of stamp duty on shares~~, improvements to personal equity plans and employee share schemes, reform of the taxation of life assurance, pensions, and unit trusts, measures to promote unleaded petrol, and abolition of the earnings rule for pensioners. The measures are summarised in Table 1.1

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, as set out in the public expenditure White Paper. This chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1988–89.

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Public sector finances

1.07 Chapter 6 presents the complete financial picture for the public sector. The public sector debt repayment is forecast to be [£14 billion] in 1988–89. A further debt repayment of [£12 billion] is forecast for 1989–90, equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The forecast takes account of the measures in the Budget which are expected to reduce taxation and National Insurance contributions by £1·9 billion, after adjusting for the net cost of indexing direct and indirect tax rates and allowances. Table 1.2 shows the main components of general government receipts and expenditures.

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Table 1.2 The finances of the public sector[1]

	£ billion		
	1988–89		1989–90
	1988 Budget	Latest estimate	Forecast
RECEIPTS			
Inland Revenue:			
Income tax	42·1	43·5	47·1
Corporation tax[2]	19·8	18·8	22·0
Petroleum revenue tax	1·2	1·3	1·3
Capital gains tax	2·0	2·4	2·1
Inheritance tax	1·0	1·1	1·1
Stamp duties	2·0	2·3	2·6
Total Inland Revenue	**68·0**	**69·4**	**76·1**
Customs and Excise:			
Value added tax	26·2	27·5	29·8
Petrol, derv duties etc.	8·4	8·7	8·7
Tobacco duties	5·0	5·1	5·1
Alcohol duties	4·5	4·6	4·7
Betting and gaming duties	0·9	0·9	0·9
Car tax	1·3	1·4	1·4
Customs duties	1·6	1·7	1·8
Agricultural levies	0·1	0·2	0·1
Total Customs and Excise	**47·9**	**49·9**	**52·5**
Vehicle excise duties	2·8	2·8	2·9
Oil royalties	0·6	0·6	0·6
Gas levy	0·4	0·4	0·4
Local authority rates[3]	19·0	18·9	20·4
Other taxes and royalties	2·5	2·7	2·8
Total taxes and royalties	**141·2**	**144·8**	**155·7**
National insurance and other contributions	31·6	32·8	34·6
Interest and dividends	5·6	6·6	6·7
Gross trading surpluses and rent	3·5	3·3	3·5
Other receipts	2·9	3·3	3·4
General government receipts	**184·9**	**190·8**	**203·8**

	£ billion		
	1988–89		1989–90
	1988 Budget	Latest estimate	Forecast
EXPENDITURE			
Department			
Social security	48·5	47·4	51·0
Health	20·7	21·8	23·2
Defence	19·2	19·0	20·1
Education and science	18·0	18·4	19·6
Home office and legal departments	7·0	7·2	8·0
Transport	5·1	4·8	5·4
Scotland	8·5	8·7	9·0
Wales	3·5	3·6	3·8
Northern Ireland	5·1	5·6	5·5
Other departments	22·8	21·7	23·1
Privatisation proceeds	−5·0	−7·0	−5·0
Reserve	3·5	—	3·5
Public expenditure planning total	**156·9**	**151·1**	**167·1**
General government gross debt interest	17·5	18·2	16·6
Other adjustments	8·6	9·2	9·5
General government expenditure	**183·0**	**178·5**	**193·2**

Receipts, expenditure and debt repayment

	£ billion		
	1988–89		1989–90
	1988 Budget	Latest estimate	Forecast
General government receipts	184·9	190·8	203·8
General government expenditure	183·0	178·5	193·2
General government debt repayment	2·0	12·3	10·6
Public corporations' market and overseas debt repayment	1·2	1·7	1·5
Public sector debt repayment	**3·2**	**14·0**	**12·1**

L

[1] *In this and other tables constituent items may not add up to totals because of rounding.*
[2] *Includes advance corporation tax (net of repayments):* 5·3 6·0 6·4
[3] *In this and other tables community charge receipts in Scotland are included with local authority rates.*

— also includes North Sea corporation tax after ACT set off and corporation tax on gains.

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FROM: C J RILEY
DATE: 3 March 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)
Mr Isaac) IR
Mr Painter)
Mr Calder)

Mr Unwin)
Mr Jefferson Smith) C&E
Mr Allen)

D
4 allowed

Chancellor
A preliminary copy, not yet circulated to copy recipients.
CJR
3/3

FSBR CHAPTER 1

not quite true! Subject to further discussions I understand.

I attach amended proofs of Chapter 1, which takes on board your comments and those of Sir Peter Middleton on the draft I circulated last week. It also reflects the latest decisions on the package; table 1.1 is up to date. The figures in table 1.2 will need amending in the light of the changes to the package and further information from the Revenue departments.

2. It would be helpful to have comments by early Monday morning.

CJR

C J RILEY

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Financial Statement and Budget Report 1989-90

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as laid before the House of Commons by
the Chancellor of the Exchequer when opening the Budget

B.L.O.

Treasury Chambers
14 March 1989

Norman Lamont

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Ordered by the House of Commons to be printed 14 March 1989

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House of Commons No. 235

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 0369

Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(−)
	1989–90		1990–91
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
National Insurance			
~~reform~~ employee contributions reformed	−985	−985	−2 785
~~reduce self-employed contributions~~	~~−50~~	~~−50~~	~~−150~~
Income Tax			
personal allowances and basic rate limit indexed	−1 465	—	—
car benefit scales increased	+155	+155	+185
Excise duties			
petrol, derv etc	—	−545	−580
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−30	−30	−75
vehicle excise duty	+40	−150	−170
tobacco	—	−235	−250
alcohol	—	−255	−280
Value Added Tax			
non-domestic construction etc	+315	+315	+540
~~bad debt relief, reform of registration rules etc~~	~~−105~~	~~−105~~	~~−270~~
~~Stamp duty on shares abolished~~	~~+10~~	~~+10~~	~~−900~~
Life assurance businesses' tax regime reformed	−20	−20	+45
Corporation Tax			
small companies' rate threshold increased	*	*	−35
Other tax changes	−75	+40	+40
Pensioners' earnings limit abolished[2]	—	—	—
Total	−~~2 235~~ 2145	−~~1 945~~ 1870	−~~4 710~~ 3470

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

[2] *Public expenditure cost of £~~125~~ 190 million in 1989–90 and £~~285~~ 375 million in 1990–91 will be met from the Reserve. See Chapter 5.*

* = Negligible

— = Nil

1 The Budget

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

higher

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and national insurance

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movement towards

The economy

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Tax and ~~N~~national ~~I~~insurance measures

X

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thresholds,

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, as set out in the public expenditure White Paper. This chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1988–89.

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	£ billion 1988–89 1988 Budget	1988–89 Latest estimate	1989–90 Forecast
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Alcohol duties	4·5	4·6	4·7
Betting and gaming duties	0·9	0·9	0·9
Car tax	1·3	1·4	1·4
Customs duties	1·6	1·7	1·8
Agricultural levies	0·1	0·2	0·1
Total Customs and Excise	**47·9**	**49·9**	**52·5**
Vehicle excise duties	2·8	2·8	2·9
Oil royalties	0·6	0·6	0·6
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Local authority rates[3]	19·0	18·9	20·4
Other taxes and royalties	2·5	2·7	2·8
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Interest and dividends	5·6	6·6	6·7
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Other receipts	2·9	3·3	3·4
General government receipts	**184·9**	**190·8**	**203·8**

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Department			
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Health	20·7	21·8	23·2
Defence	19·2	19·0	20·1
Education and science	18·0	18·4	19·6
Home office and legal departments	7·0	7·2	8·0
Transport	5·1	4·8	5·4
Scotland	8·5	8·7	9·0
Wales	3·5	3·6	3·8
Northern Ireland	5·1	5·6	5·5
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Reserve	3·5	—	3·5
Public expenditure planning total	**156·9**	**151·1**	**167·1**
General government gross debt interest	17·5	18·2	16·6
Other adjustments	8·6	9·2	9·5
General government expenditure	**183·0**	**178·5**	**193·2**

Receipts, expenditure and debt repayment

	£ billion 1988–89 1988 Budget	1988–89 Latest estimate	1989–90 Forecast
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[1] *In this and other tables constituent items may not add up to totals because of rounding.*
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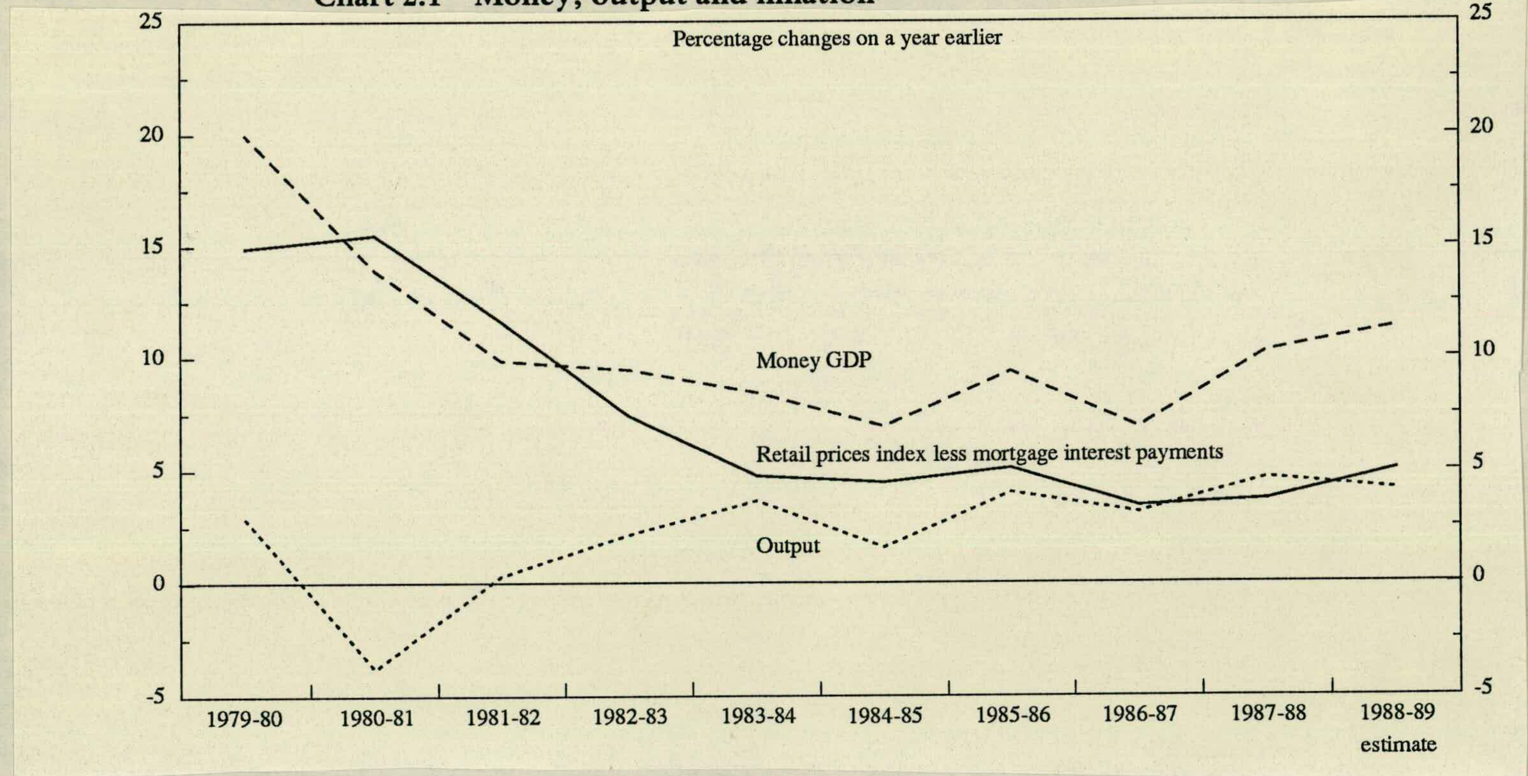
[3] *In this and other tables community charge receipts in Scotland are included with local authority rates.*

— also includes North Sea Corporation tax after ACT set off and corporation tax

Economic performance since 1980

2.06 As a result of [~~continuing~~] sound financial policies coupled with supply side reforms, substantial economic progress has been made during the 1980s. Inflation in recent years has been brought back to levels not experienced since the 1960s. The increase in the RPI excluding mortgage interest payments is likely to have averaged about 5 per cent in 1988–89, compared with over 15 per cent in the first year of the MTFS. The growth of GDP has averaged around 3 per cent a year since 1980–81, while productivity performance has improved sharply compared both with the UK's record in the second half of the 1970s and with the performance of other industrial countries. Latest figures put the workforce in employment [almost 700 000] above its 1980–81 level and at an all time high. Industrial profitability has recovered to levels not seen for 20 ~~25~~ years. The UK has acquired one of the largest stocks of net overseas assets in the world.

Chart 2.1 Money, output and inflation



2.07 The early years of the MTFS saw a sharp decline in money GDP growth. Output fell in the first year but started to recover in 1981; as output accelerated money GDP growth settled down between about 7 and 9½ per cent a year. Since 1986, the growth of money GDP has risen somewhat, with higher output growth matched by an upward movement in inflation.

2.08 As in other industrial countries, recent growth of demand in the UK has been much stronger than expected; here this has occurred in the face of high real interest rates and a substantial tightening of fiscal policy. Private sector investment has surged—growing by perhaps 25 per cent over the past two years. And several years of rising asset prices and increased consumer borrowing have helped to stimulate household expenditure. The collapse of stock market prices in October 1987 did not dampen demand in the way that had been widely expected.

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Objective for money GDP

2.09 The Government's intention remains to bring down inflation further over a period of years and ultimately to achieve price stability. To this end, it plans to reduce the rate of growth of money GDP over the medium term; monetary policy will be directed to achieving this. Money GDP growth in 1988–89 is estimated to have overshot the path published in last year's MTFS by ~~some~~ over 3~~½~~ percentage points; but current prospects, discussed in Chapter 3, are for a substantial slowdown in demand in 1989 and the first half of 1990, in part the result of the tightening of policy during 1988. Money GDP growth in 1989–90 is forecast to be about 1~~½~~ percentage point higher than envisaged in last year's MTFS.

Why, then, is the 1991-92 growth of money GDP ½% under that in the 1988 MTFS?

2.10 It is the Government's policy not to accommodate inflationary impulses. To the extent that faster money GDP growth reflects supply side improvements it is sensible to raise the money GDP objective to accommodate the faster potential growth; but to the extent that faster growth of money GDP reflects only higher demand with no supply side improvement, the Government will take action designed to return to its planned path for money GDP growth over the medium term.

2.11 As compared with last year the Government has revised its view of the likely real growth rate over the medium term, taking account of a slower projected decline in oil output. The medium term trend in output growth consistent with declining inflation is now put at 2¾ per cent, compared with 2½ per cent assumed last year; the medium term trend in non-North Sea output growth consistent with declining inflation is put at 3 per cent.

2.12 Table 2.1 sets out the Government's revised objectives for money GDP. The aim is to get back by 1991–92 onto the path implied by last year's money GDP objectives, after allowing for the higher trend output growth now assumed. The new path is intended to be consistent with reducing inflation to 3 per cent by 1991–92, as ~~assumed~~ envisaged in last year's MTFS. There will inevitably be some fluctuation around ~~this~~ the path for money GDP ~~path~~. ~~For any particular year~~ Moreover, the ~~precise~~ split between output and inflation implied by ~~achievement of the money GDP path shown in Table 2.1~~ it is ~~inevitably~~ subject to unavoidable uncertainty; illustrative assumptions are shown in ~~the table~~ Table 2.1. Following two years of rapid growth, output is likely to grow somewhat less than trend in the next two years.

Table 2.1 Money GDP growth, output and inflation[1]

		1988–89	1989–90	1990–91	1991–92	1992–93
Money GDP		**10¾**	~~7½~~ 8	**6**	**6**	**5½**
Real GDP:	non-North Sea	5	2½	2¼	3	3
	total	4	2½	2	2¾	2¾
Inflation:	GDP deflator	6½	5½	4	3	2½

[1] Percentage changes on previous financial year. The figures for 1989–90 are forecasts; the figures for subsequent years show the Government's medium term objectives for money GDP and consistent assumptions for output and inflation. The projections in the table make no allowance for any effect of the replacement of local authority rates by the Community Charge on recorded growth in money GDP or the GDP deflator.

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, with its antecedents,

(COBO)

Further Measures Liberalising the Financial Markets

The removal of controls in financial markets since 1979 has contributed to greater competition and efficiency in the allocation of capital. Further liberalisation was announced in the Budget. The Control of Borrowing Order, which goes back to the immediate post-War period, ~~will now apply only to local authorities. This means that from [today] the~~ The Bank ~~of England~~ will no longer operate a new issues queue in the equity and bond markets. The regulatory regime for sterling commercial paper and short-term corporate bonds is also to be significantly liberalised, creating a single regime for sterling paper with an initial maturity of [1] to 5 years. In addition, the restrictions preventing certain organisations, including foreign sovereigns and private companies, from making sterling issues in this maturity range will be removed.

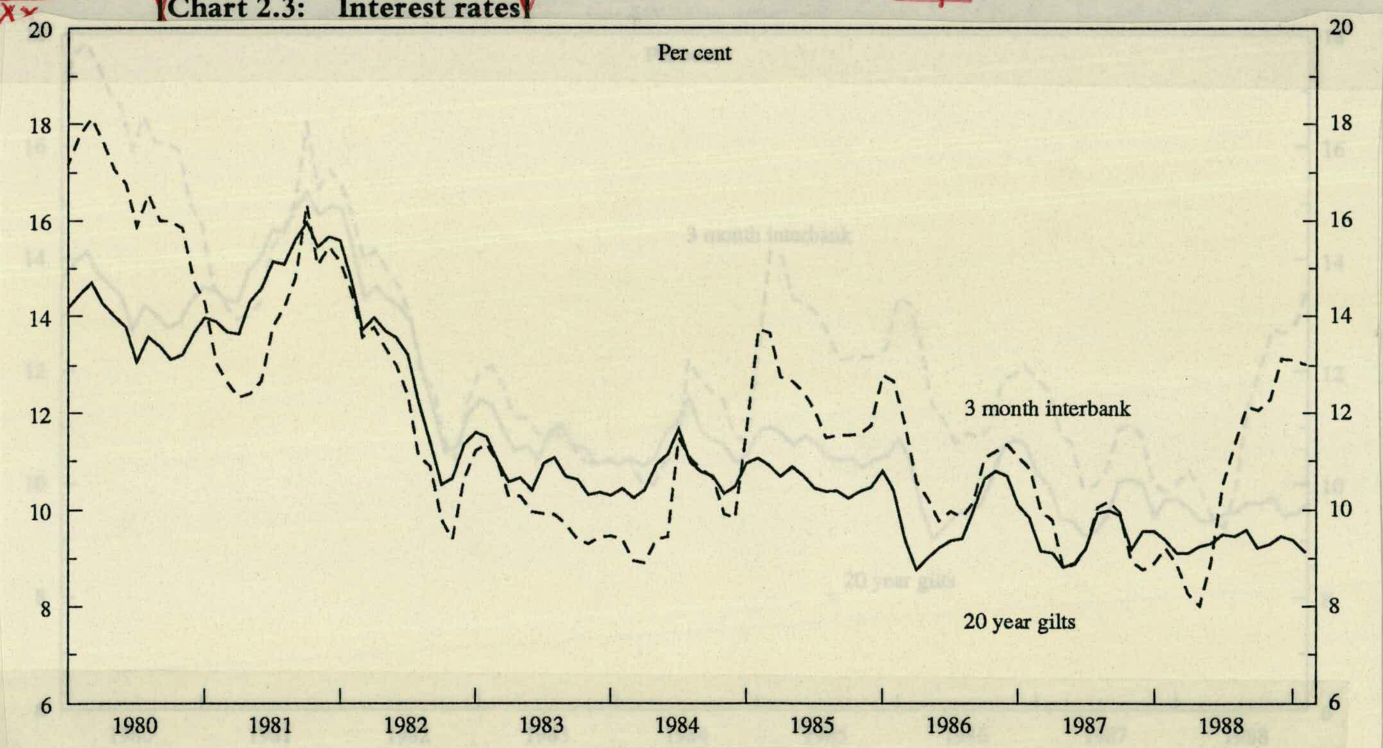
up

is to be revoked and its parent legislation repealed. A General Consent has been issued by the Treasury which means that it will no longer be necessary for new issues (other than local authorities) to obtain the Bank of England's consent to the timing of their issues.

COBO itself will remain in ~~place~~, solely for local authorities, only until new controls on their borrowing, contained in the Local Government and Housing Bill, come into force.

2.15 Here, as in other countries, monetary policy is implemented by changing the level of short-term interest rates. The process of financial liberalisation has increased the power of interest rates as a policy instrument. They can now fulfil their function as the price of money and credit unhampered by quantitative controls. At the same time, the rise in borrowing and holdings of liquidity, which followed liberalisation, means that interest rates now act on a wider base.

Chart 2.3: Interest rates



2.16 Decisions about interest rates are made on the basis of a comprehensive assessment of monetary conditions. The evidence of a range of indicators has to be appraised and balanced. But the assessment gives particular weight to

BUDGET SECRET—BUDGET LIST ONLY

0359

the behaviour of narrow money in relation to its target range and to the exchange rate. Attention is also paid to the behaviour of broad money ~~and~~ , or liquidity. Short-term interest rates fell from 9 per cent in early 1988 to touch 7½ per cent for a fortnight in May. Thereafter, they were raised steadily to reach 13 per cent by the end of November, where they have remained. ~~Longer term interest rates have scarcely moved, generally fluctuating between 9 and 9½ per cent throughout the past year. Currently they stand at just over 9 per cent.~~

X

2.17 Longer term interest rates have been stable despite the rise in short rates. 20 year gilts ~~yeilds~~ yields have fluctuated between around 9 and 9½ percent throughout the past year and currently stand near the middle of this range. This relative stability has been a feature of recent years. Since the sharp decline in 1982, the trend in long rates has been gently downwards, with only minor fluctuations.

2.17 8 Narrow money, as measured by M0, has continued to have a reliable and predictable relationship with money GDP. Reflecting the higher growth of money GDP, the 12 month growth rate of M0 has been above the target range throughout 1988–89. M0 grew particularly rapidly between March and September last year, but has slowed sharply since the autumn in response to the higher interest rates in the second half of 1988. Its [~~estimated~~] X annualised growth over the last six months, seasonally adjusted, is [under 3 per cent], the lowest since the middle of 1987.

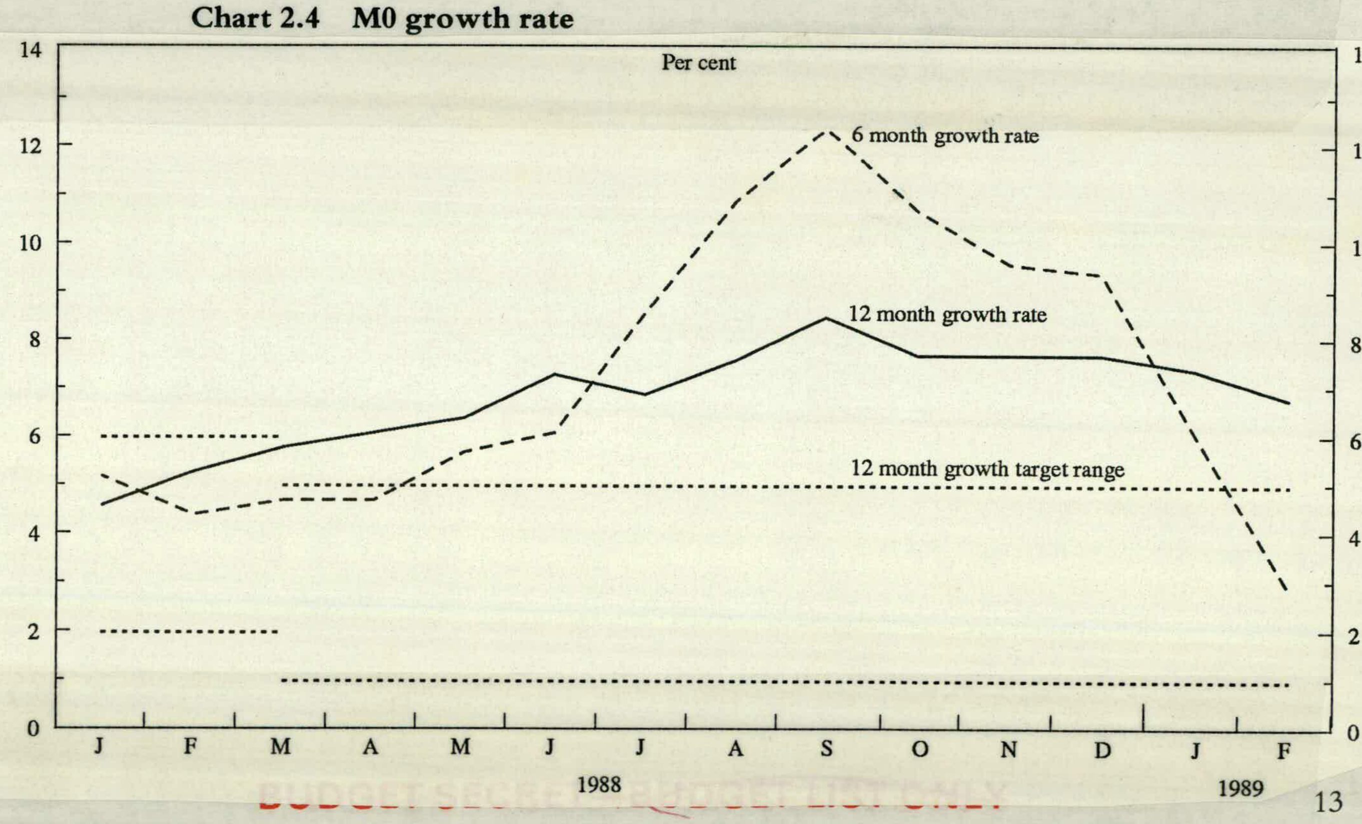
2.18 9 For 1989–90, a target range for M0 of 1–5 per cent has been set, the same as the illustrative range for that year in last year's MTFS. Measured by the 12 month growth rate, it is likely to begin the year above the target range. But as the deceleration over recent months continues, it will come back within it. The ranges given in Table 2.2 for later years are illustrative and show a steady fall consistent with the declining path for money GDP growth.

Table 2.2 Growth of M0[1]

1988–89	1989–90	1990–91	1991–92	1992–93
7½	1 to 5	0 to 4	0 to 4	−1 to 3

[1] 1988–89: forecast per cent change on previous financial year;
1989–90: target range for 12 month growth rate; 1990–91 onwards: illustrative ranges.

Chart 2.4 M0 growth rate



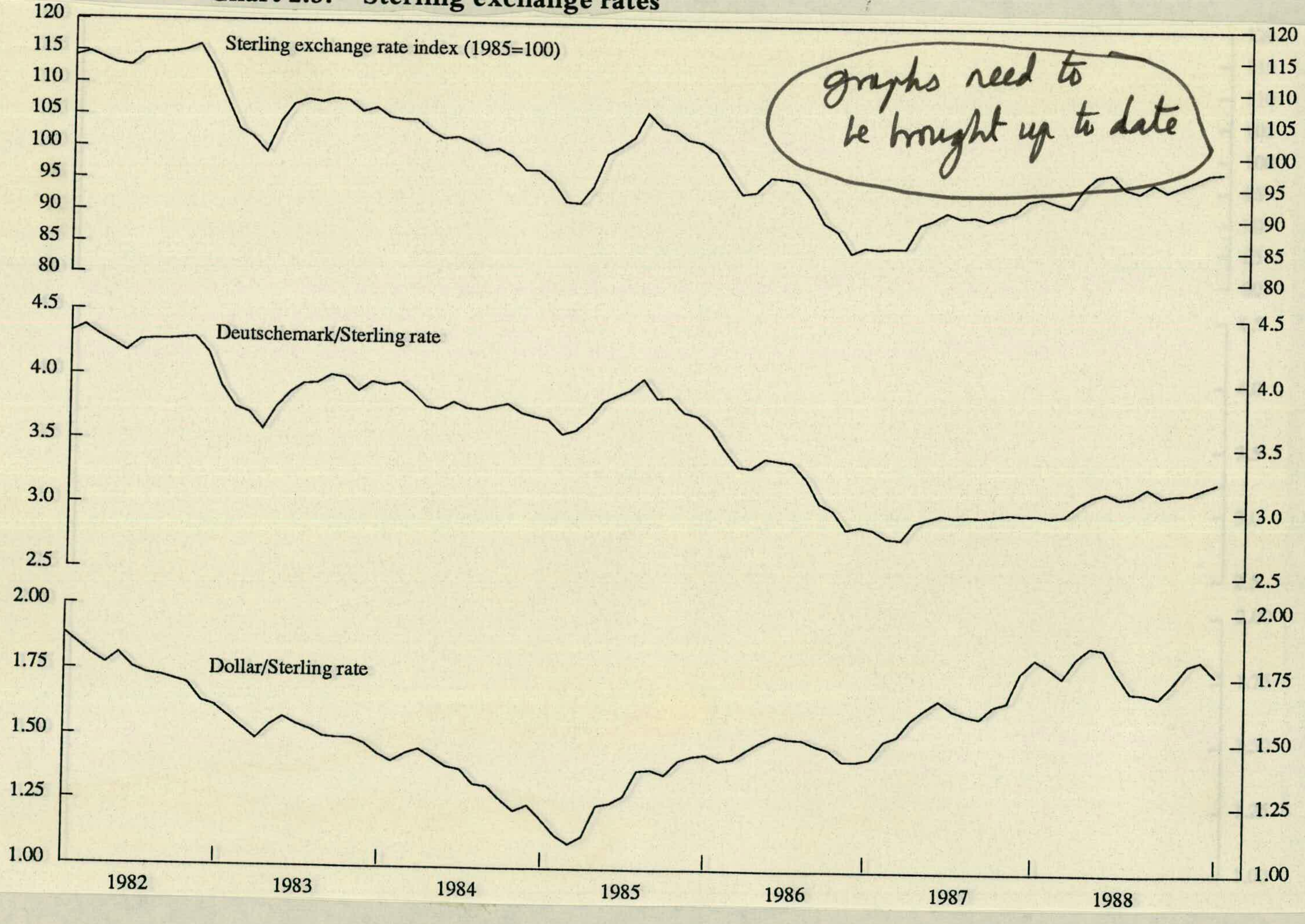
BUDGET SECRET—BUDGET LIST ONLY

slighty

2.~~19~~20 The exchange rate is a key influence upon, and a key indicator of, monetary conditions. It has to be considered together with all the evidence of domestic indicators in making monetary policy decisions. Monetary policy has the overriding task of defeating inflation: the Government is accordingly not prepared to accommodate increases in domestic costs by exchange rate depreciation. Sterling has risen against the deutschemark over the past year. The dollar has also risen against the deutschemark, though it has shown little change against the yen.

2.2~~0~~1 Exchange rates are also important in international economic relationships. The improved co-operation between the G7 countries, who share a common counter-inflationary objective, has been clearly beneficial to the international community.

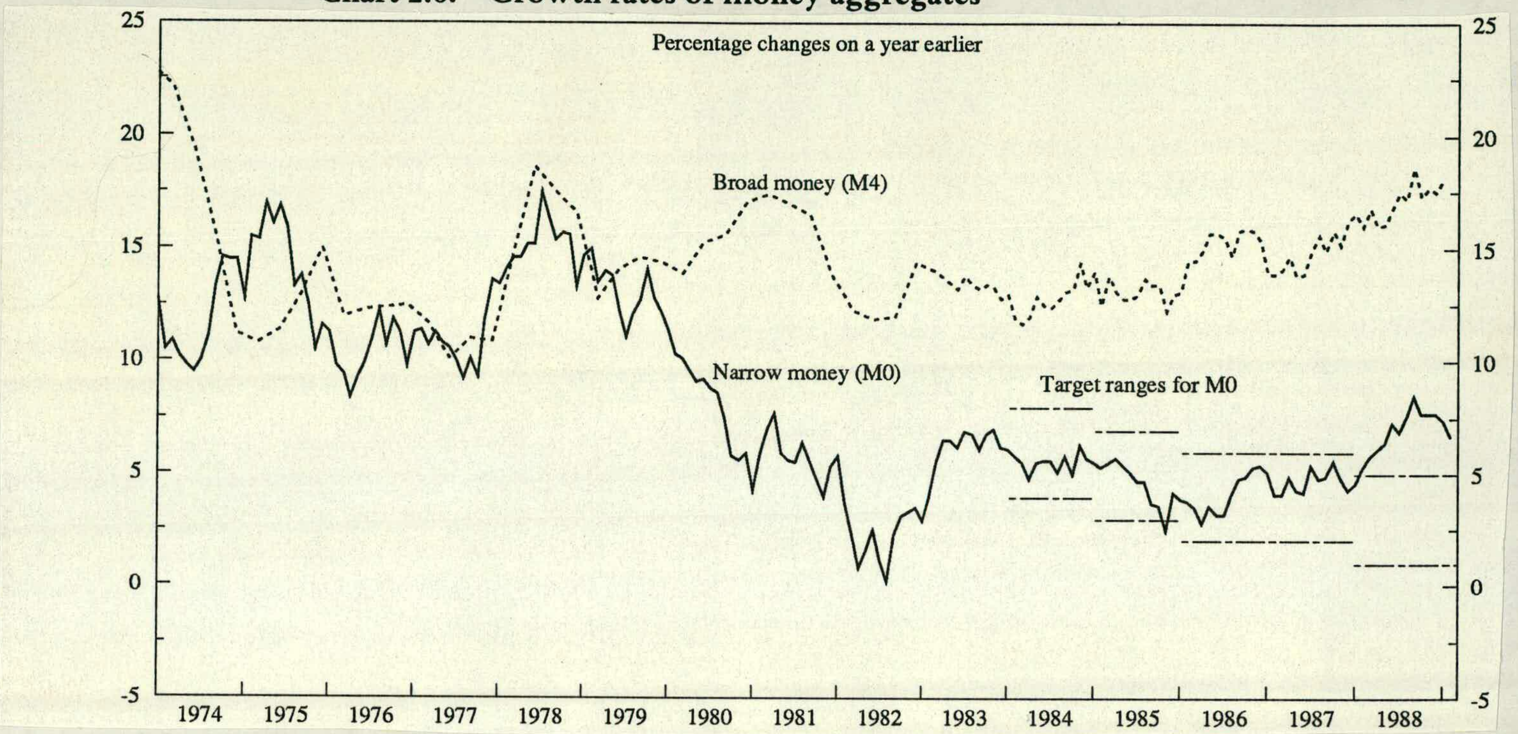
Chart 2.5: Sterling exchange rates



2.2~~1~~2 In assessing monetary conditions, the interpretation of broad money, or liquidity, requires considerable judgment. There have been significant changes in the relationship between broad money and spending ~~in recent~~ over the years. Because it is used as a store of value as well as for transactions purposes, what matters, so far as subsequent inflationary pressure is concerned, is not its growth rate alone but the extent to which people are prepared to hold interest-bearing money balances rather than to spend them.

X

Chart 2.6: Growth rates of money aggregates



Funding policy

2.22 3 The Government will continue to conduct its own financial affairs so as to have a broadly neutral impact on liquidity. That is embodied in the policy of funding the net total of maturing debt, the PSBR, and any underlying increase in the foreign exchange reserves, by sales of debt outside the banking and building society sectors. Should this total be negative, then 'unfunding' will be required, that is, the authorities will make purchases of debt. Gilts bought in by the Bank of England are normally held in its Issue u/c department. The Government is taking powers, in this year's Finance Bill, to enable the National Loans Fund to acquire these gilts for cancellation.

2.23 4 Now that the public sector is repaying ~~the~~ debt, it is possible to devote more attention to the structure of the remaining debt, both to secure lower expected servicing costs and to improve the quality of debt by reducing reliance on borrowing in the form of liquid instruments. Attention will also be paid to smoothing the profile of redemptions. The reverse auction conducted in January 1989, the first of its kind, enabled the authorities to make substantial purchases of gilts maturing in 1989–90, a year when maturities will be particularly heavy. [The gilts which the authorities purchased were also becoming increasingly liquid.]

Re X, [ ], surely all dated gilts become increasingly liquid by the effusion of time. Should be either clarified or (better) deleted

2.24 5 ~~In taking account of costs, the Government will decide~~ In general, however, the Government decides what types and maturity of debt to repurchase or issue, depending on current relativities and expected future yields. In 1988–89, the Government took the view that, on this criterion, its longer term debt looked relatively expensive borrowing ~~to service~~. Accordingly, much of the buying-in of conventional gilts required by the full fund policy was of longer maturity issues, so as to secure greater future debt interest savings. The fact that the Government has been a net repurchaser of long term debt and the emergence of a downward sloping yield curve have created favourable conditions for longer term borrowing by the private sector. The increasing volume of fixed rate sterling borrowing by companies has been a welcome development.

particularly

e/c

reflected

Reverse order of first two sentences

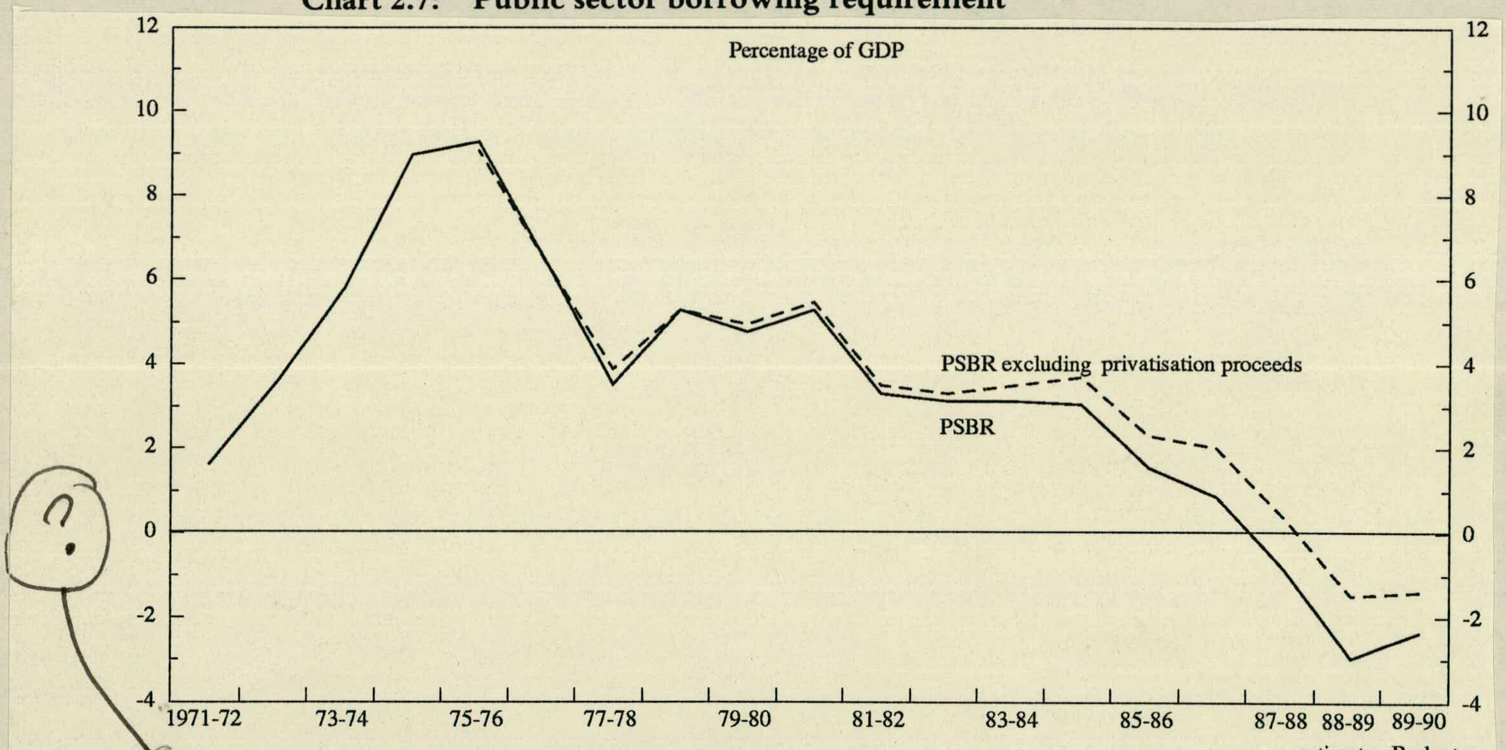
2.25 [6] In circumstances when the Government believes it will reduce inflation in a way that is not yet fully reflected in market yields, index-linked borrowing becomes particularly attractive to the Government as compared with conventional gilts. ~~In addition,~~ Indexed debt has the advantage of reducing uncertainty, to both the Government and investors, about future real yields. Net sales of indexed gilts continued in 1988–89, despite the reduction in total gilts outstanding, and about one eighth of ~~the~~ all gilts outstanding are now in indexed form.

outstanding

Fiscal policy

2.26 [7] It is now expected that the net repayment of debt in 1988–89 will total about £[14] billion ([3] per cent of GDP), compared with a forecast in last year's Budget of £3 billion. Even allowing for the fact that privatisation proceeds are now expected to be some £2 billion higher than forecast a year ago, this means that the fiscal stance has been considerably tighter than planned, reflecting in large part the strength of economic activity which has both boosted tax revenues and depressed public expenditure.

Chart 2.7: Public sector borrowing requirement



?

1 *Negative values indicate a public sector debt repayment.*

see redraft in cover-note

2.27 [8] ~~The long term objective of fiscal policy remains a balanced budget. This helps to ensure that the state is making no claim on the flow of the nation's saving or on flows from overseas. It reduces the burden of debt servicing, making room for lower taxes and higher public expenditure on priority services, and it also helps to secure confidence in sterling and in the financial stability of the economy.~~

gradually

2.2~~8~~9 The Government intends to move gradually from the present surplus towards a balanced budget ~~[gradually/progressively]~~ over the medium term. The PSDR for 1989–90 has been set at £12 billion; this is equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The projected PSDR path thereafter is shown in table 2.7. As usual, the PSDR to be set in future Budgets will be reviewed in the light of circumstances at the time; as tax rates are set on the basis of medium to longer term objectives the PSDR will tend to be increased by GDP growth above trend, and to be reduced by below trend GDP growth.

u/c

Public expenditure

From control of public expenditure, coupled with

2.~~29~~30 The Government's objective for expenditure is to maintain a downward trend over the medium term in the ratio of general government expenditure to GDP. ~~Partly as a result of~~ the strength of economic activity, the ratio of GGE excluding privatisation proceeds to GDP ~~has fallen~~ by 7 percentage points since 1982–83. This is the largest and most sustained fall since the immediate post-war period and it has brought the ratio back to levels not experienced since the ~~late~~ 1960s. The Government is determined to build on this achievement.

has caused

to fall

X

Table 2.3: General government expenditure (excluding privatisation proceeds) as a percentage of GDP[1]

1963-64 36¼

1964–65	36	1974–75	48¼	1984–85	46¼
1965–66	37¼	1975–76	48½	1985–86	44½
1966–67	38¾	1976–77	46	1986–87	43¾
1967–68	42¼	1977–78	42¾	1987–88	41½
1968–69	41	1978–79	43¼	1988–89	39¼
1969–70	40¼	1979–80	43½	1989–90	39¼
1970–71	40¾	1980–81	46	1990–91	39
1971–72	41	1981–82	46½	1991–92	38¾
1972–73	41	1982–83	46¾	1992–93	38
1973–74	42¾	1983–84	45¾		

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 onwards: MTFS projections.*

Is there no typographical construction for distinguishing the future from the past? (eg former in italics)

IS THERE SCOPE FOR GETTING 1988-89 UP?

2.3~~0~~1 Projections of government expenditure are shown in Table 2.4. For the period to 1991–92, they incorporate the public expenditure plans shown in the public expenditure White Paper (Cm 601–621); the projections of gross debt interest payments and other adjustments are consistent with the latest economic projections and assumptions. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1992–93. Decisions will be taken in the 1989 Survey.

Table 2.4 General government expenditure[1]

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Public expenditure planning total	145·7	150 ~~151~~·6	167	179	192	200
Gross debt interest	17·8	18·3	16·5	15	14·5	14
Other adjustments	8·3	9·9	10	10·5	9·5	9·5
General government expenditure[2]	**171·~~8~~ 7**	**178·8**	**194**	**205**	**216**	**223**
Privatisation proceeds	5·2	7·0	5	5	5	5
General government expenditure excluding privatisation proceeds	**177·0**	**185·8**	**199**	**210**	**221**	**228**

[1] *For 1987–88 to 1991–92, the figures are taken from Table 5.1.*

[2] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1989–90 onwards*; except for debt interest and other adjustments which are rounded to the nearest ~~£~~ £0.5 billion. *General government expenditure is assumed to grow by 1% in real terms in 1992–93.*

Add Riley paragraph

Revenue

2.3~~1~~ 2 The growth in government revenues over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. Government revenues from the North Sea are projected to decline relative to money GDP as oil output falls. After taking account of the tax reductions announced in the Budget, non-North Sea revenues are also projected to grow at a little under the rate of growth of non-oil money GDP.

Table 2.5 General government receipts

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Taxes on incomes, expenditure and capital						
National insurance and other contributions						
Interest and dividends						
Other receipts						
General government receipts[1]						
of which						
North Sea tax[2]						

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1988–89 onwards.*

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

Table 2.6: Non-oil taxes and national insurance contributions as a percentage of non-oil money GDP[1]

1963-64	29				
1964–65	29½	1974–75	35¾	1984–85	37¾
1965–66	31¼	1975–76	36¼	1985–86	37
1966–67	32	1976–77	36	1986–87	37½
1967–68	33¼	1977–78	35	1987–88	37¾
1968–69	35¼	1978–79	34¼	1988–89	37½
1969–70	36¾	1979–80	35½	1989–90	[37½]
1970–71	36¼	1980–81	36¼	1990–91	[36½]
1971–72	34¾	1981–82	38¾	1991–92	[36½]
1972–73	32½	1982–83	38¼	1992–93	[35½]
1973–74	33¼	1983–84	37¾		

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 MTFS onwards: MTFS projections.*

See comment on Table 2·3 — perhaps even more desirable here

mp.pc/Riley/087

CONFIDENTIAL

PMP

FROM: C J RILEY
DATE: 3 March 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Sedgwick
Mr S Davies
Mr Gieve
Mr Pickford
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Riley

I think you have got the "But" in the wrong sentence. See below.

JA 3/3

cc PPS
PS/CST
Sir P. Middleton
Sir T. Burns
Mrs Lomax
Mr Culpin
Mr Gieve

TAX POLICY AND THE MTFS

Reading through the latest version of the MTFS, I was struck by the asymmetry between the sections on public expenditure and revenue. The expenditure section has a ringing paragraph about objectives and achievements (2.30), followed by a boring paragraph describing where the projections come from (2.31). The revenue section has only a boring paragraph (2.32); and there is no reference to the tax burden figures given in table 2.6.

2. In consultation with Robert Culpin I have cooked up the following which could, if you agree, go at the beginning of the revenue section, followed by table 2.6:

275

"The Government's objectives for taxation are to reduce tax rates and bring down the tax burden. Much progress has been made in reducing tax rates and reforming the structure of the tax system; and the tax burden has fallen from the peak of 1981-82. ~~But~~ The Government's success in bringing down the share of public expenditure has so far been reflected mainly in the emergence of a budget surplus. But moving back towards a balanced budget over the medium term should also enable continued public expenditure restraint to be reflected in a gradual fall in the tax burden."

3. Would you be prepared to consider inserting something along these lines?

C J RILEY

mp.pc/Riley/087

CONFIDENTIAL

FROM: C J RILEY
DATE: 3 March 1989

[2.28] — should this go in FBR's (the tax reduction?)

CHANCELLOR

Many thanks: This para is just what is needed. N.

(But also note on Mr Davies below) –

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Sedgwick
Mr S Davies
Mr Gieve
Mr Pickford
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

TAX POLICY AND THE MTFS

— below

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"The Government's objectives for taxation are to reduce tax rates and bring down the tax burden. Much progress has been made in reducing rates and reforming the structure of the tax system; and the tax burden has fallen from the peak of 1981-82. But the Government's success in bringing down the share of public expenditure has so far been reflected mainly in the emergence of a budget surplus. Moving back towards a balanced budget over the medium term should enable continued public expenditure restraint to be reflected in a gradual fall in the tax burden."

3. Would you be prepared to consider inserting something along these lines?

CJR

C J RILEY

FROM: A C S ALLAN

DATE: 3 March 1989

MR S J DAVIES

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mr Pickford
Mr Barrie
Mr Savage
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

FSBR: CHAPTER 2

The Chancellor was grateful for your note of 2 March about the 1982 FSBR! He was content with the annual fiscal adjustment path in your final paragraph. And the PSDR path is clearly an improvement on the previous ones. But equally clearly we cannot yet take a final decision, as the figures are still moving around. When we do, we will also need to keep a close eye on the tax burden in 1989-90 compared with 1988-89, and also on the public expenditure ratio path.

ACSA

A C S ALLAN

chex.ps/aa/32 **BUDGET SECRET**

COPY NO. 15 **OF** 16.

FROM: A C S ALLAN
DATE: 3 March 1989

MR MOWL

cc Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr S J Davies
Mr Gieve
Mr Pickford
Mr Patterson
Mrs Chaplin

PSDR IN 1989-90

The Chancellor was grateful for your minute of 2 March. He awaits the further submission promised next week. But he feels it looks increasingly as if it might be sensible to show the same PSDR in 1989-90 as the estimated outturn for 1988-89, despite lower privatisation proceeds. (This still provides some flexibility, of course, since we have some flexibility over what we estimate for 1988-89 outturn).

ACSA

A C S ALLAN

chex.ps/aa/46 BUDGET SECRET

COPY NO. 28 OF 28.

FROM: A C S ALLAN

DATE: 6 March 1989

MR S J DAVIES

cc	PS/Chief Secretary	Mr Riley
	PS/Financial Secretary	Mr Sedgwick
	PS/Paymaster General	Mr Gieve
	PS/Economic Secretary	Mr Grice
	Sir P Middleton	Miss O'Mara
	Sir T Burns	Mr Pickford
	Mr Anson	Mr Barry
	Mr Wicks	Mr Savage
	Mr Monck	Miss Simpson
	Mr Scholar	Mrs Chaplin
	Mrs Lomax	Mr Call
	Mr Peretz	Mr Tyrie

1989 FSBR: CHAPTER 2

The Chancellor was grateful for your minute of 2 March.

2. He very much agreed with the addition on tax policy suggested by Mr Riley in his minute of 3 March, and would be grateful if this could be included.

3. He has redrafted paragraph 2.28, on fiscal policy, to read:

"The long term objective of fiscal policy remains a balanced budget. This provides a clear and simple rule, with a good historical pedigree. It constitutes a firm buttress for monetary policy in the struggle against inflation, while enabling the burden of public debt, and with it debt interest, steadily to diminish as a proportion of the economy as a whole. And it means that as public expenditure declines as a share of GDP, so too can the burden of taxation."

... 4. I attach a copy of the relevant pages with his other comments marked.

ACSA

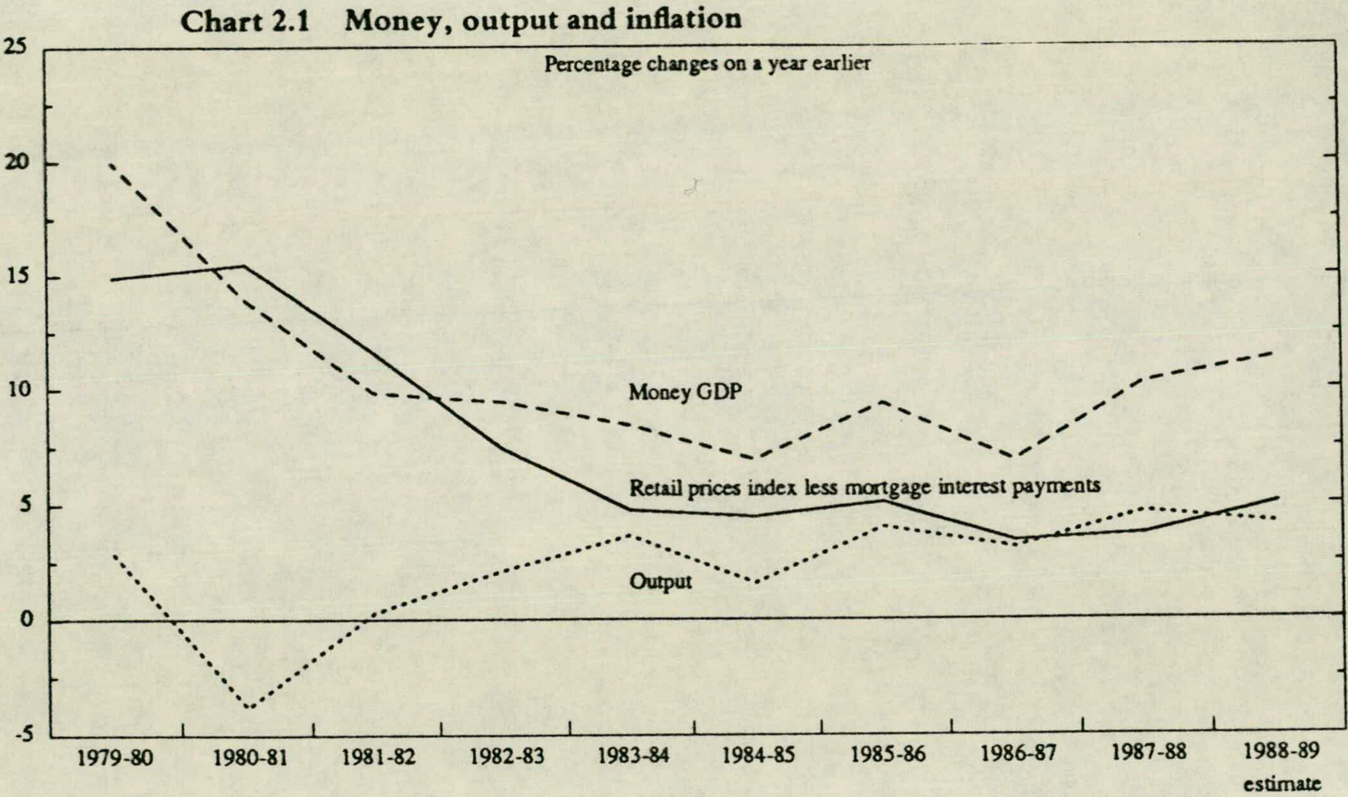
A C S ALLAN

X

Economic performance since 1980

2.06 As a result of ~~continuing~~ sound financial policies coupled with supply side reforms, substantial economic progress has been made during the 1980s. Inflation in recent years has been brought back to levels not experienced since the 1960s. The increase in the RPI excluding mortgage interest payments is likely to have averaged about 5 per cent in 1988–89, compared with over 15 per cent in the first year of the MTFS. The growth of GDP has averaged around 3 per cent a year since 1980–81, while productivity performance has improved sharply compared both with the UK's record in the second half of the 1970s and with the performance of other industrial countries. Latest figures put the workforce in employment [almost 700 000] above its 1980–81 level and at an all time high. Industrial profitability has recovered to levels not seen for 20 years. The UK has acquired one of the largest stocks of net overseas assets in the world.

Chart 2.1 Money, output and inflation



2.07 The early years of the MTFS saw a sharp decline in money GDP growth. Output fell in the first year but started to recover in 1981; as output accelerated money GDP growth settled down between about 7 and 9½ per cent a year. Since 1986, the growth of money GDP has risen somewhat, with higher output growth matched by an upward movement in inflation.

2.08 As in other industrial countries, recent growth of demand in the UK has been much stronger than expected; here this has occurred in the face of high real interest rates and a substantial tightening of fiscal policy. Private sector investment has surged—growing by perhaps 25 per cent over the past two years. And several years of rising asset prices and increased consumer borrowing have helped to stimulate household expenditure. The collapse of stock market prices in October 1987 did not dampen demand in the way that had been widely expected.

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BUDGET SECRET—~~BUDGET LIST ONLY~~

0356

Objective for money GDP

2.09 The Government's intention remains to bring down inflation further over a period of years and ultimately to achieve price stability. To this end, it plans to reduce the rate of growth of money GDP over the medium term; monetary policy will be directed to achieving this. Money GDP growth in 1988–89 is estimated to have overshot the path published in last year's MTFS by ~~some~~ over 3 percentage points; but current prospects, discussed in Chapter 3, are for a substantial slowdown in demand in 1989 and the first half of 1990, in part the result of the tightening of policy during 1988. Money GDP growth in 1989–90 is forecast to be about ½ percentage point higher than envisaged in last year's MTFS.

Why, then, is the 1991-92 growth of money GDP ½% under that in the 1988 MTFS?

2.10 It is the Government's policy not to accommodate inflationary impulses. To the extent that faster money GDP growth reflects supply side improvements it is sensible to raise the money GDP objective to accommodate the faster potential growth; but to the extent that faster growth of money GDP reflects only higher demand with no supply side improvement, the Government will take action designed to return to its planned path for money GDP growth over the medium term.

2.11 As compared with last year the Government has revised its view of the likely real growth rate over the medium term, taking account of a slower projected decline in oil output. The medium term trend in output growth consistent with declining inflation is now put at 2¾ per cent, compared with 2½ per cent assumed last year; the medium term trend in non-North Sea output growth consistent with declining inflation is put at 3 per cent.

2.12 Table 2.1 sets out the Government's revised objectives for money GDP. The aim is to get back by 1991–92 onto the path implied by last year's money GDP objectives, after allowing for the higher trend output growth now assumed. The new path is intended to be consistent with reducing inflation to 3 per cent by 1991–92, as ~~assumed~~ envisaged in last year's MTFS. There will inevitably be some fluctuation around ~~this~~ the path for money GDP ~~path~~. ~~For any particular year~~ Moreover, the ~~precise~~ split between output and inflation implied by it ~~achievement of the money GDP path shown in Table 2.1~~ is ~~inevitably~~ subject to unavoidable uncertainty; illustrative assumptions are shown in ~~the table~~ Table 2.1. Following two years of rapid growth, output is likely to grow somewhat less than trend in the next two years.

Table 2.1 Money GDP growth, output and inflation[1]

		1988–89	1989–90	1990–91	1991–92	1992–93
Money GDP		10¾	~~7¾~~ 8	6	6	5½
Real GDP:	non-North Sea	5	2½	2¼	3	3
	total	4	2½	2	2¾	2¾
Inflation:	GDP deflator	6½	5½	4	3	2½

[1] *Percentage changes on previous financial year. The figures for 1989–90 are forecasts; the figures for subsequent years show the Government's medium term objectives for money GDP and consistent assumptions for output and inflation. The projections in the table make no allowance for any effect of the replacement of local authority rates by the Community Charge on recorded growth in money GDP or the GDP deflator.*

BUDGET SECRET—~~BUDGET LIST ONLY~~

, with its antecedents,

Further Measures Liberalising the Financial Markets

The removal of controls in financial markets since 1979 has contributed to greater competition and efficiency in the allocation of capital. Further liberalisation was announced in the Budget. The Control of Borrowing Order, which goes back to the immediate post-War period, ~~will now apply only to local authorities.~~ ~~This~~ The ~~means that from [today] the~~ Bank ~~of England~~ will no longer operate a new issues queue in the equity and bond markets. The regulatory regime for sterling commercial paper and short-term corporate bonds is also to be significantly liberalised, creating a single regime for sterling paper with an initial maturity of [1] to 5 years. In addition, the restrictions preventing certain organisations, including foreign sovereigns and private companies, from making sterling issues in this maturity range will be removed.

up

(COBO)

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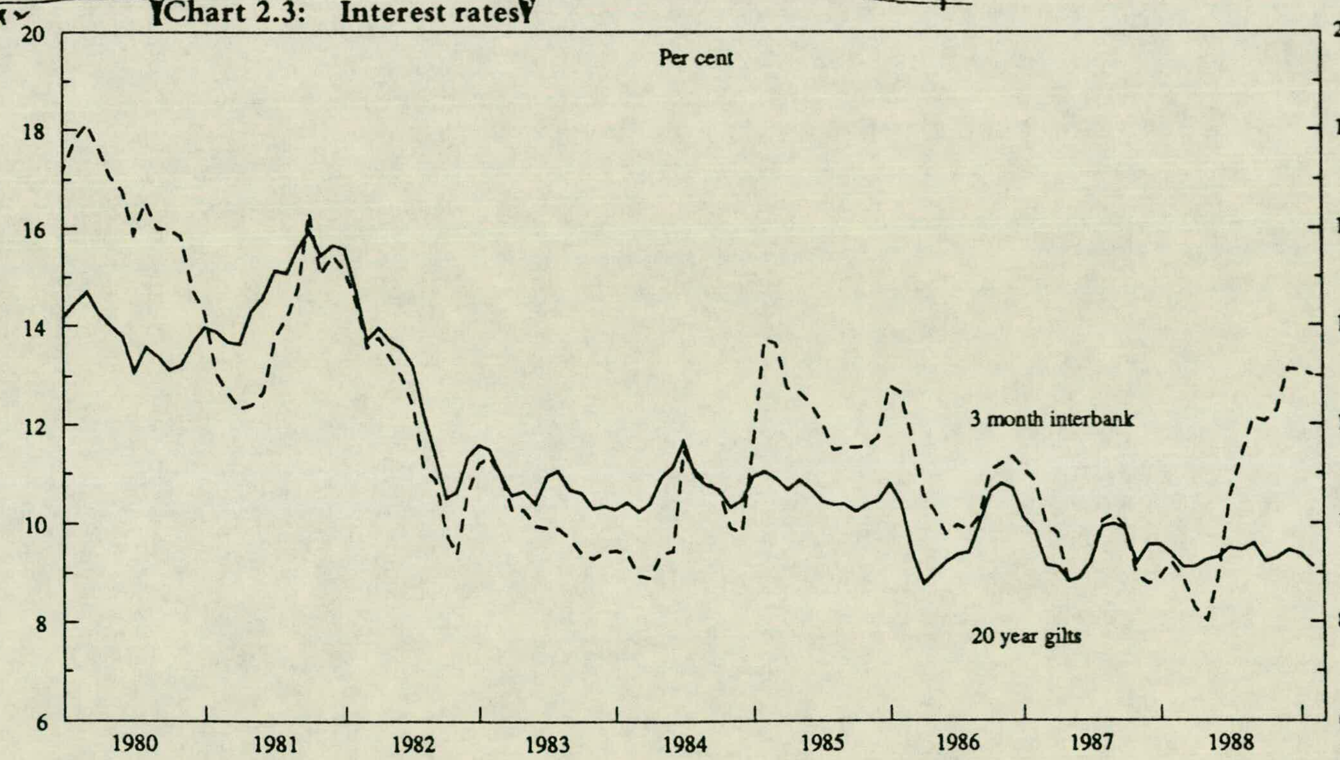
2.15 Here, as in other countries, monetary policy is implemented by changing the level of short-term interest rates. The process of financial liberalisation has increased the power of interest rates as a policy instrument. They can now fulfil their function as the price of money and credit unhampered by quantitative controls. At the same time, the rise in borrowing and holdings of liquidity, which followed liberalisation, means that interest rates now act on a wider base.

COBO itself will remain in ~~force~~ place, solely for local authorities, only until new controls on their borrowing, contained in the Local Government and Housing Bill, come into force.

Chart 2.3: Interest rates



2.16 Decisions about interest rates are made on the basis of a comprehensive assessment of monetary conditions. The evidence of a range of indicators has to be appraised and balanced. But the assessment gives particular weight to the behaviour of narrow money in relation to its target range and to the exchange rate. Attention is also paid to the behaviour of broad money ~~and~~ , or liquidity. Short-term interest rates fell from 9 per cent in early 1988 to touch 7½ per cent for a fortnight in May. Thereafter, they were raised steadily to reach 13 per cent by the end of November, where they have remained. ~~Longer term interest rates have scarcely moved, generally fluctuating between 9 and 9½ per cent throughout the past year. Currently they stand at just over 9 per cent.~~

X

2.17 Longer term interest rates have been stable despite the rise in short rates. 20 year gilts ~~yeat~~ yields have fluctuated between around 9 and 9½ per cent throughout the past year and currently stand near the middle of this range. This relative stability has been a feature of recent years. Since the sharp decline in 1982, the trend in long rates has been gently downwards, with only minor fluctuations.

2.18 Narrow money, as measured by M0, has continued to have a reliable and predictable relationship with money GDP. Reflecting the higher growth of money GDP, the 12 month growth rate of M0 has been above the target range throughout 1988–89. M0 grew particularly rapidly between March and September last year, but has slowed sharply since the autumn in response to the higher interest rates in the second half of 1988. Its [~~estimated~~] seasonally adjusted annualised growth over the last six months is [under 3 per cent], the lowest since the middle of 1987. X

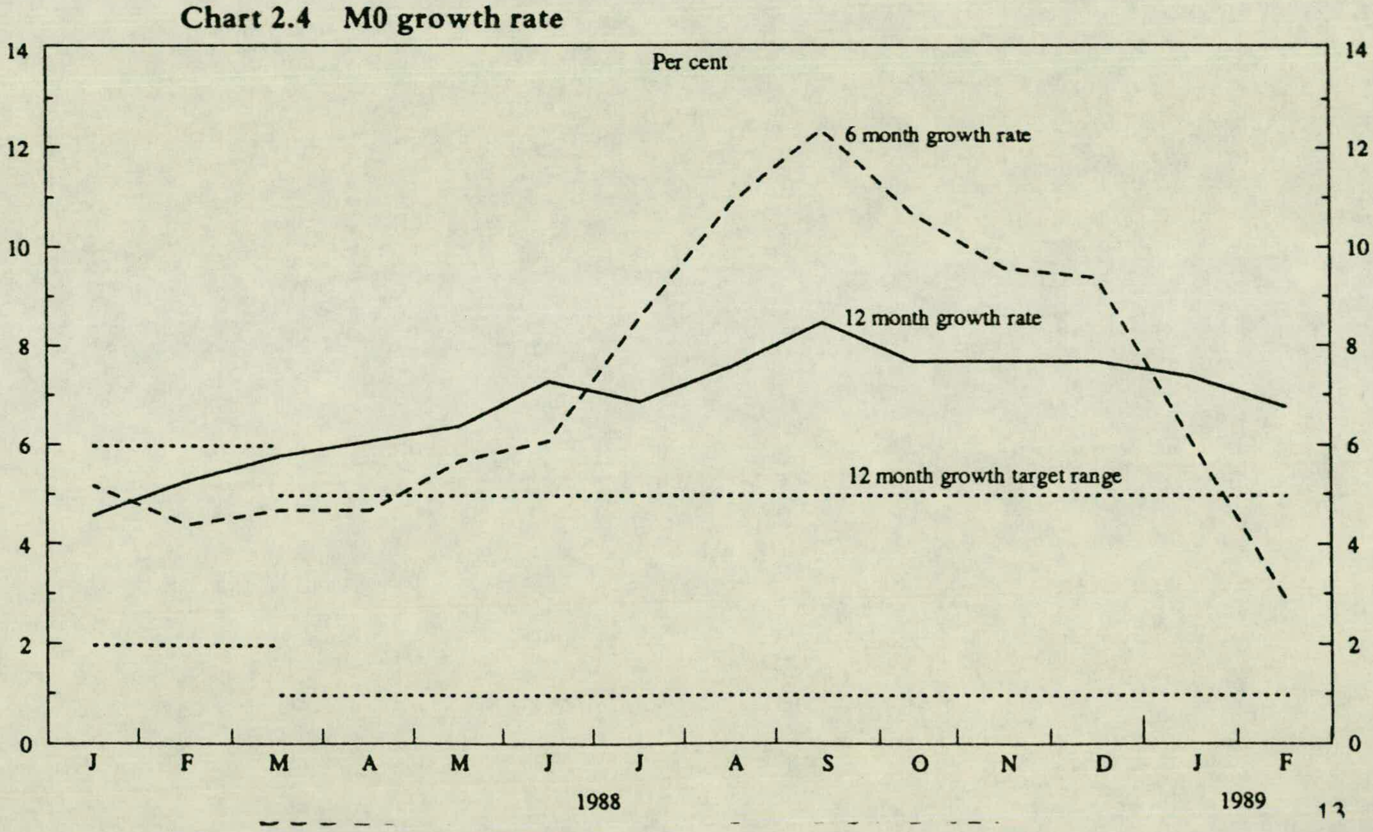
2.19 For 1989–90, a target range for M0 of 1–5 per cent has been set, the same as the illustrative range for that year in last year's MTFS. Measured by the 12 month growth rate, it is likely to begin the year above the target range. But as the deceleration over recent months continues, it will come back within it. The ranges given in Table 2.2 for later years are illustrative and show a steady fall consistent with the declining path for money GDP growth.

Table 2.2 Growth of M0[1]

1988–89	1989–90	1990–91	1991–92	1992–93
7½	1 to 5	0 to 4	0 to 4	−1 to 3

[1] 1988–89: forecast per cent change on previous financial year;
1989–90: target range for 12 month growth rate; 1990–91 onwards: illustrative ranges.

Chart 2.4 M0 growth rate

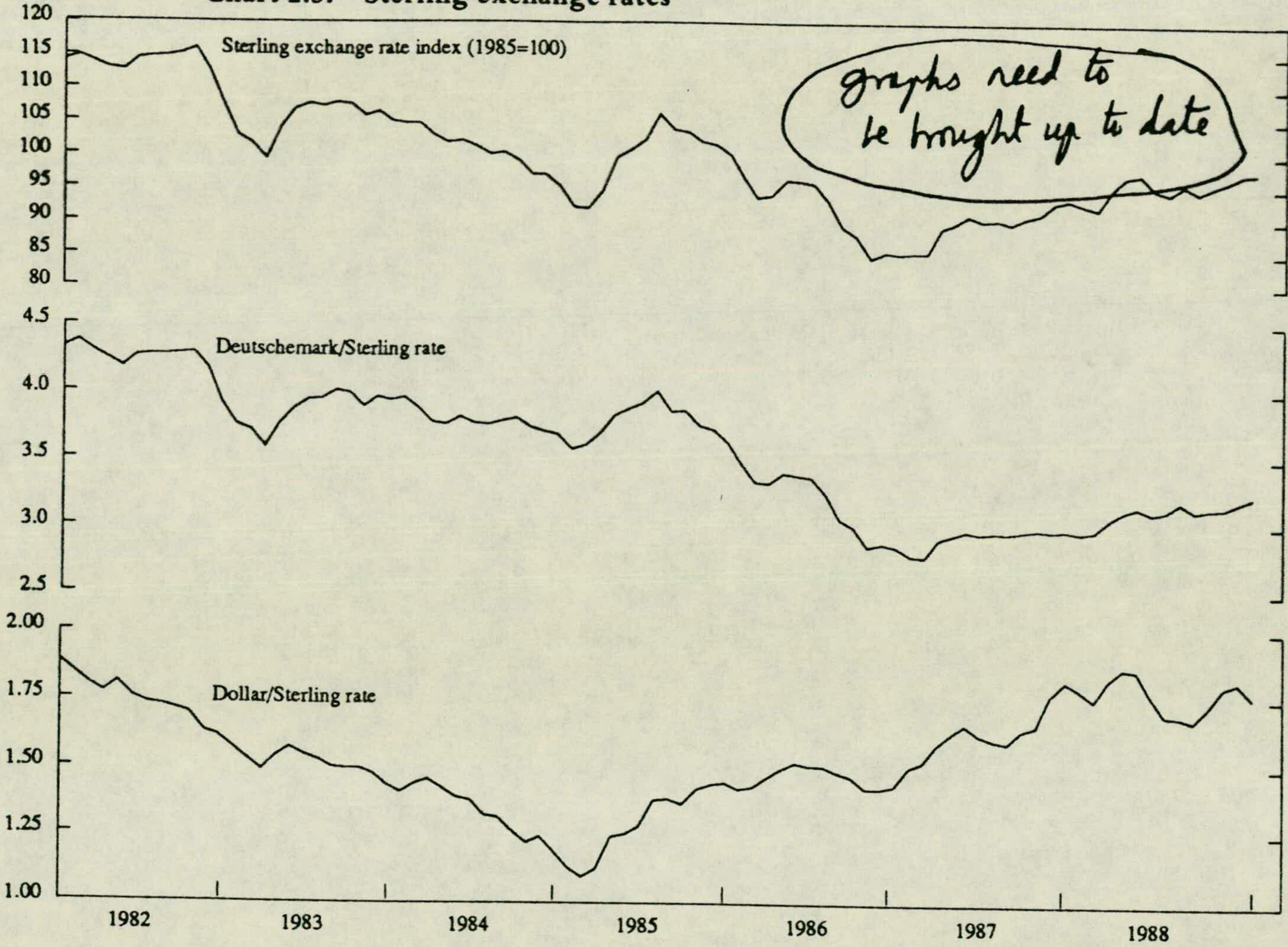


slightly

20
2.~~19~~ The exchange rate is a key influence upon, and a key indicator of, monetary conditions. It has to be considered together with all the evidence of domestic indicators in making monetary policy decisions. Monetary policy has the overriding task of defeating inflation: the Government is accordingly not prepared to accommodate increases in domestic costs by exchange rate depreciation. Sterling has risen against the deutschemark over the past year. The dollar has also risen against the deutschemark, though it has shown little change against the yen.

2.2~~0~~1 Exchange rates are also important in international economic relationships. The improved co-operation between the G7 countries, who share a common counter-inflationary objective, has been clearly beneficial to the international community.

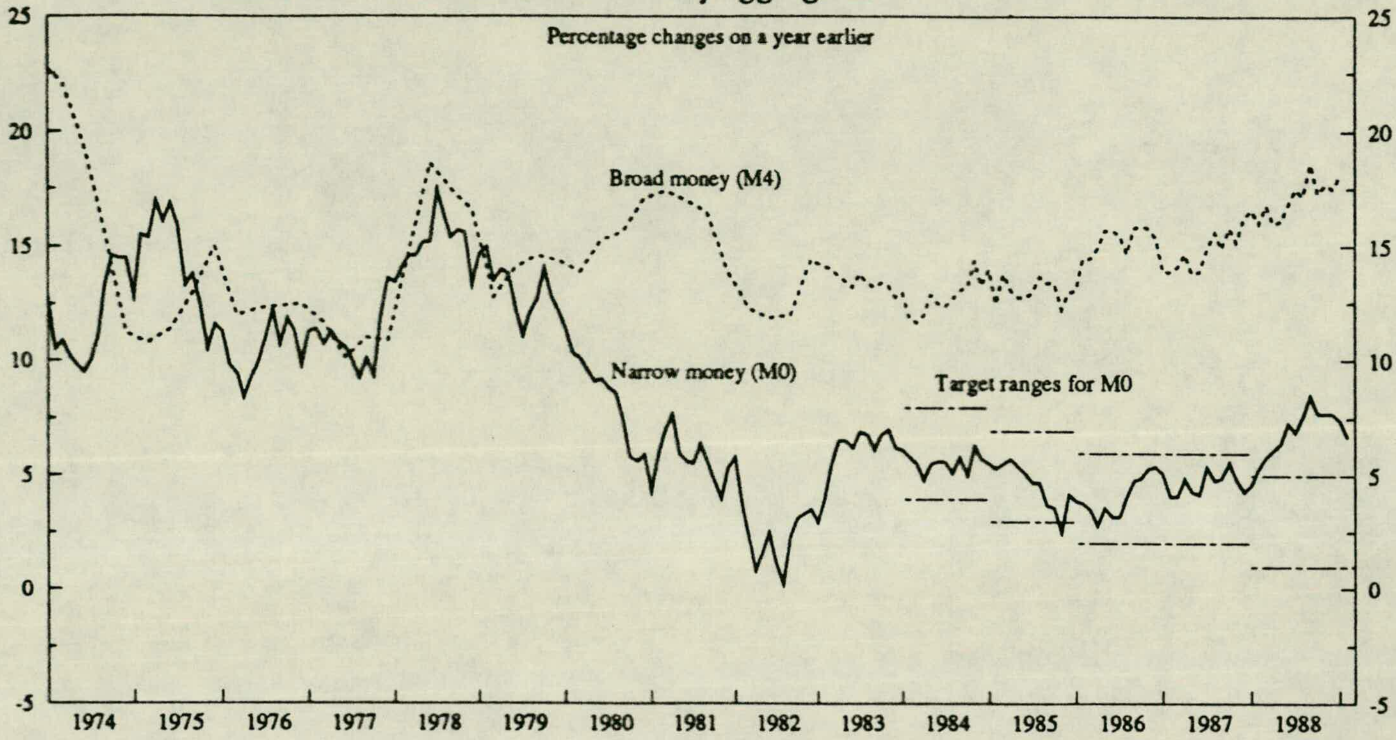
Chart 2.5: Sterling exchange rates



2
2.2~~1~~ In assessing monetary conditions, the interpretation of broad money, or liquidity, requires considerable judgment. There have been significant changes in the relationship between broad money and spending ~~in recent~~ over the years. Because it is used as a store of value as well as for transactions purposes, what matters, so far as subsequent inflationary pressure is concerned, is not its growth rate alone but the extent to which people are prepared to hold interest-bearing money balances rather than to spend them.

X

Chart 2.6: Growth rates of money aggregates



Funding policy

(b)

2.22 [3] The Government will continue to conduct its own financial affairs so as to have a broadly neutral impact on liquidity. That embodied in the policy of funding the net total of maturing debt, the PSBR, and any underlying increase in the foreign exchange reserves, by sales of debt outside the banking and building society sectors. Should this total be negative, then 'unfunding' will be required, that is, the authorities will make purchases of debt. Gilts bought in by the Bank of England are normally held in its Issue w/c department. The Government is taking powers, in this year's Finance Bill, to enable the National Loans Fund to acquire these gilts for cancellation.

Re X, [ ], surely all dated gilts become increasingly liquid by the effluxion of time. Should be either clarified or (better) deleted

2.23 [4] Now that the public sector is repaying ~~the~~ debt, it is possible to devote more attention to the structure of the remaining debt, both to secure lower expected servicing costs and to improve the quality of debt by reducing reliance on borrowing in the form of liquid instruments. Attention will also be paid to smoothing the profile of redemptions. The reverse auction conducted in January 1989, the first of its kind, enabled the authorities to make substantial purchases of gilts maturing in 1989–90, a year when maturities will be particularly heavy. [The gilts which the authorities purchased were also becoming increasingly liquid.]

2.24 [5] ~~In taking account of costs, the Government will decide~~ what types and maturity of debt to repurchase or issue, depending on current relativities and expected future yields. In 1988–89, the Government took the view that, on this criterion, its longer term debt looked relatively expensive ~~to service~~.

borrowing

In general, however, the Government decides

Accordingly, much of the buying-in of conventional gilts required by the full fund policy was of longer maturity issues, so as to secure greater future debt interest savings. The fact that the Government has been a net repurchaser of long term debt and the emergence of a downward sloping yield curve have created favourable conditions for longer term borrowing by the private sector. The increasing volume of fixed rate sterling borrowing by companies has been a welcome development.

particularly

e/c

reflected

Reverse order of first two sentences

2.25 6 In circumstances when the Government believes it will reduce inflation in a way that is not yet fully in market yields, index-linked borrowing becomes attractive to the Government as compared with conventional gilts. ~~In addition,~~ Indexed debt has the advantage of reducing uncertainty, to both the Government and investors, about future real yields. Net sales of indexed gilts continued in 1988–89, despite the reduction in total gilts outstanding, and about one eighth of ~~the~~ all gilts are now in indexed form.

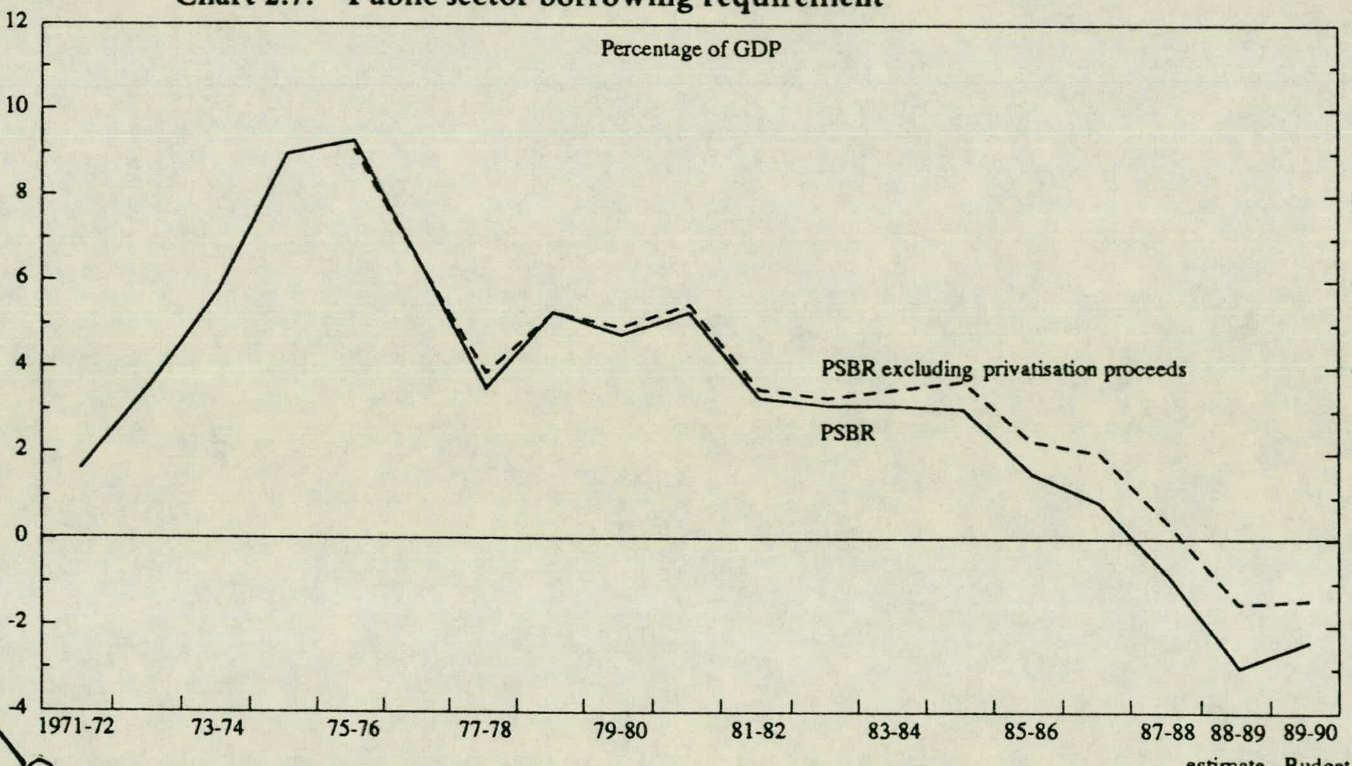
x x

outstanding

Fiscal policy

2.26 7 It is now expected that the net repayment of debt in 1988–89 will total about £[14] billion ([3] per cent of GDP), compared with a forecast in last year's Budget of £3 billion. Even allowing for the fact that privatisation proceeds are now expected to be some £2 billion higher than forecast a year ago, this means that the fiscal stance has been considerably tighter than planned, reflecting in large part the strength of economic activity which has both boosted tax revenues and depressed public expenditure.

Chart 2.7: Public sector borrowing requirement



?

(1) Negative values indicate a public sector debt repayment.

see redraft in cover-note

2.27 8 The long term objective of fiscal policy remains a balanced budget. This helps to ensure that the state is making no claim on the flow of the nation's saving or on flows from overseas. It reduces the burden of debt servicing, making room for lower taxes and higher public expenditure on priority services, and it also helps to secure confidence in sterling and in the financial stability of the economy.

gradually

2.~~28~~29 The Government intends to move from the present surplus towards a balanced budget ~~{gradually/progressively}~~ over the medium term. The PSDR for 1989–90 has been set at £12 billion; this is equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The projected PSDR path thereafter is shown in table 2.7. As usual, the PSDR to be set in future Budgets will be reviewed in the light of circumstances at the time; as tax rates are set on the basis of medium to longer term objectives the PSDR will tend to be increased by GDP growth above trend, and to be reduced by below trend GDP growth.

u/c

From control of public expenditure, coupled with

Public expenditure

2.~~29~~30 The Government's objective for expenditure is to maintain a downward trend over the medium term in the ratio of general government expenditure to GDP. ~~Partly as a result of~~ the strength of economic activity, the ratio of GGE excluding privatisation proceeds to GDP ~~has fallen~~ by 7 percentage points since 1982–83. This is the largest and most sustained fall since the immediate post-war period and it has brought the ratio back to levels not experienced since the ~~late~~ 1960s. The Government is determined to build on this achievement.

has caused

X

to fall

Table 2.3: General government expenditure (excluding privatisation proceeds) as a percentage of GDP[1]

1963-64	36¼				
1964–65	36	1974–75	48¼	1984–85	46¼
1965–66	37¼	1975–76	48½	1985–86	44½
1966–67	38¾	1976–77	46	1986–87	43¾
1967–68	42¼	1977–78	42¾	1987–88	41¼
1968–69	41	1978–79	43¼	1988–89	39¼
1969–70	40¼	1979–80	43½	1989–90	39¼
1970–71	40¾	1980–81	46	1990–91	39
1971–72	41	1981–82	46½	1991–92	38¾
1972–73	41	1982–83	46¾	1992–93	38
1973–74	42¾	1983–84	45¾		

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 onwards: MTFS projections.*

Is there no typographical construction for distinguishing the future from the past? (eg former in italics)

IS THERE SCOPE FOR GETTING 1988-89 UP?

2.~~30~~31 Projections of government expenditure are shown in Table 2.4. For the period to 1991–92, they incorporate the public expenditure plans shown in the public expenditure White Paper (Cm 601–621); the projections of gross debt interest payments and other adjustments are consistent with the latest economic projections and assumptions. It is provisionally assumed that general government expenditure will grow by 1 per cent in real terms in 1992–93. Decisions will be taken in the 1989 Survey.

Table 2.4 General government expenditure[1]

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Public expenditure planning total	145·7	150 ~~151~~·6	167	179	192	200
Gross debt interest	17·8	18·3	16·5	15	14·5	14
Other adjustments	8·3	9·9	10	10·5	9·5	9·5
General government expenditure[2]	**171·~~8~~ 7**	**178·8**	**194**	**205**	**216**	**223**
Privatisation proceeds	5·2	7·0	5	5	5	5
General government expenditure excluding privatisation proceeds	**177·0**	**185·8**	**199**	**210**	**221**	**228**

[1] *For 1987–88 to 1991–92, the figures are taken from Table 5.1.*

[2] *General government expenditure, and its components, are rounded to the nearest £1 billion from 1989–90 onwards. General government expenditure is assumed to grow by 1% in real terms in 1992–93.*

; except for debt interest and other adjustments which are rounded to the nearest £0.5 billion

Revenue

Add Riley paragraph

2.3~~1~~2 The growth in government revenues over the medium term will depend on the growth of incomes, spending and prices, as well as on policy decisions. Government revenues from the North Sea are projected to decline relative to money GDP as oil output falls. After taking account of the tax reductions announced in the Budget, non-North Sea revenues are also projected to grow at a little under the rate of growth of non-oil money GDP.

Table 2.5 General government receipts

	£ billion, cash					
	1987–88	1988–89	1989–90	1990–91	1991–92	1992–93
Taxes on incomes, expenditure and capital						
National insurance and other contributions						
Interest and dividends						
Other receipts						
General government receipts[1]						
of which						
North Sea tax[2]						

[1] *General government receipts, and its components, are rounded to the nearest £1 billion from 1988–89 onwards.*

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

Table 2.6: Non-oil taxes and national insurance contributions as a percentage of non-oil money GDP[1]

1963–64	29				
1964–65	29½	1974–75	35¾	1984–85	37¾
1965–66	31¼	1975–76	36¼	1985–86	37
1966–67	32	1976–77	36	1986–87	37½
1967–68	33¼	1977–78	35	1987–88	37¾
1968–69	35¼	1978–79	34¼	1988–89	37½
1969–70	36¾	1979–80	35½	1989–90	[37½]
1970–71	36¼	1980–81	36¼	1990–91	[36½]
1971–72	34¾	1981–82	38¾	1991–92	[36½]
1972–73	32½	1982–83	38¼	1992–93	[35½]
1973–74	33¼	1983–84	37½		

See comment on Table 2·3 – perhaps even more desirable here

[1] *1988–89: latest estimate; 1989–90: forecast; 1990-91 MTFS onwards: MTFS projections.*

BUDGET CONFIDENTIAL

Inland Revenue

J R Calder, Director of Statistics

Somerset House
London WC2R 1LB

Telephone 01-438 6609

6 March 1989

pp

Mr C J Riley
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear Chris,

FSBR CHAPTER 1

I mentioned to you last week that, in our view, showing the receipts basis for Schedule E as a separate item in table 1.1 was giving it undue prominence in a table designed to present the main Budget measures. The proposal is important for the Revenue in terms of our staffing needs, but affects a relatively small proportion of the tax-paying population. Another awkwardness is that the measure has a long-term yield but appears in table 1.1 with a significant cost in 1989-90 and 1990-91. This point is, of course, covered in Chapter 4, but cannot be signalled in table 1.1 without an additional footnote. For these reasons we suggest that the item should be included in 'other tax changes' where the cost figures would become: -155, -120, -35.

If, however, the Chancellor wishes to show the item separately in table 1.1, it would be preferable to give it the heading:

- basis of assessment for Schedule E simplified.

Yours sincerely,

Julian Calder

J R CALDER

cc PS/Chancellor
PS/Financial Secretary
Mr Culpin

Mr Painter
Mr Lewis (o/r)
Mr I Fraser
Mr McManus
Mr Eason
Mr Ko

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

PS. See [illegible] do [illegible] @ X;

Ch

Are you content with this (first draft of Table 1.1) to go to PM? Last year's format would produce something absurdly skeletal

Yes. But let's please [illegible] the table together, 1988 (even more [illegible]) [illegible] the abolition of the pensioners' earnings rule.

NL

chex.ps/aa/39

version based on last year's format

ANNEX

APPROXIMATE COSTS(*)

	1989-90	1990-91
		£ billion
Freeze excise duties	-1.2	-1.3
VAT: Non domestic construction etc	+0.3	+0.5
VAT: bad debts, registration	-0.1	-0.3
Increase car scales by 20 per cent	+0.1	+0.1
Abolish stamp duty on shares from 1/4/90	-	-0.8
Other changes (net) ~~(includes life assurance charges, reducing duty on unleaded petrol and surcharging 2-star)~~	-0.1	-0.1
	----	----
TOTAL	-1.0	-1.9

* Net of indexation/revaloristion

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[Only needs early work if you want radical revision. Otherwise after lunch is fine]

Ch
OK? Incorporates comments from Robert. (last year's below — final version of this will be a BLO paper)

AIDE MEMOIRE ON BUDGET

Income tax and NICs

not yet. (will show you tomorrow)

I await

For the purposes of the figuring in the attached table, it has been assumed that personal allowances and the basic rate limit are indexed; that there is no change in the basic rate; and that there are no changes to NICs. ~~May be scope to do more than this~~ A NICs reform is still under consideration.

Excise duties

2. No change in any of the main excise duties. The duty on unleaded petrol reduced to produce a pump price differential of 2p a litre (approximately 9p a gallon) with 4 star leaded petrol; a surcharge on 2 star leaded petrol to bring it up to the same price as 4 star. Increased VED for coaches and rigid heavy goods vehicles (agreed with DTp).

VAT

3. Implement the changes resulting from the European Court of Justice decision, as already announced; the bulk of the additional yield comes from the public sector (the impact of this on public expenditure was taken into account in the Autumn Statement). No other changes in VAT coverage.

Company cars

4. Car scales (which determine amount of taxable benefit from company cars) to be increased by 20 per cent. ~~[A larger increase would be appropriate if there were reductions in income tax.]~~ desirable

Corporation tax

5. Thresholds for the small companies' rate increased by 50 per cent; rate itself assumed to remain at 25p.

Stamp duty on shares

6. Abolish stamp duty on share transactions, probably from 1 April 1990. Announcement and legislation needed now to enable the Stock Exchange's new paperless transactions system ('TAURUS') to be planned and implemented on this basis.

Life assurance

7. Maintain the existing structure of taxation. Reduce the tax rates on policyholder's income and gains to 25 per cent (from 35 per cent and 30 per cent

respectively). Ring-fence life offices' pension business, so that expenses there cannot be set off against income on life business. Abolish life assurance premium duty. (Life offices will also gain about £100 million a year from the abolition of stamp duty on shares; this is included in the costings of that measure). Allow selling expenses to be deducted from taxable income and gains only over seven years, instead of being offset in full against income and gains in the first year; phase this change over four years.

Unit trusts

8. Reduce the Corporation Tax rate on unfranked income (principally dividends on gilts) from 35 per cent to 25 per cent from January 1990.

Pensions

9. For final salary schemes, place a limit on tax privileged pensions. Deregulate, so that the Revenue no longer ~~determine~~ lay down how much pension someone can be paid, but only how much tax-privileged pension. Pensions will be payable from tax privileged funds on earnings of up to £60,000 a year. This translates into limits of £40,000 a year on the total pension and £90,000 on the tax-free

lump sum. These limits will apply only to new pension scheme members, and will be indexed to prices. Employers will be free to pay additional amounts without tax privilege.

10. For personal pensions, increase the percentage of earnings which may be contributed with tax relief, subject to a cash limit.

PEPs

11. The limit on the total annual investment to be raised from £3,000 to £4,800; and within that the limits on investments in unit and investment trusts from £750 to £2,400. Rules greatly simplified.

Employee share schemes and ESOPs

12. Various increases in the limits for employee share schemes. And to enable the development of ESOPs, Corporation Tax relief on company contributions.

CGT

13. Abolition of the tax deferral on gifts (but not to charities, or on business assets, or between husband

and wives). This was introduced in [1980] to avoid the double charge to CGT and CTT on lifetime gifts, but the CTT charge has since been abolished. The exemption limit for CGT to be frozen, but no effective doubling (for married couples) when independent taxation comes in next year.

Deregulation/Simplification

14. A number of measures of deregulation and simplification: additional VAT bad debt relief; simplification of VAT registration rules; changing Schedule E to be charged on a receipts basis; a radical simplification the rules on close investment companies: unincorporated businesses to be allowed to set capital gains against trading losses; the Control of Borrowing Order to be abolished.

Other proposals

15. Other proposals include:

(i) converting the higher age allowance for the over-80s to one that covers all those over 75; and reducing the marginal withdrawal rate for age allowances to below 40 per cent;

(ii) increasing the PRP limits to £[X], and other simplifications to the PRP rules;

(iii) increasing the Payroll Giving limit from X to Y;

~~[~~ (iv) implementing the tax relief for private health insurance for the elderly~~]~~.

35

COPY NO 35 OF COPIES

FROM: A C S ALLAN
DATE: 6 March 1989

Pg

MR RILEY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Beighton - IR
Mr Isaac - IR
Mr Painter - IR
Mr Calder - IR

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E

FSBR CHAPTER 1

The Chancellor was grateful for your minute of 3 March. He had the following comments:

(i) On NICs, table 1.1 should say "employee contributions reformed and reduced".

(ii) The new basis of assessment for Schedule E should be included in "other tax changes" rather than shown separately in table 1.

(iii) Is "small companies' rate threshold" the correct terminology?

(iv) He would prefer the table to include "..." rather than "-" against the abolition of the pensioners earnings rules.

(v) In paragraph 1.01 he would not want the addition of the word "higher", as shown in manuscript.

(vi) He prefers the original text on the balanced Budget (ie "a gradual return to a balanced Budget ...").

ACSA

A C S ALLAN

BUDGET CONFIDENTIAL

Inland Revenue

J R Calder, Director of Statistics

Somerset House
London WC2R 1LB

Telephone 01-438 6609

7 March 1989

pup
(BLO
strong).

Mr C J Riley
HM Treasury
Parliament Street
LONDON SW1P 3AG

Dear Chris,

FSBR CHAPTER 1

This is to confirm that we are content for table 1.1 to say:

- small companies' profits limits increased.

Yours ever,
Julian.

J R CALDER

cc PS/Chancellor
Mr Gilhooly
Mr S J Flanagan
Mr Isaac
Mr McGivern
Mr J H Reed
Mr Fitzpatrick
Mr Ko

D628 BUDGET SECRET

Py

FROM: S J DAVIES
DATE: 8th March 1989

COPY NO.....1.. OF 27

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Monck
Mr Scholar
Mrs Lomax
Mr Peretz
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Grice
Miss O'Mara
Mr Pickford
Mr Barrie
Mr Savage
Miss J C Simpson
Mr Call
Mrs Chaplin
Mr Tyrie

Thanks. Discussion

MTFS FISCAL PROJECTIONS

This note reports revised medium term fiscal projections, taking account of changes to the data for the recent past and of further work by the Revenue Departments, and considers the medium term path for the PSDR. It is consistent with the latest version of the forecast, reported in Colin Mowl's minute of today. — below Ch draft.

2. The position reported in my submission of 2 March on the MTFS fiscal prospect was that on the basis of the PSDR path:

1989-90	1990-91	1991-92	1992-93
12	9	6	3

our "central projection" would be for an annual fiscal adjustment path of:

1990-91	1991-92	1992-93
0	0	4

3. I suggested that we might aim to publish a path showing the same <u>cumulative</u> fiscal adjustment by 1992-93 as our "central projection", but with a smoother annual path, viz:

1990-91	1991-92	1992-93
1	1	2

Revised projections

4. There have been substantial changes in the last few days, with considerable revisions to the national accounts data for 1987 and 1988. We now have a slightly higher level of tax revenue in 1990-91 and the later years, though the profile is otherwise very similar. Our best view about medium term fiscal prospects now is that a PSDR path of 12/9/6/3 would give the following path for the fiscal adjustment

Annual fiscal adjustment			**Cumulative fiscal adjustment by 1992-93**
1990-91	**1991-92**	**1992-93**	
0+	2-	4	6

5. Our central projection for <u>general government expenditure</u> (on MTFS economic assumptions) puts it by 1992-93 about £3½ billion above the path that we have agreed to publish (the published path will be in line with the PEWP up to 1991-92, with 1 per cent real growth in 1992-93). The central projection for <u>general government revenues</u> is for a small decline in the underlying tax burden (before the effects of 1988 and 1989 Budget changes and before any future fiscal adjustments) after 1990-91.

	1987-88	**1988-89**	**1989-90**	**1990-91**	**1991-92**	**1992-93**
Non-oil tax burden before future fiscal adjustments:						
X Projected	37.4	37.2	37.5	37.3	37.1	37.0
Before 1988 and 1989 Budget changes	37.4	38.1	39.1	39.3	39.3	39.2

6. As you know, the £12 billion PSDR assumed here for 1989-90 is not our best forecast for that year, and includes a £1½ billion "safety margin". This safety margin has been carried through to later years in the fiscal adjustment paths considered above, and so does not affect the fiscal adjustment. If we were to start from a higher PSDR figure in 1989-90 (say £13½ billion), but to have a faster annual decline in the PSDR (eg 13½/10/6/3) this would leave us with a higher cumulative fiscal adjustment by the end of the period. If we were to leave the rate of decline virtually the same as in this note - eg a 13½/11/8/5 path, ending with a zero PSDR after privatisation proceeds in 1992-93 - then the annual and cumulative fiscal adjustments would be virtually the same as in this note.

Fiscal adjustment for publication

7. Starting from the "central projections" of the fiscal adjustment shown earlier, the two things that will determine the fiscal adjustment that we will actually show are:

- the decision to publish GGE figures which are different from (ie lower than) our central forecast on MTFS economic assumptions: this raises the fiscal adjustment path relative to our "central projections".

- the extent to which we adjust revenues to offset the lower expenditure and so get back towards our central fiscal adjustment path (we may also want anyway to smooth revenues to even out the fiscal adjustment profile).

8. For a given PSDR path, bringing GGE down to PEWP levels will raise the fiscal adjustment, so we would want to bring down the revenue figures from our "central projection" to avoid overstating the available fiscal adjustment. By 1992-93 the amount involved is some £3½ billion, about 0.6 per cent of GDP. The danger is that, in adjusting down expenditure, we will show a implausible fall in the tax burden before fiscal adjustment. (The tax burden

after fiscal adjustment - which will be shown in FSBR Table 2.5 - is not, of course, affected by any smoothing of pre-fiscal adjustment revenue).

9. We consider below 3 possible fiscal adjustment paths for publication, all based on a 12/9/6/3 PSDR path. We show the underlying tax burden and increases in non-oil revenues that would be consistent with the different fiscal adjustment paths. (It will not be possible to deduce these figures precisely from the published projections, because of the rounding - to the nearest £1 billion - of the published figures.)

	1989-90	1990-91	1991-92	1992-93
Option 1				
Annual fiscal adjustment	-	1	1	4
Cumulative fiscal adjustment	-	1	2	6
Non-oil tax burden :post fiscal adjustment	37.5	37.0	36.5	35.5
:pre fiscal adjustment	37.5	37.2	36.9	36.5
:pre fiscal adjustment and before effects of 1988 and 1989 Budgets	39.1	39.2	39.1	38.7
Annual growth in non-oil taxes pre fiscal adjustment	9.1	5.2	4.7	3.5
Option 2				
Annual fiscal adjustment	-	1	2	4
Cumulative fiscal adjustment	-	1	3	7
Non-oil tax burden :post fiscal adjustment	37.5	37.0	36.5	35.5
:pre fiscal adjustment	37.5	37.2	37.0	36.7
:pre fiscal adjustment and before effects of 1988 and 1989 Budgets	39.1	39.2	39.2	38.9
Annual growth in non-oil taxes pre fiscal adjustment	9.1	5.2	5.2	3.6

	1989-90	1990-91	1991-92	1992-93
Option 3				
Annual fiscal adjustment	-	1	2	3
Cumulative fiscal adjustment	-	1	3	6
Non-oil tax burden :post fiscal adjustment	37.5	37.0	36.5	35.5
:pre fiscal adjustment	37.5	37.2	37.0	36.5
:pre fiscal adjustment and before effects of 1988 and 1989 Budgets	39.1	39.2	39.2	38.7
Annual growth in non-oil taxes pre fiscal adjustment	9.1	5.2	5.2	2.9

10. Options 1 and 3 have the advantages of showing a final cumulative fiscal adjustment that is the same as our "central projection" - £6 billion by 1992-93. At the same time they show a larger fall in the underlying tax burden than Option 2.

11. The biggest problem is with 1992-93. Partly because of the decision to publish only a 1 per cent real rise in GGE in 1992-93, we are bound to show a large annual fiscal adjustment in that year. Getting the annual fiscal adjustment down as low as £3 billion in 1992-93 would require a 0.5 point fall in the non-oil tax burden between 1991-92 and 1992-93, with only about a 3 per cent rise in non-oil revenues. This will be difficult to justify. Even showing a £4 billion fiscal adjustment in the final year will imply only a 3½ per cent increase in non-oil revenue in that year.

12. All of these options may arouse some scepticism over the implied fall in the tax burden. We will have to deal with any queries about this as best as we can, drawing attention to the build up of the effects of the 1988 and 1989 Budgets and to the implications of the current high rates of investment for capital allowances. We certainly do not want to show an unduly

over-optimistic set of fiscal adjustments, which we would be doing if we showed a flat or rising tax burden. We think the best option to go for is Option 1, in spite of the uneven annual fiscal adjustment.

S J D.

S J DAVIES

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COPY NO. 20 OF 33 COPIES

MP

FROM: C J RILEY
DATE: 8 March 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
~~Miss Wallace~~
Mrs Chaplin
Mr Tyrie
Mr Call

Sir Anthony Battishill)
Mr Beighton)
Mr Isaac) IR
Mr Painter)
Mr Calder)

Mr Unwin)
Mr Jefferson Smith) C&E
Mr Allen)

FSBR CHAPTER 1

I attach amended proofs of Chapter 1, taking on board your earlier comments.

2. There are some small changes to the numbers in table 1.1. In addition, Mr Culpin has suggested a neater and simpler version of the section on excise duties, amalgamating all the unchanged duties into one line and specifying which VED rates are being changed. Which version do you prefer?

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3. Table 1.2 does not take account of the latest revisions to the forecast, and will anyway have to be amended in the light of your decisions on the PSDR. I will show you the revision numbers as soon as possible. Note that I have reinserted footnote 2 which you had earlier deleted; classification changes have changed the GGE figures by more than a £100 million in 1988-89, and so we would prefer to retain this standard footnote.

4. The proofs must go back to the printers by noon tomorrow (Thursday), so I would be grateful for comments by 11 am.

CJR

C J RILEY

Table 1.1 The Budget measures[1]

	£ million 1989–90 Changes from a non-indexed base	1989–90 Changes from an indexed base	yield(+)/cost(−) 1990–91 Changes from an indexed base
National insurance			
employee contributions reformed and reduced	−980	−980	−2 80~~5~~0
Income tax			
personal allowances and basic rate limit indexed	−1 465	—	—
car benefit scales increased	+160	+160	+200
Excise duties			
petrol, derv etc	—	−545	−580
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−40	−40	−100
vehicle excise duty	+40	−150	−170
tobacco	—	−235	−250
alcohol	—	−255	−280
Value ~~A~~added ~~T~~tax			
non-domestic construction etc	+315	+315	+5~~40~~35
Life assurance tax regime reformed	−20	−20	+45
Corporation tax			
small companies' profits limits increased	*	*	−35
Other tax changes	−1 60	−1 25	−55
Pensioners' earnings limit abolished[2]	...	...	...
Total	**−2 150**	**−1 875**	**−3 490**

[1] *These measures, and the basis of the costings shown, are described in detail in Chapter 4.*
* = *Negligible.*
... = Not applicable

[2] *Public expenditure cost of £190 million in 1989–90 and £375 million in 1990–91 will be met from the Reserve. See Chapter 5.*
— = *Nil.*

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 0993

Culpin version

Table 1.1 **The Budget measures**[1]

	£ million 1989–90		yield(+)/cost(−) 1990–91
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
National insurance			
employee contributions reformed and reduced	−980	−980	−2 80~~5~~0
Income tax			
personal allowances and basic rate limit indexed	−1 465	—	—
car benefit scales increased	+160	+160	+200
Excise duties			
most duties unchanged	—	−1225	−1320
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−40	−40	−100
vehicle excise duty rates for taxis, buses and some lorries increased	+40	+40	+40
Value ~~A~~added ~~T~~tax			
non-domestic construction etc	+315	+315	+5~~40~~35
Life assurance tax regime reformed	−20	−20	+45
Corporation tax			
small companies' profits limits increased	★	★	−35
Other tax changes	−1/60	−1/25	−55
Pensioners' earnings limit abolished[2]	...	...	...
Total	**−2 150**	**−1 875**	**−3 490**

[1] *These measures, and the basis of the costings shown, are described in detail in Chapter 4.*
★ = *Negligible.*
... = Not applicable

[2] *Public expenditure cost of £190 million in 1989–90 and £3[illegible]5 million in 1990–91 will be met from the Reserve. See Chapter 5*
— = *Nil.*

1 The Budget

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

1.02 The Financial Statement and Budget Report (FSBR) supplements the Chancellor's Budget Statement. It presents the Medium Term Financial Strategy (MTFS); describes developments in the economy over the past year; provides forecasts to mid-1990; sets out the tax and national insurance proposals in the Budget; summarises the Government's spending plans; and gives forecasts for the public finances for the year ahead.

The Medium Term Financial Strategy

1.03 Chapter 2 describes the MTFS, which provides the framework for the Government's economic policy. The objectives of the MTFS and the central role of monetary policy have remained unchanged throughout the 1980s, a period of substantial economic progress. Monetary policy is designed to reduce money GDP growth and thus inflation over the medium term, with the ultimate objective of achieving stable prices; in this year's MTFS money GDP growth falls to around 5½ per cent over the next four years. Monetary policy is buttressed by a sound fiscal policy, with a substantial budget surplus in both 1988–89 and 1989–90; a gradual return to a balanced budget is projected over the medium term, with both taxes and public expenditure declining as a share of GDP. The MTFS is complemented by policies designed to improve the working of markets and the supply performance of the economy.

The economy

1.04 Chapter 3 describes the main developments in the economy in 1988 and the prospect until mid-1990. ~~In recent years economic trends have become increasingly difficult to interpret because of inconsistencies within the national and sectoral accounts; adjusted figures that reduce (but do not eliminate) these inconsistencies are used throughout the FSBR~~. The economy grew strongly again in 1988, by 4½ per cent, with the largest fall in unemployment since the war. GDP is forecast to grow by a further 2[illegible] per cent in 1989. ~~on the basis of growth through the year lower than this.~~ Inflation is forecast to be on a downward trend in the second half of 1989.

Tax and national insurance measures

1.05 Chapter 4 sets out the tax and national insurance proposals in the Budget. They include reform and reduction of employee national insurance contributions, indexation of the main income tax thresholds, improvements to personal equity plans and employee share schemes, reform of the taxation of life assurance, pensions, and unit trusts, measures to promote unleaded petrol, and abolition of the earnings rule for pensioners. The measures are summarised in Table 1.1.

Public expenditure

1.06 Chapter 5 summarises the Government's spending plans, as set out in the public expenditure White Paper. This chapter also provides the latest estimate of the outturn for the public expenditure planning total in 1988–89

Public sector finances

1.07 Chapter 6 presents the complete financial picture for the public sector. The public sector debt repayment is forecast to be [£14 billion] in 1988–89. A further debt repayment of [£12 billion] is forecast for 1989–90, equivalent to £7 billion net of privatisation proceeds, the same as in 1988–89. The forecast takes account of the measures in the Budget which are expected to reduce taxation and national insurance contributions by £1·9 billion, after adjusting for the net cost of indexing direct and indirect tax rates and allowances. Table 1.2 shows the main components of general government receipts and expenditures.

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Table 1.2 The finances of the public sector[1]

	£ billion 1988–89 1988 Budget[2]	1988–89 Latest estimate	1989–90 Forecast
RECEIPTS			
Inland Revenue:			
Income tax	42·1	43·5	47·1
Corporation tax[3]	19·8	18·8	22·0
Petroleum revenue tax	1·2	1·3	1·3
Capital gains tax	2·0	2·4	2·1
Inheritance tax	1·0	1·1	1·1
Stamp duties	2·0	2·3	2·6
Total Inland Revenue	**68·0**	**69·4**	**76·1**
Customs and Excise:			
Value added tax	26·2	27·5	29·8
Petrol, derv duties etc.	8·4	8·7	8·7
Tobacco duties	5·0	5·1	5·1
Alcohol duties	4·5	4·6	4·7
Betting and gaming duties	0·9	0·9	0·9
Car tax	1·3	1·4	1·4
Customs duties	1·6	1·7	1·8
Agricultural levies	0·1	0·2	0·1
Total Customs and Excise	**47·9**	**49·9**	**52·5**
Vehicle excise duties	2·8	2·8	2·9
Oil royalties	0·6	0·6	0·6
Gas levy	0·4	0·4	0·4
Local authority rates[4]	19·0	18·9	20·4
Other taxes and royalties	2·5	2·7	2·8
Total taxes and royalties	**141·2**	**144·8**	**155·7**
National insurance and other contributions	31·6	32·8	34·6
Interest and dividends	5·6	6·6	6·7
Gross trading surpluses and rent	3·5	3·3	3·5
Other receipts	2·9	3·3	3·4
General government receipts	**184·9**	**190·8**	**203·8**

	£ billion 1988–89 1988 Budget[2]	1988–89 Latest estimate	1989–90 Forecast
EXPENDITURE			
Department			
Social security	48·5	47·4	51·0
Health	20·7	21·8	23·2
Defence	19·2	19·0	20·1
Education and science	18·0	18·4	19·6
Home office and legal departments	7·0	7·2	8·0
Transport	5·1	4·8	5·4
Scotland	8·5	8·7	9·0
Wales	3·5	3·6	3·8
Northern Ireland	5·1	5·6	5·5
Other departments	22·8	21·7	23·1
Privatisation proceeds	−5·0	−7·0	−5·0
Reserve	3·5	—	3·5
Public expenditure planning total	**156·9**	**151·1**	**167·1**
General government gross debt interest	17·5	18·2	16·6
Other adjustments	8·6	9·2	9·5
General government expenditure	**183·0**	**178·5**	**193·2**

Receipts, expenditure and debt repayment

	£ billion 1988–89 1988 Budget[2]	1988–89 Latest estimate	1989–90 Forecast
General government receipts	184·9	190·8	203·8
General government expenditure	183·0	178·5	193·2
General government debt repayment	2·0	12·3	10·6
Public corporations' market and overseas debt repayment	1·2	1·7	1·5
Public sector debt repayment	**3·2**	**14·0**	**12·1**

[1] *In this and other tables constituent items may not add up to totals because of rounding.*
[2] *On current definitions.*
[3] *Includes advance corporation tax (net of repayments):* 5·3 6·0 6·4
— *also includes North Sea Corporation tax after ACT set off and corporation tax on gains.*
[4] *In this and other tables community charge receipts in Scotland are included with local authority rates.*

mg.ee/dlcp/8.3-aa

BUDGET SECRET

COPY NO. 1 OF 2

From : D L C Peretz
Date : 8 March 1989

MR A ALLAN

FSBR : PARAGRAPHS 2.24 AND 2.25

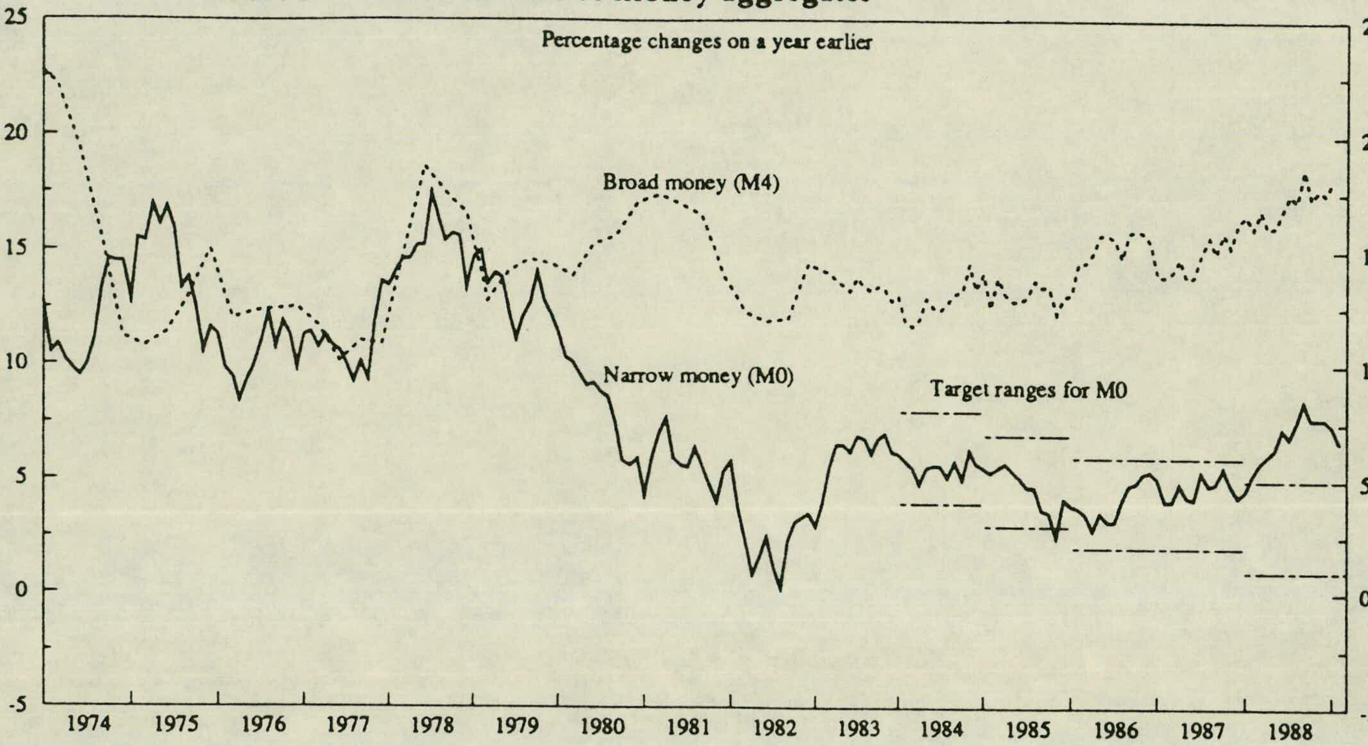
We spoke about this. I would like to suggest the small further drafting changes marked on the attached copy.

Sorry ~~too~~ wording: is the "In general" is or "as a general" for the purposes in

DLCP

D L C PERETZ

Chart 2.6: **Growth rates of money aggregates**



Funding policy

2.22 [3] The Government will continue to conduct its own financial affairs so as to have a broadly neutral impact on liquidity. That embodied in the policy of funding the net total of maturing debt, the PSBR, and any underlying increase in the foreign exchange reserves, by sales of debt outside the banking and building society sectors. Should this total be negative, then 'unfunding' will be required, that is, the authorities will make purchases of debt. Gilts bought in by the Bank of England are normally held in its Issue department. The Government is taking powers, in this year's Finance Bill, to enable the National Loans Fund to acquire these gilts for cancellation.

w/c

2.23 [4] Now that the public sector is repaying ~~the~~ debt, it is possible to devote more attention to the structure of the remaining debt, both to secure lower expected servicing costs and to improve the quality of debt by reducing reliance on borrowing in the form of liquid instruments. Attention will also be paid to smoothing the profile of redemptions. The reverse auction conducted in January 1989, the first of its kind, enabled the authorities to make substantial purchases of liquid gilts maturing in 1989–90, a year when maturities will be particularly heavy. ~~The gilts which the authorities purchased were also becoming increasingly liquid~~.

Re X, [ ], surely all dated gilts become increasingly liquid by the effluxion of time. Should be either clarified or (better) deleted

2.24 [5] ~~In taking account of costs~~, ~~the Government will decide~~ what types and maturity of debt to repurchase or issue, depending on current relativities and expected future yields. In 1988–89, the Government took the view that, on this criterion, its longer term debt looked relatively expensive ~~to service~~.

borrowing

In general, however in seeking to reduce servicing costs the Government decides

Accordingly, much of the buying-in of conventional gilts required by the full fund policy was of longer maturity issues, so as to secure greater future debt interest savings. The fact that the Government has been a net repurchaser of long term debt and the emergence of a downward sloping yield curve have created favourable conditions for longer term borrowing by the private sector. The increasing volume of fixed rate sterling borrowing by companies has been a welcome development.

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BUDGET SECRET
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COPY NO: 1 OF 24 COPIES

FROM: COLIN MOWL
DATE: 8 March 1989

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Sedgwick
Mr Riley
Mr Culpin
Mr Peretz
Mrs Lomax
Mr Hibberd
Mrs R Butler
Mr S J Davies
Mr Gieve
Mr Pickford
Mr Patterson
Mrs Wright
Mrs Todd
Miss Simpson
Mrs Chaplin
Mr Call

PSDR IN 1988-89 AND 1989-90

This minute, written in consultation with Mr Scholar and Mr Sedgwick, summarises our latest forecasts of the PSDR in 1988-89 and 1989-90 and makes recommendations about what figures to publish in the FSBR. We need decisions now to complete the figuring for the Budget speech and briefing, and for chapters 1, 2, 5 and 6 of the FSBR. Your decision for 1988-89 may have to be reviewed tomorrow however if there is a major surprise when we receive the first estimate of the PSDR in February. (At present we only have an estimate of the central government element.)

Best estimates

(a) 1988-89

2. Our central forecast for 1988-89 has barely changed. It is now a PSDR of £14.4 billion, compared with a previous forecast of £14.5 billion. The February outturn on central government own account was a £0.3 billion higher repayment than forecast last month, but we have increased our forecast of central government expenditure in March a little, and - for what it is worth - the newly available local authority borrowing intentions survey points to a higher level of LA borrowing than previously forecast.

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[illegible]. This forecast is consistent with a planning total outturn of £150.4 billion, a little below GEP's latest estimate of £150.6 billion (Mr Richardson's minute to the Chief Secretary of March 6). It implies that central government cash outlays in March will be 10.1 per cent of the annual total, compared with in equivalent figure for March last year of 10.2 per cent.

(b) 1989-90

4. Our current forecasts for activity and inflation show growth of money GDP in 1989-90 of 7½ per cent, the same as underlying our last PSDR forecast. Taking account of the final Budget package, our central forecast for 1989-90 is a PSDR of £13.4 billion, much the same as our previous forecast of £13.5 billion. There are a number of large, offsetting changes however. The main ones are:

- an upward revision to tax and NIC receipts of £1½ billion, mainly from extra corporation tax reflecting a revised assessment by Inland Revenue and ourselves of the likely level of tax for given profits etc <u>and</u> also higher profits in 1988;

- a downward revision of £½ billion to the forecast of the planning total, largely due to a lower forecast of local authority current spending following receipt of early information on LA budgets (an overspend of £1½ billion now forecast);

- an upward revision of £1½ billion to the forecast of net debt interest payments following a more detailed review of the prospects in light of the latest assumptions on the composition and timing of funding and debt repayment; (v large)

5. The forecast planning total outturn in 1989-90 is now £½ billion below the level provided for in the 1989 PEWP.

6. The forecast has a small rise in the (post-Budget) non-oil tax burden in 1989-90.

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Non-oil taxes and NICs as % of non-oil GDP

1987-88	1988-89	1989-90
37.4	37.2	37.5

Flat 37.4's better.

7. Excluding privatisation proceeds the forecast is for the PSDR to rise by £1 billion between 1988-89 and 1989-90. The 1988 and 1989 Budgets reduce receipts by about £4 billion in 1989-90 relative to 1988-89. Excluding both privatisation proceeds and Budget effects the PSDR is therefore forecast to rise by £5 billion in 1989-90. While this is our best forecast and there are risks in both directions, looked at in these terms our forecast seems less cautious, especially in the context of the forecast cyclical slowdown in activity (some of the effect of the slowdown, on corporation tax for example, comes through in later years).

Figures for the FSBR

8. On the basis of central forecasts largely the same as now - £14½ billion in 1988-89 and £13½ billion in 1989-90 - you provisionally decided to publish PSDR figures of £14 billion and £12 billion in 1988-89 and 1989-90 respectively ie. no change between years in the PSDR excluding privatisation proceeds.

(a) 1988-89

9. Outsiders will probably judge the plausibility of our 1988-89 forecast by comparing the implied February/March total (and once the February outturn is published two days after the Budget, the implied March figure) with the corresponding period of last year. This suggests that, on the basis of present information, the very lowest PSDR that could be published is one which assumes the same PSDR (excluding privatisation proceeds) as in February and March last year, ie. £13.2 billion, derived as follows:

	£ billion
April to January outturn	15.5
Privatisation proceeds to come	1.0
PSDR excluding privatisation proceeds in February and March last year	-3.3
	13.2

It is well known however that the PSDR in April to January was well above the level of the previous year (excluding privatisation proceeds by £0.8 billion a month on average) and it would look very odd if our forecast for the year as a whole did not imply that this pattern continued, at least to some extent. (And we already know that the CG own account repayment in February was £0.2 billion above last year's level.)

10. There would be no reason however to publish a forecast for the year which implied a February/March PSDR more than £1.6 billion above last year (ie. the rate at which it has been above last year in the first 10 months) ie. a PSDR of £14.8 billion.

11. On the assumption that we would not publish a figure above our best estimate, the figure published should be in the range £13.2 billion to £14.4 billion. A forecast towards the bottom of this range, say £13.5 billion or below, could well be treated with a good deal of scepticism. On the other hand a figure at the top of the range would provide no safety margin. (On present GDP estimates a PSDR of at least £13.5 billion is needed to exceed the 1969-70 surplus excluding privatisation proceeds as a per cent of GDP.)

12. If we were to publish a figure below our best estimate we would have to reduce our forecast of receipts but not to quite the same extent because we could push our figures for expenditure up a little. Our best estimate of the planning total is £0.2 billion below the figure recommended by GEP for publication and there is always scope for edging up debt interest at the margin (but we would need to liaise with GEP on the GGE ratios). The choice therefore comes down to two alternatives a PSDR which rounds either to £13½ billion (say 13.6 unrounded) or to £14 billion (say 13.9 or 14.0).

(b) 1989-90

13. We assume that you still wish to publish a PSDR for 1989-90 below our best estimate so that there is some safety margin. If you wish to show an unchanged non-oil tax burden we need to reduce tax receipts by about £1½ billion compared with our best estimate. There should be little difficulty in making further downward adjustments to the PSDR (from higher debt interest payments and/or lower non-tax receipts) if these are required.

14. The table below summarises the main options.

	1988-89 PSDR	1988-89 Safety margin	1989-90 PSDR	1989-90 Safety margin
Best estimates	14.4	-	13.4	-
<u>Options for FSBR</u>				
(i)	13.6	0.8	13.4	0.0
(ii)	13.6	0.8	12.0	1.4
(iii)	13.6	0.8	11.5	1.9
(iv)	13.9	0.5	12.4	1.0
(v)	13.9	0.5	12.0	1.4

15. Option (i) has no change in the PSDR between years but is not really acceptable as it has no 1989-90 safety margin.

16. Options (iii) and (v) show no change between years in the level of the PSDR excluding privatisation proceeds. (Option (v) is, in round terms, the one you decided upon provisionally.)

17. Options (ii) and (iv) show no change in the PSDR excluding privatisation proceeds as a percentage of money GDP.

18. All the options will show the public expenditure planning total in 1989-90 as in the PEWP. We have not yet gone through the detailed GGE arithmetic with GEP but we think there should be no major problems in reconciling any of the PSDR options with acceptable paths for GGE.

<u>Conclusion</u>

19. On the basis of our latest forecasts there is no need to depart from your earlier decision ie. option (v). However, depending on how you wish to present the fiscal stance, options (ii), (iii) and (iv) are all perfectly feasible.

20. We should be grateful for your decisions by <u>9.30am tomorrow morning (Thursday)</u> so that we can carry through the implications to the FSBR, Budget brief, etc.

Colin Mowl

COLIN MOWL

COPY NO 20 OF 34 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

rp

MR RILEY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Sedgwick
Mrs Butler
Mr S Davies
Mr Gilhooly
Mr Mowl
Mr Macpherson
Miss Simpson
Miss Wallace
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Beighton - IR
Mr Isaac - IR
Mr Painter - IR
Mr Calder - IR

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E

FSBR CHAPTER 1

The Chancellor was grateful for your minute of 8 March. He had the following comments.

(i) On excise duties, he would prefer the order in Table 1.1 to be

- Duty on unleaded petrol ...
- Vehicle Excise Duty rates ...
- Other duties unchanged.

He accepts that this will mean an increase in the figures for the cost of the unleaded petrol changes measured from an indexed base, and a reduction in the figure for the yield from the VED changes.

(ii) Given that the "other tax changes" had got as large as -£160 million in 1989-90, he wondered whether we ought to disaggregate Schedule E after all; but after further advice he accepted that the existing treatment can stand.

(iii) Amend paragraph 1.05 to read "...improvements to personal equity plans and employee share schemes, reform of the taxation of life assurance, changes to the taxation of pensions and unit trusts...".

A C S ALLAN

MP

COPY NO 17 OF 24 COPIES

FROM: A C S ALLAN
DATE: 9 March 1989

MR MACPHERSON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr Gieve
Mr Gilhooly
Mr Matthews
Miss Simpson
Miss Wallace

Sir A Battishill - IR
Mr Calder - IR

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

FSBR CHAPTER 4

The Chancellor was grateful for your minute of 8 March. He had the following points:

(i) He would move up Schedule E to the income tax part of the narrative section.

(ii) Should the penultimate indent of paragraph 4.02 refer to "age allowances" rather than "age allowance"?

(iii) In the text on Schedule E, why do we need the addition of "in practice" ("not already in practice taxed on a receipts basis").

(iv) The beginning of paragraph 4.12 should be amended to read: "A number of changes will be made to the taxation of pensions. In the case of occupational pensions:".

(v) Chart 4.1 is much too big, and should be reduced to half its present size.

(vi) The Chancellor feels it might be worth changing the second grouping in table 4.1 to "income tax, corporation tax <u>and stamp duty</u>", so that the abolition of life assurance policy duty can be brought together with the other two lines on life assurance companies. But this is not essential if it causes great problems.

(vii) The Chancellor would prefer to have a line at the end of table 4.1 showing "total Budget changes", as in table 1.1.

(viii) Why do we need the addition of the words "level of" in the notes to lines 1-5?

(ix) Amend the new note to line 22 to read "...in particular, to spread over 7 years the relief for the costs of acquiring new business (other than pension and general annuity business), subject to transitional arrangements in the first 4 years; and to reduce the corporation tax rate ..."

ACSA

A C S ALLAN

FROM: A C S ALLAN
DATE: 9 March 1989

pg

MR PERETZ

FSBR: PARAGRAPHS 2.24 AND 2.25

I showed the Chancellor your minute of 8 March. But he decided not to take your addition on board: he felt that "in general" was adequate.

ACSA

A C S ALLAN

BUDGET SECRET COPY 1 OF 4

FROM: S J FLANAGAN
DATE: 9 MARCH 1989

MR RILEY cc M. Allan

cc Mr Culpin
Mr Macpherson

FSBR TABLE 1.1

If we change the order of the excise duty section, the numbers would have to change as well. The result would be:

EXCISE DUTIES			
duty on unleaded petrol reduced, duty increased for 2 and 3 star petrol	−40	−95	−170
vehicle excise duty for taxis, buses and some lorries increased	+40	+5	—
other duties unchanged	—	−1135	−1210

2. This looks odd – particularly the VED line. There would, of course, have to be changes to table 4.1 as well.

Not so! That's the rigidity that arises from showing the comparison all in real terms!

Steven Flanagan
S J FLANAGAN

CJ

I still think this is the right treatment

AA

I agree.
N.

188/3

178/8

fp.pk/macpherson/8.3.03

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FROM: N I MACPHERSON
DATE: 8 March 1989

1. MR GILLOOLY 8/3

2. CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Gieve
Mr Matthews
Miss Simpson
Miss Wallace

Sir A Battishill) IR
Mr Calder)

Mr Unwin) C&E
Mr P R H Allen)

FSBR CHAPTER 4

I attach the latest proof of Chapter 4.

2. Now that relocation costs has been dropped, there is a case for moving Schedule E to the income tax part of the narrative section perhaps after "charitable giving", since it sits rather oddly between PEPs and pensions. However, I have assumed you do not want to give it the front page treatment.

3. I have added a sentence to paragraph 4.03 by way of explanation. This brings it more into line with the Budget Speech.

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4. The main changes are to the Annex. There are new notes on life assurance, which take on board your comments. "VAT: input supplies" (note 55) and "duty reliefs: diplomats" (note 69) have been included for the first time; this is because they are covered by the Budget Resolutions. I have also changed the VAT ECJ notes slightly.

5. I would be grateful for comments by midday tomorrow.

Nick Macpherson

N I MACPHERSON

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4 The Budget tax and national insurance proposals

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

Income tax

4.02 The main income tax thresholds will be increased in line with the statutory indexation provisions (based on the increase of 6·8 per cent in the RPI in the year to December 1988); the higher level of age allowance currently given to those aged 80 and over will be extended to those aged 75 and over. This will mean that:

the single person's and wife's earned income allowances will rise from £2 605 to £2 785;

the married allowance will rise from £4 095 to £4 375;

the additional personal allowance and widow's bereavement allowance will rise from £1 490 to £1 590;

the age allowance for those aged 65 to 74 will rise from £3 180 to £3 400 (single) and from £5 035 to £5 385 (married);

the age allowance for those aged 75 and over will rise from £3 180 (for single people aged under 80) and from £3 310 (for single people aged 80 and over) to £3 540; and from £5 035 (for married couples aged under 80) and from £5 205 (for married couples aged 80 and over) to £5 565;

the income limit for the age allowance will rise from £10 600 to £11 400;

the basic rate limit will rise from £19 300 to £20 700 of taxable income.

4.03 The age allowance withdrawal rate will be reduced from £2 of allowance for each £3 of income to £1 of allowance for each £2 of income above the income limit of £11 400. This means that the marginal tax rate for someone with income just above the limit will fall from nearly 42 per cent to 37.5 per cent.

Benefits in kind

4.04 Car benefit scale charges will be increased by one third from 6 April 1989.

Private medical insurance

4.05 Income tax relief will be given from 6 April 1990 on private medical insurance premiums for those aged 60 and over.

Charitable giving

4.06 The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be doubled from £240 to £480 a year from 6 April 1989.

Employee share ownership plans (ESOPs)

4.07 Tax relief will be given for payments by companies to qualifying ESOP trusts.

Approved employee share schemes

4.08 The annual limit for individual participation in the 1978 all-employee share scheme will be increased to £2 000 or—if greater—10 per cent of pay up to a maximum of £6 000. The 1980 SAYE share option scheme limit will be increased from £100 to £150 per month. The maximum discount from the share price at which options may be granted under these schemes will be doubled to 20 per cent.

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Profit-related pay **4.09** The cash ceiling on the amount of profit-related pay attracting tax relief will be increased to £4 000. A number of other changes will simplify and improve the PRP rules.

Personal equity plans **4.10** The annual limit on investment in Personal Equity Plans will be increased from £3 000 to £4 800. The annual limit on investment in unit and investment trusts will be increased to £2 400, irrespective of other holdings. ~~and restricted to~~ investment in unit and investment trusts will be restricted to trusts which invest mainly in UK equities. The PEP rules will be greatly simplified.

Schedule E assessment **4.11** The basis of assessment for Schedule E (remuneration of employees and directors) will be changed from ~~earnings~~ accruals to receipts. Bringing the systems of assessment and collection (PAYE) into line will simplify the taxation of the half million directors and employees not already in practice taxed on the receipts basis.

~~**Relocation expenses** **4.12** Payments an employer makes towards the additional housing costs of an employee transferred to a more expensive location will no longer be exempt from tax.~~

Pensions ~~4.13~~ 4.12 The tax regime for pensions will be ~~amended~~ changed. For occupational schemes the main features will be:

employers will be able to set up "top up" schemes for their employees, with no limits on benefits, but without special tax reliefs;

a limit will be placed on pensions paid from tax-approved schemes, based on earnings of £60 000 a year. This is consistent with a tax-privileged pension of up to £40 000 a year or maximum tax free lump sum of up to £90 000. The limit will be indexed to prices;

the rules for tax approved pensions, particularly affecting those who take early retirement, will be simplified and improved.

These changes will apply to schemes set up on or after Budget day and to new members joining existing schemes on or after ~~that date~~ 1 June 1989.

~~4.14~~ 4.13 New simplified rules will be introduced for monitoring additional voluntary contributions. Any surplus contributions made will be returned to employees, subject to a special tax charge.

~~4.15~~ 4.14 Annual contribution limits for personal pension schemes will be increased as a percentage of earnings, subject to an overall cash limit based on the £60 000 earnings limit for occupational schemes.

Life assurance ~~4.16~~ 4.15 The tax regime for life assurance companies will be reformed. The main changes, to be introduced from 1 January 1990, are:

pension and general annuity business expenses will be deductible only from pension or general annuity business profits;

relief for expenses of acquiring new life assurance business (other than pension or general annuity business) will be spread over seven years: this change will be phased in gradually over four years;

the rate of tax charged on income and capital gains attributable to policy holders will be reduced to a rate equal to the basic rate of income tax (25 per cent);

life assurance policy duty will be abolished.

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Unit trusts ~~4.17~~ 4.16 A new tax regime will be introduced from 1 January 1990 for unit trusts investing in transferable securities which are freely marketable throughout the European Community under the UCITS directive. The rate of corporation tax charged on their income will be reduced to a rate equal to the basic rate of income tax (25 per cent).

COBO and deep discounted bonds ~~4.18~~ 4.17 The new issues queue will be abolished by a general consent under the Control of Borrowing Order and the regime for deep discounted bonds, including certain index-linked bonds, will be amended with effect from Budget day.

Business taxation ~~4.19~~ 4.18 The profits limit for the small companies' corporation tax rate of 25 per cent for financial year 1989 will be raised from £100 000 to £150 000 and the limit for marginal relief will be raised from £500 000 to £750 000.

~~4.20~~ 4.19 The main rate of corporation tax for the financial year 1989 will be 35 per cent.

~~4.21~~ 4.20 The apportionment rules for close companies will be abolished. Special provisions including a corporation tax rate equal to the higher rate of income tax (40 per cent) will be introduced for close investment companies which distribute less than a specified percentage of their profits.

Capital gains tax ~~4.22~~ 4.21 The capital gains tax annual exempt amount will remain at £5 000 in the case of individuals and £2 500 in the case of most trusts.

~~4.23~~ 4.22 The disposal value limit below which chattels are exempt from charges on capital gains will be doubled from £3 000 to £6 000.

~~4.24~~ 4.23 Capital gains tax deferral on lifetime gifts will be restricted to certain types of gift—in particular, gifts of business, farm and heritage assets, gifts on which there is an immediate charge to inheritance tax, and gifts to charity.

Inheritance tax ~~4.25~~ 4.24 From ~~Budget day~~ 6 April 1989 the threshold for inheritance tax will be increased in line with the statutory indexation provisions from £110 000 to £118 000.

VAT and car tax ~~4.26~~ 4.25 From 15 March 1989 the VAT registration limits will be raised to £23 600 a year, and £8000 a quarter.

~~4.27~~ 4.26 To comply with the European Court judgment of 21 June 1988 certain previously zero rated goods and services will be subject to VAT at the standard rate. As announced on 6 February, the regime will aim to minimise the tax and compliance burden.

~~4.28~~ 4.27 Non-residential construction and property development will be liable to VAT from 1 April 1989 with transitional relief for prior contractual commitments. Landlords will be given the option to tax rents of non-residential buildings from 1 August 1989. VAT will also be applied from 1 April 1989 to news services and to protective boots and helmets supplied to employers ~~and to news services~~; and from 1 July 1990 it will be applied to fuel and power supplied to businesses, and to water and sewerage services supplied to industry.

~~4.29~~ 4.28 VAT relief for charities will be extended to charity fund-raising events, certain types of advertising and medical sterilising equipment. Cars leased to the disabled will be relieved of car tax.

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Excise duty 4.29 ~~4.30~~ The duty on unleaded petrol will be reduced by the equivalent of just under 1p a litre (nearly 4p a gallon) including VAT. A higher rate of duty will be introduced on 2 and 3 star leaded petrol. This will add nearly 1p a litre (4p a gallon) including VAT to the tax charged on these grades.

ITV levy 4.30 ~~4.31~~ From 1 January 1990, the additional payments made by ITV programme contractors will be assessed on a mixture of net advertising revenue and profits.

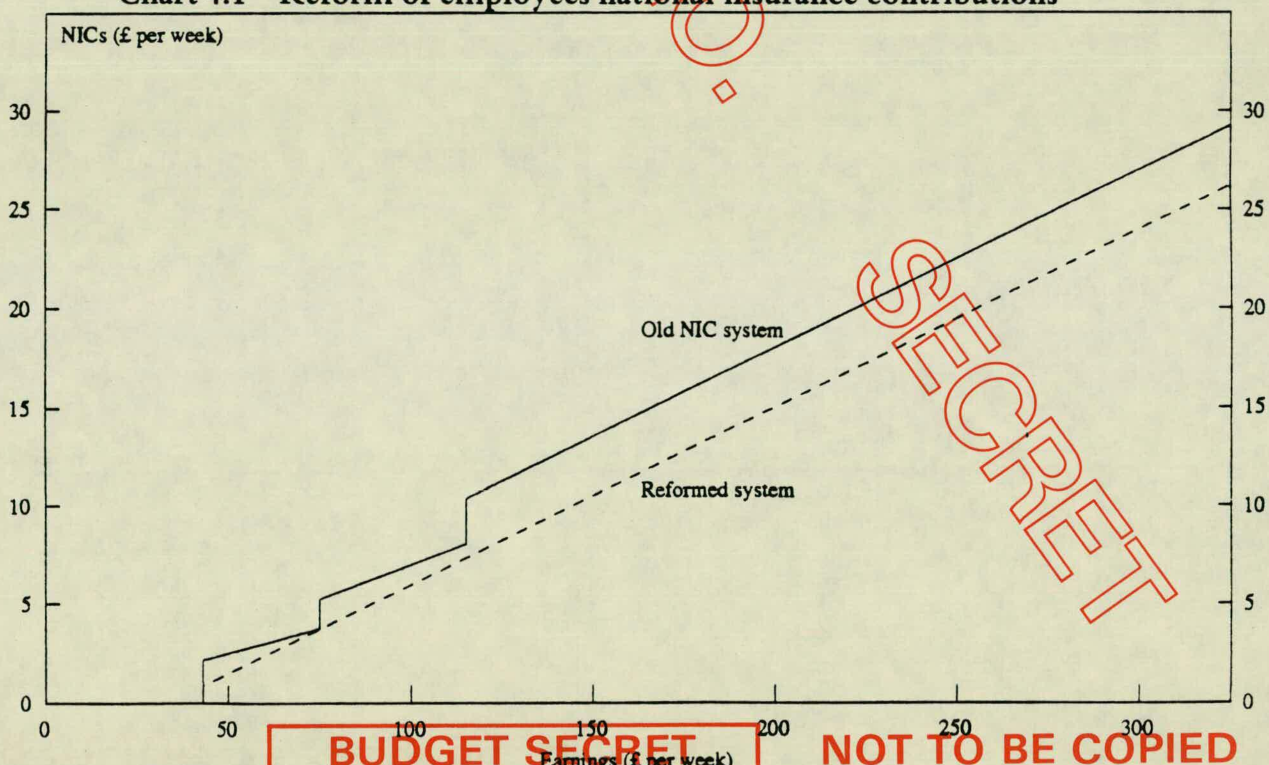
Tax administration 4.31 ~~4.32~~ In light of recommendations by the Keith Committee, measures are proposed to:

- simplify and update the system of interest and monetary penalties for tax offences;
- revise ~~modernise~~ the Inland Revenue's powers ~~for~~ to obtain information about a taxpayer under enquiry, to allow questions to be put to the taxpayer and to provide the taxpayer with greater safeguards;
- amend the Inland Revenue's search powers to provide greater protection for the taxpayer;
- improve compliance by employers in filing end of year returns of PAYE and NIC deductions.

Tax confidentiality 4.32 ~~4.33~~ Criminal sanctions will be provided against unlawful disclosure of information relating to a taxpayer by employees or former employees of the Inland Revenue and Customs and Excise.

National insurance 4.33 ~~4.34~~ From 5 ~~[2]~~ October, the structure of employees' national insurance contributions will be reformed. Employees will pay Class 1 contributions equal to 2 per cent of earnings up to the lower earnings limit (£43 a week in 1989–90) and 9 per cent of earnings above the lower earnings limit, up to the upper earnings limit (£325 a week in 1989–90). Those earning below the lower earnings limit will continue to pay no Class 1 contributions.

Chart 4.1 Reform of employees national insurance contributions



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4·34 **~~4.35~~** From ~~[2]~~ 1 October the rule whereby state retirement pensioners earning more than £75 a week have their pensions reduced, and those earning over £120 a week have their pension abated entirely, will be abolished. The public expenditure cost of abolition will be about £190 million in 1989–90 and ~~£370~~ £375 million in 1990–91. This cost will be met from the Reserve, and is therefore not included in Table 4.1. (Nor does Table 4.1 include the increased tax revenue that will flow from the changes, ~~£40~~ £20 million in 1989–90 and ~~£90~~ £110 million in 1990–91.)

~~**4.36** The Class 3 voluntary contributions will be reduced from £4·15 to £2·85 a week from 2 October 1989.~~

4·35 **~~4.37~~** These changes to national insurance contributions and the pensioners' earnings rule will be included in the Social Security Bill now before Parliament.

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(A)
21 Life assurance companies: pension measures — — +155
22 Life assurance companies – acquisition costs and rate reduction — — -30

Table 4.1 Direct effects of changes in taxation and national insurance

See Annex 4 Paragraph numbers	£ million Estimated effect on receipts in: 1989–90 Changes from a non-indexed base	1989–90 Changes from an indexed base	1990–91 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Increase in single allowance of £180 and married allowance of £280 in	−1 130	—	—
2 Increase in additional personal allowance and widow's bereavement allowance of £100	−10	—	—
3 Increase in age allowances in line with statutory indexation	−100	—	—
4 Extension of higher age allowance for those aged 80 and over to those aged 75 and over	−10	−10	−15
5 Increase in income limit for age allowance of £800	−15	—	—
6 Reduction in age allowance withdrawal rate	−5	−5	−5
7 Increase in basic rate limit ~~by~~ £1 400 to £20 700	−210	—	—
8 Fringe benefits—one third increase in car benefit scales	+160	+160	+200
~~9 Removal of extra-statutory concession on additional housing costs~~	~~+5~~	~~+5~~	~~+30~~
9 ~~10~~ Tax relief for private medical insurance for those aged 60 or over	—	—	−40
10 ~~11~~ Pension schemes—amendments to tax rules	*	*	*
11 ~~12~~ Payroll giving to charities—increase in donation limit to £480 a year	*	*	*
12 ~~13~~ Membership covenants to heritage charities	−5	−5	−10
13 ~~14~~ Liberalisation of profit-related pay legislation	−10	−10	−15
14 ~~15~~ Increase in approved employee share limits	*	*	*
15 ~~16~~ Employee priority in public offer of shares	*	*	*
16 ~~17~~ Changes in material interest tests	*	*	−5
17 ~~18~~ Abolition of tax relief on new loans to buy Business Expansion Scheme shares	*	*	+5
18 ~~19~~ Schedule E—change to receipts basis of assessment	−80	−80	−60
19 ~~20~~ Changes in settlements provisions where settlor or spouse can benefit	*	*	*
20 ~~21~~ Tax deductible from tax credit payments to US companies	—	—	—
Income tax and corporation tax			
Insert (A) ~~22 Taxation of income, gains and profits of life assurance companies~~	~~*~~	~~*~~	~~+125~~
23 Abolition of close company apportionment	*	*	*
24 Capital allowances—safety at sports grounds and miscellaneous amendments	*	*	*
25 Extension of relief for pre-trading expenditure	*	*	*
26 Subcontractor tax scheme—reduction in paperwork requirements	—	—	—
Income tax and capital gains tax			
27 Personal Equity Plans—increase in limits etc.	−5	−5	−10
Income tax, corporation tax and capital gains tax			
28 Keith committee—administrative changes	*	*	*
29 Deep discounted bonds—taxation of uplift as income	—	—	+15
30 Tax charge on switching investments in offshore funds	*	*	*
Corporation tax			
31 Increase in profits limits for small companies rate and marginal relief	*	*	−35
32 Reduction in tax rate for certain unit trusts	—	—	*
33 Relief for payments to ESOP trusts	*	*	*
34 Advance corporation tax amendments	*	*	*
35 Sale of subsidiaries	*	*	*
Capital gains tax			
36 No change in annual exempt amount	—	*	+10
37 Restriction of gifts relief	*	*	+25
38 Change in the rules for Lloyd's underwriters – stock lending	—	—	*

* = Negligible — = Nil

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Inserts x and y below

(x)	55 Self-supplies - input tax	*	*	*
(y)	69 Relief from duty and tax for diplomats etc.	—	—	—

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

See Annex ~~4.5~~ paragraph numbers	£ million Estimated effect on receipts in: 1989–90 Changes from a non-indexed base	1989–90 Changes from an indexed base	1990–91 Changes from an indexed base
Capital gains tax and corporation tax			
39 UK branches of foreign businesses—changes affecting capital gains	*	*	*
40 Technical changes associated with rebasing of capital gains	*	*	*
41 Increase in capital gains chattels exemption to ~~£5000~~ £6000	*	*	*
42 Exemption of certain bonds from charges on capital gains	*	*	*
Capital gains tax and inheritance tax			
43 Gifts to housing associations	*	*	*
Inheritance tax			
44 Increase of £8 000 in threshold	−35	—	—
45 Changes in rules for varying dispositions on death	+5	+5	+15
Stamp duty			
46 Abolition of life assurance policy duty	−20	−20	−80
TOTAL INLAND REVENUE	~~−1465~~ −1470	~~+35~~ +30	~~+150~~ +120
CUSTOMS AND EXCISE			
Value added tax			
47 Increase in registration limit	*	*	*
48 Revised tax regime for construction, buildings and land	+310	+310	+440
49 Change in liability of news services	+5	+5	+5
50 Change in liability of certain protective boots and helmets	*	*	*
51 Change in liability of certain supplies of fuel and power	—	—	~~+95~~ +90
52 Change in liability of certain water and sewerage services	—	—	*
53 Reliefs for charities	−5	−5	−5
Insert x **54** Relief for research and development cars	*	*	−5
Car tax			
56 ~~**55**~~ Relief for vehicles leased to disabled	−10	−10	−10
Excise duties			
57 ~~**56**~~ No change in rate of spirits duty	—	−65	−70
58 ~~**57**~~ No change in rate of beer duty	—	−140	−155
59 ~~**58**~~ No change in rate of duty on cider and perry	—	−5	−5
60 ~~**59**~~ No change in rate of duty on wine and made-wine	—	−45	−50
61 ~~**60**~~ No change in rate of duty on 4 star petrol etc.	—	−440	−465
62 ~~**61**~~ No change in rate of duty on derv	—	−95	−105
63 ~~**62**~~ No change in rate of duty on minor oils	—	−10	−10
64 ~~**63**~~ No change in rates of tobacco products duties	—	−235	−250
65 ~~**64**~~ Restriction on blending of duty-paid made-wine	*	*	*
66 ~~**65**~~ Determination of original gravity of beer	*	*	*
67 ~~**66**~~ Reduction in duty on unleaded petrol	−35	−35	−90
Insert y 68 ~~**67**~~ Increase in duty on 2 star and 3 star petrol	−5	−5	−10
TOTAL CUSTOMS AND EXCISE	+260	−775	~~−690~~ −695
Vehicle excise duty			
70 ~~**68**~~ No change in VED on cars, light vans and main lorry rates	—	−190	−210
71 ~~**69**~~ Increase in VED rates for taxis, buses and coaches	+20	+20	+20
72 ~~**70**~~ Increase in ~~certain other~~ VED rates for certain lorries and other vehicles	+20	+20	+20
TOTAL VED	+40	−150	−170

* = *Negligible* — = *Nil*

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

See Annex 4 paragraph numbers		£ million Estimated effect on receipts in: 1989–90 Changes from a non-indexed base	1989–90 Changes from an indexed base	1990–91 Changes from an indexed base
	Other			
73 ~~71~~	ITV levy re-basing	—	—	+45
74 ~~72~~	Sale of vehicle registration ~~numbers~~ marks	*	*	+10
75 ~~73~~	Unauthorised disclosure of confidential information	—	—	—
	TOTAL OTHER	*	*	+55 Bold
	TOTAL CHANGES IN TAXATION	~~−1165~~ −1170	~~−890~~ −895	~~−670~~ −690
	National insurance contributions			
76 ~~74~~	~~Reform~~ Employee contributions reformed and reduced	−980	−980	−2800
	~~75 Reduce Class 3 contributions~~	~~*~~	~~*~~	~~−5~~
	TOTAL CHANGES TO NATIONAL INSURANCE CONTRIBUTIONS	**−980**	**−980**	~~−2805~~ −2800

* = *Negligible* — = *Nil*

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Annex to Chapter 4

Explanatory notes to Table 4.1

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

The direct effect of a tax change is the difference the between the yield of tax which would arise on the basis of the rates of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime). The difference in yield is generally calculated by applying the pre- and post-Budget regimes to the same tax base. This base is the post-Budget base—that is, the levels of income, consumption, profits, etc forecast for future years on the assumption that all the measures proposed in the Budget take effect.

Tax changes may cause changes in taxpayers' behaviour, which in turn can alter the tax base and hence revenue. The direct effects are estimated subject to the constraint that, in general, total incomes and total expenditure are fixed at their post-Budget levels. Thus the estimates in the table do not include income effects—that is, effects arising solely from the impact of changes in taxes on disposable incomes. Nor do they include the effects of changes in the tax base arising from changes in pre-tax incomes, the general level of prices or other macro-economic variables which may result from the proposed tax change. But other behavioural effects are taken into account where it is thought that they will have a significant effect on the yield.

For Customs and Excise taxes and duties, all the estimates of yield incorporate the effects of the tax changes on relative prices and associated changes in the pattern of consumers' expenditure. Aggregate income and consumers' expenditure at factor cost are assumed not to change. This is a slight modification of previous practice in which nominal consumers' expenditure at market prices, rather than at factor cost, was held constant. Examples where behavioural effects are taken into account for Inland Revenue taxes include changes involving the take-up of a new or modified relief.

The post-Budget forecast of each tax given in Table 1.2 takes account of all the effects of the measures announced in the Budget, and not just the direct effects included in Table 4.1.

The figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1989–90. Budget proposals are compared with a non-indexed base—that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1988–89 levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1989–90, measured against an indexed base. The indexed base for 1989–90 is obtained by increasing 1988–89 allowances, thresholds and rates of duty by 6·8 per cent, the increase in the RPI over the year to December 1988.

The figures in the third column show the direct effect on receipts in 1990–91, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1989–90 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1988 and 1989 (shown in Table 3.13).

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The remainder of this annex provides a commentary on the Budget proposals in Table 4.1; the paragraph numbers refer to the lines in this table. Additional information is provided for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1989–90 or 1990–91; or where the impact of the proposal is expected to build up over a period of years.

Income tax **1** to **5** The increases in the main income tax allowances are in line with the statutory indexation provisions (based on the increase of 6·8 per cent in the RPI in the year to December 1988). The higher level of age allowance currently given to those aged 80 and over will be extended to those aged 75 ~~years~~ and over. ~~(The cost of indexation for those aged between 75 and 79 is included in line 3.)~~

6 The age allowance withdrawal rate will be reduced from £2 of allowance~~s~~ for each £3 of income to £1 of allowance~~s~~ for each £2 of income above the income limit of £11 400.

7 The increase in the basic rate limit is in line with the statutory indexation provisions.

8 For 1989–90 the scales for taxing car benefits will be increased by ~~20 per cent~~ one third from their 1988–89 levels. The estimated yield takes account of behavioural effects.

~~**9** The extra-statutory concession concerned with certain reimbursements by employers of additional housing costs incurred by their employees who have had to move with their jobs to more expensive locations will be withdrawn from 6 April 1989, subject to transitional arrangements. A statutory relief will be introduced to replace the extra-statutory concession which has exempted employees from tax on the cost of removal expenses paid by employers. The tax yield of these measures will eventually be of the order of £100 million after transitional arrangements have ceased to take effect.~~

9 ~~**10**~~ Tax relief will be available (with basic rate relief given at source) for eligible premiums paid in 1990–91 and subsequent years for private medical insurance for those aged 60 ~~years~~ and over. The cost for 1990–91 assumes an increase in take-up in the region of 10 per cent as a result of the new relief. Eventual costs will depend, among other things, on the extent to which medical insurance for the over-60s is promoted and taken up.

10 ~~**11**~~ The amendments to the tax rules for pension schemes will mean that:

for tax-approved schemes, earnings over £60 000 a year will be ignored for the purpose of calculating benefits (consistent with a maximum pension of £40 000, or tax-free lump sum of £90 000). Other amendments will be made to the tax rules to improve early retirement benefits, to allow a two-thirds final salary pension on retirement after 20 years' service between ages 50 and 70 and to simplify calculation of tax-free lump sums. These changes apply to new schemes set up on or after 14 March 1989 and to new members joining existing schemes on or after 1 June 1989; ~~that date~~;

employers will be able to set up top-up schemes with no limits on benefits, but without tax privileges such as tax-free investment build-up;

new rules will allow surplus voluntary contributions to be returned to the member instead of reducing benefits from the employer's scheme. The voluntary scheme will deduct a 35 per cent charge from the refund to recoup the tax advantages enjoyed on contributions and build-up. There will be a further liability on higher rate taxpayers;

changes will be made to the personal pensions tax rules to increase from 1988–89 the age related contribution limits. The increased limit will be subject to the £60 000 earnings cap. And the rules for calculating tax-free lump sums will be simplified.

These measures are expected to have a broadly neutral revenue effect in the early years.

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11 ~~12~~ The limit on charitable donations qualifying for relief under payroll deduction schemes will be increased from £240 to £480 from April 1989. The cost will depend on take-up.

12 ~~13~~ The conditions for relief for charitable covenants will be relaxed so that where a member of a heritage charity is given free entry to view the charity's property, that benefit will not disqualify the covenant payments from relief. The cost will depend on take-up.

13 ~~14~~ The main ~~A~~amendments to the profit-related pay (PRP) legislation will:

abolish the "5 per cent test" on a PRP scheme's eligibility for registration;

increase to £4 000 the cash limit on the amount of PRP attracting tax relief;

allow scheme employers to alter, subject to conditions, the rules of PRP schemes already registered; and

enable PRP schemes to be registered for certain employment units using the profits of the whole business rather than of the employment unit itself.

The cost will depend on take-up.

14 ~~15~~ The annual limit on the value of shares which may be given to an employee under an approved all-employee profit-sharing share scheme will be increased, with effect from 6 April 1989, from £1 250 (or 10 per cent of pay up to a maximum of £5 000) to £2 000 (or 10 per cent of pay up to £6 000). The limit on monthly savings made by an employee under an approved savings-related share option scheme will be increased, from a day to be appointed, from £100 to £150. The maximum discount on the share price at which options may be granted under these schemes will be increased from 10 per cent to 20 per cent. The use of consortium shares in an approved employee share scheme will be extended to include the shares of any member of a consortium owning 5 per cent or more of the company's ordinary share capital in place of the previous 15 per cent limit.

15 ~~16~~ There will be relaxations in the conditions under which income tax relief is given to employees who benefit by virtue of their employment from priority in applying for a public offer of shares.

16 ~~17~~ Changes will be made in the material interest tests relating to an employee's eligibility to participate in an approved employee share scheme or a registered profit-related pay scheme, and an individual's entitlement to close company interest relief. Subject to certain conditions, shares held by a trust of which the employee is a beneficiary will be disregarded when reckoning whether he has material interest.

17 ~~18~~ Relief for interest on loans to acquire Business Expansion Scheme shares ~~issued~~ on or after 14 March 1989 will be abolished.

18 ~~19~~ From 6 April 1989 Schedule E emoluments will be assessed for the year in which they are received instead of the year for which they are earned. There will be a transitional cost, but from 1992–93 when the transition is complete, there will be an annual yield of about £50 million.

19 ~~20~~ A change will be made to the provisions which treat certain settlement income as the settlor's for higher rate tax purposes to ensure that income from outright gifts between husband and wife will be treated under Independent Taxation as the income of the recipient of the gift. For certain other settlements the present provisions will be extended to the basic rate, producing a small revenue yield.

20 ~~21~~ Legislation will be introduced to make clear the amount of UK tax that is deductible from UK tax credits to which non-residents may be entitled under a double taxation convention. This measure will prevent a potential Exchequer loss of about £15 million a year.

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Income tax and corporation tax

22 From 1 January 1990, the rules for taxing life assurance companies will be changed. The main changes are:

to allow relief for the expenses of pension, general annuity and other life assurance business only against their respective profits;

to spread the relief for the costs of acquiring new business (other than pension and general annuity business) over seven years, subject to transitional arrangements in the first four years to phase out the present immediate relief; and

to reduce the corporation tax rate on income and capital gains attributable to policyholders to 25 per cent.

The yield in 1990–91 and the immediately following years is reduced by the proposed transitional arrangements, and by the carry-forward of unrelieved expenses from past years. The yield in all years depends on developments in the industry, particularly in the level of new business, and is therefore highly uncertain.

Insert new para.s 21 and 22 attached

23 The apportionment rules for close companies will be abolished. A higher rate of corporation tax equal to the higher rate of income tax of 40 per cent will be introduced for close investment companies which distribute less than a specified percentage of their profits. A close investment company will no longer get tax relief for interest payments, annual payments or management expenses unless these would have been deductible if paid by an individual.

24 The legislation relating to capital allowances for safety expenditure at sports grounds will be amended from 1 January 1989 to take account of the extension of safety certificate requirements to regulated stands at undesignated sports grounds. Minor amendments will be made to the capital allowances legislation to correct defects and anomalies in advance of the consolidation of that legislation.

25 The period for which relief may be available for business expenditure incurred before a trade begins will be increased from three to five years. The cost of this proposal will take some years to build up and could amount to tens of millions of pounds.

26 Subject to consultation, the paperwork requirements of the scheme for subcontractors in the construction industry will be ~~reduced~~. ~~for example by aggregation of small payments onto a single voucher~~.

Income tax and capital gains tax

27 The main changes are:

an increase in the overall annual limit on investment in a Personal Equity Plan to £4 800;

within that an increase in the limit for investment in authorised unit trusts and investment trusts to £2 400, coupled with a new requirement that the trust must invest mostly in UK equities;

significant simplifications for plan managers; and

the facility for new share issues to be brought within plans.

The costs assume take-up in the region of 400 000 in the first full year. The cost is likely to reach £30 million after five years.

Income tax, corporation tax and capital gains tax

28 In the light of recommendations of the Keith Committee, administrative changes will be made:

to update the system of monetary penalties for tax offences in line with inflation and remove obsolete penalties;

to introduce a uniform time limit of 20 years for recovery of tax lost through default;

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Para 21 From 1 January 1990, life assurance companies will be allowed to set relief for the expenses of pension, general annuity and other life assurance business only against their respective profits. There will be other measures to align the tax treatment of pension profits income more closely with industry accounting practice. The yield in 1990-91 and the immediately following years is reduced by the carry-forward of unrelieved expenses from past years. The long term yield is expected to be about £250 million.

Para 22 Other changes will be made from 1 January 1990 to the rules for taxing life assurance companies: in particular, to spread the relief for the costs of acquiring new business (other than pension and general annuity business) over seven years, subject to transitional arrangements in the first four years to phase out the present immediate relief; and to reduce the corporation tax rate on income and capital gains attributable to policy holders to 25 per cent. The impact of these measures in 1990-91 and subsequent years is affected by the proposed transitional arrangements. The long-run effect is expected to be broadly revenue-neutral.

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to allow taxpayers further time to claim reliefs where an Inspector discovers that further tax is due;

× to ~~modernise~~ revise the Inland Revenue's powers to obtain information about a taxpayer under enquiry, to allow questions to be put to the taxpayer, provide greater safeguards for the taxpayer and protect audit papers and tax advice from disclosure by his accountant;

to amend the Inland Revenue's search powers to provide greater safeguards for the taxpayer;

to create a new criminal offence for the deliberate destruction of documents called for under the Inland Revenue's information powers;

to change the filing date for returns of PAYE and NIC deductions by employers from 19 April to 19 May, tighten up the penalties for late filing gradually over a period of years, leading to the introduction of automatic penalties for all late filing (but not before 1995).

The effect on revenue in subsequent years is expected to be small.

29 From Budget day the existing corporate deep discount legislation in Schedule 4 ICTA 1988 will be widened to include non-variable deep discounted securities issued by non-corporate borrowers. On a sale or redemption the accrued discount will be taxed as income. Any excess or shortfall will be taxed as a capital gain or loss unless the security is exempt from capital gains tax as a qualifying corporate bond. Where deep discounted securities have variable features so that the precise accrued discount at any particular time cannot be determined in advance (including certain index-linked bonds), the whole of the uplift between cost price and sale or redemption price will be taxed as income. The eventual yield is uncertain but is estimated at around £50 million.

30 A tax charge will be imposed on UK investors on gains when they switch holdings within an offshore fund.

Corporation Tax

31 The profits limit for the small companies' corporation tax rate of 25 per cent for financial year 1989 will be raised from £100 000 to £150 000 and the limit for marginal relief will be raised from £500 000 to £750 000.

32 From 1 January 1990 all unit trusts that are UCITS (Undertakings for Collective Investment in Transferable Securities) under the relevant European Communities legislation will be subject to corporation tax on their income at a rate of 25 per cent. The cost will rise to about £20 million from 1991–92 onwards.

33 Payments made by a company to an ESOP trust will be deductible in calculating its corporation tax liability where the trust meets conditions aimed at ensuring the distribution of shares in the company to all of its employees, on similar terms, within a reasonable time.

34 Various minor changes will be made to the advance corporation tax (ACT) rules concerning a company which is part of a group or consortium.

35 Measures will be introduced to counter avoidance of tax on disposals of subsidiaries in ways which could cause a substantial loss of tax.

Capital Gains Tax

36 The capital gains tax annual exempt amount will remain at £5000 in the case of individuals and £2500 in the case of most trusts.

37 Capital gains tax gifts relief (which allows deferral on gifts) will be restricted to certain types of gift, the main categories being gifts of business, farm and heritage assets and gifts on which there is an immediate charge to inheritance tax. The revenue yield in 1991–92 is estimated at £40 million. The change will not affect gifts to charities or between spouses.

38 The capital gains tax rules and rules about the transfer of securities applying to assets held by Lloyd's underwriters in their premiums trust funds will be amended to facilitate stock lending to market makers.

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Capital Gains Tax and Corporation Tax

39 Changes will be made to the rules for the taxation of capital gains of foreign businesses with UK branches or agencies or with operations on the UK continental shelf. The main effect will be to counter possible developments which could lead to a significant loss of tax.

40 Technical changes will be made in relation to the application of the provisions in the Finance Act 1988 for rebasing the taxation of capital gains to 1982 in certain special situations.

41 Chattels with a disposal value of less than £3 000 are exempt from charges on capital gains. The limit will be doubled to £6 000.

42 Certain sterling bonds will be exempted from capital gains tax and corporation tax on gains. The main effect will be to counter use of the indexation allowance in ways which could cause a significant loss of tax.

Capital gains tax and Inheritance Tax

43 Certain gifts to registered housing associations will qualify for capital gains tax deferral and inheritance tax exemption.

Inheritance Tax

44 The estimated full year cost of indexation attributable to taxable estates in 1989–90 is £80 million.

45 The facility for varying the disposition of a deceased person's assets with effect for inheritance tax will be limited to those variations making adequate provision for his or her dependants.

Stamp Duty

46 Life assurance policy duty will be abolished from 1 January 1990. The cost in 1990–91 takes account of the consequential change in corporation tax liability.

Value Added Tax

47 From 15 March 1989, the registration limits will become £23 600 a year and £8000 a quarter

48 From 1 April 1989, VAT will be applied at the standard rate to the construction and sale of new non-residential buildings. From 1 August 1989, landlords will be able to opt to charge tax on their non-residential ~~property and land transactions~~ rents and sales of used buildings; and VAT at the standard rate will be applied in limited circumstances to building land where this is necessary to ensure fair competition. Tenants whose landlords opt to tax existing leases will pay tax on only half of the rent in the first year. The phasing in period will be five years where the tenant is a charity. Transitional relief will allow zero rating to continue for certain developments where legal commitments had been entered into before 21 June 1988.

49 From 1 April 1989, VAT will be applied at the standard rate to news services (but not newspapers).

50 From 1 April 1989, VAT will be applied at the standard rate to protective boots and helmets supplied to employers.

51 From 1 July 1990, VAT will be applied at the standard rate to fuel and power supplied to businesses.

52 From 1 July 1990, VAT will be applied at the standard rate to water and sewerage services supplied to industry.

53 From 1 April 1989, VAT relief for charities will be extended to charity and certain other fund-raising events, medical sterilising equipment and classified and certain other types of advertising.

54 From 1 August 1989, all cars used by manufacturers for research and development purposes will be relieved of VAT.

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Insert new (55) (attached)

Car Tax 56 ~~55~~ From 1 April 1989 vehicles leased to the disabled will be relieved of car tax.

Excise duties 57-64 ~~56–63~~ There will be no change in the rates of duty on alcoholic drinks, tobacco products and most hydrocarbon oils.

65 ~~64~~ The duty arrangements for made-wine will be brought into line with those applicable to wine of fresh grapes by prohibiting duty-paid blending.

66 ~~65~~ The rules for determining the original gravity of beer for duty purposes will be clarified.

67 ~~66~~ The duty on unleaded petrol will be reduced by the equivalent of 0·8p a litre (3·6p a gallon) including VAT.

68 ~~67~~ A higher rate of duty will be introduced on two and three star leaded petrol. This will add 0·9p a litre (4·1p a gallon) including VAT to the tax charged on these grades. Despite the increase in duty, the revenue effect of this change is negative as a result of expected switching from two and three star to unleaded petrol.

Insert new (69) attached

Vehicle excise duties 70 ~~68~~ There will be no change in the duties on cars, light vans, motor cycles and most lorries.

71 ~~69~~ From 15 March 1989, the number of duty rates for ~~taxis~~, coaches and ~~lorries~~ buses will be reduced from over sixty to five and rates will be ~~adjusted~~ increased; duty rates will also be increased for taxis.

72 ~~70~~ From 15 March 1989, the rates of duty on certain rigid lorries will be increased to bring them more into line with rates for articulated vehicles of similar gross weight. The rate of duty for special types capable of carrying very long, wide or heavy loads will be increased to £3 100.

Other 73 ~~71~~ From 1 January 1990, the additional payments made by ITV programme contractors will be assessed on a mixture of net advertising revenue and profits.

74 ~~72~~ A pilot scheme making certain vehicle registration ~~numbers~~ marks available for sale to the public will begin in December 1989.

75 ~~73~~ Criminal sanctions will be provided against unlawful disclosure of information relating to a taxpayer by employees or former employees of the Inland Revenue and Customs and Excise.

National Insurance Contributions 76 ~~74~~ From 5 October 1989, employees will pay Class 1 contributions equal to 2 per cent of earnings up to the lower earnings limit (£43 a week in 1989–90) and 9 per cent of earnings above the lower earnings limit, up to the upper earnings limit (£325 a week in 1989–90). Those earning below the lower earnings limit will continue to pay no Class 1 contributions.

~~75 From 2 October 1989, Class 3 voluntary contributions will be reduced from £4·15 a week to £2·85 a week.~~

Para 55 From Royal Assent, Customs and Excise will be given the power to determine the correct attribution of input tax in respect of self-supplies of goods and services.

Para 69 Statutory provision will be made for a number of duty and tax reliefs currently granted to diplomats, members of international organisations and visiting forces by means of extra-statutory class concessions. A power to impose sanctions for breaching the conditions of the reliefs will be introduced.

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FROM: COLIN MOWL
DATE: 8 March 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Wicks
Mr Scholar
Mr Sedgwick
Mr Riley
Mr Culpin
Mrs Lomax
Mr S J Davies
Mr Hibberd
Mrs R Butler
Mr Pickford
Mr Gieve
Mr Patterson
Mrs Wright
Mrs Todd
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Calder - IR
Mr Vernon - C&E

a
Looks OK,
subject to numbers ✓

FSBR CHAPTER 6

I attach the latest proof of chapter 6. It incorporates all your suggestions on the previous version.

2. The only additional change we have made is to amend the reference to debt (paragraph 6.03) to "lower than at any point since the First World War" from "lower than at any point since before the First World War". Further work on the likely level of debt at end-1988-89 suggests it may not be lower, relative to GDP, than in 1915.

relevant to Budget speech

3. None of the figures have been changed, pending your response to my separate submission today on the PSDR in 1988-89 and 1989-90.

4. You asked us to confirm the reference in paragraph 6.07 to profits in 1987 being lower than recorded at the time of the 1988 Budget. The relevant figures are as follows:

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Non North Sea ICCs

	Profits				Fixed Investment			
	1988 FSBR		Latest		1988 FSBR		Latest	
	£bn	% increase	£bn	% increase	£bn	% increase	£bn	% increase
1987	62.0	25.7	56.0	24.3	26.4	13.3	28.8	20.2

Any explanation ?!!

The latest estimates are subject to further revision by the CSO before publication.

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5. We should be grateful for any further comments on chapter 6 by **9.30am tomorrow (Thursday)** so that we can return the proofs to the printer by noon the same day.

good question - a big difference

Colin Mowl

COLIN MOWL

B.L.O.

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6 The public sector's finances

6.01. This chapter brings together revenue and spending and provides an analysis and forecast of the public sector's overall financial position in 1989–90, together with some explanation of the main differences between estimated outturn in 1988–89 and last year's forecast.

Debt repayment

6.02. The latest estimate is for a public sector debt repayment (PSDR) of £14 billion in 1988–89, equivalent to 3 per cent of GDP, or £7 billion excluding privatisation proceeds. Even this last figure represents a larger net repayment as a proportion of GDP than in any year since the beginning of the 1950s—the earliest date for which comparable figures are available. Both the public sector financial balance and the general government financial balance are also estimated to be in substantial surplus in 1988–89.

6.03. The forecast is for a further substantial PSDR of around £12 billion in 1989–90. Excluding privatisation proceeds the PSDR is forecast to be about the same in 1989–90 as in 1988–89.

Table 6.1 Public sector debt repayment

	£ billion and as per cent of GDP			
	1987–88	1988–89		1989–90
	Outturn	1988 Budget	Latest estimate	Forecast
Public sector debt repayment				
£ billion	3·5	3·2	14·0	12·1
as per cent of GDP	¾	¾	3	2¼
PSDR excluding privatisation proceeds				
£ billion	−1·6	−1·8	7·0	7·1
as per cent of GDP	−½	−½	1½	1½

6.04. The stock of net public sector debt has fallen from over 50 per cent of money GDP in 1979 to 38½ per cent (£171 billion) at the end of 1987–88. It is forecast to be about £[157] billion, or [31½] per cent of GDP, at the end of 1988–89. Relative to GDP the stock of government debt is now lower than at any point since the First World War. There should be a further large fall in net public sector debt in 1989–90, in both nominal terms and as a percentage of GDP.

Changes since last Budget

6.05. The PSDR in 1988–89 is now estimated to be nearly £11 billion higher than forecast in last year's Budget. As table 6.2 shows, the higher net repayment comes roughly equally from higher receipts and lower expenditure, including £2 billion additional privatisation proceeds (see table 1.2 for a detailed comparison of the components). Much of the extra receipts reflects the higher than forecast growth of money GDP. Higher growth has also contributed to the lower than forecast expenditure, primarily through lower spending on social security and improved finances of public corporations.

Table 6.2 Changes to receipts, expenditure and debt repayment since 1988 Budget[1]

	£ billion	
	1987–88	1988–89
Receipts		
Taxes, royalties and national insurance contributions	+0·8	+4·8
Other receipts	−0·7	+1·1
Total receipts	**+0·2**	**+5·9**
Expenditure		
Privatisation proceeds	−0·1	−2·0
Other general government	+0·2	−2·4
Public corporations' market and overseas finance	−0·4	−0·6
Total expenditure	**−0·3**	**−5·0**
PSDR	**+0·5**	**+10·8**

[1] *+ higher receipts, higher expenditure, or higher debt repayment;*
− lower receipts or lower expenditure.

Does this mean [illegible]

6.06. The main contributors to the higher than expected receipts are income tax (£1½ billion), national insurance contributions (£1¼ billion), VAT (£1¼ billion) and interest receipts (£1 billion). The first two largely reflect higher total wages and salaries. Higher VAT receipts are the result of faster growth of consumer spending in total and a change in its composition towards those goods and services which are subject to VAT.

6.07. Corporation tax receipts again rose strongly in 1988–89 but not by as much as forecast. Within the total, advance corporation tax (ACT) receipts were higher than forecast, reflecting high dividend payments in 1988, but other corporation tax receipts rose much less than expected. The latter is likely to be mainly the result of lower profits and higher investment in 1987 than shown by the recorded figures available at the time of the last Budget.

6.08. Privatisation proceeds were £2 billion higher than projected at the time of the last Budget. Expenditure excluding privatisation proceeds was lower than forecast, largely as a result of lower social security expenditure and higher local authority capital receipts.

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

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Public sector's finances: analysis by type or activity

6.10. Table 1.2 analyses the public sector's finances by type or activity. The main receipts of general government (ie central plus local government) are grouped according to the kind of activity which gives rise to them, while spending is shown by department, as in Chapter 5 and in the public expenditure White Paper.

Receipts

6.11. General government receipts are estimated to have risen by 9½ to 10 per cent in 1988–89, just below the growth of money GDP. They are forecast to rise by 6½ to 7 per cent in 1989–90, a little less than the forecast growth of money GDP.

6.12. Within general government receipts North Sea revenues fell sharply in 1988–89, as forecast. They are forecast to fall by a further 15 per cent in 1989–90, mainly the delayed effect on corporation tax of falling profits in earlier years. Oil production is expected to be lower in 1989 than in 1988, due mainly to the continued effect of the Piper Alpha disaster and accidents in the Fulmar and Brent fields. The forecast assumes that North Sea oil prices will remain close to recent levels. PRT receipts are forecast to be the same in 1989–90 as in 1988–89 despite the projected fall in production because there were repayments of advance PRT in 1988–89 and none are forecast for 1989–90.

Table 6.3 North Sea revenues

	£ billion			
	1987–88	1988–89		1989–90
	Outturn	1988 Budget	Latest estimate	Forecast
North Sea corporation tax[1]	1·4	1·5	1·3	0·8
Petroleum revenue tax[2]	2·3	1·2	1·3	1·3
Oil royalties	1·0	0·6	0·6	0·6
Total North Sea revenues	**4·7**	**3·3**	**3·2**	**2·7**
[1] Before ACT set off of:	*0·7*	*0·8*	*0·8*	*0·5*

[2] Includes advance petroleum revenue tax

6.13. Excluding North Sea revenues general government receipts rose by over 10½ per cent in 1988–89 and are forecast to rise by about 7 per cent in 1989–90. Within the overall increase forecast for 1989–90 there is:

an 8 per cent increase in income tax receipts;

an 18 per cent increase in non-oil corporation tax, with ACT growing more slowly than the rest;

an 8 per cent increase in VAT receipts, a little less than the increase in consumers' expenditure, reflecting relatively slow growth of spending subject to VAT;

little change in receipts from the excise duties on petrol, tobacco and alcohol;

an 8 per cent increase in local authorities' net receipts of rates (and community charge in Scotland);

a 5½ per cent increase in national insurance contributions, after allowing for the reforms to employees' contributions announced in the Budget.

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Taxes as a share of GDP

6.14. Table 6.4 shows total taxes and national insurance contributions (NICs) as a percentage of GDP. Both the total and non-oil percentages are estimated to have fallen in 1988–89, by about half a percentage point in each case, compared with a forecast of no change in last year's Budget. Given the payments lags in the tax system a fall in the percentage is likely when there is a pick-up in the growth of money GDP. Some taxes, such as mainstream corporation tax, are paid some time after the period for which the liability is incurred. For over 20 per cent of total tax receipts the payments lags are one year or longer; receipts of these taxes are therefore unaffected by changes in GDP in the same year. With other taxes, stamp duty for example, there is a variable relationship between changes in the tax base and changes in money GDP.

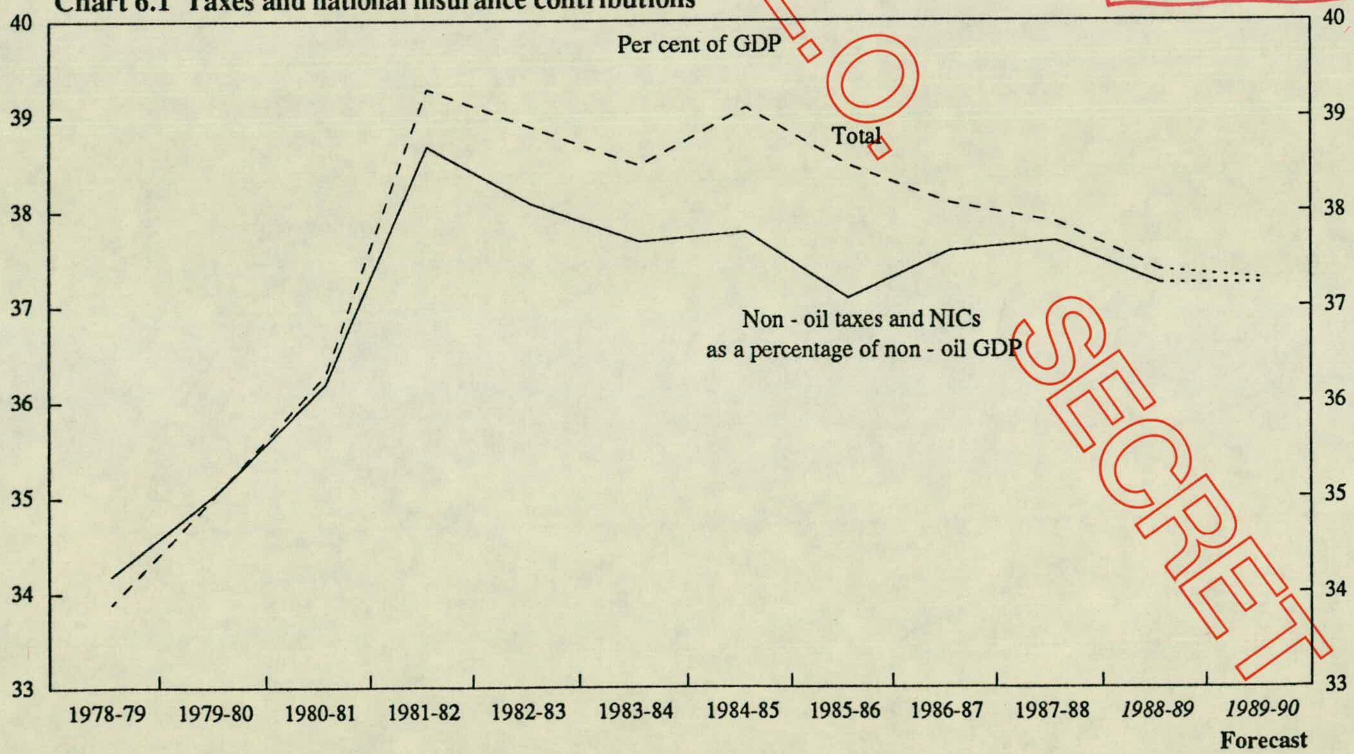
6.15. The forecast is for non-oil taxes and NICs to be the same as a percentage of non-oil GDP in 1989–90 as in 1988–89. In other words, the changes in the Budget merely offset real fiscal drag—the tendency for average tax rates to rise in a progressive tax system indexed to price changes. With the projected fall in North Sea revenues in 1989–90, total taxes and NICs are forecast to fall slightly as a percentage of GDP.

Table 6.4 Taxes and national insurance contributions as a percentage of GDP

	1983–84	1984–85	1985–86	1986–87	1987–88	1988–89 Latest estimate	1989–90 Forecast
Total taxes and NICs as a share of total GDP	38·5	39·1	38·5	38·1	38·0	37·6	37·4
Non-oil taxes and NICs as a share of non-oil GDP	37·7	37·8	37·1	37·6	37·7	37·4	37·4

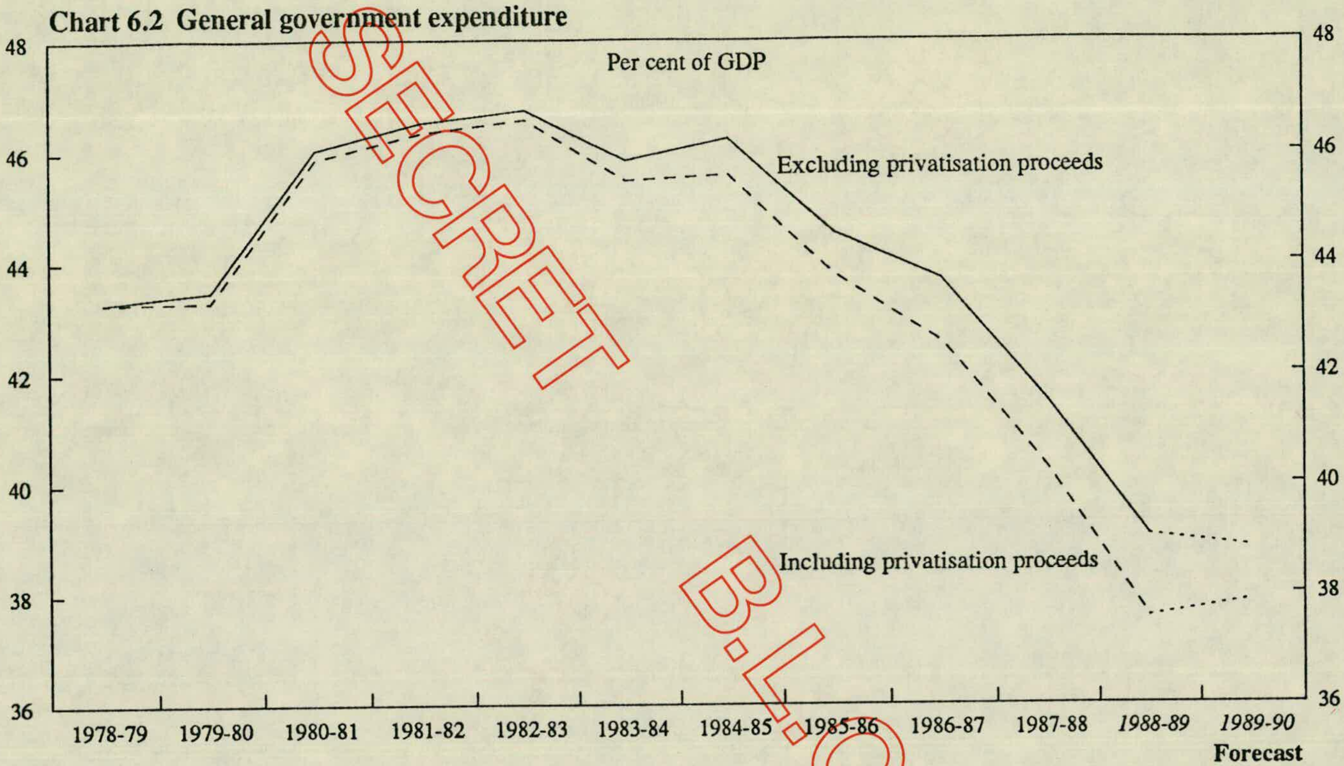
NB

Chart 6.1 Taxes and national insurance contributions



Expenditure **6.16**. General government expenditure (GGE) excluding privatisation proceeds is now estimated to have increased by under 5 per cent in 1988–89, and is forecast to rise by nearly 7 per cent in 1989–90, below the growth of money GDP in both years. The ratio of GGE excluding privatisation proceeds to money GDP is therefore expected to fall in both years, as illustrated in chart 6.2.

Chart 6.2 General government expenditure



6.17. Within GGE, gross debt interest payments rose in cash terms in 1988–89 partly because of higher interest rates and inflation (which raises the cost of servicing indexed debt). Net debt repayment reduces interest payments, other things being equal, but not immediately; and because of the rise in the foreign exchange reserves and other short-term assets in 1987–88 and early 1988–89 some of the effect has come through initially as higher interest receipts. Interest and dividend receipts rose by £½ billion in 1988–89, despite a fall in the dividend element following the sale of the Government's remaining shareholding in BP.

6.18. Debt interest payments are forecast to fall substantially in 1989–90, against a background of no change in interest and dividend receipts.

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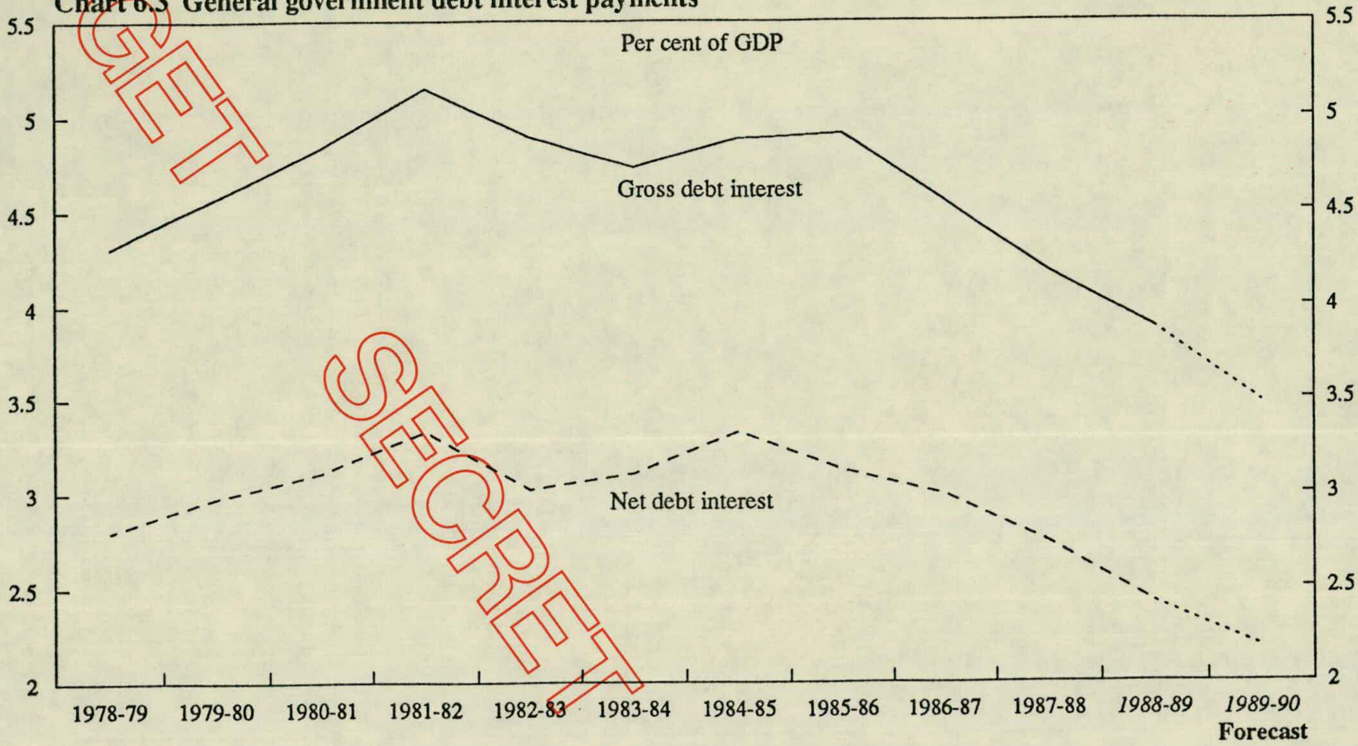
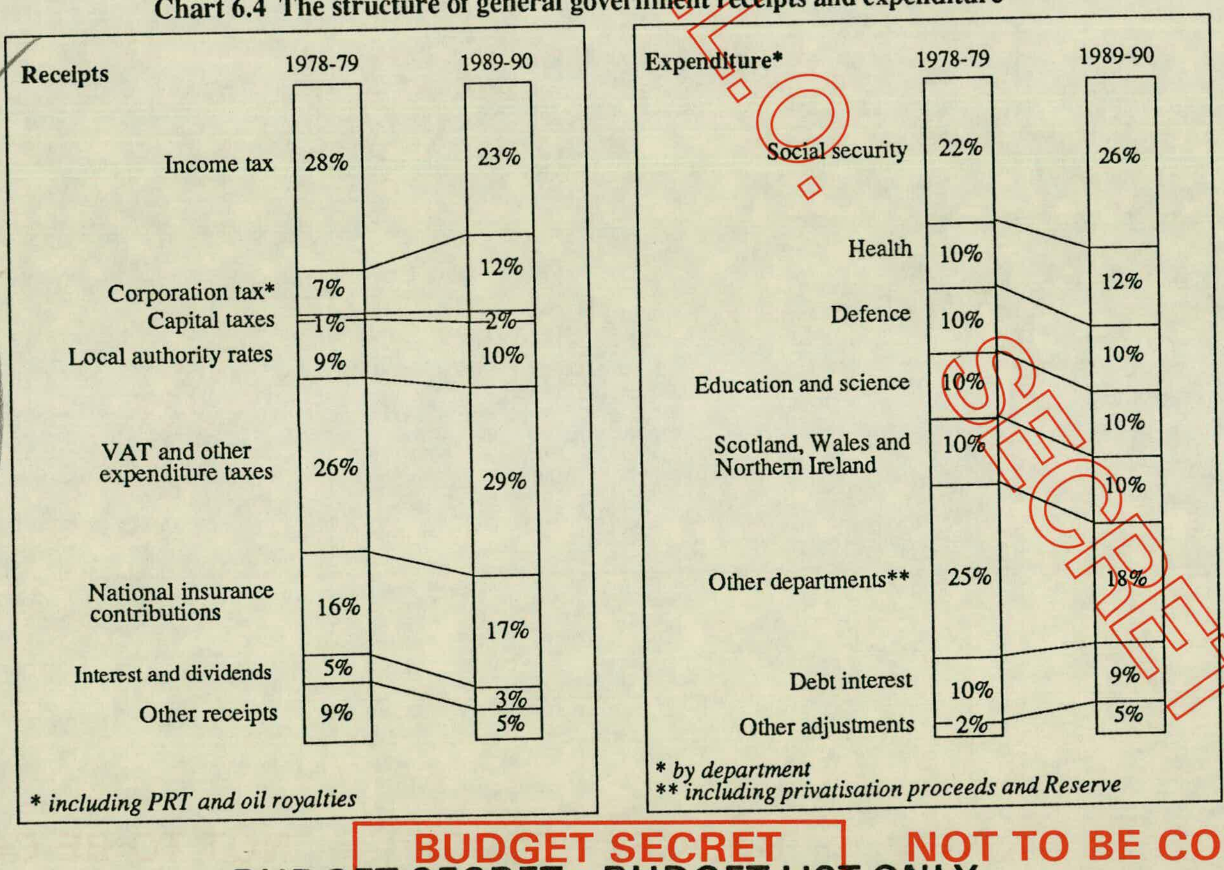
Chart 6.3 General government debt interest payments



6.19. Chart 6.4 shows the changes in the structure of general government receipts and expenditure which have taken place since 1978–79.

Chart 6.4 The structure of general government receipts and expenditure



we shall try to widen the capital taxes band

Thanks

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Public sector's finances: analysis by sector

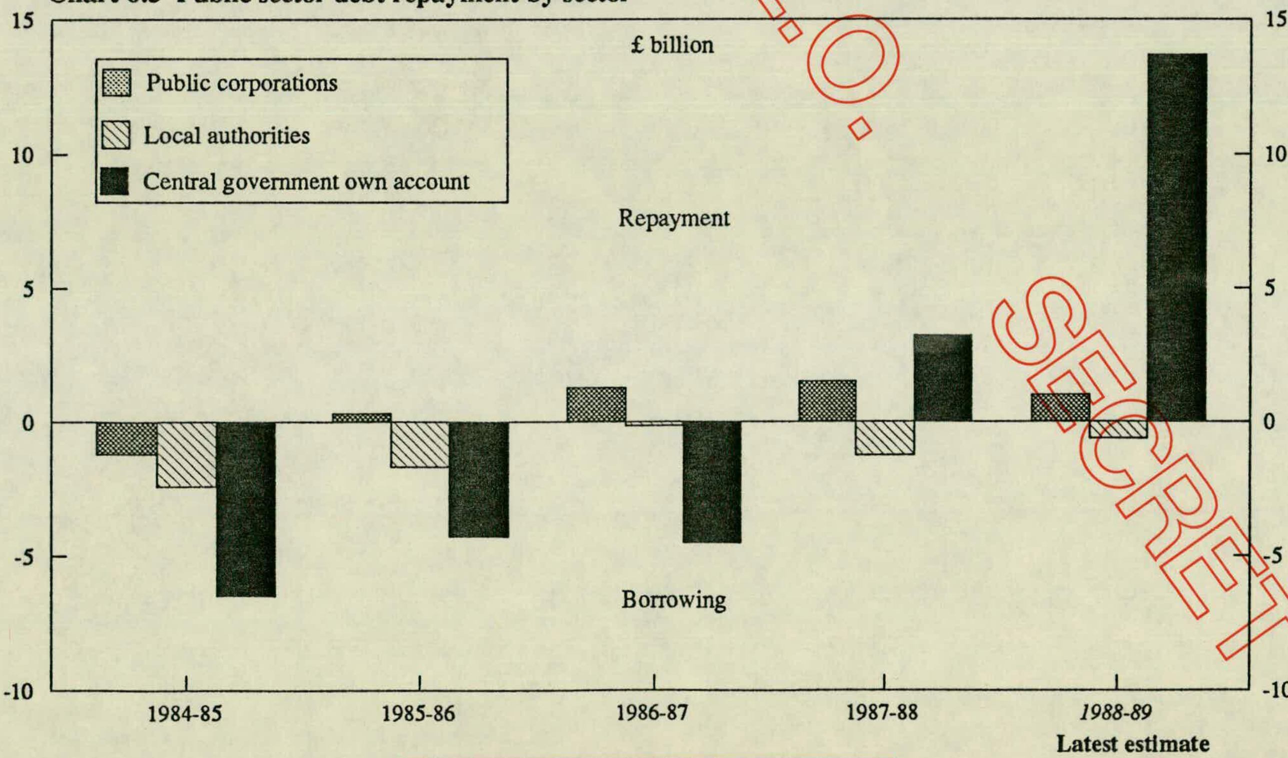
6.20. Table 6.5 shows net debt repayment in 1987–88 and 1988–89 by central government, local authorities and public corporations.

Table 6.5 Public sector debt repayment

	£ billion			
	1987–88 Outturn		1988–89 Latest estimate	
1 Central government debt repayment on own account	**3·2**		**13·2**	
2 Local authority debt repayment	**−1·2**		**−0·6**	
3 of which to: central government		−4·1		−5·5
4 market and overseas		2·9		4·9
5 Public corporations' debt repayment	**1·5**		**1·4**	
6 of which to: central government		0·0		−0·8
7 market and overseas		1·5		2·2
8 Public sector debt repayment	**3·5**		**14·0**	
Central government debt repayment (lines 1+3+6)		−0·9		6·9

6.21. The PSDR in the first ten months of 1988–89 was £15·5 billion, substantially higher than in the same period of 1987–88, both including and excluding privatisation proceeds. The greater part of the increase was on central government own account. Taking into account both further privatisation proceeds of about £1 billion due in March and the well established pattern of high borrowing in March, the forecast for 1988–89 as a whole is a public sector net debt repayment of £14 billion.

Chart 6.5 Public sector debt repayment by sector



6.22. Tables 6.6 to 6.8 show estimated outturns and forecasts of receipts and expenditure in 1988–89 and 1989–90 for each of the three sectors. Expenditure in 1989–90 does not include an allocation of the Reserve, although the forecast of the PSDR assumes that the Reserve is fully spent.

Central government

6.23. Central government expenditure in table 6.6 includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Table 6.7 and 6.8. The forecast large rise in 1989–90 in net lending etc is mainly the result of a lower level of privatisation proceeds and higher capital grants to local authorities.

Table 6.6 Central government transactions

	£ billion		
	1987–88 Outturn	1988–89 Latest estimate	1989–90 Forecast[1]
Receipts			
Taxes and royalties	115·8	125·4	135·8
National insurance and other contributions	29·0	32·9	33·9
Other	10·4	11·5	13·5
Total receipts	**155·1**	**169·7**	**183·2**
Expenditure			
Current expenditure on goods and services	52·5	56·8	61·4
Current grants and subsidies	80·5	80·1	86·2
Interest	17·2	17·7	17·8
Net lending[2], capital expenditure, and cash expenditure on company securities	1·6	2·0	6·2
Total expenditure	**151·8**	**156·5**	**171·6**
Consolidated Fund revenues	*123·0*	*135·5*	*141·2*

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

Local authorities

6.24. Local authority receipts consist primarily of rate income (and, in Scotland, community charge income) plus grants from central government. The forecast increase in income (net of ~~rate~~ rebates) between 1988–89 and 1989–90 takes account of available information about rate decisions by local authorities, additions to rateable value, and the announced levels of community charge in Scotland. The forecast of expenditure in 1989–90 is lower than it would otherwise have been because of the transfer of polytechnics from the local authority to the private sector.

x

6.25. From information available about the first ten months it looks as if the local authority borrowing requirement will turn out to be rather lower in 1988–89 than in 1987–88, partly due to lower net capital spending as a result of rising capital receipts.

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Table 6.7 Local authority transactions

	£ billion		
	1987–88 Outturn	1988–89 Latest estimate	1989–90 Forecast[1]
Receipts			
Rates and community charge[2]	17·0	18·9	20·4
Rate and revenue support grant	12·5	12·7	13·0
Other grants from central government	12·0	12·3	14·3
Other	5·4	5·8	6·3
Total receipts	**46·9**	**49·7**	**54·1**
Expenditure			
Current expenditure on goods and services	34·6	36·4	36·9
Current grants and subsidies	5·5	6·0	6·8
Interest	4·4	4·7	4·7
Net lending and capital expenditure	3·6	3·3	3·1
Total expenditure	**48·1**	**50·4**	**51·4**

[1] *Excluding any allocation from the Reserve.*
[2] *Net of rate rebates:* — *1·9* — *1·6* — *1·6*

Public corporations

6.26. Table 6.8 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. Changes in public corporations' income and expenditure from one year to another are affected by privatisations which involve re-classifying privatised industries from the public to the private sector in the national accounts. For example the 12 per cent increase in gross trading surplus in 1988–89 would have been larger had British Steel not been excluded, following its privatisation.

Table 6.8 Public corporations' transactions

	£ billion		
	1987–88 Outturn	1988–89 Latest estimate	1989–90 Forecast[1]
Receipts			
Gross trading surplus (including subsidies)	6·8	7·6	8·1
Other	2·4	2·5	2·8
Total receipts	**9·2**	**10·1**	**11·0**
Expenditure			
Interest, dividends and taxes on income	3·1	3·2	3·8
Net lending and capital expenditure	4·5	5·4	5·8
Total expenditure	**7·6**	**8·7**	**9·6**
Public corporations' contribution to planning total:			
nationalised industries' external finance	*0·3*	*0·4*	*0·0*
other public corporations	*0·5*	*0·6*	*0·9*

[1] *Excluding any allocation from the Reserve*

Public sector's finances: analysis by economic category

6.27. The full analysis of receipts and expenditure by economic category is shown in Table 6.9, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment), shows the derivation of the public sector financial surplus. The financial surplus, unlike the PSDR, is not wholly a measure of cash transactions because certain items above line 24 in Table 6.9, for example some taxes included in lines 1 and 2, are measured on an accruals basis. An accruals adjustment is accordingly made in line 28.

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

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Table 6.9 Public sector transactions by sub-sector and economic category

		£ billion				
		1988–89 Latest estimate				
		General government			Public corporations	Public sector
	Line[1]	Central government	Local authorities	Total		
Current and capital receipts						
Taxes on income, and oil royalties	1	62·3	—	62·3	−0·2	62·1
Taxes on expenditure	2	57·9	18·9	76·8	—	76·8
Taxes on capital	3	5·2	—	5·2	—	5·2
National insurance and other contributions	4	32·9	—	32·9	—	32·9
Gross trading surplus	5	−0·5	0·4	−0·1	7·6	7·6
Rent and miscellaneous current transfers	6	0·4	3·1	3·5	0·5	4·1
Interest and dividends from private sector and abroad	7	3·5	1·2	4·7	0·7	5·3
Interest and dividends within public sector	8	6·0	−4·0	2·1	−2·1	—
Imputed charge for non-trading capital consumption	9	1·3	1·6	2·9	—	2·9
Capital transfers from private sector	10	—	—	—	0·2	0·2
Total receipts	11	**169·1**	**21·2**	**190·3**	**6·6**	**196·9**
Current and capital expenditure						
Current expenditure on goods and services	12	56·8	36·4	93·2	—	93·2
Subsidies	13	4·1	1·0	5·1	—	5·1
Current grants to personal sector	14	49·1	5·0	54·1	—	54·1
Current grants paid abroad	15	2·9	—	2·9	—	2·9
Current grants within public sector	16	23·9	−23·9	—	—	—
Debt interest	17	17·7	0·6	18·3	0·6	18·9
Gross domestic fixed capital formation	18	4·0	2·8	6·7	5·0	11·7
Increase in stocks	19	−0·4	—	−0·4	0·3	—
Capital grants to private sector	20	3·1	0·7	3·8	0·1	3·9
Capital grants within public sector	21	1·9	−1·0	0·8	−0·8	—
Total expenditure	22	**163·1**	**21·5**	**184·6**	**5·2**	**189·8**
Unallocated Reserve	23	—	—	—	—	—
Financial surplus	24	**6·0**	**−0·3**	**5·7**	**1·4**	**7·1**
Financial transactions						
Net lending to private sector and abroad	25	0·5	−0·3	0·3	—	0·3
Cash expenditure on company securities (including privatisation proceeds)	26	−7·1	0·1	−7·1	—	−7·1
Transactions concerning certain public sector pension schemes	27	−0·7	—	−0·7	—	−0·7
Accruals adjustments	28	−0·2	−0·2	−0·4	—	−0·4
Miscellaneous financial transactions	29	0·2	0·8	1·0	—	1·0
Debt repayment	30	**13·2**	**−0·6**	**12·6**	**1·4**	**14·0**

[1] *Financial surplus (line 24) = receipts (line 11) − expenditure (line 22) − Reserve (line 23).*
Debt repayment (line 30) = financial surplus (line 24) − financial transactions (lines 25 to 29).

[2] *including community charge in Scotland.*

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6 The public sector's finances

£ billion

1989–90 Forecast

Line[1]	General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector	
						Current and capital receipts
1	68·7	—	69·2	−0·6	68·1	Taxes on income, and oil royalties
2	61·8	20·4	82·3	—	82·3	Taxes on expenditure[2]
3	5·2	—	5·2	—	5·2	Taxes on capital
4	33·9	—	33·9	—	33·9	National insurance and other contributions
5	−0·5	0·5	—	8·1	8·1	Gross trading surplus
6	0·4	3·3	3·7	0·7	4·4	Rent and miscellaneous current transfers
7	3·3	1·4	4·6	0·6	5·2	Interest and dividends from private sector and abroad
8	6·7	−4·2	2·5	−2·5	—	Interest and dividends within public sector
9	1·4	1·7	3·1	—	3·1	Imputed charge for non-trading capital consumption
10	—	—	—	0·2	0·2	Capital transfers from private sector
11	**181·0**	**23·1**	**204·1**	**6·4**	**210·6**	**Total receipts**
						Current and capital expenditure
12	61·4	36·9	98·3	—	98·3	Current expenditure on goods and services
13	4·5	0·9	5·4	—	5·4	Subsidies
14	52·9	5·8	58·8	—	58·8	Current grants to personal sector
15	4·0	—	4·0	—	4·0	Current grants paid abroad
16	24·7	−24·7	—	—	—	Current grants within public sector
17	16·7	0·4	17·0	0·5	17·5	Debt interest
18	5·1	2·5	7·6	5·6	13·2	Gross domestic fixed capital formation
19	−0·3	—	−0·3	0·2	−0·1	Increase in stocks
20	2·4	0·8	3·2	0·1	3·3	Capital grants to private sector
21	3·6	−2·5	1·1	−1·1	—	Capital grants within public sector
22	**175·1**	**20·0**	**195·1**	**5·2**	**200·3**	**Total expenditure**
23					3·5	Unallocated Reserve
24					**6·9**	**Financial surplus**
						Financial transactions
25	0·4	−0·2	0·2	—	0·2	Net lending to private sector and abroad
26	−5·0	—	−5·0	—	−5·0	Cash expenditure on company securities (including privatisation proceeds)
27	−0·2	—	−0·2	—	−0·2	Transactions concerning certain public sector pension schemes
28	−0·9	−0·2	−1·1	—	−1·1	Accruals adjustments
29	0·2	0·8	1·0	−0·1	1·0	Miscellaneous financial transactions
30					**12·1**	**Debt repayment**

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FROM: N I MACPHERSON
DATE: 8 March 1989

1. MR GILHOOLY

2. CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mr A C S Allan
Mr Gieve
Mr Matthews
Miss Simpson
Miss Wallace

Sir A Battishill) IR
Mr Calder)

Mr Unwin) C&E
Mr P R H Allen)

Ch

A few comments

& a few from me, pension

AA

FSBR CHAPTER 4

I attach the latest proof of Chapter 4.

2. Now that relocation costs has been dropped, there is a case for moving Schedule E to the income tax part of the narrative section perhaps after "charitable giving", since it sits rather oddly between PEPs and pensions. However, I have assumed you do not want to give it the front page treatment. I would move it up

3. I have added a sentence to paragraph 4.03 by way of explanation. This brings it more into line with the Budget Speech.

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4. The main changes are to the Annex. There are new notes on life assurance, which take on board your comments. "VAT: input supplies" (note 55) and "duty reliefs: diplomats" (note 69) have been included for the first time; this is because they are covered by the Budget Resolutions. I have also changed the VAT ECJ notes slightly.

5. I would be grateful for comments by midday tomorrow.

Nick Macpherson

N I MACPHERSON

4 The Budget tax and national insurance proposals

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

Income tax

4.02 The main income tax thresholds will be increased in line with the statutory indexation provisions (based on the increase of 6·8 per cent in the RPI in the year to December 1988); the higher level of age allowance currently given to those aged 80 and over will be extended to those aged 75 and over. This will mean that:

the single person's and wife's earned income allowances will rise from £2 605 to £2 785;

the married allowance will rise from £4 095 to £4 375;

the additional personal allowance and widow's bereavement allowance will rise from £1 490 to £1 590;

the age allowance for those aged 65 to 74 will rise from £3 180 to £3 400 (single) and from £5 035 to £5 385 (married);

the age allowance for those aged 75 and over will rise from £3 180 (for single people aged under 80) and from £3 310 (for single people aged 80 and over) to £3 540; and from £5 035 (for married couples aged under 80) and from £5 205 (for married couples aged 80 and over) to £5 565.

the income limit for the age allowances will rise from £10 600 to £11 400;

the basic rate limit will rise from £19 300 to £20 700 of taxable income.

4.03 The age allowance withdrawal rate will be reduced from £2 of ~~allowances~~ allowance for each £3 of income to £1 of ~~allowances~~ allowance for each £2 of income above the income limit of £11 400. This means that the marginal tax rate for someone with income just above the limit will fall from nearly 42 per cent to 37.5 per cent.

(see cover note)

Benefits in kind

4.04 Car benefit scale charges will be increased by one third from 6 April 1989.

Private medical insurance

4.05 Income tax relief will be given from 6 April 1990 on private medical insurance premiums for those aged 60 and over.

Charitable giving

4.06 The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be doubled from £240 to £480 a year from 6 April 1989.

Employee share ownership plans (ESOPs)

4.07 Tax relief will be given for payments by companies to qualifying ESOP trusts.

Approved employee share schemes

4.08 The annual limit for individual participation in the 1978 all-employee share scheme will be increased to £2 000 or—if greater—10 per cent of pay up to a maximum of £6 000. The 1980 SAYE share option scheme limit will be increased from £100 to £150 per month. The maximum discount from the share price at which options may be granted under these schemes will be doubled to 20 per cent.

Profit-related pay 4.09 The cash ceiling on the amount of profit-related pay attracting tax relief will be increased to £4 000. A number of other changes will simplify and improve the PRP rules.

Personal equity plans 4.10 The annual limit on investment in Personal Equity Plans will be increased from £3 000 to £4 800. The annual limit on investment in unit and investment trusts will be increased to £2 400, irrespective of other holdings. Investment in ~~and restricted to~~ unit and investment trusts will be restricted to trusts which invest mainly in UK equities. The PEP rules will be greatly simplified.

Schedule E assessment 4.11 The basis of assessment for Schedule E (remuneration of employees and directors) will be changed from accruals ~~earnings~~ to receipts. Bringing the systems of assessment and collection (PAYE) into line will simplify the taxation of the half million directors and employees not already taxed on the receipts basis.

Move up? Yes

in practice? Why going quickly

Relocation expenses ~~4.12 Payments an employer makes towards the additional housing costs of an employee transferred to a more expensive location will no longer be exempt from tax.~~

Pensions 4.12 ~~4.13 The tax regime for pensions will be amended. For occupational schemes the main features will be:~~ changed — almost worse than 'reformed'?!

A ~~package~~ number of changes will be made to the taxation ~~tax regime~~ of ~~for~~ pensions. In the case of occupational pensions:

employers will be able to set up "top up" schemes for their employees, with no limits on benefits, but without special tax reliefs;

a limit will be placed on pensions paid from tax-approved schemes, based on earnings of £60 000 a year. This is consistent with a tax privileged pension of up to £40 000 a year or maximum tax free lump sum of up to £90 000. The limit will be indexed to prices;

the rules for tax approved pensions, particularly affecting those who take early retirement, will be simplified and improved.

These changes will apply to schemes set up on or after Budget day and to new members joining existing schemes on or after ~~that date.~~ 1 June 1989.

4.13 ~~4.14~~ New simplified rules will be introduced for monitoring additional voluntary contributions. Any surplus contributions made will be returned to employees, subject to a special tax charge.

4.14 ~~4.15~~ Annual contribution limits for personal pension schemes will be increased as a percentage of earnings, subject to an overall cash limit based on the £60 000 earnings limit for occupational schemes.

Life assurance 4.15 ~~4.16~~ The tax regime for life assurance companies will be reformed. The main changes, to be introduced from 1 January 1990, are:

pension and general annuity business expenses will be deductible only from pension or general annuity business profits;

relief for expenses of acquiring new life assurance business (other than pension or general annuity business) will be spread over seven years: this change will be phased in gradually over four years;

the rate of tax charged on income and capital gains attributable to policy holders will be reduced to a rate equal to the basic rate of income tax (25 per cent);

life assurance policy duty will be abolished.

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Unit trusts ~~4.17~~ 4.16 A new tax regime will be introduced from 1 January 1990 for unit trusts investing in transferable securities which are freely marketable throughout the European Community under the UCITS directive. The rate of corporation tax charged on their income will be reduced to a rate equal to the basic rate of income tax (25 per cent).

COBO and deep discounted bonds ~~4.18~~ 4.17 The new issues queue will be abolished by a general consent under the Control of Borrowing Order and the regime for deep discounted bonds, including certain index-linked bonds, will be amended with effect from Budget day.

Business taxation ~~4.19~~ 4.18 The profits limit for the small companies' corporation tax rate of 25 per cent for financial year 1989 will be raised from £100 000 to £150 000 and the limit for marginal relief will be raised from £500 000 to £750 000.

~~4.20~~ 4.19 The main rate of corporation tax for the financial year 1989 will be 35 per cent.

~~4.21~~ 4.20 The apportionment rules for close companies will be abolished. Special provisions including a corporation tax rate equal to the higher rate of income tax (40 per cent) will be introduced for close investment companies which distribute less than a specified percentage of their profits.

Capital gains tax ~~4.22~~ 4.21 The capital gains tax annual exempt amount will remain at £5 000 in the case of individuals and £2 500 in the case of most trusts.

~~4.23~~ 4.22 The disposal value limit below which chattels are exempt from charges on capital gains will be doubled from £3 000 to £6 000.

~~4.24~~ 4.23 Capital gains tax deferral on lifetime gifts will be restricted to certain types of gift—in particular, gifts of business, farm and heritage assets, gifts on which there is an immediate charge to inheritance tax, and gifts to charity.

Inheritance tax ~~4.25~~ 4.24 From ~~Budget day~~ 6 April 1989 the threshold for inheritance tax will be increased in line with the statutory indexation provisions from £110 000 to £118 000.

VAT and car tax ~~4.26~~ 4.25 From 15 March 1989 the VAT registration limits will be raised to £23 600 a year, and £8000 a quarter.

~~4.27~~ 4.26 To comply with the European Court judgment of 21 June 1988 certain previously zero rated goods and services will be subject to VAT at the standard rate. As announced on 6 February, the regime will aim to minimise the tax and compliance burden.

~~4.28~~ 4.27 Non-residential construction and property development will be liable to VAT from 1 April 1989 with transitional relief for prior contractual commitments. Landlords will be given the option to tax rents of non-residential buildings from 1 August 1989. VAT will also be applied from 1 April 1989 to news services and to protective boots and helmets supplied to employers ~~and to news services~~; and from 1 July 1990 it will be applied to fuel and power supplied to businesses, and to water and sewerage services supplied to industry.

~~4.29~~ 4.28 VAT relief for charities will be extended to charity fund-raising events, certain types of advertising and medical sterilising equipment. Cars leased to the disabled will be relieved of car tax.

Excise duty ~~4.30~~ 4.29 The duty on unleaded petrol will be reduced by the equivalent of just under 1p a litre (nearly 4p a gallon) including VAT. A higher rate of duty will be introduced on 2 and 3 star leaded petrol. This will add nearly 1p a litre (4p a gallon) including VAT to the tax charged on these grades.

ITV levy ~~4.31~~ 4.30 From 1 January 1990, the additional payments made by ITV programme contractors will be assessed on a mixture of net advertising revenue and profits.

Tax administration ~~4.32~~ 4.31 In light of recommendations by the Keith Committee, measures are proposed to:

- simplify and update the system of interest and monetary penalties for tax offences;
- ~~modernise~~ revise the Inland Revenue's powers ~~for~~ to obtain information about a taxpayer under enquiry, to allow questions to be put to the taxpayer and to provide the taxpayer with greater safeguards;
- amend the Inland Revenue's search powers to provide greater protection for the taxpayer;
- improve compliance by employers in filing end of year returns of PAYE and NIC deductions.

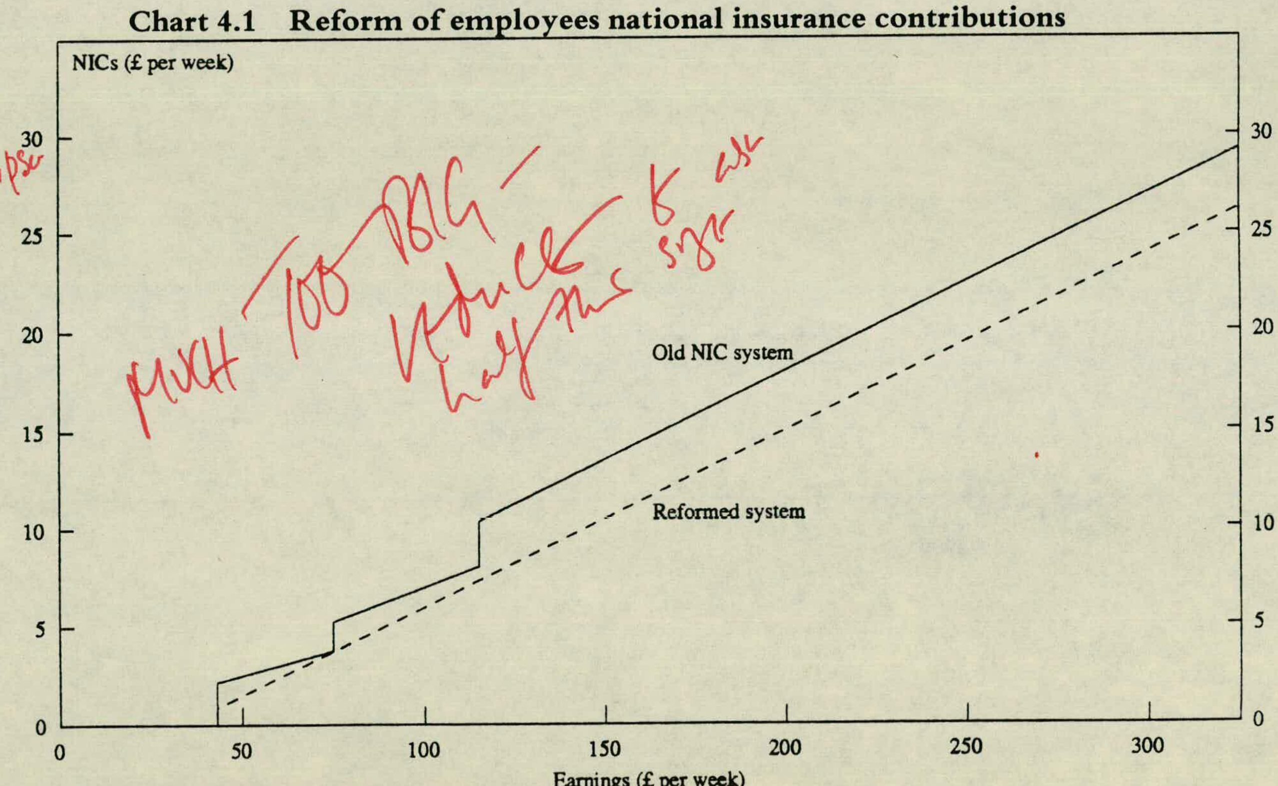
Tax confidentiality ~~4.33~~ 4.32 Criminal sanctions will be provided against unlawful disclosure of information relating to a taxpayer by employees or former employees of the Inland Revenue and Customs and Excise.

National insurance ~~4.34~~ 4.33 From ~~[2]~~ 5 October, the structure of employees' national insurance contributions will be reformed. Employees will pay Class 1 contributions equal to 2 per cent of earnings up to the lower earnings limit (£43 a week in 1989–90) and 9 per cent of earnings above the lower earnings limit, up to the upper earnings limit (£325 a week in 1989–90). Those earning below the lower earnings limit will continue to pay no Class 1 contributions.

Yet and the date !!

* for Budget Speech, press say 'from the beginning of October', for both NIC & earnings rule

Chart 4.1 Reform of employees national insurance contributions



✓ (I understand)

4.34 ~~**4.35**~~ From ~~[2]~~ 1 October the rule whereby state retirement pensioners earning more than £75 a week have their pensions reduced, and those earning over £120 a week have their pension abated entirely, will be abolished. The public expenditure cost of abolition will be about £190 million in 1989–90 and ~~£370~~ £375 million in 1990–91. This cost will be met from the Reserve, and is therefore not included in Table 4.1. (Nor does Table 4.1 include the increased tax revenue that will flow from the changes, ~~£40~~ £20 million in 1989–90 and ~~£90~~ £110 million in 1990–91.)

~~**4.36** The Class 3 voluntary contributions will be reduced from £4·15 to £2·85 a week from 2 October 1989.~~

4.35 ~~**4.37**~~ These changes to national insurance contributions and the pensioners' earnings rule will be included in the Social Security Bill now before Parliament.

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A

21	Life assurance companies - pension measures	—	—	+155
22	Life assurance companies - acquisition costs and rate reduction	—	—	-30

Table 4.1 Direct effects of changes in taxation and national insurance

See Annex 4 Paragraph numbers	£ million Estimated effect on receipts in: 1989–90 Changes from a non-indexed base	1989–90 Changes from an indexed base	1990–91 Changes from an indexed base
INLAND REVENUE			
Income tax			
1 Increase in single allowance of £180 and married allowance of £280 in	−1 130	—	—
2 Increase in additional personal allowance and widow's bereavement allowance of £100	−10	—	—
3 Increase in age allowances in line with statutory indexation	−100	—	—
4 Extension of higher age allowance for those aged 80 and over to those aged 75 and over	−10	−10	−15
5 Increase in income limit for age allowance of £800	−15	—	—
6 Reduction in age allowance withdrawal rate	−5	−5	−5
7 Increase in basic rate limit of £1 400 to £20 700	−210	—	—
8 Fringe benefits—one third increase in car benefit scales	+160	+160	+200
~~9 Removal of extra-statutory concession on additional housing costs~~	~~+5~~	~~+5~~	~~+30~~
9 ~~10~~ Tax relief for private medical insurance for those aged 60 or over	—	—	−40
10 ~~11~~ Pension schemes—amendments to tax rules	⋆	⋆	⋆
11 ~~12~~ Payroll giving to charities—increase in donation limit to £480 a year	⋆	⋆	⋆
12 ~~13~~ Membership covenants to heritage charities	−5	−5	−10
13 ~~14~~ Liberalisation of profit-related pay legislation	−10	−10	−15
14 ~~15~~ Increase in approved employee share limits	⋆	⋆	⋆
15 ~~16~~ Employee priority in public offer of shares	⋆	⋆	⋆
16 ~~17~~ Changes in material interest tests	⋆	⋆	−5
17 ~~18~~ Abolition of tax relief on new loans to buy Business Expansion Scheme shares	⋆	⋆	+5
18 ~~19~~ Schedule E—change to receipts basis of assessment	−80	−80	−60
19 ~~20~~ Changes in settlements provisions where settlor or spouse can benefit	⋆	⋆	⋆
20 ~~21~~ Tax deductible from tax credit payments to US companies	—	—	—
Income tax and corporation tax ? have IT, CT and Stamp Duty, & bring LAPD in here [illegible]			
Insert A ~~22 Taxation of income, gains and profits of life assurance companies~~	~~⋆~~	~~⋆~~	~~+125~~
23 Abolition of close company apportionment	⋆	⋆	⋆
24 Capital allowances—safety at sports grounds and miscellaneous amendments	⋆	⋆	⋆
25 Extension of relief for pre-trading expenditure	⋆	⋆	⋆
26 Subcontractor tax scheme—reduction in paperwork requirements	—	—	—
Income tax and capital gains tax			
27 Personal Equity Plans—increase in limits etc.	−5	−5	−10
Income tax, corporation tax and capital gains tax			
28 Keith committee—administrative changes	⋆	⋆	⋆
29 Deep discounted bonds—taxation of uplift as income	—	—	+15
30 Tax charge on switching investments in offshore funds	⋆	⋆	⋆
Corporation tax			
31 Increase in profits limits for small companies rate and marginal relief	⋆	⋆	−35
32 Reduction in tax rate for certain unit trusts	—	—	⋆
33 Relief for payments to ESOP trusts	⋆	⋆	⋆
34 Advance corporation tax amendments	⋆	⋆	⋆
35 Sale of subsidiaries	⋆	⋆	⋆
Capital gains tax			
36 No change in annual exempt amount	—	⋆	+10
37 Restriction of gifts relief	⋆	⋆	+25
38 Change in the rules for Lloyd's underwriters - stock lending	—	—	⋆

⋆ = *Negligible* — = *Nil*

Inserts x and y below

(x)	55 Self-supplies - input tax	*	*	*
(y)	69 Relief from duty and tax for diplomats etc.	—	—	—

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

See Annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1989–90 Changes from a non-indexed base	1989–90 Changes from an indexed base	1990–91 Changes from an indexed base
Capital gains tax and corporation tax			
39 UK branches of foreign businesses—changes affecting capital gains	⋆	⋆	⋆
40 Technical changes associated with rebasing of capital gains	⋆	⋆	⋆
41 Increase in capital gains chattels exemption to ~~£5 000~~ £6 000	⋆	⋆	⋆
42 Exemption of certain bonds from charges on capital gains	⋆	⋆	⋆
Capital gains tax and inheritance tax			
43 Gifts to housing associations	⋆	⋆	⋆
Inheritance tax			
? **44** Increase of £8 000 in threshold	−35	—	—
45 Changes in rules for varying dispositions on death	+5	+5	+15
Stamp duty			
46 Abolition of life assurance policy duty	−20	−20	−80
TOTAL INLAND REVENUE	~~−1 465~~ −1470	~~+35~~ +30	~~+150~~ +120
CUSTOMS AND EXCISE			
Value added tax			
47 Increase in registration limit	⋆	⋆	⋆
48 Revised tax regime for construction, buildings and land	+310	+310	+440
49 Change in liability of news services	+5	+5	+5
50 Change in liability of certain protective boots and helmets	⋆	⋆	⋆
51 Change in liability of certain supplies of fuel and power	—	—	~~+95~~ +90
52 Change in liability of certain water and sewerage services	—	—	⋆
53 Reliefs for charities	−5	−5	−5
Insert x **54** Relief for research and development cars	⋆	⋆	−5
Car tax			
56 ~~**55**~~ Relief for vehicles leased to disabled	−10	−10	−10
Excise duties			
57 ~~**56**~~ No change in rate of spirits duty	—	−65	−70
58 ~~**57**~~ No change in rate of beer duty	—	−140	−155
59 ~~**58**~~ No change in rate of duty on cider and perry	—	−5	−5
60 ~~**59**~~ No change in rate of duty on wine and made-wine	—	−45	−50
61 ~~**60**~~ No change in rate of duty on 4 star petrol etc.	—	−440	−465
62 ~~**61**~~ No change in rate of duty on derv	—	−95	−105
63 ~~**62**~~ No change in rate of duty on minor oils	—	−10	−10
64 ~~**63**~~ No change in rates of tobacco products duties	—	−235	−250
65 ~~**64**~~ Restriction on blending of duty-paid made-wine	⋆	⋆	⋆
66 ~~**65**~~ Determination of original gravity of beer	⋆	⋆	⋆
67 ~~**66**~~ Reduction in duty on unleaded petrol	−35	−35	−90
Insert y 68 ~~**67**~~ Increase in duty on 2 star and 3 star petrol	−5	−5	−10
TOTAL CUSTOMS AND EXCISE	**+260**	**−775**	~~**−690**~~ −695
Vehicle excise duty			
70 ~~**68**~~ No change in VED on cars, light vans and main lorry rates	—	−190	−210
71 ~~**69**~~ Increase in VED rates for taxis, buses and coaches	+20	+20	+20
72 ~~**70**~~ Increase in ~~certain other~~ VED rates for certain lorries and other vehicles	+20	+20	+20
TOTAL VED	**+40**	**−150**	**−170**

⋆ = *Negligible* — = *Nil*

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

See Annex 4 paragraph numbers	£ million Estimated effect on receipts in: 1989–90 Changes from a non-indexed base	Changes from an indexed base	1990–91 Changes from an indexed base
Other			
73 ~~71~~ ITV levy re-basing	—	—	+45
74 ~~72~~ Sale of vehicle registration ~~numbers~~ marks	*	*	+10
75 ~~73~~ Unauthorised disclosure of confidential information	—	—	—
TOTAL OTHER	*	*	+55 Bold
TOTAL CHANGES IN TAXATION	~~−1165~~ −1170	~~−890~~ −895	~~−670~~ −690
National insurance contributions			
76 ~~74~~ ~~Reform~~ Employee contributions reformed and reduced	−980	−980	−2800
~~75 Reduce Class 3 contributions~~	~~*~~	~~*~~	~~−5~~
TOTAL CHANGES TO NATIONAL INSURANCE CONTRIBUTIONS	**−980**	**−980**	~~−2805~~ −2800

* = *Negligible* — = *Nil*

Prefer to have a line @ end, "total Budget changes" (as per Table 1.1)

Annex to Chapter 4

Explanatory notes to Table 4.1

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

The direct effect of a tax change is the difference the between the yield of tax which would arise on the basis of the rates of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime). The difference in yield is generally calculated by applying the pre- and post-Budget regimes to the same tax base. This base is the post-Budget base—that is, the levels of income, consumption, profits, etc forecast for future years on the assumption that all the measures proposed in the Budget take effect.

Tax changes may cause changes in taxpayers' behaviour, which in turn can alter the tax base and hence revenue. The direct effects are estimated subject to the constraint that, in general, total incomes and total expenditure are fixed at their post-Budget levels. Thus the estimates in the table do not include income effects—that is, effects arising solely from the impact of changes in taxes on disposable incomes. Nor do they include the effects of changes in the tax base arising from changes in pre-tax incomes, the general level of prices or other macro-economic variables which may result from the proposed tax change. But other behavioural effects are taken into account where it is thought that they will have a significant effect on the yield.

For Customs and Excise taxes and duties, all the estimates of yield incorporate the effects of the tax changes on relative prices and associated changes in the pattern of consumers' expenditure. Aggregate income and consumers' expenditure at factor cost are assumed not to change. This is a slight modification of previous practice in which nominal consumers' expenditure at market prices, rather than at factor cost, was held constant. Examples where behavioural effects are taken into account for Inland Revenue taxes include changes involving the take-up of a new or modified relief.

The post-Budget forecast of each tax given in Table 1.2 takes account of all the effects of the measures announced in the Budget, and not just the direct effects included in Table 4.1.

The figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1989–90. Budget proposals are compared with a non-indexed base—that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1988–89 levels.

The figures in the second column show the direct effect of the Budget proposals on receipts in 1989–90, measured against an indexed base. The indexed base for 1989–90 is obtained by increasing 1988–89 allowances, thresholds and rates of duty by 6·8 per cent, the increase in the RPI over the year to December 1988.

The figures in the third column show the direct effect on receipts in 1990-91, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1989–90 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1988 and 1989 (shown in Table 3.13).

The remainder of this annex provides a commentary on the Budget proposals in Table 4.1; the paragraph numbers refer to the lines in this table. Additional information is provided for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1989–90 or 1990–91; or where the impact of the proposal is expected to build up over a period of years.

Income Tax t

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Why?

1 to 5 The increases in the main income tax allowances are in line with the statutory indexation provisions (based on the increase of 6·8 per cent in the RPI in the year to December 1988). The higher age allowance currently given to those aged 80 and over will be extended to those aged 75 ~~years~~ and over. ~~(The cost of indexation for those aged between 75 and 79 is included in line 3.)~~

6 The age allowance withdrawal rate will be reduced from £2 of allowances for each £3 of income to £1 of allowances for each £2 of income above the income limit of £11 400.

7 The increase in the basic rate limit is in line with the statutory indexation provisions.

8 For 1989–90 the scales for taxing car benefits will be increased by one third ~~20 per cent~~ from their 1988–89 levels. The estimated yield takes account of behavioural effects.

~~**9** The extra-statutory concession concerned with certain reimbursements by employers of additional housing costs incurred by their employees who have had to move with their jobs to more expensive locations will be withdrawn from 6 April 1989, subject to transitional arrangements. A statutory relief will be introduced to replace the extra-statutory concession which has exempted employees from tax on the cost of removal expenses paid by employers. The tax yield of these measures will eventually be of the order of £100 million after transitional arrangements have ceased to take effect.~~

9 ~~**10**~~ Tax relief will be available (with basic rate relief given at source) for eligible premiums paid in 1990–91 and subsequent years for private medical insurance for those aged 60 ~~years~~ and over. The cost for 1990–91 assumes an increase in take-up in the region of 10 per cent as a result of the new relief. Eventual costs will depend, among other things, on the extent to which medical insurance for the over-60s is promoted and taken up.

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10 ~~**11**~~ The amendments to the tax rules for pension schemes will mean that:

for tax~~-~~approved schemes, earnings over £60 000 a year will be ignored for the purpose of calculating benefits (consistent with a maximum pension of £40 000, or tax-free lump sum of £90 000). Other amendments will be made to the tax rules to improve early retirement benefits, to allow a two-thirds final salary pension on retirement after 20 years' service between ages 50 and 70 and to simplify calculation of tax-free lump sums. These changes apply to new schemes set up on or after 14 March 1989 and to new members joining existing schemes on or after 1 June 1989; ~~that date~~;

employers will be able to set up top-up schemes with no limits on benefits, but without tax privileges such as tax-free investment build-up;

new rules will allow surplus voluntary contributions to be returned to the member instead of reducing benefits from the employer's scheme. The voluntary scheme will deduct a 35 per cent charge from the refund to recoup the tax advantages enjoyed on contributions and build-up. There will be a further liability on higher rate taxpayers;

changes will be made to the personal pensions tax rules to increase from 1988–89 the age related contribution limits. The increased limit will be subject to the £60 000 earnings cap. And the rules for calculating tax-free lump sums will be simplified.

These measures are expected to have a broadly neutral revenue effect in the early years.

11 ~~12~~ The limit on charitable donations qualifying for relief under payroll deduction schemes will be increased from £240 to £480 from April 1989. The cost will depend on take-up.

12 ~~13~~ The conditions for relief for charitable covenants will be relaxed so that where a member of a heritage charity is given free entry to view the charity's property, that benefit will not disqualify the covenant payments from relief. The cost will depend on take-up.

13 ~~14~~ The main ~~A~~ amendments to the profit-related pay (PRP) legislation will:

abolish the "5 per cent test" on a PRP scheme's eligibility for registration;

increase to £4 000 the cash limit on the amount of PRP attracting tax relief;

allow scheme employers to alter, subject to conditions, the rules of PRP schemes already registered; and

enable PRP schemes to be registered for certain employment units using the profits of the whole business rather than of the employment unit itself.

The cost will depend on take-up.

14 ~~15~~ The annual limit on the value of shares which may be given to an employee under an approved all-employee profit-sharing share scheme will be increased, with effect from 6 April 1989, from £1 250 (or 10 per cent of pay up to a maximum of £5 000) to £2 000 (or 10 per cent of pay up to £6 000). The limit on monthly savings made by an employee under an approved savings-related share option scheme will be increased, from a day to be appointed, from £100 to £150. The maximum discount on the share price at which options may be granted under these schemes will be increased from 10 per cent to 20 per cent. The use of consortium shares in an approved employee share scheme will be extended to include the shares of any member of a consortium owning 5 per cent or more of the company's ordinary share capital in place of the previous 15 per cent limit.

15 ~~16~~ There will be relaxations in the conditions under which income tax relief is given to employees who benefit by virtue of their employment from priority in applying for a public offer of shares.

16 ~~17~~ Changes will be made in the material interest tests relating to an employee's eligibility to participate in an approved employee share scheme or a registered profit-related pay scheme, and an individual's entitlement to close company interest relief. Subject to certain conditions, shares held by a trust of which the employee is a beneficiary will be disregarded when reckoning whether he has material interest.

17 ~~18~~ Relief for interest on loans to acquire Business Expansion Scheme shares ~~issued~~ on or after 14 March 1989 will be abolished.

18 ~~19~~ From 6 April 1989 Schedule E emoluments will be assessed for the year in which they are received instead of the year for which they are earned. There will be a transitional cost, but from 1992–93 when the transition is complete, there will be an annual yield of about £50 million.

19 ~~20~~ A change will be made to the provisions which treat certain settlement income as the settlor's for higher rate tax purposes to ensure that income from outright gifts between husband and wife will be treated under Independent Taxation as the income of the recipient of the gift. For certain other settlements the present provisions will be extended to the basic rate, producing a small revenue yield.

20 ~~21~~ Legislation will be introduced to make clear the amount of UK tax that is deductible from UK tax credits to which non-residents may be entitled under a double taxation convention. This measure will prevent a potential Exchequer loss of about £15 million a year.

BUDGET SECRET—BUDGET LIST ONLY

Income tax and corporation tax

22 From 1 January 1990, the rules for taxing life assurance companies will be changed. The main changes are:

to allow relief for the expenses of pension, general annuity and other life assurance business only against their respective profits;

to spread the relief for the costs of acquiring new business (other than pension and general annuity business) over seven years, subject to transitional arrangements in the first four years to phase out the present immediate relief; and

to reduce the corporation tax rate on income and capital gains attributable to policyholders to 25 per cent.

The yield in 1990–91 and the immediately following years is reduced by the proposed transitional arrangements, and by the carry-forward of unrelieved expenses from past years. The yield in all years depends on developments in the industry, particularly in the level of new business, and is therefore highly uncertain.

Insert new para.s 21 and 22 attached

23 The apportionment rules for close companies will be abolished. A higher rate of corporation tax equal to the higher rate of income tax of 40 per cent will be introduced for close investment companies which distribute less than a specified percentage of their profits. A close investment company will no longer get tax relief for interest payments, annual payments or management expenses unless these would have been deductible if paid by an individual.

24 The legislation relating to capital allowances for safety expenditure at sports grounds will be amended from 1 January 1989 to take account of the extension of safety certificate requirements to regulated stands at undesignated sports grounds. Minor amendments will be made to the capital allowances legislation to correct defects and anomalies in advance of the consolidation of that legislation.

25 The period for which relief may be available for business expenditure incurred before a trade begins will be increased from three to five years. The cost of this proposal will take some years to build up and could amount to tens of millions of pounds.

x
x

26 Subject to consultation, the paperwork requirements of the scheme for subcontractors in the construction industry will be reduced. ~~for example by aggregation of small payments onto a single voucher~~.

Income tax and capital gains tax

27 The main changes are:

an increase in the overall annual limit on investment in a Personal Equity Plan to £4 800;

within that an increase in the limit for investment in authorised unit trusts and investment trusts to £2 400, coupled with a new requirement that the trust must invest mostly in UK equities;

significant simplifications for plan managers; and

the facility for new share issues to be brought within plans.

The costs assume take-up in the region of 400 000 in the first full year. The cost is likely to reach £30 million after five years.

Income tax, corporation tax and capital gains tax

28 In the light of recommendations of the Keith Committee, administrative changes will be made:

to update the system of monetary penalties for tax offences in line with inflation and remove obsolete penalties;

to introduce a uniform time limit of 20 years for recovery of tax lost through default;

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Para 21 From 1 January 1990, life assurance companies will be allowed to set relief for the expenses of pension, general annuity and other life assurance business only against their respective profits. There will be other measures to align the tax treatment of pension profits income more closely with industry accounting practice. The yield in 1990-91 and the immediately following years is reduced by the carry-forward of unrelieved expenses from past years. The long term yield is expected to be about £250 million.

Para 22 Other changes will be made from 1 January 1990 to the rules for taxing life assurance companies: in particular, to spread over seven years the relief for the costs of acquiring new business (other than pension and general annuity business), ~~over seven years,~~ subject to transitional arrangements in the first four years, ~~; to phase out the present immediate relief;~~ and to reduce the corporation tax rate on income and capital gains attributable to policy holders to 25 per cent. The impact of these measures in 1990-91 and subsequent years is affected by the proposed transitional arrangements. The long-run effect is expected to be broadly revenue-neutral.

prefer

v clumsy

to allow taxpayers further time to claim reliefs where an Inspector discovers that further tax is due;

to ~~modernise~~ revise the Inland Revenue's powers to obtain information about a taxpayer under enquiry, to allow questions to be put to the taxpayer, provide greater safeguards for the taxpayer and protect audit papers and tax advice from disclosure by his accountant;

to amend the Inland Revenue's search powers to provide greater safeguards for the taxpayer;

to create a new criminal offence for the deliberate destruction of documents called for under the Inland Revenue's information powers;

to change the filing date for returns of PAYE and NIC deductions by employers from 19 April to 19 May, tighten up the penalties for late filing gradually over a period of years, leading to the introduction of automatic penalties for all late filing (but not before 1995).

The effect on revenue in subsequent years is expected to be small.

29 From Budget day the existing corporate deep discount legislation in Schedule 4 ICTA 1988 will be widened to include non-variable deep discounted securities issued by non-corporate borrowers. On a sale or redemption the accrued discount will be taxed as income. Any excess or shortfall will be taxed as a capital gain or loss unless the security is exempt from capital gains tax as a qualifying corporate bond. Where deep discounted securities have variable features so that the precise accrued discount at any particular time cannot be determined in advance (including certain index-linked bonds), the whole of the uplift between cost price and sale or redemption price will be taxed as income. The eventual yield is uncertain but is estimated at around £50 million.

30 A tax charge will be imposed on UK investors on gains when they switch holdings within an offshore fund.

Corporation Tax

31 The profits limit for the small companies' corporation tax rate of 25 per cent for financial year 1989 will be raised from £100 000 to £150 000 and the limit for marginal relief will be raised from £500 000 to £750 000.

32 From 1 January 1990 all unit trusts that are UCITS (Undertakings for Collective Investment in Transferable Securities) under the relevant European Communities legislation will be subject to corporation tax on their income at a rate of 25 per cent. The cost will rise to about £20 million from 1991–92 onwards.

33 Payments made by a company to an ESOP trust will be deductible in calculating its corporation tax liability where the trust meets conditions aimed at ensuring the distribution of shares in the company to all of its employees, on similar terms, within a reasonable time.

34 Various minor changes will be made to the advance corporation tax (ACT) rules concerning a company which is part of a group or consortium.

35 Measures will be introduced to counter avoidance of tax on disposals of subsidiaries in ways which could cause a substantial loss of tax.

Capital Gains Tax

36 The capital gains tax annual exempt amount will remain at £5 000 in the case of individuals and £2500 in the case of most trusts.

37 Capital gains tax gifts relief (which allows deferral on gifts) will be restricted to certain types of gift, the main categories being gifts of business, farm and heritage assets and gifts on which there is an immediate charge to inheritance tax. The revenue yield in 1991–92 is estimated at £40 million. The change will not affect gifts to charities or between spouses.

38 The capital gains tax rules and rules about the transfer of securities applying to assets held by Lloyd's underwriters in their premiums trust funds will be amended to facilitate stock lending to market makers.

Capital Gains Tax and Corporation Tax

39 Changes will be made to the rules for the taxation of capital gains of foreign businesses with UK branches or agencies or with operations on the UK continental shelf. The main effect will be to counter possible developments which could lead to a significant loss of tax.

40 Technical changes will be made in relation to the application of the provisions in the Finance Act 1988 for rebasing the taxation of capital gains to 1982 in certain special situations.

41 Chattels with a disposal value of less than £3 000 are exempt from charges on capital gains. The limit will be doubled to £6 000.

42 Certain sterling bonds will be exempted from capital gains tax and corporation tax on gains. The main effect will be to counter use of the indexation allowance in ways which could cause a significant loss of tax.

Capital gains tax and Inheritance Tax

43 Certain gifts to registered housing associations will qualify for capital gains tax deferral and inheritance tax exemption.

Inheritance Tax

44 The estimated full year cost of indexation attributable to taxable estates in 1989–90 is £80 million.

45 The facility for varying the disposition of a deceased person's assets with effect for inheritance tax will be limited to those variations making adequate provision for his or her dependants.

Stamp Duty

46 Life assurance policy duty will be abolished from 1 January 1990. The cost in 1990–91 takes account of the consequential change in corporation tax liability.

Value Added Tax

47 From 15 March 1989, the registration limits will become £23 600 a year and £8000 a quarter.

48 From 1 April 1989, VAT will be applied at the standard rate to the construction and sale of new non-residential buildings. From 1 August 1989, landlords will be able to opt to charge tax on their non-residential rents and sales of used buildings, ~~property and land transactions~~ and VAT at the standard rate will be applied in limited circumstances to building land where this is necessary to ensure fair competition. Tenants whose landlords opt to tax existing leases will pay tax on only half of the rent in the first year. The phasing in period will be five years where the tenant is a charity. Transitional relief will allow zero rating to continue for certain developments where legal commitments had been entered into before 21 June 1988.

49 From 1 April 1989, VAT will be applied at the standard rate to news services (but not newspapers).

50 From 1 April 1989, VAT will be applied at the standard rate to protective boots and helmets supplied to employers.

51 From 1 July 1990, VAT will be applied at the standard rate to fuel and power supplied to businesses.

52 From 1 July 1990, VAT will be applied at the standard rate to water and sewerage services supplied to industry.

53 From 1 April 1989, VAT relief for charities will be extended to charity and certain other fund-raising events, medical sterilising equipment and classified and certain other types of advertising.

54 From 1 August 1989, all cars used by manufacturers for research and development purposes will be relieved of VAT.

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BUDGET SECRET—BUDGET LIST ONLY

Insert new 55 (attached)

Car Tax ~~55~~ 56 From 1 April 1989, vehicles leased to the disabled will be relieved of car tax.

Excise duties ~~56–63~~ 57-64 There will be no change in the rates of duty on alcoholic drinks, tobacco products and most hydrocarbon oils.

~~64~~ 65 The duty arrangements for made-wine will be brought into line with those applicable to wine of fresh grapes by prohibiting duty-paid blending.

~~65~~ 66 The rules for determining the original gravity of beer for duty purposes will be clarified.

~~66~~ 67 The duty on unleaded petrol will be reduced by the equivalent of 0·8p a litre (3·6p a gallon) including VAT.

~~67~~ 68 A higher rate of duty will be introduced on two and three star leaded petrol. This will add 0·9p a litre (4·1p a gallon) including VAT to the tax charged on these grades. Despite the increase in duty, the revenue effect of this change is negative as a result of expected switching from two and three star to unleaded petrol.

Insert new 69 attached

Vehicle excise duties ~~68~~ 70 There will be no change in the duties on cars, light vans, motor cycles and most lorries.

~~69~~ 71 From 15 March 1989, the number of duty rates for ~~taxis,~~ coaches and ~~lorries~~ buses will be reduced from over sixty to five and rates will be ~~adjusted.~~ increased; duty rates will also be increased for taxis.

~~70~~ 72 From 15 March 1989, the rates of duty on certain rigid lorries will be increased to bring them more into line with rates for articulated vehicles of similar gross weight. The rate of duty for special types capable of carrying very long, wide or heavy loads will be increased to £3 100.

Other ~~71~~ 73 From 1 January 1990, the additional payments made by ITV programme contractors will be assessed on a mixture of net advertising revenue and profits.

~~72~~ 74 A pilot scheme making certain vehicle registration ~~numbers~~ marks available for sale to the public will begin in December 1989.

~~73~~ 75 Criminal sanctions will be provided against unlawful disclosure of information relating to a taxpayer by employees or former employees of the Inland Revenue and Customs and Excise.

National Insurance Contributions ~~74~~ 76 From ~~2~~ 5 October 1989, employees will pay Class 1 contributions equal to 2 per cent of earnings up to the lower earnings limit (£43 a week in 1989–90) and 9 per cent of earnings above the lower earnings limit, up to the upper earnings limit (£325 a week in 1989–90). Those earning below the lower earnings limit will continue to pay no Class 1 contributions.

~~75 From 2 October 1989, Class 3 voluntary contributions will be reduced from £4·15 a week to £2·85 a week.~~

Para 55 From Royal Assent, Customs and Excise will be given the power to determine the correct attribution of input tax in respect of self-supplies of goods and services.

Para 69 Statutory provision will be made for a number of duty and tax reliefs currently granted to diplomats, members of international organisations and visiting forces by means of extra-statutory class concessions. A power to impose sanctions for breaching the conditions of the reliefs will be introduced.