FILE NUMBER

PO-CH/NL/0714 PART A

FOR DISPOSAL ADVICE SEE INSIDE COVER

DATE		
SIGNATURE		
DISPOSAL DIRECTIONS	DESTROY AFTER YEARS	PRESERVE

FILE BEGINS 06/03/1986

ENDS 14/04/1986

FILE TITLE

BUDGET 1986

1/2

F39

Copy 1 of 13

FROM: M C SCHOLAR
DATE: 14 March 1986

MR LAVELLE

cc: Sir P Middleton
Mr Cassell
Mr Monck
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Pratt

PS/IR
PS/C&E

BUDGET GUIDANCE FOR OVERSEAS POSTS

I attach a copy of the draft guidance to overseas posts which I have submitted to the Chancellor this evening. It takes account of the comments I received on an earlier draft.

MCS

M C SCHOLAR

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

This year's Budget comes at a time of great change, with the dramatic and unprecedented fall in oil prices. But the Budget's main themes are those of its predecessors - the defeat of inflation, and the creation of an enterprise culture which will promote the growth of output and employment.

Economic Background: the effects of the oil price fall

2. Output in the world economy has been rising since early 1983 and inflation has been coming down since 1980. The fall in the oil price will be of particular help to oil-importing countries, both in the developed and the developing world. A period of low inflation and good growth in output and trade is in prospect. There are worrying problems associated with payments imbalances and external indebtedness. But the benefits to trade, output and inflation from the fall in oil prices should prove substantial.

3. At home, inflation, after the upward movement last year, is now down to 5½ per cent and is set to fall to below 4 per cent in a few months. Output continues to grow strongly. In 1985, the economy grew by 3½ per cent, faster than any other country in the European Community, and the United States. The UK is now about to enter its sixth year of growth at an average level of 3 per cent.

4. The pattern of growth remains broadly based. Manufacturing exporters have fully maintained their share of world trade - and a further 6 per cent growth in manufactured exports is forecast in 1986. Investment is expected to grow by about 5 per cent this year. On the balance of payments the forecast is for a current account surplus of £3½ billion.

5. Employment has continued to rise - around 600,000 more people in work since June 1983 - but unemployment remains stubbornly and disappointingly high.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

6. Because of the UK's position as a major oil producer, the oil price fall will help the major non-oil countries more than it will help us. There will be an adverse effect on our terms of trade, because we lose more from our export earnings than we gain from lower import prices. Government revenues will also be adversely affected. But there will be valuable benefits for the non oil economy, especially for manufacturing, with lower costs and higher profits. The increase in world trade which should follow lower oil prices will provide an excellent opportunity for British exporters. Overall there should be a net benefit on output and inflation.

Budget Strategy

7. The Government's Medium Term Financial Strategy (MTFS) is, as usual, extended one year forward in the Budget. It is designed steadily to reduce the growth of total spending power in the economy over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further economic growth. Target ranges are set for the growth of narrow and broad money in 1986-87, and the Government will continue in operating policy to have regard to a range of other evidence about monetary conditions - of which the most important is the exchange rate.

8. To support monetary policy the Government intends to keep public borrowing at a low level. The 1985-86 Public Sector Borrowing Requirement (PSBR) is expected to come out at around £7 billion or 2 per cent of GDP, the lowest level since 1971-72. This outcome was achieved in spite of the fall in oil revenues, because of restraint in public expenditure and the buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

9. Last year's MTFS indicated for 1986-87 oil revenues of £11½ billion, and scope for possible tax reductions of £3½ billion. Since then the outlook for the public finances has been substantially affected by the sharp fall in oil prices. Assuming the oil price remains at

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

$15 a barrel for the rest of 1986 and in 1987, oil revenues for 1986-87 are projected at £6 billion. But for the buoyancy in non oil revenues and the firm restraint on public spending, an increase in taxation would have been necessary in this year's Budget.

10. Last year's MTFS also indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP. The Government have decided to stick broadly to this figure, but, given the uncertainties over the oil price, to go a little below it and provide for a PSBR of £7 billion, or 1¾ per cent of GDP. That figure takes account of the Budget measures, which provide for a reduction in the burden of taxation of a little under £1 billion.

Help for the unemployed

11. The continuing high level of pay settlements is continuing to inhibit the growth of employment. In the longer term greater wage flexibility is essential for the creation of lasting jobs. This year, to add to the measures the Government has already taken to encourage such flexibility, and to encourage identification between employee and enterprise, the Government is to consider issuing a consultative document after preliminary discussions about a possible incentive scheme of tax relief to encourage special profit sharing schemes, in which at least 20 per cent of pay is directly linked to the success of the enterprise.

12. For the more immediate future, the measures announced in last year's Budget are still to show most of their effect. The expansion of the Youth Training Scheme to cover all 16 and 17 year olds comes into effect next month. The increase in the size of the Community Programme (which provides work of community benefit, for the long term unemployed) is going ahead fast. This year the Government is raising the target for expansion from 230,000 places by June 1986, to 255,000 by the end of 1986, compared with the present level of about 200,000 places.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

13. The long term unemployed will also benefit from the development of the pilot schemes, originally announced by the Secretary of State for Employment last year, into a single programme covering the whole country (Restart). As a result of this programme all the long term unemployed will be called for counselling interview; and offered help to find work; and those who take a job at less than £80 a week will receive a "Jobstart" £20 a week grant for 6 months.

14. In addition, the Enterprise Allowance Scheme is being expanded to an annual entry of 100,000 to give more unemployed people help to start their own business; and a new scheme - the New Workers Scheme - will provide a cash incentive to employers to create jobs for young people aged 18-20 at realistic wages.

15. The public expenditure cost of these and other changes will be £195 million in 1986-87 and £290 million in 1987-88. After allowing for social security savings, the net public expenditure cost will be £100 million and £165 million respectively. The cost will be charged to the public expenditure Reserve and so there will be no increase in the public spending planning total.

Taxes on Business and Enterprise

16. The Corporation Tax structure announced in 1984 comes fully into force this year with the main rate coming down to 35 per cent.

17. In addition, the Business Expansion Scheme which was due to come to an end in April 1987 will be extended indefinitely. It is already attracting substantial amounts of new equity capital into unquoted companies. A number of improvements to the Scheme are proposed, including measures to ensure that it is focussed on high risk investment. It will also be extended to certain forms of ship chartering.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

18. Small businesses will also benefit by the extension of the Loan Guarantee Scheme for three years, and the halving of the premium charged for the Government guarantee from 5 per cent to 2½ per cent. The abolition of the Capital Transfer Tax on gifts between individuals during their lifetime, will be a further help. The tax will be renamed the Inheritance Tax.

Savings and investment

19. The Budget includes a number of further measures to reform the taxation of savings and investment. There is to be a radical new scheme to encourage individuals to invest directly in equities. This scheme should, in time, bring about a further considerable extension of share ownership in Britain. Any adult will be able to invest up to £200 a month in shares. As long as the investment is kept in a special account - called the Personal Equity Plan - for a minimum period, all reinvested dividends and capital gains will be free of tax.

20. To retain its pre-eminence as a financial centre the City of London must remain fully competitive, world-wide. The ending of fixed commissions (the 'Big Bang') on 27 October will help reduce dealing costs. The Budget gives further help, by halving the rate of Stamp Duty on share transactions. The cost will be recouped by bringing into tax a range of transactions which are at present entirely free of Stamp Duty.

21. The present rules relating to pension fund surpluses will be clarified. Where a refund is made, under the new arrangements, to employers they will be subject to tax at 40%.

Charities

22. A number of specific concessions will be made, relieving charities from VAT in respect of certain purchases. The Government has decided to supplement the measures it has already taken to assist charities with a substantial new package, directed towards charitable giving rather than towards the charities themselves. By

- abolishing the upper limit on relief at higher rates of income for convenants

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

- allowing tax relief to companies for one-off gifts up to a maximum of 3 per cent of dividends
- providing relief to individuals for regular gifts of up to £100 a year to charity where these are deducted at source by their employers

the Budget should stimulate additional charitable giving of about £120 million a year - at least twice the cost to the Exchequer of these measures.

Taxes on Spending

23. Overall, excise duties will be increased by about the same amount as would be required to keep pace with inflation. Petrol and derv duties will be increased by rather more than this - by 7½p a gallon and 6½p respectively. Given the recent increase in oil companies' profit margins these increases need not be passed on to the consumer. The real tax burden on the motorist will be kept unchanged, with no general increase in Vehicle Excise duty on cars and lorries. In recognition of the dangers to health cigarettes and hand rolling tobacco will be increased by the equivalent of just over 11p a packet of 20 king size. Cigars and pipe tobacco duties will not be changed. There will be no increase in the duties on any alcoholic drinks. This should help with the difficulties currently faced by the Scotch whisky industry.

24. No major changes are proposed in VAT (apart from the changes in relation to charities.)

Income Tax

25. As foreshadowed in the Budget Statement last year, the Government has published a Green Paper on personal taxation discussing options. In particular, it outlines a possible reform (made possible by computerisation) of the system of income tax personal allowances. Everyone would have a tax allowance in his or her own right. A husband and wife would be taxed independently, but would be able to transfer unused allowances to each other.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

Married women would have the opportunity of privacy in their tax affairs; the tax penalties on marriage would be removed; and more tax relief would go to couples at the point when they are most likely to need it, when one of the partners is not in paid work.

26. The Government is making further reductions in income tax, in order to increase incentives. Since 1979, allowances have been increased by 22 per cent in real terms so that they are now higher, as a proportion of average earnings than, for example, in Germany or the United States. This year, basic allowances are increased in line with prices and the basic rate of income tax is reduced by 1 penny - improving incentives for the 95 per cent of employees, and for the 90 per cent of all self-employed people and unincorporated businesses, for whom the basic rate is also the marginal rate. This is the first cut in the basic rate for seven years. The new basic rate will be 29p in the £. There will be a comparable change in the small firms Corporation Tax rate.

Summary

27. The Budget maintains the Government's strategy to defeat inflation and to create the conditions for further growth of output and employment. The overall burden of taxation is being reduced. Specific measures will be taken to help the unemployed; to promote enterprise and initiative; to reform the taxation of savings, and investment; and to increase charitable giving.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

COVERING BUDGET SECRET
BUDGET LIST ONLY

F30

COPY NO 4 OF 10 COPIES

FROM: R PRATT
DATE: 14 MARCH 1986

MR EVANS
MR RILEY
MRS BUTLER

cc Principal Private Secretary
PS/Sir Peter Middleton
Mr Odling-Smee
Mr Scholar
Mr Turnbull
Mr S Davies

FSBR CHARTS

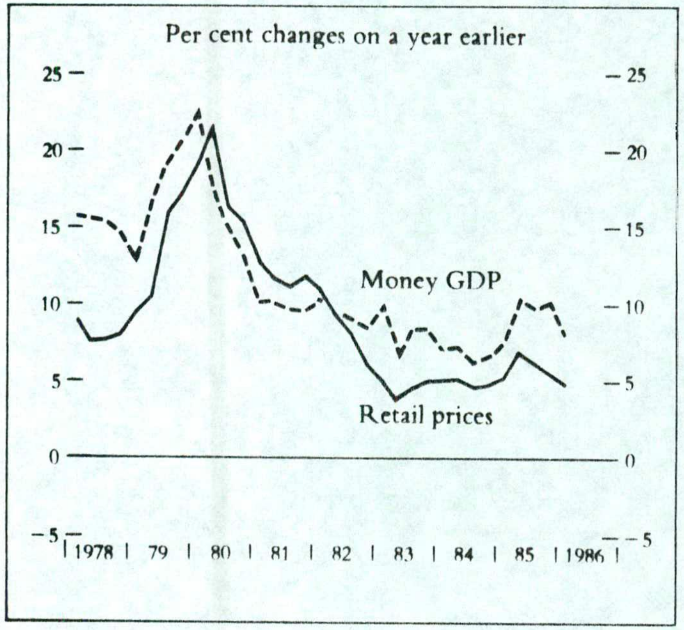
I attach copies of all the charts ~~(with one exception, see below)~~ as they have now been drawn by the CSO.

~~2. The only exception is chart 3.6 (UK export share). A copy of this will be submitted later on this evening.~~

Richard Pratt

RICHARD PRATT

Chart 2.1 Money GDP output and inflation



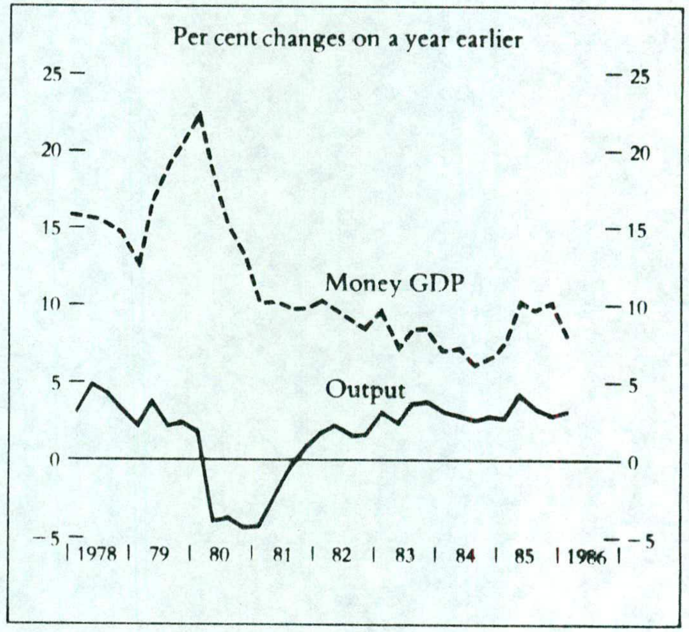


Chart 2.2 Monetary growth

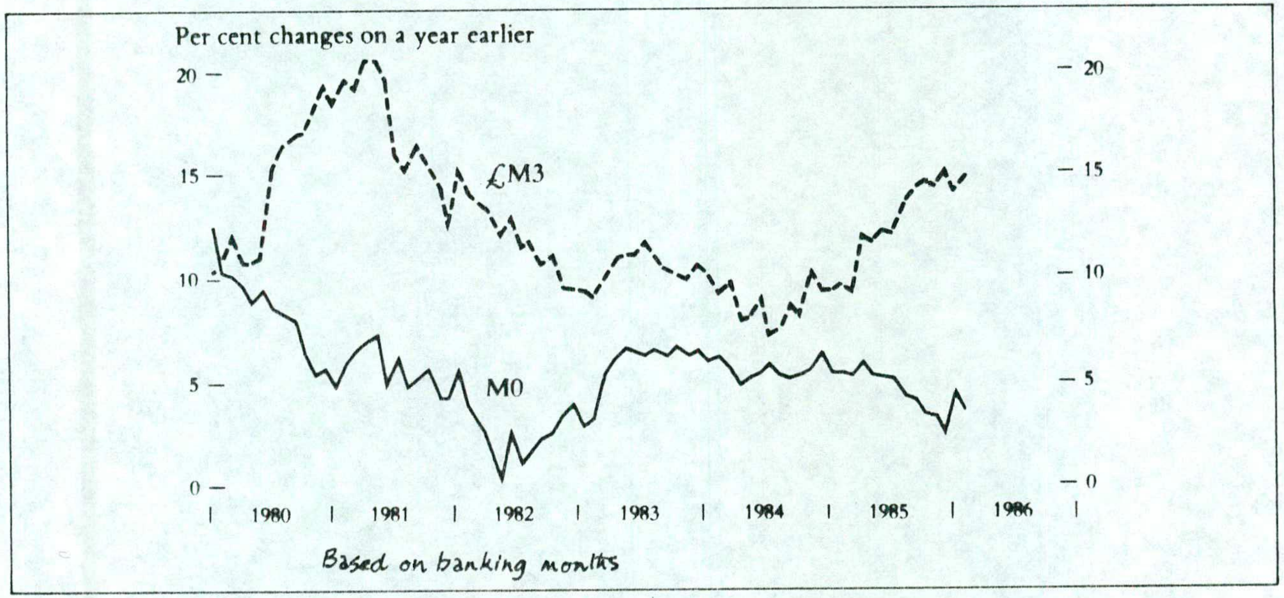


Chart 2.3 Velocity of the monetary aggregates

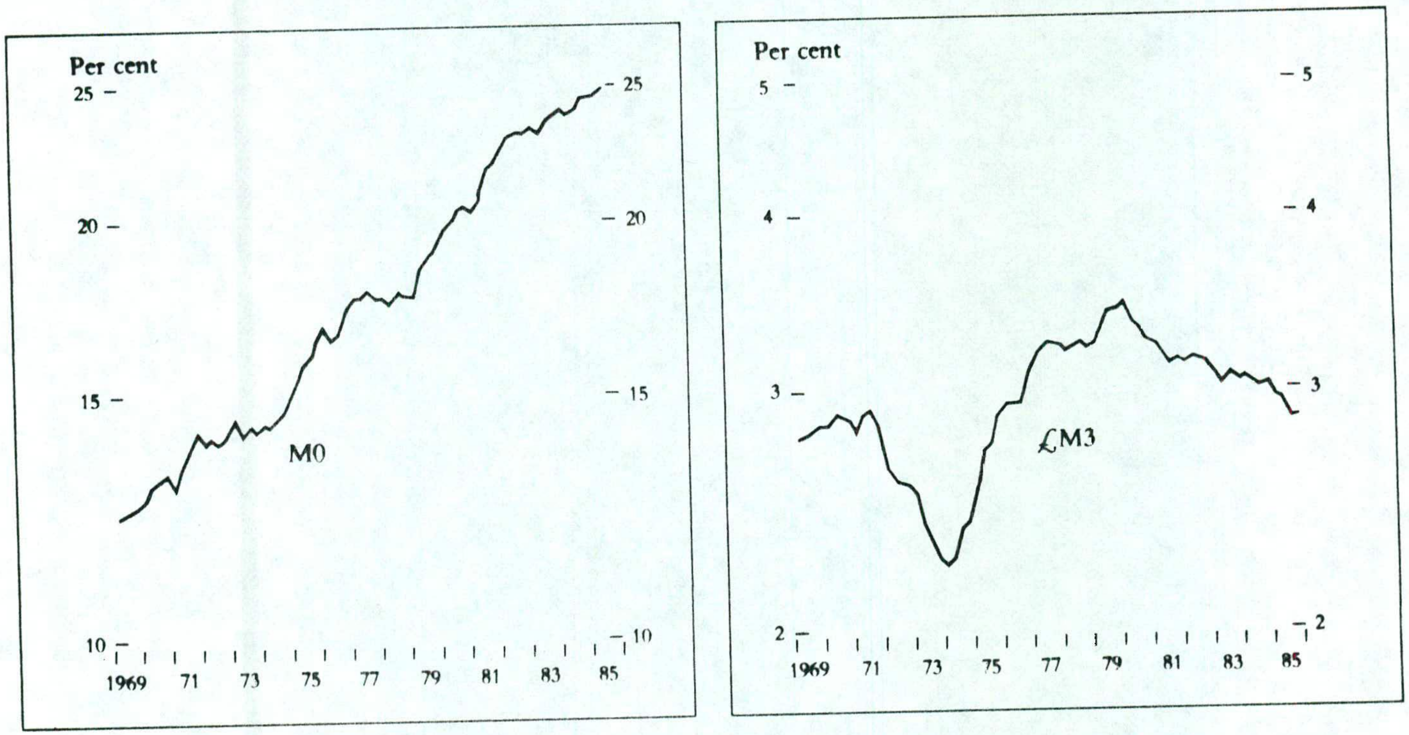


Chart 2.4 Public sector borrowing requirement

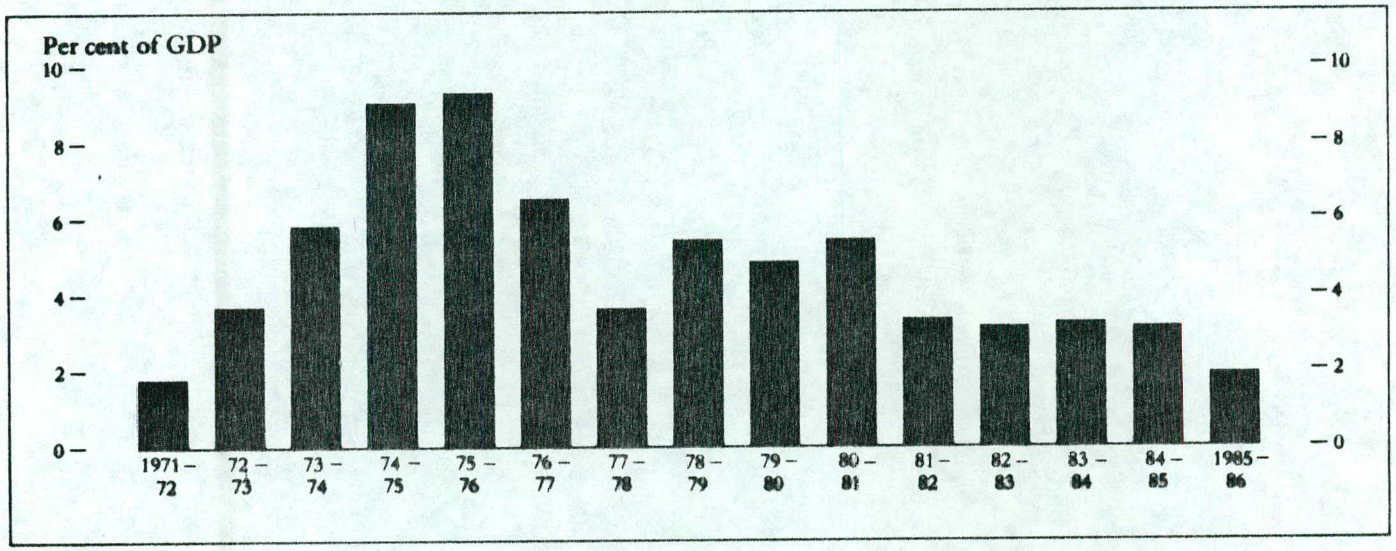


Chart 3.1 Commodity prices

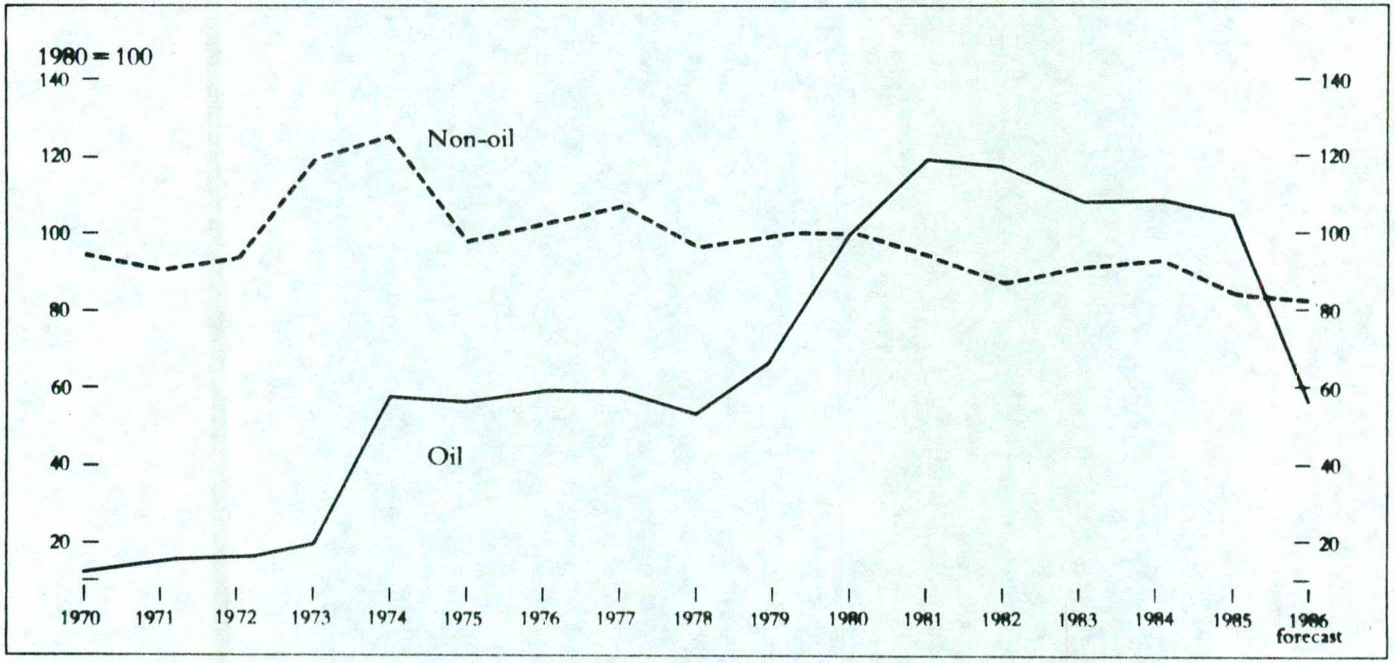


Chart 3.2 Oil Production

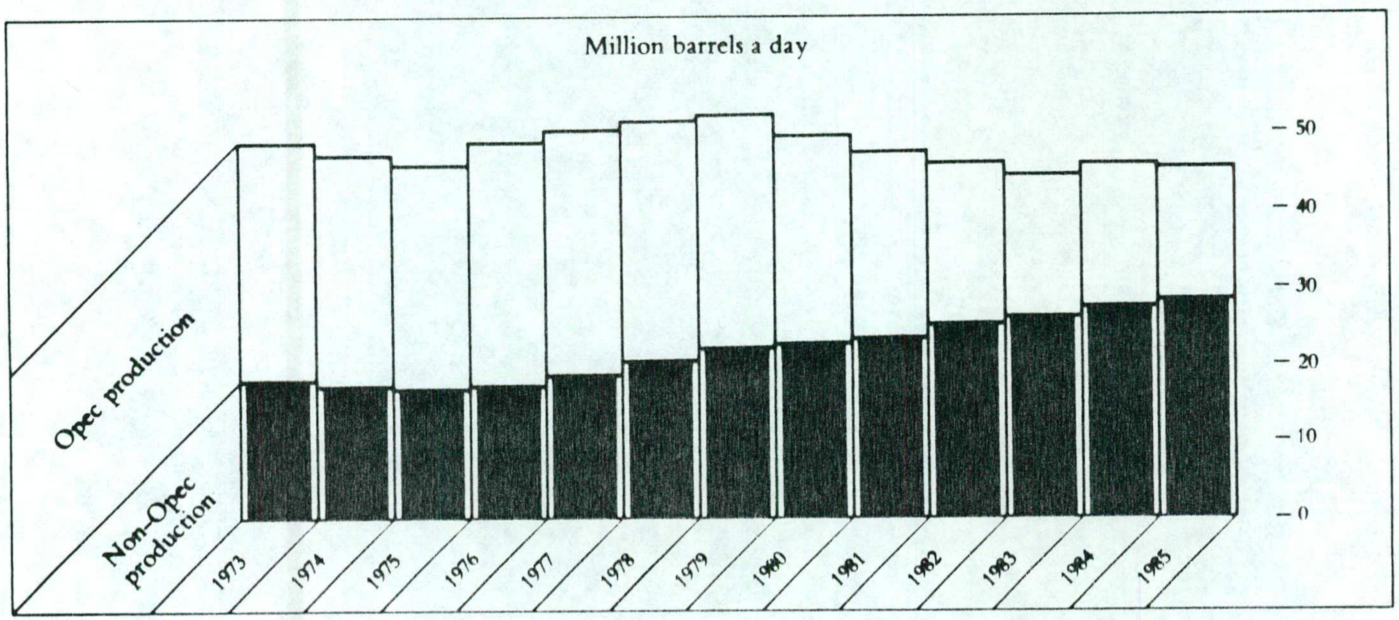


Chart 3.3 Growth and inflation

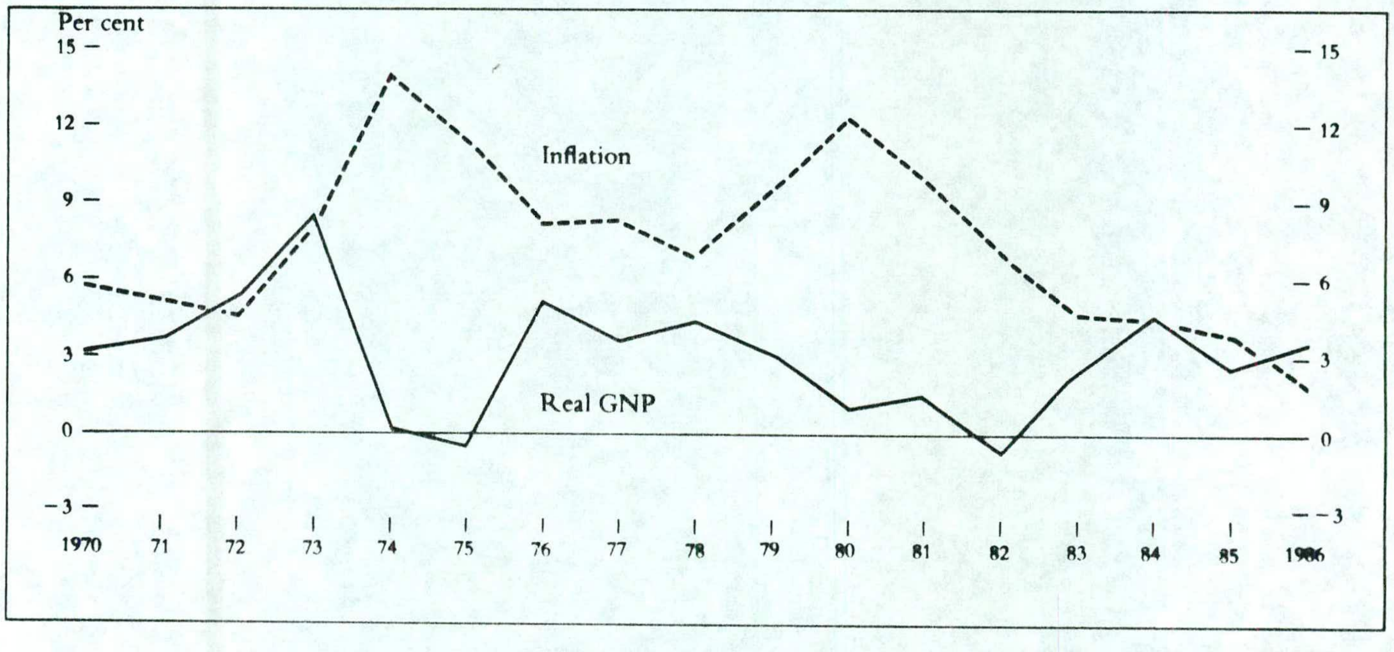


Chart 3.4 Sterling exchange rates

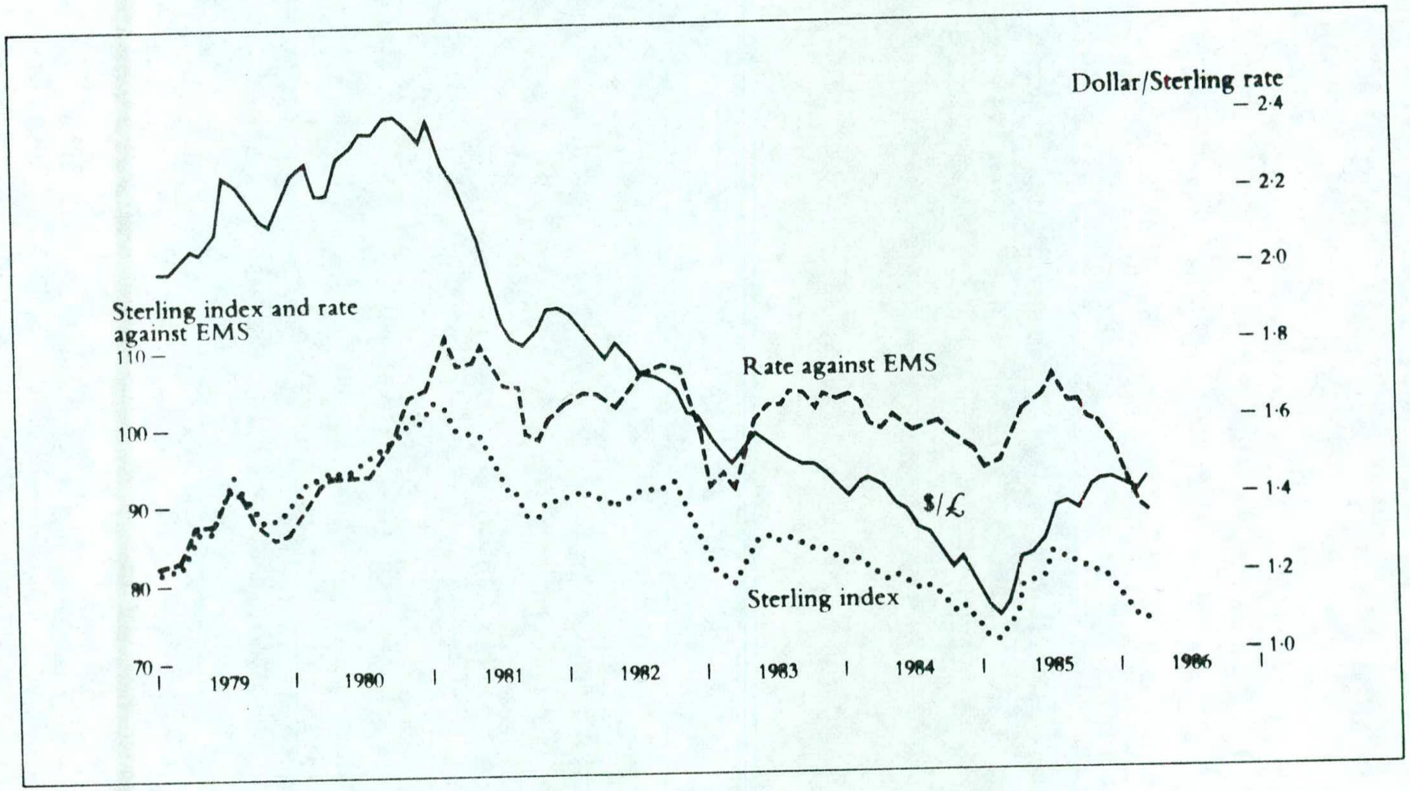


Chart 3.4 Sterling exchange rates

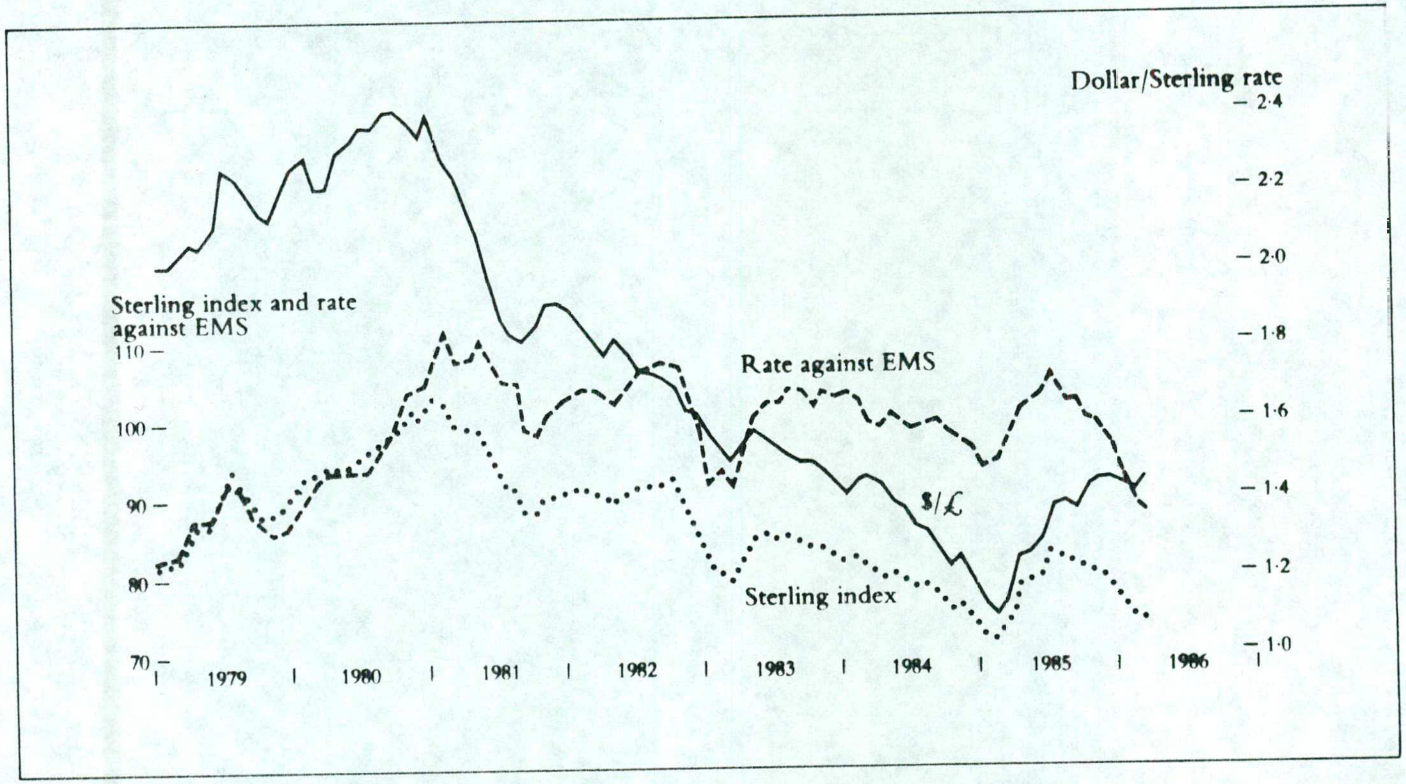


Chart 3.5 Interest rates in the UK

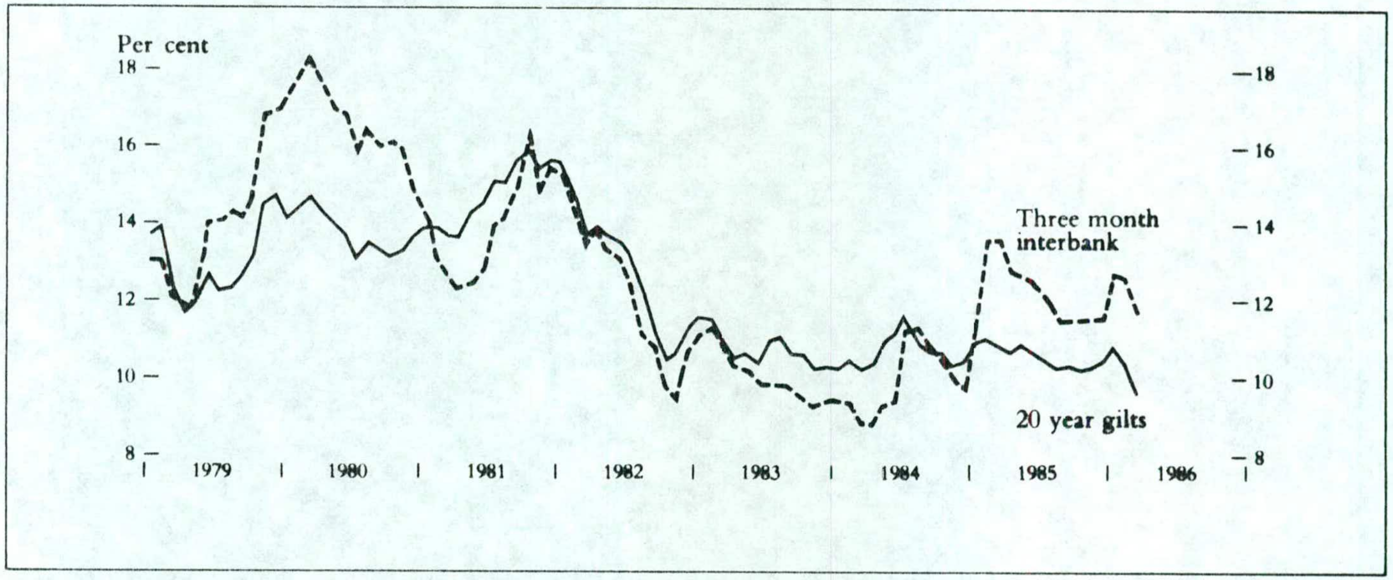


Chart 3.7 The current account of the Balance of payments

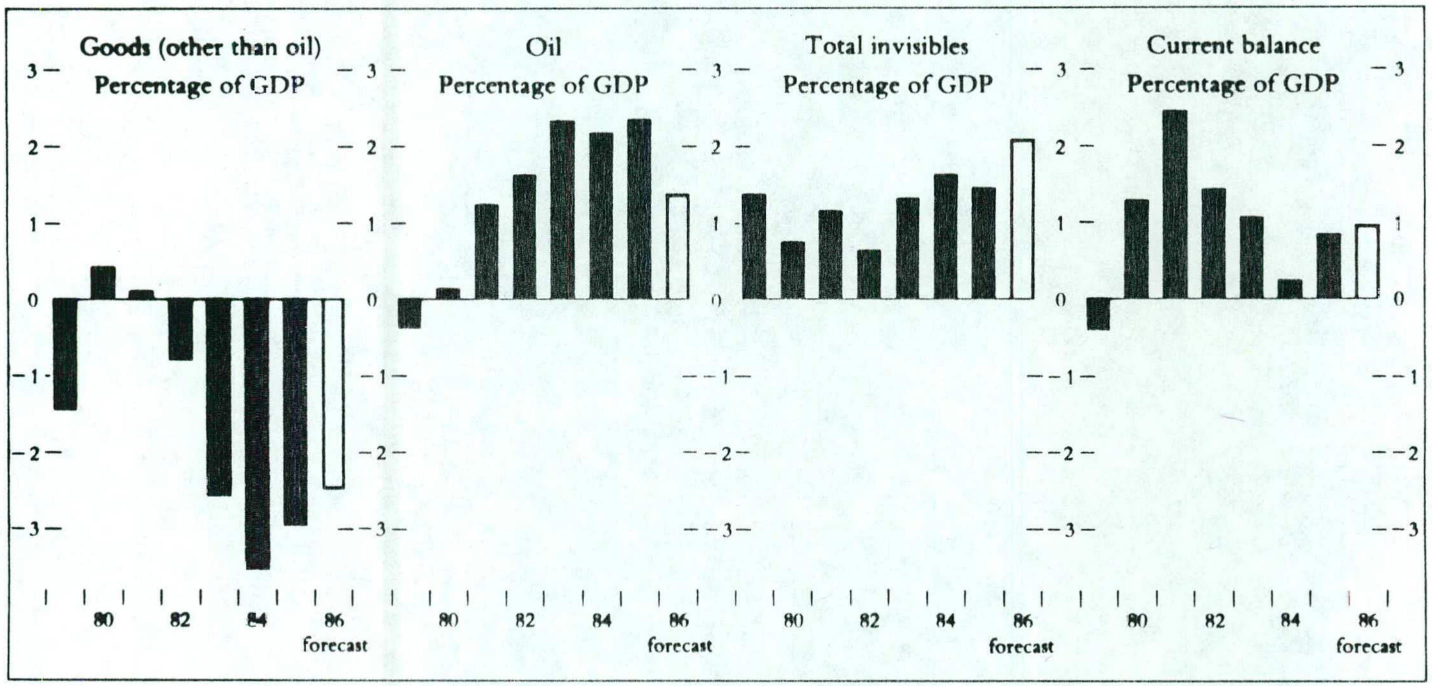


Chart 3-8 Unit labour costs in manufacturing

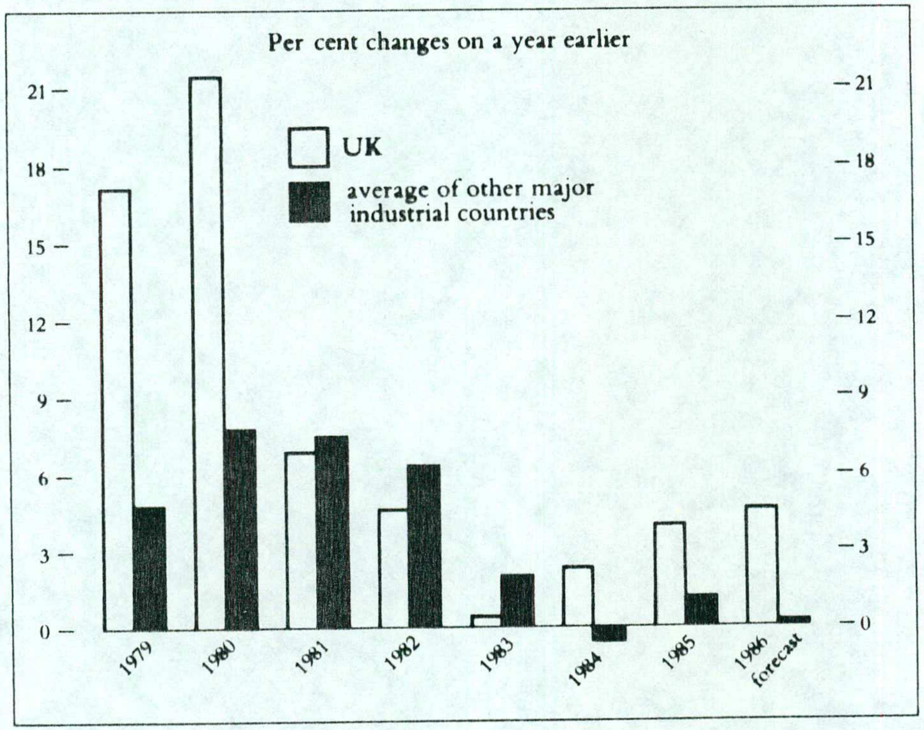


Chart 3.9 Gross domestic product

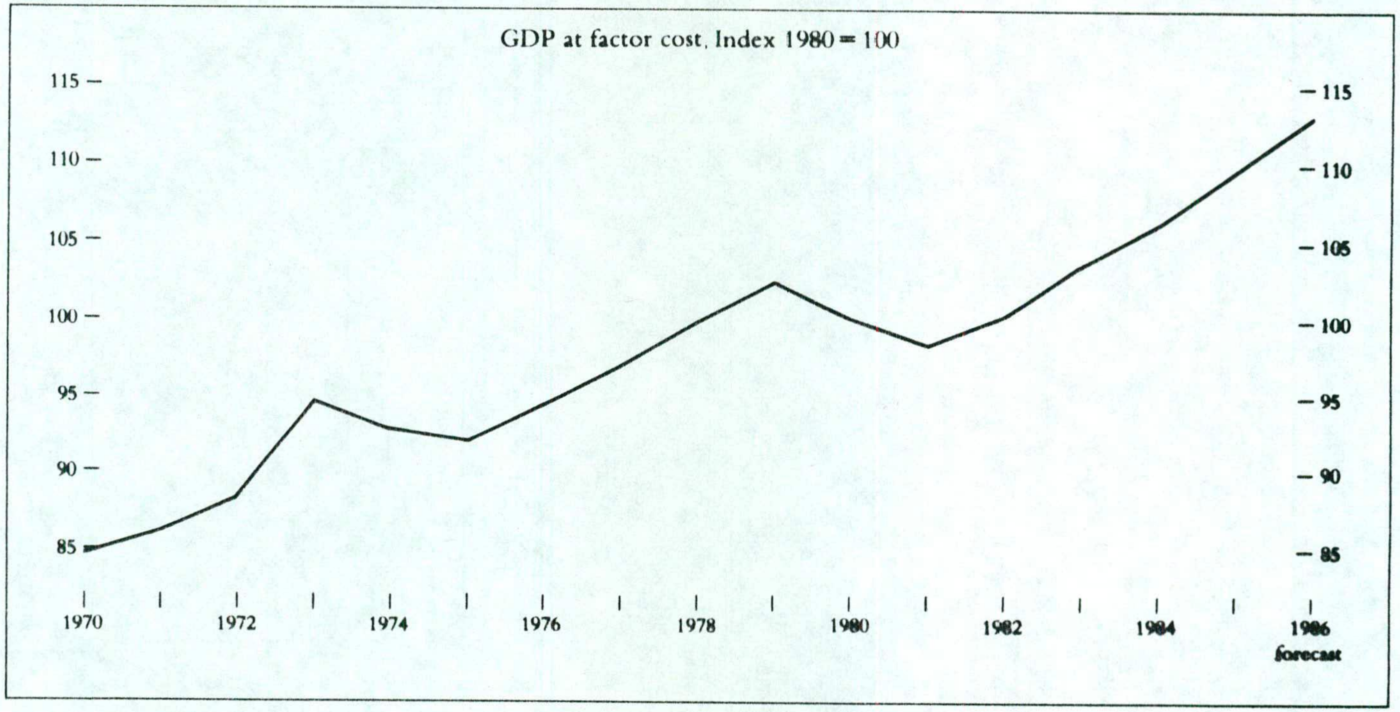


Chart 3.10 Personal income and expenditure

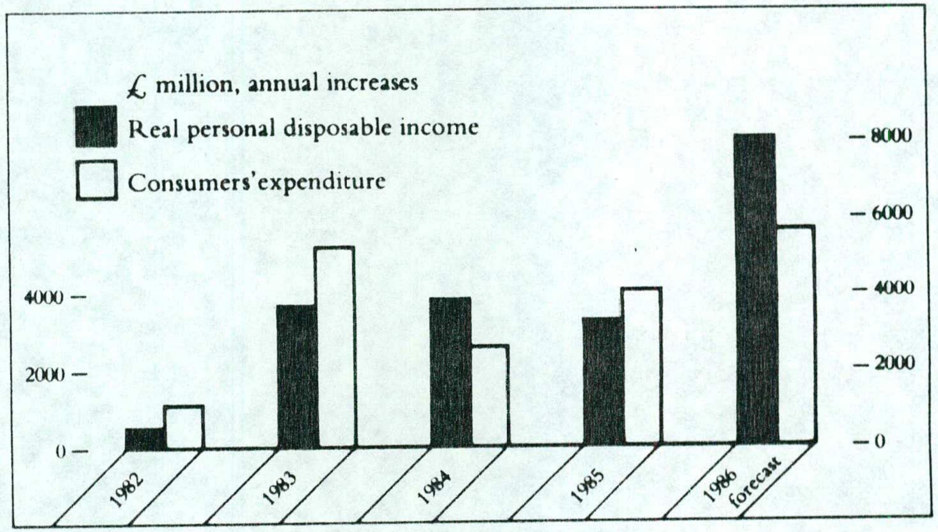


Chart 3.11 Real rate of return ICCs

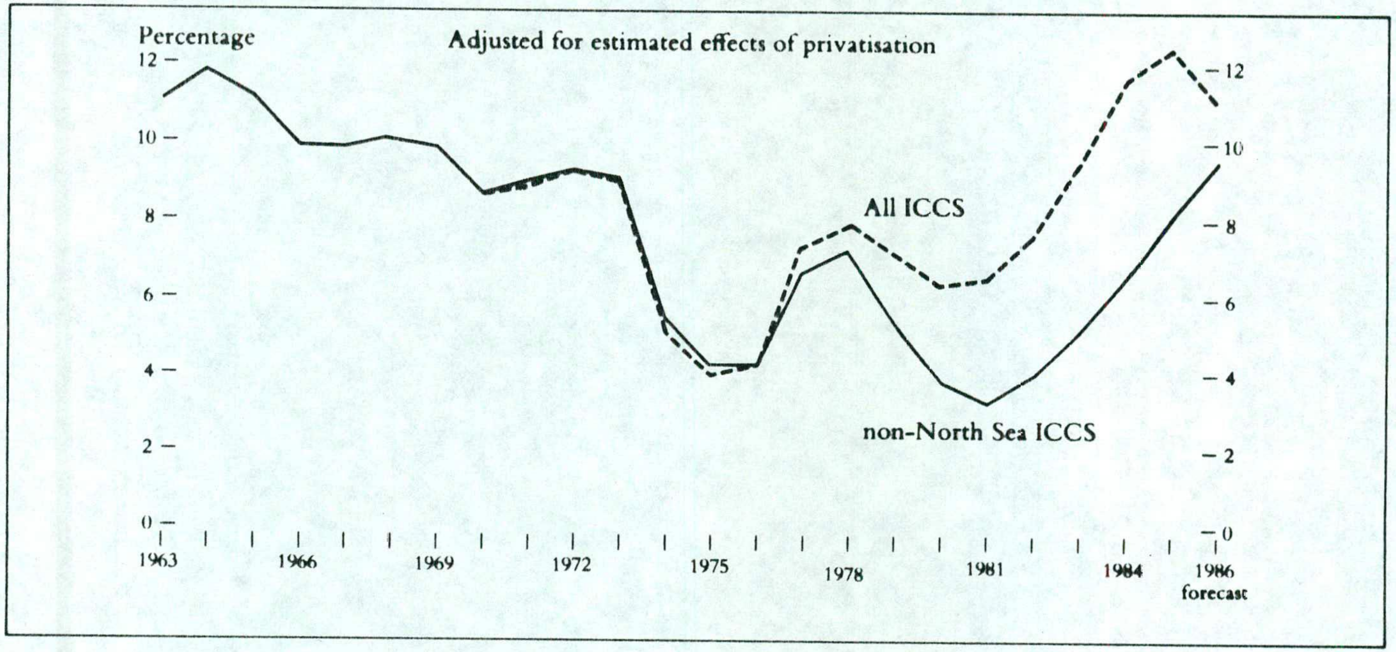


Chart 3.12 Stock ratios

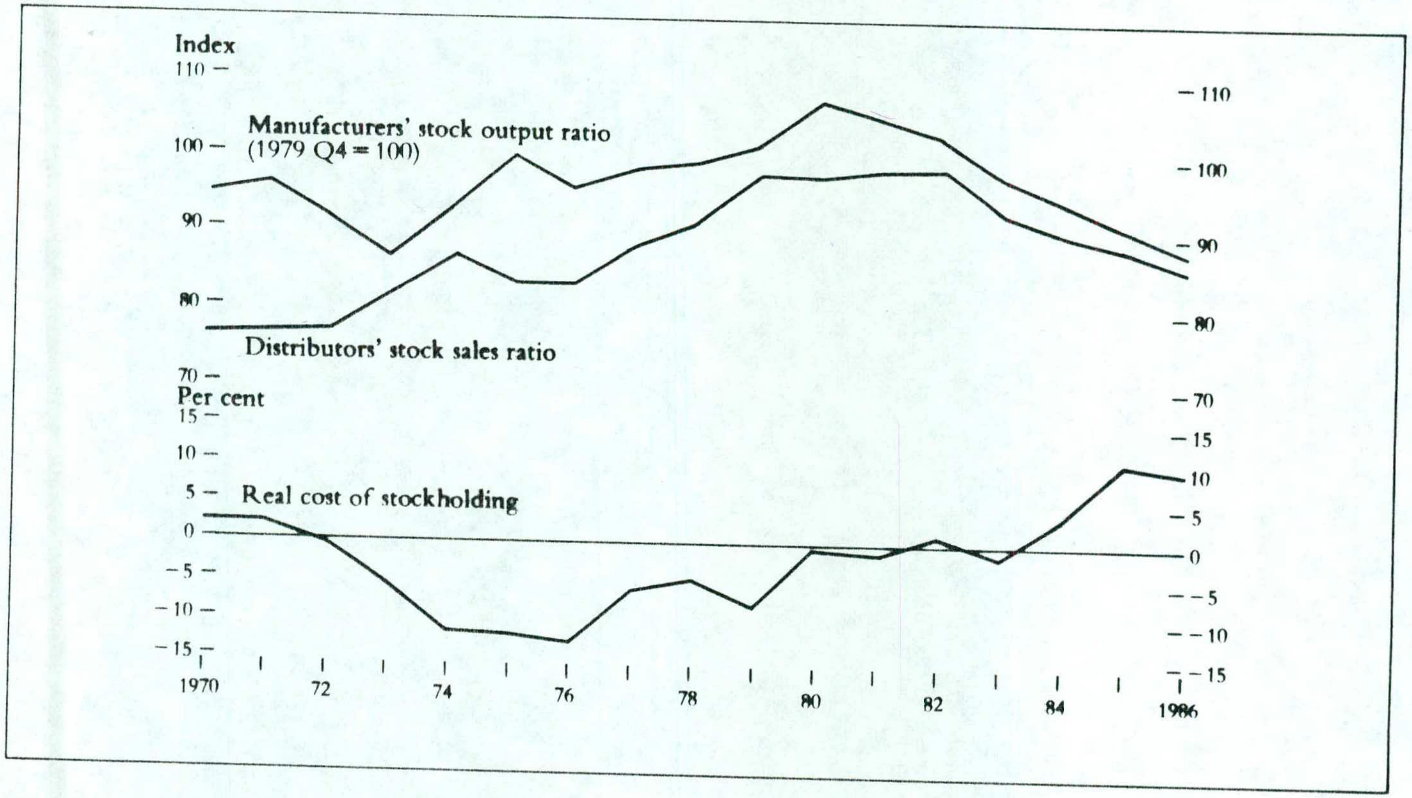


Chart 3.13 Output employment and output per head

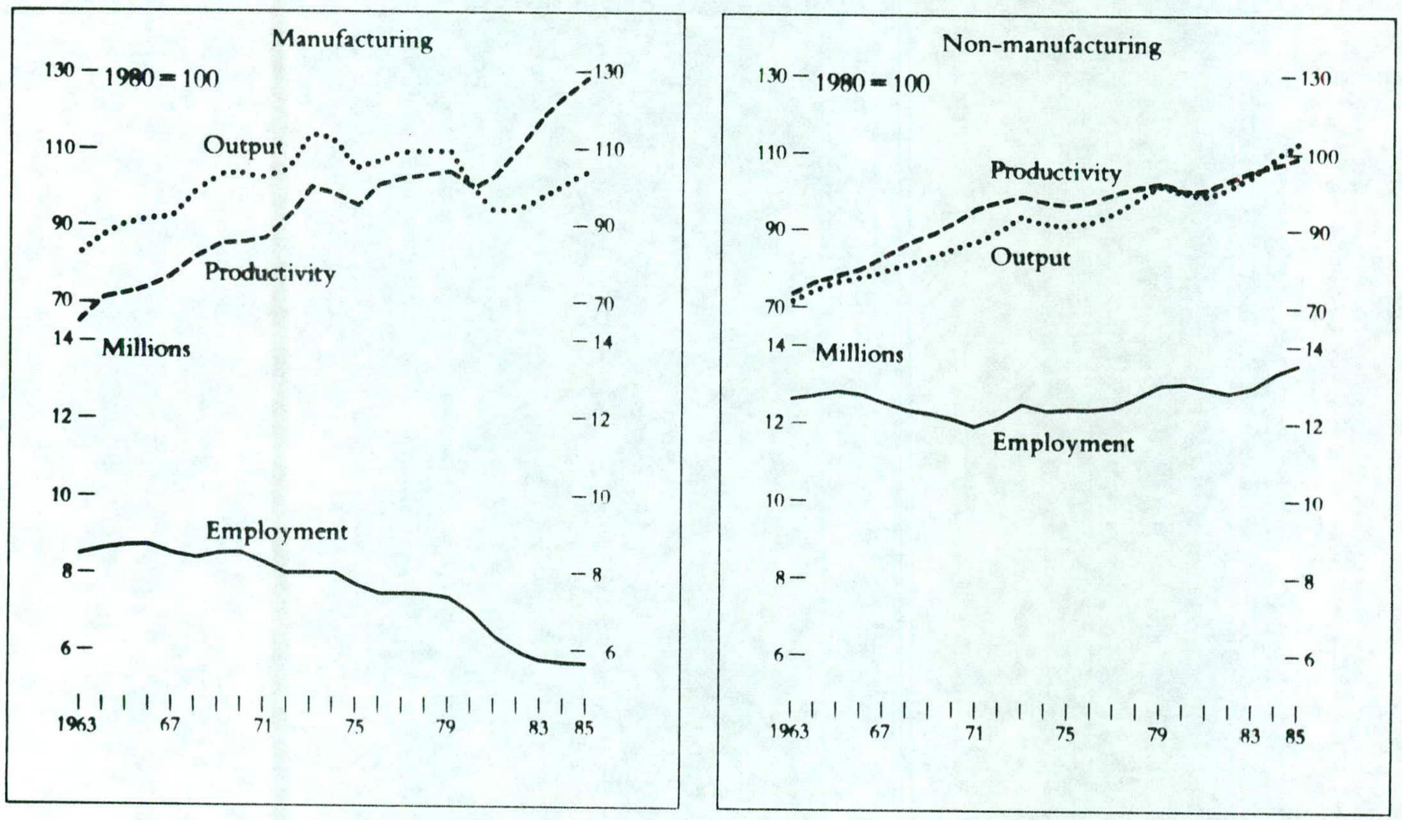


Chart 5.1 Trends in public expenditure

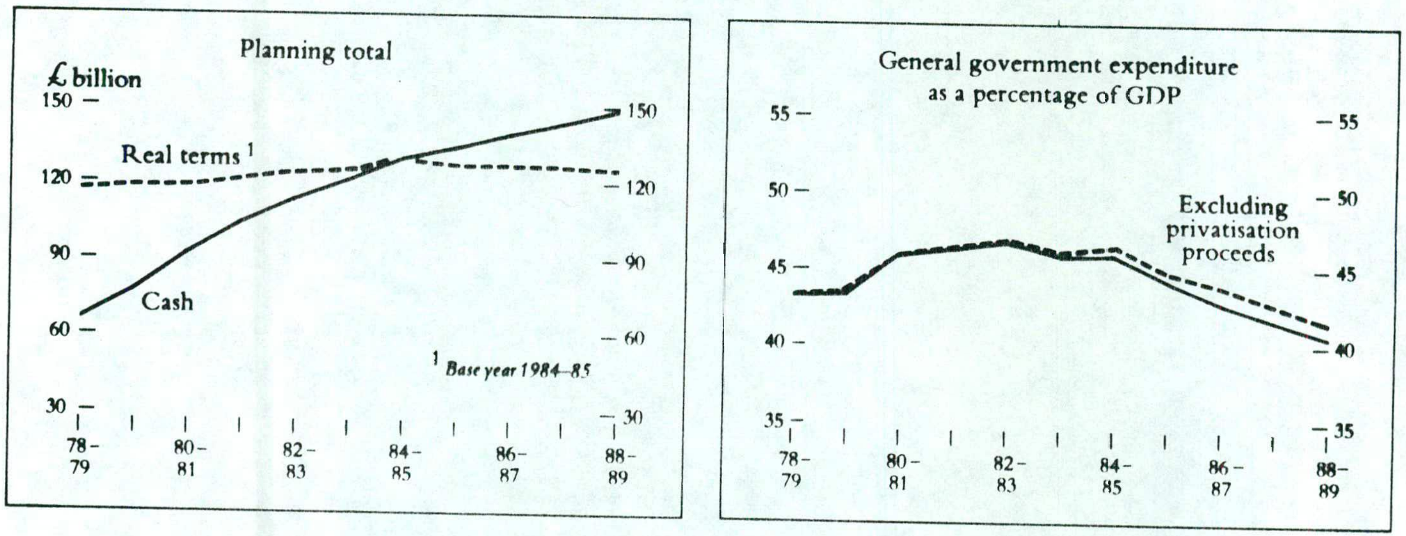
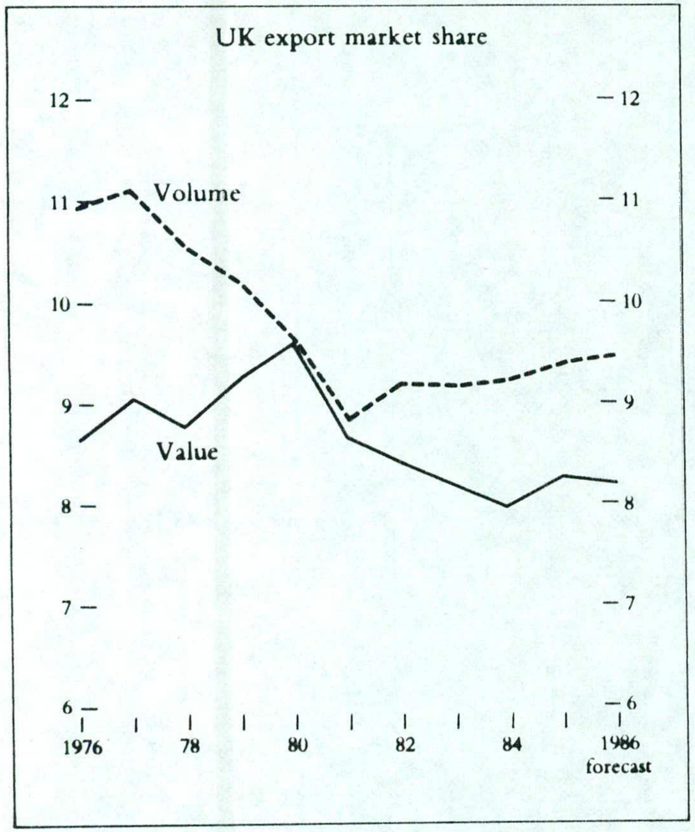
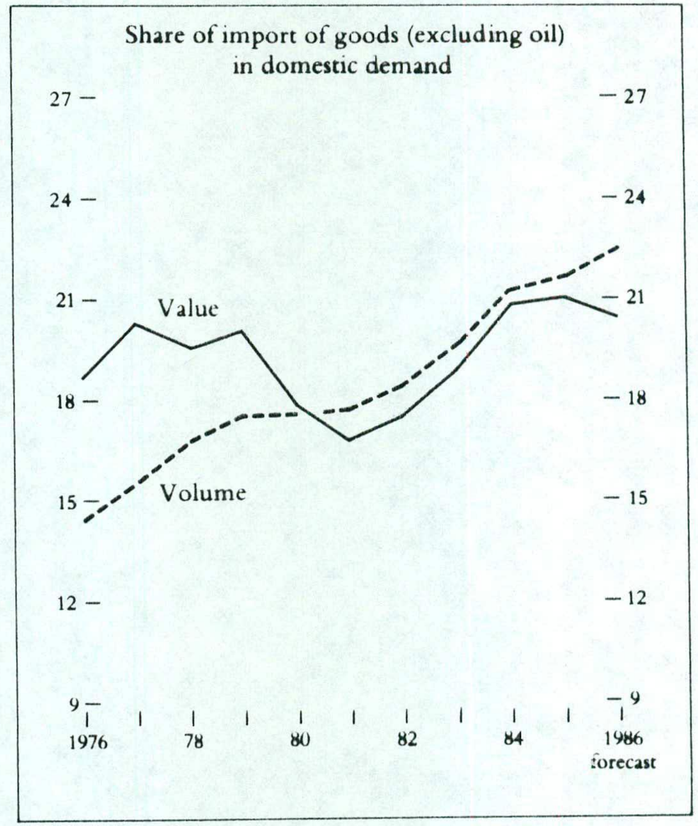


Chart 3.6 UK export share





F35

FROM: M C SCHOLAR
DATE: 14 March 1986

* Get last year's & on year before's.

CHANCELLOR

cc: Sir P Middleton
Mr Pratt

BUDGET SUMMARY FOR THE QUEEN

I have revised the draft Budget summary which I submitted to you on Wednesday evening in the light of your comments, passed on to me orally by Mrs Lomax. The new draft makes rather more than the last draft did of oil, the basic rate cut, charities, the personal equity plan, and the continuing pre-eminence of the City following the Stamp Duty package .

2. If you are content with this summary it can, I suggest, also serve as the guidance telegram on the Budget we send out to overseas posts.

MCS

M C SCHOLAR

I have amended.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

~~BUDGET SUMMARY FOR THE QUEEN~~

1986 BUDGET: SUMMARY OF MAIN POINTS

This year's Budget comes at a time of great change, with the dramatic and unprecedented collapse of the ~~fall in~~ oil prices. But the Budget's main themes are those of its predecessors - the defeat of inflation, and the creation of an enterprise culture which will promote the growth of output and employment.

Economic Background: the effects of the oil price fall

2. Output in the ~~world~~ economy has been rising since early 1983 and World inflation has been coming down since 1980. The fall in the oil price will be of particular help to oil-importing countries, both in the developed and the developing world. A period of low inflation and good growth in output and trade is in prospect. ~~There are worrying problems associated with payments imbalances and external indebtedness. But the benefits to trade, output and inflation from the fall in oil prices should prove substantial.~~

3. At home, inflation, after the temporary upward movement last year, is now down to 5½ per cent and is set to fall to below 4 per cent within the next ~~in a~~ few months. Output continues to grow strongly. In 1985, the UK economy grew by 3½ per cent, faster than any other country in the European Community, and faster than the United States, too. ~~The UK~~ We are now about to enter ~~its~~ our sixth successive year of growth at an average level of 3 per cent.

4. The pattern of growth remains broadly based. Manufacturing exporters have fully maintained their share of world trade - and a further 6 per cent growth in manufactured exports is forecast in 1986. Investment is expected to grow by about 5 per cent this year. On the balance of payments the forecast is for a current account surplus of £3½ billion.

5. Employment has continued to rise - there are around 600,000 more people in work than in ~~since~~ June 1983 - but unemployment remains stubbornly and disappointingly high.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

6. Because of the UK's position as a major oil producer, the oil price fall will help ~~the~~ most other major ~~non-oil~~ industrial countries more than it will help us. There will also be an adverse effect on our terms of trade, because we lose more from our export earnings than we gain from lower import prices, and inevitably the Government's ~~revenues~~ oil revenues will ~~also be adversely affected~~ be sharply reduced. Against this, But there will be valuable benefits for the non oil economy, especially for manufacturing, with lower costs and higher profits. The increase in world trade which should follow lower oil prices will provide an excellent opportunity for British exporters. Overall there should be a modest net benefit to Britain in terms of ~~on~~ output and inflation.

<u>**Budget Strategy**</u>

7. The Government's Medium Term Financial Strategy (MTFS) is~~, as usual,~~ extended ~~one year forward~~ for a further year, to 1989-90, in the Budget. It is designed steadily to reduce the growth of total spending power in the economy over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further sustained economic growth. Target ranges are set for the growth of narrow and broad money in 1986-87, and the Government will continue in operating policy to have regard to a range of other evidence about monetary conditions - of which the most important is the exchange rate.

8. To support monetary policy the Government intends to keep public borrowing at a low level. The 1985-86 Public Sector Borrowing Requirement (PSBR) is expected to come out at ~~around~~ a little under £7 billion or 2 per cent of GDP, the lowest level since 1971-72. This outcome was achieved in spite of the fall in oil revenues, because of restraint in public expenditure and the buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

9. Last year's MTFS indicated for 1986-87 oil revenues of £11½ billion, and scope for possible tax reductions of £3½ billion. Since then the outlook for the public finances has been substantially affected by the sharp fall in oil prices. Assuming the oil price ~~remains~~ [illegible] at

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

averages

$15 a barrel for the rest of 1986 ~~and in 1987~~, oil revenues for 1986-87 are projected at £6 billion. But for the buoyancy in non-oil revenues and ~~the~~ firm restraint on public spending, ~~an~~ a significant increase in taxation would have been necessary in this year's Budget.

10. Last year's MTFS also indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP. ~~The Government have~~ The Chancellor has decided to stick broadly to this figure, but, given the uncertainties over the oil price, to go a little below it and provide for a PSBR of £7 billion, or 1¾ per cent of GDP. That figure takes account of the Budget measures, which provide for a reduction in the real burden of taxation of a ~~little~~ slightly under £1 billion.

Help for the unemployed

11. The continuing high level of pay settlements is continuing to inhibit the growth of employment. In the longer term greater wage flexibility is essential for the creation of lasting jobs. This year, to add to the measures the Government has already taken to encourage such flexibility, and to encourage identification between employee and enterprise, the Government is to consider issuing a consultative document, ~~after~~ if preliminary discussions on satisfactory, about a possible incentive scheme of tax relief to encourage ~~special~~ profit sharing schemes, in which ~~at least 20 per cent of~~ total pay is directly ~~linked to~~ affected by the success of the enterprise.

12. For the more immediate future, the measures announced in last year's Budget are still to show most of their effect. The expansion of the Youth Training Scheme to cover all 16 and 17 year olds comes into effect next month. The increase in the size of the Community Programme (which provides work of community benefit, for the long term unemployed) is going ahead fast. This year the Government is raising the target for expansion from 230,000 places by June 1986, to 255,000 by the end of 1986, compared with the present level of about 200,000 places.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

13. The long term unemployed will also benefit from the development of the pilot schemes, originally announced by the Secretary of State for Employment last year, into a single programme covering the whole country (Restart). As a result of this programme all the long term unemployed will be called for counselling interviews and offered help to find work; and those who take a job at less than £80 a week will receive a "Jobstart" £20 a week grant for 6 months.

14. In addition, the Enterprise Allowance Scheme is being expanded to an annual entry of 100,000 to give more unemployed people help to start their own business; and a new scheme - the New Workers Scheme - will provide a cash incentive to employers to create jobs for young people aged 18-20 at realistic wages.

15. The public expenditure cost of these and other changes will be £195 million in 1986-87 and £290 million in 1987-88. After allowing for social security savings, the net public expenditure cost will be £100 million and £165 million respectively. The cost will be charged to the public expenditure Reserve and so there will be no increase in the public spending planning total.

Taxes on Business and Enterprise

16. The Corporation Tax structure announced in 1984 comes fully into force this year with the main rate coming down to 35 per cent.

17. In addition, the Business Expansion Scheme which was due to come to an end in April 1987 will be extended indefinitely. It is already attracting substantial amounts of new equity capital into unquoted companies. A number of improvements to the Scheme are proposed, including measures to ensure that it is genuinely focussed on high risk investment. It will also be extended to certain forms of UK ship chartering.

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

18. Small businesses will also benefit by the extension of the Loan Guarantee Scheme for three years, and the halving of the premium charged for the Government guarantee from 5 per cent to 2½ per cent. The abolition of the Capital Transfer Tax on gifts between individuals during their lifetime, will be a further help to family businesses. The tax will be renamed the Inheritance Tax.

Savings and investment

19. The Budget includes a number of further measures to reform the taxation of savings and investment. There is to be a radical new scheme to encourage individuals to invest directly in equities. This scheme should, in time, bring about a further considerable extension of share ownership in Britain. Any adult will be able to invest up to £200 a month in shares. As long as the investment is kept in a special account - called the Personal Equity Plan - for a relatively short minimum period, all reinvested dividends and capital gains will be free of tax.

20. To retain its international pre-eminence as a financial centre the City of London must ~~remain~~ be fully competitive, world-wide. The ending of fixed commissions (the 'Big Bang') on 27 October will help reduce dealing costs. ~~The Budget gives further help, by halving the rate of Stamp~~ But the Chancellor has concluded that to meet successfully the mounting direct competition from New York and Tokyo, it is necessary to reduce from 1% to ½% the Stamp Duty on share transactions. The cost will be recouped by bringing into tax a range of financial transactions which are at present entirely free of Stamp Duty.

21. The present rules relating to pension fund surpluses will be clarified. Where a refund is made, under the new arrangements, to employers they will be subject to tax at 40%.

Charities

22. A number of specific concessions will be made, relieving charities from VAT in respect of certain purchases. In addition, The Government has decided to supplement the measures it has already taken to assist charities with a substantial new package, directed towards charitable giving rather than towards the charities themselves. By

- abolishing the upper limit on relief at higher rates of income for convenants

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

- allowing tax relief to companies for one-off gifts up to a maximum of 3 per cent of dividends
- providing relief to individuals for regular gifts of up to £100 a year to charity where these are deducted at source by their employers

the Budget should eventually stimulate additional charitable giving by probably ~~of about £120 million a year - at least~~ twice the cost to the Exchequer of these measures.

£70 million

Taxes on Spending

23. Overall, excise duties will be increased by ~~about~~ the same amount as would be required to keep pace with inflation. Petrol and derv duties will be increased by rather more than this - by 7½p a gallon and 6½p respectively. Given the recent increase in oil companies' profit margins these increases should ~~need~~ not be passed on to the consumer. The real tax burden on the road user ~~motorist~~ will be kept unchanged, with no general increase in Vehicle Excise duty on cars and lorries. In recognition of the dangers to health cigarettes and hand rolling tobacco will be increased by the equivalent of just over 11p a packet of 20 king size. Cigars and pipe tobacco duties will not be changed. There will be no increase in the duties on any alcoholic drinks. This should help with the difficulties currently faced by the Scotch whisky industry.

24. No major changes are proposed in VAT. ~~(apart from the changes in relation to charities.)~~

Income Tax

25. As foreshadowed in the Budget Statement last year, the Government has published a Green Paper on personal taxation discussing options. In particular, it outlines a possible reform (made possible by computerisation) of the system of income tax personal allowances. Everyone would have a basic tax allowance in his or her own right. A husband and wife would be taxed independently, but would be able to transfer unused allowances to each other.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Married women would (for the first time) have the opportunity of privacy in their tax affairs; the tax penalties on marriage would be removed; and more tax relief would go to couples (earlier) at the point when they are most likely to need it, when ~~one of the partners is not in paid work.~~ the wife gives up paid work to start a family.

26. The Government is making further reductions in income tax, in order to increase incentives. Since 1979, allowances have been increased by 22 per cent in real terms so that they are now higher, as a proportion of average earnings than, for example, in Germany or the United States. This year, basic allowances are increased in line with prices and the basic rate of income tax is reduced by 1 penny - improving incentives for the 95 per cent of employees, and for the 90 per cent of all self-employed people and unincorporated businesses, for whom the basic rate is also the marginal rate. This is the first cut in the basic rate for seven years. The new basic rate will be 29p in the £. There will be a comparable change in the small firms Corporation Tax rate.

Summary

27. The Budget maintains the Government's strategy to defeat inflation and to create the conditions for further growth of output and employment. The overall burden of taxation is being modestly reduced. Specific measures will be taken to help the unemployed; to promote enterprise and initiative; to reform the taxation of savings, and investment; and to increase charitable giving.

HM Treasury
17 March 1986

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

F33

JT

276/008

COPY NO / OF 5

FROM: M C SCHOLAR
DATE: 17 March 1986

MR FRAY (Chancellors office)

cc: Sir G Littler
Mrs Lomax (minute only)
Mr Kuczys "

1986 BUDGET: GUIDANCE FOR OVERSEAS POSTS

I have amended the guidance I submitted to the Chancellor on Friday evening in accordance with his comments, and made the slight adaptations necessary to make it suitable to be a telegram to overseas posts.

2. This is attached, and you are to hand it over to the Foreign Office when the Chancellor sits down tomorrow.

MCS

M C SCHOLAR

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BSQ

1986 BUDGET: SUMMARY OF MAIN POINTS

This year's Budget comes at a time of great change, with the dramatic and unprecedented collapse of the oil price. But the Budget's main themes are those of its predecessors - the defeat of inflation, and the creation of an enterprise culture which will promote the growth of output and employment.

Economic Background: the effects of the oil price fall

2. Output in the world economy has been rising since early 1983 and world inflation has been coming down since 1980. The fall in the oil price will be of particular help to oil-importing countries, both in the developed and the developing world. A period of low inflation and good growth in output and trade is in prospect.

3. At home, inflation, after the temporary upward movement last year, is now down to 5½ per cent and is set to fall to below 4 per cent within the next few months. Output continues to grow strongly. In 1985, the UK economy grew by 3½ per cent, faster than any other country in the European Community, and faster than the United States, too. The UK is now about to enter its sixth successive year of growth at an average level of 3 per cent.

4. The pattern of growth remains broadly based. Manufacturing exporters have fully maintained their share of world trade - and a further 6 per cent growth in manufactured exports is forecast in 1986. Investment is expected to grow by about 5 per cent this year. On the balance of payments the forecast is for a current account surplus of £3½ billion.

5. Employment has continued to rise - there are around 600,000 more people in work than in June 1983 - but unemployment remains stubbornly and disappointingly high.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

6. Because of the UK's position as a major oil producer, the oil price fall will help most other major industrial countries more than it will help the UK. There will also be an adverse effect on UK terms of trade, because we lose more from our export earnings than we gain from lower import prices, and inevitably the Government's oil revenues will be sharply reduced. But against this, there will be valuable benefits for the non-oil economy, especially for manufacturing, with lower costs and higher profits. The increase in world trade which should follow lower oil prices will provide an excellent opportunity for British exporters. Overall there should be a modest net benefit to Britain in terms of output and inflation.

Budget Strategy

7. The Government's Medium Term Financial Strategy (MTFS) is extended for a further year, to 1989-90, in the Budget. It is designed steadily to reduce the growth of total spending power in the economy (money GDP) over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further sustained economic growth. Target ranges are set for the growth of narrow and broad money in 1986-87, and the Government will continue in operating policy to have regard to a range of other evidence about monetary conditions - of which the most important is the exchange rate.

8. To support monetary policy the Government intends to keep public borrowing at a low level. The 1985-86 Public Sector Borrowing Requirement (PSBR) is expected to come out at a little under £7 billion or 2 per cent of GDP, the lowest level since 1971-72. This outcome was achieved in spite of the fall in oil revenues, because of restraint in public expenditure and the buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

9. Last year's MTFS indicated for 1986-87 oil revenues of £11½ billion, and scope for possible tax reductions of £3½ billion. Since then the outlook for the public finances has been substantially affected by the sharp fall in oil prices. Assuming the oil price averages $15 a barrel for the rest of 1986 and in 1987, oil revenues for 1986-87 are projected at £6 billion. But for the buoyancy of non-oil revenues and firm restraint on public spending, a significant increase in taxation would have been necessary in this year's Budget.

10. Last year's MTFS also indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP. The Chancellor has decided to stick broadly to this figure, but, given the uncertainties over the oil price, to go a little below it and provide for a PSBR of £7 billion, or 1¾ per cent of GDP. That figure takes account of the Budget measures, which provide for a reduction in the real burden of taxation of a shade under £1 billion.

Help for the unemployed

11. The high level of pay settlements is continuing to inhibit the growth of employment. In the longer term greater wage flexibility is essential for the creation of lasting jobs. This year, to add to the measures the Government has already taken to encourage such flexibility, and to encourage identification between employee and enterprise, the Government is to consider issuing a consultative document, if preliminary discussions are satisfactory, about a possible incentive scheme of tax relief to encourage profit sharing schemes in which total pay is directly affected by the success of the enterprise.

12. For the more immediate future, the measures announced in last year's Budget are still to show most of their effect. The expansion of the Youth Training Scheme to cover all 16 and 17 year olds comes into effect next month. The increase in the size of the Community Programme (which provides work of community benefit, for the long term unemployed) is going ahead fast. This year the Government is raising the target for expansion from 230,000 places by June 1986, to 255,000 by the end of 1986, compared with the present level of about 200,000 places.

13. The long term unemployed will also benefit from the development of the pilot schemes, originally announced by the Secretary of State for Employment last year, into a single programme covering the whole country (Restart). As a result of this programme all the long term unemployed will be called for counselling interview and offered help to find work; and those who take a job at less than £80 a week will receive a "Jobstart" £20 a week grant for 6 months.

14. In addition, the Enterprise Allowance Scheme is being expanded to an annual entry of 100,000 to give more unemployed people help to start their own business; and a new scheme - the New Workers Scheme - will provide a cash incentive to employers to create jobs for young people aged 18-20 at realistic wages.

15. The public expenditure cost of these and other changes will be £195 million in 1986-87 and £290 million in 1987-88. After allowing for social security savings, the net public expenditure cost will be £100 million and £165 million respectively. The cost will be charged to the public expenditure Reserve and so there will be no increase in the public spending planning total.

<u>**Taxes on Business and Enterprise**</u>

16. The Corporation Tax structure announced in 1984 comes fully into force this year with the main rate coming down to 35 per cent.

17. In addition, the Business Expansion Scheme which was due to come to an end in April 1987 will be extended indefinitely. It is already attracting substantial amounts of new equity capital into unquoted companies. A number of improvements to the Scheme are proposed, including measures to ensure that it is genuinely focussed on high risk investment. It will also be extended to certain forms of UK ship chartering.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

18. Small businesses will also benefit by the extension of the Loan Guarantee Scheme for three years, and the halving of the premium charged for the Government guarantee from 5 per cent to 2½ per cent. The abolition of the Capital Transfer Tax on gifts between individuals during their lifetime will be a further help to family businesses. The tax will be renamed the Inheritance Tax.

Savings and investment

19. The Budget includes a number of further measures to reform the taxation of savings and investment. There is to be a radical new scheme to encourage individuals to invest directly in equities. This scheme should, in time, bring about a further considerable extension of share ownership in Britain. Any adult will be able to invest up to £200 a month in shares. As long as the investment is kept in a special account - called the Personal Equity Plan - for a relatively short minimum period, all reinvested dividends and capital gains will be free of tax.

20. To retain its international pre-eminence as a financial centre the City of London must be fully competitive, world-wide. The ending of fixed commissions (the 'Big Bang') on 27 October will help reduce dealing costs. But the Chancellor has concluded that to meet successfully the increasingly fierce competition from New York and Tokyo, it is necessary to reduce from 1% to ½% the Stamp Duty on share transactions. The cost will be recouped by bringing into tax a range of financial transactions which are at present entirely free of Stamp Duty.

21. The present rules relating to pension fund surpluses will be clarified. Under the new arrangements, where a refund is made to employers it will be subject to tax at 40%.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Charities

22. A number of specific concessions will be made, relieving charities from VAT in respect of certain purchases. In addition, the Government has decided to supplement the measures it has already taken to assist charities with a substantial new package, directed towards charitable giving rather than towards the charities themselves. By

- abolishing the upper limit on relief at higher rates of income for convenants
- allowing tax relief to companies for one-off gifts up to a maximum of 3 per cent of dividends
- providing relief to individuals for regular gifts of up to £100 a year to charity where these are deducted at source by their employers

the Budget should eventually stimulate additional charitable giving by probably twice the £70 million cost to the Exchequer of these measures.

Taxes on Spending

23. Overall, excise duties will be increased by the same amount as would be required to keep pace with inflation. Petrol and derv duties will be increased by rather more than this - by 7½p a gallon and 6½p respectively. Given the recent increase in oil companies' profit margins these increases should not be passed on to the consumer. The real tax burden on the road user will be kept unchanged, with no general increase in Vehicle Excise duty on cars and lorries. In recognition of the dangers to health cigarettes and hand rolling tobacco will be increased by the equivalent of just over 11p a packet of 20 king size. Cigars and pipe tobacco duties will not be changed. There will be no increase in the duties on any alcoholic drinks. This should help with the difficulties currently faced by the Scotch whisky industry.

24. No major changes are proposed in VAT.

Income Tax

25. As foreshadowed in the Budget Statement last year, the Government has published a Green Paper on personal taxation discussing options. In particular, it outlines a possible reform (made possible by computerisation) of the system of income tax personal allowances. Everyone would have a basic tax allowance in his or her own right. A husband and wife would be taxed independently, but would be able to transfer unused allowances to each other. Married women would for the first time have the opportunity of privacy in their tax affairs; the existing tax penalties on marriage would be removed; and more tax relief would go to couples at the point when they are most likely to need it, when the wife gives up paid work to start a family.

26. The Government is making further reductions in income tax, in order to increase incentives. Since 1979, allowances have been increased by 22 per cent in real terms so that they are now higher, as a proportion of average earnings than, for example, in Germany or the United States. This year, basic allowances are increased in line with prices and the basic rate of income tax is reduced by 1 penny - improving incentives for the 95 per cent of employees, and for the 90 per cent of all self-employed people and unincorporated businesses, for whom the basic rate is also the marginal rate. This is the first cut in the basic rate for seven years. The new basic rate will be 29p in the £. There will be a comparable change in the small firms Corporation Tax rate.

Summary

27. The Budget maintains the Government's strategy to defeat inflation and to create the conditions for further growth of output and employment. The overall burden of taxation is being modestly reduced. Specific measures will be taken to help the unemployed; to promote enterprise and initiative; to reform the taxation of savings and investment, and to increase charitable giving.

HM Treasury

17 March 1986

BUDGET SECRET
BUDGET LIST ONLY
NOT TO BE COPIED

00130

F36

Check McManus about checking

RESOLUTIONS TO BE MOVED BY THE CHANCELLOR OF THE EXCHEQUER

18th MARCH 1986

Note.
Andrew Walker said being scrutinized in full in IR and Carole Appleton said same for C+E. FST's office in lead for HMT.

RO 14/3

FIRST DRAFT

Second Proof (Second Print) — 7.3.86

Mr Chancellor of the Exchequer

PROVISIONAL COLLECTION OF TAXES: That, pursuant to section 5 of the Provisional Collection of Taxes Act 1968, provisional statutory effect shall be given to the following Motions:—

(*a*) Tobacco products (Motion No. 2);

(*b*) Hydrocarbon oil (Motion No. 3);

(*c*) Vehicles excise duty (hackney carriages and farmers' goods vehicles) (Motion No. 4).

ARRANGEMENTS OF WAYS AND MEANS RESOLUTIONS

1. Amendment of the law.
2. Tobacco products.
3. Hydrocarbon oil.
4. Vehicles excise duty (hackney carriages and farmers' goods vehicles).
5. Vehicles excise duty (trade licences).
6. Abolition of certain excise licence duties.
7. General betting duty, pool betting duty and bingo duty.
8. Customs and excise duties (warehousing).
9. Value added tax (registration).
10. Value added tax (zero-rating).
11. Value added tax (relief on importation).
12. Value added tax (provision of accommodation).
13. Income tax (charge and rates for 1986–87).
14. Income tax (indexed personal reliefs etc.): operative date for PAYE.
15. Relief for interest (limit for 1986–87).
16. Advance corporation tax (rate for financial year 1986).
17. Building societies.
18. Shares and rights to acquire shares obtained by directors and employees.
19. Occupational pension schemes: repayments to employers.
20. Enterprise allowance.
21. Business expansion scheme.
22. Company reconstructions.
23. Loans to participators.
24. Charities.
25. Value added tax penalties etc. (income tax and corporation tax).
26. Associated companies (oil and gas industry).
27. Capital allowances (machinery and plant etc.).
28. Capital allowances (mineral exploration and extraction).
29. Dual resident trusts: capital gains tax.
30. Securities (income tax, capital gains tax and corporation tax).
31. Transactions tax.
32. Stamp duty (transfers for purpose of issuing depositary receipts).
33. Stamp duty (depositary receipts: other transfers).
34. Stamp duty (clearance services).
35. Stamp duty (reconstructions etc.).
36. Stamp duty (acquisitions).
37. Stamp duty (loan capital).
38. Stamp duty (bearer letters of allotment etc.).
39. Stamp duty (letters of allotment).
40. Stamp duty (company's purchase of own shares).
41. Stamp duty (shares and marketable securities).
42. Tax under Capital Transfer Tax Act 1984.
43. Oil taxation: light gases.
44. Oil taxation: attribution of chargeable receipts and allowable expenditure.
45. Relief from tax (incidental and consequential charges).

1. Amendment of the law

That it is expedient to amend the law with respect to the National Debt and public revenue and to make further provision in connection with finance; but this Resolution does not extend to the making of any amendment with respect to value added tax so as to provide—

(*a*) for zero-rating or exempting any supply;

(*b*) for refunding any amount of tax;

(*c*) for varying the rate of that tax otherwise than in relation to all supplies and importations; or

(*d*) for any relief other than relief applying to goods of whatever description or services of whatever description.

2. Tobacco products

That, as from 21st March 1986, the rates of duty on cigarettes and hand-rolling tobacco specified in Schedule 1 to the Tobacco Products Duty Act 1979 shall be increased—

(*a*) in the case of cigarettes, to an amount equal to 21 per cent of the retail price plus £30.61 per thousand cigarettes; and

(*b*) in the case of hand-rolling tobacco, to £49.64 per kilogram:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

3. Hydrocarbon oil

That, as from 6 o'clock in the evening of 18th March 1986,—

(1) the rates of duty specified in section 6(1) of the Hydrocarbon Oil Duties Act 1979 shall be increased—

(*a*) in the case of light oil, from £0.1794 a litre to £0.1938 a litre; and

(*b*) in the case of heavy oil, from £0.1515 a litre to £0.1639 a litre; and

(2) in subsection (1) of section 11 of that Act (rebate on heavy oil) for paragraphs (*a*) and (*b*) there shall be substituted—

"(*a*) in the case of fuel oil, of £0.0077 a litre less than the rate at which the duty is for the time being chargeable;

(*b*) in the case of gas oil, of £0.0110 a litre less than the rate at which the duty is for the time being chargeable; and

(*c*) in the case of heavy oil other than fuel oil and gas oil, equal to the rate at which the duty is for the time being chargeable"; and

(3) for subsection (2) of section 11 of that Act (definition of types of heavy oil) there shall be substituted—

"(2) In this section—

'fuel oil' means heavy oil which contains in solution an amount of asphaltenes of not less than 0.5 per cent or which contains less than 0.5 per cent but not less than 0.1 per cent of asphaltenes and has a closed flash point not exceeding 150°C; and

'gas oil' means heavy oil of which not more than 50 per cent by volume distils at a temperature not exceeding 240°C and of which more than 50 per cent by volume distils at a temperature not exceeding 340°C":

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

4. Vehicles excise duty (hackney carriages and farmers' goods vehicles)

That the Vehicles (Excise) Act 1971 and the Vehicles (Excise) Act (Northern Ireland) 1972 shall have effect, in relation to licences taken out after 18th March 1986, with the amendments set out below;

But this Resolution shall not authorise the making of amendments which would result in different provisions being in force in different parts of Great Britain:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

(1) For Part II of Schedule 2 to each of the Acts of 1971 and 1972 (annual rates of duty for hackney carriages there shall be substituted the following—

PART II

Description of vehicle	Rate of duty
	£
Hackney carriages	52.50 with an additional £1.05 for each person above 20 (excluding the driver) for which the vehicle has seating capacity.

(2) In Schedule 4 to each of the Acts of 1971 and 1972 (annual rates of duty on goods vehicles)—

(*a*) in Part I, in sub-paragraph (2) of paragraph 6 (farmer's goods vehicle or showman's goods vehicle having a plated gross weight or a plated train weight) in paragraph (b) (weight exceeding 7·5 tonnes but not exceeding 12 tonnes) for "£135" (which applies to farmers' goods vehicles only) there shall be substituted "£155"; and

(*b*) in Part II, for Tables A(1), C(1) and D(1) (rates for farmers' goods vehicles having plated weight exceeding 12 tonnes) there shall be substituted the Tables set out below:

TABLE A(1)

RATES OF DUTY ON RIGID GOODS VEHICLES EXCEEDING 12 TONNES PLATED GROSS WEIGHT

RATES FOR FARMERS' GOODS VEHICLES

Plated gross weight of vehicle		Rate of duty		
1. Exceeding	2. Not exceeding	3. Two axle vehicle	4. Three axle vehicle	5. Four or more axle vehicle
tonnes	tonnes	£	£	£
12	13	210	170	170
13	14	280	175	175
14	15	350	175	175
15	17	475	180	175
17	19	—	240	175
19	21	—	320	180
21	23	—	420	245
23	25	—	720	330
25	27	—	—	465
27	29	—	—	665
29	30.49	—	—	1,090

TABLE C(1)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING ONLY 2 AXLES

RATES FOR FARMERS' GOODS VEHICLES

Plated train weight of tractor unit		Rate of duty		
1.	2.	3.	4.	5.
Exceeding	Not exceeding	For a tractor unit to be used with semi-trailers with any number of axles	For a tractor unit to be used only with semi-trailers with not less than two axles	For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	235	215	215
14	16	290	220	220
16	18	330	220	220
18	20	385	220	220
20	22	435	270	220
22	23	465	300	220
23	25	530	365	225
25	26	530	405	265
26	28	530	500	345
28	29	555	555	390
29	31	765	765	495
31	33	1,115	1,115	780
33	34	1,230	1,230	1,150
34	36	1,405	1,405	1,405
36	38	1,580	1,580	1,580

TABLE D(1)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING THREE OR MORE AXLES

RATES FOR FARMERS' GOODS VEHICLES

Plated train weight of tractor unit		Rate of duty		
1.	2.	3.	4.	5.
Exceeding	Not exceeding	For a tractor unit to be used with semi-trailers with any number of axles	For a tractor unit to be used only with semi-trailers with not less than two axles	For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	215	215	215
14	20	220	220	220
20	22	270	220	220
22	23	300	220	220
23	25	365	220	220
25	26	405	225	220
26	28	500	230	225
28	29	555	270	230
29	31	765	325	240
31	33	1,115	495	250
33	34	1,140	725	315
34	36	1,205	1,035	475
36	38	1,390	1,390	710

5. Vehicles excise duty (trade licences)

That provision may be made with respect to the rates of duty applicable to trade licences under section 16 of each of the Vehicles (Excise) Act 1971 and the Vehicles (Excise) Act (Northern Ireland) 1972.

6. Abolition of certain excise licence duties

That no excise licence duty shall be chargeable on the grant after 18th March 1986 of an excise licence under any provision of the Alcoholic Liquor Duties Act 1979 or under section 2 of the Matches and Mechanical Lighters Duties Act 1979:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

7. General betting duty, pool betting duty and bingo duty

That provision may be made extending to Northern Ireland the provisions of the Betting and Gaming Duties Act 1981 relating to general betting duty, pool betting duty and bingo duty.

8. Customs and excise duties (warehousing)

That provision may be made with respect to the matters which may be dealt with in regulations under section 93 of the Customs and Excise Management Act 1979 (warehousing regulations).

9. Value added tax (registration)

That for the purposes of the Value Added Tax Act 1983 provision may be made with respect to the registration of two or more persons as one taxable person.

10. Value added tax (zero-rating)

That provision may be made for the imposition of conditions with respect to the zero-rating of supplies of goods by virtue of section 16(6) of the Value Added Tax Act 1983.

11. Value added tax (relief on importation)

That provision may be made with respect to conditional relief from value added tax under section 19 of the Value Added Tax Act 1983.

12. Value added tax (provision of accommodation)

That provision may be made with respect to the valuation for the purposes of value added tax of certain supplies of services consisting in the provision of accommodation.

13. Income tax (charge and rates for 1986–87)

That—

(1) Income tax for the year 1986–87 shall be charged at the basic rate of 30 per cent and, in respect of so much of an individual's total income as exceeds £17,200 (the basic rate limit as determined under subsection (4) of section 24 of the Finance Act 1980—indexation), at such higher rates as are specified in the Table below (in which the higher rate bands are those as so determined):

TABLE

Higher rate bands	*Higher rate*
The first £3,200	40 per cent.
The next £5,500	45 per cent.
The next £8,400	50 per cent.
The next £8,400	55 per cent.
The remainder	60 per cent.

(2) This Resolution shall not require any change to be made in the amounts deductible or repayable under section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) before 18th May 1986:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

14. Income tax (indexed personal reliefs etc.): operative date for PAYE

For the year 1986–87, in subsection (7) of section 24 of the Finance Act 1980 (which specifies the date from which indexed changes in income tax thresholds and allowances are to be brought into account for the purposes of PAYE) for "5th May" there shall be substituted "18th May":

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

15. Relief for interest (limit for 1986–87)

That, for the year 1986–87, the qualifying maximum referred to in paragraphs 5(1) and 24(3) of Schedule 1 to the Finance Act 1974 (limit on relief for interest on certain loans for the purchase or improvement of land) shall be £30,000:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

16. Advance corporation tax (rate for financial year 1986)

That the rate of advance corporation tax for the financial year 1986 shall be three-sevenths.

17. Building societies

That provision may be made with respect to the treatment for the purposes of income tax and corporation tax of dividends and interest payable in respect of shares in or deposits with or loans to a building society.

18. Shares and rights to acquire shares obtained by directors and employees

That charges to income tax may be imposed by provisions amending section 186 of the Income and Corporation Taxes Act 1970 (directors and employees granted rights to acquire shares) and section 79 of the Finance Act 1972 (share incentive schemes).

19. Occupational pension schemes: repayments to employers

That charges to tax may be imposed by provisions about payments to employers out of funds held for the purposes of occupational pension schemes.

20. Enterprise allowance

That provision may be made for charging enterprise allowance to tax under Case VI of Schedule D rather than Case I or II.

21. Business expansion scheme

That provision may be made amending Schedule 5 to the Finance Act 1983.

22. Company reconstructions

That provision may be made with respect to relief from tax where a company ceases to carry on a trade or part of a trade.

23. Loans to participators

That provision may be made with respect to tax chargeable under section 286 of the Income and Corporation Taxes Act 1970.

24. Charities

That provision may be made with respect to—

(*a*) exemption under section 360 of the Income and Corporation Taxes Act 1970 (exemptions for charities from tax under Schedules A to F);

(*b*) section 145 of the Capital Gains Tax Act 1979 (certain gains accruing to charities not to be chargeable gains); and

(*c*) covenanted payments to charities and payments by one charity to another.

25. Value added tax penalties etc. (income tax and corporation tax)

That charges to income tax and corporation tax may be imposed by provisions with respect to penalties, interest and surcharge under Chapter II of Part I of the Finance Act 1985 (value added tax).

26. Associated companies (oil and gas industry)

That provision may be made extending the cases in which two companies are associated with one another for the purposes of Part II of the Oil Taxation Act 1975.

27. Capital allowances (machinery and plant etc.)

That provision may be made with respect to allowances in respect of expenditure on the provision of machinery or plant for leasing and on the provision of certain vehicles.

28. Capital allowances (mineral exploration and extraction)

That provision may be made with respect to allowances under Chapter III of Part I of the Capital Allowances Act 1968 (mines, oil wells etc.)

29. Dual resident trusts: capital gains tax

That provision may be made for denying or recovering relief under section 79 of the Finance Act 1980 (general relief for gifts) where the transferee is a body of trustees which is or becomes treated as resident both in the United Kingdom and elsewhere.

30. Securities (income tax, capital gains tax and corporation tax)

That charges to income tax, capital gains tax and corporation tax may be imposed by provisions about events occurring after 18th March 1986 in relation to securities.

31. Transactions tax

That a tax shall be charged in respect of events occurring after 18th March 1986 in relation to securities.

32. Stamp duty (transfers for purpose of issuing depositary receipts)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) Subject to paragraph (4) below, this Resolution applies where an instrument transfers shares in or marketable securities of a company registered in the United Kingdom to a person whose business is or includes holding shares in or marketable securities of that company as nominee or agent for—

(*a*) a person whose business is or includes issuing depositary receipts for shares in or marketable securities of the company, or

(*b*) persons each of whom falls within sub-paragraph (*a*) above.

(2) If stamp duty is chargeable on the instrument under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be the rate of £5 for every £100 or part of £100 of the amount or value of the consideration for the sale to which the instrument gives effect.

(3) If stamp duty is chargeable on the instrument under the heading "Conveyance or Transfer of any kind not hereinbefore described" in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be that mentioned in paragraph (2) above; and for this purpose the transaction to which the instrument gives effect shall be treated as a sale for a consideration equal to the value of the shares or marketable securities at the date the instrument is executed.

(4) This Resolution does not apply where the transfer is from one company which falls within paragraph (5) below to another company which falls within that paragraph, and the transferor held the shares or securities for the purposes of its business and the transferee acquires them for the purposes of its business.

(5) A company falls within this paragraph if it is resident in the United Kingdom at the time of the transfer, and its business is exclusively that of holding shares in or marketable securities of a company or companies registered in the United Kingdom as nominee or agent for—

(*a*) a person whose business is or includes issuing depositary receipts for shares in or marketable securities of a company or companies registered in the United Kingdom, or

(*b*) persons each of whom falls within sub-paragraph (*a*) above.

(6) For the purposes of this Resolution a depositary receipt for shares in or securities of a particular company is an instrument acknowledging—

(*a*) the deposit of such shares or securities or of an instrument evidencing the right to receive them, and

(*b*) the entitlement of a person to rights, whether expressed as units or otherwise, in or in relation to such shares or securities.

(7) For the purposes of paragraph (3) above the value of shares or securities at the date the instrument is executed shall be taken to be the price they might reasonably be expected to fetch on a sale at that time in the open market.

(8) Where paragraph (3) above applies, section 15(2) of the Stamp Act 1891 (stamping of instruments after execution) shall have effect as if the instrument were specified in the first column of the table in paragraph (d) and the transferee were specified (opposite the instrument) in the second.

(9) References in this Resolution to shares in a company include references to stock of a company.

(10) This Resolution applies to any instrument which is executed after 24th March 1986 and gives effect to a transaction effected after 18th March 1986.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

33. Stamp duty (depositary receipts: other transfers)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) This Resolution applies where shares in or marketable securities of a company registered in the United Kingdom are transferred from one company which falls within paragraph (2) below to another company which falls within that paragraph, and the transferor held them for the purposes of its business and the transferee acquires them for the purposes of its business.

(2) A company falls within this paragraph if it is resident in the United Kingdom at the time of the transfer, and its business is exclusively that of holding shares in or marketable securities of a company or companies registered in the United Kingdom as nominee or agent for—

(*a*) a person whose business is or includes issuing depositary receipts for shares in or marketable securities of a company or companies registered in the United Kingdom, or

(*b*) persons each of whom falls within sub-paragraph (*a*) above.

(3) This Resolution also applies where shares in or marketable securities of a company registered in the United Kingdom are transferred to the holder of a depositary receipt for shares in or securities of the company concerned and the transfer is made in satisfaction of his entitlement under the receipt to receive such shares or securities.

(4) The maximum stamp duty chargeable on an instrument effecting a transfer which falls within paragraph (1) or (3) above shall be 50p.

(5) For the purposes of this Resolution a depositary receipt for shares in or securities of a particular company is an instrument acknowledging—

(*a*) the deposit of such shares or securities or of an instrument evidencing the right to receive them, and

(*b*) the entitlement of a person (the holder of the receipt) to rights, whether expressed as units or otherwise, in or in relation to such shares or securities.

(6) References in this Resolution to shares in a company include references to stock of a company.

(7) This Resolution applies to any instrument which is executed after 24th March 1986 and gives effect to a transaction effected after 18th March 1986.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

34. Stamp duty (clearance services)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) This Resolution applies where an instrument transfers shares in or marketable securities of a company registered in the United Kingdom—

(*a*) to a person whose business is or includes the provision of clearance sevices for the purchase and sale of shares or marketable securities, or

(*b*) to a person whose business is or includes holding shares or marketable securities as nominee for a person or persons falling within sub-paragraph (a) above.

(2) If stamp duty is chargeable on the instrument under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be the rate of £5 for every £100 or part of £100 of the amount or value of the consideration for the sale to which the instrument gives effect.

(3) If stamp duty is chargeable on the instrument under the heading "Conveyance or Transfer of any kind not hereinbefore described" in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be that mentioned in paragraph (2) above; and for this purpose the transaction to which the instrument gives effect shall be treated as a sale for a consideration equal to the value of the shares or marketable securities at the date the instrument is executed.

(4) For the purposes of paragraph (3) above the value of shares or securities at the date the instrument is executed shall be taken to be the price they might reasonably be expected to fetch on a sale at that time in the open market.

(5) Where paragraph (3) above applies, section 15(2) of the Stamp Act 1891 (stamping of instruments after execution) shall have effect as if the instrument were specified in the first column of the table in paragraph (*d*) and the transferee were specified (opposite the instrument) in the second.

(6) References in this Resolution to shares in a company include references to stock of a company.

(7) This Resolution applies to any instrument which is executed after 24th March 1986 and gives effect to a transaction effected after 18th March 1986.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

35. Stamp duty (reconstructions etc.)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) In section 55 of the Finance Act 1927 and in section 4 of the Finance Act (Northern Ireland) 1928 (reconstructions and amalgamations) in paragraph (B) of subsection (1) for the words "not be chargeable" there shall be substituted the words "be chargeable at the rates mentioned in subsection (9) of this section" and for the words "nor shall any such duty be chargeable" there shall be substituted the word "or".

(2) In consequence, each of those sections shall be further amended as follows—

(*a*) at the beginning of paragraph (B) of subsection (1) there shall be inserted the words "If a claim is made under this section";

(*b*) in paragraph (*a*) of the proviso to subsection (1) the words from "either it" to "liable or" and from "either that" to "duty or" shall be omitted, and in paragraph (*c*) of that proviso the words "for exemption" shall be omitted;

(*c*) in subsection (2) for the words "for exemption under paragraph (B) of subsection (1) of" there shall be substituted the word "under";

(*d*) in subsection (5) the words "for exemption" shall be omitted;

(*e*) in subsection (6), in paragraph (*a*) the words "for exemption from duty" shall be omitted, in paragraph (*c*) for the word "exemption" there shall be substituted the word "claim", and in the words following paragraph (*c*) for the word "exemption" there shall be substituted the word "claim", for the word "remitted" (in the first place where it occurs) there shall be substituted the word "unpaid" and the words from "in the case of duty remitted under paragraph (A)" to "the said subsection" shall be omitted;

(*f*) in subsection (7) for the words "for exemption from duty under subsection (1) of" there shall be substituted the word "under", for the words "such exemption" there shall be substituted the words "such a claim to be allowed" and for the words "have been remitted" there shall be substituted the words "not have been chargeable".

(3) At the end of each of those sections there shall be inserted—

"(9) The rate is the rate of 50p for every £100 or part of £100 of the amount or value of [the consideration for the sale to which the [instrument] gives effect.]"

(4) In paragraph 12 of Schedule 18 to the Finance Act 1980 (demergers) for sub-paragraph (1) there shall be substituted—

"(1) If a document executed solely for the purpose of effecting an exempt distribution is chargeable with stamp duty under the heading 'Conveyance or Transfer on Sale' in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be the rate of 50p for every £100 or part of £100 of the amount or value of the consideration for the sale to which the document gives effect.

(1A) If a document executed solely for the purpose of effecting an exempt distribution is chargeable with stamp duty under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891, it shall not be treated as duly stamped unless it is stamped in accordance with section 12 of the Stamp Act 1891 with a particular stamp denoting that it is duly stamped."

(5) In Paragraph 12(3) of Schedule 18 to the Finance Act 1980 for the words "this paragraph" there shall be substituted the words "sub-paragraph (2) above".

(6) In section 78 of the Finance Act 1985 (takeovers) the following shall be substituted for subsection (2)—

"(2) If the instrument transferring the shares in company B by way of the exchange is chargeable with stamp duty under the heading 'Conveyance or Transfer on Sale' in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be the rate of 50p for every £100 or part of £100 of the amount or value of the consideration for the sale to which the instrument gives effect."

(7) In section 79 of the Finance Act 1985 (voluntary winding-up: transfer of shares) the following shall be substituted for subsection (2)—

"(2) If the instrument transferring the shares in company B to company A is chargeable with stamp duty under the heading 'Conveyance or Transfer on Sale' in Schedule 1 to the Stamp Act 1891, the rate at which the duty is charged under that heading shall be the rate of 50p for every £100 or part of £100 of the amount or value of the consideration for the sale to which the instrument gives effect."

(8) In section 78 and in section 79 of the Finance Act 1985—

(*a*) in subsection (3) for the word "ignored" there shall be substituted the words "treated as reduced by [50 per cent.]";

(*b*) subsection (9) shall be omitted;

(*c*) in subsection (10) for "(3)" there shall be substituted "(2) or (3)".

(9) This Resolution applies to any [instrument] which is executed after 24th March 1986 unless—

(*a*) it is executed in pursuance of an unconditional contract made on or before 18th March 1986 [, or

(*b*) it transfers stock or marketable securities and is executed in pursuance of a general offer (for the stock or securities) which became unconditional as to acceptances on or before 18th March 1986].

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

36. Stamp duty (acquisitions)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) This Resolution applies where a company (the acquiring company) acquires the whole or part of an undertaking of another company (the target company).

(2) If the first and second conditions (as defined below) are fulfilled, stamp duty under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891 shall not be chargeable on an instrument executed for the purposes of or in connection with the transfer of the undertaking or part.

(3) An instrument on which stamp duty is not chargeable by virtue only of paragraph (2) above shall not be taken to be duly stamped unless [it is stamped with the duty to which it would be liable but for that subsection or] it has, in accordance with section 12 of the Stamp Act 1891, been stamped with a particular stamp denoting that it is not chargeable with any duty.

(4) The first condition is that the registered office of the acquiring company is in the United Kingdom and that the consideration for the acquisition—

(*a*) consists of or includes the issue of shares in the acquiring company to the target company or to all or any of its shareholders;

(*b*) includes nothing else (if anything) but cash not exceeding 10 per cent of the nominal value of those shares, or the assumption or discharge by the acquiring company of liabilities of the target company, or both.

(5) The second condition is that—

(*a*) each shareholder of one of the companies is a shareholder of the other,

(*b*) the proportion of shares of one of the companies held by any shareholder is the same as the proportion of shares of the other company held by that shareholder, and

(*c*) [it is shown to the satisfaction of the Commissioners that] the acquisition of the undertaking is effected for bona fide commercial reasons and does not form part of a scheme or arrangement of which the main purpose, or one of the main purposes, is avoidance of liability to stamp duty, income tax, corporation tax or capital gains tax.

(6) This Resolution applies to any instrument which is executed after 24th March 1986 unless it is executed in pursuance of an unconditional contract made on or before 18th March 1986.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

37. Stamp duty (loan capital)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) The following provisions shall cease to have effect—

(*a*) in section 62 of the Finance Act 1963, subsections (2) and (6) (commonwealth stock);

(*b*) in section 11 of the Finance Act (Northern Ireland) 1963, subsections (2) and (5) (commonwealth stock);

(*c*) section 29 of the Finance Act 1967 (local authority capital);

(*d*) section 6 of the Finance Act (Northern Ireland) 1967 (local authority capital);

(*e*) section 126 of the Finance Act 1976 (loan capital).

(2) Stamp duty under the heading "Bearer Instrument" in Schedule 1 to the Stamp Act 1891 shall not be chargeable on the issue of an instrument which relates to loan capital or on the transfer of the loan capital constituted by, or transferable by means of, such an instrument.

(3) Stamp duty shall not be chargeable on any instrument which transfers short-term loan capital.

(4) Where stamp duty under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891 is chargeable on an instrument which transfers loan capital, the rate at which the duty is charged under that heading shall be the rate of 50p for every £100 or part of £100 of the amount or value of the consideration for the sale to which the instrument gives effect.

(5) In this Resolution "loan capital" means—

(*a*) any debenture stock, corporation stock or funded debt, by whatever name known, issued by a body corporate or other body of persons (which here includes a local authority and any body whether formed or established in the United Kingdom or elsewhere);

(*b*) any capital raised by such a body if the capital is borrowed or has the character of borrowed money, and whether it is in the form of stock or any other form;

(*c*) stock or marketable securities issued by the government of any country or territory outside the United Kingdom.

(6) In this Resolution "short-term loan capital" means loan capital— the date (or latest date) for the repayment of which is not more than five years after the date on which it is issued or raised.

(7) In construing sections 80(3) and 81(3) of the Finance Act 1985 (definitions by reference to section 126 of the Finance Act 1976) the effect of this Resolution shall be ignored.

(8) This Resolution applies to—

(*a*) any instrument which falls within section 60(1) of the Finance Act 1963 (bearers chargeable on issue) and which is issued after 24th March 1986;

(*b*) any other instrument which is executed after 24th March 1986 and gives effect to a transaction effected after 18th March 1986.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

38. Stamp duty (bearer letters of allotment etc.)

That the following provisions shall have effect for the period beginning 25th March 1986 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) In Schedule 1 to the Stamp Act 1891, in the heading "Bearer Instrument", paragraph 2 of the exemptions (bearer letter of allotment etc. required to be surrendered not later than six months after issue) shall be omitted.

(2) Where duty under that heading is chargeable on issue, this Resolution applies to any instrument issued after 24th March 1986, unless it is issued [by a company] in pursuance of a general offer [for its shares] [by the company for another company's shares] and the offer became unconditional as to acceptances on or before 18th March 1986.

(3) Where duty under that heading is chargeable on transfer of the stock constituted by or transferable by means of the bearer instrument concerned, this Resolution applies to any instrument [effecting such a transfer] after 24th March 1986.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

39. Stamp duty (letters of allotment)

That provision may be made for abolishing the exemption from stamp duty provided by section 65(1) of the Finance Act 1963 and section 14(1) of the Finance Act (Northern Ireland) 1963.

40. Stamp duty (company's purchase of own shares)

That provision may be made for charging stamp duty on returns delivered under section 169 of the Companies Act 1985 or Article 53 of the Companies (Northern Ireland) Order 1982.

41. Stamp duty (shares and marketable securities)

That provision may be made allowing the Treasury to make regulations by virtue of which the stamp duty chargeable on any instrument transferring shares or marketable securities is increased if the transfer is to a person specified in the regulations.

42. Tax under Capital Transfer Tax Act 1984

That charges to tax under Capital Transfer Tax Act 1984 may be imposed—

(*a*) by provisions relating to deaths occurring on or after 18th March 1986;

(*b*) by provisions removing relief referable to mutual transfers where at least one of the transfers occurs on or after that date; and

(*c*) by provisions relating to relief under Chapter I (business property) or Chapter II (agricultural property) of Part V of that Act in the case of transfers of value on or after that date.

43. Oil taxation: light gases

That, for the purpose of petroleum revenue tax, provision may be made with respect to the valuation of light gases.

44. Oil taxation: attribution of chargeable receipts and allowable expenditure

That, in any case where—

(*a*) tariff receipts or disposal receipts arising in a chargeable period ending after 30 June 1982, or

(*b*) allowable expenditure, within the meaning of Part II of Schedule 1 to the Oil Taxation Act 1983,

fall to be (or have at any time since the passing of the said Act of 1983 fallen to be) attributed to one of two or more oil fields and development decisions relating to those fields were first made on the same day, provision may be made for determining which of those decisions is to be presumed to have been made first.

45. Relief from tax (incidental and consequential charges)

That it is expedient to authorise any incidental or consequential charges to any duty or tax (including charges having retrospective effect) which may arise from provisions designed in general to afford relief from tax.

PROCEDURE RESOLUTION

PROCEDURE (FUTURE TAXATION): That, notwithstanding anything to the contrary in the practice of the House relating to matters which may be included in Finance Bills, any Finance Bill of the present Session may contain provision taking effect in a future year—

(*a*) with respect to the treatment for the purposes of value added tax of fuel which is or is to be provided or appropriated by a taxable person for private use in a motor vehicle; and

(*b*) relief for investment in corporate trades.

BUDGET

233
8850

FROM: MISS M O'MARA
DATE: 12 MARCH 1986

CHANCELLOR OF THE EXCHEQUER

cc As on attached list

1986 BUDGET BRIEF: SECOND DRAFT

I attach the second full draft of the Budget brief.

SECRET

2. There are still a few gaps and square brackets which we hope to remove in the next day or so and many of the numbers are still subject to change. If possible, we will reorder some of the briefs provided late in the day as a result of the basic rate cut but not if it threatens to wreck our cross referencing system!

3. Given the size of the document, we suggest you concentrate on a few key briefs, selecting from among:

In separate folder below. (The rest - a book - I'll send later)

B.L.O.

A1 Budget strategy

A2 Summary of main points

B8 Industry act forecast of UK economy

C1 Economic effects of oil price fall

C2 Effect of oil price fall on public finances

D1 MTFS: Strategy and historical perspective

D2 MTFS: fiscal projections

D3 Changes in fiscal projections since 1985 FSBR

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

E1 Monetary policy

E2 Fiscal policy

E3 PSBR: 1985-86 and 1986-87

G1 Budget and jobs

G2 Employment measures

J1 Reform of personal taxation: Green Paper

K1 Effects of Budget on business

K2 Budget and enterprise

L1 Charities: general

M1 Income tax: main changes

Q3 Pension scheme surpluses

Q4 Personal Equity Plan

4. It would be most helpful to have your comments by close of play tomorrow, Thursday. We aim to produce a further, near final, draft over the weekend.

Mom

MISS M O'MARA

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

A1: BUDGET STRATEGY

242/83

A1 BUDGET STRATEGY

[See also Industry Act forecast of UK economy (Brief B8), Alternative policies (B19), Economic effects of oil price fall (C1), MTFS: strategy and historical perspective (D1), Monetary policy (E1), Fiscal policy (E2), Budget and jobs (G1), Budget and enterprise (K2) and Income Tax: main points (M1)].

Check level of oil price assumption in the SH[illegible]

Factual

(i) Government's objectives remain unchanged:

- conquest of inflation;

- creation of enterprise culture.

Only route to lasting jobs.

(ii) Government's adherence to firm monetary and fiscal policies has enabled economy to weather both coal strike and oil price fall and yet maintain inflation on downward trend, steady and balanced growth, secure current account surplus and rising employment.

(iii) High level of unemployment remains major problem, though prospect improving. Responsibility for reduction lies primarily with management through:

- improved industrial and economic performance;

- lower rate of pay settlements.

Excessive ~~Rapid~~ growth of ~~earnings~~ labour costs per unit of output Achilles heel of British economy.

(iv) Government continues to pursue economic policy within framework of Medium Term Financial Strategy (MTFS), designed to reduce growth of total spending power in economy (money GDP) at pace which will gradually squeeze inflation out of system, while leaving adequate room for real growth.

(v) Central role for monetary policy in influencing growth of money GDP, through variations in short-term interest rates.

(vi) Given dramatic fall in oil price, with consequences for North Sea tax revenues, need to maintain prudent fiscal policy. 1986 Budget therefore:

- updates MTFS to 1989-90, with PSBR low and money GDP growth declining;

- announces £7 billion PSBR for 1986-87, £½ billion lower than in 1985 MTFS;

- maintains public expenditure planning totals at levels of 1986 Public Expenditure White Paper;

- proposes tax reductions of almost £1 billion in 1986-87. ~~and just £1 billion in 1987-88.~~

WPU

(vii) 1986 Budget aims to further growth of employment

- by range of measures to stimulate growth of business and enterprise;
- by emphasising link between pay and jobs through proposals for consultation about possible tax relief on profit sharing schemes;
- by specific help focussed on long term and young unemployed.

(viii) Firm control of public expenditure enables Budget to take forward Government's aims of tax reduction and reform

- basic rate of tax reduced to 29 per cent;
- publication of Green Paper on personal tax reform;
- abolition of Capital Transfer Tax on lifetime giving and transformation into Inheritance Tax.

(ix) Budget furthers Government objective of widening share ownership and shifting balance from institutional to individual saving through introduction of Personal Equity Plan. Problem of excessive pension fund surpluses tackled.

Package of measures to encourage charitable giving

(x) ~~Charities package, like employment measures,~~ demonstrates Government's ~~concern for disadvantaged, while placing emphasis on private sector support.~~

support for good causes and voluntary movement

(xi) With need to maintain ~~downward pressure on inflation,~~ increases in tobacco duty above revalorisation offset by standstill on alcohol. Following oil price fall, increase in petrol duty above revalorisation but offset by standstill on VED.

slight

Positive

(i) As result of Government's firm monetary and fiscal policies, outlook for 1986 is for first year with 3 per cent growth and 3½ per cent inflation ~~since 1963.~~ for almost quarter of a century.

(ii) UK has taken oil price fall in its stride. Contrast Saudis, forced to postpone 1986-87 Budget for 5 months.

about losing over half our

(iii) Economy has adjusted to halving of North Sea tax revenue in 25 weeks. ~~No~~ So no fears ~~for~~ in next 25 years.

lower

(iv) 1985-86 ~~first year in which~~ public spending ~~has fallen~~ in real terms ~~since [1977-78].~~ even allowing for coal strike. First substantial reduction in PSBR as proportion of GDP since 1981-82 - now at lowest percentage since 1971-72.

(v) Economic forecast is for falling inflation falling, steady growth, substantial current surplus and further growth in employment.

(vi) Prudent fiscal stance is sensible response to oil price fall.

(vii) MTFS reveals declining path of money GDP, reflecting Government's objective of further reduction in inflation with sustained growth in output and projects low PSBR steady in cash terms to 1989-90.

A1

(viii) Budget demonstrates Government's concern for unemployed both in immediate relief and in measures designed to encourage enterprise, initiative and stimulate growth of new jobs.

(ix) First reduction in basic rate of tax for 7 years. Since 1979, basic rate down by 4p and income tax thresholds up by 22 per cent in real terms.

(x) Income tax changes mean £2.60 per week for married man on average earnings.

(xi) ? Green Paper ~~Proposals~~ mark further stage in tax reform programme.

(xii) ~~CTT is fourth tax~~ to be abolished since 1983. Tax on lifetime gifts to family tax

(xiii) Budget furthers aim of wider share ownership.

(xiv) Measures ensure City able to compete with markets abroad as 27 October changes implemented.

(xv) Charities will welcome most substantial package of assistance to charitable giving ever.

(xvi) Fiscal adjustment in future years in MTFS ~~sizeable, suggesting~~ Suggests further scope for ~~substantial~~ tax cuts in future. Too early to tell how much can be achieved. But Government ~~committed to~~ wants to see further reductions in ~~basic rate of~~ Income tax.

(xvii) 1986 Budget is safeguard for present and springboard for future.

Defensive

(i) PSBR should be increasd in response to high unemployment. No shortage of demand in economy. Given state of oil market, prudent fiscal stance essential. Higher PSBR would simply raise inflation and interest rates, choking growth and employment.

(ii) Higher public expenditure would have more direct impact on unemployment and be more cost effective. Tax cuts justified on merits: go hand in hand with employment creation. Government believes beyond basic provision, people should be left to spend their money as wish, and so respond with effort and enterprise. Tax cuts have wide supply side benefits, not reflected in model simulations.

(iii) Employment measures palliative. No. Focussed on young and long term unemployed where problem most severe. Important to ease (back) into labour market.

(iv) High unemployment Government's responsibility. No. Key to improvement lies in improved industrial performance and lower level of pay settlements. If growth of pay slower, more jobs would be created and scope for lower interest rates too.

(v) Budget inappropriate response to oil price fall. Cautious response right, given major changes in oil market. ~~Balance of excise duty package reflects oil price fall.~~ (not fully)

WPU

(vi) £1 billion of Budget measures imprudent. No. ~~Budget judgement finely balanced.~~ But 1986-87 PSBR at £7 billion still below level projected in 1985 MTFS, even when Budget measures taken into account, despite loss of oil revenues.

(vii) With higher privatisation proceeds, £7 billion PSBR indicates relaxation in fiscal stance. PSBR of $1\frac{3}{4}$ per cent of GDP not easy stance at all, especially given loss of oil revenues. Even excluding privatisation proceeds in full, lowest proportion of GDP since 1971-72.

(viii) With £1 billion Budget package and substantially lower oil revenues, 1986-87 PSBR must be cooked. No. Non oil revenues buoyant, reflecting steady growth of economy and health of corporate sector. PSBR outturns for 1985-86 to date indicate trend.

(ix) £1 billion package inconsistent with Government's statements pre-Budget. Clear that scope for manoeuvre has been affected by North Sea revenues, £5 billion lower in 1986-87 than forecast in 1985 Budget. 1985 MTFS projected fiscal adjustment of £3.5 billion for 1986-87. Prime Minister emphasised need for "prudent cautious Budget". 1986-87 PSBR of £7 billion represents just this.

(x) Government has abandoned plans for tax reform. No. Having raised tax thresholds to respectable level, now taking action on basic rate. Putting forward ideas for wide ranging changes in personal taxation.

(xi) Reduction in basic rate of tax should take second place to rise in thresholds. Government had raised tax thresholds by 20 per cent in real terms since 1979 pre-Budget. UK no longer out of line with other major industrial nations in point on income scale when taxpayer becomes liable to tax. But well out of line in rate at which starts to pay tax. Time to put right.

(xii) Too much help to City; not enough to unemployed: Stamp duty package revenue neutral. Employment measures worth £195 million in 1986-87 and £290 million 1987-88 gross. Give everyone unemployed for over year chance of help to find job.

Contact point: Miss M O'Mara (EB) 233 8850

A2: SUMMARY OF MAIN POINTS

242/63

A2

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET SECRET

A2 SUMMARY OF MAIN POINTS

A MTFS

(i) MTFS sets out nominal framework of economic policy: designed to bring inflation down further over medium term through gradual decline in growth of money GDP, achieved by monetary and fiscal policy.

(ii) Money GDP and PSBR paths set out for 1986-87 to 1989-90 in FSBR, together with target ranges for monetary aggregates, MO and £M3 for 1986-87 and illustrative ranges for MO from 1987-88 to 1989-90. Illustrative ranges for £M3 in future years not given because uncertainties surrounding its velocity trend are at present too great (see Brief D1).

(iii) Money GDP growth in 1986-87 same as in 1985 MTFS, with higher output growth and lower inflation; gradual decline thereafter at about same rate as in 1985 MTFS. MO range for 1986-87 also same as in 1985 MTFS. £M3 target range for 1986-87 raised to accommodate revised assumptions about velocity.

(iv) PSBR forecast £6.8 billion in 1985-86. Figures for 1985-86 below forecast in 1985 MTFS - higher non oil revenues offsetting lower oil revenues (latter because of higher exchange rate than forecast; fall in oil prices yet to affect oil revenues). Lowest borrowing figures as percentage of GDP since 1971-71. 72

(v) PSBR for 1986-87 forecast at £7.1 billion, (£½ billion below figure in 1985 MFTS). Sharp fall in oil revenues partly offset by higher non-oil revenues. Lower PSBR than forecast in 1985 reflects caution in face of unsettled oil market.

(vi) Overall, Budget reduces taxes by just under £1 billion in 1986-87. Expenditure measures met from Reserve, and overall effect of Budget on PSBR also just under £1 billion.

B.L.O.

B MAIN TAX MEASURES

(i) Income tax

- basic rate reduced by 1p to 29p in £.
- all allowances increased in line with inflation (ie 5.7 per cent); higher rate thresholds increased by £1,000;
- social security benefit uprating in 1986-87 to be exempt from income tax;
- Green Paper on personal taxation published;

SECRET

(ii) Indirect taxes

(Overall effect of excise and Vehicle Excise Duty changes is same as if all duties had been increased in line with inflation - ie increased yield of £785 million)

- petrol duty up by equivalent of 7.5p a gallon; derv by 6.5p;
- car and lorry VED unchanged;

WPU

BUDGET SECRET

NOT TO BE COPIED

- cigarettes up by a little over 11p a packet of 20 (no increase on pipe tobacco and cigars);

- alcoholic drinks ~~duty~~ [illegible] unchanged;

- small changes in minor oil and VED duties;

- VAT registration threshold increased in line with inflation.

(iii) Charities

- Increased giving to be encouraged by

  abolition of limit on higher rate relief for covenanted donations;

  tax relief for giving by individuals through payroll schemes run (voluntarily) by employers;

  tax relief for single gifts by companies up to 3 per cent of dividends.

- Measures to prevent abuse.

- VAT concessions for charities expenditure on number of items, including distress alarms/lifts for handicapped; medicinal products; welfare vehicles; recording equipment; non-classified newspaper advertising.

(iv) Savings and Investment

- Stamp duty rate on share transactions cut to ½ per cent, but levied on wider range of share transactions by removing some exemptions (eg on loan stock, takeovers & mergers, deals unwound within single Stock Exchange account etc).

- New incentive scheme for personal investment in equities (Personal Equity Plan). Tax relief from Capital Gains Tax ~~(CGT)~~ (on gains) and income tax (on dividends) if cash invested in shares held for minimum period and dividends reinvested. Maximum investment £200 per month quoted shares (including unlisted securities market) only.

- New clarified regime for dealing with excessive surpluses held in pension funds, over and above need to meet pension liabilities

  all surpluses over 5 per cent (calculated according to prescribed assumptions) must be reduced to below 5 per cent within 5 years by reducing (or suspending) contributions, increasing benefits, or making refunds;

  if refunds to employers, tax charge of 40 per cent to be levied on employers.

WPU

- Number of small improvements to help worker co-operatives and others make use of employee share schemes.

(vi) Business and Enterprise

- Business Expansion Scheme (BES) extended indefinitely (previously due to close in April 1987). Asset based activities excluded to concentrate scheme on high risk investments. New BES shares exempt from CGT on first sale.

- Loan Guarantee Scheme extended for 3 years. Premiums halved from 5 to 2½ per cent.

- Lifetime charge on Capital Transfer Tax (CTT) abolished. CTT (renamed Inheritance Tax) now levied on inheritance only (except that gifts into trusts remain unchanged) with charge tapered from seven years before death.

to protect charge on death,

- No change to basic structure of Corporation Tax (rate reduced to 35 per cent, as announced in 1984 Budget). Reforms to Agricultural Buildings Allowance (introduction of balancing adjustments on disposal or destruction) and Mines and Oil Wells Allowances (on lines of 1985 consultative document). Small firms CT rate reduced to 29 per cent with income tax basic rate.

on line

- Profit sharing: consultative document to be issued containing proposals for new scheme offering tax relief on 10 per cent of income for employees who agree, with their employers, profit sharing scheme in which at least 20 per cent of income directly related to profits of enterprise.

- Car and car fuel benefit scales restructured to come into line with EC directive on exhaust emissions; scales revised to ensure revenue neutrality; and then car benefit scales increased by 10 per cent. Car fuel benefit scales unchanged - also to be used for assessing VAT on fuel used for private purposes;

C EMPLOYMENT MEASURES

- Expansion of Community Programme. Present target 230,000 places by June 1986. New target 255,000 September 1986.

- Nationwide extension of ~~Jobstart~~ 'Restart' pilot schemes for long term unemployed, offering special interviews and £20/week grant, for 6 months if wages are below £80 week.

Jobstart

check Monica

- Expansion of Enterprise Allowance Scheme. Present target rate of entry 80,000 in 1986-87. New target annual rate of entry 100,000 by April 1987.

- New Workers Scheme: new scheme providing £15/week for employers of 18/19 year olds earning less than £55/week or of 20 year olds earning less than £65/week.

D IMPACT ON RPI AND TPI

	Indexed Base		Non-Indexed Base	
	RPI	TPI	RPI	TPI
Excise duties				
Income tax				
[October NIC changes]				
Total Budget impact affect				

Contact point: R Pratt (CU) 233 8737

WPU

B8: INDUSTRY ACT FORECAST OF UK ECONOMY

242/19

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B8

B8 INDUSTRY ACT FORECAST OF UK ECONOMY

[See also other briefs in Section B, Economic effects of oil price fall (Brief C1), MTFS: strategy and historical perspective (D1), MTFS: fiscal projections (D2) and PSBR: 1985-86 and 1986-87 (E3)]

Factual

(i) Short term economic forecast in Part 3 of FSBR meets Industry Act 1975 requirement for Government to publish two forecasts a year. Forecast covers period to mid 1987.

(ii) MTFS in Part 2 of FSBR embodies assumptions about prices and output for 1987-88 to 1989-90. (See D1, D2.)

(iii) Main points of FSBR forecasts (see also Table 1):

(a) Inflation	Outturn 1985Q4	Forecast 1986Q4	Forecast 1987Q2
RPI	~~5.5~~ about 5½	3½	3½

(See also B3.)

(b) Output and demand	Outturn/ Forecast 1985	Forecast 1986	Forecast 1987H1
GDP (average est.)	3½	3	2½
GDP (adjusted for coal strike)	2½	2½	2½
GDP (adjusted for coal strike and excluding oil)	2½	2½	3
Manufacturing output	3	3	2
Consumers' expenditure	2½	4	4
General Government consumption	½	1	½
Fixed investment	1	5	½
Exports of goods and services	6½	5	3
Imports of goods and services	3	6	5
Change in stockbuilding (as per cent of level of GDP)	½	0	½

1986 will be first year with growth of 3 per cent and inflation down to 4 per cent ~~since 1963.~~

For about a quarter of a century.

WPU

242/19

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B8

(c) Current account of balance of payments

Use new table

£ billion

	Oil	Other Goods(1)	Invisibles	Total: Actual and forecast	Total: After allowing for special factors(2)
1983	7	-8 (-2½)	4	3	3
1984	7	-11½ (-4)	5½	1	4
1985	8	-10 (-3)	5	3	4½
1986 (forecasts)	5	-9½ (-3½)	8	3½	3

(1) Balance on manufactures in brackets.

(2) Timing of EC rebates and effect of coal strike.

Trade deficit on manufactures expected to be £3 billion in 1986 following £3 billion in 1985. (See also B5.)

(just under £7)

(d) PSBR: forecast to be £6¾ billion (1¾ 2 per cent of GDP) in 1985-86 and £7 billion (1¾ per cent of GDP) in 1986-87. (See also E3.)

(e) World economy

	1984	**1985**	**1986**	**1987H1**
Real GNP(1)	4½	2½	3½	4
Consumer prices(1)	4½	4	2½	1½
World imports (constant prices)	10	3	6	5½
World trade in manufactures (constant prices, UK export markets)	8½	4½	5	5

(1) US, Japan, Germany, France, UK, Italy and Canada.

(See also B1.)

(f) Forecast assumes

- sterling will not change much from present level, either in dollar or effective terms;

- oil prices average $15 per barrel over next year.

WPU

242/19

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B8

(ii) Comparison of Industry Act forecast and outside forecasts: See B9.

Positive

(i) Forecast implies following increases in GDP:

But the comparison better than this?

	1986H1	1987H1
from 1979Q2 peak	8 ½	10 ½
from 1981Q2 trough	15	17 ½

Six years to 1987H1 forecast to show average 2½ per cent annual growth, compared with 2 per cent in 1970s.

(ii) 1986 ~~will~~ (shd) see best combined performance of growth and inflation since ~~1963.~~ (as before)

(iii) Forecast rise in output consistent with continued rise in employed labour force - already 600,000 more in work since June 1983. (See also B6.)

(iv) Non-oil company profits rising strongly in real terms since 1981. Expected to rise further in 1986. Non-oil companies' net rate of return in 1986 expected to be higher than in any year since 1973. Will provide incentive to invest and increase output.

(v) Business investment to increase strongly again in 1986 (4 to 5 per cent growth in both 1985 and 1986).

(vi) Exports to increase 5 per cent in 1986 following growth of 6½ per cent in 1985.

(vii) CBI February enquiry into manufacturing shows improvements in order books (both total and export) and suggests further increase in output. Enquiry was best response on prospects for output and prices since enquiry began.

Defensive

(i) Growth slowdown in 1986-87: Not in non-oil economy in underlying terms. Growth in non-oil GDP, adjusted for coal strike, expected at 2½ per cent in 1986, increasing to 3 per cent in year to 1987H1 following 2½ per cent increase in 1985.

(ii) No increase in non-oil growth, despite allegedly beneficial effects of lower oil prices. (FSBR forecast of 3 per cent growth in 1986 unchanged from Autumn Statement.) Fall in oil prices not expected to have marked effect on UK growth in short term: but benefits to finances of non-oil companies augurs well for performance of economy over medium term. (See also C1.)

(iii) Growth fuelled by consumption boom. Growth in consumers' expenditure picking up. But investment and exports both forecast to rise faster than consumers' expenditure.

242/19

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B8

(iv) Surveys suggest fall in manufacturing investment. Slowdown in manufacturing investment reflects earlier bringing forward of spending in anticipation of reduction in capital allowances. But no real signs of downturn and fundamental determinants of manufacturing investment remain very favourable.

(v) Slowdown in export growth. Export performance in 1985 exceptional - manufactured exports grew twice as fast as world trade. Projected growth in exports of manufactures during 1986, substantial 5 per cent in volume terms, fully in line with overall growth in world trade.

(vi) No fall in deficit in manufactured goods. Overall current account forecast to be in healthy surplus despite fall in oil prices. That is what matters. Manufacturing industry did well in 1984 and 1985 and expected to do well in 1986 - 2½ per cent increase in output, 5 per cent increase in exports and rise in profitability. (See also B5, B7.)

(vii) Treasury over-optimistic on current balance given lower oil exports. (Current balance surplus of £3½ billion forecast for 1986, afer £3 billion surplus in 1985): Forecast allows for effects of lower oil prices on visible balance and for offsetting effects of lower profits earned by foreign oil companies operating in North Sea. Current balance figures distorted by effects of coal strike and delayed receipt of rebate on 1984 EC contribution. After allowing for special factors, underlying surplus falls from £4½ billion in 1985 to £ billion in 1986. (See also B5.)

NB

(viii) UK unit labour costs worsening relative to our competitors. Cost and price competitiveness expected to be little different from average of last three years. But growth of labour costs in UK is much too high. For industry to take full advantage of opportunities now faces, much lower pay settlements needed. (See also B2, B3.)

(ix) Fall in overall company profitability in 1986. North Sea profits accounted for about one third of total in 1985. Naturally fall as result of lower oil prices. But non-oil companies' profitability up and expected to be higher in 1986 than in any year since 1973.

(x) $15 oil price assumption: Given volatility of market, ~~wide~~ range of assumptions ~~could be justified~~ possible but this assumption prudent and realistic. (See also C1.)

to consumers

(xi) Lower oil prices assumed to feed into profit margins rather than manufacturers' prices. Lower oil prices expected to be passed ~~on in lower prices~~. But bound to be some increase in profit margins as well given scale of reduction in costs.

(xii) Nationalised industry prices rising faster than inflation as whole. Most nationalised industry prices set just once a year, so take time to reflect changes in costs (adjusting much more slowly than eg petrol prices.) By 1987Q2 nationalised industry prices forecast to rise less than prices generally.

(xiii) UK inflation and output performance expected to be worse than in rest of world. Clearly UK cannot expect to benefit from oil price fall to extent of industralised countries who are major net importers of oil. Better comparison is with past UK performance. Forecast is for sixth year of continued GDP growth at average 2½ per cent a year (2 per cent average in 1970s) and inflation at ~~4~~ 3½ per cent in year to 1986Q4 ~~falling to 3¾ per cent~~ and also in year to 1987Q2 (12½ per cent average in 1970s). (See also B1.)

NB [illegible]

Compares with [illegible] of $xy over past [illegible]

WPU

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

Good track record: growth ~~[illegible]~~ in 1985 3½% as forecast in last year's Budget

(xiv) Unemployment prospect: Growth in unemployment slowed during 1985: increase of 5,000 a month in 6 months to February, compared with 10-15,000 a month increase over most of last two years. Prospects now look better than for some years - growth in labour force probably starting to slow down and employment and output continuing to rise. (See also B6.)

(xv) Treasury forecasts on growth over-optimistic compared to outside forecasts. Outside forecasters have revised up GDP growth forecast for 1986 gradually coming into line with Industry Act forecast. (See B9.)

(xvi) Economy flat since 1985Q1. Path of GDP affected by temporarily depressed North Sea production and distorted profile of investment spending. Growth picked up again in Q4 when GDP(O) rose at annual rate of 2½ per cent. (See also B2.)

(xvii) Projected consumption growth in 1986 fuelled by high real wage growth Recovery therefore unsustainable. No. MTFS designed to ensure will be sufficient demand in economy to maintain overall growth. But high real wage growth will certainly damage job prospects.

(xiii) UK growth in 1986 unbalanced compared with other economies No. Private consumption in most major OECD countries expected to grow by 2-4 per cent a year and GDP growth expected to be in same range. Little different from UK.

(xiv) Switch to consumption growth will increase imports and worsen further balance of trade in non oil goods. Balance of trade depends on many factors other than composition of demand, including relative labour costs and non price competitiveness. Forecast takes all factors into account and shows no deterioration of non oil trade balance or of manufacturing balance.

Contact point: Peter Allum (EA1) 233 4696

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B8

TABLE 1

Prospects: summary

		Forecast	Average errors from past forecasts*
A.	**Output and expenditure:**		
		at constant 1980 prices; per cent changes between 1985 and 1986	
	Domestic demand of which:	3½	1
	Consumers' expenditure	4	1
	General Government consumption	1	1
	Fixed investment	5	2½
	Change in stockbuilding (as per cent of level of GDP)	0	¾
	Exports of goods and services	5	2½
	Imports of goods and services	6	2½
	Gross domestic product: total	3	1
	manufacturing	3	2½
B.	**Inflation:**		
	Retail prices index:	per cent change	
	1985Q4 to 1986Q4	3½	2
	1986Q2 to 1987Q2	3½	3½
	Deflator for GDP at market prices:	per cent change on year earlier	
	Financial year 1985-86	5½	1
	Financial year 1986-87	3¾	2
C.	**Balance of payments on current account:**	£billion:	
	1986	3½	2
	1987 first half (at annual rate)	1½	
D.	**Money GDP at market prices:**	per cent change on year earlier	
	Financial year 1985-86	9	1½
	Financial year 1986-87	6½	1½
E.	**PSBR:**	£ billion (in brackets per cent of GDP at market prices)	
	Financial year 1985-86	6¾(1.9)	1¼
	Financial year 1986-87	7 (1.8)	4½(1½)

Source: FSBR Table [3.14]

WPU

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B8

Table 2

Comparisons of official forecasts

(a) Output

	1985	1986	1987H1
GDP (per cent change on year earlier)			
- 1985 Budget IAF	3 ½	2 ½ (1986H1 on 1985H1)	not app
- 1985 Autumn Statement IAF	3 ½	3	not app
- 1986 Budget IAF	3 ½	3	2 ½
Manufacturing output (per cent change on year earlier)	**1985**	**1986**	**1987H1**
- 1985 Budget IAF	2 ½	2 (1986H1 on 1985H1)	not app
- 1985 Autumn Statement IAF	2 ½	2 ½	not app
- 1986 Budget IAF	3	2 ½	2

(b) Inflation

	1985Q4	1986Q2	1986Q4	1987Q2
RPI (per cent change on year earlier)				
- 1985 Budget IAF	5	4 ½	not app	not app
- 1985	5 ½	not app	3 ¾	not app
- 1986 Budget IAF	5 ½	not app	3 ½	3 ½

	1985-86	1986-87	1987-88	1988-89
GDP deflator (per cent change on year earlier)				
- 1985 Budget IAF	5	4 ½*	3 ½*	3*
- 1985 Autumn Statement IAF	5	4 ½	3 ½*	3*
- 1986 Budget IAF	5 ½	3 ¾	3 ¾*	3*

* assumption

WPU

* Errors relate to average differences (on either side of central figure) between forecast and outturn. For method of calculating these errors see 'Economic Progress Report' June 1981. Calculations for constant price variables [and GDP deflator] derived from forecasts made during period between June 1965 and October 1983. For current balance and retail price index, forecasts made between June 1970 and October 1983 used. For PSBR, Budget forecasts since 1967 used. Errors are after adjustment for effects of major changes in fiscal policy where excluded from forecasts.

C1: ECONOMIC EFFECTS OF OIL PRICE FALL

242/26

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

C1

C1 ECONOMIC EFFECTS OF OIL PRICE FALL

[See also World economy (Brief B1), UK economy: recent developments (B2), Balance of payments and competitiveness (B5) Industry Act forecast of UK economy (B8) and Effect of oil price fall on public finances (C2).]

Factual

(i) Prices

(a) Brent spot prices - per barrel.

		$	£
average	1979	20.6	9.7
	1980	34.7	14.9
	1981	37.3	18.4
	1982	32.9	18.8
	1983	29.3	19.3
	1984	28.8	21.3
	1985	27.6	21.5
March	1985	28.0	24.9
November	1985	29.7	20.6
January	1986	22.1	15.6
February	1986	17.3	12.1
~~14 March~~ March (first ½)	1986	[ ]	[ ]

(b) per cent changes in Brent spot price

	$	£
From March 1985		
- to February 1986	-38	-51
- to 14 March 1986	[ ]	[ ]
From November 1985		
- to February 1986	-42	-41
- to 14 March 1986	[ ]	[ ]

(c) Futures/forward prices $/bl 14 March

	April	May	June	December
Brent (14 March)	[16.3]	[16.1]	[0]	[ ]
West Texas Intermediate (13 March)	[16.9]	[16.9]	[17.5]	[ ]

el?

WPU

(ii) Output

(a) Oil and NGL* output

(million tonnes)

1980	1981	1982	1983	1984	1985
81	89	103	115	126	127

* Natural Gas Liquids.

(b) Forecast ranges for output announced by Minister of State for Energy on [ ] March 1986. Given in form of ranges because of uncertainties. Ranges increased from those published in 1985 in light of new information from oil companies:

(million tonnes)

	1986	1987	1988	1989	1990
Forecast ranges	120-135	110-130	100-125	90-120	85-115

(c) FSBR indicates production in 1986 likely to be close to level in 1985 and 1984.

(d) Share of world* output

North Sea output about 6 per cent of world output in 1985

* non-Communist world production, plus Communist net exports.

(iii) Balance of payments

(a) Balance of trade in oil

£ billion

1980	1981	1982	1983	1984	1985	1986 forecast
+0.3	+3.1	+4.6	+6.8	+7.1 (2¼)	+8.2 (1)	+5½

( ) reduction in balance of trade in oil due to effects of coal strike

242/26

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

C1

CHECK — end & since 1973

(d) Real oil prices

- currently at lowest level since early 1979.

- ~~Oil price in 1974, after first major oil price rise, just under $10.~~

- Real world price, taking 1980 as 100, now about 70 - lowest since early 1979 - compared with under 60 in 1974.

/Check

What about £ price?

(e) FSBR assumptions:

- North Sea oil prices assumed to average $15 a barrel ~~in 1986-87~~ from now to end 1987.

- Large fall in oil prices between November and February assumed to persist.

- Implies oil prices in 1986-87 expected to be rather below, in real terms, level between 1974 and 1979.

(f) Previous falls in oil prices

September 1982 - July 1983

Brent spot price in dollars fell $6/bl (17½ per cent)

Brent spot price in sterling fell £1/bl (5½ per cent)

Retail petrol price fell 6 pence a gallon (3½ per cent)

~~Previous Chancellor noted on 27 January 1983 '... although the modest fall in the price of oil represents both gains and losses for this country, the overall effect is likely to be beneficial. It would however be in no one's interest if the price of oil were to fall too far too fast'. (OR vol 35 col 1046).~~

Thanks!

WPU

(b) FSBR forecast:

- Prospect for substantial fall in surplus on trade in oil in 1986 as result of lower oil prices.

- Fall in oil surplus partly offset in current account as whole by reduced invisible earnings of foreign owned companies operating in North Sea.

(c) Overseas debt fallen from £23.3 billion at start of 1979 to £14.6 billion currently.

(iv) Role of North Sea in economy

(a) Contribution to GNP: About [5] per cent in 1985. Expected to be [ ] per cent in 1986.

(b) Share of North Sea revenues in total tax and NIC receipts: [8½] per cent in 1985-86. Expected to fall to [ ] in 1986-87.

(c) North Sea investment: [5] per cent of total UK capital investment in 1985. Expected to recover in 1986 to level similar to that in 1984, mainly reflecting increases in expenditures on oil fields already under development and on gas fields due for development.

(d) Net oil exports: 8 per cent of total exports of goods and services in 1985 (15½ per cent gross).

(e) North Sea accounts under ½ per cent of total UK employment.

(v) Effect of North Sea output on GDP

(a) - North Sea oil contributed under ½ per cent a year to average growth rate of economy of about 3 per cent a year during current upswing [1981H1-to date]. Contributed about 1 per cent a year in recovery of 1975-79.

- Has contributed ½ per cent a year since 1979, compared with annual growth of 1¼ per cent.

(b) Fall in oil output forecast between 1986H1 and 1987H1 may cut total GDP growth by over ½ per cent.

(c) Over MTFS period fall in oil production expected to reduce GDP growth rate by ¼ per cent a year from [1986-87] to 1989-90.

Positive

(i) Use made of North Sea revenue

- Reduction by one-third in official overseas debt accumulated in 1970s.
- Reduction in PSBR as share of GDP, helping bring inflation down. Good for investment. Total domestic fixed investment at record levels in 1985.
- Build-up in net overseas assets to estimated £90 billion end-1985, (24 per cent of GDP) compared with £12½ billion (6 per cent of GDP) end 1979. Now brings annual income of £2¼ billion a year. Will continue to provide income in future, as oil production declines.

(ii) UK has weathered storm of falling oil prices. Despite virtual halving in oil prices and consequent large reduction in oil revenues, UK economy resilient. Prospects for economic growth, inflation and balance of payments in 1986 good.

(iii) Scare stories about effect on economy when North Sea oil runs out discredited: UK taken virtual halving in oil prices and consequent reduction in revenues since turn of year in its stride. If can survive unscathed loss of half ~~over~~ our North Sea oil revenues in less than 25 weeks, then prospective loss of other half over remainder of next 25 years should not cause undue concern.

(iv) Beneficial effects of lower oil prices

(a) General: Lower prices will encourage higher world trade and output, with lower world inflation. Overall effects on both output and inflation in the UK are expected to be broadly neutral - if anything, ~~slightly~~ beneficial.

(b) Industry and consumers

- Companies gain from lower oil prices through reductions in their raw materials and energy costs.
- Benefits enjoyed in the form of higher profits or passed on to consumers through lower prices.
- Associated fall in exchange rate will also increase profits in manufacturing and other traded goods and services sectors
- Will encourage exports and import substitution and thus make up for decline in value of net oil exports.

(c) Ready reckoner

Sustained \$1/bl fall in crude oil prices reduces industry's costs by over £100 million a year, assuming fall feeds through fully into oil product prices and assuming other things (including exchange rate and other energy costs) unchanged. (NB 1 per cent off wages bill would save industry £1 billion; sustained 1 per cent cut in interest rates £250 million.)

242/26

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

C1

(vi) Petrol prices

(a) Composition of petrol prices - [December 1985]

	p/gallon	per cent of retail prices
Tax excluded price	83.4	44
Duty	81.6	43
VAT	24.7	13
Retail price	189.7	100

Note: VAT levied at 15 per cent of tax excluded price plus duty.

(b) Fall in petrol prices

- Pump prices down already 13p a gallon (about 5 per cent) between May 1985 peak and January 1986.

- No official figures available after 15 January 1986. Prices fell a little between December and January, as expected. But cuts of 3p a gallon announced by Esso, Shell and BP on 4 February and small changes in pump prices between January and February might have been as much as 5p a gallon. If these falls confirmed, petrol prices in February lower than year previously.

(c) Effect on RPI: 10 per cent fall in pump prices reduces level of RPI directly by about ½ per cent.

(d) FSBR forecast: Fall in oil prices expected to work through to petrol prices in course of 1986.

(e) Petrol prices and crude prices

- Margins (tax excluded price less costs of crude oil) increased substantially in 1985H1. Still relatively high by end of 1985. Fall in petrol prices (13p a gallon) between May peak and ~~January 1986~~ reflected both cuts in margins and falls in crude prices.

  wa Dec 1985

- Since December crude oil prices fallen by about 30 per cent in sterling terms. Much smaller fall in petrol prices, implying large increase in margins. (See below.)

WPU

242/26

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

taken this risk into account.

C1

Defensive

(i) Contingency plans if oil price below $15. Government will take whatever action necessary to maintain thrust of policies. Prudent Budget ~~allows for just this risk.~~

(ii) Lower oil prices have reduced scope for tax cuts over MTFS period. true of 1986-87 but not of future years. Adjusted to loss of oil revenues in single year. Tax cuts thereafter depend on maintaining firm control over expenditure.

(iii) High UK oil production/upward revisions to oil production ranges will aggravate world oil market imbalance. North Sea production expected to be little changed between 1985 and 1986 with gradual decline thereafter. In 1985 North Sea output represented only 6 per cent of world production.

(iv) Government should curb North Sea production to stabilise prices. UK continues to maintain freest oil province in world: decisions on how much to produce made not by Government but by oil companies. UK can take lower oil prices in its stride and has. Most OPEC members (and Norway), heavily dependent on oil exports, will suffer much more (cf Saudis' decision to postpone Budget - see C 2). No way in which UK will become country member of OPEC.

(v) UK should join OPEC. Not in UK's interest. Successful development of North Sea taken place in free market environment. Restrictions would damage confidence on which development based. Would damage prospects for oil production in 1990s and beyond.

(vi) Development of UK Continental Shelf. Lower oil prices will reduce development and exploration expenditure to 1990. Serious effects on production in 1990s and regional unemployment. Need to subsidise North Sea exploration and development. Exploration and development depend on price expectations looking far ahead. Many analysts expect real oil prices to rise in 1990s. But if prices stay at current levels, would expect North Sea activity to fall. Non-North Sea activity should increase.

(vii) Effect of lower oil prices on North Sea activity: Oil prices would have to fall very far - well into single figures - for any significant effect on production from existing fields. Exploration and development depend on price expectations, often looking very far ahead. Most analysts expect real oil prices to rise in 1990s.

(viii) GDP growth since 1979 simply reflects higher oil output. In upswing - 1981H1 to 1985H1 - oil accounted for less than ½ per cent of annual growth of around 3 per cent. (Contributed double that in previous recovery.)

(ix) Effect of lower oil prices on balance of payments: Oil surplus will be reduced but partly offset in current account by reduced invisible earnings by foreign owned companies operating in North Sea. Associated fall in exchange rate will encourage exports and import substitution and make up for decline in value of net oil exports. Current account still forecast in healthy surplus in 1986. (See B8.)

(x) Effect of lower oil prices on employment: Industry will certainly benefit from lower production costs as oil prices fall; but outlook for employment depends crucially on level of pay settlements.

(xi) Petrol prices not fallen enough. Matter for oil companies and their customers. Companies have made large windfall gains from recent fall in oil prices but competition will make itself felt.

Contact point: G Hacche (EA2) 233 3871

C2: EFFECT OF OIL PRICE FALL ON PUBLIC FINANCES

242/87

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

C2

C2 EFFECT ON OIL PRICE FALL ON PUBLIC FINANCES

[See also Economic effects of oil price fall (Brief C1), Fiscal policy (E2), North Sea taxation (N2) and Petrol, derv and other hydrocarbon oils (S2)]

Factual

(i) Tax revenues

£ billion

(a)	**1984-85**	**1985-86**	**1986-87**	**1987-88**	**1988-89**	**1989-90**
1985 FSBR	12	13 ½	11 ½	9 ½	8 ½	not app
1986 FSBR	12	11 ½	6	4	4	4

(b) Assumptions

- North Sea oil prices assumed to average $15 ~~in 1986-87~~ between now & end 1987.

- Sterling does not change much from present level in dollar or effective terms. in 1986-87.

- Production assumed to be close to centre of latest Department of Energy ranges. 1986 production close to level in 1985 and 1984.

(c) Comparison with 1985 FSBR:

- 1985-86: £2 billion shortfall. Mainly reflects stronger $/£ exchange rate than assumed in 1985 FSBR.

- 1986-87 and beyond: Lower forecast in 1986 FSBR mainly reflects lower assumed $ oil prices ~~and higher $/£ exchange rate,~~ partly offset by higher assumed production.

(d) Tax valuations:

- Oil sold in open market to non-associated companies taxed on actual price realised.

- Oil sold to refining affiliates taxed at market value. Market value determined by evidence of open market deals.

WPU

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(e) Ready reckoners

Revenue in 1986-87 depends on prices and production in 1986.

Effect on North Sea revenues in 1986-87 of:

	£ million
$1 barrel lower oil price on average in 1986 (assuming other things including exchange rate unchanged)	-400
1 per cent higher $/£ exchange rate on average in 1986	-60
1 per cent lower sterling oil price on average in 1986	-70
1 per cent lower production in 1986, assuming lower production is spread evenly across fields	-55

[Chancellor to be consulted on publication of any or all these figures this week.]

(ii) Effect of lower oil prices on public finances

(a) Public expenditure: Direct effect is to reduce public sector costs. But overall impact will depend on effect of lower oil prices on other variables such as exchange rate, inflation, employment etc.

(b) On nationalised industries generally: Position will vary between industries. For industries mainly involved, much depends on whether recent change in oil prices is seen as temporary or longer lasting, dependent on OPEC future actions. May be little point in adjusting to temporary change.

(c) Coal industry: For NCB to decide how to adjust capacity to match market demand. Will depend on view taken of medium term trend for oil price path. Too soon to judge.

Positive

(i) Effect on public finances: Direct effect is to reduce public sector costs. Overall impact uncertain (see above).

(ii) NCB viability threatened by lower oil prices: Changing energy market obviously requires dynamic response from all energy industries. No doubt that effort to improve productivity and reduce costs right course for NCB. Judgement about future market demand obviously crucial for assessment of adjustment required.

(iii) Lower oil prices mean more pit closures: For NCB to decide how to adjust capacity to match market demand.

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(iv) Effect on coal prices: Market reaction to rapid changes in prices difficult to gauge but depends crucially on view taken about sustainability of oil price path. Too soon to say what medium term trend will emerge.

(v) Effect on electricity prices: For electricity boards to set own tariffs consistent with External Financing Limits and financial targets. Understand (nominal) increases of some 5 per cent intended this spring.

Defensive

(vi) Changes needed in North Sea tax regime. See N2.

(vii) Petrol duty: See S2.

Contact point: G Hacche (EA2) 233 3871

D1: MTFS: STRATEGY AND HISTORICAL PERSPECTIVE

242/22

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

D1 MTFS: STRATEGY AND HISTORICAL PERSPECTIVE

[See also Interest and exchange rates (Brief B4), other briefs in Sections D and E, Budget and jobs (G1) and Labour market (G3)]

Factual

(i) MTFS provides nominal framework for economic policy. Designed to squeeze inflation out of system gradually over medium term and leave adequate room for real growth by steadily reducing growth of total spending power in economy (as measured by money GDP) through appropriate monetary and fiscal policies.

(ii) Introduced in 1980 Budget. Updated each year in FSBR.

(iii) 1986 MTFS, set out in FSBR:

- restates primary objective of MTFS;
- describes means of achieving this through monetary and fiscal policy;
- sets targets for monetary aggregates MO and £M3 in 1986-87 and provides illustrative range for MO in later years;
- provides revised fiscal arithmetic to 1989-90; rolls this forward for extra year compared with 1985 MTFS.

(iv) Figures for 1989-90 entirely illustrative since 1986 Public Expenditure White Paper (PEWP) plans end in 1988-89. Same status as final year (1988-89) in 1985 MTFS which covered same period as 1984 MTFS (see D2).

(v) Financial framework: Money GDP path reflects objective of further reduction in inflation and continued growth in output at sustainable rate in medium term. Aim will be to avoid substantial departures from path in either direction in medium term. Reflects broad medium term objectives; not target.

Money GDP growth (percentage change on previous financial year)

	1985-86	1986-87	1987-88	1988-89	1989-90
	estimate	MTFS projections			
1986 MTFS	9 (7¾)*	6½	6¼	6	5½
1985 MTFS	8½ (7½)*	6½	5¾	5	

*adjusted for coal strike

WPU

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(vi) Growth of money GDP:

percentage change on previous financial year

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
latest estimate	19.7	13.9	10.1	9.4	7.9	7.0	8.8
(adjusted for coal strike)						(8.4)	(7.5)

(vii) Output/inflation split:

percentage change on previous financial year

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
Inflation							
- RPI	15.8	16.3	11.5	7.1	3.7	5.1	5.9
- GDP deflator	16.9	18.7	10.1	7.0	4.6	4.6	5.0
Real GDP	2.7	-3.8	-0.1	2.3	3.3	2.3	3.7
						(3.7)	(2.5)

( ) adjusted for coal strike

(viii) Monetary ranges:

(percentage change)

	1985-86 estimate	1986-87 targets	1987-88 illustrative ranges	1988-89	1989-90
Narrow money: (MO)					
1986 MTFS	3½	2-6	2-6	1-5	1-5
1985 MTFS	3-7	2-6	1-5	0-4	
Broad money: (£M3)					
1986 MTFS	14¾	11-15			
1985 MTFS	5-9	4-8	3-7	2-6	

Performance of monetary aggregates will be assessed in light of other relevant indicators, especially exchange rate. No illustrative ranges for £M3 after 1986-87 because uncertainties about velocity trend at present too great. Target ranges for later years decided nearer time. (See also E1.)

(ix) PSBR projections broadly as envisaged in 1984 and 1985 MTFS, with period extended to 1989-90 (see also D2, E2, E3):

PSBR	1985-86 estimate	1986-87 forecast	1987-88	1988-89 MTFS projection	1989-90
£ billion	7	7	7	7	7
as percentage of GDP	2	1¾	1¾	1½	1½

(x) Economic assumptions: Declining inflation to 3 per cent in 1989-90 corresponds to declining money GDP growth. Output growth at 2½ per cent a year, up from 2 per cent in 1985 MTFS. Except in 1986-87, when oil price fall has greatest impact, inflation declines at similar rate to 1985 MTFS:

	1985-86	1986-87	1987-88	1988-89	1989-90
Real GDP					
1986 MTFS					
- Non North Sea	3¾	2¾	2¾	2¾	2¾
- total	3½	2¼	2½	2½	2½
1985 MTFS					
- Non North Sea	2¼	2½	2½	2½	
- total	2¼	2	2	2	
Inflation (GDP deflator)					
- 1986 MTFS	5½	3¾	3¾	3½	3
- 1985 MTFS	5	4½	3½	3	

(xi) MTFS, complemented by microeconomic policies which promote enterprise and flexibility, creating conditions conducive to growth of output and employment. (See also B8.)

(xii) Money demand pledge: At February 1985 meeting of National Economic Development Council (NEDC), Chancellor said money demand would not be reduced by wage restraint. Reinforced in 1985 Budget Speech which emphasised MTFS was as firm guarantee against inadequate money demand as against excessive money demand. Point restated at December 1985 NEDC meeting. (See also G3.)

Positive

(i) MTFS ensures consistent policy. MTFS framed in medium-term perspective. Ensures sustainable financial policies and consistency between monetary and fiscal policies.

(ii) MTFS provides predictable framework for private companies, individuals and financial markets by reducing inflation and avoiding sharp fluctuations in nominal demand. Increases efficiency by helping them take sensible, forward-looking decisions.

242/22

(iii) 5 years of continuous growth combined with declining inflation show benefits of firm financial framework for policy as set out in MTFS for successive years.

(iv) Strategic objective of lower money GDP growth achieved, much as envisaged. Growth in money GDP fell from nearly 20 per cent in 1979-80 to ~~10 per cent in 1981-82 and~~ estimated 9 per cent in 1985-86 (see above).

(v) Inflation (RPI) fallen from 16.3 per cent in 1980-81 to projected 5.9 per cent in 1985-86 and still on downward trend. Has left room within declining growth of money GDP for sustained growth in output. Output fell during first two years of MTFS during world recession but growing at 3 per cent per annum since. Division of money GDP growth between output growth and inflation improved (see above).

(vi) PSBR in 1985-86 as percentage of GDP (2 per cent) expected to be lowest since 1971-72. True even if privatisation proceeds excluded (3 per cent).

(vii) PSBR remains low over period of MTFS, falling from 1¾ per cent of GDP in 1986-87 to 1½ per cent by 1989-90, despite lower oil revenues.

(viii) PSBR average of 3¾ per cent of GDP so far under current administration, compared with average of nearly 7 per cent under Labour Government. (See also D2, E2 and E3.)

(ix) Money demand pledge: MTFS will ensure growth of nominal demand neither excessive nor deficient and that slower growth of pay translated into more output and employment.

Defensive

(i) MTFS defunct/discredited by frequent changes in monetary targets. Strategic objective of lower money GDP growth achieved much as envisaged. Growth in money GDP fallen from nearly 20 per cent in 1979-80 to about 9 per cent in 1985-86 and RPI inflation from 16 to 6 per cent. Vindicates Government's approach of taking account of all indicators and adjusting monetary targets in Budget in light of developments in financial markets. (See also B4 and D2.)

(ii) Why continue to reduce money GDP growth? UK can live with 5 per cent inflation. Present inflation rate much lower than in 1970s but still too high by previous standards, imposing significant costs in terms of uncertainty and inefficiency of economy. Prices still double every 14 years with 5 per cent inflation and UK exports become uncompetitive. Within MTFS framework, lower inflation brings higher output growth, while microeconomic policies help smooth path to stable prices and higher output by making markets more flexible.

(iii) Increase in inflation from 1987-89 compared with 1985 MTFS reflects weakening of resolve? No. Reduction in inflation from 1985-86 still projected at same rate over medium term as in 1985 MTFS. ~~Inflation in 1986-87 alone significantly lower than envisaged in 1985, because of falling oil prices.~~ Inflation path inevitably influenced by factors outside Government's control (eg oil prices) but general trend towards stable prices is what counts. 1986 MTFS maintains progress, with inflation down to 3 per cent by 1989-90.

WPU

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(xiii) Present strategy not consistent with fall in unemployment. MTFS, together with Government's microeconomic measures, provides best framework for lasting reduction in unemployment. Around 600,000 more people in work since June 1983 while most of benefit of Budget changes still be felt. But sustained improvement depends critically upon retraint in pay settlements. More expansionary financial policies would raise inflation again and any beneficial impact would be short-lived. (See also G1.)

(xiv) Ultimate inflation objective: MTFS path makes substantial progress towards objective of stable prices, with inflation down to 3 per cent by 1989-90. Stable prices remain ultimate objective.

(xv) Why roll MTFS on for further year, beyond PEWP plans? Provides appropriate medium term horizon.

Contact point: P D Spencer (MP1) 233 5521

D2: MTFS:
FISCAL PROJECTIONS

242/42

BUDGET SECRET
until after the Budget Speech on 18.3.86
then UNCLASSIFIED

D2

D2 MTFS: FISCAL PROJECTIONS

[See also briefs in Section C, other briefs in Section D, Fiscal policy (Brief E2), PSBR: 1985-86 and 1986-87 (E3) and Public expenditure: general (H1)]

Factual

(i) Status

1985-86: Estimate including 11 months' outturn but still with margin of error of at least ± £1 billion.

1986-87: Forecast consistent with taxation and other Budget decisions and with economic prospect to mid-1987 set out in Part 3 of FSBR.

1987-88 and later years: Illustrative projection based on stylised assumptions, including illustrative path for PSBR, consistent with money GDP path underlying MTFS.

(ii) PSBR path (to nearest £1 billion and nearest ¼ per cent of GDP) for 1986 MTFS. 1985 MTFS figures were published to nearest £½ billion):

	1985-86	1986-87	1987-88	1988-89	1989-90
	Estimate	**Forecast**	**Projections**		
1986 MTFS					
£ billion	7~~*~~	[7]	[7]	[7]	[7]
Per cent of GDP	2	1 ¾	[1 ¾]	[1 ½]	[1 ½]
1985 MTFS (1985 Autumn Statement in brackets)					
£ billion	7 (8)	7 ½	7	7 ½	not app
Per cent of GDP	2 (2¼)	2	1 ¾	1 ¾	not app

~~* To nearest £¼ billion.~~

(iii) Economic assumptions

	1986-87 (Forecast)	1987-88	1988-89	1989-90	Average of 4 Years
Growth in real GDP	3	[2 ½]	[2 ½]	[2 ½]	[2 ½]
- excluding North Sea	[2 ¾]	[2 ¾]	[2 ¾]	[2 ¾]	[2 ¾]
Inflation rate*	[3 ¾]	[3 ¾]	[3 ½]	[3]	[3 ½]
Growth in money GDP	[6 ½]	[6 ¼]	[6]	[5 ½]	[6]

* GDP deflator

WPU

BUDGET SECRET
until after the Budget Speech on 18.3.86
then UNCLASSIFIED

No major change in effective exchange rate assumed from year to year.

(iv) Public expenditure assumptions

(a) 1986-87 to 1988-89 Consistent with plans in 1986 Public Expenditure White Paper (Cmnd 9702).

(b) 1989-90 No decisions yet taken. For illustrative purposes, planning total taken to be at same level, in real terms, as in 1988-89.

(v) Fiscal adjustment: Shows extent to which, if public expenditure path achieved and economy develops as assumed, would be room for lower taxes (or higher spending) than in base projections:

Implied fiscal adjustments (to nearest £1 billion)

£ billion, cash

	1986-87	**1987-88**	**1988-89**	**1989-90**
Annual fiscal adjustment	not app	[2]	[4]	[3]
Cumulative total	not app	[2]	[6]	[9]

(vi) Percentages of money GDP

	1985-86	**1986-87**	**1987-88**	**1988-89**	**1989-90**
General Government expenditure	44	43	41 ½	40 ½	39 ½
General Government receipts*	42	41	40 ½	40 ½	40
(o/w non-North Sea taxes*	28 ½	29	30	30	30
Cumulative fiscal adjustment	not app	not app	½	1 ½	2
PSBR	2	1 ¾	1 ¾	1 ½	1 ½

* Before fiscal adjustment

(vii) Figures suggest room within MTFS path for PSBR to reduce burden of taxation eg by about £[2] billion in 1987-88. But experience shows such figures should be treated with caution.

Positive

(i) Fiscal projections indicate coherence and feasibility of fiscal plans underlying financial framework. Broad features same as in previous MTFS.

(ii) Projections given for full four year period, into next decade. Success of MTFS to date shows value of consistent forward strategy.

Ramsed

WPU

BUDGET SECRET
until after the Budget Speech on 18.3.86
then UNCLASSIFIED

(iii) Projections reaffirm Government's determination to roll back frontiers of state and reduce tax burden. Ratios of expenditure and taxation to GDP (after fiscal adjustment) decline.

(iv) By 1989-90, general government expenditure projected to be lowest proportion of GDP since 1966-67.

(v) Sustained firm expenditure control allows fiscal adjustment to be used to reduce tax burden. MTFS sets stage for steady decline in government receipts as percentage of GDP throughout period.

(vi) Low PSBR ratio, together with declining monetary growth, underpins steady reduction in inflation and money GDP growth.

(vii) Cumulative fiscal adjustment sizeable in spite of sharp reduction in oil revenues. Refutes charge that Government's strategy relies on North Sea oil windfall.

Defensive

(i) GDP growth too optimistic/pessimistic: See D1.

(ii) Upward revision of inflation projection shows Government not serious about reducing inflation further: See D1.

(iii) PSBR path: See E1.

(iv) Last year of projections meaningless because no expenditure plans for that year. In principle, fiscal adjustment could be used to reduce taxes or to raise expenditure. But assumed planning total for 1989-90 in line with Government's strategy to reduce public expenditure's share of GDP.

(v) Fiscal adjustment overestimated because public expenditure plans always overshot. No. Public expenditure plans realistic (see H1). But continued firm control of expenditure necessary if fiscal adjustment to be available to reduce burden of taxation.

(vi) Fiscal adjustment overestimated because receipts projections too optimistic. Buoyant tax revenues to be expected in healthy growing economy. Fall in energy prices helps non-North Sea economy. Projections fully reflect prospect of lower North Sea revenues. (See also C1.)

(vii) Fiscal adjustment underestimated because non-North Sea tax projections too pessimistic. Major uncertainties surround tax projections. But no reason to suppose projections not central. Non-North Sea taxes projected to rise broadly in line with money GDP, before fiscal adjustment. At higher levels than in 1985 MTFS, reflecting healthy prospects for economy. (See E3.)

(viii) Fiscal projections vary too much from year to year to be useful. Projections illustrative of broad thrust of policy: not forecast. Main features remain unchanged

- public expenditure falling as share of GDP;
- continued low public borrowing;

BUDGET SECRET
until after the Budget Speech on 18.3.86
then UNCLASSIFIED

- fiscal adjustment available to reduce tax burden.

(ix) <u>If difficulties in publishing fiscal adjustment in Autumn Statement, why publish now</u>? MTFS is <u>medium term</u> strategy. Budget is right time to reconsider and update. Fiscal adjustment is important part of strategy so right to publish in context of updated MTFS. Not appropriate to update MTFS in autumn. Nor has published fiscal adjustment in past Autumn Statements been good guide to actual adjustment in subsequent Budget.

Crank up whenever [illegible] Lawson [illegible] FA publish autumn 1985, before Jan collapse

<u>Contact point:</u> J W Grice (MP1) 233 8911

WPU

D3: CHANGES IN FISCAL PROJECTIONS SINCE 1985 FSBR

242/80

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

D3

D3 CHANGES IN FISCAL PROJECTIONS SINCE 1985 FSBR

[See also other briefs in Section D, PSBR: 1985-86 and 1986-87 (Brief E3) and Debt interest (H4)]

Factual

(i) Changes set out ~~in detail~~ ridiculous in table at Annex. — no good — need summary table here showing . Also give Budget non-oil revenues.

(ii) (a) In 1986-87, reduction in oil revenues (£5 billion)

- partly offset by increase in non-oil receipts before Budget measures (£3 billion)
- but partly reduces fiscal adjustment in 1985 MTFS (£3½ billion)
- leaving about £1 billion for 1986 Budget measures.

(b) In 1987-88 and 1988-89 similar picture but

- increase in non-oil receipts greater
- leaving fiscal adjustment of £2½ billion in 1987-88 and [£] billion in 1988-89.

NO GOOD! SIMPLE TABLES NEEDED

(iii) Changes in expenditure:

Planning total (line 1): outturn in 1985-86 expected to be £½ billion lower than in 1985 FSBR. Planning total in 1988-89 revised in 1986 Public Expenditure White Paper (PEWP). (See H1.)

Debt interest payments (line 2): projections unchanged from 1985. (See H4.)

Public corporations' market and overseas borrowing (PCMOB) (line 3). These changes do not affect PSBR (see below, line 16). (PCMOB is included in planning total and in PSBR, but not in general government expenditure.) So removed from line 3 and added back in line 10.

Other (line 4): includes all other changes that need to be made to reach general government expenditure in national accounts terms. Fall of £½ billion in 1985-86 reflects large unforeseen accruals adjustment, offset in line 11.

(iv) Changes in receipts:

North Sea taxes (line 6): reduction on 1985 MTFS projections reflects both lower $ oil price and higher $/£ exchange rate.

Non-North Sea taxes (line 7): upward revisions in 1985-86 reflect buoyancy of receipts (particularly of VAT, capital taxes and stamp duties) so far in 1985-86. In later years, higher accrued taxes partly reflect carrying-through of this buoyancy, but mainly higher path of money incomes than in 1985 MTFS. These increases are net of £1 billion Budget reductions.

WPU

National Insurance and other contributions (NICs) (line 8): [higher projections in later years of MTFS reflect higher money incomes.]

Interest and dividends (line 9): little change on 1985 projections.

Other receipts (line 19): include rent, capital consumption, gross trading surpluses, receipts from certain public sector pension schemes and miscellaneous receipts. Lower figures for later years reflect shortfall partly in rent receipts, partly capital consumption and partly miscellaneous financial transactions.

Accruals adjustments (line 11): reduction in 1985-86 reflects unforeseen accruals adjustment on subsidies to public corporation, offset in line 4.

(v) Changes in borrowing:

Fiscal adjustment (line 14): fiscal adjustment in 1986-87 in 1985 MTFS was £3½ billion. Used up, partly by Budget measures, but mainly by shortfall in net receipts (because of oil). Similar effect in reducing cumulative fiscal adjustments in later years. (See also D2.)

General government borrowing requirement (GGBR) (line 15): determined, up to and including 1986-87, by difference between general government expenditure and receipts. For 1987-88 onwards, also affected by fiscal adjustment. Can be seen as determined by assumed PSBR (line 17), adjusted for PCMOB (line 16).

PCMOB (line 16): these changes do not affect PSBR. In 1985-86, public corporations repaid less market and overseas debt than assumed in 1985 MTFS and borrowed less from central government. Change projected to persist in 1986-87. In 1988-89, expected to continue repaying market and overseas debt, unlike in 1985 projections.

PSBR (line 17): PSBR lower by £½ billion in 1986-87 and by £½ billion in 1988-89. Latter reflects assumed reduction in PSBR/GDP ratio of ¼ per cent.

(vi) Main classification changes

(a) ECGD and shipbuilding credit interest support costs now treated as subsidy in both Public Expenditure Survey (PES) and national accounts. (Previously PES treated them as subsidy within planning total (line 1) while national accounts treated them as part of interest payments (line 3); offsetting adjustment then required to avoid double counting. Now both line 2 and line 4 reduced.)

(b) Certain payments of interest by British Telecom (Statutory Corporation) to Post Office Staff Superannuation Fund now included in interest payments (line 2). Were previously included in transactions concerning certain public sector pension schemes (line 10).

(c) Some items previously treated as taxes on expenditure (line 7) now in new category, "miscellaneous current transfers" (included in line 10).

Positive

(i) PSBR in 1985-86 slightly lower than 1985 FSBR forecast, despite £2 billion shortfall in oil revenues.

TABLE!

Reasons:

(a) non-oil revenues higher (particularly VAT) and

(b) public expenditure slightly lower.

(ii) PSBR in 1986-87 slightly lower than 1985 FSBR forecast, despite £5 billion shortfall in oil revenues.

Reasons:

(a) non-oil revenues higher, reflecting mainly higher non-oil money GDP but also buoyant receipts in 1985-86, and

(b) fiscal adjustment in 1985 MTFS (£3½ billion) reduced to £1 billion of Budget measures.

Defensive

(i) Oil price, and oil revenues, may be even lower than forecast. Yes, but prudent Budget allows for just this risk.

(ii) Non-oil revenues increase optimistic. No. (See E3).

Contact point: S F D Powell (PSF) 233 5507

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

D3

Changes from 1985 MTFS Projections

		1984-85	1985-86	1986-87	1987-88	1988-89
					£ billion cash	
Expenditure						
1.	Planning total	0	- ½	0	0	+ ½
2.	Interest payments(1)	-0.1	0	0	0	0
3.	Public corporations market and overseas borrowing	-0.1	-1	- ½	0	+ ½
4.	Other adjustments(1)	+0.6	- ½	0	0	0
5.	General government(1) expenditure	+0.3	-2	-1	0	1 ½
Receipts						
6.	North Sea tax(2)	0	-2	-5	-5 ½	-4
7.	Other taxes(1)(2)	+0.4	+2	+2 ½	+3 ½	+3 ½
8.	National Insurance and other contributions	+0.2	- ½	0	0	0
9.	Interest and dividends	-0.2	0	0	0	- ½
10.	Other receipts(1)	+0.3	0	- ½	-1	-1
11.	Accruals adjustment	0	- ½	+ ½	0	0
12.	General government receipts(1)	+0.8	-1	-3	-4	-2
13.	General government expenditure less receipts	-0.5	-1 ½	+2 ½	+4	+3½
14.	Implied cumulative fiscal adjustment(3)	0	0	-3 ½	-4 ½	-3 ½
15.	GGBR	-0.5	-1½	-1	0	+0
16.	Public corporations' market and overseas borrowing	+0.1	+1	+ ½	0	- ½
17.	PSBR	-0.4	0	- ½	0	- ½

(1) After allowing for classification changes which add following amounts:

	1984-85	1985-86	1986-87	1987-88	1988-89
Interest payments	-0.3	-0.2	0	+0.1	+0.1
Other adjustments	+0.5	+0.5	+0.2	+0.1	+0.1
General government expenditure	+0.2	+0.3	+0.2	+0.2	+0.2
Other taxes	-0.2	-0.2	-0.3	-0.3	-0.3
Other receipts	+0.4	+0.5	+0.5	+0.5	+0.5
General government receipts	+0.2	+0.3	+0.2	+0.2	+0.2

(2) Allocation of tax receipts between North Sea and other is affected by treatment of advance corporation tax set-off.

(3) Line (14) = (17) - (16) - (13)

WPU

E1: MONETARY POLICY

242/5

CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

E1

E1 MONETARY POLICY

[See also Exchange rate and interest rates (Brief B4) and MTFS: strategy and historical perspective (D1)]

Factual

(i) Monetary growth 1985-86:

Monetary aggregates: growth to mid-February (seasonally adjusted)

Per cent	3 month annualised	6 month annualised	Latest 12 months	1985 Budget target range
MO	4¾	3¾	3½	3-7
£M3	6¾	13	14¾	5-9

Sterling lending grew by £1.5 billion in banking February, ~~compar~~ed with average ~~£1.4 billion over latest 3 months and £1.5 billion~~ over latest 6 months.

(ii) Status of 1985-86 £M3 target: Chancellor said in Mansion House speech, 17 October, that with hindsight £M3 target range set too low in 1985 Budget. To try to bring £M3 back within target range would have implied unwarranted tightening of policy and authorities would not attempt it.

(iii) Monetary targets 1986-87: 1986 Budget sets target ranges for limits of growth of narrow and broad money over 12 months to each month through 1986-87:

Narrow	-	MO	-	2 to 6 per cent
				(2 to 6 per cent)
Broad	-	£M3	-	11 to 15 per cent
				(4 to 8 per cent)

Illustrative ranges

1985 MTFS ~~targets~~ for 1986-87 shown in brackets.

- MO range in line with illustrative figures in 1985 MTFS and 1 percentage point lower than 1985 target range.

- £M3 range 6 percentage points higher than 1985 MTFS. Reflects rapid fall in velocity in recent years.

(iv) Later years: Actual targets will be decided nearer time. MTFS sets out illustrative ranges for MO for 1987-88 to 1989-90, showing decline in growth. No ranges for £M3 in later years because uncertainties surrounding its velocity trend at present too great.

(v) Circumstances in which authorities will take action: Will take action if underlying growth of MO or £M3 moves outside its range unless other indicators suggest monetary conditions clearly satisfactory. If £M3 triggered action on interest rates, it would respond only slowly and would be unlikely to return to its range within target period. Main impact would be on MO and exchange rate and,

adjust

WPU

provided other indicators satisfactory, continued growth of £M3 outside target range would not be cause for concern.

(vi) Policy instruments: short-term interest rates ~~principal~~ essential instrument for achieving appropriate monetary conditions.

(vii) In decisions on interest rates, Government makes careful assessment of behaviour of monetary aggregates in relation to their targets and other indicators, especially exchange rate.

(viii) Monetary effects of Budget: Not customary to provide estimates.

(ix) Funding and bill mountain. In recent years authorities have held down £M3 by selling more government debt than needed to fund PSBR ("overfunding"). Meant net flows of cash to Exchequer, for technical reasons offset by authorities' market assistance, mainly purchase of commercial bills. This "bill mountain" reached £17 billion in July 1985. Not sustainable policy. Chancellor announced on 17 October aim that funding (net sales of government debt to UK non-bank private sector plus external finance of public sector) should broadly equal PSBR. Leaves short-term interest rates as principal policy instrument.

(x) Velocity (ratio of money GDP to stock of given monetary aggregate):

(a) MO velocity trend relatively steady over long period - rising since before 1970 as institutional change and technological improvements led to progressive reduction in use of cash;

(b) £M3 velocity trend has varied greatly - falling since 1980.

When velocity is rising (ie people want to hold lower stock of particular monetary aggregate for given level of expenditure and income), target range can be set lower without implying tightening of monetary policy and vice versa.

Positive

(i) Benefits of firm monetary policy continue to come in falling inflation. Objectives of declining path for money GDP growth and falling inflation met.

(ii) Government remains firmly committed to maintaining sound monetary conditions as key to further progress in reducing inflation. Balance of evidence indicates that monetary conditions sufficiently tight.

(iii) Short-term interest rates will continue to be held as high as needed to maintain monetary conditions that will keep steady downward pressure on inflation, but no higher.

Defensive

(i) Reasons for £M3 growth above 1985 Budget target range People want to hold more of their financial assets in liquid form, counted in £M3, as structural innovation makes more attractive liquid instruments available.

(ii) 1986-87 £M3 target range too loose: Target range is realistic and takes account of £M3's declining velocity.

(ii) Low MO target too tight: Realistic. Based on well-established and steady trend increase in MO velocity as people turn to non-cash means of payment.

(iii) MO illustrative ranges for future years show less ambitious aim for cutting inflation Government's main priority continues to be reduction of inflation. Gentle decline in MO growth reflects gradual decline in money GDP growth.

(iv) Should have dropped £M3: Important to continue to pay regard to wider liquidity.

(v) Should pay more attention to broader money eg PSL2. No special role for broader aggregates. Among range of indicators taken into account in assessing monetary conditions.

(vi) Aiming for centre of target ranges: Ranges are ranges.

(vii) Move to monetary base control next step: No plans.. But experience with MO as target aggregate useful if move to monetary base control considered in future.

(viii) Credit boom: Evidence of sterling lending (see above) difficult to interpret. On balance of all evidence, monetary conditions sufficiently tight.

(ix) Increased role for exchange rate in monetary policy: No change of emphasis. Have always taken exchange rate into account in assessing monetary conditions. Will continue to do so.

(x) No National Savings announcement in Budget Speech. Announcement will be made in next few days.

Contact point: S N Wood (HF3) 233 4533

E2: FISCAL POLICY

242/33

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

E2

E2 FISCAL POLICY

[See also World economy (Brief B2), briefs in Section D, PSBR: 1985-86 and 1986-87 (E3) and Public Sector borrowing: historical statistics and international comparisons (E4)]

Factual

(i) Fiscal policy integral part of MTFS, supporting monetary policy as means of reducing growth of money GDP and so securing lower inflation. (See also E4.)

(ii) Fiscal policy described in terms of PSBR. Available on timely basis and not prone to revision, unlike other indicators. Government takes explicit account of composition of PSBR as well as level.

(iii) Step down in PSBR in 1985-86 envisaged in 1985 MTFS achieved. 1986 MTFS shows PSBR continuing to fall as percentage of GDP. Essentially same path as in 1985 MTFS:

	1984-85	1985-86 estimate	1986-87 forecast	1987-88	1988-89 MTFS projection	1989-90
PSBR						
(£ billion)						
1986 MTFS	10 ½	7	7	7	7	7
1985 MTFS	10 ½	7	7 ½	7	7 ½	
(as per cent of GDP)	Check					
1986 MTFS	3 ¼	2	1 ¾	1 ¾	1 ½	1 ½
1985 MTFS	3 ¼	2	2	1 ¾	1 ½	

WPU

242/33

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

E2

(iv) Privatisation proceeds increased since 1985 MTFS. But oil revenues sharply lower:

(£ billion)

	1984-85	**1985-86**	**1986-87**	**1987-88**	**1988-89**	**1989-90**
Oil revenues						
1985 MTFS	12	13 ½	11 ½	9 ½	8 ½	not app
1986 MTFS	12	11 ½	6	4	4 ½	4 ½
Privatisation proceeds						
1985 MTFS	2	2 ½	2	2	2	not app
1986 MTFS	2	2 ½	4 ¾	4 ¾	4 ¾	4 ¾

(v) Despite substantial loss of oil revenues, MTFS shows PSBR, excluding privatisation proceeds, smaller percentage of GDP by 1989-90 than in 1985-86. Lowest figure since 1971-72. (See also E4.) Eh?

Positive

First

(i) Between 1979-80 and 1984-85, PSBR as percentage of GDP averages at 3¾ per cent, about half figure of previous Government (6¾ per cent). 1985-86 ratio expected to be lowest since 1971-72, even if privatisation proceeds excluded. ~~Second major downward step under this Government~~ (see E3).

since 1981-82

(ii) 1985 MTFS forecast for PSBR in 1985-86 likely to be undershot despite loss of £2 billion of oil revenues. (See E3.)

(iii) Despite further loss of oil revenues in 1986-87 and later years, 1986 MTFS ~~envisages no difficulty in keeping~~ PSBR low. Essentially same path as in 1985 MTFS.

Envisages keeping

Defensive

(i) Fiscal policy too tight. No shortage of demand in economy. Money GDP rose by over 9 per cent in year to 1985 Q3.

(ii) Higher PSBR needed to reduce unemployment. Unemployment will come down if pay grows less rapidly, without change in fiscal policy. Fiscal expansion would raise inflation and interest rates and hence stifle any initial increase in employment.

(iii) Loss of oil revenues in 1986-87 means PSBR should be higher than 1985-86. Given state of oil market, higher PSBR would risk upsetting markets and jeopardising inflation objective. Real interest rates already high. Increased privatisation proceeds point to lower PSBR. Budget judgement reflects balance of arguments.

Given oil price uncertainty
this is right and prudent.
No risks with inflation

WPU

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

E2

(iv) Fiscal policy too loose. In making Budget judgement, Government taken account of higher privatisation proceeds as well as lower oil revenues and other factors in 1986-87. Fiscal policy not loose; remains consistent with monetary policy designed to exert steady downward pressure on inflation.

(v) PSBR path does not decline in medium term. Should be judged relative to GDP. PSBR falls from 2 per cent of GDP in 1985-86 (already lowest since 1971-72) to 1½ per cent by 1989-90.

(vi) Privatisation programme accelerated to finance tax cuts. No. Expansion of privatisation programme reflects increasing momentum of popular and successful programme - not covert relaxation of fiscal policy. Fiscal policy remains consistent with medium term objectives.

(vii) Adjust PSBR for oil revenues. Without these, would have been as high in 1985-86 as in 1978-79. Fiscal policy consistent with medium term objectives. Average PSBR as proportion of GDP under Labour Government (6¾ per cent) higher than in 1978-79 (5½ per cent) and nearly double that so far under present Government (3¾ per cent). [In any case, should not adjust PSBR for all oil revenues. Implies not legitimate to use them to reduce other taxes at all.]

(viii) Upswing in recent years reflects expansionary fiscal policy. No. growth in output mainly reflects lower inflation and increasing impact of Government's supply side policies. Upswing began in 1981 when on any definition, fiscal policy tightened significantly.

(ix) US budget deficit has boosted output and employment. See B2.

(x) Status of MTFS projections: See D2.

(xi) Events in oil market likely to knock fiscal projections off course. MTFS provides framework within which Government responds to events in oil market and elsewhere, ensuring steady downward pressure on money GDP growth and inflation maintained. Government will take whatever action necessary to secure this. In view of uncertainties, Budget leaves room for manoeuvre if oil prices change.

(xii) Scope for tax cuts: With public expenditure under firm control and healthy growth in economy, should be scope for tax cuts in future years. FSBR gives illustrative figures for fiscal adjustment. But experience shows should be treated with great caution. (See also D2.)

(xiii) Changes in fiscal/monetary mix: See D1.

(xiv) Criteria by which fiscal policy set: Monetary policy must be supported by appropriate fiscal policy. But scope for varying balance between them, especially in short term. Depends on various factors, including level of overseas interest rates and strength of sterling. Current uncertainty about oil prices points to caution in fiscal policy.

(xv) How are oil revenues taken into account in setting PSBR? Rising oil revenue made it appropriate to move quickly towards Government's objective of lower PSBR. Important factor in decision to aim for lower PSBR path announced in 1984 MTFS, now achieved. Fall in oil revenue now in prospect is an important factor in 1986 Budget judgement, but must be seen alongside others such as higher privatisation receipts, and need for fiscal caution, given state of market.

oil

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(xvi) How are privatisation proceeds taken into account in setting PSBR? Privatisation proceeds clearly important. Changes have relatively small effects on monetary conditions and privatisation has continuing effects on public sector accounts. [Other things being equal, might point to lower PSBR.]

(xvii) Fiscal policy should focus on Public Sector Financial Deficit (PSFD) or PSBR adjusted for oil revenues, privatisation proceeds, inflation, economic cycle etc? No single measure of fiscal policy. Best to stay with PSBR (data available quickly, not subject to revision) and take account of changes in composition in deciding level.

Contact point: P D Spencer (MP1) 233 5521

E3: PSBR: 1985-86
AND 1986-87

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

E3

E3 PSBR IN 1985-86 AND 1986-87

[See also briefs in Section D, Public sector borrowing: historical statistics and international comparisons (Brief E4) and Public expenditure: general (H1)]

A PSBR IN 1985-86

Factual

(i) Estimated 1985-86 PSBR lower than 1985 FSBR forecast despite £2 billion shortfall in oil revenues because non-oil revenues (particular VAT) higher. Public expenditure remains within planning total.

(ii) Changes to projections of expenditure and receipts since 1985 FSBR: See D3.

Positive

(i) Aim of UK Government to achieve progressive reduction in PSBR/GDP ratio in support of monetary policy designed to achieve falling inflation. (See D1.)

(ii) In each of years 1981-82 to 1985-86, PSBR/GDP ratio lower than in any year under previous Labour administration, when ratio peaked at 9¼ per cent (1975-76).

(iii) PSBR/GDP ratio forecast in Budget to be 2 per cent in 1985-86, lowest since 1971-72. Lowest even if exclude privatisation proceeds. Government budget deficit, as proportion of GDP, in middle of range of OECD countries. (See E4.)

Defensive

(i) PSBR lower than in 1985 Budget despite lower oil taxes:

- £2 billion lower oil revenues largely offset by higher non-North Sea tax receipts;

- public expenditure a little lower.

(ii) PSBR lower than in Autumn Statement. Public expenditure lower and onshore tax receipts higher.

(iii) Higher non-North Sea receipts: Tax receipts (excluding North Sea) so far in 1985-86 very buoyant:

- VAT receipts expected to be £1 billion higher than in 1985 FSBR, because of higher than expected proportion of consumer spending liable to VAT;

- other receipts (eg stamp duties, advance corporation tax, capital taxes) also more buoyant.

More needed.

(iv) 1985-86 PSBR looks large compared with April-February outturn. March borrowing always high (see E4). High end year expenditure; low income (eg low rate income for local authorities). Lower oil revenues will affect this March in particular.

WPU

242/36

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

E3

(v) Buoyant non-North Sea receipts in 1985-86 suggest forecasts for later years pessimistic. No. Non-North Sea receipts growing in line with non-oil money GDP. Projections make due allowance for projected decline in North Sea receipts.

B PSBR IN 1986-87

Factual

(i) PSBR for 1986-87 forecast at £7.1 billion (1¾ per cent of GDP).

(ii) £½ billion (and ¼ per cent of GDP) lower than in 1985 MTFS, after fiscal adjustment. £2 billion higher before fiscal adjustment:

	£ billion 1986-87	**FSBR 1985**	**FSBR 1986**
1.	PSBR	7½	7
2.	Fiscal adjustment	3½	1*
3.	Implied PSBR before fiscal adjustment	4	6

*contribution of Budget measures.

(iii) Within PSBR, broadly unchanged since 1985 MTFS, offsetting factors at work:

(a) North Sea revenues in 1986-87 now projected £5 billion lower than in 1985 FSBR.

(b) Other tax receipts £3½ billion higher before Budget measures, reflecting mainly higher money GDP but also buoyant receipts in 1985-86.

(c) Fiscal adjustment in 1985 MTFS (£3½ billion) reduced to £1 billion of Budget measures.

(d) Other general government receipts about £½ billion lower, reflecting several items (gross trading surpluses, capital consumption, interest receipts and rent).

(See D3.)

(iv) While projected PSBR flat between 1985-86 and 1986-87, public sector financial deficit (PSFD) rises by £2 billion, because of higher privatisation proceeds:

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED
E3

		£ billion
	1985-86	**1986-87**
PSFD	**10.1**	**12.3**
Privatisation proceeds	-2.7	-4.8
Other adjustments*	-0.6	-0.4
PSBR	**6.8**	**7.1**

*including net lending and accruals adjustments

(v) Change in PSBR between 1985-86 and 1986-87. Table shows constituents of year-on-year change in PSBR:

		£ billion
		1986-87 on 1985-86
Revenues		
(i)	North Sea revenues	-5.4
(ii)	Expenditure taxes	+5.1
(iii)	Income tax	+3.0
(iv)	LA rates	+1.9
(v)	Other GG receipts (excl interest and dividends)	+1.7
(vi)	Total receipts	+6.3
Expenditure		
(vii)	Privatisation proceeds	-2.2
(viii)	Planning total (excl (vii))	+8.1
(ix)	National account adjustments to (viii)	-0.7
(x)	Net GG debt interest	+0.6
(xi)	Total expenditure	+5.8
GGBR		-0.5
PCMOB*		0.7
PSBR		0.3

* Public corporations' market and overseas borrowing.

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(vi) Error on PSBR forecasts for year ahead: Average absolute error on past PSBR forecasts made at Budget time is about 1¼ per cent of GDP (over last 10 years) equivalent to around £5 billion in 1986-87; about 1 per cent of GDP (over last 5 years) equivalent to around £4 billion in 1986-87:

	FSBR*	Outturn	Difference	As percentage of GDP
1975-76	9.1	10.6	+1.5	+1.4
1976-77	11.9	8.5	-3.3	-2.6
1977-78	9.5	5.6	-3.9	-2.6
1978-79	8.6	9.2	+0.6	+0.3
1979-80	7.6	9.9	+2.3	+1.1
1980-81	8.5	13.2	+4.7	+2.0
1981-82	10.6	8.8	-1.8	-0.7
1982-83	10.5	9.2	-1.4	-0.5
1983-84	6.9	10.0	+3.2	+1.0
1984-85	7.2	10.1	+2.9	+0.9
1985-86	7.1	6.8 (f)	-0.3	-0.1

* after adjusting for in-year policy changes

(f) forecast

Positive

(i) Although PSBR little changed in £ billion between 1985-86 and 1986-87, falls as proportion of GDP (from 2 per cent to 1¾ per cent).

(ii) PSBR still on MTFS track, despite loss of North Sea revenues. Should be consistent with decline in growth of money GDP and inflation over medium term.

Defensive

(i) Public expenditure plans for 1986-87 realistic: Yes. (See H1.)

(ii) Assumptions about spending £4½ billion Reserve: (See H1).

(iii) Forecast for 1986-87 too pessimistic. No. Figures in FSBR give best, central forecast of PSBR. But bear in mind error on forecasts (see above).

(iv) Increase in PSFD represents easier fiscal stance. No unique measure of fiscal stance. Fact that increase in PSFD between 1985-86 and 1986-87 ~~more~~ than fall in North Sea revenues taken into account in forming Budget judgement.

much less!

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(v) Increase in non-oil revenues in 1986-87 surprisingly large. No. Corporation tax receipts growing strongly because of 20 per cent increase in company incomes between 1984 and 1985. Income tax growing slower than non-oil money GDP, reflecting Budget package.

Contact point: S F D Powell (PSF) 233 5507

G1: BUDGET + JOBS

242/32

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

G1

G1 BUDGET AND JOBS

[See also Employment and unemployment statistics (Brief B6), Outside forecasts (B9), Alternative policies (B10), Supply side (F1), other briefs in Section G, Infrastructure (H2), National Insurance contributions (J2), Effect on incentives and traps (J4), Budget and enterprise (K2), Income tax: main changes (M1) and Profit sharing (M5) and Taxation of Enterprise Allowance (M9)]

Factual

(i) Unemployment can be reduced by

(a) steady improvement in performance of business and industry and thus in economy as whole. Government economic policy designed to assist this;

(b) lower pay settlements allowing employees to be priced into work.

(ii) Recent performance:

(a) Around 600,000 more people in work and almost 700,000 new jobs (net) created since June 1983. (Differences between figures accounted for by rough estimate of those holding two jobs.)

(b) More jobs created in UK since June 1983 than in rest of EC put together.

(See also B6.)

(iii) Economic factors working in favour of higher employment

(a) Greater labour market flexibility (see G3).
(b) Slowdown in growth of labour supply to 100,000 a year from 510,000 in 1984.
(c) Fall in oil prices and exchange rate will help tradeable goods and services to expand, especially manufacturing sector (see C1).
(d) CBI pressing employers to control costs more effectively.

(iv) Prospects: OECD predict UK will be top of EC employment growth league in 1986 ('Economic Outlook', December 1985).

(v) 1985 Budget and jobs

(a) National Insurance contributions (NICs) restructured, reducing cost of employing lower paid and encouraging young and unskilled to take jobs.

(b) 5 per cent real increase in income tax thresholds took 540,000 of working age out of tax with its disincentive effects.

(c) Youth Training Scheme (YTS) exended to 2 years from April 1986.

(d) 100,000 extra Community Programme (CP) places by June 1986.

(e) Change in "unfair dismissal" provisions of employment protection legislation.

WPU

242/32

(f) Reform of Wages Councils.

(vi) 1985 Autumn Statement and jobs

(a) annual rate of entry to Enterprise Allowance Scheme (EAS) to increase by 15,000 by early 1987 and reduction in qualifying period from 13 to 8 weeks.

(b) Pilot of Jobstart payment of £20/week for long term unemployed taking job for under £80 week.

(c) Pilot of in-depth counselling interviews for long term unemployed. (See K2 for Autumn Statement enterprise measures.)

(vii) 1986 Budget and jobs

Measures centred on

(a) long term unemployed

- nationwide extension of Jobstart;

- expansion of CP to 255,000 places in 1986 and increase in average wage limit. (For details, see G2.)

(b) young

- New Workers Scheme (NWS) with provision for 100,000 entrants in 1987-88.

- also helped by expansion of CP (currently provides about 120,000 places for 18-24 year olds unemployed for 6 months or more);

- and by downward pressure on wage settlements exerted by NWS. (For details, see G2.)

(c) Self-employment

(c) Also

- Reduction in basic rate increases work incentives.

- Indexation of income tax thresholds removes 550,000 from disincentive effects of tax system. (See J4, M1.)

- Expansion of annual rate of entry to EAS from 64,000 to 100,000 by April 1987 and change in tax treatment of Allowance. For every 100 businesses helped under EAS, 99 new jobs created. (See G2, K2, M9))

(viii) Cost of 1986 Budget measures which affect employment

(a) Extension of Jobstart: £100 million in 1986-87.

(b) Expansion of CP: £60 million in 1986-87 and £120 million in 1987-88.

(c) Introduction of NWS: £25 million in 1986-87 and £50 million in 1987-88.

(d) Reduction in basic rate: £835 million in 1986-87 and £1,250 million in 1987-88.

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(v) Budget measures consistent with action taken in 1985 Budget and Autumn Statement. No panic reaction: building on success.

Defensive

(i) Few jobs have resulted from 1985 Budget. Only have figures for growth in employment to 1985Q3. But in any case, effect of 1985 Budget measure only just beginning to work through

- two year YTS starts in April 1986;
- only just over half announced expansion of CP places so far occurred;
- Wages Council legislation still passing through House;

but

- unfair dismissal changes apply to all those entering employment from 1 June 1985.

(ii) If wage inflexibility is major cause of unemployment, what is Government doing to remedy problem? Level of pay settlements primarily matter for employers. But

- October's NIC restructuring gave employers incentive to take on more low paid workers.
- Wages Council reform will encourage employment of young and low paid.
- Payments under NWS and Jobstart Scheme put downward pressure on wages.
- Profit sharing, if developed, could have useful ~~demonstration~~ & effect on pay ~~for wage~~ flexibility (see M5).

(iii) Incomes policy better method of tackling unemployment. Flexible labour market is route to lower unemployment and Government has taken many steps to encourage that (see G3). Incomes policy would only create distortions, with resulting wage explosion once controls lifted. Nevertheless, employers and employees have responsibility to negotiate moderate pay settlements.

Put as (ix)(b) here

(iv) Unemployment currently costing £24 billion a year. Unemployment benefit and supplementary benefit paid to unemployed expected to total about £6¾ billion in 1986-87. But as no easy route to zero unemployment, debatable how much even of that sum is 'avoidable cost' to public purse. Impossible to calculate tax receipts forgone. Revenue consequences vary greatly with causes of unemployment. Cannot tell how much unemployed would earn if found work.

Put (ix)(c) here

(v) Every 100,000 unemployed cost nation £880 million in lost output. No direct link between numbers unemployed and output forgone. Impossible to tell what unemployed would produce or earn if found work or, more importantly, what wider macro-economic implications for output would be.

(vi) With unemployment so high Government should increase, not reduce, PSBR. Bigger PSBR would add to ~~nominal~~ money demand - but no shortage of demand in economy. Prudent fiscal policy has enabled economy to weather both coal strike

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

Experience of 1970s has shown that high PSBR leads to higher inflation, and interest rates

and oil price fall. Given state of oil market, must leave margin of safety. ~~Higher PSBR would in any case result in higher inflation and interest rates, choking growth and employment.~~

(vii) Investment in public sector capital would increase production, reduce unemployment and save money. Total public expenditure must be kept under control to secure lower inflation, sustained growth lower taxation and jobs that last. Government makes every effort to find room within overall spending total for projects that show proper return. Overall level of investment more important than public sector's record alone. Total fixed investment in economy at all time record in real terms in 1985. (See also H2.) & further sizeable rise forecast for 1986

(viii) Labour Party plans to create more jobs through additional spending on capital investment and repair and maintenance. Additional Government spending might boost unemployment in very short term but effect sooon dissipated as inflation/interest rates rose. To distribute funds on 'first come first served' basis, as Mr Hattersley suggests, would be blatant denial of priorities. (See H2.)

(ix) Proposals of Select Committee on Employment would eliminate long term unemployment in 3 years at cost of £3.3 billion. Unemployment ~~to~~ can only be be reduced by ~~pay restraint by~~, making markets more efficient and enabling economy to perform better, and by moderation in pay settlements, not by large and rapid increase in public spending, putting other gains at risk.

(x) Costs of creating jobs via tax cuts greater than via infrastructure and direct employment measures. This kind of calculation ~~very suspect~~ mistaken. Takes ~~little~~ no account of wider supply side benefits of tax cuts.

(xi) Incentive effects of increasing tax thresholds bogus, since those initially taken out of tax are drawn back later in year as earnings rise. (See M1.)

(xii) Why abolish redundancy rebates in November 1986 when unemployment so high? Savings on Redundancy Fund allowed last November's increases in provision in Employment programme for enterprise, employment and small firms. Employees' redundancy payment entitlement not affected. Rebates will still be paid to firms employing under and redundancy payments will still be made direct 10 people to employees of firms in financial difficulties. For most large firms, rebates very small part of redundancy costs.

Contact point: Miss M O'Mara (EB) 233 8850

G2: EMPLOYMENT MEASURES

242/37

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

CHSTR to PMCCR

G2 EMPLOYMENT MEASURES

Department of Employment issuing Press Notice on Budget Day and another on 19 March.

[See also Employment and unemployment statistics (Brief B6), Industry Act forecast of UK economy (B8), Supply side (F1), other briefs in Section G, Public expenditure: general (H1) and Taxation of Enterprise Allowance (M9)]

(i) Description of existing measures (excluding Budget additions) given in Table 1 below.

(ii) Past, present and planned cost of existing measures (excluding Budget additions) given in Table 2 below.

(iii) 1985 Budget

- expanded Community Programme (CP) to 230,000 places by June 1986 (currently about 200,000 places);
- extended Youth Training Scheme (YTS) to 2 years from April 1986;

at additional cost of £600 million in 1986-87 and £800 million in 1987-88.

(iv) 1985 Autumn Statement

- expanded Enterprise Allowance Scheme to annual rate of 80,000 entrants by April 1987.
- introduced Jobstart allowance and interview pilot schemes in 9 areas, covering about 3 per cent of long term unemployed.

For other Autumn Statement measures, see K2.

(v) Inner Cities initiative: Task forces announced for 8 small inner city areas (total population 300,000) to get better results from existing inner city programmes through improved co-ordination, new ways of working and involvement of local people. Resources to be directed from existing programmes, plus £5 million additional provision (Paymaster General 6 February OR vol 91 no 52 col 446).

(vi) 1986 Budget:

(a) Jobstart initiative

- extended nationwide as soon as possible;
- intensive programme will offer interviews to all of long-term unemployed in 1986-87;
- where appropriate, offers places on employment or training schemes or in Jobclubs (providing encouragement and facilities for job search) or on specially designed 1-2 week Restart training courses.
- allowance of £20/week taxable for 6 months to those unemployed over 1 year getting full time job paying £80 or less.

(b) Community Programme

- target for expansion 1986 raised to 255,000 places;
- limit on average wage paid per project (ie maximum sum Manpower Services Commission will reimburse) to rise from £63 to £67 on 1 April 1986 (previous rise was in October 1984).

(c) Enterprise Allowance Scheme (currently 65,000 entrants at annual rate)

- expanded to annual rate of 100,000 entrants by April 1987;
- change in tax treatment of Allowance (see M9).

(d) New Workers Scheme

- introduced from 1 April 1986;
- provides £15/week allowance for 12 months for employers of 18-19 year olds earning £55/week or less and 20 year olds earning £65 or less (full time jobs only);
- provision for up to 100,000 entrants in 1987-88.

also

Loan Guarantee Scheme

- extended for 3 years;
- rules revised from 1 April 1986;
- premium halved from 5 per cent to 2½ per cent;
- Government guarantee remains at 70 per cent;
- provides for loans up to £90 million in 1986-87 and £130 million in 1987-88 and 1988-89.

Scheme introduced in 1981 to facilitate supply of finance, otherwise unobtainable, to small firms. 70 per cent of qualifying loan guaranteed. Borrower pays 5 per cent premium. Government to end February assisted in 16,600 loans worth £540 million.

Parliamentary Under Secretary of State for Industry reported on 1 July (OR vol 82 no 145 WA5) cost per job of £2,200 for lending guaranteed up to 31 May 1984, allowing for estimated failure rate but not other factors.

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

G2

(vii) Public expenditure gross costs

Schemes	1986-87	1987-88
		£ million
Extension of Jobstart interviews	85	45
Extension of Jobstart allowance	15	25
Expansion of Community Programme and extra provision for increase in average wage to £67	60	120
Expansion of Enterprise Allowance Scheme	5	35
Extension of Loan Guarantee Scheme	negligible	5
New Workers Scheme	25	50
Total (including Northern Ireland consequential)	**195**	**290**
Total (net of benefit savings)	**100**	**165**

Costs met from within Reserves in 1986 Public Expenditure White Paper, so from within unchanged planning totals.

(viii) Long term unemployment: statistics

	January		
	1984	**1985**	**1986**
18-24s unemployed over 6 months:			
number	507,300	522,200	499,200
per cent of age group	10.5	10.9	10.5
Over 25s unemployed over 1 year			
number	802,300	908,200	978,100
per cent of age group	4.5	5.1	5.4
Total unemployed over 1 year			
number	1,132,000	1,255,000	1,311,300
per cent	4.8	5.3	5.6

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(ix) Youth unemployment: statistics

	January		
	1984	**1985**	**1986**
18-19s: unemployed:			
number	375,400	359,600	328,800
per cent of age group	27.1	26.5	24.7

(20s not separately available)

(x) - Jobstart covers those unemployed over 1 year;

- CP covers those aged 25 and over unemployed over 1 year (34 per cent of participants) and 18-24s unemployed over 6 months (66 per cent).

(xi) CBI Budget representations: Recommended extra spending on employment and environmental measures at £1 billion extra net Exchequer cost. Public expenditure cost rather higher. Claimed would provide jobs for 330,000 people within two years.

Proposal	**net cost (£ million)**
Urban development grant	150
Derelict land grant	150
Building improvement programme	400
Enterprise Allowance etc	300

(xii) Select Committee on Employment recommended: elimination of long term unemployment within 3 years by creating 1 million jobs at cost of £3.3 billion net:

Proposal	**net cost (£ million)**	**new jobs**
Building improvement	1,500	300,000
Health and social services jobs	400	100,000
£40/week wage subsidy	1,400	350,000

Said measures should

- create additional jobs at lowest feasible cost to Exchequer;
- lead to regular jobs;
- involve private sector as much as possible.

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(First Report 1985-86)

(xiii) CBI on responsibility of industry for creating employment:

- "[CBI] proposals are designed to make the economy more competitive while keeping inflation low. Only if this is achieved can we bring down the level of unemployment. Business has the prime responsibility for its competitive position." (CBI Budget representations, January 1986)

- "Trade and industry are capable of doing more" (Sir Terence Beckett, 'Times' 3 March 1986).

(xiv) CBI on Government record:

"The Government's own policies have contributed to an impressive pace of job creation". (Sir Terence Beckett, 'Times', 3 March 1986)

(xv) Layard Scheme: Professor Layard claims (most recently in 'Times' 10 February 1986) that possible to increase substantially public works programmes targetted on long term unemployed since higher employment of this group would not increase pressure on wages (Similar proposals put forward by London Business School and Gavyn Davies). Also claims tax cuts much less efficient than employment measures at reducing unemployment.

Positive 1st: Total spending on schemes already - approaching £2bn a yr) ~~[illegible]~~ . On top of this,

(i) Major increases in programme for unemployed, especially young and long term unemployed.

(ii) Government

- adding nearly £200 million to DE programme in 1986-87;

- nearly £300 million in 1987-88;

- (excluding YTS) 30 per cent increase in 1985-86 spending on employment measures;

- spending nearly £3 billion on employment measures plus YTS by 1988-89, compared with around £300 million in 1978-79.

(iii) All within existing planning total.

(iv) Extension of Jobstart imaginative and flexible way to give appropriate help to long term unemployed to find real jobs, get useful training or other work experience. Extension reflects encouraging initial results of pilots.

(v) Jobstart allowance gives greater financial incentive to take jobs (particularly to those on high benefit).

(vi) Expanded Community Programme

- will help over 330,000 of long term unemployed every year;
- offers jobs on work of community benefit;
- helps participants find jobs afterwards (twice as likely to find work afterwards as average long term unemployed).
- increase in average wage limit will give sponsors confidence in projects.

(vii) Enterprise Allowance Scheme expanded by more than half as much again against current levels. EAS encourages enterprise and self employment among unemployed. 3 out of 5 people taking advantage of full 12 months Enterprise Allowance still trading 3 years after setting up in business. On average, every 100 of these businesses have created 99 jobs.

(viii) New Workers Scheme helps group with highest unemployment rate.

(ix) Loan Guarantee Scheme helps enterprise and creation of real jobs.

(x) Increases build on success of major increases in 1985 Budget and 1985 Autumn Statement (see above). Much of benefit of these measures and of National Insurance contribution (NIC) restructuring still to come through.

(xi) Responsibility for helping long term unemployed: lies primarily with employers. More sensible pay settlements for those in work would improve prospects for jobs dramatically.

Defensive

(i) Too little too late:

- in how many? years to end 1986-87 will have spent over £8.5 billion on employment measures and YTS;
- YTS has taken more than 1 million trainees;
- CP more than 750,000 participants since inception;
- Enterprise Allowance Scheme and Job Release Scheme more than 425,000 participates since inception;
- Jobstart will offer help to all long term unemployed.

(ii) No net addition to planning total: Additional employment measures proper charge to Reserve. Created to cover just this kind of development. Control over public expenditure remains essential to ease pressure on public sector borrowing and to preserve scope for future tax reductions.

(iii) Government rejected proposals of CBI and Employment Committee: CBI and Select Committee packages likely to be more expensive and less effective in reducing count than claimed. Creating artificial jobs for long term unemployed largely at expense of others. Building improvement programme over twice as expensive in terms of net cost per person off count as Government schemes. (Does not meet Committee's own criteria.) Government has produced better package:

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

- offers appropriate help to all long term unemployed;
- encourages more real and lasting jobs for long term and young unemployed;
- far more cost-effective;
- Government's policy of controlling public expenditure and bringing down inflation has created conditions for real and lasting jobs, as CBI acknowledge. Spending billions of pounds of taxpayers' money would undo past gains.

(iv) Community Programme average wage limit increase too small: 6.3 per cent increase over ceiling set in October 1982 very reasonable; should reinforce Sponsors' confidence in projects.

(v) Jobstart interviews simply frighten people off count. Help long term unemployed by offering in-depth interview leading to offer of job or training or other help. Not intended to frighten people off count. But if some fraudulent claimants ceased claiming, helpful side effect.

(vi) Jobs at eligible pay levels for New Workers and Jobstart allowance do not exist. Schemes designed to reduce pay of those least able to look after themselves. Such jobs do exist and more will. Schemes designed to create more real and lasting jobs, especially for young and those on high benefits. Excessive pay rates have destroyed jobs in many areas.

(vii) More help for long term unemployed would not increase wage pressure since excluded from labour market. Budget measures (especially Jobstart) help to bring long term unemployed back into real jobs. Much to be preferred to schemes leading simply to massive substitution and displacement.

(viii) Why retain asset test in LGS? (Since 1985 applicants have to pass test of already having pledged any assets as securities for conventional loans before qualifying for LGS.) If LGS assistance given to those with security for conventional loans, much more likely to substitute for other financing. Also banks have found personal commitment from borrowers desirable, obviously lacking in borrowers who have security to offer, but unwilling to do so.

(ix) Cost per job under LGS: Primary purpose of LGS is to encourage enterprising small businesses by providing access to finance otherwise unavailable. Creates healthier economy, which in due course leads to more jobs. [~~Will have short term beneficial effect on employment, but not primary aim. [IF PRESSED: Estimates given by PUS for Industry in July 1985 of £2,200 per job were broad brush. Overestimate net Exchequer cost per person off count as calculated on more refined basis.]~~]

(x) Government creating artificial jobs: Budget measures (Jobstart, EAS) concentrate on encouraging unemployed to find real jobs.

Impossible to calculate numbers.

(xi) Other DE savings mean Budget package not as generous as looks. No. Savings part of separate reordering of DE priorities. Do not detract from value of Budget package.

Contact point: A J T MacAuslan (IAE3) 233 3690
WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

G2

Existing employment measures (excluding Budget changes)

TABLE 1

	Start Date	Aim	Numbers covered (January 1986)	Effect on count (January 1986)	Expenditure 1985-86 (£ million)	Expenditure 1986-87 (£ million)	Net exchequer cost per off count in 1985-86 (£)	Prospects of those on employment and training schemes
Community Industry	1975-76	Provides temporary jobs of benefit to community for personally and socially disadvantaged 16-19 year olds	8,000	7,500	25	26	1,200	
Job Release Scheme	1976-77	Helps older workers to retire early and release jobs to unemployed	46,000	40,500	185	123	1,870	
Youth Training Scheme	1983-84	Provides programme of training and planned work experience designed to give school leavers range of practical skills to help them compete more effectively in labour market	320,000	241,000	800	906	not app	60 per cent of those leaving YTS enter employment
Community Programme	1981-82	Provides up to year's work for long-term unemployed adults on projects of benefit to community	183,000	170,000	680	1,017	1,900	ex-CP workers twice as likely to get jobs as other long-term unemployed

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

G2

TABLE 1

	Start Date	Aim	Numbers covered (January 1986)	Effect on count (January 1986)	Expenditure 1985-86 (£ million)	Expenditure 1986-87 (£ million)	Net exchequer cost per off count in 1985-86 (£)	Prospects of those on employment and training schemes
Young Workers Scheme	1982-83	Encourages employers to take on young people at realistic rates of pay	57,000	15,500	30	19	1,400	90 per cent stay with employer when YWS payments end
Enterprise Allowance	1983-84	Provides weekly payments of £40 for year to help unemployed people set up their own business	52,000	17,000	110	142	2,700	3 out of 5 still trading three years after setting up EAS business; on average, every 100 of those businesses create 99 additional jobs
Job Splitting Scheme	1983-84	Encourages employers to split existing full-time jobs and so open up more opportunities for unemployed	290	280	1	3	-150	
Voluntary Projects	1982-83	To create opportunities for unemployed to participate in voluntary activities which help them find employment or obtain formal training	not app	not app	12	14	not app	

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

TABLE 1

	Start Date	Aim	Numbers covered (January 1986)	Effect on count (January 1986)	Expenditure 1985-86 (£ million)	Expenditure 1986-87 (£ million)	Net exchequer cost per off count in 1985-86 (£)	Prospects of those on employment and training schemes
Jobstart allowance	1985-86	Offers allowance of £20/week for maximum of 6 months for those starting job at less than £80/week	4,000	?	0.2	2	?	
Jobstart interviews	1985-86	Provides in-depth interviews and offers job opportunities to long-term unemployed from range of opportunities	50,000	?	1	1	?	

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

Table 2

EXPENDITURE ON MAJOR EMPLOYMENT AND TRAINING MEASURES*: 1979-80 TO 1988-89

* excluding administration costs and Budget changes

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89
				outturn				forecast outturn		provision	
Temporary Employment Subsidy	133	41									
Job Creation Programme	77	5	1								
Community Industry	12	17	19	21	23	24	24	25	26	26	27
Job Release Scheme	22	85	136	134	212	258	280	185	123	103	108
Small Firms Employment Subsidy	12	45	11								
YOP/YTS	63	122	212	394	542	728	785	800	906	1,085	1,202
Special Temporary Employment Programme	9	51	46								
Temporary Short Time Working Compensation Scheme	1	24	365	260	72	27	6				
CEP/CP				87	160	403	534	680	1,017	1,051	1,072
Enterprise Allowance Scheme					2	23	77	110	142	160	164
Young Workers Scheme					41	58	41	30	19		
Job Splitting Scheme						1	1	1	3	2	
Voluntary Projects Programme						6	9	12	14	12	12
TOTAL	329	390	790	896	1,052	1,528	1,757	1,843	2,250	2,439	2,585

J1: REFORM OF PERSONAL TAXATION: GREEN PAPER

242/65

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

J1

J1 REFORM OF PERSONAL TAXATION: GREEN PAPER

[Treasury issuing Press Notice on Budget Day.]

[See also Tax reform (Brief A3) and Effects on incentives and traps (J4)]

Factual

(i) Budget announces publication of Green Paper "The Reform of Personal Taxation". [Cmnd no?]

(ii) Green Paper has three parts:

(a) Part 1 deals with reform of personal allowances and taxation of husband and wife. Sets out arguments for reform, and possible new system of independent taxation with transferable allowances.

(b) Part 2 looks at implications for other areas of tax system.

(c) Part 3 looks at longer-term issues: relationship between tax and social security system; and possible changes in way tax system run.

(iii) Part 1 discusses possible new system under which:

Clarity depends on resources being available. But if they were,

- everyone would have tax allowance in own right;

- married people without enough income to use up allowance would be able to transfer unused balance to their partners;

- there would be end to aggregation of husband and wife's income for tax purposes, giving opportunity for privacy and independence to married women.

(iv) If system adopted, intention would be that no tax payer should lose in cash terms. Effect would be:

- Married man who is sole earner currently gets married man's allowance (worth about 1½ single allowances). Wife gets no allowance. Under new regime couple would get 2 single allowances and wife could transfer any unused part to husband. Would gain substantially.

- Two-earner married couples currently get equivalent of 2½ single allowances. Would ~~each~~ get 2 single allowances ~~with~~ transferable ~~allowances~~ in future. But single allowance would be increased to ensure no cash loss, whilst wife currently earns less than single allowance will gain.

- One-earner married couples where wife is sole earner currently get 2½ single allowances. With transferable allowances couple would get 2 single allowances just as if husband sole earner. No cash loss.

WPU

242/65

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(v) Part II of Green Paper discusses implications of transferable allowances for:

3 - future of age allowance

4 - future of additional personal allowance for single parents;

1 - treatment of investment income; wife's would no longer be aggregated with that of husband

5 - treatment of husband's and wife' capital gains;

2 - mortgage interest relief ceiling of £30,000 for married couples. If this were applied to residence, not borrower, would end present advantage to unmarried couples (who get two rations of relief).

(vi) Tax and benefits: Part III of Green Paper explains proposals already announced will produce more coherent relationship between two systems. Complete integration impractical and undesirable. But Government will look at scope for further rationalisation, as computerisation in DHSS and Inland Revenue carried forward.

(vii) Integration of tax and national insurance contributions (NICs): Green Paper concludes combined charge could have some benefits but that these would be outweighed by damage to contributory principle and major distributional effects.

(viii) Administration in longer term: Green Paper sets out advantages and disadvantages of non-cumulation for PAYE (ie running PAYE treating each pay day in isolation, without looking at tax deducted on previous pay days) and of self-assessment. Invites views. No proposals at this stage.

(ix) 62.4 per cent of married women of working age are in paid work (or looking for it). Of rest 66 per cent looking after children or other relatives; 5 per cent permanently unable to work; only 12 per cent under 50 and keeping house.

(x) Present system uniquely generous to two-earner couples among major countries. Germany, France, Denmark, Ireland, US and Canada all give broadly same tax relief to one-earner and two-earner couples.

(xi) Present system unchanged since 1942 when redesigned to meet wartime needs.

(xii) Review began in 1980 with Green Paper, "The Taxation of Husband and Wife" [Cmnd?]. Set out three possible changes to present system

- optional independent taxation;

- independent taxation with allowances either fully or partially transferable between spouses;

- mandatory separate taxation with increased cash benefits.

Public comments showed widespread desire for change; many favoured fully transferable allowances, others cash benefit approach. Current Green Paper focuses on transferable allowances.

WPU

BUDGET CONFIDENTIAL
until after Budget Speech on 18.3.86
then UNCLASSIFIED

Positive

(i) Green Paper part of Government's continuing programme of tax reform. (See A3.)

(ii) Present system for taxing husband and wife has serious shortcomings

- married women cannot have independence and privacy in their tax affairs;

- can cause tax penalty on marriage;

- by giving 1½ single allowances to one-earner couple and 2½ allowances to two-earner couple, system bears hardest on many couples at point when need most help (ie when have only one earner and young family);

- expensive to raise tax thresholds for one-earner couples - largest group in unemployment and poverty traps.

(iii) Transferable allowances very simple to understand. Perfectly feasible to run with proper planning and computer support (see below).

(iv) With transferable allowances:

- married women would have opportunity for full independence and privacy;

- transferable allowances and related changes would remove tax penalty on marriage (see above);

- equal allowances for all married couples would mean increase in allowances for married man supporting family, providing more sensible basis for further threshold increases.

(v) Right to review personal tax system now when computerisation of PAYE opens new options.

Defensive

(i) General

(a) 5 year silence since last Green Paper: Always made clear that radical reform of personal tax depended on computerisation - not fully complete until 1989. Tax reform in other areas since 1980: overhaul of company tax; capital gains tax indexation; NIC restructuring etc. (See A3.)

(b) Another Green Paper: Right to consult on far-reaching change. Green Paper develops specific ideas; goes well beyond husband and wife issues.

(c) Timing: First step is full consultation. Change not possible before 1990, given reliance on Inland Revenue computerisation.

(d) Why can change not be introduced before Inland Revenue computerisation? [IR to supply]

(ii) Transferable Allowances (TAs)

(a) Mandatory separate taxation with cash benefits better option: Important tax system should recognise circumstances where one spouse dependent on other - every other country does. TAs do this flexibly without drawing invidious distinctions between couples. Mandatory separate taxation would [increase tax for all one-earner couples and] pay out benefits to those deemed to be "deserving". ?

(b) TAs waste money.

give full figs

No more than 12 per cent of non-working married women are under 50 and simply "keeping house".

(c) TAs bad for married women's incentives. Reform would merely remove positive discrimination in favour of two-earner couples, unique to UK. Neither necessary nor economically desirable in present conditions. Denmark, with TAs for some time, has highest proportion of married women working of any country in EC.

(d) TAs are Government attempt to reduce unemployment totals. Government has welcomed growth in part-time female employment; up nearly ½ million since June 1983.

(e) Two-earner couples lose out. Would not lose in cash terms. [IF PRESSED: Cost of introducing TAs at a stroke would be substantial on no cash loser basis. But Green Paper (paragraph 3.7) explains how phasing could spread and contain cost.]

(f) Elderly and single parents could lose from abolition of special allowances. Not intended that elderly or single parents, or any other group, should lose in cash terms as result of introduction of TAs. Future of special allowances under TAs would be for consideration (ie Green Paper does not now propose abolition).

(g) Tax changes ineffective way to alleviate poverty and unemployment traps after social security reforms. Still vital to reduce taxes, to let people keep more of their earnings. More efficient than both paying tax and relying on income-related benefit. Raising tax thresholds will increase net income for some, so no longer need income-related benefits at all. TAs more effective than present system at directing tax relief to those in traps because increase allowances for one earner couples, currently biggest single group in traps.

(h) TAs complicated to run: TAs would be flexible system, taking account of changing circumstances of individuals. Inevitably more adjustments needed than under present system, but perfectly feasible with proper planning and computer support.

(j) Better if TAs independent: [IR to supply]

(iii) Tax and social security

Should integrate tax and social security. Green Paper sets out arguments for and against. Concludes complete integration undesirable and impractical:

- taxes and benefits have different purposes, and therefore often cover different people;
- look at different concepts of need/ability to pay;
- operate on different timescales.

Proposals in Green Paper and in Social Security Bill produce more coherent relationship between two. Government will continue to look for scope for further rationalisation.

Contact points: B A Mace (Inland Revenue) 2541 6546
A P Hudson (Inland Revenue) 2541 7349

K1: EFFECTS OF BUDGET ON BUSINESS

24 4

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

K1

K1 EFFECTS OF BUDGET ON BUSINESS

[See also Manufacturing industry in UK (Brief B7), Economic effects of oil price fall (C1), Balance and burden of taxes on income and spending (J5), International Comparisons (J6), Budget and enterprise (K2), Small and unincorporated businesses (K3), Inland Revenue and charities (L2) Benefits in kind (M2), Employee share schemes (M4), Profit sharing (M5), Overseas travel expenses (M6), briefs in Sections N, P and Q, Registration/deregistration thresholds and small businesses (R2), Motoring expenses (R3), Disaggregation (R4), Petrol, derv and other hydrocarbon oils (S2), VED (S3) and Keith Report (T1)].

[illegible]

Main pt: [illegible]

Factual

(i) 1984 business tax reform

- abolished incentive capital allowance system in stages; stock relief immediately;

- reduced main corporation tax (CT) rate to 35 per cent in three annual stages; small companies rate to 30 per cent immediately.

(ii) Transition now completed. 1986-87 first full year of post 1984 system.

(iii) 1986 Budget completes 1984 reform by restructuring mines and oil wells allowances (MOWA) and agricultural buildings allowance (ABA). (See N3, N4.)

(iii) ~~As consequence of~~ In line with basic rate cut, further cut in small companies CT rate to 29 per cent in 1986-87.

(v) 1986 Budget measures which affect business

(a) Enterprise (see K2):

- Business Expansion Scheme extended indefintely (see N1).

- Loan Guarantee Scheme extended for 3 years (see G2);

- improvements to employee share schemes (see M4);

- proposals to give tax relief on profit sharing (see M5);

- Personal Equity Plan will encourage more individual investment in company equities (see Q4);

- expansion and improved tax treatment of Enterprise Allowance (see G2);

- abolition of Capital Transfer Tax charge on lifetime giving eases transfer of small businesses (see P2).

(b) North Sea taxation: No major change. Minor technical change to assist exploration in inshore waters (see N2).

(c) VAT

- registration and deregistration thresholds increased (see R2);

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

- action on avoidance by disaggregation will cost business £20 million in 1987-88 (see R4)

- scale VAT charge for business spending on 'private petrol' will cost business £40 million in 1987-88 (see R3).

(d) Excise duties: Increase in petrol and derv duties (just under 1½ times inflation) and gas oil duty offset by unaltered car and lorry VED, and abolition of some minor oil duties. Business cost increases in 1986-87 in cash terms:

petrol	:	+	£125 million
derv	:	+	£ 85 million
minor oil duties	:	+	£ 10 million
VED	:	+	£ 5 millon

Total increase £225 million, only £5 million more than indexation across board.

(e) Pension fund surpluses: New objective rules cut down uncertainty and Inland Revenue discretion (see Q3).

(f) Motoring expenses

- restructured scale for car benefits increased by 10 per cent for 1987-88 but no change in car fuel benefits (see M2). Will cost business £15 million more;

- scale VAT charge for business spending on 'private petrol' from 1 April 1987. Will cost business £40 million in 1987-88.

(g) Concessions on overseas travel expenses (see M6).

(h) Charities: Increased scope for company charitable giving: no limits for covenants by close companies; relief for single gifts by non-close companies. (See L2).

(vi) Effect of Budget on manufacturing: No change to 1984 business tax reform: meets case for stable, predictable tax environment. Inheritance tax, employee share scheme improvements, better BES targetting help small, growing manufacturers. Restructured car benefit scale modest help to competitiveness of UK car industry.

(vii) Effect of Budget on companies operating in North Sea: Continuing stability for North Sea companies. Technical changes help activity in onshore waters (see N2).

(viii) Effect of Budget on agriculture: Reform of ABA recognises special position of short-life agricultural buildings and works. Minimises compliance costs (see N4). Improved CGT "part disposal" provision may help where land sold to repay debt (see P3).

(ix) Effect of Budget on financial companies:

- Stamp duty changes cut dealing costs, help international competitiveness of City. But revenue-neutral overall. (See Q1, Q2.)

- Personal Equity Plan (tax relief for share investment) brings new business to stock market. (See Q4.)

- Technical changes to prepare for City revolution. (See Q6.)

(x) Effect of Budget on small businesses: See K3.

(xi) Balance and burden of company taxation: See J5.

(xii) International comparisons: See J6.

(xiii) CBI business representations:

(a) initially (published 14 January) proposed net £3.3 billion package

- as first priority £1 billion for job creation measures and infrastructure spending to create 330,000 jobs within two years;

- 10 per cent increase in thresholds over indexation, cost £2.1 billion in full year;

- 10 per cent business derating, cost £420 million in full year;

- 100 per cent CTT relief for business assets;

- abolition of capital duty.

(b) following oil price fall, representations modified (Sir J Cleminson to Chancellor, 10 February)

- to concede fiscal adjustment would be "nothing like" £3.5 billion first proposed;

- to restate priority for job creation and infrastructure package;

- tax allowances to be increased, if further money available;

- other tax measures not mentioned.

(xiv) Equipment Leasing Association (ELA) claimed UK industrial investment could fall by 4 per cent in long term as direct result of 1984 Budget tax changes (press release 29 November 1985 reporting study by Bath University). But confirmed overall reduction in CT burden in longer term.

(xv) ELA/Ernst and Whinney Study [to be supplied]

Positive

(i) Strategy of 1984 reforms unchanged - reduced distortion and lower tax rates leading to improved incentives, higher quality investment. Changes to MOWA and ABA complete reform programme.

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(ii) Main corporation tax rate confirmed at 35 per cent for 1986-87: lowest in any major industrialised country.

(iii) Small companies rate further reduced to 29 per cent in line with basic rate income tax cut.

(iv) 1984 reform broadly revenue neutral for business as whole over transition. Long-term reduction in overall tax burden confirmed by recent independent study (see above).

(v) Extension of BES helps enterprise and innovation.

(vi) Inheritance Tax: exemption for lifetime gifts increases incentives to enterprise and growth.

(vii) Charities package: no limit on covenants for close companies, relief for single gifts by non-close companies. Increases scope for charitable giving by business.

(viii) Profit sharing: Consultation announced on possible tax incentive for profit-sharing arrangements. Scheme would replace slice of wages with profit-linked element to increase flexibility. Could cut cost of new jobs (see M4).

(ix) Employee share scheme changes ease access for family and employee owned companies; worker cooperatives.

Defensive

(i) In context of prudent Budget, no case for across-the-board reductions in business tax. Most businessmen would accept this. (CBI modified Budget representations following oil price fall);

(ii) Business benefiting from lower energy costs (see C1). Oil duty and VED broadly neutral: do not clawback fuel price reductions as widely predicted.

(iii) Higher capital allowances/extended transitional period No case for relaxation. Total business investment up 7 per cent in 1985. DTI Intentions Survey suggests further growth in 1986 and 1987.

(iv) 1984 reform means reduced investment. 1984 capital allowance changes cut tax subsidy to low-grade projects. So slight fall in quantity of investment projects motivated by tax, not market, reasons should improve quality. But effect likely to be much less than ELA's 4 per cent.

(v) [Ernst and Whinney: international comparisons - to come].

(vi) Keith Report: Legislation for Inland Revenue taxes delayed to 1987 to allow further consultation (see T1).

(vii) More relief needed for research and development (R and D): Already special relief for R and D: Scientific research allowance retained at incentive rate of 100 per cent. Other allowances reduced as part of 1984 package.

Contact point: M Haigh (FP) 233 757

WPU

K2: BUDGET AND ENTERPRISE

242/76

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

K2 BUDGET AND ENTERPRISE

[See also Supply side (Brief F1) Employment measures (G2), Employee share schemes (M4), Profit sharing (M5), Business Expansion Scheme (N1) Capital Transfer Tax: Inheritance Tax (P2) and Personal Equity Plan (Q4)]

Factual

(i) 1985 Budget included

- reduction in Class 2 national insurance contributions for self-employed and tax relief for Class 4 contributions - to help small businesses;

- reduction in national insurance contributions for low paid employees (increasing incentives) and their employers (reducing cost of employment);

- Business Expansion Scheme extended to research and development companies;

- abolition of Development Land Tax;

- reform of Capital Gains Tax (CGT), especially improvement of retirement relief and indexation provisions, helping small business.

(ii) Enterprise measures announced in 1985 Autumn Statement:

- expansion of Enterprise Allowance Scheme;
- increased provision for tourism;
- more money for Local Enterprise Agencies;
- temporary extension of Loan Guarantee Scheme (LGS).

(iii) 1986 Budget measures:

(a) Business Expansion Scheme (BES): Extended indefinitely. Asset based activities excluded. CGT exemption for new BES shares on first sale (see N1).

(b) Loan Guarantee Scheme (LGS): Extended for 3 years. Premium halved from 5 per cent to 2½ per cent (see G2).

(c) Employee share schemes: Easier access to schemes for worker co-operatives and other improvements to existing arrangements (see M4).

(d) Profit sharing: Consultative document proposing scheme to give tax relief on proportion of earnings of employees where enter into agreement with employer to relate minimum proportion of income to profits (see M5).

(e) Personal Equity Plan: New tax incentives for investment in equities - no capital gains tax on gains and no income tax on reinvested dividends if equities held for minimum period of 12-24 months (see Q4).

(f) Enterprise Allowance: Rate of entry increased. Present target 80,000 in 1986-87. New target is annual rate of 100,000 by April 1987 (see G2). Change in tax treatment of Allowance, in future to be taxed as separate source of income (under Case VI of Schedule D), preventing allowance being taken into account more than once for tax purposes (see M9).

(g) Capital Transfer Tax (CTT): Changes to Inheritance Tax. Charge on lifetime giving abolished for individuals. Duty tapered from 7 years before death. Helps transfer of small businesses. (See P2.)

(iv) Overall cost of 1986 Budget measures: £40 million 1986-87
£115 million 1987-88

Positive

(i) Forms part of consistent strategy to encourage small businesses and improve efficiency of economy. Helps raise finance to start up businesses (LGS); provides income when starting up business (EAS) and avoids tax burden from CTT when businesses transferred by individuals in their lifetime.

(ii) Further encouragement for employees to identify with business by encouraging employee share schemes and profit sharing.

(iii) Profit sharing would also help increase wage flexibility over long term. By reducing fixed costs of employing workers, employers less likely to lay off employees if profits decline. Consultative document to stimulate views on practicalities/details.

Defensive

(i) Measures too small to have any impact: Effect cannot be measured by short term costs. Intended to improve long term supply performance of economy by encouraging enterprise and growth of small businesses. Taken together with other supply side measures (see F1), will improve climate for enterprise and prospects for jobs.

(ii) Effect on unemployment: Part of range of measures designed to improve supply performance of economy. Encouraging initiative, enterprise and small businesses will improve prospects for jobs.

Contact point: R Pratt (CU) 233 8737

LI: CHARITIES
- GENERAL

L1 CHARITIES: GENERAL

Inland Revenue and Customs and Excise issuing Press Notices on Budget Day.

[See also other briefs in Section L]

Factual

(i) Summary of charity reliefs before 1986 Budget

(a) Charities exempt from income and corporation taxes on receipts (except certain trading income) and from capital gains tax, provided income or gains applied for charitable purposes.

(b) Individuals can deduct basic rate tax from all payments to charities under deeds of covenant lasting at least 4 years (reduced from 7 in 1980); higher rate relief allowed since 1980 on payments up to limit. Increased to £10,000 in 1985.

(c) Companies get corporation tax relief on covenanted payments. Other payments to charities (eg sponsorship) also deductible as expenses, provided not capital spending and wholly incurred for purposes of business. From 1983 Budget cost of employees seconded to charities deductible too.

(d) Gifts and bequests to charities exempt from Capital Transfer Tax (CTT). (Initially subject to upper limit; £250,000 by 1983 but abolished in 1983 Budget.) Also exempt from stamp duty.

(e) VAT zero-rate relief for donated goods; medical scientific and computer equipment; RNLI lifeboats, slipways and launching equipment; ambulances and adapted welfare vehicles and items for handicapped; certain construction work for disabled access to charities' buildings; charges for leasing of cars to handicapped by Motability.

(ii) 1986 Budget contains following further proposals:

(a) Higher rate relief: £10,000 limit for higher rate relief on covenanted donations by individuals (see above) abolished. (Details in L2.)

(b) Company giving: for first time companies (excluding close companies) will be able to claim corporation tax relief for single gifts to charities, up to maximum of 3 per cent of dividends paid by company in relevant accounting period. (Details in L2.)

(c) Payroll giving: new scheme proposed, to operate from April 1987, following consultation. Would allow employees of participating employers to obtain tax relief for donations, up to £100 a year limit, made to charities through deductions from wages and salaries. (Details in L2.)

(d) VAT: zero-rate relief (see above) extended to non-classified newspaper advertising and medicinal products supplied to charities; non-specialised recording equipment used by charities for blind; installation of lifts and distress alarms for handicapped and their charities; video and refrigeration equipment used by charities and other eligible bodies for medical purposes and non-adapted welfare vehicles used by such bodies for transporting blind, deaf and mentally handicapped. (Details in L3.)

(e) Abuses: measures to be taken to prevent tax reliefs for charities being abused. (Details in L2.)

Positive

(i) Wide-ranging package of measures, building on reliefs granted since 1979, to encourage support for voluntary sector, while ensuring that tax reliefs for charities not abused.

(ii) Package of reliefs worth in total perhaps £60 million in 1987-88 in terms of revenue forgone, though difficult to predict effects on giving to charities. Measures against abuse yield £20 million in 1987-88.

(iii) Direct grants to charities by Government more than doubled since 1979 to some £215 million in 1984-85, while grants by other Government agencies more than trebled to £1,400 million.

Defensive

(i) Why not give tax relief for all gifts to charities? Proposals for relief for single donations by companies and removal of higher rate relief limit on individual covenanted gifts respond to charities' most pressing concerns in this area. Some charities expressed concern that single gift relief for individuals might reduce and destabilise present flow of income from covenants. Government therefore proceeding cautiously, with proposals to introduce limited payroll relief in 1987. (See L2.)

(ii) Relief for donations bonanza for public schools like Eton? (Dr Oonagh McDonald MP, reported 'Guardian' 20 February 1986) Education remains legitimate charitable object. Relief for donations available to all charities - up to them to use measures now available. (See L2.)

(iii) No general VAT relief for charities Any scheme of relief would involve about 100,000 charities. Would necessitate substantial addition to Customs and Excise manpower. Would benefit whole range of charities according to pattern of spending on taxable goods and services, not necessarily reflecting extent of public support. Revenue cost would be considerable - estimated to be in range of £140-£160 million. (See L3.)

Contact point: A B Murray (FP) 233 8534

M1: INCOME TAX
- MAIN CHANGES

24[illegible]3

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

M1 INCOME TAX

Inland Revenue issuing Press Notices on Budget Day.

[See also Reform of personal taxation: Green Paper (Brief J1), Effects of tax and NIC changes on living standards (J3), Effects on incentives and traps (J4), Balance and burden of taxes on income and spending (J5), International comparisons (J6) Social security benefits (J7), Inland Revenue and Charities (L2), other briefs in Section M and Cut in basic rate: business consequentials (N7)]

A MAIN CHANGES

Factual

(i) Basic rate reduced from 30 per cent to 29 per cent; no change in higher rates (40, 45, 50, 55, 60).

(ii) Main personal allowances (basic married and single allowances, age allowances and additional personal allowance) increased in line with statutory indexation (Section 24 Finance Act 1980):

	1986-87	1985-86	Increase over 1988-86	
	£	£	£	per cent
Married man's	3,655	3,455	200	5.8
Single (and wife's earned income)	2,335	2,205	130	5.9
Additional personal and widow's bereavement	1,320	1,250	70	5.6
Age: married man's	4,505	4,255	250	5.9
Age: single	2,850	2,690	160	5.9
Age: income limit	9,400	8,800	600	6.8

(Some increases larger han 5.7 per cent increase in RPI in year to December 1985 because of statutory rounding provisions.)

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(iii) (a) Threshold for first (40 per cent) higher rate also increased in line with statutory indexation;

(b) widths of bands for subsequent higher rates remain at 1985-86 levels. (All higher rate thresholds rise by £1,000.)

Band per cent	1986-87	1985-86	Increase in Threshold	
	£	£	£	per cent
40	17,201-20,200	16,201-19,200	1,000	6.2
45	20,201-25,400	19,201-24,400	1,000	5.2
50	25,401-33,300	24,401-32,300	1,000	4.1
55	3~~4~~3,301-42,200	32,301-40,200	1,000	3.1
60	over 41,200	over 40,200	1,000	~~2.9~~ 2.5

(iv) Tax reductions (including any tax overpaid after 6 April) in pay packets on first pay day after 17 May.

(v) Typical weekly tax reductions for basic rate taxpayers:

	£ per week	
	Single	Married
Income £ per week		
100	1.30	1.45
150	1.80	1.95
200	2.30	2.45
250	2.80	2.95

(vi) New weekly tax thresholds £70.29 married; £44.90 single.

(vii) Chancellor reaffirmed Government's target of cutting basic rate to 25 per cent set by Sir Geoffrey Howe in June 1979 Budget (OR vol 968 no 15 col 261).

WPU

(viii) Cost

	£ million		
	Estimated effect on receipts in 1986-87		**Estimated effect on receipts in 1987-88**
	Indexed base	**Non-indexed base**	**Non-indexed base**
Allowances	0	-1,020	-1,285
Basic rate limit	0	-70	-145
Reduction in basic rate	-835	-835	-1,250
Further higher rate thresholds	+15	-35	-70
	-820	-1,960	-2,750

(ix) Indexation cost in base of FSBR forecast: £1,140 million for 1986-87.

(x) Taxpayer numbers:

(a) some 550,000 fewer taxpayers than if allowances had remained at 1985-86 levels.

(b) about 150,000 fewer higher rate taxpayers than if allowances and thresholds had remained at 1985-86 levels.

(c) about 1.4 million fewer taxpayers in 1986-87 compared with indexed 1978-79 tax regime.

(xi) Labour Party committed to no increase in basic rate (Mr Hattersley OR vol 91 no 56 col 984 12 February 1986).

(xii) If money spent on basic rate reduction had been used further to increase main personal allowances and give same cash increase on age allowance (as in 1985), main allowances would increase in real terms by 5.4 per cent to:

	£
Married man's	3,845
Single (and wife's earned income)	2,455
Age: married man's	4,645
Age: single	2,940

Positive

(i) Cut in basic rate reduces marginal rate for [ ] million working taxpayers. Improves incentives for more people than allowance increase.

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(ii) By international standards, starting rate of tax in UK is high. But on thresholds, UK position compares favourably with number of countries, including West Germany and US.

(iii) 29 per cent is lowest basic or standard rate of income tax since before Second World War. (But lower reduced rates in 1950s were marginal rates for majority of taxpayers).

(iv) Those on middle incomes benefit because basic rate cut gives more to them than equivalent cost increase in allowances.

(v) Unincorporated businesses: No reduction in marginal tax rates on profits since 1979, compared with reduction from 52 per cent in 1982-83 to 35 per cent in 1986-87 in Corporation Tax on profits of incorporated businesses. Cut in basic rate to 29 per cent will reduce marginal tax rates for majority of unincorporated businesses.

(vi) Real value of married man's allowance still highest since Second World War. Real value of single person's allowance highest since 1973-74.

(vii) Single parents: additional personal allowance (APA) for single parents up by £70 to £1,320 (worth 40p a week in cash terms; £1.15 including single allowance).

(viii) Widows and single women aged 60-64: "Clear water" between basic pension and single allowances around £330 in 1985-86 (£300 in 1984-85). Well over half women in group aged 60-64 will not have to pay tax. About 60,000 fewer widows will pay tax in 1986-87 compared with no change in allowances.

(ix) Proposed increase in allowances will take 550,000 people out of tax altogether.

(x) Income tax changes in Budget will typically mean reduction of £2.45 per week for married man on average earnings, and reduction of £2.30 a week for single person on same earnings.

(x) Indexation of allowances alone gives minimum weekly tax reduction of 75p single, £1.15 married to basic rate taxpayers.

(xii) Incentives improved for [23 million] taxpayers (95 per cent of total) whose marginal rate is basic rate (see also J4).

(xiii) Assuming increase in earnings of 7 per cent in line with Government Actuary's assumption, average rates of tax down in 1986-87 compared with 1985-86 for everyone except single earning £45-55 per week; married earning £70-88 per week and all 60 per cent tax rate payers.

2[illegible]73

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

M1

Defensive

(i) Greatest cash reductions in tax go to highest paid:

- in terms of percentage of income taken in tax (average tax rate), gains larger for lowest paid.

- with progressive income tax system, inevitable that higher paid get larger cash reductions.

- less than full indexation of second and subsequent higher rate thresholds means 60 per cent taxpayer gains only 23p per week more than under statutory indexation with no basic rate cut.

(ii) Should have increased allowances above indexation rather than cut basic rate:

- Government's objective both to increase allowances and cut rates.

- Basic allowances pre-Budget already 20 per cent higher in real terms than in 1978-79. But no cut in basic rate since 1979.

- UK around OECD average in point on income scale at which taxpayer becomes liable to tax. But well out of line in rate at which starts to pay tax (see J6).

- Cut in basic rate improves incentives for 95 per cent of all taxpayers.

- Cut in basic rate helps unincorporated business and self employed too. Source of many new jobs.

- Basic rate cut worth more than equal cost increase in allowance to:

  (a) single person earning over 60 per cent of average earnings (£120/week)

  (b) married man earning over 90 per cent of average earnings (£190/week).

  This group has benefited least from tax changes since 1979.

- Only minority of those taken out of tax by threshold increases are genuinely "needy"; 80 per cent are juveniles, pensioners and working wives.

- Once means tested benefits calculated on net income basis (following social security reforms), both cuts in tax rates and increases in thresholds will be ~~partly~~ offset by reduced benefits for those on low incomes. So must be judged by effect on majority not those at bottom of income scale.

- Green Paper on Reform of Personal Taxation looks forward to further increases in allowances if change to transferable allowances implemented. Basic rate cut reduces cost of change.

WPU

242/73

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

M1

(iii) Reduced rate band

- Reduced rate band very costly. For same cost as one point off basic rate could have band of only about £1,000 at 25 per cent. Would reduce marginal rates only for single people earning less than £64 per week; married earning less than £90 per week; some [ ] million taxpayers out of total of [ ] million of working age. Basic rate cut improves incentives for [ ] million.

- Reduced NIC rates introduced last year for those with low earnings.

- Reduced rate band involves heavy administrative costs for Revenue and additional compliance costs for employers (especially small employers).

- Abolition of reduced rate band in 1980 saved 1,300 staff in Revenue.

- Reduced rate band not ~~practicable~~ administratively possible in 1986-87 when Revenue staff heavily engaged in changing to computerised working (COP).

(iv) No help for poverty/unemployment traps: See J4.

(v) Tax reductions help only those on middle incomes:

(a) Those with low incomes have already benefited substantially from tax and NIC changes under this Government. Pre-1986 Budget, thresholds increased 20 per cent in real terms; 1986 Budget takes to 22 per cent. NICs reduced for those on low earnings.

(b) Those on high incomes have benefited from reduction in highest rate of tax on earned income from 83 per cent to 60 per cent. ~~and from abolition of Investment Income Surcharge.~~

Straightforward all taxpayers, & worth more than ~~tax~~ thresholds for those above £120 single < £180 married

Contact point: B A Mace (Inland Revenue) 2541 6546

WPU

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

B ELDERLY: AGE ALLOWANCE

Factual

(i) Age allowance (for those 65 and over) increased in line with statutory indexation provisions.

(ii) Married age allowance increased by £250; single age allowance by £160.

(iii) Means minimum weekly tax reduction for elderly of £0.92 single and £1.44 married.

(iv) Elderly also benefit from reduction in basic rate.

(v) Income limit for age allowance increased from £8,800 in 1985-86 to £9,400 (in line with statutory indexation).

(vi) Single pension currently £38.30 per week and married couple's pension £61.30. Uprating already announced for July 1986 will take single pension up to £38.70 per week and married couple's pension up to £61.95 (see J7).

Positive

(i) Age allowance remains around 10 per cent higher in real terms than in 1978-79. Taking account of pension uprating in July 1986:

(a) pensioners with basic state pension only will pay no tax;

(b) - single pensioners can have income up to about £16 per week over basic pension before pay tax (about £1 more than in 1985-86);

- married pensioner nearly £25 per week (nearly £2 more than 1985-86);

(c) in all, about 60 per cent of elderly households (singles 65 or over; couples with one or both spouses 65 or over) will pay no tax.

(ii) Differential of age allowance over corresponding basic allowances up by £50 (to £850) for married couples; up by £30 (to £515) for single elderly. Age allowance over 20 per cent higher than basic allowances.

(iii) With increase in income limit for age allowance, married pensioner can have income up to £10,675 before benefit from age allowance disappears (£10,000 for 1985-86); single pensioner up to £10,173 (£9,528 for 1985-86).

Defensive

(i) Differential of age allowance over basic allowances should be widened.

- Age allowances at highest ever level in real terms since introduction in 1975-76.

- Taking account of changes in structure, highest tax threshold for elderly married since Second World War; for elderly single since 1973-74.

- "Clear water" over basic pension over [17] per cent higher in real terms than in 1978-79 for married over 65s; [20] per cent higher for single elderly.

(ii) Future of age allowance on change to transferable allowances: See J1.

Contact point: B A Mace (Inland Revenue) 2541 6546

C PERSONAL TAXATION: CONSEQUENTIALS OF CUT IN BASIC RATE

Inland Revenue issuing Press Notice on Budget Day.

(a) Effect on covenants

Factual

(i) Basic rate tax deducted from covenant payments; repayable to recipient where appropriate.

(ii) Basic rate reduction means that:

(a) for "gross" covenants, convenantor has to increase net payment (eg to pay £100 less tax, has to increase net payment from £70 to £71);

(b) for "net" covenants, convenantor continues to pay same net sum (eg £70 if paying £70 after tax at current rate) but tax repayment available to recipients (eg charities) slightly reduced becasue net payment grossed up at 29 per cent rather than 30 per cent.

Positive

Cut in basic rate increases individual's net income, so more available for charitable giving if he wishes. Other Budget tax changes encourage this.

Defensive

(i) People with gross covenants have to increase net payment. Yes. Since less tax to deduct. But they pay correspondingly less tax on their own income.

(ii) Charities lose out on net convenants. Repayment is reduced slightly, but inevitable result of basic rate reduction. General tax reduction and special incentives for charitable giving (see L2) will encourage donors to give more.

Contact point: C Stewart (Inland Revenue) 2541 7414

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(b) Additional rate on trusts and life assurance premium relief

Factual

(i) Additional rate (in addition to basic rate) charged on income of discretionary and accumulation trusts: 15 per cent 1985-86; 16 per cent 1986-87.

(ii) Rate fixed automatically by legislation as difference between basic rate and second higher rate (45 per cent).

(iii) Beneficiaries get credit for basic and additional rate tax when income distributed to them.

(iv) Rate of life assurance premium relief unchanged at 15 per cent.

Defensive

(i) Wrong to increase rate. Additional rate charge broadly represents higher - not basic - rate liability. Higher rates not being reduced.

(ii) Charge unfair on (eg orphans' trusts, small trusts). When income distributed, beneficiaries get full credit for tax paid by trustees. Can claim replayment of additional rate of tax if basic rate taxpayers, plus basic rate tax if non-taxpayers.

(iii) No change in relief on life assurance premiums. [IR to supply]

Contact point: C Stewart (Inland Revenue) 2541 7414

(c) Deduction of tax from annuities, interest etc

Factual

(i) Where right or obligation to deduct tax at basic rate from annuities, other annual payments (eg alimony), interest, royalties etc, rate at which deduction to be made reduced to 29 per cent after 5 April 1986.

(ii) For UK Government securities and foreign dividends paid in UK, deductions at 30 per cent permitted for 1 month after passing of Resolution, but over-deduction to be adjusted later by Tax Office on production of evidence of over-deduction.

(iii) For annuities, annual payments (including alimony), royalties and other annual interest, payer must make good any over-deduction.

(iv) Inland Revenue to issue circular (available from Tax Offices) outlining details.

Contact point: B O'Connor (Inland Revenue) 2541 6218

Q3: PENSION SCHEME SURPLUSES

2[illegible]/75

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

Q3

Q3 PENSION SCHEME SURPLUSES

Inland Revenue issuing Press Notice on Budget Day.

Factual

(i) (a) Pension fund contributions currently tax deductible for employers and employees.

(b) Pension funds currently permitted to build up assets free of capital gains tax and income tax.

(ii) Some pension funds at present heavily overfunded as result of improved financial climate, especially lower inflation and reduced membership as result of restructuring of industry and resulting redundancies.

(iii) Inland Revenue currently has to exercise discretionary powers:

(a) to require excessive surpluses be diminished;

(b) to turn down increasing requests for refunds from companies with excessive surpluses which previously have had to top up funds in deficit.

(iv) 1986 Finance Bill will replace uncertain and discretionary arrangements with clear and objective legislation.

(a) For purposes of proposed new regime, pension fund assets and liabilities will be valued, for those purposes only, on pre-determined actuarial basis (to be prescribed in Regulations). On advice from Government Actuary's Department (GAD), will incorporate

- prudent actuarial assumptions;

- secure funding method ("Projected Unit Credit") (ie method will result in reasonable contingency margin after using prudent actuarial assumptions).

(b) If, on basis of this valuation, projected value of scheme assets exceeds 105 per cent of projected cost of scheme liabilities (ie 5 per cent surplus), pension fund trustees shall reduce surplus by

- contribution reduction/holidays;

  and/or

- benefit improvements (within Inland Revenue limits);

  and/or

- refunds to employers.

Any combination of these three methods may be used to reduce surplus. ~~If refund~~ made, surplus must not fall below 5 per cent.

WPU

It is for trustees to decide, which, but

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

(Trustees may set at whatever level they wish, but no relief given below that figure). ?

(c) All refunds subject to free-standing income tax or corporation tax at 40 per cent.

Explain why (present tax relief figures) — see defensive (vi)(b) — not defensive!

(v) New rules to apply to

- all schemes from 6 April 1987;
- voluntary refunds from Budget Day.

(vi) Legislative timetable: Enabling legislation in 1986 Finance Bill. Details of new regime in Regulations (to be laid later in 1986(?) 1986-87?). Which? 1986

(vii) Relationship with contracted out bonus under State-earnings Related Pension Scheme (SERPS): ~~use of prudent actuarial assumptions, plus 5 per cent surplus margin, avoids clash with payments (excluding bonus) by DHSS to contracted-out schemes.~~ GAD's actuarial assumptions & those made for SERPS purposes.

(viii) Revenue saving: New rules will lead to modest reduction in present cost of pension scheme tax reliefs. Overall effect (highly tentative):

	£ million
1986-87	+20)
1987-88	+120)

Positive

(i) New regime will substitute clear and objective rules for present uncertainty and administrative discretion.

(ii) New facility for businesses to obtain refunds, if pension scheme in substantial surplus. Might

- avert cash-flow crisis, thereby protecting employees' jobs and pensions;
- facilitate expansion/new investment with benefits for output (and thus earnings of scheme members) and scope for more jobs.

(iii) Specified actuarial basis (with secure funding method and prudent assumptions) will offer full safeguard for pension schemes' solvency: no compulsory refunds below 5 per cent; no possibility that choice of actuarial assumptions might be biassed to produce (or conceal) surpluses.

(iv) New 40 per cent charge will deter "pension schemes stripping" by takeovers. Inland Revenue powerless to stop strips, and at present usually no tax paid when pension fund gobbled up by predator. In future, tax must be paid.

BUDGET SECRET
until after Budget Speech on 18.3.86
then UNCLASSIFIED

Q3

Defensive

(i) Excessive surpluses shows pension fund well-managed? Not necessarily. In any case represent, misuse of tax privilege intended solely to encourage provision of pensions.

(ii) Endangering security of pension funds: No. As first priority, scheme trustees must maintain fund fully sufficient to meet prospective scheme liabilities - together with adequate contingency reserve. Ensured by

- 5 per cent margin permitted;
- "Projected Unit Credit" more secure than bases used by most current schemes;
- specified actuarial assumptions (on GAD advice) at prudent level: essentially same as those used by GAD for contracting-out rules.

(iii) Permitting employers to raid schemes: No. If scheme in excessive surplus, trustees should be able to reduce it by whatever means consider appropriate (subject to safeguards against abuse). Trustees are independent and responsible for seeing that scheme remains solvent.

(iv) Heavy administrative burden for funds? No. Valuation on GAD lines will only be carried out every [ ] years and basic data on which it will be based is similar to that required anyway from Trustees' "commercial" actuarial valuation.

(v) Schemes should not be able to accumulate, with benefit of generous tax relief, excessive surpluses. Requirement of periodic valuations on specified basis will reduce scope for parking spare profits and ensure excessive surpluses reduced.

(vi) Special tax on refunds:

(a) Revenue rules should not prevent refunds where desirable or necessary: but rules should not offer tax incentive for refunds as opposed to contribution reductions/benefit improvement.

(b) Recovery charge of 40 per cent enables Exchequer to recoup some measure of previously given tax relief: tax relief on contributions and tax-free build up of funds.

(c) If tax recovery charge could be set off against losses etc, would offer scope for abuse cf US where takeovers reportedly arranged in order to strip pension funds of assets.

(vii) Contracted-out rebate includes 7.5 per cent bonus: mismatch with 5 per cent ceiling.

- Risk hypothetical. Specified funding basis for new rules more secure than that adopted by most schemes, so problems unlikely to arise in practice. GAD advise 5 per cent margin adequate.
- Trustees always free to improve benefits above minimum level.
- Discussions with DHSS and Occupational Pension Board after Budget Day.

WPU

Contact point: N C Munro (Inland Revenue) 2541 6487

BUDGET SECRET
until after Budget Speech on 18.3.86.
then UNCLASSIFIED

Q4 PERSONAL EQUITY PLAN

Inland Revenue issuing Press Notice on Budget Day.

[See also Budget and enterprise (Brief K2), Wider share ownership (K5) and City revolution and Building Societies Bill (Q5)]

Factual

(i) New tax incentives for investment in equities: no tax relief on input. But if investment held for minimum qualifying period (12-24 months)

- no capital gains tax (CGT) on ultimate gains;
- no income tax on dividends if reinvested in scheme.

(ii) Eligible investors: Individuals aged 18 or over resident or ordinarily resident in UK.

(iii) Qualifying investments: ordinary (not preference) shares quoted on UK Stock Exchange or dealt in on Unlisted Securities Market (USM). May be switched without tax penalty.

(iv) Shares beneficially owned by investors (who will have voting rights etc). But administered by registered plan managers (stockbrokers, banks, etc).

(v) Limit on investment: One plan of up to £2,400 a year (lump sum or instalments). No limit on how many yearly plans can be made, nor on how long each plan can last, so after 3 years, investor could have 3 yearly plans.

(vi) Qualifying period: Investment in calendar year 1 must be continued throughout calendar year 2 eg investment in 1988 plan (whether 1 January or 31 December) must be continued until 31 December 1989. Thereafter, investment may be realised without tax or dividends taken out in cash (but taxed).

(vii) Details of scheme to be in Regulations laid later in 1986, after consultations with interested parties.

(viii) Enabling legislation in 1986 Finance Bill.

(ix) Commencement date: 1 January 1987.

(x) Exchequer cost will depend on take-up. But estimated cost:

- negligible in 1986-87;
- £25 million in 1987-88.

(xi) Loi Monory approach/US Individual Retirement Account (IRA): relief on amount invested but clawback of relief if money withdrawn before end of holding period (eg 5 years for Loi Monory).

Positive

(i) Proposed new scheme further stage in Government strategy of encouraging people's capitalism: investment in homes, in workplace, in British industry.

WPU

(ii) Further reduction in fiscal distortions at present favouring institutional investment.

(iii) Simplicity: Provided investment kept in for qualifying period and sale proceeds and dividends reinvested

- no tax to pay;
- no need to report to Inland Revenue.

Gets Inland Revenue off back of investor.

(iv) Because tax relief is 'rear end' loaded

- initial Exchequer cost is low;
- no restriction/penalties (other than normal tax rules) required on early withdrawals. Longer investors stay in scheme, greater their benefits;
- no tax on exit;

ie does not have disadvantages of "front end" loaded Loi Monory (see above).

(v) Matches DNS scheme: annual investment up to £2,400 but in equities rather than fixed interest.

(vi) Since scheme confined to ordinary shares quoted on UK stock exchange or dealt in on USM, bulk of new investment will benefit UK companies.

(vii) Scope for instalment arrangements for yearly plans will help make scheme more attractive to small investors.

Defensive

(i) Main beneficiaries will be well-off investors. No. Possibility of instalment arrangements (cf success of DNS Yearly Plan) will enable ordinary people to participate.

(ii) Existing shareholdings will simply be assigned to scheme. Not so: qualifying investment must be in cash.

(iii) Plan managers will not be prepared to handle small investments. No. after 27 October (see Q5) market will be different. Signs that many market makers want to attract small investors.

(iv) Scheme unattractive because of CGT annual exemption (£5,900 in 1985-86). Purpose of scheme to encourage investors to retain shares, accumulate plans and reinvest dividends. Even small investors could build up sizeable holdings over period.

(v) Long-term cost open-ended: Agree full cost will not come through for many years. One attraction of scheme. But real cost depends on how money going into scheme would otherwise have been invested (or spent) and what tax consequences would have been.

BUDGET SECRET
until after Budget Speech on 18.3.86.
then UNCLASSIFIED

(vi) 'Loi Monory'/US Individual Retirement Accounts (IRAs) better incentive since give immediate tax relief for investment (see above). No. Loi Monory approach has many drawbacks:

- need for restrictions/penalties on premature withdrawals, "locking in" investments for significant period of years;
- scope for recycling same money;
- high initial cost (and therefore lower annual limit on qualifying investment);
- complex rules to enforce tax when money eventually withdrawn;
- alternatively, outright subsidy (if tax exemption on both investment and disinvestment) much too generous for scheme of this open kind;
- unwelcome implications for Inland Revenue manpower targets (in processing claims for relief).

(vii) Scheme should be extended to unquoted shares/unit trusts/options and futures. No: purpose of scheme is to encourage ordinary people to invest directly in shares.

Contact point: N Munro (Inland Revenue) 2541 6487

WPU