

PO-CH/NL/0013

PART D

PO CH/NL/0013  
PART. D.

PO CH/NL/0013  
PART. D.

1987 BUDGET  
STATEMENTS,

AD'S 25/13 NAGIS 14/11/96.

THIS FOLDER HAS BEEN  
REGISTERED ON THE  
REGISTRY SYSTEM

COPY NO 10 OF 12 COPIES *pur*

FROM: A C S ALLAN

DATE: 11 March 1987

SIR T BURNS

cc Sir P Middleton  
Mr Cassell  
Mr Odling Smee  
Mr Scholar  
Mr Sedgwick  
Mr Culpin  
Miss O'Mara  
Mr Ross Goobey

**BUDGET STATEMENT: PSBR**

The Chancellor now proposes to use the following passage in place of paragraph D7 in the fifth draft of the Budget statement.

"Indeed, I believe it is right to go below it. Since its inception in 1980, the MFTS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. We have now reached what I judged to be its appropriate destination: a PSBR of 1 per cent of GDP. I intend to stick to that figure. That will maintain a degree of fiscal prudence that, until this year, had been recorded on only two occasions since the War."

2. I should be grateful for any comments as soon as possible.

*ACSA*

A C S ALLAN

BUDGET  
CONFIDENTIAL

FROM: D RAYNER

DATE: 11 March 1987

1. MR. GRAY

2. PS/CHANCELLOR (Mr. Hudson)

cc Mr MacAuslan O/R

## BUDGET SPEECH: EMPLOYMENT AND TRAINING MEASURES

*Not exactly* You asked us to try and clear an acceptable form of words with DE on the UK's employment and training measures in relation to those in competitor countries.

PARA B6.

2. There are a number of pitfalls to be avoided in making international comparisons. For example, DE say that:

(i) in absolute terms, more people are (naturally) helped by employment and training measures in the US than in the UK;

(ii) an equal or higher percentage of the unemployed are covered by government schemes in France and Sweden;

(iii) on most definitions, West Germany can match or exceed the UK's measures in terms of quality and scope.

3. However, in spite of this, DE have said that they would be prepared to defend the following form of words for the Chancellor's Budget speech:

"This Government has developed its employment and training measures on a scale which no other country can match."

4. DE are satisfied that point (iii) in para 2 above is covered by the fact that West Germany's schemes are generally run by employers rather than directly by government - hence "its"; and that points (i) and (ii) are covered by the fact that the rate of growth in recent years has probably been higher in the UK than elsewhere - hence "developed".

5. Because of the sensitivity of such statements, DE have asked that any changes to the above form of words be cleared with them in advance.

C. If you wanted to incorporate the sentence in 3, in para B6, it could you could stop the penultimate sentence at "unemployed" - insert the new sentence there.

AHH

D Rayner.

D RAYNER

BUDGET CONFIDENTIAL

PWP



FROM: S P Judge

DATE: 11 March 1987

~~PRINCIPAL~~ PRIVATE SECRETARY

cc Chief Secretary  
Financial Secretary  
Economic Secretary  
Sir Peter Middleton  
Sir Terence Burns  
Mr F E R Butler  
Mr Wilson  
Mr Cassell  
Mr Monck  
Mr Sedgwick  
Mr Odling Smee  
Mr Culpin  
Miss O'Mara  
Miss Sinclair  
Miss Evans  
Mr Cropper  
Mr Tyrie  
Mr Ross Goobey  
  
Sir Angus Fraser - C&E  
Mr Knox - C&E  
Mr Howard - C&E  
Mr Jefferson Smith - C&E  
Mr Wilmott - C&E  
Mr Bone - C&E

**BUDGET STATEMENT: TAXATION SECTION: FOURTH DRAFT**

The Minister of State suggests the following composite redraft of the sentence in paragraph E37 referring to small businesses:

"There will be special arrangements to deal with the problem of brewers' tied houses. I am also taking this opportunity to relieve a significant number of small businesses from this provision".

I checked this with Mr Jefferson Smith, who confirmed that it is factually accurate. He added that there are about 13,000 partly exempt traders at present: the new measures will add about 6,000 big firms and the new **de minimis** rules will eliminate about 2,000 small traders. Unfortunately the 13,000 figure cannot be split between "small" and "large" firms, but "significant" is clearly a fair adjective.

S P JUDGE  
Private Secretary



FROM: FINANCIAL SECRETARY

DATE: 11 March 1987

**CHANCELLOR**

FS? 's comments on 4th  
draft just received!

Para nos. are the same  
except as marked.

AMT

cc Chief Secretary  
Economic Secretary  
Minister of State  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Miss O'Mara  
Mr Hudson  
Mr Cropper  
Mr Tyrie  
Mr Ross Goobey  
PS/IR

**BUDGET STATEMENT: TAXATION SECTION: FOURTH DRAFT**

I am sorry that I missed your deadline <sup>by ~~so~~ nearly 24 hours!</sup> for comment on this latest draft, and hope it is not too late to contribute some further thoughts.

**Paragraph E22: BES**

I apologise for pressing the point but I do think that there is a slight danger of arousing false expectations in the film industry unless you are a little more specific about the sorts of company that will benefit. (ie. those engaged in post-production distribution activities). I also think that the end-year bunching point is the more significant and perhaps should come first in the paragraph.

He  
wants  
to add  
below.

**Paragraph E46: PRP**

At the risk of repetition, I suggest an addition at the end: "But I hope as many companies as possible will be encouraged to take up this opportunity."

**Paragraph F2:**

Perhaps "when ambitions were more limited and language more inhibited" is a little ponderous? Could it not be deleted? **NO?** What's wrong with the phrase "property-owning democracy"?

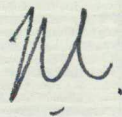
Paragraph F4:

You might just insert at the end, "A most interesting finding of the Survey was that share-holding in this country is now roughly as widespread as in the US. Our ambition is both to deepen and widen share-ownership so that more people own more shares."

Paragraph F15: *→ NOW F17.*

After "...since 1982" insert: "and the TUC have made representations to me that these limits should be increased."?

(Lawson the conciliator!) *→ I think this might get a hollow laugh.*



NORMAN LAMONT

*I gather from a later note that this isn't right. It's 20% of adult population here, ~ 20% of total population in USA, which may translate into c. 25% of adult population.*

PWP



FROM: FINANCIAL SECRETARY  
DATE: 11 March 1987

CHANCELLOR

cc Chief Secretary  
Economic Secretary  
Minister of State  
Sir P Middleton  
Mr Scholar  
Mr Culpin  
Miss O'Mara  
Mr Hudson  
Mr Cropper  
Mr Tyrie  
Mr Ross Goobey  
PS/IR

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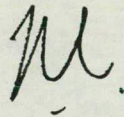


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After "...since 1982" insert: "and the TUC have made representations to me that these limits should be increased."?  
(Lawson the conciliator!)



NORMAN LAMONT

*Phf*



FROM: S P Judge

DATE: 11 March 1987

PRINCIPAL PRIVATE SECRETARY

- cc Chief Secretary
- Financial Secretary
- Economic Secretary
- Sir Peter Middleton
- Sir Terence Burns
- Mr F E R Butler
- Mr Wilson
- Mr Cassell
- Mr Monck
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- Mr Ross Goobey
- Sir Angus Fraser - C&E
- Mr Knox - C&E
- Mr Howard - C&E
- Mr Jefferson Smith - C&E
- Mr Wilmott - C&E
- Mr Bone - C&E

*Andner*

*✓*

*An advance copy - + my earlier draftings. Not did not like "set free" and thought a+b were over-technical.*

**BUDGET STATEMENT: TAXATION SECTION: FOURTH DRAFT**

The Minister of State suggests the following composite redraft of the sentence in paragraph E37 referring to small businesses:

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*SPJ*

S P JUDGE  
Private Secretary

**X. EXCHANGE CONTROL**

X1. Before I turn to my proposals for changes in taxation, I have one other important change of a specific nature to announce.

X2. In 1979, a few months after the present Government had first taken office, my predecessor announced the abolition of exchange controls, which had been in continuous operation ever since the outbreak of war in 1939. That bold action has, over the past 7½ years, proved wholly beneficial to the British economy; and I am glad to note that other European countries are now moving in the same direction.

X3. But although the operation of exchange control has ceased, the Exchange Control Act itself remains on the Statute book. So long as it does, there is likely to persist a nagging fear that, in certain circumstances, exchange control might be reimposed; and such uncertainty could be damaging.

X4. I have therefore concluded that the time has come to repeal the Act. The necessary legislation will be contained in this year's Finance Bill.

X5. I note that, in what was clearly intended to be a major speech in New York in September, the Deputy-Leader of the Labour Party declared that, and I quote:

"The Labour Party has no intention of reintroducing statutory exchange controls".

I am confident, therefore, that the proposal I have just made will be welcomed on all sides of the House.



PWP  
P. Cropper's  
comments on  
5th draft.

Chancellor.

Thanks!

The speech reads well.

I have made a few  
suggestions to Alex. (below)

My main criticism is  
that not enough is made  
of the Income Tax cut. It  
is offered almost apologetically.

Perhaps the provocation will  
be the place for the up beat.

I will cut  
down to budget  
up - 5%  
Thanks!  
PJ

BUDGET SECRET

B6 First sentence too long. Why not:

OK? ✓ "... Restart programme for the long-term unemployed. Starting next month...?"

Not elegant, but doesn't read too badly, I think. ✓ B13.14 Last sentence of 13 "But...." First sentence of 14 "But...".

(+ does!) ✓ (A2) D3 "In the event, this year's PSBR ....". First time round I misread this to apply to 1986-87. Should we say "In the event the PSBR for the year now drawing to a close looks like turning out at only £4¼ million....".

May need to redraft anyway? ✗ D7 Line 8: Suggest "This would represent a degree of fiscal ....".

✗ E17.18. I find the last sentence of 17 a bit obscure.

This changes the argument a bit. ✗ E36 Argument a bit too compact? How about "An essential element in any ongoing programme of tax reduction and reform must always be the elimination of unintended or unjustified tax breaks. These may be very beneficial to some, but they result in taxpayers generally having to pay more than they need do.

OK? ✓ E41 Suggest: "Where PAYE is not applied properly by an employer and a formal assessment .....".

✗ F2 Cautiously, I suggest "cautious" rather than "inhibited".

Yes, unless IR think misleading? (I have tried to check, but nobody is there.) ✓ F15 There is something a little pejorative about "certain new Friendly Societies which had been set up for purely commercial reasons". Maybe "had been set up purely as investment media".

F25

Suggest: "As for the other Capital Taxes, the yield of Capital Gains Tax has risen in real terms by over 80 per cent and of Stamp Duty by more than 140 per cent. These improved yields are not unconnected with the fact that, since we first took office, the apparent severity of these taxes has been significantly eased."

H3

Line 4 omit "And"?

H4

22 per cent: I have seen 23 per cent used elsewhere.

23% now out of date, I think.

H11

We need a bit more enthusiasm here, before moving on to ACT. For example: "...to 27 per cent. This will reduce the tax bill for every payer of income tax. It will be worth over £3 a week to a married man on average earnings. It will mean that, since the dark days of the middle seventies, the basic rate of income tax has come down by eight points, from 35 per cent to 27 per cent."

In General: I suggest that the damper placed on our spirits in D9 may be too heavy .... "this greatly diminishes the scope I have this year for reducing the burden of taxation....". It doesn't actually reduce it all that greatly: two pence is not bad. But, put like that right at the beginning of the tax section it may depress some of the simpler souls and make it difficult for them to concentrate on the hard tack that follows. Why not "Inevitably this may somewhat limit ...." rather than "this greatly diminishes".

Certainly not "may".

P J C

11/3/87

If diminished it is £3 billion (from £7bn to £4bn): hence a great damper

**BUDGET CONFIDENTIAL**



FROM: A P HUDSON  
DATE: 10 March 1987

PS/FINANCIAL SECRETARY

cc: Mr Cassell  
Mr Scholar  
Miss Noble  
Miss Sinclair  
Mr Cropper  
Mr Ross Goobey  
Mr Corlett - IR  
Mr Munro - IR

**BUDGET STATEMENT: PENSIONS**

The Chancellor has revised the section of the Budget Statement dealing with pensions this morning.

... 2. I attach the new version, which you may like to see before your meeting on presentation.

A handwritten signature consisting of the letters "A P" followed by a stylized flourish.

A P HUDSON



F5. And then there is wider pension ownership. Two years ago, the Government embarked on a major strategy to extend the coverage of private pension provision and to give individuals far more flexibility and choice in the way they provide for their retirement. We have already introduced a number of important new measures to that end, and the tax changes I am announcing today will complete the picture.

F6. The cornerstone of the Government's pensions strategy is the introduction of an entirely new means of provision for retirement, developed by my Rt Hon Friend the Secretary of State for Social Services: the personal pension.

F6A. Personal pensions are an important new dimension of ownership. They will enable

employees - if they so wish - to opt out of their employers' schemes and make their own arrangements, tailored to fit their own circumstances. And they will be a new opportunity for the 10 million employees who at present do not belong to an occupational scheme to make provision of their own and, if they so wish, to contract out of SERPS.

F7. In my Budget last year I undertook to bring forward proposals to give personal pensions the same favourable tax treatment as is currently enjoyed by retirement annuities. These were duly contained in a consultative document published last November, and the necessary legislation will be contained in this year's Finance Bill.

F8. In addition, to encourage a wider spread of occupational schemes, employers will be able to set up simplified schemes with the minimum of red tape. This will be particularly welcome to many small employers who have been discouraged by the complexity and open-ended commitment of a full-blown final salary scheme. And there will be much greater scope for transferring between different types of pension scheme. Again, the Finance Bill will contain the necessary tax provisions.

F9. Finally, I have decided to go beyond the proposals set out in the consultative document in one important respect. I propose to allow members of occupational pension schemes to make additional voluntary contributions, with full tax relief, to a separate plan of their own choice instead of, as now, being restricted to plans within their employer's schemes. They will be able to top their pensions right up to the present tax approval limits.

F10. The proposals I have outlined - along with the measures my Rt Hon Friend has already taken - will make it easier for people to take their pensions with them when they change jobs, which will be good for labour mobility and independence. They will widen the range of choices people can make about their pensions; and will mean that in future individuals will have much more control over the way in which their own pension contributions are invested.

F10A Taken as a whole, the changes we have made in the last two years have brought about a radical transformation in the ways people can provide for their retirement. There are new options for employers, and much greater freedom for individuals to plan their own pensions. This will lead to a further major extension of ownership, as people start to take advantage of the new opportunities.

F11. But the generous tax treatment of pensions can be justified only if it is not abused. I propose, therefore, to introduce some limited changes to the present rules to restrict the excessive relief which can be obtained in some circumstances, particularly by a few very highly paid people. These will include a stricter definition of final salary and, for all arrangements entered into from today, an upper limit of £150,000 on the maximum permissible tax-free lump sum, coupled with more rigorous rules on how pension and lump-sum benefits can be calculated.

F12. The cost of the overall package will inevitably depend on take up, but with that proviso is estimated at £65 million in 1988-89.



FROM: A P HUDSON

DATE: 13 March 1987

PS/FINANCIAL SECRETARY

cc Chief Secretary  
Economic Secretary  
Minister of State  
Sir P Middleton  
Sir T Burns  
Mr Scholar  
Mr Culpin  
Miss O'Mara  
Mr Cropper  
Mr Ross Goobey  
Mr Tyrie  
Mr Prescott - IR

**BUDGET STATEMENT: FIFTH DRAFT**

The Chancellor has seen the Financial Secretary's 12 March minute.

2. He has decided not to mention the three measures on employee share ownership in the Budget Speech. He thinks the Financial Secretary could refer to them in his own speech the following day. But he does not think the announcement of a review will cut much ice.

A handwritten signature consisting of the letters 'A P H' in a stylized, cursive script.

A P HUDSON



FROM: A P HUDSON

DATE: 16 March 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary  
PS/Economic Secretary  
PS/Minister of State  
Mr Scholar  
Miss O'Mara  
Mr Cropper  
Mr Tyrie  
Mr Ross Goobey  
Mr Mace - IR

**BUDGET STATEMENT: SIXTH DRAFT**

The Chancellor has seen the Financial Secretary's 13 March minute. He does not think it is quite accurate to say that "anyone" on average earnings gains over £3 a week. For a women on average adult female earnings, the gain is considerably lower.

2. Paragraph F23 already hints at the "cut taxes to increase receipts" issue. The Chancellor does not believe we can sensibly apply the argument to the higher rates of income tax in a Budget which, so far from cutting the higher rates, is actually making them (albeit marginally) more severe. And of course the Lafferite case is most unlikely to be valid or even plausible for the basic rate. The Chancellor is quite happy for the argument to be used in the Budget Debate and thereafter

- (a) in the context of what we have done; and
- (b) as a hint of what we may do in the future.

But, to repeat, not in the context of what we are doing this year.

A handwritten signature in black ink, appearing to be "A P HUDSON".

A P HUDSON

**BUDGET SECRET**  
Covering BUDGET LIST ONLY



COPY NO. 2 OF 3 .

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

13 March 1987

John Footman Esq  
PS/Governor  
Bank of England  
Threadneedle Street  
LONDON EC2

*Dear John*

**BUDGET STATEMENT**

I attach a copy of the latest draft of the Chancellor's Budget Statement.

*Yours  
Alec*

A C S ALLAN

# Word Count



SECTION 'X' : 214

SECTION D : 2523 = 18.6<sup>(19)</sup>  
(EXCL. D.23).

SECTION E : 1309 9.7<sup>(10)</sup>

SECTION F : 482 3.6<sup>(4)</sup>

SECTION G : 760 5.6<sup>(6)</sup>

---

5288

= 39 minutes





1. Andrew  
2. Michael

AHH

24 Feb 20

Mr Scholar

I've transferred the relevant comments onto my copy.

AHH

Michael sees this on condition he is not to be offended if I have scribbled a rude remark against one of the passages he laboured hardest over to get just right!

Alan

Alex ✓

Oh  
I ✓ must agree (Sedgwick stuff is  
partly unusable). Raise at start of  
movie? AM

I am afraid this is very uneven - there is a limit to the  
extent to which I can rewrite the works of P Sedgwick et al.

I received in fact very few comments on the outline, notwithstanding  
the Chancellor's exhortation (Revenue Customs & A Ross Gorbey are the  
honourable exceptions).

I suggest that the strategy for next week should be

- ① If the Chancellor has any time to work on it you minute  
out his comments.
- ② You ask Terry to rewrite the Economy section, Peter to  
do the monetary policy and borrowing bits. You could divide  
up the tax material for rewriting between Frank <sup>Nick Monck,</sup> Peter  
<sub>Andrew Hudson</sub> Cropper, Alastair R-G [and me]. You ask everyone  
without fail to send comments on this version by Wednesday  
night. Andrew H could try his hand at a peroration (work generally on the draft).
- ③ Then I put together another version for the Chancellor next  
Friday - which will, in effect, be the best that the office can  
produce. The way is then clear for the Chancellor, over two  
weekends, to work on it - and for us to bring the rest of the presentation  
into line.

OK?

McS 20/2

ES2  
DC

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COPY 1 NO OF 37 COPIES

FROM: M C SCHOLAR  
DATE: 20 FEBRUARY 1987

**CHANCELLOR OF THE EXCHEQUER**

- cc Principal Private Secretary
- Chief Secretary (2)
- Financial Secretary (2)
- Economic Secretary (2)
- Minister of State (2)
- Sir Peter Middleton
- Sir Terence Burns
- Sir Geoffrey Littler
- Mr F E R Butler
- Mr Wilson
- Mr Cassell
- Mr Monck
- Mr Sedgwick
- Mr Odling-Smee
- Mr Culpin
- Miss O'Mara
- Miss Sinclair
- Miss Evans
- Mr Cropper
- Mr Tyrie
- Mr Ross Goobey
- Mr Battishill - IR
- Mr Isaac - IR
- Mr Painter - IR
- Mr Beighton - IR
- Mr McManus - IR
- Sir Angus Fraser - C&E
- Mr Knox - C&E
- Mr Wilmott - C&E
- Mr Bone - C&E

**BUDGET SECRET**

**SECRET**

**B.L.O.**

*Ch*  
*Order of business*  
*& enterprise doesn't*  
*quite work. It ends*  
*with rather random*  
*collection of bits & pieces.*  
*Suggested re-ordering on*  
*content page*  
*AA*

**BUDGET STATEMENT: FIRST DRAFT**

I enclose a first draft of the Budget Statement. This follows the outline you saw last weekend, and takes account of points which have been made to me following your request at Monday's overview meeting.

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

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BUDGET

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SECRET

B.L.O.

SECRET

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BUDGET LIST ONLY**

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3. One or two points of detail:-

- (a) The business and enterprise section (which is perhaps on the long side) starts with VAT and small businesses, as you suggested at our discussion last week. This works well, except that it is perhaps a little odd to come to the main Corporation Tax rate after all these details.
- (b) The Revenue have suggested moving Pay and File from its present position in the section on streamlining Corporation Tax to a new subsection on tax reform which starts off with all the Keith measures, at the end of Business and Enterprise.
- (c) It might be best to omit the paragraphs on US tax reform (p 33). If so, we should certainly keep Pay and File where it is.
- (d) Customs think that VAT partial exemption (p 39) would sit more comfortably in the anti-avoidance section than in its present home, taxes on spending. I am inclined to agree.

4. Last year you spoke for 1 hour 16 minutes. You suggested that this year we might aim for about 1 hour. The present draft is about one hour in length.

5. I enclose, too, a suggested peroration by Mr Ross Goobey.

MCS

M C SCHOLAR

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BUDGET

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SECRET

B.L.O.

SECRET

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**BUDGET STATEMENT: FIRST DRAFT**

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*Business*

*CT*

*Oil tax*

*VAT small business*

*Tax avoidance*

*Enterprise*

*PRP*

*BES*

*WSO*

*See with*

*How's*

*B.L.O.*

*SECRET*

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SECRET

B.L.O.

SECRET

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**BUDGET SECRET**

Introduction

? does this fit in with long track record of success?

ht smug

1. The setting for the Budget this year is more favourable than it has been for many years. We are entering our seventh year of steady growth, in what is now our accustomed place at the top of the international league table. We are entering our fourth year in which this steady growth has been combined with low inflation. And we are entering one more year in which the public finances are sound and strong.

2. These are the fruits of the Government's determination to hold to our policies of sound money and free markets. I gladly reaffirm these policies today. They provide the only sure basis for more jobs and lasting, productive, jobs.

3. I shall begin by reviewing the economic background to the Budget. I shall then deal with monetary policy and with the fiscal prospect this year and next. Finally I shall propose some changes in taxation designed to assist in achieving our economic objectives. As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

**BUDGET SECRET**

BUDGET

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B.L.O.

SECRET

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Economic Background

4. I begin with the economic background.
5. The first estimates for growth in 1986 show output some  $[2\frac{1}{2}-2\frac{3}{4}]$  per cent higher than in 1985. We have experienced steady growth at <sup>around</sup>  $[just\ under]$  3 per cent  $[-$  with only minor deviations one way or the other  $-]$  since the beginning of 1981. This remarkable period of growth is an enormous improvement on the traumas and poor performance of the mid and late 1970s. Indeed it compares very well with the best growth performance in earlier periods.
6. It is worth examining the lessons of this recent period of successful growth.

It has coincided with a sharp fall in inflation.

It has occurred as the Government has pursued progressively tighter fiscal and monetary policies - with the PSBR in 1986-87 [at  $\pounds 4\frac{1}{2}$  billion] the lowest as a share of GDP since 1969-70.

Because the Government has not succumbed to the pressure from many quarters for an artificial

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*Better put in  
more details.*

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fiscal stimulus, which would inevitably carry with it the risk of a rise in inflation, the prospect is for satisfactory growth to continue in 1987 and beyond [without a rise in underlying] inflation. *remains low.*  
*while*

7. In short the recipe for sustained growth and falling inflation is the very opposite of the conventional neo-Keynesian wisdom of the late 1960s and 1970s, which is still all too evident in certain parts of this House.

8. Our growth performance in 1986 was achieved against a difficult world background. There were already signs of a [mild] slowdown in the world economy towards the end of 1985. One of the first consequences of the fall in the oil price at the beginning of 1986 was for certain oil producers to cut their imports from developed countries like the UK. Other less developed countries reacted in a similar way in response to falls in other commodity prices.

9. As I expected at this time last year the lower oil price led to lower inflation in the developed countries and boosted domestic demand. We have heard a lot in recent months about domestic demand - and private consumption in particular - growing at an unhealthily high rate in the UK. The critics seem unaware both that the growth of domestic demand in 1986 in the other economies

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*only!*

*Feebly put  
(and come better  
in MTF section?)*

*dumsy*

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of the major 7 appears to have been higher than in the UK, and that high consumption growth in the developed economies was an expected and quite justified consequence of the fall in the oil price.

10. While exports from countries such as the UK suffered from the contraction in OPEC and LDC markets in the first half of 1986, there now appears to have been a pick up in exports from developed countries in the second half of the year. This renewed growth in developed countries' exports has contributed to a marked improvement in industrial output in most of these countries during the second half of 1986. There are reasonable grounds for expecting world demand for developed countries exports to continue to grow in 1987. The growth of markets for UK exports of manufactures should rise from [2½] per cent in 1986 to [3½] per cent in 1987. GNP in the major economies is likely to rise at [2½] per cent in 1987, the same as in 1986.

11. While in some ways the world economy has adjusted well to the large fall in the oil price at the beginning of last year, there are undoubtedly very real risks to its satisfactory performance. There has been considerable turbulence in foreign exchange markets as the three largest economies - the United States, Japan and Germany - grapple with major external imbalances that adversely affect other economies.

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*This is all  
incredibly  
turgid.*

*put in  
65/67  
stuff*

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12. It is essential that the US takes further steps to control its budget deficit, which in turn will help to reduce its large current account deficit. Similarly both Japan and Germany must adopt policies first to prevent their very large current account surpluses growing further, and then to ensure their reduction.

13. The reduction in the large external imbalances in the three major economies is essential to ensure the continuation of low inflation and steady growth, which has been such a major achievement of the international economy in recent years. Above all a slide into protectionism in the US and elsewhere would be a disaster for the world economy and major trading nations such as the UK.

14. [Reference to G5/G7 talks.]

15. Turning to the UK economy the prospect is for <sup>another</sup> a year of steady, balanced growth. It is clear that the growth of consumers' expenditure in 1986 - at just under 5 per cent - was given a temporary boost by the lower oil price and the fall in other commodity prices. The probable fall in the growth of consumers' expenditure in 1987 is likely to be matched by the welcome rise in investment that industrial surveys clearly signal.

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*Must avoid costly doubt  
A6-7 commitment  
to do this*

*Too defensive*

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16. The manufacturing sector in particular faces a good year, following its improved performance during the second half of 1986. In the year to the fourth quarter of 1986 exports of manufactures grew by  $9\frac{1}{2}$  per cent and productivity by over 4 per cent, while its wage costs rose by just over  $3\frac{1}{2}$  per cent.

17. Indeed the UK's overall productivity performance has been particularly strong in the last few years. In the 1960s and 1970s the UK was at the bottom of the international productivity league. Productivity performance was particularly bad in the period after 1973, with manufacturing productivity in the UK growing on average at a mere  $\frac{1}{4}$  per cent a year. Since 1979 the average growth of productivity for the economy as a whole has been higher than in any of the other major 7 economies in the period since 1979, averaging  $3\frac{1}{2}$  per cent a year. That is indeed an achievement. All the signs are that 1987 will see a continuation of the recent strong performance of manufacturing industry, with exports, output, and productivity growing at very satisfactory rates.

18. This strength was all the more remarkable because it was maintained in a difficult year in which the UK economy adjusted to the large fall in the oil price. The public finances in particular suffered a reduction of

*Sedgwick  
drafting.*

*! drafting*

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just over half the revenues from the North Sea. But because the underlying industrial performance of the UK economy is much stronger than in earlier years the economy weathered this storm, as it has weathered other storms in recent years which in earlier times would have led to crisis and catastrophe. Indeed the Government's finances have markedly strengthened not because I raised tax rates to make good the loss of oil revenues, but because the sustained growth of the economy has produced a higher level of non-oil revenue than anyone expected.

*but can't  
all state need a  
revenue buoyancy  
to faster than expected  
growth.*

*Much more  
care needed*

19. In our projections for future years we have, in the light of all the uncertainties, kept unchanged the assumption we adopted last year of a \$15 oil price.

20. Real interest rates are high in the UK, in large part because in a growing economy private sector credit demand is so buoyant. The recent level of real interest rates has not prevented strong growth of demand and output. By continuing to keep a very firm control on public finances we shall ensure that the Government does not - as governments have all too often in the past - add to pressure on real interest rates.

*"Hear hear" from  
Labour leaders!*

*Do we want  
this live??  
(is it true?)*

21. As forecast at the time of the Autumn Statement in November, the current account of the balance of payments was in broad balance in 1986. This follows a cumulative

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current account surplus of £21 billion since 1979, which enabled the UK to build up a large net stock of overseas assets during the period when oil prices were high and North Sea output rising to its peak.

22. On present prospects there is likely to be a current account deficit of [£2 billion] in 1987. It is not at all surprising that the UK should experience a small deficit on this scale - equal to approximately  $\frac{1}{2}$  per cent of GDP - following the immediate loss of over £4 billion net exports of oil as a result of the fall in the oil price. In time the fall in the exchange rate that followed the drop in the oil price should lead to an improved non-oil trade performance. The UK's large stock of net overseas assets will provide a lasting contribution to the current account in the future.

*Handwritten notes:*  
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2030

*Already happening*

*See 1985  
markets  
again  
"ooh aah" from  
Labour leaders  
(start with 1986  
round)*

23. Inflation is likely to rise for a time during the middle of this year to a little above 5 per cent. But it should thereafter fall, to [4 $\frac{1}{2}$ ] per cent in the final quarter of the year. Short term changes in inflation, such as those experienced in 1986 and likely in 1987, are predictable fluctuations around an unambiguously downward trend. The Government remains determined to squeeze inflation out of the system altogether and will take whatever action is needed to achieve this overriding aim.

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24. To sum up the prospect, we can look forward to <sup>another</sup> a year of balanced growth in 1987 with consumers' expenditure lower and investment growth higher than last year. Exports are likely to grow significantly faster than the economy as a whole.

25. Unemployment should continue to fall gradually, as it has done since the middle of last year. In last year's Budget I said that employment prospects depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

26. I do not believe that this improvement would have occurred were it not for the stability and soundness of the Government's overall management of the economy, together with our policies to encourage enterprise efficiency and flexibility. From the beginning the Government has taken action to promote competition, incentives, and free markets, and to press ahead with deregulation and privatisation. All these measures, enacted in successive Budgets and other legislation, are now bearing fruit, and we see the proof of this on all sides - not least in the success of British industry in international markets.

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27. British industry now has an outstanding opportunity as a result of low inflation, rapidly rising productivity, and the highest profitability for 20 years. If it will take a firm grip on its costs, and make room for its crucially important spending on R and D and training, its present successes should mark the beginning of a new era of pre-eminence in domestic and international markets alike.

*overflow*

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Monetary policy

28. We shall continue to follow the prudent financial policies laid down in successive versions of the medium term financial strategy. They provide a stable and predictable environment for markets and for business: a framework that permits the economy to grow steadily while giving a guarantee against a return to rising inflation, and the industrial and market instability which comes with that.

*Could have ultimate reputation of neo-Keynesian here.*

29. The centrepiece of the strategy is the Government's commitment to achieve a steady reduction in inflation and the growth of money GDP. This requires tight control of monetary conditions, using short-term interest rates as the main instrument of policy.

30. Last year I set target ranges of 2 to 6 per cent for narrow money, M0, and 11-15 per cent for a measure of broad money, £M3. The target range for M0 next year will again be 2 to 6 per cent, as indicated in last year's MTFS. For broad money, on the other hand, a rapid rate of growth has proved consistent with monetary conditions which have continued to bear down effectively on inflation. Indeed, as I have explained at length on several occasions, the growth of broad money has become increasingly difficult to interpret, both at home and

*Give Gov some credit? (copy King's letter)*

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abroad. I have concluded that the behaviour of broad money is now too uncertain for it to be sensible to set a target range for it next year. But although interpretation is difficult, it is still important to monitor closely the growth of liquidity in the economy. We will take the behaviour of the various measures of broad money carefully into account in assessing monetary conditions and setting interest rates.

31. We will also continue to take account of the other financial indicators, and in particular the exchange rate, which can provide a good guide to policy when other indicators are hard to interpret. Decisions on short term interest rates will continue to be made after a careful assessment of all the evidence of monetary conditions.

32. I have one change to announce in the arrangements which are used for financing the Government's borrowing. Following last year's changes in the structure of the gilts market, the Bank of England has been conducting consultations on the possibility of carrying out an experimental series of gilts auctions in 1987-88. I can now announce that this experiment will go ahead [with the first auction to be held in May(?)]. The Bank of England will be announcing details [later today/in the week]. Auctions will supplement the traditional methods of

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selling gilts by tender and through the operation of taps, and they will provide fixed points during the year at which known amounts of Government stock can be sold. I believe this will mark an important improvement in the techniques available for financing the Government borrowing requirement.

*? effect*

33. I will say no more about monetary policy, except once more to repeat what I have said on a number of occasions in the past: that while the changes which have swept through financial markets world-wide in recent years have necessarily altered, and complicated, the techniques of monetary management, there has been no change whatever in the essence of the Government's policy. We continue to attach the highest priority to sound money.

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33a But I have one very important change to announce. It is now 7<sup>1</sup>/<sub>2</sub> years since the Government abolished exchange controls, an action that has proved wholly beneficial to the economy. In 1979 we left the Exchange Control Act on the statute book, albeit in abeyance. The Act is an anachronism and serves no useful purpose. Its continued existence does, however, have one disadvantage. Some

investors may be concerned that if some other party formed a Government - however unlikely that may seem - they might try to use the Act to reimpose controls at short notice. I have therefore concluded that the time has come to repeal the Act itself, and will introduce the necessary legislation in this year's Finance Bill. [I noted that the Rt Hon Member for Sparkbrook assured investors, in a speech in New York last year, that the Labour Party had no intention of reintroducing statutory exchange controls. Although it is unlikely that this pledge will ever be put to the test, I trust that it means I will be able to count on all party support for this particular Budget measure.]

NB!

*Unlikely  
as to whether  
in fact goes to  
the union*

*Answer  
for that*

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Public Sector Borrowing

34. An important component of the success of the MTFS has been the reduction in the level of public sector borrowing. [It looks as though] borrowing in 1986-87 is turning out to be considerably lower than the £7 billion I expected at the time of last year's Budget. I now expect an outturn for the financial year as a whole of only ~~1.75%~~. This is ~~a little below~~ <sup>1 1/2</sup> ~~1 1/2~~ per cent of GDP, a lower percentage than in any year since 1969-70.

Moreover the same comparison would still hold if ~~the PSBR were adjusted for privatisation proceeds.~~

35. This makes 1986-87 the second successive year in which the PSBR has been at about  $1\frac{1}{2}$  per cent of GDP. There have now been two marked downward steps in the PSBR since 1979. In 1981-82 it was reduced from 5 per cent to about 3 per cent, where it stayed for the next four years. And then in 1985-86 it fell to  $1\frac{1}{2}$  per cent.

36. Meanwhile - to the great surprise of those who think that economic growth can result only from fiscal expansion - output has risen, as I have indicated, at a steady 3 per cent a year. Indeed its rise began in 1981 just as the PSBR was taking its first big step down - and just as we were being told that it could not rise, given

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SDP  
won't be nearly that high  
3-1/4  
1 1/2  
2 1/2

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declining public borrowing. The truth is that strong and sustainable output growth depends on a healthy and productive private sector. And this is most likely to thrive when the Government is restricting its own demands on the economy.

overcome

37. It is not only the borrowing requirement that this Government has been reining back. Government expenditure as a proportion of GDP has also been falling since 1982-83. This has eased the burden on the private sector by permitting a reduction in taxes. And it has enabled us to sustain a remarkable loss of oil revenues from last year's oil price fall without raising non-oil tax rates or borrowing.

38. I intend to continue this successful fiscal strategy. The Public Expenditure White Paper published in January showed a continued decline in Government expenditure relative to GDP over the next three years. Some further reduction in borrowing over the medium term is also required to support the declining path of money GDP growth.

22

39. For the year ahead, borrowing plans need to take account of a number of factors. North Sea revenues are expected to be [unchanged from the 1986-87 level] in 1987-88, and then to decline gradually. The rate of

All this is  
over the  
entire  
long period

We want to get  
around John (MPS);  
Mack's 1986-87  
proposal was to  
get 12% of the  
total in the  
first year with  
the rest in  
subsequent years.  
/G.../

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growth of output and the revenues it brings may be a little higher over the next year or so than can be sustained over the medium term. With real interest rates high, all this points to a reduction in borrowing next year then little further change over the medium term.

*will*  
*Against*

40. I am therefore providing for a PSBR in 1987-88 of £[ ] billion or [ ] per cent of GDP. The figures for later years will be set in future Budgets, but the illustrative path in the Red Book shows the PSBR remaining at [ ] per cent of GDP.

*copy*

41. This is a cautious and prudent policy. It will create more room for private sector demand without putting pressure on inflation or interest rates. It will provide a very necessary margin for safety. And it will improve the balance in the economy, between the public and private sectors, between the domestic economy and the balance of payments, and between consumption and investment.

*Given we need some answer to question that is fiscal policy for, this spraying of grapes shot seems a reasonable effort.*

42. It will not, unfortunately, allow room for the substantial reduction in taxation to which this Government attaches such importance. That is regrettable, but necessary, for we are determined, as we have been for the past eight years, to take no risks with inflation, and no risks with our management of the public finances.

*What!  
Need softer lead-in:  
This inevitably limits the scope for reductions in taxation. But [strength of revenues means] still scope for some reductions.*

43. I turn now to my proposals for changes in taxation.

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*Handwritten notes:*  
What is the...  
Banks...  
Business Enterprise?

Business and Enterprise

*Handwritten:* Needs reading

44. First, the taxation of business and enterprise.

45. The Government last autumn made a series of proposals on accounting and record-keeping for VAT which will have an important impact on a crucial sector of the economy - small businesses. These measures have been welcomed by representative bodies and individual businessmen alike.

*Handwritten:*  
It does read  
oddly to launch  
in with just  
few lines. But  
could be OK if  
preceded by  
bit about  
intel importance  
of small business.

46. I therefore propose that with effect from 1 October 1987, there should be an optional system of cash accounting for VAT for companies with an annual turnover [below £250,000. Companies will account for VAT on basis of cash paid and received. Because they will not be liable to pay VAT until they have been paid by their customers, this will ease their cash-flow problems, as well as giving them automatic bad debt relief - a relief for which they have long argued.

47. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT; [I am applying for this today.]

*Handwritten:*  
Possible order  
CT Main rate  
Cap gains  
pay + file

*Handwritten:*  
Q57  
Small bus VAT package  
Arrangements: VAT paid amounts  
DR Cs (ofus)  
payable date  
Lloyds  
Misc. the BES + Comp Cons  
\*PRP

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48. In addition, I propose an optional system of annual accounting for VAT which will mean that businesses with an annual turnover below £250,000 will be able to make payments on account and send only one return a year to Customs. This change will come into effect in the second half of 1988.

49. In future the period within which businesses must notify and be registered for VAT will be extended from ten days to one month.

50. I also propose that the special VAT schemes for retailers should be changed in a number of ways in order to make simpler schemes available to more small and medium-sized businesses.

51. But there are two matters on which the representations I have received persuaded me it would not be right to proceed as suggested in our autumn consultative document. I shall not be going ahead with the proposal for compulsory deregistration of traders below the VAT threshold; or with the proposal to withdraw the standard method of accounting for VAT used by retailers.

52. I propose to increase the VAT registration threshold to £21,300 in line with the maximum permitted under

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existing European Community law <sup>be are</sup> arguing vigorously in Brussels for flexibility to set a higher limit.

53. Overall, the proposals which I have just outlined will help ease the burden <sup>accounting for</sup> of VAT <sup>on smaller firms</sup> [whose] <sup>these</sup> management energies should be concentrated on generating profits. The thicket of controls, regulations and form filling will be made more penetrable.

54. I turn now to larger companies, specifically those liable to pay Corporation Tax at the main rate.

55. I have received a number of representations about the help it gives to companies to have advance notice of the Corporation Tax rate for the year ahead.

56. Accordingly I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

57. The <sup>final stage</sup> reformed system of Corporation Tax which I introduced in my 1984 Budget has now been in force since the beginning of the present financial year. I propose this year to complete <sup>supplement?</sup> this reform with a number of measures to streamline the administration of Corporation Tax.

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*dummy*

58. At present there is an anomalous situation whereby companies established before 1965 can have accounting periods of different lengths for their liability to Corporation Tax; but companies established since 1965 must all account for the tax nine months after the end of the period on which it is due.

*Save  
an amount  
of 1/2*

59. This difference in the treatment of companies no longer has any justification. I propose, therefore, that all companies and building societies should be liable to pay Corporation Tax nine months after the end of the accounting period on which the tax is due. This will be more equitable between companies than the present regime; it will rationalise the arrangements for collecting Corporation Tax from companies; and it will smooth the flow of tax receipts into the Exchequer, which in turn will help management of the PSBR. A quite separate, but important, reason for changing the present arrangements is that they are open to abuse which could put the timing of a substantial proportion of the Corporation Tax yield at risk. There will be a transitional period during which the change will be phased in.

*160  
162*

60. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. Under Pay and File companies will estimate and pay their tax liabilities on the normal due

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date, without the need for the Inland Revenue to make thousands of estimated assessments or for companies to appeal against them. Tax liabilities will be finally settled once companies submit their returns and accounts. The new system will include provision for interest payments by the Inland Revenue where tax is overpaid; and parallel provision for interest payments by companies where tax is underpaid.

61. This new method was set out in a consultative document on the recommendations in the Keith Committee Report issued in December. It was generally welcomed both by business and by tax specialists.

62. The introduction of Pay and File is part of a wider programme of streamlining tax collection, including major developments in the Inland Revenue's computer systems, which will not be completed for some years. But by legislating now we shall be able to meet the request made by many taxpayers and their advisers that they should have a firm basis and a lengthy period to prepare for the implementation of this important new scheme.

63. As a further streamlining measure, I propose a change in the taxation of companies' capital gains. At present this is unduly complicated, involving an artificial adjustment of the amount of the gain on which Corporation Tax is charged.

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"fractions"

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64. The change I am proposing will also meet the numerous representations I have received that companies should be allowed to set payments of Advance Corporation Tax against tax liability on capital gains.

65. There is much force in the argument that there is little real difference between companies' capital gains and income from other sources.

66. I therefore propose to rationalise and simplify this part of the Corporation Tax system. With effect from [today], the capital gains of large and small companies will be charged, without adjustment, at the appropriate Corporation Tax rate. At the same time, companies will be allowed to set payments of Advance Corporation Tax against their tax liability on capital gains.

67. These three measures to streamline the Corporation Tax system are expected together to yield about £255 million in 1988-89.

68. I turn now to the oil industry. My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effect on the industry of last year's sharp fall in oil price and subsequent developments. While the industry itself is generally confident about the longer

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term prospects, it has suggested that in the short-term the trough in activity could lose it some of the capacity in our offshore industry, in Scotland and elsewhere, which will certainly be required in the longer term.

69. Last autumn, I introduced legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. That helped companies with cash flow difficulties. I also announced, last November, proposals, on pricing and valuation, to protect the revenue flow under the existing system.

70. I now propose two new Petroleum Revenue Tax reliefs. With effect from today, participators in oil fields may elect to have up to 10 per cent of the costs of developing new oil fields, until payback, set against their Petroleum Revenue Tax liabilities in other fields. I am also proposing a new relief for [certain research expenditure on oil extraction. This is] research which is not related to a particular field, and so is not at present allowed for Petroleum Revenue Tax.

71. [Reference to ring-fence ACT?]

72. These measures should over the next two years or so, help both the oil companies themselves and those in Scotland and elsewhere for whom they generate work.

*Need to be  
careful not  
to overplay  
or small  
changes.*

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73. I turn now to profit-related pay.

74. I suggested last year that it might be possible to introduce changes to the tax system which would run with the grain of, and reinforce, efforts to break up the rigidity of the pay system in this country.

75. I pointed last year to two considerable advantages of arrangements which relate pay to profit. First, they lead to a closer identification of employees with the companies in which they work. Second, they make costs more flexible in the face of changing market conditions and hence help to make employment more stable.

76. My remarks led to a lively debate and last July we published a Green Paper on profit related pay. I warmly welcome the discussion and responses that the document generated. Those firms who already have profit-related pay schemes generally believe they have worked well. And many others are considering introducing them.

77. I have decided that the time is right to introduce a system of tax relief to employees in qualifying profit-related pay schemes. This should encourage many more firms to bring these schemes into operation. I have decided that this innovation should apply, at least initially, only to the private sector, as the Green Paper envisaged.

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78. It will of course be necessary for certain specific requirements to be met before tax relief is payable, and for schemes to be registered with the Inland Revenue before the profit year begins. But I have been anxious to keep the administration simple and to ensure that firms have as much flexibility as possible in designing schemes which suit their circumstances.

79. Perhaps the key issue in response to the Green Paper - and no doubt to some of those considering whether to introduce schemes - is the level of tax relief. The Green Paper suggested that one quarter of PRP payments might be eligible. I have now decided to double this to a half. This will mean that for someone on average earnings receiving 5 per cent of pay as PRP, the tax relief will be equivalent to 1p off the basic rate of income tax. It underlines the importance the Government attaches to this major new initiative. It will take time for the cost to the Exchequer to build up and its size will clearly depend on take-up but full year costs could exceed £100 million by the end of the decade.

80. Profit related pay is not a panacea, but I believe it will help tackle some of the deep seated problems of the UK economy by promoting greater flexibility and enterprise, and so help further to strengthen the prospects for employment. I hope that both sides of

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industry will now respond enthusiastically to this opportunity as we look forward to the 1990s. Full details of the tax relief scheme will be published in the forthcoming Finance Bill.

*Tax avoidance*

81. The Government's aim is to reduce taxes overall. But hand in hand with this we aim also to ensure that tax is collected fairly and effectively and that the law enables the right amount of tax collected. I have a number of proposals to make today in this regard.

82. First, I propose to tackle the present over-generous treatment of tax credit for foreign withholding tax paid on interest on bank loans. The effect of the present rules is to give tax relief on profits unrelated to the loan which produced the interest in the first place. Here our rules will be made comparable to those operating in other countries. Credit for any foreign withholding tax actually paid, or deemed to be paid, on interest received by banks from overseas lending will be able to be offset only against the Corporation Tax due on the turn on the relevant loan. For new loans, the change will apply from 1 April 1987. The effective date for existing loans will be 1 April 1988.

83. Second, I propose to deny the double deduction of interest payments by dual resident companies, with effect

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from 1 April 1987. The proposed change follows on the action taken in this area by the United States last year, to which I shall return in a moment. Trading companies will not be affected.

84. Third, I propose legislation on the taxation of Lloyd's to ensure that the normal tax treatment of provision for outstanding insurance liabilities applies to Lloyd's members in the same way as to insurance companies and other financial traders. These proposals will affect the tax treatment of Lloyd's Reinsurance to Close and will first apply to premiums paid for the close of the 1985 Lloyd's account at 31 December 1987. The new arrangements will be phased in over a three year period.

85. Fourth, I propose a change to deal with certain cases where there is serious delay in paying tax due under PAYE and sub-contractors' deduction schemes. Following the approach recommended by the Keith Committee, I am proposing to introduce an interest charge where tax is paid late following a formal assessment. This change will take effect from April 1988.

*Must have  
S-R?*

86. Fifth, it is quite common for payments to directors to be left out of the base for PAYE calculations. This also leads to delay in paying tax. I propose to remedy this by defining more closely what should be included in

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the base for calculating PAYE. Again, this will meet a recommendation of the Keith Committee.

87. All these measures will help to ensure that the right amount of tax is paid by all taxpayers. There is no reason why the bulk of taxpayers, both individual and corporate, should subsidize the few who are able to reduce their tax bill through accidental features or weaknesses in existing tax law.

88. I need to set the 1988-89 car and car fuel benefit scales for those with company cars. I propose a 10 per cent increase in the car benefit scale charges. I propose no change to the car fuel benefit scales which are now also used for VAT purposes.

89. [I am glad to be able to announce now that I propose to give statutory effect to two extra-statutory concessions whereby training costs incurred by employers and employees can be offset against tax liability. Training is vital in a dynamic and resilient economy. The tax system is already helping here, and this measure is designed to ensure that this fact becomes more widely known.]

90. Last year I was glad to confirm that the Business Expansion Scheme would continue indefinitely in view of

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- rag bag  
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its outstanding success. The changes made to the Scheme in 1986 have improved its targeting, with the result that more BES money is now going into the type of higher risk venture for which the Scheme was designed.

91. The scheme is now on a generally satisfactory basis. But to improve it still further, I propose two changes.

92. The first is a measure to deal with the problem of year-end bunching, about which a number of people have made representations. I propose that, for investments made in the first half of the tax year, the investor should be able to opt for part of the relief to be given for the previous year. This measure, which will apply to investments made after 5 April 1987, should make it easier for companies to raise BES finance throughout the year.

93. The second is a relaxation of the rules to make it easier for independent film companies to benefit from BES investment. I believe that this will be widely welcomed in the film industry.

94. The Business Expansion Scheme has done much to encourage high risk share ownership. More generally, the Government has given a major boost to wider share ownership through action on three fronts: employee share

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schemes, privatisation and the introduction of Personal Equity Plans.

95. The growth in employee share schemes since 1979 has been remarkable. We started with about 30 schemes. Now there are over 1,200, open to all employees and covering more than 1½ million workers.

96. I have already taken steps to amend the "material interest" test for employees and directors in close companies, to facilitate the adoption of employee share schemes in such companies.

97. I now propose a further measure to assist employee share schemes in special circumstances. In future employees in a company which is taken over will be able to exchange their existing share options under an approved scheme for options over shares in the acquiring company.

98. I am further arranging for a review, with the help of outside experts, of the effect of Section 79 of the 1972 Finance Act on the tax treatment of employee-acquired shares. The aim of the review will be to improve and simplify the rules, consistent with the underlying purpose of countering tax avoidance, so as to allow greater flexibility and encouragement to enterprise.

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99. Privatisation brings many benefits for the economy at large, as well as for the industries privatised and their consumers. Not the least of these benefits is the breakthrough we have been able to make in wider share ownership.

100. As the House knows, the British Telecom sale in 1984 brought a step-change in the number of share-owners. Over 2 million people applied, and around half of them had never owned shares before. Subsequent sales consolidated this success, and British Gas proved another landmark for wider share ownership. 4½ million applications were received on behalf of 5 million people, the largest number of applications ever received in a flotation anywhere in the world.

101. I am particularly glad that employees have seized the chance to become shareholders - sometimes, it must be said, against the advice of their trades unions. About 90 per cent of the employees in the privatised companies floated on the stock market have become shareholders.

102. The success of these policies has been clear for some time, but estimates of current shareholder numbers have differed. I therefore commissioned, in conjunction with the Stock Exchange, a major survey of individual shareholders. This indicates that there are now

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[ ] million individual shareholders in the UK, [and confirms that shareholder numbers have trebled since 1979].

103. But we are not going to stop there. There is a great deal of scope, not only for further widening of share ownership but also for existing shareholders to add to their portfolios. Our measures to promote employee share schemes and our plans for further privatisation sales will continue to play an important part in this.

104. The Personal Equity Scheme announced last year is a major new stimulus to the spread of share ownership. Already over [ ] have applied to become plan managers, including banks, stockbrokers, unit trusts, building societies and investment advisers. And there are [ ] PEP holders, including [ ] people who previously had not owned shares directly.

105. PEPs are now successfully launched, and going well. In time they, with the other measures we will have taken, will alter the landscape of attitudes to saving, investment and share-ownership in Britain.

106. All the tax proposals I have just put forward are concerned in one way or another with business and enterprise. They continue the thrust of the reforms we have introduced in successive Budgets.

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107. The US tax reform package has been much commented upon and welcomed, for closing tax loopholes and removing distortions. Yet on the structure of business taxation the US is essentially following the approach we adopted here in 1984. Otherwise, the US reform is substantially concerned with removing shelters which do not exist in the UK. One exception to this is the double deductibility of interest by dual resident companies, which as I have already said, we like the US are now acting to remedy. With this measure are linked the other measures I have just announced to produce a fairer and more effective tax system. They are part and parcel of the continuing programme of tax reform which we are pursuing.

108. The size of any reform is related to the size of the problems it tackles. There is no need whatever for us to be defensive about the UK record on tax reform. Besides reforming the business tax structure in 1984 and this year we have abolished four unnecessary taxes and cut the rates of most of the remaining direct taxes.

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Savings and investment

*W&S memo for*

109. In my last Budget, I promised to bring forward proposals for the tax treatment of the new personal pensions which will be introduced from 1 January 1988. Accordingly, we published a consultative document last November. This proposed that the tax reliefs for personal pensions should be broadly in line with the arrangements applying to retirement annuities.

110. The consultative document also outlined other important reforms in the pensions field. Employers will be able to set up simplified occupational schemes with minimum red tape. There will be much greater transferability between different types of pension scheme.

111. These proposals have been welcomed, and I now propose to put them into effect.

112. These important and innovative reforms will widen the pensions choice for millions of working people. They will be of particular benefit to the 10 million employees in this country who do not belong to occupational pension schemes.

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113. I have decided, however, to go beyond the proposals in the consultative document in a further, important, way. I propose to allow members of occupational schemes to top up their pension through additional voluntary contributions to a separate plan of their own choice. They will be able to top up their pension in this way right up to the present tax approval limits.

114. This proposal, together with those in the consultative document, will make it easier for people to take their pensions with them when they change jobs. This will be good for labour mobility and for independence. In future people will have more control over their provision in old age.

115. But these improvements can be justified only if they are properly used. Some new safeguards are necessary to discourage exploitation, particularly by certain very highly paid employees. My proposals to deal with abuses of this kind - some of which are to come into effect immediately - are described in a further consultative document published today.

*don't you need to be a bit more specific*

116. On inheritance tax I propose a substantial increase in the threshold from £71,000 to £90,000 and a significant simplification of the structure by reducing the number of rates of tax from seven to four. The

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effect will be to reduce the number of estates liable to IHT by about a third, and to give worthwhile reductions in tax at all levels, particularly on smaller estates.

117. Last year by abolishing the iniquitous Capital Transfer Tax lifetime charge I exempted outright lifetime gifts made more than seven years before the donor's death - to encourage lifetime giving. This year, as a further encouragement to lifetime giving, I am extending the exemption to lifetime gifts made for a limited period of time. I am also increasing the rate of IHT business relief for substantial holdings in unquoted companies, while in future minority holdings in USM companies will be treated in the same way as those in companies with a full listing. This will concentrate business relief where it is most needed: to avoid loss of family control and forced sales to raise cash to pay the tax.

118. I propose to increase the annual exempt amount of capital gains from £6,300 to £6,600. I am also increasing the amount of capital gains relieved from tax on retirement from £100,000 to £125,000.

119. In my 1984 Budget I reformed the limits that apply to tax exempt life assurance issued by friendly societies. I did so because certain societies had widely abused the privileges traditionally enjoyed by the

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friendly society movement. These societies were set up purely for commercial reasons, far removed from the mutual self-help role which the movement has sponsored for decades.

120. I now propose a further change. Societies will in future be able to offer tax-exempt policies based on annual premiums of up to £100. Again, this is intended to improve the position of the older, long-established societies, who will be able to operate economically, without effectively changing the position of commercial societies.

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for other

Taxes on spending

121. [Introduction setting scene - depends on decision on excise duties.]

122. [Excise duties - passage in light of decisions.]

later

123. In last year's Budget I announced that I had decided to introduce a duty differential in favour of unleaded petrol, to offset its higher production costs. I can now announce that the differential will be 5 pence. This means that unleaded petrol should be cheaper at the pump than 4 star leaded petrol, encouraging the switch to less polluting fuel. The measure will take effect from 6 o'clock this evening.

124. Following changes to the regulations for betting shops, whose effect has been to tilt the balance of advantage towards off-course betting compared with on-course betting, and in the light of concern about declining attendances at race courses, I have decided to abolish from today the duty on on-course betting. At the same time I propose to increase the duty on gaming machine licences.

Sorry that in my choice of Budget day I disappointed some hon members who would otherwise have been at Aeltenham for the Champion Hurdle. But . . .

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125. There will be no changes in the rate or coverage of Value Added Tax. But I have one change here to announce - a change which has already been the subject of extensive consultation.

126. Where businesses are carrying out activities some of which are liable to VAT and some of which are not, the present rules are over-generous on the amount of input tax which can be deducted. We have already announced that the rules on VAT input tax deductions are to be revised so as to curb tax avoidance and prevent distortion of competition. The proposals could have had an unintended impact on certain sectors and, following exchanges with those concerned, I now propose arrangements which will be reasonable in their impact on all sectors while safeguarding the position of the Exchequer.

127. Last year I introduced a very significant package of new tax reliefs to encourage charitable giving. These included the new payroll giving scheme which starts next month. As I announced before Christmas, I propose to increase the limit on donations under the scheme to £120 a year.

128. We now have a very generous tax regime for charitable giving, and I know charities will not expect any further major reliefs on this front this year. But

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following representations from the Charities VAT and Tax Reform Group, I am prepared to agree to certain additions to the VAT concessions which were introduced last year.

129. I propose to extend VAT relief to welfare vehicles used by hospices to transport the terminally ill; to specialised equipment used by mountain rescue and first aid services; to the donation of goods for export to a charity; to installing or adapting lavatory or bathroom facilities in charity residential homes for the disabled; [and to drugs and chemicals supplied to charities and directly used in medical research].

130. [I also propose relief from car tax on vehicles supplied to Motability for leasing]

Income tax

131. Finally I turn to income tax.

132. Lower rates of tax are good for incentives and a stimulus to enterprise. The best chance of increased prosperity for all will come when the UK is placed firmly in the league of countries with low taxation and high growth. Our tax reform strategy has been to move as quickly as is prudently possible in this direction.

Aren't we  
there?

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133. We have already made a very substantial reduction in the top rate of income tax, reducing it from the penal level of 83 per cent under the previous Government to 60 per cent. Since we took office in 1979 we have abolished the investment income surcharge and brought down the basic rate of tax by 4 percentage points.

*for 332 & 292.*  
During the same period we have increased the basic tax thresholds by 22 per cent in real terms taking 1.4 million people who would otherwise be liable out of income tax altogether. The married man's allowance now stands at its highest level in real terms since the war.

*Wrong start given no change in top rates*  
134. Despite these tax reductions top rate taxpayers are now paying a larger proportion of the total than before. In 1978-79 the top 5 per cent of taxpayers were contributing 24 per cent of the total yield of income tax, but in the current year that figure has risen to 27 per cent.

135. Meanwhile I propose for 1986-87 to raise the main personal allowances in line with the statutory indexation provisions.

136. The single person's allowance will therefore rise by £90 to £2,425 and the married man's allowance by £140 to £3,795.

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137. Similarly the single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675.

*^ Over 80s*

138. The age allowance income limit becomes £9,800.

139. The blind allowance was last raised in 1981 when it was increased by £180 to its present level of £360. For 1986-87 I am proposing a further £180 increase in the allowance taking it to £540. ~~I am very pleased to announce this extra measure of help for a deserving group.~~

140. Turning to the rates of income tax, I believe that all the income tax rates need to come down if we are to remain competitive with those countries which are now making substantial reductions, particularly in their top rates. But this year I intend to give priority to a further reduction in the basic rate since it is the marginal rate for 95 per cent of the taxpaying population.

*last year*  
141. In my ~~last~~ Budget speech I said that I shared the aim of my predecessor to reduce the basic rate of income tax to no more than 25 per cent. That remains my objective.

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142. But reductions in the basic rate are expensive. It would be wrong to move to our goal of a 25 per cent basic rate more quickly than is prudent.

143. The revenue cost of all the tax measures I have so far announced will be [£ million] in 1987-88. I have already announced that I am providing a borrowing requirement of [£4 billion] for 1987-88. Taking account of all of this, and on a cautious view of forecast revenues and expenditure in 1987-88, I am glad to say that I have room for a total tax reduction of some [£2 billion next year]. I am therefore taking 2p off the basic rate in 1987-88.

144. ~~This reduction, to a basic rate of 27 pence in the pound, brings down marginal rates for the overwhelming majority of ordinary taxpayers.~~ The cut in the rate will be worth over £3 per week to a married man on average earnings.

145. The threshold for the 40 per cent rate will be raised in line with statutory indexation to £17,900 and the threshold for the 45 per cent rate will go up by £200 [to £20,400]. The thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain at their 1986-87 levels.

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*Don't say 2p*  
*Don't say 2p*

*Cost*  
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146. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

147. The reduction in the basic rate to 27 per cent will, of course, mean a similar reduction in Advance Corporation Tax.

148. I also propose to reduce the small companies' rate of corporation tax to 27 per cent in line with the new basic rate. This change, together with the reduction in income tax, will mean that small companies and the unincorporated sector will see a significant fall in their tax burden. This Budget, therefore, gives the best possible help to small businesses, which are so crucial for future growth and employment.

**Peroration**

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*to John 14/2/4*  
*SECRET*

*76 Review over:*  
*revises*  
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*B.L.O.*

*135, 136, 137, 138, 145, 139)*

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**Peroration**

*need declines  
1/3?*

The Government has/is now realised/realising the dream of Governments for over twenty years: vigorous but steady and balanced growth, low inflation, increases in public expenditure in priority areas, a change in the unemployment trend and lower tax rates. To those who espouse alternative economic policies I would make the comment: if it isn't broken, don't fix it. The onus of proof of the economic policies which are on offer has shifted more firmly still onto those who want change. In my view it is no coincidence that, by concentrating on control of expenditure and lower tax rates, this Government has set free the latent spirit of enterprise and we are reaping that harvest in higher revenues and a buoyant economy. Any return to higher spending and higher taxes would risk the vicious circle of lower revenues forcing lower public spending and we would all suffer, the poor perhaps the most.

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39. I turn now to my proposals for changes in taxation.

Business and Enterprise

Corporation Tax

40. First, taxes affecting business and enterprise.

41. <sup>My</sup> The central objective [of my reforms in this area has been to remove obstacles to business success. The national insurance surcharge and the development land tax have gone altogether. The reformed system of corporation tax came fully into effect last April, and for the past year, the rate of tax on company profits has been lower in Britain than in any major industrial nation, though the Americans are now set to emulate us. The sharper incentive this gives companies to improve their performance benefits employees, customers, shareholders, and the nation as a whole.

42. During the transition to the new system, companies were given advance notice of the main rate of Corporation Tax for the year ahead. This helped them in their forward planning, and I intend, as far

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as possible, to continue the practice of fixing the rate in advance.

43. Accordingly, I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent.

Company Capital Gains

44. I have a further measure of streamlining to propose. The present system of taxing companies' capital gains is <sup>unduly</sup> complicated: gains are charged to corporation tax, but the amount of the gain is first adjusted by a certain fraction so that the effective rate of tax is the same as on individuals' capital gains. [But] I see much force in the view that, with the greatly reduced Corporation Tax rates, there is less justification for this difference between the tax treatment of companies' capital gains and their income from other sources.

45. I therefore propose that with effect from today, the capital gains of large and small companies will be charged at the appropriate Corporation Tax rate, without adjustment, except for the indexation which applies to all post-1982 gains.

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46. ~~At the same time, I am~~ proposing to enable companies to set payments of Advance Corporation Tax against their tax liability on capital gains. This remedies a longstanding complaint which has been the subject of regular representations.

47. Together, these measures are expected to yield about £60 million in 1988-89 and £100 million in a full year.

*Prigun's  
Facts*

**Pay and File**

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51. Within the company sector, the ~~oil industry~~ <sup>North Sea</sup> has faced a year of adjustment following last year's sharp fall in the oil price. My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effects on North Sea producers and their suppliers. The industry itself is generally confident about the longer term prospects, but ~~companies have~~ <sup>it has been</sup> suggested that in the short-term the trough in activity could lead to the loss of some of the capacity, in Scotland and elsewhere, that will ~~certainly be~~ <sup>be needed</sup> required in the longer run.

What happens  
 & what is  
 whole is  
 done well,  
 The North Sea  
 oil sector has  
 inevitably  
 been hit by  
 1 1/2 years on  
 more collapse.

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52. Last autumn, with this problem in mind, I introduced legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. That has already helped many of the <sup>smaller</sup> ~~small~~ <sup>face</sup> companies with cash flow difficulties.

Transfer to 215  
Enron

53. I now propose two <sup>new</sup> Petroleum Revenue Tax reliefs. First, with effect from today, participators may elect to have up to 10 per cent of the costs of developing new oil fields, until income from the new fields exceeds the costs incurred, set against their Petroleum Revenue Tax liabilities in other fields. Second, I am proposing a new relief for research expenditure on oil extraction that is not related to a particular field, and so is not at present allowed for Petroleum Revenue Tax.

I think we need some indication that these are modest means.

54. Together, these <sup>changes</sup> ~~will~~ <sup>should</sup> give a <sup>worthwhile</sup> ~~further~~ measure of help, both to the oil companies themselves and to those for whom they generate work, that will assist them in meeting the difficulties of the next five years or so.

Small Businesses

55. The growth of the small business sector has been one of the most encouraging developments in the

The  
UK  
industry

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1980s. Between 1983 and 1985, 550 new businesses, on average, were created each week. Small businesses have a vital role to play in the economy, not least in job creation. The Government has introduced a wide range of measures to help this sector and to make it easier for small businesses to get on with the job of making profits.

56. Representations have been made to me from time to time about the difficulties some small businesses experience with VAT, both with its impact on their cash flow and with the record-keeping required. I therefore authorised Customs and Excise to issue a consultative document last autumn proposing certain changes, which have been broadly welcomed by representative bodies and individual businessmen alike.

57. One of the proposals which received a very wide welcome was that for a optional system of cash accounting for businesses with a turnover of up to £100,000. Indeed, there were many requests for this option <sup>could</sup> to be available more widely. *a higher limit, so that*

58. In the light of this I now propose <sup>propose that</sup> that, with effect from 1 October, companies with an annual turnover of up to £250,000 should, if they so *a substantial cause is the limit.*

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choose, be able to account for VAT on the basis of cash paid and received. They will thus not have to pay VAT until they have been paid by their customers, which will ease their cash-flow problems, as well as giving them automatic relief for bad debts.

59. The proposal is subject to our obtaining the necessary derogation from the EC Sixth Directive on VAT; I am applying for this today.

2

60. To help small businesses with the handling of VAT, I <sup>also</sup> propose an optional system of annual accounting, which will mean that businesses with an annual turnover below £250,000 will be able to make payments on account and send only one return a year to Customs. This change will come into effect in the second half of 1988.

3

61. I have two further changes to propose here. First, the period within which businesses must apply to be registered for VAT will be extended from ten days to thirty days.

4

62. Second, the rules for the special VAT schemes for retailers will be changed to make them simpler for small and medium-sized businesses.

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63. But there are two matters on which the representations have persuaded me it would not be right to proceed. I shall not be going ahead with the proposal for compulsory deregistration of traders below the VAT threshold; nor with the withdrawal of the standard method of accounting for VAT used by retailers.

64. For the coming year, I propose to increase the VAT registration threshold itself to £21,300, the maximum permitted under existing European Community law. We shall continue to argue vigorously in Brussels for flexibility to set a higher limit.

65. The proposals I have just outlined go further, in some respects, than those published in the autumn. They will help ease the burden of VAT on smaller firms - and allow more of their management energies to be concentrated on generating profits. Some controls, forms and regulations are inevitable, but we are continuing to prune this bureaucratic thicket as much as possible.

**Tax avoidance**

*As well as simplifying the tax system,*  
66. The Government is determined to make further progress in reducing the burden of taxation. But

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hand in hand with this we must ensure that tax is collected fairly and effectively, and that the law enables the right amount of tax to be collected. I have [a <sup>four</sup> number of] proposals to make today in this regard.

67. The first of these concerns VAT, and has already been the subject of extensive consultation.

*cap*

Where a business' activities are in part liable to VAT and in part <sup>exempt</sup> [not], the present rules are over-generous on the amount of input tax which can be deducted, and are being exploited. We have already announced that these rules are to be revised so as to curb tax avoidance and prevent distortion of competition. There will be generous and straightforward reliefs for small businesses, and administration will be kept as simple as is consistent with the prevention of wholly unacceptable losses of revenue. The changes will come into effect on 1 April, and are estimated to prevent a revenue loss in 1987-88 of £300 million.

*No. Gov. Wdy + 1988-89*

68. Second, I propose to take action on dual residence, so that dual resident companies in multinational groups will no longer be able to secure two tax reliefs for one and the same interest payment. Trading companies will not be affected.

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This change, which will take effect from 1 April 1987, follows on the action taken in this area by the United States last year. <sup>This is</sup> Indeed, <sup>has</sup> [this] is one <sup>of the few</sup> areas where [we can follow] the United States, [since the US tax reforms are substantially concerned with removing tax shelters which do not exist here.]

69. My third proposal concerns the timing of corporation tax payments. At present companies established before 1965 may pay their corporation tax up to 21 months after the end of the period for which it is due; but companies established since 1965 must all pay their tax after nine months and some building societies <sup>have to</sup> pay earlier still. This <sup>difference</sup> difference in the treatment of companies no longer has any justification; and it is open to an abuse which could put the timing of a substantial proportion of the corporation tax yield at risk.

70. I propose, therefore, that all companies and building societies should be liable to pay Corporation Tax nine months after the end of the accounting period on which the tax is due. This will be more equitable between companies than the present regime; it will rationalise the arrangements for collecting Corporation Tax from companies; and it will smooth the flow of tax

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reforms have - until now - gone further than ours: most of the rest of these reforms are designed to remove tax shelters which do not exist here, either because we never allowed them or because we have already abolished them.

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Business Expansion

74. Last year I was glad to confirm that, in view of its outstanding success, the Business Expansion Scheme would continue in being indefinitely. The changes I made to the Scheme in 1986 have improved its targetting. More BES money is now going into the higher risk ventures for which the Scheme was designed.

75. The scheme is now on a generally satisfactory basis. But I propose two further improvements.

76. The first is a measure to deal with the problem of end-year bunching, about which a number of people have made representations. I propose that, for investments made in the first half of the tax year, the investor will be able to claim part of the relief against income of the previous year. This measure, which will apply to investments made after 5 April 1987, should make it easier for companies to raise BES finance throughout the year.

77. The second measure is a relaxation of the rules to make it easier for independent film companies to benefit from BES investment. I hope that this will be widely welcomed in the film industry.

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78. I need to set the 1988-89 car and car fuel benefit scales for those with company cars. The car scale charges still fall well short of the true value of the benefits and as in the last three years I propose to increase them by 10 per cent. I propose no change to the car fuel benefit scales which from 6 April will also used for VAT purposes.

Is this right?  
What about existing stat-  
statutory concession?  
Can't really see  
till after  
Overseas  
although...

79. Training and retraining are vital to a dynamic, flexible economy. It is most important that there should be no disincentive for people who are likely to be changing jobs, which might hold them back from training and acquiring new work skills. At present, training of this kind provided by an employers is treated as a taxable benefit. I propose to take it out of tax.

Profit-related pay

80. I turn now to profit-related pay.

81. I suggested last year the possibility of introducing changes to the tax system which would run with the grain of, and reinforce, efforts to break up the rigidity of the pay system in this country.

82. I pointed then to two considerable advantages of arrangements which relate pay to profits. First,

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they lead to a closer identification of employees with the firms in which they work. Second, they make for more flexibility in the face of changing market conditions and hence help to make employment more stable.

83. My remarks led to a lively debate, and last July we published a Green Paper on profit related pay. I warmly welcome the discussion and responses that the document generated. Those firms which already have profit-related pay schemes generally believe they have worked well. And many other firms are considering introducing them.

84. I have therefore decided that the time is right to give a measure of tax relief for employees in qualifying profit-related pay schemes.

85. This should encourage many more firms to bring these schemes into operation. [Initially, at least, these schemes will be confined to the private sector.] Certain conditions will [of course] have to be met before tax relief is available. But firms will have as much flexibility as possible to design schemes to suit their particular needs, and the administration will be kept simple.

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86. A key issue is the level of tax relief. The Green Paper suggested that one quarter of an employee's profit-related pay might get tax relief. I have now decided to double this to a half. So for someone on average earnings receiving 5 per cent of their pay as PRP, the tax relief will be equivalent to a penny off the basic rate of income tax. That underlines the importance the Government attaches to this major new initiative. Depending on take-up the full year cost could well build up to over £100 million by the end of the decade.

87. Profit related pay is not a panacea. But I believe it will be of practical help in tackling some of the deep seated problems of the UK economy by promoting greater flexibility and enterprise, and so help further to strengthen the prospects for employment. I hope that employees and employers alike will now respond enthusiastically to this opportunity as we look forward to the 1990s.

**Savings and Investment**

88. I now turn to savings and investment

89. First, share ownership. This Government has given a major boost to wider share ownership through

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action on three fronts: employee share schemes, privatisation, and the introduction of Personal Equity Plans.

90. The growth in approved employee share schemes since 1979 has been remarkable. We started with about 30 schemes. Now there are over 1,200 open to all employees which cover some 1½ million workers in over 10,000 companies.

91. I now propose a further measure in this area. In future, employees in a company which is taken over will be able to exchange their existing share options under an approved scheme for options over shares in the acquiring company.

92. I am, further, instituting a review, with the help of outside practitioners, of the effect of Section 79 of the 1972 Finance Act which deals with the tax treatment of employee-acquired shares outside approved schemes. The aim of the review will be to suggest how to improve and simplify the rules, consistent with the underlying purpose of countering tax avoidance, so as to allow greater flexibility and encouragement to enterprise.

~~1,500,000~~  
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93. Privatisation brings a wide range of benefits for the economy at large, as well as for the industries privatised and for their consumers. Not the least of these benefits is the breakthrough we have been able to make in wider share ownership.

94. As the House knows, the British Telecom sale in 1984 brought a step-change in the number of share-owners. Over 2 million people applied, half of whom had never owned shares before. Last year's sale of British Gas proved another landmark for wider share ownership. 4½ million applications were received on behalf of 5 million people, the largest number of applications ever received in a flotation anywhere in the world. [Plus reference to TSB? - review in the light of the results of the Treasury/Stock Exchange Survey, expected on 2 March.]

95. I am particularly glad that employees have seized the chance to become shareholders - sometimes, it must be said, against the advice of their trades unions. No fewer than 90 per cent of the employees in the privatised companies floated on the stock market have become shareholders.

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96. The success of these policies has been clear for some time, but estimates of the number of shareholders have varied. I therefore commissioned, in conjunction with the Stock Exchange, a major survey of individual shareholders and have recently received the results. The survey shows that there are now [ ] million individual shareholders in the UK. [This is fully three times the number in 1979.]

97. But we are not going to stop there. There is a great deal of scope, not only for increasing still further the number of people owning shares but also for existing shareholders to add to their portfolios. Our measures to promote employee share schemes and our plans for further privatisation sales will continue to play an important part.

98. The Personal Equity Plans announced in my last Budget came into operation on January 1st and are already beginning to show impressive results. Already over 165 banks, stockbrokers, unit trusts, building societies and investment advisers have applied to become plan managers and the investor is being offered a wide range of plans to choose from. Over 2,000 people a day are currently taking out PEPs, and there is evidence that many of these had

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not previously owned shares directly and are basic rate taxpayers.

99. PEPs are now successfully launched, and going well. In time they, with the other measures we have taken, will alter the landscape of attitudes towards saving, investment and share-ownership in this country. ]

**Pensions**

100. I turn now to pensions.

101. In my last Budget, I promised to bring forward proposals for the tax treatment of the new personal pensions which are to be introduced from 1 January 1988. Accordingly, we published a consultative document last November.

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103. As foreshadowed in last year's Budget, and in the consultative document, I now propose to extend to these new personal pensions broadly the same tax treatment that applies to retirement annuities.

104. I also propose to implement other reforms contained in the consultative document, which have been widely welcomed.

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112. [Turning to the capital taxes I propose to increase the annual exempt amount of capital gains from £6,300 to £6,600. I am also increasing the maximum amount of capital gains relieved from tax on retirement from £100,000 to £125,000.]

113. The burden of inheritance tax - which raises over £1 billion - falls disproportionately on those with relatively small estates, many of which consist

*Why pop look!*  
*small business firms*

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entirely of the family house. I therefore propose a substantial increase in the threshold from £71,000 to £90,000 and a simplification of the rates structure. The effect will be to reduce the number of estates liable to the tax by about a third and to give worthwhile reductions at all levels, particularly for smaller estates.

114. Last year I removed a widely resented obstacle to lifetime giving by exempting outright gifts between individuals made more than 7 years before the donor's death. This year I can go further. I propose to extend the exemption on similar terms to gifts involving settled property in which there is an interest in possession, though this will not apply to discretionary trusts.

115. ~~The proposed changes in rates and bands will help businesses.~~ But I propose to go further by increasing business relief for shares in unquoted companies. The rate of relief for substantial minority holdings in such companies will be increased from 30 per cent to 50 per cent. To reflect the progress of the unlisted securities market, in future all holdings in USM companies will be treated like those with a full listing. These changes will concentrate relief on assets which do not readily provide funds to pay the tax or which could only do so at the risk of damaging the business.

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Taxes on spending

116. I turn now to taxes on spending.

117. I have no changes to announce in the rate or coverage of Value Added Tax, except for some further reliefs for charities.

118. We have a very generous tax regime for charitable giving, following the package of new reliefs I introduced last year, and in particular the payroll giving scheme which starts next month. As I announced before Christmas, I propose to increase the limit on donations under the scheme to £120 a year.

119. I know charities will not expect any major changes this year. But following representations from the Charities VAT and Tax Reform Group, I have decided to extend the VAT reliefs introduced last year to certain new areas: to installing or adapting lavatory or bathroom facilities in charity residential homes for the disabled; to certain welfare vehicles used by hospices to transport the terminally ill; to drugs and chemicals supplied to charities and directly used in medical research; to

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goods donated for export by a charity for relief of distress; and to specialised location and identification equipment used by mountain rescue and first aid services.

120. On excise duties, I announced last year that I had decided to introduce a duty differential in favour of unleaded petrol, to offset its higher production costs. I can now announce that the differential will be 5 pence. This means that unleaded petrol should be no dearer at the pump than 4 star leaded petrol. The measure will take effect from 6 o'clock this evening.

121. The gaming machine licence duty has not been changed since 1982, and I propose to increase it by about a quarter, which will restore it to its 1982 value. I propose no change in the level of duty on off-course betting, where the reforms introduced by my Rt Hon Friend the Home Secretary have done much to improve betting shops' prospects. But, mindful of the adverse effects of declining attendances at racecourses, and with a view to consoling those Hon Members who, but for my choice of Budget date, would have spent the day at Cheltenham watching the Champion Hurdle, I propose to abolish the duty on on-course betting from 29 March.

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122. Taken together, these measures are broadly revenue-neutral.

*As last year, the following for 1988's changes,*

123. I propose to increase the rates of vehicle excise duty on farmers' lorries, to bring them into line with the use they make of the public roads. This change will take effect from midnight tonight. I also propose to increase the rates of duty on trade licences and to create a new taxation class for recovery vehicles. These changes will take effect from 1 January 1988.

124. [Passage on excise duties to be drafted later.]

124a. I have no further changes to propose <sup>on</sup> [in the] excise duties.

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Income Tax

125. Finally I turn to income tax.

126. Lower rates of tax are good for incentives and a stimulus to enterprise. The best chance of increased prosperity for all will come when Britain is placed firmly in the league of countries with low taxation and high growth. Our tax reform strategy has been to move as quickly as is prudently possible in this direction.

127. We have already made a very substantial reduction in the top rate of income tax, reducing it from the penal level of 83 per cent under the previous Government to 60 per cent. We have abolished the investment income surcharge and brought the basic rate of tax down from 33 per cent to 29 per cent. The main tax thresholds are now 22 per cent higher in real terms than in 1979, taking 1.4 million people out of income tax altogether. [The married man's allowance will therefore remain at its highest level in real terms since the war.]

128. We now need to carry this process a step further.

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129. I propose for 1987-88 to raise the main personal allowances in line with the statutory indexation provisions.

130. The single person's allowance will therefore rise by £90 to £2,425 and the married man's allowance by £140 to £3,795.

131. The single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675.

132. I propose, however, to give an extra increase in the age allowance to people aged 80 or over. For them, it will be raised by twice the amount due under indexation so that, for the very elderly, the single age allowance will be £3,070 and the married age allowance, £4,845. Around 400,000 single people and married couples will benefit from this new provision and the extra increase in the allowance will take up to 25,000 of them out of income tax altogether.

133. The blind person's allowance was last raised in 1981 when it was increased by £180 to its present level of £360. For 1987-88, I am proposing a further £180 increase, to £540.

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134. As to the higher rates of income tax, the threshold for the 40 per cent rate will be raised in line with statutory indexation to £17,900 and the threshold for the 45 per cent rate will go up by £200 to £20,400. But I have decided that the thresholds for the 50 per cent, 55 per cent and 60 per cent rates will remain <sup>unchanged.</sup> at their 1986-87 levels.

135. In my Budget speech last year, I reaffirmed the aim set out by my predecessor in 1979, to reduce the basic rate of income tax to no more than 25 per cent. That remains my objective.

136. But reductions in the basic rate are expensive. It costs well over £1 billion to reduce the rate by one percentage point. Given the overriding need for prudence on public borrowing - on which I am not prepared to compromise - I cannot achieve the goal of a 25 per cent basic rate this year. But I can take a further useful step towards it. I am therefore cutting 2 pence off the basic rate for 1987-88.

137. This reduction to a rate of 27 pence in the pound brings down marginal rates for the overwhelming majority of taxpayers. It will be

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worth over £3 per week to a married man on average earnings.

138. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

139. The basic rate reduction will, of course, mean a similar reduction in Advance Corporation Tax.

140. As a further measure to help small businesses, I have decided also to reduce the small companies' rate of corporation tax to 27 per cent. Following the proposals I announced earlier, this rate will also apply to small companies' capital gains, which are currently taxed at 30 per cent. The changes to income tax and corporation tax will mean a significant fall in the tax burden on small companies and the unincorporated sector. This gives the best possible incentive to small businesses, which are so crucial for future growth and employment.

141. The total cost of the income tax changes will be some £2½ billion in 1987-88. The overall cost of all the measures I have announced today will be just over £2 billion. This is consistent with my

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objective of a PSBR of no more than 1 per cent of GDP. I have accordingly set the PSBR for 1987-88 at £4 billion.

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Peroration

142. Mr Deputy Speaker, we now have a vigorous and resilient economy, entering its seventh year of steady growth. Inflation remains low; the number of people in work continues to rise; and unemployment is now on a downward trend.

143. In this Budget, I have been able to reduce public borrowing to 1 per cent of GDP, and to make a further reduction in income tax; [in the next year, public spending will fall as a proportion of GDP, but spending in priority areas will increase.]

144. To succeed on all these fronts together is a goal that has eluded successive Governments for decades.

145. This achievement is the direct result of the prudent economic policies pursued since 1979.

146. This Budget carries forward those policies. I commend it to the House.

*redo  
FRX instrument  
pursued*

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## X. EXCHANGE CONTROL

- X B.1. Before I turn to my proposals for changes in taxation, I have one other <sup>important</sup> change of a specific nature to announce.
- X B.2. In 1979, a few months after we had first taken office, my predecessor announced the abolition of exchange controls, which had been in <sup>continuous</sup> operation ever since the outbreak of war in 1939. That bold action has, over the past 7½ years, proved wholly beneficial to the British economy; and I am glad to note that other European countries are now moving in the same direction.
- X B.3. But although the operation of exchange control has ceased, the Exchange Control Act <sup>itself</sup> remains on the Statute book. So long as it does, there is likely to ~~persist~~ <sup>persist</sup> a nagging uncertainty that, in some circumstances, exchange control might be reimposed; and such uncertainty could be ~~very~~ <sup>very</sup> damaging.
- X B.4. I have therefore concluded that no time has come to repeal the Act. ~~The necessary~~ <sup>The necessary</sup> legislative amendments will be contained in this year's Finance Bill.

B.S. I note that, in a major speech in New York  
in September, the Deputy-Leader of the Labour Party  
declared that, and I quote: ~~that~~

"The Labour Party has no intention

of introducing statutory exchange controls."

I am confident, therefore, that ~~the~~ no proposal I have  
just made will be welcomed on all sides of the House.

*Miss - PWP*

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*Mr Scholar*

FROM: M C SCHOLAR  
DATE: 25 FEBRUARY 1987

MR A P HUDSON

*Scribbled comments from me and Mr Allan. Where possible, I've discussed these with IR first.*

*AMH*

cc Mr Cassell  
Mr Cropper  
Mr Ross Goobey  
Miss Sinclair  
Mr Haigh  
Mr Romanski  
Mr Johns - IR  
Mr Wilmott-CU

**BUDGET SPEECH: REDRAFT**

*26.2.*

You and I have been asked to prepare a revised draft of the tax section of the Budget speech, and we have agreed initially to split the task as in the attached schedule, to prepare a first new version\* as indicated, then seek quick comments from one-another and copy recipients.

2. I have to put it all together once more, on Friday, so I would be grateful for comments by close tomorrow.

*\* only part of my section attached. More coming.*

*MLJ*

M C SCHOLAR

*MLJ*

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FROM: A.P. HUDSON  
DATE: 24 February 1988

MR SCHOLAR

~~Mr Cassell~~

BUDGET SPEECH: TAX SECTION

1. I think we agreed to ~~re-draft~~ the split the speech as follows,  
using the Chancellor's new order:

(1) Business and Enterprise

- APH {
- (a) Corporation Tax - main rate (paras 54-56);  
- capital gains (63-66);  
- Pay and File (60-62).
  - (b) Oil (68-72)
  - (c) Small businesses (45-53)
- MCS {
- (d) Anti-avoidance - homily (31);  
- VAT partial exemption (125-6);  
- Dual-resident companies (83);  
- CT payment dates (58-59);  
- banks (82);  
- Lloyds (84).
- ~~APH~~  
MCS {
- (e) Miscellaneous - BES (90-<sup>93</sup>~~91~~);  
- company cars (88-89);  
- PRP (73-80).

(2) Savings and Investment

- MCS {
- (a) Wider Share Ownership (94-106);
  - (b) Pensions (109-115);
  - (c) CGT and friendly societies (118-120);
  - (d) Inheritance Tax (116-117).

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(3) Taxes on Spending

- APH {
- (a) Specific duties (121-124);
  - (b) VAT (127-130).

(4) Income Tax

APH { Reordered as follows: 131-133, 135-137, 138, 145, 139, 141, 142, 147, 148, 144, 146.

2. This covers ~~all except the following~~ the great majority of paragraphs. Of the rest:

- 44, 57, and 87, are linking passages which may ~~be~~ be used or redrafted as appropriate;
- 67 will need to be fitted in somewhere, ~~or~~ perhaps split between at the end of the anti-avoidance section;
- 85-86, 107-108, and 134 have been dropped;
- and 160 will have to be redrafted within the income tax section.

A. P. HUDSON

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Tax avoidance

1. The Government is determined to make further progress in reducing the burden of taxation. But hand in hand with this we must ensure that tax is collected fairly and effectively, and that the law enables the right amount of tax to be collected. I have a number of proposals to make today in this regard.

2. The first of these concerns VAT, and has already been the subject of extensive consultation. Where a business <sup>makes both exempt and taxable supplies</sup> is in part liable to VAT and in part not, the present rules are over-generous on the amount of input tax which can be deducted, and are being exploited. We have already announced that these rules are to be revised so as to curb tax avoidance and prevent distortion of competition. There will be generous <sup>straightforward</sup> and simple reliefs for small businesses, and administration will be kept as simple as is consistent with the prevention of wholly unacceptable <sup>losses of</sup> revenue loss. The changes will come into effect on 1 April, and are estimated to prevent <sup>a</sup> revenue loss in 1987-88 of £300 million.

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3. Second, I propose to take action [on dual residency], so that dual resident groups of companies will no longer be able to secure a tax deduction twice for the same interest payment. This change, which will take effect from 1 April 1987, <sup>and</sup> follows on the action taken in this area by the United States last year. Indeed, it is the only US tax avoidance measure which we can follow in this country, since the US tax reforms are substantially concerned with removing tax shelters which do not exist here.

4. My third proposal concerns the timing of corporation tax payments. At present companies established before 1965 may pay their corporation tax up to 21 months after the end of the period for which it is due; but companies established since 1965 must all pay their tax within nine months. This difference [in the treatment of companies] <sup>there is</sup> no longer has any justification; <sup>for</sup> and it is open to an abuse which <sup>could lead to delays in the payment</sup> could put the timing of a substantial proportion of the corporation tax yield <sup>at risk</sup>.

5. I propose, therefore, that all companies and building societies should be ~~liable to~~ pay Corporation Tax nine months after the end of the accounting period <sup>for</sup> on which the tax is due. <sup>This</sup> ~~will be more equitable between companies than the~~ <sup>system will be fairer, and easier to administer,</sup>

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Lloyd's members in the same way as to insurance companies and other financial traders. These proposals will affect the tax treatment of Lloyd's Reinsurance to Close and will first apply to premiums paid for the close of the 1985 Lloyd's account at 31 December 1987. The new arrangements will be phased in over a three year period.

8. I have a number of further proposals, to improve the taxation of business and enterprise.

9. Last year I was glad to confirm that, in view of its outstanding success, the Business Expansion Scheme would continue in being indefinitely. The changes I made to the Scheme in 1986 have improved its targetting. More BES money is now going into the higher risk ventures for which the Scheme was designed.

10. The scheme is now on a generally satisfactory basis. But [to improve it still further] I propose two [changes]. *into improvement*

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11. The first is a measure to deal with the problem of end-year bunching, about which a number of people have made representations. I propose that, for investments made in the first half of the tax year,

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the investor should be able to opt for part of the relief to be given for the previous year. This measure, which will apply to investments made after 5 April 1987, should make it easier for companies to raise BES finance throughout the year.

x 12. The second <sup>measure</sup> is a relaxation of the rules to make it easier for independent film companies to benefit from BES investment. I <sup>hope</sup> believe that this will be widely welcomed in the film industry.

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FROM: A. P. HUDSON

DATE: 27 February 1987

CHANCELLOR

BUDGET SPEECH: MONETARY AND FISCAL POLICY

1. I think Tony's draft is a ~~much~~ better starting point than Peter's.

But the first 3 paragraphs don't provide ~~a~~ the clear statement of policy that's needed. How about something on these lines,<sup>2</sup> more like last year's?

For its part, the Government will continue to pursue sound and prudent financial management.

The framework for ~~that~~ policy will ~~be the~~ continue to be the Medium Term Financial Strategy, as it has been since 1980. And the central objective will continue to be to reduce steadily the growth of money GDP, so as to squeeze inflation out of the system and make room for real growth.

~~We have~~

~~[The MTFS has proved to be an invaluable~~

~~the success of that~~

~~that policy~~

The vindication of that policy, enshrined in successive versions of the MTFS, lies in the combination of low inflation and steady growth which we have enjoyed for three years already.

We shall build on this success. ~~Growth will continue at a healthy~~ ~~pace.~~ Our policy will continue to exert downward pressure on money GDP over the medium term, <sup>to reduce inflation further, and</sup> to make ~~a~~ progress towards our ultimate objective of stable prices.

APH

27.2.

Introduction

Terry's revision  
of his draft from  
last week

1. The setting for the Budget this year is more favourable than it has been for many years. We are entering our seventh year of steady growth, once again at the top of the international league table. ~~We are entering our fourth year in which this steady growth has been combined with low inflation. And we are entering one more year in which the public~~ *Throughout the ~~draft~~ push - balance* finances are sound and strong.

2. These are the fruits of the Government's determination to hold to our policies of sound money and free markets. I gladly reaffirm these policies today. They provide the only sure basis for more jobs and lasting, productive, jobs.

3. I shall begin by reviewing the economic background to the Budget. I shall then deal with monetary policy and with the fiscal prospect this year and next. Finally I shall propose some changes in taxation designed to assist in achieving our economic objectives. As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

Introduction

1. The setting for the Budget this year is more favourable than it has been for many years. We are entering our seventh year of steady growth, once again at the top of the international league table. We are entering <sup>the</sup> [our] fourth year in which this steady growth has been combined with low inflation. And we are entering one more year in which the public finances are sound and strong.

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Economic Background

4. The past year <sup>was</sup> [has been] dominated by the sudden collapse of oil prices. Inevitably, the difficulties the world economy experienced in adjusting to <sup>this</sup> [the sharp fall in oil prices] has influenced our economic performance. During the summer there were worries that the "pause" in activity was <sup>the</sup> [a] precursor <sup>to</sup> [of] a longer period of stagnation although I explained at the time why it was likely to be short lived. <sup>Events since then have proved me right.</sup> Helped by the benefits of prudent fiscal and monetary policies - and the progressive strengthening of the supply performance of the economy - <sup>about a slow-down in activity</sup> [those] worries have now been set aside and the economy has developed broadly as I set out a year ago.

5. In 1986 as a whole output has grown by a further 2½ per cent or so. This compares well with other industrialised countries and continues the steady economic growth we have experienced since 1981. We have now had 6 years of growth at around 3 per cent a year; one of the longest and steadiest periods of expansion since the war. And it has coincided with falling inflation. For the past four years inflation has averaged less than 5 per cent.

Get away for this point.

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This is an impressive combination. For 1986 as a whole inflation averaged 3.4 per cent - the lowest annual figure since 1967.

6. Last year our growth performance was achieved against a difficult world background. Demand in the industrial economies grew rapidly but the oil producers and other developing economies cut back their imports more than expected. As a result the industrialised countries experienced weak export demand in the early months of 1986.

7. UK exports initially reflected this weakness but have grown strongly since the middle of the year. Over the last three months the volume of visible exports, excluding oil, was almost 10 per cent higher than a year earlier - a performance stronger than in any other major economy. It has been reflected in the performance of manufacturing industry; <sup>where</sup> output grew rapidly in the second half of 1986 [having been weak in the early months of this year.]

8. The steady growth performance of the economy as a whole has contributed to a welcome fall in unemployment, although the level is still much too high. Since August unemployment has fallen by more

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than 100,000, the largest six-monthly fall since 1973. Adult unemployment, long-term unemployment and youth unemployment are all lower than a year ago. And since the early months of last year we have seen a further surge in productivity, particularly in manufacturing industry. This builds on the good productivity performance achieved by British industry since 1981. In the six years <sup>up</sup> prior to 1979 UK productivity growth in manufacturing was, at  $\frac{1}{2}$  per cent, the lowest of all the Summit Seven countries. In the seven years since 1979 our annual rate of growth of output per head in manufacturing industry has been higher than any other member of that group.

9. The current account of the balance of payments showed a small deficit in 1986. This follows a cumulative current account surplus of (£21) billion since 1979 which enabled the UK to build up a stock of overseas assets in excess of [£100] billion - (a stock) second only to that of Japan. Some deterioration in our current account is not surprising in the face of £5 billion loss on oil trade and the weaker than expected growth of some of our important markets. But the <sup>of over</sup> importance of this should not be exaggerated. The exchange rate adjustment that followed the fall in oil prices is

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already contributing to improved non-oil trade performance and [the UK's large stock of net] <sup>earnings on our</sup> overseas assets will provide a lasting contribution to the current account in the future.

10. Looking ahead, I expect 1987 to be [a] <sup>another</sup> year of steady, balanced growth with continued low inflation. [Domestic demand is expected to continue to grow rapidly and combined with vigorous export growth should mean another year of 3 per cent growth.] <sup>And</sup> The composition of [domestic demand] <sup>the</sup> growth <sup>in demand</sup> is likely to be more balanced than last year, when growth of consumers' expenditure was given a boost by the lower oil price and the fall in commodity prices. [Next] <sup>This</sup> year consumer spending is likely to show slower growth [but industrial surveys point to stronger growth of investment.]

11. The manufacturing sector in particular <sup>is not for</sup> faces a good year. Building on the improved performance during the second half of 1986 I expect to see continued strong growth <sup>manufacturing</sup> of exports, output and productivity.

12. And with 3½ per cent growth in the non-oil economy in prospect there is every chance of unemployment continuing to fall throughout 1987 at

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with balance when... held back by... and to be outpaced by the growth in investment and in exports.

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the rate seen in the past 6 months. In last year's Budget I said that employment prospects depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

13. As <sup>indicated</sup> [anticipated] in the Autumn Statement inflation may edge up for a time, perhaps to 5 per cent by the middle of the year, but should then fall back to 4 per cent by the end of the year. Since the last Election most of the short-term swings in the monthly RPI have mirrored changes in the mortgage interest rate. [For example] the monthly low of 3.7 per cent in 1983 and 2.4 per cent in 1986 coincided with falling mortgage rates; the monthly high of 7 per cent in 1985 reflected a rising mortgage rate. The pattern expected this year is largely the result of mortgage rate increases at the end of last year coupled with the effect on the 12-month comparison of the temporary dip in petrol prices last summer.

14. The recent and prospective performance in inflation is in historical terms a good one and one that we can point to with some satisfaction. But it is higher than in most other major industrial

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countries and it remains an important objective of the Government to keep inflation on an unambiguously downward underlying trend.

15. The growth of the UK's main overseas markets should be somewhat stronger in 1987 than in 1986. There are, however, risks that the outturn could be less favourable. It is possible that developing countries and oil producers could import less from the developed economies than we now expect. We cannot be sure that protection will be held at bay.

And problems in foreign exchange markets could lead to reactions that dampen demand and output in the major economies.

16. It was for that reason that Ministers and Central Bank Governors, <sup>from some of the main industrialised countries</sup> [meeting] in Paris on 21-22 February, <sup>and</sup> agreed <sup>met</sup> that [in current circumstances] a period of stability would now be desirable. [Accordingly,] the UK and other countries represented there agreed to co-operate closely to foster stability of exchange rates around current levels. The Plaza agreement 18 months ago succeeded in reducing dangerous protectionist pressures that were building up in the United States. This subsequent agreement is designed to give a breathing space for the benefits of past exchange rate

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And the unsettled conditions in the foreign exchange market which we had seen since the autumn created the potential problems for some of the major economies.

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adjustments to show through on trade balances. At the same time it will give the United States, Germany and Japan an opportunity to reinforce the policies already in place to improve the balance in their economies between domestic and external demand.

17. [On the assumption that] overseas markets [will] grow more quickly in 1987 than in 1986, <sup>and</sup> the prospect is for continued strong growth of UK exports. [But because non-oil imports have been growing rapidly at the same time as our surplus on oil account has been reduced there] is likely to be a modest current account deficit of [£2½] billion in 1987; around ½ per cent of GDP. <sup>should</sup>

But we have experienced a £x billion fall in our oil trade surplus, and non-oil imports have grown as the domestic economy has expanded. The result

18. [To summarise,] British industry now has an outstanding opportunity with growing markets at home and overseas, low inflation, improved profitability and rapidly growing productivity. If industry is able to control its costs and protect its competitive advantage we can look forward to many more years of strong growth combined with low inflation.

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Economic Background

*Nineteen-eighty-six was*

4. ~~The past year has been dominated by the sudden collapse of oil prices.~~ <sup>the</sup> Inevitably, the difficulties ~~the world economy experienced in adjusting to the sharp fall in oil prices has influenced our economic performance.~~ <sup>the affects</sup> During the summer there were worries that the "pause" in ~~activity was a precursor of a longer period of stagnation~~ <sup>economic growth</sup> although I explained at the time why it was likely to be short lived. Helped by the benefits of prudent fiscal and monetary policies - and the progressive strengthening of the supply performance of the economy - those worries have now been set aside and the economy has developed broadly as I set out a year ago.

*The UK economy was affected not only directly, in a major production capacity, but also by the pause in world growth as the world has adjusted to the shock. Despite the disturbance, however, in many respects the economy has developed as I forecasted a year ago.*

*While the economy has developed as the world has.*

5. In 1986 as a whole output has ~~grown by a further 2½ per cent or so.~~ <sup>grown</sup> This compares well with other industrialised countries, ~~and continues the steady economic growth we have experienced since 1981.~~ <sup>the trend of the economy</sup> We have now had 6 years of growth at around 3 per cent a year; one of the longest and steadiest periods of expansion since the war. And it has coincided with falling inflation. <sup>the level of inflation</sup> ~~For the past four years~~ <sup>of the period</sup> inflation has averaged less than 5 per cent.



than 100,000, the largest six-monthly fall since 1973. ~~Adult unemployment, long-term unemployment and youth unemployment are all lower than a year ago.~~ And since the early months of last year we have seen a further surge in productivity, particularly in manufacturing industry. This builds on the ~~good~~ <sup>remarkable</sup> productivity <sup>growth</sup> performance achieved by British industry ~~since 1981.~~ <sup>in the 1980s. Higher in 1980s</sup> In the ~~six~~ <sup>seven</sup> years prior to 1979 UK productivity growth in manufacturing was ~~at 3/4 per cent,~~ <sup>three quarters of one</sup> the lowest of all the ~~Summit~~ <sup>major Western countries.</sup> ~~Seven~~ countries. In the seven years since 1979 our annual rate of growth of output per head in manufacturing industry has been ~~higher than any other member of that group.~~ <sup>the highest of all the seven major industrial countries.</sup>

[Because all other comparisons are with 1979.]

This improvement in productivity - both absolute and relative to other countries - can not be explained by a weakening of production. Manufacturing output is lower than it was in 1979, but between 1973 and 1979 it fell by almost as much. And the gap between manufacturing output in the UK and the average of the Summit Seven <sup>increased by more</sup> ~~between 1973 and 1979 than it has since 1979.~~

Too defensive? (keep for use later if necessary) AA

9. The current account of the balance of payments ~~showed a small deficit~~ <sup>was not deficit by £1 billion</sup> in 1986. This ~~follows a~~ <sup>follows</sup> cumulative current account surplus ~~of £20 billion~~ <sup>since 1979</sup> of ~~£20 billion~~ <sup>some</sup> since 1979 which ~~enabled the UK to build up a stock of overseas assets in excess of £100 billion - a stock second only to that of Japan.~~ <sup>has</sup> ~~Some~~ <sup>was not</sup> deterioration in our current account ~~is not~~ <sup>was not</sup> surprising in the face of ~~£5 billion loss~~ <sup>of £5 billion</sup> on oil trade ~~and the weaker than expected growth of some of our important markets.~~ <sup>and the weaker than expected growth of some of our important markets.</sup> But the ~~importance~~ <sup>importance</sup> of this should not be exaggerated. The exchange rate adjustment that followed the fall in oil prices is

already contributing to improved non-oil trade performance, and the UK's large stock of net overseas assets, will provide a lasting contribution to the current account in the future. *year ahead.*

10. Looking ahead, I expect 1987 to be <sup>another</sup> a year of steady, balanced growth with continued low inflation. Domestic demand is expected to continue

to grow rapidly and combined with vigorous export growth should mean another year of 3 per cent growth. The composition of domestic demand growth is likely to be more balanced than last year when growth of consumers' expenditure was given a boost by the lower oil price and the fall in commodity prices. Next year consumer spending is likely to show slower growth but industrial surveys point to stronger growth of investment.

11. The manufacturing sector in particular <sup>is set for</sup> faces a good year. Building on the improved performance during the second half of 1986, I expect to see continued strong growth of exports, output and productivity.

12. ~~And~~ <sup>and with</sup> With 3½ per cent growth in the non-oil economy in prospect there is every chance of unemployment continuing to fall throughout 1987. ~~at~~

*Which now  
shows a well over  
£100m, bigger  
than that of  
the whole of  
the world apart  
from Japan,*

*This builds on recent  
improved performance. ~~despite~~  
in overseas markets UK  
exports of manufactures  
maintained their share in  
volume terms between 1981 and  
1985, after a long period of  
decline. In 1986 our  
share seems to have risen.  
And despite the impression  
sometimes given, the share of  
imports in the UK markets  
for manufactures is below  
the equivalent share in the  
German market.*

*The prospect for this year and  
next is good. Profitability  
is much better; <sup>and</sup> the recent  
improvement in our  
competitiveness should be maintaining*

*Take output  
to 3 per cent  
growth  
with  
inflation  
under 3%  
The manufacturing  
sector is particularly  
set for a good year*



~~the rate seen in the past 6 months.~~ In last year's Budget <sup>speech</sup> I said that employment prospects depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

Is this enough about jobs?  
I think it probably is, but it risks the comment "In a speech of X minutes, the Chancellor devoted 3 sentences to unemployment."

Despite the slow growth in exports, it will take time for the full effect of a higher rate adjustment to work through. The current account is showing a deficit of some £2½ billion, an ~~amount~~ a half of our job creation goals.

1 forecast

13. As ~~anticipated~~ in the Autumn Statement, inflation may edge up for a time, <sup>perhaps</sup> to 5 per cent by the middle of the year, ~~but should then fall back to 4 per cent by the end of the year.~~ <sup>before fall</sup> Since

the last Election most of the short-term swings in the monthly RPI have mirrored changes in the mortgage interest rate. For example the monthly low of 3.7 per cent in 1983 and 2.4 per cent in 1986 coincided with falling mortgage rates; the monthly high of 7 per cent in 1985 reflected a rising mortgage rate. The <sup>is</sup> pattern ~~expected~~ this year is largely the result of mortgage rate increases at the end of last year coupled with the effect on the 12-month comparison of the temporary dip in petrol prices last summer.

14. The recent and prospective performance in inflation is in historical terms a good one and one that we can point to with some satisfaction. But it is higher than in most other major industrial

While short-term fluctuations are manageable, it runs the risk of some dips to keep a lid on an unemployment problem  
- 6 -

countries and it remains an <sup>central?</sup> important objective of the Government to keep inflation on an unambiguously downward underlying trend.

15. <sup>Perhaps</sup> [The growth of the UK's main overseas markets should be somewhat stronger in 1987 than in 1986, there are ~~however~~ risks that the outturn could be less favourable. [It is possible that] developing countries and oil producers could import less from the developed economies than we now expect. We cannot be sure that protection will be held at bay. And problems in foreign exchange markets could lead to reactions that dampen demand and output in the major economies. ~~But~~ <sup>One of the main risks we face is that we could see the possibility of simultaneous slow down in activity in all three major economies - the USA, Japan, and West Germany.</sup>

16. It was for that reason that Ministers and Central Bank Governors, meeting in Paris on 21-22 February, agreed that in current circumstances a period of stability would now be desirable. Accordingly, the UK and other countries represented there agreed to co-operate closely to foster stability of exchange rates around current levels. The Plaza agreement 18 months ago succeeded in reducing dangerous protectionist pressures that were building up in the United States. This subsequent agreement is designed to give a breathing space for the benefits of past exchange rate

[Otherwise sounds as tho' we don't believe our forecast.]

Is this quite right?  
Isn't the point that this slowdown could occur anyway & would be exacerbated by further instability turbulence in the markets.

adjustments to show through on trade balances. At the same time it will give the United States, Germany and Japan an opportunity to reinforce the policies already in place to improve the balance in their economies between domestic and external demand.

17. On the assumption that overseas markets will grow more quickly in 1987 than in 1986, the prospect is for continued strong growth of UK exports. But because non-oil imports have been growing rapidly at the same time as our surplus on oil account has been reduced there is likely to be a modest current account deficit of [ $\pounds 2\frac{1}{2}$ ] billion in 1987; around  $\frac{1}{2}$  per cent of GDP.

18. To summarise, British industry now has an outstanding opportunity with growing markets at home and overseas, low inflation, improved profitability and rapidly growing productivity. If industry is able to control its costs and protect its competitive advantage we can look forward to many more years of strong growth combined with low inflation.

Following the fall in oil prices some adjustment in the balance of our economy was necessary. <sup>As I forecasted last year but</sup> One important part of that adjustment <sup>was likely</sup> to be the renewed growth of manufacturing industry. Obviously we still need to make more progress but it is also clear that we are seeing the necessary adjustment taking place.

1. For its part the Government will continue to pursue sound and prudent financial management. The framework for that policy will continue to be the Medium Term Financial Strategy, as it has been since 1980. It is designed to bring inflation down further over a period of years and ultimately to achieve price stability.

2. The MTFFS has provided a durable framework in which monetary policy has been pursued with steady persistence and a clear sense of direction. It has proved adaptable to changing circumstances both at home and beyond our shores. Above all it has proved a success. We shall build on this success.

3. Monetary conditions will be set so as to maintain the gradual reduction in money GDP over the medium term. In the short run there will be fluctuations but it is the medium term trend which is important. Experience over the past seven years shows that this policy will deliver a combination of low inflation and steady growth.

4. The achievement of a declining path for money GDP growth requires firm monetary policies supported by low public sector borrowing. Our commitment to anti-inflationary monetary policies is demonstrated by the declining path up to 1991 for growth of money supply as measured by M0.

5. Short-term interest rates remain the essential instrument of monetary policy. Changes in interest rates are made in response to changes in monetary conditions. In turn monetary conditions are assessed in the light of movements in narrow and broad money, and the behaviour of other financial indicators, in particular the exchange rate. There is no mechanical formula for taking these factors into account; a balance must be struck.

6. For narrow money the target range for 1987-88 will be 2-6 per cent - exactly as indicated in last year's MTFFS.

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7. There is no target for broad money this year. Rapid changes in financial markets associated with wholly desirable institutional changes have affected monetary indicators throughout the world. The interpretation of particular monetary conditions <sup>measures of the money supply (?)</sup> has become very difficult. In the United States, M1 has been put temporarily into cold storage. In this country rapid £M3 growth has proved consistent with monetary conditions which have demonstrably brought about lower inflation. <sup>£M3 has become</sup> ~~It is~~ too uncertain a measure to use for target purposes, as was vividly demonstrated by the Governor of the Bank of England in his Loughborough speech. We shall continue to <sup>take account of movements in</sup> make judgements about broad money in assessing monetary conditions. But I have selected a more reliable guide for the monetary target.

8. <sup>assessing</sup> The exchange rate will continue to play a significant part in monetary conditions and thus in decisions about short-term interest rates. The recent agreement by the 6 major industrial nations to reduce existing imbalances and co-operate to foster the stability of exchange rates will reduce uncertainty. It is entirely consistent with our medium-term objectives and has been widely welcomed.

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this get a  
jeer at the  
start of the  
para. Better to  
give the explanation  
first.

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for £1500  
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Monetary policy

19. In ~~1979~~, I presented to the House the first Red Book of the newly elected Conservative Government. It followed the attempt of the previous Government to guide the economy without the least sense of monetary strategy. Fifteen Budget packages of one sort or another in the five years up to 1979 had left inflation at 12 per cent and rising. The country was demoralised and falling steadily behind our competitors.

20. In the words of my Rt Hon Friend the then Chancellor, the 1979 Budget marked a "new beginning". Since then the financial picture has been transformed. With it has come a growing confidence in Britain and a transformation of our standing in the world today. It has transformed, too, the approach of British management and indeed the whole British people to the future. New energies have been released. And the key which has unlocked them has been the stable framework enshrined in the medium term strategy.

21. This has provided a durable setting in which monetary policy has been pursued with steady persistence and a clear sense of direction. It has

The policies it set out were in marked contrast to



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proved adaptable to changing circumstances both at home and beyond our shores. Above all it has proved a success.

22. We shall build on this success, as the 1987 Red Book shows.

*so as bring about a*  
23. Monetary conditions will be set to [continue the] gradual reduction in money GDP over the medium term *and hence* thus bringing about further reductions in inflation. [This is demonstrated by the declining growth of the money supply as measured by M0 in the period up to 1991 and] *M0 in* the target range, for 1987-88 which will be 2-6 per cent - exactly as indicated in last year's MTF5; *and the path for the period up to 1991 shows a steady decline.*

*our assessment of*  
24. The exchange rate will continue to play a significant part in monetary conditions and thus in decisions about short term interest rates. [The recent agreement by the 6 major industrial nations to reduce existing imbalances and co-operate to foster the stability of exchange rates will reduce uncertainty. It is entirely consistent with our medium term objectives and has been widely welcomed.]

25. In assessing monetary conditions we shall continue to consider a wide range of information

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about the money supply. <sup>But</sup> There is no target for broad money this year. Rapid changes in financial markets associated with wholly desirable institutional changes have affected monetary indicators throughout the world. [The interpretation of particular monetary measures has become very difficult.] In the United States, M1 has temporarily lost its target status. In this country rapid £M3 growth has proved consistent with monetary conditions which have demonstrably brought about lower inflation. It is too uncertain a measure to use for target purposes, as was explained by the Governor of the Bank of England in his Loughborough lecture. We shall continue to make judgements about broad money in assessing monetary conditions. But I have selected the more reliable guide, M0, for the monetary target.

This is wrong order.  
Should highlight difficulties part,  
Don say before no £M3 target!

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Public borrowing

26. A crucial part of the new beginning in 1979 was the need to reduce the burden of financing the public sector so as to leave room for industry and commerce to prosper. Here we have been completely successful. The PSBR in 1978-79 was  $5\frac{1}{2}$  per cent of GDP and rising. By contrast the PSBR in 1986-87 will be [around]  $1\frac{1}{2}$  per cent of GDP for the second *to below*

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successive year] and falling. [Next year,] in 1987-88, I expect to achieve my [ultimate] objective of a PSBR of no more than 1 per cent of GDP. [We inherited a PSBR of 5½ per cent of GDP. During our first Parliament it was reduced to 3 per cent; it is now down to 1½ per cent; and next year I expect to achieve my ultimate objective of a PSBR at around 1 per cent of GDP.] And I confidently expect to keep it there for the medium term.

27. There have been a number of contributory factors to this success. Much the most important has been the control of public expenditure, which has been falling as a proportion of [total expenditure in the economy] since 1982. But the cumulative effects of the steady increase in output and prosperity since 1981 have also been important. Companies are more profitable than they have been in living memory, against the background of a reformed tax structure. Activity is booming in the financial markets helped by the reduction in stamp duty last year. And the population as a whole has achieved new levels of prosperity.

28. With continuing prudent policies, there is no reason why] these favourable developments should [not] continue. This year they have enabled us to [live

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absorb

to

through a near halving of oil revenues - and achieve  
a lower borrowing requirement than we set at this  
time last year. In the future they hold out the  
inviting prospect of both low public borrowing and  
lower taxes.

29. Combined with sound monetary policy in the  
MTFS, they offer the basis for the further creation  
of wealth and as much insurance as is possible in an  
uncertain world from the economic shocks which beset  
us from time to time.

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## PUBLIC SECTOR BORROWING

9. An important component of the success of the MTF5 has been the reduction in the level of public sector borrowing.

10. Last year the Budget arithmetic was dominated by the sudden collapse of our oil revenues, which have fallen from £11 1/2 billion in 1985-86 to an estimated £4 1/2 billion in 1986-87. I introduced a cautious Budget which nevertheless left me some room to reduce taxes. [The <sup>set a PSBR of</sup> PSBR was expected to be around £7 billion in the current financial year.

11. In spite of lower oil revenues it now appears that the PSBR this year will, for the second year in succession, be lower than

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the budget estimate. We now estimate that this year's PSBR will be £5 billion, or about 1 1/4 per cent of GDP. <sup>6/1m</sup> If privatisation proceeds are added back, it is still lower as a share of GDP than in any year since 1969-70.

12. As last year, this successful outcome is due to two factors. First, public expenditure has been held within the planning total and continues to fall as a proportion of GDP. The second factor has been a marked surge in non-oil revenues. This is not the result of a short-lived boom; the economy <sup>as a whole</sup> has performed <sup>w</sup> in line with our projections. It is the consequence of higher than expected effective tax rates for a given level of economic activity.

Prompt the question: why were your revenue forecasts so far out?

how to be  
Burr  
m

13. This means that the PSBR this year, as a proportion of GDP, is about one quarter of the level we inherited in 1978-79. There have been two marked steps downwards. The first step brought the PSBR from 5 1/4 per cent to around 3 per cent in 1981-82. The second step brought it down from 3 per cent to 1 1/4 per cent in 1985-86. <sub>sub 1 1/2</sub>

14. Last year's MTFs indicated a PSBR for 1987-88 of £7 billion. There is a sensible presumption that I stick to the pre-announced figure. But given the outturn for this year and the buoyancy of revenues projected for next year I have decided to aim to make faster progress towards the desired low level for the PSBR. [I am not sure whether it is intended to mention the figure here or later].

how

15. North Sea revenues are forecast at about £5 billion, the same level as in 1986-87. In the light of the uncertainty surrounding oil prices I have stuck to the assumption made last year that oil prices will average \$15 dollars a barrel. The proceeds from the privatisation programme are expected to be £5 billion, as set out in the Autumn Statement.

16. This is a cautious and prudent policy. Unfortunately, it will not allow room for the substantial reduction in taxation to

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which this Government attaches such importance. That is regrettable, but necessary, for we are determined, as we have been for the past eight years, to take no risks with inflation, and no risks with our management of the public finances.

*Save this thought for the reversion?* [17. Even so I will be able to announce some reductions in taxation. It is a measure of the soundness of our policies that at the same time we shall be able to maintain public borrowing at unequivocally low levels despite the sizeable additions we have made to the level of public expenditure, and despite the slashing of our oil revenues.]

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## PUBLIC SECTOR BORROWING

9. An important component of the success of the MTFS has been the reduction in the level of public sector borrowing.

10. Last year the Budget arithmetic was dominated by the sudden collapse of our oil revenues, which have fallen from £11 1/2 billion in 1985-86 to an estimated £4 1/2 billion in 1986-87. I introduced a cautious Budget which nevertheless left me some room to reduce taxes. The PSBR was expected to be around £7 billion in the current financial year.

11. In spite of lower oil revenues it now appears that the PSBR this year will, for the second year in succession, be lower than

the Budget estimate. We now estimate that this year's PSBR will be £5 billion, or about 1 1/4 per cent of GDP. If privatisation proceeds are added back, it is still lower as a share of GDP than in any year since 1969-70.

12. As last year, <sup>the strength of public finances</sup> ~~this successful outcome~~ is due to two factors. First, public expenditure has been held within the planning total and continues to fall as a proportion of GDP. The second factor has been a marked surge in non-oil revenues. This is not the result of a short-lived <sup>expenditure</sup> boom; ~~the economy has performed in line with our projections.~~ It is the consequence of higher than expected effective tax rates for a given level of economic activity.

13. This means that the PSBR this year, as a proportion of GDP, is about one quarter of the level we inherited in 1978-79. There have been two marked steps downwards. The first step brought the PSBR from 5 1/4 per cent to around 3 per cent in 1981-82. The second step brought it down from 3 per cent to 1 1/4 per cent in 1985-86.

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of handle*

14. Last year's MTFs indicated a PSBR for 1987-88 of £7 billion. There is a sensible presumption that I stick to the pre-announced figure. But given the outturn for this year and the buoyancy of revenues projected for next year I have decided to aim to make faster progress towards the desired low level for the PSBR, ~~I am not sure whether it is intended to mention the figure here or later~~. <sup>Accordingly I</sup> have provided for a PSBR of £4 billion, or 1 per cent of GDP.

15. North Sea revenues are forecast at about £5 billion, the same level as in 1986-87. In the light of the uncertainty surrounding oil prices I have stuck to the assumption made last year that oil prices will average \$15 dollars a barrel. The proceeds from the privatisation programme are expected to be £5 billion, as set out in the Autumn Statement.

16. This is a cautious and prudent policy. Unfortunately, it will not allow room for the substantial reduction in taxation to

which this Government attaches such importance. That is regrettable, but necessary, for we are determined, as we have been for the past eight years, to take no risks with inflation, and no risks with our management of the public finances.

17. Even so I will be able to announce some reductions in taxation. It is a measure of the soundness of our policies that at the same time we shall be able to maintain public borrowing at unequivocally low levels despite the sizeable additions we have made to the level of public expenditure, and despite the slashing of our oil revenues.

**SPEECH: MONETARY POLICY (Sir T Burns' draft)**Tax Revenues

Despite the tax cuts I made last year, I now estimate that for 1986-87 non-oil taxes have risen by 12 per cent, or by 5 per cent more than money GDP. The buoyancy of revenue has not been due to taxes on personal incomes or spending; they are up by 9 per cent and 10 per cent respectively. The large increases have been due to corporation tax which is up by a third, and stamp duty and capital taxes which are up by a quarter. For similar reasons, if I were to make no changes to taxation this year, I estimate that non-oil taxes would again rise faster than money GDP; in other words, the non-oil tax burden would rise again. Because we have made plans for a further reduction in the share of public expenditure in the economy, a rise in the tax burden is unnecessary.

## The Verdict

30. The economy is now performing as well as that of any developed nation, in marked contrast to the record of the 1970s. That improvement could not have occurred without the policies we have implemented to encourage enterprise, efficiency and flexibility. From the beginning the Government has taken action to promote competition, incentives, and freer markets and to press ahead with deregulation and privatisation. These measures are now bearing fruit and we see the proof of this in the renewed success of British industry in international markets.

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31. We are also reaping the benefits of prudent fiscal and monetary policies set in a clear medium-term framework. Over the past 7 years there has been a vigorous debate in this country about the conduct of fiscal and monetary policies - in particular whether it was possible to have a sustained recovery of output without a fiscal stimulus. The post-war neo-Keynesian approach was to try to stimulate economic performance by expansionary fiscal policy and accommodating monetary policy whenever there was any sign of weakening growth. In practice it failed to provide other than short-term gains to output and merely spelled long-term trouble; rising inflation and a succession of financial crises. We turned our back on that approach.

32. Instead we have directed monetary and fiscal policy towards steadily reducing inflation and providing a stable financial environment within which a reinvigorated economy could perform.

33. Our critics have constantly changed their ground as events have confounded their gloomy predictions. Initially they said it would not be possible to reduce inflation without incomes policy. They then said inflation was only falling



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because we were in a self-perpetuating downward spiral which meant the PSBR would get bigger rather than smaller. Then we had the question "where will the growth come from?" And the suggestion that it was impossible to have steady growth consistent with a falling budget deficit. When it became clear that the economy was growing, we were warned that it was a flash in the pan and would peter out. Year after year we were told that although growth this year might be better than expected next year it would slow down. And that if we did have sustained recovery inflation would roar ahead again. I could go on.

34. But what has been the outcome? Sustained growth at near to 3 per cent a year for about 6 years against a background of falling inflation - from  $16\frac{1}{2}$  per cent at the end of 1980 to [4] per cent over the past 18 months.

35. More recently the nature of the debate has changed and it has been suggested we are in danger of overheating which finally will bring the recovery to an end. Again this demonstrates a lack of understanding of why this upswing is different in character from other upswings; and why it is so well based.

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36. The length of the upswing is not just a matter of chance. It reflects the soundness of the recovery; improved industrial performance; an absence of artificial fiscal stimulus; an absence of speculative build-up of stocks by industry; and an absence of inflationary pressure based on easy monetary conditions. Above all because the recovery has been at a comfortable pace it has not shown the strains and stresses that once were so familiar.

37. We have eschewed active demand management in response to expectations of short-term fluctuations; we have been prepared to take difficult action with interest rates when it was necessary to maintain sound monetary conditions; and we have made steady progress in bringing the PSBR down as a percentage of GDP. Excluding asset sales the PSBR is now a lower percentage of GDP than any year since 1969-70.

38. The debate about monetary and fiscal policy is surely now over. Given the historically low budget deficits of the past two years there can be no clearer proof than the enthusiasm with which those who accused us of starving the economy of demand now accuse us of generating excess demand and of changing the conduct of policy. They were wrong then; they are wrong now.



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**A. INTRODUCTION**

A1. The setting for this year's Budget is more favourable than it has been for very many years. We are entering our seventh successive year of steady growth, at the top of the international league table. We are entering the fifth year in which this steady growth has been combined with low inflation. The public finances are sound and strong, and unemployment is falling.

A2. These are the fruits of the Government's determination, in bad times as well as good, to hold firmly to our policies of sound money and free markets. Once again, I reaffirm those policies.

A3. So the Budget I present today is a Budget built on success, and a Budget for success.

A4. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then turn to monetary policy and to the fiscal prospect this year and next. Finally, I shall propose some changes in taxation designed to improve still further the prospects that lie before us. A number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.



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B. THE ECONOMIC BACKGROUND

B1. I start with the economic background.

B2. Nineteen eighty-six was dominated by the sudden collapse of the oil price. Our own economy was affected not only directly, as a major oil producer and exporter, but also by the pause in world growth as the world economy adjusted to what has been described as the third oil shock. Despite this dislocation, however, the economy has developed in most respects as I foreshadowed a year ago.

B3. In 1986 as a whole output grew by a further 2½ per cent or so, which compares well with the experience of other industrialised countries. Indeed, we have now enjoyed the longest period of steady growth, at a rate approaching 3 per cent, that the UK economy has known since the War. And

this has coincided with falling inflation, which at 3½ per cent in 1986 recorded the lowest figure for almost 20 years. Over the lifetime of this Parliament, inflation has averaged less than 5 per cent.

B4. During the first half of last year exports were affected by the pause in world growth to which I

B3A. And this greatly improves growth performance

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It is also  
recall that  
in the 1960s, and  
again in the 1970s,  
Britain's growth rate  
was the lowest of  
all the major  
European economies.  
By contrast, during  
the 1980s, our growth  
rate has been the  
highest of all the  
major European  
economies.

(and hence output)

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have already referred. But since the middle of the year <sup>expts</sup> they have grown strongly. Indeed, over the last three months the volume of non-oil visible exports was almost 10 per cent higher than a year earlier - a better performance than that of any other major economy. This pattern was reflected in the rapid growth of manufacturing output in the second half of last year.

B5. This resurgence of economic growth, coupled with the special measures we have taken, has brought about a welcome fall in the number of people out of work. Since August unemployment has fallen by more than 100,000; the largest six-monthly fall since 1973. Though the numbers out of work are still far too high, both youth unemployment and long-term unemployment are now lower than they were a year ago.

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B6. I announced a number of specific employment measures in my last Budget, and since then, my Rt Hon and Noble Friend the Secretary of State for Employment has <sup>just</sup> extended the <sup>Restart programme</sup> Restart programme for the long-term unemployed, ~~so that,~~ starting next month, all those who have been unemployed for more than six months will be offered Restart interviews twice a year, to give them individual advice and help. There will also be more places on the successful Enterprise Allowance Scheme, helping

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unemployed people to set up their own businesses. Again, the number of Jobclubs is to be quadrupled, with room for 150,000 people a year. And once fully under way, the new Job Training Scheme will give a quarter of a million others, most of them young people, work experience and vocational training. Together with the Youth Training Scheme, ~~these measures give carefully targetted and practical help to the unemployed on a scale~~ <sup>which</sup> no other country can match. But the best hope of all for the unemployed lies in the continuing vigour of the economy.

*and other programmes, what this means is that this Government has developed its employment & training measures*

B7. Since the early months of last year, there has been a further surge in manufacturing productivity. This continues the remarkable improvement in productivity growth achieved by British industry throughout the 1980s. In the 1960s, and again in the 1970s, growth in manufacturing productivity in the UK was the lowest of all the seven major industrial countries in the world. During the 1980s, our annual rate of growth of output per head in manufacturing has been the highest of all the seven major industrial countries.

B8. The recorded current account of the balance of payments went into deficit in 1986 by around £1 billion. This followed a cumulative current account surplus of some £20 billion between 1979 and

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1985. Some deterioration in our current account was inevitable in the face of a £5 billion loss of earnings on oil trade virtually overnight. But the significance of this should not be exaggerated. The exchange rate adjustment that followed the fall in the oil price is already contributing to an improved non-oil trade performance. And earnings from the massive stock of net overseas assets we have acquired since 1979, which at well over £100 billion is second only to that of Japan, will provide a continuing support to the current account in the years ahead.

B9. Looking ahead, I expect 1987 to be another year of steady, balanced growth with low inflation. Total output is forecast to rise by 3 per cent, with exports and investment up rather more than that. Manufacturing industry, in particular, should do well. And with the non-oil economy set to grow at  $3\frac{1}{2}$  per cent, there is every prospect of unemployment continuing to fall throughout 1987. In last year's Budget Speech I said that the outlook for jobs depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

B10. Despite the strong growth in exports, it will inevitably take time for the full effect of the



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exchange rate adjustment to work through. The current account is thus likely to remain in deficit this year, by some £2½ billion, around half of one per cent of GDP.

B11. As I foreshadowed in the Autumn Statement, inflation may continue to edge up for a time, perhaps to a little over 4½ per cent by the Summer, before falling back to 4 per cent by the end of the year. While short-term fluctuations are inescapable, it remains the Government's prime objective to keep inflation on an unambiguously downward underlying trend.

B12. Given the continuation of present policies in this country, the biggest risk to the excellent prospect I have outlined is that of a downturn in the world economy as a whole. There are still serious imbalances afflicting the three major economies - the United States on the one hand and Japan and Germany on the other - which, if not handled properly, could lead to a simultaneous downturn in all three. And this in turn could be exacerbated by renewed turmoil in the foreign exchange markets, whose tendency to overshoot is as notorious as it is damaging.

B13. It was to address these dangers that the Finance Ministers and Central Bank Governors of

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six major nations met in Paris last month, and agreed among other things to co-operate closely in fostering a period of exchange rate stability. In my Budget Speech last year, I said:

"Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on."

That is what we have now done, with Plaza II. But it would be idle to deny that the wider risks still remain.

B14. ~~But~~ short of a world downturn, which can and must be avoided, British industry now has an outstanding opportunity, with growing markets at home and overseas, low inflation, rapidly growing productivity and greatly improved profitability. Provided it can control its costs and maintain its present competitive advantage, and assuming the continuation of present policies, we can look forward to many more years of strong growth combined with low inflation.

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**C. MONETARY POLICY**

C1. For its part, the Government will keep in place a sound and prudent financial framework. That means, as it has done since 1980, the medium-term financial strategy.

C2. The central objective of the MTFS is steadily to reduce the growth of money GDP over the medium term, so as to squeeze inflation out of the system and ultimately to achieve price stability.

C3. This requires monetary discipline buttressed by low public sector borrowing. The essential instrument of monetary policy must remain short term interest rates. These will continue to be set in the light of monetary conditions as indicated principally by the growth of narrow and broad money and the behaviour of the exchange rate.

C4. For narrow money, M0, the target range for next year will be 2 to 6 per cent, as foreshadowed in last year's MTFS. For broad money, however, as the Governor of the Bank of England cogently argued in his Loughborough lecture last October, in current circumstances it is probably wiser to eschew an explicit target altogether. But broad money will continue to be taken into account in assessing

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monetary conditions, as of course will the exchange rate.

C5. In my Lombard Association speech last April, I set out at considerable length precisely how in practice monetary policy is operated. While I note that in some quarters this was felt to be unclear or in some other way unsatisfactory, I am struck by the fact that Mr Paul Volcker, Chairman of the United States Federal Reserve Board, in his written testimony to the Senate last month, explained how the Fed operates monetary policy in remarkably similar terms.

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D. PUBLIC SECTOR BORROWING

D1. I mentioned a moment ago the need to keep public sector borrowing low.

D2. The final outturn for the public sector borrowing requirement <sup>last year,</sup> in 1985-86 was just under £6 billion, equivalent to  $1\frac{1}{2}$  per cent of GDP, the lowest level since 1970-71. In my Budget last year, faced with a massive loss of what now looks like £7 billion of North Sea oil revenue, I nonetheless decided to hold the PSBR for <sup>this year,</sup> 1986-87, to £7 billion, or  $1\frac{3}{4}$  per cent of GDP.

D3. In the event, this year's PSBR looks like turning out at only <sup>£4</sup> £4½ billion, or <sup>1</sup>  $1\frac{1}{4}$  per cent of GDP: the second successive year of significant undershoot.

D4. This successful outcome is chiefly attributable to the remarkable buoyancy of non-oil tax revenues. And this in turn is due not to some short-term surge in consumer spending, but in particular to an increase <sup>over last year's</sup> of no less than a third in the yield of Corporation Tax from an increasingly profitable business and industry.

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D5. Looking ahead, there is still a degree of uncertainty surrounding oil prices, and I have therefore stuck to the assumption I made last year that the North Sea price will average \$15 a barrel. But it is clear that the increased flow of non-oil tax revenues, coupled with the prospective further growth of the economy in excess of the growth of public expenditure, puts the public finances in an exceptionally strong position.

D6. I intend to keep it that way. Last year's MTFS indicated a PSBR for 1987-88 of £7 billion, or  $1\frac{3}{4}$  per cent of GDP; and, as the House will recall, I gave an assurance at the time of the Autumn Statement, when I announced a £4 $\frac{3}{4}$  billion increase in planned public spending in 1987-88, that on no account would I exceed that figure.

D7. Indeed, I believe it is right to go below it. Since its inception in 1980, the MTFS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. ~~We now have the chance, not merely to take a further step along that path, but to reach what I judge to be its appropriate destination: a PSBR of 1 per cent of GDP. This would represent the maintenance of a degree of fiscal prudence that has been recorded on only two occasions since the War.~~

*We have now reached*

*I intend to stick to that figure. This represents what I intend to stick to until this year, had I not*

*Maintain a degree of*

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D8. Accordingly, I have decided to provide for a PSBR in 1987-88 of £4 billion.

D9. Inevitably, this greatly diminishes the scope I have this year for reducing the burden of taxation, which of course remains a major objective of Government policy. But I am sure it is right to err on the side of prudence and caution, and to build a still firmer base for the future. That is the principle on which both I and my predecessor have consistently conducted economic policy these past eight years, and I see no reason to depart from it now.

D10. Meanwhile, I would make one further observation, of a different nature. Economic arguments are seldom concluded, one way or another. This is chiefly because it is unusual for economic policies to be held in place long enough to provide sufficient evidence. But the 1980s have been different; and, as a result, one critically important economic argument has now been concluded, finally and decisively.

D11. Throughout our period of office, our critics have consistently maintained not only that a fiscal stimulus would produce real economic growth, but that without an expansionary fiscal policy sustained growth was impossible. They were wrong,

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and have been proved wrong. The British economy is now embarking on its seventh successive year of steady growth, *an average rate of growth of 3 per cent* at ~~approaching~~ 3 per cent a year. And during that time the PSBR, even if privatisation proceeds are added back, has been deliberately and steadily reduced from a shade under 6 per cent of GDP to a little over 2 per cent. Indeed, had I or my predecessor at any time heeded the advice of our so-called expansionist critics, the British economy would never have been in the unprecedentedly favourable position it is in today.

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**X. EXCHANGE CONTROL**

X1. Before I turn to my proposals for changes in taxation, I have one other important change of a specific nature to announce.

X2. In 1979, a few months after the present Government had first taken office, my predecessor announced the abolition of exchange controls, which had been in continuous operation ever since the outbreak of war in 1939. That bold action has, over the past 7½ years, proved wholly beneficial to the British economy; and I am glad to note that other European countries are now moving in the same direction.

X3. But although the operation of exchange control has ceased, the Exchange Control Act itself remains on the Statute book. So long as it does, there is likely to persist a nagging fear that, in certain circumstances, exchange control might be reimposed; and such uncertainty could be damaging.

X4. I have therefore concluded that the time has come to repeal the Act. The necessary legislation will be contained in this year's Finance Bill.

X5. I note that, in what was clearly intended to be a major speech in New York in September, the Deputy-Leader of the Labour Party declared that, and I quote:

"The Labour Party has no intention of reintroducing statutory exchange controls".

I am confident, therefore, that the proposal I have just made will be welcomed on all sides of the House.

**E. BUSINESS AND ENTERPRISE**

E1. I now turn to taxation. First, taxes on business.

E2. The fundamental reform of the Corporation Tax system which I introduced in 1984 came fully into effect last April. The new system has undoubtedly improved the quality of business investment decisions in Britain, and is also encouraging more overseas companies to set up here.

E3. During the transition to the new system, companies were given advance notice of the main rate of Corporation Tax for the year ahead. This helped them in their forward planning, and I intend as far as possible to continue the practice of setting the rate in advance. Accordingly, I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent - lower than in any other major industrial nation, though the United States is now set to emulate us.

E4. The low rate of Corporation Tax enables me to introduce a further simplification into the system.

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E5. At present, while companies' capital gains are liable to Corporation Tax, the amount of such gains is first adjusted by a certain fraction so that the effective rate of tax is the same as that on capital gains made by individuals. This dates back to the time when the two rates of tax were far apart.

E6. This is no longer the case: indeed, the Corporation Tax rate for small companies is now below the Capital Gains Tax rate.

E7. I therefore propose that, from today, companies' capital gains be charged at the appropriate Corporation Tax rate, without adjustment, save for the indexation which applies to all post-1982 gains.

E8. It has, however, been argued that it is wrong that, where companies distribute capital gains as dividends, the gains are taxed twice, once in the hands of the company and once in the hands of the shareholder. I believe there is some justice in this complaint. Accordingly, I propose to remedy it by allowing companies to set payments of Advance Corporation Tax against their liability to tax on capital gains.

E9. Taken together, these changes should yield £60 million in 1988-89.

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E10. I also have some further simplification and rationalisation of the Corporation Tax system to announce.

E11. At present, some companies established before 1965 do not have to pay their Corporation Tax until up to 21 months after the end of the period for which it is due, whereas companies established since 1965 have to pay their tax after 9 months - and some building societies have to pay sooner still.

E12. This difference in treatment cannot be justified. Moreover, it is open to an abuse which could put the timing of a substantial proportion of the total Corporation Tax yield at risk.

E13. I therefore propose that all companies and building societies should be treated the same way, with all liable to pay Corporation Tax nine months after the end of the accounting period on which the tax is due. The change will be phased in, but I would expect it to yield around £100 million in 1988-89.

E14. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. At present, many company accounts are not received in time to agree the tax liability before payment is due. So there is a



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laborious process of an estimated assessment from the Inland Revenue and an appeal from the company. Under Pay and File companies will estimate their tax liabilities themselves, and pay on the normal due date. Tax liabilities will be finalised once companies submit their returns and accounts. Where it turns out that the initial payment was too low, the company will pay interest to the Revenue; where the initial payment was too high, the Revenue will pay interest to the company.

E15. This new approach was set out in last December's consultative document on the recommendations in the Keith Committee Report, and was generally welcomed by the business community and their tax advisers.

E16. As this change is part of a wider programme of streamlining tax collection, including major developments in the Inland Revenue's computer systems, it will not come into force until the early 1990s. But by legislating now I am giving taxpayers and their advisers a firm basis on which to prepare for the new scheme.

E17. While business and industry as a whole is doing well, the North Sea oil sector has inevitably been hard hit by last year's oil price collapse. My Rt Hon Friend the Secretary of State for Energy and I

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have followed closely the effects on North Sea producers and their suppliers. The industry itself is generally confident about the longer-term prospects; while as for the tax system, not only is it inherently price-sensitive, but the companies themselves have repeatedly stressed their desire for stability.

E18. However, in the light of the immediate problems, I introduced last autumn legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. This has already helped many of the smaller and medium-sized companies faced with cash flow difficulties.

E19. I now propose two further Petroleum Revenue Tax reliefs. First, as from today companies may elect to have up to 10 per cent of the costs of developing certain new fields set against their Petroleum Revenue Tax liabilities in existing fields, until such time as the income of those new fields exceeds the costs incurred. Second, there will be a new relief against PRT for spending on research into UK oil extraction that is not related to any particular field.

E20. I hope that these carefully targeted changes will give a worthwhile measure of help to the North Sea oil sector.

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E21. I have to set the 1988-89 car and car fuel benefit scales for those with company cars. The car scale charges still fall well short of the true value of the benefit, and as last year I propose to increase them by 10 per cent. There will be no change in the car fuel scales which, as already announced, will also be used for VAT purposes from 6 April.

E22. Last year I put the Business Expansion Scheme onto a permanent footing. This year I have two further improvements to propose. First, the rules will be relaxed to make it easier for independent film companies to benefit from the scheme. Second, there have been complaints that the present rules produce end-year bunching of BES investments, and hence <sup>may</sup> crowd out some projects and lead to bad decisions on others. I propose therefore to permit the investor to claim part of the relief against his previous year's income. This will make it easier for companies to raise BES finance throughout the year.

E23. Training and retraining are vital to a flexible and competitive economy. Some employers may be willing to help with the retraining of workers who wish to move on to a different job. At present if employers finance training unrelated to an employee's existing job, the employee will

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generally be liable to tax on the cost. I propose to exempt from tax the cost of training in this kind of case, to encourage more companies to help employees to acquire new skills for new jobs.

E24. The past few years have seen a remarkable and most welcome growth in the number of small businesses and the self-employed. The Government has done a great deal to lighten the burdens on this vitally important sector of the economy. But I am well aware that problems remain, not least in the field of VAT.

E25. Accordingly, I asked Customs and Excise to issue a consultative document last autumn canvassing a number of changes. In the light of the responses to that document, I have four proposals to make.

E26. Perhaps the biggest problem faced by the small businessman today is the trade customer who is late in paying his bills: so late, sometimes, that VAT becomes due before the bill has been paid. I can do nothing about late payment; but I can, I hope, do something about the VAT problem.

E27. My first and most important proposal, therefore, is that, as from 1 October, businesses whose annual turnover is under £ $\frac{1}{4}$  million, which



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means more than half of all traders registered for VAT, will be able to choose to account for VAT on the basis of cash paid and received. In other words, they will have no liability to pay VAT until they themselves have received the money from their customers. In addition to easing the cash flow problems caused by late payers, this system will of course provide automatic VAT relief for bad debts.

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E28. I have to warn the House, however, that I cannot legally introduce this change without first obtaining a derogation from the European Community's Sixth VAT Directive. I am applying for the necessary derogation today. The House will note that the upper limit of  $\frac{1}{4}$  million is considerably greater than the  $\frac{1}{4}$  million suggested in the consultative document.

E29. Second, I propose to give these businesses the option of accounting for VAT on an annual basis. Instead of making quarterly returns, they would make regular payments on account, and then file a single return at the end of the year. This option, which offers considerable streamlining, will be available next year.

E30. Third, the period within which businesses must apply to be registered for VAT will be extended from ten to thirty days.

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E31. Fourth, there will be changes to the rules for the special VAT schemes for retailers, and more small and medium-sized businesses will be able to make use of the simpler schemes.

E32. I believe that the changes I have outlined, and in particular the option to move to cash accounting, will be widely welcomed by the small business community. The cost will be £115 million in 1987-88 and £60 million in 1988-89.

E33. In addition, I propose to increase the VAT threshold to £21,300, to keep it at the maximum permitted under existing European Community law.

E34. In the light of the responses to the consultative document, I shall not be going ahead either with the withdrawal of the so-called standard method by which retailers calculate their gross takings for VAT, or with the compulsory deregistration of traders below the VAT threshold.

E35. I have one further measure to help the small businessman, unrelated to VAT. I propose to increase the limit for Capital Gains Tax retirement relief by 25 per cent, from £100,000 to £125,000. As usual, the annual Capital Gains Tax exempt amount will be increased, in line with statutory indexation, to £6,600.

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E36. An essential element in any ongoing programme of tax reduction and reform must always be the elimination of unintended or unjustified tax breaks, which cause rates of tax generally to be higher than they need to be. Accordingly, I have five proposals to make today to this end.

E37. The first concerns VAT, and has already been the subject of extensive consultation. The House will be aware that a business that provides a service that is exempt from VAT cannot in turn deduct input tax on its purchases. But where the activities of a business are in part liable to VAT and in part exempt, the existing rules are excessively generous as to the amount of input tax that can be deducted; and this generosity is being exploited on a growing scale. The rules must therefore be changed, and the changes, which I announced to the House last December, will come into effect on 1 April. There will be special arrangements to deal with the problem of brewers' tied houses. I am also taking <sup>this</sup> the opportunity of <sup>a significant</sup> ~~the new rules~~ to exclude <sup>the scope of</sup> large numbers of small businesses from being taxed under this provision, ~~altogether~~. The yield from this change, which in effect is a measure of the potential revenue loss, will be some £300 million in 1987-88 and £400 million in 1988-89.

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E38. Second, I propose to change the law so that companies in multinational groups which enjoy dual residence will no longer be able to secure tax relief twice on one and the same interest payment. Genuine trading companies will not be affected. This change, which will take effect on 1 April, follows the similar action recently taken by the United States. The change will yield £125 million in 1988-89.

E39. Third, I propose to end the present excessively generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans. In future, banks will be able to offset this tax credit only against tax on the profit on the relevant loan, and not more widely. This will bring our rules broadly into line with those in most other countries. The change will apply from 1 April this year for new loans and from 1 April next year for existing loans. It will yield some £20 million in 1988-89.

E40. Fourth, the tax treatment of Lloyd's syndicates as it applies to the Reinsurance to Close system is clearly unsatisfactory. I therefore propose to bring it into line with that of provisions for outstanding liabilities made by ordinary insurance companies and, indeed, of comparable provisions made by other financial traders. I have



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asked the Inland Revenue to consult urgently with Lloyd's about the details of the legislation. The new rules will first apply to premiums payable for the Lloyds account which closes on 31 December this year.

E41. Fifth, I also propose to implement the Keith Committee's recommendation that interest should be charged in the limited number of cases where ~~PAYE is not applied properly~~ <sup>(An employer does not apply)</sup> and a formal assessment has to be made to recover the tax. The change will take effect from April next year, and the yield in 1988-89 is estimated at £45 million.

E42. I have one further proposal to make in the broad field of the taxation of business and enterprise.

E43. In my Budget last year I suggested the possibility of introducing a measure of tax relief for profit-related pay.

E44. I pointed then to two considerable advantages that might be expected to flow from arrangements which relate pay to profits. First, the workforce would have a more direct personal interest in the profits earned by the firm in which they work; and, second, there would be a greater degree of pay flexibility in the face of changing market

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conditions. Such flexibility is vital if, as a nation, we are to defeat the scourge of unemployment.

E45. Last July I presented a Green Paper on Profit-Related Pay in conjunction with my Rt Hon and Noble Friend the Secretary of State for Employment and my Rt Hon Friend the Secretary of State for Trade and Industry. I now propose to introduce a scheme of tax relief broadly along the lines floated in the Green Paper.

E46. My proposals depart from those in the Green Paper in one important respect. I am doubling the proportion of an employee's profit-related pay that is eligible for tax relief from a quarter to a half, up to a maximum of £3,000. So for someone on average earnings receiving 5 per cent of their pay in profit-related form, the tax relief will be equivalent to a penny off the basic rate of income tax. The cost will inevitably depend on take-up: it could be £50 million in 1988-89, building up to substantially more than that, as take-up grows, and the proportion of an employee's pay which is profit-related rises.

E47. Profit-related pay is no panacea. But then there are no panaceas. What it is is a tool to help British business gradually to overcome one of our

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biggest national handicaps: the nature and  
behaviour of our labour market. I am today  
challenging British management to take advantage of  
that tool and to make good use of it, for the good  
of their firm, their workforce and their country.

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**F. TAXES ON SAVING**

F1. I turn now to the taxation of savings.

F2. A central theme and purpose of the Government's policies is the creation of a genuine popular capitalism: what used to be called, when ambitions were more limited and language more inhibited, a property-owning democracy.

F3. That means wider home ownership, wider share ownership, and wider pension ownership. Over the past eight years, the Government has actively promoted the first two, and has now embarked on the third. Home ownership, above all through the council tenant's right to buy. And share ownership, through the rapid growth of employee share schemes; through the massively successful privatisation programme, where Britain has led the world; and most recently through the new Personal Equity Plans, which I announced in last year's Budget and which started up on 1 January this year. In the first month of the scheme, more than 2,000 people a day took out Personal Equity Plans, many of them first-time investors, as I had hoped.

F4. We know that 63 per cent of households now own their own homes, compared with 55 per cent in 1979.



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There have been, however, no official figures for the more explosive growth of share ownership in Britain over the past eight years. The Treasury and the Stock Exchange therefore jointly commissioned a major independent survey of individual shareholding in Britain. The results are now available. They show that there are now some 8½ million individual shareholders in this country - amounting to one fifth of the total adult population, and roughly three times the number there were in 1979. I am

F5. And then there is wider pension ownership. Two years ago, the Government embarked on a major strategy to extend the coverage of private pension provision and to give individuals far more flexibility and choice in the way they provide for their retirement. We have already introduced a number of important new measures to that end, and the tax changes I am announcing today will complete the picture.

F6. The cornerstone of the Government's pensions strategy is the introduction of an entirely new means of provision for retirement, developed by my Rt Hon Friend the Secretary of State for Social Services. *This is the personal pension, which will be launched on 1 January next year.*

F7. Personal pensions are an important new dimension of ownership. They will enable

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employees - if they so wish - to opt out of their employers' schemes and make their own arrangements, tailored to fit their own circumstances. And they will provide a new opportunity for the 10 million employees who at present do not belong to an occupational scheme to make provision of their own and, if they so wish, to contract out of SERPS.

F8. In my Budget last year I undertook to bring forward proposals to give personal pensions the same favourable tax treatment as is currently enjoyed by retirement annuities. These were duly contained in a consultative document published last November, and the necessary legislation will be contained in this year's Finance Bill.

F9. In addition, to encourage a wider spread of occupational schemes, employers will be able to set up simplified schemes with the minimum of red tape. This will be particularly welcome to many small employers who have been discouraged by the complexity and open-ended commitment of a full-blown final salary scheme. And there will be much greater scope for transferring between different types of pension scheme. Again, the Finance Bill will contain the necessary tax provisions.

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F10. Finally, I have decided to go beyond the proposals set out in the consultative document in one important respect. I propose to allow members of occupational pension schemes to make additional voluntary contributions, with full tax relief, to a separate plan of their own choice instead of, as now, being restricted to plans within their employer's schemes. They will be able to top their pensions right up to the present tax approval limits.

F11. The proposals I have outlined - along with the measures my Rt Hon Friend has already taken - will make it easier for people to take their pensions with them when they change jobs, which will be good both for labour mobility and for independence. They will widen the range of choices people can make about their pensions, and will mean that in future individuals will have much more control over the way in which their own pension contributions are invested.

F12. Taken as a whole, the changes we have made in the last two years have brought about a radical transformation in the ways people can provide for their retirement. There are new options for employers, and much greater freedom for individuals to plan their own pensions. This will lead to a further major extension of ownership, as people start to take advantage of the new opportunities.

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F13. But the generous tax treatment of pensions can be justified only if it is not abused. I propose, therefore, to introduce some limited changes to the present rules to restrict the excessive relief which can be obtained in some circumstances, particularly by a few very highly paid people. These will include a stricter definition of final salary and, for all arrangements entered into from today, an upper limit of £150,000 on the maximum permissible tax-free lump sum, coupled with more rigorous rules on how pension and lump-sum benefits can be calculated.

F14. The cost of the overall pensions package will inevitably depend on take up, but with that proviso is estimated at £65 million in 1988-89.

F15. In my 1984 Budget I reformed the limits that apply to tax exempt life assurance issued by friendly societies. I did so because the movement's tax privileges were being increasingly exploited by certain new Friendly Societies which had been set up ~~as simple as tax-efficient mutual societies~~ *as simple as tax-efficient mutual societies.* for purely commercial reasons.

F16. However, I am anxious that the traditional Friendly Societies, which have played a valuable part in mutual self-help for many generations, should be able to plan for the future with confidence. I have therefore decided to replace the



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existing limit based on the sum assured with a new limit based on annual premiums. I propose to set this at £100 a year, which will greatly increase the scope of the traditional societies to offer life policies to their members.

F17. The tax-exempt limits governing sickness and accident benefits which trade unions provide for their members have not been changed since 1982. With effect from today, I propose to increase them to £3,000 for lump sums and £625 for annuities.

F18. Finally, in this section, I turn to Inheritance Tax.

F19. In my Budget last year I abolished the pernicious Capital Transfer Tax on lifetime gifts between individuals, which was particularly damaging to the ownership and health of family business. This year I propose to extend the same exemption from tax, on similar terms, to gifts involving settled property where there is an interest in possession. This will not, however, apply to discretionary trusts. These changes will be of particular benefit to family businesses and to heritage properties, both of which are often held in trust.

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F20. I also propose to make two minor changes affecting business assets. First, in what is perhaps an unwanted tribute to the unlisted securities market, holdings in USM companies will henceforth be treated for Inheritance Tax purposes in precisely the same way as holdings in companies with a full Stock Exchange listing. Second, business relief for minority holdings in excess of 25 per cent in unquoted companies will be increased from 30 per cent to 50 per cent. The purpose of both these changes is to concentrate business relief more accurately on those assets which could provide funds to pay the tax only at the risk of damaging the business.

F21. Thanks to the efforts of this Government, the tax regime for the nation's heritage has been much improved. Today, I have two further changes to propose. First, I am exempting from Inheritance Tax settled property that is put into a heritage maintenance fund within two years of the death of a life tenant. And second, I propose to improve the arrangements for acceptance of property in lieu of tax. In future, owners will have the choice of either the present system, or an arrangement under which no interest would be charged between the offer and acceptance, but the tax would be based on the market value at the date of the offer and not, as now, at the date of acceptance.

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F22. The abolition of the tax on lifetime giving was of the first importance to family businesses. But I remain conscious that it did little to help the smallest taxable estates, where the family home is often the main asset.

F23. I therefore propose to make a substantial increase in the threshold for Inheritance Tax, from £71,000 to £90,000, coupled with a simplification of the rate structure from seven rates to four. As a result of this change, the number of estates liable to Inheritance Tax will be cut by roughly a third. The cost will be £75 million in 1987-88 and £170 million in 1988-89.

F24. Despite this substantial relief, however, and all the other much-needed reliefs that my predecessor and I have introduced since 1979, the House may be interested to learn that the expected yield of Inheritance Tax, in 1987-88, at almost £1 billion, is nearly three times the yield of Capital Transfer Tax in 1978-79, an increase in real terms of almost 50 per cent.

F25. As for the other Capital Taxes, ~~the severity of which has also been significantly eased since we first took office, the consequence is that the yield of Capital Gains Tax has risen in real terms by over 80 per cent and of Stamp Duty by more than 140 per cent.~~

*These measures yields are not uncommensurate with the fact that since we first took office, the severity of these taxes has been significantly eased.*

*over the same period*

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**G. TAXES ON SPENDING**

G1. I now turn to the taxation of spending.

G2. I have already announced some important changes in value added tax to prevent avoidance and to help the small businessman. I have no other proposals for major changes in VAT this year.

G3. However, in the light of representations I have received, I have decided to extend slightly the VAT reliefs I introduced last year for certain aspects of charitable work.

G4. I propose to relieve charities from VAT on certain welfare vehicles used by hospices to transport the terminally ill; on installing or adapting lavatory or bathroom facilities in charity homes for the disabled; on drugs and chemicals used by a charity in medical research; and on specialised location and identification equipment employed by mountain rescue and first aid services.

G5. While on the subject of charitable giving, I should remind the House that this year's Finance Bill will increase the limit on donations to charity under the new payroll giving scheme, which starts next month, from £100 to £120 a year.



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G6. Next, the excise duties. I propose to maintain the revenue from the taxation of gambling, but to make some readjustment within the total. I therefore propose to increase the gaming machine licence duty by about a quarter, which will restore it in real terms to its 1982 level, when it was last increased; and to offset this by abolishing, from 29 March, the tax on on-course betting. I hope this measure will be of some assistance to the racing and bloodstock industry, as well as consoling those hon Members who have complained to me about the clash this year between Budget Day and the Champion Hurdle.

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G7. In my Budget Statement last year, I gave advance notice of my intention to introduce a tax differential in favour of unleaded petrol so as to offset its higher production cost. I can now announce that the differential will be 5 pence a gallon. This means that the pump price of unleaded petrol should be no higher than that of 4-star leaded petrol. The change will take effect from 6 o'clock this evening.

G8. Following on from the action I took last year, I propose to increase the rates of Vehicle Excise Duty on farmers' lorries, to bring them into line with the use they make of the public roads. This change will take effect from midnight tonight. I

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also propose to increase the rates of duty on trade licences and to rationalise the taxation of recovery vehicles.

G9. I have no further changes to propose this year in the rates of excise duty.

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H. INCOME TAX

H1. Finally, I turn to income tax.

H2. There is now a worldwide consensus on the economic desirability of tax reform and tax reduction, and in particular the reduction of income tax. This was demonstrated most recently by the various national policy declarations that emerged from last month's meeting of Finance Ministers from the major industrial nations.

H3. Lower rates of tax sharpen up incentives and stimulate enterprise, which in turn is the only route to improved economic performance. ~~And~~ it is only by improving our economic performance that we will be able to afford to spend more on public services; only by improving our economic performance that we will be able to create jobs on the scale <sup>that</sup> we all want to see.

H4. That is why, ever since we first took office in 1979, we have consistently sought to reduce the burden of income tax. We have cut the basic rate of tax from 33 per cent to 29 per cent and sharply reduced the punitive higher rates we inherited from the Party opposite. We have increased the main tax allowances by 22 per cent more than inflation,

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taking almost 1½ million people out of income tax altogether.

H5. For 1987 88 I propose to raise all the main thresholds and allowances by the statutory indexation factor of 3.7 per cent, rounded up. Thus the single person's allowance will rise by £90 to £2,425 and the married man's allowance by £140 to £3,795. The single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675. The age allowance income limit becomes £9,800. I propose to raise the first, 40 per cent, higher rate threshold by £700 to £17,900, in line with statutory indexation; but the threshold for the 45 per cent rate will go up by only £200 to £20,400. The other higher rate thresholds will remain unchanged.

H6. I have two other changes in allowances to announce. First, I propose to give an additional increase in the age allowance for those aged 80 or over. For them, the increase will be double the amount due under statutory indexation, so that, for the very elderly, the single age allowance will rise by £220 to £3,070 and the married age allowance by £340 to £4,845. Around 400,000 taxpayers will benefit from this new measure, and up to 25,000 of them will be taken out of income tax altogether.



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H7. Second, the blind person's allowance has remained unchanged since 1981, when it was increased by £180 to its present level of £360. For 1987-88 I propose to increase it by a further £180, to £540.

H8. Finally, I turn to the basic rate of income tax. This is the starting rate of income tax for everyone and the marginal rate for the overwhelming majority of taxpayers.

H9. In my Budget speech last year I reaffirmed the aim set out by my predecessor in 1979, to reduce the basic rate of income tax to no more than 25 per cent. That remains my firm objective.

H10. However, given my decision to use the greater part of the fiscal scope I now have to reduce the Public Sector Borrowing Requirement, that goal cannot be achieved in this Budget.

H11. I can, however, take a further step towards it, as I did last year. I am therefore reducing the basic rate of income tax by twopence, to 27 per cent. This reduction will be worth <sup>more than</sup> over £3 a week to a married man on average earnings.

H12. There will, of course, be a consequential reduction in the rate of Advance Corporation Tax, and - as last year - I also propose a corresponding

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*which will simplify the law,*

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cut in the small companies' rate of Corporation Tax from 29 per cent to 27 per cent. Taken together with the income tax change, this will mean a significant reduction in the tax burden on small businesses, which are so crucial for future growth and employment.

H13. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May. They will cost a little over £2 billion in 1987-88 over and above the cost of statutory indexation.

H14. The overall cost of all the measures in this year's Budget, again on an indexed basis, is a little over £2½ billion. And I have been able to make this worthwhile reduction in tax while still achieving my objective of a PSBR of £4 billion.

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FROM: A P HUDSON

DATE: 11 March 1987

CHANCELLOR

- cc Mr Cassell
- Mr Monck
- Mr Scholar
- Mr Culpin
- Miss O'Mara
- Mr Wilmett C & E

**BUDGET BROADCAST: BUDGET MEASURES SECTION**

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... I attach a draft of a rather longer Budget measures section. I am afraid I have not yet had time to get comments from copy recipients.

*APH*

A P HUDSON

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**BUDGET BROADCAST: BUDGET MEASURES SECTION**  
SECOND DRAFT

[But there's still a lot to do, and today's measures will help us further along the road.]

They are all measures which take forward the policies we've followed ever since we came to office. ~~First and foremost, to keep the~~ Government's finances under control, and to get Government borrowing down. High Government borrowing all too easily feeds through into higher inflation. Low borrowing gives private companies the room they need to invest in new products and new jobs. We have already reduced Government borrowing substantially, and next year it will be lower, relative to our national output, than at almost any time since the early 1950s.

But along with sound Government finances, it's hard work and enterprise that have restored our economy to health. And it's those same qualities that will maintain our progress and create more jobs.

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That's why I cut income tax today. Last year, I was only able to take a penny off; this year, I can go further and take two pence off. Lower income tax gives everybody a bigger incentive to play their part and help their firms to succeed. If people keep more of their own earnings - and a married man on average earnings will be £3 a week better off - they will be even keener to make that extra ounce of effort that helps us get ahead of our competitors.

I also announced a special tax relief for employees who have part of their pay directly related to the profits their firm makes. [For some people, this could be worth the same as another penny off the basic rate, or more.] They will have the strongest possible incentive to give of their best. And if the firm does go through a lean patch and its profits fall, it is less likely to have to lay people off, because its costs adjust automatically.

For small businesses, which are so important in creating new jobs, I've lifted some of the burdens of VAT. In future, small businesses will not have to pay VAT until their customers have paid their bills, which will make life a

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~~good deal easier~~ for many firms. And, they will be able to send in their VAT forms once a year, instead of every three months. This will leave them more time to concentrate on the real task of succeeding in business.

Apart from these measures to help businesses, I have also helped people who want to save for their retirement. There will be a generous new tax relief for personal pensions, which are a new opportunity for people who don't get a pension from their employer. And there will also be tax relief for those who want to top up their existing pension contributions. So people now have a much wider choice in providing for their future.

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