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PART B

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1988 BUDGET SPEECH

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9.3.88

Start:- 29-2-88

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FROM: A P HUDSON

DATE: 29 February 1988

CHIEF SECRETARY

cc	Financial Secretary	Mr Pickford
	Paymaster General	Mr R I G Allen
	Economic Secretary	Miss Sinclair
	Sir P Middleton	Mr Riley
	Sir T Burns	Miss Simpson
	Sir G Littler	Miss C Evans
	Mr Anson	Miss Hay
	Sir A Wilson	Mr Michie
	Mr Byatt	Mr Cropper
	Mr Monck	Mr Tyrie
	Mr Scholar	Mr Call
	Mr Sedgwick	Mr Battishill - IR
	Mr Odling-Smee	Mr Isaac - IR
	Mr Culpin	Mr Painter - IR
	Mr Turnbull	Mr Beighton - IR
	Mr Peretz	Mr McManus - IR
	Mr A C S Allan	Mr Unwin - C&E
		Mr Knox - C&E
		Mr P R H Allen - C&E

BUDGET STATEMENT: THIRD DRAFT

... I attach the third draft of the Budget Speech.

2. Sections F-M are the Chancellor's own draft. He will work through the rest in detail next weekend.

3. The Chancellor would be grateful for comments on the tax section by close on Wednesday, 2 March, at the latest. If there are any further comments on the early sections, I shall be happy to have them.

AH

A P HUDSON

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Draft of 29 February

CHANCELLOR OF THE EXCHEQUER'S BUDGET STATEMENT

15 MARCH 1988

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**BUDGET SECRET
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A1. As I present the first Budget of this Parliament, I am struck by the contrast with the settings for the initial budgets of our previous two parliaments.

A2. In 1979, we were faced with double-digit inflation that seemed endemic. We had not only to conquer that but also to restore the enterprise culture to a country which many thought had lost it forever.

A3. By 1984, our success against inflation was clear, and the first signs were showing through of the vigorous growth and rising employment that our supply side reforms had unlocked. The task was to turn this recovery into lasting economic success.

A4. Now in 1988, we are now entering our eighth successive year of steady growth, and the sixth in which this has been combined with low inflation. Last year saw the largest fall in unemployment since the war.

A6. These successes have not been achieved easily. They have required the resolute pursuit of firm financial policies, coupled with reforms to make the economy work better.

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A6. I reaffirm those policies today.

A7. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then deal with Monetary Policy, and the public finances this year and next. Finally, I shall propose a number of measures of tax reform, designed to build on the economic success that is already so evident.

A8. As usual, a number of press releases, filling out the details of my tax 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. 1987 will be remembered for the worldwide collapse in equity markets in October. Dramatic as that was last autumn, we can now begin to see it in a longer perspective. As I suggested at the time, its impact has been more limited than many people suggested. In many markets, the falls in share prices did little more than reverse the rapid rises that had taken place earlier in the year. And, business confidence does not seem to have been much affected.

B3. In spite of the dramas in the financial markets, the UK economy in 1987 built on and indeed surpassed the strong performance of previous years.

B4. The growth rate looks to be turning out to be something over 4 per cent. This is the best performance since 1973, and bettered only three times since the War. And whereas 1973 was a freak sudden spurt, that contained the seeds of its own undoing, 1987 can be seen as a year of slightly above-average growth within a steady upward trend. In each of the last five years, the growth rate has been close to $2\frac{1}{2}$ per cent or better - something we have not achieved since the War. During both the 1960s

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and the 1970s, Britain's growth rate was the lowest of all the major European economies. During the 1980s, it has been the highest.

B5. Growth in 1987 turned out significantly faster than expected, [with exports, and consumer spending all rising faster than expected]. Inflation, however, turned out broadly as forecast in last year's Budget, averaging just over 4 per cent.

B6. 1987 was thus the first year since 1964 in which real growth exceeded retail price inflation - something many people thought the British economy would never see again.

B7. The plain fact is that the economy has been transformed. Our financial policies have given the private sector the room and confidence to expand. And our supply-side policies have reduced the burdens which held British industry in check for far too long. This has brought a step change in the efficiency, enterprise, and adaptability of all sectors of the economy.

B8. The combination of steady growth and low inflation, which eluded previous Governments for decades, has now been with us throughout the past five years. And in 1987, the rapid growth of new jobs, which has been going on for a number of years, fed through into a fall of half a million in the numbers of people out of work.

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Unemployment fell in all regions. And the proportion of the workforce unemployed has fallen by a bigger margin than in any other major country.

B9. As I predicted a year ago, the performance of manufacturing industry was outstanding, with output up 5½ per cent. Once again, the success of manufacturing was founded on a sharp improvement in productivity. Since 1979, output per head in manufacturing has gone up faster here than in any other major industrial country. We continued to lead the way in 1987 - a stark contrast to the 1960s and 1970s when in this, as in so much else, we were bottom of the league. British manufacturers have maintained their share of world trade since the early 1980s, after decades in which it fell constantly.

B10. Although growth in 1987 was significantly faster than I expected, the strong export performance means that the deficit on the current account of the balance of payments was [precisely in line with the forecast of £2½ billion] which I made this time last year. This largely reflects the extent to which growth in the UK outpaced other countries.

B11. Looking ahead to 1988, I expect another year of healthy growth with low inflation.

B12. Output is forecast to rise by 3 per cent, more or less in line with the steady trend of recent years.

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Exports should continue to rise, though probably not as high as in 1987, when our non-oil exports grew by 7 per cent, and manufacturing exports by 9 per cent. Consumer spending is likely to grow rather more slowly than in 1987. By contrast, surveys suggest that business investment is set to be much stronger.

B13. The non-oil economy, which is the main source of new jobs, should expand more rapidly than total GDP, at a rate of $3\frac{1}{2}$ per cent. [There is likely to be some easing of growth through the year. Even so,] There is every prospect of that unemployment will continue to fall [though the speed of this may slow from the record decline in 1987].

B14. Whereas growth in 1988 is likely to turn out slightly stronger than I forecast in the Autumn Statement, inflation should be a little lower. Inflation, as measured by the RPI, crept up to just under $4\frac{1}{2}$ per cent in the third quarter of last year, but has since fallen back to under $3\frac{1}{2}$ per cent. These fluctuations largely mirror fluctuations in the mortgage rate, and the prospect is that the underlying inflation rate should stay at around 4 per cent during 1988.

B15. Our recent record of sustained low inflation is impressive, when compared with the UK's earlier experience at times of rapid growth. But many of our major competitors have still lower inflation rates, and

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getting inflation down continues to be my top priority. Under the last Labour Government, inflation averaged over 15 per cent. In our first Parliament, we got it down to just over 11 per cent. In our second Parliament; it was a little under 5 per cent. I am determined to get it lower still in the third term, and, in due course, to eliminate it altogether.

B16. The UK is again likely to grow faster than most of the other major countries in 1988. In particular, growth in Europe, which is increasingly the most important market for UK exports, is likely to remain sluggish. With our surplus on oil trade falling as North Sea oil output falls, the current account deficit may increase to some £4½ billion in 1988, around 1 per cent of GDP.

B17. This will be very much smaller than the external imbalances elsewhere. With the continuation of prudent policies and with the considerable international confidence in the UK economy, we should be well able to finance it. The deficit will diminish, when the rates of growth here and overseas come back into line.

B18. The prospects both for exporters and for a further fall in unemployment, will depend crucially on employers keeping their costs firmly under control. Unit labour costs in manufacturing hardly rose at all in 1987, after three years of increasing significantly faster than our competitors. It is vital that employers do not let this

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slip, and keep a tight grip on costs, and in particular pay costs.

B19. However, the more serious dangers lie in the world economic scene. Growth in the major seven countries was around 3 per cent in 1987, close to what I forecast in the Budget last year. Healthy growth in North America, Japan, and the UK offset a sluggish performance in Continental Europe, especially Germany. And the latest indications suggest that activity remains fairly buoyant, though the stock market collapse is likely to dampen demand in the US. I expect growth in the major seven countries to be around $2\frac{1}{2}$ per cent in 1988, slightly slower than this year.

B20. But the prospect of sustained growth is an uncertain one, given the persistent large imbalances within the world economy: the huge budget deficit in the United States; and the US current account deficit, which has its counterpart in the surpluses in Japan, Germany, and other countries. The steps that have been taken to reduce these imbalances are the right ones, and they are starting to bear fruit. But there is a long way to go. And there is the constant danger that the process of adjustment - which may well be slow - will be damaged either by further gyrations in the value of the dollar, or by a slide into protectionism.

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B21. That is why I believe the best environment for a sustained reduction in the imbalances, and indeed for healthy growth in the world economy, is one of greater exchange rate stability. That is the best climate for companies, including, of course, British companies, to plan ahead and invest. And it saves them spending precious time on exchange rate management.

B22. I explained in a speech to the International Monetary Fund in Washington last September, and again in the House in January, the case for a flexible system of managed floating, and for making exchange rates the focus of policy co-ordination. The aim is greater stability in exchange rates, and in the dollar in particular, coupled with the ability to manage any changes that may be necessary in an orderly way. This was the objective of the Louvre agreement, and of the G7 agreement in December. And whereas the dollar fell over 30 per cent against the Deutschmark in the eighteen months before the Louvre agreement, it is now within [8 per cent] of the level at the time of the Louvre.

B23. Success in achieving these objectives depends, in the end, on countries' putting the right fiscal and monetary policies in place, and keeping them there. That process will be a great deal easier if it is conducted, as it has been, in a framework of international co-operation. I can assure the House that we shall be playing our full part.

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B24. Provided there are no new shocks in the world economy, and that the risks at home are contained, there is every reason to expect that the combination of steady growth and low inflation, which we enjoyed throughout the last Parliament, will continue throughout this Parliament and beyond.

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C. MONETARY POLICY

The job for the Government is to maintain the steady and cautious financial policies which we have now pursued for nearly nine years, and which have brought the British economy to the very strong position I have described. Sound money and strong public finances will again provide the essential framework for steady growth with low inflation, and will keep us in the best possible position to weather any shocks we may face, at home or abroad - just as in the past we were able to take in our stride [the Falklands conflict], the coal strike, and the collapse of the oil price.

C2. The Medium-Term Financial Strategy will continue to provide a framework for reducing the growth of money GDP, and hence inflation, over the medium term. It also provides businesses with the stability they need to plan ahead with confidence.

C3. The objectives of the MTFES will be achieved by maintaining firm monetary discipline, buttressed by a prudent fiscal stance.

C4. An important element in this is maintaining a stable exchange rate, with the rate against the Deutschmark of

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particular importance. [Over the past year, this has given a new focus to monetary policy.] [We have achieved this over the past year, despite market pressures on sterling and despite renewed instability in the dollar towards the end of 1987.] This gives businesses the stability they have asked for. And it provides a firm anchor for bringing inflation down over the medium term.

C5. [For much of 1987, maintaining a stable exchange rate meant, in practice, resisting pressure for sterling to rise. But let me make absolutely clear that I would resist downward pressure, if that were to emerge in response to domestic cost pressures, with equal determination.]

C6. Achieving these objectives implies a reduction in monetary growth in the medium term. This is shown in the declining ranges shown for the narrowest measure of money, MO, in the MTFS. The target range for 1988-89 is [1-5 per cent, as shown in last year's MTFS] OR [2-6 per cent, the same as for last year, with a 1-5 per cent illustrative range for 1989-90]. I shall also continue to take account of the growth of the broad money and liquidity, particularly those that include the liabilities of building societies as well as banks. But as last year, there will be no explicit target. [Possible reference to revised funding rule.]

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C7. Short-term interest rates remain the essential instrument of monetary policy. I will continue to vary them as necessary, on a continuous assessment of monetary conditions, to ensure that inflationary pressures are not accommodated.

C8. A firm monetary policy has brought inflation down to a level not seen for 20 years, and kept it there. Progress towards the ultimate objective of stable prices is unlikely to be steady, and its timing cannot be predicted - not least because it depends in part on events beyond our shores. [But by setting the strategic objectives we have, and operating policy to meet them, we are certain to achieve that goal.]

C9. The essence of the policy I have described is non-accommodation. If businesses allow their costs to rise too fast, I shall not allow sterling to fall to enable them to remain competitive. That would be a surrender to inflation. The track record shows that we are ready to take prompt action whenever it is necessary to do so. That policy has stood us in good stead. I reaffirm it today.

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D. PUBLIC SECTOR FINANCES

D1. As I have said, a firm monetary policy has to be buttressed by a prudent fiscal stance.

D2. At one time, it was regarded as the hallmark of good housekeeping for a Government not to spend more than it raised in taxes. Over the years, less and less attention was paid to this, until, in 1975-76, the last Labour Government borrowed what, in today's terms, would amount to [nearly £40,000 million.]

D3. This profligacy not only forced us to ask the IMF to bail us out. It also stored up an enormous burden of debt interest, for which the nation is still paying the bill.

D4. That is why, when we came to office, one of our main objectives was to bring down Government borrowing. We have reduced the Public Sector Borrowing Requirement from around 5 per cent of GDP at the start of the 1980s, to around 3 per cent by 1983, and to 1 per cent in 1986-87. Today, I am able to report to the House that I have brought this process to its logical conclusion - a balanced budget.

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D5. The budget in 1987-88 looks, in fact, to have been in surplus by some £3 billion - something achieved on only one previous occasion since the early 1950s. Instead of a public sector borrowing requirement, we have a public sector debt repayment, instead of the PSBR, the PSDR. Even excluding privatisation proceeds altogether, the PSBR of [$\frac{1}{2}$ per cent of GDP] is also lower than in all but one year since the early 1950s.

D6. This is an excellent outcome. It is the fruit of a consistently cautious fiscal stance, eight years of firm control of public spending; and the strong and vigorous economy that has resulted. It is thus not a one-off achievement in an exceptional year, but something we can be confident of holding on to.

D7. Corporation Tax receipts, based on the buoyant profits of a thriving and healthy company sector, are ahead of forecast. Revenues from Income Tax and VAT have also been greater than expected. And North Sea revenues are up because the oil price was higher than expected.

D8. The continued strength of the economy has also helped to ensure that public spending has remained within plans. Lower unemployment has kept down social security spending. The trading performance of the nationalised industries has improved. And the capital receipts of local authorities and new towns have been buoyant. So I now estimate that the planning total for 1987-88 will be

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[£147.4] billion, about £1 billion lower than projected in the Public Expenditure White Paper in January.

D9. Looking ahead to 1988-89, I have to remind the House that I have already announced, in the Autumn Statement, an increase of over £4½ billion in public expenditure programmes. This has enabled us, in particular, to increase our plans for spending on the Health Service by £700 million, on education and science by over £600 million, and on law and order by over £350 million, while ensuring that public spending continues to fall as a percentage of GDP. I also announced a corresponding increase of £6 billion in programme spending in 1989-90.

D10. I also need to have regard to the tax burden. The buoyancy of the tax revenues means that, leaving aside the oil sector, total taxes and national insurance contributions have risen as a share for GDP for two years in succession. The tax burden thus remains at much the same level as it was 3 or 4 years ago, and nearly 4 percentage points higher than when we took office.

D11. But strong as the case is for lower taxes, the factor that has weighed most heavily with me in setting the PSBR for the coming year is the need to maintain a prudent and cautious fiscal stance. [This buttresses a sound monetary policy in keeping downward pressure on inflation. It creates more room for the private sector to borrow, invest, and grow. It leads to permanently

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lower debt interest payments, so represents an investment for future years. And it gives room for manoeuvre in the event of shocks.]

D12. I have therefore decided to provide for a budget surplus, a PSDR, of £3 billion, the same as this year's expected outturn.

D13. A balanced budget is a sound discipline for the medium term, too. I have therefore projected a PSBR of zero in the remaining three years of the MTF5. This is equivalent to a PSBR, excluding privatisation proceeds, of 1 per cent of GDP, [the level which I said last year was the appropriate destination for policy]. I have been able to reach that destination earlier than I expected. [As privatisation receipts reduce, as they are bound to do, I intend to stick to a PSBR of zero as the norm. Inevitably, there will be fluctuations, on either side, but these should be kept to within 1 per cent of GDP.]

D14. A balanced budget represents security for the present and an investment for the future. No other major industrial country is in balance, let alone in surplus. And even if we had no privatisation proceeds at all, our budget deficit would still be lower than in all the major seven countries, except Japan.

D15. I have to tell the House, however, with considerable regret, that the prudent fiscal stance I have adopted for

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1988-89 means that there will be no scope at all for reducing the tax burden next year. I therefore expect taxes, outside the oil sector, to remain steady as a share of national income.

D16. However, the strength of the economy means that I shall still have some room to reduce tax rates.

D17. The plain fact is that sound policies, pursued consistently over a number of years, have established a virtuous circle in our public finances.

D18. The reductions we have achieved in borrowing and public spending as a share of GDP, coupled with lower tax rates, have created the room for the private sector to expand. This expansion has generated higher output, higher profits, and higher incomes, and hence higher tax yields. This in turn has created scope for lower borrowing, and lower tax rates - indeed, the latter become necessary simply to prevent the tax burden rising, because of the buoyancy of revenues. And so the circle goes on.

D19. On the expenditure side, lower borrowing has reduced the debt interest we have to pay. Debt interest now accounts for over half a percentage point of GDP less than it did only three years ago. This is equivalent to a saving of nearly £3 billion each year. And the pattern of borrowing I have set out in the MTFs should bring ~~of~~ a

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further saving of £2½ billion a year, by 1990-91. This means that, within any given total for public spending, there can be higher spending on programmes. And the continuing search for value for money - the equivalent in the public sector of the supply-side reforms in the private sector - means that more can be achieved for a given amount of spending.

D20. No other major country has achieved falling debt interest payments. They have all seen increases in public sector debt relative to national income over the 1980s, compared with our falling debt income ratio. [In one or two cases there is a risk of a vicious circle developing: more borrowing raises interest payments, and hence more borrowing still is needed just to service the debt. Our virtuous circle stands in sharp contrast.]

D21. This virtuous circle is a cause for satisfaction. But it is certainly no cause for complacency. It took several years to repair the damage done to the public finances by previous governments. But it would take next to no time to slip out of the virtuous circle, if we were ever to abandon the policies that put us there.

D22. This Government has consistently pursued prudent financial policies for the best part of a decade. And the plans I have just announced, which now extend well into the next decade, enshrine the epitome of financial prudence - the balanced budget.

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E. TAX REFORM

E1. Sound finance is the essential foundation for a successful economy. But by itself, it cannot create economic growth or more jobs. That depends on markets that work properly, on businesses that show enterprise and take risks, and on the hard work and effort of the individuals who work for them.

E2. That is why the reforms we have made - and are continuing to make - of the supply side of the economy are so crucial. Privatisation, and reducing the burdens on businesses, have played a vital part in the transformation of the British economy. And so has tax reform.

E3. Nine years ago, in the first Budget of this Government's period in office, my predecessor set this country on the right road - the road of tax reduction and tax reform. He ended the penal taxation of incomes and started us on the way to an acceptable basic rate.

E4. The British people responded as we always knew they would. And the evidence is there for all to see: the richest 5 per cent of taxpayers now contribute a higher proportion of income tax revenues than when they were taxed at penal rates.

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E5. Four years ago, in the first Budget of the second Parliament of this Government, I turned my attention especially to business taxation. I announced a radical overhaul of the taxes on companies.

E6. And they, too, responded as we always knew they would. British business, indeed, has never looked back. I gave companies one of the lowest tax rates in the world, and they responded with the best performance for the best part of a generation.

E7. The reforms I introduced in my first Budget are now being emulated around the world.

E8. Today, I have further improvements to make in business taxation. But the main structure has stood us in good stead, and I intend to leave well alone.

E9. The main focus of the reforms I shall announce today is on personal taxes.

E10. And first the taxation of married women.

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F. INDEPENDENT TAXATION AND TAX PENALTIES ON MARRIAGE

F1. The present system for the taxation of married couples goes back 180 years. It taxes the income of a married woman as if it belonged to her husband. Quite simply, that is no longer acceptable.

F2. This is a matter on which there has been extensive consultation. The time has come to take action.

F3. I therefore propose a major reform of personal taxation, with three objectives. First, to give married women the same privacy and independence in their tax affairs as everyone else. Second, to end the tax penalties that can arise on marriage. And third, to ensure that the tax system continues to recognise marriage.

F4. I have decided to introduce, at the earliest practicable date, April 1990, a completely new system of independent taxation.

F5. Under the new system, a husband and wife will be taxed independently, on the whole of their income. All taxpayers, male or female, married or single, will be entitled to the same personal allowance, which will be available against income of all kinds, whether from earning or savings.

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F6. In addition, there will be a married couple's allowance, equivalent in value to the difference under the old system between the married man's allowance and the single allowance. This new allowance will go in the first instance to the husband, so that his tax threshold does not fall. But if he does not have enough income to use it in full, he will be able to transfer any unused portion to his wife, to set against her income.

F7. Thus while the tax system will continue to recognise marriage, from 1990 married women will pay their own tax, on the basis of their own income, and have their own tax return, when one is necessary. ~~I recognise of course, that many married women will in practice ask their husbands to handle their tax affairs, as before;~~ But what matters is that for married women, for the first time ever, complete independence and privacy will be an option.

F8. In the same way, husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each, instead of one between them, as now. But transfers of capital between husband and wife will continue to be entirely free of any liability of tax.

F9. Moreover, new system will start considerably earlier than would have been possible for most of the

There will, of course, be nothing to stop married women asking

and no doubt many will do so.

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other reforms that have been put forward, in particular transferable allowances. The necessary legislation will be contained in this year's Finance Bill. The cost of this historic reform, which for the first time ever gives a fair deal to married women will be £690 million in 1990-91.

F10. I mentioned a few moments ago the tax penalties on marriage. It is clearly wrong that some couples should find themselves paying more tax, simply because they are married. I propose to put that right.

F11. Independent taxation by itself will remove the most common penalty - the taxation of a married woman's savings income at her husband's tax rate. But there are two other tax penalties on marriage, and I propose to abolish both of them, in advance of Independent Taxation.

F12. Under the present system an unmarried couple can get twice as much mortgage interest relief as a married couple. This has attracted increasing - and justified - criticism. I propose to put a stop to it as from August this year. In future, the £30,000 limit on mortgage interest relief will be related to the house or flat, irrespective of the number of borrowers. This was the solution put forward in the 1986 Green Paper on Personal Taxation, and it was widely welcomed. Existing mortgages will be unaffected.

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F13. The second anomaly is that an unmarried couple with children can each claim the Additional Personal Allowance, and thus get more tax relief than a married couple in the same position. I therefore propose to restrict the Additional Personal Allowance to one per couple. This will take effect from April 1989.

F14. Thus this Budget will eliminate, for all practical purposes, all the tax penalties which, under the present system, can arise on marriage.

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G1. I turn now to business taxation.

G2. The major reform of business taxation, which I introduced in 1984, and which was completed in 1986, has given us the lowest Corporation Tax rate of any major European country. This has encouraged overseas companies to invest in Britain, and has improved the quality of investment by British firms. It is a crucial part of an environment in which company profitability has recovered to its highest level for some twenty years. It has succeeded in its objectives.

G3. I do not therefore propose any further ^{changes to the structure} [reform] of Corporation Tax. ^{And} The main Corporation Tax rate for 1988-89 will be unchanged at 35 per cent.

G4. But I do have three ^{to other business taxes} changes to propose ^{for} [businesses in] ^{which affect} particular sectors.

G5. First, oil. My Rt. Hon. friend the Secretary of State for Energy will shortly be bringing forward legislation to abolish royalties, from 1 July, for all Southern Basin and onshore fields developed after April 1982. At the same time, I propose to reduce the

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Petroleum Revenue Tax oil allowance for these fields to 100,000 tonnes per changeable period.

G6. Coupled with the substantial oil tax reforms introduced in 1983, this will mean the end of royalties for all future fields. Tax liability will be more closely related to profitability. This will help to keep up the pace of UK oil and gas activity, which has already made an impressive recovery from the oil price collapse of two years ago.

G7. Second, Building Societies. The 1986 Building Societies Act gives Building Societies the power, to convert themselves into companies, if they so wish. At present, however, they would face a heavy, and unintended, tax charge if they did so. I propose to rectify this.

G8. Third, I propose two changes to the tax arrangements for Lloyd's. One meets a point Lloyds have raised on last year's legislation on reinsurance to close. The second will simplify the administrative arrangements for taxing Lloyds members. These changes will help to ensure that the system for taxing Lloyds is effective while taking full account of the special features of Lloyds.

G9. British exporters have done extremely well in recent years, thanks to major improvements in efficiency and

Un / two
There is a substantial break here. Is there a case for taking G9-G11 (which deal mainly with CT) before G4?

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quality. But no exporter could honestly claim that his success hinged on the fact that the cost of entertaining overseas customers is tax deductible, whereas business entertainment generally is not - although, again, there is deductibility for the cost to an importer of entertaining overseas suppliers. There is absolutely no case for this anomalous treatment, which lends itself to abuse. I therefore propose to simplify matters by making all business entertainment non-deductible for tax purposes.

1 G10. I have ^{also} reviewed the unsatisfactory provisions governing company residence and migration under Section 482 of the Income and Corporation Taxes Act 1970.

G11. In future, companies will be resident in the UK if they are incorporated here. A small number of companies which are not incorporated in the UK, but are centrally managed and controlled here, will also be deemed to be resident. Companies resident in the UK and wishing to migrate will be able to do so, provided they pay their tax first, including any accrued capital gains tax liability. In return, the requirement for companies to seek Treasury consent before they migrate will be abolished.

G12. The encouragement of small businesses and new businesses - which are so vital a source of enterprise,

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innovation, and new jobs has been a central theme of Government policy. And the rate of business formation, net of failures, which has averaged 500 a week, week in, week out, since 1979, shows beyond any doubt the continuing vigour of this sector.

G13. Many new businesses have been greatly assisted by the very successful Business Expansion Scheme, which has now been running for nearly five years. During that time it has enabled new and expanding companies to raise equity finance to the tune, on average, of £150 million a year.

G14. However, the rapid growth of the venture capital market since 1983 has meant that companies seeking relatively large amounts of equity investment can now raise these readily, while smaller companies looking for more modest amounts can still find it difficult to do so.

G15. To improve the targeting of BES, I therefore propose to introduce a ceiling of half a million pounds on the amount any company can raise under the scheme. Investment should thus be better directed at the smaller newer and riskier businesses, particularly those outside the South-East of England, which can still find it hard to raise equity finance in other ways. In the special circumstances of the shipping industry, however, the ceiling will be £5 million.

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G16. This measure is expected to save some £25 million a year.

(Is there a case for combining costs of 2 AES measures (net cost £15m) ? This is into bid)

G17. I have one further announcement affecting the Business Expansion Scheme.

G18. One of the key reasons for our economic transformation has been the reform of the supply side of the economy.

G19. As to the labour market, there is still some way to go. The tax relief I introduced last year for profit-related pay will, in time, help to increase pay flexibility. But if successful firms are to expand further, and if we are to build on the substantial reductions in unemployment, we have to ensure that people can move to where the new jobs are.

G20. For years, the shortage of private rented accommodation has been an obstacle to labour mobility. The Government's proposals to deregulate new rents are already going through the House. Deregulation will, over time, substantially increase the supply of housing for rent. But this will not happen overnight, and there is a case for a special incentive to speed up the process in the early years.

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G21. I therefore propose to extend the Business Expansion Scheme to include companies specialising in the letting of residential property on an assured tenancy basis.

G22. The BES is well suited to this task. Since full tax relief is given immediately, it should bring forward new investment straight away, meeting the objective of stimulating interest in the early years. And we are building on success.

G23. The ceiling for this type of investment will be £5 million, as for shipping. But since the relief is specifically designed to provide an extra stimulus in the early years of the new regime, it will run only for investments made before [April 1993]. The cost will depend on take-up, but may be some £40 million a year.

(see earlier)

G24. This change will reinforce the impact of deregulation, in reviving the private rented sector of housing in Britain.

G25. In last year's Budget I raised the ceiling for Capital gains tax retirement relief from £100,000 of gain to £125,000. But I still do not believe that is sufficient to help the small businessman whose entire wealth is tied up in the business and who is faced with a heavy capital gains tax bill when he sells up on retirement. I therefore propose to extend the relief so

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that, on top of the exemption, half of any gain between £125,000 and £500,000 will also be completely free of tax.

G26. While on the subject of capital gains tax, I propose to extend rollover relief to a group of assets whose only characteristic in common is that none of them existed when the existing list of qualifying assets was drawn up. They are milk quotas, potato quotas [do they exist?], satellites and spacecraft. I know that this will be warmly welcomed in the farming and extra-terrestrial community alike.

G27. Lastly, on the small business front, I propose to increase the VAT threshold to £22,100, the maximum permitted under existing European Community Law.

G28. Throughout my time as Chancellor, I have been on the look-out for taxes to abolish. Abolition is the simplest form of reform. I have already abolished the National Insurance surcharge, The Investment Income surcharge, Development Land Tax, and the tax on lifetime gifts. Today I propose to abolish a further tax: Capital Duty.

G29 At present, companies have to pay a 1 per cent duty whenever they raise new capital - whenever, for example, a new company is formed or an existing company makes a rights issue. This is undesirable on two counts. It is

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a burden on companies who need to secure external finance for expansion. And it discriminates against risk capital as compared with debt finance and bank borrowing.

G30 Capital Duty is a relatively recent impost, having been reluctantly introduced in 1973 in compliance with our obligations under European Community Law. But the relevant Community Directive has now been amended. Accordingly, I propose to abolish capital duty with effect from [today].

G31 At the same time, I propose to get rid of the Unit Trust Instrument Duty, a similar though much less substantial impost, which is levied at the ^a/_h of $\frac{1}{4}$ per cent on all property put into a unit trust. I know the unit trust movement will welcome this minor relief, and I trust the benefit will be fully reflected in lower charges to investors.

G32. The cost of abolishing these two duties will be of the order of £100 million in 1988-89. [The demise of Capital Duty brings the number of sizeable taxes I have abolished up to five: an average of one a Budget.]

Is this "sizable" ?
(perhaps OK in relation to DLT)

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H. COVENANTS AND MAINTENANCE

H1. I turn now to an important area of personal taxation which is ripe for reform and simplification: the taxation of payments made under deeds of covenant and maintenance agreements.

H2. Charities apart, these payments are simply particular ways of transferring income from one person to another. Most transfers ^{that} take place within families - [housekeeping money from ^{where} a husband ^{passes some of his income} to his wife, for example - and] are rightly and properly wholly outside the scope of the tax system. But, over the years, the Inland Revenue has been increasingly brought into this area, for reasons which have little to do with logic and much to do with history and accident.

H3. This involvement of the Revenue in transactions which, in principle, should be none of their concern has introduced a new knot of complexity, much of it quite unnecessary, into the tax system. The reforms I am proposing today will greatly simplify all this, [bring to an end a method of tax relief for the better off that can no longer be justified; will remove some lesser-known, but nonetheless unacceptable tax penalties on marriage; will reduce the burden of tax on those recipients of maintenance least able to bear it; will reduce the

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must frequently
from one member
of a family to
another - a
parent contributing
money to his child
or a husband paying
maintenance to
his ex-wife.

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pressure on the Courts; and will improve the incentive to work both for students and for separated and divorced wives.

H4. First, covenants. With the exception of covenants to charities, which will be wholly unaffected by the changes I am proposing today, I propose to take all new covenants made on or after today out of the tax system altogether. Those receiving these payments will not be liable to tax on them and those making the payments will get no tax relief on them. The tax treatment of existing covenants will continue unchanged.

H5. The largest group of people affected will be students, and their parents, many of whom currently choose, for example, to make their contributions to the maintenance grant by covenant. As I have indicated, those who have already made such covenants will continue to benefit from them. For students who begin their studies in the next academic year, the parental contribution to the maintenance grant will be assessed on a new, more generous, scale, reflecting the withdrawal of the tax relief on new covenants. My right the Secretary of State for Education and Science will be announcing the new scale later today.

H6. There will be no compensation for the loss of tax advantage in other cases - the grandparent, for example, about to covenant to pay a grandchild's school fees. But

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once rates of income tax are set at reasonable levels, this is precisely the sort of tax shelter it is right to dispense with.

H7. This reform will remove a wholly unnecessary complication from the tax system. Making the deed of covenant, and filling in the Revenue's forms, took much time and effort for the taxpayer and student alike; and a technical mistake could render the covenant legally void, and deny the recipients their tax relief altogether. The procedures were complicated and wasteful: local authorities had first to compute parental income for the means tested grant; then restrict the student grant accordingly; parents then made their covenants; the Revenue checked the student's income; then, finally, on receipt of the necessary claim forms, sent the tax repayments to the students.

H8. It would be difficult to devise a more convoluted way of getting money in to the hands of students.

H9. My proposals sweep all these complications away, but retain the same overall level of support for students.

They will also greatly improve students' incentives to take part-time or holiday jobs; for, when the old system has run out, no student will find that his or her personal allowance has all been used up by covenanted income so that tax has to be paid on the first pound of income he or she earns.

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H10. Similar considerations apply to maintenance payments. The present arrangements are complex and cumbersome, and mean that the Revenue have to send tax returns to divorced and separated people whose tax affairs would otherwise be very simple. Again, there is no reason in principle why the tax system should be involved in the making of these transfers of income at all, except insofar as is necessary to compensate the payer for the reduction in his tax threshold from the married to the single allowance when the marriage has broken down.

H11. So I am proposing that in future separated or divorced spouses receiving payments under maintenance agreements will not have to pay any tax whatever on them. Those making these payments will, on the other hand, get tax relief on the payments that are made, but only up to a limit equal to the difference between the married allowance and the single allowance. There will no longer be tax relief at all for maintenance payments other than to separated or divorced spouses.

H12. This new system will be much simpler for all concerned. It will reduce the tax burden of those who are least able to bear it, since the great majority of those who receive maintenance payments, and who will be wholly relieved of tax on these payments, are at the lower end of the income scale; and because the limit on tax relief for payers is sufficiently high to ensure that

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the great majority of payments to divorced or separated spouses will continue to enjoy tax relief.

H13. These changes will also remove one of the lesser-known tax penalties on marriage. For tax relief greatly in excess of that which is available to a married couple will no longer be available to a divorced couple who make very large income transfers between themselves; nor will it be possible to make artificial tax-efficient transfers to minor children - a device at present available to the unmarried but not to the married.

H14. The new provisions will protect people who are either making or receiving payments under existing Court Orders or agreements. The same protection will run for people who have already applied for Court Orders, provided these are made by 30 June.

H15. My proposals on covenants will yield £25 million in 1988-89 and £85 million in 1989-90. The additional expenditure on student grants will be £X million in 1988-89 and £X million in the following year. My proposals on maintenance payments should be [revenue neutral] [bring a small yield in 1988-89 and 1989-90].

H16. As I have already indicated, covenants to charities will be entirely unaffected by these changes, which essentially concern covenants between individuals. Indeed, I have a new measure to help charities further.

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The payroll giving scheme has now been running for nearly a year. I am glad that so many employers have already set up schemes, and I hope as many employees as possible will take advantage of them. In order to give further encouragement to charitable giving, and to assist the growth of the payroll giving scheme, I propose to double the limit on tax-allowable donations under the scheme from £10 a month to £20 a month.

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J. TAXES ON SPENDING

J1. I now turn to the taxation of spending.

J2. I have one change to propose today affecting the coverage of Value Added Tax, which will remain at 15 per cent. Confectionery was brought in to VAT by the RHM for Leeds East in 1974, and the legal definition of confectionery goes back further still to the days of purchase tax. It has worked less and less well over the years, as new products have come on to the market. In particular, recent cases before VAT tribunals appear to suggest that some chewy cereal bars are subject to VAT, whereas hard cereal bars are not. I propose to clarify the law so that both types are taxed.

J3. I propose to raise the excise duties as a whole in line with inflation, but to make some modest adjustments within the total. The duty on cigarettes and hand-rolling tobacco will be increased, by the equivalent, including VAT, of three pence for a packet of 20 cigarettes. This will take effect from midnight on Thursday. The duty on a typical packet of 5 cigars will rise by 2 pence, but that on pipe tobacco will remain unchanged.

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J4. As to the alcohol duties, I propose increases which, including VAT, will put a penny on the price of a pint of beer and cider, fourpence on a bottle of table wine, and sixpence on a bottle of sparkling wine. There will once again be no increase in the duty on ~~fortified wines and~~ spirits.

J5. Drinks known as 'coolers', which are mixtures of an alcoholic drink and a soft drink, have become more popular in recent years. The existing duty structure caters satisfactorily for products based on wine, but not for those based on beer or spirits. I propose, therefore, to introduce a new and lower duty band for these low strength products, to encourage the young in particular to choose them in preference to more alcoholic beverages. For the same reason, I propose to abolish the minimum duty charge on beer, which will reduce the duty on beers with a low alcohol content.

J6. I propose once again to leave the main rates of Vehicle Excise Duty unchanged. But I shall be introducing a new special tax class for a small category of very large and heavy vehicles. These juggernauts cause a substantial amount of wear and tear on the roads, but currently pay a concessionary rate of duty. The excise duty for these vehicles will go from £130 up to £1600 this year, and will rise again next year to a level which corresponds with the maximum rate of duty paid by

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other heavy goods vehicles. There will also be some minor adjustments to the rates of duty within the HGV classes.

J7. To recover the revenue forgone by not revalorising Vehicle Excise Duty, I propose increases in petrol and derv over and above the rate of inflation, which, including VAT, will raise the price of petrol by about sixpence a gallon, and that of derv by fivepence a gallon. These changes will take effect from 6 o'clock tonight.

J8. In my Budget last year, I sought to promote the use of lead-free petrol, with all the environmental benefits it brings, by introducing a duty differential in its favour. Despite this, consumption of lead-free petrol remains disappointingly low. Accordingly, I propose to double the duty differential in its favour by exempting it from the duty increase I have announced for leaded petrol. This means that, despite the higher production costs, the pump price of unleaded petrol should at least no higher than that of ordinary 2-star petrol. It is now up to the petrol companies to promote the sale of unleaded petrol far more effectively than they have done hitherto.

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K. TAXES ON CAPITAL

K1. The emergence of the capital-owning democracy has been one of the most remarkable features of the 1980s. Encouraged by Government policy, [some 2½ million families have bought their homes.] And our new proposals for personal pensions, which come in to effect in July, will give a new dimension to pension ownership.

K2. But the most dramatic change has been in share ownership. In last year's Budget, I announced the results of a joint Treasury/Stock Exchange survey of the number of shareholders in this country. This revealed that some 8½ million people - one adult in five - owned shares, about three times the number in 1979.

K3. A similar survey has been carried out this year. Despite all the stories of people taking quick profits on privatisation shares, and despite the stock market collapse, the results show that the number of individual shareholders has, if anything risen slightly, to very nearly 9 million.

K4. I have two proposals to encourage share ownership further to announce today.

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The proportion
A family
owning their
own home for
x% to y%

*I realise this
sets slightly
odds into
encouraging
private
renting, but
I find the 2 1/2 m
statistic v odd*

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K5. First, Personal Equity Plans are off to a successful start. Over a quarter of a million people took out plans in 1987, and subscribed nearly £½ billion between them. To give further encouragement to this form of investment, I propose to increase the annual limit from £2,400 to £3,000. The new higher limit will apply retrospectively as from 1 January this year.

K6. Second, measures to encourage employee share ownership have featured in seven out of the last eight Budgets. As a result, the number of all-employee share schemes has risen from 30 in 1979 to over 1400 today, involving well over 10,000 companies, and providing shares and options for well over 1½ million employees.

K7. Following extensive consultation, I propose to relax the provisions of Section 79 of the 1972 Finance Act, relating to employee shares obtained outside the approved schemes, so as to encourage the spread of these schemes.

K8. I have already, in previous Budgets, substantially reformed the taxation of capital, with the replacement of Capital Transfer Tax by Inheritance Tax. But I believe this process can and should be taken further. Last year, I reduced the rates of tax from seven to four; this year I propose to simplify the tax still further by levying it at a flat rate of 40 per cent.

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K9. At the same time I propose to raise the threshold for Inheritance Tax from £90,000 to £110,000.

K10. The increase in the threshold will reduce the number of estates liable to tax by a quarter allowing many more people to inherit the family home free of tax. And the flat rate of 40 per cent means that for the family business, enjoying 50 per cent business relief, the effective rate of tax can never exceed 20 per cent, one of the lowest rates in the industrialised world.

K11. The Inheritance Tax reforms will cost £100 million in 1988-89.

K12. Lastly, Capital Gains Tax. Strictly speaking, this should not be a tax on capital as such at all. Nor is it, so far as gains which have arisen since 1982 are concerned, thanks to the indexation provisions introduced by my predecessor in 1982, as extended in my 1985 Budget.

K13. But with gains that arose prior to 1982, the tax falls largely on purely paper profits resulting from the rampant inflation of the 'seventies. In other words, it bites deeply, and capriciously, into the capital itself.

K14. This has long been recognised as manifestly unjust. Indeed, from the time I first entered this House I have

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argued that Capital Gains Tax should fall only on real gains, and not on inflation-induced paper gains. I have therefore looked hard to see if the indexation provisions could be applied right back to the inception of the tax in 1965. Unfortunately, they cannot. The necessary information is in many cases no longer available.

K15. Accordingly, I have decided to bring the base date for the tax forward from 1965 to 1982. That is to say, for all disposals on or after 6 April, any capital gain arising before April 1982 will be exempt from tax altogether, for individuals and companies alike.

K16. This Budget thus ends once and for all the injustice of taxing inflationary gains. It will also benefit the economy by unlocking assets which have been virtually sterilised because of the penal tax that would have arisen on any sale. And it will help many small businessmen and farmers in particular.

K17. At the same time, it is necessary to review the size of the annual exempt slice. This currently stands at the relatively high level of £6,600, largely as a result of the substantial increase enacted by my predecessor in 1982, explicitly as rough and ready partial compensation for the continued taxation of pre-1982 paper gains. I therefore propose [not yet decided]. It should also be borne in mind that, with the introduction of independent

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taxation in 1990, a husband and wife will each have their own exempt slice.

K18. Rebasing the tax so as to produce a fully indexed system makes it possible to bring the taxation of gains closer to that of income. In principle, there is little economic difference between income and capital gains. And, insofar as there is a difference, it is by no means clear why one should be taxed more heavily than the other. Taxing them at different rates distorts investment decisions and inevitably creates a major tax avoidance industry. [It has also tended to produce a bias in favour of capital gain and against income which is not conducive to a healthy capital market.]

K19. I therefore propose a fundamental reform. Subject to the new base date, capital gains will continue to be worked out as now, with the present exemptions and reliefs. In particular, the principal private residence will remain tax-free. But the indexed gain will then be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income.

K20. At present, with capital gains taxed at 30 per cent for everybody, ^{are in theory taxed} the system purports to tax basic rate taxpayers more heavily on capital gains than on investment income, whereas higher rate taxpayers face a lower rate of tax on gains. This contrast is hard to

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justify. In future, the rate of tax on income and capital gains will always be the same.

K21. These changes will not take effect until 6 April.

K22. Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is what we do already for companies. And it is also now the practice in the United States, even without the relief of indexation.

K23. The changes I have announced, taken as a whole, represent a thoroughgoing reform of capital gains tax which will benefit the economy and eradicate a major injustice. They will sharply reduce the damaging effects of the tax, while ensuring that capital gains remain properly taxed and the yield of income tax adequately protected.

K24. They are expected to yield £45 million in 1988-89, and cost £290 million in 1989-90. The cost in this case is a measure of the tax that should never have been levied in the first place.

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L. **INCOME TAX**

L1. Finally, I turn to income tax.

L2. I have followed with interest the press speculation about the size of the so-called giveaway that would come in this Budget, through lower taxes in general, and lower income tax in particular. Of course, the Government has no money of its own to give away. Any tax reductions are a question of taking less.

L3. There has also been much discussion about the trade-off between tax cuts and public spending increases. There is no such trade-off. The plain fact is that if you have a successful economy, you can, over time, have both. And if you have a feeble economy, you can have neither.

L4. The way to a strong economy is to boost incentives and enterprise. And that means keeping income tax as low as possible.

L5. Income tax has been cut in each of the last six Budgets - [the first time this has ever occurred.] And the strength of the economy over that period speaks for itself.

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L6. However, reforming Income Tax is not simply a matter of cutting the rate. I also have to look at all the various allowances and reliefs to check that they are still justified.

L7. With this in mind, I have a number of proposals to announce.

L8. First, forestry. Given the special characteristics of forestry, including a gap of anything up to a hundred years between the costs of planting and the income from selling the felled timber, I accept that some special tax treatment is warranted.

L9. But the present system is not. It has been said that it encourages the wrong people to plant the wrong trees in the wrong places. Whether that is so or not, what it certainly does is enable mostly top rate taxpayers to shelter their other income from tax, by setting it against forestry losses, while the proceeds from any eventual sale are effectively tax free. Indeed a whole industry has grown up to promote this particular form of tax avoidance.

L10. The time has come to bring it to an end. I propose to do so by the simple expedient of taking commercial woodlands out of the tax system altogether. That is to say, as from today, receipts from the sale of trees or felled timber will not be liable to tax. But, equally,

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subject only to transitional provisions, expenditure on commercial woodlands will no longer be allowed as a deduction for income tax or corporation tax.

L11. It is perhaps, a measure of the absurdity of the present system that the complete exemption of the forestry industry from tax will, in time, produce a yield of at least £10 million a year.

L12. But in order to further the Government's objectives for the rural areas, I have agreed with my Rt. Hon. friends with responsibilities for forestry that there should be a parallel increase in planting grants. Full details of the new grant scheme will be announced next week.

x L13. The net effect of these changes will be to end an increasingly blatant forum of tax avoidance; to simplify the tax system, abolishing the archaic Schedule B in its entirety; and to enable the Government to secure its forestry objectives with proper regard for the environment, including a better balance between broad-leaved trees and conifers.

L14. Next, benefits in kind - perhaps better known as perks. One of the biggest tax-induced distortions in the Economy today is the growing tendency to provide remuneration in kind rather than in cash. It must be right to move towards a system of lower taxes all round and fewer tax breaks of this kind.

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L15. Far and away the most widespread benefit in kind is the company car, which remains massively undertaxed. Independent studies, based on figures supplied by the AA, suggest that a typical company car, such as a 1.6 litre Sierra, is worth at least £3000 a year to the employer. But the scale charge on which the employer is taxed is only £700: less than a quarter of the true value.

L16. This discrepancy is too great to be allowed to continue. On the other hand, the scale of the undertaxation is so great that it cannot be put right in a single year. But in a Budget when I am able to reduce tax rates, there is a strong case for a step change in the taxation of these benefits. I therefore propose to double the car scales for 1988-89. This increase subsumes the 10 per cent increase which I had already announced for 1988-89. The yield from this will be £[] million in 1988-89.

x L17. As I have indicated, even this large increase ⁱⁿ tax will leave the benefit from company cars significantly undertaxed. It will therefore be necessary to return to this in future years.

L18. The scales for the taxation of car fuel adequately reflect the value of the benefit, and I propose to leave them unchanged.

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L19. In principle, everybody should be liable to tax on benefits in kind, just as they are on remuneration in cash. But for reasons of administrative convenience, most benefits are taxed only on directors and those employees whose earnings, including benefits, are above £8,500. This threshold has remained unchanged for many years. In the special circumstances of this year, with the car benefit scale charge doubled, a modest increase is justified. Otherwise, tens of thousands of people, on below average earnings, would be saddled with a substantial increase in their tax liability as they cross the threshold for the first time. I therefore propose to increase the limit to £10,000. I do not intend to increase it again. The cost of this concession will be £50 million in 1988-89.

L20. Next mortgage interest relief. This Government is committed to the further spread of home ownership. Mortgage interest relief has an important role to play in achieving that aim, and will continue in place, against both the basic and higher rates of tax.

L21. However, in addition to the move to the residence basis I have already announced, which will remove the most widely-resented tax penalty on marriage, I have one simplification and one reform to propose in this connection.

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L22. The simplification is to bring to an end, for new loans only, relief for the purchase of a home for a dependent relative or a divorced or separated spouse. This will make little practical difference, since relief will still be available if the relative or spouse makes the payments directly; but this will usefully simplify the administration of the system.

L23. The reform I have in mind concerns the parallel tax relief for home improvement loans. Most of these loans are for fittings such as double glazing, and have played a significant part in the recent growth of consumer credit. This may be partly due to the substantial scope for abuse, as loans ^{supposedly} ~~absurdly~~ taken out for home improvements ^{are} and used for other purposes, a matter which was the subject of a recent report from the Public Accounts Committee.

L24. I propose, therefore, to end tax relief for all new home improvement loans taken out after 5 April. Existing home improvement loans will be unaffected. This is expected to yield £80 million in 1988-89 and £200 million in 1989-90.

L25. Among the legacies of the years of penal top tax rates is the complicated special relief for large redundancy payments. This is no longer justified. I therefore propose a major simplification, increasing the exemption limit for these payments from £25,000 to

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£30,000, but abolishing the additional relief for larger amounts. By the same token, top slicing relief for lease premiums and the like will also disappear.

L26. I have a few changes to propose this year following from the recommendations of the Keith Committee. Most are designed to improve compliance, and to help the Revenue to uncover taxpayers who do not declare all their income, particularly where large amounts of tax are being lost. This measure is expected to yield £10 million in 1988-89, and more in later years. However, I propose a number of relaxations to the VAT enforcement regime, which will make life easier for businesses, while safeguarding tax revenue. Some of the penalties will be reduced from midnight tonight.

L27. Finally, I turn to income tax itself.

L28. In our general election manifesto last year, we committed ourselves to reducing the basic rate of income tax to 25 pence in the £ as it was prudent to do so.

This pledge followed a reduction of two pence in the £ to 27 pence in last year's Budget.

L29. At the time, this was regarded with some scepticism, not to say cynicism, by the Opposition, who no doubt recalled that Labour Governments reduce tax only in front of an election, and at all other times increased it.

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Indeed, ~~shortly before last year's~~ Budget the Rt Hon Gentleman the Deputy Leader of the Labour Party said this:

"I must advise the Chancellor of something he already knows: whichever party wins the general election, the tax cuts he makes in this Budget will be reversed."

L30. The time has come to put the RHG out of his misery. So far from reversing the 1987 Budget tax reductions, I propose to take this, the first opportunity since the general election, to fulfil our manifesto pledge. The basic rate of income tax for 1988-89 will be 25 pence in the pound.

L31. The small companies' rate of corporation tax will similarly be reduced to 25 per cent. This means that the basic rate of income tax, and the corporation tax rate for small companies, will both be at their lowest level since the war.

L32. With the basic rate at this lower level, I am taking the opportunity to simplify the system by abolishing three minor personal allowances which have been unchanged, in cash terms, since 1960: the housekeeper allowance, the dependent relative allowance, and the son's and daughter's services allowances. These are relics of a bygone age, and each allowance is worth, at most, 70 pence a week to a basic rate taxpayer.

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L33. Life Assurance premium relief remains in place for policies taken out before the 1984 Budget. It has traditionally been given at half the basic rate of income tax. I therefore propose to reduce it to $12\frac{1}{2}$ per cent. But, to give life offices time to adjust, this change will not take effect until 6 April 1989.

L34. Ever since the abolition of the Investment Income surcharge, I have been pressed to abolish the additional rate which applies to the income of discretionary trusts and for certain other purposes. I cannot do that; but I propose to reduce it to 10 p.c.

L35. I now turn to the tax thresholds. The statutory indexation formula means that I should increase all the principal income tax allowances and benefits by the increase in the RPI over the year to last December, or 3.7 per cent, rounded up. I propose to do more than that; indeed exactly twice as much.

L36. Thus the single allowance will go up not by £90, as required by indexation, but by £180, to £2605; and the married allowance will go up not by £150 but by £300, to £4095. Similarly the single age allowance will rise by £220 to £3180 and the married age allowance by £360 to £5035. The higher allowances for taxpayers aged 80 and over, which I introduced in the last Budget, will correspondingly be increased by £240 and £360 to £3310 and £5205 respectively, and the new age allowance income

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limit will be £10,600. The additional pension allowance and widow's bereavement allowance will thus rise by £120 to £1490; while the upper limit of taxable income for the basic rate band will be increased to £19,300.

L37. The increases I have just announced mean that the basic personal allowances will be fully 25 per cent higher, in real terms, than they were in 1978-79, Labour's last year. Indeed, the married man's tax threshold will be at its highest level in real terms for nearly half a century.

L38. I now turn to the higher rates of income tax. It is now nine years since my predecessor, in his first Budget in 1979, reduced the top rate of tax from the absurd 83 per cent that prevailed under Labour to 60 per cent, where it has remained ever since.

L39. At that time, this was broadly in line with the European average for the top rate of tax. It is now one of the highest. And not only do the majority of European Countries now have a top rate of tax below 60 per cent, but in the English-speaking countries outside Europe - not only the United States and Canada, but Socialist Australia and New Zealand, too - the top rate is now below 50 per cent, something ^{gone} well below.

L40. The reason for the worldwide trend towards lower top rates of tax is clear. Excessive rates of income tax

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destroy enterprise, encourage avoidance, and drive talent to move hospital shares overseas. As a result, so far from raising additional revenue, over time they actually raise less.

L41. By contrast, a reduction in the top rates of tax can, before long, result in a higher, not a lower, yield to the Exchequer. Despite the substantial reduction in the top rate of tax in 1979, and the subsequent abolition of the investment revenue surcharge in 1984, the top five per cent of taxpayers today not only contribute X per cent more in real terms than they did in 1978-79, Labour's last year: they also contribute a significantly higher proportion of the total yield of income tax.

L42. Indeed, even after the changes I am about to announce, and before the beneficial effects have had time to work through, the top 5 per cent of taxpayers will contribute some 27 per cent of the total yield of income tax, compared with 24 per cent in 1978-79.

L43. As I have indicated, after nine years I believe the time has come to make a further reduction in the top rate of income tax. I therefore propose to abolish all the higher rates of tax above 40 per cent.

L44. This will leave us with a simple system of income tax consisting of a basic rate of 25 per cent and a

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single higher rate of 40 per cent. And, indeed, a system of personal taxation on which there is no rate in excess of 40 per cent.

L45. I believe that 40 per cent is a reasonable top rate of tax. But, bearing in mind that the basic rate of tax is also the starting rate of tax, I believe that 25 per cent is still too high.

L46. Since we first took office in 1979, we have reduced the basic rate of income tax from a third to a quarter. Our aim should surely be to get it down to a fifth - a rate of 20 pence in the pound - as soon as we prudently and sensibly can.

L46. Meanwhile, I have today been able to reduce income tax at all levels, with increases in both the personal allowances and the higher rate threshold, and reductions in both the basic and higher rates. The tax reduction for a married man on average earnings in 1988-89 will be worth nearly £5 a week. The changes will take effect under PAYE on the first pay day after 14 June. They will cost £00 billion in 1988-89 over and above the cost of statutory indexation.

L47. The total cost of all the measures in this year's Budget, again on an indexed basis, is £00 billion.

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FROM: A P HUDSON

DATE: 1 March 1988

MR K F MURPHY

BUDGET SPEECH: THIRD DRAFT

The Chancellor has redrafted slightly the ^{attached} paragraph in the Budget Speech about Building Society Incorporation. Please could you let me know if you are content?

A handwritten signature in black ink, appearing to be 'A P Hudson'.

A P HUDSON

G7. Second, Building Societies. The 1986 Building Societies Act gives Building Societies the power, to convert themselves into companies, if they so wish. At present, however, they would face a heavy, and unintended, tax charge if they did so. I propose to rectify this.



FROM: A P HUDSON
DATE: 1 March 1988

MR BURR

cc Mr Anson (without attachment)

BUDGET SPEECH: THIRD DRAFT: SECTION H

... Mr Anson asked me to let you have the attached copy of Section H of the Budget Speech, on covenants and maintenance, which now incorporates the Chancellor's comments.

2. I understand he will have a word with you, before commenting on the points on students.

A handwritten signature in black ink, consisting of the letters 'A P' followed by a stylized 'H'.

A P HUDSON

BUDGET CONFIDENTIAL



FROM: A P HUDSON

DATE: 1 March 1988

MRS LOMAX

BUDGET SPEECH: CAPITAL DUTY

Many thanks for your help with the draft section of the speech on Capital Duty.

... 2. I attach the present draft, which incorporates the Chancellor's comments. Please could you let me know if you are content?

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

A P HUDSON

BUDGET CONFIDENTIAL

CHIEF SECRETARY

*I understand CS7
has agreed to Andrew
Turnbull's suggestion
in para 4.*

FROM: A TURNBULL
DATE: 7 MARCH 1988

cc PS/Chancellor
Mr Anson
Miss Peirson
Mr Burr
Mr Revolta
Mr Hudson

BUDGET SPEECH

Now D10 in 4th draft

Paragraph D9 of the third draft of the Speech read:

"Looking ahead to 1988-89, I have to remind the House that I have already announced, in the Autumn Statement, an increase of over £4½ billion in public expenditure programmes. This has enabled us, in particular, to increase our plans for spending on the Health Service by £700 million, on education and science by £600 million and on law and order by over £350 million, while ensuring that public spending continues to fall as a percentage of GDP. I also announced a corresponding increase of £6 billion in programme spending in 1989-90."

2. You commented on this paragraph:

"The £700 million increase on health is right but we should reformulate to mention the £1.1 billion we have continually used."

3. There are difficulties in injecting the figure of £1.1 billion into the paragraph as it is now constructed. The fact that it is a year to year figure rather than an increase over previous plans would, presumably, be made clear in the drafting. But more difficult is the fact that the £1.1 billion figure refers to a different concept from the £700 million. The latter is for the NHS in England whereas the £1.1 billion is for the NHS UK.

4. An alternative approach which avoids proliferating figures and keeps them all on the same basis would be to draft the second

sentence as:

"This has enabled us, in particular, to increase our plans for spending on health and personal social services by £1 billion, on education and science by £900 million, and on law and order by £500 million while ensuring that ...".

All figures are then on exactly the same basis, being increases over previous plans on a UK basis, including local authority expenditure. They can all be justified by reference to Table 2.7 of the PEWP. This also keeps a figure of £1 billion in the public eye for health.

5. Are you content with this formulation?

AT

A TURNBULL



FROM: MOIRA WALLACE

DATE: 8 March 1988

MR BURR

cc Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Mr Anson
 Mr Scholar
 Mr Culpin
 Miss Sinclair
 Mr Hudson
 Mr Cropper
 Mr Tyrie
 Mr Isaac - IR
 Mr Corlett - IR
 Mr Steward - IR
 PS/IR

STUDENTS AND COVENANTS

The Chancellor was grateful for your minute of 7 March. As I explained, he is now inclined to make a concession on 17-year olds, and he has redrafted the letter to Mr Rifkind accordingly. He is also content to make the concession on summer term starters (your paragraph 9), and I should be grateful if you could pass this on at official level.

2. The Chancellor is also content with the recommendations in your paragraph 10: that DES press notices should issue the morning after the Budget; that Chief Information Officers should be warned that there will be press notices, but not what they will say; and that the two-tier parental contribution scale should be presented as for four years only. The Chancellor has noted that the last of these may require a consequential amendment to the Budget speech.

A handwritten signature in cursive script, appearing to read 'M. Wallace'.

MOIRA WALLACE

FROM: MIKE DAVIES
DATE: 8 MARCH 88

MR HUDSON

cc Mr Instone
Mr Betenson
Mr Pickford
Miss Simpson

BUDGET SPEECH : HOME OWNERSHIP

Your minute to Mr Betenson of today.

The figure for families - this should really be households - who have bought there own homes, is the increase in total owner occupation from April 1979 to September 1987 and now stands at 2.9 million. I suggest therefore that the sentence should read:

"Encouraged by Government policy, nearly 3 million more households are now owner occupiers than in 1979, bringing the total number of families who have bought their own homes to 63 per cent of all households"

Mike Davies

MIKE DAVIES

AD

Pl. ring Mike Davies & ask him to confirm 2.9 is right, given that the Cons. ~~Plan~~ Manifesto in May 1987 said 2½.

AH



FROM: S P JUDGE
DATE: 8 March 1988

MR A P HUDSON

- cc PPS
- PS/Chief Secretary
- PS/Financial Secretary
- PS/Economic Secretary
- Sir Peter Middleton
- Sir Terence Burns
- Sir Geoffrey Littler
- Mr Anson
- Dame Anne Mueller
- Sir Anthony Wilson
- Mr Byatt
- Mr Monck
- Mr Scholar
- Mr Sedgwick
- Mr Odling-Smee
- Mr Culpin
- Mr Turnbull
- Mr Peretz
- Mr Mole
- Mr Pickford
- Mr R I G Allen
- Miss Sinclair
- Mr Riley
- Miss Simpson
- Miss C Evans
- Miss Hay
- Mr Michie
- Mr Cropper
- Mr Tyrie
- Mr Call
- Mr Battishill - IR
- Mr Isaac - IR
- Mr Painter - IR
- Mr Batton - IR
- Mr McManus - IR
- PS/Inland Revenue
- Mr Unwin - C&E
- Mr Knox - C&E
- Mr P R H Allen - C&E
- PS/Customs & Excise

BUDGET STATEMENT: THIRD AND FOURTH DRAFTS

The Paymaster General read the third draft over the weekend.

2. I attach a note setting out those of his comments which have not been overtaken by the fourth draft. Paragraph numbers refer to the latest version.

3. I will let you have any further comments he has tomorrow.

S P JUDGE
Private Secretary

PAYMASTER GENERAL'S COMMENTS ON DRAFT BUDGET STATEMENT

✓ G12: Isn't the "500 a week" a net VAT registration figure?

Not major ✓ G26: On-course betting duty could be added to the list of abolished taxes.

✓ G30: Redraft last clause to read: "a batting average of one a Budget".

✓ J2: Add at end of paragraph: "I hope this will be regarded as a case of just desserts".

✓ J6, fourth sentence: The words "will go from £130 up to £1,600" look odd.

✓ L15, penultimate sentence: The Paymaster thinks "replaces" would be better than "subsumes".

8 March 1988

BUDGET CONFIDENTIAL

FROM: J. ANSON
8th March, 1988.

MR. HUDSON

c.c. PS/Chancellor
PS/CST
Sir Peter Middleton
Sir T. Burns
Mr. Monck
Mr. Scholar
Mr. Culpin
Mr. Turnbull
Mr. Odling-Smee
Miss Sinclair
Mr. Mowl
Mr. R. I. G. Allen
Mr. Tyrie
Mr. Call
Mr. Corlett (I.R.)

BUDGET STATEMENT: FOURTH DRAFT

Paragraph D.10

I am afraid D.10 is now not quite right. The increase of £4½ billion in the first sentence was the total of increases to all programmes, and cannot then all be attributed to priority programmes. The same point arises on the last sentence of that paragraph.

I suggest that the first sentence could anyway be simpler:

"I have already announced, in the Autumn Statement last November, a substantial increase of over £4½ billion in the amounts allocated to public expenditure programmes for 1988-89."

In the last sentence, you could then substitute "allocations to" for "spending on priority".

Mr. Turnbull has already commented separately (his minute of 7th March to the Chief Secretary) on the numbers in the second and third sentences of that paragraph. I

BUDGET CONFIDENTIAL

would suggest that if people are to take in the distinction between these two sentences as they listen to them, you need to insert "between 1987-88 and 1988-89" after "increases" in line 9; and delete "in 1988-89" in line 11. It might also be clearer to substitute "amounts" for the second use of "increases" in line 8.

Paragraph D.11


There is a confusion in D.11 between "public expenditure" in line 1, which implicitly excludes debt interest, and the same expression in the penultimate line, which implicitly includes debt interest. I suggest substituting "spending programmes" in line 1, and "public spending" (which is the phrase we normally use for GGE) in the penultimate line.

Paragraph H.6

This paragraph, and particularly the words "later today" in the last line, is subject to the decisions on Mr. Burr's submission of 7th March about the timing of the DES and SED Press Notices and other details of the new parental contribution scale. I can see considerable attraction in being able to say that the new scale would be published "later today", but we have assumed that the Chancellor would not want a central Budget decision communicated to DES and SED before the Budget statement.

Paragraph K.19

In line 3, I assume "loan" should be "lower".


J. ANSON



FROM: A P HUDSON
DATE: 8 March 1988

APH

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Culpin
Mr Pickford

Mr Painter - IR
Mr Johns - IR
Mr McManus - IR

BUDGET SPEECH: PARAGRAPH L21

The Chancellor would be grateful if you could consider if he would be open to criticism if he dropped paragraph L21 from the Budget Speech. This is the paragraph about the ending of relief for the purchase of a home for a dependent relative or a divorced or separated spouse.

2. Please could you let me know your view by 6.00pm tomorrow (9 March).

APH

A P HUDSON



FROM: A P HUDSON

DATE: 8 March 1988

 CHANCELLOR 

Cr. We agreed to put "accrued" back in. Here's the - tortuous - reasoning for Mr Houghton taking it out:

BUDGET SPEECH: PARAGRAPH G7 ON SECTION 482

I spoke to Brian Houghton about why he suggested dropping "accrued" from the middle sentence in this paragraph.

2. He sees no difficulty about putting it back in.
3. His reasoning for dropping it was as follows. This paragraph talks about two types of cases - necessarily briefly.

(a) The first case is the company which transfers its trade or business abroad. This is a deemed disposal, and the company pays CGT under the normal rules. So the capital gains are "accrued" or "unrealised", but only in the sense that any capital gains are, immediately before a disposal takes place.

(b) The second case is the non-UK incorporated company which moves its central management and control abroad. That is where we are introducing the new exit charge, which is on gains which remain "accrued" or "unrealised" in every sense. And that is the case Mr Fawcett has in mind when he refers to "unrealised gains" in his press release. ^(Below) In other words the first turet under Details is (a) above, and the third turet is this point.

So "accrued" is defensible in both cases, but means something slightly different. That is why Mr Houghton thought it simpler to leave it out.

A P HUDSON

BUDGET CONFIDENTIAL



FROM: A P HUDSON
DATE: 8 March 1988

MR BETENSON

cc Mr Instone
Mr Pickford
Miss Simpson

BUDGET SPEECH: HOME OWNERSHIP

The Budget Speech includes the sentence:

"Encouraged by Government policy, some 2½ million families have bought their homes, bringing the total to 63 per cent of all households."

This is based on the Conservative Manifesto and the TWEB. Please could you confirm the sentence as drafted is correct?

A P HUDSON



FROM: A P HUDSON

DATE: 8 March 1988

MR SCHOLAR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Culpin
Mr Pickford

Mr Painter - IR
Mr Johns - IR
Mr McManus - IR

BUDGET SPEECH: PARAGRAPH L21

The Chancellor would be grateful if you could consider if he would be open to criticism if he dropped paragraph L21 from the Budget Speech. This is the paragraph about the ending of relief for the purchase of a home for a dependent relative or a divorced or separated spouse.

2. Please could you let me know your view by 6.00pm tomorrow (9 March).

A handwritten signature in black ink, consisting of stylized initials 'APH' followed by a horizontal line.

A P HUDSON



FROM: A C S ALLAN

DATE: 9 March 1988

MR TYRIE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Culpin
Mr Scholar
Mr Turnbull
Mr Hudson
Mr Cropper
Mr Call

THE NHS AND THE BUDGET

The Chancellor was most grateful for your minute of 4 March and the various comments on it. In the light of this, he has prepared the ... attached line.

2. He commented that there are a number of other good points raised by Ministers and Advisers; but it is necessary to concentrate on a clear and simple story, and that is what he has done in his line. Section D of the Budget Speech is also relevant.

A handwritten signature in black ink, appearing to read 'A C S Allan'.

A C S ALLAN

THE NHS AND THE BUDGET

The question is, why, when you are in such a strong financial position, with so much money to give away, are you spending it all on tax cuts and none on the NHS, which is starved of funds.

2. The answer should make the following points:

- (i) we are not giving money away, we are taking less than we would otherwise have done;
- (ii) as it is, the burden of tax (tax etc. as a percentage of GDP) has not been reduced in this Budget at all: without the measures it would have increased;
- (iii) it is only the policies of sound public finance (eliminating Government borrowing) and stimulating enterprise (income tax cuts crucial here) that have given us the strong economy that creates the resources in the first place;
- (iv) that is why, unlike like Labour we have been able to afford a substantial further increase in spending on the NHS. It was announced, not in the Budget, but last November (give key figures);
- (v) but although spending on the NHS has risen substantially both in real terms and as a share of total public expenditure, all is clearly far from well with the NHS. That is why we have set up a fundamental review, and will be announcing our conclusions as soon as we are in a position to do so;
- (vi) meanwhile, the reduction in debt interest as a result of our prudent policies will clearly leave more money to be spent on public expenditure programmes in general, and the NHS in particular.

BUDGET CONFIDENTIAL



FROM: A P HUDSON

DATE: 9 March 1988

MR NEILSON

cc Mrs Lomax

BUDGET SPEECH: FOURTH DRAFT: PARAGRAPHS K1-K7

... I attach these paragraphs of the Budget Speech. Please could I have any comments as soon as possible.

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

A P HUDSON

K. TAXES ON CAPITAL

K1. The emergence of the capital-owning democracy has been one of the most remarkable features of the 1980s. Encouraged by Government policy, some 2½ million families have bought their homes, bringing the total to 62 per cent of all households. And our proposals for personal pensions, which come in to effect in July, will give a new dimension to pension ownership.

K2. But the most dramatic change has been in share ownership. In last year's Budget, I announced the results of a joint Treasury/Stock Exchange survey of the number of shareholders in this country. This revealed that some 8½¹⁰⁰ million people - one adult in five - owned shares, about three times the number in 1979.

K3. A similar survey has been carried out this year. Despite all the stories of people taking quick profits on privatisation shares, and despite the stock market collapse, the results show that the number of individual shareholders has if anything risen further over the past 12 months, to very nearly 9 million. This illustrates in a quite remarkable fashion the way in which the habit of share ownership is now taking root.

K4. I have two proposals to encourage share ownership still further to announce today.

K5. First, ¹⁰⁰ Personal Equity Plans are off to a successful start. Over a quarter of a million people took out plans in 1987, and subscribed nearly £½ billion between them. To give further encouragement to this form of investment, I propose to increase the annual limit from £2,400 to £3,000. The new higher limit will apply as from 1 January this year.

K6. Second, measures to encourage employee share ownership have featured in seven out of the last eight Budgets. As a result, the number of approved all-employee share schemes has risen from 30 in 1979 to over 1400 today, involving well over 10,000 companies, and providing shares and options for well over 1½ million employees.

K7. Following extensive consultation, including the publication of draft clauses, I propose to relax the provisions of Section 79 of the 1972 Finance Act, so that, while maintaining protection against abuse, companies will be able to provide shares to their employees outside the approved schemes on reasonable terms. This will be of particular benefit to unquoted companies and their employees.

REF: APH/46

COPY NO. OF 10.

FROM: A P HUDSON

DATE: 10 March 1988

CHANCELLOR

cc Mr Scholar
Mr Culpin
Mr Pickford
Mr R I G Allen
Mr A C S Allan
Miss Simpson

SPEECHES AFTER THE BUDGET

I have been thinking about whether it is worth planning more specifically than in previous years how we use post-Budget speeches to put across the message of the Budget.

Budget Debates

2. The first opportunity to reinforce the message is in the Budget Debates. There are some points which we want to feature in all the speeches (strength of the economy, balanced budget, case for tax reform, benefits of cutting income tax, etc.). And there are other points which deserve one detailed explanation, but not necessarily more than one (for example, BES reform, private renting, and forestry).

3. The other Treasury Ministers' plans - all fairly provisional - are as follows:

- The Chief Secretary is planning to cover income tax, forestry, company cars, possibly CGT, Independent Taxation, and the balanced budget.
- The Financial Secretary is planning to cover some or all of wider share ownership, the higher rates, tax cuts versus public spending, covenants and maintenance, and the BES (especially renting). He will do more on Independent Taxation and CGT, if the Chief Secretary decides not to go into detail.

- The Economic Secretary is thinking about doing PRP, importers' details, and funding policy.

4. We have three opening speeches and two wind-ups to go at, with your wind-up speech on Monday covering the whole Budget. A possible division of labour might be as follows.

Themes for all speeches

Strong economy - the result of sound financial policies and supply-side reform, including tax reductions and tax reform

Balanced budget

Tax reform

Case for lower income tax.

Wednesday 16th

CST: full explanation on income tax, removal of tax shelters, CGT reform; few well chosen words on the NHS; balanced budget;

FST: Wider share ownership; capital taxes; Independent Taxation; Covenants and Maintenance.

Thursday 17th

Mr Fowler: rapid fall in unemployment; small business measures, BES reform, private renting;

EST: PRP; importers' details; funding policy(?); CGT (if not done by FST).

Monday 21st

Mr Clarke: performance of company sector; enterprise culture;

Ch Ex: Budget as a whole.

5. If you agree such a division of labour would be useful, I suggest we prepare a letter for Alex Allan to send to the Private Offices of Mr Fowler and Mr Clarke on Budget evening, to guide them in preparing their speeches. *You might also think about how far the subjects should be divided between Treasury Ministers. Prayers?*

Other speeches

... 6. I attach lists of your speeches, and those of the other Treasury Ministers.

7. The question is whether we want to identify now any particular opportunities to talk about particular subjects. In some cases, the subject matter is clear: we cover PRP, Scotch whisky, and the BES by the end of June.

8. One obvious gap is Independent Taxation. Perhaps we should engineer a suitable motion for the Conservative Womens' Conference, on 24-25 May, you have an invitation to speak, which we have pencilled in.

9. One point about your own programme. We decided at Speech Committee to use the American Correspondents on 29 March for a full speech on tax reform. I spoke to Robert Culpin: although he thinks such a speech is a good idea, and is happy to help write it, he feels strongly that this is not the occasion. He says this is the time to get booming Britain into the American press. They only want a few remarks and then to ask questions. There isn't normally a press release. So they are not the best audience for a big speech on tax reform, and we would miss the chance to get some good stories about the economy in the US press. That said, there is no other obvious opportunity to speak about tax reform within the next few weeks.



A P HUDSON

RESTRICTED

CHANCELLOR'S SPEECH PROGRAMME

DATE: 26 February 1988

DATE	ORGANISATION	OCCASION	VENUE	SUBJECT/NOTES
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Monday 21	Budget Wind up			
Thursday 24	CPC Budget Seminar	Evening	London	
Saturday 26	East Midlands YCs	AGM		
Tuesday 29	Association of American correspondents in London	Lunch	London	
APRIL				
Friday 8	Konigswinter Conference	Government dinner	Cambridge	FCO to draft
Wednesday 13	International meetings		Washington	Usual world economy topics
Saturday 23	Western Area	Provincial Annual Meeting	Exeter	
Wednesday 27	Huntingdon CA	Dinner		(CST's constituency)
Friday 29	Worthing CA	Annual Dinner	Worthing	
MAY				
Friday 6	Royal Mint	Trial of the Pyx	London	
Wednesday 18	OECD	Ministerial meeting	Paris	
Tuesday 24	Wokingham CA	Portcullis Club (Drinks)	HoC	(John Redwood MP)
JUNE				
Thursday 2	National Union Executive Committee		London	
Friday 3	Leicestershire BMA	Annual Address	Leicestershire	
Friday 10	Oxford dons	Private meeting	Oxford	John Patten MP
Thursday 16	Royal Naval College	Armada Dinner	Greenwich	
Sunday 19	Summit		Toronto	
Monday 27	Adam Smith Institute	Privatisation seminar	London	

DATE	ORGANISATION	OCCASION	VENUE	SUBJECT/NOTES
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SEPTEMBER				
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MINISTER

DATE

FUNCTION

CST

Friday 1 July

Association of District
Councils Annual Conference

CST

Wednesday 13 July

City Dialogue Lunch

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REF: APH/46

COPY NO. 10 OF 10.

FROM: A P HUDSON

DATE: 10 March 1988

CHANCELLOR

cc Mr Scholar
Mr Culpin
Mr Pickford
Mr R I G Allen
Mr A C S Allan
Miss Simpson

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BUDGET: CONFIDENTIAL



FROM: J J HEYWOOD

DATE: // March 1988

MR HUDSON

cc PS/Chief Secretary
 PS/Paymaster General
 PS/Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Anson
 Mr Scholar
 Mr Culpin
 Mr Corlett - IR
 Mr Cropper
 Mr Tyrie
 Mr Call

BUDGET STATEMENT: FIFTH DRAFT

The Financial Secretary had two comments on the latest draft:

i. Is there a case for sticking in a paragraph (perhaps in Section D) on the buoyancy of revenues? The Financial Secretary suggests that this might start by saying that the Labour party have been asking us to spend "the money" without knowing where it has come from and why it is available. He would then go on to say that "buoyancy" has come from the dynamic economy which in turn has resulted from our supply-side policies, and from the 1984 tax reform;

ii. on H13 the Financial Secretary was left wondering what was meant by "an unmarried couple". If this is intended to cover divorced and separated couples, the implication remains that the current tax regime embodies an incentive to get divorced. If on the other hand, this phrase is intended to refer to people who have never been married, he thinks the second sentence is misleading - it implies that tax relief will be reduced rather than abolished. And if we are going to move into this awkward territory (the deserted mother in Brixton!), the Financial Secretary believes we need to

No.

Yes.

No

the clever solicitors & accountants who calculate how to ~~maximise~~ minimise their tax. I've had a go at simplifying this para.

make the "bull point" too that such payments will no longer be taxable. His preferred re-draft would be to delete "greatly in excess of that which is available to a married couple" and to add a final sentence "But in line with the treatment of payments within a married couple, maintenance payments between unmarried partners will not be taxable".

9.12

JEREMY HEYWOOD
Private Secretary

~~only a~~ three quarters done)

only 4 per cent in 1986-87. Today I am able to tell the House that ~~I have brought this process to its ultimate conclusion.~~ ^m In 1987-88, the year now ending, we are set to ~~achieve~~ ^{secure} something previously achieved only on one isolated occasion since the early 1950s: a balanced budget.

D5. Indeed, we have gone even further. It looks as if the final outturn for 1987-88 will be a budget surplus of £3 billion. Instead of a PSBR, a PSDR: not a Public Sector Borrowing Requirement, but a public sector debt repayment.

D6. And, incidentally, even if there had been no privatisation proceeds at all, the resulting PSBR, at a half of one per cent of GDP, would still have been the lowest in all but one year since the early 'fifties.



PWP

C. n/12 p.5
Sony: carbon
writing
on
1/100

~~PARA~~ →

Page 17, last line.

You ~~wrote~~ put "at least

£1,100 million

£1000 m " in for health,

but the Turnbull note below

says £1100m, which, I gather,

is consistent. Which do you

want?

AMH

14.3.



FROM: A P HUDSON

DATE: 11 March 1988

MRS LOMAX

BUDGET SPEECH: SECTIONS ON OWNERSHIP, AND CAPITAL DUTY

... I attach two extracts from the fifth draft of the Budget Speech: paragraphs G24-G28 on Capital Duty, and paragraphs K1-K8 on Ownership.

2. Please could you let me have any comments by close tonight. I shall not then circulate these sections again unless there are changes of substance.

A handwritten signature in black ink, consisting of the letters "A P H" with a long horizontal stroke extending to the right.

A P HUDSON

G24. Throughout my time as Chancellor, I have been on the look-out for taxes to abolish. Abolition is clearly the simplest variety of reform. I have already abolished the National Insurance surcharge, the Investment Income surcharge, Development Land Tax, and the tax on lifetime gifts. Today I propose to abolish a further tax: Capital Duty.

G25 At present, companies have to pay a 1 per cent duty whenever they raise new capital - whenever, for example, a new company is formed or an existing company sells new shares to the public. This is undesirable on two counts. It is a burden on companies who need to secure external finance for expansion. And it discriminates against equity capital as compared with debt finance and bank borrowing.

G26. Capital Duty is a relatively recent impost which had to be introduced in 1973 in compliance with our obligations under European Community Law. But the relevant Community Directive has now been amended. Accordingly, I propose to abolish Capital Duty with effect from midnight tonight.

G27 At the same time, I propose to get rid of the Unit Trust Instrument Duty, a similar though much less substantial tax, which is levied at the rate of $\frac{1}{4}$ per cent on all property put into a unit trust. I know the unit trust movement will welcome this minor relief, and I trust the benefit will be fully passed on to investors.

G28. The cost of abolishing these two taxes will be of the order of £100 million in 1988-89. Not counting minor imposts, the demise of Capital Duty brings the number of taxes I have abolished up to five: an average of one a Budget.

K. TAXES ON CAPITAL

K1. I now turn to taxes on capital.

K2. The emergence of the capital-owning democracy has been one of the most remarkable features of the 1980s. Encouraged by Government policy, almost three million families have bought their homes, bringing the total to nearly two households in three. And our proposals for personal pensions, which come in to effect in July, will give a new dimension to pension ownership.

K3. But the most dramatic change has been in share ownership. In last year's Budget, I announced the results of a joint Treasury/Stock Exchange survey of the number of shareholders in this country. This revealed that some 8½ million people - one adult in five - owned shares, about three times the number in 1979.

K4. A similar survey has been carried out this year. Despite all the stories of people taking quick profits on privatisation shares, and despite the stock market collapse, the results show that the number of individual shareholders has if anything risen further over the past 12 months, to very nearly 9 million. This illustrates in

a quite remarkable fashion how the habit of share ownership is now taking root.

K5. I have two proposals to encourage share ownership still further to announce today.

K6. First, Personal Equity Plans are off to a successful start. Over a quarter of a million people took out PEPs in 1987, and subscribed nearly £½ billion between them. To give further encouragement to this form of investment, I propose to increase the annual limit from £2,400 to £3,000. The new higher limit will apply to all plans taken out this year.

K7. Second, measures to encourage employee share ownership have featured in seven out of the last eight Budgets. As a result, the number of approved all-employee share schemes has risen from 30 in 1979 to over 1400 today, involving well over 10,000 companies, and providing shares and options for well over 1½ million employees.

K8. Following extensive consultation, including the publication of draft clauses, I propose to relax the provisions of Section 79 of the 1972 Finance Act. This will make it easier for companies to provide shares to their employees outside the approved schemes without giving rise to an undue charge to tax. This will be of

particular benefit to subsidiary companies and their employees.



FROM: A P HUDSON

DATE: 11 March 1988

MR H P EVANS

cc Mr Hibberd
Mr Botterill
Mr S W Matthews
Mr Patterson

BUDGET SPEECH: SECTION B

... I attach the fifth draft of Section B of the Budget Speech. Please could I have any comments by close tonight.

2. There may be a further draft circulated on Monday morning (14 March), but this is not certain. So it would be helpful if all the facts and figures could be checked at this stage.

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

A P HUDSON

B. THE ECONOMIC BACKGROUND

B1. I start with the economic background.

B2. The strength and durability of the economic upswing has now exceeded all post-War records. We are about to enter our eighth successive year of sustained growth, and the sixth in which this has been combined with low inflation. And even without looking to 1988, the six years to 1987 have been the longest period of steady growth, at a rate averaging 3 per cent a year, for half a century.

B3. This performance compares favourably not only with our own past, but also with the economic performance of other countries. During the 1960s and the 1970s, Britain's growth rate was the lowest of all the major European economies. During the 1980s, our growth rate has been the highest of all the major European economies.

B4. In 1987 as a whole, output grew by $4\frac{1}{2}$ per cent, while inflation averaged $4\frac{1}{4}$ per cent. Thus last year, for the first time for a generation, the rate of growth exceeded the rate of inflation. At the same time unemployment fell more than in any other year since the War, in every region of the country, and faster than in any other major nation.

B5. The plain fact is that the British economy has been transformed. Prudent financial policies have given business and industry the confidence to expand, while supply side reforms have progressively removed the barriers to enterprise.

B6. Nowhere has this transformation been more marked than in manufacturing, where output rose last year by $5\frac{1}{2}$ per cent. This outstanding performance was founded on a further big improvement in manufacturing productivity. In the 1980s, output per head in manufacturing has gone up faster in Britain than in any other major industrial country, and we led the way once again last year. This is in stark contrast to the 1960s and 1970s, when in manufacturing productivity growth, as in so much else, we were bottom of the league.

B7. The current account of the balance of payments is now estimated to have been in deficit last year, after seven successive years of surplus, by a little over $\text{£}1\frac{1}{2}$ billion. This is well below the deficit I forecast at the time of last year's Budget, despite growth turning out stronger than forecast. The reason for this was the better than expected performance of visible trade, with exports of manufactures up by $8\frac{1}{2}$ per cent. This continues the pattern of the 1980s, with British manufacturers maintaining their share of an expanding world trade, after decades during which Britain's share was steadily declining.

B8. Looking ahead, I expect 1988 to be yet another year of healthy growth with low inflation; and there is every prospect that unemployment will continue to fall, although probably not as rapidly as last year.

B9. The pace of non-oil growth is likely to ease from now on, returning to the underlying trend of the past few years. But output for 1988 as a whole is forecast to be 3 per cent higher than in 1987, with the non-oil economy up by $3\frac{1}{2}$ per cent. Business investment is forecast to grow particularly strongly, with a rise of $8\frac{1}{2}$ per cent.

B10. As last year, inflation is forecast to end the year at 4 per cent. While this is still too high, it is a testimony to the soundness of our policies that the present strong and sustained upswing is the first for more than a generation that has not led to a resurgence of inflation.

B11. With growth in the UK economy likely to continue to outpace that of most other major countries, particularly in continental Europe, and with our oil surplus falling as North Sea oil production declines, the current account of the balance of payments is forecast to remain in deficit this year, by some £4 billion, equivalent to less than one per cent of GDP. Given the strength of the economy in general, and of our public finances in particular, not to mention our massive net overseas asset

position, I foresee no difficulty in financing a temporary current account deficit of this magnitude.

B12. But the outlook both for exports and for jobs will depend critically on employers keeping their costs firmly under control. Unit labour costs in manufacturing scarcely rose at all in 1987. It is vital that employers do not let this slip, and keep a tight grip on all their costs, not least pay.

B13. In my Budget speech last year, I warned that:

"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."

That remains the case. The dramatic collapse in the world's equity markets last October was not the second coming of 1929 and the harbinger of a 1930s-style world slump, as so many feared at the time - although it could have been a great deal nastier had the authorities in the major nations not responded in a prompt and appropriate way. It was essentially an overdue market correction which did little more than reverse the rapid rise in share prices of the previous year. Certainly, business confidence does not seem to have been greatly affected, and growth in the seven major industrial countries as a whole this year is likely to be only slightly lower than last year.

B14. But Black Monday was also a warning. The world's three largest economies - the United States, Japan and Germany - have made a number of the policy adjustments necessary to reduce the imbalances which have for so long afflicted them, and there is evidence that the measures they have taken are starting to bear fruit. But there is still a long way to go; and meanwhile there is the constant danger that the process of adjustment, and with it the world economy as a whole, could be gravely damaged either by further wild gyrations in the dollar exchange rate or by a lurch into protectionism.

B15. There are some who continue to insist that the simple and only solution to these imbalances lies in a further substantial fall in the dollar, even though the source of the problem lies elsewhere. They see exchange rate changes as a miracle cure, whatever the illness. They wholly ignore the damage that exchange rate volatility does to economic health, and distract attention from the fundamental causes of the imbalances.

B16. Success in reducing these imbalances depends on countries putting the right fiscal and monetary policies in place, and keeping them there. But the necessary adjustments are much more likely to be achieved if the objective of greater exchange rate stability is given an explicit role in the process of international co-operation, as has been the case for well over

two years now. I can assure the House that we shall play
our full part.

Put

*AMT
I have agreed with
Mr T as to amount
to go into
Budget speech
and into
Mr Cropper's
backbench
brief, if you are content
upon 14/3*

FROM: A TURNBULL
DATE: 14 MARCH 1988

CHIEF SECRETARY

cc PS/Chancellor
Mr Anson
Miss Peirson
Mr Gieve
Mr Pickford
Mrs Butler
Mr Tyrie

BUDGET SPEECH

You asked me to look again at the drafting of paragraph D.10 and try to find a way of building on £1.1 billion for the year to year increase in health spending.

2. It can be done in the following ways:

"... allocated to programmes up by over £4½ billion. This means that next year we will be spending ^{at least} £1.1 billion ^{£1,100 million} more on health than this, ^{at least} around £900 million more on education and science and ^{at least} £500 million more on law and order."

3. The basis of the figures in each case is:

i. Health: NHS UK, 1988-89 plans on 1987-88 estimated outturn, as in PEWP modified by subsequent additions.

ii. Education and science and law and order: both 1988-89 plans UK over 1987-88 estimated outturn as in PEWP. We do not have exact UK figures for 1987-88 outturn so we have taken the PEWP figures and checked them against latest changes for DES, Home Office and Scottish Office. Rounded to nearest £100 million, the figures are sound.

AT

A TURNBULL

PS/Chief Secretary cc as before + RIG Allen
To confirm my conversation with the
Ch/Ex. He pointed out that the £1.1 billion
and the other figures compared plans with outturn and
made no allowance for any additions from the Reserve

FROM: A TURNBULL
DATE: 14 MARCH 1988

CHIEF SECRETARY

which could be substantiated, He agreed to accept
this formulation with the insertion of 'at least'
before the figures, in acknowledgement of the
possibility of drawings from the Reserve.

N4/121
PT.13

cc PS/Chancellor
Mr Anson
Miss Peirson
Mr Gieve
Mr Pickford
Mrs Butler
Mr Tyrrie

AT
14/13

BUDGET SPEECH

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do not have exact UK figures for 1987-88 outturn so we
have taken the PEWP figures and checked them against latest
changes for DES, Home Office and Scottish Office. Rounded
to nearest £100 million, the figures are sound.

AT

Revised version, incorporating
comments from Sir T Burns.

Pyg

MONETARY POLICY

2.09 Interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure downward pressure on inflation.

2.10 [Within that framework,] [either: the Government will continue to pursue a policy of exchange rate stability, with the rate against the Deutschmark being of particular importance.] [or the Government attaches particular importance to maintaining exchange rate stability, notably against the Deutschmark.] Industry has benefitted from the greater stability of exchange rates over the past year. It also provides an important financial discipline, since increases in domestic costs will not be accommodated by a lower exchange rate. This discipline unpins the declining path of money GDP growth and inflation].

2.10 Achieving these objectives requires a reduction in monetary growth over the medium-term ...

Ch

No comments yet from Peter - I have copied this version to him.

AT

BUDGET CONFIDENTIAL

ML/121
PT-B

FROM: M C SCHOLAR
DATE: 9 MARCH 1988

Prof

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Peter Middleton
Mr Culpin
Mr Pickford
Miss Sinclair
Mr Painter - IR
Mr Johns - IR
Mr McManus - IR

*As agreed with
Andrew*

AA

*Thanks.
I will take out.*

BUDGET SPEECH: L21

You asked if you would be open to criticism if you dropped this paragraph - about the ending of relief for the purchase of a home for a dependent relative or a divorced or separated spouse - from the Budget Speech.

2. I think you could be criticised; some might say that this relief, although small, was significant, and that it was a bit sharp to bury its demise in an Inland Revenue Press Notice.

3. But if you keep it in I think you will have to expand it, by mentioning the capital gains tax exemption on the sale of a house bought for a dependent relative, which is also being abolished. That would mean adding to the end of L21 - or replacing the existing second sentence with - something on the lines of:

"At the same time the exemption from capital gains tax will be withdrawn, but again with full protection for existing cases."

4. But I think you should leave the paragraph out. The Revenue do not know how many people will be affected adversely, but they must be few in number given that the relief will still be available if the relative or spouse makes the payments directly (hence the negligible yield from the change). And all existing cases are being protected, so there are no losers. We cannot put everything in the Speech.

Mus

M C SCHOLAR

mp

9 HOUSE OF LORDS,
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*NL/121
B*

CH/EXCHEQUER	
REC.	09 MAR 1988 <i>9/3</i>
ACTION	PS/CST PS/FET PS/PNG PS/EST
COPIES TO	SIR P. MIDDLETON MR SCHOLAR MR CULPIN MR SE SWICOME PS/IR MR CORLETT 1/2 MR STUART. 1/2

March 1988

✓

Dear Nigel,

Budget - Taxation of Maintenance Payments

I am pleased to learn that it is now agreed that the new rules will apply only to court orders made after Budget Day. That will preclude any possibility of the courts being wrong footed on that day because they do not know of the changes.

On a more general point, the restrictions on the advice that I have been able to seek about the proposed changes means that I am unable to say with certainty at this stage whether they will have a significant impact on legal aid expenditure or court resources. I must therefore reserve the right to return to this matter with you if any such expenditure is identified and to seek the necessary adjustments to my Department's planned spending under those heads.

I have made arrangements with the Treasury Solicitor's Office for the Scottish Courts to be informed.

Yours ever,

James.

The Right Honourable
Nigel Lawson M.P.
The Treasury
Parliament Street
London
SW1P 3AG

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Pl. amend.
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²⁹
Draft of 26 February

CHANCELLOR OF THE EXCHEQUER'S BUDGET STATEMENT

15 MARCH 1988

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J		TAXES ON SPENDING
K		OWNERSHIP
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M		INHERITANCE TAX
N		INCOME TAX
P		PERORATION ON TAX REFORM
Q		CONCLUSION (TO COME)

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A. INTRODUCTION

A1. As I present the first Budget of this Parliament, I am struck by the contrast with the settings for the initial budgets of our previous two parliaments.

A2. In 1979, we were faced with double-digit inflation that seemed endemic. We had not only to conquer that but also to restore the enterprise culture to a country which many thought had lost it forever.

A3. By 1984, our success against inflation was clear, and the first signs were showing through of the vigorous growth and rising employment that our supply side reforms had unlocked. The task was to turn this recovery into lasting economic success.

A4. Now in 1988, we are now entering our eighth successive year of steady growth, and the sixth in which this has been combined with low inflation. Last year saw the largest fall in unemployment since the war.

A6. These successes have not been achieved easily. They have required the resolute pursuit of firm financial policies, coupled with reforms to make the economy work better.

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A6. I reaffirm those policies today.

A7. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then deal with Monetary Policy, and the public finances this year and next. Finally, I shall propose a number of measures of tax reform, designed to build on the economic success that is already so evident.

A8. As usual, a number of press releases, filling out the details of my tax 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. 1987 will be remembered for the worldwide collapse in equity markets in October. Dramatic as that was last autumn, we can now begin to see it in a longer perspective. As I suggested at the time, its impact has been more limited than many people suggested. In many markets, the falls in share prices did little more than reverse the rapid rises that had taken place earlier in the year. And, business confidence does not seem to have been much affected.

B3. In spite of the dramas in the financial markets, the UK economy in 1987 built on and indeed surpassed the strong performance of previous years.

B4. The growth rate looks to be turning out to be something over 4 per cent. This is the best performance since 1973, and bettered only three times since the War. And whereas 1973 was a freak sudden spurt, that contained the seeds of its own undoing, 1987 can be seen as a year of slightly above-average growth within a steady upward trend. In each of the last five years, the growth rate has been close to $2\frac{1}{2}$ per cent or better - something we have not achieved since the War. During both the 1960s

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and the 1970s, Britain's growth rate was the lowest of all the major European economies. During the 1980s, it has been the highest.

B5. Growth in 1987 turned out significantly faster than expected, [with exports, and consumer spending all rising faster than expected]. Inflation, however, turned out broadly as forecast in last year's Budget, averaging just over 4 per cent.

B6. 1987 was thus the first year ^{for a decade} since 1964 in which real growth exceeded retail price inflation. [something many people thought the British economy would never see again.]

B7. The plain fact is that the economy has been transformed. Our financial policies have given the private sector the room and confidence to expand. And our supply-side policies have reduced the burdens which held British industry in check for far too long. This has brought a step change in the efficiency, enterprise, and adaptability of all sectors of the economy.

B8. The combination of steady growth and low inflation, which eluded previous Governments for decades, has now been with us throughout the past five years. And in 1987, the rapid growth of new jobs, which has been going on for a number of years, fed through into a fall of half a million in the numbers of people out of work.

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Unemployment fell in all regions. And the proportion of the workforce unemployed has fallen by a bigger margin than in any other major country.

B9. As I predicted a year ago, the performance of manufacturing industry was outstanding, with output up 5½ per cent. Once again, the success of manufacturing was founded on a sharp improvement in productivity. Since 1979, output per head in manufacturing has gone up faster here than in any other major industrial country. We continued to lead the way in 1987 - a stark contrast to the 1960s and 1970s when in this, as in so much else, we were bottom of the league. British manufacturers have maintained their share of world trade since the early 1980s, after decades in which it fell constantly.

B10. Although growth in 1987 was significantly faster than I expected, the strong export performance means that the deficit on the current account of the balance of payments was [precisely in line with the forecast of £2½ billion], which I made this time last year. This largely reflects the extent to which growth in the UK outpaced other countries.

B11. Looking ahead to 1988, I expect another year of healthy growth with low inflation.

B12. Output is forecast to rise by 3 per cent, more or less in line with the steady trend of recent years.

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Exports should continue to rise, though probably not as high as in 1987, when our non-oil exports grew by 7 per cent, and manufacturing exports by 9 per cent. Consumer spending is likely to grow rather more slowly than in 1987. By contrast, surveys suggest that business investment is set to be much stronger.

B13. The non-oil economy, which is the main source of new jobs, should expand more rapidly than total GDP, at a rate of $3\frac{1}{2}$ per cent. [There is likely to be some easing of growth through the year. Even so,] There is every prospect of that unemployment will continue to fall [though the speed of this may slow from the record decline in 1987].

B14. Whereas growth in 1988 is likely to turn out slightly stronger than I forecast in the Autumn Statement, inflation should be a little lower. Inflation, as measured by the RPI, crept up to just under $4\frac{1}{2}$ per cent in the third quarter of last year, but has since fallen back to under $3\frac{1}{2}$ per cent. These fluctuations largely mirror fluctuations in the mortgage rate, and the prospect is that the underlying inflation rate should stay at around 4 per cent during 1988.

B15. Our recent record of sustained low inflation is impressive, when compared with the UK's earlier experience at times of rapid growth. But many of our major competitors have still lower inflation rates, and

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getting inflation down continues to be my top priority. Under the last Labour Government, inflation averaged over 15 per cent. In our first Parliament, we got it down to just over 11 per cent. In our second Parliament; it was a little under 5 per cent. I am determined to get it lower still in the third term, and, in due course, to eliminate it altogether.

B16. The UK is again likely to grow faster than most of the other major countries in 1988. In particular, growth in Europe, which is increasingly the most important market for UK exports, is likely to remain sluggish. With our surplus on oil trade falling as North Sea oil output falls, the current account deficit may increase to some £4½ billion in 1988, around 1 per cent of GDP.

B17. This will be very much smaller than the external imbalances [elsewhere.] With the continuation of prudent policies and with the considerable international confidence in the UK economy, we should be well able to finance it. The deficit will diminish, when the rates of growth here and overseas come back into line.

B18. The prospects both for exporters and for a further fall in unemployment, will depend crucially on employers keeping their costs firmly under control. Unit labour costs in manufacturing hardly rose at all in 1987, after three years of increasing significantly faster than our competitors. It is vital that employers do not let this

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slip, and keep a tight grip on costs, and in particular pay costs.

B19. However, the more serious dangers lie in the world economic scene. Growth in the major seven countries was around 3 per cent in 1987, close to what I forecast in the Budget last year. Healthy growth in North America, Japan, and the UK offset a sluggish performance in Continental Europe, especially Germany. And the latest indications suggest that activity remains fairly buoyant, though the stock market collapse is likely to dampen demand in the US. I expect growth in the major seven countries to be around $2\frac{1}{2}$ per cent in 1988, slightly slower than this year.

B20. But the prospect of sustained growth is an uncertain one, given the persistent large imbalances within the world economy: the huge budget deficit in the United States; and the US current account deficit, which has its counterpart in the surpluses in Japan, Germany, and other countries. The steps that have been taken to reduce these imbalances are the right ones, and they are starting to bear fruit. But there is a long way to go. And there is the constant danger that the process of adjustment - which may well be slow - will be damaged either by further gyrations in the value of the dollar, or by a slide into protectionism.

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B21. That is why I believe the best environment for a sustained reduction in the imbalances, and indeed for healthy growth in the world economy, is one of greater exchange rate stability. That is the best climate for companies, including, of course, British companies, to plan ahead and invest. And it saves them spending precious time on exchange rate management.

B22. I explained in a speech to the International Monetary Fund in Washington last September, and again in the House in January, the case for a flexible system of managed floating, and for making exchange rates the focus of policy co-ordination. The aim is greater stability in exchange rates, and in the dollar in particular, coupled with the ability to manage any changes that may be necessary in an orderly way. This was the objective of the Louvre agreement, and of the G7 agreement in December. And whereas the dollar fell over 30 per cent against the Deutschmark in the eighteen months before the Louvre agreement, it is now within [8 per cent] of the level at the time of the Louvre.

B23. Success in achieving these objectives depends, in the end, on countries' putting the right fiscal and monetary policies in place, and keeping them there. That process will be a great deal easier if it is conducted, as it has been, in a framework of international co-operation. I can assure the House that we shall be playing our full part.

*with
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MR Axel*

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B24. Provided there are no new shocks in the world economy, and that the risks at home are contained, there is every reason to expect that the combination of steady growth and low inflation, which we enjoyed throughout the last Parliament, will continue throughout this Parliament and beyond.

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C. MONETARY POLICY

The job for the Government is to maintain the steady and cautious financial policies which we have now pursued for nearly nine years, and which have brought the British economy to the very strong position I have described. Sound money and strong public finances will again provide the essential framework for steady growth with low inflation, and will keep us in the best possible position to weather any shocks we may face, at home or abroad - just as in the past we were able to take in our stride ~~[the Falklands conflict]~~, the coal strike, and the collapse of the oil price.

C2. The Medium-Term Financial Strategy will continue to provide a framework for reducing the growth of money GDP, and hence inflation, over the medium term. It also provides businesses with the stability they need to plan ahead with confidence.

C3. The objectives of the MTFPS will be achieved by maintaining firm monetary discipline, buttressed by a prudent fiscal stance.

C4. An important element in this is maintaining a stable exchange rate, with the rate against the Deutschmark of

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particular importance. [Over the past year, this has given a new focus to monetary policy.] [We have achieved this over the past year, despite market pressures on sterling and despite renewed instability in the dollar towards the end of 1987.] This gives businesses the stability they have asked for. And it provides a firm anchor for bringing inflation down over the medium term.

C5. [For much of 1987, maintaining a stable exchange rate meant, in practice, resisting pressure for sterling to rise. But let me make absolutely clear that I would resist downward pressure, if that were to emerge in response to domestic cost pressures, with equal determination.]

C6. Achieving these objectives implies a reduction in monetary growth in the medium term. This is shown in the declining ranges shown for the narrowest measure of money, M0, in the MTFs. The target range for 1988-89 is [1-5 per cent, as shown in last year's MTFs] OR [2-6 per cent, the same as for last year, with a 1-5 per cent illustrative range for 1989-90]. I shall also continue to take account of the growth of the broad money and liquidity, particularly ^{M4,} ~~those~~ ^{which} that includes the liabilities of building societies as well as banks. But as last year, there will be no explicit target. [Possible reference to revised funding rule.]

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C7. ~~Short-term interest rates~~ remain the essential instrument of monetary policy. I will continue to vary them as necessary, on a continuous assessment of monetary conditions, to ensure that inflationary pressures are not accommodated.

C8. A firm monetary policy has brought inflation down to a level not seen for 20 years, and kept it there. Progress towards the ultimate objective of stable prices is unlikely to be steady, and its timing cannot be predicted - not least because it depends in part on events beyond our shores. [But by setting the strategic objectives we have, and operating policy to meet them, we are certain to achieve that goal.]

C9. The essence of the policy I have described is non-accomodation. If businesses allow their costs to rise too fast, I shall not allow sterling to fall to enable them to remain competitive. That would be a surrender to inflation. The track record shows that we are ready to take prompt action whenever it is necessary to do so. That policy has stood us in good stead. I reaffirm it today.

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D. PUBLIC SECTOR FINANCES

D1. As I have said, a firm monetary policy has to be buttressed by a prudent fiscal stance.

D2. At one time, it was regarded as the hallmark of good housekeeping for a Government not to spend more than it raised in taxes. Over the years, less and less attention was paid to this, until, in 1975-76, the last Labour Government borrowed what, in today's terms, would amount to [nearly £40,000 million.]

D3. This profligacy not only forced us to ask the IMF to bail us out. It also stored up an enormous burden of debt interest, for which the nation is still paying the bill.

D4. That is why, when we came to office, one of our main objectives was to bring down Government borrowing. We have reduced the Public Sector Borrowing Requirement from around 5 per cent of GDP at the start of the 1980s, to around 3 per cent by 1983, and to 1 per cent in 1986-87. Today, I am able to report to the House that I have brought this process to its logical conclusion - a balanced budget.

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D5. The budget in 1987-88 looks, in fact, to have been in surplus by some £3 billion - something achieved on only one previous occasion since the early 1950s. Instead of a public sector borrowing requirement, we have a public sector debt repayment, instead of the PSBR, the PSDR. Even ~~excluding privatisation proceeds altogether,~~ ^{if there had been no} ~~the PSBR of [$\frac{1}{2}$ per cent of GDP]~~ ^{at all,} ~~is also~~ ^{would have been} lower than in all but one year since the early 1950s.

D6. This is an excellent outcome. It is the fruit of a consistently cautious fiscal stance, eight years of firm control of public spending; and the strong and vigorous economy that has resulted. It is thus not a one-off achievement in an exceptional year, but something we can be confident of holding on to.

D7. Corporation Tax receipts, based on the buoyant profits of a thriving and healthy company sector, are ahead of forecast. Revenues from Income Tax and VAT have also been greater than expected. And North Sea revenues are up because the oil price was higher than expected.

D8. The continued strength of the economy has also helped to ensure that public spending has remained within plans. Lower unemployment has kept down social security spending. The trading performance of the nationalised industries has improved. And the capital receipts of local authorities and new towns have been buoyant. So I now estimate that the planning total for 1987-88 will be

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[£147.4] billion, about £1 billion lower than projected in the Public Expenditure White Paper in January.

D9. Looking ahead to 1988-89, I have to remind the House that I have already announced, in the Autumn Statement, an increase of over £4½ billion in public expenditure programmes. This has enabled us, in particular, to increase our plans for spending on the Health Service by £700 million, on education and science by over £600 million, and on law and order by over £350 million, while ensuring that public spending continues to fall as a percentage of GDP. I also announced a corresponding increase of £6 billion in programme spending in 1989-90.

D10. I also need to have regard to the tax burden. The buoyancy of the tax revenues means that, leaving aside the oil sector, total taxes and national insurance contributions have risen as a share for GDP for two years in succession. The tax burden thus remains at much the same level as it was 3 or 4 years ago, and nearly 4 percentage points higher than when we took office.

D11. But strong as the case is for lower taxes, the factor that has weighed most heavily with me in setting the PSBR for the coming year is the need to maintain a prudent and cautious fiscal stance. [This buttresses a sound monetary policy in keeping downward pressure on inflation. It creates more room for the private sector to borrow, invest, and grow. It leads to permanent]

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*rephrasing -
+ some for paragraph*

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lower debt interest payments, so represents an investment for future years. And it gives room for manoeuvre in the event of shocks.]

D12. I have therefore decided to provide for a budget surplus, a PSDR, of £3 billion, the same as this year's expected outturn.

D13. A balanced budget is a sound discipline for the medium term, too. I have therefore projected a PSBR of zero in the remaining three years of the MTFS. This is equivalent to a PSBR, excluding privatisation proceeds, of 1 per cent of GDP, [the level which I said last year was the appropriate destination for policy]. I have been able to reach that destination earlier than I expected. [As privatisation receipts reduce, as they are bound to do, I intend to stick to a PSBR of zero as the norm. Inevitably, there will be fluctuations, on either side, but these should be kept to within 1 per cent of GDP.]

D14. A balanced budget represents security for the present and an investment for the future. No other major industrial country is in balance, let alone in surplus. And even if we had no privatisation proceeds at all, our budget deficit would still be lower than in all the major seven countries, except Japan.

D15. I have to tell the House, however, with considerable regret, that the prudent fiscal stance I have adopted for

Check Japan

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1988-89 means that there will be no scope at all for reducing the tax burden next year. ^{in the Budget} I therefore expect taxes, ~~outside the oil sector,~~ to remain steady as a share of national income.

D16. However, the strength of the economy means that I shall still have some room to reduce tax rates.

D17. The plain fact is that sound policies, pursued consistently over a number of years, have established a virtuous circle in our public finances.

D18. The reductions we have achieved in borrowing and public spending as a share of GDP, coupled with lower tax rates, have created the room for the private sector to expand. This expansion has generated higher output, higher profits, and higher incomes, and hence higher tax yields. This in turn has created scope for lower borrowing, and lower tax rates -indeed, the latter become necessary simply to prevent the tax burden rising, because of the buoyancy of revenues. And so the circle goes on.

D19. On the expenditure side, lower borrowing has reduced the debt interest we have to pay. Debt interest now accounts for over half a percentage point of GDP less than it did only three years ago. This is equivalent to a saving of nearly £3 billion each year. And the pattern of borrowing I have set out in the MTFs should bring ~~of a~~

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further saving of £2½ billion a year, by 1990-91. This means that, within any given total for public spending, there can be higher spending on programmes. And the continuing search for value for money - the equivalent in the public sector of the supply-side reforms in the private sector - means that more can be achieved for a given amount of spending.

D20. No other major country has achieved falling debt interest payments. They have all seen increases in public sector debt relative to national income over the 1980s, compared with our falling debt income ratio. [In one or two cases there is a risk of a vicious circle developing: more borrowing raises interest payments, and hence more borrowing still is needed just to service the debt. Our virtuous circle stands in sharp contrast.]

D21. This virtuous circle is a cause for satisfaction. But it is certainly no cause for complacency. It took several years to repair the damage done to the public finances by previous governments. But it would take next to no time to slip out of the virtuous circle, if we were ever to abandon the policies that put us there.

D22. This Government has consistently pursued prudent financial policies for the best part of a decade. And the plans I have just announced, which now extend well into the next decade, enshrine the epitome of financial prudence - the balanced budget.

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E. TAX REFORM

E1. Sound finance is the essential foundation for a successful economy. But by itself, it cannot create economic growth or more jobs. That depends on markets that work properly, on businesses that show enterprise and take risks, and on the hard work and effort of the individuals who work for them.

E2. That is why the reforms we have made - and are continuing to make - of the supply side of the economy are so crucial. Privatisation, and reducing the burdens on businesses, have played a vital part in the transformation of the British economy. And so has tax reform.

E3. Nine years ago, in the first Budget of this Government's period in office, my predecessor set this country on the right road - the road of tax reduction and tax reform. He ended the penal taxation of incomes and started us on the way to an acceptable basic rate.

E4. The British people responded as we always knew they would. And the evidence is there for all to see: the richest 5 per cent of taxpayers now contribute a higher proportion of income tax revenues than when they were taxed at penal rates.

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E5. Four years ago, in the first Budget of the second Parliament of this Government, I turned my attention especially to business taxation. I announced a radical overhaul of the taxes on companies.

E6. And they, too, responded as we always knew they would. British business, indeed, has never looked back. I gave companies one of the lowest tax rates in the world, and they responded with the best performance for the best part of a generation.

E7. The reforms I introduced in my first Budget are now being emulated around the world.

E8. Today, I have further improvements to make in business taxation. But the main structure has stood us in good stead, and I intend to leave well alone.

E9. The main focus of the reforms I shall announce today is on personal taxes.

E10. And first the taxation of married women.

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F. **INDEPENDENT TAXATION** *AND TAX PENALTIES ON MARRIAGES*

F1. The present system for the taxation of married couples goes back 180 years. It taxes ^{*(the income of)*} a married woman's ~~income~~ as if it belonged to her husband. ~~In the last part of the twentieth century, that is simply not~~ *Quite simply, that is no longer* acceptable.

This is a matter on which
F2. There has been extensive consultation, ~~on this subject.~~ The time has come to take action.

of personal taxation, of the income tax system
F3. I therefore propose a major reform, with three objectives. First, to give married women the same privacy and independence in their tax affairs as everyone else. Second, to end the tax penalties that can arise on marriage. And third, to ensure that the tax system continues to recognise marriage.

practical
F4. I have decided to introduce, at the earliest possible date, ~~of~~ April 1990, a completely new system of Independent Taxation. ~~The necessary legislation will be contained in this year's Finance Bill.~~

F5. Under the new system, a husband and wife will be taxed independently, on the whole of their income. ~~The married man's allowance and wife's earned income allowance will go, and~~ *A* all taxpayers, male or female, married or single, will ~~start with~~ *be entitled to* the same personal

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allowance, which will be available against income of all kinds, whether from earnings or savings. /set

F6. In addition, there will be a married couple's allowance,

F6. Married women will pay their own tax, irrespective of their husbands' income, and they will be able to fill in their own tax return, when one is necessary. [Married women who wish to ask their husbands to continue to handle their tax affairs will, of course, be free to do so, provided they sign any tax returns themselves.]

F7. If nothing else were done, there would be no recognition of marriage and, all married couples would see a substantial fall in their tax threshold. I am therefore introducing a new married couple's allowance,

in value equivalent under the old system to the difference between the married man's allowance and the single allowance. This new allowance will go in the first instance to the husband, so that his tax threshold does not fall. But if he does not have enough income to use it in full, (he will be able to transfer any unused portion to his wife, to set) his wife will be able to set any unused portion against her income.

In the same way, F8. any A husband and wife will also be taxed independently on their capital gains, they may have, with an annual exemption each, instead of one between them, as now. But transfers of capital between husband and wife will continue to be entirely free of any liability to tax. exempt from both capital gains tax and inheritance tax.

F7. Thus while the tax system will continue to recognize marriage, from 1990 married women will be able to pay their own tax, on the basis of their own income, and have their own tax return, when one is necessary. I recognize that many married women will want to ask their husbands to handle their tax affairs, as before. But what matters is that for married women,

for the first time ever, complete independence & privacy will be an option.

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F9. This new approach will give complete privacy and independence to married women, for the first time in the history of income tax. And it combines this with continuing recognition of marriage in the tax system.

⁹ Married
F10. The new system will start considerably earlier than would have been possible for most of the other reforms that have been put forward, in particular transferable allowances. The ^{necessary} legislation will be ^{contained} in this year's Finance Bill.

The cost of this historic reform, which for the first time ever gives a fair deal to married women, will be £690 million in 1990-91.

Penalties on marriage

¹⁰
F11. I mentioned a few moments ago the tax penalties on marriage. It is clearly ^{wrong} ~~absurd~~ that some couples should find themselves paying more tax, simply because they ~~get~~ ^{are} married. I propose to put that right.

¹¹
F12. Independent taxation by itself will remove the most common ~~tax~~ ^{two} penalty ~~on marriage~~ - the taxation of a married woman's savings income at her husband's tax rate. ~~I am also introducing measures to tackle the other tax penalties, and these can take effect in advance of Independent Taxation.~~ *But there are other tax penalties on marriage, and I propose to abolish both of them.*

¹² Under the present system, an
F13. ~~The biggest problem comes with mortgage interest relief. An unmarried couple can get twice as much relief as a single person or a married couple, and that has~~ *mortgage interest* ^{This}

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propose
attracted increasing - and justified - criticism. I am
to putting ~~it~~ a stop to it from August this year. In future,
as mortgage interest the £30,000 limit on relief will be related to the house
or flat, irrespective of the number of borrowers. This
was the solution put forward in the 1986 Green Paper on
Personal Taxation, and it was *widely* generally welcomed.
Existing mortgages, ~~however~~, will be unaffected.

13 Tax secret
F14. A ~~further~~ anomaly is that an unmarried couple with
~~two~~ children can each claim the Additional Personal
Allowance, and thus get more tax relief than a married
couple in the same position. I therefore propose to
restrict the Additional Personal Allowance to one per
couple. This will take effect from April 1989.

14 Thus
F15. This Budget will eliminate, for all practical
all purposes, *under the present system,* the tax penalties which can arise on marriage.

F16. The reform I have described gives married women
privacy and independence in tax for the first time. And
it does so in a way which continues to recognise
marriage, and eliminates the penalties against it.

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G. BUSINESS TAXATION

G1. I turn now to business taxation.

G2. The major reform of business taxation, which I introduced in 1984, *and which was completed in 1986,* has given us the lowest Corporation Tax rate of any major European country. This has encouraged overseas companies to invest in Britain, and has improved the quality of investment by British firms. ~~And it is a crucial part of an environment in which company profits, leaving aside the oil sector, have risen to the highest level since 1973. This has left companies in a very healthy financial position, despite the strong growth of business investment.~~

profitability has recovered to its highest level for some twenty years. It has succeeded in its objectives.

*See
FSBR
Chap 3
para 3.34
& graph*

G3. I do not therefore propose any ~~major changes to the Corporation Tax regime this year.~~ *further reform of* The main Corporation Tax rate for 1988-89 will be unchanged at 35 per cent.

But I do
G4. ~~I~~ have three changes to propose for businesses in particular sectors.

oil.
G5. First, North Sea companies are making an impressive recovery from the oil price collapse of 1986. ~~Since we reformed the tax regime for new offshore oil fields in 1983, a new generation of fields has come into being,~~

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the Southern Basin and onshore. Many of these are highly profitable, and there is no reason for an overall reduction in tax. But I have decided to restructure the ~~burden~~. My Rt. Hon. friend the Secretary of State for Energy will ~~therefore~~ shortly be bringing forward legislation to abolish royalties, from 1 July, for all Southern Basin and on shore fields developed after April 1982. At the same time, I propose to reduce the ~~PRT~~ ^{Petroleum Revenue Tax} oil allowance for these fields to 100,000 tonnes per chargeable period.

Compled with the substantial oil tax reforms introduced in 1983, this

G6. This reform will mean an end to royalties for all future fields. Tax ^(profitability) will be more closely related to profitability. ~~It~~ will help to keep up the pace of ~~our~~ ^{UK} oil and gas activity, which will ~~also benefit the offshore supplies industry.~~ ^{has already made an impressive recovery from the oil price collapse of two years ago.}

The end of

G7. Second, Building Societies. The 1986 Building Societies Act gives Building Societies the power ^{to themselves into} to convert ~~to become~~ ^{so?} companies, if they wish. At present, however, they would face a heavy, and unintended, tax charge if they did so. I propose to rectify this.

G8. Third, I propose two changes to the tax arrangements for Lloyd's. One meets a point Lloyds have raised on last year's legislation on reinsurance to close. The second will simplify the administrative arrangements for taxing Lloyd's members. These changes will help to ensure

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that the system for taxing Lloyds is effective but also ^{While taking} ~~full~~ ^{takes} account of the special features of Lloyds.

G9. British exporters have done extremely well in recent years, thanks to major improvements in efficiency and quality. But no exporter could honestly claim that his success hinged on the ^{fact} anomaly that the cost of entertaining overseas customers ~~remains~~ ^{is} tax deductible, whereas business entertainment generally is not. ^{not - although,} And the ^{again, there is deductibility for the cost to an importer} same relief applied, of course, to import agents ^{of introducing overseas suppliers.} entertaining overseas suppliers. There is absolutely no case for this ^{anomalous} special treatment, ^{which lends itself to abuse.} I therefore propose to simplify matters, by making all business entertainment non-deductible for tax purposes.

does that cover VAT? it shd.

Section 482

G10. The very low rate of Corporation Tax gives companies every incentive to take risks and make profits. But we need to make sure that, once those profits are made, the ^{due} tax is paid. With this in mind, I have reviewed the provisions governing company residence and migration under Section 482 of the Income and Corporation Taxes Act 1970.

G10.

G11. The present rules are discretionary, uncertain, and can be exploited. I propose a new regime which will be simpler and more objective.

unsatisfactory

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G12. For the vast majority of companies, the residence test will be simply whether they are incorporated here.

The small number of companies which are not incorporated in the UK, but are centrally managed and controlled here, will also be deemed to be resident. Companies wishing to migrate will be able to do so, provided they pay their tax first. This will end the need for companies to seek Treasury consent before they migrate, and the criminal penalty they face if they do not comply.

In future, companies will be resident in the UK if they are incorporated here.
resistant in the UK and
able to
Including any accumulated capital gains tax liability.
In return, the
Requirements
will be abolished.

G13. These measures will safeguard a very substantial amount of revenue.

Move between red lines to end of business section.

Capital Duty and Unit Trust Instrument Duty

G14. Throughout my time as Chancellor, I have been on the look-out for taxes to abolish. The abolition of the stamp duty on insurance contracts, the investment premium stamp duty, and the law tax, today I propose to abolish a further tax: Capital Duty.

G14. I have one proposal to announce affecting the cost of finance for companies.

G15²⁹ At present, companies have to pay a 1 per cent duty whenever they raise new capital - whenever, for example, a new company is formed or an existing company makes a rights issue. This is *undesirable* on two counts. It is a burden on companies who need to secure external finance for expansion. And it discriminates against risk capital as compared with debt finance and bank borrowing.

And no tax on lifetime gifts.

reluctantly

G16³⁰ Capital Duty was originally imposed at the behest of the European Community, and until recently we were not at been introduced in 1973 in compliance with our obligations under European Community law. But the relevant Community

is a relatively recent imposition, having

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directive has now been amended. Accordingly,

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liberty to modify it. Happily, the position has now changed, and I propose to abolish this ^{Capital} duty with effect from [today].

³¹ G17 At the same time, I propose to get rid of the Unit Trust Instrument Duty, a similar ^(though much less substantial) impost, which is levied at the ^a rate of $\frac{1}{4}$ per cent on all property put into a unit trust. I know the ^(unit trust investors) industry will welcome this minor relief, and I trust the benefit will be fully reflected in lower charges to investors.

³² G18. The cost of abolishing these two duties will be of the order of £100 million in 1988-89. ^{Duty brings in} They bring the ^{the demise of Capital} number of taxes I have abolished up to ~~six~~, ^{five} ^{an average of one a Budget.} ^{Signable}

~~Small Businesses~~

¹² G19. The encouragement of small businesses and new businesses - which are so vital a source of enterprise, innovation, and new jobs - has been a central theme of Government policy. And the rate of business ^{formation,} start-ups, ^(with n, with out) which has averaged 500 a week, ^{not of failures,} since 1979, ~~net of those which fail,~~ shows beyond any doubt the continuing vigour of this sector.

G20. Last year, I enabled small businesses to opt for cash accounting for VAT, to help with cash flow problems, and for annual accounting, to ease the burden of

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~~form-filling. These measures have been widely welcomed, and I have no changes to propose this year. But I shall, as usual, be increasing the VAT registration threshold so that it remains at the maximum permitted under European Community law. In 1988-89, the threshold will be £22,100.~~

13
G21. Many new businesses have been greatly assisted by the

~~G21. Many new and growing businesses used to find difficulty in raising equity finance. The Business Expansion Scheme, which we devised to meet that need, has now been running for nearly five years. It has been a great success, enabling new and expanding companies to raise £150 million a year, on average.~~

Very successful business

Busy Nat time

It has enabled equity finance to be raised, in volume, of

14 However,

~~G22. The rapid growth of the venture capital market since 1983 means that companies seeking relatively large amounts of equity investment can now raise these readily, but smaller companies looking for more modest amounts can still run into difficulties.~~

while

find it difficult to do so.

15

~~G23. To improve the targeting of BES, I therefore propose to introduce a ceiling of half a million pounds on the amount a company can raise under the scheme. Investment will thus be better directed at the smaller enterprises and new businesses, particularly those at local level, which can still find it hard to raise finance in other ways. In the special circumstances of the shipping industry, however, the ceiling will be £10 million.~~

any
showed

(new and initiatives)

of England

outside the South-East

equity

£5

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¹⁶
G24. This measure is expected to save some £25 million a year.

¹⁷
G25. I have one further announcement affecting the ~~BES~~.
Business Expansion Scheme.

¹⁸
G26. One of the key reasons for our economic transformation has been the reform of the supply side of the economy.

¹⁹
G27. As to the labour market, there is still some way to go. The tax relief I introduced last year for profit-related pay will, in time, help to increase pay flexibility. But if successful firms are to expand further, and if we are to build on the substantial reductions in unemployment, we have to ensure that people can move to where the new jobs are.

²⁰
G28. For years, the shortage of private rented accommodation has been an obstacle to labour mobility.

~~There have been increasingly frequent complaints from employers in the Midlands and the South that they can recruit the skilled workers they need from, for example, the North East, but that these workers cannot then take the jobs, because they cannot find suitable accommodation for their families.~~

~~G29. The Government's proposals to deregulate new rents are already going through the House. In future, any~~

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landlord will be able to let on the assured tenancy basis, at market rents, but with security of tenure protected.

²⁰ G30. Deregulation will, ~~in due course,~~ ^{over time, substantially} ~~itself~~ increase the supply of housing for rent. But this will not happen overnight, and there is a case for a special incentive to speed up the process in the early years.

²¹ G31. I therefore propose to extend the ~~BES~~ ^{Business Expansion Scheme} to include companies specialising in the letting of residential property on an assured tenancy basis.

²² G32. The BES is well suited to this ~~area.~~ ^{task.} Since full ~~tax~~ relief is given immediately, it should bring forward new investment straightaway, meeting the objective of stimulating interest in the early years. And we are building on success.

²³ G33. I ~~have decided to provide~~ ^{The} a higher ceiling ~~of~~ ^(will be 25 million, as for shoppping) £10 million for this type of investment. But since the relief is specifically designed to provide an extra stimulus in the early years of the new regime, it will run ^{only} for investments made ^{before} until [April 1993]. The cost will depend on take-up, but may be some £40 million a year.

Shd be Shop Chanting, I suspect, w/ shopp

IR are putting up a note on the precise time period.

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²⁴
G34. This change will reinforce the impact of deregulation, in reviving the private rented sector in this country. *of housing*
Britain.

G35. The measures I have announced will add to the attractions of Britain as a place to do business, for firms large and small. It is up to businesses to continue to take full advantage of the opportunities that they now have.

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²⁷
G35. Lastly, on the small business front, I propose to increase the VAT threshold to £22,100, the maximum permitted under existing European Community law.

insert G14 - G18 (inclusive)
here.

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last year

A. ^{G25.} In last year's Budget I ~~raised~~ ^{raised} the ceiling for Capital gains tax retirement relief from £100,000 of gain to £125,000. But I still do not believe that is sufficient to help the small businessman whose entire wealth is tied up in the business and who is faced with a heavy Capital gains tax bill when he sells up on retirement. I therefore propose to extend the relief so that, on top of the exemption, half of any gain between £125,000 and £500,000 will also be completely free of tax.

G26.

B. While on the subject of Capital Gains Tax, I propose to extend rollover relief to a group of assets whose only ~~common~~ characteristic in common is that none of them exists when the last of qualifying assets was drawn up. They are milk quotas, potato quotas [do they exist?], satellites and spacecraft. I know that this will be warmly welcomed in the farming and extra-terrestrial communities alike.

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H. **COVENANTS AND MAINTENANCE**

H1. I turn now to an important area of personal taxation which is ripe for reform and simplification: the taxation of payments made under deeds of covenant and maintenance ~~payments.~~ *agreements.*

Chantys apart,

H2. *Chantys apart,* These payments are simply particular ways of transferring income from one person to another. Most transfers take place within families - *housekeeping* - ~~pocket~~ money from a *husband* parent to a *wife,* child, for example - and are rightly and properly wholly outside the scope of the tax system. But, over the years, the Inland Revenue has been increasingly brought into this area, for reasons which have little to do with logic and much to do with history and accident.

H3. This involvement of the Revenue in transactions which, in principle, should be none of their concern has introduced a new knot of complexity, much of it quite unnecessary, into the tax system. The reforms I am proposing today will greatly simplify all this; will remove some lesser-known, but nonetheless *(unacceptable of being unjustified)* offensive, tax penalties on marriage; will reduce the burden of tax on those recipients of maintenance least able to bear it; will reduce the pressure on the Courts; and will improve the incentive to work both for students and for separated and divorced *wives.* women.

bring to an end a method of tax relief for the better off than can no longer be justified; will

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Can this be justified? Will not the courts award less if it is tax-free?

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Which will be wholly unaffected by changes I am proposing today,

H4. First, covenants. With the exception of covenants to charities, I propose to take all new covenants made on or after today out of the tax system altogether. Those receiving these payments will not be liable to tax on them and those making the payments will get no tax relief on them. The tax treatment of Existing covenants will be ~~unaffected~~ ^{untouched} by this change. continue unchanged.

H5. The largest group of people affected will be students, and their parents, many of whom currently choose for example, to make their contributions to the maintenance grant by covenant. As I have already, Those who have already made such covenants will continue to benefit from them. For students who begin their studies in the next academic year, the parental contribution to the maintenance grant will be assessed on a new, more generous, scale, reflecting the withdrawal of the tax relief on new covenants. My right the Secretary of State for Education and Science will be announcing the new scale later today.

H6. This reform will remove a wholly unnecessary complication from the tax system. Making the deed of covenant, and filling in the Revenue's forms, took much time and effort for the taxpayer and student alike; and a technical mistake could render the covenant legally void, and deny the recipients their tax relief altogether. The procedures were complicated and wasteful: local authorities had first to compute parental income for the means tested grant; then

H5A
There will be no compensation for the loss of tax advantage in other cases - the grandparents, for example, about to pay a grandchild's school fees. But once with of income tax are set at reasonable levels, this is precisely the sort of tax shelter it is right to ~~allow~~ displace with.

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restrict ~~the student grant~~ accordingly; parents then made their covenants; the Revenue checked the student's income; then, finally, on receipt of the necessary claim forms, sent the tax repayments to the students.

H7. It would be difficult to devise a more convoluted way of getting money in to the hands of students.

H8. My proposals sweep all these complications away, but retain the same overall level of support for students. They also greatly improve students' incentives to take part-time or holiday jobs; ~~soon~~ ^{for}, when the old system has run out, no student will find that his or her personal allowance has all been used up by covenanted income so that tax has to be paid on the first pound of income he or she earns.

H9. Similar considerations apply to maintenance payments. The present arrangements are complex and cumbersome, and mean that the Revenue have to send tax returns to divorced and separated people whose tax affairs would otherwise be very simple. Again, there is no reason in principle why the tax system should be involved in the making of these transfers of income other ^{at all,} than to recognise the expense of maintaining two households, where a marriage breaks down. ~~The single allowance when the marriage has broken down.~~

except as far as is necessary to compensate the payer for the reduction in his tax threshold from the married to the single allowance when the marriage has broken down.

H10. So I am proposing that in future ~~ex-wives or husbands~~ ^{separated or divorced spouses} receiving payments under maintenance agreements

They won't be 'ex' if they are separated but not divorced

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will not have to pay any tax whatever on them.

~~Ex-husbands or wives~~ ^{Those} making these payments will, on the

other hand, get tax relief on the payments that are made,

^{but only} up to a limit equal to ^{the difference between the married} [the married couple's allowance].

^{allowance - the single allowance.}

~~But, above that limit relief will stop, and there will no~~

longer be tax relief at all for ~~other kinds of~~

~~maintenance payments.~~ ^{other than to separated or divorced}

^{spouses.}

H11. This new system will be much simpler for all

concerned. It will reduce the tax burden of those who

are least able to bear it, since the great majority of

those who receive maintenance payments, and who will be

wholly relieved of tax on these payments, are at the

lower end of the income scale; and because ~~I have set~~

limit on tax relief for payers ^{is sufficiently high to ensure} ~~at a level which will mean~~

that the great majority of payments to divorced or

separated spouses will continue to enjoy tax relief.

H12. These changes will also remove ^{one of the lesser-known} tax penalties on

marriage, ~~which have given offence to many.~~ ^{For tax} Tax relief

greatly in excess of that which is available to a married

couple will no longer be available to a divorced couple

who make very large income transfers between themselves;

~~nor will it be possible to make artificial tax-relieved~~ ^{tax-efficient}

transfers to ^{minor} ~~their~~ children ~~under 18~~ - a ^{device} privilege at

present available to the ^{unmarried} ~~non-married~~ but not to the

married.†

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H13. The ~~new~~ provisions will protect people who are either making or receiving payments under existing Court Orders or agreements. The same protection will run for people who have already applied for Court Orders, provided these are made by 30 June.

H14. My proposals on covenants will ~~bring a tax yield of~~ £25 million in 1988-89 ~~rising to~~ ^{and} £85 million ~~the~~ ^{in 1989-90.} following year. The additional expenditure on student grants will be £X million in 1988-89 and £X million in the following year. My proposals on maintenance payments should be [revenue neutral] [bring a small yield in 1988-89 and 1989-90].

X

As I have already indicated,

H15. Covenants to charities will be entirely unaffected. ^{by these changes, which concern covenants between individuals.} Indeed, I have a new measure to help charities further.

The payroll giving scheme has now been running for nearly a year. I am glad that so many employers have already set up schemes, and I hope as many employees as possible will take advantage of them. In order to give further encouragement to charitable giving, and to assist the growth of the payroll giving scheme, I propose to double the limit on tax-allowable donations under the scheme from £10 a month to £20 a month.

Essentially

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(1 then 26 is less over a year was)
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J. TAXES ON SPENDING

J1. I now turn to the taxation of spending.

~~J2. The rate of Value Added Tax in 1988-89 will remain at 15 per cent.~~

~~J3. I have one change to propose affecting the coverage of VAT. Confectionery was brought in to VAT by the RHM for Leeds East in 1974, and the legal definition goes back further still to the days of purchase tax. It has worked less and less well over the years, as new products have come on to the market. In particular, recent cases before VAT tribunals ^{have} appeared to suggest that some chewy cereal bars ~~are~~ subject to VAT, whereas hard cereal bars ~~are~~ not. I propose to clarify the ^{law} legislation so that both types are taxed. [Anything further on spectacles?]~~

³
J4. I propose to raise the excise duties as a whole [broadly in line with inflation] but to make some modest adjustments within the total. The duty on cigarettes and hand-rolling tobacco will be increased, by the equivalent, including VAT, of three pence for a packet of 20 cigarettes. This will take effect (from midnight on Thursday. The duty on a ^{typical} packet of 5 cigars will rise by 2 pence, but that on pipe tobacco will remain unchanged.

*I have only one further
I have one change to propose affecting the coverage of VAT. Confectionery was brought in to VAT by the RHM for Leeds East in 1974, and the legal definition goes back further still to the days of purchase tax. It has worked less and less well over the years, as new products have come on to the market. In particular, recent cases before VAT tribunals have appeared to suggest that some chewy cereal bars are subject to VAT, whereas hard cereal bars are not. I propose to clarify the law legislation so that both types are taxed. [Anything further on spectacles?]*

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"fourpence" etc
old be one
word.
AHH

4
J5. As to the alcohol duties, I propose increases which, including VAT, will put a penny on the price of a pint of beer and cider, ^{four} 4 pence on a bottle of table wine, and ^{six} 6 pence of a bottle of sparkling wine. There will be no increase in the duty on ~~spirits and~~ fortified wines ^{and} ~~and~~ ^{spirits.}

When do
the changes
in goods
duties
take
effect?

5
J6. Drinks known as 'coolers', which are mixtures of an alcoholic drink and a soft drink, have become more popular in recent years. The existing duty structure caters satisfactorily for products based on wine, but discriminates ^{not for} against those based on beer ^{or?} and ^{and lower} spirits. I propose, therefore, to introduce a new duty band for these low strength products. I ~~also~~ propose to abolish the minimum duty charge on beer, which will reduce the duty on beers with a low alcohol content.

To encourage
the young in
particular to
choose them
in preference to
more alcoholic
beverages.
For the same
reasons.

6
J7. I propose ^{once again} to leave the main rates of Vehicle Excise Duty unchanged. But I shall be introducing a new special tax class for a small category of very large and heavy vehicles. These juggernauts cause a ^{substantial} significant amount of wear and tear on the roads, but currently pay a concessionary rate of duty. The excise duty for these vehicles will go up ^{from £130} to £1600 this year, ^{and will rise again} from ~~£130~~, and next year to a level which corresponds with the maximum rate of duty paid by other heavy goods vehicles. There will also be some minor adjustments to the rates of duty within the HGV classes.

Why
a concern
rate?

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7
J8. To recoup the revenue forgone by holding VED steady, ^(Excise Duty)
I propose increases in petrol and derv over and above ^(the rate of inflation) revalorisation, which, including VAT, will raise the price of petrol by about ^{six} 6 pence a gallon, and that of derv by ^{five} 5 pence a gallon. ^{These changes will take effect from 6 o'clock tonight.}

J9. It is clear that more widespread use of unleaded petrol can only be of benefit to the environment. Unleaded petrol costs more to produce than leaded fuel and this is reflected in the pump price.

J10. To encourage wider use of unleaded fuel, I therefore reduced the duty on it by five pence a gallon, in my Budget last year. This went some way to offset the higher production costs. I now propose to complete the job, and to double the duty differential between leaded and unleaded petrol to 10 pence, by simply exempting unleaded petrol from this year's duty increase. This means that the pump price of unleaded petrol should be no more than that of ordinary 2 star petrol. This removes the bar to the use of unleaded petrol. I hope the petrol companies will respond by promoting it as it deserves.

J11. The changes on road fuels will take effect from 6 o'clock tonight.

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39%
In my budget last year, I sought to promote the use of lead-free petrol, with all the environmental benefits it brings, by introducing a duty differential in its favour. Despite this, consumption of lead-free petrol remains disappointingly low. According to reports, I propose to double the duty differential.
Unleaded petrol is the equivalent of 2 star, but not marketed as such.

In its favour by exempting it from the duty increase announced for lead petrol. This higher production cost should be reflected in the pump price of unleaded petrol. It is now up to the petrol companies to make effective use of unleaded petrol. I have done this to.

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K. ~~OWNERSHIP~~ TAXES ON CAPITAL

Emergence of the Capital-owning Democracy

K1. The spread of ownership has been one of the most remarkable features of the 1980s. Encouraged by Government policy, some 2½ million families have bought their homes. And our new proposals for personal pensions, which come in to effect in July, will give a new dimension to pension ownership.

K2. But the most dramatic change has been in share ownership. In last year's Budget, I announced the results of a joint Treasury/Stock Exchange survey of the number of shareholders in this country. This revealed that some 8½ million people - one adult in five - owned shares, about three times the number in 1979.

K3. A similar survey has been carried out this year. *In spite of* the stories of people *taking quick profits* on privatisation shares, and *in spite of* the stock market collapse, the *results* show that the number of *individual* shareholders has *actually* risen slightly, to *very* nearly 9 million.

(to encourage share ownership further)

K4. I have two proposals to announce today.

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K5. First, Personal Equity Plans are off to a successful start. Over a quarter of a million people took out plans in 1987, and subscribed nearly £½ billion between them. To give further encouragement to this form of investment, I propose to increase the limit for 1988 from £2,400 to

Annual ~~will apply to this~~
The new higher limit will apply retrospectively from 1 January this year.

K6. Second, measures to encourage employee share ownership have featured in seven out of the last eight Budgets. As a result, the number of all-employee share schemes approved under the 1978 and 1980 Finance Acts has risen from 30 in 1979 to over 1400 today, involving well over 10,000 companies, and providing shares and options for well over 1½ million employees. ~~The shares and options had an initial market value of nearly £3 billion.~~

K7. Following *extensive* consultation, I propose to relax the provisions of Section 79 of the 1972 Finance Act, relating to employee shares obtained outside the approved schemes, so as to encourage the spread of these schemes.

a bit cryptic

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K 8. I have already, in previous Budgets, substantially reformed the taxation of capital, with the replacement of Capital Transfer Tax by Inheritance Tax. But I believe this process can and should be taken further.

Last year I reduced the rates of tax from seven to four: this year I propose to simplify the tax still further by levying it at a ~~single~~ flat rate of 40 per cent.

K 9. At the same time I propose to raise the threshold for inheritance tax ~~to~~ ~~£20,000~~ ~~to~~ ~~£7~~ from £90,000 to £110,000.

K 10. The increase in the threshold will reduce

the number of estates liable to tax by a quarter, allowing many more people to ^{inherit} ~~inherit~~ ~~their~~ ~~property~~ ~~tax~~ ~~free~~ ~~of~~ ~~tax~~. ~~And the flat rate of 40 per cent~~

means that ^{for} the family business, ~~which~~ enjoying 50 per cent business relief, the effective rate of tax ~~can never exceed~~ (20 per cent, one of the lowest rates in the industrial world.

K 11. The inheritance tax reforms will cost £100 million in 1988-89.



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K 12. Lastly, Capital Gains Tax. Strictly speaking, this should not be a tax on capital ~~at all~~ as such at all. Nor is it, so far as gains ~~wjix~~ arisen since 1982 are concerned, which have ~~arisen since 1982~~/thanks to the indexation provisions introduced by my predecessor in ~~1962~~ 1982, ~~and~~ as extended in ~~my~~ 1985 Budget.

K 13. But ~~the absence of indexation prior to 1982~~ with gains that arose prior to 1982, the tax falls ~~on~~ largely on purely paper profits resulting from the ~~rapid~~ rampant inflation of the 'seventies. In other words, it bites deeply, and capriciously, into the capital itself.

K 14. This ~~has~~ long been recognised as manifestly unjust. Indeed, from the time I first entered this House I have argued that Capital ~~Gains~~ Tax should fall only on real gains, and not on inflation-induced paper gains. ~~I~~ I have therefore looked hard to see if the indexation provisions could be ~~backdated~~ applied right back to the inception of the tax in 1965. Unfortunately, they cannot. The necessary information is ~~in~~ in many cases no longer available.

K 15. Accordingly, I have decided to bring the base date for the tax forward from 1965 to 1982. That is to say, for all disposals on or after 6 April, any capital gain arising before April 1982 will be exempt from tax altogether, for individuals and companies alike.

K 16. This Budget thus ends once and for all the injustice of taxing inflationary gains. It will also ~~benefit~~ benefit the economy by unlocking assets which have been virtually sterilised because of the penal tax that would have arisen on any sale. And it will help ^{many} small businessmen and farmers in particular.

K 17. At the same time, it is necessary to review the size of the annual



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exempt slice. This currently stands at the relatively high level of £6,600, largely as a result of the substantial increase enacted by my predecessor in 1982, explicitly as ~~an~~ ^{partial} rough and ready/compensation for continued taxation of ~~inflationary~~ pre-1982 paper gains. I therefore propose ^{*}/not yet finally decided/. It should also be borne in mind that, with the introduction of independent taxation in 1990, a ~~husband~~ husband and wife will each have their own exempt slice.

more
over

acquisition and disposal since 1965. And in many cases, that information is simply not available.

L4. I have therefore decided that, for disposals on or after 6 April this year, capital gains arising before April 1982 will be exempt from tax altogether, for both individuals and companies.

L5. Taxpayers will, however, be able to use the actual acquisition cost of an asset, if that is higher than its 1982 value and thus produces a smaller gain. So there is no question of taxpayers' losing from this measure.

L6. This Budget therefore ends once and for all the injustice of taxing inflationary gains. It will thus enable taxpayers to realise investments that they have been forced to retain because they faced a high tax bill.

K18. Rebasing the tax so as to produce a fully indexed system, makes it possible.

~~L7. Rebasing capital gains makes it easier to bring the taxation of gains closer to that of income. In logic,~~

In principle,

~~there is little difference between income and capital gains. Taxing them at different rates encourages people to base investment decisions on tax considerations, rather than economic ones. And it has lumbered the economy with much of the deadweight of a tax avoidance industry.~~

[It has also tended to produce a bias in favour of capital gain and against income which is not conducive to a healthy capital market.]

And, moreover as there is a difference, it is by no means clear why one should be taxed more heavily than the other.

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K 19. L8. I therefore propose a major reform. Subject to the new base date, capital gains will continue to be worked out as now, with the present exemptions and reliefs. *(In particular, the* principal private residence will remain tax-free, *and the* annual exempt amount will remain at its present level of £6,600. But the indexed gain will then be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income.

X *K 20.* L9. At present, with capital gains taxed at 30 per cent for everybody, *(the system purports to tax)* basic rate taxpayers are taxed ~~more~~ *(Capital & Investment)* heavily on gains than on income, whereas higher rate taxpayers face a lower rate of tax *(on gains.)* ~~There is a contrast~~ *Thus contrast is hard to justify. In future, the* on income and gains will be the same. And I can reassure *rate of tax on income & capital gains will always* Hon. Members who are anxious to know what those rates *be the same.* will be that they will not have to contain their impatience much longer.

K 21. L10. These changes will not take effect until 6 April.

K 22. L11. Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is what we do already for companies. And it is ~~already~~ *also now* the practice in the USA and many other major countries. *United States, even without the indexation.* Investors will no longer waste so much time on tax planning.

L12. The saving on tax planning will be of particular benefit to small businessmen, who will be able to

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concentrate their energies on the real job of making profits. I have one other CGT measure that will help them further.

L13. Capital gains tax can be a fairly heavy burden when someone sells up on retirement, and this can be a disincentive to the entrepreneur. At present, retirement relief exempts the first £125,000 of the gain from tax. I now propose to extend it so that, on top of the exemption, half of any gain between £125,000 and £500,000 will also be completely free of tax.

L14. I also propose to extend CGT rollover relief to a group of items which, I venture to suggest, will not be grouped together in any other context. They are satellites, spacecrafts, milk, and potatoes.

Worth some kind of joke, though maybe not this.

K 23. L15. The changes I have announced, taken as a whole, represent the ~~biggest~~ ^{a thoroughgoing} reform of capital gains tax ~~since its introduction in 1965.~~ ^{which will benefit the economy and eradicate a major injustice.} They will sharply reduce the damaging effects of the tax, while ensuring that capital gains remain properly taxed, ~~and the yield of income tax is adequately protected.~~ ^{and the yield of income tax is adequately protected.}

K 24. ~~L16. Allowing for likely behavioural responses to these changes, the overall effect is expected to be an additional yield of £45 million in 1988-89, and a cost of £290 million in 1989-90.~~ ^{They are expected to} ~~The cost is a measure of~~ ^{in this case is a measure of the tax that should have been given a first place.}

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L N. **INCOME TAX**

1 turn 15

N1. Finally, income tax.

N2. I have followed with interest the press speculation about the size of the so-called giveaway that would come in this Budget, through lower taxes in general, and lower income tax in particular. Of course, the Government has no money of its own to give away. Any tax reductions are a question of taking less.

N3. There has also been ~~a lot of speculation~~ *much discussion* about the trade-off between tax cuts and public spending increases. There is no such trade-off. The plain fact is that if you have a successful economy, you can, over time, have both. And if you have a feeble economy, you can have neither.

N4. The way to a strong economy is to boost incentives and enterprise. And that means keeping income tax as low as possible.

N5. Income tax has been cut in each of the last six Budgets - [the first time this has ever occurred.] And the strength of the economy over that period speaks for itself.

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N6. However, reforming Income Tax is not simply a matter of cutting the rate. I also have to look at all the various allowances and reliefs to check that they are still justified.

N7. With this in mind, I have a number of proposals to announce.

FORESTRY

N8. First, the present tax treatment of forestry has been very widely criticised. It enables mostly top rate taxpayers to shelter other income from tax by offsetting it against losses from forestry, while the proceeds from the eventual sale are effectively tax-free.

N9. This is a misuse of the tax system. But I am satisfied that special features of forestry - including the gap of up to 100 years between planting costs and the income from felling - mean that simply taxing it like any other business would create major problems.

N10. I therefore propose to take commercial woodlands out of the tax system altogether. As from today, subject to transitional provisions, expenditure on these woodlands will not be allowed as a deduction for income tax or corporation tax. And receipts from the sale of trees or timber will not be taxed.

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N8. First, forestry. Given the special characteristics of forestry, including a gap of anything up to ~~100~~ ^{a hundred} years between the costs of planting and the income from selling the felled timber, I accept that some special tax treatment is warranted.

N9. But the present system is not. It has been said that it encourages the wrong people to plant in the wrong trees in the wrong places. Whether that is so or not, what it certainly does is enable ^{mostly} top rate taxpayers to shelter their other income from tax, by setting it against forestry losses, while the proceeds from any eventual sale are effectively tax free. Indeed a whole industry has grown up to provide this ~~tax avoidance~~ particular form of tax avoidance.

N10. The time has come to bring it to an end. I propose to do so by the simple expedient of taking commercial woodlands out of the ~~income and corporation~~ tax system altogether. That is to say, as from today, receipts from the sale of trees or felled timber will not be liable to tax. But, equally, subject only to transitional provisions, expenditure on commercial woodlands will no longer be allowed as a deduction for income tax or corporation tax.

N11. It is, perhaps, a measure of the absurdity of the
public system that ~~the~~ the complete exemption of the
forestry industry ~~from~~ from tax will, on time, produce
a yield of at least £10 million a year.

N12. But ~~to~~ in order to further ~~promote~~ the
Government's objectives for ~~the~~ the rural areas,
I have agreed with my Rt hon Friends with
responsibilities for forestry that there shall be a
parallel increase in planting grants. Full details of
the new grant scheme will be announced next
week.

N13. The net effect of these changes will be to end
an unnecessary, ~~obscure~~ ^{obscure} form of tax avoidance;
~~a major~~ ~~source~~ ~~of~~ ~~the~~ ~~tax~~ ~~system~~; to simplify
the tax system, abolish the archaic Schedule B in
its entirety; and to enable the Government to secure for
the forestry objectives with proper regard for ~~environmental~~
environment,
~~environmental~~ ~~and~~ ~~to~~ ~~achieve~~ a better balance between broad-
leaved trees & conifers.

N. 14. Next, benefits a kind - perhaps better known as perks. ~~One of the~~ One of the biggest tax-induced distortions in the economy today is the ~~growing~~ growing tendency to provide remuneration a kind rather than in cash. ~~It is~~ ~~clear~~ ~~that~~ ~~you~~ ~~to~~ ~~make~~ ~~a~~ ~~significant~~ ~~step~~ ~~it~~ must be right to move towards a system of lower taxes ^(all round) fewer tax breaks of this kind.

N 15. Far and away the most popular widespread benefit a kind is the company car, which remains massively undertaxed. Independent studies, based on figures supplied by the AA, suggest that a typical company car, such as a 1.6 litre Sierra, is worth at least £3000 a year to the employee. [Is it really? This seems v. high. Not justify.] But the scale change on which the employee is taxed is only £700: ^{less than a} ~~one~~ (quarter of the true value).

N 16. ~~The~~ This discrepancy is too great to be allowed to continue. On the other hand, the

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~~N15. This cannot possibly be justified. Indeed, the scale of the undertaxation is so great that it cannot be put right in a single year. But in a Budget when I am able to reduce tax rates, there is a strong case for a step change in the taxation of these benefits. I therefore propose to double the car scales for 1988-89.~~

~~N16. This increase subsumes the 10 per cent increase which I had already announced for 1988-89. [For 1989-90, I propose a further increase of 10 per cent, bringing the total extra yield from cars to £280 million. Even with these increases, the benefit will remain undertaxed.]~~

17
N16A. As I have indicated, even this large increase in tax will leave no benefit from company cars significantly undertaxed. It will therefore be necessary to return to this in future years.

~~N17. The scales for the taxation of car fuel adequately reflect the value of the benefit, and I propose to leave them unchanged. [But, for simplicity, I propose to exempt car parking benefits from tax. Most are in practice already exempt on de minimis grounds.]~~

just as they are on remuneration or cash.

19
N18. In principle, everybody should pay tax on benefits in kind. But for practical reasons, most benefits are taxed only on directors, and employees whose earnings, including benefits, are above £8,500. This threshold has remained unchanged for many years. In the special circumstances of this year, a modest increase is justified. Otherwise, tens of thousands of people, on well below average earnings, would be taxed on their benefits for the first time, as a result of the higher scale charge for cars. I therefore propose to increase

(be liable to)
reasons of administrative convenience.
those
(with no car scale charge)
be satisfied with a substantial increase in their tax liability as they cross the threshold for the first time.

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the limit to £10,000. I don't intend to increase it again.

The cost of this concession will be £50 million in 1988-89.

N 19. ²⁰ ~~Provision~~ [Car parking - still to be done - will go here] mortgage interest relief. This Government is committed to no further spread of home ownership.

Mortgage interest relief has an important role to play in achieving that aim, and will ~~continue~~ continue in place, against both the basic and higher rates of tax.

N 20. ²¹ ~~In addition to the more~~ ~~the~~ ~~residence~~ ~~based~~ ~~1~~ ~~have~~ ~~already~~ ~~announced~~, which will remove the most widely-visited tax penalties on marriage, I have set simplification and reform to progress in this connection.

N 21. ²² The simplification is to bring to an end, for new loans only, relief for the purchase of a home for a dependent relative or a divorced or separated spouse. This will make little practical difference, since relief will still be available if the relative or spouse makes the payments directly; but it will usefully simplify the administration of the system.

N 22. ²³ The reform I have in mind concerns the parallel tax relief for home improvement loans. Most of these ~~loans~~ ~~are~~ loans are for fittings such as double glazing, and have ~~been~~ ~~played~~ played a significant part

in the recent growth of consumer credit. This may be partly due to the substantial scope for abuse, as loans ostensibly taken out for home improvements are used for other purposes, a matter which was the subject of a recent report from the Public Accounts Committee.

N 23. ²⁴ I propose, therefore, to end tax relief for all new home improvement loans taken out after 5 April.

^{EXISTING} Existing home improvement loans will be unaffected.

This is expected to yield £80 million in 1988-89 → £200 million in 1989-90.

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25
N24

~~N22.~~ Among the legacies of the years of penal top tax rates is the complicated special relief for large redundancy payments. This is no longer justified. I therefore propose a major simplification, increasing the exemption limit for these payments from £25,000 to £30,000, but abolishing the additional relief for larger amounts. By the same token, top slicing relief for lease premiums and the like will also disappear.

26
N25

~~N23.~~ I have a few changes to propose this year following from the recommendations of the Keith Committee. Most are designed to improve compliance, and to help the Revenue to uncover taxpayers who do not declare all their income, particularly where large amounts of tax are being lost. This measure is expected to yield £10 million in 1988-89, and more in later years. However, I propose a number of relaxations to the VAT enforcement regime, which will make life easier for businesses, while safeguarding tax revenue. Some of the penalties will be reduced from midnight tonight.

27
N26

~~N24.~~ Finally, I turn to income tax itself.

~~N 25. In our~~

~~N25. In 1979, my predecessor announced:~~

~~"Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."~~

~~I have reaffirmed that aim on a number of occasions, and it was a key part of our Manifesto at the last Election.~~

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LONDON SW1A 0AA

~~N 27~~

N ²⁸27. In our general election manifesto last year, we committed ourselves to reducing the basic rate of income tax to 25 pence in the £ as soon as it was prudent to do so. URGENT: LET ME SEE MANIFESTO WORDING This pledge followed a reduction of twopence in the £ to 27 pence in last year's Budget.

N ²⁹28. At the time, this was ~~regarded~~ regarded with ~~some~~ some scepticism, not to say cynicism, by the Opposition, who ~~no~~ no doubt recalled that ~~Labour~~ ^{reduce} Labour Governments ~~reduced~~ tax only in front of an election, and at all other times increase it. Indeed, shortly before last year's Budget the Rt hon Gentleman the deputy leader of the Labour Party said this:

"I must advise the Chancellor of something he already knows: whichever party wins the general election, the tax cuts he makes in this Budget will be reversed."

N ³⁰29. The time has come to put the RHG out of his misery. So far from reversing the 1987 Budget tax reductions, I propose to take this, the first opportunity since the ~~election~~ general election, to fulfil our manifesto pledge. The basic rate of income tax for 1988-89 will be 25 pence in the pound.

N ³¹30. The small ~~companies~~ companies' rate of corporation tax will similarly ~~be~~ be reduced to 25 per cent. This means that the basic rate of income tax, and the corporation tax rate for small companies, will both be at their lowest level since the war.

~~(N29 & N30 deleted)~~

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N30. When they were last in office, the Labour Party introduced, ten years ago, an income tax rate of 25 per cent. It was a reduced rate, which was the marginal rate for less than 15 per cent of tax payers. By contrast, 25 pence in the pound will now be the marginal rate for over 95 per cent of taxpayers.

³²
N31. With the basic rate at this lower level, I am taking the opportunity to simplify the system by abolishing three minor personal allowances which have been unchanged, in cash terms, since 1960: the housekeeper allowance, the dependent relative allowance, and the son's and daughter's services allowances. These are relics of a bygone age, and each allowance is worth, at most, 70 pence a week to a basic rate taxpayer.

³³
N32. Life Assurance premium relief remains in place for policies taken out before the 1984 Budget. It has traditionally been given at half the basic rate of income tax. I therefore propose to reduce it to 12½ per cent. But, to give life offices time to adjust, this change will not take effect until 6 April 1989.

³⁴
N 32A. Ever since the abolition of the Investment Income Surcharge, I have been pressed to abolish the additional rate which applies to the income of discretionary trusts and for certain other purposes. I cannot do that; but I propose to reduce it to 10 p.c.

~~N33. Over our period in office, we have increased the basic income tax allowances by 22 per cent more than inflation, taking 1¼ million people out of tax altogether. For 1988-89, statutory indexation provides for an increase in allowances of 3.7 per cent. I have decided to raise allowances by [twice as much].~~

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35
N 33. I now turn to the tax thresholds. The statutory indexation formula means that I shall increase all the principal income tax allowances and bands by ~~the~~ the increase in the RPI over the year to last October, or 3.7 per cent, rounded up. I propose to do more than that: index ~~the~~ exactly twice as much.

36
N 34. Thus the single allowance will go up not by £90, as required by indexation, but by £180, to £2605; and the married allowance will go up not by £150 but by £300, to £4095. Similarly, the single age allowance will not be £220 to £3180 and the married age allowance by £360 to £5035. The higher allowances for taxpayers ~~over~~ ages 80 and over, which I introduced in the last Budget, will correspondingly be raised by £240 to £360 to £3310 and £5205 respectively, and the ^{new} age allowance income limit will be £10,600. The additional pension allowance and widow's bereavement allowance will thus not be £120 to £1490; while the upper limit of taxable income for the basic rate band ~~will~~ will be increased to £19,300.

~~N34. [This means that the single person's allowance will go up by £180 to £2,605 and the married man's allowance by £300 to £4,095. The single age allowance will rise by £220 to £3,180 and the married age allowance by £360 to £5,035. The higher allowances for taxpayers aged 80 and over, which I introduced in the last Budget, will also be increased by [twice the indexation amounts]. The age allowance income limit becomes £10,600.]~~

³⁷
N35. The increases I have just announced mean that the basic personal allowances will be fully 25 per cent higher, in real terms, than they were in 1978-79, Labour's last year. ^{index} The married man's tax threshold will be at its highest level ^{in real terms} for nearly half a century.

~~N36. Since 1983-84, the number of people paying higher rate tax has increased by over 50 per cent. This damages incentives for middle managers and others at that level of income. I therefore propose to raise the higher rate threshold by just over 10 per cent, to £20,000 of taxable income.~~

~~N37. There has been no cut in the higher rates themselves since that made by my predecessor in his first Budget, in 1979. This removed the worst effects of the absurd rates that had applied under the Labour Government and were penalising enterprise and driving talented and successful people to work abroad.~~

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N 36. I now turn to the higher rates of income tax. It is now some years since my predecessor, in his first Budget in 1979, reduced the top rate of tax from the absurd 83 per cent that prevailed under Labour to 60 per cent, where it has remained ever since.

N 37. ³⁸⁹ At that time, this was broadly ~~unprecedented~~ top in line with the European average for the top rate of tax. It is now one of the highest. And not only do the majority of European countries now have a top rate of tax below 60 per cent, but in the English-speaking countries outside Europe - not only the United States & Canada, but ~~the~~ socialist Australia & New Zealand, too - the top rate is now below 50 per cent, sometimes well below.

N 38. ⁴⁰ The reason for the worldwide trend towards lower top rates of tax is clear. Excessive rates of income tax destroy ~~entrepreneurship~~ ^(encourage avoidance,) & drive talent to more hospitable shores. ~~As a result,~~ so far from raising additional revenue, ~~they~~ ~~less~~ ~~than~~ over time they actually raise less.

N 39. ⁴¹ By contrast, a reduction in the top rates of

N 36. I now turn to the higher rates of income tax.

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N 39. By contrast, a reduction in the top rates of

tax cuts, before long, result in a higher, not a lower, yield to the Exchequer. Despite the substantial reduction in the top rate of tax in 1979, and the subsequent abolition of the investment income surcharge in 1984, the top five per cent of taxpayers today not only contribute X per cent more in real terms than they did in 1978-79, Labour's last year: they also contribute a significantly higher proportion of the total yield of income tax.

N 40. Indeed, even after the changes I am about to announce, ~~the top 5 per cent of taxpayers will still~~ and before the budgetary officials have had time to work through, the top 5 per cent of taxpayers will contribute some 27 per cent of the total yield of income tax, compared with 24 per cent in 1978-79.

N 41. As I have indicated, after nine years I believe the time has come to make a further reduction in the top rate of income tax. ~~Indeed~~ I therefore propose to abolish all the higher rates of tax above 40 per cent.

N 42. This will leave us with a simple system of income tax consisting of a basic rate of

25 per cent and a single higher rate of 40 per cent. And, indeed, a ~~personal tax system~~ system of ~~direct taxation, both personal and corporate~~, personal taxation in which there is no rate in excess of 40 per cent.

N⁴³43. I believe that 40 per cent is a reasonable top rate of tax. But, bearing in mind that the basic rate of tax is also the starting rate of tax, I believe that 25 per cent is still too high.

N⁴⁴44. Since we first took office in 1979, we have reduced the basic rate of income tax from a third to a quarter. Our aim should surely be to get it down to a fifth - a rate of 20 per cent on the pound - as soon as we prudently and sensibly can.

1979, the higher rates now yield almost twice as much revenue in real terms, as they did in Labour's last year, and higher rate taxpayers pay a significantly higher share of the total yield of income tax.

N43. Even after the changes I have announced, the top 5 per cent of taxpayers will still pay around 27 per cent of the total yield of income tax compared with 24 per cent in 1978-79.

N44. We have now reduced the basic rate of income tax from $\frac{1}{3}$ to $\frac{1}{4}$. I do not intend to stop there. My aim now is to get it down to $\frac{1}{5}$ - a rate of 20 pence in the pound - as soon as I prudently can.

N44. Meanwhile, I have today been able to reduce income tax

~~N45. These changes mean that income tax is being reduced~~
at all levels, with increases in both the personal allowances and the higher rate threshold, and reductions in both the basic and higher rates. The tax reduction for a married man on average earnings in 1988-89 will be *with* ~~(nearly)~~ £5 a week. The changes will take effect under PAYE on the first pay day after 14 June. They will cost £00 billion in 1988-89 over and above the cost of statutory indexation.

47
N45.

N46. The total cost of all the measures in this year's Budget, again on an indexed basis, is £00 billion.

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