PO-CH/NL/0361 PART D

SECRET

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PO -CH /NL/0361

PART D

1988 BUDGET SPEECH AND STATEMENT

DD's 25 years N.Agis 24/11/95.

PO -CH /NL/0361
PART D

4-3-88

CLOSED

CONTINUED ON:-

PART E

Your Ref Tony

with compliments We spoke

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: Direct Line 01 - 270
Switchboard 01 - 270 - 3000

032/041/lk

RESTRICTED

FROM: M C REES

DATE: 1 March 1988

MR MICHIE

cc Mr Rawlings
Mr Ralph
SAP H/41

BUDGET LIST: CENTRAL REPROGRAPHIC UNIT, COMMITTEE SECTION AND OFFICE SERVICES

As in previous years the copying and collation of Budget papers requires the addition of CRU, Office Services and some Committee Section staff to the Budget list to assist with the final preparations.

Mr Rawlings feels that this year the following staff will be needed:-

From Monday 7 March

Miss Titmuss) Mrs Rose) Mrs Coles)	CRU	(To handle 1st and 2nd drafts of Budget brief)
Mrs Ebsworth)		(To provide photocopying facilities for the Chancellor's office)

From Friday 11 March

Mr Rawlings) Mr Ralph)	Office Services	(To handle Press Notices etc arriving early for weekend collation)

From Saturday 12 March

Mrs Ashkar) Miss Cushion) Miss Pittman)	CRU

RESTRICTED

From Saturday 12 March

Mr Porteous	)		
Mr Lodge	)		
Miss Fitzsimmons	)	Office Services	(To assist in collation
Mr Wells	)		
Mr Stonehouse	)		of Budget Press Notices
Mr Copeland	)		etc)
Miss Gidman	)		
Mr Edwards	)		
Mr Easey	)		

Mr Payne	)		
Mr Berwick	)		
Mr Sears	)	Private	(To assist in collation
Mr Khan	)	Office	of Budget Press Notices
Mr Hannaford	)	'Volunteers'	etc)

From Monday 14 March

Miss Howard	)	CRU

I should be grateful if you would seek Sir Peter Middleton's authority to these additions to the Budget list.

M C REES

Pg

FROM: MICHAEL GUNTON

DATE: 1 MARCH 1988

MR FOUNTAIN

cc Mrs Lawson
PPS Chancellor - 12/2
Mr Allen
Mr Bush
Mrs Thorpe

MEDIA ACTIVITIES IN NO.11

Following our conversation yesterday may I confirm the dates of media visits to No 11 and the arrangements we discussed.

On Friday, 4 March, a BBC team including production staff and camera crew, probably about five people, will be at No.11 at around 2.30 pm for a 3 pm interview with the Chancellor. Details of names and vehicle (if any) will be sent to you before the event.

On Saturday, 12 March Press photographers and television crews - probably about 20 people in all, will be at No 11 from 10.15 am until about 11.45 am for a photographic session with the Chancellor and his family. They will enter via No 10 as agreed so that they can be efficiently scrutinized by security. Details of those attending will be sent to you on 10 March. You agreed that the power at No 11 will be left on until noon !

On Tuesday 15 March the Chancellor and his family will take part in the traditional walk in St James's Park, leaving No. 11 at about 8.50 am. Photographers will be allowed to film the family leaving and returning to No.11. The route to be taken and the Downing Street filming arrangement have all been agreed with the Cannon Row and St James's Park police.

At around 3 pm the Chancellor and Mrs Lawson will leave for the House with the usual photographic facilities being allowed to press and television. We have agreed with Cannon Row police that all photographers should be in Downing Street before 2.15 pm - when the Prime Minister leaves for the House - or will be held outside Downing Street until after she has departed.

On Wednesday, 16 March the Chancellor will be briefing specialist correspondents at No.11 and giving lunch to some of the Economist editorial staff. Again, details of numbers and names will be given to you beforehand.

On Thursday, 17 March, the Chancellor will be entertaining about six regional journalists to lunch. Their names will also be sent in advance.

On Friday, 18 March the Chancellor will be briefing members of the Sunday lobby at No.11. Time and details will be forwarded to you in due course.

MICHAEL GUNTON

Budget Speech

M. PERORATION

In this Budget, I have reaffirmed the prudent policies which have brought us unprecedented economic strength.

I have announced a radical reform of the taxation of marriage, which for the first time ever will give married women a fair deal from the tax system.

I have eliminated the long-standing injustice of taxing inflationary gains, and ~~[illegible]~~ abolished a fifth tax.

I have radically reformed the structure of personal taxation, so that there is no rate anywhere in the system in excess of 40 per cent.

After an Autumn Statement which substantially increased public spending in priority areas, I have once again cut the basic rate of income tax, fulfilling our manifesto pledge of a basic rate of 25 pence in the £ and setting a new target of 20 pence in the £.

And I have balanced the Budget.

I commend this Budget to the House.

4372/034

RESTRICTED

Alex Pg

FROM: J J HEYWOOD
DATE: 2 March 1988

MR WALKER - IR

cc PS/Chancellor
Mr Culpin
Mr Gunton
Mr Cropper
PS/IR

PERSONAL FINANCE EDITORS ASSOCIATION

The Financial Secretary has agreed to see members of this association on the morning of 17 March to give some on-the-record briefing on the Budget in time for the weekend press.

2. The Financial Secretary would like official support and I would be grateful if you together with perhaps 3 Revenue colleagues could be available. Obviously the areas to be covered cannot be predicted with certainty until after the Budget, but I would suggest that provisionally, Michael Johns, Brian Mace and Michael Cayley might be lined up to attend.

3. Can we touch base on 16 March?

JJH

J J HEYWOOD
Private Secretary

myf

FROM: MISS M P WALLACE

DATE: 2 MARCH 1988

CHANCELLOR

BUDGET DAY: GUEST SEATS AND BOX LIST

We spoke about your choice of guests for the Galleries on Budget day.* I shall now write to invite them all, except of course for Mrs Lawson, Tom and your mother. Do you also want to invite Caroline personally, or shall I drop her a note? And shall I write to Mr Hyde-Thomson, diplomatically reminding him that it would be helpful to know in good time if he cannot make it, or would it be better for Caroline to handle this?

2. We also discussed the Box list for Budget day. Traditionally, this would be:

1. Sir P Middleton
2. Sir T Burns
3. Sir G Littler
4. Mr Anson
5. Mr Battishlll
6. Mr Unwin
7. Mr Scholar
8. Mr Allan
9. Mr Hudson
10. Mr Gray No.10

3. When we spoke earlier I said I thought we would have room for Robert in the box (Michael Scholar sat there last year). I am afraid I had forgotten that Geoff traditionally sits in the box:

* your manuscript on my minute behind

he didn't last year because he was abroad, but this year I understand he will be in London. If you think we should stick with the box list above we could put Robert and John Odling-Smee on the reserve list for gallery seats. But Alex thinks Robert, at least, would not be particularly bothered if he didn't go at all.

MW.

MOIRA WALLACE

RA7.73

BUDGET CONFIDENTIAL

FROM: A C S ALLAN

DATE: 2 March 1988

MR KNOX - CUSTOMS AND EXCISE

cc PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Cropper
Mr P R H Allen
PS/IR

MOTABILITY: POSSIBLE BUDGET STARTER

The Chancellor was grateful for your minute of (?) 29 February. This was discussed briefly at the Overview meeting, where it was agreed that this lollipop should not be introduced this year, but should be reconsidered as a starter for next year.

ACSA

A C S ALLAN

~~Alex~~ Julie
Brilliant
Dave
Julie Alex

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

20-30 mins

Julie 1

Please fix short chats on Tuesday or Wednesday for ~~speak~~ Ch to speak to

2079 ~~Howe~~ phone call (when does he get back from Moscow?

Separately ~~Hurd~~ 273 2559 Sarah.

~~Younger~~ 218 2113.

~~Young~~ 215 5422 Margaret

~~Moore~~ 210 5097

~~Parkinson~~ 215 5038

Alex

PRE-CABINET NOBBLING.

CST - side

X	Howe	You
X	Mackay	You are seeing anyway
X	Hurd	You
	Walker	Noone.
X	Younger	You ?
CST	Fowler	CST
CST	King	CST
CST	Ridley	You are seeing anyway.
X	Young	? CST (But you will need to see him again about cars)
X	Baker	? You (seeing him anyway about student covenants)
	Clarke	CST
CST	MacGregor	CST
CST	Rifkind	? CST (you'll need to see him sometime about students)
	Channon	CST
X	Moore	You ! Cecil
CST	Wakeham	You
X	Parkinson	? CST (unless you'd prefer)

jc12

BUDGET SECRET - TASK FORCE LIST

COPY NO 1 OF 10

From: J ODLING-SMEE

2nd March 1988

MR S DAVIES

cc Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Mowl
Mr A C S Allan
Miss C Evans

NOTIFYING THE PRIME MINISTER ABOUT THE BUDGET

Many thanks for your draft, which I have amended a little, taking account of Mr Scholar's comments and the redraft of the exchange rate paragraph in the MTFS. I would be grateful if Messrs Scholar and Peretz would look closely at this.

2. You told me that Mr Sedgwick suggested that it would be best if this note went to the Prime Minister after we have the February borrowing requirement figures and the Chancellor has decided on the PSBR for 1987-88. I agree, and therefore propose not to put a draft to the Chancellor until next Wednesday or Thursday. Could I ask for comments on this draft by the end of the week?

3. Mr Culpin is planning to submit a draft note on the tax changes in the Budget later this week or early next week. It can then go to the Prime Minister before the MTFS note as it did last year.

J ODLING-SMEE

Draft Minute from the Chancellor to:

PRIME MINISTER

1988 BUDGET: MTFS

I am writing to let you know what I plan to say about the PSBR and monetary policy in the Budget.

Public sector borrowing

2. As you know, the PSBR in 1987-88 is turning out to be much lower than I expected. In the Autumn Statement I reduced my forecast from £4 billion to £1 billion. The results since then have been even better than expected; rather than a borrowing requirement, there will be net repayment of public debt in 1987-88 as a whole. In the eleven months to February there was a budget surplus of [..] billion. Even after excluding privatisation proceeds, there was a surplus of [..] billion, compared with a deficit of [..] billion in the same period of 1986-87.

3. The amount of borrowing in the last month of the year is hard to predict accurately, but it is always considerable. It is, however, likely still to leave us with a sizeable budget surplus for 1987-88 as a whole. My plan is to publish a budget surplus of about £3 billion, which is on the cautious side.

4. The Medium-Term Financial Strategy this year will cover the period up to 1991-92, and for the years 1989-90 to 1991-92 I plan to show the budget in balance - the PSBR at zero. To set the PSBR at zero in 1988-89, however, would require tax cuts of about £7 billion given the buoyancy of revenues. Tax cuts on this scale would run counter to the gradualist approach that we have to economic policy. The package that we have agreed, involving tax cuts costing some £4 billion in 1988-89, is forecast to leave the budget in surplus by

some £3 billion. On current forecasts, I expect to have room for further tax cuts over the MTFS period as long as we stick to our expenditure plans.

<u>Monetary policy</u>

5. The MTFS will, of course, say that our aim is to bring inflation and money GDP growth down over the medium term, and that this requires firm monetary policy supported by prudent fiscal policy. I plan to say that the government attaches particular importance to maintaining a stable exchange rate, notably the rate against the deutschemark.

6. I intend to set a target for M0 growth in 1988-89, with illustrative ranges for later years. As last year, I do not intend to set a target for broad money although its behaviour will continue to be taken into account in the assessment of monetary conditions.

7. M0 growth over the last year has averaged 5 per cent, within the target range of 2-6 per cent set a year ago. The target range for M0 growth in 1988-89 will be 1-5 per cent, the same as the illustrative range for 1988-89 in last year's MTFS. For the future years of the MTFS I shall be publishing the same illustrative ranges as in last year's FSBR.

8. This approach has been discussed with the Bank who are content with it.

9. These proposals give a financial framework for the medium term within which we can make further progress in reducing inflation, and in cutting taxes and public spending as a share of GDP. I would be glad to know if you are content with them.

RWP
Anybody

DORLAND

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FAX

FOR THE URGENT ATTENTION OF **MR RICHARD ALLEN**

PLEASE HAND DELIVER AS SOON AS POSSIBLE.

TO:	RICHARD ALLEN, TREASURY SECRETARY, TREASURY CHAMBER
FROM:	CHRIS HUCKLE
DATE:	4 MARCH 1988
PAGES:	2

DEAR MR ALLEN

ATTACHED IS A REFERENCE LAYOUT FOR OUR SUNDAY EXPRESS POSTER FEATURING THE CHANCELLOR'S ARTICLE.

THE FIGURE ON THE RIGHT OF THE LAYOUT WILL BE A STOCK SHOT OF THE CHANCELLOR HIMSELF.

I WILL PHONE YOU THIS AFTERNOON FOR YOUR COMMENTS.

MANY THANKS FOR YOUR HELP.

YOURS SINCERELY

CHIRS HUCKLE

Ch

I think this is quite striking!

Any objections?

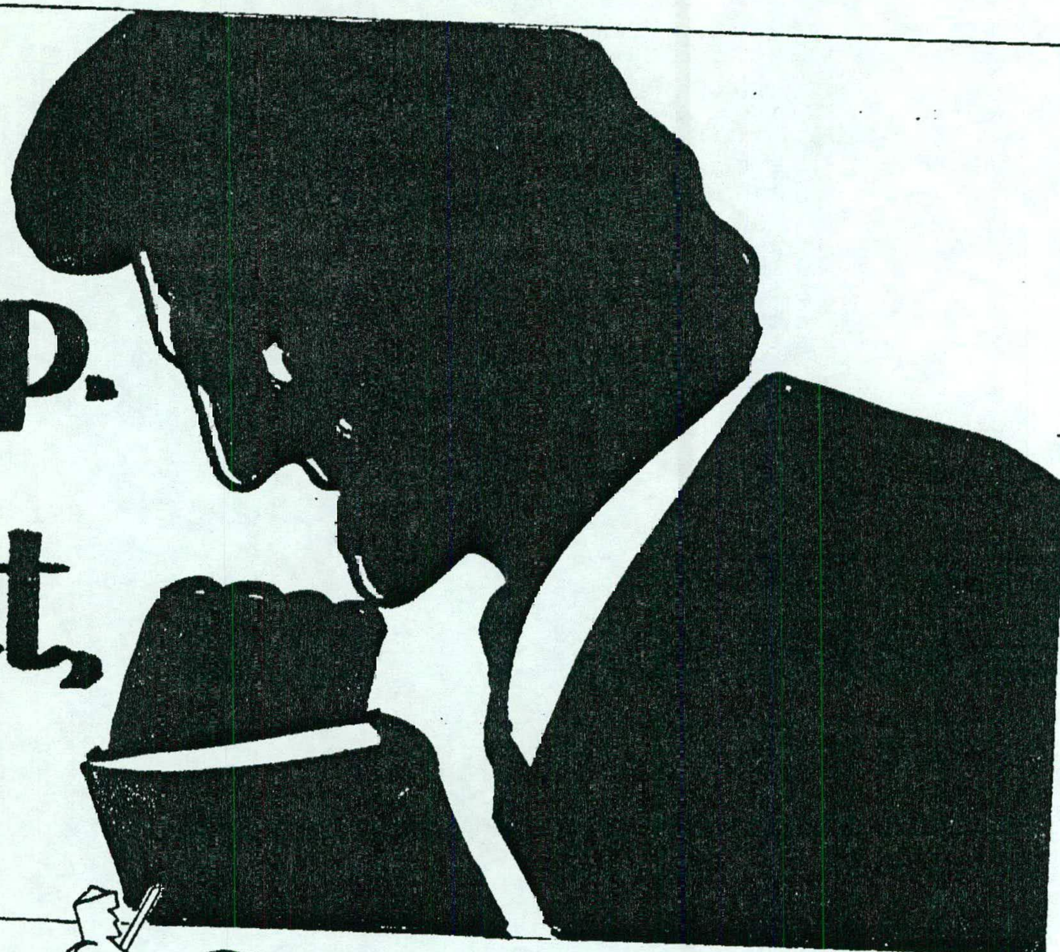
RA

4/3

119/3.

2p or not 2p.

Nigel's budget, by Nigel.



March 20 The budget explained. Exclusive.

SUNDAY EXPRESS

BUDGET CONFIDENTIAL

FROM: A P HUDSON
DATE: 2 MARCH 1988

CHANCELLOR

PARAGRAPH G9

1. You asked whether this paragraph included VAT. The short answer is yes, and I have made that clear.

2. The Revenue had two comments.

3. The simple one is that they say they cannot substantiate the point about abuse.

4. The second is that they say that it was only import agents, not importers generally, who could deduct the cost of entertaining overseas suppliers. The technical point is that relief is available for entertaining an overseas customer. An import agent gets it because the overseas businessman is a customer for his services as an agent.

5. Perhaps we could shorten this paragraph.(!)

APH

A P HUDSON

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

COPY NO 1 OF 33 COPIES

FROM: M C SCHOLAR
DATE: 2 MARCH 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Sir Geoffrey Littler
Mr Anson
Sir Anthony Wilson
Mr Byatt
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Mr Pickford
Mr R I G Allen
Miss Sinclair
Mr Riley
Miss C Evans
Mr Cropper
Mr Tyrie
Mr Call
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr McManus - IR
Mr Unwin - C&E
Mr Knox - C&E
Mr P Allen - C&E

BUDGET SPEECH: THIRD DRAFT

You asked for comments on the tax section of the Budget speech.

2. I think F9 might better begin "Moreover, the new system will start considerably earlier than would have been possible for most of the alternatives that have been canvassed, in particular transferable allowances."

3. In G6, I think it is difficult to mention the changes to the North Sea fiscal regime without mentioning their overall cost, given that it is as much as £55 million in 1989-90. You could put at the end of this paragraph

> "These proposals will cost £55 million in 1989-90; over the life of the fields affected they should be broadly revenue- neutral."

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Alternatively you could use the present FSBR formulation:

"These proposals have a cumulative cost of around £40 million in the first five years, but in the long run they are expected to be broadly revenue-neutral."

I think the latter is better.

4. To soften the announcement of the reduced oil allowance in G5 we might put in a reference to the profitability of these fields. If you agree I will supply some words.

1R

5. To avoid an intervention from Mr Skinner or somebody I suggest that you delete in the first sentence of G19 "there is still some way to go" and run the sentence on so as to read "As to the labour market, the tax relief I introduced last year ..."

6. In G25, second sentence, I would say

"But I am determined to do still more to help the small businessman ...".

7. In G28 you could say "... Development Land Tax, the tax on lifetime gifts, and - today - royalties on new oil and gas fields. I now propose to abolish a further tax: Capital Duty."

8. In G32, ~~second sentence~~ "sizeable" seems a little weak. Could we say "major"?

9. On H3, you told me that the Chancellor has queried the claim that the reforms will reduce the burden of tax on those recipients of maintenance least able to bear it. I have talked to Mr Corlett about this. It is certainly likely that Courts will make smaller awards given that the recipients are freed of the liability to pay tax on them, and that the payers will in some cases be paying tax. But it remains true that the burden of tax will be reduced for these people, and I do not see why we should not make this point. Mr Corlett agrees. The same point applies in H12.

10. In H5, line 3, I don't think we need "for example".

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11. The first line of H6 should I think read "There will be no compensation for the loss of tax advantage ...".

12. In H10, 3 lines from the bottom it might read better if instead of "payer" we had "man paying maintenance".

13. In H11, penultimate line, it might be easier on the listener to add before "maintenance" "for payments above this limit or for".

14. K3, penultimate line, after "risen slightly" add "over the past 12 months".

15. In K8 I think we want 3 lines from the bottom "I have reduced the rate of inheritance tax ...". Then in K9, you could delete "for inheritance tax".

16. In K18 I suggest "economy" rather than "capital market".

17. K20 might go better turned round, with the last sentence softened slightly as follows:-

> K20. At present, with capital gains taxed at 30 per cent for everybody, higher rate taxpayers face a <u>lower</u> -sometimes much lower - rate of tax on gains while basic rate taxpayers can find themselves taxed <u>more</u> heavily on capital gains than on investment income. This contrast is hard to justify. I propose in future to apply the <u>same</u> rate to income and capital gains.

18. In K22, second sentence, begin "It is - since Budget day last year - what we do already for companies". I find the last sentence as drafted rather compressed. Try "And it is now also the practice in the United States, although the American taxpayer does not benefit from either indexation or the annual exempt amount.

19. I have always felt rather uneasy about L2. It seems to me rather commonplace, and not a strong paragraph.

20. In L15, two and three lines from the bottom you want "employee" (twice).

21. In L40, the typist has made a Freudian slip in including "hospital" in line 2. Try "welcoming"?

22. I find the beginning of L42 a little compressed, although I can see why it has been drafted this way.

D. Crave
pp M C SCHOLAR

BUDGET SECRET
BUDGET LIST ONLY

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FINANCIAL SECRETARY TO THE TREASURY

FROM: **J J HEYWOOD**
DATE: **2 March 1988**

MR HUDSON

NB Back pp & look under @ new draft

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

BUDGET STATEMENT: THIRD DRAFT

The Financial Secretary has the following suggestions/comments on this draft.

B 8: The first sentence repeats A4 and could be deleted. the second and third sentences could be added to the end of B6.

B 9: This is a very good story and could easily be beefed up (eg the last clause could be amended and extended to read "after decades of continuous decline under Governments of both political parties. I think this remarkable turnaround in the performance of manufacturing industry is something that all members of the House can applaud").

B10: Delete square brackets (ie keep the bracketed words in the text) and begin last sentence with "The deficit" rather than "This".

B12: Replace "high" with "rapidly".

B15: Last line: isn't this a rather pointless hostage to fortune? If not, replace first line of page 7 with "gradually squeezing inflation out of the system continues to be my central objective".

C 1: Delete square brackets and add "and the major stock market falls of 1987".

C 6: For 1988/89 go for 1-5 per cent range.

D13: Delete "As privatisation receipts reduce, as they are bound to do".

E 6: Start second sentence "I gave companies the lowest tax rate in Europe..."

F 7: Re-draft last sentence to read "But what matters is that for the first time ever married women will have the right to complete independence and privacy in their tax affairs".

F13: Shouldn't the first line contain the words "living together" after "unmarried couple", and the last line contain the word "co-habiting" before "couple"?

G 8: Re-draft second sentence to read "The first meets the only point Lloyd's...". The third sentence should read "The second will benefit both Lloyd's and the Revenue by simplifying...".

G11: Last sentence, insert "anachronistic" before "requirement".

G26: Delete this paragraph - measures already announced and very minor.

K 7: This should mention the fact that the S.79 reform will be of particular benefit to unquoted companies. It might be worth mentioning the other employee share scheme measures (an amendment to the 1984 scheme, and the relief from tax of priority allocations).

K20: Is it worth inserting the thoughts here that most CGT payers are basic rate taxpayers and that with a 27 per cent rate of income tax the reform will reduce the rate of tax for most payers? Perhaps this point could instead be made after the income tax section.

K22: Substitute last clause with "with the big difference that in the US there is neither indexation relief nor a separate capital gains threshold".

L10: Is it worth inserting "but paradoxical" after "simple" in the second sentence?

J J HEYWOOD
Private Secretary

008/4207

BUDGET SECRET: TASK FORCE LIST

FROM: **CHIEF SECRETARY**
DATE: **3 March 1988**

CHANCELLOR

cc:
Financial Secretary
Paymaster General
Economic Secretary
Sir Peter Middleton
Sir T Burns
Sir G Littler
Mr Anson
Sir A Wilson
Mr Byatt
Mr Monck
Mr Scholar
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Mr Turnbull
Mr Peretz
Mr A C S Allan
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 Painte - IR
Mr Beighton - IR
Mr McManus - IR
Mr Unwin C&E
Mr Knox C&E
Mr P R H Allen C&E

BUDGET SPEECH: THIRD DRAFT

I have read the Budget speech which, in general, reads extremely well. I have the following comments:-

B6 This is a real bull point. I would make a little more of it. Thus:"1987 was a real landmark. It was ......"

B13. I would include the first set of words in brackets.

BUDGET SECRET: TASK FORCE LIST

C1 A matter of taste but in a potentially irritable House (where is money for the NHS?) I would not mention the Falklands (Money for war and not for the sick). I would prefer "... take in our stride setbacks such as the coal strike and the collapse in the oil price"

C5 I would include this paragraph.

C8 I would delete the words in brackets.

D4 Another good cheer line. I would draw it out. Thus ...... " ....logical conclusion - this year we have a balanced budget" [It gives colleagues longer to absorb - and respond].

?

D9 The £700 million increase on Health is right but we should reformulate to mention to £1.1 billion we have continually used.

D11 I would include the words in brackets.

D15 This is fun but an arcane point. It will shock the less economically literate Members. Should you therefore make D16 more explicit. Thus:-

D16 "However, the growth of national income and the strength of the economy means that I shall still have some room to reduce tax rates and I shall come to this later."

Colleagues will be reassured by this and I would prefer them relaxed and re-assured rather than edgy during this speech!

D20 Delete words in brackets

E6 E4 notes that reduction of higher rates of personal taxation led to an increased yield. For the sake of symmetry can we make the same claim for company taxes following the 1984 Budget.

BUDGET SECRET: TASK FORCE LIST

F7 I would reverse the sense of the last two sentences.

Thus:-

"For the first time ever, married women will have the option of complete independence and privacy although I recognise that in practice many may still ask their husbands to handle their tax affairs."

But there will be a difference - it will be their choice in future."

Done. **H6** Something wrong in the first sentence!

Redrafted. **H10** Something wrong in the third sentence!

J6 The Excise Duty increase looks wrong. — but it isn't (juggernauts.)

K3 I would add: "This illustrates in a quite remarkable fashion the way in which the habit of share owning is now taking root."

L9 The "wrong tree in the wrong place" remark was used by Gordon Brown in the debate last week. You could attribute it if you wished to be mischievous!

L19 Now to be deleted as no change now proposed in P11D.

L23 Do we want to mention the growth in consumer credit? This sits slightly uneasily with our line that most of the growth is home ownership.

L28 'Soon' is omitted from line 3.

L36 How many people are taken out of tax entirely by the increase in thresholds? If the figure is significant we should mention it.

L43 This is reform as well as tax reduction. Five rates merge into one. I would be inclined to make sure of this - it is a good tale to tell.

This is a landmark budget. We need a peroration that categorises it as such - perhaps as a "Budget of tax reform and reductions" Other ideas will suggest themselves but this point deserves some further thought. My instinct is that it is important that we give it a 'theme' before our opponents do.

Jim Ruth

pp JOHN MAJOR

(Drafted by the Chief Secretary and signed in his absence).

CHANCELLOR OF THE EXCHEQUER

PWP

C.

1. The ~~very~~ latest version of Chs 3-6 the FSBR which FP have is the one sent to the printer, below. This is clean, but has the printers' codes and has the tables detached from the text. If you would prefer your own copies, with your MS amendments, I'll let you have those instead.

2. Ch. 1 below.

3. Ch. 2 with you in folder for bilateral with Eddie.

AGH

29.2.

As sent to printer.

3

μh1μThe economy: recent developments and prospects to mid 1989

μh2μSummary

μ0μμbμ3.01μrμ 1988 should see growth of 3 per cent, the average rate over the last six years, but appreciably below the 4¼ per cent growth in 1987. Inflation is expected to remain low and there are good prospects for a further fall in unemployment.

μh3μAssumptions

μ0μμbμ3.02μrμ The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy. As last year it assumes that North Sea oil prices will average $15 a barrel over the year ahead, and that the exchange rate will remain close to its current level.

μh3μDemand and activity

μ0μμbμ3.03μrμ The economy grew strongly in 1987, with GDP growth of 4¼ per cent and manufacturing output growth of 5½ per cent. Domestic demand grew by just under 4 per cent, the same as in 1986. It is expected to grow at a similar rate in 1988, with slightly lower growth of consumer spending being offset by markedly faster growth of investment. GDP is forecast to grow by 3 per cent (3½ per cent for non-oil GDP).

μh3μInflation

μ0μμbμ3.04μrμ ~~[To be drafted]~~ RPI inflation was just over 4 per cent in 1987. It fell to 3¼ per cent in January 1988, but may edge up to 4 per cent by the fourth quarter of 1988.

μh3μLabour market

μ0μμbμ3.05μrμ Employment has risen strongly over the past year, with unemployment falling by half a million - the largest decline since the war. With non-oil GDP growing at close to 3 per cent during 1988, unemployment should continue to fall.

μh3μWorld economy

μ0μμbμ3.06μrμ GNP in the main industrial economies grew by about 3 per cent last year. Some slackening in growth is likely in 1988 particularly in the United States, and growth in the main industrialised countries in aggregate could ease slightly to 2½ per cent. Industrial production picked up strongly during 1987. Associated with this were faster growth in trade in manufactures and some recovery in industrial materials prices. World trade in manufactures appears to have grown by about 5½ per cent in 1987 and should grow by a similar amount this year.

μh3μUK trade and current account

μ0μμbμ3.07μrμ Both export and import volumes grew rapidly last year: some moderation in growth is likely in 1988. Following recent revisions to the surplus on invisibles the current account is now estimated to have been in deficit by £1 billion in 1987. A deficit of £3 billion (¾ per cent of GDP) is forecast for 1988.

μh2μFinancial conditions

μh3μExchange rates

μ0μμbμ3.08μrμ Sterling has been stable against the Deutschemark over the past year. There was an inflow of $[20] billion into the reserves in the year to February. Following the Louvre accord the dollar remained stable against the major currencies for much of 1987,

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before falling further towards the end of the year. It has risen slightly in the early months of 1988, in the wake of the G7 statement just before Christmas and improved US trade figures.

µh3µInterest rates

µ0µµbµ3.09µrµ Short-term interest rates in the UK fell from 11 per cent at the beginning of 1987 to 9 per cent in July. They rose to 10 per cent in August, but came down again to 8½ per cent in the immediate aftermath of October's stock market collapse. Following the restoration of more settled markets earlier this year short term interest rates returned to around 9 per cent. Longer term interest rates have followed a similar profile to short-term rates, but with smaller fluctuations. In recent weeks they have been around 9½ per cent.

Printer insert Chart 3.1 Interest rates in the UK

µh3µNarrow money

µ0µµbµ3.10µrµ M0 growth, which fell in early 1987, rose rapidly in the summer reflecting lower interest rates. It may move to the top of or outside its target range in the early part of the financial year but should be within the [1-5] per cent range later in the year.

Printer insert Chart 3.2 Growth rates of monetary aggregates

µh3µBroad money

µ0µµbµ3.11µrµ M4, which includes the liabilities of both banks and building societies, has grown at close to 16 per cent over the past year. As in recent years there has been a sharp fall in its velocity.

µh2µWorld economy

µh3µRecent developments

µ0µµbµ3.12µrµ Output growth in the industrialised countries strengthened in the second half of 1987, particularly in North America and Japan. Real GNP in the major seven OECD countries is estimated to have increased by 3 per cent in 1987, marginally faster than in 1986.

µ0µµbµ3.13µr Part of the substantial falls in import prices in 1986 - notably for oil, but also for many other primary commodities - were reversed in 1987. Oil prices recovered from their low point of the summer of 1986, but have weakened a little in recent months. Prices of other industrial materials rose as world activity picked up. Nevertheless, consumer price inflation in the major economies has remained low. In Japan and Germany the appreciation of their currencies meant that inflation was close to zero. But in the US, consumer price inflation rose to 4½ per cent at the end of 1987.

Printer insert Chart 3.3 Real commodity prices

µ0µµbµ3.14µrµ The improved terms of trade for developing countries boosted the exports of the major industrialised countries and helped to strengthen business investment. This more than offset some slowdown in the growth of real personal incomes and in consumer spending. As a result industrial production has been particularly buoyant; output in the major seven OECD economies was over 5 per cent higher in December 1987 than a year earlier.

Printer insert Chart 3.4 Major seven economies' real GNP and industrial production

µ0µµbµ3.15µrµ Equity prices in the US and most other countries continued to rise in the first part of 1987, reaching an all-time high in a number of countries around mid-year. In

large part the subsequent fall in equity prices can be seen as a correction, even though the scale and sharpness of the fall in October were unprecedented. Prompt action by the monetary authorities in the major countries to reduce interest rates and provide sufficient liquidity helped to prevent a major collapse of confidence.

µ0µµbµ3.16µrµ In the United States domestic demand growth, which had averaged 5½ per cent a year between 1983 and 1986, slowed to 2½ per cent in 1987; as a result the growth of import volumes has also slowed. US export volumes are now responding strongly to the massive depreciation of the dollar from its 1985 peak; by the fourth quarter of last year they were 17 per cent higher than a year earlier. These favourable movements in trade volumes were, for much of 1987, offset in money terms by the effects of the dollar's fall. But more recent figures have suggested some decline in the US trade deficit.

µ0µµbµ3.17µrµ A two year phase of relatively slow growth in Japan ended in the spring of 1987 as exports stopped falling and domestic demand picked up sharply. But in Germany both real domestic demand and GNP grew slowly in 1987. The current account surpluses of both Japan and Germany fell slightly in relation to their GNP in 1987, with that of Japan falling rather faster.

µ0µµbµ3.18µrµ World import volumes are estimated to have grown by more than 4 per cent in 1987. This is slightly lower than in 1986, when there was a substantial rise in oil trade as stocks were rebuilt. The growth of trade in manufactures in 1987 - provisionally estimated at about 5½ per cent - picked up substantially, helped by the continued buoyancy of domestic demand in the major seven countries and by increased demand from the rest of the world.

µh3µProspects

µ0µµbµ3.19µrµ Table 3.1 shows the forecast for activity and inflation in the major seven OECD countries, and for world trade. In aggregate real GNP in the major seven countries is expected to grow a little less strongly in 1988 than in 1987, though industrial production should remain buoyant. Inflation is likely to stay low.

Printer insert Table 3.1 World economy

µ0µµbµ3.20µrµ As a result of the continued strength of industrial activity, some further modest rise in non-food commodity prices is expected during 1988. Food prices, however, are likely to be held down by continued over-supply, encouraged by high levels of support in many OECD countries. The forecast is based on the assumption that North Sea oil prices will average $15 a barrel in 1988.

µ0µµbµ3.21µrµ Imports by industrial countries are expected to grow less rapidly than in 1986 and 1987. However, imports by non-oil developing countries will be helped by stronger commodity prices, and hence export earnings. Total world trade in 1988 is forecast to continue to grow at close to the rate experienced in 1987.

µh2µUK trade and the balance of payments

µh3µRelative costs and prices

µ0µµbµ3.22µrµ UK unit labour costs in manufacturing rose only slightly in 1987, at a similar rate to the average in the other major economies, with rapid productivity growth largely offsetting a continuing high level of pay increases. Despite some appreciation of sterling against the dollar the UK's cost competitiveness remains clearly more favourable than in 1984 and 1985 before the fall in world oil prices. The maintenance of competitiveness in the year ahead will depend on success in continuing to restrain unit cost increases.

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Printer insert Table 3.2 The exchange rate and cost competitiveness

µh3µTrade volumes (goods other than oil)

µ0µµbµ3.23µrµ Non-oil export volumes rose by 7 per cent in 1987. Manufactured exports rose particularly strongly, reflecting renewed growth in world trade and the UK's strong competitive position. Non-oil export volumes are forecast to rise in 1988 by a further 5 per cent.

µ0µµbµ3.24µrµ The UK increased its share of world trade in manufactures slightly in 1987. Its volume share has remained broadly stable since 1981, in marked contrast to the previous long-term decline. This improved performance is forecast to continue in 1988.

Printer insert Table 3.3 Visible trade

µ0µµbµ3.25µrµ Non-oil import volumes fell unexpectedly in early 1987, but rose during the rest of the year, and were 8½ per cent higher than in 1986. The increases were widespread with higher imports of materials and capital goods reflecting the strong growth of UK production, stocks and investment. Consumer goods imports also rose in response to the rise in consumer spending. The volume of imports is forecast to rise less rapdily through the year ahead as output growth slows.

Printer insert Chart 3.5 Export shares and import penetration

µh3µOil trade

µ0µµbµ3.26µrµ There was a surplus in oil trade of £4 billion in 1987, little changed from 1986. Higher oil prices and a fall in domestic demand more than offset a decline in North Sea production. In 1988 oil production is likely to decline further and be close to the centre of the Department of Energy's range while domestic demand for oil may rise modestly. The oil trade surplus is expected to fall by £1½ billion, to about £2½ billion

µh3µTrade prices and the terms of trade

µ0µµbµ3.27µrµ The terms of trade, which fell in 1986 as oil prices declined, improved again in 1987 as oil prices firmed and as sterling's appreciation offset some rise in world commodity prices in the latter part of the year. Little further change in the terms of trade is expected during the rest of 1988.

µh3µInvisibles and overseas assets

µ0µµbµ3.28µrµ The latest estimate for the surplus on invisibles in 1987, at £8½ billion, is as forecast in last year's FSBR. This is the same as the outturn in 1986, with increased transfers to the European Community offset by higher net earnings from services and from the UK's net overseas assets. The invisible surplus seems likely to rise in 1988 partly because of lower net payments abroad by North Sea oil companies.

µ0µµbµ3.29µrµ The value of the UK's stock of net overseas assets is estimated provisionally to have been about £90 billion at the end of 1987, some £20 billion down on end-1986. This decline is largely due to the fall in world equity markets and in the sterling value of UK assets in North America following the fall in the US dollar.

µh3µCurrent account

µ0µµbµ3.30µrµ The current account deficit is estimated to have been £1 billion in 1987, the improvement over the forecast in last year's FSBR being due to unexpected strength of exports of manufactures. A deficit of £3 billion (¾ per cent of GDP) is forecast for 1988, largely as a result of the projected decline in the oil surplus. The deficit on non-oil trade is forecast to show little further change from the level in the second half of 1987.

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Printer insert Table 3.4 Current account

µh2µDemand and activity

µ0µµbµ3.31µrµ The UK economy grew by 4¼ per cent in 1987. Growth was strong throughout the economy; manufacturing output rose by 5½ per cent, construction output by 8 per cent and output of the service industries by 5½ per cent.

µh3µPersonal sector expenditure

µ0µµbµ3.32µrµ Consumers' expenditure is now estimated to have risen by 5 per cent in 1987, slightly less than in 1986. The growth in consumer spending was faster than the 3½ per cent growth in real personal disposable income, and the savings ratio once again fell.

µ0µµbµ3.33µrµ A number of factors could account for the decline in the savings ratio in recent years. Inflation has been at a low level not experienced since the 1960s. Recent increases in real house prices and in equity prices up to October 1987 may also have contributed. Finally, employers have taken so-called "holidays" on their contributions to employees' pension funds, which score as reduced personal saving.

Printer insert Chart 3.6 Personal savings ratio

µ0µµbµ3.34µrµ Consumers' expenditure is forecast to increase by 4 per cent in 1988 and the savings ratio is expected to bounce back a little. Private investment in new dwellings could rise by around 2½ per cent in 1988, rather more slowly than over the last two years.

µh3µCompany incomes and expenditure

µ0µµbµ3.35µrµ Company profitability improved sharply again in 1987. For the year as a whole the rate of return of non-North Sea industrial and commercial companies was probably 10-11 per cent - the highest level for about 20 years. Manufacturing profitability grew particularly strongly.

Printer insert Chart 3.7 Companies' real rate of return

µ0µµbµ3.36µrµ Preliminary estimates suggest that manufacturing investment grew by 3½ per cent last year, while total non-oil business investment grew by 7 per cent. The latest DTI Investment Intentions Survey suggested a strong pick up in manufacturing investment growth, to about 11 per cent in 1988. The January CBI Industrial Trends Enquiry, the first full enquiry since the fall in share prices, confirms that prospect, with a near record balance of manufacturing firms expecting to increase investment. The DTI Survey also indicated further steady growth, of about 6 per cent, in non manufacturing investment. This outlook for company investment is consistent with the recent and prospective buoyancy in output, real profitability, and company finances, and it will add to industrial capacity. North Sea investment has fallen sharply since 1984, but is expected to recover a little in 1988.

Printer insert Table 3.5 Gross fixed domestic capital formation

µ0µµµ3.37µrµ Despite a rise in stocks in 1987, stock-output and stock sales ratios continued their trend decline of the last eight years. These downward trends are expected to continue in 1988, though, as last year, there is still likely to be modest stockbuilding.

Printer insert Chart 3.8 Stockbuilding as a share of GDP

µh3µProspects for demand and activity

µ0µµbµ3.38µrµ GDP growth is likely to moderate to around 3 per cent (3½ per cent excluding oil) in 1988, close to the average between 1981 and 1987. Domestic demand is

forecast to rise at around the same rate in 1988 as in 1987; some slowdown in consumer spending should be offset by buoyant investment prospects. But declining North Sea output (and lower oil exports) may reduce GDP growth by around $\frac{1}{2}$-$\frac{3}{4}$ per cent, rather more than in 1987. Manufacturing output is expected to rise faster than non-oil GDP in 1988, as it did in 1987.

Printer insert Table 3.6 Domestic demand and GDP

μh2μInflation

μ0μμbμ3.39μrμ The annual rate of inflation as measured by the RPI was 4.1 per cent in 1987Q4, in line with the forecasts in the 1987 FSBR and Autumn Statement. The average rate for 1987 as a whole was also 4.1 per cent. Last year was the first time in [23] years that inflation was lower than the growth in GDP, which is now estimated at 4.3 per cent.

Printer insert Chart 3.9 Annual increases in the RPI

μ0μμbμ3.40μrμ Settlements in manufacturing industry recorded by the CBI show a fall of about $\frac{3}{4}$ percentage point between the 1985-86 and 1986-87 pay rounds. There was a similar picture in the services sector. Average earnings, boosted by record overtime working in manufacturing, rose by 8 per cent. But unit labour costs in manufacturing were probably unchanged in the year to the fourth quarter of 1987, reflecting a sharp increase in labour productivity.

Printer insert Chart 3.10 Unit labour costs in manufacturing

μh3μProspects

μ0μμbμ3.41μrμ It is difficult to discern a reliable trend in recent private sector pay settlements. They have been markedly lower than the recent high growth in earnings, which reflects record overtime working and bonus payments. Recent data suggest that settlements may turn out a little higher in 1988 than in 1987 but overtime working (and overtime earnings) should fall as economic growth moves back closer to trend.

μ0μμbμ3.42μrμ In 1987 rapid growth in productivity meant that manufacturing unit labour costs rose only fractionally, in line with other major industrial countries. Continued growth in underlying productivity should mean that manufacturing unit labour costs grow only slowly in 1988, though in other major industrialised countries no unit labour cost growth at all is forecast.

Printer insert Table 3.7 Costs in manufacturing

μ0μμbμ3.43μrμ Table 3.7 shows that manufacturers' profit margins rose significantly in 1987 for the third year in succession. There may be further increases in 1988 if producers take some advantage of falling import costs to raise profits, as they did in 1986. Over the longer term, high profitability should lead to continued growth in investment, capacity and productivity. Together these should enhance prospects for controlling industrial costs.

μ0μμbμ3.44μrμ Inflation has come down during the first quarter of 1988, aided by lower import costs and recent cuts in mortgage interest rates. It may edge up a little partly as a result of the Budget proposals and the effects of local authority rate increases. There will also be some real increases in nationalised industry prices following a decline in real terms over the past three years. The RPI is forecast to rise by 4 per cent in the year to the fourth quarter of 1988.

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Printer insert Table 3.8 Retail prices index

µ0µµbµ3.45µrµ The GDP deflator measures the price of domestic value added - principally unit labour costs and profits per unit of output. It does not include import prices. The GDP deflator at market prices is forecast to rise by 5¼ per cent in 1987-88 (a little faster than expected in the Autumn Statement), following an increase of 3¾ per cent in 1986-87. The higher rate of increase in 1987-88 is accounted for by a recovery in North Sea profits, which had fallen by over 50 per cent in 1986-87 following the sharp fall in oil prices. The GDP deflator is now forecast to rise by 4½ per cent in 1988-89.

µh3µProductivity and the labour market

µ0µµbµ3.46µrµ Preliminary estimates suggest that the employed labour force in Great Britain rose sharply during 1987; in the year to September 1987 it is estimated to have risen by 454,000. Self-employment has grown particularly strongly, as many more people have taken advantage of the opportunities offered by the buoyant economic climate. Total employment has now risen by over 1½ million since March 1983.

Printer insert Table 3.9 Employment

µ0µµbµ3.47µrµ Productivity has also been growing strongly. In 1987 manufacturing productivity rose by almost 7 per cent. In the year to 1987Q3 (the latest period for which comparable data are available) UK manufacturing productivity rose faster than in any other major industrial country. It has now risen by an average of 4 per cent per annum since 1979. Underlying growth in labour productivity in manufacturing industry may now be higher than in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this, as a result of the large rise in part-time employment.

Printer insert Table 3.10 Output per head of the employed labour force

Printer insert Chart 3.11 Output and productivity

µh2µUnemployment

µ0µµbµ3.48µrµ Seasonally adjusted adult unemployment in the UK has fallen in each of the last eighteen months. It has now come down by almost 650,000 since July 1986. Over the same period long term unemployment (over one year's duration) has fallen by around 250,000. The improved trend in unemployment has been mainly the result of strong growth of output and employment. Unemployment should continue to fall in the year ahead. But excessive pay settlements could threaten further progress.

µh2µForecast and outturn

µ0µµbµ3.49µrµ Table 3.11 compares the main elements of the forecast published in the 1987 FSBR with the outturn or latest estimate.

Printer insert Table 3.11 Forecast and outturn

µ0µµbµ3.50µrµ Inflation in the fourth quarter of 1987 was in line with the forecast made a year ago while the current account deficit is now estimated to have been rather smaller than forecast. Although the data on which the latest estimates of GDP in 1987 are based are still very uncertain, it is clear that both money and real GDP growth have been stronger than forecast. The PSBR in 1987-88 is likely to turn out about £[ ] billion lower than last year's forecast. This error - which is slightly higher than average errors on past forecasts - reflects a combination of lower than expected general government expenditure and, in particular, higher than forecast tax revenues.

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µ0µµbµ3.51µrµ This year's forecast is summarised in Table 3.12.

µh2µRisks and uncertainties

µ0µµbµ3.52µrµ No forecast is complete without an indication of error margins. Table 3.12 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about [£200] billion; and for the current account of the balance of payments exceed £[150] billion.

Printer insert Table 3.12 The prospects: summary

Printer insert Table 3.13 Constant price forecasts of expenditure, imports and gross domestic product

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Table 3.1: World economy

	Per cent changes on a year earlier			
	1986	Estimate 1987	Forecasts 1988	1989H1
Major seven countries[1]:				
Real GNP	2¾	3	2½	2
Real domestic demand	3¾	3	2½	2
Industrial production	1	3½	4½	2¾
Consumer prices	2	2¾	3¼	3¼
World trade, at constant prices				
Total imports	5	4¼	4¼	3¼
Trade in manufactures	2	5½	5	3¼

[1]US, Japan, Germany, UK, France, Italy and Canada.

3.19 As a result of the continued strength of industrial activity, some further modest rise in non-food commodity prices is expected during 1988. Food prices, however, are likely to be held down by continued over-supply, encouraged by high levels of support in many OECD countries. The forecast is based on the assumption that North Sea oil prices will average $15 a barrel.

3.20 Imports by industrial countries are expected to grow less rapidly than in 1986 and 1987. However, imports by non-oil developing countries will be helped by stronger commodity prices, and hence export earnings. Total world trade in 1988 is forecast to continue to grow at close to the rate experienced in 1987.

UK trade and the balance of payments

Relative costs and prices

3.21 UK unit labour costs in manufacturing rose only slightly in 1987, at a similar rate to the average in the other major economies, with rapid productivity growth largely offsetting a continuing high level of pay increases. Despite some appreciation of sterling against the dollar the

UK's cost competitiveness remains clearly more favourable than in 1984 and 1985 before the fall in world oil prices. The maintenance of competitiveness in the year ahead will depend on success in continuing to restrain unit cost increases.

Table 3.2: The exchange rate and cost competitiveness

	Sterling index (1975=100)	Relative unit labour costs* (1980=100)
1985 Q4	80	88
1986 Q4	68	71
1987 Q4	75	79

* Ratio of UK manufacturing sector's costs to those overseas.

Trade volumes (goods other than oil)

3.22 Non-oil export volumes rose by 7 per cent in 1987. Manufactured exports rose particularly strongly, reflecting renewed growth in world trade and the UK's strong competitive position. Non-oil export volumes are forecast to rise in 1988 by a further 5 per cent.

3.23 The UK increased its share of world trade in manufactures slightly in 1987. Its volume share has remained broadly stable since 1981, in marked contrast to the previous long-term decline. This improved performance is forecast to continue in 1988.

Table 3.3: Visible trade

Per cent changes on previous year

	All goods			Goods less oil		
	Export volume	Import volume	Terms of trade*	Export volume	Import volume	Terms of trade*
1986	3½	6½	-5	4	6	-½
1987	5½	7½	1	7	8½	1
1988 Forecast	3½	7	1	5	6½	1½

* ratio of export average values to import average values.

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Trade prices and the terms of trade 3.26 The terms of trade, which fell in 1986 as oil prices declined, improved again in 1987 as oil prices firmed and as sterling's appreciation offset some rise in world commodity prices in the latter part of the year. Little further change in the terms of trade is expected during the rest of 1988.

Invisibles and overseas assets 3.27 The surplus on invisibles was unchanged in 1987 as increased transfers to the European Community were offset by higher net earnings from services and from the UK's net overseas assets. It seems likely to rise in 1988 partly because of lower net payments abroad by North Sea oil companies.

3.28 The value of the UK's stock of net overseas assets is estimated provisionally to have been about £90 billion at the end of 1987 [some 20 per cent down on end-1986]. This decline is largely due to the fall in world equity markets and in the sterling value of UK assets in North America following the fall in the US dollar.

Current account 3.29 The current account deficit is estimated to have been £1 billion in 1987. The forecast for 1988 is for a rise in the deficit to £3 billion (¾ per cent of GDP), reflecting in particular the projected decline in the oil surplus. The deficit on non-oil trade is forecast to show little further change from the level in the second half of 1987.

Table 3.4: Current account

£ billion

	Manufactures	Oil	Other goods	Invisibles	Current balance
1986	-5½	4	-7	8½	½
1987	-6½	4	-7½	8½	-1
1988 Forecast	-8½	2½	-6½	9½	-3

Demand and Activity

3.30 The UK economy grew by 4¼ per cent in 1987. Growth was strong throughout the economy; manufacturing output rose

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Table 3.5: Gross fixed domestic capital formation

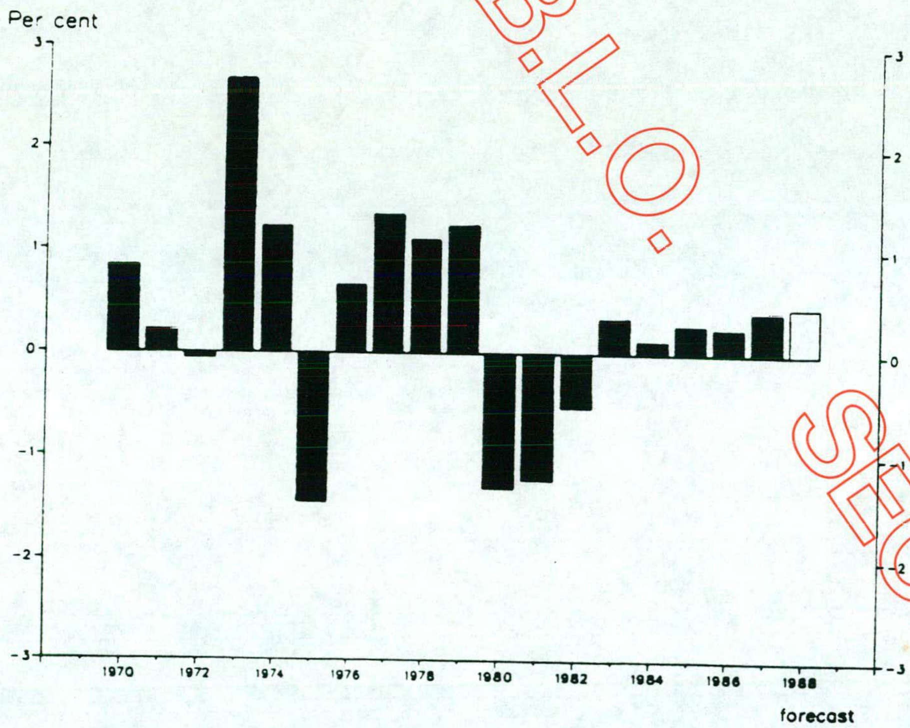
	£billion at 1980 prices	Per cent changes on a year earlier		
	1986	1986	1987	Forecast 1988
Business[1]	29.8	- 3	4½	8½
of which (i) non-oil business	27.8	- 2	6½	8½
(ii) manufacturing	7.1	- 5½	3½	11½
Private dwellings[2]	9.6	6½	5	2
General government	7.0	5½	- 1½	2
Total fixed investment	**46.4**	**0**	**3½**	**6**

1 Includes investment by public corporations

2 Includes purchases less sales of land by persons, companies and public corporations, other than purchases of council houses.

~~3.36 Despite a rise in stocks in 1987 stock-output and stock-sales ratios continued their trend decline of the last eight years. These downward trends are expected to continue in 1988, though, as last year, there is still likely to be modest stockbuilding.~~

Chart 3.8: Stockbuilding as a share of GDP.



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Prospects for demand and activity

3.37 GDP growth is likely to moderate to around 3 per cent (3½ per cent excluding oil) in 1988, close to the average between 1981 and 1987. Domestic demand is forecast to rise at around the same rate in 1988 as in 1987; some slowdown in consumer spending should be offset by buoyant investment prospects. But declining North Sea output (and lower oil exports) may reduce GDP growth by around ½-¾ per cent, rather more than in 1987. Manufacturing output is expected to rise faster than non-oil GDP in 1988, as it did in 1987.

Table 3.6: Domestic demand and GDP

	Per cent changes on a year earlier		
		Forecasts	
	1987	1988	1989H1
Domestic demand	4	4	2½
Exports of goods and services[1]	5½(7)		
Imports of goods and services[1]	7 (8)		
GDP[1,2]	4¼	3 (3½)	2½(3)
Manufacturing production	5½	5	2½

1 Non-oil shown in brackets
2 Average measure

Inflation

3.38 The annual rate of inflation as measured by the RPI was 4.1 per cent in 1987Q4, in line with the forecasts in the 1987 FSBR and Autumn Statement, and 4.1 per cent for 1987 as a whole. Last year was the first year since [1964] that inflation was lower than the growth of GDP (4.3 per cent). Producer output price inflation (excluding food, drink and tobacco industries) was 4¼ per cent in the year to 1987Q4.

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Prospects

3.40 It is difficult to discern a reliable trend in recent private sector settlements. They were markedly lower than the recent high growth in earnings, which reflects record overtime working and bonus payments, associated with the exceptional growth of the economy last year. Nevertheless recent data suggest that settlements may turn out a little higher in 1988 than in 1987. But overtime working (and overtime earnings) should fall as economic growth moves back closer to trend. Even so employees should still enjoy a further substantial increase in real earnings. In 1987 rapid growth in productivity ensured that manufacturing unit labour costs rose at about the same rate as in other major industrialised countries. Sustained growth in underlying productivity should contain the growth in manufacturing unit labour costs.

Table 3.7: Costs in manufacturing

	Per cent changes on a year earlier			
	Unit labour costs	Cost of materials and fuel[1]	Estimated total unit costs[2]	Output prices[1]
1986	4	-11	-½	4½
1987	0	5	1½	4½
1988 Forecast	1½	0	1	4½

1 Producer prices excluding food, drink and tobacco industries.
2 Including costs of bought in services.

3.41 Table 3.7 shows that manufacturers' profit margins rose significantly in 1987 for the third year in succession. There may be further increases in 1988 if producers take some advantage of falling import costs to raise profits, as they did in 1986. Over the longer term, high profitability should lead to continued growth in investment, capacity and productivity. Together these should enhance prospects for controlling industrial costs.

3.42 Inflation has come down during the first quarter of 1988, aided by lower import costs and recent cuts in mortgage interest rates. It may edge up a little partly as a result of the Budget proposals and the effects of local authority rate increases. There will also be some real

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increases in nationalised industry prices following a decline in real terms over the past three years. The RPI is forecast to rise by 4 per cent in the year to the fourth quarter of 1988.

Table 3.8: Retail prices index

	Weight in 1987	Per cent changes on a year earlier 1987Q4	Forecasts 1988Q4	1989Q2
Food	16½	3½	2½	2½
Nationalised industries	6	2¼	6½	5¼
Housing	15	7	7¼	9
Other	62½	3¾	3¼	3¼
Total	100	4	4	4

3.43 The GDP deflator measures the price of domestic value added - principally unit labour costs and profits per unit of output. It does not include import prices. The GDP deflator at market prices is forecast to rise by 5¼ per cent in 1987-88 (a little faster than expected in the Autumn Statement), following an increase of 3¼ per cent in 1986-87. The higher rate of increase in 1987-88 is accounted for by a recovery in North Sea profits, which had fallen by over 50 per cent in 1986-87 following the sharp fall in oil prices. The GDP deflator is now forecast to rise by 4½ per cent in 1988-89.

Productivity and the labour market

3.44 Preliminary estimates suggest that the employed labour force in Great Britain rose sharply during 1987; in the year to September 1987 it is estimated to have risen by 454,000. Self-employment has grown particularly strongly, as many more people have taken advantage of the opportunities offered by the buoyant economic climate. Total employment has now risen by over 1½ million since March 1983.

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Table 3.9: Employment

	Thousands, change in GB seasonally adjusted				
	Employees in employment		Self-employed	HM Forces	Employed labour force
	Male	Female			
September 1984 to September 1985	+ 55	+200	+ 90	- 3	+343
September 1985 to September 1986	- 81	+150	+ 71	- 3	+136
September 1986 to September 1987	+ 24	+225	+207*	- 3	+453

* Figures for self employment after June 1987 are projections based on self employment growth over the previous six years.

3.45 Productivity has also been growing strongly. In 1987 manufacturing productivity rose by almost 7 per cent. In the year to 1987Q3 (the latest date for which comparable data are available) UK manufacturing productivity rose faster than in any other major industrial country. It has now risen by an average of 4 per cent per annum since 1979. Underlying growth in labour productivity in manufacturing industry may now be higher than in the 1960s. This has been accompanied recently by a substantial improvement in capital productivity. Non-manufacturing output per hour has risen by about 2 per cent a year since 1979, and by about 2½ per cent a year since 1983. Output per head has grown less than this, as a result of the large rise in part-time employment.

Table 3.10: Output per head of the employed labour force

	Per cent changes					
	Annual averages			1984Q4 to 1985Q4	1985Q4 to 1986Q4	1986Q4 to 1987Q4[2]
	1964-73	1973-79	1979-87			
Manufacturing	3¾	¾	4	2¼	6½	6¾
Non-manufacturing[1]	3	½	1½	3½	3½	3½
Whole economy	2¾	1¼	2	2¾	3¼	3¼
Non-North Sea economy	2¾	½	2	2½	3¾	3½

[1] Excludes public services and North Sea oil and gas extraction.
[2] Partly forecast

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Table 3.11: Forecast and outturn

	1987 FSBR forecast	Latest estimate/ forecast	Average errors from past forecasts
Total gross domestic product; per cent change between 1986 and 1987	3	4¼	¾
RPI: per cent increase between the fourth quarters of 1986 and 1987	4	4	1½
Money GDP, per cent change between 1986-87 and 1987-88	7½	9¾	1½
Current account of the balance of payments in 1987, £ billion	-2½	-1	3
PSBR, financial year 1987-88, £ billion	4		5

3.48 Inflation in the fourth quarter of 1987 ~~and the current balance for 1987 as a whole were both~~ was in line with the forecast made a year ago, while the current account deficit is now estimated to have been rather smaller than forecast. Although the data on which the latest estimates of GDP in 1987 are based are still very uncertain, it is clear that both money and real GDP growth have been stronger than forecast. The PSBR in 1987-88 is likely to turn out about £[ ] billion lower than last year's forecast. This error - which is slightly higher than average errors on past forecasts - reflects a combination of lower than expected general government expenditure and, in particular, higher than forecast tax revenues.

3.49 This year's forecast is summarised in table 3.12.

Risks and uncertainties

3.50 No forecast is complete without an indication of error margins. Table 3.12 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide an indication of possible errors in the current forecast. Those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR, including the revenues of the public corporations, are about [£200] billion; and for the current account of the balance of payments exceed £[150] billion.

Table 3.12 The prospects: summary

	Forecast 1986 to 1987	Forecast 1987 to 1988	Average errors from past forecasts[1]
Output and expenditure at constant 1980 prices	per cent changes		percentage points
Domestic demand	4	4	1
of which:			
consumers' expenditure	5	4	1
general government consumption	[½]	[2]	1
fixed investment	3½	6	2¼
change in stockbuilding (as per cent of level of GDP)	½	0	½
Exports of goods and services	5½	3½	1¾
Imports of goods and services	7	6	2¼
Gross domestic product :total	4 to 4¼	3	¾
:manufacturing	5½	5	1½
Inflation			
Retail prices index	per cent changes		
1987Q4 to 1988Q4		4	1¼
1988Q2 to 1989Q2		4	1¾
Deflator for GDP at market prices	per cent changes on a year earlier		
Financial year 1987-88		5¼	¾
Financial year 1988-89		4½	1¾
Money GDP at market prices	£ billion[2]		
Financial year 1987-88		424(9¾-10)	1
Financial year 1988-89		457(7½)	1½
Balance of payments on current account	£ billion		
1988		-4 to -5	3½
1989 first half (at an annual rate)		-4 to -5	4½
PSBR	£ billion[3]		
Financial year 1987-88			1(¼%)
Financial year 1988-89			5(1¼%)

[1]The errors relate to the average differences (on either side of the central figure) between forecast and outturn over the last ten years.

[2]Per cent change on previous financial year in brackets; average error shown relates to the forecast of the percentage change.

[3]Per cent of GDP at market prices shown in brackets.

TABLE 3.13 CONSTANT PRICE FORECASTS OF EXPENDITURE, IMPORTS AND GROSS DOMESTIC PRODUCT*

£ billion at 1980 prices, seasonally adjusted

	Consumers' expenditure	General Government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less imports of goods and services	Less adjustment to factor cost	Plus statistical adjustment	Gross domestic product at factor cost	GDP index (average estimate) 1980=100
1983	144.4	50.6	41.6	64.4	0.7	**301.7**	62.6	31.6	0.2	**207.7**	104.0
1984	147.6	51.0	45.0	68.8	0.3	**312.7**	68.7	32.7	1.3	**212.7**	106.5
1985	153.3	51.0	46.4	72.7	0.6	**324.0**	70.5	33.8	0.6	**220.3**	110.3
1986	162.9	51.4	46.4	74.9	0.6	**336.3**	75.1	35.4	1.3	**227.1**	113.7
1987	171.3	51.6	48.1	79.2	0.8	**351.1**	80.3	37.3	3.4	**236.8**	118.6
1988	178.2	52.5	51.1	81.8	1.0	**364.6**	85.4	38.8	3.6	**244.1**	122.2
1986H1	80.3	25.7	22.8	36.6	0.4	**165.8**	36.1	17.4	0.4	**112.7**	112.9
H2	82.6	25.8	23.6	38.3	0.2	**170.4**	38.9	18.0	0.9	**114.4**	114.6
1987H1	84.1	25.6	23.7	38.9	-0.2	**172.1**	38.4	18.3	1.5	**116.9**	117.0
H2	87.2	26.0	24.4	40.4	1.3	**179.0**	41.9	19.0	1.9	**119.9**	120.1
1988H1	88.6	26.2	25.2	40.7	0.6	**181.3**	42.2	19.3	1.8	**121.7**	121.9
H2	89.6	26.3	25.9	41.0	0.5	**183.3**	43.1	19.5	1.8	**122.4**	122.6
1989H1	91.1	26.5	26.2	41.6	0.4	**185.7**	43.6	19.7	1.8	**124.2**	124.4
Per cent changes											
1985 to 1986	6½	1	0	3	-	3½	6½	4½	-	3	3
1986 to 1987	5	½	3½	5½	-	4½	7	5½	-	4½	4½
1987 to 1988	4	2	6	3½	-	4	6	4	-	3	3
1988H1 to 1989H1	3	1	4½	2	-	2½	3½	2	-	2½	2½

* GDP figures in the table are based on "compromise" estimates of gross domestic product, reflecting, for the past, average movements in constant price expenditure, output and income estimates of GDP. Percentage changes are calculated from unrounded levels and then rounded to half per cent. Figures for 1988H1 and beyond are forecasts. Figures for periods up to the end of 1987 are based mainly on the national accounts published earlier (covering periods up to 1987Q3) and incorporate some revised and later data and forecasts. A full set of national accounts, to end 1987, will be published by the CSO on 18 March.

µh1µ4 The Budget tax proposals

µ0µµbµr4.01µrµ The main tax changes proposed in the Budget are summarised below. A full list of changes is given in Table 4.1

µh3µIncome tax

µ0µµbµ4.02µrµ The basic rate of income tax will be reduced to 25 per cent.

µ0µµbµ4.03µrµ There will be a single higher rate of income tax of 40 per cent, which will apply to taxable income over £19,300.

µ0µµbµ4.04 The main income tax personal allowances will be increased by twice the amounts due under the statutory indexation provisions (based on the increase of 3.7 per cent in the RPI in the year to December 1987). This will mean that:

µ1µthe single person's and wife's earned income allowances will rise by £180 from £2,425 to £2,605;

µ1µthe married allowance will rise by £300 from £3,795 to £4,095;

µ1µthe age allowance for those aged 65 to 79 will rise by £220 from £2,960 to £3,180 (single) and by £360 from £4,675 to £5,035 (married);

µ1µthe age allowance for those aged 80 or over will rise by £240 from £3,070 to £3,310 (single) and by £360 from £4,845 to £5,205 (married);

µ1µthe income limit for age allowance will rise by £800 from £9,800 to £10,600;

µ1µthe additional personal allowance and widow's bereavement allowance will rise by £120 from £1,370 to £1,490.

µ0µµbµ4.05µrµ The dependent relative allowance of up to £145, the housekeeper allowance of £100 and the allowance for the services of a son or daughter of £55 will be abolished.

µ0µµbµ4.06µrµ From 6 April 1989 an unmarried couple will not be entitled to more than one additional personal allowance.

µh3µLife assurance premium relief

µ0µµbµ4.07µrµ The rate of premium relief for life assurance policies taken out before 14 March 1984 will be reduced to 12½ per cent from 6 April 1989.

µh3µBenefits in kind

µ0µµbµ4.08µrµ Car benefit scale charges for 1988-89 will be set at twice their 1987-88 levels.

µh3µMortgage interest relief

µ0µµbµ4.09µrµ For loans taken out from 1 August 1988, tax relief will be limited to the interest on £30,000 per residence, regardless of the number of borrowers. Relief on new loans for home improvements will be abolished from 6 April 1988. So will relief on new loans for the purchase of residences for dependent relatives and divorced or separated spouses.

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µh3µCovenants

µ0µµbµ4.10µrµ The tax treatment of covenants will be reformed and simplified. Non-charitable covenants made by individuals on or after Budget day will no longer attract tax relief, and income from such covenants made after Budget day will not be taxable in the hands of the recipient. There will be parallel changes in the student grant system (see paragraph 5.04). Covenants to charities will not be affected, nor will non-charitable covenants made before Budget day.

µh3µCharitable giving

µ0µµbµ4.11µrµ The limit on charitable donations qualifying for tax relief under the payroll giving scheme will be doubled from £120 to £240 a year from 1988-89.

µh3µMaintenance payments

µ0µµbµ4.12µrµ The tax treatment of maintenance payments will be reformed. Under new maintenance arrangements recipients will not be liable to tax on the payments; relief for those making payments will be restricted to payments to a divorced or separated spouse, up to a limit of [£1,490]. Transitional provisions will be introduced to protect existing maintenance arrangements.

µh3µPersonal equity plans

µ0µµbµ4.13µrµ The annual limit on investment in a personal equity plan will be increased from £2,400 to £3,000.

µh3µEmployee share schemes

µ0µµbµ4.14µrµ Following consultation last year, the income tax charge on unapproved employee share schemes under Section 79 of the 1972 Finance Act will be eased.

µh3µLloyd's

µ0µµbµ4.15µrµ Changes will be made to the present administrative arrangements for taxing members of Lloyd's.

µ0µµbµ4.16µrµ The legislation on Lloyd's reinsurance to close will be modified to give relief to Lloyd's members who leave syndicates at the end of the underwriting year.

µh3µTrusts

µ0µµbµ4.17µrµ The additional rate of income tax charged on discretionary and accumulation trusts will be reduced from 18 per cent to 10 per cent for 1988-89.

µh3µCapital gains

µ0µµbµ4.18µrµ The base date for capital gains will be brought forward from 6 April 1965 to 31 March 1982; gains accrued before that date will no longer be liable to tax. The present indexation provisions will continue to apply to gains accruing from 31 March 1982. This proposal will also apply to companies' gains.

µ0µµbµ4.19µrµ Gains, after deduction of the exempt amount and allowing for rebasing to 1982 and indexation, will be added to income and taxed at income tax rates (as if they were the marginal slice of income).

µ0µµbµ4.20µrµ The capital gains tax annual exempt amount will be reduced to £5,000 in the case of individuals and £[2,500] in the case of most trusts.

µ0µµbµ4.21µrµ From 6 April 1988, 50 per cent of any gains between £125,000 and £500,000 will qualify for retirement relief, subject to the general conditions for the relief.

µh3µInheritance tax

µ0µµbµ4.22µrµ From Budget Day the threshold for inheritance tax will be increased from £90,000 to £110,000. Chargeable transfers above this amount will be taxed at a single rate of 40 per cent. The £100,000 limit on the amount that can be given to a political party without incurring inheritance tax will be abolished.

µh3µBusiness tax

µ0µµbµ4.23µrµ The small companies' rate of corporation tax will be reduced to 25 per cent for the financial year 1988.

µ0µµbµ4.24µrµ The rate of advance corporation tax (ACT) for 1988-89 will go down automatically to $1/_3$ as a consequence of the reduction in the basic rate of income tax.

µ0µµbµ4.25µrµ The main rate of corporation tax for the financial year 1988 will be 35 per cent.

µ0µµbµ4.26µrµ In common with other business entertainment, the cost of entertaining overseas businessmen will no longer be an allowable business expense for tax purposes. This change will take effect from Budget Day, except for commitments entered into before that date. From 1 August 1988 the VAT paid by businesses on this entertainment will no longer be deductible.

µ0µµbµ4.27µrµ A number of changes will be made to prevent tax charges arising on the conversion of building societies into public limited companies.

µh3µBusiness Expansion Scheme

µ0µµbµ4.28µrµ Investment in private rented housing will be encouraged by extending the Business Expansion Scheme to give relief on investment in companies letting on the new assured tenancy basis.

µ0µµbµ4.29µrµ A general limit of £500,000 will be set on relief under the Business Expansion Scheme for total investment in any one company in any period of twelve months, with a higher limit of £10 million for investment in companies providing private rented housing [or shipping].

µh3µForestry

µ0µµbµ4.30µrµ Income from the occupation of commercial woodlands will be removed from the scope of Income Tax and Corporation Tax. (See paragraph 5.04 for details of the proposed increase in grants for forestry.)

µh3µOil taxation

µ0µµbµ4.31µrµ Oil allowance for Petrolum Revenue Tax (PRT) will be reduced to 100,000 tonnes per chargeable period for all Southern Basin and onshore fields given development consent on or after 1 April 1982. (At the same time the Secretary of State for Energy proposes to abolish royalty payments for these fields.)

µ0µµbµ4.32µrµ A new capital gains relief will be provided for disposals of oil licence interests in undeveloped areas wherever the consideration includes a work programme or another licence interest.

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µh3µCompany residence and migration

µ0µµbµ4.33µrµ On Royal Assent, Section 482(1) (a) and (b) of the Taxes Act will be repealed with effect from Budget Day. In future companies will be resident in the United Kingdom if incorporated here or centrally managed and controlled here. They will no longer need Treasury consent to move their residence abroad [and the criminal penalty for non-compliance will cease]. Companies will be able to migrate if they pay their tax liability, including liability on accrued gains.

µh3µVAT

µ0µµbµ4.34µrµ From 16 March 1988 the registration limits will become £22,100 per annum and £7,500 per quarter.

µ0µµbµ4.35µrµ The provision for applying VAT to confectionery will be amended with the main effect of taxing all cereal bars at the standard rate.

µh3µExcise duties

µ0µµbµ4.36µrµ The dut~~y~~ies on beer~~, light wine,~~ and ~~sparkling~~ and fortified wine will rise by the equivalent of ~~[~~1p~~]~~ on a typical pint of beer, just over ~~[~~4p~~]~~ on a bottle of table wine~~, a little~~ and just over ~~[~~6p~~]~~ on a bottle of sherry ~~sparkling wine and [ ] on a bottle of fortified wine~~ (all inclusive of VAT). The duties on spirits will remain unchanged. The minimum duty charge for beer will be abolished and provision will be made for restructuring the duties on low strength mixed drinks.

µ0µµbµ4.37µrµ The duty on leaded petrol will be increased by the equivalent of [just over 5½p] a gallon (inclusive of VAT). The duty on unleaded petrol will remain unchanged, so that the duty differential in its favour vis a vis leaded petrol will be increased. The duty on derv will rise by the equivalent of [just under 5p] a gallon.

µ0µµbµ4.38µrµ The specific duties on cigarettes, hand-rolling tobacco and cigars will rise by the equivalent of [over 3p] on a packet of 20 cigarettes and [nearly 2p] on a packet on 5 small cigars. The duty on pipe tobacco will remain unchanged.

µh3µTax administration

µ0µµbµ4.39µrµ The VAT civil penalty system, introduced in 1985, has been reviewed and various easements are proposed. In the light of recommendations by the Keith Committee, changes will be made:

µ1µto encourage people to notify the Inland Revenue if they are liable to tax;

µ1µto introduce a tax-geared penalty for failure to notify liability;

µ1µto improve the information powers of the Inland Revenue;

µ1µto charge interest where payment to the Inland Revenue of income tax deducted by employers is delayed beyond the end of the tax year (the interest charge will be implemented when the necessary Inland Revenue computer systems are in place).

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µh2µIndependent taxation for married couples

µ0µ The present system of taxing husbands and wives, under which a married woman's income is treated in law as if it belonged to her husband, has been unchanged since the earliest days of income tax. Green Papers published in 1980 and 1986 have considered how the system might be reformed. There is general agreement that the present law is no longer acceptable, and wide support for an early change to a new and more up-to-date system.

µ0µ A major reform of the system is therefore proposed to give husbands and wives independence and privacy in their tax affairs and remove the tax penalties on marriage which can occur under the present system. The new system will be introduced from 6 April 1990 to allow for the necessary preparations.

µ0µ From 6 April 1990, husbands and wives will be taxed independently on their income and chargeable capital gains. This will mean that:

µ1µhusband and wife will become independent taxpayers each with their own allowances and rate-bands to set against their own income (from whatever source); each will be responsible for handling their own tax affairs with the Inland Revenue;

µ1µevery taxpayer will be entitled to a personal allowance, equivalent to the existing allowance for single people;

µ1µthere will be a new married couple's allowance (based on the difference between the present married allowance and the single allowance). This will be set first against the husband's income, but any unused amount may be transferred to the wife;

µ1µmarried women will qualify in their own right for the higher levels of personal allowance for taxpayers aged 65-79 and those aged 80 or over. Higher levels of married couples allowance will apply where either partner in a couple is aged 65-79 (or aged 80 or over).

µ1µ[there will be transitional protection for the small number of couples whose allowances would be reduced as a result of the change to the new system;]

µ1µa husband's and wife's capital gains will be taxed independently; each spouse will be entitled to the same exempt amount as a single person;

µ1µthe existing exemptions from capital gains tax and inheritance tax on transfers of capital between husband and wife will continue;

µ1µthe new system will mean that a number of provisions, including the wife's earnings election and separate assessment, can be abolished.

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million. Estimated effect on receipts in: 1988-89. Changes from a non-indexed base	1988-89. Changes from an indexed base	1989-90. Changes from an indexed base
	INLAND REVENUE			
	Income tax			
1	Increase in single allowance of £180 and married allowance of £300	-1245	-620	-810
2	Increase in additional personal allowance and widow's bereavement allowance of £120	-15	-5	-10
3	Increase in age allowance of £220 (single) and £360 (married) for those aged 65 to 79	-90	-45	-55
4	Increase in age allowance of £240 (single) and £360 (married) for those aged 80 and over	-15	-10	-10
5	Increase in income limit for age allowance of £800	-10	-5	-10
6	Reduction of 2p in basic rate	-2060	-2060	-2860
7	Increase in basic rate limit of £2,100 to £19,300	-295	-215	-400
8	Abolition of higher rates of income tax above 40p	-1015	-960	-2050
9	Abolition of minor personal allowances	+10	+10	+10
10	Restriction on additional personal allowance for unmarried couples	-	-	+5
11	Reduction in relief on life assurance premiums	-	-	+70
12	Fringe benefits - car benefit scales	+230	+230	~~[illegible]~~ +280
13	Fringe benefits - earnings threshold (P11D limit)	-50	-50	-50
14	Fringe benefits - car parking space	-5	-5	-5
15	Mortgage interest relief ceiling applied to residence	+5	+5	+20
16	Abolition of tax relief on new home improvement loans	+80	+90	+200
17	Abolition of tax relief on new loans for homes for dependent relatives, divorced and separated spouses	*	*	*
18	Abolition of tax relief on new covenants	+40	+15	+100
19	Payroll giving to charities - increase in donation limit to £240 a year	*	*	*
20	Change in rules for maintenance payments	~~-20~~ -10	~~-20~~ -10	~~-20~~ -5
21	Change in additional rate on discretionary trusts	-5	-5	-10
22	Lloyds: reform of administrative arrangements		*	*
23	Lloyd's reinsurance to close - relief for leavers	*	*	*
24	Unapproved employee share schemes : relaxation of charge	*	*	*
25	Employee priority in public offer of shares	*	*	*
26	Approved FA 1984 employee share option schemes - restricted shares	*	*	*
27	Assessing procedure for Schedule E		-	-
28	Redundancy payments : change to scale of charge	*	*	*
29	Withdrawal of 'top-slicing' relief for tax charged on premiums for leases, etc	*	*	*
	Income tax and capital gains tax			
30	Independent taxation of income and chargeable capital gains of husband and wife from 1990-91	*	*	-10 (1)†
31	Business Expansion Scheme - limit on relief	*	*	+25
32	Business Expansion Scheme - private rented housing	*	*	-5
33	Personal Equity Plans - increase in limit	*	*	-5

† (1) allows for some postponement of realisation of gains by married couples (see annex note 30)
* = Negligible   - = Nil

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million: Estimated effect on receipts in: 1988-89: Changes from a non-indexed base	1988-89: Changes from an indexed base	1989-90: Changes from an indexed base
	Income tax and corporation tax			
34	Forestry - removal of commercial woodlands from scope of tax	-	-	*
[35	Personal pensions - minor changes	-10	-10	-5]
36	Refunds of employee pension contributions	+15	+15	+15
37	Occupational pensions - minor amendments	-	-	-
38	End of year interest on PAYE and subcontractors deductions	-	-	-
39	Capital allowances - exempt persons	-	-	-
40	Capital allowances - safety at sports grounds	*	*	*
41	Capital allowances - abolition of quarantine premises relief	*	*	*
42	Withdrawal of relief for business entertainment of overseas ~~customers~~ businessmen	*	*	+5
43	Rebasing capital gains of companies to March 1982	-25	-25	-235
	Capital gains tax			
44	Rebasing capital gains of individuals and trusts to March 1982	-	-	-75
45	Charging gains of individuals and trusts at income tax rates	+70	+70	+60
46	Annual exempt amount	-	-	+10
47	Retirement relief	-	-	-10
48	Building and Co-operative society shares	*	*	*
49	Homes provided for dependent relatives	-	-	*
	Corporation tax			
50	Reduction in rate of ACT to 1/3 re [illegible] the amount of the distribution	-380	-380	-200
51	Reduction in small companies' rate [illegible] per cent	*	*	-50
52	Company residence and migration - new [illegible]	-	-	-
53	Definition of an investment trust	-	-	-
54	Indexation allowance - intra-group [illegible]	-	-	-
55	Intra-group share exchanges	-	-	-
56	Capital allowances - assured tenan[illegible]	-	-	-
	Corporation tax and capital gains [illegible]			
57	Rollover relief for satellites, [illegible]	*	*	-5
	Income tax, corporation tax and ca[illegible]			
58	Keith Committee administrative char[illegible]	+[illegible]	+[illegible]	+10
	Income tax, corporation tax, capita[illegible]			
59	Conversion of building societies in[illegible] companies - changes in tax rules	-	[illegible]	-

* = Negligible - = Nil

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million — Estimated effect on receipts in: 1988-89 — Changes from a non-indexed base	1988-89 — Changes from an indexed base	1989-90 — Changes from an indexed base
	Oil taxation			
60	Reduction in PRT oil allowances for certain fields	+30	+30	+30
61	New capital gains relief for certain oil licence disposals	-5	-5	-5
62	Petroleum revenue tax relief for certain tariff related costs	-	-	-
	Inheritance tax			
63	Increase in threshold and change to flat rate	-120	-100	-200
64	Abolition of limit on gifts to political parties	*	*	*
	Stamp duties			
65	Stamp duty and reserve tax on paired shares	-	-	-
	TOTAL INLAND REVENUE	~~-4870~~ -4,860	~~-4025~~ -4015	~~-6245~~ -6280
	CUSTOMS AND EXCISE			
	Value added tax			
67	Keith Committee - review of civil penalties	*	*	*
68	Increase in registration limits	*	*	*
69	Revised registration requirements	*	*	*
66 ~~67~~	Change in liability of certain confectionery	+5	+5	+10
70	Revision of approved self-billing arrangements	+5	+5	+5
71	Revised treatment of business entertainment for overseas customers	*	*	*
	Excise duties			
72	No change in rate of spirits duty	-	-15	~~[illegible]~~ -25
73	Increase in rate of beer duty	+5	+[illegible]	~~+[illegible]~~ +15
74	Abolition of minimum duty charge for beer	*	*	*
75	Increase in rate of duty on cider and perry	+5	+5	~~+[illegible]~~ *
76	Increase in rate of duty on light wine and made-wine duties	+20	+[illegible]	~~+[illegible]~~ +15
77	No change in rates of duty on fortified wines	-	-5	~~[illegible]~~ *
78	Revised duty regime for low strength mixed drinks	*	*	*
79	Increase in rate of duty on leaded petrol etc	+175	+[illegible]	+[illegible]
80	Increase in rate of duty on derv	+75	+[illegible]	+[illegible]
81	No change in rates of minor oil duties	-	-5	~~[illegible]~~ -10
82	Increase in rates of duties on cigarettes, hand-rolling tobacco and cigars	+110	[illegible]	
83	No change in rate of duty on pipe tobacco	-	*	~~[illegible]~~ -5
	TOTAL CUSTOM AND EXCISE	+505	+110	~~[illegible]~~ +15

* = Negligible - = Nil

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Table 4.1 Direct effects of changes in taxation

See Annex 4 Paragraph numbers		£ million Estimated effect on receipts in: 1988-89 Changes from a non-indexed base	1988-89 Changes from an indexed base	1989-90 Changes from an indexed base
	Vehicle excise duty			
84	No change in VED on car, light van and main lorry rates	-	-100	-110
85	Increase in certain other VED rates	+20	+20	+20
86	New VED class for exceptional loads	*	*	*
	TOTAL VED	+20	-80	-90
	Other			
87	Bus fuel grants	-5	*	-5
	~~TOTAL VED AND OTHER~~	~~+15~~	~~-80~~	~~-95~~
	TOTAL CHANGES IN TAXATION	~~-4270~~ -4280	~~[illegible]~~ -3985	~~[illegible]~~ -6300

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µh1µAnnex to Chapter 4

µh2µHow the figures in Table 4.1 have been calculated

µ0µTable 4.1 gives the direct effects of changes in taxation. Estimates are rounded to the nearest £5 million. "Negligible" means less than £3 million.

µ0µThe direct effect of a tax change is the difference between the yield of the tax which would arise on the basis of the rate of tax, allowances, etc prevailing before the Budget (the pre-Budget regime) and the yield after the changes proposed in the Budget (the post-Budget regime).

µ0µFor Inland Revenue taxes (and VED) the difference in yield for each tax is generally calculated by applying the pre- and post-Budget tax regimes to the same tax base. This base is the post-Budget base - that is the levels of income, profits etc forecast for future years on the assumption that all the measures proposed in the Budget take effect. In certain cases, however, the difference in yield also takes account of changes in taxpayers' behaviour arising from the tax change where these behavioural changes can be directly attributed to the change in tax.

µ0µFor Customs and Excise taxes and duties, the calculation takes into account, where possible, the effect of the tax change on the pattern of consumers' expenditure and the resulting impact on other expenditure taxes but makes no allowance for secondary effects: in particular, it is assumed that total consumers' expenditure does not change. A fuller description of the methodology is in Economic Trends, March 1980.

µ0µTable 4.1 shows the expected change in receipts of tax resulting from the Budget proposals. Additional information is provided in the commentary below for those proposals where the effect on tax liabilities in the first complete year to which the change applies (full year effect) is substantially different from the effect on receipts in either 1988-89 or 1989-90; or where the impact of the proposal is expected to build up over a period of years.

µ0µThe figures in the first column of Table 4.1 show the direct effect of the Budget proposals on receipts in 1988-89. Budget proposals are compared with a non-indexed base - that is, with the pre-Budget regime of allowances, thresholds and rates of duty at 1987-88 levels.

µ0µThe figures in the second column show the direct effect of the Budget proposals on receipts in 1988-89, measured against an indexed base. The indexed base for 1988-89 is obtained by increasing 1987-88 allowances, thresholds and rates of duty by 3.7 per cent, the increase in the RPI over the year to December 1987.

µ0µThe figures in the third column show the direct effect on receipts in 1989-90, also measured against an indexed base. For this comparison, both the Budget proposals and the indexed base for 1988-89 have been further indexed by the forecast movement in the RPI between the fourth quarters of 1987 and 1988 (shown in Table 3.13).

µ0µThe estimates shown in Table 4.1 do not reflect changes in the tax base arising from changes in money incomes and in the general level of prices and other economic variables which may result from the proposed tax change. These secondary effects are, of course, taken into account in estimating the impact of the tax change on the PSBR. The base for the post-Budget forecast of each tax (given in Table 6B.3) takes account of the effects, direct and secondary, of all the measures announced in the Budget.

µ0µThe remainder of this annex provides further details on the Budget proposals in Table 4.1. The paragraph numbers refer to the lines in this table.

μh3μIncome tax

μ0μμbμ1μrμ to μbμ5μrμ See paragraph 4.04.

μ0μμbμ6μrμ See paragraph 4.02. This item includes the saving in public expenditure on mortgage interest relief to those below the tax threshold. The effect of the consequential change in the rate of advance corporation tax (ACT) is shown in line [50] of Table 4.1

μ0μμbμ7μrμ The basic rate limit will rise by £2,100 from £17,900 to ~~£20,000~~ £19,300 ~~The increase is three times the amount due under statutory indexation.~~

μ0μμbμ8μrμ See paragraph 4.03.

μ0μμbμ9μrμ See paragraph 4.05

μ0μμbμ10μrμ See paragraph 4.06.

μ0μμbμ11μrμ Following the reductions in the basic rate of income tax in successive Budgets, the rate of relief for life assurance premiums on policies taken out before 14 March 1984 will be reduced to from 15 per cent to 12.5 per cent from 6 April 1989. The starting date is to allow life offices time to make the necessary preparations.

μ0μμbμ12μrμ For 1988-89 the scale for taxing car benefits for directors and for "higher paid" employees will be double the 1987-88 levels. The previously announced scales for 1988-89 will not apply. Yields are measured from these previously announced scales. No change is proposed for 1988-89 and 1989-90 to the scale charges for car fuel benefit also used for VAT purposes.

μ0μμbμ13μrμ See paragraph 4.09.

μ0μμbμ14μrμ The provision of a car parking space for the use of directors or higher-paid employees will be exempt from tax from 6 April 1988.

μ0μμbμ15μrμ to μbμ17μrμ See paragraph 4.10. Relief for loans for the purchase on improvement of let property is not affected.

μ0μμbμ18μrμ See paragraph 4.11. The change is estimated to yield £160 million in 1990-91, £175 million in 1991-92, and £[210] million eventually. These figures do not include the effect on public expenditure of the parallel change in the student grant system.

μ0μμbμ19μrμ See paragraph 4.12

μ0μμbμ20μrμ The new tax regime for maintenance payments in paragraph 4.13 will mean that:

μ1μfor payments under new maintenance arrangements, relief will be restricted to payments to a divorced or separated spouse, up to a limit equal to ~~the single allowance~~ £[1,490] Recipients will not be liable to tax on maintenance payments;

μ1μfor existing maintenance arrangements, in 1988-89 the present rules will continue to apply [except that a divorced or separated spouse will be exempt from tax on the first [~~£2,605~~] (~~the single allowance~~) of maintenance received (after grossing up at the basic rate where tax has been deducted by the payer).] From 1989-90, all payments will be made gross; relief for the payer will be limited to the amount which qualified for relief in 1988-89; and the tax liability on the recipient will be limited to the amount taxable in 1988-89.

μ0μThe changes are estimated to cost £[15] million in 1990-91 and £[10] million in 1991-92, and to [yield £20 million] eventually.

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µ0µµbµ21µrµ See paragraph 4.16.

µ0µµbµ22µrµ See paragraph 4.28. [The legislation will first take effect for the Lloyd's 1986 Account, which closes at the end of 1988.]

µ0µµbµ23µrµ The legislation on Lloyd's reinsurance to close (RIC) will be modified so that it will not apply to Lloyd's members who ceased membership of a syndicate at the end of the underwriting year, and are therefore not members of the syndicate to which the relevant RIC premium is paid. [The legislation will first take effect for the Lloyd's 1985 Account, which closed at the end of 1987. This is the first year to which the 1987 legislation on Lloyd's RIC will apply.]

µ0µµbµ24µrµ Changes will be made to the rules (Section 79 Finance Act 1972) governing unapproved employee share schemes. The present charge (to income tax) on the whole of any growth in value of certain employee-acquired shares is to be replaced in most cases with a new, more narrowly, targeted charge that will arise only if and to the extent that value is shifted preferentially into the employee shares. This relaxation will also apply to shares in "qualifying" subsidiaries. These changes will take effect from 26 October 1987 when draft clauses incorporating the proposed changes were published for consultation.

µ0µµbµ25µrµ From 23 September 1987, any benefit resulting from priority in applying for a public offer of shares given to employees by virture of their employment will be exempt from income tax.

µ0µµbµ26µrµ Changes will be made to approved discretionary share option legislation to enable employees to enable employees to borrow to purchase their option shares without losing tax relief.

µ0µµbµ27µrµ Legislation will be introduced to ensure that the Inland Revenue continue to have power to make an income tax assessment, on certain types of income assessable on the "current year" basis, in the course of the year in which the income is received.

µ0µµbµ28µrµ The limit below which redundancy and certain other lump sum payments are exempt from income tax will be increased from £25,000 to £30,000. The reduced rates of tax which apply to the next £50,000 of such payment will be abolished.

µ0µµbµ29µrµ The "top-slicing" relief which applies to the tax charged on premiums for leases and certain other payments will be withdrawn.

µ0µµbµ30µrµ The new system of independent taxation for husbands and wives will apply from 1990-91. The revenue costs in 1990-91 and 1991-92 (based on the existing distribution of income between husbands and wives) are estimated at £[630] and £[970] million respectively for income tax. For capital gains tax, the prospect of independent taxation may lead some couples to defer disposals until the new arrangements are in place; and from 1990-91 onwards, couples may transfer assets between them where one spouse has unused annual exempt amount on basic rate band. The figure for 1989-90 in Table 4.1 reflects the deferral of disposals. Costs for capital gains tax in 1990-91 and 1991-92 are each estimated at £60 million. Those estimates which allow for changes in taxpayers' behaviour are subject to a high degree of uncertainty.

µ0µµbµ34µrµ and µbµ32µrµ See paragraphs 4.26 and 4.27. The estimated revenue effects depend on take up and are highly uncertain.

µ0µµbµ33µrµ The annual limit on investment in a PEP will be raised from £2,400 to £3,000. At the same time the amount which may be held in cash will be increased from £240 and £300 (or, in each case, 10 per cent of total market value of a plan). [And the amount which may be invested in a unit trust or investment trust will rise from £420 to £xxx (or, if greater, 25 per cent of total investment).] The changes will apply from calendar year 1988.

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µ0µµbµ34µrµ Schedule B will be abolished with effect from 1988-89. With effect from 15 March 1988 (subject to transitional provisions extending to 5 April 1992) the right of occupiers of commercial woodlands to elect to be assessed to tax on their profits or losses under Schedule D will be abolished. The eventual net annual saving is estimated at £[10] million. [Provision for increased forestry grants will be introduced as from [ ].

µ0µµbµ35µrµ [Changes will be made to the tax rules for personal pensions relating to the payment by DHSS of contracting-out rebates.]

µ0µµbµ36µrµ The rate of tax on refunds of employee pension contributions will be increased from 10 per cent to 20 per cent.

µ0µµbµ37µrµ Minor amendments are to be made to the 1987 legislation which dealt with exploitation of pensions tax reliefs.

µ0µµbµ38µrµ Interest will be charged where an employer or contractor delays payment to the Inland Revenue of amounts deducted under the PAYE or subcontractor deduction schemes beyond 19 April immediately following the deduction year. This interest charge will not be introduced before 1992.

µ0µµbµ39µrµ The rules for calculating industrial buildings allowance following a sale and those for transfers of machinery or plant between connected persons will be amended to prevent excessive relief where one person is not chargeable to tax in the United Kingdom. These changes will prevent a potential Exchequer loss of up to £150 million in 1991-92 with a diminishing effect in later years.]

µ0µµbµ40µrµ The legislation relating to capital allowances for safety expenditure at sports grounds will be amended from 1 January 1988 to take account of changes to the Safety at Sports Grounds Act 1975.

µ0µµbµ41µrµ Capital allowances on expenditure at certain quarantine premises will be abolished from 16 March 1988.

µ0µµbµ42µrµ See paragraph 4.24. The yield from the VAT change is shown separately at item 71.

µ0µµbµ43µrµ and µbµ44µrµ See paragraph 4.17. The total cost of rebasing will build up to a peak of some £850 million in 1991-92, of which the amount attributable to companies' gains is about three-quarters. The figures take account of the likely effect of this measure on the volume and timing of disposals; and, to individuals and trusts, are additional to the effect on item 45.

µ0µµbµ45µrµ See paragraph 4.18. Until the introduction of independent taxation in 1990-91, the gains of married couples will be taxed as the marginal slice of the husband's income. The revenue yield in 1990-91 is estimated at £40 million and in 1991-92 at £85 million. The figures take account of the likely effect of taxing gains at income tax rates on the volume and timing of disposals.

µ0µµbµ46µrµ See paragraph 4.19.

µ0µµbµ47µrµ See paragraph 4.20. Retirement relief currently exempts business gains up to £125,000, subject to certain qualifying conditions.

µ0µµbµ48µrµ From 4 July 1987, disposals of shares in Building and Co-operative Societies will not qualify for indexation relief.

µ0µµbµ49µrµ From 6 April 1988, the capital gains tax exemption for homes provided for dependent relatives will cease to be available. There will be special provisions to ensure

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that exemption continues where a dwelling would have qualified for this exemption on a disposal before 1988-89.

µ0µµbµ50µrµ and µbµ51µrµ See paragraph 4.22. The reduction in ACT will be balanced by an increase in the subsequent liability to mainstream corporation tax.

µ0µµbµ52µrµ

See paragraph 4.33.µ0µµbµ53µrµ The Finance (No 2) Act 1987 repealed part of the definition of an investment trust. The full definition will be reinstated, and the legislation will include provision to ensure that the repeal was never effective.

µ0µµbµ54µrµ The indexation allowance will be denied or restricted on disposal of certain intra-group lebts and shareholdings. This provision counters use of the indexation allowance to create large artificial capital losses which could cause a significant loss of tax.

µ0µµbµ55µrµ As a result of a recent court ruling, share exchanges by companies in the same group can now give rise to capital gains or losses being taxed or allowed more than once. The legislation will be amended so as to remove that anomaly.

µ0µµbµ56µrµ Capital allowances in respect of properties let on assured tenancy terms by "approved bodies" will come to an end when the Housing Bill takes effect. Changes will be made to the capital allowances legislation to ensure that relief for past years is not withdrawn and to provide transitional arrangements in respect of expenditure already incurred.

µ0µµbµ57µrµ Rollover relief will be extended to satellities and spacecraft from 28 July 1987 and to milk and potato quotas from 30 October 1987.

µ0µµbµ58µrµµ1µ(a) The present flat rate penalty for failure to notify liability to tax will be replaced by a fully mitigable penalty up to the amount of tax unpaid.

µ1µ(b) The Revenue's power to call for returns of information will be extended to details (where relevant for tax) of payments for services by Government Departments, grants or subsidies paid out of public funds and the names of licence holders.

µ1µ(c) The Revenue's power to call for documents relating to taxpayers suspected of avoidance or evasion will be extended to include the Department of National Savings, and, in order to identify taxpayers suspected of serious default, to documents relating to taxpayers who identity is not known to the Revenue.

µ1µ(d) The Revenue will be allowed the same access to records held on computer as it is allowed to records held on paper.

µ0µThe estimated yield of these measures is based on the unreported tax liabilities which will be uncovered.

µ0µµbµ59µrµ Changes in the tax rules concerning the conversion of building societies into public limited companies are necessary in order to prevent unintended tax charges arising.

µ0µµbµ60µrµ See paragraph 4.31. The PRT oil allowance for Southern Basin and onshore fields given development consent on or after 1 April 1982 is to be reduced to 100,000 tonnes per chargeable period, with a cumulative total of 2 million tonnes. The yield figures in Table 4.1 relate to this proposal only. At the same time, it is proposed to abolish royalty on these fields. These two measures have cumulative cost of around £[40] million in the first five years [in part because it is estimated that they will accelerate certain developments], but in the long run they are expected to be broadly revenue neutral.

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µ0µµbµ61µrµ See paragraph 4.32. For disposals of oil licences in undeveloped areas where the consideration includes a work programme or another licence interest, that work programme or other licence interest will be deemed to have a nil value.

µ0µµbµ62µrµ All tariff-related expenditure incurred by an asset owner will be allowed against his PRT liability on tariff income arising from third party use of those assets, even though his principal field has ceased production. No cost will arise until after fields owning assets used by others cease production.

µ0µµbµ63µrµ and µbµ64µrµ The estimated cost for 1990-91 of the proposed rate structure for inheritance tax in paragraph 4.21 is £240 million, measured against the indexed base. For 1991-92 it is £270 million. The estimated full year cost attributable to transfers in 1988-89 is £220 million. To qualify for exemption, transfers to political parties must be made on or within one year of death.

µ0µµbµ65µrµ Changes are proposed to stamp duties and the reserve tax on shares in a UK and a non-UK company where the shares are paired and can only be transferred as a unit.

µh3µValue added tax

µ0µµbµ66µrµ See paragraph 4.40.

µ0µµbµ67µrµ Amendments will be made to the civil penalty system including the introduction of a time-related penalty for late registration; the halving of daily penalties; changes to the ~~rates~~ rules about eligibility to repayment supplement; and changes to the ~~rates~~ rules for persons who persistently misdeclare their liability.

µ0µµbµ68µrµ See paragraph 4.38.µ0µµbµ69µrµ The rules for registration of voluntary and intending traders will be simplifed and restrictions and conditions removed.

µ0µµbµ70µrµ From [ ], where a taxable person issues himself with an invoice under the terms of an approved self-billing arrangement, he will be responsible for determining the correct VAT liability.

µ0µµbµ72µrµ See paragraph 4.26. The change will bring the treatment of VAT incurred by businesses on entertaining foreign businessmen ~~it~~ into line with the treatment of other business entertainment.

µ3µExcise duties

µ0µµbµ72µrµ See paragraph 4.41.

µ0µµbµ73µrµ The duty on typical beer will be increased by [4.7 per cent], equivalent to [1p] a pint (inclusive of ~~consequential~~ VAT).

µ0µµbµ74µrµ 1 October 1988, beer duty will be charged on the basis of £[0.90] a hectolitre for every degree by which the original gravity of the beer exceeds 1000µsµoµrµ.

µ0µµbµ75µrµ The duty on cider and perry will be increased by [9.7] per cent or [1p] a pint (inclusive of consequential VAT).

µ0µµbµ76µrµ The duties on ~~still table~~ wine and made-wine ~~and sparkling wine~~ will be increased by ~~[4.7]~~ per cent, equivalent to ~~[4p]~~ on a 75cl bottle of still wine, ~~and [6.1p]~~ on a 70cl bottle of sparkling wine (~~both~~ inclusive of ~~consequential~~ VAT].

5.9p

µ0µµbµ77µrµ See paragraph 4.41.

4.5

3.8p

6.1p

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µ0µµbµ78µrµ Lower strength mixed drinks, not exceeding 5.5 per cent alcohol, will be dutied according to their alcoholic strength on a scale proportionate to table wine duty. This will bring duties on wine-based and similar mixed drinks into line.

µ0µµbµ79µrµ The duty on leaded petrol will be increased by [5.5] per cent or [5.6p] a gallon (inclusive of consequential VAT). The duty on unleaded petrol will remain unchanged so that the tax differential in favour of unleaded petrol will rise to [10.6p] a gallon.

µ0µµbµ80µrµ The duty on derv will be increased by [5.7] per cent, equivalent to [4.9p] a gallon (inclusive of consequential VAT).

µ0µµbµ81µrµ There will be no change in the rates of duty on gas oil and fuel oil.

µ0µµbµ82µrµ The specific duties on cigarettes, hand-rolling tobacco and cigars will be increased by [3.8] per cent or [3.4p] a packet of 20 cigarettes and [1.9p] a package of 5 small cigars (both inclusive of consequential VAT).

µ0µµbµ83µrµ See paragraph 4.43.

µ3µVehicle excise duties

µ0µµbµ84µrµ There will be no change in the duties on cars, light vans, motor cycles, buses, coaches and most lorries.

µ0µµbµ85µrµ From 16 March 1988 the rates of duty for the heaviest rigid lorries will rise by about 10 per cent bringing them more into line with rates for articulated vehicles of similar gross weight.

µ0µµbµ86µrµ From 1 June 1988 a new tax class will be introduced for heavy goods vehicles (special types) capable of carrying very long, wide or heavy loads. The rate of VED for these special types will be raised to £1,600. These vehicles cause as much wear and tear as the heaviest HGVs but currently pay a restricted HGV rate (£130).

µ0µµbµ87µrµ There will be no change in bus fuel grant.

Printer

Late amendments - not on disc - shown in red.

µh1µ5 Public expenditure

µ0µµbµ5.01µrµ The Government's expenditure plans were set out in the Public Expenditure White Paper (Cm 288). These plans are summarised in Table 5.1. The Budget makes no change to these plans, apart from two consequentials of the tax proposals, described in paragraph 5.04.

µh3µChanges since previous Budget

µ0µµbµ5.02µrµ Since the last FSBR, extra resources have been allocated to priority services such as health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also been increased.

µh3µPublic spending trends

µ0µµbµ5.03µrµ The reduction in the burden of debt interest, in unemployment and in subsidies to industry have helped make room for these increases while maintaining the Government's policy of reducing the share of national income taken by public expenditure. General government spending excluding privatisation proceeds has fallen from 47 per cent of GDP in 1982-83 to [41½ per cent] now. This fall is planned to continue.

5

Printer insert Table 5.1 Public expenditure

µh3µBudget measures

µ0µµbµ5.04µrµ Two of the Budget measures have consequences for public expenditure. In parallel with the abolition of tax relief on new covenants between individuals, including covenants to students - see pargraph 4.A - the parental contribution scale is being revised for those starting their studies from the 1988-89 academic year onwards. This will cost some £20 million in 1988-89, rising to £80 million in 1991-92. In parallel with the change in the tax treatment of forestry - see paragraph 4.B - there will be an increase in grants to forestry estimated to cost about £x million in 1989-90 rising to £y million in 1991-92. The expenditure arising from these changes will be charged to the Reserve and will not add to the Planning Totals.

µh3µ1987-88 outturn

µ0µµbµ5.05µrµ The latest estimates for the outturn for the planning total in 1987-88, which are still subject to some uncertainty, suggest that it is likely to be about £[146.4] billion, £[2.2] billion below the plans shown in the 1987 public expenditure White Paper and the 1987 Budget and £[0.9] billion below the outturn figure shown in the 1988 public expenditure White Paper. A breakdown is shown in Table 5.2. Of the Reserve of £3.5 billion, only £[1.4] billion was therefore required to meet additions to departmental programmes.

Printer insert Table 5.2 Comparison of plans and estimated outturn for 1987-88

µ0µµbµ5.06µrµ The major changes between plans and estimated outturn for particular programmes are:

µ1µa net increase of £[1.2] billion in central government expenditure mainly due to an ~~of~~ increase £[0.6] billion in expenditure by DHSS on Health and Personal Social Services (reflecting the cost of the 1987 nurses and doctors and dentists pay settlements), and higher net payments to the European Communities (£[0.8] billion) offset by lower payments by the Intervention Board for Agricultural Produce (£[0.3] billion); expenditure by DHSS on social security is now estimated to be £[ ] above last year's plans, this is £[0.2] billion below the estimate in the public expenditure White Paper;

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µ1µan overspend of £[1.4] billion on the plans for local authority current expenditure;

µ1µa net underspend of £[0.6] billion on local authority capital expenditure, reflecting £[0.4] billion higher gross spending, more than offset by £[1.0] billion higher capital receipts. [The net underspend is £[ ] greater than that shown in the public expenditure White Paper;]

µ1µbetter results for nationalised industries and other public corporations, by £[0.6] billion, due principally to higher profitability of British Steel and increased capital receipts from New Towns £[0.2] billion.

Printer insert Table 5.3 Public expenditure by spending authority

µh3µPublic expenditure by spending authority

µ0µµbµ5.07µrµ Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament through the annual Supply Estimates and covers the expenditure of government departments for their own activities as well as their funding of other bodies such as the National Health Service. Most of the remainder consists of social security payments paid out of the National Insurance Fund. Spending by local authorities accounts for about one quarter of public expenditure. Nationalised industries and other public corporations account for the remainder of the total. Table 5.3 gives outturn figures for the last two years and the plans as published in the public expenditure White Paper.

µh3µSupply Estimates

µ0µµbµ5.08µrµ For 1988-89, the plans set out in the public expenditure White Paper have now been translated, where appropriate, into detailed control totals in Supply Estimates. The total Estimates provision for 1988-89 for which the Government is seeking Parliamentary approval is shown in Table 5.4. The main Estimates for 1988-89 are published in a series of booklets on 15 March 1988 with a Summary and Guide (Cm [ ]) which explains the Supply procedure and summarises the Estimates. It also explains how they relate to the public expenditure planning total.

µ0µµbµ5.09µrµ Of the £[108.3] billion included in the Supply Estimates, £[83.0] is direct public expenditure. The remaining £[25.3] billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public expenditure. [Nearly 60] per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Printer insert Table 5.4 Supply expenditure

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Table 5.1 Public expenditure

£ billion

	1986-87 Outturn	1987-88 Estimated outturn	1988-89 Plans	1989-90 Plans	1990-91 Plans
Department					
DHSS - social security	44.4	[46.3]	48.5	51.1	53.6
DHSS - health and personal social services	17.9	[19.7]	20.7	21.7	22.7
Defence	18.1	[18.7]	19.2	20.0	20.6
Education and science	15.7	[17.1]	18.0	18.6	19.2
Scotland, Wales and Northern Ireland	15.4	[16.4]	17.1	17.5	17.9
Other departments	32.0	[33.2]	34.9	36.2	36.7
Privatisation proceeds	-4.4	[-5.0]	-5.0	-5.0	-5.0
Reserve			3.5	7.0	10.5
Public expenditure planning total	**139.2**	**[146.4]**	**156.8**	**167.1**	**176.1**
General government gross debt interest*	17.6	[17.5]	[17.5]	[17]	[17]
Other adjustments*	8.0	[8.1]	[8.4]	[8]	[9]
General government expenditure*	**164.8**	**[171.6]**	**[183.0]**	**[193]**	**[201]**
General government expenditure excluding privatisation proceeds					
In real terms (base year 1986-87)	[169.2]	[168.2]	[171.4]	[173.5]	[174.4]
As a percentage of GDP	[43¾]	[41½]	[41¼]	[40¾]	[40]

*1989-90 and 1990-91 figures rounded to the nearest £1 billion

Changes since previous Budget

5.04 Since the last FSBR, extra resources have been allocated to priority services such as health, education, law and order, defence and inner cities. Provision for social security and local authority current spending has also been increased.

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Table 5.2 Comparison of plans and estimated outturn for 1987-88

	1987-88 £ billion		
	Plans[1]	Estimated outturn	Outturn minus plans
Central government[2]	108.3	[109.5]	[+1.2]
Local authority[2]	40.2	[41.0]	[+0.8]
of which:			
relevant expenditure	31.0	[32.2]	[+1.3]
other current	4.9	[5.1]	[+0.1]
capital	4.3	[3.7]	[-0.6]
Nationalised industries and other public corporations	1.6	[1.0]	[-0.6]
Privatisation proceeds	-5.0	[-5.0]	
Reserve	3.5		[-3.5]
Public expenditure planning total	**148.6**	**[146.4]**	**[-2.2]**

[1]Plans from The Government's Expenditure Plans 1987-88 to 1990-91, Cm 56, adjusted for classification changes.
[2]Excluding finance for nationalised industries and other public corporations

5.08 The major changes between plans and estimated outturn for particular programmes are

a net increase of £[1.2] billion in central government expenditure mainly due to an increase in expenditure by DHSS on Health and Personal Social Services of £[0.6] billion and higher net payments to the European

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~~a decrease of over £100 million on housing expenditure by the Department of the Environment~~

~~a decrease of £70 million in local authority capital expenditure~~

Table 5.3 Public expenditure by spending authority

	£ billion				
	1986-87 Outturn	1987-88 Estimated outturn	1988-89 Plans	1989-90 Plans	1990-91 Plans
Central government*	104.6	[109.5]	114.2	120.2	124.7
of which:					
Voted in Estimates	73.4	[77.0]	81.0	84.6	87.6
other	31.2	[32.6]	33.2	35.6	37.1
Local authorities*	37.9	[41.0]	42.6	44.0	45.2
of which:					
relevant expenditure	29.4	[32.2]	33.2	34.3	35.4
other current	4.8	[5.1]	5.4	5.7	5.9
capital	3.7	[3.7]	4.0	4.0	3.9
Nationalised industries	0.4	[0.4]	0.7	0.0	-0.4
Other public corporations	0.8	[0.6]	0.8	1.0	1.0
Privatisation proceeds	-4.4	[-5.0]	-5.0	-5.0	-5.0
Reserve			3.5	7.0	10.5
Public expenditure planning total	139.2	[146.4]	156.8	167.1	176.1

*Excluding finance for nationalised industries and other public corporations

Public expenditure by spending authority

5.10 Central government spending makes up about three quarters of the planning total. About 70 per cent of this is voted by Parliament

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5.12 Of the £[108.3] billion included in the Supply Estimates, £[83.0] billion is direct public expenditure. The remaining £[25.3] billion does not feature directly as public expenditure because it consists of grants to local authorities and finance for other bodies whose spending is counted as public expenditure. [Nearly 60] per cent of the money voted in Estimates is subject to cash limits, which provide the Government with greater control over its cash expenditure during the financial year.

Table 5.4 Supply expenditure

	£ billion			
	1986-87		1987-88	1988-89
	Expected outturn in 1987 Budget	Final outturn	Expected outturn	Provision
Main Supply Estimates	99.1	99.1	[104.5]	[108.3]
Supplementaries and net underspending	2.8	2.4	[1.2]	
Total Supply expenditure	**101.9**	**101.5**	**[105.7]**	
(public expenditure element)	(77.3)	[(77.1)]	[(79.7)]	

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µh1µ6 The public sector's finances

µh3µThe scope of this chapter

µ0µµbµ6.01µrµ This chapter brings together revenue (discussed in Chapter 4) and spending (in Chapter 5), and provides an analysis and forecast of the public sector's finances in 1988-89 together with estimates of outturn in 1987-88. It also comments on the main features of the public sector's finances in those two years, including the most important changes that have taken place since last year's projections. Table 6.1 is a summary.

Printer insert Table 6.1 Public expenditure, receipts and borrowing

µ0µµbµ6.02µrµ There is now estimated to be a negative public sector borrowing requirement, ie. a budget surplus, of about £3 billion in 1987-88, compared with the forecast of a PSBR of £4 billion made a year ago. This would be the first budget surplus since 1969-70 and only the second since 1952, the earliest year for which PSBR figures were available. A budget surplus of about £3 billion is also forecast in 1988-89.

µh3µPublic sector's finances: three-fold analysis

µ0µµbµ6.03µrµ The public sector's finances can be analysed in a number of different ways: by type or activity, by sector and by economic category. The rest of this chapter sets out these three analyses in detail.

6

µh2µPublic sector's finances: analysis by type or activity

µ0µµbµ6.04µrµ Table 1.2 analyses the public sector's finances by type or activity. The main receipts of general government (ie. central plus local government) are grouped according to the kind of activity which gives rise to them, while spending is shown by department, as in Chapter 5 and in the public expenditure White Paper. Its bottom line, the PSBR, is derived from those two totals. This derivation is repeated in Table 6.1.

µh3µReceipts

µ0µµbµ6.05µrµ General government receipts in 1987-88 are now projected to exceed the 1987 Budget forecast by about £4¾ billion. As Table 1.2 shows, most components of general government receipts are likely to be higher than originally forecast. The main contributors to the extra receipts are income tax (£1 billion), VAT (~~£1 billion~~), and North Sea Revenues (£¾ billion).

µ0µµbµ6.06µrµ Additional income tax receipts are mainly the result of the stronger growth of the economy and higher incomes. VAT receipts have increased by more in 1987-88 than would have been expected from the recorded increase in total consumer spending: this implies either that the proportion of total spending which goes on goods and services subject to VAT has increased, or that estimates of consumer spending in 1987 may be revised up later. The higher than expected oil revenues in 1987-88 are largely the result of a higher dollar oil price than assumed last year.

µ0µµbµ6.07µrµ General government receipts are forecast to rise by 6½ per cent in 1988-89, following an estimated 8½ per cent increase in 1987-88. This is a little less than the rate of growth forecast for money GDP. Without the Budget measures however forecast growth in receipts would be about 1½ percentage points above that of money GDP.

µ0µµbµ6.08µrµ Oil revenues, which in the event in 1987-88 were only slightly below the 1986-87 level, are forecast to fall by about £1 billion in 1988-89 as a result of both a lower average oil price and lower production. The forecast assumes that oil prices [remain close to recent levels]. Oil production is assumed to fall in 1988 to a level close to the centre of

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the Department of Energy's range. A $1 a barrel difference in the oil price in 1988 would change revenues by about £250 million in 1988-89 and £300 million in a full year. A change of 1 million tonnes in oil production in 1988, spread evenly across fields, would alter revenues by about £40 million in 1988-89 and £45 million in a full year.

µ0µµbµ6.09µrµ Non-oil receipts are forecast to rise by 7 per cent in 1988-89. As can be seen from Table 1.2 there is within this overall increase:

µ1µa 1½ per cent increase in income tax receipts. Without the Budget measures the forecast increase would have been 10 per cent;

µ1µa further rise of 24 per cent in receipts of corporation tax (including ACT but excluding North Sea mainstream corporation tax). This reflects continued growth in company profits in 1987.

µ1µa 16 per cent rise in capital taxes, mainly reflecting rising asset prices in earlier years;

µ1µa 8 per cent increase in VAT, in line with the forecast increase in consumers' expenditure;

µ1µa 5½ per cent increase in the excise duties on petrol, tobacco and alcohol, a little below the increase in consumers' expenditure reflecting the trend decline in the share of these items in the total;

µ1µa small fall in stamp duty following the fall in stock market prices and turnover.

µ0µµbµ6.10µrµ Table 6.2 shows taxes (including rates) and national insurance contributions as a percentage of GDP. Non-oil taxes have risen slightly as a percentage of non-oil GDP in each of the last two years, and [a further marginal increase] is forecast for 1988-89. Without the Budget measures the 1988-89 figure would have been about one percentage point higher.

Printer insert Table 6.2 Taxes and national insurance contributions (NICs) as a percentage of GDP

µh3µExpenditure

µ0µµbµ6.11µrµ General government expenditure is now forecast to be about £171½ billion in 1987-88, £2 billion lower than in the 1987 Budget forecast. The outturn for the planning total is expected to be £2½ billion lower than in the original plans, and gross debt interest payments nearly £½ billion lower than forecast. Partly offsetting these is an increase in other national accounts adjustments.

µ0µµbµ6.12µrµ General government expenditure is expected to rise by 6¾ per cent in 1988-89, to £183 billion. The planning total, at £156.8 billion, is as published in the public expenditure White Paper (Cm 288). General government gross debt interest payments in 1988-89 are now forecast to be lower than projected in the White Paper as a result of the marked reduction in the PSBR.

µh3µBorrowing

µ0µµbµ6.13µrµ The difference between general government receipts and expenditure is the general government borowing requirement (GGBR), as shown in Table 6.1. As general government lending to public corporations is included in general government expenditure, the GGBR together with public corporations' market and overseas borrowing, gives the PSBR.

µ0µµbµ6.14µrµ There was a substantial budget surplus in the first ten months of 1987-88. Excluding privatisation proceeds the PSBR was some £5½ billion lower than in the same period of 1986-87. This reduction in borrowing was almost entirely due to lower central government own account borrowing. Local authority borrowing has been higher than in 1986-87 and public corporations' borrowing little changed. Taking into account the well established pattern of relatively high borrowing in the final two months of the year, the forecast for 1987-88 as a whole is a budget surplus of about £3 billion, or ¾ per cent of GDP.

µ0µµbµ6.15µrµ A further budget surplus of £3 billion, or ¾ per cent of GDP, is forecast for 1988-89.

µh3µTrends in receipts and expenditure

µ0µµbµ6.16µrµ Chart 6.1 shows trends in taxes and expenditure as percentages of GDP. Revenues from non-oil taxes and national insurance contributions fell as a percentage of non-oil GDP between 1981-82 and 1985-86, but since then it has been rising. [It is forecast to rise marginally in 1988-89.] The ratio of general government expenditure (excluding privatisation proceeds) to GDP has fallen every year since 1982-83 except for a small rise in 1984-85 as a result of the miners' strike; it is forecast to fall again in 1988-89.

Printer insert Chart 6.1 Taxes and expenditure as a percentage of GDP

µ0µµbµ6.17µrµ Chart 6.2 shows the significant changes in the structure of general government receipts and expenditure which have taken place since 1978-79.

Printer insert Chart 6.2 The structure of receipts and expenditure

µh2µPublic sector's finances: analysis by sector

µ0µµbµ6.18µrµ Table 6.3 shows net borrowing in 1986-87 and 1987-88 by central government, local authorities and public corporations.

Printer insert Table 6.3 Public sector borrowing requirement

µ0µµbµ6.19µrµ Tables 6.4 to 6.6 show estimated outturns and forecasts of receipts and expenditure in 1987-88 and 1988-89 for each of the three sectors. These tables include some of the analysis by economic category in Table 6.7. Expenditure in 1988-89 does not include an allocation of the Reserve, although the forecast of the PSBR assumes that the Reserve is fully spent.

µh3µCentral government

µ0µµbµ6.20µrµ Central government spending includes grants and subsidies to local authorities and public corporations (including nationalised industries), which are included in the receipts of those sectors, shown in Table 6.5 and 6.6.

Printer insert Table 6.4 Central government transactions

µh3µLocal authorities

µ0µµbµ6.21µrµ Local authority receipts consist primarily of rate income plus grants from central government. The forecast increase in rate income (net of rate rebates) between 1987-88 and 1988-89 takes account of available information about rate decisions by local authorities, additions to rateable value, and changes to the system of rate rebates introduced by the Social Security Act 1986.

µ0µµbµ6.22µrµ The local authority borrowing requirement (LABR) fell sharply in 1986-87 to £¼ billion, from £1¾ billion in 1985-86. The LABR in the first ten months of 1987-88 was higher than in the same period of 1986-87 and it seems likely that borrowing in the year as a whole will be above that in 1986-87, although still well below the levels of earlier years. The estimates of local authority receipts and expenditure do not fully explain the LABR in 1986-87 and 1987-88 (other receipts in Table 6.5 and miscellaneous financial transactions in Table 6.7 include a balancing item).

Printer insert Table 6.5 Local authority transactions

µh3µPublic corporations

µ0µµbµ6.23µrµ Table 6.6 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations) their net external finance, ie their borrowing plus subsidies and grants, is included in the public expenditure planning total. Public corporations' net external financing requirement, and not their borrowing requirement (PCBR), is the best measure of the public corporations' total contribution to the PSBR, because it includes, in addition to borrowing, subsidies and grants provided by the central government which have to be financed from taxation or central government borrowing.

Printer insert Table 6.6 Public corporations' transactions

µ0µµbµ6.24µrµ Changes in public corporations' income and expenditure from one year to another are affected by privatisation which involve re-classifying privatised industries from the public corporation to the private sector in the national accounts. For example, although Table 6.6 shows a fall in gross trading surplus in 1987-88, the gross trading surplus of those industries remaining in the public sector rose strongly in 1987-88. The underlying buoyancy of the gross trading surplus is a major reason why the PCBR is estimated to have risen only slightly between 1986-87 and 1987-88, despite the inclusion in the 1986-87 figures of negative net borrowing by corporations now in the private sector.

µh2µPublic sector's finances: analysis by economic category

µ0µµbµ6.25µrµ The full analysis of receipts and expenditure by economic category is shown in Table 6.7, with a breakdown between central government, local authorities and public corporations. This analysis, which distinguishes between current and capital transactions (and within the latter between physical and financial investment) shows the derivation of the public sector financial deficit. The financial deficit, unlike the PSBR, is not wholly a measure of cash transactions because certain items above line 24 in Table 6.7, for example some taxes included in lines 1 and 2, are measured on an accruals basis. An accruals adjustment is accordingly made in line 28.

µ0µµbµ6.26µrµ The unallocated Reserve is assumed to be used up by spending on current items or physical capital formation ie. in transactions that fall above the financial surplus/deficit line. In practice allocations from the Reserve can affect financial transactions (lines 25 to 29).

Printer insert Table 6.7 Public sector transactions by sub-sector and economic category

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µh1µAnnex to Chapter 6

µh2µPart A: relationship between tables in Chapter 6, and with Table 1.2; and outturn data

µh3µRelationship between tables

µ0µµbµ6A.1µrµ Table 6.7 is based on the definitions used to compile the national accounts. In order to show the financial deficit for each sector, lending and other financial transactions are separated from the analysis of receipts and expenditure in lines 1-23 and shown in lines 25-29. These lines show the relationship between the financial deficit (line 24) and the borrowing requirement for each sector (line 30).

µ0µµbµ6A.2µrµ Tables 6.4-6.6 are summary versions of the sectoral columns of Table 6.7. The information in Table 6.7 is rearranged so that, for example, central government grants to local authorities (which appear as negative expenditure in the local authorities column of Table 6.7, lines 16 and 21) appear as receipts in Table 6.5. Interest paid by local authorities to central government (which appears as negative receipts in the local authorities column of Table 6.7, line 8) appears as expenditure in Table 6.5. Finally, lending and other financial transactions (lines 25-29 of Table 6.7) are included in the receipts and expenditure of Tables 6.4-6.6.

µ0µµbµ6A.3µrµ Table 1.2 in Chapter 1 uses the same information as Table 6.7, but again rearranges it. To derive general government expenditure, it starts by giving a departmental breakdown of the public expenditure planning total: that includes not only general government expenditure items in the third column of Table 6.7 (including the "financial transactions" in lines 25-26), but also borrowing or capital expenditure by public corporations in the fourth column. General government expenditure as shown in Table 1.2 is then obtained by adding general government debt interest from the third column of Table 6.7 and the national accounts adjustments already included in Table 6.7, and deducting public corporations' borrowing from the market and from overseas.

µ0µµbµ6A.4µrµ Alternatively, general government expenditure in Table 1.2 (and Table 2.4) can be obtained as the sum of lines 22, 23, 25 and 26 (third column) in Table 6.7 and on-lending to public corporations in Table 6.3.

µ0µµbµ6A.5µrµ To derive general government receipts, Table 1.2 takes the receipts shown in the third column of Table 6.7 (lines 11, 27, 28 and 29) and rearranges them according to the type of activity which gives rise to them. For example, oil revenues comprise North Sea corporation tax and petroleum revenue tax (included in "taxes on income" in Table 6.7) plus oil royalties. The sub total "total taxes and royalties" is the same as the first line of Table 2.5 in Chapter 2.

µh3µOutturn data

µ0µµbµ6A.6µrµ Outturns for the PSBR and the statutory central government accounts (as in Tables 6B.1-4 in Part B of the Annex) are compiled monthly and published by press notice 12 working days after the end of the month and then in more detail in Tables 2.5 and 3.12 and 3.16 of the following issue of Financial Statistics. Details of the PSBR on national accounts definitions, as in Table 6.7, are compiled quarterly and published in sections 2 to 5 of Financial Statistics three months after the end of the quarter.

µ0µµbµ6A.7µrµ The first outturn for the PSBR in 1987-88 will accordingly be published on April 20. The first national accounts outturns for 1987-88 will appear in the June issue of Financial Statistics, including supplementary Table 13 which is based on Table 6.7.

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µh2µPart B: central government transactions

µh3µCommentary on the tables

µ0µµbµ6B.1µrµ The tables in Part B of this Annex are confined to central government transactions, and are based on the statutory funds and accounts. Their relationship to the accounts of central government on a national accounts basis (as in Table 6.4) is described in the Financial Statistics Explanatory Handbook (1987 edition, p38). The receipts and payments in the Part B tables are all shown on a cash basis, not accrued. Table 1.2, however, shows the main categories of taxes on an accrued basis as in the national accounts: for instance the item "income tax" in Table 1.2 differs slightly from "income tax" in Table 6B.3

Printer insert Table 6B.1 Summary of central government transactions

Printer insert Table 6B.2 Consolidated Fund expenditure

Printer insert Table 6B.3 Consolidated Fund revenue

Printer insert Table 6B.4 National Loans Fund receipts and payments

THE PUBLIC SECTOR'S FINANCES

The scope of this chapter

6.01 This chapter brings together revenue (discussed in Chapter 4) and spending (in Chapter 5), and provides an analysis and forecast of the public sector's finances in 1988-89 together with estimates of outturn in 1987-88. It also comments on the main features of the public sector's finances in those two years, including the most important changes that have taken place since last year's projections. Table 6.1 is a summary.

Table 6.1 Public expenditure, receipts and borrowing

	£ billion			
	1986-87	1987-88		1988-89
	Outturn	1987 Budget	Latest estimate	Forecast
General government expenditure	164.8	173.5	171.6	182.8
General government receipts	160.0	168.8	173.5	184.7
General government borrowing requirement	4.9	4.7	- 2.0	- 1.9
Public corporations' market and overseas borrowing	- 1.5	- 0.8	- 0.9	- 1.2
Public sector borrowing requirement	3.4	3.9	- 2.9	- 3.1

6.02 There is now estimated to be net public sector debt repayment (PSDR) of about £3 billion in 1987-88, compared with a forecast of a public sector borrowing requirement (PSBR) of £4 billion made a year ago. This would be the first budget surplus since 1969-70 and only the second since 1952, the earliest year for which PSBR figures are available. There is also forecast to be a net repayment of about £3 billion in 1988-89.

Public sector's finances: three-fold analysis

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

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takes account of available information about rate decisions by local authorities, additions to rateable value, and changes to the system of rate rebates introduced by the Social Security Act 1986.

6.22 The local authority borrowing requirement (LABR) fell sharply in 1986-87 to £¼ billion, from £1¾ billion in 1985-86. The LABR in the first ten months of 1987-88 was higher than in the same period of 1986-87 and it seems likely that borrowing in the year as a whole will be above that in 1986-87, although still well below the levels of the years immediately prior to that. The estimates of local authority receipts and expenditure do not fully explain the LABR in 1986-87 and 1987-88 (other receipts in table 6.5 and miscellaneous financial transactions in table 6.7 include a balancing item).

Table 6.5 Local authority transactions

	£ billion		
	1986-87 Outturn	1987-88 Latest estimate	1988-89 Forecast
Receipts			
Rates (net of rate rebates)[1]	15.6	17.0	19.2
Rate support grant	11.8	12.6	13.3
Other grants from central government	11.0	12.1	12.2
Other	6.3	5.2	5.6
Total receipts	**44.7**	**46.9**	**50.4**
Expenditure			
Current expenditure on goods and services	31.1	34.1	35.2
Current grants and subsidies	5.4	5.8	6.0
Interest	4.1	4.4	4.5
Net lending and capital expenditure	4.2	3.8	4.4
Total expenditure	**44.8**	**48.1**	**50.1[2]**

1 Memo: Rate rebates 1.7 1.8 1.4

2 Excluding any allocation from the Reserve

Public corporations

6.23 Table 6.6 shows public corporations' transactions. The public corporations' receipts include subsidies and capital grants from central and local government. For the nationalised industries (and the majority of other public corporations) their net external finance, ie. their borrowing plus subsidies and grants, is included in the public expenditure planning total. Public corporations' net external financing requirement, and not their borrowing requirement (PCBR), is the best measure of the public corporations' total contribution to the PSBR, because it also includes as well as borrowing subsidies and grants provided by the central government which have to be financed from taxation or central government borrowing.

Table 6.6 Public corporations' transactions

	£ billion		
	1986-87 Outturn	1987-88 Latest estimate	1988-89 Forecast
Receipts			
Gross trading surplus (including subsidies)	7.4	7.0	7.4
Other	2.9	2.1	2.2
Total receipts	**10.3**	**9.1**	**9.6**
Expenditure			
Interest, dividends and taxes on income	3.3	3.1	3.8
Net lending and capital expenditure	5.5	4.7	5.7
Total expenditure	**8.8**	**7.9**	**9.5***
Memo: nationalised industries' external finance	0.4	0.4	0.7
other public corporations' contribution to the planning total	0.8	0.6	0.8

* Excluding any allocation from the Reserve

6.24 Changes in public corporations' income and expenditure from one year to another are affected by privatisations which

Table 6.7 Public sector transactions by sub-sector and economic category

	Line[1]	£ billion 1987–88 Latest estimates General government: Central government	Local authorities	Total	Public corporations	Public sector
Current and capital receipts						
Taxes on income, and oil royalties	1	59.2	-	59.2	-0.1	59.1
Taxes on expenditure	2	52.4	17.0	69.4	-	69.4
Taxes on capital	3	3.6	-	3.6	-	3.6
National insurance and other contributions	4	28.8	-	28.8	-	28.8
Gross trading surplus	5	-0.6	0.5	-0.1	7.0	6.9
Rent and miscellaneous current transfers	6	0.3	3.0	3.4	0.5	3.9
Interest and dividends from private sector and abroad	7	3.2	0.9	4.1	0.7	4.8
Interest and dividends within public sector	8	5.8	-3.7	2.1	-2.1	-
Imputed charge for non-trading capital consumption	9	1.2	1.6	2.7	-	2.7
Capital transfers from private sector	10	-	-	-	0.1	0.1
Total receipts	11	**154.0**	**19.3**	**173.2**	**6.1**	**179.4**
Current and capital expenditure						
Current expenditure on goods and services	12	53.0	34.1	87.1	-	87.1
Subsidies	13	5.2	1.0	6.2	-	6.2
Current grants to personal sector	14	48.2	4.7	53.0	-	53.0
Current grants paid abroad	15	3.6	-	3.6	-	3.6
Current grants within public sector	16	23.7	-23.7	-	-	-
Debt interest	17	16.9	0.6	17.5	0.6	18.1
Gross domestic fixed capital formation	18	3.6	3.8	7.4	4.5	11.9
Increase in stocks	19	-0.1	-	-0.1	0.1	-
Capital grants to private sector	20	1.9	0.6	2.5	0.1	2.6
Capital grants within public sector	21	1.7	-1.0	0.7	-0.7	-
Total expenditure	22	**157.7**	**20.2**	**177.9**	**4.6**	**182.4**
Unallocated Reserve	23	-	-	-	-	-
Financial surplus/deficit	24	**-3.7**	**-0.9**	**-4.6**	**1.6**	**-3.0**
Financial transactions						
Net lending to private sector and abroad	25	-0.1	0.6	0.5	-0.1	0.4
Cash expenditure on company securities (net) (including privatisation proceeds)	26	5.4	-	5.4	-	5.4
Transactions concerning certain public sector pension schemes	27	0.6	-	0.6	-	0.6
Accruals adjustments	28	0.1	0.1	0.1	-	0.1
Miscellaneous financial transactions	29	0.6	-0.9	-0.3	-0.2	-0.6
Borrowing requirement	30	**-2.8**	**1.1**	**-1.6**	**-1.2**	**-2.9**

[1] *Relationship between lines.* (24) = (11) − (22) + (23)
(30) = −(24 to 29)

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£ billion[1]

1988–89 Forecasts

Line[2]	General government: Central government	General government: Local authorities	General government: Total	Public corporations	Public sector	
						Current and capital receipts
1	62.0	-	62.0	-0.7	61.3	Taxes on income, and oil royalties
2	55.6	19.2	74.8	-	74.8	Taxes on expenditure
3	4.2	-	4.2	-	4.2	Taxes on capital
4	31.6	-	31.6	-	31.6	National insurance and other contributions
5	-0.1	0.5	0.5	7.4	7.9	Gross trading surplus
6	0.4	3.0	3.4	0.6	3.9	Rent and miscellaneous current transfers
7	3.0	0.9	3.8	0.7	4.5	Interest and dividends from private sector and abroad
8	6.1	-4.1	2.0	-2.0	-	Interest and dividends within public sector
9	1.2	1.6	2.8	-	2.8	Imputed charge for non-trading capital consumption
10	-	-	-	0.2	0.2	Capital transfers from private sector
11	**163.8**	**21.1**	**184.9**	**6.1**	**191.0**	**Total receipts**
						Current and capital expenditure
12	55.5	35.2	90.7	-	90.7	Current expenditure on goods and services
13	4.6	0.9	5.6	-	5.6	Subsidies
14	50.5	5.0	55.5	-	55.5	Current grants to personal sector
15	2.9	-	2.9	-	2.9	Current grants paid abroad
16	24.7	-24.7	-	-	-	Current grants within public sector
17	17.4	0.2	17.6	0.9	18.5	Debt interest
18	3.9	4.0	8.0	5.4	13.4	Gross domestic fixed capital formation
19	-	-	-	0.1	0.1	Increase in stocks
20	1.9	0.7	2.6	0.1	2.6	Capital grants to private sector
21	1.5	-0.8	0.7	-0.7	-	Capital grants within public sector
22	**163.0**	**20.6**	**183.6**	**5.8**	**189.4**	**Total expenditure**
23					3.5	Unallocated Reserve
24					**-1.9**	**Financial surplus/deficit**
						Financial transactions
25	-0.5	0.3	-0.2	-0.1	-0.3	Net lending to private sector and abroad
26	5.0	-	5.0	-	5.0	Cash expenditure on company securities (net) (including privatisation proceeds)
27	0.6	-	0.6	-	0.6	Transactions concerning certain public sector pension schemes
28	-0.1	-	-0.1	-	-	Accruals adjustments
29	0.3	-0.5	-0.2	-0.2	-0.3	Miscellaneous financial transactions
30					**-3.1**	**Borrowing requirement**

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6A.7 The first outturn for the PSBR in 1987-88 will accordingly be published on April 20. The first national accounts outturns for 1987-88 will appear in the June issue of Financial Statistics, including supplementary Table 13 which is based on Table 6.7.

Part B: central government transactions

Commentary on the tables

6B.1 The tables in Part B of this Annex are confined to central government transactions, and are based on the statutory funds and accounts. Their relationship to the accounts of central government on a national accounts basis (as in Table 6.4) is described in the Financial Statistics Explanatory Handbook (1987 edition, p38). The receipts and payments in the Part B tables are all shown on a cash basis, not accrued. Table 1.2, however, shows the main categories of taxes on an accrued basis as in the national accounts: for instance the item "income tax" in Table 1.2 differs slightly from "income tax" in Table 6B.3.

Table 6B.1 Summary of central government transactions

	£ billion 1987-88 Latest estimate
Consolidated Fund	
Revenue (Table 6B.3)	123.0
Expenditure (Table 6B.2)	121.2
National Loans Fund (Table 6B.4)	
Receipts	16.7
Payments	21.6
Surplus transferred from Consolidated Fund	1.8
Total net borrowing by the National Loans Fund	3.1
Surplus on other funds and accounts (net)	1.0
Central government borrowing requirement* (Table 6.3)	**2.1**

* Including borrowing for on-lending to local authorities and public corporations

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Table 6B.2 Consolidated Fund expenditure

	£ million 1987-88 latest estimate
Supply issues[1]	105,190
Standing services	
Payment to the National Loans Fund in respect of service of the national debt	9,800
Northern Ireland - share of taxes etc	2,220
Payments to the European Communities	3,890
Other services	100
Total standing services	16,010
Total Consolidated Fund expenditure	**121,200**

[1] Supply Issues are monies paid from the Consolidated Fund to departments' cash accounts with the Paymaster General for spending on Supply. Supply Expenditure (see Table 5.4) equates closely to total Supply Issues in most years, although there may sometimes be slight timing differences between the two.

Table 6B.3 Consolidated Fund revenue

£ million

	1987-88 1987 Budget	1987-88 Latest estimate	1988-89 Forecast
Inland Revenue			
Income tax[1]	39,900	41,250	41,730
Corporation tax[2,3]	15,000	15,800	19,420
Petroleum revenue tax[4]	1,680	2,210	1,340
Capital gains tax	1,300	1,350	1,790
Development land tax	20	25	10
Inheritance tax[5]	1,100	1,070	970
Stamp duties	2,100	2,450	2,200
Total Inland Revenue	**61,100**	**64,150**	**67,460**
Customs and Excise			
Value added tax	23,300	24,300	26,220
Petrol, derv etc	7,800	7,700	8,370
Cigarettes and other tobacco	4,800	4,800	4,930
Spirits, beer, wine, cider and perry	4,300	4,300	4,400
Betting and gaming	800	780	860
Car tax	1,100	1,100	1,210
Other excise duties	20	20	20
EC own resources[6]			
Customs duties, etc	1,350	1,440	1,480
Agricultural levies	230	190	200
Total Customs and Excise	**43,800**	**44,630**	**47,670**
Vehicle excise duties[7]	2,600	2,720	2,770
Gas levy	490	520	500
Broadcasting receiving licences	1,030	1,030	1,140
Interest and dividends	1,020	1,080	680
Other[8]	7,600	8,930	7,050
Total Consolidated Fund revenue	**117,500**	**123,040**	**127,270**

1 See paragraph 6B.1			
2 Includes advance corporation tax (net of repayments)	4,700	4,900	5,590
3 North Sea corporation tax	1,400	1,360	1,500
of which satisfied by setting off ACT	800	630	780

Liability to corporation tax arising in respect of North Sea production may be satisfied by setting off ACT arising on dividends paid in previous periods in respect of both onshore activities. Dividends and ACT associated with North Sea activities alone cannot be identified.

4 Includes advance payments of petroleum revenue tax
5 Includes estate duty and capital transfer tax
6 Customs duties and agricultural levies are accountable to the European Communities as 'own resources'; actual payments to the Communities are recorded in Table 6B.2.
7 Includes driving licence receipts
8 Includes the 10 per cent of 'own resources' refunded by the European Communities to meet the costs of collection, privatisation proceeds and oil royalties (see Table 1.2).

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Table 6B.4 National Loans Fund receipts and payments

	£ million 1987-88 Latest estimate
Receipts	
Interest on loans, profits of the Issue Department of the Bank of England, etc	6,920
Service of the National Debt - balance met from the Consolidated Fund	9,800
Total receipts	**16,720**
Payments	
Service of the National Debt:	
interest	16,550
management and expenses	170
Total service of the National Debt	16,720
Loans to:	
nationalised industries	- 320
other public corporations	- 160
local authorities	5,190
private sector and within central government	180
Total National Loans Fund lending*	4,890
Consolidated Fund surplus	1,840
Total payments	**20,610**

* On-lending to local authorities and public corporations in Table 6.3 includes, in addition to National Loans Fund lending, net lending from other funds and accounts (mainly Supply Issues in Table 6B.2).

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cc Sir G Littler O/R
Mr Culpin
Mr Allan

Miss Sinclair

Please would you prepare a draft for Sir G Littler's return from various international meetings on Friday 11 March?

MCS 4/3

pps

COPY NO 1c OF 4

FROM: A C S ALLAN
DATE: 3 March 1988

MR SCHOLAR

cc Sir G Littler

BUDGET: MESSAGE TO G5 AND/OR EC COLLEAGUES

The Chancellor was grateful for your minute of 1 March. He sees little point in a message to Finance Minister colleagues about the Budget measures, since their own Embassies will in any event report to them. But he is tempted to shock them with short message giving growth forecast, budget surplus and top rate! What do you and Sir G Littler think?

ACSA

A C S ALLAN

506/CUR

BF 8/3

COPY NO 4 OF 4

FROM: A C S ALLAN
DATE: 3 March 1988

MR SCHOLAR

cc Sir G Littler

BUDGET: MESSAGE TO G5 AND/OR EC COLLEAGUES

The Chancellor was grateful for your minute of 1 March. He sees little point in a message to Finance Minister colleagues about the Budget measures, since their own Embassies will in any event report to them. But he is tempted to shock them with short message giving growth forecast, budget surplus and top rate! What do you and Sir G Littler think?

ACSA

A C S ALLAN

7 MAR 1988

The Association for the Protection of Rural Scotland

14a Napier Road, Edinburgh EH10 5AY Telephone: (031) 229 1898

PMP

The Right Honourable Norman Lamont Esq., M.P.,
Treasury Chambers,
Parliament Street,
LONDON
SW1P 3AG

7 MAR 1988

Mr. Monck
PPS, CST
Sir P. Middleton Mr. Anson
Mr. Burgner Mr. Marshall IR

3rd March 1988

Dear Minister,

As the budget approaches, it was agreed at our quarterly Council Meeting held on Tuesday, 1st March, that I should write to you to ask that you consider the Treasury's fiscal approach to forestry and tree planting with a view to revising it.

As you know, financial benefits accrue to investors primarily through tax relief rather than through grant aid. This system creates an advantage to persons who, without knowledge of the area to be planted, have money which they wish to be salted away in an investment that has the greatest tax advantage to them, without regard to any other factor. This has, unfortunately, led to a position where great areas of Scotland are being planted, largely to take advantage of the Treasury's fiscal rules in the matter.

A.P.R.S. is not opposed to forestry. It is not opposed to forestry being grant aided provided it is done in such a way as to enhance the countryside and provide jobs. The present financial system encourages mono-culture and not silviculture.

A.P.R.S. does not think that forestry planting would stop if a system of forestry grants was used in place of the present system. The forestry industry, like farming, is flexible, and would soon accustom itself to the new, while possibly regretting the demise of the old.

There is a general feeling in the rural areas of Scotland that many forestry schemes are done without regard to the fishing, the scenery, the tourist industry or to local employment. /......

RH

cont.

The Working Party on Forestry created by A.P.R.S. in 1987 was chaired by our Chairman, who is a farmer, and included a land use consultant, a land-owner with nursery plantations as well as forests, a botanist, a planner, a solicitor involved in many large estates in Scotland, the Assistant Director, who is a civil engineer and retired colonial administrator and myself. Its recommendations were approved by our Council whose membership is very wide. I enclose a list showing their names and whom they represent. I enclose a copy of our press release dated 21/7/87.

We hope that you will take steps to re-consider the tax concessions for forestry and revise them in such a way as will be seen to be just to the taxpayer, the forestry industry and to the rural environment.

Yours sincerely

Director

THE COUNCIL

ELECTED MEMBERS

President	Sir Ilay Campbell of Succoth, Bart.
Chairman	Donald A. Reid W.S.
Vice-Chairman	Patrick Playfair-Hannay
Members	Mrs. R.M. Hedderwick, Edinburgh
	J. Grant Roger, Melrose
	Stewart Tod, R.I.B.A., R.I.A.S., Edinburgh
	G. Ronald Curtis, Edinburgh
	Wm. M. Black, Edinburgh
	Lt. Comm. H. Campbell-Gibson, R.N., Argyll
	Hon. C.A. Pearson, Aberdeenshire
	Mrs. Catherine Crawford, Edinburgh
	Mrs. Margaret Ogilvie, Angus
	Miss Sally Balfour, Montrose

CONSTITUENT BODIES and their REPRESENTATIVES

Automobile Association	I.W. Herd
The Caravan and Camping Club of G.B. and I. Ltd.	J. Sutherland
Caravan Club	T.A.L. Wallace
Countrywide Holidays Association	A.I. Paine, M.A., F.B.I.M.
Cyclists Touring Club	D.M.W. Napier
Holiday Fellowship Ltd.	M.J. Carter
Ladies Scottish Climbing Club	Miss Jean Galbraith
National Farmers Union of Scotland	J.A. Melrose
National Trust for Scotland	Mrs. Margaret Ogilvie
Ramblers Association	Wm. Forsyth
Royal Automobile Club	S. Horton
Royal Highland & Agricultural Society	J. Manuel
Royal Incorporation of Architects in Scotland	I.M. Begg, D.A. (Edin.), R.I.B.A., R.I.A.S.
Royal Institution of Chartered Surveyors	Robert Balfour, A.R.I.C.S.
Royal Scottish Forestry Society	Professor C.J. Taylor
Royal Scottish Society for Painters in Watercolours	Wm. J.L. Baillie, R.S.A.
Scottish Salmon Anglers Federation	Gerald Barry
Scottish Countryside Rangers Association	Bob Reid
Scottish Landowners Federation	Mrs. Anna Boreham
Scottish Mountaineering Club	C.C. Gorrie, B.Sc.
Scottish National Housing and Town Planning Association	Councillor Mrs. Gardner
Scottish Women's Rural Institutes	Mrs. J. Hunter Blair
Scottish Youth Hostels Association	J.L. Taylor
The Salmon Conservancy	Mrs. Harriet Comfort
Society of Scottish Artists	–

AFFILIATED SOCIETIES and their REPRESENTATIVES

Ardlamont Preservation Society	Mrs. Fiona Torbet
Banff Preservation Society	Mrs. M.M. Urquhart of Craigston
Berwickshire Civic Society	D. Maxwell
Berwickshire Naturalists Club	P.W. Simpson, C.A.
Central & North Fife Preservation Society	Captain D.O. Fairlie, M.B.E., D.L.
Cockburn Association	Oliver Barratt
Council for British Archaeology Scotland	R.C. Callender
Crail Preservation Society	Dr. C. Grant
Galloway Preservation Society	A.C. Wolffe, M.B.E., R.I.B.A., F.R.I.A.S., M.R.T.P.I., F.S.A.(Scot.)
Glasgow Tree Lovers Society	Mrs. S.T. McSkimming
Kilcreggan & Roseneath Amenity Society	H. Craig, B.Sc.(Hons) Eng.
Kyle & Carrick Civic Society	Robert Close
Lasswade District Civic Society	D.J. O'Brien
Orkney Heritage Society	Mrs. Eric Linklater
St. Andrews Preservation Trust	H.L.M. Stewart
St. Andrews Society of East Lothian	Mrs. J. Routledge

EXECUTIVE COMMITTEE

Chairman	Donald A. Reid, W.S.
Vice-Chairman	Patrick Playfair-Hannay

MEMBERS

To serve for one year	Robert Close
	Mrs. Anna Boreham
To serve for two years	Hon. Charles Pearson
	Lt. Comm. H. Campbell Gibson
To serve for three years	Stewart Tod, R.I.B.A., R.I.A.S.
	Miss J. Galbraith

The following was co-opted on to the committee and became Deputy Director on a voluntary basis

W.M. Black

HISTORIC ROADS & BRIDGES COMMITTEE

Chairman	G. Ronald Curtis
Members	D.A. Reid; C.C. Gorrie
	S. Tod; W.M. Black
	Geoffrey Stell; R.L. Smith

The Association for the Protection of Rural Scotland
14a Napier Road, Edinburgh EH10 5AY Telephone: (031) 229 1898

FORESTRY

Press Release

21/7/87.

A.P.R.S., aware of the public interest in afforestation and indeed the public debate that has been proceeding for some time now, has felt that some radical suggestions as to how to proceed in the short term, might lead to a more satisfactory outcome to the problem.

A.P.R.S. accepts that forestry, both planting and re-planting should be subject to a licence granted by a national body advised by more representative Regional Forestry Advisory Committees, which would have a much greater requirement to consult more widely than the existing Regional Forestry Advisory Committees have at present. The refusal to grant a licence would mean that there would be no forestry grant or fiscal (tax) benefit from planting.

A.P.R.S. believes that the Forestry Commission is not the proper body to grant licences for this purpose. The reason for this is that the Forestry Commission was created to encourage forestry and to ensure that the country has a strategic supply of timber. While other constraints have been placed on it since its creation, nevertheless its major job is to ensure that planting of trees occurs.

A.P.R.S. has considered whether or not planning committees of local authorities with planning powers would be the proper bodies to grant licences for this purpose. It has come down against this solution because, inter alia, this would not protect the national interest, (local planning committees can be idiosyncratic), because forests can and do overlap local council areas and this could lead to unacceptable solutions. The expertise in such councils is very limited and to increase staffing in all local councils so that they could each employ the necessary extra staff would be a larger burden than most councils could face today with government restrictions placed on them.

A.P.R.S. believes that a body independent of the Forestry Commission would be the way ahead. It believes that a body such as the Countryside Commission for Scotland with expanded staffing and resources as required is a sensible body to undertake the issue of licences. It is, after all, the one body in Scotland that has an overview of the whole of rural Scotland.

With its present level of staffing, the Countryside Commission for Scotland could not do the necessary work, therefore additional resources would have to be made available to it. This would prove less expensive a way of dealing with the situation than if all local planning authorities had extra staff. The alternative would be to create a new body independent of the Forestry Commission but this would have much more costly implications.

A.P.R.S. believes that shelter belts and amenity planting up to 2.5 hectares should be excluded from the licence system.

A.P.R.S. envisages that the Forestry Commission or in appropriate cases the Department of Agriculture and Fisheries for Scotland, would still issue the grant and oversee the maintenance of the woodlands for a five year period.

It is worth repeating that, under our proposals, if a licence were not granted there would be no financial benefit of any kind to the planter.

4.

For more information contact:-

Patrick Playfair-Hannay

Chairman of A.P.R.S. and of the Forestry Working Group.

Telephone: 057 382 227 (Yetholm exchange)

or

Robert L Smith

Director of A.P.R.S.

Telephone: 031 229 1898 (Edinburgh)

mjd 4/31An

CONFIDENTIAL

PMP

FROM: A P HUDSON
DATE: 3 March 1988

SIR T BURNS

cc Mr ACS Allan

BUDGET SPEECH: SECTION B

I attach a slightly revised version of Section B.

2. Perhaps we could discuss this, once you have finished working through it. There are three things, in particular, which I am not yet happy with:

(a) Inflation - should we make the point that, in contrast to previous periods, inflation has remained low during this spell of rapid growth, and if so, where? And should we put the commitment to stable prices here, or in the Monetary section, or both? (Or neither!)

(b) The current account, 1987 and the forecast.

(c) The last few paragraphs on the world economy.

APH

A P HUDSON

mjd 17/B

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 predicted. 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 [both in the three quarters before the collapse, and in the fourth quarter after it.]

B4. Output in 1987 looks to have grown by 4.3 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 was a year of slightly above-average growth within a steady upward trend. Indeed, the six years to 1987 have been the longest period of steady growth, at a rate averaging 3 per cent a year, that we have achieved since the War. During both the 1960s 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. Although growth in 1987 turned out significantly faster than expected, [with exports and consumer spending both rising faster than had been predicted], inflation turned out broadly as forecast in last year's Budget, at a little over 4 per cent.

B6. 1987 was [a real landmark:] the first year for a generation in which the rate of real growth was higher than the rate of inflation.

B7. The plain fact is that the economy has been transformed. Prudent financial policies have given the private sector the room and confidence to expand. And supply-side ~~policies~~ reform, including tax reform, has reduced the burdens which held British industry and individual enterprise in check for far too long.

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 fed through into a fall of half a million in the numbers of people out of work [including a sizeable fall in the number of long-term unemployed]. Unemployment fell in all regions. And the proportion of the workforce unemployed fell by a bigger margin than in any other major country.

B9. [As I predicted a year ago], the performance of manufacturing industry was outstanding in 1987, with output up by 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, and we again led the way in 1987. This is a stark contrast to the 1960s and 1970s, when in productivity, as in so much else, we were bottom of the league.

B10. The current account of the balance of payments in 1987 looks to have been in deficit by £1 billion, or ¼ per cent of GDP, well below the forecast I made this time last year. The surplus on invisible trade turned out very close to what was forecast, and the improvement overall is the result of a very strong rise in exports, with non-oil exports up 7 per cent, and manufactures up 9 per cent. [British manufacturers have maintained their share of world trade since the early 1980s, after decades in which it fell constantly.]

B11. Thus, in 1987, growth turned out ahead of forecast, but inflation was in line with expectations, and the current account well below what was forecast, even though growth in the UK outpaced other countries. This excellent outcome is testimony to the step change that has taken place in the efficiency and adaptability of British businesses.

B12. Looking ahead to 1988, I expect another year of healthy growth with low inflation.

B13. Output is forecast to rise by 3 per cent, more or less in line with the steady trend of recent years. The rise in exports is set to continue, though the pace may moderate. Consumer spending is likely to grow rather more slowly than in 1987, but business investment is set to be much stronger.

B14. The non-oil economy, which is the main source of new jobs, should expand more rapidly than total GDP, at a rate of 3½ per cent. [The pace of growth may ease over the year, but] there is every prospect that unemployment will continue to fall [though the speed of this may slow from the record decline in 1987].

B15. [Inflation, as measured by the RPI, rose to just under 4½ per cent in the third quarter of last year, but has since fallen back to under 3½ 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.

B16. [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 gradually squeezing inflation out of the system continues to be my central priority. Under the last Labour Government, inflation averaged over 15 per cent. In our first Parliament, we got it down to 11½ 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.]

B17. The UK is again likely to grow faster than most 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. I expect the non-oil trade balance to remain at around the same level as in the second half of 1987. But with our surplus on oil trade falling as North Sea oil output falls, the current account deficit may increase to some £3 billion in 1988, around ¾ per cent of GDP.

B18. This will be very much smaller than the external imbalances in the three largest economies. 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.

B19. 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 slip, and keep a tight grip on costs, and in particular pay costs.

B20. 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. Strong growth in North America, Japan, and the UK offset a sluggish performance in Continental Europe, especially Germany.

B21. The latest indications suggest that activity remains fairly buoyant. But the stock market collapse is likely to dampen demand in the US, and I expect overall growth in the major seven countries to be around 2½ per cent in 1988, slightly slower than this year.

B22. However, the prospect of sustained growth is an uncertain one, given the persistence of the 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 of Japan and Germany.

B23. These countries have begun to make the policy adjustments necessary to reduce these imbalances. And there are signs that the steps they have taken 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.

B24. That is why I believe that greater exchange rate stability provides the right framework for a sustained reduction in the imbalances, and indeed for healthy growth in the world economy. Stable currencies offer the best climate for companies, including, of course, British companies, to plan ahead and invest - not least because they do not have to spend precious time on coping with currency fluctuations.

B25. 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, of course, the objective of the Louvre agreement, and of the G7 agreement in December. And although there have been periods of turbulence, it is worth noting that the dollar is now within [8 per cent] of the rate against the Deutschmark that applied at the time of the Louvre.

B26. Success in achieving stable currencies, and a reduction in the imbalances, 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, in a framework of international co-operation, as has been the case for well over two years now. I can assure the House that we shall be playing our full part.

B27. 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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BUDGET

COPY NO 4 OF 4

FROM: A P HUDSON
DATE: 3 March 1988

MR MOWL

cc Mr Sedgwick (without attachment

BUDGET SPEECH: SECTIONS A-D

... As promised, I attach a copy of the whole of the Economic Section of the Budget Speech.

2. Please could I have any comments by lunchtime tomorrow.

APH

A P HUDSON

SECRET

B.L.O.

SECRET

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FROM: COLIN MOWL
DATE: 4 March 1988

MR A P HUDSON

cc Mr Sedgwick
Mr Odling-Smee

BUDGET SPEECH

Para D10

The non-oil tax burden was 34.1 per cent in 1978-79 and is projected at 37.5 in 1987-88. This is an increase of 3½ per cent, not "nearly 4 percentage points" as stated in the draft. The latter figure is the change in the total tax burden.

Colin Mowl

COLIN MOWL

Mr Mowl

~~Dropped from speech~~

Thanks. This is out of the speech at the moment, but I'll bear it in mind for future drafts.

APH

4483/4/PN

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BUDGET

COPY NO 1 OF 10

FROM: ROBERT CULPIN
DATE: 3 March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Sir P Middleton
Mr Scholar
Mr Odling-Smee
Mr Pickford
Mr Riley
Miss Sinclair

SECRET

THE BUDGET

I attach a draft to the Prime Minister as requested. I expect to let you have the final table of costings tomorrow, in good time to get the whole thing into the Prime Minister's weekend box.

OK as amended, but table must go with it – [illegible]

B.L.O.

ROBERT CULPIN

Ch
I have marked a few minor points where draft has been amended.
Plus one substantive amendment to Para 43.

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REF NO:
COPY NO OF

PRIME MINISTER

This minute sets out my proposals for the Budget this year.

2. My aim, as always, has been to devise a Budget which will give us a solid financial framework, with a safety margin built into it. My specific objectives this year are to balance the budget, reduce income tax rates, and carry forward the process of tax reform. Even with conservative forecasts of revenues, I can finance the measures I am about to describe within a budget surplus for 1988-89 of about the same size as now seems likely in 1987-88. I will be sending you a separate note shortly about the MTFS, including my proposals for monetary targets and the precise level of the PSBR.

Income tax

3. I propose to redeem our Manifesto pledge to reduce the basic rate to 25p in the pound. But I do not wish to give the impression that this means that our task is now completed. I therefore propose to announce a new target for the basic rate of income tax, of 20p in the £, to be reached as and when it is prudent to do so.

4. I propose to increase the personal allowances, including the age allowance for pensioners, and the upper limit for the basic rate band, by twice the amount required for indexation - ie roughly 7½ per cent. ~~This will take nearly ¾ million people~~

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~~out of tax altogether~~. The main personal allowances will then be 26 per cent higher in real terms than they were when we came into office. This increase in allowances meets the concern about those at the bottom of the income tax scale which was expressed by a number of colleagues when we discussed the Budget prospect in Cabinet.

5. I propose to tidy up the system by doing away with three very minor personal allowances - those for a housekeeper, a son's or daughter's services, and a dependent relative. These are a left-over from the inter-war period, before Beveridge. They have been frozen for years, and are tiny: the largest is only worth about 50p a week. Few people claim them; and any losses will be swamped by gains from the main income tax reductions.

6. To simplify the system still further, I propose to do away with two other rules about dependent relatives. First, I propose to abolish the tax relief on new mortgages taken out to buy houses or flats for dependent relatives: the relatives themselves will have to ~~can perfectly well~~ claim the relief instead. Second, I propose to end the special CGT exemption for sales of assets held by dependent relatives: they are no different in principle from any other assets.

7. The changes to the basic rate and the allowances will benefit about 25 million people - far more than will be affected by any other measures in the Budget. The married man on average earnings will gain nearly £5 a week.

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8. This is clearly the year to bring down the higher rates as well. I propose to abolish all the higher rates of tax above the first higher rate of 40 per cent. This will give us one of the lowest top rates in the world, and a simple tax system consisting of a basic rate of 25 per cent and a single higher rate of 40 per cent (which will be reached at a <u>taxable</u> income of £19,300.)

9. Taken together, these measures will give the clearest possible boost to the enterprise culture and so help to strengthen the economy further. And we can point to a proven record of success. The top 5 per cent of earners now contribute a higher proportion of ~~our~~ income tax revenues than when they were subject to Labour's penal rates; and companies have gone from strength to strength since I cut corporation tax, so that they too are contributing a higher proportion of ~~our~~ their tax revenues.

Capital Gains Tax

10. With the basic rate down to 25 per cent, the flat rate tax of 30 per cent on capital gains looks high for basic rate taxpayers. We clearly cannot afford to bring it down for everyone. With the top rate down to only 40 per cent, I think the right course is to align CGT with income tax. Capital gains will then be charged at the same two rates as income - 25 per cent and 40 per cent. This will greatly reduce both the excessive incentive to invest for capital gain, rather than income, and ~~greatly reduce~~ the artificial conversion of income into capital gain.

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11. Alignment with income tax will put CGT on the same footing as in the United States, though our effective top rate of tax on capital gains will ~~be substantially~~ in fact be significantly lower than the Americans', because they have no provision for indexation.

12. At the same time, I propose to abolish altogether the taxation of paper gains. CGT has been indexed since 1982, when it was reformed by Geoffrey Howe. But indexation really came too late. It indexes away the low inflation of recent years, but does nothing about the ravages of the '70s. There are people and companies who have held assets since the 1960s or 1970s, or even earlier, and cannot realise them without paying substantial tax on pre-1982 paper gains. I propose to put a complete end to the taxation of all gains made before 1982. CGT will be charged only on <u>real</u> gains made since then.

13. When Geoffrey Howe introduced indexation in 1982, he made explicit rough-and-ready compensation for the problem of pre-1982 gains by exempting an extra £2,000 a year of gains from tax. That compensation ~~is~~ will no longer be justified. I therefore propose to reduce the annual CGT exemption from its present £6,600 to a round £5,000. The Americans, incidentally, have no such exemption at all. The further change described in paragraph 23 below is also relevant in this context.

14. I remain concerned with the impact CGT can have on the small businessman selling up on retirement. People are more reluctant to build up capital if they feel they will face a large tax bill at the end of it. At present, they can realise

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£125,000 without paying tax. I propose to extend this retirement relief, so that half of any gain between £125,000 and £500,000 will be completely free of tax.

Inheritance tax

15. For similar reasons, I propose to reduce and simplify inheritance tax. I propose to raise the starting point from £90,000 to £110,000, sweep away three rates altogether, and set a single flat rate of 40 per cent. This means that we shall have reduced inheritance tax from seven rates to one in the course of two budgets.

16. It also means that the number of estates caught by inheritance tax will be reduced by a quarter, and that ordinary people will be able to pass on ordinary homes without being taxed. And with 50 per cent business relief, the effective rate for family businesses passing from one generation to the next will be only 20 per cent. That, too, will be one of the lowest rates in the world.

17. I propose to abolish the limit on bequests to political parties which are free of inheritance tax. This will put political parties back on a par with charities for inheritance tax, as they originally were.

The personal tax system

18. These changes to income tax, capital gains tax and inheritance tax will leave no rate in the personal tax system

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above 40 per cent.

19. I propose to complement this reduction in rates with further reforms. The first is to put the tax treatment of marriage on to a sound footing.

Tax penalties on marriage

20. I propose to end in this Budget the three main tax penalties on marriage.

21. First, there is the fact that cohabiting couples can get twice as much mortgage interest relief as married couples. This is widely resented and criticised, and quite rightly so. We paved the way for a change in the 1986 Green Paper on the Reform of Personal Taxation. I propose to implement the proposal there, which is to make the £30,000 limit on mortgage relief apply X [~~to the~~] per house, flat or "residence". This will not take effect until August 1988, to give the building societies and borrowers time to adjust. Existing mortgages, and those taken out before August 1988, will not be affected.

22. Second, there is the abuse that a cohabiting couple with two children can claim two additional personal allowances - the tax relief designed for single parents. I propose to limit them to one from 1989. This will mean that they have, at most, the same tax relief as a married couple.

23. Third, there is the fact that married couples are allowed only one annual CGT exemption between them. I propose to give

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husbands and wives separate annual exemptions with effect from 1990.

Independent taxation

24. This last proposal is part of my wider proposals to introduce independent taxation for husbands and wives in 1990. I propose to give separate personal allowances to husbands and wives, just as if they were single, but with a special married couple's allowance on top, equivalent under the present system to the difference between the single and married allowance. This will meet the growing demand (vigorously expressed at last year's Party Conference) for privacy and independence for married women, and guarantee them a fair deal from the tax system. It will do this sooner than most people are expecting, and at relatively modest cost. No-one will lose, but a number will gain. My Private Secretary has sent yours a draft press notice which sets out the proposals at greater length.

Maintenance and Covenants

25. I propose to reform and greatly simplify the taxation of maintenance and covenants, other than covenants to charity, which will not be touched. [~~The problem here is that~~] the tax system ~~has become~~ is currently involved in all sorts of transactions between individuals which should be nothing to do with the Inland Revenue. In the normal case, if one person gives income to another (for example a husband giving money to a wife or child), the Inland Revenue is not involved. But if someone gives the money by way of a covenant or maintenance payment, we tax the recipient

and return the money to the donor in tax relief. This is absurdly complex. It would be a great prize to ~~cut through~~ simplify it.

26. Covenants are the easier case. Most (but ~~by no means~~ not of course) all) of those affected (by my proposals) are from parents to students: they have grown in a quite unintended way as a result of the decision to reduce the age of majority to 18. For the future, I propose to stop both taxing ~~the~~ students (or any/other covenant recipients) on their receipts, ~~stop~~ and) giving tax relief to the parents (or other covenanting donors), ~~and~~ thus taking the tax ~~mean~~ out of the transaction altogether. I propose to make a broadly compensating reduction in the parental contribution to student grants at mandatory rates. Existing covenants will be unaffected. Kenneth Baker is content. There will be a modest yield from this reform, since high tax payers will lose the ability to make a tax saving via ~~covenants~~ covenanting.

27. Maintenance payments are more difficult, and I have made some adjustments in the details of my original proposals. Most of these payments are from divorced men to their ex-wives or children. It is, in principle, easy to stop taxing future recipients, and I propose to do that. The pure logic would be to stop giving tax relief altogether to future donors; but this could, in practice, be unduly harsh, and there is no equivalent of the parental contribution to student grants by which to compensate them. I have therefore decided that, in future, a man supporting a separated or divorced wife should still be able to enjoy tax relief on the payments he makes, but only up to the difference between the married allowance (which he formerly had) (to which he was reduced following the separation or divorce). and the single allowance. For 1988-89 this will be £1,490.

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28. I would have liked to say that existing maintenance agreements will be unaffected. But this could look harsh to existing recipients of maintenance payments, all of whom would prefer to switch to the new system, and so be freed from tax on their receipts. I have therefore decided, in these cases, to exempt up to £1490 of receipts from tax straightaway. There will be other transitional arrangements to protect the interests of existing donors.

29. The Lord Chancellor has been ~~extremely~~ most helpful to me in refining these proposals. He is kindly arranging for his Department to get the necessary messages to the Courts after the Budget. And I am also having leaflets prepared to explain the new rules to those affected.

Charities

30. As I mentioned above, I propose to leave unchanged the tax relief for covenants to charities. At the same time I propose to double the amount people can give to charities, tax free, under the payroll giving scheme.

Company cars

31. The big reductions in income tax rates will enable me to tackle a number of areas where the tax system provides reliefs which are hard to justify. The most significant in revenue terms is the taxation of company cars. At present, we value them for tax purposes at only a quarter of what they are worth.

I clearly could not move to full valuation in one go. But I propose to double the car scales in 1988-89.

32. About 95 per cent of those with company cars will still benefit from the Budget overall, because they gain more on income tax rates and allowances than they lose on cars. I do not expect these measures to have a large effect on the car industry. David Young is content.

33. As a minor simplification, I propose to exempt from tax the benefit of free car parking provided by an employer.

Forestry

34. I shall, as agreed, announce in the Budget our main conclusions on forestry. We shall be ending a tax shelter which has become more and more ludicrous and widely criticised, and switching to an improved grant regime which should be much better for the environment. I have not yet ~~got~~ secured agreement on the new grant regime (which will not strictly speaking be a Budget measure), but hope to do so soon.

Home improvement relief

35. I propose to abolish the tax relief on home improvement loans taken out after April. They have become a form of cheap consumer credit. Few are used to finance extensions or loft conversions. Most go on items such as double-glazing which could reasonably be expected to be met out of savings. Some, in practice, finance cars or holidays. It is virtually impossible

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to police what they are used for, and PAC criticism has been mounting.

36. Most of the loans affected are small - half are for less than £3,000. And, of course, no existing loans will be affected. I do not, therefore, expect a significant effect on the construction industry. Nicholas Ridley is content.

Life assurance premium relief

37. The tax relief for pre-1984 life assurance premium payments is traditionally set at half the basic rate of tax. For simplicity, we have not adjusted it every time we have reduced the basic rate; but I propose to reduce it this year to 12½ per cent.

Share ownership

38. I shall be reporting in the Budget that share ownership has increased slightly in the last year, despite the stock market collapse. To encourage it further, I propose to raise the limit on Personal Equity Plans from £2,400 to £3,000, and to relax the restrictions on employee shares obtained outside the approved employee
share schemes.

Business expansion scheme

39. I propose to extend the BES, for five years, to companies providing property for rent on an assured tenancy basis. This should help Nicholas Ridley give a kick-start to the private

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renting initiative, which I strongly support.

40. At the same time, I propose to limit the amount which any one company can raise through the BES, so as to encourage the flow of funds into smaller firms, in general and start-ups in particular.

Other taxes on business

41. So far as the main rate of corporation tax is concerned, I intend to leave well alone. But I shall bring the small companies' rate down to 25 per cent, in line with the basic rate of income tax.

42. I propose to abolish capital duty altogther. This is a 1 per cent tax on companies which raise new capital, introduced in 1973 to meet EC obligations which have since been relaxed. I also propose to abolish the unit trust instrument duty of ¼ per cent on all property put into a unit trust.

(simplify the system further by ending the special

43. I propose to ~~end the~~ corporation tax deduction for entertaining overseas customers ~~businessmen~~, ~~thus and hence~~ putting all business entertainment on the same footing. ~~which applies equally to exporters entertaining customers and importers entertaining foreign suppliers.~~ The corresponding VAT exemption on entertaining foreign customers ~~businessmen~~ should also go.

44. I propose to increase the VAT threshold to £22,100, the maximum permitted under EC law.

45. On more technical matters, I propose to remove an unintended

PN

tax obstacle to building societies converting into companies; to simplify the administrative arrangements for taxing members of Lloyd's, and to sort out a problem for members of Lloyd's when they leave syndicates.

Company residence and migration

46. I propose to change the rules for the minority of companies which wish to change their country of residence. At present the rules require the Treasury to give formal consent and are backed up by criminal sanctions. I propose to substitute objective tests. Companies will be free to migrate if they wish, but will have to pay their accrued UK taxes first. This will avoid the loss of what could be very substantial sums of revenue, and ~~[illegible]~~ is in line with the practice in most other countries.

Excise duties

47. Finally, I propose broadly to raise the excise duties in line with inflation. But I propose no change in the tax on unleaded petrol: this means that the differential between leaded and unleaded will double to just over 10p a gallon. I also propose no change in the tax on spirits or pipe tobacco, or in the main rates of vehicle excise duty: the cost of keeping VED unchanged will be financed by a slightly larger increase (some 6p a gallon) in the petrol tax. I propose to reduce the taxation of some low alcohol drinks. And I propose to introduce a higher VED charge on juggernauts which exact a considerable toll on the

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road system. Table 1 sets out the proposals in detail.

48. I have a small change to announce on VAT, to apply the tax to all cereal bars, instead of just to some as now; this tidies up an awkward borderline.

SW to attach

Cost and RPI effect

49. Table 2 [to follow] shows the cost of the package. It will add about 0.4 per cent to the RPI as conventionally measured - about 0.28 per cent from indexing the excise duties (which is of course already in the baseline) ~~[for our forecasts]~~ of course and the other 0.12 per cent from reducing the basic rate of income tax (which increases the net cost of mortgage payments).

50. I should be glad to know that you are content.

N. L.
4 March 1988

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Table 1 Excise Duties

Product	Unit	Duty increase (per cent)	Price increase (pence) Proposed	Diff. from Reval.
Beer	Pint	4.7	1.0	+0.2
Cider	Pint	9.7	1.0	+0.6
Table wine	75cl	4.5	3.8	+0.7
Sparkling wine	70cl	4.5	5.9	+1.1
Sherry	70cl	4.5	6.1	+1.1
Spirits	75cl	nil	nil	-20.1
Cigarettes	20KS	3.7	3.4	nil
Cigars	5 whiffs	3.7	1.9	nil
Pipe tobacco	25 grams	nil	nil	-2.7
Petrol (leaded)	Gallon	5.5	5.5	+1.8
Petrol (unleaded)	Gallon	nil	nil	-3.6
Derv	Gallon	5.5	4.7	+1.5
VED (cars)	-	nil	nil	-£3.70
VED (other)	-	nil	nil	-(various)
Gas oil	Litre	nil	nil	-0.2
Fuel oil	Litre	nil	nil	-0.1

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DRAFT

PRIME MINISTER

[~~I have now completed my proposals for the Budget.~~] This minute sets [them] out my proposals for the Budget this year.

Expand on lines of last year

2. TAKE OUT A [~~My~~ objectives are to balance the budget, reduce income tax rates, and carry forward the process of tax reform. Even with conservative forecasts of revenues, [~~On the best estimates available to me~~], I can finance the measures I am about to describe within a ~~modest~~ budget surplus for 1988-89 of about the same size as now seems likely in 1987-88. I will be sending you a separate note shortly about the MTFS, including [~~about that and the MTFS~~] about my proposals for monetary targets & the precise level of the PSBR.

Income tax

3. I propose to redeem, ~~at long last,~~ our Manifesto pledge to reduce the basic rate to 25p in the pound. ~~We shall then have brought it down from a third to a quarter. I propose to say that we should aim now to bring it down to [at] a fifth, as and when it is prudent.~~ But I do not wish to give the impression that this means that our task is now completed. I therefore propose to announce a new target for the basic rate of income tax, of 20p in the £, to be reached as and when it is prudent to do so.

[~~4. The Opposition argued last year that the similar 2p reduction, from 29p to 27p, would have to be reversed after the Election [check]. We shall be able to give the lie direct to that.~~]

5. I propose to increase the personal allowances, including the age allowance for pensioners, and the ~~starting point~~ upper limit for ~~higher rate tax,~~ the basic rate band, by ~~roughly 7½ per cent~~ - twice the amount i.e. roughly 7½ per cent required for indexation. This will take nearly ¾ million people out of tax altogether. The main personal allowances will then be 26 per cent higher in real terms than they were when we came into office. This ~~The~~ increase in allowances ~~is of proportionately greatest benefit to the lower paid, as was pointed out at Cabinet~~ meets the concern expressed by a number of colleagues when we discussed the Pub Exp prospects in Cabinet.

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INSERT paras 40 & 41 here

6. The changes to the basic rate and the allowances will benefit about 25 million people - far more than will be affected by any other measures in the Budget. The married man on average earnings will gain nearly £5 a week.

7. This is clearly the year to bring down the higher rates as well. I propose to abolish all the higher rates of tax above the first higher rate of 40 per cent. ~~a radical reform, to get rid of four tax rates altogether, and set a single top rate of 40 per cent.~~ This will give us one of the lowest top rates in the world, and a simple tax system consisting of a basic rate of 25% and a single higher rate of 40% (which will be reached at a taxable income of £19,300).

8. Taken together, these measures will give the clearest possible boost to the enterprise culture and so help to strengthen ~~[which produces a strong]~~ the further economy. And we can point to a proven record of success. The top 5 per cent now contribute a higher proportion of our revenues than when they were subject to Labour's penal rates; and companies have gone from strength to strength since I cut corporation tax, so that they too are contributing a higher proportion of our revenues.

Capital Gains Tax

9. With the basic rate down to 25 per cent, the flat rate tax of 30 per cent on capital gains looks high for basic rate taxpayers. We clearly cannot afford to bring it down for everyone. With the top rate down to only 40 per cent, I think the right course is to align CGT with income tax. Capital gains will then be charged at the same two rates as income - 25 per cent and 40 per cent. This will greatly reduce the excessive ~~unhealthy~~ incentive to invest for capital ~~speculative~~ gain, rather than income, and greatly reduce the artificial conversion of income into capital gain.

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10. Alignment with income tax will put CGT on the same footing as in the United States~~, and a number of other countries~~.

11. At the same time, I propose to abolish altogether the taxation of paper gains. CGT has been indexed since 1982, when it was reformed by Geoffrey Howe. But indexation really came too late. It indexes away the low inflation of recent years, but does nothing about the ravages of the '70s. There are people and companies who have held assets since the 1960s or 1970s, or even earlier, and cannot realise them without paying substantial tax on pre-1982 paper gains~~, which are entirely illusory~~. I propose to put a complete end to the taxation of all gains made ~~make~~ before 1982. CGT will be charged only on real gains made since then.

~~12.~~ ~~This means that~~ though our effective rate of tax on capital gains will be substantially lower than the Americans', because they have no provision for indexation ~~whatever~~.

13. When Geoffrey Howe introduced indexation in 1982, he made explicit compensation for the problem of pre 1982 gains ~~fact that it could not apply before then,~~ by exempting an extra £2,000 a year of gains from tax. That compensation is no longer justified ~~will now be redundant~~. I therefore propose to reduce the annual CGT exemption from its present £6,600 to a round £5,000. The Americans, incidentally, have no such exemption at all. The further change described in paragraph 23 below is also relevant in this context.

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14. I remain concerned with the impact CGT can have on ~~someone~~ the small businessman selling up ~~for~~ on retirement. People are more reluctant to build up capital if they feel they will face a large tax bill at the end of it. At present, they can realise £125,000 without paying tax. I propose to extend this retirement relief, so that half of any gain between £125,000 and £500,000 will be completely free of tax.

Inheritance tax

15. For similar reasons, I propose to reduce and simplify inheritance tax. I propose to raise the starting point from £90,000 to £110,000, sweep away three rates altogether, and set a single flat rate of 40 per cent. This means that we shall have reduced inheritance tax from seven rates to one in the course of two budgets.

The number of estates caught by inheritance tax will be reduced by a quarter, and that

16. It also means that ordinary people will be able to pass on ordinary homes without being ~~caught~~ taxed. And with 50 per cent business relief, the effective rate for ~~people passing on businesses~~ family businesses passing from one generation to the next will be only 20 per cent. That, too, will be one of the lowest rates in the world.

17. I propose to abolish the limit on bequests to political parties which are free of inheritance tax. This will put political parties back on a par with charities for inheritance tax, as they ~~previously~~ originally were.

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The personal tax system

18. These changes to income tax, capital gains tax and inheritance tax will leave no rate in the personal tax system above 40 per cent.

19. I propose to complement this reduction in rates with further reforms. The first is to put the tax treatment of marriage on to a sound footing.

Tax penalties on marriage

20. I propose to end in this Budget the three main tax penalties on marriage.

~~wording restriction~~
~~much~~ [illegible]

21. First, there is the ~~nonsense~~ that cohabiting couples can get twice as much mortgage interest relief as married couples. This is widely resented and criticised, and quite rightly so. We paved the way for a change in the 1986 Green Paper on the Reform of Personal Taxation. I propose to implement the proposal there, which is to make the £30,000 limit on mortgage relief apply ~~£30,000~~ per house, flat or "residence". This will not take effect until August 1988, to give the building societies and borrowers time to adjust. It will ~~And it will not, of course, affect any~~ Existing mortgages, and those taken out before August 1988, will not be affected.

22. Second, there is the abuse that a cohabiting couple with two children can claim two additional personal allowances - the tax relief designed for single parents. I propose to limit them to one from 1989. This will mean that they have, at most, the same tax relief as a married couple.

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23. Third, there is the fact that married couples are allowed only one annual CGT exemption between them. I propose to give husbands and wives separate annual exemptions with effect from 1990.

Independent taxation

24. This last proposal is ~~, of course,~~ part of my wider proposals to introduce independent taxation for husbands and wives in 1990. I propose to give separate personal allowances to husbands and wives, with a special married couple's allowance on top. This will meet the ~~widespread~~ growing demand for privacy and independence for married women, and guarantee them a fair deal ~~in~~ from the tax system. It will do this sooner than most people are expecting, and at relatively modest cost. No-one will lose, but a number will gain. My Private Secretary has sent yours a draft press notice which sets out the proposals at greater length.

(just as [illegible] with single, but [illegible]

, equivalent under the present system to the difference between the single and married allowance

(vigorously expressed at last year's Party Conf)

Is this OK or should we spell it out?

Sh'd be OK, but let me see it again

Maintenance and Covenants

25. I propose ~~this year~~ to reform the taxation of maintenance and covenants ~~, which is a mess.~~ The tax system has become involved in all sorts of transactions between individuals which should be nothing to do with the ~~Government~~ Inland Revenue. In the normal case, if ~~X~~ one person gives ~~money~~ income to ~~Y~~ another (for example a husband giving money to a wife or child), the Inland Revenue is not involved. But if ~~X~~ someone gives the money by way a covenant or maintenance payment, we tax ~~Y~~ the recipient and return ~~some~~ of the money to ~~X~~ the donor in tax relief. This is ~~a complete nonsense~~ absurdly complex. It would be a great prize to cut through it.

and great simplification

(other than covenants to charity, which will not be touched.)

but by no means all of those affected by my proposals

26. Covenants are the easier case. Most are from parents to students. For the future, I propose to stop taxing the students or other recipients on their receipts, stop giving tax relief to the parents, or other donors, and

and this has grown in a quite unintended way from the decision to reduce the age of majority to 18.

make a broadly compensating reduction in the parental contribution to student grants at mandatory rates. Existing covenants will be unaffected. Kenneth Baker is content. There will be ~~some~~ a modest yield from this reform, since high tax payers will lose the ability to make a tax saving via covenants.

27. Maintenance payments are more difficult, and I have made some adjustments in the details of my original proposals. Most of these payments are from divorced men to their ex-wives or children. It is, in principle, easy to stop taxing future recipients, and I propose to do that. The pure logic would be to stop giving tax relief altogether to future donors; but this could, in practice, be unduly harsh, and there is no equivalent of the parental contribution to student grants by which to compensate them. I have therefore decided that, in future, a ~~divorced~~ man supporting ~~an~~ a separated or divorced ~~ex-~~wife should ~~, as a maximum,~~ still be able to enjoy tax relief on the payments he makes, but only up to the difference between the married allowance and the single allowance (for 1988-89, this will be £1,490). ~~get the same tax relief as a married man. [**NB:** This skates deliberately over children]. This means that he will be eligible for tax relief of up to £1490, which I expect to index.~~

28. So for the future, the system will be simple. Future recipients will be freed from tax, and future donors will all be on exactly the same footing.

29. I would have liked to say that existing maintenance agreements will be unaffected. But this could look harsh to existing recipients of maintenance payments, all of whom would prefer to switch to the new system, and so be freed from tax on their receipts. I have therefore decided to exempt, in these cases, £1490 of receipts from tax straightaway. There will be other transitional arrangements to protect the interests of existing donors.

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30. The Lord Chancellor has been extremely helpful to me in ~~formulating~~ refining these proposals. He is kindly arranging for his Department to get the necessary messages to the Courts after the Budget. And I am also having [~~booklets~~] leaflets prepared to explain the new rules to those affected.

Charities

31. I propose to leave unchanged the tax relief for covenants to charities. ~~And~~ At the same time I propose to double the amount people can give to charities, tax free, under the payroll giving scheme.

Company cars

32. The big reductions in income tax rates will enable me to tackle a number of [~~nonsenses, of which~~] areas where the tax system provides ~~unintentionally generous reliefs.~~ reliefs which are hard to justify. The most significant in revenue terms is the taxation of company cars. At present, we value them for tax purposes at only a quarter of what they are worth. I [~~have no intention of making too drastic an increase~~] clearly could not move to full valuation [~~at~~] in one go. But I propose to double the car scales in 1988-89.

[~~33. As in previous years, I propose to leave unchanged the point at which people become liable to tax on such benefits in kind.~~] Do we need this.

34. [~~Since~~] About 95 per cent of ~~people~~ those with company cars will still benefit from the Budget, overall, because they gain more on income tax rates and allowances than they lose on cars. I do not expect these measures to have a large effect on the car industry. David Young is content.

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36. I shall, as agreed, announce in the Budget our main conclusions on forestry. We shall be ending a tax shelter which has become more and more ludicrous and widely criticised, and switching to ~~a~~ an improved grant regime which should be much better for the environment. ~~I expect this change to be widely welcomed.~~ I have not yet got agreement on the new grant regime but hope to do so soon.

Home improvement relief

37. I propose to abolish the tax relief on home improvement loans taken out after April. They have become ~~little more than~~ a form of cheap consumer credit. Few are used to finance extensions or loft conversions. Most go on items such as double-glazing, ~~or central heating.~~ which could reasonably be expected to be met out of savings. Some, in practice, finance cars or holidays. It is virtually impossible to police what they are used for, and PAC criticism has been mounting.

38. Most of the loans affected are small - half are for less than £3,000. And, of course, no existing loans will be affected. I do not, therefore, expect a ~~large~~ significant effect on the construction industry. Nick Ridley is content.

Minor reliefs

Unnecessary?

[39. With the big reduction in the top rate of income tax, we no longer need the special reliefs which apply to redundancy payments and lease premia. These are, essentially, devices for alleviating the 60 per cent tax which would at present fall on lump sum receipts. They can lapse with the abolition of the 60 per cent rate.]

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40. I also propose to tidy up the system by doing away with three [~~tiddlers among the~~] very minor personal allowances - those for a housekeeper, a son's or daughter's services, and a dependent relative. These are a left-over from the inter-war period, before Beveridge. They have been frozen for years, and are tiny: the largest is only worth about 50p a week. Few people claim them; and any losses will be swamped by gains from the main income tax reductions.

To go into para 56

To simplify the system still further, I propose to do away with two other

41. ~~For completeness, I should add that a couple of other~~ minor [~~bizarre~~] rules about dependent relatives~~. will also disappear. I doubt if many people even know they exist.~~ [First, I propose to abolish the tax relief on new mortgages taken out to buy houses or flats for dependent relatives: the relatives themselves can perfectly well claim the relief. Second, I propose to end the special CGT exemption for sales of assets held by dependent relatives: they are no different in principle from any other assets].

Life assurance premium relief

42. The tax relief for pre-1984 life assurance premium payments is traditionally set at half the basic rate of tax. For simplicity, we have not adjusted it every time we have reduced the basic rate; but I propose to reduce it this year to 12½ per cent.

Share ownership

43. I shall be reporting in the Budget that share ownership has increased slightly in the last year, despite the stock market collapse. To encourage it further, I propose to raise the limit on Personal Equity Plans from £2,400 to £3,000, and to relax the restrictions on employee shares obtained outside the approved schemes.

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Business expansion scheme

44. I propose to extend the BES, for five years, to companies providing property for rent on an assured tenancy basis. This should help Nicholas Ridley give a kick-start to the private renting initiative, which I strongly support.

45. At the same time, I propose to limit the amount which any one company can raise through the BES, so as to encourage the flow of funds into smaller firms.

Other taxes on business

46. So far as the main rate of corporation tax is concerned, I intend to leave well alone. But I shall bring the small companies' rate down to 25 per cent. In line with the basic rate of income tax, ~~we shall then have reduced it from a third to a quarter~~.

47. I propose to abolish capital duty altogther. This is a 1 per cent tax on companies which raise new capital, introduced in 1973 to meet EC obligations which have since been relaxed. I also propose to abolish the unit trust instrument duty of ¼ per cent on all property put into a unit trust.

~~Cecil Parkinson's proposal~~

~~48. I propose to abolish royalties for all future North Sea oil fields, and to relate oil taxes more closely to profitability.~~

49. I propose to end the ~~minor~~ corporation tax deduction for entertaining overseas ~~contacts. There is no such deduction for entertaining domestic customers.~~ businessmen, which applies equally to exporters entertaining customers and importers entertaining foreign suppliers. The corresponding VAT exemption on entertaining foreign businessmen should also go.

TAKE IN B

Insert VAT threshold here

50. On more technical matters, I propose to remove an unintended tax obstacle to building societies converting into companies; to simplify the administrative arrangements for taxing members of Lloyd's, and to sort out a problem for members of Lloyd's when they leave syndicates.

require the Treasury to give formal consent and are backed up by criminal sanctions

Company residence and migration

51. I propose to change the rules for the minority of companies which wish to change their ~~place~~ country of residence. At present the rules [~~are discretionary~~]. I propose to substitute objective tests. Companies will be free to migrate if they wish, but will have to pay their accrued UK taxes first. This will avoid the loss of what could be a substantial sum of revenue.

Excise duties

52. Finally, I propose broadly to raise the excise duties in line with inflation [~~as a whole to yield the equivalent of indexation~~]. But ~~there will be~~ I propose no change in the tax on unleaded petrol: this means that the differential between leaded and unleaded will double to just over 10p a gallon. I also propose ~~There will be~~ ~~also~~ no change in the tax on spirits or pipe tobacco, or in the main rates of vehicle excise duty. The cost of keeping VED unchanged will be financed by a slightly larger increase in the petrol tax. I propose to reduce the taxation of some low alcohol drinks. And I propose to introduce a higher VED charge on juggernauts which exact a considerable toll on the road system. Table 1 [to follow] sets out the proposals in detail.

53. I have a small change to announce on VAT, to apply the tax to all cereal bars, instead of just some as now; this tidies up an awkward borderline.

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Cost and RPI effect

54. Table 2 [to follow] shows the cost of the package. It will add about 0.4 per cent to the RPI as conventionally measured - about 0.28 per cent from indexing the excise duties (which [illegible], in no [illegible], of course) and the other 0.12 per cent from reducing the basic rate of income tax (which increases ~~net~~ the cost of mortgage payments).

55. I should be glad to know that you are content.

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COPY NO. 13 OF 13

FROM: A P HUDSON

DATE: 4 March 1988

SIR T BURNS

cc Sir P Middleton
Mr Scholar
Mr Odling-Smee
Mr Sedgwick
Mr Culpin
Mr Pickford
Miss Simpson
Mr Cropper
Mr Tyrie

BUDGET SPEECH: SECTIONS A-E: DRAFT OF 4 MARCH

Many thanks for your comments on these sections of the Budget Speech today.

2. I attach the version which I have put in to the Chancellor for the weekend. Since he will revise it heavily, I am not doing a full circulation. But you and copy recipients may like to have it, in case you want to work on it over the weekend.

APH

A P HUDSON

 Draft of 4 March

A. INTRODUCTION

A1. When this Government came to office in 1979, we inherited an economy, in which double-digit inflation seemed endemic, and the enterprise culture seemed to have gone for ever.

A2. Over two Parliaments we have transformed that picture, in a way few thought would be possible. Now, as I present the first Budget of our third Parliament, we are entering our eighth successive year of steady growth, and the sixth in which this has been combined with low inflation. And last year saw the largest fall in unemployment since the war.

A3. 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.

A4. I reaffirm those policies today.

A5. 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

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tax reform, designed to build on the economic success that is already so evident.

A6. 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.

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, we can now begin to see it in a longer perspective. 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. Last year, in spite of the dramas in the financial markets, the UK economy built on and indeed surpassed the strong performance of previous years [both in the three quarters before the collapse, and in the fourth quarter after it.]

B4. The growth rate, at more than [4] per cent, was the highest since 1973, and has been bettered only three times since the War. But by contrast with some periods in the past, last year was no freak sudden spurt, containing the seeds of its own undoing, but a temporary quickening within a steady upward trend. Indeed, the six years to 1987 have been the longest period of steady growth, at a rate averaging 3 per cent a year, that we have achieved since the War.

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B5. During both the 1960s and the 1970s, Britain's growth rate was the lowest of all the major European economies. During the 1980s, it has been the highest.

B6. Inflation last year turned out at a little over 4 per cent. 1987 was thus an important landmark: the first year for a generation in which the rate of real growth was higher than the rate of inflation.

B7. The plain fact is that the economy has been transformed. Prudent financial policies have given the private sector the stability and confidence to expand. And supply-side reform, including tax reform, has removed many of the burdens which held British industry and individual enterprise in check for far too long.

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.] It has brought [1½ million] new jobs. And over the past eighteen months, this has fed through into a fall of 650,000 in the numbers of people out of work [including a sizeable fall in the number of long-term unemployed]. Unemployment fell in all regions. And the proportion of the workforce unemployed fell by a bigger margin than in any other major country.

B9. The performance of manufacturing industry has been every bit as outstanding as I predicted a year ago, with

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output up by 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, and we led the way again last year. This is a stark contrast to the 1960s and 1970s, when in productivity, as in so much else, we were bottom of the league.

B10. The current account of the balance of payments in 1987 looks to have been in deficit by £1 billion, or ¼ per cent of GDP, well below the forecast I made this time last year even though growth in the UK outpaced other countries. The surplus on invisible trade turned out very close to what was forecast. But we saw a further strong rise in exports, with non-oil exports up 7 per cent, and manufactures up 9 per cent. This continues the pattern of the 1980s, with British manufacturers maintaining their share of world trade, after decades in which it fell constantly. And imports grew very much in line with expectations despite the buoyancy of domestic demand.

[B11. Thus, comparing what happened last year with the forecast in the last budget, growth was up, inflation was in line, and the current account was lower than expected. This excellent outcome is testimony to the step change that has taken place in the efficiency and adaptability of British businesses.]

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B12. Looking ahead to 1988, I expect another year of healthy growth with low inflation: and there is every prospect that unemployment will continue to fall [though the speed of this may slow from the record decline in 1987.]

B13. Output is forecast to rise by 3 per cent, more or less in line with the steady trend of recent years. The rise in exports is set to continue, though the pace may moderate. Consumer spending is likely to grow rather more slowly than in 1987, but business investment is set to be much stronger.

B14. The non-oil economy should expand more rapidly than total GDP. For the year as a whole non-oil output may grow by 3½ per cent although the pace of growth is likely to ease from now on and through the year may be close to the trend of the past few years.

B15. The underlying inflation rate should stay at around 4 per cent during 1988, as it did during 1987, though there are inevitably fluctuations, mostly mirroring changes in the mortgage rate. This record of low inflation is particularly impressive, since it has been sustained at a time of rapid growth.

B16. Although growth is expected to be slower than last year, it is again likely to be faster than most other major countries. A particular worry is that growth in

Europe, which is increasingly the most important market for UK exports, could remain sluggish. This inevitably has implications for our current account. Although I expect the non-oil trade balance to remain at around the same level as in the second half of 1987, with our surplus on oil trade falling as North Sea oil output declines, the current account deficit may increase to some £3 billion in 1988 - around ¾ per cent of GDP.

B17. In time, as the rates of growth here and overseas come back into line, I expect the deficit to decline. Meanwhile, with the continuation of prudent monetary and fiscal policies and with the considerable international confidence in the performance of the UK economy, this should pose no financing problem.

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 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 industrial countries was around 3 per cent in 1987, close to the forecast I made in the Budget last year.

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B20. The latest indications suggest that, despite the stock market collapse, activity remains fairly buoyant, and I expect overall growth in the major seven countries to be around 2½ per cent in 1988 - only slightly slower than this year.

B21. However, there are considerable uncertainties given the persistence of the large imbalances within the three largest countries, the US, Japan and Germany.

B22. These countries have begun to make the policy adjustments necessary to reduce these imbalances. And there are signs that the steps they have taken 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 take time - could be damaged either by further gyrations in the value of the dollar, or by a slide into protectionism.

B23. Some commentators continue to insist that the way to solve these imbalances lies in further substantial exchange rate adjustments, even though the source of the problem lies elsewhere. They see exchange rate adjustment as a miracle cure, whatever the illness. They ignore the damage that uncertainty and exchange rate volatility does to economic health. And they distract attention from the fundamental causes of the imbalances.

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B24. 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. After the damage inflicted on the world economy during the 1980s by the gyrations of the dollar, there is substantial support for reduced instability of exchange rates, and of the dollar in particular. The Louvre agreement was a start, and it has been followed up by the G7 agreement in December. And although there have been periods of turbulence, it is worth noting that the dollar is now within [8 per cent] of the rate against the Deutschmark that applied at the time of the Louvre.

B25. Success in achieving stable currencies, and a reduction in the imbalances, depends, in the end, on countries' putting the right fiscal and monetary policies in place, and keeping them there. But these 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 co-operation, as has been the case for well over two years now. I can assure the House that we shall be playing our full part.

B26. 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 been the foundation for the economic performance I have described.

C2. Sound money, and prudent public finances, are the essential framework for steady growth and low inflation. And the maintenance of sound and prudent finances 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 setbacks such as the coal strike and the collapse of the oil price, and the stock market collapse].

C3. The Medium-Term Financial Strategy, now in its ninth year, will continue to provide the framework for reducing the growth of money GDP, and hence inflation, over the medium term. These will be achieved by maintaining firm monetary discipline, buttressed by a prudent fiscal stance.

C4. Short term interest rates remain the essential instrument of monetary policy. Within a continuous and comprehensive assessment of monetary conditions, I will

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continue to set interest rates at the level necessary to ensure that inflationary pressures are not accommodated.

C5. I attach particular importance to maintaining a stable exchange rate, notably the rate against the Deutschmark. [Sterling has remained broadly stable against the Deutschmark since the Louvre meeting more than a year ago, despite market pressures on sterling and despite the instability in the dollar towards the end of 1987.] A stable currency is helpful to business. And it provides an important financial discipline. [To allow sterling to fall if businesses allow their costs to rise too fast would be to surrender to inflation. And, as the track record shows, that I am simply not prepared to do.]

C6. Achieving our objectives for inflation also requires a reduction in monetary growth in the medium term. For narrow money, M0, the target range for 1988-89 is 1-5 per cent, as shown in last year's MTFS. I shall also continue to take account of broad money and liquidity, though as last year, there will be no explicit target. [Among the measures of broad money, those which include building society deposits are increasingly important.]

C7. A sound monetary policy has brought inflation down to levels not seen for twenty years. [Progress towards the ultimate objective of stable prices is unlikely to be

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steady, and its timing cannot be predicted. But I am determined that, over time, we shall squeeze inflation out of the system altogether.

D. PUBLIC SECTOR FINANCES

D1. As I have said, a sound 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, this robust idea became increasingly ignored, culminating in 1975-76, when the last Labour Government borrowed what, in today's terms, would amount to [around £40,000 million.]

D3. This profligacy not only forced them to ask the IMF to bail Britain out. It also added vast amounts to the national debt.

D4. One of our main objectives, when we came to office, 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. This year, we have eliminated borrowing altogether.

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D5. The budget in 1987-88 looks 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. And even if there had been no privatisation proceeds at all, the PSBR would have been lower than in all but one year since the early 1950s.

D6. This excellent outcome reflects both higher than expected receipts, and a lower outturn on the expenditure side. With the economy growing rapidly, revenues from a number of taxes have risen faster than expected. Income tax and VAT have been particularly buoyant, and revenues from the North Sea are up significantly.

D7. On the expenditure side, 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. I now estimate that the planning total for 1987-88 will be [£146.4] billion, some £2 billion lower than projected in the Public Expenditure White Paper in January.

D8. The balanced budget is thus the fruit of a consistently cautious fiscal stance, firm control of public spending, and the strong and vigorous economy that

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has resulted. It is not just a one-off achievement in an exceptional year, but something we intend to hold on to.

D9. A balanced budget is a sound discipline for the medium-term. It buttresses monetary policy. It creates more room for the private sector to borrow, invest, and grow. It leads to a lower burden of debt interest, which represents an investment for future years. And it gives room for manoeuvre in the event of shocks.

D10. Looking ahead to 1988-89, the factor that has weighed most heavily with me in setting the PSBR is the need to stick to a prudent and cautious fiscal stance. I have therefore decided to provide for a budget surplus, of £3 billion, the same as this year's expected outturn. Beyond that, I have projected a PSBR of zero in the remaining three years of the Medium-Term Financial Strategy.

[D11. Looking further ahead, as privatisation receipts decline, as they are bound to do, I intend to stick to a PSBR of zero as the norm. In the very nature of things, there will be fluctuations, on either side. But I intend to keep these generally to within 1 per cent of GDP.]

D12. 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

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budget deficit would still be lower than in all the major seven countries, except Japan.

D13. The budget surplus for 1988-89 inevitably limits the scope that would have been available for reductions in the tax burden, which, leaving aside the oil sector, has actually risen, as a share of GDP, for two years in succession.

D14. Moreover, as the House will appreciate, any room for manoeuvre was already constrained by the public expenditure plans for 1988-89, which I announced in the Autumn Statement. These show an increase of over £4½ billion in spending on 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

D15. Indeed, I have to tell the House, with considerable regret, that these spending increases, coupled with the need for a prudent fiscal stance mean that there will be no scope at all for reducing the tax burden next year.

D16. However, because of the buoyancy of tax revenue, which reflects the strength of the economy, I shall still

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have some room to reduce tax rates [and I shall come to this later.]

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, all of which have increased tax yields. This buoyancy has in turn created scope for lower borrowing, and lower tax rates. 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 a further saving of £2½ billion a year, by 1990-91. This means that, within any given total for public spending, more can be spent 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.

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D20. No other major country has succeeded in reducing its debt interest payments. Indeed, the rest of the major seven 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 an achievement of great value. But it is 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 removed the worst excesses of the penal taxation of incomes and started us on the way to an acceptable basic rate of income tax.

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 <u>higher</u>

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proportion of income tax revenues than when they were taxed at penal rates.

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 the lowest tax rate in Europe, and they responded with the best performance for the best part of a generation. And the yield from company taxes is rising as a result.

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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CHANCELLOR OF THE EXCHEQUER

FROM: A. P. HUDSON

DATE: 4 March 1988

CHANCELLOR

BUDGET SPEECH

1. I attach a revised version of Sections A – E. The main changes since last weekend are taking in your comments, some editing by me, and Terry having gone through B – D in detail, partly to bring it into line with the MTFS.

2. Terry's comments are recent, so in places the drafting bears his stamp! He's still not happy with the presentation of the reasons for the 1988-89 PSBR, & may return to it next week.

3. You asked about the fiscal position in Japan. Pl. see the enclosed note by P. Sedgwick which gives the figures; ~~though I'm afraid I haven't rechecked this week~~. C. Mowl is checking the latest position — now confirms they are still the latest available.

4. You also asked about S. 482. ~~A separate~~ The maroon folder ~~on this includes~~ See flag on Mr Fawcett's note in maroon folder. I think this substantiates the point that we're coming into line with other countries. We could add a sentence at the end of GII, ~~to say~~ along the lines:

"The new approach will be clearer, and simpler, and more closely in line with the practice in other countries."

Over

5. I have a few late comments on ~~Ca~~ the Capital Duty section. See (illicit) copy with amendments marked, (Flagged).

6. I marked an FST amendment on para K20, on Wednesday night's version, to add the point that the majority of CGT payers were basic rate taxpayers. I ~~must~~ must say I thought this was true, a part of the canon. But Michael Cayley says only 40% are basic rate.

AAH

BUDGET SECRET: BLO

FROM: A. P. HUDSON
DATE: 4 March 1988

CHANCELLOR

BUDGET SPEECH

1. A few points that have come in during the afternoon.

(a) My earlier note was cryptic about why Terry was unhappy with the presentation of the PSBR for future years in Section D. His point is that the general reasons for having a balanced budget, set out in D9, ~~as~~ justify the PSBR of zero in the medium term. They do not, by themselves, justify a surplus of 3 in 1988-89 - that ~~depends on~~ is due to exceptional revenue buoyancy, & the need for graduation. He thinks the problem is mainly one of ordering, in D9 & D10.

(b) I'm afraid I didn't have time to revise/think further about your comment last week on the spending figures, now in D14. Return to this next week?

(c) Michael Scholar has a point on F13 - that ~~we seem to be~~ it's odd to be giving the APA to couples at all. ~~The simplest~~ I don't think it's too serious, actually. But I've marked a possible alternative (Flagged).

(d) Tim Burr has some comments on H7-8 (Flagged). ~~The drafting's not right, but the whole of this section is ... will be worked through, is by no means right yet.~~ The latest estimate of spending on covenants is £15m in 1988-89 and £30m in 1989-90.

Over

(e) ~~You said we have a~~ You wanted to slot in car parking at L 19. My own feeling is to say the minimum, e.g

"~~B.~~ for simplicity, I propose to exempt car parking benefits from tax. Most are in practice exempt already, on *de minimis* grounds."

(f) Figures on income tax:

- CS7 suggested, for L37 or so, giving a figure for the numbers taken out of tax: over $\frac{3}{4}$ million;

- the total cost of income tax package, L46 (2nd!) over £4 billion.

(g) Peter Cropper suggests expanding L46 on $\frac{1}{3} \rightarrow \frac{1}{4} \rightarrow \frac{1}{5}$ ~~to~~ along the lines:

"~~When~~ In 1979... 33p... $\frac{1}{3}$; now... 25p... $\frac{1}{4}$; our aim... 20p... $\frac{1}{5}$."

2. I'll be at home on Saturday, and will probably come in to work on Sunday afternoon to catch up on reading etc, so let me know if there's anything to be done then.

AHT

4.3.

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.

PJC: Reads as if married women are a rare species. (APH: That's the point!)

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, pensions, or savings.

B. Mace (BAM)

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.

ACSA (et al.)

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

FST/BAM

married women will have the right to

See CST redraft in minute (which I like less than the ACSA/FST version.)

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, and many will no doubt do so. But what matters is that, ~~for married women,~~ for the first time ever, complete independence and privacy ~~will be an option.~~ in their tax affairs.

F8. In the same way, a 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 to tax.

PJC [IR]

Furthermore, it will be possible to bring the new system into action [much sooner]

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

MCS
BAM (Drop TAs)

~~other reforms~~ alternatives that have been ~~put forward~~ canvassed, [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~~ nearly £700 million in 1990-91.

BAM

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~~ these, in advance of Independent Taxation.

BAM: Draws attention to inv. income.
BAM: NB Maintenance etc still to come.

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.

BAM
F57

F13. Another [The second] anomaly is that an unmarried couple living together 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 co-habiting couple. This will take effect from April 1989.

F57

One or 2 people note that "Thus..." is a bit misleading, because we haven't yet got to covenants/maintenance. I wouldn't worry, myself.

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

G. BUSINESS TAXATION

APH: Nearer Bgt Day, we might review the numbers of "turn to"!

[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.

ACSA

G3. I do not therefore propose any further changes to the structure ~~reform~~ of Corporation Tax. And ~~T~~the main Corporation Tax rate for 1988-89 will be unchanged at 35 per cent.

ACSA/APH

G4. But I do have three changes to propose to other ~~for~~ aspects of business taxation. ~~businesses in particular sectors.~~

APH:
I ~~propose to restructure~~ the tax regime for the new generation of Southern Basin and onshore fields, to relate tax liability more closely to profitability.

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

[Present draft ~~is~~ not clear that abolition of royalties is a new proposal; IR also thought we shd say upfront why we're doing this.]

26

Petroleum Revenue Tax oil allowance for these fields to 100,000 tonnes per chargeable 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. These proposals have a cumulative cost of around £40m in the first five years, but in the long run they are expected to be broadly revenue-neutral.

APH

[FST wd mention here abolition of tax on gains on transfers of licence interests, but hasn't supplied words yet.]

MCS

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.

FST

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

FST

ACSA wd move G9-11 – mainly CT measures – before G4-G8. That's logical, but it does put bad news before good.

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~~ hinges on the fact that the cost of entertaining overseas customers is tax deductible, whereas business entertainment generally is not. ~~- although, again,~~ And, there is also deductibility, of course, for the cost to an importer agent 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, including for VAT.

APH (See note.)

IR

C+E.

ACSA

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

B. Houghton:

take themselves or their assets abroad

FST

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 continue ~~be deemed~~ to be resident. Companies resident in the UK and wishing to ~~migrate~~ take themselves or their assets abroad will be able to do so, provided they pay their tax ~~first~~, including any ~~accrued~~ capital gains tax liability. In return, the anachronistic 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, 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 some £150 million a year, on average

APH (Drafting)

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~~ ship chartering, however, the ceiling will be £5 million.

x

Drop this, or combine with g cost of renting in G 23.

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

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.

MCS (Avoids D. Skinner interruption.)

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~~ encourage more people ~~can~~ to move to where the new jobs are.

RIGA

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.

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~~ could be of the order of £40 million a year.

[IR have yet to advise on date.]

PJC

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~~ am determined to do more 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

MCS

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

FST wd delete: meas ures already announced & v. minor. (APH: a shame.)

N.B. Technically, MCayley told me that potato quotas existed in the 1950s, but nobody cared until milk quotas came in.

[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~~ present list of qualifying assets was drawn up. They are milk quotas, potato quotas, satellites and spacecraft. I know that this will be warmly welcomed in the farming and extra-terrestrial communities 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.

PJC

MCS

G28. Throughout my time as Chancellor, I have been on the look-out for taxes to abolish. Abolition is the simplest ~~form~~ kind of reform. I have already abolished the National Insurance surcharge, the Investment Income surcharge, Development Land Tax, and the tax on lifetime gifts and - today - royalties on new oil and gas fields. [Today] I now 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 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.

PJC

G30 Capital Duty is a relatively recent impost, having been reluctantly introduced by a British government 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].~~ [midnight tonight].

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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 rate of ¼ 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.

(APH: 2 trusts, but I don't think it matters.)

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~~ major taxes I have abolished up to five: an average of one a Budget.

PJC would omit, because can't be precise.
MCS

(ACSA, by contrast, wonders if CD or DLT are "sizeable".)

D. PUBLIC SECTOR FINANCES

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

D2. At one time, it was regarded as the hallmark of good government to maintain a balanced budget .... ~~housekeeping for a Government not to spend more than it raised in taxes.~~ Over the years, this robust idea became increasingly ignored, culminating in 1975-76, when the last Labour Government borrowed what, in today's terms, would amount to [around £40,000 million.]

D3. This profligacy not only forced them to ask the IMF to bail Britain out. It also ~~added vast amounts to the national debt.~~ (burden of debt without a future generations)

D4. One of our main objectives, when we came to office, was to bring down Government borrowing. We ~~have~~ steadily reduced the Public Sector Borrowing Requirement from ~~around~~ the 5½ per cent of GDP ~~at the start of the 1980s, to around 3 per cent by 1983, and~~ we inherited to only 1 per cent ~~in~~ last year, 1986-87. Today, I am able to report to the House that I have brought this process to its logical conclusion. This ~~year,~~ 1987-88, we have ~~eliminated borrowing altogether.~~ a balanced budget.

Instead, ...

from previous page

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D5. The budget in 1987-88 looks 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. And even if there had been no privatisation proceeds at all, the PSBR would have been lower than in all but one year since the early 1950s.

D6. This excellent outcome reflects both higher than expected receipts, and a lower outturn on the expenditure side. With the economy growing rapidly, revenues from a number of taxes have risen faster than expected. Income tax and VAT have been particularly buoyant, and revenues from the North Sea are up significantly.

Taxes +£4½bn

D7. On the expenditure side, 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. I now estimate that the planning total for 1987-88 will be [£146.4] billion, some £2 billion lower than projected in the Public Expenditure White Paper in January.

PX -£2bn

D8. The balanced budget is thus the fruit of a consistently cautious fiscal stance, firm control of public spending, and the strong and vigorous economy that

has resulted. It is not just a one-off achievement in an exceptional year, but something we intend to hold on to.

D9. A balanced budget is a sound discipline for the medium-term. It buttresses monetary policy. It creates more room for the private sector to borrow, invest, and grow. It leads to a lower burden of debt interest, which represents an investment for future years. And it gives room for manoeuvre in the event of shocks.

much later

D10. Looking ahead to 1988-89, the factor that has weighed most heavily with me in setting the PSBR is the need to stick to a prudent and cautious fiscal stance. I have therefore decided to provide for a budget surplus, of £3 billion, the same as this year's expected outturn. Beyond that, I have projected a PSBR of zero in the remaining three years of the Medium-Term Financial Strategy.

[D11. Looking further ahead, as privatisation receipts decline, as they are bound to do, I intend to stick to a PSBR of zero as the norm. In the very nature of things, there will be fluctuations, on either side. But I intend to keep these generally to within 1 per cent of GDP.]

D12. 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

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budget deficit would still be lower than in all the major seven countries, except Japan.

D13. The budget surplus for 1988-89 inevitably limits the scope that would have been available for reductions in the tax burden, which, leaving aside the oil sector, has actually risen, as a share of GDP, for two years in succession.

D14. Moreover, as the House will appreciate, any room for manoeuvre was already constrained by the public expenditure plans for 1988-89, which I announced in the Autumn Statement. These show an increase of over £4½ billion in spending on 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

CST: figs?

D15. Indeed, I have to tell the House, with considerable regret, that these spending increases, coupled with the need for a prudent fiscal stance mean that there will be no scope at all for reducing the tax burden next year.

much later - though after 810

D16. However, because of the buoyancy of tax revenue, which reflects the strength of the economy, I shall still

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have some room to reduce tax rates [and I shall come to this later.]

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, all of which have increased tax yields. This buoyancy has in turn created scope for lower borrowing, and lower tax rates. 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 a further saving of £2½ billion a year, by 1990-91. This means that, within any given total for public spending, more can be spent 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.~~

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D20. No other major country has succeeded in reducing its debt interest payments. Indeed, the rest of the major seven 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 an achievement of great value. But it is 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.

steady, and its timing cannot be predicted. But I am determined that, over time, we shall squeeze inflation out of the system altogether.

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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, we can now begin to see it in a longer perspective. 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. Last year, in spite of the dramas in the financial markets, the UK economy built on and indeed surpassed the strong performance of previous years [both in the three quarters before the collapse, and in the fourth quarter after it.]

B4. The growth rate, at more than [4] per cent, was the highest since 1973, and has been bettered only three times since the War. But by contrast with some periods in the past, last year was no freak sudden spurt, containing the seeds of its own undoing, but a temporary quickening within a steady upward trend. Indeed, the six years to 1987 have been the longest period of steady growth, at a rate averaging 3 per cent a year, that we have achieved since the War.

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B5. During both the 1960s and the 1970s, Britain's growth rate was the lowest of all the major European economies. During the 1980s, it has been the highest.

B6. Inflation last year turned out at a little over 4 per cent. 1987 was thus an important landmark: the first year for a generation in which the rate of real growth was higher than the rate of inflation.

CST: Burgess

B7. The plain fact is that the economy has been transformed. Prudent financial policies have given the private sector the stability and confidence to expand. And supply-side reform, including tax reform, has removed many of the burdens which held British industry and individual enterprise in check for far too long.

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.] It has brought [1½ million] new jobs. And over the past eighteen months, this has fed through into a fall of 650,000 in the numbers of people out of work [including a sizeable fall in the number of long-term unemployed]. Unemployment fell in all regions. And the proportion of the workforce unemployed fell by a bigger margin than in any other major country.

B9. The performance of manufacturing industry has been every bit as outstanding as I predicted a year ago, with

FST: Burgess

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output up by 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, and we led the way again last year. This is a stark contrast to the 1960s and 1970s, when in productivity, as in so much else, we were bottom of the league.

B10. The current account of the balance of payments in 1987 looks to have been in deficit by £1 billion, or ¼ per cent of GDP, well below the forecast I made this time last year even though growth in the UK outpaced other countries. The surplus on invisible trade turned out very close to what was forecast. But we saw a further strong rise in exports, with non-oil exports up 7 per cent, and manufactures up 9 per cent. This continues the pattern of the 1980s, with British manufacturers maintaining their share of world trade, after decades in which it fell constantly. And imports grew very much in line with expectations despite the buoyancy of domestic demand.

[B11. Thus, comparing what happened last year with the forecast in the last budget, growth was up, inflation was in line, and the current account was lower than expected. This excellent outcome is testimony to the step change that has taken place in the efficiency and adaptability of British businesses.]

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B12. Looking ahead to 1988, I expect another year of healthy growth with low inflation: and there is every prospect that unemployment will continue to fall [though the speed of this may slow from the record decline in 1987.]

B13. Output is forecast to rise by 3 per cent, more or less in line with the steady trend of recent years. The rise in exports is set to continue, though the pace may moderate. Consumer spending is likely to grow rather more slowly than in 1987, but business investment is set to be much stronger.

B14. The non-oil economy should expand more rapidly than total GDP. For the year as a whole non-oil output may grow by 3½ per cent although the pace of growth is likely to ease from now on and through the year may be close to the trend of the past few years.

B15. The underlying inflation rate should stay at around 4 per cent during 1988, as it did during 1987, though there are inevitably fluctuations, mostly mirroring changes in the mortgage rate. This record of low inflation is particularly impressive, since it has been sustained at a time of rapid growth.

B16. Although growth is expected to be slower than last year, it is again likely to be faster than most other major countries. A particular worry is that growth in

Europe, which is increasingly the most important market for UK exports, could remain sluggish. This inevitably has implications for our current account. Although I expect the non-oil trade balance to remain at around the same level as in the second half of 1987, with our surplus on oil trade falling as North Sea oil output declines, the current account deficit may increase to some £3 billion in 1988 - around ¾ per cent of GDP.

B17. In time, as the rates of growth here and overseas come back into line, I expect the deficit to decline. Meanwhile, with the continuation of prudent monetary and fiscal policies and with the considerable international confidence in the performance of the UK economy, this should pose no financing problem.

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 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 industrial countries was around 3 per cent in 1987, close to the forecast I made in the Budget last year.

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Taken in summary of B2

B20. The latest indications suggest that, despite the stock market collapse, activity remains fairly buoyant, and I expect overall growth in the major seven countries to be around 2½ per cent in 1988 - only slightly slower than this year.

B21. However, there are considerable uncertainties given the persistence of the large imbalances within the three largest countries, the US, Japan and Germany.

B22. These countries have begun to make the policy adjustments necessary to reduce these imbalances. And there are signs that the steps they have taken 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 take time - could be damaged either by further gyrations in the ~~value of the~~ dollar, XR or by a slide into protectionism.

B23. Some commentators continue to insist that the way to solve these imbalances lies in further substantial exchange rate adjustments, even though the source of the problem lies elsewhere. They see exchange rate adjustment as a miracle cure, whatever the illness. They ignore the damage that uncertainty and exchange rate volatility does to economic health. And they distract attention from the fundamental causes of the imbalances.

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 another. Most transfers take place within families - housekeeping money from a husband to a 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 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 rt hon Friend 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

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 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.

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 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.

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.

C. ~~You asked about~~ mentioned Starter 34. No lobby to mention it.
AHH

EST thinks J2 is too prominent, too long, & cd come later in Sect. J.

J. TAXES ON SPENDING

J1. I now turn to the taxation of spending.

PEM

J2. I have one minor 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~~ [is no longer working] well ~~over the years~~, as new products have come on to the market. In particular, recent legal cases ~~before VAT tribunals~~ appear to suggest that some [chewy] cereal bars, but not all, are subject to VAT, [whereas hard cereal bars are not]. I propose to clarify the law so that ~~both types~~ all cereal bars are taxed.

C&E. FP reckons ours is OK.

C&E.

PEM wd omit "chewy" to avoid a snigger!

PEM

J3. ~~I propose~~ My main proposal is 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 threepence for a packet of 20 cigarettes. This will take effect from midnight on Thursday. The duty on a ~~typical~~ packet of five small cigars will rise by two pence, but that on pipe tobacco will remain unchanged.

[Problem. The increase is 3·4p. C&E want to say either "over 3" or "3½". Both will sound odd in the House. How about "three to four pence"?]

C&E

C+E ×

C+E (!)

"

J4. As to the alcohol duties, I propose increases which, including VAT, will put about a penny on the price of a pint of average-strength beer and of cider, fourpence on a bottle of table wine, and sixpence on a bottle of sherry and of sparkling wine. There will once again be no increase in the duty on spirits. These changes will take effect from 6 o'clock tonight.

RIGA: Scope for a joke if you drink a spritzer during the speech.

C&E: See minute.

J5. Drinks known as 'coolers', which are mixtures of an alcoholic drink and a soft drink, have become more popular in recent years. But ~~The~~ the existing duty structure is confused and means that many types are overtaxed. ~~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 move to drinks with a lower alcohol content. ~~choose them in preference to more alcoholic beverages.~~ For the same reason, I propose from 1 October to abolish the minimum duty charge on beer, which will encourage the spread of low-alcohol beers. ~~reduce the duty on beers with a low alcohol content.~~

APH

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 very small category of ~~very~~ exceptionally large and heavy vehicles used to transport special loads. These juggernauts cause a substantial amount of wear and tear on the roads, but currently pay a ~~concessionary~~ very low 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

APH

[You asked why "concessionary". That's not right, & I have redrafted. The rate has been v. low for ages, & FP surmise that nobody spotted it because there are only 400 vehicles doing 5000 miles p.a. each. But the PAC pointed out the wear & tear on the roads.]

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.

[More rounding problems: see C+E minute.]

APH: From C+E press notice.

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. As a result, the number of garages stocking lead-free petrol has more than trebled. But ~~Despite this,~~ consumption ~~of lead-free petrol~~ remains disappointingly low. Accordingly, I propose to [more than] 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 worst] be [no higher than] below that of ordinary 2-star petrol. It is now up to the [petrol companies] motor industry to promote the [sale] use of unleaded petrol far more effectively than [they have done] hitherto.

C+E

C+E

C+E think petrol companies have done all they can.

K. TAXES ON CAPITAL

ACSA
the proportion of families owning their own home has risen from [55%] to [62%].

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.

MCS
CST

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, 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 owning is now taking root.

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

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 for 1988 from £2,400 to £3,000. [The new higher limit will apply retrospectively as from 1 January this year.]

Tony Kuczys doesn't like "retrospectively".

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.

APH

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.

See my note, + FST's minute.

PEM: "Pause"

APH

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

MCS

PEM

MCS

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.

IR: will reduce tax liabilities at all levels. They

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

PJC thinks this is not v. clear.

EST

K12. Lastly, Capital Gains Tax. [Strictly speaking, this should not be a tax on original 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~~ and extended in my 1985 Budget.

APH

APH/IR

K13. But ~~with~~ for gains that arose ~~prior~~ before 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

45

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.

APH

K16. This Budget thus ends once and for all the injustice of taxing inflationary gains. ~~It~~ This 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 to reduce the exemption to £5000 for 1988-89. ~~[not yet decided].~~ It should also be borne in mind that, with the introduction of independent 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 many people have the option of taking remuneration in either form. 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~~ economy.]

PEM

PJC: Pension fund bias is bigger.
PEM wd omit [ ] sentence in [ ].
MCS

IR: PEM wd move K20 to here

K19. I therefore propose a fundamental reform. Subject to the new base date and the consequential reduction in the annual exemption, capital gains will continue to be worked out as now, with the present exemptions and reliefs, ~~In particular~~ including that for 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] the top slice of income.

APH

PEM: "speak slowly"

APH

K20. At present, with capital gains taxed at 30 per cent for everybody, higher rate taxpayers face a lower - sometimes much lower - rate of tax on gains while basic rate taxpayers - the majority of CGT payers - can find themselves 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

MCS:

FST

(47)

PEM wd keep last sentence of K20, as a separate para before K21.

~~RIGA~~
MCS
(APH: I'd take the first MCS comment, but the second one here ~~makes~~ it sounds like a fresh proposal.)

justify. ~~In future, the marginal rate of tax on income and capital gains will always be the same.~~ I propose in future to apply the same rate to income and capital gains.

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

MCS

K22. Taxing capital gains at income tax rates makes for greater neutrality in the tax system. It is - since Budget Day last year - what we do already for companies. And it is also now the practice in the United States, ~~even without the relief of indexation.~~ although the American taxpayer does not benefit from either indexation or the annual exempt amount.

MCS
(FST has something v. similar.)

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.

IR
IR

K24. They are expected to yield £45 million in 1988-89, and cost £210 million in 1989-90. The cost in this case [is a measure of] reflects, the tax that should never have been levied in the first place.

PEM comments "groan - good", i.e., I presume, the para works well rhetorically!

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L. INCOME TAX

L1. Finally, I turn to income tax.

MCS would drop - commonplace & weak. (APH: I'll ask him for a better para!)

[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, of people's earnings, and less of companies' profits.]

AG?

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.

PEM

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

XX

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.

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.

Jill Rutter wondered if this would be clear to hearers.

CST notes similar formulation used by G. Brown in PE WP debate. Attribute it?

PJC: adds insult to injury.

AG?

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.

FST: worth while? (APH: No.)

IR want to reorder.

A

L10. The time has come to bring it to an end. I propose to do so by the simple but paradoxical 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,~~

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

A

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

IR

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.

L13. The net effect of these changes will be to end an increasingly blatant form 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.

RIGA thinks this para builds up expectations for a much bigger change.

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.

See flagged note on figures.

IR concerned that this appears to make the full value into a target. This is also AGT's point at L17.

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 employee. But the scale charge on which the employee is taxed is only £700: much less than [a quarter of] the true value.

PEM

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 sharp? 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 £~~[ ]~~ 290 million in 1988-89.

x

AGT would omit.

[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.

[Car parking, to come.]

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.

APH: I still don't think we need mention this.

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.

RGA thinks still too much stress on abuse; ~~and~~ could mention focussing relief on home ownership.

CST thinks this sits uneasily with line that most of credit growth is home ownership. (APH: wd look odd if this were the only ref to credit in the speech.)

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 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.

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

£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.

"Why ?"?
(APH: Not worried.)

L35. I now turn to the tax thresholds. The statutory indexation formula means that I should increase ~~all~~ the main ~~principal~~ income tax allowances and bands 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.

BAM

EST

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

BAM wd do the APA/WBA here

I + others noted that this is a v. long list of numbers. But it does emphasise what's being done for taxpayers on low incomes before you announce the higher rates.

destroy enterprise, encourage avoidance, and drive talent to more hospitable shores 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 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.

MCS thinks this a bit compressed.

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.

APH: omit?
CST

L43. [As I have indicated,] after nine years I believe the time has come to make a further reform and 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 single higher rate of 40 per cent. And, indeed, a system of personal taxation in which there is no rate in excess of 40 per cent.

AGT thinks this, & these paras generally, give too great an air of finality to tax reductions.

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.

ACSA

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~~ now be to get it down to a fifth - a rate of 20 pence in the pound - as soon as we prudently and sensibly can.

BAM

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~~ basic rate limit, 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.

See CST minute on peroration - I told Jill this was to come

C. This section is much commented on. The consensus is that it's too long, but opinions differ on what to drop. If you like, I'll have a quick go at a revised version. AHH

H. COVENANTS AND MAINTENANCE

C W Corlett (CWC)

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.~~ arrangements.

ACSA: PJC

, most frequently from one member of a family to another - a parent covenanting income to his child or a husband paying maintenance to his ex-wife

CWC

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 a husband to a wife, for example -and are rightly and properly ~~wholly~~ outside the scope of the tax system altogether. 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.

CWC: omit ref to IR

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~~ form 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

ACSA: omit rest of para.

PJC

See MCS minute.

MCS/APH

pressure on the Courts; and will ~~improve the~~ eliminate a disincentive to work both for students and for separated and divorced wives. Furthermore, the student covenant system is not a very healthy introduction for young people to the British tax system, or paid work.

PJC

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 by individuals on or after today out of the tax system altogether. ~~Those~~ People receiving these payments will not be liable to tax on them and ~~those~~ people making the payments will get no tax relief on them. The tax treatment of existing covenants will continue unchanged.

CWC

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 rt hon Friend the Secretary of State for Education and Science will be announcing the new scale later today.

MCS

PJC

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

RIGA would omit.

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

ACSA and CWC ~~would~~ wd omit down to 1st sentence of H9.

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 whereby students received support, for example, 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,~~ and sent the tax repayments to the students.

CWC

CWC: on receipt of the necessary claim forms

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.]

RIGA wd omit.

[They 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.]

36

CWC

H10. Similar considerations apply to maintenance payments. The present arrangements are complex and confusing for people going through ~~divorce or~~ separation and divorce. ~~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~~ man paying maintenance for the reduction in his tax threshold from the married to the single allowance when the marriage has broken down.

MCS

CWC: though it is right that there should be some recognition of the fact that the ex-husband is continuing to support his ex-wife.

H11. So I am proposing that, for new agreements, ~~in future~~ separated or divorced spouses receiving payments under new maintenance orders and agreements will not have to pay any tax whatever on them.

CWC

CWC

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 payments above this limit or for maintenance payments other than to separated or divorced spouses.

MCS: for payments above this limit or

CWC wd put H14 here →

H12. ~~This~~ The 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

CWC: reduce the benefit that can be obtained by the better off paying large amounts of maintenance, and protect the position of those in between.

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

CWC wd omit or shorten to 1 sentence. MCS & APH would keep.

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.

CWC

H14. The present rules will continue to apply to ~~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. From April 1989, there will be special transitional rules to continue that protection.

APH: Have to think further about what to quote here.

H15. My proposals on covenants will yield £~~25~~ 45 million in 1988-89 and £~~85~~ 105 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 will cost £10 million in 1988-89 and £5 million in 1989-90, but will have a small yield in the longer term. ~~should be [revenue neutral] [bring a small yield in 1988-89 and 1989-90]~~.

CWC

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 proposal ~~new measure~~ to help charities further.

LAM Another

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 ~~put this right.~~ put this right, with ~~restrict the Additional Personal Allowance to one per couple. This will take~~ effect from April 1989.

MCS

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

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~~ sells new shares to the public. This is undesirable on two counts. It is

RBW

sells shares to the public.

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.

RBW ✗

[Apparently no evidence that it was reluctant.]

G30 Capital Duty is a relatively recent impost, which had ~~having~~ to be ~~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 rate of ¼ 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 passed on in full ~~fully reflected in lower charges~~ to investors.

RBW/FIM ... not lower charges but lower spreads.

~~Apparently~~ IRs FIM say the benefit will be lower spreads, not lower charges.

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.

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: ~~of effort: not only did~~ local authorities ~~had~~ have first to compute parental income for the means tested grant, then and restrict the student grant accordingly; but in addition parents ~~then~~ made their covenants; the Revenue checked the student's income; ~~then~~ and, finally, on receipt of the necessary claim forms, sent the tax repayments to the students.

of effort; not only did

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

The new parental contribution scale will take the place of the tax relief.

H9. 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; 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.

~~The new parental contrib'n scale will take the place of the tax relief.~~