

PO-CH/NL/0514

PART A

PO CH/NL/OS14

PART. A

PO CH/NL/OS14
PART. A

1989 BUDGET NOTE
FOR THE QUEEN AND
OVERSEAS POST.

13-3-89

THIS FOLDER HAS BEEN
REGISTERED ON THE
REGISTRY SYSTEM

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

COPY NO. 1 OF 25 COPIES

FROM: C J RILEY
DATE: 7 March 1989

CHANCELLOR _____

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

Ch

Some suggestions made

*Thanks.
OK as
But need
contact [unclear] of [unclear] & [unclear] Mr.*

SP

Check & [unclear]

AT

NOTE FOR THE QUEEN AND OVERSEAS POSTS

I attach a note prepared with the help of FP. I suggest that, as last year, the same note should be used for both the Queen and overseas posts.

2. It would be helpful to have your comments by close on Thursday so that we can prepare a final draft by Friday. We shall need to check the numbers when we have finalised the national accounts figures accounts and you have made final decisions about the PSBR. The text will need looking at in the light of any amendments to the FSBR and the latest version of the speech.

C J RILEY

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

1989 BUDGET : SUMMARY OF MAIN POINTS

The UK economy remains in a very strong position. Growth has been [buoyant] over the past two years, and unemployment [is falling] rapidly. Profitability is now at its highest level since the 1960s, productivity has been growing rapidly, and companies are investing for the future. The public finances are very strong. This year's Budget maintains the prudent and cautious approach to financial policy, combined with tax measures to improve the supply side, which has brought about the transformation of UK economic performance over the last decade.

2. The main points are:-

- a public sector debt repayment of ⁷¹⁴ [£12 billion] in 1989-90, the same as 1988-89, after ~~allowing for~~ ^{the autumn inc} privatisation proceeds, with gradual movement ^{back} towards a balanced budget over the medium term;
- a major reform of [the structure of] employees' national insurance contributions, with reductions of £3 a week for most employees;
- no change in income tax rates; ^{tax} ~~but~~ thresholds increased in line with inflation;

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

See new into UK 9

BUDGET SECRET

BUDGET SECRET

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

- measures to help the elderly, including abolition of the pensioners' earnings rule and improvements in age allowances;

- a reduction in the duty on unleaded petrol, designed to produce a pump price differential of 9p a gallon with 4 star ~~unleaded~~; *with 10p a gallon*
(over 2p a litre)

- no change in the main excise duties;

- new tax incentives for share ownership, including major improvements to Personal Equity Plans;

- reform of the taxation of ~~pensions~~ and life assurance companies, *and some changes to the pension tax regime for occupational & personal pensions.*

Economic background

3. The ~~last decade~~ *1980s have* has seen major improvements in the performance of the British economy. Since ~~1982~~ *1983* inflation has averaged *5%*, compared with *15%* between 1974 and 1979. At the same time we have had an unprecedented ~~eight~~ *seven* years of steady, sustainable growth averaging in excess of 3% a year. Output has grown faster in the 1980s than *all other major* European countries, whereas ~~it~~ *the UK* was at the bottom of the league in the previous two decades.

4. In 1988 total output grew by *some* 4½%, faster than forecast a year ago. This is the first time since *for at least 20 years* the mid-1960s that there have been two successive years of growth above 4 per cent.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Manufacturing output has grown particularly rapidly, by over 7% in 1988 following 5½% in 1987, and now stands [4%] above the peak in 1974. Unemployment has fallen by over half a million in the past

year, more than in any other major country. We now have more people in work than ever before.

Over the past seven years investment has grown very nearly twice as fast as consumption, and 5. It seems clear that investment has been a major source of growth in the past two years. The growth of total fixed investment may well have been in double figures last year, the largest increase for almost 25 years [to be checked].

Productivity continues to grow at a more rapid pace than in other major industrialised countries, with the exception of Japan.

There has been a dramatic & sustained improvement in productivity growth, which in manufacturing has exceeded that of all other major nations during the 80s.

6. With consumers' expenditure also extremely buoyant, domestic demand probably grew by about 7% in 1988, faster than the economy's capacity to supply. This has led to an increase in inflationary pressures and a widening current account deficit. The RPI has grown by about 7½% over the last year, though the underlying inflation rate currently stands at about 5½%; published figures put the current account deficit at [£14½ billion] in 1988, but with a very large balancing item in the balance of payments accounts this may well overstate the true deficit.

7. Since the summer, monetary policy has been tightened significantly to deal with the emerging inflationary pressures, and this is now starting to bring the economy back to a sustainable path. Following two years of above average growth, the Chancellor expects growth to be somewhat below trend over the coming year. But even so, GDP in 1989 is forecast to be higher than in 1988, with the non-oil economy up by 3%. Business

Since the summer, monetary policy has been tightened significantly to deal with the emerging inflationary pressures, and this is now starting to bring the economy back to a sustainable path. Following two years of above average growth, the Chancellor expects growth to be somewhat below trend over the coming year. But even so, GDP in 1989 is forecast to be higher than in 1988, with the non-oil economy up by 3%. Business

though growth in the course of 1989 will be less than this, at 2 per cent.

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Business
investment is forecast to continue growing strongly, with a rise of 10%. ~~RPI~~ *as recorded by RPI* inflation is forecast to come down to 5½% by the end of the year and 4½% by the middle of 1990.

8. The slow down in domestic demand should lead to a ~~gradual~~ *in due course* improvement of the current account. But this is unlikely to occur quickly; continued buoyancy of investment will add to imports of capital goods for the time being, and it will take some time before the additions to industrial capacity feed through into better trade performance. The current account ~~is thus forecast to be in deficit by [fx billion],~~ *deficit* the same as in 1988. *to be*

Budget strategy

9. The medium term financial strategy continues to provide the framework for the Government's *macro* economic policy, and this is the tenth occasion on which it has been set out in the FSBR. Although the precise form in which the strategy has been expressed has changed as the economy has itself evolved, the essential objectives remain the same. The overriding aim is to bring down inflation by reducing the growth of money GDP, and ultimately to achieve price stability.

10. Short term interest rates will be held at whatever level is necessary *for as long as necessary, to get on top of inflation.* ~~to ensure that inflation is clearly on a downward trend.~~ Decisions on interest rates will continue to be based on a comprehensive assessment of monetary conditions, in which particular weight is given to the behaviour of M0 and the exchange rate. The Chancellor is setting a target range of 1-5% for the growth of M0 in 1989-90; the 12 month growth rate is likely to begin the year above this range, but as the deceleration over recent months continues *falls down* it should come back within it.

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

11. In its early years of office, one of the Government's main objectives was to bring down the rate of Government borrowing. Now the public finances have been completely transformed, with the budget in surplus for the last two years. It seems likely that the outturn in 1988-89 will be a ~~debt repayment~~ ^{surplus} of £14 billion.

~~[This remarkable improvement in the fiscal position] No other major country enjoys a comparable surplus. [owes much to the buoyancy of the economy, as well as somewhat higher privatisation proceeds than originally planned.]~~

12. Although the longer term aim of fiscal policy is a balanced budget, the Chancellor believes that this should be approached gradually.

~~[In present circumstances, with continuing strength of domestic demand, substantial privatisation proceeds, and the likelihood that some favourable cyclical influences on the public finances will tend to unwind as the economy reverts to a more sustainable growth rate, a particularly cautious approach is indicated.]~~

The Chancellor has ^{almost £14} thus budgeted for a further substantial ^{sack} PSDR of ~~£12~~ billion in 1989-90, before moving gradually towards budget balance over the medium term.

Capital markets liberalisation

13. The Chancellor is introducing a substantial liberalisation of the London sterling capital market. He is abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. He is also

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes should give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

Taxation and national insurance contributions

14. The Chancellor is introducing a major reform of national insurance contributions, and tax measures which promote unleaded petrol, encourage wider share ownership, and improve the taxation of savings. *(Employers')* He is also reforming the tax treatment of life assurance and pension money changes to the tax regime for occupational pensions.

Employees' national insurance contributions

15. The Chancellor is restructuring employees' National insurance contributions from ~~6~~ *10 beginning of* October. Employees whose earnings are at or above the Lower Earnings Limit (LEL) of £43 a week will pay 2 per cent (86 pence) on earnings up to the LEL, and 9 per cent on earnings above the LEL up to the Upper Earnings Limit (UEL) of £325 a week. ~~This replaces the current system in which NICs are charged at three different rates, depending on earnings, on the whole of an employee's earnings.~~

16. The Chancellor's reform ends the situation whereby many lower paid employees found that a £1 increase in earnings led to an additional NIC charge greater than £1. The take-home pay of everyone earning £115 a week or more will increase by £3 a week, with lesser amounts going to those below that level. *(but the cost in 1989-90 will be £1.67/m.)* The full year cost of the reform will be £2 3/4 billion, The greater part of that will go to employees on below average earnings.

BUDGET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Income tax

17. The Chancellor is raising the main personal allowances and the basic rate limit by 6.8 per cent in line with inflation.

Stark point for higher rate tax in line with inflation. ~~accordance with Statute & taxation~~

18. The income tax scale charges for company cars are being increased by a third, bringing them closer into line with the true value of the benefits which company cars provide.

19. For elderly taxpayers he is extending the higher age allowance to those aged 75 and over (at present, 80 and over); he is reducing the rate at which the age allowance is withdrawn for those earning £11,400; and ~~redeeming the last outstanding 1979~~ ~~Manifesto commitment~~ - he is abolishing the pensioners' earnings rule, thereby allowing those who choose to work on beyond the statutory retirement age to do so without having their state retirement pension reduced. The Finance Bill will also include the new tax relief for pensioners' health insurance premiums announced in January.

(not for this)

Excise duties

one of the largest in European Community

*HAS THIS BEEN CHECKED?
I HAVE STILL NOT SEEN AN
BE LEAGUE TABLE*

20. The Chancellor is increasing the duty differential between leaded and unleaded petrol by ~~something over 3~~ ^{almost 4} pence a gallon, which should result in a pump-price differential of nearly 10 pence a gallon. He is also increasing the duty on 2 and 3 star petrol, making the pump price at least as high as 4 star. Together, these measures will accelerate the trend from leaded to unleaded petrol.

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

21. He is simplifying Vehicle Excise Duty rates, reducing their number by about one third. He is also increasing the VED paid by coaches and by non-articulated lorries, so that the motoring taxes they pay will cover the wear and tear they impose on the roads, putting their taxation on a more equal footing with private cars and articulated lorries respectively.

22. He is making no other changes to excise duty rates. *this year.*

Capital gains tax

23. Independent taxation of husband and wife, being introduced in April 1990, will give *husbands & wives* their own separate CGT thresholds. In the light of that, the Chancellor is maintaining the exemption limit at its present £5,000 a year.

24. The exemption of gifts from CGT has become a *simple* popular form of tax avoidance. The Chancellor will restrict the exemption in future to gifts of businesses and farms and gifts to the heritage; and to gifts between husband and wife. Gifts to charities will also continue to be exempt. The Chancellor is doubling the exemption from CGT for gifts of *personal belongings* individual chattels from £3,000 to £6,000. *for each chattel.*

Inheritance tax

25. The Chancellor will raise the threshold for inheritance tax from £110,000 to £118,000, in line with inflation.

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Value added tax

26. The Chancellor is raising the VAT registration threshold by the maximum allowed under EC Law, to £23,600.

27. The Finance Bill will implement the judgement of the European Court of Justice requiring the UK to end the zero rating of non-domestic construction; of supplies of electricity and gas to non-domestic consumers, and of water and sewerage to industry; of protective clothing and headgear bought by employers; and news services (but not newspapers, which continue to be zero-rated).

28. The loss of these zero-rates derives directly from the 6th EC VAT Directive agreed to by the UK in 1977. ~~Generous~~ *transitional* provisions will be included in the Finance Bill to assist commerce and industry to adjust to the changes.

Charities

29. The Chancellor is taking special *particulars* steps to soften the impact of the ECJ judgement on charities. In *addition*, he is doubling the annual amount which can be given tax free to charities under the payroll giving scheme from £240 to £480 a year. He is extending VAT exemption to cover all advertising by charities. He is also exempting from VAT fund-raising events by charities (and certain other fund-raising, including that for political parties and trades unions). He is changing the covenant rules so that the

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

National Trust and similar charities can offer members free or cheap entry to their properties without loss of tax relief. And he is exempting from special car tax vehicles ~~purchased by Motability~~ for leasing to the disabled.

Corporation tax

30. The Chancellor is increasing the level of profits ^{up to £100,000} at which the 25 per cent small companies rate applies from £100,000 to £150,000 a year; and increasing the threshold at which the 35 per cent main rate applies from £500,000 to £750,000 a year. These changes will reduce the tax burden for more than half the companies which do not already pay the small companies rate. ~~The main rate will remain unchanged at 35 per cent.~~

He is greatly simplifying the tax regime for close companies - unquoted
31. [He is raising to a special rate of 40 per cent the corporation tax paid by close companies which do not distribute their profits. This allows the apportionment rules currently needed to prevent tax avoidance to be abolished.]

[Middle Revenue Dept. :-)]

unquoted companies controlled by up to five people, which companies

companies controlled by a small group of people, often families

Measures to encourage wider share ownership

No available majority of small companies, and fund business a pain
32. The Chancellor is introducing a number of specific tax measures to encourage further widening of share ownership. [The number of shareholders has, encouragingly, remained at around 9 million over the last year despite the Stock Market difficulties of October 1987.]

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

33. He is increasing from £3,000 to £4,800 the annual amount which can be invested in a Personal Equity Plan, and allowing up to half that amount to be held in unit trusts ^{or trusts - trusts} investing in UK equities. ~~PEPs will be allowed to include~~ new share issues, including privatisation issues, ^{He is} The rules governing PEPs will also be made simpler and more flexible. ^{man}

to be added into a PEP.

34. He is increasing the ^{value} ~~number~~ of shares which can be given to an employee ~~income tax free~~ via an Employee Share Scheme, and simplifying the rules. He is also removing obstacles to Employee Share Ownership Plans which, like the share schemes, provide means for employees to acquire shares in the companies employing them.

35. The Chancellor will also make various improvements and simplifications to the rules applying to Profit Related Pay.

36. Together these measures will further stimulate wider share ownership and the greater identification of employees with the companies ^{for which they work for.} ~~they work for.~~

Life assurance

37. Following a ~~full~~ process of consultation with the Life Assurance industry and others, the Chancellor has decided to introduce changes to the tax regime governing Life Assurance taking effect from 1 January 1990. ~~The main changes are to separate the profits and expenses of pension business from those for life assurance, and to remedy defects in the tax regime special to this industry which have meant that some rapidly-growing companies have been paying little or no tax.~~ ^{will be removed.} ^{are the proposals} ^{are the proposals}

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

In future, the expenses of selling new policies will be spread against profits over seven years, but this

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

will be accompanied by a

38. ~~He will take advantage of the broadening of the tax base to reduce the rates of tax paid on policyholders' income and gains from 35 per cent and 30 per cent respectively to 25 per cent, the basic rate of income tax. He will also abolish Life Assurance Premium Duty, the special stamp duty paid on Life Assurance policies.~~

39. ~~The separation of pension from Life Assurance business will yield some £155 million in 1990-91 prices. The other changes are broadly revenue neutral. The Chancellor will phase in the overall package, to allow individual companies time to adjust to the new regime.~~

Unit trusts

40. The Chancellor will reduce from 1 January 1990 the Corporation Tax rate payable on certain unit trusts to 25 per cent, the basic rate of income tax. He will also tax switches between offshore umbrella funds, to align their treatment with that of UK-based trusts. These measures will put the UK unit trusts involved in a better competitive position to win business as the EC market is liberalised.

Pensions

41. The Chancellor will make an important deregulatory change to occupational pensions, allowing employers to pay pensions beyond the Inland Revenue limits without, as at present, loss of tax

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

relief. To allow this change, a limit will be placed on the maximum size of tax-privileged pensions and tax free lump sums, based on a salary of £60,000 a year indexed to inflation. These changes will apply to new pension schemes and new members of existing pension schemes: existing members will not be affected.

42. The Chancellor ~~is introducing a similar cap for personal pensions and~~ is increasing the tax-free contributions which people aged over 35 can make to buy ^{personal} such pensions, *subject to the same earnings cap as for occupational pensions.*

Car number plates

43. The Chancellor will include in the Finance Bill provision for the sale to the public of "cherished" car registration numbers.

Security equipment

44. The Chancellor will exempt from taxation as a benefit in kind the security equipment which some employers now have to provide at the homes of key employees at risk from terrorist and other attacks.

Tax administration

45. The Chancellor will also include in the Finance Bill provisions for fairer and more effective enforcement on Inland Revenue taxes; and to restore criminal sanctions against Revenue or Customs officials who reveal information about the private affairs of taxpayers.

*WORTH
TELEVISION
HM N Q
PBR
(+ other)*

*attractive
offerings*

BUDGET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Summary

46. The Budget continues the economic policies which have brought about the transformation of UK economic performance over the last decade. It introduces a major reform of ^{reduction in} employees' national insurance contributions, ~~and takes forward the process of tax reform.~~ At the same time, the Chancellor has budgeted for a substantial Public Sector Debt Repayment in the year ahead.

hwa
1

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET CONFIDENTIAL

FROM: J. ANSON
8th March, 1989.

MR. RILEY

c.c. PPS

PS/CST

PS/FST

PS/PMG

PS/EST

Sir Peter Middleton

Mr. Scholar

Mr. Culpin

Mrs. Lomax

Mr. Gieve

Mr. McIntyre

NOTE FOR THE QUEEN AND OVERSEAS POSTS

Could I suggest some drafting amendments to your note, primarily to group the earnings rule change with other national insurance measures, and not, as at present, under the heading of income tax.

2. I suggest, in the side-heading of paragraph 14, delete "contributions", and amend the side-heading of paragraph 15 to "National insurance". Then add, after paragraph 16, a new short paragraph, containing the substance of lines 4-8 of the present paragraph 19:-

"17. In addition - redeeming the last outstanding 1979 Manifesto commitment - he is abolishing the pensioners' earnings rule, thereby allowing retirement pensioners who choose to work on beyond the statutory retirement age to do so without having their state retirement pension reduced."

The corresponding words in paragraph 19 should then of course be deleted.

3. Other minor points, mainly to bring it into line with the amendments I have already suggested in the "Budget in Brief":

- Paragraph 2, second indent, amend the concluding words to read "reductions of up to £3 a week;".

BUDGET CONFIDENTIAL

- Page 2, line 2, inset "retirement" before "pensioners".
- In paragraph 15, delete the last 10 words. What is being changed is the number of rates. It will still be "depending on earnings". And the last line is inconsistent with the existence of a UEL.



J. ANSON

**BUDGET SECRET
BUDGET LIST ONLY**

ACSA/89/16
NOT TO BE COPIED

COPY NO.

8 OF 15



FROM: A C S ALLAN

DATE: 10 March 1989

MR C J RILEY

- cc Mr Wicks
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mr S Davies
- Mr Gieve
- Mr Gilhooly
- Mr Matthews
- Mr Pickford
- Miss Simpson
- Mr Tyrie

1 Mr. Nichie
 2 Miss Hagg
 I have passed
 the comments
 marked to Chris
 Riley.

ACSA
13/3

NOTE FOR THE QUEEN AND OVERSEAS POSTS

... The Chancellor was grateful for your minute of 7 March. I attach a revised version with his comments incorporated. I should be grateful for any comments by noon on Monday at the latest.

ACSA
 A C S ALLAN

92/8

B076
532

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET SECRET

SECRET

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

**BUDGET SECRET
BUDGET LIST ONLY****NOT TO BE COPIED****1989 BUDGET: SUMMARY OF MAIN POINTS**

The background to this year's Budget is one in which the United Kingdom has enjoyed two years of exceptionally strong growth. With high investment, rapid productivity growth and a major improvement in profitability, the UK is very well placed to build on the achievements of recent years. But the rapid expansion in the last two years has produced some build-up of inflationary pressures, and monetary policy has been tightened sharply since last summer to deal with that. This year's Budget therefore adopts a continued prudent and cautious approach to financial policy, and the Chancellor is budgeting for a further massive repayment of public sector debt. But this is combined with further reforms and reductions in taxation and national insurance contributions to improve the supply side of the economy and continue the transformation of Britain's economic performance.

2. The main points are:-

- a public sector debt repayment of [£14 billion] in 1989-90, the same as the outturn for 1988-89, with gradual movement back towards a balanced budget over the medium term;
- a major reform of employees' national insurance contributions, with reductions of £3 a week for most employees;
- no change in income tax rates, tax thresholds increased in line with inflation;
- measures to help the elderly, including abolition of the pensioners' earnings rule and improvements in age allowances;

**BUDGET SECRET
BUDGET LIST ONLY****NOT TO BE COPIED**

BUDGET SECRET
BUDGET LIST ONLY

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

- a reduction in the duty on unleaded petrol, designed to produce a pump price differential of getting on for 10p a gallon (over 2p a litre) with 4 star leaded;
- no change in the main excise duties;
- new tax incentives for share ownership, including major improvements to Personal Equity Plans;
- reform of the taxation of life assurance companies and some changes to the tax regime for occupational and personal pensions.

Economic background

3. The 1980s have seen major improvements in the performance of the British economy. Since 1983 inflation has averaged under 5 per cent, compared with over 15 per cent between 1974 and 1979. At the same time we have had an unprecedented seven years of steady, sustainable growth averaging in excess of 3 per cent a year. Output has grown faster in the 1980s than in all other main European countries, whereas the UK was at the bottom of the league in each of the previous two decades.

4. In 1988 total output grew by some 4½ per cent, faster than forecast a year ago. This is the first time for at least 40 years that there have been two successive years of growth above 4 per cent. Manufacturing output has grown particularly rapidly, by over 7 per cent in 1988 following 5½ per cent in 1987. Unemployment has fallen by over half a million in the past year, more than in any other major country. We now have more people in work than ever before.

5. Over the past seven years investment has grown very nearly twice as fast as consumption, and total business investment is now

BUDGET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

a higher proportion of national income than ever before. And investment has grown particularly strongly over the last two years. Over the 1980s as a whole, investment has grown faster than in any other of the main European economies. There has been a dramatic and sustained improvement in productivity growth, which in manufacturing has exceeded that of all other major nations during the '80s.

6. With consumers' expenditure also extremely buoyant, domestic demand probably grew by about 7 per cent in 1988, faster than the economy's capacity to supply. This has led to an increase in inflationary pressures and a widening in the current account deficit. The RPI has grown by about $7\frac{1}{2}$ per cent over the last year, though the underlying inflation rate (excluding mortgage interest payments) currently stands at about $5\frac{1}{2}$ per cent; published figures put the current account deficit at around £14½ billion in 1988, but with a very large positive balancing item in the external accounts this may well overstate the true deficit.

7. Since the Summer, monetary policy, which must necessarily play the key role in combating inflation, has been tightened sharply to deal with the emerging inflationary pressures, and some slowdown in real growth is probably inevitable while inflation is being brought firmly back onto a downward path. Following two years of above average growth, the Chancellor expects growth to be somewhat below trend over the coming year. But even so, GDP in 1989 is forecast to be $2\frac{1}{2}$ per cent higher in 1989 than in 1988, with the non-oil economy up by 3 per cent, though growth in the course of 1989 is forecast to be rather less than this, at 2 per cent. Business investment is forecast to continue growing strongly, with a rise of 10 per cent. Inflation as recorded by the RPI is forecast to come down to $5\frac{1}{2}$ per cent by the end of the year and $4\frac{1}{2}$ per cent by the middle of 1990.

What does this mean?

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

8. The slowdown in domestic demand should lead in due course to an improvement in the current account. But this is unlikely to occur quickly; continued buoyancy of investment will add to imports of capital goods for the time being, and it will take some time before the additions to industrial capacity feed through into better trade performance. The current account deficit is thus forecast to be the same as in 1988.

Budget strategy

9. The medium term financial strategy continues to provide the framework for the Government's macroeconomic policy, and this is the tenth occasion on which it has been set out in the FSBR. Although the precise form in which the strategy has been expressed has changed as the economy has itself evolved, the essential objectives remain the same. The overriding aim is to bring down inflation by reducing the growth of money GDP, and ultimately to achieve price stability.

10. Short term interest rates will be held at whatever level is necessary, for as long as necessary, to get on top of inflation. Decisions on interest rates will continue to be based on a comprehensive assessment of monetary conditions, in which particular weight is given to the behaviour of MO and the exchange rate. The Chancellor is setting a target range of 1-5 per cent for the growth of MO in 1989-90; the 12 month growth rate is likely to begin the year above this range, but as the deceleration over recent months continues it should fairly soon come back within it.

11. In its early years of office, one of the Government's main objectives was to bring down the rate of Government borrowing. Now the public finances have been completely transformed, with the budget in surplus for the last two years. It seems likely that

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

the outturn in 1988-89 will be a debt repayment of £14 billion. No other major country enjoys a comparable surplus.

12. Although the longer term aim of fiscal policy is a balanced budget, the Chancellor believes that this should be approached gradually. The Chancellor has thus budgeted for a further substantial PSDR of almost £14 billion in 1989-90, before moving gradually back towards budget balance over the medium term.

Capital markets liberalisation

13. The Chancellor is introducing a substantial liberalisation of the London sterling capital market. He is abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. He is also making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes should give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

Taxation and national insurance contributions

14. The Chancellor is introducing a major reform of employees' national insurance contributions, and tax measures which promote unleaded petrol and encourage wider share ownership. He is also reforming the tax treatment of life assurance and making changes to the tax regime for occupational pensions.

Employees' national insurance contributions

15. The Chancellor is restructuring employees' National insurance contributions from the beginning of October. Employees whose earnings are at or above the Lower Earnings Limit (LEL) of £43 a week will pay 2 per cent (86 pence) on earnings up to the LEL, and

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

9 per cent on earnings above the LEL up to the Upper Earnings Limit (UEL) of £325 a week.

16. The Chancellor's reform ends the situation whereby many lower paid employees found that a £1 increase in earnings led to an additional NIC charge greater than £1. The take-home pay of everyone earning £115 a week or more will increase by £3 a week, with lesser amounts going to those below that level. The full year cost of the reform will be £2 3/4 billion, but the cost in 1989-90 will be £1 billion. The greater part of that will go to employees on below average earnings.

Income tax

17. The Chancellor is raising the main personal allowances and the starting point for higher rate tax in line with inflation.

18. The income tax scale charges for company cars are being increased by a third, bringing them closer into line with the true value of the benefits which company cars provide.

19. For elderly taxpayers ^{the Chancellor} he is extending the higher age allowance to those aged 75 and over (at present, 80 and over); he is reducing the rate at which the age allowance is withdrawn for those earning ^{over} £11,400; and he is abolishing the pensioners' earnings rule, thereby allowing those who choose to work on beyond the statutory retirement age to do so without having their state retirement pension reduced. The Finance Bill will also include the new tax relief for pensioners' health insurance premiums announced in January.

Excise duties

20. The Chancellor is increasing the ^{tax} duty differential between leaded and unleaded petrol by almost 4 pence a gallon, which

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

should result in a pump-price differential of nearly 10 pence a gallon, one of the largest in the European Community. He is also increasing the duty on 2 and 3 star petrol, making the pump price at least as high as 4 star. Together, these measures will accelerate the trend from leaded to unleaded petrol.

X
21. He is simplifying ^{main} Vehicle Excise Duty rates, reducing their number by about one third. He is also increasing the VED paid by ^{buses and} coaches and by ~~non-articulated lorries~~, so that the ^{duty} motoring taxes they pay will cover the wear and tear they impose on the roads, ^{and on non-articulated lorries to put them} putting their taxation on a more equal footing with ~~private cars and articulated lorries~~ respectively. _{2 vehicles.}

22. He is making no other changes to excise duty rates this year.

Capital gains tax

23. Independent taxation of husband and wife, being introduced in April 1990, will give husbands and wives their own separate CGT thresholds. In the light of that, the Chancellor is maintaining the exemption limit at its present £5,000 a year.

24. The exemption of gifts from CGT has become a simple form of tax avoidance. The Chancellor will restrict the exemption in future to gifts of businesses and farms and gifts to the heritage; and to gifts between husband and wife. Gifts to charities will also continue to be exempt. But the Chancellor is doubling the exemption from CGT for gifts of chattels from £3,000 to £6,000 for each chattel.

Inheritance tax

25. The Chancellor will raise the threshold for inheritance tax from £110,000 to £118,000, in line with inflation.

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

**BUDGET SECRET
BUDGET LIST ONLY**

NOT TO BE COPIED

Value added tax

26. The Chancellor is raising the VAT registration threshold by the maximum allowed under EC Law, to £23,600.

27. The Finance Bill will implement the judgement of the European Court of Justice requiring the UK to end the zero rating of non-domestic construction; of supplies of electricity and gas to non-domestic consumers, and of water and sewerage to industry; of protective clothing and headgear bought by employers; and news services (but not newspapers, which continue to be zero-rated).

28. The loss of these zero-rates derives directly from the 6th EC VAT Directive agreed to by the UK in 1977. Transitional provisions will be included in the Finance Bill to assist commerce and industry to adjust to the changes.

Charities

Bit strong?
29. The Chancellor is taking special steps to soften the impact of the ECJ judgement on charities. *In addition* In particular, he is doubling the annual amount which can be given tax free to charities under the payroll giving scheme from £240 to £480 a year. He is extending VAT *zero-rating* exemption to cover all advertising by charities, *and certain types of medical equipment used by charities*. He is also exempting from VAT fund-raising events by charities (and certain other fund-raising, including that for political parties and trades unions). He is changing the covenant rules so that the National Trust and similar charities can offer members free or cheap entry to their properties without loss of tax relief. And he is exempting from special car tax vehicles *included* for leasing to the disabled.

sterling equipment

BUDGET SECRET
BUDGET LIST ONLY

BUDGET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Corporation tax

30. The Chancellor is increasing the level of profits up to which the 25 per cent small companies rate applies from £100,000 to £150,000 a year; and increasing the threshold at which the 35 per cent main rate applies from £500,000 to £750,000 a year. These changes will reduce the tax burden for more than half the companies which do not already pay the small companies rate.

31. He is greatly simplifying the tax regime for close companies - unquoted companies controlled by up to five people, which comprises the overwhelming majority of small companies.

Measures to encourage wider share ownership

32. The Chancellor is introducing a number of specific tax measures to encourage further widening of share ownership.

33. He is increasing from £3,000 to £4,800 the annual amount which can be invested in a Personal Equity Plan, and allowing up to half that amount to be held in unit trusts or investment trusts investing mainly in UK equities. He is allowing new share issues, including privatisation issues, to be added into a PEP. The rules governing PEPs will also be made simpler and more flexible.

34. He is increasing the value of shares which can be given to an employee via an Employee Share Scheme, and simplifying the rules. He is also removing obstacles to Employee Share Ownership Plans which, like the share schemes, provide means for employees to acquire shares in the companies employing them.

35. The Chancellor will also make various improvements and simplifications to the rules applying to Profit Related Pay.

BUDGET SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

36. Together these measures will further stimulate wider share ownership and the greater identification of employees with the companies for which they work.

Life assurance

37. Following a process of consultation with the Life Assurance industry and others, the Chancellor has decided to introduce changes to the tax regime governing Life Assurance taking effect from 1 January 1990. The profits and expenses of pension business are to be separated from those for life assurance, ^{and allowed against pension profits only} and defects in the tax regime special to this industry will be remedied. In future, ^{tax reliefs for the} the expenses of selling new ^{life assurance} policies will be spread against ~~profits~~ over seven years, but this broadening of the tax base will be accompanied by a reduction in the rates of tax paid on policyholders' income and gains from 35 per cent and 30 per cent respectively to 25 per cent, the basic rate of income tax. He will also abolish Life Assurance Policy Duty, the special stamp duty paid on Life Assurance policies. The Chancellor will phase-in the overall package, to allow individual companies time to adjust to the new regime.

Unit trusts

38. The Chancellor will reduce from 1 January 1990 the Corporation Tax rate payable on certain unit trusts to 25 per cent, the basic rate of income tax. He will also tax switches between offshore umbrella funds, to align their treatment with that of UK-based trusts. These measures will put the UK unit trusts involved in a better competitive position to win business as the EC market is liberalised.

BUDGET SECRET
BUDGET LIST ONLY

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

Pensions

39. The Chancellor will make an important deregulatory change to occupational pensions, allowing employers to pay pensions beyond the Inland Revenue limits without, as at present, loss of tax relief for the entire pension scheme; but at the same time he will place a limit on the maximum size of tax-privileged pensions and tax free lump sums, based on a salary of £60,000 a year indexed to inflation. These changes will apply to new pension schemes and new members of existing pension schemes: existing members will not be affected. The Chancellor is increasing the tax-free contributions which people aged over 35 can make to buy personal pensions, subject to the same earnings cap as for occupational pensions.

Car number plates

40. The Chancellor will include in the Finance Bill provision for the sale to the public of "cherished" car registration numbers.

Tax administration

8/ 41. The Chancellor will also include in the Finance Bill provisions for fairer and more effective enforcement of Inland Revenue taxes; and to restore criminal sanctions against Revenue or Customs officials who reveal information about the private affairs of taxpayers.

Summary

42. The Budget continues the economic policies which have brought about the transformation of UK economic performance over the last decade. It introduces a major reform of, and reduction in, employees' national insurance contributions. At the same time,

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

the Chancellor has budgeted for a substantial Public Sector Debt Repayment in the year ahead.

BUDGET SECRET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

BUDGET

SECRET

B.L.O.

SECRET

BUDGET SECRET
BUDGET LIST ONLY

NOT TO BE COPIED

CONFIDENTIAL

FROM: P N SEDGWICK
DATE: 13 MARCH 1989*pyg*

PPS

cc Sir T Burns
Mr Riley
Mr Pickford
Ms Wallace**NOTE FOR THE QUEEN AND TELEGRAM FOR POSTS**

A few points in addition to the one on the growth record on which I have minuted separately.

Paragraph 3

The claim on inflation in the second sentence is only just true if the time periods are chosen carefully. The RPI inflation rate between January 1983 and January 1989 is a whisker over 5 per cent. Further months with RPI inflation quite high (starting with the February figure next week) will further weaken the claim, which would be best expressed in terms of the average inflation rate between 1983 and 1988.

Paragraph 7

Chapter 3 of the FSBR has a forecast for the growth of business investment in 1989 of 8 per cent - not 10 per cent.

Paragraph 8

Last sentence: this claim refers to 1989.

P.N.S

P N SEDGWICK

BLO

ACSA/89/16



COPY NO. 13

OF 15

FROM: A C S ALLAN

DATE: 10 March 1989

MR C J RILEY

- cc Mr Wicks
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mr S Davies
- Mr Gieve
- Mr Gilhooly
- Mr Matthews
- Mr Pickford
- Miss Simpson
- Mr Tyrie

NOTE FOR THE QUEEN AND OVERSEAS POSTS

... The Chancellor was grateful for your minute of 7 March. I attach a revised version with his comments incorporated. I should be grateful for any comments by noon on Monday at the latest.

ACSA

A C S ALLAN

Ch

A few proposed amendments marked

At

OK on sheet
Thank you

centre

1989 BUDGET: SUMMARY OF MAIN POINTS

The background to this year's Budget is one in which the United Kingdom has enjoyed two years of exceptionally strong growth. With high investment, rapid productivity growth and a major improvement in profitability, the UK is very well placed to build on the achievements of recent years. But the rapid expansion in the last two years has produced some build-up of inflationary pressures, and monetary policy has been tightened sharply since last summer to deal with that. This year's Budget therefore adopts a continued prudent and cautious approach to financial policy, and the Chancellor is budgeting for a further massive repayment of public sector debt. But this is combined with further reforms and reductions in taxation and national insurance contributions to improve the supply side of the economy and continue the transformation of Britain's economic performance.

2. The main points are:-

- a public sector debt repayment of ~~£14 billion~~ in 1989-90, the same as the outturn for 1988-89, with gradual movement back towards a balanced budget over the medium term;
- a major reform of employees' national insurance contributions, with reductions of £3 a week for most employees;
- no change in income tax rates, tax thresholds increased in line with inflation;
- measures to help the elderly, including abolition of the pensioners' earnings rule and improvements in age allowances;

- a reduction in the duty on unleaded petrol, designed to produce a pump price differential of getting on for 10p a gallon (over 2p a litre) with 4 star leaded;
- no change in the main excise duties;
- new tax incentives for share ownership, including major improvements to Personal Equity Plans;
- reform of the taxation of life assurance companies and some changes to the tax regime for occupational and personal pensions.

Economic background

3. The 1980s have seen major improvements in the performance of the British economy. Since 1983 inflation has averaged ~~under~~ 5 per cent, compared with over 15 per cent between 1974 and 1979. At the same time we have had an unprecedented seven years of steady, ~~sustainable~~ growth averaging in excess of 3 per cent a year. Output has grown faster in the 1980s than in all other main European countries, whereas the UK was at the bottom of the league in each of the previous two decades.

4. In 1988 total output grew by some 4½ per cent, faster than forecast a year ago. This is the first time for ~~at least~~ ~~40 years~~ that there have been two successive years of growth above 4 per cent. Manufacturing output has grown particularly rapidly, by over 7 per cent in 1988 following 5½ per cent in 1987. Unemployment has fallen by over half a million in the past year, more than in any other major country. We now have more people in work than ever before.

5. Over the past seven years investment has grown ~~very nearly~~ twice as fast as consumption, and total business investment is now

Pickford
(or under 5 per cent 83-88)
Pickford

TB & others
(see PHS
note)

Pickford

a generation

a quarter of a century

more than

a higher proportion of national income than ever before. And investment has grown particularly strongly over the last two years. Over the 1980s as a whole, investment has grown faster than in any other of the main European economies. There has been a dramatic and sustained improvement in productivity growth, which in manufacturing has exceeded that of all other major nations during the '80s.

almost getting on for/approaching industrialised

6. With consumers' expenditure also extremely buoyant, domestic demand probably grew by ~~about~~ 7 per cent in 1988, faster than the economy's capacity to supply. This has led to an increase in inflationary pressures and a widening in the current account deficit. The RPI has grown by ~~about~~ 7½ per cent over the ~~last~~ year, though the underlying inflation rate (excluding mortgage interest payments) currently stands at ~~about~~ 5½ per cent; published figures put the current account deficit at around £14½ billion in 1988, but with a very large positive balancing item in the external accounts this may well overstate the true deficit.

7. Since the Summer, monetary policy, which must necessarily play the key role in combating inflation, has been tightened sharply to deal with the emerging inflationary pressures, ~~and~~ some slowdown in real growth is probably inevitable while inflation is being brought firmly back onto a downward path. ~~Following~~ ^{STEP} two years of above average growth, the Chancellor expects growth to be somewhat below trend over the coming year. But even so, GDP in 1989 ^{as a whole} is forecast to be 2½ per cent higher ~~in 1989~~ than in 1988, with the non-oil economy up by 3 per cent, ~~though growth in the course of 1989 is forecast to be rather less than this, at 2 per cent.~~ Business investment is forecast to continue growing strongly, with a rise of ⁸10 per cent. Inflation as recorded by the RPI is forecast to come down to 5½ per cent by the end of the year and 4½ per cent by the middle of 1990.

PNS (Forting)
Purdy

AA = GJR

Fell by many to be unpredictable

PNS (as in FSR)

Call savings But

it is forecast growing at about 2 per cent from now until the beginning of 1990.

8. The slowdown in domestic demand should lead in due course to an improvement in the current account. But this is unlikely to occur quickly; continued buoyancy of investment will add to imports of capital goods for the time being, and it will take some time before the additions to industrial capacity feed through into better trade performance. The current account deficit ^{this year} is thus forecast to be the same as in 1988.

Budget strategy

9. The medium term financial strategy continues to provide the framework for the Government's macroeconomic policy, and this is the tenth occasion on which it has been set out in the FSBR. Although the precise form in which the strategy has been expressed has changed as the economy has itself evolved, the essential objectives remain the same. The overriding aim is to bring down inflation by reducing the growth of money GDP, and ultimately to achieve price stability.

10. Short term interest rates will be held at whatever level is necessary, for as long as necessary, to get on top of inflation. Decisions on interest rates will continue to be based on a comprehensive assessment of monetary conditions, in which particular weight is given to the behaviour of MO and the exchange rate. The Chancellor is setting a target range of 1-5 per cent for the growth of MO in 1989-90; the 12 month growth rate is likely to begin the year above this range, but as the deceleration over recent months continues it should fairly soon come back within it.

11. In its early years of office, one of the Government's main objectives was to bring down the rate of Government borrowing. Now the public finances have been completely transformed, with the budget in surplus for the last two years. It seems likely that

the outturn in 1988-89 will be a debt repayment of £14 billion. No other major country enjoys a comparable surplus.

12. Although the longer term aim of fiscal policy is a balanced budget, the Chancellor believes that this should be approached gradually. The Chancellor has thus budgeted for a further substantial PSDR of almost £14 billion in 1989-90, before moving gradually back towards budget balance over the medium term.

Capital markets liberalisation

13. The Chancellor is introducing a substantial liberalisation of the London sterling capital market. He is abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. He is also making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes should give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

[Some quibbles that this doesn't make clear restrictions will continue for LA issues, but I don't think matters for this audience]

Taxation and national insurance contributions

14. The Chancellor is introducing a major reform of employees' national insurance contributions, and tax measures which promote unleaded petrol and encourage wider share ownership. He is also reforming the tax treatment of life assurance and making changes to the tax regime for occupational pensions.

Employees' national insurance contributions

15. The Chancellor is restructuring employees' National insurance contributions from the beginning of October. Employees whose earnings are at or above the Lower Earnings Limit (LEL) of £43 a week will pay 2 per cent (86 pence) on earnings up to the LEL, and

9 per cent on earnings above the LEL up to the Upper Earnings Limit (UEL) of £325 a week.

16. The Chancellor's reform ends the situation whereby many lower paid employees found that a £1 increase in earnings led to an additional NIC charge greater than £1. The take-home pay of everyone earning £115 a week or more will increase by £3 a week, with lesser amounts going to those below that level. The full year cost of the reform will be £2 3/4 billion, but the cost in 1989-90 will be £1 billion. The greater part of that will go to employees on below average earnings.

Income tax

17. The Chancellor is raising the main personal allowances and the starting point for higher rate tax in line with inflation.

He is increasing
18. *(For consistency)* The income tax scale charges for company cars ~~are being increased~~ by a third, bringing them closer into line with the true value of the benefits which company cars provide.

^
19. For elderly taxpayers he is extending the higher age allowance to those aged 75 and over (at present, 80 and over); he is reducing the rate at which the age allowance is withdrawn for those earning ^{over} £11,400; and he is abolishing the pensioners' earnings rule, thereby allowing those who choose to work on beyond the statutory retirement age to do so without having their state retirement pension reduced. The Finance Bill will also include the new tax relief for pensioners' health insurance premiums announced in January.

Excise duties

20. The Chancellor is increasing the ^{tax} ~~duty~~ differential between leaded and unleaded petrol by almost 4 pence a gallon, ~~which~~

This will mean that the ^{tax} differential in the UK will be larger than that of any other EC country except Denmark. It.

(for consistency with Budget speech)

should result in a pump-price differential of nearly 10 pence a gallon. ~~One of the largest in the European Community.~~ He is also increasing the duty on 2 and 3 star petrol, making the pump price at least as high as 4 star. Together, these measures will accelerate the trend from leaded to unleaded petrol.

(EP) ^{the main} 21. He is simplifying Vehicle Excise Duty rates, reducing their number by about one third. He is also increasing the VED paid by ^{wives and} coaches ^{the heavier} ~~and by non-articulated lorries,~~ so that the ^{duty} ~~motoring taxes~~ they pay will cover the wear and tear they impose on the roads, putting their taxation on a more equal footing with ~~private cars~~ ^{and} articulated lorries ~~respectively,~~ ^{and increasing the duty on the heaviest non-articulated lorries}

22. He is making no other changes to excise duty rates this year.

Capital gains tax

23. Independent taxation of husband and wife, being introduced in April 1990, will give husbands and wives their own separate CGT thresholds. In the light of that, the Chancellor is maintaining the exemption limit at its present £5,000 a year.

24. The exemption of gifts from CGT has become a simple form of tax avoidance. The Chancellor will restrict the exemption in future to gifts of businesses ^{and} farms and gifts to the heritage; and to gifts between husband and wife. Gifts to charities will also continue to be exempt. But the Chancellor is doubling the exemption from CGT for gifts of chattels from £3,000 to £6,000 for each chattel.

Inheritance tax

25. The Chancellor will raise the threshold for inheritance tax from £110,000 to £118,000, in line with inflation.

Value added tax

26. The Chancellor is raising the VAT registration threshold by the maximum allowed under EC Law, to £23,600.

27. The Finance Bill will implement the judgement of the European Court of Justice requiring the UK to end the zero rating of non-domestic construction; of supplies of electricity and gas to non-domestic consumers, and of water and sewerage to industry; of protective clothing and headgear bought by employers; and news services (but not newspapers, which continue to be zero-rated).

28. The loss of these zero-rates derives directly from the 6th EC VAT Directive agreed to by the UK in 1977. Transitional provisions will be included in the Finance Bill to assist commerce and industry to adjust to the changes.

Charities

29. The Chancellor is taking special steps to soften the impact of the ECJ judgement on charities. In ^{addition} ~~particular~~, he is doubling the annual amount which can be given tax free to charities under the payroll giving scheme from £240 to £480 a year. He is extending VAT ^{zero-rating} ~~exemption~~ to cover all advertising by charities. He is also exempting from VAT fund-raising events by charities (and certain other fund-raising, including that for political parties and trades unions). He is ^{also} changing the covenant rules so that the National Trust and similar charities can offer members free or cheap entry to their properties without loss of tax relief. And he is exempting from special car tax vehicles for leasing to the disabled.

as well as sterilising equipment used by charities

purchased

Corporation tax

30. The Chancellor is increasing the level of profits up to which the 25 per cent small companies rate applies from £100,000 to £150,000 a year; and increasing the threshold at which the 35 per cent main rate applies from £500,000 to £750,000 a year. These changes will reduce the tax burden for more than half the companies which do not already pay the small companies rate.

31. He is greatly simplifying the tax regime for close companies - unquoted companies controlled by up to five people, which comprises the overwhelming majority of small companies.

Measures to encourage wider share ownership

32. The Chancellor is introducing a number of specific tax measures to encourage further widening of share ownership.

33. He is increasing from £3,000 to £4,800 the annual amount which can be invested in a Personal Equity Plan, and allowing up to half that amount to be held in unit trusts or investment trusts investing mainly in UK equities. He is allowing new share issues, including privatisation issues, to be added into a PEP. The rules governing PEPs will also be made simpler and more flexible.

34. He is increasing the value of shares which can be given to an employee via an Employee Share Scheme, and simplifying the rules. He is also removing obstacles to Employee Share Ownership Plans which, like the share schemes, provide means for employees to acquire shares in the companies employing them.

35. The Chancellor will also make various improvements and simplifications to the rules applying to Profit Related Pay.

36. Together these measures will further stimulate wider share ownership and the greater identification of employees with the companies for which they work.

Life assurance

and allowed against pension profits only

EP

37. Following a process of consultation with the Life Assurance industry and others, the Chancellor has decided to introduce changes to the tax regime governing Life Assurance taking effect from 1 January 1990. The ~~profits and~~ expenses of pension business are to be separated from those for life assurance, and defects in the tax regime special to this industry will be remedied. In future, ^{tax relief for} the expenses of selling new ^{life assurance} policies will be spread ~~against profits~~ over seven years, but this ~~broadening of the tax base~~ will be accompanied by a reduction in the rates of tax paid on policyholders' income and gains from 35 per cent and 30 per cent respectively to 25 per cent, the basic rate of income tax. He will also abolish Life Assurance Policy Duty, the special stamp duty paid on Life Assurance policies. The Chancellor will phase-in the ~~overall package~~ ^{new treatment of the expense of selling new policies} to allow individual companies time to adjust to the new regime.

Unit trusts

38. The Chancellor will reduce from 1 January 1990 the Corporation Tax rate payable on certain unit trusts to 25 per cent, the basic rate of income tax. He will also tax switches between offshore umbrella funds, to align their treatment with that of UK-based trusts. These measures will put the UK unit trusts involved in a better competitive position to win business as the EC market is liberalised.

Pensions

39. The Chancellor will make an important deregulatory change to occupational pensions, allowing employers to pay pensions beyond the Inland Revenue limits without, as at present, loss of tax relief for the entire pension scheme; but at the same time he will place a limit on the maximum size of tax-privileged pensions and tax free lump sums, based on a salary of £60,000 a year indexed to inflation. These changes will apply to new pension schemes and new members of existing pension schemes: existing members will not be affected. The Chancellor is increasing the tax-free contributions which people aged over 35 can make to buy personal pensions, subject to the same earnings cap as for occupational pensions.

Car number plates

40. The Chancellor will include in the Finance Bill provision for the sale to the public of "cherished" car registration numbers.

Tax administration

X 41. The Chancellor will also include in the Finance Bill provisions for fairer and more effective enforcement of Inland Revenue taxes; and to restore criminal sanctions against Revenue or Customs officials who reveal information about the private affairs of taxpayers.

Summary

42. The Budget continues the economic policies which have brought about the transformation of UK economic performance over the last decade. It introduces a major reform of, and reduction in, employees' national insurance contributions. At the same time,

the Chancellor has budgeted for a substantial Public Sector Debt Repayment in the year ahead.

Chex-aa / opendocs / queen

*Pls use this
in minutes.*

NEW INTRO TO SUMMARY FOR QUEEN/POSTS

The background to this year's budget is one in which the United Kingdom has enjoyed two years of exceptionally strong growth. With high investment, rapid productivity growth and a major improvement in profitability, the UK is very well placed to build on the achievements of recent years. But the rapid expansion in the last two years has produced some build-up of inflationary pressures, and monetary policy has been tightened sharply since last summer to deal with that. This year's Budget therefore adopts a continued prudent and cautious approach to financial policy, and the Chancellor is budgetting for a further massive repayment of public sector debt. But this is combined with further ~~tax reforms and tax reductions~~ [*] to improve the supply side of the economy and continue the transformation of Britain's economic performance.

[* a general point: 'tax reforms and tax reductions' rolls off the tongue much more easily than something like 'further reforms and reductions in taxation and national insurance contributions'. But should we insist on scrupulous accuracy throughout the Budget documentation and briefing?]

*Yes, I'm
agreed*

BUDGET SECRET: BLO

REF: JMGT/51

COPY NO OF 25

FROM: J M G TAYLOR

DATE: 11 March 1988

MR ODLING-SMEE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Peretz
Mr Sedgwick
Mr Turnbull
Mr R I G Allen
Mr S Davies
Mr Pickford
Mr Riley
Miss Sinclair
Miss C Evans
Mr Cropper
Mr Tyrie
Mr Call

NOTE FOR THE QUEEN AND OVERSEAS POSTS

The Chancellor was grateful for your minute of 8 March, and the enclosed draft note.

... 2. The Chancellor has reworked the opening section (to paragraph 14), and I attach his redraft. I also attach the rest of your draft, with his preferred changes marked.



J M G TAYLOR

1987 BUDGET: SUMMARY OF MAIN POINTS

The background to this year's Budget is an extremely favourable one. The economy is growing strongly, unemployment is falling rapidly, while inflation remains low. The public finances are exceptionally strong. This year's Budget will help the economy to continue this excellent progress, by improving incentives and encouraging enterprise, against the background of sound financial policies.

2. The main points are:

- a Budget surplus of £3 billion in both 1987-88 and 1988-89, and the prospect of a balanced budget over the medium term;
- major reform and simplification of personal taxation;
- income tax allowances raised by twice as much as inflation, the basic rate reduced to 25p in the £, and all higher rates above 40 per cent abolished;
- a completely new system of taxation for married couples, to take effect in 1990, which will, for the first time ever, give married women privacy and independence and end tax penalties on marriage.

Economic Background

3. The strength and durability of the economic upswing in Britain has now exceeded all post War records. The UK is about to enter its eighth successive year of sustained growth, and the sixth in which this has been combined with low inflation. It has now seen the longest period of steady growth, at a rate averaging 3 per cent a year, for half a century. During 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.

4. In 1987, total output grew by 4½ per cent, substantially stronger than forecast a year ago, while inflation averaged 4¼ per

cent. Unemployment fell by half a million, more than in any other year since the War, in every region of the country, and faster than in any other major nation. The substantial fall in long-term unemployment is particularly encouraging.

5. Manufacturing industry performed particularly well in 1987. Manufacturing output rose by $5\frac{1}{2}$ per cent, and there was a further large improvement in manufacturing productivity: in the 1980s, output per head in manufacturing industry has risen faster in Britain than in any other industrial country.

6. After seven successive years of surplus, the current account of the balance of payments is now estimated to have been in deficit last year by a little over $\pounds 1\frac{1}{2}$ billion. This is a smaller deficit than forecast in last year's Budget, thanks to a better than expected performance on visible trade, with exports of manufactured goods up by $8\frac{1}{2}$ per cent.

7. The Chancellor expects 1988 to be another year of healthy growth with low inflation; and there is every prospect that unemployment will continue to fall, although probably not as rapidly as last year. The pace of growth is likely to ease somewhat, returning to the underlined trend of the past few years. Output for 1988 as a whole is forecast to be 3 per cent higher than in 1987, with the non-oil economy up by $3\frac{1}{2}$ per cent. Business investment is forecast to grow particularly strongly, with a rise of $8\frac{1}{2}$ per cent. As last year, inflation is forecast end the year at 4 per cent.

8. With growth in the UK likely to continue to outpace that of most other major countries, particularly in continental Europe, and with the oil surplus falling as North Sea production declines, the current account of the balance of payments is forecast to remain in deficit in 1988, by some $\pounds 4$ billion, equivalent to less than 1 per cent of GDP. The forecast assumes that the oil price will remain close to recent market levels.

Budget Strategy

9. The medium term financial strategy continues to provide the framework for the Government's economic policy, as it has done since 1980. It is designed to reduce the growth of total spending power in the economy steadily over a period of years, at a pace which will gradually squeeze inflation out of the system, while leaving room for further sustained economic growth.

10. Interest rate decisions are based on a continuous and comprehensive assessment of monetary conditions so as to ensure downward pressure on inflation. Industry has benefitted from the greater stability of exchange rates over the past year, and the Government will continue to pursue a policy of exchange rate stability, with the rate against the deutschemark being of particular importance. The Chancellor is setting a target range of 1 to 5 per cent for narrow money in 1988-89; like last year, there will be no explicit target for broad money.

11. One of the Government's main objectives, since it first took office in 1979, has been to bring down Government borrowing. It has been reduced from $5\frac{1}{4}$ per cent of national income in 1978-79 to only three-quarters of one per cent in 1986-87. In 1987-88, it now looks as if the outturn will be a Budget surplus - something previously achieved on only one isolated occasion since 1952.
[Check]

12. The Chancellor believes that a balanced budget is a valuable discipline for the medium term, and intends that a zero borrowing requirement should be the norm from now on, though there are bound to be fluctuations on either side from year to year. For 1988-89, the Chancellor has decided that it is prudent to budget for a surplus of £3 billion, the same size as expected as in 1987-88. This is after allowing for the substantial increases in public expenditure announced in last November's Autumn Statement, including additional spending of over £1 billion on health.

Taxation

13. The Chancellor is introducing major reforms in personal taxation, designed to sharpen incentives and provide a further boost to the supply-side of the economy.

14. [Continue as in Odling-Smee draft.]

Summary

^{DN:} [Goes At end of text]

47. The Budget continues the economic policies which have brought about the renewed strength of the British economy. It introduces major reforms of personal taxation including: new arrangements for taxing husbands and wives which will give married women privacy and independence in their tax affairs for the first time; an end to the taxation of inflationary gains; and the elimination of all personal tax rates over 40 per cent. The Chancellor has reduced the basic rate of income tax to 25 per cent, and set a new target of 20 per cent. And he has done this within the context of a balanced budget.

Income tax

14. The Chancellor is raising the main personal allowances by twice the amount needed to compensate for inflation - that is, by roughly 7½ per cent. This includes the special age allowance for pensioners. It also applies to the upper limit for the basic rate band (i.e. the point at which the higher rates of tax begin).

15. He is reducing the basic rate of income tax by 2p in the £, to 25p. This meets the Government's manifesto commitment. He is also announcing a new target for the basic rate, of 20p in the £, to be reached as and when it is prudent.

16. The Chancellor is radically reforming the ^{higher rates of tax} ~~taxation of higher incomes~~. He is abolishing all of the higher rates of tax above 40p. Income tax will thus be reduced from a six rate to a two rate system; and the ^{higher} ~~top~~ rate (reached at a taxable income of £19,300) will be one of the lowest top rates in the world.

17. The income tax changes will benefit all 25 million taxpayers. ~~The~~ ^A married man on average earnings will gain nearly £5 a week.

18. ^{At the same time} ~~These big reductions enable~~ the Chancellor ^{is reducing of the special} ~~to reduce~~ some reliefs in the income tax system, which are hard to justify. First, ~~the Chancellor is raising the valuation of company cars for income tax purposes. (They are taxed in the hands of recipients under PAYE.) At present, they are valued for income tax at only a quarter of what they are worth. The Chancellor is doubling that with effect from 1988-89.~~

19. ^{First} ~~Second~~, he is ending the tax shelter for forestry, which has been widely criticised, and switching to an improved system of grants ~~for forestry, which will maintain the Government's planting objective and encourage in particular the planting of broad-leaved trees.~~ ^{Support through grants will be better targeted, e.g. to encourage better balance between broad-leaved trees and conifers. There is no change in the Government's planting aim.}

20. ^{Second} ~~Third~~, he is abolishing the tax relief on home improvement loans, most of which are small and finance minor improvements such as double-glazing, rather than extensions or ~~loft~~ conversions, ^{and which have been widely abused. This concentrates mortgage interest relief on its primary purpose: house purchase.}

He is also doubling the income tax liability on company cars, which have long been taxed at substantially less than they are worth.

21. ~~In line with the reduction in the basic rate of tax, the relief on pre-1984 life assurance premium payments is coming down to 12½ per cent. It is traditionally set at half the basic rate.~~

Excise duties

22. The Chancellor is raising the excise duties, as a whole, broadly in line with inflation. However:

a. there is 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;

b. there is 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 from *the increased* petrol ~~tax~~ ^{duty, which will go up by} up nearly 6p a gallon;

c. ~~so as~~ to encourage switching, particularly by the young, from high-alcohol to low-alcohol drinks there are reductions in the taxation of some low alcohol drinks; and

~~d. the Chancellor is introducing a higher VED charge on one group of juggernauts which exact a considerable toll on the road system.~~

Capital gains tax

23. Since 1982, capital gains tax has been charged only on 'real' gains: ~~if they have been made since then:~~ the paper gains which simply reflect inflation are no longer taxed. But these arrangements do not apply to gains made before 1982. This means that there are people and companies who have held assets since the 1960s or 1970s, or even earlier, who cannot realise them without paying substantial tax on ^{profits} paper gains made before 1982.

24. The Chancellor proposes to rectify this by exempting from tax all gains made before 1982. There will then be no taxation of ^{inflationary} paper gains whatever.

25. The real gains which are subject to tax will be charged at the same tax rates as income - 25 per cent and 40 per cent. This will reduce the incentive to convert income artificially into capital, and to invest for speculative gain rather than income. (Companies' gains are already taxed at the same rate as their profits: this change was made in the last Budget.)

26. The annual exempt amount of gains which individuals can make without paying tax is being reduced from £6,600 to £5,000. The present high level of the exemption was introduced explicitly to compensate for the fact that paper gains made before 1982 were, until now, subject to tax. The need for such compensation falls away under the Chancellor's reforms.

27. At the same time the Chancellor is increasing the amount of relief from capital gains tax which is available to a small businessman selling his business on retirement.

Inheritance tax

28. The Chancellor is raising the threshold for inheritance tax from £90,000 to £110,000. This will reduce by a quarter the number of estates which are taxed. In particular, it will allow ordinary people to pass on their homes without being taxed.

X 29. The Chancellor is also reducing the tax from four rates to one (having reduced it from seven last year). The new flat rate will be 40 per cent. For ^{many} family businesses passing from one generation to another, this means the effective rate will be only 20 per cent, because there is 50 per cent business relief.

Taxes on business

30. The main Corporation Tax rate remains at 35 per cent. The small companies' rate is reduced from 27 per cent to 25 per cent, in line with the basic rate of tax.

X 31. The VAT threshold is being increased by the maximum permitted under EC law, ^{to} ~~it will be~~ £22,100.

32. Capital Duty, the 1 per cent tax paid by companies which raise new capital is being abolished, as is the $\frac{1}{4}$ per cent duty paid on all property put into a unit trust.

33. The special tax reliefs for entertaining foreign customers are also being abolished, so that the entertainment of foreign business contacts is put on the same footing as domestic ones.

X 34. There will be a change in the rules affecting the small number of companies which wish to change their country of residence for tax purposes. At present the rules require an application to the Treasury for formal consent, and are backed up by criminal sanctions. New rules, similar to those which exist in ~~a good many~~ ^{most} other countries, will be introduced to allow companies to migrate if they wish, provided they pay the tax due to the UK Exchequer first. The rules will be based on objective criteria and will no longer involve either an application to the Treasury for consent, or criminal sanctions.

Business Expansion Scheme

X 34. The Chancellor is extending the Business Expansion Scheme, under which investors obtain immediate tax relief for investment in ~~high risk companies~~ ^{new businesses in Personal}, to include investment in companies providing housing for rent. This extension will last for five years. It is designed to help revive the private rented sector, in conjunction with the deregulation of rents. These measures should make it easier for people seeking work to find accommodation for themselves and their families, at a price they can afford.

Share ownership

X 35. The Chancellor is increasing the limit on the amount which can be invested by individuals in Personal Equity Plans from £2,400 to £3,000, and relaxing some of the restrictions on shares owned by employees in the companies in which they work.

Maintenance and Covenants

36. The Chancellor proposes to reform the taxation of maintenance and covenant payments, other than covenants to charity which are untouched. The present arrangements are complex and involve unnecessary work for both taxpayers and the Revenue.

37. Most maintenance payments are made by divorced men to their ex-wives or children. At present the Inland Revenue taxes the recipients, and returns the money to donors in tax relief. The Chancellor proposes instead that future recipients should be freed from tax on their maintenance. Donors will still be able to enjoy tax relief on payments to separated or divorced wives, but only up to a limit, ~~defined as~~ ^{set equal to} the difference between the married allowance and the single allowance. In 1988-89 this will be £1,490. Existing arrangements will be protected, and existing recipients will be freed from tax on the first £1,490 of their maintenance.

38. ~~In the case of~~ ^{For} covenants between individuals, the Chancellor is again making the income tax free in the hands of recipients. Tax relief for donors is being abolished. The largest ^{single} group affected will be students and their parents: covenants have simply become a convoluted way of getting State support into the hands of students, in a way that shelters the parents' income from tax. There will be a broadly compensating reduction in the parental contribution to student grants at mandatory rates.

Charities

39. As well as leaving tax relief on covenants to charity unchanged, the Chancellor is doubling the amount which people can give to charities free of tax under the payroll-giving scheme.

Independent taxation

40. The Chancellor is announcing in the Budget that a major reform of the taxation of married couples will take effect in 1990, the earliest practicable date. The present system, which dates back 180

xy years, taxes the income of a married woman as if it belonged to her husband. ^{if} This can lead to a tax penalty on marriage, ^{also} where ^{with} married couples ^{paying} pay more tax simply because they are married. ~~It also~~ ^{This} denies privacy and independence to married women.

41. Under the new system a husband and wife will be taxed independently, on all their income. Married women will pay their own tax on their own income, and be responsible for their own tax return if one is necessary. All tax payers, male or female, married or single, will be entitled to the same personal allowance.

42. The tax system will continue to recognise marriage. Married couples will get a married couple's allowance equal in value to the difference under the present system between the single allowance and the married man's allowance.

Tax penalties on marriage

x 43. The new system will remove a number of the tax penalties on marriage. The most common penalty, the taxation of a married woman's savings income at her husband's ^{marginal} ~~tax~~ rate, will disappear altogether; and husband and wife will be taxed independently on any capital gains they may have, with an annual exemption each instead of one between them. Transfers of capital between husband and wife will continue to be free of tax.

x 44. The Chancellor is abolishing two other tax penalties on marriage, ahead of Independent Taxation. First, ~~mortgage interest relief~~ ^{of mortgage interest relief}. Under the present system, an unmarried couple can get twice as much relief ~~(on loans up to £60,000)~~ as a married couple. ~~(limited to £30,000)~~. From August 1988 the limit of £30,000 will be applied to the house or flat, so that married and unmarried couples will get the same amount of relief. Existing borrowers will not be affected.

x 45. The second penalty arises because an unmarried couple with children can each claim an Additional Personal Allowance, giving them more tax relief than a married couple in the same position. In future unmarried couples will be entitled to only one Additional Personal Allowance.

46. Thus the Chancellor is abolishing, for all practical purposes, all the tax penalties which, under the present system, can arise on marriage.

Summary

[47 (above)]

BUDGET Secret
BLD

ACSA/89/170

REF NO.
COPY NO.

15 OF 15



FROM: A C S ALLAN

DATE: 13 March 1989

MR C J RILEY

- cc Mr Wicks
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mr S Davies
- Mr Gieve
- Mr Gilhooly
- Mr Matthews
- Mr Pickford
- Miss Simpson
- Mr Tyrie

NOTE FOR THE QUEEN AND OVERSEAS POSTS

... The Chancellor was grateful for the further comments from you and others on the draft I circulated on Friday. I attach the final version. I should be grateful if you could arrange for it to be dispatched to Posts once the Chancellor has sat down.

ACSA

A C S ALLAN

1989 BUDGET: SUMMARY OF MAIN POINTS

The background to this year's Budget is one in which the United Kingdom has enjoyed two years of exceptionally strong growth. With high investment, rapid productivity growth and a major improvement in profitability, the UK is very well placed to build on the achievements of recent years. But the rapid expansion in the last two years has produced some build-up of inflationary pressures, and monetary policy has been tightened sharply since last summer to deal with that. This year's Budget therefore adopts a continued prudent and cautious approach to financial policy, and the Chancellor is budgeting for a further massive repayment of public sector debt. But this is combined with further reforms and reductions in taxation and national insurance contributions to improve the supply side of the economy and continue the transformation of Britain's economic performance.

2. The main points are:-

- a public sector debt repayment of £14 billion in 1989-90, the same as the outturn for 1988-89, with gradual movement back towards a balanced budget over the medium term;
- a major reform of employees' national insurance contributions, with reductions of £3 a week for most employees;
- no change in income tax rates, tax thresholds increased in line with inflation;
- measures to help the elderly, including abolition of the pensioners' earnings rule and improvements in age allowances;
- a reduction in the duty on unleaded petrol, designed to produce a pump price differential of getting on for 10p a gallon (over 2p a litre) with 4 star leaded;

- no change in the main excise duties;
- new tax incentives for share ownership, including major improvements to Personal Equity Plans;
- reform of the taxation of life assurance companies and some changes to the tax regime for occupational and personal pensions.

Economic background

3. The 1980s have seen major improvements in the performance of the British economy. Since 1983 inflation has averaged 5 per cent, compared with over 15 per cent between 1974 and 1979. At the same time we have had an unprecedented seven years of steady growth averaging in excess of 3 per cent a year. Output has grown faster in the 1980s than in all other main European countries, whereas the UK was at the bottom of the league in each of the previous two decades.

4. In 1988 total output grew by some 4½ per cent, faster than forecast a year ago. This is the first time for a generation that there have been two successive years of growth above 4 per cent. Manufacturing output has grown particularly rapidly, by over 7 per cent in 1988 following 5½ per cent in 1987. Unemployment has fallen by over half a million in the past year, more than in any other major country. We now have more people in work than ever before.

5. Over the past seven years investment has grown more than twice as fast as consumption, and total business investment is now a higher proportion of national income than ever before. And investment has grown particularly strongly over the last two years. Over the 1980s as a whole, investment has grown faster than in any other of the main European economies. There has been a dramatic and sustained improvement in productivity growth, which

in manufacturing has exceeded that of all other major nations during the '80s.

6. With consumers' expenditure also extremely buoyant, domestic demand probably grew by almost 7 per cent in 1988, faster than the economy's capacity to supply. This has led to an increase in inflationary pressures and a widening in the current account deficit. The RPI has grown by $7\frac{1}{2}$ per cent over the past year, though the underlying inflation rate (excluding mortgage interest payments) currently stands at $5\frac{1}{2}$ per cent; published figures put the current account deficit at around £14½ billion in 1988, but with a very large positive balancing item in the external accounts this may well overstate the true deficit.

7. Since the Summer, monetary policy, which must necessarily play the key role in combating inflation, has been tightened sharply to deal with the emerging inflationary pressures. Some slowdown in real growth is probably inevitable while inflation is being brought firmly back onto a downward path. Following two years of above average growth, the Chancellor expects growth to be somewhat below trend over the coming year: it is forecast at about 2 per cent from now until the beginning of 1990. But even so, GDP in 1989 as a whole is forecast to be $2\frac{1}{2}$ per cent higher than in 1988, with the non-oil economy up by 3 per cent. Business investment is forecast to continue growing strongly, with a rise of 8 per cent. Inflation as recorded by the RPI is forecast to come down to $5\frac{1}{2}$ per cent by the end of the year and $4\frac{1}{2}$ per cent by the middle of 1990.

8. The slowdown in domestic demand should lead in due course to an improvement in the current account. But this is unlikely to occur quickly; continued buoyancy of investment will add to imports of capital goods for the time being, and it will take some time before the additions to industrial capacity feed through into better trade performance. The current account deficit this year is thus forecast to be the same as in 1988.

Budget strategy

9. The medium term financial strategy continues to provide the framework for the Government's macroeconomic policy, and this is the tenth occasion on which it has been set out in the FSBR. Although the precise form in which the strategy has been expressed has changed as the economy has itself evolved, the essential objectives remain the same. The overriding aim is to bring down inflation by reducing the growth of money GDP, and ultimately to achieve price stability.

10. Short term interest rates will be held at whatever level is necessary, for as long as necessary, to get on top of inflation. Decisions on interest rates will continue to be based on a comprehensive assessment of monetary conditions, in which particular weight is given to the behaviour of MO and the exchange rate. The Chancellor is setting a target range of 1-5 per cent for the growth of MO in 1989-90; the 12 month growth rate is likely to begin the year above this range, but as the deceleration over recent months continues it should fairly soon come back within it.

11. In its early years of office, one of the Government's main objectives was to bring down the rate of Government borrowing. Now the public finances have been completely transformed, with the budget in surplus for the last two years. It seems likely that the outturn in 1988-89 will be a debt repayment of £14 billion. No other major country enjoys a comparable surplus.

12. Although the longer term aim of fiscal policy is a balanced budget, the Chancellor believes that this should be approached gradually. The Chancellor has thus budgeted for a further substantial PSDR of almost £14 billion in 1989-90, before moving gradually back towards budget balance over the medium term.

Capital markets liberalisation

13. The Chancellor is introducing a substantial liberalisation of the London sterling capital market. He is abolishing the queue for bond and equity issues which has been operated by the Bank of England since 1946, opening up the market for sterling paper and at the same time simplifying its regulatory regime. He is also making some consequential changes in the taxation of deep discount and other bonds. Taken together all these changes should give greater flexibility to those who issue capital in London; and wider choice to those who invest here.

Taxation and national insurance contributions

14. The Chancellor is introducing a major reform of employees' national insurance contributions, and tax measures which promote unleaded petrol and encourage wider share ownership. He is also reforming the tax treatment of life assurance and making changes to the tax regime for occupational pensions.

Employees' national insurance contributions

15. The Chancellor is restructuring employees' National insurance contributions from the beginning of October. Employees whose earnings are at or above the Lower Earnings Limit (LEL) of £43 a week will pay 2 per cent (86 pence) on earnings up to the LEL, and 9 per cent on earnings above the LEL up to the Upper Earnings Limit (UEL) of £325 a week.

16. The Chancellor's reform ends the situation whereby many lower paid employees found that a £1 increase in earnings led to an additional NIC charge greater than £1. The take-home pay of everyone earning £115 a week or more will increase by £3 a week, with lesser amounts going to those below that level. The full year cost of the reform will be £2 3/4 billion, but the cost in 1989-90 will be £1 billion. The greater part of that will go to employees on below average earnings.

Income tax

17. The Chancellor is raising the main personal allowances and the starting point for higher rate tax in line with inflation.

18. He is increasing the income tax scale charges for company cars by a third, bringing them closer into line with the true value of the benefits which company cars provide.

19. For elderly taxpayers he is extending the higher age allowance to those aged 75 and over (at present, 80 and over); he is reducing the rate at which the age allowance is withdrawn for those earning over £11,400; and he is abolishing the pensioners' earnings rule, thereby allowing those who choose to work on beyond the statutory retirement age to do so without having their state retirement pension reduced. The Finance Bill will also include the new tax relief for pensioners' health insurance premiums announced in January.

Excise duties

20. The Chancellor is increasing the tax differential between leaded and unleaded petrol by almost 4 pence a gallon. This will mean the tax differential in the UK will be larger than that of any other EC country except Denmark. It should result in a pump-price differential of nearly 10 pence a gallon. He is also increasing the duty on 2 and 3 star petrol, making the pump price at least as high as 4 star. Together, these measures will accelerate the trend from leaded to unleaded petrol.

21. He is simplifying the main Vehicle Excise Duty rates, reducing their number by about one third. He is also increasing the VED paid by buses and coaches so that the duty they pay will cover the wear and tear they impose on the roads, and increasing the duty on the heaviest non-articulated lorries, putting their taxation on a more equal footing with articulated lorries.

22. He is making no other changes to excise duty rates this year.

Capital gains tax

23. Independent taxation of husband and wife, being introduced in April 1990, will give husbands and wives their own separate CGT thresholds. In the light of that, the Chancellor is maintaining the exemption limit at its present £5,000 a year.

24. The exemption of gifts from CGT has become a simple form of tax avoidance. The Chancellor will restrict the exemption in future to gifts of businesses, farms and gifts to the heritage; and to gifts between husband and wife. Gifts to charities will also continue to be exempt. But the Chancellor is doubling the exemption from CGT for gifts of chattels from £3,000 to £6,000 for each chattel.

Inheritance tax

25. The Chancellor will raise the threshold for inheritance tax from £110,000 to £118,000, in line with inflation.

Value added tax

26. The Chancellor is raising the VAT registration threshold by the maximum allowed under EC Law, to £23,600.

27. The Finance Bill will implement the judgement of the European Court of Justice requiring the UK to end the zero rating of non-domestic construction; of supplies of electricity and gas to non-domestic consumers, and of water and sewerage to industry; of protective clothing and headgear bought by employers; and of news services (but not newspapers, which continue to be zero-rated).

28. The loss of these zero-rates derives directly from the 6th EC VAT Directive agreed to by the UK in 1977. Transitional provisions will be included in the Finance Bill to assist commerce and industry to adjust to the changes.

Charities

29. The Chancellor is taking special steps to soften the impact of the ECJ judgement on charities. He is extending VAT zero-rating to cover all advertising by charities as well as sterilising equipment used by charities. He is also exempting from VAT fund-raising events by charities (and certain other fund-raising, including that for political parties and trades unions). In addition, he is doubling the annual amount which can be given tax free to charities under the payroll giving scheme from £240 to £480 a year. He is also changing the covenant rules so that the National Trust and similar charities can offer members free or cheap entry to their properties without loss of tax relief. And he is exempting from special car tax vehicles purchased for leasing to the disabled.

Corporation tax

30. The Chancellor is increasing the level of profits up to which the 25 per cent small companies rate applies from £100,000 to £150,000 a year; and increasing the threshold at which the 35 per cent main rate applies from £500,000 to £750,000 a year. These changes will reduce the tax burden for more than half the companies which do not already pay the small companies rate.

31. He is greatly simplifying the tax regime for close companies - unquoted companies controlled by up to five people, which comprises the overwhelming majority of small companies.

Measures to encourage wider share ownership

32. The Chancellor is introducing a number of specific tax measures to encourage further widening of share ownership.

33. He is increasing from £3,000 to £4,800 the annual amount which can be invested in a Personal Equity Plan, and allowing up

to half that amount to be held in unit trusts or investment trusts investing mainly in UK equities. He is allowing new share issues, including privatisation issues, to be added into a PEP. The rules governing PEPs will also be made simpler and more flexible.

34. He is increasing the value of shares which can be given to an employee via an Employee Share Scheme, and simplifying the rules. He is also removing obstacles to Employee Share Ownership Plans which, like the share schemes, provide means for employees to acquire shares in the companies employing them.

35. The Chancellor will also make various improvements and simplifications to the rules applying to Profit Related Pay.

36. Together these measures will further stimulate wider share ownership and the greater identification of employees with the companies for which they work.

Life assurance

37. Following a process of consultation with the Life Assurance industry and others, the Chancellor has decided to introduce changes to the tax regime governing Life Assurance taking effect from 1 January 1990. The expenses of pension business are to be separated from those for life assurance and allowed against pension profits only, and defects in the tax regime special to this industry will be remedied. In future, tax relief for the expenses of selling new life assurance policies will be spread over seven years, but this will be accompanied by a reduction in the rates of tax paid on policyholders' income and gains from 35 per cent and 30 per cent respectively to 25 per cent, the basic rate of income tax. He will also abolish Life Assurance Policy Duty, the special stamp duty paid on Life Assurance policies. The Chancellor will phase-in the new treatment of the expenses of selling new policies to allow individual companies time to adjust to the new regime.

Unit trusts

38. The Chancellor will reduce from 1 January 1990 the Corporation Tax rate payable on certain unit trusts to 25 per cent, the basic rate of income tax. He will also tax switches between offshore umbrella funds, to align their treatment with that of UK-based trusts. These measures will put the UK unit trusts involved in a better competitive position to win business as the EC market is liberalised.

Pensions

39. The Chancellor will make an important deregulatory change to occupational pensions, allowing employers to pay pensions beyond the Inland Revenue limits without, as at present, loss of tax relief for the entire pension scheme; but at the same time he will place a limit on the maximum size of tax-privileged pensions and tax free lump sums, based on a salary of £60,000 a year indexed to inflation. These changes will apply to new pension schemes and new members of existing pension schemes: existing members will not be affected. The Chancellor is increasing the tax-free contributions which people aged over 35 can make to buy personal pensions, subject to the same earnings cap as for occupational pensions.

Car number plates

40. The Chancellor will include in the Finance Bill provision for the sale to the public of "cherished" car registration numbers.

Tax administration

41. The Chancellor will also include in the Finance Bill provisions for fairer and more effective enforcement of Inland Revenue taxes; and to restore criminal sanctions against Revenue or Customs officials who reveal information about the private affairs of taxpayers.

Summary

42. The Budget continues the economic policies which have brought about the transformation of UK economic performance over the last decade. It introduces a major reform of, and reduction in, employees' national insurance contributions. At the same time, the Chancellor has budgeted for a substantial Public Sector Debt Repayment in the year ahead.