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1985 BUDGET
SPEECH.

16.3.85

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BUDGET-SECRET

SPARE

Ref no. M54
COPY 20^a OF 20FROM: MRS R LOMAX
DATE: 13 March 1985

PS/CUSTOMS AND EXCISE

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Littler
Mr Cassell
Mr Monger
Mr Griffiths
Mr Folger
Mr Cropper
Mr H Davies
Mr Lord
PS/IR
Mr Wilmott (C&E)R.
Comments from
Alison French

Ruo

BUDGET SPEECH SIXTH DRAFT: SECTION K

Could you please arrange for the attached redraft of Section K to be checked for factual accuracy. Comments should reach this office - through you please - by close of play today.

MOM

for RACHEL LOMAX

R
Surely Customs will have to provide a clear redraft of the first sentence of para 14. I know it is really a very limited concession - they should make it very clear (in short sentences).Ruo
13/3**BUDGET-SECRET**

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K. PERSONAL TAXATION: TAXES ON SPENDING

1. I turn now to the taxation of personal income and spending. My Budget last year shifted some of the burden of personal taxation from earnings to spending. Today I propose to make a further move in this direction.

2. Accordingly, I propose to increase the revenue from the excise duties by rather more than is required simply to keep pace with inflation - a less painful task now that inflation is relatively low.

3. I propose to increase the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of sixpence on a package of 20 cigarettes. These changes will take effect from midnight on Thursday. I do not however propose any increase at all in the duties on cigars and pipe tobacco.

4. I propose increases which, including VAT, will put between a penny and twopence a pint on most beer (depending on its strength); a penny a pint on cider, sixpence on a bottle of table wine and about tenpence a bottle on sparkling or fortified wine. In recognition of the current difficulties of the Scotch whisky industry, however, I propose to increase the duty on spirits by only tenpence a bottle, well below the amount needed to keep pace with inflation. All these changes take effect from midnight tonight.

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5. I propose to increase the duty on petrol and derv by amounts which, including VAT, will raise the price at the pumps by approximately fourpence and threepence-halfpenny a gallon respectively. This does no more than keep pace with inflation. These increases will take effect from 6 o'clock this evening. As last year, I do not propose any change in the duty on heavy fuel oil.

6. I do propose this year, however, to raise more revenue from the Vehicle Excise Duty. For cars and light vans the duty will go up by £10 to £100, although there will be no increase at all for pre-1947 cars. On the advice of my Rt Hon Friend the Secretary of State for Transport, the pattern of duty on lorries will be changed to correspond more closely to the amount of damage they do to the roads. Accordingly, while the duty for most lorries will remain unchanged, for 150,000 of the heaviest rigid lorries there will be increases ranging from 7 per cent to 29 per cent.

7. These changes in the excise duties will, all told, raise an extra £820 million in 1985-86, some £235 million more than is required to keep pace with inflation. The FSE XXXX [overall] impact [effect] on the RPI of ^{all} these changes will be one half of one percent. This has already been taken into account in the forecast I have given the House of 5 per cent inflation by the end of the year.

8. I now turn to VAT.

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9. I have followed with interest the unprecedented speculation that has built up over recent months about my alleged intentions for VAT. Value Added Tax is of course the biggest single revenue raiser among the indirect taxes, and a major extension of the VAT base, which at present covers little more than half of consumer spending, could finance a significant reduction in income tax as well as removing an obvious economic distortion. Accordingly my Treasury colleagues and I have, over the past 18 months, been reviewing the possibility of extending the VAT base [in a number of ways], and indeed I introduced a significant change in this direction in last year's Budget.

(Less Revealing)

10. At the same time, during the course of this review, various candidates have been progressively ruled out on a variety of grounds. I rejected the idea of imposing VAT on books, for example, as far back as January 1984 - well before the current agitation had even begun. It has been suggested that it might have been helpful to the House if I had made a practice of announcing a decision to take no action in a particular direction as soon as each such decision had been taken. But a moment's reflection must make it clear why successive Chancellors have eschewed this course, ever since Mr Gladstone, in 1853, first laid down the doctrine, in these terms:

"If the executive government is, with any advantage to the country, ordinarily to discharge the function of the initiative with respect to finance, it is

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BUDGET-SECRET

absolutely necessary that the strictest silence should be observed, not in contempt of pressure, but yet, notwithstanding all pressure, till the time arrives when the views of the Government can be regularly and comprehensively disclosed."

11. I can, however, now inform the House that the review has been completed, and that, apart from two relatively minor changes I shall be proposing today, I have decided not to make any further autonomous extensions of the VAT base during the lifetime of this Parliament. I am obliged to use the qualification 'autonomous' since, as hon Members will be aware, this is a field in which European Community law has to be reckoned with. But as the House will know, where we are currently under threat, we are vigorously fighting our ^{cause (or corner).} case.

12. The first change I propose to make concerns advertisements in newspapers and magazines. At present all other advertising is taxed, but newspaper and magazine advertising is not. There is no justification for this anomaly. It is one thing to maintain that newspapers and magazines should not be liable to VAT: quite another to argue that those who advertise in them should enjoy a similar immunity. Accordingly, I propose that from 1 May newspaper and magazine advertising should be subject to VAT. This will raise £30 million in 1985-86 and £50 million in a full year.

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? x
Sir P. Middel
wondered 'it
sounds like
VAT on
newspapers

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13. The other change I propose to make concerns credit cards and similar payment cards, a part of the financial sector which has enjoyed exceptional growth over the past few years. From 1 May transactions between the companies providing the cards and the outlets which accept them will be classified as exempt. This means that the companies will not be able to recover VAT in respect of such transactions. This will raise £15 million in 1985-86 and £20 million in a full year. It is not expected to have any direct effects on the changes made to card holders.

XX

14. I also have a modest VAT concession to make. I have decided to extend the existing VAT relief for medical or scientific equipment bought with donated funds for use in hospitals and the like to cover computer equipment for certain medical uses. Customs and Excise will be announcing the precise details of the reliefs, which will take effect from 1 May.

Yuk!



15. Finally, on VAT, these are the recommendations of the Keith Report on the Enforcement Powers of the Revenue Departments. These recommendations, which taken as a whole strike a careful balance between the powers of the Customs and Excise and the protection of the taxpayer, are principally concerned with improving the fairness and efficiency of the administration of VAT. After extensive consultation, draft clauses were published in November, as a basis for further consultations. The substantive

X

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clauses will appear in this year's Finance Bill. Among other things they will contain powers to deal with the problem of the late payment of VAT. This is expected to bring in extra revenue of about £50 million in 1985-86. By 1988-89 there will have been a cumulative once-for-all revenue gain of about £600 million. Proposals on the Inland Revenue aspects of the Keith Report will follow in next year's Finance Bill. I should like to take this opportunity to pay tribute to Lord Keith and his colleagues for their thorough and professional Report and set of recommendations.

16. Taking into account the improved relief for VAT on bad debts and the new relief for VAT on temporary imports, the overall effect of the VAT changes I have proposed will be to increase the yield of the tax by £60 million in 1985-86 rising eventually to £190 million in a full year. They will have no impact on the RPI. The additional revenue raised from the Excise Duties and VAT taken together with help me to lighten to some extent the burden of income tax.

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Ref No. M53

Copy 21^a of 21FROM: MRS R LOMAX
DATE: 13 March 1985

PS/INLAND REVENUE

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Littler
Mr Cassell
Mr Battishill
Mr Monger
Mr R Allen
Mr Folger
Mr Cropper
Mr H Davies
Mr Lord
Mr Isaac (IR)
PS/C&E*R.*
IR. comments (with
one from Sir P. Middleton)
indicated.*Rho 13/3***BUDGET SPEECH SIXTH DRAFT: SECTION L**

Could you please arrange for the attached redraft of Section L to be checked for factual accuracy. Comments should reach this office - through you please - by close of play today.

*mom**for* RACHEL LOMAX*R.*
One insert suggested
in para 5.*Rho 13/3***BUDGET-SECRET**

BUDGET-SECRET

X

L. PERSONAL TAXATION: ^{DIRECT} INCOME TAX

(OR TAXES ON INCOME
+ CAPITAL)

1. But before turning to income tax, I should briefly mention Capital Transfer Tax. Since 1979 the burden of this tax has been very greatly reduced, and I propose to maintain that position this year by raising the threshold and rate bands set last year in line with statutory indexation. In addition, I propose to widen the scope of the existing CTT exemption for amenity land surrounding a house of outstanding heritage quality. I am sure that this will be welcomed by all those concerned with the preservation of our national heritage.

2. I now turn to income tax.

X

Significant

3. As I announced last year, on 6 April the banks move over to the composite rate system for the payment of tax on bank interest. I now need to legislate to put the corresponding building society composite tax payment dates on broadly the same footing, as from April 1986. Contrary to press rumours, this will not produce additional revenue. I also propose to legislate this year to bring new loans above the £30,000 mortgage interest relief ceiling into the MIRAS system [with effect from] ^{by} April 1987. [at the very latest.]

4. I need to set the 1986-87 car benefit scales for those whose employers provide them with the use of a car.

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As last year, I propose to increase both the car and fuel scales by 10 per cent with effect from April 1986. This will still leave the scale levels well short of the true value of the benefit.

5. There has been some discussion of late about the tax treatment of charities. It has been our consistent policy over the past five years to focus relief rather on the act of giving to charity. In accordance with this principle I now propose to increase ^{to double} from £5,000 to £10,000, the limit to which relief at the higher rates of tax is allowed to individuals for covenants to charities.

Worthwhile ^X inset?

6. I now turn to my main income tax proposals.

7. I propose to make no change this year in the rates of income tax. As last year, I believe it is right to concentrate most of the limited resources at my disposal on raising the starting point for tax. Increases in the basic tax thresholds benefit all taxpayers, but they give proportionately more help to those on smaller incomes - and right at the bottom end of the scale take a significant number of people out ^{of} tax altogether. The tax thresholds we have in this country are too low whether compared with [our principal] ^{many of our} competitors or with our own not so distant past. They discourage young people from starting work and are a major cause of the poverty and unemployment traps. A budget for jobs and for enterprise has to give high priority to raising the tax thresholds.

X

X

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X

8. The statutory indexation formula means that I should increase all the principal income tax allowances and bands by 4.6 per cent, the increase in the Retail Price Index over the year to last December, rounded up. For the higher rate thresholds and bands I propose this year to do just that. The first higher rate of 40 per cent will be reached at a taxable income of £16,200 and the top rate of 60 per cent will apply to taxable income above £40,200.

9. For the basic thresholds I can do more. Statutory indexation would imply an increase in the single person's allowance of £100. I propose to increase it by precisely twice as much - £200 - from £2,005 to £2,205. Statutory indexation would imply an increase in the married man's allowance of £150. Again, I propose to raise it by precisely twice as much - £300 - from £3,155 to £3,455

10. I propose to increase the age allowances this year by the same cash amount as the corresponding basic allowances. Thus the single age allowance will rise by £200 from £2,490 to £2,690 and the married age allowance will go up by £300 from £3,955 to £4,255.

X

11. The increase in the basic allowances of almost 10 per cent, or some 5 per cent in real terms, means that for 1985-86 they will be well over 20 per cent higher in real terms than they were in 1978-79, Labour's last year.

These increases
↳ It means that most single people will enjoy an income tax

X

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X
cut of at least £1.15 a week and most married couples an income tax cut of at least £1.73 a week. Compared with no increase at all ^{in allowances} some 800,000 people on low incomes - 100,000 of them widows - will be taken out of tax altogether. That is almost twice as many as would have been taken out of tax had the allowances merely been indexed.

12. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May. Their cost is considerable: £1.6 billion in 1985-86, of which roughly half represents the cost of indexation.

→ Insert X from previous para (Sir P. Middleton suggestion)

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BUDGET-SECRETREF No. M56
COPY 19 OF 20FROM: MRS R LOMAX
DATE: 13 March 1985

MR MONCK

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Littler
Mr Byatt
Mr Battishill
Mr Folger
Mr Mercer
Mr Cropper
Mr H Davies
Mr Lord
PS/IR
PS/C&E**BUDGET SPEECH SIXTH DRAFT: SECTION G2**

Could you please arrange for the attached redraft of the second part of Section G to be checked for factual accuracy and, where necessary, cleared with other Departments. Comments should reach this office - through you please - as soon as humanly possible, and not later than 11am tomorrow morning.

RL.

RACHEL LOMAX

BUDGET-SECRET

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G2: EMPLOYMENT AND TRAINING MEASURES

1. Over the last two years we have brought about substantial improvements in vocational education and training for the 14-18 age group. In particular, the Youth Training Scheme has become a successful bridge between school and work.

2. But despite this advance, we in this country still fail to prepare our school-leavers adequately for work. Many employers still fail to recognise that training is an investment in their own commercial interest. And too many trainees are reluctant to accept rates of pay which reflect their inexperience and low contribution to value added, something I shall refer to again later. This is in marked contrast to our major competitors overseas.

3. The Government has therefore decided to promote a major expansion of the Youth Training Scheme. Provided employers are prepared to pay the bulk of the cost, the Government for its part is prepared to provide further funds, over and above the existing £750 million a year of public expenditure on the YTS, to set up an important new scheme. The object of the new scheme would be eventually to provide all 16 or 17 year olds who do not continue in full-time education with the offer of job-related training leading to a recognised qualification. The scheme would offer a place up to the age of 18 - that is

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to say, it would last for two years for 16 year olds and one year for 17 year olds.

4. The principal aims of the scheme are a better qualified workforce and more realistic pay levels for young people. But it would also be a major step towards our objective of ensuring that every youngster under the age of 18 has the choice of either staying in full time education, taking a job or receiving training. We want to move to a position where unemployment for anyone under the age of 18 should cease to be an option. But first we have to get this ambitious new scheme in place. It will require a major effort from employers, trade unions and trainees, but one which I am sure they are willing to make.

5. The existing YTS provides foundation training and preparation for work. The new scheme will involve occupational training for both the employed and the unemployed and will aim to meet industry's need for skilled and motivated employees. It would not be unreasonable to expect employers to meet the full cost, as employers in other countries are prepared to do. Indeed, this is essential if the new scheme is to be viable in the longer term. But I recognise that such a major change in attitudes may take time. I am therefore prepared to set aside a fixed sum in public funds to launch the new scheme and get it moving in the right direction. My Rt Hon Friend the Secretary of State for

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Employment and my noble Friend the Minister without Portfolio will be announcing details of the scheme in a press notice tomorrow

6. My Rt Hon Friend the Secretary of State will then arrange consultations through the Manpower Services Commission about the share of the cost to be borne by employers, the level of trainee allowances, the quality of training to be provided, and the qualifications it will lead to. Our aim is that these consultations should be completed by July so that the new scheme can be in place for this year's school leavers. Provided the outcome of these consultations is satisfactory, I have undertaken to increase the Department of Employment's programme by £150 million in 1986-87 and £300 million in 1987-88 for this scheme.

7. As well as inadequate basic training, we in this country are increasingly suffering from the fact that our output of graduates in high technology disciplines has not been keeping pace with the expanding needs of industry. My Rt Hon Friend the Secretary of State for Education and Science will therefore be announcing later today shortly a special programme, costing around £40 million over the next three years, to provide additional places in selected higher education institutions, principally in electronic engineering and computer sciences. In this case the cost will be met from within existing public expenditure programmes.

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8. While school-leavers will be catered for by the Youth Training Scheme, there remains the problem of the long-term unemployed genuinely seeking work. The Community Programme, which (insert brief description here), has proved to be of considerable value in this context, with a significant proportion of those who leave it going on into other jobs.

9. I have therefore agreed to make funds available to enable the Manpower Services Commission to offer an additional 100,000 Community Programme places by June 1986. Those between 18 and 24 who have been unemployed for six months or more, and older people who have been unemployed for over a year, will be eligible for these places. My Rt. Hon. Friend the Secretary of State for Employment will be announcing the full details of this proposal [in a press notice later today/tomorrow]. The Department of Employment's programme will be increased by £140 million in 1985-86 and £460 million in 1986-87 to accommodate this.

10. To an even greater extent than with the Youth Training Scheme, the net public expenditure cost will be substantially less than the gross cost because of savings on social security benefits. The net addition to the expenditure programmes as a result of all the proposals I have announced today will be £75 million in 1985-86 and £300 million in 1986-87.

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11. But in this, as in so many other fields, higher public expenditure can at best be only a part of a wider response to the problem. The Government has therefore decided to take further steps to remove legal impediments to the effective functioning of the labour market. However well intentioned, these impediments can only lead to fewer jobs. My Rt Hon Friend will be announcing two important measures tomorrow. First, he will be extending to all employers the provisions on unfair dismissal which currently apply to small firms. The qualifying period for unfair dismissal claims will thus become two years for all new employees. This should lessen the reluctance of employers to take on new people.

12. Second, my Rt Hon Friend will be issuing a consultative document about the future of the Wages Councils. The main effect of Wages Councils is to increase unemployment by making it illegal for many employers, particularly small employers, to employ people, especially young people, at wages that the employers can afford and for which the potential employees are prepared to work. The document will cover a number of proposals for radical change, including complete abolition.

BUDGET-SECRET

BUDGET-SECRETFROM: MRS R LOMAX
DATE: 13 March 1985

MR MONGER

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr Battishill
Mr Folger
Mr Cropper
Mr H Davies
Mr Lord
PS/IR
Mr Isaac (IR)
Mr Blythe (IR)
PS/C&E**BUDGET SPEECH SIXTH DRAFT: SECTION H**

Could you please arrange for the attached redraft of Section H to be checked for factual accuracy. Comments should reach this office - through you please - by close of play today.



RACHEL LOMAX

BUDGET-SECRET

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H TAX REFORM

I now turn to taxation.

2. In my Budget last year I announced a radical reform of the Corporation Tax system. This had been preceded by the Green Paper on Corporation Tax issued by my predecessor in 1982.

3. I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

4. I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

4a. It is the firm policy of the Government to reduce the burden of income tax. But we need to make sure that the reliefs we can afford are concentrated where they will do most good.

5. The present structure of personal income tax is unsatisfactory in many ways. The threshold is still too low. Too many young people in particular start paying tax at too low a level. And too many families find themselves in the poverty and unemployment traps. The

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system discriminates in favour of the married man whose wife goes out to work and against the wife who stays at home to look after the children. It denies to the partners in a marriage the full opportunity for independence and privacy which they have a right to expect in their tax affairs.

6. I believe that these defects can be removed by a change to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance. But if a married woman, or for that matter a married man, was unable to make full use of their allowance the unused portion could be transferred, if they so wished, to their husband or wife.

7. This reform would produce a more logical and straightforward system. It would open the way for a significant rise in tax thresholds for families where the wife works at home, where the problems of the poverty and unemployment traps are most pronounced. It would also give a greater incentive for young people to seek work.

8. It would enable far more people to be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the wife feels it right to stay at home rather than go out to

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work, which increasingly nowadays means discrimination against the family with young children.

9. It would give every married women the opportunity for privacy in her tax affairs. Her personal allowance would be her own unless she chose to transfer it to her husband. Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The whole business of aggregating a wife's earned income and investment income with her husband's income for tax would end.

10. A reform of this kind would require major changes in the way the tax system is run, far beyond its present capacity to deliver. But the computerisation of PAYE is well under way and the full range of facilities should be available by 1989. So it is essential to lose no time in preparing for the changes we wish to make once computerisation is in place. I shall therefore be issuing later this year a Green Paper setting out full details of the proposals I have just outlined as a basis for full and informed discussion. I intend to introduce the necessary legislation in 1987 with a view to full implementation by April 1990. The Green Paper will also discuss other options opened up by computerisation, ranging from non-cumulation to a closer integration of the tax and benefit systems after an appropriate period of consultation.

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BUDGET-SECRET

11. There is also a case for changing the tax treatment of pension funds, as part of a thorough-going reform of the tax treatment of personal savings generally. Any fundamental reform of this kind would also, in the same way, need to be preceded by the publication of a Green Paper.

12. The House will, I am sure, be interested to learn that I have no such Green Paper in mind at the present time.

13. Nor, indeed, despite the unparalleled spate of pre-Budget rumours, do any of the detailed proposals in my Budget affect the tax-deductibility of pension fund contributions, the tax-free nature of pension fund income and capital gains, or the anomalous but much loved tax-free lump sum.

14. I note, incidentally, that it is now the official policy of the Opposition to levy a full rate of tax on any pension fund which invests its members' savings in ways of which the Labour Party disapproves.

15. We on this side of the House wholly reject that approach. Indeed, my Rt. Hon. Friends and I envisage a considerably larger role for bona fide private pension provision than exists at the present time, and we shall be expecting the pensions industry to play an active and constructive part in helping to bring this about.

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16. Meanwhile, I have a number of important proposals for tax reform to announce today, which will both simplify the system and encourage enterprise.

17. First, Capital Gains Tax. Last year I was unable to do anything about the acknowledged defects of this tax, notably its combination of unfairness and complexity, and undertook to come back to it this year.

18. This I now do.

19. I have decided that the right way to reform Capital Gains Tax is to build on the important change made by my predecessor three years ago, when he introduced the 1982 indexation relief.

20. That relief, valuable though it is, and increasingly valuable as it will become, suffers from three serious limitations.

21. First, the indexation does not cover to the first 12 months of the ownership of an asset. This provision, introduced to discourage the short term conversion of income into capital, required complex identification rules for shares, has made the tax very much more complicated. I am now in a position to remedy this defect. Hon members will recall that I announced last month measures to put an end to the practice known as bondwashing, which represented the principal device for converting income

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into less heavily taxed capital gains. Having done that, I propose to abolish the 12 month rule so far as most disposals are concerned with effect from 6 April. In the case of certain fixed interest securities, however, the rule will need to remain in being until the anti-bondwashing provisions take effect on 28 February 1986.

22. Second, the indexation does not at present extend to losses. I propose that it should do so.

23. Third, the present indexation provision unfairly discriminates against those who acquired their assets prior to 1982, since for them the allowance is based not on the 1982 value of the asset but on its original cost. I now propose that this injustice be remedied, and the indexation allowance will henceforth be based on March 1982 values. There will still, of course, be no indexation of capital gains made prior to 1982, but at least all purely inflationary gains made since that date will now be free of tax, irrespective of when the asset was acquired.

24. This three-pronged reform of Capital Gains Tax will make life simpler for the taxpayer, help the efficient working of the capital markets, relieve the burden on well-established family businesses, and encourage risk-taking and enterprise. Combined with the statutory indexation of the exempt amount, which will rise in 1985-86 to £5,900, these changes will remove some 15,000

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taxpayers from liability altogether. Increasingly the tax will be levied on real and not inflationary gains. With these reforms, I believe the tax is now on a broadly acceptable and sustainable basis.

25. The combined cost of the three reforms I have announced is £155 million in a full year, but none of it falls in 1985-86.

26. I turn next to the stamp duties.

27. Following widespread consultation I have decided that the time has come to simplify and modernise these ancient duties. I propose in this Budget to sweep away no fewer than 15 separate duties, including the contract note duty and the 1 per cent duty on gifts. Altogether, the changes I am proposing should reduce by over 40 per cent the number of documents which require to be stamped.

28. My final proposal for reform concerns Development Land Tax.

29. This is a particularly complex tax, which was introduced in response to the problem of soaring land values at a time of high inflation. Its chief practical effect is to discourage the bringing forward of land for development. The disincentive effects will grow further as the gap widens between the 60 per cent rate of DLT and a Corporation Tax rate which is on the way down to 35 per cent.

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30. I have therefore decided to abolish Development Land Tax altogether, with immediate effect. At the same time I propose to cancel all deferred charges under the tax. The net cost will be some £20 million in 1985-86 and £50 million in a full year. This compares, incidentally, with a collection cost for DLT of some £5 million a year. Development gains will of course continue to be subject to income tax, corporation tax and capital gains tax, in the same way as any other income or capital gains.

31. The abolition of Development Land Tax will, I am sure, be especially welcomed by the building and construction industry. It will also remove no fewer than 200 pages of highly complex legislation from the Statute Book.

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Ref No. M50

COPY 20^A OF 20FROM: MRS R LOMAX
DATE: 13 March 1985

MR BAILEY

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Littler
Mr Battishill
Mr Scholar
Miss Peirson
Mr Stibbard
Mr Folger
Mr Cropper
Mr H Davies
Mr Lord
PS/IR
PS/C&E**BUDGET SPEECH SIXTH DRAFT: SECTION F**

Could you please arrange for the attached redraft of Section F to be checked for factual accuracy. Comments should reach this office - through you please -by close of play today.



RACHEL LOMAX

BUDGET-SECRET

BUDGET-SECRET

F. PUBLIC EXPENDITURE

As the House is aware, the Government's economic strategy is founded on twin pillars: a monetary policy designed to bring down the rate of inflation and a supply side policy designed to improve the competitive performance of the economy.

2. The supply side policy is based on the profound conviction, based on practical experience both at home and overseas, that the route to better economic performance is through the encouragement of enterprise, efficiency and flexibility; the promotion of competition, deregulation and free markets; through pressing ahead with privatisation and improving incentives.

3. The argument over which will have a bigger impact on demand, increased public expenditure or lower taxation, completely misses the point. The case for lower taxation derives entirely from the Government's supply side policy: as a means of enhancing incentives, eliminating distortions, improving the use of resources, lightening burdens and heightening the spirit of enterprise.

4. Given the overriding priority of anti-inflation policy, the need to ensure that the Budget deficit is of a size that can and will be soundly financed, this can

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only be achieved by maintaining the firmest possible control of public expenditure.

5. Controlling public expenditure is one of the most difficult tasks facing any democratic government in the modern world. Public expenditure acquires its own momentum and creates its own vested interests. To control it requires constant vigilance and a determination to succeed despite the inevitable setbacks. We have that determination, and have succeeded in holding its growth below that of the economy as a whole. To achieve that has required difficult decisions in successive public expenditure rounds.

6. But there is no virtue in self-delusion. There is no benefit to sound economic management or effective control from sticking to figures which subsequent events have made unattainable.

7. The Budget is the right time to reassess the prospects for spending, revenue, and for borrowing. Such a reassessment must take account of changes in the economic scene since the Public Expenditure Review in the autumn. Of these, the single most important factor has been the coal strike, whose public expenditure cost in 1984-85 is estimated at some £2½ billion -about £1 billion more than allowed for in the Autumn Statement and the Public Expenditure White Paper which explicitly assumed that the strike would end at Christmas. There will also be some further cost in 1985-86.

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8. But quite apart from the coal strike, the upward pressures on public spending remain intense, with the effects of higher interest rates and a lower exchange rate superimposed on the problems of increased take-up of social security benefits and local authority overspending. I now estimate that this year's public expenditure planning total will be exceeded by some £3½ billion - an overshoot of about 2½ per cent, of which over two-thirds is attributable to the coal strike.

9. In the light of this revised estimate of the outturn for the current year I have reassessed the adequacy of the Reserves for 1985-86, 1986-87 and 1987-88 provided in the January White Paper. In order to provide a realistic basis on which to plan and control the level of public spending I have felt it prudent to add £2 billion to the Reserve and thus to the White Paper planning totals for each of the three years.

10. At the same time, I have increased the figure for debt interest, which is outside the planning total, by £½ billion a year above the levels shown in the White Paper, which itself contained significantly higher figures than last year's Red Book.

11. These estimating changes mean that the planning totals for the next three years have been increased by about 1½ per cent. But let there be no misunderstanding. The new totals still represent a tough target. There is

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~~no slackening in our determination~~ to curb the size of the public sector. No cash has been added to programmes. Calls on the reserve will continue to be judged on the strictest criteria.

12. Public expenditure will continue to fall as a proportion of GDP, as it has since 1981-82. Expenditure will stay broadly flat in real terms at about this year's level, adjusted for the coal strike. To achieve even these new figures future Public Expenditure Surveys will need to be at least as tough as their predecessors; and there can be no let-up in the tight control of individual spending programmes within the cash limits set for the coming year.

13. On the other side of the public accounts, expected tax receipts have also been revised upwards, partly for related reasons. But not by as much. The scope I have for tax cuts this year is therefore only half the amount I indicated might be available in my Statement to the House in November. In other words, the measures I shall shortly announce will, after indexation, contribute some £ $\frac{3}{4}$ billion net to the £7 billion borrowing requirement I have set for 1985-86.

BUDGET-SECRET

FROM: MRS R LOMAX

DATE: 14 March 1985

Whole Speech (Sections B-M)(BLO)

MR BATTISHILL

cc Chief Secretary
 Financial Secretary
 Minister of State
 Economic Secretary
 Sir P Middleton
 Mr Bailey
 Sir T Burns
 Mr Littler
 Mr A Wilson
 Mr Anson
 Mr Byatt
 Mr Cassell
 Mr Kemp
 Mr Monck
 Mr Unwin
 Mr Monger
 Mr Odling-Smee
 Mr Culpin
 Mr Folger
 Mr Cropper
 Mr Lord
 Mr H Davies

PS/IR
 PS/C&E

Part of Speech only (Budget Secret)

Mr Evans (Sections B,E,F)
 Mr Lankester (Sections C,D,E)
 Mr Lavelle (Sections B,D)
 Mr Scholar (Sections F,G)
 Miss Peirson (Sections E,F)
 Mr Peretz (Sections C,D)
 Ms Seammen (Section M)
 Mr Shields (Section B)
 Mr Mercer (Section G)
 Mr Riley (Sections C,D,E)
 Mr Green - IR (Section J)
 Mr Isaac - IR (Sections H,L)
 Mr Knox - C&E (Section K)

BUDGET SPEECH 7TH DRAFT

I attach for most recipients a near final draft of the complete Budget Speech. Any further comments should reach this office by lunch time on Friday.

MOM
 for MRS R LOMAX

A INTRODUCTION

1. I said last year that the Budget would set the course for this Parliament.

2. My Budget today will reaffirm the Government's determination to hold to that course, the purpose of which is no less than the defeat of inflation. For that is the only way to secure lasting growth and thus provide the conditions for a high level of employment. We have not wavered from that purpose. Nor will we do so.

3. But to grasp the opportunities arising from lower inflation, the economy needs to be more efficient, more flexible, and more ready to respond to change.

4. So the Budget today has two themes, themes that are inseparably linked - to continue the drive against inflation and to help in creating the conditions for more jobs.

5. I shall begin by outlining recent economic developments and future prospects. I shall then deal with the medium term financial strategy, monetary policy, and the PSBR. I shall then discuss public expenditure and employment. Finally, I shall make proposals for tax changes.

6. As usual, a number of press releases filling out the details of my tax proposals will be available from the Vote Office as soon as I have sat down.

B. THE ECONOMIC BACKGROUND

I start with the economic background.

2. Once again we can look back on a year of steady growth and low inflation. During 1984 as a whole, inflation remained at around 5 per cent. Output grew by a further $2\frac{1}{2}$ per cent, with investment up by 6 per cent and non-oil exports by 7 per cent, to reach all-time record levels in each case.

3. Manufacturing industry recovered particularly strongly, with output up by $3\frac{1}{2}$ per cent - the biggest rise in any single year since 1973 - exports up by 10 per cent and investment by 13 per cent. The current account of the balance of payments has remained in surplus, for the fifth year in succession. By international standards, too, the economy has performed well. Our growth was above, and our inflation below the European Community average.

4. Moreover, this progress has been achieved in the teeth of an unprecedentedly long and damaging coal strike. The costs, both economic and constitutional, of submitting to this strike would have been infinitely greater than the costs that have been incurred in successfully resisting it. But in the short term the nation has had to pay a heavy price.

5. The coal strike has reduced the level of national output by over $1\frac{1}{4}$ per cent and worsened the balance of payments by some £4 billion. It has increased public expenditure by £ $2\frac{1}{2}$ billion and public sector borrowing by £ $2\frac{3}{4}$ billion. It has meant a lower exchange rate and higher interest rates. It has cost us confidence abroad and jobs at home.

6. It is a remarkable tribute to the underlying strength of the British economy that it has been able to withstand so long and damaging a strike in such good shape.

7. Looking ahead, we are now about to embark on what will be the fifth successive year of steady growth, with output in 1985 as a whole set to rise by a further $3\frac{1}{2}$ per cent. Inflation may edge up for a time, perhaps to 6 per cent by the middle of the year, but should then fall back to 5 per cent by the end of the year and lower still in 1986.

8. While there can be no disputing the strength and durability of the economic upswing, there is equally no disputing the fact that it is marred by a tragically high level of unemployment. And this despite the fact that the latest figures suggest that employment has risen by half a million over the past two years, with a further increase likely over the year ahead. I shall have more to say about the prospects for jobs, and the ways in

which the Government can help to improve them, later in my speech.

9. If at home the past year has been overshadowed by the coal strike, internationally it has been overshadowed by the relentless rise of the dollar. To finance its massive budget deficit the United States is importing a large part of the rest of the world's savings and exporting some of its own inflation.

10. For the first time since the first world war the United States has become a net debtor, and could quite soon become the world's largest debtor. The counterpart of this massive capital inflow is a huge and growing current account deficit and a manifestly overvalued dollar, which in turn is daily adding strength to the protectionist lobbies within the United States.

11. As Federal Reserve Chairman Paul Volcker last month testified to Congress, the United States is living on borrowed money and borrowed time. But it is not only America that is paying the interest.

12. There has been no precedent for the prolonged surge in the dollar which has dominated the financial world over the past year - a rise of some 30 per cent against all the major European currencies from an already overvalued base.

13. All this has led to one of the most turbulent years in the financial markets within living memory. It has been, and will continue to be, a time for strong nerves and sound policies.

C. THE MEDIUM-TERM FINANCIAL STRATEGY

We have already shown that we are not afraid to take action, however unpopular, to keep the Medium-Term Financial Strategy on course in an unpredictable and uncertain world.

2. That strategy was first launched 5 years ago next week. Its opening words were these:

"The Government's objectives for the medium term are to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment."

3. We have achieved those objectives to a greater degree than almost any commentator dared to forecast at the time. And our commitment to them remains as great today as it was five years ago. So too is our commitment to the strategy as the means of achieving those objectives.

4. The Medium-Term Financial Strategy is designed to ensure a reasonable growth of demand in money terms -and indeed has succeeded in doing so.

5. We are determined to maintain steady downward pressure on inflation. It is not in the gift of any

Government to eliminate short-term fluctuations along the way, but the underlying direction has to be downwards. It is this concern which governs the desirable growth of total spending power in the economy, as measured by money GDP.

6. The great mistake of postwar demand management, which still has some devotees today, was to react to rising unemployment by injecting more money into the system, whether through the Budget or through the banks. So far from halting the upward trend of unemployment, this simply generated runaway inflation, the reversal of which inevitably led to still further job losses.

7. That course we will not follow.

8. A policy for demand couched unambiguously in terms of money provides a further important advantage. For it ensures that wage restraint really will provide more jobs. I repeat today the undertaking I gave the National Economic Development Council last month: the Medium Term Financial Strategy is as firm a guarantee against inadequate money demand as it is against excessive money demand.

D. MONETARY POLICY AND THE EXCHANGE RATE

Within the MTFS, the central role is played by monetary policy, since it is by controlling the growth of money in the economy that the Government is able to influence the growth of money demand.

2. Last year I set target ranges of 4-8 per cent for narrow money and 6-10 per cent for broad money. Over the twelve months to mid-February, narrow money, as represented by the target aggregate of notes, coins and bankers' deposits, grew at around the middle of its range, and broad money, as represented by the target aggregate £M3, grew at just below the top of its range.

3. For next year I shall be retaining the same two target aggregates and setting the target ranges indicated in last year's MTFS - that is to say, a reduction in monetary growth of 1 per cent in each case. I attach equal importance to both.

4. There are those who argue that if we stick to sound internal policies the exchange rate can be left to take care of itself. But significant movements in the exchange rate, whatever their cause, can have a short-term impact on the general price level and on inflationary expectations. This process can acquire a momentum of its own, making sound internal policies harder to implement. Benign neglect is not an option.

5. That is why I have repeatedly argued that it is necessary to take the exchange rate into account in judging monetary conditions. Unfortunately, perhaps, there is no mechanical formula which enables us to balance the appropriate combination of the exchange rate and domestic monetary growth needed to keep financial policy on track. But a balance does have to be struck, and struck in a way that takes no chances with inflation.

6. For there should be no doubt about the Government's commitment to maintain monetary conditions that will continue to bring down inflation. Short term interest rates will be held at the level needed to achieve this.

E. PUBLIC SECTOR BORROWING

While monetary policy is at the heart of the Medium-Term Financial Strategy, it needs to be buttressed by an appropriate fiscal policy.

2. The outturn for the Public Sector Borrowing Requirement for 1983-84 was £9 $\frac{3}{4}$ billion, or 3 $\frac{1}{4}$ per cent of GDP. In my Budget last year I planned to reduce it substantially in 1984-85 to £7 $\frac{1}{4}$ billion, or 2 $\frac{1}{4}$ per cent of GDP. In the event, this year's PSBR looks like turning out at £10 $\frac{1}{2}$ billion, or 3 $\frac{1}{4}$ per cent of GDP - the same proportion as in each of the three previous years.

3. All but £ $\frac{1}{2}$ billion of this substantial overrun is directly attributable to the cost of the coal strike. I believe it was right to meet the large but once-for-all cost of keeping the economy going throughout the coal strike by borrowing, thus in effect spreading the cost over a number of years. But it is now necessary to return to the path I outlined in last year's MTFS.

4. That means that the PSBR for the coming year, 1985-86, will be set at £7 billion, equivalent to 2 per cent of GDP. As this year, some £3 billion will be financed through National Savings.

5. I have been urged by some to provide for a still lower borrowing requirement in order to impress the financial markets. Others have argued that the present high level of interest rates would justify a more relaxed fiscal stance.

6. There is nothing sacrosanct about the precise mix of monetary and fiscal policies required to meet the objectives of the Medium-Term Financial Strategy. But this is not the year to make adjustments in either direction. The wisest course is to stick to our preannounced path.

7. This means that, for the coming year, a substantial reduction in the PSBR must take precedence over our objectives for reducing the burden of tax.

F. PUBLIC EXPENDITURE

As the House is aware, the Government's economic strategy is founded on twin pillars: a monetary policy designed to bring down the rate of inflation and a supply side policy designed to improve the competitive performance of the economy.

2. The supply side policy is rooted in a profound conviction, itself born of practical experience both at home and overseas, that the way to improve economic performance and create more jobs is to encourage enterprise, efficiency and flexibility; to promote competition, deregulation and free markets; to press ahead with privatisation and to improve incentives.

3. The argument over which will have a bigger impact on demand, increased public expenditure or lower taxation, completely misses the point. The case for lower taxation rests on the Government's supply side policy: lower taxes will help to enhance incentives, eliminate distortions, improve the use of resources and heighten the spirit of enterprise.

4. But given the need to ensure that the Budget deficit is of a size that can and will be soundly financed, lower taxes can only be achieved by maintaining the firmest possible control of public expenditure.

5. Controlling public expenditure is one of the most difficult tasks facing any democratic government in the modern world. Public expenditure acquires its own momentum and creates its own vested interests. To control it requires constant vigilance and a determination to succeed despite the inevitable setbacks. We have that determination, and have succeeded in bringing the growth of public spending below that of the economy as a whole. This achievement has required difficult decisions in successive public expenditure rounds.

6. But there is no benefit to sound economic management or effective control from sticking to figures which subsequent events have made unattainable.

7. The Budget is the right time to reassess the prospects for spending, revenue, and for borrowing. As my Rt. Hon. and learned Friend the Chief Secretary made plain in the recent debate on the Public Expenditure White Paper, any such reassessment must take account of changes in the economic scene since the Public Expenditure Review in the autumn. Of these, the single most important factor has been the coal strike, whose public expenditure cost in 1984-85 is estimated at some £2½ billion - about £1 billion more than allowed for in the Autumn Statement and the Public Expenditure White Paper which explicitly assumed that the strike would end at Christmas. There will also be some further cost in 1985-86.

8. I now estimate that this year's public expenditure planning total will be exceeded by some £3¼ billion - an overshoot of about 2½ per cent, of which over two-thirds is attributable to the coal strike. In addition, since the White Paper was prepared, we have had to accommodate the effects of higher interest rates and a lower exchange rate. But quite apart from the coal strike, the upward pressures on public spending remain intense, not least from increased take-up of social security benefits and further local authority overspending.

9. In the light of the revised estimate of the outturn for the current year and the pressures to which I have referred, I have reassessed the adequacy of the Reserves for 1985-86, 1986-87 and 1987-88 provided in the January White Paper. In order to provide a realistic basis on which to plan and control the level of public spending, I have felt it prudent to add £2 billion to the Reserve and thus to the White Paper planning totals for each of the three years. I have also felt obliged to increase the figure for debt interest by £½ billion a year.

10. These estimating changes mean that the planning totals for the next three years have been increased by about 1½ per cent. But let there be no misunderstanding. The new totals still represent a tough target. There is no slackening in our determination to curb the size of the public sector. No cash has been added to programmes. Calls on the Reserve will still be judged on the strictest criteria.

11. Public expenditure will continue to fall as a proportion of GDP, as it has, the coal strike apart, since 1981-82. Expenditure will stay broadly flat in real terms at about this year's level, excluding the costs of the coal strike. To achieve even these new figures, future Public Expenditure Surveys will have to be at least as tough as their predecessors; and there can be no let-up in the tight control of individual spending programmes within the cash limits set for the coming year.

12. On the other side of the public accounts, expected tax receipts have also been revised upwards, partly for related reasons. But not by as much. The scope I have for tax cuts this year is therefore only half the amount I indicated might be available in my Statement to the House in November. In other words, the measures I shall shortly announce will, after indexation, contribute some £ $\frac{3}{4}$ billion net to the £7 billion borrowing requirement I have set for 1985-86.

G1. THE PROSPECT FOR JOBS

In determining the nature of those measures I have had one overriding object in mind. This must be a Budget for jobs.

2. But it is important to be clear what this means. Jobs are created by an industry that is profitable, competitive, efficient and well-managed. And this in turn requires a workforce with the right skills, one that is adaptable, reliable, motivated and prepared to work at wages that employers can afford to pay.

3. The extent to which Government - let alone a single Budget - can bring about these conditions is clearly limited. We cannot inculcate the spirit of enterprise by an Act of Parliament, or abolish trade union obstructiveness simply by adding a few more pages to the Statute Book.

4. We cannot even legislate to prevent workers from pricing themselves out of jobs although previous administrations have tried, with uniformly dismal results. Last year, despite a further encouraging growth in productivity, wage costs per unit of manufacturing output rose by some 4 per cent. In each of our three most formidable industrial competitors, the United States, Germany and Japan, unit wage costs actually fell.

This is bad for competitiveness and bad for jobs. Too much of the benefits of economic growth are currently being enjoyed in higher living standards for those in work: too little in the form of better job prospects for those out of work. In a free society, the ultimate remedy must lie with those responsible for collective bargaining throughout the length and breadth of the economy.

5. But limited though the role of Government is, it remains an important one. To prepare the soil in which enterprise can best flourish. To remove impediments to the proper functioning of markets in general and the labour market in particular. To correct the deficiencies in our education and training that make it hard for industry - and individuals - to change technological gear. To construct a pattern of taxation that does least damage to incentives; and does least to deter the unemployed from seeking work and business from taking them on.

6. We have made progress on all these fronts. Inevitably, it takes time for the effects to come through. That is not surprising: patterns of behaviour acquired over decades cannot be changed overnight. And there is much still to be done.

7. But there is no other way. If it were possible to create jobs simply by boosting Government borrowing and

Government spending there would be no unemployment in the world today, for nothing is easier for a Government than to borrow and spend. Impatience is a bad counsellor.

8. In setting macro economic policy for the year ahead I have had one object in mind: the continuing reduction of inflation.

9. Equally, in deciding my individual Budget proposals within that overall framework, I have sought throughout to make those changes that will do most to promote enterprise and employment.

10. Our attack on the evil of unemployment is clear, coherent and strong. The measures I shall announce today represent further steps along the road we have been taking since 1979. They will help us to ensure that more new jobs are created and that they will be jobs that last.

G2: EMPLOYMENT AND TRAINING MEASURES

1. Over the last two years we have brought about substantial improvements in vocational education and training for the 14-18 age group. In particular, the Youth Training Scheme has become a successful bridge between school and work. It has also helped to make young people's pay expectations more realistic.

2. But despite this advance, we in this country still fail to prepare our school-leavers adequately for work. Many employers still fail to recognise that training is an investment in their own commercial interest. And too many trainees are still reluctant to accept rates of pay which reflect their inexperience and low contribution to value added. In both respects there is a marked contrast with our major competitors overseas.

3. The Government has therefore carried out a comprehensive review of the provision for the 14-18 age group, led by my noble friend the Minister without Portfolio. It has decided to promote a major expansion of the Youth Training Scheme. Provided employers are prepared to pay the bulk of the cost, the Government for its part is prepared to provide further funds, over and above the existing £750 million a year of public expenditure on the YTS, to set up an important new scheme. The object of the new scheme would be eventually

to provide all 16 or 17 year olds who do not continue in full-time education with the offer of job-related training leading to a recognised qualification. The scheme would offer places lasting two years for 16 year olds and one year for 17 year olds.

4. The principal aim of the scheme is a better qualified workforce. But it would also be a major step towards our objective of ensuring that every youngster under the age of 18 has the choice of either staying in full-time education, taking a job or receiving training. We want to move to a position where unemployment for anyone under the age of 18 should cease to be an option. But first we have to get this ambitious new scheme in place. It will require a major effort from employers, trade unions and trainees, but one which I am sure they are willing to make.

5. The existing YTS provides foundation training and preparation for work. The new scheme will involve occupational training for both the employed and the unemployed and will aim to meet industry's need for skilled and motivated employees. It would not be unreasonable to expect employers to meet the full cost, as employers in other countries are prepared to do. Indeed, this is essential if the new scheme is to be viable in the longer term. But I recognise that such a major change in attitudes may take time. I am therefore prepared to set aside a fixed sum in public funds to

launch the new scheme and get it moving in the right direction.

6. My Rt Hon Friend the Secretary of State will be arranging consultations through the Manpower Services Commission about the share of the cost to be borne by employers, the level of trainee allowances, and the quality of training to be provided. Our aim is that these consultations should be completed by July so that the two year programme can be in place for this year's school leavers. Provided the outcome of these consultations is satisfactory, I have undertaken to increase the Department of Employment's programme by £145 million in 1986-87 and £300 million in 1987-88. The total for the first year includes £20 million for additional in-service teacher training related to the Technical and Vocational Education Initiative.

7. As well as inadequate basic training, we in this country are increasingly suffering from the fact that our output of graduates in high technology disciplines has not been keeping pace with the expanding needs of industry. My Rt Hon Friend the Secretary of State for Education and Science will therefore be announcing later today a special programme, costing around £40 million over the next three years, to provide additional places in selected higher education institutions, principally in engineering and technology. In this case the cost will be met from within existing public expenditure programmes.

8. While school-leavers will be catered for by the Youth Training Scheme, there remains the problem of the long-term unemployed genuinely seeking work. Under the Community Programme, local authorities and voluntary bodies provide temporary work for the long-term unemployed on projects of community benefit. It has proved to be of considerable value in this context, with a significant proportion of those who leave it going on into other jobs.

9. I have therefore agreed to make funds available to enable the Manpower Services Commission to offer an additional 100,000 Community Programme places by June 1986. Those between 18 and 24 who have been unemployed for six months or more, and older people who have been unemployed for over a year, will be eligible for these places. The Department of Employment's programme will be increased by £140 million in 1985-86 and £460 million in 1986-87 to accommodate this.

10. To an even greater extent than with the Youth Training Scheme, the net public expenditure cost will be substantially less than the gross cost because of savings on social security benefits. The net addition to the expenditure programmes as a result of all the proposals I have announced today will be £75 million in 1985-86 and £295 million in 1986-87.

11. But in this, as in so many other fields, higher public expenditure can at best be only a part of a wider response to the problem. The Government has therefore decided to take further steps to remove legal impediments to the effective functioning of the labour market. However well intentioned, these impediments can only lead to fewer jobs. My Rt Hon Friend will be taking important steps. First, he will be extending to all employers the provisions on unfair dismissal which currently apply to small firms. The qualifying period for unfair dismissal claims will thus become two years for all new employees. This should lessen the reluctance of employers to take on new people.

12. Second, my Rt Hon Friend will be issuing a consultative document about the future of the Wages Councils [later this week]. The main effect of Wages Councils is to increase unemployment by making it illegal for many employers, particularly small employers, to employ people, especially young people, at wages that the employers can afford and for which the potential employees are prepared to work. The document will cover a number of proposals for radical change, including complete abolition.

13. My Rt. Hon. Friends the Secretaries of State for Employment and for Education and Science will each be issuing press notices later today about measures I have mentioned.

H TAX REFORM

I now turn to taxation.

2. In my Budget last year I announced a radical reform of the Corporation Tax system. This had been preceded by the Green Paper on Corporation Tax issued by my predecessor in 1982.

3. I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

4. I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

4a. It is the Government's firm policy to reduce the burden of income tax. But we need to make sure that the reliefs we can afford are concentrated where they will do most good.

5. The present structure of personal income tax is far from satisfactory. The threshold is still too low. Too many young people start paying tax at too low a level. And too many families find themselves in the poverty and unemployment traps. The system discriminates in favour

of the married man whose wife goes out to work and against the wife who stays at home to look after the children. It denies to the partners in a marriage the full opportunity for independence and privacy which they have a right to expect in their tax affairs.

6. I believe that these defects can and should be removed by changing to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance. But if a married woman, or for that matter a married man, was unable to make full use of their allowance the unused portion could be transferred, if they so wished, to their husband or wife.

7. This reform would produce a more logical and straightforward system. It would open the way for a significant rise in tax thresholds for families where the wife works in the home, where the problems of the poverty and unemployment traps are most pronounced. It would also give a greater incentive for young people to seek work.

8. It would enable far more people to be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the

wife feels it right to stay at home rather than go out to work, which increasingly nowadays means discrimination against the family with young children.

9. It would give every married woman the opportunity for privacy in her tax affairs. Her personal allowance would be her own unless she chose to transfer any unused balance to her husband. Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The whole business of aggregating a wife's earned income and investment income with her husband's income for tax would end.

10. A reform of this kind would require major changes in the way the tax system is run, far beyond its present capacity to deliver. But the computerisation of PAYE is well under way, with the main programme due to be completed by 1987 and the full range of facilities available by 1989. So it is essential to lose no time in preparing for the changes we wish to make once computerisation is in place. The Green Paper will set out full details of the proposals I have just outlined as a basis for public discussion. After an appropriate period of consultation I intend to introduce the necessary legislation in 1987 with a view to full implementation by April 1990. The Green Paper will also discuss other options opened up by computerisation, ranging from non-cumulation to a closer integration of the tax and benefit systems.

11. There is also a case for changing the tax treatment of pension funds, as part of a thorough-going reform of the tax treatment of personal savings generally. Any fundamental reform of this kind would also, in the same way, need to be preceded by the publication of a Green Paper.

12. The House will, I am sure, be interested to learn that I have no such Green Paper in mind.

13. Nor, indeed, despite the unparalleled spate of pre-Budget agitation, do any of the detailed proposals in my Budget affect the tax-deductibility of pension fund contributions, the tax-free nature of pension fund income and capital gains, or the tax-free lump sum.

14. I note, incidentally, that it is now the official policy of the Opposition to levy a full rate of tax on any pension fund which invests its members' savings in ways of which the Labour Party disapproves.

15. We on this side of the House wholly reject that approach. Indeed, my Rt. Hon. Friends and I envisage a considerably larger role for bona fide private pension provision than exists at the present time, and we shall be expecting the pensions industry to play an active and constructive part in helping to bring this about.

16. Meanwhile, I have a number of other important proposals for tax reform to announce today, which will both simplify the system and encourage enterprise.

17. First, Capital Gains Tax. Last year I was unable to do anything about the acknowledged defects of this tax, notably its combination of unfairness and complexity, and undertook to come back to it this year.

18. This I now do.

19. I have decided that the right way to reform Capital Gains Tax is to build on the important change made by my predecessor three years ago, when he introduced the 1982 indexation relief.

20. That relief, valuable though it is, and increasingly valuable as it will become, suffers from three serious limitations.

21. First, indexation does not cover the first 12 months of the ownership of an asset. This provision was introduced to discourage the short term conversion of income into capital. But it has made the tax very much more complicated for the taxpayer. I am now in a position to remedy this defect. Hon members will recall that I announced last month measures to put an end to the practice known as bondwashing, the principal device for converting income into less heavily taxed capital gains.

Having done that, I propose to abolish the 12 month rule. So far as most disposals are concerned this will take effect from 6 April. In the case of certain fixed interest securities, however, the rule will need to remain in being until the anti-bondwashing provisions take effect on 28 February 1986.

22. Second, the indexation does not at present extend to losses. I propose to remove this restriction.

23. Third, the present indexation provision unfairly discriminates against those who acquired their assets prior to 1982. For them the allowance is based not on the 1982 value of the asset but on its original cost. I now propose to remedy this injustice. The indexation allowance will henceforth be based on March 1982 values. Capital gains made prior to 1982 will still not be indexed, of course; but at least all purely inflationary gains made since that date will now be free of tax, irrespective of when the asset was acquired.

24. This three-pronged reform of Capital Gains Tax will produce a fairer tax, make life simpler for the taxpayer, help the efficient working of the capital markets, relieve the burden on family businesses and encourage risk-taking and enterprise. Combined with the statutory indexation of the exempt amount, which will rise in 1985-86 to £5,900, these changes will remove some 15,000 taxpayers from liability altogether. Increasingly the

tax will be levied on real and not inflationary gains. With these reforms, I believe the tax is now on a broadly acceptable and sustainable basis.

25. The combined cost of the three reforms I have announced is £155 million in a full year, but none of it falls in 1985-86.

26. I turn next to the stamp duties.

27. Following widespread consultation I have decided that the time has come to simplify and modernise these ancient duties. I propose in this Budget to sweep away no fewer than 15 separate duties, including the contract note duty and the 1 per cent duty on gifts. Altogether, the changes I am proposing should reduce by over 40 per cent the number of documents which require to be stamped.

28. My final proposal for reform concerns Development Land Tax.

29. This is a particularly complex tax, which was introduced in response to the problem of soaring land values at a time of high inflation. Its chief practical effect is to discourage the bringing forward of land for development. This disincentive effect will grow as the gap widens between the 60 per cent rate of DLT and a Corporation Tax rate which is on the way down to 35 per cent.

30. I have therefore decided to abolish Development Land Tax altogether, with immediate effect. At the same time I propose to cancel all deferred charges under the tax. The net cost will be some £20 million in 1985-86 and £50 million in a full year. This compares, incidentally, with a collection cost for DLT of some £5 million a year. Development gains will of course continue to be subject to income tax, corporation tax and capital gains tax, in the same way as any other income or capital gains.

31. The abolition of Development Land Tax will, I am sure, be especially welcomed by the building and construction industry. It will also remove no fewer than 200 pages of highly complex legislation from the Statute Book.

J. BUSINESS TAXATION

1. I now turn to other aspects of business taxation. It cannot be repeated too often that it is businesses and not Governments that create jobs. The Government's responsibility is to foster the conditions which will encourage businesses to grow and create more jobs. The measures I have to announce are designed with that end in view.

2. First, Corporation Tax. The reforms I announced last year set out a new and improved framework of business taxation for the remainder of this Parliament and beyond. So this year I have only limited changes to make.

3. As I promised last year, I have reviewed the Scientific Research Allowance. Given the particular importance of expenditure on research and development if British industry is to hold its own in a competitive world, I have decided, exceptionally, not to reduce this allowances in line with the changes in the other capital allowances. A few minor changes apart, the Scientific Research Allowance will thus remain at 100 per cent.

4. I have also decided to modify the new capital allowance system as it applies to short life assets. While the new structure of capital allowances enables the

generality of plant and machinery to be written off over a period that fairly reflects their useful life, I accept that there is a problem with those assets which enjoy only a short life, including in particular high technology assets which tend to suffer a rapid rate of obsolescence.

5. Accordingly, from next year, a business will be able to exclude from its general pool of capital expenditure any asset which it believes will have only a short life; so that if the asset is subsequently scrapped after, say, four years, it will be fully written off for tax over that period. I believe that this change will be widely welcomed. The benefit to business could rise to about £300 m in the 1990's.

6. I now turn to a group of measures which will be of particular interest to smaller businesses and the self-employed, a sector of the economy where an increasing proportion of the jobs of the future is likely to be found.

7. Over the past five years the ranks of the self-employed have risen from under 2 million when we first took office in 1979 to 2½ million in 1984 - an increase of well over half a million or some 30 per cent. And the growth in self-employment has been a particularly marked feature of the encouraging growth in overall employment that has occurred since the Spring of 1983.

8. But the self-employed suffer from one long-standing grievance so far as tax is concerned. While the National Insurance Contribution paid by an employee cannot be set against tax, the National Insurance Contribution paid by the employer on the employee's behalf can. Yet the National Insurance Contribution paid by the self-employed cannot be set against tax at all.

9. Today I propose to remedy that grievance. As from 6 April, tax relief will be allowed for half the graduated Class 4 National Insurance Contribution paid by the self-employed. In addition, I have agreed with my Right hon Friend the Secretary of State for Social Services that, as from the beginning of October, the flat rate Class 2 National Insurance Contribution payable by the self-employed will be reduced from £4.75 to £3.50 a week. The cost of these changes will be £55 million in 1985-86 and £155 million in a full year.

10. Last year I undertook to review the scope of VAT relief for bad debts, a matter of considerable concern to small businesses who suffer most from this type of default. In the light of legislation now proceeding in another place on the reform of the insolvency law, I propose to widen the scope of the existing relief. The new rules will take effect as soon as the provisions of the Insolvency Bill are implemented and will cost some £25 million in the first full year.

11. Although the Business Expansion Scheme has been in existence only two years it has already made an impressive contribution to the promotion and growth of new businesses. Last year getting on for 20,000 people took advantage of the tax reliefs offered by the Business Expansion Scheme to invest some £100 million in more than 500 companies. Well over half the total investment went to young and very young start up companies.

12. I have two changes to propose. The scheme was designed to encourage investment by individuals in new and expanding businesses in risk areas. Accordingly, I propose to include within the coverage of the scheme companies formed to carry out research and development. However by the same token I propose to exclude from the scheme certain ventures which primarily involve property development. Building and construction will, of course, continue to be a qualifying trade under the Business Expansion Scheme.

13. I have already announced a substantial reform of the Capital Gains Tax. In addition, I propose to implement many of the proposals contained in last year's consultative document on CGT retirement relief, notably to reduce the age for full relief to 60 and to extend relief to those who are obliged by ill-health to retire before that age. This relief is particularly important to the proprietors of small businesses concerned at the capital gains tax they might have to pay when they come to sell their business on retirement.

14. Finally, on the small business front, I propose to increase the VAT registration threshold to £19,500 from midnight tonight.

15. I now turn to a number of other detailed measures affecting business.

16. The number of employee share schemes has increased from 30 when we first took office in 1979 to some 850 today, involving over the whole period shares with an initial value of more than £1 billion. The wholehearted commitment of employees to the success of the companies in which they work is vital to our country's economic future. To maintain and build on this progress I propose to reduce from seven to five years the period after which there is no income tax liability on the value of shares given to employees' under profit sharing schemes.

17. Last year the Inland Revenue issued, on my authority, a consultative document on the taxation of partnerships which contained proposals for tackling the avoidance device to which the Public Accounts Committee drew attention several years ago. Now we must act. I propose that where a partnership ceases and the business is carried on broadly unchanged by a new partnership which may be virtually indistinguishable from the old one, the new partnership will be taxed for the first four years on the profits actually arising in those years.

18. I have one further proposal of importance to a number of businesses. Last year I decided to remove a competitive disadvantage to British manufacturers by levying VAT on imports. I am glad to say that thanks to the hard and effective work put in by Customs in ^{co-operation} ~~consultation~~ with the Port management and trade interests involved, the transition to the new system has not been the painful process many feared. But in response to representations I have decided it would be right to modify the system in two respects.

19. First, I propose to relieve from VAT certain goods which are imported into this country solely for repair, or for processing which does not change their identity, and are then re-exported to their original owners overseas. Second, goods which are temporarily exported from the UK and then reimported after repair or processing abroad, will bear VAT only on the value of the repair or processing. These reliefs will take effect on 1 June and have a once-for-all cost in 1985-86 of £30 million.

20. I have no major new proposals this year on the taxation of North Sea oil. I remain committed to the incentives for new fields introduced by my predecessor in 1983, when I myself was Secretary of State for Energy. They have proved highly effective. Since the 1983 Budget 19 development projects have received approval as compared with 2 in the previous 2 years. I have, as

indicated last year, reviewed incremental investment in existing fields, but I have not been persuaded that there is an economic case for introducing new fiscal reliefs at this stage. My only proposal for change, apart from some minor technical measures, is to remove immediate PRT relief for onshore exploration and appraisal expenditure. Onshore activities are sufficiently low-cost not to need this special incentive.

21. In last year's Budget Statement I mentioned the Government's deep concern at the spread of unitary taxation within the United States, and the threat that this posed to the US subsidiaries of British companies. Since then, I am glad to note that several American States have abolished unitary taxation; but in others, notably California, no change has yet been made. We shall continue to press for action to be taken this year, and fully support the campaign being waged by the CBI and others on this issue.

K. PERSONAL TAXATION: TAXES ON SPENDING

1. I turn now to the taxation of personal income and spending. My Budget last year shifted some of the burden of personal taxation from earnings to spending. Today I propose to make a further move in this direction.

2. Accordingly, I propose to increase the revenue from the excise duties by rather more than is required simply to keep pace with inflation - a less painful task now that inflation is relatively low.

3. I propose to increase the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of sixpence on a package of 20 cigarettes. These changes will take effect from midnight on Thursday. I do not however propose any increase at all in the duties on cigars and pipe tobacco.

4. I propose increases which, including VAT, will put between a penny and twopence a pint on most beer (depending on its strength); a penny a pint on cider, sixpence on a bottle of table wine and about tenpence a bottle on sparkling or fortified wine. In recognition of the current difficulties of the Scotch whisky industry, however, I propose to increase the duty on spirits by only tenpence a bottle, well below the amount needed to keep pace with inflation. All these changes take effect from midnight tonight.

5. I propose to increase the duty on petrol and derv by amounts which, including VAT, will raise the price at the pumps by approximately fourpence and threepence-halfpenny a gallon respectively. This does no more than keep pace with inflation. These increases will take effect from 6 o'clock this evening. As last year, I do not propose any change in the duty on heavy fuel oil.

6. I do propose this year, however, to raise more revenue from the Vehicle Excise Duty. For cars and light vans the duty will go up by £10 to £100, although there will be no increase at all for pre-1947 cars. On the advice of my Rt Hon Friend the Secretary of State for Transport, the pattern of duty on lorries will be changed to correspond more closely to the amount of damage they do to the roads. Accordingly, for 150,000 of the heaviest rigid lorries there will be increases ranging from £30 to £360. But for most lorries the rates will remain unchanged.

7. These changes in the excise duties will, all told, raise an extra £820 million in 1985-86, some £235 million more than is required to keep pace with inflation. The overall impact effect on the RPI of these changes will be one half of one percent. This has already been taken into account in the forecast I have given the House of 5 per cent inflation by the end of the year.

8. I now turn to VAT.

9. I have followed with interest the unprecedented speculation that has built up over recent months about my alleged intentions for VAT. Value Added Tax is of course the biggest single revenue raiser among the indirect taxes, and a major extension of the VAT base, which at present covers little more than half of consumer spending, could finance a significant reduction in income tax as well as removing an obvious economic distortion. Accordingly my Treasury colleagues and I have, over the past 18 months, been reviewing the possibility of extending the VAT base, and indeed I introduced a significant change in this direction in last year's Budget.

10. At the same time, during the course of this review, various candidates have been progressively ruled out on a variety of grounds. I rejected the idea of imposing VAT on books, for example, as far back as January 1984 - well before the current agitation had even begun. It has been suggested that it might have been helpful to the House if I had made a practice of announcing a decision to take no action in a particular direction as soon as each such decision had been taken. But a moment's reflection must make it clear why successive Chancellors have eschewed this course, ever since Mr Gladstone, in 1853, first laid down the doctrine, in these terms:

"If the executive government is, with any advantage to the country, ordinarily to discharge the function of the initiative with respect to finance, it is

absolutely necessary that the strictest silence should be observed, not in contempt of pressure, but yet, notwithstanding all pressure, till the time arrives when the views of the Government can be regularly and comprehensively disclosed."

11. I can, however, now inform the House that the review has been completed, and that, apart from two relatively minor changes I shall be proposing today, I have decided not to make any further autonomous extensions of the VAT base during the lifetime of this Parliament. I am obliged to use the qualification 'autonomous' since, as hon Members will be aware, this is a field in which European Community law has to be reckoned with. But as the House will know, where we are currently under threat, we are vigorously fighting our case.

12. The first change I propose to make concerns newspapers and magazines. At present, while all other advertising is taxed, newspaper and magazine advertising is not. There is no justification for this anomaly. It is one thing to maintain that newspapers and magazines should not be liable to VAT: quite another to argue that those who advertise in them should enjoy a similar immunity. Accordingly, I propose that from 1 May newspaper and magazine advertising should be subject to VAT. This will raise £30 million in 1985-86 and £50 million in a full year.

13. The other change I propose to make concerns credit cards and similar payment cards, a part of the financial sector which has enjoyed exceptional growth over the past few years. From 1 May transactions between the companies providing the cards and the outlets which accept them will be classified as exempt. This means that the companies will not be able to recover VAT in respect of such transactions. This will raise £15 million in 1985-86 and £20 million in a full year. It is not expected to have any direct effect on the charges made to card holders.

14. I also have a modest VAT concession to make. I have decided to extend the existing VAT relief for medical or scientific equipment bought with donated funds for use in hospitals and the like to cover computer equipment for certain medical uses. Customs and Excise will be announcing the precise details of the reliefs, which will take effect from 1 May.

15. Finally, on VAT, there are the recommendations of the Keith Report on the Enforcement Powers of the Revenue Departments. These recommendations, which taken as a whole strike a careful balance between the powers of the Customs and Excise and the protection of the taxpayer, are principally concerned with improving the fairness and efficiency of the administration of VAT. After extensive consultation, draft clauses were published in November, as a basis for further consultations. The substantive

clauses will appear in this year's Finance Bill. Among other things they will contain powers to deal with the problem of the late payment of VAT. This is expected to bring in extra revenue of about £50 million in 1985-86. By 1988-89 there will have been a cumulative once-for-all revenue gain of about £600 million. Proposals on the Inland Revenue aspects of the Keith Report will follow in next year's Finance Bill. I should like to take this opportunity to pay tribute to Lord Keith and his colleagues for their thorough and professional Report and set of recommendations.

16. Taking into account the improved relief for VAT on bad debts and the new relief for VAT on temporary imports, the overall effect of the VAT changes I have proposed will be to increase the yield of the tax by £60 million in 1985-86 rising eventually to £190 million in a full year. They will have no impact on the RPI. The additional revenue raised from the Excise Duties and VAT taken together with help me to lighten to some extent the burden of income tax.

L. PERSONAL TAXATION: INCOME TAX

1. But before turning to income tax, I should briefly mention Capital Transfer Tax. Since 1979 the burden of this tax has been very greatly reduced, and I propose to maintain that position this year by raising the threshold and rate bands set last year in line with statutory indexation. In addition, I propose to widen the scope of the existing CTT exemption for amenity land surrounding a house of outstanding heritage quality. I am sure that this will be welcomed by all those concerned with the preservation of our national heritage.

2. I now turn to income tax.

3. As I announced last year, on 6 April the banks move over to the composite rate system for the payment of tax on bank interest. I now need to legislate to put the corresponding building society composite tax payment dates on broadly the same footing, as from April 1986. Contrary to press rumours, this will not produce additional revenue. As an administrative saving, I also propose to legislate this year to bring new loans above the mortgage interest relief ceiling into the MIRAS system by April 1987. The ceiling itself will remain at £30,000 for 1985-86.

4. I need to set the 1986-87 car benefit scales for those whose employers provide them with the use of a car. As last year, I propose to increase both the car and fuel scales by 10 per cent with effect from April 1986. This will still leave the scale levels well short of the true value of the benefit.

5. There has been some discussion of late about the tax treatment of charities. It has been our consistent policy over the past five years to focus relief rather on the act of giving to charity. In accordance with this principle I now propose to increase from £5,000 to £10,000 the limit to which relief at the higher rates of tax is allowed to individuals for covenants to charities.

6. I now turn to my main income tax proposals.

7. I propose to make no change this year in the rates of income tax. As last year, I believe it is right to concentrate most of the limited resources at my disposal on raising the starting point for tax. Increases in the basic tax thresholds benefit all taxpayers, but they give proportionately more help to those on smaller incomes - and right at the bottom end of the scale take a significant number of people out tax altogether. Low tax thresholds discourage young people from starting work and are a major cause of the poverty and unemployment traps. A budget for jobs and for enterprise has to give high priority to raising the tax thresholds.

8. The statutory indexation formula means that I should increase all the principal income tax allowances and bands by 4.6 per cent, the increase in the Retail Price Index over the year to last December, rounded up. For the higher rate threshold and bands I propose this year ⁴⁷ to do just that. The first higher rate of 40 per cent will be reached at a taxable income of £16,200 and the top rate of 60 per cent will apply to taxable income above £40,200.

9. For the basic thresholds I can do more. Statutory indexation would imply an increase in the single person's allowance of £100. I propose to increase it by precisely twice as much - £200 - from £2,005 to £2,205. Statutory indexation would imply an increase in the married man's allowance of £150. Again, I propose to raise it by precisely twice as much - £300 - from £3,155 to £3,455

10. I propose to increase the age allowances this year by the same cash amount as the corresponding basic allowances. Thus the single age allowance will rise by £200 from £2,490 to £2,690 and the married age allowance will go up by £300 from £3,955 to £4,255.

11. These increases mean that most single people will enjoy an income tax cut of at least £1.15 a week and most married couples an income tax cut of at least £1.73 a week. Some 800,000 people on low incomes - 100,000 of them widows - will be taken out of tax altogether. That

is almost twice as many as would have been taken out of tax had the allowances merely been indexed.

12. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May. Their cost is considerable: £1.6 billion in 1985-86, of which roughly half represents the cost of indexation.

13. The increase in the basic allowances of almost 10 per cent, or some 5 per cent in real terms, means that for 1985-86 they will be over 20 per cent higher in real terms than they were in 1978-79, Labour's last year.

M. NATIONAL INSURANCE CONTRIBUTIONS

1. I have one last announcement to make. As the House will recall, I made the usual announcement about the level of National Insurance contributions for 1985-86 in my Autumn Statement. However, in collaboration with my Rt. Hon. Friend the Secretary of State for Social Services, I have now concluded that the structure of National Insurance contributions should be radically changed in order to encourage the creation of jobs where the problem of unemployment is most severe -among the unskilled and the low paid.

2. I do not need to remind the House of the importance of National Insurance contributions, especially for the lower paid. For many it is a much more significant burden than income tax. Indeed a married man pays more in National Insurance contributions than he does in income tax, at earnings up to £87 a week.

3. The major criticism of the present system is the lower earnings limit - the level of earnings below which no contributions are payable. This acts as a distortion and a disincentive for employer and employees alike.

4. Above the lower earnings limit, both employers and employees immediately become liable to full Class 1 rates on total earnings. For 1985-86 these rates have been set at 10.45 per cent for employers and 9 per cent for

employees on earnings above the present lower earnings limit of £35.50. So the employee earning £35 a week pays no National Insurance contributions at all, and neither does the employer; while someone on £36 faces contributions of £3.24 a week and there is a further £3.70 charge on his employer.

5. This abrupt entry into full National Insurance contribution liability is a real disincentive to the employee to work, and to the employer to take people on, at low levels of pay.

6. Some have argued that I should correct this by raising the lower earnings limit substantially. This would be a mistake. It would create an even sharper and more abrupt entry to full liability at a higher level of earnings at which it would affect more people. Others have suggested turning the lower earnings limit into an allowance and financing the considerable cost of doing so by raising the main NIC rates. That too would be a mistake as it would have substantial adverse effects on incentives across a wide band of earnings.

7. But I fully accept that this discouragement of employment of the lower paid must be ended. I have proposals to make under two heads: on the employer's contribution and on the employee's.

8. First, on the employer's contribution, I propose to replace the present uniform rate of 10.45 per cent by standard rates. The LEL will be kept unchanged, and then the new contribution rates will apply to total earnings as at present. But a new lower rate of 5 per cent will be introduced for workers earning between the LEL and £55 a week. This rate will rise to 7 per cent for those earning between £55 and £90 a week, and to 9 per cent for those earning between £90 and £130 a week. The present rate of 10.45 per cent will be paid only where earnings exceed £130 a week.

9. But I have to find the money to finance this reform. I therefore propose to remove the upper earnings limit so far as the employer's contribution is concerned. This means that the full employer's rate of 10.45 per cent will become payable on all earnings above £130 a week, and not just those up to £265 a week.

10. Secondly, on the employee's contributions. I propose to introduce similar graduated rates for these contributions too. Above the LEL which, as for employers will remain unchanged, the new reduced rate will thus be 5 per cent for those earning up to £55 a week, and 7 per cent for those between £55 and £90 a week. For those above £90 a week, and up to the UEL, the present 9 per cent rate will apply.

11. I have not thought it right to abolish the upper earnings limit for employees. Whereas for employers, the UEL merely acts to reduce the relative cost of employing those earning above the limit as compared with those earning below it, for the employee, quite apart from the relevance of the UEL for benefit entitlement, to abolish it would mean the emergence of excessive combined marginal rates of tax and NICs for those on the higher rates of income tax.

12. As I have already indicated, I propose also to make a corresponding reduction in the contributions paid by the self-employed. The flat rate Class 2 contributions will be reduced from £4.75 to £3.50 a week. This change is, of course, in addition to the introduction of tax relief on the Class 4 contributions by the self-employed which I announced earlier.

13. For 1985-86 the changes I am proposing will cost a total of £160 million, made up of £30 million less in employers' contributions, £100 million less in employees' contributions and £30 million less in contributions from the self-employed. The comparable figures for a full year are £80 million, £270 million and £100 million respectively.

14. Legislation to give effect to this radical restructuring of National Insurance contributions will be included in the Social Security Bill now before

Parliament, and I expect the new rate to take effect from the beginning of October. I should make it clear that these changes are not intended to affect anyone's benefit entitlement, nor will they affect the arrangements for the contracted-out rebate. [New rules will be introduced to protect benefit rights.]

15. The restructuring will significantly improve the flexibility of the labour market and the prospects for jobs. It will bring about a substantial reduction in the cost of employing the low paid and sharpen their incentives.

16. This reform will reduced the cost of employing somebody with earnings just below £90 a week by about £3.10 a week. The distortion in favour of employing the higher paid will be removed. The total reduction in the cost of employing the 8½ million workers with earnings of less than £130 a week will be nearly £900 million in a full year. And at a cost of a further £270 million in a full year, National Insurance contributions will be reduced for some 3½ million workers with earnings of up to £90 a week. This benefit will, of course, be combined with that from the substantial increase in thresholds I have already announced. A married man with earnings of just below £90 will gain about £1.80 a week from the NIC change in addition to the £1.73 a week from the increase in thresholds.

17. The reduction in the total tax "take" -by which I mean tax and both employers' and employees' National Insurance contributions - is even more dramatic. At £50 a week it is cut in half and at £80 a week the reduction is still a drop of close to 30 per cent.

18. These are changes of a very major order. They are a direct and powerful attack on disincentives to employment. They will attack the problem of unemployment where it is most acute, at the point at which many of our young people first enter the workforce.

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FROM: MRS R LOMAX

DATE: 15 March 1985



cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr Cassell
Mr Monck
Mr Evans
Mr Scholar
Mr Odling-Smee
Mr Riley
PS/IR
PS/C&E

MR PRATT

FSBR

The Chancellor has seen the third draft of the FSBR, forwarded under cover of your minute of 13 March.

2. He has no comments on part 1.
3. On part 2 he would like to see the following changes:-

Paragraph 2.05 He prefers the alternative wording suggested in the margin ("as a form of savings"); in the final line the wording agreed with the Governor reads "has somewhat diminished".

Paragraph 2.07 First sentence should read "the sterling exchange rate index".

Paragraph 2.15 Redraft the first sentence "the PSBR for 1985-86 is forecast to be £7 billion, or 2 per cent of GDP, the figure indicated in last year's MTFS."

Paragraph 2.20 Final sentence: This is subject to correspondence with Mr Walker.

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Paragraph 2.24 Redraft the second sentence as follows "But the Government is committed to maintain the progress to lower inflation in the medium term secured by the steady decline in monetary growth which is at the heart of the MTFs,...."

Annex. Paragraph 2a.1 The Chancellor has asked why the total for 1988-89 in line 16 is not + $\frac{1}{2}$?

4. His comments on part 3 are as follows:-

Paragraph 3.02 Redraft the final sentence as follows "With the labour force growing quite rapidly the number of those claiming unemployment benefit has continued to increase."

Paragraph 3.13 line 3 Replace "low" by "lower".

Paragraph 3.22 line 5 Insert "import of" before "basic materials fell".

Paragraph 3.33 He thinks something has gone wrong with the second sentence.

Paragraph 3.37 Redraft first sentence "Latest estimates suggests that growth of GDP was about 2 $\frac{1}{2}$ per cent in 1984".

Paragraph 3.38 penultimate line "business" should read "businesses" (at end of line)

Paragraph 3.53 The end of the penultimate sentence should read "but below that of the 1960s".

5. He has one query of part 4, arising from paragraph 4.29. He reads this to imply that the employers' UEL is retained for contracted-out employers. He would be grateful for urgent advice.

6. Comments on part 5 are as follows:-

Table 5.1 The Chancellor would like to delete the line entitled "Special employment measures" and put the figures along side it against the title "Budget measures".

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7. Subject to these comments he is content.

P.wo.

MRS R LOMAX

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FROM: MRS R LOMAX

DATE: 16 March 1985

BUDGET

MR BATTISHILL

Whole Speech (Sections A-M)(BLO)

- cc Chief Secretary
- Financial Secretary
- Minister of State
- Economic Secretary
- Sir P Middleton
- Mr Bailey
- Sir T Burns
- Mr Littler
- Mr A Wilson
- Mr Anson
- Mr Byatt
- Mr Cassell
- Mr Kemp
- *Mr Monck
- Mr Unwin
- *Mr Monger
- Mr Odling-Smee
- Mr Culpin
- *Mr Folger
- Mr Pratt
- Mr Cropper
- Mr Lord
- Mr H Davies
- *PS/IR
- Sir L Airey - IR
- Mr Isaac - IR
- Mr Green - IR
- *PS/C&E
- Mr Fraser - C&E
- Mr Knox - C&E

SECRET

B.L.O.

Part of Speech only (Budget Secret)

- *Mr Evans (Sections B,E,F)
- *Mr Lankester (Sections C,D,E)
- *Mr Lavelle (Sections B,D)
- *Mr Scholar (Sections F,G)
- *Miss Peirson (Sections E,F)
- Mr Peretz (Sections C,D)
- *Ms Seammen (Section M)
- *Mr Shields (Section B)
- *Mr Mercer (Section G)
- *Mr Riley (Sections C,D,E)

BUDGET SPEECH 8TH DRAFT

I attach, for most recipients, a provisional final draft of the complete Budget Speech. Would those copy recipients marked with an asterisk (*) please double check their sections of the speech for factual accuracy. Last minute comments should reach this office by lunch-time on Monday 18 March.

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MRS R LOMAX

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A. INTRODUCTION

1. In last year's Budget Statement I set the course for this Parliament.

2. Today I reaffirm the Government's determination to hold to that course, the purpose of which is nothing less than the defeat of inflation. We have not wavered from that purpose. Nor will we.

3. But the defeat of inflation, essential though it is, is not enough. We must also do what we can to combat the scourge of unemployment. Nor is there any conflict between these two objectives.

4. So my Budget today has two themes: to continue the drive against inflation and to help create the conditions for more jobs.

5. I shall begin by reviewing the economic background to the Budget. I shall then deal with the Medium-Term Financial Strategy, with monetary policy, and with the fiscal prospect, both this year and next. I shall then turn to the Government's strategy for jobs, and the measures to implement that strategy. These will involve action on a number of fronts, including both tax reduction and tax reform.

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6. As usual, a number of press releases filling out the details of my tax proposals will be available from the Vote Office as soon as I have sat down.

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B. THE ECONOMIC BACKGROUND

I start with the economic background.

2. Once again we can look back on a year of steady growth and low inflation. During 1984 as a whole, inflation remained at around 5 per cent. Output grew by a further 2½ per cent, with investment up by 6 per cent and non-oil exports by 9 per cent, to reach all-time record levels in each case.

3. Manufacturing industry recovered particularly strongly, with output up by 3½ per cent - the biggest rise in any single year since 1973 - exports up by 10 per cent and investment by 13 per cent. The current account of the balance of payments has remained in surplus, for the fifth successive year. By international standards, too, the economy has performed well. Our growth was above, and our inflation below, the European Community average.

4. Moreover, this progress has been achieved in the teeth of the coal strike, for which, in the short term, the nation has had to pay a heavy price. In the current financial year the coal strike has reduced the level of national output by over 1¼ per cent and worsened the balance of payments by some £4 billion. It has increased public expenditure by £2½ billion and public sector

borrowing by £2 $\frac{3}{4}$ billion. It has meant a lower exchange rate and higher interest rates. It has cost us confidence abroad and jobs at home.

5. But the costs, both economic and constitutional, of submitting to this strike would have been infinitely greater than the costs that have been incurred in successfully resisting it.

6. And it is a remarkable tribute to the underlying strength of the British economy that it has been able to withstand so long and damaging a strike in such good shape.

7. Looking ahead, we are now about to embark on what will be the fifth successive year of steady growth, with output in 1985 as a whole set to rise by a further 3 $\frac{1}{2}$ per cent. Inflation may edge up for a time, perhaps to 6 per cent by the middle of the year, but should then fall back to 5 per cent by the end of the year and lower still in 1986.

8. While there can be no disputing the strength and durability of the economic upswing, there is equally no disputing the fact that it is marred by an unacceptably high level of unemployment. And this despite the fact that the latest figures suggest that employment has risen by half a million over the past two years, with a further increase likely over the year ahead. I shall have more

to say about the prospects for jobs, and the ways in which the Government can help to improve them, later in my speech.

9. If at home the past year has been overshadowed by the coal strike, internationally it has been dominated by the relentless rise of the dollar. To finance its massive budget deficit the United States is importing a large part of the rest of the world's savings and exporting some of its own inflation.

10. This year, for the first time since the first world war, the United States is likely to become a net debtor, and could quite soon become the world's largest debtor. The counterpart of this massive capital inflow is a huge and growing current account deficit and a manifestly overvalued dollar, which in turn is daily adding strength to the protectionist lobbies within the United States.

11. There has been no precedent for the prolonged surge in the dollar which has dominated the financial world over the past year - a rise of some 30 per cent against all the major European currencies from what many considered an already overvalued base.

12. This is not a sustainable state of affairs. As Federal Reserve Chairman Paul Volcker last month testified to Congress, the United States is living on borrowed money and borrowed time. But meanwhile it is not only America that is paying the interest.

13. All this has led to one of the most turbulent years in the financial markets within living memory. It has been, and will continue to be, a time for strong nerves and sound policies.

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C. THE MEDIUM-TERM FINANCIAL STRATEGY

We have already shown that we are not afraid to take action, however unpopular, to keep the Medium-Term Financial Strategy on course in an unpredictable and uncertain world.

2. That strategy was first launched five years ago next week. Its opening words were these:

"The Government's objectives for the medium term are to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment."

3. We have achieved those objectives to a greater degree than almost any commentator dared to forecast at the time. And our commitment to them remains as great today as it was five years ago. So too is our commitment to the strategy as the means of achieving those objectives.

4. The Medium-Term Financial Strategy is designed to ensure a reasonable growth of demand in money terms -and indeed has succeeded in doing so.

5. We are determined to maintain steady downward pressure on inflation. It is not in the gift of any

Government to eliminate short-term fluctuations along the way, but the underlying direction has to be downwards. It is this concern which governs the desirable growth of total spending power in the economy, as measured by money GDP.

6. The great mistake of postwar demand management, which still has some devotees today, was to react to rising unemployment by injecting more money into the system, whether through the Budget or through the banks. So far from halting the upward trend of unemployment, this simply generated runaway inflation.

7. That course we will not follow.

8. A policy for demand expressed unambiguously in terms of money provides a further important advantage. For it ensures that wage restraint really will provide more jobs. I repeat today the undertaking I gave the National Economic Development Council last month: the Medium-Term Financial Strategy is as firm a guarantee against inadequate money demand as it is against excessive money demand.

D. MONETARY POLICY AND THE EXCHANGE RATE

Within the MTFs, the central role is played by monetary policy, since it is by controlling the growth of money in the economy that the Government is able to influence the growth of money demand.

2. Last year I set target ranges of 4-8 per cent for narrow money and 6-10 per cent for broad money. Over the twelve months to mid-February, the targeted measure of narrow money grew at around the middle of its range, and that of broad money at just below the top of its range.

3. For next year I shall be retaining the same two target aggregates. I attach equal importance to both. The target ranges for 1985-86 will be those indicated in last year's MTFs - that is to say, a reduction in monetary growth of 1 per cent in each case.

4. There are those who argue that if we stick to sound internal policies the exchange rate can be left to take care of itself. But significant movements in the exchange rate, whatever their cause, can have a short-term impact on the general price level and on inflationary expectations. This process can acquire a momentum of its own, making sound internal policies harder to implement. Benign neglect is not an option.

5. That is why I have repeatedly argued that it is necessary to take the exchange rate into account in judging monetary conditions. There is no mechanical formula which enables us to balance the appropriate combination of the exchange rate and domestic monetary growth needed to keep financial policy on track. But a balance still has to be struck, and struck in a way that takes no chances with inflation.

6. For there should be no doubt about the Government's commitment to maintain monetary conditions that will continue to bring down inflation. Short-term interest rates will be held at the level needed to achieve this.

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E. PUBLIC SECTOR BORROWING

While monetary policy is at the heart of the Medium-Term Financial Strategy, it needs to be buttressed by an appropriate fiscal policy.

2. The outturn for the Public Sector Borrowing Requirement for 1983-84 was £9½ billion, or 3¼ per cent of GDP. In my Budget last year I planned to reduce it substantially in 1984-85 to £7¼ billion, or 2¼ per cent of GDP. In the event, this year's PSBR looks like turning out at £10½ billion, or 3¼ per cent of GDP - the same proportion as in each of the three previous years.

3. All but £½ billion of this substantial overrun is directly attributable to the cost of the coal strike. I believe it was right to meet the large but once-for-all cost of keeping the economy going throughout the coal strike by borrowing, thus in effect spreading the cost over a number of years. But it is now necessary to return to the path I outlined last year.

4. That means that the PSBR for the coming year, 1985-86, will be set at £7 billion, equivalent to 2 per cent of GDP. As this year, some £3 billion will be financed through National Savings.

5. I have been urged by some to provide for a still lower borrowing requirement in order to impress the financial markets. Others have argued that the present high level of interest rates would justify a more relaxed fiscal stance.

6. There is nothing sacrosanct about the precise mix of monetary and fiscal policies required to meet the objectives of the Medium-Term Financial Strategy. But this is not the year to make adjustments in either direction. The wisest course is to stick to our preannounced path.

7. This means that, for the coming year, a substantial reduction in the PSBR must take precedence over our objectives for reducing the burden of tax.

F. PUBLIC EXPENDITURE

As the House is aware, the Government's economic strategy is founded on twin pillars: a monetary policy designed to bring down inflation and a supply side policy designed to improve the competitive performance of the economy.

2. The supply side policy is rooted in a profound conviction, itself born of practical experience both at home and overseas, that the way to improve economic performance and create more jobs is to encourage enterprise, efficiency and flexibility; to promote competition, deregulation and free markets; to press ahead with privatisation and to improve incentives.

3. The argument over which will have a bigger impact on demand, increased public expenditure or lower taxation, completely misses the point. The case for lower taxation rests on supply side policy: lower taxes will help to enhance incentives, eliminate distortions, improve the use of resources and heighten the spirit of enterprise.

4. But given the need to ensure that the Budget deficit is of a size that can and will be soundly financed, lower taxes can only be achieved by maintaining the firmest possible control of public expenditure.

5. Controlling public expenditure is one of the most difficult tasks facing any democratic government in the modern world. Public expenditure acquires its own momentum and creates its own vested interests. To control it requires constant vigilance, and a determination to succeed despite the inevitable setbacks. We have that determination, and have succeeded in bringing the growth of public spending below that of the economy as a whole. This achievement has required difficult decisions in successive public expenditure reviews.

6. But there is no benefit to sound economic management or effective control from sticking to public expenditure figures which subsequent events have made unattainable.

7. The Budget is the right time to reassess the prospects for revenue, spending, and borrowing. As my Rt. Hon. and learned Friend the Chief Secretary made plain in the recent debate on the Public Expenditure White Paper, any such reassessment must take account of changes in the economic scene since the Public Expenditure Review in the autumn. Of these, the single most important factor has been the coal strike, whose public expenditure cost in 1984-85 is estimated at some £2½ billion - about £1 billion more than allowed for in the Autumn Statement and the Public Expenditure White Paper which explicitly assumed that the strike would end at Christmas. There will also be some further cost in 1985-86.

8. I now estimate that this year's public expenditure planning total will be exceeded by nearly £3½ billion, of which over two-thirds is attributable to the coal strike. But quite apart from the coal strike, the upward pressures on public spending remain intense, not least from increased take-up of social security benefits and further local authority overspending. In addition, since the White Paper was prepared, we have had to accommodate the effects of higher interest rates and a lower exchange rate.

9. In the light of the revised estimate of the outturn for the current year and the pressures to which I have referred, I have reassessed the adequacy of the Reserves for 1985-86, 1986-87 and 1987-88 provided in the January White Paper. In order to provide a more realistic basis on which to plan and control the level of public spending, I have judged it prudent to add £2 billion to the Reserve and thus to the White Paper planning totals for each of the three years. At the same time, I have further increased the estimate for debt interest in each year.

10. These increases in the size of the Reserve mean that the planning totals for the next three years are now higher by about 1½ per cent. But let there be no misunderstanding. The new totals still represent a tough target. No cash has been allocated to individual programmes. Calls on the Reserve will still be judged on

the strictest criteria. There is no slackening in our determination to curb the size of the public sector.

11. Public expenditure will continue to fall as a proportion of GDP, as it has, the coal strike apart, since 1981-82. Expenditure is planned to stay broadly flat in real terms at about this year's level, excluding the costs of the coal strike. To achieve even these new figures, future Public Expenditure Surveys will have to be at least as tough as their predecessors; and there can be no let-up in the tight control of individual spending programmes within the cash limits set for the coming year.

12. On the other side of the public accounts, tax receipts, too, are now expected to be higher, partly for related reasons. But not by as much. The scope I have for tax cuts this year is therefore only half the amount I indicated might be available in my Statement to the House in November. In other words, the measures I shall shortly announce will, after indexation, contribute some £½ billion net to the £7 billion borrowing requirement I have set for 1985-86.

G1. THE STRATEGY FOR JOBS

In determining the nature of those measures, within the overall anti-inflationary framework I have just described, I have had one overriding object in mind. This must be a Budget for jobs.

2. But it is important to be clear what this means. Jobs are created by firms that are profitable, competitive, efficient and well-managed. And this in turn requires a workforce with the right skills, one that is adaptable, reliable, motivated and prepared to work at wages that employers can afford to pay.

3. The extent to which Government - let alone a single Budget - can bring about these conditions is clearly limited. We cannot instantaneously inculcate the spirit of enterprise by an Act of Parliament, or abolish trade union obstructiveness overnight simply by adding a few more pages to the Statute Book.

4. We cannot even legislate to prevent workers from pricing themselves out of jobs - although previous administrations have tried, with uniformly dismal results. Last year, despite a further encouraging growth in productivity, wage costs per unit of manufacturing output rose by some 4 per cent. In the United States,

Germany and Japan, unit wage costs actually fell. This is bad for our competitiveness and bad for jobs. Too much of the benefit of economic growth is currently being enjoyed in higher living standards for those in work: too little in the form of better job prospects for those out of work. In a free society, the remedy lies in the hands of those responsible for collective bargaining throughout the economy.

5. But limited though the role of Government is, it remains an important one. To prepare the soil in which enterprise can best flourish. To remove impediments to the proper functioning of markets in general and the labour market in particular. To correct the deficiencies in our education and training that make it hard for industry - and individuals - to change technological gear. To construct a pattern of taxation that does least damage to incentives; and in particular does least to deter the unemployed from seeking work and business from taking them on.

6. We have made progress on all these fronts. Inevitably, it takes time for the effects to come through. That is not surprising: patterns of behaviour acquired over decades cannot be changed overnight. And there is much still to be done.

7. But there is no short cut. If it were possible to create jobs simply by boosting Government borrowing and

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Government spending there would be no unemployment in the world today, for nothing is easier for a Government than to borrow and spend. Impatience is a bad counsellor.

8. In setting macro-economic policy for the year ahead I have had one object in mind: the continuing reduction of inflation.

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9. Equally, in deciding my individual Budget proposals within that overall framework, I have sought throughout to make those changes that will do most to promote enterprise and employment.

10. Our attack on the evil of unemployment is clear, coherent and strong. The measures I shall announce today represent further steps along the road we have been taking since 1979. They will help us to ensure that more new jobs are created and that they will be jobs that last.

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G2: EMPLOYMENT AND TRAINING MEASURES

1. Among our problems in this country is our failure to prepare our school-leavers adequately for work. Since it was first launched in 1983, the Youth Training Scheme has proved to be a very successful bridge between school and work. It has also helped to make young people's pay expectations more realistic. But too many trainees are still reluctant to accept rates of pay which reflect their inexperience. And too many employers still fail to recognise that training is an investment in their own commercial interest. This is in marked contrast to our major competitors overseas.

2. The Government has therefore decided to promote a major expansion of the Youth Training Scheme. Provided employers contribute a major share of the cost, the Government is prepared to provide further funds, to launch this expansion, over and above the existing £800 million a year of public expenditure on the YTS. The object is eventually to provide all 16 or 17 year olds who do not continue in full-time education with the offer of job-related training leading to a recognised qualification. The scheme would offer places lasting two years for 16 year olds and one year for 17 year old school-leavers.

3. The main aim of the scheme is a better qualified workforce. But it would also be a major step towards our objective of ensuring that every youngster under the age of 18 will either be in full-time education, in a job or receiving training, with unemployment no longer an option. But first we have to get this ambitious new scheme in place. It will require the co-operation of employers, trade unions and school leavers, which I am sure they will wish to give.

4. The existing YTS provides foundation training and preparation for work. The expanded scheme will also involve occupational training for both the employed and the unemployed and will aim to meet industry's need for skilled and motivated employees. In the long run, we expect employers to meet the full cost, as those in other countries do. But I recognise that such a major change in attitudes may take time. I am therefore prepared to set aside a fixed sum in public funds to launch the new scheme and get it moving in the right direction.

5. My Rt Hon Friend the Secretary of State for Employment will be arranging consultations through the Manpower Services Commission about the quality of the training, the share of the cost to be borne by employers, and the level of trainee allowances. Our aim is that these consultations should be completed by the end of June so that the two-year scheme will be in place for 16 year olds leaving school this year. Provided the

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outcome is satisfactory, I have undertaken to increase the Department of Employment's programme by £125 million in 1986-87 and £300 million in 1987-88. This expenditure will be partly offset by savings in social security payments and the ending of the Young Workers Scheme which will close for applications at the end of March 1986.

6. To prepare young people for the world of work, it is also important to improve the quality of relevant teaching in schools. I am therefore providing the MSC with an additional £20 million in 1986-87 to finance a programme of appropriate in-service teacher training courses.

7. As well as inadequate basic training, our output of graduates in high technology disciplines has not been keeping pace with the expanding needs of industry. My Rt Hon Friend the Secretary of State for Education and Science will therefore be announcing later today a special programme, costing around £40 million over the next three years, to provide additional places in engineering and technology at selected higher education institutions. In this case the cost will be met from within existing public expenditure programmes.

8. While school-leavers are catered for by the Youth Training Scheme, there remains the problem of the long-term unemployed genuinely seeking work. Under the Community Programme, local authorities and voluntary bodies provide temporary work for the long-term

unemployed on projects of community benefit. This scheme, which at present provides 130,000 places, has proved its worth, with a significant proportion of those who leave it going on to other jobs.

9. I have therefore agreed to make funds available to provide an additional 100,000 Community Programme places by June 1986. These places will be for 18 and 24 year olds who have been unemployed for six months or more, and others who have been unemployed for over a year. The Department of Employment's programme will be further increased by £140 million in 1985-86 and £460 million in 1986-87 to accommodate this.

10. To an even greater extent than with the Youth Training Scheme, the net public expenditure cost will be substantially less than the gross cost because of savings on social security benefits. The net addition to public expenditure as a result of all the proposals I have announced today will be £75 million in 1985-86, £300 million in 1986-87, and £400 million in 1987-88.

11. In addition to the measures I have just described, we need to take further steps to remove legal impediments to the effective functioning of the labour market. However well intentioned, these impediments can only lead to fewer jobs. Accordingly, my Rt Hon Friend the Secretary of State for Employment will be extending to all employers the provisions on unfair dismissal which

currently ~~apply to small firms~~. The qualifying period for unfair dismissal claims will thus become two years for all new employees. This is a reasonable period of time and should lessen the reluctance of some employers to take on new people.

12. In addition, my Rt Hon Friend will be issuing a consultative document about the future of the Wages Councils later this week. The main effect of Wages Councils is to destroy jobs by making it illegal for employers to offer work at wages they can afford and which people are prepared to accept. The losers include many small firms, and young people looking for their first job. The document will cover a number of proposals for radical change, including complete abolition.

13. My Rt. Hon. Friends the Secretaries of State for Employment and for Education and Science will be issuing press notices later today giving further details of these measures.

H TAX REFORM

I now turn to taxation.

2. This Budget carries forward the theme of tax reform I set out last year. Reform designed to make life a little simpler for the taxpayer. And above all reform designed to improve our economic performance over the longer term, on which the jobs of the future will depend.

3. In my Budget last year I announced a radical reform of the Corporation Tax system. This had been preceded by the Green Paper on Corporation Tax issued by my predecessor in 1982.

4. I am satisfied that the right way to proceed with major tax reform is to issue a Green Paper first, as a basis for full and informed discussion, followed by legislation when the results of that discussion have been fully digested.

5. I therefore propose to issue a Green Paper later this year on the reform of personal income tax.

6. The computerisation of PAYE makes this the right time to review the system of personal taxation. The work is well under way and should be complete by

1989. The Green Paper will therefore discuss a range of options opened up by computerisation, from non-cumulation to closer integration between the tax and benefit systems, and including in particular restructuring the system of personal allowances.

7. It is the Government's firm policy to reduce the burden of income tax. But we need to make sure that the reliefs we can afford are concentrated where they will do most good.

8. The present structure of personal income tax is far from satisfactory. Too many young people start paying tax at too low a level. And too many families find themselves in the poverty and unemployment traps. The system discriminates against the family in which the wife stays at home to look after the children. It denies to the partners in a marriage the full opportunity for independence and privacy which they have a right to expect in their tax affairs.

9. There is therefore a strong case for changing to a new system of personal allowances more suited to today's economic and social needs. Under this, everyone, man or woman, married or single, would have the same standard allowance. But if either one of a married couple was unable to make full use of their allowance the unused portion could be transferred, if they so wished, to their partner.

10. This reform would produce a more logical and straightforward system. It would open the way for a significant rise in tax thresholds for families where the wife works in the home, where the problems of the poverty and unemployment traps are most pronounced. It would also enable us to give a greater incentive for young people to seek work.

11. Under this system, far more people could be taken out of the poverty and unemployment traps, and indeed taken out of tax altogether, for a given sum of overall tax relief than is possible under the present system. It would end the present discrimination against the family where the wife feels it right to stay at home rather than go out to work, which increasingly nowadays means discrimination against the family with young children.

12. It would give every married woman the opportunity for privacy in her tax affairs. Her personal allowance would be her own unless she chose to transfer any unused balance to her husband. Husbands and wives would each be taxed separately on their own income irrespective of the income of the other. The whole business of aggregating a wife's earned income and investment income with her husband's income for tax would end, thus removing an increasingly widely-felt grievance.

13. The Green Paper will set out full details of the proposals I have just outlined, as a basis for public

discussion. With legislation in 1987, a system on these lines could be fully implemented by April 1990.

14. There is also a case for changing the tax treatment of pension funds, as part of a thorough-going reform of the tax treatment of personal savings generally. Any fundamental reform of this kind would also, in the same way, need to be preceded by the publication of a Green Paper.

15. The House will, I am sure, be interested to learn that I have no such Green Paper in mind.

16. Nor, indeed, despite the unparalleled spate of pre-Budget agitation do any of the detailed proposals in my Budget affect the tax-deductibility of pension fund contributions, the tax-free nature of pension fund income and capital gains, or the anomalous but much-loved tax-free lump sum.

17. Meanwhile, I have a number of other important proposals for tax reform to announce today, which will both simplify the system and encourage enterprise.

18. First, Capital Gains Tax. Last year I was unable to do anything about the acknowledged defects of this tax, notably its combination of unfairness and complexity, and undertook to come back to it this year.

19. This I now do.

20. I have decided that the right way to reform Capital Gains Tax is to build on the important change made by my predecessor three years ago, when he introduced the 1982 indexation relief.

21. That relief, valuable though it is, and increasingly valuable as it will become, suffers from three serious limitations.

22. First, indexation does not cover the first 12 months of the ownership of an asset. This provision was introduced to discourage the short term conversion of income into capital. But it has made the tax very much more complicated for the taxpayer. I am now in a position to remedy this defect. Hon members will recall that I announced last month measures to put an end to the practice known as bondwashing, the principal device for converting income into less heavily taxed capital gains. Having done that, I propose to abolish the 12 month rule. So far as most disposals are concerned, this will take effect from 6 April. In the case of certain fixed interest securities, however, the rule will need to remain in being until the anti-bondwashing provisions take effect on 28 February 1986.

23. Second, the indexation does not at present extend to losses. I propose to remove this restriction.

24. Third, the present indexation provision unfairly discriminates against those who acquired their assets prior to 1982. For them the allowance is based not on the 1982 value of the asset but on its original cost. I now propose to remedy this injustice. The indexation allowance will henceforth be based on March 1982 values. Capital gains made prior to 1982 will still not be indexed, of course; but at least all purely inflationary gains made since that date will now be free of tax, irrespective of when the asset was acquired.

25. This three-pronged reform of Capital Gains Tax will produce a fairer tax, make life simpler for the taxpayer, help the efficient working of the capital markets, relieve the burden on family businesses and encourage risk-taking and enterprise. Combined with the statutory indexation of the exempt amount, which will rise in 1985-86 to £5,900, these changes will remove some 15,000 taxpayers from liability altogether. Increasingly the tax will be levied on real and not inflationary gains. With these reforms, I believe the tax is now on a broadly acceptable and sustainable basis.

26. The combined cost of the threefold reform I have announced is £155 million in a full year; but none of it falls in 1985-86.

27. I turn next to the stamp duties.

28. Following widespread consultation, I have decided that the time has come to simplify and modernise these ancient duties. I propose in this Budget to sweep away 15 separate duties, including the contract note duty and the 1 per cent duty on gifts. Altogether, the changes I am proposing should reduce by over 40 per cent the number of documents which require to be stamped.

29. My final proposal for reform concerns Development Land Tax.

30. This is a particularly complex tax, which was introduced in response to the problem of soaring land values at a time of high inflation. Its chief practical effect is to discourage the bringing forward of land for development. This disincentive effect will grow as the gap widens between the 60 per cent rate of DLT and a Corporation Tax rate which is on the way down to 35 per cent.

31. I have therefore decided to abolish Development Land Tax altogether, with immediate effect. At the same time I propose to cancel all deferred charges under the tax. The net cost will be some £20 million in 1985-86 and £50 million in a full year. This compares, incidentally, with a collection cost for DLT of some £5 million a year. Development gains will of course continue to be subject

to income tax, Corporation Tax and Capital Gains Tax, in the same way as any other income or capital gains.

32. The abolition of Development Land Tax will, I am sure, be especially welcomed by the building and construction industry. It will also remove no fewer than 200 pages of highly complex legislation from the Statute Book.

33. This follows the abolition of the National Insurance Surcharge and the Investment Income Surcharge in last year's Budget. Three pernicious taxes swept away in two years.

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J. BUSINESS TAXATION

1. I now turn to other aspects of business taxation. It cannot be repeated too often that it is businesses and not Governments that create jobs. The Government's responsibility is to foster the conditions which will encourage businesses to grow and create more jobs. The measures I have to announce are designed with that end in view.

2. First, Corporation Tax. The reforms I announced last year set out a new and improved framework of business taxation for the remainder of this Parliament and beyond. So this year I have only limited changes to make.

3. As I promised last year, I have reviewed the Scientific Research Allowance. Given the particular importance of expenditure on research and development if British industry is to hold its own in a competitive world, I have decided, exceptionally, not to reduce this allowance in line with the changes in the other capital allowances. A few minor changes apart, the Scientific Research Allowance will remain at 100 per cent.

4. I have also decided to modify the new capital allowance system as it applies to short life assets. While the new structure of capital allowances enables

most plant and machinery to be written off over a period that more than fairly reflects their useful life, I accept that there is a problem with those assets which enjoy only a short life, in particular high technology assets.

5. Accordingly, from next year, a business will be able to exclude from its general pool of capital expenditure any asset which it believes will have only a short life; so that if the asset is subsequently scrapped after, say, four years, it will be fully written off for tax over that period. I believe that this change will be widely welcomed. The benefit to business could rise to about £300 million in the early 1990s.

6. I now turn to a number of other detailed measures affecting business.

7. The number of employee share schemes has increased from 30 when we first took office in 1979 to some 850 today. The wholehearted commitment of employees to the success of the companies in which they work is vital to our country's economic future. To maintain and build on this progress I propose to reduce the retention period for profit sharing schemes from seven to five years.

8. I propose to take action to deal with tax avoidance by partnerships, following the consultative document issued last year.

9. In my last Budget I removed a competitive disadvantage to British manufacturers by levying VAT on imports. I have decided to modify the new regime in two respects.

10. First, I propose to relieve from VAT certain goods which are imported into this country solely for repair, or for processing which does not change their identity, and are then re-exported to their owners overseas. Second, goods which are temporarily exported from the UK and then reimported after repair or processing abroad, will bear VAT only on the value of the repair or processing. These reliefs will take effect on 1 June and have a once-for-all cost in 1985-86 of £30 million.

11. I propose to introduce secondary legislation to remove the constraint imposed by the Banking Act which at present prevents companies from financing themselves by a series of issues of short-term securities. This should provide a useful alternative to bank borrowing.

12. I have no major new proposals this year on the taxation of North Sea oil. I have reviewed the economics of incremental investment in existing fields, but I have not been persuaded that there is a case for introducing new fiscal reliefs at this stage. My only proposal for change, apart from some minor technical measures, is to remove immediate PRT relief for onshore exploration and

appraisal expenditure. Onshore activities are sufficiently low-cost not to need this special incentive.

13. In last year's Budget Statement I mentioned the Government's deep concern at the spread of unitary taxation within the United States, and the threat that this posed to the US subsidiaries of British companies. Since then, I am glad to note that several American States have abolished unitary taxation; but in others, notably California, no change has yet been made. We shall continue to press for action to be taken this year, and fully support the campaign being waged by the CBI and others on this issue.

14. Finally, I turn to a group of measures which will be of particular importance to smaller businesses and the self-employed, a sector of the economy where an increasing proportion of the jobs of the future is likely to be found.

15. I have already announced a substantial reform of the Capital Gains Tax. In addition, I propose to implement many of the proposals contained in last year's consultative document on CGT retirement relief, notably to reduce the age for full relief to 60 and to extend relief to those who are obliged by ill-health to retire before that age. This relief is particularly important

to the proprietors of small businesses concerned at the Capital Gains Tax they might have to pay when they come to sell their business on retirement.

16. Although the Business Expansion Scheme has been in existence only two years, it has already made an impressive contribution to the promotion and growth of new businesses. Last year almost 20,000 people took advantage of the tax reliefs offered by the Business Expansion Scheme to invest some £100 million in more than 500 companies. Over half of this went to provide equity capital for new businesses.

17. I have two changes to propose. The scheme was designed to encourage investment by individuals in new and expanding businesses in risk areas. Accordingly, I propose to include within the scheme companies formed to carry out research and development. By the same token I propose to exclude from the scheme certain ventures which primarily involve property development. Building and construction will, of course, continue to be a qualifying trade.

18. Last year I undertook to review the scope of VAT relief for bad debts, a matter of considerable concern to small businesses. In the light of legislation now proceeding in another place on the reform of the insolvency law, I propose to widen the scope of the

existing relief. The new rules will take effect as soon as the provisions of the Insolvency Bill are implemented and will cost some £25 million in a full year.

19. I propose to increase the VAT threshold to £19,500 from midnight tonight.

20. Over the past five years the ranks of the self-employed have risen by well over half a million or some 30 per cent. And the growth in self-employment has been a particularly marked feature of the encouraging growth in overall employment that has occurred since the spring of 1983.

21. But the self-employed suffer from one long-standing grievance so far as tax is concerned. While the National Insurance contribution paid by an employee cannot be set against tax, the National Insurance contribution paid by the employer on the employee's behalf can. Yet none of the National Insurance contribution paid by the self-employed can be set against tax at all.

22. Today I propose to remedy this grievance. As from 6 April, tax relief will be allowed for half the graduated Class 4 National Insurance contribution paid by the self-employed. In addition, I have agreed with my Right Hon Friend the Secretary of State for Social Services that, as from the beginning of October, the flat

rate Class 2 National Insurance contribution payable by the self-employed will be reduced from £4.75 to £3.50 a week. The benefit of these reliefs to the self-employed will be £55 million in 1985-86 and £155 million in a full year.

23. All this adds up to a substantial package of measures to help small business and the self-employed, which I am sure the whole House will welcome.

K. PERSONAL TAXATION: TAXES ON SPENDING

1. I turn now to the taxation of personal income and spending. My Budget last year shifted some of the burden of personal taxation from earnings to spending. Today I propose to make a further move in this direction.

2. Accordingly, I propose to increase the revenue from the excise duties by rather more than is required simply to keep pace with inflation - a less painful task now that inflation is relatively low.

3. I propose to increase the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of sixpence on a packet of 20 cigarettes. These changes will take effect from midnight on Thursday. I do not however propose any increase at all in the duties on cigars and pipe tobacco.

4. I propose increases which, including VAT, will put between a penny and twopence a pint on most beer (depending on its strength); a penny a pint on cider, sixpence on a bottle of table wine and about tenpence a bottle on sparkling or fortified wine. In recognition of the current difficulties of the Scotch whisky industry, however, I propose to increase the duty on spirits by only tenpence a bottle, well below the amount needed to keep pace with inflation. All these changes take effect from midnight tonight.

5. I propose to increase the duty on petrol and derv by amounts which, including VAT, will raise the price at the pumps by approximately fourpence and threepence-halfpenny a gallon respectively. This does no more than keep pace with inflation. These increases will take effect from 6 o'clock this evening. As last year, I do not propose any change in the duty on heavy fuel oil.

6. I do propose this year, however, to raise more revenue from the Vehicle Excise Duty. For cars and light vans the duty will go up by £10 to £100. On the advice of my Rt Hon Friend the Secretary of State for Transport, the pattern of duty on lorries will be changed to correspond more closely to the amount of wear and tear they cause to the roads. While there will be substantial increases in duty for some of the heaviest rigid lorries, for most lorries the rates will remain unchanged.

7. These changes in the excise duties will, all told, raise an extra £820 million in 1985-86, some £235 million more than is required to keep pace with inflation. The overall impact effect on the RPI of these changes will be one half of one per cent. This has already been taken into account in the forecast I have given the House of 5 per cent inflation by the end of the year.

8. I now turn to VAT.

9. I have followed with interest the unprecedented speculation that has built up over recent months about my alleged intentions for VAT.

10. I can now inform the House that apart from one change I shall be proposing today, I do not intend to make any further extensions of the VAT base during the lifetime of this Parliament. This is, of course, a field in which European Community law has to be reckoned with. But as the House will be aware, where we are currently under challenge, we are vigorously fighting our case.

11. The change I propose to make concerns newspapers and magazines. At present, while all other advertising is taxed, newspaper and magazine advertising is not. There is no justification for this anomaly. It is one thing to maintain that newspapers and magazines should not be liable to VAT: quite another to argue that those who advertise in them should enjoy a similar immunity. Accordingly, I propose that from 1 May newspaper and magazine advertising should be subject to VAT. This will raise £30 million in 1985-86 and £50 million in a full year.

12. Credit cards and similar payment cards are a part of the financial sector which has enjoyed exceptional growth over the past few years. I propose that from 1 May transactions between the companies providing the cards and the outlets which accept them should be classified as exempt. This means that the companies will not be able to recover VAT in respect of such transactions. This will raise £15 million in 1985-86 and £20 million in a full year. It should not directly affect the charges made to card holders.

13. I also have a modest VAT concession to make. I have decided to extend the existing VAT relief for medical or scientific equipment bought with donated funds for use in hospitals and the like to cover computer equipment for certain medical uses. Customs and Excise will be announcing the precise details of the reliefs, which will take effect from 1 May.

14. Following extensive consultations, I propose to include in this year's Finance Bill legislation to implement most of the recommendations of the Keith Report on the Enforcement Powers of the Revenue Departments, including measures to deal with the problem of the late payment of VAT. This is expected to bring in extra

revenue of about £50 million in 1985-86. By 1988-89 there will have been a cumulative once-for-all revenue gain of about £600 million. Proposals on the Inland Revenue aspects of the Keith Report will follow in next year's Finance Bill.

15. The VAT changes I have just proposed will bring in £90 million in 1985-86, rising eventually to £215 million in a full year. They will have no impact on the RPI. The additional revenue raised from the Excise Duties and VAT taken together will help me to lighten the burden of income tax.

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L. PERSONAL TAXATION: INCOME TAX

1. Before turning to income tax, I should briefly mention Capital Transfer Tax. Since 1979 the burden of this tax has been very significantly reduced, and I propose to maintain that position this year by raising the threshold and rate bands set last year in line with statutory indexation. In addition, I propose to widen the scope of the existing CTT exemption for amenity land surrounding a house of outstanding heritage quality. I am sure that this will be welcomed by all those concerned with the preservation of our national heritage.

2. I now turn to income tax.

3. On 6 April the banks will move over to the composite rate system for the payment of tax on bank interest. I now need to legislate to put the corresponding composite rate payments by building societies on a similar footing, as from next year. This will not produce any additional revenue. As an administrative saving, I also propose to legislate this year to bring new loans above the mortgage interest relief ceiling into the MIRAS system by April 1987. The ceiling itself will remain at £30,000 for 1985-86.

4. I need to set the 1986-87 car benefit scales for those whose employers provide them with the use of a car. As last year, I propose to increase both the car and fuel scales by 10 per cent with effect from April 1986. This will still leave the scale levels well short of the true value of the benefit.

5. To give further help to charities, I propose to increase from £5,000 to £10,000 the limit to which relief at the higher rates of tax is allowed for covenants.

6. I now turn to my main income tax proposals.

7. I propose to make no change this year in the rates of income tax. Once again, I believe it is right to concentrate most of the limited resources at my disposal on raising the starting point for tax. Increases in the basic tax thresholds benefit all taxpayers, but they give proportionately more help to those on low incomes. This year, a Budget for jobs and for enterprise has to give high priority to raising the tax thresholds.

8. The statutory indexation formula means that I should increase all the principal income tax allowances and bands by 4.6 per cent, the increase in the Retail Price Index over the year to last December, rounded up. For the higher rate threshold and bands I propose this year

to do just that. The first higher rate of 40 per cent will be reached at a taxable income of £16,200 and the top rate of 60 per cent will apply to taxable income above £40,200.

9. For the basic thresholds I can do more. Statutory indexation would imply an increase in the single person's allowance of £100. I propose to increase it by precisely twice as much - £200 - from £2,005 to £2,205. Statutory indexation would imply an increase in the married man's allowance of £150. Again, I propose to raise it by precisely twice as much - £300 - from £3,155 to £3,455

10. I propose to increase the age allowances this year by the same cash amount as the corresponding basic allowances. Thus the single age allowance will rise by £200 from £2,490 to £2,690 and the married age allowance will go up by £300 from £3,955 to £4,255.

11. These increases mean that most single people will enjoy an income tax cut of at least £1.15 a week and most married couples an income tax cut of at least £1.73 a week. Some 800,000 people on low incomes - 100,000 of them widows - who would have paid tax if thresholds had not been increased, will pay no tax at all in 1985-86. That is almost twice as many as would have been taken out of tax had the allowances merely been indexed.

12. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May. Their cost is considerable: £1.6 billion in 1985-86, of which roughly half represents the cost of indexation.

13. The increase in the basic allowances of almost 10 per cent, or some 5 per cent in real terms, means that for 1985-86 they will be over 20 per cent higher in real terms than they were in 1978-79, Labour's last year.

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M. NATIONAL INSURANCE CONTRIBUTIONS

1. I have one last proposal to make.
2. I have already set out the broad lines of the Government's strategy to improve the prospects for jobs. I have described a number of measures to improve training, remove legislative barriers to employment, and stimulate enterprise; and I have also raised tax thresholds substantially for the second year running. 58
3. But I want to do more to improve job prospects for young people and the unskilled, among whom the problem of unemployment is most severe. 2-
4. I have concluded that an effective response to this problem must include direct action in two related areas - to cut the costs of employing the young and unskilled, and to sharpen their own incentives to work at wages which employers can afford to pay. 44
5. I am therefore proposing, in collaboration with my Rt. Hon. Friend the Secretary of State for Social Services, that the structure of National Insurance contributions should be radically reformed in order to encourage the creation of more jobs. The essential features of the contributory principle will be preserved. 98

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6. The changes will affect both employers and employees contributions.

7. Given the limited resources at my disposal, I cannot afford this year to make a further substantial reduction in the overall burden of employment costs, following the abolition of the National Insurance Surcharge in last year's Budget. I therefore propose to abolish the upper earnings limit for the employer's National Insurance contribution, which for 1985-86 has been set at £265 a week.

8. Under existing arrangements, an employer pays in National Insurance the same cash sum, which for the coming year would be roughly £27 a week, for all employees above the upper earnings limit, regardless of whether the employee is paid £15,000 a year or £50,000. Under the new and arguably fairer scheme I am now proposing, the employer's liability will be the same flat 10.45 per cent of earnings as at present applies to all those below the upper earnings limit.

9. The £800 million raised by this change in a full year enables me to make a worthwhile reduction in the cost of employing people at the lower end of the earnings scale. There, instead of the uniform 10.45 per cent, I propose to introduce a system of graduated rates.

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10. As now, there will be no National Insurance payable below the lower earnings limit, which for 1985-86 has been set at £35.50 a week, broadly in line with the single person's pension. But for employees earning between this and £55 a week, the employer will in future have to pay only 5 per cent instead of 10.45 per cent; for employees earning between £55 a week and £90 a week the new rate for employers will be 7 per cent; and in respect of those earning between £90 and £130 a week the employer will pay 9 per cent. The full employers' rate of 10.45 per cent will apply only in respect of those earning over £130 a week.

11. These changes represent substantial reductions in the cost of employing the lower paid. They will significantly improve the flexibility of the labour market and the prospects for jobs. I recognise that employers cannot be expected to welcome the increased cost of employing higher paid workers, but for business and industry as a whole the increase in the cost of the higher paid will be fully offset - indeed rather more than offset - by the reduced cost of employing lower paid workers.

12. Moreover I propose to introduce a similar system of graduated National Insurance contribution rates for the employees themselves at the lower end of the earnings scale. At present, all those earning more than the lower earnings limit pay a flat rate of 9 per cent on total

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earnings up to the upper earnings limit, and nothing on any amount they may earn above that limit.

13. This system makes National Insurance contributions a particularly heavy burden for the low paid. While a married man on average male earnings [£180] a week pays more than twice as much in income tax as he does in National Insurance, and one on twice the average pays four times as much in tax as in National Insurance, the married man on half national average male earnings pays virtually as much in National Insurance as he does in income tax.

14. I propose that, in future, those earning between £35.50 and £55 a week pay at the rate of 5 per cent, and those earning between £55 and £90 a week 7 per cent. Only those who earn above £90 a week will be liable to the full 9 per cent on their earnings.

15. But I do not propose to abolish the upper earnings limit for employees' contributions. It is an integral part of the contributory system on which their benefit entitlement is based. Moreover if it were abolished, those on the higher rates of income tax would face unacceptably high combined marginal rates taking into account liability to both tax and National Insurance contributions.

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16. This represents a substantial reduction in the burden of National Insurance contributions on lower paid employees. In addition, as I have already indicated, I propose a corresponding reduction in the contributions paid by the self-employed. The flat rate Class 2 contributions will be reduced from £4.75 to £3.50 a week. This change is, of course, in addition to the introduction of tax relief on the Class 4 contributions by the self-employed which I announced earlier.

17. My Rt Hon Friend the Secretary of State for Social Services will include legislation to give effect to this radical restructuring of National Insurance contributions in the Social Security Bill now before Parliament, and I expect the new rates to take effect from the beginning of October. I should make it clear that these changes are not intended to affect benefit rights, and new rules will be introduced to protect those rights. Nor will the changes affect arrangements for the contracted-out rebate.

18. The overall cost of the changes I have announced will be £450 million in a full year, made up of £80 million less in employers' contributions, £270 million less in employees' contributions, and £100 million less in contributions from the self-employed. In 1985-86 the total cost will be £160 million.

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19. The effect on job prospects will, over time, be substantial. The radical restructuring I have announced will encourage employers take on the young and unskilled, and give them, in turn, an incentive to seek work at wages the employers can afford. The cost of employing some 8½ million people on earnings of less than £130 a week will be reduced by almost £900 million in a full year. It will cost an employer £3 a week less to employ a young person or unskilled worker at just below £90 a week.

20. And the take-home pay of some 3½ million people with earnings up to this level will be further increased, on top of the significant real increases in income tax thresholds I have already announced. A single youngster on just under £90 a week will pay about £1.80 a week less in National Insurance on top of the reduction in his income tax bill of £1.15 a week - an overall increase in take-home pay of almost £3 a week.

21. The reduction in the total burden on the low paid - income tax plus employers' and employees' National Insurance contributions combined - is even more dramatic. For someone on £80 a week it is cut by almost 30 per cent and at £50 a week it is cut in half.

22. These are changes of a major order. They amount to a direct and powerful attack on disincentives to employment. They tackle the problem of unemployment

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where it is most acute. They complete by Budget for jobs.

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N. CONCLUSION

In this Budget, Mr Deputy Speaker, I have reaffirmed the Government's commitment to the defeat of inflation through the maintenance of sound money. I have shown how the policy framework of the medium-term financial strategy will sustain continued growth and rising employment. I have made further radical proposals for taxation and National Insurance, and abolished outright a third tax. I have announced a coherent and wide-ranging set of measures to promote jobs - a number of which my Rt. Hon. Friends the Secretaries of State for Employment, Education and the Social Services will be describing to the House in more detail. The principles of the Mais Lecture I delivered last June have been translated into action. I commend this Budget to the House.

B. THE ECONOMIC BACKGROUND

I start with the economic background.

2. Once again we can look back on a year of steady growth and low inflation. During 1984 as a whole, inflation remained at around 5 per cent. Output grew by a further $2\frac{1}{2}$ per cent, with investment up by 6 per cent and non-oil exports by 7 per cent, to reach all-time record levels in each case. Manufacturing industry recovered particularly strongly, with output up by $3\frac{1}{2}$ per cent - the biggest rise in any single year since 1973 - exports up by 10 per cent and investment by 13 per cent. The current account of the balance of payments has remained in surplus, for the fifth year in succession. By international standards the economy has performed creditably. Our growth was above and our inflation below, the European Community average.

3. Perhaps the most remarkable aspect of the progress we have made since my last Budget is that it has been achieved in the teeth of an unprecedentedly long and damaging coal strike. While the costs, both economic and constitutional, of submitting to this strike would have been infinitely greater than the costs that have been incurred in successfully resisting it, in the short term the nation has had to pay a heavy price.

4. The coal strike has reduced the level of national output by over $1\frac{1}{4}$ per cent and the current account payments surplus by almost £4 billion. It has increased public expenditure by $£2\frac{1}{2}$ billion and public sector borrowing by $£2\frac{3}{4}$ billion. It has meant a lower exchange rate and higher interest rates. It has cost us confidence abroad and jobs at home.

5. It is a remarkable tribute to the underlying strength of the British economy that it has been able to withstand so long and damaging a strike in such good shape.

6. Looking ahead, we are now about to embark on what will be the fifth successive year of steady growth, with output in 1985 as a whole set to rise by a further 3 per cent. Inflation may initially edge up a little, perhaps to 6 per cent by the middle of the year, before falling back to 5 per cent by the end of the year and lower still in 1986.

7. While there can be no disputing the strength and durability of the economic upswing, there is equally no disputing the fact that it is marred by a tragically high level of unemployment. And this is despite the fact that the latest figures suggest that employment, including in particular self-employment, has risen by half a million over the past two years, and is likely to increase still further over the year ahead. I shall have more to say

about the prospects for jobs, and the ways in which the Government can help, later in my speech.

8. If at home the past year has been overshadowed by the coal strike, internationally it has been overshadowed by the relentless rise of the dollar. The Government of the United States is now fully seized of the need to reduce substantially over time, starting now, its vast \$200 billion budget deficit. But it has yet to demonstrate that it has the political will to take the uncomfortable measures required to achieve this. Meanwhile it continues to import a large part of the rest of the world's savings and to export part of its own inflation. For the first time since the first world war the United States has become a net debtor, and could quite soon become the world's largest debtor. The counterpart of this massive capital inflow is a huge and growing current account deficit and a grotesquely overvalued dollar, which in turn is daily adding strength to the protectionist lobbies within the United States.

9. As Federal Reserve Chairman Paul Volcker last month testified to Congress, the United States is living on borrowed money and borrowed time. But it is not only America that is paying the interest.

10. There has been no precedent for the prolonged surge in the dollar which has dominated the financial world over the past year - a rise of some 30 per cent against

all the major European currencies from an already overvalued base.

11. All this has led to one of the most turbulent years in the financial markets within living memory. It has been, and will continue to be, a time for strong nerves and sound policies.

C. THE MEDIUM-TERM FINANCIAL STRATEGY

We have already shown that we are not afraid to take action, however unpopular, to keep the Medium-Term Financial Strategy on course in an unpredictable and uncertain world.

2. That strategy was first launched 5 years ago next week. Its opening words were these:

"The Government's objectives for the medium term are to bring down the rate of inflation and to create conditions for a sustainable growth of output and employment."

3. We have achieved those objectives to a greater degree than any commentator dared to forecast at the time. And our commitment to them remains as great today as it was five years ago. So is our commitment to the MTFSS as the means of achieving those objectives.

4. The Medium-Term Financial Strategy is designed to maintain a reasonable growth of demand in money terms - and indeed has succeeded in doing so. Needless to say, the more this growth of money demand takes the form of higher real output, and the less it takes the form of higher prices, the better. But although Government can influence the inflation/output mix - and all our micro-

economic policies are designed to that end - it cannot dictate it.

5. The great mistake of postwar demand management, which still has some devotees today, was to react to disappointing output and employment performance by injecting more money into the system, whether through the Budget or through the banks. So far from stopping the upward trend of unemployment, this generated runaway inflation, the reversal of which inevitably led to still further job losses.

6. That course we will not follow.

7. We are determined to maintain a steady downward pressure on the inflation rate. It is not in the gift of any Government to eliminate short-term fluctuations along the way, but the underlying direction has to be downwards. It is this concern which governs the desirable growth of total spending power in the economy, as measured by money GDP, over the coming years.

8. In short, the strategy aims to bring about an average growth of spending power over the next few years which will produce rising output and more jobs provided that inflationary pressures are suitably restrained. The knowledge that inflationary increases in total costs - whether due to excessive pay increases or any other factor - will not be financed is an essential bulwark for restraint.

9. All this is very much in the spirit of the 1944 Employment Policy White Paper, which repeatedly stressed that policies to maintain demand could succeed in providing jobs only if wage and price rises were moderate.

10. Moreover, a policy for demand couched unambiguously in terms of money provides a further important advantage. For it ensures that wage restraint really will provide more jobs. I repeat today the undertaking I gave the National Economic Development Council last month: the MTFS is as firm a guarantee against the emergence of inadequate money demand as it is against the emergence of excessive money demand.

D. MONETARY POLICY AND THE EXCHANGE RATE

Within the MTFs, the central role is played by monetary policy, since it is by controlling the growth of money in the economy that the Government is able to influence the growth of money demand.

2. Last year I set target ranges of 4-8 per cent for narrow money and 6-10 per cent for broad money. Over the twelve months to mid-February, narrow money, as represented by the target aggregate of notes, coins and bankers' deposits, grew at around the middle of its range, and broad money, as represented by the target aggregate £M3, grew at just below the top of its range.

3. For next year I shall be retaining the same two target aggregates and setting the target ranges indicated in last year's MTFs - that is to say, a reduction in monetary growth of 1 per cent in each case. Equal importance will be attached to both.

4. There are those who argue that if we stick to sound internal policies the exchange rate can be left to take care of itself. Unfortunately significant movements in the exchange rate, whatever their cause, can have a short-term impact on the general price level and damage inflationary expectations. This process can acquire a momentum of its own, making sound internal policies

harder to implement and more restrictive in their effect on the real economy. Benign neglect is not an option.

5. That is why I have repeatedly argued that it is necessary to take the exchange rate into account in judging monetary conditions. Unfortunately, perhaps, there is no mechanical formula which enables us to balance the appropriate combination of the exchange rate and domestic monetary growth needed to keep financial policy on track. But a balance does have to be struck, and struck in a way that takes no chances with inflation.

6. For there should be no doubt about the Government's commitment to maintain monetary conditions that will continue to bring about lower inflation. Short term interest rates will be held at the level needed to achieve this.

E. PUBLIC SECTOR BORROWING

While monetary policy is at the heart of the Medium-Term Financial Strategy, it needs to be buttressed by an appropriate fiscal policy.

2. The final outturn for the Public Sector Borrowing Requirement for 1983-84 was £9 $\frac{3}{4}$ billion, or 3 $\frac{1}{4}$ per cent of GDP. In my Budget last year I planned to reduce it substantially in 1984-85 to £7 $\frac{1}{4}$ billion, or 2 $\frac{1}{4}$ per cent of GDP. In the event, it looks like turning out at £10 $\frac{1}{2}$ billion, or 3 $\frac{1}{4}$ per cent of GDP - the same proportion as in each of the three previous years.

3. All but £ $\frac{1}{2}$ billion of this substantial overrun is directly attributable to the cost of the coal strike. I believe it was right to meet the large but once-for-all cost of keeping the economy going throughout the coal strike by borrowing, thus in effect spreading the cost over a number of years. But it is now necessary to return to the path I outlined in last year's MTFS.

4. That means that the PSBR for the coming year, 1985-86, will be set at £7 billion, equivalent to 2 per cent of GDP. As this year, some £3 billion will be financed through National Savings.

5. I have been urged by some to provide for a still lower borrowing requirement in order to impress the financial markets, while others have argued that the present high level of interest rates would justify a more relaxed fiscal stance.

6. There is nothing sacrosanct about the precise mix of monetary and fiscal policies required to meet the objectives of the Medium-Term Financial Strategy. But this is not the year to make adjustments in either direction, and the wisest course is to stick to our preannounced path.

7. This means that, for the coming year, a substantial reduction in the PSBR must take precedence over our objectives for the reduction of tax.

F. PUBLIC EXPENDITURE

As the House is aware, the Government's economic strategy is founded on twin pillars: a monetary policy designed to bring down the rate of inflation and a supply side policy designed to improve the competitive performance of the economy.

2. The supply side policy is based on the profound conviction, based on practical experience both at home and overseas, that the route to better economic performance is through the encouragement of enterprise, efficiency and flexibility; the promotion of competition, deregulation and free markets; through pressing ahead with privatisation and improving incentives.

3. The argument over which will have a bigger impact on demand, increased public expenditure or lower taxation, completely misses the point. The case for lower taxation derives entirely from the Government's supply side policy: as a means of enhancing incentives, eliminating distortions, improving the use of resources, lightening burdens and heightening the spirit of enterprise.

4. But given the overriding priority of anti-inflation policy, the need to ensure that the Budget deficit is of a size that can and will be soundly financed, this can

only be achieved by maintaining the firmest possible control of public expenditure.

5. But controlling public expenditure is one of the most difficult tasks facing any democratic government in the modern world. It acquires its own momentum and its own vested interests. To control it requires constant vigilance and a determination to succeed despite the inevitable setbacks. We have that determination, and have succeeded in holding its growth below that of the economy as a whole. To achieve that has required difficult decisions in successive public expenditure rounds.

6. But there is no virtue in self-delusion. No benefit to sound economic management or effective control from sticking to figures which subsequent events have made unattainable.

7. The Budget is the right time to reassess the prospects for spending, revenue, and for borrowing. Such a reassessment must take account of changes in the economic scene since the Public Expenditure Review in the autumn. Of these, the single most single most important factor has been the coal strike whose public expenditure cost in 1984-85 is estimated at some £2½ billion -about £1 billion more than allowed for in the Autumn Statement and the White Paper which explicitly assumed that the strike would end at Christmas. There will also be some

further cost in 1985-86. But quite apart from the coal strike, the upward pressures on public spending remain intense, with the effects of higher interest rates and a lower exchange rate superimposed on the problems of increased take-up of social security benefits and local authority overspending. I now estimate that this year's public expenditure planning total will be exceeded by some £3¼ billion - an overshoot of about 2½ per cent, of which over two-thirds is attributable to the coal strike.

8. In the light of this revised estimate of the outturn for the current year I have reassessed the adequacy of the Reserves for 1985-86, 1986-87 and 1987-88 provided in the January White Paper. In order to provide a realistic basis on which to plan and control the level of public spending I have felt it prudent to add £2 billion to the Reserve and thus to the White Paper planning totals for each of the three years.

9. At the same time, I have increased the figure for debt interest, which is outside the planning total, by £½ billion a year above the levels shown in the White Paper, which itself contained significantly higher figures than last year's Red Book.

10. These estimating changes mean that the planning totals for the next three years have been increased by about 1½ per cent. But let there be no misunderstanding.

The new totals still represent a tough target. There is no slackening in our determination to curb the size of the public sector. No cash has been added to programmes. Calls on the reserve will continue to be judged on the strictest criteria.

11. Public expenditure will continue to fall as a proportion of GDP, as it has since 1981-82. Expenditure will stay broadly flat in real terms at about this year's level, adjusted for the coal strike. To achieve even these new figures will mean that future Public Expenditure Surveys will need to be at least as tough as their predecessors; and there can be no let-up in the tight control of individual spending programmes within the cash limits set for the coming year.

12. On the other side of the public accounts, expected tax receipts have also been revised upwards, partly for related reasons. But not by as much. The scope I have for tax cuts this year is therefore only half the amount I indicated might be available in my Statement to the House in November. In other words, the measures I shall shortly announce will, after indexation, contribute some £ $\frac{3}{4}$ billion net to the £7 billion borrowing requirement I have set for 1985-86.