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BUDGET 1979: MINUTES OF MEETINGS

CH/EX. REF. NO. B(79)1
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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT THE TREASURY AT 11.00 A.M. ON WEDNESDAY, 9TH MAY, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Mr. Couzens
Sir Fred Atkinson
Mr. Lovell
Mr. Unwin
Sir William Pile) Inland Revenue
Mr. J.M. Green)
Mr. Lovelock) Customs and Excise
Mr. Phelps)
Mr. Adam Ridley

PREPARATIONS FOR THE BUDGET

The Chancellor outlined his general approach to the preparation of his first Budget, distinguishing between proposals which he wished to see implemented immediately and those which should await a later Finance Bill. The following records the main conclusions and points made in discussion. The Chancellor began by making four points:

(a) Monetary Targets. He aimed to reduce the current monetary target from 8-12 per cent to 7-11 per cent.

(b) PSBR. The lower monetary target should be supported by a PSBR reduced to no more than £8 billion for 1979/80.

(c) Exchange Control. The Chancellor wished to make some early relaxation in exchange control.

(d) Presentation. The Budget should be presented in the context of a longer term programme of stabilisation, though the Chancellor thought it inadvisable to be committed publicly to medium term targets for the money supply and PSBR.

Public Expenditure

2. The Chancellor said the aim should be to achieve maximum savings in public expenditure in the current financial year. Ministers would need to be assured that all actual or contingent public expenditure claims had been identified and allowed for in forecasting the PSBR. The Chancellor

invited the Treasury to confirm that the existing forecasts took account of all outstanding public expenditure claims.

3. The Chancellor then went on to identify the following aspects of the Government's policy on public expenditure:

(a) there should be a greater emphasise than so far identified by officials on savings in revenue rather than capital expenditure;

(b) there was a predisposition to leave spending Ministers free to decide how to achieve savings within their own programmes;

(c) public sector disposals would have an important part to play. The Government's policy should be presented not as doctrinaire denationalisation nor as the disposal of surplus assets but as a genuine means of reducing the PSBR. There should be four elements:

(i) Public sector land:
(ii) Sales of council houses;
(iii) Readily disposal assets (e.g. shareholdings in BP; the NEB etc.); and
(iv) Some private participation in public corporations. This would require legislation and would not be for the Budget.

The Chancellor invited

Sir Anthony Rawlinson to prepare, in consultation with other departments as necessary, advice on (i) and (ii) above; and

Sir Lawrence Airey to prepare advice, after similar consultation, on (iii) and (iv) above.

4. Charges. The Chancellor said that, whilst it remained a legitimate objective to raise public service charges to more realistic levels, this might have to take second place to the immediate need to embark upon a substanital switch from direct to indirect taxation this year. Ministers would probably wish to endorse the announced 5p increase in school meal charges; other increases would need to be carefully examined for their effects upon the RPT.

Taxation

5. Within the limits of politically acceptable price increases, the Chancellor said he would wish to make the maximum possible switch from indirect to direct taxation in his first Budget. The late Budget also imposed particular constraints this year. Since any increases in indirect taxes could not be made effective until after Budget Day he asked whether there existed any means by which reductions in income tax could operate from a current date rather than back-dated to 6th April. Sir William Pile said that, with an annual tax, splitting the year in this way

was not a feasible proposition. The Chancellor invited Sir William Pile to re-examine the feasibility of making income tax changes effective from a current date.

6. The Chancellor then went on to identify the following proposals.

7. Income Tax

(i) He wished to eliminate the reduced rate band this year, if this could be linked with attainment of a 25 per cent basic rate over 2 years.

(ii) He wished, if possible, to reduce the top rate on earned income to 60 per cent this year. This should have priority over widening other higher rate bands. The latter could be left until 1980, when he might wish also to introduce formal indexation of the higher rate structure.

(iii) Personal allowances. Thresholds should be raised by more than the amounts included in the caretaker Finance Act. Within the available revenue, the amount of the increase would be determined by the need to "buy out" the loss of the reduced rate band, keep clear head room above the national insurance retirement pension and offset the effects on prices of the proposed switch to indirect taxation.

(iv) Basic rate. Subject again to available revenue the Chancellor said he would like to cut the basic rate by up to 3p this year.

(v) Age Allowance. The Chancellor wished to consider abolishing the ceiling (and marginal provisions) for the age allowance. The cost would be £80 or £90 million.

(vi) Investment Income Surcharge. The Chancellor was inclined to raise the surcharge threshold to £4,500 (or to £4,000 or £5,000 if administratively simpler), at the same time withdrawing the specially favourable provisions for the elderly. He also favoured a suggestion by the Financial Secretary that a doubling of the threshold justified removing the 10 per cent rate of surcharge on the first £500 of surchargeable investment income. This might point to raising the threshold to £5,000.

(vii) War Widows' Pensions. The Chancellor confirmed his wish to remove the residual tax liability on war widows' pensions at a cost of some £6 million. This should be included in the Budget.

(viii) Charities. The Chancellor said he would wish to consider the consequences for charities of reducing income tax and increasing indirect taxes. Sir William Pile said that the Inland Revenue had a note in preparation.

(ix) Interest Relief. The Chancellor said he did not wish to restore interest relief in toto. However, the Finance Bill should make provision for a temporary extension of the 6-year transitional period for interest relief in the Finance Act 1974.

8. Businesses. The Chancellor said he was disposed to consider two changes:

(i) raising the profits limits for the rate of corporation tax paid by small companies; and

(ii) assuming the legislation was not over-lengthy and complicated, provide for some arrangement for a rolling programme to write off past stock relief.

9. Other direct matters

(i) Petroleum Revenue Tax. The Chancellor said he was inclined not to disturb the changes already foreshadowed in rates of PRT. The Minister of State (Commons) would consider whether anyfurther changes in PRT should be introduced this year.

(ii) Discretionary Trusts. The transitional arrangements for capital distributions needed to be extended for at least one year.

(iii) Stamp Duty on Houses and Land. The Chancellor regarded action on the £15,000 threshold as of greater priority than raising the £25,000 limit for mortgage interest relief. Stamp duty relief should be included in the Budget.

(iv) Development Land Tax. The Chancellor said he wished, if possible, to reduce the current rates of DLT; or at least extend beyond 31st March 1980 the current transitional rates. The Minister of State (Lords) would consider the case for other changes in DLT, including raising the £10,000 exemption level.

(v) Capital Transfer Tax. The Chancellor said he was looking to make an early easement in the burden of CTT - both in the starting points and in the tax scales. He had in mind larger changes than those canvassed in the Revenue brief (B13(c)). The Minister of State (Lords) would consider a possible package with the Inland Revenue.

(vi) Capital Gains Tax. The Chancellor said he wanted to remove the inflationary element from the taxation

of capital gains either by tapering or indexing them. He personally preferred indexation. After a short discussion, Ministers agreed that it was best to leave changes in CGT until a later year.

(vii) Benefits in kind. After a brief discussion, the Chancellor indicated that he was willing to consider proposals from the Inland Revenue to deal with the loophole in the 1971 legislation on car leasing and the provision of petrol as a benefit in kind. In a longer time scale he was not unsympathetic to a more substantial review of the benefits in kind legislation.

National Insurance Surcharge

10. The Chancellor said he would not wish to make any changes in NIS this year. In a longer time scale re-consideration of the NIS might be necessary in the context of decisions to phase out employment subsidies. He agreed that officials should inform DHSS that there would be no change in the Budget.

Indirect Taxes

11. VAT. The Chancellor said that the Government's taxation strategy depended on getting a substantial extra yield from VAT. He was inclined to increase the standard and higher rates to a new 15 per cent uniform rate if the price effects could be tolerated. In discussion, it was suggested that the Chancellor might wish to considered both the compounding effects on particular prices of increases in VAT and specific duties, and also possibly the industrial effects on the motor car industry (including implications for changes in the car tax). The Chancellor agreed that the Treasury should consult the Department of Industry in confidence at official level.

Specific Duties

12. Although specific duties had not generally been increased for two years, the Chancellor thought it would be sufficient this year to restore them to April 1978 levels. He saw no reason to exclude alcohol or tobacco duties; noted EEC considerations affecting the duty on wine; he would wish to take a considered view in the light of advice from Customs and Excise. The Chancellor

invited Mr. Lovelock to prepare advice on a package of increases in specific duties for his consideration.

Motoring Taxes

13. The Chancellor did not wish to proceed with the switch from VED to petrol duty: it seemed to promise only modest staff savings for the loss of an important source of revenue. He noted, however, that too little time remained before the Budget for necessary consultation with the Civil Service department and the Ministry of Transport. VED should be left unchanged this year. He would consider options for increasing the duties on petrol and derv on advice from the Customs and Excise. The Chancellor

invited Mr. Lovelock to prepare a note.

Other Taxation Matters

14. Taxation of the Family. The Chancellor said Ministers would wish to proceed with early publication of a Green Paper on this subject. This would be reaffirmed in his Budget statement.

Miscellaneous Matters

15. Among other issues for later consideration, the Chancellor mentioned the tax treatment of the National Heritage, Forestry, Charities; VAT simplification; profit-sharing and wider

share ownership; and the Wilson Committee recommendations on small businesses.

Royal Commission on Gambling (The Rothschild Commission)

16. This was also an important area for later consideration, particularly the scope for raising more revenue from casinos. The Chancellor agreed that it was not a matter for action in his first Budget.

Social Security Benefits

17. The Chancellor identified the following matters for early consideration.

(a) Pensioners. Steps would need to be taken to help pensioners meet the higher cost of living resulting from the switch to greater indirect taxation. The choice was between an improved pension uprating in November; an enlarged Christmas bonus; or some combination of the two. Social Security Ministers would have views.

(b) Families. There might also be a similar case for a further increase in child benefit, though arguably less strong than for pensioners because most childrens' goods were zero-rated for VAT.

(c) Taxation of short-term benefits. The Minister of State (Lords) had been considering possible approaches in advance of computerisation. Differential uprating of long and short term social security benefits might also have a part to play in redressing the imbalance between income in and out of employment.

Finance Bill

18. In a brief discussion, Ministers generally agreed that the Finance Bill would probably have to be taken wholly on the floor of the House this year. The length of the Bill would need to be contained. Some minor matters were essential including, for example, matters consequential on the ending of child tax allowances; and on the UK/US double taxation treaty. The Government's supporters would press for action on other matters e.g. retirement annuities. It would be helpful if the two revenue departments would prepare early submissions on the possible minor starters in their respective fields. These would be considered by the Financial Secretary in conjunction with the two Ministers of State.

Prices Index

19. The Chancellor said that, in Opposition, the Government had given thought to ways of developing an index parallel to the RPI which could take account of the effect of changes in income tax on family income. Mr. Adam Ridley had taken the lead in this. It would be useful if officials would consider, with the help of the CSO, how best to make progress in this area.

The Chancellor

invited Sir Douglas Wass to set work in hand.

Conclusions

20. Sir Douglas Wass suggested that officials should prepare an illustrative package of indirect tax changes, with their estimated price effects, for the Chancellor's consideration. The Chancellor agreed.

(A.M.W. BATTISHILL)
9th May, 1979

Circulation
Those present
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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 5.15 PM ON TUESDAY, 15TH MAY, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Sir Fred Atkinson
Mr. Lovell
Mr. Unwin
Mr. Shepherd

Mr. Ridley
Mr. Cropper

Sir William Pile) Inland Revenue
Mr. J.M. Green)

Mr. D.A. Lovelock) Customs and Excise
Mr. A.J. Phelps)

PREPARATIONS FOR THE BUDGET

The Chancellor held a wide-ranging discussion on the Budget submissions prepared since his meeting on 9th May. The following records the main conclusions and points made in discussion. Recorded decisions should be regarded as provisional until the Chancellor has discussed them with the Prime Minister. They are also subject to further work and Ministerial consideration of the likely economic and revenue effects of certain aspects of the tax package.

Effects of the package

2. The Financial Secretary expressed reservations about the forecast size of reduction in economic activity in the "sighting shot" described in Mr. Unwin's minute of 10th May which seemed

to take no account of the contribution to be made by improving the supply side of the economy. The Minister of State (Lords) similarly felt that the estimated yield from raising VAT, in conjunction with simultaneous cuts in income tax, was seriously under-estimated because of the assumption of a constant level of activity.

It was agreed that the Financial Secretary would pursue these questions urgently with officials in the light of advice contained in Mr. Odling-Smee's minute of 15th May to him.

Public Expenditure

3. Sir Anthony Rawlinson confirmed that the analysis in Mr. Unwin's note included broadly accurate figures for the proposed specific cuts in public expenditure now before Ministers. Allowance had also been made in the base line for the proposed squeeze on cash limits though the latest proposals, if secured, could make a further contribution. On the disposal of assets the Financial Secretary hoped to achieve £1 million (of which sales of BP shares would form the largest part); he was on the point of writing to colleagues.

The Chancellor asked the Financial Secretary to let him have a report on assets disposal by the weekend if possible.

Distributional effects

4. Ministers noted that the effects of the switch from direct to indirect taxation would require very careful presentation, particularly as regards any net reduction in real income for those on average and below average incomes. It would be important to stress by all possible means, including Press notices and background briefing, the beneficial effect on take-home pay of the income tax changes. Particular care would be needed in handling the RPI effects of the Budget, including the consequence of any increased public service charges.

The Chancellor asked the Financial Secretary to assume particular responsibility for this aspect of the Budget presentation.

Income tax changes

5. Splitting the tax year. Ministers noted with regret the force of the practical and conceptual problems involved in changing the level of income tax rates and allowances with effect from a date other than the beginning of the financial year, described in Sir William Pile's minute of 11th May.

It was agreed that this would not be pursued further.

6. Reduced rate relief. The cost of buying out the reduced rate fell in direct proportion to the size of reduction made in the basic rate of tax. The estimates of cost made by the Minister of State (Lords) had been based on the supposition that basic rate would be reduced to 30 per cent in the first year. One alternative (paragraph 3 of Sir William Pile's minute), to reduce the cost of the income tax package, would be to postpone abolition of the reduced rate until 1980 and to link that with a further reduction in the basic rate to 25 per cent. In costing the buying-out of the reduced rate, officials had assumed that the consequential increase in personal allowances would need to maintain the present differential between single people and married couples. This produced an uncovenanted benefit for married couples in a £70 increase in the married allowance beyond what was needed to offset withdrawal of the reduced rate band. A cheaper alternative would be to substitute a flat rate increase for all taxpayers - at the cost of temporarily setting back progress towards the 1:1.6 differential between the single and married allowance followed in the social security system. After some discussion, the Chancellor said he would like to give further consideration to the revenue and distributional consequences of alternative approaches to the reduced rate band.

The Chancellor invited Sir William Pile to provide specimen income tables on the assumptions of (a) a 31 per cent basic rate with the reduced rate band retained; (b) a 30 per cent basic rate with the reduced rate band bought out with a differential increase in single and married allowances; and (c) a 30 per cent basic rate with the reduced rate band bought out with the same (minimum) increase in both allowances.

7. Higher rate relief. Paragraph 5 of Sir William Pile's note had described possible alternative changes in the higher rate structure which would reduce the cost in a full year from £m900 to £m750. These involved an onset higher rate of 35 per cent (rather than 40 per cent) and a top rate this year of 65 per cent (rather than 60 per cent), moving to rates of 35 per cent and 60 per cent respectively in 1980. Some Ministers felt that it would be politically disadvantageous to extend over two Finance Bills implementation of the Government's commitment to reduce the higher rates of tax, though it might arguably be easier to make phased changes at the bottom of the higher rate scale. The Chancellor decided that (a) the top rate should be reduced to 60 per cent this year; and

(b) the first higher rate should be reduced to 35 per cent unless a 40 per cent rate proved to be significantly cheaper;

(c) the higher rate threshold points should be increased to £10,000, £12,000, £14,000, £16,000, £20,000 and £25,000.

8. Age allowance. The Chancellor decided to defer abolition of the age allowance income limit until 1980. In the current year the income limits should be increased to £5,000, with a promise of abolition to come. The saving would be £m120.

9. Investment income surcharge. Ministers considered the Inland Revenue suggestion (paragraph 8 of Sir William Pile's minute) of raising the threshold for the over- and under-65s to £5,000 and £3,000 respectively. After a brief discussion, the Chancellor decided not to disturb existing proposals.

The threshold for investment income surcharge should be raised to £5,000 for all taxpayers, with a single rate of surcharge of 15 per cent.

10. Net savings. The Chancellor asked Sir William Pile to reconsider the potential savings in the income tax package (identified in paragraph 9 of his minute) in the light of the discussion.

Indirect tax changes

11. VAT. After a short discussion the Chancellor decided to include in the Budget a single rate of 15 per cent.

12. Alcoholic drinks duties. After a short discussion the Chancellor

(a) decided on a 10 per cent increase in the duties on beer, spirits, wine and made wine;

(b) invited the Financial Secretary and the Minister of State (Commons) to consider and advise him on action in respect of cider duty and the duty on English wines; and

(c) decided against action in the current year on duty deferment for wines and spirits.

13. Tobacco products duty. In discussion, there was general support for a 10 per cent increase in the duty on cigarettes, hand-rolling tobacco and cigars, in addition to the increase in VAT. But there were competing arguments for including pipe tobacco; on the one hand, exceptions from a general increase in duty would be difficult to defend; on the other hand, the incidence of pipe smoking was higher among the elderly. After a short

discussion, the Chancellor:

(a) decided on an across-the-board 10 per cent increase in duty, without differentiation;

(b) decided that the rate of duty increase inclusive of VAT on a typical packet of 20 cigarettes should be rounded down to 8p; and

(c) invited the Minister of State (Commons) to consider and advise on the balance between the ad valorem and specific elements of the duty on cigarettes.

14. Motoring taxes. Ministers agreed to defer discussion on VED pending a Treasury submission. On petrol and derv duties, the Minister of State (Lords) argued for a straight increase of 4½p a gallon, given the apparent ease with which the oil companies had raised the price in recent months. This would yield roughly an extra £80 million over and above a 10 per cent increase of 3½p a gallon. Parliamentary handling of such a large increase would need careful consideration in the light of the Conservative Opposition's attitude to Mr. Healey's proposed increase in petrol duty in 1977. It was generally agreed that there was a strong case for removing the present differential between the duties on derv and petrol; but this was not a priority for the current year.

The Chancellor decided to include a duty increase of 4½p on petrol and derv. Mr. Lovell was authorised to inform the Department of Transport in strict confidence.

15. Rebated oil duty. The Financial Secretary had suggested distinguishing between gas oil and heavy fuel oil on industrial considerations. Mr. Lovelock warned that this raised complications, including the need for an additional notice. Decisions were needed by the end of the week. Customs and Excise would advise urgently. Mr. Lovell suggested that removing heavy

fuel oil from a duty increase would so reduce the yield as to cash doubt on the wisdom of increasing the duty at all. The Chancellor took note.

Petroleum Revenue Tax

16. The Financial Secretary had suggested (his note of 14th May) that PRT should be the subject of separate legislation this autumn in an Oil Taxation (amendment) Bill. The substance of the matter apart, this would need to be cleared first with the Government's business managers. The Financial Secretary would approach the Leader of the House.

Child Benefit

17. There was general agreement with the conclusion in Mr. Lovell's minute of 11th May that families had no stronger case than childless couples to be compensated for the indirect tax package.

The Chancellor said work should proceed on the basis that child benefit would not be increased in the Budget.

Exchange Control

18. Ministers noted that there might be a case for announcing any exchange control relaxations on a date before Budget Day. The suggestion was not however without risk and the Chancellor said he would want advice from the Treasury and the Bank.

The Chancellor invited Sir Douglas Wass to be guided accordingly.

Outside forecasts

19. The Chancellor raised the question of the Treasury forecasters' access to forecasts prepared by outside bodies. Sir Fred Atkinson confirmed that the forecasters were in touch with current work by the London Business School, the National Institute etc., and were taking

account of current revisions by these bodies. The LBS had just updated their PSBR forecast in line with that of the Treasury.

It was agreed that Sir Fred Atkinson would provide the Chancellor with a summary comparison of outside forecasts.

Next meeting

20. The Chancellor said he envisaged holding another meeting on the Budget on Thursday, 17th May.

(A.M.W. BATTISHILL)
16th May, 1979

Circulation:
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Mr. Littler

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COPY NO. 1 OF 21 COPIES

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 10.30 AM ON FRIDAY, 18TH MAY, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Sir Fred Atkinson
Mr. Lovell
Mr. Unwin
Mr. Shepherd
Mr. Ridley
Mr. Cropper
Sir William Pile) Inland Revenue
Mr. J.M. Green)
Mr. D.A. Lovelock) Customs and Excise
Mr. A.J. Phelps)

PREPARATIONS FOR THE BUDGET

The Chancellor said he would like to have before the weekend an up-to-date picture of the Budget arithmetic in the light of Cabinet decisions on public expenditure and the further review of his proposed tax package. This should identify, on the best available information, the likely PSBR; agreed reductions in public expenditure (including an estimate for sales of assets); and the consequences of his decisions on direct and indirect taxation. The provisional "sighting shot" in Mr. Unwin's minute of 10th May should be revised for the weekend. The public expenditure figures in particular would need to be increased on account of

(a) the additional 1 per cent squeeze on central Government pay cash limits agreed by Cabinet;

(b) the £300 million cut in RSG; and

(c) the £500 million addition to specific cuts agreed in Cabinet.

Against that:

(d) the £300 million reduction in the contingency reserve would need reconsideration in the light of the Chancellor's discussion of Social Security with the Secretary of State.

Mr. Unwin was invited to be guided accordingly.

2. Announcement about cash limits. The Chancellor pointed to the difficult situation arising in relation to the negotiations on teachers' pay. These were compounded by the ignorance of the local authorities and the teachers' unions of the proposed cut in the RSG. He was increasingly persuaded that he should include an announcement in his speech in the Economic Debate on 22nd May. The Lord President's meeting on 21st May with the Civil Service Staff Side was an additional factor. On the other hand, the RSG cut was intended to apply generally and there were dangers in linking it too directly with pay issues.

The Chancellor invited Sir Anthony Rawlinson to consider what he should say about the RSG and cash limits in his speech in the Debate on the Address on 22nd May.

3. Disposal of assets. The Financial Secretary hoped to have replies from Colleagues before the weekend, or on 21st May at latest. He was aiming at a higher figure than originally envisaged. The position of BNOC was particulary important. The Chancellor reported strong support in the Cabinet for ensuring

a widely based dispersal of shares, not just to institutional investors. It was noted that this might be most easily accomplished for BP shares, by arrangements in relation to over-subscription which ensured priority for smaller bids.

Indirect Taxes

4. The Chancellor noted that final decisions on indirect taxes needed to take account both of revenue considerations and politically acceptable limits to the increase in the RPI. In respect of the latter, the Prime Minister considered the maximum to be 3¾ per cent. Since the RPI effect of the provisional package was larger than that, it was necessary to consider how it could be re-shaped to limit the RPI increase to 3½ per cent. The choices seemed to be between:

(a) VAT of 12½ per cent combined with (broadly) 10 per cent increases in specific duties; or

(b) maintaining the 15 per cent VAT, whilst dropping the specific duty increases in whole or in part.

5. In favour of (a), it was suggested that an increase to 15 per cent went beyond public expectations, and would be highly unpopular; that there were good non-revenue arguments for increasing specific duties (e.g. on tobacco and petrol); and that there would be criticism if the Chancellor increased a wide range of prices through a substantial VAT increase, and made no change in the specific duties. In favour of (b) it was argued that increases in specific duties were regressive whereas VAT was mildly progressive (though not widely acknowledged as such); that cigarettes and drink etc. would stand to bear a significant price increase through VAT, whether or not specific duties were changed (e.g. 6p on a package of cigarettes; 2¼p on a pint of beer; and 28p on

a bottle of whisky, with a 15 per cent VAT); and that drinks and tobacco were particularly heavily RPI-weighted. It was also suggested that VAT increases in successive years, (e.g. to 12½ per cent this year; and 15 per cent next year) would be extremely unwelcome to industry and doubtful politically.

6. A number of other points were made. The Chief Secretary argued in favour of keeping to the original proposals, despite their price consequences; it was clear that the Chancellor would need to raise the maximum amount of revenue to achieve his PSBR target. The benefit in public reception was hardly likely to be commensurate with the loss in revenue. On the other hand, very large price increases could reflect adversely on the next wage-round. Of the range of indirect taxes only derv, VED and the duty on rebated oil had insignificant price effects (but important industrial implications). An ACT surcharge, though neutral in relation to prices, was thought to be ruled out for other reasons.

7. Summing up this part of the discussion, the Chancellor said he preferred to hold to the provisional decision on a 15 per cent VAT, trimming back on the specific duties as necessary.

8. Against that background, the meeting went on to review decisions on the specific duties.

9. Tobacco duty.

(a) Balance of specific and ad valorem duties. The Chancellor took note that this had been decided by the Minister of State (Commons) (his minute of 17th May to the Chancellor).

(b) Pipe Tobacco. The Minister of State (Commons) rehearsed the case, on employment and distributional grounds, for excepting pipe tobacco from the proposed increase in duty. After a short discussion, Ministers decided that no exception should be made.

10. Alcoholic Drinks. Only the cider duty remained to be settled. The Chancellor agreed that the duty should not be increased this year.

11. Rebated Oil Duty. The Financial Secretary did not wish to press this year his suggested distinction between heavy fuel oil and the duty on gas oil. A 10 per cent increase in duty on both types of oil was agreed.

12. VED

(a) Structure. The Chancellor confirmed his intention to make no changes in the structure of VED this year.

(b) Petrol Duty. The Chancellor took note of the conclusions in Mr. Lovell's minute of 16th May. After a short discussion, the Chancellor confirmed his intention to increase the petrol duty if possible by 4½p on a gallon.

(c) Commercial Vehicles. The Chancellor decided on (i) a 10 per cent increase in the duty on derv (3½p on a gallon) and (ii) a 10 per cent increase in VED on commercial vehicles (rather than a graduated charge related to size).

Ministers took note that these proposals would not be unacceptable to the Ministry of Transport; and would help to remove the present differential between the duties on

derv and petrol.

Possible Modifications

13. The Chancellor concluded that work should proceed on the basis of a choice between the following alternative tax packages:

(a) a 15 per cent VAT plus the full range of specific duty increases already decided; and

(b) the same package less the increases in the duties on tobacco and alcohol.

Miscellaneous Direct Tax Matters

14. Car Leasing. After a short discussion the Chancellor authorised the inclusion of legislation on the lines of the Inland Revenue minute of 10th May to close the existing loophole.

15. PRT. The main outstanding point related to retrospection. The Minister of State (Commons), on revenue considerations, had reluctantly acquiesced in retrospection to 1st January 1979. The Chancellor said he would like to see a note of the arguments. Subject to that, the package could go forward on that basis.

16. Stock Relief. This still remained to be considered.

17. Development Land Tax. Ministers were agreed that the rate should be reduced to 60 per cent. The Inland Revenue had suggested raising the exempt slice from £10,000 to £20,000. The Minister of State (Lords) considered this inadequate in the context of the Government's commitment to repeal the Community Land Act; he favoured increasing the exempt slice to £50,000 at least, despite the loss of revenue involved. Sir William Pile thought this called into question the future viability of DLT. The Chancellor decided that

(a) the exempt slice should be increased to £50,000;

(b) the rate should be reduced to 60 per cent;

(c) the proposed structural review should still proceed after the Budget.

18. Stamp Duty. The Chancellor decided to defer a final decision on raising the threshold for the duty on transfers of land and property.

19. Benefits in kind: Petrol. The Chancellor confirmed that he did not want to take action on this in the current Finance Bill.

20. Taxation of people working overseas. Mr. Green suggested that Ministers might wish to consider ending the present partial exemption for overseas earnings as a counterpart to the proposed reduction in the top rates of income tax. Both the Financial Secretary and the Minister of State (Lords) supported this. The Chancellor asked Sir William Pile to provide a note.

Income Tax Structure

21. The meeting considered the Minister of State (Lords) minute to the Chancellor, Budget: Tax Arithmetic and Sir William Pile's minute of 17th May on income tax packages. The Chancellor confirmed three preliminary points:

(a) the higher rate scale should begin at 40 per cent rather than 35 per cent;

(b) the age allowance ceiling should be increased to £5,000, accompanied by a statement of intention to abolish the ceiling altogether in 1980;

(c) the investment income surcharge threshold should be raised to £5,000 for all taxpayers.

22. Reduced rate band. The Minister of State (Lords) said that the proposal to "buy out" the reduced rate band had two advantages: administrative savings for the Inland Revenue and provision of a substantial increase in tax thresholds. But there could be awkward distributional effects unless there was room for more than equivalent increases in personal allowances. With the reduction in basic rate limited to 30 per cent this year he concluded that the balance of advantage lay in not buying out the reduced rate band this year but in increasing personal allowances. He favoured package 3 in the Inland Revenue note, but with a basic rate of 30 per cent. (Table 2 annexed to his minute). The reduced rate could then be bought out in 1980 at considerably less cost - either by going straight to a basic rate of 25 per cent or to an intermediate basic rate of 27½ per cent. In favour of this approach, an immediate increase in personal allowances

(a) would enable the Government to improve on the indexation provided in the caretaker Finance Bill;

(b) would provide a somewhat better distributional balance in the gains to high and low income groups; and

(c) would keep the tax threshold ahead of the single pension.

23. Summing up this part of the discussion the Chancellor said he was attracted by this approach. The balance of advantage seemed to him to argue against buying out the reduced rate this year and in favour of an increase in personal allowances coupled with a reduction in the basic rate to 30 per cent. Planning should therefore proceed on the basis

of Package 3, with the basic rate reduced from 33 per cent to 30 per cent. This should be included when Mr. Unwin revised the first "sighting shot".

Capital Taxes

24. After a brief discussion, Ministers agreed that CTT changes should be deferred until the following year. The Chancellor's Budget statement should include an intention to review CTT before his next Budget.

Conclusion

25. The Chancellor invited Mr. Unwin to prepare, in the light of the discussion, a revised version of the tables attached to his minute of 10th May.

(A.M.W. BATTISHILL)
18th May, 1979

Circulation

Those present
Mr. Littler

BUDGET : SECRET

CH/EX REF NO B(79)14

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7TH MEETING

NOTE FOR THE RECORD

CHANCELLOR'S MORNING MEETING 23RD MAY

Present:

Chancellor
Chief Secretary
Financial Secretary
Ministers of State, Commons and Lords
Mr Ridley
Mr Cropper

Europe

1. The Chancellor reviewed the Government's approach to the EEC Budget. Renegotiation had to be thought of as a continuing process. The British sense of grievance over our budgetary contribution had to be vented in its own right, and not as part of a narrow campaign for "juste retour". Convergence had to be seen in perspective.

Budgetary Arithmetic

2. The Chancellor reported on the Prime Minister's concern about the RPI. Treasury Ministers were unanimous that the higher rate was an essential foundation for future budgetary policy.

3. It had to be constantly emphasised that comparison of prices and earnings at the gross level would be totally misleading. In conditions of a tax switch, the proper comparison had to be between prices and net disposable incomes in current prices* when appraising the Budget.

4. Mr Ridley would assist the Chancellor in the preparation of a further letter for the Prime Minister on Budget options. This would emphasise that a PSBR estimate emerging from the forecasting process

*ie real standard of living

at the upper end of the range would reinforce the need for strong action on VAT. The £8 billion PSBR for 1979/80 remained the target.

ACT Surcharge

5. This possibility to be placed on the agenda for Thursday afternoon's Budget meeting. Full analysis was urgently required in advance. Reference was made to Mr Healey's mention of this possibility in the House of Commons on 22nd May.

Personal Allowances

6. Minister of State (Lords) had estimated the extra cost of higher personal allowances:

Package 5 over Package 4 : £360 million first year

Package 6 over Package 4 : £220 million first year
(with £600 reduced rate band)

Other RPI Factors

7. The Chancellor referred to Sir Fred Atkinson's note covering estimates of the aggregate nationalised industry price increase effects. He also reported the Minister of Agriculture's preference for 1½p on milk rather than 1p.

PRT

8. Minister of State (Commons) was completing a paper on PRT and was still anxious that marginal and smaller fields should not be too severely hit by the new package. There was a general feeling that the August 1978 package had been tough at the time it was announced, but it had been retrospectively legitimised by the subsequent rise in oil prices.

Exchange Control

9. The wider issue of freedom for portfolio investment would require thorough consideration after the Budget, and reference should be made to it in the note on progress in this area which the Chancellor would wish to send to the Prime Minister.

PETER CROPPER

23rd May 1979

Circulation: Those present
Mr Battishill
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Mr K E Couzens
Sir Fred Atkinson

CH/EX. REF. NO. B(79)16

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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 9.00 A.M. ON FRIDAY, 25TH MAY, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey
Sir Fred Atkinson
Mr. Lovell
Mr. Unwin
Mr. Shepherd
Mr. Ridley
Mr. Cropper

Sir William Pile)
Mr. J.M. Green) Inland Revenue

Mr. D.A. Lovelock)
Mr. A.J. Phelps) Customs and Excise

PREPARATIONS FOR THE BUDGET

The Chancellor reported that the Prime Minister had now approved the broad strategy of his Budget, including a 15 per cent VAT, a 15 per cent increase in petrol duty (but see below) and no increases in the specific duties on tobacco and drink. There should be no increase in prescription charges and an increase of 5p - not 10p - in school meal charges. Offsetting cuts in expenditure would be required from DES but not in respect of the health service from DHSS. This would enable the main income tax package to be included in full.

2. The Forecast. The assumptions underlying the revised Treasury national income forecast (attached to Mr. Shepherd's minute of 24th May) were close to those of the "second sighting

shot". Compared with Ministers' present intentions, both the income tax reductions and the prospective cuts in public expenditure were somewhat understated. The forecast assumed asset disposals of £750 million, compared with the target of £1.2 billion. There was possibly also some marginal under-scoring of output in Q1 1980 for supply side factors.

3. PSBR. After a brief discussion, the Chancellor confirmed that his PSBR target for 1979/80 should be taken as £8¼ billion.

4. Monetary Target. With a 7-11 per cent monetary target and a 15 per cent GDP deflator somewhat higher interest rates might be needed to finance a PSBR of even £8¼ billion, without unrealistic assumptions about the capacity for further increasing the velocity of circulation of money. The effect of higher interest rates would have to be balanced against the psychological impact of lowering the monetary aggregates. It was arguable that unless there could be reasonable confidence of keeping the money growth to about 9 per cent, it would be better to hold to a target range of 8-12 per cent. This would need to be considered at a meeting the following week.

5. VAT. The Chancellor confirmed his decision to move to a single rate of 15 per cent.

6. Drink and Tobacco. The Chancellor confirmed that he would make no increase in the specific duty on drink or tobacco.

7. Petrol, Oil and Derv. The Prime Minister had asked that consideration should be given to ways of increasing the tax element in the price of petrol actually borne by businesses, either by replacing VAT on petrol wholly or partly by an increase in the specific duty, or by means of a blocking Order (on the lines of business purchases of motor cars) disallowing refund of VAT on petrol used for business purposes. A separate

VAT rate for petrol was undesirable; whilst zero-rating ran against EEC objections. A blocking Order, if feasible, could increase the VAT yield by about £300 million in a full year and £150 million in the first year.

8. After a short discussion of Mr. Lovelock's minute of 24th May on the oil duties, the Chancellor said he would like to give further consideration to the six packages shown in the Annex, and to a seventh package - package G, suggested by the Minister of State (Commons). Package G comprised a 23 per cent increase in petrol duty (7p on a gallon); a 20 per cent increase in the duty on derv (also 7p on a gallon); and a 20 per cent increase on rebated oil (½p on a gallon). This had little effect on the RPI in the first two years; and would yield an extra £75 million in a full year (£60 million in the first year) compared with package F. The Chancellor

invited Mr. Lovelock to prepare a further note which would (a) examine the possibility of a blocking Order on the VAT paid on petrol on the lines discussed; and (b) consider the arguments for and against the most promising 4 packages for petrol, derv and rebated oil (including packages E, F and G.)

9. Income Tax. The Chancellor said he was attracted by the presentational advantages flowing from the further increases in tax thresholds which had been suggested by the Minister of State (Lords). Together with the increases in the caretaker Finance Act, this would raise the tax thresholds by £3 a week (single) and £5 a week (married) compared with 1978/79 levels. Package 6, which narrowed the width of the reduced rate band by £150, saved £140 million in the first year (£165 million in a full year). Against that, it penalised people with only around half average earnings; it might provoke hostility from the TUC; and looked parsimonious in the light of the total income tax package. It was not easy to present a narrowing

of the reduced rate band as a step towards its elimination unless there was reasonable certainty of getting the basic rate down to 25 per cent in 1980. For these reasons, package 5 was to be preferred to package 6. However, if the personal allowances could be increased by a further £20 the Chancellor would then be able to say that he had doubled the increases required by the Rooker-Wise amendment. This would have considerable presentational value. The Chancellor

> invited Sir William Pile to produce a note on a further package which increased the single allowance by £180 and the married allowance by £280.

10. Higher Rates. In a brief discussion of possible offsetting savings, it was noted that the CBI proposals increased the higher rate threshold to £9,000 rather than £10,000. Despite the saving, there was general agreement that this was not a desirable change to make.

11. Small Businesses. The Budget could be presented as a highly attractive one for small businessmen. The unified rate of VAT and the income tax reductions were particularly helpful in this respect, as was the absence of any increase in NIS. Reception by the small business lobby would be even further improved by an assurance in the Budget speech that the Chancellor intended to deal with CTT the following year.

12. ACT. The Prime Minister regarded an ACT surcharge as unattractive industrially and politically. The Chancellor shared this view. It need not be pursued any further.

13. PRT. After a short discussion, Ministers' earlier decision about retrospection to 1st January 1979 was confirmed. Doubts had been raised about the dangers of hybridity if the Finance Bill included a provision to bring BNOC within the charge to PRT. If there was any risk of this, the Chancellor said the

provision should be excluded from the Finance Bill and taken in separate legislation. In that event, there should be a firm statement of intention at the time of the Budget. The Financial Secretary suggested that any announcement should also include details of the method of charging BNOC to avoid blighting the Government's disposal policy.

14. Foreign Earnings Relief. This had been considered by the Financial Secretary and the Ministers of State. Withdrawal of the special 25 per cent relief for foreigh earnings rested on the proposition that higher ratepayers stood to gain substantial amounts from the Budget. Unfortunately, there were significant groups, like mariners and construction workers, benefiting from the foreign earnings relief who paid tax only at the basic rate. They would lose heavily if the relief were to be withdrawn this year. On balance, therefore, Ministers had concluded against withdrawal this year. The merits of withdrawal in a future year remained to be considered. The Chancellor agreed.

15. Conclusion. The Chancellor said he would find it helpful if officials would prepare

(a) an up-to-date statement of the Budget arithmetic reflecting the decisions now taken and the further options under consideration; and

(b) a check list of the major and minor finance bill starters, with an indication of the state of decisions.

(A.M.W. BATTISHILL)
29th May, 1979

Circulation: Those present
Mr. Littler

CH/EX. REF. NO. B(79)21
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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT THE TREASURY AT 3.00 P.M. ON THURSDAY, 31ST JUNE, 1979

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Anthony Rawlinson
Mr. Couzens
Sir Fred Atkinson
Mr. Lovell
Mr. Shepherd
Mr. Unwin
Mr. Ridley
Mr. Cropper
Sir William Pile, Mr. Green — Inland Revenue
Mr. Lovelock, Mr. Phelps — Customs & Excise

BUDGET PREPARATION

The meeting reviewed remaining open issues. The following records the conclusions reached.

PSBR

2. The most recent computer run was reported as showing a forecast PSBR of £8.55 billion, which was subsequently revised downwards to £8.15 billion on discovery of an error in the run. The forecast assumed package E for oil, petrol and derv and income tax package 7. The PSBR figure was subject to confirmation and possible adjustment when the delayed trade figures were known.

Petrol: Business Use

3. The meeting considered Mr. Lovelock's minute of 25th May and Mr. Lovell's minute of 30th May. The Chancellor confirmed, after a brief discussion, that he was not prepared to accept, without closer examination, the uncertain industrial consequences attending a "blocking" provision on VAT paid on purchases of petrol for business use, or, a fortiori, charged on derv. He would minute the Prime Minister accordingly. Since a blocking provision under section 3(9) of the Finance Act 1972 could be made by Order, the Chancellor was not precluded from taking action after the Budget, with or without an announcement in the Budget Speech, if he decided that was desirable.

Customs and Excise would consider the possibilities urgently and provide a note.

Increase in Oil Duty

4. After discussion, Ministers unanimously decided in favour of including package G in Mr. Lovelock's note of 24th May. Revenue considerations this year took priority over the fiscal case for eliminating the differential between the duties on petrol and derv, and the large increase on derv could be justified by reference to the absence of changes in VED on commercial vehicles this year. The large increase in the duty on rebated oil was also thought to be tolerable.

Income Tax

5. Higher Rate Scale. The Chancellor confirmed his wish to keep to scale A in the minute of 30th May from the Minister of State (Lords), unless further substantial savings in the income tax package proved to be essential to keep within a PSBR target of £8¼ billion.

6. Thresholds. A final choice between (preferred) package 7 and package 5 was deferred pending further examination of the PSBR forecast. Ministers concluded that, on the basis of

present information, unless the final PSBR forecast was revised upwards by more than £0.3 billion, the Chancellor would be able to afford to include package 7 whilst remaining within the target level for the PSBR. The critical path for final income tax decisions was likely to be determined by the timetable for preparing the FSBR. The deadline for choosing between package 5 and package 7 was thought to be Tuesday, 5th June: this would be checked.

Budget Checklist

7. The meeting then went quickly through the checklist of items circulated with Mr. Lovell's minute of 30th May, with the following results.

8. Capital Transfer Tax. The transitional arrangements for discretionary trusts had now been settled.

9. US Double Taxation Agreement. The Chancellor said he would like to examine the point about retrospection. Sir William Pile said he would provide a note urgently.

10. Corporation Tax: Small Companies. The Chancellor decided that the proposals for "small companies" were not sufficently generous. He decided to raise the profit limits by £10,000 to £60,000 and the limit for marginal relief by £15,000 to £100,000. This would enable the Government to take credit for real increases in the limits, not just revalorisation.

11. Stock Relief: Dips. The exclusion of any relief for "dips" was re-examined. After a brief discussion, the Chancellor concluded that the decision not to give relief should stand. The objections were partly cost (£35 million) and legislative complexity, and partly that of disturbing the stability of the corporate tax structure.

Amendment of Law Resolution

15. Ministers recognised that the arguments were finely balanced for and against framing the Budget Resolutions so as to exclude a debate on the taxation of social security benefits; but concluded, on balance, against such an exclusion.

Next Steps

16. The Chancellor said he would now report his main conclusions to the Prime Minister. Draft minutes should be prepared

(a) reporting his consideration of the Prime Minister's suggestion for disallowing the VAT element in business purchases of petrol (Customs and Excise);

(b) describe the total Budget package and its constituent parts (Mr. Unwin); and

(c) commenting on the forecasts, which would be sent to the Prime Minister at the weekend (Mr. Unwin and Mr. Shepherd to co-ordinate).

(A.M.W. BATTISHILL)
1st June, 1979

Circulation

Those present
Sir Douglas Wass
Sir Lawrence Airey

BUDGET CONFIDENTIAL

MR LOVELL

cc Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Sir Fred Atkinson
Mr Littler
Mr Unwin
Mr Kemp
Miss Whalley
Mr Corlett
Mr Griffiths
Mr Hood

Chairman (Inland Revenue)
Chairman (Customs & Excise)

CHILD BENEFITS AND THE INDIRECT TAX PACKAGE

The Chancellor has seen your submission of 11 May. On paragraph 4, he has commented that we shall also need, of course, an assessment on the basis of this Budget's proposals for income tax.

M. A. HALL
14 May 1979

CH/EX. REF. NO. B(79)2
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cc: Chief Secretary
Financial Secretary
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Mr. Littler
Mr. Unwin
Mr. Lovell
Mr. Corlett
Miss O'Mara
Mr. Mortimer
PS/Inland Revenue

MINISTER OF STATE (COMMONS)

REDUCTION OF BASIC RATE: EFFECT ON NET CHARITABLE COVENANTS

The Chancellor would be grateful if you would let him have advice on Mr. Green's minute of 14th May on this subject.

(A.M.W. BATTISHILL)
16th May, 1979

REDUCTION OF BASIC RATE : EFFECT ON NET CHARITABLE COVENANTS

Note by the Inland Revenue

1. This paper is concerned with the effect of a reduction in the basic rate of income tax on the income received by charities through 'net' covenants.

BACKGROUND

2. Most charities rely in some degree on income paid to them by supporters under deeds of covenant. When periodic sums are paid to a charity under a valid deed of covenant two income tax rules come into play:-

a. the covenantor deducts basic rate tax from each payment and accounts for it to the Revenue (in most cases he is able to retain the tax deducted and so, in effect, obtain basic rate tax relief on his payment); and

b. the charity, being entitled to exemption from tax, is able to reclaim from the Revenue the amount of tax deducted - thus making good the full covenanted sum.

From the charity's point of view it effectively receives each covenanted payment in two parts - from the covenantor the net amount after tax deduction and from the Revenue the tax deduction itself.

'GROSS' COVENANTS

3. Where a covenantor undertakes to pay a fixed sum (a 'gross' covenant) the amount of the charity's income is not affected by changes in the basic rate of tax. An individual who covenants to pay, say, £100 annually to his chosen charity

will at present (with the basic rate at 33 per cent) actually pay £67 to the charity and the charity will recover the £33 tax from the Revenue. If the basic rate were to be reduced to 30 per cent the covenantor would then pay £70 to the charity and the latter would reclaim the £30 tax. Either way the charity would receive £100 - no more and no less.

'NET' COVENANTS

4. However, most covenants provide for the payment not of a fixed gross sum but of a specified net sum, using some such phraseology as "..... such an amount as after deduction of tax will leave the clear net sum of £X". With such covenants the amount of the charity's income is affected by every change in the basic rate. A covenantor who pays a net sum of, say, £100 annually is, at the current basic rate of 33 per cent, effectively paying the equivalent of £149.25 gross (tax on which, at 33 per cent, equals £49.25); he pays the £100 to the charity and the charity is able to reclaim £49.25 from the Revenue. If now the basic rate were to be reduced to 30 per cent the corresponding figures would be £142.86 gross, less tax (at 30 per cent) of £42.86, leaving £100 net. The charity would receive the same £100 from the covenantor but could recover only £42.86 from the Revenue. In relation to their 'net' covenants charities (by contrast with the rest of the population) benefit from increases in the basic rate and are disadvantaged when the rate is reduced.

RECENT HISTORY

5. The following table, covering the years since the introduction of the unified tax system, shows the effect of changes in the basic rate on a charity's income from a net covenant for £100 per annum.

Year	Basic Rate	Net payment	Tax recovered by charity	Gross payment	Increase/decrease on previous year's income
1973/74	30%	£100	£42.86	£142.86	-
1974/75	33%	£100	£49.25	£149.25	+ £6.39
1975/76	35%	£100	£53.85	£153.85	+ £4.60
1976/77	35%	£100	£53.85	£153.85	no change
1977/78	34%	£100	£51.52	£151.52	- £2.33
1978/79	33%	£100	£49.25	£149.25	- £2.27

Understandably, charities have made no complaint when the rate has risen. And in general they have taken in their stride (with some minor grumbling for effect) the consequences of the small reductions in the rate. Over the period covered by the table they have had no experience of a substantial reduction in the tax rate.

MAJOR REDUCTION : THE ONLY PRECEDENT

6. There has been only one previous instance of a major reduction in the tax rate. This occurred on the introduction of the unified tax system when the old "standard rate" of 38.75 per cent for 1972/73 was replaced by the new "basic rate" of 30 per cent for 1973/74. On those figures, had nothing been done, the tax repayment on a net covenant for £100 would have fallen from £63.27 to £42.86. Accordingly on that occasion a special transitional relief was provided to cushion the charities concerned against the effects of the abrupt change of system. (Briefly, for the four years beginning with 1973/74 a charity would claim additional payments amounting to 100 per cent, 75 per cent, 50 per cent and 25 per cent respectively of a figure representing the difference between the repayments due to it in respect of its 'net' covenants under the old and the new systems. The 4-year taper reflected the fact that old covenants, expiring regularly, would be replaced gradually by covenants entered into in the knowledge of the new system. The cost of the additional relief, over the 4-year period, was estimated at about £7½m but proved in practice to be about £11.6m.)

THE PRESENT QUESTION

7. Against this background the question is whether any special dispensation for charities should be allowed in the context of a reduction in the basic rate this year.

PROSPECTIVE LOSS TO CHARITIES

8. As a rough guide to what is involved, our best estimate of the immediate (first year) "loss" of income to charities (from smaller tax repayments on a reduction in the basic rate) would be about £4m-£4½m if the rate were reduced from 33 per cent to 30 per cent and about £10m-£11m on a reduction to 25 per cent. If the transitional relief were on the same basis as in 1973 with full compensation in the first year, the cost for the first year would be the same (the cost in 1979/80 would be £3m and £7½m respectively) and the cost of the whole scheme of compensation £10m-£11m for a reduction to 30 per cent basic rate and £24¼m-£27½m for a reduction to 25 per cent.

FACTORS FAVOURING RELIEF

9. The main argument - indeed the only one of any significance - favouring special relief for charities in this situation is that they need to be cushioned against abrupt and unforeseeable reductions in their income. It is no doubt even more true for charities than for the rest of us that when income rises the calls upon it expand to absorb the increase, and when it is falling the need to refuse assistance for deserving cases is particularly distressing. Charities (it may be considered) can be expected to ride minor ups and downs in their tax repayments but can reasonably look for protection against large unpredictable reductions.

FACTORS AGAINST

10. There are, on the other hand, several considerations on the opposite side -

a. By and large, charities which accept 'net' covenants do so because it is to their advantage (covenantors find it less complicated to pay a fixed sum to the charity and are presumed to respond more readily to that system); they may reasonably be expected to tolerate any inconveniences of the system along with its benefits.

b. The party which really benefits from a reduction in the tax rate is the covenantor and logically it is to him the charity should look if it wants protection from the change. It would be unreasonable to expect the Exchequer to bear the costs of the benefits to charities from a rise in the tax rate and to bail them out when the rate is reduced.

c. The transitional relief allowed for 1973/74 to 1976/77 was unique in several respects -

i. It was given because the change in the tax rate resulted from a re-structuring of the tax system. The charities, in appealing for the relief, and the Chancellor, in announcing it in his Budget statement, were both at pains to emphasise that the justifications for the relief lay in the change of system.

ii. The scale of the change was exceptional. Reduction of the tax rate from 38.75 per cent to 30 per cent reduced the gross value of a £100 net covenant from £163.27 to £142.86. To

produce the same proportionate reduction now (from a gross value of £149.25 to £130.59) would require the basic rate to be cut from 33 per cent to about 23½ per cent.

iii. Although the relief was calculated on the premise that the new rate of tax would be 30 per cent, the payments for the year 1974/75, 1975/76 and 1976/77 were made without revising the basis of relief - notwithstanding that the basic rate for the first of those years was in due course fixed at 33 per cent and for the two later years at 35 per cent. In effect, charities gained handsomely on the swings and should not now mind too much if they are expected to bear the loss on the roundabouts.

CONCLUSION

11. The argument for special relief must be judged by reference to the size of the proposed reduction in the basic rate and period over which that reduction takes place. A reduction as large as 8 percentage points, that is from 33 to 25, in one year might be thought to call for some relieving action. If, however, a reduction of this order is spread over two or more years, then charities have longer to adjust to it and to persuade their supporters to increase the amount of their net covenants (as they can well afford to do out of their increased net after tax income) to leave the charities in the same net position.

INLAND REVENUE
Somerset House
May 1979

BUDGET SECRET

SPARE

CH/EX. REF. NO. 6179/6

COPY NO. 12 OF 12 COPIES

cc: Chief Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Mr. Littler
Mr. Lovell
Mr. Corlett
PS/Inland Revenue

FINANCIAL SECRETARY

CAR LEASING

The Chancellor has seen Mrs. Diggle's minute of 17th May to Mr. Broadbent on this subject. The Chancellor agreed at Friday's Budget meeting that legislation might be included in the Finance Bill. He is content that you and the Minister of State (Commons) should settle the details, consulting the Chief Secretary as necessary.

(A.M.W. BATTISHILL)
21st May, 1979

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cc: Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Mr. Littler
Mr. Lovell
Mr. Unwin
Mr. Griffiths
Mr. Ridley
Mr. Cropper
PS/Inland Revenue

MR. LOVELOCK

BUDGET 1979: EFFECTIVE DATES OF CHANGES IN CUSTOMS AND EXCISE TAXES

The Chancellor read your submission of 18th May at the weekend. Subject to the views of other Treasury Ministers he is inclined to go along with the recommendations listed in paragraph 13 of your minute.

(A.M.W. BATTISHILL)
21st May, 1979

BUDGET SECRET

CH/EX. REF. NO. B(79)8

COPY NO. 9 OF 10 COPIES

cc: Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Lawrence Airey
Mr. Anson
Mr. Bailey
Mr. F.E.R. Butler

SIR ANTHONY RAWLINSON

CASH LIMITS AND VAT

The Chancellor has read and taken note of your minute of 18th May to the Chief Secretary on the feasibility of squeezing Departments even harder through the cash limits by asking them to absorb the consequences of a 15 per cent VAT.

(A.M.W. BATTISHILL)
21st May, 1979

BUDGET SECRET

BUDGET SECRET

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cc: Chief Secretary
Financial Secretary
Minister of State (Lords)
Sir Douglas Wass
Sir Lawrence Airey
Mr. Littler
Mr. Bridgeman
Mr. Lovell
Mr. Unwin
Mr. Corlett
Mr. Mortimer
Miss O'Mara

MINISTER OF STATE (COMMONS)

STAMP DUTY ON HOUSE PURCHASE

The Chancellor was grateful for your minute of 18th May on this subject.

2. He is content with your conclusion that the stamp duty thresholds should be left unchanged this year.

(A.M.W. BATTISHILL)
21st May, 1979

BUDGET SECRET

BUDGET SECRET

SPARE

CH/EX. REF. NO. B(79)10

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cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Mr. Couzens
Sir Fred Atkinson
Mr. Unwin
Mr. Lovell
Mr. Ridley
Mr. Cropper

PS/INLAND REVENUE

ACT SURCHARGE

At the Budget meeting in the Chancellor of the Exchequer's room on Friday, brief reference was made to the possibility of an ACT surcharge as the means of raising additional revenue this year. The Chancellor was not attracted to the idea at the time, but has since been giving the matter further thought. He would be grateful if the Inland Revenue, in consultation with the FP Division of the Treasury, would let him have a note urgently setting out the considerations for and against. For the purposes of illustration, I suggest you assume a surcharge of 50 per cent, lasting for one year or two.

(A.M.W. BATTISHILL)
21st May, 1979

BUDGET SECRET

BUDGET SECRET

SPARE

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COPY NO. 3R of 3R COPIES

PRIME MINISTER

I have already mentioned to you in a general way how my thinking on the Budget has been developing. To meet the 12th June deadline I must now firm up several important decisions without further delay, and I must do so with your support. I have therefore set out below the considerations most relevant to those decisions.

2. Even taking full credit for the latest proposals for cuts (not yet agreed by colleagues) we shall have a very tough task in cutting this year's PSBR back to £8bn. This will be a very substantial reduction, both absolutely and in real terms, on the outturn for 1978-79, which is now thought likely to be around £9 bn, well above Denis Healey's target. We have also to allow for the likelihood that the new short-term forecast (due later this week) will predict a PSBR for 1979-80 (on pre-Budget policies) lying between £10 bn and £11 bn, rather than the £10 bn we now assume.

3. On the tax front we have identified in broad terms a package of income tax cuts which constitutes an irreducible minimum. Its principal features are

(1) cutting the basic rate to 30%, and the higher rates to 60% maximum;

(2) a modest but significant improvement in the allowances over and above the provisions of the caretaker Finance Act.

4. We have deferred "buying out" the 25% reduced rate band until next year, and set our face firmly against a number of other

/smaller

smaller but highly desirable changes. The principal details are set out in the attached table, though it must be stressed that the costings are provisional and subject to revision when the forecast is available. (I can explain when we meet the other smaller changes which we have in mind - some of which are important in terms of presentation and confidence).

5. As you will know from last Thursday's Cabinet, we have now taken an extremely firm line on public spending for 1979-80, and I do not think that there are more economies of any significance to be found if we can secure what we have bid for.

6. On the indirect tax front the position is tough but, I believe, manageable. Even if this week's new forecast does not worsen the PSBR arithmetic, the minimum direct tax package can only be financed with a 15% VAT rate. This is crucial and equally important for next year. The only margin turns on whether or not we increase the duty on drink and tobacco, both of which have a heavy weight in the price index, together with the other specific duties. If they are included, the immediate impact of the indirect tax changes on the RPI is about 4.3%. If not, it is just over 3½%. We need to balance this difference against the importance of reducing the PSBR by the extra £200 million that is involved.

7. Looking beyond the mechanics and arithmetic of the proposals is still difficult. But one or two points are already clear. On conventional economic arithmetic the impact of our measures would be deemed to be quite severely contractionary. But insofar as <u>any</u> Government - including a Labour one - would have had to cut the PSBR back to circa £8.5 bn, <u>any</u> responsible Budget at this juncture would tend to have a contractionary effect. I intend of course to stress this point in the course of my Budget speech. But I think that, in contrast to a Labour Government, we would expect to see our Budget lead to an improvement in confidence at home and

/abroad

abroad, amongst both consumers and investors. This should lead to a more favourable outcome.

8. Furthermore, one must allow something on the plus side for the impact on the "supply side" of the economy of an important first step towards getting right our tax structure and incentives. No one can know quite how much that intangible but vital consideration is worth, or when it will come into effect. But it is no less relevant for that.

9. Finally there is the question of confidence in our policies in the longer term. If I can give really firm and convincing indications in my Budget speech of the Government's ability and determination to get public spending and borrowing down and to control the money supply in the longer term, then the response of the economy should be swifter and more positive. This points, of course, to the extreme importance of our securing early agreement from our colleagues to the need for longer run economies on the scale we shall be putting forward in this Thursday's Cabinet discussion of the medium-term public spending survey.

(GEOFFREY HOWE)
21st May 1979.

	PSBR 1979-80 (£million)	RPI impact effect
Direct Tax		
Increase* in single and married allowances by £120 and £190 respectively, together with corresponding age allowance increases		
Reduction in basic rate to 30p	+£2,790	
Improvements in higher rate structure and top rate 60%		
Investment income surcharge: single threshold of £5,000		
Public Expenditure		
Cash limits squeeze on prices and pay (assumed £720 million reduction in volume of central Government spending).		
RSG cut of £300m (assumed £100m reduction in volume of LAs spending).		
Specific cuts of £1.3 bn.	-£3,000	0.4%
Contingency reserve cut of £250 million.		
Sales of assets of £1 bn.		
Indirect Tax		
VAT at 15%		
15% increase in petrol duty.		
10% increase in specific duties except VED	-£1750	4.3%
Alternatively		
As above, but excluding drink and tobacco	-£1550	3.6%

* Including Caretaker Finance Act increases.

(Note: These figures are rough estimates based on the use of current ready reckoners and assuming a floating exchange rate and unchanged monetary growth).

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CH/EX. REF. NO. B(79)12

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

21 May, 1979

Dear Norman.

THE FUTURE OF VEHICLE EXCISE DUTY (VED)

Thank you for your letter of 14th May in which you refer to the line that you propose you should take if questioned about our policy on the future of vehicle excise duty as it applies to petrol engined vehicles. You will have seen that Christopher Soames wrote to me on the same day raising the question of how I propose to deal with this subject in the Budget.

I agree with you that we ought to review the previous Government's decision to abolish VED and to make up the revenue loss through the petrol duty before we decide either to confirm the policy or to reverse it. As you will know, I was anything but convinced by the case for abolition. We are obviously bound to give some weight to the manpower savings which are alleged to be possible, but there is also the related question, which Christopher Soames refers to in his letter of possible changes on the procedures for vehicle registration.

Above all, of course, I have the revenue implications to bear in mind. "An old tax is," as they say, "a good tax" - particularly when you recall that it will yield about £800 million in the current year. Would not a modern on-line computer facility at Swansea enable us to save the (claimed) £20 million in staff costs, without losing the revenue?

There is clearly no time to resolve this issue before the Budget. I go along with the proposition in Christopher's letter to the effect that I should make it clear that any changes I might propose in the transport taxes in my Budget statement are without prejudice to the future of VED which will be subject to early review. I hope that we in fact can decide what to do about this in the course of the summer. All the relevant material is available and I see no need for an extensive further review by officials. Against

The Rt. Hon. Norman Fowler, MP,

BUDGET SECRET

BUDGET SECRET

this background I am content for you to deal with any questions concerning the matter on the lines proposed in your letter - that we shall be reviewing the whole operation of the tax and that, pending a decision, we shall not be proceeding with the consultations on the phasing of the change from VED to petrol tax which were initiated by the previous Government.

I am sending a copy of this letter to Christopher Soames and a copy of both our letters to the Prime Minister.

(GEOFFREY HOWE)

CH/EX. REF NO. B(79)15
COPY NO. 3 OF 3 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

When we discussed the Budget yesterday you expressed concern about the likely impact on prices of the proposals described in my minute of 21st May. You asked for more information about the inflation prospect and the impact on it of different Budget packages. This minute does that and examines the consequences of the various alternatives.

2. I must start with income tax. We are committed to substantial income tax reductions. The Budget in this respect will be seen as a test of our resolution to implement commitments we have entered upon in Opposition. The minimum changes required in my judgement are as follows:

To cut the basic rate to 30 per cent.

To cut the top rate to 60 per cent on income over £25,000.

To increase the single and married allowances by £120 and £190 respectively (including the £90 and £140 included in the caretaker Finance Act)

The cost of these changes in 1979/80 is around £3.1 billion (£3.9 billion in a full year). Together with other less costly improvements (eg. for old people and on investment income) the cost this year to the PSBR is about £2.8 billion. And if it were possible to do more than this on the thresholds the package would be better-balanced, particularly in relaton to those at the bottom of the income scale.

4. It is clearly right that we must look to finance cuts in income tax by cuts in public expenditure. The proposals agreed

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in Cabinet amount to about £3.4 billion in 1979/80, including £1 billion from sales of assets. It is critical to the Budget arithmetic that Colleagues deliver these cuts in full.

5. The PSBR for 1979/80 is currently forecast on unchanged policies at about £10¼ billion. The net effect of our intended public expenditure cuts and of the income tax reductions (including the minor reliefs) would reduce this figure to around £10 billion. This contrasts with our target reduction to at least £8 billion.

6. We can only attain this objective by increasing indirect taxes, as we have said we would. This will put up prices. Before any Budget changes the RPI is forecast to rise to about 13 per cent by the end of this year. The choice is between adding to that figure or falling well short of our PSBR target; or, of course, doing much less than we want in reducing income tax. These are the variables. I can see no other alternatives.

7. An increase in VAT to a unified 15 per cent, coupled with a 15 per cent increase on petrol duty and a 10 per cent increase on other specific duties would just about close the gap. We would be in sight of a £8 billion PSBR, perhaps just a little more. But the RPI would increase by 4.3 per cent on this account. (I ignore any other small increase which might arise from putting up charges). The same package, but omitting increases in the duty on tobacco and drink, would reduce the price increase to 3.6 per cent. But the PSBR would be £0.2 billion higher.

8. A 12½ per cent VAT would reduce the RPI increase to 2.9 per cent, if coupled with a 10 per cent increase in the

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specific duties (15 per cent on petrol). But this would increase the PSBR by £½ billion to over £8½ billion. Excluding any increase on drink and tobacco would reduce the RPI increase even further, to 2.3 per cent, but increase the PSBR by another £0.2 billion.

9. Lastly, a 10 per cent VAT would reduce the RPI increase to 1.6 per cent, coupled with a 10 per cent increase in specific duties (15 per cent on petrol). This would increase the PSBR by a full £1 billion, compared with a 15 per cent VAT - to a figure over £9 billion. In short, it is simply not possible to make worthwhile income tax reductions and keep the PSBR to around £8 billion without a 15 per cent VAT. With a 12½ per cent rate income tax expectations would be sadly disappointed; with only a 10 per cent rate we could scarcely make a start.

10. That said, with the year on year rate of increase in average earnings likely to be around 15% at the end of the year, I do not under-rate the significance of adding 3½-4 per cent to an already rising RPI.

11. But a comparison between gross earnings and prices gives an incomplete and distorted picture. What matters is a comparison between take home pay and prices, and everyone would be securing substantial income tax cuts. Such a package would be presented as giving greater personal choice. This message may be easier to get across if the switch to indirect taxation is immediate and ambitious than with a more muted version.

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12. It is true that the perceived rate of inflation will suffer an immediate shock, but this will not then be repeated month after month. By September or October there would be substantial tax rebates coming just at a critical period for wage bargaining, or the formulation of prospective wage claims. At what will be the most difficult period for wage negotiation, the Budget price increase will be in the past. Against that background, we must consider whether an extra one or two per cent on the RPI on top of what would be necessary anyway would make a critical difference to the climate for earnings in the next pay round. This can only be a matter of judgement, but I see no reason to suppose that this would make a critical difference in the sense of crossing some threshold of danger. In my judgement, this Budget provides our only opportunity to make a radical switch from direct to indirect taxation and thus honour the commitment on which our credibility depends. Coupled with firm monetary policies, one or two additional points on the RPI should not be decisive.

13. I hope we may have an early opportunity to talk this through. I am sorry to burden you with more figures (in the attached tables), but I am rapidly approaching the administrative deadline for a decision on the indirect taxes. The necessary printing timetable requires identification of a limited range of options by the weekend and final choices by the end of 31st May.

(GEOFFREY HOWE)

	PSBR 1979-80 (£million)	RPI impact effect
Direct Tax		
Increase* in single and married allowances by £120 and £190 respectively, together with corresponding age allowance increases		
Reduction in basic rate to 30p	+£2,790	
Improvements in higher rate structure and top rate 60%		
Investment income surcharge: single threshold of £5,000		
Public Expenditure		
Cash limits squeeze on prices and pay (assumed £720 million reduction in volume of central Government spending).		
RSG cut of £300m (assumed £100m reduction in volume of LAs spending).		
Specific cuts of £1.3 bn.	-£3,000	0.4%
Contingency reserve cut of £250 million.		
Sales of assets of £1 bn.		
Indirect Tax		
VAT at 15%		
15% increase in petrol duty.		
10% increase in specific duties except VED	-£1750	4.3%
Alternatively		
As above, but excluding drink and tobacco	-£1550	3.6%

*. Including Caretaker Finance Act increases.

(Note: These figures are rough estimates based on the use of current ready reckoners and assuming a floating exchange rate and unchanged monetary growth).

	PSBR 1979-80 (£ million)	RPI impact effect
Direct Tax		
Increase* in single and married allowances by £120 and £190 respectively, together with corresponding age allowance increases		
Reduction in basic rate to 30p	+£2,790	
Improvements in higher rate structure and top rate 60%		
Investment income surcharge: single threshold of £5,000		
Public Expenditure		
Cash limits squeeze on prices and pay (assumed £630 million reduction in volume of central Government spending)		
RSG cut of £300m (assumed £100 m reduction in volume of LAs spending).	-£2920	0.4%
Specific cuts of £1.3 bn		
Contingency reserve cut of £250 million		
Sales of assets of £1 bn		
Indirect Tax		
VAT at 12½%		
15% increase in petrol duty	-£1,265	2.9%
10% increase in specific duties except VED		
Alternatively		
As above, but excluding drink and tobacco	-£1060	2.3%

* Including Caretaker Finance Act increases.

(Note: These figures are rough estimates based on the use of current ready reckoners and assuming a floating exchange rate and unchanged monetary growth).

	PRBR 1979-80 (£ million)	RPI impact effect
Direct Tax		
Increase* in single and married allowances by £120 and £190 respectively, together with corresponding age allowance increases		
Reduction in basic rate to 30p	+£2,790	
Improvements in higher rate structure and top rate 60%		
Investment income surcharge: single threshold of £5,000		
Public Expenditure		
Cash limits squeeze on prices and pay (assumed £540 million reduction in volume of central Government spending)	-£2,830	0.4%
RSG cut of £300m (assumed £100m reduction in volume of LAs spending).		
Specific cuts of £1.3 bn		
Contingency reserve cut of £250 million		
Sales of assets of £1 bn		
Indirect Tax		
VAT at 10%	- £750	1.6%
15% increase in petrol duty		
10% increase in specific duties except VED on cars.		

*Including Caretaker Finance Act increases.

(Note: These figures are very rough estimates of the orders of magnitude based on the use of current ready reckoners and assuming a floating exchange rate and unchanged monetary growth).

BUDGET SECRET

SPARE

CH/EX. REF. NO. B(79)18

COPY NO. 15 OF 15 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

31 May, 1979

Dear Norman

Thank you for your letter of 14th May in which you proposed a package of 'tilted' increases in vehicle excise duty on the heavier goods vehicles. I am sorry to have taken so long to reply but I wanted to take the decision in the light of the shape of the Budget package as a whole.

I have now decided that in view of the size of the increases that we are contemplating in the road fuel duties, it would not be appropriate to make any increase in vehicle excise duty this year. I understand that, when you were consulted at an earlier stage in our deliberations, you took the same view, so I hope this decision will be acceptable to you. The decision can be explained, not only by the diesel duty increase, but also by the need to restructure the duty from unladen to gross vehicle weight. Perhaps, after the Budget, our officials could get together to discuss this further.

Yours

(GEOFFREY HOWE)

The Rt. Hon. Norman Fowler, M.P.

BUDGET SECRET

BUDGET CONFIDENTIAL

cc Chief Secretary
Minister of State (Lords)
Minister of State (Commons)
Financial Secretary
Sir Douglas Wass
Sir Fred Atkinson
Sir Lawrence Airey
Sir Anthony Rawlinson
Mr. Littler
Mr. Bridgeman
Miss Brown
Mr. Butler
Mr. Cassell
Mr. Lovell
Mr. Shepherd
Mr. Odling-Smee
Mr. L. J. Taylor
Mr. R. G. Ward
Miss O'Mara
PS/Inland Revenue
PS/Customs and Excise

MR. UNWIN

DEFINITION OF THE BUDGET

The Chancellor has seen your minute of 30th May. With one proviso, he accepts your definition, taking credit for the increase in PRT as part of the Budget package. He wishes to sanitize from the package the increases in nationalised industry prices which he regards as an unavoidable inheritance from the previous Government.

(M. A. HALL)
31st May, 1979

BUDGET SECRET

CH/EX. REF. NO. B(79)19

COPY NO. 4 OF 5 COPIES

PERSONAL

cc: Mr. Shepherd
Mr. Lovell

MR. UNWIN

This records some points the Chancellor made to me at the end of this afternoon's meeting. I record them now before they are forgotten. They need to form the basis for reporting to the Prime Minister tomorrow.

2. The Chancellor wants to send the Prime Minister three pieces of paper:

(a) A report on some ideas for making the business use of petrol more expensive. I am asking Customs and Excise to provide a draft minute.

(b) A short summary note on the total budget package as it now stands, with its component parts. Because of (c) below this can now be free-standing.

(c) A minute with which can be sent the forecast. This can build on Mr. Shepherd's draft of 30th May but will need to be expanded in several respects. See below. It needs also to incorporate what is said about the path for prices. Your separate draft will then fall.

3. Concentrating therefore on (c) the Chancellor has suggested a number of points to be covered.

(i) The first requirement is to defuse - or put into perspective - some of the more gloomy aspects of the forecast.

(ii) Prices. First, the 17½ per cent end-year prices figure needs to be dissected and defused. The line should be that most of this is in the pipeline already - due to earnings, commodity prices, the Price Commission etc. Those for the nationalised industries fall into two parts: those caused by the Budget and those flowing

/from existing

from existing policy on cash limits. Implication is that only a small part of this arises from the Budget as such. Finally, as for indirect taxes, the increases come down from the x per cent implicit in 15 per cent VAT plus 15 per cent specific duties to only 3.6 per cent on the present Budget package. To this extent, the Chancellor has sought to meet the Prime Minister's concern.

(iii) Also on prices, the Chancellor thinks he ought to say something about the lower National Institute forecast for inflation so as to shade some of the gloom in our own forecast.

(iv) Two final points on the forecast as a whole. First, the Chancellor wants to convey that the Treasury forecast follows a demand based short-term model (if that can be sustained) whereas the Government's policy is based upon (implicitly) a longer term supply-based model. Second, in interpreting the results, one must remember that Mr. Healey's Budget would also have had a depressive effect upon the economy to get down to a PSBR of £8½ billion.

4. This note looks altogether a more substantial piece of work than either your note on the short-term inflation prospect or the short cover minute I commissioned from Mr. Shepherd. The deadline for it is really tomorrow afternoon.

(A.M.W. BATTISHILL)
31st May, 1979

BUDGET - CONFIDENTIAL

May. Top sent. Please enter as necessary. JN

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

1st June 1979

Dear Mr Marsden

BUDGET PUBLICATIONS 1979

As usual, I am writing to seek your co-operation in dealing with the Budget Publications.

The following documents will be published on Budget Day, Tuesday, 12 June 1979. Copies will be deposited in the Vote Office in sealed packets (marked with the appropriate embargo) during the course of the day and I should be grateful if you would release them at the appropriate times.

1.	Budget Resolutions (1500 copies)	Delivered at 3.30pm under seal to be broken when the Chancellor sits down.
2.	Financial Statement and Budget Report	(a) "Blue" Version - for release before the Budget Statement (1400 copies)
		(b) "Red" Version - for release when the Chancellor sits down (2000 copies)

In addition to the foregoing there will be a number of press notices. Brian Dyer will be in touch with you about this.

I am copying this letter to Clive Mitchell, Printed Paper Office, House of Lords, who should receive the standard number of copies of all these documents except the Budget Resolutions, and I should be grateful if he would make similar arrangements for their release.

Yours sincerely

A J Nelson.

A J NELSON
Private Secretary

P K Marsden, Esq OBE

BUDGET CONFIDENTIAL

Mr Mortimer - FP
Mr Locke - CU
Miss O'Mara
Mr Chambers - EOG
My Dyer - Parliamentary Clerk
Mr Godfrey - IDT
Mr Mower - IDT
Mr Collinson - Estimates Clerk
Mr B Smith - Accounts
Mr Bottrill - EB
Miss Deyes - EB
Mr MacKlen - GEP(2)
Mr Robbins - EGA(3)
Mrs M Robertson - Chancellor's Office
PS/Inland Revenue
PS/Customs and Excise
Mr McKendrick - Stationery Office

PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (Lords)
PS/Minister of State (Commons)

BUDGET PUBLICATIONS 1979

I am circulating to those concerned with the distribution of these documents, the letter I am today sending to the Deliverer of the Vote at the House of Commons.

In addition, Mrs. M Robertson in the Chancellor's Office (Room 82/3rd Floor) should receive by 10.30 am on Budget Day:-

Budget Resolutions - 40 copies (Mr. Randell Parliamentary Counsel arranges)

Financial Statement and Budget Report - "Red" 330 copies (Mr. B. Smith Accounts arranges)

AJN

A J NELSON
4th June 1979

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

1st June 1979

Dear Mr Marsden

BUDGET PUBLICATIONS 1979

As usual, I am writing to seek your co-operation in dealing with the Budget Publications.

The following documents will be published on Budget Day, Tuesday, 12 June 1979. Copies will be deposited in the Vote Office in sealed packets (marked with the appropriate embargo) during the course of the day and I should be grateful if you would release them at the appropriate times.

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Yours sincerely

A J Nelson.

A J NELSON
Private Secretary

P K Marsden, Esq OBE

BUDGET CONFIDENTIAL

cc Chief Secretary
Financial Secretary
Minister of State (Lords)
Minister of State (Commons)
Sir Douglas Wass
Sir Lawrence Airey
Sir Fred Atkinson
Mr. Littler
Mr. Lovell
Mr. Unwin
Mr. Corlett
Mr. Mortimer
Miss O'Mara
Mr. Cropper
Mr. Ridley
Mr. Lovelock - C/E

PS/INLAND REVENUE

SMALL COMPANY RATE OF CORPORATION TAX

The Chancellor was grateful for your minute of 1st June on this subject. He has decided, however, that he does not want to disturb the decision to raise the upper limit to £100,000.

A.M.W. BATTISHILL
4th June, 1979

CH/EX. REF. NO SPARE B(79)23

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Treasury Chambers, Parliament Street, SW1P 3AG
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PRIME MINISTER

Following our discussion a week ago I have now more or less settled the main budget proposals and I thought it would be helpful to let you have a summary of them this weekend. For operational reasons it was necessary to settle the indirect tax changes by last night and, subject to the comments below, I hope it will not be necessary to make any further significant changes in the package.

2. I have framed the proposals in the light of the updated National Income Forecast which became available this week. I am sending a copy of this to you under a separate covering note. The forecast will, however, need to be revised over the weekend to take account of the latest information both on the economy and on the package itself. If, as is possible, this leads to some upward revision to the forecast of the PSBR, I shall need to consider some adjustment to the income tax proposals. I hope this will not be necessary; but I shall want to settle this by Monday evening if we are to be able to meet the timetable for producing the necessary Budget documentation.

3. The main constituents of the package may be summarised as follows:-

Direct tax: I am planning to do a little more on the thresholds than was included in the "minimum" package in my minute to you of 23 May. This will give the package a better balance and in particular

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01-233 3000

help those lower down the income scale. More specifically, the main income tax reductions proposed are:-

- a 3p cut in the basic rate to 30 per cent
- a cut in the top rate to 60 per cent on taxable income over £25,000, with a first higher rate band of £2,000 at 40 per cent starting at £10,000;
- increases in the single and married allowances of £180 and £280 respectively over the 1978-79 levels - double the increases under indexation provisions of the caretaker Finance Act.

The total cost of these changes in 1979-80, together with related increases in the age allowances and other less costly improvements (eg on investment incomes), is estimated at about £3.6 billion (£4.5 billion in a full year). I am also proposing some smaller changes in corporate taxation (eg on stock relief and to help small companies). The base rate and structure of corporation tax will, however, remain unchanged.

Indirect tax: As we agreed last week, VAT will be increased to a unified rate of 15 per cent and I am proposing increases in the duty on petrol and derv of 7p a gallon (a duty increase of about 23 per cent on petrol and 20 per cent on derv). The duties

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on alcohol and tobacco will remain unchanged, as we also agreed. These increases will yield about £2.3 billion this year (£4.1 billion in a full year) and have an impact effect of about 3 3/4 per cent to the RPI.

Public expenditure: Subject to the developments at E Committee this morning of which you are aware, the package will be as agreed by Cabinet, including the reductions in specific progammes and sales of assets that we discussed yesterday. The outlook for prices following the Budget will mean that the cash limits squeeze will be somewhat greater than colleagues have so far been led to expect: the Chief Secretary and I are considering the implications of this. The effect of the increase in prescription charges to 45p, and of additional price increases by the nationalised industries due to the package, will be to add about 0.3 per cent to the RPI by the middle of next year by which time it should once again be on a downward path. In my Budget statement I shall give some account of all the main expenditure cuts; I am sure the House will expect this.

4. There are two other tax measures I should mention. First, there is general agreement that the present rate of Development Land Tax is too high and is reducing the supply of development land and acting as a brake on the building and construction industries. I am therefore proposing to

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to reduce the rate to 60 per cent and to raise the exemption to £50,000. This should assist the release of development land and lighten the burden of tax. Second, we have inherited our predecessor's decision to increase petroleum revenue tax from 1st January. With some modifications I propose to implement this. It seems right in present circumstances, when we are seeking to reduce the burden of direct taxation, to look to the North Sea for a larger revenue contribution.

5. I hope that this combination of measures will enable me to publish in the Industry Act forecast, which will be contained in the Financial Statement and Budget Report, a PSBR forecast for this year of £8¼ billion. This will be within our PSBR target. But if any substantial upward revision proves necessary, I shall, as indicated above, consider an offsetting revision to the income tax proposals. But even if this does prove necessary, the increases in the thresholds should still be very substantial.

(G.H.)
June, 1979

cc: Chief Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Lawrence Airey
Mr. Littler
Mr. Lovell
Mr. Corlett
Mr. Cropper
Mr. Ridley

FINANCIAL SECRETARY

BUDGET RESOLUTIONS

The Chancellor would be grateful if you and the two Ministers of State would assume responsibility for examing the Budget Resolutions.

(A.M.W. BATTISHILL)
4th June, 1979

SPARE

CH/EX. REF. NO. B(79)24

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PRIME MINISTER

VAT ON PETROL

At our discussion on 24th May you asked me to examine ways of increasing the revenue paid on the purchase of petrol for business use, by for example replacing the VAT element with a higher rate of specific duty. I find there are great difficulties in achieving what you want in this way but that effectively the same result can be secured by introducing a "blocking" provision to prevent the deduction of VAT on petrol for business use. Any such provision could not, in this context, extend to VAT on diesel road fuel (derv) because of its importance for industrial costs.

2. It would be technically possible to introduce a "blocking" provision as a Budget measure, to take effect (by Order) on Monday 18th June together with the VAT increase to 15 per cent. It would have to cover all petrol used by businesses: there could be no halfway house - for example, we could not block VAT deduction only in respect of the Budget increase from 12½ per cent to 15 per cent. There might be some difficulties with the EEC, but these could probably be surmounted. The effect of the measure would be to raise additional revenue of about £250 million in a full year and £125 million in 1979/80. The RPI would increase by about 0.2 per cent over time and total UK petrol consumption might be reduced by up to 2 per cent a year in the long run.

4. However, there would be a number of disadvantages:-

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01-233 3000

(i) The revenue gain from the proposal would be reflected in an addition to business costs. This would not be limited to expenditure on petrol for cars, but would extend to other business expenditure on petrol - for example, delivery vans and taxis (which amount to about one-third of all "business use" of petrol). The effect would be very selective and would no doubt give rise to many not unreasonable complaints. We shall be adding to business costs through the 7p excise duty increases for petrol and derv and through the extra VAT on new cars (the subject of an existing blocking Order). I do not think it would be right to do more at this stage - necessarily in a very random fashion.

(ii) By altering the balance of taxation between petrol and derv, the measure could have a potentially serious effect on the UK car market. As you know, the outlook for our car manufacturing industry is already poor, and we ought not to risk further damage by straining the traditional loyalty of the company car market to British manufacturers. At present, virtually no diesel cars are manufactured in the UK, but output has been increasing elsewhere, especially in France and Germany.

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I am satisfied that a selective (petrol only) increase of this kind could induce a significant switch to diesel cars, with a consequent increase in the volume of imports.

(iii) Criticism could also be levelled at us on the grounds that the move was much too much of a leap in the dark. We often spoke out in Opposition against ill-considered proposals brought forward in a hurry. I would not like us to be tarred with the same brush. (The blocking Order on cars, to which I have referred above, was part of the original structure of VAT which was the subject of widespread consultation over a long period.)

5. These disadvantages seem to me considerably to outweigh the revenue and energy conservation attractions of the proposal. I have therefore decided not to include the proposal in my forthcoming Budget. Nevertheless, we must clearly expect the energy supply situation to remain tight for some time to come, and there could well be a case in the longer term for a blocking Order (quite possibly applying to Derv as well as to petrol). I propose therefore to instruct officials to give it detailed consideration after the Budget, for possible action either next year or, if the energy supply situation should seriously deteriorate, later this year

(G.H.)
June, 1979

BUDGET SECRET

CH/EX. REF. NO. B(79)25

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cc Chief Secretary
Minister of State (Lords)
Minister of State (Commons)
Financial Secretary
Sir Douglas Wass
Sir Fred Atkinson
Sir Lawrence Airey
Sir Anthony Rawlinson
Mr. Couzens
Mr. Littler
Mr. Bridgeman
Miss Brown
Mr. Butler
Mr. Cassell
Mr. Lovell
Mr. Shepherd
Mr. Odling-Smee
Mr. L. J. Taylor
Mr R. G. Ward
Miss O'Mara

PS/Inland Revenue
PS/Customs and Excise
Mr. Ridley

MR. UNWIN

DEFINITION OF THE BUDGET : NATIONALISED INDUSTRY PRICES

The Chancellor is grateful for your minute of 1st June and the accompanying tables. The division between those nationalised industry prices stemming directly from the Budget expenditure cuts and those which do not, seems to him to be very satisfactory.

A. M. W. BATTISHILL
4th June, 1979

CH/EX. REF. NO. B(79)27
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cc: Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Couzens
Sir Lawrence Airey
Sir Anthony Rawlinson
Sir Fred Atkinson
Mr. Byatt
Mr. Littler
Mr. Anson
Mr. Hancock
Mr. Bridgeman
Miss Brown
Mr. Butler
Mr. Middleton
Mr. Cassell
Mr. Lovell
Mr. Unwin
Mr. Evans
Mr. Odling-Smee
Mr. Sedgwick
Mr. Melliss
Mr. Ridley

CHIEF SECRETARY

FORECASTS FOR THE PSBR

The Chancellor would be grateful to have advice from you, the Financial Secretary and Mr. Ridley on Mr. Shepherd's minute of 1st June. I understand the Financial Secretary has discussed this with officials and will be minuting shortly.

2. As time is short I took the precaution of speaking to your Private Secretary about this in advance.

(A.M.W. BATTISHILL)
4th June, 1979

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cc: Chief Secretary
Financial Secretary
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Minister of State (L)
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Sir Lawrence Airey
Mr. Littler
Mr. Lovell
Mr. Ridley
Miss D.E. Barratt
PS/Customs & Excise

MR. GRIFFITHS

VEHICLE EXCISE DUTY

This note records our brief telephone conversation in which I confirmed the Chancellor's agreement that you should communicate to the Ministry of Transport at official level the Chancellor's Budget decision on the level of derv duty.

(A.M.W. BATTISHILL)
4th June, 1979

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MR. UNWIN

BUDGET SPEECH - DRAFT OF 5TH JUNE

I attach sections of the Budget Speech in the form revised by the Chancellor yesterday. This draft at present lacks section D (a new approach), F (inflation) and N (peroration), on which the Chancellor is still working.

2. Comments received in the Chancellor's office by the weekend, and some received yesterday, have been taken into account so far as possible.

3. The Chancellor would be grateful if Mr. Ridley would give particular attention to section C on the international environment.

4. The Financial Secretary has suggested that, when covering the public expenditure cuts, it would be a good idea to express these inter alia as percentage cuts in current and capital expenditure respectively. The aim would be to show that this is the first package for some time that has not taken the soft option of striking at capital expenditure, something about which the Expenditure Committee have been exercised for some time. Perhaps Mr. Butler would take this point onboard.

5. I should be grateful if Mr. Bottrill would be responsible for ensuring all figures are checked for accuracy on this and successive drafts, and if other comments could reach me by 5.00 p.m. this evening, if possible. The passages in square brackets will need particular attention.

6. The remaining sections of the Speech will follow as soon as possible.

(A.M.W. BATTISHILL)
5th June, 1979

Circulation

Chief Secretary
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MEG Members
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Mr. Kemp
Mr. L.J. Taylor
Mr. Jeremiah
Mr. Ridley
Mr. Cropper

Sir William Pile) Inland Revenue
Mr. Lovelock) Customs & Excise

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INTRODUCTION

A.1 It is a little over five years since my predecessor, the rt. hon. Member for Leeds East, rose at this despatch box to present his first Budget. Like me, he did so within a very few weeks of his Party's success at a General Election. In compressing the huge and complex process of Budget-making into so short a time, he faced - as I have done - a formidable task.

A.2 Like him, I have received unstinting support not just from my colleages on the Treasury Bench but from many people, of every rank, within the Treasury and the two Revenue Departments. But for the willingness of all these people to work far beyond even their sense of duty it would scarcely have been

/possible for me

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possible for me to present this Budget at all.

A.3 So I gladly echo my predecessor in acknowledging this assistance with a very real sense of gratitude.

A.4 I echo him too - and, however surprising it may now seem, I assure the House that I quote his very words - in saying that I approach my task "in a mood of humility and trepidation".

A.5 I say that not so much because of the novelty of the experience for me - although that is daunting enough. I do so because of my sense of dismay at the growing, almost total, familiarity of the occasion from the point of view of the British people, whom we all seek to represent in this place.

/For I am,

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A.6 For I am, let me remind the House, the fourth Chancellor to come into office with a new Government within the last fifteen years. The late Iain Macleod survived too tragically short a time to be included in this series, so that before myself, there was the present Leader of the Opposition, in 1964; my noble friend, Lord Barber, in 1970; and the rt. hon. Gentleman, the Member for Leeds East, in 1974.

A.7 The familiar feature about the first Budget Speech of each of my three predecessors is that every one of them has found cause to complain, with more or less cause, about the disagreeable nature of the economic estate that has come his way.

/The House will

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A.8 The House will understand, in light of that I see every reason to take the same view as my predecessors.

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B. YEARS OF DECLINE

B.1 But it would be a very barren exercise if I were simply to leave it at that. So I shall take this opportunity to put the matter in a rather longer perspective.

B.2 Only a quarter of a century ago - within the memory of almost every Member of this House - the people of the United Kingdom still enjoyed higher living standards than citizens of any of the larger countries of Europe. Amongst the free nations of the world, Britain was second only to the United States in economic strength.

B.3 In the twenty-five years since then, we have, it is true, become more prosperous. But others, like Germany and France, have achieved a great deal more - and by now have

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/far outstripped

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far outstripped us.

B.4 Their combined share of world trade in manufactured goods, which in 1954 was the same as ours alone, is now three times as large as ours. The gross national product of France is now one and a half times as large as that of the United Kingdom. And that of Western Germany is more than twice as large.

B.5 There has, of course, been a lot to say by way of mitigation or explanation of these developments. And, as the spokesman for one of Europe's "less prosperous countries" - what a humiliating description - we have all become very good at saying it. At least until recently, we have been able to claim a good record in most of those things that can

/be summed up i

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be summed up in the phrase "the quality of life". But in the last few years, the seediness and the sullenness has begun to dominate the scene. And the hard facts of our relative decline have become increasingly plain.

B.6 Of course, the years since 1974 have been, for most of the Western industrialised countries, a period of slower growth and higher inflation than in the decade before 1974. But the UK has had a worse record on both counts than almost any of our main competitors. On output, we took over 4 years to get back to the level of the first quarter of 1974 which was the period of the 3-day week. On inflation we reached in 1975 a year on year rate of nearly 27 per cent, worse than any of our EEC partners. And when the last

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/Administratio

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Administration left office the rate was rising again quite strongly - and rising more for domestic reasons than because of oil prices.

B.7 The facts of the recent past speak for themselves. Consumer spending rose last year by 5½ per cent. But manufacturing output rose by only 1 per cent. In the result, it was more than 4 per cent lower in 1978 than in 1973. Pre-tax real rates of return [on] fell to less than half of their level in the 1960s. And the volume of manufactured imports rose last year by no less than 13 per cent. The current account of the balance of payments for 1978 was barely in surplus, despite a massive contribution of £3½ billion from North Sea oil. The figures now

/available.

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available for the first [ ] months of this year show

B.8 On that form there is little reason to expect any improvement in economic performance in the future. In many respects, indeed, the prospect is more gloomy than the immediate past. Productivity is currently rising only about half as fast as in the early 1970s - at about one-[ ] of the rate in Western Germany, for example, And there is no indication of any change in this trend. Last year's growth in demand - founded, as it was, on growing consumption - could never have been regarded as self-sustaining. It was indeed self-defeating. This makes it increasingly likely that the recent falls in unemployment /will quickly be

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will quickly be reversed. Meanwhile, as I have already noted, inflation is back on a sharply rising trend [reaching double figures for the first time in 16 months in April]. It is small wonder that British industry is demoralised and the British people disillusioned.

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C. INTERNATIONAL ENVIRONMENT

C.1 Perhaps the first lesson to be learned from this story of decline is that our problems are very largely of our own making. Too often in the past we have tended to hope that international changes might offer some easy way out of our difficulties. Or to be all too willing to blame our problems on such conditions, as being beyond our control. Certainly the international environment is unlikely to give us any comfort in the years immediately ahead.

C.2 Oil is once again a major problem. With the reduction in Iranian production, conditions in the market have become very tight. Oil prices are [now on average about 25 per cent higher than six months ago]. This is one

/reason why

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reason why inflation is now rising in most countries and why growth is likely to be significantly lower than in 1978. In these circumstances, we clearly now need to do more about both conservation and about supply of energy. We must implement the energy saving proposals which we have agreed internationally. In this Budget I intend to announce measures that will contribute to that end.

C.3 The energy problem is, of course, one of those subjects where the right international agreement can and should help both us and the wider world economy. I have no doubt that it will be an important subject of discussion at the next meeting of the Council of Europe and at the Economic Summit in Tokyo at the end of this month. I hope too that the

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/better distribution

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better distribution of current account balances we have seen in recent months will continue and will help to maintain the greater stability of exchange rates which have been another feature of this period.

C.4 In this uncertain world economic environment the European Community can be a source of stability and of strength for its members. As a Government, we are firmly committed to the objectives of the Community. There is, however, one important area where present EEC policies will hinder our efforts to help ourselves and to raise our living standards towards the levels of our more successful partners. At present the UK and Italy, which are among the poorer members of the Community, are making transfers of resources, chiefly through the Community Budget, to richer member

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/states.

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states. We have already warned our partners that this situation cannot continue. It is both unfair and against the interests of the Community itself, which cannot hope to progress and prosper on so insecure a foundation. I am confident that the problem and our reaction to it are becoming more fully understood by our partners and that we shall be able to build an agreement which meets the UK case upon this understanding.

C.5 But no international effort can be a substitute for the efforts that are necessary to eradicate the deep-seated weaknesses of our own domestic economy.

C.6 Growing production of North Sea oil should certainly enable the UK, better than most countries, to meet the problems of world

/energy shortage

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energy shortage. But it is all too likely, on the other hand, to shield us from the truth about our underlying balance of payments. Certainly North Sea oil will not itself do anything to solve the problems on the supply side of our economy or remove the risks of excessive inflation. The moral once again is that it is for us to put our own house in order. Only then shall we be better able to match the performance of our main partners in the world economy and once again play a respected role in international councils.

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E. EXCHANGE CONTROL

E.1 Before I come to my main proposals, I propose to deal with the question of exchange control.

E.2 Outward capital flows from the UK are more tightly controlled than those from any other major industralised country and in a world of floating exchange rates, the current regime is clearly an anachronism.

E.3 Sterling is at present relatively strong. This flows from the realisation that, as a result of North Sea oil, the United Kingdom is relatively better placed to deal with the present wolrd shortage. This is therefore an appropriate time to start liberalising our exchange controls in accordance with our obligations under the EEC Treaty. There is anyway a strong case now for giving both companies and individuals

wider freedom of choice, and for reducing the distortions and costs which controls are bound to impose on economic decisions.

E.4 We intend to move in this area one step at a time, and, in this initial stage, we are placing emphasis on direct investment. A Press Notice will be issued today giving details.

E.5 I have decided that the main relaxation is to be a ration of £5 million per project per year for new outward direct investment. This should allow the majority of UK firms who invest overseas all the sterling finance they are likely to want. The two-thirds rule, which restricts the re-investment of profits earned overseas, will be abolished. This greater freedom in the financing od direct investment abroad does not, as is sometimes feared, threaten jobs in the United Kingdom. The weight of evidence /is that,

is that, if as a result overseas investment is increased, our position in world export markets will in general be strengthened.

E.6 There should also be some easement of the controls affecting individuals. I am therefore making significant relaxations in the rules concerning tavel and emigration allowances, overseas property, and cash gifts and payments to dependants. And sterling finance will once more be permitted for third-country trade [conducted by UK merchants]. In the field of portfolio investment, I am taking two steps at this stage. I am abolishing the requirement to maintain 115 per cent cover for overseas portfolios financed by foreign currency borrowing; and official exchange will henceforth be available for meeting interest payments on such borrowing.

/E.7 As time goes b

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E.7 As time goes by, I shall be studying further proposals for a gradual relaxation of control. Announcements will be made when conditions are appropriate. The pace of relaxation will obviously be influenced by the effect of international events on sterling as well as by the speed with which we can solve the economic problems that face us.

E.8 In our external policy we have to take account of our official external debts. These at present amount to $22 billion - a massive increase on the $8 billion which the previous Government inherited in 1974. It is the Government's intention to reduce this burden of external debt substantially during the life of this Parliament.

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G. MONETARY POLICY

G.1 As I remarked in the House 3 weeks ago, the rt. hon. Gentleman, my predecessor, was on the right lines in adopting a system of monetary targets. But he did not go far enough. Despite setting a target range of 8-12 per cent, in the year to mid April sterling M3 is now estimated to have risen by 11½ per cent. [Set out annualised rate during last 6 months and 3 months]. If the public expenditure policies which we inherited had been left unchanged, it would not have been possible even to meet the 8-12 per cent target without a further savage squeeze on the private sector, involving a sharp increase in the total tax burden.

/This Government

G.2 This Government are committed to the progressive reduction of the rate of growth of the money supply. It is therefore my intention to lower the target range for the remainder of this year, 1979-80, by 1 per cent rather than to leave it unchanged. The new target range, to apply to the growth of sterling M3 in the 10 months to the banking make-up day in April 1980, will therefore be an annual rate of 7 per cent to 11 per cent. I will roll this target forward by 6 months in the autumn.

G.3 Equally important, I intend to shift the balance in the way in which the monetary target is achieved from an excessive reliance on interest rates and curbs on the private sector to a greater emphasis on fiscal restraint and curbs upon the public sector. This requires a

/significant

significant reduction in the PSBR from the £ billion forecast on the basis of existing policies.

G.4 There are limits to what the Government can do in this first Budget with two months of the financial year already passed. This is indeed a severe handicap. But we shall nonetheless reduce the public sector's financial needs sufficiently for it to be possible to achieve the lower monetary target with less restraint on the private sector. And if the private sector exercises restraint when settling prices and wages, there should be room within the monetary target for its financial needs to be met too.

/It is with

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G.5 It is with diffidence that I offer any estimate of the extent of Government borrowing in 1979-80. As the rt. hon. Gentleman, the Member for Leeds East, found to his cost, the PSBR is a fickle and elusive statistic. But I judge that the fiscal policies I shall announce today will be sufficient to reduce the borrowing requirements to [ ] in the current year, as compared with the outturn of £9¼ billion for 1978-79. I intend a further progressive reduction in the PSBR in future years.

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H. PUBLIC EXPENDITURE

H.1 As we have always said, a major contribution to reducing the borrowing requirement and the burden of direct taxation must come from savings in public spending and from drawing back the boundaries of the public sector. Our review of the plans we have inherited, and our campaign to eliminate waste and needless bureaucracy, are only just beginning. But substantial reductions can be made in the remainder of this financial year.

H.2 First, as I made clear three weeks ago, we shall not raise the cash limits to cover higher prices than provided for in the cash limits originally published for this year. On pay, we will honour the commitments entered upon by our predecessors. But here again we will limit the

/adjustment of the

adjustment of the cash limits so that substantial offsetting economies will have to be found.

H.3 My rt hon Friend the Secretary of State for the Environment has informed the local authorities that the increase orders on the Rate Support Grant for England and Wales will provide at least [£300 million] less than will be required to cover the Government's full share of the increased costs arising from pay settlements. This will make substantial economies in local authority spending essential. And we reserve the right to increase the abatement when we see the cost of the remaining settlements this year. A similar policy will be applied in Scotland.

H.4 In the Civil Service, my noble Friend the Lord President has announced that economies of at

/least 3 per cent

3 per cent will be obtained this year and that recruitment will be regulated accordingly. The cash limits on Departments and fringe bodies will be set to ensure that these economies are achieved.

H.5 I estimate that this cash limits policy will reduce planned expenditure by about [£1000 million at 1979 Survey prices].

H.6 On top of these reductions resulting from the policy on cash limits, my rt. hon. and hon. Friends have reviewed the programmes for their Departments and have identified further specific reductions we are being made in the plans this year. The changes in each Minister's programmes are listed in a Press Notice being issued by the Treasury today and further details will be given by the Ministers concerned. But the House will want to

/know where

know where the main reductions will be made.

All figures are at 1979 Survey prices.

[Industry and Trade (including export credit)

Energy

Employment

Environment

Transport

Aid

Education

Social Services]

H.7 My rt. hon Friends the Secretaries of State for Scotland, [Wales] and Northern Ireland are making corresponding reductions in their own programmes where these are separate.

H.8 In one programme we are increasing the plans. An extra £100 million is being provided for the defence programme this year. This will

/enable essential

enable essential projects in the equipment programme to go ahead. But these specific cuts in programmes, after including the extra provision for defence, will amount to a further net reduction of £1¼ billion this year.

H.9 In addition to these specific reductions in public expenditure programmes, we shall not need as large a Contingency Reserve as provided for 1979-80 in the last Government's public expenditure White Paper. We do not intend to allow for other than very small additions to programmes during this year.

H.10 The Contingency Reserve for the current year now stands at [just over £600 million]. This balance remains after allowing for expenditure from 1978-79 by Civil Service industrial action in the last weeks of the previous Government and for the social security measures which I shall be

/announcing later

announcing later this afternoon.

H.11 We have decided to cut the Reserve by £250 million. Any further decision to add to the volume of programmes in the remainder of this year will be met from the [£350 million] remaining in the Reserve.

H.12 As I have already indicated, we are only just embarking on our review of the plans we have inherited and the scope for reducing the size of the public sector. But there are already a number of major options for early sales of assets.

H.13 Final decisions have not been taken and we must retain flexibility on timing and the choice of assets in order to ensure a fair price. I am confident that the proceeds of sales in the current financial year will be £1.2 billion and I have made this assumption in the Budget arithmetic.

[I do not

[I do not propose to announce the details today because it would be wrong to unsettle the financial markets] or [The largest single item in our present view will be part of the Government's shareholding in BP, which is likely to account for about a half of the total. Assets of the National Enterprise Board will be nearly a tenth of the total. The remainder will largely come from the oil interests of the British Gas Corporation and BNOC].

H.14 In total I estimate that the overall saving in public expenditure this year from the measures I have announced will amount to [over £3 billion at 1979 Survey prices]. We shall also be working out in the context of the annual Public Expenditure Survey the scope for further and more substantial savings in public expenditure programmes for future years. Yet given

/the scale of

the scale of the problems we have inherited, even this cut in public spending in the current year will be insufficient to allow me at the same time to reduce the PSBR to the figure of £8¼ billion which I have already mentioned and at the same time to implement the first stage of the substantive reductions in income tax which I regard as essential. I must therefore look for a further contribution from indirect taxes.

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I. INDIRECT TAXATION

I.1 Because of the late Budget, the additional revenue obtained in the current financial year from increases in the indirect taxes will be substantially less than the amount which would be raised in a full year. Inevitably this has given me less freedom than I would have liked this year. Nevertheless, I am determined to make a start on our plans to implement a major switch from taxes on income to taxes on spending, so as to restore incentives, to make it more worthwhile to work, and, at the same time, to increase the freedom of choice of the individual.

Value Added Tax

I.2 First, Value Added Tax. I propose to unify the two existing positive rates.

/This will

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This will be a desirable simplification of the VAT system, and will be especially welcomed by small traders.

I.3 The new unified rate will be 15 per cent. This new rate will come into effect on Monday 18th June. I recognise that the scale of the increase is larger than has been generally expected. But I must stress that only an increase of this size could provide sufficient scope for a real start to be made on cutting income tax and giving the British people the incentive to get our economy moving at a pace comparable to that of our competitors. [When one takes account of the wide range of goods which are (and will, of course, remain) zero rated, the total burden of VAT is

/equivalent to

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equivalent to per cent on the total range of consumer spending. This compares favourably with the lowest rate in any other country in the European Community [namely per cent in].

I.4 The yield from the increase is estimated at £1175m in 1979/80 and £3550m in a full year. Thus it will provide scope for further direct tax reductions in later years. The relatively small size of the yield this year reflects the loss of over two months' revenue and the gap before traders pay over VAT receipts to the authorities - an average of about 3 months. This has, however, an important and helpful effect in another direction. For as these funds build up in traders' hands, they provide

/a substantial

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a substantial boost to the liquidity of the firms and companies concerned.

I.5 The effect of the increase on the RPI will be to raise it immediately by about 3.5 per cent. But the House should bear in mind that VAT does not apply to necessities like food, fuel, housing and transport. These zero-rated items, together with other reliefs from VAT, cover in total nearly half of consumers' expenditure. Moreover, the evidence is that people tend to spend proportionally more on VAT rated goods as their incomes rise - this means it is a moderately progressive tax.

I.6 However, I appreciate that those who do not currently pay income tax, and I

/have in mind

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have in mind particularly those living on National Insurance pensions, will not benefit from my income tax proposals and will be anxious about the effect of this indirect tax switch on their standard of living. I should, therefore, make it clear now that the proposals I shall be announcing shortly for the uprating of Social Security benefits, including pensions, will take full account of the effect on prices of the VAT increase .

Excise Duties

I.7 I turn now to the excise duties. The sharp increase in VAT will, of course, add significantly to the shop prices of drink and tobacco. [For example

/the VAT

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the VAT increase will mean an extra p on a bottle of whisky, p on a pint of beer and p on a standard packet of 20 cigarettes.] In these circumstances, I do not think it would be justifiable to raise those prices further in the present year.

Hydrocarbon Oil Duties

I.8 The oil duties however raise wider issues. I have already indicated that I shall be announcing today measures which will help us to meet the growing and undoubted need to conserve oil. At a time when there is a worldwide shortage of crude oil it is essential that we should play our full part in achieving the 5 per cent reduction in consumption to which the previous Government rightly committed us.

/I therefore

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I.9 I therefore propose to increase all the oil duties this year. In the particular case of petrol, the VAT increase from 12½ per cent to 15 per cent will be smaller than for many other items. With this in mind therefore I also propose to increase the petrol duty by about 15 per cent - 4½p a gallon - which will result in a total price change of just over 7p a gallon. I also propose to increase the duty on derv by the same sum, 4½p per gallon, and the duty on heavy oil other than derv, by ¼p, about 10 per cent. I am not, however, increasing the duty for burning oil and for domestic paraffin, which is the oil used most commonly in the home, particularly by pensioners. The yield from these excise duty changes is estimated

/at an

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at an additional £325 million in a full year and £250 million in 1979/80. The immediate increase in the RPI will be less than a quarter of one per cent.

Vehicle Excise Duty

I.10 I have decided to make no change in the rate of vehicle excise duty. Our predecessors announced their intention of abolishing the duty on petrol driven vehicles. In consultation with my colleagues, I shall be reviewing again the future of this duty and we shall announce our conclusions in due course. For heavier goods vehicles my rt. hon. Friend, the Minister of Transport, will be announcing plans for restructuring the form of this tax, and for the moment therefore it seems best to leave this duty unchanged also. Nor do I propose any increase in the Car Tax.

BUDGET-SECRET

J. SOCIAL SECURITY PAYMENTS

J.1 As I have already explained, we have taken steps to mitigate the effect of the indirect tax measures upon the poorer section of the community.

J.2 We have accordingly decided to increase the rate of retirement pensions in November by £ to £ for a married couple, and by £ to £ for a single person. As we promised, these increases take account of the underestimate which the last Government made of the actual rise in earnings and prices between November 1977 and November 1978, and are well above the figures of £4 and £2.50. Other social security benefits will also be increased, and my rt. hon. Friend, the Secretary of State for Social Services, will announce full details [tomorrow].

/This means that

J.3 This means that pensioners and other beneficiaries will be fully protected against the forecast increase in prices. This is what is really important. But the extent to which we can afford to go further than this - to add improvements in real terms - must depend on the extent to which the economy as a whole, which depends on the productive capacity of those in work, can afford it.

J.4 Under the present rules long term benefits are uprated on the basis of the movement in prices or earnings, whichever is the greater. The Government have decided, however, that for the future the requirement for the mandatory uprating of long term benefits should be based on price movements, and we shall be introducing legislation to this end. This will be a minimum requirement, and will preserve the

/standard of

standard of living of beneficiaries by protecting them against cost increases, including the effects of the indirect tax changes I have just announced. Of course we shall want to be able to do more and I am confident that in time, as our economy improves, it will be possible to do so and ensure that pensioners share in the increase in national prosperity. That is why my other proposals today will make a determined start in restoring to working people the incentives that are necessary if they are to achieve greater prosperity both for themselves and for those others in our society who depend on them.

[J.5 The change will make no difference to this year, since the rise in prices in the year to November is now forecast as greater than the rise in earnings, and is thus fully reflected /in the figures

in the figures I have just announced.]

J.6 We also propose other social security increases. Single parent families face particular problems, and we propose that the one parent premium shoudl go up from £2 to £2.50 next November. The disabled are another section of the community who need particular help, and so mobility allowance will increase from £10 to £12 in the autumn. And we shall, of course, honour our commitment to pay a Christmas bonus this year of £10.

J.7 These measures overall will cost about £ million in 1979-80, and £ million in a full year, of which £ million will be charged against the Contingency Reserve. As the House knows, my general policy is to make substantial reductions in public expenditure. But this

/must not be

must not be done in a way which bears unduly on those least able to withstand it.

J.8 Our social security system has become far too complicated and it can reduce the incentive to work. This has been widely recognised on both sides of this House. It is important to correct this. My rt. hon. Friend, the Secretary of State, is therefore putting in hand urgent measures to tighten up on abuse and fraud and we are also studying other aspects of the social security system.

K. BUSINESS TAXATION

K.1 If the country is to increase its prosperity and to create the wealth upon which improvements in our public and social services must depend, we need a vigorous and profitable company sector. Profitability has dropped sharply in recent years and the rate of return on capital employed is now far too low. This is especially true of manufacturing industry.

K.2 Companies only survive by making profits. All the Government can do is help to create favourable conditions. But without adequate profitability we will not see the growth of new investment and new job opportunities which everyone wants. Against that background, I propose no change this year within the general system or in the rates of corporation tax.

/That is not,

K.3 That is not, however, to rule out the need for particular changes to meet particular needs. In particular, it is important that the tax system should take account of the effects of price changes on businesses, and do so in a way that is reasonably objective, equitable and simple to administer. The Government will be reviewing a number of aspects of the present system at the same time as the accountacy profession's latest proposals for current cost accounting, and I shall be arranging for the Inland Revenue to enter into consultations later in the year with the profession and with business.

K.4 I have three further detailed proposals to make this year. First, small businesses. We on this side of the House have consistently championed the cause of smaller businesses.

In the tax field, there is one measure that will do more than anything else to encourage the contribution that smaller businesses - indeed businesses of every size - can make to enterprise, innovation and employment. That is, a major reduction in the burden of income tax. But I also propose to raise this year the profit limits for the small companies rate of corporation tax - to the figure of £60,000 at the lower end and of £100,000 at the upper end. This will go some way further than is necessary to maintain their real value.

K.5 Second, stock relief. The Finance Bill will include legislation to honour the undertaking which my predecessor gave last year, and which we on this side of the House supported, to write off the deferred tax liabilities arising from stock relief given

for the first two years of the scheme - 1973-74 and 1974-75; and to write off these liabilities in respect of subsequent years successively, after an interval of six years.

K.6 In addition, following consultations which the Inland Revenue have had with industry, I am proposing two further changes in the stock relief scheme. I intend to reduce the profit restriction for unincorporated businesses from 15 per cent to 10 per cent; and all businesses will be given greater flexibility in the amount of relief that they can claim. Both these changes will be of particular benefit to smaller businesses.

K.7 Third, the present legislation contains a weakness which enables leased cars to avoid the special rules restricting capital allowances for business cars generally. There has

/recently been

recently been an explosive growth of car leasing, [partly as a result of that loophole, with the result that] the loss of tax is currently running at about £175m a year; and could well rise to £200m next year if I take no action. I propose to put this right with effect from today.

K.8 Details of these tax proposals will be given in press notices which the Inland Revenue are issuing today.

K.9 Finally, if industry is to flourish, we also need a vigorous capital market. In this context the control of dividends has now outlived its original purpose. The control will accordingly come to an end when the existing legislation expires on 31st July.

L. PETROLEUM REVENUE AND CAPITAL TAXATION

L.1 I turn next to petroleum revenue tax and capital taxation. The previous Government announced last August that they proposed to increase the former from 1st January 1979. These proposals were discussed very fully by the last Government with the industry and we ourselves have had representations about them which we have carefully considered.

L.2 Although we did not oppose them at the time, I am not sure that when the proposals were announced they were wholly justified in their intended aim of securing a fairer balance of shares between the public and the companies of this national resource. Companies cannot be expected to invest in the North Sea unless the return they get from successful development rewards them commensurately for the

/risks they have

risks they have taken and which we are continuing to look to them to take. But judged against the recent developments in the world oil situation the package of PRT proposals for increasing the Government's take from the North Sea is justified. There will accordingly be provisions in the Finance Bill to implement it. I also propose, however, to introduce some changes in the PRT expenditure rules for which the industry have been pressing for some time. Moreover, the British National Oil Corporation will no longer be exempted from PRT.

L.3 These proposals will increase the Government's revenue from the North Sea by about £ million, in the year 1979-80 and by about £ million to 1985.

L.4 On capital taxation, we made it clear in our manifesto that in the longer term we shall

make the taxation of capital simpler and less oppressive. I intend to achieve both these aims, but the circumstances I have described put a limit on what can prudently be done immediately and I cannot this year give changes here the priority I should wish. I shall however be carefully examining capital taxation and meanwhile, so as not to prejudice the position of trustees of discretionary trusts, I intend to defer by two years the full implementation of the capital transfer tax regime.

L.5 There is, however, one aspect of capital taxation which cries out for change at the earliest opportunity. I refer to the Development Land Tax, which has combined with the Community Land Act to prevent several worthwhile developments and to increase

unemployment in the construction industries.

L.6 We have made it clear that we shall repeal the Community Land Act at the earliest convenient opportunity. I do not propose to go so far as that with the Development Land Tax. For we accept that it is right there should be a special tax, at a higher than normal rate, on large gains from land which increases in value as the result of the grant, or prospect, of permission to develop it.

L.7 The consensus of informed opinion is, however, that the rate of Development Land Tax is too high. It is this which is reducing the supply of development land and acting as a brake on the building and construction industries. I therefore propose that instead of the present rates of 66.2/3rds per cent and 80 per cent, which the previous Government intended should

rise to 100 per cent, Development Land Tax shall for the future be charged at a single rate of 60 per cent. I also propose that the amount of development value which can be realised in a financial year without liability to Development Land Tax should be raised from £10,000 to £50,000. Both these changes take effect for disposals made on or after today. Further details are given in a press statement being issued by the Inland Revenue today.

L8. These changes will put Development Land Tax on a sounder basis. Owners of land suitable for development should no longer feel impelled to hold back in the hope that the tax rate will be further lowered. We shall keep the operation of the tax under review to see whether other changes are called for. I believe that my present proposals deal with the most important issue of this tax and will remove

the major uncertainty which has been hanging over the market.

M. INCOME TAX

M.1 I now come to the income tax reductions which are the keystone of my policy. It is the excessive levels to which the income tax has been driven over the years which bears so heavy a responsibility for the lack lustre performance of the British economy. We need therefore to cut the income tax at all levels - at the bottom, in the middle and at the top; this means in turn that we must raise the thresholds, reduce the basic rate and cut the top rates. For the reasons I have already explained I cannot do as much this year as I would have liked and I cannot do as much as is needed. But I propose taking a significant step forward in this Budget. I wish to leave no doubt in anyone's mind that this Budget is only the first instalment of income tax changes which

/we shall bring

we shall bring to fruition in the years to come.

M.2 I begin with the higher rates of tax. These rates no longer affect only those on very high incomes. They apply to the senior executives and the middle managers in industry and increasingly to skilled workers: as well as to professional people and the proprietors of small businesses. These are the people upon whom our hopes for initiative, greater enterprise and hence greater national prosperity must depend.

M.3 It is universally recognised that the present top rate of 83 per cent is an absurdity: in itself it brings in very little revenue but acts as a severe disincentive and is a patent injustice. The previous Government recognised this: it was simply they did nothing about it.

/I propose

I propose an overdue measure of reform. The top rate will be cut to 60 per cent and this rate will apply to taxable income over £25,000. At the other end of the scale, the present threshold of £8,000 is quite inadequate. I propose raising it to £10,000. Even at this figure it will be less in real terms that it was in 1973. In between I propose a new scale of rates less steeply progressive than the old rates which will ensure that middle management, so important to the success of British industry, will have their tax burden reduced to more reasonable proportions.

M.4 But it is not only at the top of the income range that the burden of income tax is particularly oppressive. The same is true for those on the lowest taxable incomes. That is the importance of the tax thresholds, to which I turn next.

The increases proposed in the April Finance Act, which were not of course implemented, were quite inadequate. I propose to double these increases. This means that the single allowance will go up, not by £90, but by £180; the married allowance will go up, not by £140, but by £280. For the single person the threshold will go up by nearly £3.50 a week: and if he is paying tax at the basic rate his tax will be reduced, by this change alone, by a full £1 a week. This is quite apart from the consequences of any further changes that I have to propose. For the married man the threshold will go up by £5.38 a week and if he is paying tax at the basic rate his tax will be reduced by £1.60 a week.

/M.5 I have

M.5 I have three other changes to propose to the allowances. First the age allowance will be raised by £240 for the single person and £380 for the married person. These again are double the figures proposed in the April Finance Act. In addition the income limit will be raised. Last year the limit for the full allowance was £4,000. This year I propose raising it to £5,000.

M.6 Second I propose raising the threshold for the investment income surcharge. The justification for retaining the surcharge is itself debateable. Certainlty there can be no argument but that it bites at far too low a level of income. Almost half [?] the surcharge is paid by people over 65. This is a tax falling with particular severity on those who have had to make provision for their retirement

out of their savings and have no inflation proof pensions to fall back on. The undue severity of the tax was recognised by the previous Govenrment by introducing what were no more than palliatives in the form of a reduced rate applied to the first few pounds of investment income and a marginally higher threshold for those over 65. We propose instead raising the threshold to £5,000 for everyone: the rate above that level will remain at 15 per cent. This approach combines a considerable simplification of the tax with a measure of justice that is long overdue.

M.7 Third we propose implementing our manifesto pledge and provision will be made in the Finance Bill to exempt war widow's pensions entirely from tax.

/M.8 I come

M.8 I come finally to the basic rate. For the great majority of workers - some 21 million in all - it is the basic rate which determines the tax liability. It is the basic rate which is also the marginal rate falling on additional earnings whether they come from overtime, or greater productivity, or reflect greater skill or the rewards of promotion. Everywhere one meets complaint and criticism of the effect of the income tax in eroding differentials, reducing the rewards of skilled workers and making effort and promotion barely worthwhile. My long term aim is to reduce the basic rate of income tax to 25 per cent. This year I propose taking a first and significant step in this direction by reducing the rate from 33 per cent to 30 per cent. Nothing less than this would provide both the incentive we need and the conviction that we really mean business.

/M.9 The total

M.9 The total cost of these income tax reductions, including the cost of increases in personal allowances proposed in April but not implemented at the time, will be £4,520 million in a full year. The lion's share, no less than £3,560 million or nearly four fifths of the total, represents the cost of increasing the personal allowances and reducing the basic rate. The cost this year will be £3,595 million.

M.10 Had no increase been made in the tax thresholds the number of people paying tax this year would have risen to 26.7 million. This will now be reduced to 25.4 million. The number of people paying tax at the higher rates would have risen by nearly 1,200,000: as it is the number will be 650,000. The number liable to the investment income surcharge will be reduced from a prospective 850,000 to

270,000. All the changes will simplify administration and reduce the work load on the Inland Revenue.

M.11 The changes in allowances will be implemented for most taxpayers on the first pay day after [August 1st]. The reduction in the rates of tax will be given effect as soon as new tax tables are ready in [October].

M.12 These reductions in the burden of income tax, which are as substantial as they are unprecedented, mean that people will have more money in their pockets to pay the higher prices for those goods and services on which tax is being increased. For the great majority of people the rise in take home pay will be more than enough to pay the increased bills. [This is weak: but it is not easy to see how to strengthen it and preserve accuracy.]

M.13 A full year's income tax reductions will be received even though my Budget is being presented two months or more after the start of the year. On this basis the income tax changes mean that for the married couple where the husband earns £100 a week, which is close to average earnings, there will be an increase in take home pay averaged over the remainder of the financial year of £3.94 a week. The increases in VAT and petrol duty will increase family expenditure by [£2.94]. So that, taking both the direct and indirect tax changes into account, the family will be [£1] per week better off. Similarly, where the husband earns £60 per week there will be a gain of [66p] a week, while the position of the couple on £150 per week will improve by p a week. Not only will such families be financially

better off, in terms of real take home pay, but also the choice of the way they spend their income will rest increasingly with them, and not with the Government.

M.14 [A table and explanatory note giving the details of these effects will be issued by the Treasury today.]

M.15 These changes represent only the first stage in the major reduction in the burden of direct taxation that we are pledged to make. But I hope that the net effects of my proposals as a whole - and not simply the immediate effects on prices of some of them - will be studied carefully, particularly by those who will be involved in the pay bargaining. It would not only be foolish but positively damaging to the worker's own best interest, if an attempt were

/made to

made to recover by excessive pay claims what has already been more than made good by these unprecedented reductions in income tax.

BUDGET CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 June 1979

Dear Keith

CAPITAL ALLOWANCES FOR LEASED CARS

I am writing to tell you of a change in the capital allowances for leased cars which we propose introducing in this year's Finance Bill. It has already been the subject of confidential discussions with your officials.

Briefly, the present position is that the cost of business cars generally qualifies for capital allowances at the rate of 25 per cent on the reducing balance basis (i.e. on the balance of cost remaining after deducting any allowance previously given). However, the cost of taxis and private hire cars has always qualified for the 100 per cent first year allowance, and in 1975 an appeal tribunal decided that under the present provisions cars leased to businesses for a period of years also qualified for 100 per cent allowances. This decision did not increase the total tax relief available over the life of the leased car, but made it more valuable by making it available earlier.

For a number of reasons leasing of business cars has grown very rapidly in recent years, and we have now reached the point where this unintended distinction between business cars which are leased and business cars acquired in other ways is currently costing the revenue about £175 million per annum. Given the overriding need to make room for reductions in personal taxation, we have concluded that this should not be allowed to continue, and that we ought to introduce provisions to limit 100 per cent allowances to the much narrower group of vehicles for which those allowances were originally intended. It is generally recognised that the present tax rules for leased cars are anomalous, and action on car leasing in this year's Finance Bill has been widely anticipated in the press.

In reaching this conclusion we have, of course, tried to evaluate and take full account of the likely impact of such a change on the UK car market and car industry. Clearly, it can

/only be

The Rt. Hon. Sir Keith Joseph, MP

only be unwelcome to the industry. Its impact should be slight, both because leasing still has only a relatively small share of the business car market and because we will not be reducing the total tax relief given but spreading it over a longer period. Because of the other advantages of leasing - in particular for cash flow and companies with tax losses - it seems likely that car leasing will continue to expand, despite any change in the tax rules, though probably at a slower rate than before. Against this background we concluded that the industrial implications ought not to stand in the way of correcting what is a very clear and has become a very expensive anomaly.

There is another capital allowances rule relating to cars we propose changing. Expensive cars - those costing more than £5,000 - qualify for a lower rate of allowances - the maximum in any year being £1,250 (25 per cent of £5,000). These limits were fixed in 1976, and having regard to the increase in car prices which has taken place since then, we are proposing that they should be increased to £8,000 with the maximum annual allowance in any year becoming £2,000. We also propose taking power to change these limits in future by Treasury Order so that they can more easily be kept at appropriate levels.

Leased cars at present escape the special provisions for expensive cars, and leasing has therefore been particularly attractive for more expensive business cars. Closing the car leasing loophole might therefore have a rather greater effect on the demand for expensive cars than for business cars generally. Increasing the limits for the special rules for expensive cars - which will apply to all business cars and not just those which are leased - should, however, help to offset any fall in demand resulting from the changes in the leasing rules. I hope it will be seen as a gesture of goodwill towards the car industry, and will make the changes for leased cars more acceptable to them.

(GEOFFREY HOWE)

BUDGET SECRET

CH/EX. REF. NO. B(79)31

COPY NO. 11 OF 12 COPIES

cc: Chief Secretary
Financial Secretary
Minister of State (Lords)
Mr. Lovell
Mr. Unwin
Mr. Ridley
Mr. Cropper
Mr. de Waal (Parly.Counsel)

MINISTER OF STATE (COMMONS)

TOBACCO PRODUCTS DUTY : CIGARETTES

The Chancellor has seen a copy of Mr. Phelps' minute of 4th June and would be content for you to settle the balance between ad valorem and specific duty elements in the duty on cigarettes.

(A.M.W. BATTISHILL)
5th June 1979

BUDGET SECRET

BUDGET SECRET

CH/EX. REF. NO. B(79)32
COPY NO. 17 OF 18 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

I have been thinking about the decision we took on Friday to increase prescription charges in the Budget to 45p.

2. I am sure it is right to put up the charge. My only anxiety is whether 45p is - or will look like - the right figure. In terms of maintaining the value of the charge since it was fixed in 1971, it should be about 56p or 57p. We have, sensibly enough, rejected the idea of such mathematical precision.

3. Having said that, would not the round sum of 50p seem much more natural if we have to have this sort of increase?

4. I feel sure it would arouse no more protest than 45p, which will look like an odd figure to have plucked out of the air. Indeed, 50p might conceivably arouse less protest simply because patients and dispensary staff alike will be saved the bother of dealing with 5p change. (Least important of all, in this presentational context, 50p would bring in an estimated further £5 million in this very difficult year.) I should like to suggest, even at this late stage, that we go for 50p rather than 45p after all.

5. I am copying this to colleagues on E Committee, Patrick Jenkin and to Sir John Hunt.

(G.H.)
5 June, 1979

BUDGET SECRET

BUDGET : SECRET

CH/EX REF NO B(79)33

COPY NO 21 OF 22 COPIES

cc Chief Secretary
Financial Secretary
Minister of State (Lords)
Minister of State (Commons)
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Sir Fred Atkinson
Mr Couzens
Mr Unwin
Mr Littler
Mr Lovell
Mr Corlett
Mr Mortimer
Miss O'Mara
Mr Cropper
Mr Ridley

PS/INLAND REVENUE

BUDGET PERSONAL TAX CHANGES: IMPLEMENTATION

1. The Chancellor has considered your minute of 5th June on the timetable for implementing the personal tax changes to be introduced in the Budget.

2. He has observed that your proposals appear to be in line with expectations. I think you may take it, therefore, that unless other Treasury Ministers dissent, these proposals have the Chancellor's approval.

A M W BATTISHILL

6th June 1979

BUDGET SECRET

CH/EX. REF. NO. B(79)34

COPY NO. 43 OF 45 COPIES

MR. UNWIN

BUDGET SPEECH - DRAFT OF 6TH JUNE

..... I attach a further revise of the Budget Speech incorporating comments received yesterday which the Chancellor has approved. This draft includes new Sections D (Causes of decline), DA (A new approach) and DB (Inflation). There will be no Section F (the material having been included elsewhere); and the Chancellor will complete Section N (peroration) later.

2. All comments received in the Chancellor's Office by close of play last night have been taken into consideration.

3. I should be grateful to receive comments on this draft if possible by 4.00 p.m. tomorrow. The passages in square brackets will again need particular attention. I should also like to fill in as many gaps as possible on this round.

(A.M.W. BATTISHILL)
6th June, 1979

Circulation:

Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
PCC Members
MEG Members
Miss Brown
Mr. Kemp
Mr. L.J. Taylor
Mr. Jeremiah
Mr. Ridley
Mr. Cropper
Sir William Pile (I.R.)
Mr. Lovelock (C. & E.)

BUDGET SECRET

BUDGET-SECRET

INTRODUCTION

A.1 It is a little over five years since my predecessor, the rt. hon. Member for Leeds East, rose at this despatch box to present his first Budget. Like me, he did so within a very few weeks of his Party's success at a General Election. In compressing the huge and complex process of Budget-making into so short a time, he faced - as I have done - a formidable task.

A.2 Like him, I have received unstinting support not just from my colleages on the Treasury Bench but from many people, of every rank, within the Treasury and the two Revenue Departments. But for the willingness of all these people to work far beyond even their sense of duty it would scarcely have been

/possible for me

BUDGET-SECRET

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possible for me to present this Budget at all.

A.3 So I gladly echo my predecessor in acknowledging this assistance with a very real sense of gratitude.

A.4 I echo him too - and, however surprising it may now seem, I assure the House that I quote his very words - in saying that I approach my task "in a mood of humility and trepidation".

A.5 I say that not so much because of the novelty of the experience for me - although that is daunting enough. I do so because of my sense of dismay at the growing, almost total, familiarity of the occasion from the point of view of the British people, whom we all seek to represent in this place.

/For I am,

BUDGET-SECRET

A.6 For I am, let me remind the House, the fourth Chancellor to come into office with a new Government within the last fifteen years. The late Iain Macleod survived too tragically short a time to be included in this series, so that before myself, in 1964 there was the present Leader of the Opposition; in 1970, my noble friend, Lord Barber; and in 1974, the rt. hon. Gentleman, the Member for Leeds East.

A.7. The familiar feature about the first Budget Speech of each of my three predecessors is that every one of them found cause to complain, with more or less justice, about the disagreeable nature of the economic estate that had come his way.

/The House will

BUDGET-SECRET

A.8 The House will understand, in light of that I see every reason to take the same view as my predecessors.

BUDGET-SECRET

B. YEARS OF DECLINE

B.1 But it would be a very barren exercise if I were simply to leave it at that. So I shall take this opportunity to put the matter in a rather longer perspective.

B.2 Only a quarter of a century ago - within the memory of almost every Member of this House - the people of the United Kingdom still enjoyed higher living standards than citizens of any of the larger countries of Europe. Amongst the free nations of the world, Britain was second only to the United States in economic strength.

B.3 In the twenty-five years since then, we have, it is true, become more prosperous. But others, like Germany and France, have achieved a great deal more - and by now have

/far outstripped

far outstripped us.

B.4 Their combined share of world trade in manufactured goods, which in 1954 was the same as ours alone, is now three times as large as ours. The gross national product of France is now one and a half times as large as that of the United Kingdom. And that of Western Germany is more than twice as large.

B.5 There has, of course, been a lot to say by way of mitigation or explanation of these developments. And, as the spokesman for one of Europe's "less prosperous countries" - what a humiliating description - we have all become very good at saying it. At least until recently, we have been able to claim a good record in most of those things that can

/be summed up in

be summed up in the phrase "the quality of life". But in the last few years, the seediness and the sullenness has begun to dominate the scene. And the hard facts of our relative decline have become increasingly plain.

B.6 Of course, the years since 1974 have been, for most of the Western industrialised countries, a period of slower growth and higher inflation than in the decade before 1974. But the UK has had a worse record on both counts than almost any of our main competitors. On output, we took over 4 years to get back to the level of the first quarter of 1974 which was the period of the 3-day week. On inflation we reached in 1975 a year on year rate of nearly 27 per cent, worse than any of our EEC partners. And when the last

Administration left office the rate was rising again quite strongly - and rising more for domestic reasons than because of oil prices.

B.7. The facts of the recent past speak for themselves. Consumer spending rose last year by five times as much as manufacturing output. We actually produced less, more than 4 per cent less, in 1978 than in 1973. Pre-tax real rates of return on capital fell to less than half of their level in the 1960s. And the volume of manufactured imports rose last year by no less than 13 per cent. The current account of the balance of payments for 1978 was barely in surplus, despite a massive contribution of £3½ billion from North Sea oil.

[B.8. On that form there is little reason to expect any improvement in economic performance in the future. In many respects, indeed, the prospect is more gloomy than the immediate past. Productivity is currently rising only about half as fast as in the early 1970s - at about one-[ ] of the rate in Western Germany, for example. And there is no indication of any change in this trend. Last year's growth in demand - founded, as it was, on growing consumption - could never have been regarded as self-sustaining. It was indeed self-defeating. This makes it increasingly likely that the recent falls in unemployment

/will quickly

will quickly be reversed. Meanwhile, as I have already noted, inflation is back on a sharply rising trend [reaching double figures for the first time in 16 months in April]. It is small wonder that British industry is demoralised and the British people disillusioned.]

C. INTERNATIONAL ENVIRONMENT

C.1. As inhabitants of a country deeply involved in the international economy, we have increasingly looked to events in other countries as an explanation of our troubles. Since the Yom-Kippur war of 1973 scarcely a day has passed without press, radio or television telling us in one way or another that the world economy is in crisis. The point has now been rammed home so often that all but a small minority of the British people put the blame for our economic troubles on the outside world; the oil crisis; the dollar crisis; the Common Market, and so on. Not on themselves.

C.2. [As I've already pointed out] *The record shows that this belief is quite false and very dangerous. Dangerous because it points us in

/quite the wrong

*Ideally the first 2 sentences of B6 should be carried forward to this part of Section C. At the very least some re-ordering of B is needed to get the best transition between B & C, whether in the present text, or in the redraft proposed here.

quite the wrong directions for the future. It suggests either that we might be rescued simply by a return of the world economy to its former buoyancy; or that if today's disturbed international environment continues, we shall not be able to put much right. In truth the troubles we suffer from are largely of our own making. If we tackle them ourselves, we can pull the economy round even in an economic blizzard. If we do nothing to change course, nothing happening beyond these shores can help us.

C.3. As it happens, the international environment is unlikely to give us any comfort in the years immediately ahead. Oil, in particular is once again a problem with the reduction in Iranian production conditions in the market have become very tight.

/Oil prices are

Oil prices are [now on average about 25 per cent higher than six months ago]. This is one reason why inflation is now rising in most countries and why growth is likely to be significantly lower than in 1978. In these circumstances, we clearly now need to do more about both conservation and about supply of energy. We must put into effect the energy saving proposals which we have agreed internationally. In this Budget I am announcing measures to that end.

C.4. The energy problem is, of course, a subject which is clearly best dealt with collaboratively among the major consumer countries. I have no doubt that it will be an important subject of discussion at the next meeting of the European Council and at the Economic Summit in Tokyo at the end of this month. We have to recognise that there is both a short-term and

a long-term problem of the sufficiency of oil supplies in relation to demands which a growing world economy is bound to make. I hope too that the better distribution of current account balances we have seen in recent months will continue and will help to maintain the greater stability of exchange rates which have been another feature of this period.

C.5. In this uncertain world economic environment the European Community can be a source of stability and of strength for its members. As a Government, we are firmly committed to the objectives of the Community. In one important area, however, present EEC policies hinder our efforts to help ourselves and to raise our living standards towards the levels of our more successful partners. At present the UK and Italy, which are among the poorer members of the Community,

are[making transfers of resources], chiefly through the Community Budget, to richer member states. We have already warned our partners that this situation cannot continue. It is both unfair and against the interests of the Community itself, which cannot hope to progress and prosper in so insecure a foundation. I am confident that the problem and our reaction to it are becoming more fully understood by our partners and that we shall be able to build an agreement which meets the UK case upon this understanding.

C.6. But progress internationally, whether on energy policy or the Community Budget, will not eradicate the deep-seated weaknesses of our own domestic economy. Nor will North Sea oil.

C.7. Growing production from the North Sea should certainly shield the UK from the transfer of income which other consumers, dependent upon

external supplies, are bound to suffer as the price of energy rises. But this protection should not shield us from the truth about what has been happening to the balance of our trade in traditional products, in particular manufactures. From having a surplus in trading manufactures of £ million in 1973, we had a deficit of £ million in 1978.

C.8. North Sea oil will not itself do anything to solve the problems on the supply side of our economy or remove the risks of excessive inflation. Indeed, in some respects it may actually make matters worse, unless we correct some other aspects of policy which are working in the wrong direction at the moment. The moral once again is that it is for us to put our own house in order. Only then shall we be better able to match the performance of our main partners in the world economy and once again play a

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respected role in international councils.

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D. THE CAUSES OF DECLINE

D.1. So we find ourselves, yet again, asking the question: how are we to check, and then reverse, the long decline?

D.2. There are some who argue that there is nothing that can be done. Just as a man is unable, by taking thought, to add a cubit to his own stature, so a nation, they say, cannot consciously decide to improve its performance. Some go on, even more gloomily, to conclude that the British people have decided, consciously or unconsciously, to abandon the quest for prosperity - and have become reconciled to the prospect of relative, and increasing, poverty.

D.3. I doubt if there are many Members of this House who share that view. I am sure, for example, that the rt. hon. Gentleman, the Leader

of the Opposition and the Member for Leeds, East do not. They have attended, as I have done, at international gatherings and tried to plead the cause of Britain as a "less prosperous country" - in the jargon of our times. And the words must have stuck in their throat - as they do in mine. In the same way, I believe, they offend the deep sense of patriotism of all our fellow citizens who are still proud to call themselves British. And they <u>are</u> still proud.

D.4. The question is what can we, the politicians, do about it?

D.5. We should do well to begin, I suggest, by acknowledging one truth - that there is a strict limit to our capacity, as politicians, to influence these things for the better.

D.6. I suspect that that is much more widely accepted outside the House of Commons than it is

inside this place, But it is none the less true for that.

D.7. I do not mean to be unkind to my predecessor when I invite the House, for a moment, to consider his example, The Government of which he was such a distinguished member firmly believed, as I understand it, that it was possible for Government to manage, indeed to plan, the economy, so as to ensure its continuously efficient performance.

D.8. This is anything but a party point. For that same belief has been more or less widely shared. The rt. hon. Gentleman, the Member for Leeds East certainly espoused it with enthusiasm. For in four years of office he introduced no less than [16] Budgets and economic "packages".

D.9. But, at the end of five years, he must

/ask himself

ask himself to what avail? Are we not driven to the conclusion that the notion of demand management, of "fine tuning" as it has come to be known, has by now been tested almost to destruction?

D.10. Certainly the rt. hon. Gentleman, the Leader of the Opposition, seems to have taken that view. For, as he said in a memorable and courageous speech in September, 1976:

> "We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting Government spending. I tell you, in all candour", said the rt. hon. Gentleman, "that that option no longer exists and that insofar as it ever did exist, it worked by injecting inflation into the economy. And each time that happened the average level of unemployment has risen. Higher inflation, followed by higher unemployment", concluded the rt. hon. Gentleman, "that is the history of the last twenty years."

D.11. On that basis, I approach my task this afternoon on at least one important piece of

/common ground

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common ground, which I am glad to be able to share with my two Labour predecessors in this House. And that common ground is this: that the poor performance of the British economy in recent years has been due not to a shortage of demand but to a series of failures on what is known as the supply side of the economy.

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DA. A NEW APPROACH

DA.1. It is, of course, the belief of this Government that many of those failures on the supply side are themselves the result of actions and interventions by Government itself: of laws that stifle enterprise and perhaps above all of a tax system that might have been especially designed to discourage and punish success.

DA.2. That is why we are convinced that an entirely new approach is necessary if we are to revive the economy and shake off the effects of the long-term decline, which has got much worse in the last five years. Our strategy is based on three simple objectives:

- we need to restore incentives, by allowing people to keep more of what they earn, so that hard work pays, talent and ability is appreciated, and success is rewarded;

- we need to

- we need to restore freedom of choice by reducing the role of the State and enlarging that of the individual;

and - we need to ensure, so far as possible, that those who play any part in the process of collective bargaining are obliged to live with the consequences of their actions - for that is the way to promote a proper sense of responsibility.

DA.3. These objectives are simple but their implications are profound. They amount to nothing less than a change in the whole climate in which our economy functions. We must remove the constraints and discouragements of recent years and allow personal choice and individual responsibility, enterprise and reward to flourish. Only in this way can the economy regain its capacity to produce the wealth on which genuine new jobs and improved public and social services must depend.

/DA.4. The tax

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DA.3. The tax changes I shall propose today will be only the first step. But they will take us a long way in the new direction that is essential.

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DB INFLATION

DB.1 These policies will not, of course, bear fruit unless we are at the same time squeezing inflation out of the system, above all by the sustained pursuit of firm monetary discipline, supported by fiscal policies that are consistent with it. With this Government, financial discipline will begin at home. It will apply as rigorously to the public sector as it does to the private sector. And it will be sustained. Finance will determine public spending, not the reverse.

DB.2 Financial responsibility by the Government must, of course, be supported by a corresponding acceptance of responsibility elsewhere. Higher pay that is not accompanied by higher output can only lead to higher

/unemployment.

unemployment. This is the crucial reason for moderation, realism and responsibility in pay bargaining. It is important that this emphasis should be fully understood by all those involved in wage negotiations. We shall be more willing to consider better methods of ensuring that it is. In recent years people's sense of responsibility has too often been undermined - frequently as a result of formal pay policies imposed by Government. Responsibility cannot thrive unless it has freedom and flexibility - and this is what we are offering.

DB.3 Given the fiscal and monetary policies we are pledged to pursue, irresponsible pay settlements are bound, as I have said, to threaten loss of jobs, as they have done in the past. Responsible and realistic

on the other hand, will take full account - on both sides of the negotiation - of what the rate-payer and the tax-payer can afford, and of what the consumer is prepared to pay.

E EXCHANGE CONTROL

E.1 Before I come to my main proposals, I propose to deal with the question of exchange control.

E.2 Outward capital flows from the UK are more tightly controlled than those from any other major industrialised country. Sterling is at present relatively strong. This flows partly from the realisation that, as a result of North Sea oil, the UK is relatively better placed to deal with present world oil problems. Moreover I am determined to pursue firm fiscal and monetary policies which will make exchange control support for sterling less necessary. This is therefore an appropriate time to start liberalising our exchange controls in accordance with our obligations under the EEC Treaty and I have consulted the Commission

about the decisions I am announcing today. There is anyway a strong case now for giving both companies and individuals wider freedom of choice, and for reducing the distortions and costs which controls are bound to impose on economic decisions.

E.4 We intend to move in this area one step at a time, and, in this initial stage, we are placing emphasis on direct investment. A Press Notice will be issued today giving details.

E.5 I have decided that the main relaxation is to be automatic access to official exchange up to £5 million per project per year for new outward direct investment. This should allow the majority of UK firms who invest overseas all the sterling finance they are likely to want. The two-thirds

/rule, which

restricts the re-investment of profits earned overseas, will be abolished. This greater freedom in the financing of direct investment abroad does not, as is sometimes feared, threaten jobs in the United Kingdom. The weight of evidence is that, if as a result overseas investment is increased, our position in world export markets will in general be strengthened. [And inasmuch as greater outward flows of stering hold (bring) down the exchange rate, they increase the price competitiveness of our imports and exports. This, too helps add to jobs and output.]

E.6 There should also be some easement of the controls affecting individuals. I am therefore making significant relaxations in the rules concerning travel and emigration allowances,

/overseas property,

overseas property, and cash gifts and payments to dependants. And sterling finance will once more be permitted for third-country trade [conducted by UK merchants]. In the field of portfolio investment, I am taking two steps at this stage. I am abolishing the requirement to maintain 115 per cent cover for overseas portfolios financed by foreign currency borrowing; and official exchange will henceforth be available for meeting interest payments on such borrowing.

E.7 As time goes by, I shall be studying further proposals for a gradual relaxation of control. Announcements will be made when conditions are appropriate. The pace of relaxation will obviously be influenced by the effect of international events on sterling as well as by the speed with

which we can solve the economic problems that face us.

[E.8 In our external policy we have to take account of our official external debts. These at present amount to $22 billion - a massive increase on the $8 billion which the previous Government inherited in 1974. It is the Government's intention to reduce this burden of external debt substantially during the life of this Parliament.]

G. MONETARY POLICY

G.1 As I remarked in the House 3 weeks ago, the rt. hon. Gentleman, my predecessor, was undoubtedly right to adopt a system of monetary targets. But he did not go far enough, nor were his policies adequate to meet his own objectives. Despite setting a target range of 8-12 per cent, in the year to [mid April sterling M3 is now estimated to have risen by 11½ per cent. Set out and update annualised rate during last 6 months and 3 months]. [Supply figures on high Government borrowing 78/9, 79/80] It is now clear that if the public expenditure policies which we inherited had been left unchanged, it would have been quite impossible to meet the rt. hon. Gentleman's 8-12 per cent target without a further savage squeeze on the private sector,

/involving a

involving a sharp increase in the total tax burden.

G.2 This Government are committed to the progressive reduction of the rate of growth of the money supply. It is therefore my intention to lower the target range for the remainder of this year, 1979-80. The new target range, to apply to the growth of sterling M3 in the 10 months to the banking make-up day in April 1980, will therefore be an annual rate of 7 per cent to 11 per cent. I will roll this target forward by 6 months in the autumn.

G.3 Equally important, I intend to shift the balance in the way in which the monetary target is achieved from an excessive reliance on interest rates and curbs on the private sector to a greater emphasis on fiscal restraint and curbs upon the public sector. This requires a

significant reduction in the PSBR from the £[ ] billion forecast on the basis of existing policies.

G.4 There are limits to what the Government can do in this first Budget with two months of the financial year already passed. This is indeed a severe handicap. But we shall nonetheless reduce the public sector's financial needs sufficiently for it to be possible to achieve the lower monetary target with less restraint on the private sector. And if the private sector exercises restraint when concluding pay bargains there should be scope for keeping within the monetary target at moderate levels of interest rates.

G.5 As the rt. hon. Gentleman, the Member for Leeds East, found to his cost, the PSBR is a fickle and elusive statistic. That is why I

offer my estimate of the extent of Government borrowing in 1979-80 with a degree of diffidence. But I judge that the fiscal policies I shall announce today will be sufficient to reduce the borrowing requirements to [ ] in the current year, as compared with the outturn of £9¼ billion for 1978-79. As a percange of GDP that will represent a reduction from [ ] per cent last year to [ ] per cent in the current year. That is an important step in the right direction. I intend a further progressive reduction in the [burden of Government borrowing] in the future years.

PUBLIC EXPENDITURE

H.1 As we have always said, a major contribution to reducing the borrowing requirement and the burden of direct taxation must come from savings in public spending and from drawing back the boundaries of the public sector. In present circumstances it is our strategy on tax that is the priority: we want finance to determine expenditure, not expenditure finance. Our review of the plans we have inherited, and our campaign to eliminate waste and needless bureaucracy, are only just beginning. But substantial reductions can be made in the remainder of this financial year.

H.2 First, as I made clear three weeks ago, we shall not raise the cash limits originally published for this year.

/On pay,

On pay, we will honour the commitments to the univeristies and the health authorities entered upon by our predecessors. But in general we will limit the adjustment of the cash limits so that substantial offsetting economies will have to be found.

H.3 The need for substantial economies applies also to local authority expenditure, where the Government's contribution is made through the rate support grant. As I said three weeks ago, we shall take account of pay settlements in calculating the increase orders for the rate support grant, but we shall make a significant across-the-board reduction from the total thus calculated. I can now tell the House that the reduction will be at least £300 million for England and Wales and £35 million for Scotland. We reserve

/the right

the right to increase the abatement when we see the cost of the remaining pay increases this year. In coming to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute.

H.4 My hon Friend the Minister of State, Civil Service Department, has announced that economies of 3 per cent will be applied to the Civil Service this year and that recruitment will be regulated accordingly. The cash limits on Departments and fringe bodies will be set to ensure that these economies are achieved.

H.5 I estimate that this cash limits policy will reduce the volume of planned expenditure by about [£1,000 million at 1979 Survery prices].

H.6 On top of these reductions resulting from the policy on cash limits, my rt. hon.

/and hon. Friends

and hon. Friends have reviewed the programmes for their Departments and have identified further specific reductions which are being made in the plans this year. The changes in each Minister's programmes are listed in a Press Notice being issued by the Treasury today and further details will be given by the Ministers concerned. But the House will want to know where the main reductions will be made. All figures are at 1979 Survey prices.

H.7 We are making an immediate start in [phasing back] expenditure on industrial and employment subsidies. My rt. hon Friend the Secretary of State for Industry is reducing expenditure on industrial support this year by £200 million. A quarter of the total will be secured by cutting the provision for new projects by the Department

of Industry and by the National Enterprise Board. The remainder will be found [As suggested by the rt. hon. Gentleman the Member for Leeds East?] by imposition of a delay of 4 months in payments of approved claims for regional development grant.

H.8 My rt. hon. Friend the Secretary of State for Employment has reviewed the programme of the Manpower Services Commission and the special employment programmes of the Department of Employment. Support from these programmes is to be concentrated on the areas where unemployment is highest, and savings of over £170 million will be made this year.

H.9 The Government's decision to abolish the Price Commission has already been

/announced.

announced. This will contribute to savings of £5 million which my rt. hon. Friend the Secretary of State for Trade is making in his programme this year. In addition, [once again as suggested by the rt. hon Gentleman, the Member for Leeds East] the Co-operative Bank has agreed to refinance in 1979/80 fixed rate export credits currently being financed by the Export Credits Guarantee Department to the value of £25 million.

H.10 The programmes for which my rt. hon Friend the Secretary of State for Energy is responsible are being reduced by £200 million. The finance provided to expand the activities of the British National Oil Corporation is being cut back, and action is being taken to reduce the external financing requirements of the electricity, gas and coal industries. In taking such action, the industries have

have been asked so far as possible to avoid increases in domestic fuel charges on top of those required to meet the cash limits announced by the previous Government.

H.11 My rt. hon. Friend the Secretary of State for the Environment is making savings of about £440 million from his programmes this year, mainly by scrapping the Community Land Act, deferring water authority investment and reducing the existing allocation to housing authorities. Provision for housing expenditure will still be sufficient to sustain the currently forecast level of new housebuilding approvals and a vigorous programme of improvements. The action which I shall propose on Development Land Tax should help to revitalise the contribution from the private sector to the nation's housing.

H.12 The programmes for which my rt. hon Friend the Minister for Transport is responsible are being reduced by £25 million by means of cutting British Rail's current cash limit and expenditure on roads.

H.13 As we have repeatedly made clear, it is not our intention to reduce spending on the Health Service, but the contribution made by some charges has become out of date. This applies especially to prescription charges which have stood at their present level for eight years. It is proposed to increase prescription charges to [45]p. This will still leave them cheaper in real terms than they were in 1971, and the present wide range of exemptions covering children and the elderly amongst others will, of course, be maintained.

/Certain dental

Certain dental charges will also be increased. These increases in charges will yield £[34] million in 1979/80.

H.14 Most current expenditure on the education programme is the responsibility of local authorities and will be affected by the decisions on the rate support grant. My rt. hon. Friend the Secretary of State for Education and Science is reducing expenditure in those areas of the education and science programmes within the Government's direct control by £55 million, mainly by abandoning the proposal for pilot schemes for mandatory awards to 16-18 year olds who stay on in school or college; by reducing [some] Government grants for science, and for universities and colleges; by decreasing the building programmes; and by increasing fees

/for overseas

overseas students. We shall not add to the increase of 5p in the school meal charge which was planned by our predecessors for the autumn term.

H.15 We have identified savings of just under £3 million which can be made in this year's programmes covering arts, libraries and the heritage.

H.16 There will also be a reduction in the programme for overseas aid. The Government intend to maintain an effective aid programme. But our ability to provide aid - and, more important, to provide markets for developing countries' exports - is necessarily conditioned by our economic strength, to which the restraint of public expenditure will contribute. Where, as in the case of aid, expenditure involves external transfers,

/it is

it is particularly onerous. The aid programme this year will therefore be reduced by £50 million to a total of £790 million. [This compares with disbursements last year of about £775 million on the same price basis].

H.17 For some of the programmes I have mentioned, my rt. hon. Friends the Secretaries of State for Scotland and Wales and Northern Ireland are separately responsible for expenditure within their own areas. They are making reductions in their own programmes including, in the case of Scotland and Wales, reductions in provision for the Scottish and Welsh Development Agencies.

H.18 In two areas we are providing for increased expenditure - pensions and defence.

/I shall deal

I shall deal with pensions improvements in a few minutes. An extra £100 million is being provided for the defence budget this year. This will enable essential projects in the equipment programme to go ahead.

H.19 These specific reductions in programmes, after taking account of the extra provision for defence, amount to £1¼ billion this year.

H.20 In addition to these specific reductions in public expenditure programmes, we shall not need as large a Contingency Reserve as provided for 1979/80 in the last Government's public expenditure White Paper. We do not intend to allow for other than very small additions to programmes during this year.

/H.21 The

H.21 The Contingency Reserve for the current year now stands at [just 'over £500 million]. This balance remains after allowing for expenditure deferred from 1978/79 by Civil Service industrial action in the last weeks of the previous Government and for the social security measures which I shall be announcing later this afternoon.

H.22 We have decided to cut the Reserve by £250 million. Any further decision to add to the volume of programmes in the remainder of this year will be met from the [£250 million] remaining in the Reserve.

H.23 As I have already indicated, we are only just embarking on our review of the plans we have inherited and the scope for reducing the size of the public sector. But there are already a number of major

options for early sales of assets.

H.24 Final decisions have not been taken and we must retain flexibility on timing and the choice of assets in order to ensure a fair price. I do not therefore propose to announce the details today. But I am confident that the proceeds of sales in the current financial year will be [£1.2 billion] and I have made this assumption in the Budget arithmetic. The total will be largely made up from sales of part of the Government's shareholdings in British Petroleum and of the National Enterprise Board's holdings and from sales of [oil interests of the British Gas Corporation and the British National Oil Corporation].

H.25 In total I estimate that the overall reduction in planned public expenditure

this year from the measures I have announced will amount to [over £3 billion at 1979 Survey prices]. We shall also be examining in the context of the annual Public Expenditure Survey the scope for further and more substantial savings in future years. Yet given the scale of the problems we have inherited, even this cut in public spending in the current year will be insufficient to allow me at the same time to reduce the Public Sector Borrowing Requirement to a tolerable level and to implement the first stage of the substantial reductions in income tax which I regard as essential. I must therefore look for a further contribution from indirect taxes.

I. INDIRECT TAXATION

I.1 Because of the late Budget, the additional revenue obtained in the current financial year from increases in the indirect taxes will be substantially less than the amount which would be raised in a full year. Inevitably this has given me less freedom than I would have liked this year. Nevertheless, I am determined to make a start on our plans to implement a major switch from taxes on income to taxes on spending, so as to restore incentives, to make it more worthwhile to work, and, at the same time, to increase the freedom of choice of the individual. [Reference to Election mandate].

Value Added Tax

I.2 First, Value Added Tax. I propose to unify the two existing positive rates.

/This will

This will be a desirable simplification of the VAT system, and will be especially welcomed by small traders.

I.3 The new unified rate will be 15 per cent. This new rate will come into effect on Monday 18th June. I recognise that the scale of the increase is larger than has been generally expected. But I must stress that only an increase of this size could provide sufficient scope for a real start to be made on cutting income tax and giving the British people the incentive to get our economy moving at a pace comparable to that of our competitors. [When one takes account of the wide range of goods which are (and will, of course, remain) zero rated, the total burden of VAT is

/equivalent to

equivalent to 8 per cent on the total range of consumer spending.

1.4 The yield from the increase is estimated at [£2035m] in 1979/80 and [£4175m] in a full year. Thus it will provide scope for further direct tax reductions in later years. The relatively small size of the yield this year reflects the loss of over two months' revenue and the gap before traders pay over VAT receipts to the authorities - an average of about 3 months. This has, however, an important and helpful effect in another direction. For as these funds build up in traders' hands, the provide a substantial boost to the liquidity of the firms and companies concerned. Concern has been expressed that an increase in VAT

/would apply

to telephone bills for calls made before the date of the change. I am proposing transitional provision to deal with this and some of the other problems in this field.

I.5 The effect of the increase on the RPI will be to raise it immediately by about 3.5 per cent. But the House should bear in mind that VAT does not apply to necessities like food, heating and light, house prices and rents and public transport. These zero-rated items, together with other reliefs from VAT, cover in total half of consumers' expenditure Moreover, the evidence is that people tend to spend proportionally more on VAT rated goods as their income rise - this means it is a moderately progressive tax.

1.6 However, I appreciate that those who do not currently pay income tax, and I

/have in mind

have in mind particularly those living on National Insurance pensions, will not benefit from my income tax proposals and will be anxious about the effect of this indirect tax switch on their standard of living. I should, therefore, make it clear now that the proposals I shall be announcing shortly for the uprating of Social Security benefits, including pensions, will take full account of the effect on prices of the VAT [and other indirect] increases.

Excise Duties

I.7 I turn now to the excise duties. The sharp increase in VAT will, of course, add significantly to the shop prices of drink and tobacco. For example

/the VAT

the VAT increase will mean about an extra 28p on a bottle of whisky, 2p on a pint of beer and 6p on a typical packet of 20 cigarettes. In these circumstances, I do not think it would be justifiable to raise those prices further in the present year.

Hydrocarbon Oil Duties

I.8 The oil duties however raise wider issues. I have already indicated that I shall be announcing today measures which will help us to meet the growing and undoubted need to conserve oil. At a time when there is a worldwide shortage of crude oil it is essential that we should play our full part in achieving the 5 per cent reduction in consumption to which the previous Government rightly committed us.

/I therefore

I.9 I therefore propose to increase all the main oil duties this year. In the particular case of petrol, the VAT increase from 12½ per cent to 15 per cent will be smaller than for many other items. With this in mind therefore I also propose to increase the petrol duty by about 23 per cent - 7p a gallon - which will result in a total price change of about 10p a gallon. I also propose to increase the duty on derv by the same sum, 7p per gallon, and the duty on heavy oil other than derv, by ½p, about 20 per cent. I am not, however, increasing the duty for burning oil and for domestic paraffin, which is the oil used most commonly in the home, particularly by pensioners. The yield from these excise duty changes is estimated

/at an

at an additional £525 million in a full year and £380 million in 1979/80. [The immediate increase in the RPI will be about a quarter of one per cent.

Vehicle Excise Duty

I.10 In view of the increase I am proposing in the road fuel duties I have decided to make no change in the rate of vehicle excise duty. Our predecessors announced their intention of abolishing the duty on petrol driven vehicles. My colleagues and I are reviewing the future of this duty and we shall announce our conclusion in due course. For heavier goods vehicles my rt. hon. Friend, the Minister of Transport, will be announcing plans for restructuring the form of this tax, and for the moment therefore it seems best to leave this duty unchanged also.

J. SOCIAL SECURITY PAYMENTS

J.1 As I have already explained, we have taken steps to mitigate the effect of the indirect tax measures upon the poorer section of the community.

J.2 We have accordingly decided to increase the standardrate of retirement pensions in November by £ to £ for a married couple, and by £ to £ for a single person. As we promised, these increases take account of the underestimate which the last Government made of the actual rise in earnings and prices between November 1977 and November 1978, and are well above the figures of £4 and £2.50 announced by the Previous Government. Other social security benefits will also be increased, and my rt. hon. Friend, the Secretary of State for Social Services, will announce full details [tomorrow].

/This means that

J.3 This means that National Insurance pensioners and other beneficiaries will be fully protected against the forecast increase in prices. This is what is really important. But the extent to which we can afford to go further than this - to add improvements in real terms - must depend on the extent to which the economy as a whole, which depends on the productive capacity of those in work, can afford it.

J.4 Under the present rules long term benefits are uprated on the basis of the movement in prices or earnings, whichever is the greater. The Government have decided, however, that for the future the requirement for the statutory uprating of long term benefits should be based on price movements, and we shall be introducing legislation to this end. This will be a minimum requirement, and will preserve the

/standard of

standard of living of beneficiaries by protecting them against cost increases, including the effect of indirect tax changes, including those which I have just announced. Of course we shall want to be able to do more and I am confident that in time, as our economy improves, it will be possible to do so and ensure that pensioners share in the increase in national prosperity. That is why my other proposals today will make a determined start in restoring to working people the incentives that are necessary if they are to achieve greater prosperity both for themselves and for those others in our society who depend on them.

J.5 [The change will make no difference this year since the forecast rise in prices for the year to November is greater than the increase in earnings expected over the same period.

The figures I have just mentioned fully reflect this forecast price increase].

J.6 We also propose other social security increases. Single parent families face particular problems, and we propose that the one parent premium should go up from £2 to £2.50 next November. We also want to help the disabled. Mobility allowance will accordingly be increased from £10 to £12 in the autumn. And we shall, of course, honour our commitment to pay a Christmas bonus this year of £10.

J.7 These measures overall will cost about £ million in 1979/80, and £ million in a full year, of which £ million will be charged against the Contingency Reserve. As the House knows, my general policy is to make substantial reductions in public expenditure. But this

/must not be

must not be done in a way which bears unduly on those least able to withstand it.

J.8 Our social security system has become far too complicated and it can reduce the incentive to work. This has been widely recognised on both sides of this House. It is important to correct this. My rt. hon. Friend, the Secretary of State, is therefore putting in hand urgent measures to tighten up on abuse and fraud and we are also studying other aspects of the social security system.

K. BUSINESS TAXATION

K.1 If the country is to increase its prosperity and to create the wealth upon which improvements in our public and social services must depend, we need a vigorous and profitable company sector. Profitability has dropped sharply in recent years and the rate of return on capital employed is now far too low. This is especially true of manufacturing industry.

K.2 Companies only survive by making profits. All the Government can do is help to create favourable conditions. But without adequate profitability we will not see the growth of new investment and new job opportunities which everyone wants. Against that background, I propose no change this year within the general system or in the rates of corporation tax.

/That is not,

K.3 That is not, however, to rule out the need for changes to meet specific needs. In particular, it is important that the tax system should take account of the effects of price changes on businesses, and do so in a way that is reasonably objective, equitable and simple to administer. The Government will be reviewing a number of aspects of the present system at the same time as the accountacy profession's latest proposals for current cost accounting, and I shall be arranging for the Inland Revenue to enter into consultations later in the year with the profession and with business.

K.4 I have three further detailed proposals to make this year. First, small businesses. We on this side of the House have consistently championed the cause of smaller businesses.

In the tax field, there is one measure that will do more than anything else to encourage the contribution that smaller businesses - indeed businesses of every size - can make to enterprise, innovation and employment. That is, a major reduction in the burden of income tax. But I also propose to raise this year the profit limits for the small companies rate of corporation tax - to the figure of £60,000 at the lower end and of £100,000 at the upper end. This will go some way further than is necessary to maintain their real value.

K.5 Second, stock relief. The Finance Bill will include legislation to honour the undertaking which my predecessor gave last year, and which we on this side of the House supported, to write off the deferred tax liabilities arising from stock relief given

for the first two years of the scheme - 1973-74 and 1974-75; and to write off these liabilities in respect of subsequent years successively, after an interval of six years.

K.6 In addition, following consultations which the Inland Revenue have had with industry, I am proposing two further changes in the stock relief scheme. I intend to reduce the profit restriction for unincorporated businesses from 15 per cent to 10 per cent; and all businesses will be given greater flexibility in the amount of relief that they can claim. Both these changes will be of particular benefit to smaller businesses.

K.7 Third, the present legislation contains a weakness which enables leased cars to avoid the special rules restricting capital allowances for business cars generally. There has

recently been an explosive growth of car leasing, partly as a result of that loophole, with the result that the loss of tax is currently running at about £175m a year; and could well rise to £200m next year if I take no action. I propose to put this right with effect from today.

K.8 Details of these tax proposals will be given in press notices which the Inland Revenue are issuing today.

K.9 Finally, if industry is to flourish, we also need a vigorous capital market. In this context the control of dividends has now outlived its original purpose. The control will accordingly come to an end when the existing legislation expires on 31st July.

L.. PETROLEUM REVENUE AND CAPITAL TAXATION

L.1 I turn next to petroleum revenue tax and capital taxation. The previous Government announced last August that they proposed to increase the former from 1st January 1979. These proposals were discussed very fully by the last Government with the industry and we ourselves have had representations about them which we have carefully considered.

L.2 Although we did not oppose them at the time, I am not sure that when the proposals were announced they were wholly justified in their intended aim of securing a fairer balance of shares between the public and the companies of this national resource. Companies cannot be expected to invest in the North Sea unless the return they get from successful development rewards them commensurately for the

/risks they have

risks they have taken and which we are continuing to look to them to take. But judged against the recent developments in the world oil situation the package of PRT proposals for increasing the Government's take from the North Sea is justified. There will accordingly be provisions in the Finance Bill to implement it. I also propose, however, to introduce some changes in the PRT expenditure rules for which the industry have been pressing for some time. Moreover, the British National Oil Corporation will no longer be exempted from PRT.

L.3 These proposals will increase the Government's revenue from the North Sea by about £[ ]million, in the year 1979-80 and by about £ million to 1985.

L.4 On capital taxation, we made it clear in our manifesto that in the longer term we shall

make the taxation of capital simpler and less oppressive. I intend to achieve both these aims. But the issues involved are difficult and complex and there has been quite inadequate time to study them properly to enable action to be taken in this Budget. We shall however now be examining all the issues involved. Meanwhile so as not to prejudice the position of trustees of discretionary trusts, I intend to defer by two years the full implementation of the existing capital transfer tax regime. [Are the other "deferment" proposals mentioned?].

L.5 There is, however, one aspect of capital taxation which cries out for change at the earliest opportunity. I refer to the Development Land Tax, which has combined with the Community Land Act to prevent much worthwhile development and to increase

/unemployment

unemployment in the construction industries.

L.6 We have already said that we will repeal the Community Land Act. I propose now to deal with the Development Land Tax which is reducing the supply of development land and acting as a brake on the building and construction industries. I propose that in place of the present rates of 66.2/3rds per cent and 80 per cent, which the previous Government intended should rise to 100 per cent, Development Land Tax shall for the future be charged at a single rate of 60 per cent. The amount of development value which can be realised in a financial year without liability to Development Land Tax will be raised from £10,000 to £50,000. Both these changes take effect for disposals made on or after today. [Further details are given in a press statement being issued by the Inland Revenue today.]

/L.7 I do not

L.7 I do not propose any further reductions in rate or increase in the exempt slice. Owners of development land will therefore have no reason for holding back in the hope of further tax reductions. What I have said today should therefore remove the major uncertainties which have been hanging over the marker.

M. INCOME TAX

M.1 I now come to the income tax reductions which are the keystone of my policy. It is the excessive levels to which the income tax has been driven over the years which bears so heavy a responsibility for the lack lustre performance of the British economy. We need therefore to cut the income tax at all levels - at the bottom, in the middle and at the top; this means in turn that we must raise the thresholds, reduce the basic rate and cut the top rates. For the reasons I have already explained I cannot do as much this year as I would have liked and I cannot do as much as is needed. But I propose taking a significant step forward in this Budget. I wish to leave no doubt in anyone's mind that this Budget is only the first instalment of income tax changes which

/we shall bring

we shall bring to fruition in the years to come.

M.2 I begin with the higher rates of tax. These rates no longer affect only those on very high incomes. They apply to the senior executives and the middle managers in industry and to some skilled workers: as well as to professional people and the proprietors of small businesses. These are the people upon whom our hopes for initiative, greater enterprise and hence greater national prosperity must depend.

M.3 It is universally recognised that the present top rate of 83 per cent is an absurdity: in itself it brings in very little revenue but acts as a severe disincentive and is a patent injustice. The previous Government recognised this: it was simply they did nothing about it.

/I propose

I propose an overdue measure of reform. The top rate will be cut to 60 per cent and this rate will apply to taxable income over £25,000. At the other end of the higher rate scale, the present threshold of £8,000 is quite inadequate. I propose raising it to £10,000. Even at this figure it will be less in real terms that it was in 1973. In between I propose a new scale of rates less steeply progressive than the old rates which will ensure that middle management, so important to the success of British industry, will have their tax burden reduced to more reasonable proportions.

M.4 But it is not only at the top of the income range that the burden of income tax is particularly oppressive. The same is true for those on the lowest taxable incomes. That is the importance of the tax thresholds, to which I turn next.

The increases proposed in the April Finance Act, which were not of course implemented, were quite inadequate. I propose to double these increases. This means that the single allowance will go up, not by £90, but by £180; the married allowance will go up, not by £140, but by £280. For the single person the threshold will go up by nearly £3.50 a week: and if he is paying tax at the basic rate his tax will be reduced, by this change alone, by a full £1 a week. For the married man the threshold will go up by £5.38 a week and if he is paying tax at the basic rate his tax will be reduced by £1.78 a week. This is quite apart from the consequences of any further changes that I have to propose.

/M.5 I have

M.5. I have three other changes to propose. First the age allowance will be raised by £240 for the single person and £380 for the married person. These again are double the figures proposed in the April Finance Act. Last year the limit for the full allowance was £4,000. This year I propose raising it to £5,000, more than twice the increase proposed in the April Finance Act.

M.6. Second I propose raising the threshold for the investment income surcharge. The justification for retaining the surcharge is itself debatable. Certainly there can be no argument but that it bites at far too low a level of income. Almost half the surcharge is paid by people over 65. This is moreover a tax which falls with particular severity on those who have had to make provision for their

/retirement

retirement out of their savings and have no inflation proof pensions to fall back on. The undue severity of the tax was recognised by the previous Government by introducing what were no more than palliatives in the form of a reduced rate applied to the first slice of investment income and a slightly higher threshold for those over 65. We propose instead raising the threshold to £5,000 for everyone: the rate above that level will remain at 15 per cent. This approach combines a considerable simplication of the tax with a measure of justice that is long overdue.

M.7. Third we propose implementing our election pledge to war widows. Provision will be made in the Finance Bill to exempt their pensions entirely from tax.

/M.8. I come

M.8 I come finally to the basic rate. For the great majority of workers - some 21 million in all - it is the basic rate which determines the tax liability. It is the basic rate which is also the marginal rate falling on additional earnings whether they come from overtime, or greater productivity, or reflect greater skill or the rewards of promotion. Everywhere one meets complaint and criticism of the effect of the income tax in eroding differentials, reducing the rewards of skilled workers and making effort and promotion barely worthwhile. My long term aim is to reduce the basic rate of income tax to 25 per cent. This year I propose taking a first and significant step in this direction by reducing the rate from 33 per cent to 30 per cent. Nothing less than this would provide both the incentive we need and the conviction that we really mean business.

/M.9 The total

M.9. The total cost of these income tax reductions, including the cost of increases in personal allowances proposed in April but not implemented at the time, will be £4,570 million in a full year. The lion's share, no less than £3,660 million or four-fifths of the total, represents the cost of increasing the personal allowances and reducing the basic rate. The cost this year will be £3,590 million.

M.10. As a result of the increase in the tax thresholds 1.3 million people who would otherwise have paid tax this year will not be required to do so. The number of people paying tax at the higher rates would have risen to nearly 1·2 million: as it is the number will be 650,000. The number liable to the investment income surcharge will be reduced from a prospective 850,000 to

/270,000.

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270,000. All the changes will simplify administration and reduce the work load on the Inland Revenue.

M.11. The changes in allowances will be implemented for most taxpayers on the first pay day after 12th July. The reduction in the rates of tax will be given effect as soon as new tax tables are ready in October. [Give illustrative examples of tax repayments.]

M.12. A full year's income tax reductions will be received even though my Budget is being presented two months or more after the start of the year. On this basis the income tax changes mean that for the married couple where the husband earns £100 a week, which is close to average earnings, there will be an increase in take-home pay averaged over the remainder of the financial year of £4.07 a week. The increases in VAT and petrol duty will increase family expenditure by £2.76. So that, taking both the direct and

BUDGET-SECRET

/indirect tax

indirect tax changes into account, the family will be £1.31 per week better off. Similarly, where the husband earns £60 per week there will be a real gain of 77p a week, while the position of the couple on £150 per week will improve by £1.96 a week. [Not only will such families be financially better off, in terms of real take-home pay, but also the choice of the way they spend their income will rest increasingly with them, and not with the Government.]

M.13. These reductions in the burden of income tax, which are as substantial as they are unprecedented, mean that wage and salary earners will have more money in their pockets to buy the goods and services they help to produce. True the prices of a good many of these goods and services will be increased by my tax proposals. But virtually every family in the land will have

/more money

more money coming in to pay the increased bills, and with some to spare. And what is more, the choice of the way they spend their higher income will rest increasingly with them, and not with the Government. I emphasise too that this is only the first instalment of our tax-cutting programme.

M.14. [A table and explanatory note giving the details of these effects will be issued by the Treasury today.]

M.15. These changes represent only the first stage in the major reduction in the burden of direct taxation that we are pledged to make. But I hope that the net effects of my proposals as a whole - and not simply the immediate effects on prices of some of them - will be studied carefully, particularly by those who will be involved in the pay bargaining. It would not

only be foolish but positively damaging to the worker's own best interest, if an attempt were made to recover by excessive pay claims what has already been more than made good by these unprecedented reductions in income tax.

PS/CST
PS/PST
PS/MST(C)
PS/MST(L)
Sir D Wass
Sir L Airey
Mr F Jones
Mr Monck
Mr Wicks
Mr Slater
Mr Coulstock
PS/IR.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

6 June, 1979

Dear David

Thank you for your letter of 30th May giving me your views about the proposed changes in PRT, which I have discussed with Peter Rees.

This matter of whether to proceed with the PRT package as announced last August by Joel Barnett or whether to modify it is a difficult one and I am glad to know that the only difference between us is that you would prefer the oil allowance to be cut back by one quarter instead of one half. I understand your reasons for this; nevertheless the view which Peter and I are inclined to take is that it is unnecessary for us to forego any part of the increase in revenue that the PRT package will bring. The line we propose to take is that we are not sure there was sufficient scope, when it was announced, for a 60-35-½ package. It was too severe and would have badly hit marginal fields. But events have overtaken this judgment. The price of North Sea crude has risen sharply and this has made the package a necessity. Prices are still rising and there will be those (the TUC have already seen me about this) who will be wanting me to introduce measures over and above the package to tax away the windfall profits the oil companies will be making in 1979. We ought not, of course, pay too much regard to this; what we are concerned with is having a fiscal regime under which companies can get an adequate rate of return from their North Sea operations, sufficient to encourage them to develop marginal fields, and which ensures that the Government's take is adequate. But because we shall have to give the industry some assurances about fiscal stability in the North Sea, we are not going to get two bites at the cherry and what we introduce now will have to last for a number of years unless the whole economics of the industry

/change.

The Rt. Hon. David Howell, M.P.

change. I do not think that a concession on the oil allowance is going to be easy to justify against a background of escalating prices and in any case it would be so small that I doubt whether it would change the views of the industry about the package.

What I am more attracted to is your suggestion that we should announce that the Government is going to look at the special problems of marginal fields. A concession on the oil allowance would be a gift to the profitable fields (like Forties and Piper) with no guarantee that it would do much, if anything, to encourage exploration and the development of marginal fields. The announcement of a special study, in consultation with the industry, of how the Government can if necessary assist marginal fields seems to me to be much more attractive and would do much to forestall criticism that the package was going to hit marginal fields (which I am not convinced about anyway). I would, however, add that I think it would have to be made clear that such a study would be without prior commitment to change.

As well as the package I shall be mentioning the "sweeteners" in my Budget Speech and also the removal of BNOC's PRT exemption. But as regards the announcement of a special study of marginal fields and the removal of BNOC's priviledged position with regard to assignments this would probably best be done in the Budget debates.

Finally, I am afraid that we cannot proceed this year with 6 pages of complex legislation on valuation and I am glad to note that you are not pressing for this. It is a strong candidate for next year.

(GEOFFREY HOWE)

cc: Chief Secretary
Financial Secretary
Minister of State (C)
Sir Douglas Wass
Sir Lawrence Airey
Sir Anthony Rawlinson
Mr. Littler
Mr. Unwin
Mr. Lovell
Mr. Corlett
Mr. Ridley
Mr. Cropper
PS/Inland Revenue

MINISTER OF STATE (LORDS)

BUDGET SPEECH - TAXATION OF SHORT TERM BENEFITS

The Chancellor has seen your minute of 4th June and shares your view that taxation of short term benefits is not a subject to which to refer in the Budget Speech.

(A.M.W. BATTISHILL)
7th June, 1979

CH/EX. REF. NO. B(79)36
COPY NO. 10 OF 10 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

RATE SUPPORT GRANT 1979-80

We agreed in Cabinet last month that an across the board cut in the current year's RSG cash limit for England and Wales of at least £300 million should be made, with a corresponding reduction for Scotland. But we reached this decision before negotiations on teachers' pay had recognised that the amount of the abatement might need to be increased when the size of this settlement was known. Following your Private Secretary's letter of 21st May, I did not quantify the size of the reduction we had in mind in my speech during the Debate on the Address.

2. However, I think it would be right for me to reveal the figures in my Budget speech, since this is an essential part of our strategy on cash limits and public expenditure reductions in the current year. It is important that the local authorities should be informed as soon as possible of the size of the grant reductions we intend to make, if they are to take action to achieve significant economies in the current year. This is a point which the local authority associations have stressed in recent discussions in the Consultative Council and in the Convention of Scottish Local Authorities.

/3. I have

3. I have considered with Michael Heseltine and George Younger whether the reduction of £300 million for England and Wales, and the corresponding sum of £35 million for Scotland, should be increased because of the teachers' settlement, as Cabinet envisaged might be necessary. We have concluded that it would be right to adhere for the present to these figures, on the grounds that the first stage of the teachers' settlement was along the lines of the offer approved by Cabinet and that abatements of this size will represent a substantial financial constraint on local government. But I propose to announce that we will keep our options open on the possibility of making further reductions if they should be required in the light of the settlement reached for local authority white collar grades, the comparability awards by the Clegg Commission for the manuals, and the further settlement due in November for the manuals. We shall need to reach a final decision on the size of the abatement before the RSG Increase Orders are made at the end of this year.

4. Michael Heseltine and George Younger are content for me to deal with these reductions in the Budget Speech. I propose to do so in terms of the attached draft paragraph. I should be grateful for your agreement.

5. I am copying this minute to the Home Secretary, the Secretaries of State for the Environment, Education, Social Services, Scotland, Wales and Transport, and to Sir John Hunt.

(G.H.)
7 June, 1979

CONFIDENTIAL

DRAFT PARAGRAPH FOR BUDGET SPEECH

RSG CASH LIMIT CUT

"The need for substantial economies applies to local authority expenditure, where the Government's contribution is made through the Rate Support Grant. As I said three weeks ago, we shall take account of pay settlements in calculating the Increase Orders for the Rate Support Grant, but we shall make a significant across-the-board reduction from the total thus calculated. I can now tell the House that the reduction will be £300 million for England and Wales and £35 million for Scotland. These figures may have to be increased when we know the cost of further pay increases and will be finally determined in November before the Increase Orders are made. In coming to this decision a major factor has been how much in present circumstances it is reasonable for the tax-payer to contribute."

BUDGET SECRET

CH/EX. REF. NO. B(79)37

COPY NO. ___ OF 45 COPIES

MR. UNWIN

BUDGET SPEECH - DRAFT OF 8TH JUNE

I attach a further revise of the Budget Speech incorporating comments received by close last night which the Chancellor has approved.

2. Since there have been some significant structural changes from the last draft I also enclose a short key which identifies the provenance of the present Sections.

3. I am afraid I must ask for comments on this draft by 6.00 p.m. today so that the Chancellor can work on it again tonight. There are still a substantial number of gaps and we ought to aim to fill as many as possible on this round.

4. We are planning to produce another draft at the weekend for comment early on Monday.

(A.M.W. BATTISHILL)
8th June 1979

Circulation: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
PCC Members
MEG Members
Miss Brown
Mr. Kemp
Mr. L.J. Taylor
Mr. Jeremiah
Mr. Ridley
Mr. Cropper
Sir William Pile (I.R.)
Mr. Lovelock (C. & E.)

BUDGET SECRET

BUDGET SPEECH

KEY TO DRAFT OF 8 JUNE

8 JUNE DRAFT	corresponds with	6 JUNE DRAFT
A. INTRODUCTION		A. INTRODUCTION
B. THE YEARS OF DECLINE		B. THE YEARS OF DECLINE (with some re-ordering
C. INTERNATIONAL BACKGROUND		C. INTERNATIONAL ENVIRONMENT
D. THE CAUSES OF DECLINE		D. THE CAUSES OF DECLINE (much shortened)
DA. A FRESH APPROACH		DA. A NEW APPROACH (plus new introductory section by Financial Secretary)
DB. INFLATION		DB. INFLATION
E. [SPARE]		
F. MONETARY POLICY		G. MONETARY POLICY (as revised by Financial Secretary and HF.)
G. EXCHANGE CONTROL		E. EXCHANGE CONTROL
H. PUBLIC EXPENDITURE		H. PUBLIC EXPENDITURE (shortened and revised H.18-22 : disposals section revised by Financial Secretary)
I. INDIRECT TAXATION		I. INDIRECT TAXATION (less hydrocarbon oil duties and VED - carried to Section K. Redrafted by MST(L))
J. SOCIAL SECURITY		J. SOCIAL SECURITY
K. PETROLEUM TAXES		L. PETROLEUM REVENUE AND CAPITAL TAXATION. (Capital taxes moved to Section L, Business Taxation. Car leasing moved from Section L)

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L. BUSINESS TAXATION - INCLUDING CAPITAL TAXATION	K. BUSINESS TAXATION (revised by MST(L) and now includes capital taxes from Section L)
M. INCOME TAX	M. INCOME TAX (revised by MST(L)
[N. PERORATION]	[N. PERORATION]

8th June 1979

INTRODUCTION

A.1 It is a little over five years since my predecessor, the rt. hon. Member for Leeds East, rose at this despatch box to present his first Budget. Like me, he did so within a very few weeks of his Party's success at a General Election. In compressing the huge and complex process of Budget-making into so short a time, he faced - as I have done - a formidable task.

A.2 Like him, I have received unstinting support not just from my fellow Treasury Ministers but from many people, of every rank, within the Treasury and the two Revenue Departments. But for the willingness of all these people to work far beyond a sense of duty it would scarcely have been

/possible for me

possible for me to present this Budget at all.

A.3 So I gladly echo my predecessor in acknowledging this assistance with a very real sense of gratitude.

A.4 I echo him too in saying that I approach my task - and I assure the House that I quote his very words - "in a mood of humility and trepidation".

A.5 I say that not just because of the novelty of the experience for me - although that is daunting enough - but much more because of my sense of dismay at the disturbing familiarity of the occasion from the point of view of almost everybody else.

/A.6 For, as

A.6 For, as the House will recall, this is the fourth Budget in the last fifteen years to be introduced by a new Chancellor in a new Government. The late Iain Macleod, alas, did not survive long enough to be included in this series. Before myself there was, in 1964, the present Leader of the Opposition; in 1970, my noble friend, Lord Barber; and in 1974, the rt. hon. Gentleman, the Member for Leeds East.

A.7 And the depressingly familiar featureabout the first Budget Speech of each of these three predecessors is that every one of them found cause to complain, with more or less justice, about the disagreeable nature of the economic estate that had come his way.

THE YEARS OF DECLINE

B.1. For almost all the facts of the recent past tell the same story. Consumer spending rose last year, in percentage terms, by seven times as much as manufacturing output. Indeed, we actually manufactured 4 per cent less goods in 1978 than in 1973. But the volume of manufactured imports rose last year by no less than 13 per cent. Even at a time when demand was rising strongly, the economy had almost lost its capacity to increase supply. Had it not been for the massive contribution made by North Sea oil, last years current account would have been in deficit to the extent of £3 billion. Meanwhile, the pre-tax real rates of return on capital had fallen to less than half their level in the 1960s. And well before the last Administration left office inflation was back

on a sharply rising trend. The April figure of [10.3] per cent told much less than the whole truth about their legacy.

B.2. On that form, and on the policies which brought it about, there is little reasons to expect any improvement in economic performance in the future. In many respects, indeed, the prospect is more gloomy than the immediate past. Productivity is currently rising only about half as fast as in the early 1970s. And there is no indication of any change for the better in this trend. Last year's growth in demand - founded, as it was, on growing consumption - could never have been sustained. It was indeed largely met from imports. [This makes it increasingly likely that the recent falls in unemployment will quickly be reversed.] It is small wonder that British industry is

/demoralised

demoralised and the British people disillusioned.

B.3. But it would not be right to suggest that our problems are all the fault of the last administration. It is important to place the last five years in a rather longer perspective.

B.4. For only a quarter of a century ago - within the memory of almost every Member of this House - the people of the United Kingdom still enjoyed higher living standards than citizens of any of the larger countries of Europe. Amongst the free nations of the world, Britain was second only to the United States in economic strength.

/B.5. We have

B.5. We have not, of course, stood still in the twenty-five years since then. But others, like Germany and France, have achieved a great deal more - and by now have far outstripped us.

B.6. Their combined share of world trade in manufactured goods, which in 1954 was almost the same as ours alone, is now more than three times as large as ours. The gross national product of France is now one and a half times as large as that of the United Kingdom. And that of Western Germany is more than twice as large.

B.7. There has, of course, been a lot to say by way of mitigation or explanation of these developments. [And, as the spokesmen for one of Europe's "less prosperous countries" -

/what a humiliating

what a humiliating description - we have all become very good at saying it.] At least until recently, we have been able to claim a good record in most of those things that can be summed up in the phrase "the quality of life". But in the last few years, the seediness and the sullenness have begun to dominate the scene. The hard facts of our relative decline have become increasingly plain. And the threat of absolute decline has gradually became very real.

C. INTERNATIONAL BACKGROUND

C.1 Now as inhabitants of a country deeply involved in the international economy, we naturally pay a great deal of attention to events outside our own country. Since the Yom Kippur war of 1973 scarcely a day has passed without press, radio or television telling us in one way or another that the world economy is in crisis. However that may be, I have no doubt that it would be very dangerous if preoccupation with the oil crisis, the dollar crisis, or with this or that Common Market crisis led us to believe that our economic troubles could be blamed mainly on the outside world. That might suggest either that we should be rescued simply by

/a return of

a return of the world economy to its former buoyancy; or that if today's disturbed international environment continued we should not be able to put much right. In truth the troubles we suffer from are largely made in Britain. If we tackle them ourselves, we can pull the ecomomy round even in a world of slow growth. If we do nothing to change course, nothing that happens beyond these shores can help us.

C.2 As it happens, the international environment is unlikely to give us any comfort in the years immediately ahead. Oil, in particular, is once again a problem. With the reduction in Iranian production conditions in the market have become very tight.

/Oil prices

Oil prices are now on average about 30 per cent higher than six months ago. This is one reason why inflation is now rising in most countries and why growth is likely to be significantly lower than in 1978. In these circumstances, we clearly now need to do more about both conservation and about supply of energy. We must put into effect the energy saving proposals which we have agreed internationally. Some of the measures I shall be announcing later will help us to do so.

C.3 The energy problem can, of course, be mitigated by co-operation among the major consumer countries. For that reason it will be an important subject for discussion at the next meeting of the European Council, and at the Economic Summit in Tokyo at the end of this month. We have to recognise

that there is both a short-term and a long-term problem in matching available oil supplies to the demands which a growing world economy is bound to make. [It is certainly to be hoped that the better distribution of current account balances which we have seen in recent months will continue and will help to maintain the greater stability of exchange rates which has been another feature of this period].

C.4 In this uncertain world economic environment, the European Community can be a source of stability and of strength for its members. In one important area, however, present EEC policies seriously hinder our efforts to help ourselves. At present the United Kingdom and Italy, which are among

/the poorer

the poorer members of the Community are transferring substantial resources, chiefly through the Community Budget, to richer member states. We have already made it very clear to our partners that this situation cannot be allowed to continue. It is plainly unfair, but it is against the interests of the Community itself, which cannot expect to progress on so insecure a foundation. I am confident that our view of this problem is becoming more fully understood by our partners. Upon the basis of this understanding; we shall continue to press for an agreement which meets the United Kingdom case.

C.5 But, I repeat, progress internationally, whether on energy policy or on the Community Budget, will not eradicate the deep-seated weaknesses of our own domestic economy.

 Nor will

C.6 Nor will North Sea oil. Growing production from the North Sea may shield us, to some extent, from the transfer of income which other consumers, dependent upon external supplies, are bound to suffer as the price of energy rises. But this protection must not be allowed to shield us from the truth about what has been happening to the balance of our trade in traditional products, in particular manufactures.

C.7 North Sea oil itself will do nothing to solve the problems on the supply side of our economy. Nor will it remove the risks of excessive inflation. [Indeed, in some respects it may actually make matters worse, unless we correct some other aspects of policy which are at present

/working in

working in the wrong direction.] The moral once again is that it is for us to put our own house in order.

D. THE CAUSES OF DECLINE

D.1. So we find ourselves, yet again, asking the question: how are we to check, and then reverse, the long decline?

D.2. In particular, what can we, the politicians, do about it?

D.3. We should do well to begin, I suggest, by acknowledging that there is a strict limit to our capacity, as politicians, to influence these things for the better.

D.4. I suspect that the view is much more widely accepted outside the House of Commons than it is inside this place. But it is none the less true for that.

/D.5. I do

D.5. I do not mean to be unkind to my predecessor when I invite the House, for a moment, to consider his example. The Government of which he was a distinguished member firmly believed, as I understand it, that it was possible for Government to manage, indeed to plan, the economy, so as to promote efficiency and growth.

D.6. This is certainly not a narrow party point. For that same belief has been more or less widely shared. The rt. hon. Gentleman, the Member for Leeds East, certainly espoused it with enthusiasm. For in five years of office he introduced no less than [16] Budgets and economic "packages", and financed a wide range of policies in the name of "the regeneration of industry".

D.7. But, at the end of five years, he must ask himself, to what avail? Are we not driven to the conclusion that the notion of demand management, of "fine tuning" as it has come to be known, has by now been tested almost to destruction?

D.8. Certainly the rt. hon. Gentleman, the Leader of the Opposition, seems to have taken that view. For, as he said in a memorable and courageous speech in September, 1976:

> "We used to think that you could just spending your way out of a recession and increase employment by cutting taxes and boosting Government spending. I tell you, in all candour", said the rt. hon. Gentleman, "that that option no longer exists and that, insofar as it every did exist, it worked by injecting inflation into the economy. And each time that happened the average level of unemployment has risen. Higher inflation, followed by higher unemployment", concluded the rt. hon. Gentleman, "that is the history of the last twenty years."

D.9. On that basis, I approach my task this afternoon on this crucially important piece of common ground, which I am glad to be able to share with my two Labour predecessors in this House, that the poor performance of the British economy in recent years has been due not to a shortage of demand but to a series of failures on what is known as the supply side of the economy.

DA. A FRESH APPROACH

DA.1. Now it is the belief of this Government that many of those failures on the supply side are themselves the result of actions and interventions by Government itself: of laws that stand in the way of change and stifle enterprise; and, as important as anything, of a tax system that might have been especially designed to discourage innovation and punish success.

DA.2. This is why we are convined that an entirely fresh approach is necessary if we are to check the long-term economic decline, which has gathered pace in the last five years. Our strategy is based on four simple objectives:

- We need to restore incentives, by allowing people to keep more of what they earn, so that hard work pays, talent and ability is appreciated, and success is rewarded;

- We need to enlarge freedom of choice by reducing the role of the State and enlarging that of the individual;

- We need to reduce the burden of financing the public sector, and its impact on the rest of the economy, to a level which will allow commerce and industry to prosper;

and - We need to ensure, so far as possible, that those who play any part in the process of collective bargaining are obliged to live with the consequences of their actions - for that is the way to promote a proper sense of responsibility.

DA.3. These objectives are simple but their implications are profound. They require a complete change in the way in which our economy is allowed to work. They require us to remove the constraints and discouragement of recent year. Only in this way can we begin to motivate businessmen, managers and the many other key individuals on which we depend to produce genuine new jobs and the wealth

with which to improve public and social services.

DA.4. The tax changes I shall propose today will be only the first step. But they will take us a long way in the new direction that is essential.

DB INFLATION

DB.1 These policies will not, of course, succeed unless we are at the same time squeezing inflation out of the system. The control of inflation and the establishment of sound money is crucial. We propose to exercise this control through firm monetary discipline, strict control over public expenditure and a fiscal stance which is consistent with both. Financial discipline must begin at home. It will apply therefore as rigorously to the public sector as it does to the private sector. And it will be sustained. [Finance will determine public spending; not the reverse].

DB.2 Financial responsibility on the part of Government must be supported by a

/corresponding

corresponding acceptance of responsibility elsewhere. In particular, we must as a nation accept that the only source out of which increases in real wages and salaries can come is an increase in national production. Higher pay that is not accompanied by higher output can only lead to higher unemployment. This is the crucial reason for moderation, realism and responsibility in pay bargaining. It is important that this emphasis should be fully understood by all those involved in wage negotiations. We shall be more than willing to consider better methods of ensuring that it is. In recent years people's sense of responsibility has too often been undermined on both sides of industry - frequently as a result of formal pay policies imposed by Government. Responsibility cannot thrive unless it is

accompanied by freedom and flexibility - and this is what we are offering.

DB.3 Given the fiscal and monetary policies to which we are most resolutely committed, irresponsible pay settlements are bound, as I have said, to destroy jobs, as they have done in the past. Responsible bargaining necessarily means different things to different people and in different kinds of firms and industry. But on both sides of the table certain basic things must be respected: in the public sector, what the rate payer and tax payer can afford; in industry, what the customer is prepared to pay, what the management must be able to profitably invest, and what the pressure of competition demands; and throughout the economy, the

/limits imposed

limits imposed by the need to control the money supply and greatly reduce its rate of growth.

F. MONETARY POLICY

F.1. To that end, I told the House three weeks ago, the rt. hon. Gentleman, my predecessor, was undoubtedly right to adopt a system of monetary targets. But he did not go far enough, nor were his policies adequate to meet his own objectives. Although monetary growth in 1978-79 as a whole was just within the target range of 8-12 per cent, it was growing at an annual rate of 13 per cent in the second half of the year. Moreover, the May figures now becoming available indicate that the underlying growth was still above the top range and, if anything, accelerating. One cause of this has been the high rate of central government borrowing - £2½ billion in April and May alone.

/F.2. It is

F.2. It is now clear that if the public expenditure policies which we inherited had been left unchanged, it would have been quite impossible to meet the rt. hon. Gentleman's 8-12 per cent target without a further savage squeeze on the private sector, involving both a sharp increase in the total tax burden and even higher interest rates. Not for the first time the levels of public spending and borrowing which he permitted were far too high to be compatible with the monetary targets he had set himself.

F.3. This Government are committed to the progressive reduction of the rate of growth of the money supply. It is therefore my intention, as the first step in this process, to lower the target range for the remainder of this year, 1979-80. The new target range,

/to apply to

to apply to the growth of sterling M3 in the 10 months to the banking make-up day in April 1980, will therefore be an annual rate of 7 per cent - 11 per cent. I will roll this target forward by six months in the autumn.

F.4. Equally important, I intend to shift progressively the balance in the way in which the monetary target is achieved from an excessive reliance on interest rates and curbs on the private sector to a greater emphasis on fiscal restraint and curbs upon the public sector. This requires as a first step a significant reduction in the PSBR from the £10 billion, which is forecast for the present year before taking account of the increase in income tax allowances proposed in the April Finance Act, or of this Government's policy on cash limits or of any of the measures I

/shall announce

shall announce later. [Refer to "Healey Budget"]

F.5. There are limits to what the Government can do in this first Budget with two months of the financial year already passed. This is indeed a severe handicap. But we intend nonetheless to reduce the public sector's financial needs sufficiently for it to be possible to achieve the lower monetary target with less restraint on the private sector. And if the private sector in turn exercises restraint when concluding pay bargains there should be scope for keeping within the monetary target at tolerable levels of interest rates.

F.6. As the rt. hon. Gentleman, the Member for Leeds East, found to his cost, the public sector borrowing requirement is a fickle and elusive statistic. That is why I offer my estimate of the extent of Government borrowing in 1979-80 with a degree of diffidence. But my best estimate is that the changes in taxation and public expenditure I am announcing today will be sifficient to reduce the PSBR to £8¼ billion in the current year, as compared with the outturn of £9¼ billion for 1978-79. As a percentage of GDP that will represent a reduction from [ ] per cent last year to [ ] per cent in the current year. That is an important step in the right direction. But it is only the first. I intend to continue along this path in the years ahead.

G. EXCHANGE CONTROL

G.1. Before I come to my main proposals, I propose to deal with the question of exchange control.

G.2. Sterling is at present relatively strong, and I expect it to remain so. This strength flows partly from the realisation that, as a result of North Sea oil, the UK is better placed than most of our competitors to deal with present world oil problems. Moreover, I am determined to pursue firm fiscal and monetary polices which will maintain confidence in the currency. This is therefore an appropriate time to start dismantling our apparatus of controls on outward capital flows, which is more restrictive than any other major industrialised country finds it necessary to maintain. I believe the case is overwhelming,

/in this context

in this context as in others, for giving both companies and individuals wider freedom of choice, and for reducing the distortions and costs which controls are bound to impose on economic decisions. These costs bear particularly heavily on smaller companies.

G.3. We intend to move in this area one step at a time, and, in this initial stage, we are placing emphasis on direct investment overseas. [A Press Notice will be issued today giving details.] [Details are being made available in the Vote Office.]

G.4. I have decided that the main relaxation is that access to official exchange up to £5 million per project per year will be freely permitted for new outward direct investment. This should allow the majority of UK firms who invest overseas all the sterling finance they

/are likely

are likely to want. The two-thirds rule, which restricts the re-investment of profits earned overseas, will be abolished. This greater freedom in the financing of direct investment abroad does not, as is sometimes feared, threaten jobs in the United Kingdom. The weight of evidence is that, if as a result overseas investment is increased, our position in world export markets will in general be strengthened, to the benefit of output and jobs in the country. Moreover, additional investment overseas today will yield an income that will benefit the current account of the balance of payments in the future, when the overseas earnings from North Sea oil begin to decline.

/G.5. During the

G.5. During the sterling crisis of 1976, the last Government stopped the use of sterling by UK merchants to finance third country trade. This restriction, which has caused a loss of international business to British merchants, will now be abolished.

G.6. I have also decided that there should be some immediate easement of the controls affecting individuals. I am therefore making significant relaxations in the rules concerning travel and emigration allowances, overseas property, and cash gifts and payments to dependants. In the field of portfolio investment, I am taking two modest steps at this stage. I am abolishing the requirement to maintain 115 per cent cover for overseas portfolios financed by foreign currency borrowing; and official exchange will henceforth

be available for meeting interest payments on such borrowing.

G.7. As the House knows the liberalisation of exchange controls is also one of our obligations under the EEC Treaty. I have accordingly informed the Commission of the decisions I am announcing today.

G.8. As time goes by, I intend to make further proposals for the progressive dismantling of exchange control. Announcements will be made when conditions are appropriate. The pace of relaxation will obviously be influenced by sterling's strength as well as by the speed with which we can solve the economic problems that face us.

/G.9. In

G.9. In our external policy we have also to take account of our official external debts. These at present amount to $22 billion - a massive increase on the $8 billion which the previous Government inherited in 1974. It is the Government's intention to reduce this burden of external debt substantially during the life of this Parliament.

H. PUBLIC EXPENDITURE

H.1. A major contribution to reducing the borrowing requirement and the burden of direct taxation must come from savings in public spending and from drawing back the boundaries of the public sector. In present circumstances it is our strategy for tax and economic recovery that must have overriding priority: finance must determine expenditure, not expenditure finance. Substantial reductions can and will be made in the remainder of this financial year.

H.2. First, as I made clear three weeks ago, we shall not raise the cash limits to cover higher prices than provided for in the cash limits originally published for this year. On pay in the public sector, while we will honour the commitments to the universities and the

/health authorities

health authorities entered upon by our predecessors, in general we will limit the adjustment of the cash limits so that substantial offsetting economies will have to be found.

H.3. The need for substantial economies applies also to local authority expenditure, where the Government's contribution is made through the rate support grant. As I said three weeks ago, we shall take account of pay settlements in calculating the increase orders for the rate support grant, but we shall make a significant across-the-board reduction from the total thus calculated. I can now tell the House that the reduction will be at least £300 million for England and Wales and £35 million for Scotland. These figures may have to be increased when we know the cost of further pay increases and will be finally determined in November before the Increase Orders are made. In coming

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to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute.

H.4. The cash limits on Departments and fringe bodies are being set to ensure that economies of 3 per cent are achieved on manpower costs this year, as announced by my hon. Friend the Minister of State, Civil Service Department.

H.5. I estimate that this cash limits policy will reduce the volume of planned expenditure by about £1,000 million at 1979 Survey prices.

H.6. On top of these reductions resulting from the policy on cash limits, my rt. hon. and hon. Friends have reviewed the plans for their Departments and nationalised industries and have identified further specific reductions which are

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which are being made this year. The changes are listed in a Press Notice issued by the Treasury today and further details will be given by the Ministers concerned. But the House will want to know where the main reductions will be made. All figures are at 1979 Survey prices.

H.7. We are making an immediate start in reducing expenditure on industrial and employment subsidies. My rt. hon. Friend, the Secretary of State for Industry, is cutting expenditure on industrial support this year by £200 million from the provision for new projects by the Department of Industry and by the National Enterprise Board, and by imposition of a delay of 4 months in payments of approved claims for regional development grant. Support from the employment programmes is to be concentrated on the areas where unemployment is highest, and

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/savings of

savings of over £170 million will be made this year.

H.8. In the area for which my rt. hon. Friend the Secretary of State for Energy is responsible savings of over £320 million are being made this year in the finance for BNOC and the electricity, gas and coal industries. The industries have been asked so far as possible to avoid increases in fuel charges on top of those required to meet the cash limits announced by the previous Government.

H.9. My rt. hon. Friend, the Secretary of State for the Environment, is making savings of about £440 million from his programmes this year, mainly by scrapping the Community Land Act, deferring water authority investment and reducing the existing allocation to housing authorities.

/H.10. As we

H.10. As we have repeatedly made clear, it is not our intention to reduce spending on the Health Service. But we cannot ignore the fact that the contribution made by some health charges has greatly diminished in recent years. This applies especially to prescription charges which have stood at their present level for eight years during which prices have risen by [ ] It is therefore proposed to increase prescription charges to 45p. This will still leave them cheaper in real terms than they were in 1971, and the present wide range of exemptions covering children and the elderly amongst others will, of course, be maintained. Certain dental charges will also be increased.

H.11. My rt. hon. Friend, the Secretary of State for Education and Science is reducing expenditure in those areas of the education and

/science programmes

science programmes within the Government's direct control by about £55 million.

We shall not add to the increase of 5p in the school meal charge which was planned by our predecessors for the autumn term.

H.12. The aid programme this year is being reduced by £50 million. Savings are also being made on the transport, trade and arts programmes.

H.13. My rt. hon. Friends, the Secretaries of State for Scotland and Wales and Northern Ireland are making comparable reductions in their own programmes.

H.14. In total these reductions amount to over £1½ billion this year.

H.15. In addition, we do not intend to use as large a Contingency Reserve as provided for

1979-80 in the last Government's public expenditure White Paper.

H.16. We have decided to cut the Reserve by £250 million. Any further decision to add to the volume of programmes in the remainder of this year will be met from the [£250 million] remaining in the Reserve.

H.17. In two areas we are providing for increased expenditure - defence and pensions. An extra £100 million is being provided for the defence budget this year. This will enable essential projects in the equipment programme to go ahead. I shall return to the pensions improvements shortly.

H.18. As I have already indicated, we are only just embarking on our review of the plans we have inherited and the scope for reducing the size of the public sector. But there are

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already a number of major options for early sales of assets.

H.19 Sales of state-owned assets to the private sector serve the immediate purpose of helping to reduce the excessive Public Sector Borrowing Requirement with which I was faced. This is all the more necessary this year, given the great difficulty of cutting back public sector spending programmes once the year in question has already begun. For future years the contribution made by the sale of assets to total public expenditure savings will not need to be so great.

H.20. But such sales have a much more fundamental place in our overall programme than the short term reduction of the PSBR. They are an essential part of our long term programme, which

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/we intend to

we intend to sustain over the years that lie ahead, of promoting the widest possible participation by the people in the ownership of British industry, including the nationalised industries.

H.20. This objective - public ownership in the true meaning of the term - has implications not merely for the scale and duration of our programme for the sale of state-owned assets, but also for the methods of sale we shall adopt over the years.

H.21. So far as this year's disposals are concerned, we must obviously retain flexibility on timing and on the precise mix of assets in order to ensure a fair price. I do not therefore propose to announce the details today. But I intend to ensure that the proceeds of sales in the current financial year will amount

to some £1 billion and I have taken account of this in the Budget arithmetic. [The biggest contributor to this total will be the sale of part of the Government's shareholding in British Petroleum.] [or: The total will be largely made up from sales of part of the Government's shareholdings in British Petroleum and of the National Enterprise Board's holdings and from sales of other public sector assets]

H.22. In total I estimate that the reductions I have announced will amount to about £3½ billion at 1979 Survey prices and £4 billion at current prices. Yet given the scale of the problem we have inherited, I must look for a further contribution from indirect taxes to finance the first stage of the substantial reductions in income tax I regard as essential.

I INDIRECT TAXATION

I.1 We made it clear in our Manifesto that in order to pay for the income tax cuts the country needs we must be prepared to switch from taxes on earnings to taxes on spending. This is the only way that we can restore incentives and make it more worthwhile to work; and at the same time increase the freedom of choice of the individual. We must make a start now.

I.2 I have therefore reviewed all the possible forms of indirect taxation to decide where the increased revenue could best come from. There are many cogent arguments in favour of the VAT.

First people tend to spend proportionately more on goods liable to VAT as their income rises. This means that

unlike most indirect taxes the VAT is not regressive: on the contrary it is mildly progressive.

Second large areas of consumer expenditure, in fact about half the total, are not chargeable to VAT. Food, children's clothes, heating and light, house prices and rents, and public transport are all zero rated.

Third in countrast to taxes such as those on alcohol and tobacco, the VAT is very broadly based.

Fourth there is a real opportunity for simplifying the administration of the tax by having one rate instead of two.

In his Speech on 22nd May, the rt. hon.

/Gentleman

Gentleman the member for Leeds East seemed to favour increases in the Surcharge on National Insurance Contributions or in Advance Corporation Tax. The first of these falls on British industry including production for export while imports are exempt. It is clearly therefore inferior to the VAT which falls on imports but not on exports. The second, an increase in Advance Corporation Tax, would seriously damage the liquidity of industry at a particularly difficult time: in contrast an increase in VAT actually increases in VAT actually increases industry's liquidity.

I.3 For all these reasons my choice must fall on the VAT. Moreover the increase I make must be sufficient to provide the funds needed to make the reductions in

income tax which are so essential. I propose therefore that as from next Monday VAT should be charged at a new unified rate of 15 per cent.

1.4 Allowing for the wide range of goods and services which are zero rated - and which will stay zero rated - the new rate I propose is equivalent to 8% averaged over the whole of consumer expenditure. [This is significantly less than the average in the European Community and indeed only one other country in the Community - - has an average rate as low as 8 per cent].

1.5 The yield from the increase is estimated at [£2035m] in 1979/80 and [£4175m] in a full year. Thus it will provide scope for further direct tax reductions in later years. The relatively

small size of the yield this year reflects the loss of over two months' revenue and the gap before traders pay over VAT receipts to the authorities - an average of over 3 months. This gap has, however, an important and helpful effect. For as these funds build up in traders' hands, they provide a substantial boost to the liquidity of the firms and companies concerned. Concern has been expressed that an increase in VAT would apply to telephone bills for calls made before the date of change. I am proposing transitional provisions to deal with this and some of the other problems in this field.

I.6 The sharp increase in VAT will, of course, add significantly to the shop prices of drink and tobacco. For example

/the VAT

the VAT increase will mean about an extra 28p on a bottle of whisky, 2p on a pint of beer and 6p on a typical packet of 20 cigarettes. In these circumstances, I do not think it would be justifiable to raise those prices further in the present year.

1.7 I fully realise that this increase in Value Added Tax will result in a rise in prices - in fact a rise of about 3½ per cent in the Retail Price Index. This, is, of course, a once for all effect, and it is similar in magnitude to the effect on the RPI of proposals made by the rt. hon. Gentleman my predecessor in his Budget of 1974. In fact he added 3¾ per cent to the RPI on that occasion, and he raised

/income tax

income tax at the same time from 30 pence to 33 pence in the pound. At least I am not about to emulate the rt.hon. Gentleman with that particular spring double. There never was a time when it was going to be easy to effect the switch from direct to indirect taxes and the present moment is no exception. But the action has been postponed too long already. Indeed the former administration actually made matters worse at one moment when it cut the basic rate of VAT from 10 per cent to 8 per cent at a time when it was actually raising income tax. [I do not think anybody really welcomed that con-trick]. We are, therefore, proposing to deal with this overdue reform boldly and forthwith.

/I.8 The House

I.8 The House should bear in mind that as I have already indicated VAT does not fall on a wide range of necessities and this means that the increase will fall less heavily on people in the lower income groups: and as will be apparent when I come to my income tax proposals we shall be [putting money into people's pockets] to enable them to pay the increased VAT. I appreciate that those who are not liable to income tax and I have in mind particularly many of those living on retirement pensions will not benefit from my income tax proposals. This brings me to our proposals in the field of Social Security.

J. SOCIAL SECURITY PAYMENTS

J.1. We have decided to increase the standard rate of retirement pensions in November by £[6] to [£37.30] for a married couple and by £[3.80] to £[23.30] for a single person. As we promised, these increases take full account of the underestimate which the last Government made of the actual rise in earnings between November 1977 and November 1978, and are well above the figures of £4 and £2.50 announced by the previous Government. [Indeed these are the biggest increases that any Government has ever given.] Other social security benefits will also be increased, and my rt. hon. Friend, the Secretary of State for Social Services, will announce full details [tomorrow].

/J.2 This

J.2. This means that National Insurance pensioners and other beneficiaries will be fully protected against the forecast increase in prices. This is what is really important. But the extent to which we can afford to go further than this - to add improvements in real terms - must depend on the extent to which the economy as a whole, which depends on the productive capacity of those in work, can afford it.

J.3. Under the present rules long term benefits are uprated on the basis of the movement in prices or earnings, whichever is the greater. The Government have decided, however, that for the future the requirement for the statutory uprating of [long term] benefits should be based on price movements, and we shall be introducing legislation to this end. This will be a

minimum requirement, and will fully protect the value of these long-term benefits against price increases at all times, including those arising from indirect taxes such as I have just announced. Of course we want to be able to do more. I am confident that in time, as our economy improves, it will be possible to do so and ensure that pensioners share in the increase in national prosperity. That is one more reason why my other proposals today are so important. For they will make a determined start on restoring to working people incentives that are necessary if they are to achieve greater prosperity not only for themselves but also for others in our society who depend on them.

J.4. [The change will make no difference this year since the forecast rise in prices for the year to November is greater than the increase in earnings expected over the same period. The

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figures I have just mentioned fully reflect this forecast price increase.]

J.5. We also propose other social security increases. Single parent families face particular problems, and we propose that the one parent premium should go up from £2 to £2.50 next November. We also want to help the disabled. Mobility allowance will accordingly be increased from £10 to £12 in the autumn. And we shall, of course, honour our commitment to pay a Christmas bonus this year of £10.

J.6. These measures overall will cost about £[ ] million in 1979-80 and £[ ] million will be charged against the Contingency Reserve. As the House knows, my general policy is to make substantial reductions in public expenditure. But this must be and is being done in a way which bears fairly on the more vulnerable members

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/of society.

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of society.

J.7. Our social security system has become far too complicated and it can reduce the incentive to work. The problem and the need to correct it is widely recognised on both sides of this House. We are therefore studying a number of aspects of the social security system to see what can be done to simplify it. My rt. hon. Friend, the Secretary of State, is also putting in hand urgent measures to tighten up on abuse and fraud.

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K. TAXATION OF OIL AND PETROLEUM

Hydrocarbon Oil Duties

K.1. I dealt earlier with the excise duties on tobacco, drink etc. The oil duties however raise wider issues. I have already indicated that I shall be announcing today measures which will help us to meet the growing and undoubted need to conserve oil. At a time when there is a worldwide shortage of crude oil it is essential that we should play our full part in achieving the 5 per cent reduction in consumption to which the previous Government rightly committed us.

K.2. I therefore propose to increase all the main oil duties this year. In the particular case of petrol, the VAT increase from 12½ per cent to 15 per cent will be smaller than for many other items. With this in mind therefore

I also propose to increase the petrol duty by about 23 per cent - 7p a gallon - which will result in a total price change of about 10p a gallon. I also propose to increase the duty on derv by the same sum, 7p per gallon, and the duty on heavy oil other than derv, by ½p, about 20 per cent. I am not, however, increasing the duty for burning oil and for domestic paraffin, which is the oil used most commonly in the home, particularly by pensioners. The yield from these excise duty changes is estimated at an additional £525 million in a full year and £380 million in 1979/80. [The immediate increase in the RPI will be about a quarter of one per cent.]

/Vehicle Excise Duty

Vehicle Excise Duty

K.3. In view of the increase I am proposing in the roal fuel duties I have decided to make no change in the rate of vehicle excise duty. Our predecessors announced their intention of abolishing the duty on petrol driven vehicles. My colleagues and I are reviewing the future of this duty and we shall announce our conclusion in due course. For heavier goods vehicles my rt. hon. Friend, the Minister of Transport, will be announcing plans for restructuring the form of this tax, and for the moment therefore it seems best to leave this duty unchanged also.

Car Leasing

K.4. Before I leave the subject of motor cars, there is a particular issue I need to deal with. There is a weakness in the present legislation relating to the computation of profits which

enables leased cars to avoid the special rules restricting capital allowances for business cars. [There has recently been an explosive growth of car leasing, partly as a result of that loophole]

This has resulted in a loss of tax which is currently running at about £175m a year; and which could well rise to £200m next year if I take no action. I propose to put this right with effect from today.

K.5. Details of the stock relief and car leasing proposals will be [made available in the Vote Office] [given in press notices which the Inland Revenue are issuing today.]

Petroleum Revenue Tax

K.6. I turn next to petroleum revenue tax. The previous Government announced last August that they proposed to increase this tax from

1st January 1979. These proposals were discussed very fully by the last Government with the industry and we ourselves had had representations about them which we have carefully considered.

K.7. Although we did not oppose them at the time, I am not sure that when the proposals were announced they were wholly justified in their intended aim of securing a fairer balance of shares of this national resource. Companies cannot be expected to invest in the North Sea unless the return they get from successful development rewards them commensurately for the risks they have taken and which we are continuing to look to them to take. But judged against the recent developments in the world oil situation the package of PRT proposals for increasing the Government's take from the North

Sea is justified. There will accordingly be provisions in the Finance Bill to implement it. I also propose, however, to introduce some changes in the PRT expenditure rules for which the industry have been pressing for some time. Moreover, the British National Oil Corporation will no longer be exempted from PRT.

K.8. These proposals will increase the Government's revenue from the North Sea by about £[ ] million, in the year 1979-80 and by about £ million to 1985.

L. BUSINESS TAXATION - INCLUDING CAPITAL TAXATION

L.1. Before I deal with the taxation of business profits, I propose to refer to the taxation of capital, a matter of vital interest to business as well as to individuals.

L.2. We made it clear in our Manifesto that we were determined to make the taxation of capital simpler and less oppressive. No-one can defend the Capital Gains Tax in its present form. Most of the yield comes from paper gains arising from inflation and the tax therefore is simply a levy on the capital itself. The Capital Transfer Tax, despite the improvements we were able to secure in the last Parliament as a result of constant pressure from our Benches, is oppressive, harmful to business, and a real deterrent to initiative and enterprise. It is perfectly natural that

people should want to build up capital on their own and pass it on to their children and this is particularly true of the small business.

L.3. The issues involved in both of these taxes are difficult and complex. We need time to study them and devise the best solutions. I have therefore decided that we should not attempt to legislate in this Finance Bill, but should press ahead with a study in depth with a view to legislating at the earliest possible date. There is however one specific issue on which legislation is required to hold the present position: I propose, in the case of discretionary trusts, to extend the period for transitional relief for a further two years and to defer for two years the introduction of the periodic charge.

/L.4. The

L.4. The Development Land Tax, however, is a very different matter and immediate action is necessary. This tax has combined with the Community Land Act to prevent much worthwhile development and to increase unemployment in the construction industries. We have already said that we will repeal the Community Land Act. I propose now to deal with the Development Land Tax. In place of the present rates of 66.2/3rds per cent and 80 per cent, which the previous Government intended should rise to 100 per cent, I propose that Development Land Tax will in future be charged at a single rate of 60 per cent. The amount of development value which can be realised in a financial year without liability to Development Land Tax will be raised from £10,000 to £50,000. Both these changes take effect for disposals made on or after today.

[Does this rule out indexation]

L.5. [I do not propose any further reductions in rate or increase in the exempt slice.] Owners of development land will therefore have no reason for holding back in the hope of further tax reductions. What I have said today should therefore remove the major uncertainties which have been hanging over the market.

L.6. I now turn to the taxation of profits. If the country is to increase its prosperity and to create the wealth upon which improvements in our public and social services must depend, we need a vigorous, profitable and expanding company sector. Profitability has dropped sharply in recent years and the rate of return on capital employed is now far too low. This is especially true of manufacturing industry.

/L.7. Against

L.7. Against that background I propose no change this year within the general system or in the rates of Corporation Tax. Without higher profits we shall not see the new investment and jobs which are so urgently needed. Achieving those profits is very largely the task of management and work people. The Government can help or hinder them, and this is no time to add to the difficulties that they face by raising taxes on profits still further. [Nor would it be right to make any major changes in the system of taxation without careful consultation in advance.]

L.8. Looking further ahead, however, it is important that the tax system should take account of the effects of inflation on businesses, and do so in a way that is reasonably objective, equitable and simple

/to administer.

to administer. The Government will therefore be reviewing a number of aspects of the present system at the same time as the accountancy profession's latest proposals for current cost accounting. I am arranging for the Inland Revenue to consult the accountancy profession and business in the year.

L.9. I need however to deal now with the question of stock relief. The Finance Bill will include legislation to honour the undertaking which my predecessor gave last year, and which we on this side of the House supported, to write off the deferred tax liabilities arising from stock relief given for the first two years of the scheme - 1973-74 and 1974-75; and to write off these liabilities in respect of subsequent years successively, after an interval of six years.

/L.10. In addition,

L.10. In addition, following consultations which the Inland Revenue have had with industry, I am proposing two further changes in the stock relief scheme. I intend to reduce the profit restriction for unincorporated businesses from 15 per cent to 10 per cent; and all businesses will be given greater flexibility in the amount of relief that they can claim. Both these changes will be of particular benefit to small businesses.

L.11. I now come to dividend control. If industry is to flourish it needs not only adequate profits but a vigorous capital market to provide funds for investment and expansion. The control of dividends has now outlived its purpose. The control will accordingly come to an end when the existing legislation expires on 31st July.

/L.12. We on this

L.12. We on this side of the House have consistently championed the cause of smaller businesses. In the tax field, there is one measure that will do more than anything else to encourage the contribution that smaller businesses - indeed businesses of every size - can make to enterprise, innovation and employment. That is, a major reduction in the burden of income tax. I will come to that in due course. But I also propose to raise this year the profit limits for the small companies rate of corporation tax - to the figure of £60,000 at the lower end and of £100,000 at the upper end. This will go some way further than is necessary to maintain their real value.

M. INCOME TAX

M.1. I now come to the income tax reductions which are the keystone of my policy. It is the excessive levels to which the income tax has been driven over the years which bears so heavy a responsibility for the lack lustre performance of the British economy. We need therefore to cut the income tax at all levels - at the bottom, in the middle and at the top; this means in turn that we must raise the thresholds, reduce the basic rate and cut the top rates. For the reasons I have already explained I cannot do as much this year as I would have liked and I cannot do as much as is needed. But I propose taking a significant step forward in this Budget. I wish to leave no doubt in anyone's mind that this Budget marks a real turning point. It is only the first instalment of income tax changes which we

shall bring to fruition in the years to come.

M.2. I begin with the higher rates of tax. These rates no longer affect only those on very high incomes. They apply to the senior executives and the middle managers in industry and to some skilled workers: as well as to professional people and the proprietors of small businesses. These are the people upon whom our hopes for initiative, greater enterprise and hence greater national prosperity must depend.

M.3. It is universally recognised that the present top rate of 83 per cent on earned income is an absurdity and the rate of 98 per cent on investment income even worse. Such rates bring in very little revenue but they act as a severe disincentive and are a patent injustice.

The previous Government recognised this. But they did nothing about it. I propose an overdue measure of reform. The top rate will be cut from the present 83 per cent to 60 per cent and this rate will apply to taxable income over £25,000. At the other end of the higher rate scale, the present threshold of £8,000 is quite inadequate. I propose raising it to £10,000. Even at this figure it will be less in real terms that it was in 1973. In between I propose a new scale of rates less steeply progressive than the old rates which will ensure that middle management, so important to the success of British industry, will have their tax burden reduced to more reasonable proportions.

M.4. The top rate of 60 per cent on earned income I now prpose fulfills our Election commitment to reduce the top rate to the

European average. The top rate in France is 60 per cent: in Germany it is 56 per cent: while in the United States it is only 50 per cent. Moreover the new top rate will be reached at an income level which is lower and in some instances significantly lower than is common elsewhere. This is a matter to which we may need to return on a future occasion.

M.5. While therefore the reductions I propose are substantial they are no more than the circumstances require. They will still in general leave people in the top income groups more highly taxed than people in corresponding positions in other industrialised countries. We have to compete with such countries, not only in the sale of goods and services, but in attracting and retaining the talent required to run our industry efficiently and profitably

and thereby provide the employment opportunities for our people we so desperately need.

M.6. We have over the years spent too much time and effort trying to "level down". This is no good to anybody. It is much more important that we should have a prosperous society. And we cannot have a prosperous society unless we are prepared to have prosperous people in that society.

M.7. But it is not only at the top of the income range that the burden of income tax is particularly oppressive. The same is true for those on the lowest taxable incomes. That is the importance of the tax thresholds, to which I turn next. The increases proposed in the April Finance Act, which were not of course implemented, were quite inadequate. I propose

to double these increases. This means that the single allowance will go up, not by £90, but by £180; the married allowance will go up, not by £140, but by £280. This means that a single person's taxfree earnings will go up by nearly £3.50 a week and if he is paying tax at the basic rate he will get a full £1 a week extra in his pay packet. A married man's taxfree earnings will go up by £5.38 a week, and if he is paying tax at the basic rate, he will find an extra £1.78 a week in his pay packet. This is quite apart from the consequences of any further changes that I have to propose.

M.8. I have in fact three other changes to propose before I come to the rates of income tax. First, especially for the elderly the age allowance will be raised by £240 for the single person and £380 for the married person.

These again are double the figures proposed in the April Finance Act. Last year the limit for the full allowance was £4,000. This year I propose raising it to £5,000, more than twice the increase proposed in the April Finance Act.

M.9. Second I propose raising the threshold for the investment income surcharge. The justification for retaining the surcharge is itself debatable. Certainly there can be no argument but that it bites at far too low a level of income. Almost half the surcharge is paid by people over 65. This is moreover a tax which falls with particular severity on those who have had to make provision for their retirement out of their savings and have no occupational pensions to fall back on. The undue severity of the tax was recognised by the

previous Government by introducing what were no more than palliatives in the form of a reduced rate applied to the first slice of income liable to the surcharge and a slightly higher threshold for those over 65. We propose instead raising the reshold to £5,000 for everyone: the rate above that level will reamin at 15 per cent. This approach combines a considerable simplication of the tax with a measure of justice that is long overdue.

M.10. Third we propose implementing our election pledge to war widows. Provision will be made in the Finance Bill to exempt their pensions entirely from tax.

M.11. I come finally to the basic rate. For the great majority of taxpayers - some 21 million in all - it is the basic rate which determines

/the tax liability.

the tax liability. It is the basic rate which is also the marginal rate falling on additional earnings whether they come from overtime, or greater productivity, or reflect greater skill or the rewards of promotion. Everywhere one meets complaint and criticism of the effect of the income tax in eroding differentials, reducing the rewards of skilled workers and discouraging effort, initiative and responsibility. My long term aim is to reduce the basic rate of income tax to 25 per cent. This year I propose taking a first and significant step in this direction by reducing the rate from 33 per cent to 30 per cent. Nothing less than this would provide both the incentive we need and the conviction that we really mean business.

/M.12. The total cost

M.12. The total cost of these income tax reductions, including the cost of increases in personal allowances proposed in April but not implemented at the time, will be £4,570 million in a full year. The lion's share, no less than £3,660 million or four-fifths of the total, represents the cost of increasing the personal allowances and reducing the basic rate. The cost this year will be £3,590 million.

M.13. As a result of the increase in the tax thresholds 1.3 million people who would otherwise have paid tax this year will not be required to do so. The number of people paying tax at the higher rates would have been 1.2 million: instead the number will be virtually halved to 650,000. The number liable to the

/investment

investment income surcharge will be reduced to a third of what it would have been - from 850,000 to 270,000. All the changes will simplify administration and reduce the work load on the Inland Revenue.

M.14. The changes in allowances will be implemented for most taxpayers on the first pay day after 12th July. The reduction in the rates of tax will be given effect as soon as new tax table are ready in October. [Give illustrative example of tax repayments.]

M.15. A full year's income tax reductions will be received even though my Budget is being presented two months or more after the start of the year. One this basis the income tax changes mean that for the married couple where the husband earns £100 a week, which is close to average earnings, there will be an increase in take-home pay averaged over the remainder of the financial

year of £4.07 a week. The increases in VAT and petrol duty will increase family expenditure by £2.76. So that, taking both the direct and indirect tax changes into account, the family will be £1.31 per week better off. Similarly, where the husband earns £60 per week there will be a real gain of 77p a week, while the position of the couple on £150 per week will improve by £1.96 a week.

M.16. These reductions in the burden of income tax, which are as substantial as they are unprecedented, mean that wage and salary earners will have more money in their pockets to buy the goods and services they help to produce. True the prices of a good many of these goods and services will be increased by my tax proposals. But virtually every family in the land will have more money coming in to pay the increased bills, and with some to spare. And what is more, the choice of the way they spend their higher income will rest increasingly with them, and not with

/the Government.

BUDGET-SECRET

the Government. I emphasise too that this is only the first instalment of our tax-cutting programme.

M.17. These changes represent only the first stage in the major reduction in the burden of direct taxation that we are pledged and determined to make. The net effects of my proposals as a whole - and not simply the immediate effects on prices of some of them - should be studied carefully, particularly by those who will be involved in the pay bargaining. It would be not only foolish but positively damaging to the nation as a whole, as well as to the individual's own self-interest, if an attempt were made to recover by excessive pay claims what has already been more than made good by these unprecedented reductions in income tax.

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BUDGET SECRET

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MR. UNWIN

BUDGET SPEECH - DRAFT OF 9TH JUNE

I attach a further revise of the Budget Speech incorporating comments received before close last night. The Chancellor worked on the text overnight and this revise also incorporates further changes he has made.

2. Subject to any further thoughts which the Chancellor may have over the weekend this should be regarded as a near final text. I should therefore be grateful if all concerned would carefully examine it for accuracy, and let me know as soon as possible if any factual errors have crept in.

3. I should be grateful if Mr. Bottrill would make a final check of the figures.

4. Corrections please by 12 noon on Monday.

(A.M.W. BATTISHILL)

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A INTRODUCTION

A 1. It is a little over five years since my predecessor, the rt. hon. Member for Leeds East, rose at this despatch box to present his first Budget. Like me, he did so within a very few weeks of his Party's success at a General Election. In compressing the huge and complex process of Budget-making into so short a time, he faced - as I have done - a formidable task.

A 2. Like him, I have received unstinting support not just from my fellow Treasury Ministers but from many people, of every rank, within the Treasury and the two Revenue Departments. But for the willingness of all these people to work far beyond a sense of duty it would scarcely have been possible for me to present this Budget at all.

A 3. So I gladly echo my predecessor in acknowledging

/this assistance

this assistance with a very real sense of gratitude.

A 4. I echo him too in saying that I approach my task - and I assure the House that I quote his very words - "in a mood of humility and trepidation".

A 5. I say that not just because of the novelty of the experience for me - although that is daunting enough - but much more because of my sense of dismay at the disturbing familiarity of the occasion from the point of view of almost everybody else.

A 6. For, as the House will recall, this is the fourth Budget in the last fifteen years to be introduced by a new Chancellor in a new Government. The late Iain Macleod, alas, did not survive long enough to be included in this series. Before myself there was, in 1964, the present Leader of the Opposition; in 1970, my noble friend, Lord Barber; and in 1974, the rt. hon.

/Gentleman, the

Gentleman, the Member for Leeds East.

A7. The depressingly familiar feature of the first Budget Speech of each of these three predecessors is that every one of them found cause to complain, with more or less justice, about the disagreeable nature of the economic estate that had come his way.

A8. The House will understand, in light of the figures published last Friday, which showed that the current account of the balance of payments in the first four months of this year was no less than £1½ billion in deficit, that I see every reason to take the same view as my predecessors.

/B THE YEARS OF DECLINE

B THE YEARS OF DECLINE

B.1 For so many of the facts tell the same story. Consumer spending rose last year, in percentage terms, by seven times as much as manufacturing output. We actually manufactured 4 per cent less goods in 1978 than in 1973. But the volume of manufactured imports went up last year by 13½ per cent. When demand was rising strongly, the economy had almost lost its capacity to increase supply. The current account of the balance of payments was barely in surplus last year, despite a massive contribution of £3½ billion from North Sea oil. Meanwhile, the pre-tax real rates of return on capital had fallen to less than half their level in the 1960s. And well before the last Administration left office inflation was back on a rising trend. The April figure for the RPI of 10.1 per cent told much less than the whole truth about their legacy.

/On that form,

B 2. On that form, and on the policies which brought it about, there is little reason to expect any improvement in the future. In many ways indeed, the prospect is more gloomy than the immediate past. Productivity is rising only about half as fast as in the early 1970s. And there is no sign of any change for the better there. Last year's growth in demand - founded, as it was, on growing consumption - could never have been sustained. For, as the trade figures make clear, it was largely met from imports. This is perhaps the main reason why the recent fall in unemployment was, in any event, likely to be reversed. It is little wonder that those who work in British industry are so deeply worried about their future.

B 3. It would be too easy to conclude that these problems are all the fault of the last administration. But I want to place the last five years in a rather longer perspective.

/Only a quarter

B4. Only a quarter of a century ago - within the memory of almost every Member of this House - the people of the United Kingdom still enjoyed higher living standards than the citizens of any of the larger countries of Europe. Amongst the free nations of the world, Britain was then second only to the United States in economic strength.

B5. Of course, we have not stood still since then. But others, like Germany and France, have achieved a great deal more. By now they have far outstripped us, and are moving further ahead all the time.

B6. For example, their combined share of world trade in manufactured goods, which in 1954 was almost the same as ours alone, is now more than three times as large as ours. The French now produce half as much again as we do, while the Germans produce more than twice as much.

/There has,

B 7. There has, of course, been plenty to say in mitigation or explanation of these developments. At least until recently, we have been able to claim a good record in most of those things that can be summed up in the phrase "the quality of life". But in the last few years, the hard facts of our relative decline have become increasingly plain. And the threat of absolute decline has gradually become very real.

/C INTERNATIONAL BACKGROUND

C. INTERNATIONAL BACKGROUND

C.1 Now as inhabitants of a country that has always been deeply involved in the international economy, we naturally pay a great deal of attention to events outside our own country. And, since the Yom Kippur war in 1973, scarcely a day has passed without press, radio or television telling us, in one way or another, that the world economy is in crisis. That may well be so. But it would be very dangerous if preoccupation with "the oil crisis", "the dollar crisis", or with this or that "Common Market crisis" led us to believe that our economic troubles could be blamed mainly on the outside world. That could all too easily suggest either that we should be rescued simply by a return of the world economy to its former buoyancy; or that if the world were to continue in the economic doldrums,

/we should not

we should not be able to put much right here at home. The truth is that our troubles are very largely home-made. If we tackle them ourselves, then we can pull our own economy round, even in a world of slow growth. If we do nothing to change course, then nothing that happens beyond these shores can help us.

C2. As it happens, the international environment is unlikely to give us any comfort in the years immediately ahead. Oil, in particular, is once again a problem. With the cut in Iranian production market conditions have become very tight. Oil prices are now, on average, about 30 per cent higher than six months ago. This is one reason why inflation is now rising in most countries and why growth is likely to be significantly lower than in 1978. In these circumstances, we clearly now need to do more

/about both

about both conservation and supply of energy. We must achieve the oil saving objectives to which we are committed internationally. Some of the measures I shall be announcing later will help us to do so.

C3. The energy problem can, of course, be mitigated by co-operation among the major consumer countries. For that reason it will be an important subject for discussion at the next meeting of the European Council, and at the Economic Summit in Tokyo at the end of this month. We have to recognise that there is both a short-term and a long-term problem in matching available oil supplies to the demands which a growing world economy is bound to make.

C4. In this disturbed situation, the European Community can, and should, be a source of stability and of strength for its members. In one important

/area, however,

area, however, present EEC policies are seriously hindering our efforts to help ourselves. At present the United Kingdom and Italy, which are among the poorer members of the Community, are transferring substantial resources, chiefly through the Community Budget, to richer member states. We have already made it very clear to our partners that this situation cannot be allowed to continue. It is plainly unfair. And it is against the interests of the Community itself, which cannot expect to progress on such an insecure foundation. I am confident that our view of this problem is becoming more fully understood by our partners. Upon the basis of this understanding, we shall continue to press for an agreement which meets the United Kingdom case.

C5. But, I repeat, progress internationally, whether on energy policy or within the Community, will not

/cure the

cure the deep-seated weaknesses of our own domestic economy.

C6. Nor will North Sea oil. Growing production from the North Sea may shield us, to some extent, from the transfer of income which other countries, without their own oil, are bound to suffer as prices rise. But this protection must not be allowed to shield us from the truth about what has been happening to the balance of our own trade, particularly in manufactured goods.

C7. North Sea oil will itself do nothing to solve the problems on the supply side of our economy. Nor will it check inflation. Indeed, in some respects it may actually make matters worse, unless we correct some other aspects of policy which are at present working in the wrong direction. The moral once again is that it is for us now to take the

/decisive action

decisive action that is needed to put our own house in order.

/D. CAUSES OF DECLINE

D THE CAUSES OF DECLINE

D1 So we find ourselves, yet again, asking the question: how are we to check, and then reverse, the long decline? In particular, what can we, here in this House of Commons, do about it?

D2 We do well to begin, I suggest, by acknowledging that there is a definite limit to our capacity, as politicians, to influence these things for the better. I suspect that that view is much more widely accepted outside this place than it is within.

D3 I do not mean to be unkind to my predecessor when I invite the House, for a moment, to consider his example. The Government of which he was a distinguished member firmly believed that it was possible for Government to manage, indeed to plan, the economy, so as to promote efficiency and growth. The rt. hon. Gentleman, the

/Member for Leeds East,

Member for Leeds East, espoused this belief with enthusiasm. For in five years of office he introduced no less than 15 Budgets and economic "packages", and financed a wide range of policies in the name of "the regeneration of industry".

D4 But, at the end of five years, he must ask himself, to what avail? Has the industrial strategy, as he conceived it, really transformed the outlook for British industry? Are we not driven to the conclusion that the notions of demand management, expanding public spending and "fine tuning" (as it has come to be known), have now been tested almost to destruction?

D5 Certainly the rt. hon. Gentleman, the Leader of the Opposition, has come round to that view. For, as he said in a memorable speech on September , 1976:

/"We used to think

"We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting Government spending. I tell you, in all candour", said the rt. hon. Gentleman, "that that option no longer exists and that, insofar as it ever did exist, it worked by injecting inflation into the economy.. And each time that happened the average level of unemployment has risen. Higher inflation, followed by higher unemployment", concluded the rt. hon. Gentleman, "that is the history of the last twenty years."

D6 The rt. hon. Gentleman, the Member for Leeds East, has, in the event, been proclaiming the same conclusion. For he has throughout asserted the importance of monetary policy. He rightly began the practice of setting money supply targets. And he has claimed to make his public spending plans accordingly. This means that I am able to approach my task this afternoon on this one, crucially important, piece of common ground. For I can agree with my two Labour predecessors in this House, that the poor performance of the British economy in recent years has not

/been due to

been due to a shortage of demand. We are suffering from a growing series of failures on what is known as the supply side of the economy.

/DA A FRESH APPROACH

DA A FRESH APPROACH

DA1 It is our belief that many of these failures are themselves the result of actions and interventions by Government itself: laws that stand in the way of change and stifle enterprise; and, as important as anything, a structure of taxation that might have been especially designed to discourage innovation and punish success.

DA2 So we are convinced that an entirely fresh approach is necessary if we are to check the long-term economic decline, which has gathered pace in the last five years.

DA3 Our strategy is based on four principles.

DA4 We need to strengthen financial incentives, by allowing people to keep more of what they earn, so that hard work pays, talent and ability are appreciated, and success is rewarded.

/We need to

DA5 We need to enlarge freedom of choice by reducing the role of the state and enlarging that of the individual.

DA6 We need to reduce the burden of financing the public sector, and its impact on the rest of the economy, to a level which will leave room for commerce and industry to prosper.

DA7 And we need to ensure, so far as possible, that those who play any part in the process of collective bargaining are obliged to live with the consequences of their actions - for that is the way to promote a proper sense of responsibility.

DA8 These are simple principles. But they require substantial change in the way in which our economy is allowed to work. They require us to remove the constraints and discouragement of recent years. Only

/in this way

in this way can we revive the motivation of businessmen, managers and the many other key individuals on whom we depend to produce genuine new jobs and the wealth that will be needed to improve public and social services.

DA9 The tax changes I shall propose today will be only the first step. But they will take us a long way in the new direction that is essential.

DB INFLATION

DB1 These policies will not, of course, succeed unless we are at the same time squeezing inflation out of the system. It is crucially important to re-establish sound money. We intend to achieve this through firm monetary discipline and fiscal policies consistent with it, including strict control over public expenditure. Financial discipline must begin at home. It will apply therefore as rigorously to the public sector as it does to the private sector. And it will be sustained.

DB2 Financial responsibility on the part of Government must be supported by a corresponding acceptance of responsibility elsewhere. People must understand and accept that the only basis for real increases in wages and salaries is an increase

/in national

in national production. Higher pay that is not accompanied by higher productivity can only lead to higher inflation and unemployment.

DB3 This is the crucial reason for moderation, realism and responsibility in pay bargaining. It is important for this to be fully understood by all those involved in wage negotiation. We shall be more than willing to consider better methods of ensuring that it is.

DB4 In recent years people's sense of responsibility has too often been undermined on both sides of industry, frequently as a result of formal pay policies imposed by Government. Responsibility cannot thrive unless it is accompanied by freedom and flexibility - and this is what we are offering. Given the monetary and fiscal policies to which we are firmly committed, irresponsibility is bound,

/as I have

as I have said, to threaten the destruction of jobs, as to some extent it has done in the past.

DB5 Responsible bargaining necessarily means different things to different people and in different kinds of firms and industry. But on both sides of the table certain limitations must be recognised : in the public sector, what the rate payer and tax payer can afford; in industry, what the customer is prepared to pay, what the firm needs to invest, and what the pressure of competition demands; and, throughout the economy, the limits imposed by the need to control the money supply.

(F)

MONETARY POLICY

F MONETARY POLICY

F1 As I have already observed, my predecessor was undoubtedly right to adopt a system of monetary targets. But his other policies were seldom consistent with his own monetary objectives. Thus, although monetary growth in 1978-79 as a whole was just within the target range of 8-12 per cent, it was growing in the second half of the year at an annual rate of almost 13 per cent. Moreover, the May figures, now becoming available, indicate that the underlying growth is still above the top range and, if anything, accelerating. One cause of this has been the high rate of central government borrowing: £2½ billion in April and May.

F2 It is now clear that the public expenditure policies which we inherited would have made it quite impossible to meet the rt. hon. Gentleman's 8-12 per cent target without a further savage squeeze on the private sector, involving

/both a sharp

both a sharp increase in the total tax burden and even higher interest rates. Not for the first time, the levels of public spending and borrowing which he permitted were far too high to be compatible with his own monetary targets.

F3 We are committed to the progressive reduction of the rate of growth of the money supply. I therefore intend, as the first step in this process, to make a modest change in the target range for the remainder of this year, 1979-80. The new target range, to apply to the growth of sterling M3 in the 10 months to the banking make-up day in April 1980, will therefore be an annual rate of 7 per cent - 11 per cent. I will roll the target forward by six months in the autumn.

F4 Equally important, I intend to shift progressively the balance in the way in which the monetary target is achieved from an excessive reliance on interest rates and curbs on the private sector to a greater emphasis on fiscal restraint and economy by the public sector. This requires, as a first step, a significant reduction in the Public Sector Borrowing Requirement from the figure of around £10 billion that it would otherwise have reached this year.

/There are, however,

F5 There are, however, limits to what can be done in this Budget, with two and a half months of the financial year already passed, to curtail the scale of public spending in the current year. This is indeed a severe handicap. But I intend, even so, to reduce the public sector's financial needs enough to make it possible to achieve my monetary target in due course, with less restraint on the private sector.

F.6 I return now to consider the right size of the Public Sector Borrowing Requirement in the current year. As my predecessor found to his cost, this is a fickle and elusive statistic. That is why I offer my judgement of the scale of Government borrowing in 1979-80 with a degree of diffidence. Having said that, my best estimate is that the changes in taxation and public expenditure which I am announcing today will be sufficient to reduce the PSBR to £8¼ billion in the current year, as compared with the outturn of £9¼ billion for 1978-79. As a percentage of GDP, that will represent a reduction of over 5½ per cent last year to under 4½ per cent in the current year. That is an important step in the right direction. But it is only the first. I intend to continue along this path in the years ahead.

/It will no doubt

F.7 It will no doubt be argued by some - although I do not think it can be so argued by my predecessor - that fiscal action to bring down the PSBR to the figure I have mentioned is unduly severe. And indeed the conventional forecasting arithmetic, which, in accordance with custom and statute, I am publishing in the Financial Statement, does suggest that the economy will show no growth in the period immediately ahead.

F.8 But this prospect, insofar as it can be viewed as a reliable prediction, cannot be taken to mean that the Budget is, in the by now traditional language of Keynesian economists, too contractionary. To make this claim is to argue that an alternative course of fiscal policy would produce more growth and more employment. I believe this argument to be profoundly wrong.

F.9 To aim at a significantly higher Public Sector Borrowing Requirement - in other words to ease the stance

/of fiscal policy

of fiscal policy - would be likely to fuel the fire of inflation and worsen the balance of payments. In the end, we should have less growth, less employment, a bigger deficit and a faster rate of growth of prices. From the quotation I made earlier of the Leader of the Opposition, I believe that he too fully supports this analysis. It follows that any decline in economic activity which might, on a narrow view, be attributed to this Budget will in reality not have been caused by the Budget but by the economic situation which has made such measures inevitable, while inflation is brought under firm control.

G EXCHANGE CONTROL

G1 I come now to my proposals. I propose to deal first with the question of exchange control.

G2 Sterling is at present relatively strong, and I expect it to remain so. This strength flows partly from the realisation that, as a result of North Sea oil, the UK is better placed than most of our competitors to deal with present world oil problems. Our fiscal and monetary policies should maintain confidence in the currency. This is, therefore, an appropriate time to start dismantling our apparatus of controls on outward capital flows. Our present régime is more restrictive than in any other major industrialised country. There is an overwhelming case, in this context as in others, for giving both companies and individuals wider freedom of choice. This should reduce the distortions and costs which controls are bound

/to impose

to impose on economic decisions. These costs bear particularly heavily on smaller companies.

G3 We intend to move one step at a time, and, in this initial stage, we are placing emphasis on direct investment overseas. Details are being made available in the Vote Office.

G4 I have decided that the main relaxation should be for access to official exchange up to £5 million per project per year to be freely permitted for new outward direct investment. This should allow the majority of UK firms who invest overseas all the sterling finance they are likely to want. The two-thirds rule, which restricts the re-investment of profits earned overseas, will be abolished. This greater freedom in the financing of direct investment abroad does not, as is sometimes feared, threaten jobs in the United Kingdom. The weight of evidence

/is that overseas

is that overseas investment generally strengthens our position in world export markets to the benefit of output and jobs in this country. Moreover, additional investment overseas today will yield an income that will stand us in good stead when the overseas earnings from North Sea oil begin to decline.

G5 During the sterling crisis of 1976, the last Government stopped the use of sterling to finance third country trade. This restriction has placed British merchants at a disadvantage in international business and I am taking the opportunity to restore the facility to them as soon as the details can be worked out.

G6 I have also decided that there should be some immediate easement of the controls affecting individuals. I am, therefore, making significant relaxations in the rules concerning travel and emigration allowances,

/overseas property,

overseas property, and cash gifts and payments to dependants. In the field of portfolio investment, I am taking two modest steps at this stage. I am abolishing the requirement to maintain 115 per cent cover for overseas portfolios financed by foreign currency borrowing; and official exchange will henceforth be available for meeting interest payments on such borrowing. The 1975 controls on gold coins will also be abolished.

G7 As the House knows, the liberalisation of exchange controls is one of our obligations under the EEC Treaty. I have accordingly consulted the Commission about the decisions I am announcing today.

G8 As time goes by, I intend to take further steps in the progressive dismantling of exchange control. The pace of relaxation will obviously be influenced by sterling's strength as well as by the speed with which

/we can solve

we can solve the economic problems that face us.

G9 In our external policy we have also to take account of our official external debts. These at present amount to 22 billion dollars - a massive increase on the 8 billion dollars which the previous Government inherited in 1974. It is our intention to reduce this burden of external debt substantially during the life of this Parliament.

/ H PUBLIC EXPENDITURE

H. PUBLIC EXPENDITURE

H1. In order to reduce the borrowing requirement and the burden of direct taxation we must make savings in public spending and draw back the boundaries of the public sector. We are as committed as any Government to a high standard of public services. But these can only be achieved if the economy is strong. So our first priority must be to strengthen the economy - to reduce inflation and to restore incentives. Finance must determine expenditure, not expenditure finance. Substantial reductions in expenditure can and will be made in the remainder of this financial year.

H2. First, as I made clear three weeks ago, we shall not raise the cash limits to cover higher prices than provided for in the cash limits originally published for this year. On pay in the public

/services, while

services, while we will honour the commitments to the universities and the health authorities entered upon by our predecessors, in general we will limit the adjustment of the cash limits so that substantial offsetting economies will have to be found.

H3. The need for substantial economies applies to local authority expenditure, where the Government's contribution is made through the rate support grant. As I said three weeks ago, we shall take account of pay settlements in calculating the increase orders for the rate support grant, but we shall make a significant across-the-board reduction from the total so calculated. I can now tell the House that the reduction will be £300 million for England and Wales and £35 million for Scotland. These figures may have to be increased when we know the cost of further pay increases and will be finally

determined in November, before the increase orders are made. In coming to this decision, a major factor has been how much in present circumstances it is reasonable for the taxpayer to contribute.

H4. The cash limits on Departments and fringe bodies are being set to ensure that economies of 3 per cent are achieved on manpower costs this year, as announced by my hon. Friend the Minister of State, Civil Service Department.

H5. I estimate that this cash limits policy will reduce the volume of planned expenditure by about £1 billion at 1979 Survey prices.

H6. On top of these reductions resulting from the policy on cash limits, my rt. hon. and hon. Friends have reviewed the plans for their Departments and the nationalised industries and have identified

/further specific

further specific reductions which are being made this year. The changes are listed in a notice to be issued by the Treasury today, and available in the Vote Office. Further details will be given by the Ministers concerned. But the House will want to know where the main reductions will be made. All figures are at 1979 Survey prices.

H7. We are making an immediate start in reducing expenditure on industrial and employment subsidies. My rt. hon. Friend, the Secretary of State for Industry, is cutting expenditure on industrial support this year by £210 million. This will come out of the provision for new projects by the Department of Industry and by the National Enterprise Board, and by imposition of a delay of 4 months in payments of approved claims for regional development grant. Support for employment programmes is to be

/concentrated on

concentrated on the areas where unemployment is highest. So that savings of over £170 million will be made this year.

H8. In the area for which my rt. hon. Friend the Secretary of State for Energy is responsible savings of over £320 million are being made this year in the finance for BNOC and the electricity, gas and coal industries. The industries have been asked to avoid so far as possible increases in fuel charges beyond those required to meet the cash limits announced by the previous Government.

H9. My rt. hon. Friend, the Secretary of State for the Environment, is making savings of about £440 million from his programmes this year, mainly by scrapping the Community Land Act, deferring water authority investment and reducing the existing

/allocations to

allocations to housing authorities.

H10. As we have repeatedly made clear, it is not our intention to reduce spending on the Health Service. But we cannot ignore the fact that the contribution made by some health charges has greatly diminished in recent years. This applies especially to prescription charges, which have stood at their present level for eight years, during which prices have risen over 2½ times. It is therefore proposed to increase prescription charges to 45p. This will still leave them cheaper in real terms than they were in 1971, and the present wide range of exemptions covering children and the elderly amongst others will, of course, be maintained. Certain dental charges will also be increased. These changes will yield £34 million in 1979/80 for Great Britain as a whole.

H11. /My rt. hon. Friend,

H11. My rt. hon. Friend, the Secretary of State for Education and Science, is reducing expenditure in those areas of the education and science programmes within the Government's direct control by about £55 million. We shall not add to the increase of 5p in the school meal charge which was planned by our predecessors for the autumn term.

H12. The aid programme this year is being reduced by £50 million. Savings are also being made on the transport, trade and arts programmes.

H13. My rt. hon. Friends, the Secretaries of State for Scotland, Wales and Northern Ireland are making comparable reductions in their own programmes.

H14. In total these reductions amount to over £1½ billion this year.

/In addition,

H15 In addition, we do not intend to use as large a Contingency Reserve as provided for 1979-80 in the last Government's public expenditure White Paper.

H16. We have decided to cut the Reserve by £250 million. Any further decision to add to the volume of programmes in the remainder of this year will be met from the balance of just over £250 million remaining in the Reserve.

H17 In two areas we are providing for increased expenditure - defence and pensions. An extra £100 million is being provided for the defence budget this year. This will enable essential projects in the equipment programme to go ahead. I shall return to the pensions improvements shortly.

H18 As I have already indicated, we are only just

/embarking on our

embarking on our review of the plans we have inherited and of the scope for reducing the size of the public sector. But it is already clear that the scope for sales of assets is substantial.

H19 Sales of state-owned assets to the private sector serve the immediate purpose of helping to reduce the excessive Public Sector Borrowing Requirement with which I was faced. This is all the more necessary this year, given the great difficulty of cutting back public sector spending programmes once the year has already begun.

H20 But such sales are not justified simply by the help they give to the short-term reduction of the PSBR. They are an essential part of our long-term programme of promoting the widest possible participation by the people in the ownership of British industry.

H21 /This objective

H21 This objective - wider public ownership in the true meaning of the term - has implications not merely for the scale of our programme, but also for the methods of sale we shall adopt.

H22 So far as this year's disposals are concerned, we must obviously retain flexibility on timing and on the precise mix of assets in order to ensure a fair price. I do not therefore propose to announce the details today. But I intend to ensure that the proceeds of sales in the current financial year will amount to some £1 billion and I have taken account of this in the Budget arithmetic. The biggest contribution to this total will come from the sale of a further part of the Government's shareholding in British Petroleum, where we shall be following the example set by the last administration in 1975.

/ H23 In total I

H23 In total I estimate that the economies I have announced will amount to about £3½ billion at 1979 Survey prices and £4 billion at current prices. Yet given the scale of the problem we have inherited, I must look for a further contribution from indirect taxes to finance the first stage of our plans for the reduction of income tax.

I INDIRECT TAXATION

I1 We made it clear in our Manifesto that we intended to switch some of the tax burden from taxes on earnings to taxes on spending. This is the only way that we can restore incentives and make it more worthwhile to work; and at the same time increase the freedom of choice of the individual. We must make a start now.

I2 I have reviewed the whole field of indirect taxation to decide where the increased revenue could best come from. There are many cogent arguments at this stage in favour of the VAT.

First, large areas of consumer expenditure, in fact about half the total, are not chargeable to VAT. Food, children's clothes, heating and light, housing and public transport are all zero rated.

/Second people

Second, people with bigger incomes tend to spend proportionately more on goods liable to VAT. This means that, unlike most indirect taxes, the VAT is not regressive.

Third, by comparison with taxes such as those on alcohol and tobacco, the VAT is much more broadly based.

Fourth, there is a real opportunity for simplifying the operation of the tax by having one rate instead of two.

In his Speech on 22nd May, the rt. hon. Gentleman the Member for Leeds East seemed to favour increases in the surcharge on National Insurance contributions or in Advance Corporation Tax. The National Insurance Surcharge falls on the whole of British industry, including

/production for export,

production for export, but not on imports. It is inferior in this respect to VAT, which falls on imports but not on exports. This is clearly significant in light of the latest trade figures. An increase in Advance Corporation Tax would seriously damage the overall liquidity of industry at a particularly difficult time: in contrast an increase in VAT actually increases it.

L3 For all these reasons my choice must fall on the VAT. Moreover, the increase I make must be sufficient to provide for substantial and worthwhile reductions in income tax. I propose, therefore, that as from next Monday VAT should be charged at a new unified rate of 15 per cent.

I4 Allowing for the wide range of goods and services which are zero rated - and which will stay zero rated - the new rate I propose is equivalent to 8 per cent

/averaged over

averaged over the whole of consumer expenditure. This is significantly less than the average in the European Community.

15 The yield from the increase to 15 per cent is estimated at £2035 million in 1979/80 and £4175 million in a full year. Thus it will provide scope for further direct tax reductions in later years. The relatively small size of the yield this year reflects the loss of over two months' revenue between April and the present, and the time lag allowed to traders before they pay over VAT receipts to the authorities - an average of over 3 months. I have referred to the helpful contribution this gap provides towards improving liquidity. For as these funds build up in traders' hands, they provide a substantial boost to the liquidity of the firms and companies concerned. Concern has been expressed that

/an increase

an increase in VAT would apply to telephone bills for calls made before the date of change. I am proposing transitional provisions to deal with this and some of the other problems in this field.

F6 The sharp increase in VAT will, of course, add significantly to the point of sale prices of drink and tobacco. For example the VAT increase will mean about an extra 28p on a bottle of spirits, 2p on a pint of beer and 6p on a typical packet of 20 cigarettes. In these circumstances, I do not think it would be justifiable to make a separate increase in the excise duties on drink and tobacco this year.

F7 I fully realise that this increase in Value Added Tax will result in a rise in prices - in fact a rise of about 3½ per cent in the Retail Price Index. This is, of course, a once-for-all effect. But there never was a

/time when it

time when it was going to be easy to effect the switch from direct to indirect taxes and the present moment is no exception. The action has been postponed too long already. Indeed, the former administration actually made matters worse at one moment when it cut the basic rate of VAT from 10 per cent to 8 per cent in a period when it was actually raising income tax. We are, therefore, proposing to deal with this overdue reform boldly and forthwith.

18. The House should bear in mind that, as I have already indicated, VAT does not fall on a wide range of necessities. This means that the increase will fall less heavily on people in the lower income groups. And, as will be apparent when I come to my income tax proposals, we shall be leaving people with more money in their pockets which will enable them to pay the increased VAT.

/I appreciate

I appreciate that those who are not liable to income tax, and I have in mind particularly many of those living on retirement pensions, will not benefit from my income tax proposals. So this brings me to our proposals in the field of Social Security.

/J SOCIAL SECURITY PAYMENTS

J SOCIAL SECURITY PAYMENTS

J1 We have decided to increase the standard rate of retirement pensions in November by £6.10 to £37.30 for a married couple and by £3.80 to £23.30 for a single person. As we promised, these increases take full account of the underestimate which the last Government made of the actual rise in earnings between November 1977 and November 1978, and are well above the figures of £4 and £2.50 announced by the previous Government. Other social security benefits will also be increased, and my rt. hon. Friend, the Secretary of State for Social Services, will announce full details tomorrow.

J2 This means that National Insurance pensioners and other beneficiaries will be fully protected against the forecast increase in prices. This is what is really important. But the extent to which we can afford to go

/further than this -

further than this - to add improvements in real terms - must depend on the productive capacity of those in work.

J3 Under the present rules pensions are uprated on the basis of the movement in prices or earnings, whichever is the greater. The Government have decided, however, that for the future the requirement for the statutory uprating of pensions should be based on price movements, and we shall be introducing legislation to this end. This will be a minimum requirement, and will fully protect the value of these pensions against price increases at all times, including those arising from indirect taxes such as I have just announced. Of course we want to be able to do more. I am confident that in time, as our economy improves, it will be possible to do more and ensure that pensioners share in the increase in national prosperity. That is one more reason why my other

/proposals today

proposals today are so important. For they are intended to strengthen the productive capacity of the economy as a whole.

J4 The change will make no difference this year since the forecast rise in prices for the year to November is greater than the increase in earnings expected over the same period. The figures I have just mentioned fully reflect this forecast price increase.

J5 We also propose to improve certain other social security benefits. Child benefit went up by £1 per week only two months ago, and a further increase this year is not justified. But single parent families face particular problems, and we propose that the one parent premium should go up from £2 to £2.50 next November. We also want to help the disabled. Mobility allowance will accordingly be increased from £10 to £12 in the autumn.

/And we shall,

And we shall, of course, honour our commitment to pay a Christmas bonus this year of £10.

J6 These measures overall will cost about £1100 million in 1979/80 and £2700 million in a full year. As the House knows, my general policy is to make substantial reductions in public expenditure. But the reductions in public expenditure must not be done in a way which bear unfairly on the more vulnerable members of society.

/Our social security

[J7 Our social security system has become far too complicated and it sometimes acts to reduce the incentive to work. The problem is widely recognised on both sides of this House. We are therefore studying a number of aspects of the social security system to see what can be done to simplify it. My rt. hon. Friend, the Secretary of State, is also putting in hand urgent measures to tighten up on abuse and fraud.]

K TAXATION OF OIL AND PETROLEUM

Hydrocarbon Oil Duties

K1 I dealt earlier with the excise duties on tobacco and drink. The oil duties, however, raise wider issues. I have already indicated my intention to announce measures which will help us to meet the growing and undoubted need to conserve oil. At a time when there is a worldwide shortage of crude oil it is essential that we should play our full part in achieving the 5 per cent reduction in consumption to which the previous Government rightly committed us.

K2 I therefore propose to increase all the main oil duties this year. In the particular case of petrol, the VAT increase from 12½ per cent to 15 per cent will be smaller than for many other items. With this in mind I propose to increase the petrol duty by about 23 per cent -

/7p a gallon -

7p a gallon - which will result in a total price change of about 10p a gallon. I also propose to increase the duty on derv by the same sum, 7p per gallon, and the duty on heavy oil other than derv, by ½p, that is by about 20 per cent. I am not, however, increasing the duty for burning oil and for domestic paraffin, which is the oil used most commonly in the home, particularly by pensioners. The yield from these excise duty changes is estimated at an additional £525 million in a full year and £400 million in 1979/80. The immediate increase in the RPI will be about a quarter of one per cent.

Vehicle Excise Duty

K3 In view of the increase I am proposing in the road fuel duties I have decided to make no change in the rate of vehicle excise duty. Our predecessors announced their intention of abolishing the duty on petrol driven vehicles.

/As my rt. hon. Friend

As my rt. hon. Friend, the Minister of Transport has already said, we are reviewing the future of this duty and we shall announce our conclusions in due course. For heavier goods vehicles my rt. hon. Friend will be announcing plans for restructuring the form of this tax.

Car Leasing

K4 Before I leave the subject of motor cars, there is a particular issue I need to deal with. There is a weakness in the present legislation on capital allowances which enables leased cars to avoid the special rules restricting allowances for business cars. This has resulted in a loss of tax which is currently running at about £175 million a year; and which could well rise to £200 million next year if I take no action. I propose to put this right with effect from today.

/Petroleum Revenue Tax

Petroleum Revenue Tax

K5 I turn next to petroleum revenue tax. The previous Government announced last August that they proposed to increase this tax from 1st January 1979. These proposals were discussed very fully by the last Government with the industry and we ourselves have had representations about them, which we have carefully considered.

K6 Although we did not oppose them at the time, I am not sure that, when the proposals were announced, they were wholly justified in their intended aim of securing a fairer balance in sharing the proceeds from our oil resources. Companies cannot be expected to invest in the North Sea unless the return they get from successful development rewards them commensurately for the risks they have taken and which we are continuing to look to them to take. But judged against the recent developments in the world oil situation I consider that the package of

/PRT proposals

PRT proposals for increasing the Government's take from the North Sea is now fully justified. There will accordingly be provisions in the Finance Bill to implement it. I also propose, however, to introduce some changes in the PRT expenditure rules for which the industry have been pressing for some time. Moreover, the British National Oil Corporation will no longer be exempted from PRT.

K7 These proposals will increase the Government's revenue from the North Sea by about £110 million in the year 1979/80, and by about £1800 million to 1985.

/L BUSINESS TAXATION - INCLUDING CAPITAL TAXATION

L. BUSINESS TAXATION - INCLUDING CAPITAL TAXATION

L1. Before I deal with the taxation of business profits, I propose to refer to the taxation of capital, a matter of vital interest to business as well as to individuals.

L2. We made it clear in our Manifesto that we were determined to make the taxation of capital simpler and less oppressive. The objection to Capital Gains Tax in its present form is that most of the yield comes from paper gains arising from inflation. The tax is, therefore, simply a levy on the capital itself. The Capital Transfer Tax, despite the improvements we were able to secure in the last Parliament by constant pressure from our Benches, is oppressive, harmful to business, and a real deterrent to initiative and enterprise. It is perfectly natural that people should want to build

/up capital

up capital of their own and pass it on to their children; this is particularly true of the small business proprietor.

L3. The issues involved in both of these taxes are difficult and complex. We need more time to study them and devise the best solutions. I have therefore decided that we should not attempt to legislate in the coming Finance Bill, but should press ahead with a thorough study, with a view to legislating at the earliest possible date. There is however one specific issue on which legislation is required in order to hold the present position: I propose to extend for a further two years the period for CTT transitional relief for capital distributions from discretionary trusts and to defer for two years the introduction of the periodic charge.

L4. The Development Land Tax, however, is a very

/different matter

different matter and calls for immediate action. This tax has combined with the Community Land Act to prevent much worthwhile development and to increase unemployment in the construction industries. We have already said that we will repeal the Community Land Act. I propose now to deal with the Development Land Tax. In place of the present rates of 66⅔ per cent and 80 per cent, which the previous Government intended should rise to 100 per cent, I propose that Development Land Tax will in future be charged at a single rate of 60 per cent. The amount of development value which can be realised in a financial year without liability to Development Land Tax will be raised from £10,000 to £50,000. Both these changes take effect for disposals made on or after today.

L5. I do not propose to make any further reductions

/in rate;

in rate; and the generous increase in the exempt slice should mean that it will not need early revision. Owners of development land will, therefore, have no reason for holding back in the hope of further tax reductions. What I have said today should remove the major uncertainties which have been hanging over the market.

L6. I now turn to the taxation of profits. A vigorous, profitable and expanding company sector is essential if we are to rebuild this country's prosperity. Profitability has dropped sharply in recent years and the rate of return on capital employed is now far too low. This is especially true of manufacturing industry.

L7 Without higher profits we shall not see the new investment and jobs which are so urgently needed. Achieving those profits is very largely the task of

/management and

management and work people. The Government can help or hinder them, and this is no time to add to the difficulties that they face by raising taxes on profits still further. Against that background I propose no change this year in the general system or in the rates of Corporation Tax. Nor would it be right to make any major changes in the system of taxation without careful consultation in advance.

L8 Looking further ahead, however, it is important that the tax system should take account of the effects of inflation on businesses, and do so in a way that is reasonably objective, equitable and simple to administer. The Government will therefore be reviewing a number of aspects of the present system, at the same time as the accountancy profession's latest proposals for current cost accounting. I am arranging for the Inland Revenue

/to consult the

to consult the accountancy profession and business later in the year.

L9. I need however to deal now with the question of stock relief. The Finance Bill will include legislation to honour the undertaking which my predecessor gave last year, and which we on this side of the House supported, to write off the deferred tax liabilities arising from stock relief given for the first two years of the scheme - 1973-74 and 1974-75; and to write off these liabilities in respect of subsequent years successively, after an interval of six years.

L10 In addition, following consultations which the Inland Revenue have had with industry, I am proposing two further changes in the stock relief scheme. I intend to reduce the profit restriction for unincorporated businesses from 15 per cent to 10 per

/cent; and all

cent; and all businesses will be given greater flexibility in the amount of relief that they can claim. Both these changes will be of particular benefit to small businesses.

L11 Details of the stock relief and car leasing proposals will be given in Inland Revenue Press Noticeswhich I am making available in the Vote Office.

L12 I now come to dividend control. If industry is to flourish it needs not only adequate profits but a vigorous capital market to provide funds for investment and expansion. The control of dividends has now outlived its purpose. The control will accordingly come to an end when the existing legislation expires on 31st July.

L13 We on this side of the House have consistently championed the cause of smaller businesses. So I

/also propose to

also propose to raise this year the profit limits for the small companies rate of corporation tax - to the figure of £60,000 at the lower end and of £100,000 at the upper end. This will go some way further than is necessary to maintain their real value. In the tax field, however there is one measure that will do more than anything else to encourage the contribution that smaller businesses - indeed businesses of every size - can make to enterprise, innovation and employment. That is, a major reduction in the burden of income tax. I will come to that in due course.

/INCOME TAX

M INCOME TAX

M1 I now come to the income tax reductions, which are the keystone of my policy. The excessive levels of income tax bear a heavy responsibility for the lack-lustre performance of the British economy. We need, therefore, to cut income tax at all levels. For the reasons I have already explained, I cannot do as much this year as I should have liked, and I cannot do as much as is needed. But, although it contains only the first instalment of income tax changes which we shall bring forward in the future, I wish to leave no doubt in anyone's mind that this Budget marks a real turning point.

M2 I begin with the higher rates of tax. The upper rates no longer affect only those on very high incomes. They apply to senior executives and middle managers in industry and frequently to skilled workers: as well as to professional people and the proprietors of small

businesses. These are the people upon whom most of our hopes for initiative, greater enterprise and national prosperity must depend.

M3 It is universally recognised that the present top rate of 83 per cent on earned income is an absurdity. The rate of 98 per cent on investment income is even worse. Such rates bring in very little revenue. But they act as a severe disincentive and are a patent injustice. Some members of the previous Government recognised this. But they did nothing about it. I propose an overdue measure of reform. The top rate will be cut from the present 83 per cent to 60 per cent. This new top rate will apply to taxable income over £25,000. At the other end of the higher rate scale, the present threshold of £8,000 is too low. I propose raising it to £10,000. Even at this figure it will be less in real terms than it was in 1973. In between I propose a new scale of rates less steeply progressive than the old scale.

/The top rate

M4 The top rate of 60 per cent on earned income I now propose fulfils our commitment to reduce the top rate to the European average. The top rate in France is 60 per cent. In Germany, it is 56 per cent. In the United States, it is only 50 per cent. The new top rate will still be reached at an income level which is lower and in some instances significantly lower than is common elsewhere. This is a matter to which we may need to return on a future occasion.

M5 So, while the reductions I propose are substantial, they are no more than the circumstances require. They will still in general leave people in the top income groups more highly taxed than people in corresponding positions in other industrialised countries. We have to compete with such countries, not only in the sale of goods and services, but in attracting and retaining

/the talent required

the talent required to run our industry efficiently and profitably and thereby provide the employment opportunities that our people so desperately need.

M6 We have over the years spent too much time and effort trying to "level down". This is no good to anybody. It is much more important to have a prosperous society. And we cannot have a prosperous society unless we are prepared to have some prosperous people.

M7 But it is not only at the top of the income range that the burden of income tax is particularly oppressive. The same is true for those on the lowest taxable incomes. That is the importance of the tax thresholds, to which I turn next. The increases proposed in the April Finance Act, which were not of course implemented, were not sufficient. I propose to double these increases. This means that the amount a single person can earn tax-free

/will go up

will go up, not by £90, but by £180. The married allowance will go up, not by £140, but by £280. A single person's tax-free earnings will thus go up by nearly £3.50 a week, and if he is paying tax at the basic rate he will get a full £1 a week extra in his pay packet. The amount that a married man can earn tax-free will go up by £5.38 a week; and if he is paying tax at the basic rate, he will find an extra £1.78 a week in his pay packet. This is quite apart from the consequences of any further changes that I have to propose.

M8 I have in fact three other changes to propose before I come to the basic rate of income tax. First, to help the elderly, the age allowance will be raised by £240 for the single person and £380 for the married person. These again are double the figures proposed in the April Finance Act. Last year the limit for the full allowance was £4,000. This year I propose raising it to £5,000, more

/than twice the

than twice the increase proposed in the April Finance Act.

M9 Second, I propose raising the threshold for the investment income surcharge. The justification for retaining the surcharge is itself debatable. Certainly there can be no argument but that it bites at far too low a level of income. Almost half the surcharge is paid by people over 65. This is moreover a tax which falls with particular severity on those who have had to make provision for their retirement out of their savings and have no occupational pensions to fall back on. The undue severity of the tax was recognised by the previous Government by introducing what were no more than palliatives in the form of a reduced rate applied to the first slice of income liable to the surcharge and a slightly higher threshold for those over 65. We propose instead to raise

/the threshold

the threshold to £5,000 for everyone; the rate above that level will remain at 15 per cent. This approach combines a considerable simplication of the tax with a measure of justice that is long overdue.

M10 Third, we propose implementing our election pledge to war widows. Provision will be made in the Finance Bill to exempt their pensions entirely from tax.

M11 I come finally to the basic rate. For the great majority of taxpayers - some 21 million in all - it is the basic rate which determines the tax liability. It is the basic rate which is also the marginal rate falling on additional earnings whether they come from overtime, or greater productivity, or reflect greater skill or the rewards of promotion. Everywhere one meets complaint and criticism that income tax erodes differentials, reduces the rewards of skilled workers and discourages effort,

/initiative and

initiative and responsibility. This year I propose taking a first and significant step to deal with these complaints by reducing the rate from 33 per cent to 30 per cent. Nothing less than this would provide both the incentive we need and the conviction that we really mean business. [My long term aim is to reduce the basic rate of income tax to 25 per cent.]

M12 The total cost of these income tax reductions, including the cost of increases in personal allowances proposed in April but not implemented at the time, will be £4,540 million in a full year. The lion's share, no less than £3,460 million or over three-quarters of the total, represents the cost of increasing the personal allowances and reducing the basic rate. The cost this year of all the income tax changes will be £3,500 million.

/As a result

M13 As a result of the increase in the tax thresholds, 1.3 million people who would otherwise have paid tax this year will not be required to do so. The number of people paying tax at the higher rates would have been 1.2 million: the number will be virtually halved to 650,000. The number liable to the investment income surcharge will be reduced to about a third of what it would have been - from 850,000 to 300,000. All the changes will simplify administration and reduce the work load on the Inland Revenue.

M14 The changes in allowances will be implemented for most taxpayers on the first pay day after 12th July. The reduction in the rates of tax will be given effect as soon as new tax tables are ready in October.

/A full year's

M15 A full year's income tax reductions will be received even though my Budget is being presented two months or more after the start of the year. On this basis the income tax changes mean that for the married couple where the husband earns £100 a week, which is close to average earnings, there will be an increase in take-home pay averaged over the remainder of the financial year of over £4 a week. The increases in VAT and petrol duty will increase family expenditure by about £2.75. So that, taking both the direct and indirect tax changes into account, the family will be about £1.30 per week better off. Similarly, where the husband earns £60 per week there will be a real gain of over 75p a week, while the position of the couple on £150 per week will improve by nearly £2 a week.

/These reductions

M16 These reductions in the burden of income tax, which are as substantial as they are unprecedented, mean that wage and salary earners will have more money in their pockets to buy the goods and services they help to produce. True the prices of a good many of these goods and services will be increased by my tax proposals. But we have done everything we can to ensure that every family in the land will have more money coming in to pay the increased bills, and with some to spare. And what is more, the choice of the way they spend their higher income will rest increasingly with them, and not with the Government.

M17 These changes represent only the first stage in the major reduction in the burden of direct taxation that we are determined to make. The net effects of my proposals as a whole - and not simply the immediate effects on prices of some of them - should be studied carefully, particularly

/by those who

by those who will be involved in pay bargaining. It would be not only foolish but positively damaging to the nation as a whole, as well as to the individual's own self-interest, if an attempt were made to recover by excessive pay claims what has already been more than made good by these unprecedented reductions in income tax.

BUDGET SECRET

CH/EX. REF. NO. B(79)39
COPY NO. 2 OF 2 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9th June, 1979

Dear Tim,

I enclose a copy of the latest draft of the Chancellor's Budget Speech.

The Chancellor will be working on it again tomorrow but he thought the Prime Minister might care to see a copy in its present form at the weekend.

Yours ever,

Tony Battishill

(A.M.W. BATTISHILL)

T.P. Lankester, Esq.,

BUDGET SECRET

BUDGET-SECRET

CH/EX. REF. NO. B(79) 41

COPY NO. 4 OF 4 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

T P Lankester Esq
10 Downing Street
London
SW1

11 June 1979

Dear Tim,

RATE SUPPORT GRANT 1979-80

The Prime Minister asked how the £35 million for the reduction in the RSG cash limit for Scotland had been calculated.

2. You will remember that the proposal put to Cabinet was that the RSG cash limit for England and Wales should be reduced by £200 million. We originally thought in terms of reducing the Scottish cash limit by the same proportion as £200 million bears to the cash limit for England and Wales. This gave a figure of £30 million. The Scots argued for calculating the reduction on the 90:10 ratio which is used for dealing with the England and Wales:Scotland shares of comparable PESC programmes which would have given a cut of £22 million for the Scots. As a compromise, which the Scots accepted, the figure of £25 million was put to Cabinet.

3. In fact Cabinet agreed that the cut for England and Wales should be £300 million which would have given a figure, proportionately, of £37½ million for Scotland. With the agreement of the Scots, this was rounded down to £35 million because, given that the underlying calculation was a bit by and large, £37½ million looked too precise and would have been difficult to justify publicly. In fact, as you will see, £35 million comes out very close to the 90:10 ratio mentioned above.

Yours ever,

MH

(M A HALL)