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PREM 19/1720

Part 14

MT

— SECRET —

Confidential Filing

The 1985 Budget

The 1986 Budget

Economic Policy

Pt 1 : May 1979

Pt 14 : April 1985

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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31.1.86							

PART 14 ends:-

DN to PM 31.1.86

PART 15 begins:-

Middleton (HMT) to NLW 5.2.86

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(85) 10th meeting, item 2	19/03/1985

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed [signature]

Date 15/09/14

PREM Records Team

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

1. House of Commons Hansard, 19 March 1985, Columns 787-810 "Budget Statement"

2. House of Commons Hansard, 20 March 1985, Columns 873-962 "Budget Resolutions and Economic Situation"

Signed AWayland Date 4 November 2014

PREM Records Team

SECRET

PRIME MINISTER

BUDGET

The Treasury holds most of the cards in discussion about the Budget, and without being able to discuss this with them or having seen any of the papers, the comments below come with a health warning.

Nigel and I have discussed this and agree on the assessment, though he has not seen these words.

First, with some hesitation, some comments on the politics of prudence.

A prudent budget in practice turns on the size of the PSBR and the amount of tax cuts. There is a balance sheet to be struck. On one side, a somewhat more relaxed budget would give the Chancellor and the Government some shorter term popularity, many of the Cabinet colleagues would accept it more readily, and it would give the Chancellor greater scope for progress towards reforming the tax system and restoring incentives. It would be presented as helping to improve the supply side of the economy and no doubt the figures could be shown to be sufficiently consistent with the last MTFS. In the shorter term, a somewhat more relaxed budget would also help output and employment, though the amounts we are discussing are relatively small in terms of the economy as a whole.

On the other side of the balance sheet, a more relaxed budget risks damage to market confidence. It could look like the start of an electoral bribe, and it could risk confirming the view that, particularly with the changes in the composition of the Cabinet and the Westlands affair, you are no longer "the same prudent old Maggie" as Brian Walden described you.

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This budget will have an important bearing on the economy in the run up to the election. The Chancellor is keeping discussion very close even within the Treasury. He will not tell Cabinet colleagues much of his thinking at Cabinet on 13 February. We wonder whether on this occasion you should not seek to involve a small group of colleagues (eg, Lord Whitelaw, Mr. Tebbit and Sir Geoffrey Howe). But no doubt this would be resented deeply by the Chancellor.

I suggest you start with the economic scene in your discussion with the Chancellor. What are the prospects for inflation, output, interest rates and unemployment? What are the risks? How does the Chancellor see the prospects for oil prices?

My guess is that the forecast will show a rather better export prospect than the Treasury expected in the autumn, but perhaps rather slower growth of investment and consumption. The inflation prospect may on balance (lower exchange rate versus lower oil prices) be a little worse.

If the Chancellor feels that oil prices are more likely to fall below what has been assumed in the forecast than to rise above the forecast level, that will point still more firmly towards the need for a prudent Budget, partly because of the effect on revenues and partly because a fall in oil prices is much like a cut in indirect taxation.

I think you need not spend too much time on monetary policy. But you will want to emphasise your concern that a measure of broad money needs to be kept in the picture.

Fiscal policy is at present the key. Here there are three areas for discussion:

(i) The size of the PSBR.

(ii) The size of the fiscal adjustment.

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(iii)The assurance the Chancellor needs to give the markets about the action he may take if oil prices fall.

Taking the third point first, Sir Geoffrey Howe gave such an assurance to the markets in both the 1982 and 1983 budgets. This is particularly important because Budget Day seems often to fall around the time when OPEC have a meeting and when also the markets are becoming anxious about falling oil prices as Spring comes. In 1982 Sir Geoffreh Howe said:

> "Obviously, if there was (sic) to be a prolonged fall in the oil price, below the level we currently expect, then both the beneficial effect on activity and domestic prices, and the revenue-loss effect on the PSBR, would be increased. It would be wholly irresponsible for me to rule out the possibility of having to take action to correct the fiscal balance, if that were to happen."

The uncertainties this year may need a repetition of those words.

The size of the PSBR and the size of the fiscal adjustment give separate signals to the markets. Large tax cuts may look irresponsible even if the PSBR is acceptably low.

In the 1985 MTFS, as we discussed last night, the Chancellor indicated a PSBR of £7 billion or 2% of GDP for 1986/87. The Autumn Statement increased asset sales by £2½ billion. On a crude calculation the PSBR should therefore be set at around £5 billion to offset this. Alan Walters recommended £5½ billion.

I mentioned last night that our financial deficit is high by comparison with our savings ratio. We rank with the United States and France. Figures for Japan, Switzerland and Germany are substantially lower. (This calculation - by Phillips and Drew - does not simply look at savings ratios; it also takes

See the table enclosed.

into account estimates of capital consumption in each country.)

In the other direction, even if asset sales are treated as borrowing (to use our loose description), the PSBR would still be around only 2 3/4% of GDP. It would still be possible, as you did in the autumn, to say that borrowing, excluding asset sales, was lower than in any year since 1971/72. (This assumes that the PSBR for 1985/86 comes out as in the autumn statement.) A table showing this argument is attached.

Market expectations are also important. Some are expecting the Chancellor to announce a higher PSBR than £7½ billion. £6 billion or below would probably come as a very pleasant surprise.

The size of the fiscal adjustment is hard to guess. In present circumstances, my feeling is that tax reductions of as much as £2 billion might be risky - even though that has been the size of the tax reductions for the past few years. But this is very much a matter of judgement.

The fourth major area for discussion is thresholds versus the basic rate. 1% off the basic rate and higher rates would cost £1300 million, roughly the same as increasing all the main personal allowances and higher rate thresholds by 5%. (5% of the married man's allowance is £170.)

A reduction in the basic rate clearly is more regressive than raising the thresholds. £170 on the married man's allowance would be worth £52 a year to someone paying the basic rate of tax, and this is the maximum gain for someone with a taxable income of up to £16,200. In contrast, 1% off the basic rate would be worth £162 to someone with a taxable income of £16,200. There is also a much stronger constituency for raising the thresholds than for reducing the basic rate, though the Institute of Directors favour action on the basic rate. Cabinet colleagues are likely to express views about this aspect at Cabinet on 13 February. There has also been some Press comment that a reduction in the basic rate would be more of an electoral bribe.

You might like to look at the IMF staff appraisal of the UK economy which the Treasury have just received which supports the arguments for a prudent fiscal policy, probably leaving little room for tax cuts.

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(ix) Historic comparisons of PSBR/Money GDP ratios

Per cent

	Rounded PSBR	PSBR	Unrounded PSBR excluding privatisation proceeds	PSFD*
1971-72	1¾	1.6	1.6	1.1
1972-73	3½	3.6	3.6	3.0
1973-74	5¾	5.8	5.8	4.6
1974-75	9	8.9	8.9	6.7
1975-76	9¼	9.3	9.3	7.4
1976-97	6½	6.4	6.4	5.8
1977-78	3½	3.6	3.9	4.4
1978-79	5¼	5.4	5.4	4.9
1974-75 to 1978-79	6¾	6.7	6.8	5.8
1979-80	4¾	4.8	5.3	3.9
1980-81	5½	5.4	5.5	5.1
1981-82	3¼	3.3	3.3	2.2
1982-83	3	3.1	3.3	3.0
1983-84	3¼	3.2	3.6	3.9
1984-85	3	3.1	3.8	3.8
1979-80 to 1984-85	3¾	3.8	4.1	3.7
1985-86 (projected)	2¼	2.2	2.9	3.1
1986-87	2	2.0	2.7	

* Public sector financial deficit

Positive

(i) Government's strategy to maintain monetary conditions which will bring about further reduction in inflation, supported by lower public sector borrowing, remains on course.

(ii) Steady pursuit of MTFS policies has enabled economy to enter fifth year of sustained growth at average rate, so far, of 3 per cent a year, accompanied by fall in inflation from average of 15 per cent (and rising) under Labour to less than 6 per cent now (and falling).

(iii) Autumn Statement confirms prospect of continued strong growth and falling inflation, with public expenditure as proportion of GDP continuing its downward trend since peak year of 1982-83.

(iv) PSBR in 1985-86 expected to be lowest as percentage of money GDP (2¼) since 1971-72.

size and the timing of the exchange rate adjustment, the response of the monetary and fiscal authorities, and the way the world economy at large reacts to the fall in energy prices.

VIII. Staff Appraisal

The U.K. economy is entering its sixth year of uninterrupted growth. Even including the severe downturn in 1979-81, the average growth rate over the past seven years has been about the same as that of France and Germany while it had been significantly lower in the preceding 20 years. Productivity gains have accelerated, and the profitability of the enterprise sector has improved considerably. The current account of the balance of payments has continued to register surpluses reflecting increased receipts from oil and invisibles. The economy has also undergone rather fundamental transformations: deregulation, privatization, tax reform, and the creation of numerous small- and medium-sized firms will over time improve the efficiency and flexibility of the whole economy.

Costs and prices decelerated rapidly between 1980 and 1983, but there has been little progress since then. Wages and earnings even showed signs of edging higher in 1985, especially in manufacturing. Both consumer prices and unit labor costs are now rising in the United Kingdom faster than in the other main industrial countries. This is especially disappointing considering that the rate of unemployment is also well above that of the other countries. Although unemployment appears to have stabilized since the summer of 1985, its resistance to decline represents a major challenge for the Government.

The U.K. authorities' overall economic strategy rests on a medium-term framework for financial policies aimed at setting the growth in nominal GDP on a slowly decelerating path, and they have broadly succeeded in meeting that goal (Chart 1). The improvement in the split between price and output and between employment and unemployment is essentially left to supply-side measures, and in particular to those designed to improve the functioning of the labor market. The staff continues to support this strategy. Attempts at pushing up the rate of growth through easier financial policies would run the risk of rekindling inflationary expectations, which as the experience of 1985 demonstrates, remain sensitive to financial developments, and of jeopardizing external equilibrium. If such attempts involved a change in the policy mix based on fiscal expansion, they would result in a disadvantageous shift in the composition of demand. ie less investment, more consumption

The emphasis placed by the authorities on the need to reduce labor market rigidities has led to the adoption of a number of measures designed to curb union power, to eliminate some of the disincentives to employment, to reduce distortions in the tax system affecting the relative cost of labor and capital, and to improve training and increase labor mobility. These measures have not, however, prevented a continuous rise in real wages which, in turn, has impeded a permanent reduction in unemployment. The U.K. authorities have rightly argued that the measures they have introduced will take time for their full effect to be felt, but the staff would also stress the need for further action. There are still a number of obstacles to labor mobility--related in part to housing policies--and disincentives both to firms to increase employment, such as the high costs of separation, and to the unemployed to take low-paying jobs, which could be reduced by Government action. The persistence of high unemployment has led the U.K. authorities to take direct measures to reduce it in the form of work and training schemes and financial incentives for employers to create--and the unemployed to accept--jobs at the low end of the pay scale. The staff supports these measures and their possible extension, inasmuch as they appear to be cost effective and contribute to greater wage flexibility.

. In formulating financial policies, the U.K. authorities should aim at a policy mix which is consistent with long-term objectives. These objectives, as the staff sees them, should be to close the gap between the level of productivity in the United Kingdom and the other main industrial countries, to secure price stability, to create the conditions for sustained employment growth, and to prepare for a decline in foreign exchange receipts from North Sea oil. With respect to the last objective, the staff is less optimistic than the U.K. authorities about prospects for the balance of payments and foresees a current account deficit emerging as early as 1987, even with relatively subdued growth of domestic demand. The staff favors therefore a mix of financial policies that encourages investment, a major determinant of productivity gains and employment creation, and exports.

It is the staff's view that a sufficiently tight fiscal policy would shore up confidence in financial markets and permit a reduction of interest rates at a time when the complete phasing out of tax allowances is likely to be accompanied by a marked weakening of investment activity. Excluding transitory receipts from North Sea oil and asset sales, the PSBR is well above the medium-term target of 1 percent of GDP and the United Kingdom's net public debt as a percentage of GDP, despite its recent decline, remains above that of the other G-5 countries. The staff hopes, therefore, that the decline of the PSBR for the next fiscal year as projected in the last Budget will be achieved and that allowance will be made for the planned increase in asset sales. This will probably leave little room for tax cuts, given the expected shortfall in receipts from oil production, but the reduction in energy prices may be viewed as the equivalent of a tax cut. Some restructuring of taxes may also be possible--even in the absence of a tax cut--to implement the authorities' intended shift from taxation of income to taxation of expenditure. The staff supports the U.K. authorities' emphasis on the need for tax cuts from a supply-side perspective and agrees that the level of tax rates and thresholds acts as a disincentive to work and acquire greater skills. It believes, however, that tax cuts should be predicated on a permanent containment of expenditure. In this respect the staff welcomes the authorities' reaffirmation of their intention to stabilize public expenditure in real terms and to tighten control on outlays. The recently announced reform of the social security system could also contribute in a more distant time horizon to a deceleration of public spending.

Turning to monetary policy, the staff agrees that, notwithstanding the rapid expansion of the broad monetary aggregates, the weight of the evidence suggests that monetary policy has not been too loose. At the same time, the high level of liquidity in the economy is cause for caution. Given the additional uncertainties associated with the stance of fiscal policy under the next budget and with developments in the oil market, it would be premature to lower interest rates significantly at present, even though they remain well above those in the main industrial countries. The interpretation of the monetary aggregates remains difficult and, in pursuing their nominal income target, the monetary authorities will need to pay attention to the full range of indicators of monetary conditions and be prepared to react promptly if they perceive that nominal GDP may be moving off its targeted path.

The staff agrees that the exchange rate can provide useful signals on monetary conditions, and that, in view of the fragility of the recent subsidence of inflationary expectations, the authorities cannot be complacent as to the size and speed of a depreciation. However, it believes that some exchange rate flexibility should continue to be allowed in response to developments at home or abroad which affect permanently the external position of the United Kingdom. The authorities do not disagree that the real effective exchange rate of sterling will need to depreciate over time as export receipts from oil decline, a development which may occur rather sooner than expected if the recent sharp fall in oil prices is not reversed. Their preference is to see such a real depreciation achieved through a larger decline in domestic costs and prices than in the main trading partner countries rather than through a nominal depreciation, and they view a firm nominal exchange rate as an effective instrument to keep pressure on enterprises to resist excessive wage claims. Nevertheless, the authorities have been prepared to allow the rate to depreciate when this could be done without undermining progress against inflation or the confidence of financial markets. The staff agrees that a depreciation of the nominal effective exchange rate must not be perceived as an automatic response to a loss of competitiveness resulting from enterprises' inappropriate wage and price decisions, but welcomes the recognition by the U.K. authorities that in certain circumstances, such as a pronounced fall in oil prices, it may be necessary to accept an adjustment of the exchange rate. Financial policies should, however, remain firm enough to dispel any doubt about the authorities' commitment to fight inflation.

The staff welcomes the U.K. authorities' reaffirmation of their commitment to an open trade system and their support for a new GATT round, and a liberalization of the Multi-Fibre Arrangement. It

a way of saying don't join the EMS?

encourages the United Kingdom to use available opportunities to press within the European Communities for the rollback of existing barriers to trade in agricultural and industrial products, as well as in services.

It is recommended that the next Article IV consultation with the United Kingdom be held according to the standard 12-month cycle.

United Kingdom - Basic Data

Area and population	
Area	94,247 square miles (244,100 square kilometers)
Population (mid-1984)	56.5 million
GDP per capita (1984)	£5,653

Composition of GDP in 1984, at current prices	In billions of pounds	Distribution in per cent
Private consumption	194.7	61.0
Public consumption	69.7	21.8
Total investment (including stockbuilding)	55.1	17.3
Total domestic demand	319.5	100.1
Exports of goods and services	91.7	28.7
Imports of goods and services	91.8	28.8
GDP at market prices (expenditure estimate)	319.4	100.0

Selected economic data, annual percentage change (period average)	1983	1984	1985
Real GDP (at market prices, average estimate)	3.2	2.6	3.5 1/
Manufacturing production	2.9	3.8	2.7 2/
Average earnings 3/	9.0	8.8	8.7 2/
Unit wage costs 3/	1.3	3.4	6.2 2/
Retail price index	4.6	5.0	6.1
Rate of unemployment (in percent)	12.3	12.7	13.1
Mo 4/	6.4	6.6	2.2
£M3 4/	10.5	9.5	15.0

Public sector accounts, in billions of pounds	1983/84 Outturn	1984/85 Outturn	1985/86 Estimate 5/
General government receipts	128.4	139.4	149.0
General government expenditure 6/	140.4	157.3	160.5
Financial balance	-12.0	-11.9	-11.5
(In percent of GDP)	(-3.9)	(-3.6)	(-3.2)
Public sector borrowing requirement	9.7	10.2	8.0
(In percent of GDP)	(3.2)	(3.1)	(2.2)

Balance of payments, in billions of pounds	1983	1984	1985 7/
Exports	60.8	70.4	78.7
Imports	61.6	74.5	81.4
Trade balance	-0.8	-4.1	-2.7
Net invisibles	4.0	5.2	5.6
Current account balance	3.1	1.1	2.9
Investment and other long-term capital	-6.5	-12.0	-14.2
External sterling liabilities	4.2	6.4	7.5
Trade credits and other short-term capital 8/	-1.6	3.2	4.8
Balance for official financing	-0.8	-1.3	0.2
Gross reserves, official basis (billions of SDRs) 9/	17.0	16.0	14.2
Gross reserves, IFS basis (billions of SDRs) 9/	11.5	10.3	12.6 10/
Average effective exchange rate index (1980 = 100) 11/	86.7	81.9	81.5

1/ First half of 1985 over the corresponding period of 1984.
2/ First three quarters of 1985 over the corresponding period of 1984.
3/ Manufacturing sector.
4/ End period; for 1985, mid-December over mid-December.
5/ Revised estimate based on the Autumn Statement, 1985.
6/ Excluding net lending.
7/ First three quarters at annual rate; current transactions are seasonally adjusted while capital transactions are not.
8/ Including balancing item and allocation of SDRs.
9/ As of the end of December, unless indicated otherwise.
10/ November 1985.
11/ Annual average.

5B.

SUMMARY TABLE JANUARY 1986 FORECAST

		MAIN FORECAST	LOWER OIL PRICES	
		$20	$18	$15
1.	World GNP (major 7 excluding UK) % change on year earlier			
	1986	3	3.2	3½
	1987	3	3.2	3½
2.	Effective Exchange Rate (1975 = 100)			
	1986 Q4	75	74	72
	1987 Q4	73	72	70
3.	Oil prices, $ Brent spot			
	1986 Q4	20	18	15
	1987 Q4	21½	19½	16½
4.	Nominal GDP (mp) (% change on year earlier)			
	1986-87	6.7	6.5	6.2
	1987-88	6.8	6.8	6.7
5.	GDP Volume (% change on year earlier)			
	1986	2.7	2.7	2.8
	1987	1.7	1.7	1.8
6.	RPI (% change on year earlier)			
	1986 Q4	4.1	4.1	4.0
	1987 Q4	4.3	4.3	4.2
7.	Current Balance (£ billion)			
	1986	4¼	4	3¾
	1987	1½	1	½
8.	Fiscal Adjustment (annual not cumulative) £bn			
	1986-87	2¼	1¾	¾
	1987-88	4¼	3½	2¼

LOWER OIL PRICE VARIANT

$15 case ($18 case in brackets)

% change from base

Year	Major 7 (excl. UK) GDP	Major 7 (excl. UK) Consumer Price Index	Real GDP	RPI	Nominal GDP	Real National Disposable Income	£ Effective exchange rate
1986-87	+0.6 (+0.2)	-1.1 (-0.4)	+0.1 (0.04)	-0.1 (-0.02)	-0.5 (-0.2)	-0.3 (-0.1)	-3.8 (-1.5)
1987-88	+1.1 (+0.4)	-2.2 (-0.9)	+0.1 (0.04)	-0.1 (-0.04)	-0.6 (-0.2)	-0.4 (-0.2)	-3.1 (-1.4)
1988-89	+1.3 (+0.5)	-2.3 (-0.9)	0 (0)	+0.1 (+0.04)	-0.2(-0.1)	-0.2 (-0.1)	-3.2 (-1.3)
1989-90	+1.2 (+0.5)	-2.0 (-0.8)	0 (0)	-0.1 (+0.04)	0 (0)	-0.2 (-0.1)	-2.8 (-1.1)

	Labour cost competitiveness	Earnings	Employees in employment (000s)	North Sea Revenues (£bn)	Fiscal Adjustment (£bn)	World Trade in manufactures (UK weighted)
1986-87	-3.8 (-1.5)	+0.2 (+0.1)	+10 (+ 4)	-1.6 (-0.6)	-1.4 (-0.6)	+0.7 (+0.3)
1987-88	-2.9 (-1.2)	+0.3 (+0.1)	+70 (+30)	-2.2 (-0.9)	-2.0 (-0.8)	+1.5 (+0.6)
1988-89	-2.9 (-1.2)	+0.6 (+0.2)	+70 (+30)	-2.1 (-0.8)	-1.6 (-0.6)	+1.5 (+0.6)
1989-90	-3.2 (-1.3)	+1.0 (+0.4)	+10 (+ 4)	-1.9 (-0.7)	-1.2 (-0.5)	+1.4 (+0.6)

5A

PRIME MINISTER

31 January 1986

BUDGET ISSUES

Your meeting with the Chancellor can begin by surveying the state of the economy and the forecast. The basic message is encouraging - more so than a lot of the outside forecasts. We can hope for continuing buoyant growth (maybe 3% in 1986 and 2% in 1987). Inflation might remain steady at about 4%. The crucial policy questions boil down to how tight a monetary policy you want and how loose a fiscal policy.

There are four big issues for the meeting:

A. Monetary Policy

B. PSBR

C. Income Tax Cuts: Rates v. Allowances

D. Other Taxes

A. Monetary Policy

Broad money cannot be ignored. The City still cares about it. Moreover, it measures the dry tinderwood in the economy - the money available to be spent and fuel inflation unless real interest rates stay high. So the Chancellor is likely to want to publish a target for Sterling M_3 or some variant of it, and we recommend you agree to this.

But you could press the Chancellor on what happens if broad money overshoots its target figure during next year: what will he do to convince the market that the target is taken seriously by the Government?

Narrow money is more important. M_0 has a good track record as an indicator of inflation. It responds well to increases in interest rates. If inflation is to come down to 3% or less, it is crucial that the published ranges over the next 2 years show reduced numbers, eg 1-5% for 1986/87 and 0-4% for 1987/88.

All this means that we are in for a further period of high interest rates. There is little prospect of a fall in the cost of mortgages.

B. PSBR

FISCAL STANCE IN 1985 BUDGET £bn

	1985-6	1986-7	1987-8	1988-9
PSBR	7	7.5	7	7.5
Fiscal Adjustment		3.5	3	3
Asset Sales	2.5	2	2	2

The Treasury now expect the PSBR to turn out at around £7 billion for 1985-86. This is good news. It is better than the £8 billion estimate in the Autumn Statement. The market expects an even higher number.

There have been two big changes since the 1985 Budget.

The fall in the oil price cuts our oil revenues dramatically:

	£bn	
	1986-7	1987-8
1985 Budget forecast	11.5	9.5
Reduction assuming oil at $20 per barrel	-3.5	-3.0

The sale of BGC has whacked up receipts from asset sales:

	£bn	
	1986-7	1987-8
1985 Budget	2	2
Now planned	4.5	4.25

The key issue is whether you keep to the target of £7.5 billion, counting asset sales as negative expenditure. This might permit about £2 billion of tax cuts next year. Alternatively, we could be cautious because of the higher asset sales and go for a tight PSBR of £5.5 billion without any net tax cuts. A compromise of £6.5 billion would allow the Chancellor net tax cuts of £1 billion.

The Chancellor's instinct may be to go for tax cuts of around £2 billion and a PSBR of about £7.5 billion. The arguments in favour are:

a. The lower oil price and reduced revenues are temporary and erratic. Our North Sea oil revenue assumption is now on the pessimistic side.

b. The PSBR target set out in the last Budget was on the low side. The PSBR could still be falling as a percentage of GDP. The famous tough Budget of 1981 gave us a PSBR in 1981-82 that was 3.3% of GDP. Even after counting back asset sales, a PSBR of £7.5 billion in 1986-87 would be about 2.75% of GDP.

The arguments for a more cautious approach are:

a. Lower oil prices are like a tax cut - but unfortunately the Chancellor doesn't get the credit.

b. It would be a brave forecaster who offered to predict with near certainty the future course of the oil price.

c. We must not let a loose fiscal policy expose us to the risk of high inflation or the loss of City confidence.

The total size of the British economy is approaching £400 billion. So a change in the PSBR of £1 billion either way isn't going to make that much difference. It's well within the margin of error of the Treasury forecast. We would be prepared to see a PSBR of £7.5 billion, provided that monetary policy is tight to keep inflation down and keep City confidence. Moreover, that little bit extra on the PSBR enables the Chancellor to be more adventurous in changing the tax system.

C. Income Tax Cuts: Rates v. Allowances

The economic argument is between a large change in the marginal rate of tax for a small number of people (allowances) versus a small change in the marginal rate for a large number of people (rates). The effects on the overall economy are much the same in either case.

Therefore the choice must be made on political grounds. Allowances have become a trifle dull, whereas rates may excite more people. In any case, further big changes in allowances can legitimately be delayed until after the Green Paper on tax reform. However, the back-benches appear to want to carry on upping the allowances.

The Policy Unit view has been consistently to favour a cut in the basic rate. If you could get income tax down to 28p in this Budget, and push it down further to 25p in 1987, you would really have something to show the electorate. But a 1p reduction might look rather feeble. So if you want to reduce the rate, it has to be by 2p, and we are again driven to accept that the PSBR should be at around £7 billion. This might give a fiscal adjustment of about £1.5 billion, with maybe another £0.5 billion coming from indirect taxes - notably petrol duty.

D. Other Taxes

You could press the Chancellor for his ideas here.

The morass of CGT and CTT must be looked at again. At the moment, we get the worst of all possible worlds. They don't raise much money - CTT doesn't raise much more than the death duties which it replaced. But they remain very unpopular because they are so complicated. We recommend a major simplification lubricated by further reductions in the total burden of these capital taxes.

The tax reliefs for pension funds remain a scandal. They are sitting on huge untaxed surpluses which Roy Hattersley can direct into every bankrupt company without future pensioners so much as noticing. The big obstacle to reform is the Chancellor's promise last year that he would only act after consulting. But he could argue that circumstances had changed, and begin with, say, a specially reduced rate of CGT levied on gains accruing within funds.

Now that Norman Fowler is going to give everyone a right to a personal pension, the tax system needs to reinforce this right, rather than undermine it. In particular, there should be some tax relief for people who wish to save towards a personal pension on top of their normal occupational scheme. The American evidence is that this is the best way of building up personal property-ownership. The Revenue are producing a consultation document in the Autumn. You could press the Chancellor to make it positive so that he can claim some advance credit for it in his Budget speech.

Another lesson from America is the enormous volume of private charity stimulated by generous tax reliefs. There is a strong tide running in favour of a better tax régime for companies' charitable activities.

Conclusion

Our proposals hang together.

First, set a tight monetary policy. We recommend that you insist on:

a broad money figure in the MTFS;

a lower target range for M_0.

Provided that monetary policy carries on the fight against inflation, we believe that a PSBR of £7 -7.5 billion need not be imprudent. Moreover, it enables the Chancellor to be much more bold on tax reform.

A PSBR of £7 billion gives a fiscal adjustment of about £1.5 billion. With higher indirect taxes of £500 million, this could finance a tax cut in the basic rate of 2p.

The Chancellor should also use any extra room for manoeuvre for some reforms in capital taxes and a generous tax régime for personal pensions and charities.

David Willetts

BRIAN GRIFFITHS DAVID WILLETTS

PRESS

Prime Minister ②

PRIME MINISTER

THE BUDGET OF MARCH 1985

The public sector financial deficit of the UK when measured as a percentage of GDP was roughly the same as that of the United States.

Even taking account of our higher savings rate than the United States, this is too high and is not sustainable. Such a high fiscal deficit throws a big burden on interest rates and crowds out private sector development.

A first budget priority should be to reduce the financial deficit of the public sector. In present conditions, this probably means a fiscal adjustment of less than $1bn. In terms of PSBR, it amounts to some £5½bn.

As we saw in 1981 such a 'tight' budget will not depress demand and reduce growth; on the contrary, it will generate market confidence, lower interest rates and promote expansion. You will regain control.

Whatever room there is for tax reductions should be concentrated on raising thresholds. They are still far too high and inhibit both employment and enterprise.

The MTFS

This is the appropriate time to drop M3, PSL2, or any other broad aggregate from the targets. They have been eliminated de facto long ago - we should formalise their demise. Our targets, as in Germany and Switzerland, should be the monetary base. As the Treasury papers have shown, this has always served us well and can be used with confidence to guard against persistent inflation. A steady declining growth rate for Mo to approximately zero will eliminate inflation.

The only argument against Mo is said to be City incredulity. However the City has been tutored in the past by the Bank to the view that Mo, as mainly notes and coin, could not be a suitable indicator, compared with some measure of credit, such as M3, PSL2, etc. This view has been discredited (and not merely in the UK). With the Banks cooperation, City credibility in Mo could be quickly established.

As far as the budgetary targets are concerned, may I suggest they be recast in the form of financial deficits of the public sector. These exclude, inter alia, the negative effects of asset sales and so they are much more appropriate as a means of fiscal effects than the PSBRs. In practise, this would not involve any substantial change in the movements of the PSBR or financial deficits since the asset sales are predicted to be about constant for the next three years.

The Exchange Rate

I can only reiterate what I have said so often: our domestic monetary policy should be adjusted to achieve stability and inflation-free growth in our domestic economy. To hold our domestic monetary policy hostage to all the rumours, reports, politics and external events that assail us is a recipe for violent instability in the whole economy. Of course we cannot ignore external events etc, but we should not magnify them and inflict them on Britain in the form of violent oscilations in interest rates.

In particular, the appropriate policy for a falling oil price is to let the exchange rate depreciate (but of course not to encourage a depreciation). I do not accept the "losing control" argument unless it can be shown clearly that monetary/fiscal policy is loose (as in December 1984 and January 1985). This is clearly not the case in January 1986; I think our present monetary policy is too restrictive.

In short, I think that the case which you made in this morning's meeting was analytically correct, and, although I venture far from my last here, politically adept.

ALAN WALTERS
<u>24 January 1986</u>

CONFIDENTIAL

PRIME MINISTER

BUDGET

The Chancellor would like to have a long talk with you towards the end of the month about progress towards the Budget.

I have pencilled in a two-hour meeting for Friday, 31 January. But I have heard that the Chancellor is considering inviting you and DT to dinner with him and Mrs. Lawson instead. You and he would then have a talk after dinner, much as I believe you did at about that time in 1984.

To hold the discussion in this way would undoubtedly have some advantages in terms of a relaxed atmosphere and so on, but it probably also has the advantage for the Chancellor that no-one else from No. 10 would be there. The result would be that the Chancellor would have held two major discussions with you with no opportunity for others in No. 10 (Nigel, Brian Griffiths or myself) either to offer advice on the Budget proposals from your point of view or to take a note.

I very much hope you will agree that this would be undesirable.

Other options, in place of a dinner at No. 11, would be either to retain the long bilateral scheduled for 31 January, or to pre-empt the Chancellor's invitation by offering a further dinner of the kind you held in December and with the same cast. Good idea - and it would save Therese.

You might like to have a word.

Amanda Ross
(DUTY CLERK)
pp DAVID NORGROVE

16 January 1986

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

13 January 1986

NBPM

Dear David,

1986 BUDGET DAY

I have seen Rachel Lomax's letter to you of 10 January. This is to record that the Lord Privy Seal is content to make the announcement of the date of the Budget on 16 January.

I am copying this letter to Rachel Lomax and to Murdo Maclean.

Yours,
Alison

ALISON SMITH
Private Secretary

D Norgrove Esq
Private Secretary to the
Prime Minister

Econ Pol
Budget
PT 14

CONFIDENTIAL

File

PA

cc BG

10 DOWNING STREET

From the Private Secretary 13 January 1986

1986 BUDGET DAY

The Prime Minister has seen your letter to me of 10 January and is content for you to announce on January 16th that Budget Day will be March 18th.

I am copying this letter to David Morris (Lord Privy Seal's office) and Murdo Maclean (Chief Whips Office).

(David Norgrove)

Mrs.Rachel Lomax,
HM Treasury.

CONFIDENTIAL

L/020

CONFIDENTIAL

Prime Minister

Content?

DRN 10/1

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

David Norgrove Esq
No 10 Downing Street
London
SW1

Yes

10 January 1986

Dear David

1986 BUDGET DAY

As you know, we have been planning on the assumption that Budget day this year will be on March 18th.

It has become customary to announce the date of the Budget in the first Business Statement after the Christmas Recess (although we departed from this practice last year in order to assist the planning of the sale of shares in British Aerospace). The Chancellor wishes, this year, to follow recent practice and this would point to an announcement during the Business Statement on Thursday 16th January.

I should be grateful for confirmation that the Prime Minister is content for us to announce, on January 16th, that Budget day will be March 18th.

I am copying this to David Morris (Lord Privy Seal) and Murdo Maclean (Chief Whip). If the Lord Privy Seal is content for an announcement to be made on 16th January, I would be grateful if the Whip's office could make the necessary arrangements.

Yours ever
Rachel

RACHEL LOMAX

DM/5

CONFIDENTIAL

CC/BG

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6460

Switchboard 01-213 3000

Prime Minister 4

A number of mostly small suggestions.

DRN 7/1

John Mogg Esq
Private Secretary to the
Secretary of State for
Trade and Industry
1 Victoria Street
LONDON SW1

7 January 1986

Dear John

1986 BUDGET

Lord Young was most grateful to your Secretary of State for sending him a copy of his attached letter of 23 December making suggestions for measures in the 1986 Budget.

... You may in turn like to see the attached notes which Lord Young has himself sent to the Chancellor covering a number of matters related to the Budget in which this Department is particularly interested. As you will see the submission concentrates on four main themes. These are encouraging self-employment, encouraging the availability of finance to small companies, encouraging wider share-ownership and participation, and finally further measures to reduce the burdens on business.

I am sending a copy of this letter and enclosure to David Norgrove (No 10).

Yours ever

Leigh

LEIGH LEWIS
Principal Private Secretary

CONFIDENTIAL

BUDGET SUBMISSION

Self-employment

A number of positive steps could be taken to encourage self-employment.

1. The burden of paperwork on the self employed (and the Revenue) in claiming minor expenses to offset against income is excessive. We should consider a small business allowance to replace claims for minor items of business expenditure. If expenditure exceeds the allowance, claims could be submitted as now. The intention is to set the allowance at a relatively low level so that loss of revenue would be minimal but time wasting arguments about minor expenses are removed. This would be a relatively minor simplification to reduce the burden of paperwork on new start-ups and the small self-employed business.

2. The self employed pay National Insurance Contributions on a flat rate basis (weekly Class 2 contributions) and on a profits related basis (Class 4 contributions collected twice in the tax year by Inland Revenue). It would simplify the system, and remove the complication of claiming the small earnings exemption limit, if the Class 2 contribution were abolished. The reduction in contributions should be recouped by increasing the contribution rate on Class 4 contributions. This redistribution of the burden of payments would help start-up businesses and the lower paid self-employed, at the expense of the higher paid self employed. It would also ease the burden of paperwork on the self employed.

3. "Right to be self-employed". Although there must be doubts as to whether changes in tax and employment status greatly affect enterprise, there is a need to clarify the law on self-employment and to make it easier for people to become self employed. The risk of reclassification for tax purposes may deter some people from self-employment and the existence of disagreements between DHSS and Inland Revenue over whether someone is self-employed highlights the need for clarification in this area. We would not argue in favour of a single test for self employed status but the tests applied need to be clear and established to encourage self employment.

Finance for small companies

Improvements in the flow of finance to small companies could be made in a number of ways.

1. Loans made by charitable trusts to assist small firms and start-ups should be included within the scope of charitable purposes. This has proved possible but required a fairly complicated legal procedure to achieve. If this could be made easier by a change in regulations or legislation a new source of money for new entrepreneurs could be tapped.

2. Capital Transfer Tax diverts entrepreneurs into tax planning and can weaken a company which is being transferred. CTT should not be payable while assets are retained in the business being transferred. A 100 per cent relief from CTT on the transfer of business assets would achieve this, at an annual cost of about £70 million.

3. Venture Capital Funds are providing an important source of finance for companies. Some have moved off shore to avoid the double Capital Gains Tax (on the funds and on the investors) when investments are sold by unquoted capital venture funds. CGT exemption for unquoted capital venture funds would be desirable to remove the complexity of venture capital funds operating offshore. The cost of exemption would be minimal.

4. There are also some minor changes in company taxation which cost very little but are technically worth making.

"Disincorporation relief" When companies become incorporated, relief exists for Capital Gains Tax and to allow the carry forward of trading losses, but similar reliefs do not exist for businesses which disincorporate. Companies which disincorporate should be allowed the same reliefs that are avilable to companies which incorporate.

Corporation Tax on associated companies. The rules which aim to prevent abuse of the lower rate of corporation tax for small profits (below £100,000) by disaggregating companies, can have anomalous effects. Associated companies may be charged the full rate of tax even though total profits would be below £100,000. The cost of overcoming this problem should not be great through technical changes in corporation tax.

Ownership/participation

1. Abolition of stamp duty on the transfer of shares will encourage direct share ownership and help to reduce the cost of raising new equity. It may also help to encourage the development of an OTC market. If the cost of abolition (about £170 million) is excessive within the Budget arithmetic, a cut in the rate of stamp duty to ½ per cent would still be worthwhile.

2. We should look for further ways to encourage employee share schemes. One approach would be to widen the scope of the executive share option schemes to encourage the spread of schemes to smaller companies with limited equity capital. Too much of the benefit of the present arrangements is going to executives in large companies when we want to encourage real entrepreneurs who take risks in starting or joining small companies. To achieve this, the definition of "material interest" could be widened to 25 per cent of ordinary share capital for unquoted companies. We also need to encourage wider general employee share schemes. One approach would be to look for ways to make all-employee share schemes more attractive to employers and employees such as increasing the allocation limits under the 1978 Finance Act. Profit Sharing Schemes and the limits on options in the 1980 Finance Act Share Option Scheme.

3. Some specific changes could be made to encourage employee controlled companies (ECC's) and particularly to enable ECC's to expand subsequently while remaining employee controlled. Detailed changes are given in the attached note. Costs should be minimal.

Burdens on business

Some changes which would have a major impact in reducing burdens on business also affect revenue. Three issues which are consistently raised with us by business are identified below.

1. VAT threshold. Our scope to raise the VAT threshold will, of course, be determined by negotiations with the European Community. If we gain flexibility the threshold should be raised substantially.
If negotiations do not succeed, then, as well as normal indexation, we might to look for other ways to make progress in this area within EC rules, for example exempting very small firms, or very small firms in a wide range of sectors.

2. The P11D threshold has not been indexed against inflation and has reached a point where the £8,500 threshold catches a wide range of employees not normally regarded as higher paid. Unless very drastic simplification of the information required from companies can be achieved a substantial increase in the threshold - to around £15,000 to take account of inflation - is needed to reduce the burden of compliance.

3. The Keith recommendations on VAT which were introduced in this year's Budget have drawn a lot of criticism over VAT penalties and record keeping. It would be in keeping with the decision on the Keith recommendations on Inland Revenue taxes to undertake a thorough review of both penalties and record keeping requirements. We would urge that the penalties be imposed only after a longer time period - and much less rigidly - and that the record keeping be reduced to three years, at least for small firms.

CONFIDENTIAL

EMPLOYEE CONTROLLED COMPANIES (ECCs)

Given the increasing interest in the establishment of enterprises in which employees themselves own a controlling interest and our desire to encourage wider share ownership among employees there are sound political reasons for giving further encouragement to employee controlled companies. There are 5 specific areas where small, but helpful changes could be made.

1. The special interest relief for employee controlled companies introduced in the 1983 Finance Act has been helpful. But the relief is available broadly only where the shares are acquired before or within 12 months after the company becomes employee controlled. Without creating a precedent for a general relief for employees taking out loans to invest in the companies which they work it would be helpful to extend the employee buy-out relief so that all new employees in an employee controlled company have the chance to make use of the relief upon joining. The relief might be extended, for example, to all employees within 12 months of taking up employment within an ECC. This would be helpful in preventing the creation of different categories of employees and would reduce discrimination between employees in ECCs and their counterparts in close companies or partnerships. This would also avoid a situation where growth is slowed down unnecessarily because new members are unable to obtain as many shares as existing members, unless an ECC was prepared to revert to being a conventional company.

2. It would also be helpful to those employees who wish to take over and run their companies if the present definition of an employee controlled company could be enlarged to include those where the shares are owned both by the employees themselves and by a trust which holds the shares on behalf of the employees. At present buy-out reliefs are only available in circumstances where there is a clear right to individual ownership within a trust. This would also be of particular benefit in circumstances where the shares were given to a trust at below market value to ensure that the capital base of the business did not become weakened by shareholders seeking to realise any immediate gain or by the need to buy and sell shares from those leaving or joining at market price to ensure that employee control did not become diluted.

3. Employee controlled companies are effectively prohibited from making use of the Employee Share Ownership Schemes under the 1978 Finance Act because they issue different classes of shares to employees and outside investors. This arises from the necessity to ensure that employee shares are redeemable and that the shares can therefore be retained on the retirement or resignation of an employee and that new recruits are therefore able to "buy in" into the business. If external finance in a form of equity investment is being raised, for example in a management buy-out, two classes of shares are automatically created within one class inevitably being redeemable. While it would not be right to introduce an advantage to ECCs which other businesses could not make use of this might be avoided if all shares issued by an ECC could ~~not~~ be classified as being of one type for the purposes of the 1978 legislation so long as the only difference was that the employee was obliged to sell his share back to the company on his retirement. This proposal has been made on a number of occasions by the cooperative movement and it could be a useful means of ensuring that he impetus, behind the recent popularity of employee share ownership is not reduced. A particular concern is that if the shares were all of one class and freely tradeable, it would not be clear at any one time whether the busines remained in control of the employees.

4. At present ECC's benefit from a concession which exempts the owner from capital transfer tax liability if his shares are donated to a trust which owns 50% or more of the shares within 12 months of the donation. However if some shares change ownership in this way but the remainder are brought back by the company at less than their market price because the owner is anxious to hand over the company to the employees, a CTT liability arises. While any extension of the present exemption may involve a risk that value could be passed from one shareholder to another with no CTT liability this could be overcome by, for example, restricting the relief to circumstances where all directors sold their shares at the same time at a price which represented less than their full market value. Such a change would be helpful in encouraging the creation of ECCs and would provide those who have built up the business with an important mechanism by which he could hand it over to the employees without incurring any adverse tax liability. This would allow the Owner of the business to hand it over to the employees and still retain some value for himself.

5. In order to further improve the climate for widening share ownership among employees another small but nonetheless helpful improvement would be an upward adjustment to the allocation limits under the 1978 Finance Act Employee Share Ownership Schemes which were last changed in 1983.

the timing of the
post Chevening bilateral
& the timing of the Sec. Cabinet
(on the latter, I expect I'll be
seeking CH advice i.d.c.).
But you might also like to cast
an eye over the PM's forward
diary. I do think good long
bilateral slots are crucial -
& those on earlier stage than
J. Kerr suggests.

Kieran.

7/1/86

PERSONAL AND CONFIDENTIAL

FROM: J O KERR

DATE: 15 March 1984 filed under date of covering minute 7.1.86

BUDGET PREPARATIONS: PRIVATE OFFICE GUIDELINES

The Guardian leak apart, the Chancellor was well content with the way in which the Budget preparation exercise was handled this year, and has in particular confirmed that he sees value in the two innovations made since his days as Financial Secretary - ie the early weekend "Chevening" conference, and the regular pattern of formal "overview" meetings. Following the leak enquiry, and before next year's preparations start, it will be necessary to establish with him whether for security reasons he wishes to move closer to a system of making the Budget in water-tight compartments, with only a very few individuals having the run of the whole ship. These notes are descriptive of the current practice; and would need to be reviewed in the light of any decision to tighten internal security.

Initial Preparations

2. The first point to note is that it is essential to make an early start. This year the Chancellor had constructed by early September his private list of the main candidate tax reforms; and most items on his list saw the light of day on 13 March. Of course one has at that stage very little feel for how much forecast room for manoeuvre there will be; but it is possible, and highly desirable, to arrive at a rough allocation of priorities. It is not necessary - or I think desirable - for the Chancellor's preliminary thoughts to be disseminated at all; though he will wish to discuss them with the Permanent Secretary at various points in the autumn. Having a rough plan up his sleeve does however help him to guide Treasury Ministers on the areas of reform which they should be pursuing with the Revenue Departments: it is also useful to him in deciding how best to play discussions in No 10, ~~Chequers seminars~~, and - next year - the involvement of Lord Cockfield on tax reform. Given that October and early November tends to be much taken up with Survey

and then Autumn Statement issues, it is important to get cracking in September (and therefore not to let the CFM/G5/G10/Interim Committee/Development Committee/IMF/IBRD meetings obtrude too much).

Chevening

3. The FCO are already aware that the Chancellor will wish to hold another Chevening conference next January. Dates should be settled, and a firm booking made, before the summer break. Negotiations should be conducted between Private Offices, after discussion between the Chancellor and the Permanent Secretary; and the outcome should be confirmed in a short letter from the Chancellor to the Foreign Secretary (whose house Chevening notionally is).

4. The three previous such conferences have taken place on the first or second weekend after the Christmas break. With the likelihood of an April Budget next year - and that is a decision which ought if possible to be settled very early on, though the announcement is not made until the first Thursday after Parliament's return from the Christmas recess - it might be possible to consider moving one weekend later. But it would still be important to ensure that the key paper - by Sir T Burns - is available for Christmas reading.

5. The Chevening agenda is drawn up by the Permanent Secretary in consultation with the Chancellor. So too is the invitation list - ~~or at least~~ ie The names of those in addition to Ministers, Permanent Secretaries and Special Advisers, who are to be invited to come for all/part of the weekend. (It is important to let Ministers and Permanent Secretaries know <u>in the summer</u> of the chosen date: if there were to be any absentees, much of the point of the exercise would be lost. A decision on whether wives are, as in the past, to be invited also has to be taken.)

6. The Chancellor and the Permanent Secretary have agreed that for future Chevenings <u>all</u> papers will be circulated to Ministers at least one week in advance.

CHANCELLOR OF THE EXCHEQUER

Overviews

9 6A 7. Since 1982 we have developed a regular practice of Budget "overview" meetings each Tuesday morning, starting 9 days after the Chevening conference. The discipline these impose on the flow of papers and decision-taking is useful: their other primary purpose is to involve the full Ministerial team. So Private Offices need to be told, at Christmas-time, when the weekly series will start, and to be reminded that "overviews" are to be treated as virtually unbreakable engagements.

8. The agenda for each "overview" should be decided on the preceding Wednesday/Thursday; and all those commissioned to produce papers for it should be reminded - again on the Wednesday/Thursday - that such papers must reach the offices of all "overview" members by the Friday night. A formal agenda notice should go round on the Thursday/Friday. The Monday should be used for small meetings - eg of Ministers, or between the Chancellor and the Permanent Secretary - on particular issues to be taken on the Tuesday. People should be discouraged from raising at the "overview" issues emerging from papers not mentioned on the agenda notice. All "overviews" should be formally recorded, with clear action instructions.

9. The permanent membership of the "overview" team is clearly a matter which will have to be reviewed following the leak.

10. A permanent feature of each "overview" agenda should be a score-card minute from the Central Unit, produced on the previous Friday and incorporating all Budget decisions taken up to then.

Cabinet

11. The November Economic Cabinet does not, and should not, have much Budgetary significance. The February Economic Cabinet is however crucial, not least because it can have substantial impact

on the parameters of the eventual PSBR decision. Its date needs to be fixed with No 10 and the Cabinet Office before Christmas - and a late Budget could mean a move from the early February dates of recent years to a mid-February date. But it is worth bearing in mind that the closer the date gets to Budget day, the greater the risk that the Chancellor will be pressed to show a little of his hand. The scope of the Chancellor's paper needs to be decided quite soon after Chevening: the 1983 and 1984 papers followed a similar pattern, and were well received. The paper must of course be cleared in advance with No 10.

12. The Budget Cabinet - ie on the morning of Budget day - has not caused problems since 1981. No paper is, of course, circulated.

Prime Minister

13. The Chancellor ought if possible to have an opportunity for a long private talk with the Prime Minister in late January/early February about the probable broad outline of the Budget. This was contrived in No 11 in 1984, and worked extremely well. When all the main Budget measures have been settled internally - and this ought to happen at the latest some 2½ weeks before Budget day - the Prime Minister's formal endorsement should be obtained through a series of formal minutes from the Chancellor. There were 6 such minutes in 1984: they deserve very careful drafting. Some attention to timing is also desirable: the Chancellor's weekly "bilateral" talks with the Prime Minister, which for much of the year are movable feasts, and sometimes quite short, need in the key period - ie 2-4 weeks before the Budget, to become very firm entries in both diaries, and must not be rushed. The Chancellor's minutes should be timed to arrive fairly early on the afternoon of the day before the "bilateral" in question, so that the Prime Minister has time to digest them before she sees the Chancellor.

14. Budget secrecy in No 10 is good, and strictly observed. In previous years Sir A Walters was an "overview" member: in 1984 we were not asked to, and did not, extend this facility to Mr Redwood. He - but none of his Political Unit staff - did however see the Chancellor's minutes. The only Private Secretaries who did so were Mr Butler and Mr Turnbull. Mr Ingham was brought in only to be shown a Speech draft on the Thursday before Budget day.

Cabinet colleagues

(2) 15. In early February the Private Office must, after consultations, draw up a list of all those Cabinet colleagues who have to be consulted on individual Budget measures. Except when the matter is highly technical, such consultations go best in No 11, in great Budget mystique, and with no officials present. The most obvious exception is oil taxation, where an existing Working Group of Revenue/Treasury/Energy officials has a good tradition of reaching agreements, without leaking.

16. For Budget '85, special arrangements will have to be made for Lord Cockfield. I suspect that the Chancellor will wish him to join all main internal meetings on the Capital Taxes, and some on personal tax, but will not wish him to become a permanent member of
3A the "overview" team. This however needs to be confirmed in the autumn.

Chancellor's diary

17. It is important to ensure that the diary is kept reasonably free from extraneous engagements/meetings in the Budget period. Budget "purdah" provides a good excuse for turning down all social lunches/dinners, all speaking engagements, and press activities from early February. But a free ½ day should be preserved in each week once the "overview" season has started, in order to allow the Chancellor to focus in No 11 on key Budget issues, rather than doing so via the

overnight box, with no officials around for informal discussions. Either 17 or 10 days before the Budget, the Chancellor should be given a 3 day weekend at Stony Stanton to work on the Speech. (17 days in advance would be best, but 10 days worked perfectly well this year.)

Budget Speech

18. The preparation and circulation of early drafts of the Budget Speech is a Central Unit task. (I think it very likely that the circulation will be much reduced, following this year's leak.) The Private Office take over the Speech as soon as all the main Budget measures have been decided - ie some 2½ weeks before Budget day. Its preparation becomes the principal task in the last week.

19. The Chancellor likes to write - ie re-write - all his own stuff. But it helps if the Private Office produce formulae along lines that may be broadly acceptable to replace obviously unusable chunks of (eg Revenue) gunge. And the Private Office must of course clear, with the key officials concerned, formulae emerging from No 11, whether constructed by the Chancellor or constructed in the Private Office and blessed by him.

20. The text must be completed over the weekend before Budget day. That means that the final draft has to go round on the preceding Thursday, and the provisional final version on the Saturday. No 10 should get their draft by the Wednesday at the latest, and should then see succeeding versions.

Handling the Revenue Departments

21. The Private Office need to be particularly careful during the Budget period to keep in very close touch with the heads of the Revenue and Customs. Both need to be aware of all meetings on their subjects which will involve the Chancellor, and to be given the opportunity to attend. Both need to be consulted each week about the "overview" agendas; and it pays for the PPS to have a separate informal

Who?

weekly conversation to enable both to mention any worries not being brought out in the papers. And Customs need to be asked - in early February - to produce a private list of their real deadlines for excise duty and VAT decisions; and need to be made to feel that this remains the top paper in Private Office trays throughout.

Handling other Treasury Ministers

22. Extended "Prayers" meetings, without PPSs, are useful in January - pre- and post-Chevening, and at least once or twice during the final run-up to the Budget. In the last month, the normal form should be for normal "Prayers" meetings to be two-part, with the PPSs being thrown out at half-time to allow for some discussion of Budgetary matters thereafter.

23. The key point is to ensure that all Ministers (a) feel fully involved in the whole Budget process; and (b) are clear as to the precise tasks which have been delegated to them, and when their recommendations will be required. Informal liaison between the Private Office and other Ministerial Private Offices, usually on a nightly basis, is important in the last few weeks.

Budget Day Arrangements

24. The press razamataz needs to be pre-planned, at least a couple of weeks in advance. Timings for the Finance Committee and Lobby engagements need to be watched. And work on the Budget Broadcast should start very early on. (The first step is for the Chancellor to confirm to Mr A Jay in early January that his assistance would again be welcome; in February - or for an April Budget early March - preliminary decisions need to be taken on charts and graphics; a script for the first half (ie not covering the measures) needs to be with Mr Jay at least 2/2½ weeks before the day; and weekly meetings to check on progress should be set up. Mr Folger and Mr Portillo carried the main load this year: with considerable success.)

J O KERR

6.1.86

cc Econ Pol: mtgs with Chancellor - Oct 1983

5

PRIME MINISTER

You have a two hour bilateral with the Chancellor tomorrow afternoon. There are three major topics for discussion:

- the markets
- the Budget
- the Green Paper on Personal Taxation

I suggest you start with the markets (see my separate note about base rates). This will set the right flavour for discussion of the Budget.

In this context you might also raise with him the extent of intervention in the foreign exchange markets, whether directly or by meeting departments' needs from the reserves - over $400 million down last month, and a fall every month since August, the floating rate note aside. This surely cannot be allowed to go on, nor should the Chancellor agree at the G5 this month to further intervention by the UK. (You might ask the Chancellor what the agenda is to be for this meeting and what he thinks is likely to come out of it.)

On the Budget, the Chancellor intends to give you some first thoughts about the overall fiscal and monetary framework. The Treasury say the monetary discussion is not very advanced. On fiscal policy, the Treasury say public comment has an exaggerated idea of the Chancellor's intentions. I am told privately that the Chancellor has no present intention of increasing the PSBR for 1986-87 beyond the £7½ billion envisaged in the 1985 MTFS. The question is rather how much below that figure he should aim. The £2½ billion higher asset sales point in one direction; lower oil revenues may point in the other.

The flavour of the public comment is given in the notes by Phillips & Drew below. Though these papers do not show it, some people are saying that the Chancellor intends to increase the PSBR. On the other hand, see the tables on pages 13 and

14 of the Phillips & Drew pamphlet.

You might also like to look at the record (dictated from memory) of your dinner with the Chancellor last month.

I suggest that at this stage you should not get into a dicussion of detailed numbers for the PSBR even if the Chancellor wished to do so.

The next area for discussion is the main blocks of the Budget.

On direct taxation, should priority be given to reducing the basic rate or increasing allowances? (Note that reductions in the basic rate reduce the cost of transferable allowances.) Do you want to argue for simplifying the higher rate band? (You noted this morning that one of them is rather narrow - see the table attached.)

On indirect taxation, the blip downwards in inflation in the middle of this year would ease the pain of more than revalorisation. One possibility, as always, would be to raise VAT. Politically difficult perhaps, but it has a relatively low RPI effect for the revenue it raises. On specific duties, the uncertainty about oil prices may mean that the Chancellor should say, as Sir Geoffrey Howe did in 1982 and 1983, that if oil prices fall he would be prepared to raise specific duties to compensate for the effect on the PSBR.

Thirdly, employment measures. The Chancellor will not want to reinforce the tradition of increasing public expenditure at Budget time. To do so is bad for Survey discipline, partly because it looks as though the Chancellor is reserving goodies for himself. But I am told that Lord Young's ideas, discussed at the time of the Autumn Statement, are regarded as imaginative and that they could be reasonably cheap. An increase in the community programme, as favoured by the CBI, would be worth keeping up the sleeve in case the unemployment figures began to rise again.

Fourthly, the Chancellor may broach a miscellany of ideas about, eg, pension fund surpluses and charities. On charities, there has in the last few months been some correspondence stemming from a report by Sir Adam Ridley which proposed greater tax deductability for charity giving, among other things.

The discussion on <u>the Green Paper on Personal Taxation</u> has been postponed. But the discussion tomorrow could be used to steer the Chancellor in a way which would head off a row. You could perhaps make the following points to him:

(i) recognise that he is committed to publishing a Green Paper and agree that we should work towards publishing it on Budget Day;

(ii) the Green Paper as at present drafted is almost white on the main issue and sets out only one side of the case; it also risks looking imprudent (£5.3 billion);

(iii) you will need to see what colleagues think, but in any case the Green Paper will need to be redrafted to make it more green and recognise that there are arguments against the proposal;

(iv) the Green Paper should also acknowledge that £5.3 billion may not be available: it could show the benefits of the proposal on several different bases, eg revenue neutral, £2½ billion available and no losers;

(v) you will want to look very carefully at some of the more minor proposals as well, eg why should not mortgage interest relief be split and transferable between husband and wife at £15,000 or some higher level? [I am not clear what in fact this would achieve: would the idea be to allow the split relief to be used against different houses?]

DAVID NORGROVE

6 January 1986

JAlAIA

BANDS OF TAXABLE INCOME

£	Per cent
0 - 16,200	30
16,201 - 19,200	40
19,201 - 24,400	45
24,401 - 32,300	50
32,301 - 40,200	55
over 40,200	60

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ccBG

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DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

23 December 1985

CONFIDENTIAL

The Rt. Hon. Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1

Prime Minister 4

DRN
23/12

Dear Nigel,

1986 BUDGET

At this time of year, my predecessors have made suggestions to the Chancellor of the Exchequer for tax measures in the Budget designed to help promote initiative and a spirit of enterprise among the business community. I should like to do the same this year.

2 The economic context for next year's Budget is again encouraging, with a sixth successive year of economic growth forecast, inflation set to fall below 4 per cent in the course of next year, and a healthy balance of payments surplus on current account again in prospect. Unemployment is still rightly seen as the least satisfactory aspect of the economy, and more recently the acceleration of earnings is causing us concern.

3 In this situation, I believe that, if you have room to reduce taxes, it would be right this year to concentrate mainly on personal taxation. The incentive this will give to hard work and enterprise on the part of individuals will of course be of considerable indirect help to business.

4 The main choice would then be whether to reduce the basic rate of income tax, or to raise the threshold at which tax becomes payable, and the higher rate bands, by more than the rate of inflation. My own firm view is that the benefit from raising the threshold is much greater than from reducing the basic rate, for any given amount of tax revenue foregone. For a married man the impact of a 30 per cent marginal rate of tax comes at only 33 per cent of average earnings. The revenue which would be sacrificed by a 1p cut in the basic rate would enable all tax thresholds to be raised by about 6 per cent, taking approximately 500,000 people out of income tax altogether. This would in my view be just as

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effective a selling point as a cut in the basic rate; and if the higher rate bands were also increased, this would maintain the incentive for higher earners as well.

5 My proposals for changes in taxation directly affecting industry and commerce are set out in detail in the enclosed note by my officials. If there are points in them which your officials would like to clarify, my people are, as in earlier years, available for continuing discussion.

6 The first group of proposals concern the taxation of financial services. Something will have to be done, not later than the ending of single capacity now fixed for October 1986, about the difference between the tax treatment of jobbers and others who buy and sell securities. I believe that we should take the opportunity to remove stamp duty altogether on securities transactions. I recognise that the revenue loss involved, about £460m, is substantial. But London will in the next year or so come into more direct competition than ever before with New York, Tokyo and other international financial markets. It is most important that the London market should not at this strategic moment be burdened with less favourable tax treatment, and hence with higher transactions costs, than our competitors. Already, the volume of trading in some leading British equities is higher in New York in the form of ADR's than in London, and transaction costs are the main reason. My other proposals in the financial services sector would bring modest but useful benefits to the City, without incurring significant revenue costs.

7 The decisions in the last Budget to preserve the 100 per cent Scientific Research Allowance, and to include research and development among the activities eligible under the Business Expansion Scheme, were helpful. But I remain very concerned about the volume of non-defence industrial R and D being undertaken in the UK, which is lower than that of our major competitors. I would not endorse some of the more ambitious ideas which some have put forward, such as the tax credits for incremental R and D available in some other countries. But I should like to revert to two measures which Norman Tebbit proposed last year - to allow tax relief on R and D expenditure undertaken before trading commences; and to widen the definition of scientific research so that it includes development which is not specific to a particular product. Neither change would be expensive; and I believe that between them they would be likely to further both an increased volume of R and D, and more fruitful collaboration between industry and higher education.

8 I favour a substantial increase in the threshold for VAT registration, as soon as this can be achieved consistently with our Community obligations. VAT was clearly identified in the Burdens exercise as one of the main obstacles to the setting up and

DW5AET

expansion of new businesses. I was heartened to learn of M Delors' undertaking to the Prime Minister that the Commission would recommend a higher threshold to the Council. In the meantime, I hope you will be able at least to increase the threshold in line with the movement in the r.p.i, perhaps to £20,500.

9 I understand that you are proposing to review the future of the Business Expansion Scheme in the light of the Peat Marwick Report. I should welcome in early sight of the report, and an opportunity to contribute to your thinking on Peat Marwick's conclusions. In the meantime, our detailed note includes two suggestions for relaxation in the present rules governing eligibility for BES relief. These are within the spirit of the BES objective of stimulating investment in new businesses,particularly in areas like high technology which are of great potential benefit to the economy.

10 I note in passing that the Inland Revenue are reported to be checking whether some of the BES schemes which have been marketed, with the emphasis on asset backing and the prospect of capital appreciation, in fact fall outside the BES rules since they have the character of investment rather than trade. I should not be unduly concerned if it were found that some schemes of this kind fell on the wrong side of the line. Nor would I favour the relaxation, urged by the CBI and others, of the rules restricting BES investments in companies by directors and their families. The deadweight cost would be large and the scope for avoidance considerable.

11 Apart from the Business Expansion Scheme, I have several suggestions to make which would promote enterprise by easing the tax burden on smaller and unincorporated companies. The most important of these is the extension from 30 per cent and 50 per cent to 100 per cent of relief from Capital Transfer Tax for business assets transferred at a cost of some £70m in revenue loss. Even at the reduced 70 per cent and 50 per cent rates, the impact of CTT on small family businesses remains a serious disincentive to expansion and a good deal of time and energy in devoted to avoidance. The other proposals in this group are technical improvements with few revenue implications. But the present situation in which Enterprise Allowance receipts are, in effect, taxed several times over is causing resentment and should be ended.

12 I also receive many proposals for tax concessions for particular industrial sectors. Most of these are at variance with our policy of fiscal neutrality, and have little merit, but I would like to put forward four proposals affecting individual sectors.

13 The first is that the breakpoints for the assessment of car benefit should be aligned with those for the new EC engine emission standards when they come into force.

DW5AET

This will enable BL to compete more effectively with imports, particularly from the major multinationals. I would be happy for this change to be made on a revenue neutral basis.

14 The other three relate to mining. The Inland Revenue consultation document on mines and oil wells allowances, was broadly welcomed by my Department. But there is a good case, in addition to the proposals in the consultation document, for applying the Scientific Research Allowance, which already covers oil exploration, to metals exploration; and for extending the period for which expenditure on making land good after mining has ceased qualifies for relief. I also favour retaining the present tax treatment of second hand costs of mineral rights in the UK.

15 I am copying this letter and enclosure to the Prime Minister and David Young; and to Sir Robert Armstrong.

I would very much like to have a chance to talk to you informally about this before any decisions are taken. I would particularly like to elaborate substantially on Paragraph 4.

Yours,

LEON BRITTAN

Leon

DW5AET

1986 BUDGET

STAMP DUTY ON SECURITIES TRANSACTIONS

1. The City of London is already in vigorous competition with other financial centres in a world market for securities. But transaction costs remain high by international standards. For a purchase and sale of £100,000 worth of securities, they work out at about 2 1/4 per cent (including 1 per cent stamp duty) compared with 1 per cent in New York (no tax) and 1 3/4 per cent in Tokyo (½ per cent tax). It has been estimated that the halving of stamp duty in the 1984 Budget is leading to a 70 per cent growth in the volume of transactions on the London Stock Exchange. But this is unlikely to bring turnover, as a proportion of total market value, into line with New York and Tokyo levels. In 1983, London turnover was 18 per cent of market value, compared with 43 per cent in Tokyo and 50 per cent in New York. For some leading UK equities, trading volume in the US now exceeds that in London.

2. The ending of 'single capacity' in October 1985 will require, as a minimum, legislation to extend to all market makers the exemption from the 1 per cent rate of stamp duty now enjoyed by jobbers. But this will not change the transaction costs faced by a buyer of shares in London. Removal of the 1 per cent stamp duty costs faced will make the City more competitive internationally and can be expected to lead to a further expansion of trading volume. It will also benefit the better second line UK companies by facilitating a more liquid market in their shares, and so making it easier for them to raise equity finance on favourable terms. Stamp duty is also a tax which discriminates against equity financing, and is thus an obstacle to the Government's objectives of promoting wider share ownership, and the availability of risk capital to companies. For the reasons given in Mr Tebbit's letter of 14 January 1985 to the Chancellor, the abolition of stamp duty on securities transactions need not involve the complete abolition of stamp duty at much greater cost.

STAMP DUTY ON TRUST DEEDS

3. Trust deeds executed in the UK by trustees on behalf of holders of bearer securities in non-sterling currencies issued in the UK are currently subject to stamp duty. To avoid this duty, London houses commonly execute abroad trust deeds for such bondholders. As well as this being an administrative burden to the London houses, it more importantly means a loss of potential invisible earnings to the UK. The duty on such deeds should be abolished.

UNIT TRUST INSTRUMENT DUTY

4. There are strong grounds for abolishing the duty. This will secure equivalence of treatment between direct investors and those investing through unit trusts. (This principle is accepted for CGT). And it will promote wider share ownership; unit trusts are particularly suitable for smaller investors. Subject to the Secretary of State making the appropriate orders, the Financial Services Bill once enacted will allow authorised unit trusts to invest beyond their current securities restriction. Instrument duty on unit trusts would place these new style trusts at a competitive disadvantage to other financial institutions operating in those extended areas. For instance, Money Market Funds would find it difficult to compete with high interest deposit accounts if 1/4 per cent of any interest was immediately lost in duty. The Revenue loss would be about £15m.

INTEREST ON CORPORATE BONDS

5. It would both enable UK companies to enjoy a wider range of funding possibilities, and enhance the City's international competitiveness, if London could evolve a short-term corporate bond market with good liquidity. This would attract investors and would offer companies the advantage of greater flexibility in the size and timing of their debt issues. Short-dated bonds may be expected to facilitate the return of companies to the fixed interest market. This development is, however, being impeded by the current requirement to pay interest net of tax. Alternative debt instruments, such as certain bank certificates of deposit and Eurobonds, are allowed to bear interest gross. Domestic corporate bonds of less than five years maturity should also be allowed to bear interest gross.

ALLOWANCE FOR TAX PURPOSES OF R AND D EXPENDITURE BY ENTERPRISE NOT YET TRADING

6. This proposal figured in DTI representations on the 1985 Budget (paragraph 12 of the paper enclosed with the letter of 20th December from the Secretary of State for Trade and Industry to the Chancellor). The objective of the change would be to enable expenditure io be incurred on research and development with the benefit of tax relief from the outset, by an enterprise established for that purpose. The R and D would have to be undertaken with a commercial application in view; but the tax relief would be granted before successful R and D enabled trading to commence, and indeed regardless of whether that point was reached. The enterprise concerned might be either a consortium or a limited partnership. It is recognised that different issues

of tax policy apply to each. It is also accepted that a limit might have to be set to the period for which tax relief could be given without trade commencing.

7. This change, which would bring UK legislation approximately into line with US law as revealed in Snow v. Commissioner (1981) has been advocated to the DTI in contacts with senior industrialists as likely to contribute to an increase in the level of civil industrial R and D in the UK. It would be likely to do so by:-

a) enabling companies to set up joint subsidiaries to conduct high risk R and D which none would be willing to take on its own balance sheet.

b) enabling companies to 'spin out' speculative R and D into separate organisations, in which key employees could have their own equity stake.

c) providing a convenient means of cooperation in R and D between companies and higher education institutions. It is the Government's policy to encourage such cooperation, and the commercial exploitation of R and D done in higher education institutions.

d) providing a vehicle for direct investment by financial institutions in R and D.

DEFINITION OF R AND D

8. The DTI representations on the 1986 Budget drew attention (para 10 of paper referred to above) to the need for a clearer definition of research than the one used for the Scientific Research Allowance and for the tax status of the Research Associations. It would help encourage civil industrial R and D if such a definition clearly covered not only 'pure' research, but the development and testing needed to demonstrate the commercial feasibility of the results of 'research'. The precise formulation would have to reflect the terminology of UK tax statutes. But the corresponding provisions of the US Internal Revenue Code, and paragraph 43 of the 'Frascati' definition of R and D used in OECD, illustrate what we have in mind.

BUSINESS EXPANSION SCHEME

a) Relax Rule Against Overseas Subsidiaries

9. It is accepted that BES relief should be available only for investment in enterprises carrying on activities wholly or mainly in the UK. But to apply this criterion, in the case of a group of companies, to each subsidiary individually, is unduly restrictive. There are cases,

particularly in high technology industry, where it has been found essential to have a US incorporated subsidiary. Such activities are at present effectively prevented from benefitting from the BES. This could be rectified by applying the test of whether the activities are 'wholly or mainly in the UK' to the group as a whole.

b) Accept shares subject to call options as eligible shares for the BES

10. Proprietors of a BES company may wish to accept equity from a BES investor subject to a right on the proprietor's side to buy the investor out once the five year period has elapsed. Such arrangements have been ruled ineligible for BES relief on the grounds that shares subject to such a call option are not beneficially owned by the investor. Provided that there is only a right on the proprietor's side to buy out the investor, and not a right on the investor's side to be bought out, the risk bearing charactor of the investment is not impaired. The existence of a call option should not rule out eligibility for BES relief in such cases.

ENTERPRISE ALLOWANCE SCHEME

11. Payments under the scheme count as taxable trading income of the recipient and are therefore subject to the special commencement rules for assessing new businesses. Consequently, scheme payments will normally be included in profits which form the basis of the first three years of assessment. In extreme cases this means that tax and Class 4 NICs can exceed the grant, while in the rest the tax and NICs can consume a lion's share of the grant. This undermines the effectiveness of the scheme in creating and sustaining new businesses. It is also leading to bad publicity for a scheme otherwise widely acknowledged as successful.

12. It is recognised that a S117lCTA 1970 election can be made to prevent multiple assessment of EAS payments. But an election means that the normal advantage to new businesses of basing the assessments for two or three years on the first year's profits (which are generally low) is lost. It is undesirable that EAS recipients should be prejudiced in this way compared to non-EAS recipients. And, since profits tend to rise sharply in the initial years of trading, a S117 election may not in fact, overall, be beneficial.

13. A solution would be to tax EAS receipts separately from trading profits, under Case VI of Schedule D.

ASSOCIATED COMPANIES - CORPORATION TAX

14. The 1982 Green Paper on Corporation Tax recognised (para 16.18) the anomalies created by the present rules for allocating the small company provisions between associated companies. Undesirable distortions are placed on business organisation as a result of the anomalies. With Corporation Tax continuing for the foreseeable future in substantially its present form, the anomalies should be tackled.

DISINCROPROATION RELIEF

15. In certain circumstances it can be desirable for businesses to disincorporate. They may have become incorporated on poor advice, their circumstances may have changed or legislative changes, including taxation, may mean that incorporation is no longer commercially sound. Whilst reliefs exist in respect of Capital Gains Tax and to allow the carry forward of trading losses when businesses become incorporated, similar reliefs do not exist for businesses disincorporating. There seems to be no good reason for this and appropriate reliefs should be introduced.

1984 SHARE OPTION SCHEME - PARTICIPATION LIMIT

16. It is accepted that there must be a limit on the maximum equity stake that a qualifying individual can have in companies referred to at para 4(1)(b) of Schedule 10 FA84. The present 10 per cent 'material interest' definition is reasonable for large companies, but it makes it difficult for small companies to offer suitably attractive remuneration packages to attract, motivate and retain key employees. A 25 per cent limit, at least for unquoted companies, is proposed.

CAPITAL TRANSFER TAX - 100 PER CENT BUSINESS PROPERTY RELIEF

17. There have been a number of useful measures introduced since 1979 to reduce the burden on business of this tax. However, it still presents difficulties, particularly at the upper end of the small firm sector. There is a disincentive to expand, shares or business assets may have to be sold to pay the tax and much time and money is absorbed in complex tax planning.

18. Two principal options exist for improving the position: 100 per cent Business Property Relief and Hold-Over Relief. The first is recommended as the better alternative. It would completely free businesses from the burden of CTT charges and planning and would not lock families into trades or cause the valuation difficulties of hold-over relief.

"COMPANY" CARS

19. The Schedule E scale benefits legislation in respect of employer provided cars and car fuel gives a strong incentive to manufacturers to market cars with cylinder capacities at or below the breakpoints of 1300cc and 1800cc. The breakpoints under the new EC vehicle emissions directive will create similar market pressures at 1400cc and 2000cc. It will be relatively easy for the major international vehicle assemblers to offer a range of four engine sizes in this central area of the volume car market. It would be much harder for Austin Rover. Their ability to compete across the range will be much greater if the tax breakpoints are aligned with the emission ones. Failure to do so could mean, in the worst cases, either Austin Rover needing to undertake increased investment of up to £46m or suffer loss of sales leading to an annual cash flow dcterioration of up to £22m - the latter is the more likely outcome, given the constraints on Austin Rover's ability to fund new programmes.

20. Ford's engine production in the UK would also be boosted by aligning the tax breakpoints with the emission ones. This is because Ford's 1300cc and 1800cc engines will be produced abroad whereas 1400cc and 2000cc ones will be produced in the UK.

21. Officials have recently submitted a paper to Inland Revenue setting out the arguments in more detail. The proposal to bring the tax breakppints into line with the emission ones is made on a revenue neutral basis. It is realised that there will be losers amongst those receiving "company" cars. But the long term benefits to the UK car manufacturing industry are believed to outweigh considerably the short term disadvantages.

22. Related to this issue it is noted that Customs and Excise issued a Consultation Document in October regarding the VAT treatment of motoring expenses. The overall package proposed is welcomed as a considerable simplification of the proposals made last year. But since scale charges are proposed for fuel benefits it will be important to ensure that, as argued for Income Tax, the breakpoints are the same as the new emission ones. The Consultation Document does not propose a commencement date for scale charges. The best option would seem to be to introduce the charges with effect from 6 April 1987, coincidental with revision of Income Tax breakpoints.

MINES AND OIL WELLS ALLOWANCES

APPLICATION OF SCIENTIFIC RESEARCH ALLOWANCE

23. (This point is raised in relation to the present definition of 'scientific research' and without prejudice to the proposal at paragraphs 10 above). At present, the Inland Revenue allow Scientific Research Allowances (SRAs) on oil exploration expenditure, provided it is not in 'mature' areas (and therefore passes the 'extension of knowledge' test at S94(1) CAA 1968). It is understood that on this basis all UK and North Sea Sector oil exploration qualifies for SRAs. But, other than in certain exceptional cases, it has been the Inland Revenue's practice not to give SRAs on UK mineral mining, on the grounds that there is no 'extension of knowledge'.

24. In the case of UK metalliferous expenditure, the distortion, for SRA purposes, between it and oil expenditure is both unsound and undesirable. Whilst in the case of non-metalliferous exploration in the UK there are likely to be grounds for arguing that there is no 'extension of knowledge' this is not the case with metalliferous expenditure. (Metalliferous ones covering barium minerals, flourspar and native metals). Knowledge of metalliferous geology in the UK is by no means comprehensive and there seems no logic in distinguishing metalliferous exploration from oil exploration in this respect.

25. The justification for giving a 100 per cent accelerated depreciation allowance for metalliferous exploration is also strong. Metalliferous mining companies are generally mobile multi-nationals and if reserves are to be found and exploited in the UK it is important that the UK tax regime be competitive with rival countries. Metalliferous exploration is a high cost high risk activity with very long lead times and the tax position is a crucial element in determining whether to explore. Countries such as Australia, Canada and the US treat exploration expenditure in effect as a revenue item; unless the UK also gives 100 per cent accelerated allowances UK metalliferous exploration is bound to be handicapped. This will mean a loss of potential exports, potential tax revenues and potential jobs - jobs in remote upland areas where they are greatly needed.

RESTORATION COSTS

26. The proposal to allow relief for restoration expenditure incurred after the cessation of trading is welcomed. But limiting qualifying expenditure to that incurred within three years of the trade ceasing is unduly restrictive. Environmental pressures against mining and quarrying projects are becoming increasingly strong, and UK

planning authorities set stringent conditions for restoration followed by after-care of worked-out sites. These processes often have to continue for much longer than the proposed three years. The Town and Country Planning (Minerals) Act 1981 itself allows planning authorities to impose after-care conditions for five years from the date of compliance with their restoration stipulations. However, the Town and Country Planning (Minerals) Act formula is open-ended and and it is appreciated that similar provisions in tax law are unlikely to be practicable. Lengthening the proposed three year period to six, though, should not present undue technical and administrative difficulties but would allow a more acceptable proportion of restoration expenditure to be relieved. Such an extension should be made.

SECOND HAND COSTS

27. The Consultation Paper proposes to bring the treatment of second hand costs of mineral deposits in the UK into line with the treatment of such costs outside the UK, by limiting the allowance for second hand costs to initial costs. The desire to simplify the treatment of second hand costs is understood, and it is appreciated that to bring the treatment of such costs outside the UK into line with the present system for second hand costs within the UK would be expensive. Nevertheless, to limit the allowance for second hand costs in the UK to initial costs would be likely to discourage the exploitation of UK mineral resources. Smaller mining entrepreneurs are often prepared to engage in exploration for metals where the risk of failure are high; and when they find a deposit they frequently need to bring in larger partners to develop it. A less favourable tax treatment of second hand costs will make such development less attractive, and so have a dampening effect on exploration activity. The present treatment of second hand costs in the UK should be retained.

Department of Trade and Industry

December 1985

CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary 25 September 1985

1986 BUDGET

The Prime Minister has seen your letter of 23 September. She is content that the Chancellor should plan provisionally on a date of 18 March for the Budget. She has noted that an announcement would not be made until the New Year.

DAVID NORGROVE

Tony Kuczys Esq
H M Treasury

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Caroline OK? David.

Cenlo

Agreed not Fine CR 24/9

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

David Norgrove Esq
10 Downing Street
LONDON SW1

2

23 September 1985

Prime Minister
This is OK for your diary. As in past recent years the Budget comes before we know the PSBR outturn, but this is probably unavoidable given the date of Easter. If we waited till after Easter (April 7) the budget would be getting too late.
DRN 24/9

Dear David

1986 BUDGET

The Chancellor has been considering the timing of next year's Budget. He has provisionally decided that the best date would be 18 March. This is feasible in terms of the Parliamentary timetable, timetable for Publications of Statistics, and diaries.

The Chancellor would be grateful for confirmation that the Prime Minister is content that we should plan provisionally on this date. An announcement would not of course be made until the New Year.

I am copying this letter to David Morris (Lord Privy Seal's Office) and Murdo Maclean (Chief Whip's Office).

Yours sincerely
Tony Kuczys

A W KUCZYS
Private Secretary

23. IX.

cc NO

NBPM
DRN
13/9

FCS/85/242

CHANCELLOR OF THE EXCHEQUER

VAT Margin Scheme on Secondhand Goods: Reasoned Opinion

1. Thank you for your letter of 4 September.

2. In view of the time factor and the arguments in your letter, I agree with the reply to the Commission which you propose. I am, however, worried by the Law Officers' opinion that this is a case we are unlikely to win, and I share their view that the cumulative impact of our defending such cases needs to be examined with a view to adopting a coherent approach, and one which will not damage our credibility with the Court. I hope that such an examination can be arranged very soon and certainly before we are irrevocably committed in this particular case.

3. I am copying this minute to the Prime Minister, colleagues in OD(E), the Lord Advocate and Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
13 September 1985

ECON POL: Budget: Pt 14

VP116

010 Budget

file now pse.

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

10 September 1985

David Norgrove Esq
10 Downing Street
London SW1

Dear David,

You asked me a couple of questions last week about the scope for income tax cuts had the Government not abolished NIS.

NIS at the full 3½ per cent inherited in 1979 would have raised £3⅓ billion from the private sector this year (about £5 billion in total: but the public sector share would not, of course, be available to finance income tax cuts). This would be sufficient to finance a basic rate cut of almost three percentage points.

There is arguably an offset from the increase in employers NIC rates since 1979. But we think this is sufficiently small (less than one-half a percentage point) not to merit any special caution.

Yours sincerely,

Phil Wynn Owen.

P WYNN OWEN
Assistant Private Secretary

10 F

AM

4 September 1985

PRESS ADVERTISEMENT: KEITH PACKAGE

The Prime Minister has seen your letter to me of 2 September. She noted the explanations and regret expressed by Customs and Excise about the advertisement of the changes to the VAT rules. She urges the need for great sensitivity in all tax matters, including of course those which fall to the Inland Revenue, as well as those which are the responsibility of Customs and Excise.

(DAVID NORGROVE)

Philip Wynn Owen, Esq.,
HM Treasury.

CCNO

DN to see
NBPM
CDP
5/9.

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

FOREIGN AND COMMONWEALTH SECRETARY

VAT MARGIN SCHEME ON SECONDHAND GOODS: REASONED OPINION

Last Summer the European Commission issued a warning letter under Article 169 of the Treaty of Rome alleging that the two most recently introduced VAT secondhand schemes, those for firearms and for horses and ponies, were in breach of the Sixth VAT Directive. This has now been followed by a Reasoned Opinion, the step before infraction proceedings are brought before the European Court. Although the matter is not in itself of wide importance, our deadline for reply is such that there is insufficient time for discussion in OD(E) in the normal way. I am therefore writing to seek your consent, and that of colleagues in the Committee, to the proposed line of our reply.

Background

2. The alleged infraction revolves around the interpretation of Article 32 of the Sixth Directive, which permits Member States to retain existing special systems for used goods pending agreement on a Community system. Our interpretation has been that this would permit new schemes to be introduced after the adoption of the Sixth Directive in 1977, provided that the basic **system** of relief (that of charging tax only on the profit margin) was not changed. The Commission did not challenge this view when the firearms scheme was introduced in December 1981, but

did so immediately the horses and ponies Order came into force in October 1983, claiming that Article 32 was a standstill provision.

3. Our legal advice was that our interpretation would be unlikely to succeed before the European Court, and in replying to the Article 169 warning letter we offered a possible compromise, a firm commitment that the UK would introduce no new schemes if proceedings were dropped. The issue of the Reasoned Opinion marks the rejection of this offer and leaves us only with the options of withdrawing the schemes or defending them against proceedings in the Court.

Analysis

4. There are practical reasons, concerned with the application of the tax, which persuaded Treasury Ministers to introduce these recent schemes in the first place; for these reasons we would be reluctant to withdraw them.

5. Although our legal argument is not likely to find favour with the European Court, there are tactical reasons for not yielding at this stage. Article 32 requires the Council to adopt "... before 31 December 1977 a Community taxation system to be applied to used goods", ie a system of general application. This has not yet been done, although the Commission has had proposals (the draft Seventh Directive) in train since 1978. The Luxembourg Presidency has progress on the Seventh Directive as one of its objectives and the Commission, in Lord Cockfield's recent White Paper on the Internal Market, has indicated a commitment to securing its adoption this year. Even if early adoption is not achieved, renewed discussion of the draft

Directive could well help us by persuading the Commission of the undesirability of pursuing one Member State over two particular schemes while at the same time pressing for a Community-wide scheme of universal application.

Line Proposed

6. We suggest that our reply should mount as robust a defence to the arguments of the Reasoned Opinion as possible. In the discussions on the draft Seventh Directive we should try to persuade the Commission to soft-pedal its proceedings, reviewing the position later in the year but with the expectation that we shall let them progress to the European Court if discussion of the Seventh Directive founders.

Timetable

7. Our already extended deadline for reply to the Commission is 6 September but informally we are seeking a few days grace through UKREP. I should therefore be grateful for very urgent comments on the line we propose.

8. I am copying this to the Prime Minister, colleagues in OD(E) and Sir Robert Armstrong.

N L

4 September 1985

LP2.68

CC/BI

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

2 September 1985

David Norgrove Esq
10 Downing Street
LONDON SW1

Prime Minister

Agree to note the explanations and regret offered by Customs and urge the need for sensitivity in all tax matters, including those which fall to the Inland Revenue?

DRN 3/9

Yes

Dear David,

PRESS ADVERTISEMENT: KEITH PACKAGE

You wrote to me on 5 August expressing the Prime Minister's concern about the Customs and Excise advertisement which appeared in the national press on 2 August.

The Keith package in this year's Finance Act represented, in total, the largest change to VAT legislation since its inception in 1973 and, mainly because of the extensive computer reprogramming which is necessary, has to be implemented in stages. The default (including late payment) surcharge, together with the reasonable excuse safeguard, you referred to in your note will not be implemented until the autumn of 1986, and the serious misdeclaration provisions, together with the reasonable excuse safeguard, will not be implemented before July 1988.

A leaflet setting out the changes effective from Royal Assent, which covers the substitution of civil remedies for criminal penalties and all rights of appeal, including reasonable excuse, will be included in traders' next VAT returns. Because these leaflets would not be received by traders before September, Customs and Excise considered it right, immediately following Royal Assent, to advertise in the national press drawing attention to the changes which would have the most immediate impact and not leave them disadvantaged for the lack of any clear communication. The changes with most immediate impact were those relating to VAT records and registration. No impression of hostility or oppressiveness towards small businesses was intended but with hindsight Customs and Excise regret that insufficient attention was paid to the presentational aspects of the advertisement and appreciate the Prime Minister's comments.

Customs and Excise have emphasised the balanced nature of the package to their own staff, together with the expectation of businesses of sympathetic consideration while they adjust to the new circumstances (see the attached extract from the instructions to VAT officers).

If it is necessary to issue a press advertisement before the implementation of default surcharge in 1986, Customs and Excise will ensure that the presentation is balanced and draws attention to the trader's rights of appeal.

Yours sincerely,

Phil Wynn Owen

P WYNN OWEN
Assistant Private Secretary

1.1 Background

In July 1980 the Government set up an independent committee of inquiry into the tax enforcement powers of Inland Revenue and Customs and Excise. The Committee was chaired by Lord Keith of Kinkel, one of the Law Lords. Other members were representative of business interests, the legal and accounting professions, tax specialists and trade unions. Officials from both of the revenue departments were seconded to act as secretaries. During the inquiry about 250 individuals and organisations gave evidence.

In March 1983 Volumes 1 and 2 of the Keith Report were published, dealing mainly with income tax and VAT powers. In July the first consultative exercise invited interested parties to comment on the recommendations of Volumes 1 and 2. In November 1984 Customs and Excise published a consultative document called "The Collection of Value Added Tax" which included draft legislation to implement the bulk of the VAT recommendations. In response to this second round of consultation the views of some 140 organisations and individuals were received and considered before amended draft legislation was published in the 1985 Finance Bill.

This book is a guide to the Keith recommendations, the resulting legislation in the 1985 Finance Act and how the changes in the law are to be applied.

The changes are the most radical since the introductions of value added tax in 1973. The package is a balanced one: officers' powers have been increased in some areas, but there are also increases in the rights of a trader in others. When you apply the new powers, you must remember that the interests of private citizens are going to be affected by your actions. You are also to bear in mind that citizens have a right to expect, not only that their affairs will be dealt with effectively and expeditiously, but that their personal feelings, no less than their rights as an individual, will be sympathetically and fairly considered.

The Keith Report commented that "tax gatherers have been unpopular throughout history". These changes in the law are not likely to alter that situation, but your attitude and approach will materially affect the level of co-operation you receive.

ECON POL: Budget: Pt 14.

File

(LO3ALE) 089

10 DOWNING STREET

From the Private Secretary

30 August 1985

Dear Rachel,

TAX REFORM GREEN PAPER

The Prime Minister and the Chancellor agreed today that it would be useful for the Prime Minister to see a draft of the Tax Reform Green paper on her return from the Middle East on 21/22 September.

Yours sincerely,

David

David Norgrove

Mrs. Rachel Lomax,
H.M. Treasury.

195/19

CARBON

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

FROM: N MONCK
DATE: 16 August 1985

cc CST
FST
MST
EST
Sir P Middleton (o/r)
Sir T Burns (o/r)
Mr Bailey
Mr Kemp
Mr Byatt
Mr Cassell
Mr Burgner
Mr Odling-Smee (o/r)
Mr Monger
Mr Spackman
Mr Wicks (o/r)
Mr Culpin
Mr Gilhooly
Mr C Riley
Mr Shaw (o/r)
Mr G White (o/r)
Ms Sinclair
Mr Folger
Ms Henderson (o/r)
Mr L Hunt
Mr Halligan
Mr H Davies
Mr Cropper
Mr Lord
PS/Inland Revenue
Mr Farmer - I/R
Mr Weeden - I/R

for Budget

PROFIT SHARING, CO-OPERATIVES, TWO-TIER WAGES AND JOBS

This submission:

(a) reports the work we have done so far on various mechanisms, operating at the level of the individual firm, which might reduce labour costs at the margin. Their attraction is, of course, the claim that by putting the pay and jobs thesis into practice they would increase employment within the nominal macro-economic policy framework; and

(b) asks you to decide whether you want further work done on one or more of them. The possible outcome might include a consultative document and legislation in the Finance Bill at least for profit sharing.

2. Despite the attractions in theory, the submission is discouraging about substantive benefits in the next two or three years, partly because of doubts about the practical scope for getting such schemes adopted on any scale. There are, however, potential presentational gains (at the expense of some risk) which you will want to consider.

3. You will want to look at this submission alongside Mr Kemp's on the Jobs Added Contribution and variants.

4. The field is a wide one and I have summarised the work we have done in the attached paper. The main bit of economic analysis of the Weitzman profit sharing payments and co-operatives is in its Annex A; it was prepared by Mr White's

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EI Division with a macro-economic input from MP. Pay, FP, IAE as well as the Inland Revenue, who produced Annex B, have all contributed.

5. I should record that several participants think for various reasons, not least the continuing strength of the existing obstacles to wage flexibility, that profit-sharing is not worth pursuing further. I certainly agree that the practical problems are great, (eg the Inland Revenue's capacity problem and the trade-off between a wastefully loose qualification for tax relief and low take-up may prove insoluble or too difficult), that the benefits of pursuing profit-sharing for employment are likely to be very small in the next two years and uncertain in scale in the longer term. But if you are attracted by the possibility of a modest, though by no means assured, presentational gain in the next year or so, I think it would be worth taking the work at least one stage further.

6. You may want to discuss this with us. It would be helpful to know whether:

(a) you want us to do further work, bringing in DE and DTI, to see whether we can produce the outline of a plausible consultative document;

(b) if so, whether you would envisage publication in the late autumn so that you would assess reactions in time to decide whether to include a tax incentive in the 1986 Budget and Finance Bill; and

(c) whether a consultative document should cover only profit-sharing and perhaps co-operatives; or whether you want two-tier pay - which I think best pursued in a very low key way - covered as well.

(d) whether you wish the Revenue to examine ways of overcoming their capacity problem (see paragraph 6(e) of the paper).

NM

N MONCK

PROFIT-SHARING, CO-OPERATIVES AND TWO-TIER WAGES

The Mechanisms

The paper is mainly about profit- (or value added) sharing by employees on lines proposed by Martin Weitzman, but also covers co-operatives and, as the Chancellor asked, two-tier wages. All these mechanisms have in common an actual or claimed potential for reducing labour costs at the margin and thus promoting wage flexibility, particularly downwards. But there is an important difference between Weitzman and two-tier wages. The Weitzman proposals involve increasing employment by lowering, at least at the outset, the remuneration* of existing employees or "insiders" as well as the "pay" offered to new employees or "outsiders". Two-tier wages by definition do not threaten the pay of insiders (unless they change jobs) and might even be accompanied by an increase. (Co-operatives may or may not do either, depending on their rules). This difference is important because the case for a fiscal incentive to insiders is much stronger for Weitzman than for two-tier bargaining. Without a fiscal incentive insiders might either reject share contracts completely or accept them only at the expense of a disastrous increase in base pay.

2. For clarity of exposition the effects of each mechanism are set out first in the rest of this note on the hypothesis that it could be introduced and spread reasonably widely. But such a hypothesis effectively wishes away unions and other obstacles to pay flexibility as well as employers' wish for a quiet life. In reality these obstacles mean that there are great difficulties and/or disadvantages in fulfilling the hypothesis of widespread introduction. In the case of profit-sharing, at least it also assumes a tax relief whose cost effectiveness would be uncertain. Different considerations would apply if only a few firms introduced such mechanisms. If they pitched their remuneration packages wrongly, they could lose labour to competitors.

II PROFIT SHARING AND CO-COPERATIVES

(i) **Characteristics and effects**

3. The economics of the Weitzman proposal are analysed in Annex A which ends with a brief summary (flag A). This analysis is not by any means the last word. Weitzman claims that profit-sharing will improve the short run adjustment process

*After the introduction of a profit-sharing contract "remuneration" would count either wholly of a share in profits or, more probably, of a combination of a profit share and a continuing conventional wage described as "base pay" in this paper.

in the labour market. Annex A argues that Weitzman ignores some disadvantages and overstates the advantages. You should be extremely wary of the illustrative numbers given in the tables at the end of Annex A. However, it suggests that if the hurdle of introduction and probable transitional costs (see paragraph 6(b) below) were crossed, Weitzman contracts could create an incentive for a profit maximising employer to increase sales volume by lowering prices and increasing employment (or at least employment hours). If employment rose, the total remuneration per hour of insiders would fall. But their after-tax income could rise, at least on certain combinations of assumptions, if a new tax relief were introduced for workers who contracted to take a significant proportion of their remuneration as share income. We envisage that the qualifying proportion might be 20 per cent. The costing in paragraph 6(f) below assumes that the tax relief would be complete exemption for 10 per cent of income from employment - roughly corresponding to a 15 per cent rate cut on the 20 per cent of share income.

4. The existence and size of this beneficial zone in which sales volume, profits, employment and post-tax remuneration could all be higher than with a fixed wage system depends on a number of assumptions including:

> the elasticity of demand for the product, the production function, the form of the new share contract and the numbers in it, and the generosity of the tax relief.

The analysis suggests that a contract linked to profit rather than value-added would be more promising. On optimistic assumptions Table 1 in the technical appendix to Annex A indicates the possibility of a 15 per cent increase in employment hours if the profit link initially were 20 per cent of total remuneration. The incentive to employers of an increase in profits is modest, amounting to only 2 per cent over the base case. Moreover, the elasticity of demand is assumed to be 3, as Weitzman assumes, whereas the elasticity implied by the pay and jobs work for the economy as a whole is more like 1. Table 2 in the technical appendix to Annex A gives figures for less optimistic assumptions about elasticity and the marginal productivity of labour. The least optimistic figures are more relevant to the economy as a whole, though they may still overstate employment gains.

5. There are other factors which would reduce the net effect of any employment benefits of Weitzman contracts:

(a) a Weitzman scheme gives employees an incentive to see that profits per head are as high as possible. It should thus encourage productivity improvements, but at the same time gives insiders an incentive to restrict, and possibly reduce, employment levels and to work overtime;

(b) the revenue cost of the tax incentive would reduce the scope for conventional cuts in income tax which would otherwise have exercised some moderating effect on pay, so helping jobs. This needs to be allowed for in estimating the net effect of the incentive.

Weitzman contracts would also inhibit investment which raises the capital:labour ratio. But in the short run this would not have much effect on employment.

(ii) Introducing share contracts

6. Annex B outlines the sort of tax relief that might be introduced as an incentive to the introduction of share contracts, and identifies some of the likely policy and practical problems. A good deal more work would be needed on this, but the following aspects are clearly important:

(a) **Definition**. Tax relief would require Inland Revenue approval of the share contract. Only employees participating in the contract who accepted the conversion of at least 20 per cent of their total remuneration in the latest completed pre-contract year into share income (linked to profits, or some measure of performance) would qualify. The requirements would be both difficult to formulate and probably lengthy, if waste and abuse were to be minimised. Individual payment-by-results systems would not qualify but systems related to group performance, probably including existing schemes (eg John Lewis), would qualify;

(b) **Employees and Unions**. It is essential to the proposal that employees would be asked to accept in advance a downside risk on total remuneration, as well as an upside potential. Unions and employees would also need to accept more employees being taken on if the employers thought it profitable to do so, even if the reduction in total gross remuneration were not fully compensated by the tax relief. There is no reason to expect unions and employees to be significantly more ready to accept the pay and jobs thesis in this form than they are at present, apart from the possible lure of the tax relief and the element of upside potential. If qualifying share contracts were not required to cover all the employees in a particular enterprise but only those willing to join, the benefit for jobs would be reduced and growing disparities of remuneration in a single workplace income could cause difficulties. Negotiators of contracts would almost certainly want to raise the base wage or impose costs on the employees in some other form in return for accepting the downside risk; and once the contract was operating, employees might seek large compensatory base wage increases if share income had fallen;

(c) **Period of operation of the tax relief**. As the effects of the scheme are speculative it might be appropriate to introduce it on an experimental basis for a period of say 3 or 5 years but a temporary scheme would be less attractive;

(d) **Employers**. The number of employers who would want to negotiate share contracts might be limited. The combination of the burden of negotiation itself, the compensating initial pay increase unions might demand, the demand elasticities they face, uncertainties about whether their employees would honour the terms of the contract or demand further Vredeling-type rights of consultation, and perhaps the relatively small potential increase in profits might deter employers from starting talks about a share contract or lead them to break them off in favour of a conventional wage deal. If this happened, the scheme might be a very damp squib. On these grounds tax relief for employers as well as employees could be advocated. But apart from the cost, this would lessen the pressure on employers to ensure that the terms on which share contracts were introduced really offered the prospect of lower employment costs.

(e) **Inland Revenue capacity**. Depending on the kind of tax relief contemplated, and the estimate of its likely popularity, Inland Revenue advise that it is most unlikely they could take on the introduction and operation of such a measure over the next two or three years. As the Chancellor is aware, this view reflects their concern about the current state of work in local offices, the need to reduce the record level of arrears and keep them under control - and, above all, the priority that must be given to the successful implementation of COP to provide staff savings and pave the way for Transferable Allowances. Staff costs would in any event seem likely to be considerable, though it has not been possible to estimate those at this stage;

(f) **Revenue cost**. It is possible to estimate the revenue cost for a given number of takers. For each one million workers covered by such contracts, the revenue cost in a full year, assuming average earnings, might be of the order of £275 million. The extent to which such costs would buy extra employment in the short-term would depend on the extent of initial compensation achieved by unions: this might raise labour costs sufficiently to offset much of the potential jobs gain. In the longer-term, however, this initial disadvantage would wear off.

Co-operatives

7. The paper at Annex A suggests that conventional co-operatives would contribute less to expanding employment, though they probably would help to preserve existing jobs by reducing remuneration involuntarily or voluntarily. It is possible, however, that the tax relief might lead to the creation of co-operatives with Weitzman-type rules; if so, the gain to employment would be the same as for ordinary companies.

8. The definition of qualifying contracts could in practice exclude a good many existing co-operatives by setting a minimum number of members above the average of nine.

III TWO-TIER WAGE BARGAINING

(i) Characteristics and effects

9. Mr Gilhooly's submission of 29 July described the main features of two-tier pay and the little we know of it in the US and here. Outsiders, often but not exclusively young workers, are taken on at lower rates than existing insiders. This should help the unemployed to find employment. But a formal scheme could damage the labour market by inhibiting job changes unless some way could be found of allowing insiders in a firm to switch to another on insider rates of pay. This would be complicated. We have asked the Department of Employment to assemble more information on two-tier bargaining in the US and its effectiveness as quickly as they can.

(ii) Introducing and extending two-tier pay

10. Mr Gilhooly's note argues that it would be worth considering:

(a) trying to get management organisations and individual employers in the private sector interested in a low key way;

(b) proposing two-tier pay in the public sector, including the public services;

(c) exploring two-tier pay in NEDC.

He pointed out that (c) risks outright condemnation by the TUC on the grounds that two-tier pay undermines the rate for the job principle.

11. You asked us to consider tax reliefs or grants as a further means of encouraging two-tier pay. There are two reasons for thinking this much less

appropriate than in the case of profit sharing contracts:

(a) although in practice insiders may object to two-tier pay on rate for the job grounds, they are not themselves, as in Weitzman, being asked to accept a downside risk, unless they change jobs. Employers also have a direct incentive to negotiate two-tier pay wherever they can do so. It is not clear to whom an incentive should be paid;

(b) an incentive provided by the Government would entail a high profile for two-tier arrangements because there would have to be rules and procedures for getting hold of the incentive. Among other things these would have to specify some gap between the remuneration of insiders and outsiders. Except in areas where unions are very weak, employers would probably have to negotiate two-tier arrangements formally with the unions. This process might either set back the spread of two-tier pay or raise the cost to the Government of achieving what could have been done anyway.

12. If, nevertheless, the Chancellor favoured an incentive, it would no doubt be possible to devise one. Three possible groups might receive a subsidy: employers; insider employees; and outsider employees.

13. If employers got the subsidy, the scheme would be like Professor Layard's marginal employment subsidy (MES). Because of high dead weight, such schemes have normally scored very badly on cost-effectiveness. The net Exchequer cost per net job or per person off the unemployment count would be about £5,000 or £15,000 respectively if, as DE currently assume, the subsidy to the employer was £80 a week. This would still compare pretty badly with Exchequer costs of the order of £2,000 a year per person off the count for the cheaper Special Employment Measures, though the extra jobs induced might have a better prospect of lasting.

14. It is unlikely for several reasons that the cost per job figures would be improved by imposing the two-tier wage restriction. Indeed, they could well rise primarily because wages for insiders may well be increased as part of negotiations about a lower wage for new recruits. In addition the imposition of the second-tier wage as a condition for subsidised recruitment may increase substitution by employers of new employees for existing workers. Because of the relative average age of new recruits compared with existing workers, there is already, in practice often a differential in terms of earnings and labour costs. Second-tier wages for newly hired workers would result in lower revenue flowbacks under an MES.

15. Giving the subsidy to outsiders might in principle be the least hard to defend and would also help to blunt the unemployment trap. But this would presumably provoke even stronger opposition from insiders than there would be anyway. If insiders got it as well, the purpose would be to overcome their resistance on rate for the job grounds rather than to compensate them for a downside risk; it would, of course, greatly increase the cost.

IV PROVISIONAL ASSESSMENT AND POSSIBLE NEXT STEPS

16. The attraction of all these schemes is as a way round the obstacles to straightforward downward pay flexibility in the interests of getting more jobs in a non-accommodating macro-economic policy framework. Those obstacles would, however, still be there and are likely to restrict the extent to which any of these devices could be introduced and produce useful job effects in the next two years or so. They are not going to change the world in that period even with a fiscal incentive.

17. However, although the job benefits are at best likely to be much smaller than Weitzman suggests, there is in principle a clear case for such an incentive to employees for profit-sharing: and an extension of two-tier bargaining would also help employment, though in this case a low-key approach seems much more promising than any formal public initiative or incentive or even Government backing outside some of its own negotiations. To these arguments about merits might be added a presentational case for pursuing profit-sharing in a public way. The two year exemption from employment protection rights has been extended from small employers to all employers and Ministers collectively have decided on reform rather than abolition of the wages councils. There is now no obvious statutory change in the institutional structure of the labour market which would advance the pay and jobs thesis. Without some initiative on profit-sharing (or along JAC lines) the Government will probably have nothing better than exhortation to fall back on in defending the unemployment figures over coming months.

18. The Chancellor will want to consider initiating public discussion of profit sharing schemes of the Weitzman type, combined with a tax incentive. The presentation would have to be fairly low key. There are risks, and employers might not be greatly attracted, let alone employees. But testing reactions may be better than doing nothing. The case for the incentive also has the positive virtue of highlighting the connection between the attitudes of the employed and helping the unemployed which we tried with meagre success to get across in the NEDC jobs debate.

19. If the Chancellor were attracted by this, it would be natural to have in mind a consultative document. If the response was negative, the proposals could be dropped without too much loss of face provided the presentation had been low key. If the response was positive and the practical problems proved soluble, legislation in the 1986 Finance Bill could be announced in the Budget. This would imply a consultative document in the late autumn. One difficulty in producing a plausible document would be the balance between presenting share contracts as a way of increasing jobs and, more traditionally, as a way of getting employees involved in high productivity. It may be difficult to ride both horses without exposing the conflict implied in paragraph 5(a) above. The immediate next step for us would be to complete the work on the analysis and practicalities which we have started and to consult DE and DTI about it. It would be premature to reach a view at this stage on anything more than the next steps outlined at the end of the covering minute.

ANNEX A Economic Analysis by EI of Weitzman Share Contracts and Co-operatives

Annex B Note by the Inland Revenue on a Weitzman Tax Relief.

16 August 1985

ANNEX A

ALTERNATIVE LABOUR REMUNERATION SYSTEMS

A. Weitzman's propositions

1. In a recent book (The Share Economy) Weitzman* has proposed an approach to compensation payments for labour which would mean that there was less tendency for a producer to shed labour and reduce output in response to any given shock. The short term response of business to an external shock would on the proposed approach tend to be to hold the quantity of labour and output at its full employment level, whilst taking the adjustment on price in both product and factor markets. This paper gives our preliminary analysis.

2. This desirable state of affairs is said to be brought about by changing the compensation payments to labour from a wage system to one based on some share of business income. At the heart of Weitzman's argument for this change is his view that it will transform the incentives of the employers to employ more workers. As long as each worker must be paid a given money wage, the employers will take on workers only to the point at which the extra worker increases the value of the firm's net output by at least as much as the extra worker's wage. But if the workers as a whole are paid 80 per cent of the value of the firm's net output, the employer will receive 20 per cent of whatever is produced. So, assuming profit maximisation, an additional worker will be taken on as long as he or she adds <u>anything</u> to the value of the firm's net output, or until the employers can find no more unemployed workers to employ.

3. An economy in which firms had a pure share payment system would be one in which there was excess demand for labour. In Weitzman's analogy, firms would "cruise around like vacuum cleaners on wheels, searching in nooks and crannies for extra workers to suck in at existing compensation parameter values."

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* M L WEITZMAN The Share Economy (1985)

4. The share system proposed by Weitzman, will tend to imply short-run flexibility in compensation payments but it cannot escape longer term tendencies to equilibrium which may involve adjustment to the compensation coefficient (eg the 80 per cent referred to in paragraph 2). He argues that in the long run all labour remuneration systems converge to the same equilibrium, but under fixed wages the adjustment mechanism is through quantities rather than prices.

B. Weitzman's assumptions

5. The propositions advanced by Weitzman (much more formally in the EJ article than in the book or as summarised above) are based on a number of assumptions*. In the first place, the typical firm is assumed, in the jargon, to be monopolistically competitive. In other words, there are a large number of such firms with relatively free entry into and exit from the industry, but each firm sells a product which is somewhat different from other products in the same market. Hence, each firm faces a downward sloping demand curve - a rise in price will lose it some but not all business to competitors. Demand is further assumed to be sufficiently elastic so that a cut in price allows sales to increase to such an extent that the firm's total revenues increase. However, the extent of any employment generating effects will depend upon the production and market conditions the firm faces.

6. Secondly, Weitzman treats labour as a uniform, homogeneous and freely substitutable factor of production. On the face of it, this seems unrealistic, but it is no more so than many other theoretical expositions about the operation of labour markets. However Weitzman goes further and assumes that even a firm with a fixed capital stock may add to its labour force without diminishing the output per man.

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* M L WEITZMAN (1983) Some Macroeconomic Implications of Alternative Compensation Systems. EJ: Pp 763-783

7. Thirdly, a share economy is assumed to be one where a significant proportion of firms use share compensation systems. Weitzman concedes that a share system would not have all the virtues claimed for it where only a small minority of firms had such compensation procedures since the firm operating the share system would tend to lose workers to the firms remaining on the fixed wage system. Indeed, since an individual firm and its workers do not consider the externalities (the macroeconomic benefits) of the compensation system they adopt, Weitzman argues that there may be an interventionist role for government in encouraging the adoption of share systems by tax incentives. These incentives should thus attempt to bring about a critical mass of profit sharing firms, however, perhaps the best that could be done in practice is to introduce a permissive regime encouraging the adoption of share systems.

8. Fourthly, Weitzman assumes that the compensation parameter (the 80 per cent referred to in paragraph 2) is sticky over the short-run and certainly stickier than the firm's decision to hire or fire labour. He does envisage the parameter forming part of the annual wage negotiation.

C. **Comments**

9. There have been a number of academic comments on the Weitzman propositions but no-one seems to have systematically taken them apart. The following comments seem relevant and taken together suggest caution in claiming too much for the Weitzman arguments.

(a) The nature of the product market

10. The assumption that the typical firm is monopolistically competitive does not seem unreasonable. Weitzman interprets this product market condition to mean that firms are "eager to find new customers and to sell more output at existing

prices without limit". For this to be so the firm must be able to produce additional output at a unit cost less than the cost of existing output. The thrust of Weitzman's work is to transform the labour cost structure facing the firm to make this so.

11. Weitzman's analysis is at the level of the individual firm, and while the firm's demand may be fairly elastic, total demand in the economy is much less. It follows from this that the share firm's expansion will tend to be restricted by competition from other share firms, or offset by falls in output and employment in fixed-wage competitors who have been undercut. So that the aggregate effect on employment could be somewhat smaller.

(b) Labour market conditions

12. The assumption of homogeneous and freely substitutable labour is unrealistic, but is widely used in economic analysis to simplify problems. However the assumption seems particularly critical in this case when the only constraint on the vacuum cleaner's cruising is full employment. Constraints on substitution between skilled and unskilled labour are unavoidable, at least in the short-run, and bottlenecks in skilled labour supply may be encountered before full employment is achieved.

13. The assumption of contant returns to labour (paragraph 6) is equally unrealistic and certainly is not standard economic practice. Changing the assumption will not affect the incentive to employers to take on more labour provided it adds something to output, however little. Labour remuneration per head is, however, reduced when employment increases, which means that existing employees are given an incentive to resist any increase.

14. In the labour market envisaged by Weitzman, the suppliers of labour are assumed not to act collectively to ration jobs, although this might seem an obvious response

to an employer eager to take on more employees and by so doing depress the average levels of compensation. More generally, all impediments to the expansion of employment, including hiring and training costs and capacity constraints tend to be assumed away. Impediments to the firing of labour are not relevant in Weitzman's share economy because he considers the situation of redundancy to be unnecessary.

15. The shift to a share economy may raise the degree of uncertainty on the part of suppliers of labour as to the total remuneration they will receive but on the other hand the risk of unemployment may be diminished for a given real wage. The total effect of this on labour supply is therefore ambiguous. In any event, since firms are more likely to adjust to external shocks in a share economy through prices rather than quantities, there may be some offsetting incentive for firms to invest more in training as well as for them to take on more labour.

(c) <u>Disincentives to Capital-Investment</u>

16. If it is assumed that firms are managed in the interests of the existing owners of the capital invested in them, then there would be reduced incentive to contemplate new capital investment. A proportion of the value added of any new capital equipment would accrue to the workers automatically, given a sticky compensation share parameter (the 80 per cent of paragraph 2). Unless managers could rely on negotiating downward flexibility of the share allocated to wages, capital investment projects would be discouraged relative to the position prevailing in a pure wage economy, though in practice productivity improvements may partly be shared even in that case. However, this difficulty would only arise in the context of substituting capital for labour. In the present context with the need to substitute labour for capital rather than the reverse this may not be too much of a problem.

(d) <u>Macro-economic Implications</u>

17. Weitzman claims that profit sharing itself will not alter the state of the economy in the long run. But it will alter the speed with which the economy approaches equilibrium and reduce the extent to which employment varies in response to shocks hitting the economy. It does this by providing a mechanism for wages to adjust more quickly to the market clearing level. Among the implications of this, taken at face value, are:

(i) inflation is not affected in the long run. It is determined essentially by monetary and fiscal policies via the growth of nominal demand.

(ii) the level of unemployment which is consistent with stable inflation (the NAIRU), to which the economy tends in the long run, is not affected. Thus the scope for profit sharing to help in reducing unemployment depends on where the NAIRU is.

(iii) if the economy is some way above the NAIRU, profit sharing will enable it to be achieved more quickly, and it will do so without any long term adverse effect on inflation.

(iv) cyclical variations in unemployment will be reduced in scale. Adjustments will be concentrated more on real wages - prices rather than quantities - which will fall in cyclical downturns as profits fall, and <u>vice versa</u> in upturns, partially reversing the cyclical pattern that is normal in a fixed wage system.

18. While (i) and (iv) can probably be accepted, the other two conclusions are in practice subject to doubt. It is quite likely, for example, that profit sharing <u>will</u> alter the long run equilibrium of the economy. It may

well lead to increased demand for labour at any given level of real wages, so that in the long run the economy is likely to run with some combination of higher real wages, higher employment and higher output. The more responsive is the labour supply to changes in real wages, the more likely is employment to be higher - and the NAIRU lower - in the long run.

19. Another feature of profit sharing is that it provides workers with a stronger incentive to improve working practices and increase producitivty, and hence profit per head, since this will lead directly to higher wages. This, may not increase employment much if at all in the long run equilibrium, but it is likely to raise output and real wages. On the other hand to the extent that some investment is inhibited there may be an offset to this effect.

20. Much of Weitzman's analysis about the comparative properties of profit sharing and wage systems assumes that the systems are already in place. This may not affect the longer run analysis, but it clearly does affect the dynamics of behaviour in the short run. The transition from a wage system to a profit sharing system will itself have short run effects which need to be taken into account in assessing the conclusion (iii) that the economy will move more quickly to the NAIRU without adding to inflation.

21. Factors which need to be taken into account in assessing the short term effects include the following:

(a) the level of wages agreed _ex ante_ at the initiation of share contracts. This could be _higher_ than the intial level of wages if Trades Unions perceive that share schemes will tend to drive average wages down, given the sort of publicity Weitzman's ideas have already received, this seems quite likely.

(b) the effects of the (temporary) tax incentives in relation to other ways of spending any given fiscal adjustment. The tax incentives may reduce the scale of ex ante upward pressure on wages noted at (a), and may even reverse it. But this effect may not be much greater than for a straightfoward cut in income taxation.

(c) the effects of increased productivity induced by profit sharing. This would tend to reduce the scale of short term benefits to employment, and could in principle even lead to a temporary net shedding of labour.

E. Empirical testing of Weitzman's propositions

22. Weitzman asserts that "Japan offers a living laboratory" for many of his ideas and that it "displays all the broad tendencies predicted by the theory". In a recent working paper* from the Centre for Labour Economics, Wadhwani examines the validity of these assertions.

23. Wadhwani concludes that bonus payments (which in the late 1970's comprised about 20% of total earnings) do respond to corporate profitability. However there is little evidence that this leads to the predicted "broad tendencies". The predicted high levels of labour utilisation in Japan cannot be inferred from the low Japanese unemployment rate. This is because the policy of life-time employment, the existence of large numbers of temporary workers, agricultural and other self-employed persons, and the presence of many unpaid family workers in the labour force, all tend to disguise the level of labour under-utilisation in times of slump. This cyclical under-utilisation is high-lighted by Wadhwani's finding that Japan's record of cyclical variability in output is not noticeably better than other economies. This conflicts with Weitzman's predicted output stability.

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* S WADHWANI (1985) The Macroeconomics of Profit-Sharing: Some Empirical Evidence.

CLE Working Paper No. 732 L.S.E.

24. On inflation Wadwhani's evidence is no kinder. According to Weitzman's model profit-sharing should reduce wage inflation and import-price inflation, and increase monetary growth. An examination of Japanese trends pre-war (when profit-sharing was less pronounced) and post-war shows the differences to be the opposite of those predicted.

F. Theoretical testing of Weitzman's propositions

25. In his book Weitzman suggests two possible alternatives for his share system. In both any change to earnings as a result of employment changes is shared by all employees not just new entrants. The first is a pure share-system in which all earnings are related to some measure of firm performance. Different terms are used by Weitzman for this performance measure. Weitzman's terminology is vague because he considers that the employment generating properties of his model are not dependent on the company performance measure chosen. However, he seems to have in mind some measure of value-added (ie gross revenue less materials, components etc costs). At the risk of perpetuating confusion, in what follows this measure will be referred to as revenue.

26. Analysis shows that the employment generating potential of a pure share system is limited only by demand for output. Regardless of the firm's production function employment will increase as long as new output increases total revenue. In practice such a system would be difficult to introduce, and would be restricted by the benefit floor, which constitutes a "minimum wage".

27. The alternative share-system considered by Weitzman is a hybrid system in which earnings are made up of a base wage and a share component. Two possible forms of this hybrid system are considered here, both of which have a component of earnings as a base wage in which the share component is related either to revenue or to revenue less the base wage.

28. The hybrid share systems will at the outset have to be negotiated and this will determine the <u>initial</u> proportion of earnings represented by the base wage and the share component. Over time as the firm adjusts its employment this proportion will change. While under the pure-share system the cost of hiring the last unit of labour is zero, with a base wage this is not so. A "cut-off point" is introduced. When the value of output produced by that last unit falls below the cut-off point the firm will not hire more labour. Under the shared-profit system the cut-off point is equal to the base wage itself; under the shared-revenue approach it is somewhat higher. The shared-profit system may therefore be a better option than shared-revenue, though the higher gearing of wages to revenue involved may in practice mean that a higher base wage would be demanded.

29. As an indication of the kind of results which might be obtained: with a base wage set at 80% of the original fixed wage, the shared-revenue system would raise the optimal labour force for an individual firm by between 3% and 5% under a range of plausible assumptions about the elasticity of demand and the production function. Under the same assumptions the effects of a shared-profit system could be between 4% and 15%. A base wage of 90% roughly halves these increases, while at 50% the increases would be higher. The details of the calculations are set out in the technical appendix.

30. Such employment increases could also be obtained by reducing wages in a fixed wage system. The advantage of the share systems is that they allow similar increases in employment with smaller reductions in labour remuneration. But our analysis suggests that if workers participating in share schemes were exempt from tax on 10% of their total income, this would be sufficient to prevent any fall in take-home pay even for cases where employment increased by, say, 10%.

31. But it must be stressed that the numbers above should be treated with great caution and almost certainly overstate the overall effects. First, the analysis has been conducted for an individual firm, thus ignoring any economy wide effects. Some of the employment increases would be at the expense of the other firms. Even if all firms were operating in similar fashion, the increases in demand (and thus employment) generated by wage and price reductions would be greatly reduced as competitors cut prices in line. Effects for the economy as a whole would be proportionately much smaller. Second, they ignore the possibility of wages being set initially at a higher level than prevailed previously and ignore any tendency for contracts to be renegotiated. Third the effect of productivity changes which are likely to occur given the increased interest the workers have in the profits of the firm, have been ignored. The possible increase in productivity could at least in the short run, offset the increases in employment and loss in pre tax earnings. Finally, the likely increases in material and capital costs as output and employment rise have been ignored, thus the possible employment generating effects would tend to be reduced.

G. Meade's discriminating labour-capital partnerships

32. Another share system is the 'Discriminating Labour-Capital Partnerships' proposed by Meade*. This proposed system avoids the possible disincentives for capital investment, while preserving the effects of the Weitzman proposals on the level and stability of employment.

33. Meade proposes that two types of 'share certifiates' should be issued.

(a) Capital Share Certificates. Issued to all people receiving directly or indirectly through profits, interest, rent etc. in proportion to their existing income from the business. These Certificates could be traded as thus transferable from one owner to another.

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* J MEADE Discriminating Labour-Capital Partnerships. Paper given at CLE, LSE on 3 May 1985.

(b) Labour Share Certificates. Issued to all employees in proportion to their existing earnings from the business. Unlike the Capital Share Certificates the Labour Share Certificates are not transferable, but tied to the individual employee and cancelled when the employee quites or retires. However, these Certificates would <u>not</u> be cancelled if the employee leaves the firm involuntarily. Therefore, the employee is guaranteed his share of income/employment until retirement.

34. The result of this is that both capitalists and workers receive the same income as before the issue, but everyone concerned would be able to share in the success or failure of the business. Thus decisions about capital investment would be taken jointly with resultant action only if it is advantageous to both types of shareholders. Therefore, the problem of sticky share parameters on investment incentives are avoided in Meade's model. The issue of additional Capital Share Certificates to finance capital investment automatically results in the appropriate increase in the share of revenue accruing to capital.

35. A different feature of Meade's proposals is that the 'equal pay for equal work' idea, embodied in a wage and Weitzman share system, is rejected. Since any additional worker reduces the marginal revenue product, he or she is paid a fixed wage or expected dividened on newly issued Labour Share Certificates related to this lower marginal reenue product. Thus, whenever a new worker is employed all existing capital-labour partners would be better off - thus encouraging the employment of new workers. The apparent unfairness of the 'unequal pay for equal work' idea, will according to Meade, disappear over time, as the new hands become old hands and enjoy the privileges of the 'insiders'.

36. Although the idea of labour-capital partnerships does offer a way rouund the investment disincentives of a pure

share system, it is rather cumbersome. For example, the idea to weight the number of votes to which each Share Certificate is entitled by some formula which measured the present value of the interest which each shareholder had in the fortunes of the firm, would be extremely difficult to apply in practice. [This idea is suggested because of the problem of workers close to retirement voting on a long-term investment project; for example]. In addition as Meade himself suggests, a labour-capital partnership could only work in an atmosphere of mutual trust in which the partners wished to make the partnership work, a situation which may not be easily obtainable.

H. Cooperatives & Employment

37. In the conventional view cooperatives differ from the share-income proposals because they aim to maximise average labour remuneration, rather than total profit. Hence the optimal labour force of a cooperative is reached when the value added to production by the last member (the Value of the Marginal Product, or VMP) equals existing earnings per head, while the entrepreneurial firm equates VMP and wage rate.

38. Faced with a fall in demand for output the entrepreneurial firm sheds labour since VMP is now lower than the wage rate. In the cooperative average earnings also fall at least as much as VMP, and the cooperative has no incentie to shed labour. It may even have an incentive to increase membership.

39. A rise in demand reverses this effect: the cooperative may now have an incentive to shed labour. Two things follow from this. Firstly, a cooperative will tend to react to changes in demand with price changes while the entrepreneurial firm tends to adjust both. Secondly employment in a cooperative economy would tend to be static except where cooperatives are formed or dissolved.

40. Hence faced with unemployment the need to create new business is greater in a cooperative economy than in an entrepreneurial economy. Although it has been argued that new cooperatives would be more easily established than new entrepreneuiral firms since lenders of capital would be attracted by the absence of a fixed wage bill. Against this must be set the probable lack of security and management expertise, and the organisational problems of forming a new cooperative by joint decision compared with the ability of the entrepreneur to act on opportunities as they arise.

I. Conclusions

41. Cooperatives do not offer the employment-generating advantages of Weitzman's proposals and should not be considered with them.

42. A pure-share system, even with a minimum wage provided this is not set too high, produces the greatest incentive for employers to increase employment (with the lowest remuneration) in the short run. However such a system may be difficult to introduce.

43. Hybrid systems which incorporate a basic wage as well as a share of revenue or profit, could produce short run increases in employment for individual firms. This increase would be larger:

(a) the more elastic the demand for output

(b) the less marginal product falls as labour is increased

(c) the lower the basic wage.

44. For any given basic wage a shared-profit system may generate more employment in the short run than a shared-revenue system.

45. In a share economy the objectives of workers and management still diverge: workers have an interest in raising the basic wage and in restricting employment, whereas managements interest is in reducing the basic wage and increasing employment.

46. An examination of Weitzman's theory, and the little empirical testing that has been carried out of its predicted effects, suggest that the more extravagant claims that profit-sharing "eliminates the worst features of stagflation" should be treated with due caution, if not scepticism. There seems in particular to be insufficient regard given to capacity constraints (skilled labour), the effects on capital-labour substitution, and wage pressure as full employment is approached. Nevertheless, although Weitzman's vacuum cleaner's cruising may be more limited than he claims, the point remains that the stronger link between prices and wages brought about by profit-sharing does seem likely to make the adjustment process to shocks more concentrated on prices than quantities. As such it seems likely to reduce cyclical fluctuations in employment. But it would be wrong to imagine that substantial gains to employment in the short term, following the introduction of share contracts would be guaranteed. They could be smaller or even, under not implausible assumptions about productivity, negative.

47. Finally, a drawback with the Weitzman proposals is the possible disincentive effects on capital investment. But this is only likely to be a serious problem for labour-saving investment, which anyway may not be particularly desirable in current circumstances. Meade, offers a way round the problem with his proposed discriminating labour-capital partnerships, but this proposal does involve rather cumbersome arrangements relying on the mutual trust between both parties.

PROFIT SHARING: A TECHNICAL APPENDIX

This appendix sets out the derivation of the "cut-off points" which are the central feature of the theoretical assessment in Section E of the main paper. Analysis starts from Weitzman's initial position of MRP = $24/hr and a labour force of 500,000 hours. Table 1 displays the preliminary results obtained with an elasticity assumed to be -3, and labour exponent* of 0.5 a "favourable" case. Table 2 contains comparative results for two sets of assumptions, one, an intermediate case with elasticity -2 and labour exponent 0.5 and an "unfavourable" case (-1.5,0.2). Figure 1 graphs MRP against labour under these assumptions.

* The labour exponent reflects the change in marginal product as labour is increased. The higher the exponent the less MP declines, a value of 1 produces constant MP, 0 produces zero MP.

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TABLE 1

CALCULATIONS UNDER FAVOURABLE ASSUMPTIONS[1]

	Base Wage as % of original wage	Base Wage $/hr	Equilibrium Share income component $/hr	Total labour Remuneration $/hr	Post-tax[2] Labour Remuneration $/hr	Cut-off point $/hr	Equilibrium labour force 1,000 hours	% increase in hours over $24 fixed wage	Profits $m	% increase in profits over $24 fixed wage
1 Fixed Wage	100	24	0	24	16.80	24.00	500.0	0.0	6.00	-
	75	18	0	18	12.60	18.00	595.6	19.0	9.27	54.5
	50	12	0	12	8.40	12.00	720.0	44.0	13.20	120.0
2/3 Pure share[3] of 66.67%; "minimum wage" of $16/hr		-	16.00	16.00	11.68	3.13	991.58	98.3	7.93	32.2
4 Shared Revenue	95	22.80	1.19	23.99	17.51	23.59	505.7	1.1	6.00	-
	90	21.60	2.38	23.98	17.51	23.14	512.2	2.4	6.01	0.2
	80	19.20	4.71	23.91	17.45	22.15	526.7	5.3	6.02	0.3
	50	12.00	11.91	23.19	16.93	18.00	595.0	19.0	6.18	3.0
	20	4.80	15.60	20.40	14.59	10.29	762.9	52.6	6.75	12.5
5 Shared Profit	95	22.80	1.16	23.96	17.49	22.80	517.1	3.4	6.01	0.1
	90 ~~80~~	21.60	2.26	23.86	17.42	21.60	535.1	7.0	6.03	0.3
	80	19.20	4.27	23.47	17.13	19.20	574.0	14.8	6.12	2.0
	50	12.00	9.17	21.17	15.45	12.00	720.0	44.0	6.60	10.0
	20	4.80	12.64	17.44	12.73	4.80	929.8	86.0	7.34	22.3

Notes: 1. Elasticity =-3 (following weitzman), labour production exponent = 0.5.

2. Assuming the whole fixed wage is taxed at 30%, and that 10% of the total remuneration of share systems is tax-exempt, the remainder taxed at 30%.

3. Being the share giving an initial labour remuneration of $24/hr.

TABLE 2

CALCULATIONS UNDER LESS FAVOURABLE ASSUMPTIONS

	Base Wage as % of original wage	Base Wage $/hr	Equilibrium Share income component $/hr	Total Labour Remuneration $/hr	Post-tax[2] Labour Remuneration $/hr	Cut-off point $/hr	Equilibrium Labour force 1,000 hours	% increase in hours over £24 fixed wage	Profits $m	% increase in profits over £24 fixed wage
A. UNDER INTERMEDIATE ASSUMPTIONS: ELASTICITY OF DEMAND = -2, LABOUR PRODUCTION EXPONENT = 0.5										
1 Fixed wage of $24/hr		24.00		24.00	16.80	24.00	500.00	-	12.00	-
2/3 Pure share of[1] 50% + "minimum wage" of $16/hr	-	0	17.28	17.28	12.61	0	781.25	56.25	13.50	12.5
4	90	21.60	2.37	23.97	17.50	22.74	510.67	2.13	12.01	0.1
shared	90	19.20	4.69	23.89	17.44	21.33	523.02	4.60	12.03	0.3
Revenue	50	12.00	11.09	23.09	16.86	16.00	573.98	14.80	12.21	1.8
5	90	21.60	2.31	23.91	17.45	21.60	520.62	4.12	12.02	0.2
Share	80	19.20	4.45	23.65	17.27	19.20	542.53	8.51	12.08	0.7
Profit	50	12.00	10.08	22.08	16.12	12.00	617.28	23.46	12.44	3.7
B. UNDER UNFAVOURABLE ASSUMPTIONS: ELASTICITY OF DEMAND = -3, LABOUR PRODUCTION EXPONENT = 0.2										
1 Fixed Wage		24.00	0	24.00	16.80	24.00	500.00	-	24.00	-
2/3 Pure share of[1] 33.33% + "minimum wage" of $16/hr	-	19.59	19.59	19.59	14.30	0	638.14	27.63	25.00	4.2
4	90	21.60	2.38	23.98	17.50	22.34	507.33	1.47	24.01	0.0
Shared	80	19.20	4.70	23.90	17.45	20.57	515.42	3.08	24.02	0.1
Revenue	50	12.00	11.25	23.25	16.98	14.40	546.13	9.23	36.88	53.7
5	90	21.60	2.35	23.95	17.48	21.60	510.67	2.13	24.01	0.0
Shared	80	19.20	4.61	23.81	17.38	19.20	521.89	4.38	24.05	0.2
Revenue	50	12.00	10.85	22.85	16.68	12.00	559.27	11.85	24.27	1.1

Notes: 1. Being the share giving an initial labour remunderation of $24/hr

2. Assuming the whole fixed wage is taxed at 30%, and that 10% of the total remuneration of share system is tax-exempt, the remainder taxed at 30%.

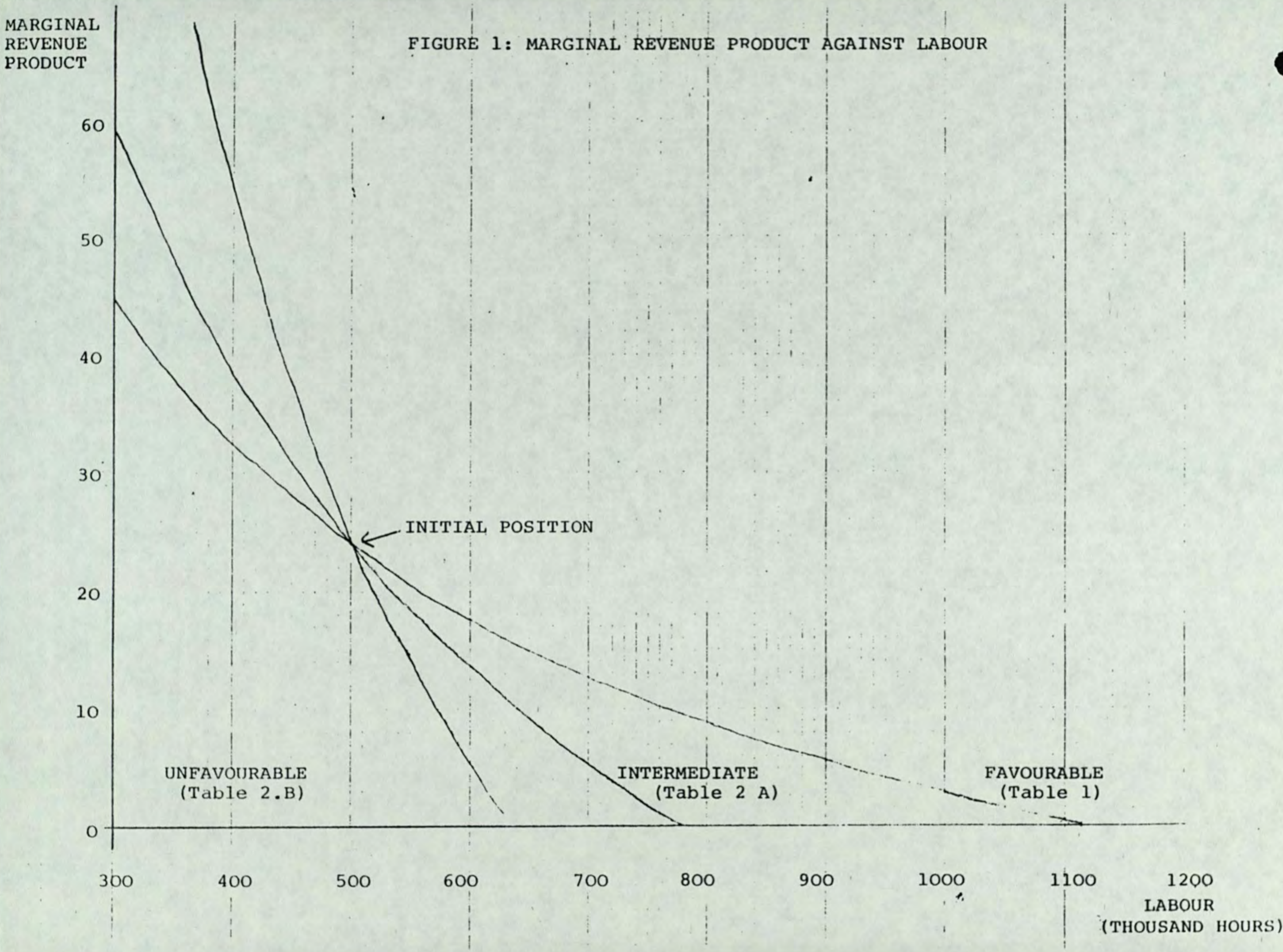

FIGURE 1: MARGINAL REVENUE PRODUCT AGAINST LABOUR
MARGINAL REVENUE PRODUCT
60
50
40
30
20
10
0
INITIAL POSITION
UNFAVOURABLE (Table 2.B)
INTERMEDIATE (Table 2 A)
FAVOURABLE (Table 1)
300
400
500
600
700
800
900
1000
1100
1200
LABOUR (THOUSAND HOURS)

THE REMUNERATION SYSTEMS

A1. W = earnings per employee

BW = base wage = λ Wo, where Wo = W under fixed wage system and λ = propotion of Wo used to set BW

R = total revenue

L = quantity of labour

r = R/L

k = proportion of r or profit recieved by labour, determined by the requirement that initial renumeration equal Wo

π = profits before deduction of fixed costs

All five system are variants of two basic models:

(i) W = BW + kr (shared revenue approach)

(ii) W = BW + k (r - BW) (shared profit approach)

A2. A company using the shared revenue approach (A1(i)) would maximise the following profit function:

$$\pi = R - BWL - (k\ r)\ L$$
$$= (1 - k)\ R - BWL$$

At a maximum $\frac{d\pi}{dL} = (1 - k)\frac{dR}{dL} - BW = 0$

$$\therefore \quad \frac{dR}{dL} = \frac{BW}{1-k} \qquad (1)$$

ie the marginal revenue product (LHS) is equal to the base wage divided by one minus the share parameter (RHS).

A3. Weitzman's pure share approach is a special case of equation (i) where BW = 0

$$\text{ie } \frac{dR}{dL} = 0 \qquad (2)$$

A4. The fixed wage system is a special case of equation (1) where BW = Wo and k = 0.

$$\text{ie } \frac{dR}{dL} = Wo \qquad (3)$$

A5. The pure shre/minimum wage system is a special case where $\frac{dR}{dL} \geqslant W_m$

W_m = minimum wage

if the constraint is operative: $\frac{dR}{dL} = W_m$ (4)

If inoperative the model behaves as the pure share approach.

A6. A company using (A1 (ii)) would maximise the following profit function:

$$\pi = R - \left[BW - k\ (r - BW)\ \ L \right]$$
$$= (1 - k)\ (R - BWL)$$

At a maximum $\frac{d\pi}{dL} = (1 - k) \cdot \left(\frac{dR}{dL} - BW\right) = 0$

$$\therefore \quad \frac{dR}{dL} = BW \qquad (5)$$

A7. Equations (1) to (5) define the "cut-off" points of the five systems. Only if the LHS of the equation is greater than the RHS will the firm wish to employ more workers. So employment is determined as the value of L that satisfies MRP = W_c, where MRP is the Marginal Revenue Product of Labour (= $\frac{dR}{dL}$) and W_c is the cut-off point.

ANNEX B

A HYPOTHETICAL TAX RELIEF TO ENCOURAGE 'WEITZMAN' SHARE INCOME CONTRACTS

Note by the Revenue

1. A variety of difficulties would be met in designing, introducing and operating a fiscal incentive for "Weitzman" share contracts. In order to identify these we have considered the effects of promoting a relief taking the following form.

I **A Hypothetical tax relief**

2. Employees who contract to convert a minimum percentage of their earnings (we have assumed 20 per cent) to variable share income, linked to a performance indicator for their employer's firm in accordance with a scheme approved by the Inland Revenue, would qualify for total income tax relief on a designated percentage (we have assumed 10 per cent) of their total remuneration from that employment. The scheme might be introduced for a experimental period, say, three years.

Essential features on approved contract

3. To obtain Revenue approval a contract would have to provide

(a) that at the outset a minimum of 20 per cent consisted of or would be converted into (variable) share income rather than (fixed) wage/salary income;

(b) that share income would be linked to a measurable (and verifiable) index of the performance of the firm or a clearly definable unit of the firm;

(c) that the employer was and would continue to be free to engage new employees as and when he chose;

(d) that increases in the base wage element would not be granted for at least a year or would be limited in a specific way.

In addition, it may be necessary to restrict approval to employers of a certain size and to contracts of a certain minimum length; and a variety of other conditions would be needed.

II <u>Problems</u>

4. These fall broadly under four headings:

a. fiscal policy;

b. approval

c. monitoring of operation of approved contracts;

d. operating procedures of the tax relief.

<u>Fiscal policy</u>

5. To guard against abuse and wasted tax expenditure legislation for the tax relief would probably be lengthy and complex. Apart from running counter to pressures for tax simplification and compliance burden reduction, initial comprehension of and ongoing compliance with these complex provisions might prove an offputting and excessive burden to employers.

6. It is assumed that, as with other tax reliefs, this one could operate at the employee's marginal rate and its value to the employee would depend on the level of his total taxable income. Higher rate taxpayers would benefit most. At the other end of the scale, tax relief might simply reduce entitlement to Mr Fowler's proposed family credit.

7. As well as conflicting with the interest of tax neutrality, a relief of this kind might be seen as acknowledging an inadequacy in the Government's policies favouring employee involvement and wider share ownership through tax relief for approved employee share schemes. It might well displace such schemes. It could be criticised for encouraging only the means and not the end. (For example, an existing employee's relief would be maximised if, instead of taking on more employees, an employer sought to increase profits by using overtime).

8. Introducing complex legislation of this kind for a short experimental period, particularly in the light of the considerable doubts about the main proposal's merit, would be very difficult to justify.

Approval of share contracts

9. The expertise required to ensure that contracts satisfied in every detail the conditions for approval would call for Revenue staff with a specialist accounting background but would extend to matters which on the whole would not be within the experience of Inspectors. Checks would have to include the adequacy of descriptions of

a. the share income units

b. the method chosen for the measurement of performance

c. how adjustments would be made in the event of changes in working methods, investment etc, or the movement of employees from work with the share income 'unit' to somewhere else in the firm.

This work would almost certainly have to be done under pressure from employers to obtain swift approval (because of linkage with pay negotiations) and would require high calibre (and scarce) staff.

Monitoring of approved contracts

10. This would require the same high competence as approval and would be a major and technically complicated commitment even if undertaken on a sample basis. It is difficult envisaging this work being done other than by visits to employer's premises to examine six monthly accounts and wages records. (Accounts received in tax offices relate to accounting periods long since ended and would not in any event give detailed information required to check that the approved contract was being properly observed.) The fact that employers and employees would share an interest in maximising the tax relief would compound the problem.

Operating the tax relief

11. The compliance and administrative burden for employers and the resource cost for Inland Revenue would be large whatever method was adopted to give the tax relief. In addition, enhancement of Revenue computer systems and, where appropriate, those of employers would almost certainly be necessary.

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10 DOWNING STREET

From the Private Secretary 5 August 1985

LATE PAYMENT OF VAT

The Prime Minister has seen the attached advertisement by Customs and Excise. She has commented that the notice is calculated to present the VAT man as hostile and oppressive to small businesses. Her understanding of the changes made to the law following the Keith Report was that in return for tougher penalties for late payment of VAT, a number of changes would be introduced to safeguard the position of the taxpayer, e.g. the substitution of civil remedies for criminal penalties; and an escape clause which provided that the trader will not be liable to the surcharge where he has shown due diligence in submitting his return or has a reasonable excuse.

She hopes that in future a more balanced picture can be presented, both for VAT and when the Inland Revenue tasks are tackled next year.

(Andrew Turnbull)

Tony Kuczys, Esq.,
H.M. Treasury.

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(1)

PRIME MINISTER

LATE PAYMENT OF VAT

My understanding of the Keith process was that in return for agreement on tougher penalties for late payment of VAT (arrears exceed £1½b) a number of changes would be introduced to safeguard the position of the taxpayer:

- civil remedies would be substituted for criminal penalties;

- an escape clause which provides ~~for~~ that the trader will not be liable to the surcharge where he has shown due diligence in submitting his return or has a reasonable excuse.

The trick in securing public acceptance is to present both sides of the coin. The attached notice issued by Customs and Excise presents only the negative side. Agree Treasury Ministers be asked to take more care in presenting the VAT man as a responsible official rather than an arbitrary tyrant.?

AT

Yes – very much so – the advert is awful rubbish.

Andrew Turnbull
2 August 1985

BEMAVR

r inability to manage the ...ntry's economy.

However, some economists ...ue that controls could be ...ed to stimulate the economy ...d direct ...ds which would ...herwise b... trapped towards ...ojects which would reduce ...employment among blacks, a ...tor in the unrest.

The wide powers the Govern...ent assumed under the state ...emergency appear to be fail...g to end turmoil within the ...untry.

Continued on Back Page
Dockers bar cargo, Page 9
Money Markets, Page 37
Lex, Back Page

companies could be "disloyal to their workers by burdening them with costs they can't carry."

He said that the future of BL did "not necessarily" lie in becoming part of a Japanese multi-national. Flexible manufacturing systems had lowered production costs for smaller car companies. "Therefore you can have companies such as BL

Continued on Back Page
Tebbit interview, Pabe 25

...all the new regulations, which affected about 85,000 people, and rethink its position. In addition to the rules on period of lodgings, they also imposed reductions in the amounts people under 25 could claim for meals and rent. That part of the regulations still stands.

Last night, Mr Tony Newton, Social Security Minister, confirmed that all existing regulations apart from those referred to in the judgment would continue to apply.

...appeared repeatedly in High Court actions brought by local authorities against pieces of local government legislation, although only Mr Heseltine has had a judgment entered against him as Environment Secretary. Mr Jenkin lost a case in 1980 when he had Mr Fowler's present job: he was held to have acted unlawfully when he threw out a south London health authority and installed commissioners in a row over cash limits.

...shuffle

...y and Jersey, "backed by ...e resources of BAII." Staff ...the Channel Islands opera...ons "may well all go and we ...ay have to re-staff," he said.

Mr Alan Corbin, who heads ...erations in the Channel ...lands, and the staff, are to ...oin the operations of James ...apel in the same area, prob...bly in September.

In the City yesterday it was ...ggested that Mr McGivern, ...ho is in his late 20s, was ...ceiving a six-figure "golden ...llo," or transfer fee, for sign...g with the Barclays securities ...erations.

Barclays Bank has been con...dering taking legal steps ...ainst defectors from Wedd ...urlacher Mordaunt. Eight ...ther people have departed in ...e past few weeks to join the ...curities operations of Klein...rt Benson, the merchant ...ank. They include two mem...rs of Wedd's nine-man ...anagement team. Barclays is ...pected to clarify its attitude ... the defections when it ...nounces its results today.

VAT CHANGES

From 25th July 1985 there are important changes.

VAT RECORDS

VAT records and accounts must be kept for <u>six</u> years not three. This change applies to records of all transactions since August 1982.

If you fail to keep and produce VAT records you will now incur financial penalties.

REGISTERING FOR VAT

If you fail to apply for registration at the proper time you will be liable to a financial penalty. The registration turnover limits are currently £19,500 a year or £6,500 in any one quarter. Details of the registration requirements, including the time limits for applying, are explained in the leaflet <u>Should I be registered for VAT?</u>– available from local VAT offices.

OTHER CHANGES

Other important changes affect:

- ☐ assessments
- ☐ appeals to VAT tribunals
- ☐ financial penalties for all VAT offences
- ☐ investigation of serious fraud.

FURTHER INFORMATION

Details of these changes are in a leaflet <u>VAT: Important changes.</u> Copies of this leaflet will be sent to all VAT registered businesses with their next VAT return. The leaflet is also available, with help if you need it, from local VAT offices. Addresses are in the phone book under "Customs and Excise."

VAT NEWS

ISSUED BY HM CUSTOMS AND EXCISE

...s markets, 01-246 8086

NAPM

AT 2/8

MR TURNBULL

1 August 1985

VAT

Attached is a photocopy of an advert on the front page of today's Financial Times. If this is the way the Customs and Excise sell the caring face of the VAT-man, it is no wonder that he is unpopular.

Peter Warry

PETER WARRY

10 DOWNING STREET

Prime Minister ②

This charge is justified but it will no doubt be argued against by Terence Higgins, Peter Hardcastle and other Budget buffs.

AT
25/7

M

ce/B1

THE CASE AGAINST PUBLICATION OF THE SIZE OF THE ASSUMED FISCAL ADJUSTMENT IN THE AUTUMN STATEMENT

FACTUAL

The Chancellor told the TCSC on 3 April that in the light of experience, publication of the assumed fiscal adjustment in the Autumn Statement was not a helpful practice and it might well be sensible to discontinue it. This followed unhelpful and unfounded specualtion around the turn of the year by commentators and the markets about the size of tax reductions.

2. The TCSC, in their report on the 1985 Budget, argued that it would be quite wrong to omit estimates of the fiscal adjustment and that "...there should be no future difficulty in avoiding the problems which arose this year."

3. The Treasury, in a reply sent to the TCSC on 25 June, set out at greater length why it was seriously considering whether it might be better to discontinue the practice of continued publication of an updated fiscal adjustment in the Autumn.

POSITIVE

The prospective fiscal adjustment is a piece of arithmetic which follows from the economic forecast published in the Autumn Statement, assuming unchanged tax rates, indexation of allowances and tax bands, and the same PSBR as in the Financial Statement and Budget Report published earlier in the year at Budget time. It has little or no practical value since the margin of uncertainty is massive and no operational decisions are based upon it.

2. It certainly is not a guide to the likely scale of tax changes in the Budget. Budget decisions are taken several months later, based on later information, a completely new economic forecast and reflecting decisions about the appropriate size of the PSBR taken in the context of the review of the medium-term strategy undertaken at Budget time.

3. Experience since the fiscal adjustment was first published in the 1982 Autumn Statement shows that it is assigned a significance out of all proportion to its very limited value. Experience this year was no exception. Despite copious

health warnings (see next paragraph), it provoked endless and often wild speculation about the likely extent of tax cuts in the Budget. This undoubtedly contributed to the concern in the financial markets about the Government's resolve to maintain sound control of fiscal and monetary conditions, which was a factor in the unsettled conditions in the foreign exchange markets earlier this year.

4. The Government made absolutely clear the enormous margins of uncertainty involved in calculation of the fiscal adjustment. For example, in the printed Autumn Statement:

> "Any estimate of the fiscal adjustment for 1985-86 is extremely uncertain: it depends on revenue and expenditure estimates all of which are subject to major uncertainties, in both directions. For the public sector as a whole, the flows on either side of the account approach £200 billion."

And in the Chancellor's Sunday Times article on 30 December 1094 when he said:

> "(I may add that I wish I were as confident as the press appear to be that I will have even half the scope for tax cuts that they write about)".

5. But as the Chancellor told the TCSC on 3 April:

> "...nobody took the slightest interest in the health warning; all they did was to latch on to the figure and then it was thought that this was to be the objective, come what may, and all sorts of false conclusions were drawn..."

6. Thus, there is a strong case to discontinue publication of the updated fiscal adjustment in the autumn.

DEFENSIVE

The Government has no wish to withhold from Parliament or the public information about the public finances which, unlike the updated fiscal adjustment, does genuinely assist public understanding and debate. Indeed, there has been considerable improvement of information published by this Government about the public finances, eg in the Public Expenditure White Papers, and in the Autumn Statement itself. The Government hopes to continue with these improvements.

[Mr. Michael Portillo]

given to witchcraft. Recently, my right hon. Friend the Chancellor of the Exchequer referred to the belief that public expenditure could cure all our ills as

"an ancient form of witchcraft."

I assure my right hon. Friend that nowadays the good people of Winchmore Hill are no more attracted to that practice than their near neighbours in Palmers Green or Cockfosters.

Frequently, when discussion in the House turns to public expenditure, a number of hon. Members wonder whether they can improve on the traditional procedures by which they consider the revenue that the Government raise at one time of the year, in the Budget, and how that money is spent at another time of the year, in the autumn round of discussions. The Armstrong committee considered that matter in 1980 and came forward with a series of proposals for bringing the consideration of taxation and spending together. The proposal was considered by the Treasury and Civil Service Select Committee and the Select Committee on Procedure (Finance). The Government went some way towards meeting the point by devising the "Autumn Statement" in the form in which we now know it.

In its present form, the "Autumn Statement" has given rise to a number of unforeseen difficulties. Public and press attention naturally focus on that part of the "Autumn Statement" in which the Government say how they view the prospective fiscal adjustment in the following Budget —whether they consider that taxation is likely to be increased or decreased. During the past two years we have seen that, whatever the Government say, the results can be unfortunate. In November 1983 the Government announced that the prospect was for a moderate increase in taxation in the following Budget. The Government were denounced for being too gloomy. People asked whether the Government were still committed to their policy of cutting taxation. In the event, all that gloom was unnecessary, because the Government were able to decrease taxes in the Budget.

Last November, the Government said that the prospect was for a decrease in taxation in the Budget, but that statement brought denunciation on the Government. At first people said, "The Government have underestimated how much money there is to give away in the Budget." People thought that the Government were being too cautious. Subsequently, the Government were denounced for having thrown caution to the wind. It appeared that the Government were more determined to cut taxation than to continue their fight against inflation.

No one can reliably estimate in the autumn the leeway that the Government will have in the spring. Whatever figure is announced, it either increases or depresses expectations. More importantly, it creates confusion about the Government's policy. Sometimes that can have serious consequences.

Our present arrangements are an uneasy halfway house between our traditional procedures and the radical proposals in the Armstrong report. This middle position does not satisfy those hon. Members who want a thoroughgoing reform. On the other hand, it sets a number of hares running about in a way that is not helpful to the Government or to the House. I cannot help thinking that the present position is likely to prove unstable and that we shall want to move either forward towards the Armstrong proposals or backward to the position in the old days when the Chancellor said very little in advance of his Budget statement.

May I use the opportunity of my maiden speech, Mr. Speaker, to make a point that concerns the relationship between public expenditure and unemployment? I am reminded of what happened to me last year at the Conservative party conference in Brighton. At about 2 am on what proved to be that terrible morning of 12 October, I was standing in the bar of the Grand hotel. Because the hour was late I got into a heated discussion with a journalist. He said, "The Government's policies are designed to create unemployment." Of course, I disagreed with that. The discussion became heated. To emphasise his point, the journalist beat the pillar beside us with his fist and said, "This is a pillar; that is a fact. Your policies are to create unemployment; that is a fact, too." The discussion became even more acrmonious and the journalist rather abusive, so I left the Grand hotel and went safely to bed in my hotel down the road.

In the morning I reflected on two things. First, I was grateful to that journalist for having been abusive towards me; otherwise I might have stayed in the Grand hotel and been there at the time the bomb went off. Secondly, I reflected on the fact that the pillar which he had thumped with his hand and which represented for him absolute certainty was probably a pile of rubble. I thought that, in the light of day, the journalist, too, was a little less certain about the motives of Government policy.

Although I understand that the Opposition believe with absolute conviction that the way to reduce unemployment is to increase public spending, I ask them to understand the absolute sincerity with which Conservative Members say that to increase public spending is to increase taxation which would lead to fewer jobs and higher unemployment.

6.8 pm

Mr. Richard Wainwright (Colne Valley): It is a great pleasure to congratulate warmly the hon. Member for Enfield, Southgate (Mr Portillo) on an admirable maiden speech. I am sure that hon. Members on both sides of the House who had the pleasure of listening to him agree that he was eloquent, confident and witty. As one who took a humble part in the election which brought the hon. Gentleman to the House, I thought that he was as agile in marshalling his presentation this afternoon as he was during the campaign in dealing with the garden gates and garden paths of Southgate. I do not want the hon. Gentleman to be alarmed. I have no intention of carrying that congratulation to the lengths that were applied earlier to his colleague and hon. Friend the Member for Enfield, North (Mr. Eggar), was who was described as winsome. That is a compliment that I shall spare the hon. Member for Southgate.

I understand that one consequence of the hon. Gentleman's election to the House is that the Conservative party has lost his expert assistance in its back rooms. But it has gained an expert Back Bencher, who may not remain a Back Bencher for long if his party returns to power during his tenure of the Enfield, Southgate seat. I am sure that we all look forward to hearing a great deal more from him and also to discovering in his later speeches whether he is in favour of advance to a green Budget, or whether he wants to go back to the bad old days which were so warmly greeted by the Conservative party antiquarians when he mentioned them in his speech.

1. ~~IF~~ 2CF

Quotes – Pse take a copy DF

Keep for quotations & speeches

PRIME MINISTER (2) AT

19 July 1985

SDP PROPOSALS FOR TAX REFORM

The SDP have just published a Green Paper on the tax system. John Redwood and I thought you might be able to exploit some of their juicier proposals.

Merge National Insurance Contributions and Basic Income Tax at a 39% Rate

* End the contributory principle.

* Increase the tax burden on people earning around £15,000-£20,000, who are above the UEL but below higher-rate income tax.

* Reduce tax thresholds. (The SDP Green Paper suggests a 6% cut to cover the loss of National Insurance on the first tranche of income.)

Income tax should become an "exemption of savings" tax

Income tax would become an expenditure tax of the type proposed by Professor James Meade in a 1978 Report for the Institute of Fiscal Studies. All taxpayers would fill in a return at the end of the year, showing their income and the change in their financial assets. Tax would be levied on income, less any increase in savings (or plus any realisation of savings).

The Chancellor of the Exchequer has commented that:

> "Going from an income base to an expenditure base would constitute a massive upheaval, with a multitude of side effects. No country has (understandably) moved to this, despite its theoretical attractions. (We considered it very fully in Opposition, but concluded that it was not a practical proposition.)"

Other Changes to Income Tax

* Taxation of full value of company cars.

* Personal tax allowances only to give relief against basic rate tax.

* Abolition of the married man's allowance. (The Chancellor is also working on this, but he would increase total tax reliefs. The SDP would raise more tax and spend it on benefits.)

* A 9% reduction in the rate for pensioners to offset damage to them of merging tax and NIC.

Capital Taxation

* All realised gains from saving and investment to be taxed as income. So if you sell your house, any receipts you don't save or spend on another house would bear income tax without indexation of capital gains.

The SDP would:

- end National Insurance;
- lower tax thresholds and raise income tax to 39%;
- increase the tax burden on middle income groups;
- clobber company cars;
- tax your home as income if you don't reinvest the money.

David Willetts

DAVID WILLETTS

FAIRNESS AND ENTERPRISE

I INTRODUCTION

A tax system should be fair, should encourage the creation of wealth and should be simple to understand and administer.

These aims may not be totally achievable and will sometimes conflict. But no one can argue that our present system comes near achieving any of them : it is neither fair nor economically efficient, nor simple.

(a) Fairness:

A fair system would impose burdens according to a person's ability to pay, and, in the view of Social Democrats, should help to reduce inequalities. The present system does neither.

Income tax for instance, is at first sight a fair tax because it taxes higher incomes at higher rates. But a closer look shows appearances to be deceptive. First, National Insurance contributions are also a tax on income. They are however, a tax which takes a much higher proportion of income from the lower paid than the higher paid. Secondly, some low earners find that when they earn £1 more they actually end up worse off, after taking account of the extra tax they pay and the means-tested benefits they lose. Thirdly, the favourable tax treatment of perks like company cars and the effect of tax exemptions for mortgage interest and pension contributions greatly reduce the tax burdens on those with higher incomes.

Compare two couples where the wife stays at home to look after the children. Husband A is a manager earning £24000 a year, has a £25000 mortgage on his house, contributes 5% of his salary to a company pension scheme and runs a company car.
Husband B is a semi-skilled worker earning £8000 a year, lives in a Council house and is not in an occupational pension scheme. In a fair tax system one would have expected Husband A to pay a higher proportion of his total income in taxes than Husband B. In fact he pays slightly less. Husband A pays 24%, Husband B 26%. In addition, Husband A, unlike Husband B, receives a substantial subsidy on the cost of running his car, which may be equivalent to severaly thousand pounds extra salary.

Finally, and what is most frequently ignored, the owners of capital largely escape the attention of the tax men. Most people who are rich inherited their wealth. The rest overwhelmingly derive their wealth from capital gains. But both inheritance and capital gains are taxed lightly, much more lightly than income.

(b) Economic Efficiency and the Encouragement of Enterprise

When a tax system discourages investment in risk it is inefficient . The present system discriminates in favour of some savings and against others in a way that channels savings into safe institutions rather than new entrepreneurial ventures. When a tax system distorts the choice of career by favouring a career in financial institutions rather than manufacturing, it is inefficient. The present system treats those who make money from dealing in money or property more favourably than those whose income depends on a salary. When a system increases reliance on perks it is inefficient. The present system discriminates in favour of payments in kind rather than in cash and encourages reliance on perks. Lastly, a tax system is inefficient, as well as unfair, when it makes it

easier for people to stay rich than become rich. The present system discriminates in favour of owners and inheritors rather than earners and the creators of wealth

(c) Simplicity:

Most people in Britain do not know how their tax bill is worked out and many do not even know how much tax they pay. The rate at which tax is deducted on the same wages or salary may vary from week to week. Self employed people are taxed not on current, but the previous year's earnings. Capital gains are taxed at a different rate from income, but the distinction between what is capital and what is income is so obscure that an army of highly paid experts exploit opportunities for avoidance.

Complexity adds to the unpopularity of taxation because people resent what they cannot understand. Complexity adds to unfairness because it redistributes wealth from those who cannot, or do not, exploit tax loopholes to those who can, and do. It also increases the costs of collection, which overall are four times as high in Britain as in the United States. In some cases, such as Capital Gains Tax, a vast effort of collection at high administrative cost produces an almost negligible yield. The tax system is a vast labyrinth in which all are lost except those who can afford expert advice.

II OUTLINE OF PROPOSED REFORMS

The proposals which follow are all changes to the structure of the tax system. There are many important questions which we are not trying to answer in this paper. For example, we assume that the same total revenue is raised from taxation as now, although many people are mainly concerned that the total burden of taxation should be lowered or that it should be raised to pay for better social services. We address the question instead how the total burden of tax should be distributed between different groups of tax payers.

Again this Green Paper is not, in general, concerned with the relief of poverty. This remains a central aim of the SDP. It requires a massive reform and simplification of our social security system and an end to the separate treatment of tax and benefits. Our proposal to achieve these aims through an integrated tax/benefit system are contained in our White Paper on Attacking Poverty.

Again, these proposals do not deal with indirect taxes or rates and the possibility of a local income tax, all of which can be altered, abolished or introduced as thought appropriate. Nor do they deal with corporation tax. This Green Paper is solely concerned with the structure of personal, direct taxation.

Overall our strategy for tax reform is three-fold:- to reduce unfair and unproductive inequalities, to simplify, and at the same time to encourage enterprise. Our proposals fall into two categories - those which can be implemented straightaway and a more fundamental longer term reform which reconciles the demands of fairness and efficiency by taxing more heavily those who spend out of capital and treating more favourably the earners and creators of wealth.

Particular Proposals

(1) We will abolish the present National Insurance system and integrate it with income tax. The right to benefits will no longer depend on a person's contribution record, although in some cases a work test will have to be retained. Employers' contributions are in effect a payroll tax. We make no proposals in this Green Paper to abolish them but we will in due course examine whether there is not a way of raising similar revenue from corporations which has a less depressing effect on employment.

The abolition of the National Insurance system will greatly improve the position of part-timers and very low earners; it will end the absurdity and injustice whereby liability for National Insurance contributions can make people worse off if they earn more; and it will make the whole tax system more sensible. In the next section we give examples of how anomalous and indefensible the system has become and how the 1985 Budget has actually made it even more absurd.

(2) We will see that perks are taxed at their full value and will encourage employers to pay wages and salaries in cash, rather than in kind. Perks not only distort the fairness of the tax system - they enhance status and the worst kind of class differentiation at work. We will also limit some of the inequalties caused by exemptions, by restricting mortgage interest relief to the basic rate of tax. Further, we will make personal allowances worth the same to all tax payers, whereas they are now worth more to those who pay tax at the higher rates.

(3) We will reform capital taxation. As already mentioned, one of the unfair (and inefficient) features of the present system is the different treatment of owners and earners. This disparity of treatment has been aggravated by recent reforms which have emasculated the Capital Transfer Tax and substantially eased the taxation of capital gains. Our main proposals will transform the tax treatment of capital gains. But we shall tighten Capital Transfer Tax so that it becomes an effective tax on the transfer and inheritance of capital.

These are our proposals for immediate reform. But we also propose a more basic change - a new deal for savings and investment - which will take longer to implement, mainly because we shall have to face considerable problems of transition. It will however be a charter for enterprise, which will not only promote the creation of wealth but will also help towards our other aims of making the tax system fairer and simpler, namely:-

(4) We shall move gradually to a system where all savings and investments are exempt from tax, but where the sale or realisation of savings and investment will be treated as income. So the total income which is liable to tax includes proceeds from the sale of capital as well as earnings, but any part which is saved or invested (or re-invested) can be deducted in computing liability. At the moment some savings only are exempted (like mortgage payments, investment in the Business Expansion Scheme, or pension contributions). Other savings, however, like investment in a building society account or investment in shares, are discriminated against.

Our reforms will give a better deal to small savers who invest in building societies. They will be treated in the same way as those who now invest in pensions or the Business Expansion Scheme. So will people who invest in shares. Under our scheme those who invest in their own business or their family business will get tax relief on their investment. Thus enterprise will be encouraged. At the same time, because spending out of the sale of capital will be taxed as part of income, owners will no longer be treated more favourably than earners. Because what concerns the tax man will only be what people do with the proceeds of a sale of an asset (whether they re-invest it and get tax relief, or spend it and have it taxed as income) the question whether someone has made a capital gain or a capital loss becomes irrelevant. Capital Gains Tax can therefore be abolished and the tax system can be greatly simplified.

III. DETAILS OF OUR PROPOSALS

NATIONAL INSURANCE

National Insurance Contributions (NICs) are a regressive tax. They are a tax and not a proper insurance system

because contributions are not assessed on any actuarial basis. Nor is there a Fund in any meaningful sense; only a purposeless set of national accounts whose main effect, at vast administrative cost, is to make the tax system more complex that it need be.

As a tax, National Insurance contributions are a regressive social security tax with peculiarly anomalous features. They start a long way below the income tax threshold, at 5% on earnings of £35.50 per week. They then become payable not, as with income tax, only on earnings above that level, but on all earnings. At £55 a week the rates goes up to 7%, which again becomes payable not just on earnings above £55, but on all earnings. The same thing happens again at £90 a week, when the 9% rate applies. Then payments stop above the NIC ceiling, at £265 a week, when the tax rate actually drops. The absurdities can best be illustrated by examples :

(a) Earnings £35.00 per week - no tax payable. Earnings rise to £36.00 per week : NIC at 5% due on all income:- £1.80 becomes payable and one ends up 80p a week worse off than on £35.00 a week.

(b) Earnings £54.00. NIC's payable: £2.70 (at 5%). Earnings rise to £55.00. NIC's payable: £3.85 (at 7%) and one is actually 15p worse off. (If the person is single, he or she has also started to pay income tax at 30% and is 45p worse off).

(c) Earnings £89.00. NIC's payable: £6.23 (at 7%). Earnings rise to £90.00. NIC's payable £8.10 (at 9%) plus income tax, so that one is £1.17 worse off.

(d) Finally, if earnings rise beyond £265.00 a week, the tax rate on extra earnings actually drops - from 39% (NIC's plus income tax) to 30% (income tax only). It does not rise again until the higher rate band of 40% is reached. When that happens depends on allowances and exemptions like mortgage interest relief, but will be when earnings are at least £4700 a year higher.

No one in their senses would design, or could possibly defend, a tax system in which the progression of tax rates was: 0% - over 100% - 5% - 35% - over 100% - 37% over 100% - 39% - 30% - 40% - 45%, and so on. But that is the tax system we have.

It is clear that the system should be scrapped and integrated with income tax. This will be a great simplification and will enable us to end the nonsense of administering a so-called National Insurance Fund which has no justification. It will enable us to end the anomaly whereby unearned income is taxed more lightly than earned income below the present NIC ceiling. Pensioners will need separate consideration because they do not pay NICs. We would therefore have to introduce a special pensioners allowance equivalent to 9% if the new income tax rates, to replace the combined NICs plus income tax rate, started at 39%. (* Note: If SERPS is continued, present arrangements for contracting out could be replaced by a payment from the Exchequer, like the subsidy to mortgage interest, which reduces the occupational pension contributions of those contracted out and leaves them no worse off than they are now).

We can also devise a more rational progression of rates, without the dip between 39% and 40%, which we saw in example (d) above. We return presently to the question of what the higher rates should be.

Abolition of NIC's raises a number of consequential problems. First, what happens to employers' contributions? These will be treated as a payroll tax, which is what in effect they already are; but the whole structure of payroll taxes is in need of a separate review.

Next, although benefits are not at present actuarially linked to contributions, you cannot qualify for flat rate N.I. benefits unless a number of contributions have been paid. Will benefits, like unemployment benefit, become payable under our scheme to anyone who is unemployed? Unfortunately, this would be impossibly expensive. Married women for example who had not worked and paid no tax could automatically qualify for unemployment benefit. It will therefore be necessary to introduce a work test, but this will be less oppressive than the present need to prove a contribution record.

Tax Thresholds

If NIC's are abolished, tax thresholds will have to be adjusted. Because NIC contributions start at a very low level and are then payable on all income, including income below the threshold, to start the new integrated income tax from existing income tax thresholds upwards would mean a considerable loss of revenue. Some of this would be recovered by the yield from incomes above the present NIC ceiling. But if the change is to be revenue neutral, i.e. to yield the same total tax as the present system, we will have to do two things : raise the threshold as compared with the old NICs and lower it slightly as compared with the present income tax. The new thresholds would be about 5.5% lower than the present ones for income tax. The overall effect, however, would be of considerable help to the lower paid and would leave the basic rate tax payer marginally better off.

A More Gradual Scale of Tax Rates

If NICs are integrated with income tax, we can devise a more defensible progression of tax rates. It is, however often argued that the long plateau at 39%, starting suddenly at that high level, should be replaced by a series of more gradual steps - say 10% - 20% - 30% and so on.

The cost of such a change would however be enormous. The Meacher Committee in 1982 showed that so much revenue would be lost by lower rates on the first slice of everyone's income that, to make up for the loss, the top rate of 60% would have to start when taxable earnings reached a level less than one and a quarter times average earnings. (*Note This has not stopped its chairman constantly arguing for the change which his own committee showed to be impracticable).

There is another argument against a more graduated scale and in favour of a wider band at the basic rate. Most people would agree that what matters is that low earners should pay the lowest amount of tax possible, that is, should pay a low percentage of their overall income in tax. A graduated scale which starts at a lower point (which it would have to, to raise the same total revenue) will actually leave low earners worse off. To quote a very simplified example:

> Someone earns £6000. At a threshold of £2000 and with a tax rate of 30% they pay £1200 tax. If the tax rates were 20% between a threshhold of £1000 and earnings of £3000, and 30% between £3000 and £6000, their total tax bill would be £1300. (If the threshhold were £3000 and the tax rate 35%, on the other hand, the tax bill would be only £1050).

To use technical terms, the advocates of a more gradual scale confuse the importance of marginal rates and effective rates. What matters to the low paid is effective rates (i.e. the total tax paid). The fact is that higher thresholds help low earners more than lower tax rates, although direct help for them through benefits, like our Basic Benefit scheme, can help them most of all. Paradoxically, it seems that the long basic rate plateau is one of the better features of the British tax system. It is simpler to administer than a more graduated scale and fairer.

In the integrated tax system which would replace NICs plus income tax we propose that the starting rate should be 39% (the same as the combined rate is now) and it would obviously make sense to continue this 39% rate until the 45% band is reached, rather than to have a separate 40% band in between. The other higher rate bands could then be kept as now or adjusted as wished. As the abolition of the dip in tax rates between the end of the NIC ceiling and the point at which the 40% rate now starts would mean a considerable increase in the tax burdens of people with higher earnings, the abolition of this "dip" would have to be phased.

Another advantage of an integrated tax system is that it would end the anomaly (and injustice) of taxing unearned income more lightly than earned income. Since the abolition of the investment surcharge, unearned income has been treated more favourably because it escapes the NICs chargeable on earnings. The extra revenue from an integrated tax rate can be used to reduce thresholds (or increase the Basic Benefit) - although the extra yield is not large.

EXEMPTIONS AND PERKS

As we showed in our example in the introduction, income tax is much less fair than it seems because allowances and exemptions like mortgage interest relief and relief on pension contributions greatly reduce the tax burden on higher incomes. In addition perks aggravate inequalities. The irony is that most executives, given the choice between perks and the freedom to spend an equivalent sum in cash as they liked, would choose the latter.

There are however formidable difficulties in the way of change. Take mortgage interest relief. People have assumed commitments in buying their house which often stretch them to the limit. To abolish the fiscal privilege of house owners would be the last straw. What's more, mortgage interest relief puts up the value of houses. Abolishing the relief would bring it down. Overnight millions would see a big cut in the value of their principal asset. The same is true of pensions: to scrap tax relief for contributions would mean big cuts in pension benefits. As for company cars, they are now so widely provided that two thirds of new cars bought are bought by companies. They are also now a major part of executive salaries.

We cannot start again from scratch and have to face facts. It would be wrong simply to abolish mortgage interest relief. We propose instead to lessen the unfairness of the tax system by limiting the relief to the present basic rate of tax. The relief will continue to be granted by deduction at source. As for pensions, the way to deal with the specifically privileged position of this particular form of saving is not to scrap it but to extend relief on all savings. We deal with this in our longer term proposals for a new deal for savings and investment.

Perks however are a nettle we must grasp. There are some perks which are fully taxed, like help with school fees; others however, like help with mortgage payments, the Revenue seems to ignore for no good reason. Some perks are undoubtedly difficult to deal with. The principal perk however is the subsidy to company cars. This benefit was originally developed as an answer to salary freezes and very high tax rates; but when executive salaries waxed and high tax rates waned, car perks still multiplied. If they were taxed at full value we have no doubt that payment through perks would end and employers would provide compensating salary rises. What people earned would be clearly seen and above board. It would give individual executives wider freedom of choice in spending their money. (They might prefer better holidays to bigger cars). It would be healthier for the company, and for industrial relations and would do a great deal to ease the problem of public transport. We therefore propose to move by stages to the full taxation of the value of the company car so that car perks are gradually phased out.

TAX ALLOWANCES

We shall also change the way people benefit from personal allowances. As mentioned earlier, they are worth more to high rate than basic rate tax payers. If personal allowances are increased by £200, the basic rate tax payer pays £60 less tax, but a 60% rate tax payer is saved £120 tax. The fair solution is to turn personal allowances against income, which benefit higher tax payers most, into personal allowances to be set off against tax.

This can be done by restricting their maximum value to what they are worth to a basic rate tax payer. An example can explain what this means. Suppose single personal allowance is is £2000 and the tax rate is 39%. The allowance is worth £780 maximum to a basic rate tax payer (39% x 2000). Under the present system it is be worth £1200 to a 60% rate tax payer (60% X 2000). Under our reform it is be worth £780 at the most to everyone.

THE TAXATION OF WOMEN

In our Poverty White Paper we said we would phase out the married man's extra allowance to pay for our Basic Benefit. How should we approach the taxation of women?

On principle, women's rights require that women should be separately taxed. Indeed, on the face of it, the Chancellor has moved in that direction by suggesting that instead of the MMA, husbands and wives, like single people, should in future each receive the same personal allowance, but where one spouse did not work the allowance could be transferred to the working spouse.

The snag is that this creates a big disincentive against women working. If a wife went out to work, her husband would suffer a dramatic cut in his take-home pay because he would suddenly lose the benefit of her transferred allowance. Husbands would often therefore object strongly to their wives taking paid work.

We agree that the MMA is an anachronism, as we said in our White Paper on Poverty. Those who need help to look after children can be most effectively helped by the generous provision for children in our Basic Benefit and some increase in the child benefit. Otherwise men and women should in general be taxed alike, and qualify for the same tax allowances (which would not be transferable). In order to ensure privacy, each individual should also have a right to their own separate tax form.

The only problem arises with unearned income, where separate taxation could lead to a loss of £500 million p.a. or more as assets were transferred into the name of the spouse with lower income. The benefit of this loss to the Revenue would go to the richest people in the country. As a compromise between two conflicting principles of equality we propose that the first £500 of investment income should be separately taxed, like earned income, but that above that sum investment income would, as now, be aggregated with that of the higher earning spouse. An alternative would be to tax all unearned income separately but to apply CTT to gifts between spouses. We will study this possibility further, but it seems likely that so many special provisions would have to be made for special circumstances that the tax system would be made much more complex.

CAPITAL TAXATION

The principal capital taxes which exist today are Stamp Duty, Capital Gains Tax (CGT) and Capital Transfer Tax (CTT).

Stamp Duty

Stamp Duty is the oldest of all our present taxes. It is still a substantial revenue raiser (£860 million in 1984-85) and is simple and cheap to collect. We do not propose at present any major changes in stamp duty,

though we recognise the need to watch out for the risk that stamp duty on share transfers may damage the position of London as an international financial centre.

CGT

The potential impact of capital gains tax has been sharply reduced by a number of changes introduced in recent budgets. Some of these we disagree with; in particular we think the exemption for an individual of the first £5,900 of gains is far too large. The exemption ought to be reduced to an amount equal to the personal allowance for income tax. However, we support the most important change, which is the indexation of acquisition costs. We do not think it is right to charge tax on inflationary gains. Tax on inflationary gains constitutes a wealth tax in a particularly unsatisfactory form - irrational in its application and economically inefficient.

The effect of indexation, however, is likely to be to reduce the yield of CGT very considerably over the next few years as gains which arose before the beginning of indexation in March 1982 work themselves out of the system. The ultimate yield of CGT, in present cash terms, may be as little as £200 million a year (against £710 million in 1984/85), and collection and compliance costs will be high in relation to the yield. This raises the question whether CGT shouold be abolished, or alternatively, whether chargeable gains should be taxed as income and CGT merged with income tax.

In the longer term, our proposed new deal for savings will abolish the distinction between income and capital and make CGT redundant. That is one of the major advantages of our reform. This will take some time to bring about, however, and interim arrangements will be needed.

We do not think that, in the interim period, CGT should be abolished. This would exaggerate the often artificial distinction between income and capital, encourage tax avoidance schemes, and give an unfair advantage to those who are in a position to obtain capital gains. On the other hand, there is much to be said for simplifying the tax system by taxing indexed capital gains as income. The gain represents an increase in spendable assets just as much as income does.

If CGT is merged with income tax, however, we would extend the present right to defer tax where the proceeds of sale of certain business assets are reinvested in other assets of the same type, and would grant a similar right to defer tax where the proceeds of sale of non-business assets are reinvested. This has several advantages, in particular:

(1) It is a step towards our long-term aim of giving tax relief on savings but treating all net dissaving as part of the tax base;

(2) It eliminates the economic inefficiency of imposing a tax charge on a simple switching of investments;

(3) it eliminates the need to make statutory provision for the hardship which can be caused by treating an abnormal capital gain as income of the year in which it is realised.

The question whether CGT should be merged with income tax, however, depends mainly on the speed with which it is possible to move to our longer-term aim of the new deal for savings. It is only if that aim is likely to be deferred for several years that the project of merging CGT and income tax would become worthwhile.

CTT

We start by looking at CTT as it is and how it could be changed, before we examine the merits of turning it from a tax on the donor's estate or gifts into an Inheritance or

Accessions tax which would tax the legacy or gift according to the amounts received by the legatee or donee.

CTT is the most important of the capital taxes - not because of its potential as a large source of revenue, still less because of the current yield (which at an estimated £674 million for 1984-85 is less than that of either stamp duty or CGT) but because of its crucial social function in creating a more equal society and breaking down the accumulations of hereditary wealth which dominated British society before the First World War and to some extent still exist today.

The desire to provide for one's children is a strong and legitimate human instinct. It is an important motive in the creation of new wealth, and it encourages saving and investment. We do not, therefore, propose that CTT should become a confiscatory tax. We do, however, wish to make it an effective tax - which at present it is not. We think that the accumulation of hereditary wealth in the hands of a small proportion of the population is socially divisive and economically inefficient. Although inequalities of wealth are not as gross as they were eighty years ago, they are still too great and we believe that CTT has an important role to play in reducing them.

CTT was introduced in 1975 to replace estate duty. Estate duty suffered from the major defect that it was chargeable only on death or on gifts within seven years before death, so that it bore heavily only on those who died unluckily young or were too greedy to hand over their assets to their children in good time. It was believed that CTT, as a more comprehensive tax chargeable on gifts at any time during the donor's life, would be more effective.

This has not turned out to be the case. Inland Revenue statistics suggest that the steady and substantial decline in the proportion of wealth concentrated in the hands of the richest members of society, which had continued for most of the century, came to an end about 1978 and may now even be starting to go into reverse. The proportion of wealth (including occupational pension rights) owned by the top 5% of the adult population, for example, was 34% in both 1979 and 1982, after falling from 40% in 1976 and 46% in 1971. The yield from estate duty reached a peak of £459 million in 1972-73 - in real terms, much higher than the present yield from CTT (£674 million). The proportion of total tax revenues yielded by estate duty and CTT has declined from 20% in 1928-29 to 1% in 1983-84.

The changes made to CTT by the Conservative Government since 1979 have effectively emasculated it. The rates of tax chargeable on death have been reduced, and the rates chargeable on lifetime gifts have been reduced even more. Exemptions and reliefs have been extended. The following examples show how small the burden of CTT can now be.

The highest rate of tax that is payable on gifts made more than three years before death is 30%, whatever the total amount of other gifts the donor has made. Farm land is valued for CTT at only half its real value - reducing the effective top rate of tax to 15%. Furthermore, unless the land is sold this tax is payable by ten annual instalments, interest-free and unindexed. CTT on farm land handed on more than three years before death, therefore, is chargeable at a rate which cannot exceed 1.5% a year over a period of 10 years. Effectively, this means that agricultural estates can be preserved intact forever.

In addition, although CTT is a progressive and cumulative tax (which means that the larger the gift the higher the rate of tax, and that the rate of tax takes into account gifts previously made as well as the one on which tax is being charged) the present Government has abolished the original lifetime cumulations of gifts and allows a clean slate start every ten years. Given that no tax is payable on the first £67,000 of gifts, and that there is an annual

exemption of £3000, a man who starts passing his assets over to his children when he is in his 30's and lives for another 40 years will be able to make gifts over the course of his lifetime worth £400,000 entirely tax free. This can be doubled if the gift is in the form of agricultural land or business assets which are treated for CTT as having only half of their real value - and doubled again if the donor's wife is able to make similar gifts. Thus, a wealthy couple can over the course of their married life hand over to their children assets worth £1.6 million without paying a penny in CTT.

We believe that a number of major changes are needed in order to make CTT an effective tax. In particular:

(i) tax rates should be based on the total of all gifts previously made by the donor or testator, not merely those made within the previous 10 years;

(ii) the lower rates of tax on lifetime gifts should be restricted to gifts below some specified maximum instead of going all the way up the scale, as at present;

(iii) the present rate structure is unsatisfactory. There is no tax on the first £67,000; tax then becomes payable at 30% and rises by a series of narrow steps up to £299,000, where the top rate of 60% becomes payable. We think that the present starting point is too high, and should be reduced to £40,000. Tax should start at 10% and rise by a series of 10% increases to a top rate of perhaps 70% on really large fortunes;

(iv) we recognise that there is a case for providing some relief for agricultural and business assets. The argument is that a farmer's son who is forced to sell the farm to pay CTT on his father's death may lose not only his inheritance but his job. Nevertheless, the relief now given needs to be restricted. We will accordingly keep instalment relief but propose to limit the devaluation of agricultural land for CTT purposes to what can fairly be described as family farms.

We will keep the exemption on transfers between spouses and the relief for charitable gifts. We also accept the principle of relief for heritage property. The relief for heritage property kept within the family cost the Exchequer £50 million in 1983-84 (as much as agricultural and business assets relief put together) and of course it goes entirely to those who are already wealthy. On the other hand, it is a conditional relief and is lost if the property is sold, and its abolition would place an intolerable strain on the National Trust and other heritage bodies. We would not therefore abolish it.

Accessions or Inheritance Tax

An Accessions Tax is a tax, not on the cumulative total of gifts made by the donor (as in CTT) but on the cumulative total of gifts received by the donee. The advantage claimed for an Accessions Tax is that it encourages donors to disperse their wealth more widely. There is no doubt that the yield from an Accessions Tax would be less, because a lower rate of tax would be payable by several donees on the separate gifts they had received than the rate payable by the donor on the total of gifts he had made. In addition, the costs of collection would be higher because there would have to be assesments on more people. So less tax would be collected at greater cost. This would be acceptable if an Accessions Tax did in fact lead to a wider dispersal of wealth.

We are however, doubtful whether it would have a significant effect. Donors almost always give the bulk of their estates to their direct descendants and it is unlikely that an Accessions Tax would persuade them to alter this. It might persuade them to equalise benefits

among their children; but outside landowning families this is already the norm. If we were starting from scratch, we might well adopt an Accessions Tax rather than CTT. However, the transition from CTT to an Accession Tax would be complicated and lengthy and we do not think the advantages of an Accessions Tax are sufficient to justify the change. In addition, CTT fits in better than an Accessions Tax with our proposals discussed below for a new deal for savings.

Wealth Tax

Many people argue that if the present tax system unduly favours owners at the expense of earners the obvious answer is to bring in an annual wealth tax. Although a number of European countries impose such a tax, it is not a substantial source of revenue in any of them. In neither Sweden nor West Germany (two often quoted examples) does it yield more than 1% of total tax revenues and in neither does it have any effect on the distribution of wealth. In the Republic of Ireland the introduction of wealth tax was a complete failure - insignificant in its yield, very costly to collect and politically deeply unpopular. No satisfactory proposals came out of the House of Commons Select Committee that looked at the tax in 1975. When the practical administrative problems of a wealth tax are examined, its superficial attractions fade away.

The administration costs of a wealth tax would be high in relation to the yield, both for the Revenue and for taxpayers. There would be strong objections to bringing into the net of wealth tax future pension rights and life assurance policies (which produce no income); business assets (because of the cash flow problems which would result from having to pay the tax); personal chattels (because of valuation problems); and owner-occupied houses (because rates are in effect already a tax on the capital value of the building). Yet all of them are very important constituents of personal wealth. We believe that a beefed-up CTT would be at least as effective a method of reducing inequality as an annual wealth tax, with a considerably lower ratio of cost to revenue and a greater degree of acceptability to the taxpayer. To impose an annual wealth tax on top of CTT would in our view be an unnecessary complication of the tax system.

IV. A NEW DEAL FOR SAVINGS AND INVESTMENT

Defects in our Present Treatment of Savings

So far we have dealt with particular changes which can be introduced at once - turning NICs into a social security tax, limiting mortgage interest relief to the basic rate, taxing perks in full, turning allowances into tax credits and making CTT into an effective tax on gifts and inheritance.

But there are other more fundamental changes which are needed, which will however take time to introduce.

Our present income tax has two fundamental defects. First, the definition of what is taxable income is narrow and far from coherent. Secondly, exemptions have eroded the tax base, so much so that if there were no exemptions the basic rate could be cut by as much as a third.

This is not the place to discuss the concept of income in great detail, but it does seem odd that one source of increased spending power, a wage or a salary, should be taxed much more heavily than other sources of increased spending power, such as money received as a gift or from the sale of shares. It can also be very difficult in some cases to distinguish between capital gains and earnings from trade. For example if you buy, convert and sell a house you don't live in and make a profit, this transaction might be regarded as realising an investment (i.e. a capital gain) or as trading (i.e. as income). The money

you gain is the same money. The tax you pay will be much higher in one case than the other.

Again, if someone owns a large amount of wealth and pays for his ocean-racing yacht out of capital, his tax bill will be much lower than if he tries to finance the same expenditure out of a salary - in fact he will almost certainly not be able to afford the cash however high his salary might be. So, if you want to be really rich, choose rich parents - two thirds of the richest 1% in Britain inherited their wealth - or deal in property or go into the City and become a stockbroker. Differences of salary are not a major cause of inequality and income tax as it stands does little to redistribute wealth.

When we come to the exemptions, we find that the tax treatment of savings, which greatly narrows the tax base, is neither fair nor economically desirable.

The rich can exploit the exemptions, e.g. by putting up to £40000 into the Business Expansion Scheme. They will be relieved of tax on their investment at their highest tax rate. The favourite means of saving of the less well off is a Building Society. If their earnings are below or close to the level of the tax threshold, they get a raw deal because tax is deducted from their savings even if they are not liable to tax on their income.

Apart from its unfairness, our present system of exempting some savings and not others also limits the supply of risk capital. It has the effect of channeling savings overwhelmingly into institutional hands - into the Building Societies which finance the mortgages and into the pension funds or life insurance companies which manage the pensions. In recent decades wealth held through institutions has grown inexorably while personal wealth over which a person has direct control and which he or she can realise if they want to, for an emergency or to start a business, has steadily declined. In the past 20 years or so the proportion of personal wealth tied up in house ownership, pensions and life assurance has risen from about 40% to over 79%. (In the US it is about 50%).

Unfortunately institutional saving is by its nature unadventurous. It has to be because the duty of managers of a pension fund is to safeguard the pension. For the individual, a house and a pension provide security, but they also tend to make people more reluctant to move or change jobs. If someone wants to chance their arm and set up a business, money in the bank is more useful than rights to a pension. It is no coincidence that while more people in Britain would like to start their own firm than in any other industrial country, fewer have actually done so than in any other country except Holland. Our tax system, with its discriminatory treatment of savings, makes Britain a less enterprising society.

That is why the government promoted the Business Expansion Scheme. (BES). The aim of BES is admirable : to encourage investment in small businesses. The snag is that when you provide a few very special tax exemptions, they draw the tax avoiders like bees drawn to honey. The BES became a property developers' ramp, the biggest tax haven for the rich for decades, which has actually done little to help the kind of entrepreneurship we need. The worst and most obvious abuses of BES as a tax haven have now been blocked in the 1985 Budget, but no doubt ingenious minds will invent new ones. In any event the scheme is restrictive in other ways. There is no tax relief if you invest in your own business or your family's business; and the relief is removed if the investor wants to take a personal interest in playing any kind of managerial or supervisory role.

A more general exemption for investment would be a better way of achieving the aims of BES.

The answer lies in a new deal for savings which can increase the fairness of the system, provide a spur to the

enterprising and simplify taxation enormously. These are bold claims, but they can be substantiated. First, however, we must set out the principles of the reform and how it would work.

The New System

All savings and investment will be deductible from tax. All realisation of savings and investment plus gifts and legacies received will be part of the tax base.

At the moment the Revenue wants to know what we earn from employment and other sources such as pensions, rents, dividends and interests, and whether we make any payments which are deductible from tax (like mortgage interest or pension contributions). They also want to know about capital transactions to see if any capital gains tax is payable and for this purpose they need to know the original acquisition costs of each asset as well as its sale price.

Under our reform, the revenue will still want to know income from employment and other sources. They will also need details of the realisation of savings (i.e. the total sales of assets), details of gifts received, loans taken out, receipts from life policies and net withdrawals from a bank account and details of investment in savings (i.e. the total purchase of assets, loans repaid, premiums paid for life policies and net deposits in a bank account). You pay tax on income, plus realised savings, less new savings. In the Appendix we set out the kind of shape the tax form would take. The following examples show how it would work in practice:

(a) Earnings £15000. £1000 drawn from bank account. £500 BT shares sold. £2500 put into Building Society account. Tax base is £15000; + 1000 + 500; - 2500; i.e. £14000

(b) Earnings £15000. Net proceeds of sale of house (less repayment of mortgage) £10000. Deposit on purchase of new house: £10000. No other sales or investments. Tax base is £15000; + 10000; - 10000; i.e. £15000

(c) Earnings £15000. £15000 shares sold. (No investment. Money all spent). Tax base is £15000 + 15000 i.e. £30000. (If the money had not all been spent but partially saved or re-invested, the tax base would have been accordingly reduced).

(d) Earnings £15000. Lump sum of £20000 received under life policy. £18000 reinvested partly in shares, partly in deposit account. Tax base is £15000; + 20000; - 18000; i.e. £17000.

One should add that PAYE can remain unaffected. Thus if, say, the total tax due on £15000 were 25% or £3750 and this was deducted through PAYE, then in Example (a) there would at the end of the year be a repayment due of, say, 39% on £500, that is £195. In Example (b) there would be no end of the year adjustment. In Example (c) extra tax would be due on £15000, part of which would be tax at a higher rate. In Example (d) extra tax would again be due, on £2000. It follows that people who realise no savings and make no investment in savings are simply taxed on their own income, as now.

Personal allowances could remain unaltered (or diminished or increased) or turned into allowances against tax as we have suggested. Pension contributions would of course be deductible as savings. Mortgage interest relief would be given as now with a deduction at the basic rate at source, but without relief for tax payable at the higher rates.

Fairness

We have already mentioned that small savers, who put their money in a Building Society, will get a fairer deal. They

will get the same advantages which were previously reserved for rich investors in the Business Expansion Scheme.

A recurrent theme of this Green Paper has also been the unfair distribution of the tax burden between earners and owners. We have argued that an annual wealth tax is no answer to this disparity of treatment. It requires a tighter CTT. But the best answer is to combine an effective tax on money handed from generation to generation with a somewhat heavier tax burden on the big spenders and a lighter burden on those who build up a business.

This is precisely what our new deal for savers does. Those who sell their capital to finance their expenditure will find the proceeds of sale treated as income and will pay more tax. High earners who invest will pay less and will be able to increase their wealth during their working lives. Most people would, we believe, accept that we should not discourage people from creating wealth through their own efforts but should derive more of our revenue from those who inherit wealth through no effort of their own. So the tax system will be fairer.

Wealth Creation: A Charter for the Enterprising

Our reform will be a charter for enterprise. Most people will no doubt continue to make saving for a house and for a pension their top priorities. But that will be because these are good things to save for, not because of the tax advantages they attract. Once all savings are treated alike, other forms of savings will become relatively more attractive than they are now; and it is not unreasonable to suppose that some of the savings now invested in houses or pensions will be put into more accessible, easily usable forms. People who want to be more mobile will choose the sort of savings that increase mobility and will be less keen to be tied down with a house or a pension. It will become easier to start a new business with one's own savings, which is how most new businesses start, or with help from relations. (Such help does not now qualify for relief under the Business Expansion Scheme). A person with business experience who invests in a small business will not be disqualified from getting tax relief, as he is now, because he wants to keep his eye on his investment as a director of the company. The birth rate of new businesses might rise to the sort of levels which we can see in Germany, America or Japan giving better prospects for future employment.

To sum up, it will be easier for the ordinary person to build up some capital during their working lives.

Some people argue that relief for all savings will increase the total which is saved. If true this would be beneficial, since by and large Britain has consumed too much and invested too little. But probably this claim must be treated with caution. The overall level of saving is unpredictable and sometimes illogical. It sometimes goes up when inflation is high and when saving is unprofitable; and goes down when inflation drops. What would change is the distribution of savings, with a somewhat smaller percentage being saved through institutions and a higher percentage available as risk capital. Nothing could be better calculated to promote innovation and enterprise.

The change would have certain other economic advantages. Adjusting tax for inflation becomes much easier. The effect of inflation on capital gains and capital losses imposes major problems for the taxman. With the end of capital gains tax the problem disappears. One will simply have to index the allowances and the higher rate bands, as is already done.

Finally, if governments wish to influence demand by tax changes, changes in income tax rates will become much more effective. With all savings exempt from income tax, what is effectively taxed is a person's total spending. A rise in rates will be a major deterrent to personal spending; a

drop will be a strong encouragement. But whether governments wish to use this weapon is not a matter for this Green Paper.

Simplicity

To simplify the tax system would be a great achievement. Most major changes add to complexity, so that they are often rightly regarded with deep scepticism.

Nevertheless, our new deal for savings should bring about a major simplification, principally by abolishing altogether the complex, and unproductive, Capital Gains Tax.

As mentioned, at the moment the blurred distinction between some kinds of capital gains and income provides a field day for the tax avoidance industry. Under our reform the original cost of an asset which has been sold becomes irrelevant and the distinction between capital gains and income likewise. All the tax man will need to know is the total proceeds of sale and the total cost of new acquisitions. Whether a gain or a loss has been made on the sale of a house or land or shares or any other kind of savings is irrelevant. The proceeds are taxable as income, but if they are not spent but re-invested they become exempt from tax.

This makes the individual's tax return of capital transactions much simpler. He or she no longer has to trace the records of the acquisition costs of every asset sold. The taxation of trading activities will also be much simpler. Tax will be based on the cash accounts of a business and owners will simply be taxed on the net amount they have withdrawn from the business during the year. *

*** Note: We do not deal in this Green Paper with Corporation Tax but in principle this can be dealt with in much the same way by a cash flow tax on corporations, based on the difference between receipts from the sale of goods and services (including capital sales) and the cost of**

acquiring goods and services. But this is a subject that requires separate treatment.

We can also abolish the complex qualifying rules which decide when pension contributions are deductible. As pensions are no longer a specially privileged form of savings the rules can simply be scrapped.

Now it will be argued that while the capital/income definition becomes irrelevant, a new distinction becomes vital: that between "savings", which are deductible, and "consumption", which is not. Is a house "saving"? Yes. A second house? Repairs to a house? Adding a bathroom? A car, a yacht, the cost of a training course?

There is no doubt that there will be arguments about what are savings and disputes about what shall qualify as savings. But the problem will be less serious than that created by the elusive and almost indefinable concept of income which nourishes the avoidance industry. This is for two reasons:- first, saving can be quite arbitrarily defined; and second, over a life time it does not really matter what is treated as saving and what is not.

Suppose we define savings as the purchase of, or investment in, "registered assets" and then draw up a list of what we decide shall be registered assets. What is put into the list will be to some extent arbitrarily decided. The list will almost certainly include one's house, shares, business expenditure, building society accounts, in fact all the things people now regard as savings. There would of course, be arguments as to what was investment in a house (as there are now about what alterations are subject to VAT), what is business expenditure, etc; and no doubt different parties would occasionally take different views about what should or should not be on the list of registered assets.

But there are disadvantages as well as advantages in having something classified as a registered asset. The

purchase of a registered asset is deductible from income tax. But the proceeds of its sale become taxable income. Buying a non-registered asset gives rise to no tax relief, but the proceeds of its sale are not taxable income.

That is why, over a life time, the distinction is not too important. You could even allow both registered and unregistered bank accounts. Deposits in the first attract tax relief but are taxable if withdrawn. Deposits and withdrawals from the second do not have to be declared at all. You could use a non-registered bank account to even out your tax bill between different years, deliberately paying more tax, by putting money in a non-registered account, in a year of otherwise light consumer expenditure and paying less tax in a year of heavier spending by withdrawing from that account.

Certainly the savings/consumption distinction is most unlikely to become anything like the source of tax complexity which the capital/income one has been.

What will of course be needed is an end of the year tax return by everyone. Most people with investments already have to make one and the need for it will become universal under our tax/benefit scheme. As the Appendix shows it will be a much simpler form than the present tax return and the experience of other countries, where annual returns are the norm, suggests that it should present no particular difficulties.

Effect on Revenue

While detailed figures are not available it seems more than probable that the total yield from taxation will be the same under our new deal for savings as under the present system. At first sight this may seem surprising as all savings, not just some, will get tax relief.

The reason is that the realisation of savings will be taxed as income. Already exemptions have gone so far that you would make up in tax on realisation of savings what you would lose by exempting savings that are now non-exempt.

Transition

The reform we propose is not a panacea. All sorts of problems remain - tax fraud is an obvious one; nor is any tax system proof against the ingenuity of the tax avoiders although we believe the scope for them will be more restricted. Nor will tax changes suddenly galvanise the economy. The effects are likely to be marginal and will take time.

The biggest problem we see with our reform is one of transition. How can we avoid the unfairness of suddenly taxing the proceeds of sale of an asset which was purchased out of taxed income? Pensioners might have bought shares during their working lives out of taxed income, expecting to live partly on capital when they retired. They should not be taxed twice over. There is also a danger that a sudden change over on D-day would lead some people, on D-day minus one, to turn all their savings into jewelry (which will almost certainly not be a "registered asset") or Krugerrands or antiques. When sold after D-Day, no tax would be payable, and the non-registered assets could then be turned into registered assets with a corresponding reduction of income tax.

We can see ways in which our reform could be introduced gradually - e.g. £1000 of registered assets not now exempt could be deductible in year 1, £5000 in year 2, and so on as desired. But we do not have all the answers. The problems of transition will need further study in which the Inland Revenue must be involved. But we can state categorically that people who have counted on spending some of their savings in retirement will be safeguarded.

The whole process however of introducing tax changes should be altered: reforms are nearly always made ad hoc

without regard to their effect on the tax system as a whole - hence the tax jungle we have now. In due course there should be established a permanent standing committee of the House of Commons to examine all proposed changes in the structure of taxation. When there have been special select committees on proposed changes in the past, their reports have nearly always proved useful. Major changes should never be kept up the Chancellor's sleeve until Budget day. They should be thoroughly discussed even before they are introduced. Indeed we would implement the recommendations of the Armstrong Report of 1980 which called for the publication of a Green Budget leading to the open discussion of the Chancellor's Budget plans well before the Budget itself. We must end the absurd secrecy surrounding the Budget, which no other country preserves.

In the meantime we have a goal and a clear view of the criteria by which all changes should be judged. The present government has sometimes talked of promoting fiscal neutrality by reducing exemptions; but they have also proceeded in an opposite direction; e.g. by creating the tax haven of the Business Expansion Scheme. Our route to fiscal neutrality is an easier one, because we are moving with the constant political pressures to exempt more and more savings that have created the present exemptions. The Chancellor has found the obstacles in his way almost insuperable because he is swimming against the current. Fairness, efficiency and simplicity are our criteria and the way to achieve them in the longer term is through our new deal for savings.

V SUMMARY OF PROPOSALS

A Immediate

* National Insurance Contributions will be abolished and replaced by an integrated income tax. The new tax threshold will be some 5.5% lower than the present income tax but much higher than the thresholds for NICs, to the advantage of the lower paid.

Tax rates will start at 39% (the combined rate of income tax plus NICs) and will stay at that rate until the 45% band is reached. If SERPS are kept there will be relief for those contracted out. There will be a 9% allowance for pensioners to avoid increasing their tax burdens. The higher rate above the previous NIC ceiling will be phased in gradually.

* Men and women will be taxed separately. The Married Man's extra allowance will be phased out (as proposed in our White Paper on Attacking Poverty), to pay for Basic Benefit that will give substantial extra help to those in need, especially families with children;

* Mortgage relief will be preserved in its present form but will no longer be given against higher rates of tax. We will move towards taxing company cars at their full value;

* Personal allowances against income will be transformed into allowances against tax so that they will be worth the same for all tax payers;

* Capital Transfer Tax will be transformed into an effective tax on inheritance with a reformed rate structure based on total gifts made, not merely on gifts within the previous 10 years.

B. Long Term: New Deal for Savings

There will also be a longer term fundamental reform of income tax to provide a completely new deal on savings:-

* All savings and investment will be exempt from tax, while dissaving and disinvestment will be treated as part of income. The small saver who invests in a Building Society account will get the same tax advantages as the rich man who invests in the Business Expansion Scheme; and investment in one's own

business will be treated as favourably as investment in pensions. But those who spend out [illegible] the sale of capital will be taxed more heavily.

* Capital Gains Tax will be abolished so that the distinction between income from earnings and income from capital gains becomes irrelevant and the tax system is greatly simplified.

Finally, a permanent standing committee of the House of Commons will be set up to examine all proposed changes in the structure of taxation. There will be a "Green Budget" produced at the end of the calendar year to announce plans for the final budget so that Budget secrecy will be ended.

NBPM AT 12/7

PRIME MINISTER 11 July 1985

INLAND REVENUE PRACTICES

The Inland Revenue are still busily upsetting people. The latest group to be worried are working women who have access to crêche facilities at their place of work. Whilst this is a taxable benefit for anyone earning more than £8,500 a year, on a strict interpretation of the law, the Inland Revenue has not usually levied tax on this benefit. (Today Programme, Monday 8 July)

People naturally dislike a system where for years they receive a benefit and the Revenue do not tax it, and then suddenly decide on a stricter interpretation of the law and levy a tax on it. It has happened in many companies with car parking spaces, lunches and other perks. Yet it remains irregular. If I work as an Oxford don, my meals are free and untaxed. If I work as a banker, my free lunches are taxed!

Wouldn't it be a good idea to have a meeting with the Chancellor and the Financial Secretary to encourage them to get more grip over the workings of the Inland Revenue? Don't taxpayers have a right to know in advance what is and is not taxable? And should the Revenue be left with so much discretion as to which part of the law they enforce, when, and on whom?

During the discussion of the Keith proposals on income tax, these matters could be tidied up in time for next year's Finance Bill, so that one way or another people could be quite clear as to which perks were taxable and which were not, and the Revenue's discretion substantially reduced.

JR

JOHN REDWOOD

Inland Revenue
CENTRAL DIVISION
Somerset House
London
WC2R 1LB

Telephone 01-438
-6832

NR 11/7
Mr Roche
Be content for
us OK
D.

T J Flesher Esq
Prime Minister's Private Office
10 Downing Street
LONDON SW1

9 July 1985

Dear Mr Flesher

PUBLICATION OF BOARD OF INLAND REVENUE'S ANNUAL REPORT

The Board of Inland Revenue intend shortly to publish their 127th Annual Report, for the year ended 31 December 1984.

The Report contains the usual sections outlining changes in the Department's staff and organisation, analysing our collection performance and describing recent direct tax developments. It also includes a number of diagrams illustrating key facts about the Department and its work. There are, in addition, three special chapters this year. The first, Chapter 3, considers how income tax thresholds have changed since 1938/39 in current prices, constant prices and relative to earnings, and what the consequences have been for the number of income taxpayers and the staff required to administer income tax. Chapter 4 gives an account of progress to date of the project for computerising PAYE (COP) and Schedule D assessing (CODA) and Chapter 7 describes the Department's work on international taxation.

We do not consider that there is any politically sensitive material in the Report and it is unlikely to arouse controversy. There are one or two topics which might attract some press interest - for instance, the special chapters and there is usually interest in some of the figures (eg remissions and cost of collection) - but overall we would not expect the Report to excite much press comment.

We propose to arrange for the Report to be laid before Parliament by 11.00 am on Wednesday 24 July and to publish it at 3.30 pm the same day. I should be grateful if you would let me know whether the proposed publication date meets with your approval.

Yours sincerely

D. Shaw

D SHAW

11. VII AM 85

B cc JR

Inland Revenue

Policy Division
Somerset House

cf / Attach to Treasury letter ... re on late payment of tax
AT

7 June 1985

MISS O'MARA
CHANCELLOR'S OFFICE

KEITH REPORT IMPLEMENTATION

I attach as requested the brief note for the Prime Minister on the Keith proposals affecting the Inland Revenue.

J O'Hare

J O'HARE

KEITH REPORT PROPOSALS AFFECTING INLAND REVENUE

1. The broad aims of the 172 recommendations are

i. to make more explicit the scope of the Revenue powers, thereby giving the taxpayer greater certainty about his rights and obligations,

ii. to reduce the scope for administrative discretion; and

iii. to provide better safeguards for the taxpayer.

Taxpayers' safeguards

2. The major benefit for the individual taxpayer lies in enhanced rights of appeal - to the independent Commissioners and the Courts - against assessments, penalties etc.

Obligations

3. Keith proposes that it should be made much clearer to taxpayers what they are required to tell the Revenue

about their income, when they are required to do it and what records they should keep. In some cases this may involve some tightening up of the present rules eg, there is a requirement, which does not exist at present, on businesses to keep adequate records.

In other cases, the rules are relaxed - eg the time which the ordinary person has to send in his return is extended from one month to six months.

Penalties

5. The proposals will result in the simplification and rationalisation of the system of tax penalties. Some penalties will increase; others will be reduced.

Overall balance

6. Keith intended that his recommendations should provide a balanced package of measures - in particular he was keen to ensure that, wherever he proposed increased powers for the Revenue, there should be appropriate and matching means of redress for the taxpayer.

7. Most outside commentators consider that the Committee has generally succeeded in achieving this.

CO Budget

Pt 14.

ref 1016.

7.83 CONFIDENTIAL

B/F with further Treasury note
AT 7/6

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

4 June 1985

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew,

LATE PAYMENT OF VAT AND OTHER TAXES

As requested in your letter of 25 April, I attach a note setting out whether tax payers are entitled to receive interest for late payment of refunds and what provisions there are to ensure that the Government pays its bills on time.

The Prime Minister was concerned that the implementation of the Keith Committee recommendations on late payment of VAT would discriminate against the taxpayer, particularly small businesses. As the note points out, the provisions for the Revenue departments to pay interest (or sometimes a flat-rate "bonus") on late repayment are very often as generous, if not more so, than the corresponding obligations on taxpayers paying late.

The Chancellor will however be seeking to improve and simplify the rules on the Inland Revenue side in the context of the forthcoming "Keith" legislation relating to Revenue taxes; cost-effective implementation of these changes will be one important outcome of the Revenue's current computerisation projects. So far as payment of Government bills is concerned, interest is not generally due, in line with wider commercial practice. But Departments are required to - and generally do - pay promptly.

Yours ever
Rachel.

MRS R LOMAX
Principal Private Secretary

LATE PAYMENT OF TAX

This note sets out the provisions under which taxpayers are entitled to receive interest for late payment of refunds from revenue departments; and also the arrangements for the payment of bills by Government departments.

Customs and Excise taxes and duties

2. There is at present no money sanction for late payment of VAT or other Customs and Excise duties, or for late refund by the Customs. In the nature of things, payment of Customs and Excise duties is immediate and very largely final. Late payment and refund of these duties are not significant problems and there are no plans to propose general interest charges either way. However given the present extensive zero-rating for VAT, repayments are a common and continuing feature of the tax and computerised arrangements are made to pay them promptly. Late payment of VAT by taxpayers gives rise to an average of £1200m of arrears at any time.

3. Following the Keith Committee's recommendations, we are introducing two sets of measures in this year's Finance Bill. First, we propose a flat surcharge at a starting rate of 5 per cent, irrespective of the length of the delay and subject to a minimum of £30, for taxpayers who are consistently late only (after two previous late payments within a year and issue of a warning notice at any stage) rising by 5 per cent steps to a top rate of 30 per cent after 5 further defaults. If, at any stage, the taxpayer pays promptly for a whole year, he leaves the surcharge system and starts again with a clean sheet.

4. So far as refunds by Customs are concerned, we propose that Customs should have the same one month's grace as the taxpayer to clear a claim (excluding time to pursue reasonable enquiries or clear up taxpayer errors in the return): after that a supplement will be due again at 5 per cent, subject to a minimum of £30, for all such delays, including the first, and not just where Customs are consistently late in paying.

5. In general our proposals favour the taxpayer - he can pay late from time to time free of surcharge, but the Customs will always pay a supplement on late refunds. The rates are only the <u>same</u> both ways where the taxpayer already has a history of recent late payment, and only <u>higher</u> for the taxpayer where default has been really persistent.

6. We also propose an interest charge where investigation shows that taxpayers have underdeclared, or overclaimed, VAT rather than simply paid it late. When this is put into

effect in 1988 interest will run at the same rate, currently 11 per cent, as already applies to Inland Revenue taxes. No issue of symmetry really arises here. Given that VAT is self-assessed, it is up to the taxpayer to see that he does not overdeclare or underclaim in his return; if and when he does discover an error he can claim back any VAT overdeclard (or underclaimed) in his next return. The supplement already mentioned then runs in the case of delay by Customs.

Inland Revenue taxes

7. There is already provision for interest at a common rate (currently 11 per cent) on both underpayments by the taxpayer and refunds by the Inland Revenue. But the present rules do not provide complete symmetry in other respects - particularly as regards the starting date from which interest begins to run. It may be helpful to look separately at the assessed taxes (notably corporation tax, Schedule D income tax and CGT) which are paid direct by the taxpayer; and Schedule E, almost entirely collected by deduction at source under PAYE.

8. Assessed taxes. The legislation in each case lays down clear "due dates" on which tax is meant to be paid. But interest on underpayments and refunds does not generally run from these dates. This is largely a reflection of the fact that, traditionally, liabilities are in practice often fixed only in estimated amounts by the due date, for lack of full information from the taxpayer. Final settlement - whether involving more tax from the taxpayer of a refund on tax to him - follows some time later. The detailed interest rules are complex: but their basic effect is to accommodate this process by allowing a "breathing space" before interest begins to run - broadly 6 months from the due date for the taxpayer in the case of underpayments, and 12 months from the due date for the Revenue in the case of refunds. We looked in 1980-81 at the possibility of harmonising this "breathing space" at 6 months either way, but decided against it partly on arguments of consistency with the position of PAYE/Schedule E (see below) but also because of the large revenue and staff costs involved.

9. The aim is to work towards a more symmetrical, and very much simpler, interest regime for the assessed taxes, once this can be achieved at acceptable staff cost. Two current developments will help in that direction: first the Keith compliance proposals relating the Inland Revenue - on which we are currently consulting with a view to legislation next year - and secondly, the completion of Inland Revenue computer projects now under way or projected.

10. PAYE/Schedule E. Two groups are involved here: employers, who are liable to deduct and pay over PAYE during the course of the year; and individual employees who are subject

to PAYE. So far as employers are concerned, there are currently no money sanctions for late payment. Following the Keith Committee's recommendations, however, we are consulting this year on a surcharge system parallel to that for VAT. The issue of symmetry does not generally arise here, since there is no analogue in the PAYE system to VAT "repayment traders" who are eligible for consistent and substantial refunds; but we will be considering what provision is appropriate to compensate for delay in the exceptional cases where payment is due from the Revenue to employers operating PAYE.

11. So far as the individual employee is concerned, overpayments or underpayments under PAYE are calculated as part of the Revenue's review of PAYE returns after the end of the tax year. Underpayments are not generally recovered in cash from the taxpayer, but collected, without interest, through extra PAYE deductions in a later year. Overpayments are refunded in cash: interest is payable if and to the extent that refund is delayed beyond 12 months from the end of the deduction year in question. As in the case of the assessed taxes, this "breathing space" is designed to cut out the heavy revenue and, particularly, staff costs involved in paying a large number of relatively trivial amounts of interest.

12. In this area, therefore, the present rules - paying interest on some refunds, but not charging it on underpayments - already operate asymmetrically in the taxpayer's favour. There are no plans to change that: indeed in the long run it should be possible to tilt the balance a little further in the taxpayer's favour by reducing the current "breathing space" on refunds to less than 12 months. Again this must rest on implementation of the Keith compliance recommendations and on the full implementation of the computerisation of PAYE project ("COP"), which together will allow interest on repayments to be processed on a larger scale at acceptable staff cost.

Government payment of bills

13. Turning to the question of payment to contractors, Departments are required to pay promptly, and generally do so. They will shortly be reminded of this requirement in updated accounting guidelines. Where there is delay, what interest may be due is of course determined by the terms of the contract with the supplier, in the absence of any duty in general law for purchasers at large to pay interest. Government contracts - as is quite normal - do not generally provide for interest on late payment, but we do exceptionally pay compensation <u>ex gratia</u> in cases of hardship or serious departmental default.

Econ Pol: Budget Pt 4

B/F 3/6

AT

16 May 1985

PRIME MINISTER

THE INLAND REVENUE AND THE KEITH REPORT

David Hobson tells me the Keith recommendations on income tax contain some political difficulties. Tight time limits for the submission of returns and accounts; powers of entry to business premises, with random checks; tightening of the net on casual employees; and publications of the names in civil fraud cases, are amongst some of the more contentious items.

It was intended to set these out in a White Paper issued well before the next Budget, prior to their enactment in the 1986 Finance Bill.

It would be a good idea to discuss with Nigel how this can be handled sensitively. Many of our supporters feel that the Inland Revenue already have strong powers; are slow to make repayments of tax owing to the taxpayer, but all too quick to levy tax due; the current system of interest charges is asymmetrical between tax owed and tax due; and that the Inland Revenue already pry too much.

Treasury are preparing a note on symmetry.

It would be pity to run into undue flak in 1986 by seeming to buttress the powers of the Reveneue. It might be better to do nothing if we can't come up with something helpful.

JR

JOHN REDWOOD

21/252

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Mark Addison Esq
10 Downing Street
LONDON
SW1

1 May 1985

cc ~~Mrs Wall~~

Dear Mark

ICI CASE

...Following my letter of 9 April, I enclose a further note from Inland Revenue on recent developments on the ICI case.

Yours sincerely

Vivien Life

VIVIEN LIFE

FROM: M A HILL

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

30 April 1985

FINANCIAL SECRETARY

ICI CASE

1. The purpose of this note is to report on developments on the ICI case since my note of 4 April. It focusses in particular on whether or not either side is likely to appeal against the High Court decision.

2. You will recall that, though the original judgment was delivered in January, the Judge did not give his decision on whether ICI was then entitled to any relief by way of declaration until 3 April. The transcript of that decision became available last week. Having now had an opportunity to study this transcript in the light of our Solicitor's advice, we see no reason to depart from our preliminary view on the appeal issue (as indicated in my note of 4 April). In other words we still think:

a. it would not be worth the Government taking the initiative to appeal against the original judgment and subsequent decision on declarations;

and b. If, however, ICI were themselves to appeal, the Government would probably wish to cross-appeal, by way of serving a respondent's notice.

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cc Chancellor of the Exchequer
Chief Secretary
Sir Peter Middleton
Mr Cassell
Mr Robson
Mr Lord
Mr Evans IDT
Mr Ricks (Treasury Sol)

Sir Lawrence Airey
Mr Green
Mr Rogers
Mr Pitts
Mr Painter
Mr Cleave
Mr Elliss
Mrs Hubbard
Miss Hill
Mr J P O Lewis
Mr McManus
PS/IR

3. Should the Government want to take the initiative to appeal, they would of course need to do so within the normal 28 day period - ie by 1 May. But further study of the single declaration which was granted, and of the transcript of this hearing, has confirmed our preliminary assessment that there is nothing there which should cause the Government/Revenue much - if any - difficulty in practice. Our informal contacts with the oil companies potentially affected by this declaration suggest that they too share this view, and are now fairly relaxed about the case as a whole.

4. Admittedly some of the points in the original judgment which went against us may be open to challenge. But none of these are points on which anything of practical significance hinges. Moreover if the Government/Revenue took the initiative to appeal on these points, it could be seen as tantamount to admitting that they had "lost" the original case. Against this background, the heavy expenditure of official resources necessarily involved would seem to outweigh any benefits to be gained from the Government initiating an appeal.

5. The situation would be rather different if ICI themselves appealed. (Whilst we have no firm indications of what ICI propose to do, the whispers that have reached us in recent days suggest they probably will appeal.) In this event the Government would be bound to commit official resources to the issue. It would then seem self-defeating not to take the opportunity to reargue at least some of the points on which the Judge found against us in his judgment, particularly as failure to do so could equally be interpreted as a (retrospective) admission of defeat. However a final decision on this issue cannot sensibly be made in advance of seeing the precise terms of any notice of appeal ICI themselves serve in this case.

6. Assuming the Government/Revenue wished in effect

to cross-appeal, two options would be open. We could simply serve a notice of appeal like ICI, or we could serve a "respondent's notice". Our legal advisers tell us that, in terms of the arguments we are permitted to advance, there is nothing to be gained from serving a notice of appeal which cannot likewise be gained from serving a respondent's notice. The only practical difference lies in the time limits which would apply. An appeal would have to be lodged within the general 28 day time limit, whereas the Government would have a further 21 days from the date of ICI's own appeal in which to serve a respondent's notice. As it would clearly be beneficial for the Government to have the maximum time possible to set out its case to best advantage, we would propose - if the need arises - to go down the respondent's notice route.

7. In view of their earlier interest, you may wish to tell the No.10 Press Office of these latest developments in the ICI case.

MH

M A HILL

Econ Pol. - Budget Pt 14

-7 MAY 1985

PRIME MINISTER

It is worth recording that as a result of the Budget employees receiving less than half average earnings will pay £270 million less in National Insurance contributions and £400 million less in income tax. The burden on the low paid has therefore been lifted by a total of £670 million as a result of the last Budget.

TP

29 April 1985

CONFIDENTIAL

Subject

file VC

10 DOWNING STREET

cc Master

From the Private Secretary

25 April 1985

Dear Rachel.

LATE PAYMENT OF VAT

During the course of their meeting today, the Prime Minister raised with the Chancellor his proposals to reduce late payment of VAT. She was concerned about the effects on small businesses. The Chancellor explained that the Keith proposals had been the subject of very extensive consultation and in certain respects were more favourable to traders than the status quo. Criminal sanctions were being removed and provisions inserted to allow traders to avoid the surcharge if they acted with "due diligence" and had "reasonable excuse". The Prime Minister felt that small businesses were often the victim of late payments by large companies and by the public sector. She asked the Chancellor to prepare a note setting out what provisions there were to ensure that the Government paid its bills on time and whether taxpayers were entitled to receive interest for late payment of refunds.

Yours sincerely

Andrew Turnbull

(ANDREW TURNBULL)

Mrs Rachel Lomax,
HM Treasury.

CONFIDENTIAL

B

CONFIDENTIAL

PRIME MINISTER

LATE PAYMENT OF VAT

In the Budget, the Chancellor announced his intention to implement most of the recommendations of the Keith Report on Late Payment of VAT. The history is as follows.

In 1980 the Chancellor established a Committee under Lord Keith of Kinkel to report on all aspects of the Inland Revenue and Customs and Excise enforcement powers. The Committee reported in 1983. On VAT, Keith was concerned at the extent of late payment. In the normal way traders have use of the money which has been paid by their customers in VAT for $2^1/_2$ months. VAT returns were made quarterly and so the average time VAT is retained by the trader is $1^1/_2$ months. In addition the trader has a further month to pay tax after submitting his return.

Keith found that three quarters of all traders were paying late and that arrears totalled around £$1^1/_2$ billion. He felt that the existing criminal penalties were excessive and, as a result were not being applied effectively. He therefore recommended that civil remedies be introduced, with an interest penalty on tax not declared and a surcharge for tax paid late.

The Government issued a consultation document in July 1983 and reported the results to Parliament in early 1984. The PAC strongly supported the Keith approach. The Government issued a further document in November 1984 setting out its conclusions but asking for comments by January 1985. Thus there have been two rounds of consultation. Following the second round modified proposals were published in the Finance Bill. A rising surcharge is to be imposed where tax is still outstanding more than one month after the VAT return should have been made. This starts at 5 per cent for tax one month late rising to 30 per cent for tax six months late, by which time the trader will have had use of the VAT money for $8^1/_2$ months. As a response to the consultations, the Finance Bill includes an escape clause which provides that the trader will not be liable to the surcharge where he has shown due diligence in submitting his return or has a reasonable excuse.

The effect of the measures is estimated to be an increase in annual revenue of £50 million as a result of more accurate returns. In addition there could be a once and for all return in the culmulative arrears of £600 million.

AT

24 April 1985

[Mr. Lawson]

particularly marked feature of the encouraging growth in overall employment that has occured since the spring of 1983.

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

Today I propose to remedy this grievance. As from 6 April, tax relief will be allowed for half the graduated class 4 national insurance contribution paid by the self-employed. In addition, I have agreed with my right hon. Friend the Secretary of State for Social Services that, as from the beginning of October, the flat rate class 2 national insurance contribution payable by the self-employed will be reduced from £4·75 to £3·50 a week. The benefit of these reliefs to the self-employed will be £55 million in 1985-86 and £155 million in a full year.

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

PERSONAL TAXATION: TAXES ON SPENDING

I turn now to the taxation of personal income and spending. My budget last year shifted some of the burden of personal taxation from earnings to spending. Today I propose to make a further move in this direction. Accordingly, I propose to increase the revenue from the excise duties by rather more than is required simply to keep pace with inflation—a less painful task now that inflation is relatively low.

I propose to increase the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of 6p on a packet of 20 cigarettes. This will take effect from midnight on Thursday. I do not, however, propose any increase at all in the duties on cigars and pipe tobacco.

I propose increases which, including VAT, will put between 1p and 2p a pint on most beer, depending on its strength, 1p a pint on cider, 6p on a bottle of table wine and about 10p a bottle on sparkling or fortified wine. In recognition of the current difficulties of the scotch whisky industry, however, I propose to increase the duty on spirits by only 10p a bottle, well below the amount needed to keep pace with inflation. [HON. MEMBERS: "Hear, hear."] All these changes take effect from midnight tonight.

I propose to increase the duty on petrol and derv by amounts which, including VAT, will raise the price at the pumps by approximately 4p and 3½p a gallon respectively. This does no more than keep pace with inflation. These increases will take effect from 6 o'clock this evening. As last year, I do not propose any change in the duty on heavy fuel oil.

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

These changes in the excise duty will, all told, raise an extra £820 million in 1985-86, some £235 million more than is required to keep pace with inflation. The overall impact effect on the retail price index of these changes will be 0·5 per cent. This has already been taken into account in the forecast that I have given the House of 5 per cent. inflation by the end of the year.

I now turn to VAT. I have followed with interest the speculation that has built up over recent months about my alleged intentions for VAT. Most of it—such as the so-called proposal to levy VAT on books—has concerned matters which have not even been under consideration. But to have revealed this prematurely would not have stilled speculation; it would merely have concentrated it on those matters that were under consideration — a practice that no Chancellor, rightly, has sought to encourage.

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

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

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

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

Following extensive consultations, I propose to include in this year's Finance Bill legislation to implement most of the recommendations of the first two volumes of the Keith report on the enforcement powers of the revenue departments, including measures to deal with the problem of the late payment of VAT. This is expected to bring in extra revenue of about £50 million in 1985-86. By 1988-89, there will have been a cumulative once-for-all revenue gain of about £600 million. Proposals on the Inland Revenue aspects of the Keith report will follow in next year's Finance Bill.

The VAT changes I have just proposed will bring in £90 million in 1985-86, rising eventually to £215 million in a full year. They will have no impact on the RPI. The

EXPRESS OPINION

Nigel must stop this VAT folly

ONCE again a Government Minister puts his great hobnail boots into his party's supporters. This time it is Nigel Lawson, the Chancellor of the Exchequer.

His Customs and Excise Department threatens to clobber the traders who are late in paying VAT. And the penalty for delayed payments is a surcharge of up to 30 per cent. That could wreck some small businesses.

Naturally, protests are mounting at this iniquitous measure.

The Government seems to have developed a passion for punishing its own people. Sir Keith Joseph's Education Department wanted to charge university fees to parents, most of whom had borne the cost of independent education thereby saving the State expense. That proposal was abandoned. The VAT plan should follow the same path.

It is ludicrous that the Queen should be presenting awards to innovative small enterprises—such as the five-strong Bristol firm producing tungsten darts—while her Ministers are cudgelling similar companies for minor failings.

Of course everyone should pay their taxes promptly. The Taxman should pay rebates promptly too.

Does the Inland Revenue fine itself when it takes too much money from the taxpayer?

Ministers should get their act together. Their job is to promote the country's prosperity.

They will do that by encouraging small businessmen. Not hounding them.

Lesson for Sir

POSTAL workers involved in unofficial industrial action end their strike. Very wise.

A spasm of anger at management stupidity is understandable. A long drawn out

EXACTLY 10 YEARS AFTER THE

At last A d h in

From PHILIP FINN in New York

TEN YEARS ago the United States walked away from the most disastrous and debilitating war in history. After a decade of increasing unhappiness and hostility at home, the Americans pulled their demoralised troops out of Vietnam.

The boys, mostly conscripts to a conflict for which they had little heart, went home in shame. There was no hero's welcome, and for thousands of veterans the horror of war was followed by public recrimination.

For this was also the most unpopular war in American history, and the nation had no inclination to applaud the men who fought it.

Only now is America beginning to acknowledge the sacrifices made by the half million soldiers who went to Vietnam. Only now is it realising that an estimated 35 per cent of the survivors still suffer—from depression, anxiety, sleeplessness and re-experienced traumas.

Former private Rich Perricone believes that the nightmare days are over for the veterans. "I think we are at last being made to feel we are important and that what we did was for our country," he says.

Perricone is a Vietnam veteran who spent five and a half harrowing years as a prisoner of the North Vietnamese. His country barely gave him a thankyou when he returned.

But now, after 10 years being treated "worse than dirt rags," Rich and thousands like him are to be honoured by a nation that has found its conscience. This week the flags and the bunting are coming out.

RUINED AND TORN

Flashbacks are featured on all the networks, newspapers carry Bible-length series and magazines carry gory reminders on their covers.

The wounds of war still abound. Time has not washed away the miseries of those who lost loved ones, nor the agonies of men whose bodies were torn and ruined.

And those who were conscripted and went to the end of the world have never quite been able to understand why they came back to be treated like lepers.

"It was not our fault. We

we came home," says Rich Perricone.

He was captured at Pleiku on July 12, 1967, and spent the next 2,064 days — "I kept count of every one"—first in Cambodia, and then at the notorious Hanoi Hilton.

"I shared a hut with four other guys, and our blood used to boil when newly captured pilots came in and told us about the anti-war movement going on back home.

"It was even worse when anti-war campaigners Jane Fonda and Attorney-General Ramsey Clark went out there.

"And then when we returned home we were

OUO

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AT

HA/04

BACKGROUND ECONOMIC BRIEFING

COMPARISON OF SHORT-TERM FORECASTS

Compiled by
EB Division
HM Treasury (Tel: 01 233-4489)

Since the Budget, new forecasts have been published by Phillips & Drew, Simon & Coates, Henley and the CBI. LBS and Liverpool have revised their pre-Budget forecasts to take account of the Budget measures. The usual summary sheets of outside forecasts for 1985 and 1986 are attached. An additional table compares post-Budget and pre-Budget forecasts of output, inflation and unemployment.

2. GDP growth is still expected to average 3 per cent in 1985 and 2 per cent in 1986. The range around this consensus however has widened since last month. For 1985 the CBI top the range with expected growth of 4 per cent, mainly as a result of further strong growth in the manufacturing sector.

3. Retail price inflation is expected to peak in the second quarter of 1985 at around 6 per cent and then to decline to 5.7 per cent by 1985Q4 and 5.4 per cent by 1986Q4. All outside forecasters are more pessimistic about retail price inflation prospects for 1985Q4 than the Government's Industry Act forecast. This is similar to the position at this time last year as the following table shows:

		RPI forecasts for Q4			
	IAF	Consensus	Range	Outturn	
Consensus in April 1984	4½	5.4	4¾ (CBI) - 6.8 (NIESR)	4¾	1984Q4
" " " 1985	5	5.7	5.3 (Oxford) - 6.5 (NIESR)	-	1985Q4

4. Overall the Budget has had little impact on the consensus view of unemployment. Unemployment in 1985Q4 is expected to be at or around present levels. Thereafter the consensus is for unemployment to continue to rise slowly through to 1986Q4 - to a level of about 3.2 million (UK s.a.). Individual forecasters vary widely from LBS, who expect unemployment to fall below 2.9 million, to Simon & Coates who continue to forecast 3.5 million unemployed by the end of 1986.

David Walton

DAVID WALTON
17 April 1985

UNCLASSIFIED

POST-BUDGET AND PRE-BUDGET FORECASTS FOR OUTPUT, INFLATION, AND UNEMPLOYMENT

Percentage change on previous year

	GDP(average)				RETAIL PRICES - Q4 (*)				UNEMPLOYMENT - Q4			
	1985		1986		1985		1986		1985		1986	
	Post-Budget	Pre-Budget	Post-Budget	Pre-Budget	Post-Budget	Pre-Budget	Post-Budget	Pre-Budget	Post-Budget	Pre-Budget	Post-Budget	Pre-Budget
1985 FSBR forecast (1)	3.5	3.5	2.5	-	5.0	4.5	4.5	-	-	-	-	-
LBS (2)	3.3	3.6	2.4	2.6	(5.3)k	(5.3)k	(4.9)k	(5.1)k	3.09	3.15	2.90	3.09
Phillips & Drew	3.3	3.1	1.8	1.3	5.6	5.6	5.4	5.4	3.19	3.18	3.19	3.26
Simon & Coates (3)	3.3	3.7	1.2	0.9	5.4	5.4	4.9	4.9	3.09	3.09	3.50	3.50
Henley (4)	2.9	2.8	1.6	1.6	5.7	6.0	5.5	5.8	3.20	3.20	3.28	3.24
Liverpool (5)	3.2	3.0	4.1	3.8	(3.5)k	(3.7)k	(2.2)k	(2.7)k	3.15k	3.15k	2.92k	3.01k
CBI (6)	4.0	3.2	2.5	-	(5.0)	(4.9)	(4.8)	-	3.10	3.00	3.10	-
Consensus of Outside Forecasts Made Post- and Pre-Budget	3.3	3.2	2.3	2.0	5.6	5.7	5.3	5.4	3.13	3.12	3.19	3.27

NOTES

(*) Consumer prices in brackets

(1) GDP forecast up to 1986 H1, inflation forecast up to 1986 Q2.

(2) GDP (output measure); inflation refers to consumer prices, whole year on whole year percentage change.

(3) GDP (output measure).

(4) GDP (output measure).

(5) GDP (expenditure measure); inflation refers to consumer prices, whole year on whole year percentage change.

(6) Inflation refers to consumer prices.

k whole year.

EB Division, HM Treasury
17 April 1985

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COMPARISON OF FORECASTS - SUMMARY TABLES

FORECASTS FOR 1984-85

Except where specified figures are percentage changes on previous year

Date of Forecast	IAF(m)	NIESR	LBS	Phillips & Drew	Simon & Coates	Henley	C'bridge Econ	L'pool	CBI	OECD	CUBS
	Mar '85	Feb '85	Mar '85	Apr '85	Apr '85	Apr '85	Oct '84	Mar '85	Mar '85	Dec '84	Autumn '84
		Forecasts for financial year 1984-1985									
M0 growth	4-8	7.0	5.0	5.5k	6.6k	-	-	5.5k	-	-	6.0k
£M3 growth	6-10	9.7	8.9	9.3k	10.2k	9.8	-	-	-	-	-
PSBR (£bn)	10.5	9.0	10.1	10.5	9.7	10.0	-	9.5	10.5	-	10.4k

Date of Forecast	Oxford	OUTSIDE CONSENSUS	OUTSIDE RANGE		Other City forecasts not reflected in consensus: Capel-Cure	Wood Mack	Scrimgeour
	Jan '85				Feb '85	Apr '85	Feb '85
M0 growth	-	6.0	5.0 (LBS)	7.0 (NIESR)	-	-	-
£M3 growth	9.4	9.5	8.9 (LBS)	9.8 (Henley)	10.0	-	10.0
PSBR (£bn)	9.2	9.8	9.0 (NIESR)	10.5 (P&D,CBI)	10.0	10.1	9.9

NOTES:

(k) calendar year 1984 (m) Industry Act forecast

'Consensus' is defined as an unweighted average of comparable outside forecasts

EB Division, HM Treasury 16 April 1985

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COMPARISON OF FORECASTS - SUMMARY TABLES

FORECASTS FOR 1985/1985-86

Except where specified figures are percentage changes on previous year (GDP components in constant 1980 prices)

	IAF(m)	NIESR	LBS	Phillips & Drew	Simon & Coates	Henley	C'bridge Econ	L'pool	CBI	OECD	CUBS	Oxford	OUTSIDE CONSENSUS	OUTSIDE RANGE		Other City forecasts not reflected in consensus: Capel-Cure	Wood Mack	Scrim-geour	
Date of Forecast	Mar '85	Feb '85	Mar '85	Apr '85	Apr '85	Apr '85	Oct '84	Mar '85	Mar '85	Dec '84	Autumn '84	Jan '85				Feb '85	Apr '85	Feb '85	
Forecasts for calendar year 1985																			
GDP	3.5 (A)	2.8 (O)	3.3 (O)	3.3 (A)	3.3 (O)	2.9 (O)	2.1 (O)	3.2 (E)	4.0 (A)	3.0 (A)	2.9 (O)	2.5 (A)	3.0	2.1 (C'bridge)	4.0 (CBI)	3.1 (A)	3.3 (A)	2.9 (A)	GDP
Consumers' Expenditure	3.0	2.6	2.8	2.5	2.4	2.3	2.4	2.2c	2.5	2.0	-	2.0	2.4	2.0 (OECD,Oxford)	2.8 (LBS)	2.3	2.5	2.4	Consumers' Expenditure
General Govt Consumption	2.0	1.0	1.9	0.8	0.7	2.5	0.8	-1.2d	2.0	0.75	-	0.8	1.3	0.7 (S&C)	2.5 (Henley)	1.0	1.2	1.5	General Govt Consumption
Gross Fixed Investment	2.0	0.1	2.6	3.0	4.1	0.8	2.1	11.4e	3.75	4.25	-	2.3	2.6	0.1 (NIESR)	4.25 (OECD)	-	2.0	3.4	Gross Fixed Investment
-public	-	-10.1	-8.6	-9.4	-6.0	-12.8	-	-	-6.0	1.25	-	-6.0	-7.2	-12.8 (Henley)	1.25 (OECD)	-20.0	-	-10.2	-public
-private	-	3.6	6.6	7.4	7.7	5.4	-	-	7.2	7.5f	-	5.2	6.2	3.6 (NIESR)	7.7 (S&C)	10.0	-	8.2	-private
Stockbuilding (£bn)	-0.3	1.0	0.6	-0.4	0.4	1.0	1.3	-	0.5	0.5n	-	0.4	0.6	-0.4 (P&D)	1.3 (C'bridge)	0.8	1.0	0.7	Stockbuilding (£bn)
Exports (goods & services)	6.5	5.4	7.0	6.1	7.5	5.4	4.5	-	7.5	4.0	-	5.5	5.9	4.0 (OECD)	7.5 (S&C,CBI)	5.8	6.3	7.3	Exports (goods & services)
Imports (goods & services)	3.5	4.5	6.4	3.4	5.5	4.7	4.8	-	4.5	4.25	-	3.5	4.6	3.4 (P&D)	6.4 (LBS)	3.5	4.1	6.1	Imports (goods & services)
RPI (CPI) - 4th Qtr	5.0	6.5	(5.3)k	5.6	5.4	5.7	(7.2)k	(3.5)k	(5.0)	(5.25)k	-	5.3	5.7	5.3 (Oxford)	6.5 (NIESR)	5.6k	5.3	5.7	RPI (CPI) Q4
Average Earnings (g)	-	8.4	8.0	8.1	8.4	7.7	9.5	4.8	7.0	6.75	-	8.4	7.7	4.8 (L'pool)	9.5 (C'bridge)	7.8	8.0	8.3	Average Earnings (g)
RPDI	-	2.7	2.4	2.4	2.5	2.3	-	-	2.6	-	-	2.0	2.4	2.0 (Oxford)	2.7 (NIESR)	3.0	-	2.1	RPDI
Unemployment (UK adults million - 4th Qtr)	-	3.20	3.09	3.19	3.09	3.20	3.2k	3.15k	3.10	-	-	3.16	3.15	3.09 (LBS,S&C)	3.20 (Henley)	3.20	3.2k	3.17	(UK adults) Unemployment (million Q4)
World trade (g)	5.5	6.0	5.7	5.5	5.5	5.5	-	5.0	7.0	6.0	-	5.8	5.8	5.0 (L'pool)	7.0 (CBI)	4.5	6.0	5.8	World trade (g)
Current Account (£bn)	3.0	0.7	-0.7	1.6	2.2	0.1	2.9	-0.9	2.3	-0.5	-	1.0	0.9	-0.9 (L'pool)	2.9 (C'bridge)	0.0	2.9	0.9	Current Account (£bn)
Sterling Index(1975=100) Q4	-	68.5	76.0	71.5	71.0	70.2	-	77.4k	78.5j	-	76.7j	75.8	72.2	68.5 (NIESR)	76.0 (LBS)	67.0	77.8	72.0	Sterling Index Q4(1975=100)
Short term interest rate (g) - 4th Qtr	-	-	10.0	10.5	9.5	10.5	-	10.0k	-	-	-	9.7	10.0	9.5 (S&C)	10.5 (P&D,Henley)	11.0	10.5	12.5p	Short term interest rate Q4 (g)
Forecasts for financial year 1985-1986																**Forecasts for 1985-1986**			
M0 growth	3-7	8.0	3.1	6.0k	4.0k	-	-	6.0k	-	-	5.2k	-	5.6	3.1 (LBS)	8.0 (NIESR)	-	-	-	M0 growth
£M3 growth	5-9	9.0	7.1	8.5k	6.2k	8.9	-	-	-	-	-	10.4	8.9	7.1 (LBS)	10.4 (Oxford)	9.0	-	11.0	£M3 growth
PSBR (£bn)	7.0	9.6	6.6	6.7	6.5	8.7	-	7.2	7.7	-	9.5k	6.6	7.5	6.5 (S&C)	9.6 (NIESR)	7.5	8.0	7.5	PSBR (£bn)

NOTES:

(A) average measure
(O) output measure
(E) expenditure measure
(c) non durable consumption
(d) current and capital including stockbuilding
(e) private sector investment and stock-building and durable consumption
(f) non-residential
(g) for definition see individual forecast summaries
(j) 1980 = 100
(k) calendar year 1985
(m) Industry Act forecast
(n) change in stockbuilding as a % of GDP in previous period
(p) fiscal year 1985-86

'Consensus' is defined as an unweighted average of comparable outside forecasts

EB Division, HM Treasury

16 April 1985

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COMPARISON OF FORECASTS - SUMMARY TABLES

FORECASTS FOR 1986/1986-87

Except where specified figures are percentage changes on previous year (GDP components in constant 1980 prices)

	IAF(m)	NIESR	LBS	Phillips & Drew	Simon & Coates	Henley	C'bridge Econ	L'pool	CBI	OECD	CUBS	Oxford	OUTSIDE CONSENSUS	OUTSIDE RANGE		Capel-Cure	Wood Mack	Scrim-geour	
																Other City forecasts not reflected in consensus			
Date of Forecast	Mar '85	Feb '85	Mar '85	Apr '85	Apr '85	Apr '85	Oct '84	Mar '85	Mar '85	Dec '84	Autumn '84	Jan '85				Feb '85	Apr '85	Feb '85	
Forecasts for calendar year 1986																			
GDP	2.5f (A)	0.9 (O)	2.4 (O)	1.8 (A)	1.2 (O)	1.6 (O)	1.3 (O)	4.1 (E)	2.5 (A)	-	2.9 (O)	2.1 (A)	2.1	0.9 (NIESR)	4.1 (L'pool)	2.6 (A)	1.7 (A)	2.3 (A)	GDP
Consumers' Expenditure	4f	0.9	2.8	2.0	3.0	1.8	2.1	3.0c	3.0	-	-	3.6	2.4	0.9 (NIESR)	3.6 (Oxford)	1.9	2.5	3.0	Consumers' Expenditure
General Govt Consumption	-1f	0.5	0.8	1.0	0.9	0.6	1.0	2.9d	-0.5	-	-	0.7	0.6	-0.5 (CBI)	1.0 (P&D,C'bridge)	1.0	0.9	1.0	General Govt Consumption
Gross Fixed Investment	1f	-1.0	2.3	2.3	-0.9	2.5	2.4	3.9e	4.0	-	-	2.5	1.8	-1.0 (NIESR)	4.0 (CBI)	-	2.1	2.1	Gross Fixed Investment
-public	-	-4.9	1.9	3.7	-0.2	5.0	-	-	-2.6	-	-	1.0	0.6	-4.9 (NIESR)	5.0 (Henley)	-4.0	-	1.0	-public
-private	-	0.1	2.8	1.9	-0.5	1.8	-	-	6.1	-	-	3.3	2.2	-0.5 (S&C)	6.1 (CBI)	3.5	-	2.4	-private
Stockbuilding (£bn)	0.4r	0.9	0.2	0.0	-0.1	0.7	1.4	-	0.6	-	-	1.5	0.7	-0.1 (S&C)	1.5 (Oxford)	0.6	1.0	1.6	Stockbuilding (£bn)
Exports (goods & services)	3f	4.6	4.1	3.2	3.1	2.9	2.2	-	4.3	-	-	2.0	3.3	2.0 (Oxford)	4.6 (NIESR)	6.0	2.3	2.8	Exports (goods & services)
Imports (goods & services)	3.5f	3.0	2.9	3.9	3.7	2.0	4.7	-	3.6	-	-	5.1	3.6	2.0 (Henley)	5.1 (Oxford)	2.0	3.3	4.1	Imports (goods & services)
RPI (CPI) - 4th Qtr	4.5n	6.5	(4.9)k	5.4	4.9	5.5	(6.8)k	(2.2)k	(4.8)	-	-	4.6	5.4	4.6 (Oxford)	6.5 (NIESR)	5.8k	5.5	4.6	RPI (CPI) Q4
Average Earnings (g)	-	7.7	7.2	7.5	7.8	8.5	8.7	2.9	6.6	-	-	7.3	7.1	2.9 (L'pool)	8.7 (C'bridge)	7.6	7.5	8.0	Average Earnings (g)
RPDI	-	0.5	2.0	2.0	2.7	2.2	-	-	3.1	-	-	4.0	2.4	0.5 (NIESR)	4.0 (Oxford)	1.8	-	2.7	RPDI
Unemployment (UK adults million - 4th Qtr)	-	3.40	2.90	3.19	3.50	3.28	3.4k	2.92k	3.10	-	-	3.18	3.22	2.90 (LBS)	3.50 (S&C)	3.30	3.2k	3.22	(UK adults) Unemployment (million Q4)
World trade (g)	4.5f	4.5	5.2	4.6	3.0	3.5	-	5.0	4.5	-	-	3.5	4.2	3.0 (S&C)	5.2 (LBS)	4.0	4.0	4.0	World trade (g)
Current Account (£bn)	3r	1.4	1.7	1.0	3.4	0.7	2.3	1.4	1.6	-	-	-1.4	1.3	-1.4 (Oxford)	3.4 (S&C)	2.0	0.9	-0.1	Current Account (£bn)
Sterling Index(1975=100) Q4	-	66.2	76.0	71.5	75.0	71.2	-	76.9k	78.5j	-	81.7j	73.0	72.2	66.2 (NIESR)	76.0 (LBS)	65.0	75.7	72.0	Sterling Index Q4(1975=100)
Short term interest rate (g) - 4th Qtr	-	-	8.0	8.5	8.5	10.0	-	7.5k	-	-	-	9.0	8.8	8.0 (LBS)	10.0 (Henley)	9.0	9.5	10.0p	Short term interest rate Q4 (g)
Forecasts for financial year 1986-1987																Forecasts for 1986-1987			
M0 growth	2-6	6.0	4.0	6.2k	3.7k	-	-	5.0k	-	-	4.2k	-	5.0	4.0 (LBS)	6.0 (NIESR)	-	-	-	M0 growth
£M3 growth	4-8	8.0	7.3	7.5k	7.6k	9.5	-	-	-	-	-	9.7	8.6	7.3 (LBS)	9.7 (Oxford)	8.0	-	14.0	£M3 growth
PSBR (£bn)	7.5	8.5	6.7	9.7	7.5	8.7	-	6.9	-	-	8.7k	7.7	8.0	6.7 (LBS)	9.7 (P&D)	7.5	7.5	8.6	PSBR (£bn)

NOTES:

- (A) average measure
- (O) output measure
- (E) expenditure measure
- (c) non durable consumption
- (f) 1985H1 to 1986H1
- (j) 1980 = 100
- (n) 1985Q2 to 1986Q2
- (d) current and capital including stockbuilding
- (g) for definition see individual forecast summaries
- (k) calendar year 1986
- (p) fiscal year 1986-87
- (e) private sector investment and stockbuilding and durable consumption
- (m) Industry Act forecast
- (r) 1986H1 at annual rate

'Consensus' is defined as an unweighted average of comparable outside forecasts

EB Division, HM Treasury

16 April 1985

59/254

CR/CF
pl. p.c.

Treasury Chambers, Parliament Street, SW1P 3AG

Mark Addison Esq
10 Downing Street
LONDON

9 April 1985

Dear Mark

ICI CASE

I attach a further report from Inland Revenue on the Judge's decision on this case. It has not yet been shown to the Financial Secretary who is out of the office. However, your press office may find it useful to see the line proposed in paragraphs 9-11, which is unlikely to cause the Financial Secretary any difficulties.

Yours sincerely
Vivien Life

VIVIEN LIFE

cc Christie ~~Wall~~
as discussed
MEA 10/4

FROM: M A HILL

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE
DATED: 4 APRIL 1985

FINANCIAL SECRETARY

ICI CASE

1. As indicated in Mr Crawley's 22 November note, there has recently been a further hearing before the High Court Judge to decide whether ICI were entitled to any relief by way of declaration in the light of the judgment delivered last January. Though the actual hearing took place last week (ie 25-27 March), the Judge reserved his decision and gave it only yesterday (3 April).

2. Given the terms of the original judgment, this decision was highly satisfactory from the Government/Revenue point of view. Equally the oil companies themselves (notably Shell and Esso) were well pleased with by the outcome. ICI had been contending for 7 substantive declarations, seeking in particular:

   i. To nullify elections already accepted under the 1982 Act. (ICI they could not of course know whether any such election had in fact been made. But they had inferred that Shell/Esso had made such elections which, if allowed to stand, would determine the

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cc Chancellor of the Exchequer
Chief Secretary
Sir Peter Middleton
Mr Cassell
Mr Robson
Mr Lord
Mr Evans IDT
Mr Ricks (Treasury Sol)
Sir Lawrence Airey
Mr Green
Mr Rogers
Mr Pitts
Mr Painter
Mr Cleave
Mr Elliss
Mrs Hubbard
Miss Hill
Mr J P O Lewis
Mr McManus
PS/IR

tax valuations in respect of Mossmorran until well into the 1990s).

ii. To set out in precise terms the sort of valuation which would be acceptable under any new election.

iii. To reopen the whole EEC issue, by claiming that to allow elections already accepted to continue to have effect would itself constitute a State aid.

3. In the event the only remedy which the Judge was prepared to grant was a single declaration in respect of future valuations. In essence this seeks to ensure that, when considering any such valuatons made in future, the Revenue does not adopt those approaches to the determination of fuel value which the original judgment had found either contrary to the requirements of existing statutory provisions or "Wednesbury unreasonable" (see paragraphs 4-7 of the summary attached to Mr Crawley's 29 January note). In the normal course of events, this means that any valuation under an existing election will be unaffected. The final wording of this declaration was left to be settled between Junior Counsel.

4. After the Judge had delivered this decision in the High Court yesterday, ICI made two further applications. The first related to costs. On this they contended that in the light of the ICI "victory", the Crown should bear the whole of ICI's costs in this case. This application did not succeed: the Judge determined that there should be "no order as to costs". (This means that each side bears its own costs - an outcome which we were going to contend in any event and which we would see as entirely reasonable.) Second ICI renewed their application for discovery - in particular asking for access to documents relating to the discussions between the Government and relevant Departments which ICI alleged had led to assurances

as to the level of valuation which would be determined under the 1982 Act. This application, too, was turned down by the Judge.

Where next?

5. The only way either side can continue the action, therefore, is by way of appeal to the Court of Appeal. Both parties have 28 days (ie until 1 May) to lodge such an appeal. Clearly this is something neither we nor ICI can decide until there has been opportunity to study the transcript of the Judge's decision yesterday and the precise terms of the declaration.

6. Our preliminary assessment, however, is that it would probably not be worth the Crown taking the initiative in appealling. We see the terms of the one declaration which has been granted as giving rise to little difficulty in practice. Any problems which arise are likely to hinge on the wider application of the Judge's findings on the interpretation of our domestic law on the definition of a "sale at arm's length". (This is the potential problem outlined in paragraph 18 of the attachment to Mr Crawley's 29 January note.) But we see no realistic prospect of overturning the Judge's findings in this respect on appeal. Any remedy - if remedy is needed - would have to operate directly on the legislation itself.

7. It is not possible to predict at this stage whether or not ICI will themselves appeal. But if they do, we should probably want to cross-appeal, or at least to serve a respondent's notice. This would then enable us to reargue the points on which the Judge found against us in his judgment. As indicated in paragraphs 14-16 of the attachment to Mr Crawley's 29 January note, we think there could be good grounds for challenging the Judge's findings on valuation - in particular his conclusion that for the Revenue to rely on our expert

witness's third approach would be "Wednesbury unreasonable". And if we were to appeal, we should certainly want to consider further also challenging the decision that ICI has "locus standi" in these proceedings.

8. We will of course keep you in touch with developments on this issue of appeal.

Handling of press enquiries etc

9. Throughout recent weeks, ICI have gone to considerable lengths to present what has happened in this case as a "victory" for ICI - and per contra a "defeat" for the Government/Revenue. Against this background we feel it would be appropriate to take a rather more positive line on press enquiries etc than would normally be the case with issues of this kind.

10. In particular we would propose to stress three of features of the Judge's judgment and subsequent decisions. The first would be to emphasise that the Judge dismissed entirely ICI's original and (until the actual hearing) main contention - ie that the 1982 legislation and its implementation was in some way a State aid requiring notification under the Treaty of Rome. Second, focussing on the recent decision on declarations, we would underline the gulf between the wideranging declarations which ICI were seeking (see paragraph 2 above) and the single declaration the Judge actually granted. Third, we would suggest that ICI's claim to have succeeded in their action should be measured against the fact that the Judge did not award them their costs.

11. If questioned specifically on the issue of appeal to a higher Court, the line must remain as set out in Mr Crawley's 22 March note. In other words we cannot at this stage go further than pointing out that this

is a matter to be considered (by both the Government and ICI) in the light of detailed study of the terms of the decision delivered yesterday.

12. As with previous notes on the ICI case, you may wish to consider sending a copy of this report to the No.10 Press Office.

MAH

M A HILL

ICI Case - Budget?

THE BUDGET -- THE CHANCELLOR OF THE EXCHEQUER, THE RT. HON. NIGEL LAWSON, MP for the Government

RECORDED FROM TRANSMISSION: BBC-1 21.25 DATE: 19th March, 1985

RT.HON.NIGEL LAWSON MP:
[CHANCELLOR OF THE EXCHEQUER] It must be rather puzzling for anybody outside the narrow and rather hectic worls of finance and politics to understand what is really happening to this country's economy.

Are we doing well, or aren't we?

Is there a recovery, or are things getting worse?

One day we are told that inflation is down, that exports are up and the economy is growing, and the next day we hear that unemployment is stuck at well over the three million mark.

Well which picture is the true one?

The answer is that they are both true. But although that explains the facts, it does not really solve the puzzle. Part of the answer is that for many years we have suffered from massive over-manning in much of our industry. The big shake-out in the last six years has enabled us to produce just as much, in fact considerably more, with many fewer people and as a result, British industry is now much more successful and much more competitive.

But far too many of the lost jobs have not yet been replaced by new ones, and I will be looking at the reason for that in a moment or two.

There can be no question that the British economy today is strong, prosperous, and on an upward path. All the signs tell the same story. Take inflation first, in 1970 it was running at six per cent. Then there was that terrifying surge to twenty-four per cent in the mid-seventies under Labour, followed by a fall and then another surge. So that when we took over in 1979, it was back into double figures and rising fast.

We brought that under control and now it is down to around five per cent, its lowest level since the 1960's and holding steady, and I mean to get it lower still.

JS /Contd....

RT.HON. NIGEL LAWSON MP: Or take living standards. For the average man in work, take home pay has gone up ten per cent faster than prices since we first took office in 1979, and the prospects for the future are at least as good.

Britain's output for example, is now at its highest level ever, and is set to grow even higher next year -- and what is more -- our exports are now at an all-time record, even without taking into account North Sea oil.

And it is even more impressive if you look at our growth of output beside that of our competitors. From 1970 to 1982, we were right at the bottom of the Common Market league table. In 1983 we were top, and despite the coal strike, we were third last year, and this year the international forecasts of the O.E.C.D. think that we will be top again.

And for investment in new machinery and the like by business and industry, which is one of the key pointers to future growth and jobs, it is the same story. It has been rising steeply since we got inflation under control and was at its highest level ever in 1984, and this year it looks to be even better.

All this shows beyond any question that we have got Britain back on the path of strong and steady growth, and this despite the year long coal strike. Happily, the strike is now behind us, but at the time it cost us dear. Indeed, you know, it is a real tribute to the strength and success of the British economy that despite the strike, we have had record growth, record investment and record exports.

And yet, for all that, we do still have more than three million unemployed, and that adds up to a terrible human problem. What is the reason for it? If we are to understand the reason, the first point to note is that it is not just a British problem. In 1970, our unemployment in this country was a little higher than the Common Market average. You can see how much it had grown by the end of last year, but the Common Market average has grown by just about the same proportion during the same period.

So why aren't we creating more jobs? Well the plain fact is that we are. There has been an increase of almost half-a-million in the number of jobs in Britain since you returned us to office in the General Election of 1983. But it hasn't reduced the unemployment figures, because the number of people looking for jobs has increased even faster. But more jobs are being created all the same.

And that is why it remains this Government's policy to do everything that any Government can, and Government can only do so much to create a climate that allows the economy to grow and encourages people to create new jobs and jobs that will last.

RT. HON. NIGEL LAWSON MP: In today's Budget, I made a number of changes which will help us to do just that. Last year you will recall, I removed the National Insurance surcharge, Labour's tax on jobs. This year, with the surcharge out of the way, I have gone further and cut National Insurance contributions themselves for people on low incomes and for those who employ them. It will be a lot cheaper for employers to take such people on, and they in turn will keep a lot more of what they earn.

And I have been able to cut Income Tax a bit too, so that the tax paid by most married couples will go down by almost one pound seventy-five a week on top of any benefit they may get from the reduction in National Insurance contributions for the low paid.

At the same time, the Government has acted directly to help two sets of people in particular difficulty. School-leavers and the long term unemployed. The improved Youth Training Scheme I announced today should eventually offer two years of training to any sixteen-year-old who wants it, and for those who have been out of work for a fair time, there will be another one hundred thousand places on the Community Programme, so it all adds up to a real 'Budget for Jobs'.

This year has certainly had its ups and downs. But the underlying trend has been growth and success, with even more encouraging pointers to the future.

If I don't sound as happy as I ought to be, it is because you can't be completely happy while there are still so many people around who want to work and can't find a job. Some people seem to believe that Governments can simply buy jobs -- I tell you, they can't. If they could, there would never be any unemployment, because there is nothing easier for Governments than spending other people's money.

But this Budget will help and it will do so without taking any risks with inflation. In the meanwhile, the steady rise of production, of living standards, of investment and of exports are the best possible signs we could have that we are the right track.

JS

№ 09

RESOLUTIONS TO BE MOVED BY THE CHANCELLOR OF THE EXCHEQUER

19th MARCH 1985

Mr. Chancellor of the Exchequer

Provisional Collection of Taxes: That pursuant to section 5 of the Provisional Collection of Taxes Act 1968 provisional statutory effect shall be given to the following Motions:—

(*a*) Spirits (Motion No. 2)

(*b*) Beer (Motion No. 3)

(*c*) Wine and made-wine (Motion No. 4)

(*d*) Cider (Motion No. 6)

(*e*) Tobacco products (Motion No. 7)

(*f*) Hydrocarbon Oil (Motion No. 8)

(*g*) Vehicles excise duty (Motion No. 10)

ARRANGEMENT OF WAYS AND MEANS RESOLUTIONS

1. Amendment of the law

That it is expedient to amend the law with respect to the National Debt and public revenue and to make further provision in connection with finance; but this Resolution does not extend to the making of any amendment with respect to value added tax so as to provide—

(*a*) for zero-rating or exempting any supply;

(*b*) for refunding any amount of tax, otherwise than by a provision relating to the insolvency of a person to whom goods or services have been supplied;

(*c*) for varying the rate of that tax otherwise than in relation to all supplies and importations; or

(*d*) for any relief other than relief applying to goods of whatever description or services of whatever description.

2. Spirits

That, as from 20th March 1985, the rate of duty specified in section 5 of the Alcoholic Liquor Duties Act 1979 shall be increased from £15·48 per litre of alcohol in the spirits to £15·77 per litre of alcohol in the spirits.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

3. Beer

That, as from 20th March 1985, the rates of duty specified in section 36 of the Alcoholic Liquor Duties Act 1979 shall be increased—

(*a*) from £24·00 for each hectolitre to £25·80 for each hectolitre; and

(*b*) from £0·80 for each additional degree of original gravity exceeding 1030 degrees to £0·86 for each such additional degree.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

4. Wine and made-wine

That, as from 20th March 1985, the rates of duty under sections 54 and 55 of the Alcoholic Liquor Duties Act 1979 shall be as follows—

Description of wine or made-wine	Rates of duty per hectolitre
	£
(1) Wine or made-wine of a strength of less than 15 per cent and not being sparkling	98.00
(2) Sparkling wine or sparkling made-wine of a strength of less than 15 per cent	161.80
(3) Wine or made-wine of a strength of not less than 15 per cent but not exceeding 18 per cent	169.00
(4) Wine or made-wine of a strength exceeding 18 per cent but not exceeding 22 per cent	194.90
(5) Wine or made-wine of a strength exceeding 22 per cent ...	194.90 plus £15.77 for every 1 per cent or part of 1 per cent in excess of 22 per cent.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

5. Blending of wines subject to different duty rates

That, with respect to the blending or otherwise mixing of wines on or after 26th March 1985, section 54 of the Alcoholic Liquor Duties Act 1979 (charge of excise duty on wine) shall have effect with the insertion, after subsection (3), of the following subsections:—

"(3A) For the purposes of this Act, the process of blending or otherwise mixing two or more wines (in this subsection and subsection (3B) below referred to as "the constituent wines") constitutes the production of wine if—

(*a*) the rate of duty applicable to one of the constituent wines is different from that applicable to the other or, as the case may be, at least one of the others; and

(*b*) the rate of duty applicable to the wine which is the product of the blending or other mixing is higher than that which is applicable to at least one of the constituent wines; and

(*c*) the blending or other mixing is with a view to dealing wholesale in the wine which is the product thereof;

and for the purposes of this subsection the rate of duty applicable to any wine is that which is or would be chargeable under subsection (1) above on its importation into the United Kingdom or, as the case may be, on its production as mentioned in paragraph (*b*) of that subsection.

(3B) Where, by virtue of subsection (3A) above, wine is produced in the United Kingdom, duty shall be chargeable on that wine by virtue of paragraph (*b*) of subsection (1) above whether or not duty was previously charged on all or any of the constituent wines by virtue of paragraph (*a*) or paragraph (*b*) of that subsection; but nothing in this subsection shall affect the operation of any regulations under section 56 below giving relief from duty on wine so produced by reference to duty charged on all or any of the constituent wines."

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

6. Cider

That, as from 20th March 1985, the rate of duty specified in section 62(1) of the Alcoholic Liquor Duties Act 1979 shall be increased from £14·28 per hectolitre to £15·80 per hectolitre.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

7. Tobacco products

That, as from 22nd March 1985, the rates of duty on cigarettes and hand-rolling tobacco specified in Schedule 1 to the Tobacco Products Duty Act 1979 shall be increased—

(*a*) in the case of cigarettes, to an amount equal to 21 per cent of the retail price plus £26·95 per thousand cigarettes, and

(*b*) in the case of hand-rolling tobacco, to £43·73 per kilogram.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

8. Hydrocarbon oil

That, as from 6 o'clock in the evening of 19th March 1985, the rates of duty specified in section 6(1) of the Hydrocarbon Oil Duties Act 1979 shall be increased—

(*a*) in the case of light oil, from £0·1716 a litre to £0·1794 a litre; and

(*b*) in the case of heavy oil, from £0·1448 a litre to £0·1515 a litre.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

9. Hydrocarbon oil (mixing)

That provision may be made allowing the Commissioners of Customs and Excise to charge a duty of excise on hydrocarbon oil which has become mixed with other hydrocarbon oil.

10. Vehicles excise duty

That the Vehicles (Excise) Act 1971 and the Vehicles (Excise) Act (Northern Ireland) 1972 shall have effect, in relation to licences taken out after 19th March 1985, with the amendments set out below.

But this Resolution shall not authorise the making of amendments which would result in different provisions being in force in different parts of Great Britain.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

(1) For the provisions of Part II of Schedules 1 to 5 to each of the Acts of 1971 and 1972 (annual rates of duty) there shall be substituted the provisions set out below:

PROVISIONS SUBSTITUTED FOR PART II OF SCHEDULE 1 TO ACT OF 1971 AND ACT OF 1972

Description of vehicle	Rate of duty
	£
1. Bicycles and tricycles of which the cylinder capacity of the engine does not exceed 150 cubic centimetres	10.00
2. Bicycles of which the cylinder capacity of the engine exceeds 150 cubic centimetres but does not exceed 250 cubic centimetres; tricycles (other than those in the foregoing paragraph) and vehicles (other than mowing machines) with more than three wheels, being tricycles and vehicles neither constructed nor adapted for use nor used for the carriage of a driver or passenger ...	20.00
3. Bicycles and tricycles not in the foregoing paragraphs	40.00

PROVISIONS SUBSTITUTED FOR PART II OF SCHEDULE 2 TO ACT OF 1971 AND ACT OF 1972

Description of vehicle	Rate of duty
Hackney carriages	£ 50.00 with an additional £1.00 for each person above 20 (excluding the driver) for which the vehicle has seating capacity.

PROVISIONS SUBSTITUTED FOR PART II OF SCHEDULE 3 TO ACT OF 1971 AND ACT OF 1972

	Weight unladen of vehicle		Rate of duty	
1. Description of vehicle	2. Exceeding	3. Not exceeding	4. Initial	5. Additional for each ton or part of a ton in excess of the weight in column 2
			£	£
1. Agricultural machines; digging machines; mobile cranes; works trucks; mowing machines; fishermen's tractors	—	—	16.00	—
2. Haulage vehicles, being showmen's vehicles	— $7\frac{1}{4}$ tons 8 tons 10 tons	$7\frac{1}{4}$ tons 8 tons 10 tons —	151.00 180.00 212.00 212.00	— — — 32.50
3. Haulage vehicles, not being showmen's vehicles	— 2 tons 4 tons 6 tons $7\frac{1}{4}$ tons 8 tons 9 tons 10 tons 11 tons	2 tons 4 tons 6 tons $7\frac{1}{4}$ tons 8 tons 9 tons 10 tons 11 tons —	179.00 322.00 465.00 608.00 743.00 869.00 995.00 1,138.00 1,138.00	— — — — — — — — 142.00

Provisions Substituted for Part II of Schedule 4 to Act of 1971 and Act of 1972

Table A
Rates of Duty on Rigid Goods Vehicles Exceeding 12 Tonnes Plated Gross Weight

General Rates

Plated gross weight of vehicle		Rate of duty		
1. Exceeding	2. Not exceeding	3. Two axle vehicle	4. Three axle vehicle	5. Four or more axle vehicle
tonnes	tonnes	£	£	£
12	13	410	320	320
13	14	570	340	340
14	15	740	340	340
15	17	1,030	340	340
17	19	—	490	340
19	21	—	660	340
21	23	—	900	490
23	25	—	1,610	690
25	27	—	—	1,000
27	29	—	—	1,470
29	30.49	—	—	2,420

Table A(1)
Rates of Duty on Rigid Goods Vehicles Exceeding 12 Tonnes Plated Gross Weight

Rates for Farmers' Goods Vehicles

Plated gross weight of vehicle		Rate of duty		
1. Exceeding	2. Not exceeding	3. Two axle vehicle	4. Three axle vehicle	5. Four or more axle vehicle
tonnes	tonnes	£	£	£
12	13	175	145	145
13	14	215	150	150
14	15	255	150	150
15	17	335	160	150
17	19	—	190	150
19	21	—	240	160
21	23	—	295	195
23	25	—	475	245
25	27	—	—	325
27	29	—	—	445
29	30.49	—	—	725

Table A(2)
Rates of Duty on Rigid Goods Vehicles Exceeding 12 Tonnes Plated Gross Weight

Rates for Showmen's Goods Vehicles

Plated gross weight of vehicle		Rate of duty		
1. Exceeding	2. Not exceeding	3. Two axle vehicle	4. Three axle vehicle	5. Four or more axle vehicle
tonnes	tonnes	£	£	£
12	13	105	90	90
13	14	145	90	90
14	15	185	90	90
15	17	260	90	90
17	19	—	125	90
19	21	—	165	90
21	23	—	225	125
23	25	—	405	175
25	27	—	—	250
27	29	—	—	370
29	30.49	—	—	605

Table B
Supplementary Rates of Duty on Rigid Goods Vehicles Over 12 Tonnes Used for Drawing Trailers Exceeding 4 Tonnes Plated Gross Weight

General Rates

Gross weight of trailer		Duty supplement
Exceeding	Not exceeding	
tonnes	tonnes	£
4	8	80
8	10	100
10	12	130
12	14	180
14	—	355

Table B(1)

Supplementary Rates of Duty on Rigid Goods Vehicles Over 12 Tonnes Used for Drawing Trailers Exceeding 4 Tonnes Plated Gross Weight

Rates for Farmers' Goods Vehicles

Gross weight of trailer		Duty supplement
Exceeding	Not exceeding	
tonnes	tonnes	£
4	8	80
8	10	100
10	12	130
12	14	180
14	—	355

Table B(2)

Supplementary Rates of Duty on Rigid Goods Vehicles Over 12 Tonnes Used for Drawing Trailers Exceeding 4 Tonnes Plated Gross Weight

Rates for Showmen's Goods Vehicles

Gross weight of trailer		Duty supplement
Exceeding	Not exceeding	
		£
—	—	80

Table C

Rates of Duty on Tractor Units Exceeding 12 Tonnes Plated Train Weight and Having only 2 Axles

General Rates

Plated train weight of tractor unit		Rate of duty		
1.	2.	3.	4.	5.
Exceeding	Not exceeding	For a tractor unit to be used with semi-trailers with any number of axles	For a tractor unit to be used only with semi-trailers with not less than two axles	For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	470	420	420
14	16	590	440	440
16	18	690	440	440
18	20	810	440	440
20	22	940	550	440
22	23	1,000	620	440
23	25	1,150	780	440
25	26	1,150	870	530
26	28	1,150	1,090	720
28	29	1,210	1,210	820
29	31	1,680	1,680	1,050
31	33	2,450	2,450	1,680
33	34	2,450	2,450	2,250
34	36	2,750	2,750	2,750
36	38	3,100	3,100	3,100

TABLE C(1)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING ONLY 2 AXLES

RATES FOR FARMERS' GOODS VEHICLES

Plated train weight of tractor unit		Rate of duty		
1. Exceeding	2. Not exceeding	3. For a tractor unit to be used with semi-trailers with any number of axles	4. For a tractor unit to be used only with semi-trailers with not less than two axles	5. For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	190	175	175
14	16	225	180	180
16	18	250	180	180
18	20	280	180	180
20	22	310	205	180
22	23	325	225	180
23	25	370	265	185
25	26	370	285	210
26	28	370	345	260
28	29	380	380	285
29	31	525	525	355
31	33	755	755	550
33	34	990	990	950
34	36	1,155	1,155	1,155
36	38	1,300	1,300	1,300

TABLE C(2)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING ONLY 2 AXLES

RATES FOR SHOWMEN'S GOODS VEHICLES

Plated train weight of tractor unit		Rate of duty		
1. Exceeding	2. Not exceeding	3. For a tractor unit to be used with semi-trailers with any number of axles	4. For a tractor unit to be used only with semi-trailers with not less than two axles	5. For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	120	105	105
14	16	150	110	110
16	18	175	110	110
18	20	205	110	110
20	22	235	140	110
22	23	250	155	110
23	25	290	195	110
25	26	290	220	135
26	28	290	275	180
28	29	305	305	205
29	31	420	420	265
31	33	615	615	420
33	34	615	615	565
34	36	690	690	690
36	38	775	775	775

Table D

Rates of Duty on Tractor Units Exceeding 12 Tonnes Plated Train Weight and Having 3 or More Axles

General Rates

Plated train weight of tractor unit		Rate of duty		
1. Exceeding	2. Not exceeding	3. For a tractor unit to be used with semi-trailers with any number of axles	4. For a tractor unit to be used only with semi-trailers with not less than two axles	5. For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	420	420	420
14	20	440	440	440
20	22	550	440	440
22	23	620	440	440
23	25	780	440	440
25	26	870	440	440
26	28	1,090	440	440
28	29	1,210	520	440
29	31	1,680	640	440
31	33	2,450	970	440
33	34	2,450	1,420	550
34	36	2,450	2,030	830
36	38	2,730	2,730	1,240

Table D(1)

Rates of Duty on Tractor Units Exceeding 12 Tonnes Plated Train Weight and Having 3 or More Axles

Rates for Farmers' Goods Vehicles

Plated train weight of tractor unit		Rate of duty		
1. Exceeding	2. Not exceeding	3. For a tractor unit to be used with semi-trailers with any number of axles	4. For a tractor unit to be used only with semi-trailers with not less than two axles	5. For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	175	175	175
14	20	180	180	180
20	22	205	180	180
22	23	225	180	180
23	25	265	180	180
25	26	285	185	180
26	28	345	200	190
28	29	380	225	200
29	31	525	270	220
31	33	755	405	240
33	34	805	595	300
34	36	935	855	455
36	38	1,145	1,145	680

TABLE D(2)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING 3 OR MORE AXLES

RATES FOR SHOWMEN'S GOODS VEHICLES

Plated train weight of tractor unit		Rate of duty		
1. Exceeding	2. Not exceeding	3. For a tractor unit to be used with semi-trailers with any number of axles	4. For a tractor unit to be used only with semi-trailers with not less than two axles	5. For a tractor unit to be used only with semi-trailers with not less than three axles
tonnes	tonnes	£	£	£
12	14	105	105	105
14	18	110	110	110
18	20	110	110	110
20	22	140	110	110
22	23	155	110	110
23	25	195	110	110
25	26	220	110	110
26	28	275	110	110
28	29	305	130	110
29	31	420	160	110
31	33	615	245	110
33	34	615	355	140
34	36	615	510	210
36	38	685	685	310

PROVISIONS SUBSTITUTED FOR PART II OF SCHEDULE 5 TO ACT OF 1971 AND ACT OF 1972

Description of vehicle	Rate of duty
	£
1. Any vehicle first registered under the Roads Act 1920 before 1st January 1947, or which, if its first registration for taxation purposes had been effected in Northern Ireland, would have been so first registered under the Act as in force in Northern Ireland	60.00
2. Other vehicles	100.00

(2) In section 2(1)(*b*) of each of the Acts of 1971 and 1972 (six month licence for vehicles with annual rate exceeding £18) for " £18 " there shall be substituted " £35 ".

(3) In section 16 of the Act of 1971 (rates of duty for trade licences) in subsection (5), including that subsection as set out in paragraph 12 of Part I of Schedule 7 to that Act, for " £44 " there shall be substituted " £46 ".

(4) In section 16 of the Act of 1972 (rates of duty for trade licences) in subsection (6), including that subsection as set out in paragraph 12 of Part I of Schedule 9 to that Act, for " £44 " there shall be substituted " £46 ".

(5) In the heading of Schedule 1 to each of the Acts of 1971 and 1972 and in paragraph 1 of Part I of each of those Schedules (annual rates of duty on certain vehicles not exceeding 425 kilograms) for " 425 KG." and " 425 kilograms " there shall be substituted respectively " 450 KG." and " 450 kilograms ".

(6) In each of the Acts of 1971 and 1972, in paragraph 6(1) of Part I of Schedule 4, for " £67 " there shall be substituted " £75 ".

(7) The following shall be substituted for paragraph 6(2) of Part I of Schedule 4 to the Act of 1971—

" (2) If a farmer's goods vehicle or a showman's goods vehicle has a plated gross weight or a plated train weight, the annual rate of duty applicable to it shall be—

(*a*) if that weight does not exceed 7·5 tonnes, £90;

(*b*) if that weight exceeds 7·5 tonnes but does not exceed 12 tonnes, £135 in the case of a farmer's goods vehicle and £90 in the case of a showman's goods vehicle; and

(*c*) if that weight exceeds 12 tonnes, the appropriate Part II rate."

(8) The following shall be substituted for paragraph 6(2) of Part I of Schedule 4 to the Act of 1972—

" (2) If a farmer's goods vehicle or a showman's goods vehicle has a relevant maximum weight or a relevant maximum train weight, the annual rate of duty applicable to it shall be —

(*a*) if that weight does not exceed 7·5 tonnes, £90;

(*b*) if that weight exceeds 7·5 tonnes but does not exceed 12 tonnes, £135 in the case of a farmer's goods vehicle and £90 in the case of a showman's goods vehicle; and

(*c*) if that weight exceeds 12 tonnes, the appropriate Part II rate."

(9) In each of the Acts of 1971 and 1972, in paragraph 7 of Part I of Schedule 4, for " £90 " there shall be substituted " £100 ".

11. Gaming machine licence duty

That provision may be made extending to Northern Ireland the provisions of the Betting and Gaming Duties Act 1981 relating to gaming machine licence duty.

12. Value added tax (newspaper advertisements)

That, with respect to supplies made on or after 1st May 1985, Schedule 5 to the Value Added Tax Act 1983 shall have effect with the omission of Group 5 (newspaper advertisements).

This Resolution shall not authorise the making of amendments that would make value added tax chargeable at a rate other than either nil or the rate specified in section 9 of the Value Added Tax Act 1983.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

13. Income tax (charge and rates for 1985–86)

That—

(1) Income tax for the year 1985–86 shall be charged at the basic rate of 30 per cent and, in respect of so much of an individual's total income as exceeds £16,200 (the basic rate limit as determined under subsection (4) of section 24 of the Finance Act 1980—indexation), at such higher rates as are specified in the Table below (in which the higher rate bands are those as so determined):

TABLE

Higher rate bands	*Higher rate*
The first £3,000	40 per cent.
The next £5,200	45 per cent.
The next £7,900	50 per cent.
The next £7,900	55 per cent.
The remainder	60 per cent.

(2) This Resolution shall not require any change to be made in the amounts deductible or repayable under section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) before 18th May 1985.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

14. Income tax (personal reliefs)

That—

(1) Section 24(5) of the Finance Act 1980 (increase of personal reliefs) shall not apply for the year 1985–86.

(2) In section 8 of the Income and Corporation Taxes Act 1970 (personal reliefs)—

(*a*) in subsection (1)(*a*) (married) for "£3,155" there shall be substituted "£3,455";

(*b*) in subsections (1)(*a*) (single) and (2) (wife's earned income relief) for "£2,005" there shall be substituted "£2,205";

(*c*) in subsection (1A) (age allowance) for "£3,955" and "£2,490" there shall be substituted "£4,255" and "£2,690" respectively; and

(*d*) in subsection (1B) (income limit for age allowance) for "£8,100" there shall be substituted "£8,800".

(3) This Resolution shall not require any change to be made in the amounts deductible or repayable under section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) before 18th May 1985.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

15. Relief for interest (limit for 1985–86)

That, for the year 1985–86, the qualifying maximum referred to in paragraphs 5(1) and 24(3) of Schedule 1 to the Finance Act 1974 (limit on relief for interest on certain loans for the purchase or improvement of land) shall be £30,000.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

16. Advance corporation tax (rate for financial year 1985)

That the rate of advance corporation tax for the financial year 1985 shall be three-sevenths.

17. Capital allowances (machinery and plant)

That provision may be made with respect to allowances for machinery and plant under Chapter I of Part III of the Finance Act 1971.

18. Capital allowances (dredging, agricultural land and hotels)

That charges to income tax may be imposed by provisions—

(*a*) terminating initial allowances under section 67 of the Capital Allowances Act 1968 (dredging);

(*b*) terminating initial allowances and reducing writing-down allowances under section 68 of that Act (agricultural land and buildings); and

(*c*) terminating initial allowances in respect of capital expenditure incurred in respect of qualifying hotels, within the meaning of section 38 of the Finance Act 1978.

19. Capital allowances (scientific research)

That provision may be made with respect to allowances for capital expenditure on scientific research under Part II of the Capital Allowances Act 1968.

20. Interest paid on deposits with banks etc.

That provision may be made amending Schedule 8 to the Finance Act 1984.

21. Securities

That charges to income tax, capital gains tax and corporation tax may be imposed by provisions about transactions occurring on or after 28th February 1985 in relation to securities.

22. Friendly societies

That provision may be made with respect to—

(*a*) the conditions to be fulfilled in order that friendly societies and branches thereof may be entitled to claim exemption from tax;

(*b*) the application of the limits on tax exempt business of friendly societies and branches thereof in relation to contracts for annuities made before 1st June 1984;

(*c*) the conditions under which policies issued by friendly societies and branches thereof on or after 19th March 1985, or issued before that date and varied on or after it, are to be regarded as qualifying policies within the meaning of Part I of Schedule 1 to the Income and Corporation Taxes Act 1970; and

(*d*) the application of Chapter III of Part XIV of the said Act of 1970 in relation to contracts for annuities entered into by friendly societies and branches thereof on or after 1st June 1984.

23. Offshore life assurance

That provision may be made amending Part III of Schedule 15 to the Finance Act 1984.

24. Business expansion scheme

That provision may be made excluding property development, in certain circumstances, from the trades which are treated as qualifying trades for the purpose of Schedule 5 to the Finance Act 1983.

25. Partnerships (basis of assessment)

That provision may be made for altering the basis of assessment relating to partnerships.

26. Limited partners (reliefs)

That provision may be made with respect to reliefs from tax available to limited partners and persons in a similar position.

27. London Regional Transport

That, in computing for the purposes of corporation tax the profit or loss of London Regional Transport for any accounting period beginning on or after 1st April 1985, the loss of the London Transport Executive for any earlier accounting period shall be computed as if section 16(1)(*b*) of the Finance Act 1970 had not been enacted.

28. Valuation of oil (income tax and corporation tax)

That provision may be made, for the purposes of income tax and corporation tax, with respect to oil appropriated in certain circumstances to refining or to any use except production purposes of an oil field.

29. Commodity futures, financial futures and traded options

That provision may be made for bringing gains on certain disposals of commodity futures, financial futures and traded options within the charge to capital gains tax or corporation tax on chargeable gains.

30. Capital gains (retirement relief)

That provision may be made restricting the offices and employments which are relevant to the giving of relief from capital gains tax on the disposal by a person retiring from an office or employment of assets provided or held for the purposes of that office or employment.

31. Capital gains (series of transactions)

That charges to capital gains tax and corporation tax may be imposed by provisions relating to assets disposed of in a series of transactions.

32. Capital transfer tax (conditional exemption)

That charges to capital transfer tax may be imposed by provisions relating to conditional exemption.

33. Stamp duty (takeovers)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) Paragraph (2) below applies where a company (company A) issues relevant securities (but issues or transfers no other property) in exchange for shares in another company (company B) and company A—

(*a*) has control of company B, or

(*b*) will have such control in consequence of the exchange or of a general offer as a result of which the exchange is made.

(2) Stamp duty under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891 shall not be chargeable on an instrument transferring the shares in company B (by way of the exchange).

(3) Where paragraph (2) above would apply but for the fact that company A not only issues relevant securities but also issues or transfers other property (whether or not it is or includes money) by way of the exchange, the value of the relevant securities shall be ignored in calculating stamp duty under the heading mentioned in that paragraph on an instrument transferring the shares in company B (by way of the exchange).

(4) In this Resolution "securities" includes shares, and "relevant securities" means securities which may be registered in a register kept by or on behalf of company A and in relation to which the terms of the general offer or other arrangement providing for the exchange make no provision for partial or total conversion directly or indirectly into money (whether by way of redemption, sale or otherwise) at a time which falls or may fall before the expiry of the period of three years commencing with the day on which the exchange is completed.

(5) For the purposes of this Resolution relevant securities shall not be taken to have been issued unless they are registered, in a register kept by or on behalf of company A, in the name of the person transferring the shares in company B by way of the exchange.

(6) References in this Resolution to shares in company B include references to convertible loan capital of the company; and "convertible loan capital" means loan capital mentioned in section 126(2) of the Finance Act 1976.

(7) For the purposes of this Resolution company A has control of company B if company A has power to control company B's affairs by virtue of holding shares in, or possessing voting power in relation to, company B or any other body corporate.

(8) In this Resolution "general offer" means an offer made to members of company B or any class of them, and—

(*a*) includes an offer made with exceptions for persons connected with company A, but

(*b*) excludes an offer made with exceptions for persons who are not connected with company A,

and a person is connected with a company if he would be so connected for the purposes of the Capital Gains Tax Act 1979.

(9) An instrument in respect of which stamp duty is not chargeable by virtue only of paragraph (2) above shall not be taken to be duly stamped unless it is stamped with the duty to which it would be liable but for that paragraph or it has, in accordance with section 12 of the Stamp Act 1891, been stamped with a particular stamp denoting that it is not chargeable with any duty.

(10) An instrument in respect of which reduced stamp duty is chargeable by virtue of paragraph (3) above shall not be taken to be duly stamped unless it is stamped with the duty to which it would be liable but for that paragraph or it has, in accordance with section 12 of the Stamp Act 1891, been stamped with a particular stamp denoting that it is duly stamped.

(11) Paragraphs (1) to (10) above shall apply to—

(*a*) instruments executed on or after 26th March 1985, and

(*b*) instruments executed on or after 19th March 1985 which are stamped on or after 26th March 1985.

(12) For the purposes of section 14(4) of the Stamp Act 1891 (instruments not to be given in evidence etc. unless stamped in accordance with the law in force at the time of first execution), the law in force at the time of execution of an instrument falling within paragraph (11)(*b*) above shall be deemed to be that as varied in accordance with this Resolution.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

34. Stamp duty (voluntary winding up: transfer of shares)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) Paragraph (2) below applies where a company is being wound up altogether voluntarily and there is an arrangement under section 287 of the Companies Act 1948 or section 257 of the Companies Act (Northern Ireland) 1960 whereby—

(*a*) its liquidator transfers to another company (company A) shares in a company (company B) which is a subsidiary of the company being wound up,

(*b*) company A issues relevant securities (but issues or transfers no other property) to the liquidator or a member or members of the company being wound up, and

(*c*) company A acquires control of company B (in consequence of the transfer of shares in company B).

(2) Stamp duty under the heading "Conveyance or Transfer on Sale" in Schedule 1 to the Stamp Act 1891 shall not be chargeable on an instrument transferring the shares in company B to company A.

(3) Where paragraph (2) above would apply but for the fact that company A not only issues relevant securities but also issues or transfers other property (whether or not it is or includes money) the value of the relevant securities shall be ignored in calculating stamp duty under the heading mentioned in that paragraph on an instrument transferring the shares in company B to company A.

(4) In this Resolution "securities" includes shares, and "relevant securities" means securities which may be registered in a register kept by or on behalf of company A and in relation to which the terms of the arrangement make no provision for partial or total conversion directly or indirectly into money (whether by way of redemption, sale or otherwise) at a time which falls or may fall before the expiry of the period of three years commencing with the day on which the arrangement is completed.

(5) For the purposes of this Resolution relevant securities shall not be taken to have been issued unless they are registered, in a register kept by or on behalf of company A, in the name of the liquidator or member concerned of the company being wound up.

(6) References in this Resolution to shares in company B include references to convertible loan capital of the company; and "convertible loan capital" means loan capital mentioned in section 126(2) of the Finance Act 1976.

(7) For the purposes of this Resolution company A has control of company B if company A has power to control company B's affairs by virtue of holding shares in, or possessing voting power in relation to, company B or any other body corporate.

(8) In this Resolution "subsidiary" has the same meaning as in the Companies Act 1948 or the Companies Act (Northern Ireland) 1960, as the case may be.

(9) An instrument in respect of which stamp duty is not chargeable by virtue only of paragraph (2) above shall not be taken to be duly stamped unless it is stamped with the duty to which it would be liable but for that paragraph or it has, in accordance with section 12 of the Stamp Act 1891, been stamped with a particular stamp denoting that it is not chargeable with any duty.

(10) An instrument in respect of which reduced stamp duty is chargeable by virtue of paragraph (3) above shall not be taken to be duly stamped unless it is stamped with the duty to which it would be liable but for that paragraph or it has, in accordance with section 12 of the Stamp Act 1891, been stamped with a particular stamp denoting that it is duly stamped.

(11) Paragraphs (1) to (10) above shall apply to—

(*a*) instruments executed on or after 26th March 1985, and

(*b*) instruments executed on or after 19th March 1985 which are stamped on or after 26th March 1985.

(12) For the purposes of section 14(4) of the Stamp Act 1891 (instruments not to be given in evidence etc. unless stamped in accordance with the law in force at the time of first execution), the law in force at the time of execution of an instrument falling within paragraph (11)(*b*) above shall be deemed to be that as varied in accordance with this Resolution.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

35. Stamp duty (gifts inter vivos)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) The stamp duty chargeable by virtue of section 74 of the Finance (1909–10) Act 1910 (gifts inter vivos) is abolished.

(2) In section 58(7) of the Stamp Act 1891 (valuation by reference to value for purposes of section 74 of 1910 Act) for the words from " the value " to the end there shall be substituted " the value at any time of any property, that value shall be taken to be the price which the property might reasonably be expected to fetch on a sale at that time in the open market."

(3) An instrument—

(*a*) in respect of which stamp duty would be chargeable by virtue of section 74 of the 1910 Act apart from paragraph (1) above, and

(*b*) on which stamp duty is not chargeable under the heading " Conveyance or Transfer on Sale " in Schedule 1 to the Stamp Act 1891,

shall not be deemed to be duly stamped unless it has, in accordance with section 12 of the 1891 Act, been stamped with a particular stamp denoting that it is duly stamped or that it is not chargeable with any duty.

(4) Paragraphs (1) to (3) above shall apply to—

(*a*) instruments executed on or after 26th March 1985, and

(*b*) instruments executed on or after 19th March 1985 which are stamped on or after 26th March 1985.

(5) For the purposes of section 14(4) of the Stamp Act 1891 (instruments not to be given in evidence etc. unless stamped in accordance with the law in force at the time of first execution), the law in force at the time of execution of an instrument falling within paragraph (4)(*b*) above shall be deemed to be that as varied in accordance with this Resolution.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

36. Stamp duty (transfers in connection with divorce etc.)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) Stamp duty under the heading " Conveyance or Transfer on Sale " in Schedule 1 to the Stamp Act 1891 shall not be chargeable on an instrument by which property is conveyed or transferred from one party to a marriage to the other if the instrument—

(*a*) is executed in pursuance of an order of a court made on granting in respect of the parties a decree of divorce, nullity of marriage or judicial separation, or

(*b*) is executed in pursuance of an order of a court which is made in connection with the dissolution or annulment of the marriage or the parties' judicial separation and which is made at any time after the granting of such a decree, or

(*c*) is executed at any time in pursuance of an agreement of the parties made in contemplation of or otherwise in connection with the dissolution or annulment of the marriage or their judicial separation.

(2) An instrument in respect of which stamp duty is not chargeable under the heading mentioned in paragraph (1) above by virtue only of that paragraph shall be chargeable under this paragraph with stamp duty of 50p.

(3) Paragraphs (1) and (2) above shall apply to instruments executed on or after 26th March 1985.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

37. Stamp duty (death: varying dispositions, and appropriations)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) Where, within the period of two years after a person's death, any of the dispositions (whether effected by will, under the law relating to intestacy or otherwise) of the property of which he was competent to dispose are varied by an instrument executed by the persons or any of the persons who benefit or would benefit under the dispositions, stamp duty under the heading " Conveyance or Transfer on Sale " in Schedule 1 to the Stamp Act 1891 shall not be chargeable on the instrument.

(2) Paragraph (1) above does not apply where the variation is made for any consideration in money or money's worth other than consideration consisting of the making of a variation in respect of another of the dispositions.

(3) Paragraph (1) above applies whether or not the administration of the estate is complete or the property has been distributed in accordance with the original dispositions.

(4) Where property is appropriated by a personal representative in or towards satisfaction of a general legacy of money, stamp duty under the heading mentioned in paragraph (1) above shall not be chargeable on an instrument giving effect to the appropriation.

(5) An instrument in respect of which stamp duty is not chargeable under the heading mentioned in paragraph (1) above by virtue only of paragraph (1) or (4) above shall be chargeable under this paragraph with stamp duty of 50p.

(6) But an instrument which is chargeable under paragraph (5) above shall not be treated as duly stamped unless it has, in accordance with section 12 of the Stamp Act 1891, been stamped with a particular stamp denoting that it is duly stamped.

(7) Paragraphs (1) to (6) above shall apply to instruments executed on or after 26th March 1985.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

38. Stamp duty (repeal of certain fixed duties)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) The following headings specified in Schedule 1 to the Stamp Act 1891 shall be omitted—

(*a*) The heading beginning " Agreement or contract made or entered into pursuant to the Highways Acts ".

(*b*) The headings beginning " Appointment of a new trustee, and appointment in execution of a power of any property ".

(*c*) The heading beginning " Charter of resignation ".

(*d*) The heading beginning " Covenant. Any separate deed of covenant ".

(*e*) The heading " Deed of any kind whatsoever, not described in this schedule ".

(*f*) The headings beginning " Letter of allotment and letter of renunciation " and " Scrip certificate, scrip ".

(*g*) The heading beginning " Letter or power of attorney, and commission, factory, mandate ".

(*h*) The heading beginning " Precept of clare constat ".

(*i*) The heading " Procuration, deed, or other instrument of ".

(*j*) The heading beginning " Resignation ", together with the heading " instrument of resignation of any lands or other heritable subjects in Scotland not of burgage tenure ".

(*k*) The heading " Revocation of any use or trust of any property by any writing, not being a will ".

(*l*) The heading beginning " Seisin " and the heading " Notarial instrument to be expeded and recorded in any register of sasines ".

(*m*) The heading " Warrant of attorney of any other kind ".

(*n*) The heading beginning " Writ ".

(2) In section 7 of the Finance Act 1907 (stamping of hire-purchase agreements) for the words from " shall only be charged " to the end there shall be substituted " shall not be charged with any stamp duty ".

(3) Paragraphs (1) and (2) above shall apply to—

(*a*) instruments executed on or after 26th March 1985, and

(*b*) instruments executed on or after 19th March 1985 which are not stamped before 26th March 1985.

(4) For the purposes of section 14(4) of the Stamp Act 1891 (instruments not to be given in evidence etc. unless stamped in accordance with the law in force at the time of first execution), the law in force at the time of execution of an instrument falling within paragraph (3)(*b*) above shall be deemed to be that as varied in accordance with this Resolution.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

39. Stamp duty (abolition of duty on contract notes)

That the following provisions shall have effect for the period beginning 26th March 1985 and ending 31 days after the earliest of the dates mentioned in section 50(2) of the Finance Act 1973—

(1) Subsections (1) and (2) of section 77 of the Finance (1909–10) Act 1910 (duty on contract notes) shall cease to have effect.

(2) Paragraph (1) above shall apply to contract notes made and executed on or after 26th March 1985.

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of section 50 of the Finance Act 1973.

40. Stamp duty (exchange rates)

That provision may be made for the application to certain instruments of section 6 of the Stamp Act 1891 instead of section 12 of the Finance Act 1899.

41. Oil taxation (limit on tax payable)

That provision may be made with respect to the chargeable periods which are relevant for the purposes of section 9(1) of the Oil Taxation Act 1975.

42. Oil taxation (exploration and appraisal expenditure)

That provision may be made limiting expenditure qualifying for relief under section 5A of the Oil Taxation Act 1975—

(*a*) by restricting the areas relevant to subsection (2) of that section; and

(*b*) by treating certain expenditure as reduced by the value of oil won in the course of operations to which the expenditure relates.

43. Relief from tax (incidental and consequential charges)

That it is expedient to authorise any incidental or consequential charges to any duty or tax (including charges having retrospective effect) which may arise from provisions designed in general to afford relief from tax.

PROCEDURE RESOLUTION

PROCEDURE (FUTURE TAXATION): That, notwithstanding anything to the contrary in the practice of the House relating to matters which may be included in Finance Bills, any Finance Bill of the present Session may contain the following provisions taking effect in a future year—

(*a*) provisions with respect to the deduction of tax from interest on certain loans;

(*b*) provisions with respect to allowances under Chapters IV and V of Part I of the Capital Allowances Act 1968 (dredging and agricultural land and buildings);

(*c*) provisions amending section 343 of the Income and Corporation Taxes Act 1970 (building societies);

(*d*) provisions with respect to allowances under Chapter I of Part XIV of the Income and Corporation Taxes Act 1970 (patents and know-how);

(*e*) provisions with respect to allowances and charges under Chapter I of Part III of the Finance Act 1971 (machinery and plant);

(*f*) provisions with respect to initial allowances in respect of expenditure on qualifying hotels, within the meaning of section 38 of the Finance Act 1978; and

(*g*) provisions amending section 56 of the Finance Act 1978 (capital receipts in respect of shares subject to approved profit sharing schemes).

A INTRODUCTION

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

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

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

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

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

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

B. THE ECONOMIC BACKGROUND

I start with the economic background.

2. Once again we can look back on a year of steady growth and low inflation. During 1984 as a whole, inflation remained at around 5 per cent. Output grew by a further 2½ per cent, with investment up by 6 per cent and non-oil exports by 7 per cent, to reach all-time record levels in each case.

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

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

5. The coal strike has reduced the level of national output by over 1¼ per cent and worsened the balance of payments by some £4 billion. It has increased public expenditure by £2½ billion and public sector borrowing by £2¾ billion. It has meant a lower exchange rate and higher interest rates. It has cost us confidence abroad and jobs at home.

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

7. Looking ahead, we are now about to embark on what will be the fifth successive year of steady growth, with output in 1985 as a whole set to rise by a further 3½ per cent. Inflation may edge up for a time, perhaps to 6 per cent by the middle of the year, but should then fall back to 5 per cent by the end of the year and lower still in 1986.

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

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

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

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

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

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

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

C. THE MEDIUM-TERM FINANCIAL STRATEGY

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

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

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

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

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

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

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

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

7. That course we will not follow.

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

D. MONETARY POLICY AND THE EXCHANGE RATE

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

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

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

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

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

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

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E. PUBLIC SECTOR BORROWING

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

2. The outturn for the Public Sector Borrowing Requirement for 1983-84 was £9¾ billion, or 3¼ per cent of GDP. In my Budget last year I planned to reduce it substantially in 1984-85 to £7¼ billion, or 2¼ per cent of GDP. In the event, this year's PSBR looks like turning out at £10½ billion, or 3¼ per cent of GDP - the same proportion as in each of the three previous years.

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

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

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

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

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

F. PUBLIC EXPENDITURE

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

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

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

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

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

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

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

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

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

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

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

12. On the other side of the public accounts, expected tax receipts have also been revised upwards, partly for related reasons. But not by as much. The scope I have for tax cuts this year is therefore only half the amount I indicated might be available in my Statement to the House in November. In other words, the measures I shall shortly announce will, after indexation, contribute some £¾ billion net to the £7 billion borrowing requirement I have set for 1985-86.

G1. THE PROSPECT FOR JOBS

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

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

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

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

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

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

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

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

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

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

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

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

G2: EMPLOYMENT AND TRAINING MEASURES

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

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

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

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

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

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

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

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

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

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

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

3

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

11. But in this, as in so many other fields, higher public expenditure can at best be only a part of a wider response to the problem. The Government has therefore (4) decided to take further steps to remove legal impediments to the effective functioning of the labour market. However well intentioned, these impediments can only lead to fewer jobs. My Rt Hon Friend will be taking important steps. First, he will be extending to all employers the provisions on unfair dismissal which currently apply to small firms. The qualifying period for unfair dimissal claims will thus become two years for all new employees. This should lessen the reluctance of employers to take on new people.

12. Second, my Rt Hon Friend will be issuing a consultative document about the future of the Wages (5) Councils [later this week]. The main effect of Wages Councils is to increase unemployment by making it illegal for many employers, particularly small employers, to employ people, especially young people, at wages that the employers can afford and for which the potential employees are prepared to work. The document will cover a number of proposals for radical change, including complete abolition.

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

H TAX REFORM

I now turn to taxation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

18. This I now do.

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

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

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

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

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

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

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

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

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

26. I turn next to the stamp duties.

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

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

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

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

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

J. BUSINESS TAXATION

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

K. PERSONAL TAXATION: TAXES ON SPENDING

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

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

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

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

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

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

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

8. I now turn to VAT.

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

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

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

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

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

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

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

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

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

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

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

L. PERSONAL TAXATION: INCOME TAX

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

2. I now turn to income tax.

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

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

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

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

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

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

9. For the basic thresholds I can do more. Statutory indexation would imply an increase in the single person's allowance of £100. I propose to increase it by precisely twice as much - £200 - from £2,005 to £2205. Statutory indexation would imply an increase in the married man's allowance of £150. Again, I propose to raise it by precisely twice as much - £300 - from £3,155 to £3,455

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

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

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

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

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

M. **NATIONAL INSURANCE CONTRIBUTIONS**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

F E R Butler Esq
Private Secretary
10 Downing Street
LONDON SW1

18 March 1985

Dear Robin

BUDGET: PUBLIC EXPENDITURE

I mentioned to Andrew Turnbull before the weekend that we were preparing a single positive speaking note about the public expenditure changes to be announced in the Budget. I enclose a copy . The Chief Secretary will be drawing on this note in his speech in the Budget debate on Wednesday 20 March and in subsequent contacts with the press. The note is in addition to the usual Budget brief which will provide standard Q and A type briefing.

Yours sincerely

Richard Broadbent

R J BROADBENT
PRIVATE SECRETARY

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POSITIVE SPEAKING NOTE ON EXPENDITURE FIGURES

1 The control of public expenditure is central to the Government's continuing economic objectives:

- to defeat inflation through firm restraint on Government borrowing;

- to improve the performance of the economy and thus achieve higher growth and more jobs, by rolling back the public sector and reducing the burden of tax

2. In practice this means setting realistic and achievable plans and control figures, in line with the Government's unchanged objective of reducing the share of national income taken up by public spending.

3. The objective is being achieved. Expenditure has been falling as a proportion of GDP since 1981-82, apart from the wholly exceptional one-off costs of the coal strike. This fall is planned to continue with spending held broadly constant in real terms while the economy continues to grow.

4. And the Government has succeeded in sticking to cash limits on programmes within its direct control.

5. But it has, admittedly, been less successful in extending control over other programmes. For example:

(i) In demand-led programmes like social security, once rates and entitlements are fixed, spending depends on how many qualified applicants apply. This is a matter of forecasting, not control. But action is in hand to improve forecasting, and policy is under review to provide a simpler, more cost-effective system.

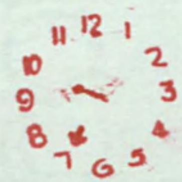
(ii) Local authority current and capital spending is not directly controlled by central government, only influenced. But action is in hand here to make that influence more effective; eg rate-capping, tougher holdback rules on grant, and a lower prescribed proportion for capital receipts.

6 Substantial uncertainties are, however, bound to remain. Under a system of cash planning, the provision for uncertainties has to be reviewed from time to time. It is now clear, in the light of the 1984-85 outturn, that the White Paper Reserves are unlikely to be adequate. So they are being increased to make quite sure they are adequate to cope with unexpected developments.

7. This does not mean that the expenditure objective has been changed; progress has been made and will continue. Plans for individual programmes have also not been changed.

8. This does not weaken cash planning, or the detailed controls on individual programmes. It demonstrates the government's determination to budget on a realistic and prudent basis, and to ensure that spending is held within the planned levels.

18 MAR 1985



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Mr F E R Butler (No 10)

13

FROM: MRS R LOMAX

DATE: 18 March 1985

CH/EX REF NO M97

COPY NO 10 OF 32 COPIES

MR BATTISHILL

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Littler
Mr Cassell
Mr Monck
Mr Monger
Mr Scholar
Mr Culpin
Mr Folger
Mr Cropper
Mr H Davies
Mr Lord
PS/IR
PS/C&E

The Chancellor has slightly re-ordered and marginally changed some of the material in the ... eighth draft, circulated under my minute of 16 March. I attach copies of the sections principally affected ie B, C, F, G2, H and K. Any further comments should reach this office as soon as possible.

RL.

RACHEL LOMAX

M80

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Ref no M98

COPY 2 OF 11 ~~II~~

N BPM

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

The Rt Hon Norman Tebbit MP
Secretary of State for Trade & Industry
Department of Trade & Industry
1 Victoria Street
London SW1H OET

18 March 1985

Dear Secretary of State,

TAXATION OF FRINGE BENEFITS - CARS AND PETROL

In recent years I have written to you a day or so in advance of publication of new scales for measuring these benefits.

In my Budget Speech tomorrow, I propose to announce for 1986/87 overall increases for both sets of scales of about 10 per cent. This is in line with the increase for 1985/86 and continues our gradualist policy of increasing the scales towards more realistic levels. I hope in particular that it will reassure those in the motor industry who have expressed concern about our longer-term intentions.

The scales proposed for 1986/87 are (1985/86 in brackets):

	Car Benefits	Fuel Benefits
1300cc or less	£450 (410)	£450 (410)
1301 - 1800cc	£575 (525)	£575 (525)
Over 1800cc	£900 (825)	£900 (825)
£19,250-£29,000 (£17,500-£26,500)	£1,320(1,200)	not applicable
Over £29,000	£2,100(1,900)	" "

These proposals will be the subject of Treasury Orders during the summer.

I am copying this letter to the Prime Minister, Peter Walker and Nicholas Ridley.

Yours sincerely,

Margaret O'Hara

NIGEL LAWSON
(approved by the Chancellor and signed in his absence)

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FROM: MRS R LOMAX
DATE: 16 March 1985

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Whole Speech (Sections A-M)(BLO)

MR BATTISHILL

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

*PS/IR
Sir L Airey - IR
Mr Isaac - IR
Mr Green - IR
*PS/C&E
Mr Fraser - C&E
Mr Knox - C&E

Part of Speech only (Budget Secret)

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

BUDGET SPEECH 8TH DRAFT

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

MRS R LOMAX

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12

A. INTRODUCTION

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

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

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

Two themes

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

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

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

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B. THE ECONOMIC BACKGROUND

I START WITH THE ECONOMIC BACKGROUND.

2. ONCE AGAIN WE CAN LOOK BACK ON A YEAR OF STEADY GROWTH AND LOW INFLATION. DURING 1984 AS A WHOLE, INFLATION REMAINED AT AROUND 5 PER CENT. OUTPUT GREW BY A FURTHER 2½ PER CENT, WITH INVESTMENT UP BY 6 PER CENT AND NON-OIL EXPORTS BY 9 PER CENT, TO REACH ALL-TIME RECORD LEVELS IN EACH CASE.

3. MANUFACTURING INDUSTRY RECOVERED PARTICULARLY STRONGLY, WITH OUTPUT UP BY 3½ PER CENT - THE BIGGEST RISE IN ANY SINGLE YEAR SINCE 1973 -EXPORTS UP BY 10 PER CENT AND INVESTMENT BY 13 PER CENT. THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS HAS REMAINED IN SURPLUS, FOR THE FIFTH SUCCESSIVE YEAR. BY INTERNATIONAL STANDARDS, TOO, THE ECONOMY HAS PERFORMED WELL. OUR GROWTH WAS ABOVE, AND OUR INFLATION BELOW, THE EUROPEAN COMMUNITY AVERAGE.

4. MOREOVER, THIS PROGRESS HAS BEEN ACHIEVED IN THE TEETH OF THE COAL STRIKE, FOR WHICH, IN THE SHORT TERM, THE NATION HAS HAD TO PAY A HEAVY PRICE. IN THE CURRENT FINANCIAL YEAR THE COAL STRIKE HAS REDUCED THE LEVEL OF NATIONAL OUTPUT BY OVER 1¼ PER CENT AND WORSENED THE BALANCE OF PAYMENTS BY SOME £4 BILLION. IT HAS INCREASED PUBLIC EXPENDITURE BY £2½ BILLION AND PUBLIC SECTOR

BORROWING BY £2¾ BILLION. IT HAS MEANT A LOWER EXCHANGE RATE AND HIGHER INTEREST RATES. IT HAS COST US CONFIDENCE ABROAD AND JOBS AT HOME.

5. BUT THE COSTS, BOTH ECONOMIC AND CONSTITUTIONAL, OF SUBMITTING TO THIS STRIKE WOULD HAVE BEEN INFINITELY GREATER THAN THE COSTS THAT HAVE BEEN INCURRED IN SUCCESSFULLY RESISTING IT.

6. AND IT IS A REMARKABLE TRIBUTE TO THE UNDERLYING STRENGTH OF THE BRITISH ECONOMY THAT IT HAS BEEN ABLE TO WITHSTAND SO LONG AND DAMAGING A STRIKE IN SUCH GOOD SHAPE.

7. LOOKING AHEAD, WE ARE NOW ABOUT TO EMBARK ON WHAT WILL BE THE FIFTH SUCCESSIVE YEAR OF STEADY GROWTH, WITH OUTPUT IN 1985 AS A WHOLE SET TO RISE BY A FURTHER 3½ PER CENT. INFLATION MAY EDGE UP FOR A TIME, PERHAPS TO 6 PER CENT BY THE MIDDLE OF THE YEAR, BUT SHOULD THEN FALL BACK TO 5 PER CENT BY THE END OF THE YEAR AND LOWER STILL IN 1986.

8. WHILE THERE CAN BE NO DISPUTING THE STRENGTH AND DURABILITY OF THE ECONOMIC UPSWING, THERE IS EQUALLY NO DISPUTING THE FACT THAT IT IS MARRED BY AN UNACCEPTABLY HIGH LEVEL OF UNEMPLOYMENT. AND THIS DESPITE THE FACT THAT THE LATEST FIGURES SUGGEST THAT EMPLOYMENT HAS RISEN BY HALF A MILLION OVER THE PAST TWO YEARS, WITH A FURTHER INCREASE LIKELY OVER THE YEAR AHEAD.

9. IF AT HOME THE PAST YEAR HAS BEEN OVERSHADOWED BY THE COAL STRIKE, INTERNATIONALLY IT HAS BEEN DOMINATED BY THE RELENTLESS SURGE OF THE DOLLAR, WHICH ROSE BY A FURTHER 30 PER CENT AGAINST ALL THE MAJOR EUROPEAN CURRENCIES. TO FINANCE ITS MASSIVE BUDGET DEFICIT THE UNITED STATES IS IMPORTING A LARGE PART OF THE REST OF THE WORLD'S SAVINGS AND EXPORTING SOME OF ITS OWN INFLATION.

10. THIS IS NOT A SUSTAINABLE STATE OF AFFAIRS. AS FEDERAL RESERVE CHAIRMAN PAUL VOLCKER LAST MONTH TESTIFIED TO CONGRESS, THE UNITED STATES IS LIVING ON BORROWED MONEY AND BORROWED TIME. BUT MEANWHILE IT IS NOT ONLY AMERICA THAT IS PAYING THE INTEREST.

11. ALL THIS HAS LED TO ONE OF THE MOST TURBULENT YEARS IN THE FINANCIAL MARKETS WITHIN LIVING MEMORY. IT HAS BEEN, AND WILL CONTINUE TO BE, A TIME FOR STRONG NERVES AND SOUND POLICIES.

C. THE MEDIUM-TERM FINANCIAL STRATEGY

WE HAVE ALREADY SHOWN THAT WE ARE NOT AFRAID TO TAKE ACTION, HOWEVER difficult UNPOPULAR, TO KEEP THE MEDIUM-TERM FINANCIAL STRATEGY ON COURSE IN AN UNPREDICTABLE AND UNCERTAIN WORLD.

2. THAT STRATEGY WAS FIRST LAUNCHED FIVE YEARS AGO NEXT WEEK. ITS OPENING WORDS WERE THESE:

> "THE GOVERNMENT'S OBJECTIVES FOR THE MEDIUM TERM ARE TO BRING DOWN THE RATE OF INFLATION AND TO CREATE CONDITIONS FOR A SUSTAINABLE GROWTH OF OUTPUT AND EMPLOYMENT."

3. WE HAVE ACHIEVED THOSE OBJECTIVES TO A GREATER DEGREE THAN ALMOST ANY COMMENTATOR DARED TO FORECAST AT THE TIME. AND OUR COMMITMENT TO THEM REMAINS AS GREAT TODAY AS IT WAS FIVE YEARS AGO. SO TOO IS OUR COMMITMENT TO THE STRATEGY AS THE MEANS OF ACHIEVING THOSE OBJECTIVES.

4. THE MEDIUM-TERM FINANCIAL STRATEGY WAS DESIGNED TO ENSURE A REASONABLE GROWTH OF DEMAND IN MONEY TERMS - AND INDEED HAS SUCCEEDED IN DOING SO.

5. WE ARE DETERMINED TO MAINTAIN STEADY DOWNWARD PRESSURE ON INFLATION. IT IS NOT IN THE GIFT OF ANY

GOVERNMENT TO ELIMINATE SHORT-TERM FLUCTUATIONS ALONG THE WAY, BUT THE UNDERLYING DIRECTION HAS TO BE DOWNWARDS. IT IS THIS OBJECTIVE WHICH GOVERNS THE DESIRABLE GROWTH OF TOTAL SPENDING POWER IN THE ECONOMY, AS MEASURED BY MONEY GDP.

6. THE GOVERNMENT'S ECONOMIC STRATEGY HAS TWO KEY COMPONENTS: A MONETARY POLICY DESIGNED TO BRING DOWN INFLATION AND A SUPPLY SIDE POLICY DESIGNED TO IMPROVE THE COMPETITIVE PERFORMANCE OF THE ECONOMY.

7. THE SUPPLY SIDE POLICY IS ROOTED IN A PROFOUND CONVICTION, ITSELF BORN OF PRACTICAL EXPERIENCE BOTH AT HOME AND OVERSEAS, THAT THE WAY TO IMPROVE ECONOMIC PERFORMANCE AND CREATE MORE JOBS IS TO ENCOURAGE ENTERPRISE, EFFICIENCY AND FLEXIBILITY; TO PROMOTE COMPETITION, DEREGULATION AND FREE MARKETS; TO PRESS AHEAD WITH PRIVATISATION AND TO IMPROVE INCENTIVES.

8. THE ARGUMENT OVER WHICH WILL HAVE A BIGGER IMPACT ON DEMAND, INCREASED PUBLIC EXPENDITURE OR LOWER TAXATION, COMPLETELY MISSES THE POINT. THE CASE FOR LOWER TAXATION RESTS ON SUPPLY SIDE POLICY: LOWER TAXES WILL HELP TO ENHANCE INCENTIVES, ELIMINATE DISTORTIONS, IMPROVE THE USE OF RESOURCES AND HEIGHTEN THE SPIRIT OF ENTERPRISE.

9. THE GREAT MISTAKE OF POSTWAR DEMAND MANAGEMENT, WHICH STILL HAS SOME DEVOTEES TODAY, WAS TO REACT TO RISING UNEMPLOYMENT BY INJECTING MORE MONEY INTO THE

SYSTEM, WHETHER THROUGH THE BUDGET OR THROUGH THE BANKS. SO FAR FROM HALTING THE UPWARD TREND OF UNEMPLOYMENT, THIS SIMPLY GENERATED RUNAWAY INFLATION.

10. THAT COURSE WE WILL NOT FOLLOW.

11. A POLICY FOR DEMAND EXPRESSED UNAMBIGUOUSLY IN TERMS OF MONEY PROVIDES A FURTHER IMPORTANT ADVANTAGE. FOR IT ENSURES THAT WAGE RESTRAINT REALLY WILL CAN PROVIDE MORE JOBS. I REPEAT TODAY THE UNDERTAKING I GAVE THE NATINAL ECONOMIC DEVELOPMENT COUNCIL LAST MONTH: THE MEDIUM-TERM FINANCIAL STRATEGY IS AS FIRM A GUARANTEE AGAINST INADEQUATE MONEY DEMAND AS IT IS AGAINST EXCESSIVE MONEY DEMAND.

D. MONETARY POLICY AND THE EXCHANGE RATE

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

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

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

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

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

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

E. PUBLIC SECTOR BORROWING

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

2. The outturn for the Public Sector Borrowing Requirement for 1983-84 was £9¾ billion, or 3¼ per cent of GDP. In my Budget last year I planned to reduce it substantially in 1984-85 to £7¼ billion, or 2¼ per cent of GDP. In the event, this year's PSBR looks like turning out at £10½ billion, or 3¼ per cent of GDP - the same proportion as in each of the three previous years.

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

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

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

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

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

F. PUBLIC EXPENDITURE

GIVEN THE NEED TO ENSURE THAT THE BUDGET DEFICIT IS OF A SIZE THAT CAN AND WILL BE SOUNDLY FINANCED, LOWER TAXES CAN ONLY BE ACHIEVED BY MAINTAINING THE FIRMEST POSSIBLE CONTROL OF PUBLIC EXPENDITURE.

2. CONTROLLING PUBLIC EXPENDITURE IS ONE OF THE MOST DIFFICULT TASKS FACING ANY DEMOCRATIC GOVERNMENT IN THE MODERN WORLD. PUBLIC EXPENDITURE ACQUIRES ITS OWN MOMENTUM AND CREATES ITS OWN VESTED INTERESTS. TO CONTROL IT REQUIRES CONSTANT VIGILANCE, AND A DETERMINATION TO SUCCEED DESPITE THE INEVITABLE SETBACKS. WE HAVE THAT DETERMINATION, AND HAVE SUCCEEDED IN BRINGING THE GROWTH OF PUBLIC SPENDING BELOW THAT OF THE ECONOMY AS A WHOLE. THIS ACHIEVEMENT HAS REQUIRED DIFFICULT DECISIONS IN SUCCESSIVE PUBLIC EXPENDITURE REVIEWS.

3. BUT THERE IS NO BENEFIT TO SOUND ECONOMIC MANAGEMENT OR EFFECTIVE CONTROL FROM STICKING TO PUBLIC EXPENDITURE FIGURES WHICH SUBSEQUENT EVENTS HAVE MADE UNATTAINABLE.

4. AS MY RT. HON. AND LEARNED FRIEND THE CHIEF SECRETARY MADE PLAIN IN THE RECENT DEBATE ON THE PUBLIC EXPENDITURE WHITE PAPER THE NORMAL (PRE-BUDGET) REVIEW OF THE FISCAL PROSPECT HAS HAD TO TAKE ACCOUNT OF CHANGES IN THE ECONOMIC SCENE SINCE THE PUBLIC EXPENDITURE REVIEW IN

THE AUTUMN. OF THESE, THE MOST IMPORTANT HAS BEEN THE COAL STRIKE, WHOSE PUBLIC EXPENDITURE COST IN 1984-85 IS ESTIMATED AT SOME £2½ BILLION - ABOUT £1 BILLION MORE THAN ALLOWED FOR IN THE AUTUMN STATEMENT AND IN THE PUBLIC EXPENDITURE WHITE PAPER WHICH EXPLICITLY ASSUMED THAT THE STRIKE WOULD END AT CHRISTMAS. THERE WILL ALSO BE SOME FURTHER COST IN 1985-86.

5. I NOW ESTIMATE THAT THIS YEAR'S PUBLIC EXPENDITURE PLANNING TOTAL WILL BE EXCEEDED BY NEARLY £3½ BILLION, OF WHICH OVER TWO-THIRDS IS ATTRIBUTABLE TO THE COAL STRIKE. BUT QUITE APART FROM THE COAL STRIKE, THE UPWARD PRESSURES ON PUBLIC SPENDING REMAIN INTENSE, NOT LEAST FROM INCREASED TAKE-UP OF SOCIAL SECURITY BENEFITS AND FURTHER LOCAL AUTHORITY OVERSPENDING. IN ADDITION, SINCE THE WHITE PAPER WAS PREPARED, WE HAVE HAD TO ACCOMMODATE THE EFFECTS OF HIGHER INTEREST RATES AND A LOWER EXCHANGE RATE.

6. I HAVE REASSESSED THE ADEQUACY OF THE RESERVES FOR 1985-86, 1986-87 AND 1987-88 PROVIDED IN THE JANUARY WHITE PAPER. IN ORDER TO PROVIDE A MORE REALISTIC BASIS ON WHICH TO PLAN AND CONTROL THE LEVEL OF PUBLIC SPENDING, I HAVE JUDGED IT PRUDENT TO ADD £2 BILLION TO THE RESERVE AND THUS TO THE WHITE PAPER PLANNING TOTALS FOR EACH OF THE THREE YEARS. AT THE SAME TIME, I HAVE FURTHER INCREASED THE ESTIMATE FOR DEBT INTEREST IN EACH YEAR.

7. THESE INCREASES IN THE SIZE OF THE RESERVE MEAN THAT THE PLANNING TOTALS FOR THE NEXT THREE YEARS ARE NOW HIGHER BY ABOUT 1½ PER CENT. BUT LET THERE BE NO MISUNDERSTANDING. THE NEW TOTALS STILL REPRESENT A TOUGH TARGET. NO EXTRA CASH HAS BEEN ALLOCATED TO INDIVIDUAL PROGRAMMES. CALLS ON THE RESERVE WILL STILL BE JUDGED ON THE STRICTEST CRITERIA. THERE IS NO SLACKENING IN OUR DETERMINATION TO CURB THE SIZE OF THE PUBLIC SECTOR.

8. PUBLIC EXPENDITURE WILL CONTINUE TO FALL AS A PROPORTION OF GDP, AS IT HAS, THE COAL STRIKE APART, SINCE 1981-82. EXPENDITURE IS PLANNED TO STAY BROADLY FLAT IN REAL TERMS AT ABOUT THIS YEAR'S LEVEL, EXCLUDING THE COSTS OF THE COAL STRIKE. TO ACHIEVE EVEN THESE NEW FIGURES, FUTURE PUBLIC EXPENDITURE SURVEYS WILL HAVE TO BE AT LEAST AS TOUGH AS THEIR PREDECESSORS; AND THERE CAN BE NO LET-UP IN THE TIGHT CONTROL OF INDIVIDUAL SPENDING PROGRAMMES WITHIN THE CASH LIMITS SET FOR THE COMING YEAR.

9. ON THE OTHER SIDE OF THE PUBLIC ACCOUNTS, TAX RECEIPTS, TOO, ARE NOW EXPECTED TO BE HIGHER OVER THE NEXT THREE YEARS, PARTLY FOR RELATED REASONS. BUT NOT BY AS MUCH. THE SCOPE I HAVE FOR TAX CUTS THIS YEAR IS THEREFORE ONLY HALF THE AMOUNT I INDICATED MIGHT BE AVAILABLE IN MY STATEMENT TO THE HOUSE IN NOVEMBER. IN OTHER WORDS, THE MEASURES I SHALL SHORTLY ANNOUNCE WILL, AFTER INDEXATION, CONTRIBUTE SOME £¾ BILLION NET TO THE £7 BILLION BORROWING REQUIREMENT I HAVE SET FOR 1985-86.

Read after G1

G2: EMPLOYMENT AND TRAINING MEASURES

1. ONE OF THE MOST LONG-STANDING PROBLEMS IN THIS COUNTRY IS OUR FAILURE TO PREPARE OUR SCHOOL-LEAVERS ADEQUATELY FOR WORK. SINCE IT WAS FIRST LAUNCHED IN 1983, THE YOUTH TRAINING SCHEME HAS PROVED TO BE A VERY SUCCESSFUL BRIDGE BETWEEN SCHOOL AND WORK. IT HAS ALSO HELPED TO MAKE YOUNG PEOPLE'S PAY EXPECTATIONS MORE REALISTIC. BUT TOO MANY TRAINEES ARE STILL RELUCTANT TO ACCEPT RATES OF PAY WHICH REFLECT THEIR INEXPERIENCE. AND TOO MANY EMPLOYERS STILL FAIL TO RECOGNISE THAT TRAINING IS AN INVESTMENT IN THEIR OWN COMMERCIAL INTEREST. THIS IS IN MARKED CONTRAST TO OUR MAJOR COMPETITORS OVERSEAS.

2. THE GOVERNMENT HAS THEREFORE DECIDED TO PROMOTE A MAJOR EXPANSION OF THE YOUTH TRAINING SCHEME. PROVIDED EMPLOYERS CONTRIBUTE A MAJOR SHARE OF THE COST, THE GOVERNMENT IS PREPARED TO PROVIDE FURTHER FUNDS TO LAUNCH THIS EXPANSION, OVER AND ABOVE THE EXISTING £800 MILLION A YEAR OF PUBLIC EXPENDITURE ON THE YTS. THE OBJECT IS EVENTUALLY TO PROVIDE ALL 16 OR 17 YEAR OLDS WHO DO NOT CONTINUE IN FULL-TIME EDUCATION WITH THE OFFER OF JOB-RELATED TRAINING LEADING TO A RECOGNISED QUALIFICATION. THE SCHEME WOULD OFFER PLACES LASTING TWO YEARS FOR 16 YEAR OLDS AND ONE YEAR FOR 17 YEAR OLD SCHOOL-LEAVERS.

G1. THE STRATEGY FOR JOBS

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

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

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

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

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

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

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

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

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

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

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

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

Now read first page of G2 (one page back)

See new page before G1

G2: EMPLOYMENT AND TRAINING MEASURES

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

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

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

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

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

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

6. I am also providing the MSC with an additional £20 million in 1986-87 to finance a programme of appropriate in-service teacher training courses.

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

8. While school-leavers are catered for by the Youth Training Scheme, there remains the problem of the long-term unemployed genuinely seeking work. Under the Community Programme, local authorities and voluntary bodies provide temporary work for the long-term unemployed on projects of community benefit. This scheme, which at present provides 130,000 places, has

PROVED ITS WORTH, WITH A SIGNIFICANT PROPORTION OF THOSE WHO LEAVE IT GOING ON TO OTHER JOBS.

9. I HAVE THEREFORE AGREED TO MAKE FUNDS AVAILABLE TO PROVIDE AN ADDITIONAL 100,000 COMMUNITY PROGRAMME PLACES BY JUNE 1986. THESE PLACES WILL BE FOR 18 TO 24 YEAR OLDS WHO HAVE BEEN UNEMPLOYED FOR SIX MONTHS OR MORE, AND OTHERS WHO HAVE BEEN UNEMPLOYED FOR OVER A YEAR. TO ACCOMMODATE THIS, THE DEPARTMENT OF EMPLOYMENT'S PROGRAMME WILL BE FURTHER INCREASED BY £140 MILLION IN 1985-86 AND £460 MILLION IN 1986-87 TO ACCOMMODATE THIS.

10. TO AN EVEN GREATER EXTENT THAN WITH THE YOUTH TRAINING SCHEME, THE NET PUBLIC EXPENDITURE COST WILL BE SUBSTANTIALLY LESS THAN THE GROSS COST BECAUSE OF SAVINGS ON SOCIAL SECURITY BENEFITS. THE NET ADDITION TO PUBLIC EXPENDITURE AS A RESULT OF ALL THE PROPOSALS I HAVE ANNOUNCED TODAY WILL BE £75 MILLION IN 1985-86, £300 MILLION IN 1986-87, AND £400 MILLION IN 1987-88.

11. WE ALSO NEED TO DO MORE TO REMOVE LEGISLATIVE IMPEDIMENTS TO THE EFFECTIVE FUNCTIONING OF THE LABOUR MARKET. HOWEVER WELL INTENTIONED, THEY CAN ONLY LEAD TO FEWER JOBS. ACCORDINGLY, MY RT HON FRIEND THE SECRETARY OF STATE FOR EMPLOYMENT WILL BE EXTENDING TO ALL EMPLOYERS THE PROVISIONS ON UNFAIR DISMISSAL WHICH CURRENTLY APPLY TO SMALL FIRMS. THE QUALIFYING PERIOD FOR UNFAIR DISMISSAL CLAIMS WILL THUS BECOME TWO YEARS FOR ALL NEW EMPLOYEES. THIS IS A REASONABLE PERIOD OF

time and should lessen the reluctance of some employers to take on new people.

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

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

H TAX REFORM

I NOW TURN TO TAXATION.

2. THIS BUDGET CARRIES FORWARD THE THEME OF TAX REFORM I SET OUT LAST YEAR. REFORM DESIGNED TO MAKE LIFE A LITTLE SIMPLER FOR THE TAXPAYER. AND ABOVE ALL REFORM DESIGNED TO IMPROVE OUR ECONOMIC PERFORMANCE OVER THE LONGER TERM, ON WHICH THE JOBS OF THE FUTURE WILL DEPEND.

3. IN MY BUDGET LAST YEAR I ANNOUNCED A RADICAL REFORM OF THE CORPORATION TAX SYSTEM. THIS HAD BEEN PRECEDED BY THE GREEN PAPER ON CORPORATION TAX ISSUED BY MY PREDECESSOR IN 1982.

4. I AM SATISFIED THAT THE RIGHT WAY TO PROCEED WITH MAJOR TAX REFORM IS TO ISSUE A GREEN PAPER FIRST, AS A BASIS FOR FULL AND INFORMED DISCUSSION, FOLLOWED BY LEGISLATION WHEN THE RESULTS OF THAT DISCUSSION HAVE BEEN FULLY DIGESTED.

5. I THEREFORE PROPOSE TO ISSUE A GREEN PAPER LATER THIS YEAR ON THE REFORM OF PERSONAL INCOME TAX.

6. THE COMPUTERISATION OF PAYE MAKES THIS THE RIGHT TIME TO REVIEW THE SYSTEM OF PERSONAL TAXATION. THE WORK IS WELL UNDER WAY AND SHOULD BE COMPLETE BY

1989. THE GREEN PAPER WILL THEREFORE DISCUSS A RANGE OF OPTIONS OPENED UP BY COMPUTERISATION, FROM NON-CUMULATION (of P.A.Y.E) TO CLOSER ALIGNMENT BETWEEN THE TAX AND BENEFIT SYSTEMS, AND INCLUDING IN PARTICULAR A REFORM OF THE PRESENT SYSTEM OF PERSONAL ALLOWANCES.

7. IT IS THE GOVERNMENT'S FIRM POLICY TO REDUCE THE BURDEN OF INCOME TAX. BUT WE NEED TO MAKE SURE THAT THE RELIEFS WE CAN AFFORD ARE CONCENTRATED WHERE THEY WILL DO MOST GOOD.

8. THE PRESENT STRUCTURE OF PERSONAL INCOME TAX IS FAR FROM SATISFACTORY. TOO MANY YOUNG PEOPLE START PAYING TAX AT TOO LOW A LEVEL. AND TOO MANY FAMILIES FIND THEMSELVES IN THE POVERTY AND UNEMPLOYMENT TRAPS. THE SYSTEM DISCRIMINATES AGAINST THE FAMILY IN WHICH THE WIFE STAYS AT HOME TO LOOK AFTER THE CHILDREN. IT DENIES TO THE PARTNERS IN A MARRIAGE THE INDEPENDENCE AND PRIVACY IN THEIR TAX AFFAIRS WHICH THEY HAVE A RIGHT TO EXPECT.

9. THERE IS THEREFORE A STRONG CASE FOR CHANGING TO A NEW SYSTEM OF PERSONAL ALLOWANCES MORE SUITED TO TODAY'S ECONOMIC AND SOCIAL NEEDS. UNDER THIS, EVERYONE, MAN OR WOMAN, MARRIED OR SINGLE, WOULD HAVE THE SAME STANDARD ALLOWANCE. BUT IF EITHER HALF OF A MARRIED COUPLE WERE UNABLE TO MAKE FULL USE OF THEIR ALLOWANCE, THE UNUSED PORTION COULD BE TRANSFERRED, IF THEY SO WISHED, TO THEIR PARTNER.

10. THIS REFORM WOULD PRODUCE A MORE LOGICAL AND STRAIGHTFORWARD SYSTEM. IT WOULD OPEN THE WAY FOR A SIGNIFICANT RISE IN TAX THRESHOLDS FOR FAMILIES WHERE THE WIFE WORKS IN THE HOME, WHERE THE PROBLEMS OF THE POVERTY AND UNEMPLOYMENT TRAPS ARE MOST PRONOUNCED.

11. UNDER THIS SYSTEM, FAR MORE PEOPLE COULD BE TAKEN OUT OF THE POVERTY AND UNEMPLOYMENT TRAPS, AND INDEED TAKEN OUT OF TAX ALTOGETHER, FOR A GIVEN SUM OF OVERALL TAX RELIEF THAN IS POSSIBLE UNDER THE PRESENT SYSTEM. IT WOULD END THE PRESENT DISCRIMINATION AGAINST THE FAMILY WHERE THE WIFE FEELS IT RIGHT TO STAY AT HOME, WHICH INCREASINGLY NOWADAYS MEANS DISCRIMINATION AGAINST THE FAMILY WITH YOUNG CHILDREN.

12. HUSBANDS AND WIVES WOULD EACH BE TAXED SEPARATELY ON THEIR OWN INCOME IRRESPECTIVE OF THE INCOME OF THE OTHER. THE AGGREGATION FOR TAX PURPOSES OF A WIFE'S EARNED INCOME AND INVESTMENT INCOME WITH HER HUSBAND'S WOULD END, THUS REMOVING WHAT HAS BECOME AN INCREASING SOURCE OF RESENTMENT AMONG WOMEN.

13. THE GREEN PAPER WILL SET OUT FULL DETAILS OF THE PROPOSALS I HAVE JUST OUTLINED, AS A BASIS FOR PUBLIC DISCUSSION. AFTER AN APPROPRIATE PERIOD FOR CONSULTATION, IT WOULD BE POSSIBLE TO LEGISLATE IN 1987 AND HAVE A SYSTEM ON THESE LINES FULLY IN PLACE BY APRIL 1990.

14. THERE IS ALSO A CASE FOR CHANGING THE TAX TREATMENT OF PENSION FUNDS, AS PART OF A THOROUGH-GOING REFORM OF THE TAX TREATMENT OF PERSONAL SAVINGS GENERALLY. ANY FUNDAMENTAL REFORM OF THIS KIND WOULD ALSO, IN THE SAME WAY, NEED TO BE PRECEDED BY THE PUBLICATION OF A GREEN PAPER.

15. THE HOUSE WILL, I AM SURE, BE INTERESTED TO LEARN THAT I HAVE NO SUCH GREEN PAPER IN MIND.

16. NOR, INDEED, DESPITE THE UNPARALLELLED PRE-BUDGET AGITATION DO ANY OF THE DETAILED PROPOSALS IN MY BUDGET AFFECT THE TAX-DEDUCTIBILITY OF PENSION FUND CONTRIBUTIONS, THE TAX-FREE NATURE OF PENSION FUND INCOME AND CAPITAL GAINS, OR THE ANOMALOUS BUT MUCH-LOVED TAX-FREE LUMP SUM.

17. MEANWHILE, I HAVE A NUMBER OF OTHER IMPORTANT PROPOSALS FOR TAX REFORM TO ANNOUNCE TODAY, WHICH WILL BOTH SIMPLIFY THE SYSTEM AND ENCOURAGE ENTERPRISE.

18. FIRST, CAPITAL GAINS TAX. LAST YEAR I WAS UNABLE TO DO ANYTHING ABOUT THE ACKNOWLEDGED DEFECTS OF THIS TAX, NOTABLY ITS COMBINATION OF UNFAIRNESS AND COMPLEXITY, AND UNDERTOOK TO COME BACK TO IT THIS YEAR.

19. THIS I NOW DO.

20. I HAVE DECIDED THAT THE RIGHT WAY TO REFORM CAPITAL GAINS TAX IS TO BUILD ON THE IMPORTANT CHANGE MADE BY MY PREDECESSOR THREE YEARS AGO, WHEN HE INTRODUCED THE 1982 INDEXATION RELIEF.

21. THAT RELIEF, VALUABLE THOUGH IT IS, AND INCREASINGLY VALUABLE AS IT WILL BECOME, SUFFERS FROM THREE SERIOUS LIMITATIONS.

22. FIRST, INDEXATION DOES NOT COVER THE FIRST 12 MONTHS OF THE OWNERSHIP OF AN ASSET. THIS PROVISION WAS INTRODUCED TO DISCOURAGE THE SHORT TERM CONVERSION OF INCOME INTO CAPITAL. BUT IT HAS MADE THE TAX VERY MUCH MORE COMPLICATED FOR THE TAXPAYER. I AM NOW IN A POSITION TO REMEDY THIS DEFECT. HON MEMBERS WILL RECALL THAT I ANNOUNCED LAST MONTH MEASURES TO PUT AN END TO THE PRACTICE KNOWN AS BONDWASHING, THE PRINCIPAL DEVICE FOR CONVERTING INCOME INTO LESS HEAVILY TAXED CAPITAL GAINS. HAVING DONE THAT, I PROPOSE TO ABOLISH THE 12 MONTH RULE. SO FAR AS MOST DISPOSALS ARE CONCERNED, THIS WILL TAKE EFFECT FROM 6 APRIL. IN THE CASE OF CERTAIN FIXED INTEREST SECURITIES, HOWEVER, THE RULE WILL NEED TO REMAIN IN BEING UNTIL THE ANTI-BONDWASHING PROVISIONS TAKE EFFECT ON 28 FEBRUARY 1986.

23. SECOND, THE INDEXATION DOES NOT AT PRESENT EXTEND TO LOSSES. I PROPOSE TO REMOVE THIS RESTRICTION.

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

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

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

27. I turn next to the stamp duties.

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

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

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

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

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

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

J. **BUSINESS TAXATION**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

K. PERSONAL TAXATION: TAXES ON SPENDING

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

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

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

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

K. PERSONAL TAXATION: TAXES ON SPENDING

1. I TURN NOW TO THE TAXATION OF PERSONAL INCOME AND SPENDING. MY BUDGET LAST YEAR SHIFTED SOME OF THE BURDEN OF PERSONAL TAXATION FROM EARNINGS TO SPENDING. TODAY I PROPOSE TO MAKE A FURTHER MOVE IN THIS DIRECTION.

2. ACCORDINGLY, I PROPOSE TO INCREASE THE REVENUE FROM THE EXCISE DUTIES BY RATHER MORE THAN IS REQUIRED SIMPLY TO KEEP PACE WITH INFLATION - A LESS PAINFUL TASK NOW THAT INFLATION IS RELATIVELY LOW.

3. I PROPOSE TO INCREASE THE DUTY ON CIGARETTES AND HAND-ROLLING TOBACCO BY THE EQUIVALENT, INCLUDING VAT, OF SIXPENCE ON A PACKET OF 20 CIGARETTES. THESE CHANGES WILL TAKE EFECT FROM MIDNIGHT ON THURSDAY. I DO NOT HOWEVER PROPOSE ANY INCREASE AT ALL IN THE DUTIES ON CIGARS AND PIPE TOBACCO.

4. I PROPOSE INCREASES WHICH, INCLUDING VAT, WILL PUT BETWEEN A PENNY AND TWOPENCE A PINT ON MOST BEER (DEPENDING ON ITS STRENGTH); A PENNY A PINT ON CIDER, SIXPENCE ON A BOTTLE OF TABLE WINE AND ABOUT TENPENCE A BOTTLE ON SPARKLING OR FORTIFIED WINE. IN RECOGNITION OF THE CURRENT DIFFICULTIES OF THE SCOTCH WHISKY INDUSTRY, HOWEVER, I PROPOSE TO INCREASE THE DUTY ON SPIRITS BY ONLY TENPENCE A BOTTLE, WELL BELOW THE AMOUNT NEEDED TO KEEP PACE WITH INFLATION. ALL THESE CHANGES TAKE EFFECT FROM MIDNIGHT TONIGHT.

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

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

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

8. I now turn to VAT.

9. I HAVE FOLLOWED WITH INTEREST THE SPECULATION THAT HAS BUILT UP OVER RECENT MONTHS ABOUT MY ALLEGED INTENTIONS FOR VAT. MOST OF IT - SUCH AS THE SO-CALLED PROPOSAL TO LEVY VAT ON BOOKS - HAS CONCERNED MATTERS WHICH HAVE NOT EVEN BEEN UNDER CONSIDERATION. BUT TO HAVE REVEALED THIS PREMATURELY WOULD NOT HAVE STILLED SPECULATION; IT WOULD MERELY HAVE CONCENTRATED IT ON THOSE MATTERS THAT WERE UNDER CONSIDERATION - A PRACTICE THAT NO CHANCELLOR, RIGHTLY, HAS SOUGHT TO ENCOURAGE.

10. I CAN NOW INFORM THE HOUSE THAT, APART FROM ONE CHANGE I SHALL BE PROPOSING TODAY, I DO NOT INTEND TO MAKE ANY FURTHER EXTENSIONS OF THE VAT BASE DURING THE LIFETIME OF THIS PARLIAMENT. THIS IS, OF COURSE, A FIELD IN WHICH EUROPEAN COMMUNITY LAW HAS TO BE RECKONED WITH. BUT AS THE HOUSE WILL BE AWARE, WHERE WE ARE CURRENTLY UNDER CHALLENGE, WE ARE VIGOROUSLY FIGHTING OUR CASE.

11. THE CHANGE I PROPOSE TO MAKE CONCERNS NEWSPAPERS AND MAGAZINES. AT PRESENT, WHILE ALL OTHER ADVERTISING IS TAXED, NEWSPAPER AND MAGAZINE ADVERTISING IS NOT. THERE IS NO JUSTIFICATION FOR THIS ANOMALY. IT IS ONE THING TO MAINTAIN THAT NEWSPAPERS AND MAGAZINES SHOULD NOT BE LIABLE TO VAT: QUITE ANOTHER TO ARGUE THAT THOSE WHO ADVERTISE IN THEM SHOULD ENJOY A SIMILAR IMMUNITY. ACCORDINGLY, I PROPOSE THAT FROM 1 MAY NEWSPAPER AND MAGAZINE ADVERTISING SHOULD BE SUBJECT TO VAT. THIS WILL RAISE £30 MILLION IN 1985-86 AND £50 MILLION IN A FULL YEAR.

12. I ALSO PROPOSE TO CHANGE THE VAT TREATMENT OF CREDIT CARDS AND SIMILAR PAYMENT CARDS - A PART OF THE FINANCIAL SECTOR WHICH HAS ENJOYED EXCEPTIONAL GROWTH OVER THE PAST FEW YEARS. I PROPOSE THAT FROM 1 MAY TRANSACTIONS BETWEEN THE COMPANIES PROVIDING THE CARDS AND THE OUTLETS WHICH ACCEPT THEM SHOULD BE CLASSIFIED AS EXEMPT. THIS MEANS THAT THE COMPANIES WILL NOT BE ABLE TO RECOVER VAT IN RESPECT OF SUCH TRANSACTIONS. THIS WILL RAISE £15 MILLION IN 1985-86 AND £20 MILLION IN A FULL YEAR. IT SHOULD NOT DIRECTLY AFFECT THE CHARGES MADE TO CARD HOLDERS.

13. I ALSO HAVE A MODEST VAT CONCESSION TO MAKE. I HAVE DECIDED TO EXTEND THE EXISTING VAT RELIEF FOR MEDICAL OR SCIENTIFIC EQUIPMENT BOUGHT WITH DONATED FUNDS FOR USE IN HOSPITALS AND THE LIKE TO COVER COMPUTER EQUIPMENT FOR CERTAIN MEDICAL USES. CUSTOMS AND EXCISE WILL BE ANNOUNCING THE PRECISE DETAILS OF THE RELIEFS, WHICH WILL TAKE EFFECT FROM 1 MAY.

14. FOLLOWING EXTENSIVE CONSULTATIONS, I PROPOSE TO INCLUDE IN THIS YEAR'S FINANCE BILL LEGISLATION TO IMPLEMENT MOST OF THE RECOMMENDATIONS OF THE KEITH REPORT ON THE ENFORCEMENT POWERS OF THE REVENUE DEPARTMENTS, INCLUDING MEASURES TO DEAL WITH THE PROBLEM OF THE LATE PAYMENT OF VAT. THIS IS EXPECTED TO BRING IN EXTRA REVENUE OF ABOUT £50 MILLION IN 1985-86. BY 1988-89 THERE WILL HAVE BEEN A CUMULATIVE ONCE-FOR-ALL REVENUE

GAIN OF ABOUT £600 MILLION. PROPOSALS ON THE INLAND REVENUE ASPECTS OF THE KEITH REPORT WILL FOLLOW IN NEXT YEAR'S FINANCE BILL.

15. THE VAT CHANGES I HAVE JUST PROPOSED WILL BRING IN £90 MILLION IN 1985-86, RISING EVENTUALLY TO £215 MILLION IN A FULL YEAR. THEY WILL HAVE NO IMPACT ON THE RPI. THE ADDITIONAL REVENUE RAISED FROM THE EXCISE DUTIES AND VAT TAKEN TOGETHER WILL HELP ME TO LIGHTEN THE BURDEN OF INCOME TAX.

L. PERSONAL TAXATION: INCOME TAX

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

2. I now turn to income tax.

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

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

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

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

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

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

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

9. For the basic thresholds I can do more. Statutory indexation would imply an increase in the single person's allowance of £100. I propose to increase it by precisely twice as much - £200 - from £2,005 to £2205. Statutory indexation would imply an increase in the married man's allowance of £150. Again, I propose to raise it by precisely twice as much - £300 - from £3,155 to £3,455

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

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

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

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

M. NATIONAL INSURANCE CONTRIBUTIONS

1. I have one last proposal to make.

2. I have already set out the broad lines of the Government's strategy to improve the prospects for jobs. I have described a number of measures to improve training, remove legislative barriers to employment, and stimulate enterprise; and I have also raised tax thresholds substantially for the second year running.

3. But I want to do more to improve job prospects for young people and the unskilled, among whom the problem of unemployment is most severe.

4. I have concluded that an effective response to this problem must include direct action in two related areas - to cut the costs of employing the young and unskilled, and to sharpen their own incentives to work at wages which employers can afford to pay.

5. I am therefore proposing, in collaboration with my Rt. Hon. Friend the Secretary of State for Social Services, that the structure of National Insurance contributions should be radically reformed in order to encourage the creation of more jobs. The essential features of the contributory principle will be preserved.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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N. CONCLUSION

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

010

A. Tomlinson

CABINET OFFICE
70 Whitehall London SW1A 2AS Telephone 01-233 3299

From the Minister without Portfolio
The Rt Hon Lord Young of Graffham

P Wynn-Owen Esq
Assistant Private Secretary to
the Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON SW1

15 March 1985

Dear Philip,

BUDGET DAY PRESS NOTICES: 14-18s

will attach if required

We spoke about my letter of 11 March 1985 concerning Budget Day Press Notices. I am now writing to confirm that Lord Young will not be issuing a press notice on Budget Day.

I am copying to recipients of the earlier correspondence.

Yours sincerely

Jayne Hulley

pp S G RATCLIFFE
Assistant Private Secretary

8-9

FROM: C R PICKERING
DATE: 14 MARCH 1985

MR FOLGER

cc PS/Chancellor
TWEB/alternative policies checklist recipients

'ALTERNATIVE BUDGETS' 1985

Mr Hattersley released an alternative budget after all. I enclose a summary. which can be used with section C of the checklist attached to my minute of 13 March.

C R Pickering

C R PICKERING

C
LABOUR

Mr Hattersley
Press Conference
on 13.3.85

(i) Use 'fiscal adjustment' (£1.5 billion) and increase PSBR (£3.5 billion) to finance investment on infrastructure and manufacturing; employment effect 270,000 first year. 1 million over three years.

(ii) £3 per week increase in child benefit

(iii) £5 per week increase in single person's pension. £8 married couple

(iv) Introduce long-term supplementary benefit for long-term unemployed

Total cost (ii)-(iv) £2.85 billion. net of inflation and a clawback of other benefit costs. Financed by restoring tax of the rich to 1979 levels. by restoring 1979-84

(v) Reduction in Capital Gains Tax

(vi) Reduction in Capital Transfer Tax

(vii) Abolition of investment income surcharge

(viii) Reduction in top income tax rate bands

Total revenue effect (vi)-(viii) £3 billion

(ix) Abolish UEL for NICs. to finance lifting NIC threshold and/or income tax personal allowances. and/or reducing employers' NICs via employment subsidy.

3.31

SECRET

NB PM

AF 15/3

3

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

14 March 1985

The Rt Hon Peter Walker MBE MP
Secretary of State for Energy
Department of Energy
Thames House South
Millbank
LONDON SW1

Dear Peter

FSBR

Thank you for your letter of 13 March. We have to recognise that the table in the FSBR showing a fall in North Sea tax revenues will indicate to informed commentators that a fall in sterling oil prices has been assumed for the medium term. It is likely that this will come up at the Treasury Committee, where officials may be pressed on this.

But I understand your anxiety about being explicit in the FSBR itself, and as you suggested I have deleted the sentence which referred to an assumption of some fall in world oil prices.

The next paragraph reads:

> "Government revenue from the North Sea is projected to fall in both real and nominal terms after 1985-86 as North Sea output and real oil prices both fall, but this is more than offset by rising revenues from the growing non-North Sea economy."

This does not necessarily imply any fall in actual oil prices, but only that they will not keep pace with prices generally. There was a reference in last year's FSBR which clearly implied a fall in real oil prices.

The substance of the other drafting points has been incorporated in the latest version of the FSBR. My officials have been in touch with yours over the estimated costs of the coal strike.

I am copying this to the Prime Minister and to Geoffrey Howe.

Ever
Nigel

NIGEL LAWSON

Economic Policy PT 13
Budget

8-9

FROM: C R PICKERING
DATE: 13 MARCH 1985

MR FOLGER

cc PS/Chancellor
All recipients of the Treasury Weekly Brief and/or EB checklist of alternative policies

'ALTERNATIVE BUDGETS' 1985

I enclose a checklist of alternative Budget strategies which have been published during the Budget season.

2. Among others, it summarises the Alliance's proposals. I understand the Labour Party does not intend to issue a statement or document summarising their Budget ideas. Instead, they are relying on the recent speeches of Mr Hattersley. The few substantive proposals he has made are summarised at part C.

C R Pickering

C R PICKERING

1984-85 CHECKLIST OF ALTERNATIVE BUDGET PROPOSALS

CONTENTS

EB Division
HM Treasury

room 99/2 GOGGS
01 233 5503

NB. 1. The information in this Checklist is based on the actual documents where available: otherwise it depends on Press reports only.

2. Costings and predictions quoted are primarily those of the authors of the policies: they are not necessarily endorsed by the Treasury.

A CBI

A1 **Make it Work**
CBI Budget representation
published 23 January 1985

Endorses Government's strategy for defeating inflation and holding down public sector costs to make room for lower interest rates and lower tax burden. Within strategy, Government could in 1985 Budget help stimulate business activity so as to create more jobs in medium term by

(i) raising personal tax allowances by 10 per cent (cost £1.5 billion in 85-86, £1.7 billion in full year). NB this to be followed by similar higher-than-inflation increases in succeeding years

(ii) reducing (employee) NI contributions - and make start on reform of structure esp. harsh impact on contributor of payment on full earnings when threshold crossed.

(iii) improving capital allowances to be set against corporation tax to 25% straight line write down (cost nil 85-86, £0.9bn in full year)

(iv) giving partial rates relief for business premises (cost £0.6 billion in 85-86, £0.4 billion in full year)

(v) exempting from Capital Gains Tax of stock held for over 7 years (cost £ nil in 85-86, £0.65 billion in full year) - pending review of whole system.

- Above, with various other measures listed in the CBI submission, is estimated to increase PSBR by £2 billion above figure yielded by tax neutral policies in 85-86, £3 billion in full year (after allowing for increased revenue from expanding economy) but keep it declining absolutely and as percentage of GDP
- On expenditure side CBI claim that economies could be made in current spending sufficient to release up to £6 billion over time for increased infrastructure spending.

A2 Institute of Directors
Budget representations
published 15 January 1985

Urges Government to keep to framework of MTFS and work towards zero inflation, aim to reduce level of public expenditure not just hold it steady, and introduce Medium Term Fiscal Strategy.

Specific recommendations designed to reduce 'the distortions of the price mechanism through taxation' include:

(i) Reduction in basic and higher income tax rates by 1p, and higher rates by additional 5p (cost £1.3 billion in 85-86)

(ii) Increasing all personal allowances and higher rate thresholds by 4 per cent above indexation (cost £0.7 billion in 85-86)

(iii) Abolishing CTT (cost £¼ billion in 85-86) and CGT and DLT

(iv) (Re)introduction of child allowance against income tax in place of Child Benefit

(v) Increasing VAT threshold

(vi) No change in relief on mortgage interest payments and pension contributions

(vii) No change in VAT base.

A3 Association of British Chamber of Commerce Budget representations published 4 February 1985

Argue against using any available fiscal adjustment to raise after tax incomes of the employed but rather use public sector capital spending to provide more jobs - apart from fact that infrastructure spending 'justifiable in its own right'.

Recommend:-

- £1 billion capital outlay on improving communications (road construction, railway electrification); clearing derelict land; improving water and sewerage systems; replacing improving or repairing housing
- to be financed from sale of part of PSA estate and by cutting current spending

B TUC

B1	Budget representations published 13 December 1984	Recommends £2.3 billion programme in Budget ('complementary' to TUC's repeated recommendations for increase in public sector capital investment programme) for increased current spending designed to 'reverse trend towards greater inequality and poverty', including (i) keep universal Child Benefit and increase to £9.85 (with parallel increase for single parents) (ii) increase retirement pension to £45.60 (single), £73.30 (married) (iii) pay long term rate supplementary benefit to long term unemployed (iv) rescind 1984 housing benefit cuts (v) No change in VAT base - Cost to be met by forgoing £1¾ billion fiscal adjustment tax cuts plus recourse to Reserve.

C	LABOUR PARTY		
C1	Mr Hattersley's speech in St Albans on 8.1.85	(i)	Called for £3 billion in job creation. half instead of tax cuts and half funded by borrowing and maintaining PSBR at 1984-85 level.
C2	Mr Hattersley in House of Commons Debate on unemployment 15.1.85 (OR cols 197-211)	(i)	MTFS should be abandoned: economy needs an increase in real demand.
3.	Mr Hattersley in House of Commons Debate on the economy 31.1.85 (OR cols 490-496)	(i)	£1½ billion tax cuts should be replaced by investment in infrastructure
		(ii)	Increase expenditure on special employment measures
C4	Radio interview of Mr Hattersley 8.3.85	(i)	Priorities to alleviate poverty and unemployment
		(ii)	Redistribute 'rather more than £3 billion' of tax reliefs to the 'very rich' down the income scale. Measures to include abolishing UEL for NICs.
		(iii)	Increase public sector capital investment. while holding PSBR at 1984-85 level.

D CONSERVATIVE CRITICS

D1 Work to be Done
published 18 February 1985

Pamphlet described as 'an employment policy for 1985 and beyond' published by Mr Nigel Forman MP and Mr J Maples MP, proposes 'imaginative and eclectic approach' involving acceptance of £10 billion PSBR in 1985-86 (£3 billion above 1984 FSBR figure) permitting allocation of £4¾ billion to employment-creating measures:-

(i) 'modest real increase' in personal allowances (not costed);

(ii) more resources allocated to urban renewal and expanded programme of home improvement grants (PSBR cost £1 bn);

(iii) cut in employers' NIC - from 10¼ per cent to 8¼ per cent (PSBR cost £1.6bn);

(iv) increase in lower earnings limit for NIC - to be financed by lifting upper limit;

(v) encouraging labour mobility by relaxing rules on resale of council houses, abolishing stamp duty on house purchase (cost £200 m in full year), and pushing on with reform of occupational pensions;

(vi) 'more positive' Government trade and industrial policy (eg more support for new technology, 'worthwhile' infrastructure projects to go ahead, measures to discourage locations of businesses in overdeveloped areas), combined with energetic pursuit of liberalisation of international trade;

(vii) direct subsidies to employers taking on new labour (based on proportion of PSBR cost of their staying out of work);

(viii) easier conditions for payment of Enterprise Allowance;

(ix) expansion of vocational training and retraining, for adults, especially the unemployed;

(x) encouragement of part-time work by such measures as higher earnings disregards for benefit purposes;

(xi) extension of longer term rate of Supplementary Benefit to the long-term unemployed.

D2 Tory Reform Group
Budget representations
5.3.85

Priority to reduce unemployment. Main specific proposals:

(i) At least £2 billion on public sector capital investment, particularly housing.

(ii) Index income tax thresholds (but not higher rate bands), alcohol and other duties (except cigarettes and tobacco - more than index)

(iii) Better to more than index duties than increase VAT coverage. (No VAT on books and newspapers)

(iv) Increase Child Benefit: increase taxable against higher rates

(v) Extend YTS to all 17 year olds

(vi) 1 year 'holiday' from NICs for new workers. young unemployed and long-term unemployed. Revise UEL. Better to reduce NICs than increase income tax thresholds

(vii) Give long term unemployed higher rate supplementary benefit

(viii) Do not reduce tax relief on pension contributions.

D3 Edward Heath 'Guardian' 13.3.85

Advocates 'Medium term real strategy'. In 1985-86 would set PSBR at £12 billion. to finance:

(i) £2 billion on infrastructure investment

(ii) increase child benefit by £1.85 per child per week (cost £975 million)

(iii) £1.5 billion on national training system

(iv) £1.5 billion for Department of Trade and Industry investment in manufacturing industry and regional policy.

E ALLIANCE PARTIES

E1 Dr Owen speech at Carmarthen (SDP Welsh Council) 14 October 1984

also set out, in brief, in article in 'The Times' 4 November 1984

Proposals for reducing unemployment by 1 million presented as compromise 'National Jobs Plan' susceptible of bipartisan adoption (while falling short of what Alliance parties would ideally endorse), at a cost of £2.9 billion over two years (1984-85 and 1985-86).

(i) Emergency measures restructure employers' NIC building - in incentives to employ low-skilled and additional workers, expand Community Programme and employ more women in Personal and Social Services - net total cost to PSBR £1.82bn

(ii) Capital investment at net total cost of £1 billion in housebuilding and renovation, roads and sewer repairs and maintenance

(iii) Encouragement of innovation expansion of Loan Guarantee Scheme, Enterprise Allowance Scheme, Office and Service Industries Grant Scheme: net total cost to PSBR £116 million

Dr Owen recognises the risk of inflationary pressures from adoption of his Plan, and proposes making the capital spending programme conditional on low pay rise undertakings and warning the private sector that 'a tough counter-inflation tax' might yet be considered by the Government.

E2 Dr Owen in Debate 15 January 1985 (Hansard col 218)

Recommended action on:-

A falling £

(i) mobilise concerted action among European countries to put moral pressure on US to reduce deficit;

(ii) explore ways of curbing oil price volatility eg by restricting UK output (in concert with Norway and);

(iii) join exchange rate mechanism of EMS (at or below current £/DM values);

B unemployment

(i) increase public sector investment (private sector investment needs to rise too);

(ii) ease poverty and unemployment 'traps' by improving family support rather than through tax cuts;

(iii) increase spending on community programme

(iv) reduce and restructure national insurance contributions to ease burden on employers - to be self-financing if only possible way.

Above to be financed by accepting higher PSBR and/or accepting postponement of tax cuts and/or 'sensible' degree of widening of VAT base (not food). Any tax cuts to be 'specifically and positively geared to creating more jobs'.

E3 Alliance 'Economic Strategy' and Budget priorities for 1985' (published 1 March 1985)

Priorities are 'those out of work and those in need'. Main elements to proposals are:

A) more expansionary budget policy. Increase public expenditure by around £4 billion in 1985-86. partly funded from 'fiscal adjustment' of £1.5 billion and partly through increasing PSBR by £1.9 billion.

Specific proposals are:

(a) Reduce employers' NICs by 1% (gross cost £745 million and re-structure by raising UEL to finance NIC 'holiday' for employees recruited from long-term unemployed.

(b) Increase public sector capital spending by £1 billion. (£800 million on construction. £200 million on roads)

(c) Increase Community Programme from 130.000 to 250.000 in 1985-86. and introduce new programme for long-term unemployed under 25. Total gross cost £685 million.

(d) Extend YTS to two years. to cover all 16 and 17 year olds who apply. at gross cost of £600 million.

(e) Long-term unemployed under 60 to receive long-term supplementary benefit at cost of £485 million.

(f) Restore cut in heating allowance at cost of £85 million.

(g) Extend and restructure Family Income Supplement. at cost of £475 million.

B) 'Steady' monetary policy. supporting 'stable and competitive' exchange rate within EMS. Industrial credit scheme. offering low interest rate finance for some industrial investment.

C) Possible pay freeze in first year of incomes policy. followed by. if necessary. pay 'norms' reinforced by 'inflation tax'.

F ECONOMISTS

F1	Mr John Kay, Director of Institute of Fiscal Studies addressing Society of Business Economists 13 December 1984 (compare option B at G3 below)	Proposed package of 'tax reforms' including higher take home pay and encouragement of personal investment:- (i) income tax cuts, either through raising thresholds or lowering basic rate, worth £5 billion (ii) capital gains tax and stamp duty to be abolished - cost £1.5 billion to be financed by:- (i) extension of VAT to more items including fuel and food (contingent on modifying income tax structure to give proportionately more to lower incomes to offset impact of paying more VAT) (ii) new taxes on pension funds' investment income and tax on pension lump sums.
F2	Dr Paul Nield of Phillips & Drew in Sunday Times 3 February 1985	Budget speech should contain reaffirmation of philosophy of MTFS and following proposals: (i) Target ranges for 1985-86 to be as in 1984 MTFS - with emphasis on holding aggregates to middle of that range; (ii) PSBR set at £5 billion - £2 billion less than in 1984 FSBR - after taking account of revised forecasts of North Sea tax revenue, tax reforms featuring more revenue from taxes on spending, inducements to build savings and elimination of anomalies between different forms and more than indexation of personal allowances, with view to improving working of supply side. (Net effect a negative fiscal adjustment of £½ billion.) NB The tax reforms would include bringing lump sums on retirement into tax (on a phased basis), extending VAT to more goods and services eg books, newspapers, construction, banking services.
F3	IFS Budget Briefing 1985 published by Institute of Fiscal Studies 18 February 1985	Offers two alternative options - tighter fiscal policy versus tax reforms to benefit supply side: A Achieve reduction in PSBR to £6 billion (£1 billion less than in 1984 FSBR) while (i) increasing personal allowances in real terms by 8 per cent - comparable last year -financed by (ii) modest extension of VAT (newspaper advertising, luxury foods), (iii) modest increase in above normal indexation in duties on drink and petrol, (iv) tax on financial services, (v) once for all acceleration of receipts from building societies.

B Set PSBR at £7 billion as in 1984 FSBR and achieve massive switch between taxes on income and on spending, involving (i) 20 per cent real increase in personal allowances (more than twice Option A that is), (ii) reduction in income tax higher rates, (iii) abolition of CGT financed by (iv) applying VAT at 5 per cent to goods and services currently exempt or zerorated, (v) doubling Option A increase above indexation for petrol duties, (vi) introduce 20 per cent tax on pension funds' income.

Discussing the options, IFS argues increasing VAT not so regressive as widely believed provided proceeds applied to increasing child benefit and lowering tax thresholds which it favours while disagreeing with view this would significantly help ease poverty trap or increase incentive to work. IFS also give reasons against introducing taxation of funds income, consider reform of NI contributions to incorporate them into tax system would ease traps, and believe use of the fiscal adjustment for public investment would create more jobs than tax cuts.

F4 NIESR

February Review
published 21 February 1985

Predicts need for £2.5 billion increase in taxation in 1985 Budget to adhere to £7 billion PSBR in 1985-86, as in 1984 FSBR. [Estimated to be equivalent to extra 2½ per cent in £ on income tax or VAT rate rise from 15 to 18 per cent.]

Argues for relaxation of PSBR to permit tax cuts - or public spending increase. Visualises £11 billion PSBR if £1½ billion tax cuts of Autumn Statement to be achieved.

F5 Patrick Minford, in 'Daily Telegraph' on 4.3.85

(i) Substantial tax cuts essential, 1985-86. PSBR target £8 billion, allowing £2 billion cuts (net PSBR effect £1.5 billion). Further £1 billion tax cuts financed from tax increases, mainly of pension fund income.

(ii) Tax thresholds to be raised 20 per cent above indexation, at total cost of £3 billion.

(iii) Target ranges of 3-7 per cent for MO and 3-9 per cent for M3.

(iv) Increase threshold and UEL of NICs. Perhaps abolish UEL.

(v) Long-term aim to reform tax treatment of pension funds, mortgage interest relief and VAT exemptions/zero rating.

F6 Richard Layard in 'Guardian' on 8.3.85

Budget should be carefully structured so extra jobs do not generate labour shortages: best to concentrate on long-term unemployment:

(i) job guarantee for long-term unemployed: all unemployed more than 1 year to be on Community Programme, within two years. 750,000 jobs cost about £1½ billion.

(ii) Increase infrastructure investment.

(iii) Reduce employers' NICs and exempt long-term unemployed for first 2 years of employment. Full year cost £1 billion. New jobs to be exempted from NICs. Full year cost also £1 billion. Abolish NICs on, say, first £90 of wages.

(iv) Introduce coudnter-inflation tax.

Mr. Turnbull

SECRETARY OF STATE FOR ENERGY

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 2AG

13 March 1985

Dear Nigel,

NORTH SEA FISCAL REGIME: 1985 BUDGET

Thank you for your letter of 8 March.

I am very pleased that you have decided to maintain immediate relief against corporation tax for oil and gas exploration and appraisal expenditure. This will certainly help to maintain the rates of drilling and discovery at high levels at a time of considerable uncertainty over oil prices.

I note that you intend to withdraw relief against PRT for expenditure on onshore exploration and appraisal. I would be grateful for sight of the form of words to be used in announcing the change. I think that we should also ask our officials to monitor its impact and report back by the end of 1985.

As you say, it is for the industry to mount a better case for a concession on incremental projects than they have done so far, but we must give them every chance to do so. My officials will be consulting yours on the draft of letters to send to the individual companies involved. These will make clear the need for further thinking by the companies, as, doubtless, will John Moore's letter to UKOOA.

I note your intention to publish a consultative document on mines and oil wells allowances in the early summer. The Inland Revenue will, I am sure, be clearing this with officials of other Departments involved, including mine, before publication. I assume that the document will not cover allowances for development drilling. We will need to look at any proposals to change these in the light of further progress on incrementals.

I have already indicated my agreement to the minor changes you propose on extended production tests and on the Oil Taxation Act 1983.

I am copying this to the Prime Minister.

Peter

PETER WALKER

CONFIDENTIAL

~~BUDGET SECRET~~

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

PRIME MINISTER

THE BUDGET: EFFECT ON CIVIL SERVICE MANPOWER

I thought you would like a brief report of the Budget's effect on Civil Service manpower numbers.

2. The only significant effect arises from the employment and training measures, which are estimated to require some 2,000 extra staff in the MSC - about 1250 for the new training scheme for 16-18 year olds, and about 775 for the Community Programme. These increases will build up gradually, and the full effect will not come through before 1 April 1988. I must emphasise that these are only preliminary estimates, which take no account of offsetting savings in benefit administration and from the abolition of the Young Workers Scheme. We would hope to refine them and pare them down over the coming months.

3. These increases can, on present indications and to the extent to which they cannot be absorbed, be met from the contingency margin, which we increased from 7,500 to 10,000 in the 1984 Survey. There need, therefore, be no increase in the overall plans for the Civil Service which we published in the January Public Expenditure White Paper.

4. There will also be some - very much smaller - increases in the Revenue Departments and DHSS manpower. But I expect

other changes - some increases and some decreases - after the Budget and during the Public Expenditure Survey, and I do not propose any change in the manpower plans for these Departments at present.

5. I am sending copies of this minute to Norman Fowler and Tom King.

N.L.

N.L.
13 March 1985

10 DOWNING STREET

Prime Minister

If you have time, though there is a slot at 17.30 but this will also have to cover the speed.

AT

13/3

I agree – this is not green – it is virtually pronouncing a change which has not even been discussed in E or in Cabinet

MT

PRIME MINISTER

Draft Green Paper on Personal Income Tax

You are due to discuss this with the Chancellor on Thursday, at 18.30 ~~before Cabinet~~. The following points struck me:

(i) The tone is not very "Green". In the introduction the Chancellor launches into his proposals and sets the context, i.e. the opportunities afforded by computerisation, at the end. Without saying very much different in substance, the tone would be better if he said:

"Approaching computerisation - opens up new options for reform of personal tax - my preference is for transferable allowances. What do you the public think?"

At a couple of points - paras. 3.1 and 4.5, the Chancellor gives the impression that he is pressing on with the preparatory work even before there is any public reaction. A "Greener" tone would give the Government the option of retreating if the reaction were adverse.

(ii) Annex 2 sets out the international comparisons. In general the UK has

- a low ratio for single: married, one earner thresholds;
- a high ratio for single: married two earner thresholds;
- a high ratio for married, one earner to married two earner.

/ (iii) The Chancellor's

(iii) The Chancellor's proposal increases the single threshold by 20%, £575, worth £3.32 per week; 680,000 out of tax. It raises the married one earner threshold by 63%, £2,005,worth £11.57 per week. 620,000 out of tax.

(iv) Annex 4 spells out the gainers and those who stand still - there are no losers. The gainers are single people including widows; one earner couples; two earner couples where one spouse is very part-time; two earner couples paying higher rate tax. The only group to stand still are two earner couples where both pay at basic rate. These represent only 3.3 million out of 17.7 million taxpaying units.

(v) The synopsis does not provide details of the treatment of investment income, though it hints at independent taxation. There must be quite a lot of revenue at stake if husband and wife are allowed to distribute investment income between them to best advantage. Measures against artificial schemes are hinted at, but would these turn out to make the system more, not less complex?

(vi) The synopsis does not cover mortgage interest. Several options, including allowing husband and wife their own ration of mortgage interest are still being looked at.

There is still some work to be done before any publication in the summer. At this stage the Chancellor seeks agreement to canvassing the basic principle of transferable allowances.

13 March, 1985

ANDREW TURNBULL

7.77 COVERING ~~BUDGET~~ CONFIDENTIAL

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

12 March 1985

Andrew Turnbull Esq
10 Downing Street
LONDON
SW1

Dear Andrew

DRAFT GREEN PAPER ON PERSONAL INCOME TAX

As promised I attach two copies of the draft synopsis of the proposed Green Paper on personal income taxation, for discussion at the Prime Minister's bilateral with the Chancellor on Thursday morning.

Yours ever
Rachel.

MRS R LOMAX
Principal Private Secretary

(1) Too white, too much impression of I'm getting on with this unless you stop me. too little genuine consultation
(2) Gainers & losers set out in Annex. Single people; widows; two earner couples where wife is very part time when they elect for separate taxation. Only group to stand still are two earner families where both paying at standard rate 3,350 out of 17,660 thousand taxpayer units.
(8) Annex 2 sets out international comparisons. In general UK has low scores for S/MOE and high for S/MTE and M/MTE

DRAFT MINISTERIAL FOREWORD/INTRODUCTION

1. Last year I reformed the system of business taxation, setting the pattern for the next three years and beyond. In this year's Budget, I foreshadowed a programme for the reform of personal taxation.

2. My objective in both reforms is to create a tax structure that reflects the changing needs of the modern world and encourages the creation of wealth and jobs.

3. The Government is committed to reducing the burden of income tax. But changes in income tax are expensive and the money can only be found to the extent that it is not pre-empted by increases in public expenditure. It costs £1 billion to put the main personal allowances up by 5 per cent or to reduce the basic rate by 1 per cent. So it is vital to ensure that any resources that are available for reducing the burden of tax are put to the best possible use.

4. We need a tax system which is fair, comprehensible, and makes economic sense.

5. Measured against these criteria, the present system has a number of drawbacks:

- it discriminates in favour of two-earner families, at the expense of those where the wife stays at home to look after the children

- married women have no separate tax status; both their investment income and, normally, their earned income is aggregated with their husbands'

- low tax thresholds contribute to the poverty and unemployment traps - which are a disincentive to work

- it is complex and difficult for taxpayers to understand.

wishes to explore?

6. The Government can see considerable advantages in adopting a new system of personal taxation, based on a single transferable allowance for each taxpayer.

7. Under such a system everybody, man or woman, married or single, in or out of paid employment, would have the same standard tax allowance. Where one partner to a marriage is unable to make a full use of his or her tax allowance he or she would have the right (if they wish) to transfer the unused allowance to the other partner.

8. This reform would mean that all taxpayers would have exactly the same allowance. All married couples, whether one partner or both is earning, would have the equivalent of two allowances. The existing married man's allowance would disappear. The aggregation of husband and wife's income would go.

9. The single transferable allowance system offers three main advantages.

- it ends the present discrimination against the family where the wife works at home, which nowadays increasingly means discrimination against the family with young children

- unused allowances can be transferred within a marriage, ensuring that each taxpaying couple can take full advantage of them

- it gives married women equality and the right to privacy in their tax affairs, removing the anomalies created by the existing aggregation system.

10. It would, furthermore, enable the Government to raise tax thresholds both for families where the wife works at home and for young people and other low earners to a level that would be prohibitively expensive under the present system. For a given amount of tax relief it would take far more people out of the poverty and unemployment traps -and out of the tax net altogether - than is possible under the present system.

11. Transferable allowances would require changes to the way the tax system is run. These will be made possible by the computerisation of PAYE which is well under way; this is due to be largely completed by the end of 1987. It is essential to plan now for the tax structure that will be operated under a fully computerised system. The change to a new system can take place as soon as all the new facilities are available.

12. While this preparatory work is proceeding we are publishing this Green Paper to explain our proposals for reform in more detail. Subject to the outcome of the consultation period which will follow this Green paper, the Government propose to introduce the necessary legislation for a change in the system in 1987. New arrangements could be fully operational from April 1990.

13. Computerisation also opens up the possibility of other changes in the tax and benefit systems, which are discussed in the paper, and its Annexes.

REVISED OUTLINE OF GREEN PAPER

Chapter 1: The Objectives of Reform

Background: Reform of the Tax System

1.1 Government committed to tax reform.

1.2 1984 Budget achieved major reform of corporate tax system including substantial reduction in corporation tax rates; and dealt with distorting effects of capital allowances and stock relief.

1.3 1985 Budget sets in hand reform of personal income tax to reduce the tax burden and bring tax structure into line with reality of modern society. Green Paper outlines objectives and describes a system Government believes compatible with them. Outside comments welcome.

Objectives of Reform

1.4 Reform will have three specific aims

1.5 First: to provide a fairer system. To remove discrimination against couples with only one breadwinner. To remedy anachronistic treatment of married women (following 1980 Green Paper).

1.6 Second: simplification. Structure of system should be as simple as possible.

1.7 Third: to find cost effective answers to the problems caused by low tax thresholds. Consistent objective has been to increase income tax threshold. But very costly within present system. Reform needed so that, within limit of what can be afforded more can be done to reduce the burden of tax on the young and low paid, and to tackle the problems of the poverty trap and the unemployment trap.

1.8 Under the new system everyone would have a tax allowance in their own right; man or woman, married or single, in or out of paid employment. But tax system should continue to recognise the status of marriage, so unused allowances would be fully transferable within a marriage. Aggregation of husband and wife's income (investment as well as earned) would go. So structure will recognise each individual's right to independence and privacy in tax matters.

Chapter 2: The Case for Change and Proposals for Reform

Background

2.1 Structure of personal allowances has remained the same since the Second World War. Some of most important features of personal income tax system go back much further.

2.2 In brief:

Present structure

Single people:	1 personal allowance
Married men:	approx 1½ the single person's allowance
Married women:	wife's earned income allowance, equal to single personal allowance

Thus:	single person:	1 allowance
	one-earner couple:	approx 1½ single allowance
	two-earner couple:	approx 2½ single allowance.

Wife's income aggregated with husband's income. Fuller details in Annex 1.

How the present structure originated

2.3 Before the War, there was an allowance for a single person, and an allowance of at least half as much again for a married man, who was expected to support his wife.

2.4 It was then unusual for a married woman to be in paid employment - only 10 per cent were in 1931 - but where she was in paid work, her husband got a small allowance to set against her earnings. This brought couple's total allowances up to roughly twice the single allowance.

2.5 In 1942 as part of the drive to encourage women to contribute to the war effort, the wife's earned income allowance was increased to the level of the single allowance. Wife's earned income allowance has remained at same level as single allowance ever since.

2.6 Married man has continued to get a higher allowance whether or not his wife is in paid employment. This gives the UK a system which, by international standards, discriminates in favour of two earner couples and against most one-earner couples. (See Annex 2 for international comparisons.)

Social aspects

2.7 Under present system:

- A married woman has no tax allowance of her own to set against her own income (wife's earned income allowance only available if she has earned income of her own, and even then theallowance belongs in strict law to the husband).

- Where wife has investment income of her own, couple may pay more in tax than two single people - a tax penalty on marriage.

- Because husband is nominally responsible for returning all couple's income and paying all the couple's tax, wife cannot have privacy in her financial affairs.

2.8 Major social and economic changes since the structure of allowances was fixed during the War. Very large proportion of women in paid employment. Now the rule rather than the exception for married women to go out to work except when they have young children. The great majority of women will be working at some point in their married lives; half of all married women already work outside the home, and the proportion is likely to go on rising.

2.9 It is right that everyone should have same tax allowance. All married women should have their own tax allowance - not just those who work outside the home. There is no reason to discriminate in favour of the married man whose wife goes out to work, as against single people and married couples where the wife works at home.

Traps

2.10 Low tax thresholds are one of the main causes of the poverty and unemployment traps. People most affected by these traps are married men on low earnings supporting families.* Traps wrong in themselves and bad for the economy.

2.11 Government has made progress, raising tax thresholds by [16] per cent in real terms, taking almost 1 million people** out of tax since 1978-79 (compared with indexation). But still too many people paying tax and in traps. New system will be more accurately targetted at those worst affected by low tax thresholds.

---

* By historical accident, the present system does give relatively high tax thresholds already to married women supporting families: see Annex 1.

** Pre-Budget figures.

<u>Proposals for reform</u>

2.12 Government therefore proposing the system of single transferable allowances, which should correct many of the drawbacks of existing scheme.

2.13 Government's intention would be to phase in the new system over two years with no couples losing out in cash terms. The new allowance will be set at the level at which two such combined allowances currently given to a two-earner couple. Effects will be as follows.

- <u>Single people</u> will gain from increase in allowance. Helps young people looking for their first job. Unemployment worst among single youngsters.

- <u>Married man who is sole earner</u> will see a substantial increase in his tax threshold. This will reduce numbers of those most affected by poverty and unemployment traps.

- <u>Two-earner married couples</u> and married couples where the <u>wife is the sole earner</u> will keep the same total allowances in cash terms.

2.14 Phasing in such a change over 2 years would cost around £4.5 billion. But the effect would be to lift about 200,000 more tax units (mainly married couples) out of tax than would be the case if allowances were raised under the present system at a similar cost to the Exchequer. (Annex 3 shows how the change might be phased in; Annex 4 gives more details of the effects on couples in different circumstances.)

Aggregation of husbands' and wives' income

2.15 New system will also deal with widespread and justified criticism of present tax system among women. Aggregation of both earned income and investment income will be ended; and both partners in a marriage will have right to refuse transfer of any unused allowance. The rule which says that the income of a married woman living with her husband is deemed for income tax purposes to be his income and not her income will be ended. Husband and wife can have equal privacy and independence in tax matters.

2.16 Annex 5 gives more details of the treatment of investment income and discusses possible implications for other aspects of the income tax and for the capital taxes.

Particular groups

2.17 Annex 6 discusses how the new system will affect the elderly; Annex 7 looks at the position of single parents.

How the system will work

2.18 When it is fully phased in system will run broadly as follows:

(a) Before the start of the tax year a partner in a married couple who thinks he/she will have no income during that year may arrange for the tax office to give the whole of the unused allowance to the other partner, who will benefit through the PAYE code.

(b) If one partner thinks that he/she will only have modest earnings - eg from a part-time job - they may arrange for the tax office to transfer only part of the allowance.

(c) Otherwise each partner will get a single allowance.

(d) The position will be reviewed after the end of the tax year to ensure that the couple have received the right allowances.

Chapter 3: Practical implications of the change

pre-empting consultation?

3.1 Introduction of fully transferable allowances represents a major change in the tax system. Government have set in hand the planning for this change and, subject to the response to this Green Paper, intend to legislate during the life of this Parliament. Change will directly concern something like 1 million employers, 600 Tax Offices and [12] million married couples. Will also affect indirectly a further [9] million single people.

Computer support

3.2 To run smoothly, system of fully transferable allowances requires new administrative infrastructure in the Inland Revenue.

3.3 Government has already authorised the Revenue to go ahead with two major computer projects. A pilot system for computerisation of PAYE (COP) has been running live in the West Midlands for well over a year. COP system is now being extended across the whole country, region by region, and its installation beginning this year will be complete by late 1987 or early 1988. Procedures for taxing self employment income under Schedule D are also being computerised (CODA). This new system also will be in place by 1989.

3.4 Government has now authorised Inland Revenue to enhance this basic computer system by two further developments: an efficient data transmission network, enabling the 600 Tax Offices to exchange information quickly and economically with each other, and with the offices responsible for collection and enforcement; and also a computer based national index, which will maintain up to date records of each taxpayer, his or her employer (or self employment), together with the necessary information to connect the tax records of married couples.

3.5 This development will provide Inland Revenue with computer support it needs to run a fully transferable allowance system. The link can be created and maintained between the tax records of husbands and wives who (because they may have different employers) may be dealt with by Tax Offices hundreds of miles apart. For the great majority of couples these records are not linked at present. Computer system will also enable tax offices to handle the many more cases which will need to be reviewed after the end of the year.

3.6 Without these added facilities it would be almost impossible to run fully transferable allowances. First requirement is therefore that necessary computer support should be in place in the Revenue before the administrative action to change to the system of fully transferable allowances can begin.

3.7 The Revenue will be using the computer facilities in the COP and CODA systems, and the new integrated data network, to set up the new national index; and the index cannot therefore be completed until after the other facilities are in place (1989). This explains why changeover to the new system cannot begin until then.

3.8 Annex 8 looks in more detail at the administrative consequences of the change.

Chapter 4: Next Steps

4.1 This Green Paper outlines main features of the proposed reform to a system of fully transferable allowances.

4.2 In the long run computerisation in the Inland Revenue will open up wider possibilities for change. Government will be considering the case for changing from present cumulative PAYE to a system of non-cumulation and 100 per cent end year review, of the kind used by the USA and many other countries. This would imply major changes for employers, taxpayers and Revenue administration.

4.3 With wider computerisation of DHSS, Government will also be considering the case for closer integration between data bases for tax and social security, and the systems themselves.

4.4 Government not bringing forward any proposals for change in these wider areas at present. But implications need to be studied. Annexes 9 and 10 set out some of the issues for consideration. Full consultation before any decision is made. Important to note that move to fully transferable allowances does not prejudice any of these possible changes.

4.5 In shorter term, over the coming months Government will be working up the necessary detailed procedures to operate fully transferable allowances. Will want to discuss with, in particular, employers' representatives, what the reform would imply for changes in employers' payroll procedures.

4.6 The Government will welcome comments, both on the proposed reform itself and, in due course, on the detailed procedures.

4.7 Subject to that, the Government intend to legislate in this Parliament [1987?]. During [1988 and 1989] Tax Offices will be asking married couples for the information necessary to link their tax records, set up the national index, and to give them the appropriate allowances. The new system could come into operation in the 1990-91 tax year.

Summary of Annexes

Annex 1 **The present structure of personal income tax**

Explanation of the present system and personal allowances, including those for elderly people.

Annex 2 **International Comparisons**

Comparison of levels of personal allowances available to single people and married couples in [15] other countries. The UK is exceptionally generous in the scale of allowances given to two-earner couples but relatively much less generous to one-earner couples.

Annex 3 **Phasing in the new structure**

Text and tables to show how the new structure could be phased in, the consequences for different couples, and the costs to the Exchequer. A two-year phasing-in period could avoid losers in cash terms, at a total cost of £4.5 billion for the non-elderly.

Annex 4 **Distributional effects**

Text and tables to show the effects of the new system on different families at various income levels

Annex 5 **Consequences for investment income, other aspects of income tax and capital taxes**

Consequences of independent taxation for wives with investment income. Possible measures to counter artificial income splitting.

- Treatment of mortgage interest ceiling for married couples.

- Treatment of other limits for husband and wife.

- Implications for capital taxes.

Annex 6 **The Elderly**

To what extent should transferability extend to the age allowance; might age allowance be phased out as part of the change; and the distributional consequences of the options.

Annex 7 **Single parents**

Single parents currently receive an additional allowance equal to about half the single allowance; should this extra allowance be phased out as part of the change and/or converted into increased One Parent Benefit.

Annex 8 **Administrative consequences of fully transferable allowances**

- Staff costs of running the new system: would depend on the detail, but much less than under a manual system.

- Setting up costs.

  Capital costs of integrated data network national index - necessary in any event for efficient working of Revenue in 1990s.

Annex 9 **Administration in the longer term**

Computerisation opens up possibility of moving to taxation on a non-cumulative basis as in US. Would be attractive for small business.

Annex 10 **Integration of tax and social security**

Raises wider issues. Clarify possible objectives and how far they would be met by different schemes proposed. Explain administrative consequences.

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Annex 1 The Present Structure of Personal Income Tax

1. The basis of the present system of taxing married couples is that the incomes of a husband and wife are added together and treated as the husband's and taxed at his marginal rate. He is formally responsible for handling the couple's tax affairs, claiming the allowances, and paying the tax.

2. The personal allowances are as follows:

- the married man's allowance (£3155 in 1984/85) can be set against any income of the couple;

- the wife's earned income allowance (£2005 in 1984/85) is technically an allowance available to the husband to set against his wife's earnings only; in practice, it is usually given against the wife's earnings directly under PAYE.

Because the married man's allowance can be set against any income of the couple, it is available against the wife's earnings if the husband has no income of his own. But the reverse does not apply: if the wife has no earnings, the husband cannot claim the benefit of the wife's earned income allowance.

3. Thus the total allowances available to couples in different circumstances are:

Both working	(3155 + 2005)	5160
Husband only working		3155
Wife only working	(2005 + 3155)	5160

The Elderly

4. People over 65 have higher tax allowances, if their income is below a certain limit (see paragraph 5 below):

single age allowance	£2490
married man's age allowance	£3955

The wife's earned income allowance for married women over 65 is the same as for younger people, £2005.

5. Age allowance is given in full up to income of £8100 - this limit applies to single people and to the joint income of a married couple. The allowance is then withdrawn by £2 for every £3 of income over that limit, until it is reduced to the same level as the corresponding basic allowance.

Wife's earnings election

6. Where husband and wife both have substantial earnings they may elect to have their earnings taxed separately. Each partner then gets a single allowance and his/her own set of tax rate bands. The election does not affect the investment income of the wife which remains aggregated with her husband's income.

Annex 2.

International Comparisons (DETAILS ARE SUBJECT TO CONFIRMATION).

1. Comparisons are very difficult to make, especially in such a confined area as the level of allowances available to single people and married couples. In many instances a comparison is impossible because the system provides allowances which vary with the size of earnings.

2. The comparisons which follow, so far as possible, give an indication of the ratio of allowances in three cases. These are:

	Col 1		Col 2		Col 3	
	Single:	Married One Earner	Single:	Married Two Earner	Married: One Earner	Married Two Earner
[UK	1 :	1.5	1 :	2.5	1 :	1.66]

[It has been assumed for a one earnier married couple that

a. the husband is the earner and

b. the wife has no income.

For all cases it is assumed the taxpayers have no children or other dependents.]

3. Denmark

1:2	1:2	1:1

Since 1983 a system of fully transferable allowances and independent taxation has applied. This does not extend to investment income which is aggregated with the income of the spouse with the highest earned income.

4. Ireland

1:2	1:2	1:1

Married couples can be taxed separately or jointly. The ratios given above are based on joint taxation which most married couples opt for. In addition to extra allowances with joint taxation a married couple also enjoy a special scale of rates with bands double that for single taxpayers so they usually pay less tax than a single person with the same size income.

5. Germany

1:2	1:2	1:1

In addition to allowances, married couples have the choice of separate assessment, where each are taxed as individuals, or income splitting. In the latter case the total income is divided by 2 and the tax calculated on that part. This is then multiplied by two to get the total tax due. This gives married couples an added advantage particularly where the incomes vary. Effectively any higher income which may be taxed at a higher rate is transferred to the lower income and taxed at a lower rate.

6. France

1:2	1:2	1:1

The French have a family quotent system under which income of the family (including children) is aggregated and then divided by a certain coefficient. The tax is calculated on that reduced amount and then multiplied by the same coefficient to get the total tax due. For a husband and wife only, the coefficient is 2 and the effect is therefore similar to the German splitting system. The ratios above are not based on allowances but on the effect of this system on the zero rate band only. Allowances, or expense deductions, have maximum or minimum values, but vary with a. the size of income and b. the type of job. So a comparison of allowances alone is not possible.

7. Italy

Taxpayers are allowed tax deductions as opposed to personal allowances. A husband and wife are assessed separately, although an additional tax deduction is available to them if one spouse has taxable income not exceeding a specific level. Tax deductions vary with income levels so a comparison is not possible.

8. Luxembourg

1:1.78	1:2	1:1.12

A husband and wife are assessed jointly. One tax scale applies to all taxpayers but a married couple's tax is calculated by applying the table to only half their income and then multiplying the result by 2. As the table includes a zero rate band, this is effectively doubled for married taxpayers. (This same method also applies to a single taxpayer who has been divorced less than 5 years at the start of the tax year - so in the ratios shown such a person is equivalent to a one earner married couple.)

Broadly, allowances to set against income are doubled for two earner married couples. The ratios given include minimum special expenses and employment income allowance.

9. Belgium

A comparison cannot usefully be made because allowances for employment income vary with income up to a maximum level. Furthermore the tax position of married couples varies depending upon the size of their total net income.

10. <u>Netherlands</u>

Allowances vary and are broadly dependent upon 1. age, 2. size of income and 3. whether or not the taxpayer lives with someone (not necessarily a spouse). A comparison is not therefore possible.

11. <u>USA</u>

1:1.6	1:>1:6 (2.5 max)	1:>1 (1.55 max)

Married couples can be taxed separately but in practice most opt for joint taxation. This is generally more beneficial, a different scale of tax rates then applies with wider bands, which includes a larger zero rate band than available to single taxpayers and marrieds taxed separately. One and two earner couples filing joint returns both receive double the exemption given to a single taxpayer. In addition, two earner couples, taxed jointly, get an extra exemption equivalent to 10 per cent of the lesser of $30,000 or the amount of the lower earning spouse's earned income. (Hence the variation in rates.)

12. <u>Japan</u>

Individuals are taxed separately but a special exemption is available for a spouse who has no income, or income which does not exceed a specified level. In addition, there are basic allowances which vary with the level of income, so a comparison is not possible.

13. <u>Sweden</u>

1:1	1:2	1:2

Individuals pay both National Income Tax (at progressive rates) and Local Income Tax (at a flat rate which can vary from area to area).

A personal deduction is given to all taxpayers but can only be set against local income tax. Husband and wife are taxed separately although the unearned income of both is aggregated with that of the spouse with the highest earned income. The tax calculated on the unearned income is then split between the spouses in proportion to the amounts of their respective unearned income.

All taxpayers benefit from a zero rate band on National income tax upon which the above ratios are based. There is no special treatment for a dependent spouse.

14. Greece

1:1.24 1:2 1:1.6

Spouses are taxed separately although a husband is entitled to an allowance for a wife provided her income is less than a specified level. He is also entitled to a tax reduction for his wife but only if she has no taxable income. If allowances or tax reductions cannot be used in full by the husband, they are transferred to the wife.

The ratios provided take into account the basic personal allowance, the maximum value of the general employee's allowance, (this allowance will vary with income) the zero rate band effect and converting the tax reduction for a one earner family into an allowance taking the lowest rate of tax only. (11 per cent.)

15. Canada

1:1.87 1:2 1:1.07

Husband and wife are taxed on an individual basis, but a married person supporting a spouse is entitled to a further allowance over and above that available to single taxpayers. This further allowance is reduced $ for $ if the supported spouses income exceeds a set level.

16. Australia

1:1.6 1:2 1:1.25

Husband and wife are taxed separately. A spouse is entitled to a tax rebate only where he/she maintains the other spouse.

Where the supported spouse has income above a specified amount the rebate is reduced by $1 for every $4 by which the spouse's net income exceeds that amount.

The tax scale of rates includes a zero rate band. The first tax rate above this is 30 per cent. The ratios therefore take into account the maximum value of the tax rebate at the 30 per cent rate to a one earner couple.

17. New Zealand

1:1 1:2 1:2

A husband and wife are taxed separately. The only basic allowance given for all taxpayers is a standard deduction for employment expenses. Otherwise taxpayers receive tax rebates against income. The 'principal income earner' rebate is available to most individuals and varies with income.

A special rebate was also available for a dependent spouse but this was abolished with effect from 1 April 1983.

The ratios given above are based on the entitlement to the 'principal income earner' rebate and will only hold good if it is assumed that the income of the single taxpayer and that of each married taxpayer is identical.

18. It would be wrong to attempt to draw any worthwhile conclusions from a limited comparison of this kind. In the majority of cases, the effect of any one country's tax system on married or single people is far more complex than the outline above demonstrates.

Where comparisons of this sort are made, it may well be the case that other features of the tax system provide additional tax advantages to married couples which are not reflected within the narrow confines of the allowances given.

but UK in general has a low figure in col 1, a high figure in col 2 and col 3.

ANNEX 3: PHASING IN THE NEW STRUCTURE

1. Aim will be to phase in fully transferable allowances over [two year] period avoiding cash losers amongst two-earner couples.

2. But this will involve substantial forward commitment of resources (£4.5 billion at current prices and income levels). Precise way in which system would be phased in would therefore need to be considered in light of economic circumstances at the time.

3. Phasing in over two years enables the cost to be spread.

4. For illustration, at 1984-85 allowance levels, a possible two-year phasing in scheme would be

Year 1

(i) Reduce married man's allowance to £2,855. -300

(ii) Raise single allowance and wife's earned income allowance to £2,305. +300

(iii) Introduce transferable component of £1,200 within wife's earned income allowance. (The married man's allowance is, under present rules, already available to set against a wife's income if the husband has insufficient income of his own.)

Year 2

(i) Raise single allowance to £2,580. +275

(ii) Convert wife's earned income allowances into a single allowance. at £2,580

(iii) Replace married man's allowance by single allowance of £2,580. −275

(iv) Make single allowance fully transferable between spouses.

[5. Position of elderly would need special consideration in light of decision about future of age allowance.]

Annex 4

FULLY TRANSFERABLE ALLOWANCES: DISTRIBUTIONAL EFFECTS

1. The attached tables show the detailed effect of introducing fully transferable allowances.

TABLE 1

EFFECT OF FULLY TRANSFERABLE ALLOWANCES

After transition with no cash losers

Non-elderly

	Amount of Allowance Before	Amount of Allowance After	Numbers (thousands)		Amount of cash gain
Single (7.8 million)	2,005	2,580	680 (9%)	taken out of tax	up to £3.32 per week
	+575	20%	7,000 (90%)	currently liable at basic rate	£3.32 per week
			100 (1%)	currently liable at higher rates	over £3.32 per week
One-earner couples (4.4 million)	3,155	5,160	620 (14%)	taken out of tax	up to £11.57 per week
	+£2,005	63%	3,580 (81%)	currently liable at basic rate	£11.57 per week
			220 (5%)	current liable at higher rates	over £11.57 per week
Two-earner couples (5.5 million)					
gains for the part time — wife earns less than £2,005	3,155 to 5,160	5,160	1,800 (33%)		up to £11.57 per week
no gain here — wife earns over £2,005					
- couple do not elect	5,160	5,160	3,300 (60%)		no gain
- couple liable at higher rates but do not elect	5,160	5,160	200 (4%)		gain depends on split of income between husband and wife.
i.e. gains for professional women — couple elects	4,010	5,160	160 (3%)		at least £6.63 per week

TABLE 2

Distribution of gains after transition with no cash losers

(1984-85 allowance levels)

Size of gain	Number of taxpayers (thousands)	Per cent
No gain/loss	3,300	19
Taken out of tax	1,300	7
Total gainers remaining in tax	13,060	74
	17,660	100

Annex 5	Consequences for investment income, other aspects of income tax and capital taxes
Annex 6	The Elderly
Annex 7	Single parents
Annex 8	Administrative consequences of fully transferable allowances
Annex 10	Integration of tax and social security

Still in preparation; dependent on decisions.

Annex 69 Administration in the Longer Term

1. Chapter 4 of the Green Paper explained that work is in hand on a study of how the tax system might be run in the longer term. This annex sets out some of the possibilities under consideration.

2. There are basically three stages in the work of calculating and settling tax bills:

(a) Before the year - coding, to give taxpayers their personal allowances and to make other adjustments;

(b) During the year - taking account of changes in personal circumstances, job changes, and fluctuating income;

(c) At the end of the year - calculation of any repayment due or tax still owed, and settling the balance.

3. Changes could be made to any or all of these stages. Some could be made independently; others only make sense in conjunction with changes to other parts of the tax system.

Before the year

4. The most likely change here would be a move from Revenue-coding to self-coding by taxpayers.

5. This would save work for the Revenue. By the same token, it would impose a burden on taxpayers, and would make life more difficult for employers who would receive coding notices piecemeal from their employees instead of in a batch from the tax office.

6. The first question to consider is how well taxpayers could cope with self-coding under the present system. Some simplification would certainly be desirable and perhaps essential. And particularly if coupled with a change to non-cumulation (see paragraphs 8 to 10), self-coding would mean that many taxpayers would have paid too little or, typically, too much tax by the end of the year.

7. Self-coding would inevitably mean more work for the Revenue in reviewing cases at the end of the year. It would be for consideration whether this would require returns from all taxpayers or whether, as information technology develops, the information provided by income payers would be enough in many cases (see 13 below).

During the year

8. The key question here is whether to retain the present system of cumulation or to move to non-cumulation.

9. A change to non-cumulation would have these advantages.

(a) Some employers, particularly those whose payrolls were not computerised, might find non-cumulation simpler to operate during the year, but this could be offset by any extra work from self-coding (see paragraph 5 above).

(b) Non-cumulation for IT could help to make it easier to integrate tax and NIC deductions into a single set of tables.

(c) Non-cumulation could mean an end to the current staff-intensive system for handling taxpayers moving from one employer to another.

10. The central disadvantage of non-cumulation is that it will not produce the right result for a high proportion of taxpayers. Of itself, non-cumulation would tend to mean that taxpayers would overpay tax - the person with breaks in employment will lose the benefit of some of his personal allowances, and the person who receives a bonus may find himself paying higher rates for the week in question.

<u>After the end of the year</u>

11. Either of the preceding changes would inevitably mean more work in sorting out cases after the end of the year. This extra work could either be done entirely by the Revenue, as happens at the moment, or there could be a move to self-assessment.

12. The Revenue could assess all taxpayers on the basis of information provided by the taxpayer. All taxpayers would therefore have to fill in returns, which the Revenue would process. There would be perhaps 20 million returns to handle, and millions of assessments and repayments to follow.

13. The paper mountain which that would generate would be reduced sharply, as technology develops, by an alternative approach. Information could be provided by <u>income payers</u> - employers, banks, companies paying dividends etc - on electronic tape. The Revenue would assess on the basis of this information, and fewer taxpayers would have to fill in returns.

14. Self-assessment would take a good deal of work from the Revenue, at the cost of putting the work on the taxpayer. A number of important changes would have to be made before self-assessment could be introduced. Some

simplification to the tax system would be needed, to ease the actual process of self-assessing. In particular, the basis of assessment for Schedule D would have to be brought into line with that for income from employment.

15. Under a non-cumulative system, and a fortiori under self-assessment, a compliance regime with more effective and automatic penalties would be required, to ensure that taxpayers met their obligiations.

16. A switch to the sort of system described in this Annex would have four main advantages.

(a) The new system might be run by fewer staff.

(b) The marginal extra staff cost of running transferable allowances within such a system might be small.

(c) Small (non-computerised) employers might be able to calculate the deductions for tax and NIC from one table.

(d) The way might be opened to further policy options.

The main possible disadvantages are that there would be extra compliance requirements for taxpayers and on balance possibly, for some employers. Taxpayers could also often pay too much tax during the year, though in expectation of an eventual repayment.

File

FERB

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Andrew
Could you arrange for No. 10 to have as many copies as we need. I would like one please.
FERB
13.3

Privat Secretary (Economic Affairs)
10, Downing Street,
London SW1

Your reference

Our reference A/30

Date 13th March 1985

Dear Private Secretary

BUDGET BRIEF 1985

As with previous years we are making available a detailed budget brief for use by ministers.

The brief will be about 250 pages thick and should not be confused with press release and associated material which you may be obtaining from our Information Division. The brief will be available when the Chancellor sits down on Budget Day. We can send it through the normal delivery service or you may wish to collect. Could you let me know on 233-3639 if you intend to take the latter course. Note that messengers should collect from the enquiry room close to our Parliament Street entrance at around 5.15pm Tuesday 19 March.

B A Collins

B A COLLINS

3 briefs
2 sets of Press Notices

File

2 ~~8~~

AT o/c

01 211 6402

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Streeet
LONDON
SW1P 3AG

13 March 1985

Dear Nigel

FSBR Financial Statement & Budget Report (ie Red book)

I have seen the paragraphs which it is proposed should be included in the FSBR dealing with oil and coal matters. There are two aspects of these forecasts which need to be handled with great care: oil price movements and oil production.

Clearly we do not wish at the present time to signal to the market or to OPEC that we expect to see an early fall in oil prices; similarly we need to play down the fact that our forecasts of production in 1985 are higher than previously.

I am particularly concerned about the references in the draft text to oil price movements. I would prefer there to be no reference to the possibility of a fall whether in sterling, dollar or SDR terms. Can I suggest that after the third sentence of the paragraph headed "Revenue" in part 2 the text should read:

> "Projections of Government revenues assume that revenue from the North Sea falls in both real and nominal terms after 1985/6 as North Sea oil output falls, or becomes less profitable, but that this is more than offset by rising revenues from the growing non-North Sea economy".

I appreciate that the forecasts do in fact assume a fall in sterling oil prices but in dealing with any questions which might follow the Budget I think we should be as evasive about this as I understand we usually are about forecasts of the sterling/dollar exchange rate. It seems to me that making public forecasts of the oil price now entail for us very similar market risks to making "official" forecasts of the exchange rate.

Today's announcement about BNOC is another reason for avoiding oil price forecasts in connection with the Budget. We do not want to multiply risks with OPEC or the market.

If you can accept the change I propose, then I hope your officials and mine can agree the wording in any press notice and briefing to reflect this point. Similarly I hope that you will clear with me whatever you propose to include in your Budget speech on this matter and on the sensitive topic of the cost of the coal strike.

I am enclosing with this letter a note by my officials suggesting some drafting changes and points which need clarification.

I am copying this to the Prime Minister and Geoffrey Howe.

PETER WALKER

FSBR - DEPARTMENT OF ENERGY POINTS

Oil

i) We note that the Treasury's central forecast for 1985/6 production is the same as the Department's but that Treasury are basing calculations for the 3 subsequent years on output 3m tonnes per annum higher than our forecast.

ii) In the proposed text itself in paragraph 3.05 redraft the third sentence as follows:

"With oil production at or near its peak and with high sterling oil prices, the production.........."

iii) In the last sentence of 3.05 we think 6% is too low. The figure is more like 6½% based on BGC contract prices for gas and in round terms is probably better put at 7%.

iv) In paragraph 3.10, first sentence, delete the words "and early 1985" as prices are as much as $2 above the 31 December levels. In the third sentence insert after the word "falling" "in 1984".

v) Re-draft paragraph 3.24 as

"North sea oil production could well peak in 1985 and with the end of the coal strike fuel imports should fall in 1985 compared with 1984. 1985 could be the peak year for contribution of oil to the balance of payments".

Coal

vi) Although we think the figures for the cost of the strike are of the right order of magnitude we will need for our own purposes to know their make-up. Could we have the detailed calculations? Subject to seeing those we are content with the text on this point.

vii) The reference in 3.39 to a reduction of about two-thirds in coal output for 1984 is put at 51m tonnes which is 44% of forecast. We suggest the reference is to output being reduced by "well over half".

Ph

cc Mr Turnbull

10 DOWNING STREET

From the Press Secretary

12 March 1985

Dear Robert,

I am grateful to you for keeping me posted on your pre-Budget, Budget day and post-Budget plans.

You may recall that a few weeks ago I mentioned the desirability of clearly fixing responsibility for the cost of the coal strike on Mr Scargill.

Recently, I wrote a minute to the Lord President which said:

"It might be possible to include in the Budget speech an itemised list of cost clearly understandable to the man on the Clapham omnibus - viz:-

'The cost of Mr Scargill's strike adds up to:

- £A for extra oil burn
- £B for keeping the Queen's peace
- £C for damage inflicted on NCB equipment and property
- £D for extra costs to steel industry
- £E for cost to British Rail; etc.

'All this adds up, taking account of such offsets as wages not paid during the strike, to Mr Scargill costing the nation - the taxpayer - £F so far. That is the price we must all pay, for the buck stops with the taxpayer.

'Mr Scargill has cost:

- £X for every man, woman and child in Britain
- £Y for every British taxpayer
- £Z for every old age pensioner.

'The money we have spent on this man could have bought:

- an x reduction on income tax
- a y increase in retirement pension; etc

'Mr Scargill is clearly the most expensive trade union leader in history and not only does the taxpayer know it; so do his members for they have lost an average £8000 during the strike and as taxpayers also have to foot their share of the total bill.'"

Lord Whitelaw has written back and said:

"I think the Chancellor should see this and make up his mind as to how he will present it. I think there are some fine judgments of exact wording to be considered. Personally I would not go too far on the anti-Scargill line."

Yours Sincerely

Bernard

BERNARD INGHAM

Robert Culpin, Esq.,
Press Secretary and
Head of Information,
HM Treasury,
Parliament Street
SW1.

NBPM

c. ~~Press~~ Office

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

P Wynn Owen Esq
Assistant Private Secretary
Chancellor of the Exchequer
Parliament Street
London SW1P 3AG

12 March 1985

Dear Philip,

BUDGET DAY PRESS RELEASES

In reply to your letter of 6 March, I can confirm that the DES will wish to issue two press notices on Budget Day.

The first will expand in broad terms on the Chancellor's announcement of the funding of a switch in higher education towards engineering.

The second will complement the Chancellor's announcement of an expansion of the YTS and the Employment Secretary's amplification of this: my Secretary of State will make a statement in broad terms declaring his intention to legislate to introduce a specific grant regime for in-service training for teachers, setting the (still to be agreed) 1985/86 and 1986/87 bridging arrangements for TVEI-related training in that wider context.

I am copying this to the private secretaries of the Secretaries of State for Energy, Defence, Scotland, Wales, Employment, Trade and Industry, the Minister without Portfolio, Andrew Turnbull (No 10) and Richard Hatfield (Cabinet Office).

Yours,

Elizabeth

MISS C E HODKINSON
Private Secretary

Econ Pol: 1985 Budget: Pt 13

13 MAR 1985

~~BUDGET - SECRET~~ FILE

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DCAANM

No 2 of 2

cc Master

10 DOWNING STREET

From the Private Secretary

12 March 1985

At a meeting on 8 March, the Chancellor discussed with the Prime Minister the Budget proposals set out in his minute of 7 March. These were agreed subject to the following points.

The Prime Minister was concerned that the Budget might be interpreted as a retreat from the financial restraint which the Government had exercised hitherto. The increase of £2½ billion in the public expenditure total would not be accompanied by any announcement of intention to bring the figures down again but would be accompanied by cuts in taxation. City opinion was unprepared for this. The Chancellor explained that maintaining the existing figures would not be credible. The target for borrowing would, however, be firmly adhered to. It was agreed that the expenditure increase would have to be explained very carefully in the Budget speech and the Chancellor undertook to pay special attention to the drafting of this passage.

The Prime Minister was concerned that the restructuring of the National Insurance contributions gave away too much to employers. The Chancellor said that a net reduction was necessary in aggregate in order to ensure that the losses of particular groups of employers, e.g. in manufacturing, were not excessive. Nevertheless, he agreed to look again at this proposal.

The Chancellor set out the proposals he wished to include in the Green Paper on Personal Taxation. The system of transferable personal allowances would channel such tax cuts as were possible in the next Parliament towards the two groups that needed them most. The gainers would be one earner families where poverty was most ac~~c~~ute and single persons, most of whom were under 25, where unemployment was highest. The Prime Minister expressed doubts about the political attractiveness of this proposal. She thought it would be unpopular, particularly among working wives in industrial areas such as the Midlands and the North West where the Government had built up significant support. The Prime Minister also argued for the reintroduction of child tax allowances which would open the way for a reduction in child benefit. The discussion was inconclusive and the Chancellor agreed to show the Prime Minister a synopsis of his Green Paper.

(Andrew Turnbull)

Mrs. Rachel Lomax,
HM Treasury.

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Mr A. Turnbull

CC NO

NBPM

AT 12/3

CABINET OFFICE

70 Whitehall London SW1A 2AS Telephone 01-233 3299

From the Minister without Portfolio

The Rt Hon Lord Young of Graffham

P Wynn Owen Esq
Assistant Private Secretary to the Chancellor
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

11 March 1985

Dear Philip,

BUDGET DAY PRESS NOTICES

We spoke earlier today about your letter of 6 March concerning Budget Day Press Notices. Although I have not yet had the chance to discuss this matter with Lord Young (because of his absence in China), I am confident that my Minister will wish to brief the Press on his training proposals which were agreed at E(A) on 7 March.

We have taken note of the need to clear any press notices with the Treasury. I am copying to recipients of yours.

Yours sincerely

Stephen Ratcliffe

Stephen Ratcliffe
Private Secretary

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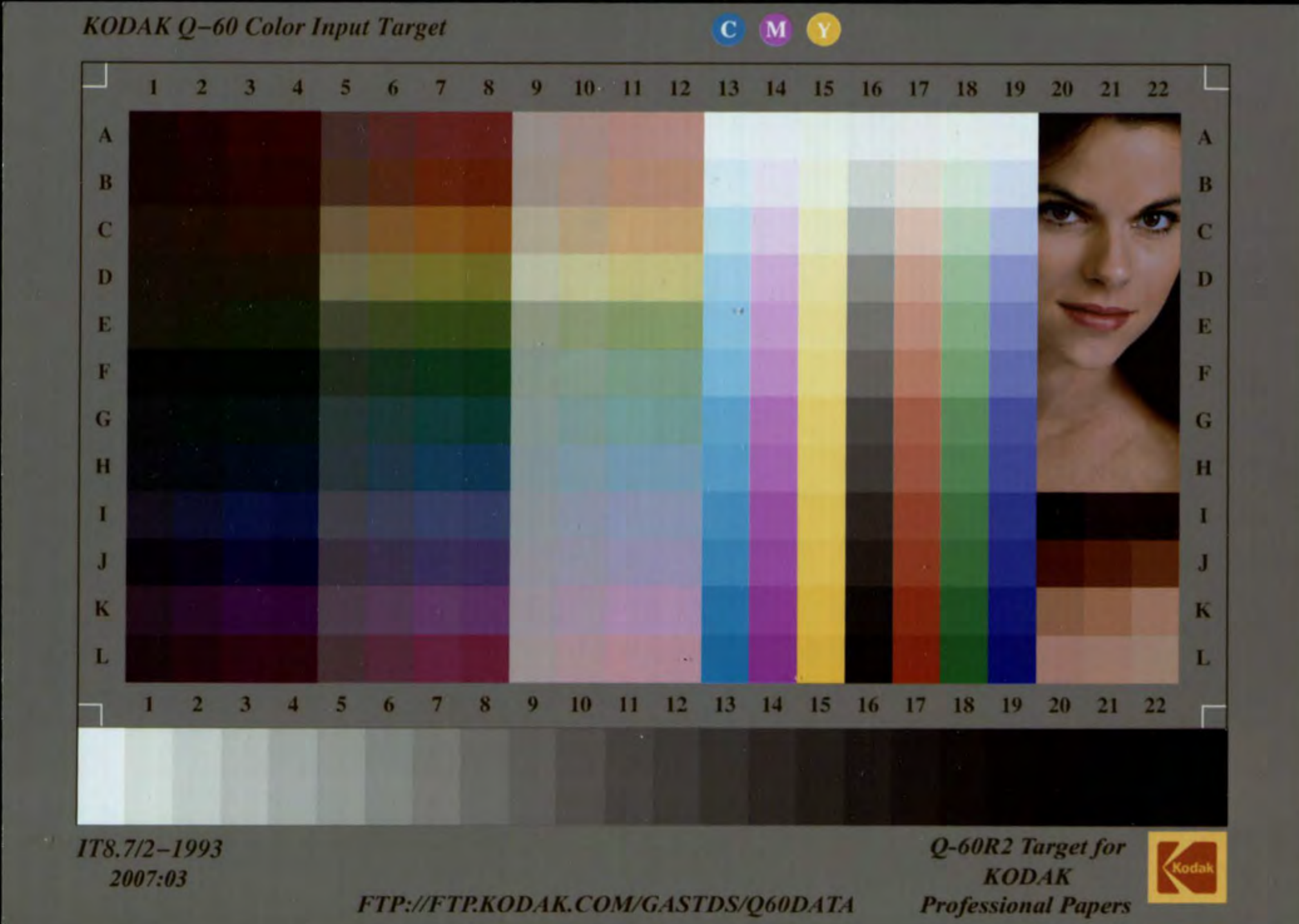
Econ Pol.
Budget Pt 13

PART 13 ends:-

Ch. Ex to SS/Energy 8/3/85

PART 14 begins:-

Cab. o/f to HMT 11/3/85



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