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PREM 19/1721

PART 15

M7

SECRET

Confidential Filing

The 1986 Budget.

1986 BUDGET BRIEFS IN SEPERATE BOX.

Financial Statement & Report 1986-87 &
DRAFT 1986 BUDGET SPEECHES IN ATTACHED FOLDER

ECONOMIC POLICY

Part 1 : May 1979

Part 15: Feb. 1986

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~7.2.86~~							
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PT 15 ENDS							

PREM 19/1721

PART 15 ends:-

DN to HMT 24/4/86

PART 16 begins:-

D. HOBSON to PM 12/5/86

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(86) 6th meeting, item 2	13/02/1986
CC(86) 11th meeting, item 1	18/03/1986
CC(86) 12th meeting, item 1	20/03/1986

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 _____ Date 15/09/2014

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.

Financial Statement and Budget Report 1986-87
Published by HMSO. ISBN 0 10 227386 3

Signed _____ Date 15/09/2014

PREM Records Team

DSG

File bc: Prof. Griffiths.

10 DOWNING STREET

From the Private Secretary

24 April 1986

STAMP DUTY

The Prime Minister today discussed with the Chancellor the changes in the Budget proposals on stamp duty set out in the Chancellor's minute of 23 April: withdrawal of the ½% duty on registered loan stock, a reduction in the rate of duty on ADRs and an exemption for certain very short-term transactions by broker-dealers. The Chancellor also said that measures which would permit the development of a commercial paper market in the United Kingdom would be announced when the Chief Secretary moves the Second Reading of the Finance Bill.

The Prime Minister was content with all these proposals.

David Norgrove

Mrs. Rachel Lomax,
H. M. Treasury.

DSG

PH/68

CONFIDENTIAL

cc R/UP

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

23 April 1986

PRIME MINISTER

STAMP DUTY

You will recall that we discussed, earlier this month, the pressures that had arisen for certain changes in the Budget proposals on stamp duty. The main points were set out in your Private Secretary's letter of 7 April.

Since then we have had consultations with the interested parties, and I am writing now to let you know the conclusions I have reached.

First, I can confirm that I intend to withdraw the proposal for a half per cent duty on registered loan stock. This change will become effective at the earliest practicable date. I hope that, with the sharp fall that has occurred since the Budget in long-term interest rates, this will encourage some new issues of this stock which might otherwise have been made on the Euro-sterling market.

Second, the consultations have suggested that it should be possible to prevent a serious erosion of the £600 million a year yield from stamp duty on registered shares by means of a duty on ADRs (and other depository receipts) considerably lower than the 5 per cent rate proposed in the Budget. What I have mind is a rate of 1½ per cent, which should, I hope, be enough to deter UK investors from using ADRs as an avoidance device without causing problems for those British firms who seek US investors via the ADR route. But given the uncertainties of the post-big bang world, I will need to make it clear that we stand ready to increase the rate if in the event we find that 1½ per cent does not give

adequate protection to the revenue. This change will be retrospective to Budget Day.

Finally, I am still considering, and will implement if it proves technically possible, an exemption from stamp duty post-big bang, for certain very short term transactions by broker-dealers, thus putting them on all fours with the exemption already proposed for market-makers.

As I indicated to you, I intend that John MacGregor should announce all these changes when he moves the Second Reading of the Finance Bill on Tuesday (29 April).

We can discuss further, if you wish, when we meet tomorrow.

Rachel Lomax

N.L.

(approved by the Chancellor and signed in his absence)

ONO

EFPPS. R 23/4.

DN.

22 BISHOPSGATE
LONDON EC2N 4BQ
TEL: 01-634 3000

21 April 1986

Weekend Box

The Rt. Hon. Margaret Thatcher, P.C., M.P.,
10 Downing Street,
London SW1

Dear Prime Minister,

I have been travelling since our recent meeting, but did not want more time to pass by without thanking you for your kindness in sparing so much time for our discussions which Alan Walters had kindly arranged. We certainly covered a wide range of topics and I found the conversation most stimulating.

Needless to say, I am a great admirer of your policies and your steadfastness which I find a continuing inspiration. As a U.S. Citizen and non-voting U.K. resident it is probably inappropriate to use the expression 'your obedient servant' but I should like to wish you continued and deserved success.

Yours sincerely,

Jack Hennessy

J.M. HENNESSY

MJ

10 DOWNING STREET

From the Private Secretary

14 April 1986

THE BUDGET: WHAT BUSINESSMEN REALLY THINK

The Prime Minister read with great interest the survey of business opinion about the 1986 Budget which you sent me with your letter of 7 April.

I am copying this letter to Andrew Lansley (Chancellor of the Duchy's Office).

(DAVID NORGROVE)

Mrs. Rachel Lomax,
HM Treasury.

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58/ms

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

David Norgrove Esq
10 Downing Street
Whitehall
London SW1A 2AB

Prime Minister +
The Chancellor presumably would also like you to look at pages 1 and 2!

7 April 1986

Dear David

DRN
8/4.

THE BUDGET: What businessmen really think

The Chancellor thought the Prime Minister might be interested to see the attached survey of business opinion about the 1986 Budget. She may be particularly interested in the answers to the question on page 9 - what would you like to see in next year's Budget?

I am copying this to Andrew Lansley (Chancellor of the Duchy's office).

Yours ever
Rachel

RACHEL LOMAX

Enc

Sir Peter Lane

THE BUDGET

What Businessmen Really Think

BinderHamlyn

CHARTERED ACCOUNTANTS

THE BUDGET

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What Businessmen Really Think

Businessmen are by and large happy with Nigel Lawson's budget last week. The result is seen as good for their companies with positive effects on macro-economic indicators, too. This is the flavour of the results from a survey conducted for us by Dewe Rogerson shortly after the announcement of the budget measures.

Nigel Lawson comes out of the budget with flying colours. The vast majority of businessmen say that he is doing a good job and are confident that the measures will benefit themselves, their companies and the country as a whole. Hardly anyone sees the budget as having a detrimental effect, although some doubt is expressed as to whether the Government is actively trying to tackle the problems that face businesses.

The majority of businessmen feel that the budget will have a positive effect on interest rates, consumer spending, inflation and exchange rates. They are less sure about its effect on unemployment : here they see it as being neutral.

We also asked about specific budget measures; half the companies would not consider the Chancellor's suggestion that lower pay rises could be compensated for by giving employees a share of the company's profits. They are less sure as to their employees' reaction to the scheme.

Another budget measure, the abolition of Capital Transfer Tax on lifetime gifts, is seen as easing the succession of family businesses. Few companies would be prepared to pay the new tax proposed on returning the surplus from pension funds back to their companies. They would prefer to increase the benefits of the scheme or reduce contributions.

And what about next year's budget? Tax cuts are the priority for businessmen, followed some way behind by measures to reduce unemployment.

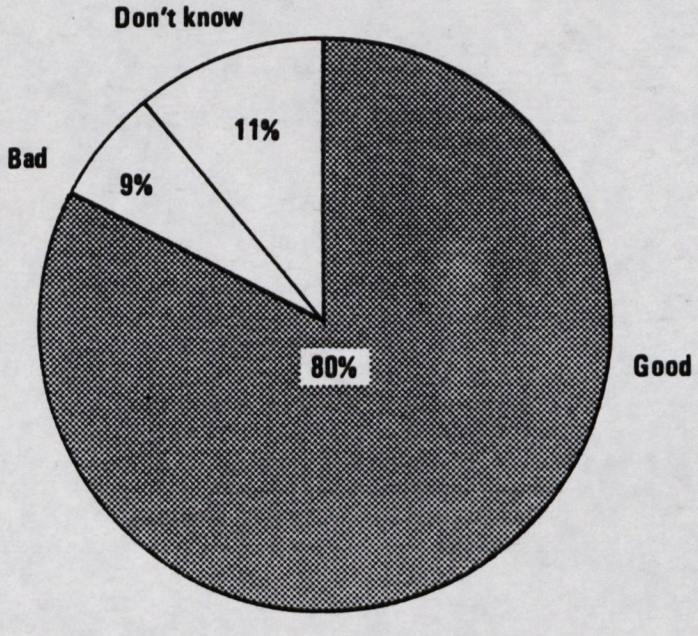
Technical Note

Dewe Rogerson interviewed by telephone on 19 and 20 March 1986, a representative sample of 232 companies with turnovers of more than half a million pounds. At each company the interviewee was either the Managing Director, Finance Director, Company Secretary or another senior Board Member.

The Chancellor of the Exchequer

Businessmen are pleased with the job Nigel Lawson is doing as Chancellor. Indeed, four in five say he is doing a good job with only one in ten holding the opposite view.

Q "Do you think that Nigel Lawson is doing a good job or a bad job as Chancellor of the Exchequer?"



Base : All

Rating of the Budget

Businessmen view the effect of the budget as being better for business generally than for their individual companies. This is not to say they feel that it will be bad for their company but they hold a more neutral view.

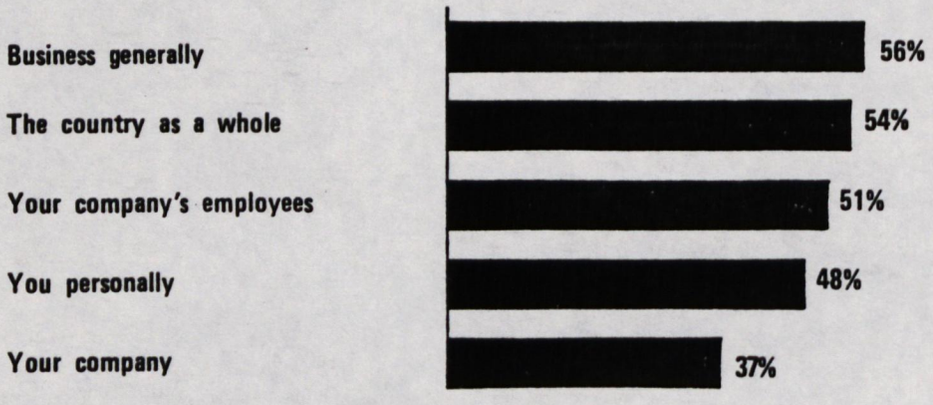
Around half of businessmen see the Chancellor's measures as benefiting the country, their company's employees and them personally. Very few believe that the effect of the budget will be negative.

This favourable view is attributed to the consistency of a budget with no sweeping changes. It is also seen as having been neutral, with the reduction in interest rates particularly welcomed:

> "It was psychologically good. It was neutral but with the right incentives without causing inflationary pressure"
>
> "Any budget which doesn't introduce wild sweeping changes is a good thing for business. It increases confidence in the Government and is a good thing generally"
>
> "It's an encouragement to capitalism. Any explanation of capitalism to the small person has to be a good thing"
>
> "The main thing is the cut in interest rates which will follow what he has done. It doesn't damage sterling and public sector borrowing is well down"
>
> "It's in the context of the general policy and that's good for business"

Q "On balance do you think Tuesday's budget was a good thing, a bad thing or would it make no difference to.....?

Percentage saying a good thing for.....



Base : All

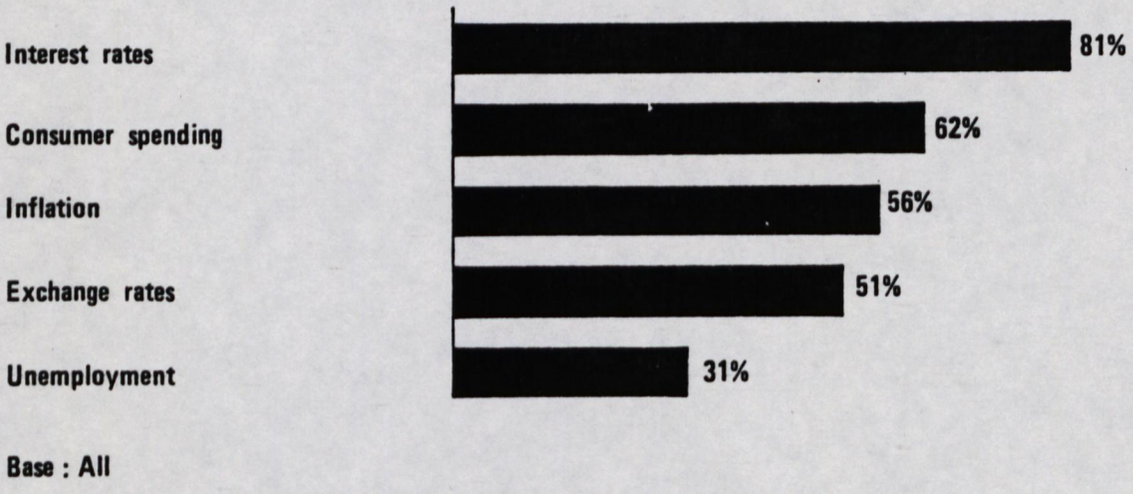
The Effect of the Budget

As well as asking businessmen what they felt the effect of the budget would be on their company, we were also interested to see how they viewed it in terms of the economy as a whole. Again the response was a positive one, particularly on its effect on interest rates.

The Chancellor's measures are also seen as being favourable in relation to consumer spending, inflation and exchange rates. Few believe the result to be negative on any of these economic indicators.

The effect of the budget on unemployment is viewed less positively with the majority anticipating a neutral effect.

Q "For each of the following areas I read out, will you tell me whether the budget will have a positive effect, a negative effect or will it have no effect at all?"



Profit Sharing

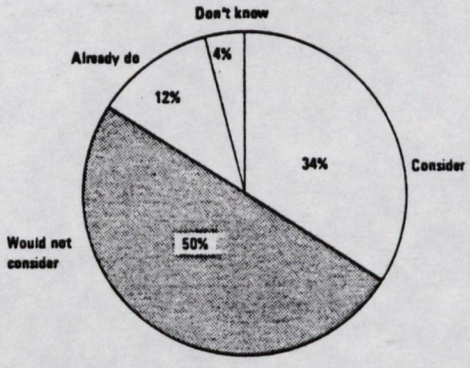
One of the suggestions that the Chancellor made in his speech on Tuesday was that companies could compensate for giving their employees lower wage rises by giving them a share in the profits of the company. Businessmen's reactions to this proposal are not positive, with half saying it would not be considered. However, one in ten do say that they already have such a policy.

Opinion is more equally divided over what the reaction of employees would be to such a scheme. As many believed they wouldn't be interested as said they would.

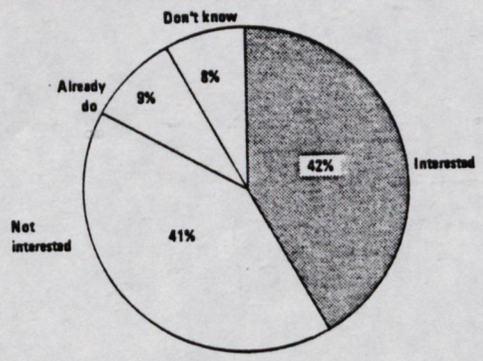
Q "The Chancellor has suggested that companies should reduce the level of wage increases and compensate for these lower increases by giving employees a share in the profits of their company. Do you think that this is something you might consider in your company or not?"

Q "And do you think that your employees would be interested in such a scheme, or not?"

Would you consider it.....?



Would your employees be interested.....?

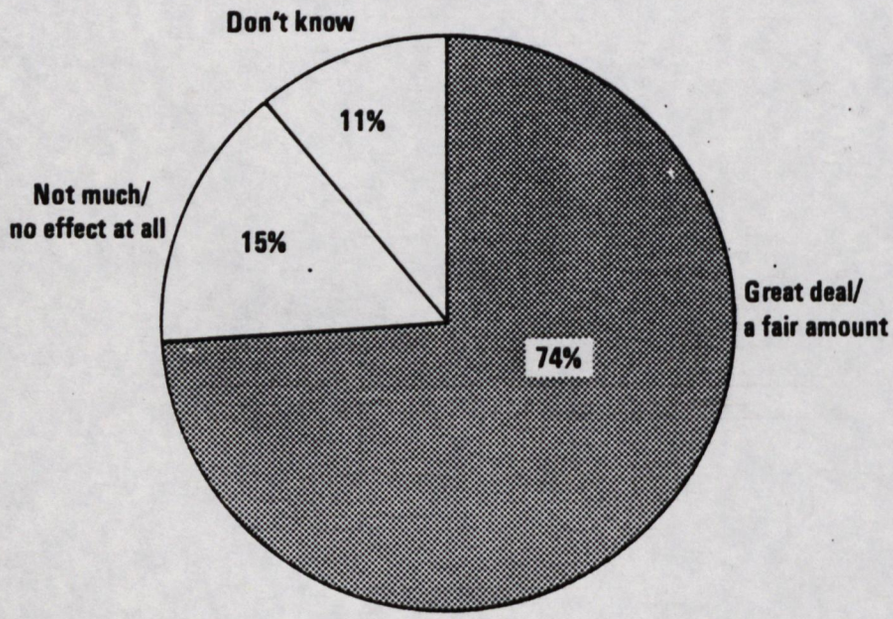


Base : All

The Chancellor abolished Capital Transfer Tax on lifetime gifts in his budget. One of the possible effects of this could be to ease the succession of family businesses. We asked businessmen whether they believed that this would result from the tax change.

The overwhelming majority of businessmen do believe that succession of family businesses will be made easier and few doubt the effectiveness of the measure.

Q "How much effect do you think that the abolition of capital transfer tax on lifetime gifts will have on easing succession of family businesses. Will it have a great deal of effect, a fair amount of effect, not much effect or no effect at all?"

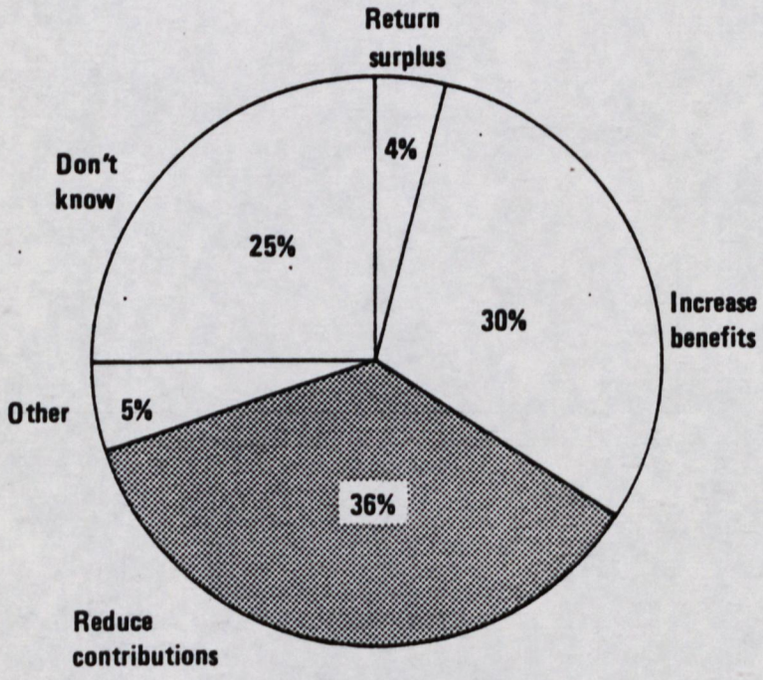


Base : All

Pension Schemes

A new tax that the Chancellor introduced was one of 40 per cent on pension fund surpluses if they are returned to the company. Few businessmen would be prepared to return any surplus and pay this tax, preferring instead to increase benefits under the scheme or reduce the contributions paid.

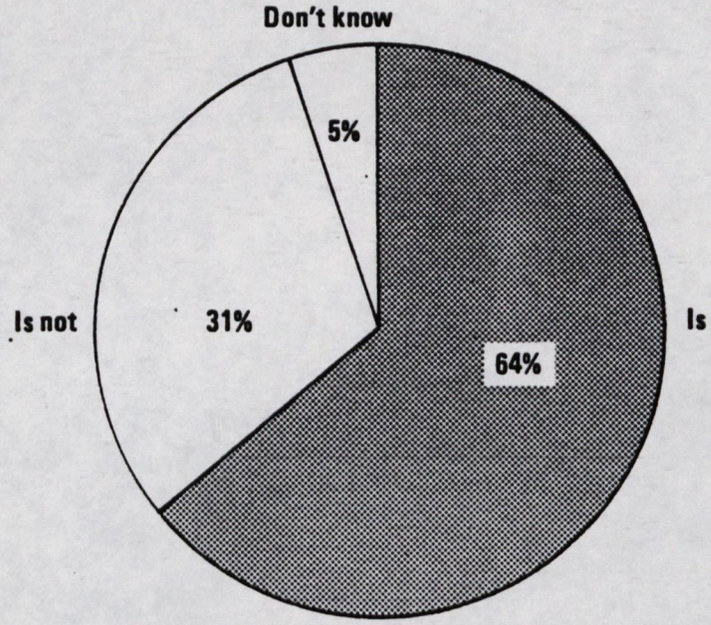
Q "Turning now to pension schemes. In the event that your pension scheme is overfunded, do you think you would return the surplus back to your company and pay the 40 per cent tax as proposed in the budget, would you increase the benefits under the scheme or would you reduce contributions?"



Base : All

The budget itself was well received by businessmen, but we wanted to see whether they felt the Government was actively helping businesses. The majority do feel that it is but as many as one in three do not feel that the Government is actively trying to tackle the problems that face their businesses today.

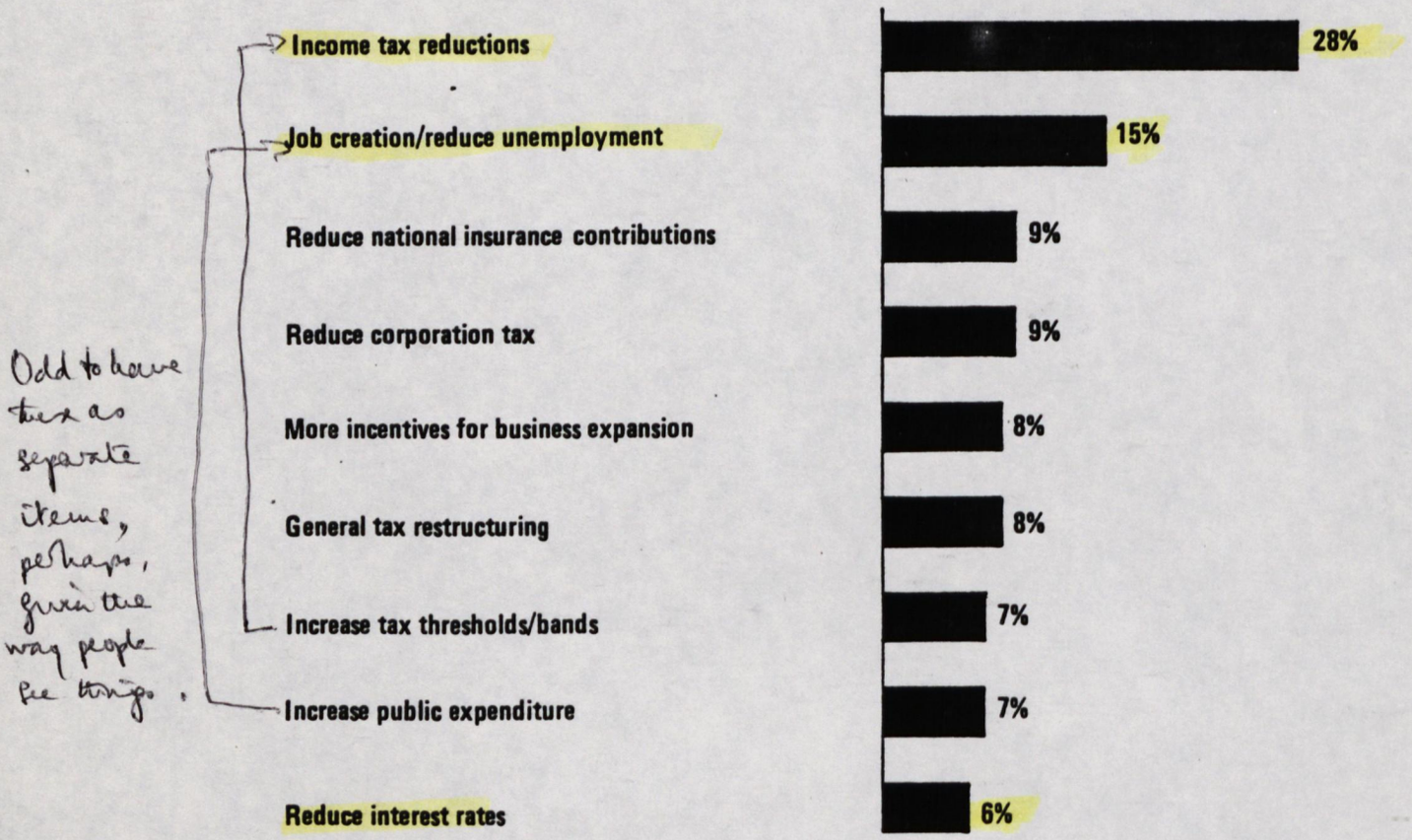
Q "Do you think that the Government is, or is not, actively trying to tackle the problems that face businesses today?"



Base : All

With this year's budget behind them, we asked businessmen what they hoped to see next year. The most favoured option was tax cuts followed some way behind by measures to reduce unemployment. Two other hopes were expressed by around one in ten, reduced national insurance contributions and reduced corporation tax.

Q "Finally, what would you like to see in next year's budget?"



(no other answers mentioned by more than 3%)

Base : All

Odd to have tax as separate items, perhaps, given the way people see things.

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CONFIDENTIAL

FILE CAJALS

SUBJECT cc MASTER

10 DOWNING STREET

7 April 1986

From the Private Secretary

STAMP DUTY

The Prime Minister and the Chancellor this afternoon discussed the mounting pressures for a change in the Budget proposals on stamp duty.

The Chancellor said that his present intention was to announce during the course of the second reading debate the withdrawal of the proposal for half a per cent stamp duty on loan stock. The Prime Minister asked whether this could be brought forward, but accepted that it would make sense to make the announcement on second reading.

The Chancellor further explained that the proposal for a five per cent duty on ADRs was designed to protect a yield of £600 million a year from stamp duty on securities. ADRs were in fact a means of avoiding protectionism in the United States: the American regulations required certain US financial institutions only to buy American securities and ADR certificates were classified as American. The Chancellor however recognised the concern about the proposal and the Treasury would be undertaking intensive consultations about it in the coming days. The Chancellor said it was possible that he would decide to reduce the size of the proposed increase. If he decided in favour of making such a change this would also be announced during the second reading of the Finance Bill.

The Chancellor mentioned finally that he would announce proposals to mitigate the effect of the proposal on certain hard cases, where a transaction had been in progress at the time of the Budget.

DAVID NORGROVE

Tony Kuczys, Esq.,
H.M. Treasury

JB

CONFIDENTIAL

SUBJECT cc MASTER

10 DOWNING STREET

25 March 1986

From the Private Secretary

Dear Tony,

STAMP DUTY

The Prime Minister has seen Lord Hanson's letter of 21 March to the Chancellor about the imposition of stamp duty at 5 per cent on conversion of shares into ADRs. She also saw today Mr. Jack Hennessey, Chairman of Credit Suisse First Boston Bank, who made similar representations that the imposition of the 5 per cent stamp duty was protectionist, and would damage the ability of British companies to raise equity in American markets. He mentioned the risk of damage to the sale of British Gas. He also argued that the extension of the coverage of stamp duty at ½ per cent would simply drive transactions offshore, giving as examples the ICI amd MEPC Euro-sterling issues which were made after the Budget.

The Prime Minister would be grateful for the Chancellor's comments both about the criticisms of the 5 per cent stamp duty on conversion of shares into ADRs and about the effect of extending the coverage of ½ per cent stamp duty.

Yours,

David.

(David Norgrove)

Tony Kuczys, Esq.,
HM Treasury.

CONFIDENTIAL

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10 DOWNING STREET

From the Private Secretary

24 March 1986

ICI CASE

The Prime Minister has seen your letter to me of 21 March which described how the Revenue proposes to handle the recent Court of Appeal judgement in the ICI case. The Prime Minister read this without comment.

(David Norgrove)

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

CONFIDENTIAL

10 DOWNING STREET

Prime Minister 2

There is some special pleading in this. But the Chancellor's proposal for 5% stamp duty on ADRs is protectionist.

DRN
24/3

Please refer to Chancellor himself

MT

WITH COMPLIMENTS

Lord Hanson

C2413

Hanson Industries

410 Park Avenue
New York, NY 10022
Telephone (212) 759-8477
Telex 96.17.75

Sir Gordon White K.B.E.
Chairman

21st March 1986

Dear Nigel,

I am writing to you as an interested party in connection with the Budget proposal concerning stamp duty at 5% on conversion of shares into ADRs, something which I feel would be extremely detrimental to the declared policy of encouraging US investors into UK industry.

Hanson Trust is an extensive user of securities markets in virtually every aspect: as a company with its shares quoted on the Stock Exchange; as a corporate investor and, through our many pension funds, as a long term institution. We are also about to make a sponsored ADR issue in New York. Hence our special interest.

To its utmost credit, your Government has consistently favoured free trade and set its face resolutely against protectionism and special pleading. The Stock Exchange must be able to compete effectively and fairly with other securities markets and be able to retain our rightful share of business within the City. But to favour the Stock Exchange so positively is going too far.

The purpose of issuing ADRs is not to avoid stamp duty but to extend the market for shares to new investors. In the United States, many investors are not able to hold UK registered shares. Furthermore, the ADR form eases problems of settlement for purchases and sales.

There is a further reason, often overlooked, for UK quoted companies seeking listings for their shares in overseas markets. In order to continue to invest successfully overseas, companies such as Hanson Trust have had to rely on borrowings in the local, primarily US, currency to finance expansion. This creates a wide geographic gap between ownership and operation. Since a balance must be maintained between debt and equity, the ability to place out, in effect, part of a UK equity issue to the vast United States investing public will have a favourable impact on the terms. The ADR is a convenient means of achieving this aim. The additional stamp duty would be an additional and unnecessary burden.

/continued ...

21st March 1986

I urge you to consider the larger and longer term implication for British industry, its overseas expansion plans and its capital raising needs. The UK economy, in the light of the increasingly global investment environment, can only benefit from the greater involvement of overseas investors.

My greatest fear is that this kind of action will give ammunition to the protectionist lobbies in the United States. As you know, British industrialists have been working hard on such issues as the abolition of the Unitary Tax principle. It is vital that no measures are taken that encourage reciprocal action against our national interests.

With best regards.

Yours Gordon.

P.S. Many congratulations.

The Rt Hon Nigel Lawson, MP,
The Chancellor of the Exchequer,
11 Downing Street,
London, SW1

Think positive —top industrialist

HANSON Trust is one of the most amazing success stories of post-war Britain.

Twenty-two years ago, Hanson Trust profits were virtually nothing—last year they were up to £252m.

Market capitalisation exceeds £3bn and there are 64,000 employees whose activities range from brick-making to Ever-Ready batteries, from engineering to department stores and airport duty-free shops.

LORD HANSON, Huddersfield-born, the man who has led from the front all the way, takes issue in the accompanying article with politicians and others who bleat about manufacturing's contraction and argue the case for more taxpayers' subsidy.

"Hanson Trust is one of Britain's biggest manufacturing industries. But we have many service companies . . . are they less valuable than producing pots and pans. Let's be positive," he urges.

"If we continue to fight for competitive industry and for the freedom of the individual, we need not despair about our manufacturing industry,"

WHATEVER happened to our manufacturing industry? It has certainly shrunk. Where did it go? It must be the Government's fault. Of course—that goes without saying; we all know that everything's the Government's fault.

It is all the fashion now to wail about the decline of our country's manufacturing base. Politicians have had quite a bit to say about it recently—especially Labour politicians and a Liberal or two and even a former Tory Prime Minister. Not too many of them have actually earned a crust in industry.

Essentially what these people are saying is:

- The erosion of Britain's manufacturing base must cease and it is for the Government to act to stop it.
- It is our birthright as a nation to produce steel and ships and coal and cars, and the taxpayer must fork out—yesterday, today, tomorrow—yea even unto eternity, to preserve this birthright.

Recently the wailers and moaners have found another war cry. "Save our helicopters and save our cars and our trucks! Deliver us from the foreign devils who just want to turn us into assemblers and tin-bashers."

Industrial sickness

What stuff and nonsense all this is.

Hanson Trust is one of Britain's biggest manufacturing companies.

I am proud of our factories and our managers and our workforces. But that doesn't mean that manufacturing is the be-all and end-all of prosperity.

We have many service companies—department stores, hire businesses, duty-free shops at airports—are they less valuable than producing pots or pans?

Of course I'm not arguing that we can just as well survive and prosper as a service economy. But I am questioning whether politicians or economists can tell us what volume of manufacturing industry we ought to have.

In fact, I think I can offer some encouraging words.

I consider that our manufacturing base will start to expand. I say this with some confidence because I believe we have got to the bottom—or anyway near the bottom—of our long-term industrial sickness and lack of competitiveness.

We have—for some years now—recognised and faced the truth that business prospers only when you serve the customer and fight for your share of the market.

The truth of the matter is that any remaining problems in our country do not lie in manufacturing industry. By and large we are pretty competitive.

We still need to work harder to win a bigger share—not, as is usually argued, a bigger share of the export markets—but of our own home market. But we're not doing badly in industry.

'Work harder to win bigger share of the home market'

What we must not do is to relax the effort. We have to press on with shifting the nationalised industries into the private sector. We must continue to encourage the Government to go on with privatisation, including the services sector and, in particular, to reduce the size and bureaucracy of the local authorities.

We have to keep up the pressure to encourage enterprise and initiative.

Siren voices

Since the turning point of 1979 we have come to an environment where incentives encourage and reward those who accept risk and work hard to create the nation's wealth and employment. It has been a hard struggle to reach this stage, but now we see that new businesses—lasting and prosperous ones—and production are on the increase.

But now the siren voices are heard again. Why not a little stimulation here? Why not continuing subsidy there? Why not just another little billion of the taxpayers' money to keep this or that industry alive? It would be a policy of return to the bad old days and in my view the Government is right to resist it.

If we continue to fight for competitive industry and to fight for the freedom of the individual, we need not despair about our manufacturing industry. For myself, as a Yorkshireman and an industrialist, I am not at all despondent.



Lord Hanson—offering encouraging words

BT/62

CONFIDENTIAL

010

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

David Norgrove Esq
10 Downing Street

21 March 1986

Prime Minister 2

To note.

DAS
21/3.

Dear David,

ICI CASE

The Chancellor thinks the Prime Minister should know how we propose to handle the recent Court of Appeal judgement in this case.

The Prime Minister will recall that before the Mossmorran ethylene project went ahead four years ago, Esso and Shell sought Government assistance. On the tax side, they wanted a PRT exemption for ethane used for petrochemical purposes, failing which a change in the way such gas is valued for PRT when - as for Mossmorran - companies take it on a long term basis from their own field. Ministers told them they could not have exemption but agreed that the existing rules were inappropriate for valuing gas of a kind normally sold on a long-term basis. They said they would introduce legislation to secure that interaffiliate transfers should be treated on a similar basis to long term arm's length contracts: and that they understood the Revenue had agreed a particular price formula for the Mossmorran ethane should the proposed legislation become law. The legislation was passed in the 1982 Finance Act.

ICI, with an existing ethylene plant but a different feedstock (naphtha), suspected this was giving Shell/Esso a subsidy. By process of judicial review they challenged both the law itself and the way the Revenue said they would apply it in assessing a price formula. (Shell/Esso's actual tax affairs were not exposed to the Courts, but the general context of the legislation was known.) ICI are not now pursuing the first point; but on 24 February the Court of Appeal gave judgement in their favour on the second, and refused leave to appeal against this to the Lords.

There are some very complicated legal and tax issues here both for the companies and for the Government. And it raises some wider policy considerations - including the possibility, at some stage, of amending legislation. One way forward is to petition the House of Lords for leave to appeal to them, and if leave is

granted, to appeal. Whether in the event an appeal will be the best course of action cannot yet be decided, but it would be unwise to close off this option. The Revenue therefore intend to keep it open by petitioning within the time limit. This expires on 24 March.

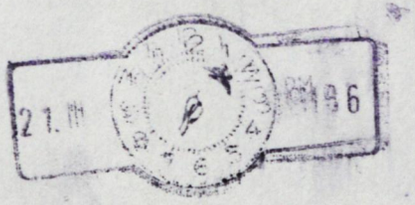
We shall not initiate any publicity, but ICI (who will receive notice of the petition) or the press (who could easily find out) may.

Until now, the respondent in the case has been the Attorney General: since the legal issue is now one of Inland Revenue administration we are considering with the Attorney General's office in whose name the petition should be made.

Yours sincerely,

Philip Wynn Owen

pp **A W KUCZYS**



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PARTY POLITICAL BROADCAST

THE BUDGET

Rt Hon ROY JENKINS MP

RECORDED FROM TRANSMISSION: BBC 1 DATE: THursday 2130 20.3.86

THE RT HON ROY JENKINS MP
FINANCE SPOKESMAN, SDP/LIBERAL ALLIANCE: This Budget would be quite a good Budget if conditions in Britain today were satisfactory and the prospects were set fair. The Chancellor, broadly speaking, says they are. I say they're not. This is the core of the argument. I say they're not for two reasons; first and most obvious is the level of unemployment. The Lawson strategy involves the acceptance of this into the indefinite future. Of course - neither he nor the Prime Minister wants unemployment for its own sake. But apart from a few small measures at the edges, they are prepared to do nothing about it. They just express the hope that free markets and low inflation will spontaneously deal with the problem; they've not done so. And there's no evidence at all that they will. Inflation has come down quite a bit, although many other countries have done better still. But unemployment has gone up. It will not come down until present policies change. The Government is not going to alter these policies, therefore its approach is essentially one of accepting well over three million unemployed, and hoping that the rest of the country won't take too much notice of them. Apart from its callousness, this passing by on the other side won't work for hard headed reasons as well. Here we have three and a quarter million unemployed in what the Government claims is the fifth year of a boom. How many are we going to have when there's a turn-down? For international or other reasons; and how many more people in these circumstances are going to feel insecure about their own jobs and their children's future? And what effect is unemployment, stubborn at well over three million, easily capable of soaring beyond four million, condemning a big junk of each generation of school-leavers little prospect of a proper job, what is that going to do to the cohesion of our society, peace on our streets and to safety in our homes?

There's another hard headed consideration beyond that. Unemployment is terribly expensive. Not just in deprivation for the individual and loss of resources for the nation, but in straight cash terms for the Exchequor. SInce this Government came in it has received fifty-one billion pounds in oil revenues and spent thirty-three billion of them on unemployment benefit. Now the oil is beginning to go and the price is going faster and, at the same time, the most appalling strains are appearing in our public services. The Health Service is being forced to close hospital wards; schools are in danger of becoming more of an industrial battleground than places of education. Universities are squeezed and scientific research starved. Our streets look run-down, public transport declines and our housing stock deteriorates. Without the oil, and with unemployment at its present level draining away vast billions a year, the outlook for these services which are so vital to nearly all of us, is dismal, under any Government. The present condition of Britain is therefore not such, in my view, as to justify Mr Lawson's ingenious but complacent Budget.

Continued.....

And the prospect is still worse than the present.

I've already mentioned the public expenditure aspect of this. And there's another balance which has tobe struck. That is our account with the rest of the world; paying our way abroad. Oil, again, has sustained this. But under its protective but inovating shadow, our trade in manufactured goods has gone into deficit for the first time since the industrial revolution. That deficit and the derelict industrial sites of the West Midlands and elsewhere are the reverse side of the same coin. And the deficit shows signs of getting dangerously wider. Invisibles and service earnings are important. They cannot cover, without an oil surplus, the gap left by a manufacturing industry still producing less, still investing less, than in 1979. To safeguard this dangerous flank, the priority this year ought to have been to try to repair the damage done to industry in the earlier years of this Government.

Here again there is a prospect which does not remotely justify our Budget of 'steady as she goes', a Budget of a Minister of Taxation rather than of a Chancellor of the Exchequor looking to the broader strategy of the nation's needs.

Is such a broader strategy possible? Prime Minister and the Chancellor try to deny this. They are like a couple of defence lawyers who put in a plea for their client saying 'he didn't do it, but if he did it was justified'. They say their strategy is working splendidly, but if it isn't it's not their fault, because no Government can affect the economic climate or create real jobs. Is that true? Well, there are a remarkable number of people who think differently. Some of them with as least as much accumulated wisdom as Mr Lawson.

Obviously the Alliance thinks differently. It has put forward its own carefully costed Budget strategy which is estimated to reduce unemployment by at least three quarters of a million over three years at a cost to public sector borrowing of three point five billion pounds. This would concentrate on doubling the community programme, cutting employers national insurance contribution by ten percent, giving special help to those most in need, quite unlike this Budget which does nothing for the casualties of Mrs Thatcher's Britain. And securing a strong improvement in public investment - housing,roads, hospitals, railways. There are a few differences of detail, but the general thrust of this approach commands a remarkably wide measure of support across and outside politics. Two recent select committees, one of the House of Lords, one of the House of Commons agree. So do the non-Party Charter for Jobs; so does the Confederation of British Industry; so does nearly every Tory Minister who has left Mrs Thatcher's GOvernment.

Now, of course, they may all be wrong, they may all be benevolent or stupid or irresponsible, and wisdom and sense may repose only in the head of Mr Nigel Lawson and of his few associates. But it doesn't seem very plausible. Surely it would be sensible, confronted by our present problems, not arrogantly to dismiss this wide confluence of view, but to use it as a basis for a policy which united rather than divided the nation, and offered a route of escape from our present afflictions and mounting future dilemmas.

COntinued.....

I've so far left Mr Hattersley out of my list. He talked quite a lot of good sense last night, but I thought he marred it by announcing like a clever conjurer that he had got just the right amount of money to pay for the benefits he proposed and that was by taking back every penny of tax concession that any lucky person had received since 1979. It was the politics of tit-for-tat, of undoing everything the other side had done, carried to its mechanical extreme. And those are the politics this country has had too much of and cannot any longer afford. This is not a good Budget for the poor. The ALliance would have introduced a much fairer one, but it would not be concerned with paying off old Party scores.

The crux of the economic problem is this: unemployment, it is increasingly clear, will not be brought down without a stimulus from the Government, which this Government will not give. But a stimulus will not work without a confident response from private industry which the Labour Party's policies could not secure. The Alliance would give that stimulus and secure that response.

R. Hattersley

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PARTY POLITICAL BROADCAST

RT HON. ROY HATTERSLEY MP

RECORDED FROM TRANSMISSION: BBC 2 **DATE:** Wed. 19 March 1986

RT HON ROY HATTERSLEY MP
SHADOW CHANCELLOR: I'm not going to spend the next ten minutes in the usual Party politicalargument. I don't agree with what the Chancellor did yesterday and he wouldn't expect me to. I wanted a massive assault on unemployment - a million new jobs in two years. But all we got was plans for ninety thousand, not even enough to make up for the hundred and thirtythousand men and women who lost their jobs inJanuary alone. In wanted a national campaign to help the least well off, those who have been left behindby this government, but from this Budget we got nothing to help the lowest paid, the pensioners or the families.

I wanted help for British industry; money for new investment at a price our companies could afford. What we got was a cut in stamp duty on the sale of shares. Another hand out for the people who make nothing except money.

But you already know that Labour stands for jobs, for helping the low paid and the families and for rebuilding the industries this Government has destroyed. So, instead of the usual Party arguments, I'm going to tell you how we could tackle the curse of poverty, the waste and misery of unemployment and the growing crisis of our lost manufacturing industry. That's what the Budget ought to have been about. I'm going to tell you what we would have done ina Labour Budget.

First of all something has to be done for those in our society who are least well off. Every day we read stories of pensioners who genuinely can't make ends meet. And during our last hard winter, old people actually froze to death because they couldn't afford topay their gas and electricity bills. I know that it's difficult to believe that such things can happen in Britain in 1986 but they can and they do. And the only answer is a decent pension. That's why Labour would increase the single pension by five pounds a week, with an eight pound increase for the pensioner couple. That's what we owe to the people who have given their working life to the service of our community. Family hardship's also growing in Mrs Thatcher's Britain. Some of it, the product of rising unemployment, and some the result of disgracefully small wages earned by the lowest paid. A cut in the standard rate of income tax, which the Chancellor told us was his attempt to help the poor, will do nothing to help those families who, at best, struggle to make ends meet. A cut in the standard rate of tax favours the rich far more than it helps the rest. For example, a family earning fifty thousand pounds a year, yesterday got a tax cut of eight pounds a week. Compare that with what you are going to enjoy as a result of yesterday's Budget.

Now we want to concentrate help on the families that need it most. Ands the best way to do that is to match the increase in old age pensions with an increase in child benefit. We would increase child benefit by three pounds a week.

There's a third group which needs our help - the long-term unemployed. There are now nearly one and a half million men and women who have been out of work for a year or more. That's more than the full total of unemployment when Mrs Thatcher first became Prime Minister. To be out of work for a year is in itself bad enough; skills, savings, confidence, even hope gradually drains away. But long-term unemployment in Britain carries a special and unnecessary penalty. The long-term unemployed aren't paid full, supplementary benefit. Even now unemployment pay is barely enough to live on. To deny some of the unemployed full benefit is simply barbarous. To increase the pension, to improve child benefit and to offer help to the long-term unemployed would cost three and a half thousand million pounds. That's a very great deal of money. Fortunately we know where to find it. And in spite of all the promises about tax cuts, our tax bill is twenty-nine thousand million pounds a year, higher today than it was when Mrs Thatcher first became Prime Minister. Most people, nineteen out of twenty, paymore. A lucky five percent pay less. The lucky ones, the highest paid five percent, have received three and a half thousand million pounds in tax cuts. And remember the rest of the country actually pays more.

We ought not to begrudge the lucky five percent their good fortune, but we must face the problem that it causes. By giving special hand-outs to people that need them least, the Chancellor has neglected those who most need assistance.

If we are to help the families right in the bottom of the wage scale, we have to call for a greater contribution from the people at the top. I'd then use the extra three and a half thousand million pounds to help those most in need. To give a five pound increase to the single pensioner and an eight pound increase to the pensioner couple; a three pound increase in child benefit, and help to the long term unemployed. Now if you think that's wrong let me ask you a simple question.

Many pensioners can't afford the basic necessityof life. We have to make a choice; which is the most important? Tax cuts for those at the top, or a little extra money for our old people? We choose to help the pensioners.

The second theme of Labour's Budget is putting Britain back to work, creating as I repeat we can create, about one million new jobs in the first two years of a Labour Government. I don't pretend that's anything except a major task. Under this Government unemployment has more than doubled. From just over one million to three and a half million. That is one graph that the Chancellor didn't show you in his broadcast last night. But we know how jobs can be created. Wemust invest in new and improved housing. We must rebuild our schools and hospitals. Wemust mend roads and improve the efficiencyof our railways. All this work is desperately needed and it creates jobs.

There's an equally desperate need to extend and expand the caring services, such as nursing and help for the community as a whole. Everynew job there solves two problems. It helps us all and it cuts unemployment. And we ought to give anincentive to industry, an inventive to employ more people by reducing costs through a cut in the national insurance contribution. And as well as that, we ought to institute the special programme that would provide jobs for all thelong term unemployed.

Taking all those things together we can cut unemployment by something like one million in two years.

Our programme for putting Britain back to work costs money. Of course it does. But it is money well spent, for unemployment is not only a social scandal, it actually costs us twenty one thousand million pounds a year in taxes lost to the treasury and benefits the Government has to pay to the unemployed. It also costs thirty billion pounds inlost production.

I think we all know what we ought to do. For there's a time in the life of an economy, as there is in the life of a company or family when it is prudent to borrow money and invest in the future. Many of you will have taken such a decision about your own homes. When you decided that taking out a mortgage was more sensible than going on paying rent. Many of you who work in factories will have seen them grow more prosperous because they've borrowed to invest in new plant andmachinery. Now the time has come for Britain to do the same. It's the rule followed by our more successful competitors, and by Britain in the past. Because we all know that if you borrow prudently you grow, you expand and you prosper.

What Labour would have put into its Budget offers new hope for Britain, hope for families, hope for the unemployed, hope for industry; and it offers hope for all the people who want to see a more prosperous country in which the increased wealth is more equally shared. That's what the Budget ought to have been about - charting the country's course for the next year and for the years to follow. Yesterday we didn't have such a Budget. We had a Budget for only some of the people; for men and women with two hundred pounds a month to spend on shares; for families who want to manipulate their estates in order to avoid death duty, and for the stock brokers who went wild with delight to hear that the taxes on their share deals hadbeen cut in half.

We believe that the people in Britain want something better than that. The families in work want jobs for the unemployed, and the comfortably off want to help the lowest paid. More than that, we all want to avoid the turmoil and resentment that comes from a divided society. We need to unite, not divide our nation and our Budget, the Labour Budget, would help to build that united Britain.

NBPM

MR NORGROVE

17 March 1986

PROFIT-SHARING SCHEMES

The Chancellor wants to announce in the Budget that he will consult on a proposal to give tax relief for schemes enabling employees to share directly in the profits of their companies. The Prime Minister is worried that this will be open to abuse by high-paid City slickers.

No - a side point

But the purpose of the scheme is exactly the opposite. High-paid people in the City already enjoy generous "top hat" share option schemes. The aim is to encourage schemes which spread out to the wider workforce.

That is why the Treasury would envisage the following sorts of rules for any such scheme:

i. At least 80% of the workforce have to participate in the scheme.

ii. A maximum of, say, £2,000 of profit-related income.

iii. A possible maximum cut-off point for eligible salaries.

iv. Although exempt from income tax, such schemes might bear CGT. This would not be a burden for most people, but would penalise the very rich.

v. Rewards must be genuinely related to profits.

Such a scheme would have the support not only of free marketeers like Sam Brittan, but also possibly of unsympathetic commentators such as Gavyn Davies and Victor Keegan. They see it as a genuine attempt to spread a share in profits more widely: they would not be interested if they thought it was just to make City salaries even bigger.

Finally, the Chancellor is of course only proposing at this stage to consult on the scheme. His idea is very Green. He would envisage first of all talking privately to organisations such as the CBI, and then issuing a consultation document. If it is apparent that such schemes will flourish only in the City, then the idea should not and would not be pursued. But to remove it from the Budget speech would weaken the important message that everyone should share in the success of their companies.

David Willetts

DAVID WILLETTS

COPY NO 1 OF 4

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BUDGET CONFIDENTIAL

Prime Minister
You already know the main points in this.
DHS
17/3

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

17 March 1986

The Rt. Hon. Paul Channon MP
Secretary of State for Trade and Industry

Top copy sent to you by mistake.

TAXATION OF FRINGE BENEFITS -
COMPANY CARS AND FREE FUEL FOR PRIVATE MOTORING: 1987/88

As in recent years I am writing to you and colleagues concerned with details of the changes I propose to the scales for taxing these benefits, and which I shall be announcing in my Budget. These scales are set a year in advance, so the changes this time relate to 1987/88. The changes this year are also a little more complex than usual.

In response to representations from the SMMT and others, supported by Leon Brittan and by Nick Ridley, my main proposal is to change the present 1300cc and 1800cc engine-size breakpoints in both the car and car fuel benefits scales to 1400cc and 2000cc respectively, to align with those in the proposed EC Directive on motor exhaust emissions. This change will apply from April 1987.

Changing the engine-size breakpoints will place a significant number of company car users in a lower charge band than previously, and would therefore result in a loss of revenue. To prevent this, the scale charges themselves will also be adjusted so as to achieve broad revenue neutrality. In addition, I propose to increase the restructured car benefit scale charges by 10 per cent in 1987/88 in continuation of our policy gradually to increase these charges towards a realistic measure of the benefit.

There will, however, be no general increase in the car fuel scale for 1987/88. This will be kept at broadly the 1986/87 level, but with restructuring. From 1987/88, therefore, the car fuel scale will no longer be the same as the car benefit scale, recognising that the car fuel scale already comes close to a realistic measure of benefit.

I also propose that, from April 1987, the income tax car fuel scale should be used to assess VAT due on petrol provided out of business resources for private motoring by registered traders and their employees. This will simplify the present arrangements for

restricting the amount of input tax that can be offset against VAT where petrol is provided for private motoring.

Finally, I also propose to increase by 10 per cent the scale charges for more expensive cars, and cars without a cubic capacity, but I do not propose to increase the cash breakpoints for these scales.

The main scales for 1987/88 resulting from these proposed changes are summarised below (1986/87 figures in brackets):

	Car Benefits	Car Fuel Benefits
1400cc(1300cc) or less	525 (450)	480 (450)
1401cc(1301cc) - 2000cc(1800cc)	700 (575)	600 (575)
Over 2000cc (1800cc)	1,100(900)	900 (900)
£19,250 - £29,000	1,450 (1,320)	Scale for relevant
Over £29,000	2,300 (2,100)	engine size applies

These proposals will be the subject of Treasury Orders during April.

I am copying this letter to the Prime Minister, and to Peter Walker and Nicholas Ridley.

NIGEL LAWSON

RR7.36

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BUDGET REF NO JJ 30
COPY NO 38 OF 46

FROM: MRS R LOMAX
DATE: 17 March 1986

MR SCHOLAR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Cassell
Mr Kemp
Mr Lavelle
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Miss Sinclair
Mr Pratt
Mr Dyer
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Battishill - IR
Mr Isaac - IR
PS/IR

Sir A Fraser - C&E
Mr Knox - C&E
PS/C&E

Mr Norgrove - No.10

Governor - B/E

Section B only
Mr Kelly

Sections D & H only
Mr Peretz

Section H only
Miss Noble

Sections C & J only

Mr Robson

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BUDGET SPEECH - FINAL DRAFT

I attach a final draft of the Budget speech, reflecting the changes the Chancellor made over the weekend, in response to comments received by Friday 14 March.

2. I would be grateful if Mr Kelly would update the figures in Section B for changes in exchange rates since the Plaza agreement, in the light of today's closing prices; and if Mr Monger would consider (with PE) whether any changes need to be made to the references to petrol prices in Section J. Any other comments should reach this office as soon as possible, and no later than lunchtime today.

RL

RACHEL LOMAX

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1986 BUDGET SPEECH

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A. Introduction

The background to this year's Budget is the dramatic and unprecedented fall in the world oil price.

But the Government's objectives remain unchanged: the conquest of inflation and the creation of an enterprise culture.

And the Government's policies are unchanged, too: policies of sound money and free markets.

Not least, because these are the only routes to more jobs, and jobs that last.

So my Budget today will carry forward the themes of my two previous Budgets, and sow some seeds for the future.

In the course of my speech I shall begin by reviewing the general economic background to the Budget, and go on to deal with the specific issue of oil.

I shall next discuss monetary policy and the fiscal prospect, both this year and next.

I shall then turn to the question of direct help for the unemployed.

Finally, I shall propose some changes in taxation designed to assist in achieving the economic objectives I have already outlined.

As usual, a number of press releases, filling out the details of my 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.

The strength and durability of the current economic upswing continues to confound the commentators.

We can now look back to very nearly five years of growth at around 3 per cent a year.

Even more important, 1985 was the third successive year in which we secured the elusive combination of steady growth and low inflation - the first time this has been achieved since the 'sixties.

In 1985 as a whole, output grew by a further 3½ per cent, the highest rate of growth in the European Community, and higher than the United States, too.

Within that total non-oil exports grew by 7 per cent, to reach yet another all-time record.

Despite a marked slowdown in the growth of world trade from the heady pace of 1984, the current account of the balance of payments was in surplus for the sixth year in succession - this time by some £3 billion.

Inflation ended the year at around 5½ per cent and falling.

Employment continued to rise, though still not fast enough to reduce the distressingly high number of people out of work.

I shall have more to say about unemployment later.

Manufacturing industry, the subject of so much ill-informed comment, had another successful year, with its output up by 3 per cent, its productivity up by almost 4 per cent, and both its investment and its exports up by 6 per cent.

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At the heart of this success lies a remarkable turn-around in productivity.

In the six years prior to 1979, Britain's annual rate of growth of manufacturing productivity, at less than 1 per cent, was the lowest of all the Group of Five major industrial nations.

In the six years since 1979, our annual rate of growth of manufacturing productivity, at 3½ per cent, has been second only to that of Japan.

Looking ahead, I expect 1986 to be a further year of steady growth with low inflation.

Indeed, with output forecast to rise by 3 per cent, and inflation to fall to 3½ per cent, 1986 is set to register our best overall performance in terms of output and inflation for a generation.

The pattern of growth should show a satisfactory balance, too, with exports and investment expected to grow rather faster than consumer spending - as indeed they have during the sustained upswing as a whole.

But the uncertainties inherent in all these forecasts, good though their track record has been, are reinforced by constant reminders that we live in an uncertain and turbulent world.

One particularly difficult aspect of this is the febrile nature of the world currency markets.

There has been some improvement here.

The Plaza Agreement between the Group of Five Finance Ministers last September has undoubtedly led to a more sustainable pattern of exchange rates worldwide.

Since that meeting, the dollar has fallen by some (15) per cent against the other major currencies as a whole, with the pound moving up by (7) per cent, the Deutschemark by (25) per cent and

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the Yen by (32) per cent - a pattern broadly in line with what those of us who were party to the agreement had hoped to see.

This process will be assisted further if the passage of the Gramm-Rudman amendment succeeds in securing its objective of a much-needed reduction in the United States budget deficit.

Meanwhile, the Plaza Agreement has already succeeded in reducing, at least for the time being, the dangerous protectionist pressures that were building up in the United States.

Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on.

But the most dramatic development on the world economic scene, and one of considerable importance to this country, has of course been the collapse in the price of oil.

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C. Oil

I presented my Budget last year at the end of a 12-month coal strike.

I observed at the time that it was a remarkable tribute to the underlying strength of the British economy that it had been able to withstand so long and damaging a strike in such good shape.

We now have to face a challenge of a very different kind.

Over the past few months the price of oil has almost halved, and with it our prospective North Sea oil tax revenues and earnings from oil exports.

In real terms, the price is now back to what it was before the first oil shock in 1973.

Not surprisingly, perhaps, this initially caused a fair amount of turmoil in the financial markets with sterling under pressure.

I decided that it was right to respond with an immediate one per cent rise in short term interest rates in early January, and this helped to prevent the downward movement of the exchange rate from developing an unhealthy momentum of its own.

But equally I thought it right to resist the pressure, which for a time was very strong indeed, to raise interest rates still further.

OPEC
mt.

Meanwhile, let me repeat that there is no question whatever, and never has been any question, of the UK cutting back its oil production in an attempt to secure a higher oil price.

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In the first place, the whole outstanding success of the North Sea has been based on the fact that it is the freest oil province in the world, in which decisions on levels of output are a matter for the companies and not for the Government.

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other goods and services, and a major oil consumer.

There is no overall UK national interest in keeping oil prices high.

I am of course aware that a Report, recently published in another place, and which attracted a certain amount of publicity at the time, predicted that

> "as the oil revenues diminish the country will experience adverse effects which will worsen with time"

- effects of a most alarming nature.

Had the authors of that Report dreamed at the time that half the oil revenues were about to disappear within a matter of months, their conclusions would no doubt have been even more apocalyptic.

As the House knows, I have always believed their analysis, which was widely shared by Rt hon and hon Members opposite, to be profoundly mistaken.

But certainly it is going to be put to the test sooner than anyone expected.

The United Kingdom is likely to remain an oil producer, of a gradually diminishing volume of oil, for the next 25 years or so.

If we can survive unscathed the loss of half our North Sea oil revenues in less than 25 weeks, then the prospective loss of the other half over the remainder of the next 25 years should not cause us undue concern.

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It is, of course, true that in relative terms we do lose from the collapse of the oil price.

That is to say, the really big gains will be made by the major non-oil-producing countries such as Germany and Japan, where growth will be boosted and inflation, already low, is likely to fall virtually to zero.

But the oil price fall will be beneficial for the industrialised world as a whole, and even for the United Kingdom what we gain on the swings should, over time, more than offset what we lose on the roundabouts.

In particular, I expect that the levels of economic activity and inflation will if anything be slightly better than they would have been without the oil price collapse.

And what of the balance of payments?

Thanks to the abolition of exchange control in 1979, we have been able to use a good part of our earnings from North Sea oil since then to build up a massive stock of overseas assets.

Our net overseas assets have in fact risen more than sevenfold from £12 billion at the end of 1979 to almost £90 billion at the end of last year.

This is a far bigger total than that possessed by any other major nation, with the perhaps inevitable exception of Japan.

The earnings from those assets will be of increasing value to our balance of payments in the years ahead.

So, too, should the improvement in our manufacturing trade balance.

For while the British economy may not gain a great deal overall as a result of the oil price collapse, there will be considerable differences <u>within</u> the economy.

No uncertain winners and losers.

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The major potential beneficiary will be the internationally traded sector of industry in general, and manufacturing in particular, which is already enjoying both cheaper energy and a lower exchange rate against most of its major competitors, at a time when inflation is falling.

This provides British industry with an outstanding opportunity both to increase its exports and to reduce import penetration in the home market.

But it will only be able to seize that opportunity if it meets two conditions.

First, it must keep firmer control of its labour costs.

Second, it must spend more of its much healthier level of profits on investing for the future in Research and Development and in training.

Both the opportunity, and the responsibility to see that it is not thrown away, rest fairly and squarely on the shoulders of British management.

Meanwhile, despite the massive fall in oil prices, I expect the current account of the balance of payments to remain in sizeable surplus this year, by some £3½ billion.

As I have indicated, there will be pluses and minuses within the economy.

If industry is the main gainer, the main loser, at least today, is the Chancellor of the Exchequer.

I can live with that.

But it does mean that North Sea oil revenues, which are likely to amount to some £11½ billion for 1985-86, are bound to be very much less in 1986-87.

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Indeed, on the assumption of an average North Sea oil price of for the rest of this year $15 a barrel, which is close to the average for the past month of around $16 a barrel, oil revenues in 1986-87 will be virtually halved at some £6 billion.

This has obvious implications for the Budget.

But the important fact is that, just as we successfully weathered a year long coal strike, so we have been able to take the unprecedented collapse in the oil price in our stride.

We have been able to do so, first, because of the underlying strength of the economy in terms of growth, inflation and the external account.

And, second, by virtue of the reputation we have earned over seven years for sound and prudent financial management.

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D. Monetary Policy

The framework within which that sound and prudent financial management has been pursued, and will continue to be pursued, is the Government's Medium Term Financial Strategy.

At the heart of the MTFS lies the objective of steadily reducing the growth of total spending power in the economy, as measured by GDP in cash terms, at a pace that will gradually squeeze inflation out of the system while at the same time leaving adequate room for sustained growth in real output.

That we have done.

Over the past six years the rate of growth of money GDP has been halved.

And this has brought about a combination of low inflation and steady growth.

We shall continue to maintain steady downward pressure on inflation.

That means above all controlling the growth of money in the economy.

Last year I set target ranges of 3 to 7 per cent for narrow money, MO, and 5 to 9 per cent for broad money, £M3.

During 1985-86 the targeted measure of narrow money has grown towards the bottom end of its range.

The target range for next year will be 2-6 per cent, as foreshadowed in last year's MTFS.

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For broad money it has been clear since the autumn that the range was set too low.

Throughout the 1980s - and in sharp contrast to the 1970s - broad money has grown far faster than money GDP.

Experience has demonstrated that this has not posed a threat to inflation.

This rapid growth largely reflects the increased attractions of holding interest bearing deposits, at a time both of low inflation and high real interest rates, and of innovation and liberalisation in the financial system.

Accordingly, I am setting next year's target range for broad money well above that indicated in last year's MTFS, at 11-15 per cent.

Given the experience of the past six years, I believe this is not only a more realistic range, but one which is wholly consistent with the further decline in inflation I intend to achieve.

Short term interest rates are the essential instrument of monetary policy.

Changes in interest rates have a reasonably quick and direct effect on narrow money, as they do on the exchange rate.

Their effect on broad money is more complex and much more delayed.

As explained in the Red Book, there is thus an important difference in the operational significance of the targets for narrow and broad money.

Needless to say, I shall continue to monitor the evidence of other financial indicators, of which the most important is the exchange rate.

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I will say no more about monetary policy today.

Except to repeat what I said at the Mansion House last Autumn: that while financial liberalisation and innovation have inevitably made the process of monetary management more complicated, there has been no change whatever in the essence of policy.

The Government continues to attach the highest priority to sound money.

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E. Public Sector Borrowing

Though there is nothing sacrosanct about the precise mix, monetary policy must always be supported by an appropriate fiscal policy. That means, in plain English, keeping public [sector] borrowing low.

? Government

The outturn for the public sector borrowing requirement in 1984-85, which had to bear the bulk of the cost of resisting the coal strike, was £10 billion, or just over 3 per cent of GDP.

In my Budget last year I planned to reduce it substantially in 1985-86, to £7 billion, or 2 per cent of GDP.

In the event, despite the loss of £2 billion of North Sea oil revenue, this year's PSBR looks like turning out at a little under £7 billion, given that the total for the first eleven months comes to under £3 billion.

This successful outcome, which represents the most substantial reduction in the PSBR as a proportion of GDP since 1981-82, is attributable to two factors.

First, public expenditure has been kept under firm control. Not only is the outturn likely to be within the planning total, but spending in 1985-86 is expected to be below the previous year's level in real terms, even after allowing for the effects of the coal strike.

And the second factor behind the successful PSBR outturn for 1985-86 is that the £2 billion shortfall in oil revenues has been offset by the increased buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

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Last year's MTFS indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP.

Some would argue that, in the light of the £2½ billion increase in projected privatisation proceeds, I ought to aim well below that. Others would claim that, since the sharp drop envisaged in oil revenues is more than double the rise in privatisation proceeds, a higher figure would be appropriate.

As last year, my judgement is that the wisest course is to stick broadly to our pre-announced figure.

But given the uncertainties over the oil price, I have decided, within that framework, to err on the side of caution, and provide for a PSBR of £7 billion, or 1¾ per cent of GDP.

Needless to say, this does not enable me to reduce taxation by anything like the £3½ billion foreshadowed in last year's MTFS.

Indeed, given the assumed loss of more than £5 billion of oil revenues in 1986-87, compared with what was envisaged a year ago, I would have expected to have had to increase taxes in this year's Budget.

However, not only have the tax revenues this year from the 95 per cent of the economy that is not oil proved to be notably buoyant, but there is every sign that this will continue into 1986-87, assisted by a rather higher rate of economic growth than was foreseen in last year's MTFS.

This continued vigour of the non-North Sea economy, which is likely to add more than £3 billion to expected non-North Sea tax revenues, coupled with public spending which remains under firm control, has transformed what might have been a bleak prospect.

As a result, I am able this year to accommodate a relatively modest net reduction in the burden of taxation, of a shade under £1 billion.

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F. Help for the unemployed

I turn now to the continuing problem of high unemployment.

It is a problem that can be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.

The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables workers to be priced into jobs instead of pricing them out of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's weakness lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

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And in a free economy - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's cost structure in general and its wage costs in particular.

In the new and improved climate of industrial relations, and with inflation falling and set to fall further, there can be no excuse for failure to discharge that responsibility.

I have, however, considered whether there is anything further Government can do to assist this over the longer term.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system. If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur.

One way out of this might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

This would not only give the workforce a more direct personal interest in their company's success, as existing employee share schemes do.

It would also mean that, when business is slack, companies would be under less pressure to lay men off; and they would in general be keener to take them on than if pay costs were fixed, irrespective of company profitability.

This would clearly be in industry's own interest, and most emphatically in the best interests of the unemployed.

It should therefore occur without any prompting from government.

But there is considerable inertia to overcome.

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So it might make sense to offer some temporary measure of tax relief to the employees concerned to help get profit sharing agreements of the right kind off the ground, and to secure the benefits that would undoubtedly accrue if they really caught on.

Inevitably, the design of such a relief, and the precise definition of qualifying agreements, would be matters of some complexity. would need to be drawn with considerable care.

The Government therefore propose to discuss with employers and others to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.

If these preliminary discussions are sufficiently encouraging, we would prepare a consultative document setting out a detailed scheme for wider consideration. Next year's Finance Bill.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.

In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to recognised vocational qualifications.

The new and expanded YTS will duly come into operation next month. It will be a giant step towards our objective of ensuring that no youngster under the age of 18 need be unemployed.

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, or, in the case of those between 18 and 24, for more than six months.

The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

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I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 255,000 places - very nearly double the number that existed a year ago.

At the same time, the average wage limit for the Community Programme will be raised to £67 a week from next month.

Last November my Rt. Hon. and Noble Friend announced two pilot schemes to provide further help for the long-term unemployed. These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and a Jobstart allowance of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week.

The pilot schemes are already proving effective, and I have accordingly decided to provide the funds to develop them into a single programme covering the entire country.

This means that every single one of the long-term unemployed throughout the land will be called for an interview and offered help in finding a job.

I shall also be providing the resources to launch a brand new scheme - the New Workers Scheme - to help 18-20 year olds to find a job.

This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at up to £55 a week or a 20 year old at up to £65 a week.

The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

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Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.

Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be increased from its present figure of 65,000 to 100,000 by April 1987, and to provide more training for those involved.

At the same time I propose to improve the tax treatment of payments made under this scheme.

The total public expenditure cost of the measures I have outlined, together with consequential spending in Northern Ireland, comes to £195 million in 1986-87 and £290 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £100 million in 1986-87 and £165 million in 1987-88.

This will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

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G. Business and Enterprise

I now turn to the taxation of business and enterprise.

While the measures I have just announced help the unemployed directly, in the long run what really matters is the creation of a climate in which business and industry flourish.

For it is companies, not Governments,which create jobs.

The reformed system of business taxation which I introduced in my 1984 Budget has reached the end of its transitional phase and comes fully into force next month.

From then on the United Kingdom will have, at 35 per cent, the lowest rate of Corporation Tax of any major industrial nation.

This year I have only two further amendments to make.

First, I propose to ensure a full measure of depreciation for tax purposes for short life agricultural buildings and works, by giving the taxpayer the option of making balancing adjustments on the sale or destruction of such buildings.

Second, I propose to reform the mines and oil wells allowances broadly along the lines of the proposals published in last July's consultative document.

The overall net benefit of this to the industries concerned will amount to £45 million in 1987-88.

Otherwise I propose only minor technical changes to the taxation of North Sea oil; but I am continuing to keep the economics of incremental investment under review, and shall not hesitate to introduce at the earliest opportunity any changes which may prove

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necessary to ensure that worthwhile projects are not frustrated by the fiscal regime.

I need to set the 1987-88 car and fuel benefit scale charges for those with company cars.

At the same time the motor industry has represented to me that the discrepancy between the engine size break points in these scales and the break points in the new European Community directive on car exhaust emissions is potentially damaging to its international competitiveness.

Accordingly I propose, from April 1987, to change our break points to those in the new directive.

At the same time, as last year, I propose to increase the (restructured) car benefit scale charges by 10 per cent.

This will still leave the scale charges well short of the true value of the benefit.

The fuel scale will also be restructured, but there will be no general increase in the charges; and as from April 1987 the same scale will also be used to assess the VAT due on petrol used by registered traders and their employees.

This will be simpler and more equitable than the present system, and will also bring in an extra £40 million of revenue in 1987-88.

I propose to increase the VAT threshold to £20,500, in line with the maximum permitted under existing European Community law.

I also propose to correct an anomaly in the taxation of international entertainers and sportsmen.

When British entertainers or sportsmen work overseas, the foreign tax authorities normally levy a withholding tax on their earnings.

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But at the present time we levy no such tax on the earnings of foreign entertainers and sportsmen when they work in the United Kingdom.

I believe that, in future, we should fall into line with most of the rest of the world.

Accordingly, I propose to withhold tax at the basic rate on the earnings of overseas entertainers and sportsmen in the UK. This should yield £75 million in 1987-88.

A key element in the Government's strategy for jobs is the encouragement of new businesses.

As the House knows, I have been reviewing the future of the Business Expansion Scheme, which is due to come to an end in April 1987.

I have been assisted in this review by the independent report commissioned by the Inland Revenue from the consultants Peat, Marwick, which is being published in full today.

I am placing a copy in the Library of the House.

It is quite clear - and this is confirmed by the evidence in the Peat Marwick report - that the Business Expansion Scheme, which my predecessor introduced in 1983 as an improvement on the 1981 Business Start-up Scheme, has been an outstanding success.

It has fully achieved its aim of attracting new equity capital into unquoted companies.

The amount subscribed has been running at well over £100 million a year, and steadily rising; and a high proportion of this has gone into new and small businesses.

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Roughly half the companies involved raised sums of less than £50,000 each.

I therefore have no hesitation in proposing to extend the life of the Business Expansion Scheme, which is due to expire next year, indefinitely.

But at the same time, despite the exclusions of farmland and property development in my two previous Budgets, I am concerned that too much BES money is being diverted from the high risk areas for which the scheme was always intended into areas where the risk is very much less.

Accordingly, I propose, from now on, to exclude from the scheme all companies holding more than half their net assets in the form of land and buildings.

I also propose to exclude companies whose main purpose is to invest in objects, such as fine wines, whose value may be expected to rise over time.

At the same time, I have one new inclusion to announce.

I have decided to bring within the scope of the BES companies engaged in the chartering of UK-registered ships.

This will provide new opportunities for investment in shipping engaged in the coastal, short sea and offshore trades.

I propose to take power to make further changes in the ambit of the scheme by Order.

Finally, having taken steps to target the Business Expansion Scheme more carefully, I propose to improve it.

BES shares issued after today will be entirely free of Capital Gains Tax on their first sale.

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And as a further measure of help for small and new businesses, the Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying bank loans, will also be extended, in this case for a further three years.
The House will be glad to learn that the premium will be halved from 5 per cent to 2½ per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.
In addition to statutory indexation of the threshold and rate bands, I propose this year to reform the tax radically.

In essence, the Capital Transfer Tax is two taxes, as its two separate scales imply: an inheritance tax and a lifetime gifts tax.
We have had an inheritance tax in some shape or form ever since Sir William Harcourt reintroduced the Estate Duty in 1894.
But the lifetime gifts tax which the Labour Government introduced in 1974, in the teeth of united Conservative opposition, is an unwelcome and unwarranted impost.
By deterring lifetime giving, it has had the effect of locking in assets, particularly the ownership of family businesses, often to the detriment of the businesses concerned.

Accordingly, I propose to abolish entirely the tax on lifetime gifts to individuals.

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As with the old Estate Duty, there will be a tapered charge on gifts made within seven years of death and provisions to charge gifts made with reservation; and the regime for trusts, which is needed as a protection for the death charge, will be kept broadly unchanged.

The cost of abolishing the tax on lifetime giving will be £35 million in 1986-87 and £55 million in 1987-88.

In recognition of the radically changed nature of the tax I have decided to rename it the Inheritance Tax.

My two previous Budgets abolished three unnecessary taxes.

The National Insurance Surcharge, the Investment Income Surcharge, and Development Land Tax.

The abolition of the tax on lifetime gifts adds a fourth.

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H. Savings and Investment

I now turn to the taxation of savings and investment.

In my 1984 Budget I introduced a major reform of the taxation of savings and investment designed to improve the direction and quality of both.

Today I propose to carry this reform further forward.

The Social Security Bill now before Parliament proposes important and far-reaching changes in pension provision, notably by encouraging the growth of personal pensions.

Those changes - to which the Government attach the highest importance - have been warmly welcomed, both for the greater freedom they will give to existing pension scheme members and for the new scope they will offer to the millions of working people who are not in an occupational pension scheme.

In the light of these changes, I intend later this year to publish detailed proposals designed to give personal pensions the same favourable tax treatment as is currently enjoyed by retirement annuities.

Publication of these proposals will enable there to be the widest possible consultation prior to legislation in next year's Finance Bill.

Meanwhile, I can assure the House that, as I made clear last year, I have no plans to change that favourable tax treatment.

New wheeze

But I do need to deal with the growing problem of the rules governing pension fund surpluses.

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The dramatic improvement in the financial climate compared with a decade ago, most notably as a result of the sharp fall in inflation, has seen a number of pension funds become heavily overfunded.

This presents a double problem, both aspects of which the Inland Revenue is at present having to deal with through the exercise of its discretionary powers.

In the first place, excessive surpluses, even if they arise unintentionally, represent the misuse of a tax privilege which was intended to assist the provision of pensions, and for no other purpose.

So the Inland Revenue requires from time to time that surpluses be diminished.

But at the same time the Revenue feels obliged to turn down many of the increasing number of requests from companies which, often for good reasons, wish to take refunds from their pension funds into the company itself.

The absence of clear rules on how surpluses should and may be dealt with, and the consequent reliance that has to be placed on the exercise by the Inland Revenue of its discretion, have created considerable uncertainty and have unnecessarily constrained trustees' freedom of action.

I therefore propose to replace these discretionary arrangements with clear and objective statutory provisions.

In future, the amount of any surplus in a fund will be determined for tax purposes in accordance with published guidelines, based on a secure funding method and prudent actuarial assumptions, as advised by the Government Actuary.

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Where a surplus is 5 per cent or less of total liabilities no action will need to be taken.

Where it is higher than that action will be required to eliminate the excess.

It will be entirely a matter for the trustees and employers to decide whether the reduction is to be achieved by increasing benefits, or reducing contributions, or making a refund to the company.

If, and only if, they choose to make a refund, the employer will be liable to tax at a rate of 40 per cent of the amount refunded, so as broadly to recover the tax relief previously given.

The effect of these new arrangements is likely to be a yield of £20 million in 1986-87 and £120 million in 1987-88.

Next, Stamp Duty.

I have no change to propose in the stamp duty on houses and other property, which I reduced to 1 per cent, with a higher threshold, in my 1984 Budget.

But there is a formidable case this year for a further reduction in the rate of stamp duty on share transfers.

The City of London is the pre-eminent financial centre of Europe. The massive £6 billion it contributes to our invisible earnings is but one measure of the resulting benefit to the British economy.

But competition in financial services nowadays is not continental, but global.

The City revolution now under way, due to culminate with the ending of fixed commissions - the so-called Big Bang - on 27 October, is essential if London is to compete successfully against New York and Tokyo.

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And if London cannot win a major share of the global securities market, its present world pre-eminence in other financial services will be threatened.

Successful competition depends on a number of factors, but one of the most important is the level of dealing costs.

The abolition of fixed commissions will certainly help.

But with no tax at all on share transactions in New York, and roughly ½ per cent in Tokyo, under the existing tax regime London will still be vulnerable.

I therefore propose to reduce Stamp Duty on share transactions from 1 per cent to ½ per cent as from the date of the Big Bang.

But I believe it is right that the full cost of this should be met from within the financial sector itself.

Accordingly, I propose to bring into tax at the new ½ per cent rate a range of financial transactions which are at present entirely free of Stamp Duty.

These include transactions in loan stock other than short bonds and gilt edged securities, transactions unwound within a single Stock Exchange account, letters of allotment, the purchase by a company of its own shares, and takeovers and mergers.

There will also be a special rate of 5 per cent on the conversion of UK shares into ADRs and other forms of depositary receipt.

Some of these changes, including the new ADR charge, will take effect immediately: others will be delayed until the Big Bang.

This further halving of the stamp duty on equities should enable London to compete successfully in the worldwide securities market.

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It will also provide a further fillip to wider share ownership in the UK.

Just as we have made Britain a nation of home owners, it is the long-term ambition of this Government to make the British people a nation of share-owners, too; to create a people's capitalism, in which more and more men and women have a direct personal stake in British business and industry.

Both through the rapid growth of employee share schemes, and through the outstandingly successful privatisation programme, much progress has been made.

But not enough.

Nor, I fear, will we ever achieve our goal so long as the tax system continues to discriminate so heavily in favour of institutional investment rather than direct share ownership.

Accordingly I propose to introduce a radical new scheme to encourage direct investment in UK equities.

Starting next January, any adult will be able to invest up to £200 a month, or £2400 a year, in shares.

These will be held in a special account which I am calling a Personal Equity Plan.

So long as the investment is kept in the plan for a relatively short minimum period, of between one and two years, all reinvested dividends, and all capital gains on disposals, will be entirely free of tax.

The longer the investment is kept in the plan, the more the tax relief will build up and the greater will be the benefits.

And there will be no need to provide any information to the Inland Revenue.

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Although the scheme will be open to everyone, it is specially designed to encourage smaller savers, and particularly those who may never previously have invested in equities in their lives.
So the plans will be simple and flexible to operate.
Anyone who is legally able to deal in securities will be eligible to register as a plan manager.
But the investor himself will own the shares - and the rights that go with them, including voting rights.
And it will be for the investor to choose whether to make the investment decisions himself or to give the plan manager authority to act on his behalf.

The cost of the scheme will be around £25 million in 1987-88, but will build up in later years as more plans are taken out.

This is a substantial, innovative and exciting new scheme.
I am confident that, over time, it will bring about a dramatic extension of share ownership in Britain.
Although wholly different in structure from the Loi Monory in France, I expect it to be every bit as successful in achieving its objective.

I am sure the whole House will welcome this far-reaching package of measures to reform the taxation of savings and investment.

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I. Charities

I now turn to the tax treatment of charities and charitable giving.

In almost every facet of the nation's affairs it becomes increasingly clear that private action is more effective than State action.

This is particularly well illustrated by the success of charitable organisations up and down the land in the fields of famine relief, social welfare, medicine, education (including the universities), the arts and the heritage.

This Government has already done a great deal to assist charities, both through the tax system and in other ways.

I believe the time has come to take a further step forward.

The first question is whether any further fiscal relief should be given to the charities themselves, through relief from VAT, or to the act of giving.

In the light of representations from the Charities VAT Reform Group, I am prepared this year, exceptionally, to make a number of specific concessions on the VAT front.

I propose to relieve charities from VAT on their non-classified press advertising; on medicinal products where they are engaged in the treatment or care of people or animals, or in medical research; on lifts and distress alarm systems for the handicapped; on refrigeration and video equipment for use in medical applications purchased by charities from donated funds; on recording equipment for talking books and newspapers used by charities for the blind;

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and on welfare vehicles used by charities to transport the deaf, blind or mentally handicapped.

But in general I am convinced that the right way to help charities is not by relieving the charities themselves from VAT, but by encouraging the act of charitable giving.

I say this for two principal reasons.

First, it is clearly better that the amount of tax relief is related to the amount of support a charity is able to attract, rather than to the value of goods and services it happens to purchase.

And, second, whereas a £ of VAT relief is worth precisely that, a £ of tax relief on giving is likely to generate more than a £ of income going to charity.

My principal proposals therefore relate directly to the act of giving to charity.

First, I propose to abolish altogether the upper limit on relief at the higher rates of income tax on charitable covenants.

At the same time I propose to act to stop the abuse of the tax system by ensuring that tax relief goes only to money which is used for charitable purposes.

Next, companies.

It is widely believed that corporate giving to charity would be more generous than it is at present if tax relief did not depend on the company entering into a four-year covenant.

Accordingly, I propose to allow companies (other than close companies) to enjoy tax relief on one-off gifts to charity up to a

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maximum of 3 per cent of the company's annual dividend payment to its shareholders.

There will, of course, continue to be no limit on the amount a company can covenant to charity.

Many charities have made clear to me their fear that to introduce a similar relief for one-off donations by individuals would weaken them by reducing the stability they enjoy as a result of the binding force of covenants.

Instead, therefore, I propose to encourage individual giving to charity by a different means, that of tax relief for payroll giving.

From April 1987 it will be open to any employer to set up a scheme under which employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them.

All in all, the proposals I have announced today add up to a very substantial package of assistance to charities and charitable giving.

Their cost to the exchequer will depend on how generously companies and employees respond to this initiative.

But my best estimate is that it could amount to as much as £70 million in 1987-88.

This will be partly paid for by the measures to curb abuse, which may save some £20 million a year.

I would hope, too, that the additional charitable giving these concessions stimulate will be at least twice the amount of the extra tax relief given.

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J. Personal Taxes: Taxes on spending

I now turn to the taxation of spending.

So far as the indirect taxes are concerned, the overriding question this year is how far I should recover from the oil consumer the tax revenues I have lost from the oil producer, as a result of the massive fall in the oil price.

Since November the price of petrol at the pump has fallen by roughly 12 pence a gallon.

If the oil companies had passed on the full amount of the fall in the oil price to date, the price of petrol at the pump could easily have been a further 12 pence a gallon lower still.

There is clearly scope, therefore, for a sizeable increase in petrol tax this year.

I have concluded, however, that at the present time, while I must certainly maintain the real value of the revenue I get from the motorist, I will not increase it.

But I do believe it makes sense to look again, in the light of the radically changed circumstances, at the relative weight of petrol tax and Vehicle Excise Duty.

Accordingly, I propose to increase the duty on petrol by an amount which, including VAT, would - if it were wholly passed on to the consumer - raise the price at the pump by sevenpence halfpenny a gallon.

This is twopence more than is needed to keep pace with inflation, and that enables me to keep VED at last year's level of £100 for

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cars and light vans, leaving the overall burden on the motorist unchanged in real terms.

Moreover, given the very substantial increase in the oil companies' margins, there is clearly no need for the pump price of petrol to go up at all.

Indeed, it ought to fall further.

In the same way, I propose to increase the duty on derv by an amount which - if it were wholly passed on to the consumer, which, to repeat, it should certainly not be - would raise the price at the pump by sixpence halfpenny, including VAT.

This will enable me to avoid any increase this year in the Vehicle Excise Duty on lorries, too.

So far as the other oil duties are concerned, I have one or two changes to make.

Not to the duty on heavy fuel oil, which will remain unchanged as it has done since 1980.

No mention of central heating

But I propose to increase the very modest duty on gas oil, by a penny-halfpenny a gallon.

And I propose to abolish altogether the duties on aviation kerosene, or Avtur - which at present is taxed for domestic flights only - and on lubricating oils.

All these changes in duty will take effect from 6 o'clock this evening.

Finally, so far as oil products are concerned, I am anxious to do what I reasonably can to assist the introduction of lead-free petrol.

The case for this on health grounds is clear.

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I have therefore decided to create a duty differential in its favour to offset its higher production costs.

My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

Next, tobacco.

In the light of the representations I have received on health grounds, I have decided to increase the duty on cigarettes by appreciably more than is needed to keep pace with inflation.

I therefore propose an increase in the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of approximately eleven pence on a packet of 20 cigarettes.

This will take effect from midnight on Thursday.

As last year, I propose no increase at all on the duties on cigars and pipe tobacco, which are more heavily taxed here than in most comparable countries.

Finally, drink.

As the House will recall, I was obliged in 1984 to increase the duty on beer by slightly more than I would have wished as a consequence of the judgement against the UK in the European Court of Justice.

I now propose no increase at all in the duty on beer.

Nor do I propose any increase in the duties on cider, table wine, sparkling wine, fortified wine or spirits.

This last decision will, I hope, be particularly welcome in Scotland.

Next, VAT.

I propose to stop the abuse of long stay relief for hotel accommodation, and make certain other minor changes.

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But I have no proposals for major changes in Value Added Tax this year.

The changes I have announced in the excise duties will, all told, raise an extra £795 million in 1986-87, the same amount as I would have raised had I simply increased all the excise duties in line with inflation.

The overall impact effect on the RPI, if all the increases were fully passed on, would be one half of one per cent.

This has already been taken into account in the forecast I have given the House of 3½ per cent inflation by the end of the year.

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K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to the closer integration of the tax and benefit systems.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

Yet that is what happens today.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

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To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and poverty traps for a given amount of tax relief than is possible under the present tax system.

Given the timetable of computerisation, none of this could in practice be implemented until the 1990s.

But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should be free of tax altogether.

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

This will enable them to be fully taken into account before PAYE codes are issued for 1987-88.

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However, to bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

But as hon Members will know from their postbags, it could be confusing for many old-age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating.

I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87.

The cost of this will be £15 million.

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour.

We have increased the main tax thresholds by some 22 per cent more than inflation - and the greater part of that 22 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough.

The burden of income tax is still too great.

Nothing could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

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They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for reductions in the basic rate of tax, too.

The basic rate is the starting rate of tax.

And it is the crucially important marginal rate of tax for some 95 per cent of all employees and 90 per cent of all self-employed and unincorporated businesses.

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent, rounded up.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400.

I propose to raise all the higher rate thresholds by exactly £1,000.

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This is fully in line with statutory indexation for the first - 40 per cent - higher rate, but less than half statutory indexation for the top - 60 per cent - rate.

Given the need for caution in the light of current circumstances, I do not have scope this year for a reduction in the basic rate of income tax, beyond one penny in the pound.

But this reduction from 30 per cent to 29 per cent still represents the first cut in the basic rate of income tax since my predecessor took it down from 33 per cent to 30 per cent in 1979.

So long as this Government remains in office, it will not be the last.

There will, of course, be a consequential reduction in the rate of Advance Corporation Tax.

And I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, not on the rich but on the great majority of ordinary taxpayers.

As a result of the adjustments I have made to the higher rate thresholds, the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

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They will cost £935 million in 1986-87, over and above the cost of statutory indexation.

Seven years ago, when my predecessor cut the basic rate of income tax from 33 per cent to 30 per cent, he added:

> "Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

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L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial range of measures to help the unemployed.

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy, and abolished a fourth tax.

I have announced the most substantial package of assistance to charitable giving ever, and cut the basic rate of income tax.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

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10 DOWNING STREET

From the Private Secretary 17 March 1986

CIVIL SERVICE MANPOWER

The Prime Minister was grateful for the Chancellor's minute of 14 March about the effects of the Budget on Civil Service manpower numbers.

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury.

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Treasury Chambers, Parliament Street, SW1P 3AG
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Prime Minister 2

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PRIME MINISTER

CIVIL SERVICE MANPOWER

Following my earlier minutes to you about my Budget proposals, I thought you might like a brief note on the effect of the Budget on Civil Service manpower numbers.

As last year, the most significant effect arises from the Department of Employment measures, which will require about 2,000 extra staff at April 1987 and April 1988. The largest single item is the nationwide extension of the counselling initiative and Jobstart allowance pilot schemes for the long-term unemployed, where there will be a continuing requirement, after an early peak, of about 1,000 staff. In addition, there will be an increase of 300 in the staff dealing with fraud, and a number of other more modest additions.

There will be no extra staff required in Customs and Excise. In the Inland Revenue, there will be a small reduction in 1986-87, thanks in part to a new simplified procedure for reporting benefits in kind; but in 1987-88, as the extra staffing requirements for a number of Budget measures come through, there will be a net increase of 300 staff.

On the face of it, the increases for the Department of Employment measures mean that the Government's overall manpower targets for both 1 April 1987 and 1 April 1988 will be breached. But, as John MacGregor pointed out in his minute to you of 7 March, it will in any case be necessary to look at the overall position after the Budget and make a reassessment, as part of the 1986 Public Expenditure Survey.

N.L.

14 March 1986

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

13 March 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David,

BUDGET SPEECH

I attach a complete draft of the Budget speech for you to show the Prime Minister. The Chancellor will be working on it further over the weekend, particularly on the monetary policy section.

Yours ever
Rachel

RACHEL LOMAX
Principal Private Secretary

Prime Minister

I have marked a few comments which I have passed to the Treasury as my own.

JS
14/3

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1986 BUDGET SPEECH

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A. Introduction

The background to this year's Budget is the dramatic and unprecedented fall in the world oil price.

But the Government's objectives remain unchanged: the conquest of inflation and the creation of an enterprise culture.

And the Government's policies are unchanged, too: policies of sound money and free markets.

Not least because these are the only routes to more jobs.

So my Budget today will carry forward the themes of my two previous Budgets, and sow some seeds for the future.

In the course of my speech I shall begin by reviewing the general economic background to the Budget, and go on to deal with the specific issue of oil.

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I shall then discuss monetary policy and the fiscal prospect, both this year and next.

I shall then turn to the question of direct help for the unemployed.

Finally, I shall propose some changes in taxation designed to assist in achieving the economic objectives I have already outlined.

As usual, a number of press releases, filling out the details of my 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.

The strength and durability of the current economic upswing continues to confound the commentators.

We can now look back to very nearly five years of growth at around 3 per cent a year.

Even more important, 1985 was the third successive year in which we secured the elusive combination of steady growth and low inflation - the first time this has been achieved since the 'sixties.

In 1985 as a whole, output grew by a further 3½ per cent, the highest rate of growth in the European Community, and higher than the United States, too.

Within that total non-oil exports grew by over 6 per cent, to reach yet another all-time record.

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Despite a marked slowdown in the growth of world trade from the heady pace of 1984, the current account of the balance of payments was in surplus for the sixth year in succession - this time by some £3 billion.

Inflation ended the year at around 5½ per cent and falling.

Employment continued to rise, though still not fast enough to reduce the distressingly high number of people out of work.

I shall have more to say about that later.

Manufacturing industry, the subject of so much ill-informed comment, had another successful year, with its output up by 3 per cent, its productivity by 4 per cent, its investment by 5 per cent, and its exports by 6 per cent.

As the London Business School recently observed, looking at Britain's recent performance:

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"There has been no previous five year period in recent history over which manufacturing industry has been so successful in holding its market share, and in keeping pace with world output".

At the heart of this success lies a remarkable turn-around in productivity.

In the six years prior to 1979, Britain's annual rate of growth of manufacturing productivity, at less than 1 per cent, was the lowest of all the Group of Five major industrial nations.

In the six years since 1979, our annual rate of growth of manufacturing productivity, at 3½ per cent, has been second only to that of Japan.

Looking ahead, I expect 1986 to be a further year of steady growth with low inflation.

Indeed, with output forecast to rise by 3 per cent, and inflation to fall to 4 per cent, 1986 is set to register our best overall performance for a generation.

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The pattern of growth should also show a satisfactory balance, with exports and investment expected to grow rather faster than consumer spending - as indeed they have during the sustained upswing as a whole.

But the uncertainties inherent in all these forecasts, good though their track record has been, is reinforced by constant reminders that we live in an uncertain and turbulent world.

One particular difficult aspect of this is the febrile nature of the world currency markets.

There has been some improvement here.

The Plaza Agreement between the Group of Five Finance Ministers last September has undoubtedly led to a more sustainable pattern of exchange rates worldwide.

Since Plaza, the dollar has fallen by some (15) per cent against the other major currencies as a whole, with the pound moving up by (5) per cent, the Deutschemark by (20) per

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cent and the Yen by (30) per cent - a pattern broadly in line with what those of us who were party to the agreement intended.

This process will be assisted further if the passage of the Gramm-Rudman amendment succeeds in securing its objective of a much-needed reduction in the United States budget deficit.

Meanwhile, the Plaza Agreement has already succeeded in reducing, at least for the time being, the dangerous protectionist pressures that were building up in the United States.

Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on.

But the most dramatic development on the world economic scene, and one of considerable importance to this country, has of course been the collapse in the price of oil.

It is to that I now turn.

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C. **Oil**

I presented my Budget last year at the end of a 12-month coal strike.

I observed at the time that it was a remarkable tribute to the underlying strength of the British economy that it had been able to withstand so long and damaging a strike in such good shape.

We now have to face a challenge of a very different kind.

Over the past few months the price of oil has almost halved, and with it our North Sea oil tax revenues and earnings from oil exports.

Not surprisingly, perhaps, this initially caused a fair amount of turmoil in the financial markets, with sterling falling by some 8 per cent.

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I decided that it was right to respond with an immediate one per cent rise in short term interest rates in early January, and this helped to prevent the downward movement of the exchange rate from developing an unhealthy momentum of its own.

But equally I thought it right to resist the for a time very strong, but to my mind unjustified, pressure to raise interest rates still further.

That pressure now appears to have subsided.

[There has been some speculation that the turbulence in the oil market, which from time to time has fed through into the financial markets, has been deliberately exacerbated by some leading OPEC countries in an attempt to force the United Kingdom to cut back its own oil production and thus become a de facto member of the cartel.

Omit the passage in [ ]: it would give unnecessary offence eg to the Saudis.

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It has even been suggested that the decision to hold a meeting of OPEC Ministers to coincide with today's Budget is part of that same process.

I have to say that, if any such tactics are indeed being employed, those employing them are wasting their time.

There is no question whatever, and never has been any question, of the UK cutting back its oil production in order to secure a higher oil price.

In the first place, the whole outstanding success of the North Sea has been based on the fact that it is the freest oil province in the world, in which decisions on levels of output are a matter for the companies and not for the Government.

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other

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goods and services, and a major oil consumer: there is no overall UK national interest in keeping oil prices high.

I am aware that a Report, recently published in another place, which attracted a certain amount of publicity at the time, predicted that

> "as the oil revenues diminish the country will experience adverse effects which will worsen with time"

- effects of a most alarming nature.

Had the authors of that Report dreamed at the time that half the oil revenues would disappear within a matter of months, their conclusions would no doubt have been even more apocalyptic.

As the House knows, I have always believed their analysis to have been profoundly mistaken.

But certainly it is going to be put to the test sooner than anyone expected.

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The United Kingdom is likely to remain an oil producer, of a gradually diminishing volume of oil, for the next 25 years or so.

If we can survive unscathed the loss of half our North Sea oil revenues in less than 25 weeks, then the prospective loss of the other half over the remainder of the next 25 years should not cause us undue concern.

It is, of course, true that in relative terms we do lose from the collapse of the oil price. That is to say, the really big gains will be made by the major non-oil-producing countries such as Germany and Japan, where growth will be boosted and inflation, already low, is likely to fall virtually to zero.

But the oil price fall will be beneficial for the industrialised world as a whole, and even for the United Kingdom what we gain on the swings will more than offset what we lose on the roundabouts.

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To be precise, I expect that the levels of economic activity and inflation will if anything be slightly better than what they would have been without the oil price collapse.

And what of the balance of payments?

Thanks to the abolition of exchange control in 1979, we have been able to use a good part of our earnings from North Sea oil since then to build up a massive stock of overseas assets.

Our net overseas assets have in fact risen more than sevenfold from £12 billion at the end of 1979 to some £85 billion at the end of last year.

This is a far bigger total than that possessed by any other European country, and bigger than the United States, too.

The earnings from those assets will be of increasing value to our balance of payments in the years ahead.

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So, too, should the improvement in our manufacturing trade balance.

For while the British economy may not gain a great deal overall as a result of the oil price collapse, there will be considerable differences within the economy.

The major gainer will be the internationally traded sector of industry in general, and manufacturing in particular, which is already enjoying both lower oil prices and a lower exchange rate against its major competitors.

This provides British industry with an outstanding opportunity both to increase its exports and reduce import penetration in the home market.

It has no excuse for not seizing that unique opportunity.

But it will only be able to do so if it meets two conditions.

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First, it must keep firmer control of its labour costs.

Second, it must spend more of its much healthier level of profits on investing for the future in Research and Development and in training.

Both the opportunity, and the responsibility to see that it is not thrown away, rest fairly and squarely on the shoulders of British management.

Meanwhile, despite the massive fall in oil prices, I expect the current account of the balance of payments to remain in sizeable surplus this year, by some £3½ billion.

As I have said, there will be gainers and losers within the economy.

If industry is the main gainer, the main loser, at least in the short term, is the Chancellor of the Exchequer.

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Clearly, what is good for the British economy is not always good for the Chancellor.

I can live with that.

But it does mean that North Sea oil revenues, which are likely to amount to not far short of £12 billion for 1985-86, are bound to be very much less in 1986-87.

Indeed, on the assumption of an average North Sea oil price of $15 a barrel, which is close to the average for the past month of $16 a barrel, oil revenues in 1986-87 will be virtually halved at some £6 billion.

This has obvious implications for the Budget.

But the important fact is that, just as we successfully weathered a year long coal strike, we have been able to take the unprecedented collapse in the oil price in our stride.

We have been able to do so, first, because of the underlying strength of the economy in terms of growth, inflation and the external account.

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And, second, by virtue of the reputation we have earned over seven years for sound and prudent financial management.

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This section is being heavily rewritten.

D. Monetary Policy

The framework within which that sound and prudent financial management has been pursued, and will continue to be pursued, is the Government's Medium Term Financial Strategy. As usual, I am extending it forward a year.

At the heart of the MTFS lies the objective of steadily reducing the growth of total spending power in the economy, as measured by GDP in cash terms, over a period of years, at a pace that will gradually squeeze inflation out of the system while at the same time leaving adequate room for real growth.

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

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Last year I set target ranges of 3 to 7 per cent for narrow money and 5 to 9 per cent for broad money, or liquidity.

Over the 12 months to mid-February, the targeted measure of narrow money, M0, grew towards the bottom of its range, but that of broad money, £M3, at well above the top of its range.

In my speech at the Mansion House last October, I explained why this was so, and how monetary policy would henceforth be conducted.

Consistent with that, I shall be retaining the same two target aggregates for next year.

For narrow money, the target range for 1986-87 will be that indicated in last year's MTFS, namely 2 to 6 per cent.

For broad money it will be 11 to 15 per cent.

This reflects the well-established demand, at a time of low inflation and significantly positive real interest rates, to hold a higher proportion of savings in liquid form.

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It is thus wholly consistent with a further decline in inflation, which it is the Government's firm intention to achieve.

In operating policy, it will of course continue to be necessary to have regard to a range of other evidence about monetary conditions, of which the most important is the exchange rate. The only effective instrument of monetary policy is the level of short-term interest rates.

There is thus necessarily some difference in status between the targets for narrow and broad money.

Further details are given in the Red Book.

The House will, I know, be glad to learn that that is all I propose to say about monetary policy today - except to repeat what I said at the Mansion House, that the acid test of moentary poilicy is its success in reducing inflation.

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The proof of the pudding is in the eating.

I shall be giving a fuller exposition of the Government's monetary policy, and how it is conducted, at an early date.

[Consider "standard" insert on interest rates and pay, as explanation (in part) of why ours are so high]

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E. Public Sector Borrowing

Monetary policy must always be supported by an appropriate fiscal policy.

That means, in plain English, keeping public sector borrowing low.

The outturn for the public sector borrowing requirement in 1984-85, which had to bear the bulk of the cost of resisting the coal strike, was £10 billion, or just over 3 per cent of GDP.

In my Budget last year I planned to reduce it substantially in 1985-86, to £7 billion, or 2 per cent of GDP.

In the event, despite the loss of £2 billion of North Sea oil revenue, this year's PSBR looks like turning out at a little under £7 billion,

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given that the total for the first eleven months comes to under £3 billion.

This successful outcome, which represents the most substantial reduction in the PSBR as a proportion of GDP since 1981-82, is attributable to two factors.

First, public expenditure has been kept under firm control.

Not only is the outturn likely to be well within the planning total, but spending in 1985-86 is expected to be below the previous year's level in real terms, even after allowing for the effects of the coal strike.

And the second factor behind the successful PSBR outturn for 1985-86 is that the £2 billion shortfall in oil revenues has been offset by the increased buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

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Last year's MTFS indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP.

Some would argue that, in the light of the £2½ billion increase in projected privatisation proceeds, I ought to aim well below that.

Others would claim that, since the sharp drop envisaged in oil revenues is more than double the rise in privatisation proceeds, a higher figure would be appropriate.

As last year, my judgement is that the wisest course is to stick broadly to our pre-announced figure.

But given the uncertainties over the oil price, I have decided, within that framework, to err on the side of caution, and provide for a PSBR of £7 billion, or 1¼ per cent of GDP.

Needless to say, this does not enable me to reduce taxation by anything like the £3½ billion foreshadowed in last year's MTFS.

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Drop described as £12bn to £6bn earlier on.

Indeed, given the assumed loss of more than £5 billion of oil revenues in 1986-87, compared with what was envisaged a year ago, I would have expected to have had to increase taxes in this year's Budget.

However, not only have the tax revenues this year from the 95 per cent of the economy that is not oil proved to be notably buoyant, but there is every sign that this will continue into 1986-87, assisted by a rather higher rate of economic growth than was foreseen in last year's MTFS.

This continued vigour of the non-North Sea economy, which is likely to add more than £3 billion to expected non-North Sea tax revenues, coupled with public spending which remains under firm control, has transformed what might have been a bleak prospect.

As a result, I am able this year to accommodate a relatively modest net reduction in the burden of taxation, of a shade under £1 billion.

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[It may well be, of course, that the oil price turns out to be different from the $15 a barrel I have assumed for this year's Budget.

If any departure is purely short term, that is most unlikely to have any significance for policy.

But even if it is more than short term, the cautious fiscal stance I have decided to adopt puts us in a sound position to take it in our stride.]

This passage creates a presumption against action if the oil prices falls further. This is probably realistic but note that in 1982 Sir G Howe said:

"If there was to be a prolonged fall in the oil price ... it would be wholly irresponsible of me to rule out the possibility of having to take action to correct the fiscal balance ..."

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F. Help for the unemployed

I turn first to the continuing problem of high unemployment.

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It is a problem that can be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.

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The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables workers to be priced into jobs instead of

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pricing them out of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's weakness lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly. But pay is rising faster still.

It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

And I have to say that, in a free economy - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's

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The new and expanded YTS will duly come into operation next month.

It will be a giant step towards our objective of ensuring that no youngster under the age of 18 need be unemployed.

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, or, in the case of those between 18 and 24, for more than six months.

The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 250,000 places - very nearly double the number that existed a year ago.

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At the same time, the average wage limit for the Community Programme will be raised to £67 a week from next month.

Last November my Rt. Hon. and Noble Friend announced two new pilot schemes to provide further help for the long-term unemployed. These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and a Jobstart allowance of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week. The pilot schemes are already proving effective, and I have accordingly decided to provide the funds to develop these imaginative new initiatives into a single programme covering the entire country.

This means that every single one of the long-term unemployed throughout the land will

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be called to interviews and offered help in finding a job.

I shall also be providing the resources to launch a new scheme - the New Workers Scheme - to help 18-20 year olds to find a job. This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week.

The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.

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Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be increased from its present rate of 64,000 to 100,000 by April 1987, and to provide more training for those involved.

At the same time I propose to improve the tax treatment of payments made under this scheme.

The total public expenditure cost of the measures I have outlined comes to £195 million in 1986-87 and £290 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £100 million in 1986-87 and £165 million in 1987-88.

This will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

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G. Business and Enterprise

I now turn to the taxation of business and enterprise.

While the measures I have just announced help the unemployed directly, in the long run what really matters is the creation of a climate in which business and enterprise flourish.

For it is business and enterprise, not Government, who create jobs.

The new and improved system of business taxation which I introduced in my 1984 Budget has reached the end of its transitional phase and comes fully into force next month.

From then on the United Kingdom will have, at 35 per cent, the lowest rate of Corporation Tax of any major industrial nation.

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This year I have only two further amendments to make.

First, I propose to ensure a full measure of depreciation for tax purposes for short life agricultural buildings and works, by giving the taxpayer the option of making balancing adjustments on the sale or destruction of such buildings.

Second, I propose to reform the mines and oil wells allowances broadly along the lines of the proposals published in last July's consultative document.

The overall net benefit of this to the industries concerned will amount to £45 million in 1987-88.

Otherwise I propose only minor technical changes to the taxation of North Sea oil; but I am continuing to keep the economics of incremental investment under review, and shall not hesitate to introduce at the earliest

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opportunity any changes which may prove necessary.

I need to set the 1987-88 car and fuel benefit scale charges for those with company cars.

At the same time the motor industry have represented to me that the discrepancy between the engine size break points in these scales and the break points in the new European Community directive on car exhaust emissions is potentially damaging to their international competitiveness.

Accordingly I propose from April 1987, to change our break points to those in the new directive.

At the same time, as last year, I propose to increase the (restructured) car benefit scale charges by 10 per cent.

This will still leave the scale charges well short of the true value of the benefit.

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The fuel scale will also be restructured, but the charges will remain unchanged; and as from April 1987 it will also be used to assess the VAT due on petrol used by registered traders and their employees.

This will be simpler and more equitable than the present system, and will also bring in an extra £40 million of revenue in 1987-88.

I propose to increase the VAT threshold to £20,500 from midnight tonight.

I also propose to rectify an anomaly in the taxation of international entertainers and sportsmen.

When British entertainers or sportsmen work overseas, the foreign tax authorities normally levy a withholding tax on their earnings.

But at the present time we levy no such tax on the earnings of foreign entertainers and sportsmen visiting the UK.

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I believe that, in future, we should fall into line with most of the rest of the world.

Accordingly, I propose to introduce a withholding tax of 30 per cent - the same rate as applies in the United States - on the earnings of overseas entertainers and sportsmen in the UK. This should yield £75 million in 1987-88.

A key element in the Government's strategy for jobs is the encouragement of new businesses.

As the House knows, I have been reviewing the future of the Business Expansion Scheme, which is due to come to an end in April 1987.

I have been assisted in this review by the independent report commissioned by the Inland Revenue from the consultants Peat, Marwick and Mitchell, which is being published in full today.

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I am placing a copy in the Library of the House.

It is quite clear - and this is confirmed by the evidence in the Peat Marwick report - that the Business Expansion Scheme, which my predecessor introduced in 1983 as an improvement on the 1981 Business Start-up Scheme, has been an outstanding success.

It has fully achieved its aim of attracting new equity capital into unquoted companies.

It has been attracting well over £100 million a year, a high proportion of which has gone into new and small businesses.

Well over half the companies involved raised sums of less than £50,000 each.

I therefore have no hesitation in proposing to extend the life of the Business Expansion Scheme indefinitely.

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But at the same time, despite the exclusions of farmland and property development in my two previous Budgets, I am concerned that too much BES money is being diverted from the high risk areas for which the scehme was always intended into areas where the risk is very much less.

Accordingly, I propose, from now on, to exclude from the scheme all companies holding more than half their assets in the form of land and buildings.

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I also propose to exclude companies whose main purpose is to invest in objects, such as fine wines, whose value may be expected to rise over time.

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And I have decided to bring within the scope of BES companies engaged in the chartering of UK-registered ships.

This will provide new opportunities for successful investment in both new and secondhand tonnage in the hard-pressed coastal, short sea and offshore trades.

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I propose to take power to make further changes in the ambit of the scheme by Order.

Finally, having taken steps to target the Business Expansion Scheme more carefully, I propose to improve it.

BES shares issued after today will be entirely free of Capital Gains Tax on their first sale.

And as a further measure of help for small and new businesses, the Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying bank loans, will also be extended, in this case for a further three years.

My hon Friends will be glad to learn that the premium will be halved from 5 per cent to 2½ per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its

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Introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running unquoted family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.

In addition to statutory indexation of the threshold and rate bands, I propose this year to reform the tax radically.

In essence, the Capital Transfer Tax is two taxes, as its two separate scales imply: an inheritance tax and a lifetime gifts tax.

We have had an inheritance tax in some shape or form ever since Lord Harcourt introduced the Estate Duty in 1894.

But the lifetime gifts tax which the Labour Government introduced in 1974, in the teeth of wholehearted Conservative opposition, is an unwelcome and unwanted impost.

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By deterring lifetime giving, it has had the effect of locking in assets, particularly the ownership of family businesses, often to the detriment of the businesses concerned.

Accordingly, I propose to abolish entirely the tax on lifetime gifts to individuals.

As with the old Estate Duty, there will be a tapered charge on gifts made within seven years of death and provisions to charge gifts made with reservation; and the regime for trusts, which is needed as a protection for the death charge, will be kept broadly unchanged.

The cost of abolishing the tax on lifetime giving will be £35 million in 1986-87 and £55 million in 1987-88.

In recognition of the radically changed nature of the tax I have decided to rename it the Inheritance Tax.

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My two previous Budgets abolished three unnecessary taxes.

The National Insurance Surcharge, the Investment Income Surcharge, and Development Land Tax.

The abolition of the tax on lifetime gifts adds a fourth.

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H. Savings and Investment

I now turn to the taxation of savings and investment.

In my 1984 Budget I introduced a major reform of the taxation of savings and investment designed to improve the direction and quality of both.

Today I propose to carry this reform further forward.

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The Social Security Bill now before Parliament proposes important and far-reaching changes in pension provision, notably by encouraging the growth of personal pensions.

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Those changes - to which the Government attach the utmost importance - have been warmly welcomed, both for the greater freedom they will give to existing pension scheme members

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and for the new scope they will offer to the millions of working people who are not in an occupational pension scheme.

In the light of these changes, I intend later this year to publish detailed proposals designed to give personal pensions the same highly favourable tax treatment as is currently enjoyed by retirement annuities.

Publication of these proposals will enable there to be the widest possible consultation prior to legislation in next year's Finance Bill.

Meanwhile, I can assure the House that, as I made clear last year, I have no plans to change that favourable tax treatment.

But I do need to deal with the growing problem of pension fund surpluses.

The dramatic improvement in the financial climate compared with a decade ago, most notably as a result of the sharp fall in

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inflation, has seen a number of pension funds become heavily overfunded.

This presents a double problem, both aspects of which the Inland Revenue is at present having to deal with through the exercise of its discretionary powers.

In the first place, excessive surpluses, even if they arise unintentionally, represent the misuse of a tax privilege which was intended to assist the provision of pensions, and for no other purpose.

So the Inland Revenue requires from time to time that surpluses be diminished.

But at the same time the Revenue feels obliged to turn down many of the increasing number of requests from companies which, often for good reasons, wish to take refunds from their pension funds into the company itself.

The absence of clear rules on how surpluses should and may be dealt with, and the

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consequent reliance that has to be placed on the exercise by the Inland Revenue of its discretion, have created considerable uncertainty and unnecessarily constrained trustees' freedom of action.

I therefore propose to replace these discretionary arrangements with clear and objective statutory provision.

In future, the amount of any surplus in a fund will be determined for tax purposes in accordance with standard published guidelines, based on a secure funding method and prudent actuarial assumptions, as advised by the Government Actuary.

Where a surplus is 5 per cent or less of total assets no action will need to be taken.

Where it is higher than that action will be required to eliminate the excess.

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It will be entirely a matter for the trustees and employers to decide whether the reduction is to be achieved by increasing benefits, or reducing contributions, or making a refund to the company.

If, and only if, they choose to make a refund, the company will be liable to tax at a rate of 40 per cent of the amount refunded, so as broadly to recover the tax relief previously given.

The effect of these new arrangements is likely to be a yield of £25 million in 1986-87 and £120 million in 1987-88.

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Next, Stamp Duty.

I have no change to propose in the stamp duty on houses and other property.

But despite the all-round reduction in Stamp Duty to 1 per cent which I made in my 1984 Budget, there is a formidable case this year

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for a further reduction in the rate of stamp duty on share transfers.

The City of London is the pre-eminent financial centre of Europe.

The massive £6 billion it contributes to our invisible exports is but one measure of the benefit this confers on the British economy.

But competition in financial services nowadays is not continental, but global.

The City revolution now under way, due to culminate with the ending of fixed commissions - the so-called Big Bang - on 27 October, is essential if London is to compete successfully against New York and Tokyo.

And if London cannot win a major share of the global securities market, its present world pre-eminence in other financial services will be threatened.

Successful competition depends on a number of factors, but one of the most important is the level of dealing costs.

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The abolition of fixed commissions will certainly help.

But with no tax at all on share transactions in New York, and roughly ½ per cent in Tokyo, London will still be vulnerable.

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I therefore propose to reduce Stamp Duty on share transactions from 1 per cent to ½ per cent as from the date of the Big Bang, currently scheduled for 27 October.

But I believe it is right that the cost of this should be met from within the financial sector itself.

B.L.O.

Accordingly, I propose to bring into tax at the new ½ per cent rate a range of financial transactions which are at present entirely free of Stamp Duty.

These include transactions in loan stock other than short bonds and gilt edged securities, transactions unwound within a Stock Exchange

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account, letters of allotment, the purchase by a company of its own shares, and takeovers and mergers.

There will also be a special rate of 5 per cent on the conversion of UK shares into ADRs and other forms of depositary receipt.

Some of these changes, including the new ADR charge, will take effect immediately: others will be delayed until the Big Bang.

This further halving of the stamp duty on equities should enable London to compete successfully in the worldwide securities market.

It will also provide a further fillip to wider share ownership in the UK.

Just as we have made Britain a nation of home owners, it is the long-term ambition of this Government to enable the British people to become a nation of share-owners, too; to create

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popular?

a people's capitalism, in which more and more men and women have a direct personal stake in British business and industry.

Both through the rapid growth of employee share schemes, and through the massively successful privatisation programme, much progress has been made.

But not enough.

Nor, I fear, will we ever achieve our goal so long as the tax system continues to discriminate so heavily in favour of institutional investment rather than direct share ownership.

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B.L.O.

Accordingly I propose to introduce a radical new scheme to encourage direct investment in UK equities.

Starting next January, any adult will be able to invest up to £200 a month, or £2400 a year, in shares.

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These will be held in a special account which I am calling a Personal Equity Plan.

So long as the investment is kept in the plan for a minimum period, at most two years, all reinvested dividends, and all capital gains on disposals, will be entirely free of tax.

The longer the investment is kept in the plan, the more the tax relief will build up and the greater will be the rewards.

Although the scheme will be open to everyone, it is specially designed to encourage smaller savers, and particularly those who may never previously have invested in equities in their lives.

So the plans will be simple and flexible to operate.

Anyone who is legally permitted to deal in securities will be able to act as a plan manager.

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But the investor himself will own the shares - and the rights that go with them, including voting rights.

And it will be for the investor to choose whether to make the investment decisions himself or to give the plan manager authority to act on his behalf.

The cost of the scheme will be around £25 million in 1987-88, but will build up in later years as more plans are taken out.

This is a substantial, innovative and exciting new scheme.

I am confident that, over time, it will bring about a dramatic extension of share ownership in Britain.

Although wholly different in structure from the Loi Monory in France, I expect it to be every bit as successful in achieving its objective.

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I am sure the whole House will welcome this far-reaching package of measures to reform the taxation of savings and investment.

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I. Charities

I now turn to the tax treatment of charities and charitable giving.

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In almost every facet of the nation's affairs it becomes increasingly clear that private action is more effective than State action. This is particularly well illustrated by the success of charitable organisations up and down the land in the fields of education, social welfare, medicine, the arts and the heritage.

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This Government has already done a great deal to assist charities, both through the tax system and in other ways.

I believe the time has come to take a further step forward.

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The fundamental question is whether any further fiscal relief should be given to the charities themselves, through relief from VAT, or to the act of giving.

In the light of representations from the Charities VAT Reform Group, I am prepared this year, exceptionally, to make a number of specific concessions on this front.

I propose to relieve charities from VAT on their non-classified press advertising; on medicinal products where they are engaged in the treatment or care of people or animals, or in medical research; on lifts and distress alarm systems for the handicapped; on refrigeration and video equipment purchased by charities from donated funds; on recording equipment used by charities for the blind; and on welfare vehicles used by charities to transport the deaf, blind or mentally handicapped.

An oddly miscellaneous list. Better perhaps to mention only one or two.

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The cost of these reliefs is some £10 million.

But in general I am convinced that the right way to help charities is not by relieving the charities themselves from VAT, but by encouraging the act of charitable giving.

I say this for two principal reasons.

First, it is clearly better that the amount of tax relief is related to the amount of support a charity is able to attract, rather than to the value of goods and services it happens to purchase.

And, second, whereas a £ of VAT relief is worth precisely that, a £ of tax relief on giving is likely to generate more than a £ of income going to charity.

My principal proposals therefore relate directly to the act of giving to charity.

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First, I propose to abolish altogether the upper limit on relief at the higher rates of income tax on charitable covenants.

At the same time I propose to act to stop the abuse of the tax system by ensuring that tax relief goes only to money which is used directly for charitable purposes.

Next, companies.

It is widely believed that corporate giving to charity would be more generous than it is at present if tax relief did not depend on the company entering into a four-year covenant or some form of sponsorship arrangement.

Accordingly, I propose to allow companies (other than close companies) to enjoy tax relief on one-off gifts to charity up to a maximum of 3 per cent of the company's annual dividend payment to its share-holders.

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There will, of course, continue to be no limit on the amount a company can covenant to charity.

I do not, however, propose to extend a similar relief for one-off donations by individuals. Quite apart from the administrative costs, which would be formidable, many charities have made clear to me their fear that to do this would weaken them by reducing the stability they enjoy as a result of the binding force of covenants.

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Instead, I propose to encourage individual giving to charity by a different means, that of payroll giving.

From April 1987 it will be open to any employer to set up a scheme under which employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them.

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All in all, the proposals I have announced today add up to a very substantial package of assistance to charities and charitable giving. Their cost to the exchequer will depend on how generously companies and employees respond to this initiative.

But my best estimate is that it could amount to £50 million in 1987-88.

This will be partly paid for by the measures to curb abuse, which may save as much as £20 million a year.

The additional charitable giving these concessions stimulate should be at least twice the cost of the tax relief given.

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J. Personal Taxes: Taxes on spending

Finally, I turn to the taxation of spending and income.

So far as the indirect taxes are concerned, the overriding question this year is how far I should recover from the oil consumer the tax revenues I have lost from the oil producer, as a result of the massive fall in the oil price. So far this year the price of petrol at the pump has fallen by roughly 11 pence a gallon. If the oil companies had passed on the full amount of the fall in the oil price to date, the price of petrol at the pump could easily have been a further 10 pence a gallon lower still.

There is clearly scope, therefore, for a sizeable increase in petrol tax this year.

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I have concluded, however, that at the present time, while I must certainly maintain the real value of the revenue I get from the motorist, I will not increase it.

But I do believe it makes sense to look again, in the light of the radically changed circumstances, at the relative weight of petrol tax and Vehicle Excise Duty.

Accordingly, I propose to increase the duty on petrol by an amount which, including VAT, would - if it were wholly passed on to the consumer - raise the price at the pump by sevenpence halfpenny a gallon.

This is twopence more than is needed to keep pace with inflation, and that enables me to keep VED at last year's level of £100 for cars and light vans, leaving the overall burden on the motorist unchanged in real terms.

Moreover, given the fat that has accumulated in the oil companies' margins, there is clearly no

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need for the pump price of petrol to go up at all.

In the same way, I propose to increase the duty on derv by an amount which would - if it were wholly passed on to the consumer, which it should not be - raise the price at the pump by sixpence halfpenny, including VAT.

This will enable me to avoid any increase this year in the Vehicle Excise Duty on lorries, too.

So far as the other oil duties are concerned, I have one or two changes to make.

Not to the duty on heavy fuel oil, which will remain unchanged as it has done since 1980.

But I propose to increase the very modest duty on gas oil, much of which is used for central heating, by a penny-halfpenny a gallon.

And I propose to abolish altogether the duties on aviation kerosene, or Avtur - which at

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present is taxed for domestic flights only - and on most lubricating oils.

All these changes in duty will take effect from 6 o'clock this evening.

Finally, so far as oil products are concerned, I am anxious to do what I reasonably can to assist the introduction of lead-free petrol.

The case for this on health grounds is clear. I have therefore decided to create a duty differential in its favour to offset its higher production costs.

My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

Next, tobacco.

In the light of the representations I have received on health grounds, I have decided to increase the duty on cigarettes by appreciably

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more than is needed to keep pace with inflation.

I therefore propose an increase in the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of approximately eleven pence on a packet of 20 cigarettes.

This will take effect from midnight on Thursday.

As last year, I propose no increase at all on the duties on cigars and pipe tobacco.

Finally, drink.

As the House will recall, I was obliged in 1984 to increase the duty on beer by slightly more than I would have wished as a consequence of the judgement against the UK in the European Court of Justice.

I now propose no increase at all in the duty on beer - for the first time since 1979.

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Nor do I propose any increase in the duties on cider, table wine, sparkling wine, fortified wine or spirits.

This last decision will, I hope, be particularly welcome to the Scotch Whisky industry.

I have no major proposals for changes in Value Added Tax.

The changes I have announced in the excise duties will, all told, raise an extra £795 million in 1986-87, the same amount as I would have raised had I simply increased all the excise duties in line with inflation.

The overall impact effect on the RPI, if all the increases were fully passed on, would be one half of one per cent.

This has already been taken into account in the forecast I have given the House of 4 per cent inflation by the end of the year.

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K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to the closer integration of the tax and benefit systems.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with

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the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

Yet that is what happens at the present time.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

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To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and poverty traps for a given amount of tax relief than is possible under the present tax system. Given the timetable of computerisation, none of this could in practice be implemented until the 1990s.

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But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

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Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should be free of tax altogether.

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

This will enable them to be fully taken into account before PAYE codes are issued for 1987-88.

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However, to bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

The increases have been criticised by some as derisory.

I wholly reject that allegation.

Surely a page and a half on this is too much.

They are fully in line with the rise in the cost of living over the relevant period; and to suggest that pensioners and others would sooner have high inflation and high upratings than low inflation and correspondingly low upratings is sheer poppycock.

But I do accept that it could be confusing for many old-age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating.

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I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87. The cost of this will be £15 million.

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour.

We have increased the main tax thresholds by some 20 per cent more than inflation - and the greater part of that 20 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough. The burden of income tax is still too great.

Nothing could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and

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specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for reductions in the basic rate of tax, too.

The basic rate is the starting rate of tax.

And it is the crucially important marginal rate of tax for 95 per cent of all employees and

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over 90 per cent of all self-employed and unincorporated businesses.

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent, rounded up.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400.

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I propose to raise all the higher rate thresholds by exactly £1,000.

Thus the first higher rate of 40 per cent will be reached at a taxable income of £17,200, in line with statutory indexation, and the top rate of 60 per cent will apply to taxable income above £41,200 - some £1,500 less than statutory indexation.

Given the need for caution in the light of current circumstances, I do not have scope this year for a reduction in the basic rate of income tax, beyond one penny in the pound.

But this reduction from 30 per cent to 29 per cent still represents the first cut in the basic rate of income tax since 1979.

And so long as this Government remains in office, it will not be the last.

I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

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The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, not on the rich but on the great majority of ordinary taxpayers.

Thus the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

They will cost £935 million in 1986-87, over and above the cost of statutory indexation.

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Seven years ago, when my predecessor cut the basic rate of income tax from 33 per cent to 30 per cent, he added:

> "Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

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L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

Too long a formation?

No - a good summary.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial range of measures to help the unemployed.

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy and abolished outright a fourth tax.

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I have announced the most substantial package of assistance to charitable giving ever, and proposed the first cut in the basic rate of income tax for seven years.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

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FROM: MRS R LOMAX
DATE: 13 March 1986

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COPY Nº: 37 OF 51

MR CASSELL

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Kemp
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Battishill - IR
Mr Isaac - IR
Mr McManus - IR
PS/IR

Sir A Fraser - C&E
Mr Knox - C&E
PS/C&E

Mr Norgrove - No.10

Section C only
Mr Peretz
Mr Riley
Mr Kelly
Mr Walsh
Mr Robson
Mr Haache

Section E only
Mr Turnbull
Miss Peirson
Mr Riley

BUDGET SPEECH (FOURTH DRAFT): SECTIONS C AND E

I now attach a redraft of section E, which was missing from the version of the speech circulated last night; there are also one or two small consequential changes to section C, which I am therefore recirculating. The remaining section of the speech - section D on monetary policy - will be circulated shortly.

2. I would be grateful if you would conduct a thorough final check for factual accuracy, and let me have any comments no later than 10.00 am on Friday 14 March.

RACHEL LOMAX

C. Oil

I presented my Budget last year at the end of a 12-month coal strike.

I observed at the time that it was a remarkable tribute to the underlying strength of the British economy that it had been able to withstand so long and damaging a strike in such good shape.

We now have to face a challenge of a very different kind.

Over the past few months the price of oil has almost halved, and with it our North Sea oil tax revenues and earnings from oil exports.

Not surprisingly, perhaps, this initially caused a fair amount of turmoil in the financial markets, with sterling falling by some 8 per cent.

I decided that it was right to respond with an immediate one per cent rise in short term interest rates in early January, and this helped to prevent the downward movement of the exchange rate from developing an unhealthy momentum of its own.

But equally I thought it right to resist the for a time very strong, but to my mind unjustified, pressure to raise interest rates still further.

That pressure now appears to have subsided.

There has been some speculation that the turbulence in the oil market, which from time to time has fed through into the financial markets, has been deliberately exacerbated by some leading OPEC countries in an attempt to force the United Kingdom to cut back its own oil production and thus become a de facto member of the cartel.

It has even been suggested that the decision to hold a meeting of OPEC Ministers to coincide with today's Budget is part of that same process.

I have to say that, if any such tactics are indeed being employed, those employing them are wasting their time.

There is no question whatever, and never has been any question, of the UK cutting back its oil production in order to secure a higher oil price.

In the first place, the whole outstanding success of the North Sea has been based on the fact that it is the freest oil province in the world, in which decisions on levels of output are a matter for the companies and not for the Government.

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other

goods and services, and a major oil consumer: there is no overall UK national interest in keeping oil prices high.

I am aware that a Report, recently published in another place, which attracted a certain amount of publicity at the time, predicted that

> "as the oil revenues diminish the country will experience adverse effects which will worsen with time"

- effects of a most alarming nature.

Had the authors of that Report dreamed at the time that half the oil revenues would disappear within a matter of months, their conclusions would no doubt have been even more apocalyptic.

As the House knows, I have always believed their analysis to have been profoundly mistaken.

But certainly it is going to be put to the test sooner than anyone expected.

The United Kingdom is likely to remain an oil producer, of a gradually diminishing volume of oil, for the next 25 years or so.

If we can survive unscathed the loss of half our North Sea oil revenues in less than 25 weeks, then the prospective loss of the other half over the remainder of the next 25 years should not cause us undue concern.

It is, of course, true that in relative terms we do lose from the collapse of the oil price. That is to say, the really big gains will be made by the major non-oil-producing countries such as Germany and Japan, where growth will be boosted and inflation, already low, is likely to fall virtually to zero.

But the oil price fall will be beneficial for the industrialised world as a whole, and even for the United Kingdom what we gain on the swings will more than offset what we lose on the roundabouts.

To be precise, I expect that the levels of economic activity and inflation will if anything be slightly better than what they would have been without the oil price collapse.

And what of the balance of payments?

Thanks to the abolition of exchange control in 1979, we have been able to use a good part of our earnings from North Sea oil since then to build up a massive stock of overseas assets.

Our net overseas assets have in fact risen more than sevenfold from £12 billion at the end of 1979 to some £85 billion at the end of last year.

This is a far bigger total than that possessed by any other European country, and bigger than the United States, too.

The earnings from those assets will be of increasing value to our balance of payments in the years ahead.

So, too, should the improvement in our manufacturing trade balance.

For while the British economy may not gain a great deal overall as a result of the oil price collapse, there will be considerable differences within the economy.

The major gainer will be the internationally traded sector of industry in general, and manufacturing in particular, which is already enjoying both lower oil prices and a lower exchange rate against its major competitors.

This provides British industry with an outstanding opportunity both to increase its exports and reduce import penetration in the home market.

It has no excuse for not seizing that unique opportunity.

But it will only be able to do so if it meets two conditions.

First, it must keep firmer control of its labour costs.

Second, it must spend more of its much healthier level of profits on investing for the future in Research and Development and in training.

Both the opportunity, and the responsibility to see that it is not thrown away, rest fairly and squarely on the shoulders of British management.

Meanwhile, despite the massive fall in oil prices, I expect the current account of the balance of payments to remain in sizeable surplus this year, by some £3½ billion.

As I have said, there will be gainers and losers within the economy.

If industry is the main gainer, the main loser, at least in the short term, is the Chancellor of the Exchequer.

Clearly, what is good for the British economy is not always good for the Chancellor.

I can live with that.

But it does mean that North Sea oil revenues, which are likely to amount to not far short of £12 billion for 1985-86, are bound to be very much less in 1986-87.

Indeed, on the assumption of an average North Sea oil price of $15 a barrel, which is close to the average for the past month of $16 a barrel, oil revenues in 1986-87 will be virtually halved at some £6 billion.

This has obvious implications for the Budget.

But the important fact is that, just as we successfully weathered a year long coal strike, we have been able to take the unprecedented collapse in the oil price in our stride.

We have been able to do so, first, because of the underlying strength of the economy in terms of growth, inflation and the external account.

And, second, by virtue of the reputation we have earned over seven years for sound and prudent financial management.

E. Public Sector Borrowing

Monetary policy must always be supported by an appropriate fiscal policy.

That means, in plain English, keeping public sector borrowing low.

The outturn for the public sector borrowing requirement in 1984-85, which had to bear the bulk of the cost of resisting the coal strike, was £10 billion, or just over 3 per cent of GDP.

In my Budget last year I planned to reduce it substantially in 1985-86, to £7 billion, or 2 per cent of GDP.

In the event, despite the loss of £2 billion of North Sea oil revenue, this year's PSBR looks like turning out at a little under £7 billion,

given that the total for the first eleven months comes to under £3 billion.

This successful outcome, which represents the most substantial reduction in the PSBR as a proportion of GDP since 1981-82, is attributable to two factors.

First, public expenditure has been kept under firm control.

Not only is the outturn likely to be well within the planning total, but spending in 1985-86 is expected to be below the previous year's level in real terms, even after allowing for the effects of the coal strike.

And the second factor behind the successful PSBR outturn for 1985-86 is that the £2 billion shortfall in oil revenues has been offset by the increased buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

Last year's MTFS indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP.

Some would argue that, in the light of the £2½ billion increase in projected privatisation proceeds, I ought to aim well below that.

Others would claim that, since the sharp drop envisaged in oil revenues is more than double the rise in privatisation proceeds, a higher figure would be appropriate.

As last year, my judgement is that the wisest course is to stick broadly to our pre-announced figure.

But given the uncertainties over the oil price, I have decided, within that framework, to err on the side of caution, and provide for a PSBR of £7 billion, or 1¼ per cent of GDP.

Needless to say, this does not enable me to reduce taxation by anything like the £3½ billion foreshadowed in last year's MTFS.

Indeed, given the assumed loss of more than £5 billion of oil revenues in 1986-87, compared with what was envisaged a year ago, I would have expected to have had to increase taxes in this year's Budget.

However, not only have the tax revenues this year from the 95 per cent of the economy that is not oil proved to be notably buoyant, but there is every sign that this will continue into 1986-87, assisted by a rather higher rate of economic growth than was foreseen in last year's MTFS.

This continued vigour of the non-North Sea economy, which is likely to add more than £3 billion to expected non-North Sea tax revenues, coupled with public spending which remains under firm control, has transformed what might have been a bleak prospect.

As a result, I am able this year to accommodate a relatively modest net reduction in the burden of taxation, of a shade under £1 billion.

[It may well be, of course, that the oil price turns out to be different from the $15 a barrel I have assumed for this year's Budget.

If any departure is purely short term, that is most unlikely to have any significance for policy.

But even if it is more than short term, the cautious fiscal stance I have decided to adopt puts us in a sound position to take it in our stride.]

PH/18

BUDGET SECRET Ref No: 62J

COPY NO: 36 of 42

FROM: MRS R LOMAX
DATE: 13 MARCH 1986

MR CASSELL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Kemp
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Culpin
Mr Kelly
Miss O'Mara
Mr Riley
Mr Walsh
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Battishill - IR
Mr Isaac - IR
Mr McManus - IR
PS/IR
Sir A Fraser - C&E
Mr Knox - C&E
PS/C&E

Mr Norgrove - No.10

BUDGET SPEECH (FOURTH DRAFT): SECTION D

I now attach the remaining section of the Budget Speech - section D on monetary policy.

2. I would be grateful if you would conduct a thorough final check for factual accuracy, and let me have any comments no later than **2pm** on Friday 14 March.

RL

RACHEL LOMAX

D. Monetary Policy

The framework within which that sound and prudent financial management has been pursued, and will continue to be pursued, is the Government's Medium Term Financial Strategy.

As usual, I am extending it forward a year.

At the heart of the MTFS lies the objective of steadily reducing the growth of total spending power in the economy, as measured by GDP in cash terms, at a pace that will gradually squeeze inflation out of the system while at the same time leaving adequate room for sustained growth in real output.

That we have done.

Over the past six years the rate of growth of money GDP has been halved.

And this has brought about a combination of low inflation and steady growth.

We shall continue to maintain steady downward pressure on inflation.

That means above all controlling the growth of money in the economy.

Last year I set target ranges of 3 to 7 per cent for narrow money and 5 to 9 per cent for broad money.

During 1985-86 the targeted measure of narrow money has grown towards the bottom end of its range.

The target range for next year will be 2-6 per cent, as foreshadowed in last year's MTFS.

For broad money, or liquidity, it has been clear since the autumn that the range was set too low.

Throughout the 1980s - and in sharp contrast to the 1970s - broad money has grown far faster than money GDP.

Experience has demonstrated that this has not posed a threat to inflation.

This rapid growth largely reflects the increased attractions of holding interest bearing deposits, at a time of low inflation and high real interest rates, and at a time, too, of innovation and liberalisation in the financial system.

Accordingly, I am setting next year's target range for broad money well above that indicated in the MTFS, at 11-15 per cent.

Given the experience of the past six years, this will be wholly consistent with the further decline in inflation which I expect to achieve.

Short term interest rates are the essential instrument of monetary policy.

So far as the monetary targets are concerned changes in interest rates have the same unambiguous effect on narrow money as they do on the exchange rate.

Their effect on broad money is less certain and much slower acting.

There is thus necessarily some difference in status between the two targets for narrow and broad money.

Needless to say, I shall continue to monitor the evidence of other financial indicators, of which the most important is the exchange rate.

I will say no more about monetary policy today. Except to repeat what I said at the Mansion House last Autumn: that while financial liberalisation and innovation have inevitably made the process of monetary management more

complicated, there has been no change whatever in the essence of policy.

The Government continues to attach the highest priority to sound money.

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cost structure in general and its wage costs in particular.

In the new and improved climate of industrial relations, and with inflation falling and set to fall further, there can be no excuse for failure to discharge that responsibility.

I have, however, considered whether there is anything further Government can do to assist this over the longer term.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur. One way out of this might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

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This would not only give the workforce a more direct personal interest in their company's success, as existing employee share schemes do.

It would also mean that, when business is slack, companies would be under less pressure to lay men off; and they would in general be keener to take men on than if pay costs were fixed, irrespective of company profitability.

It might, therefore, make sense to offer some measure of tax relief to the employees concerned to help get profit sharing agreements of the right kind off the ground, and to secure the benefits they could eventually bring if they really caught on.

The broad characteristics of such agreements are clear.

But the design of such a relief, and the precise definition of qualifying agreements, is a matter of some complexity.

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I am keenly aware of the practical difficulties.

The Government therefore proposes to discuss with employers and others to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.

If these preliminary discussions are sufficiently encouraging, we would prepare a consultative document setting out a detailed scheme for wider consideration.

The earliest opportunity for legislation would be next year's Finance Bill.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.

In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to recognised vocational qualifications.

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10 DOWNING STREET

From the Private Secretary

13 March 1986

1986 BUDGET

The Prime Minister is entirely content with the proposals set out in the Chancellor's two undated minutes, one about the MTFS for this year's Budget and the other about employment measures.

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury.

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PRIME MINISTER

BILATERAL

The main item for discussion is the Budget.

I suggest you concentrate on the PSBR for 1986-87. You should press the Chancellor for firm assurances about the figure of £7 billion. Is this a real, unmassaged, figure? Does it include any margin for error? (I understand that the PSBR for February is likely to leave borrowing for the first eleven months of 1985-86 at under £3 billion.)

You could also ask when the Chancellor intends to bring about the expected fall in base rates: on Budget Day or after? Three month inter-bank rates are at present at $11\frac{3}{4}$ per cent, which would allow a one per cent fall in base rates.

On other matters:

(i) JMB seems to have gone fairly quiet; (!)

(ii) you may want to discuss the morning's meeting on BL;

(iii) a paper on electricity prices is now in preparation. The Chancellor of course is concerned not only about the costs of having to provide extra support for the NCB, but also about the need for an increase in electricity prices to give the sale of British Gas a good start and to boost the receipts. But Ministers need to know the facts about the problem before they reach a decision.

DLN

DAVID NORGROVE
12 March 1986

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11/3/86

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PRIME MINISTER

BUDGET PROPOSALS: EMPLOYMENT MEASURES

I promised to let you know the main lines of the agreement I have reached with David Young on a Budget package of public expenditure measures to help the unemployed.

Last year I announced the new 2-year Youth Training Scheme and a substantial expansion of the Community Programme. These measures were financed by an addition to the planning total. This year, as I mentioned to you, it is essential to keep the measures to a level that can be financed from the Reserve. We cannot allow a further increase in the public expenditure planning total.

The package I have agreed is based on the proposals put forward by David Young at your meeting last November. Its main components are:

(a) an increase in the 1986 expansion target for Community Programme places: by Christmas we will have almost twice as many places as we had before the 1985 Budget. At the same time, the average wage limit for the CP will be raised to £67 a week as from next month;

(£63 at present)

(b) nationwide extension of David's imaginative initiatives for helping the long-term unemployed - counselling and the £20 Job start allowance. This means that every single one of the long-term unemployed will be called to interviews and offered help towards finding a job. The evidence of the pilots suggest that many of those who are on the register, but ought not to be, sign off when called up for an interview;

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(c) a New Workers Scheme to help create jobs for 18-20 year olds - a successor to Alan Walters' Young Workers Scheme. This will pay £15 a week to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week;

(d) an enlargement of the Enterprise Allowance Scheme for the unemployed who wish to set up on their own. The annual rate of entry will rise from 64,000 now to 100,000 by April 1987 and there will be more training for those on the scheme. The tax treatment of the Allowance will also be improved.

As I told you last week, I shall also be announcing an extension and improvement of the Loan Guarantee Scheme.

The gross expenditure additions to David's programme will be £190 million in 1986-87 and £280 million in 1987-88. After allowing for an offsetting reduction in social security spending the net public expenditure cost will be £100 million in 1986-87 and £165 million in 1987-88. These will be charged to the Reserve so that there will be no increase in the planning total.

I would be glad to know if you are content with this package of measures.

Yes. MF

N.L.

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1 of 12

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PRIME MINISTER

1986 BUDGET: MTFS

My two previous minutes set out my Budget tax proposals with the exception of those for income tax, which we agreed at our meeting on 5 March.

I have since agreed a package of employment measures with David Young, on which I have minuted you separately.

This leaves the question of the PSBR and monetary targets for 1986-87.

Public Sector Borrowing

The latest indications are that this year's PSBR will come out slightly below the £7 billion forecast in the last Budget (and still more below the figure forecast last Autumn). A substantial shortfall on oil revenues has been more than made up by the buoyancy of other tax revenues and an expected small underspending of the Reserve. We have thus achieved this year a significant step down in the PSBR, the first since 1981-82, reducing the PSBR as a proportion of GDP from over 3 per cent to just 2 per cent.

Last year's MTFS envisaged a PSBR of £7½ billion for 1986-87 (after allowing for a "fiscal adjustment" of £3½ billion). Since then we have added £2½ billion to expected receipts from privatisation, offsetting a similar addition to gross expenditure plans. We have had to revise down our forecast of oil revenues by over £5 billion (on an assumed oil price averaging $15 a barrel for the financial year 1986-87). But other tax receipts are forecast to be significantly higher than was expected a year ago. So the reduction in total government tax revenues is rather less than £3 billion.

At unchanged tax rates, therefore, we would foresee a PSBR of around £6 billion. The Budget package that we have agreed would come to just under £1 billion, raising the PSBR to £7 billion or 1¾ per cent of GDP.

In view of all the uncertainties I think it is wise to err on the side of caution and aim for a borrowing figure below the £7½ billion envisaged a year ago. It is important that the Budget should be seen by the markets as sound and responsible. I think that a PSBR of £7 billion would be so regarded, and indeed should leave us with some room for manoeuvre if, for example, there were a further weakening in oil prices later in the year.

For the remaining years of the MTFS period, I plan to show a path in which the PSBR falls slightly further to 1½ per cent of GDP by 1988-89. (Each ¼ per cent of GDP is approximately £1 billion.)

Monetary Targets

For the monetary targets in 1986-87 I intend to stick to MO and £M3. In view of its past behaviour, a case can be made for dropping £M3 altogether. As you know, £M3 has for some years shown a tendency to grow more rapidly than money GDP, partly in response to financial liberalisation, and partly because high real interest rates have increased the demand for broad money as a medium for saving. £M3 growth has regularly exceeded our expectations, without adverse consequences for inflation. This year has been no exception. A year ago we set a range of 5 to 9 per cent growth for 1985-86; in the 12 months to February the actual growth of £M3 has been nearly 15 per cent. And yet all the indications are that inflation is set to fall further over the coming year.

After careful consideration, however, I have concluded that dropping £M3 would risk giving the wrong signal about our attitude to liquidity. But I cannot risk a repetition of this year's experience.

We must set a range for 1986-87 that is both credible and achievable. I have decided that this should be 11-15 per cent, to allow for a continuation of the recent velocity trend. In view of all the uncertainties about broad money, however, I do not propose to show ranges of £M3 growth for the years beyond 1986-87.

The choice of target range for MO has been much easier. Its growth over the past 12 months has been 3½ per cent, towards the bottom of the 3-7 per cent range set a year ago, and I am reaffirming for 1986-87 the 2-6 per cent range indicated in last year's MTFS. As in the last two years, I shall be publishing illustrative ranges for MO for the whole MTFS period.

The presentation of monetary policy has undoubtedly suffered from the continuing problems with £M3, and the market's reluctance to accept MO as a substitute. I have sought to re-establish the credibility of the MTFS by giving a slightly more prominent role to money GDP in explaining the Government's strategy. This has no real operational significance, but it is a useful way of making the point that, whatever the problems with particular monetary aggregates, the Government remains committed to reducing the growth in money incomes, as a means of achieving a further reduction in inflation.

This approach has been fully discussed with the Bank who support these recommendations.

N.L.

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FROM: MRS R LOMAX
DATE: 12 March 1986

MR SCHOLAR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Cassell
Mr Kemp
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Battishill - IR
Mr Isaac - IR
Mr McManus - IR
PS/IR

Sir A Fraser - C&E
Mr Knox - C&E
PS/C&E

Mr Norgrove - No.10

Sections B,C only
Mr Peretz
Mr Riley
Mr Kelly
Mr Walsh

Section C only
Mr Robson
Mr Haache

Section F only
Mr Shaw

Section G,H,I,J,K only
Miss Sinclair

Section H only
Mr Peretz
Miss Noble

BUDGET SPEECH (FOURTH DRAFT)

I attach a near final draft of the Budget speech (excluding sections D and E which will be circulated as soon as possible). This takes account of all comments received by close on Tuesday 11 March.

2. I should be grateful if the following people would conduct a thorough and final check for factual accuracy:-

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Mr Evans:- Sections B and C

Mr Cassell:- Sections [D, E,] and H

Mr Monck:- Section F

Mr Monger:- Sections G, I, J, and K

Miss O'Mara:- Sections A and L

3. All further comments should be submitted in writing, in the form of precise drafting suggestions, specifying the reason for making the change and any appropriate background information. (This applies in particular to comments which the Chancellor has already considered once and rejected.)

4. All comments should reach this office by close of play on Thursday 13 March. I would be grateful for advance warning of any points that cannot be checked before this deadline.

RACHEL LOMAX

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BUDGET

1986 BUDGET SPEECH

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B. The Economic Background

C. Oil

D. Monetary Policy

E. Public Sector Borrowing

F. Help for the unemployed

G. Business taxation

H. Savings & Investment

I. Charities

J. Taxes on Spending

K. Income Tax

L. Conclusion

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A. Introduction

The background to this year's Budget is the dramatic and unprecedented fall in the world oil price.

But the Government's objectives remain unchanged: the conquest of inflation and the creation of an enterprise culture.

And the Government's policies are unchanged, too: policies of sound money and free markets. Not least because these are the only routes to more jobs.

So my Budget today will carry forward the themes of my two previous Budgets, and sow some seeds for the future.

In the course of my speech I shall begin by reviewing the general economic background to the Budget, and go on to deal with the specific issue of oil.

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I shall then discuss monetary policy and the fiscal prospect, both this year and next.

I shall then turn to the question of direct help for the unemployed.

Finally, I shall propose some changes in taxation designed to assist in achieving the economic objectives I have already outlined.

As usual, a number of press releases, filling out the details of my 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.

The strength and durability of the current economic upswing continues to confound the commentators.

We can now look back to very nearly five years of growth at around 3 per cent a year.

Even more important, 1985 was the third successive year in which we secured the elusive combination of steady growth and low inflation - the first time this has been achieved since the 'sixties.

In 1985 as a whole, output grew by a further 3½ per cent, the highest rate of growth in the European Community, and higher than the United States, too.

Within that total non-oil exports grew by over 6 per cent, to reach yet another all-time record.

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Despite a marked slowdown in the growth of world trade from the heady pace of 1984, the current account of the balance of payments was in surplus for the sixth year in succession - this time by some £3 billion.

Inflation ended the year at around 5½ per cent and falling.

Employment continued to rise, though still not fast enough to reduce the distressingly high number of people out of work.

I shall have more to say about that later.

Manufacturing industry, the subject of so much ill-informed comment, had another successful year, with its output up by 3 per cent, its productivity by 4 per cent, its investment by 5 per cent, and its exports by 6 per cent.

As the London Business School recently observed, looking at Britain's recent performance:

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"There has been no previous five year period in recent history over which manufacturing industry has been so successful in holding its market share, and in keeping pace with world output".

At the heart of this success lies a remarkable turn-around in productivity.

In the six years prior to 1979, Britain's annual rate of growth of manufacturing productivity, at less than 1 per cent, was the lowest of all the Group of Five major industrial nations.

In the six years since 1979, our annual rate of growth of manufacturing productivity, at 3½ per cent, has been second only to that of Japan.

Looking ahead, I expect 1986 to be a further year of steady growth with low inflation.

Indeed, with output forecast to rise by 3 per cent, and inflation to fall to 4 per cent, 1986 is set to register our best overall performance for a generation.

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The pattern of growth should also show a satisfactory balance, with exports and investment expected to grow rather faster than consumer spending - as indeed they have during the sustained upswing as a whole.

But the uncertainties inherent in all these forecasts, good though their track record has been, is reinforced by constant reminders that we live in an uncertain and turbulent world.

One particular difficult aspect of this is the febrile nature of the world currency markets. There has been some improvement here.

The Plaza Agreement between the Group of Five Finance Ministers last September has undoubtedly led to a more sustainable pattern of exchange rates worldwide.

Since Plaza, the dollar has fallen by some (15) per cent against the other major currencies as a whole, with the pound moving up by (5) per cent, the Deutschemark by (20) per

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cent and the Yen by (30) per cent - a pattern broadly in line with what those of us who were party to the agreement intended.

This process will be assisted further if the passage of the Gramm-Rudman amendment succeeds in securing its objective of a much-needed reduction in the United States budget deficit.

Meanwhile, the Plaza Agreement has already succeeded in reducing, at least for the time being, the dangerous protectionist pressures that were building up in the United States.

Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on.

But the most dramatic development on the world economic scene, and one of considerable importance to this country, has of course been the collapse in the price of oil.

It is to that I now turn.

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C. Oil

I presented my Budget last year at the end of a 12-month coal strike.

I observed at the time that it was a remarkable tribute to the underlying strength of the British economy that it had been able to withstand so long and damaging a strike in such good shape.

We now have to face a challenge of a very different kind.

Over the past few months the price of oil has almost halved, and with it our North Sea oil tax revenues and earnings from oil exports.

Not surprisingly, perhaps, this initially caused a fair amount of turmoil in the financial markets, with sterling falling by some 8 per cent.

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I decided that it was right to respond with an immediate one per cent rise in short term interest rates in early January, and this helped to prevent the downward movement of the exchange rate from developing an unhealthy momentum of its own.

But equally I thought it right to resist the for a time very strong, but to my mind unjustified, pressure to raise interest rates still further.

That pressure now appears to have subsided.

There has been some speculation that the turbulence in the oil market, which from time to time has fed through into the financial markets, has been deliberately exacerbated by some leading OPEC countries in an attempt to force the United Kingdom to cut back its own oil production and thus become a de facto member of the cartel.

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It has even been suggested that the decision to hold a meeting of OPEC Ministers to coincide with today's Budget is part of that same process.

I have to say that, if any such tactics are indeed being employed, those employing them are wasting their time.

There is no question whatever, and never has been any question, of the UK cutting back its oil production in order to secure a higher oil price.

In the first place, the whole outstanding success of the North Sea has been based on the fact that it is the freest oil province in the world, in which decisions on levels of output are a matter for the companies and not for the Government.

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other

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goods and services, and a major oil consumer: there is no overall UK national interest in keeping oil prices high.

I am aware that a Report, recently published in another place, which attracted a certain amount of publicity at the time, predicted that

> "as the oil revenues diminish the country will experience adverse effects which will worsen with time"

- effects of a most alarming nature.

Had the authors of that Report dreamed at the time that half the oil revenues would disappear within a matter of months, their conclusions would no doubt have been even more apocalyptic.

As the House knows, I have always believed their analysis to have been profoundly mistaken.

But certainly it is going to be put to the test sooner than anyone expected.

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The United Kingdom is likely to remain an oil producer, of a gradually diminishing volume of oil, for the next 25 years or so.

If we can survive unscathed the loss of half our North Sea oil revenues in less than 25 weeks, then the prospective loss of the other half over the remainder of the next 25 years should not cause us undue concern.

It is, of course, true that in relative terms we do lose from the collapse of the oil price. That is to say, the really big gains will be made by the major non-oil-producing countries such as Germany and Japan, where growth will be boosted and inflation, already low, is likely to fall virtually to zero.

But the oil price fall will be beneficial for the industrialised world as a whole, and even for the United Kingdom what we gain on the swings will more than offset what we lose on the roundabouts.

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To be precise, I expect that the levels of economic activity and inflation will if anything be slightly better than what they would have been without the oil price collapse.

And what of the balance of payments?

Thanks to the abolition of exchange control in 1979, we have been able to use a good part of our earnings from North Sea oil since then to build up a massive stock of overseas assets.

Our net overseas assets have in fact risen from £12 billion at the end of 1979 to almost £90 billion at the end of last year.

This is a far bigger total than that possessed by any other European country, and bigger than the United States, too.

The earnings from those assets will be of increasing value to our balance of payments in the years ahead.

So, too, should the improvement in our manufacturing trade balance.

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For while the British economy may not gain a great deal overall as a result of the oil price collapse, there will be considerable differences within the economy.

The major gainer will be the internationally traded sector of industry in general, and manufacturing in particular, which is already enjoying both lower oil prices and a lower exchange rate against its major competitors.

This provides British industry with an outstanding opportunity both to increase its exports and reduce import penetration in the home market.

It has no excuse for not seizing that unique opportunity.

But it will only be able to do so if it meets two conditions.

First, it must keep firmer control of its labour costs.

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Second, it must spend more of its much healthier level of profits on investing for the future in Research and Development and in training.

Both the opportunity, and the responsibility to see that it is not thrown away, rest fairly and squarely on the shoulders of British management.

Meanwhile, despite the massive fall in oil prices, I expect the current account of the balance of payments to remain in sizeable surplus this year, by some £3½ billion.

As I have said, there will be gainers and losers within the economy.

If industry is the main gainer, the main loser, at least in the short term, is the Chancellor of the Exchequer.

Clearly, what is good for the British economy is not always good for the Chancellor.

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I can live with that.

But it does mean that North Sea oil revenues, which are likely to amount to not far short of £12 billion for 1985-86, are expected to plummet to £6 billion next year, 1986-87 and perhaps some £4 billion in 1987-88.

A loss of more than £5 billion between this year and next.

This has obvious implications for the Budget.

But the important fact is that, just as we successfully weathered a year long coal strike, we have been able to take the unprecedented collapse in the oil price in our stride.

We have been able to do so, first, because of the underlying strength of the economy in terms of growth, inflation and the external account.

And, second, by virtue of the reputation we have earned over seven years for sound and prudent financial management.

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F. Help for the unemployed

I turn first to the continuing problem of high unemployment.

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It is a problem that can be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.

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The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables workers to be priced into jobs instead of

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pricing them out of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's weakness lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

And I have to say that, in a free economy - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's

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cost structure in general and its wage costs in particular.

In the new and improved climate of industrial relations, and with inflation falling and set to fall further, there can be no excuse for failure to discharge that responsibility.

I have, however, considered whether there is anything further Government can do to assist this over the longer term.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur. One way out of this might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

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This would not only give the workforce a more direct personal interest in their company's success, as existing employee share schemes do.

It would also mean that, when business is slack, companies would be under less pressure to lay men off; and they would in general be keener to take men on than if pay costs were fixed, irrespective of company profitability.

It might, therefore, make sense to offer some measure of tax relief to the employees concerned to help get profit sharing agreements of the right kind off the ground, and to secure the benefits they could eventually bring if they really caught on.

The broad characteristics of such agreements are clear.

But the design of such a relief, and the precise definition of qualifying agreements, is a matter of some complexity.

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I am keenly aware of the practical difficulties.

The Government therefore proposes to discuss with employers and others to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.

If these preliminary discussions are sufficiently encouraging, we would prepare a consultative document setting out a detailed scheme for wider consideration.

The earliest opportunity for legislation would be next year's Finance Bill.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.

In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to recognised vocational qualifications.

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The new and expanded YTS will duly come into operation next month.

It will be a giant step towards our objective of ensuring that no youngster under the age of 18 need be unemployed.

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, or, in the case of those between 18 and 24, for more than six months.

The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 250,000 places - very nearly double the number that existed a year ago.

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At the same time, the average wage limit for the Community Programme will be raised to £67 a week from next month.

Last November my Rt. Hon. and Noble Friend announced two new pilot schemes to provide further help for the long-term unemployed. These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and a Jobstart allowance of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week. The pilot schemes are already proving effective, and I have accordingly decided to provide the funds to develop these imaginative new initiatives into a single programme covering the entire country.

This means that every single one of the long-term unemployed throughout the land will

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be called to interviews and offered help in finding a job.

I shall also be providing the resources to launch a new scheme - the New Workers Scheme - to help 18-20 year olds to find a job. This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at not more than £55 a week or a 20 year old at not more than £65 a week.

The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.

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Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be increased from its present rate of 64,000 to 100,000 by April 1987, and to provide more training for those involved.

At the same time I propose to improve the tax treatment of payments made under this scheme.

The total public expenditure cost of the measures I have outlined comes to £195 million in 1986-87 and £290 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £100 million in 1986-87 and £165 million in 1987-88.

This will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

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G. Business and Enterprise

I now turn to the taxation of business and enterprise.

While the measures I have just announced help the unemployed directly, in the long run what really matters is the creation of a climate in which business and enterprise flourish.

For it is business and enterprise, not Government, who create jobs.

The new and improved system of business taxation which I introduced in my 1984 Budget has reached the end of its transitional phase and comes fully into force next month.

From then on the United Kingdom will have, at 35 per cent, the lowest rate of Corporation Tax of any major industrial nation.

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This year I have only two further amendments to make.

First, I propose to ensure a full measure of depreciation for tax purposes for short life agricultural buildings and works, by giving the taxpayer the option of making balancing adjustments on the sale or destruction of such buildings.

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Second, I propose to reform the mines and oil wells allowances broadly along the lines of the proposals published in last July's consultative document.

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The overall net benefit of this to the industries concerned will amount to £45 million in 1987-88.

Otherwise I propose only minor technical changes to the taxation of North Sea oil; but I am continuing to keep the economics of incremental investment under review, and shall not hesitate to introduce at the earliest

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opportunity any changes which may prove necessary.

I need to set the 1987-88 car and fuel benefit scale charges for those with company cars.

At the same time the motor industry have represented to me that the discrepancy between the engine size break points in these scales and the break points in the new European Community directive on car exhaust emissions is potentially damaging to their international competitiveness.

Accordingly I propose from April 1987, to change our break points to those in the new directive.

At the same time, as last year, I propose to increase the (restructured) car benefit scale charges by 10 per cent.

This will still leave the scale charges well short of the true value of the benefit.

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The fuel scale will also be restructured, but the charges will remain unchanged; and as from April 1987 it will also be used to assess the VAT due on petrol used by registered traders and their employees.

This will be simpler and more equitable than the present system, and will also bring in an extra £40 million of revenue in 1987-88.

I propose to increase the VAT threshold to £20,500 from midnight tonight.

I also propose to rectify an anomaly in the taxation of international entertainers and sportsmen.

When British entertainers or sportsmen work overseas, the foreign tax authorities normally levy a withholding tax on their earnings.

But at the present time we levy no such tax on the earnings of foreign entertainers and sportsmen visiting the UK.

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I believe that, in future, we should fall into line with most of the rest of the world.

Accordingly, I propose to introduce a withholding tax of 30 per cent - the same rate as applies in the United States - on the earnings of overseas entertainers and sportsmen in the UK. This should yield £75 million in 1987-88.

A key element in the Government's strategy for jobs is the encouragement of new businesses.

As the House knows, I have been reviewing the future of the Business Expansion Scheme, which is due to come to an end in April 1987.

I have been assisted in this review by the independent report commissioned by the Inland Revenue from the consultants Peat, Marwick and Mitchell, which is being published in full today.

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I am placing a copy in the Library of the House.

It is quite clear - and this is confirmed by the evidence in the Peat Marwick report - that the Business Expansion Scheme, which my predecessor introduced in 1983 as an improvement on the 1981 Business Start-up Scheme, has been an outstanding success.

It has fully achieved its aim of attracting new equity capital into unquoted companies.

It has been attracting well over £100 million a year, a high proportion of which has gone into new and small businesses.

Well over half the companies involved raised sums of less than £50,000 each.

I therefore have no hesitation in proposing to extend the life of the Business Expansion Scheme indefinitely.

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But at the same time, despite the exclusions of farmland and property development in my two previous Budgets, I am concerned that too much BES money is being diverted from the high risk areas for which the scehme was always intended into areas where the risk is very much less.

Accordingly, I propose, from now on, to exclude from the scheme all companies holding more than half their assets in the form of land and buildings.

I also propose to exclude companies whose main purpose is to invest in objects, such as fine wines, whose value may be expected to rise over time.

And I have decided to bring within the scope of BES companies engaged in the chartering of UK-registered ships.

This will provide new opportunities for successful investment in both new and secondhand tonnage in the hard-pressed coastal, short sea and offshore trades.

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I propose to take power to make further changes in the ambit of the scheme by Order.

Finally, having taken steps to target the Business Expansion Scheme more carefully, I propose to improve it.

BES shares issued after today will be entirely free of Capital Gains Tax on their first sale.

And as a further measure of help for small and new businesses, the Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying bank loans, will also be extended, in this case for a further three years.

My hon Friends will be glad to learn that the premium will be halved from 5 per cent to 2½ per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its

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introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running unquoted family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.

In addition to statutory indexation of the threshold and rate bands, I propose this year to reform the tax radically.

In essence, the Capital Transfer Tax is two taxes, as its two separate scales imply: an inheritance tax and a lifetime gifts tax.

We have had an inheritance tax in some shape or form ever since Lord Harcourt introduced the Estate Duty in 1894.

But the lifetime gifts tax which the Labour Government introduced in 1974, in the teeth of wholehearted Conservative opposition, is an unwelcome and unwanted impost.

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By deterring lifetime giving, it has had the effect of locking in assets, particularly the ownership of family businesses, often to the detriment of the businesses concerned.

Accordingly, I propose to abolish entirely the tax on lifetime gifts to individuals.

As with the old Estate Duty, there will be a tapered charge on gifts made within seven years of death and provisions to charge gifts made with reservation; and the regime for trusts, which is needed as a protection for the death charge, will be kept broadly unchanged.

The cost of abolishing the tax on lifetime giving will be £35 million in 1986-87 and £55 million in 1987-88.

In recognition of the radically changed nature of the tax I have decided to rename it the Inheritance Tax.

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My two previous Budgets abolished three unnecessary taxes.

The National Insurance Surcharge, the Investment Income Surcharge, and Development Land Tax.

The abolition of the tax on lifetime gifts adds a fourth.

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H. Savings and Investment

I now turn to the taxation of savings and investment.

In my 1984 Budget I introduced a major reform of the taxation of savings and investment designed to improve the direction and quality of both.

Today I propose to carry this reform further forward.

The Social Security Bill now before Parliament proposes important and far-reaching changes in pension provision, notably by encouraging the growth of personal pensions.

Those changes - to which the Government attach the utmost importance - have been warmly welcomed, both for the greater freedom they will give to existing pension scheme members

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and for the new scope they will offer to the millions of working people who are not in an occupational pension scheme.

In the light of these changes, I intend later this year to publish detailed proposals designed to give personal pensions the same highly favourable tax treatment as is currently enjoyed by retirement annuities.

Publication of these proposals will enable there to be the widest possible consultation prior to legislation in next year's Finance Bill.

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Meanwhile, I can assure the House that, as I made clear last year, I have no plans to change that favourable tax treatment.

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But I do need to deal with the growing problem of pension fund surpluses.

The dramatic improvement in the financial climate compared with a decade ago, most notably as a result of the sharp fall in

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inflation, has seen a number of pension funds become heavily overfunded.

This presents a double problem, both aspects of which the Inland Revenue is at present having to deal with through the exercise of its discretionary powers.

In the first place, excessive surpluses, even if they arise unintentionally, represent the misuse of a tax privilege which was intended to assist the provision of pensions, and for no other purpose.

So the Inland Revenue requires from time to time that surpluses be diminished.

But at the same time the Revenue feels obliged to turn down many of the increasing number of requests from companies which, often for good reasons, wish to take refunds from their pension funds into the company itself.

The absence of clear rules on how surpluses should and may be dealt with, and the

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consequent reliance that has to be placed on the exercise by the Inland Revenue of its discretion, have created considerable uncertainty and unnecessarily constrained trustees' freedom of action.

I therefore propose to replace these discretionary arrangements with clear and objective statutory provision.

In future, the amount of any surplus in a fund will be determined for tax purposes in accordance with standard published guidelines, based on a secure funding method and prudent actuarial assumptions, as advised by the Government Actuary.

Where a surplus is 5 per cent or less of total assets no action will need to be taken.

Where it is higher than that action will be required to eliminate the excess.

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It will be entirely a matter for the trustees and employers to decide whether the reduction is to be achieved by increasing benefits, or reducing contributions, or making a refund to the company.

If, and only if, they choose to make a refund, the company will be liable to tax at a rate of 40 per cent of the amount refunded, so as broadly to recover the tax relief previously given.

The effect of these new arrangements is likely to be a yield of £25 million in 1986-87 and £120 million in 1987-88.

Next, Stamp Duty.

I have no change to propose in the stamp duty on houses and other property.

But despite the all-round reduction in Stamp Duty to 1 per cent which I made in my 1984 Budget, there is a formidable case this year

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for a further reduction in the rate of stamp duty on share transfers.

The City of London is the pre-eminent financial centre of Europe.

The massive £6 billion it contributes to our invisible exports is but one measure of the benefit this confers on the British economy.

But competition in financial services nowadays is not continental, but global.

The City revolution now under way, due to culminate with the ending of fixed commissions - the so-called Big Bang - on 27 October, is essential if London is to compete successfully against New York and Tokyo.

And if London cannot win a major share of the global securities market, its present world pre-eminence in other financial services will be threatened.

Successful competition depends on a number of factors, but one of the most important is the level of dealing costs.

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The abolition of fixed commissions will certainly help.

But with no tax at all on share transactions in New York, and roughly ½ per cent in Tokyo, London will still be vulnerable.

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I therefore propose to reduce Stamp Duty on share transactions from 1 per cent to ½ per cent as from the date of the Big Bang, currently scheduled for 27 October.

But I believe it is right that the cost of this should be met from within the financial sector itself.

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Accordingly, I propose to bring into tax at the new ½ per cent rate a range of financial transactions which are at present entirely free of Stamp Duty.

These include transactions in loan stock other than short bonds and gilt edged securities, transactions unwound within a Stock Exchange

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account, letters of allotment, the purchase by a company of its own shares, and takeovers and mergers.

There will also be a special rate of 5 per cent on the conversion of UK shares into ADRs and other forms of depositary receipt.

Some of these changes, including the new ADR charge, will take effect immediately: others will be delayed until the Big Bang.

This further halving of the stamp duty on equities should enable London to compete successfully in the worldwide securities market.

It will also provide a further fillip to wider share ownership in the UK.

Just as we have made Britain a nation of home owners, it is the long-term ambition of this Government to enable the British people to become a nation of share-owners, too; to create

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a people's capitalism, in which more and more men and women have a direct personal stake in British business and industry.

Both through the rapid growth of employee share schemes, and through the massively successful privatisation programme, much progress has been made.

But not enough.

Nor, I fear, will we ever achieve our goal so long as the tax system continues to discriminate so heavily in favour of institutional investment rather than direct share ownership.

Accordingly I propose to introduce a radical new scheme to encourage direct investment in UK equities.

Starting next January, any adult will be able to invest up to £200 a month, or £2400 a year, in shares.

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These will be held in a special account which I am calling a Personal Equity Plan.

So long as the investment is kept in the plan for a minimum period, at most two years, all reinvested dividends, and all capital gains on disposals, will be entirely free of tax.

The longer the investment is kept in the plan, the more the tax relief will build up and the greater will be the rewards.

Although the scheme will be open to everyone, it is specially designed to encourage smaller savers, and particularly those who may never previously have invested in equities in their lives.

So the plans will be simple and flexible to operate.

Anyone who is legally permitted to deal in securities will be able to act as a plan manager.

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But the investor himself will own the shares - and the rights that go with them, including voting rights.

And it will be for the investor to choose whether to make the investment decisions himself or to give the plan manager authority to act on his behalf.

The cost of the scheme will be around £25 million in 1987-88, but will build up in later years as more plans are taken out.

This is a substantial, innovative and exciting new scheme.

I am confident that, over time, it will bring about a dramatic extension of share ownership in Britain.

Although wholly different in structure from the Loi Monory in France, I expect it to be every bit as successful in achieving its objective.

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I am sure the whole House will welcome this far-reaching package of measures to reform the taxation of savings and investment.

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I. Charities

I now turn to the tax treatment of charities and charitable giving.

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In almost every facet of the nation's affairs it becomes increasingly clear that private action is more effective than State action.

This is particularly well illustrated by the success of charitable organisations up and down the land in the fields of education, social welfare, medicine, the arts and the heritage.

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This Government has already done a great deal to assist charities, both through the tax system and in other ways.

I believe the time has come to take a further step forward.

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The fundamental question is whether any further fiscal relief should be given to the charities themselves, through relief from VAT, or to the act of giving.

In the light of representations from the Charities VAT Reform Group, I am prepared this year, exceptionally, to make a number of specific concessions on this front.

I propose to relieve charities from VAT on their non-classified press advertising; on medicinal products where they are engaged in the treatment or care of people or animals, or in medical research; on lifts and distress alarm systems for the handicapped; on refrigeration and video equipment purchased by charities from donated funds; on recording equipment used by charities for the blind; and on welfare vehicles used by charities to transport the deaf, blind or mentally handicapped.

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The cost of these reliefs is some £10 million.

But in general I am convinced that the right way to help charities is not by relieving the charities themselves from VAT, but by encouraging the act of charitable giving.

I say this for two principal reasons.

First, it is clearly better that the amount of tax relief is related to the amount of support a charity is able to attract, rather than to the value of goods and services it happens to purchase.

And, second, whereas a £ of VAT relief is worth precisely that, a £ of tax relief on giving is likely to generate more than a £ of income going to charity.

My principal proposals therefore relate directly to the act of giving to charity.

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First, I propose to abolish altogether the upper limit on relief at the higher rates of income tax on charitable covenants.

At the same time I propose to act to stop the abuse of the tax system by ensuring that tax relief goes only to money which is used directly for charitable purposes.

Next, companies.

It is widely believed that corporate giving to charity would be more generous than it is at present if tax relief did not depend on the company entering into a four-year covenant or some form of sponsorship arrangement.

Accordingly, I propose to allow companies (other than close companies) to enjoy tax relief on one-off gifts to charity up to a maximum of 3 per cent of the company's annual dividend payment to its share-holders.

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There will, of course, continue to be no limit on the amount a company can covenant to charity.

I do not, however, propose to extend a similar relief for one-off donations by individuals. Quite apart from the administrative costs, which would be formidable, many charities have made clear to me their fear that to do this would weaken them by reducing the stability they enjoy as a result of the binding force of covenants.

Instead, I propose to encourage individual giving to charity by a different means, that of payroll giving.

From April 1987 it will be open to any employer to set up a scheme under which employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them.

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All in all, the proposals I have announced today add up to a very substantial package of assistance to charities and charitable giving. Their cost to the exchequer will depend on how generously companies and employees respond to this initiative.

But my best estimate is that it could amount to £50 million in 1987-88.

This will be partly paid for by the measures to curb abuse, which may save as much as £20 million a year.

The additional charitable giving these concessions stimulate should be at least twice the cost of the tax relief given.

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J. Personal Taxes: Taxes on spending

Finally, I turn to the taxation of spending and income.

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So far as the indirect taxes are concerned, the overriding question this year is how far I should recover from the oil consumer the tax revenues I have lost from the oil producer, as a result of the massive fall in the oil price. So far this year the price of petrol at the pump has fallen by roughly 11 pence a gallon. If the oil companies had passed on the full amount of the fall in the oil price to date, the price of petrol at the pump could easily have been a further 10 pence a gallon lower still.

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There is clearly scope, therefore, for a sizeable increase in petrol tax this year.

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I have concluded, however, that at the present time, while I must certainly maintain the real value of the revenue I get from the motorist, I will not increase it.

But I do believe it makes sense to look again, in the light of the radically changed circumstances, at the relative weight of petrol tax and Vehicle Excise Duty.

Accordingly, I propose to increase the duty on petrol by an amount which, including VAT, would - if it were wholly passed on to the consumer - raise the price at the pump by sevenpence halfpenny a gallon.

This is twopence more than is needed to keep pace with inflation, and that enables me to keep VED at last year's level of £100 for cars and light vans, leaving the overall burden on the motorist unchanged in real terms.

Moreover, given the fat that has accumulated in the oil companies' margins, there is clearly no

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need for the pump price of petrol to go up at all.

In the same way, I propose to increase the duty on derv by an amount which would - if it were wholly passed on to the consumer, which it should not be - raise the price at the pump by sixpence halfpenny, including VAT.

This will enable me to avoid any increase this year in the Vehicle Excise Duty on lorries, too.

So far as the other oil duties are concerned, I have one or two changes to make.

Not to the duty on heavy fuel oil, which will remain unchanged as it has done since 1980.

But I propose to increase the very modest duty on gas oil, much of which is used for central heating, by a penny-halfpenny a gallon.

And I propose to abolish altogether the duties on aviation kerosene, or Avtur - which at

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present is taxed for domestic flights only - and on most lubricating oils.

All these changes in duty will take effect from 6 o'clock this evening.

Finally, so far as oil products are concerned, I am anxious to do what I reasonably can to assist the introduction of lead-free petrol. The case for this on health grounds is clear. I have therefore decided to create a duty differential in its favour to offset its higher production costs.

My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

Next, tobacco.

In the light of the representations I have received on health grounds, I have decided to increase the duty on cigarettes by appreciably

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more than is needed to keep pace with inflation.

I therefore propose an increase in the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of approximately eleven pence on a packet of 20 cigarettes.

This will take effect from midnight on Thursday.

As last year, I propose no increase at all on the duties on cigars and pipe tobacco.

Finally, drink.

As the House will recall, I was obliged in 1984 to increase the duty on beer by slightly more than I would have wished as a consequence of the judgement against the UK in the European Court of Justice.

I now propose no increase at all in the duty on beer - for the first time since 1979.

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Nor do I propose any increase in the duties on cider, table wine, sparkling wine, fortified wine or spirits.

This last decision will, I hope, be particularly welcome to the Scotch Whisky industry.

I have no major proposals for changes in Value Added Tax.

The changes I have announced in the excise duties will, all told, raise an extra £795 million in 1986-87, the same amount as I would have raised had I simply increased all the excise duties in line with inflation.

The overall impact effect on the RPI, if all the increases were fully passed on, would be one half of one per cent.

This has already been taken into account in the forecast I have given the House of 4 per cent inflation by the end of the year.

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K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to the closer integration of the tax and benefit systems.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with

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the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

Yet that is what happens at the present time.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

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To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and poverty traps for a given amount of tax relief than is possible under the present tax system. Given the timetable of computerisation, none of this could in practice be implemented until the 1990s.

But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

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Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should be free of tax altogether.

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

This will enable them to be fully taken into account before PAYE codes are issued for 1987-88.

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However, to bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

The increases have been criticised by some as derisory.

I wholly reject that allegation.

They are fully in line with the rise in the cost of living over the relevant period; and to suggest that pensioners and others would sooner have high inflation and high upratings than low inflation and correspondingly low upratings is sheer poppycock.

But I do accept that it could be confusing for many old-age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating.

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I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87. The cost of this will be £15 million.

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour.

We have increased the main tax thresholds by some 20 per cent more than inflation - and the greater part of that 20 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough. The burden of income tax is still too great.

Nothing could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and

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specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for reductions in the basic rate of tax, too.

The basic rate is the starting rate of tax.

And it is the crucially important marginal rate of tax for 95 per cent of all employees and

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over 90 per cent of all self-employed and unincorporated businesses.

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent, rounded up.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400.

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I propose to raise all the higher rate thresholds by exactly £1,000.

Thus the first higher rate of 40 per cent will be reached at a taxable income of £17,200, in line with statutory indexation, and the top rate of 60 per cent will apply to taxable income above £41,200 - some £1,500 less than statutory indexation.

Given the need for caution in the light of current circumstances, I do not have scope this year for a reduction in the basic rate of income tax, beyond one penny in the pound.

But this reduction from 30 per cent to 29 per cent still represents the first cut in the basic rate of income tax since 1979.

And so long as this Government remains in office, it will not be the last.

I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

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The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, not on the rich but on the great majority of ordinary taxpayers.

Thus the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

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: some £2 billion in 1986-87, of which over half represents the cost of indexation.

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Seven years ago, when my predecessor cut the basic rate of income tax from 33 per cent to 30 per cent, he added:

> "Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

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L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial range of measures to help the unemployed.

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy.

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And I have abolished outright a fourth tax - the tax on lifetime gifts.

I have announced the most substantial package of assistance to charitable giving ever, and proposed the first cut in the basic rate of income tax for seven years.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

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DW

FROM: S D KING
DATE: 12 MARCH 1986

1. MISS O'MARA
2. CHANCELLOR OF THE EXCHEQUER

MOM 13/3

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Terence Burns
Mr Monck
Mr H P Evans
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr S Davies
Mr Riley
Mr Dyer (+1 for No. 10)
Mr Allum
Mr Grice
Mr Pickering
Mr Spencer
Mr Vernon
Mr Davies
Mr Cropper
Mr Lord
JD/05

SIMON AND COATES MARCH FORECAST

Simon and Coates' latest bulletin will be published at 00.01am on Friday 14 March. Apart from the forecast, the bulletin contains the text of a lecture delivered by Gavyn Davies at the University of Ulster entitled 'Where economists now agree', and an article on the likely content of the Budget and the medium term policy implications given lower oil prices. A summary of the latter is attached.

Assumptions

2. S&C's forecast is based on an average oil price of $19/bl and an effective exchange rate averaging 72-73.

3. S&C assume tax cuts of around £½-1 billion and a PSBR outturn of £8½ billion in 1986-87 above a £7¾ billion target.

4. MO growth is assumed to be broadly in line with MTFS targets, although £M3 is expected to exceed existing government targets into the medium term.

Forecast

5. S&C

(except where specified, figures are percentage changes on previous year)

	1986		1987	
	(last months's forecast in brackets)			
GDP*	2.4	(2.1)	2.6	(2.3)
Consumers' expenditure	3.8	(3.6)	3.4	(3.1)
General Government Consumption	1.0	(1.0)	1.0	(1.0)
Gross Fixed Investment	2.7	(2.7)	2.8	(2.8)
Exports	2.6	(2.1)	3.5	(3.2)
Imports	3.9	(3.9)	4.4	(4.4)
RPI (Q4)	3.5	(3.5)	4.8	(5.0)
Unemployment (UK adults, million, Q4)	3.07	(3.03)	2.97	(3.00)
Current Account (£bn)	3.5	(2.8)	2.6	(2.4)
PSBR (financial year, £bn)	9.3	(9.3)	9.0	(9.0)

* output measure

6. The main points of the forecast are:

(a) Retail prices inflation falling to 3½ per cent by 1986Q4 helped by lower oil prices. However, from then the rate of inflation is expected to rise steadily to reach 4¾ per cent by 1987Q4 following unit cost pressures, and a slight decline in sterling (again, through lower oil prices).

(b) GDP growth of 2½ per cent in 1986 (up from 2¼ per cent last month) and a further 2½ per cent in 1987.

(c) Unemployment forecast in 1986Q4 of 3.07 million. Although slightly up on last month, it has been revised down by almost ½ million since April 1985. However, S&C expect unemployment under 3 million in 1987Q4.

(d) Base rates to reach a peak of 13 per cent in 1986Q1 before declining to an average 11½ per cent from 1986Q3 onwards. The effective exchange rate is expected to peak at 75.3 in 1986Q2 before falling gradually to 71 in 1987Q4.

UK Economic Commentary - The Budget

7. S&C assume that the Budget proposals will be based on a Treasury oil price assumption of $15/barrel, giving a PSBR 'target' of around £7¾ billion in 1986-87 and scope for around £½-1 billion in tax cuts. This assumes that the fall in oil revenues from the levels forecast in the 1985 FSBR will be partially offset by increased non oil revenues, (notably CT revenues £1½ billion higher than at the time of the Autumn Statement) and here, they maintain, they are more optimistic than other forecasters.

8. S&C give a summary of likely Budget measures. They suggest tentatively complete indexation and on top of that a reduced rate band, halving of stamp duty, new taxes on financial services and 'windfall earnings', a NIC package, employment measures and an increase in petrol duty above revalorisation. They look for an MO target range of 2.6 per cent and a money GDP "illustration" target of 6½ per cent but no new £M3 target range.

Response to oil price fall

9. S&C emphasise the supply side benefits of the oil price fall. They see a trade off between a permanent inflation gain and a temporary output gain but, with unemployment high in the UK, believe the Government will opt for higher output over the short term. This implies allowing a real exchange rate fall and ensuring the benefits are not choked off by an excessively tight monetary policy. S&C advocate effectively replacing monetary targets by a unit cost target. Given the favourable supply side effects stemming from the oil price fall and the fact that higher taxation of the non-North Sea sector in substitution for the loss of North Sea tax revenue is likely to have a greater effect on economic activity, S&C suggest government borrowing (as measured by the PSFD) should act as a shock absorber and be allowed to rise. But they note that the PSFD has already increased by £3 billion since the 1985 Budget and would therefore keep it at its current level, implying a PSBR below £8 billion.

10. S&C give their usual assessment of the likely course of the MTFS in the next few years. First they give "targets" for the PSBR which they feel are likely to be set in the FSBR. For 1986-87, they have £7¾ billion which they think, with the help of oil prices above $15 the Government has a reasonable chance of meeting. For the next two financial years, they set the PSBR at £7 billion. However, with buoyancy in revenue not expected to offset overshoots in public expenditure, S&C expect PSBR outturns of £8½ billion, £8 billion and £8½ billion respectively.

Lecture Text - 'Where economists now agree'

11. This lecture highlights some of the theoretical and policy making disputes of the late 1970s, and argues that there is now a greater degree of consensus in the economics profession. There are six major areas in which Davies argues there is substantial agreement

(a) the operation of monetary targets is not, in itself, sufficient for macroeconomic policy: the relation between money and national income is imprecise, and money is difficult to define and control

(b) some form of nominal target should should be set by the Government (eg nominal GDP, unit costs, or sterling exchange rate)

(c) there is a role for fiscal policy to assist in hitting the chosen nominal target

(d) inflationary shocks should not be accommodated by the Government

(e) wages are important in determining the levels of employment and unemployment - the Government has 'allowed' unemployment to rise simply in order to keep inflation (attributed to an accommodating stance toward wage bargaining between unions and oligopolistic firms) in check

(f) Government attempts to stimulate demand should take account of the supply side of the economy.

12. However, Davies believes that no major consensus has been reached over unemployment. He rejects the argument that because the labour force has been growing very rapidly unemployment has increased, since growth of this magnitude in the past has been accompanied by falling unemployment. He also rejects three further arguments. Technical change was, he argues, at least as rapid in the 60s and 70s, and yet unemployment did not increase as quickly. Though the world recession hit other countries, they did not experience the same rate of increase in unemployment as the UK. And whilst employment has risen substantially since 1983, there has been little change on a full time equivalent basis.

13. One possible explanation is that the replacement ratio is too high, preventing the real wage in the non-unionised sector from falling for enough to clear the market. But Davies claims that most studies show that the replacement ratio is too low to have any great influence. Davies' preferred explanation is that bargaining between unions and firms increases the likelihood of inflation at any given level of output, thus raising the NAIRU. Davies recommends that the Government should do something to influence the bargaining behaviour (an incomes policy, or profit sharing, for example), especially when a pool of long term unemployed is assumed to be effectively out of the labour market, and thus unable to

affect the wage bargaining process. Furthermore, Davies expresses concern that this pool, and thus the NAIRU, may tend to rise if the economy is slow to adjust from an initial disequilibrium position and if the actual level of unemployment is above the NAIRU. He concludes by lending support to the House of Commons Select Committee on Employment, and says that their package is about 'ten times more cost effective per job ...[than] income tax cuts.'

Lines to take

14. Prospects: S&C's GDP forecast for 1986 up from 2 per cent last month to 2½ per cent, and far higher than the ¾ per cent forecast they were giving in February 1985, S&C forecast sustained growth to continue through 1987 and 1988. Inflation forecast to be 3½ per cent by 1986Q4. S&C expect unemployment to fall below 3 million in 1987. All in all suggest increasing optimism over the performance of the economy.

15. On S&C's assessment of likely Budget measures. Wait till Budget.

16. Government has an inflation 'target'. Aim is to maintain steady downward pressure on inflation. Price stability remains ultimate objective.

17. Problems with monetary targets? Not so. Necessary to look at range of monetary indication. Conflicting signals. On balance policy firm but not excessively tight. And look at achievements. Inflation 5.5 per cent and falling; fifth successive year of economic growth.

18. Should use unit cost target? No. Davies admits that Government cannot control unit costs. Simply reflects Davies' belief that inflation generated by wage pressures, not loose monetary policy. Government sees link between pay and jobs.

19. Should use nominal GDP target? Practical obstacles: data arrive late, and liable to revision; nominal GDP takes time to respond to policy changes.

20. Fiscal policy has been relaxed Chancellor has adopted a permanent income approach? Fiscal policy is prudent. PSBR is low. Privatisation not pursued to disguise 'relaxed' fiscal stance, but to encourage supply side benefits of enterprise and efficiency.

21. Role for fiscal policy in hitting nominal targets? Fiscal expansion will ultimately lead to crowding out. Low PSBR will, however, provide microeconomic supply side benefits.

22. PSBR a garbage statistic? Ridiculous claim. PSBR only measure of fiscal stance available on a timely basis.

23. S&C agree with Government that inflationary shocks should not be accommodated, and that wages are important in determining the level of unemployment.

24. Government has 'allowed' unemployment to rise? Nonsense. More realism on wages required by employers and employees if unemployment is to come down. A more accommodating policy would, as Davies admits, only let inflation rise again, with disastrous long term consequences for both output and unemployment.

25. Recent rise in labour force not unprecedented? Labour force rose by 510,000 in 1984. Largest rise in single year since figures began to be collected.

26. On a full-time equivalent basis, little change in number of jobs since 1983? Full-time equivalent calculation fraught with uncertainty. Around 600,000 more people in work since June 1983 and no evidence that bulk of them work particularly short week. Davies like others omits self-employed.

27. H of C Select Committee's measures ten times more cost efficient per job than income tax cuts? Takes no account of supply side benefit of tax cuts in terms of incentives and improved efficiency.

28. Long term unemployed do not affect wage bargaining. No conclusive evidence on this. Therefore imprudent to take policy measures assuming that they do not.

S D KING

NOT FOR PUBLICATION
BEFORE 00.01 HOURS
FRIDAY 14 MARCH 1986

Simon & Coates

The Economics Analyst

Not for Publication Before 00.01 Hours on Friday 14 March 1986

Information: *Chief Economists:*
Gavyn Davies (UK) *Work: 01-588 3644* *Home: 01-691 2077*
David Morrison (International) *Work: 01-588 3644* *Home: 01-541 0214*

PUBLIC SECTOR BORROWING AFTER OPEC III

1. This will not be a Budget in which Mr. Lawson can make a major splash as a tax-cutter or a tax-reformer. Exactly how he re-shuffles the tax system will be of only passing interest from a macro-economic standpoint, though individual tax changes may have important market implications. (Our own guesses about the likely package appear on pp2—4.) Much more interesting this year are the major strategic issues raised by the oil price crash, and the financial markets should judge Mr. Lawson mainly on whether his medium term plans successfully come to grips with the new situation.

2. Essentially, the Chancellor needs to re-cast the MTFS to take account of the new world, post OPEC III. Even if the Treasury forecast is based on some bounce-back in oil prices, government revenues from the North Sea in 1986/87 are likely to be less than half of the £11½bn expected a year ago (see table overleaf). The big question is: how much of this, if any, should be added to government borrowing?

3. There are four reasons why it is legitimate for government borrowing to rise in response to reduced oil revenues. These are:

   (i) ***Demand Effects.*** Oil revenues have a lower short-term impact on demand than other forms of government revenue. A simple replacement of oil receipts by increased taxation elsewhere therefore depresses the economy — something which is entirely inappropriate in view of the supply-side gains which the onshore economy will enjoy as a result of lower energy costs. This can only be avoided by allowing borrowing to rise, perhaps by about £4bn relative to plans made this time last year.

   (ii) ***Public Sector Balance Sheet Considerations.*** In order to leave the net worth of the public sector constant, the government should "consume" through lower taxation only that portion of the oil revenues in excess of the ***permanent*** increase in revenue to be derived from oil. The likely excess of actual revenue over permanent revenue has fallen by £4—5bn since the 1985 Budget plans were published; on public sector balance sheet considerations this should now be added to public borrowing in 1986/87.

   (iii) ***Absorbing The Shock.*** The loss of oil revenues should be partially offset in the long term by an increase in non-oil receipts as the growth performance of the onshore economy improves. Consequently, if tax ***rates*** are left unchanged from now on, public borrowing will initially rise in response to reduced oil receipts, but will then fall back as the non-oil economy expands. In these circumstances, it is legitimate to allow a short-run increase in borrowing as the economy adjusts to lower oil prices. The alternative is to allow a temporary increase in tax ***rates*** in order to stabilise public borrowing. But this is surely more de-stabilising for the private sector than accepting a temporary rise in borrowing.

   (iv) ***Hitting the Money GDP Target.*** It is now increasingly agreed by economists from all sides that fiscal

P.T.O.

policy changes have a role to play in ensuring that money GDP targets are achieved. The existing target for money GDP growth in 1986/87 is 6½%, and on our forecast this seems likely to be ***undershot*** by about 1%. It would almost certainly be missed on the low side by an even wider margin if the fiscal stance is now allowed to tighten (see above). Some easing in the fiscal stance, ***as well as*** the downward shift in the 'invisible' exchange rate target which has already occurred, therefore appears legitimate. In order to achieve this combination, it may be important to ease monetary policy by cutting ***interest rates*** immediately after the Budget. Otherwise undesirable upward pressure might develop on the currency.

4. These factors suggest that, ***in order to achieve the same ultimate objectives set for the economy a year ago***, the Chancellor would need to increase public borrowing relative to the targets announced in March 1985. These targets were £7½bn for the PSBR and an implied £9½bn for the PSFD (the public sector financial deficit). From now on, it is sensible to concentrate ***only*** on the PSFD, since the PSBR total can be massaged to any extent the Chancellor chooses by varying the path for privatisation receipts. (For example, there is at least £2—3bn of flexibility in this year's PSBR projection to be derived by varying the timing of British Gas receipts and the subsequent payment to the Exchequer of the loan stock which BGC is rumoured to be raising after privatisation.) ***In consequence, the PSBR is now an economically irrelevant statistic*** (though it does of course determine the level of gilt sales).

5. Concentrating on the PSFD, the above arguments suggest that an increase from £9½bn to about £14bn would be necessary to achieve the same ultimate economic objectives that were set a year ago. How likely is it that Mr. Lawson will contemplate such an increase? At first sight, it might seem wholly implausible. Yet the Chancellor has already moved a long way down this road in the past 12 months — he has simply disguised the shift by increasing the privatisation programme, thus leaving the (economically irrelevant) PSBR unchanged. For example, if the PSBR target in the Budget is left at £7½—8bn, the planned receipts of £4¾bn from privatisation would leave the PSFD at around £12½bn, only £1½bn short of the "appropriate" target mentioned above. A small slippage relative to target could easily wipe out even this small margin.

6. Hence the government has already accepted the case for responding to reduced oil revenues by increasing the level of government borrowing. The only question is whether the Chancellor comes clean and admits this, presenting a clear rationalisation for what he is doing. If he does, the markets would probably be unruffled, accepting the new strategy as defensible, especially if the exchange rate and/or monetary targets are simultaneously beefed up. On the other hand, if the Chancellor tries to disguise what he is doing — attempting to focus attention on a garbage statistic such as the PSBR — he will deserve and receive less long-term respect from the markets.

Table 1: Possible Changes Between 1985 and 1986 Budgets (as forecast on pp2—4)

£bn	Projections for 1986/87 made in: 1985 Budget	1986 Budget (forecast)	Change
1. Oil Revenues	11.5	5.0	-6.5
2. Underlying Non-oil Revenues	147.5	151.5	4.0
3. Tax Cuts	3.5	0.75	-2.75
4. Total Non-oil Receipts	144.0	150.75	6.75
5. Total Receipts	155.5	155.75	0.25
6. Total Expenditure (excl. asset sales)	166.0	169.25	3.25
7. Public Corp. Borrowing	-1.0	-1.0	0
8. PSFD	9.5	12.5	3.0
9. Asset Sales	2.0	4.75	2.75
10. PSBR	7.5	7.75	0.25

11 March 1986

010 RP2.65

cc BG

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

6 March 1986

Sarah Straight
Assistant Private Secretary to the
Secretary of State for Transport

NBPM.

Dear Sarah,

BUDGET DAY PRESS NOTICES

As you will be aware, the Chancellor will be giving his Budget Statement on Tuesday 18 March. In handling press notices, we propose to follow the arrangements of previous years under which all press notices, including those issued by departments other than the Chancellor's, are collated by the Treasury and issued both to the press and the House.

Your Department and others will doubtless already be considering whether you wish to issue any press notices on Budget day. I would be grateful for confirmation, by close on Monday 10 March of the subject matter of any such notices. It would also be helpful if you could let me have by then a contact point (name and telephone number) for any subsequent enquiry on each. Press notices should, of course, be cleared in draft with the appropriate expenditure divisions in the Treasury as early as possible.

As you will appreciate, the Treasury will be photocopying and collating a large volume of material over the weekend before the Budget. As a consequence, I am afraid that we must ask for copies of press notices to be sent to us by no later than midday on Friday, 14 March. We will require 1725 copies in all. These should be sent to our Committee Section preferably split within the package into three sets numbering 1150, 460 and 115 copies respectively.

I am sending a copy of this letter to the Private Secretaries of all other Cabinet Ministers, David Norgrove (No.10) and Michael Stark (Cabinet Office).

Yours sincerely,

Philip Wynn Owen.

P WYNN OWEN
Assistant Private Secretary

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

5 March 1986

BUDGET PROPOSALS

The Prime Minister is content with the Budget proposals set out in the Chancellor's minute to her of today. (minute mtu DRN 6/3/86)

DAVID NORGROVE

Mrs Rachel Lomax,
H M Treasury

CONFIDENTIAL

RR7.8

BUDGET SECRET

Copy No. 1 of 8
Ref No. 23J
S

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

Prime Minister
The Chancellor has already mentioned most (perhaps not all) of these proposals to you. Content?
DRS 5/3

PRIME MINISTER

BUDGET PROPOSALS

You already have my Budget proposals on indirect taxes. I still have to reach a final view on income tax, in the light of the latest economic forecast, which I shall want to discuss further with you when we next meet. This minute covers my remaining tax proposals, none of which depend on what is done on income tax. In addition, as you know, I am discussing with David Young a package of public expenditure measures to help the long-term unemployed, on which I hope to be able to report early next week. The cost of these will be met from the Reserve.

None of the measures described below will have significant effects on revenue next year. Taken together, they are more or less revenue-neutral. But overall they should help to encourage enterprise and improve the performance of the economy - and hence, of course, employment. In particular, I have been concerned to devise measures which carry further forward the themes of my previous Budgets.

Business and Enterprise

First, measures for business and enterprise. The Business Expansion Scheme is due to end next year and I have been reviewing its future with the help of a report from Peat Marwick. This report confirms that the BES has been an outstanding success in its aim of attracting new equity capital into unquoted companies, a high proportion of them new

and small businesses. I therefore propose to continue the Scheme indefinitely. At the same time I feel I must take action to prevent abuse of the Scheme by excluding from its scope companies holding more than half their assets in the form of land and buildings and certain other activities which are threatening to bring the BES into disrepute (eg. investment in fine wines). These exclusions will serve to target the scheme more firmly on risk investment. I propose at the same time to improve the scheme further, by exempting BES shares issued after Budget Day from Capital Gains Tax on first sale.

My major proposal in this field is on Capital Transfer Tax. I intend to abolish the tax on lifetime gifts, which has had a particularly damaging effect in locking up assets and impeding the mobility of capital. You will recall the fierce attack we mounted on the taxation of lifetime giving when it was first introduced by Labour in 1974. This cost will be £35m in 1986-7 and £55m in 1987-8. The charge on death would of course remain, supported by a tapered charge on gifts made within seven years of death. In recognition of the radically changed nature of the tax I propose to rename it the Inheritance Tax. This will, in effect, be the fourth tax abolished since 1983. I believe this proposal will be warmly welcomed by all those who own and run family businesses. — The Unquoted Companies Group will feel it doesn't go far enough.

I shall also be proposing a number of smaller measures to help business, including the extension and improvement of the Loan Guarantee Scheme, under which the Government guarantees bank loans to small and new businesses. In addition, I am planning to announce that we will embark on very preliminary discussions with employers and others about the feasibility of devising incentives for profit-sharing agreements in industry, perhaps through some temporary measure of tax relief, as a means of increasing the flexibility of the labour market.

Pre Thurs
Is "Inheritance Tax" a good name.
Shades of "Wealth" Duties.
NLW

As last year, I propose to increase the scale charge for assessing the taxable benefit of company cars by 10 per cent. At the same time, in response to representations from the motor industry, I shall be changing the engine scale break points to come into line with the break points in the new European Community directive on exhaust emissions. The fuel scale will remain unchanged but, as from April 1987, it will also be used to assess the VAT due on petrol used by registered traders and their employees.

I should also like to rectify an anomaly in the taxation of overseas entertainers and sportsmen visiting the UK. In virtually every other major country - including the US, Germany and France - a tax is imposed on visiting British entertainers and sportsmen. There is no reason to give foreign visitors here more favourable treatment than British visitors receive abroad. If the necessary legislation can be drafted in time, I propose to impose a witholding tax of 30 per cent on the earnings of these people. The change will bring in extra revenue of up to £100 million in 1987-8. No doubt there will be complaints (although most of the tax will be at the expense of Revenue authorities overseas) but there is an indisputable case for taking this action and the best time to do so is now.

This has to be right - but it will increase the pressure for greater support for the Arts Council.

Savings and Investment

There is clearly a very strong case for reducing - if not abolishing altogether - the Stamp Duty on equities to coincide with the Stock Exchange's Big Bang in October. With no tax at all on share transactions in New York and only half a per cent in Tokyo, the current rate of duty of 1 per cent threatens to make London uncompetitive in the fast developing world market for financial services. If London cannot win a major share of

the global securities market its present world pre-eminence in other financial services will be threatened. I would therefore like to cut the rate to ½ per cent in October. But I believe it would be politically awkward in the present climate of opinion about the City to reduce the overall contribution which financial services make to the Exchequer. I therefore propose to recoup the entire cost of the rate reduction by applying the duty to other transactions which currently escape it, such as intra-account transactions and takeovers and mergers. There will also be a special rate of 5 per cent on the conversion of UK shares into American Depository Receipts, the method increasingly used to escape Stamp Duty and transfer dealings abroad.

This change will have the incidental benefit of reducing the cost of share dealings by individuals. But I am anxious to find more immediate ways of promoting our policy of encouraging direct share ownership by individuals. I therefore intend to propose a radical new scheme under which individuals can invest up to £2,400 a year in equity shares to be held in a special account known (unless I can think up a better name) as a Personal Equity Plan. While in the Plan investments will be entirely free of all capital gains tax and income tax on dividends. They need be held only for a short qualifying period (under two years) before they can be withdrawn tax-free. The cost will be negligible in 1986-7, and about £25 million in 1987-8. The cost in later years will depend on take-up, but it is bound to rise. I am sure that over time this measure will dramatically extend share ownership in Britain, just as the rather different Loi Monory has in France.

I plan to announce in the Budget Speech my intention to introduce in next year's Finance Bill provisons which will, in effect, give personal pensions the same highly favourable tax

treatment as is enjoyed by other funded pension schemes. I shall reiterate the assurance I gave last year, that I have no plans to change that favourable tax treatment in any way. But I do need to clarify the Revenue's discretionary rules for dealing with the growing problem of pension fund surpluses. As inflation has fallen and the climate for investment has improved, many pension funds have become heavily, and undesirably, over-funded. This is now attracting some attention in the press. Excessive surpluses are a clear abuse of the tax privileges enjoyed by the funds. Nor are they in the interests of pension fund members who are denied the higher benefits or lower contributions they might otherwise enjoy. At the same time the Revenue is having to use its discretionary powers to turn down many of the increasing number of requests for refunds from companies which, in the 70s, had to top-up funds which were then in deficit.

The result is an inevitably arbitrary state of affairs which is causing dissatisfaction all round. I therefore propose clear and objective legislation under which funds with surpluses of more than 5 per cent (calculated on standard published guidelines, based on the most conservative funding and actuarial methods) will be required to eliminate their excess over a period of years. How they do so will be entirely a matter for the trustees: they can choose to increase benefits, or reduce contributions, or make a refund to the company. But if there is a refund, there will be a tax of 40 per cent on the company (not the pension fund) to recover at least part of the tax relief it will have obtained on its contributions, and to discourage abuse of this tax relief through "parking". These changes should bring in an extra £20 million in 1986-7 and £120 million 1987-8. In devising this scheme, I have had the benefit of the advice of the Government Actuary.

Charities

Finally, I have decided to make major changes in the tax treatment of charities. Charitable giving substitutes private action for State action and we have already done much to encourage it. I have been urged by many colleagues to do more. I have three proposals: first, I intend to abolish the upper limit on relief at the higher rates of tax on charitable covenants, while at the same time stopping the abuse of the tax system by certain sorts of private charity. Secondly, I propose to allow companies, other than close companies, tax relief on one-off gifts up to a maximum of 3 per cent of their dividend payments. Thirdly, I shall propose a new scheme of payroll giving under which, if employers agree, employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them. These new measures will of course be in addition to the present tax relief for covenants by both companies and individuals. They should in time lead to a substantial increase in charitable giving. The cost will be negligible in 1986-7 and about £60 million in 1987-8 in gross terms, partly offset by a yield of around £20 million from the anti-abuse measures.

As I told you last week, I also wish to make a number of minor but carefully chosen concessions to charities on the VAT front.

I would be glad to know if you are content with this package of measures.

Rachel Lomax

N.L.

5 March 1986

6

(approved by the Chancellor & signed in his absence)

Revenue Effects of Budget Changes

Cost-/Yield+	1986-87	1987-88	£m
Business and Enterprise			
Business expansion scheme	neg	+10	
Capital transfer tax	-35	-55	
Car and fuel benefits	neg	+15	
Overseas entertainers	nil	+100	
Savings and investment			
Stamp Duty	neg	+10	
Personal Equity Plan	neg	-25	
Pension fund surpluses	+20	+120	
Charities			
Package of reliefs	neg	-60	
Anti-abuse measures	neg	+20	
VAT concessions	-10	-10	
Total	-25	+125	
Memo			
Loan Guarantee Scheme (+additional expenditure)	nil	10	

RR7.8

BUDGET SECRET

4

COPY NO: 1 OF 8
REF Nº: 22J

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

Copy replaced by later version: this one has errors.

PRIME MINISTER

BUDGET PROPOSALS

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As last year, I propose to increase the scale charge for assessing the taxable benefit of company cars by 10 per cent. At the same time, in response to representations from the motor industry, I shall be changing the engine scale break points to come into line with the break points in the new European Community directive on exhaust emissions. The fuel scale will remain unchanged but, as from April 1987, it will also be used to assess the VAT due on petrol used by registered traders and their employees. The result will be a fairer system, which will also bring in £40 milion in 1987-88.

I should also like to rectify an anomaly in the taxation of overseas entertainers and sportsmen visiting the UK. In virtually every other major country - including the US, Germany and France - a tax is imposed on visiting British entertainers and sportsmen. There is no reason to give foreign visitors here more favourable treatment than British visitors receive abroad. If the necessary legislation can be drafted in time, I propose to impose a witholding tax of 30 per cent on the earnings of these people. The change will bring in extra revenue of up to £100 million in 1987-8. No doubt there will be complaints (although most of the tax will be at the expense of Revenue authorities overseas) but there is an indisputable case for taking this action and the best time to do so is now.

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the global securities market its present world pre-eminence in other financial services will be threatened. I would therefore like to cut the rate to ½ per cent in October. But I believe it would be politically awkward in the present climate of opinion about the City to reduce the overall contribution which financial services make to the Exchequer. I therefore propose to recoup the entire cost of the rate reduction by applying the duty to other transactions which currently escape it, such as intra-account transactions and takeovers and mergers. There will also be a special rate of 5 per cent on the conversion of UK shares into American Depository Receipts, the method increasingly used to escape Stamp Duty and transfer dealings abroad.

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The result is an inevitably arbitrary state of affairs which is causing dissatisfaction all round. I therefore propose clear and objective legislation under which funds with surpluses of more than 5 per cent (calculated on standard published guidelines, based on the most conservative funding and actuarial methods) will be required to eliminate their excess over a period of year. How they do so will be entirely a matter for the trustees: they can choose to increase benefits, or reduce contributions, or make a refund to the company. But if there is a refund, there will be a tax of 40 per cent on the company (not the pension fund) to recover at least part of the tax relief it will have obtained on its contributions, and to discourage abuse of this tax relief through "parking". These changes should bring in an extra £25 milion in 1986-7 and £140 million 1987-8. In devising this scheme, I have had the benefit of the advice of the Government Actuary.

Charities

Finally, I have decided to make major changes in the tax treatment of charities. Charitable giving substitues private action for State action and we have already done much to encourage it. I have been urged by many colleagues to do more. I have three proposals: first, I intend to abolish the upper limit on relief at the higher rates of tax on charitable covenants, while at the same time stopping the abuse of the tax system by certain sorts of private charity. Secondly, I propose to allow companies, other than close companies, tax relief on one-off gifts up to a maximum of 3 per cent of their dividend payments. Thirdly, I shall propose a new scheme of payroll giving under which, if employers agree, employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them. These new measures will of course be in addition to the present tax relief for covenants by both companies and individuals. They should in time lead to a substantial increase in charitable giving. The cost will be negligible in 1986-7 and about £60 million in 1987-8 in gross terms, partly offset by a yield of around £20 million from the anti-abuse measures.

As I told you last week, I also wish to make a number of minor but carefully chosen concessions to charities on the VAT front.

I would be glad to know if you are content with this package of measures.

Nigel Lawson

N.L.

5 March 1986

(approved by the Chancellor
& signed in his absence)

BM

BUDGET CONFIDENTIAL

File

10 DOWNING STREET

From the Private Secretary

26 February 1986

BUDGET: INDIRECT TAXES

The Prime Minister is content with the proposed changes to the indirect taxes set out in the Chancellor's minute to her of today.

(David Norgrove)

Mrs. Rachel Lomax,
HM Treasury

BUDGET CONFIDENTIAL

Ref No 13J

BR/17

BUDGET SECRET

COPY NO 1 OF 6 .

3

PRIME MINISTER

I am writing to let you know what I have in mind for indirect taxes in the Budget.

I have reached the view that it would not be sensible to do more than revalorise the excise duties as a whole this year. There is no prospect of a major offsetting reduction in income tax. So I see little point in jeopardising the good prospect for a further significant reduction in inflation by adding unnecessarily to the RPI. But I think it is attractive to take the opportunity to reduce sharply the number of individual tax increases in the Budget, rather than simply uprating all the duties by the 5.7 per cent indexation factor.

As far as the motorist goes, I propose to put up petrol duty by 7½p a gallon and the duty on derv by 6½p a gallon. In each case this is about 2p a gallon more than revalorisation - but far less than most people are predicting. This will enable me to leave all the main VED rates unchanged.

Moreover, given the sharp fall in the oil price that has already occurred, and the slowness of the oil companies so far to reflect this in lower prices at the pump, there is no need for fuel duty increases of this order to be passed on to the consumer at all.

As Norman Fowler reminds me every year, there is considerable pressure on health grounds to increase the tax on cigarettes by appreciably more than revalorisation. I therefore propose an increase equivalent to approximately 11p on a typical packet of 20, with, as last year, no increase in the tax on pipe tobacco and cigars.

Simple revalorisation would be about 5p.

BUDGET SECRET

This will mean that there is no need for any increase at all in the duty on alcoholic drinks - for the first time since 1979. The prize here will be the absence of any increase in the tax on beer - which, you will recall, I had to put up by more than I would otherwise have done in 1984, to conform with the EC infraction judgement. The standstill on whisky will, of course, go down well in Scotland.

The overall impact of this package on the RPI, as conventionally calculated, will be to add about 0.5 per cent, entirely reflecting the effect of revalorisation. This is the same as last year's Budget, so there will be no change in the annual figure on this account.

I also propose to simplify the indirect tax system slightly by abolishing one or two of the minor oil duties and recouping the small loss of revenue from a 1½p increase in the duty on gas oil. This has been unchanged since 1980, leaving gas oil clearly under-taxed at the present time, relative to the rest of the EC. The duty on heavy fuel oil would once again remain unchanged.

So far as VAT is concerned, with the exception of one or two minor concessions to charities - relief on their newspaper advertising, and on medicinal products supplied to them - I am proposing to make no changes here, either to the rate or the base. However, I do intend to increase the VAT threshold to £20,500, in line with revalorisation, in spite of the Commission's contention (which we reject) that it is already higher than Community law allows.

I would be grateful to know if you would be content with these changes.

Yes NL

N.L.

26 February 1986

? RPI at 0.5%

what allowance for petrol tax's not taking full increase?

196/25

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

FROM: N MONCK
DATE: 25 February 1986

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Byatt
Mr Kemp
Mr Burgner
Mr Scholar
Mr Odling-Smee
Mr Monger
Mr Shaw
Mr G M White
Mr Gilhooly
Mr Culpin
Miss Noble
Mr Guy
Mr Cropper
Mr H J Davies
Mr Lord
Mr Isaac)
Mr Lewis) I/Revenue
Mr Farmer)

PROFIT SHARING

... I attach a draft consultative document. It is in two main parts. The first gives a political and economic statement of the case for tax relief to stimulate profit sharing (paragraphs 1-12). The second, which would be in a slightly smaller type face, describes the scheme. A final version would have an Annex with a worked example of a profit sharing agreement with tax relief in action. But this is not ready yet. The first section is largely Mr Davies' work and the second section IAE's making use of a very helpful contribution from the Revenue.

The tone

2. The draft could be attacked for not being enthusiastic enough or, alternatively, for under-playing the practical difficulties. What we have tried to do, following what you have said after seeing Lord Young, Mr Channon and my minute of 17 February reporting their officials' reactions, is to draft a document which:

(a) is sufficiently positive to get people interested and to score the "political plus" which Mr Channon expected; but

(b) sufficiently cool to allow the Government to drop the scheme without severe embarrassment.

3. Although the draft needs much more work, it probably gives you a fair basis for judging the general impression that a document steering between these two

CONFIDENTIAL

requirements will give. But I think it is true that the draft does understate the practical complexities, though most pay systems are in fact appallingly complicated to the outsider.

Specific points on the draft

4. I draw your attention to paragraph 17 in which we introduce the option of phasing the 20 per cent conversion over two years. Douglas Smith in DE has commented that this new feature "might go some way to mitigate" the danger of an initial inflationary blip from unions bidding-up fixed pay to offset the downside risk from the scheme.

5. In the opening section we have under-played the distinction between existing employee share schemes, which are mostly a negligible element in total remuneration, and the new scheme, in order to meet your desire to present the latter as building on existing schemes.

6. In paragraph 24 we plump for giving tax relief up to a year before the employee's remuneration is affected by the profit sharing agreement. This increases the risk of abuse (see paragraph 22) but also increases the attractiveness of profit sharing agreements.

7. You may think the last paragraph is rather too definite about legislating in 1987 if the response to consultation is favourable. In a desire to be positive we have not qualified it with any proviso about availability of resources etc. Nor have we repeated the requirement in paragraph 1 that the take-up should be "sufficiently large and broadly based" which is code for enough factories to outweigh the city slickers.

8. We envisage that the profit-linked income would be subject to employees' national insurance contributions. This means that we have to decide whether to rule out profit sharing income coming through a trust, as with the John Lewis Partnership, from access to tax relief, if DHSS do not block the loophole in the present NIC regulations.

Questions for decision and next steps

9. The first question is whether you want to pursue this proposal.

10. If you do, I recommend you to get Lord Young and Mr Channon to associate themselves with you. To do that, you will want to send them an improved version of the attached draft.

11. The second question is what changes you want made in the draft.

12. You are also planning to consult Sir John Hoskyns.

13. At a later stage you will want to consider the handling of the proposal after a document has been issued. The possibilities include a discussion in NEDC and inspiring favourable Press articles etc.

N MONCK

PROFIT SHARING: DRAFT CONSULTATIVE DOCUMENT

Introduction

Profit-sharing brings considerable economic benefits. This paper explains the economic case for a further Government initiative to encourage expansion of arrangements for relating employees' income to profits, describes a possible scheme of tax relief which could promote profit-sharing on a voluntary basis, and invites comments, particularly on the likely take-up. If the response suggests that the take-up would be sufficiently large and broadly based, the Government will consider bringing forward legislation in the 1987 Finance Bill.

2. One way of linking income to profits is employee share ownership. This Government has taken a number of steps to encourage the growth of employee share ownership in the United Kingdom. The provisions in the 1978 Finance Act for employee share ownership were significantly relaxed in 1980. Tax relief for all employee Save As You Earn employee share option schemes was introduced in the Finance Act 1980, and in 1984 a discretionary share option scheme was brought in. Also throughout its period of office, in pursuing its policy of privatising state enterprises wherever possible, the Government has paid special attention to the desire of the workforce of those industries to own shares in them.

3. These policies have accelerated the spread of employee share ownership. Already more than a thousand all employee share schemes are in operation and a further 1300 FA 1984 share option schemes. More than a million employees have received shares or interests in shares in the companies in which they work - around 400,000 of them in the newly privatised companies.

4. It is clear from the success of these schemes that there is considerable enthusiasm among working people for a closer association with the companies in which they work. The growth of employee share ownership has been parallelled by an increase in the coverage of payments-by-results systems, and a very rapid expansion in the number of worker co-operatives, from some 300 in 1979 to more than 1,000 today. [After the passage of the 1986 Finance Act members of co-operatives will also be able to participate in employee share schemes.]

5. The Government recognises the importance of these developments. Closer identification of the interests of employees and employers serves to break down

the "them and us" mentality which has long been a damaging feature of industrial relations in the UK. Employee share ownership introduces a new element of flexibility into patterns of remuneration. It encourages employees to be more concerned about the long term future of the businesses in which they work, since part of their income is related to the long run profitability of the company's investment. As a result, employees will be more ready to raise productivity and to negotiate pay agreements which contribute to corporate growth. This, in turn, is likely to lead to higher investment and higher levels of employment.

6. Current trends suggest that employee share ownership will continue to expand in the existing fiscal and regulatory environment. But though the growth so far has been rapid - and the Government will continue to encourage such schemes - there are many companies and many areas of the economy in which little progress has been made. In part this may be because the existing forms of employee share ownership are not always applicable.

7. There is therefore a case for considering new initiatives to build on the success of existing schemes and to go beyond them. One such initiative would encourage the introduction of profit sharing schemes which did not depend on the issue of new shares, but which linked a significant proportion of total remuneration to the profitability of the employment unit.

Profit Sharing

8. The economic case for profit sharing rests on what is a straightforward proposition. If a large number of employees convert a significant part of their remuneration from wages to a profit-linked income then output and employment are likely to be more stable and, on average over time, there is a higher level of economic activity. The economy as a whole will be more resistant to economic shocks, for example in a downturn some of the necessary adjustments could take the form of a small across the board reduction in profit-linked income, rather than redundancies and reductions in the size of the workforce. Adjustments, in other words, are more likely to take the form of changes in prices than of quantities*.

9. At the level of the individual profit sharing firm, there will in general be a greater incentive to retain or take on labour. From the employer's

*The impact of profit sharing on output, investment, employment and competition has been discussed in a number of recent academic papers. [Annex B lists the principal references.]

perspective the short run marginal cost of employing an additional person is reduced. If the proportion of total profit available to the workforce is fixed, then employers will wish to take on additional employees as long as the value they add is higher than the non-profit-linked element of their remuneration. Since there should be an increase in the aggregate demand for labour, profit sharing does not in the long run imply any general reduction in employee incomes.

10. A large scale shift in patterns of remuneration from pure wage to wages and profit-linked income could, therefore, be beneficial to the economy as a whole. There are signs that many companies appreciate the benefits, in their enthusiasm to establish employee share ownership schemes. But some of the benefits of profit sharing go beyond the existing employers and employees of a particular firm. They accrue to the unemployed who may be taken on in the future, and to society as a whole which would benefit from a lower level of unemployment. There may therefore be a case for encouraging the spread of profit-sharing agreements by a tax concession to existing employees, lowering their average tax rate if they are prepared to convert a proportion of their existing remuneration to a share of profit.

11. When profits rise employees will benefit directly. But an individual employee converting a substantial proportion of current remuneration into profit-linked income undoubtedly faces the prospect of increased volatility in total remuneration. A reduction in tax, in the form of a percentage of <u>total</u> pay free of income tax would provide an inducement to workers to accept this volatility, giving higher net wages at current profit levels, and cushioning employees against the impact of a future fall in profit on take home pay.

12. The remainder of this paper outlines a scheme offering tax relief to participants in profit sharing agreements designed to deliver the benefits described above.

A POSSIBLE SCHEME FOR TAX RELIEF

13 The precise form of profit sharing agreements is likely to vary from case to case. But if tax relief is to be granted certain minimum conditions would have to be met. The Government believes the following would be essential if the scheme were to yield savings:

a. at the outset at least 20 per cent of pay must be linked to profit;

b. at least 80 per cent of employees must be covered.

If these two principal conditions were met, then 10 per cent of total income could be tax-free, up to a maximum of £2,000 per employee. Other detailed conditions for qualification for tax relief are considered below.

14. Legislation would be needed to define the profit sharing agreements satisfying the criteria for tax relief. Existing arrangements which met the criteria would be eligible as well as new ones. Certain aspects would need to be precise. The legislation would have to strike a balance between the precision needed to attain the objectives and minimise abuse and the simplicity and flexibility needed to make the scheme workable.

15. The Government's provisional view is that the legislation would need to cover the following areas:

a. the definition of employment unit to be covered by the profit sharing agreement and the minimum proportion of the workforce participating;

b. the proportion of employees' remuneration to be converted to profit-linked income at the outset; the formulae for relating individual profit linked income to changes in profits; the measure of profits to be used, how frequently it should be recalculated, and how quickly changes in it should be reflected in profit-linked income;

c. agreement by employees not to impede the taking on of extra labour;

d. the duration of the agreement.

Each of these areas is discussed below.

The Employment Unit and Minimum Participation

16. An agreement could cover all the employees of a profit-making business, but the employment unit could be any identifiable group of employees for which a matching audited measure of profits is available. In practice it might not always be possible to achieve full participation because particular employees, or particular groups of employees, prefer not to participate. The introduction of such an agreement with less than 100 per cent employee participation is likely to be more complicated to operate because there would be two groups of employees with different pay arrangements and different interests. The introduction of such an arrangement would only be justified if a significant proportion of the employees decided to participate: it is suggested that the minimum limit of participation should be 80 per cent of the employees within the relevant employment unit.

Profit Linking

17. To get the benefit of tax relief on 10 per cent, at least 20 per cent, of total remuneration (including overtime and bonus payments) would need to be converted to profit linked income. This conversion could be made in a single move at the outset. Another possibility might be to include a year of transition. For example in the first year of any scheme tax relief might be available on five per cent of total remuneration if at least ten per cent of total remuneration were converted to profit linked income with agreement to a further ten per cent of income becoming profit linked in the second year, when tax relief would increase from 5 per cent to 10 per cent of total remuneration. After the initial period the proportion of total remuneration which was profit linked income would vary, reflecting changes to profits and the movement in the residual pay which would continue to be the subject of normal pay bargaining, but the proportion of total remuneration free of tax would remain the full 10 per cent.

18. The legislation would probably need to prescribe a standard formula for calculating changes in the aggregate profit linked income for the employment unit as a result of changes in profits. The distribution of the aggregate to each employee would be weekly or monthly in accordance with the normal pay arrangements, and would be pro rata to total non-profit linked income. Profit linked income for each individual would probably be fixed for a forthcoming profit-linked accounting period, and be recalculated to take account of changes in the workforce and the relative pay of individuals only when new profit figures were available. [A worked example will be appended]

19. The legislation would not need to prescribe a single definition of profits but there would need to be a requirement that the profit statement was certified by an independent qualified accountant as showing a "true and fair" picture of the results for the period calculated on a consistent basis for the purpose of comparing profits between successive periods. At the sub-company level this would require auditors to satisfy themselves that costs and revenues were fairly allocated between profit centres, and that fair transfer prices for goods and services within the company were used.

20. Agreements could differ about the frequency with which profit declarations were made. For the purposes of receiving tax relief new profit figures would have to be calculated at least annually. Some employers might make profit declarations for the purposes of the scheme every six months or more frequently to make profit linked income closely responsive to profits. Agreements would need to provide for a maximum period after the accounting period within which changes should be made in the profit linked income, in order to prevent either side deliberately delaying the provision and use of new profit figures when there was a sharp change in either direction in the level of profits.

Freedom to engage additional workers

21. One of the main purposes of profit-sharing in the longer term would be to increase the flexibility of the labour market by making labour costs more responsive to profitability. Employers should then be more willing to accept the risks associated with expanding the labour force. It would need to be part of any profit sharing agreement that employees participating and receiving the benefits of tax relief would undertake not to obstruct the employment of extra workers who would be allowed to joint the profit sharing scheme.

Duration of agreements

22. The full benefits of profit-sharing would arise in the medium to longer term. Therefore the tax relief would only be available for profit sharing agreements intended to last for a minimum of three years. It would defeat the purpose if agreements could be broken at will by either side and mutual agreement to termination would be no guarantee against abuse of tax relief. However circumstances might arise in which it would be unreasonable or impossible to require an agreement to run its full course, for instance in the case of take-overs or amalgamations. Therefore there would be a need to allow break clauses in agreements which when activated would not prompt recovery of tax relief. The intention would be to allow reasonable commercial flexibility in the changing of agreements whilst ensuring so as far as possible that there were safeguards to prevent abuse. The earlier the tax relief became available the greater the risk of abuse.

Other issues to be covered in agreements

23. Agreements would have to deal with other issues which might not be covered in legislation. For example agreements might contain provisions as to arbitration between employer and employee in cases of dispute. Employers would have to consider the implications of conversion to profit-linked income for incentives provided for promotion, overtime and shift working. They would need to assess the implications of profit linking for superannuation arrangements.

Operation of Tax Relief

24. It is for decision whether the tax relief should take effect immediately an agreement is implemented - or only after the first remuneration dependent on profit-linked income becomes payable. As the tax relief is intended as an encouragement to an employee to enter into a profit sharing agreement there is a strong case that tax relief should be available from the date of implementation of a profit sharing agreement approved by the Inland Revenue. On the other hand, this would mean tax relief became available for up to a year before the employee's remuneration was affected by the terms of the agreement.

25. The aim would be to make the administration of the scheme as simple as possible to the employer. Tax relief would be given in the same way that relief is given to superannuation payments so that it would be reflected in the weekly or monthly take-home pay of participants. Employers would make returns to the Inland Revenue certifying the amount of relief awarded and the necessary records would be subject to audit checks, similar to those applicable to PAYE. The intention would be to streamline the approval procedure with as much guidance as possible being provided. An appeals procedure would be needed for disputes about entitlement to tax relief.

Coverage

26. All employees including those in unincorporated businesses would be eligible to participate in qualifying agreements, with the exception of those employed in the public service and those employed in non-profit making organisations or others which do not produce profit and loss accounts. Special consideration would have to be given to the position of the trading public sector. Controlling directors and the self employed would not be eligible for tax relief under this scheme. In general, employers rather than employees would be liable to the Inland Revenue for repayment of sums falsely given in tax relief under profit-sharing agreements.

27. The initial direct revenue cost of the tax relief would depend upon the take-up. If ten per cent of taxable pay up to £2,000 per annum became free of income tax under a profit sharing agreement approved for the purpose by the Inland Revenue the cost to the Exchequer would be approximately £250 miillion per annum for every one million participating employees.

Conclusion

28. The legislation proposed would not in any way alter the existing freedoms of employers and employees to agree pay levels and pay systems in the normal process of collective bargaining, but if the pay system involved profit sharing by an agreement consistent with the proposed legislation income tax relief would become available.

29. Profit sharing offers benefits for employers, employees, potential employees and the economy as a whole. But these benefits will not be achieved unless a substantial number of employees are involved. Likely take-up will therefore be a key factor in the Government's decision on whether to proceed with legislation. If, taking account of reactions to this consultative document, the Government decide to go ahead, the intention would be to legislate in the 1987 Finance Bill.

2153/35

CF?

FINANCIAL SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Mark Addison Esq
10 Downing Street
LONDON SW1

21 February 1986

cc Nicki Jewell (Prem Office)

Dear Mr Addison

ICI CASE

See Pt 14

Following Vivien Life's letter of 1 May, I enclose a further note from Inland Revenue on recent developments on the ICI case.

yours sincerely

C H Mankelow

MISS C H MANKELOW

Inland Revenue

Policy Division
Somerset House

From M A Hill

Date 21 February 1986

PS/FINANCIAL SECRETARY

ICI CASE

1. The purpose of this note is to confirm what we told the Financial Secretary about progress on the ICI case at Wednesday's meeting to discuss Budget Starter 157.

2. The Court of Appeal will deliver their judgment at 10 a.m. next Monday, 24 February. If the decision is adverse to the Government on any issue, Counsel has been asked - following the Revenue's normal practice in Court of Appeal cases - to make a formal application for leave to appeal to the House of Lords. This does not indicate a positive decision to appeal; it merely keeps the option open in the event that, in the light of detailed consideration of the terms of the judgment, the Government decides that an appeal would be appropriate.

3. The judgment will be delivered in open court, and it is possible that there will be enquiries from the press or public. We shall in fact be providing briefing for the Revenue Press Office in advance of Monday's judgment and would suggest that, if specific tax questions do arise, these are referred to our Press Office.

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cc PS/Chancellor
Mr Robson
Miss Sinclair
Mr Ricks (Treasury Solicitor)
Mr Evans (IDT)
Mr Battishill
Mr Pitts
Mr Cleave
Mr Thornhill
Mr Elliss
Mr Johnson
Miss Hill
Miss Hay
Ms Tyrrell - Press Secretary

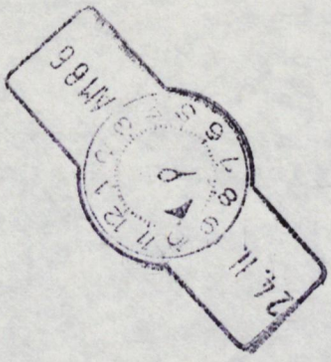
PS to me

4. Your office has copied previous notes on the ICI case to the Number 10 Press Office, and you may wish to let them have a copy of this note too.

MAH

M A HILL

ECON POL: Budget : PE 15



Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

Director-General
Sir Terence Beckett CBE

Secretary
Maurice Hunt

CBI

DN ✗ see.
No need to reply.

13 January 1986 R14.

Dear Member

The CBI's Budget Representations to the Chancellor are being published on Tuesday 14 January.

I am enclosing a copy of the shortened version of the Representations. However, please do not hesitate to contact me if you would like to have a copy of the full version, or indeed, if you have any queries about the package.

Yours faithfully

Shona Duncan

Shona Duncan
Parliamentary Assistant

SECRET

PRIME MINISTER

12 February 1986

CABINET: BUDGET AND ECONOMIC STRATEGY

Considerable Caution

The Chancellor has struck just the right note in his submission on Budget strategy for tomorrow's discussion at Cabinet - "considerable caution". With current oil prices of $16.70 pb, 3-month oil futures prices of $15.40-$16.10, and great uncertainty over the longer-term outlook, the room for maanoeuvre is severely limited.

Aiming for a PSBR of more than £7.5 billion, on top of the extra asset sales of £2.5 billion, would be seen by investors as abandoning the MTFS. It would risk higher inflation and higher interest rates.

The benefits of falling oil prices

Colleagues may need to be cheered up. Falling oil prices may be bad for Treasury receipts, but they are good for the economy as a whole. A fall in the oil price is rather like a tax cut - but one for which the Chancellor can't take the credit. It raises output and reduces inflation. Even the CBI can smile as manufacturing gets a double boost - lower costs and a lower exchange rate.

SECRET

The timing of tax cuts

If the economy performs as the Treasury expects, there is still room for tax cuts in 1987. Far better to be cautious now and cut later, than cut now and have to raise taxes next year.

This view is reinforced by the Institute of Fiscal Studies Report published today. That suggests that, while the decline in oil prices eliminates the 1986 fiscal adjustment, it increases the amount by which the Chancellor can cut taxes in 1987.

BRIAN GRIFFITHS

David Willetts

DAVID WILLETTS

RR3.47

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

12 February 1986

D R Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David,

The Chancellor has been giving some thought to what, if anything, should be said to the Press about tomorrow's Cabinet discussion of the economy. He suggests that the No.10 Press Office should say no more and no less than at this time last year - viz

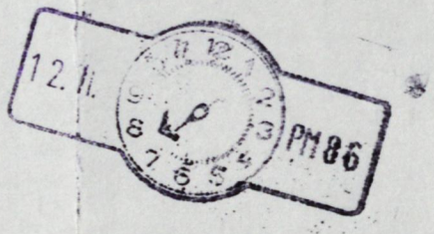
> "The Cabinet today had the usual discussion about the economy which takes place before each Budget. There was continuing support for the economic strategy."

If the Prime Minister agrees with this perhaps you would pass on the above form of words to Bernard Ingham?

Yours ever

Rachel.

MRS R LOMAX
Principal Private Secretary


12.11.
PM86

1. MR NORGROVE

2. PRIME MINISTER

CABINET - PRE-BUDGET DISCUSSION

This occasion tomorrow assumes considerable political significance in view of:

i. the increased importance of Cabinet Government after the Westland affair;

ii. the close scrutiny being attached to all Government discussions/decisions for confirmation of the media's currently fashionable view that you have lost power;

iii. the argument between the tax cutters and consolidators; between the standard rate cutters and the higher threshold men; and the risk takers versus the prudent lobby;

iv. the report in the FT today (see Annex I).

David Norgrove is asking the Chancellor to provide a speaking note for use after Cabinet.

I would, however, like to be able to deploy any guidance at the earliest possible opportunity after the pre-Budget discussion is over. It is very important you colour the original reporting and force those Ministers who would wish to put their own oar in to brief against the background of first impressions created by official briefing.

I would be grateful for a very fast line out of Cabinet once the economic discussion is complete.

BERNARD INGHAM
12 February 1986

FINANCIAL TIMES: WEDNESDAY, FEBRUARY 12, 1986

Budget caution may be challenged

BY PETER RIDDELL, POLITICAL EDITOR

TREASURY CAUTION about the scope for fiscal relexation in the March 18 Budget is likely to be challenged at tomorrow's Cabinet discussion of the economic outlook by a senior minister, who believes there is an extra £1bn to £2bn of leeway.

The minister has been circulating figures claiming that even on cautious assumptions there is £2bn to £2.5bn available in fiscal adjustment (either tax cuts or additional public spending).

Moreover, the leeway could be £3bn to £3.5bn if allowance is made for slightly more buoyant non-oil tax revenue as a result of higher than expected growth in earnings and prices over the past year. This factor, the minister says, has not been sufficiently stressed in Treasury papers.

These figures are based on forecasts showing that, on current policy, borrowing in 1986-87 would be between £5bn and £7bn, depending on the oil price, and on an assumed post-budget level of between £7.5bn and £9bn.

The minister will argue, along with a number of colleagues in the Cabinet mainstream, some of whom are not as optimistic as him, in favour of a mixture of increases in income tax thresholds and additional public investment.

This contrasts with the Treasury's greater than usual caution in view of uncertainty about oil prices and tax revenue from the North Sea. While playing down expectations, Mr Nigel Lawson the Chancellor, has apparently indicated that he wants tax cuts of at least £1bn. Decisions will be taken nearer the date and will depend in part on the extent to which public borrowing is allowed to rise above the current target of £7.5bn for 1986-87, and on whether indirect taxes are raised.

Some commentators have suggested that there may be little room, however, for any significant fiscal relaxation.

The pre budget Cabinet discussions have in recent years, been low-key. But in the new post-Westland mood of collective discussion, some ministers want at least to air their views while recognising the decisions lie solely with the Chancellor, especially given this year's uncertainties.

Tomorrow's meeting is regarded by several ministers as merely a forerunner of crucial discussions in the summer about public spending plans which will shape the Government's strategy in the run up to the general election.

A growing number of ministers believe that any available money would have the greatest political effect if it were used to ease some of the pressure on local authorities, especially in the shire counties, and to boost spending on education and training and on selected public capital investment rather than on tax cuts. These ministers argue that any tax cuts should, until the new social security system comes in, in 1988, be in the form of higher thresholds rather than a lower basic rate.

However, other senior ministers, including a number of Mrs Thatcher's close allies, argue that the priority should remain a lower basic or standard rate of income tax to boost incentives.

In this debate Lord Young, the Employment Secretary, Mr John Biffen the leader of the Commons, and Mr George Younger, the Defence Secretary, as well as a number of younger Cabinet ministers, favour higher thresholds.

In the Commons yesterday, Tory MPs rallied behind the Prime Minister following the weekend clashes between senior ministers. After being greeted with loud mock cheers and a waving of order papers by Labour MPs, Mrs Thatcher gave an exaggerated bow. She said she had seen off three Labour leaders and hoped to see off another.

PRESS RELEASE

EMBARGOED UNTIL NOON, WEDNESDAY 12 FEBRUARY 1986
10 FEBRUARY 1986
Contacts: John King, Mike Devereux, Robert Markless
(01-636 3784)

IFS GREEN BUDGET 1986

Although plummeting oil prices mean that there is now little scope for the Chancellor to make tax cuts in 1986 he could well find in excess of £4bn to give away in 1987. This is one of the major findings of an IFS analysis published today (Wednesday 12 February 1986). The Chancellor's options for his Budget on 18 March is presented in the fifth annual IFS 'Green Budget' together with a supplementary report Oil Prices and Budget Strategy' by Michael Devereux. This considers in detail the effects on the Government's financial position caused by the dramatic decline in oil prices in recent weeks.

This year the conflicting pressures on the Chancellor will be more than usually difficult to reconcile. Only a few months ago it was widely expected that tax reductions of £3 billion or more could be made without jeopardising the Government's target of a £7.5 billion PSBR in 1986/7. But by mid-January, as IFS shows, most of that prospective 'fiscal adjustment' had been eliminated by falling dollar oil prices and a rise in the dollar value of sterling. With the further fall in oil prices that has since taken place, it would now be necessary to increase taxes in 1986 to keep the PSBR to its target level - even when full credit is taken for the £2 billion that the Government plans to raise during the year from additional asset sales.

So the Chancellor must either disappoint the strong political constituencies

for reductions in income tax and measures aimed more directly at reducing unemployment, or he must revise his PSBR target. We expect that he will disappoint those expecting tax cuts in this Budget.

We do, however, believe he could promise and be able to deliver tax cuts in 1987. The decline in oil prices creates only a temporary hole in the Government's financial position while it eliminates the 1986 fiscal adjustment (with an unchanged PSBR target), and the IFS analysis shows that it actually increases the amount by which the Chancellor should be able to cut taxes in 1987 by over £4 bn.

The debate about the appropriate way to reduce tax levels therefore remains relevant. The 'Green Budget' discusses the merits of reducing rates of income tax or raising allowances and looks at other direct tax changes that could form part of another 'budget for jobs'.

- Ends -

Note to Editors

The IFS 'Green Budget' Conference will be held on Wednesday 12 February 1986.

IFS Report Series No.20 Budget Briefing 1986: The IFS "Green Budget" edited by John King.
IFS Report Series No.21 Oil Prices and Budget Strategy by Michael Devereux.

Further information on the conference and on the publications (price £10 each) are available from the Institute for Fiscal Studies, 180-182 Tottenham Court Road, London W1P 9LE.

file

10 DOWNING STREET

From the Private Secretary

10 February 1986

Nigel Wicks has passed to me your letter of 5 February and the copy of the latest forecast which you sent him. He has asked me to deal with Budget and Budget-related papers. I have briefed Brian Griffiths on Budget security.

David Norgrove

Sir Peter Middleton, K.C.B.,
H.M. Treasury.

SECRET

Prime Minister 1

You will want to be careful who is in the room when you speak to Mr Biffen

N. L. W. 7.2

PRIME MINISTER

BUDGET

You agreed with the Chancellor that you would discuss Thursday's economic Cabinet with Mr. Biffen and Mr. Younger. Your meeting on Monday with Lord Whitelaw, Mr. Tebbit and Mr. Biffen would provide an opportunity for doing half of that.

I do not know how far you would want to go in revealing the Chancellor's thinking, but the two points on which presumably he would want Cabinet to reach agreement are:

(i) the need for a prudent Budget (he mentioned this at your bilateral);

(ii) if in present circumstances that means no scope for tax reductions beyond indexation, then no tax reductions are the right decision for economic health.

David Norgrove

7 February 1986

(DG2AUS)

SECRET

820

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000

Direct Dialling 01-233 4265

Sir Peter Middleton KCB
Permanent Secretary

Covering SECRET

MD Norgrove
PC do x
including the
briefing of
Professor Griffiths.

N L Wicks Esq
10 Downing Street
LONDON
SW1

5 February 1986

N.L.W.
7.2

Dear Nigel

... I attach a copy of the pre-Budget Economic Forecast. It is for your personal use and for that of David Norgrove. It must in no circumstances be passed to anyone else or the contents disclosed. I am sending another copy on similar conditions to Brian Griffiths.

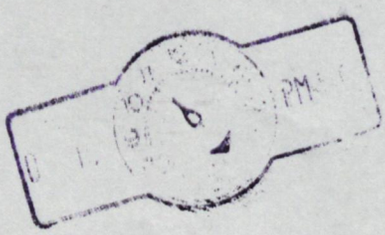
... We are approaching the point when the Chancellor will wish to provide the Prime Minister with Budget and Budget-related material. You might therefore like to have a copy of the Budget Security instructions. Unless I hear to the contrary I shall assume that you deal with any such papers with an equivalent degree of security. In particular, I shall assume that the No 10 list for these papers is yourself, David Norgrove and Brian Griffiths - and no one else. I should be grateful if you could ensure that Brian, who is new to all this, is briefed on the handling of Budget material.

X

Yours,

Kieran Murphy
(private secretary)

pp P E MIDDLETON



2652/12

RESTRICTED

H M TREASURY

OFFICE NOTICE

Professor Griffiths
Would you read this please, initial, and return?
DRN 10/2

DRN
BG 10/2

ON(GENERAL)(85) 127
20 DECEMBER 1985

BUDGET SECURITY

I attach a note setting out this year's Budget security instructions. They apply without exception to Ministers, advisers and officials. Breaches of these instructions will be treated as a serious matter.

2. The special arrangements for Budget security are designed to give additional protection to information about Budget decisions. This year's instructions follow the general lines of last year's instructions, although some points have been clarified. The instructions have been approved by the Chancellor of the Exchequer.

3. All members of the department should recognise the sensitivity of Budget material, and take every care to ensure that its integrity is preserved. Heads of Divisions and Private Offices should ensure that staff who are likely to handle Budget papers understand the instructions. The Assistant Budget Security Officer in EOG2 will also help ensure that the staff most heavily involved understand the procedures and have the equipment to carry them out.

4. All members of the department should also note that the Budget Security instructions contain guidance (paragraphs 144 to 147) on contacts with journalists, in the period from the beginning of January to Budget Day, which apply whether or not you have any involvement with Budget work. The term "journalist" should be interpreted widely to include contributors to specialists publications, brokers circulars, newsletters etc; indeed anyone who is in a position to make easy contact with the media. Most staff will not have any such contacts. But if you do you must observe these instructions, to protect your own position and that of the department against suspicion. In any contacts, you must take particular care, as inferences can be drawn from the most casual remark or refusal to comment.

5. The major changes in this year's instructions compared with last year are:

(a) the use of Budget classification has been extended to cover any public expenditure changes to be announced in the Budget, not just social security changes - all staff working on any such change should familiarise themselves with the Budget Security instructions; and

(b) **BUDGET SECRET: BUDGET LIST ONLY** documents are to be prepared on plain paper and copied on to the special paper bearing printed security markings - it is essential that close security be maintained over the typed original (paragraph 158(b) and (c)).

6. There are a number of other points in the instructions to which I would draw particular attention:

(a) The rules for handling Budget Secret: Budget List Only documents set out in paragraph 158 must be adhered to strictly. In particular, documents for which this classification is appropriate must not be sent or shown to anybody who is not on the authorised list of recipients (the "Budget List") which has been approved by me. Any alterations to the list require my prior approval.

(b) Care should be exercised in applying the right classification to Budget documents, in accordance with the guidance of paragraphs 151 and 152. In particular, a reply to or comments on a minute should not automatically be given the same classification as the original minute.

(c) Great care should be taken to ensure that titles of Budget Secret documents and above are not themselves revealing of the contents of the Budget, as they may be seen by staff not authorised to have access to Budget information (paragraph 158(a), 160(a)).

(d) A minute containing Budget classified material should not be written unless it is strictly necessary and, if it is, should not be circulated to those who do not have a real operational need to see it. If a person only needs to see part of a document, he should only be sent that part, not the whole document (paragraph 155).

(e) Each copy of every document classified Budget Secret or above must be individually numbered, in sequence (paragraph 158(c), 160(f)).

(f) Documents which are classified Budget Secret or above must always be sent in double envelopes, even if they are being sent within the Treasury. The inner envelope should bear the appropriate address label with all details fully completed (paragraph 158(d), 160(a)).

(g) Budget classified papers may not be filed by allocated Clerks (or Sector Registries) until after Budget Day, unless specifically authorised. Until then, such papers which have been passed to a Principal must be kept by him so that other staff do not have access to them (paragraph 158(f), 160(d)).

(h) Additional security furniture will be required by some staff. It is essential that requisitions for this be made as soon as possible from the Assistant Budget Security Officer in EOG 2 (extension 7861) (paragraph 158(g), 160(d)).

7. A copy of the Budget list is being sent today to those persons whose names are included on it.

8. The system of special spot checks on Budget classified documents (paragraph 161) will continue. These checks are carried out on my authority. I ask all members of staff to co-operate so that the checks can be carried out with the minimum of disturbance.

9. Further guidance on any aspect of the Budget security instructions can be obtained from the Budget Security Officer, Mr Romanski, the Principal in FP (Indirect taxation branch - extension 5237), who will be assisted in the performance of his duties during the Budget season by Mr Rees, EOG2 (extension 7861).

10. Please insert these instructions in the copy of "HM Treasury Security Instructions" in your possession and destroy the previous version.

PETER MIDDLETON

XIII. BUDGET SECURITY

Relations with the Press

144. This first subsection applies to all Treasury staff in the pre-Budget period, including officials who are not involved in work connected with the Budget. References to 'journalist' in this section are to be interpreted widely to include contributors to specialist and academic publications, brokers' circulars, newsletters and other similar publications. References to the pre-Budget period should be taken to mean the period between the beginning of January and Budget Day itself.

145. Formal contacts with journalists in the pre-Budget period may only be undertaken with the prior authority of the Permanent Secretary or, in his absence, either the Under Secretary (Central Unit) or one of the Second Permanent Secretaries. If permission for such contact is granted, a report should be submitted immediately after it takes place to the head of IDT, copied to the Permanent Secretary and the Budget Security Officer, whatever the subject matter of the discussion.

146. Telephone calls from journalists are to be referred in the first instance to IDT. If any conversation takes place directly with a journalist in the pre-Budget period a report is to be sent to IDT copied to the Budget Security Officer, whatever the subject matter of the conversation.

147. If any other contacts take place with journalists in the pre-Budget period, no matter how informal, a report of the fact is to be made to IDT copied to the Budget Security Officer, together with a very brief account of any discussion of official matters.

Budget classification and its use

148. Special security arrangements apply to certain information connected with the Budget. The arrangements apply in addition to the normal departmental security procedures and are intended to provide additional protection for information about Budget decisions. It is the responsibility of every person involved in Budget work to be familiar with, and operate, these instructions. EOG will ensure that those most heavily involved understand the procedures.

149. The recipient of a Budget classified document is, at all times, personally responsible for its security. This applies even if custody of the document is entrusted to another member of his or her staff (where this is permitted).

150. The Budget security arrangements apply to information concerning Ministerial decisions on:

(a) the Budget judgement and in particular the PSBR;

(b) all taxation matters connected with the Budget; and

(c) any social security or other public expenditure changes to be announced in the Budget.

In addition, the Budget classification may be applied to papers which are regarded as particularly sensitive despite the fact that no decisions are recorded - where, for example, the very fact that a matter is being discussed is sensitive, or where the total contents of a document might reveal the approach to the Budget likely to be adopted by Ministers. Care and common-sense are needed in applying the classification in such cases. In any cases of doubt over the use of the Budget classification the Treasury Budget Security Officer (see paragraph 165) should be consulted.

151. There is a special security classification to be used for certain Budget documents, ie for those papers which reveal the contents or probable contents of the whole, or a very substantial or particularly sensitive part, of the Budget. The Chancellor may also decide that papers dealing with particular subjects be given this classification. The classification is "BUDGET SECRET - BUDGET LIST ONLY". Strict rules are laid down for access to, and handling of, documents with this classification. These are set out in paragraph 154 and 158 below. Examples of papers which are to be given this classification include:

- papers, including records of meetings, which give an overall picture of Budget strategy;
- complete drafts of the Budget speech (and the most sensitive extracts such as complete drafts of the tax sections);
- full drafts of the Budget Brief, or particularly sensitive parts of it;
- full draft of the FSBR (and early drafts of the sections dealing with Budget proposals); and
- the Budget Resolutions, as a whole.

Papers dealing with individual taxes would not normally require BUDGET SECRET - BUDGET LIST ONLY classification, unless this is required by the Chancellor.

152. Otherwise, Budget security rules require that the ordinary security classification of documents be prefixed by the word BUDGET. BUDGET: TOP SECRET should only be

used where the material would fall clearly within the definition of TOP SECRET even if it were not to be included in the Budget. BUDGET: SECRET is the correct classification for all other papers on the main Budgetary items (ie the main tax rates and social security benefits and other major changes in tax legislation or public expenditure). BUDGET: CONFIDENTIAL should be used for papers recording decisions on other Budget matters, including all other decisions on tax items. The classification of a document is not necessarily the appropriate classification for a minute commenting on or replying to it even if the original document is classified BUDGET SECRET-BUDGET LIST ONLY. For example, a submission to a Minister on a minor Budget matter, suggesting a range of options, may properly not have a Budget classification, but a note from a Ministerial Office recording a decision on it should be given a Budget classification. On the other hand, a minute containing comments on a document should bear the classification appropriate to its contents and should only bear the same classification as the original document where it is appropriate.

153. A Budget classification is not, in general, required for papers containing:

(a) Ministerial decisions relating to economic forecasts, monetary policy, exchange rate policy and other items not directly related to tax or public expenditure decisions, even where these are in the context of a Budget;

(b) arguments for and against a particular course of action, or recommendations from officials to Ministers or other Ministers to the Chancellor unless the papers are particularly sensitive (see paragraph 146); or

(c) lists of options in which no decision on any of the matters in paragraph 146 is recorded.

Communication of Budget classified information

154. Documents for which the "BUDGET LIST ONLY" classification is appropriate may only be circulated to persons who are on the "Budget list", a list of recipients of such documents approved by the Permanent Secretary. Under no circumstances are they to be circulated or shown, or the contents communicated in any other way, to a person not on that list. A copy of the Budget list will be made available to each person who is on the list. If it is considered essential to show a BUDGET LIST ONLY document to a person not on the Budget list, the prior approval of the Parmanent Secretary must be sought, in writing, to the addition of his name to the Budget list. This applies right up to the Budget Day.

155. The circulation of all Budget classified documents is to be restricted to the absolute minimum consistent with operational requirements. Before writing Budget classified material all originators must ask themselves:

(a) Is the document necessary at all? (A private face-to-face conversation is more secure than a written note - paragraph 13 contains guidance on the security of telephone conversations.)

(b) If the document is necessary, need it be circulated? (Only copy a document to those people who need to be aware of its contents.)

(c) Need the document quote precise details of decisions eg proposed tax rates?

(d) Does the document require a Budget classification?

(e) Is the title likely to be a security risk? (Particularly in the case of BUDGET SECRET and more highly classified documents, the title is likely to be seen by persons who are not authorized to have access to the contents, so it is essential that the title does not reveal any sensitive information.)

(f) Do all recipients need a copy of the whole document? If a part of the document would suffice, send only that part. It is essential that persons do not see parts of documents containing classified material which they have no operational need to see.

156. BUDGET LIST ONLY documents may not be shown to anybody who is not on the Budget list (except for the normal arrangements whereby the Queen, Prime Minister, certain staff at Number 10 and the Governor of the Bank of England are told the contents of the Budget). Other BUDGET classified information may be communicated to staff in the Chancellor's Departments (and the Office of the Parliamentary Counsel), only if they need to know about it for the efficient performance of their duties.

157. Budget classified information must not be communicated to anyone outside the Chancellor's Departments and the office of the Parliamentary Counsel without prior authority having been obtained from the Budget Security Officer. There are only three general exceptions to this rule. First, FP group have authority to communicate to specified Department of Transport officials Budget decisions on VED and the duties on hydrocarbon oils. Second, the head of FP has authority to communicate to specified officials in the Department of Health and Social Security certain information about Budget changes in personal taxation. Third, as is appropriate for public expenditure

matters, ST group will discuss any social security changes to be announced in the Budget with DHSS officials. In all these instances the Divisions concerned must ensure that these Departments are aware of the need for particular care in handling the information. Similarly, if a Treasury Minister writes to a Minister in another Department on a Budget classified matter, his Private Secretary should ensure that the other Private Office are aware of the significance of the Budget classification, and in particular of the need to ensure that the letter is shown or copied only to those who need to see it.

Preparation and handling of BUDGET SECRET: BUDGET LIST ONLY documents

158. In addition to the normal security instructions regarding handling of SECRET documents, set out in paragraphs 42 to 103, the following special instructions apply to the handling of BUDGET SECRET: BUDGET LIST ONLY documents:

(a) The title of the document must not give away any sensitive information as to its contents as it will be used on the label on the inner envelope and may therefore be seen by persons not authorised to handle the document. A code word should be used if necessary.

(b) The document must be typed on plain paper. The security classification is not to be typed. Documents may be typed by a Personal Secretary if she is herself on the Budget list. The typist's initials should appear on each page of the document. The originator is responsible for the security of the typed master, which must be given a number in the sequential series used for copies.

(c) Copies of the typed master must be made onto the special paper bearing printed 'BUDGET SECRET: BUDGET LIST ONLY' markings on one side of the paper only. Each copy of the document must be sequentially numbered.

(d) The documents must always be enclosed in the special distinguishing folder marked "BUDGET SECRET: BUDGET LIST ONLY" for transmission. They must always be transmitted in double envelopes even if sent within the building. The inner envelope must bear the special "BUDGET SECRET: BUDGET LIST ONLY" label completed with the relevant details in full. If more than one document is sent in one envelope, details of each document must be shown on the label. If a BUDGET SECRET: BUDGET LIST ONLY document is to be sent or copied to a Minister, he should be sent two copies. A receipt must always be obtained for all copies of "BUDGET SECRET: BUDGET LIST ONLY" documents. It is the responsibility of the originator to ensure that a receipt is returned for each copy which has been sent out. These receipts must be retained until after Budget day.

(e) If they are being sent to other Departments, the documents must be sent by messenger or by the special van service which operates between the Treasury, the Revenue Departments and Parliamentary Counsel's Office. If these are not available, the documents may be sent by special signature service of the IDS. In every case receipts must be obtained for the documents. In no circumstances may the documents be sent by post or transmitted on facsimile equipment except for the secure fasimile link between the Treasury and the Revenue Departments.

(f) Each Recipient is responsible for ensuring that every BUDGET SECRET: BUDGET LIST ONLY document is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this - this applies particularly at Principal level. A document may be entered in the security register by the Personal Secretary or allocated Clerk from the information shown on the label, without opening the inner envelope. If this is done, the number of the security register entry is to be written on the label. The recipient of the document is to ensure that the security register number is shown and should copy it onto the document itself. In some areas, Personal Secretaries or Clerks may themselves be included on the Budget list authorised to handle BUDGET SECURITY: BUDGET LIST ONLY material. Only in such cases may they open the inner evelopes, in which case the security register number may be written on the document itself. BUDGET SECRET: BUDGET LIST ONLY documents may not be filed until after Budget Day except where the Clerk concerned is on the Budget List.

(g) Each copy of a BUDGET SECRET: BUDGET LIST ONLY document is personal to its recipient. It may not be shown to any person not on the Budget list in any circumstances, and shown (but not copied) to a person who is on the Budget list only if there is a real operational need for him to see it. The fact that a person is on the Budget list does not mean that he must see all BUDGET LIST ONLY documents. It is the recipient's responsibility to ensure that the document is not seen by any person who is not authorised to have access to it. It can be kept in the recipient's own security cupboard only if all persons who are entitled to know the combination number have been specifically authorised to handle BUDGET SECRET: BUDGET LIST ONLY documents. Otherwise it will be necessary to store such documents in a separate document box or security cupboard whose combination number is known only to the recipient (and any

authorized handler of such material). Officials who require additional security furniture for this purpose should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 7861).

(h) It is essential that BUDGET SECRET: BUDGET LIST ONLY documents are not left unattended by the person who is responsible for their custody - he must lock them away whenever he leaves his room.

(i) BUDGET SECRET: BUDGET LIST ONLY documents may on no account be photocopied except by the originator (or his Personal Secretary, on his authority, if she has typed the document). If a person not on the original list of copy addressees is subsequently to be given a copy of such a document, it must be provided by the originator and the name of the recipient properly recorded. He may retain a small stock of additional numbered copies of the document for this purpose (which are to be treated as accountable documents). If he needs to take an additional copy of the document, it must be numbered in the original series. The above rules as to handling and control of the document apply to additional copies.

(j) BUDGET SECRET: BUDGET LIST ONLY documents may only be taken out of the office to meetings if this is absolutely unavoidable. They may be taken home only if the Permanent Secretary has given his prior approval, either for a particular occasion or generally for a particular individual. Permission will only normally be given if the person concerned has a security container at his home. Any documents taken out of the office must be carried in a locked briefcase, box or pouch and kept securely at all times.

(k) Where a person only needs to see a part of a BUDGET SECRET: BUDGET LIST ONLY document, he should be sent only a copy of the relevant extract. The copy extract should be given a number in the same series as the full copies. It should be given the security classification, appropriate to the sensitivity of the matter contained in it - the security classification at the top of the front page should be amended in manuscript if necessary. The recipient of the extract should treat it in accordance with the security classification shown on the document.

(l) If a BUDGET SECRET: BUDGET LIST ONLY document is to be destroyed before the Budget, it is to be sent to the Budget Security Officer in double envelopes, the inner envelope bearing the appropriate label, and marked for destruction. The Budget Security Officer will carry out the destruction in accordance with the standing instructions.

159. If a Budget sensitive document meets the criteria of paragraph 24 for classification as TOP SECRET it should be classified as "BUDGET TOP SECRET: BUDGET LIST ONLY". The distinguishing folder and address labels for "BUDGET SECRET: BUDGET LIST ONLY" documents are to be used amended accordingly in manuscript. The instructions of paragraph 158 are to be followed, expect where the normal security instructions for TOP SECRET documents impose more stringent requirements, in which case those should be obeyed.

Handling of other Budget classified documents

160. The normal rules for the control and transmission of classified documents (paragraphs 42-103 of H M Treasury Security Instructions) must be applied to all other documents which carry the prefix: BUDGET, except as modified below:

(a) BUDGET: TOP SECRET and BUDGET: SECRET documents must always be transmitted in double envelopes, even if only sent within the building and the inner envelope must hear a completed BUDGET: SECRET label. As the title will be shown on the label and may be seen by staff not authorised to handle the document, the title should be carefully chosen to avoid revealing any sensitive information. If two or more papers are included in one inner envelope, details of both must be shown on the label. BUDGET: TOP SECRET and BUDGET SECRET documents sent outside the building must be accompanied by receipts (but it should be noted that if a BUDGET SECRET document is received from Customs and Excise it will not necessarily be accompanied by a receipt when it reaches the recipient's office as bulk receipts are used for documents transmitted by document pouch to the Treasury).

(b) BUDGET: TOP SECRET and BUDGET: SECRET documents should normally be sent by messenger to other departments. If no messenger is available, they should be sent by special signature service of the IDS, a receipt being obtained from the post room. BUDGET: CONFIDENTIAL documents should be sent either by messenger or the IDS. Budget classified documents must not, in any circumstances, be sent by post or transmitted on facsimile equipment, except for the secure facsimile link between the Treasury and the Revenue Departments.

(c) Each recipient is responsible for ensuring that every document classified BUDGET SECRET and above is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this -this applies particularly at Principal level. Staff who are not

authorised to handle BUDGET SECRET documents may record them in the Security Register, provided that they have been received in double envelopes, using the information shown on the label. If this is done, the inner envelope must be passed to the recipient unopened, the number of the security register entry being shown on the label. If this procedure is followed it does not detract from the recipient's responsibility that receipt of the document has been recorded, so he should ensure that the security register number is shown on the label and copy it to the document itself.

(d) BUDGET classified documents are not to be filed or otherwise handled by Divisional Clerks until after the Budget. Principals are personally responsible for all BUDGET classified documents passed to them, and for ensuring that no other person is able to obtain access to them. Principals who will require a combination lock document box or security cupboard for BUDGET classified material should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 7861). It should be noted that this instruction applies to BUDGET CONFIDENTIAL as well as more highly classified material.

(e) Personal secretaries may continue to handle papers classified BUDGET SECRET or BUDGET CONFIDENTIAL as may Divisional clerks working with the Principals CU and FP (Budget co-ordination branch). Files in those branches containing BUDGET classified papers must bear the appropriate classification on the outside.

(f) All copies of documents of BUDGET SECRET classification or higher must be uniquely numbered in series, whatever the length of the circulation list. Copies of BUDGET CONFIDENTIAL documents need not be sequentially numbered. BUDGET classified material including BUDGET CONFIDENTIAL may only be copied on the authority of an SEO or above, or Personal Secretary acting on behalf of a higher grade officer, but recipients should as far as possible avoid making copies of Budget classified material. The making of copies must be carried out in accordance with paragraph 54.

(g) The arrangements set out in paragraphs 68-75 for taking classified papers out of the office apply to BUDGET: SECRET and BUDGET: CONFIDENTIAL documents, but BUDGET: SECRET papers are subject to the overriding restriction that they must not be taken out of the office unless absolutely unavoidable. In such an event, they should be carried in a locked briefcase, box or pouch and kept securely at all times.

(h) BUDGET: SECRET or TOP SECRET waste should be destroyed by shredding; arrangements for this may be made with EOG (extension 7861). Recipients must keep a proper record of any such documents they destroy. Production of such a record is necessary to meet the requirements of the spot checks described in paragraph 161.

General points

161. To ensure that the required procedures are being adhered to, Budget classified documents will be subject to a series of spot checks. There will be random checks of individual copies of classified documents sent to named individuals. There will also be more systematic searches of complete circulation lists of particularly sensitive Budget classified papers. These checks will be carried out by FP and EOG.

162. Budget classified papers must not be typed in typing pools. Particular care should be taken about the custody of carbons, photocopies, dictating machine tapes, word-processing discs, shorthand notes etc containing classified information.

163. The disposal of any BUDGET SECRET or above document is to be recorded in the security register. Where a Principal wishes to dispose of a document he is to take care that this does not enable any unauthorised person to see its contents.

164. If BUDGET classified papers do not state the post-Budget classification, recipients should alter the classification as appropriate after Budget day. The 'BUDGET' prefix should always be deleted after Budget day, as it no longer has any significance. Papers which refer only to decisions which were announced in the Budget may be declassified. Papers containing advice or background to such decisions should generally be classified CONFIDENTIAL. Papers containing references to courses of action which were not pursued, which were classified BUDGET SECRET, should remain SECRET.

Queries

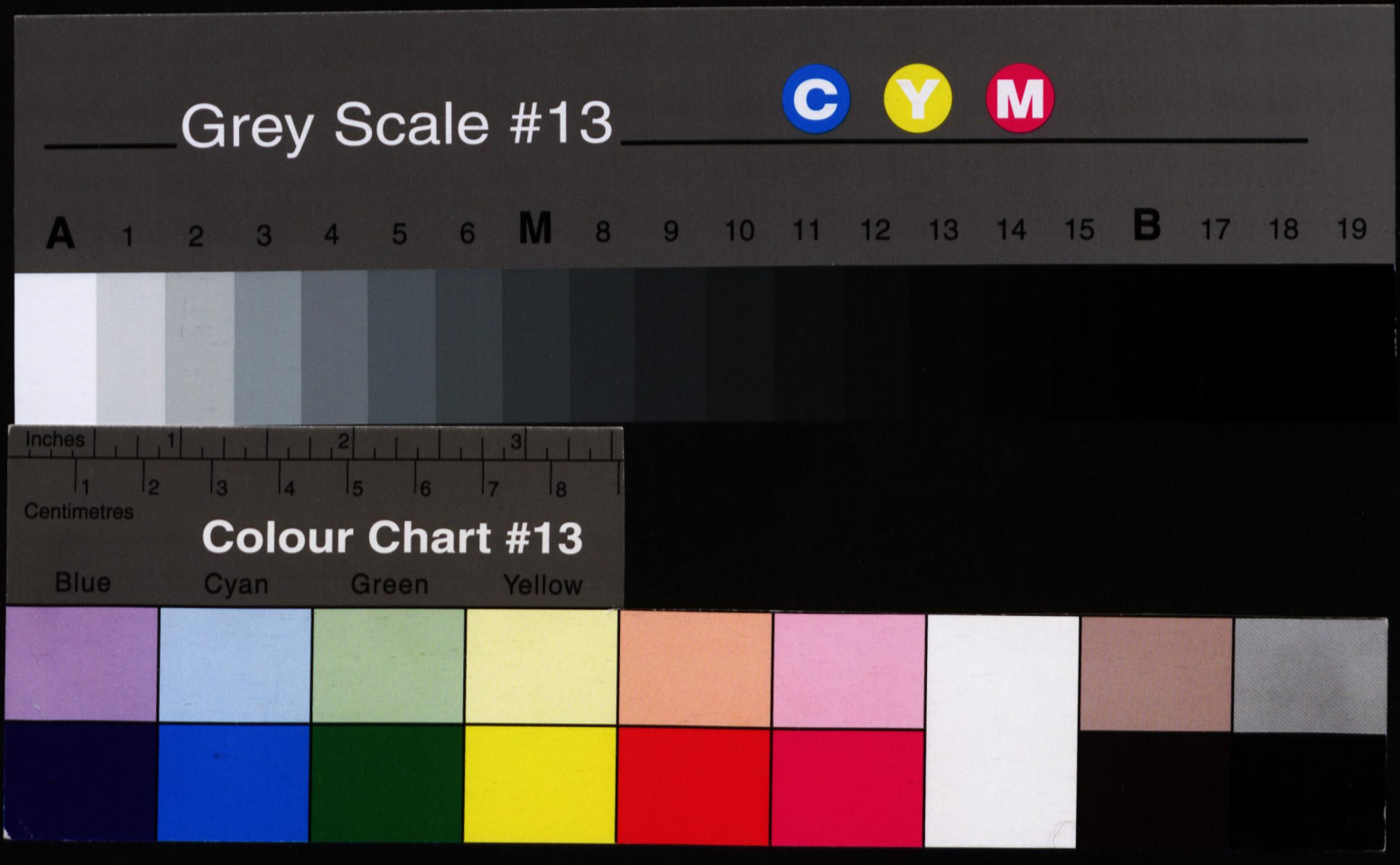
165. Any questions about the Budget Security instructions should be addressed to the Budget Security Officer, who is the Principal in FP Division (Indirect taxation branch) (extension 5237).

PART 14 ends:-

DN to PM 31-1-86

PART 15 begins:-

middleton (HMT) to NLW 5.2.86


Grey Scale #13
C
Y
M
A 1 2 3 4 5 6 M 8 9 10 11 12 13 14 15 B 17 18 19
Inches
Centimetres
Colour Chart #13
Blue
Cyan
Green
Yellow