

BUDGET SECRET
Covering BUDGET LIST ONLYCOPY NO. 1 OF 3* *A4*Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

13 March 1987

David Norgrove Esq
10 Downing Street
LONDON SW1*Dear David,***BUDGET STATEMENT**

I attach the latest draft of the Chancellor's Budget Statement. You have kindly agreed that you will arrange for the Prime Minister's comments to be sent to the Chancellor at Stoney Stanton on Saturday.

*F.2. Prop. - 0.5% downing
G.8. Famous Loans**Yours*
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A C S ALLAN** cc 2+3 without attachment*

A. INTRODUCTION

A1. The setting for this year's Budget is more favourable than it has been for very many years. We are entering our seventh successive year of steady growth, at the top of the international league table. We are entering the fifth year in which this steady growth has been combined with low inflation. The public finances are sound and strong, and unemployment is falling.

A2. These are the fruits of the Government's determination, in bad times as well as good, to hold firmly to our policies of sound money and free markets. Once again, I reaffirm those policies.

A3. So the Budget I present today is a Budget built on success, and a Budget for success.

A4. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then turn to monetary policy and to the fiscal prospect this year and next. Finally, I shall propose some changes in taxation designed to improve still further the prospects that lie before us. 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

B1. I start with the economic background.

B2. Nineteen eighty-six was dominated by the sudden collapse of the oil price. Our own economy was affected not only directly, as a major oil producer and exporter, but also by the pause in world growth as the world economy adjusted to what has been described as the third oil shock. Despite this dislocation, however, the economy has developed in most respects as I foreshadowed a year ago.

B3. In 1986 as a whole output grew by a further 2½ per cent or so, which compares well with the experience of other industrialised countries. It is worth recalling that in the 1960s, and again in the 1970s, Britain's growth rate was the lowest of all the major European economies. By contrast, during the 1980s, our growth rate has been the highest of all the major European economies.

B4. And this greatly improved growth performance has coincided with falling inflation, which at 3½ per cent in 1986 recorded the lowest figure for

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almost 20 years. Over the lifetime of this Parliament, inflation has averaged less than 5 per cent.

B5. During the first half of last year exports and hence output were affected by the pause in world growth to which I have already referred. But since the middle of the year exports have grown strongly. Indeed, over the last three months the volume of exports of manufactures was 6 per cent higher than a year earlier - a better performance than that of any other major economy. This pattern was reflected in the rapid growth of manufacturing output in the second half of last year.

B6. This resurgence of economic growth, coupled with the special measures we have taken, has brought about a welcome fall in the number of people out of work. Since August unemployment has fallen by more than 100,000; the largest six-monthly fall since 1973. Though the numbers out of work are still far too high, both youth unemployment and long-term unemployment are now lower than they were a year ago.

B7. I announced a number of specific employment measures in my last Budget, and since then, my Rt Hon and Noble Friend the Secretary of State for Employment has further extended the successful

Restart programme for the long-term unemployed. There will also be more places on the successful Enterprise Allowance Scheme, and the number of Jobclubs is to be quadrupled. The new Job Training Scheme will give a quarter of a million people, most of them youngsters, vocational training leading to recognised qualifications. With these and other measures, this Government has developed its employment and training programmes on a scale which no other country can match. But the best hope of all for the unemployed lies in the continuing vigour of the economy.

B8. Since the early months of last year, there has been a further surge in manufacturing productivity. This continues the remarkable improvement in productivity growth achieved by British industry throughout the 1980s. In the 1960s, and again in the 1970s, growth in manufacturing productivity in the UK was the lowest of all the seven major industrial countries in the world. During the 1980s, our annual rate of growth of output per head in manufacturing has been the highest of all the seven major industrial countries.

B9. The recorded current account of the balance of payments went into deficit in 1986 by around £1 billion. This followed a cumulative current account surplus of some £20 billion between 1979 and

1985. Some deterioration in our current account was inevitable in the face of a £5 billion loss of earnings on oil trade virtually overnight. But the significance of this should not be exaggerated. The exchange rate adjustment that followed the fall in the oil price is already contributing to an improved non-oil trade performance. And earnings from the massive stock of net overseas assets we have acquired since 1979, which at well over £100 billion is second only to that of Japan, will provide a continuing support to the current account in the years ahead.

B10. Looking ahead, I expect 1987 to be another year of balanced growth with low inflation. Total output is forecast to rise by 3 per cent, with exports and investment up rather more than that. By then we will have registered the longest period of steady growth, at a rate approaching 3 per cent a year, that the British economy has known since the War. Manufacturing industry, in particular, should do well in 1987. And with the non-oil economy set to grow at $3\frac{1}{2}$ per cent, there is every prospect of unemployment continuing to fall throughout the year. In last year's Budget Speech I said that the outlook for jobs depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

B11. Despite the strong growth in exports, it will inevitably take time for the full effect of the exchange rate adjustment to work through. The current account is thus likely to remain in deficit this year, by some £2½ billion, around half of one per cent of GDP.

B12. As I foreshadowed in the Autumn Statement, inflation may continue to edge up for a time, perhaps to a little over 4½ per cent by the Summer, before falling back to 4 per cent by the end of the year. While short-term fluctuations are inescapable, it remains the Government's prime objective to keep inflation on an unambiguously downward underlying trend.

B13. Given the continuation of present policies in this country, the biggest risk to the excellent prospect I have outlined is that of a downturn in the world economy as a whole. There are still serious imbalances afflicting the three major economies - the United States on the one hand and Japan and Germany on the other - which, if not handled properly, could lead to a simultaneous downturn in all three. And this in turn could be exacerbated by renewed turmoil in the foreign exchange markets, whose tendency to overshoot is as notorious as it is damaging.

B14. It was to address these dangers that the Finance Ministers and Central Bank Governors of six major nations met in Paris last month, and agreed among other things to co-operate closely in fostering a period of exchange rate stability. In my Budget Speech last year, I said:

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

That is what we have now done, with Plaza II. But it would be idle to deny that the wider risks still remain.

B15. Short of a world downturn, which can and must be avoided, British industry now has an outstanding opportunity, with growing markets at home and overseas, low inflation, rapidly growing productivity and greatly improved profitability. Provided it can control its costs and maintain its present competitive advantage, and assuming the continuation of present policies, we can look forward to many more years of strong growth combined with low inflation.

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C. MONETARY POLICY

C1. For its part, the Government will keep in place a sound and prudent financial framework. That means, as it has done since 1980, the medium-term financial strategy.

C2. The central objective of the MTFS is steadily to reduce the growth of money GDP over the medium term, so as to squeeze inflation out of the system and ultimately to achieve price stability.

C3. This requires monetary discipline buttressed by low public sector borrowing. The essential instrument of monetary policy must remain short term interest rates. These will continue to be set in the light of monetary conditions as indicated principally by the growth of narrow and broad money and the behaviour of the exchange rate.

C4. For narrow money, MO, the target range for next year will be 2 to 6 per cent, as foreshadowed in last year's MTFS. For broad money, however, as the Governor of the Bank of England cogently argued in his Loughborough lecture last October, in current circumstances it is probably wiser to eschew an explicit target altogether. But broad money will continue to be taken into account in assessing

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monetary conditions, as of course will the exchange rate.

C5. In my Lombard Association speech last April, I set out at considerable length precisely how in practice monetary policy is operated. Rt Hon and Hon Members who are interested in such matters will no doubt have observed that Mr Paul Volcker, Chairman of the United States Federal Reserve Board, in his written testimony to the Senate last month, explained how the Fed operates monetary policy in remarkably similar terms.

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D. PUBLIC SECTOR BORROWING

D1. I mentioned a moment ago the need to keep public sector borrowing low.

D2. The final outturn for the public sector borrowing requirement last year, 1985-86, was just under £6 billion, equivalent to 1½ per cent of GDP, the lowest level since 1970-71. In my Budget last year, faced with a massive loss of what now looks like £7 billion of North Sea oil revenue, I nonetheless decided to hold the PSBR for this year, 1986-87, to £7 billion, or 1½ per cent of GDP.

D3. In the event, this year's PSBR looks like turning out at only £4 billion, or 1 per cent of GDP: the second successive year of significant undershoot.

D4. This successful outcome is chiefly attributable to the remarkable buoyancy of non-oil tax revenues. And this in turn is due not to some short-term surge in consumer spending, but in particular to an increase over last year of no less than a third in the yield of Corporation Tax from an increasingly profitable business and industry.

D5. Looking ahead, there is still a degree of uncertainty surrounding oil prices, and I have therefore stuck to the assumption I made last year that the North Sea price will average \$15 a barrel. But it is clear that the increased flow of non-oil tax revenues, coupled with the prospective further growth of the economy in excess of the growth of public expenditure, puts the public finances in an exceptionally strong position.

D6. I intend to keep it that way. Last year's MTFS indicated a PSBR for 1987-88 of £7 billion, or $1\frac{1}{4}$ per cent of GDP; and, as the House will recall, I gave an assurance at the time of the Autumn Statement, when I announced a £4 $\frac{3}{4}$ billion increase in planned public spending in 1987-88, that on no account would I exceed that figure.

D7. Indeed, I believe it is right to go below it. Since its inception in 1980, the MTFS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. We have now reached what I judge ^{at present} to be its appropriate destination: a PSBR of 1 per cent of GDP. [I intend to stick to that figure.] This will ^{establish} maintain a degree of PSBR prudence that, until this year, had been achieved on only two occasions since 1950.

D8. Accordingly, I have decided to provide for a PSBR in 1987-88 of £4 billion.

D9. Inevitably, this greatly diminishes the scope I have this year for reducing the burden of taxation, which of course remains a major objective of Government policy. But I am sure it is right to err on the side of prudence and caution, and to build a still firmer base for the future. That is the principle on which both I and my predecessor have consistently conducted economic policy these past eight years, and I see no reason to depart from it now.

D10. Meanwhile, I would make one further observation, of a different nature. Economic arguments are seldom concluded, one way or another. This is chiefly because it is unusual for economic policies to be held in place long enough to provide sufficient evidence. But the 1980s have been different; and, as a result, one critically important economic argument has now been concluded, finally and decisively.

D11. Throughout our period of office, our critics have consistently maintained not only that a fiscal stimulus would produce real economic growth, but that without an expansionary fiscal policy

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sustained growth was impossible. They were wrong, and have been proved wrong. The British economy is now embarking on its seventh successive year of steady growth, at an average rate of getting on for 3 per cent a year. And during that time the PSBR, even if privatisation proceeds are added back, has been deliberately and steadily reduced from a shade under 6 per cent of GDP to a little over 2 per cent. Indeed, had I or my predecessor at any time heeded the advice of our so-called expansionist critics, the British economy would never have been in the unprecedentedly favourable position it is in today.

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X. EXCHANGE CONTROL

X1. Before I turn to my proposals for changes in taxation, I have one other important change of a specific nature to announce.

X2. In 1979, a few months after the present Government had first taken office, my predecessor announced the abolition of exchange controls, which had been in continuous operation ever since the outbreak of war in 1939. That bold action has, over the past 7½ years, proved wholly beneficial to the British economy; and I am glad to note that other European countries are now moving in the same direction.

X3. But although the operation of exchange control has ceased, the Exchange Control Act itself remains on the Statute book. So long as it does, there is likely to persist a nagging fear that, in certain circumstances, exchange control might be reimposed; and such uncertainty could be damaging.

X4. I have therefore concluded that the time has come to repeal the Act. The necessary legislation will be contained in this year's Finance Bill.

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X5. I note that, in what was clearly intended to be a major speech in New York in September, the Deputy-Leader of the Labour Party declared that, and I quote:

"The Labour Party has no intention of reintroducing statutory exchange controls".

I am confident, therefore, that the proposal I have just made will be welcomed on all sides of the House.

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E. BUSINESS AND ENTERPRISE

E1. I now turn to taxation. First, taxes on business.

E2. The fundamental reform of the Corporation Tax system which I introduced in 1984 came fully into effect last April. The new system has undoubtedly improved the quality of business investment decisions in Britain, and is also encouraging more overseas companies to set up here.

E3. During the transition to the new system, companies were given advance notice of the main rate of Corporation Tax for the year ahead. This helped them in their forward planning, and I intend as far as possible to continue the practice of setting the rate in advance. Accordingly, I can announce now that the main rate of Corporation Tax in 1987-88 will be unchanged at 35 per cent - lower than in any other major industrial nation, though the United States is now set to emulate us.

E4. The low rate of Corporation Tax enables me to introduced a further simplification into the system.

E5. At present, while companies' capital gains are liable to Corporation Tax, the amount of such gains is first adjusted by a certain fraction so that the effective rate of tax is the same as that on capital gains made by individuals. This dates back to the time when the two rates of tax were far apart.

E6. This is no longer the case: indeed, the Corporation Tax rate for small companies is now below the Capital Gains Tax rate.

E7. I therefore propose that, from today, companies' capital gains be charged at the appropriate Corporation Tax rate, without adjustment, save for the indexation which applies to all post-1982 gains.

E8. It has, however, been argued that it is wrong that, where companies distribute capital gains as dividends, the gains are taxed twice, once in the hands of the company and once in the hands of the shareholder. I believe there is some justice in this complaint. Accordingly, I propose to remedy it by allowing companies to set payments of Advance Corporation Tax against their liability to tax on capital gains.

E9. Taken together, these changes should yield £60 million in 1988-89.

E10. I also have some further simplification and rationalisation of the Corporation Tax system to announce.

E11. At present, some companies established before 1965 do not have to pay their Corporation Tax until up to 21 months after the end of the period for which it is due, whereas companies established since 1965 have to pay their tax after 9 months - and some building societies have to pay sooner still.

E12. This difference in treatment cannot be justified. Moreover, it is open to an abuse which could put the timing of a substantial proportion of the total Corporation Tax yield at risk.

E13. I therefore propose that all companies and building societies should be treated the same way, with all liable to pay Corporation Tax nine months after the end of the accounting period on which the tax is due. The change will be phased in, but I would expect it to yield around £100 million in 1988-89.

E14. I also propose to legislate now to pave the way for a new method of collecting Corporation Tax, to be known as Pay and File. Under this system companies will estimate their tax liabilities themselves, and pay on the normal due date. Where it turns out that the initial payment was too low, the company will pay interest to the Revenue; where the initial payment was too high, the Revenue will pay interest to the company.

E15. This new approach, which has already been generally welcomed by the business community, is part of a wider programme of streamlining tax collection, and will not come into force until the early 1990s. But by legislating now I am giving taxpayers and their advisers a firm basis on which to prepare for the new scheme.

E16. While business and industry as a whole is doing well, the North Sea oil sector has inevitably been hard hit by last year's oil price collapse. My Rt Hon Friend the Secretary of State for Energy and I have followed closely the effects on North Sea producers and their suppliers. The industry itself is generally confident about the longer-term prospects; while as for the tax system, not only is it inherently price-sensitive, but the companies themselves have repeatedly stressed their desire for stability.

E17. However, in the light of the immediate problems, I introduced last autumn legislation to bring forward the repayment of over £300 million of Advance Petroleum Revenue Tax. This has already helped many of the smaller and medium-sized companies faced with cash flow difficulties.

E18. I now propose two further Petroleum Revenue Tax reliefs. First, as from today companies may elect to have up to 10 per cent of the costs of developing certain new fields set against their Petroleum Revenue Tax liabilities in existing fields, until such time as the income of those new fields exceeds the costs incurred. Second, there will be a new relief against PRT for spending on research into UK oil extraction that is not related to any particular field.

E19. I hope that these carefully targeted changes will give a worthwhile measure of help to the North Sea oil sector.

E20. I have to set the 1988-89 car and car fuel benefit scales for those with company cars. The car scale charges still fall well short of the true value of the benefit, and as last year I propose to increase them by 10 per cent. There will be no change in the car fuel scales which, as already

announced, will also be used for VAT purposes from 6 April.

E21. Last year I put the Business Expansion Scheme onto a permanent footing. However, there is evidence that the present rules produce end-year bunching of BES investments, and hence may crowd out some projects and lead to bad decisions on others.

I propose therefore to permit the investor to claim part of the relief against his previous year's income. This will make it easier for companies to raise BES finance throughout the year.

E22. Training and retraining are vital to a flexible and competitive economy. Some employers may be willing to help with the retraining of workers who are leaving their current employment. At present the tax system can be an obstacle to this. I propose that both employers and employees should be exempt from tax in this kind of case, which should encourage workers to acquire new skills for new jobs.

E23. The past few years have seen a remarkable and most welcome growth in the number of small businesses and the self-employed. The Government has done a great deal to lighten the burdens on this vitally important sector of the economy. But I am

well aware that problems remain, not least in the field of VAT.

E24. Accordingly, I asked Customs and Excise to issue a consultative document last autumn canvassing a number of changes. In the light of the responses to that document, I have four proposals to make.

E25. Perhaps the biggest problem faced by the small businessman today is the trade customer who is late in paying his bills: so late, sometimes, that VAT becomes due before the bill has been paid. I can do nothing about late payment; but I can, I hope, do something about the VAT problem.

E26. My first and most important proposal, therefore, is that, as from 1 October, businesses whose annual turnover is under £½ million, which means more than half of all traders registered for VAT, will be able to choose to account for VAT on the basis of cash paid and received. In other words, they will have no liability to pay VAT until they themselves have received the money from their customers. In addition to easing the cash flow problems caused by late payers, this system will of course provide automatic VAT relief for bad debts.

E27. I have to warn the House, however, that I cannot legally introduce this change without first obtaining a derogation from the European Community's Sixth VAT Directive. I am applying for the necessary derogation today. The House will note that the upper limit of £4 million is considerably greater than the £100,000 suggested in the consultative document.

E28. Second, I propose to give these businesses the option of accounting for VAT on an annual basis. Instead of making quarterly returns, they would make regular payments on account, and then file a single return at the end of the year. This option, which offers considerable streamlining, will be available next year.

E29. Third, the period within which businesses must apply to be registered for VAT will be extended from ten to thirty days.

E30. Fourth, there will be changes to the rules for the special VAT schemes for retailers, and more small and medium-sized businesses will be able to make use of the simpler schemes.

E31. I believe that the changes I have outlined, and in particular the option to move to cash accounting,

will be widely welcomed by the small business community. The cost will be £115 million in 1987-88 and £60 million in 1988-89.

E32. In addition, I propose to increase the VAT threshold to £21,300, to keep it at the maximum permitted under existing European Community law.

E33. In the light of the responses to the consultative document, I shall not be going ahead either with the withdrawal of the so-called standard method by which retailers calculate their gross takings for VAT, or with the compulsory deregistration of traders below the VAT threshold.

E34. I have one further measure to help the small businessman, unrelated to VAT. I propose to increase the limit for Capital Gains Tax retirement relief by 25 per cent, from £100,000 to £125,000.

E35. An essential element in any ongoing programme of tax reduction and reform must always be the elimination of unintended or unjustified tax breaks, which cause rates of tax generally to be higher than they need to be. Accordingly, I have five proposals to make today to this end.

E36. The first concerns VAT, and has already been the subject of extensive consultation. The House will be aware that a business that provides a service that is exempt from VAT cannot in turn deduct input tax on its purchases. But where the activities of a business are in part liable to VAT and in part exempt, the existing rules are excessively generous as to the amount of input tax that can be deducted; and this generosity is being exploited on a growing scale. The rules must therefore be changed, and the changes, which I announced to the House last December, will come into effect on 1 April. There will be special arrangements to deal with the problem of brewers' tied houses. I am also taking this opportunity to exclude a significant number of small businesses from the scope of this provision. The yield from this change, which in effect is a measure of the potential revenue loss, will be some £300 million in 1987-88 and £400 million in 1988-89.

E37. Second, I propose to change the law so that companies in multinational groups which enjoy dual residence will no longer be able to secure tax relief twice on one and the same interest payment. Genuine trading companies will not be affected. This change, which will take effect on 1 April, follows the similar action recently taken by the

United States. It will yield £125 million in 1988-89.

E38. Third, I propose to end the present excessively generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans. In future, banks will be able to offset this tax credit only against tax on the profit on the relevant loan, and not more widely. This will bring our rules broadly into line with those in most other countries. The change will apply from 1 April this year for new loans and from 1 April next year for existing loans. It will yield some £20 million in 1988-89.

E39. Fourth, the tax treatment of Lloyd's syndicates as it applies to the Reinsurance to Close system is clearly unsatisfactory. I therefore propose to bring it into line with that of provisions for outstanding liabilities made by ordinary insurance companies and, indeed, of comparable provisions made by other financial traders. I have asked the Inland Revenue to consult urgently with Lloyd's about the details of the legislation. The new rules will first apply to premiums payable for the Lloyds account which closes on 31 December this year.

E40 Fifth, I also propose to implement the Keith Committee's recommendation that interest should be charged in the limited number of cases where an employer does not apply PAYE properly and a formal assessment has to be made to recover the tax. The change will take effect from April next year, and the yield in 1988-89 is estimated at £45 million.

E41. I have one further proposal to make in the broad field of the taxation of business and enterprise.

E42. In my Budget last year I suggested the possibility of introducing a measure of tax relief for profit-related pay.

E43. I pointed then to two considerable advantages that might be expected to flow from arrangements which relate pay to profits. First, the workforce would have a more direct personal interest in the profits earned by the firm in which they work; and, second, there would be a greater degree of pay flexibility in the face of changing market conditions. Such flexibility is vital if, as a nation, we are to defeat the scourge of unemployment.

E44. Last July I presented a Green Paper on Profit-Related Pay in conjunction with my Rt Hon and Noble Friend the Secretary of State for Employment and my Rt Hon Friend the Secretary of State for Trade and Industry. I now propose to introduce a scheme of tax relief broadly along the lines floated in the Green Paper.

E45. My proposals depart from those in the Green Paper in one important respect. I am doubling the proportion of an employee's profit-related pay that will be tax free from a quarter to a half, and I am also increasing the upper limits on the relief. So for a married man on average earnings receiving 5 per cent of his pay in profit-related form, the tax relief will be equivalent to a penny off the basic rate of income tax. The cost will inevitably depend on take-up: it could be £50 million in 1988-89, building up to substantially more than that, as take-up grows, and the proportion of an employee's pay which is profitrelated rises.

E46. Profit-related pay is no panacea. But then there are no panaceas. What it is is a tool to help British business gradually to overcome one of our biggest national handicaps: the nature and behaviour of our labour market. I am today challenging British management to take advantage of

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that tool and to make good use of it, for the good
of their firm, their workforce and their country.

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F. TAXES ON SAVING

F1. I turn now to the taxation of savings.

F2. A central theme and purpose of the Government's policies is the creation of a genuine popular capitalism: [what used to be called, when ambitions were more limited and language more inhibited, a property-owning democracy.]

F3. That means wider home ownership, wider share ownership, and wider pension ownership. Over the past eight years, the Government has actively promoted the first two, and has now embarked on the third. Home ownership, above all through the council tenant's right to buy. And share ownership, through the rapid growth of employee share schemes; through the massively successful privatisation programme, where Britain has led the world; and most recently through the new Personal Equity Plans, which I announced in last year's Budget and which started up on 1 January this year. In the first month of the scheme, more than 2,000 people a day took out Personal Equity Plans, many of them first-time investors, as I had hoped.

F4. We know that 63 per cent of households now own their own homes, $2\frac{1}{2}$ million more than in 1979. There have been, however, no official figures for the more explosive growth of share ownership in Britain over the past eight years. The Treasury and the Stock Exchange therefore jointly commissioned a major independent survey of individual shareholding in Britain. The results are now available. They show that there are now some $8\frac{1}{2}$ million individual shareholders in this country - amounting to one fifth of the total adult population, and roughly three times the number there were in 1979.

F5. And then there is wider pension ownership. Two years ago, the Government embarked on a major strategy to extend the coverage of private pension provision and to give individuals far more flexibility and choice in the way they provide for their retirement. We have already introduced a number of important new measures to that end, and the tax changes I am announcing today will complete the picture.

F6. The cornerstone of the Government's pensions strategy is the introduction of an entirely new means of provision for retirement, developed by my Rt Hon Friend the Secretary of State for Social Services. This is the personal pension, which will

~~Services. This is the personal pension, which will~~
be launched at the beginning of next year, three
months earlier than planned.

F7. Personal pensions are an important new
dimension of ownership. They will enable
employees - if they so wish - to opt out of their
employers' schemes and make their own arrangements,
tailored to fit their own circumstances. And they
will provide a new opportunity for the 10 million
employees who at present do not belong to an
occupational scheme to make provision of their own
and, if they so wish, to contract out of SERPS.

F8. In my Budget last year I undertook to bring
forward proposals to give personal pensions the same
favourable tax treatment as is currently enjoyed by
retirement annuities. These were duly contained in
a consultative document published last November,
and the necessary legislation will be contained in
this year's Finance Bill.

F9. In addition, to encourage a wider spread of
occupational schemes, employers will be able to set
up simplified schemes with the minimum of red tape.
This will be particularly welcome to many small
employers who have been discouraged by the
complexity and open-ended commitment of a
full-blown final salary scheme. And there will be

much greater scope for transferring between different types of pension scheme. Again, the Finance Bill will contain the necessary tax provisions.

F10. Finally, I have decided to go beyond the proposals set out in the consultative document in one important respect. I propose to allow members of occupational pension schemes to make additional voluntary contributions, with full tax relief, to a separate plan of their own choice instead of, as now, being restricted to plans within their employer's schemes. They will be able to top their pensions right up to the present tax approval limits.

F11. The proposals I have outlined - along with the measures my Rt Hon Friend has already taken - will make it easier for people to take their pensions with them when they change jobs, which will be good both for labour mobility and for independence. They will widen the range of choices people can make about their pensions; and will mean that in future individuals will have much more control over the way in which their own pension contributions are invested.

F12. Taken as a whole, the changes we have made in the last two years have brought about a radical transformation in the ways people can provide for their retirement. There are new options for employers, and much greater freedom for individuals to plan their own pensions. This will lead to a further major extension of ownership, as people start to take advantage of the new opportunities.

F13. But the generous tax treatment of pensions can be justified only if it is not abused. I propose, therefore, to introduce some limited changes to the present rules to restrict the excessive relief which can be obtained in some circumstances, particularly by a few very highly paid people. These will include a stricter definition of final salary and, for all arrangements entered into from today, an upper limit of £150,000 on the maximum permissible tax-free lump sum, coupled with more rigorous rules on how pension and lump-sum benefits can be calculated.

F14. The cost of the overall pensions package will inevitably depend on take up, but with that proviso is estimated at £65 million in 1988-89.

F.15 For Friendly Societies, I have decided to replace the existing tax-exempt life assurance

limit based on the sum assured with a new limit based on annual premiums. I propose to set this at £100 a year, which will greatly increase the scope of the traditional societies to offer life policies to their members.

F16. The tax-exempt limits governing sickness and accident benefits which trade unions provide for their members have not been changed since 1982. With effect from today, I propose to increase them to £3,000 for lump sums and £625 for annuities.

F17. Finally, in this section, I turn to Inheritance Tax.

F18. In my Budget last year I abolished the pernicious Capital Transfer Tax on lifetime gifts between individuals, which was particularly damaging to the ownership and health of family business. This year I propose to extend the same exemption from tax, on similar terms, to gifts involving settled property where there is an interest in possession. This will not, however, apply to discretionary trusts. These changes will be of particular benefit to family businesses and to heritage properties, both of which are often held in trust.

F19. I also propose to make two minor changes affecting business assets. First, in what is perhaps an unwanted tribute to the unlisted securities market, holdings in USM companies will henceforth be treated for Inheritance Tax purposes in precisely the same way as holdings in companies with a full Stock Exchange listing. Second, business relief for minority holdings in excess of 25 per cent in unquoted companies will be increased from 30 per cent to 50 per cent. The purpose of both these changes is to concentrate business relief more accurately on those assets which could provide funds to pay the tax only at the risk of damaging the business.

F20. The abolition of the tax on lifetime giving was of the first importance to family businesses. But I remain conscious that it did little to help the smallest taxable estates, where the family home is often the main asset.

F21. I therefore propose to make a substantial increase in the threshold for Inheritance Tax, from £71,000 to £90,000, coupled with a simplification of the rate structure from seven rates to four. As a result of this change, the number of estates liable to Inheritance Tax will be cut by roughly a third.

The cost will be £75 million in 1987-88 and £170 million in 1988-89.

F22. Despite this substantial relief, however, and all the other much-needed reliefs that my predecessor and I have introduced since 1979, the House may be interested to learn that the expected yield of Inheritance Tax in 1987-88, at over £1 billion, is nearly three times the yield of Capital Transfer Tax in 1978-79, an increase in real terms of almost 50 per cent.

F23. As for the other Capital Taxes, over the same period the yield of Capital Gains Tax has risen in real terms by more than 80 per cent and of Stamp Duty by 140 per cent. These increased yields are not unconnected with the fact that, since we first took office, the severity of these taxes has been significantly eased.

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G. TAXES ON SPENDING

G1. I now turn to the taxation of spending.

G2. I have already announced some important changes in value added tax to prevent avoidance and to help the small businessman. I have no other proposals for major changes in VAT this year.

G3. However, in the light of representations I have received, I have decided to extend slightly the VAT reliefs I introduced last year for certain aspects of charitable work.

G4. I propose to relieve charities from VAT on certain welfare vehicles used by hospices to transport the terminally ill; on installing or adapting lavatory or bathroom facilities in charity homes for the disabled; on drugs and chemicals used by a charity in medical research; and on specialised location and identification equipment employed by mountain rescue and first aid services.

G5. While on the subject of charitable giving, I should remind the House that this year's Finance Bill will increase the limit on donations to charity under the new payroll giving scheme, which starts next month, from £100 to £120 a year.

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G6. Next, the excise duties. I propose to maintain the revenue from the taxation of gambling, but to make some readjustment within the total. I therefore propose to increase the gaming machine licence duty by about a quarter, which will restore it in real terms to its 1982 level, when it was last increased; and to offset this by abolishing, from 29 March, the tax on on-course betting. I hope this measure will be of some assistance to the racing and bloodstock industry, as well as consoling those hon Members who have complained to me about the clash this year between Budget Day and the Champion Hurdle.

G7. In my Budget Statement last year, I gave advance notice of my intention to introduce a tax differential in favour of unleaded petrol so as to offset its higher production cost. I can now announce that the differential will be 5 pence a gallon. This means that the pump price of unleaded petrol should be no higher than that of 4-star leaded petrol. The change will take effect from 6 o'clock this evening.

G8. Following on from the action I took last year, I propose to increase the rates of Vehicle Excise Duty on farmers' lorries, to bring them into line with the use they make of the public roads. This change will take effect from midnight tonight. I

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also propose to increase the rates of duty on trade licences and to rationalise the taxation of recovery vehicles.

G9. I have no further changes to propose this year in the rates of excise duty.

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H. INCOME TAX

H1. Finally, I turn to income tax.

H2. There is now a worldwide consensus on the economic desirability of tax reform and tax reduction, and in particular the reduction of income tax. This was demonstrated most recently by the various national policy declarations that emerged from last month's meeting of Finance Ministers from the major industrial nations.

H3. Lower rates of tax sharpen up incentives and stimulate enterprise, which in turn is the only route to improved economic performance. It is only by improving our economic performance that we will be able to afford to spend more on public services; only by improving our economic performance that we will be able to create jobs on the scale that we all want to see.

H4. That is why, ever since we first took office in 1979, we have consistently sought to reduce the burden of income tax. We have cut the basic rate of tax from 33 per cent to 29 per cent and sharply reduced the punitive higher rates we inherited from the Party opposite. We have increased the main tax

allowances by 22 per cent more than inflation, taking almost 1½ million people out of income tax altogether.

H5. For 1987-88 I propose to raise all the main thresholds and allowances by the statutory indexation factor of 3.7 per cent, rounded up. Thus the single person's allowance will rise by £90 to £2,425 and the married man's allowance by £140 to £3,795. The single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675. The age allowance income limit becomes £9,800. I propose to raise the first, 40 per cent, higher rate threshold by £700 to £17,900, in line with statutory indexation; but the threshold for the 45 per cent rate will go up by only £200 to £20,400. The other higher rate thresholds will remain unchanged.

H6. I have two other changes in allowances to announce. First, I propose to give an additional increase in the age allowance for those aged 80 or over. For them, the increase will be double the amount due under statutory indexation, so that, for the very elderly, the single age allowance will rise by £220 to £3,070 and the married age allowance by £340 to £4,845. Around 400,000 taxpayers will

benefit from this new measure, and up to 25,000 of them will be taken out of income tax altogether.

H7. Second, the blind person's allowance has remained unchanged since 1981, when it was increased by £180 to its present level of £360. For 1987-88 I propose to increase it by a further £180, to £540.

H8. Finally, I turn to the basic rate of income tax. This is the starting rate of income tax for everyone and the marginal rate for the overwhelming majority of taxpayers.

H9. In my Budget speech last year I reaffirmed the aim set out by my predecessor in 1979, to reduce the basic rate of income tax to no more than 25 per cent. That remains my firm objective.

H10. However, given my decision to use the greater part of the fiscal scope I now have to reduce the Public Sector Borrowing Requirement, that goal cannot be achieved in this Budget.

H11. I can, however, take a further step towards it, as I did last year. I am therefore reducing the basic rate of income tax by twopence, to 27 per cent. This reduction, which will benefit every

taxpayer in the land, will be worth more than £3 a week to a married man on average earnings.

H12. There will, of course, be a consequential reduction in the rate of Advance Corporation Tax, and - as last year - I also propose a corresponding cut in the small companies' rate of Corporation Tax from 29 per cent to 27 per cent. Taken together with the income tax change, this will mean a significant reduction in the tax burden on small businesses, which are so crucial for future growth and employment.

H13. The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May. They will cost a little over £2 billion in 1987-88 over and above the cost of statutory indexation.

H14. The overall cost of all the measures in this year's Budget, again on an indexed basis, is a little over £2½ billion. And I have been able to make this worthwhile reduction in tax while still achieving my objective of a PSBR of £4 billion.