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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

Note

P.M. spoke to the Chancellor on the telephone on 17/3 and gave him various technical comments.

RREG 18/3

PRIME MINISTER

As promised I attach:

- the draft Budget speech in 2 sections
- the scorecard and forecast summary.

I have asked one or two quick thoughts on the text. The Chancellor is aiming to finalise it (at last) on Sunday afternoon. So it would help to get any comments to him before then. He will, however, be out of touch on Sunday morning.

There are 2 options:

(1) You could ring the Chancellor from Cleaver, then both of you will have the text in front of you.

(2) You could ring me before you go to Cleaver. I won't have the text, but you could give me passport changes. I would then pass them on to the Chancellor's office later in the day.

RREG
16/3

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Draft 16 March 1990

DRAFT

BUDGET SPEECH

Does it? Surely bringing down inflation is the main objective?

[Mr Speaker] The Government's economic policy has two main objectives.

2. The first is to bring down inflation. Until that happens, we will not be able to reduce interest rates and keep them down.

3. The second is to enable this country to take the opportunities of the 1990s. In Western Europe, the single market is nearly on us and the whole of Eastern Europe has opened up in a most dramatic way. I wish to see British business take advantage of these changes.

4. These two objectives are closely related. Unless we succeed in the first, we are unlikely to do so in the second.

5. So this Budget will take no risks with inflation. It will maintain a strong fiscal surplus.

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6. It will, above all, be a budget for savers. It will provide new incentives to save and to give. It will bring the introduction of independent taxation for married women. It will introduce important new measures for business. It will keep up the pace of supply side reform. It will remove an old grievance from the tax system and make the social security system fairer. And it will abolish two taxes.

7. I will come to the detailed measures later. First, I wish to review the performance of the economy in 1989 and preview the prospects for 1990; I will then deal with monetary policy and public sector finances.

8. As usual, the Red Book, together with a number of Press Releases filling out the details of the Budget measures, will be available from the Vote Office as soon as I have sat down.

ECONOMIC PERFORMANCE AND PROSPECTS

9. First, the economic background.

10. 1989 saw continued buoyant growth in world trade despite some slow down in the growth of the major economies particularly in the United States. However increased inflation and fears of overheating in continental Europe led to increases in short-term interest rates in most major

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economies during the year and, more recently, a rise in long-term interest rate particularly in Germany where uncertainty about the effects of monetary union has been an additional factor.

11. This tightening of monetary policy is likely to bring lower growth in 1990 than in 1989 and, in due course a fall in inflation. We are likely, therefore, also to see a slower growth in world trade in the current year, although the exciting developments in Eastern Europe improve the longer-term prospects.

12. In this country during the last year, business confidence has been a good deal stronger than many expected. New businesses have outnumbered closures, by around 1,500 every week, a record never before approached. Employment has continued to rise, and unemployment to fall. Almost 27 million of our fellow citizens are in work today - a larger number than ever before and $1\frac{1}{2}$ million more than at the beginning of the '80s. Business investment has risen by a further 9 per cent in the last year, taking it to 15 per cent of national output - the highest level ever.

13. And companies have not just been investing in plant and machinery. Their spending on research and development has also risen in real terms by almost 50 per cent in the

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five years to 1988. They now spend over £500 million a year of their own money on R&D. Similarly in the 5 years up to 1989 the numbers of employees receiving training has increased by over 70 per cent.

14. These are all favourable developments but recently they have been accompanied by the return of inflationary pressures. That, beyond any doubt, is the most urgent problem, before us today.

15. To a degree it is a problem common to all nations. Throughout the Group of Seven leading economies of the Western world inflation has risen significantly since its low point in 1986 and 1987. But our affliction has been sharper. It has arisen from a combination of reasons - some welcome and some not. The record rise in business investment is obviously welcome; but it has been accompanied by a similar growth in borrowing and in consumer spending. Thus investment has been rising but the savings to finance it have not.

16. This has led to excessive growth in domestic demand, a revival of inflationary pressures, and a current account deficit, a good deal of which itself represents suppressed inflation.

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17. As soon as these developments became clear, policy was tightened, and interest rates have now been in double figures for 20 months. This tight monetary policy has been backed by large Budget surpluses throughout the last three years. So monetary and fiscal policy have acted together.

18. Squeezing out inflation is always a slow business and this occasion is proving no exception. But there is now clear evidence that demand is slowing down. High Street sales are now only 2 per cent up on a year ago. The housing market has cooled off noticeably. New car and vehicle registrations are down. Business spending is slowing and import growth has almost come to a halt.

19. And as demand has fallen back, output growth has fallen also, to just over 2 per cent in 1989.

20. No one likes to see the economy slow but it is inevitable if we are to push inflation downwards. I now expect the economy to grow by only 1 per cent this year, compared with the above trend growth of $4^1/_2$ per cent in 1987 and 1988. This single statistic shows the extent of the downward pressure on inflation. But growth should return in 1991 towards its sustainable rate of around $2^3/_4$ per cent.

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21. I am confident that the period of low growth will be short-lived because of the permanent improvements in the underlying economy in the 1980s. Investment has grown more than twice as fast as consumption over the last eight years. As this additional capacity is fully utilised inflationary pressures will lessen and more normal growth will resume. No one need have any doubt about that.

22. Last year also saw a record level of foreign direct investment into Britain. These investments are particularly welcome as they are in industrial sectors like cars and electronic goods where a high proportion of the output is usually exported. For example, I wonder how many people realise that Britain now runs a trade surplus in colour TVs.

23. This increased capacity will enable British industry to meet domestic demand and to respond to export opportunities. Indeed, that is already beginning to happen. The current account deficit for 1989 as a whole was a little over the £20 billion I forecast at the time of the Autumn Statement. But the deficit in the last 3 months was substantially lower than in the previous quarter and, in particular, the manufacturing deficit is now improving. Exports have been growing faster than imports for at last [X] months.

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24. The reason for this improvement is twofold. A year ago, rapidly expanding domestic demand sucked in imports to meet a market that domestic manufacturers could not supply. Moreover, that same demand absorbed British goods that would otherwise have been exported. This pattern is now reversing.

25. Exports are now growing rapidly, regaining the share of world markets they lost in 1988. Last year, the volume of exports of manufactures grew by $11^{1}/_{2}$ per cent - the highest recorded rate for nearly 20 years.

26. It is encouraging - though not surprising - to see British industry responding so well to export opportunities. And it illustrates clearly that the deficit is not caused by poor industrial competitiveness. The primary problem has been excess demand and as that is reduced the current account will improve. I expect the deficit to fall to £15 billion in 1990 and further thereafter.

I can't this will give rise to hollow laughter

a colossal figure

27. But notwithstanding the prospect of lower growth we cannot afford to relax policy. The buoyancy of past demand means that inflation has been far more stubborn than anyone expected. A significant fall is still some months away and a number of factors will ensure that the position will worsen noticeably before it improves. This will be reflected in the Retail Price Index during the next few months.

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28. The largest single factor is the growth of some £4 billion in local authority spending next year. This is mainly responsible for the expected growth of over 30 per cent in average community charges compared with domestic rates, which will add over 1 per cent to the RPI next month.

29. Similarly the further rise in mortgage rates last month will also increase the Retail Price Index. As a result, I now expect that RPI inflation may still be a little over 7 per cent by the fourth quarter of this year, compared to the $5\frac{3}{4}$ per cent I had previously forecast.

30. Beyond that - as these one-off increases drop out of the index and the effect of monetary tightening builds up, I expect inflation to fall below 5 per cent during 1991.

31. To summarise, the economy - both consumption and investment - has been very resilient in recent years. Adjustment so far has been gradual. But this is not necessarily a good guide to the future. The gradual adjustment may continue but equally the turnaround may become quite sharp.

32. I do not propose to pretend certainty where there can be none. I am only too well aware that it is against an

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uncertain background that I must set monetary and fiscal policy, to which I now turn.

MONETARY POLICY

33. I want to deal with monetary policy and interest rates first for two reasons: because they are of great concern in the House and in the country and because as always they provide the key to progress on inflation.

34. I know that high interest rates are unpopular. But they are most unpopular as they become most effective. They discourage spending and borrowing. They act directly on the things we have to influence if we are to get inflation down.

35. Interest rates are also the most flexible way of responding to what can be a rapidly changing situation. They can be raised quickly when necessary. And they can be relaxed just as quickly when it is safe to do so.

36. In recent months I have looked carefully to see if there is an effective alternative to interest rates. Many people, I know, favour direct controls on bank lending, hire purchase and consumer credit. But [apart from their inherent undesirability and unfairness,] it is extremely unlikely that they would work in the modern world. They were becoming less

it is also unfair to let mortgages go hard

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and less effective even before exchange controls were abolished over ten years ago. Their main impact now would be to replace domestic borrowing with overseas borrowing. For these days it would be a simple matter for any High Street bank to arrange its lending through an overseas branch.

37. It is for this reason that governments of all persuasions throughout the Western world are abolishing credit controls and are relying on interest rates to control money and thus inflation. The same is true of those in Eastern Europe who are seeking to join the Western system.

38. But as financial markets have become more open to competition their behaviour has changed enormously. They have become harder to read and that has made monetary conditions more difficult to judge as well. This is one of the consequences of financial deregulation which has brought great benefits as well as some problems.

39. So, although monetary policy remains the key to controlling inflation, it is not realistic to suppose that we can take decisions solely by reference to the way any one particular measure of money is growing. In a more sophisticated world, we must apply judgement and take into account the other evidence about monetary conditions that may be available .

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? Go straight to para 43.

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Refer 40. Put 41 & 42 after 45

40. Inflationary pressures will always be with us. Whether they originate in international circumstance or domestic behaviour, they are not easy to counter. But faced with such pressures what we can do is to seek to bring the inflation rate back onto a downward path. That is the objective of the Medium Term Financial Strategy I am publishing today.

41. Progress on reducing inflation is as essential for social reasons as it is for the economy. It is also a vital pre-condition of our taking sterling into the exchange rate mechanism of the European Monetary System. Our commitment to do so was set out at Madrid, it remains firm, and the conditions for entry remain unchanged.

NB

42. In due course, joining the exchange rate mechanism will provide a new short term framework for interest rate decisions. But even then, no one should suppose it will bring a dispensation from the need for - strong domestic monetary control. Indeed, quite the reverse. Commitment to the one will reinforce the commitment to the other.

43. In recent weeks I have re-examined the role of monetary targets. I have concluded that it is sensible to maintain a target for narrow money, and that this is best measured by

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the familiar aggregate M0. Since this is essentially notes and coin, it clearly is not a comprehensive measure of money in all its uses. But it does have value as a proven indicator of transactions and has been a reliable guide for many years. For next year I have set the target range at 1 to 5 per cent. Although the growth of MO has fallen from its earlier peaks, it is likely to start the year above the range and it may be some months before it falls within it.

44. I have also examined closely the case for reintroducing a target for broad money. I can understand why some favour this. At times broad money has given a useful indication of the build up of inflationary pressure. The difficulty is that its message has always varied in quality: its growth can represent money that is about to be spent, or money that is very definitely being saved: savings which I wish to encourage as will become apparent later in my speech. So, although we will monitor M4 carefully, and give it weight in our decisions, I do not intend to set an target for the year ahead.

45. Finally I have reviewed whether there should be any changes in the Government's funding policy. The objectives must be to manage public debt in a way that supports monetary policy, without distorting financial markets. I have concluded that in general policy should continue to be guided

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by the funding rule followed in recent years, with the public sector avoiding sustained under or overfunding. But in practice the rule cannot and should not be operated rigidly. In particular, in recent years there has been an increase in the size of the Treasury bill issue, largely as a result of a change in the financial position of local authorities. In the circumstances, the Government will if necessary adjust its funding operations, increasing gilt sales or reducing gilt purchases, to take account of this.

46. To sum up, interest rate decisions will continue to be made on the basis of the growth of monetary aggregates, and a range of other evidence most notably the exchange rate. This matters because it provides important information about domestic monetary conditions - quite apart from having a direct effect on prices. But there is, as I have made clear, no single lodestar to guide us in monetary policy. Life would be simpler if there were but it just does not exist. So judgement is unavoidable.

47. And for now the judgement must remain this: interest rates must stay high for some time to come. The moment I judge I can safely lower them, I will. But to reduce them prematurely only to increase them again would be extremely damaging. When I bring them down it will be because I believe they are likely to stay down.

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48. In Chapter 2 of this year's Red Book I have provided a much longer and more comprehensive account than usual of how monetary policy, including funding policy, is to be operated over the years ahead. I hope this will be helpful to the House, and in particular to members of the Treasury and Civil Service Select Committee when they come to examine the Budget documents in detail.

FISCAL POLICY

49. Although monetary policy must play the main role in tackling inflation, a tight fiscal policy is also essential. It cannot do the work of monetary policy, but it can and must support it.

50. The dramatic improvement in the state of public finances over the last 10 years under the stewardships of my RHFs is an achievement of which they can be rightly proud. For decades successive Governments have spent more than they were prepared to raise honestly from taxation and made up the shortfall by borrowing. They left the bill to be picked up by future generations.

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51. Over decades that bill mounted to very considerable levels. Today, just paying the interest on the accumulated debt accounts for 10p on income tax.

52. Over the past 10 years we have reversed that trend; and in the last three we have re-paid around £25 billion, reducing the burden of government debt to levels we have not seen since before the first world war.

53. The rewards of this repayment will be felt by future generations but they bring also an immediate benefit. As a result of the debt repayments we are saving over £2,500 million a year in debt interest. That is sufficient to meet the annual cost of 150 district general hospitals.

54. The very large Budget surpluses in 1988 and 1989 owed much to cyclical factors. In the current year, as I indicated to the House some months ago, we expect the surplus to fall back. The position is still uncertain, as it usually is at this time of year, but our best estimate is that the debt repayment this year will be around £7 billion. £9.6m

55. This fall in the surplus owes less to the slowdown in growth than to a number of special factors. We have seen a fall in privatisation proceeds from the very high level achieved in 1988-89. There has also been a sharp and

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unwelcome increase in local authority spending. This has been particularly marked in their capital spending, as they have sought to forestall the new controls which will take effect in April. As a result, we now expect the public expenditure planning total this year to be overshot by £$2^1/_4$ billion. The overshoot arises solely because of overspending by local authorities; central government expenditure remains well under control.

56. Another, but much more welcome, factor reducing the surplus has been the higher national insurance rebates that have resulted from the huge success of personal pensions. This extension of choice is a considerable tribute to my RHF, Sutton Coldfield. Over $3^1/_2$ million people have now been taken out personal pensions. As well as benefiting the individuals concerned, in the long-term this will reduce public spending. But it also reduces national insurance receipts, by £$2^1/_2$ billion this year.

57. Next year, some of these factors will not be repeated but we will see the effect of slower growth on the debt repayment. In particular corporation tax receipts are likely to be significantly lower, not least because of the higher investment of recent years which entitles businesses to higher allowances against tax. These allowances will be

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worth over £9 billion to companies next year. These cyclical factors will build further in subsequent years.

58. It is against the medium-term fiscal prospect that I have framed the Budget judgement; for fiscal policy is not a flexible instrument which should be altered to meet short-term contingencies. Fine tuning fiscal policy is not only disruptive to the public sector, business, and to taxpayers but its effects on the economy are both uncertain and often destablising.

59. Accordingly, I am budgeting next year for a further Public Sector Debt repayment of £7 billion - the same as this year. Looking further ahead, I expect our fiscal position to move towards the medium-term objective of a balanced budget, an objective I reaffirm today.

60. The overall effect of the Budget measures I announce today will be to maintain a tight fiscal policy, modestly increasing the yield from taxation by approaching £$^{1}/_{2}$ billion next year and just under £1 billion in the year after that.

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cc: Mr Gray (No.10) (2)
Mr O'Donnell (6)
Mr Ritchie (3)

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MPMW 16/3

DRAFT: 16.03.1990
CLOSE OF PLAY

TAXATION SECTION

I now come to the detailed measures in this year's Budget. And I shall begin with the taxation of business.

2. Everyone in this country benefits from the success of British enterprise. Tax reform cannot create success but it can help it, and encourage it.

VAT

3. Within the tight fiscal position I judge necessary, I am able to make some changes that should help small and medium sized companies.

4. Cash flow is particularly important to companies of this size. To improve it, therefore, I have two measures that should help.

5. At present, traders pay Value Added Tax on all their sales, even if their customers do not actually pay the bill. They can only claim VAT relief for a bad debt when the debtor has been declared formally insolvent. As a result, the

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trader - who has dealt in good faith - can be out of pocket, in some cases for years, and often for large sums.

6. This has long been resented by businesses and the time has come to deal with it. I therefore propose that from April next year all debts which are over 2 years old and written off in the trader's accounts will qualify automatically for relief from VAT. This will be worth some £150 million to business next year.

7. I also propose to help smaller companies by simplifying the rules for traders registering for VAT. At present whether or not you have to register depends on quarterly and annual turnover thresholds. You only have to say this to realise how difficult it is. Businesses also have to peer into the future to see if these limits might possibly be exceeded within the next year. This complication is unnecessary. So as from today, I propose a simple rule for VAT registration. This will be based on actual turnover in the preceding 12 months and not unknown turnover in the distant future. It will bring certainty and simplicity in place of uncertainty and complexity. Because businesses will, in general, register later than they otherwise would have, it will save them £35 million in 1990-91 and £75 million the year after.

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8. I have two further VAT changes. First, I propose to increase the VAT threshold to £25,400, a modest sum, but the maximum permitted under European Community law.

9. The second change will affect companies which provide accommodation for their own Directors. As things stand, the firm can deduct the VAT they pay on this, for something that is more a fringe benefit than a legitimate business cost. Frankly I do not believe this generous treatment is justified. I therefore propose that VAT paid on Directors' accommodation should no longer be deductible. This will take effect from [April 5 this year].

CORPORATION TAX

10. I also have some changes to Corporation Tax. While the main rate of corporation tax will remain at 35 per cent, I have some changes to propose that will reduce the burden of tax for small companies.

11. At present companies with profits below £150,000 pay a reduced rate of Corporation Tax of 25 per cent. For the coming financial year, I propose to raise this ceiling by one third, to £200,000. This amounts to a doubling in two years of the profits levels for the reduced rate, and will be of special benefit to smaller growing companies.

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12. For companies with profits above this limit, the average rate of tax gradually rises until they reach the upper profits limit of £$^{3}/_{4}$ million a year. I propose to widen this intermediate band by raising the upper profits limit, again by a third, to £1 million. This means that no single company will be liable for the full rate of Corporation Tax until its profits reach £1 million a year. This represents the most favourable structure of tax rates for small companies anywhere in the EC.

TRAINING

13. I also have one specific tax change to help training.

B.I.O.

14. One of the most welcome features of the last few years has been the massive amounts of money being invested in training throughout the economy. Indeed, the latest estimates put this at some £20 billion a year.

15. All companies' expenditure on training is, of course, tax allowable, and in addition the Government is spending £2$^{1}/_{2}$ billion a year on training programmes. Over £2 billion of this will in future be spent through TECs, most of which will be coming into operation over the next year.

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16. I believe that TECs will do much to improve training in this country, and I have no doubt that we shall see the benefits in years to come. They will give the private sector a new opportunity to determine its own needs, contribute to them, and receive generous cash and tax help to meet them.

17. The Government has undertaken to match local business donations to TECs pound for pound within certain limits. I now propose to encourage business to put more money into training by giving tax relief on business donations to TECs for five years until April 1995. And I propose to extend the same concession to local enterprise agencies until the same date.

STAMP DUTY

18. My next announcement has implications for one in four of the adult population. For that is the number of people - nearly 11 million people - who own shares in the UK today, a new record.

19. Over the next few months, the Stock Exchange will be taking crucial decisions on their plans for a new share-dealing system, affectionately known as TAURUS. This will cut costs and eliminate paper forms, and provide a modern computerised system for transferring shares.

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Decisions on the design of the new systems for TAURUS will have to be taken shortly. We need, therefore, to decide what stamp duty regime to apply to paperless transactions.

20. As we approach 1992 we can expect even sharper international competition in financial services, much of it from other European centres. Competitive and practical arguments point in the same direction. I have therefore decided to abolish stamp duty on securities late in 1991-92 to coincide as far as possible with the introduction of paperless dealing.

21. The assumption in the Red Book is that abolition will be at the end of 1991, at a revenue cost of £120 million in 1991-92. This date will be subject to confirmation later when I have fuller information about the progress of TAURUS. However, although there is some flexibility about the timing, there is no doubt about the decision to abolish stamp duty on shares. I have made the announcement now to remove uncertainty and make clear that there is no need to plan for stamp duty within TAURUS. I should add, for the avoidance of doubt, that stamp duty on land and property will be unaffected by this measure.

22. Both the abolition of the tax and the introduction of a more modern dealing system will help to secure the UK's

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position as a financial centre in an increasingly competitive global market. Furthermore, by reducing transaction costs they will permit higher returns for 11 million holders of occupational pension schemes, the $3^1/_2$ million personal pension holders as well as the many millions of people who hold life assurance policies or unit trusts. It will also be of particular benefit to small shareholders.

LIFE ASSURANCE

23. The Finance Bill will also include a number of measures on Life Assurance, announced by my HF the Financial Secretary last December, which flow from the changes in the 1989 Finance Act. The measures followed extensive consultation with the industry. They put the taxation of life-assurance companies' unit trust holdings on a sounder footing and make a number of technical improvements. They will yield £50 million in 1990-91.

BANKS

24. I also have a measure to announce which will clarify the tax regime for banks.

25. Tax relief is rightly available to banks as it is to other lenders for bad and doubtful debts. But it has given

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rise to two problems. First, in recent years the banks have increased very substantially the amounts written off for their lending to Third World countries. That has been widely welcomed, but sudden increases do have an adverse impact on the public finances. Over time, the tax cost of the 1989 increases could amount to going on for £1 billion.

26. Second, although the principle is clear, it is less clear how to implement it in practice. This is because the relief available depends on the extent to which the debts are estimated to be irrecoverable - and that is often far from clear-cut. This difficulty is magnified when the debts in question are those of sovereign nations rather than individuals or firms.

27. This is an unsatisfactory position for the banks, for the Inland Revenue, and for the taxpayer. I have therefore decided to resolve it, and remove the uncertainties in the present law. Banks will continue to be able to offset their losses on sovereign loans fully against tax, but under a clearer mechanism than previously; and there will be a limit on future increases in the cost of this tax relief.

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28. For next year, banks' tax relief on such provisions will be limited to the same high proportion of debts as this mechanism indicates for 1989. Thereafter, the ceiling will be increased in steps of

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5 per cent a year, so that the banks will, in time, get all the tax relief which they are due. If the banks sell their debt to a third party and crystallise their losses, their tax relief on them will be similarly phased. But where the debt is sold back to the foreign state, to reduce its debt once and for all, then tax relief on that loss will be available in full and immediately.

29. This measure produces a cash flow yield of around £200 million in 1991-92, compared with what might be expected if I took no action. This will unwind in later years.

TAXES ON SPENDING

30. I now turn to taxes on spending. Given the need to keep a tight fiscal position, my judgement is that, taken as a whole, the excise duties must rise broadly in line with inflation. Within that overall constraint, however, I have some modest adjustments to make.

31. First, Vehicle Excise Duty. I propose a number of changes in VED to remove anomalies in the taxation of different types of lorries. These changes will also further reduce the number of different VED rates. Last year's Budget removed 80 different VED rates, and I propose to eliminate a

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further 188 today. This will greatly simplify the system, but will by no means perfect it.

32. Vehicle Excise Duty on cars - the tax disc - will be unchanged once again this year at £100. Nor will there by any change in VED for buses, coaches, taxis and many lorries.

33. I will recoup the cost of this by increasing petrol and DERV duties by rather more than strict revalorisation would justify. These will rise by 10 per cent. This will add 9p to a gallon of DERV and almost 11 pence to a gallon of leaded petrol.

34. For unleaded petrol the cash increase will be smaller at around 9 pence per gallon. This will widen the tax differential in favour of unleaded still further, to almost 16 pence a gallon. The market share of unleaded petrol has increased fivefold, to 30 per cent, since the changes in the last Budget. I hope and expect to see it increase even further.

35. For alcohol, with one exception, I propose to raise the duties in line with inflation. This will put 7p on a bottle of table wine, but only tuppence on a pint of beer. Spirits, however, have enjoyed a duty standstill since 1985. I

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propose therefore an increase of 10 per cent, which will increase the price of a bottle of spirits by 54p.

36. I propose also a 10 per cent increase in duty for cigarettes, which will put 10p on a packet of 20. The duty on cigars will rise similarly and will add 5p to the cost of a packet of five small cigars. But I do not this year propose any increase in duty on pipe tobacco. This at least will be one measure which will command the support of the Leader of the Opposition.

FOOTBALL

37. I now turn to football.

38. The tragedies at Bradford and Hillsborough Football grounds shocked us all. The Report by Lord Justice Taylor made recommendations to improve comfort and safety in our football league grounds over the next ten years.

39. Implementing the programme of work envisaged in the Taylor Report will place a significant burden on football clubs, which many of them will find extremely hard to bear. For many are in a very weak financial position, and only a handful are profitable. I recognise this problem, but I believe there is an acceptable way to overcome it. The first

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priority is to ensure that vital improvements in safety and comfort can be made. And the second is to avert what would otherwise be the closure of many of our grounds. If we help football now, I believe football will be able to help itself in future.

40. Let me say first that much of the expenditure required to meet the Taylor recommendations is eligible for capital allowances or for full offset against tax. But there is still some confusion in this area, and I have asked the Inland Revenue to provide urgent guidance to clarify the tax position.

41. But tax allowances cannot help where there is no profit to set costs against. I have therefore reviewed the rate of Pool Betting Duty the tax which is paid by the pools companies on the stakes they receive. This currently stands at $42^{1}/_{2}$ per cent. I propose to reduce it to 40 per cent on the clear understanding that the full amount saved is passed by the pools promoters to the Football Trust, and is used by them to improve the safety and comfort of fans at English and Scottish football league grounds.

42. I am confident that such an arrangement can be negotiated with the pools promoters and the football authorities. Provided that we do so, the duty will be

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reduced, in the first instance for 5 years. At the end of that period, we shall review the position again.

43. This reduction will yield around £100 million for football over five years. It will be added to the £75 million which the Football Trust have said will be available over the next ten years. These sums represent very significant contributions to ensuring that football league clubs bring their grounds up to the safety standards we all want to see.

44. Millions of people watch football every year. With better and safer grounds I hope they will continue to do so, and that many more will join them.

INCOME TAX

45. Next, I deal with income tax.

46. I have no change to announce to either the basic or the higher rate of tax. They will remain at 25p and 40p respectively. I re-affirm our objective of a basic rate of 20p, but I can make no move towards it this year.

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47. However, I do propose to uprate the main income tax allowances by the statutory indexation factor of 7.7 per cent, rounded up.

48. The personal allowance will rise by £220 to £3,005. The new married couple's allowance will be set at £1,720, as will the additional personal allowance for single parents, and the widow's bereavement allowance. But the basic rate limit, the level at which higher rate liability begins, will be unchanged, at £20,700 of taxable income.

49. The allowances for the elderly will be fully uprated in line with inflation. For those aged 65 to 74, the personal allowance goes up by £270 to £3,670 and the married couples' allowance by £160 to £2,145. For those aged 75 and over, the personal allowance goes up by £280 to £3,820 and the married couples' allowance will be £2,185. The income limit for these allowances also rises by 7.7 per cent to £12,300.

50. I also propose to raise the IHT threshold by £10,000 to £128,000 in line with inflation.

51. I do not propose to increase the Capital Gains tax exemption from its present level of £5,000 [this year]. However, the introduction of independent taxation means married couples will benefit from two exempt amounts

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totalling £10,000 a year, rather than having to share one between them as at present.

COMPANY CARS

52. I also have to set the scales for the taxation of the private use of company cars. The tax treatment of this benefit remains generous, though less so than previously, as a result of the significant increases in these scales in recent Budgets. I therefore propose an increase - but a smaller one than in previous years, at 20 per cent. The yield from this will be £160 million in 1990-91. There will be no change in the fuel scales.

BLIND ALLOWANCE

53. In the tax system there is one allowance - the tax allowance for the blind - that although anomalous has long been accepted as a proper recognition of the special difficulties faced by blind people. The allowance is modest, but welcome, at £540 a year. I propose to make it less modest and more welcome, and double it to £1,080.

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WORKPLACE NURSERIES

54. Before I leave income tax, I have a supply side measure to announce, which will help the labour market to work better.

55. We have always made it clear that it is not for the Government to encourage or discourage women with children to go out to work. That is rightly a decision for the parents to take, and one in which the Government should not interfere.

56. But it is undeniable that an increasing number of mothers do want to return to work. And many employers - in private industry, and in public services such as health and education - are keen to encourage them to do so.

57. However, at present, if an employer provides a nursery for his staff in order to recruit and retain skilled people, any employee who benefits and who earns more than £8,500 a year is required to pay tax on the assessed value of the benefit in kind. Many employers have argued that this has created recruitment difficulties for them, and many women see this as a positive disincentive to return to work.

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58. For these reasons, therefore, I have decided to exempt the value of workplace nurseries and playgroups from taxation as a benefit in kind. This will take effect from 6 April this year.

59. I accept the view of many businesses that this will give extra impetus to the trend for employers to invest in good quality nursery provision for their staff. And it has the additional advantage that it will make the tax system a little bit simpler for employers and the Inland Revenue to administer.

CHARITIES

60. I indicated at the beginning of this speech that this Budget would include incentives both to save and to give. I will come to saving in a moment, but I want to deal with giving first.

61. We are by instinct a generous nation to causes that appeal to us. The tax system already offers a great deal of help to charities. It offers reliefs on their income and expenditure. And it provides incentives to encourage charitable giving. There is a relief for charitable covenants that has now been in operation for many years, and is worth nearly £200 million to charities every year. The

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Inland Revenue are today issuing new guidance to help charities and donors who wish to give through charitable covenants.

62. Since 1987 relief for covenants has been complemented by the payroll giving scheme, a very user-friendly way to relieve regular giving from tax. This scheme has been doing well since its launch and I now propose to increase the annual limit from £480 to £600.

63. These reliefs are focused mainly on regular giving, which is of great importance to charities. But they are ill-suited to encourage the one-off gift which, for a variety of reasons, many people find more convenient. Over the years, this has been a persistent source of concern to charities. This year, I propose to go some way to meet those concerns.

64. I propose a Gift Aid which will give tax relief for large single money donations. It is not practical to operate a relief for all small one-off gifts. Nor do I wish to undermine regular giving through payroll giving and covenants. [Initially], therefore, the lower qualifying limit will be £600 per donation, although relief will be available on individual gifts up to an annual ceiling of £5 million per donor.

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65. This new relief, which will apply to gifts by both individuals and companies, will come into operation from 1st October this year. I am confident that it will maintain and strengthen the growth of charitable giving, and I very much hope that charities will promote it actively.

66. Before I leave the subject of charities I should also mention a package of further VAT reliefs giving help especially to organisations engaged in sea rescue and medical care and research. They will come into effect on 1 May and give an additional benefit of about £5 million a year to charitable work. Full details are set out in a Customs and Excise press release being issued today.

SAVINGS

67. I now turn to the taxation of savings. As I do so I am conscious that the majority of personal savings are the fruits of earnings which have already been taxed.

68. I start with saving in shares.

69. The development of the personal equity plan, which stands to the credit of my predecessor, has been an important boost for share-ownership. Last year was a record one for

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PEPs, with over 300,000 plans taken out, to the value of some £750 million.

70. To build on this success I propose to raise the overall annual limit on investment in PEPs by a quarter, from £4,800 to £6,000. Within that, the annual limit on investment in unit and investment trusts will be increased by the same percentage, to £3,000.

71. I am also sympathetic to the problems investment and unit trusts face in qualifying for PEP treatment, as a result of the requirement that 75 per cent of their portfolio should be invested in ordinary UK equities. I propose therefore to relax this rule, to 50 per cent. I also propose to raise the PEP limit for those [unit and investment] trusts that do not satisfy this rule, from the present £750 to £900.

72. Last year, my RHF put employee share-ownership plans, or ESOPs, as they are known, on the statute book. ESOPs are a vehicle for giving employees a direct stake in the business for which they work. I believe they are an attractive option and deserve further encouragement. I therefore propose to introduce a rollover relief from capital gains tax for sales of shares to ESOPs. This will enable company owners, particularly in the unquoted sector, to transfer their shares to their workforce without themselves incurring an immediate

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tax charge. I believe this will remove an impediment to the development of ESOPs and give this form of employee share ownership the fillip it deserves.

INDEPENDENT TAXATION

73. In a moment, I will turn to some new and significant tax changes for savers. But first, I wish to turn to a reform which was announced in the 1988 Budget and comes into effect next month - independent taxation for women. There is too little understanding of what this change will mean. But it will fundamentally change the financial affairs of women.

74. At present the taxation of married women's income is wholly inconsistent with their role in society. In tax law their income is still considered to belong to their husbands. The effect of this is twofold. It denies married women any privacy or independence in tax matters. And too often it results in heavier taxation than is fair. Frankly it is time for this system to go, and go it will from April.

75. In future, a husband and wife will be taxed entirely separately. Every married woman will have a tax allowance of her own to set against her income - whether this income is from earnings, pension or savings.

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76. Three and three quarter million people will gain, of whom 2 million have incomes of less than £5,000 a year. One million elderly married couples will pay less tax, with 200,000 pensioner couples taken out of tax altogether.

77. No one will be sorry to see the old system go. One of its worst features was its treatment of the savings of married women. Whether they had other income or not, the interest on their savings was added to their husband's income and taxed at his rate. This was a clear penalty on thrift. But from April all that will end. This may well be the area where the reform has its greatest effect and will be most welcomed.

COMPOSITE RATE TAX

78. However, it has thrown into sharp relief another aspect of the tax system that affects all savers, and which no longer deserves to survive.

79. Some women will see the benefit of independent taxation automatically, if they have their money invested in national savings, or other accounts which pay interest gross of tax. However, many women, particularly those with only small savings, prefer to save with High Street banks or building societies. And so, frankly, do many other small savers. For

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all these savers, income tax - or rather a proxy for it, the so-called composite rate - is deducted [before it ever gets to the saver, and] whether or not the saver is liable to pay tax.

80. Composite rate tax was introduced originally in 1894, and put on the statute book in 1951. It currently stands at just under 22 per cent. It is deducted at source. It cannot be reclaimed in any circumstances. This means that basic rate taxpayers gain a little - currently 3 per cent, compared with what they should pay - and non-taxpayers are worse off by 22 per cent.

81. The attraction of composite rate is that it allows small amounts of tax to be collected with ease from large numbers of people. It is very convenient and very cost-effective. But the fact remains that with CRT, we tax people on low incomes who should not be taxed.

82. The scale of this is compelling. Once Independent Taxation is implemented there will be 14 million people - nearly one quarter of the population - who have savings income that does not merit taxation, but which will be taxed under present legislation.

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83. They include some 5 million married women with little or no other income of their own, 4 million pensioners, $2\frac{1}{2}$ million other adults, and $2\frac{1}{2}$ million children with small savings accounts - often funded with small gifts of money from grandparents, or savings from pocket money.

84. It has, of course, always been possible for these people to avoid taxation, by saving in accounts that pay interest gross or where tax can be reclaimed. But the convenience of using banks and building societies has meant that they have not done so.

85. There is no way out of this problem other than to abolish composite rate tax entirely. This I propose to do with effect from 6 April 1991, the earliest practicable date. From then on tax will fall on those who should pay it, and will not fall on those who should not pay it.

86. We shall discuss with the banks and building societies how to effect this change. I envisage a scheme of self-certification that will allow non-taxpayers to be paid gross. For other savers, tax at basic rate will be deducted at source. Unlike composite rate tax it will be reclaimable by any non-taxpayers who, for any reason, may not have been able to self-certify for gross payment.

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87. This change will reduce significantly the amount of tax paid by many married women, pensioners, children, and others with small savings. It will relieve them of tax which they should never pay. And by removing the penalty of composite rate tax it will play an important part in encouraging the savings habit.

NATIONAL SAVINGS

88. Meanwhile, I am announcing today a 1 per cent increase in the interest rates paid on National Savings Investment Account and Income Bonds, where interest is already paid gross of tax. This too will help encourage saving, particularly by non-taxpayers. The Department for National Savings will also be introducing later this year a new Series of the Capital Bond, with simpler arrangements for paying tax on interest.

TESSA

89. However, I want to do more encourage the saving habit among taxpayers - all of them. In the 11 years we have been in office, a series of Budgets have removed penal rates of tax, abolished the investment income surcharge and introduced important new schemes to encourage saving and investment. I intend to build on those measures today. And that means

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going beyond the incentives to saving that we have built up over the last 10 years. These schemes have been immensely successful in spreading share ownership, and will continue to be so in the future. But I now want to extend savings incentives to the mass of ordinary taxpaying savers - and potential savers - who prefer to put their money in their High Street banks and building societies.

90. My next measure is addressed precisely to them. I propose to introduce a wholly new tax incentive which will reward saving and encourage people to build up a stock of capital.

91. The scheme will work as follows. Every adult will be entitled to one Tax Exempt Special Savings Account, TESSA for short. This account can be held at any bank or building society. The essence of the scheme is to encourage people to save regularly over a 5 year period. The incentive for them to do so is that all the interest earned on their capital will be entirely free of tax, provided only that the capital is left undisturbed over the 5 years.

92. The annual limit on the amount that can be invested will be £1,800, or £150 a month. In the first year, anyone who has capital that they are willing to tie up for longer can put this money in their account from the outset, up to a

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limit of £3,000. But the overall limit of £9,000 for the whole plan applies nonetheless.

93. To cope with the circumstances of many small savers - particularly pensioners - who use the interest on their savings for their everyday expenses, it will be possible to withdraw interest as it accrues, but only up to the net-of-tax level. At the end of the 5 years, the depositor then gets a bonus representing the money which would otherwise have gone in tax. The depositor will get this provided none of the capital has been withdrawn before the five years is up. They can, of course, withdraw the capital at any time, but without tax relief.

94. This scheme is convenient, flexible and simple. It caters for those who want to save monthly, annually, or in irregular amounts. I believe it represents a substantial incentive to save, and I am confident that TESSA will play its part in reviving the culture of thrift. I also believe it is both desirable and fair to reduce tax on small savings.

95. This new relief will be available from next January. Its cost will depend on take-up but could be around £200 million in the first full year, rising significantly in the longer-term.

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CAPITAL DISREGARDS

96. This Budget has contained a number of savings measures. I turn now to the removal of a savings disincentive.

97. As the House knows, the income-related benefits - housing benefit, community charge benefit, income support and family credit - are subject to a capital rule. Above a certain level of capital - £6,000 in the case of income support and family credit, and £8,000 in the case of housing benefit and community charge benefit, the claimant becomes completely ineligible for assistance, however low their income may be.

98. Many people resent this rule because they believe it represents a penalty on thrift and self-provision. They ask why they should save when, by doing so, they lose benefits to which they would otherwise have been entitled. This is particularly felt by elderly people who have to run down their capital, and having retired are less able to replenish it. A further problem that has arisen is that the Community Charge is an individual charge, but married couples have their capital aggregated to determine their benefit entitlement.

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99. There must, of course, be some upper limit, for benefits must be directed where they are most needed. But I have reviewed the present limits, together with my RHS, SoS ...., and have decided that they should be raised.

100. I therefore propose to raise the capital limit at which benefit is extinguished for those on income support or family credit from £6,000 to £8,000. But the principal grievance is felt in respect of the capital limits for housing benefit and community charge benefit. I therefore propose to increase the capital cut-offs for these help from £8,000 to £16,000. This measure will benefit around $^{1}/_{4}$ million people in all, two thirds of them pensioners, who are at present excluded from benefit.

£6,000 on single pension?

101. Mr RHF is laying the necessary regulations today so that the limits will be increased when benefits are uprated at the beginning of April [1 April for housing and community charge benefits and 9 April for family credit and income support.] Although there is no statutory requirement to consult the local authorities about increases in the capital limits for housing and community charge benefits, my RHF will, of course, be discussing with them the implementation of these changes straightaway. The public expenditure cost will be some £120 million a year from 1990-91, which will be met from

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the Reserve and not add to the overall planned spending totals.

PERORATION

[To follow.]

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Table 1.1 The Budget measures[1]

	£ million		yield(+)/cost(−)
	1990–91		1991–92
	Changes from a non-indexed base	Changes from an indexed base	Changes from an indexed base
Income tax			
~~age-related allowances increased by 10%~~	~~[illegible]~~	~~[illegible]~~	~~[illegible]~~
~~other~~ main allowances ~~and basis or limit~~ indexed	~~[illegible]~~	+220	+400
car benefit scales increased by 20%	+160	+160	+200
benefits ~~of workplace nurseries~~ exempted	−10	−10	−10
Excise duties			
tobacco duties increased	+330	+75	+85
petrol, derv and other oils duties increased	+795	+175	+195
alcohol duties increased	+310	+20	+25
vehicle excise duty on cars, buses etc unchanged	—	−185	−190
other vehicle excise duty changes	+15	−25	−25
pool betting duty rate reduced	−20	−20	−20
Tax Exempt Special Savings Accounts	−20	−20	−200
Composite rate tax abolished	—	—	+50
Stamp duty on shares abolished	+5	+5	−120
Corporation tax			
small companies' limits increased by a third	*	*	−25
relief for sovereign debt ~~provisions~~ phased	*	*	+200
Value added tax			
bad debt relief	—	—	−150
reform of registration rules	−35	−35	−75
Other tax changes	+35	+70	+115
Capital limits raised for income-related benefits[2]	...	...	...
Total	+70	+430	+955

[1] *The tax measures, and the basis of the costings shown, are described in detail in Chapter 4.*

[2] *See Chapter 5. Public expenditure costs of £120 million in 1990–91 will be met from the Reserve.*

− = *Nil.*
* = *Negligible.*
... = *Not applicable.*

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P.N.S 14.III

The economy: recent developments and prospects to mid-1991

ease number first 9 paras 3.01, 3.02 etc etc

Summary

3.1 GDP is forecast to grow by 1 per cent in 1990, following above trend growth for three years. RPI inflation should begin to fall by the end of 1990, reaching 5 per cent by mid-1991.

Assumptions 3.2 The forecast assumes that fiscal and monetary policies are operated within the framework of the Medium Term Financial Strategy (MTFS). It assumes that both North Sea oil prices and sterling remain close to recent levels. The public sector debt repayment (PSDR) is forecast to be about £7 billion in 1989–90 and [illegible] in 1990–91.

Demand and activity 3.3 GDP growth slowed to 2¼ per cent in 1989, partly because of a large fall in North Sea oil output. Growth of consumers' expenditure slowed markedly through 1989 and fixed investment ~~probably~~ flattened off ~~in mid-year.~~ But exports accelerated sharply in the second half of 1989, while import growth fell.

3.4 Domestic demand is forecast to ~~be lower~~ fall in 1990 ~~than in 1989.~~ But this is likely to be offset by strong growth in net exports, and GDP is forecast to rise by 1 per cent.

Inflation 3.5 ~~Total~~ Retail price inflation was 7½ per cent in the fourth quarter of 1989; excluding mortgage interest payments it was 6 per cent. Total RPI inflation is expected to rise further in the coming months, before falling to 7 per cent by the fourth quarter of 1990 in response to the continued slow-down in the economy. It is forecast to fall to 4 per cent by mid-1991 and further thereafter.

Trade and current account 3.6 The current account deficit was nearly £21 billion in 1989, ~~but~~ began to fall in ~~the closing~~ months ~~of the year. It~~ is forecast to ~~fall to~~ £1 billion in 1990.

Labour market 3.7 Employment has continued to rise rapidly, while unemployment has fallen. With a forecast of low output growth, unemployment could level off in the coming months and may rise, although much depends on the behaviour of wage bargainers.

World economy 3.8 Growth of world trade and GNP slowed in 1989, but both were still above the trends for the 1970s and 1980s. ~~A further slight slowing down is forecast for 1990.~~ Inflation in the major economies picked up in 1989 and is now generally as high as or higher than a year ago. It is forecast to moderate ~~very~~ slightly in 1990.

Table 3.10 Economic prospects: summary

	Percentage changes on a year earlier unless otherwise stated			
		Forecast		Average errors
	1989	1990	1991 H1	from past forecasts[1]
GDP and domestic demand at constant prices				
Domestic demand	3¼	−½	¾	1¼
of which:				
Consumers' expenditure	3¾	1¼	¾	1¼
General government consumption	½	½	¾	1
Fixed investment	4¾	−1¼	−¾	3½
Change in stockbuilding (as percent of GDP)	−¼	−¼	¼	½
Exports of goods and services	4	7¼	5½	1½
Imports of goods and services	7	1¾	3	2¾
Gross domestic product (average measure)	2¼	1	1½	¾
Manufacturing output	4¾	0	¼	1¾
Balance of payments current account (£ billion)	−21	−15	−12[3]	5¼
Inflation				
Retail price index (Q4 on Q4)	7½	7¼	5[4]	1¼
GDP deflator at market prices (financial year)[2]	6¼ (6½)	4½ (6½)		¾
Money GDP at market prices (financial year)[2]	8¾ (8½)	5¾ (7½)		1½
£ billion	517 (518)	541/8 (555/8)		
PSDR (financial year)				
£ billion	7	7		3½
per cent of GDP	1¼	1¼		½

[1] *The errors relate to the average differences (on either side of the central figure) between FSBR Industry Act Forecasts and outturn over the last ten years, and apply to the forecasts for 1990.*

[2] *The figures in brackets adjust for the distortion to money GDP and the GDP deflator arising from the abolition of domestic rates. This is explained in the box on page xx.*

[3] *At an annual rate.*

[4] *Q2 on Q2.*

BUDGET SECRET—BUDGET LIST ONLY