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PART E

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PART E

1986 BUDGET SPEECH

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PART E

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BUDGET SECRET

COPY NO 1 OF 12.

PRINCIPAL PRIVATE SECRETARY

FROM: N MONCK
DATE: 13 March 1986

cc PS/Chief Secretary
PS/Financial Secretary
Mr Odling-Smee
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Pratt
Mr H Davies
Mr Shaw
Mr Lewis I.R.

SECTION F: HELP FOR THE UNEMPLOYED

First there are a few points of accuracy:

- at the bottom of page 6 the change you made last night has not appeared: the figure should be "255,000" instead of "250,000" places.

- At the top of page 9 substitute "65,000" for "64,000".

- The first sentence in the middle of the page about the total public expenditure cost is not quite true unless you add the admittedly boring words ", including the consequentials for Northern Ireland".

addition made.

2. Two points of a different kind arise at the bottom of page 4 in the Profit-Sharing Section. First, it seems odd to say that the characteristics of desirable agreements "are clear" but not to say what they are. Secondly, the last sentence of the page implies that the whole of the practical problem is to do with the tax relief, whereas the pay part is a lot of it. I suggest substituting the following for the last three lines of the page:

BUDGET CONFID.

Mrs Lomax

SPEECH

One extra amendment to Section C. Tony Battishill feels that the fourth sentence on page 1 links the halving of oil prices too closely with the fall in North Sea oil revenues (different period, other factors etc) and would prefer:

"... has almost halved, as have our expectations for North Sea oil ~~[illegible]~~ revenues ..."

This is a little more accurate, but the original was clear, so case for change is marginal.

HPE.
13/3

Late change from CSO:

Section B, page 2, line 16: "investment by 6 per cent"

2 small queries

BUDGET CONFIDENTIAL

FROM: H P EVANS

DATE: 13 March 1986

PRINCIPAL PRIVATE SECRETARY

cc Sir T Burns
Mr Cassell
Mr Monck
Mr Odling-Smee
Miss O'Mara

BUDGET SPEECH (FOURTH DRAFT)

I have checked Parts B and C.

B page 1, final two lines: replace "over 6" by "7".

B page 2-3: Sir Terence Burns and I feel that this quotation from the LBS is out of place and should be dropped. The comparisons are extremely sensitive to the time period (starting from the very low level of UK manufacturing output, and low share of world trade, in 1981). Moreover the statement about manufacturing industry holding its market share is true in volume, but not in value, terms. These difficulties over time periods and volume/value shares can be seen in chart 3.6 of the FSBR. An alternative formulation would be:

"In recent years [since 1983], UK manufacturers have maintained their share of a market which has seen substantial growth [over 13 per cent between 1983 and 1985]. This is a far better performance than in the previous 20 years."

"And there has been a remarkable turn-around in productivity" [so as to allow credit for factors other than productivity].

B page 3, line 15: $3\frac{1}{2}$ per cent is correct, as is the comparison. Productivity is here measured as output per head (not per man hour) for consistency with Part 3 of the FSBR.

B page 3, final sentence: " ... and inflation to fall to $3\frac{1}{2}$ per cent, 1986 is set to register our best overall performance for over two decades" or "a generation" [1963 was better].

B pages 4-5, currency movements: at close on 12 March the figures were 15, 7, 25, 32.

(references to C are to version of 13 March)

C page 1 final sentence: I suggest that "with sterling falling by some 8 per cent" is deleted. We would need to specify the period (November to late February), but this does not square with "initially" in that paragraph, nor with "responding ... in January" in the next paragraph. The change in the effective rate between November and January was only a little over 2 per cent, and quoting that figure at the end of the final sentence on page 1 would not help to illustrate the turmoil in financial markets.

C page 5, last sentence: there is a danger of overstating the net benefits and underplaying the uncertainties. I suggest at a minimum: " ... what we gain on the swings should more ..."

C page 6, line 12: "almost £90 billion" has been agreed with the CSO (and is in Part 3 of the FSBR).

C pages 7-8: there is a problem, highlighted by Mr Monck, between the bullishness of this section about manufacturing and the more modest picture presented in Part 3 of the FSBR. The latter shows no change in the manufacturing trade deficit in 1986 and a rise in manufacturing output over the forecast period close to that of total output. So I think that this section of the speech should put emphasis on potential gains (which may not in practice be realised) rather than imply major gains by manufacturing in the short-term. Accordingly:

page 7, first sentence: delete

page 7, line 7: "The major potential gainer ..."

page 7, line 11: " ... a lower exchange rate against most of its major competitors." — why : not $?

page 7, lines 16-17: delete this sentence because double negatives are best avoided and because this is not unique: other countries gain, some more than us; and the fall in the exchange rate roughly offsets the tendency of UK inflation (especially of wage costs - as chart 3.8 in the FSBR makes very clear) to be above that of other countries.

C page 9 lines 5-10: the paragraphs on oil need to be brought closer into line with the other documents:

" ... North Sea oil revenues, which are likely to amount to about £11½ billion for 1985-86 ..." [nowhere else is this figure rounded].

" ... on the assumption of an average North Sea oil price of $15 a barrel for the rest of 1986, which is close to the average of the past month of around $16 a barrel, ..."

precise

H.

HPE

hpe65c

H P EVANS

CONFIDENTIAL

From: J ODLING-SMEE

13th March 1986

PRINCIPAL PRIVATE SECRETARY

cc Sir Terence Burns
Mr Byatt
Mr Cassell
Mr Evans
Mr Scholar

BUDGET SPEECH (FOURTH DRAFT): SECTION C

Only one comment, which again reflects my concern that we should not give the impression that we believe that the UK as a whole is better off after the fall in oil prices. In the final sentence of page 5, I suggest that the words "more than" should be deleted. That will at least leave vague whether the gains are greater or less than the losses.

J OS

J ODLING-SMEE

COPY NO 1 OF 10 COPIES

MRS LOMAX

c Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Odling-Smee
Mr Scholar
Mr Culpin
Mr Hacche

BUDGET SPEECH (FOURTH DRAFT): SECTIONS C AND E

I have not seen earlier versions of the Budget Speech and may be repeating points made by others.

2. I find the second part of the last paragraph on page 5 of Section C "even for the UK what we gain on the swings will more than offset what we lose on the roundabouts" open to objection. It seems to me - and outsiders will also make the point - that this neglects the terms of trade loss which we suffer as a net oil exporter.

3. I suggest deletion of "more than" which I think is untrue, and substitution of "goes a long way to offset". An alternative would be to refer only to the gains and end the paragraph as follows:-

> " . . . industrialised world as a whole and the UK as a major trading nation will get its share of these benefits".

4. On a smaller point I find "outstanding" and "unique" opportunity on page 7 of Section C rather overstated. Might be more convincing without the adjectives.

IB

I C R BYATT
13 March 1986

FROM: MISS M O'MARA
DATE: 13 MARCH 1986

PRINCIPAL PRIVATE SECRETARY

cc
Mr Monck
Mr H P Evans
Mr Odling-Smee
Mr Scholar
Mr Cropper
Mr Lord
Mr Davies
A/48

BUDGET SPEECH (4TH DRAFT)

You gave EB responsibility for looking at sections A and L of the speech. We have only one comment which reflects Mr Monck's concern too.

Section A, paragraph 3: Replace "more" by "lasting". We would admit that there are other ways of creating jobs in the very short term. But they could not be sustained.

MOM

MISS M O'MARA

Rachel

BUDGET SPEECH : SECTION G

Top of page 3 : delete "which may prove necessary."

substitute "needed to ensure that worthwhile projects are not frustrated by the fiscal régime."

(Proposed by D/Energy officials. Mr Walker will see this paragraph of the Speech, and the proposed amendment, over the weekend. Steve Robson's view is that this is verbose but otherwise OK.)

AWK

14/3

Chief Economic Adviser to the Treasury

Rachel: Section C: 012

2 comments following my discussion with the Chancellor.

1. Page 4. Full stop at end of first line.
New paragraph ~~beginning~~
"There is no overall .... prices high"

This is to make the national interest argument general rather than specific to consumer/producer conflict.

2. Page 5 final paragraph, penultimate line - remove "more than"
Page 6 ~~open~~ first sentence
"To be precise, although our net exports of oil will provide less income to the UK, I expect that the level of activity ......

P.T.O

This should take account of the RNDI issue.

3 The Byatt calculations show a clear loss to RNDI over the whole period.

[illegible]

B,2

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

I shall have more to say about that later.

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

I would rather drop this.
The quote seems out of place.
And ~~best~~ depends firmly on the time period chosen.

HPE is suggesting a redraft.

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

Higgins has accepted, subject to finding UK Committee on Monday.

March

– Tues 25 Troy officials

– Wed 26 March.

9 April – TUC & CBI

Govan 14 April

Cp7

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

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

The forecast suggests they will not take it all.

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

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

Omit Overtone

~~It has no excuse~~ for not seizing that unique ~~opportunity.~~

But it will only be able to ~~do so~~ seize the opportunity if it meets two conditions.

E15

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

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

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

I prefer not to have this section at all. We can reserve our position on this hypothetical question... wait & see... If it is to be in then change ~~stop~~ the final part of the last sentence – it sounds too cleverly that action will not be taken.

more than is needed to keep pace with inflation.

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

This will take effect from midnight on Thursday.

As last year, I propose no increase at all on the duties on cigars and pipe tobacco.

Finally, drink.

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

I now propose no increase at all in the duty on beer - for the first time since 1979.

Hardly an own goal

I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87. The cost of this will be £15 million.

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

We have increased the main tax thresholds by some 20 per cent more than inflation - and the greater part of that 20 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough. The burden of income tax is still too great.

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

The two go hand in hand.

It is no accident that the two of the most successful economies in the world, both overall and

K

I find it difficult to define in what terms the US and Japan are the two most successful.

FROM: H P EVANS
DATE: 14 March 1985

MRS LOMAX

cc Sir T Burns

BUDGET SPEECH (FOURTH DRAFT)

An additional point on section B, page 2. The CSO have revised down slightly the manufacturing output figure for 1985, with the result that productivity growth is (currently) estimated at 3.7 per cent, which ought to round to $3\frac{1}{2}$ per cent. Taking account also of the revision to manufacturing investment, the sentence could now read:

> " ... another successful year, with its output up by 3 per cent, its productivity up by almost 4 per cent, its investment and exports up by 6 per cent."

HPE

H P EVANS

hpe67c

FROM: M C SCHOLAR
DATE: 13 March 1986

MRS LOMAX

cc: Miss Peirson
Miss Sinclair
Mr Pratt
Mr Calder-IR

INCOME TAX CHANGES: ACT

In your minute of 11 March, you noted that the Chancellor proposed, as a radical step, to assimilate ACT with income tax in tables 4.2 and 6.B3 of the FSBR. However, in reply to Mr Beighton's submission of 12 March, you said that the Chancellor was prepared to retreat from his radical suggestion, and would accept the existing treatment in table 4.2 (now 4.1), where ACT is shown separately.

2. I should be grateful for confirmation that the Chancellor is now content that table 6.B3 (and also table 1.2) should, as in earlier FSBRs, keep ACT in the corporation tax line. (In yesterday's draft, table 6.B3 did so but table 1.2 did not.)

MCS

M C SCHOLAR

DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

01-212 3434

Ch/ Little changed from the first draft you saw over the weekend AWK 10/3

A W Kuczys Esq
Private Secretary to
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

CH/EXCHEQUER
REC. 10 MAR 1986
ACTION MR SCHOLAR 10/3
COPIES TO PS/CST, PS/FST
SIR P. MIDDLETON
MR F.E.R. BUTLER
MR MONCK
MR CASSELL
MR GILMORE
MR MONGER
MR REVOLTA
PS/IR.

10 March 1986

OK: s/b this in speech v.

Dear Tony,

CHANCELLOR'S BUDGET STATEMENT

We discussed the possibility of the Chancellor including in his Budget Statement a brief reference highlighting the decision to extend BES to ship chartering. My Secretary of State suggests that the Chancellor might refer to this in the following way:-

> And "I have decided to bring ship chartering within the scope of BES. This will provide new opportunities for successful investment in both new and secondhand tonnage in the hard pressed coastal, short sea and off shore trades."

I have explained to Philip Wynn-Owen that we shall also be submitting a Press Notice, to be issued as part of the Budget pack, drawing attention to the extension of BES to ship chartering. In view of this, I do not think there is any need to take forward the possibility of a reference to shipping in the Financial Secretary's wind up speech.

I am sending a copy of this letter to Vivien Life.

Yours Sincerely,

Jon.

J CUNLIFFE
Private Secretary

PH/1

BUDGET CONFIDENTIAL

FROM: A W KUCZYS
DATE: 7 MARCH 1986

1. MRS LOMAX

2. CHANCELLOR

BES AND SHIPPING: BUDGET SPEECH

When you saw the Secretary of State for Transport this week he said he might want to suggest a form of words for use in the Budget Speech to stress the Government's concern about the shipping industry. He has now done so; his initial draft is as follows:

> "I have decided to bring ship-chartering within the scope of the BES. This will greatly stimulate opportunities for much-needed investment in both new and second-hand ships in the hard-pressed coastal, short-sea and off-shore trades."

A more considered draft will follow in writing on Monday. (This first draft was given to me by his office by 'phone.)

await it.

AWK

A W KUCZYS

PS/ See also Mr Ridley's letter of tonight (below) asking for a major extension of BES to help shipping AWK

I wd be surprised if X wd [illegible] on; but we can [illegible] look @ Y'n

CHANCELLOR OF THE EXCHEQUER

Ch

I think the annotated copy of Section G of the Speech is with you. But I attach a suggestion for slotting in Mr Ridley's passage on shipping.

AWK
11/3

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

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

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

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

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

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

[Insert here brief passage on relief for o/seas travel expenses]

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

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

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

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

Accordingly, I propose to introduce a withholding tax of 30 per cent - the same rate as applies in the United States - on the earnings of overseas entertainers and sportsmen in the UK. This should yield £125 million in 1987-88.]

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

I have been assisted in this review by the independent report commissioned by the Inland Revenue from the consultants Peat, Marwick and Mitchell.

I would like to thank Peat's for their very full report, which the Inland Revenue will be publishing today (CHECK).

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

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

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

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

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

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

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

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

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

[~~And I propose to include within the ambit of the scheme companies engaged in ship chartering~~.]

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

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

BES shares issued after today will be entirely free of Capital

TAKE IN MR RIDLEY'S SENTENCES ON SHIP CHARTERING

Gains Tax on their first sale. And I have - - -

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

~~My hon Friends will be glad to learn that the premium will be reduced from 5 per cent to 3 per cent.~~

FROM: MRS R LOMAX
DATE: 13 March 1986

REF NO: 56 J
COPY NO: 40 OF 51

MR CASSELL

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Kemp
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Peretz → Mr Scholar
Mr Culpin
Miss O'Mara
Mr Kelly
Mr Riley → Mr Pratt
Mr Walsh
Mr Cropper
Mr Lord
Mr H Davies

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

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

Mr Norgrove - No.10

Section C D only
Mr Peretz
Mr Riley
~~Mr Kelly~~
Mr Walsh
~~Mr Robson~~
~~Mr Haache~~

Section E only
~~Mr Turnbull~~
~~Miss Peirson~~
~~Mr Riley~~

BUDGET SPEECH (FOURTH DRAFT): SECTION~~S C AND E~~ D

I now attach a redraft of section E, which was missing from the version of the speech circulated last night; there are also one or two small consequential changes to section C, which I am therefore recirculating. The remaining section of the speech - section D on monetary policy - will be circulated shortly.

2. I would be grateful if you would conduct a thorough final check for factual accuracy, and let me have any comments no later than 10.00 am on Friday 14 March.

RL

RACHEL LOMAX

C. Oil

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

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

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

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

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

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

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

That pressure now appears to have subsided.

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

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

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

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

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

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other goods and services, and a major oil consumer: there is no overall UK national interest in keeping oil prices high.

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

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

- effects of a most alarming nature.

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

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

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

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

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

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

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

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

And what of the balance of payments?

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

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

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

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

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

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

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

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

It has no excuse for not seizing that unique opportunity.

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

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

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

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

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

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

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

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

I can live with that.

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

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

This has obvious implications for the Budget.

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

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

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

E. Public Sector Borrowing

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

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

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

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

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

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

First, public expenditure has been kept under firm control.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

to weather any further storms.

Terry - too bold

RL

p/f

FROM: MRS R LOMAX

DATE: 13 March 1986

REF NO: 56 J

COPY NO: 39 OF 51

MR CASSELL

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

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

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

Mr Norgrove - No.10

Section C only
Mr Peretz
Mr Riley
Mr Kelly
Mr Walsh
Mr Robson
Mr Haache

This should not be highlighted

Section E only
Mr Turnbull
Miss Peirson
Mr Riley

BUDGET SPEECH (FOURTH DRAFT): SECTIONS C AND E

I now attach a redraft of section E, which was missing from the version of the speech circulated last night; there are also one or two small consequential changes to section C, which I am therefore recirculating. The remaining section of the speech - section D on monetary policy - will be circulated shortly.

2. I would be grateful if you would conduct a thorough final check for factual accuracy, and let me have any comments no later than 10.00 am on Friday 14 March.

RL

RACHEL LOMAX

C. Oil

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

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

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

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

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

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

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

That pressure now appears to have subsided.

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

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

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

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

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

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other goods and services, and a major oil consumer: there is no overall UK national interest in keeping oil prices high.

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

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

- effects of a most alarming nature.

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

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

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

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

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

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

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

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

And what of the balance of payments?

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

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

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

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

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

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

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

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

It has no excuse for not seizing that unique opportunity.

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

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

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

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

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

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

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

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

I can live with that.

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

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

This has obvious implications for the Budget.

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

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

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

E. Public Sector Borrowing

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

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

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

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

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

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

First, public expenditure has been kept under firm control.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

PH/18

BUDGET SECRET Ref No: 62J (D)

COPY NO: 37 of 42

FROM: MRS R LOMAX
DATE: 13 MARCH 1986

MR CASSELL

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Kemp
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr Culpin
Mr Kelly
Miss O'Mara
Mr Riley
Mr Walsh
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Battishill - IR
Mr Isaac - IR
Mr McManus - IR
PS/IR
Sir A Fraser - C&E
Mr Knox - C&E
PS/C&E

Mr Norgrove - No.10

BUDGET SPEECH (FOURTH DRAFT): SECTION D

I now attach the remaining section of the Budget Speech - section D on monetary policy.

2. I would be grateful if you would conduct a thorough final check for factual accuracy, and let me have any comments no later than **2pm** on Friday 14 March.

RL

RACHEL LOMAX

Rachel
Not dropped,
Speech is OK
AWK

BUDGET SECRET   COPY NUMBER 1 OF 3

MRS LOMAX

Tony please [illegible]

FROM: C R PICKERING
DATE: 13 March 1986

cc Miss O'Mara
A/41

BUDGET SPEECH (FOURTH DRAFT)

I have three comments.

2. In section F, page 6, penultimate line, it says the target for 'this year' for Community Programme places will be 250,000. As far as I know, this figure should be 255,000.

3. In section H, page 8, lines 1 and 2, it says purchase by a company of its own shares is one of the transactions on which Stamp Duty willbe raised. The Revenue told me yesterday it had been dropped. I have asked Mr Walker (IR) to check and see that you are given a correction if necessary.

4. Perhaps more importantly, section K, page 6, line 2, paragraph 3 says that thresholds have increased by 'some 20 per cent' since 1979. Mr Short told EB yesterday this figure is now 22 per cent, because the uprating of thresholds takes account of inflation to December 1985, but we are forecasting inflation to fall to 4 per cent by the end of 1986.

C R Pickering

C R PICKERING

pg

DRAFT SPEECH

However, I do accept that - as many honourable Members will know from their post-bags - it could be confusing for many old age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating.

We have already acted to remove this problem for the future. The pension increase in April 1987 will be at the start of the tax year. It will be taken fully into account before PAYE codes are issued for 1987/88. Pensioners and widows will find the new system much simpler and easier to understand.

Meanwhile I am sure that my hon Friends will share my view that we should not trouble some 3 million pensioners with the complexities of a final in-year recoding for the transitional uprating this July. I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986/87. The cost of this will be £15 million.

dividends on the shares, and all capital gains on disposals, will be entirely free of tax, provided only that they are reinvested within the Plan.

The new Personal Equity Plans will have to be administered by authorised dealers in securities.

But it will be the investor himself who chooses what share to buy, and retains the ownership of them until such time as he chooses to sell them.

The cost of this measure will be around £25 million in 1987-88.

I am confident that this radical new scheme will, over time, bring about a dramatic extension of share ownership in Britain.

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

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

Where that surplus is 5 per cent of total assets or less, no action will be taken.

But where the surplus is in excess of 5 per cent the fund will be required to eliminate that excess.

There are, basically, three different ways in which an excessive pension fund surplus can be reduced: by higher benefits, or lower contributions, or by a refund to the company - or, indeed, by some combination of these.

It will be entirely a matter for the trustees of the funds concerned which route is chosen.

But to the extent that the money is refunded to the company, the company will be liable to a special tax of 40 per cent of the amount refunded.

Only in this way is it possible to ensure that at least some of the tax relief previously given is recovered when money in the funds is

Copy 2 of 11

pwt

ECONOMIC SECRETARY TO THE TREASURY

FROM: M NEILSON
DATE: 14 March 1986

MISS O'MARA

cc: Chancellor
CST
FST
MST
Sir P Middleton
Mr Monger
Mr Corlett - IR
PS/IR

BUDGET BRIEF : SECOND DRAFT

The Economic Secretary has the following comments on the draft Budget brief attached to your minute of 12 March, which he thought was a very impressive achievement.

P2. CTT

Item (ix) on insurance is obscure can it not include the simple response that schemes which are not designed to "mitigate" tax will not be affected?

Q1 Stamp duty

The factual material could include international comparisons of dealing costs.

Q3 Pension Scheme Surpluses

The Economic Secretary believes that the United States makes a recovery charge on pension fund refunds. The briefing could include chapter and verse on recovery charges in other countries.

2. The positive point should make clear the basis of calculation is prudent and conservative.

MN

M NEILSON

BUDGET CONFIDENTIAL

FROM: M W Norgrove

DATE: 14 March 1986

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Cassell
Mr Monger
Mr Culpin
Miss O'Mara
Mr Pratt
Mr Cropper
Mr H Davies

PS/Inland Revenue

BUDGET SPEECH: FOURTH DRAFT: SECTION G

As discussed, the Harcourt Section on page 6 would be more accurate as follows:

> "We have had an inheritance tax in some shape or form ever since Sir William Harcourt's Estate Duty of 1894".

This avoids claiming that Harcourt "introduced" the duty - Estate Duty was first introduced by Goschen in 1889 (temporarily); there have been taxes of sorts on inheritance on and off since 1694 - but we cannot claim "ever since 1694"; so this formulation seems best.

M W NORGROVE
Private Secretary

FROM: M W Norgrove

DATE: 13 March 1986

PRINCIPAL PRIVATE SECRETARY

cc Mr Monger
Mr C M Kelly
Mr Cropper
Mr Lord

PS/Customs & Excise

BUDGET SPEECH (FOURTH DRAFT): SECTION H AND SECTION I

? On page 6 of Section H, for "invisible exports" in line 6, read "invisible earnings" (the gross invisible exports figure is grossly inflated by the banks' contribution which itself is over £40 billion). EFI agree.

In the list of VAT reliefs for charities (on page 2 of Section I) the Minister of State suggests inserting "for use in medical applications" after "video equipment" in order not to give the impression that the relief is being extended more widely than it is. (I understand we have had problems in the past of charities being disappointed by the true extent of a relief which had been announced in slightly misleadingly generous terms.) Customs and FP agree.

MWN

M W NORGROVE
Private Secretary

CONFIDENTIAL

From: SIR PETER MIDDLETON

Date: 14 March 1986

MRS LOMAX

cc PS/Economic Secretary
Sir T Burns
Mr Cassell
Mr Scholar
Mr Peretz
Mr H Davies

BUDGET SPEECH: SECTION D

I still think this section would leave a less gnomic impression if it referred to M0 and M3 by name. I doubt whether there is any serious risk that in a short exposition like this it would provoke mirth in the House. And I think that the piece on broad money is better as a specific comment on £M3.

P E MIDDLETON

pw

FROM: A W KUCZYS
DATE: 14 March 1986

MRS LOMAX

BUDGET SPEECH (FOURTH DRAFT)

I set out below the comments I have collected on the fourth draft of the Speech. Unattributed comments are my own, and can therefore be safely ignored!

C: Oil

Page 1, line 11: Delete "and with it our", insert "as have our expectations for". (Tony Battishill.)

Pages 2 to 3: David Norgrove is worried that the section: "There has been some speculation ..." through to "... are wasting their time." will cause offence to the Saudis. He suggests deleting the whole passage.

Page 6, line 3: Delete "what".

Page 7, 6 lines up: After "exports and" insert "to".

E. Public Sector Borrowing

Page 2, line 9: Delete "well". (Andrew Turnbull: repeat of his previous suggestion: the FSBR says "slightly below the planning total": we do not want to over emphasise the shortfall.)

Page 5: David Norgrove wondered whether it was intentional to appear to rule out the possibility of an in-year change.

F. Help for the unemployed

Page 1, Line 1: Delete "first", insert "now".

Page 3, line 9: Delete "this".

Page 4, line 7 and 8: Delete "men", insert "people" or "workers". (Sexism.)

G. Business and Enterprise

Page 1: Delete the first sentence. (To avoid repeating "business and enterprise" three times in as many sentences.

Page 2, 5 lines up: Delete "otherwise".

Page 3, 8 lines up: After "propose" insert a comma.

Page 5, last sentence: After "Peat, Marwick" delete "and Mitchell".

Page 6, 5 lines up: Delete "well over". (Inland Revenue: factual accuracy)

Page 7, line 5: Spelling of "Scheme". Line 9: Before "assets" insert "net". (Inland Revenue: important for factual accuracy.) Bottom of page 7: Delete "both new and secondhand tonnage", insert "companies operating". (Inland Revenue, with Department of Transport agreement: not essential, but probably an improvement.)

Page 8, 5 lines up: Delete "My hon Friends", insert "The House".

Page 9, line 3: Delete "unquoted". (Surely unnecessary: a quoted company can hardly be a "family business".)

H. Savings and Investment

Page 1: Amend second sentence to read:

"In my 1984 Budget I introduced major reforms designed to reduce distortions caused by the tax system."

(To avoid repetition of "savings and investment", and also because the previous draft left a slight hint that the Government knew what the "right" direction of savings was, and wanted to push it that way: shades of the National Investment Bank.)

Page 4: line 1: "... inflation, and much improved returns on investment, has seen a number of pension funds accrue large surpluses" (David Norgrove)

Page 4, line 8: Delete "provision", insert "provisions".

I. Charities

Second half of page 2: David Norgrove suggests a shorter sentence rather than this shopping list which might prompt people to ask why these items but not others? Perhaps:

"I propose to relieve charities from VAT on their non-classified press advertising; on lifts and distress alarm systems for the handicapped; on welfare vehicles used by charities to transport the deaf, blind or mentally handicapped; and on a number of other items."

Page 6, final sentence: Before "The additional" insert "I hope that". In the next line, change "should" to "will". (Inland Revenue: This is a hope, not a forecast.)

Page 6, line 8: "£50 million" should be "£70 million". (FP)

K. Income Tax

Page 3, final sentence ("The Government ... how to proceed."): Perhaps omit? Sounds very tentative and over cautious.

Page 5: David Norgrove wondered whether it was necessary to spend so much time on the social security uprating, and the proposed exemption.

AWK

A W KUCZYS

*now attached

Rachel

I spoke to George Monger.

① He will resubmit his comments on the speech in usable form* (tho' he was unrepentant, & cdn't see why his first effort caused difficulties!)

② The RPI effect is made up as follows:

Indirect taxes	.54
(of which indexation:	.50)
Mortgage relief	.07
	.61

Was your .57 made up of the 2nd & 3rd lines?

AWK

BUDGET SECRET

COPY NO 1 OF 6

FROM: G W MONGER
DATE: 14 March 1986

MR KUCZYS
PS/CHANCELLOR

cc PS/Financial Secretary
Mr Cassell
Mr McManus - IR

BUDGET SPEECH

You asked me to set out the passage on the July uprating as amended according to Mr Lewis' proposal of 11 March, which I understand the Chancellor is inclined to accept.

This is attached. It replaces the text from "Second, the House will be aware" on page 4 of the draft dated 12 March to "£15 million" on page 6.

G W MONGER

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

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

The increases have been criticised by some as derisory.

I wholly reject that allegation.

They are fully in line with the rise in the cost of living over the relevant period; and to suggest that pensioners and others would sooner have high inflation and high upratings than low inflation and correspondingly low upratings is sheer poppycock.

However, I do accept that - as many honourable Members will know from their post-bags - it could be confusing for many old age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating.

BUDGET SECRET

FROM: A W KUCZYS
DATE: 14 March 1986

REF NO 67J
COPY NO 18 OF 20

MR CULPIN

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr H Evans
Mr Monger
Mr Odling-Smee
Mr Scholar
Miss O'Mara
Mr Pratt
Mr H Davies

BUDGET EPR

The Chancellor was most grateful for the draft EPR supplement attached to your minute of 12 March. He has commented:- "This is very good, and well worth doing". He suggests a few minor amendments:-

(a) Paragraph 8, line 3: redraft to read: "... to grow by around 3 per cent, with a faster growth in investment and exports. The ... "

(b) Paragraph 9, penultimate sentence: redraft to read as follows: "They will reduce the marginal rate of tax for 14 million taxpayers - 95 per cent of the total - with a married man on average earnings receiving an increase in take home pay of £x a week."

(c) Paragraph 13, second indent: "A halving of the rate of Stamp Duty on share transactions, from 1 per cent to ½ per cent, financed by a broadening of the base of the tax."

(d) Paragraph 15, final sentence: "There is a marked increase in the tax on cigarettes, but there is no increase in the duties on pipe tobacco, cigars or any alcoholic drinks."

(e) Paragraph 19, last indent: "... will be expanded from about 200,000 places to 255,000, by [date]."

2. The Chancellor agrees with the Economic Secretary that personal equity plan and charities (paragraph 13) deserve paragraphs of their own: the former needs to be pretty positive, but the latter can be merely descriptive.

3. The Chancellor also assumes you will be considering the Financial Secretary's point in Miss Life's minute of 13 March.

AWK

A W KUCZYS

5.72

BUDGET SECRET

Ref No. 68 J
Copy 3 of 5

FROM: N G FRAY
DATE: 14 March 1986

PS/ECONOMIC SECRETARY

PERSONAL EQUITY PLANS: DNS

The Chancellor has seen and was grateful for your minute of 12 March.

Nigel Fray

N G FRAY

BUDGET SECRET

Ref No 71J
Copy No 20 of 20

FROM: A W KUCZYS
DATE: 17 MARCH 1986

PS/FINANCIAL SECRETARY

cc PS/Economic Secretary
PS/Minister of State
Sir P Middlton
Mr F E R Butler
Mr Anson
Mr Kemp
Mr Monger
Mr Scholar
Mr C D Butler
Miss Sinclair
Mr Copper
Mr H Davies
Mr Lord
Mr Corlett IR
PS/IR

PENSION FUND SURPLUS RULES: INDEXED SCHEMES

The Chancellor has seen Mr Kemp's minute of 13 March, and Mr Corlett's of 14 March. He has noted (paragraph 5 of Mr Corlett's) that local authority superannuation schemes are not in any case within the scope of the tax approval code. He wonders whether they should be?

AWK

A W KUCZYS

Just arrived. I have only noted X, as tempus it candidacy at this stage.

BUDGET SECRET

COPY NO 1 OF 34 COPIES

MINISTER OF STATE TREASURY

FROM: M W Norgrove

DATE: 17 March 1986

MRS LOMAX

cc List attached

BUDGET SPEECH - FINAL DRAFT

The Minister of State's comments are as follows:

Section C, page 4: the Minister suggests "international trading sector" to "internationally traded sector", preferring the active to the more politically supine passive;

Section F, page 1: the Minister suggests that any potential ambiguity in the sentence which begins "For the plain fact is ..." would be removed by replacing "faster than is consistent with low unemployment" by "too fast to secure low unemployment"

Section F, page 4: the Minister is not sure that Jobstart can be included in the sentence which begins "The pilot schemes are already proving effective" (only 60 people have been taken in so far); "already producing results" might be preferable.

Section J, pages 1 and 2: the Minister wonders whether the reference to the halfpenny here might give rise to catcalls reminding the Chancellor of its abolition. '7.5 and 6.5 pence' are alternatives, or '7 and a half p' and '6 and a half p'.

Section J, page 2, final line: the Minister has commented that the case for lead-free petrol is not clear "on health grounds": an MRC finding on the epidemiology involved stressed that the case was much more ambiguous - so pedantic prudence might argue for "environmental" rather than "health". There is also probably more political mileage anyway in "environmental" - ie "The case for this on environmental grounds is clear".

listed

X

MWN

M W NORGROVE
Private Secretary

31cc + 2 float + 1 top
34 total

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Anson
Mr Byatt
Mr Cassell
Mr Kemp
Mr Lavelle
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Mr Scholar
Miss O'Mara
Miss Sinclair
Mr Pratt
Mr Dyer
Mr Cropper
Mr Lord
Mr H Davies

PS/Inland Revenue
Mr Battishill - IR
Mr Isaac - IR

PS/Customs & Excise
Mr Knox - C&E

Mr Norgrove - No 10

RP7.36

BUDGET REF NO JJ30
COPY NO ____ OF 46

FROM: MRS R LOMAX
DATE: 17 March 1986

MR SCHOLAR

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

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

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

Mr Norgrove - No.10

Governor - B/E

Section B only
Mr Kelly

Sections D & H only
Mr Peretz

Section H only
Miss Noble

Sections C & J only

Mr Robson

BUDGET SPEECH - FINAL DRAFT

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

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

RL.

1986 BUDGET SPEECH

Index

A. Introduction

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

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

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

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

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

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

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

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

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

As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

B. The Economic Background

I start with the economic background.

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

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

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

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

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

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

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

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

I shall have more to say about unemployment later.

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

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

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

In the six years since 1979, our annual rate of growth of manufacturing productivity, at $3\frac{1}{2}$ per cent, has been second only to that of Japan.

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

Indeed, with output forecast to rise by 3 per cent, and inflation to fall to $3\frac{1}{2}$ per cent, 1986 is set to register our best overall performance in terms of output and inflation for a generation.

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

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

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

There has been some improvement here.

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

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

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

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

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

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

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

C. Oil

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

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

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

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

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

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

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

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

That pressure on our currency subsided.
And though the financial markets remain somewhat volatile, the mood has changed considerably, assisted by a modest but welcome reduction in interest rates overseas.

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

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

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

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

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

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

- effects of a most alarming nature.

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

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

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

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

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

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

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

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

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

And what of the balance of payments?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I can live with that.

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

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

This has obvious implications for the Budget.

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

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

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

D. Monetary Policy

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

It provides as firm a guarantee against inadequate money demand as it does against excessive money demand.

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

That we have done.

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

And a further significant reduction is envisaged for 1986-87.

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

We shall continue to maintain steady downward pressure on inflation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I will say no more about monetary policy today.

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

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

E. Public Sector Borrowing

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

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

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

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

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

First, public expenditure has been kept under firm control.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

F. Help for the unemployed

I turn now to the continuing problem of high unemployment.

It is a problem that can be solved - and there is no secret about how.
The solution to the problem of unemployment - and it is the only solution - requires progress on two key fronts.
The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.
That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.
The second is a level of pay which enables workers to be priced into jobs instead of pricing them out of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's weakness lies.
For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.
Productivity is, indeed, rising quite rapidly.
But pay is rising faster still.
It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

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

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

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

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur.

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

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

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

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

It should therefore occur without any prompting from government.

But there is considerable inertia to overcome.

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

Inevitably, the design of such a relief, and the precise definition of qualifying agreements, would be matters of some complexity.

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

If these preliminary discussions are sufficiently encouraging, we would prepare a consultative document setting out a detailed scheme for wider consideration.

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

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

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

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

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

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

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 255,000 places - very nearly double the number that existed a year ago.
At the same time, the average wage limit for the Community Programme will be raised to £67 a week from next month.

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

I shall also be providing the resources to launch a brand new scheme - the New Workers Scheme - to help 18-20 year olds to find a job.
This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at up to £55 a week or a 20 year old at up to £65 a week.
The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

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

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

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

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

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

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

G. Business and Enterprise

I now turn to the taxation of business and enterprise.

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

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

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

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

This year I have only two further amendments to make.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The House will be glad to learn that the premium will be halved from 5 per cent to 2½ per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.

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

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

We have had an inheritance tax in some shape or form ever since Sir William Harcourt reintroduced the Estate Duty in 1894.

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

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

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

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

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

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

My two previous Budgets abolished three unnecessary taxes.

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

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

H. Savings and Investment

I now turn to the taxation of savings and investment.

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

Today I propose to carry this reform further forward.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Next, Stamp Duty.

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

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

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

The massive £6 billion it contributes to our invisible earnings is but one measure of the resulting benefit to the British economy.

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

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

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

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

The abolition of fixed commissions will certainly help.

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

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

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

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

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

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

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

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

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

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

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

But not enough.

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

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

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

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

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

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

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

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

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

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

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

I. Charities

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

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

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

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

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

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

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

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

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

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

I say this for two principal reasons.

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

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

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

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

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

Next, companies.

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

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

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

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

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

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

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

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

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

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

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

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

J. **Personal Taxes: Taxes on spending**

I now turn to the taxation of spending.

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

Since November the price of petrol at the pump has fallen by amyty up to 15 ~~roughly 12~~ pence a gallon.

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

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

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

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

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

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

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

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

Indeed, it ought to fall further.

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

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

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

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

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

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

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

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

The case for this on health grounds is clear.

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

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

Next, tobacco.

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

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

This will take effect from midnight on Thursday.

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

Finally, drink.

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

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

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

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

Next, VAT.

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

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

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

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

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

K. Income Tax

Finally, I turn to income tax.

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

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

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

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

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

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

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

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

Yet that is what happens today.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The cost of this will be £15 million.

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

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

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

The burden of income tax is still too great.

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

The two go hand in hand.

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

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

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

The case for higher tax thresholds is well understood.

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

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

The basic rate is the starting rate of tax.

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

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

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

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

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

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

The age allowance income limit becomes £9,400.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I share that aim.

L. Conclusion

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

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

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

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

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

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

I commend it to the House.

RR7.36

Mrs Lomax

BUDGET REF NO 69J
COPY NO 1 OF 4

FROM: MRS R LOMAX
DATE: 17 March 1986

MR SCHOLAR

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

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

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

Mr Norgrove - No.10

Governor - B/E

Section B only
Mr Kelly

Sections D & H only
Mr Peretz

Section H only
Miss Noble

Sections C & J only

Mr Robson

BUDGET SPEECH - FINAL DRAFT

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

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

RL

RACHEL LOMAX

B. The Economic Background

I start with the economic background.

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

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

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

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

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

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

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

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

I shall have more to say about unemployment later.

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

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

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

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

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

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

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

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

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

There has been some improvement here.

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

Since that meeting, the dollar has fallen by some 16 ~~(15)~~ per cent against the other major currencies as a whole, with the pound moving up by (7) per cent, the Deutschemark by 26 ~~(25)~~ per cent and the Yen by (~~32~~ 36) per cent - a pattern broadly in line with what those of us who were party to the agreement had hoped to see.

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

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

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

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

1986 BUDGET SPEECH

Index

A. Introduction

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

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

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

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

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

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

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

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

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

As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

One comment on p1.

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(P2 heads head Checkup at 4:30)

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only 2 weeks short of 5 years: delete

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To be checked at close today

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

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

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

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

p 1, 3 (for Burns sentence *), 4, 5, RETYPE

C. Oil

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

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

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

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

In real terms, the price is now back to what it was ~~before the first oil shock in~~ at the end of 1973. either after 1973 or before 1979 (Economist comparison was with 1973 Q4: oil price rise was Oct 1973)

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

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

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

That pressure in due course subsidised.

And though the financial markets remain somewhat volatile, the mood has changed considerably, assisted by a modest, but welcome, reduction in interest rates overseas.

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

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

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

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

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

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

- effects of a most alarming nature.

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

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

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

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

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

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

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

Burns para rework

~~[For the UK, it will mean lower income, to the extent that our production of oil exceeds our own consumption.]~~
And inevitably we suffer a decline in the value of our net oil exports.

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

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

And what of the balance of payments?

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

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

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

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

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

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

lower oil costs

~~NM: "cheaper energy" is ammunition for D.En re ELECTRICITY prices~~

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

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

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

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

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

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

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

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

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

I can live with that.

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

~~Reason – ? [illegible]~~

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

This has obvious implications for the Budget.

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

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

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

RETYPE

D. <u>Monetary Policy</u>

No further comments.

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

It provides as firm a guarantee against inadequate money demand as it does against excessive money demand.

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

That we have done.

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

And a further significant reduction is envisaged for 1986-87.

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

We shall continue to maintain steady downward pressure on inflation.

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

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

During 1985-86 the targeted measure of narrow money has grown towards the bottom end of its range.
The target range for next year will be 2-6 per cent, as foreshadowed in last year's MTFS.

For broad money it has been clear since the autumn that the range was set too low.
Throughout the 1980s - and in sharp contrast to the 1970s - broad money has grown far faster than money GDP.
Experience has demonstrated that this has not posed a threat to inflation.
This rapid growth largely reflects the increased attractions of holding interest bearing deposits, at a time both of low inflation and high real interest rates, and of innovation and liberalisation in the financial system.
Accordingly, I am setting next year's target range for broad money well above that indicated in last year's MTFS, at 11-15 per cent.
Given the experience of the past six years, I believe this is not only a more realistic range, but one which is wholly consistent with the further decline in inflation I intend to achieve.

Short term interest rates are the essential instrument of monetary policy.
Changes in interest rates have a reasonably quick and direct effect on narrow money, as they do on the exchange rate.
Their effect on broad money is more complex and much more delayed.
As explained in the Red Book, there is thus an important difference in the operational significance of the targets for narrow and broad money.

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

I will say no more about monetary policy today.
Except to repeat what I said at the Mansion House last Autumn: that while financial liberalisation and innovation have inevitably made the process of monetary management more complicated, there has been no change whatever in the essence of policy.
The Government continues to attach the highest priority to sound money.

RETYPE P 1/

E. Public Sector Borrowing

Though there is nothing sacrosanct about the precise mix, monetary policy must always be supported by an appropriate fiscal policy.

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

delete or "Government" (plain English, avoids repetition)

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

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

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

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

First, public expenditure has been kept under firm control.

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

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

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

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

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

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

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

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

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

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

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

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

~~ie compared with statutory indexation~~ (Scholar)

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

But if any departure is purely short term, it is most unlikely to have any significance for policy.

RETYPE
Sec p5

F. Help for the unemployed

I turn now to the continuing problem of high unemployment.

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

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

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

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

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

It is here that Britain's weakness lies.

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

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

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

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

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

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

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur.

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

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

It would also mean that, when business is slack, companies would be under less pressure to lay men off; and by the same token they would in general be keener to take them on.

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

It should therefore occur without any prompting from government.

But there is considerable inertia to overcome.

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

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

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

If these preliminary discussions are sufficiently encouraging, we would prepare a consultative document setting out a detailed scheme for wider consideration.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The total public expenditure cost of the measures I have outlined, together with consequential spending in Northern Ireland, comes to £195 million in 1986-87 and ~~£290~~ £285 million in 1987-88.

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

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

Includes £5m for Loan Guarantee Scheme, which you haven't yet mentioned. Change to £285m?

See p5

G. Business and Enterprise

I now turn to the taxation of business and enterprise.

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

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

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

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

This year I have only two further amendments to make.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The House will be glad to learn that the premium will be halved from 5 per cent to 2½ per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.

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

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

We have had an inheritance tax in some shape or form ever since Sir William Harcourt's ~~reintroduced the~~ introduced his Estate Duty in 1894.

Harcourt's ED was quite the same as Goschen's. Everyone prefers this.

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

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

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

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

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

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

My two previous Budgets abolished three unnecessary taxes.

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

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

See p 5.

H. Savings and Investment

I now turn to the taxation of savings and investment.

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

Today I propose to carry this reform further forward.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Next, Stamp Duty.

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

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

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

The massive £6 billion it contributes to our invisible earnings is but one measure of the resulting benefit to the British economy.

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

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

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

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

The abolition of fixed commissions will certainly help.

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

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

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

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

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

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

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

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

OK: but if any more trouble with No 10 I will change back!

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

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

PM prefers (people's = communist)

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

But not enough.

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

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

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

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

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

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

IR

And there will normally be no need ~~to provide any information to the Inland Revenue~~ for the Inland Revenue to get involved at all.

IR need to have right to check up in particular cases eg suspected abuse.

OK

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

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

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

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

p1,2

I. Charities

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

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

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

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

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

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

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

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

C+E (some are VAT exempt already)

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

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

I say this for two principal reasons.

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

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

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

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

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

Next, companies.

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

PM shd [illegible]

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

Can't understand why not extend this to close companies

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

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

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

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

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

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

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

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

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

I would hope, too, that the additional charitable giving these concessions stimulate will be at least twice the amount of the extra tax relief given.

p1, 2, 3

J. Personal Taxes: Taxes on spending

I now turn to the taxation of spending.

So far as the indirect taxes are concerned, the overriding question this year is how far I should recover from the oil consumer the tax revenues I have lost from the oil producer, as a result of the massive fall in the oil price.

Since November the price of petrol at the pump has fallen by anything up to 15 pence ~~roughly 12 pence~~ a gallon.

But if the oil companies had passed on the full amount of the fall in the oil price to date, the price of petrol at the pump could ~~easily~~ have been ~~a further~~ 12 pence a gallon lower still.

There is clearly scope, therefore, for a sizeable increase in petrol tax this year.

I have concluded, however, that at the present time, while I must certainly maintain the real value of the revenue I get from the motorist, I will not increase it.

But I do believe it makes sense to look again, in the light of the radically changed circumstances, at the relative weight of petrol tax and Vehicle Excise Duty.

Accordingly, I propose to increase the duty on petrol by an amount which, including VAT, would - if it were wholly passed on to the consumer - raise the price at the pump by sevenpence halfpenny a gallon.

This is twopence more than is needed to keep pace with inflation, and that enables me to keep VED at last year's level of £100 for

cars and light vans, leaving the overall burden on the motorist unchanged in real terms.

Moreover, given the very substantial increase in the oil companies' margins, there is clearly no need for the pump price of petrol to go up at all.

Indeed, it ought to fall further.

In the same way, I propose to increase the duty on derv by an amount which - if it were wholly passed on to the consumer, which, to repeat, it should certainly not be - would raise the price at the pump by sixpence halfpenny, including VAT.

This will enable me to avoid any general increase this year in the Vehicle Excise Duty on lorries, too. ~~(Bigger VED on few most lorries with viso, as part of programme of making heavy vehicles make contribution to road costs)~~ OK, with [illegible]

So far as the other oil duties are concerned, I have one or two changes to make.

Not to the duty on heavy fuel oil, which will remain unchanged as it has done since 1980.

But I propose to increase the very modest duty on gas oil, by a penny-halfpenny a gallon.

And I propose to abolish altogether the duties on aviation kerosene, or Avtur - which at present is taxed for domestic flights only - and on Most lubricating oils.

C&E Some of lighter lubricating oils fall under the definition of gas oil (eg oil for sewing machines, bicycles etc) OK

All these changes in duty will take effect from 6 o'clock this evening.

Finally, so far as oil products are concerned, I am anxious to do what I reasonably can to assist the introduction of lead-free petrol.

The case for this on ~~health~~ environmental ~~CASE~~ grounds is clear.

I have therefore decided to create a duty differential in its favour to offset its higher production costs.

My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

Next, tobacco.

In the light of the representations I have received on health grounds, I have decided to increase the duty on cigarettes by appreciably more than is needed to keep pace with inflation.

I therefore propose an increase in the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of approximately eleven pence on a packet of 20 cigarettes.

This will take effect from midnight on Thursday.

~~C&E have long been used by lobby in the past years.~~

As last year, I propose no increase at all on the duties on cigars and pipe tobacco, which are more heavily taxed here than in most comparable countries.

Finally, drink.

As the House will recall, I was obliged in 1984 to increase the duty on beer by slightly more than I would have wished as a consequence of the judgement against the UK in the European Court of Justice.

I now propose no increase at all in the duty on beer.

Nor do I propose any increase in the duties on cider, table wine, sparkling wine, fortified wine or spirits.

This last decision will, I hope, be particularly welcome in Scotland.

~~(C&E) going on since 1972 - C&E may be accused of conniving~~

Next, VAT.

I propose to stop the ~~abuse~~ misuse of long stay relief for hotel accommodation, and make certain other minor changes.

But I have no proposals for major changes in Value Added Tax this year.

The changes I have announced in the excise duties will, all told, raise an extra £795 million in 1986-87, the same amount as I would have raised had I simply increased all the excise duties in line with inflation.

The overall impact effect on the RPI, if all the increases were fully passed on, would be one half of one per cent.

This has already been taken into account in the forecast I have given the House of 3½ per cent inflation by the end of the year.

p3,

K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to the closer integration of the tax and benefit systems.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

Yet that is what happens today.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and poverty traps for a given amount of tax relief than is possible under the present tax system.

Given the timetable of computerisation, none of this could in practice be implemented until the 1990s.

But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should be free of tax altogether.

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

This will enable them to be fully taken into account before PAYE codes are issued for 1987-88.

However, to bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

But as hon Members will know from their postbags, it could be confusing for many old-age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating.

I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87.

The cost of this will be £15 million.

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour.

We have increased the main tax thresholds by some ~~22~~ 20 per cent more than inflation - and the greater part of that ~~22~~ 20 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough.

The burden of income tax is still too great.

Nothing could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

NB On present inflation forecasts, 22% will be true for 1986-87; but 20% is the figure by which allowances in 85-86 exceed 78-79 in real terms

OK

They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for reductions in the basic rate of tax, too.

The basic rate is the starting rate of tax.

And it is the crucially important marginal rate of tax for some 95 per cent of all employees and 90 per cent of all self-employed and unincorporated businesses.

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent, rounded up.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400.

I propose to raise all the higher rate thresholds by exactly £1,000.

This is fully in line with statutory indexation for the first - 40 per cent - higher rate, but less than half statutory indexation for the top - 60 per cent - rate.

Given the need for caution in the light of current circumstances, I do not have scope this year for a reduction in the basic rate of income tax, beyond one penny in the pound.

But this reduction from 30 per cent to 29 per cent still represents the first cut in the basic rate of income tax since my predecessor took it down from 33 per cent to 30 per cent in 1979.

So long as this Government remains in office, it will not be the last.

There will, of course, be a consequential reduction in the rate of Advance Corporation Tax.

And I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, not on the rich but on the great majority of ordinary taxpayers.

As a result of the adjustments I have made to the higher rate thresholds, the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

They will cost £935 million in 1986-87, over and above the cost of statutory indexation.

Seven years ago, when my predecessor cut the basic rate of income tax from 33 per cent to 30 per cent, he added:

> "Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial range of measures to help the unemployed.

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy, and abolished a fourth tax.

I have announced the most substantial package of assistance to charitable giving ever, and cut the basic rate of income tax.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

BUDGET SECRET

FINANCIAL SUMMARY

1. At the time of the 1985 Budget it was envisaged that revenue would come within £4 billion of expenditure in 1986-87. £4 Bn

2. This would have permitted a "fiscal adjustment" - for ~~per~~ example in the form of tax cuts - leaving a borrowing requirement (PSBR) of £7½ billion. £7½Bn

3. In the event, oil revenues are likely to fall short by nearly £5½ billion as a result of the drop in the oil price. So one is now looking at a revenue deficiency of (£4Bn + £5½Bn). £9½Bn

4. But non-oil revenues are buoyant, consequent on economic growth and good profitability, and are likely to contribute an extra £3 billion. £6½Bn

5. Certain minor adjustments (rounding) bring this down to £6 billion. £6 Bn

6. The Chancellor has decided to set the PSBR at a cautious £7 billion, which means that £1 billion can be spared for Budget reliefs. £7 Bn

7. £1 billion is approximately the cost of cutting the basic rate by 1p.

PJC
17.3.86

007/2989

NB 2 more Sections to follow

I can understand why the RHG is in difficulties.

C/ Most of CST's speech, but two sections to follow. R 19/3

His record on forecasts, on understanding the underlying economic situation, has always been shakey.

Just before the last Election he predicted that with our policies inflation would soon be rising to double figures. It never did. It never has.

Only two months ago in this House he raised under Standing Order No. 10 the urgent issue that there would be a imminent increase in real interest rates which he described as being a matter which is directly within the responsibility of the Government. There wasn't, and the House knows today that the actual change is in the reverse direction.

And so it was in approaching this Budget. Although the dramatic fall in oil prices has been good for British industry and good for our economy, he thought it was really bad news for my RHF because of the known and substantial loss of oil

/tax

tax revenue. He hoped that that would have completely destroyed any room for manoeuvre in this Budget, or alternatively if my RHF wished to find scope for tax cuts or other new initiatives then that could only be achieved by substantial increases in indirect taxes over and above inflation, especially on petrol.

That is no doubt why he encouraged his RHF the member for Islwyn to make the theme of this response ~~as~~ jam tomorrow because as he thought the Chancellor was in a jam today.

But as the Budget unfolded it became clear that my RHF was not in a jam. He was able to reduce both direct taxes and reduce the borrowing ~~target~~ forecast for next year, thus maintaining prudent and responsible control over the economy, without any increase in the real burden of indirect taxes - thus ensuring that the benefit of the recent drop in oil prices remains

/with

with both industry and private motorists. He was able to announce a series of imaginative and innovative measures to promote enterprise, spread share ownership help charities. He was able to agree to additional employment measures on top of the very large sums we are spending already, within our planning totals. And because of this prudent management, we now learn that interest rates have come down by 1 percentage point today, bringing further benefits to businesses and to families throughout the land.

All this is a direct result of the underlying strength of the economy. The RHG called the Budget staggeringly trivial. He got it staggeringly wrong because he staggeringly misunderstood the situation.

I turn now to my second theme, enterprise and job measures to which the Right Honorable Gentleman devoted so much of his attention.

Of course all of us want to see the levels of unemployment brought down.

But we at least recognise the formidable nature of the challenge, which is a worldwide one, in face of the increasing impact of technology, the increased threats from greater competitiveness in our own and world markets from more and more newly industrialising countries, the problem of coping with substantial increases in the potential workforce - an all-time high of some 510,000 in 1984.

Faced with all these, we have made considerable progress with more new jobs being created in this country since the last election than in the rest of the Community put together.

My Right Honorable Friend the Paymaster General will be elaborating on this aspect if he catches your eye tomorrow. So I would like to confine myself today to three comments.

First, the employment and training measures currently being pursued by this Government are on a scale much wider and more extensive than ever before. We have been planning to spend £2,500 million in this year on them alone, rising to £3,000 million in 1988, compared with £300 million in the last year of the last Government. The bulk

/of the

of the benefits from last year's Budget are only now beginning to work through. The restructuring of National Insurance contributions only came into effect last October. The two year YTS begins next month. And the expansion of the Community Programme is only part-way through.

The new measures announced yesterday at some £195 million gross are on top of all that, so it is ridiculous to describe them as the response to the problem of the unemployed. They are in addition to all else that has been done.

Moreover - and this is very important - we have concentrated on those measures which have been proved to be the most cost-effective. It is of course only too easy to promise to spend much more of the taxpayers' money on such schemes and to claim that in that way one was making a greater Government contribution to jobs. But it is false. What matters is to ensure that this is the best use of taxpayers' money and that it is effectively spent. The Opposition constantly fails to take into account that every ~~£~~thousand million pounds spent on such employment measures comes from other businesses and other people in employment. Squeeze them too hard by higher taxes or higher interest rates, and you destroy hundreds of thousands of jobs which would otherwise be lasting.

Second, as a former Minister for small businesses I am delighted to see the emphasis on measures to promote enterprise, to encourage small businesses and to assist self employment. Two of the schemes for which I had initial responsibility,

/the

the Enterprise Allowance Scheme and the Loan Guarantee Scheme, have proved themselves [to be among the most cost effective in our range] and I am sure that all my Honorable and Right Honorable Friends will welcome their extension in this Budget. I am delighted too that another scheme in which I took a particularly close interest, the Business Expansion Scheme, has received the thumbs up from the Peat Marwick Report and is now being extended indefinitely; and I welcome too that the Leader of the Opposition has himself recognised its value and supported what we have proposed in this Budget.

The CTT changes are important in this context, for their main effect will be to help the family businesses. There is little incentive to build up a family business beyond a certain scale if it cannot be passed on to the next generation without heavy tax bills on transfer. Increasingly it has become clear that the effect of the lifetime gifts provision was to prevent new jobs being created by this disincentive and possibly, in order to meet the tax bills, to the actual loss of many existing jobs.

And third, it really is a nonsense to suggest that the only impact of this Budget on jobs will be through the specific employment measures. The effect of the tax reductions, of the retention of the benefits of lower oil prices in people's pockets and of the interest rate changes today will all be fed through in increased demand by tens of millions of our fellow citizens for additional goods and services. That means extra work for thousands of building firms if people choose to spend the extra retained earnings they now have that way, or for

/other

other services, or for goods - and I hope increasingly British goods - our firms continue to improve the attractiveness of their products. Many, many more jobs will be created that way than by specific employment measures, just as the key to getting more lasting job opportunities is through maintaing a climate of low inflation and structural measures to improve competitiveness. This is a point that the Opposition continually fails to understand, with its constant emphasis on purely the job numbers arising out of employment measures. Out there something like 350,000 people a month are moving into for them new jobs, the vast majority in the private sector.

004/2983

Wider Share Ownership

For me, the third main theme of this Budget is the further encouragement to wider share ownership.

For very many years I was an active member of the Wider Share Ownership Council, and like my RHF, the Financial Secretary [who will elaborate on this in his wind-up speech tonight] have a pessimistic belief in seeing the capital owning democracy, begun with the massive extension of home ownership in this country, augmented by many millions more of our fellow citizens being able to build up investments of their own, over and above their pensions and life policies, in order to enhance their financial independence of the State and to spread the investment habit. We have built on the success of previous Budgets, of privatisation issues, of increased employee participation. We are breaking down the old demarcation between capital and labour.

So I am delighted at the warm welcome given to the Chancellor's radical new scheme, the Personal Equity Plan. It is important that the tax advantages hitherto of institutional investors are counterbalanced. Small investors will now be able to build up substantial nest-eggs for their retirement, complement their pensions or for other purposes

More and more of our fellow citizens are increasingly coming to see that share ownership is just as natural and just as realistic an ambition as home ownership. This new scheme will help to turn those ambitions into reality.

Of course I do not expect the Opposition to understand or welcome it.For at heart the Party opposite believe in the municipal socialism of the town hall landlord and the central socialism of the man in Whitehall knowing how best to direct investments. On this philosohically and in practice there is a fundamental divide between the Parties, and this Budget has intensified it. Not so long ago they showed themselves to be out of touch with people's aspirations ot own their own homes, when they opposed the sale of council houses. They had had to come round to it because of its popularity. I tell them the time for people's capitalism has come.

Charities

Something of the same spirit under-lies the Budget proposals on Charities. Of course this Government has done much in successive Budgets already to help charities. But this is far underway the best Budget ever for them.

My Rt Hon Friend has given an enormous boost to charities with the radical steps he is now taking.

A vast range of activities are affected; good social causes, the arts, conservation, the heritage, education including universities, medical research and the Third World.

Of course they have been welcomed on all sides, and give the charities the opportunity to attractive a huge surge in charitable giving, estimated even to be at least £120 million ~~at up to around £140 million~~ by next year, and perhaps more.

And it is not just the national organisations who will benefit. I expect that there will be a significant boost to many small local charities in my own county and constituency, not least to the churches.

For me too there is a wider significance. There is state funding on a substantial scale for many of these purposes, and it will continue. But the decision in practice are very often concentrated in a few hands, and very much focused on the centre. Letting individuals and companies decide what they want to give to and who they want to give it to means that decisions are defused throughout the community, are in as many hands as possible and have a strong regional and local focus.

We have always supported an active and flourishing voluntary sector. These measures should re-invigorate it.

L. Conclusion

HOUSE OF COMMONS
LONDON SW1A 0AA

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us. I have described how we can ~~cope~~ take in our stride the dramatic collapse in the oil price, and benefit from its consequences. In collaboration with my rt hon and Noble Friend the Secretary of ~~Stat~~ State for Employment, I have announced a further substantial ~~package~~ battery of measures to help the unemployed. I have ~~announced~~ proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy, and abolished outright a fourth tax. I have announced the most substantial package of assistance to charitable giving ever, and proposed the first cut in the basic rate of income tax for seven years. ~~I commend this Budget to the House.~~ Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future. I commend it to the House.

BUDGET SECRET

Pwp

COPY NO 1 OF 12

FROM: G W MONGER
DATE: 17 March 1986

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Scholar
Miss Sinclair

Mr McManus - IR
Mr Wilmott - C&E

BUDGET SPEECH

I have three final comments.

2. In Section G, page 5 it is now said that Sir William Harcourt reintroduced Estate Duty in 1894. The word "reintroduced" is wrong. You could use the Minister of State's suggestion ("we have had an inheritance tax in some shape or form ever since Sir William Harcourt's Estate Duty of 1894") but Inland Revenue think it would be quite accurate to say simply: "...ever since Sir William Harcourt introduced the Estate Duty in 1894".

3. In Section J, page 2 for accuracy the statement about VED on lorries should be that the Chancellor will avoid any general increase this year. The rate on Farmers' lorries will rise as part of the programme of making them reflect their contribution to road costs.

4. In Section K, page 3, it is wrong to say "we have increased the main tax thresholds by some 22% more than inflation". The threshold will, on present expectations about inflation next year, be 22% higher in real terms in 1986-7 than in 1978-9. The statement that we "have increased" it by 22% is therefore wrong. It could be made accurate by relating it to next year but it would then anticipate the later announcement about the level of allowances next year. Altogether, it seems best to return to the formulation "we have increased the main thresholds by some 20% more than inflation". 20% is the figures by which allowances in 1985-6 exceeded those in 1978-9.

BUDGET SECRET

5. We shall if necessary minute separately about petrol prices.

[signature]

G W MONGER

BUDGET SECRET

gwp

Mrs Lomax

Budget Speech – Final Draft.

Section A

P2 Penultimate line: "other half of the remainder over"

Section F

P5. Middle line: "The total public expr cost of the measures I have outlined ...... and £290 million in 1987-88".

£5m of this is Loan Guarantee Scheme, which is not "outlined": Budget Brief G1 uses £285.

Section H

P3 "yield of ... £120 million in 1987-88". [R.L. – determined not to change "yield" to "revenue saving"?]

P3. "The massive £6 billion it contributes to our invisible earnings ....". Is this foreign earnings?

P5 Bottom two lines. I suppose information will have to be supplied to the Inland Revenue when tax is reclaimed on dividends?

[signature]

17 March

RR7.36

BUDGET REF NO JJ30
COPY NO 46 OF 46

FROM: MRS R LOMAX
DATE: 17 March 1986

MR SCHOLAR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Anson
Mr Byatt
Mr Cassell
Mr Kemp
Mr Lavelle
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Miss Sinclair
Mr Pratt
Mr Dyer
Mr Cropper
Mr Lord
Mr H Davies

Sir L Airey - IR
Mr Battishill - IR
Mr Isaac - IR
PS/IR

Sir A Fraser - C&E
Mr Knox - C&E
PS/C&E

Mr Norgrove - No.10

Governor - B/E

Section B only
Mr Kelly

Sections D & H only
Mr Peretz

Section H only
Miss Noble

Sections C & J only

Mr Robson

BUDGET SPEECH - FINAL DRAFT

I attach a final draft of the Budget speech, reflecting the changes the Chancellor made over the weekend, in response to comments received by Friday 14 March.

2. I would be grateful if Mr Kelly would update the figures in Section B for changes in exchange rates since the Plaza agreement, in the light of today's closing prices; and if Mr Monger would consider (with PE) whether any changes need to be made to the references to petrol prices in Section J. Any other comments should reach this office as soon as possible, and no later than lunchtime today.

RL

RACHEL LOMAX

1986 BUDGET SPEECH

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A. Introduction

The background to this year's Budget is the dramatic and unprecedented fall in the world oil price.

But the Government's objectives remain unchanged: the conquest of inflation and the creation of an enterprise culture.

And the Government's policies are unchanged, too: policies of sound money and free markets.

Not least, because these are the only routes to more jobs, and jobs that last.

So my Budget today will carry forward the themes of my two previous Budgets, and sow some seeds for the future.

In the course of my speech I shall begin by reviewing the general economic background to the Budget, and go on to deal with the specific issue of oil.

I shall next discuss monetary policy and the fiscal prospect, both this year and next.

I shall then turn to the question of direct help for the unemployed.

Finally, I shall propose some changes in taxation designed to assist in achieving the economic objectives I have already outlined.

As usual, a number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

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B. The Economic Background

I start with the economic background.

The strength and durability of the current economic upswing continues to confound the commentators.

We can now look back to very nearly five years of growth at around 3 per cent a year.

Even more important, 1985 was the third successive year in which we secured the elusive combination of steady growth and low inflation - the first time this has been achieved since the 'sixties.

In 1985 as a whole, output grew by a further 3½ per cent, the highest rate of growth in the European Community, and higher than the United States, too.

Within that total non-oil exports grew by 7 per cent, to reach yet another all-time record.

Despite a marked slowdown in the growth of world trade from the heady pace of 1984, the current account of the balance of payments was in surplus for the sixth year in succession - this time by some £3 billion.

Inflation ended the year at around 5½ per cent and falling.

Employment continued to rise, though still not fast enough to reduce the distressingly high number of people out of work.

I shall have more to say about unemployment later.

Manufacturing industry, the subject of so much ill-informed comment, had another successful year, with its output up by 3 per cent, its productivity up by almost 4 per cent, and both its investment and its exports up by 6 per cent.

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At the heart of this success lies a remarkable turn-around in productivity.

In the six years prior to 1979, Britain's annual rate of growth of manufacturing productivity, at less than 1 per cent, was the lowest of all the Group of Five major industrial nations.

In the six years since 1979, our annual rate of growth of manufacturing productivity, at 3½ per cent, has been second only to that of Japan.

Looking ahead, I expect 1986 to be a further year of steady growth with low inflation.

Indeed, with output forecast to rise by 3 per cent, and inflation to fall to 3½ per cent, 1986 is set to register our best overall performance in terms of output and inflation for a generation.

The pattern of growth should show a satisfactory balance, too, with exports and investment expected to grow rather faster than consumer spending - as indeed they have during the sustained upswing as a whole.

But the uncertainties inherent in all these forecasts, good though their track record has been, are reinforced by constant reminders that we live in an uncertain and turbulent world.

One particularly difficult aspect of this is the febrile nature of the world currency markets.

There has been some improvement here.

The Plaza Agreement between the Group of Five Finance Ministers last September has undoubtedly led to a more sustainable pattern of exchange rates worldwide.

Since that meeting, the dollar has fallen by some (15) per cent against the other major currencies as a whole, with the pound moving up by (7) per cent, the Deutschemark by (25) per cent and

the Yen by (32) per cent - a pattern broadly in line with what those of us who were party to the agreement had hoped to see.

This process will be assisted further if the passage of the Gramm-Rudman amendment succeeds in securing its objective of a much-needed reduction in the United States budget deficit.

Meanwhile, the Plaza Agreement has already succeeded in reducing, at least for the time being, the dangerous protectionist pressures that were building up in the United States.

Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on.

But the most dramatic development on the world economic scene, and one of considerable importance to this country, has of course been the collapse in the price of oil.

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C. Oil

I presented my Budget last year at the end of a 12-month coal strike.

I observed at the time that it was a remarkable tribute to the underlying strength of the British economy that it had been able to withstand so long and damaging a strike in such good shape.

We now have to face a challenge of a very different kind.

Over the past few months the price of oil has almost halved, and with it our prospective North Sea oil tax revenues and earnings from oil exports.

In real terms, the price is now back to what it was before the first oil shock in 1973.

Not surprisingly, perhaps, this initially caused a fair amount of turmoil in the financial markets with sterling under pressure.

I decided that it was right to respond with an immediate one per cent rise in short term interest rates in early January, and this helped to prevent the downward movement of the exchange rate from developing an unhealthy momentum of its own.

But equally I thought it right to resist the pressure, which for a time was very strong indeed, to raise interest rates still further.

Meanwhile, let me repeat that there is no question whatever, and never has been any question, of the UK cutting back its oil production in an attempt to secure a higher oil price.

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In the first place, the whole outstanding success of the North Sea has been based on the fact that it is the freest oil province in the world, in which decisions on levels of output are a matter for the companies and not for the Government.

And in the second place, we are not only, or even principally, a major oil producer; we are also a major world producer and trader of other goods and services, and a major oil consumer.

There is no overall UK national interest in keeping oil prices high.

I am of course aware that a Report, recently published in another place, and which attracted a certain amount of publicity at the time, predicted that

> "as the oil revenues diminish the country will experience adverse effects which will worsen with time"

- effects of a most alarming nature.

Had the authors of that Report dreamed at the time that half the oil revenues were about to disappear within a matter of months, their conclusions would no doubt have been even more apocalyptic.

As the House knows, I have always believed their analysis, which was widely shared by Rt hon and hon Members opposite, to be profoundly mistaken.

But certainly it is going to be put to the test sooner than anyone expected.

The United Kingdom is likely to remain an oil producer, of a gradually diminishing volume of oil, for the next 25 years or so.

If we can survive unscathed the loss of half our North Sea oil revenues in less than 25 weeks, then the prospective loss of the other half over the remainder of the next 25 years should not cause us undue concern.

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It is, of course, true that in relative terms we do lose from the collapse of the oil price.

That is to say, the really big gains will be made by the major non-oil-producing countries such as Germany and Japan, where growth will be boosted and inflation, already low, is likely to fall virtually to zero.

But the oil price fall will be beneficial for the industrialised world as a whole, and even for the United Kingdom what we gain on the swings should, over time, more than offset what we lose on the roundabouts.

In particular, I expect that the levels of economic activity and inflation will if anything be slightly better than they would have been without the oil price collapse.

And what of the balance of payments?

Thanks to the abolition of exchange control in 1979, we have been able to use a good part of our earnings from North Sea oil since then to build up a massive stock of overseas assets.

Our net overseas assets have in fact risen more than sevenfold from £12 billion at the end of 1979 to almost £90 billion at the end of last year.

This is a far bigger total than that possessed by any other major nation, with the perhaps inevitable exception of Japan.

The earnings from those assets will be of increasing value to our balance of payments in the years ahead.

So, too, should the improvement in our manufacturing trade balance.

For while the British economy may not gain a great deal overall as a result of the oil price collapse, there will be considerable differences within the economy.

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The major potential beneficiary will be the internationally traded sector of industry in general, and manufacturing in particular, which is already enjoying both cheaper energy and a lower exchange rate against most of its major competitors, at a time when inflation is falling.

This provides British industry with an outstanding opportunity both to increase its exports and to reduce import penetration in the home market.

But it will only be able to seize that opportunity if it meets two conditions.

First, it must keep firmer control of its labour costs.

Second, it must spend more of its much healthier level of profits on investing for the future in Research and Development and in training.

Both the opportunity, and the responsibility to see that it is not thrown away, rest fairly and squarely on the shoulders of British management.

Meanwhile, despite the massive fall in oil prices, I expect the current account of the balance of payments to remain in sizeable surplus this year, by some £3½ billion.

As I have indicated, there will be pluses and minuses within the economy.

If industry is the main gainer, the main loser, at least today, is the Chancellor of the Exchequer.

I can live with that.

But it does mean that North Sea oil revenues, which are likely to amount to some £11½ billion for 1985-86, are bound to be very much less in 1986-87.

Indeed, on the assumption of an average North Sea oil price of for the rest of this year $15 a barrel, which is close to the average for the past month of around $16 a barrel, oil revenues in 1986-87 will be virtually halved at some £6 billion.

This has obvious implications for the Budget.

But the important fact is that, just as we successfully weathered a year long coal strike, so we have been able to take the unprecedented collapse in the oil price in our stride.

We have been able to do so, first, because of the underlying strength of the economy in terms of growth, inflation and the external account.

And, second, by virtue of the reputation we have earned over seven years for sound and prudent financial management.

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D Monetary Policy

The framework within which that sound and prudent financial management has been pursued, and will continue to be pursued, is the Government's Medium Term Financial Strategy.

At the heart of the MTFS lies the objective of steadily reducing the growth of total spending power in the economy, as measured by GDP in cash terms, at a pace that will gradually squeeze inflation out of the system while at the same time leaving adequate room for sustained growth in real output.

That we have done.

Over the past six years the rate of growth of money GDP has been halved.

And this has brought about a combination of low inflation and steady growth.

We shall continue to maintain steady downward pressure on inflation.

That means above all controlling the growth of money in the economy.

Last year I set target ranges of 3 to 7 per cent for narrow money, MO, and 5 to 9 per cent for broad money, £M3.

During 1985-86 the targeted measure of narrow money has grown towards the bottom end of its range.

The target range for next year will be 2-6 per cent, as foreshadowed in last year's MTFS.

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For broad money it has been clear since the autumn that the range was set too low.

Throughout the 1980s - and in sharp contrast to the 1970s - broad money has grown far faster than money GDP.

Experience has demonstrated that this has not posed a threat to inflation.

This rapid growth largely reflects the increased attractions of holding interest bearing deposits, at a time both of low inflation and high real interest rates, and of innovation and liberalisation in the financial system.

Accordingly, I am setting next year's target range for broad money well above that indicated in last year's MTFS, at 11-15 per cent.

Given the experience of the past six years, I believe this is not only a more realistic range, but one which is wholly consistent with the further decline in inflation I intend to achieve.

Short term interest rates are the essential instrument of monetary policy.

Changes in interest rates have a reasonably quick and direct effect on narrow money, as they do on the exchange rate.

Their effect on broad money is more complex and much more delayed.

As explained in the Red Book, there is thus an important difference in the operational significance of the targets for narrow and broad money.

Needless to say, I shall continue to monitor the evidence of other financial indicators, of which the most important is the exchange rate.

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I will say no more about monetary policy today.

Except to repeat what I said at the Mansion House last Autumn: that while financial liberalisation and innovation have inevitably made the process of monetary management more complicated, there has been no change whatever in the essence of policy.

The Government continues to attach the highest priority to sound money.

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E. Public Sector Borrowing

Though there is nothing sacrosanct about the precise mix, monetary policy must always be supported by an appropriate fiscal policy. That means, in plain English, keeping public sector borrowing low.

The outturn for the public sector borrowing requirement in 1984-85, which had to bear the bulk of the cost of resisting the coal strike, was £10 billion, or just over 3 per cent of GDP.

In my Budget last year I planned to reduce it substantially in 1985-86, to £7 billion, or 2 per cent of GDP.

In the event, despite the loss of £2 billion of North Sea oil revenue, this year's PSBR looks like turning out at a little under £7 billion, given that the total for the first eleven months comes to under £3 billion.

This successful outcome, which represents the most substantial reduction in the PSBR as a proportion of GDP since 1981-82, is attributable to two factors.

First, public expenditure has been kept under firm control.

Not only is the outturn likely to be within the planning total, but spending in 1985-86 is expected to be below the previous year's level in real terms, even after allowing for the effects of the coal strike.

And the second factor behind the successful PSBR outturn for 1985-86 is that the £2 billion shortfall in oil revenues has been offset by the increased buoyancy of non-oil revenues, reflecting a healthy economy and an increasingly profitable corporate sector.

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Last year's MTFS indicated a PSBR for 1986-87 of £7½ billion, or 2 per cent of GDP.

Some would argue that, in the light of the £2½ billion increase in projected privatisation proceeds, I ought to aim well below that.

Others would claim that, since the sharp drop envisaged in oil revenues is more than double the rise in privatisation proceeds, a higher figure would be appropriate.

As last year, my judgement is that the wisest course is to stick broadly to our pre-announced figure.

But given the uncertainties over the oil price, I have decided, within that framework, to err on the side of caution, and provide for a PSBR of £7 billion, or 1¾ per cent of GDP.

Needless to say, this does not enable me to reduce taxation by anything like the £3½ billion foreshadowed in last year's MTFS.

Indeed, given the assumed loss of more than £5 billion of oil revenues in 1986-87, compared with what was envisaged a year ago, I would have expected to have had to increase taxes in this year's Budget.

However, not only have the tax revenues this year from the 95 per cent of the economy that is not oil proved to be notably buoyant, but there is every sign that this will continue into 1986-87, assisted by a rather higher rate of economic growth than was foreseen in last year's MTFS.

This continued vigour of the non-North Sea economy, which is likely to add more than £3 billion to expected non-North Sea tax revenues, coupled with public spending which remains under firm control, has transformed what might have been a bleak prospect.

As a result, I am able this year to accommodate a relatively modest net reduction in the burden of taxation, of a shade under £1 billion.

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F. Help for the unemployed

I turn now to the continuing problem of high unemployment.

It is a problem that *can* be solved - and there is no secret about how.

The solution to the problem of unemployment - and it is the *only* solution - requires progress on two key fronts.

The first is a sustained improvement in the performance of business and industry, and thus of the economy as a whole.

That is what every aspect of the Government's economic policy has been designed to assist, and it is already achieving impressive results.

The second is a level of pay which enables workers to be priced *into* jobs instead of pricing them *out* of jobs, and which in particular ensures that British industry can hold its own against our major industrial competitors.

It is here that Britain's weakness lies.

For the plain fact is that labour costs per unit of output in British business and industry continue to rise faster than is consistent with low unemployment and faster than our principal competitors overseas.

Productivity is, indeed, rising quite rapidly.

But pay is rising faster still.

It is this - and not our alleged dependence on oil - that constitutes the Achilles heel of the British economy.

And in a free economy - as the CBI has frankly and commendably acknowledged - it is the responsibility of employers and management to control industry's cost structure in general and its wage costs in particular.

In the new and improved climate of industrial relations, and with inflation falling and set to fall further, there can be no excuse for failure to discharge that responsibility.

I have, however, considered whether there is anything further Government can do to assist this over the longer term.

The problem we face in this country is not just the level of pay in relation to productivity, but also the rigidity of the pay system.

If the only element of flexibility is in the numbers of people employed, then redundancies are inevitably more likely to occur.

One way out of this might be to move to a system in which a significant proportion of an employee's remuneration depends directly on the company's profitability per person employed.

This would not only give the workforce a more direct personal interest in their company's success, as existing employee share schemes do.

It would also mean that, when business is slack, companies would be under less pressure to lay men off; and they would in general be keener to take them on than if pay costs were fixed, irrespective of company profitability.

This would clearly be in industry's own interest, and most emphatically in the best interests of the unemployed.

It should therefore occur without any prompting from government.

But there is considerable inertia to overcome.

So it might make sense to offer some temporary measure of tax relief to the employees concerned to help get profit sharing agreements of the right kind off the ground, and to secure the benefits that would undoubtedly accrue if they really caught on.
Inevitably, the design of such a relief, and the precise definition of qualifying agreements, would be matters of some complexity.
The Government therefore propose to discuss with employers and others to see if a workable scheme can be defined which offers the prospect of a worthwhile and broadly-based take up.
If these preliminary discussions are sufficiently encouraging, we would prepare a consultative document setting out a detailed scheme for wider consideration.

Meanwhile, there is more we can do of an immediate nature to help the unemployed.
In my Budget last year I announced the Government's intention to launch a new two-year Youth Training Scheme, leading to recognised vocational qualifications.
The new and expanded YTS will duly come into operation next month.
It will be a giant step towards our objective of ensuring that no youngster under the age of 18 need be unemployed.

I also announced in last year's Budget a substantial expansion of the Community Programme to help the long-term unemployed - those who have been out of work for over a year, or, in the case of those between 18 and 24, for more than six months.
The Community Programme, which offers work for up to a year on projects of benefit to the community, is currently providing almost 200,000 places.

I have agreed with my Rt. Hon. and Noble Friend the Secretary of State for Employment to provide the funds to raise the eventual target for this year to 255,000 places - very nearly double the number that existed a year ago.
At the same time, the average wage limit for the Community Programme will be raised to £67 a week from next month.

Last November my Rt. Hon. and Noble Friend announced two pilot schemes to provide further help for the long-term unemployed.
These new initiatives, which began in January, are a counselling scheme open to all the long-term unemployed in the pilot areas, and a Jobstart allowance of £20 a week for six months for those long-term unemployed who take a job at less than £80 a week.
The pilot schemes are already proving effective, and I have accordingly decided to provide the funds to develop them into a single programme covering the entire country.
This means that every single one of the long-term unemployed throughout the land will be called for an interview and offered help in finding a job.

I shall also be providing the resources to launch a brand new scheme - the New Workers Scheme - to help 18-20 year olds to find a job.
This will provide for a payment of £15 a week for a year to any employer taking on an 18 or 19 year old at up to £55 a week or a 20 year old at up to £65 a week.
The New Workers Scheme should provide a worthwhile incentive for employers to create jobs for young people.

Finally, I have agreed to a substantial enlargement of the proven and highly successful Enterprise Allowance Scheme, which makes payments of £40 a week for up to a year to assist unemployed men and women to set up in business on their own account.

Funds will be provided that will enable the annual rate of entry to the Enterprise Allowance Scheme to be increased from its present figure of 65,000 to 100,000 by April 1987, and to provide more training for those involved.

At the same time I propose to improve the tax treatment of payments made under this scheme.

The total public expenditure cost of the measures I have outlined, together with consequential spending in Northern Ireland, comes to £195 million in 1986-87 and £290 million in 1987-88.

These gross costs will, however be partly offset by savings on social security benefits, leaving a net public expenditure cost of £100 million in 1986-87 and £165 million in 1987-88.

This will be financed from the Reserve, and there will therefore be no overall addition to planned public spending.

G. Business and Enterprise

I now turn to the taxation of business and enterprise.

While the measures I have just announced help the unemployed directly, in the long run what really matters is the creation of a climate in which business and industry flourish.

For it is companies, not Governments, which create jobs.

The reformed system of business taxation which I introduced in my 1984 Budget has reached the end of its transitional phase and comes fully into force next month.

From then on the United Kingdom will have, at 35 per cent, the lowest rate of Corporation Tax of any major industrial nation.

This year I have only two further amendments to make.

First, I propose to ensure a full measure of depreciation for tax purposes for short life agricultural buildings and works, by giving the taxpayer the option of making balancing adjustments on the sale or destruction of such buildings.

Second, I propose to reform the mines and oil wells allowances broadly along the lines of the proposals published in last July's consultative document.

The overall net benefit of this to the industries concerned will amount to £45 million in 1987-88.

Otherwise I propose only minor technical changes to the taxation of North Sea oil; but I am continuing to keep the economics of incremental investment under review, and shall not hesitate to introduce at the earliest opportunity any changes which may prove

necessary to ensure that worthwhile projects are not frustrated by the fiscal regime.

I need to set the 1987-88 car and fuel benefit scale charges for those with company cars.

At the same time the motor industry has represented to me that the discrepancy between the engine size break points in these scales and the break points in the new European Community directive on car exhaust emissions is potentially damaging to its international competitiveness.

Accordingly I propose, from April 1987, to change our break points to those in the new directive.

At the same time, as last year, I propose to increase the (restructured) car benefit scale charges by 10 per cent.

This will still leave the scale charges well short of the true value of the benefit.

The fuel scale will also be restructured, but there will be no general increase in the charges; and as from April 1987 the same scale will also be used to assess the VAT due on petrol used by registered traders and their employees.

This will be simpler and more equitable than the present system, and will also bring in an extra £40 million of revenue in 1987-88.

I propose to increase the VAT threshold to £20,500, in line with the maximum permitted under existing European Community law.

I also propose to correct an anomaly in the taxation of international entertainers and sportsmen.

When British entertainers or sportsmen work overseas, the foreign tax authorities normally levy a withholding tax on their earnings.

But at the present time we levy no such tax on the earnings of foreign entertainers and sportsmen when they work in the United Kingdom.

I believe that, in future, we should fall into line with most of the rest of the world.

Accordingly, I propose to withhold tax at the basic rate on the earnings of overseas entertainers and sportsmen in the UK. This should yield £75 million in 1987-88.

A key element in the Government's strategy for jobs is the encouragement of new businesses.

As the House knows, I have been reviewing the future of the Business Expansion Scheme, which is due to come to an end in April 1987.

I have been assisted in this review by the independent report commissioned by the Inland Revenue from the consultants Peat, Marwick, which is being published in full today.

I am placing a copy in the Library of the House.

It is quite clear - and this is confirmed by the evidence in the Peat Marwick report - that the Business Expansion Scheme, which my predecessor introduced in 1983 as an improvement on the 1981 Business Start-up Scheme, has been an outstanding success.

It has fully achieved its aim of attracting new equity capital into unquoted companies.

The amount subscribed has been running at well over £100 million a year, and steadily rising; and a high proportion of this has gone into new and small businesses.

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Roughly half the companies involved raised sums of less than £50,000 each.

I therefore have no hesitation in proposing to extend the life of the Business Expansion Scheme, which is due to expire next year, indefinitely.

But at the same time, despite the exclusions of farmland and property development in my two previous Budgets, I am concerned that too much BES money is being diverted from the high risk areas for which the scheme was always intended into areas where the risk is very much less.

Accordingly, I propose, from now on, to exclude from the scheme all companies holding more than half their net assets in the form of land and buildings.

I also propose to exclude companies whose main purpose is to invest in objects, such as fine wines, whose value may be expected to rise over time.

At the same time, I have one new inclusion to announce.

I have decided to bring within the scope of the BES companies engaged in the chartering of UK-registered ships.

This will provide new opportunities for investment in shipping engaged in the coastal, short sea and offshore trades.

I propose to take power to make further changes in the ambit of the scheme by Order.

Finally, having taken steps to target the Business Expansion Scheme more carefully, I propose to improve it.

BES shares issued after today will be entirely free of Capital Gains Tax on their first sale.

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And as a further measure of help for small and new businesses, the Loan Guarantee Scheme, under which the Government guarantees 70 per cent of qualifying bank loans, will also be extended, in this case for a further three years.

The House will be glad to learn that the premium will be halved from 5 per cent to 2½ per cent.

My last proposal in this section concerns Capital Transfer Tax, which ever since its introduction by the Labour Government in 1974 has been a thorn in the side of those owning and running family businesses, and as such has had a damaging effect on risk-taking and enterprise within a particularly important sector of the economy.

In addition to statutory indexation of the threshold and rate bands, I propose this year to reform the tax radically.

In essence, the Capital Transfer Tax is two taxes, as its two separate scales imply: an inheritance tax and a lifetime gifts tax.

We have had an inheritance tax in some shape or form ever since Sir William Harcourt reintroduced the Estate Duty in 1894.

But the lifetime gifts tax which the Labour Government introduced in 1974, in the teeth of united Conservative opposition, is an unwelcome and unwarranted impost.

By deterring lifetime giving, it has had the effect of locking in assets, particularly the ownership of family businesses, often to the detriment of the businesses concerned.

Accordingly, I propose to abolish entirely the tax on lifetime gifts to individuals.

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As with the old Estate Duty, there will be a tapered charge on gifts made within seven years of death and provisions to charge gifts made with reservation; and the regime for trusts, which is needed as a protection for the death charge, will be kept broadly unchanged.

The cost of abolishing the tax on lifetime giving will be £35 million in 1986-87 and £55 million in 1987-88.

In recognition of the radically changed nature of the tax I have decided to rename it the Inheritance Tax.

My two previous Budgets abolished three unnecessary taxes.

The National Insurance Surcharge, the Investment Income Surcharge, and Development Land Tax.

The abolition of the tax on lifetime gifts adds a fourth.

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H. Savings and Investment

I now turn to the taxation of savings and investment.

In my 1984 Budget I introduced a major reform of the taxation of savings and investment designed to improve the direction and quality of both.

Today I propose to carry this reform further forward.

The Social Security Bill now before Parliament proposes important and far-reaching changes in pension provision, notably by encouraging the growth of personal pensions.

Those changes - to which the Government attach the highest importance - have been warmly welcomed, both for the greater freedom they will give to existing pension scheme members and for the new scope they will offer to the millions of working people who are not in an occupational pension scheme.

In the light of these changes, I intend later this year to publish detailed proposals designed to give personal pensions the same favourable tax treatment as is currently enjoyed by retirement annuities.

Publication of these proposals will enable there to be the widest possible consultation prior to legislation in next year's Finance Bill.

Meanwhile, I can assure the House that, as I made clear last year, I have no plans to change that favourable tax treatment.

But I do need to deal with the growing problem of the rules governing pension fund surpluses.

The dramatic improvement in the financial climate compared with a decade ago, most notably as a result of the sharp fall in inflation, has seen a number of pension funds become heavily overfunded.

This presents a double problem, both aspects of which the Inland Revenue is at present having to deal with through the exercise of its discretionary powers.

In the first place, excessive surpluses, even if they arise unintentionally, represent the misuse of a tax privilege which was intended to assist the provision of pensions, and for no other purpose.

So the Inland Revenue requires from time to time that surpluses be diminished.

But at the same time the Revenue feels obliged to turn down many of the increasing number of requests from companies which, often for good reasons, wish to take refunds from their pension funds into the company itself.

The absence of clear rules on how surpluses should and may be dealt with, and the consequent reliance that has to be placed on the exercise by the Inland Revenue of its discretion, have created considerable uncertainty and have unnecessarily constrained trustees' freedom of action.

I therefore propose to replace these discretionary arrangements with clear and objective statutory provisions.

In future, the amount of any surplus in a fund will be determined for tax purposes in accordance with published guidelines, based on a secure funding method and prudent actuarial assumptions, as advised by the Government Actuary.

Where a surplus is 5 per cent or less of total liabilities no action will need to be taken.

Where it is higher than that action will be required to eliminate the excess.

It will be entirely a matter for the trustees and employers to decide whether the reduction is to be achieved by increasing benefits, or reducing contributions, or making a refund to the company.

If, and only if, they choose to make a refund, the employer will be liable to tax at a rate of 40 per cent of the amount refunded, so as broadly to recover the tax relief previously given.

The effect of these new arrangements is likely to be a yield of £20 million in 1986-87 and £120 million in 1987-88.

Next, Stamp Duty.

I have no change to propose in the stamp duty on houses and other property, which I reduced to 1 per cent, with a higher threshold, in my 1984 Budget.

But there is a formidable case this year for a further reduction in the rate of stamp duty on share transfers.

The City of London is the pre-eminent financial centre of Europe.

The massive £6 billion it contributes to our invisible earnings is but one measure of the resulting benefit to the British economy.

But competition in financial services nowadays is not continental, but global.

The City revolution now under way, due to culminate with the ending of fixed commissions - the so-called Big Bang - on 27 October, is essential if London is to compete successfully against New York and Tokyo.

And if London cannot win a major share of the global securities market, its present world pre-eminence in other financial services will be threatened.

Successful competition depends on a number of factors, but one of the most important is the level of dealing costs.

The abolition of fixed commissions will certainly help.

But with no tax at all on share transactions in New York, and roughly $\frac{1}{2}$ per cent in Tokyo, under the existing tax regime London will still be vulnerable.

I therefore propose to reduce Stamp Duty on share transactions from 1 per cent to $\frac{1}{2}$ per cent as from the date of the Big Bang.

But I believe it is right that the full cost of this should be met from within the financial sector itself.

Accordingly, I propose to bring into tax at the new $\frac{1}{2}$ per cent rate a range of financial transactions which are at present entirely free of Stamp Duty.

These include transactions in loan stock other than short bonds and gilt edged securities, transactions unwound within a single Stock Exchange account, letters of allotment, the purchase by a company of its own shares, and takeovers and mergers.

There will also be a special rate of 5 per cent on the conversion of UK shares into ADRs and other forms of depositary receipt.

Some of these changes, including the new ADR charge, will take effect immediately: others will be delayed until the Big Bang.

This further halving of the stamp duty on equities should enable London to compete successfully in the worldwide securities market.

It will also provide a further fillip to wider share ownership in the UK.

Just as we have made Britain a nation of home owners, it is the long-term ambition of this Government to make the British people a nation of share-owners, too; to create a people's capitalism, in which more and more men and women have a direct personal stake in British business and industry.

Both through the rapid growth of employee share schemes, and through the outstandingly successful privatisation programme, much progress has been made.

But not enough.

Nor, I fear, will we ever achieve our goal so long as the tax system continues to discriminate so heavily in favour of institutional investment rather than direct share ownership.

Accordingly I propose to introduce a radical new scheme to encourage direct investment in UK equities.

Starting next January, any adult will be able to invest up to £200 a month, or £2400 a year, in shares.

These will be held in a special account which I am calling a Personal Equity Plan.

So long as the investment is kept in the plan for a relatively short minimum period, of between one and two years, all reinvested dividends, and all capital gains on disposals, will be entirely free of tax.

The longer the investment is kept in the plan, the more the tax relief will build up and the greater will be the benefits.

And there will be no need to provide any information to the Inland Revenue.

Although the scheme will be open to everyone, it is specially designed to encourage smaller savers, and particularly those who may never previously have invested in equities in their lives.

So the plans will be simple and flexible to operate.

Anyone who is legally able to deal in securities will be eligible to register as a plan manager.

But the investor himself will own the shares - and the rights that go with them, including voting rights.

And it will be for the investor to choose whether to make the investment decisions himself or to give the plan manager authority to act on his behalf.

The cost of the scheme will be around £25 million in 1987-88, but will build up in later years as more plans are taken out.

This is a substantial, innovative and exciting new scheme.

I am confident that, over time, it will bring about a dramatic extension of share ownership in Britain.

Although wholly different in structure from the Loi Monory in France, I expect it to be every bit as successful in achieving its objective.

I am sure the whole House will welcome this far-reaching package of measures to reform the taxation of savings and investment.

I. Charities

I now turn to the tax treatment of charities and charitable giving.

In almost every facet of the nation's affairs it becomes increasingly clear that private action is more effective than State action.

This is particularly well illustrated by the success of charitable organisations up and down the land in the fields of famine relief, social welfare, medicine, education (including the universities), the arts and the heritage.

This Government has already done a great deal to assist charities, both through the tax system and in other ways.

I believe the time has come to take a further step forward.

The first question is whether any further fiscal relief should be given to the charities themselves, through relief from VAT, or to the act of giving.

In the light of representations from the Charities VAT Reform Group, I am prepared this year, exceptionally, to make a number of specific concessions on the VAT front.

I propose to relieve charities from VAT on their non-classified press advertising; on medicinal products where they are engaged in the treatment or care of people or animals, or in medical research; on lifts and distress alarm systems for the handicapped; on refrigeration and video equipment for use in medical applications purchased by charities from donated funds; on recording equipment for talking books and newspapers used by charities for the blind;

and on welfare vehicles used by charities to transport the deaf, blind or mentally handicapped.

But in general I am convinced that the right way to help charities is not by relieving the charities themselves from VAT, but by encouraging the act of charitable giving.

I say this for two principal reasons.

First, it is clearly better that the amount of tax relief is related to the amount of support a charity is able to attract, rather than to the value of goods and services it happens to purchase.

And, second, whereas a £ of VAT relief is worth precisely that, a £ of tax relief on giving is likely to generate more than a £ of income going to charity.

My principal proposals therefore relate directly to the act of giving to charity.

First, I propose to abolish altogether the upper limit on relief at the higher rates of income tax on charitable covenants.

At the same time I propose to act to stop the abuse of the tax system by ensuring that tax relief goes only to money which is used for charitable purposes.

Next, companies.

It is widely believed that corporate giving to charity would be more generous than it is at present if tax relief did not depend on the company entering into a four-year covenant.

Accordingly, I propose to allow companies (other than close companies) to enjoy tax relief on one-off gifts to charity up to a

maximum of 3 per cent of the company's annual dividend payment to its shareholders.

There will, of course, continue to be no limit on the amount a company can covenant to charity.

Many charities have made clear to me their fear that to introduce a similar relief for one-off donations by individuals would weaken them by reducing the stability they enjoy as a result of the binding force of covenants.

Instead, therefore, I propose to encourage individual giving to charity by a different means, that of tax relief for payroll giving.

From April 1987 it will be open to any employer to set up a scheme under which employees can have charitable donations of up to £100 a year deducted from their pay, and get tax relief on them.

All in all, the proposals I have announced today add up to a very substantial package of assistance to charities and charitable giving.

Their cost to the exchequer will depend on how generously companies and employees respond to this initiative.

But my best estimate is that it could amount to as much as £70 million in 1987-88.

This will be partly paid for by the measures to curb abuse, which may save some £20 million a year.

I would hope, too, that the additional charitable giving these concessions stimulate will be at least twice the amount of the extra tax relief given.

J. Personal Taxes: Taxes on spending

I now turn to the taxation of spending.

So far as the indirect taxes are concerned, the overriding question this year is how far I should recover from the oil consumer the tax revenues I have lost from the oil producer, as a result of the massive fall in the oil price.

Since November the price of petrol at the pump has fallen by roughly 12 pence a gallon.

If the oil companies had passed on the full amount of the fall in the oil price to date, the price of petrol at the pump could easily have been a further 12 pence a gallon lower still.

There is clearly scope, therefore, for a sizeable increase in petrol tax this year.

I have concluded, however, that at the present time, while I must certainly maintain the real value of the revenue I get from the motorist, I will not increase it.

But I do believe it makes sense to look again, in the light of the radically changed circumstances, at the relative weight of petrol tax and Vehicle Excise Duty.

Accordingly, I propose to increase the duty on petrol by an amount which, including VAT, would - if it were wholly passed on to the consumer - raise the price at the pump by sevenpence halfpenny a gallon.

This is twopence more than is needed to keep pace with inflation, and that enables me to keep VED at last year's level of £100 for

cars and light vans, leaving the overall burden on the motorist unchanged in real terms.

Moreover, given the very substantial increase in the oil companies' margins, there is clearly no need for the pump price of petrol to go up at all.

Indeed, it ought to fall further.

In the same way, I propose to increase the duty on derv by an amount which - if it were wholly passed on to the consumer, which, to repeat, it should certainly not be - would raise the price at the pump by sixpence halfpenny, including VAT.

This will enable me to avoid any increase this year in the Vehicle Excise Duty on lorries, too.

So far as the other oil duties are concerned, I have one or two changes to make.

Not to the duty on heavy fuel oil, which will remain unchanged as it has done since 1980.

But I propose to increase the very modest duty on gas oil, by a penny-halfpenny a gallon.

And I propose to abolish altogether the duties on aviation kerosene, or Avtur - which at present is taxed for domestic flights only - and on lubricating oils.

All these changes in duty will take effect from 6 o'clock this evening.

Finally, so far as oil products are concerned, I am anxious to do what I reasonably can to assist the introduction of lead-free petrol.

The case for this on health grounds is clear.

I have therefore decided to create a duty differential in its favour to offset its higher production costs.
My officials will be discussing with the oil companies how this can best be achieved in time for next year's Budget.

39

Next, tobacco.

In the light of the representations I have received on health grounds, I have decided to increase the duty on cigarettes by appreciably more than is needed to keep pace with inflation. 73
I therefore propose an increase in the duty on cigarettes and hand-rolling tobacco by the equivalent, including VAT, of approximately eleven pence on a packet of 20 cigarettes. 102
This will take effect from midnight on Thursday.
As last year, I propose no increase at all on the duties on cigars and pipe tobacco, which are more heavily taxed here than in most comparable countries.

Finally, drink.

As the House will recall, I was obliged in 1984 to increase the duty
167 on beer by slightly more than I would have wished as a consequence of the judgement against the UK in the European Court of Justice.
I now propose no increase at all in the duty on beer.
Nor do I propose any increase in the duties on cider, table wine, sparkling wine, fortified wine or spirits.
This last decision will, I hope, be particularly welcome in Scotland.

Next, VAT.

I propose to stop the abuse of long stay relief for hotel accommodation, and make certain other minor changes.

242

But I have no proposals for major changes in Value Added Tax this year.

The changes I have announced in the excise duties will, all told, raise an extra £795 million in 1986-87, the same amount as I would have raised had I simply increased all the excise duties in line with inflation.

The overall impact effect on the RPI, if all the increases were fully passed on, would be one half of one per cent.

This has already been taken into account in the forecast I have given the House of $3\frac{1}{2}$ per cent inflation by the end of the year.

163

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K. Income Tax

Finally, I turn to income tax.

In my Budget speech last year I undertook to issue a Green Paper on the reform of personal taxation.

As the House is aware, I am publishing the Green Paper today.

It discusses a range of options which will in due course be opened up by the computerisation of PAYE, from the relationship between income tax and employees' national insurance contributions to the closer integration of the tax and benefit systems.

In particular, however, it outlines a possible reform of the present system of personal allowances.

The responses to my predecessor's 1980 Green Paper revealed widespread dissatisfaction with the existing arrangements, but - inevitably - no clear consensus as to what should replace them.

118

Married women increasingly resent the fact that a wife's income is treated for tax purposes as that of her husband, depriving her of the independence and privacy she has a right to expect.

There is growing complaint, too, of the way in which, in a number of respects, the present system penalises marriage itself.

And it cannot be right that the tax system should come down hardest on a married couple just at the time when the wife stops work to start a family.

203

Yet that is what happens today.

The alternative system set out in the Green Paper, of independent taxation with allowances transferable between husband and wife, would remedy all these defects.

To be acceptable, however, it would need to be accompanied by a substantial increase in the basic tax threshold.

The Government is committed to reducing the burden of income tax, and the proposal in the Green Paper suggests one way of doing that which would achieve a number of other worthwhile objectives - including the ability to take more people out of the unemployment and poverty traps for a given amount of tax relief than is possible under the present tax system.

Given the timetable of computerisation, none of this could in practice be implemented until the 1990s.

But we need to start planning for the 1990s today.

The Government will therefore carefully consider the responses to today's Green Paper before taking any decision on how to proceed.

127

Meanwhile, I have to set the tax rates and thresholds for the coming year.

But first I have two minor proposals to announce, both of which I hope the House will welcome.

First pensions paid by the German and Austrian Governments to victims of Nazi persecution are free of tax in both Germany and Austria.

In this country, however, the tax relief on such pensions is set at 50 per cent.

In future, I propose that pensions paid to victims of Nazi persecution should be free of tax altogether.

216

Second, the House will be aware that, as from next year, social security benefit upratings will be moved to April, to coincide with the tax year.

This will enable them to be fully taken into account before PAYE codes are issued for 1987-88.

However, to bridge the gap between the November 1985 and April 1987 upratings my Rt Hon friend the Secretary of State for Social Services proposes to have a special transitional uprating in July, the details of which he has recently announced.

But as hon Members will know from their postbags, it could be confusing for many old-age pensioners and widows to undergo a special mid-year tax recoding on account of the July uprating. 54

I have therefore decided that, for pensioners and widows, the benefit increases payable in July will be exempt from income tax in 1986-87.

The cost of this will be £15 million.

107

Since we first took office in 1979, we have cut the basic rate of income tax from 33 per cent to 30 per cent and sharply reduced the penal higher rates we inherited from Labour. 142

We have increased the main tax thresholds by some 22 per cent more than inflation - and the greater part of that 22 per cent has been achieved during the present Parliament.

It is a good record, but it is not good enough.

The burden of income tax is still too great. 193

Nothing could be further from the truth than the claim that we have a choice between cutting tax and cutting unemployment.

The two go hand in hand.

It is no accident that the two most successful economies in the world, both overall and specifically in terms of job creation, the United States and Japan, have the lowest level of tax as a proportion of GDP.

Reductions in taxation motivate new businesses and improve incentives at work.

269

They are a principal engine of the enterprise culture, on which our future prosperity and employment opportunities depend.

The case for higher tax thresholds is well understood.

In my two previous Budgets I have raised the married man's allowance to its highest level in real terms since the war, and higher as a proportion of average earnings than in either Germany or the United States.

But we should not overlook the need for reductions in the basic rate of tax, too.

The basic rate is the starting rate of tax.

And it is the crucially important marginal rate of tax for some 95 per cent of all employees and 90 per cent of all self-employed and unincorporated businesses. 1/19

Clearly, given the massive fall in oil revenues, this is not a year for substantial reductions in tax of any kind.

But provided the economy continues to grow as it has been, and provided we continue to maintain firm control of public expenditure, the scope should be there in the years ahead.

1/71

Meanwhile, I propose for 1986-87 to raise all the main thresholds and allowances by the statutory indexation figure of 5.7 per cent, rounded up.

The single person's allowance will therefore rise by £130 to £2,335 and the married man's allowance by £200 to £3,655.

Similarly, the single age allowance will rise by £160 to £2,850 and the married age allowance by £250 to £4,505.

The age allowance income limit becomes £9,400.

I propose to raise all the higher rate thresholds by exactly £1,000.

This is fully in line with statutory indexation for the first - 40 per cent - higher rate, but less than half statutory indexation for the top - 60 per cent - rate.

Given the need for caution in the light of current circumstances, I do not have scope this year for a reduction in the basic rate of income tax, beyond one penny in the pound.

But this reduction from 30 per cent to 29 per cent still represents the first cut in the basic rate of income tax since my predecessor took it down from 33 per cent to 30 per cent in 1979.

So long as this Government remains in office, it will not be the last.

115

There will, of course, be a consequential reduction in the rate of Advance Corporation Tax.

And I also propose a corresponding cut in the small companies' rate of Corporation Tax from 30 per cent to 29 per cent.

153

The combined effect of the various income tax changes I have just announced is to concentrate the benefit, modest as I readily concede it to be, not on the rich but on the great majority of ordinary taxpayers.

As a result of the adjustments I have made to the higher rate thresholds, the gain for those at the top of the income scale is more or less confined to what they would have received under simple indexation alone.

By contrast, the married man on average earnings will be some £2.60 a week better off, an improvement of £1.45 a week over simple indexation alone.

The income tax changes I have announced today will take effect under PAYE on the first pay day after 17 May.

They will cost £935 million in 1986-87, over and above the cost of statutory indexation.

Seven years ago, when my predecessor cut the basic rate of income tax from 33 per cent to 30 per cent, he added:

> "Our long-term aim should surely be to reduce the basic rate of income tax to no more than 25 per cent."

I share that aim.

64

L. Conclusion

In this Budget, Mr Deputy Speaker, I have reaffirmed the prudent policies that have brought us three successive years of steady growth with low inflation, and the prospect of a fourth ahead of us.

I have described how we can take in our stride the dramatic collapse in the oil price, and benefit from its consequences.

In collaboration with my rt hon and Noble Friend the Secretary of State for Employment, I have announced a further substantial range of measures to help the unemployed.

84

I have proposed a radical and far-reaching new scheme for tax-free investment in equities, so that we may truly become a share-owning democracy, and abolished a fourth tax.

I have announced the most substantial package of assistance to charitable giving ever, and cut the basic rate of income tax.

Building as it does on the achievements of the recent past, this Budget is a safeguard for the present and a springboard for the future.

I commend it to the House.

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BinderHamlyn
CHARTERED ACCOUNTANTS

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Telephone: 01-353 3020. Facsimile: 01-583 0031.
Telex: 24276 Binder G. DX: 166.

Thanks
RP

The CH/Ex has his own copy of this.
7/4

The Rt Hon John MacGregor
Chief Secretary to
The Treasury
Parliament Street
Westminster
London S W 1

Your Ref:

Our Ref: PSL/BH

Date: 3 April 1986

CHIEF SECRETARY
REC. -7 APR 1986
ACTION CX FST MST EST
COPIES TO Mr Cropper Mr Lord

Dear John

<u>The Budget</u>

I thought you might be interested to read the results of a survey which we have recently commissioned.

Yours ever
Peter

Sir Peter Lane

THE BUDGET

What Businessmen Really Think

BinderHamlyn

CHARTERED ACCOUNTANTS

THE BUDGET

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What Businessmen Really Think

Businessmen are by and large happy with Nigel Lawson's budget last week. The result is seen as good for their companies with positive effects on macro-economic indicators, too. This is the flavour of the results from a survey conducted for us by Dewe Rogerson shortly after the announcement of the budget measures.

Nigel Lawson comes out of the budget with flying colours. The vast majority of businessmen say that he is doing a good job and are confident that the measures will benefit themselves, their companies and the country as a whole. Hardly anyone sees the budget as having a detrimental effect, although some doubt is expressed as to whether the Government is actively trying to tackle the problems that face businesses.

The majority of businessmen feel that the budget will have a positive effect on interest rates, consumer spending, inflation and exchange rates. They are less sure about its effect on unemployment : here they see it as being neutral.

We also asked about specific budget measures; half the companies would not consider the Chancellor's suggestion that lower pay rises could be compensated for by giving employees a share of the company's profits. They are less sure as to their employees' reaction to the scheme.

Another budget measure, the abolition of Capital Transfer Tax on lifetime gifts, is seen as easing the succession of family businesses. Few companies would be prepared to pay the new tax proposed on returning the surplus from pension funds back to their companies. They would prefer to increase the benefits of the scheme or reduce contributions.

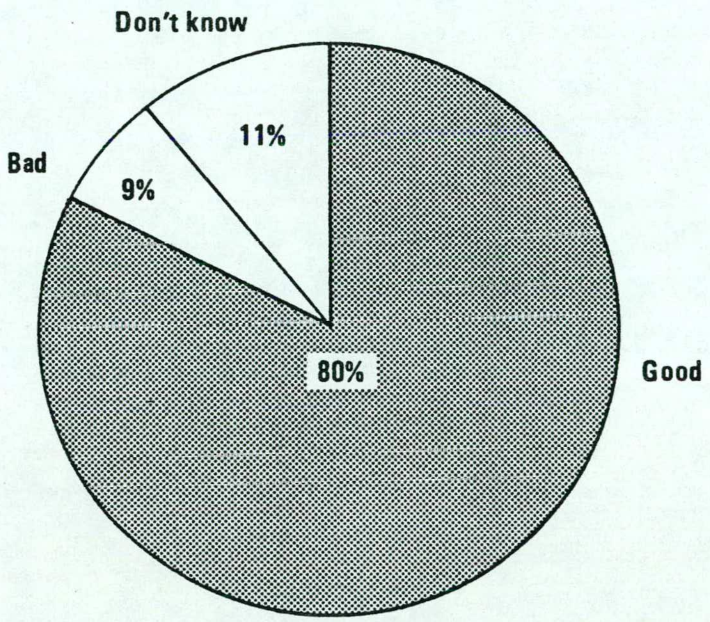
And what about next year's budget? Tax cuts are the priority for businessmen, followed some way behind by measures to reduce unemployment.

Technical Note

Dewe Rogerson interviewed by telephone on 19 and 20 March 1986, a representative sample of 232 companies with turnovers of more than half a million pounds. At each company the interviewee was either the Managing Director, Finance Director, Company Secretary or another senior Board Member.

Businessmen are pleased with the job Nigel Lawson is doing as Chancellor. Indeed, four in five say he is doing a good job with only one in ten holding the opposite view.

Q "Do you think that Nigel Lawson is doing a good job or a bad job as Chancellor of the Exchequer?"



Base : All

Rating of the Budget

Businessmen view the effect of the budget as being better for business generally than for their individual companies. This is not to say they feel that it will be bad for their company but they hold a more neutral view.

Around half of businessmen see the Chancellor's measures as benefiting the country, their company's employees and them personally. Very few believe that the effect of the budget will be negative.

This favourable view is attributed to the consistency of a budget with no sweeping changes. It is also seen as having been neutral, with the reduction in interest rates particularly welcomed:

> "It was psychologically good. It was neutral but with the right incentives without causing inflationary pressure"

> "Any budget which doesn't introduce wild sweeping changes is a good thing for business. It increases confidence in the Government and is a good thing generally"

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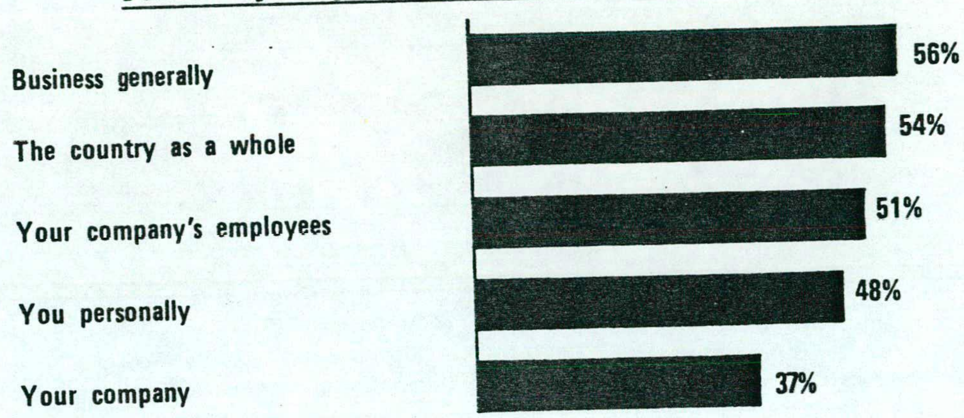
Percentage saying a good thing for.......



Base : All

As well as asking businessmen what they felt the effect of the budget would be on their company, we were also interested to see how they viewed it in terms of the economy as a whole. Again the response was a positive one, particularly on its effect on interest rates.

The Chancellor's measures are also seen as being favourable in relation to consumer spending, inflation and exchange rates. Few believe the result to be negative on any of these economic indicators.

The effect of the budget on unemployment is viewed less positively with the majority anticipating a neutral effect.

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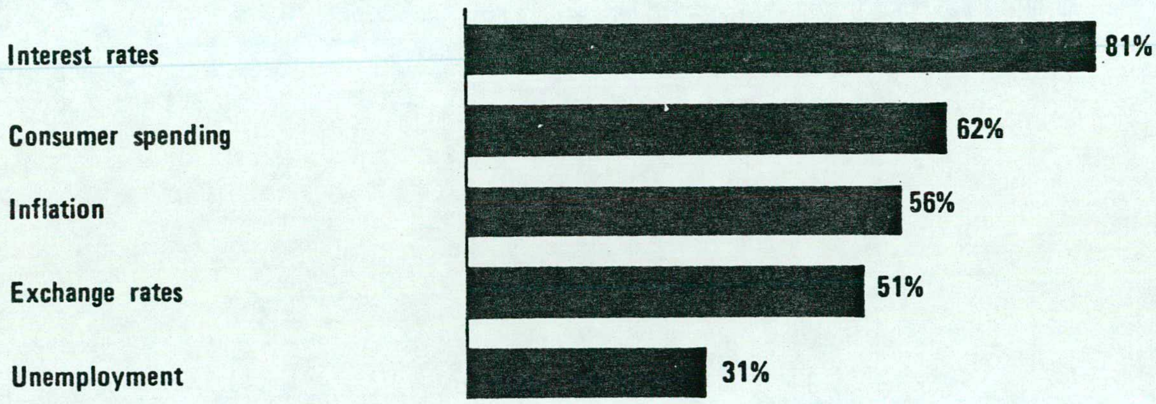


Base : All

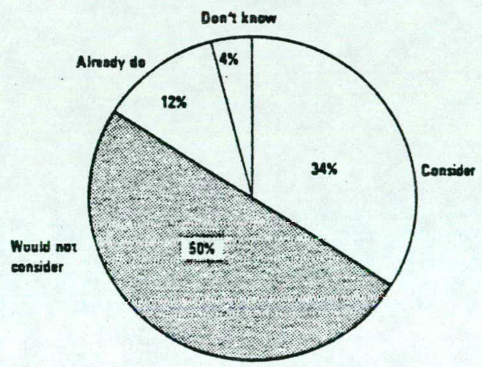
One of the suggestions that the Chancellor made in his speech on Tuesday was that companies could compensate for giving their employees lower wage rises by giving them a share in the profits of the company. Businessmen's reactions to this proposal are not positive, with half saying it would not be considered. However, one in ten do say that they already have such a policy.

Opinion is more equally divided over what the reaction of employees would be to such a scheme. As many believed they wouldn't be interested as said they would.

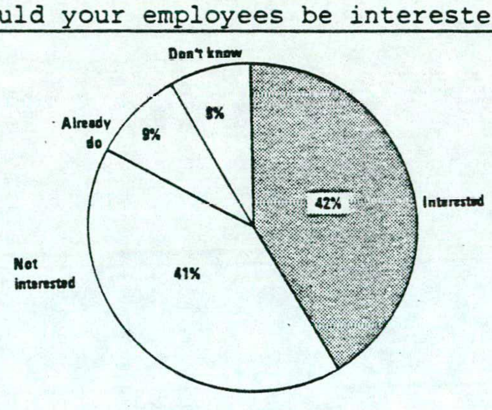
Q "The Chancellor has suggested that companies should reduce the level of wage increases and compensate for these lower increases by giving employees a share in the profits of their company. Do you think that this is something you might consider in your company or not?"

Q "And do you think that your employees would be interested in such a scheme, or not?"

Would you consider it.....?



Would your employees be interested......?

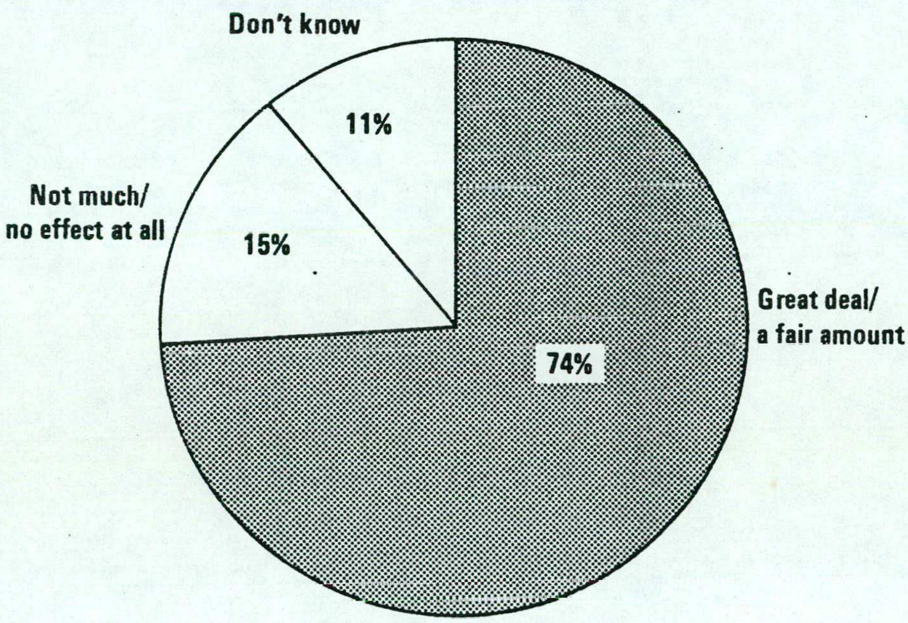


Base : All

The Chancellor abolished Capital Transfer Tax on lifetime gifts in his budget. One of the possible effects of this could be to ease the succession of family businesses. We asked businessmen whether they believed that this would result from the tax change.

The overwhelming majority of businessmen do believe that succession of family businesses will be made easier and few doubt the effectiveness of the measure.

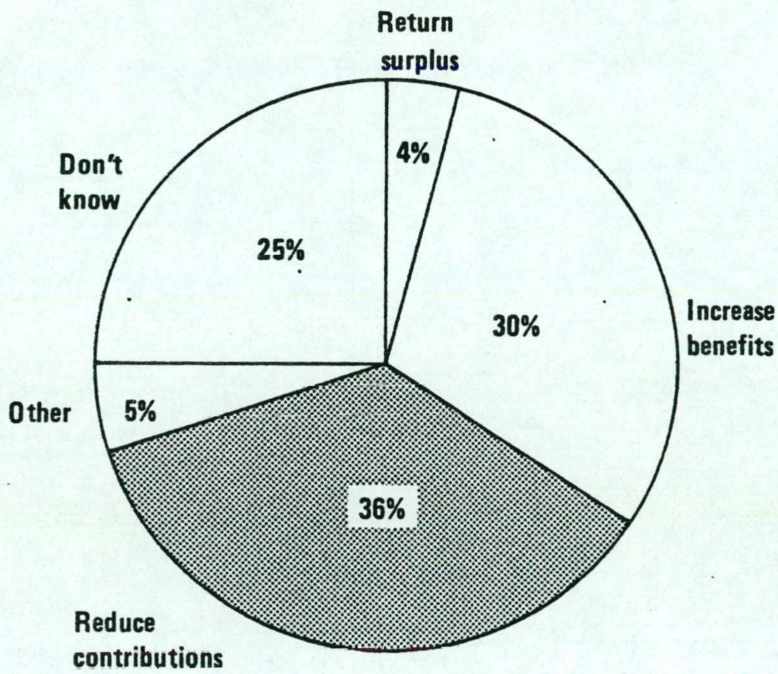
Q "How much effect do you think that the abolition of capital transfer tax on lifetime gifts will have on easing succession of family businesses. Will it have a great deal of effect, a fair amount of effect, not much effect or no effect at all?"



Base : All

A new tax that the Chancellor introduced was one of 40 per cent on pension fund surpluses if they are returned to the company. Few businessmen would be prepared to return any surplus and pay this tax, preferring instead to increase benefits under the scheme or reduce the contributions paid.

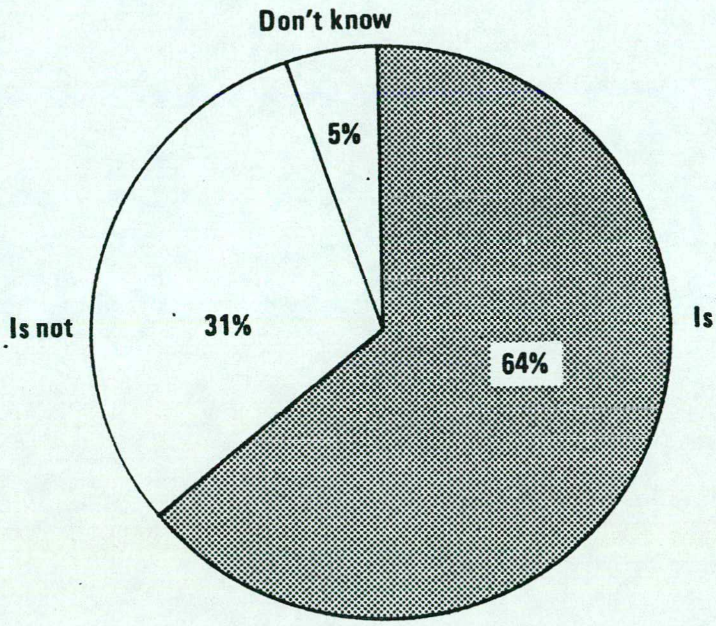
Q "Turning now to pension schemes. In the event that your pension scheme is overfunded, do you think you would return the surplus back to your company and pay the 40 per cent tax as proposed in the budget, would you increase the benefits under the scheme or would you reduce contributions?"



Base : All

The budget itself was well received by businessmen, but we wanted to see whether they felt the Government was actively helping businesses. The majority do feel that it is but as many as one in three do not feel that the Government is actively trying to tackle the problems that face their businesses today.

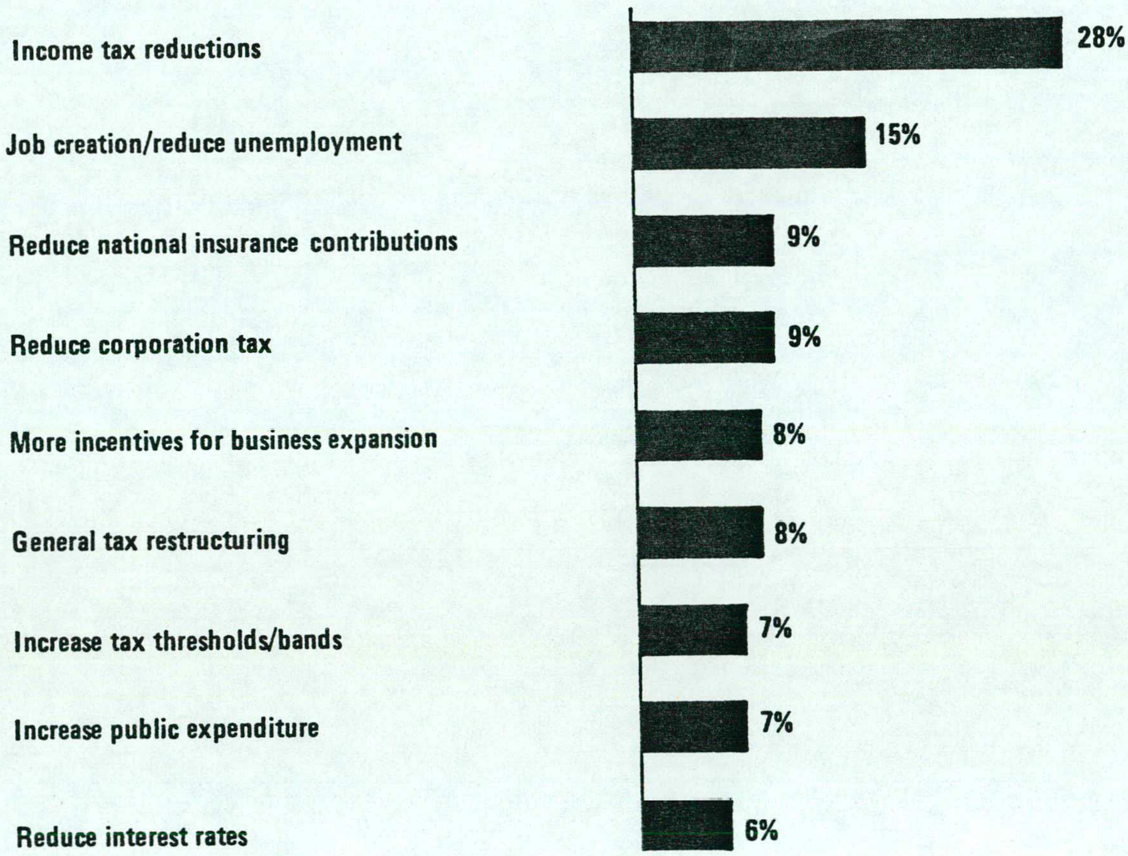
Q "Do you think that the Government is, or is not, actively trying to tackle the problems that face businesses today?"



Base : All

With this year's budget behind them, we asked businessmen what they hoped to see next year. The most favoured option was tax cuts followed some way behind by measures to reduce unemployment. Two other hopes were expressed by around one in ten, reduced national insurance contributions and reduced corporation tax.

Q "Finally, what would you like to see in next year's budget?"



(no other answers mentioned by more than 3%)

Base : All

58/ms

PM 58

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

David Norgrove Esq
10 Downing Street
Whitehall
London SW1A 2AB

7 April 1986

Dear David

THE BUDGET: What businessmen really think

The Chancellor thought the Prime Minister might be interested to see the attached survey of business opinion about the 1986 Budget. She may be particularly interested in the answers to the question on page 9 - what would you like to see in next year's Budget?

I am copying this to Andrew Lansley (Chancellor of the Duchy's office).

Yours ever
Rachel

RACHEL LOMAX

Enc

Sir Peter Lane

THE BUDGET

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BinderHamlyn
CHARTERED ACCOUNTANTS

THE BUDGET

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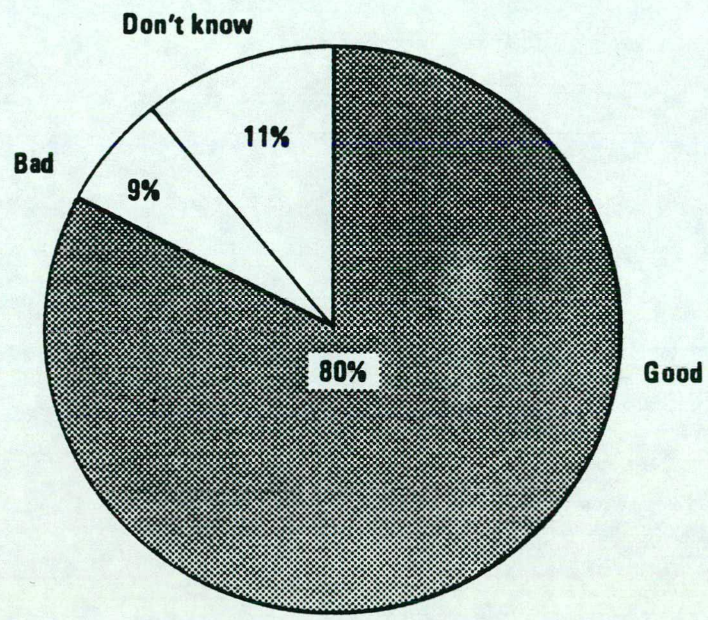

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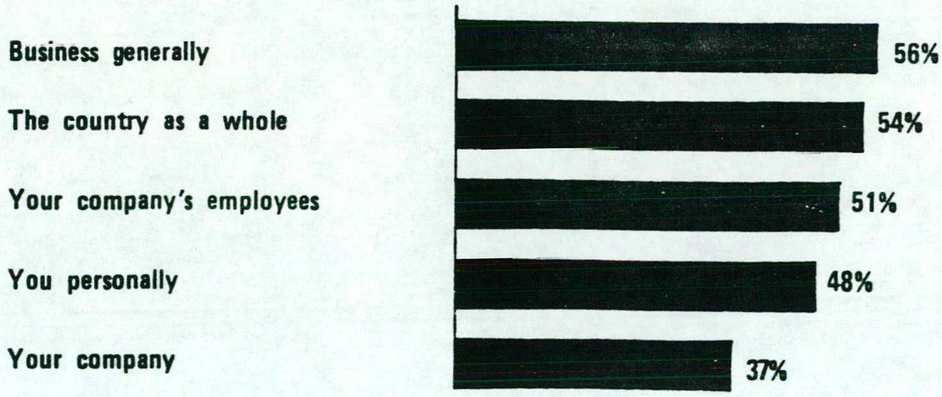

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The Effect of the Budget

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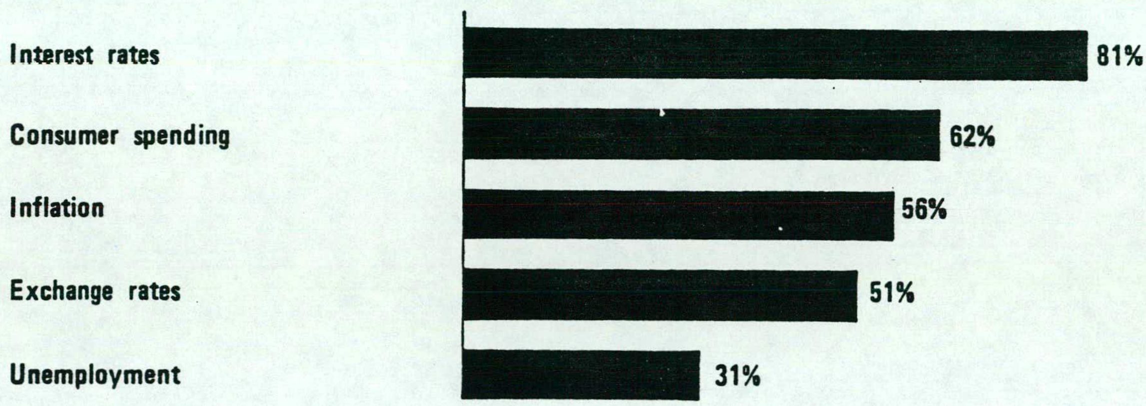

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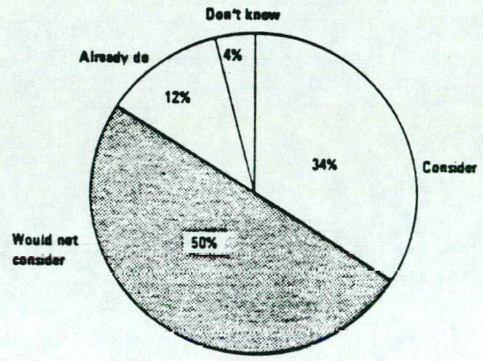
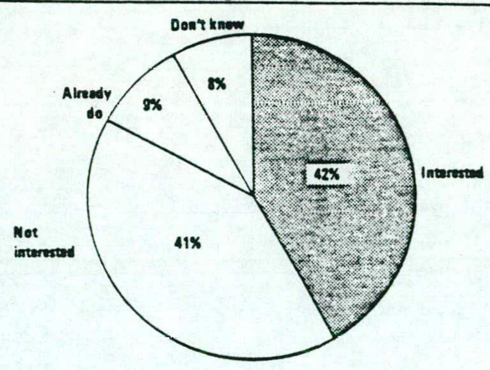


Would your employees be interested......?

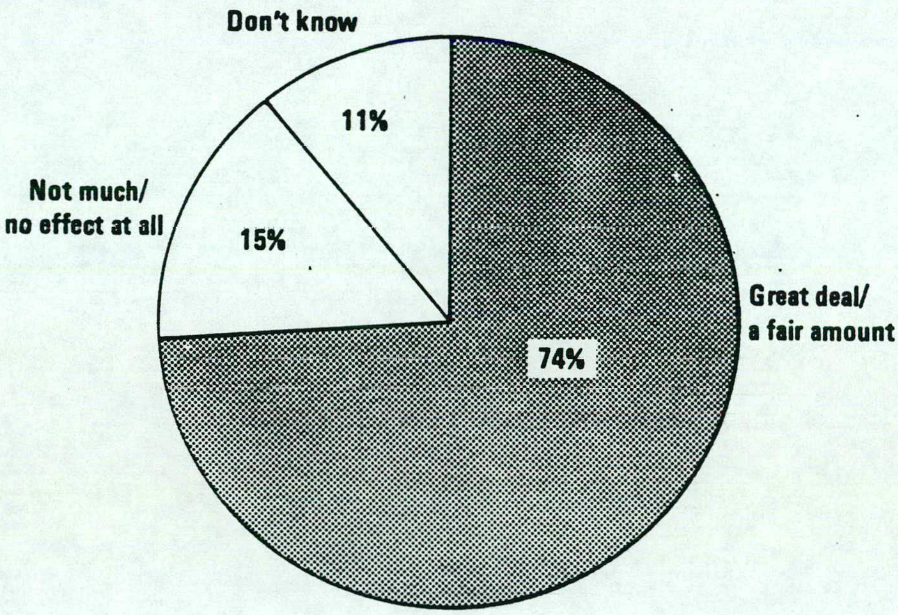


Base : All

The Chancellor abolished Capital Transfer Tax on lifetime gifts in his budget. One of the possible effects of this could be to ease the succession of family businesses. We asked businessmen whether they believed that this would result from the tax change.

The overwhelming majority of businessmen do believe that succession of family businesses will be made easier and few doubt the effectiveness of the measure.

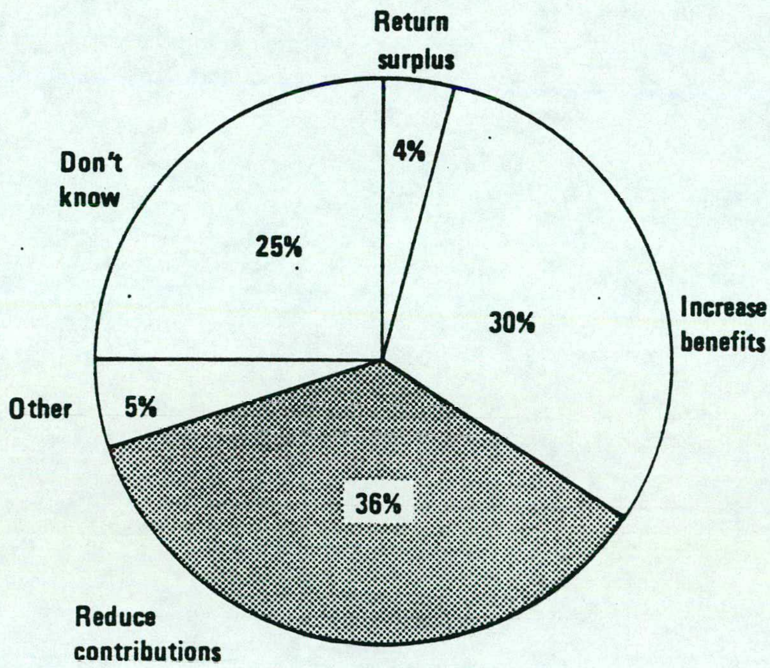
Q "How much effect do you think that the abolition of capital transfer tax on lifetime gifts will have on easing succession of family businesses. Will it have a great deal of effect, a fair amount of effect, not much effect or no effect at all?"



Base : All

A new tax that the Chancellor introduced was one of 40 per cent on pension fund surpluses if they are returned to the company. Few businessmen would be prepared to return any surplus and pay this tax, preferring instead to increase benefits under the scheme or reduce the contributions paid.

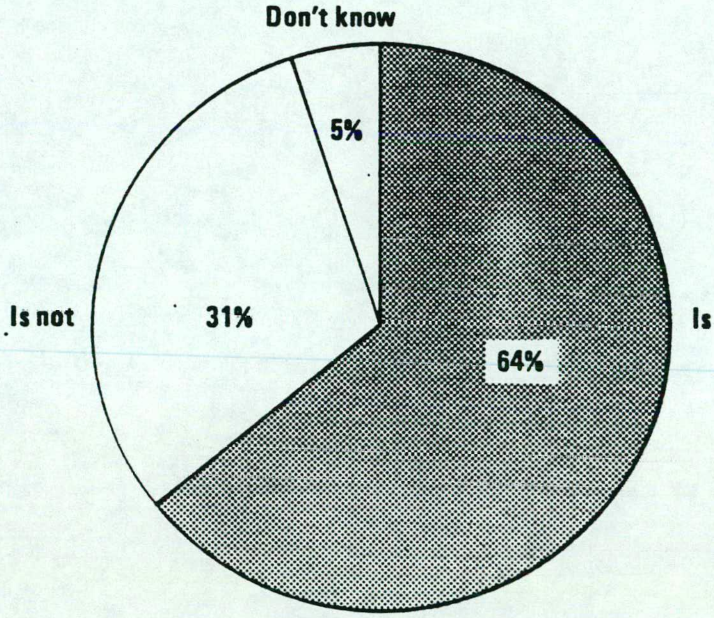
Q "Turning now to pension schemes. In the event that your pension scheme is overfunded, do you think you would return the surplus back to your company and pay the 40 per cent tax as proposed in the budget, would you increase the benefits under the scheme or would you reduce contributions?"



Base : All

The budget itself was well received by businessmen, but we wanted to see whether they felt the Government was actively helping businesses. The majority do feel that it is but as many as one in three do not feel that the Government is actively trying to tackle the problems that face their businesses today.

Q "Do you think that the Government is, or is not, actively trying to tackle the problems that face businesses today?"

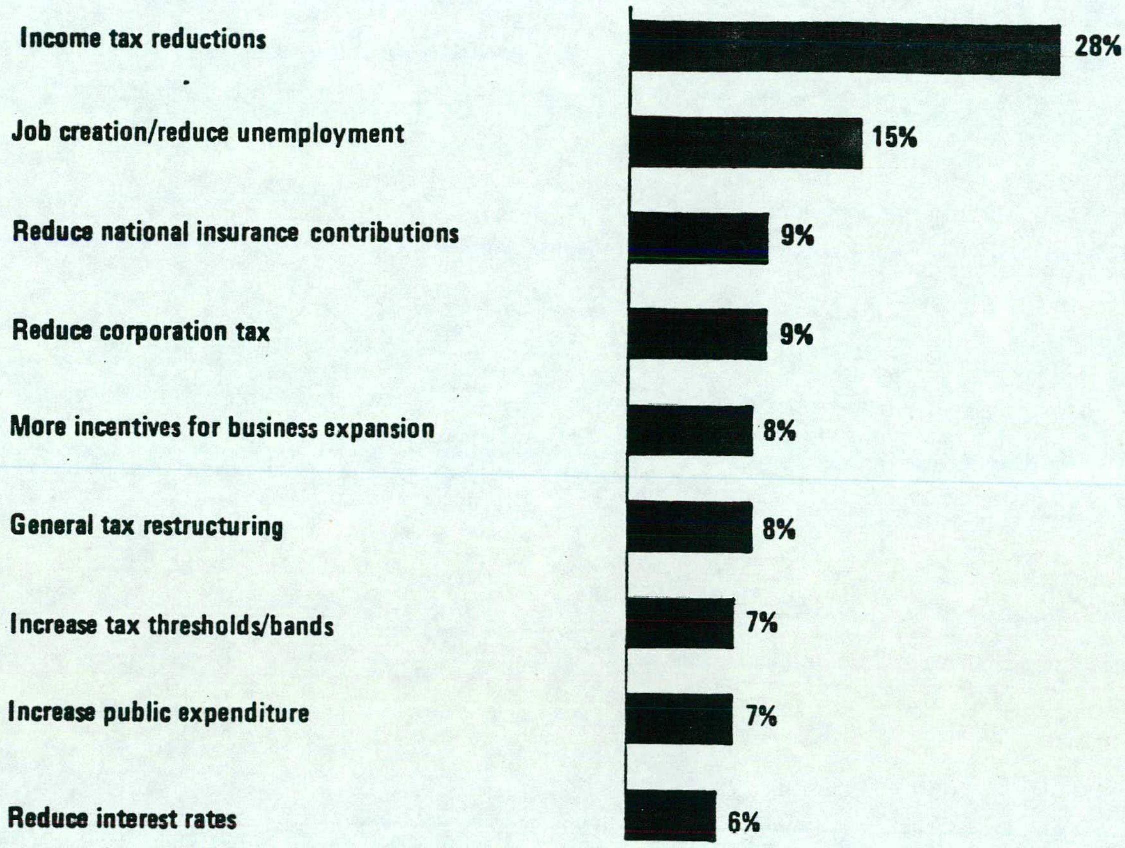


Base : All

Next Year's Budget

With this year's budget behind them, we asked businessmen what they hoped to see next year. The most favoured option was tax cuts followed some way behind by measures to reduce unemployment. Two other hopes were expressed by around one in ten, reduced national insurance contributions and reduced corporation tax.

Q "Finally, what would you like to see in next year's budget?"



(no other answers mentioned by more than 3%)

Base : All

RT8.69

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7 April 1986

J L G Lamotte Esq
Chairman
The Scotch Malt Whisky Society
The Vaults
87 Giles Street
Leith
Edinburgh
EH6 6BZ

Dear Mr Lamotte

The Chancellor has asked me to thank you for your letter of 19 March, and your kind comments about the Budget - and especially for the Longmorn Glenlivet, which is greatly appreciated.

Yours sincerely

A W Kuczys

A W KUCZYS
Private Secretary

10 DOWNING STREET

From the Private Secretary

14 April 1986

Dear Rachel,

THE BUDGET: WHAT BUSINESSMEN REALLY THINK

The Prime Minister read with great interest the survey of business opinion about the 1986 Budget which you sent me with your letter of 7 April.

I am copying this letter to Andrew Lansley (Chancellor of the Duchy's Office).

Yours

David

(DAVID NORGROVE)

CH/EXCHEQUER

REC. 15 APR 1986

ACTION

COPIES TO

Mrs. Rachel Lomax,
HM Treasury.

Spare

THE UNION OF INDEPENDENT COMPANIES

UIC

Please reply to:

21 South Terrace
London SW7 2TB

*DRAFT BY 23/4 PLEASE

CH/EXCHEQUER

REC.	17 APR 1986
	MISS SINCLAIR*
TO	CST, FST, EST, MST
	SIR P. MIDDLETON
	MR MONGER
	MR CROPPER

MR LORD
MR ROSS-GOOBEY
PS/IR
PS/C+E

National Information
Mitre House
44-46 Fleet Street
London EC4
01-583 9305 – 01-589 1945

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
Treasury Chambers
Whitehall
London SW1

15 April 1986

Dear Nigel

Please find enclosed the memorandum to you from Barry Baldwin, our National Chairman, following the detailed consideration by our National Executive of your Budget Statement. All of us in the UIC are enthused by the scope and application of your thinking in the area of independent firms.

I can assure you that we will make available a small team of specialists to Conservative members during the Committee stage of the Finance Bill when the particular clauses of specific interest to us are under examination. In this way we can assist in driving home the message to SMEs in the industrial sector that you and your colleagues are doing everything possible to encourage them and give them conditions which have done so much for our main international competitors.

Yours ever

Bill

WG Poeton
National President

Mr Hornsby

Advise, pl., in liaison with Revenue & IAE 3/who have not had a copy but who are in the lead on the loan guarantee scheme & who will have a view on SBDCs. – note deadline of 23 April

[illegible] 17/4

"To create an environment in which all who work in independent companies can thrive and prosper and make the maximum contribution to the national economy"

38

THE UNION OF INDEPENDENT COMPANIES

UIC

Please reply to:

21 South Terrace
London SW7 2TB

National Information
Mitre House
44-46 Fleet Street
London EC4
01-583 9305 – 01-589 1945

MEMORANDUM - 15 April 1986

To	The Chancellor of the Exchequer (Copies for information to Lord Young of Graffham, Mr John Moore and Mr David Trippier)
From	Barry Baldwin, National Chairman
Subject	1986 BUDGET STATEMENT Small and Medium Size Enterprises

We have been particularly encouraged by the number of your proposals which are fundamental to the increasing contribution to the UK economy which can be made by independent manufacturing and engineering enterprises.

1 Abolition of capital transfer tax on lifetime transfers of interests in independent companies.

2 Extension of the loan guarantee scheme for a further 3 years with a halving of the premium charged for the Government guarantee.

3 Exclusion from the Business Expansion Scheme of certain asset backed companies and those involved in wholesaling or retailing of goods of a kind which are collected or held as investments; together with the exemption from capital gains tax on the first disposal of BES shares.

In addition we welcome the following proposals:

4 Extension of VAT bad debt relief to two categories of formal insolvency.

5 Approval of employee share schemes in private companies which include a requirement for ex-employees to sell their shares on termination of employment.

However, we are concerned that certain areas of significant importance to our sector need to be addressed;

1 The lack of availability of long term patient money, particularly in amounts up to £100,000, which are increasingly of no interest to institutional investors in the view of the cost of assessing proposals and monitoring them subsequently.

2 The cash flow cost of investment monies in relation to the anticipated level of return which can be earned from industrial investment.

We urge you to consider the recommendations contained in our Budget submission to you in December 1985, designed to overcome these concerns.

1 (a) More effective targeting of BES monies to investment in companies engaged in manufacturing, engineering or research and development, particularly in amounts up to £100,000 maximum for each company.

(b) Introduction of Smaller Business Development Companies to channel institutional funds, including those of pension schemes, to independent industrial firms.

(c) Increase of the loan guarantee scheme ceiling to a maximum of £100,000.

2 Introduction of Smaller Business Development Bonds to reduce the cost of bank loan monies to independent industrial firms.

It is our considered opinion that much of the institutional assessment of investment opportunities in the UK is becoming increasingly medium to short term in its concept, with too much emphasis on anticipated capital gains. This is in stark contrast to the investment environment for smaller industrial enterprises which exists in West Germany and Japan and which we believe gives tremendous dynamism to the small and medium sized industrial sector in those countries.

We shall be pleased to discuss these matters of concern to us if this would be helpful to you or any of your ministerial colleagues

Barry Baldwin

CONFEDERATION OF SHIPBUILDING & ENGINEERING UNIONS

CSEU

140/142 Walworth Road
London SE 17 1JW
Tel. 01·703·2215

Gen. Secy: A. FERRY, M.B.E.

All communications must be addressed to the General Secretary

C/ To be aware
We are awaiting
reply
CR
24/4.

Our ref. AF/NLR

Your ref.

The reply must be no longer than the original letter.

The Rt.Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
11, Downing Street,
London, S.W.1.

21st April, 1986.

reply need be no longer than the original letter.

Dear Chancellor,

1986 Budget

Attached please find a copy of a letter which we have received from our Bristol District.

The sentiments of the letter have been endorsed by my Executive Council who would like your views on same.

Thanking you in anticipation.

Yours sincerely,

A. Ferry

General Secretary.

Peter ~~Stone~~ Shaw
C has seen
He has commented that reply need be no longer than original letter

Bc
HM TREASURY – MCU
RECD 24 APR 1986
IAE3
cc. APS/CHX
CHX.
18235/86

PLEASE CONFINE EACH LETTER TO ONE SUBJECT

The
CONFEDERATION
of
SHIPBUILDING
and
ENGINEERING
UNIONS

No.10 DISTRICT COMMITTEE

District Secretary
V. A. RYAN

Transport House
Victoria Street
Bristol BS1 6AY
Telephone 293001

Ref: VAR/GH/C.1.2.

24th March, 1986

Mr. A. Ferry,
General Secretary
C.S.E.U.
140-142 Walworth Road,
LONDON.
SE17 1JW

Dear Brother Ferry,

NO. 10 D.C. - Resolution
1986 BUDGET

At the meeting of the No. 10 D.C. which took place on Tuesday, 18th March, 1986, the following resolution was accepted and I have been asked by the Committee to forward to your office:

"This District Committee condemns the Government's budget proposals. We believe that this budget:

(1) Will not revitalise manufacturing industries
(2) Will not alleviate wide spread poverty
(3) Will not create jobs

We call on the Executive Council to continue to inform all members of the disastrous effects of this Government's economic policies and to continue to campaign for a change."

My Committee hopes that you will be able to extend, through your influence, an impact upon the Government Departments in respect of our concern over a budget which has failed miserably to provide any new real jobs.

Yours sincerely,

Vic Ryan

V. A. RYAN
Secretary
No. 10 District Committee

LP5.61

PWP

B/F with reply

FROM: CATHY RYDING
DATE: 25 April 1986

MR P SHAW

cc Mr T Davies (MCU)

LETTER FROM MR A FERRY
CONFEDERATION OF SHIPBUILDING AND ENGINEERING UNIONS

The Chancellor has seen a copy of Mr Ferry's letter to him of 21 April on the 1986 Budget which has been attached to you. He has commented that the reply need be no longer than the original letter.

C.R

CATHY RYDING