PART 16

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The 1986 Budget

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The 1987 Budget
(in folder attached: Financial Statement and Budget Report 1987/88)

ECONOMIC POLICY

PART 1: MAY 1979

PART 16: ~~DEC~~ MAY 1986

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PART 16 ends:-

Chancellor's Speech, Clause 20
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PART 17 begins:-

Office of PMG to DRN 2/10/87

# Published Papers

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

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HM Treasury
March 1987
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Signed _____ Date 15/7/2015

**PREM Records Team**

**CHANCELLOR'S SPEECH, CLAUSE 20**

It is wholly appropriate that we should start the Committee Stage of this year's Finance Bill with a Clause that goes to the heart of the difference between the parties in this House.

I might add that before the Budget I was urged by the Opposition not to cut income tax because the polls showed that nobody wanted lower taxes: after the Budget they accused me of indulging in a pre-election bribe.

Their concept of an unpopular bribe certainly shows that the political gutter the Labour Party inhabits is characterised not merely by its stench but by its total confusion: they manoeuvre like squid lost in their own ink.
If it is unpopular, then I can only say that this Government has consistently shown itself prepared to take whatever measures are necessary in the interests of the British economy, however unpopular they may be at the time.
If, on the other hand, it is popular, I can live with that.

By last year, we had reduced the basic rate of income tax - which is the marginal rate of tax for 95 per cent of all personal taxpayers and 90 per cent of unincorporated businesses and the self-employed - from the 33 per cent we inherited from Labour to 29 per cent. The question before the House today is whether it should be further reduced to 27 per cent - within two points of the objective set by my predecessor in 1979 of a basic rate of no more than 25p in the pound; an objective which, given the continuation of present policies, it should not take too long to achieve.
From a third to a quarter.
We on this side of the House are in no doubt.
The basic rate of tax <u>should</u> now come down to 27 per cent.
The Labour Party, the Liberal Party and the SDP are equally adamant that income tax should <u>not</u> be reduced, and are committed to voting against it.
The difference could not be plainer.
Nor is it any accident.

For the Conservative Party is the only Party committed to reducing the burden of taxation as and when it is prudent to do so.
And that is precisely what we have done.

While the Opposition parties are in the business of increasing the burden of taxation - as every Labour Government there has ever been has clearly demonstrated.
It is, of course, true that when we first took office in 1979 we inherited a massive and unsustainable level of public borrowing which had to be brought under control if there was to be any prospect of bringing down inflation, to which we were committed.
And this initially involved, as we clearly explained at the time, a temporary increase in the burden of taxation.
But that phase was already over by the time we secured the overwhelming endorsement of the British people in the General Election of 1983; and since then the path of taxation has been steadily downward.

As a result, the basic rate of tax is now sixpence in the pound lower than the rate we inherited from Labour, the lowest it has been since before the War. At the same time, personal allowances are now 22 per cent higher in real terms than in 1978-79, and the married man's allowance is at its highest level since the War.

As a result, 1.4 million people have been taken out of income tax altogether, and tax thresholds in the UK are now around the international average.
The overall burden of income tax is some £12 billion lower than it would have been if we had kept Labour's tax regime and adjusted it for inflation.

The benefits of these tax reductions have been felt at all levels of income.
The percentage of earnings taken in income tax and national insurance contributions is lower in all cases than if we had simply indexed the Labour regime.
And real take-home pay - which also, of course, takes account of the effect of changes in indirect taxation - is higher at all income levels.

This is in stark contrast to Labour's record in office.
Single people at all levels were worse off in 1978-79 than at the start of Labour's spell in office.
Under this Government, their real take-home pay is up by a fifth or more.
Or take the married man on average earnings.
Those without children were also worse off in 1978-79 than in 1973-74.
Those with children did better, it is true, and I shall quote the figures, because it is important that the House appreciates those cases where the Labour Government did actually see an increase in living standards.
The married man on average earnings with two children saw his real take-home pay go up by a half of one per cent.
Under this Government, it is up by more than 21 per cent.

I should like to take just one more specific example, because it is of some topical interest, and concerns a group whom the Opposition like to pretend have been victimised by this Government.
After the pay award announced last week, a typical nurse will have seen her real take-home pay rise by no less than 42.4 per cent since 1978-79.
If she is married to a typical teacher, their combined take-home pay will also have risen by more than 40 per cent; under Labour it rose by a mere 4 per cent.

And the effect of this year's Budget alone is to increase the take-home pay of a married man on average earnings by almost £4 a week - quite apart from any further benefit he may secure from the reduction in mortgage rates that comes into effect later this week.

The British people know all this.
They know how much better off they are than they were under Labour.
That is why they will not be taken in for one moment by the desperate black propaganda relaunched by the Labour Party this week.
[Refer to Kinnock letter]

The British people know that it is the Labour Party, with its massive public expenditure pledges to finance, that would increase the burden of taxation once again.
They know that, to pay for its £34 billion public spending programme - an extra £34 billion over and above current levels of expenditure - would require either a doubling of the basic rates of income tax or more than trebling the standard rate of VAT.

And on the subject of VAT let me say this.

My Rt. Hon. Friend the Prime Minister made it clear as far back as 1984 that we have no intention of extending VAT to food.
Beyond that, the incidence of taxation has to be determined in the light of the budgetary needs at the time, and no responsible Government could conceivably take any other position.
But what is abundantly clear is that it is the Labour party which is in business to put taxes up, and the Conservative party which is in business to bring taxes down; no amount of scaremongering can obscure that basic fact.

And as this year's Budget Red Book clearly shows - and I refer the House to Table 2.6 - the prospects on the basis of present policies are of a steady further reduction in taxation in the years ahead.

The gulf between the parties on the issue of tax is in part a profound difference of political philosophy.

We believe that what people earn and save belongs to them, and that the State should take from them only what is necessary to discharge the functions that only the State can perform, leaving people free to make their own choices and pursue their own destiny.

They believe that all resources belong to the State, that all important decisions should be taken by the State, and that people should be 'given' - that is the word they use - whatever pocket money is needed to keep them quiet.

But the gulf between the Parties is also at the heart of the difference between the two sides of this House over the conduct of economic policy.

Rt Hon and Hon Members opposite start from the proposition that the cure for any economic problem lies in State intervention, which inevitably implies ever-increasing State spending and ever-increasing taxation to pay for that spending.

The policy of this Government is clear, and distinct.
As the dismal experience of the 'seventies demonstrates beyond any reasonable doubt, the crucial role of fiscal and monetary policy must be to control and conquer inflation.
Within that framework, improved economic performance depends on the success of individual enterprise.
And this requires Government resolutely to pursue a whole range of policies designed to remove the impediments to that enterprise - through deregulation, through privatisation, and through reducing the burden of taxation.
This prescription is now accepted throughout the world.
All major countries have now embarked on policies of deregulation.
Most have embarked on programmes of privatisation, openly acknowledging the lead given by the United Kingdom.
And as for the burden of taxation, all of the other members of the Group of Five have either cut their income tax rates, or have announced plans to do so.
So has Sweden, which has traditionally been a high tax country; so have Australia and New Zealand, and, among the developing countries, India, all of which have socialist governments.
On this as on so many issues, it is the Opposition parties in this House who are out of step, and out of touch.

Everyone else knows that the only route to higher living standards and more jobs is through a more dynamic economy; and that the only route to a more dynamic economy is through lower tax rates.
It is no accident that the two most successful economies in the Group of Five, and the two with the lowest levels of unemployment, the United States and Japan, are the two with the lowest burden of public spending and taxation.

Moreover, the dynamic affect of reductions in taxation can often mean not lower but higher revenues, thus leading to the scope for still further reductions in taxation.

Inheritance tax is expected this year to yield almost 50 per cent more in real terms than Capital Transfer Tax did in 1978-79.
The yield of Capital Gains Tax is forecast to be 80 per cent higher in real terms, and Stamp Duty up by 140 per cent.
As for Income Tax, the higher rates, applying in 1987-88 are, of course, much lower than the absurd penal rates which Labour had.
But they are expected to yield 90 per cent more in real terms, and the top 5 per cent of taxpayers now contribute 28 per cent of income tax, compared to 24 per cent in Labour's last year.

And the greatly increased yield of Corporation Tax, reflecting greatly increased company profitability is clearly connected with the reform of Corporate Taxation I introduced in 1984, which brought the rate of tax on company profits in this country to the lowest in the industrialised world.

There is, as I have said, a profound difference between the two sides of the House over economic policy, of which tax policy is an integral part.

And the policies we have been pursuing have been abundantly vindicated by the results they have brought.

It is no accident that, this year, I have been able to reduce taxes by £2½ billion and to increase public spending on priority areas by £4¾ billion, while reducing public borrowing below its previously planned level by some £3 illion.

For the Opposition to claim that they would have used the money differently is beside the point. For with their policies, it would never have been there in the first place.

For as a result of <u>our</u> policies, the economy today is sounder than it has been at any time since the War - a fact increasingly recognised throughout the world.
Of course, there is always scope for further improvement: that has always been so and will always be so, in every country in the world.

Indeed, at the present time it is in the rest of the world where the biggest problems lie, as the United States and Japan, in particular, struggle to adjust successfully to the massive but necessary change that has occurred over the past two years in the $/yen exchange rate.

It is of the first importance to all of us that these two powerful nations pull back from the blind alley of a trade war and instead concentrate on measures to put their own houses in order, which in time will underpin, as is highly desirable, the present world pattern of exhange rates.

Meanwhile, the British economy is indeed, as the headline of the leading article in today's Financial Times describes us, "an island of success".

I described some of that success story in my Budget speech last month.

How our growth this year will be the highest in the industrialised world, with inflation remaining low.

How by the end of this year we will have registered the longest period of steady growth, at close to 3 per cent a year, that the British economy has known since the War.

I described the massive strength of our external position, while at home unemployment was now finally on a downward trend.

And all this, I have to say, was on the basis of deliberately cautious forecasts.

I shall not be publishing a further forecast until the Autumn, in the usual way.

But all the indicators that have been published since the Budget confirm that, if anything, we are doing even better than I suggested then.

The PSBR for 1986-87 has come out lower than I forecast in the Budget.

Inflation, too, is lower than I suggested in the Budget.
The current account of the balance of payments is also performing better, so far, than I predicted.

And output appears to be rising if anything rather faster.

This is fully reflected in the CBI's quarterly industrial trends survey, published yesterday, which is of course confined to manufacturing industry, about which the Opposition always profess particular concern.

All in all, this survey shows manufacturing industry's optimism to be at or near the highest level ever recorded, whether in respect of output, exports, orders or investment.

And of course this was before the further cut in interest rates yesterday, which I am sure the whole House will welcome.

These are the fruits of the policies we have been consistently pursuing since we first took office.

When he rises to speak, the Hon Member for Dagenham will, I have no doubt, paint a different picture - one of doom and despair, depression and disaster.

Certainly, I hope he does.

Because the more that Rt Hon and Hon Members opposite do this, the more the shattered credibility of the Labour Party further deminishes.

For all it does is to demonstrate in the clearest possible way that they are wholly out of touch with what is happening in the real world.

**Conclusion**

Mr Deputy Speaker, for the Opposition to criticise us for having increased taxation in 1979-81 when we were clearing up the mess they left behind is not merely an impertinence: it is satan denouncing sin, coming from a party which is itself implicitly committed to a massive further increase in the tax burden on ordinary people.

The only 27 per cent Labour ever knew was 27 per cent inflation - and if they were ever to regain office that is what we would see again.

No wonder they have committed themselves to reversing the 2p cut in income tax in the Budget: they hope that this lesser offence will divert attention from the fact that to finance their overall spending plans they would have to double the basic rate of income tax.

As for the Liberals and the SDP, and it would be wrong to forget them, they say that they will vote against the 2p reduction in income tax but don't know whether, if they were ever to be in a position to influence events, they would reverse it or not.

Their confusion on income tax parallels their confusion on every other aspect of economic policy - not to say more widely.

The whole world now recognises that our policies have created an economy that is stronger than at any time since the War.

The policies of the Opposition would destroy that strength.

An integral part of our policy has been the reduction of income tax, and Clause 20 is a further step forward.

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

I would remind the House of the precise words used by my predecessor in 1979, which I have reaffirmed before and reaffirm today: our long-term objective is a basic rate of no more than 25 per cent.

We do not pursue policies to meet arbitrary targets, and then sit back.

We pursue them because they are right, and because they work, and we shall continue to do so.

The contrast with the Opposition could not be greater.

We believe in building on success; they believe in a return to the failures of the past.

We believe in incentives for success; they believe in penalising those who succeed.

We believe in a free economy and a free society; they believe in State planning and State regulation.

The vote at the end of this debate will establish, once and for all, which Party is the party of lower taxation, and which Parties are the parties of higher taxation.

I commend Clause 20 to the House.

Secret

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PM Copy.

Prime Minister

to Keep.

1988 Budget

N.L.W

I have been given, privately, an outline of the Chancellor's present thinking about the 1988 Budget. This is of course still at a very early stage.

The main elements are:

- a reduction in the basic rate of tax from 27p to 25p;
- unification of all the higher rates of tax on 40p or perhaps 35p;
- abolition of the upper earnings limit (UEL) for NIC;
- help for those in the lower reaches of NIC payments, perhaps by raising the lower earnings limit or in some other way;
- capital gains tax to be paid at the same rate as income marginal tax;
- possibly outstanding capital gains tax liabilities to between 1965 and 1982 to be written off, though this is very expensive (as much as £3/4 billion);

- Overall, the Chancellor is contemplating a package of around £4 billion at this stage.

One of the difficulties still being discussed intensively is that with this package there would be around ½ million losers in a band above the upper earnings limit (£295).

There are indications that the Chancellor may look for some targetted measures to help pensioners. He is not at present planning any changes in the tax treatment of pension fund income.

Options for changing the tax treatment of husband and wife are being discussed. Transferable allowances have been ruled out. One possibility is some kind of separate taxation with a system for clawing back the married man's allowance for those on the higher rate of tax.

It is not easy to judge how attractive much of this is without costs, distributional analysis etc. But there are some useful-sounding ideas.

If you have strong feelings for or against any of this perhaps you could let me know and I will feed your reactions back very discreetly.

(The Chancellor of course knows nothing of my snooping.)

DLW
4/9.

NBPM.

cc: Chief Whip

**MR NORGROVE**

The Prime Minister this afternoon asked me to dig out my minute on Budget Presentation. I attach 2 copies.

1 destroyed. 20-3-87
G

**BERNARD INGHAM**

**17 March 1987**

c: Mr Wicks

1. MR NORGROVE
2. PRIME MINISTER

BUDGET PRESENTATION

I was struck today by the intro to the attached cutting from today's FT and its link with a briefing I had from Young and Rubicam last night on their latest research.

It seems obvious that in a potential election year, a prudent Chancellor would seek to combine lower taxes with lower borrowing (and lower interest rates), and that if he could do so the Opposition parties would have an uphill task.

What is already clear is that the Labour Party has an uphill task anyway. The steepness of its climb is related to the performance of the SDP/Lib Alliance which is now felt to have repackaged itself rather well.

Budget presentation therefore needs to have as one of its aims the neutralising of the SDP/Lib appeal which owes something to the so-called "liberal conscience".

This could best be done by a four pronged approach to Budget presentation, on the assumption that the Budget facts permit it:

1. The Government's prudent management of the economy over the last 8 years has produced six continuous years of growth, a resurgence of the economy, more jobs and at last a falling trend in unemployment.

2. This has been partly brought about by tax cuts which have encouraged enterprise, hard work etc. Consequently, I propose to reinforce this healthy development by a further modestly prudent reduction of Xp.

3. I could of course have cut taxes more because I have the spare cash to do so, but prudence requires a balanced approach. It is therefore right that I should use part of those resources to reduce borrowing and so help to lower the cost of interest rates to industry and home buyers, among others.

4. But there are other claims on available money - not the least of which are health, education and the social services. And here I want to make clear that the money to reduce taxes and borrowing is available, thanks to prudent management, over and above what we have already allocated to higher spending on these social priorities. This higher spending is not just taking place now in an election year; it has occurred in each of the last X years; and it will continue in the years immediately ahead as our published public expenditure plans show.

In other words, the prudent management of Britain's finances over the last 8 years is paying a treble dividend:

- in lower taxes
- in lower borrowing
- in higher spending on social priorities.

That's what a Conservative Government has been about in the 1980s. It is what a Conservative Government is about as we approach the 1990s. And it is what a Conservative Government intends to continue to be about as we approach the next century.

Such a presentation would accord with the advice coming from Young & Rubicam who are adamant that the Government needs to demonstrate that it is devoting <u>some</u> of the extra resources to social principles not merely now, but intends to go on doing so in the future - as its plans indicate.

**BERNARD INGHAM**
**<u>6 February 1987</u>**

FT 6/2/87



**Philip Stephens** examines the options facing the Chancellor in what looks like being an election year

# Lawson prepares Budget of sweeteners and surprises

LOWER TAXES, lower borrowing and lower interest rates are the enviable prospect that Mr Nigel Lawson, the Chancellor, sees within his grasp as he prepares for what seems almost certain to be the last Budget before a general election.

Behind the pre-Budget secrecy surrounding the Treasury it is impossible to miss the air of optimism among the Chancellor's advisers. The talk is of an "exciting" Budget, of "surprises" on March 17.

Mr Lawson's attempts to downplay expectations have had no impact in Whitehall. There is growing confidence that he will find £3bn or £4bn to split between income tax cuts, other electoral sweeteners and, with an eye on financial markets, a cut in borrowing.

"Barring a sterling crisis he will be able to be both generous and prudent. The timing is perfect," is how one insider puts it.

The final judgment of the size of the "fiscal adjustment" (the amount of cash the Chancellor has available to reduce taxes or public borrowing or a combination of both) will not be made until perhaps the beginning of next month. Last year Mr Lawson waited until 10 days before the Budget before deciding that he could afford to cut the basic rate of tax by 1p.

It is already obvious, however, that revenues from value added and corporate taxes are running far ahead of the Treasury's previous forecasts. The tax windfall—generated by the current consumer spending boom and high company profitability—was acknowledged in last November's Autumn Statement when the Treasury raised its forecast of non-oil revenues in 1986-87 by £2bn.

At that time the Treasury's internal forecasts were already pointing to a substantial fiscal adjustment, perhaps of about £2bn, even after the Government had added nearly £5bn to its public spending target for 1987-88.

**There is growing confidence that up to £4bn will be found for tax cuts**

Since then, the pace of increase in non-oil revenues has further accelerated and the Treasury expects to undershoot its £7bn target for the public sector borrowing requirement (PSBR) in this financial year.

The rise in the oil price to about $18 a barrel has provided another unexpected windfall and will allow Mr Lawson to project a price of perhaps $15 or $16 a barrel for the next financial year while still appearing cautious.

Nigel Lawson: optimistic

Finally, the likely undershoot in the PSBR has allowed Treasury officials to begin bringing forward some of the public spending which would normally fall in 1987-88 into the current year.

The decision facing Mr Lawson is how he should best use the fiscal adjustment, both in terms of maximising the Government's popularity and of ensuring that the Budget gets a vote of confidence from financial markets.

Some of the Treasury's most senior economists believe that—in the abstract — the best strategy would be to use most of the cash available to reduce next year's PSBR even further.

The argument is that the economy is growing strongly so no stimulus is needed from tax cuts. By giving an added stimulus to the consumer boom, lower taxes might also exacerbate Britain's widening trade gap, as imports account for a disproportionate share of retail sales.

A substantially lower PSBR would pave the way for lower interest rates, thus boosting prospects for investment and for more balanced growth in the economy. It might also allow a continued depreciation in the pound's value, strengthening the prospects for exports.

With an election looming, however, there are few illusions in Whitehall that Mr Lawson will opt for such a course. What does seem increasingly plausible is that he will seek the best of both worlds.

On present arithmetic the Chancellor may well be able to reduce income taxes by more than £2bn—perhaps by cutting the basic rate by 2p to 27p—and to reduce his planned borrowing target by about £1bn to £6bn.

That apparent combination of prudence and generosity might be enough for a cut in interest rates and lower mortgage rates. The latter would provide a welcome brake on the pace of increases in retail price inflation at a time when it is likely to be heading for 5 per cent.

Of course, lower taxes may not be confined to reductions in the basic rate. Mr Lawson could seek to demonstrate the Conservative Party's commitment to the lower-paid by announcing a significant increase in income tax thresholds.

The Chancellor—again with an eye on the inflation rate and votes — could also decide against raising excise duties on tobacco, petrol and alcohol by enough to take account of past inflation.

Another relatively inexpensive option would be to cut the top rates of tax, although the Prime Minister has indicated that electoral considerations point more towards doing something for the lower paid. In that context an increase in the ceiling for the special lower-rate band of employees' National Insurance contributions might be an attractive option.

The logic of Mr Lawson's past policies would dictate the removal of stamp duty on share transactions, but what would be seen as a £1bn handout to the City would almost certainly be out of tune with Mrs Thatcher's political antennae.

The Chancellor, who is temperamentally a juggler and always anxious to spring surprises, will also be looking for taxes to reform or perhaps to abolish. The increasingly complex capital [illegible]

prove a worthwhile candidate if some of its revenue can be diverted elsewhere.

Plans for the introduction of tax incentives for profit-related pay have got a lukewarm reception both within the Treasury machine and from many industrialists.

Mr Lawson, though, may well feel that he has invested too much political capital in the idea to drop the idea of even a modest move in the direction of profit-related pay.

This comfortable scenario, in which the Chancellor can afford to do most of the things he wants to do, is not, of course,

**Revenues from value added and corporate taxes are running ahead of forecasts**

immune to outside shocks. The pound still looks vulnerable on foreign exchange markets and another run on the currency could well force him to follow the advice of officials and drastically cut the PSBR target.

Barring a sterling crisis, though, Mr Lawson's fourth Budget looks to be the one where he will have all the pre-election opportunities he could hope for—and, of course, no ex-

NB: THIS TRANSCRIPT WAS TYPED FROM A TELEDIPHONE RECORDING AND NOT COPIED FROM AN ORIGINAL SCRIPT: BECAUSE OF THE POSSIBILITY OF MIS-HEARING AND THE DIFFICULTY, IN SOME CASES, OF IDENTIFYING INDIVIDUAL SPEAKERS, THE BBC CANNOT VOUCH FOR ITS ACCURACY.

BUDGET BROADCAST
by
THE CHANCELLOR OF THE EXCHEQUER

RECORDED FROM TRANSMISSION: BBC-1 at 2130 DATE: Tuesday, 17th March,'87

THE RT.HON.NIGEL LAWSON,MP (Chancellor of the Exchequer): One of the things that always surprises visitors to Britain is our strange attitude to success. It's almost as if we thought it was bad manners to admit we've done well in anything. Certainly it's true about the British economy.

We find it hard to accept that whereas less than ten years ago we were one of the weakest of the industrial nations, today we're one of the strongest.

Anyone would think our recovery was something to be ashamed of; some kind of dark secret. But like so many secrets these days it's finally found its way into the newspapers. Just about every recent survey, whether by British industry or by independent experts, finds that our economy is sound and strong and that our prespects are better than they've been for a generation.

Perhaps the clearest way to see Britain's transformation over these past eight years after decades of relative failure is to look at the economic growth in the leading European countries.

As you can see, during the sixties we were bottom of the league. Again, during the seventies, we were still bottom. But in the eighties, we've been right at the top of the league -- the fastest growing economy of all our main European rivals. And if you look at our national output over the years you can see just why.

After all the stops and starts of the seventies, when we seemed always to be lurching from one crisis to the next, we've at last had six successive years of steady growth, taking us far beyond anything we've achieved before. And this has meant higher living standards for pretty well everyone.

Over the past eight years, the take-home-pay of a man on average earnings has gone up by almost twenty percent more than the cost of living. Compare that with what happened when we last had a Labour government. In those five years, the real take-home-pay of the man on average earnings didn't go up at all -- in fact he was worse off at the end of the Labour government than he was at the beginning.

But the key to getting the British economy right has been the battle against inflation. There was that terrible peak under the Labour government in 1975, and it was rising again when we took over in 1979. Since then, we've brought it down to around four percent. And that combination of falling inflation with rising output is a blessing that Britain hasn't enjoyed at least twenty years. But there's one yardstick that's even more significant,at least as a pointer to the future. The curse of Britain's manufacturing industry throughout the sixties and seventies was low productivity. Our competitors were able fb

to produce more goods than we could with the same number of people.

During the sixties, we were bottom of the productivity league. And during the seventies, we were still bottom. But now, in the eighties, we're right at the top of the league. And if our productivity is growing faster than our rivals' then that's great news for the years to come.

Of course the toughest problem for Britain and, indeed, for most other industrial countries is unemployment. That's because so many more people have been entering the job market. It isn't because new jobs aren't being created; they are. Indeed, jobs are another of Britain's growth areas. Since 1983 France has lost almost a-quarter-of-a-million jobs. Italy has gained almost a-quarter-of-a-million jobs, and West Germany has created half-a-million jobs. But here, in Britain, we now have a million more jobs than we had in 1983 -- a net gain of a million jobs more than in all the others put together. And unemployment is now firmly on the way down.

So that's the background to today's Budget. It's not just the result of one good year; it's the reward of eight years of steady policies by the government coupled with the tremendous energy and enterprise of the British people when they're allowed and encouraged to give of their best.

But there's a lot still to do, and today's measures will help us further along the road. In my Budget today, I've once again been able to cut income tax -- this time by t'pence in the pound which will increase the take-home-pay of a man on average earnings by more than three pounds a week. And I've done so without putting any extra tax at all on petrol, beer or tobacco.

In the years ahead, I want to get income tax lower still, because that's the only way to provide real incentives and to stimulate enterprise. And that in turn is the only practical route to an economy that can afford the better public services we all want to see. And above all, to more jobs.

A lot of the new jobs will be in small businesses, and that's why I've also made a number of changes to help small businessmen and business-women specially with VAT. And I've annoucned a brand new tax relief for those whose pay is directly linked to the profit their company makes. This could easily be worth the same as an extra penny off income tax to the employees concerned. And it will give people a greater personal interest in the success of the firms where they work. And it should also mean that companies will lay fewer people off when profits fall and take more people on when profits rise. And again, I've introduced a tax relief for personal pensions which is a way of giving everyone the opportunity to make their own pension arrangements independent of their employers. And all these tax reductions come on top of the the substantial extra spending on health, on education, and on other priority services which I announced last November. All these measures are things we wanted to do for a long time, but they're only possible now because of the solid base and growing strength of Britain's economy. And we have to advance sensibly because there's always the unforeseen. If we hadn't had this firm base, then the coal strike in 1984 and 1985, or the collapse of our oil revenues in 1986 could have knocked us right off course. In fact we were strong enough to ride out both those storms. And we're now enjoying the sort of success we haven't known since the war. But we can't relax or let up. It's taken

eight long years to get ourselves into this enviable position. It would be all too easy to chuck it away and return to the high spending, high borrowing binges of the sixties and the seventies, and eight years of hard fought gains would all be thrown away. But if we stick to the steady sound policies of the past eight years, then we can all look forward to a new era of security and prosperity and of pride in the achievement of our country.

END OF BROADCAST.

fb

# RESOLUTIONS TO BE MOVED BY THE CHANCELLOR OF THE EXCHEQUER

**17th MARCH 1987**

Mr Chancellor of the Exchequer

PROVISIONAL COLLECTION OF TAXES: That, pursuant to section 5 of the Provisional Collection of Taxes Act 1968, provisional statutory effect shall be given to the following Motions:—

(a) Unleaded petrol (Motion No. 2); and

(b) Vehicles excise duty (farmers' goods vehicles) (Motion No. 3).



## ARRANGEMENT OF WAYS AND MEANS RESOLUTIONS

1. Amendment of the law.
2. Unleaded petrol.
3. Vehicles excise duty (farmers' goods vehicles).
4. Vehicles excise duty (recovery vehicles).
5. Vehicles excise duty (trade licences).
6. Abolition of general betting duty on on-course bets.
7. Gaming machine licence duty (rates).
8. Gaming machine licence duty (exemptions etc.).
9. Value added tax (credit for input tax).
10. Value added tax (supplies to groups).
11. Value added tax (valuation).
12. Value added tax (issue of securities).
13. Value added tax (supplies received from abroad).
14. Value added tax (tour operators).
15. Value added tax (transfers from the United Kingdom).
16. Value added tax (registration etc.).
17. Income tax (charge and rates for 1987–88).
18. Income tax (indexed personal reliefs etc.): operative date for PAYE.
19. Increased personal relief for those aged eighty and over.
20. Increased relief for blind persons.
21. Relief for interest (limit for 1987–88).
22. Corporation tax (charge and rate for financial year 1987).
23. Corporation tax (small companies).
24. Companies' chargeable gains.
25. Charities.
26. Registered friendly societies.
27. Annuities, etc.
28. Retirement benefits schemes.
29. Income support.
30. Pay as you earn.
31. Underwriters.
32. Foreign partnerships.
33. Companies: material interests.
34. Apportionment of income etc. of close companies.
35. Corporation tax (payment dates).
36. Charges on income.
37. Investment companies.
38. Recognised investment exchanges.
39. Controlled foreign companies.
40. Dual resident companies.
41. Double taxation relief: interest on overseas loans.
42. Advance corporation tax: oil industry.
43. Commodity futures, financial futures and options.
44. Stamp duty (clearance services).
45. Stamp duty (market makers).
46. Stamp duty (Crown exemption).
47. Stamp duty reserve tax.
48. Inheritance tax.
49. Oil taxation: nomination scheme.
50. Oil taxation: market value of oil.
51. Collective investment schemes.
52. Relief from tax (incidental and consequential charges).

170019 B*

1. Amendment of the law

That it is expedient to amend the law with respect to the National Debt and public revenue and to make further provision in connection with finance; but this Resolution does not extend to the making of any amendment with respect to value added tax so as to provide—

(*a*) for zero-rating or exempting any supply;

(*b*) for refunding any amount of tax;

(*c*) for varying the rate of that tax otherwise than in relation to all supplies and importations; or

(*d*) for relief other than relief applying to goods of whatever description or services of whatever description.

2. Unleaded petrol

That, as from 6 o'clock in the evening of 17th March 1987,—

(1) after section 13 of the Hydrocarbon Oil Duties Act 1979 there shall be inserted the following section—

"Rebate on unleaded petrol.

13A.—(1) On unleaded petrol charged with the excise duty on hydrocarbon oil and delivered for home use there shall be allowed at the time of delivery a rebate of duty at the rate of £0·0096 a litre.

(2) For the purposes of this section petrol is "unleaded" if it contains not more than 0·013 grams of lead per litre of petrol or, if the petrol is delivered for home use before 1st April 1990, not more than 0·020 grams of lead per litre of petrol.

(3) Rebate shall not be allowed under this section in any case where it is allowed under section 14 below.":

(2) in section 24 of that Act (control of use of duty-free and rebated oil) in subsection (1) (power of Commissioners to make regulations) after the words "section 12" there shall be inserted "section 13A": and

(3) in section 27 of that Act (interpretation) in the definition of "rebate" after the words "section 11" there shall be inserted "13A":

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

3. Vehicles excise duty (farmers' goods vehicles)

That Schedule 4 to each of the Vehicles (Excise) Act 1971 and the Vehicles (Excise) Act (Northern Ireland) 1972 shall have effect, in relation to licences taken out after 17th March 1987, with the amendments set out below:

But this Resolution shall not authorise the making of amendments which would result in different provisions being in force in different parts of Great Britain:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968:

(1) In Part I, in sub-paragraph (2) of paragraph 6 (farmer's goods vehicle or showman's goods vehicle having a plated gross weight or a plated train weight) in paragraph (b) (weight exceeding 7.5 tonnes but not exceeding 12 tonnes) for "£155" (which applies to farmers' goods vehicles only) there shall be substituted "£175"; and

(2) In Part II, for Tables A(1), C(1) and D(1) (rates for farmers' goods vehicles having plated weight exceeding 12 tonnes) there shall be substituted the Tables set out below:

TABLE A(1)

RATES OF DUTY ON RIGID GOODS VEHICLES EXCEEDING 12 TONNES PLATED GROSS WEIGHT

RATES FOR FARMERS' GOODS VEHICLES

| Plated gross weight of vehicle | | Rate of duty | | |
|---|---|---|---|---|
| 1. Exceeding | 2. Not exceeding | 3. Two axle vehicle | 4. Three axle vehicle | 5. Four or more axle vehicle |
| tonnes | tonnes | £ | £ | £ |
| 12 | 13 | 245 | 190 | 190 |
| 13 | 14 | 340 | 205 | 205 |
| 14 | 15 | 445 | 205 | 205 |
| 15 | 17 | 620 | 205 | 205 |
| 17 | 19 | — | 295 | 205 |
| 19 | 21 | — | 395 | 205 |
| 21 | 23 | — | 540 | 295 |
| 23 | 25 | — | 965 | 415 |
| 25 | 27 | — | — | 600 |
| 27 | 29 | — | — | 880 |
| 29 | 30.49 | — | — | 1,450 |

TABLE C(1)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING ONLY 2 AXLES

RATES FOR FARMERS' GOODS VEHICLES

| Plated train weight of tractor unit | | Rate of duty | | |
|---|---|---|---|---|
| 1. Exceeding | 2. Not exceeding | 3. For a tractor unit to be used with semi-trailers with any number of axles | 4. For a tractor unit to be used only with semi-trailers with not less than two axles | 5. For a tractor unit to be used only with semi-trailers with not less than three axles |
| tonnes | tonnes | £ | £ | £ |
| 12 | 14 | 280 | 250 | 250 |
| 14 | 16 | 355 | 265 | 265 |
| 16 | 18 | 415 | 265 | 265 |
| 18 | 20 | 485 | 265 | 265 |
| 20 | 22 | 565 | 330 | 265 |
| 22 | 23 | 600 | 370 | 265 |
| 23 | 25 | 690 | 470 | 265 |
| 25 | 26 | 690 | 520 | 320 |
| 26 | 28 | 690 | 655 | 430 |
| 28 | 29 | 725 | 725 | 490 |
| 29 | 31 | 1,010 | 1,010 | 630 |
| 31 | 33 | 1,470 | 1,470 | 1,010 |
| 33 | 34 | 1,470 | 1,470 | 1,350 |
| 34 | 36 | 1,650 | 1,650 | 1,650 |
| 36 | 38 | 1,860 | 1,860 | 1,860 |



TABLE D(1)

RATES OF DUTY ON TRACTOR UNITS EXCEEDING 12 TONNES PLATED TRAIN WEIGHT AND HAVING THREE OR MORE AXLES

RATES FOR FARMERS' GOODS VEHICLES

| Plated train weight of tractor unit | | Rate of duty | | |
|---|---|---|---|---|
| 1. Exceeding | 2. Not exceeding | 3. For a tractor unit to be used with semi-trailers with any number of axles | 4. For a tractor unit to be used only with semi-trailers with not less than two axles | 5. For a tractor unit to be used only with semi-trailers with not less than three axles |
| tonnes | tonnes | £ | £ | £ |
| 12 | 14 | 250 | 250 | 250 |
| 14 | 20 | 265 | 265 | 265 |
| 20 | 22 | 330 | 265 | 265 |
| 22 | 23 | 370 | 265 | 265 |
| 23 | 25 | 470 | 265 | 265 |
| 25 | 26 | 520 | 265 | 265 |
| 26 | 28 | 655 | 265 | 265 |
| 28 | 29 | 725 | 310 | 265 |
| 29 | 31 | 1,010 | 385 | 265 |
| 31 | 33 | 1,470 | 580 | 265 |
| 33 | 34 | 1,470 | 850 | 330 |
| 34 | 36 | 1,470 | 1,220 | 500 |
| 36 | 38 | 1,640 | 1,640 | 745 |

4. Vehicles excise duty (recovery vehicles)

That provision may be made for, and in connection with, charging duty in respect of recovery vehicles by reference to an annual rate of £50 under the Vehicles (Excise) Act 1971 and the Vehicles (Excise) Act (Northern Ireland) 1972.

5. Vehicles excise duty (trade licences)

That provision may be made with respect to the rates of duty applicable to trade licences under section 16 of each of the Vehicles (Excise) Act 1971 and the Vehicles (Excise) Act (Northern Ireland) 1972.

6. Abolition of general betting duty on on-course bets

That—

(1) General betting duty shall not be chargeable on any bet made on or after 29th March 1987 which is an on-course bet within the meaning of Part I of the Betting and Gaming Duties Act 1981 ("the 1981 Act"):

(2) Nothing in this Resolution shall affect—

(*a*) the question whether a person is for the purposes of Schedule 1 to the 1981 Act carrying on a general betting business or engaged in an activity by reason of which he is or may be or become liable for general betting duty, or

(*b*) the question whether a person is for the purposes of Schedule 2 to the Miscellaneous Transferred Excise Duties Act (Northern Ireland) 1972 carrying on a business which involves or may involve general betting duty becoming payable or engaged in an activity by reason of which he is or may be or become liable for duty:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

170019 C*

7. Gaming machine licence duty (rates)

That, with respect to licences for any period beginning on or after 1st June 1987, for the Tables set out in section 23(1) of the Betting and Gaming Duties Act 1981 there shall be substituted the following Tables:

TABLE A

*Small-prize machines*

| Description of machines authorised by the licence | Duty on whole-year licence |
|---|---|
| Chargeable at the lower rate ... ... ... ... ... | £150 per machine |
| Chargeable at the higher rate ... ... ... ... ... | £375 per machine |

TABLE B

*Other machines*

| Description of machines authorised by the licence | Duty on whole-year licence |
|---|---|
| Chargeable at the lower rate ... ... ... ... ... | £375 per machine |
| Chargeable at the higher rate ... ... ... ... ... | £960 per machine |

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

8. Gaming machine licence duty (exemptions etc.)

That provision may be made amending Schedule 4 to the Betting and Gaming Duties Act 1981 (exemptions and supplementary provisions relating to gaming machine licence duty).

9. Value added tax (credit for input tax)

That, in relation to supplies and importations made on or after 1st April 1987, the Value Added Tax Act 1983 shall have effect with the following amendments:

(1) In section 15, for subsections (1) to (3) there shall be substituted—

"(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

(*a*) taxable supplies;

(*b*) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;

(*c*) supplies which section 35 below provides are to be disregarded for the purposes of this Act and which would otherwise be taxable supplies.



(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above, and any such regulations may provide for—

(*a*) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;

(*b*) adjusting, in accordance with a proportion determined in like manner for any longer period comprising two or more prescribed accounting periods or parts thereof, the provisional attribution for any of those periods; and

(*c*) the making of payments in respect of input tax, by the Commissioners to a taxable person (or a person who has been a taxable person) or by a taxable person (or a person who has been a taxable person) to the Commissioners, in cases where events prove inaccurate an estimate on the basis of which an attribution was made."

(2) In section 6(1), for the words "the charge to tax" there shall be substituted the words "this Act".

(3) In section 35(1) and (2), for the words "shall be disregarded" there shall be substituted the words "shall, except where the contrary intention appears, be disregarded".

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

10. Value added tax (supplies to groups)

That, in relation to transfers of assets made on or after 1st April 1987, the Value Added Tax Act 1983 shall have effect with the insertion after section 29 of the following section—

"Supplies to groups.

29A.—(1) Subject to subsections (2) and (3) below, subsection (4) below applies where—

(*a*) a business, or part of a business, carried on by a taxable person is transferred as a going concern to a body corporate treated as a member of a group under section 29 above;

(*b*) on the transfer of the business or part, chargeable assets of the business are transferred to the body corporate; and

(*c*) the transfer of the assets is treated by virtue of section 3(3) (*c*) above as neither a supply of goods nor a supply of services.

(2) Subsection (4) below shall not apply if the representative member of the group is entitled to credit for the whole of the input tax on supplies to it and importations by it—

(*a*) during the prescribed accounting period in which the assets are transferred, and

(*b*) during any longer period to which regulations under section 15(3) (*b*) above relate and in which the assets are transferred.

(3) Subsection (4) below shall not apply if the Commissioners are satisfied that the assets were acquired by the taxable person transferring them more than three years before the day on which they are transferred.

(4) The chargeable assets shall be treated for the purposes of this Act as being, on the day on which they are transferred, both supplied to the representative member of the group for the purpose of its business and supplied by that member in the course or furtherance of its business.

(5) A supply treated under subsection (4) above as made by a representative member shall not be taken into account as a supply made by him when determining the allowance of input tax in his case under section 15 above.

(6) The value of a supply treated under subsection (4) above as made to or by a representative member shall be taken to be the open market value of the chargeable assets.

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(7) For the purposes of this section, the open market value of any chargeable assets shall be taken to be the price that would be paid on a sale (on which no tax is payable) between a buyer and a seller who are not in such a relationship as to affect the price.

(8) The Commissioners may reduce the tax chargeable by virtue of subsection (4) above in a case where they are satisfied that the person by whom the chargeable assets are transferred has not received credit for the full amount of input tax arising on the acquisition by him of the chargeable assets.

(9) For the purposes of this section, assets are chargeable assets if their supply in the United Kingdom by a taxable person in the course or furtherance of his business would be a taxable supply (and not a zero-rated supply).".

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

11. Value added tax (valuation)

That, in relation to supplies made on or after 1st April 1987, Schedule 4 to the Value Added Tax Act 1983 shall have effect with the insertion, at the beginning of paragraph 1(1) (c), of the words "if the supply is a taxable supply,".

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

12. Value added tax (issue of securities)

That, in relation to supplies made on or after 1st April 1987, Group 5 in Schedule 6 to the Value Added Tax Act 1983 shall have effect with the following amendments—

(*a*) at the end of item 5 there shall be added the words " or the underwriting of an issue within item 1 "; and

(*b*) after item 6 there shall be inserted the following item—

" 6A. The making of arrangements for, or the underwriting of, an issue within item 6.".

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

13. Value added tax (supplies received from abroad)

That, with respect to services supplied on or after 1st April 1987, section 7 of the Value Added Tax Act 1983 (reverse charge on supplies received from abroad) shall be amended as follows—

(*a*) in paragraph (*b*) of subsection (1), for the words " taxable person " there shall be substituted " person (in this section referred to as ' the recipient ') ";

(*b*) in subsection (1), in the words following paragraph (*b*) for the words " as if the taxable person " there shall be substituted " as if the recipient ";

(*c*) in subsections (3) and (4) for the words " taxable person " there shall be substituted " recipient "; and

(*d*) in subsection (3) for the words " the allowance " there shall be substituted " any allowance ".

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.



14. Value added tax (tour operators)

That provision may be made about the treatment for the purposes of value added tax of supplies by tour operators, travel agents and others making like supplies.

15. Value added tax (transfers from the United Kingdom)

That provision may be made repealing item 2 of Group 15 in Schedule 5 to the Value Added Tax Act 1983.

16. Value added tax (registration etc.)

That the Value Added Tax Act 1983 may be amended by provisions as to registration, and provisions treating as taxable persons certain registered persons who neither make nor intend to make taxable supplies.

17. Income tax (charge and rates for 1987–88)

That—

(1) Income tax for the year 1987–88 shall be charged at the basic rate of 27 per cent. and, in respect of so much of an individual's total income as exceeds £17,900 (the basic rate limit as determined under subsection (4) of section 24 of the Finance Act 1980—indexation), at such higher rates as are specified in the Table below:

TABLE

| *Higher rate bands* | *Higher rate* |
|---|---|
| The first £2,500 ... ... ... ... ... ... ... ... | 40 per cent. |
| The next £5,000 ... ... ... ... ... ... ... ... | 45 per cent. |
| The next £7,900 ... ... ... ... ... ... ... ... | 50 per cent. |
| The next £7,900 ... ... ... ... ... ... ... ... | 55 per cent. |
| The remainder ... ... ... ... ... ... ... ... | 60 per cent. |

(2) Section 24(4) of the Finance Act 1980 (indexation of thresholds) shall not, so far as it relates to the higher rate bands, apply for the year 1987–88:

(3) This Resolution shall not require any change to be made in the amounts deductible or repayable under section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) before 18th May 1987:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

18. Income tax (indexed personal reliefs etc.): operative date for PAYE

That, for the year 1987–88, in subsection (7) of section 24 of the Finance Act 1980 (which specifies the date from which indexed changes in income tax thresholds and allowances are to be brought into account for the purposes of PAYE) for " 5th May " there shall be substituted " 18th May ":

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

19. Increased personal relief for those aged eighty and over

That, for the year 1987–88 and subsequent years of assessment—

(1) Subject to the provisions of this Resolution, subsection (1) of section 8 of the Income and Corporation Taxes Act 1970 (personal reliefs) shall have effect—

(*a*) in relation to a claim by a person who proves that he or his wife was at any time within the year of assessment of the age of eighty or upwards, as if the sum specified in paragraph (*a*) (married) were £4,845; and

(*b*) in relation to a claim by a person who proves that he was at any time within the year of assessment of the age of eighty or upwards, as if the sum specified in paragraph (*b*) (single) were £3,070;

and for this purpose, a person who would have been of the age of eighty or upwards within the year of assessment if he had not died in the course of it shall be treated as having been of that age within that year:

(2) For any year of assessment for which a person is entitled to increased personal relief by virtue of this Resolution, he shall not be entitled to increased relief under subsection (1A) of the said section 8 (increased relief for persons of sixty-five and upwards):

(3) For the purpose of any enactment which refers to Part I of the Income and Corporation Taxes Act 1970 or to Chapter II of that Part, paragraph (1) above shall be taken to be included in that Chapter:

(4) In the following enactments—

(*a*) subsection (1B) of the said section 8 (tapering of relief under subsection (1A)), and

(*b*) paragraph 3(3) of Schedule 4 to the Finance Act 1971 (exclusion of certain reliefs where there is separate taxation of wife's earnings),

any reference to subsection (1A) of the said section 8 shall include a reference to paragraph (1) above:

(5) In subsection (8) of section 36 of the Finance Act 1976 (application of provisions relating to transfer of balance of certain reliefs between spouses) the reference in paragraph (*b*) to subsection (1A)(*b*) of the said section 8 shall include a reference to paragraph (1)(*b*) above:

(6) This Resolution shall not require any change to be made in the amounts deductible or repayable under section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) before 18th May 1987:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

20. Increased relief for blind persons

That—

(1) For the year 1987–88 and subsequent years of assessment, in section 18 of the Income and Corporation Taxes Act 1970—

(*a*) in subsection (1) (single blind persons and married couples of whom one is blind) for "£360" there shall be substituted "£540"; and

(*b*) in subsection (2) (married couples, both of whom are blind) for "£720" there shall be substituted "£1,080":

(2) This Resolution shall not require any change to be made in the amounts deductible or repayable under section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) before 18th May 1987:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.



21. Relief for interest (limit for 1987–88)

That, for the year 1987–88, the qualifying maximum referred to in paragraphs 5(1) and 24(3) of Schedule 1 to the Finance Act 1974 (limit on relief for interest on certain loans for the purchase or improvement of land) shall be £30,000:

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

22. Corporation tax (charge and rate for financial year 1987)

That corporation tax shall be charged for the financial year 1987 at the rate of 35 per cent.

23. Corporation tax (small companies)

That—

(*a*) the small companies rate for the financial year 1987 shall be 27 per cent; and

(*b*) the fraction by reference to which corporation tax charged on income is reduced under section 95(2) of the Finance Act 1972 shall for that financial year be one fiftieth.

24. Companies' chargeable gains

That provision may be made with respect to the treatment of the chargeable gains of companies for the purposes of corporation tax.

25. Charities

That, for the year 1987–88 and subsequent years of assessment, section 27(7) of the Finance Act 1986 (which limits to £100 the payroll deductions attracting relief) shall have effect with the substitution of "£120" for "£100".

And it is hereby declared that it is expedient in the public interest that this Resolution should have statutory effect under the provisions of the Provisional Collection of Taxes Act 1968.

26. Registered friendly societies

That provision may be made—

(*a*) amending section 332(2) of the Income and Corporation Taxes Act 1970 and section 64 of the Friendly Societies Act 1974 with respect to contracts for the assurance of gross sums under tax exempt life or endowment business of registered friendly societies; and

(*b*) amending the operation of section 400 of that Act with respect to gains arising in connection with policies issued in the course of such business by registered friendly societies.

27. Annuities, etc.

That provision may be made about contracts, schemes or other arrangements providing for the payment of annuities or lump sums.

28. Retirement benefits schemes

That provision may be made about retirement benefits schemes.

29. Income support

That provision may be made charging to income tax under Schedule E payments of income support under the Social Security Act 1986 or the Social Security (Northern Ireland) Order 1986.

30. Pay as you earn

That provision may be made with respect to the payments to which section 204 of the Income and Corporation Taxes Act 1970 (pay as you earn) applies.

31. Underwriters

That charges to income tax (including charges for the years of assessment 1985–86 and 1986–87) may be imposed by provisions about underwriters.

32. Foreign partnerships

That provision may be made, with retrospective effect, with respect to the taxation of persons resident in the United Kingdom who are members of partnerships resident outside the United Kingdom.

33. Companies: material interests

That provision may be made as to the cases in which a person is to be regarded as having a material interest in a company for certain purposes of the Tax Acts.

34. Apportionment of income etc. of close companies

That provision may be made amending Schedule 16 to the Finance Act 1972.

35. Corporation tax (payment dates)

That provision may be made as to the time within which corporation tax in respect of any accounting period of a company is required to be paid.

36. Charges on income

That provision may be made with respect to the dates on which certain payments made between companies are to be treated as received.



37. Investment companies

That amendments may be made to section 304 of the Income and Corporation Taxes Act 1970.

38. Recognised investment exchanges

That charges to income tax, corporation tax and capital gains tax may be imposed by provisions enabling enactments referring to The Stock Exchange to have effect, with or without modification, in relation to other recognised investment exchanges.

39. Controlled foreign companies

That provision may be made with respect to the circumstances in which a controlled foreign company, within the meaning of Chapter VI of Part II of the Finance Act 1984, is to be regarded as pursuing an acceptable distribution policy.

40. Dual resident companies

That provision may be made with respect to companies which are resident in the United Kingdom and are also within a charge to tax under the laws of a territory outside the United Kingdom.

41. Double taxation relief: interest on overseas loans

That provision may be made amending sections 65 and 66 of the Finance Act 1982.

42. Advance corporation tax: oil industry

That provision may be made with respect to—

(*a*) the setting of advance corporation tax against corporation tax on profits arising from oil extraction activities or oil rights, within the meaning of Part II of the Oil Taxation Act 1975; and

(*b*) the repayment of advance corporation tax under section 17 (3) of that Act and section 127 (5) of the Finance Act 1981.

43. Commodity futures, financial futures and options

That provision may be made—

(*a*) for bringing gains on certain disposals of commodity futures, financial futures and options within the charge to capital gains tax or corporation tax on chargeable gains, and

(*b*) with respect to the treatment under the Capital Gains Tax Act 1979 of certain options.

44. Stamp duty (clearance services)

That provision may be made with respect to stamp duty in relation to instruments transferring securities to persons concerned with clearance services.

45. Stamp duty (market makers)

That amendments may be made to section 82(6) of the Finance Act 1986.

46. Stamp duty (Crown exemption)

That charges to stamp duty may be imposed by provisions relating to instruments made by, to or with Ministers of the Crown.

47. Stamp duty reserve tax

That charges to stamp duty reserve tax may be imposed by further provisions relating to that tax.

48. Inheritance tax

That charges to inheritance tax may be imposed—

(*a*) by provisions relating to the coming to an end of an interest in possession in settled property;

(*b*) by provisions as to the circumstances in which the settlor is liable for the tax on the value transferred by a potentially exempt transfer relating to settled property;

(*c*) by provisions relating to relief under Chapter I (business property) or Chapter II (agricultural property) of Part V of the Inheritance Tax Act 1984;

(*d*) by provisions relating to settled property of the kind to which Schedule 4 to that Act (maintenance funds for historic buildings etc.) relates; and

(*e*) by provisions relating to the payment of tax by instalments.

49. Oil taxation: nomination scheme

That, in connection with a scheme relating to the nomination of sales, appropriations and other disposals of oil, provision may be made with respect to the amounts to be taken into account under the Oil Taxation Act 1975 in determining the gross profit or loss accruing to a participator in an oil field in any chargeable period.

50. Oil taxation: market value of oil

That provision may be made with respect to the determination of the market value of oil for the purposes of provisions of the Oil Taxation Act 1975.



51. Collective investment schemes

That charges to income tax, corporation tax, capital gains tax, inheritance tax, stamp duty and stamp duty reserve tax may be imposed by provisions relating to unit trust schemes or to other collective investment schemes.

52. Relief from tax (incidental and consequential charges)

That it is expedient to authorise any incidental or consequential charges to any duty or tax (including charges having retrospective effect) which may arise from provisions designed in general to afford relief from tax.

## PROCEDURE RESOLUTIONS

PROCEDURE (PERSONAL PENSION SCHEMES): That, notwithstanding anything to the contrary in the practice of the House relating to matters which may be included in Finance Bills, any Finance Bill of the present Session may make provision for the payment of sums out of or into the National Insurance Fund in connection with provisions relating to the payment of minimum contributions under Part I of the Social Security Act 1986.

PROCEDURE (EXCHANGE AND FINANCIAL CONTROL): That, notwithstanding anything to the contrary in the practice of the House relating to matters which may be included in Finance Bills, any Finance Bill of the present Session may—

(*a*) make provision for and in connection with the repeal of the Exchange Control Act 1947; and

(*b*) amend section 2 of the Banking and Financial Dealings Act 1971.

PROCEDURE (FUTURE TAXATION): That, notwithstanding anything to the contrary in the practice of the House relating to matters which may be included in Finance Bills, any Finance Bill of the present Session may contain the following provisions taking effect in a future year—

(*a*) provisions amending the Taxes Management Act 1970;

(*b*) provisions with respect to amounts due by way of penalty or interest;

(*c*) provisions with respect to interest on tax overpaid;

(*d*) provisions with respect to the payment of corporation tax without assessment; and

(*e*) provisions with respect to the time within which corporation tax in respect of any accounting period of a building society is required to be paid.

## WAYS AND MEANS

# Budget Statement

**Mr. Deputy Speaker (Mr. Harold Walker):** Before I call the Chancellor of the Exchequer, it may be for the convenience of hon. Members if I remind them that at the end of the Chancellor's speech, as in past years, copies of the Budget resolutions will not be handed around in the Chamber but will be available to hon. Members in the Vote Office.

3.34 pm

**The Chancellor of the Exchequer (Mr. Nigel Lawson):** The setting for this year's Budget is more favourable than it has been for very many years. We are now entering our seventh successive year of steady growth, and the fifth in which this has been combined with low inflation. The public finances are sound and strong, and unemployment is falling. These are the fruits of the Government's determination, in bad times as well as good, to hold firmly to our policies of sound money and free markets. Once again, I reaffirm those policies.

I shall begin, as usual, by reviewing the economic background to the Budget. I shall then turn to monetary policy and to the fiscal outlook this year and next. Finally, I shall propose some changes in taxation designed to improve still further the prospects that lie before us. A number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

## THE ECONOMIC BACKGROUND

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

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

This greatly improved growth performance has been accompanied by falling inflation, which at 3½ per cent. in 1986 reached the lowest figure for almost 20 years. Over the lifetime of this Parliament, inflation has averaged less than 5 per cent.

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

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

I announced a number of specific employment measures in my last Budget, and since then my right hon. and noble Friend the Secretary of State for Employment has further extended the restart programme for the long-term unemployed. There will also be more places on the enterprise allowance scheme, and the number of jobclubs is to be quadrupled. The new job training scheme will eventually give a quarter of a million people, most of them youngsters, vocational training leading to recognised qualifications. With these and other measures, this Government have developed their employment and training programmes on a scale which no other country can match. But the best hope of all for the unemployed is in the continued vigour of the economy.

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

The recorded current account of the balance of payments went into deficit in 1986 by around £1 billion. This followed a cumulative current account surplus of some £20 billion between 1979 and 1985. Some deterioration in our current account was inevitable in the face of a £4 billion loss of earnings on oil trade virtually overnight. But the significance of this should not be exaggerated. The exchange rate adjustment that followed the fall in the oil price is already contributing to an improved non-oil trade performance. And earnings from the massive stock of net overseas assets we have acquired since 1979 will provide a continuing support to the current account in the years ahead. At well over £100 billion, our net overseas assets are now greater than at any time since the war, and second only to those of Japan.

Looking ahead, I expect 1987 to be another year of balanced growth with low inflation. Total output is forecast to rise by 3 per cent., with exports and investment up by rather more than that. By then we will have registered the longest period of steady growth, at a rate approaching 3 per cent. a year, that the British economy has known since the war. Manufacturing industry, in particular, should do well in 1987. and with the non-oil economy set to grow at 3½ per cent., there is every prospect of unemployment continuing to fall throughout the year.

In last year's Budget speech I said that the outlook for jobs depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance is now well under way.

Despite the strong growth in exports, it will inevitably take time for the full effect of the exchange rate adjustment to work through. The current account is thus likely to remain in deficit this year, by some £2½ billion, around half of 1 per cent. of GDP.

As I foreshadowed in the autumn statement, inflation may continue to edge up for a time, perhaps exceeding 4½

**Mr. Fairbairn:** Does my right hon. Friend appreciate, I could say it in Latin, but I shall not, that the permissive society one generation on has turned out to be the criminal society?

**The Prime Minister:** My hon. and learned Friend makes his own point very effectively.

Q3. **Mr. Winnick** asked the Prime Minister if she will list her official engagements for Tuesday 17 March.

**The Prime Minister:** I refer the hon. Gentleman to the reply that I gave some moments ago.

**Mr. Winnick:** As the head of the security service, does the Prime Minister not recognise that if some dissident members of the security service in the 1970s tried to destabilise a Government whom they did not like, it strikes at the very heart of democracy? On reflection, therefore does the Prime Minister not recognise, bearing in mind the answers that were given yesterday by the Attorney-General, that we cannot be satisfied with anything less than a full judicial inquiry about what happened during the time of a Labour Government?

**The Prime Minister:** The hon. Gentleman is concerned with something that did not happen in my time and about which the Prime Minister of the day made a clear statement. *[Interruption.]*

**Mr. Speaker:** Order. I ask the House to listen to the Prime Minister.

**The Prime Minister:** The Labour Prime Minister of the day made a clear statement about it. The hon. Gentleman must take up that matter with that Prime Minister.

**Mr. Bell:** On a point of order, Mr. Speaker. Earlier, the hon. Member for Poole (Mr. Ward) said that the Leader of the Opposition had been converted to the cause of law and order. I should like you to ask him to withdraw that phrase.

**Mr. Speaker:** Order. I do not think that it was unparliamentary, although it might have been rather offensive.

**Mr. Ward:** Further to that point of order, Mr. Speaker. I had not realised what a sensitive subject law and order is with the Opposition. In view of the embarrassment, of course I withdraw it.

## NEW MEMBER

*The following Member took and subscribed the Oath:*

*Matthew Owen John Taylor Esq., for Truro.*

per cent. by the summer, before falling back to 4 per cent. by the end of the year. While short-term fluctuations are inescapable, it remains the Government's prime objective to keep inflation on an underlying downward trend.

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

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

"Provided we are not over-ambitious, I believe that the Plaza accord is something we can usefully build on."—[*Official Report*, 18 March 1986; Vol. 94, c. 167.]

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

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

## MONETARY POLICY

For their part, the Government will keep in place a sound and prudent financial framework. That means, as it has done since 1980, the medium-term financial strategy. The central objective of the MTFS is gradually to reduce the growth of money GDP over the medium term so as to squeeze inflation out of the system and ultimately to achieve price stability. This requires monetary discipline buttressed by low public sector borrowing. The essential instrument of monetary policy must remain short-term interest rates. These will continue to be set in the light of monetary conditions as indicated principally by the growth of narrow and broad money and the behaviour of the exchange rate.

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

## PUBLIC SECTOR BORROWING

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

The final outturn for the public sector borrowing requirement last year, 1985-86, was just under £6 billion, equivalent to $1\frac{1}{2}$ per cent. of GDP, the lowest level since 1970-71. In my Budget last year, faced with a massive loss of what now looks to be almost £7 billion of North sea oil revenue, I none the less decided to hold the PSBR for this year, 1986-87, to £7 billion, or $1\frac{3}{4}$ per cent. of GDP.

In the event, this year's PSBR looks like turning out at only £4 billion, or 1 per cent. of GDP—the second successive year of significant undershoot. This successful outcome is chiefly attributable to the remarkable buoyancy of non-oil tax revenues in general and of the corporation tax paid by an increasingly profitable business sector in particular.

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

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

Indeed, I believe it is right to go below it. Since its inception in 1980, the MTFS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. We have now reached what I judge to be its appropriate destination—a PSBR of 1 per cent. of GDP. My aim will be to keep it there over the years ahead. This will maintain a degree of fiscal prudence that, until this year, had been achieved on only two occasions since 1950.

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

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

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

Throughout our period of office, our critics have consistently maintained not only that a fiscal stimulus would produce real economic growth, but that without an expansionary fiscal policy sustained growth was impossible. They were wrong, and have been proved wrong. The British economy is now embarking on its seventh successive year of steady growth, at an average rate of getting on for 3 per cent. a year. And during that time the PSBR, even if privatisation proceeds are added back, has been deliberately and steadily reduced from a shade under 6 per cent. of GDP to a little over 2 per cent. Indeed, had I or my predecessor at any time heeded the advice of our so-called expansionist critics, the British economy would never have been in the unprecedentedly favourable position it is in today.

## EXCHANGE CONTROL

Before I turn to my proposals for changes in taxation, I have one other change of a specific nature to announce. In 1979, a few months after the present Government had first taken office, my predecessor announced the abolition of exchange controls, which had been in continuous operation ever since the outbreak of war in 1939. That bold action has, over the past seven and a half years, proved wholly beneficial to the British economy; and I am glad to note that other European countries are now moving in the same direction.

But the Exchange Control Act remains on the statute book. The time has come to repeal it. The necessary legislation will be contained in this year's Finance Bill.

I note that, in what was clearly intended to be a major speech in New York in September, the Deputy Leader of the Labour party declared that

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

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

## BUSINESS AND ENTERPRISE

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

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

During the transition to the new system, companies were given advance notice of the main rate of Corporation Tax for the year ahead. This helped them in their forward planning, and I intend as far as possible to continue the practice of setting the rate in advance.

Accordingly, I can announce now that the main rate of corporation tax in 1987-88 will be unchanged at 35 per cent.—lower than in any other major industrial nation, though the United States is now set to emulate us.

The low rate of corporation tax enables me to introduce a further simplification into the system.

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

This is no longer the case. Indeed, the corporation tax rate for small companies is now below the capital gains tax rate. I therefore propose that, from today, companies' capital gains be charged at the appropriate corporation tax rate, without adjustment, save for the indexation which applies to all post-1982 gains.

Hitherto, companies have not been allowed to set payments of advance corporation tax against their liability to tax on capital gains. This means that, where companies distribute capital gains as dividends, the gains are, in effect, taxed twice—once in the hands of the company, and once in the hands of the shareholder. I propose that, under the new system, companies should be able to set ACT payments against tax on capital gains.

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

I also have some further simplification and rationalisation of the corporation tax system to announce.

At present, some companies established before 1965 do not have to pay their corporation tax until up to 21 months after the end of the period for which it is due, whereas companies established since 1965 have to pay their tax after nine months—and indeed some building societies have to pay sooner still. This difference in treatment cannot be justified. Moreover, it is open to an abuse which could put the timing of a substantial proportion of the total corporation tax yield at risk.

I therefore propose that all companies and building societies should be treated the same way, with all liable to pay tax nine months after the accounting period for which it is due.

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

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

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

I believe that these carefully targeted changes will give a worthwhile measure of relief to the North sea oil sector.

Last year I put the business expansion scheme on to a permanent footing. However, the present rules still produce too much end-year bunching of BES investments, and hence may crowd out some projects and lead to bad decisions on others. I propose, therefore, to permit someone who invests in the first half of the year to claim part of the relief against his previous year's income. This will make it easier for companies to raise BES finance throughout the year.

I also propose to legislate now to pave the way ofr a new method of collecting corporation tax, to be known as pay and file. Under this system companies will estimate their tax liabilities themselves, and pay on the normal due date. Where it turns out that the initial payment was too low, the company will pay interest to the Revenue; where the initial payment was too high, the Revenue will pay interest to the company. This new approach, which has already been generally welcomed by the business community, is part of a wider programme of streamlining tax collection, and will not come into force until the early 1990s.

I have to set the 1988-89 car and fuel benefit scales for those with company cars. The car scale charges still fall well short of the true value of the benefit, and, as last year, I propose to increase them by 10 per cent. There will be no change in the fuel scales which, as already announced, will also be used for VAT purposes from 6 April. *[Interruption.]*

Training and retraining are vital to a flexible and competitive economy. At present training — *[Interruption.]* If right hon. and hon. Members are not interested in training, they show themselves to be a fraud, which we know them to be.

**Mr. Willie W. Hamilton** (Fife, Central): On a point of order, Mr. Deputy Speaker. The Chancellor's Parliamentary Private Secretary, obviously, has some amended version of the speech which he has received from a civil servant in the Box. Would you now suspend the sitting until the Chancellor is properly equipped with the new speech?

**Mr. Deputy Speaker:** Order. The hon. Gentleman knows perhaps better than any other hon. Member that, according to convention, the Chancellor is listened to without interruption. The hon. Gentleman also knows that what happens behind the Chair is not part of our proceedings.

**Mr. Lawson:** Training and retraining are vital to a flexible and competitive economy. At present, training financed by an employer that is related to the employee's current job is allowable against tax for the employer and imposes no tax burden on the employee. But an employer who is willing to finance the retraining of workers for future employment elsewhere may find that the cost of this is not allowable against tax, and the employee may find that he has received a taxable benefit. I propose to remove both these obstacles. This should help more workers to acquire new skills for new jobs.

The past few years have seen a remarkable and welcome growth in the number of small businesses and the self-employed. The Government have done a great deal to lighten the burdens on this vitally important sector of the economy. But I am well aware that problems remain, not least in the field of VAT.

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

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

My first and most important proposal, therefore, is that, as from 1 October, businesses whose annual turnover is under £¼ million, which covers more than half of all traders registered for VAT, will be able to choose to account for VAT on the basis of cash paid and received. In other words, they will have no liability to pay VAT until they themselves have received the money from their customers. In addition to easing the cash flow problems caused by late payers, this system will, of course, provide automatic VAT relief on bad debts.

I have to warn the House, however, that I cannot legally introduce this change without first obtaining a derogation from the European Community's sixth VAT directive. I am applying for the necessary derogation today. The House will note that the upper limit of £¼ million is considerably greater than the £100,000 suggested in the consultative document.

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

Third, the period within which business must apply to be registered for VAT will be extended from 10 to 30 days.

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

I believe that the changes I have outlined, and in particular the option to move to cash accounting, will be widely welcomed by the small business community. The cost will be £115 million in 1987-88 and £60 million in 1988-89.

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

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

I have one further measure to help the small business man, unrelated to VAT. I propose to increase the limit for capital gains tax retirement relief by 25 per cent. from £100,000 to £125,000.

In any ongoing programme of tax reduction and reform, where much still remains to be done, an essential element must always be the elimination of unintended or unjustified tax breaks, which cause rates of tax generally to be higher than they need to be. Accordingly, I have five proposals to make today to that end.

The first concerns VAT, and has already been the subject of extensive consultation. The House will be aware that a business that provides a service that is exempt from VAT cannot in turn deduct input tax on its purchases. But where the activities of a business are in part liable to VAT and in part exempt the existing rules are excessively generous as to the amount of input tax that can be deducted; and this generosity is being exploited on a growing scale.

The rules must therefore be changed, and the changes, which I proposed to the House last December, will come into effect on 1 April.

There will be special arrangements to deal with the problem of brewers' tied houses.

I am also taking this opportunity to exclude a significant number of small businesses from the scope of this provision. The yield from this change will be some £300 million in 1987-88 and £400 million in 1988-89.

Second, I propose to change the law so that companies in multinational groups which enjoy dual residence will no longer be able to secure tax relief twice on one and the same interest payment. Genuine trading companies will not be affected. This change, which will take effect on 1 April, follows the similar action recently taken by the United States. It will yield £125 million in 1988-89.

Third, I propose to end the present excessively generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans. In future, banks will be able to offset this tax credit only against tax on the profit on the relevant loan, and not more widely. This will bring our rules broadly into line with those in most other countries.

*[Mr. Lawson]*

The change will apply from 1 April this year for new loans and from 1 April next year for existing loans. It will yield some £20 million in 1988-89.

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

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

I have one further proposal to make in the broad field of business and tax.

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

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

Last July I presented a Green Paper on profit-related pay in conjunction with my right hon. and noble Friend the Secretary of State for Employment and my right hon. Friend the Secretary of State for Trade and Industry. I now propose to introduce a scheme of tax relief broadly along the lines floated in the Green Paper.

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

Profit-related pay is no panacea. But then there are no panaceas. What it is is a tool to help British business gradually to overcome one of our biggest national handicaps — the nature and behaviour of our labour market. I am today challenging British management to take advantage of that tool and to make good use of it, for the good of their firm, their work force and their country.

## TAXES ON SAVING

I turn now to the taxation of savings.

A central theme and purpose of the Government's policies is the creation of a genuine popular capitalism.

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

We know that 63 per cent. of households now own their own homes, 2½ million more than in 1979. However, there have been no official figures for the more explosive growth of share ownership in Britain over the past eight years. The treasury and the Stock Exchange therefore jointly commissioned a major independent survey of individual shareholding in Britain.

The results are now available. They show that there are now some 8½ million individual shareholders in this country, amounting to one fifth of the total adult population, and roughly three times the number there were in 1979.

**Mr. Eric S. Heffer** (Liverpool, Walton): So what?

**Mr. Lawson:** The hon. Gentleman may learn.

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

The cornerstone of the Government's pensions strategy is the introduction of an entirely new means of provision for retirement, developed by my right hon. Friend the Secretary of State for Social Services. This is the personal pension, which will be launched at the beginning of next year, three months earlier than planned.

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

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

In addition, to encourage a wider spread of occupational schemes, employers will be able to set up simplified schemes with the minimum of red tape. This will be particularly welcome to many small employers who have been discouraged by the complexity and open-ended commitment of a full-blown final salary scheme. And there will be much greater scope for transferring between different types of pension scheme. Again, the Finance Bill will contain the necessary tax provisions.

Finally I have decided to go beyond the proposals set out in the consultative document in one important respect.





Starting in October, I propose to allow members of occupational pension schemes to make additional voluntary contributions, with full tax relief, to a separate plan of their own choice instead of, as now, being restricted to plans within their employers' schemes. They will be able to top their pensions up to the present tax approval limits.

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

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

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

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

For friendly societies, I have decided to replace the existing tax-exempt life assurance limit based on the sum assured with a new limit based on annual premiums. I propose to set this at £100 a year, which will greatly increase the scope for the traditional societies to offer life policies to their members.

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

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

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

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

I therefore propose to make a substantial increase in the threshold for inheritance tax, from £71,000 to £90,000, coupled with a simplification of the rate structure from seven rates to four. As a result of this change, the number of estates liable to inheritance tax will be cut by roughly a third. The cost will be £75 million in 1987-88 and £170 million in 1988-89.

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

## TAXES ON SPENDING

I now turn to the taxation of spending.

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

However, in the light of representations I have received, I have decided to extend slightly the VAT reliefs I introduced last year for certain aspects of charitable work. I propose to relieve charities from VAT on certain welfare vehicles used by hospices to transport the terminally ill; on installing or adapting lavatory or bathroon facilities in charity homes for the disabled; on drugs and chemicals used by a charity in medical research; and on specialised location and indentification equipment employed by mountain rescue and first aid services.

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

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

In my Budget statement last year I undertook to introduce a tax differential in favour of unleaded petrol, to offset its higher production cost. I can now announce that the differential will be 5p a gallon. This means that the pump price of unleaded petrol should be no higher than that of four-star leaded petrol. The change will take effect from 6 o'clock this evening.

In my 1985 Budget I announced the first stage in the process of increasing the rates of vehicle excise duty on farmers' heavy lorries to bring them into line with the use they make of the public roads. I introduced the second

*[Mr. Lawson]*

stage in last year's Budget and propose to complete the process this year. I also propose to increase the rates of duty on trade licences and to rationalise the taxation of recovery vehicles.

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

## INCOME TAX

Finally, I turn to income tax.

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

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

That is why, ever since we first took office in 1979, we have consistently sought to reduce the burden of income tax. We have cut the basic rate of tax from 33 per cent. to 29 per cent. and sharply reduced the punitive higher rates we inherited from the Labour party. And we have increased the main tax allowances by 22 per cent. more than inflation, taking almost $1\frac{1}{2}$ million people out of income tax altogether.

For 1987-88 I propose to raise all the main thresholds and allowances by the statutory indexation factor of 3·7 per cent., rounded up. Thus the single person's allowance will rise by £90 to £2,425 and the married man's allowance by £140 to £3,795. The single age allowance will rise by £110 to £2,960 and the married age allowance by £170 to £4,675. The age allowance income limit becomes £9,800. I propose to raise the first 40 per cent. higher rate threshold by £700 to £17,900, in line with statutory indexation; but the threshold for the 45 per cent. rate will go up by only £200 to £20,400. The other higher rate thresholds will remain unchanged.

I have two other changes in allowances to announce.

First, I propose to give an additional increase in the age allowance for those aged 80 or over. For them, the increase will be double the amount due under statutory indexation so that, for the very elderly, the single age allowance will rise by £220 to £3,070 and the married age allowance by £340 to £4,845. Around 400,000 taxpayers will benefit from this new measure, and up to 25,000 of them will be taken out of income tax altogether.

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

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

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

However, given my decision to use the greater part of the fiscal scope I now have to reduce the public sector borrowing requirement, that goal cannot be achieved in this Budget.

I can, however, take a further step towards it, as I did last year. I am therefore reducing the basic rate of income tax by 2p to 27 per cent. This reduction, which will benefit every taxpayer in the land, will be worth more than £3 a week to a man on average earnings.

There will, of course, be a consequential reduction in the rate of advance corporation tax, and—as last year—I also propose a corresponding cut in the small companies' rate of corporation tax from 29 per cent. to 27 per cent.

Taken together with the income tax change, this will mean a significant reduction in the tax burden on small businesses, which are so important for future growth and jobs.

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

The total cost of all the measures in this year's Budget again on an indexed basis, is a little over £$2\frac{1}{2}$ billion.

## CONCLUSION

In this Budget I have reaffirmed the prudent policies which, despite a year-long coal strike followed by a collapse in the oil price, have given us the strongest economy we have known since the war.

After an autumn statement which substantially increased public spending in priority areas, I have once again cut the basic rate of income tax: a cut which the Labour party is pledged to reverse, if it is given the chance — which it will not be. And I have done this while sharply reducing public borrowing—a combination that has eluded successive Governments for decades.

This is a Budget built on success, and a Budget for success. I commend it to the House.

### Provisional Collection of Taxes

*Motion made, and Question,*

That, pursuant to section 5 of the Provisional Collection of Taxes Act 1968, provisional statutory effect shall be given to the following motions:

*(a)* Unleaded petrol (Motion No. 2); and

*(b)* Vehicles excise duty (farmers' goods vehicles) (Motion No. 3—*[Mr. Lawson.]*

*put forthwith, pursuant to Standing Order No. 50 (Ways and Means Motions), and agreed to.*

**Mr. Deputy Speaker** (Mr. Harold Walker): I shall now call the Chancellor of the Exchequer to move the motion entitled "Amendment of the law". It is on that motion that the Budget debate will take place today and on succeeding days. The remaining motions will not be put until the end of the Budget debate next week, and they will then be decided without debate.

MR 4/95

REF NO M87/10

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FROM: A C S ALLAN
DATE: 16 March 1987

MR SCHOLAR

cc: Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Sir G Littler
Mr F E R Butler
Mr Wilson
Mr Cassell
Mr Monck
Mr Sedgwick
Mr Odling-Smee
Mr Culpin
Miss O'Mara
Miss Sinclair
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey

Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Beighton - IR
Mr McManus - IR
Sir Angus Fraser - C&E
Mr Knox - C&E
Mr Wilmott - C&E
Mr Bone - C&E

Mr Norgrove
(No.10)

per B.L.O.

**BUDGET STATEMENT: FINAL DRAFT**

I attach the final draft of the Budget Statement.

2. Please could copy recipients check this very carefully, and let me have any comments by 1.00 pm.

ACSA

A C S ALLAN

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## A. INTRODUCTION

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

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

A3. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then turn to monetary policy and to the fiscal outlook this year and next. Finally, I shall propose some changes in taxation designed to improve still further the prospects that lie before us. A number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

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## B. THE ECONOMIC BACKGROUND

B1. I start with the economic background.

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

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

B4. And this greatly improved growth performance has been accompanied by falling inflation, which at 3½ per cent in 1986 reached the lowest figure for almost 20 years. Over the lifetime of this



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Parliament, inflation has averaged less than 5 per cent, while growth has averaged over 3 per cent.

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

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

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

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

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

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



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account surplus of some £20 billion between 1979 and 1985. Some deterioration in our current account was inevitable in the face of a £5 billion loss of earnings on oil trade virtually overnight. But the significance of this should not be exaggerated. The exchange rate adjustment that followed the fall in the oil price is already contributing to an improved non-oil trade performance. And earnings from the massive stock of net overseas assets we have acquired since 1979 will provide a continuing support to the current account in the years ahead. At well over £100 billion our net overseas assets are now greater than at any time since the War, and second only to those of Japan.

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B10. Looking ahead, I expect 1987 to be another year of balanced growth with low inflation. Total output is forecast to rise by 3 per cent, with exports and investment up by rather more than that. By then we will have registered the longest period of steady growth, at a rate approaching 3 per cent a year, that the British economy has known since the War. Manufacturing industry, in particular, should do well in 1987. And with the non-oil economy set to grow at 3½ per cent, there is every prospect of unemployment continuing to fall throughout the year. In last year's Budget Speech I said that the outlook for jobs depended on a sustained improvement

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in the performance of business and industry. That sustained improvement in economic performance is now well under way.

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

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

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



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exacerbated by renewed turmoil in the foreign exchange markets, whose tendency to overshoot is as notorious as it is damaging.

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

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

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

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

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## C. MONETARY POLICY

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

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

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

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



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continue to be taken into account in assessing monetary conditions, as of course will the exchange rate.

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## D. ~~PUBLIC SECTOR BORROWING~~

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

D2. The final outturn for the public sector borrowing requirement last year, 1985-86, was just under £6 billion, equivalent to 1½ per cent of GDP, the lowest level since 1970-71. In my Budget last year, faced with a massive loss of what now looks like £7 billion of North Sea oil revenue, I nonetheless decided to hold the PSBR for this year, 1986-87, to £7 billion, or 1¾ per cent of GDP.

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

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D4. This successful outcome is chiefly attributable to the remarkable buoyancy of non-oil tax revenues in general and of the Corporation Tax paid by an increasingly profitable business sector in particular.

D5. Looking ahead, there is still a degree of uncertainty surrounding oil prices, and I have

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therefore stuck to the assumption I made last year that the North Sea price will average $15 a barrel. But it is clear that the increased flow of non-oil tax revenues, coupled with the prospective further growth of the economy in excess of the growth of public expenditure, puts the public finances in a very strong position.

D6. I intend to keep it that way. Last year's MTFS indicated a PSBR for 1987-88 of £7 billion, or 1¾ per cent of GDP; and, as the House will recall, I gave an assurance at the time of the Autumn Statement, when I announced a £4¾ billion increase in planned public spending in 1987-88, that on no account would I exceed that figure.

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D7. Indeed, I believe it is right to go below it. Since its inception in 1980, the MTFS has indicated a steadily declining path for the PSBR expressed as a percentage of GDP. We have now reached what I judge to be its appropriate destination: a PSBR of 1 per cent of GDP. My aim will be to keep it there over the years ahead. This will maintain a degree of fiscal prudence that, until this year, had been achieved on only two occasions since 1950.

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

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

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

D11. Throughout our period of office, our critics have consistently maintained not only that a fiscal stimulus would produce real economic growth, but that without an expansionary fiscal policy sustained growth was impossible. They were wrong, and have been proved wrong. The British economy is now embarking on its seventh successive year of



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

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## X. EXCHANGE CONTROL

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

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

X3. But the Exchange Control Act remains on the Statute book. The time has come to repeal it. The necessary legislation will be contained in this year's Finance Bill.

X4. I note that, in what was clearly intended to be a major speech in New York in September, the Deputy-Leader of the Labour Party declared that, and I quote:

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

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

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## E. BUSINESS AND ENTERPRISE

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

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

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

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



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

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

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

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E8. Hitherto, companies have not been allowed to set payments of Advance Corporation Tax against their liability to tax on capital gains. This means that, where companies distribute capital gains as dividends, the gains are in effect taxed twice, once in the hands of the company and once in the hands of the shareholder. I propose that, under the new system, companies should be able to set ACT payments against tax on capital gains.

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

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

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

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

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

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

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

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



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themselves have repeatedly stressed their desire for stability.

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

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

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

E20. Last year I put the Business Expansion Scheme onto a permanent footing. However, there is still evidence that the present rules produce end-year



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bunching of BES investments, and hence may crowd out some projects and lead to bad decisions on others. I propose therefore to permit the investor to claim part of the relief against his previous year's income. This will make it easier for companies to raise BES finance throughout the year.

E21. I have to set the 1988-89 car and fuel benefit scales for those with company cars. The car scale charges still fall well short of the true value of the benefit, and as last year I propose to increase them by 10 per cent. There will be no change in the fuel scales which, as already announced, will also be used for VAT purposes from 6 April.

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E22. Training and retraining are vital to a flexible and competitive economy. At present, training financed by an employer that is related to the employee's current job is allowable against tax for the employer and imposes no tax burden on the employee. But an employer who is willing to finance the retraining of workers for future employment elsewhere may find that the cost of this is not allowable against tax, and the employee may find that he has received a taxable benefit. I propose to remove both these obstacles. This should help more workers to acquire new skills for new jobs.

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E23. The past few years have seen a remarkable and welcome growth in the number of small businesses and the self-employed. The Government has done a great deal to lighten the burdens on this vitally important sector of the economy. But I am well aware that problems remain, not least in the field of VAT.

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

B.L.O.

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

E26. My first and most important proposal, therefore, is that, as from 1 October, businesses whose annual turnover is under £½ million, which means more than half of all traders registered for VAT, will be able to choose to account for VAT on the basis of cash paid and received. In other words, they will have no liability to pay VAT until

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they themselves have received the money from their customers. In addition to easing the cash flow problems caused by late payers, this system will of course provide automatic VAT relief for bad debts.

E27. I have to warn the House, however, that I cannot legally introduce this change without first obtaining a derogation from the European Community's Sixth VAT Directive. I am applying for the necessary derogation today. The House will note that the upper limit of £¼ million is considerably greater than the £100,000 suggested in the consultative document.

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

B.L.O.

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

E30. Fourth, there will be changes to the rules for the special VAT schemes for retailers, and more

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small and medium-sized businesses will be able to make use of the simpler schemes.

E31. I believe that the changes I have outlined, and in particular the option to move to cash accounting, will be widely welcomed by the small business community. The cost will be £115 million in 1987-88 and £60 million in 1988-89.

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

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

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

E35. In any ongoing programme of tax reduction and reform, where much still remains to be done, an essential element must always be the elimination of

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unintended or unjustified tax breaks, which cause rates of tax generally to be higher than they need to be. Accordingly, I have five proposals to make today to that end.

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

E37. Second, I propose to change the law so that companies in multinational groups which enjoy dual residence will no longer be able to secure tax



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relief twice on one and the same interest payment. Genuine trading companies will not be affected. This change, which will take effect on 1 April, follows the similar action recently taken by the United States. It will yield £125 million in 1988-89.

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

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E39. Fourth, the tax treatment of Lloyd's syndicates as it applies to the Reinsurance to Close system is clearly unsatisfactory. I therefore propose to bring it into line with that of provisions for outstanding liabilities made by ordinary insurance companies and, indeed, of comparable provisions made by other financial traders. I have asked the Inland Revenue to consult urgently with Lloyd's about the details of the



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legislation. The new rules will first apply to premiums payable for the Lloyds account which closes on 31 December this year.

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

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

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

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



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nation, we are to defeat the scourge of unemployment.

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

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

E46. Profit-related pay is no panacea. But then there <u>are</u> no panaceas. What it is is a tool to help British business gradually to overcome one of our



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biggest national handicaps: the nature and behaviour of our labour market. I am today challenging British management to take advantage of that tool and to make good use of it, for the good of their firm, their workforce and their country.

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## F. TAXES ON SAVING

F1. I turn now to the taxation of savings.

F2. A central theme and purpose of the Government's policies is the creation of a genuine popular capitalism.

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

B.L.O.

F4. We know that 63 per cent of households now own their own homes, 2½ million more than in 1979. However, there have been no official figures for the

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more explosive growth of share ownership in Britain over the past eight years. The Treasury and the Stock Exchange therefore jointly commissioned a major independent survey of individual shareholding in Britain. The results are now available. They show that there are now some 8½ million individual shareholders in this country - amounting to one fifth of the total adult population, and roughly three times the number there were in 1979.

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

B.L.O.

F6. The cornerstone of the Government's pensions strategy is the introduction of an entirely new means of provision for retirement, developed by my Rt Hon Friend the Secretary of State for Social Services. This is the personal pension, which will be launched at the beginning of next year, three months earlier than planned.

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

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

F9. In addition, to encourage a wider spread of occupational schemes, employers will be able to set up simplified schemes with the minimum of red tape. This will be particularly welcome to many small employers who have been discouraged by the complexity and open-ended commitment of a full-blown final salary scheme. And there will be much greater scope for transferring between different types of pension scheme. Again, the Finance Bill will contain the necessary tax provisions.

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

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

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

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

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

B.L.O.

F.15 For Friendly Societies, I have decided to replace the existing tax-exempt life assurance limit based on the sum assured with a new limit based on annual premiums. I propose to set this at £100 a year, which will greatly increase the scope of the traditional societies to offer life policies to their members.

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F16. The tax-exempt limits governing sickness and accident benefits which trade unions provide for their members have not been changed since 1982.

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With effect from today, I propose to increase them to £3,000 for lump sums and £625 for annuities.

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

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

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F19. I also propose to make two minor changes affecting business assets. First, holdings in companies quoted on the unlisted securities market will henceforth be treated for Inheritance Tax purposes in precisely the same way as holdings in companies with a full Stock Exchange listing. Second, business relief for minority holdings in excess of 25 per cent in unquoted companies will be increased from 30 per cent to 50 per cent. The



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purpose of both these changes is to concentrate business relief more accurately on those assets which could provide funds to pay the tax only at the risk of damaging the business.

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

F21. I therefore propose to make a substantial increase in the threshold for Inheritance Tax, from £71,000 to £90,000, coupled with a simplification of the rate structure from seven rates to four. As a result of this change, the number of estates liable to Inheritance Tax will be cut by roughly a third. The cost will be £75 million in 1987-88 and £170 million in 1988-89.

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

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F23. It is the same story with the other capital taxes. Since we first entered office, their severity has been significantly eased. And over the same period the yield of Capital Gains Tax has risen in real terms by 80 per cent and that of Stamp Duty by 140 per cent.

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## G. TAXES ON SPENDING

G1. I now turn to the taxation of spending.

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

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

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

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



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

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

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## H. INCOME TAX

H1. Finally, I turn to income tax.

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

H14. The total cost of all the measures in this year's Budget, again on an indexed basis, is a little over £2½ billion.

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## J. CONCLUSION

J1. Mr Deputy Speaker, in this Budget I have reaffirmed the prudent policies which, despite a year-long coal strike followed by a collapse in the oil price, have given us the strongest economy we have known since the War.

J2. After an Autumn Statement which increased public spending in priority areas, I have once again cut the basic rate of income tax; a cut which the Party opposite are pledged to reverse, if they are given the chance - which they will not be. And I have done this while sharply reducing public borrowing; a combination that has eluded successive Governments for decades. This is a Budget built on success, and a Budget for success. I commend it to the House.

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10 DOWNING STREET
LONDON SW1A 2AA

*From the Private Secretary*

13 March 1987

**1987 BUDGET- MTFS**

The Prime Minister has seen the Chancellor's minute (undated) which set out his proposals for the PSBR and monetary targets for 1987/88 and the MTFS, and is content.

(David Norgrove)

Alex Allan, Esq.,
HM Treasury.

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PRIME MINISTER

The Chancellor's draft Budget Speech is below.

You may be able to pass any comments to the Chancellor by telephone. If not, there will be a car to take a minute from you to the Chancellor ready to leave at 1100 on Saturday morning. Could you please tell the Garden Room Girl at Chequers early on Saturday whether you will need the car, so that the driver can be stood down if not required? (There will be proper security for your minute.)

The speech itself is short - the Chancellor is aiming to give the shortest speech this century, under an hour - and well written. Two things struck me.

First, paragraph D7 makes several very firm statements about a PSBR set at 1 per cent of GDP. They seem to me too firm.

As you know, the MTFS will show a PSBR at 1 per cent of GDP throughout the period it covers. This may well be right. It would be possible to show the PSBR declining further to balance or even into surplus. But in the coming years privatisation proceeds are likely to decline, so the "quality" of the PSBR will be improving, and on top of that there may well be a shortfall in privatisation receipts.

On the other hand, to make firm statements about the desirability of 1 per cent of GDP is itself a hostage to fortune. Suppose the forecast next year showed another £6 billion fiscal adjustment, it would surely not be right to reduce taxation by the full amount, in almost any likely economic circumstances. There are also great uncertainties about the oil price. It could be $25 or $10 this time next year and the PSBR could quite properly be set above or below 1 per cent of GDP.

The Chancellor appears to believe that if circumstances change he can change the figure. But that is not the implication of his Budget Speech, even if there is the usual qualifiying sentence in the published MTFS that the PSBR in each year will be set nearer the time. Just possibly, he may see the figure as a way of tying down the colleagues on public expenditure. But he did not mention this point when I discussed the paragraph with him, and certainly it seems very hard to believe it would have any effect: everyone knows that the PSBR can be adjusted from year to year.

Finally, the theoretical basis for a PSBR at 1 per cent of GDP is not unchallengeable. Indeed, in the end the figure depends on the Chancellor's hunch. But if we had experience of public sector surpluses we might well regard those as the natural order of things.

I have marked on paragraph D7 three amendments designed to weaken the commitment to a PSBR of 1 per cent of GDP, whilst retaining the Chancellor's words as far as possible.

The second point to which I would draw your attention is the phrase marked in paragraph F2: "what used to be called, when ambitions were more limited and language more inhibited, a property owning democracy". This seems rather flip, though the Chancellor regards it as lightening the speech.

I attach a draft minute for your signature if you agree with these comments.

(DAVID NORGROVE)
13 March 1987

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COPY NO. 1 OF 3* A4

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

13 March 1987

David Norgrove Esq
10 Downing Street
LONDON SW1

Dear David,

**BUDGET STATEMENT**

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

Yours
Alex

A C S ALLAN

F.2. Prep. - during drafting
G.8. Famous Lines.

* cc 2+3 without attachment

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## A. INTRODUCTION

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

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

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

A4. I shall begin, as usual, by reviewing the economic background to the Budget. I shall then turn to monetary policy and to the fiscal prospect this year and next. Finally, I shall propose some changes in taxation designed to improve still further the prospects that lie before us. A number of press releases, filling out the details of my proposals, will be available from the Vote Office as soon as I have sat down.

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## B. THE ECONOMIC BACKGROUND

B1. I start with the economic background.

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

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

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



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

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

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

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

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

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

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

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

B10. Looking ahead, I expect 1987 to be another year of balanced growth with low inflation. Total output is forecast to rise by 3 per cent, with exports and investment up rather more than that. By then we will have registered the longest period of steady growth, at a rate approaching 3 per cent a year, that the British economy has known since the War. Manufacturing industry, in particular, should do well in 1987. And with the non-oil economy set to grow at 3½ per cent, there is every prospect of unemployment continuing to fall throughout the year. In last year's Budget Speech I said that the outlook for jobs depended on a sustained improvement in the performance of business and industry. That sustained improvement in economic performance has occurred and is continuing.

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

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

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

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

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

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

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

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## C. MONETARY POLICY

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

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

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

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C4. For narrow money, M0, the target range for next year will be 2 to 6 per cent, as foreshadowed in last year's MTFS. For broad money, however, as the Governor of the Bank of England cogently argued in his Loughborough lecture last October, in current circumstances it is probably wiser to eschew an explicit target altogether. But broad money will continue to be taken into account in assessing

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monetary conditions, as of course will the exchange rate.

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

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## D. PUBLIC SECTOR BORROWING

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

D2. The final outturn for the public sector borrowing requirement last year, 1985-86, was just under £6 billion, equivalent to 1½ per cent of GDP, the lowest level since 1970-71. In my Budget last year, faced with a massive loss of what now looks like £7 billion of North Sea oil revenue, I nonetheless decided to hold the PSBR for this year, 1986-87, to £7 billion, or 1¼ per cent of GDP.

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

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

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

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D6. I intend to keep it that way. Last year's MTFS indicated a PSBR for 1987-88 of £7 billion, or 1¾ per cent of GDP; and, as the House will recall, I gave an assurance at the time of the Autumn Statement, when I announced a £4¾ billion increase in planned public spending in 1987-88, that on no account would I exceed that figure.

B.L.O.

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

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

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

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

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

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

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## X. EXCHANGE CONTROL

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

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

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

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

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

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

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

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## E. BUSINESS AND ENTERPRISE

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

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

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

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

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

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

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

B.L.O.

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

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

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

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

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

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

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

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

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

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

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

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

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



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

E21. Last year I put the Business Expansion Scheme onto a permanent footing. However, there is evidence that the present rules produce end-year bunching of BES investments, and hence may crowd out some projects and lead to bad decisions on others. I propose therefore to permit the investor to claim part of the relief against his previous year's income. This will make it easier for companies to raise BES finance throughout the year.

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

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



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

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

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

E26. My first and most important proposal, therefore, is that, as from 1 October, businesses whose annual turnover is under £¼ million, which means more than half of all traders registered for VAT, will be able to choose to account for VAT on the basis of cash paid and received. In other words, they will have no liability to pay VAT until they themselves have received the money from their customers. In addition to easing the cash flow problems caused by late payers, this system will of course provide automatic VAT relief for bad debts.

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E27. I have to warn the House, however, that I cannot legally introduce this change without first obtaining a derogation from the European Community's Sixth VAT Directive. I am applying for the necessary derogation today. The House will note that the upper limit of £¼ million is considerably greater than the £100,000 suggested in the consultative document.

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

B.L.O.

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

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

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



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

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

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

B.L.O.

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

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

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

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



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

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

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



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

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

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

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

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

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

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

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

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## F. TAXES ON SAVING

F1. I turn now to the taxation of savings.

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

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

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F4. We know that 63 per cent of households now own their own homes, 2½ million more than in 1979. There have been, however, no official figures for the more explosive growth of share ownership in Britain over the past eight years. The Treasury and the Stock Exchange therefore jointly commissioned a major independent survey of individual shareholding in Britain. The results are now available. They show that there are now some 8½ million individual shareholders in this country - amounting to one fifth of the total adult population, and roughly three times the number there were in 1979.

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

B.L.O.

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

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

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

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

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



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

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

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

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

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

B.I.O.

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

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



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

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

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

B.L.O.

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

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

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

R.I.O.

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

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

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

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

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## G. TAXES ON SPENDING

G1. I now turn to the taxation of spending.

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

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

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

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

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

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

B.L.O.

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

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

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

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## H. INCOME TAX

H1. Finally, I turn to income tax.

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

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

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

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

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

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

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

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

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

B.L.O.

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

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

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

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

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

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

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

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PRIME MINISTER

The Chancellor's draft Budget Speech is below.

You may be able to pass any comments to the Chancellor by telephone. If not, there will be a car to take a minute from you to the Chancellor ready to leave at 1100 on Saturday morning. Could you please tell the Garden Room Girl at Chequers early on Saturday whether you will need the car, so that the driver can be stood down if not required? (There will be proper security for your minute.)

The speech itself is short - the Chancellor is aiming to give the shortest speech this century, under an hour - and well written. Two things struck me.

First, paragraph D7 makes several very firm statements about a PSBR set at 1 per cent of GDP. They seem to me too firm.

As you know, the MTFS will show a PSBR at 1 per cent of GDP throughout the period it covers. This may well be right. It would be possible to show the PSBR declining further to balance or even into surplus. But in the coming years privatisation proceeds are likely to decline, so the "quality" of the PSBR will be improving, and on top of that there may well be a shortfall in privatisation receipts.

On the other hand, to make firm statements about the desirability of 1 per cent of GDP is itself a hostage to fortune. Suppose the forecast next year showed another £6 billion fiscal adjustment, it would surely not be right to reduce taxation by the full amount, in almost any likely economic circumstances. There are also great uncertainties about the oil price. It could be $25 or $10 this time next year and the PSBR could quite properly be set above or below 1 per cent of GDP.

The Chancellor appears to believe that if circumstances change he can change the figure. But that is not the implication of his Budget Speech, even if there is the usual qualifiying sentence in the published MTFS that the PSBR in each year will be set nearer the time. Just possibly, he may see the figure as a way of tying down the colleagues on public expenditure. But he did not mention this point when I discussed the paragraph with him, and certainly it seems very hard to believe it would have any effect: everyone knows that the PSBR can be adjusted from year to year.

Finally, the theoretical basis for a PSBR at 1 per cent of GDP is not unchallengeable. Indeed, in the end the figure depends on the Chancellor's hunch. But if we had experience of public sector surpluses we might well regard those as the natural order of things.

I have marked on paragraph D7 three amendments designed to weaken the commitment to a PSBR of 1 per cent of GDP, whilst retaining the Chancellor's words as far as possible.

The second point to which I would draw your attention is the phrase marked in paragraph F2: "what used to be called, when ambitions were more limited and language more inhibited, a property owning democracy". This seems rather flip, though the Chancellor regards it as lightening the speech.

I attach a draft minute for your signature if you agree with these comments.

DN

(DAVID NORGROVE)
13 March 1987

DCABUG

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

13 March 1987

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

**TAXATION OF FRINGE BENEFITS - COMPANY CARS AND FREE FUEL FOR PRIVATE MOTORING: 1988-89**

As in recent years I am writing to interested colleagues about my proposals in advance of the Budget announcement.

I propose to announce that for 1988-89 the car benefit scale will be increased by 10 per cent. This is in line with the increase for the last three years and continues our policy of gradually increasing the charges to a more realistic level.

As for last year there will, however, be no increase in the car fuel scale which is being pegged at the 1987-88 level. This is because the car fuel scale has already reached a realistic measure of the value of this benefit. As I announced last year, this scale will also be used (from April 1987) for VAT purposes.

The main scales for 1988-89 resulting from these proposals are summarised below (1987-88 figures for the benefits scale in brackets):-

| | Car Benefits £ | Car Fuel Benefits £ |
|---|---|---|
| 1400cc or less | 580 (525) | 480 |
| 1401cc - 2000cc | 770 (700) | 600 |
| More than 2000cc | 1210 (1100) | 900 |
| £19,250 - £29,000 | 1595 (1450) | Scale for relevant engine size applies |
| More than £29,000 | 2530 (2300) | |

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

I am copying this letter to the Prime Minister, and to Peter Walker and John Moore.

NIGEL LAWSON

MR 9/78

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Prime Minister

Content?

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Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

PRIME MINISTER

**1987 BUDGET: MTFS**

In my minute of 5 March, I set out my tax proposals and said I would let you have a further note on the PSBR and monetary targets for 1987-88.

**Public Sector Borrowing**

The latest estimates of the February PSBR show that cumulative borrowing in the first eleven months of the year was only £0.1 billion. Borrowing in March is always large, and there will be some special factors pushing it up further this year; these include the £680 million payment to Rover. The forecast I propose to publish for the out-turn for 1986-87 is £4 billion, though considerable uncertainties remain, particularly over likely borrowing by local authorities and public corporations.

That means the PSBR has now reached what I judge to be the appropriate level for the medium term: 1 per cent of GDP. I therefore propose to set the PSBR for 1987-88 at that level. Thanks to the strength of tax revenues, I can do that at the same time as implementing the £2.6 billion tax package we have agreed. Indeed, the resulting published PSBR of £3.9 billion will be underpinned by deliberately cautious estimates of revenue, including an assumption of a $15 oil price.

For the remaining years of the MTFS period, I plan to show the PSBR remaining at 1 per cent of GDP. It is a major achievement to have reached this level well before we had earlier thought possible - a level recorded on only two previous occasions since the War.

Treasury now say that figures are only available from the early 50's and that in any case in some years in the late 40s there would probably have been surpluses.

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## Monetary Targets

As I mentioned when we spoke yesterday, for 1987-88 I intend to set a target for M0 but not for £M3. As you know, we have had increasing difficulties in interpreting changes in broad money; £M3 has for several years been erratic and shown a tendency to grow more rapidly than money GDP. This year, it has once again grown well above its target range. I do not think that dropping the £M3 target will cause any surprise at all: indeed, the markets would be surprised if it were not dropped. And as the Governor's Loughborough Lecture indicated, there is no point in switching to any other broad money target: all broad aggregates are in much the same boat.

The velocity of M0 has been much more stable, and M0 has remained within its target range of 2 to 6 per cent during 1986-87. For 1987-88, the illustrative range we set in last year's FSBR was also 2 to 6 per cent, and I see no reason to change that now. For the future years of the MTFS I shall also be publishing the same illustrative ranges as in last year's FSBR.

The dropping of a broad money target does not mean that the whole weight of monetary policy is thrown on to M0, though that has a very important role to play. I shall continue to assess monetary conditions in the light of all the available indicators, including in particular the exchange rate. And I will make it clear that, although I am not setting a formal target for £M3, I shall continue to take broad money into account in assessing monetary conditions.

This approach has been fully discussed with the Bank who support these recommendations.

These proposals will give us a solid financial framework for the medium term. I would be glad to know if you are content with them.

N.L.

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10 DOWNING STREET
LONDON SW1A 2AA

*From the Private Secretary*

6 March, 1987.

**BUDGET PROPOSALS**

The Prime Minister has seen the Chancellor's minute of 5 March which set out his proposals for this year's Budget. As you know, the Prime Minister and the Chancellor have discussed the majority of these at bilaterals in recent weeks, and the Prime Minister is content. She has noted that the Chancellor will be minuting separately about his proposals for monetary targets and PSBR.

(David Norgrove)

Alex Allan, Esq.,
HM Treasury.

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Prime Minister
Entirely as expected.
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No A1

**PRIME MINISTER**

This minute sets out my proposals for the Budget this year.

2. My aim, as in previous years, has been to devise a Budget which will give us a solid financial framework, with a safety margin built into it, for the year ahead; which will reduce taxation within the limits of prudence; and which will improve incentives and encourage enterprise.

3. I will minute you separately about my proposals for monetary targets and the PSBR when the final pieces of the jigsaw are available, early next week. But it is already plain that we shall be able this year both to plan on a PSBR substantially below the level envisaged in last year's MTFS and at the same time to afford a tax reduction of £2½ billion in 1987-88 rising to just under £3 billion in 1988-89. \ actually given as £2.6 bn.

**Income tax**

4. I propose to increase the main personal allowances by the statutory indexation factor of 3.7 per cent. As last year, I am sure our priority must be to cut the basic rate - the starting rate for everyone, and the marginal tax rate for 95 per cent of all taxpayers. I am therefore proposing a 2p cut, to 27 pence in the pound. This will do more than any other measure available to us to add momentum to the growth of the enterprise culture. It is desirable in itself and is the best means of improving the longer term potential of the economy. It also highlights the difference between our approach and that of the Opposition.

5. Our presentation of these proposals should, I suggest, follow closely the line which we got across so successfully last year:

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that it is aimed at the vast majority of taxpayers and will help all the sensitive groups in the middle - the nurse, the teacher married to a bank clerk and so on. To strengthen our presentation I propose, as last year, to set the higher rate bands so as to ensure that higher rate taxpayers will not benefit disproportionately from the income tax changes as a whole. Thus the first (40 per cent) higher rate threshold would be fully revalorised, the second (45 per cent) threshold partially revalorised, and the subsequent higher rate thresholds left unchanged.

6. For two groups I propose increases in the allowances beyond simple indexation: for those over 80 the age allowance will be increased by twice the indexation factor, ie by 7.4 per cent; and the blind allowance will go up from £360 to £540.

**Excise duties**

7. Apart from three minor changes in Vehicle Excise Duty and an increase in gaming machine duty, I am proposing no increases in the excise duties this year. This means that the overall impact of the Budget on the RPI as conventionally measured will be about 0.15 per cent (entirely reflecting the effect of the basic rate cut on mortgage payments), well below last year's 0.5 per cent. Although I expect some criticism from the health lobby I am sure that public opinion will well understand why I am not proposing tax increases on fuel, drinks and tobacco this year. I shall be reducing the duty on unleaded petrol by 5p a gallon, this honouring my promise last year; and I shall be abolishing the duty on on-course betting, recouping the revenue by the increase in the gaming machine duty.

**Business and enterprise**

8. My other Budget proposals are designed to carry further the themes of my previous Budgets. I am again taking action to tilt the balance towards small businesses, both by cutting their tax rates and by lightening the administrative load they bear. The small

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companies' rate of Corporation Tax comes down to 27 per cent, in line with the basic rate cut. The self-employed will benefit from the reductions in income tax.

9. I am also legislating to ease the burden of VAT on small businesses. My proposals here follow the lines of the consultation exercise we launched last autumn. The main change here is the introduction of "cash accounting" which will mean that companies with an annual turnover of up to £¼ million (and not £100,000, as in the consultation document) will not have to pay VAT until they themselves have been paid by their customers. This will help their cash flow, as well as giving them automatic bad debt relief, something for which they have long asked. I would personally have liked to set a still higher limit, probably £½ million; but I have reluctantly concluded, on the basis of legal and other expert advice, that that would jeopardise our prospects of getting the necessary derogation from the EC Commission. I shall also be introducing optional annual accounting, which will enable small companies to make VAT payments on account and send only one return a year to Customs and Excise; and a number of other changes, including a further increase to the VAT threshold to keep it to the maximum currently possible under European Community law.

10. I am making a number of changes to streamline the taxation of the corporate sector. These changes have been made possible by, and build upon, the 1984 corporation tax reform, which has proved an outstanding success. It is improving both the environment for business and the quality of business decisions, and at the same time increasing the yield of the tax.

11. At present companies pay corporation tax at different times depending on whether they were established before or after 1965. This difference of treatment no longer has any justification. It is also open to abuse: you may remember the Habitat case last year. I therefore propose that all companies (and building societies)

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should be treated in the same way, so that all will be liable to pay corporation tax nine months after the end of the accounting period on which the tax is due. The change will be phased in. For the longer term I am taking steps now to introduce a more streamlined method of collecting corporation tax, called Pay and File.

12. I am also making changes to the taxation of companies' capital gains. In future these will be taxed at the same rate as company income - either 35 per cent or, for small companies, 27 per cent - not, as now, at 30 per cent. Companies will be allowed to offset payment of Advance Corporation Tax against their tax liability on gains, something which will be generally welcomed.

13. Peter Walker and I have been looking closely at the effect of the last year's oil price on North Sea producers and their suppliers. We have already legislated to bring forward to 1986-87 the repayment of over £300 million of Advance Petroleum Revenue Tax. As agreed last November, I propose to introduce two further reliefs designed to encourage research and development in the North Sea oil sector. These have been carefully aimed where they should do most good. They are to allow part of the expenditure on new fields to be set against PRT liabilities on other fields; and to allow special relief for R&D even though it is not related to any individual field.

14. As in all previous years, I propose that the scale charge for assessing the taxable benefit of company cars should be increased by 10 per cent. There will be no change in the car fuel benefit scales.

15. The Budget will also contain a number of measures designed to block up loopholes where substantial losses of tax are at stake. On one of these, VAT partial exemption, we have already exchanged minutes (my minute to you of 16 December and David Norgrove's reply of 18 December) and it is now clear that the scale of avoidance is larger than we at first supposed (£300 million in 1987-88 and £400 million in 1988-89). The business community accepts that we must act to stop this practice. As you know, I am also proposing action, in line with what the US are doing, on dual resident

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companies, to stop them getting tax relief twice on the same interest payment. And I am bringing to an end the present over-generous treatment of tax credit relief for foreign withholding tax paid on interest on bank loans.

16. I have one further measure in this category. Lloyd's have now discovered a loophole in the law which prevents the Revenue from challenging for tax purposes syndicates' "Reinsurance to Close" - ie their provision for outstanding liabilities. I am proposing to put this right and to bring the arrangements for Lloyd's into line with the tax treatment of provisions for outstanding liabilities made by ordinary insurance companies. The Revenue will consult Lloyd's on the details immediately after the Budget.

17. I am convinced that, where we can, we must give a push to moves towards more flexibility on pay throughout the economy. I accordingly propose now to introduce a scheme of tax relief broadly on the lines floated in the Green Paper on Profit Related Pay which David Young, Paul Channon and I published last July. But it will be a little more generous: half, rather than a quarter, of profit-related pay will be relieved from income tax, subject to limits; even so, the very small cost of this relief will, I fear, lead to accusations that this is derisory. All the same, for someone on average earnings receiving 5 per cent of their pay in profit-related form, the tax relief will be equivalent to a penny off the basic rate of income tax. The administration will be kept simple.

**Savings**

18. I have agreed with Norman Fowler a major package of proposals on pensions which will complement the reforms in 1985 and 1986 Social Security Acts. Our aim is wider pension ownership, and to encourage people to provide for themselves in old age.

19. There are several strands to the proposals. First, I am introducing a system of tax relief for personal pensions on broadly the same lines as that now applying to retirement annuities. This will make it easier for employees to opt out of their employers' schemes and make their own arrangements; and it will also benefit

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those whose employers do not offer an occupational pension scheme. Second, I propose changes which will make it simpler for employers to set up occupational schemes with the minimum of red tape and with less of an open-ended commitment on the size of final pensions. This should encourage wider pension coverage and be of particular benefit to the 10 million or so employees who are not covered by occupational schemes.

20. Third, I am introducing arrangements to allow members of occupational schemes to make additional voluntary contributions, with full tax relief, to a plan outside their employer's scheme. They will be able to top their pension right up to the present tax approval limits. This goes well beyond what we have already announced. It will be good for choice and individual responsibility.

21. The generous tax treatment of pensions can be justified only if it is not abused. I propose, therefore, to introduce some limited changes to the present rules to restrict the excessive relief which can be obtained in some circumstances by a few people, including an upper limit of £150,000 on the tax-free lump sum and more rigorous rules for calculating final salary.

22. Last year's Budget abolished the tax on lifetime gifts between individuals. This year I propose to extend the same exemption from tax to gifts involving settled property where there is an interest in possession. This will be welcomed by many of our own supporters.

23. I am also making a substantial increase in the threshold for inheritance tax, from £71,000 to £90,000 and reducing the number of tax rates from seven to four. This change will mean worthwhile reductions in tax liability at all levels, particularly for smaller estates, and take a third of the estates currently liable to inheritance tax out of the tax net altogether.

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BUDGET SECRET

24. Last year's Budget contained a substantive package of measures to help charities. The encouragement we give to charitable giving is now very generous; and the Payroll Giving Scheme which starts next month will give it a further boost. I therefore have no major new proposals in this field, though I propose to extend slightly the VAT reliefs for charities which I introduced last year. These extensions will meet points which have been put to me by the charities lobby.

... 25. I attach a table which summarises the revenue effects of these changes. I would be grateful to know if you are content with my proposals.

N.L.

**N.L.**
5 March 1987

B.L.O.

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**REVENUE EFFECTS OF BUDGET CHANGES**

£m
(rounded to £5m)

| | 1987-88 (cost (-)/yield (+)) | 1988-89 (cost (-)/yield (+)) |
|---|---|---|
| Income tax (including higher rates) | -2160 | -2740 |
| Excise duties | - 535 | - 575 |
| VAT - small business package | - 115 | - 60 |
| - change in partial exemption rules | + 300 | + 400 |
| Corporation tax - small companies rate | * | - 45 |
| - capital gains | * | + 60 |
| - payment dates | * | + 100 |
| - dual residents | * | + 125 |
| - tax credit relief for banks | * | + 20 |
| Car and car fuel benefits | nil | + 30 |
| North Sea oil | - 5 | - 15 |
| Profit related pay | * | - 35 |
| Pensions | * | - 65 |
| Inheritance Tax | - 70 | - 150 |
| Other | - 30 | + 40 |
| **Total** | **-2595** | **-2900** |

**Note:** **(All figures are net of the cost or yield of indexation or revalorisation, which is included in the base forecast)**

**(* means negligible)**

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B.L.O.
SECRET

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From: R B SAUNDERS
Date: 5 March 1987

MR ROMANSKI

cc PPS
Mr Scholar
Mr Rees

Mr Norgrove - No 10
(with copy of Budget Security Instructions)

**BUDGET SECURITY**

Mr Allan will be sending a BLO minute to No 10 later today. Could you accordingly add the following to the Budget list:

The Prime Minister
Mr Wicks
Mr Norgrove.

R B SAUNDERS
Private Secretary

010

**with compliments**

Sir P E Middleton KCB
Permanent Secretary

H M TREASURY

## XIII. BUDGET SECURITY

### Relations with the Press

144. This first subsection applies to all Treasury staff in the pre-Budget period, including officials who are not involved in work connected with the Budget. References to 'journalist' in this section are to be interpreted widely to include contributors to specialist and academic publications, brokers' circulars, newsletters and other similar publications. References to the pre-Budget period should be taken to mean the period between the beginning of January and Budget Day itself.

145. Formal contacts with journalists in the pre-Budget period may only be undertaken with the prior authority of the Permanent Secretary or, in his absence, either the Under Secretary (FP) or one of the Second Permanent Secretaries. If permission for such contact is granted, a report should be submitted immediately after it takes place to the head of IDT, copied to the Permanent Secretary and the Budget Security Officer, whatever the subject matter of the discussion.

146. Telephone calls from journalists are to be referred in the first instance to IDT. If any conversation takes place directly with a journalist in the pre-Budget period a report is to be sent to IDT copied to the Budget Security Officer, whatever the subject matter of the conversation.

147. If any other contacts take place with journalists in the pre-Budget period, no matter how informal, a report of the fact is to be made to IDT copied to the Budget Security Officer, together with a very brief account of any discussion of official matters.

### General

148. Special security arrangements apply to certain information connected with the Budget, as described in paragraph 150. The arrangements apply in addition to the normal departmental security procedures and are intended to provide additional protection for information about Budget decisions. It is the responsibility of every person involved in Budget work to be familiar with, and operate, these instructions. EOG will ensure that those most heavily involved understand the procedures.

149. The recipient of a Budget classified document is, at all times, personally responsible for its security. This applies even if custody of the document is entrusted to another member of his or her staff (where this is permitted).

Use of Budget prefix

150. The Budget prefix should only be added to the security classification marking for documents which contain information concerning Ministerial decisions on:

(a) the Budget judgement and in particular the PSBR;

(b) all taxation matters connected with the Budget; and

(c) any social security or other public expenditure changes to be announced in the Budget.

The Budget classification should also be applied to documents in which no decisions are recorded, where the papers are particularly sensitive - for example, where the very fact that a matter is being discussed is sensitive, where there is a serious danger of forestalling or where a document might reveal the approach to the Budget likely to be adopted by Ministers. The Budget prefix should not be used on other papers which do not reveal Ministerial decisions.

151. A Budget classification is not, in general, required for papers containing:

(a) Ministerial decisions relating to economic forecasts, monetary policy, exchange rate policy and other items not directly related to tax or public expenditure decisions, even where these are in the context of a Budget;

(b) arguments for and against a particular course of action, or recommendations from officials to Ministers or other Ministers to the Chancellor unless the papers are particularly sensitive (see above); or

(c) lists of options in which no decision is recorded.

It should be borne in mind that a submission to a Minister on a Budget matter, suggesting a range of options, may properly not have a Budget classification, but a note from a Ministerial Office recording a decision on it should be given a Budget classification.

152. Care and common-sense are needed in using the Budget prefix. In any cases of doubt the Treasury Budget Security Officer (see paragraph 165) is to be consulted.

**Level of Budget classification**

153. "BUDGET SECRET - BUDGET LIST ONLY" is a special security classification to be used for certain Budget documents, ie for those papers which reveal the contents or probable contents of the whole, or a very substantial or particularly sensitive part, of the Budget. The Chancellor may also decide that papers dealing with particular subjects be

given this classification. Strict rules are laid down for access to, and handling of, documents with this classification. These are set out in paragraph 154 and 158 below. Examples of papers which are to be given this classification include:

- papers, including records of meetings, which give an overall picture of Budget strategy;
- complete drafts of the Budget speech (and the most sensitive extracts such as complete drafts of the tax sections);
- full drafts of the Budget Brief, or particularly sensitive parts of it;
- full draft of the FSBR (and early drafts of the sections dealing with Budget proposals); and
- the Budget Resolutions, as a whole.

Papers dealing with an individual tax would not normally require BUDGET SECRET - BUDGET LIST ONLY classification, unless this is required by the Chancellor.

153A. Otherwise, Budget security rules require that the ordinary security classification of documents be prefixed by the word BUDGET. BUDGET: TOP SECRET should only be used where the material would fall clearly within the definition of TOP SECRET even if it were not to be included in the Budget. BUDGET: SECRET is the correct classification for all other papers on the main Budgetary items (ie the main tax rates and social security benefits and other major changes in tax legislation or public expenditure). BUDGET: CONFIDENTIAL should be used for papers recording decisions on other Budget matters, including all other decisions on tax items. The classification of a document is not necessarily the appropriate classification for a minute commenting on or replying to it even if the original document is classified BUDGET SECRET-BUDGET LIST ONLY. For example, a minute containing comments on a document should bear the classification appropriate to its contents and should only bear the same classification as the original document where it is appropriate.

**Communication of Budget classified information**

154. Documents for which the "BUDGET LIST ONLY" classification is appropriate may only be circulated to persons who are on the "Budget list", a list of recipients of such documents approved by the Permanent Secretary. Under no circumstances are they to be circulated or shown, or the contents communicated in any other way, to a person not on that list. A copy of the Budget list will be made available to each person who is on the list. If it is considered essential to show a BUDGET LIST ONLY document to a person not on the Budget list, the prior approval of the Parmanent Secretary must be

obtained in writing to the addition of his name to the Budget list. Requests for names to be added to the Budget list should be addressed in the first instance to the Budget Security Officer. This applies right up to the Budget Day.

155. The circulation of all Budget classified documents is to be restricted to the absolute minimum consistent with operational requirements. Before writing Budget classified material all originators must ask themselves:

(a) Is the document necessary at all? (A private face-to-face conversation is more secure than a written note - paragraph 13 contains guidance on the security of telephone conversations.)

(b) If the document is necessary, need it be circulated? (Only copy a document to those people who need to be aware of its contents.)

(c) Need the document quote precise details of decisions eg proposed tax rates?

(d) Does the document require a Budget classification?

(e) Is the title likely to be a security risk? (Particularly in the case of BUDGET SECRET and more highly classified documents, the title is likely to be seen by persons who are not authorized to have access to the contents, so it is essential that the title does not reveal any sensitive information.)

(f) Do all recipients need a copy of the whole document? If a part of the document would suffice, send only that part. It is essential that persons do not see parts of documents containing classified material which they have no operational need to see.

156. BUDGET LIST ONLY documents may not be shown to anybody who is not on the Budget list (except for the normal arrangements whereby the Queen, Prime Minister, certain staff at Number 10 and the Governor of the Bank of England are told the contents of the Budget). Other BUDGET classified information may be communicated to staff in the Chancellor's Departments (and the Office of the Parliamentary Counsel), only if they need to know about it for the efficient performance of their duties.

157. Budget classified information must not be communicated to anyone outside the Chancellor's Departments and the office of the Parliamentary Counsel without prior authority having been obtained from the Budget Security Officer. There are only three general exceptions to this rule. First, FP group have authority to communicate to

specified Department of Transport officials Budget decisions on VED and the duties on hydrocarbon oils. Second, the head of FP has authority to communicate to specified officials in the Department of Health and Social Security certain information about Budget changes in personal taxation. Third, as is appropriate for public expenditure matters, ST group will discuss any social security changes to be announced in the Budget with DHSS officials. In all these instances the Divisions concerned must ensure that these Departments are aware of the need for particular care in handling the information. Similarly, if a Treasury Minister writes to a Minister in another Department on a Budget classified matter, his Private Secretary should ensure that the other Private Office are aware of the significance of the Budget classification, and in particular of the need to ensure that the letter is shown or copied only to those who need to see it.

**Preparation and handling of BUDGET SECRET: BUDGET LIST ONLY documents**

158. In addition to the normal security instructions regarding handling of SECRET documents, set out in paragraphs 42 to 103, the following special instructions apply to the handling of BUDGET SECRET: BUDGET LIST ONLY documents:

(a) The title of the document must not give away any sensitive information as to its contents as it will be used on the label on the inner envelope and may therefore be seen by persons not authorised to handle the document. A code word should be used if necessary.

(b) The document must be typed on plain paper. The security classification is not to be typed. Documents may be typed by a Personal Secretary if she is herself on the Budget list. The typist's initials should appear on each page of the document. The originator is responsible for the security of the typed master, which must be given a number in the sequential series used for copies.

(c) Copies of the typed master must be made onto the special paper bearing printed 'BUDGET SECRET: BUDGET LIST ONLY' markings on one side of the paper only. Each copy of the document must be sequentially numbered.

(d) The documents must always be enclosed in the special distinguishing folder marked "BUDGET SECRET: BUDGET LIST ONLY" for transmission. They must always be transmitted in double envelopes even if sent within the building. The inner envelope must bear the special "BUDGET SECRET: BUDGET LIST ONLY" label completed with the relevant details in full. If more than one document is sent in one envelope, details of each document must be shown on the label. If a BUDGET SECRET: BUDGET LIST ONLY document is to be sent or copied to a Minister, he should be sent two

copies. A receipt must always be obtained for all copies of "BUDGET SECRET: BUDGET LIST ONLY" documents. It is the responsibility of the originator to ensure that a receipt is returned for each copy which has been sent out. These receipts must be retained until after Budget day.

(e) If they are being sent to other Departments, the documents must be sent by messenger or by the special van service which operates between the Treasury, the Revenue Departments and Parliamentary Counsel's Office. If these are not available, the documents may be sent by special signature service of the IDS. In every case receipts must be obtained for the documents. In no circumstances may the documents be sent by post or transmitted on facsimile equipment except for the secure fasimile link between the Treasury, HM Customs and Excise, Inland Revenue, Department of Transport and the Bank of England (see paragraph 80B).

(f) Each Recipient is responsible for ensuring that every BUDGET SECRET: BUDGET LIST ONLY document is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this - this applies particularly at Principal level. A document may be entered in the security register by the Personal Secretary or allocated Clerk from the information shown on the label, without opening the inner envelope. If this is done, the number of the security register entry is to be written on the label. The recipient of the document is to ensure that the security register number is shown and should copy it onto the document itself. In some areas, Personal Secretaries or Clerks may themselves be included on the Budget list authorised to handle BUDGET SECURITY: BUDGET LIST ONLY material. Only in such cases may they open the inner evelopes, in which case the security register number may be written on the document itself. BUDGET SECRET: BUDGET LIST ONLY documents may not be filed until after Budget Day except where the Clerk concerned is on the Budget List.

(g) Each copy of a BUDGET SECRET: BUDGET LIST ONLY document is personal to its recipient. It may not be shown to any person not on the Budget list in any circumstances, and shown (but not copied) to a person who is on the Budget list only if there is a real operational need for him to see it. The fact that a person is on the Budget list does not mean that he must see all BUDGET LIST ONLY documents. It is the recipient's responsibility to ensure that the document is not seen by any person who is not authorised to have access to it. It can be kept in the recipient's own

security cupboard only if all persons who are entitled to know the combination number have been specifically authorised to handle BUDGET SECRET: BUDGET LIST ONLY documents. Otherwise it will be necessary to store such documents in a separate document box or security cupboard whose combination number is known only to the recipient (and any authorized handler of such material). Officials who require additional security furniture for this purpose should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 4859).

(h) It is essential that BUDGET SECRET: BUDGET LIST ONLY documents are not left unattended by the person who is responsible for their custody - he must lock them away whenever he leaves his room.

(i) BUDGET SECRET: BUDGET LIST ONLY documents may on no account be photocopied except by the originator (or his Personal Secretary, on his authority, if she has typed the document). If a person not on the original list of copy addressees is subsequently to be given a copy of such a document, it must be provided by the originator and the name of the recipient properly recorded. He may retain a small stock of additional numbered copies of the document for this purpose (which are to be treated as accountable documents). If he needs to take an additional copy of the document, it must be numbered in the original series. The above rules as to handling and control of the document apply to additional copies.

(j) BUDGET SECRET: BUDGET LIST ONLY documents may only be taken out of the office to meetings if this is absolutely unavoidable. They may be taken home only if the Permanent Secretary has given his prior approval, either for a particular occasion or generally for a particular individual. Permission will only normally be given if the person concerned has a security container at his home. Any documents taken out of the office must be carried in a locked briefcase, box or pouch and kept securely at all times.

(k) Where a person only needs to see a part of a BUDGET SECRET: BUDGET LIST ONLY document, he should be sent only a copy of the relevant extract. The copy extract should be given a number in the same series as the full copies. It should be given the security classification, appropriate to the sensitivity of the matter contained in it - the security classification at the top of the front page should be amended in manuscript if necessary. The recipient of the extract should treat it in accordance with the security classification shown on the document.

(1) If a BUDGET SECRET: BUDGET LIST ONLY document is to be destroyed before the Budget, it is to be sent to the Budget Security Officer in double envelopes, the inner envelope bearing the appropriate label, and marked for destruction. The Budget Security Officer will carry out the destruction in accordance with the standing instructions.

159. If a Budget sensitive document meets the criteria of paragraph 24 for classification as TOP SECRET it should be classified as "BUDGET TOP SECRET: BUDGET LIST ONLY". The distinguishing folder and address labels for "BUDGET SECRET: BUDGET LIST ONLY" documents are to be used amended accordingly in manuscript. The instructions of paragraph 158 are to be followed, expect where the normal security instructions for TOP SECRET documents impose more stringent requirements, in which case those should be obeyed.

**Handling of other Budget classified documents**

160. The normal rules for the control and transmission of classified documents (paragraphs 42-103 of H M Treasury Security Instructions) must be applied to all other documents which carry the prefix: BUDGET, except as modified below:

(a) BUDGET: TOP SECRET and BUDGET: SECRET documents must always be transmitted in double envelopes, even if only sent within the building and the inner envelope must hear a completed BUDGET: SECRET label. As the title will be shown on the label and may be seen by staff not authorised to handle the document, the title should be carefully chosen to avoid revealing any sensitive information. If two or more papers are included in one inner envelope, details of both must be shown on the label. BUDGET: TOP SECRET and BUDGET SECRET documents sent outside the building must be accompanied by receipts (but it should be noted that if a BUDGET SECRET document is received from Customs and Excise it will not necessarily be accompanied by a receipt when it reaches the recipient's office as bulk receipts are used for documents transmitted by document pouch to the Treasury).

(b) BUDGET: TOP SECRET and BUDGET: SECRET documents should normally be sent by messenger to other departments. If no messenger is available, they should be sent by special signature service of the IDS, a receipt being obtained from the post room. BUDGET: CONFIDENTIAL documents should be sent either by messenger or the IDS. Budget classified documents must not, in any circumstances, be sent by post or

transmitted on facsimile equipment, except for the secure facsimile link between the Treasury, HM Customs and Excise, Inland Revenue, Department of Transport and the Bank of England (see paragraph 80B).

(c) Each recipient is responsible for ensuring that every document classified BUDGET SECRET and above is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this -this applies particularly at Principal level. Staff who are not authorised to handle BUDGET SECRET documents may record them in the Security Register, provided that they have been received in double envelopes, using the information shown on the label. If this is done, the inner envelope must be passed to the recipient unopened, the number of the security register entry being shown on the label. If this procedure is followed it does not detract from the recipient's responsibility that receipt of the document has been recorded, so he should ensure that the security register number is shown on the label and copy it to the document itself.

(d) BUDGET classified documents are not to be filed or otherwise handled by Divisional Clerks until after the Budget. Principals are personally responsible for all BUDGET classified documents passed to them, and for ensuring that no other person is able to obtain access to them. Principals who will require a combination lock document box or security cupboard for BUDGET classified material should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 4859). It should be noted that this instruction applies to BUDGET CONFIDENTIAL as well as more highly classified material.

(e) Personal secretaries may continue to handle papers classified BUDGET SECRET or BUDGET CONFIDENTIAL as may Divisional clerks working with the Principals in FP. Files in FP containing BUDGET classified papers must bear the appropriate classification on the outside, and must be kept so that unauthorised persons can not have access to them.

(f) All copies of documents of BUDGET SECRET classification or higher must be uniquely numbered in series, whatever the length of the circulation list. Copies of BUDGET CONFIDENTIAL documents need not be sequentially numbered. BUDGET classified material including BUDGET CONFIDENTIAL may only be copied on the authority of an SEO or above, or Personal Secretary acting on behalf of a higher grade officer, but

recipients should as far as possible avoid making copies of Budget classified material. The making of copies must be carried out in accordance with paragraph 54.

(g) The arrangements set out in paragraphs 68-75 for taking classified papers out of the office apply to BUDGET: SECRET and BUDGET: CONFIDENTIAL documents, but BUDGET: SECRET papers are subject to the overriding restriction that they must not be taken out of the office unless absolutely unavoidable. In such an event, they should be carried in a locked briefcase, box or pouch and kept securely at all times.

(h) BUDGET: SECRET or TOP SECRET waste should be destroyed by shredding; arrangements for this may be made with EOG (extension 4859). Recipients must keep a proper record of any such documents they destroy. Production of such a record is necessary to meet the requirements of the spot checks described in paragraph 161.

**General points**

161. To ensure that the required procedures are being adhered to, Budget classified documents will be subject to a series of spot checks. There will be random checks of individual copies of classified documents sent to named individuals. There will also be more systematic searches of complete circulation lists of particularly sensitive Budget classified papers. These checks will be carried out by FP and EOG.

162. Budget classified papers must not be typed in typing pools. Particular care should be taken about the custody of carbons, photocopies, dictating machine tapes, word-processing discs, shorthand notes etc containing classified information.

163. The disposal of any BUDGET SECRET or above document is to be recorded in the security register. Where a Principal wishes to dispose of a document he is to take care that this does not enable any unauthorised person to see its contents.

164. If BUDGET classified papers do not state the post-Budget classification, recipients should alter the classification as appropriate after Budget day. The 'BUDGET' prefix should always be deleted after Budget day, as it no longer has any significance. Papers which refer only to decisions which were announced in the Budget may be declassified. Papers containing advice or background to such decisions should generally be classified CONFIDENTIAL. Papers containing references to courses of action which were not pursued, which were classified BUDGET SECRET, should remain SECRET.

**Queries**

165. Any questions about the Budget Security instructions should be addressed to the Budget Security Officer, who is the Principal in FP Division (Indirect taxation branch) (extension 4922).

RC2.35

CCBG
/81

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

4 March 1987

Sarah Straight
Private Secretary to the
Secretary of State for Transport

Dear Sarah,

**BUDGET DAY PRESS NOTICES**

As you will be aware, the Chancellor will be making his Budget Statement on Tuesday 17 March. In handling press notices, we propose to follow the arrangements of previous years under which all press notices, including those issued by Departments other than the Chancellor's, are collated by the Treasury and issued both to the press and the House.

Your Department and others will no doubt already be considering what press notices you wish to issue on Budget Day. I would be grateful to know your intentions by close on Monday 9 March and the subject matter of any notices which you will be producing. It would also be helpful if you could let Doug Walters here (270-5179) have by then a contact point (name and telephone number) for any subsequent enquiry on each. All press notices should, of course, be cleared in draft with the appropriate division in the Treasury as early as possible.

As you will appreciate, the Treasury will be photocopying and collating a large volume of material over the weekend before the Budget. As a consequence, I am afraid that we must ask for copies of press notices to be sent to us by no later than midday on Friday 13 March and preferably beforehand. We will require 1730 copies in all. These should be sent to our Committee Section split within the package into three sets numbering 1150, 460 and 120 copies respectively. If you are issuing more than one press notice, it would ease our handling problems considerably if they could be packaged separately.

I am sending a copy of this letter to the Private Secretaries of all other Cabinet Ministers, David Norgrove (No.10), Trevor Woolley (Cabinet Office) and all Chief Press Officers.

Yours,
Cathy

CATHY RYDING
Assistant Private Secretary

CONFIDENTIAL

file

10 DOWNING STREET
LONDON SW1A 2AA

*From the Private Secretary*

30 January 1987

**ECONOMIC CABINET**

The Prime Minister today agreed with the Chancellor that the usual pre-Budget discussion of the economy in Cabinet should be held on 12 February.

I am copying this letter to Trevor Woolley (Cabinet Office).

David Norgrove

Alex Allen, Esq.,
H.M. Treasury

CONFIDENTIAL

10 DOWNING STREET

Prime Minister 2

The CBI's Budget proposals are summarised opposite page 5.

I can find no reference to the PSBR or the likely fiscal adjustment, an astonishing omission. The document says simply that the Budget must be set within the MTFS.

I have acknowledged.

DKW
20/1

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332

From
Mr David Nickson CBE DL
President

CBI

The Rt. Hon. Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

R17/1

16 January 1987

Dear Prime Minister

I enclose a copy of our Representations to the Chancellor for this year's Budget. These will be published on 19 January.

The Representations are the result of wide consultation with our membership during the autumn and were presented to the Chancellor of the Exchequer on 9 December. Our priority this year is to give the maximum possible encouragement to enterprise and to smaller firms; these are the growth areas. I hope that you will support our proposals which are summarised in Chapter 1.

I am also sending copies of our Representations to your Cabinet colleagues.

Yours ever

David

CBI Budget Representations to the Chancellor of the Exchequer 1987

CBI

# WANTED

## FOR ENTERPRISE-

# REAL REWARDS

# CBI Budget Representations to the Chancellor of the Exchequer 1987

CBI

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# Introduction

**The Budget** is a time to review progress and look ahead. Much has been achieved on the business front in recent years. Inflation has been reduced and business has become more productive. Output is now picking up again after a pause in 1986.

For the momentum to be maintained, business must keep adapting to the changing demands of world markets and become even more competitive. Much of this depends on business itself – the control of costs, marketing and product development is up to individual firms.

But the Government also has a role to play if the UK is to be successful. Enterprise should be rewarded, and there need to be genuine incentives to effort.

The CBI had recently published its general guidelines for Government in its *Business Manifesto*. Among the guidelines for economic policy are:

- a stable fiscal and monetary policy accompanied by full UK membership of the European Monetary System;
- control of growth in real public expenditure and further reduction in the overall tax burden;
- the creation of a business climate which favours enterprise and the growth of small firms;
- lower cost burdens on business, particularly regarding rates and energy costs.

The CBI retains its commitment to the Government's Medium Term Financial Strategy (MTFS) as a basis for achieving lower inflation and lower interest rates. For the 1987 Budget, room for manoeuvre within the MTFS is limited and the position on the current account suggests caution.

The CBI's proposals are as a consequence modest, and comprise:

- a package of measures to encourage enterprise;
- additional spending on the nation's infrastructure;
- a 5% real increase in personal tax allowances.

These measures build on the progress made so far towards the competitive economy Britain needs.

But not everything can be achieved in one Budget. The CBI's Representations therefore look beyond this year to the more fundamental changes which will be needed to set the stage for business in the 1990s.

TABLE 1

## The CBI's enterprise package

Measures to encourage investment, innovation and marketing by small firms:

| | First Year Cost £m 1987/88 | Full Year Cost £m |
|---|---|---|
| **Marketing** | | |
| • Expansion of Department of Trade and Industry's 'Support for Marketing Initiative' to £12 million | 10 | 10 |
| **Research and development** | | |
| • Allocation of 1% of all major Government spending departments' R&D budgets to small firms | — | — |
| **Investment** | | |
| • Exchange risk cover for low-cost finance from Europe. | — | — |
| • Introduction of 100% capital allowance on investment up to £25,000 a year for unincorporated businesses and firms paying the lower rate of Corporation Tax | — | c 375 (Average over 5 years) |
| **Business Expansion Scheme** | | |
| • Extension of BES to give relief for 'connected persons'. | 20 | 50 |
| **Inheritance Tax** | | |
| • Extension of Business Asset Relief from Inheritance Tax to 10% | 20 | 65 |
| **Value Added Tax** | | |
| • Exemption from VAT penalties, when circumstances justify | not costed | |
| • Full VAT relief on bad debts. | not costed | |
| | 50 | 500 |

TABLE 2

## CBI 1987 Budget proposals

| | Exchequer cost £bn 1987/8 | £bn full year |
|---|---|---|
| **Enterprise** | | |
| • Measures to help smaller firms | 0.05 | 0.5 |
| **Business costs** | | |
| • Infrastructure improvements | 0.3 | 0.3 |
| **Improved incentives** | | |
| • 5% increase in personal allowances | 0.85 | 1.1 |
| Feedback effect | | c – 0.3 |
| **Total cost 1987/8** | 1.2 | |
| **Total full-year cost** (net) | | 1.6 |





# The CBI's priorities for enterprise and competitiveness

**1** Sound economic growth which brings higher living standards and lower unemployment requires business to prosper. For this to happen, business itself must take the right decisions and become more competitive.

**2** But it also requires the Government to provide a climate in which business is profitable and enterprise can flourish.

**3** With the need to control public borrowing and reduce the tax burden, the MTFS gives little room for manoeuvre. This is reinforced by the prospects for the balance of payments and inflation.

### The CBI's priorities

**4** Against this background, CBI priorities for the 1987 Budget are:

- first, measures to improve the prospects for smaller firms;
- second, additional spending on selected areas of the infrastructure;
- third, a 5% increase in the real value of personal tax allowances, to hold down the tax burden and avoid the drift of more people into the tax 'net'.

### Enterprise and small firms

**5** Much has been done over the last few years to encourage enterprise. Smaller firms help provide the flexibility in the economic system which is needed to respond quickly to change and competitive pressures, and it is these firms which are creating jobs at the present time. So the CBI believes the Government's first priority should be to help them further.

**6** To achieve this, the Government should introduce a package of measures to encourage investment, innovation and marketing by small firms in the 1987 Budget. This should include:

- expansion of initiatives to encourage R&D and marketing by small firms.
- introduction of 100% capital allowances on plant and machinery to benefit small firms and unincorporated businesses;
- tax relief to 'connected' persons under the Business Expansion Scheme;
- exclusion of business assets from inheritance tax;
- more flexible application of the system of VAT penalties and easier recovery of VAT on bad debts.

### Costs and competitiveness

**7** Improvements in competitiveness are largely up to business itself. On labour costs, the CBI has through its Pay Presentations strongly urged members to ensure that pay increases are justified by improvements in performance.

**8** The cost of capital in this country is high relative to the UK's competitors. The Government's scope for reducing interest rates is limited by international circumstances. The CBI believes that full UK membership of the EMS would provide a better environment, in which interest rates could more easily be reduced.

**9** Poor communications put up transport costs and impede development. The CBI has put proposals to the Government on increased infrastructure spending in its *Fabric of The Nation* reports. In the latest of this series, *Building a Better Britain**, the case was made for almost £1 billion a year in extra spending.

**10** In the Autumn Statement the Chancellor raised planned capital spending by £1 billion for 1987/88, mainly by increasing allocations to local authorities. The Government should:

- ensure that this corresponds to a real increase in spending and is not dissipated in pay increases;
- follow up this initiative by ensuring the capital spending is correspondingly increased in future years.

**11** More needs to be spent on roads and urban development than the Government has allowed for, even in its new plans. Capital spending in these areas should be increased by a further £300 million.

**12** The Government can contribute further to reducing business costs by:

- continuing to exert downward pressure on rate increases;
- reducing the rate burden on business when legislation is introduced on Local Authority finance;
- ensuring that tighter financing constraints for nationalised industries do not represent a hidden tax burden on business through higher energy and water prices; and
- avoiding any upward pressure on labour costs through changes in National Insurance Contributions.

** Published CBI, October 1986; price £3.50*

**Improving incentives**

**13** The CBI is committed to a reduction in the tax burden.

**14** The Government's recent Green Paper recognises the need to overhaul the personal tax system. The interaction between the tax and social security systems provides definite disincentives at the lower end of the income scale. Furthermore, recent changes to the tax system in the United States have heightened awareness of the effect of tax on incentives further up the income scale.

**15** The CBI seeks progressive simplification of the tax system to improve work incentives. This is not something that can be tackled in one Budget alone. Changes need to be phased in over a number of years.

**16** In the 1987 Budget, it is imperative that the burden of tax is not increased and is, if possible, reduced. There has been considerable progress over recent years in taking people out of tax by increasing the real value of the personal allowance. It could be argued that now is the time to reduce tax rates. Indeed, this is the CBI's long term commitment.

**17** However, the CBI believes the need to improve incentives at the lower end of the income scale must have priority for 1987/88 and that, before the Social Security Act comes into force in April 1988, this is still better achieved by a rise in personal allowances. This also has the effect of taking many people out of the tax 'net' altogether. The CBI therefore recommends a 5% real increase in personal allowances in this Budget, or more if it can be afforded when the Budget judgement is taken.

**Into the 1990s**

**18** The CBI's main Budget proposals aim to boost enterprise and promote personal endeavour. Both business and Government have a role in achieving this.

**19** The CBI looks to the Government to sustain the progress made in recent years, providing an environment in which enterprise can flourish and business succeed. Unless this happens, growth will be disappointing and unemployment remain high.

**20** But there are other factors crucial to business's longer-term performance that need to be addressed in the Budget Statement. The CBI particularly emphasises monetary policy, education and training, innovation and tax reform. Measures also need to be taken to secure the long-term future of the UK oil and gas industry.

**21** Business looks to the Government to create a stable environment, remove barriers to enterprise and reduce the tax burden. Only then can it help business to be competitive and enable the UK to meet the challenge of the future.



Chapter 2

# The economic outlook

**1** The economic prospects for the next two years, crucially dependent on oil prices and the exchange rate, provide the backdrop to the CBI's Budget Proposals, considered in detail in Chapter 3.

**Economic growth**

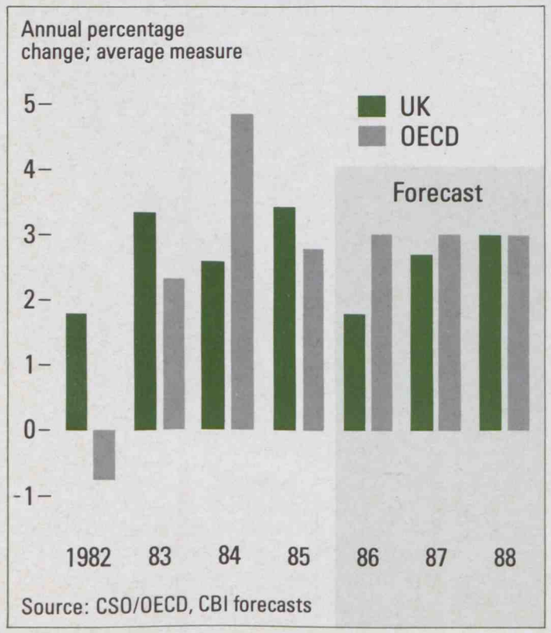
**2** Economic growth in 1987 and 1988 will, with annual rates of 2.7% and 3%, be somewhat faster than in 1986. The components of growth should become more balanced, as investment and export growth quickens, and consumers' expenditure slows from the 5.1% rise in 1986 (charts 1 and 2).

**3** Manufacturing output showed negligible growth in 1986, as industry suffered from the slowdown in world trade that immediately followed the fall in oil prices last January. As world trade picks up and industry feels the benefits from the lower level of the pound, output in manufacturing will respond, and grow by about 3% in 1987 and 2½% in 1988.

**4** The acceleration in economic growth will create about 550,000 new jobs by the end of 1988,

Chart 1

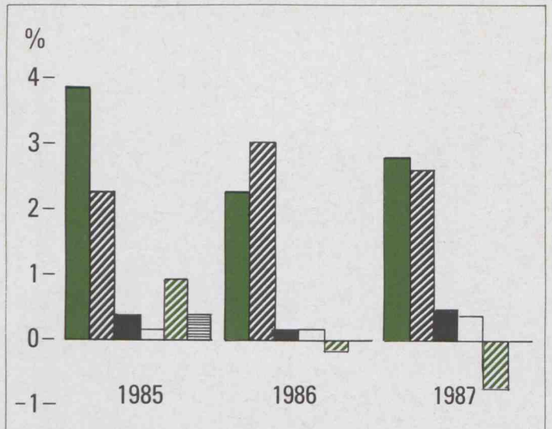
GDP growth rates 1982-88




Source: CSO/OECD, CBI forecasts

Chart 2

Contributions to changes in GDP*




Notes: *As a percent of real GDP in the previous period, s.a.
**Exports — imports

Source: CSO, CBI forecasts

predominantly in the service sector. Employment in manufacturing is expected to fall by an average of 8,000 a month for 1987 and 6,000 a month in 1988 – the result of the continued drive for efficiency in the face of intense international competition. Despite job creation, unemployment is expected to decline only slowly from current levels.

**5** Unemployment can be brought down substantially in the longer term only as the competitiveness of British industry is improved and maintained at a level that allows an increase in world market share. Success here depends on industry. But it also requires a climate of confidence enabling businessmen to plan ahead, invest and develop both their products and their markets.

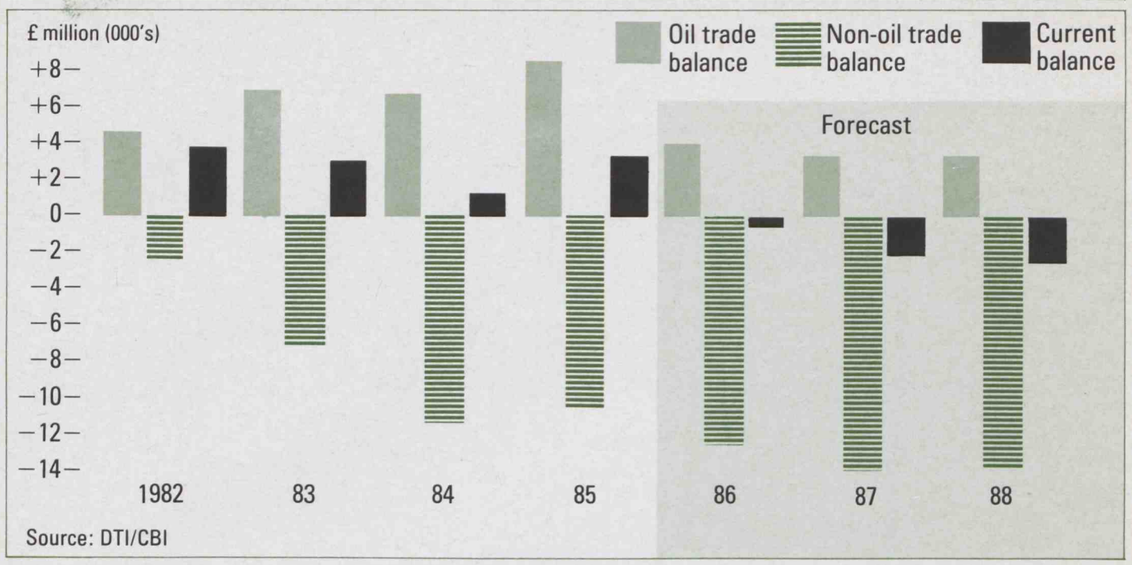
**Tax cuts, overheating and the Current Account**

**6** Both consumer spending and investment are forecast to grow rapidly over the coming year and, on the basis of the announcement in the Autumn Statement, Government spending will also rise in real terms.

**7** Fuelled by the rise in real wages, consumers' expenditure is forecast to rise by more than 5% for 1986 as a whole. Even though inflation is expected to

## Chart 3

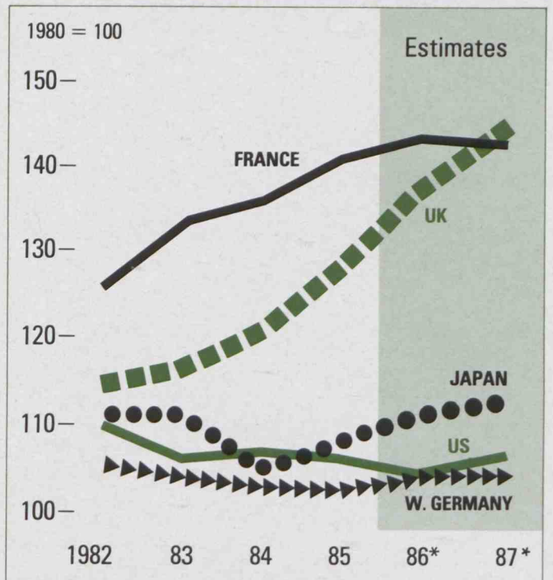
**Balance of payments on current account; oil and non-oil visible trade**




Source: DTI/CBI

## Chart 4

**Comparative unit labour costs 1982-87 (wage costs per unit of output in manufacturing)**




*CBI estimates based on OECD forecasts and data for first half of 1986

Source: NIESR, CBI estimates

accelerate through 1987 and will restrain the growth in real incomes, consumer spending is forecast to grow by $4\frac{1}{2}\%$.

**8** The CBI's Industrial Trends Survey suggests that investment growth will also quicken, encouraged by the faster growth in output. For 1987, manufacturing investment should grow by some $3\frac{1}{2}\%$ and other private investment, excluding the North Sea and housebuilding, by $6\frac{1}{2}\%$.

**9** Industry should be able to respond to the increases in demand expected during 1987. However, the experience of 1973 and 1978 indicates that, when demand is subject to rapid short-term surges, overheating can appear rapidly and with little warning. The quarterly profile of the growth in demand will therefore be crucial. The extent of any cut in income tax should be such as to avoid putting undue short-term pressure on the factor markets, causing upward pressure on prices and a further deterioration in the current account.

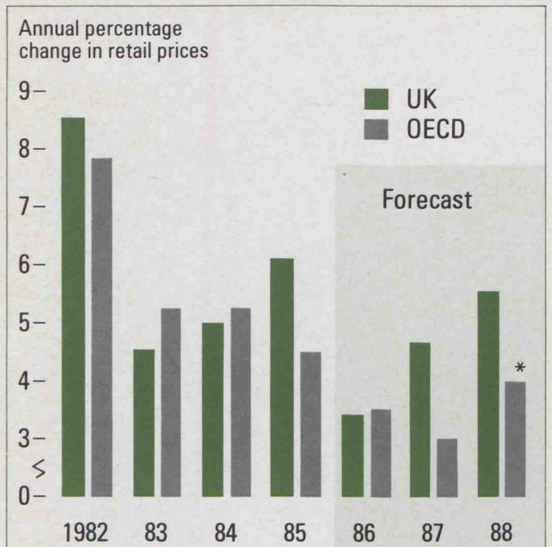
**10** The fall in oil prices has reduced the 'cushion' of the surplus on oil trade, and the non-oil trade deficit is set to increase. In spite of the more rapid $3\frac{1}{4}\%$ growth in exports in 1987 (as world trade picks up and the pound is more competitive), the rise in consumption and investment will increase imports of goods and services by about $4\frac{3}{4}\%$. The current account will therefore move into deficit for the first time since 1979, probably by about £$2\frac{1}{4}$ billion (chart 3).

**11 The Budget strategy must therefore include measures to improve business competitiveness so as to minimise the effects on the current account of more rapid growth. Only if industry can win and maintain a larger market share, can growth be sustained at a rate that can bring unemployment down substantially.**



## Chart 5

**UK inflation rate compared to OECD average 1982-88**

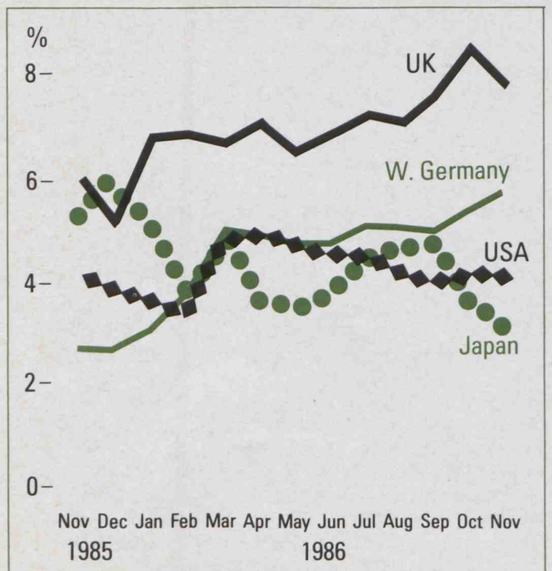



*CBI estimate

Source: OECD/CBI forecasts

## Chart 6

**Real interest rates: an international comparison**




Source: International Financial Statistics

### Employment, wages and skill shortages

**12** The UK's labour costs per unit of output are still rising faster than most competitors' (chart 4). The CBI continues to press home the message (for example, in its *Pay Presentation 1986/87 – Time for change**), that settlements must be closely linked to performance. If this is not achieved throughout the economy, our position in markets both at home and abroad will deteriorate.

**13** The difficulty faced by employers in recruiting, and the retention of key personnel, necessarily influences the level of wage settlements. Skill shortages currently affect one in eight firms in manufacturing. Despite this, potential employees are inhibited from moving to new industries in different locations, because of housing market and other conditions.

**14** While those seeking work must be prepared to adapt to changing circumstances, much needs to be done to reduce the disincentives to labour and capital mobility. The provision of education and training, in particular, needs to be improved if skill shortages are to be overcome and competitiveness increased.

### Inflation and interest rates

**15** The deterioration of the Current Account will put downward pressure on the pound, and hence upward pressure on inflation. From an average rate of 3.4% for 1986, retail price inflation is forecast to increase to 4.7% for 1987 as a whole, and by rather more in 1988 (chart 5).

**16** The pressure on the pound will also limit the scope for reducing interest rates over the next two years. Currently, real interest rates in the UK are considerably higher than for major competitors (chart 6).

**17 The Budget strategy must therefore be set within the Medium Term Financial Strategy if further upward pressure on interest rates is to be avoided.**

* *CBI, October 1986; price £5*

Chapter 3

# Taxation and public expenditure - a strategy for enterprise

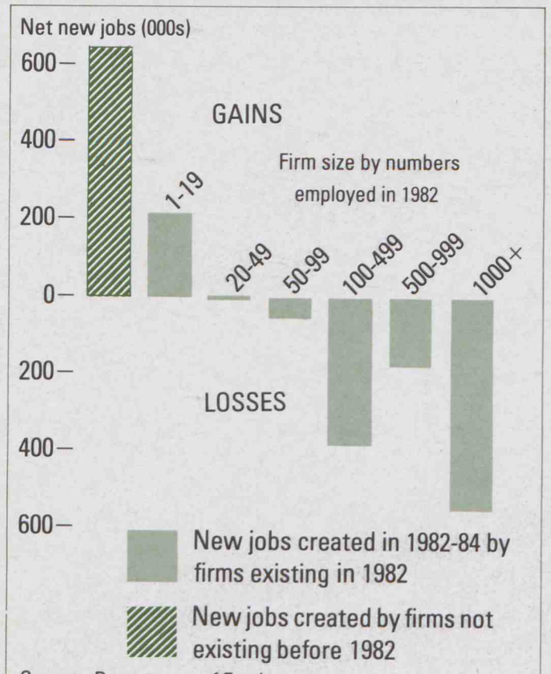
1 This chapter develops the CBI's proposals for promoting enterprise.

**Smaller firms measures**

2 The first priority is a package of measures (summarised in Table 2, Chapter 1) to encourage investment, marketing and innovation by smaller firms, and so stimulate their growth.

Chart 7

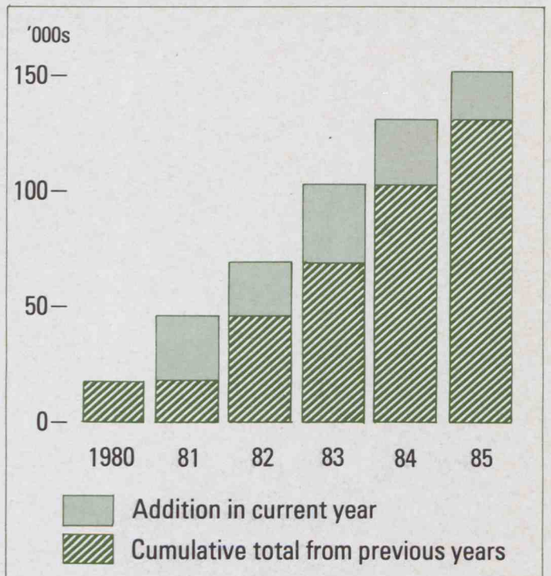
UK job creation by firm size 1982-84




Source: Department of Employment

Chart 8

Net births of UK companies 1980-85




Source: Department of Employment

3 Smaller firms should account for much of the employment growth expected over the next few years (chart 7). The CBI therefore welcomes the measures already taken by Government to encourage the start-up of new businesses (chart 8). The need now is not simply for more start-ups but for a business environment which nurtures and favours continued growth and innovation by smaller firms. With these objectives in mind, the section below outlines a range of tax and other measures aimed at providing that environment.

**Marketing**

4 Recently the DTI introduced a 'Support for Marketing' initiative aimed at small- and medium-sized businesses, which the CBI has warmly welcomed. It will improve the understanding of the importance of marketing among smaller firms and help develop market intelligence, thereby improving marketing effectiveness and performance. It has received such an enthusiastic response that demand has outstripped the budgeted programme. The CBI urges that further funds be made available.

**Research and development**

5 Chapter 4 refers to the need to develop a longer-term strategy to promote research and development. Here the CBI concentrates on more immediate issues. In the US 1¼% of the research and development budgets of each of the Federal Administration's major spending Departments is allocated to smaller firms. The UK's Ministry of Defence has recently announced moves along similar lines which the CBI has welcomed, including setting up a Small Firms Advice Division to act as a contact point for smaller firms interested in developing business with the Ministry. The CBI proposes that this initiative be extended to other Government departments, so re-allocating the available funds within given Budgets.

**Exchange risk cover**

6 The CBI was concerned when exchange risk cover for European Investment Bank Loans was withdrawn last year, and wrote to the Minister of State for Industry accordingly. The absence of such cover is a major disincentive to smaller firms taking advantage of this low-cost source of funds. Under the European Commission's Fourth New Community Instrument, low-cost finance is being made available specifically for small- and medium-sized enterprises. Without exchange risk cover or some equivalent measure, UK smaller firms are unlikely to benefit from these Community loans. So, in addition to their higher interest-rate burden, they will be further disadvantaged compared to European trading rivals.

7 The CBI therefore proposes that the Government should re-introduce exchange risk cover for this form of low-cost finance available from the European Community. This need not be costly to the Government as the scheme could be made self-financing over a number of years. Such a move would be consistent with the cover provided on loans from the European Coal and Steel Commission.

**Capital allowances on plant and machinery**

8 The CBI's 1985 Budget Representations pointed to the 'dip' in tax reliefs and the consequent effects on the cash and investment positions of businesses which would result from the 1984 changes to corporation tax and capital allowance. The effects of the dip are now being felt, particularly by smaller firms.

9 Unincorporated businesses and smaller companies, faced with higher tax bills as allowances have been reduced, are finding themselves unable to maintain their desired level of investment. At the same time they have not benefitted from the offsetting cut in the main corporation tax rate in 1984 because:

- unincorporated firms had no corresponding reduction in income tax;
- the smaller companies' rate of corporation tax was not reduced to a matching extent.

In addition, smaller firms generally find it relatively more difficult to finance the gaps in their cash position created by their endeavours to maintain their investment programmes.

10 To provide an additional incentive for such smaller firms, and help them meet their tax liabilities without having to cut their investment, the CBI proposes the introduction of 100% capital allowances on, say, the first £25,000 of their capital expenditure on plant and machinery. The current system would continue to apply to all capital expenditure above that limit.

11 In order to target this incentive towards smaller firms, the relief could be restricted to unincorporated businesses and companies taxed at the small companies' rate. The CBI would be pleased to discuss with the Government its more detailed suggestions on how this could be achieved.

**Business Expansion Scheme**

12 Since the welcome inception of the BES, the CBI has campaigned against the exclusion from tax relief of persons connected with the firm, such as employees, directors, partners and their associates. CBI members remain convinced that there is considerable untapped potential for equity investment in smaller firms by these 'connected' persons, particularly in areas away from financial centres.

13 The CBI therefore proposes that the Government should extend the Business Expansion Scheme to allow relief for 'connected' persons. There are several ways of doing this without imperilling the concept of the BES:

- giving tax relief to connected persons at less than their highest rate of tax, thus recognising that they may already have a greater association with the company than unconnected persons;
- giving relief up to a more limited ceiling of annual investment by these individuals. A limit of, say, £10,000 would still be of use to smaller firms which are not able to attract BES investment at present.

14 Clearly there could be a number of variations on this theme. Our concern is that something more should be available so that opportunities for funding are not lost. The CBI is ready to explore these ideas further with the Government.

**Taxes on business assets**

15 For many years the CBI has suggested changes to the capital taxes to encourage smaller firms, particularly in the reinvestment of profits by owner-managers. Accordingly the CBI welcomes the steps in this direction already taken by Government such as the replacement of capital transfer tax by inheritance tax.

16 However, CBI members still believe that all categories of business property should be given complete relief from inheritance tax, thereby providing greater long-term stability for business owners. Making this extension would:

- bring to an end the distinctions between types of business property at present qualifying for different rates of relief;
- meet the problems which remain under inheritance tax of a charge arising where a business owner dies before transferring the relevant business assets, or within seven years of doing so.

17 The CBI remains concerned that the capital gains tax indexation rules apply only from 1982. Because of this a large element of purely inflationary gain for 1965-82 (a period of exceptionally high inflation) is locked into the system. In 1982, the Government recognised that taxation of the inflation element in gains is wrong in principle. The CBI also believe that assets held over the longer term should be relieved

from the tax. The CBI urges the Government to review the way this tax impacts on business, and re-emphasises its previous detailed submissions on this subject, most recently in 1985.

### Value Added Tax

**18** A number of aspects of the VAT regime still cause concern; these have been described in the CBI's *Technical Budget Representations 1987**.

**19** The CBI has welcomed the Government's publication of its recent paper – 'VAT: Small Business Review' –and is responding to that paper separately. The paper contemplates, inter alia, a cash basis of VAT in place of the invoice basis. This could alleviate some of the present difficulties for those smaller firms eligible under the proposals, but there would still be difficulties for firms outside their scope.

**20** An aspect of VAT which has attracted considerable adverse publicity over the past year is the new system of VAT penalties. The CBI accepts that VAT should be paid on the due date, but members are still unhappy that the new penalty system remains mechanical and lacks adequate provision for mitigation and appeal. In each case the penalty should take proper account of the concomitant circumstances. For instance, where VAT falls to be paid to Customs before the taxpaper has been paid by his own customer, there can be genuine financial hardship.

**21** The CBI's *Technical Budget Representations* point out that the system of VAT relief for bad debts needs further improvement to bring it into line with bad debt relief for direct tax. The latter has long recognised commercial criteria for determining when debts are to be regarded as bad, and VAT should follow suit.

### Infrastructure

**22** For business of all sizes, a poor infrastructure raises costs and impedes the steps firms themselves are taking to become competitive. So the CBI's second priority for the 1987 Budget is additonal public spending in this area. In 1980, capital expenditure was nearly 10% of total government expenditure. With the exception of 1984-5, it has fallen steadily, to below 5% in 1986-7 (Chart 9).

**23** According to the Autumn Statement, capital expenditure in 1987-8 is set to be £1 billion higher than was previously planned. This increase acknowledges the force of the case that the CBI has been putting in its *Fabric of the Nation* reports, most recently in *Building a Better Britain*, which called for additional spending of £1 billion on the nation's infrastructure.

**24** The shift in the balance of public spending towards capital is welcome, though the composition of the increase is slightly different to the CBI's proposal, with more on housing and less on roads and inner cities.

**25** But more needs to be done:

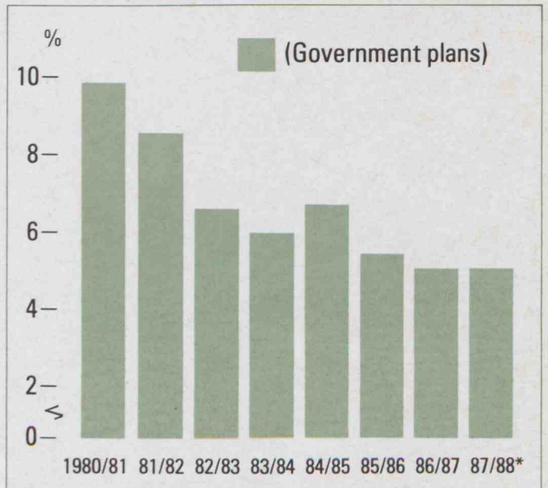
- the announced increases in the Autumn Statement partly reflect an over-run in spending this year as a result of higher than expected increases in wages and salaries. The result of this is lower growth of the volume of capital spending than the plans suggest;
- the increase in expenditure on roads does little more than preserve spending in real terms at its originally planned level;
- the Government has increased the Urban Programme by only £40 million and allocated an additional £75 million to the Urban Housing Renewal Unit. This compares to CBI proposals for an extra £300 million for inner cities. The CBI has always argued that spending in this area provides good value for money and attracts private investment.

**26** Having studied the Chancellor's Statement, the CBI proposes additional funds should be made available for:

- Urban Development Grants. Every pound spent so far by the Government on this form of grant has been matched by four pounds of private-sector money;
- Urban Regeneration Grants. Firms can claim this new form of grant directly from the Government, not via local authorities;
- Urban Development Corporations. The Government has taken the initiative in setting up four new corporations. Consideration should be given to extending this approach as a means of speeding up action on urban decay;
- accelerating the National Road Programme.

## Chart 9

**Capital expenditure as a percentage of total government expenditure**




*CBI estimates

Source: Public Expenditure White Paper, January 1986 and 1986 Autumn Statement

*Published CBI, October 1986; price £3



**27** We also propose that the Government takes steps to ensure:

- the increased allocations to the local authorities are spent on capital and are not used to fund higher current expenditure;
- the higher level of capital spending in 1987/88 is continued in 1988/89 and 1989/90.

**28** The CBI will continue to urge the Government to pursue value for money in the public sector. This includes involving private-sector management skills in public projects. Within the existing allocation of expenditure to housing, the Government is urged to give a greater role to Housing Associations, and set up the Building Improvement programme.

### Personal taxation

**29** To promote enterprise, there must be incentives for personal endeavour. Therefore the changes in personal taxes that can be afforded should reflect this. The CBI's third priority for the 1987 Budget is therefore for a reduction in personal taxation.

**30**. The question of tax reform is still being considered by the CBI and Chapter 4 touches on this subject. The CBI has already made its response to the Government's recent Green Paper* on personal taxation, and has highlighted the potential Exchequer costs of some of its proposals. The work disincentives brought about by the interaction of the social security and tax systems at the lower end of the income scale is one issue which needs particular attention.

**31** Members of the CBI believe that levels of taxation on individuals, and the numbers subject to tax, remain too high. The CBI has consistently recognised the need to improve incentives throughout the income scale by reducing rates of tax. This has been brought into sharper focus by the recent US tax reform which dramatically cut the top rate of federal tax. The effects on the whole free world could well be considerable, but because of language Britain is more vulnerable to the loss of entrepreneurial, financial and scientific skills to the US.

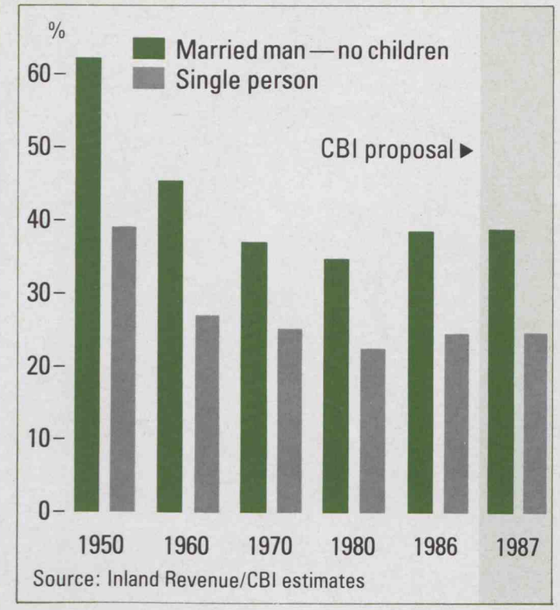
**32** However, increasing personal allowances to make work more worthwhile to those on low pay has in past Representations been a major CBI recommendation. The Government and the CBI are united in endeavouring to make the labour market more flexible so that unemployment can be reduced. Furthermore, taking people out of tax represents administrative savings.

**33** Since last year's Budget, the Social Security Act has been passed. One important implication of this is that, from April 1988, low-income families receiving the new Family Credit and Housing Benefit will lose over 90% of any reduction in tax payments through lower social security entitlements. This change will mean that raising tax allowances will no longer be an effective means of improving incentives for lower-paid heads of households from 1988/89 onwards.

* *The Reform of Personal Taxation; HMSO, March 1986*

## Chart 10

**Tax allowances (as % of average manual earnings)**




Source: Inland Revenue/CBI estimates

**34** But raising tax allowances remains the better way of improving incentives for the lower-paid in the 1987 Budget. As there is limited room for manoeuvre, the CBI believes any scope for tax reduction should be targeted towards this group.

**35** The CBI therefore recommend an increase in all main personal allowances above the rate of inflation by 5%. As Chart 10 shows, this would ensure that the overall burden of income tax does not increase relative to the position after the last Budget.

## Other taxation measures

### Technical Budget Representations

**36** Although not discussed in detail here, the CBI's *Technical Budget Representations 1987* already submitted to the Government have highlighted 58 action points to ease the burden of the UK's complex tax system. They are categorised under three themes:

- **competitiveness** – aspects of UK tax law which render more difficult the operation of UK business in the international arena;
- **incentives** – measures to encourage wealth creation and employee participation;
- **burdens on business** – areas where unnecessary compliance and administrative costs arise.

**37** Many of these technical adjustments could be made at relatively little cost to the Exchequer. The CBI renews its call for a review of the system of preparation and enactment of fiscal legislation which at present precludes, for want of Parliamentary time and Finance Bill space, early action on these more-technical changes.

**38** A separate Technical Taxation Bill has already been suggested by the CBI as one possible way forward. Anxious that the Government should, as a matter of urgency, institute a review of the UK's fiscal legislative process, the CBI would be pleased to participate in discussions on this. The experience of recent Finance Bill programmes, particularly in 1986, has served to reinforce CBI members' conviction that change is overdue.

### Indirect taxes

**39** The CBI responded to the Government's proposals of August 1986 for changing the VAT rules on partial exemption, and despite the modifications announced in December still has three concerns:

- the scale of the compliance burden entailed by the new standard method;
- the fact that more workable methods will be available only by reaching agreement with Customs or getting a Tribunal decision;
- the start date of 1 April 1987 gives little time to adapt company procedures to the new Treasury Order, and none at all to the changed definition of 'input tax' that is scheduled to be introduced in this year's Finance Act.

**40** It is essential not to burden a broad cross-section of business unnecessarily by measures intended to close specific loopholes.

### Corporation Tax – migration of companies

**41** Section 482 of the Taxes Act 1970 relating to the migration of companies and their overseas activities has long been a cause for concern to business. Since exchange controls were dismantled in 1979 and the controlled foreign companies legislation was introduced in 1984, the Section has seemed increasingly anomalous. In line with the CBI's response to recent Government consultations, its repeal is urged.

### Foreign exchange transactions

**42** In 1985 the CBI made strong representations to the Government in response to the consultative paper on a proposed Inland Revenue statement of practice on the tax treatment of foreign exchange transactions. The CBI continues to urge early legislation to provide tax relief for losses on foreign currency borrowings.

### International taxation

**43** The CBI urges the Government to press the European Community to implement in 1987 the long-debated proposals for an independent arbitration procedure in cases of relevant double taxation disputes between a taxpayer and two or more Member States. Government should endeavour to ensure that this item of taxpayer protection takes precedence over the proposed draft OECD/Council of Europe multilateral convention on mutual assistance between tax administrations.

### Worldwide unitary taxation

**44** In 1986 the CBI has appreciated the continued support of Ministers and officials in initiatives to try ending worldwide unitary taxation. Serious problems still remain, and further close liaison and co-ordinated lobbying therefore remain vital. The CBI hopes to strengthen existing contacts with Government in continuing the campaign to secure a satisfactory end to this pernicious tax.

### External trade

**45** The CBI's *Technical Budget Representations 1987* emphasise the importance of the tax system in relation to the international competitiveness of British business. Competition in world markets is becoming increasingly severe as new suppliers emerge. UK overseas trade depends primarily on the competitiveness of its goods and services.

**46** Government assistance through the British Overseas Trade Board, the Export Credit Guarantee Department and the Foreign and Commonwealth Office commercial posts must be on a scale equal to that enjoyed by our major rivals. It is essential, therefore, that the Government's present export services, both financial and advisory, are maintained and further cuts avoided. The return offered by such services, in terms of additional overseas earnings, could well justify a modest increase in the Government's support next year.



Chapter 4

# Setting the stage

**1** The UK must provide an environment in which business can succeed. This cannot be achieved by one Budget. But the Budget Statement must take account of issues affecting long-term business performance.

**2** These broader issues have all been widely discussed and are important elements of the CBI's work, both nationally (at, for example, the National Economic Development Council) and in Europe (through UNICE). They reflect the CBI's aim to provide individual incentives and ensure continued revitalisation of industry. An important component in achieving this is the control of labour costs, on which CBI views are well known.

**3** In 1984 the CBI's Budget Representations advocated a medium term business strategy. Discussion among the CBI membership on the March 1985 document *Change to Succeed* led to the publication of *Action Now* in April 1986, and in November 1986 the CBI's *Business Manifesto** listed 21 guidelines for government policies up to and beyond the next election.

**4** The Government has made changes to corporate and capital taxation, including reducing income and corporate tax rates in previous Budgets. But to improve economic performance in the years ahead, more remains to be done:

- to boost personal incentives;
- to encourage enterprise;
- to create a more stable monetary environment;
- to improve resource allocation;
- to improve education and vocational training;
- to cut where possible the state's share of business costs.

**5** Though there is much to do, the CBI readily recognises that Government can do so much and no more. In the final analysis, it is up to individuals and business to respond to enlightened reform.

**Available from CBI Publications Sales, £1.50.*

## Tax and National Insurance

**6** The CBI is concerned about the effects of taxation on the performance and international competitiveness of UK businesses of all sizes. The tax and national insurance systems must be directed to the promotion of economic growth and, in its consideration of tax reform, the CBI continues to examine how this can best be achieved.

**7** The CBI has consistently urged that the UK tax burden be reduced; it is a major proposal in the *Business Manifesto*. CBI members' perceptions of this burden and the complexity of the present system, with its negative impact on incentives and competitiveness, have been clearly illustrated in *Change to Succeed – the Nationwide Findings**.

**8** In a changing and highly competitive world the UK cannot afford a tax system which 'demotivates', is 'excessively complex', and 'discourages employment'.

## Personal tax

**9** To promote enterprise UK businesses needs the right incentives. Questions that need to be addressed include:

- the rate structure – the effects of high marginal tax rates and the impact of the tax and social security systems on the operation of the labour market;
- the tax treatment of husband and wife – where efficient use of the nation's manpower requires that men and women be treated equally for tax purposes;
- the unequal tax treatment of income derived from saving – a discouragement to certain forms of saving.

As the CBI has pointed out in its response to the Government's recent Green Paper on Personal Taxation, careful evaluation is needed before introducing potentially costly reforms.

## Business taxation

**10** Some of the many problem areas identified in recent representations (in addition to points raised in the CBI's *Technical Budget Representations 1987* and those covered in Chapter 3) include:

- the treatment of the effects of inflation;
- stamp duty on share transactions, new issues and depositary receipts which should not impair the pre-eminent position of the UK securities market;
- distortions such as car tax;
- the scope of the capital allowances system;
- the compliance burden of direct and indirect taxation;

**CBI, October 1985.*

- the impact of employers' National Insurance Contributions on competitiveness and the labour market.

The CBI urges consultation between Government and the business community on remedying defects in all these areas.

**11** Any changes to personal or corporate taxation need to take account of developing international circumstances which could affect competitiveness. The United States has modified its personal tax regime and replaced 14 rates for individuals by two main rates. Tax reform is also in hand or contemplated in other countries, including Germany and Japan. There is pressure within the European Community for approximation of indirect taxes which could affect the scope for changes in direct taxes in the UK.

**12** In view of the worldwide climate of change there is every incentive to look at the options and set down a plan of action. The CBI is fully aware that major changes would affect each taxpayer's economic behaviour. For that reason, the CBI's *Business Manifesto* stresses that change should be effected only after the fullest consultation, not just on the changes but also on the timing of their introduction.

## Local Authority rates

**13** The CBI has long argued that business rates are a bad tax which are:

- not related to ability to pay;
- unpredictable, varying much more from year to year and across locations than do the services they fund.

Business had no control over the level of rates it pays or of the local services it receives.

**14** The total business rate burden, currently over £7 billion annually, significantly inhibits the competitiveness of British business.

**15** Nor is the present domestic rate system a satisfactory local tax. The high degree of mismatch between those who vote for services and those who pay for them means accountability is poor. Hence the incentive for local authorities to operate cost-effectively is limited.

**16** The CBI therefore welcomes the Government's commitment to the long-term reform of the local tax system. In responding to the Green Paper 'Paying for Local Government' (January 1986), the CBI supports in principle the replacement of domestic rates by a community charge, though with reservations about the practical administration and the durability of such a tax.

**17** The UK's competitive performance would be improved if the property tax on business were phased out altogether, and this is the CBI's long-term objective. Business would then pay for local services by direct charging wherever possible, and contribute towards the remaining services via national taxation. As a first step towards this, CBI members would support the introduction of a Uniform Business Rate (UBR), but only on a number of conditions:

- the first UBR is set at 25% less than the average poundage in the year preceding its introduction. This can be achieved by a gradual, centrally funded derating between now and the introduction;
- the UBR is set at the same level throughout England, Wales and Scotland;
- the UBR is not allowed to increase faster than the rate of inflation;
- all non-domestic property in England, Wales and Scotland is revalued, on the same basis, before the introduction of the UBR;
- the changes are phased in so that no business faces a rate rise of more than 10% in any one year.

**18** The CBI accepts, however, that the earliest that these reforms can practicably be introduced is 1990. In the meantime the growth of the business rate burden must immediately be limited by introducing a ceiling on business rate increases, limiting them to the rate of inflation or the increase in domestic rate, whichever is the lower.

**19** The CBI also supports the steps the Government is taking to improve efficiency in local government by making it a legal requirement that competitive tenders are sought for a greater number of local services. Members urge that as many services as possible are covered by this legislation.

## Monetary policy

**20** Both the levels and the volatility of interest rates and exchange rates have a major impact on the operations of companies, particularly their investment, export and recruitment strategies. In the early 1980s, the high level of sterling was the main issue. In recent years it has been the *variability* of the exchange rate (chart 11), and its impact on interest rates (see chart 6).

**21** These economic variables are influenced by international events and by the monetary stance of the Government. This stance has evolved over recent years from a narrow commitment to targeting sterling M3 to a more or less explicit exchange rate target.

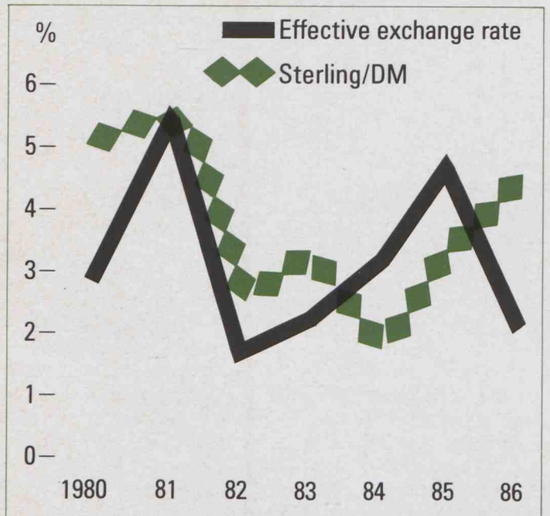
**22** To buttress sterling against unnecessary speculative pressure, the CBI would urge the Government to join the Exchange Rate Mechanism of the European Monetary System. This would reduce the volatility of sterling at least against the currencies of other European Community members (who now take half of the UK's exports) and provide scope for reducing interest rates.

**23** Monetary policy has evolved as experience with different monetary targets has developed. Against this background, an informed debate on the impact of monetary policy is vital. The CBI has always emphasised the inhibiting effect of high interest rates and exchange rate volatility on business. The conclusions and recommendations of a CBI Working



Chart 11

**Volatility of sterling: coefficients of variation (based on monthly average exchange rates)**




Notes: 1. The coefficient of variation is defined as the ratio of the standard deviation to the mean; it is a measure of relative dispersion.
2. 1986 figures to September.

Source: Financial Statistics, HMSO

Party studying the impact of monetary policy on business will be published later in 1987 as an important contribution to the debate.

## Infrastructure

**24** The physical fabric of the nation is in constant need of refurbishment and enhancement. Improvements to the infrastructure can directly lower business costs, improve profitability and so help the UK compete more effectively in international markets. Government action on this front stimulates private-sector developments and draws in private capital. The M3 and M11 motorway 'corridors' and the M25 ring are evidence of this.

**25** *Building a Better Britain* set out proposals for increased capital spending over the next five years. It stressed the need:

- to respond to changed trade flows and provide better land access to Southern and Eastern ports;
- to match overseas competitors' transport costs;
- to attract business to this country and meet the challenge of the Channel Tunnel.

**26** The Government has already announced higher spending for 1987/88. Chapter 3 argues the case for going further in the Budget. But there is no certainty that the higher level will be continued in the future. It is not only lack of resources but fluctuations in spending which have contributed to the poor state of Britain's infrastructure.

**27** The higher level of capital spending needs to be continued and major projects advanced. This particularly applies to cost-effective projects in communications, inner cities and housing. This will not only help to generate wealth and jobs, but also improve the mobility of labour.

**28** Though the Government must take the initiative in this area, it need not provide all the resources. It is important that full use is made of partnership between the public and private sectors. As proposed in *Financing the Future**, this includes:

- making full use of private-sector management resources;
- taking full advantage of leverage – where small amounts of public money attract significantly more private resources;
- greater use of contracting out;
- more extensive use of private financing arrangements such as in the Dartford crossing.

The CBI is studying other ways in which this partnership can develop and will be reporting as soon as possible.

## Education and training

### Education

**29** The business community is concerned that the education service in general, and schools in particular, have failed to prepare students for life after full-time education, especially at work. One major recommendation has been that the volume of spending on Higher Education should not be cut back, and the CBI therefore welcomes the increases announced in the Autumn Statement.

**30** Many pupils leaving UK schools are inadequately educated even in the most basic disciplines of communication and mathematics. The 40% of pupils in the bottom ability range appear to receive much less benefit from 11 years' full-time education than do their counterparts in countries such as Germany. This undermines both their ability to earn a satisfactory living in a competitive world, and British industry's ability to compete.

**31** Employers are particularly concerned at the lack of understanding of the needs of business and its role in the economy.

**32** Government at national and local levels has responded to such criticism by changes such as:

- reforming the secondary examinations system to achieve more sharply-defined criteria of performance linked to a 'core' curriculum;
- more vocational orientation through the introduction of the Certificate of Pre-Vocational Education and the Technical and Vocational Education Initiative, both of which include elements of work experience;

**Published CBI, June 1985.*

- streamlining examinations under the new National Council for Vocational Qualifications.

**33** But much remains to be done, not least the re-establishment of teachers' morale and professionalism after the damaging pay dispute of 1985/86.

**34** Business also has an important role to play. The schools/industry links (particularly Understanding British Industry) that have been developed in recent years, should be maintained and improved. Employers should be willing to find work-experience places and establish links with schools and colleges. This way business can help the education service to develop all the available talent to meet the challenges of the world at work.

## Training

**35** Three out of five employers report difficulty in filling jobs requiring certain skills, qualifications or experience. The problem is particularly prevalent in high-tech industries, though other sectors are also affected, including more traditional areas such as footwear, catering, clothing and furniture.

**36** A number of initiatives have been taken to deal with problems. For example:

- industry and government have acted together to set up, as part of the CBI Education Foundation, the Information Technology Skills Agency to help meet a shortage in the workforce of those with IT skills;
- business and the MSC are involved in a project to establish a local employers' network with the key objective of identifying local labour market needs and trying to meet them;
- proposals for meeting the shortage of mathematics and science teachers have been put forward for discussion by Government.

**37** It is vital that these and other initiatives yield results if the growth of the economy is not to be threatened.

**38** There is a general perception that expenditure on training in this country is too low and, some would argue, not as cost-effective as it should be. This can lead to the conclusion that training is a low priority, one of the causes of the UK's disappointing economic performance.

**39** Many companies can point to a first-class performance, but the CBI would like to see more and better training by business as a whole. Measures which lead to bureaucratic burdens and a pre-occupation with financial devices rather than training must be avoided. The CBI has therefore not supported the use of measures such as a refundable training tax being collected from companies by central government, or the re-establishment of statutory training boards with levy-raising powers across all sectors of industry.

**40** Specific proposals are being developed and studied, including the allocation of responsibility for paying for training between companies, individuals and government. The CBI emphasises that:

- the responsibility for training employees rests with their employers, and business accepts this;
- the Government should pay for basic education, as well as having prime responsibility for funding general vocational education;
- the prime responsibility for training the unemployed must rest with government, although –
- industry has an important role to play in providing work experience places under the Youth Training Scheme and, where possible, the Community Programme.

**41** Individuals who wish to develop their own capabilities in areas not relevant to their present employment should look to Government or themselves for support. The report of the MSC study on the funding of vocational education and training will, when published in 1988, act as a trigger for public debate and decisions in this field.

**42** The CBI is consulting members in a review of all education and training policy, including the merits of fiscal incentives to encourage more and better training. When completed, the CBI will discuss its conclusions with the Government.

## Innovation

**43** Innovation is essential for the long-term prosperity of business. It can sometimes lead to substantial and dramatic breakthroughs. At a more work-a-day level, it is incremental innovation – frequent, modest improvements to product and management – which enables a firm to maintain its competitive edge.

**44** Many aspects of innovation – product design and engineering, training, patenting and licensing, and marketing – depend largely on the individual company concerned. However, additional stimulus to innovation from government is highly desirable and is probably most readily applied to the first stage of the innovation process, namely research and development (R&D).

**45** Though spending more than in the early 70s, the UK spends a lower percentage of GDP on non-defence than its major competitors. Other countries (particularly Germany and Japan) have accelerated R&D spending at a greater rate. (See Table 3, page 19).

**46** At present, expenditure for trade purposes on scientific research, both on revenue and capital account, receives favourable tax treatment, as it can be written off against tax in the year in which it occurs. The CBI will be considering whether changes to the tax treatment of R&D as a whole should be introduced in the UK.

**47** While recognising the many programmes through which the Government supports industrial innovation, members urge endorsement of the proposals developed by the IT86 Committee, chaired by Sir Austin Bide. In contrast to the Alvey Programme of Information Technology, this represents a radical switch in emphasis, away from R&D towards applications, giving users the dominant role (and the necessary funding) to demand the products they really need, rather than accept what suppliers think they want.



**TABLE 3**

**Gross Expenditures on R&D as % of GDP (excluding proportion spent on defence)**

| | 1965 | 1972 | 1978 | 1983 |
|---|---|---|---|---|
| **UK** | 1.55 | 1.39 | 1.58 | 1.60 |
| **US** | 2.03 | 1.87 | 1.77 | 1.94 |
| **France** | 1.41 | 1.47 | 1.42 | 1.68 |
| **W Germany** | 1.25 | 2.08 | 2.11 | 2.47 |
| **Japan** | 1.46 | 1.82 | 1.92 | 2.46 |

Source: 'Industrial Competitiveness and Britain's Defence', Kaldor, Sharp, and Walker, Lloyd's Bank Review, October 1986.

## Resource allocation

**48** To improve economic performance, flows of materials, capital and labour need to be more responsive to market signals. This issue is highlighted by the North-South divide. Urban decay is one aspect, covered in an earlier chapter and addressed more fully in *Reviving the Cities**.

**49** Much has been made of the need to encourage labour to accept work where it is available, rather than wait for work to come to labour. The disparity of regional unemployment alongside labour shortages attests to the urgency of this problem. The housing market has been a major factor impeding labour mobility and contributing to skill shortages.

**50** While the move to increased owner occupation (now accounting for 60 per cent of households) is welcome, the private sector's decline within the rental market has itself contributed to the difficulties. This sector now accounts for less than 10% of the housing market – a much lower proportion than in competitor nations (see Chart 12) and a substantial decline from around 50% in the early 1950s. We need to examine the legislative and fiscal framework which has contributed to this.

**51** Increased availability of privately-rented accommodation could encourage workers to accept jobs elsewhere more readily, and would allow the young greater mobility early in their careers.

**52** To help improve labour mobility, more favourable tax treatement of the payment of relocation expenses by firms should be considered. Relocation is important to businesses wishing to re-deploy labour for greater efficiency. The CBI has set up an Employee Relocation Council to examine all relevant aspects, and is separately considering the tax issues in greater detail.

## UK offshore oil and gas industry

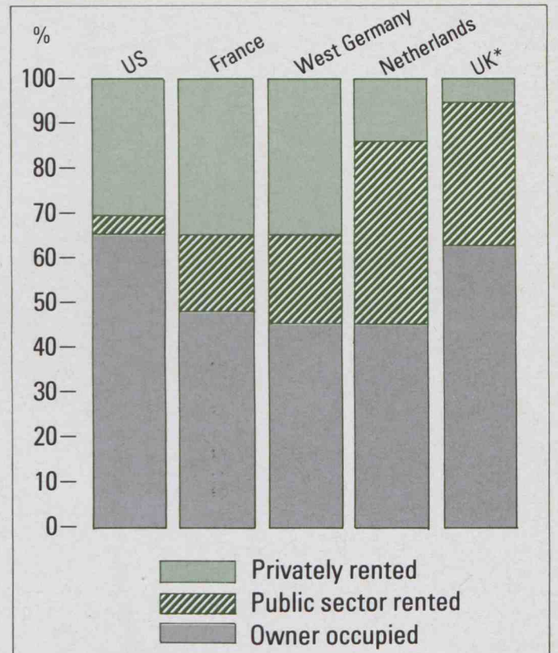
**53** The impact of the recent precipitous fall in the international price of oil has been particularly serious as far as the current account of the balance of payments, the exchange rate, and the local economy in Scotland are concerned. The buoyancy of non-oil revenues, which has to some extent cushioned the impact of this on the Exchequer, should not be allowed to conceal the seriousness of these economic implications.

**54** Notwithstanding the acceleration of PRT repayments (announced on 6 November) serious consideration should be given to easing the North Sea fiscal regime, to provide incentives for companies to sustain the pace of exploration and development. This would be justified not least in order to reduce the exposure of the UK economy if prices were to rise sharply during the 1990s.

**Published CBI, February 1986.*

**Chart 12**

**International comparison of tenures 1985**




*UK figures for 1984
Source: Department of Environment

## Conclusion

**55** Budget measures can do only so much and no more. The performance of the economy depends on industry and government working together to help foster the spirit of enterprise and endeavour.

**56** CBI members have identified the importance of education and training, regional differences, innovation, taxation, monetary policy and the infrastructure for industry's long-term performance. Specific measures have been suggested in some areas. Others are under review.

**57** Action on such issues is crucial if the UK is to plan ahead effectively for new products, new designs and new markets.

**58** Becoming more competitive is largely down to business itself. Government measures can either go with the grain, and help, or go against it, and handicap.

**59** UK business is now making progress. But it needs to sustain the momentum of change so that the benefits of economic growth can be enjoyed now and by future generations.

psl/65A

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

15 January 1987

S Wood Esq
PS/Lord Privy Seal
Privy Council Office
Whitehall
LONDON SW1A 2AT

Prime Minister
DJR
15/1

Dear Steven,

**1987 BUDGET DAY**

Thank you for your letter of 13 January. As you know, it is now planned that the Chancellor should instead announce the date of the Budget in his speech in the Debate next Tuesday.

If the Lord Privy Seal is asked about it at Business Questions tomorrow, I suggest that the line to take is simply to say that the date of the Budget will be announced shortly. (For background, it has been the normal course since 1980 to announce the date of the Budget in the first business statement after the Christmas recess, but there is no commitment to do this. The 1985 Budget day was announced early in order to fit in with the timetable for the sale of British Aerospace shares.)

I am copying this letter to David Norgrove and Murdo Maclean.

Yours sincerely,

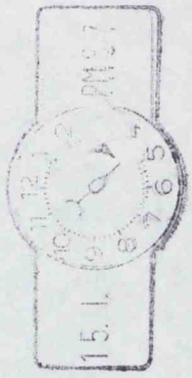
Cathy Ryding

PP A C S ALLAN

Econ Pol

BUDGET

PTC



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CABG

10 DOWNING STREET

LONDON SW1A 2AA

13 January 1987

*From the Private Secretary*

Dear Alex,

**1987 BUDGET DAY**

The Prime Minister has seen your letter to me of 12 January and is content now to go firm on 17 March as Budget Day this year. I imagine the Lord Privy Seal will now be announcing this on Thursday instead of the Chancellor tomorrow.

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

Yours,

David

David Norgrove

A.C.S. Allan, Esq.,
HM Treasury.

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PRIVY COUNCIL OFFICE
WHITEHALL. LONDON SW1A 2AT

13 January 1987

NBPP.

Dear Alex,

1987 BUDGET DAY

You sent me a copy of your letter to David Norgrove, asking for agreement that the date of the Budget should be announced by the Lord Privy Seal on 15 January.

I understand that the Prime Minister is content, and the Lord Privy Seal will do this. As last year, the appropriate form would be in answer to a supplementary from the Leader of the Opposition. We and the Chief Whip's Office will make the necessary arrangements.

I am copying this letter to David Norgrove and to Murdo Maclean.

Yours,

Steven.

S N WOOD
PRIVATE SECRETARY

A C S Allan Esq
Principal Private Secretary
HM Treasury
Parliament Street
London SW1P 3AG

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Econ Pol: Budget PT16.

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CCBG.

010

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

12 January 1987

Yes mr

D Norgrove Esq
10 Downing Street
LONDON
SW1

Prime Minister!

Content? / The Chancellor is it just likely now to announce the date in his speech on Wednesday?) DLW 12/1

Dear David

**1987 BUDGET DAY**

As you know, we have been planning on the assumption that Budget day this year will be on 17 March.

It has become customary to announce the date of the Budget in the first business statement after the Christmas recess - ie this year on Thursday, 15 January.

I should be grateful to know if the Prime Minister - and the Lord Privy Seal and Chief Whip, to whose private secretaries I am copying this letter - is content for it to be announced in the business statement on that day that Budget day will be 17 March. If so, I would be grateful if Stephen Wood would put the necessary arrangements in hand.

Yours
Alex

**A C S ALLAN**
Principal Private Secretary

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215)
(Switchboard) 01-215 7877

*Secretary of State for Trade and Industry*

**CONFIDENTIAL**

18 December 1986

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

Prime Minister 2

DCV
18/12

Dear Nigel,

**1987 BUDGET**

This seems an appropriate moment for me to give my suggestions for the inclusion of measures in your coming Budget which I feel would help commerce and industry to contribute effectively to the increase of national wealth.

You have made clear your intention to continue the process of reducing the burden of personal taxation. I share your priorities on this, and would be happy to see the bulk of any room for manoeuvre used for this purpose. Last year, you decided to offset in small part a reduction in the basic rate of income tax by increasing some of the higher rate thresholds by less than the rate of inflation. I recognise the reasons for this; but the later moves substantially to reduce the higher rates of personal tax in the United States leave us somewhat exposed in what is increasingly an international market for senior managers in industrial and commercial companies. I would therefore hope that the thresholds for higher tax rates could at least receive the benefit of full indexation this year.

I have chosen my proposals for changes in taxes which directly affect business so that they do not to a significant extent reduce the scope for action on personal taxation. Some of my specific suggestions are set out more fully in the enclosed memorandum. If there are points in them which your officials wish to follow up with mine, I hope they will do so, as in previous years.

DW4BUQ

1786 1986 BOARD OF TRADE BICENTENARY

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CONFIDENTIAL

In the field of corporate taxation, you announced in your 1984 Budget the rates of corporation tax to apply for the four year period from April 1983 to April 1987. It would be most helpful to industry in planning for the short to medium term if in your coming Budget you are able to announce the rate of corporation tax for 1987/88, and give a clear indication of your intentions for subsequent years. I naturally hope that you will find scope for some reduction in the present rate of 35 per cent; but in any event I regard it as most important that there should be no increase.

The particular aspect of corporate taxation on which I and my colleagues in DTI have received the greatest volume of representations from industry in recent months has been the tax treatment of R and D. It is commonly alleged that a number of our competitors have a more favourable fiscal regime for R&D, to the point where it pays some UK-based companies to carry out R&D abroad. We have agreed that there should be a review in the next few months of R&D taxation in other countries, and I do not propose to make any new proposals pending the outcome of the review. But I would urge you to look again at the two specific proposals made in Leon Brittan's Budget submission last year, for the extension of tax relief to expenditure incurred by a consortium on R and D before trading begins, and for the clarification of the definition of research used for the Scientific Research Allowance.

I set out the case for the first in some detail in my letter of 17 March to John Moore, and will not repeat the arguments at length. In part the proposal is a response to representations we have received from industrial companies and financial institutions; but I believe that it would have at least as much value in stimulating a new and flexible approach by industry, financial institutions and higher education to commercially oriented R & D. We are both concerned about the relatively poor R & D performance of British industry. I believe that this proposal offers one of the most cost-effective means available of stimulating an improvement. I am pleased that our officials have made good progress, on a "without prejudice" basis, in elaborating a possible scheme. I am content with the outline that has been prepared and I very much hope that you will be able to include it in the Budget.

We also receive a good many complaints that the Scientific Research Allowance, which you decided in last year's Budget to retain, is of little value because the definition of scientific research has proved in practice both narrow and uncertain. I understand that this concern is not at present matched by a significant increase in the Inland Revenue case load on the point. Nonetheless, I believe it would help industry at very little cost if the definition could

DW4BUQ

be clarified by making it more specific and relating it more closely to how R&D is actually carried out in industry. Section 1.174-2 of the US Internal Revenue Code, while doubtless unsuitable for incorporation in UK law as it stands, illustrates an approach which I think industry would find more helpful.

I should also like to propose some further changes in the tax treatment of financial services. I very much welcomed the reduction in the rate of Stamp Duty on securities transactions to ½ per cent from the date of the Big Bang. But this still means that transaction costs in London are higher than in other financial centres apart from Tokyo, and leaves the City at a competitive disadvantage at a critical moment in the evolution of a world securities market. There remains a strong case for the complete abolition of Stamp Duty on securities transactions, but I realise that the revenue loss would be significant. A further reduction of $^{1}/_{4}$ per cent be a great help to the City's competitive position, and on past form much of the apparent revenue loss would be offset by an increased volume of turnover. (I note that the yield of the 1 per cent Stamp Duty on securities transactions in 1985/6 was 15 per cent greater than the yield of the 2 per cent duty two years earlier.) The reduction of the main Stamp Duty on securities to $^{1}/_{4}$ per cent would also make possible a pro rata reduction, to 3/4%, in the new tax on the transfer of shares for the purpose of creating depositary receipts. as well as the halving of Stamp Duty Reserve Tax.

The changes to be introduced under the Financial Services Act in the range of investments permitted to authorised unit trusts will require parallel changes in the provisions defining the tax status of the trusts. Our officials are well advanced in the preparation of proposals to achieve this. I am sure that you agree that the scope of the tax changes needs to be wide enough to enable us to achieve our purpose of allowing unit trusts greater flexibility in their choice of investments within a firm regulatory framework. I also hope that you will look again at the $^{1}/_{4}$ per cent unit trust instrument duty. The amount of tax collected is quite small, and the duty is an increasing handicap to the trusts, and particularly to money market funds, in competing with other investment media.

I have two suggestions to make on the tax arrangements for life insurance. The Stamp Duty of 50p per £1000 insured distorts competition between savings media and is widely seen as discriminating against life insurance companies. More specifically, the application of this duty to the reassurance in the UK of life policies written abroad is a major burden for UK

reinsurers and seriously handicaps them in international competition for this business. This latter change would only cost about £1m and I do hope you can agree to meet it.

Like my predecessors, I have been concerned that the exemption from double capital gains charges enjoyed by unit trusts and investment trusts has not extended to unquoted venture capital companies, with the result that they have been compelled to establish residence off-shore. I am delighted therefore to hear that a solution to the problem seems to have been found that does not require legislation. I hope that continuing discussion on the tax treatment of venture capital fund managers' profit on their personal stake in the funds will have a similarly successful outcome. If solutions on both points enable the funds to come back on shore, the revenue effect will be positive.

I have also been following the progress of discussions at official level on disincorporation relief. It seems clearly right that the relief available when unincorporated traders incorporate should be matched for businesses which decide to disincorporate; and I understand that this is now accepted in principle. I recognise that to translate this into legislative terms is not straightforward, but I hope that you will be able in the Budget at least to indicate your intention to introduce disincorporation relief.

You are, I understand, looking again at the tax advantages enjoyed by dual resident companies, the cost of which has now reached substantial proportion. I have already written to Norman Lamont to say that I am content with your proposal to curtail this relief.

On VAT, I fully support your efforts to secure agreement at Community level to a new directive which would permit a substantial increase - even beyond the 35,000 ecu proposed by the Commission - in the turnover threshold above which firms must register; and I hope that you will as a minimum increase the present threshold of £20,500 in line with inflation. The proposals in the consultative document on VAT and small businesses will also in the main be welcomed by industry, and I would particularly urge the early introduction of an option for smaller traders to account for VAT on a cash basis. But I hope you will reconsider the suggestion that firms with a turnover below the registration threshold should no longer have the option of registering. This could have a serious effect on a substantial number of repayment traders.

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My final point is small in the context of the Budget as a whole but could have serious implications for jobs on Merseyside. I understand that Customs and Excise are considering a proposal to abolish the long-standing excise charge on matches and lighters. I appreciate that those duties may have to go eventually in part of wider moves to harmonise excise duties in the Community. But their early removal would gravely threaten 300 jobs at Bryant and May in Liverpool, and my own view is that abolition of the duties in the coming Budget would not be a good idea.

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

PAUL CHANNON

DW4BUQ

CONFIDENTIAL

V6

10 DOWNING STREET

LONDON SW1A 2AA

*From the Private Secretary*

18 December 1986

VAT AVOIDANCE

The Prime Minister has considered your letter to me of 17 December about the proposed announcement on VAT avoidance and in the light of this further information is content for the announcement now to be made.

David Norgrove

Mrs Cathy Ryding
HM Treasury.

EC

10 DOWNING STREET

Prime Minister

To delay this announcement until after the recess could cost £100 million.

It seems unlikely that a single announcement of this kind could be regarded as a mini-Budget.

Content now to approve it?

DLW
17/12

Yes

MR 11/10

**CONFIDENTIAL**

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

David Norgrove Esq
10 Downing Street

17 December 1986

Dear David,

**VAT AVOIDANCE**

Thank you for your letter of 17 December recording a number of questions which the Prime Minister had asked about the proposed package of measures aimed at reducing VAT avoidance. These relate to the detail of the proposals, how the changes will work, whether legislation will be required, and the possible charge of a mini-budget.

The changes to be made are inevitably complex, as will be apparent from the attached intended answer to the PQ. More essentially, both primary and secondary legislation are involved: it is the secondary legislation which prompts the urgency. The primary legislation is for the 1987 Finance Bill, but the secondary legislation has to be in place earlier, involving detailed rules to operate from 1 April 1987: draft regulations published in the New Year would allow businesses the maxium time to prepare. All but one of the changes would take effect on 1 April.

... The secondary legislation of course stems from existing primary legislation.

The primary legislation changes (yielding an expected £100 million pa) will establish a more direct link between reclaimable input tax and the future supply on which recovery should depend. Present manipulation includes taking businesses into or out of VAT groups, which the legislation would block: avoidance schemes are being actively marketed, and avoidance will grow fast unless blocked.

As to the secondary legislation, partly exempt traders can at present recover input tax through a method of apportionment based on turnover. There are current rules to protect small businesses from the compliance costs of partial exemption but large companies with massive exempt supplies have been able to recover their whole input tax by sheltering inside group registrations, which can contain as many as 400 companies. Some 6,000 large and very large businesses will be affected.

The new partial exemption rules (yielding an expected £200 million pa) will be much less susceptible to this sort of distortion, though small businesses will gain more generous relief (with at least 2,000 more excluded altogether than now).

This would certainly be an important announcement. But those participating since consultation began in early August are not expecting a delay till the Budget, and we have foreshadowed an early announcement in response to an unplanted PQ. Respondents to consultation have especially asked for adequate lead-time, and have acknowledged that the law needs tightening. The scale of avoidance is underestimated in the market place but is widely known to exist, which is what has informed our prompt action. As the Chancellor implied earlier, delay till a Budget announcement would cost £100 million: any political cost in a separate announcement is matched by at least an equal political cost in being seen to delay when an abuse is publicly recognised.

Yours,

Cathy

**CATHY RYDING**
**Assistant Private Secretary**

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**ANNEX**

To ask Mr Chancellor of the Exchequer, what representations have been received in response to a consultation document issued by Customs and Excise on 7 August entitled "VAT: Input tax: origin and scope of the right to deduct"; and if he will make a statement.

Over 100 responses were received in writing and 23 meetings have been held with trade and professional bodies. In the light of these, I propose to introduce the following measures.

1. Right to Deduct Input Tax

The right to deduct input tax as expressed in Section 14 and 15 of the Value Added Tax Act 1983 is expressed in wider terms than in the EC Sixth Directive on VAT and allows businesses to recover input tax not related to the making of taxable supplies. The right to deduct will be restricted to only such input tax as is incurred in the making of taxable supplies. An exception would be required to give effect to Article 17.3 of the Sixth Directive in favour of input tax incurred in the UK in respect of certain overseas and other non-taxable transactions.

2. VAT Group Registrations

(a) **Power to Restrict Grouping**

I do not propose to introduce new legal provisions restricting the present rights of companies to form VAT groups or to add or remove companies from existing groups. But Customs and Excise will in future exercise more strictly their power to refuse applications for group treatment where this appears necessary for the protection of the revenue.

(b) **Transfers of Going Concerns**

Where a business or its assets is transferred as a going concern to a VAT group which is or becomes partly exempt during the tax year in which the transfer takes place, the transaction will be treated as a supply to and by the group. The group would be

responsible for accounting for the tax due.

3. Valuation of Exempt Supplies

The provisions of the Value Added Tax Act 1983 governing valuation of certain supplies not made in open market conditions at present apply only to taxable supplies. To prevent input tax deduction calculations being distorted by undervaluation of exempt supplies, these provisions will be extended to exempt supplies.

1-3. Where the above proposals require legislation, I intend to include this in the 1987 Budget and Finance Bill, to take effect from 1 April 1987.

4. Partial Exemption "de minimis" Rules

The present partial exemption rules are open to serious distortion because they require proportional calculations to relate to the outputs of a business and not to its inputs. To protect against such distortions, it is necessary to prescribe that,as a normal rule, all calculations should relate directly to the input tax, including those calculations which show whether the business may reclaim all its input tax on de minimis grounds. In response to representations about the possible complexities for businesses, it is proposed that these rules should be as generous and simple as possible, so that a business can readily establish whether it is eligible for "de minimis" treatment, while not open to manipulation and substantial revenue loss.

The partial exemption rules will be amended to provide as follows.

(a) Where a taxable person's input tax attributable to exempt supplies amounts to less than any of the following:

i. £100 per month on average;

ii. Both £250 per month on average and 50% of all his input tax;

iii. Both £500 per month on average and 25% of all his input tax;

all such input tax for the relevant period may be attributed to taxable supplies. For group registrations, the provisions will apply to the group as a whole.

(b) For the purpose of the above calculations, certain exempt supplies may be ignored. These supplies will be prescribed by regulation and will include:

deposit interest;

rent (where the input tax directly attributable to lettings is less than £1,000 a year);

insurance commissions;

mortgage commissions;

assignment of debts.

Businesses will not be allowed to take advantage of these simplification measures if they are within the financial sector or within other categories, which will be prescribed, which make these supplies as a significant part of their business.

These measures will have the effect of substantially reducing the numbers of businesses needing to do calculations in order to establish whether they fall within the partial exemption "de minimis" rules.

5. Partial Exemption Standard Method

Where the "de minimis" rules do not apply, the taxable person must apportion his input tax between that which relates to taxable and that which relates to exempt supplies. The rules for attribution of input tax will be revised as follows:

i. Input tax must be identified and attributed to the greatest possible extent, as between taxable and exempt supplies and any other activity and only that tax attributable to taxable supplies may be deducted.

ii. The remaining input tax which cannot be directly attributed is to be apportioned by reference to the use made of the goods and services to which it relates. Customs and Excise will accept any method of calculation which produces a fair and reasonable apportionment between the taxable and exempt activities which these goods and services (or the largest conveniently ascertainable part of them) are used to support. An apportionment which attributes this remaining input tax in the same proportion as the input tax directly attributed under (i) will always be accepted. But in making such an apportionment, no account is to be taken of input tax on goods supplied in the same state, on supplies by agents under Section 32(4) of the Act, on supplies which are subject to specific restriction, e.g. motor cars, or on supplies of transfers of going concerns treated as taxable under paragraph 2(b) above.

iii. Customs and Excise would also be enabled to allow the use of a method other than those specified above. This would include in appropriate cases a special method based on the ratio of the taxable supplies made by a business to its total supplies.

Taxable persons who have existing approval to operate a special method may continue to operate that method. Agreements negotiated between representative trade bodies and Customs and Excise would also continue unchanged. These approvals and agreements remain subject to review in the normal way. Taxable persons operating the existing standard method or becoming partly exempt because of changes in the "de minimis" rules will have to adopt the new standard method at (i) and (ii) above. **If this is impractical or it is thought that it will not produce an accurate or fair result, Customs and Excise will consider allowing an appropriate special method.** Individual ~~buinsesses~~ businesses should apply to their local office; representative trade bodies should approach Customs and Excise headquarters.

6. Minor Amendments to the Partial Exemption Regulations

The following minor amendments will also be made:

i. Regulation 29(5). Amend to read: "The Commissioners may approve or direct different provisions for different circumstances and in particular may approve or direct, ..."

ii. Regulation 32(a). Delete "an exempt supply" and replace with "a supply".

iii. Regulation 32(e). Delete "exempt".

4-6. These changes will be implemented by revised Regulations made by the Commissioners of Customs and Excise and will come into operation from 1 April 1987. Drafts of the regulations will be circulated as soon as possible to those bodies which expressed an interest in seeing the text during the consultation. I will place copies in the Library of the House. The regulations are subject to the negative Parliamentary procedure.

7. Appeals

There is at present no specific right of appeal to the VAT Tribunal regarding the use of partial exemption methods. Such a right will be proposed in the 1987 Finance Bill.

8. Deduction of Input Tax on Capital Goods

The EC Sixth Directive, Article 20.2, requires the input tax on capital goods to be adjusted annually over a period of five years. The UK has not implemented this measure, even though it would be desirable for the protection of the revenue. It will now be introduced (by a further amendment to the partial exemption regulations) but with effect from 1 April 1988.

9. Other Matters

Concern has been expressed that the revised partial exemption rules could have an adverse and distortive effect on recovery of input tax, in respect of capital issues, including Eurobonds. Consideration is being given to exempting from VAT the supply of services in relation

to such issues.

The revenue effect of all these changes is estimated to be an increased yield of VAT in 1987-88 of £300 million.

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DA
CBG

10 DOWNING STREET
LONDON SW1A 2AA

*From the Private Secretary*

17 December 1986

**VAT AVOIDANCE**

The Prime Minister has seen the Chancellor's minute of 16 December about the proposed package of measures aimed at reducing VAT avoidance.

The Prime Minister would like to know a little more about the proposals, how the changes will work, and whether legislation will be required. She is also concerned that the announcement could look like a mini-budget.

I am sure you will be able to reassure the Prime Minister on these points. You will need to put down a Question tomorrow if the announcement is to be made before the Recess, and I should be grateful for your reply to this letter by close of business tonight.

BF 11

(DAVID NORGROVE)

Mrs. Cathy Ryding,
HM Treasury.

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JB

MR 10/15

**CONFIDENTIAL**

VCBG

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

PRIME MINISTER

**VAT AVOIDANCE**

I think you should know that I propose to announce this week a package of measures aimed at eliminating a substantial source of VAT avoidance. The problem arises essentially from manipulation of the rules by which businesses reclaim the VAT charged on their purchases. Companies making large volumes of exempt supplies can distort competition by forming a group with wholly taxable businesses and recovering all their input tax. For example, the bank which is part of British Petroleum's group registration - and the Opposition are aware that the financial sector figures prominently in this practice - can claim back all its input tax, unlike direct competitors and small businesses. The changes I propose, if implemented from April 1987, would yield £300 million in 1987-88 and £400 million in a full year.

With my authority Customs and Excise issued a consultation paper in August, on which written representations and meetings followed. Probing by Customs and Excise has served to indicate that the problem is even larger than first thought. I am sure we must put a stop to it.

There are however some sensitive areas. One consequence of tightening the rules is that a concession granted to the brewers in 1984 would have to be withdrawn. Unfortunately the brewers' chosen route for relieving the dilemma (taxing tied house rentals) is politically unattractive for quite separate reasons. However, there are other ways of tempering the loss of the concession to the brewers, and there is evidence they are ready to negotiate on these once the main issue has been settled. Peter Brooke has seen the Brewers' Society.

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Second, there is an understandable preoccupation with compliance costs. I propose to enable smaller businesses to recover the whole of their input tax, and thus to increase the number of smaller firms receiving favourable VAT input tax treatment. There will be an obligation on larger firms to engage in detailed calculations designed to prevent over-recovery of the tax but Customs and Excise will be ready to agree special methods either for whole trades or for individual firms. Moreover, compliance costs also fall on Customs who have a mutual interest in simplicity, and there will be an emphasis on practicality, accuracy and fairness.

Finally, just as I am concerned to secure early change for understandable reasons of revenue and anti-avoidance, there are also concerns about the length of time that will be available for agreeing and setting up new systems. I am particularly anxious, therefore, to make the announcement by arranged PQ before the Recess, for implementation from April 1st 1987. (Given that charges occur only quarterly in this area, delay until the New Year could cost us up to £100 million.)

N.L.

16 December 1986

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RESTRICTED

H M TREASURY

OFFICE NOTICE

ON(GENERAL)(86)99
10 DECEMBER 1986

**BUDGET SECURITY**

I attach a note setting out this year's Budget security instructions. They apply without exception to Ministers, advisers and officials. Breaches of these instructions will be treated as a serious matter.

2. The special arrangements for Budget security are designed to give additional protection to information about Budget decisions. The instructions have been approved by the Chancellor of the Exchequer. This year's instructions follow the general lines of last year's instructions. The Budget security arrangements have generally worked well in the last two years, but that must not be a reason for complacency. It is important that all concerned continue to be observe these instructions strictly.

3. All members of the department should recognise the sensitivity of Budget material, and take every care to ensure that its integrity is preserved. Heads of Divisions and Private Offices should ensure that staff who are likely to handle Budget papers understand the instructions. The Assistant Budget Security Officer in EOG2 will also help ensure that the staff most heavily involved understand the procedures and have the equipment to carry them out.

4. All members of the department should also note that the Budget Security instructions contain guidance (paragraphs 144 to 147) on contacts with journalists, in the period from the beginning of January to Budget Day, which apply whether or not you have any involvement with Budget work. The term "journalist" should be interpreted widely to include contributors to specialists publications, brokers circulars, newsletters etc; indeed anyone

who is in a position to make easy contact with the media. Most staff will not have any such contacts. But if you do you must observe these instructions, to protect your own position and that of the department against suspicion. In any contacts, you must take particular care, as inferences can be drawn from the most casual remark or refusal to comment.

5. The major change in this year's instructions compared with last year is that the guidance on use of the Budget prefix has been clarified. It is important that documents relating to the Budget be classified correctly, in accordance with the guidance in paragraphs 150 to 153A. In cases of doubt the Budget Security Officer should be consulted (see paragraph 9). Particular points to note are:

(a) the Budget prefix should be used for papers containing decisions on any public expenditure changes to be announced in the Budget; and

(b) a reply to, or comments on, a minute should not automatically be given the same classification as the original minute.

6. There are a number of other points in the instructions to which I would draw particular attention:

(a) The rules for handling Budget Secret: Budget List Only documents set out in paragraph 158 must be adhered to strictly. In particular, documents for which this classification is appropriate must not be sent or shown to anybody who is not on the authorised list of recipients (the "Budget List") which has been approved by me. Any alterations to the list require my prior approval. Special care should be taken over the custody of typed originals of Budget Secret: Budget List only documents (paragraph 158(b)).

(b) Great care should be taken to ensure that titles of Budget Secret documents and above are not themselves revealing of

the contents of the Budget, as they may be seen by staff not authorised to have access to Budget information (paragraph 158(a), 160(a)).

(c) A minute containing Budget classified material should not be written unless it is strictly necessary and, if it is, should not be circulated to those who do not have a real operational need to see it. If a person only needs to see part of a document, he should only be sent that part, not the whole document (paragraph 155).

(d) Each copy of every document classified Budget Secret or above must be individually numbered, in sequence (paragraph 158(c), 160(f)).

(e) Documents which are classified Budget Secret or above must always be sent in double envelopes, even if they are being sent within the Treasury. The inner envelope should bear the appropriate address label with all details fully completed (paragraph 158(d), 160(a)).

(f) Budget classified papers may not be filed by allocated Clerks (or Sector Registries) until after Budget Day, unless specifically authorised. Until then, such papers which have been passed to a Principal must be kept by him so that other staff do not have access to them (paragraph 158(f), 160(d)).

(g) Additional security furniture will be required by some staff. It is essential that requisitions for this be made as soon as possible from the Assistant Budget Security Officer in EOG 2 (extension 4859) (paragraph 158(g), 160(d)).

7. A copy of the Budget list is being sent today to those persons whose names are included on it.

8. The system of special spot checks on Budget classified documents (paragraph 161) will continue. These checks are carried out on

my authority. I ask all members of staff to co-operate so that the checks can be carried out with the minimum of disturbance.

9. The secure facsimile which was used last year for the transmission of Budget classification papers up to and including Budget Secret: Budget List Only between the Treasury and the Revenue Departments, has now been extended to the Bank of England and Department of Transport, at Marsham Street and DVLC Swansea (paragraph 80B). An amendment to the Treasury Security Instructions dealing with this point is also attached.

10. Further guidance on any aspect of the Budget security instructions can be obtained from the Budget Security Officer, Mr Romanski the Principal in FP (Indirect taxation branch - extension 4922), who will be assisted in the performance of his duties during the Budget season by Mr Rees, EOG2 (extension 4859).

11. Please insert these instructions in the copy of "HM Treasury Security Instructions" in your possession and destroy the previous version.

PETER MIDDLETON

3982/012

COVERING
RESTRICTED

# TREASURY SECURITY INSTRUCTIONS

## JANUARY 1983 EDITION

**AMENDMENT NO 6** 15 December 1986

1. **Replacement Pages**

Paragraphs 144-165 remove and destroy: insert new pages.

Paragraphs 80A-84 remove and destroy: insert new pages.

2. **Manuscript Amendments**

| | |
|---|---|
| Paragraph 73 | 233 7887 to read 270 4394 |
| Paragraph 137 | 233 4917 to read 270 4558 |
| Paragraph 171 | delete Mr B Older (Ext 6102) and insert Mr R Anderson (270 6408). |

## XIII. BUDGET SECURITY

### Relations with the Press

144. This first subsection applies to all Treasury staff in the pre-Budget period, including officials who are not involved in work connected with the Budget. References to 'journalist' in this section are to be interpreted widely to include contributors to specialist and academic publications, brokers' circulars, newsletters and other similar publications. References to the pre-Budget period should be taken to mean the period between the beginning of January and Budget Day itself.

145. Formal contacts with journalists in the pre-Budget period may only be undertaken with the prior authority of the Permanent Secretary or, in his absence, either the Under Secretary (FP) or one of the Second Permanent Secretaries. If permission for such contact is granted, a report should be submitted immediately after it takes place to the head of IDT, copied to the Permanent Secretary and the Budget Security Officer, whatever the subject matter of the discussion.

146. Telephone calls from journalists are to be referred in the first instance to IDT. If any conversation takes place directly with a journalist in the pre-Budget period a report is to be sent to IDT copied to the Budget Security Officer, whatever the subject matter of the conversation.

147. If any other contacts take place with journalists in the pre-Budget period, no matter how informal, a report of the fact is to be made to IDT copied to the Budget Security Officer, together with a very brief account of any discussion of official matters.

### General

148. Special security arrangements apply to certain information connected with the Budget, as described in paragraph 150. The arrangements apply in addition to the normal departmental security procedures and are intended to provide additional protection for information about Budget decisions. It is the responsibility of every person involved in Budget work to be familiar with, and operate, these instructions. EOG will ensure that those most heavily involved understand the procedures.

149. The recipient of a Budget classified document is, at all times, personally responsible for its security. This applies even if custody of the document is entrusted to another member of his or her staff (where this is permitted).

Use of Budget prefix

150. The Budget prefix should only be added to the security classification marking for documents which contain information concerning Ministerial decisions on:

(a) the Budget judgement and in particular the PSBR;

(b) all taxation matters connected with the Budget; and

(c) any social security or other public expenditure changes to be announced in the Budget.

The Budget classification should also be applied to documents in which no decisions are recorded, where the papers are particularly sensitive - for example, where the very fact that a matter is being discussed is sensitive, where there is a serious danger of forestalling or where a document might reveal the approach to the Budget likely to be adopted by Ministers. The Budget prefix should not be used on other papers which do not reveal Ministerial decisions.

151. A Budget classification is not, in general, required for papers containing:

(a) Ministerial decisions relating to economic forecasts, monetary policy, exchange rate policy and other items not directly related to tax or public expenditure decisions, even where these are in the context of a Budget;

(b) arguments for and against a particular course of action, or recommendations from officials to Ministers or other Ministers to the Chancellor unless the papers are particularly sensitive (see above); or

(c) lists of options in which no decision is recorded.

It should be borne in mind that a submission to a Minister on a Budget matter, suggesting a range of options, may properly not have a Budget classification, but a note from a Ministerial Office recording a decision on it should be given a Budget classification.

152. Care and common-sense are needed in using the Budget prefix. In any cases of doubt the Treasury Budget Security Officer (see paragraph 165) is to be consulted.

**Level of Budget classification**

153. "BUDGET SECRET - BUDGET LIST ONLY" is a special security classification to be used for certain Budget documents, ie for those papers which reveal the contents or probable contents of the whole, or a very substantial or particularly sensitive part, of the Budget. The Chancellor may also decide that papers dealing with particular subjects be

given this classification. Strict rules are laid down for access to, and handling of, documents with this classification. These are set out in paragraph 154 and 158 below. Examples of papers which are to be given this classification include:

- papers, including records of meetings, which give an overall picture of Budget strategy;
- complete drafts of the Budget speech (and the most sensitive extracts such as complete drafts of the tax sections);
- full drafts of the Budget Brief, or particularly sensitive parts of it;
- full draft of the FSBR (and early drafts of the sections dealing with Budget proposals); and
- the Budget Resolutions, as a whole.

Papers dealing with an individual tax would not normally require BUDGET SECRET - BUDGET LIST ONLY classification, unless this is required by the Chancellor.

153A. Otherwise, Budget security rules require that the ordinary security classification of documents be prefixed by the word BUDGET. BUDGET: TOP SECRET should only be used where the material would fall clearly within the definition of TOP SECRET even if it were not to be included in the Budget. BUDGET: SECRET is the correct classification for all other papers on the main Budgetary items (ie the main tax rates and social security benefits and other major changes in tax legislation or public expenditure). BUDGET: CONFIDENTIAL should be used for papers recording decisions on other Budget matters, including all other decisions on tax items. The classification of a document is not necessarily the appropriate classification for a minute commenting on or replying to it even if the original document is classified BUDGET SECRET-BUDGET LIST ONLY. For example, a minute containing comments on a document should bear the classification appropriate to its contents and should only bear the same classification as the original document where it is appropriate.

**Communication of Budget classified information**

154. Documents for which the "BUDGET LIST ONLY" classification is appropriate may only be circulated to persons who are on the "Budget list", a list of recipients of such documents approved by the Permanent Secretary. Under no circumstances are they to be circulated or shown, or the contents communicated in any other way, to a person not on that list. A copy of the Budget list will be made available to each person who is on the list. If it is considered essential to show a BUDGET LIST ONLY document to a person not on the Budget list, the prior approval of the Parmanent Secretary must be

obtained in writing to the addition of his name to the Budget list. Requests for names to be added to the Budget list should be addressed in the first instance to the Budget Security Officer. This applies right up to the Budget Day.

155. The circulation of all Budget classified documents is to be restricted to the absolute minimum consistent with operational requirements. Before writing Budget classified material all originators must ask themselves:

(a) Is the document necessary at all? (A private face-to-face conversation is more secure than a written note - paragraph 13 contains guidance on the security of telephone conversations.)

(b) If the document is necessary, need it be circulated? (Only copy a document to those people who need to be aware of its contents.)

(c) Need the document quote precise details of decisions eg proposed tax rates?

(d) Does the document require a Budget classification?

(e) Is the title likely to be a security risk? (Particularly in the case of BUDGET SECRET and more highly classified documents, the title is likely to be seen by persons who are not authorized to have access to the contents, so it is essential that the title does not reveal any sensitive information.)

(f) Do all recipients need a copy of the whole document? If a part of the document would suffice, send only that part. It is essential that persons do not see parts of documents containing classified material which they have no operational need to see.

156. BUDGET LIST ONLY documents may not be shown to anybody who is not on the Budget list (except for the normal arrangements whereby the Queen, Prime Minister, certain staff at Number 10 and the Governor of the Bank of England are told the contents of the Budget). Other BUDGET classified information may be communicated to staff in the Chancellor's Departments (and the Office of the Parliamentary Counsel), only if they need to know about it for the efficient performance of their duties.

157. Budget classified information must not be communicated to anyone outside the Chancellor's Departments and the office of the Parliamentary Counsel without prior authority having been obtained from the Budget Security Officer. There are only three general exceptions to this rule. First, FP group have authority to communicate to

specified Department of Transport officials Budget decisions on VED and the duties on hydrocarbon oils. Second, the head of FP has authority to communicate to specified officials in the Department of Health and Social Security certain information about Budget changes in personal taxation. Third, as is appropriate for public expenditure matters, ST group will discuss any social security changes to be announced in the Budget with DHSS officials. In all these instances the Divisions concerned must ensure that these Departments are aware of the need for particular care in handling the information. Similarly, if a Treasury Minister writes to a Minister in another Department on a Budget classified matter, his Private Secretary should ensure that the other Private Office are aware of the significance of the Budget classification, and in particular of the need to ensure that the letter is shown or copied only to those who need to see it.

**Preparation and handling of BUDGET SECRET: BUDGET LIST ONLY documents**

158. In addition to the normal security instructions regarding handling of SECRET documents, set out in paragraphs 42 to 103, the following special instructions apply to the handling of BUDGET SECRET: BUDGET LIST ONLY documents:

(a) The title of the document must not give away any sensitive information as to its contents as it will be used on the label on the inner envelope and may therefore be seen by persons not authorised to handle the document. A code word should be used if necessary.

(b) The document must be typed on plain paper. The security classification is not to be typed. Documents may be typed by a Personal Secretary if she is herself on the Budget list. The typist's initials should appear on each page of the document. The originator is responsible for the security of the typed master, which must be given a number in the sequential series used for copies.

(c) Copies of the typed master must be made onto the special paper bearing printed 'BUDGET SECRET: BUDGET LIST ONLY' markings on one side of the paper only. Each copy of the document must be sequentially numbered.

(d) The documents must always be enclosed in the special distinguishing folder marked "BUDGET SECRET: BUDGET LIST ONLY" for transmission. They must always be transmitted in double envelopes even if sent within the building. The inner envelope must bear the special "BUDGET SECRET: BUDGET LIST ONLY" label completed with the relevant details in full. If more than one document is sent in one envelope, details of each document must be shown on the label. If a BUDGET SECRET: BUDGET LIST ONLY document is to be sent or copied to a Minister, he should be sent two

copies. A receipt must always be obtained for all copies of "BUDGET SECRET: BUDGET LIST ONLY" documents. It is the responsibility of the originator to ensure that a receipt is returned for each copy which has been sent out. These receipts must be retained until after Budget day.

(e) If they are being sent to other Departments, the documents must be sent by messenger or by the special van service which operates between the Treasury, the Revenue Departments and Parliamentary Counsel's Office. If these are not available, the documents may be sent by special signature service of the IDS. In every case receipts must be obtained for the documents. In no circumstances may the documents be sent by post or transmitted on facsimile equipment except for the secure fasimile link between the Treasury, HM Customs and Excise, Inland Revenue, Department of Transport and the Bank of England (see paragraph 80B).

(f) Each Recipient is responsible for ensuring that every BUDGET SECRET: BUDGET LIST ONLY document is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this - this applies particularly at Principal level. A document may be entered in the security register by the Personal Secretary or allocated Clerk from the information shown on the label, without opening the inner envelope. If this is done, the number of the security register entry is to be written on the label. The recipient of the document is to ensure that the security register number is shown and should copy it onto the document itself. In some areas, Personal Secretaries or Clerks may themselves be included on the Budget list authorised to handle BUDGET SECURITY: BUDGET LIST ONLY material. Only in such cases may they open the inner evelopes, in which case the security register number may be written on the document itself. BUDGET SECRET: BUDGET LIST ONLY documents may not be filed until after Budget Day except where the Clerk concerned is on the Budget List.

(g) Each copy of a BUDGET SECRET: BUDGET LIST ONLY document is personal to its recipient. It may not be shown to any person not on the Budget list in any circumstances, and shown (but not copied) to a person who is on the Budget list only if there is a real operational need for him to see it. The fact that a person is on the Budget list does not mean that he must see all BUDGET LIST ONLY documents. It is the recipient's responsibility to ensure that the document is not seen by any person who is not authorised to have access to it. It can be kept in the recipient's own

security cupboard only if all persons who are entitled to know the combination number have been specifically authorised to handle BUDGET SECRET: BUDGET LIST ONLY documents. Otherwise it will be necessary to store such documents in a separate document box or security cupboard whose combination number is known only to the recipient (and any authorized handler of such material). Officials who require additional security furniture for this purpose should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 4859).

(h) It is essential that BUDGET SECRET: BUDGET LIST ONLY documents are not left unattended by the person who is responsible for their custody - he must lock them away whenever he leaves his room.

(i) BUDGET SECRET: BUDGET LIST ONLY documents may on no account be photocopied except by the originator (or his Personal Secretary, on his authority, if she has typed the document). If a person not on the original list of copy addressees is subsequently to be given a copy of such a document, it must be provided by the originator and the name of the recipient properly recorded. He may retain a small stock of additional numbered copies of the document for this purpose (which are to be treated as accountable documents). If he needs to take an additional copy of the document, it must be numbered in the original series. The above rules as to handling and control of the document apply to additional copies.

(j) BUDGET SECRET: BUDGET LIST ONLY documents may only be taken out of the office to meetings if this is absolutely unavoidable. They may be taken home only if the Permanent Secretary has given his prior approval, either for a particular occasion or generally for a particular individual. Permission will only normally be given if the person concerned has a security container at his home. Any documents taken out of the office must be carried in a locked briefcase, box or pouch and kept securely at all times.

(k) Where a person only needs to see a part of a BUDGET SECRET: BUDGET LIST ONLY document, he should be sent only a copy of the relevant extract. The copy extract should be given a number in the same series as the full copies. It should be given the security classification, appropriate to the sensitivity of the matter contained in it - the security classification at the top of the front page should be amended in manuscript if necessary. The recipient of the extract should treat it in accordance with the security classification shown on the document.

(1) If a BUDGET SECRET: BUDGET LIST ONLY document is to be destroyed before the Budget, it is to be sent to the Budget Security Officer in double envelopes, the inner envelope bearing the appropriate label, and marked for destruction. The Budget Security Officer will carry out the destruction in accordance with the standing instructions.

159. If a Budget sensitive document meets the criteria of paragraph 24 for classification as TOP SECRET it should be classified as "BUDGET TOP SECRET: BUDGET LIST ONLY". The distinguishing folder and address labels for "BUDGET SECRET: BUDGET LIST ONLY" documents are to be used amended accordingly in manuscript. The instructions of paragraph 158 are to be followed, expect where the normal security instructions for TOP SECRET documents impose more stringent requirements, in which case those should be obeyed.

**Handling of other Budget classified documents**

160. The normal rules for the control and transmission of classified documents (paragraphs 42-103 of H M Treasury Security Instructions) must be applied to all other documents which carry the prefix: BUDGET, except as modified below:

(a) BUDGET: TOP SECRET and BUDGET: SECRET documents must always be transmitted in double envelopes, even if only sent within the building and the inner envelope must hear a completed BUDGET: SECRET label. As the title will be shown on the label and may be seen by staff not authorised to handle the document, the title should be carefully chosen to avoid revealing any sensitive information. If two or more papers are included in one inner envelope, details of both must be shown on the label. BUDGET: TOP SECRET and BUDGET SECRET documents sent outside the building must be accompanied by receipts (but it should be noted that if a BUDGET SECRET document is received from Customs and Excise it will not necessarily be accompanied by a receipt when it reaches the recipient's office as bulk receipts are used for documents transmitted by document pouch to the Treasury).

(b) BUDGET: TOP SECRET and BUDGET: SECRET documents should normally be sent by messenger to other departments. If no messenger is available, they should be sent by special signature service of the IDS, a receipt being obtained from the post room. BUDGET: CONFIDENTIAL documents should be sent either by messenger or the IDS. Budget classified documents must not, in any circumstances, be sent by post or

transmitted on facsimile equipment, except for the secure facsimile link between the Treasury, HM Customs and Excise, Inland Revenue, Department of Transport and the Bank of England (see paragraph 80B).

(c) Each recipient is responsible for ensuring that every document classified BUDGET SECRET and above is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this -this applies particularly at Principal level. Staff who are not authorised to handle BUDGET SECRET documents may record them in the Security Register, provided that they have been received in double envelopes, using the information shown on the label. If this is done, the inner envelope must be passed to the recipient unopened, the number of the security register entry being shown on the label. If this procedure is followed it does not detract from the recipient's responsibility that receipt of the document has been recorded, so he should ensure that the security register number is shown on the label and copy it to the document itself.

(d) BUDGET classified documents are not to be filed or otherwise handled by Divisional Clerks until after the Budget. Principals are personally responsible for all BUDGET classified documents passed to them, and for ensuring that no other person is able to obtain access to them. Principals who will require a combination lock document box or security cupboard for BUDGET classified material should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 4859). It should be noted that this instruction applies to BUDGET CONFIDENTIAL as well as more highly classified material.

(e) Personal secretaries may continue to handle papers classified BUDGET SECRET or BUDGET CONFIDENTIAL as may Divisional clerks working with the Principals in FP. Files in FP containing BUDGET classified papers must bear the appropriate classification on the outside, and must be kept so that unauthorised persons can not have access to them.

(f) All copies of documents of BUDGET SECRET classification or higher must be uniquely numbered in series, whatever the length of the circulation list. Copies of BUDGET CONFIDENTIAL documents need not be sequentially numbered. BUDGET classified material including BUDGET CONFIDENTIAL may only be copied on the authority of an SEO or above, or Personal Secretary acting on behalf of a higher grade officer, but

recipients should as far as possible avoid making copies of Budget classified material. The making of copies must be carried out in accordance with paragraph 54.

(g) The arrangements set out in paragraphs 68-75 for taking classified papers out of the office apply to BUDGET: SECRET and BUDGET: CONFIDENTIAL documents, but BUDGET: SECRET papers are subject to the overriding restriction that they must not be taken out of the office unless absolutely unavoidable. In such an event, they should be carried in a locked briefcase, box or pouch and kept securely at all times.

(h) BUDGET: SECRET or TOP SECRET waste should be destroyed by shredding; arrangements for this may be made with EOG (extension 4859). Recipients must keep a proper record of any such documents they destroy. Production of such a record is necessary to meet the requirements of the spot checks described in paragraph 161.

**General points**

161. To ensure that the required procedures are being adhered to, Budget classified documents will be subject to a series of spot checks. There will be random checks of individual copies of classified documents sent to named individuals. There will also be more systematic searches of complete circulation lists of particularly sensitive Budget classified papers. These checks will be carried out by FP and EOG.

162. Budget classified papers must not be typed in typing pools. Particular care should be taken about the custody of carbons, photocopies, dictating machine tapes, word-processing discs, shorthand notes etc containing classified information.

163. The disposal of any BUDGET SECRET or above document is to be recorded in the security register. Where a Principal wishes to dispose of a document he is to take care that this does not enable any unauthorised person to see its contents.

164. If BUDGET classified papers do not state the post-Budget classification, recipients should alter the classification as appropriate after Budget day. The 'BUDGET' prefix should always be deleted after Budget day, as it no longer has any significance. Papers which refer only to decisions which were announced in the Budget may be declassified. Papers containing advice or background to such decisions should generally be classified CONFIDENTIAL. Papers containing references to courses of action which were not pursued, which were classified BUDGET SECRET, should remain SECRET.

**Queries**

165. Any questions about the Budget Security instructions should be addressed to the Budget Security Officer, who is the Principal in FP Division (Indirect taxation branch) (extension 4922).

b. Elsewhere

Single envelope in good condition, closed with economy label and bearing no security marking. Send by Messenger service, by IDS or ordinary letter post.

v. PRIVACY MARKINGS

a. IN CONFIDENCE documents, such as STAFF: IN CONFIDENCE, MANAGEMENT: IN CONFIDENCE and APPOINTMENTS: IN CONFIDENCE, if sent by Messenger service, or IDS, should go in a single envelope bearing the privacy marking. If sent by post they should go in double envelopes, the inner one prepared as above but with flap stuck down, the outer one without the privacy marking.

b. COMMERCIAL: IN CONFIDENCE documents may be sent by either Messenger service, the IDS or ordinary post. They should go in a single envelope bearing the name of the addressee but without any privacy marking.

c. COMMERCIAL: IN CONFIDENCE - NAMED DISTRIBUTION ONLY documents if sent by Messenger service or by signature service of IDS Document receipt. Double envelope, outer envelope to have flap stuck down bearing no marking and addressed by name, inner envelope to be addressed, to have flap stuck down and marked "TO BE OPENED ONLY BY [NAME]". Registered letter post or data post may also be used.

When an economy label is used, it should cover the whole width of the flap of the outer envelope to ensure the contents cannot be seen.

**Facsimile Transmissions**

80A. In no circumstances should classified information be sent abroad by facsimile; secure facilities are available via the FCO telegram system (see separate Section in HM Treasury Reference Book) and via a secure facsimile link with UKREP, Brussels. Within the London telephone area the facsimile facilities in room 75/G can be used for material up to and including Confidential provided the officer authorising its use is satisfied that the risk involved in using an insecure method is worth taking in the circumstances (eg the cost of failure to meet a specified deadline for an imminent announcement). Special rules governing the use of this facsimile for classified work are attached at Annex III.

80B. A special facsimile facility in the Chancellor's Office (Room 14/2) can be used for the transmission of Budget classified information up to and including BUDGET SECRET; BUDGET LIST ONLY and other classified economic information up to and including SECRET. This facility is only available to the Bank of England, HM Customs and Excise (King's Beam House), Inland Revenue (Somerset House), Department of Transport (Marsham Street) and DVLC Swansea and must be used for the facsimile transmission of all classified information from the Treasury to these addresses. Transmission can only be made by a member of the Chancellor's staff as they alone have been briefed on the special procedures which apply.

80C. Information about the use of facsimile is set out in the Treasury Reference Book. Enquiries about the general use of facsimile should be addressed to Mr D Lodge (270-5050) or to local Office Managers. Questions about the security aspects of the use of facsimile and about the use of the special facility referred to in para 80B above should be addressed to the Assistant Budget Security Officer in EOG2 (270-4859).

**Document receipts**

81. Document receipts (see Annex II H) should be followed up if they have not been returned within five days; reminders should be followed up if necessary after three days. Document receipts are not required when documents are delivered direct by hand of Divisional or Private Office staff between Divisions or Private Offices. Certain exceptions also apply to the Committee Section and to the section handling telegrams (Overseas Communications Section).

**Addresses overseas**

82. Classified correspondence to addresses abroad and all correspondence to Communist countries should go by diplomatic bag through the Overseas Communications Section. The procedures in paragraph 80, for transmission to external addresses, must be followed but in addition the outer envelope must be marked:-

a. with the classification (top left)

b. "by FCO Bag" (top right)

c. "Authorised Official" (lower left) and signed by the sender.

**Documents for officers going overseas**

83. Classified documents should be sent in advance by diplomatic bag. When this is impossible, special arrangements apply (see paragraph 76).

**Safe-keeping of boxes**

84. When boxes used for transmitting classified documents are not in use they should be kept locked and under lock and key, to prevent their locks from being compromised. The Stationery Clerk should be informed if a box is in need of repair. Any loss or suspicion of tampering should be reported without delay to the Assistant Departmental Security Officer. The keys of boxes should be treated as security keys (paragraphs 104-109).

WEEKEND BOX

PRIME MINISTER

POVERTY

You may like to glance at this article in The Guardian of Wednesday.

An unlikely source of helpful comment, I know, but it does point out that:

> "If the Government makes SB more generous this has the perverse effect of increasing the number in poverty measured on this basis (i.e. by relating the definition of poverty to SB levels)."

The figures are interesting, too. They show that in absolute terms - i.e. in terms of what people can buy - the proportion of people in poverty fell between 1977 and 1983. In relative terms - i.e. in relation to SB - it rose.

In general terms, increasing levels of benefit have largely compensated - in terms of poverty - for the increase in the numbers of those out of work.

Mark Addison

27 November 1986

DG2AKB

File

PRIME MINISTER

POVERTY

You may be interested to see the attached article contained in this week's New Society - not normally noted for its sympathy to Government policy.

It provides a concise and powerful criticism of the approach adopted by the Child Poverty Action Group, when they define those living in poverty as those living at incomes below 40 per cent above the Supplementary Benefit rate.

The Opposition have in the past gone along with the CPAG's views. However Mr. Kinnock on Wednesday and Mr. Meacher yesterday reverted it seems to a definition of poverty which is set at or below the level of SB. Of course, the argument nonetheless holds that increases in the level of SB increase the numbers of people living in poverty - even though many of the "poor" are better of as a result.

Mark Addison

14 November 1986

file KB

cc MF Griffiths

10 DOWNING STREET

*From the Private Secretary*

7 October 1986

**DATE OF THE 1987 BUDGET**

Thank you for your letter of 3 October about the date of next year's Budget. 10 and 17 March would suit the Prime Minister's diary perfectly well. However, King Fahd of Saudi Arabia arrives for a state visit on 24 March. Cabinet would be held before the Prime Minister left to meet the King, but the Prime Minister might not be able to attend for as much of the Budget debates as she would wish. So 24 March (if the King sticks to this date) is the least attractive of the three.

David Norgrove

A. C. S. Allan, Esq.,
H.M. Treasury.

RA3.81

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

3 October 1986

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David,

**DATE OF THE 1987 BUDGET**

The Prime Minister may wish to be aware that the Chancellor is aiming to present his Budget on 17th March next year. However, it is not yet possible to make a final decision and the 10th and 24th March are still possible alternative dates. As you know, we normally announce the date of the Budget during the first business question in the New Year.

Yours
Alex.

A C S ALLAN
Principal Private Secretary

a. how to obtain better advice on Stock Exchange market procedures so that the effects of changes in stamp duty can be better assessed in advance and

b. whether the quality control reviews of technical tax changes incorporated in the Finance Bill could be improved, particularly if they affect areas of public concern - such as charities and pension funds, and

c. whether, as an alternative, there would be advantages in resuscitating the proposal for having a separate technical tax bill, separated from the Finance Bill, which could be subject to more extended consultation procedures.

David Hobson

DAVID HOBSON

PART 15 ends:-

DN to HMT 24/4/86

PART 16 begins:-

D. HOBSON to PM 12/5/86

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