Part B.

CONFIDENTIAL

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Begins: 4/2/81
Ends: 26/2/81.

PO -CH /GH/0084
PART B

Chancellor's (Howe) Papers:

REPRESENTATIONS ON TAXES
AND INFLATION FOR THE
1981 BUDGET

Disposal Directions: 25 Years

D Adler
26/7/95

PART B

CONFIDENTIAL

4/2/81. PWP

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Sir K Couzens
Sir A Rawlinson
Mr Ryrie
Mr Burns
Mr Unwin
Mr Ridley
Mr Cropper

Sir L Airey
Sir D Lovelock

CONSERVATIVE FINANCE COMMITTEE: 3 FEBRUARY

The meeting was addressed by Sir Terence Beckett, accompanied by Sir Donald MacDougall. Not particularly well-attended. Ralph Howell in the chair.

Sir Terence Beckett said that industry's big concern was its lack of competitiveness. Industry was partly to blame for having conceded excessive pay increases in the past. But now there had been a sea-change in the average level of settlements.

Increases in industry's costs were a serious matter: nationalised industry charges, rates, energy prices, etc; to all these had to be added the problem of sterling. When he and Sir Donald MacDougall were autopsied, on their hearts would be found not the word "Calais", but the graph on page 8 of the CBI Budget representations, which showed industry's falling real rate of return. He expected profitability to decline further in 1981. The plight of industry was such that tax relief on profits would be useless: relief on costs was required.

Sir Terence then went through the list of the CBI's main Budget representations. He concluded by saying that if the PSBR outturn for this year were £11½ billion, then any PSBR smaller than £12½ billion next year would be fiscally restrictive.

Jock Bruce-Gardyne asked: (i) would not a Government announcement of a lower target rate for sterling risk pushing the currency upwards?

(ii) What did the CBI representations mean by foreign exchange market intervention that was "compatible" with firm monetary control?

Sir Terence replied this was a contentious area. But industry needed a lower exchange rate. He was glad to see that the PM had progressively been saying more about the difficulties caused by the high rate. The Government should now go further and say the rate should come down. Other countries were able to make such announcements. The pound was unlikely to plummet: North Sea oil would see to that. Sir Donald had the answer to the second question.

Sir Donald MacDougall said it was difficult to explain this briefly, but it was possible for the Bank to sell pounds and then take compensating action to mop up those pounds, without raising interest rates. The Germans had done this. He would discuss it afterwards with Mr Bruce-Gardyne. Did he?

Peter Hordern said that the effect of Sir Donald's policy must be to keep interest rates up. But supposing interest rates fell, what guarantee was there that industry would invest rather than pay higher wages?

Sir Terence said that poor profitability and high unemployment should between them keep wages from rising too fast.

Nick Lyell asked what the CBI representations meant by "infrastructure". Sir Terence replied that a list of desirable public capital projects had been submitted to the Chancellor.

Nigel Forman asked whether the CBI had a view on taxing clearers' profits. Sir Terence said the CBI had not discussed this among themselves. The banks had made tremendous efforts to keep certain companies going - but he was not saying this was a trade-off against being taxed.

Tim Eggar said the CBI representations were like a fairy-tale: everything would come right. If they were calling for bigger subsidies to nationalised industries, and for reductions in current public expenditure, were these included in the CBI's PSBR arithmetic? Sir Terence said they were calling for neither of those things; but in any case their arithmetic was correct, because Sir Donald had checked it with the Treasury.

Terence Higgins asked what would make the UK economy turn up, if there were no change in Government policy and no world upturn? Sir Terence said one had to assume the world economy would turn up. There was no sign that the UK economy had reached bottom yet.

Toby Jessel asked whether the CBI could not give a stronger lead to industry on the need to curb inflation, and why they did not give the Government more credit for the fall in inflation. Sir Terence said the CBI were already doing these things.

Geoffrey Rippon asked: (i) What would the CBI say to a PSBR of £14 billion this year?

(ii) Would the CBI accept higher personal taxation if that was the price for more public investment?

(iii) Would the CBI support a clear distinction between current and capital spending in public accounts?

Sir Terence agreed very strongly with (iii). On (i), a PSBR of £14 billion would be "crisis-stations". There would have to be further expenditure cuts. It might be necessary to dispense with part of the Rooker-Wise revalorisation, even though to do so would be "repugnant" to him.

Alan Clark said that the West German and Japanese industrial successes had taken place against rising exchange rates. The UK Government had now created conditions in which wages were rising less rapidly than prices, so industry had looked for another scapegoat and found the exchange rate. Sir Terence said West German and Japanese industry was superbly efficient. British industry could not make up the loss of competitiveness by improving productivity: the gap was too big.

Nick Budgen asked whether the CBI wanted an incomes policy; whether they would surrender monetary control if this were the price of a lower exchange-rate; and whether this lay behind the "bare-knuckle" speech. Sir Terence was against incomes policies. Monetary control was essential to the control of inflation. He could have chosen better words than "bare-knuckle fight", but the point he was making was that business should not be afraid to speak up for itself.

GEORGE CARDONA
4 February 1981

5

10, Do[illegible]ning Street,
Whitehall S.W.1

With the Private Secretary's Compliments

pa

6

52

10 DOWNING STREET

THE PRIME MINISTER

4 February 1981

Dear Sheila,

You wrote to me on 8 January enclosing this letter from Mr. T. Bourne of Fallowfield, 2 Ashby Road East, Stanhope Bretby, Burton Upon Trent, who is concerned about the tax treatment of a married couple in comparison with that of an unmarried couple living together.

First of all, I do recognise that in certain circumstances it is possible for two single people living together to enjoy a tax advantage over a married couple. However, in the interests of accuracy, I should also mention that there are other situations where the reverse is true and a married couple where both go out to work pay less tax than two single people living together.

I fully appreciate your constituent's strong feelings on this point but I am sure Mr. Bourne, as a professional man, will be the first to agree that the taxation of husband and wife is not a simple issue. For that reason Geoffrey Howe has recently published a Green Paper which, as a discussion document, is designed to serve as the basis for a full and thorough debate, both inside and outside Parliament, on the far-reaching questions it raises. I hope Mr. Bourne will be interested to read the enclosed copy of the Inland Revenue press release which gives a summary of the main points. In fact one of the options discussed is to give each individual taxpayer the same allowance and rate bands as a single person and, also, that the Inland Revenue are inviting comments.

/ I am afraid

7

I am afraid that as this is a very complex issue, and because of our desire to consult the widest range of people, whose views will have to be carefully considered, it will not be possible to make any early change to the present system. But I can assure Mr. Bourne that we shall not lose sight of the importance of maintaining and strengthening the institution of marriage in this country and that his views will be borne in mind when we come to formulate our proposals for change.

Yours ever,

(sgd) Margaret

Mrs. Sheila Faith, JP, LDS, MP.

9/2 8

PL type letters for Ch/Ex sig, & prepare suitably laundered copy of Volcker

A.5

CHANCELLOR

GILMOUR AND CARRINGTON

I have re-drafted the letters I submitted to you on 28 January to try to make clear your anxieties about public sector costs etc. I found this easy enough to weave into the Gilmour draft, but more of a challenge in the case of Carrington where I was less clear about what simple message to put over. At present these letters are designed to be complementary. You may want to copy them reciprocally, though I imagine the private offices will do so anyway. You may also want to consider whether you want a marking - such as personal & confidential - which ensures they do not get circulated around the place.

2. I think it is worth attaching the Beaumont-Dark PQ answer to Gilmour's letter, but you may prefer to leave the text to speak for itself.

Enclose only the Volcker speech - to both (Whiten out my graffiti on the title page!)

(Should anyone (B.U, T.B, f57?) give a quick glance at the revised texts

AR

ADAM RIDLEY
6 February 1981

9

DRAFT PERSONAL LETTER FOR THE CHANCELLOR TO SEND TO SIR IAN GILMOUR

have been brooding about ~~or~~ abbreviated ~~or unlucky~~ at No 11

I ~~was interested by~~ what you had to say at dinner ~~[last Thursday week]~~, and thought it might be helpful to let you have a considered reaction. You feel that the economy is suffering from deflation; that this is what is causing recession; and hence that reflation is needed.

that, even after some lapse of time,

- and entirely personal -

The terms reflation and deflation relate to demand rather than supply (or production, which is in practice broadly equivalent to it), and I think that the answer to your anxiety may lie in that distinction.

Perhaps surprisingly, our economic problem has generally not been one of lack of demand even in recent years. This is well illustrated by recent experience:

(a) In 1978 and 1979 total final expenditure in real terms rose steadily. Over the four half years it actually grew by 4½%. However, production did not respond in the same measure: GDP grew by less than half as much, while manufacturing production actually fell.

(b) By the second half of 1980 real final expenditure had fallen back to little above its level in the first half of 1978. GDP, however, was over 2% lower than at the outset, and manufacturing production over 12% lower.

There are, alas, plenty of other ways of analysing the statistics of our performance, and they all confirm this picture of an economy which is increasingly unable to meet ~~the~~ fairly buoyant demand ~~which~~ even when it is ~~there~~ present.

One is forced to conclude by the evidence that the problem lies rather in our inability to produce profitably and competitively and so to supply the markets available to us. Some of the weaknesses of the supply side are long-standing and well established. You will be as familiar as I am with the traditional criticisms of our poor delivery performance, complacency about exports and so on. ~~However~~ Since 1978 there have been other problems as well. Though prices here have risen faster than on average overseas, our exchange rate has risen fairly steadily, by some 20% between 1978(1) and 1978(2). This increase was unforeseen and uncheckable, reflecting our "petro-currency" status which we obviously cannot alter. Such a development means that whatever we might like to do, we cannot have recourse to deliberate devaluation or acquiesce in involuntary depreciation, the escape route on which previous Governments have for long been able to rely.

The exchange rate only reflects part of our troubles. To make matters worse, the rebound of earnings as our predecessors' incomes policy collapsed has greatly squeezed profits. The pressure has been particularly acute for our exporters and those competing with imports, since given the rise of the £ our labour costs have gone up by over 50% relative to those of our competitors. The real pre-tax rate of return for industrial and commercial companies other than the North Sea operators (excluding stock appreciation) is now 2.7%, little more than half the very poor 5.1% recorded in 1974, and barely a quarter of the 11% or so we managed to sustain in the 1960s. Those crude averages for companies taken as a bloc certainly conceal big divergences in experience. As ~~might well be imagined~~ one would expect, there are some broad sectors of industry which must be making substantial and unprecedented losses.

Our position has been made worse still by our inability to restrain public spending and borrowing to the levels we planned initially. This has meant a persistently high PSBR which brings with it exceptionally high interest rates; and has prevented us from being in a position to cut direct taxes on income and companies, both of which could have helped sustain industry at a testing time.

It has increasingly become clear, I think, that the problem lies above all in public sector costs - effectively pay - rather than in the physical scale of programmes, though it is not an "either/or" issue. For example, the £2 billion or so we will in fact have paid "over-the-odds" to public sector employees this financial year (thanks to Clegg and the other catch-up settlements) would, if not committed to that end, enable me to finance, ~~immediately~~ for example, ~~the near elimination of~~ a large cut in the national insurance surcharge and ~~a massive boost to industry~~ so in industrial costs. The truth is that public servants are paid very highly today in relation to the private sector, as the enclosed PQ answer shows, so there is still a good objective basis on which we can justify a major reduction in public sector costs from now on.

[Chancellor to Beau-mont-Dark 6.3.81]

This combination of rising sterling, high (though now falling) inflation and profit squeeze lies at the heart of the present recession, and extra demand cannot solve these problems. Given the unmanageability of the exchange rate, the clear priority for our macro-economic policy has to be to get inflation down to levels lower than those overseas, to rebuild our price competitiveness; and similarly to bring down the growth of wage and other costs to permit a restoration of profitability. These two changes are intended, in effect, to reduce inflation and increase real growth within a given supply of money - or level of demand, if you please.

This is why control and reduction of the growth of the money supply must play a central part in all this. And the falling inflation rate we are now experiencing should give us the courage to persevere. Though the justification for this can be couched in highflown economic jargon and described as "monetarism", I have always thought of it in simple, commonsense terms. The attached speech by Paul Volcker (Head of the Federal Reserve Bank in Washington) sets out the case in an uncomplicated practical manner which I hope you will find not unsympathetic. He certainly does not underestimate the difficulties. Nor do I.

As these are such vital issues, please don't hesitate to take me up on these thoughts - our dinner was intended to provide for just such a debate. Meantime, I am copying this letter to Peter Carrington & sending a copy of "his" letter to you - since you both showed an understandable interest in each other's points.

PERSONAL → Mr Ridley

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A.5

CHANCELLOR

GILMOUR AND CARRINGTON

I attach draft letters following up your sadly curtailed dinner which are, I hope, on the lines you want. In the Gilmour case you may want to send him the table of figures which lies behind the text if you buy the argument and analysis I proffer. In the Carrington letter I include a pregnant final paragraph, prompted by some dark mutterings I had with Lord Carrington after the MPs had all left the dinner to go and vote. I think he is worried about the impact of cuts on public opinion, and you might do worse than give this or a similar chance to note his anxiety.

fine – but I shd like the letters also to reflect my anxiety to widen the public sector's capacity to cut costs rather than programmes, the pay differential etc

Cd. you here expand both drafts a little?

AR

ADAM RIDLEY
28 January 1981

DRAFT LETTER FOR THE CHANCELLOR TO SEND TO LORD CARRINGTON

I was very sorry our "semi-working" dinner ~~last Thursday~~ at No.11 had to end so early, thus stopping us from getting to grips with the big issues — though that might have been just as well! // At all events, I am writing – after too long a delay – to Ian about his anxieties over the "deflation" question, ~~but~~ and I thought I should drop a personal line to you, too, over your point about the search for economies. As you may imagine, we see a good deal of cases such as the one you raised about the BBC external services, and it causes us just as much concern as it does you. If you have any ideas about a better way of dealing with expenditure planning and control I should be only too delighted to consider them. // As things stand, the problem you ~~refer to~~ raised ~~stems in the first instance~~ is due to ~~from~~ several independent pressures:

(a) the need to adhere to the principle of reasonably shared, ~~if not~~ though not of course equal, misery in seeking ~~cuts;~~ economies;

(b) the difficulty in identifying and eliminating real waste, which means we must necessarily cut back that much more on activities and programmes as such;

(c) the problems of adhering to our spending targets once agreed, which force me too often to "come back for more"; ~~far too frequently;~~

(d) the policy commitments in certain areas which mean that the rest of our spending programmes have to shoulder almost all of the burden of the economies we need. //

Of these four points, (c) is the one which worries me most at the moment. My experiences have since the election made it clear that it is extremely difficult to manage public spending properly if we stick with the old PESC system and its dominant concern with the volumes of spending and so on. That has helped direct our gaze away from controlling its cost, which is if anything almost more important to us from now on. // Our ~~capacity~~ inability to react flexibly on costs, and to keep them down to reasonable levels has been an Achilles heel to date, and I am sure it must be remedied soon. We have to find ways of preventing spending from running out of control and over target, as it did with Denis Healey and has done with us, too, at times when he and we were tightening up all our traditional disciplines close to breaking point. And we have to get down what I am convinced are excessive levels of public sector pay when one compares them with what has been happening to industry in recent years.

If we could make advances in these respects, then I think your problem is much easier to resolve. If you have any suggestions about these public spending issues, not least their political and presentational aspects, I should be most glad to learn them, ideally before the next PESC gets under way in a month or two. Meantime, I am copying this letter to Ian Gilmour & sending a copy of "his" letter to you – since you both share an understandable interest in each other's points.

TREASURY THURSDAY 5 FEBRUARY 1981

C - Birmingham, Selly Oak

No. 173 MR ANTHONY BEAUMONT DARK: To ask Mr Chancellor of the Exchequer, if figures are available to compare public sector pay relative to private sector earnings which give comparisons with previous years.

SIR GEOFFREY HOWE

It is possible to compare relative earnings in the public and private sectors for both manual and non-manual workers only for the period since 1970. It is estimated that public sector earnings levels moved in relation to private sector levels between 1970-72 and 1980 as shown in the table below.

Public sector earnings as a percentage of private sector earnings in 1970-72 and 1980

(full time adult males, pay unaffected by absence)

	1970-72 (average)	1980	percentage (improvement)
Manual workers	95	104	(+9)
Non-manual workers	103	102(104*)	(+1*)

Source: New Earnings Survey 1980

* Adjusted to include the increase for teachers resulting from the Report of the Standing Commission on Pay Comparability, which was paid from September 1980.

Before 1970, the statistics collected do not permit precise comparisons between public and private sector earnings. But the evidence available indicates that, for manual workers at least, the relationship between public and private sectors was fairly stable, and that 1970-72 represents the most favourable position for the public sector relative to the private sector since 1950 (see National Institute Economic Review, November 1975, p.63).

	Half Year	Total Final Expenditure	GDP	Manufacturing Production	Effective Exchange Rate	IMF Index of UK Labour Costs relative to International Competitors
1978	(1)	100.3	101	100.9	64	93.3
	(2)	101.4	102.1	101.3	62.4	95.2
1979	(1)	103.7	103.0	101.8	64	106.0
	(2)	104.9	102.9	100.5	71	118.7
1980 estimated	(1)	104.3	101.9	95.3	73.3	128.3
	(2)	100.5	98.8	88.5	76.7	145.5
Change 1978(1) to 1979(2)		+4.6%	+1.9	-0.4	+11%	+24.2
Change 1978(1) to 1980(2)		-0.3	-2.2	-12.4	+20	+55.0

Sources: Economic Trends, Treasury Estimates

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The Retail Consortium

19 Buckingham Gate, London SW1E 6LB Tel: 01-834 9526 Telex: 919291

/ 10/2

TOP COPY CH/EX ALK COPY

CH/EXCHEQUER
REC. -9 FEB 1981
ACTION PS/IR
COPIES TO CST, FST, MST(C)(L)
SIR D WASS
MR RYRIE
MR MIDDLETON
MR BATTISHILL
MR CORLETT
MR UNWIN
MR PICKERING
MR GRIFFITHS
MR GORDON
MR BURNS
MR DIXON
PS/C+E

FROM THE CHAIRMAN

The Rt. Hon. Sir Geoffrey Howe QC MP,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
London SW1P 3HE.

6 February 1981

Dear Geoffrey.

When I wrote on 8th December I indicated that I would be writing again listing a number of specific taxation points which I would be grateful if you would consider in the context of your forthcoming budget.

1. CAPITAL ALLOWANCES

The Retail Consortium has pressed since 1974 for equal treatment in the field of capital allowances as between the retailing sector and manufacturers. The arguments supporting the retail case have been publicised many times in the past. Equally it is understood by retailers that in the present economic climate it would be costly to the Treasury to accede to total parity of treatment.

However on the grounds of equity and the contribution the retailing sector makes towards overseas earnings and the economy in general we ask for the modest concession that we be treated no less fairly than the hotel industry and be granted a 20% initial allowance and a writing down allowance of 4% p.a. on all new retail buildings and retail warehouses. We suggest the allowances be confined to occupiers of premises carrying on commercial businesses.

As far as capital allowances on electrical wiring and shop fitting expenditure is concerned we ask for a return to the situation which existed for many years before the recent Cole Brothers decision.

.../

Secretary: M.G.W. Wilsey A.C.I.S.

In addition we ask for a reconsideration of the decision in the Finance Act 1980 to remove 100% capital allowances from plant leased to non-corporation tax payers, which particularly affects smaller businesses, and for the restoration of 100% capital allowances on retail leasing generally.

2. INDEXATION OF ALLOWANCES

Even in a period of falling inflation we suggest there is a case for the indexation of tax reliefs. We would expect the indexing of personal allowances in the normal way and would hope to see the principle extended into the field of unearned income, Capital Gains Tax, undistributed trading profits and retirement benefit.

3. INCOME TAX

The retail trade is unanimous in its wish to see no increase in income tax and many feel that some assistance should be given to middle management who have benefited least since the 1979 Budget.

4. CORPORATION TAX

In the light of recent Stock Relief proposals and the current low level of capital investment the effective rate of tax borne by companies is likely to be higher and consideration should be given to reducing the rate of corporation tax. In particular we urge the reduction of the Small Company rate to 35%.

5. CAPITAL TAXATION

There has been some concern at the delay in the publication of the Treasury's review of capital taxation.It would be of help if a date for consultation could be released.

6. CAPITAL GAINS TAX

I have been asked to draw your attention to the hardship experienced by shareholders in Close Companies in the event of a double charge on capital gains at the sale of a company's business and the subsequent distribution to shareholders in the winding-up of the company. In many cases of disposal of a family business the purchaser does not acquire the share but merely purchases the company's assets. The existing provision is particularly harsh where the business has been discontinued and the company liquidated as a result of a Compulsory Purchase Order.

.../

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In such a case the company is liable to Corporation Tax on the capital gain, and the shareholders may be liable to Capital Gains Tax on the increased value of their shares computed on the amount distributed in winding-up. We therefore recommend that shareholders should not be assessed for CGT in respect of the amount they receive by way of capital distribution in the winding-up of the company.

In addition we recommend that the present small disposals reliefs be extended to limited companies and to trustees.

7. CAPITAL TRANSFER TAX

I repeat the request made last year that in the context of a family business CTT payable on gifts to relatives or employees of shares in the business (both incorporated and unincorporated) be deferred until the donee disposes of the gift of shares.

8. STOCK APPRECIATION RELIEF

The consultative document on Stock Relief has been considered by the Consortium. Whilst welcoming the document as a whole both we and some of our members have submitted detailed comments to the Board of Inland revenue and hope that the particular circumstances relating to retailing are taken into account.

9. VAT

In current difficult trading conditions we are strongly opposed to any increase in the rate of VAT and the return of multiple charging rates.

We recommend that the annual taxable turnover for compulsory registration be raised to £20,000 and the de-registration limit be increased proportionately. There should be no change in the provisions which enable a large number of businesses and professional bodies registering for VAT even when their turnover is below the compulsory turnover level. The annual turnover limits associated with the special schemes for retailers should be revised upwards to take account of inflation since they were last amended.

With the increased penalties introduced for those traders who fail to render or are late in submitting a VAT return, it seems inequitable that no interest is payable on overdue refunds by Customs and Excise.

.../

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10. NATIONAL INSURANCE SURCHARGE

In my letter of 8th December I referred to our strong opposition to the continuance of the employers' National Insurance surcharge which has been further exacerbated by the new rates and levels of NI contributions contained in the Social Security (Contributions Bill). There have been suggestions in certain quarters that the Government might be considering a selective reduction of the surcharge aimed at helping manufacturing industry at the expense of distribution. This move would revive the bitter resentment felt by retailers over the introduction of Selective Employment Tax. I would therefore like to take this opportunity to make quite clear our views on this sensitive issue.

Finally, we would welcome the opportunity of discussing with your Department some of the points we have covered in this letter in more detail.

Sincerely

Peart

LORD PEART.

Confidential

PWB

See below

H M Treasury

Parliament Street London SW1P 3AG

Switchboard 01-233 3000
Direct Dialling 01-233 ....

G S Cardona
Special Adviser

9 Feb. '81

Chancellor

NUGGETS

1. A quick comment ~~of~~ on Adam's note of 9 Feb.
2. There are a lot of suggestions here: in my view the maximum political impact for the least money is doubling the blind allowance (cost £1-2 m.) Of course, it would be lovely to give them the mobility allowance, but can the Treasury press P. Jenkin to spend more?
3. Second choice proposal: half rate of stamp duty for first-time buyers.
4. One could of course do both.

G.
9/2

pmp

cc Mr Battishill
Mr Kemp

SL 10/2

23

This note by the advisers trails a number of nuggets, most of which you will, no doubt, already be aware of.

RT
10/2

CONFIDENTIAL

E.3

CHANCELLOR

cc Mr Cropper
Mr Cardona

NUGGETS

Here, at last, are some rather hurried notes. Though it may not be apparent to you, they represent the fruit of a certain amount of discussion between the Advisers, and also various aspects of the recent CRD recommendations which seem to me, personally, to be most worthy of immediate consideration. I am submitting them to you, alone, now so that you can have early sight of what we are up to. When you have had a chance to react to the general picture, and Peter and George have been prompted to make any further suggestions which may occur to them, you may then think it helpful if one or other of us circulates something more ~~idly~~ to your Ministerial colleagues and, perhaps, to officials. Perhaps you can let us have your instructions at the Ministerial meeting tomorrow morning.

AR

ADAM RIDLEY
9 February 1981

I have suggested most of the ideas I think worth considering to R.T y'day a.m. — & asked for full examination of all [illegible] [illegible] [illegible]. Show him this list — with my "[illegible]" ticked. Most, but not all, already under consid.

(RIT is liaising with P.L, with a view to a mtg - already arranged - with P.J)

CONFIDENTIAL

NUGGETS

We have had some less than fully systematic discussion amongst ourselves. The recent papers by the Conservative Research Department suggest a number, of which some attract us. We also have identified a few of our own. Needless to say they seem to be very largely proposals for higher spending. We take as our inspiration the exemption of electric cars from VED (1980) and the exemptions from income tax of war-widows' pensions (1979).

✓ CHARITIES

? (a) Rate rebates.

✓ (b) Relief from VAT on goods purchased, as proposed by Barry Baldwin on p.5 of his paper; assuming nothing can be done on

✓ (c) the perennial desire for removal of VAT on their activities generally;

✓ (d) company donations to charities tax-deductible year by year up to £1,000 per annum (Bulloch p.13, retailing proposal of National Council for Voluntary Organisations).

✗ (e) A mild version of (b), viz repairs on churches (... and certain historic buildings ...!)

DISABLED

only if tax allce scrapped?
Cost

(a) The Blind In AR's view, there is a strong case for their having the same mobility allowance as the disabled. The policing and eligibility criteria would be no more difficult. Failing that, an increase in the insultingly small £180 p.a. tax allowance would help. ✓ Mobility problems will remain crucial for the blind in the future, while electronic advances will increasingly erode many of their other problems. However one small exception is the present abatement of the blind person's TV allowance of, we believe, £1.25. This is laughable, not only in relation to the tax but all the more so since the poor beneficiaries get less value out of it as well!

(b) Invalidity Pensioners Miss Bulloch's argument (p.11) for eligibility for SB is persuasive. Not really a tax change, but could be announced in Budget.

RETIREMENT

J.B has suggested. Cost (£100m) only one, I think

(a) Early retirement has obvious attractions. The case for flexibility is very strong anyway, and a better time is difficult to think of. The analytically attractive route would be to offer all those within x years of statutory retirement age the chance to go early, their pension being abated by the appropriate amount as determined actuarially.

(b) Earnings Rule There is a commitment here to abolish within the life-time of a Parliament which we should be making a further move to honour in any case. The arithmetic establishing the "cost" has always been a little questionable in some eyes. The case for letting those who want to work after formal retirement age without arbitrary and unfair obstacles is the same as the case for early retirement. At the least the limits should be raised very substantially - cf CTT - having been left untouched in the face of substantial inflation for too long.

JOB CREATION - Tax Treatment

Later?

(a) Researches on this have not progressed as far as we had hoped [so far we have not been able to extract the chapter and verse from individual companies]. However it remains worth investigating the issue thrown up by Mr Naylor, based on his experience at Job Creation Ltd and BSC Industry. Given that many firms would be prepared to spend money, when leaving a potentially derelict site, in order to encourage new enterprise to use it; given that certain fiscal problems appear to exist (in essence, is job creation, which is not part of the "normal business" of a company, an activity eligible for normal tax reliefs?), one might consider:

(i) whether, as far as IR are concerned, they are currently ruling against the eligibility of such reconversions; and if so, whether they can be induced to change without legislation; in which case publicity alone is needed. This will above all help the profitable.

(ii) whether further company incentives might be revised to help the tax-exhausted company, for whom tax deductibility is an academic matter, at least pro tempore.

(iii) whether it would be possible to develop the concept of some kind of accredited or approved reconversion scheme, which would automatically involve special tax status, provided a firm was prepared to put up substantial sums of its own.

Such ideas are probably too vague to merit full-scale investigation at this stage. But it might be possible to announce in the budget speech that they were going to be investigated favourably. [The whole package could, in due course, be linked with a campaign aimed at, or launched with, the CBI; or related to EZs, etc etc.] David Young suggests a parallel with his proposal for financing rented housing, which is an interesting variant of the above idea. We have not yet pursued it.

Redundancy Pay The anomalies here are under investigation anyway. A linkage with business creation probably calls for expert advice.

UNEMPLOYED

The attractions are great, the ideas few. The cheap off-peak rail fare suggestion (Miss Bulloch, p.9) has a point, but would be something for BR, not Govt.

HOME-BUYERS

(a) Half-value stamp-duty for first-timers;

(b) No stamp-duty for leases under a certain length.

ENERGY

Very tempting, but anything worth doing is worth doing anyway ...

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Charities and Listed Buildings

8 It would of course be of great benefit to charities to be able to recover in full the VAT which they suffer on the supplies which they purchase. I am uncertain of the amount of revenue which accrues from this VAT but I am certain that even the partial recovery of such VAT would be greatly welcomed by charities generally. Such a move would also be in line with a sense of fairness in the taxation system.

We have received representation that it is unreasonable that individuals, who own listed buildings, should have to bear the cost of VAT on repairs to such buildings whereas those owned by VAT registered businesses are able to recover the VAT. The VAT raised from individuals in respect of such repairs must be minimal and again, from the viewpoint of fairness, this could be a useful and genuine reform.

ount of £180 a

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Charities

We strongly welcome and applaud the important tax concessions for charities announced in the last Budget. The encouragement of charitable effort is a vital part of our philosophy and a benefit to our society.

We think, however, that more publicity is required to make better known and understood the need for the donor to take advantage of relief against higher rates of tax by increasing his donation to a charity, because without his initiative the benefit is lost. It seems likely that, for this reason, charities may be losing much of the £30 million benefit which last year's Budget concession was intended to give them.

Charities and voluntary organisations have an increasingly important role to play as public provision is cut back. Often their work can be more cost-effective than public services. We think the case for boosting them, or giving them relief, is strong and is likely to remain so.

We would like further to build on our successes and we would like charitable donations (other than covenants) by companies to be off-set against Corporation Tax, as is recommended by the National Council of Voluntary Organisations. We believe that businesses should be encouraged to make charitable donations, as they are in other EEC countries, and we recommend that any registered company should be allowed to set against Corporation Tax charitable donations totalling not more than £1,000 in any one financial year.

The case for exemption from VAT is of course one that is pressed every year. This year it is given added impetus by the recent change relating to sporting activities. We are aware that this did no more than restore the previous position. Nevertheless, it is understandable if the argument is used that sporting fixtures should not be given more favourable treatment than charities. The claim that it is inconsistent simultaneously to advocate an increased role for voluntary effort, and at the same time to refuse relief in areas where it is most urgently sought by these organisations, is a damaging one.

We understand the long-sustained argument that VAT is a broad-based

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tax nd must remain so. At the same time, it is more difficult to press when the rate is 15 than when it was 8 or 10 per cent. We would very much welcome any loophole that could be found to enable charities to escape, possibly by allowing them to break down their trading activities into smaller units that would fall below the VAT threshold. As an alternative, charities might be exempted from VAT on goods bought - (this discussed in Mr. Baldwin's paper, page 5).

Listed Historic Buildings: we understand the Chancellor's reservations over making further exemptions from VAT. Nevertheless, the obligation imposed on the owners of listed buildings to maintain them puts them into a different category from other property owners. We would like to see this proposal further considered at a future date.

9. Agriculture and Forestry

Several proposals, some of them long standing, have been put to us on behalf of the farming and forestry interest. These refer to:-

i) The classification of agricultural rents as unearned income which has tended to prevent landlords reletting farms. (This point was made to Mr. Rees at the meeting of the Agricultural Forum in February 1980).

ii) The valuation of land at the time of death: the trebling in the value of both vacant possession and tenanted land in the last six years has made many comparatively poor farmers, paper millionaires.

iii) Valuation of standing timber for CTT purposes: at present timber is valued at the time of felling, and tax is payable at the rate assessed at death - in effect, foresters are taxed on the value of the growth of timber between the date of death and felling.

iv) The charging of VAT on landlords' improvements to fixed assets on a tenant's farm has tended to prevent investment for expansion and improvement. The CLA have been pressing for zero rating on this for some years.

3.2.81

to come.

We are well aware of the difficulties involved in setting any kind of cut-off point or clawback arrangement for families with higher incomes. In the majority of cases the latter would mean clawing back from the father a benefit paid to the mother. Possibly a solution might be found if and when a move is made to implement some of the proposals ensuing from the debate on the Green Paper on the Taxation of Husband and Wife.

One Parent Families

We think the child benefit increase paid to the first child of one parent families should be raised fully in line with inflation, and should not be de-indexed. This would protect these families and maintain our good record in this area.

7. International Year of Disabled People

The need for small but popular concessions is more important than ever before when the going is rough. We recognise the priority which the disabled deserve and which is widely recognised in the country. This is the only area in which we recommend small extra public expenditure in 1981-2. We think one practical way to proceed might be to make a sum - say £5 million - available to the Charities Aid Foundation for allocation to approved projects for disabled people.

Our other specific proposals are that:-

a) The mobility allowance should be non-taxable, in the same way as the attendance allowance. This would help 'Motability', the car-leasing charity of which the Prime Minister is a Patron, be seen as a compassionate measure and as a useful step towards our Manifesto aim of a more comprehensive system of income support for the disabled.

b) Invalidity pensioners should be eligible for the long-term rate of supplementary benefit, at a cost of £4 million in 1981-2 and £10 million in a full year. (At present they are in the rather curious position of being unable to qualify for the ordinary rate of supplementary benefit, because their pension is above the ordinary rate, but unless they receive the ordinary rate for a year they cannot receive the long-term rate either).

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Unfortunately, it seems likely that a high level of unemployment will persist for some time and that this situation will still be facing us at the time of the next General Election. Like the Prime Minister and the Cabinet we attach the greatest political importance to removing any misconception that the Government is unconcerned with the sum total of human misery that these figures represent.

While we appreciate the difficulty of making the change immediately we recommend that as soon as possible in 1981 flat-rate unemployment benefit be extended from 12 to 24 months. This would:-

a) Demonstrate that Conservatives do carefor the welfare of the genuinely unemployed, who have lost their jobs in regions like Scotland, Northern Ireland and the North of England on account of structural change/and through no fault of their own.

b) Ensure that help is concentrated on the long-term unemployed, many of whom are refused jobs because of their age and cannot benefit from MSC training courses for young people.

c) Reduce dependence on supplementary benefits which is extremely costly to administer.

iii) <u>Labour mobility</u>: we have four suggestions:-

a) Assistance to top up deposits for mortgages should be available for people who move to take work in a high price area.

b) The £1 off-peak fares available to pensioners might be extended to unemployed people going to seek a job, or somewhere to live near a job - the railways would not lose by making empty seats at off-peak periods available at a minimal charge, to bona fide job seekers vouched for by the employment exchange.

c) The assistance for moving that is available should be made more widely known.

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Pa 32

cc: Minister of State (C)
Mr. Caff
Mr. Cropper

PS/INLAND REVENUE

LETTER FROM THE THEATRES' NATIONAL COMMITTEE

The Chancellor has seen the letter of 2 February from John Gale, Chairman of the Theatres' National Committee.

2. He has commented that we should take their letter to the Minister of State (Commons) seriously.

L E Birnie

(MISS) L.E. BIRNIE
9 February 1981

SOVEREIGN

SOVEREIGN OIL & GAS LTD

5 Buckingham Gate, London SW1E 6JQ   01-828 9197   Telex 917960

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DB/sjp-326/15.9   9th February, 1981

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
LONDON, SW1P 3AG.

Dear Chancellor,

Enclosed, with respect, is our brief relating to possible changes in petroleum taxation, as discussed in the Inland Revenue paper, "Review of PRT Reliefs" dated 24th November, 1980, and the proposed Supplementary Petroleum Tax.

Sovereign believes that there is considerable oil potential to be found and developed both in the UK sector of the North Sea and in other parts of the Continental Shelf. Much of the potential for additional reserves is to be realised from small marginally profitable fields, from fields which underly deep water, and from the application of new enhanced recovery techniques, particularly in heavy oil deposits.

Sovereign contends that improved incentives will encourage companies to make the investment required to realise this potential and in the absence of such encouragement, the opportunity may be neglected.

We greatly appreciate being able to offer our comments concerning the proposed changes and trust that you will find them constructive in formulating your forthcoming budget.   21531

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REC.	11 FEB 1981
ACTION	PS/IR
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	Mr Wicks
	Mr Battishill

Yours faithfully,

12/2

DR. D. BIGGINS
for
W.E. RICHARDS,
Managing Director

Enc.

cc: Minister of State of Energy, Mr. H. Gray

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SOVEREIGN

SOVEREIGN OIL & GAS LTD

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BRIEF TO THE

CHANCELLOR OF THE EXCHEQUER

ON

PROPOSED CHANGES TO OIL TAXATION

SOVEREIGN OIL & GAS LTD.

FEBRUARY, 1981

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BRIEF TO THE

CHANCELLOR OF THE EXCHEQUER

ON

PROPOSED CHANGES TO OIL TAXATION

CONTENTS

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BRIEF TO THE

CHANCELLOR OF THE EXCHEQUER

ON

PROPOSED CHANGES TO OIL TAXATION

1. INTRODUCTION

Sovereign Oil & Gas Ltd.

Sovereign is an independent company 70%-owned by British institutional shareholders and 30%-owned by Dome Petroleum Limited.

The Company has been involved in North Sea exploration since the 3rd Round of licencing in 1970. Currently, the Company holds interests in several licenced areas and has been successful in obtaining further awards in the 7th Round.

Sovereign is a participant in the development of the South Brae field, scheduled to come on stream in 1983, and also holds the major share of a heavy oil discovery in block 3/28.

With the technical backing of Dome Petroleum Limited, Sovereign is planning an aggressive exploration and development programme over the next few years.

The Brief

The paper relating to oil taxation changes released on 23rd December, 1980 by the Inland Revenue outlines the following principles governing oil taxation:-

(i) There is to be an adequate means of obtaining further tax revenue.

(ii) Companies operating North Sea projects are to realise a fair return.

(iii) Reliefs must not deter proper cost control.

(iv) There is to be adequate incentive to continue exploration and new technology development.

(v) Marginal fields are to be protected, without, at the same time, disproportionately benefiting more profitable fields.

This brief addresses the impact of the tax changes discussed in the Inland Revenue paper on marginal field development, on exploration in deep water, and on enhanced oil recovery, and offers suggestions on taxation approaches with a view to achieving the objectives stated above.

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2. SUMMARY

Sovereign believes that there is considerable oil potential to be found and developed in the UK sector of the North Sea. Much of the potential for additional reserves is to be realised from small marginally profitable fields, from fields which underly deep water, and from the application of new enhanced recovery techniques, particularly in heavy oil deposits.

Sovereign contends that improved incentives will encourage companies to make the investment required to realise this potential. In the absence of incentives, the potential may never be realised.

The incentives suggested by Sovereign in this brief do not erode the UK tax take. Rather, the suggestions offered place the penalty for failure on the investor and, through tax relief, provide rewards for successful ventures.

3. MARGINAL FIELD DEVELOPMENT

It is generally accepted that discovery of smaller fields will form an increasing proportion of future discoveries and of UK Continental Shelf production. By their nature, a significant proportion of these fields are likely to be marginal.

In a study conducted by the Minister of State (PET 95/377/88), some 37 marginal fields were identified with total reserves estimated at 2.5 billion barrels. Sovereign believes the potential to be substantially in excess of this estimate.

We are supportive of the statement in the Inland Revenue Press Release of 23rd December, 1980 that "It would be important to ensure that any such changes did not unacceptably diminish the protection given to marginal fields." Given the likelihood that most new prospects in established areas are to be in the 20 to 200 million barrel range, Sovereign feels that small field discoveries should be given greater relief than exists at present.

The proposed supplementary tax imposes a 20% tax on Gross Revenues for fields which produce 20 MB/D and over. To provide an incentive for the development of marginal fields, we suggest that the proposed supplementary tax be applied on a sliding scale which varies with production as currently suggested, but at reduced rates for fields producing less that 100 MB/D. Also, we would recommend that relief from the tax be given in the early years of production. Specifically, we are proposing the following SPT rates for marginal fields:-

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Production			Currently Proposed
Million Tonnes p.a.	Approx. Daily Production	Applicable Rate of SPT Suggested by Sovereign	Rate of SPT (After deduction of 20 MB/D Tax Exemption)
1	20 MB/D	0	0
1½	30 MB/D	1	6.6
2	40 MB/D	2	10.0
2½	50 MB/D	4	12.0
3	60 MB/D	7	13.3
3½	70 MB/D	9	14.3
4	80 MB/D	11	15.0
4½	90 MB/D	15	15.6
5	100 MB/D	16	16.0
10	200 MB/D	18	18.0

A suggested phasing in of the supplementary tax is as follows:-

	Per cent of SPT Applicable
1st year of production	25
2nd year of production	50
3rd year of production	75
4th year and thereafter	100

4. ENHANCED RECOVERY OF HEAVY OIL

There are several heavy oil fields in the UK sector of the North Sea where the application of new recovery techniques could increase recovery of original oil in place from 5% to 40%.

Estimates of the reserve potential indicate that there could be oil reserves in the order of 10 billion barrels in place.

New technology is required in order to develop these reserves, and for these fields to have any impact on oil supplies in the 1990's and beyond, development of this technology will have to commence now.

Sovereign's associate company, Dome Petroleum Limited, has been working with enhanced recovery techniques in Western Canada in 14^{o} API reservoirs. These techniques employ use of steam and fire flooding to stimulate the reservoir. Sovereign is proposing to use these advanced techniques for the first time in the North Sea.

Cont./...

It is important to differentiate between enhanced recovery methods which are already in common use (such as gas and water injection) and new methods of enhanced recovery of heavy oil such as steam stimulation and fire flooding. These new techniques are much costlier, are riskier, and generally necessitate producing the reservoir at lower rates, but for a longer production life as compared with enhanced recovery techniques currently used in the North Sea.

A higher level of relief is needed to encourage investment in heavy oil recovery techniques. An effective taxing scheme would be provision of an enhanced rate of uplift, say, 50%, for expenditures incurred prior to payout. Alternatively, a deduction from PRT income of, say, 5%, of gross revenues would provide incentive required for companies to pursue enhanced oil recovery projects. Both of these taxation reliefs enhance the principle that rewards only accrue to successful projects.

5. DEEP WATER EXPLORATION

As stated in the Inland Revenue paper cited above, the prospects of further good finds may be much less than they were in the early 1970's. Sovereign believes that the best prospects are in deeper waters (1000 feet and deeper). In the West Shetland Basin, for example, we estimate the potential recoverable reserves to be in the range of 5 to 10 billion barrels. Additionally, the south-western approaches are considered to have significant hydrocarbon potential.

In these areas, the risks are considerably higher. The geological objectives are deeper, the possibility of over-pressure increases the costs of drilling, and production will be deferred until suitable proven development technology is available.

Existing incentives are inadequate to encourage widespread exploration in deep waters.

It is suggested that relief be granted at the time deep water exploration expenditure is incurred. Most effective would be relief in the form of a reduction of both PRT profit and of ring fence corporate tax profit arising in other areas of the Continental Shelf (or elsewhere in the case of corporation tax). Perhaps expenditures in deep water drilling, if not set off against PRT liability from other fields, could be available for full uplift at a rate higher than normal. If the expenditure were offset, then a lower rate of uplift would be appropriate, say, 75% of the rate related to deep water exploration.

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Touche Ross & Co.

Chartered Accountants

Our Ref: JXB/paj

9 February 1981

The Rt Hon Sir Geoffrey Howe, QC MP
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

Dear Sir Geoffrey

Interest on Bearer Bonds Issued by UK Resident Company - Deduction of Tax

You may recall that when we met with Mike Middlemas at lunch here on the 17 December we touched upon the above subject, and you were good enough to suggest that I should write to you.

I would welcome clarification as to the circumstances (if any) in which, in the official view, yearly interest paid by a company resident in the UK is not treated as "yearly interest of money chargeable to tax under Case III of Schedule D" within the meaning of TA 1970 s.54(1) so that tax must be deducted thereout subject, of course, to the express provisions of that section. I understand that it was the practice of the Inland Revenue, prior to the lifting of exchange control regulations, to permit such interest to be paid without deduction of tax. There seems to have been a change of practice since the lifting of exchange control regulations but I assume that it is not suggested that exchange control requirements affect the legal position as to deduction of tax.

The circumstances I particularly have in mind are the issue by a company resident in the UK of bearer bonds interest on which is payable by paying agents physically resident outside the UK, e.g. in Frankfurt, to whom coupons must be presented and surrendered on payment.

It is my understanding of the law that:

1. yearly interest is not chargeable under Case III of Schedule D if it is derived from a foreign source, that is to say, a source situated outside the UK;

2. debts due under negotiable instruments and securities transferable by delivery are situated where that instrument or that security is from time to time to be found and not, if there is any difference, where the debtor resides. The situation of such debts being an exception to the general rule that a debt is situated where the debtor resides;

3. the law which governs the obligation to pay a debt is irrelevant for the purpose of ascertaining the situation thereof.

cont'd.../2

Hill House 1 Little New Street London EC4A 3TR – Telex 884739 TRLNDN G – Telephone (01) 353 8011

If my understanding of the law is correct it would seem to me to follow that yearly interest paid by a paying agent physically resident outside the UK to whom the coupon securing that interest (being a negotiable instrument or a security transferable by delivery) must be, and is in fact, presented and surrendered is not chargeable under Case III of Schedule D, and may accordingly be paid without deduction of tax notwithstanding that the company which issues the bond to which the coupon is attached is resident in the UK and notwithstanding that the obligation to pay the interest is governed by the law of some part of the UK.

It would be very useful for me to be told to what extend the Board's legal advisers agree and disagree with my understanding of the law and its application to the circumstances to which I refer.

I understand it to be accepted that interest may be paid without deduction of tax if bonds are issued by a non-resident subsidiary of a UK resident company the borrowed money being re-lent to the parent. It is within my experience that uncertainty as to the official view has led to this route being followed. I would suggest that the consequent loss of tax to the UK revenue and the adverse effect on the UK balance of payments arising from employment of foreign professional advisers and liability for foreign tax as a result of foreign tax authorities requiring the money to be re-lent at a higher rate of interest, are contrary to the national interest.

Yours sincerely

J Burley

J BURLEY

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INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

17 June 1981

PS 46/20/81

MR TOLKIEN

MR BURLEY OF TOUCHE ROSS & CO

I attach a suggested reply for the Chancellor to send to Mr Burley in reply to his letter of 9 February about which you reminded me recently.

J B SHEPHERD

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√17/6

DRAFT LETTER CHANCELLOR TO MR BURLEY

I am sorry not to have replied sooner to your letter of 9 February. The tax treatment of interest paid abroad following the ending of exchange control regulations has been under review and I understand that the Inland Revenue have obtained further legal advice since you wrote.

The question of whether interest arises from a United Kingdom source chargeable to United Kingdom tax under Schedule D Case III, is not always easy to determine and may depend upon the relative significance attached to a combination of factors interpreted in the light of *case law decisions. Before the ending of exchange control, the Inland Revenue normally accepted that the interest paid by a United Kingdom company borrower could have a foreign source where, it was payable and paid abroad in a foreign currency under a foreign specialty contract, was not secured upon real property in the United Kingdom, and was paid to a non-UK resident. Tax relief to the borrowing company was extended to such foreign currency interest payments provided the conditions spelled out in Section 249, ICTA were satisfied. Payments of interest in sterling were never regarded as constituting a foreign source. At that time UK investors were effectively prevented from subscribing to foreign currency bonds, so that foreign source interest payments would be flowing entirely to non-residents.

*for example, CIR v Viscount Broome's executors (19 TC 667) and Westminster Bank Executor and Trustee Co (Channel Islands) Ltd v National Bank of Greece SA (46 TC 472)

/any

With the ending of exchange control the circumstances have changed. UK residents are now free to buy/bonds however denominated and wherever issued. As regards the effect of the present law the Inland Revenue have taken legal advice. That advice confirms that the ending of exchange control (with a greater likelihood of holders of, for example, Eurobonds henceforward including UK residents) is relevant to the Revenue's approach to the question whether a given source of interest is UK or foreign. However, the case law is not helpful when it comes to assessing the relative weight to be assigned to particular factors; and it is not clear how much importance the Courts would attach to the identity and residence of the lender. The advice to the Revenue is, however, that there are some grounds for supposing that the Courts would not now be willing to accept that the effect of creating a <u>specialty debt</u> subject to foreign law is to shift overseas a source of interest where the <u>borrower</u> is a UK resident company.

The Inland Revenue tell me that where they have been invited to comment on proposals from companies who are thinking of borrowing abroad over the past twelve months or so, their views have been in keeping with the trend of that advice.

As you say, a route to overseas borrowing remains open through a foreign finance subsidiary which on lends the proceeds to a UK parent. I realise that this has some disadvantages as you point out, but at the same time the amount of use that has been made of such facilities

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suggests that they must be acceptable commercially in various situations. But we shall continue to study the problem in the context of our general review of overseas taxation following the ending of exchange control.

GH

c. Sir D Wass
Sir K Couzens 12/2
Mr Barratt
Mr Hancock

PWP

UNITED KINGDOM TREASURY AND SUPPLY DELEGATION
BRITISH EMBASSY
WASHINGTON, D.C. 20008

10 February 1981

W/E

A J Wiggins Esq
HM Treasury

Shd not Mins. also receive this, plus attachments? Certainly the PM

Dear John,

I enclose a letter to the Chancellor which, as before, is intended for him and senior advisers on the OF side.

As the Ambassador is seeing the Chancellor on Friday, I should mention that this letter was not written before he left for England, and he will not therefore know of it.

Yours ever,

(J Anson)

Cd. go a long way in [illegible] of [illegible] for Washington?

Enc: 1

(We may need [illegible] to [illegible] [illegible] [illegible] [illegible] its [illegible] - i.e. non-FCO - nature. Not [illegible] to the PM)

Chancellor

In view of the status of these letters, we can't show them to other Ministers. But I have taken steps to ensure that J Anson's points will be reflected in the briefs the OF side of the Treasury will be producing for the PM's Washington visit.

JW
16/2

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UNITED KINGDOM TREASURY AND SUPPLY DELEGATION
BRITISH EMBASSY
WASHINGTON, D.C. 20008

10 February 1981

The Rt Hon Sir Geoffrey Howe QC MP
HM Treasury

Dear Chancellor,

You may like to have some personal reflections on the economic scene here at the beginning of the new US Administration. As the main economic policy statement is not to be made till 18 February, these are necessarily very preliminary and anecdotal comments, to provide some background to the announcement when it is made.

2. From an economic standpoint, the "lame duck" period since the election on 4 November was a lost 2½ months. The previous Administration had lost its authority, and Reagan did not add significantly to the policy statement which was issued during the campaign. We had been led to suppose that the new Reagan team would be put together very quickly and would do a good deal of work during the transition period, in order to be able to "hit the ground running". The outcome was very different.

3. Reagan certainly put together large departmental transition teams (overspending his entitlement of federal funds for the purpose), but their job was essentially one of fact-finding. Only those actually selected to fill Cabinet or sub-cabinet posts were in a position to start developing specific Administration policies for the President's approval. The process of making these appointments went very slowly. This was partly because some of those originally tipped for Cabinet office were in the event unwilling to serve. But the main reason seems to have been the recent "ethics in government" legislation which was one of the after-effects of Watergate. More time was needed to investigate the private affairs of any appointee and work out the necessary arrangements for blind trusts, conflict of interest statements, etc. Whatever the reason, inauguration day arrived without even all the Cabinet confirmed in office, and with very few nominations to the sub-cabinet posts. Consequently, little had been done by that stage to turn the generalities of the campaign trail into a properly articulated economic policy.

4. The most interesting appointment so far has been that of Dave Stockman as Director of Management and Budget. He really did "hit the ground running" and established a key role for himself, more so than most previous Directors of OMB. OMB has, in any case, gradually come more into the public eye in recent years as the conflicting pressures on the Federal budget have become more acute.

/But

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But Stockman's position seems to represent a step change. The President seems to have given him a very free hand and full support. As anecdotal evidence of this, I am told, for example, that Reagan had already indicated his willingness to endorse the OMB proposals concerning foreign aid (which you will have heard about), before they were extensively leaked and Haig was able to stage a counterattack. I have also been told that Stockman has got it established that any evidence to be given by Cabinet Secretaries before the Appropriations Committee will be cleared with Stockman, and that OMB will conduct a "dummy run" of the hearing to make sure that the department gives the right answers.

Splendid! And here briefings? Alas! no.

5. How long this honeymoon period for OMB will last is of course another matter. Haig had already made it clear that he is not prepared to let OMB dictate his foreign policy. As other Cabinet and sub-cabinet people get settled in, the departments may be better equipped to argue their case before the President and perhaps retrieve some of OMB's early gains. Stockman's reportedly brash manner must also be making him some enemies. The preparation of the President's budget is in any case not the end of the story. The real test will be whether Congress can be persuaded to enact a budget of the same sort of stringency as that which the Administration will put forward.

6. Don Regan has not yet established himself to anything like the same extent. He was not involved in the electoral campaign, and the right-wing Republicans, who were hoping for someone like Bill Simon, were not too happy about the appointment. The Press were quick to pounce on any apparent differences between his statements and those of the President and Stockman, particularly on the question whether tax cuts should have overriding priority or whether, as Paul Volcker has been arguing, they should be contingent on spending cuts being firmly decided first. Although Regan initially seemed to be leaning in the latter direction, his subsequent testimony to the Appropriations Committee leant fairly heavily towards the former; but he was then contradicted by the President (briefed apparently by Stockman) who told Congressional leaders that the cuts on both sides must be regarded as a single package. Some people are seeing in these events a significant shift in the balance of power between the Treasury and the OMB and White House staff. But it is too early to make such a judgment, and Regan clearly does not intend to let Stockman assume the role of chief economic spokesman. I have also been told that Regan made a very favourable and forceful impression at his first encounter with the foreign press.

7. Murray Weidenbaum, the Chairman of the Council of Economic Advisers, and thus the third member of the economic troika, is widely expected not to be a significant force in this Administration. His recent experience has been mainly with regulatory matters, and his appointment was rather pointedly left until well after the

/other

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other top posts had been filled. A senior member of the transition team has however told us that he is a strong personality who will not willingly take a back seat, and that he might eventually play a more important role than the press comments have suggested.

8. So much for personalities. As regards the substance, the economic starting point remains unsatisfactory with inflation (consumer prices) at 12½%, unemployment at 7½% and a Federal deficit around the $60 billion mark. Growth was rather better than expected in the fourth quarter of 1980 (5% annual rate), but a slow-down, or even a slight decline, is widely expected in the early months of this year. Some preliminary measures have already been taken - a freeze on pending regulations and on civil service recruitment, and cuts in official travel and in the employment of consultants. But the main measures are still to come. Their general thrust will be as described in the campaign, i.e. a substantial tax cut over 3 years for individuals and businesses in order to stimulate the economy and provide incentives, a balanced Budget by 1983, and a big effort to cut down the size of Government and deregulate the economy. The argument in the Press about the relative priority of tax and spending cuts, to which I have already referred, has been rather artificial, given the starting point. It is difficult to conceive that the Republicans could propose a budget which would explicitly contain a larger deficit than the current level. They therefore really have no choice but to make very large cuts indeed in projected expenditure, and the exercise in which Stockman is engaged is thus of critical importance.

9. How the measures will be taken by Congress is difficult to assess at this stage. The conventional wisdom during recent months has been that as tax cuts are easy and spending cuts are difficult, they might end up with a big deficit which would give the Fed great trouble and drive up interest rates. This is certainly a real risk, which will be compounded if (as is already being hinted) the Budget is based on a highly optimistic scenario about future inflation and unemployment. But there are also suggestions that Democrats who are worrying about re-election in 1982 may defer to what is seen as the current public mood in favour of less Government, and be prepared to go along with reductions in programmes provided they are not abolished outright; but that they may be less enthusiastic about an across-the-board cut in personal tax rates, which would mainly benefit the wealthy and which, on the latest opinion polls, is not wanted by voters as much as lower spending and a more balanced Budget.

10. There are also some big uncertainties. The effect of the President's first Budget on inflationary expectations, which is generally acknowledged to be crucial to its success, could be upset by untoward increases in oil prices, or (if the present drought continues) farm prices. However, all this must be

/speculative

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speculative, at least until we see the extent and balance of the measures which are actually proposed on 18 February. We shall of course be reporting on these in the ordinary way, and at that stage we will be better placed to offer some analysis of the future prospects.

/ 11. I enclose two press articles which may be of interest: one on the "ferment" within the Treasury, and the other a personality piece about Stockman.

Yours sincerely,

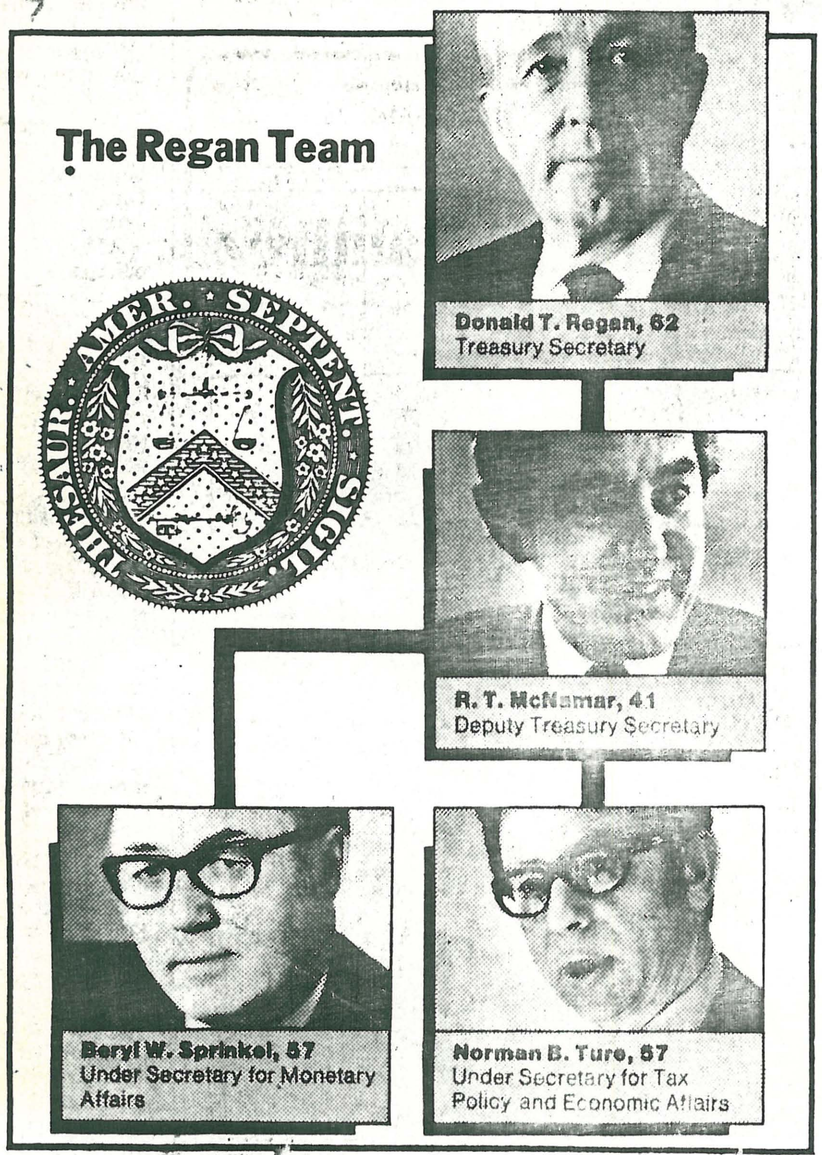
John Anson

(J Anson)

Encs: 2

The Ferment in Regan's Treasury

The Regan Team



Donald T. Regan, 62
Treasury Secretary

R. T. McNamar, 41
Deputy Treasury Secretary

Beryl W. Sprinkel, 57
Under Secretary for Monetary Affairs

Norman B. Ture, 57
Under Secretary for Tax Policy and Economic Affairs

The new Secretary seems to shift positions on tax and spending. Will supply-siders overwhelm him?

By STEVEN RATTNER

WASHINGTON

TO the casual eye, little has changed in the Treasury Department. The portraits of past Secretaries still stare down from the walls in a corner of the second floor. Bureaucrats bustle through the marble-floored corridors. Even the offices of the top officials remain unchanged — redecorating has been banned for budget reasons.

Yet all is not quiescent in this house of finance. Already, as rarely in the past, the Treasury Department has emerged as a seat of intellectual ferment.

How the new Treasury will function — and whether ferment will become turmoil — depends on how easily men representing a variety of economic viewpoints mesh their different outlooks and how well the new Secretary will be able to bring an intellectual discipline to men who in the past have mostly been free spirits.

The new Secretary, Donald T. Regan, is himself at issue. Widely expected to be a voice of pragmatism and restraint in an Administration heavily populated with economic ideologues, he has delivered himself of a variety of remarks — sometimes ambiguous, sometimes conflicting, but always impressive in style and force — that have left the distinct impression that he will not fill his anticipated role.

The varying statements illustrate both the multiplicity of viewpoints now at work in the Treasury and the task the 62-year-old former chairman of Merrill Lynch faces in overcoming his lack of Washington experience. David A. Stockman, director of the Office of Management and Budget, has already shown signs of usurping the preeminent role in economic policy usually filled by the Treasury Secretary.

"I don't understand his latest public statements which do not coincide with his previous public and private statements," said Representative James R. Jones, Democrat of Oklahoma and chairman of the House Budget Committee, of Mr. Regan. "My only concern is whether he is fully in the decision-making loop."

Take, for example, the matter of budget cuts and tax reduction. All of the senior Administration officials argue publicly that both are needed and that they should occur as simultaneously as possible. But in the practical world, simultaneity is unlikely and the Reagan Administration has been pressed on whether it would accept tax cuts passed before budget reductions are voted.

At his confirmation hearing on Jan. 6, Mr. Regan described the reduction of projected Federal spending and the easing of government regulation as "the more important parts" of the Reagan program. "Then we cut taxes," he said.

Exactly three weeks later, Mr. Regan told the Senate Appropriations Committee that the "tax program cannot wait until budget outlays are reduced." And he maintained, "We must not make the mistake of assigning a higher priority to balancing the budget than to revitalization of the economy."

He took much the same stance in a luncheon last week, rejecting suggestions that the tax cut be made contingent on achieving spending restraint. But the next day, a senior White House official pointedly disputed the Regan remark, insisting that the two proposals were

Continued on Page 15

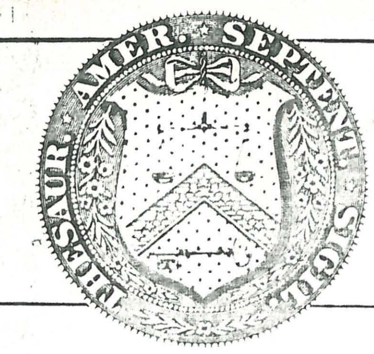
The Ferment in Regan's Treasury

Continued from Page 1

linked. Privately, senior Administration officials concede that Mr. Regan's conflicting statements reflect in part the fluctuating influences of Mr. Regan's senior aides. Within the group, the conflicts seem to result less from philosophical differences than from differences in emphasis, as in the case of the timing of tax cuts. All of the officials emphatically endorse the need for the entire program of tax cuts, budget cuts, tight control over the rate of growth of money and credit and reductions in regulation.

"What the Secretary started out to do consciously from the beginning was to put together a team bringing various perspectives to the Treasury," said R. T. (Tim) McNamar, the new deputy secretary. "We've got an economic situation to which there is no one answer."

Dominant at least in terms of numbers are the supply-side economists, a loose term for a group that stresses the positive effects of tax cuts, particularly on industry. The most senior exponent of that concept is Norman B. Ture, the Under Secretary for Tax and Economic Policy and formerly a Washington economic consultant. Mr. Ture, who was viewed as a liberal in the 1950's, has gradually become more conservative and in recent years has been touting an economic model showing that the 30 percent, three-year tax cut known as Kemp-Roth would result in major increases in employment by stimulating demand and, therefore, industrial activity.



Some feel David Stockman is seeking control of tax policy.

WITHIN the Administration, Mr. Ture, who is known for holding strong views, has forcefully advocated that the tax cuts take effect as soon as possible and that a large "capital cost recovery" provision be enacted that would allow business to write off new investments faster. Mr. Ture is also arguing that other tax changes such as the marriage penalty should be placed in a separate package.

In Mr. Ture's economic shop are two men of like views: Paul Craig Roberts, the Assistant Secretary for Economic Policy, who was part of the group that worked on the Kemp-Roth proposal, and his deputy, Steve Entin, who was a staff member of the Joint Economic Committee for Senator William V. Roth, Republican of Delaware and cosponsor of Kemp-Roth. (Two other former Roth aides are directing legislative affairs at the Treasury.)

But on the tax side, Mr. Ture's assistant secretary is John E. Chapoton, a Houston lawyer who served as tax legislative counsel in the Treasury. Among the first things Mr. Ture did when his subordinate arrived was to give him some reading materials on supply-side economics. Reports of tension have already filtered out.

Meanwhile, the Under Secretary for Monetary Affairs is Beryl W. Sprinkel, a principal advocate of monetarism, which emphasizes the need for the Federal Reserve to make the money supply grow more slowly and less erratically.

"We're not going to be reluctant to suggest to the Federal Reserve the kind of monetary policies we think they should be following," said Mr. Sprinkel. "We don't have to wait to balance the budget to get inflation under control."

But in the past, most of the Under Secretary's job has involved international monetary matters, in which the 57-year old former chief economist for the Harris Trust and Savings Bank in Chicago has comparatively little experience. "There are some areas in which I'm well informed and some in which I'm not well informed," he said.

Before Mr. Regan's recent pronouncements, Treasury watchers felt that he and Mr. McNamar would constitute a third group with a more evenhanded view of the various policy alternatives.

Mr. McNamar, an energetic and engaging 41-year-old lawyer and businessman, who was most recently executive vice president and chief financial officer of the Beneficial Standard Corporation in Los Angeles, describes himself as an "orthodox Republican," by which he means that he relies on no one solution. "We need a variety of actions," said Mr. McNamar, who was executive director of the Federal Trade Commission from 1973 to 1977.

Although Mr. Regan rejects the notion that he is possessed of a traditional Republican economic philosophy, and although he was known on Wall Street as something of a mavarick, his few public statements on economic policy before his appointment suggested a different emphasis.

Back in July, Mr. Regan called for a tax cut and talked of the need for incentives, much as he is doing now. But then, his priorities were a little different. First came accelerated depreciation, second, lower capital gains taxes and, third, protecting taxpayers against being pushed into higher tax brackets by inflation, a change that would give proportionately more relief to middle- and lower-income taxpayers than would Kemp-Roth.

Mr. Regan was also viewed as suspect by the most conservative Republicans for having supported wage-price controls in 1971 and for having lent at least tacit support to Democratic candidates, including Jimmy Carter.

While his statements have sometimes caused concern, Mr. Regan's manner of delivery has won universal praise. In meetings, the native of Boston has impressed even hardened Washingtonians with his crisp responses, steady gaze and sharp mind.

"He comes across as strong and forceful but with a sense of humor," said Charls E. Walker, a former Treasury Deputy Secretary under former President Richard M. Nixon, after a breakfast session. "He made his points and made them very clearly."

Mr. Walker also praised Mr. Regan for assembling a Treasury team quickly, probably second only to Alexander M. Haig Jr. in the State Department in speed. But other Treasury watchers also question whether Mr. Regan actually chose the team, virtually none of whom he had met before their job interviews, or whether it was pushed onto him.

Mr. Ture, for example, was reportedly at the head of a list prepared by the "kitchen cabinet," the group of California businessmen that President Reagan relied on in the early stages after his election. Mr. Regan's principal selection has been his New York public relations aide, John Kelly, who also lacks Washington experience, to fill a similar post here.

And officials such as Representative Jones wonder about the extent to which Mr. Regan is shaping Administration policy in view of the highly visible role taken by Mr. Stockman. At the outset, Mr. Regan's lesser role was attributed to his lack of experience; now, questions are being raised. "Tax policy has always been the domain of the Treasury, but now it looks like Stockman's grabbing for that too," said one concerned Treasury official.

For his part, Mr. McNamar argues that the Treasury has been trying to keep a low public profile in part because only Mr. Regan has won Senate confirmation and that "Treasury has been at every budget-cutting meeting." In addition, the economic policy council, which replaces President Carter's economic policy group, has not yet started up.

"You're talking about the first 30 days," said Mr. McNamar. "The Administration is not speaking with one consistent economic view yet, and when it does it will be Donald Regan's." ■

QUIET, PLEASE! THE TELEPHONE IS RINGING

For two blissful years the rest of the world and I enjoyed a quiet détente. It didn't bother me, nor I it.

Three months ago this happy arrangement came to an inglorious end. It was my editors who did it. They forced me to install a telephone.

What if we *need* you? they said. What if something *important* happens? Ha! The only thing important to have happened is that my life is no longer my own.

That thing be damned, I say. Let the telephone write its own stories.

I wasn't like this a year ago. I was calmer then. Easier to get along with. Less—how do you say?—querulous. Because kings were kings and men were men and no telephones to muck it up.

Oh, I had a telephone once. Then I moved. People looked at me strangely when I told them my new apartment had no phone. I hadn't paid the bill from the first one, I explained, and was afraid to face the phone company. But how can we get ahold of you? they whined. I shrugged my shoulders and they thought me mad.

In fact, this had nothing—or maybe just a little bit—to do with it. I liked not having a phone. I preferred it. But I told this only to a few very close friends, who didn't understand at all.

"You're growing up," cooed one friend sweetly after finding me at the other end of my new line. "Our relationship is really maturing."

A pox! A scourge! And nobody sees it.

By nature I am inclined toward the concept of "telephone." Something Prussian in me. Under the telephone's book-bound regimentation, nearly everyone is rendered communicable 24 hours a day.

Nice.

Not having a phone, however, I made a refreshing discovery. I discovered that when time and space are allowed their natural influence, man-made burdens dissolve almost magically. Allowing my affairs to choose their own random course, I became increasingly free to think.

For instance, the pay phone nearest to me is a three-minute walk away: not too far when phoning is essential, yet far enough to perform prophylactically at certain opportunities. Several months ago, a woman I had once known called me at the office to renew a friendship. Under a different set of circumstances, this might have resulted in a disastrous affair. We are totally incompatible.

But fate disposed of the matter cleanly and dispassionately. All eager to make a go of it, I walked to the pay phone one chilly evening to pursue the initial encounter. The line was busy and remained so for about 20 minutes. After stomping my frozen feet in boredom, I walked home again to my unwired apartment, glad to be warm again, and soon forgot all about it. So did she.

A telephone in an apartment is like a window left open in January. All manner of things come inside, few of them welcome or very pleasant. Like airsickness, telephone calls seldom come at the right time—that we actually pay money for the trouble is an affliction begging analysis.

Invariably, the telephone rings when you are cheating on your wife or lover, and it is always the wife or lover you are cheating on making the call.

Without a telephone, my little apartment became an isolation tank of private pleasures. I could play my favorite records at all volumes, read at whatever pace I chose and, best of all, allow my mind to wander through depression and delight without fear of interruption.

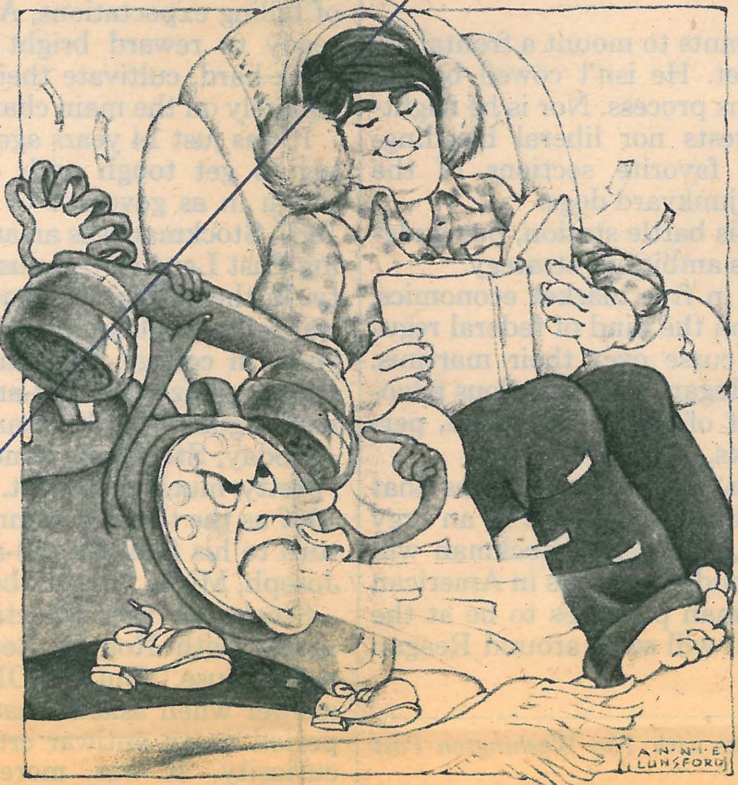
Introducing one in my home was like installing a time bomb. The mere sight of it induces an insidious anxiety: When will it go off? And when it does go off, it is as a thunderclap in a church, a jab of electricity straight to the heart.

In the three months since I was ordered to get a telephone, all my worst fears have been realized. It does ring, and at all hours. Friends locked out of their houses at 3 a.m. Editors at midnight to change stories. Editors at 8 a.m. to assign stories. Editors sending me away to write stories.

For such aggravation, I expect a reward. And if not a reward, at least justice. The company wanted me to have a phone, the company should pay for the phone. In my view, that is just.

So I approached my editors with the idea. They laughed.

—Ed Bruske



By Annie Lunsford

The Stockman Express

HOW A 34-YEAR-OLD FORMER ANTIWAR ACTIVIST AND DIVINITY STUDENT HIGHBALLED HIS WAY TO COMMAND OF THE FEDERAL BUDGET

BY WALTER SHAPIRO

Eight days before the inauguration, Ronald Reagan's cabinet hosted a black-tie dinner at the F Street Club to honor the transition teams. Donald Regan, the new treasury secretary, was sick, but he sent a toast to be read in his name.

According to a participant, Regan's dinner toast read like this: "No one has made greater use of the transition teams than I have. Only by totally working my whole transition team 15 hours a day could I keep Dave Stockman under control."

The secretary of the treasury had reason to be worried about David A. Stockman, the new director of the Office of Management and Budget. At age 34, after two terms as a Michigan congressman, Stockman is the youngest person to hold Cabinet rank in more than 150 years. He comes to power with a controversial agenda to transform American economic policy and a young man's faith in the potency of his own ideas.

For starters, Stockman wants to mount a frontal assault on the federal budget. He isn't cowed by the congressional appropriations process. Nor is he frightened by the special interests nor liberal bleeding-hearts who defend their favorite sections of the budget with the ferocity of junkyard dogs.

The OMB post may be his battle station, but budget-cutting is only part of his ambitious strategy.

Stockman, who believes in free market economics, wants to declare holy war on the kind of federal regulations that businessmen curse over their martinis. Unlike the more cautious Regan, he is a zealous advocate in the Reagan cabinet of across-the-board, permanent Kemp-Roth tax cuts.

If tax-cut strategy works, Stockman believes that the energies of America will be unleashed in an orgy of productive frenzy. And, if it fails, Stockman will have to defend the largest budget deficits in American history. Either way, Stockman promises to be at the center of the firestorm that will swirl around Reagan economic policy.

Walter Shapiro is a staff writer with The Washington Post Magazine.

In the early scrimmages among the Reagan team, Stockman has already broken away for long yardage. Alan Greenspan, a key outside adviser to Reagan, said, "Among those going into government, Stockman has the most conceptual input right now. Dave deserves the status that he has achieved. He's done an extrordinary job. He's the brightest guy around."

There are many bright, intensely driven, 34-year-old whiz kids in Washington. But Dave Stockman is different. At a time when many of his contemporaries are bucking for regional sales manager or worrying if they are partnership material, Stockman is trying to impose discipline on an unwieldy $739 billion budget.

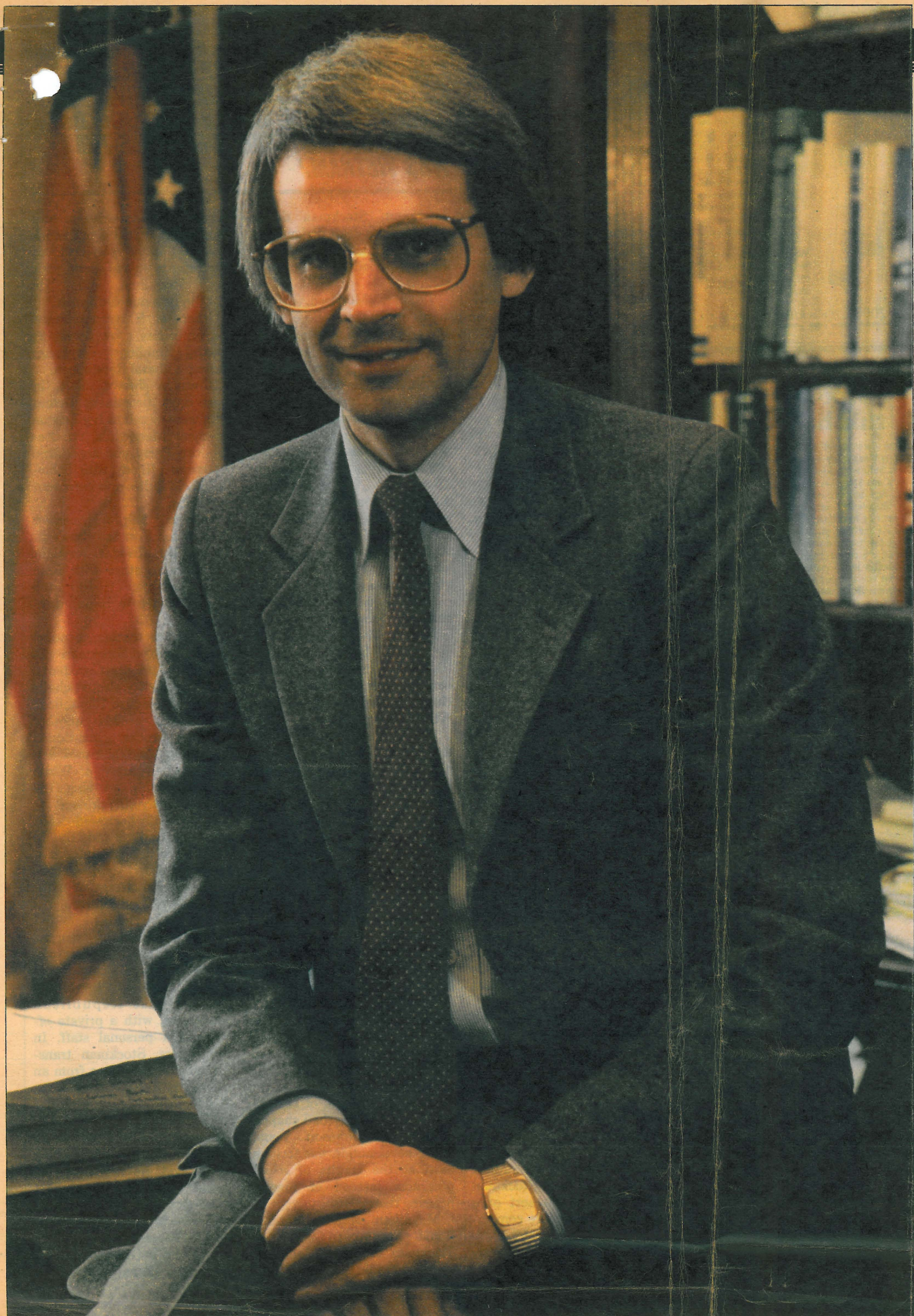
His meteoric rise is a tale of raging ambition. Stockman himself concedes that at times, it makes him "appear to be the most conniving character in history."

The Stockman saga illustrates that, even in an age of falling expectations, America is still a meritocracy, ready to reward bright Midwestern farmboys who work hard, cultivate their betters and keep their eye squarely on the main chance.

It was just 14 years ago that Ronald Reagan, pledging to get tough with campus demonstrators, was sworn in as governor of California. That same year, 1967, Stockman was an antiwar activist on the sprawling East Lansing campus of Michigan State University. In the spring, he came to Washington for an antiwar rally. That summer, between his junior and senior years in college, Stockman worked as the only full-time organizer in the Lansing area for Vietnam Summer, arguing that Vietnam was an internal civil war.

Today, Stockman remembers Vietnam Summer as "pretty much of a bust." But he also fondly recalls 1967 as the the first summer that he didn't have to return to his family's 150-acre fruit farm outside of St. Joseph, Mich., "to pick berries and haul tomatoes."

Stockman was reluctant to discuss whether he agrees with Ronald Reagan that Vietnam was "a noble cause." But the OMB director gave a revealing answer when asked what stayed with him from that period as an antiwar crusader: "I suppose the same curiosity. It was more intellectual than anything



By Bill Snead

else. The only thing that has changed is my view of the world. I'm still trying to figure out the world, even now."

The first thing you notice about Dave Stockman are the aviator glasses and the thatch of graying hair swept back in a $25 haircut from a unisex barber. His face is generally impassive, but occasionally in conversation a small smirk will play across his features. Whether it's at his Senate confirmation hearing or in his office early on a Saturday morning, Stockman wears the same conservative uniform—a dark suit from Britches, a white shirt and a sincere red tie.

Much of the surface polish is the work of Jennifer Blei, his 26-year-old girlfriend. She is one of the top computer salespeople for IBM. Two years ago, at the age of 32, Stockman did not own a pair of jeans. "I got him to buy a pair," Blei said, "but they shrank in the first washing so they ended above his ankles. But he kept wearing them. They weren't really a pair of jeans, they were more like a long pair of shorts."

Outside of his work, Stockman's life is about as riveting as the opening pages of Proust's *Remembrance of Things Past*. He and Jennifer Blei occasionally play chess. They go out to dinner at homes of friends like Rep. Jack Kemp (R-N.Y.) and Richard Straus, editor of a newsletter on Middle East affairs. But as Blei put it, "If this is going to be a personal piece about Dave Stockman, it will be a really short article."

Small towns in the Midwest breed high achievers. More top-ranking corporate executives are born there than anywhere else. The harsh farm life and the lack of other diversions instill the work ethic. The flat, unchanging landscape inspires among the brightest a desperate urge to escape.

This environment molded Dave Stockman. He grew up on a southwestern Michigan farm that has been in his mother's family since the 1890s. He even went to a one-room school.

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The living room of the family farmhouse looks like it was lifted from an old Saturday Evening Post cover, complete with a couch covered in chintz, simulated wood-grain paneling, and a recliner for Stockman's father, Al.

His mother, Carol, said that Dave, the oldest of five, "is the least emotional of the children." That comment triggered a reprise of all the old family arguments that Al Stockman, too, isn't emotional. The OMB director's father finally sat up in his recliner and said, "It's just that I don't let it show." Carol Stockman had the last word: "But you can't keep it all inside you; you'll get an ulcer."

While Dave was at Michigan State, where he originally went to study agriculture, the Stockman family was the scene of many heated debates over Vietnam. Al Stockman, a strong supporter of the war, remembers that "I felt pretty lonely at times."

Fourteen years later, with his son in the Reagan cabinet, Al Stockman finally feels vindicated. "The things Dave is preaching now," Stockman said, "were the things that I was saying back in the days when I was so out of it. College professors always know more about things than the old man at home."

There are college professors and, then, there are Harvard professors. The Stockman saga demonstrates the opportunities that can fall into your bookbag in Harvard Yard.

At Michigan State, one of Stockman's principal interests was religious philosophy. His road to the antiwar movement began at the activist Edgewood United Church of Christ in Lansing, where he also taught Sunday school.

In 1968, Stockman accepted a fellowship to Harvard Divinity School—though he had no intention of entering the clergy. Stockman attributes this decision to his "fascination" with the writings of theologian Reinhold Niebuhr. "I was trying to find a way intellectually out of the radical thicket I was in," Stockman said. "Niebuhr was sort of a bridge back to a more conventional view of the world."

Divinity school conveniently brought with it a 4-D draft deferment. Stockman denies that he was a draft dodger. But some who knew him well during this period have their suspicions.

MORRISON SAID HE'D 'BE WILLING TO SURMISE' THAT STOCKMAN KNEW DIVINITY SCHOOL WOULD 'KEEP HIM OUT OF THE DISTASTEFUL SPECTACLE THAT WAS VIETNAM.'

Truman Morrison, Stockman's minister in college, wrote one of his recommendations to Harvard. Morrison said he'd "be willing to surmise" that Stockman knew divinity school would "keep him out of the distasteful spectacle that was Vietnam."

Morrison was one of many interviewed for this article who commented on Stockman's self-absorption: "David was always thinking about David a great deal of the time. He is very narcissistic. David has always been very intent on his own personal advancement."

Nothing that Stockman did before or since was more calculated than his campaign to win Sen. Daniel Patrick Moynihan (D-N.Y.) as his mentor. Moynihan was then commuting from Harvard to his job in the Nixon White House.

At Harvard, Stockman recognized the upward mobility of the babysitter. He plotted for months to get a job as the live-in au pair student for the Moynihan family. Before his job interview, the methodical Stockman read all of Moynihan's published writings.

Stockman tended bar, carried groceries, emptied the garbage and looked after the three Moynihan children. The year left an imprint on many of his attitudes toward the federal budget.

Moynihan—along with Harvard professors James Q. Wilson and Nathan Glazer, who also influenced Stockman—were in the forefront of a group of Great Society liberals rethinking the effects of the social programs they had shaped during the Johnson years. Their novel notion was to look hard at the results of social programs instead of merely praising their goals.

Moynihan recalls that it would have been easy for Stockman to become another Harvard radical of the era. "There was something in him that said that this is not as interesting, or if you will, as promising a way to spend your life," Moynihan said. "He chose to be a nonconformist."

Others at Harvard pursued nonconformity by trashing campus buildings; Stockman became a liberal Republican.

It was a shrewd move. In those days, prominent Democrats were awash in Ivy League resumés. Meanwhile, the Republican Party was a geriatric enterprise filled with blue-haired old ladies and corpulent Rotarians.

Another helpful mentor, Washington Post associate editor David S. Broder, brought Stockman together with Rep. John Anderson (R-Ill.), the soul of moderate Republicanism.

Broder was teaching a course at Harvard and Stockman was one of his brightest students. Anderson, newly elected chairman of the House Republican Conference, needed another staffer. Broder mentioned Stockman; Moynihan took Anderson aside after a White House meeting to sing the praises of his young protegé.

Stockman borrowed $50 from his mother to fly to Washington for the interview. Anderson hired him on the spot, and the dream of a divinity degree died forever.

Eighteen months later, 25-year-old Dave Stockman became director of the House Republican Conference, with a private office and a personal staff. In three years, Stockman transformed the conference from an intellectual backwater into one of the best research factories on Capitol Hill.

Stockman calls these years "my formative period." During this period, he developed his "rabid" affinity for free-market economics. It was a conversion that was, in part, dictated by political necessity.

Anderson's liberal social views were alienating orthodox

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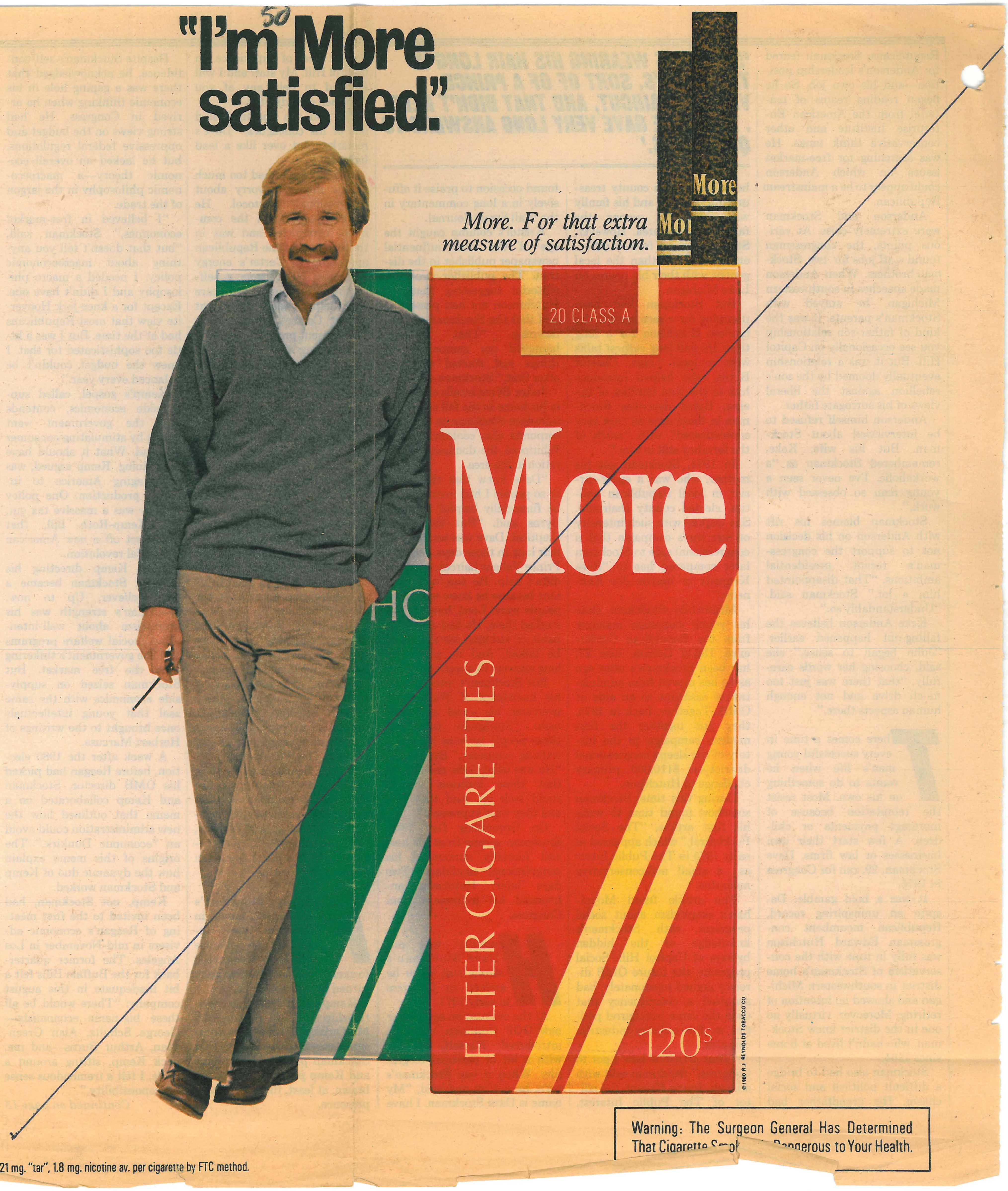
"I'm More satisfied."
More. For that extra measure of satisfaction.
More
20 CLASS A
More
FILTER CIGARETTES
120s
© 1980 R.J. REYNOLDS TOBACCO CO.
Warning: The Surgeon General Has Determined That Cigarette Smok[torn] Dangerous to Your Health.
21 mg. "tar", 1.8 mg. nicotine av. per cigarette by FTC method.

Republicans. Stockman feared for Anderson's leadership position—and his own job. So he began reading reams of material from the American Enterprise Institute and other conservative think tanks. He was searching for free-market issues on which Anderson could appear to be a mainstream Republican.

Anderson and Stockman were extremely close. At various points, the congressman found staff jobs for two Stockman brothers. When Anderson made speeches in southwestern Michigan, he stayed with Stockman's parents. It was the kind of father-son relationship you see occasionally on Capitol Hill. But it was a relationship eventually doomed by the son's rebellion against the liberal views of his surrogate father.

Anderson himself refused to be interviewed about Stockman. But his wife, Keke, remembered Stockman as "a workaholic. I've never seen a young man so obsessed with work."

Stockman blames his rift with Anderson on his decision not to support the congressman's recent presidential ambitions. "That disappointed him a lot," Stockman said. "Understandably so."

Keke Anderson believes the falling-out happened earlier. "John began to sense," she said, choosing her words carefully, "that there was just too much drive and not enough human aspects there."

There comes a time in every successful young man's life when he wants to do something on his own. Most resist the temptation because of mortgage payments or children. A few start their own businesses or law firms. Dave Stockman, 29, ran for Congress in 1976.

It was a bold gamble. Despite an uninspiring record, Republican incumbent congressman Edward Hutchison was fully in tune with the conservatism of Stockman's home district in southwestern Michigan and showed no intention of retiring. Moreover, virtually no one in the district knew Stockman, who hadn't lived at home since 1964.

Stockman also had to bridge a difficult political and social chasm. His grandfather had been Republican county treasurer for 30 years and his family was prominent among the farmers in the area. However, Stockman came from a different social class than the local gentry, with their big houses on Lake Michigan.

'DAVE WAS WEARING HIS HAIR LONG IN THOSE DAYS, SORT OF OF A PRINCE VALIANT HAIRCUT, AND THAT DIDN'T HELP . . . AND HE GAVE VERY LONG ANSWERS TO QUESTIONS.'

But Stockman had been prepping for a race against the hapless Hutchison for a long time. He had long earnest talks with a local judge, Chester Byrns, who helped introduce him to the first families of the area. Byrns describes Stockman in those days as "not very sophisticated" with "much of the farmboy still in him."

In 1974, Stockman got his mother, who was a spear-carrier in local Republican politics, elected county chairman. She worked with such intensity on her son's campaign that a congressional aide to Stockman later compared her to "Rose Kennedy or maybe Joe Kennedy."

Meanwhile Stockman stole his young campaign manager from the Republican Conference. David Gerson, now 27, has been Stockman's alter ego as he has moved from administrative assistant to an aide at OMB. Together, back in 1975, they put together the first modern campaign in the history of the sleepy congressional district—a $110,000 primary challenge to Hutchison.

During this time, Stockman somehow found time to write his first article, "The Social Porkbarrel," which appeared in early 1975 in The Public Interest, a small neo-conservative magazine.

The article fused Moynihan's skepticism about social programs with Stockman's knowledge of the hidden byways of Capitol Hill. Social programs, the future OMB director argued passionately, had acquired a constituency that used the same porkbarrel politics as the military-industrial complex.

"That article is how I got to Congress," Stockman said with a laugh. Irving Kristol, the editor of The Public Interest, found occasion to praise it effusively in a long commentary in the Wall Street Journal.

Kristol's column caught the eye of the most influential newspaper publisher in the district. The publisher wrote an editorial suggesting that the Hutchinson era had passed — and that the Stockman era was dawning. "That editorial launched our campaign and things just started to build after that," Stockman said.

Judge Byrns recalls a meeting in his home in the fall of 1975 to introduce Stockman to the local corporate elite centered around Whirlpool, the dominant corporation in the area.

"Dave knew that the dozen or so people I had invited could be financially helpful to him," Byrns said. "But they were skeptical. Dave was wearing his hair long in those days, sort of a Prince Valiant haircut, and that didn't help. He was very hesitant because he knew who these people were. Lord, how he had studied them. He had a nervous habit of stroking his mouth as he talked. And he gave very long answers to questions."

But Stockman's intellect and his knowledge of Washington overcame his social awkwardness. "Stockman fascinated those people because he was a walking computer," Byrns said. "He was using facts and figures that these business leaders could look up. And they did, and they were impressed."

On Groundhog Day 1976, Stockman sprang from his hole and formally announced his congressional candidacy. Two days later, Hutchison announced his retirement from Congress.

Humility was not Dave Stockman's strong suit when he arrived in Congress in early 1977.

At the orientation session for new GOP freshmen, everyone introduced himself, usually with a bit of personal biography. When it was Stockman's turn, he got up and said, "My name is Dave Stockman. I have a great deal of experience on Capitol Hill. My staff and I will be glad to help any of you freshmen get adjusted."

"As you can imagine," said one of his colleagues, "Dave's remarks went over like a lead balloon."

But Stockman had too much on his mind to worry about congressional protocol. He wangled a seat on the commerce committee and was in the forefront of the Republican opposition to Carter's energy programs. He became a self-taught expert on health care and helped lead the fight against Carter's hospital cost containment program.

Beginning in 1977, Stockman put together alternative conservative budget proposals. In March 1980, speaking for a group of 60 House members, he proposed $26 billion in cuts. At a House Budget Committee hearing, Stockman said that he personally wanted to cut $34 billion more.

Blessed with a safe district, Stockman could pursue his ideological interests free from much cant and hypocrisy. He voted against farm subsidies in an agricultural district. He was the only member of the Michigan delegation to oppose the Chrysler bailout.

Meanwhile, Stockman kept writing, churning out more than 20 articles on policy issues, particularly energy, regulation and economics. A third of these pieces, which helped solidify Stockman's reputation as a thinking man's conservative, appeared in the pages of The Washington Post.

At his Senate confirmation hearing, after listening to liberal senators read back some of his more controversial sentences, Stockman said ruefully, "If I do manage to get confirmed for this job, I think I'm going to stop writing."

Perhaps Stockman's shrewdest move in Congress was cementing an alliance with Jack Kemp, the former football quarterback turned tax-cut advocate.

Kemp describes their relationship as "Mr. Inside and Mr. Outside." But a more accurate assessment would be that Stockman provided the brains and Kemp provided, if not the brawn, at least, the public stage presence.

Despite Stockman's self-confidence, he acknowledged that there was a gaping hole in his economic thinking when he arrived in Congress. He had strong views on the budget and oppressive federal regulations, but he lacked an overall economic theory—a macroeconomic philosophy in the jargon of the trade.

"I believed in free-market economics," Stockman said, "but that doesn't tell you anything about macroeconomic policy. I needed a macro philosophy and I didn't have one. Except for a knee-jerk Hooverite view that most Republicans had at the time. But I was a little too sophisticated for that. I knew the budget couldn't be balanced every year."

Kemp's gospel, called supply-side economics, contends that the government went wrong by stimulating consumer demand. What it should have been doing, Kemp argued, was encouraging America to increase production. One policy remedy was a massive tax cut, the Kemp-Roth bill, that would set off a new American industrial revolution.

With Kemp directing his reading, Stockman became a true believer. Up to now, Stockman's strength was his skepticism about well-intentioned social welfare programs and the government's tinkering with the free market. But Stockman seized on supply-side economics with the same zeal that young intellectuals once brought to the writings of Herbert Marcuse.

A week after the 1980 election, before Reagan had picked his OMB director, Stockman and Kemp collaborated on a memo that outlined how the new administration could avoid an "economic Dunkirk." The origins of this memo explain how the dynamic duo of Kemp and Stockman worked.

Kemp, not Stockman, had been invited to the first meeting of Reagan's economic advisers in mid-November in Los Angeles. The former quarterback for the Buffalo Bills felt a bit inadequate in this august company: "There would be all these big-name economists—George Schultz, Alan Greenspan, Arthur Burns—and me, Jack Kemp, sitting around a table. I felt a tremendous sense of responsibility."

Continued on page 13

So Kemp turned to Stockman, his junior partner. "Dave," he said, "we've got to decide on the type of approach I'm going to take at that meeting." Stockman wrote most of the memo and Kemp carried the ball in Los Angeles.

There are signs that Kemp is bristling over Stockman's new prominence. David Gerson recalls a recent half-joking phone call from Kemp. "I'm getting tired of Dave Stockman pushing me off the front pages," Kemp said. "The next thing, I'll be seeing him on the cover of a sports magazine with his arm cocked back ready to throw a pass."

Even as a junior congressman, Dave Stockman had a lean and hungry look. He was toying with running for the Senate in 1982 or 1984. Fred Matthews, his chief congressional fund-raiser, wanted to enter him in the Iowa presidential caucuses in 1984. In the fall of 1979, Stockman tried to get Matthews, an optometrist from Dowagiac, Mich., to raise some money for an exploratory presidential campaign for Kemp.

"What's in it for you?" Matthews said he asked Stockman.

"That way I could be director of OMB," Stockman said.

Kemp never ran for president, but Stockman got to be OMB director by impersonating two presidential candidates. Before Reagan's debate with Anderson, the former California governor practiced by debating the 33-year-old two-term congressman.

Stockman had only met Reagan at large formal meetings, but he was an obvious choice to play Anderson, his former mentor. He was so good he was asked to come back for a second performance in late October as the stand-in for Carter.

The reviews were glowing. Reagan, a former actor, knew talent when he saw it. Alan Greenspan was so impressed by Stockman's impersonation of Carter that he said, "If we had the capacity to give something like an Academy Award, Stockman would have gotten it." Sen. Paul Laxalt (R-Nev.), one of Reagan's closest advisors, said the mock debates were "near-indispensable" for Stockman's unanimous selection for the OMB job.

It is said that some of the most disappointed people in life are those who achieve their dreams too early.

The director of OMB, with its far-reaching responsibilities that cut across the entire government, has always been Stockman's dream job.

"Dave has always been in awe of that position," said Jennifer Blei. "It was the place where he could implement all of his ideas. But it's always been almost like a dream to him. I always felt he'd be an OMB director. But not in 1980."

Two flames have lighted Dave Stockman's charmed life as he has moved from antiwar crusader to OMB director. One is his burning ambition and the other is his glowing faith that his ideas can shape political events.

But Stockman's idealism has always been curiously devoid of compassion. He has described the federal budget as "a coast-to-coast soupline." But he lacks the empathy also to see the budget as people to be served, instead of inflated numbers on a page.

Perhaps this lack of compassion is related to the way Stockman has used his obsession with work to keep people at arm's length.

Nothing in Stockman's career has prepared him to compromise his vocal confidence in his own opinions. An intellectual lone wolf could stand out among the Republican minority in the House. But now Dave Stockman is playing on someone else's team.

As OMB director, Stockman will win some battles in the Reagan White House, but he will lose some as well. In victory or defeat, Stockman will have to defend the administration's policies to Congress, the press and the public.

Will he bear defeat gracefully, and defer to others more powerful—but not necessarily more intelligent—than he? It is a problem that worries the Reagan team. According to corridor gossip during transition, Edwin Meese III, Reagan's closest adviser, personally selected the man who will be Stockman's deputy at OMB, Edwin L. Harper.

His mission is the same as Donald Regan's. To keep Dave Stockman under control. ■

36 C ham Place London SWIX 8HE Telephone 01-235 4551 Telex 917229 Telegrams Frasings SWI

Consult those who advised on earlier letter

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Mrs CASE
Mr ISAAC (IR)
Mr PITTS (IR)

PERSONAL

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
Chancellor of the Exchequer,
11 Downing Street,
London, S.W.1.

10th February, 1981.

Dear Geoffrey,

Re: Preference capital issue by nationalised industries

Thank you for your letter dated 30th January. I have given a great deal of thought to the "snags" raised by your officials at the Treasury. Since you encouraged me to give you my views on these objections, here is my follow up.

The first one that the preference issues could not escape being considered as part of the PSBR must be based on a misunderstanding. Non-redeemable preference shares, (let us ignore for the moment the other variety, which any way represents a smaller proportion of such issues), cannot under any circumstances be considered as a loan, since there is neither a liability nor a legal possibility of repayment.

Preference shares, (redeemable or unredeemable) are, both de jure and de facto part of shareholders funds, they are treated as such in the company's accounts, by the Inland Revenue, by creditors in liquidation, by lenders seeking collateral security and in any kind of litigation. Like ordinary shares they pay dividends not interest. Hence I can see no way in which a capital issue in the form of preference shares, even by a nationalised industry, could be considered as a loan forming part of the PSBR. Even the suggested Government guaranty of annual dividends could only be viewed as a relatively small contingent Treasury liability.

Continued/........

The officials next objection, the one that a guaranteed dividend payment is unlikely to bring significant market disciplines to bear on industries, can be overcome by using the time honoured method of participating preference shares, this would make the holders of such stock recipients of an additional percentage dividend if and when ordinary shareholders are paid an agreed minimum dividend, which is reasonably covered by profits. This makes directors responsible for profit performance to preference shareholders, whom they will face at Annual General Meetings, (a first step towards privatisation).

As to the question whether such capital issues would compete with gilts, any large issue is bound to compete on the market for available funds. However, all investment institutions divide their funds between gilts, corporate stocks and shares and property in varying and variable proportions, depending on their own funding requirements, the prevailing market sentiment and considerations of a balance between yield and security. Although there may well be a slight overlap from time to time, I would consider this a very minor consideration compared to what may result in a substantial reduction of the PSBR.

The terms of preference issues can be tailor made to fit individual requirements, and I shall be freely available to you, both to argue the case and to make specific suggestions, as from the middle of March, when I am planning to return from a trip abroad. In the meantime, good luck with your Budget preparations.

Yours ever

Francis

FAS/AFP

Remi Theudebaldo
C/O Sargent Collett
485 Fifth Avenue
New York, N. Y. 10017

54

1/2 copy CH/EX ACK

CH/EXCHEQUER
REC. 16 FEB 1981
ACTION
COPIES TO Mr MONAGHAN

February 10, 1981

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17/2

The Honorable Sir Geoffrey Howe
Chancellor of the Exchequer

Sir:

We respectfully enclose a copy of a letter to the New York Times (January 30, 1981), copies of which we recently circularized to a number of New York City publications and Washington, D. C. officials --including members of the United States Congress, high governmental appointees in the new administration and, finally, to President Ronald Reagan himself.

I NEVER SAW ← copy attached US 18/2

The letter, as you will quickly perceive, was prompted by the two juxtaposed articles--yours and that by Yale University professor William Nordhaus. After reading both pieces we felt that you clearly won "the debate", were one to place it in such context. Indeed, we found your presentation extremely edifying.

Now, in the final footnote of our letter we omitted to include a third area of governmental fiscal manipulation--namely, the borrowing avenue (in supplementation to printing new money and taxation).

Our viewpoint to prevail at the time was that in a prolonged era of gathering and relentlessly increscent inflation the function of borrowing becomes ipso facto contributory to the printing of more money, since those interim debts are not defrayed.

Further, due to a climate of governmental economic functioning as above portrayed the monetary arm and the fiscal arm become, in effect, symbiotic counterparts of the same manipulation.

In any event, we write this mainly because we were extremely impressed by your thoughtful article of analysis, in which you proved yourself fully cognizant of the monumental exigencies of the predicament.

May both of our great lands, and in extenso "The Free World" at large, defeat this extortionate inflation monster!

Faithfully yours,

Remi Theudebaldo

Remi Theudebaldo

Enclosure

Copy of letter of January 30, 1981 to the New York Times

55

COPY

Remi Theudebaldo
C/O Sargent Collett
Suite 1042 N
485 Fifth Avenue
New York, N. Y. 10017

COPY

January 30, 1981

Subject: The articles INFLATION REMEDIES: REAL AND MAKE BELIEVE by Professor William Nordhaus of Yale University and REAGAN SHOULD TALK TO MRS. THATCHER to appear in The New York Times Sunday BUSINESS section, January 25, 1981 the latter article by Sir Geoffrey Howe, Britain's Chancellor of the Exchequer.

Editor
BUSINESS Section (Sunday, January 25, 1981)
The New York Times
229 West 43rd Street
New York, N. Y. 10018

Dear Sir:

While I take it for granted that deo volente President Reagan will in due course be talking with Prime Minister Margaret Thatcher--- I would suggest here that Professor Nordhaus talk with Sir Geoffrey! One matter as plain as an immaculate sunny day must be accompanied by blue sky is that we will never terminate inflation in this country so long as the U. S. Government per a gigantic entrenched bureaucracy indulges in huge deficit spending, a self-perpetuating fiscal folly that will only mortgage the very future of these United States. This has been the sociological record from the days of F. D. R. when the modern era inflationary thrust was launched. All the king's economists and all the king's theoreticians cannot alter the truth of the above statement. Sorry Professor Nordhaus!

Sincerely yours,

Remi Theudebaldo

P. S. - When the government spends more money than it has at hand it either increases the taxes or prints more money. Either avenue is national theft by governmental manipulation. Since current taxes have long been inordinately high, the government's printing presses have been very busy. Rather than so many greenbacks the presses should be printing thousands upon thousands of pink slips.

R. T.

Added after letter was mailed:

Because of the relentless challenges posed by the Soviet Union only National Defense and related spheres warrant special dispensation respecting exclusion from vital cost-cutting activity.

R. T.

cc PPS 56
PS/CST
PS/PST
Sir K Couzens
Mr Hancock
Mr Vanin
Mr Monaghan
DF
IDCS

BRITISH EMBASSY
3100 Massachusetts Avenue, N.W.
WASHINGTON, D.C. 20008
Telephone: (202) 462-1340

26 January 1981

Mrs R E J Gilmore
Chief Information Officer
HM Treasury

Dear Rosalind,

CHANCELLOR'S ARTICLE IN THE NEW YORK TIMES

I attach a copy of the Chancellor's article, as it finally appeared in the Sunday New York Times for 25 January. We have called the Times' attention to the constitutional howler they have perpetrated by changing "with" to "within" in the seventh to last line.

but in US not in UK MC.

Copies of the article will be provided to our Consulates-General throughout the US by BIS New York.

Yours ever,

H G Walsh

Enc: 1

c.c. N P Bayne Esq
ERD FCO

R Allen Esq
HM Treasury

T Bottrill Esq
HM Treasury

Reagan Should Talk to Mrs. Thatcher

By GEOFFREY HOWE

IN recent weeks I have been struck by a number of articles in the United States press advising President Reagan on the main problems that would face him on taking office and the main steps the authors felt he should take.

What was particularly interesting to me was the close parallel between the problems identified, and the prescriptions made, in some of those articles, and my own view of the British economy. Indeed, there are close parallels with many of the industrialized countries around the world. We are all suffering from the effects of the severe rise in oil prices since 1979, which has sent the world economy into recession and added to inflationary fires.

But the parallels went further than the joint experience of recession. The articles highlighted the problems of inflation and how to tackle it, government spending and borrowing, and government over-regulation of the private sector. On all these, the authors raised issues that are important to the British economy as well.

Like the United States, after a long postwar period of growth, with relatively low inflation, we have seen serious inflation establish itself in our economy over the last decade or so. In Britain we have seen the inflationary paraphernalia of automatic indexation, wage claims at least in line with price movements, discussion of cost increases "in real terms" as if the general rise in the price level were unimportant, and so on.

Successive governments have played a part in our inflationary process, through excessive spending and borrowing, and the pretense that they can solve problems that can only be mastered by changes in economic behavior. In some cases, they have taken over tasks better performed privately.

In others, the problem has been the establishment of a level of entitlement, or standard of provision, that assumes substantial economic growth, which it is then difficult to scale down if the growth does not materialize. Thus, public spending has acquired a momentum divorced from the realities of the productive economy, which has had to bear an increasing burden. The productive sector has been further hampered by levels of personal taxation frustrating to enterprise and effort, and by an excessive number of government regulations. I find echoes of all these phenomena in descriptions of American experience as well.

These are problems which have developed over many years, and they will not be solved overnight. But I now find near universal agreement among my fellow finance ministers that inflation must be cut to restore stable conditions for growth and new employment.

There is agreement, too, that monetary control is a necessary condition for the reduction of inflation, and that this control needs to be sustained. Indeed, a responsible attitude to the money supply needs to become a permanent feature if the deeply ingrained inflationary mentality is to be eradicated. The right method of monetary control will vary from country to country according to the nature of the financial institutions in each.

But no method of control, in our highly sophisticated modern economies, can work instant miracles. So far as Britain is concerned, I do not believe there can be any doubt that monetary conditions have been tight, despite the fact that the broader monetary aggregates have been growing rather faster than the Government's target would indicate. The narrower aggregates have been growing much slower than the rate of inflation.

We have succeeded in reducing our year-on-year inflation rate from a peak of 22 percent last May to just over 15 percent, while the annualized six-month rate is much lower — well below the rates in the United States and France, for example. Meanwhile, short-term interest rates have been reduced by 3 percent since last summer. And there is increasing evidence in the labor market of the sort of realism we need to insure adequate control over domestic costs. Many wage settlements have now come down to single-figure increases. And strikes have been at an all-time low.

The task of defeating inflation is immeasurably easier if fiscal policy is consistent with the monetary stance. If the government's demand for credit is excessive, the result is high interest rates crowding out private investors, and proper monetary control itself becomes much more difficult. But again, reducing the government's borrowing requirement takes time.

I HAVE already mentioned the built-in momentum of many spending programs. It takes time to reverse this. Further, at a time of recession there is upward pressure on the fiscal deficit from higher benefit payments and lower revenues. These are often regarded as automatic stabilizers, mitigating the effects of a recession, and we have judged that we should not try to counteract their effect altogether.

Nevertheless, we are reversing inexorable growth of public expenditure, and our plans now provide for a reduction in real terms of about 1 percent a year in 1981-82 and subsequent years as compared with the previous Government's plans for a 2 percent increase.

This has enabled us also to make a start on cutting the high personal taxes that were a uniquely foolish disincentive in the British economy. This objective of cutting personal taxes is potentially in short-run conflict, as a matter of simple arithmetic, with the objective of reducing Government borrowing. The long-term answer is planned cuts in spending, and extra revenue will be derived as the economy grows.

In the meantime, we have chosen to strike a prudent balance between the two goals, and have increased revenue from indirect taxation to offset reductions in income tax. But the fact remains that in my first budget I cut income taxes across the board and reduced the top rate of tax on earnings to 60 percent from 83 percent, thus substantially increasing the rewards successful managers are able to earn.

Reducing the burden of unnecessary regulation on industry and commerce is the other supply side policy. The first stages have been quickly achieved. I have removed a battery of controls in Britain; on prices, pay, dividends and movements of capital across foreign exchanges. But not all deregulation is as simple as we should wish. We all have to take account of legitimate anxieties about such matters as health and safety, and protection of the consumer and environment. We need to allow for our separate institutional constraints.

In Britain, we are sometimes constrained by our membership in the European Community; in the United States your administrations are sometimes constrained by the division of powers within the Congress. The difficulties of tackling these problems, particularly when the world outlook is so clouded, should not be underestimated. Yet, they are problems that must be tackled vigorously if we are to restore the health of our economies.

Sir Geoffrey Howe is Britain's Chancellor of the Exchequer.

NYT
25 Feb 1981

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21202

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Richard Ellis

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ACTION Mr Mace (IR)

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Our ref: DNIP/EJW

11th February 1981

Dear Geoffrey

Thank you very much for your letter of the 21st January. Norman Bowie and I are most grateful for the obvious very serious consideration which has been given in considerable detail by you and your advisors to the proposals which we have put forward.

We note that essentially there are two points on which you feel you would need more evidence, namely:

1. That the necessary means of finance are not already readily forthcoming,

and

2. That the suggested proposals would be effective in securing the objectives set out.

It is not always easy to produce a volume of actual tangible evidence because these types of transaction, like others in the property market, are more often than not the subject of private negotiations. We are both involved in advising on property investments on a wide basis with a generally good knowledge of the market and the attitude which is adopted by institutional funds and their policies. Our experience has been that in order to develop new opportunities and new ideas it is necessary for the appropriate avenues to be opened up ahead in order to alert Trustees and Investment Managers to the opportunities which can be made for them. Looking back when the Government decided to lift Exchange Controls in October 1979 it seemed to have taken quite a while before there was any significant movement by institutional funds into overseas securities.

...continued

Coming back to the question of evidence, we were both members of the Advisory Panel on Institutional Finance in New Towns until disbanded last November. In recent years it had become very clear, for example, that the northern New Towns had difficulty in securing more than one or perhaps two finance proposals for industrial and other commercial projects, even though they may have sounded out up to fifty funds or surveyors practising in the investment market. This was also for relatively small sums of capital. On some occasions the terms were not particularly attractive but were the best obtainable. Another type of example coming immediately to mind is that of the Surrey Docks in London where over the years Trammell Crow have sought finance in the London market to carry out a development scheme which had fairly wide support, but finance was not securable.

Also, as an example of the way in which it is often necessary to lead the market, you might be interested to know that Norman Bowie was the initiator of the creation of the Property Unit Trusts in order to bring into the property market the very large numbers of small pension funds which in the late 1950s and early 1960s obviously had a desire to invest in property but had no natural outlet. It is true that no legislation was required to launch the Property Unit Trusts but it did take six years with great help from a number of people and then was only successful because of the co-operation given by the Department of Trade and Inland Revenue.

We would agree with the views expressed to you by the Inland Revenue that there has been some switch to direct investment by both insurance companies and pension funds but this is, we believe, very much because of existing tax laws. There are many funds, who do not have the same entrepreneurial outlook and whose funds we would like to see harnessed in this way, particularly as we know that present Government policy is to look very much to the private sector to assist with the problems of urban renewal etc.

...continued

We are, therefore, both of us looking ahead to create a suitable form of vehicle which will get over the known unwillingness to place very large sums by a single fund in isolation in areas of renewal and where social problems arising from essential changes in the industrial structure are most severe. Even some projects for desirable large scale central area developments can present problems.

The Corporate Tax Exempt vehicle has, in our view, very considerable merit and has advantages over the Property Unit Trusts. The latter individual funds have the power to withdraw and again they are only open to pension funds or charities and cannot bring in the very large funds, which also accrue to life insurance companies both for long term business and for the insured pension funds. The advantage of a corporate vehicle is that it brings the two types of funds together in a way which we believe makes them much more compatible and their holdings more marketable.

We have noted in particular also the comments about the likely size of the loss of tax which, obviously, is a very serious point which you must take into consideration, but many of the types of property for which finance is required are those which are already subject to allowances such as Industrial Building Allowances. Even in the case of office buildings the plant and machinery content is so high these days that considerable allowances are available even for this category.

It is an interesting comment on the present scene that property companies are, themselves in isolation, carrying out a low level of direct property investment and seem to be much more involved in coming to arrangements with an institutional fund whereby the latter own the freehold, provide all the capital and the property company is left with more or less an equity interest.

...continued

It was interesting to read in the Press recently that the Prudential sold all their shares in MEPC because they felt, apparently, that a corporate vehicle which bore corporation tax and also Capital Gains Tax was no longer a suitable means for investment in property. It seems likely to us that this trend could continue.

It was because of our mutual concern and certainly others in our profession for the need to assist less attractive areas and to provide in a positive and demonstrative way help for their maintenance that we have given the whole matter serious thought.

We will be consulting together and see if it is possible, having regard particularly to the difficulties of breaking confidences, to bring forward to you some more positive evidence and we are most grateful to you again for your detailed reply and obvious interest you have taken in the proposals.

Yours sincerely

D N Idris Pearce

Rt Hon Sir Geoffrey Howe, QC, MP
The House of Commons
Westminster
London SW1

CONFIDENTIAL

Pl attach ~~2nd~~ T's letter

KT 16/2

62

BF for next Morning Prayers on 27/2

B/F prayers folder for 20/2

Pse b/f please Ld T's letter with this for next prayers

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Ridley
Mr Cropper

B/F 12/3

PRESENTATION OF ECONOMIC POLICY

I attach a draft for the letter you were proposing to send to Mr Pym. Perhaps we could discuss it again at Friday's Morning Meeting.

2. The letter covers a lot of ground. I wonder whether it might be cut down to deal only with the form, mechanics and tone of our propaganda: after all the substance of our case on economic policy should be well-known to Mr Pym by now.

3. I have included at the end of Section 4 your argument that we ourselves should set the standards by which we are judged; but I am not wholly confident that I have interpreted your position correctly.

G.C.

GEORGE CARDONA

11 February 1981

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Draft letter to : Mr Pym
from : Chancellor

PRESENTATION OF ECONOMIC POLICY

Since our meeting with the Prime Minister and Peter Thorneycroft on 21 January, I have been reflecting on both the form and the content of our presentation of economic policy.

I find it helpful to think about this subject in four separate areas: the messages we are trying to convey to the public; the audiences at which we are aiming; procedures; and finally questions of tone and mood.

1. MESSAGES

There are several important themes we have been trying to develop since the election:

(a) Our economic problems have been building up for decades. They cannot be solved overnight.

(b) The world recession has contributed to our domestic economic problems. Governments can do little in the face of such a recession.

(c) Most other major industrial countries are suffering similar problems.

(d) Rising N.Sea oil production pushes up the exchange rate. This makes British industry less competitive internationally, but also leads to higher living standards.

(e) Government's top economic objective is to bring down inflation. A necessary condition for this is control of monetary growth; and this in turn requires control of public borrowing, not just for one year but over a long period.

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(f) Control of public borrowing requires control of public spending. (This includes spending by local authorities). Weaker control of public borrowing means higher interest rates.

(g) Pay must be kept under control, if the rise in unemployment is to be moderated. People must accept rises below past inflation.

(h) There must be action at the level of the individual firm. We can take the credit for many fiscal and other measures designed to help business, particularly new and small businesses.

(i) There is no viable alternative. Too many Governments have tried to keep up employment and living standards by printing money: we shall not follow their example.

(j) Good news: realism in pay settlements, falling inflation, new businesses, etc.

This list is not mean to be exhaustive: there are, for example, other points in Peter Thorneycroft's note of 30 January. But my list picks out the main points of Treasury interest.

2. AUDIENCES

I have divided the audiences into two groups: those with whom we communicate easily and with some success, and those with whom our communications are poor.

(a) Good communications:

No!

(i) Conservative back-benchers;
(ii) the Party in the country;
(iii) large companies;
(iv) small businesses - this has in the past been an area for concern, but if John MacGregor is able to implement his plans I expect communication to be good.

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(b) Poor communications: (v) pensioners and poverty lobbies - but could any Government satisfy them in current conditions?

(vi) the regions;
(vii) floating voters;
(viii)trade union rank and file.

How can we improve our contacts with (v) to (viii)?

3. PROCEDURES

(a) PMG Briefing Notes. These have often proved useful. But I sometimes wonder whether they are used flexibly enough. Should some of them, for example, go to all backbenchers?

(b) Central Office. I have three Special Advisers to help my department co-ordinate presentation with Central Office, but how do other departments manage? I suspect there may be gaps.

(c) Saatchi and Saatchi. Could we make more use of them? Could they, for example, advise on the next item?

(d) Organised campaigns. It would be of inestimable value if very part of both Government and Party could say the same thing at the same time. This would mean/concerting every Ministerial and backbench speech outside Parliament, every Ministerial interview, every statement by Party workers, councillors, agents, etc. I do not think this has ever been properly tried; but that is not a reason for not trying now. It is not for me to specify how you might organise such a concerted campaign, but I would venture to suggest that if you were to proumlgate a "Theme for the week" to every Minister, backbencher and Party worker, the proportion who would actually use this theme would be high enough to make the exercise wothwhile. There are of course difficulties in trying to concert publicity in this way, not least because of the very different departmental responsibilities that Ministers have. But I think it would certainly be worth trying at least one experimental concerted campaign; and unemployment inevitably suggests itself as the subject.

(e) Next general election. It is not too soon to start thinking about the next election. How shall we present ourselves? What machinery will there be for writing the Manifesto?

4. TONE OF PRESENTATION

This is perhaps the most difficult area to discuss. Peter Thorneycroft's note makes some important and fundamental points, such as the need to appear both competent and caring. It is also important that the Government should not be too defensive: part of the reason why we so often appear to be defensive is, I suspect, that officials produce excellent defensive briefing for their Ministers, but are often shy of agressive point-scoring and self-advertisement. Yet we have a good deal to be proud of: the unprecedented fall in numbers in the Civil Service for example.

Another point to be borne in mind is the need for us to set the standards by which we are to be judged. Thus we must continue to present the defeat of inflation as the overriding objective of Government policy.

Finally, the formation of a new Social Democratic Party must be a cause for some concern. Although Labour will of course suffer most from the existence of the new Party, we too risk losing votes. The correct strategy for us must, I think, be to emphasise that the Social Democrats are not a "Centre" Party at all: their economic policies are exactly those of the old Labour Party (incomes policy, modest reflation, etc): Mrs Williams and Mr Owen themselves repeatedly stress that they are "socialists". We must get across that the party structure has not been changed by the birth of a new Party to the right of the Labour Party, but that a new Party has grown to the left of the Labour Party: voters should not be deceived by the fact that the new growth has stolen the name of the old Labour Party.

I am sending copies of this letter to the PM [and to Lord Thorneycroft].

(G.H)

POLICY AND PRESENTATION

The following notes arise out of the Chairman's letter, the Kemp-Gee news letter and the C.R.D. budget representations.

1. Unemployment. There is no doubt that we will be approaching the next General Election with very high published unemployment figures. I agree completely with Lord Thorneycroft when he says that we ought to "break down the total in more detail than appears at present, at least publicly, to be done". The present position is very dangerous because :

i) everyone knows, anecdotally, that the figure of $2\frac{1}{4}$ million is inflated by scroungers,

ii) Ralph Howell is able to say, without effective contradiction, that there are a million people in this country who cannot afford to work (better, perhaps, cannot afford to pay tax on their earnings),

iii) the unemployment figures are inflated by many under-23's who should probably not be eligible for unemployment pay on the same terms as older people at all,

iv) many men with working wives can easily take spells at home,

Etc.

But, at the same time, unemployment is bringing untold tragedy to some homes, where there are invalids, sick children and so on. Without a proper analysis of the statistics nobody really knows the true picture, with the result that the left wing is able to have a field day while the right wing is all too liable to deny that there is any genuine problem. Why could not a proper review have been set in train long ago ? Preferably by a respectable research body.

2. Implications of the C.S.D. I would not agree with Kemp-Gee that "A new centre party's natural coalition partner would be the Labour Party rather than the Conservative Party". The C.S.D. and the Liberal Party will just go single-mindedly for P.R. and the alliances will be formed straight after the 1984 election on the basis of the figures that then emerge. The two centre parties will, if they hold the balance, lend their support to whichever offers them the most attractive electoral reform. There is no point in the Conservative Party trying to offer a third alternative in Social Democracy.

3. Presentation of Policy. It is very difficult to present policy with conviction when, on so many sides, the policies which were clear-cut in conception are being blunted in execution. Fringe benefits, interest rate control of M3, reduction of expenditure, cutting back the P.S.B.R., lame ducks, capital taxation. On all those fronts one is prevented from expounding policy by the fact that clear opportunities for carrying out those policies have been deiberately passed up. It is really no good Lord Thorneycroft complaining that the public gets the impression of a gentlemen and players situation - Treasury team and the rest - when that is precisely what we have got. He ought to be using his authority as Chairman to get the Cabinet sorted out. Then those of us involved in presentation would have something to get our teeth into.

4. Liaison with the Party Machine. Until Lord Thorneycroft provides something in Smith Square to liaise with, it is sheer waste of time to say "above all we need much closer working links between the Party Organisation and its Government". All too often at present one finds sullen-ness and non-commitment in one's contacts round there. Several senior members of C.R.D. would be more at home in the new party ; the recent budget submission on taxation might have been written by Dick Taverne.

The other impression one gets at Smith Square is one of sheer business inefficiency. For example, Special Advisers are still struggling to get their pay and pension arrangements sorted out for the transfer from Central Office to Civil Service; tax overpaid, running into thousands of pounds, is blocked by the Inland Revenue because of CCO delay. Pension arrangements are antedeluvian.

There are three ways of financing a political party:

i) Contributions from business and industry.
ii) Contributions from the State.
iii) Contributions from private individuals.

One understands that our income from industry is now falling fast and that the brigadiers are in despair. State aid is ruled out. Collection of private subscriptions has never been put on a proper footing.

It is obvious to me that £10 per annum could be collected from a million people in the U.K. That number of people, at least, live in families paying the higher rates of tax. That would instantly place the Party's finances on a sound footing. If the reason for inaction is that the constituency organisation and the centre cannot agree how to share the proceeds, then somebody should knock their heads together. It is preposterous that the Conservative Party should be in its present position, with the Director of the Research Department doubling up with management of Central Office and spending his time checking up that the window-cleaner has done his job properly.

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RETRA

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RETRA

Radio, Electrical and Television Retailers' Association (RETRA) Ltd

Director: R.T.Edom M.B.I.M.

ACK. V 13/2

TOP COPY CH/EX LAY

CH/EXCHEQUER

REC. 13 FEB 1981

ACTION PS/IR

COPIES TO CST, FST, MST(C)(L)
SIR D. WASS
MR RYRIE
MR MIDDLETON
MR BATTISHILL
MR DIXON
MR BUCKLEY
MR CORLETT
MR UNWIN
MR PICKERING
MR GRIFFITHS
MR CROPPER

18/2

16/2

Registered Office:
RETRA House
57-61 Newington Causeway
London SE1 6BE
Telephone: 01.403 1463 (5 lines)
Registered in England No. 374327

12th February 1981

The RT Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
The Treasury
Parliament Street
LONDON SW1P 3HE

Dear Sir Geoffrey

The Council and Multiple Shops Committee of this Association have asked me to write to you with a submission for your consideration in your forthcoming Budget.

Sales of electrical goods in the last quarter of 1980 showed a small increase on the third quarter, and the average for 1980 as a whole appears to have been some 1% higher than in 1979. Margins have been seriously affected and there is concern over the probability that retail sales will suffer further this year, as real incomes continue to fall and the accumulative effect of unemployment restrains consumer spending.

It is extremly important to our members, many of whom are small businesses, that the continual increase in operating costs is minimised as far as possible, and that there be no additional costs imposed or measures introduced that will worsen the current trading situation.

While we hope that it is almost superfluous to mention the question of rates of VAT, we submit that stability in this area is vital and trust that the existing structure and rate will remain unaltered. Increases in rate affect purchasing and rental decisions, but additionally create a substantial and lengthy work load on retailers which longer term has also to be reflected in prices and charges.

The television rental market shows few signs of growth and it will have to rely heavily on Teletext and Video Recorders for its future. Accordingly, the application of capital allowances to these products is extremely important. We would therefore again ask that consideration be given to a more favourable transition of the existing arrangements, and additionally, that there be included Teletext and Video Recorders in those arrangements. Teletext and Prestel are closely related systems, and it would seem to us logical that the former be treated in a similar way to Prestel.

Finally may I refer to employers contribution for National Insurance Surcharge payments and ask for assistance in this respect.

Yours sincerely

R T EDOM
DIRECTOR

SMALLER BUSINESSES COMMITTEE

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Chairman: John Loveridge, M.P.

Vice-Chairman: Richard Page, M.P.

Vice-Chairman: Graham Bright, M.P.

Secretary: Michael Colvin, M.P.

HOUSE OF COMMONS

LONDON SWIA OAA

TOP CH/EX ACK LAY

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REC.	18 FEB 1981
ACTION	PS IR
COPIES TO	MST(L)
	MR POTTER
	MR CROPPER

✓ 18/2

12th February, 1981

Dear Geoffrey,

I thought you might like to see a copy of the letter I sent to the Prime Minister prior to our meeting with her on 10th February which I am enclosing for you.

There is one aspect related to the Loan Guarantee Scheme I thought I should mention to you. We believe that this scheme would be mainly helpful to the kind of business which has grown quickly up to say £200,000 a year turnover and wants to double this turnover but has not got enough security to pledge to the bank and does not want to give up equity. Such a firm might need quite a substantial loan and therefore we hope that there will not be a low ceiling on loans under the scheme. We feel that very small businesses can obtain credit from the banks at the present time and although the scheme should be available for the smaller firms, it is really most needed for those that have got off the ground and now want to expand further.

Yours ever,

John.

Chairman: John Loveridge, M.P.
Vice-Chairman: Richard Page, M.P.
Vice-Chairman: Graham Bright, M.P.
Secretary: Michael Colvin, M.P.

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HOUSE OF COMMONS
LONDON SWIA OAA

5th February, 1981

Dear Prime Minister,

A CONSERVATIVE STRATEGY FOR EMPLOYMENT

Our Government has done much to bring about national good housekeeping which has resulted in a strong balance of payments, a strong pound, reduced inflation and sustained exports. Last year's budget provided a welcome first step towards such a strategy. The next step is to fill the nation's cupboard with prosperous independent businesses.

The Officers of the Smaller Businesses Committee and Mr. Grylls are very glad to be coming to talk with you. What we want is very simple. It is to persuade you that the small and medium business sector can, if supported, provide a Conservative strategy for employment.

We believe the small and medium sized sectors are the main area from which jobs can come. They will only come if the Government gives priority to this.

On 7th December, 1979, I mentioned to you the dangers of "falling company liquidity." A large number of firms have now borrowed extensively to see them through the recession and this burden of debt will make it difficult for them to find money for future expansion.

We urgently need:

1. A Loan Guarantee Scheme designed to grow on a substantial scale. (As you know, the scheme we have advocated is self-financing.)

2. Investment in small trading businesses should be able to be set against individual taxation.

3. Independent medium sized firms should be encouraged to grow and therefore Capital taxes should be cut by at least half in their real effect.

4. Machinery to inspire small business effort is inadequate. The one effective part covers only a minute fraction of the small business sector and that is the Ministry of Agriculture. By far the greater part of small business is relegated to a small unit forming part of the responsibilities of a Junior Minister at the Department of Industry. We need to co-ordinate the activities of management and scientific consultants who can help to encourage the proper take up of the Loan Guarantee Scheme.

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Outside Government we recommend an agency to cover both towns and country. This could incorporate Cosira which although very small provides a useful structure to build on.

It is difficult to find comparative statistics but some have recently been made available by the Economists Advisory Group Limited and these are mainly used in this letter.

The Wilson Committee figures show that there were only some 2,865 businesses with 100-199 staff in our manufacturing sector. This small number has a ring of death about it. In Japan success has partly depended on the scale of their small business sector. In manufacturing, for example, firms with under 200 staff employ 66% of those working in this sector. In Britain the figure is only 29%. The Government should aim to increase the number of businesses by some hundreds of thousands and should encourage existing businesses (1.3 million) to expand. In particular independent medium sized firms deserve encouragement. These firms are the most likely to turn scientific invention into practical production. Small firms have not the capital to achieve this in most cases and large firms are often more interested in their long production lines.

In West Germany I understand that bank advances to small businesses, of under 200 staff, are greater than all advances to business and government put together in this country. In Japan the discrepancy is even wider in loans outstanding to small business. They were said, in March 1979, to total £185 billion which is more than half of all business loans there. At the end of 1978, U.K. bank advances to all business were estimated at £38 billion of which independent small firms had only a limited share.

It is not the large firms with paid directors that are likely to prove the pace-setters of the future. This can come from small independent firms; but only if running such firms is made to pay better, and if educated men are encouraged to become entrepreneurs rather than to join large firms with their eyes set on a distant pension.

I know that the root of this argument is dear to your heart. We must find a Conservative way to success.

I enclose a copy of the Small Firms Expansion (Inquiry) Bill which sets out a list of 50 matters which require action from Government, together with a copy of my speech on the debate on the Wilson Reports, in both of which I have underlined some key aspects.

Our country has only half as many small businesses per head of population as Japan, and has a lower proportion than any of the seven countries studied by the Economists Advisory Group. In spite of our oil I do not believe that we can achieve the impetus required for Britain to overtake our competitors abroad without the most urgent action by the Government to stimulate independent businesses.

The cost of our programme is likely to be small compared to the outlay of money to "lame ducks" but it is no use going about such a programme on a piecemeal basis. This is probably the last year before the next election when it is possible to establish a successful Conservative strategy for employment.

Yours ever,

John

73

10, Downing Street,
Whitehall S.W.1

With the Private Secretary's Compliments

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10 DOWNING STREET

THE PRIME MINISTER

12 February 1981

Thank you for your letter of 3 February enclosing Mr. Attwood's letter. You kindly offered me the opportunity to comment. Mr. Attwood enclosed a cutting from The Guardian. Perhaps I can comment on the section he has underlined.

It is misleading to suggest that reducing inflation and unemployment are mutually exclusive alternatives. Inflation retards confidence, competitiveness and investment. It is the true enemy of jobs. Over the last twenty years or so we have painfully experienced this. Successive economic cycles combined higher inflation with higher unemployment.

Current levels of unemployment are tragic. Hard experience shows that to follow short term expediency, and attempt to spend ones way into higher employment failed. It would fail now, but succeed in raising inflation. It is a measure of our concern, that within the resources available, we have greatly increased expenditure on employment support and training. The best prospects for jobs flow from reducing inflation and improving productivity and competitiveness.

/ On the subject

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On the subject of inflation, the truth of the matter is that we inherited a firm upward trend. We have reversed this, and achieved a substantial reduction in the rate of inflation, with every prospect of further progress in the coming year.

I very much hope that when Mr. Attwood looks again at what has happened we will be able to continue to have his support in the future.

(Sgd) MARGARET THATCHER

D. A. Trippier, Esq., J.P., M.P.

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10 DOWNING STREET

THE PRIME MINISTER

12 February 1981

Thank you for your further letter about the exchange rate of 23 January.

The main points of my reply to your letter were included in my earlier reply of 22 December, but I take this opportunity to expand on them.

I believe that you exaggerate the ability of the government to control either the nominal or the real exchange rate, and that you underestimate the costs of attempting to control them. Specifically, the attempt to hold down the exchange rate in 1977 failed, and had a substantial damaging effect on monetary policy.

I am unable to follow your interpretation of the events of 1977. I do not think there can be much doubt that over the year as a whole both reduced interest rates and large scale intervention were used to try to contain the rise in the exchange rate. It is also clear that use of both instruments contributed to the subsequent acceleration of the money supply. I am not sure what you mean by the corollary that "the domestic component of the money supply was correspondingly small". If you are saying that a large inflow from abroad will automatically be offset by slow growth of other sources of monetary creation, then your contention is not borne out by the facts. While it is not possible to trace precisely by whom and in what form the sterling supplied through intervention was held (nor for sterling supplied through any other route), it is clear that the growth of both wide and narrow monetary aggregates accelerated as a result of the efforts to hold down the exchange rate.

/For a realistic

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For a realistic discussion of the Exchequer costs of unemployment (page 4 of your letter) I would refer you to an article which is being published in the latest Economic Progress Report. The argument which compares the Exchequer cost of unemployment with the gain in revenue from a return to work is of course far too simplistic: it ignores the problems created by attempts to stimulate the economy through expansionary fiscal or monetary policies.

In this context you assert that it is inconceivable that in present circumstances an increase in the money supply which was not demand-determined would not lead to an increase in output and/or a reduction in the velocity of circulation, citing the experience of the 1920s and 1930s as evidence. Yet it is evident that the economy does not behave as it did then. If it did, we would not be witnessing the coexistence of weak output and persistent inflation. You do not need to go back before the war to find a relevant example. The experience of 1977-79 will serve perfectly well. The fiscal and monetary expansion of that period, which as I explained above owed much to the increase in the money supply generated by the attempt to hold down the exchange rate, produced a rapid increase in monetary demand. Between 1977 and 1979, total domestic expenditure in money terms rose by some 30 per cent. The increase in domestic output even including North Sea oil over the period was only about 5 per cent. The rest was accounted for by increased net imports and rising prices. This demonstrates vividly that Governments are able to stimulate monetary demand but their ability to ensure that demand is reflected in increased output is limited.

The key lies in the process by which wages are determined. We are beginning to see a new realism entering wage bargaining, with settlements more closely related to what enterprises can afford. Nothing could be more calculated to halt the progress that has been made than an announcement that the Government was putting its policies into reverse.

(Sgd) MARGARET THATCHER

Austin Mitchell, Esq., MP.

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10, Downing Street,
Whitehall S.W.1

With the Private Secretary's Compliments

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THE PRIME MINISTER

12 February 1981

Thank you for your letter of 22 January about the sterling exchange rate. I am very much aware of the problems facing industry, especially small and medium sized firms like yours. I know that some of these difficulties, especially in export businesses, are caused by the strength of sterling.

The exchange rate is not set by the Government, nor have we sought a rate at the present level. I am sure you will know of the strong international factors which have affected the rate in recent months. Our possession of North Sea oil at a time of uncertainty in world oil markets is probably the most important. The UK's large current account surpluses in the last few months when other Western European countries have experienced large deficits have also lifted the rate. It is possible that in due course this upward pressure on the sterling rate could be offset, for example by outflows continuing to grow following the abolition of exchange controls, or as the prospects for other economies and currencies, such as the deutschmark, improve.

It is sometimes suggested that the Government should intervene in the foreign exchange markets to try to reduce the rate, but the Government's ability to influence events in the foreign exchange market is very limited. Experience in the UK and elsewhere has shown that such attempts usually fail, but that in the process they add to the money supply and jeopardise the fight against inflation. The consequent increase in domestic costs means there

/ are no

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are no long-term benefits to competitiveness as a result of this course. While the Government appreciates that many firms are moving as fast as they can, in the medium-term the only way to be sure to improve competitiveness again is for firms to keep increases in their own costs below those of their overseas competitors through higher productivity and sensible wage settlements.

Meanwhile, the Government is taking action to try to ease the current pressures on industry in other ways. This includes firm action to control public spending, get interest rates down and create the conditions for a resumption of sustainable growth in jobs and production. The proposals announced in November for the treatment of stocks in company taxation should also help many small firms, as should the improvements the Secretary of State for Employment is making to the Temporary Short Time Working Scheme.

(Sgd) MARGARET THATCHER

P.H.E. Brooks, Esq.
Zero 88 Lighting Limited.

BE 20/2

PWP 81

cc PS/Financial Secretary
Mr Battishill
Mr Buckley
PS/Inland Revenue

PS/CHIEF SECRETARY

LETTER FROM TEESSIDE SMALL BUSINESS CLUB

...... The Chancellor has received the attached letter of 6 February from the Chairman of the Cleveland Small Business Centre which covers the Chief Secretary's constituency.

2. The Chancellor suggests that he (the Chancellor) should send a prompt reply saying - if the Chief Secretary wishes - that he has discussed the letter with him.

3. Is this action agreeable to the Chief Secretary?

'phoned to say OK 17/2

L E Birnie

MISS L E BIRNIE
16 February 1981

Covers CST's concerns

- prompt reply from me, saying - if he wishes! - that I have discussed with him

TEESSIDE SMALL BUSINESS CLUB LTD

Cleveland Small Business Centre
16-20 Marton Road
Middlesbrough
Cleveland TS1 1HG

Tel. Middlesbrough (0642) 223421

TOP COPY CH/EX

CH/EXCHEQUER
REC. 11 FEB 1981
ACTION Mr Buckley
COPIES TO PS/FST PS/CST
Mr Battishill
PS/IR

12/2

The Right Honourable Sir Geoffrey Howe, MP
Chancellor of the Exchequer
The Treasury
Whitehall
LONDON

6th February 1981

Dear Chancellor

We are an organisation of 700 small businesses; the first and largest local small business club in the country. We have no research department but we do represent the grass roots situation and feel we have a responsibility to convey its feelings and interests to the Government.

Whilst at this pre-budget time of the year, other submissions to you will no doubt be well researched and backed by numerical evidence, we often doubt whether the true small business situation survives the reporting stages to "head office" and the strong "big company" interests.

We believe most strongly in the importance of the small firm sector - and accept that the Government does also. But does it really understand our special needs and requirements? With the capital investment required to create one job in a small firm being in the range of £2,000-£20,000 - in a large firm it could be in the order of £0.1 m, the requirement in small firms to "invest by leaps" (one cannot buy half a machine), and their quite different time horizons, policies designed with large business in mind can be quite unrealistic for small businesses.

We are not seeking favoured treatment, rather appropriate treatment - especially for new and young businesses.

Equity is difficult to obtain in the range of £2,000 to £50,000 and borrowing is, of course, expensive. It is difficult enough to run an established business with overdrafts costing 19% (usually higher than for large firms despite being secured), but to create a new one on borrowed money presents almost insuperable difficulties.

In this connection we strongly support the recent report of the Consultative Committee of the Accountancy Bodies where they advocate a more positive approach on the part of the Government

Continued .....

Help for the
Lonely Entrepreneur

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...... Continued

to encourage by fiscal means the investment of private capital in wealth creating enterprises.

Pledging houses as security for bank loans is a related problem and we know of distressing instances of houses having to be sold up to repay such loans. Further, the "domino effect" of bad debts on otherwise sound firms is a contributory factor in business failures.

In almost all other industrialised countries, loan guarantee facilities exist for small firms. Why not in the UK? A positive decision on this matter is required <u>now</u>.

We appreciate however, that a loan guarantee scheme is not the complete answer to small firm financing but if it could be introduced together with the changes advocated to make private equity investment less unattractive, we feel that considerable benefits would result.

We applaud the efforts being made by the Government to reduce inflation as quickly as possible, but at the same time deplore the failure to control public expenditure. Whilst private industry is pruning costs, similar exercises in local and central government are not obviously apparent.

In local authorities where cuts are being made, they are being carried out on consumer/service items in spite of Government requests to reduce overmanning within the town halls. Generally rates are too high and have a depressing effect on small firms.

In other areas we consider the nationalised industries seem too ready to use their monopoly position to increase charges. We would also seek a reduction in National Insurance contributions.

In broad terms, we are not seeking further grants and subsidies but a more amenable climate in which to pursue our business, to produce wealth for the country and to provide employment.

All we ask is a fair "crack of the whip" - many of us doubt whether we are actually getting it.

Despite the subjective nature of this letter, we feel very strongly about the points made and hope that you will accept them in the constructive spirit in which they are intended.

Yours sincerely

p.p.
B H WHITFIELD
Chairman

Help for the Lonely Entrepreneur

pa 84

21830

10 DOWNING STREET

THE PRIME MINISTER

CH/EXCHEQUER
REC. 16 FEB 1981

16 February, 1981

Dear Mr Ross.

Thank you for your letter of 28 January, in which you described the damaging effect which the strength of sterling is having on your export business.

I am only too well aware, from many representations that I have received, of the concern which the strength of sterling is causing to companies around this country. I know that export business is not easy at the best of times and I have been very impressed by the way in which British companies have managed to hold on to their market share.

Unfortunately, I see no quick or painless methods of getting the exchange rate down. The exchange rate is set by the market, which has taken into account our possession of oil, rising oil prices, and the firmness of the Government's resolve to defeat inflation and to rebuild the foundations for future growth. I do not think you would want me for the sake of short-term gains to abandon this attempt to overcome Britain's long-term weaknesses.

I believe that there are some encouraging signs. We were able to reduce the minimum lending rate by 2 per cent in November, and further cuts in interest rates will be made

/ as monetary

as monetary conditions and progress in inflation permit. The continued pursuit of a firm monetary policy will in my view bring lasting and substantial benefits to British industry.

I am grateful for your expressions of support and for the trouble you took to write to me.

Yours sincerely

Margaret Thatcher

Arthur Rose, Esq.

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WIDER SHARE OWNERSHIP COUNCIL

JUXON HOUSE, 94 ST. PAUL'S CHURCHYARD, LONDON, EC4M 8EH TELEPHONE: 01-248 9155 TELEX: 887521

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
London, SW1P 3AG

17th February 1981

Dear Chancellor

I have pleasure in sending you the enclosed Memorandum of Recommendations made by this Council for consideration in the preparation of your forthcoming Budget.

We shall, as usual, be very happy to come and discuss these proposals with you or your representatives at any convenient time. In the meantime we propose, unless you have any objection, to release them to the Press.

Yours sincerely

D H Gilroy

Executive Secretary

Enc.

√18/2

Top copy CH/EX Ack

CH/EXCHEQUER
REC. 18 FEB 1981
PS/IR
CST, FST, MST(C)(L)
Sir D Wass
Mr Ryrie
Mr Middleton
Mr Battishill
Mr Corlett
Mr Unwin
Mr Pickering
Mr Griffiths
Mr Cropper

WIDER SHARE OWNERSHIP COUNCIL

Budget Recommendations 1981

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In the area of savings and investment with which the Wider Share Ownership Council is concerned, the situation has not changed in any material respect during the past year. In these circumstances, the Council sees no good reason to modify the recommendations it made last year, and much of what follows - other than the technical adjustments proposed in the Appendix - effectively restates the Council's submissions of 1980.

The Council submits its recommendations against the background of a belief that a mutual understanding is needed of the part both labour and capital have to play in ensuring a successful economy. This implies that the value of capital equipment as an adjunct of labour must be appreciated, that such equipment must be used efficiently and that the providers of capital must be able to secure a real rate of return that is sufficient to ensure a ready supply of savings for industrial and commercial investment.

For the promotion of such understanding the Council believes that it is important that the savings of individuals should be channelled into investment in as direct a manner as possible so that the dependence of the rewards of savings on the success of business and industrial enterprise is fully appreciated. This is not adequately achieved at present when the tax encouragements rightly given as savings are so predominately concentrated on institutional media.

As part of the spreading of investment more widely among individuals the Council welcomes the steps already taken to facilitate worker share ownership. It recommends a number of detailed modifications designed to simplify the operation of such schemes.

In framing its recommendations this year the Council recognised that there may still be little room for any important reduction in general taxation but changes in the incidence of taxation can undoubtedly be made with advantage. The Chancellor over a year ago indicated that he proposed to tackle many of the anomalies and artificialities surrounding the taxation of capital and the income from capital. In these areas the revenue cost of changes would be modest in relation to the total budget, yet changes could have

/...

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beneficial effects on the capital market, could help to reduce the cost of capital and would be favourable to industrial and commercial activity generally.

In the light of these general comments the Council makes the following specific recommendations:

(1) The tax surcharge of 15% on investment incomes starting at £5,500 is unduly harsh. This is particularly so for individuals who out of already taxed income have accumulated and invested savings over their working life and are hoping to secure an adequate income in later years. The Council considers that the objective should be the abolition of the surcharge. It recommends as an interim measure either that the rate be halved to a surcharge of 7½% or the starting limit be raised to £10,000.

(2) The present 30% tax on capital gains continues to represent a serious levy on capital which in real terms has itself shown no gain, and indeed has frequently shown a loss. It operates, in fact, as a disguised wealth tax. While recognising the problem of complication, the Council believes that this manifest injustice can be significantly reduced by a simple combination of indexation and tapering. It recommends:-

   (a) that the starting level of the tax should be adjusted each year by reference to the movement in the retail price index for the previous year;

   (b) that the tax should be tapered by successive reductions of five percentage points in each year after the second.

(3) The Council is making no general recommendations on Capital Transfer tax. It recognises that major changes such as the replacement of an estate by a legacy tax would involve excessive complications at the present time. A simple adjustment of the tax bands to allow for inflation should, however, be made.

(4) The Council recommends that provision be made for tax relief on the net purchase of £500 of equity shares broadly on the lines of the scheme operated in France.

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This would give encouragement to small savers to invest directly in British industry and commerce, comparable with the incentives which attach to institutional schemes or National Savings.

(5) The Council considers it desirable that the stamp duty of 2% on stock transfers should be eliminated to bring equity transactions into line with Government stock transactions. As an alternative the rate could be reduced to 0.6% to harmonise with the proposed general rate in the EEC. A failure to make at least the latter adjustment must seriously penalise transactions through the London Stock Market which, with the abolition of Exchange Control, is now open to unfair competition from abroad.

(6) Now that some experience has been gained with the working of the Employee Share Participation Schemes under the 1978 Act, the Council recommends certain changes designed to secure administrative simplification. One of these relates to the handling of rights issues, one to the valuation of private company shares and two to options under an approved savings related scheme. These proposals are set out in the Appendix attached.

16.2.81

APPENDIX

1. The Handling of Rights Issues

The handling of rights issues in an approved employee share scheme under the Finance Act 1978 is unnecessarily complex, if one has to follow the present method set out in the legislation. The method does not appear to take sufficient account of the fact that every year's allocation of shares to participants is a separate "class year" in tax terms, because it involves a different period of time for working off the tax liability by continuing to hold the shares.

This necessary separation of share allocations into class years means that a process of actually handling a rights issue inside the tax net involves splitting the rights into separate small parcels relating to separate tax years and in the light of whichever of the three alternative choices is made by each participant - that is the choice between selling the rights, selling some of the rights and using the proceeds to take up the others, and thirdly, taking up the rights - allocations and disposals of shares have to be worked out for each separate year.

By contrast, if rights were to be taken out of the tax net, the rights could be bulked in one, without having to be broken up into separate class years. They could then be treated on the general share register in the same way as for other shareholders. There would of course be a tax liability, but this could be allowed for by adjusting upwards the locked-in values of the shares that remained within the tax net.

It needs to be appreciated, in the light of experience with computer systems in handling share schemes, that there is a vast difference between the simple process of adjusting locked-in values for each class year of shares appropriated to participants and on the other hand actually running through all the class years of allocations of shares to participants and allocating shares to them, rounding up and down to achieve whole numbers of shares.

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2. Valuation of a private company's shares

The Inland Revenue should consider adopting a speedier process for valuation of private company shares in a share scheme. Valuations for other purposes, such as capital transfer tax payable by shareholders, should be largely disregarded when employee share scheme valuations are being considered, for employee shares are locked in for a minimum of two years except in "compassionate" circumstances such as death and redundancy. During their locked-in period and afterwards they gradually reduce in tax liability, with the passage of time. Moreover, the amounts involved are usually small. Hence it can be argued that employee share scheme valuations need to take relatively little account of other valuations. They should be considered on a separate on-going basis.

3. Minimum Monthly Contributions for Options under an Approved Savings Related Scheme

It is quite probable that a significant number of companies will be unable to grant options under an approved savings related schare option scheme in a particular year because the total number of shares available for that purpose is insufficient to cover all the acceptances of options offered. This may arise even though the company reduces the aggregate value of options to £600 (i.e. the minimum proceeds under a SAYE Contract being 60 monthly contributions of £10 and not including the five year bonus). Except that a ballot of the acceptors is held to determine who shall be granted an option (this is unlikely to be popular with companies or employees), the offer of options would have to be cancelled in that particular year.

In order to lessen the possibility of this situation arising and to give greater opportunity for relatively low paid employees to be able to afford to save regularly and thereby be granted an option, we recommend that:

> The minimum monthly contribution under a SAYE Contract 'Fourth Issue' with the Department for National Savings and in the case of building societies, a SAYE Contractual 'Sharesave' Scheme be reduced from £10 to £5.

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If the Treasury, the Department for National Savings and the Building Societies Association feel unable to accede to this suggestion, which is of practical importance to companies wishing to encourage employees to become shareholders, then we suggest as an alternative that:

> Part II of Schedule 10 to the Finance Act 1980 be amended to explicitly allow companies to grant options (even though the aggregate value of an individual option would have to be less than £600) when there are insufficient shares available to grant all acceptors options of £600 or more in value, notwithstanding that the monthly contribution under the relevant SAYE Contract is £10 or such greater sum not exceeding £50, which the individual employee had, upon accepting the offer, stated to be his intended monthly contribution.

4. <u>Period During Which Options Can be Exercised</u>

Under paragraph 6 of Part II of Schedule 10 to the Finance Act 1980, an employee is required at the time when rights under the scheme are obtained to determine whether he wishes the five year bonus to be included or excluded (in either case a five year option would be granted) or whether he wishes the maximum bonus to be included (in which case a seven year option would be granted).

The Inland Revenue have already agreed that an employee may effectively be granted a five and seven year option lined to one SAYE Contract (for example, a monthly contribution of £10 would make possible a five year option of either £600 or £780 and a seven year option of £960). This would give him the choice of either exercising his five year option during the period of five years to five years six months following the date of commencement and automatically letting the seven year option lapse or of letting the five year option lapse and then, if he wishes, exercising his seven year option during the period seven years to seven years six months following the date of commencement.

The fundamental difficulties and complexity which paragraph 6 causes could easily be eliminated in the interests of companies

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and their employees operating approved savings related share option schemes without detracting from the essential features of share option schemes established over a number of years and as laid down in the Finance Act 1980. Accordingly, we recommend that:

> Paragraph 6 of Part II of Schedule 10 to the Finance Act 1980 be amended so that an employee is required only to stipulate the monthly contribution he wishes to make under a SAYE Contract and the aggregate value of the option he wishes to be granted being a value not less than 60 times his monthly contribution and not more than 60 times his monthly contribution plus the maximum bonus.

Further, it is recommended that to enable the full logic of the above recommendation to be put into effect, two six month 'windows' for exercising options (five years to five years six months and seven years to seven years six months) be consolidated by amending paragraph 11 of Part II of Schedule 10 to the Finance Act 1980 so that:

> An Option Holder may exercise his option at any time (within the Rules of the Scheme) between the fifth anniversary of the date of commencement of his SAYE Contract and the date being seven years, six months after the date of commencing his SAYE Contract providing that if he exercises his option before the seventh anniversary of the date of commencement, he can exercise his option only to the extent that the aggregate value of the shares at the option price is covered by the proceeds of his SAYE Contract at that time. Effectively, therefore, there would be a continuous period of two years, six months during which the Option Holder could exercise his Option in full or in part and if exercised in part, the balance of the Option would lapse.

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10, DOWNING STREET,
WHITEHALL S.W.1

With the Private Secretary's Compliments

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10 DOWNING STREET

THE PRIME MINISTER

17 February 1981

Dear Geoffrey,

You wrote to me on 8 January about a small firm of wine merchants, Dolamore Limited, who have been told by Customs and Excise that the approval of the bonded warehouse on their premises at Paddington Green would not be renewed when it expired at the end of January. I am sorry that you have not received an earlier reply; but you have probably learned that the approval has been extended while the policy in this field has been re-examined as a result of your approach.

As you will know from the letter Peter Rees sent to you just before Christmas, the paramount need to reduce the size and cost of the Civil Service means that if the Customs and Excise are to achieve their reduced manpower ceilings they cannot afford to continue the approval of small bonded warehouses when the reasonable needs of the trade for duty-free storage can be achieved more economically. Customs are adopting a uniform policy which follows consultations with the trade associations and which is described precisely in the public document which Peter Rees sent you with his letter.

Although staffing costs are important, it is also the case that the new policy is designed to meet criticisms from the trade. It provides that warehouses should be approved either where there is a general trade need which cannot be met by existing warehouses or where the warehouses meet a published minimum size requirement. This inevitably means that small warehouses such as Dolamore's which do not meet either criterion, must lose bonding facilities. Not to

/do so

do so would be to give them an unfair advantage compared with many competitors, as well as being uneconomic for the Department.

Although I am very sympathetic to the needs of small firms who contribute so much to the economic well-being of the country, I regret that it is not possible to give unconditional exemption from these rules for the company run by Mr. Bradley. However, in the circumstances Customs and Excise are now prepared to allow further time. If Mr. Bradley can submit to the local Collector, by the end of April, clear plans to indicate how the level of stocks and activity could be increased to meet the minimum requirements for continuation as a bonded warehouse, Customs will then extend the approval until 30 April 1982 to allow these plans to be realised. I should emphasise, however, that it will not be possible to go beyond this; and unless by the end of this period there has been a very substantial increase in activity, I am afraid there will be no alternative to the withdrawal of approval for the bonded warehouse facilities at Paddington Green.

I very much hope that this will not be the eventual result. In the circumstances, I hope you will agree that this is a reasonable response to this difficult case.

I am sorry to have taken so long - but I have insisted that the Treasury go over the case very thoroughly again.

Yours ever

Margaret

Geoffrey Pattie, Esq., M.P.

Mr Ridley

CST
FST
Sir D Wass
Mr Burns
Mr Ryrie
Mr Unwin

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A.R.

House of Commons
London SW1

TOP COPY CH/EX ACK LAM

CH/EXCHEQUER
REC. 19 FEB 1981
ACTION Mr RIDLEY
COPIES TO CST, FST
SIR D WASS
Mr BURNS
Mr RYRIE
Mr UNWIN

Nicholas Scott, MBE, MP

17 February 1981

N.B. also point (4) from this quarter

Confidential

Dear Geoffrey

Last year you were kind enough to see the 'Chelsea Five' to discuss the views which we had put forward in our letter of 26 February and we hope you will not think it inappropriate that we should return to the charge as you make the final preparations for the Budget which could well be vital to our electoral chances in 1983.

Last year we were worried and, despite your success in reducing inflation and in implementing a successful and necessary public sector pay policy, we remain worried. It is clear that 1981 is going to be a difficult year economically and politically and being sceptical about any imminent upturn we believe that 1982 is unlikely to see much improvement. This letter is not however a general economic treatise, which we would be ill-equipped to produce, but an attempt to express to you our worries on two particular issues - unemployment and the state of and prospects for the industrial base of our country.

As far as unemployment is concerned the trend remains alarming and it seems unlikely that we shall be able to avoid the figure reaching three million in the course of next winter; and even if we get some bottoming out in the economy it is we think common ground, and from many aspects to be welcomed, that employers are going to be reluctant to increase their workforces and, given the present level of unused capacity there should be little difficulty in achieving substantial increases in production with little or no extra labour. There will obviously be some new jobs in the service and new industries but the continuing run down of the labour intensive sector makes it difficult to envisage unemployment being below two million in time for a 1983 election unless some radical steps are taken this year.

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To achieve the sort of results we need to have we have to 'think big' in our approach to both ends of the workforce. At the younger end we need to further expand, and in particular increase the training element in, the Youth Opportunities Programme and increase the Unified Vocational Programme and thus keep a much higher proportion of youngsters off the register during the first two years after leaving school. It is however at the older end that we propose our most radical and expensive step.

We strongly recommend that the Job Release Scheme be improved by reducing the qualifying age progressively from 64 to 60. But is there not a substantial case for going further and announcing our intention of reducing the pensionable retirement age for men to 60 over a period of, say, seven or eight years? We could begin by improving the Job Release Scheme over the next two or three years and commence the move to a reduction in the retirement age in 1983 or so. We believe that this would not only help on the unemployment front but, though expensive, would be electorally very popular.

Turning to the broad industrial front our worry is that while substantial sums of money are now being provided to bail out public and private enterprises which are in trouble there is no apparent strategy designed to achieve specific objectives over the next two difficult years. We would like to see the Government announce an industrial package which would be designed to relieve corporate liquidity problems, positively encourage capital investment, assist industry in containing its costs, and aim to create an investment led recovery. The elements in such a programme might include:

(1) - of supreme importance - a further reduction in interest rates which might have the additional benefit of exercising a downward pressure on the Exchange Rate.

(2) A programme of Government support for Research and Development and associated investment. We are worried that too many companies are cutting back this area of activity in their anxiety to remain afloat but such programmes are our national seed corn.

(3) - and we acknowledge controversially - an effort to help hard-pressed manufacturing industry with its energy costs. It is no good having a blanket approach which benefits profitable banks and insurance companies with everyone else, nor should this be left to the Statutory undertakings who should concentrate on achieving commercial objectives. The Government should have powers to subsidise the energy costs of specific industries who can make a suitable case.

(4) - a negative point. No question of imposing a windfall tax on banks who are at present doing so much to help industry survive.

(5) Some help for industry in coping with the large rate increases, which seem inevitable at least in 1981/82.

(6) The abolition of the National Insurance surcharge.

Further we do urge you most strongly within the context of a sustained effort to hold down public expenditure on the consumption side, and in particular a tough, sustained public sector pay policy, to see whether something could be done about capital programmes. Borrowing to invest in sensible projects is quite distinct from borrowing to sustain consumption. The nationalised industries' investment programmes are essential elements in our recovery programme. Perhaps we may use housing as a further example. We welcome the cuts in the provision of general revenue subsidies to local housing authorities, but we query whether the massive cuts in capital programmes are wise politically or economically. We do not wish to labour the point but a new housing 'crisis' would be electorally damaging. The employment implications of restoring a sensible housing investment programme would be substantial and housing investment has previously helped us to recover from recession.

Should a new capital programme lead to a higher PSBR figure - so be it. This indicator does not, mercifully, have the same standing as it did two years ago and in any case we believe we ought to be able to present such a programme in a distinct and positive way.

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Finally, we warmly welcome the recent narrowing between the rhetoric and the reality of economic policy. We are only too aware of the difficulties and the conflicting aims which face you in what we believe to be a still deepening recession and we send you with this message our firm assurance of support in your task. As we said last year, we write as friends but very worried friends. The noun and the adjective are both valid.

In view of the scope of this letter we thought it courteous to copy it to Jim Prior, Keith Joseph, Francis Pym and also to Michael Jopling with whom you remember we first raised our worries about some aspects of economic policy.

Hugh Dykes

Charles Morrison

Bob

Robert Hicks

Nickie

Nicholas Scott

David

David Madel

Rt.Hon.Sir Geoffrey Howe QC MP.

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Geoff

10 DOWNING STREET

Private and Confidential.

17th February, 1981

My dear Geoffrey,

The Closed Shop.

The Prime Minister lunched at the I.E.A. today.

I enclose a copy of the relevant extract from Hansard (House of Lords) for 13th February, together with a copy of the Bill which Ralph Harris has in mind to introduce in the Lords.

no attached?

This Bill goes further than the kind of legislation which you suggested on the telephone this afternoon.

I have written to Ralph today, suggesting that he might get into touch with Stephen Abbott.

Yours ever,
Ian

Ian Gow

The Rt. Hon. Sir Geoffrey Howe, QC, MP.

Encs.

The Question was as follows:

To ask Her Majesty's Government whether they will make a statement on the talks between the Secretary of State for Employment and Miss Joanna Harris on the closed shop policy of the Sandwell District Council; and what steps they propose to take following these discussions.

Lord Lyell: My Lords, on 9th February, my right honourable friend the Secretary of State for Employment met Miss Joanna Harris and three other employees of Sandwell Metropolitan Borough Council who had been threatened with dismissal if they did not join a trade union. He reaffirmed his support for their refusal to give in to the council's tactics and restated his condemnation of the council's intolerant policy, and noted that NALGO is also disregarding the TUC's own guidance on the closed shop which urges tolerance. My right honourable friend went on to explain how the law now operates since the passage of the Employment Act 1980. The Government are currently reviewing the law on the closed shop in the Green Paper on Trade Union Immunities. Developments at Sandwell will be fully taken into account in the review.

Lord Harris of Greenwich: My Lords, I thank the noble Lord for that answer. First, is he aware that this closed shop policy was imposed after Miss Harris and a number of others became employees of the local authority? Secondly, is he aware that it has also been suggested that the action of the local authority is unlawful? Is that so? If their action is unlawful, are the noble Lord's department and that of the Secretary of State for the Environment proposing to warn this local authority and any others which may be contemplating equally offensive behaviour of this character that they are putting themselves at the risk of a surcharge from the district auditor? Lastly, is the Minister aware that a very large number of people in this country regard the behaviour of the local authority as absolutely outrageous in putting this young woman into the position of having to choose between her principles and joining a very, very long dole queue and that if in fact matters of this sort cannot be resolved under the present law there will be an overwhelming demand for a change in the law?

Lord Lyell: My Lords, may I reply to the noble Lord's questions in reverse order. The Government are reviewing trade union immunities so far as the closed shop is concerned in the Green Paper which is under discussion. All of us are aware of the sense of outrage and indignation which this particular case has aroused all round the country. The noble Lord asked me about a surcharge on members of the council or on the council itself. That is a hypothesis. The question of a penalty or a fine will be taken up and decided by an industrial tribunal. So far as we understand it, Miss Harris has not yet gone to a tribunal. That is her right. To the very first question which the noble Lord asked me, the answer is, Yes, the Government are aware that Miss Harris joined the council before a closed shop policy was introduced.

Lord Harris of High Cross: My Lords, may I ask the noble Lord whether he is aware of a letter which

the Secretary of State wrote to Mr. McWhirter and issued to the press on 4th February before seeing Miss Joanna Harris which, after publicly condemning the council's ruthless and inhuman closed shop policy, went on to say explicitly:

"It is quite clear that what Sandwell are proposing is unlawful under the terms of our recent Employment Act."?

May I ask the Minister whether he will now repudiate the Secretary of State and explain that in fact the Employment Act which was recently passed, regretfully, through this House without any amendment of this clause specifically licenses employers to sack employees in these circumstances and fobs them off with the possibility of compensation if they go to an industrial tribunal?

Lord Lyell: My Lords, I would not repudiate anything which my right honourable friend says. Far be it from me. I am always tempted when noble Lords quote from letters to say to them, "Read on, read on", because very often such statements are taken out of context. I do not think that the noble Lord is doing that. The noble Lord asked me about fobbing off employees. The Employment Act 1980 does no such thing. That Act strengthens the position of the employee. Under the 1980 Act, if an employee's case is proved to be conclusively in the employee's favour, at the industrial tribunal, that employee stands to gain a very large sum in compensation.

Lord Bruce of Donington: My Lords, without pressing the noble Lord further on this particular case but in the light of the review which he has announced, will he bear in mind that there are always a number of people in this country who are quite prepared to be employed at rates of pay and under conditions of work which have been gained for the class as a whole by the trade union movement without at the same time accepting part of the responsibility themselves to aid in that particular process? Will he also bear in mind that translated into purely general terms, the arrangements which are referred to in the Question have been found to be to the advantage of wide sections of British industry and have been paid tribute to many times by leading employers in this country?

Lord Lyell: My Lords, the law of this country—and, indeed, the Employment Act—does not entirely support everything that the noble Lord has said. We believe that the Employment Act has strengthened the position of each individual employee who wishes to work throughout industry in the United Kingdom, either in a union or outside it. In this particular case, Miss Harris wished to work for that authority. When she entered employment her contract in no terms stated that she had to join a union and we believe that the Employment Act 1980 strengthens the right of Miss Harris and indeed the right of every similar worker.

Lord Boyd-Carpenter: My Lords, is my noble friend aware that a right to compensation for loss of a job is not an adequate answer in cases like this, where an employee has a job of which she is fond and in which she wishes to work? Is my noble friend further aware that, if the outcome of this case is to show that this lady is to be deprived of her job, albeit with compensation, that will satisfy many of us of the complete inadequancy of the present law.

Lord Lyell: My Lords, I take my noble friend's point, but I hope he will accept that in the last resort this Government—and many others—have recognised that no Government and no law can force people to work together.

Lord Hooson: My Lords, assuming that what the district council proposed is lawful as opposed to unlawful, can we take it from the attitude of the Secretary of State towards this young lady that it is the intention of the Government, if it is found that the district council is indeed behaving lawfully, to change the law?

Lord Lyell: My Lords, I believe the question of whether it is lawful or unlawful in this young lady's case has yet to be decided, and indeed that is the very reason for which industrial tribunals exist. It is they who decide whether or not the council has acted according to the law.

Baroness Gaitskell: My Lords, can the noble Lord tell me why it is that many employers are so much in favour of the closed shop? Surely they have an argument which we should consider as well, because very many employers are in favour of the closed shop.

Lord Lyell: That well may be, my Lords, but I think the noble Baroness will recognise that that is a different question from the one which I have been asked today.

Lord Harris of Greenwich: My Lords, taking up the point made by the noble Lord, Lord Boyd-Carpenter, is the noble Lord aware that the crucial question in this case is whether this young woman can get her job back, because compensation is not enough? The central question is whether she is going to get that job back. At a time of high unemployment it is intolerable that this young woman should be put in this position by a local authority behaving in this grossly totalitarian manner.

Lord Lyell: My Lords, the Government share the feelings of your Lordships' House. I understand that it is for the industrial tribunal to decide on the merits of the case, and the industrial tribunal can require the employer to reinstate or re-employ the employee if the employee's case is found to be justified. I think that we should not pre-judge the case, nor indeed should we go on with the duties of the industrial tribunal. I understand the case will come up early next month and I think we should leave it at that.

The Lord President of the Council (Lord Soames): My Lords, in view of what my noble friend has said, I think it would be well if we were to pass on to the next business.

DRAFT of RIGHT TO WORK BILL

or EMPLOYMENT ACT (AMENDMENT) BILL

or FREEDOM OF ASSOCIATION BILL

A Bill relating to the rights of citizens to freedom of association; otherwise to amend the law relating to employees, employers, trade unions and employers' associations; to repeal the application of Section 13 and Section 14 of the Trade Union and Labour Relations Act, 1974 and for connected purposes in pursuance of the United Kingdom's solemn obligation to the European Convention for the Protection of Human Rights and Fundamental Freedoms ratified on 8 March 1951.

Be it enacted, etc.

1 (1) Any Union Membership Agreement containing any clause or provision which requires an employer to dismiss any employee or take any sanction short of dismissal against any employee for declining or otherwise refusing to join or associate with an independent trade union shall be void and unenforceable at law.

(2) Any action to secure or enforce any agreement as defined in (1) shall be unlawful notwithstanding any immunity conferred by Sections 13 and 14 of the Trade Union and Labour Relations Act, 1974.

(3) For the avoidance of doubt citizens shall pursuant to the above named Convention have the right both to join unions and the right not to join unions.

(Drafted by Norris McWhirter: 15th February 1981)

PERSONAL

pwp 165

FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR

cc Chief Secretary

PRICE BASIS OF THE SURVEY: LATER YEARS

We discussed this question yesterday with the relevant officials. We reached no firm conclusions, but it seemed fairly clear to me which way the discussion was heading.

It occurs to me, however, that before we go nap on a system which might well have to endure for another 20 years, there might be a case for your sounding out the Treasury official who is perhaps best acquainted of all with the issues at stake, but who was not able to be present at your meeting. I am thinking of course of Mr F E R Butler, who was Mr Bridgeman's predecessor as head of the GEP Group, and who was an Assistant Secretary in this group before that. He would understandably be diffident about committing himself to paper for fear of trespassing on Mr Bridgeman's territory. But I do think his views would be of considerable interest, and worth obtaining informally if a suitable opportunity can be found.

NL.

NIGEL LAWSON
18 February 1981

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10 DOWNING STREET

THE PRIME MINISTER

18 February, 1981

Dear John,

You wrote to me on 9 January enclosing a letter from your constituent, Mr R W Phelps, Chairman of the Gwent Branch of the Welsh Disabled Motorists' Club.

We have had other representations about value added tax on handcontrols for cars and, as this is the season for reviewing the boundaries of fiscal reliefs, Geoffrey Howe will certainly consider this question most carefully. You will understand that, at this stage, I cannot say anything more concrete.

Thank you so much for letting me know the Club's views.

Yours ever

Margaret

John Stradling Thomas, Esq, MP

98/2/81.

pwp

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CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (C)
MINISTER OF STATE (L)
MR NEWTON
SIR DOUGLAS WASS
SIR KENNETH COUZENS
SIR ANTHONY RAWLINSON
MR W S RYRIE
MR T BURNS
MR UNWIN
MR RIDLEY
MR CARDONA

cc Sir Lawrence Airey - IR
Sir Douglas Lovelock - C&E
Ian Stewart MP

Mr Litter
Mr Dixon
Mr Buckley

CONSERVATIVE PARTY FINANCE COMMITTEE - 17 FEBRUARY 1981

A discussion of the Scott Committee Report was led by Paul Dean MP. Fifty present.

1. Mr Dean felt that the Scott report had provided no answers to the political problem of public service indexation; nor could an answer have been expected from the Committee as constituted. Two questions remained:

i) Is comparability any longer relevant? If the Pay Research system has been suspended in respect of pay, then can it be relevant to pensions? Should we not be asking what terms are required to attract the public servants we need.

ii) What is the future of inflation proofing as such? We now have an indexed bottom tier (NI Pension & Earnings related pension). We have a top tier that is divided into three parts - public service, private pension schemes, the self employed.

2. What to do? Either abandon inflation proofing, or extend it to everybody. Mr Dean suggested a compromise solution:

i) A cut off level for public service pension indexation.

ii) Higher contributions for indexed public service pensions.

3. Lord Orr-Ewing (guest) spoke of this dreadful report.... made three recommendations:

i) Relativities should be geared to the 100 top companies, excluding banks and North Sea oil companies.

ii) Set a ceiling to indexation of 10%.

iii) Limit pensions in the public sector to, say, £10,000 pa.

It is very dangerous to rely on the judgement of one person (the Government Actuary). At least there should be a panel.

4. Robin Maxwell Hyslop. The Conservative Party has always held out against retrospection. A lot of people have accepted early retirement on the guarantee of indexed pensions. We must not go back on those assurances. Remember, in the private sector there is often the appreciation in value of a farm, a shop etc.

5. Tony Beaumont-Darke. Arrant nonsense that the captain and the crew have a lifeboat, but the passengers not. If Sir Bernard Scott had guaranteed inflation proofed pensions to his employees at Lucas Industries Ltd., Lucas would have gone bust.

6. Eric Cockeram. The government has made its problem worse by the appointment of the Scott Committee. It was inept in its choice of members. The Scottish actuary had never run a pension fund in his life - he was a life assurance man. The government must act pretty quickly to pour scorn on this report.

7. Robert McCrindle. Warned the Party of political risk. Many of the Party's most loyal workers are retired civil servants or retired headmasters. We cannot get away with de-indexing. We should

i) try to make it easier for private funds to index themselves, via indexed bonds;

ii) introduce a cut off point.

8. Chris Patten. Don't shoot the messenger. Not sure that we can write off the five million state employees. We must look at:

i) Contributions
ii) Cut off point.

9. Peter Hordern. The Scott Report made the wrong comparison. It should not have limited itself to employees' contributions. It should have looked also at employers' contributions, which have rocketed in recent years.

Indexed linked bonds are too fanciful for words. Indexation of the national debt will prevent its real value of falling over time. Solution: much higher contributions.

10. Brandon Rhys Williams. Pensions should be indexed to National Income, not to RPI.

11. Michael Hamilton. You cannot take indexed pensions away from those who have them.

12. John Browne. Took the point about retrospection; but it was quite intolerable that civil servants should get special treatment. Indexed bonds would be disastrous: the more people are insulated against inflation the less is the will and the wish to stop it.

13. Tony Marlowe. We should prevent pensioners getting more in retirement than the present incumbent of the same job receives.

14. John Watson. We should maintain past rights but, for the future, pensions should be on a commercial basis. The Commercial Union cannot sell an indexed pension contract. If they tried to, the first thing to do would be to buy their contract, the second to sell their shares.

15. Nick Budgen. We have been round this course many times. The dangerous thing about Scott is the implication that there is another way out. Indexed bonds are not a way out. They would upset the whole capital market. Granny Bonds are tolerable as a small anomaly: on a big scale they would be highly undesirable. Small firms could never borrow if index linking became a regular feature of the fixed interest market.

16. Stephen Dorrell. Would like to say a word in favour of indexed bonds. They represent an attempt to protect the capital value of past savings.

17. Sir Robert Taylor. Felt the first thing MPs had to do was to renounce indexation in their own pensions. He had put down an amendment to the Pensions Bill accordingly.

18. Peter Lloyd. The Party line, given to enquirers at Central Office during the election, was that we introduced indexed pensions and we would stand by them. At the next General Election it would be perfectly proper to change policy, but not now.

19. William Waldegrave. MPs who have bought extra years in their pension scheme would have something to say if indexing were terminated. The indexation should be related to some index of real national income, not the RPI.

20. Nigel Foreman. Agreed on a cut off point and on increased contributions. But the change must not be retrospective.

21. Paul Dean, summing up. Thought that three things had emerged.

1. There was a concensus that the government ought to do something, and do something fast.

2. It was vital to realise that Scott had concentrated solely on the employees' contribution and ignored the comparison of employers' contributions.

3. An acceptable compromise might lie in

    i) Maintaining faith with those already retired, with a cut off point if inflation goes past a certain point.

    ii) Recognising that contributions simply do not reflect modern conditions, and acting accordingly.

P J CROPPER
18 February 1981

CONFIDENTIAL

19/1/81. pwp

NOTE OF A MEETING

Record of Meeting held at No 11 Downing Street on 17 February 1981

Present: Chancellor
Colin Shepherd MP
John Major MP
Kenneth Lewis MP
David Knox MP
Mark Wolfson MP
Robin Squire MP
Keith Hampson MP
Sir David Price MP
Brian Mawhinney MP
John Hunt MP
Ivan Lawrence MP
Ian Stewart MP
Tony Newton MP

Kenneth Lewis asked what would happen if President Reagan tried to do what the UK Government had tried. If he tried to export more would this not hurt the UK economy?

Mark Wolfson said the gaping hole in the Government's strategy and the Government's presentation was the treatment of new firms: how could anyone in an area of high unemployment have any hope?

Sir David Price said that the Government was in a catch-22 situation: when reducing public expenditure the first thing done was reduce purchasing from the private sector. A considerable proportion of revenue from the North Sea was going into the old ailing industries. He had no ideological objection to money going into industry, but was it going to the right industries? The French backed successful companies with help for investment; the UK Government should be more open and discuss how our industry could be helped in a constructive way.

Ivan Lawrence said that small companies would not take on labour when the upturn came: they would just increase productivity. People should be encouraged to put their redundancy payments into starting small businesses.

Keith Hampson said that help for small companies given so far had not brought down the unemployment total. There should be more help in the form of grants, etc, to small companies in the regions who took on more employees.

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Sir David Price returned to the point that it would help to have more capital expenditure and less current expenditure by government: intelligent public purchasing was required. Also the financing of joint ventures with nationalised industries should be excluded from the PSBR.

Brian Mawhinney said he hoped for a windfall profit tax on the banks. But also banks must be told to set aside some of their profits for venture capital. Small firms should be allowed a "tax rollover" if they increased the number of their employees.

David Knox said that there were many parallels with the 1920s and 1930s. Would the eventual outcome be any different? It took a long time for the Conservative Party to live down its reputation as the party of unemployment.

Robin Squire thought that last year was the time for a bank profits tax. Banks were now doing much more to support companies. Also there were more and more public capital projects which would have to be carried out one day; labour was relatively cheap at the moment - surely this was the best time to carry out these capital schemes?

John Major said that the public had been led to believe that in dire need there would be industrial rescues, despite the cost to the PSBR; but Government were not seen as ready to spend the money to prevent industrial collapses. Small companies resented the subsidies being given to the big nationalised industries. Interest rates had now moved sharply positive: in such conditions it was very difficult to defend the continued high level of MLR.

Keith Hampson and Colin Shepherd both argued that heavy fuel oil duty should be replaced by VAT: this would lighten the burden on business.

Colin Shepherd said it was important to get the balance of the fall in inflation right. Private sector prices were down and profit margins were squeezed, while nationalised industry prices had continued to rise rapidly. But private sector profit margins would have to be restored one day and when that happened there was no prospect of a compensating slowing down in the increase in nationalised industry prices. He also argued that manning must not be artificially increased by Government subsidies.

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Finally if the Government really wanted to increase employment in small businesses the answer was to change capital taxation.

John Major thought that the real way to get small companies to expand was to reduce interest rates.

David Knox said that wage settlements had been falling in a satisfactory way, but in exceptional circumstances of high unemployment. What would happen in the upturn?

Ivan Lawrence asked why the Government did not save the £3,500 per annum paid to each unemployed person by spending this amount on capital expenditure.

GC.

GEORGE CARDONA
18 February 1981

Distribution:
PS/Chancellor
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Mr Ridley
Mr Cropper
Mr Newton MP
Mr Stewart MP

114
22464

Scottish National Party

'Pinewood',

Charleston,

Nigg,

Aberdeen.

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19th February 1981

NORTH ANGUS & MEARNS CONSTITUENCY ASSOCIATION

✓ 24/2

The Chancellor of the Exchequer,
House of Commons,
London.

Dear Sir,

On behalf of the North Angus & Mearns Constituency Association, I write to you to ask you to heed the call of the Scotch Whisky Association Information Committee not to increase the tax on Scotch whisky. As their figures show, the situation has now reached the point of diminishing returns, i.e. the increase of 50p duty in your last Budget resulted in a drop of revenue of £71m as opposed to the forecast by your Department of additional revenue of £112m.

Our concern at the treatment meted out to the industry is magnified since we are in an area of Scotland with a large number of distilleries; indeed, the area is probably second only to Strathspey in this respect. There is, for example, bulk production of grain whisky at Glenesk Distillery, Hillside, and the excellent malt of "Old Fettercairn". It serves to highten our awareness of the detrimental effect your and previous Chancellors' actions have on the industry; whisky cannot continually be regarded as a never ending source of easily collected money.

Simply to emulate the actions of your predecessors would be to add your name to the lengthy list of politicians who have regarded whisky as a bountiful provider to stock government coffers and we ask you to look at the wider issues. The industry is an employer of many workers for whom the distillery is a vital source of employment; it is efficient and, in relation to production figures, labour costs are low. In other words, it is a good example of the type of industry that your leader, Mrs Thatcher, is so concerned to promote. The product is renowned world-wide and is one of the few items by which a national image of Scotland is still fostered. The many attempts to imitate Scotch whisky indicate its desirability.

If/

Scottish National Party

If the reward for efficiency and effort is simply to be increased duty with a subsequent drop in sales, it leaves one to ponder the ethos of a supposedly free-enterprise party. The effects of that drop in sales on the small communities for whom the distilleries are vital could be catastrophic. Already many workers are on short time and this ultimately affects many others whose income depends on industries.

We therefore ask you not to impose any increase in duty in your coming Budget - not only on behalf of the Scotch whisky industry but also on behalf of all those who work or benefit from an industry whose basic sin is to have too well and thus become irresistable to countless short-sighted governments whose only interest, it would seem, is gain without consideration - a policy that must ultimately lead to loss for everyone concerned.

Yours faithfully,

William W. Fleming

Wm. Fleming,
Chairman.

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10, DOWNING STREET,

WHITEHALL S.W.1

With the Private Secretary's
Compliments

P7

10 DOWNING STREET

THE PRIME MINISTER 20 February 1981

Dear Mr. Wilson.

Thank you for your letter of 13 February about Development Land Tax and inner cities.

I will certainly ensure that the Chancellor of the Exchequer takes into account the points which you have made in reaching his Budget decisions.

Yours sincerely

Margaret Thatcher

L. A. Wilson, Esq.

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From the President
The House-Builders Federation
82, New Cavendish Street, London W1M 8AD
Telephone 01-580 5588 . Telex 265763.

Rt Hon Mrs M H Thatcher MP
10 Downing Street
LONDON SW1

LAW/JRH/PH/F.2 R18
13 February 1981

Dear Prime Minister,

DEVELOPMENT LAND TAX AND INNER CITIES

With the Budget Statement due to be made on 10 March, I am writing to draw your attention to an amendment that is urgently required to the Development Land Tax Act 1976, unless that tax is to be an instrument for sterilising private development prospects in the inner cities, New Towns and Urban Development Corporations. In view of your clear commitment which I and my members share, to the revival of our inner cities, I am sure that you would wish me to draw this to your attention, in order that you may raise it directly with the Chancellor of the Exchequer.

Stated in summary form, the problem arises because disposals of land by the public sector may not be immediately price-comparable to those in the open market; indeed, in some areas, such as the inner cities, there may be no open market with which to compare public sector disposals. Under the DLTA, the result of this lack of comparable price is that a house builder or industrial developer may agree to buy land from a local authority, at a price for which there is full public accountability. When development commences, the District Valuer may decide, for DLT valuation purposes, to impose a higher value on the land than that agreed by the parties. The developer may then discover a DLT liability that was not known or anticipated nor was it discoverable when the deal was struck and which, had it been known, may have led to the deal not being struck. Exactly these circumstances in some New Towns are currently contributing to a slow-down of disposals of New Town land, because of developers' uncertainty, and we fear that the disposals programme of the London Docklands Development Corporation could be impeded for the same reason - particularly since there is virtually no existing market there for new houses for sale, and values will need to be established by a creative partnership between private developers and LDDC.

We have proposed to the Chancellor that disposals of land by New Town Development Corporations, local authorities and Urban Development Corporations, as well as sales at arm's length at public auction or open tenders, should be automatically franked as being at full market value and should, therefore, require no further notification for DLTA purposes when subsequently developed.

.../...

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Not only would such an exemption assist your policy of inner city regeneration, but it will meet another of your objectives, the reduction of bureaucracy. The small tax losses involved in total in these cases, will be more than matched by the reduction in bureaucracy and in saving in the time currently wasted in the private sector in compliance with the DLTA, in circumstances where no DLT liability should arise. I
... enclose a copy of the paper we have sent to the Chancellor and, in view of the urgency of this matter, would ask if we could meet you to amplify our concern.

Yours sincerely

L. A. Wilson

L A Wilson
President

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The House-Builders Federation
82, New Cavendish Street, London W1M 8AD
Telephone 01-580 5588 . Telex 265763.

DEVELOPMENT LAND TAX

BUDGET REPRESENTATIONS

1. The Finance Act 1980 should have provided the Government with an opportunity to unveil its conclusions concerning the major recasting of DLTA, which it clearly perceived to be necessary in Opposition. Instead, with the exception of a well-meaning but insignificant amendment to allow for advance valuations, the amendments produced were minor. HBF had understood, and had been encouraged by Ministers in that belief, that a major review of DLT was to be undertaken as part of the review of capital taxation which was announced by the Chancellor in his Budget Statement in 1979. There has been no considered statement to indicate whether the review has taken place and what its conclusions were. The only indication of this government's attitude to the structure of DLT was the brief comment of the Financial Secretary to the Treasury on 26th June 1980, in the Standing Committee on the Finance Bill (col 958 Standing Committee A).

2. In that intervention in the Committee, the Financial Secretary drew attention to five changes made by this administration to the DLTA which, by implication, left the tax in an acceptable form. These were:-

1. the reduction in the rate of tax made in 1979,
2. the recasting of the legislation as a result of a minor amendment to Base Values,
3. the extension from one to two years of the deferral prior to first payment of instalment,
4. the introduction of advance assessments; and
5. the exemption of charities.

.../2

With the exception of the reduction in the rate, which was welcome, although it should not be forgotten that 60% is still a penal rate, these amendments do not comprise any major recasting of the tax and certainly they do virtually nothing to reduce its damaging effect on the housebuilding industry.

3. HBF again commends to the Chancellor all the points that it made in its memorandum last year and sees no reason for rewriting any of that paper, which is still fully applicable. In this paper, therefore, HBF will be reminding the Chancellor of some of the reasons for continuing to regard DLTA with dismay and will emphasise one point concerning the way in which manpower costs arising from the excessive bureaucracy of the Act can be reduced. It would appear to be consistent with government manpower and expenditure plans that any possible savings in these areas should be made and therefore whilst commending all the points that were made in last year's memorandum, a copy of which is attached, HBF emphasises the specific advantages in manpower terms of exempting certain categories of transactions from the DLTA and makes recommendations for so doing.

The origins of DLTA

4. HBF is concerned that this government has failed to carry out its promised review of the Development Land Tax Act 1976 and that it appears to have accepted it as a satisfactory piece of legislation. This is surprising, in view of the comments made by Conservative spokesmen in Opposition and also in the light of major defects of the legislation that are apparent on a comparitively cursory inspection.

5. Development Land Tax was introduced in 1976 by the Labour Government as part of its Community Land Scheme. The object of this scheme was described in the White Paper "Land" as being:-

(a) to enable the community to control the development of land in accordance with its needs and priorities; and
(b) to restore to the community the increase in the value of land arising from its efforts. (CMND 5730m para 16).

The Community Land Act 1975 dealt with objective (a) and the Development Land Tax Act 1976 with (b).

6. The two also were conceived as part of the same scheme and were complementary in purpose. They were designed to achieve a socialist solution to the ownership of development land. In that connection, it should be noted that the DLT Act was a transitional measure, designed only to deal with the problems of development gains during the period leading up to the "Second Appointed Day" under the Community Land Act, at which date;-

(a) all development land would be in the ownership of local authorities; and

(b) the basis of compensation would cease to be open market value and would become current use value.

It was never intended, even by its authors, to be a permanent measure. The rate of Development Land Tax was intended to rise from 80% to 100% as the Second Appointed Day approached, prior to disappearing or becoming redundant, (the exact details of the millennium were never, as is usually the case, entirely clear).

7. The DLT Act was confiscatory in intention and did not recognise any right to profit from the development of land, as a consequence of which, it made no distinction between "windfall" gains and gains made by entrepreneurial expertise and effort in the course of realising the development potential of land. In this, it contrasted with Development Gains Tax, introduced under the Finance Act 1974, and which was taken over by the incoming Labour Government from the previous Conservative administration. DGT did recognise the distinction and excluded land owned and developed by those holding it as stock-in-trade.

8. DLTA was and remains, therefore, part of an attack on the right to own and develop private property and to enjoy the profits from so doing, rather than a genuine attempt to deal with the problems of gains that are realised by the good fortune of inherited ownership, or by the zoning of land on a development map.

9. The Conservative Party in Opposition was clear that the Community Land Act would be repealed. It recognised that a tax on development gains, particularly to deal with windfalls, was politically necessary and, on balance, appeared to favour the retention of DLT, in a form modified

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to take account of its failure to distinguish between windfalls and gains arising as a result of skill and enterprise.

10. The 1979 Election Manifesto contained no mention of either the Community Land or the Development Land Tax Act, but there was a clear general understanding amongst all groups and interests concerned with land, that the Community Land Act would be repealed and the Development Land Tax Act extensively modified, although precisely how, was not specified.

11. This is reflected in the following passage, written by Hugh Rossi MP, then the main spokesman in Opposition on DLT matters, with whom most representative bodies including HBF has extensive consultations at the insistence of the then Shadow Chancellor, who regarded DLT as an land-policy issue. Considerable reliance was therefore placed upon Mr Rossi's assurances of amendments to come. He wrote in "National Builder", in March 1979 as follows:-

" As to the Development Land Tax, there is no outright commitment to repeal. I do not think a repeal would be acceptable"... "However, we wish to vary the Development Land Tax so that it operates in a different way, reverting to the concept of a special capital gains tax on the value added to land as a result of the granting of a planning permission. We want to side-track this difficult concept of 'deemed disposals', which makes it very difficult for any intending developer to know what his liability is likely to be before he starts his development".

12. This belief that DLT was not an acceptable solution to a Conservative administration, at least without major amendments, was reflected in the Second Reading Debate on the Bill, on 15th March 1976, both in the terms of the Opposition amendment and also in Timothy Raison M.P's careful analysis of the key shortcomings of DLT (Hansard Vol 907 No 69 col 954 and cols 960 to 963). Equally revealing are the comments of Mr Peter Rees QC MP on 27th June 1978, in the Finance Bill Committee, when he described DLT as "a badly constructed tax at a confiscatory rate" and he said, "that it might need to be recast". (Standing Committee A, 27th June 1978, col 1718).

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The failure of this government to undertake any fundamental review of the structure of DLT, as opposed to reducing its rate, is a cause both of concern and surprise to housebuilders. HBF would like to know the reason for the change of attitude towards what was always represented by Ministers of this government until taking office, as an unacceptable piece of socialist legislation.

The DLT Act - An Overview

13. The key defects in the DLT Act that affect housebuilding and to which HBF has previously drawn attention are summarised below:-

(a) DLT Act fails to distinguish between windfall gains and earned profits;

(b) Tax may be payable prior to and irrespective of any profit on a development as a consequence of the "deemed disposal";

(c) Tax payable on a "deemed disposal" on the basis of a notional value, which may often vary from the intrinsic value of the site for the development in question, according to the developer in question. The result is a higher true rate of tax than the Act prescribes;

(d) DLT is frequently a tax on inflation and conflicts with the general acceptance, since the introduction of stock appreciation relief, of the need to avoid taxing inflationary gains in the value of stock-in-trade;

(e) DLT will eventually destroy the asset structure of the housebuilding industry and will contribute to the expansion of demand for credit;

(f) DLT does not allow for development losses to be offset against development gains;

(g) There are inadequate allowances for the costs of development against gains - e.g. the cost of holding land cannot be fully included in Base Value calculations and, therefore, is not available to be offset;

(h) The tax is unreasonably bureaucratic and costly; the true cost of DLT should include not only the cost of the DLT Office, but also the cost of the time spent by District Valuers. Above all the major cost is in the senior management time in the housebuilding industry spent in compliance with the Act - e.g. there is a choice of 28 forms from which the DLTO may chose to require a developer to complete.

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(k) There is uncertainty as to liabilities until a commencement of development, because the basis of taxation of development gains is valuation at the time of a commencement. The introduction of "advance valuations" will make little difference to this, because a housebuilder still cannot discover his tax liability until he has committed himself to buying land. At that point, he may discover that the scheme for which he bought the land is non-viable by virtue solely and exclusively of DLT liabilities.

All of these points are more fully amplified in the papers previously submitted.

Reduction of Bureaucracy

14. It would be consistent with the government's wish to reduce wasteful bureaucracy if certain categories of transactions were removed from the ambit of the DLT Act altogether. We have in mind here any transactions which,as a group, involve the full range of notification by housebuilders, processing by the DLTO, reports by District Valuers and their possible assessments to tax, further negotiations but which normally result in nil liability. Clearly if there were any category of notifiable transactions which always resulted in nil liability, there would be an unanswerable case for making it a non-notifiable disposal. However, whilst these do not readily come to mind, although there may be some, it is not difficult to identify significant categories of transactions with involve substantial amounts of time and effort by DLTO, District Valuers and housebuilders and which normally result in a nil liability. These include disposals by local authorities at "best" price, (Local Government Act 1972, sections 123 and 127)disposals by New Town Development Corporations and disposals following an acquisition in an arm's length transaction where, short of criminal collusion, a full market price would normally be paid, - i.e. public auctions and open tenders.

15. In each of these categories, the overwhelming majority of disposals should result in no liability, but HBF does recognise that this is not the case in all such transactions. There may be reasons for a local authority in an inner city, in seeking to encourage developers to rejuvenate an area, disposing of land at a "best" price which may not be regarded by the DV as full market price. Equally, a New Town Development

.../7

Corporation may take a similar decision, in order to encourage development of its assets. However, HBF believes that where such decisions are taken, they reflect a view as to the price in relation to other socially desirable ends or policy objectives and that the price agreed represents the maximum price at which the housebuilder is actually prepared to undertake a scheme. Whether that is a "market" price in the eyes of the DV, it must, in reality, be the market price and the addition of a DLT liability will, and has in certain cases, result in unwillingness on the part of housebuilders to develop certain sites, (e.g. Northampton, where, because of the view taken by the DV of the value of land, housebuilders have not bid for three tracts of land put on the market by the Development Corporation). This is an example of additional liability to DLT frustrating other objects of policy which may, immediately or over the long term, return far more revenue than the tax-take.

16. In addition to making certain categories of socially desirable development difficult and also conflicting with other objects of government policy, particularly the disposal of publicly owned sites for private development, the amount of revenue raised from these relatively few cases probably does not recoup the cost of its collection; if the cost is properly assessed to include not only the time of the DLTO, DVs and local authorities, but also that of housebuilders or developers. It therefore appears that it would be prudent to write-off relatively small amounts of tax, in order to achieve two larger and more significant objectives of this government's policy;

(1) to reduce the cost of unnecessary bureaucracy; and
(2) to encourage the acquisition and development of publicly owned assets in New Towns and inner cities, where the market may not, initially, be particularly bouyant and where evidence of its prices is flimsy.

17. HBF therefore proposes that, for the purposes of the DLTA:-

(1) all disposals of land by local authorities at "best" price, as defined by Sections 123 and 127 of the Local Government Act 1972, should be deemed to have taken place at market value;

(2) all disposals of land by New Town Development Corporations should similarly be deemed; and

(3) all transactions that are clearly at arm's length - i.e. public auction, open tender, should be deemed to be at market value.

The first of these three objects can be met by an amendment to Section 18 Development Land Tax Act,to insert new sub-sections as follows:-

"18A.-(1) In relation to the deemed disposal of an interest in land which was acquired by the owner on the occasion of an earlier disposal by an authority in circumstances where that authority was under a statutory obligation (whether by virtue of section 123 of the Local Government Act 1972 or otherwise) to obtain a consideration not less than the best that could reasonable be obtained, the last foregoing section shall have effect with the modifications specified in subsections (2) and (3) of this section.

(2) Whatever the scope of the project referred to in paragraph (b) of the subsection (2) the condition prescribed in that paragraph shall be deemed to be satisfied.

(3) Accordingly, in any application to the Board under paragraph (b) of subsection (3) and notwithstanding anything in subsection (4), it shall not be necessary for the owner to specify in detail the scope of the project proposed to be undertaken."

This is indicative of the kind of amendment that might also be required to implement the two other objects.

18. It should be noted that these amendments and particularly (3) above in paragraph 17, are only required because of the failure of Section 18 of the Development Land Tax Act to operate as it was clearly intended to do by Ministers. The substitution of the <u>realistic</u> "arm's length transaction" test for the <u>notional</u> "valuation" basis for giving clearance under that section, would remove many of the anomalies that arise at present and would meet not only all the points set out above regarding the need to exempt certain disposals, but would also facilitate the operation of the Act generally.

JRH/JST
Nov 80

PMP 128

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

Rt Hon David Howell MP
Secretary of State for Energy
Thames House South
Millbank
LONDON

20 February 1981

Dear Secretary of State,

OIL TAXATION

You wrote to me today commenting on the draft minute prepared by my officials outlining my oil taxation proposals to the Prime Minister.

You suggest that I would be overstating the case to say that the industry generally accepts my proposals are justified on the basis of current North Sea economics. This must of course be a matter of judgment - as the draft makes clear - but it is not without support. The industry generally - through UKOOA - have gone as far as volunteering £1000m next year, with the prospect of more to come in future years from the reform of PRT they propose. Individual companies have gone out of their way to stress that their preferred solutions - for example Shell/Esso's "advance PRT" scheme - are capable of raising at least as much as my own proposals : some have even suggested that I could raise more than £1000m in 1981-82 if I wished. And you will recall that Dr Hammer was prepared to accept my revenue objectives.

I fully accept that the industry has argued that my objectives are better reached by other means, and that individual companies have objected to the impact of my proposals on their own finances. But my impression remains that the industry has made little serious attempt to argue that the North Sea as a whole cannot stand the extra revenues I propose to take.

So far as the new tax advance payments proposals are concerned, I recognise your concern about the effect of these proposals on industry cash flow. But I do not think these disadvantages

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can outweigh the benefits to monetary management which will be secured, particularly if - as seems quite likely - it proves impossible to develop a workable advance payment system for PRT. We are agreed, of course, that the detailed machinery needs to be modified to take account of hard cases, and our officials will be in touch on this.

Finally, the tactical question whether to introduce the PRT proposals in the Finance Bill as published, or to seek clearance with the US authorities first. I have considered your preferred course - prior clearance - carefully, and I would certainly find it attractive if we could be reasonably confident that the US authorities would give us a quick and favourable response. As it is however, we would be very lucky to have any response to a "competent authority" approach in time for legislation in this year's Bill: after the recent pressure from US companies, the US authorities would feel obliged to look at the matter very thoroughly, and experience suggests that could take many months. And if the eventual response were adverse, I am not sure that it would be easy to modify my proposals to retain creditability without losing the substance.

The risk is, therefore, that we would find ourselves a year or more hence no further forward, facing the choice between dropping PRT changes or renegotiating the treaty. In the meantime, the industry would face a long period of uncertainty; and we would find it difficult to conceal that our preferred PRT measures were in abeyance, waiting on approval from the US.

On balance, I am sure it is right to press ahead with legislation now.

I enclose a copy of the minute I have sent to the Prime Minister: you will see that it has been amended to take account of your position on the new tax advance payment and on the "US credit" aspects.

Copies go to recipients of your letter.

Yours sincerely

P. S. Jenkins

(Approved by the Chancellor of the Exchequer and signed in his absence)

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RAC Motoring Services

83 Pall Mall
London SW1Y 5HW
Telephone: 01-839 7050

TOP COPY CH/EX ACK

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REC. 24 FEB 1981
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✓ 24/2

JAW/CL

23rd February, 1981

The Rt. Hon. Sir Geoffrey Howe, QC MP
Chancellor of the Exchequer,
The Treasury,
Treasury Chambers,
Parliament Street,
London SW1P 3AG.

Dear Chancellor.

MOTOR TAXATION AND ROAD EXPENDITURE

The RAC wishes to submit for your consideration - before decisions are made about taxation changes to be announced in your next Budget Statement - the following observations concerning the need to give motorists and motor cyclists "better value for money" in regard to motoring taxation and road expenditure.

Motor Tax Income

The revenue from motor taxes is expected to reach a record total of more than £7,000 million in the current financial year. If the taxation rates should not be lowered, it must pessimistically be predicted that the income to the Exchequer from this source will be very much more during the next financial year.

The national traffic mileage has been increasing each year and the national consumption of motor fuel has still been rising, in spite of progress to make new vehicles more economical in regard to fuel consumption and other energy conservation measures such as the authorisation and encouragement of car sharing.

Continued growth of the fuel consumption and the Government's income therefrom seems to be inevitable. Regrettably, increases of other ingredients in the price of motor fuel are expected and this will automatically raise the Government's "windfall gains" from the 15% VAT in the retail purchase price. Cuts in public transport services are causing greater use of private transport for very many essential purposes and this will also contribute to the predicted traffic growth.

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Road Construction Expenditure

With road expenditure taking more than its fair share of the cuts in public expenditure necessitated by the current economic situation, it is difficult to understand how the Secretary of State for Transport justifies statements that the situation in this respect is no worse than previously. In any event, however, deferment and abandonment of urgently required new road schemes - including even vitally important motorway routes to ports - demonstrates to motor vehicle users how the benefits which they obtain from the Government's road expenditure are undeniably being reduced.

There is increasing concern about the effects of such a policy on the future requirements to facilitate economic, safe and convenient movement of the forecast greater volumes of traffic in the years ahead. Cutting back the preparation of schemes for the future could result in "running out of roads" which will be ready for construction.

The British Road Federation estimates that the Government's annual total expenditure on trunk road construction and maintenance is now about £480 million. Together with local road construction and maintenance expenditure, the total national expenditure on roads is less than £1,800 million - with a continually decreasing trend in spite of the ever-increasing immense revenue from motoring taxes.

As stressed by the RAC in evidence to the Armitage Inquiry on Lorries, People and the Environment, improvement of the national road system is urgently required - regardless of the controversial decisions to be taken about the permitted size and weight of the heavy commercial vehicle - in order to minimise accident risks and the inconvenience experienced by all other vehicle users when sharing inadequate space on congested out-of-date main roads with the large lorries. Therefore, the RAC urges the Government to implement as quickly as possible the welcome recommendation in the Armitage Report that the "continuous process in recent years of reducing both actual expenditure on road building and the share which it takes of total public expenditure has been shortsighted and should be reversed. This should be a consideration for central Government not only in deciding expenditure on its own roads but also in allocating money for local roads".

This view has been supported by recommendations in the recent report by the Select Committee on Transport in the House of Commons - following its investigation of the White Paper on Roads in England - that "capital investment in new roads should receive a high priority in the Government's allocation of resources when modest increases in public expenditure again become feasible".

Road Maintenance

The serious results of lack of sufficient resources for road maintenance for many years are becoming more apparent. With

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extremely heavy expenditure necessarily being incurred on maintenance - or virtually reconstruction - of the older sections of the motorway network, there is anxiety that the remainder of the main road network will suffer as a result of inadequate expenditure on essential maintenance work.

Many complaints are received about the spreading deterioration of other minor roads. Financial stringency is causing drastic reduction of minor improvements of roads which make valuable contributions to road accident prevention. Another adverse effect on safety is the cutting of expenditure on maintenance of traffic signs and carriageway markings - which tends to be at the lower end of the priorities list when funds are limited.

As a result, much of the national road system is rapidly becoming visibly dilapidated. This is detrimental to the amenities enjoyed by residents in the United Kingdom. It also creates an extremely unsatisfactory impression of this country's attractions to the many visiting motorists from the Continent. As stated recently by the British Travel Association, there were over 1.4 million motoring visitors last year and such tourism provided a welcome huge annual contribution (estimated at £300 million) to the balance of payments.

Motor Tax Income Attributable Public Road Costs Ratio

Official statements have revealed that the ratio of motor tax income and public road costs attributable to the use of cars and motor cycles - now 2.8:1 - has been steadily increasing during recent years. The RAC hopes that you will be willing to reduce motor taxation rates to prevent continuance of this rising trend and/or to increase substantially the grossly inadequate national road expenditure in order to achieve the desired result.

Road Investment

Whilst recognising the need for the Government's current policy to restrict public expenditure, the RAC wishes nevertheless to restate its contentions - as submitted to successive governments for many years - that greatly increased road expenditure is essential, particularly to assist trade and industry to achieve economic prosperity. This should be regarded as unavoidable capital investment in an indispensable national asset required for such purposes.

North Sea Oil

It has been pointed out previously that motorists fail to understand why they seem to receive none of the advantages to be gained from our North Sea Oil - with ever-increasing petrol prices and rising taxes thereon. There might be less resentment of this if they could see "a light at the end of the tunnel" - for instance, if arrangements were being made for some of the income from North Sea Oil to be used to implement plans for the urgently required expansion and improvement of the highway system to benefit all road users in the years ahead.

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The RAC strongly supports the recent representations by the British Road Federation recommending allocation of a substantial proportion of income from that source to capital expenditure on improvement of the road transport infrastructure. This would be a progressive measure to equip the country with better facilities to achieve future economic prosperity instead of allowing such resources to "disappear down the drain" without retention of any long-term assets accruing therefrom.

It would be some consolation to Britain's long-suffering excessively taxed motorists using the over-congested highways if the Government would initiate comprehensive plans - with guaranteed finance - to complete an efficient main road network within a fixed period. The resultant reduction of fuel consumption and of road transport costs - achievements which have been effectively demonstrated where new roads have been built - would benefit all road transport users and would stimulate the national economy.

Car Radio Licences

Whilst making representations about motoring taxation generally, I wish also to bring to your attention the strong opposition by the RAC to the recent suggestion by the Chairman of the BBC that a licence fee - at a suggested level of £10 per annum - should be reintroduced for car radios. In addition to the objections to such a tax because it would require expensive arrangements for bureaucratic administration and enforcement, it must be stressed that such unfair discrimination against car radio users - without any equivalent licence fee applicable to the use of radios elsewhere - would incense the motoring public who would rightly regard this as another unjustifiable increase of their already excessive taxation liabilities.

Employment Benefits

Press reports have suggested that you may be giving further consideration to alterations of the current liabilities relating to taxation of the benefits from private use of cars when these are provided by business concerns to employees for use in connection with their employment. The RAC's views about the principles to be taken into consideration relating to any contemplated alteration of the requirements in this connection have previously been made known to the Inland Revenue, in response to the Consultation Document issued in 1979. The views expressed at that time are still maintained.

Motoring Expenditure - Cost of Living

In spite of representations made by the RAC prior to your 1980 Budget Statement, the Vehicle Excise Duty was raised by 20% and 10p was added to the tax on each gallon of petrol. Therefore, I consider that it is appropriate to repeat some of the concluding observations in my submission to you last year and to state that such views are expressed now even more vehemently than in previous years.

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Private transport is largely used for essential purposes - including trade and business operations and for a high proportion of journeys travelling to and from work, especially when public transport services are not readily available, for instance by shift workers and residents in rural areas. It should also be recognised that use of private transport for leisure purposes makes a major contribution to the quality of life for a high proportion of the population. Greater restriction of opportunities to obtain enjoyment in this way, due to further increases of motoring taxation, would be resented - especially by car users in the lower income groups.

The 1979 family expenditure survey published recently has shown that transport expenditure is the third largest item in family budgets - after food and housing - the proportion having risen to 13.9% in 1979. It also reveals that 80% of transport spending is devoted to the purchase and running of cars.

Moreover, transport costs are a major ingredient in the prices of nearly all services and commodities. Therefore, any measures to raise motoring costs would have adverse effects on the cost of living and conflict with the vitally important objective to lower the level of inflation - whereas lower motoring taxes would help to achieve this aim.

Conclusion

I very much hope that you will give sympathetic consideration to the RAC's views which I have expressed and that decisions to be taken shortly, in regard to both motoring taxation and road expenditure, will give Britain's 25 million motor vehicle licence holders - most of whom drive cars or ride motor cycles - a much better deal than in earlier years.

Yours sincerely,

J A Williams

J. A. Williams
Chairman
Public Policy Committee

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10, Downing Street,
Whitehall S.W.1

With the Private Secretary's Compliments

10 DOWNING STREET

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THE PRIME MINISTER

25 February, 1981.

Dear Fergus,

Thank you for your letter about the enquiry from your constituent, Mr. Langley. I am happy to endorse the proposition that people employed by prosperous, profitable companies should also prosper and profit along with them. The object of our economic policies is to create the conditions in which companies can make profits and prosper and everyone associated with them can reap the benefits. Employees have an important part to play in making their companies efficient and competitive, not least by pitching their pay demands at a level which the company can afford while remaining profitable - and not expecting wages to rise faster than productivity.

Yours ever,

(SGD) MT

Fergus Montgomery, Esq., M.P.

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SIGHT AND SOUND EDUCATION LTD

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25th February 1981

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
The Treasury,
Parliament Street,
London SW1.

Dear Chancellor,

VAT on Training

I should like to bring to your attention an instance of unfair competition between the public and private sectors in the provision of vocational training.

Under present regulations, the provision of training by private colleges is subject to VAT, while the provision of identical training by public sector colleges is free of VAT. This would not matter so much if the private and public sector colleges were not in direct competition for the same market; but they are, and the present difference in their VAT treatment is clearly wrong.

Perhaps it would help if I illustrated this unfairness with the case of my own Company.

Sight and Sound Education Limited, a British Company, is the largest clerical training organisation in this country, and indeed in the world. In the UK we have eight colleges in London, Bristol, Birmingham, Manchester, Liverpool, Glasgow, Edinburgh and Leeds. In addition, we sell complete keyboard training systems to Government Departments, the Armed Services, the Police and commercial organisations. You will, for instance, find Sight and Sound in the Bank of England and the Foreign Office, though not, alas, yet in the Treasury! Outside the UK, Sight and Sound systems are currently used in 36 countries, and our courses are translated into 17 languages.

In our colleges here in the UK, we train students in keyboard skills, shorthand, book-keeping, and general clerical and secretarial duties. Some of our students pay their own fees; some are sponsored by their employers; and in addition we have become the largest private providers to the Manpower Services Commission under the TOPS and YOPS programmes.

In recent years, Sight and Sound has taken a large share of the TOPS and YOPS clerical and commercial training. The reason for this is the cost effectiveness of our intensive courses by comparison with those offered by the public sector colleges.

contd....

I enclose a copy of a study on cost effectiveness which I carried out last year. Although the actual fees charged have changed slightly since then, the differential between our fees and those of the public sector colleges has actually widened. You will see that we train a complete beginner up to the full commercial standard required by a TOPS shorthand-typist in 14 weeks; Colleges of Further Education produce the same standard in 36 weeks. Taking everything into account, therefore, it costs the taxpayer approximately three times as much to train a shorthand-typist at a College of Further Education as at a Sight and Sound College.

However, although this advantage of the private college holds good as far as the taxpayer is concerned, the gap is closed considerably as far as TSD's budget is concerned, since TSD has to pay VAT on the fees we charge, but not on the fees charged to it by the public sector colleges.

In England and Wales in 1980/81, TSD estimates that the average weekly fee paid by them for TOPS support for shorthand-typists and office machine operators in both private and public sector colleges is £40.96. This includes VAT. Excluding VAT, Sight and Sound's average weekly fee to TSD is £33.52. This gives us a very pronounced price advantage, even on the weekly fee. However, when VAT is added to our gross weekly fee, it becomes £38.55, and the advantage is greatly reduced.

Unfortunately, it is not only in competition for TOPS and YOPS training that the incidence of VAT is unfair. Colleges of Further Education also compete with private colleges for private students and Company training. Here again, the absence of VAT from their final price gives them an unfair advantage.

Please do not think that this is the usual moan of a Company wishing to have some special exemption from VAT. Sight and Sound is well able to compete effectively even under the present unfair incidence of the Tax. We are extremely successful; we have demonstrated our ability to win round after round in the battle with the public sector colleges. However, VAT does undoubtedly increase the price of training for those people who wish to buy it from a private sector college and pay for it themselves, rather than buy it from a public sector college or wait for the Government to provide it for them. I am sure the Government shares my view that wherever possible it is better for the citizen to pay for his services himself rather than have them paid for by Government. It is, therefore, crazy that when he does so he should be taxed on it, whereas when he accepts the service from the State or purchases it from a State provider no Tax is levied.

I trust that you will remove this unfairness in the forthcoming Budget.

Yours sincerely,

John Pardoe

John Pardoe
Managing Director

Encl:

Tim — To hke.

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25th February 1981

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The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
The Treasury,
Parliament Street,
London SW1.

Dear Geoffrey,

I enclose a formal letter submitting a plea for the removal of the unfair incidence of VAT on private vocational training. Since you can almost certainly not afford to lose any revenue, and since we both support the widest possible incidence of VAT, it will not be lost on you that there is more than one way of setting this unfairness to rights!

With best wishes,

Yours very sincerely,

John Pardoe

Tx v.m. for yr letter //

Quite aside from the VAT q'n — & clearly I must remain non-committal on that — I am most grateful for the opportunity to consider the other broader implications [illegible]

In any case, it was good to hear from you again [illegible]

with very good wishes

The [illegible] appears to contain some useful [illegible], which cd. be far-reaching [illegible].

Copy to CST + other [illegible] etc.

X (Also send a copy, with my comments, to Arthur Seldon, Instit. of Econ Affairs

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10, DOWNING STREET,
WHITEHALL S.W.1

With the Private Secretary's Compliments

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10 DOWNING STREET

From the Private Secretary

26 February,1981

You wrote to the Prime Minister on 29 January about action taken by the Inland Revenue to obtain payment of overdue PAYE tax and National Insurance contributions from your company.

Mrs Thatcher is, as you would expect, very much aware of the cash flow problems which some small businesses are facing at the present time, and she fully understands your concern that the Inland Revenue, in these difficult circumstances, should not adopt a heavy-handed approach to the collection of tax arrears. Mrs Thatcher has asked me to explain, however, that although the Inland Revenue are normally prepared to consider allowing a little latitude over payment of tax in general where an employer or taxpayer is facing a special financial difficulty, this would seldom be appropriate where PAYE tax deducted from employees' pay is concerned. Amounts due under the PAYE system are looked upon as being different in kind from, say, a company's tax on its profits, representing as they do that element in the total wages bill which the employer has held back on behalf of the Exchequer from the wages and salaries paid to his employees. In view of the nature of the liability, therefore, the Collector is bound to expect that PAYE deductions should reach him promptly according to the timetable which the law lays down. The date for payment is, as you will know, set some two to six weeks after the deductions are made from employees, and it does not therefore seem unreasonable that where there is a persistent failure to pay by the regular monthly dates recovery action may well be the eventual result.

The Inland Revenue have told Mrs Thatcher that your company has regularly been late with its monthly PAYE remittances for some time now, payment being delayed, on occasion, by as much as a month. They go on to explain, against this background, that the instalment due from your company for month 8 of the 1980/81 deduction year, which should have been in the Collector's hands by 19 December last, was still outstanding on 7 January. The Collector, therefore, spoke by telephone to your company on that day, ascertained the extent of the arrear and indicated that prompt payment was required. He also took the opportunity to ascertain the sum due for month 9, i.e. for deductions up to 5 January, payable before 19 January. On the same day, he wrote to you and warned you that the amount due for month 8 should be paid by 19 January if distraint proceedings were to be avoided; he went on to explain that in the event of a delay

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in payment of the further amount due for month 9, he would have to consider taking distraint action to recover it also. The Collector received your company's remittance for month 8 on 13 January, but the sum due for month 9 was still outstanding by 28 January, and he was therefore left with no real alternative but to put in train the recovery action by distraint that he had mentioned in his letter. In the event, you were able to pay the Collector when he called on you, and no further action proved to be necessary.

Mrs Thatcher appreciates that the measures taken by the Inland Revenue to obtain payment of these tax arrears will not have been welcome to your company, but she has asked me to point out that an employer who retains his employees' PAYE deductions after the date on which they are due is, in effect, financing his trading operations by means of an interest-free loan of public money. The Inland Revenue would plainly not be justified in allowing such a situation to continue and Mrs Thatcher does not feel, therefore, that the Collector was exceeding his proper duty in your own case.

Mrs Thatcher is sorry to have to send a reply which she realises you are bound to find disappointing, but the law is quite clear about when PAYE tax shall be paid, and her view is, I am afraid, that if your company finds the attentions of the Collector unwelcome, the remedy really lies in its own hands to ensure that these deductions are remitted at the proper time.

M. A. PATTISON

G G Goldsmith, Esq

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