PO-CH/NL/0046
PART A

SECRET

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PO -CH /NL/0046

PART A

1986 BUDGET
MISCELLANEOUS PAPERS

DD's 25years 26-01-95 NAgig

PO -CH /NL/0046
PART A

STARTS: 3-10-85
ENDS :- 11-02-85

CLOSED
C[illegible] ON:-
P[illegible] B

B/f 11/10 ~~PA~~

PA chase Gary McKenzie for reply

TK. ~~PA~~ SHOULD BE WITH US TODAY TONY L 11/9

Historic Houses Association

38 Ebury Street London SW1W 0LU Telephone: 01-730 9410 / 730 9419

From: The President

Rockingham Castle
Market Harborough
Leicestershire LE16 8TH
Tel: (0536) 770240

HHA.S4

3 October 1985

CH/EXCHEQUER
REC. 4 OCT 1985 4/10
ACTION Mr McKenzie (for Cx reply)
COPIES TO

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1

Dear Chancellor,

My colleagues and I are very grateful for the support you have given to the heritage in a number of ways this year. In particular, we were delighted that you were able to raise the ceiling on acceptance in lieu by allowing the public expenditure Reserve to be drawn on for large heritage items offered to the Nation.

At a more detailed level, I should like to thank you for the steps taken in the Finance Act 1985 to deal with the problem of conditional exemption from CTT of adjoining land as set out in Schedule 26 of the Act.

There remain a number of important areas where the impact of capital tax is still working against the heritage. The Appendix to this letter covers those to which we hope consideration may be given for action in 1986. They are designed to encourage the establishment for inter vivos maintenance funds, to ease a particular problem caused by trust law, and to encourage the retention of works of art in this country.

I commend them for your attention.

Yours sincerely,

Michael Saunders Watson

Enclosure.

Ch

Perhaps best to refuse a press statement?

AWK
25/10

Yes / but not a joint statement!

C

Somewhat belatedly, I sought advice from IAE and Robert Culpin on the question of a press statement.

Both recommend that you do not agree to this – firstly, because it is supposed to be an <u>informal</u> lunch and secondly, because it may well cause the press to come back after the lunch and ask what was discussed.

Are you still content for the Retail Consortium to issue a press release, subject to it being vetted by you in advance?

D
25/10

CHANCELLOR OF THE EXCHEQUER

Peter Lilley if he wants, Also Tony

C

1. You have already said you would take Nick Monck and presumably Tony?

2. Would you be content to have a photocall? Yes

3. Presumably you would wish to see any such press statement in advance? Yes.

N

D
21/10

Appendix to the President HHA's letter to the Chancellor
dated 27 September 1985

HERITAGE POINTS FOR THE 1986 FINANCE BILL

1. Maintenance Funds for Historic Building etc.

The HHA is concerned that maximum encouragement should be given to the setting up of inter vivos maintenance funds. These have the merit of establishing the designation of the property and agreeing the undertakings for maintenance and public access at an early date thus simplifying any problems that might arise later on a death or transfer when the length of time needed to process such claims becomes more critical.

It is a fact that relatively few maintenance funds have been set up and a survey has recently been conducted among HHA members to investigate the cause. A principle reason which emerges from the survey is that owners are reluctant to tie up assets in a maintenance fund unless they are actually faced with a CTT charge. Notwithstanding the relief from CTT however there are still a number of other areas where the effect of taxation is specifically inhibiting the setting up of inter vivos maintenance funds. These can be summarised as follows:-

a. The additional rate of 15% on income from the Maintenance Fund.

b. The building in of a latent liability for CGT following a transfer under S.79 of FA 1980.

c. The fact that indexation relief for CGT under S.68 of FA 1985 will not apply to assets transferred under S.79 of FA 1980 after 31 March 1982.

2. Removal of Additonal Rate from Maintenance Fund Income

S.38 of FA 1978 introduced a provision which allowed trustees of a maintenance fund to elect for the income to be treated as their own and to be taxed at the standard rate plus 15% additional rate. It is understood that the thinking behind this was to bring the treatment of income from maintenance funds into line with that of discretionary trusts. A maintenance fund is not truly discretionary however as the income cannot be applied otherwise than for heritage purposes. It can never be withdrawn for distribution to an individual and the argument that the additional rate compensates for the marginal rates of tax of an individual while in the hands of trustees is therefore invalid where a maintenance fund is concerned. Indeed it serves only to reduce the income available to be spent on the heritage property.

...../2

Furthermore, when capital is withdrawn from the maintenance fund there is a penal charge on all accumulated income of a further 30% under S.52 of FA 1980, making a total charge at current rates of 75%; 15% more than the maximum rate of income tax chargeable on an individual.

It is felt that there is now a strong case for the removal of the 15% additional rate on the income of the maintenance fund where the trustees elect for it to be treated as their own. This would undoubtedly be a major incentive for the setting up of inter vivos maintenance funds.

3. Capital Gains Tax (CGT) - 'Up Date' on Death of Maintenance Fund Settlor

When an inter vivos transfer into a maintenance fund is made under S.79 FA 1980 the latent liability for CGT at the settlor's original base cost also passes to the fund, giving rise to a situation which compares very unfavourably with a maintenance fund under will where the base cost for CGT is updated to probate. The imbalance is accentuated where, as is often the case, the assets in question are land which has been held by the settlor prior to the large rise in values which occurred in the mid 1970's.

In an attempt to deal with this problem and place inter vivos funds on the same basis for CGT as settlements under will, a new clause was tabled to the Finance Bill by Mr Timothy Eggar, and debated on 18 June 1985. The object of the clause was to treat the settlor of a maintenance fund for the purpose of CGT as if he were the life tenant of the settlement, following the parallels that exist with income tax. The clause was supported by Mr Terry Davis for the Opposition. The Minister, Mr Barney Heyhoe, was not persuaded that there was a case for such a change and it was left that further consultations would be held to establish the extent of the problem.

It is now clear that this is a problem and it is the Association's opinion that the 80 applications so far made to set up maintenance funds would be markedly increased if this measure was enacted.

4. Capital Gains Tax - Indexation Relief

S.68 of FA 1985 allows indexation for CGT for property acquired prior to 31 March 1982 to be based on its value at that date, provided the property was held by the person making the disposal on that date.

Unfortunately, for all property transferred by gift and 'held over' under S.79 of FA 1980 after 31 March 1982, as from the date of the gift (although not from 31 March 1982 up to that date), the property will continue to have the transferor's original base value as the reference point for indexation.

...../3

This is, of course, a problem which applies to all gifts, but it has particularly serious consequences for heritage property by providing yet a further disincentive to the settlement of inter vivos maintenance funds. At the report state of the 1985 Finance Bill an amendment was introduced to deal with a similar problem for husbands and wives and transfers within groups of companies but it did not deal with gifts where roll over relief has been taken. It is hoped that this apparent oversight can be corrected in the next Finance Bill.

5. Capital transfer Tax (CTT) - Settlement of Maintenance Fund on the Death of a Life Tenant

Problems continue to be experienced through the inability of trustees of a strict settlement to vary the settlement in favour of a maintenance fund unless action has been taken during the life of the life tenant. This point has been made by the Association on a number of occasions and has been the subject of correspondence between the President and the Financial Secretary, Mr John Moore.

It is essentially a practical problem and affects a considerable number of heritage properties. It is not just a question of reluctant life tenants and dilatory advisors; there is the very real problem of establishing the precise position that may obtain in advance of the life tenant's death, to say nothing of the length of time and expense of going to the Courts. Leading Lawyers and counsel concerned are all agreed that if this provision had been included with the other maintenance fund measures in FA 1980, the complications surrounding Calke Abbey and Weston Park, with the associated heavy public expenditure subsequently required, need never have occurred.

The Association will be seeking a meeting with the Revenue to raise this issue once again in the hope of action in the next Finance Bill.

6. Capital Transfer Tax - Interest on Acceptance in Lieu (AIL)

While welcoming the lifting of the ceiling on acceptance in lieu, the Association remains concerned that interest on outstanding CTT continues to run throughout the protracted negotiations involved. Much of the delay is no fault of the taxpayer and it seems entirely reasonable to suggest that where negotiations for acceptance in lieu are successfully concluded, interest on the CTT to be satisfied by the object in question should cease to run from the date on which the offer was first made.

...../4

With the delays involved, in the AIL procedures and the resulting interest which accumulates, there is a strong temptation to settle a tax bill by selling in the open market which almost certainly means that the object will go to a foreign purchaser.

The simple formula proposed would do much to redress the balance and encourage more use of AIL which will help retain our important works of art in this country.

7. Taxation of Works of Art

Last year the Association put forward two other proposals which were designed to encourage retention of works of art in this country and which were debated at the committee stage of the Finance Bill. The then Chief Secretary acknowledged that there was a problem which must be addressed, and he suggested that diminishing the fiscal penalty for taking the assets out of a state of conditional exemption was not the right approach; an attempt should be made to produce a solution that would command a wider acceptance. It would not be right, therefore, to bring these proposals back, before the Association has had a further chance to discuss will all interested parties the alternatives which were considered and rejected in 1984 and others which may yet occur.

ANNEX C

2/122 rec'd 9/10/85

CH/EXCHEQUER

REC.	7 OCT 1985
ACTION	MR GARDINER
COPIES TO	CST, FST, MST, EST
	SIR P MIDDLETON
	MR MONCK

Miss Henderson
Could you consider
7/10

10 DOWNING STREET

4 October 1985

From the Private Secretary

Dear Edmund,

BUYING BRITISH

As I mentioned to you, Lord Sieff saw the Prime Minister to describe to her the personal campaign he has been waging to persuade large companies to buy more from within the UK. He has been talking to senior staff, asking them to review their purchasing practices. He told the Prime Minister that he thought his personal efforts had been taken as far as they could go, but that they had produced useful results and would be worth trying in a broader range of companies.

The Prime Minister was enthusiastic. After some discussion it was agreed that a useful approach might be for the Prime Minister to host, say, a lunch or dinner for 10 or so senior businessmen from a range of industries, picked for the probability that they would be sympathetic. The aim would be to consult them about how best to take the initiative forward. The Prime Minister said she would be willing, if that seemed the right thing to do, to host a larger gathering at which companies who had successfully changed their buying practices could explain to others the changes they had made. Journalists might be involved at that stage.

I should be grateful for your advice on this general approach.

Names mentioned as possibilities for the initial gathering were (I may not have the titles right): Sir Alex Alexander, Sir Hector Laing, Mr. Gardiner (Metro-Cammell), Mr. Carter (Darlington and Simpson), Sir Eddie Nixon, Sir Basil Feldman, Mr. Peter Black, Mr. John King (of Babcock's). I should be grateful for your suggestions on this aspect too.

I know that the Prime Minister will want to push on with this. Could I have your advice please by close of business on Thursday 10 October?

I am copying this letter to Tony Kuczys (HM Treasury).

Yours,
David

David Norgrove

Edmund Hosker, Esq.,
Department of Trade and Industry.

ANNEX C

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

JC309
Secretary of State for Trade and Industry

Vice

PS cc. Mr Redley
Mr R. Jones
Mr Tyler
J. Henderson

14 October 1985

RESTRICTED

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

15/10

14 OCT 1985

Mr Burgner
CST, FST, MST, EST
Sir P. Middleton
Mr Monck

Mr Shaw

Dear David

IMPORT SUBSTITUTION: LORD SIEFF

Thank you for your letter of 4 October about Lord Sieff's personal campaign to persuade large companies that with a little effort they could buy more within the UK without sacrificing value for money.

Lord Sieff discussed his ideas with Mr Tebbit earlier this year at the start of his campaign. Mr Tebbit warmly welcomed his initiative, which is of course a far cry from 'buy British' pure and simple, and involves using private sector purchasing power positively to promote UK industrial competitiveness. Indeed if a tag is needed for this, we would prefer some such phrase as 'Positive Purchasing' to 'Buying British'.

In the light of this my Secretary of State would be delighted if the Prime Minister were to host a function with a small group of sympathetic businessmen to discuss how to build on Lord Sieff's work. He thinks that such a function could be of considerable value, and if the Prime Minister so wished, he would be very happy to take part.

The only reservation we would enter is that the larger and more public gathering you mention as a possible second stage will need careful handling if it is not to be seen as a direct and overt policy by Government to promote import substitution and thus fall foul of our EC and GATT obligations. One way of avoiding possible difficulty might be for Lord Sieff and a few others in the private sector to organise the second meeting with the Prime Minister as a guest of honour rather than host. A similar point arose recently on Sir Basil Feldman's proposal for a seminar at No 10 on 'Better Made in Britain' which I believe is planned for 12 February next year. You may like to look at the letter of 5 September from Andrew Lansley in reply to Mark Addison's letter of 23 August. Colin Budd (FCO) also commented on the same point in his letter of 6 September.

There is also a need to bear in mind the relationship between Lord Sieff's initiative and Sir Basil Feldman's work on import substitution. The best way forward on this is probably to invite Sir Basil to the initial gathering, and we are pleased to see that his name is already on the list of possibles.

We need a little more time to give you our considered view on the question of which other people might be invited. I shall write to you again in the next day or so on this.

I am copying this letter to Tony Kuczys (HM Treasury).

Yours ever

Edmund Hosker

EDMUND HOSKER
Private Secretary

~~But the IFS to ensure ... 'help'~~

~~Prmp~~

c/ I asked Peter Cropper to tell Robert Culpin. Ro 12/2

IOD

Graham Mather (IOD) says tomorrow's Daily Mail will carry an article recommending a £10 B^{n} PSBR: and that the Times will carry a similar message.

DJ

Private Secretary to the
Minister for Local Government

1/11/85

I SHOULD LIKE TO APPOLOGISE FOR ANY INCONVENIENCE CAUSED BY MY OMMITTING TO SEND THIS LETTER YESTERDAY.

Carter.
P.S.O 3
N16/17.
x 4499.

2

THE DEVELOPMENT COMMISSION
11 COWLEY STREET
LONDON SW1P 3NA

Telephone 01-222 9134

FROM THE CHAIRMAN

Advice pl for Mr Waldegrave: Mr Newman
cc PS/S of S
PS/Mrs Rumbold
Mr Delafons
Mr Worde
Mr Osborn

14 October 1985

The Hon. William Waldegrave MP
Minister of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

Serious point. But do unincorporated businesses pay tax if they are small?

ACKNOWLEDGEMENT SENT

Dear William -

BUDGET SUBMISSIONS

I seek your help over a Budget issue which is potentially extremely damaging to the economy of rural areas - alas so often we see our work putting rural businesses two steps forward and then the Chancellor, unwittingly, puts them one step back.

Two Budgets ago, the Chancellor announced his intention of phasing out the initial capital allowances on buildings, plant and machinery.

Whilst for incorporated businesses the cash flow effect of these changes was broadly mitigated by the progressive reduction in Corporation Tax announced at the same time, unincorporated businesses (the small firms and farms which are the backbone of the rural economy) received no compensatory tax reduction. The consequence of this will be very serious to their cash flow.

As from the next financial year, when the capital allowances on plant and machinery are to be reduced to 25% on written down values, many small businesses will have to borrow heavily in

/continued...

order to meet their tax charge before the benefit of the off-setting allowance trickles back to them over the following years. No doubt, because borrowing will rise, we shall be told how small companies are prospering and this will be another reason for keeping up interest rates!

Whilst I wholly accept that there may have been some frivolous investment when it was possible to re-claim the full cost at the outset - the fact remains that many businesses have to spend money on capital equipment to stay competitive. What is more, spreading the new rates over several years makes no allowance for the inflation adjusted replacement cost of equipment. This factor bears particularly heavily on unincorporated businesses which are being taxed again on paper profits without the benefit of any reduction in tax.

My suggestion is that the Chancellor should leave the capital allowances on plant and equipment at the present rate of 50%, in recognition of the fact that unincorporated businesses have special problems and have been treated less than fairly. Alternatively, the new 25% allowance should be calculated on the straight line method - thus ensuring a payback period of not more than four years.

Turning now to capital allowances for buildings, these are currently at 25% for the first year plus an annual writing down allowance of 4% for industrial buildings, and an initial 20% plus 10% writing down for farm buildings. Under the Chancellor's proposals, these are to be replaced by a straight 4% annual writing down allowance in each case. However, without the previous offsets, it will become virtually uneconomic to borrow from the bank. In my view, this will mean a great deal of building activity - the source of much rural employment - will cease.

As you know, our 25% redundant buildings conversion grant scheme coupled with the small workshop allowance for units of under 1,250 sq.ft. has stimulated the supply of starter premises. Some thousands of small workshops are being created. Precisely the premises that are needed by the growing band of people going into self-employment, the one bright spot on the employment scene. The removal of the first year allowance is likely to put a brake on this whole activity. Here again I would suggest the allowances be left as they are.

The combination of all these adverse factors will strike particularly hard at unincorporated businesses. It needs repeatedly to be stressed that there is nothing 'free' in allowances, they are a perfectly legitimate business expense. It makes much more sense for small businesses to be able to recover costs

/continued...

quickly from their own cash flow rather than being forced to borrow additionally at the present penally high rates - effectively lending money to the Treasury before they get it back. So, I would urge that the Chancellor mitigate the potential damage by continuing allowances at their present rate, at least to unincorporated businesses, but preferably to all.

These issues are vital ones for the rural economy and I would be very grateful if you could support them and put them to the Chancellor on behalf of the Commission.

LORD VINSON

CST
We will get advice from
Penny Boys asap tomorrow
Jim

SS/DHSS
To
Ld Pres
21/10

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522
From the Secretary of State for Social Services

The Rt Hon the Viscount Whitelaw CH MC
Lord President of the Council
Privy Council Office
Whitehall
London SW1A 2AT

21 October 1986

Dear Willie.

I have now had the opportunity to check the percentage increases which we discussed this afternoon. I hope it would be for the convenience of the Committee if I set these out.

First, my revised bid of £202 million for 1987-88 amounts to an increase of 2.9 per cent over forecast inflation on the whole NHS programme but on Hospital and Community Health Services revenue, which is the crucial measure, it amounts to 2.7 per cent and not 3.3 per cent as I believe was suggested.

Second, the increase agreed in HCHS revenue last year was 2.2 per cent over forecast inflation. As I explained, it is necessary to go higher than this next year, in particular to make an impact on waiting lists and to ease the pressures on London.

I am sending a copy of this letter to members of the Committee and to John MacGregor.

Yours ever
Norman

NORMAN FOWLER

This is a helpful pulling together of the threads, tho' I disagree in some places. I note that para 17(a) has no reference to conclusion para 80(c)(i)). I also note that there is no mention of the fact – v. relevant to taxation – the comparison with employers' NICs – that income tax cuts enable employers to pay less gross for an equivalent take-home pay. N.

CONFIDENTIAL

PM Ch.

You'll need time to read this properly – cd come back to it at your next bilateral.

RL. 22/10.

From: SIR PETER MIDDLETON

Date: 22 October 1985

1. Tony ✓
2 Phillip
3. bf for PEM bilateral on ~~29~~/10 1/11

CHANCELLOR

cc Sir T Burns
Mr Scholar

THE SQUIRRAL REPORT

TAXES

... We had a brief discussion at our last bilateral about your plans for the forthcoming Budget. I do not think that they involve preparatory work at this stage in areas which are not already covered. But you might like to cast your eye over the attached list of possible starters in the tax field to see if there is anything which strikes you. The list deliberately avoids mentioning the specific issues which we discussed.

... 2. There will be plenty of time to discuss the balance of your budget - and there is not much point in doing so now in any detail. But you might be interested to know that we had a preliminary canter over the field at PCC last week on the basis of the attached paper by Mr Monck.

3. Industry was not regarded as a very suitable target for tax cuts - though there were some advocates. Their record on pay and the failure of the NIS/NIC changes so far to influence employer attitudes significantly did not make changes in this area seem very promising. If anything was done, the CT rate, by directing

help to the more successful, had a lot to be said for it. The main reason for contemplating industry - apart from responding to pressure from the CBI, Industry year etc - is that it does give a slightly better prospect for output and jobs than the alternative of personal tax reductions.

4. Persons were not regarded as much more deserving than companies. The prospect of a substantial increase - even before any tax reductions - in real personal disposal income in 1986 (as price inflation falls well ahead of the decline in earnings growth) was an argument against allocating a large slice of the fiscal adjustment to personal tax reductions: why reward those who are grabbing too much earnings growth with tax cuts on top? Against this, reductions in personal taxation had to be a high priority, both for political and longer term supply-side reasons. Although there would be the usual case for threshold increases, several people argued that we should think hard about a basic rate reduction this time: one reason was that this was an income tax measure which would reduce, and certainly not increase, the ultimate cost of the move to transferable allowances.

5. You will not be surprised to hear that many thought against this background that the best course might be to go for a lower PSBR and not take the full benefit of extra asset sales in the form of higher expenditure and lower taxes.

6. Finally, PCC thought it quite likely that higher public expenditure on special employment measures might again prove an unavoidable element in the Budget. But, with the Star Chamber straining for the extra £50 million or even £10 million of savings, an additional bid of this kind would damage the Treasury's credibility in the 1986 Survey!

?

PEM

P E MIDDLETON

624/11

MAJOR STARTERS IN THE TAX FIELD

Personal

1. Income tax - thresholds and rates	Need to consider in conjunction with Green Paper. Lowering basic rate reduces costs of transferable allowances. Increasing allowances raises costs. But is move to transferable allowances consistent with mere indexation of allowances? (Yes)
2. Higher rate restructuring	
3. CTT - thresholds and rates	Threshold and rate bands automatically indexed. Case for doing more eg make CTT effectively a death duty, and push up rates and widen bands in recognition of growth in property values? (NB reducing life-time rate of CTT to zero would need 30 pages of legislation; abolishing it altogether would require 200 pages). ?

Plenty of room if you don't do much this year!

Stamp Duty

4. Stamp duty - rates, thresholds, Stock Exchange relief, capital duty etc	Related to "Big Bang" at Stock Exchange. Case for reducing rate on share transactions. Implications for rate on houses. Technical: reliefs for market-makers etc - announcement needed this autumn to enable Stock Exchange to plan for Big Bang (computer systems need to be redesigned.)

Wealth creation

5. Business Expansion Scheme	Modify to improve additionality. Legislate in 1986 or 1987 Finance Bill.
6. Enterprise allowance	Exempt from tax - benefits unincorporated sector.
7. Tax measures to encourage R&D	Extend relief to R&D expenditure at time it is incurred (NB expensive if extended to oil exploration)
8. Corporation tax: reduce rate to 30%, modify present staging arrangements.	CBI pressing for the second of these. Surprise (have you come down clearly for 30% last year
8A Small companies CT rate	
9. Capital Gains Tax: relief for Venture capital companies.	Boost to venture capital industry. Scope for abuse. Surely, when we talked about brochure, but Tony says it is expensive)

Pensions	
10. Personal pensions to replace SERPS.	Depends on decisions on Fowler proposals.
11. Action against pension scheme abuse - loanbacks/pension fund raids	Items 10 and 11 could produce modest tax yields and possible staff savings in Superannuation Funds Office. (FST considering)
12. Simplification of law and practice	
13. Individual Retirement Accounts*	US model - boost to private pension provision
Wider Share Ownership	
14. Remove restriction disqualification	14, 15 and 16 measures reflecting pressure from various groups
15. Access to employee share schemes for certain companies currently excluded	
16. Extension of employees' rights under savings-related share option scheme.	
17. Weitzman-type ideas*	17 and 18 much more ambitious. 17 could help with jobs, but main effect likely to be boost to wider share ownership, greater employee involvement etc.
18. Extend tax benefits on employee share ownership*	
Keith package	
19. Range of measures designed to implement recommendations in Keith Report.	Would add up to around 60 pages of Finance Bill legislation.† (Outcome of your meeting is being reported as firm decision not to go ahead in 86 - to Revenue's distress. There'll need to be a meeting to talk them through this)
Excise duties	
20. Revalorize, or raise some duties by larger or smaller amount?	Spirits duty has gone up by less than revalorisation for the last 2 years. (quite deliberately)
VAT	
21. VAT relief for charities* Whether relief on charitable giving	A lollipop. ["John Green" option on charitable giving (the Ekaye issue; note Ministers' interest)]

* NOT included in revenue Departments' starters list (Tony has asked why not - for 13 - and is keeping up on 17 too) (- because proposals not yet sufficiently advanced: Ministers will be consulted before they're added to list)

† But size could be reduced to 30 pages.

194/24

SIR PETER MIDDLETON

FROM: N MONCK
DATE: 18 October 1985

cc Sir T Burns
Mr Bailey
Mr Watson

THE COMPANY SECTOR, PAY AND UNEMPLOYMENT

I attach a slightly revised version of the PCC paper, which you planned to show to the Chancellor in its PCC form but the figures are now consistent with the final forecast.

2. The position on SERPS and the prospect for the National Insurance Fund is still unclear. ST will be putting up a submission on NICs next week. I have suggested it should give figures for the Fund based on the forecast as well as on the assumptions to be published.

NM

N MONCK

THE COMPANY SECTOR, PAY AND UNEMPLOYMENT

After a discussion on unemployment* in July, PCC asked for a paper on the "prospects for the company sector and the impact of macro-policy generally on companies." The focus was on ways of lowering pay increases and/or unemployment over the next 2 years or so. Section I is heavily dependent on provisional advice about the forecast from EA. Some possible options for discussion are noted in Section II and summarised at the end, but in general decisions are not needed until after Christmas and many key factors are still unclear.

I. Economic prospect for the company sector

2. Improved since June and better than outside forecasts. In particular outlook for inflation over 12 months to last 3 quarters of 1986 now 3-4 per cent.

3. GDP in 1986 up by about 3 per cent, nearly 1 percentage point slower in strike-corrected terms than in 1985. Slow down in export demand partly offset by a strong increase in domestic demand, particularly consumption.

4. Figures for manufacturing output recently revised, but CBI survey suggests substantially stronger growth than the current official figures. On the basis of published figures forecasters expect manufacturing output to grow by about 2½ per cent in both 1985 and 1986. Construction output expected to keep pace with manufacturing growth particularly in view of the recent strength in housing starts (see table 1).

5. Productivity growth post-1979 markedly better than in the 1970s. Partly a response to companies' difficulties in 1980 recession; but increasingly likely that underlying trend rate of productivity growth has improved. The forecasters expect some cyclical slow down but the trend in growth in manufacturing productivity forecast to remain higher than in the mid-1970s.

6. Unemployment expected to change little on balance over next 2 years or so. Recorded growth in employment in the first half of 1985 much slower than over previous 2½ years. But expected to pick up in the second half of 1985, partly as a result of Community Programme; NIC restructuring starts to have

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* PCC(85)18

an effect in 1986; employment growth over the next year and a half is expected to be at or above the average rate since early 1983.

7. Recovery of profitability of non-oil industrial and commercial companies since 1981. But pace of recovery expected to slacken from now on (see table 2).

8. In recent years companies' financial position transformed, more than usually in a recovery. But they remain cautious about taking on labour and very cautious, partly as a result of tax changes and high real interest rates, about rebuilding stocks. Finance easily available from banks, more readily now that balance sheets and gearing ratios are so much improved. Most firms have no cash or liquidity problems (see CBI survey).

9. Continuing growth in business investment: 8 per cent rise in 1985, in line with the June DTI intentions survey. For 1986 investment growth slows to 3 per cent; more optimistic than intentions survey, reflecting current buoyancy of profits and stock market. Manufacturing investment rather weaker than non-manufacturing with modest decline in 1986.

10. Little change in nominal exchange rate or real interest rate. Unit labour costs in the UK likely to rise faster than abroad. Competitors will benefit as much as we do from sluggish or falling commodity and oil prices. Competitiveness likely to fall overall but may be some improvement against Japan and Germany.

11. 1986 looks like being a year of substantial increase in real personal disposable income as price inflation comes down sharply, well ahead of the decline in earnings growth.

12. If public spending plans confirmed, there would be room for a significant fiscal adjustment in 1986-87. Fiscal stance looser than in 1985 MTFS because of rise in asset sales.

II. Policy questions relevant to Pay and Unemployment

13. Clearly no crisis case for using fiscal adjustment to help companies. But still worth considering doing so on employment or other grounds (on the assumption PSBR is not reduced despite the arguments for that).

14. So far as pay is concerned, the Chancellor has turned down JAC. Profit-sharing not an alternative: negligible or damaging short-term effect and anyway doubtful runner. Little scope for new supply side measures.

15. Exchange rate level and macro-economic policy generally are effectively acting as a restraint on pay, though profits prospect works in other direction. Table 3 suggests that the real exchange rate is now back to 1983 levels and relative unit labour costs getting near 1982 levels; the downward pressure in the tradeables sector may be stronger than recently and the falling RPI should help too.

16. The rest of paper is mainly devoted to possible measures that might directly or indirectly improve employment or unemployment prospects within the MTFS nominal framework over the next 2 years or so, though there are of course other criteria to be taken into account, eg the growth of productive potential over the long term.

Productivity and money GDP

17. Money GDP, actual and prospective, is already slightly higher than in 1985 MTFS. But if reconsideration over the next few months of both the level of productivity and its growth over the MTFS period, leads to significantly higher figures, there may be a case for a higher money GDP path. This will have implications for the path of the PSBR and the monetary targets, and will need to be considered carefully. A higher money GDP path because of a higher expected growth of productivity does not necessarily imply more rapid growth of employment than if expected productivity had not changed. But equally policy might be too tight and unemployment higher if the path of money GDP is left unchanged, despite evidence of an unexpected rise in the level or trend growth of productivity.

General tax measures in favour of companies/employers: NICs and CT

18. The prospect for companies described above means there is no "crisis case" for devoting any available fiscal adjustment to them. Equally the strong expected growth of real earnings, with the fall in oil prices acting rather like a cut in indirect taxes, suggests that concentrating on income tax cuts would produce an exceptional rise in real take home pay. Supply side benefits from this would be in the long-term. If a way of using the available fiscal adjustment that would produce earlier employment gains could be found, it would be worthwhile comparing it with the economic and political benefits of income tax cuts.

19. A straight reduction in employers' NICs has so far been pretty well ruled out on various grounds: the Budget changes on 6 October and the complications of phasing out SERPS from 1987 onwards; and the fear that companies would spend any extra money on pay. But this might be worth reconsidering if:

(a) a significant fiscal adjustment were available (a 1 point reduction in NICs costs the Exchequer £1.1 billion in a full year net of clawback and about half that if it comes into effect in October after the Budget announcement);

(b) SERPS were both retained and modified in a way that did not require a rise in the contracted-in NIC rate;

(c) the changed economic assumptions suggest that the National Insurance Fund could sustain a cut in employers' contributions for more than a single year.

It is so far not clear whether these conditions will be fulfilled, but they may be.

20. Another argument for reconsidering is that it is unlikely that the pass-through into wages is anything like complete: Treasury analysis assumes a pass-through of about a half, so that labour costs are in practice reduced. The pass-through might be less if, as the forecast implies, the real exchange rate and relative unit costs remain at the present rather high levels shown in table 3 or rise above that. It is estimated that the increase in employment from a reduction in employers' NICs is significantly greater in the first few years than that resulting from an equivalent reduction in income tax. (A NIC reduction would also incidentally ease the passage of legislation to abolish redundancy rebates). Further quantification of the effects of a reduction in employers' NICs could be made. Other ways of achieving an early improvement in the unemployment outlook are likely to involve public expenditure on top of the Autumn Statement totals. If a NIC option were reconsidered, the choice between announcement in the Autumn Statement and the Budget would need to be weighed.

21. An alternative general measure would be a reduction in the corporation tax rate for 1985-86 to 30 instead of 35 per cent which would give companies a cash flow benefit of around £1 billion in 1986-87. This too would not be worthwhile unless it could be sustained. And a reduction in CT is less likely to reduce labour costs than reduction in NICs. The hope would be that it would

lead to higher company investment in fixed assets or intangibles (R&D, training and market development), but there is little evidence for these effects of a cut in the CT rates, as with the incentive effect of income tax cuts.

Specific measures, mainly public expenditure

22. These can be grouped in four main categories:

(a) **employment measures** with a fairly reliable effect on unemployment over the next two years;

(b) **enterprise or training measures** mostly without such effects;

(c) **infrastructure spending**;

(d) **subsidies for manufacturing** (exports, R&D, training, advice, investment) whether through tax relief or public expenditure.

The manufacturing lobby would argue that despite employers' failure to restrain unit labour costs, it needs (d) as some compensation for the differential damage it suffers from a high interest rate and exchange rate policy (more exposed to foreign competition and/or more price-sensitive markets than tradeable services). There is sympathy for this line in the DTI which also advances the so called 'dynamic argument' that once manufacturers in the UK get too far behind in the competitive race, it is extremely difficult for them to get back into it either now or "when the oil runs out".

23. Lord Young is likely to present options in categories (a) and (b), in addition to those conceded as part of the net savings settled in this public expenditure round, when he meets the Prime Minister and Chancellor on Enterprise and Employment on 7 November. His own preference is for (b), but if he wins concessions in that category they would do little to reduce political pressures for (a).

24. On (a) the forecast effect of existing public expenditure provision for SEMs is:

thousands

	Effect on employment statistics from growth in SEMs	Effect on unemployment count from growth in SEMs	
		Total	Adults only
1985 Q2 to 1986 Q2	+95	-90	-70
1986 Q2 to 1987 Q2	0	-5	+5

The present total effect of SEMS on unemployment is about 410,000 and on adult unemployment about 240,000. The main reason for the flat or falling effect between 1986 and 1987 is the run-down of the Young Workers Scheme. Lord Young may well propose, probably for the Budget, that a new Young Adult Workers subsidy should be introduced for people earning less £x a week. This would probably be cost effective in terms of reducing the count, but exercise little downward pressure on pay.

25. Lord Young is said to be unenthusiastic about the community programme and has so far given preference to an expansion and easing of the terms of the enterprise allowance. But he or some other Ministers may propose that when the existing expansion comes to an end in June 1986 there should be a further expansion of CP; or of similar schemes more closely targeted on people who have been unemployed for longer periods which should do relatively little damage to labour flexibility or inflation. The supply side merits of CP etc are slight, but it remains one of the most cost-effective and reliable means of reducing the unemployment count over a specified period. E(A) agreed to return to the possibility of a benefit plus scheme which might be cheaper than CP after further work had been carried out by Professor Blaug. If Ministers were prepared to press forward on the "compulsion element" of a benefit plus scheme it is possible that pilot schemes could be set up in 1986 although it is difficult to envisage any large scale scheme before 1987-88. Lord Young knows from experience at the MISC the difficulty of introducing such a scheme.

26. In addition to the expanded enterprise allowance, which Lord Young classifies under (b), he will be announcing some small expenditure on Local Enterprise Agencies and is pressing for a continuation of the Loan Guarantee Scheme in

some form. (A Treasury submission has gone to the Chancellor on the possibility of Small Business Investment Companies and their inter-relation with the Loan Guarantee and the Business Expansion Schemes.)

You've seen + are to hold a meeting ide

27. On (c) there is probably a case both in terms of economic return and on job grounds for some additional expenditure on labour intensive construction, eg by devoting more housing expenditure to maintenance rather than new build. It is too early to say whether this goes beyond the concessions which may be made anyway in the public expenditure decisions.

28. Subsidies for manufacturing (d) would be of doubtful effectiveness and it would be inconsistent with the Treasury's past positions to depart from minimising them, whether in the form of public expenditure or tax subsidies. Tax subsidy for R&D is likely to be raised in Lord Whitelaw's group on R&D priorities, though we are trying to limit this to the narrow area discussed in the Industrial Support Review agreed with the DTI (ie tax relief for pre-trading R&D).

29. It would make sense in the presentation of the Autumn Statement to bring together any additional bids that have been conceded on (c) or (d) and to make the most of them.

<u>Summary</u>

30. (a) In general better prospect for inflation and also for output and profitability than in June. Unemployment prospect flattish;

(b) recent decisions mean that restraint of pay depends on a high exchange rate outweighing reasonable profits outlook;

(c) clearly no "crisis case" for helping companies; but equally real earnings will be rising strongly without income tax cuts;

(d) is there a case for asking Chancellor to consider relative priority of income tax cuts and action on unemployment, if there is room for a bit of both. If fiscal adjustment goes on income tax cuts in 1986, then political pressures are likely to build up afterwards for further public expenditure on SEMs. Outcome might be higher total public expenditure in 1987-88 than if significant part of fiscal adjustment in 1986 were used to help employment;

(e) some points relevant to unemployment outlook include:

(i) allowing for any significant improvement in productivity level and trend, even if once and for all, in path for money GDP in new MTFS, to avoid risk of worsening unemployment through excessively tight policy;

What was?

(ii) if all conditions in paragraph 19 are fulfilled, may be worth considering using part of fiscal adjustment to reduce employers' NICs on a sustainable basis, despite some leakage into pay and apparent political priority for income tax cuts; a NIC reduction would score twice politically as a help to employment - and thus an argument for minimising more SEMs - and to manufacturing competitiveness;

(iii) of the public expenditure options in paragraph 22 worth identifying the most cost-effective measures to reduce unemployment as much between 1986 and 1987 Q2 as is already planned for previous 12 months: supply side benefits modest at best. May need to allow for this in internal calculations. Very rough cost figures for 100,000 off the count by mid-1987 might be: net public expenditure of £100 million in 1986-87 and £300 million in 1987-88 (corresponding net Exchequer cost about £70 million and £210 million);

(iv) some more "enterprise measures" seem likely to be agreed, preferably absorbed by Lord Young, but probably an increase; we will learn more about these before the Prime Minister's meeting on 7 November;

(v) there is some case for more labour intensive spending on housing at least, eg by a switch from new building to maintenance; though not necessarily more than may be conceded anyway, especially as construction outlook is not bad;

(vi) we should continue to minimise subsidies for manufacturing, but in presenting Autumn Statement make the most of any concessions on them or on infrastructure.

18 October 1985

TABLE 1

GROWTH OF DIFFERENT SECTORS
PER CENT CHANGE ON PREVIOUS YEARS

	1983	1984	1985	1986	1986 Index: (1979=100)
GDP at a factor cost‡	3¼	2½(3½)	4 (3¼)	2¾(2¼)	111
of which: GDP (excluding North Sea) at factor cost‡	3	2 (3¼)	4 (3¼)	3 (2½)	109
Manufacturing	3	3¾	2¾	2½	97
Non-North Sea private Non-manufacturing^x	3¼	2	5½	4¼	117
(Construction*	4	3½	2	3¼	98)

* Construction forecasts are not derived from the Treasury model, and are considered by Treasury economists to be less robust.

‡ Figures in brackets are adjusted for the coal strike.

x Including non-manufacturing public trading.

TABLE 2

NET PRE-TAX REAL RATE OF RETURN

					(adjustment for privatisation)			
	1973-79 average	1980	1981	1982	1983	1984	1985	1986
(a) Non-North Sea ICCs	6.1	3.9	3.3	4.0	5.1	6½	8¼	8½
(b) All ICCs	6.4	6.4	6.5	7.6	9.4	11½	12½	11½

Note: All figures provisional

TABLE 3

EXCHANGE RATES AND COSTS

	1979	1980	1981	1982	1983	1984				1985			
						Q1	Q2	Q3	Q4	Q1	Q2	Q3	Latest (16 Oct)
£ Effective	87.3	96.1	95.3	90.7	83.3	81.8	79.8	78.2	75.3	72.1	78.9	82.1	80.4
£/$	2.12	2.33	2.08	1.75	1.52	1.44	1.41	1.31	1.23	1.11	1.26	1.38	1.41
£/DM	3.89	4.23	4.56	4.24	3.87	3.90	3.78	3.78	3.73	3.62	3.87	3.91	3.78
Wages and salaries* per unit in £: % change	15.0	22.2	9.3	4.9	1.3	3.0	1.5	3.7	5.4	5.8	6.9		6.6(1)
Real Exchange Rate+	83.0	100.21	100.8	95.9	88.5	87.5	85.6	83.8	80.8	78.2	[85]x	[89]x	
Relative unit labour costs	81.1	100	100.2	93.4	84.9	85.4	83.8	83.8	81.9	78.2	[86]x	[92]x	

Footnote

+ ERI adjusted by GDP deflators (data from Overview printout)

(1) July

* % change on year earlier in manufacturing (data from September issue of DE Gazette)

x Estimate

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

C.

- Peter Lilley and Nick Monck with you;
- you are <u>not</u> speaking;
- long guest list (Annex A);
- you refused their request to issue a press statement (about an informal lunch);
- but agreed to a photocall.

Thorough brief below. Note NEDC point in Annex B.

Rno 31/10

LD8.1

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

Peter Firmston Williams Esq OBE
Chairman

4 November 1985

This sh[d] go to the
Chairman - Firmston-Williams

~~Tom McNally Esq~~
~~Director General~~
The Retail Consortium
Commonwealth House
1-19 New Oxford Street
LONDON WC1A 1PA

most

Thank you for entertaining Peter Lilley, Nick Monck and me to lunch on Friday. It was an enjoyable occasion and I found the discussion interesting, ~~I do of course recognise~~ the important contribution which retailing makes to the economy as a whole.

particularly on the issue of

Yours

NIGEL LAWSON

RT8.99

CONFIDENTIAL

b/f with response (or 10/12) pl

FROM: A W KUCZYS

DATE: 27 November 1985

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Mr Cassell
Mr Monger
Miss Sinclair
Mr Graham OPC
Mr Lord
Mr Cropper
Mr Blythe - IR
Mr Prescott - IR
PS/IR

PS/FINANCIAL SECRETARY

RELIEF FOR OVERSEAS TRAVEL EXPENSES

The Chancellor has seen your minute of 25 November. He is content for the Revenue now to prepare instructions for Parliamentary Counsel on the basis proposed by the Financial Secretary. He is particularly pleased to note that foreign-going seafarers will benefit from the new rules.

2. You point out that careful thought will need to be given to presentation, given that we floated proposals on board and lodging in the consultative document . The Chancellor would be grateful to be reminded why we did this in the first place?

AWK

A W KUCZYS

76

RESTRICTED

From: SIR PETER MIDDLETON

Date: 9 December 1985

CHANCELLOR

C
This looks OK.
Budget list (81 people in total) at X. Para 3 of this note seems sensible, perhaps for a Prayers meeting early in New Year.
R 10/12

cc (without attachment)
Miss Kelley
Mr Scholar
Mr Monger
Miss Sinclair
Mr Culpin
Mr Porteous
Mr Romanski

BUDGET SECURITY

... You might like to glance at this year's Budget Security instructions which I intend to send out in the week before Chritmas. The main change from last year's instructions is that use of the 'Budget' prefix would be extended to cover all public expenditure changes to be announced in the Budget. In the past this has been limited to social security changes, but we felt if there were important measures in other areas, eg an employment 'package', these too should be classified with a Budget prefix. The revised instructions also contain a number of clarifications and expansions of points which gave difficulty last year, and some re-ordering of the material.

... 2. I also attach the draft Office Notice to cover the instructions. It follows the same line as last year's, emphasising the changes and the points where last year's instructions were not always followed strictly. Their importance will also be reinforced by the Senior Management of the department as part of their usual management responsibility.

3. As always, it is most important that Ministers should apply the rules to themselves. We have a number of new Ministers this year and I should be grateful if you could remind them of the

importance of security as soon as the rules are re-issued.

4. We have timed the instructions to come into force on 1 January. And, like last year, I shall apply them increasingly strictly as we near the Budget.

P E MIDDLETON

AMENDED TEXT

XIII. BUDGET SECURITY

Relations with the Press

144. This first subsection applies to all Treasury staff in the pre-Budget period, including officials who are not involved in work connected with the Budget. References to 'journalist' in this section are to be interpreted widely to include contributors to specialist and academic publications, brokers' circulars, newsletters and other similar publications. References to the pre-Budget period should be taken to mean the period between the beginning of January and Budget Day itself.

145. Formal contacts with journalists in the pre-Budget period may only be undertaken with the prior authority of the Permanent Secretary or, in his absence, either the Under Secretary (Central Unit) or one of the Second Permanent Secretaries. If permission for such contact is granted, a report should be submitted immediately after it takes place to the head of IDT, copied to the Permanent Secretary and the Budget Security Officer, whatever the subject matter of the discussion.

146. Telephone calls from journalists are to be referred in the first instance to IDT. If any conversation takes place directly with a journalist in the pre-Budget period a report is to be sent to IDT copied to the Budget Security Officer, whatever the subject matter of the conversation.

147. If any other contacts take place with journalists in the pre-Budget period, no matter how informal, a report of the fact is to be made to IDT copied to the Budget Security Officer, together with a very brief account of any discussion of official matters.

Budget classification and its use

148. Special security arrangements apply to certain information connected with the Budget. The arrangements apply in addition to the normal departmental security procedures and are intended to provide additional protection for information about Budget decisions. It is the responsibility of every person involved in Budget work to be familiar with, and operate, these instructions. EOG will ensure that those most heavily involved understand the procedures.

.49. The recipient of a Budget classified document is, at all times, personally responsible for its security. This applies even if custody of the document is entrusted to another member of his or her staff (where this is permitted).

150. The Budget security arrangements apply to information concerning Ministerial decisions on:

(a) the Budget judgement and in particular the PSBR;

(b) all taxation matters connected with the Budget; and

(c) any social security or other public expenditure changes to be announced in the Budget.

In addition, the Budget classification may be applied to papers which are regarded as particularly sensitive despite the fact that no decisions are recorded - where, for example, the very fact that a matter is being discussed is sensitive, or where the total contents of a document might reveal the approach to the Budget likely to be adopted by Ministers. Care and common-sense are needed in applying the classification in such cases. In any cases of doubt over the use of the Budget classification the Treasury Budget Security Officer (see paragraph 165) should be consulted.

151. There is a special security classification to be used for certain Budget documents, ie for those papers which reveal the contents or probable contents of the whole, or a very substantial or particularly sensitive part, of the Budget. The Chancellor may also decide that papers dealing with particular subjects be given this classification. The classification is "BUDGET SECRET - BUDGET LIST ONLY". Strict rules are laid down for access to, and handling of, documents with this classification. These are set out in paragraph 154 and 158 below. Examples of papers which are to be given this classification include:

- papers, including records of meetings, which give an overall picture of Budget strategy;
- complete drafts of the Budget speech (and the most sensitive extracts such as complete drafts of the tax sections);
- full drafts of the Budget Brief, or particularly sensitive parts of it;
- full draft of the FSBR (and early drafts of the sections dealing with Budget proposals); and
- the Budget Resolutions, as a whole.

Papers dealing with individual taxes would not normally require BUDGET SECRET - BUDGET LIST ONLY classification, unless this is required by the Chancellor.

152. Otherwise, Budget security rules require that the ordinary security classification of documents be prefixed by the word BUDGET. BUDGET: TOP SECRET should only be used where the material would fall clearly within the definition of TOP SECRET even if it were not to be included in the Budget. BUDGET: SECRET is the correct classification for all other papers on the main Budgetary items (ie the main tax rates and social security benefits and other major changes in tax legislation or public expenditure). BUDGET: CONFIDENTIAL should be used for papers recording decisions on other Budget matters, including all other decisions on tax items. The classification of a document is not necessarily the appropriate classification for a minute commenting on or replying to it even if the original document is classified BUDGET SECRET-BUDGET LIST ONLY. For example, a submission to a Minister on a minor Budget matter, suggesting a range of options, may properly not have a Budget classification, but a note from a Ministerial Office recording a decision on it should be given a Budget classification. On the other hand, a minute containing comments on a document should bear the classification appropriate to its contents and should only bear the same classification as the original document where it is appropriate.

153. A Budget classification is <u>not</u>, in general, required for papers containing:

(a) Ministerial decisions relating to economic forecasts, monetary policy, exchange rate policy and other items <u>not directly related to tax or public expenditure decisions, even where these are in the context of a Budget</u>;

(b) arguments for and against a particular course of action, or recommendations from officials to Ministers or other Ministers to the Chancellor unless the papers are particularly sensitive (see paragraph 146); or

(c) lists of options in which no decision on any of the matters in paragraph 146 is recorded.

<u>Communication of Budget classified information</u>

154. Documents for which the "BUDGET LIST ONLY" classification is appropriate may only be circulated to persons who are on the "Budget list", a list of recipients of such documents approved by the Permanent Secretary. Under no circumstances are they to be circulated or shown, or the contents communicated in any other way, to a person not on that list. A copy of the Budget list will be made available to each person who is

on the list. If it is considered essential to show a BUDGET LIST ONLY document to a person not on the Budget list, the prior approval of the Parmanent Secretary must be sought, in writing, to the addition of his name to the Budget list. This applies right up to the Budget Day.

155. The circulation of all Budget classified documents is to be restricted to the absolute minimum consistent with operational requirements. Before writing Budget classified material all originators must ask themselves:

(a) Is the document necessary at all? (A private face-to-face conversation is more secure than a written note - paragraph 13 contains guidance on the security of telephone conversations.)

(b) If the document is necessary, need it be circulated? (Only copy a document to those people who need to be aware of its contents.)

(c) Need the document quote precise details of decisions eg proposed tax rates?

(d) Does the document require a Budget classification?

(e) Is the title likely to be a security risk? (Particularly in the case of BUDGET SECRET and more highly classified documents, the title is likely to be seen by persons who are not authorized to have access to the contents, so it is essential that the title does not reveal any sensitive information.)

(f) Do all recipients need a copy of the whole document? If a part of the document would suffice, send only that part. It is essential that persons do not see parts of documents containing classified material which they have no operational need to see.

156. BUDGET LIST ONLY documents may not be shown to anybody who is not on the Budget list (except for the normal arrangements whereby the Queen, Prime Minister, certain staff at Number 10 andthe Governor of the Board of England are hold the contents of the Budget). Other BUDGET classified information may be communicated to staff in the Chancellor's Departments (and the Office of the Parliamentary Counsel), only if they need to know about it for the efficient performance of their duties.

157. Budget classified information must not be communicated to anyone outside the Chancellor's Departments and the office of the parliamentary Counsel without prior authority having been obtained from the Budget Security Officer. There are only three

general exceptions to this rule. First, FP group have authority to communicate to specified Department of Transport officials Budget decisions on VED and the duties on hydrocarbon oils. Second, the head of FP has authority to communicate to specified officials in the Department of Health and Social Security certain information about Budget changes in personal taxation. Third, as is appropriate for public expenditure matters, ST group will discuss any social security changes to be announced in the Budget with DHSS officials. In all these instances the Divisions concerned must ensure that these Departments are aware of the need for particular care in handling the information. Similarly, if a Treasury Minister writes to a Minister in another Department on a Budget classified matter, his Private Secretary should ensure that the other Private Office are aware of the significance of the Budget classification, and in particular of the need to ensure that the letter is shown or copied only to those who need to see it.

Preparation and handling of BUDGET SECRET: BUDGET LIST ONLY documents

158. In addition to the normal security instructions regarding handling of SECRET documents, set out in paragraphs 42 to 103, the following special instructions apply to the handling of BUDGET SECRET: BUDGET LIST ONLY documents:

(a) The title of the document must not give away any sensitive information as to its contents as it will be used on the label on the inner envelope and may therefore be seen by persons not authorised to handle the document. A code word should be used if necessary.

(b) The document must be typed on plain paper. The security classification is not to be typed. Documents may be typed by a Personal Secretary if she is herself on the Budget list. The typist's initials should appear on each page of the document. The originator is responsible for the security of the typed master, which must be given a number in the sequential series used for copies.

(c) Copies of the typed master must be made onto the special paper bearing printed 'BUDGET SECRET: BUDGET LIST ONLY' markings on one side of the paper only. Each copy of the document must be sequentially numbered.

(d) The documents must always be enclosed in the special distinguishing folder marked "BUDGET SECRET: BUDGET LIST ONLY" for transmission. They must always be transmitted in double envelopes even if sent within the building. The inner envelope must bear the special "BUDGET SECRET: BUDGET LIST ONLY" label completed with the relevant details in full. If more than one document is sent in one envelope, details of each document must be shown on the label. If a BUDGET SECRET: BUDGET LIST ONLY document is to be sent or copied to a Minister, he should be sent two copies. A receipt must always be obtained for all copies of "BUDGET SECRET: BUDGET LIST ONLY" documents. It is the responsibility of the originator to ensure that a receipt is returned for each copy which has been sent out. These receipts must be retained until after Budget day.

(e) If they are being sent to other Departments, the documents must be sent by messenger or by the special van service which operates between the Treasury, the Revenue Departments and Parliamentary Counsel's Office. If these are not available, the documents may be sent by special signature service of the IDS. In every case receipts must be obtained for the documents. In no circumstances may the documents be sent by post or transmitted on facsimile equipment except for the secure fasimile link between the Treasury and the Revenue Departments.

(f) Each Recipient is responsible for ensuring that every BUDGET SECRET: BUDGET LIST ONLY document is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this - this applies particularly at Principal level. A document may be entered in the security register by the Personal Secretary or allocated Clerk from the information shown on the label, without opening the inner envelope. If this is done, the number of the security register entry is to be written on the label. The recipient of the document is to ensure that the security register number is shown and should copy it onto the document itself. In some areas, Personal Secretaries or Clerks may themselves be included on the Budget list authorised to handle BUDGET SECURITY: BUDGET LIST ONLY material. Only in such cases may they open the inner evelopes, in which case the security register number may be written on the document itself. BUDGET SECRET: BUDGET LIST ONLY documents may not be filed until after Budget Day except where the Clerk concerned is on the Budget List.

(g) Each copy of a BUDGET SECRET: BUDGET LIST ONLY document is personal to its recipient. It may not be shown to any person not on the Budget list in any circumstances, and shown (but not copied) to a person who is on the Budget list only if there is a real operational need for him to see it. The fact that a person is on the Budget list does not mean that he must see all BUDGET LIST ONLY documents. It is the recipient's responsibility to ensure that the document is not seen by any person who is not authorised to have access to it. It can be kept in the recipient's own security cupboard only if all persons who are entitled to know the combination number have been specifically authorised to handle BUDGET

SECRET: BUDGET LIST ONLY documents. Otherwise it will be necessary to store such documents in a separate document box or security cupboard whose combination number is known only to the recipient (and any authorized handler of such material). Officials who require additional security furniture for this purpose should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 7861).

(h) It is essential that BUDGET SECRET: BUDGET LIST ONLY documents are not left unattended by the person who is responsible for their custody - he must lock them away whenever he leaves his room.

(i) BUDGET SECRET: BUDGET LIST ONLY documents may on no account be photocopied <u>except by the originator</u> (or his Personal Secretary, on his authority, if she has typed the document). If a person not on the original list of copy addressees is subsequently to be given a copy of such a document, it must be provided by the originator and the name of the recipient properly recorded. He may retain a small stock of additional numbered copies of the document for this purpose (which are to be treated as accountable documents). If he needs to take an additional copy of the document, it must be numbered in the original series. The above rules as to handling and control of the document apply to additional copies.

(j) BUDGET SECRET: BUDGET LIST ONLY documents may only be taken out of the office to meetings if this is <u>absolutely unavoidable</u>. They may be taken home <u>only</u> if the Permanent Secretary has given his prior approval, either for a particular occasion or generally for a particular individual. Permission will only normally be given if the person concerned has a security container at his home. Any documents taken out of the office must be carried in a locked briefcase, box or pouch and kept securely at all times.

(k) Where a person only needs to see a part of a BUDGET SECRET: BUDGET LIST ONLY document, he should be sent only a copy of the relevant extract. The copy extract should be given a number in the same series as the full copies. It should be given the security classification, appropriate to the sensitivity of the matter contained in it - the security classification at the top of the front page should be amended in manuscript if necessary. The recipient of the extract should treat it in accordance with the security classification shown on the document.

(1) If a BUDGET SECRET: BUDGET LIST ONLY document is to be destroyed before the Budget, it is to be sent to the Budget Security Officer in double envelopes, the inner envelope bearing the appropriate label, and marked for destruction. The Budget Security Officer will carry out the destruction in accordance with the standing instructions.

159. If a Budget sensitive document meets the criteria of paragraph 24 for classification as TOP SECRET it should be classified as "BUDGET TOP SECRET: BUDGET LIST ONLY". The distinguishing folder and address labels for "BUDGET SECRET: BUDGET LIST ONLY" documents are to be used amended accordingly in manuscript. The instructions of paragraph 158 are to be followed, expect where the normal security instructions for TOP SECRET documents impose more stringent requirements, in which case those should be obeyed.

Handling of other Budget classified documents

160. The normal rules for the control and transmission of classified documents (paragraphs 42-103 of H M Treasury Security Instructions) must be applied to all other documents which carry the prefix: BUDGET, except as modified below:

(a) BUDGET: TOP SECRET and BUDGET: SECRET documents must always be transmitted in double envelopes, even if only sent within the building and the inner envelope must hear a completed BUDGET: SECRET label. As the title will be shown on the label and may be seen by staff not authorised to handle the document, the title should be carefully chosen to avoid revealing any sensitive information. If two or more papers are included in one inner envelope, details of both must be shown on the label. BUDGET: TOP SECRET and BUDGET SECRET documents sent outside the building must be accompanied by receipts (but it should be noted that if a BUDGET SECRET document is received from Customs and Excise it will not necessarily be accompanied by a receipt when it reaches the recipient's office as bulk receipts are used for documents transmitted by document pouch to the Treasury).

(b) BUDGET: TOP SECRET and BUDGET: SECRET documents should normally be sent by messenger to other departments. If no messenger is available, they should be sent by special signature service of the IDS, a receipt being obtained from the post room. BUDGET: CONFIDENTIAL documents should be sent either by messenger or the IDS. Budget classified documents must not, <u>in any circumstances</u>, be sent by post or transmitted on facsimile equipment, except for the secure facsimile link between the Treasury and the Revenue Departments.

(c) Each recipient is responsible for ensuring that every document classified BUDGET SECRET and above is entered in the appropriate Security Register. He must do this himself if no-one else is available or authorised to do this -this applies particularly at Principal level. Staff who are not authorised to handle BUDGET SECRET documents may record them in the Security Register, provided that they have been received in double envelopes, using the information shown on the label. If this is done, the inner envelope must be passed to the recipient unopened, the number of the security register entry being shown on the label. If this procedure is followed it does not detract from the recipient's responsibility that receipt of the document has been recorded, so he should ensure that the security register number is shown on the label and copy it to the document itself.

(d) BUDGET classified documents are not to be filed or otherwise handled by Divisional Clerks until after the Budget. Principals are personally responsible for all BUDGET classified documents passed to them, and for ensuring that no other person is able to obtain access to them. Principals who will require a combination lock document box or security cupboard for BUDGET classified material should requisition it as soon as possible from the Assistant Budget Security Officer in EOG2 (Ext 7861). It should be noted that this instruction applies to BUDGET CONFIDENTIAL as well as more highly classified material.

(e) Personal secretaries may continue to handle papers classified BUDGET SECRET or BUDGET CONFIDENTIAL as may Divisional clerks working with the Principals CU and FP (Budget co-ordination branch). Files in those branches containing BUDGET classified papers must bear the appropriate classification on the outside.

(f) All copies of documents of BUDGET SECRET classification or higher must be uniquely numbered in series, whatever the length of the circulation list. Copies of BUDGET CONFIDENTIAL documents need not be sequentially numbered. BUDGET classified material including BUDGET CONFIDENTIAL may only be copied on the authority of an SEO or above, or Personal Secretary acting on behalf of a higher grade officer, but recipients should as far as possible avoid making copies of Budget classified material. The making of copies must be carried out in accordance with paragraph 54.

(g) The arrangements set out in paragraphs 68-75 for taking classified papers out of the office apply to BUDGET: SECRET and BUDGET: CONFIDENTIAL documents, but BUDGET: SECRET papers are subject to the overriding restriction that they must not be taken out of the office unless absolutely unavoidable. In such an event, they should be carried in a locked briefcase, box or pouch and kept securely at all times.

(h) BUDGET: SECRET or TOP SECRET waste should be destroyed by shredding; arrangements for this may be made with EOG (extension 7861). Recipients must keep a proper record of any such documents they destroy. Production of such a record is necessary to meet the requirements of the spot checks described in paragraph 161.

General points

161. To ensure that the required procedures are being adhered to, Budget classified documents will be subject to a series of spot checks. There will be random checks of individual copies of classified documents sent to named individuals. There will also be more systematic searches of complete circulation lists of particularly sensitive Budget classified papers. These checks will be carried out by FP and EOG.

162. Budget classified papers must not be typed in typing pools. Particular care should be taken about the custody of carbons, photocopies, dictating machine tapes, word-processing discs, shorthand notes etc containing classified information.

163. The disposal of any BUDGET SECRET or above document is to be recorded in the security register. Where a Principal wishes to dispose of a document he is to take care that this does not enable any unauthorised person to see its contents.

164. If BUDGET classified papers do not state the post-Budget classification, recipients should alter the classification as appropriate after Budget day. The 'BUDGET' prefix should always be deleted after Budget day, as it no longer has any significance. Papers which refer only to decisions which were announced in the Budget may be declassified. Papers containing advice or background to such decisions should generally be classified CONFIDENTIAL. Papers containing references to courses of action which were not pursued, which were classified BUDGET SECRET, should remain SECRET.

Queries

165. Any questions about the Budget Security instructions should be addressed to the Budget Security Officer, who is the Principal in FP Division (Indirect taxation branch) (extension 5237).

2652/12

RESTRICTED

H M TREASURY

OFFICE NOTICE

ON(GENERAL)(85)
4 DECEMBER 1985

BUDGET SECURITY

I attach a note setting out this year's Budget security instructions. They apply without exception to Ministers, advisers and officials. Breaches of these instructions will be treated as a serious matter.

2. The special arrangements for Budget security are designed to give additional protection to information about Budget decisions. This year's instructions follow the general lines of last year's instructions, although some points have been clarified. The instructions have been approved by the Chancellor of the Exchequer.

3. All members of the department should recognise the sensitivity of Budget material, and take every care to ensure that its integrity is preserved. Heads of Divisions and Private Offices should ensure that staff who are likely to handle Budget papers understand the instructions. The Assistant Budget Security Officer in EOG2 will also help ensure that the staff most heavily involved understand the procedures and have the equipment to carry them out.

4. The major changes in this year's instructions compared with last year are:

(a) the use of Budget classification has been extended to cover any public expenditure changes to be announced in the Budget, not just social security changes - all staff working on any such change should familiarise themselves with the Budget Security instructions; and

(b) **BUDGET SECRET: BUDGET LIST ONLY** documents are to be prepared on plain paper and copied on to the special paper bearing printed security markings - it is essential that close security be maintained over the typed original (paragraph 158(b) and (c)).

. There are a number of other points in the instructions to which I would draw particular attention:

(a) The rules for handling Budget Secret: Budget List Only documents set out in paragraph 158 must be adhered to strictly. In particular, documents for which this classification is appropriate must not be sent or shown to anybody who is not on the authorised list of recipients (the "Budget List") which has been approved by me. Any alterations to the list require my prior approval.

(b) Care should be exercised in applying the right classification to Budget documents, in accordance with the guidance of paragraphs 151 and 152. In particular, a reply to or comments on a minute should not automatically be given the same classification as the original minute.

(c) Great care should be taken to ensure that titles of Budget Secret documents and above are not themselves revealing of the contents of the Budget, as they may be seen by staff not authorised to have access to Budget information (paragraph 158(a), 160(a)).

(d) A minute containing Budget classified material should not be written unless it is strictly necessary and, if it is, should not be circulated to those who do not have a real operational need to see it. If a person only needs to see part of a document, he should only be sent that part, not the whole document (paragraph 155).

(e) Each copy of every document classified Budget Secret or above must be individually numbered, in sequence (paragraph 158(c), 160(f)).

(f) Documents which are classified Budget Secret or above must always be sent in double envelopes, even if they are being sent within the Treasury. The inner envelope should bear the appropriate address label with all details fully completed (paragraph 158(d), 160(a)).

(g) Budget classified papers may not be filed by allocated Clerks (or Sector Registries) until after Budget Day, unless specifically authorised. Until then, such papers which have been passed to a Principal must be kept by him so that other staff do not have access to them (paragraph 158(f), 160(d)).

(h) Additional security furniture will be required by some staff. It is essential that requisitions for this be made as soon as possible from the Assistant Budget Security Officer in EOG1 (extension 7861) (paragraph 158(g), 160(d)).

6. A copy of the Budget list is being sent today to those persons whose names are included on it.

7. The system of special spot checks on Budget classified documents (paragraph 161) will continue. These checks are carried out on my authority. I ask all members of staff to co-operate so that the checks can be carried out with the minimum of disturbance.

8. The Budget Security instructions also contain guidance (paragraphs 144 to 147) on contacts with journalists, in the period from the beginning of January to Budget Day, which apply whether or not you have any involvement with Budget work. The term "journalist" should be interpreted widely to include contributors to specialists publications, brokers circulars, newsletters etc; indeed anyone who is in a position to make easy contact with the media. Most staff will not have any such contacts. But if you do you must observe these instructions, to protect your own position and that of the department against suspicion. In any contacts, you must take particular care, as inferences can be drawn from the most casual remark or refusal to comment.

9. Further guidance on any aspect of the Budget security instructions can be obtained from the Budget Security Officer, who is the Principal in FP (Indirect taxation branch - extension 5237), who will be assisted in the performance of his duties during the Budget season by a member of EOG2 (extension 7861).

10. Please insert these instructions in the copy of "HM Treasury Security Instructions" in your possession and destroy the previous version.

PETER MIDDLETON

RESTRICTED

6.12.85

BUDGET LIST

Chancellor's Office

1. Chancellor
2. Mrs Lomax (PPS)
3. Mr Kuczys (PS)
4. Mr Wynn Owen (PS)
5. Mr Fray (EO)
6. Mrs Henson (CO)
7. Mr Sears (CO)
8. Mrs Willis (Pers Sec)
9. Mrs Healey (Pers Sec)
10. Mrs Modos (Pers Sec)

Other Ministers

11. Chief Secretary
12. Mr Broadbent (PS)
13. Financial Secretary
14. Ms Life (PS)
15. Economic Secretary
16. Mr Neilson (PS)
17. Minister of State
18. Mr Norgrove (PS)

Permanent Secretaries

19. Sir Peter Middleton
20. Mr Murphy (PS)
21. Sir Geoffrey Littler
22. Mrs Miller (Pers Sec)
23. Mr F E R Butler
24. Mrs Verlander (Pers Sec)
25. Sir T Burns
26. Mr Allen (PS)

Central Unit

27. Mr Scholar (US)
28. Miss Thompson (Pers Sec)
29. Mrs Crane (Typist)
30. Mr Pratt (Prin)
31. Mr Walters (SEO)
32. Mr Edwards (CO)

Accountancy Adviser

33. Mr A Wilson

Deputy Secretaries

34. Mr Cassell
35. Mr Byatt
36. Mr Monck

Special Advisers

37. Mr Cropper
38. Mr Lord
39. Mr H Davies

Fiscal Policy

40. Mr Monger (US)
41. Ms Nelson (Pers Sec)
42. Miss Sinclair (AS)
43. Mrs Harvey (Pers Sec)
44. Mr Haigh (Prin)
45. Mr Murray HEO(D))
46. Mr McKenzie (EO)
47. Mr Romanski (Prin) (Budget Security Officer)
48. Mr Rees (Budget Security assistance)

Other Treasury Officials

49. Mr Evans (US-EA)
50. Mr Odling-Smee (US-MP)
51. Mr Ritchie (Scorecards)
52. Mr Riley (AS-MP1)

Inland Revenue

1. Sir L Airey (Chairman)
2. Miss Brand (PS)
3. Mr Isaac (D Chairman)
4. Mrs Newns (Pers Sec)
5. Mr Battishill (D Chairman)
6. Mrs Ellis (Pers Sec)
7. Mr Painter (Central Division)
8. Miss Nash (Pers Sec)
9. Mr P Lewis (Central Division)
10. Miss Miles (Pers Sec)
11. Mr McManus (Central Division)
12. Mr Ridley (HEO)
13. Mr Walker (Central Division)
14. Miss Wiseman (Pers Sec)
15. Mr Calder (Statistics)
16. Miss Davies (Pers Sec)
17. Mrs Hillier (Statistics)
18. Mrs Ayling (Manpower)

Customs and Excise

1. Sir A Fraser (Chairman)
2. Ms French (PS)
3. Mr Knox (D Chairman)
4. Miss Vincent (Pers Sec)
5. Mr Jefferson Smith (Director, Internal Taxes)
6. Mr Wilmott (Asst Sec DPU)
7. Mrs Howard (Pers Sec)
8. Mr Bone (DPU - Prin)
9. Mr Fisher (DPU - SEO)
10. Mrs Hamill (DPU - Economic Adviser)
11. Mr Brennan (DPU - Senior Economic Assistant)

Pmr P

CHANCELLOR OF THE EXCHEQUER

Ch

You shd be aware of this invitation from the Unquoted Companies Group (Sir E Kaye, prop.) which the CST has accepted — on the basis at 'x' of P. Middleton's note.

As you will see, it caused some concern, but is probably OK on this basis.

AWK
8/1

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

For CST bilateral today (Wed.) at 6.30 pm

(CST is still inclined to accept this invitation)

(PEM & Michael Scholar are content on the basis of ('x' below)

AWK

From: SIR PETER MIDDLETON

Date: 20 December 1985

CHIEF SECRETARY

Financial Secretary
Economic Secretary
Minister of State
Mr Scholar
Mr Romanski
Mr H Davies

PS/IR

THE UNQUOTED COMPANIES GROUP

Mr Dighti's ~~Ms Henderson's~~ minute of 18 December causes me some concern. Perhaps I could clarify the position.

2. The Budget security instructions will operate from 1 January. There are definite rules about contact with Journalists from this point. Care also needs to be exercised more generally in outside contacts. There can never be a complete ban as Treasury Ministers' responsibilities go beyond the Budget. But Ministers must take care not to put themselves at risk. Chance remarks are subject to a high degree of misunderstanding in the pre-Budget period. At some point - usually from the beginning of February - the Chancellor will take a very restrictive view about Ministerial engagements. City lunches are of course particularly to be avoided.

X

3. So far as the Unquoted Companies group is concerned, I see no objection to your going, though representations on the Budget are best made in the office. But you should take a Private Secretary with you who should make a short note of the proceedings. It would be exceedingly unwise to enter into any discussion with them on their suggestions beyond the odd clarificatory question. They will not expect you to do more than this; this particular group are certainly used to Ministers listening to what they say without comment at this time of year.

PEM

P E MIDDLETON

For CST bilateral folder 8/1

b/f 6/1/86 P

FROM: A A DIGHT
DATE: 18 December 1985

MS HENDERSON

cc:
PPS
PS/FST
Sir P Middleton
Mr F E R Butler
Mr Monck
Mr Scholar
Mr Burgner
Mr P Shaw
Mr Cropper
Mr Lord

PS/Inland Revenue
Mr Farmer - IR

THE UNQUOTED COMPANIES GROUP

The Chief Secretary has accepted an invitation from the Unquoted Companies Group to join a few members of the group for lunch on Wednesday, 29 January.

2 The Chief Secretary would welcome a brief from you on matters of interest to the group particularly on the subject of Employee share schemes for unquoted companies, small firms needs and taxation by close of play on Monday, 20 January

A A Dight

A A DIGHT
Diary Secretary

Rachel

This means Sir Emmanuel Kaye. It is in Purdah. Looks most unwise to me

T.

Tony

Well spotted. Spoke to Richard B - who will reconsider. Check what's happened on this - if necessary warn the Chancellor R 19/12

2155/012

FINANCIAL SECRETARY TO THE TREASURY

FROM: GERALD D'SOUZA

DATE: December 1985

MR BATTERSBY - IR

cc: PS/Chancellor
PS/Chief Secretary
Sir P Middleton
Mr Cassell
Mr Mongar
Miss Sinclair
Mr Cropper
Mr Houghton - IR
PS/IR

SMALL BUSINESS BUREAU

1. The Financial Secretary has agreed to see Michael Grylls MP Chairman of the Small Business Bureau to discuss Capital Transfer Tax Relief on Tuesday 17 December at 3.15 pm.

2. Mr Grylls may be accompanied by two Vice Presidents of the Bureau, Barry Baldwin of Price Waterhouse and Michael Brent Chairman of Timite Limited.

3. I would be grateful if you could provide briefing by Friday 13 December.

Gerald D'Souza

GERALD D'SOUZA

CHANCELLOR OF THE EXCHEQUER

In addition to the several MPs in the last para of the letter requiring copies, pl copy the <u>whole</u> of the string, with C's reply to:-

PS/CST

PS/FST

PS/EST

PS/MST

Sir P. Middleton

Sir T. Burns

Mr Monger

~~Miss C[illegible]~~

Mr Scholar

Miss Sinclair

Miss Page MCU

Mr P. Lilley MP.

TIM YEO MP

HOUSE OF COMMONS
LONDON SWIA OAA
01 219 6353

10th December, 1985

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer,
H.M. Treasury,
Treasury Buildings,
Parliament Street
London. S.W.1.

C. Essentially a Budget Rep!
A short note from you saying you will bear their comments carefully in mind?
There is no request for a meeting, so I see no need to offer one at this stage.
Nor do I see any need to comment on X.
Shall I draft on that basis?
Yes pse
R 11/12

Dear Nigel

I enclose a letter from the Third Term Group on the subject of income tax and National Insurance Contributions.

X The Group would like to make this letter public at the beginning of next week, and I hope that this will give you time to consider the points which are made in the letter.

Yours ever

Tim

TIM YEO

Constituency office: 7 Queen Street, Hadleigh, Suffolk IP7 5DZ Hadleigh 823435

HOUSE OF COMMONS
LONDON SW1A OAA

10th December, 1985.

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer,
H.M. Treasury
Treasury Chambers,
Parliament Street,
London. S.W.1.

Dear Nigel

The Third Term Group approves your decision not to publish a fiscal adjustment figure with the Autumn Statement and hopes that this will encourage constructive debate about the nature, as opposed to the size, of any tax cuts which may be announced in next year's Budget.

We particularly welcomed the 1985 Budget changes on National Insurance Contributions, which were very much in line with our own suggestions discussed with you last February. We believe that next year's Budget should be used to build on these foundations.

It is our view that at present there is little pressure from those with average and above average incomes for sizeable tax cuts. These groups have benefited from the reductions already made and continue to be protected by automatic indexation of thresholds.

There is however widespread concern that income tax and national insurance contributions bite too deeply into the pay packets of below average earners. The reference to the £140 per week nurse who loses over £40 per week in deductions in your speech to the Party Conference struck a chord with us and with many of our constituents.

We also attach great importance to the need to introduce tax cuts which stimulate employment. This can best be achieved by tax and national insurance changes which significantly raise the take home pay of the lower wage earners, thus helping to make employment financially more attractive.

Accordingly we urge you most strongly to reject the idea of cutting the standard rate of income tax, for which there is limited popular demand and which is the least efficient way to relieve the burden of tax on the lower paid.

Instead we suggest that relief should be given half in the form of higher tax allowances and thresholds, and half in the form of further reductions in employees national insurance contributions in Bands 1, 2 and 3.

This combination has the advantage of conferring some benefit on all taxpayers while at the same time doing far more for every one of the 11 million workers earning up to £140 p.w. than is possible through any

continued..................

other method.

We believe that the vast majority of wage earners do not distinguish between income tax and national insurance contributions but are concerned with take home pay. Until the changes contained in your 1985 Budget were introduced, wage earners faced a basic 'deduction rate' of 39 per cent , made up of 30 per cent tax and 9 per cent national insurance contributions.

This has now been amended so that rates of 37 and 35 per cent apply to lower earners. In doing this you have effectively reintroduced the old lower rate of income tax without imposing any administrative burden on the Inland Revenue. Our proposal would take this process a stage further, without the need for structural change.

As we do not know what sum of money will be available for tax cuts we have used a figure of £2.5 billions for illustrative purposes only (the arguments hold good for any higher or lower figure).

This sum would be roughly sufficient to cut the basic and higher rates of income tax by 2 pence. This would increase the take home pay of the £140 per week nurse by £1.90 per week if single and £1.40 if married.

continued................

The same sum would finance a combination of a ~~6~~ 6.3 per cent rise in all personal tax allowances and thresholds, and a 3 per cent cut in the rates of class 1 employee national insurance contributions paid by all employees in Bands 1, 2, and 3 (i.e. employees earning from £38 to £59.99 would pay 2 per cent, from £50 to £94.99 4 per cent and from £95 to £134.99 6 per cent). This would increase the take home pay of the £140 per week nurse by £5.00 per week if single and £5.47 if married.

The relative advantages of our method are even greater for those earning below £140 per week. For example at £100 per week a married man is only 60 pence better off from a 2 p tax rate cut but is £4. 27 better off under our proposal.

We recognise that for those earning over £7,280 per annum, the attractions of cuts in the rate of income tax become progressively greater as they rise up the earnings scale. In the context of the 1986 Budget however we believe that average and above average earners, all of whom would gain significantly from our proposed threshold increase, would be satisfied to see part of the relief concentrated on the lower income group.

Changes in national insurance contributions offer the only simple way to

continued.................

target relief accurately at the low paid -the one group which is universally acknowledged to be paying too much tax - and your last Budget recognised this.

We believe that tax changes which do something for everyone but more for the worst off would be economically beneficial by stimulating work incentives at a time of unemployment and politically popular because of their obvious fairness.

Yours sincerely

Tim Yeo

TIM YEO

Steve Norris

STEVE NORRIS

Andrew J MacKay

ANDREW MACKAY

John Hannam

JOHN HANNAM

Bowen Wells

BOWEN WELLS

Virginia Bottomley

VIRGINIA BOTTOMLEY

David Harris

DAVID HARRIS

Sydney Chapman

SYDNEY CHAPMAN

Bill Benyon BILL BENYON

David Heathcoat-Amory DAVID HEATH-COAT AMORY

254/12

Revised Version

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

NOTES OF A MEETING HELD IN HM TREASURY ON 13 DECEMBER TO DISCUSS CTT : ABOLITION OF THE LIFETIME CHARGE

Present:	**Mr Isaac**
	Mr Houghton
	Mr Battersby
	Mr Thompson
	Mr Monger/Miss Sinclair
	Mr Cropper

The meeting had before it Mr Battersby's note of 6 December which covered Mr Houghton's paper of 5 December.

A. TRUSTS

Cumulation

1. Agreed to reduce settlor's cumulation period to 7 years. This would be an improvement on the present position which the Revenue were asked to cost.

2. The settlor's cumulation should exclude his lifetime gifts to individuals. Again, an improvement to be costed.

3. Entry and Exit charges on interest in possession trusts within the protection period should NOT be offset against the death charge on the life tenant, to any greater extent than provided by the existing quick succession relief.

The Financial Secretary was clear that conceding on this point would break the line that was being held elsewhere. He did not see any merit in giving ground on this point, especially as the agreed course of action on 1 and 2 above would be beneficial to Trusts.

4. (Reference to Summary of charges attached below)

(i) Accumulation and maintenance trusts for beneficiaries up to age 25;
There should be no entry charge - a change from present policy.

(ii) Temporary charitable trusts;

Maintain present position, ie normal lifetime gift charge - settlor's cumulation (as amended under 1 and 2 above).

(iii) Permanent charitable trusts;

No change - no entry charge.

(iv) Approved superannuation schemes;

No change - no entry charge

(v) Maintenance funds for heritage property;

No change - no entry charge.

The Financial Secretary remarked that the heritage trusts will however feel disadvantaged relative to other trusts who will receive concessions.

(vi) Employee Trusts (Temporary and Permanent)

No change - no entry charge on shares in company
normal lifetime charge - settler's cumulation
(as for ii) on other property.

(These trusts are being relieved elsewhere so they should not feel relatively disadvantaged here)

(vii) Newspaper trusts;

No change - normal lifetime gift charge - Settlor's cumulation (as for ii).

(viii) Trusts for mentally and physically disabled persons;

Remove entry charge.

(The Financial Secretary noted that property settled in this sort of case had to be done by way of a trust, so it was right to take away the entry charge.

(ix) Protective trusts;

No change - normal lifetime gift charge - settlor's cumulation (as for ii).

Personal judgements on the nature of the person involved have to be made by the settlor here so the normal pattern should be retained.

(x) Discretionary trusts of heritage property with conditional exemption

No change.

Periodic Charge

5. The Financial Secretary agreed with the conclusions in Mr Thompson's minute of 11 December that establishing the charge for trusts by applying the death rate to a proportion of the value of the assets rather than by applying a proportion of the death rate to the full asset value was too complicated and should not be pursued.

6. The trust rate should be half the death rate.

7. The charge should continue to be every 10 years. This would ensure the maintenance of the 30 year lifetime cycle.

B. NON-TRUST ISSUES

Main assumption - period to protect the death charge will be 7 years.

Periodic Period - Taper Relief

1. Gifts should be charged at value at date of gift.

2. The present cumulation system should be retained as the method of charge, rather than move to aggregation.

This system would be in line with promoting the idea of lifetime giving.

3. Tapering the tax rate should be retained as the taper mechanism.

4. (Para 12 of Mr Houghton's submission of 5 December refers) The Financial Secretary said that a modified version of Table A in Mr Houghton's submission might be the best option, perhaps running 100, 100, 70, 50, 30, 20, 10. He asked the Revenue to look at this further and provide figures for the cost of this sort of taper.

Other Points

5. The death charge should continue to be based on the death scale at the time of death.

6. There was general agreement that the donee should continue to be liable for extra tax on a gift within the protective period. A problem would arise, however, with a 7 year protective period because of the difficulties for an executor in going back over 7 years. Mr Houghton said that the Revenue would examine what had happened under Estate Duty when there was a 7 year protective period, and would report back on this.

7. The payment date and interest charge should continue to be as at present.

8. The charge should be based on the domicile at the date of gift.

9. The Financial Secretary agreed that it was probably best to allow the existing exemptions to continue to apply but wanted to look at this area again in due course.

C. **GIFTS WITH RESERVATIONS**

1. There should be a provision to disallow debts of the deceased where the lender has benefitted from the deceased.

2. The charge should be on the value at the time of gift. As Mr Isaac noted, this was more generous than under Estate Duty.

3. All gifts with reservation shoudl be charged, whenever made. The Financial Secretary said the line that all gifts should be charged needed to be held, but there could need to be protection for gifts made prior to the new legislation.

4. The clean line taken to encourage outright giving might create a genuine problem. The Revenue needed to consider the situation where an outright gift had been made and the donor had through sickness and/or old age had to return to the house they had given. This sort of genuine case should be catered for in the Bill as published.

5. Legislation should remove the potential double charge. The Financial Secretary thought it important particularly on possible insurance aspects to know which groups would be affected by the changes and who might be expected to argue on their behalf. He asked the Revenue to cover this in further notes.

D. **TRANSITIONAL PROVISIONS**

1. There should be no provision to allow repayment of lifetime tax already paid.

2. Pre-Budget lifetime tax should continue to count in cumulation for deaths up to 7 years after Budget Day.

3. There should probably be special provisions for trusts which have already paid a periodic charge.

The Financial Secretary asked for a figure on this, but commented that it would probably be very small.

OTHER MATTERS

The Financial Secretary said that a Budget Day announcement which would make lifetime giving easier would appeal very much to an audience of 'future givers'. Existing trusts might complain, however, at a change of rules. Mr Houghton said that the Revenue would examine the consequences of trusts re-organising and starting again. The two questions to be considered were whether this could be done and what the tax penalties for doing it would be.

The Financial Secretary confirmed that the Revenue could proceed to instruct Parliamentary Counsel on the basis of the decisions taken at the meeting. Other papers would be provided on more detailed matters.

Revenue officials would prepare a note for the Financial Secretary to send to the Chancellor outlining these decisions. This should provide a schedule to distinguish between decisions which followed the initial framework and those where some adjustment was thought desirable, with costs where possible.

NWilliams

NIGEL WILLIAMS

cc Those present
PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Scholar
Mr Davies
Mr Graham (Parliamentary Counsel)
PS/IR

CTT - SPECIAL DISCRETIONARY TRUSTS

SUMMARY OF CHARGES

TYPE	ENTRY	PERIODIC	EXIT APPROVED PURPOSE	EXIT - OTHER	NOTES
1. Accumulation and maintenance trusts for beneficiaries up to age 25.	Normal lifetime gift charge - settlor's cumulation	None	None	Flat rate	No charge when beneficiary reaches 25 or dies under that age. When all beneficiaries reach 25, becomes normal interest in possession trust.
2. Temporary charitable trusts	Normal lifetime gift charge - settlor's cumulation	None	None	Flat rate	On termination, reverts to full discretionary regime (after payment of the flat rate charge
3. Permanent charitable trusts	None	None	None	Not permitted.	-
4. Approved super-annuation schemes.	None	None	None	No provision.	On loss of approval, no charge. Reverts to full discretionary regime.
5. Maintenance funds for heritage property	None	None	None	Higher of flat rate and settlor's cumulation rate.	Cumulation deemed for this exit charge only - does not affect settlor's own cumulation.

TYPE	ENTRY	PERIODIC	EXIT APPROVED PURPOSE	EXIT - OTHER	NOTES
6. Employee trusts					
a. Temporary	Shares in company: no charge. Other property: normal lifetime gift charge - settlor's cumulation	None	None	Flat rate	On termination, reverts to full discretionary regime (after payment of flat rate charge).
b. Permanent	- ditto -	None	None	Not permitted.	
7. Newspaper trusts	Normal lifetime gift charge - settlor's cumulation.	None	None	Flat rate.	Only 3 such trusts exist.
8. Trusts for mentally or physically disabled persons					
a. property settled before 10 March 1981.	Normal lifetime gift charge - settlor's cumulation	None	None	Flat rate.	
b. property settled later	Normal lifetime gift charge - settlor's cumulation	None	Normal lifetime gift charge - "life tenants" cumulation.	Normal lifetime gift charge - "life tenants" cumulation.	Treated as if beneficiaries had interest in possession.

TYPE	ENTRY	PERIODIC	EXIT APPROVED PURPOSE	EXIT - OTHER	NOTES
9. Protective trusts					
a. which became discretionary before 12 April 1978.	Normal lifetime gift charge - settlor's cumulation	None	None	Flat rate	
b. which became discretionary later	Normal lifetime gift charge - settlor's cumulation	None	Normal lifetime gift charge "life tenant's" cumulation	Normal lifetime gift charge "life tenant's" cumulation	Treated as if beneficiaries had interest in possession.
10. Discretionary trusts of heritage property with conditional exemption	None	None	No charge if recipient repeats undertakings.	Higher of flat rate and settlor's cumulation rate.	Cumulation deemed for thi exit charge only - does not affect settlor's own cumulation.

THE DEVELOPMENT COMMISSION
11 COWLEY STREET
LONDON SW1P 3NA

Telephone 01-222 9134

FROM THE CHAIRMAN

19 December 1985

FINANCIAL SECRETARY
20 DEC 1985

John Moore Esq. MP
Financial Secretary
The Treasury
Parliament Street
LOndon SW1P 3AG

Mr N. Munro IR
PPS, OST, MST, EST,
Sir P. Middleton
Mr Cassell, Mr Monger
Miss Sinclair, Mr Cropper
PS/IR

As From:
34 Kynance Mews
London S.W.7

Dear John –

You asked for my thoughts on Loi Monery Personal Investment Pools and whether one would prefer savings to be taxed at entry or at exit.

The ceiling on the annual allowance into such pools would, presumably, have to be substantially lower under a tax free entry scheme in order to avoid undue short term erosion to the tax base.

I have discussed this matter with Philip Chappell and we both see merit in schemes which will allow a much higher entry of tax paid savings but allow these to roll up net of income and capital gains tax, as long as withdrawals do not take place within a specified number of years.

However, such schemes are unlikely to attract any where near as much new savings (which is the object of the exercise) and it would seem odd to treat them exactly the opposite way to retirement provision so, on balance, the tax free entry method is both more consistent and will better achieve the purpose of more new investment in British equities.

/continued...

But if we can't have the one, we would rather have the other than not at all.

Turning now to the changes in capital allowances. You know my great concern that we have moved from a regime of accelerated depreciation to one of retarded depreciation. I believe this will be extremely damaging to the cash flow of precisely the sort of capital intensive high growth company we would wish to see in the incorporated sector. It will also seriously affect the cash flow of small unincorporated companies that are burdened with enough borrowings - particularly in their early years.

Frankly, the rate of 25% diminishing balance is too low. I did not mention it at the time, but the suggestion that this rate be changed to straight line - thereby allowing a recovery of cost over 4 years - would not only be a much more realistic rate of depreciation but could be presented as a simplification of accountancy procedures as well. No!

There is, however, a 'free market' system that would be best of all - namely allowing companies to depreciate for tax purposes at the same rate as they depreciate in their accounts. This would have the great merit of giving freedom of choice and, at the same time, make the accounts more accurately reflect the company's cash flow position.

Finally, if there was a chance to meet those concerned who advised the Chancellor to make such an unnecessary draconian swing in capital allowances, I would like to do so. They can have no idea of the harm they will have inflicted on British industry - by over-doing the correction.

My sincere thanks for a most delightful lunch - both gastronomically and intellectually!

+ thanks for listening so patiently.

LORD VINSON

CAF
CHARITIES AID FOUNDATION
48 PEMBURY ROAD
TONBRIDGE, KENT TN9 2JD
TELEPHONE (0732) 356323

RJP

John Moore Esq.,
Financial Secretary to The Treasury,
The Treasury,
Parliament Street,
London, SW1.

2nd January 1986

Dear Sir,

I write to confirm an arrangement made over the telephone recently for Sir Reay Geddes, Mr. Peter Jay and Mr. Michael Brophy to call at your office for a meeting on Tuesday 21st January at 4.15pm.

Mr. Brophy is most grateful for the opportunity to meet with you and would propose that the informal discussions might include the points itemised on the attached sheet.

Yours faithfully,

Brenda Neale

Brenda Neale
Secretary to Michael Brophy

FINANCIAL SECRETARY	
REC.	-6 JAN 1985
ACTION	Mr STEWART - IR Briefing please
COPIES TO	PS/CHANCELLOR PS/CST PS/MST
	PS/EST MR MONGER
	Mr CROPPER Mr LORD
	MR WOODALL MISS SINCLAIR

Mr A MURRAY
PS/IR

Encl.

MB/bn

c.c. Sir Reay Geddes,
Peter Jay Esq

Proposed Agenda for the informal meeting between

Mr John Moore	Financial Secretary to H.M. Treasury
Sir Reay Geddes KBE	Chairman, Charities Aid Foundation
Mr Peter Jay	Chairman, National Council for Voluntary Organisations
Michael Brophy	Director, Charities Aid Foundation

On Tuesday 21st January, at 4.15 p.m. at The Treasury

---

1. To discuss the likelihood of a change in the donor - charity tax systems.

2. Should changes be either envisaged or possible then

   a) what these might be

   b) What role NCVO and CAF should play if any in bringing them about

3. Should fundamental changes be unlikely then to discuss what if any modifications to the covenant system would be received sympathetically.

MB/jgc

RT4.31

cc CST
FST
MST
EST
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Monck
Mr Gilmore
Mr Judd
Mr Scholar
Mr Turnbull
Mr Kaufmann
Mr Burr
Mr Satchwell
Mr Cropper
Mr Lord

PS/8

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

8 January 1986

The Rt. Hon. Douglas Hurd MP
Secretary of State for the Home Office

Dear Douglas

You wrote to me on 11 December setting out your views on what changes should be made to the levy arrangements for the ITV and ILR companies following the publication of the PAC's report.

I support your proposals to implement the main recommendations of the Working Group's report on the structure of the levies, namely to reduce the ILR levy rate to zero, to include in the ITV companies' leviable profits 50 per cent of the profits from the sale of programmes overseas, and to reduce the ITV levy rate accordingly. We are agreed that these proposals currently represent the best way of dealing with the high marginal tax-cum-levy rate without subjecting the companies to major upheavals in the course of the present franchise period. But as I pointed out in my letter of 2 August, there may well be a case for moving to a levy based on revenue at some future date.

My officials are in touch with yours about the detailed terms of the Treasury Minute. With regard to the subsidiary recommendations of the Working Party which you mention in your letter, I see no problem with the suggested changes on the free slice, loss relief or levy overpayments. I am however very doubtful about changing the accounting treatment for preliminary expenditure, since the only significant practical effect would be to give TV-AM a windfall of £2.3 million - at a time, moreover, when the company is well on the way to financial health. I hope, therefore, that you will seek to dissuade the IBA from amending its Statement of Principles to implement the change. I understand that it is aiming to do so before the end of TV-AM's financial year on 31 January, so early action will be needed if the change is to be avoided.

I would also hope that you could agree to the Group's recommendation to alter Section 35 of the Broadcasting Act 1981 so that your power to prescribe minimum levy payments in cases of "excessive expenditure" is extended for a further six months after the end of the relevant accounting period. As long as there is a profits-based levy, I feel that some safeguard of this kind is desirable, and the additional time would enable you both to have more information in which to base a decision and more time in which to reach it.

I have no objection to your suggestion that the 1986 Finance Bill be used as the vehicle for the above changes.

You also raised the possibility of publishing the Working Group's report. Perhaps we could settle that once we have taken decisions on all the issues which it raises.

Yours
Nigel

NIGEL LAWSON

Inland Revenue

Policy Division
Somerset House

FROM: C STEWART
DATE: 13 JANUARY 1986

FINANCIAL SECRETARY

CHARITIES AID FOUNDATION (CAF)

1. The CAF asked the Chief Secretary for a meeting about charities and taxation, following a commitment given by his predecessor last summer. You agreed to see them and a meeting has been fixed for 21 January. The CAF were asked to let you know what particular issues they wanted to raise.

2. We had assumed that the CAF had proposals they wanted to put to you, but the agenda enclosed with their letter of 2 January suggests that their main aim is to find out whether Ministers are intending to make changes in the present tax reliefs. It might be as well to make it clear to CAF in advance that they cannot expect to be given a preview of any possible tax changes at this time of year, and that it is up to them to put forward particular proposals if that is what they want to do. A draft letter is attached.

C STEWART

cc Mr Cropper
Mr Woodall
Mr Murray
Mr Corlett
Mr Elliott
Mrs Fletcher
Mr Stewart

cc Mr Cropper
Mr S. Woodall
Mr Murray
Mr C. Stewart IR

Treasury Chambers, Parliament Street, SW1P 3AG

15 January 1986

Michael Brophy Esq
Director
Charities Aid Foundation
48 Pembury Road
Tonbridge
Kent
TN9 2JD

Dear Mr Brophy,

Thank you for your letter of 2 January about the meeting arranged for 21 January.

To avoid any misunderstanding I think I should make it clear that - as always at this time of year - I shall not be able to give you any indication whether or not particular tax changes are likely to be made in the Budget. I assumed that in asking for a meeting you had particular points or proposals you wanted to put forward. If so I shall of course be glad to hear them, and it would be helpful if you could give my office a brief indication of what they are.

Yours sincerely

John Moore

JOHN MOORE

CAF
CHARITIES AID FOUNDATION
48 PEMBURY ROAD
TONBRIDGE, KENT TN9 2JD
TELEPHONE (0732) 356323

~~PPS~~

Note of meeting on 21/1 pl (? on b/f for 30/1)

FINANCIAL SECRETARY

John Moore Esq
Financial Secretary
The Treasury
Parliament Street
SW1P 3AG.

Mr C. Stewart
PPS, CST, MST ~~EST~~

17th January 1986

Mr Monger, Mr Cropper
Mr Ford Miss Sinclair
Mr Woodall, Mr A. Murray
PS/IR

Dear Minister

Thank you for your letter dated 15th January. With some hesitation I am replying to it without having had the opportunity to consult either my own Chairman or the Chairman of the National Council for Voluntary Organisations.

Our visit next Tuesday is to find out whether you are irrevocably behind the covenant system - realising that your answer will have to be coded <u>if you are not.</u>

It is also to make the case for experimenting with an incentive system for donors in addition to the covenant system.

We should also like to seek your cooperation in setting up a standing committee to simplify, streamline and market the covenant system, and to discuss matching grants for social welfare etc; in line with recent Arts schemes and the M.S.C Matching Grants for Enterprise Agency sponsors.

Finally, to impress upon you the significance of the new Council for Charitable Support which seeks to increase private sector involvement in the voluntary sector.

Yours sincerely

Michael Brophy

Michael Brophy
<u>Director.</u>

MB/bn

H M Treasury

with compliments

MINISTERIAL CORRESPONDENCE UNIT

APS/CHX

This is really connected with CHX constituency work. A copy of CST's reply of 25/11 is attached. Can you advise please

JP 21/1

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: 01-233

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

C/ You may wish to note due to constituency angle. Do you want to send a simple acknowledgement yourself?

Ro 21/1

~~W/E box pse.~~

PST send a slightly fuller reply than originally drafted — HJD can do this.

N.

FROM: MICHAEL LATHAM M.P. (RUTLAND & MELTON)

HOUSE OF COMMONS
LONDON SWIA OAA

20th January, 1986.

Dear Nigel,

You will recall that I wrote to you on 7th October, and also to Kenneth Clarke, summarising a meeting which a number of Conservative colleagues from the East Midlands had with the East Midlands Engineering Employers' Association at Barleythorpe, Rutland. John MacGregor was kind enough to reply on 25th November, and Kenneth Clarke did so on the 4th December.

We had a further meeting at the House of Commons last Wednesday, and I am enclosing for your attention, in case you have not already seen them, the documents which were submitted to that meeting. Since, of course, both you and Kenneth Clarke are East Midlands M.P.s anyway, you may already have seen them.

The meeting was attended by sixteen Conservative colleagues, and lasted from 11 a.m. to 12.45 p.m. All the discussion was excellent and I thought I would summarise it for you.

(1) Concern remains about the arrangements for supporting the British export effort. This was also a major matter at the October meeting. I did not show it to you at the time, because it was covered by my letter, but Mr. Peter Harrisson, of Herbert Morris Limited, of Loughborough, wrote to me then and I am enclosing a copy of his letter now. Several representatives felt that Japan, the U.S.A. and Italy were much better at providing soft loans than we were. For example, it was stated that we are offering a facility of £100 million soft loans for China, whereas Japan was offering literally billions of pounds. Italy and Australia were both offering more generous terms than we were for loans to Indonesia, and this means that we simply cannot compete for the larger projects.

(2) Another matter which remains of great concern to the industrialists is the question of Japanese penetration of this country. On balance, most of them feel that it is right to permit Japanese inward investment, but they are concerned that we will simply have assembly plants here with all the high technology and skill remaining in Japan. Indeed, the danger always will be that the enterprise will be Japanese-based and there will be little or no added value here. This requires a much tougher attitude towards agreements over the local content of the manufactured element. France actually requires an 80% local content level, and makes it a contractual requirement. We should emulate this. The unhappy experience of Commodore at Corby (not, of course, Japanese) only goes to show how much companies can benefit from Government grants but soon reduce their own employment drastically.

(3) There was a general discussion about joining the E.M.S. The general view was in favour, though some dissented. There was a great wish for exchange rate stability, though at a slightly lower pound to dollar ratio.

Cont'd.......

(4) Several Conservative M.P.s raised the question of the level of wage settlements. The employers said that this had not been a particular problem in their industry and that productivity had been increasing as well. Generally, the E.M.S. would impose an extra restraint. But, it was essential that the Japanese yen became convertible currency as well.

(5) Regarding work load, I felt that they were not as cheerful as last October. They described themselves as "worried" with competition very fierce and margins very thin. There was some recruitment by firms, especially for skilled men, many of whom had left the industry and did not intend to come back. The standard of young people coming forward for apprenticeship was often not very good. There was general backing for the Y.T.S.

(6) Investment had been maintained to some extent during the worst of the recession by Sefis (1) and (2). Investment, however, was lacking now in the absence of such help. They particularly stressed the proposals contained in paragraph 31 of the E.E.F.'s budget memorandum to you, and specifically point (d) which talks about an additional scheme of incentives for fixed investment and research and development.

I hope this will be of some help.

Yrs,

Michael.

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
Treasury Chambers,
Parliament Street,
LONDON, SW1P 3AG.

MORRIS

Herbert Morris Limited,
P.O. Box 7, North Road, Loughborough,
Leicestershire LE11 1RL, England.

Telephone: 0509 263123
Telex: 34408

Your Ref

Mr. Michael Latham, M.P.,
The House of Commons,
Westminster,
LONDON.
W1

Our Ref PWH/MTM

Contact

Date 3rd October, 1985

Dear Mr. Latham,

I was pleased to have had the opportunity of meeting you and your colleagues at Barleythorpe yesterday and to being able to discuss some of the problems which we in industry are currently facing.

I specifically raised the subject of aid and trade because it affects, not only the major contractors, but the wide spectrum of British manufacturing companies. Whilst price, quality, delivery and specification are all important, without a competitive financial package, international projects simply will not be won. We know that the Japanese, the Italians, and the Germans offer elegant finance packages typically with interest levels as low as 3 per cent and the loans repayable over periods of up to 25 years. If we want to compete then we have to offer the same.

Obtaining Government support is not by itself enough, it is often the timely support which is required. Again, British companies are on many occasions frustrated by the deliberations of Government Departments who often seem to act in opposition rather than in support of one another.

Finally, on the subject of aid and trade, I am not advocating that aid should be used indiscriminately, but only that we take every advantage to assist wealth and job creation in the United Kingdom. This would not detract from the benefits provided to the recipient nation. Surely there is nothing immoral in ensuring that the aid provided gives some benefit to us as the donor nation.

We also talked about non-tariff barriers and this is a subject which is very dear to my Company at Morris. As I explained, we have spent considerable sums of money to have our hoists type-tested for the West German market, a procedure which was not only expensive but time consuming. Our West German competitors have faced no similar barrier as we freely accept their hoists in our home market. This is not an isolated case and I can give you examples of similar situations that we have faced in Norway, Canada, Belgium and other parts of the world.

continued.../

Nothing we talked about should be construed as British industry seeking support to counter in-bred inefficiencies. We have good reasons to believe we are internationally competitive, we have modern designs, our quality can match the best of world standards and our delivery performance is proven. All we ask is for equality and for us not to have to operate at a permanent disadvantage to our international competitors.

I do hope that you will see fit to support the views expressed and that you will continue to lobby Ministers to ensure Government plays its full part in supporting UK international trade.

I look forward to seeing you again.

Kind regards.

Yours sincerely,

Peter W. Harrisson
MANAGING DIRECTOR

2220

77766

Treasury Chambers, Parliament Street, SW1P 3AG

Michael Latham Esq MP
House of Commons
LONDON
SW1A OAA

25 November 1985

Dear Michael

You wrote to Nigel Lawson on 7 October reporting on the meeting of a number of prominent East Midland Engineering firms at Barleythorpe. I am sorry not to have written sooner.

I was glad to note signs of the recovery from the recession among the views expressed. They confirm Leon Brittan's recent comment on the House of Lords' report on Overseas Trade. He pointed out that overall manufacturing output has risen 11 per cent since 1981, manufacturing by 39 per cent and manufacturing productivity by 31 per cent. And the volume of manufactured exports are, of course, at a record level.

We recognise, however, that there are still serious difficulties. UK exports of goods to Japan in the last year amounted to almost £1000 million. But the Japanese market continues to present formidable obstacles to importers. Together with our EC partners and the US, we are pressing the Japanese to take action that will improve prospects.

It might help to clear up any misunderstandings if I set out the position on dumping. The European Commission can and does act against dumped imports. To set the wheels in motion EC companies must submit a case to the Commission incorporating prima facie evidence of dumping and industry-wide injury as required under the rules of GATT. It is not generally necessary, though it may be useful, for complainants to visit exporting countries to collect evidence. Once a case has been prepared (DTI's anti-dumping unit is ready to help), the investigation is undertaken on behalf of member states by the Commission. Only in particularly complex cases is the average time taken more than 8 months, which compares favourably with the other major trading countries.

The Government shares the concern expressed about the loss of major overseas projects to foreign competitors enjoying exceptional support from their governments. We are campaigning vigorously for tighter international controls. In April, a significant advance was made at OECD when new measures of transparency and discipline for mixed credits were agreed. But we also seek to provide British companies with backing equivalent to that available to their competitors. You will have seen Leon Brittan's recent announcement of a significant increase in the flexibility of the existing ATP provision by the offer of long term low interest loans. We continue to monitor the effectiveness of the Government's support for exports in meeting what our competitors are offering and, indeed what recipient countries require.

Finally, I recognise the difficulty caused by volatility in nominal exchange rates. Greater stability is desirable. The question is how best to achieve it. As you will appreciate, this is not a problem which this country can solve on its own. What we need to see is greater convergence of economic performance in the main industrial countries, removal of market rigidities and greater attention by the dominant economies to the international implications of their domestic policies. It is to these ends that we are continuing to work.

Yours ever,

John

JOHN MacGREGOR

MEETING WITH CONSERVATIVE MEMBERS OF PARLIAMENT

*

House of Commons

*

15th January 1986

ENGINEERING EMPLOYERS'
EAST MIDLANDS ASSOCIATION

THE ASSOCIATION......

Is the largest employers' organisation in the East Midlands and a major member of the Engineering Employers' Federation.

It represents in excess of 500 engineering establishments in the East Midlands, employing about 100,000 people.

As the accepted voice of the wealth-creating sector in the East Midlands, it is in a unique position to make the views of members known. The Association and the Federation make forceful representations to the UK Government and the European Commission and, when appropriate, feed engineering employers views into the CBI, Chambers of Commerce and other organisations.

The Association is an autonomous organisation, funded entirely through members' subscriptions. Though we enjoy the closest links with the EEF, management of the Association's affairs rests firmly in the hands of its own membership through a well established framework of regional and district committees.

BENEFITS OF MEMBERSHIP

Speedy support and advice in the case of industrial disputes and problems.

Industrial tribunal cases handled by staff with wide experience in this field backed by our own legal department.

Practical professional advice in the complex sphere of Employment Law.

Informal contact and exchange of views with other employers on topical matters of concern.

Access to statistical and other information relating to wages, salaries and conditions of service on a Regional and District basis.

Views represented at the highest, influential level. An opportunity to participate with other senior executives in discussions affecting the industry generally and to meet, from time to time, Ministers, MPs and leading personalities from home and overseas who can influence our businesses.

Regular information on Government policies affecting employment and employer liability.

Ready reference handbooks on Engineering National Agreements and model Employment Practices.

Specialist advice covering a range of advisory services such as Health and Safety; Personnel and Training; Productivity; Pay Systems and Management Development.

A Small Firms Group providing a forum for the consideration of commercial and employment matters of particular interest and concern to firms with less than 200 employees.

ENGINEERING EMPLOYERS' EAST MIDLANDS ASSOCIATION

C O N T E N T S

ASSOCIATION DELEGATES AND
CONSERVATIVE MEMBERS OF PARLIAMENT
FOR EAST MIDLANDS INVITED TO MEETING

DELEGATION TO MEET MEMBERS OF PARLIAMENT

Mr M.S.M. Smith TD	-	President
Mr J. Axon	-	Site Manager, Thorn EMI Lighting Ltd, Leicester
Mr L. Berry	-	Managing Director, Mirrlees Blackstone (Stamford) Ltd.
Mr W.G. Barr	-	General Manager, Personnel & Industrial Relations, Rolls-Royce Ltd, Derby
Mr P. Brown	-	Managing Director, Timsons Ltd, Kettering
Mr J.G. Edwards	-	Managing Director, Plessey Connectors Ltd, Northampton
Mr R. Garner	-	Production Director, Davis Derby Ltd, Derby
Mr D.S. Gwynne	-	Deputy Chairman/Managing Director, The Bentley Engineering Co Ltd, Leicester
Dr R. Haynes	-	Group Chief Executive, TecQuipment Ltd, Nottingham
Dr G.E. Rippon	-	Managing Director, Maun Industries Ltd, Mansfield
Mr M.P. Tahany	-	Chairman & Managing Director, North Bridge Ltd Leicester
Mr J.S.N. Thorpe	-	Manager - Industrial Relations, Worthington Simpson Ltd, Newark

* * * * * * *

Mr N. de Jongh	-	Director, External Affairs, EEF
Miss C. Beale	-	Parliamentary Liaison Officer, EEF

* * * * * * *

Mr J.M. Stamper MBE		Director, EEEMA
Mr N.J. Chubb	-	Deputy Director, EEEMA
Mr I.L. Graham	-	Assistant Director (Industrial Relations), EEEMA

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ENGINEERING EMPLOYERS' EAST MIDLANDS ASSOCIATION

MEETING WITH CONSERVATIVE MEMBERS OF PARLIAMENT FROM EAST MIDLANDS

Wednesday 15th January 1986 at 11.00 am.

MEMBERS INVITED TO MEETING

Richard Alexander, MP	Newark
David Ashby, MP	Leicestershire North West
Richard Body, MP	Holland with Boston
Martin M. Brandon-Bravo, MP	Nottingham South
Michael R. Brown, MP	Brigg & Cleethorpes
Peter N.E. Bruinvels, MP	Leicester East
Sir Adam Butler, MP	Bosworth
Kenneth M. Carlisle, MP	Lincoln
The Rt. Hon. Kenneth Clarke, MP	Rushcliffe
Mrs Edwina Currie, MP	Derbyshire South
Stephen J. Dorrell, MP	Loughborough
Sir John A. Farr, MP	Harborough
Roger N. Freeman, MP	Kettering
Peter D. Fry, MP	Wellingborough
Christopher J. Hawkins, MP	High Peak
Richard Hickmet, MP	Glanford & Scunthorpe
The Hon. Douglas M. Hogg, MP	Grantham
Sir Philip W. Holland, MP	Gedling
Gregory Knight, MP	Derby North
Michael Knowles, MP	Nottingham East
Michael Latham, MP	Rutland & Melton
Ivan Lawrence, QC,MP	Burton

The Rt. Hon. Nigel Lawson, MP	Blaby
Edward Leigh, MP	Gainsborough & Horncastle
James Lester, MP	Broxtowe
Sir Kenneth Lewis, DL, MP	Stamford & Spalding
Antony R. Marlow, MP	Northampton North
Michael W.L. Morris, MP	Northampton South
Philip Oppenheim, MP	Amber Valley
Richard Ottaway, MP	Nottingham North
Matthew F. Parris, MP	Derbyshire West
James F. Pawsey, MP	Rugby & Kenilworth
William R. Powell, MP	Corby
The Rt. Hon. Reginald H. Prentice, JP, MP	Daventry
Peter L. Rost, MP	Erewash
Derek H. Spencer, QC, MP	Leicester South
Andrew S. Stewart, MP	Sherwood
Sir Peter H.B. Tapsell, MP	Lindsey East

THE STATE OF THE INDUSTRY

THE STATE OF THE INDUSTRY

The Association attaches considerable importance to having regular meetings with the Conservative Members of Parliament for the region. These meetings provide an opportunity not only to discuss the problems affecting the manufacturing industry, but also to look ahead at some of the major issues being considered by Parliament which have both a long term and short term effect upon the economy of the region and the country as a whole. The Association was very pleased to act as host on 2nd October to a number of regional Conservative MPs who had the opportunity of discussing informally with Managing Directors of member companies a number of issues of joint interest. However, it is felt that the annual meeting with MPs in the House of Commons is of vital interest to the engineering industry and, therefore, as on past occasions, a number of papers have been produced covering subjects of interest to those responsible for running companies and concerned about the future viability of their enterprise. The papers are not necessarily for debate at the meeting at Westminster, but can prove useful reference documents for items which are affecting the industry.

2. It has been said before, and we believe it is worth repeating, that the East Midlands views appear to be of interest to government departments, the media, etc. because of its diversification of products within the industry, and its useful mix of both large and small national and international companies: also its export record must be one of the highest of any region.

3. It is believed that the Association can quite rightly claim to speak on behalf of the manufacturing industry of the region as it is the largest employers' association in the East Midlands and although its membership is made up of engineering companies, it has other forms of association such as "Subscribers for Service" and "Subscribers for Information" which cover a number of other engineering establishments and also national and multi-national companies outside the sphere of engineering. The latter, however, do use the Association for additional services such as training, consultancy and health and safety. The Association has in membership almost 500 establishments, the largest company being Rolls-Royce at Derby, but has many small companies, some employing as few as six people. In its membership it also has companies who are highly unionised and others with no union representation at all.

4. Some firms during the recession had to shed labour to survive and, at the same time, invest in modern equipment to ensure their competitiveness. However, although many thousands left the industry in the East Midlands, there is still a shortage of skills in certain areas. The demand for competent engineers continues to outpace supply and there are critical shortages in other areas, such as systems engineers, electronic, electrical, mechanical and production engineers, and, in fact, a number of companies are experiencing difficulty in recruiting the traditional craftsmen. However, the position should be a little clearer when the results of a survey are made known. This survey is being made by the Association in conjunction with the Engineering Industry Training Board and the Manpower Services Commission in an endeavour to find out exactly where the shortages of skilled personnel are. Once the findings are known, the Association will then know what action it can take in advising government departments and educational establishments.

5. The region is well known for its good industrial relations and regular meetings are held with trade union officials on issues of importance. In fact the Association is one of the strongest advocates of employee consultation as it believes in the voluntary process rather than have rigid legislation as has been suggested in the EEC. The industry has, of course, very well-used procedure agreements which cover both manual and staff employees and allows for industrial negotiations to take place in the right atmosphere.

6. Although the major role of the Association is to assist its member companies with day to day problems of human and industrial relations and legal issues arising from legislation, it has developed over the last few years a unique supportive service which is available not only to member companies but also to industry and commerce throughout the UK and overseas. The services can be broadly listed under three headings - training, consultancy, and health and safety. Although the Association has one of the most up to date training centres in the UK - The Barleythorpe Management Centre - much of the work is undertaken in-plant or in a small centre in Leicester which is very busy handling MSC contracts particularly devised to help the unemployed and those wishing to start their own small business. The philosophy of the Association is such that it feels it must take some lead in assisting those less fortunate and, of course, it is ideally placed, with its strong industrial roots, to give practical help and guidance. The role of an employers' organisation in this type of work cannot be over-emphasised and the success rate of the various activities must confirm to government departments the wisdom of using industry-based organisation wherever possible and not concentrating solely on academic institutions. A strong influential employers' organisation is vital for the manufacturing industry and this fact is confirmed by our major international competitors such as Germany and Japan.

7. Engineering seems almost to have become Britain's secret industry. Of all the major sectors of the economy it is probably the least prominent in the public eye, yet engineering employs some 2.5 million people; sells goods and services worth more than £70 billion per annum and contributes over 10 per cent to the gross domestic product. It is five times as large as the agricultural sector; the engineering industry is 80 per cent larger than the building and construction sector; and some 40 per cent larger than the entire banking, insurance and financial services sector. Engineering is undoubtedly the key industry in the technological revolution which is transforming our world at an ever-increasing pace. For that reason alone the industry is perhaps more vital now to the future economic health and prosperity of Britain than at any time in our history, as well as being essential for the many thousands in the East Midlands whose livelihoods depend on a viable industry.

8. To the "traditional" engineering activities are now being added new developments in such fields as electronics, lasers, space, information technology, non-metallic and composite materials and bio-technology. Almost certainly these will create huge opportunities for new kinds of economic activity and employment in the foreseeable future; they will also bring increased efficiency and quality to existing economic activities. All this may seem obvious yet it is true that in Britain the engineering industry is very much hidden from the public view - when the industry does receive publicity it is often in a negative context such as the closure of a factory.

9. The Association welcomes the launch of "Industry Year 1986" as it is concerned that the public in general hold industrial activity in low social esteem and the causes of our relative decline are deeply embedded in our cultural attitudes: this does matter as talented people are being discouraged from entering the engineering industry, believing it to be unimportant, old-fashioned and of little relevance to the modern world. The UK's disappointing economic performance relative to its international competitors is probably attributable more to weakness in the exploitation and application of scientific and technological innovation and design, marketing, manufacturing, quality control and general management than to a shortage of scientific and technological innovators. However, it is believed that education is not producing sufficient qualified scientists, engineers, technologists and technicians: these categories are accounting for a steadily rising proportion of engineering industry employment and it is expected that the current shortages of competent engineers will worsen as demand continues to outpace supply. Industry Year should give the opportunity to "sell" to educational establishments the idea that "industry matters" and that the manufacturing industry is an exciting place in which to work - that it is a change and challenge environment, one which demands much from those working in it but one which provides immense satisfaction from what is achieved. The Association will be active in Industry Year and, whenever appropriate, would like to have the interest and support of Members of Parliament.

10. The product range of engineering in the region and nationally is so wide that it is difficult to define concisely. However, it can be divided into five major sectors:

[i] electrical and instrument engineering which accounts for some 34 per cent of all engineering output;

[ii] mechanical engineering which accounts for about 28 per cent of engineering output;

[iii] metal goods - this covers around 14 per cent of all engineering output;

[iv] motor vehicles and components; about 12 per cent of engineering output;

[v] aerospace equipment and other transport equipment covering 12 per cent of engineering output.

11. 1985 has been a very mixed year so far as member firms are concerned. The miners' strike did, of course, have a most damaging effect on engineering firms producing equipment for the Coal Board and although they were able to obtain some overseas business, they experienced very severe difficulties during that period; this tended to have a rippling effect and it was also believed that because of the substantial cost to government in policing the strike [action strongly supported by member firms] government expenditure in other areas was held back and again had some effect on member companies who rely on government contracts as a major part of their business. Other engineering sectors showed some improvement during 1985 - for example, aerospace - but as the home market generally was flat the industry turned more and more to exports [there is a separate paper dealing with some of the difficulties which companies were experiencing in this area].

12. The Association has encouraged member companies to consider some of the schemes devised by the government through the Department of Trade and Industry which would ensure re-equipping and planning for the future and, in fact, a number of conferences and seminars were held at our Management Centre throughout the year giving guidance and, in many cases, experience of industrial organisation. It was a very busy year for our Centre as we believe we can make a useful contribution in training and re-training to meet modern requirements. During the year we were delighted to act as hosts for conferences and special meetings of senior employers who had the opportunity of meeting a number of government ministers and senior civil servants. Although these were private meetings they were a useful opportunity for companies to raise problems and also to pass comment on government proposals and the effect on their own particular organisations. A particularly interesting exercise was the establishment of a small Association Working Party to consider the government "Burdens on Business" - Report of a Scrutiny of Administrative and Legislative Requirements. We believe that this will be of particular interest to Members of Parliament and a copy is, therefore, attached to this paper.

Trading Issues

[a] Level of Wage Settlements

The industry, conscious of the need to remain competitive and bearing in mind the level of settlements in firms overseas, endeavoured to settle wage claims at a reasonable level. During 1985 some companies were not able to make wage movements at all, others spread the award over a longer period than twelve months, but statistics show that the majority of settlements were around the 5% level. The national claim and subsequent settlement towards the end of the year allowed a 5.5% movement on the minimum time rates for the industry. Allegations that the industry is making settlements of a higher level are not generally true. Unfortunately, statistics given on the media tend to create the wrong impression but higher settlements in the private and public sector do not help engineering companies who are fighting to recover from the recession. For example, chemicals from 7% - 8%: breweries over 6%: police 7.5%: British Telecoms 7%: clearing banks 6.5%: and so forth. It is gratifying to note that the government is, however, making a stand in certain areas, particularly bearing in mind that working conditions and pensions are quite often in advance of the manufacturing industry.

[b] Government Aid for Industry

As mentioned previously in this paper, companies have been advised to study the forms of aid which are available to them from government departments. These are particularly appreciated, especially in R and D and the support for innovation. Companies also have also claimed design grants and assistance with robotics. These points again come out in the Federation's views on the budget for 1986. However, there has always been a view in the East Midlands - a minority view - that success should be rewarded by lower corporate taxation rather than financial support being made available to companies through grants.

[c] Energy Prices

Member companies watch most carefully any movement in the cost of energy - quite often they are selling their own products at very little profit in face of fierce overseas competition. It is essential that the energy industries are as efficient as the private sector has to be to survive so that industry is not over-burdened with further charges as cheaper energy is becoming more available within other countries of the EEC.

[d] Government Procurement Policy

Again it has been pointed out that the majority of foreign competitors, for example Japan and Germany, have very strong home markets, supported quite often by government policy and, therefore, our own member firms would look towards those organisations with government control or interest having a procurement policy to support UK companies and introduce some of the long overdue capital replacement programmes which, in turn, would add to the efficiency of those industries concerned.

[e] Rates Act 1984 - Statutory Duty to Consult Industry Representatives

The increasing rate burden has worried industry and, therefore, it welcomed the government legislation which required local authorities to consult with industrial rate payers prior to determining rate levies. The Association and its members have taken part in all the five county deliberations either directly from the engineering industry or linking up with other professional bodies. Although it is difficult to state what progress has been made, it is considered important that industry should continue to make its presence felt in these deliberations and, it is hoped, with the continued support of the government.

[f] Summary

One can only generalise on the state of the engineering industry in the East Midlands and it will be appreciated from the above that some sectors of the industry are very busy, others are managing and, regrettably, others are still very close to the bottom, bumping along and fighting to survive. However, the reports from the various District Meetings indicate that there is some optimism in the air for 1986. Companies have, of course, reduced their labour forces during the recession and, in many cases, are quite busy. One of the worrying factors is that because of the fierce competition, the level of profit required has not always been achieved and, in many cases, order books are fairly thin. Some companies are not obtaining the regular in-flow which would ensure a steady pattern of work and, therefore, there may be further redundancies mid-year.

Although there is a shortage of some skilled labour [as the supporting paper will indicate] there does not appear to be any indication of substantial recruitment during the next 12 months. However, it is comforting to note that quite a number of companies are now taking on apprentices and, of course, wherever possible they are supporting the government's YTS.

The Federation and the Association continue to support the government's efforts to reduce inflation which must always remain a top priority. Obviously there is concern about the high interest rates and the fluctuating pound, but it is appreciated that these issues are not necessarily under the complete control of the government of the day. Other aspects of government policy are strongly supported by the Association, e.g. to encourage enterprise, discourage bureaucracy, encourage new technology, and give support to the private sector wherever possible by reducing the legislative burden.

The Association greatly welcomes the interest and support that has been given by their representatives in Westminster: they know that they are cognisant of the part which the manufacturing industry plays in the viability of the East Midlands and the country as a whole.

JMS/JMP

6th January 1986

ENGINEERING EAST MIDLANDS EMPLOYERS' ASSOCIATION

WORKING PARTY - 'BURDENS ON BUSINESS' - REPORT OF A SCRUTINY OF ADMINISTRATIVE AND LEGISLATIVE REQUIREMENTS

1. INTRODUCTION

The Working Party was formed to comment upon the above report in line with the Federation's Circular Letter 106. It comprised of the following people:-

N. J. Chubb Assistant Director	- Engineering Employers' Association [Chairman]
Mr. T. Brown Director & Sec.	- Craven & Nicholas [Engineering] Ltd., Boston
Mr. G. S. Sanghera Managing Director	- Kaby Engineers Ltd., Leicester
Sqdr. Ldr. A. J. Weller Chairman & Managing Director	- Weller Engineering Ltd., Nottingham
Mr. P. E. Woodhead Managing Director	- R. Simon [Dryers] Ltd., Nottingham -

The above companies each employ between 30 and 60 employees.

The Working Party concentrated on the relevance and effect of the items mentioned in chapters 4 - 7 of the 'Burdens of Business' report.

[a] Action to Cut the Burden - changes in requirements.

[b] Action to Cut the Burden - enforcement.

[c] Action to Cut the Burden - communications with business.

[d] The Strategy for the Future.

The Working Party also addressed itself to items and issues which would relieve the administrative and legislative burden for the smaller company that were not mentioned in the report.

In addition, the Working Party considered the issues raised in the light of the medium size companies' position.

2. ACTION TO CUT THE BURDEN - CHANGES IN REQUIREMENTS

[a] VAT, PAYE, NIC, SSP

[i] Put the PAYE system onto a non-cumulative basis

It was felt that if this system was adopted it would simplify the administrative procedures for the smaller company as well as having direct relevance to medium and large size companies. As many companies have computerised payroll systems at the moment, it was felt that this would not have a significant effect on administrative costs but might well benefit the very small company that could enjoy quite significant savings if they were not on a computerised system.

[ii] Take more small businesses out of the VAT net.

It was felt that there would have to be a very significant increase in the VAT levels in order to take businesses out of the net. It was felt that this would not be acceptable to government and, therefore, was not considered to be a significant point. It was also felt that the suggestion to introduce a monthly payment plan might well cause more costs to companies. However, the possible improvement of "bad debt relief" in the VAT system would help companies.

[iii] Make SSP easier to integrate with firms' existing payroll systems

It was felt that the option of allowing businesses to opt out of the SSP system and pay sick pay to employees themselves at the appropriate rates without refund would not be an attractive proposition, i.e. the savings in administrative costs of not operating SSP would not outweigh the costs of the employer in bearing the whole cost.

[iv] Reduce the present multiplicity of NIC rates

It was felt that this was not a particularly burdensome problem at the moment.

[b] PLANNING, FIRE AND BUILDING REQUIREMENTS

The suggestion that it could be easier for firms to change the use of commercial premises would certainly be a welcome benefit, both for the smaller company and for their clients. It was felt that there were delays in the current planning arrangements when applications were made to change the use of commercial premises and that this should be speeded up.

However, the suggestion to rationalise the building regulations with particular reference to the conversion of existing buildings for commercial use and the possible increase of flexibility in the application of fire precautions were seen as potentially dangerous elements with regard to the safety of structures and to employees. It was felt that the current arrangments did not place an onerous burden on the smaller company.

[c] EMPLOYMENT PROTECTION, WAGES COUNCILS, HEALTH AND SAFETY AT WORK

Strong support was given to the uplifting for the qualifying periods in unfair dismissal cases from 1 to 2 years, which, in fact, has been announced by the government. It was felt that many smaller companies were inhibited from taking on employees because of the 'fear' of large compensation claims if they were dismissed. It was felt that this would encourage the recruitment of people.

So far as the redressing of the balance in unfair dismissal cases and the making of tribunal proceedings quicker and more efficient, it was felt that a lot of progress had already been made in this area in recent times and was not now considered to be a significant burden.

It was felt that any abolition or relaxation of Wages Councils' controls over young people's wages, including the current National Minimum Rates for young people established under the National Engineering Agreement, should not be undertaken as it would encourage 'sweated labour' and would not attract the right people into the industry. The Working Party felt quite strongly on this particular issue.

Similarly, the question of eliminating some of the statutory health and safety provisions was seen as a possible charter for 'rogue' employers to reduce health and safety standards.

[d] COMPANY AND CONSUMER LAW

It was felt that the elimination of the present statutory audit of accounts for shareholder managed small businesses should not be undertaken but some of the obligations contained in current legislation with regard to the contents of accounts and balance sheets could be simplified and could be contained in one balance sheet document.

[e] GENERAL POINTS

It was felt that caution should be exercised with regard to the relaxation of any general statutory duties currently being placed on employers and it was felt generally that these were not too onerous and ensured that a certain 'standard' was maintained by all employers. Fears were expressed that any relaxation in this area could possibly permit the operation of 'cowboy' employers who would not meet minimum trading standards.

With regard to the possibility of introducing 'self-certification' by firms themselves as an alternative to mandatory inspections/tests/verifications by enforcement authorities, it was felt that this could be developed a little further but with the enforcement authorities still having the right to inspect, test and verify. However, some of the current registers and forms that were required to be kept could be simplified and developed more into a self-certification system. Examples of these are the current Abrasive wheel Regulation records, the testing of pressure vessels, the checking of lifting tackle and the Disabled Persons Register.

3. ACTION TO CUT THE BURDEN - ENFORCEMENT

Critical comment was made with regard to the enforcement practice of certain government agencies and an example was given of the VAT Inspectors picking on petty items and missing some of the larger errors that could be made. It was generally felt that the various government agencies were fairly flexible in their enforcement procedures and consistent, with no major overlaps. Most of the inspecting authorities would only call by prior arrangement and were quite sympathetic if an urgent problem arose so that the management could not see them at the appointed time. However, some comment was made with regard to the position of the Factory Inspectors who turned up without appointment and would proceed to effect a tour of the works.

Comment was made with regard to the fact that the Appeals Procedure for decisions made by the enforcement authorities that were not acceptable to companies should be simplified and made easier to understand and to operate. This was felt to be a major point of criticism of current practice.

So far as methods of enforcement were concerned, it was felt that most of the government agencies already issued very helpful guidelines on enforcement practice but that some of the officials should have more 'business appreciation' training.

So far as the interface between the enforcement agencies was concerned, it was felt that generally there was no significant overlap between agencies. However, the exception to this was the relationship between the DHSS and the Inland Revenue which could combine their operations for visits to business premises to inspect records of PAYE and NIC.

4. ACTION TO CUT THE BURDEN - COMMUNICATIONS WITH BUSINESS

Generally speaking it was felt that the DHSS and VAT systems were too complex although there had been major improvements recently with regard to VAT notices. It was certainly felt that in the DHSS area literature could be made more comprehensible. Certainly the suggestion that the Government could improve enquiry facilities with freefone services would certainly help to minimise the amount of time taken by small employers in dealing with problems.

The suggestion of a 'one stop shop' was particularly welcomed. Progress had been made in this area with regard to the development of business advice centres and it was felt that this could be extended. This would certainly prevent much time being wasted by smaller companies in attempting to understand their obligations.

5. A STRATEGY FOR THE FUTURE

With regard to the three elements mentioned in the report in relation to a strategy for action, it was felt that more emphasis should be placed on the monitoring and controlling of the burden as a whole with much more emphasis being placed on the 'cost' to industry of any new regulations or Acts of Parliament. It was felt generally that opportunities for the business voice to be heard before regulatory decisions were taken were sufficient and ample opportunity existed either through trade associations or through the Engineering Employers' Association for the voice of industry to be heard. However, specific comment was made with regard to the compliance of legislation and regulations that emanated from the European Community. It was felt that these were growing out of all proportion to the benefits that might accrue and a special mention was made of the 'Social Engineering' Regulations that were being debated at the moment, especially the possible statutory enforcement of employee involvement These sorts of regulations were both unwelcome by all companies and acted as a deterrent to the development of businesses.

6. POINTS NOT SPECIFICALLY CONTAINED IN THE REPORT

It was felt that there were certain very burdensome items which affected all companies and that action could be taken in this respect that would alleviate the administrative burden on companies. The main ones were as follows:-

[a] The VAT system.

[b] The operation of Statutory Sick Pay.

[c] Heavy Goods Vehicle licencing and regulations for the operation of lorries.

[d] The abolition of the EITB.

[f] The simplification of customs and export/import documentation, both within the EEC and outside it.

[g] The abolition of the Truck Acts.

Specific comment was also made with regard to some of the statutory returns that industry had to make to government, especially the quarterly manufacturing return and the production census. It was felt that small companies in particular did not see any direct benefit of completing these forms which were at the best very much a 'guess' of the company's activities.

7. CONCLUSION

The Working Party felt that if the Government were going to have a significant effect on the burden of not only the small employer but also the medium size employer as well, then more dramatic steps would have to be taken on major issues such as the administration of VAT and SSP and the simplification of customs/import/export documentation for them to have any significant effect.

However, there were many minor items that have been mentioned in this report that whilst not significant in themselves when taken on a cumulative basis, would certainly ease the burden on business generally, not just for the smaller company.

Caution was expressed with regard to the weakening or abolition of a lot of the statutory regulations such as the Health and Safety at Work Act, the Fire Regulations, the provisions of the various Companies Acts and the operation of minimum terms and conditions of employment. It was felt that these could lead to 'rogue' employers developing with poor premises and poor working conditions which would be detrimental to the fabric of business as it is known today.

ECONOMIC POLICY AND TAXATION - "BUDGET SUBMISSION" TO H.M. TREASURY

ECONOMIC POLICY AND TAXATION - "BUDGET SUBMISSION" TO H.M. TREASURY

Over the last few years the Association has been actively involved in sending its views forward to the Federation who, in turn, make a written "Budget Submission" to the Chancellor of the Exchequer during November or early December. The purpose is to seek to influence the Government's plans for economic and taxation policy and in latter years it has concentrated on a small number of points. Therefore, it is not intended to be a comprehensive list of all points of concern to engineering employers.

2. Although there has been support by members of the Association for the Government's desire to reduce personal taxation, there is concern that this may be achieved by increasing the taxation of industry or by avoiding expenditure on such items as vocational education and training, support for science, technology in industry and investment in modern and efficient equipment and facilities. It must be emphasised that the future U.K. economy will need to depend more upon wealth generated from technology and less upon oil and gas revenues. If the country is to build a competitive presence in technology-intensive industries, action is needed now and waiting to respond to exchange rate signals will be too late.

3. The general feeling of the representation could be under the heading of "invest for survival" which it is believed is the key for the nation's future prosperity and the battle to improve export performance.

4. There are three major headings:-

i] Lower Employers' National Insurance Contributions.

The National Insurance Contribution rates should be reduced. They are no longer payment towards an insurance fund but are simply a tax on employment. Employers now pay even higher rates for employees whose earnings are above the upper limit. This places a particular burden on companies employing highly skilled staff and discourages the technology -intensive business needed for the country's future prosperity.

ii] Inflation Proofing of Corporation Tax Allowances

The present corporation tax works against companies which have positive investment programmes. The allowances for fixed investment should at least be inflation proof and unless inflation is reduced to zero, the current system imposes through inflation a tax on investment in addition to the 35% tax on profits.

We would also recommend inflation proofing of tax on stock building.

iii] Investment and Innovation

Investment and innovation should be encouraged further. A scheme of additional incentives for fixed investment and for research and development should operate for at least the next five years to develop the additional industrial technology needed to replace the nation's oil income. A scheme operating in the United States is for tax credits or the form of direct grants.

5. Federation Memorandum

A copy of the submission from the Federation to the Chancellor of the Exchequer is attached - the statement contains views expressed from the East Midlands region.

JMS/HA

6th January 1986

ENGINEERING EMPLOYERS' FEDERATION

BROADWAY HOUSE TOTHILL STREET LONDON SW1H 9NQ
TELEPHONE: 01-222 7777 TELEX: 8814718

To: Chancellor of the Exchequer

From: Engineering Employers' Federation

Subject: Economic policy and taxation

Introduction

1 The Engineering Employers' Federation has 5000 member companies, covering all sectors of the engineering and allied industries.

2 The engineering industries generate directly some 10 per cent of the gross domestic product; some 36 per cent of visible exports; and some 28 per cent of all exports of goods and services.

3 This memorandum sets out the Federation's views on economic policy, with particular emphasis on the future economic importance of industry and technology; and suggests certain implications for public expenditure and taxation.

Summary

4 The future UK economy will need to depend more upon wealth generated from technology and less upon oil and gas revenues. If we are to establish a competitive presence in technology-intensive industries, then action is needed now. Waiting to respond to exchange rate signals would be far too late.

5 At present the tax system favours projects with an early payback at the expense of the longer-term investment in technology. This is because inflation erodes the value of deferred tax allowances on investment. Government support for technological innovation and for exports has been less than foreign governments give to their industries.

6 If the tax system makes investment unattractive then industry will not be able to invest. We recommend that priority be given to incentives for investment in the industries and technologies which can generate future growth. The Government's laudable desire to reduce personal taxation should not be achieved by increasing the taxation of industry - nor by avoiding expenditure on vocational education and training; support for science, technology and industry; or investment in modern and efficient equipment and facilities.

7 We recommend in particular a reduction in the taxes paid by industry through national insurance contributions. We also recommend full inflation-proofing of corporation tax allowances for fixed capital expenditure and for stocks.

Economic policy: Laying the foundations for future prosperity

8 The Federation appreciates that recent developments in the economy show many positive features. The economy is expanding; new jobs are being created; living standards are rising for the majority

of people; and the recent resurgence of inflation seems destined to be short-lived. Nevertheless, there are reasons for concern that further serious problems may lie ahead - in the short term if world economic growth slows down and if fixed investment expenditure at home falls below its 1985 level; and in the longer term as the UK economy has to adjust to a declining trend in oil output and to rapid technological change in the world at large. Today's interest rates and exchange rates are too high. Exchange rate fluctuations have become a cause of serious disruption for industry.

9 Given the prospect of inflation at 4 per cent or less in 1986, interest rates are now so high as to inhibit economic growth. When the real cost of finance is some 10 per cent per annum, then the many projects which promise positive but more modest real pre-tax returns are not viable and will not proceed. For this reason, we believe that a reduction in real interest rates would give a large boost to economic growth.

10 We would refer to your evidence given in May 1985 to the House of Lords Select Committee on Overseas Trade. You made four points:

(a) the overseas trade surplus on fuel will diminish only at a gradual rate;

(b) the balance of trade in non-fuels, including manufactures, will tend to improve in response to a fall in the real exchange rate;

(c) interest and dividends from accumulated overseas assets could finance a future trade deficit in goods; and

(d) it is possible that the non-manufacturing private sector may play a gradually increasing role in the economy.

11 We would like to develop in particular the second and fourth points.

12 It is virtually certain that as the trade surplus in fuels diminishes there will have to be a corresponding improvement in the non-fuels balance. Our concern is not as to whether the non-fuels balance will improve; but as to the nature of that improvement.

13 If the mechanism acts in the way you have suggested - reacting to a lower real exchange rate - then the time available for industry to respond will necessarily be short. The market mechanism will only begin to generate additional manufacturing activity and capacity in arrears of actual exchange rate movements. If, in the intervening years, our capacity for manufacturing innovation and the creation of new products of high added-value has decayed, there will be no possibility of regaining the lost ground.

14 In those circumstances, the only options open to us would be to reduce imports as the oil surplus declines or to seek to make good the shortfall by the export of goods involving low or medium technologies. Such products would be in competition with those of developing countries and would sell at only a low price per hour of labour input. Advanced technology products - which can command a premium price in world markets - would have to be imported in exchange for our relatively low value exports. At present such imports are paid for by oil revenues.

15 In other words, the foreign trade account would balance in response to a falling real exchange rate as oil runs down; but would do so at the expense of a deterioration in the terms of trade and a consequent reduction in our national standard of living.

16 There is also a danger that we would be unable to pay for imports of a sufficient volume of advanced technology products to sustain the expansion of the non-manufacturing part of the economy.

17 Growth of the non-manufacturing sector is highly dependent upon manufacturing - and particularly upon engineering - for equipment and technology. In your fourth point made to the House of Lords Committee you referred to the likely continuing shift from manufacturing to non-manufacturing. The mechanism by which that shift occurs is critically dependent upon the quality - as distinct from the size - of the manufacturing sector. Existing service industries can improve their efficiency, and new service industries can emerge only if they have available new and improved products from the manufacturing sector. Those products are the essential tools of the services sector - equipment for services such as education, health care, travel, entertainment and communications.

18 Unless we have available an adequate indigenous manufacturing capacity - or we can export a sufficient value of specialised products to pay for required imports - then the goal of an expansion of service industries together with rising living standards will be unattainable.

Tax Burdens on Employment and Investment

19 Employers' national insurance contribution rates are now very high for employees earning above the upper earnings limit for employees' contributions. This is a particular burden upon companies employing highly-skilled staff and is therefore discouraging the very technology-intensive business needed for future prosperity.

20 The employers' national insurance contributions can no longer be regarded as payments towards an insurance fund. They are now simply a tax on employment, not connected with any compensating benefits received by employers, their employees or their customers. The employer now has to pay an additional tax on employee's earnings above the upper earnings limit without receiving any additional benefit; and he will have to continue to pay the national insurance levy for the redundancy fund, despite the ending of that fund and its rebates to employers.

21 There is a bias against investment in the existing system of corporation tax. A company investing in plant and machinery pays 100 per cent of the cost, but receives immediate tax relief on only 25 per cent. The balance of 75 per cent is allowed gradually in future years without compensation for inflation or for loss of interest. This is an enforced interest-free loan from the company to the government. Full tax neutrality between investment and consumption can be restored only by re-introducing 100 per cent first year allowances, so that tax relief is given as soon as expenditure is incurred.

22 A similar distortion exists regarding investment in stocks and work-in-progress, as no tax relief is given against expenditure on stockbuilding.

23 It is clear that these tax distortions are a major influence on the actual behaviour of companies. The phasing-out of 100 per cent allowances has caused a concentration of investment in 1985 into the first quarter of the year - when more favourable allowances were available - and a reduction in expenditure later in the year. The government's statistics show fixed investment in the first quarter to have been some 10 per cent above trend in manufacturing and nearly 15 per cent above trend in construction, distribution and financial services. Investment in subsequent periods has been correspondingly below trend. In this year and future years the effect of ending the 100 per cent allowances will be to reduce investment below the levels which would occur with an unbiased tax system.

Recommendations

24 We recommend that the employers' national insurance contribution rates be reduced to a low level for all employees.

25 Corporation tax allowances for fixed investment and stockbuilding should at least be inflation-proofed. Until and unless inflation is reduced to zero the present system of allowances results in a tax on investment in addition to the 35 per cent tax on profits. Ideally, we would wish to see the restoration of 100 per cent first year allowances.

26 The fixed investment allowances can be inflation-proofed, without altering the existing structure of the tax system, by increasing the pool of unrelieved expenditure each year in line with the retail prices index.

27 A similar system could be introduced for stocks, by increasing the opening value of stocks and work-in-progress in line with the movement of the retail prices index during the year.

28 In order to encourage investment and innovation, we recommend a scheme of additional incentives for fixed investment and research and development. These should operate for at least the next five years so as to develop the additional industrial technology which will be needed to replace the nation's oil income. The incentives could take the form of direct grants; or tax credits such as have been available in the United States since 1981 - although we would recommend that any tax credit scheme be simpler than the United States' scheme and be directly related to actual expenditures on fixed investment and research and development.

29 We recommend also that the Government should increase its expenditure on modern equipment for the public services, so as to take full and early advantage of the potential for improving efficiency and quality of service. This would not only generate possible future savings on current expenditure but would also help to develop a stronger UK equipment supply industry - which is predominantly in the private sector.

30 We do appreciate that the Government is already taking action in some areas such as vocational education, export support and support for innovation; but we also are certain that the effort needs to be extended substantially. That will require, in the short term at least, an increase in the amount of expenditure and reduced tax revenue from industry. To avoid this expenditure in the interests of achieving a - perhaps transient - reduction in personal taxation would

be a false economy and exceedingly damaging to the nation's future prosperity.

31 To the extent that there may be scope for tax reductions in the Budget for 1986-87, we recommend that priority should be given to:

(a) Reduction of national insurance contribution rates;
(b) Inflation-proofing of corporation tax allowances for fixed investment;
(c) Inflation-adjustment of the taxable amount of stockbuilding; and
(d) An additional scheme of incentives for fixed investment and research and development.

EXPORT - OVERSEAS TRADE

EXPORT - OVERSEAS TRADE

The Engineering Employers' Federation and the East Midlands Association believe that the deficit in the United Kingdom's balance of trade in manufactures has far reaching implications for the future prosperity of the nation and that early action is needed by Government and by industry if the nation's living standards are to be maintained and improved upon.

2. Comparing the estimated trade balances for the two years 1983-84 with those of 1963-64 we find the following changes:

	Increase/decrease in trade balance 1963/64 to 1983/84 £ billion per annum at 1984 purchasing power	
Fuels	+ 7.9	
Food, drink & tobacco	+ 4.8	
Services	+ 4.7	
Basic materials	+ 1.9	
Miscellaneous trade	- 0.1	
Semi-furnished manufactures	- 2.7	
Furnished manufactures	- 12.6	- 15.3 total manufactures.
Total trade in goods and services	+ 3.9	

3. The reason for the large increase in the fuels balance is obvious; the development of North Sea oil and gas fields whose balance of payments impact has been magnified by the increased real price of oil and gas. The trade balances in food, drink, and tobacco; services; and basic materials have together shown an improvement during the last 20 years which is greater than the improvement in the fuels balance. It is clear, however, that the manufacturing sector has lost competitiveness against the food, drink and tobacco and services sectors of the UK economy. It is also clear that the major deterioration of the manufactures trade balance has occurred in the finished goods rather than the semi-finished goods sector.

4. These developments are of serious concern to us, as engineering products account for some 85% of all UK exports of finished manufactures. We believe that this shift will have adverse consequences for the nation's future prosperity unless action is taken. The danger is that, if the present trend continues towards UK dependence on low technology and commodity-type products, then a high volume of relatively low value products will need to be exported in order to pay for imports of relatively high value advanced technology products. The UK's access to advanced technology will thus be restricted and living standards which depend very much upon technology will decline.

5. It is important to act now to prepare a United Kingdom manufacturing capacity which will be able to command a high price for its products in world markets. The development of a competitive technological capability depends ultimately on industry itself, but industry will not, indeed cannot, take action unless there is commercial advantage in doing so. At present there are several features of the economic and fiscal environment which tend to discourage commercial investment in longer term projects and in advanced technology. Only Government support can remove these obstacles.

6. The Federation with the whole-hearted support of the East Midlands Association made representation in 1985 to the Select Committee of the House of Lords on overseas trade proposing seven areas for Government action.

7. First, the Government's industrial policy should concentrate primarily on indigenous rather than imported skills. This does not mean that the UK should spurn imported technology or foreign collaboration, but that where Government support is given it should involve firms already established in the UK.

8. Second, there should be a substantial increase in Goverment assistance for industrial research and development. Unfortunately, figures show that fewer people were engaged in research and development in 1983 than in 1981.

9. Third, the Government's industrial support should concentrate on the development of technological expertise rather than purely on the volume of manufacturing capacity. This would involve both the direct support of technology in industry and an increase in public technological education and training.

10. Fourth, the fiscal bias in favour of short-term projects should preferably be reversed and one major reform required is the restoration of 100% allowances against corporation tax for fixed investment expenditure. At an inflation rate of 5% per annum, the delay in tax relief on plant and machinery causes some 17% of the real expenditure to be disallowed for tax purposes. Even if there were no inflation an investment project would still face a cash flow disadvantage through the delay in tax relief.

11. Fifth, increased support is required for major export projects. Participation in these projects is an important, perhaps essential, mechanism for the maintenance of competitive UK technological capacity. As foreign competitors receive support from their Governments, UK companies cannot compete for these projects without Government backing.

12. Sixth, the Government should seek to support UK commercial interests in the engineering field against the damaging effect of foreign protectionism and the various forms of foreign Government support for engineering.

13. Seventh, bearing in mind the particular problems associated with competition from Japan, the Government should continue to encourage and support voluntary restraint agreements where these are appropriate, in order to preserve the skills and infrastructures which will be essential for the redevelopment of key manufacturing industries.

14. The above are general points which, it is hoped, that the Government will consider for the future. These will greatly assist our East Midlands engineering industry in its battle to increase exports.

15. As has already been stated in the paper "State of the Industry" the home market remains fairly flat and, therefore, companies are, in any case, turning more to the export market to obtain business. The Association, therefore, has arranged a number of activities during the past 12 months to encourage companies to look at their engineering marketing for overseas business and also, in conjunction with the British Overseas Trade Board, a number of seminars devised to assist companies going into export business for the first time and those who are looking for "new fields to conquer". These have proved most successful and have helped companies in expanding their business.

16. A particularly helpful session took place on 14th November, when the Right Honourable, The Earl Jellicoe, Chairman of the British Overseas Trade Board, visited Barleythorpe and spoke to about 40 leading industrialists actively involved in the export business. The purpose of the meeting was to give those present the opportunity of explaining to Lord Jellicoe the problems which they were facing and the assistance which the British Overseas Trade Board and the Government could give them for the future. Prior to the meeting a questionnaire was sent out to those attending seeking information which could be usefully introduced into the discussions. Out of 24 replies received, the average percentage of total sales exported during the past 12 months of the firms concerned was 53%. Three of the companies replying indicated that 90% of their production was exported. Another question asked was - had the company increased its exports on the previous 12 months? One indicated a decrease, 5 said the same, but all the others indicated that there had been an improvement on the previous 12 months.

17. In an endeavour to find out which were the top 4 export markets for East Midlands engineering companies, we asked the companies to list these in order of importance. The results show that the EEC was the major market [with West Germany leading] and this was closely followed by the United States of America and Canada. The Middle East and Far East were equal third in importance. It was interesting to note that more companies were exporting to China than to Australia.

18. Two further questions which were asked concerned the difficulties which companies were experiencing in developing their exports. They were asked to list the names of countries and also give some general comment on the problems with which they were facing. Top of the list was Latin America where traditionally, the East Midlands has done good business over many years. Next was Japan and third Nigeria.

19. The following are some of the general points raised by companies, but not necessarily in order of importance.

a] Adverse exchange rates.

b] High interest rates.

c] Insurance of export orders.

d] Import restrictions.

e] Economic political instability.

f] Specific local design requirements.

g] More benevolent business environment enjoyed by key competitors in terms of Government support for their exports.

What was fairly consistent was inability to obtain suitable financial support.

20. After these general comments there are more specific points on a country by country basis. Some of these are repeats of what was given in the Association Paper for 1984.

i] Spain

Massive import tariffs compared with these of exporting from Spain to the UK, having a very low import duty. This is particularly difficult for companies currently negotiating long-term contracts with the motor manufacturers, as they are of the opinion that components being exported from Spain to the UK have had the benefit of export subsidies

ii] Italy

A continuing complaint that there must be subsidies supporting Italian companies as items coming out of the country are so low that they cannot be normal commercial prices. Again they suggest a concealed Government subsidy.

iii] France and Germany

In France there is a strong nationalistic prejudice and this is supported by the Government who, through good ministerial contact and an effective banking system, are able to develop export business by means of inter-related purchase deals. In West Germany, the difficulties of the exchange rate were fairly prominent during the year. It is pleasing to note that Germany appears to be an expanding market.

iv] Japan

This is still a serious area of complaint and a number of examples were given to Lord Jellicoe by firms present. For example, no UK business unless joint ventures were established with competitors in Japan and trade barriers were often introduced, often intransigence with business deals. Also there was a complaint about the inward investment in the UK by some Japanese companies (for example, Nissan) and their controlled component suppliers. Another example is the establishment of factories in Ireland and Scotland with financial support from the Government and some of these factories are in direct competition with established firms in the East Midlands who, in turn, are unable to obtain business from the Japanese manufacturers.

v] Latin America

These are all tied up with the lack of hard currency, import restrictions, finance and general ECGD restrictions.

vi] Mexico and Iran

Import restrictions and lack of customer finance.

vii] United States of America

Product liability insurance difficulties and in some cases quota restrictions.

viii] India and Korea

Companies are experiencing import licence controls.

Other countries specified on the return from companies indicate that they are having export problems due to the inability of obtaining suitable finance in comparison with their competitors. Indonesia is a typical example.

21. Although the above deal mainly with the difficulties in exporting around the world, discussion with Lord Jellicoe did extend into the areas of unfair competition and the Far Eastern countries were pinpointed once again. Taiwan and South Korea are typical examples of where products are copied, often with inferior quality materials and then dispatched into traditional UK exporting areas at cheaper prices often copying the product name. Eastern Europe is also able to give unrealistic credit terms to potential customers and latterly we have been informed that Australia is providing substantial loans at low interest rates.

22. A further question that was addressed to member firms attending was what Government/British Overseas Trade Board action or support would be of help to individual companies? There were very many suggestions and these are listed as received from the individual companies:

Reduction in interest rates.

Ease import restrictions.

Increased support for exporters.

Finance, for example, tied loans.

Political pressure where necessary (for example Japan).

Provision of competitive long-term finance.

Less violently fluctuating exchange rates.

Increase in ODA Fund.

UK lines of credit for Iraq and English speaking Africa.

Lower interest rates for export lead manufacturing.

Agency selection advice.

Long-term UK export policy and centralisation of key sectors.

23. The above are some of the suggestions made by individual companies, but three items which did come forward with considerable strength were firstly, more financial support for exporters.

Secondly, improvement in ECGD operations, for example, time taken to achieve satisfactory answers is very slow and business can be lost. Also extend the service into countries where there is an element of risk. Thirdly, continued financial support by the Government for the British Overseas Trade Board and in particular, the Trade visits which it arranges on behalf of the UK manufacturing industry.

SUMMARY

24. There are two parts in this paper, one deals with the accepted need for the country to increase its exporting potential of manufactured goods and the suggestions which were made to the House of Lords Select Committee on Overseas Trade. The second is the views of member firms who are actively involved in exporting from the East Midlands, their areas of penetration, the difficulties which they have in certain countries and also some proposals which would be helpful in making them even more competitive facing the fierce battles ahead to obtain more business. Although the latter could only be classed as a random sampling exercise, the Association is quite certain that these views expressed would represent the views of the industry as a whole.

JMS/HA

6th January 1986

THE ENGINEERING INDUSTRY'S MANPOWER, TRAINING & EDUCATIONAL OBJECTIVES

THE ENGINEERING INDUSTRY'S MANPOWER, TRAINING & EDUCATIONAL OBJECTIVES

1. Introduction

The Engineering Industry now employs considerably fewer people than it did 10 years ago. However, although fewer people are employed and the overall numbers seem likely to reduce in the future as labour productivity improves, there has been, and will be, a continuing need to improve the quality and calibre of employees working at all levels in the industry. It has been particularly noticeable that employers are requiring higher levels of education and skill in their employees as the need to improve labour productivity in order to match the performance of our overseas competitors has increased.

Therefore, in general terms employers are requiring a better educated and trained workforce, ie, a more highly motivated workforce and a workforce that can adapt rapidly to economic and technological change. It is against this particular backcloth that the Association has framed its views in this paper and examines the various trends that relate to these factors.

2. Craft and Technician Trainees

The number of trainees in the above categories within the industry has declined quite dramatically within the last 5 years or so. This, in the main, has been due to the severity of the economic climate, and the fact that many employers were forced to reduce their craft and technician intake because of the commerical pressures that they were facing in the early 1980's to reduce costs and because of an unprecedented drop in orders. This meant that many training schools were closed down or put into "moth balls". The result of this has meant that in the mid to late 1980's there has been and will be a shortage of young skilled employees who can develop their talents and are able to make a contribution to the engineering industry.

However, employers are now able to make progress in this particular field as economic prospects have somewhat improved. This has also been helped by the industry's Craft Training Agreement which has eliminated the traditional age for wage structure, and has introduced the modular approach to training. Running parallel with this is the EITB's support for the development of more flexible modules and segmented training to make the training syllabuses less "institutionalised" and more flexible and adaptable to individual employers' requirements. These two factors working together have done much to improve the training arrangements within the engineering industry. In addition the level of craft and technician intake for 1985 and subsequent years has shown and will show an upward trend. However employers must remain confident of a reasonably healthy business climate if this is to continue.

Historically, the industry has suffered from being able to attract only relatively low academic achievers into it. In addition it has been felt that the image of the industry in certain quarters has not been a particularly attractive one and that in the past the industry has not attracted people of the right calibre.

However, bearing in mind the changed economic climate and especially the introduction of advanced and complex technological equipment into companies, coupled with the pressures to have the most efficient manning levels possible, a higher standard of person is being required at these levels for the future.

3. <u>Education requirements</u>

With the above as a backcloth it is necessary to review the current education system.

Although much has and is being done already in the education field to bridge the "gulf" that has existed for generations between education and industry, more needs to be done for the future. It is particularly important that even from 12/13 years of age pupils are provided with a significant input based on how business and economics operate, at both the macro and micro levels. Therefore, syllabuses for all academic qualifications need to ensure that pupils do have a business appreciation which includes the need for adaptable responses by individuals who are able to cope with rapid and often unforeseeable changes to the business and to their own skills. Special mention should be made of the newly introduced Certificate of Pre-vocational Education which has helped in this area, with more emphasis being placed on technology appreciation and on the production of students with at least basic numeracy and literacy skills.

The current government review of vocational qualifications is also a useful input into this field. It has been agreed, at least on the employers side, that there is a need for rationalisation and integration of vocational qualifications and that a publicly funded umbrella licencing body should be set up with the involvement of the Department of Education and Science and the Manpower Services Commission to improve the national quality and currency of qualifications. The employers side has also indicated that there should be laid down criteria against which qualifications should be judged and that one of the criterion might be the need for evidence of consultation with employers about the need and relevance of the proposed qualification. Another criterion might be that any proposal for a new qualification should show that it would not duplicate any existing qualification. This is a particularly significant area for employers to provide an input so that their requirements can be met by educationalists. Our own Association is well represented and respected on many education/ industry liaison committees so that the industry's views can be taken into account.

Another very important field in this area is the development of the 2 year Youth Training Scheme. Engineering employers have been most concerned for some time about the high level of youth unemployment. Whilst the industry itself especially at craft and technician levels has well developed training schemes, the Youth Training Scheme has been most welcomed by the industry. It has enabled engineering employers to make their contribution to the nation with regard to providing training schemes for unemployed youngsters and it has also helped to contribute to their own business requirements. The abolition of the "additionality" ratio and the fact that employers can have the flexibility to take on YTS people as their own employees, or not, have been most useful factors.

For the future for most craft and technician jobs, employers feel confident that they can provide meaningful two year training programmes. If this is repeated in other industries, it will improve the calibre of training and the standard of employees entering the labour market that can only be beneficial to the nation and in particular the engineering industry. However, some reservations must be stated. Firstly, for some less skilled occupations it is difficult to imagine that meaningful training programmes can be devised to cover a two year period.

There is a possible danger that some of the training programmes might be viewed by employers as "padding" to their own requirements. Whilst, no doubt, it can be argued that this would improve education and training levels generally, if it is the government's intention, as appears to be the case, that employers should bear a greater cost of this training, then there might well be a backlash by employers saying that they are not prepared to fund training that is not directly seen to be relevant to their own needs. This is particularly critical when employers will have to watch very carefully the amount of money that can be spent on training from their own funds.

In a similar vein, some concern has been expressed in certain areas that the MSC might attempt through its Area Manpower Boards to control and interfere too much with employers' training programmes. Again, this might well be counter productive because employers then might shy away from co-operating fully with the YTS development. It is appreciated that obviously the MSC needs safeguards to ensure that youngsters are not taken unfair advantage of in any training arrangement, but there is a danger that the MSC itself should not attempt to be too "directional" in its aims. This is especially relevant in the engineering industry where, as has been mentioned earlier, there is a well developed training system for most levels of youngsters entering the industry.

Finally, on the question of YTS training, the industry commends the intention to introduce certification for YTS people. It is important that YTS people should not see themselves as inferior to other trainees and therefore the industry commends the Government's and the MSC's intentions to create a comprehensive certification system which will only help in the development of transferable educational and training skills.

4. Adult Training

As has been stated earlier the industry has slimmed down quite dramatically over the last few years, the result of which has been that companies have retained the more able and competent people and because of the fast changing requirements of companies, the employees that remain are more "valuable" to companies. However, the increased marketability of people, especially in the areas of NC and CNC skills has meant that employers have had to increase their wage rates quite considerably in some instances in order to retain these people.

In parallel with this, companies have been reporting over the last year or so a difficulty in recruiting suitably motivated and skilled people for a wide range of engineering occupations. Whilst nationally it is well known that there are shortages in the newer skills, such as computers and systems analysis work, there have been reports given to the Association throughout the region of shortages of suitable personnel in a large number of skilled engineering categories. Companies are demanding more competent and highly trained people when they recruit and there appears not to be suitable applicants available. Whilst it is recognised that the Government through the Manpower Services Commission has placed much emphasis recently on adult training support for employers, it is felt that perhaps more can be done in this area.

It is appreciated that when companies are introducing new techology, changing business methods, launching new products or undergoing other changes, financial help can be made available through the MSC if training is required. It is felt that more publicity could be given to this, especially the facility to help companies to develop the skills of its existing employees. The current information package on adult training produced by the MSC is particularly useful but more emphasis could be given to this. Our own Association is very heavily involved in bringing the various types of such assistance to employers' attention.

However, it is still felt that not so many employers know too much about, for example, the National Priority Skills Scheme which provides funding to support adult training initiatives which upgrade or update workforce skills and knowledge, provides training in multi-skills, converts skills and provides training in newly emerging skills where rapid development is needed, and finally provides training to meet existing future skill shortages.

In addition recent advances in training techniques such as the development of the "open tech" programme should be made more widely known to employers.

Because of the concern that the Association has for these skills shortages which are likely to persist for some time, the Association together with the MSC and the EITB is undertaking a major analysis into future skills requirements of engineering companies to identify problem areas and to help develop solutions. This skills shortage is particularly prevalent in the southern part of the region, ie Northamptonshire, where many companies have indicated a shortage of available and suitable people in the traditional skilled areas of machining and fitting, and even some semi-skilled occupations.

It appears that there is evidence that current Social Security benefits are acting as a positive disincentive for people to get jobs, especially in the age range 25-45, ie married people with perhaps several young children. It would appear that the range of Social Security benefits available to this class of person is acting as a definite disincentive for people to take paid employment. Therefore, employers have to attempt to recruit people in the younger age group where there is less stability and experience offered, and in the older category where there is perhaps not the motivation and physical requirements present. It is also particularly interesting to note that where companies have attempted to offer former employees who have been declared redundant their jobs back, they have not been prepared to accept them. Obviously the factors involved in this are quite complex, eg, people finding work outside the engineering industry or people not wanting full time employment, or people just wanting to exist on their redundancy benefits, along with the Social Security benefits.

Employers generally feel that there needs to be more "incentive", especially for the age and family group mentioned above, to work. It is unrealistic and undesirable to expect employers to increase their wage levels at a faster rate than they are already doing to make it more attractive for people to work than not to work, as this only leads to spiralling labour cost increases which employers cannot afford. The Government's recent announcement of its "Job Start" scheme, although very selective, to provide a top-up supplement to those people that have been unemployed for sometime who take paid employment is to be welcomed. There might well be a case for extending this concept to make it more attractive for people to work or to consider more seriously the alternative of looking more closely at certain Social Security benefits. Another alternative would be to raise income tax thresholds quite significantly to make taking a job more financially attractive.

CONCLUSION

1. Although overall numbers employed in the engineering industry will not rise in the foreseeable future and will probably drop further, there will be an increasing demand for better educated and skilled employees at all levels.

2. The education system must continue to develop its role of providing numerate, literate and motivated students who have an appreciation and commitment to the environment of industry and have qualifications and outlook that are geared to employers' requirements.

3. The impetus to give support to employers through the YTS arrangements and the adult training strategy must continue. Government and MSC cannot expect employers to bear more training costs, especially if the training is not being directed to their specific needs, although it is realised that there must be a safeguard against the "exploitation" of youngsters, and a degree of monitoring of training programmes will be necessary.

4. More analysis must be undertaken on employers' future needs for people with particular skills, and more incentive needs to be given to people to take paid employment without forcing employers to raise labour costs excessively.

NJC/CAB
January 1986

Inland Revenue

Policy Division
Somerset House

usefully Could I know before the meeting:
a) the annual expenditure of CAF and NCVO.
b) Govt. financial contributions to CAF and NCVO:

FROM: C STEWART

DATE: 20 JANUARY 1986

FINANCIAL SECRETARY

CHARITIES AID FOUNDATION (CAF)

1. You agreed to meet representatives of the CAF and the National Council for Voluntary Organisations on 21 January.

2. The attached notes by Mrs Fletcher set out the background to the meeting, give some general information about CAF and NCVO and cover a number of points which might be raised.

3. Mr Brophy's letter of 2 January said that they were aiming to find out whether changes were intended in the present tax reliefs for charitable giving, and if so what they were and what part CAF and NCVO should play in bringing them about. Your letter of 15 January made it clear that you would not be able to give any indication whether or not particular tax changes were likely in the Budget; but you would be glad to hear any particular proposals they wanted to put forward.

4. Mr Brophy's letter of 17 January suggests they have five main aims:

i. to "find out whether you are irrevocably behind the covenant system". This is another way of asking whether you are seriously considering the introduction of relief for one-off gifts (people will be less willing to make a 4-year commitment to a covenant if they can get the same relief for single donations). You will presumably not want to answer this directly. Ministers of course

cc Mr Cropper
Mr Woodall
Mr Murray

Mr Isaac
Mr Corlett
Mr Beighton
Mr Elliott
Mr Davenport
Mrs Fletcher
Mr Stewart
PS/IR.

receive representations from many quarters at this time of year and consider them, but the CAF should not jump to conclusions one way or the other from that. The CAF may refer to the attached article in to-day's Times which suggests that the Chancellor is considering relief for single gifts and that this "is known to be favoured by various Government departments". We do not know the source of this report. But it is possible that someone in the charity lobby - such as the CAF - may have heard something of the Ridley proposals through contacts with other Departments. You will presumably not want to comment on the article;

ii. to make the case for an experimental incentive for donors in addition to the covenant system. This may be some limited form of relief for single gifts - possibly a special incentive for gifts to "community trusts" (see para 12 of the attached notes);

iii. to seek your co-operation in "setting up a standing committee to simplify, streamline and market the covenant system". We are not sure exactly what changes they have in mind here. "Marketing" is really something for charities to do themselves. If they have particular suggestions for simplification, we suggest they should be asked to write setting them out, and we can consider them. It does not seem necessary to set up a "standing committee" to do this;

iv. to discuss "matching grants" for social welfare etc. This is a point for the Treasury;

v. to draw your attention to the new Council for Charitable Support. I am afraid we have no information about this.

5. Finally, you may like to know that the CAF run a magazine called "Charities". There is thus a possibility that there will be a report of their representations to you in a future issue.

CS

C STEWART

The report, which had a response rate of 71 per cent of its selected sample firms, was commissioned by the Law Society.

The first of its kind since the 1977 survey for the Royal Commission on Legal Services, the survey is likely to be used as further ammunition in current negotiations with the Government on pay for legal aid work.

In total, all firms in England and Wales were estimated to have earned almost £200 million in 1983-84. Most of that sum, 63 per cent, is earned by firms of four or more partners.

Only the big London firms of 15 or more partners earn fees of £80,000 or more.

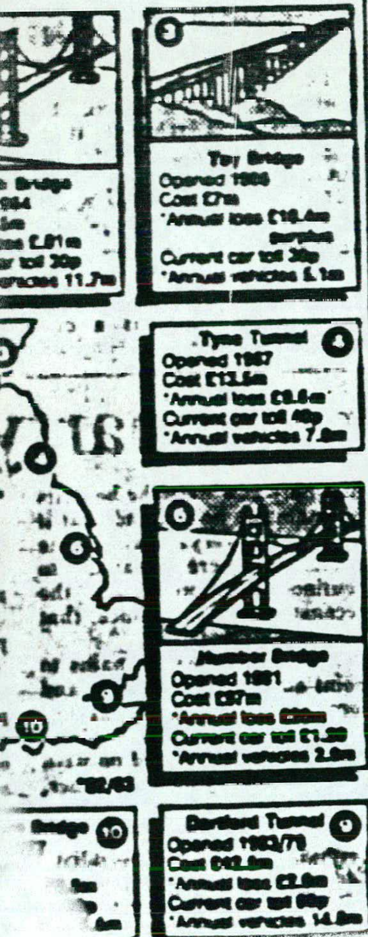
Average earnings vary according to size of firm and type of work. The net profit share for partners was £20,400 for sole practitioners; £17,900 in two-to-four partner firms; £28,400 in five to 14 partner firms; £38,200 for 15 or more partners outside London, and £81,300 for London firms of 15 or more partners.

...em losses

...tor

year, are both dwarfed by an existing surplus on road user taxation (what they pay, less what is spent on roads) of over £7,000 million a year road users pay.

Mr Ridley will not lightly write off debts or forsake revenue, however small. Instead, his solution is to sell off tolled crossing to private interests.



Charity aid tax scheme proposed

By Richard Evans
Lobby Reporter

An American-style tax incentive scheme to encourage individuals and companies to donate more to charities is being considered by the Treasury in the approach to the Budget.

If Mr Nigel Lawson, Chancellor of the Exchequer, favours the idea it would mean that people and business who make contributions to charitable organizations would be allowed to set them off against taxable income.

The radical plan, which could have far-reaching financial implications for bodies ranging from Oxfam to arts establishments with a charitable status, is known to be favoured by various governments departments.

Mr Douglas Hurd, Home Secretary, who has responsibility for charity law; Mr Norman Fowler, Secretary of State for Social Services whose department is closely linked with voluntary organizations; Mr Timothy Raison, Minister for Overseas Development; and Mr Richard Luce, Minister for the Arts, could all be expected to back such a change.

The arts world, where there is continual conflict over the level of government funding, is one key area which could benefit from a change in the tax structure. It is estimated that between £10 million and £30 million extra a year could be raised.

The Government's business sponsorship scheme, in which persuades companies to provide financial support for the arts, has been a success. Under it the Government contributes £1 for every £3 put in by commercial concerns.

But unlike those in the United States, where 80 per cent of donations for the arts come from individuals, personal contributions in Britain are relatively small.

It is argued that by allowing people to set off donations against tax, a climate would be created where individuals would be keener to give to worthy causes.

Individuals and businesses can donate cash by means of a covenant, and although that permits the recipient to claim back the tax originally paid by the donor, it is an inflexible system with donors having to give money for a minimum of four years.

If the new tax scheme is not included in Mr Lawson's Budget in March, its supporters are hopeful that it could be introduced by the end of the ...

MEETING WITH CAF AND NCVO

Previous correspondence

1. The request for a meeting was originally made to Peter Rees when he was Chief Secretary, and the intention then, as now, was that representatives of both CAF and the National Council for Voluntary Organisations (NCVO) would attend. The CAF letter of 11 May 1984 simply asked for a meeting "to discuss the possibility that during this 'Tax-reforming' Parliament consideration may be given to modifications of the covenant system". The NCVO letter of 8 May 1984 said "Our purpose will simply be to ask that a discreet and informal channel of communication at working level should be opened through which the technicalities, though not the principles, of certain possible future tax changes affecting CAF (and therefore NCVO) could be discussed. Our purpose will not be to argue the merits either way of the policy of such possible tax changes, still less to seek guidance as to whether (least of all, when) such changes will be made." It went on to say that the tax changes they had in mind would be changes affecting the covenant system and "again, let me emphasise that we are not seeking to press any arguments for or against the principle of such possible changes, but merely to ensure that in any future preparations which the Inland Revenue may wish to make for such changes certain practicalities, as seen from our point of view, are taken into account."

2. Against this background Mr Rees said he would be happy to see the charity representatives as soon as time permitted, but as far as we are aware nothing more happened until the CAF wrote to Mr John MacGregor on 19 November referring to this previous correspondence and seeking a meeting.

CAF

3. According to their literature the CAF was originally established in 1924 but changes were made to its constitution in 1974 which gave the trustees a new and wholly independent status, enabling facilities and services to be developed which give much greater scope for encouraging and facilitating the distribution of money to charity. CAF's objective is stated to be to make the giving of both companies and individuals as effective as possible. It does this mainly through a variety of financial services to donors and charities which include discretionary covenant services and administration, interest free loans and trusts. Over 12,000 individuals and companies use the discretionary covenant service principally to take advantage of the flexibility of giving made possible from one deed of covenant. Nearly 300 charities entrust CAF with the

administration of their covenants. The sum currently distributed to charity through the CAF's services is approximately £25 million. CAF also makes grants to charities, seeks to improve the mutual knowledge and awareness of donors and beneficiaries and publishes a range of directories and booklets.

NCVO

4. The NCVO claims to be the main national resource centre and development agency for voluntary organisations and charities in England. Its aim is said to be to contribute to the strength of the voluntary sector by providing a national focus for it and, where appropriate, by speaking on its behalf, particularly in response to the activities, policies and proposals of central and local government. It also aims to develop the effectiveness of the work of voluntary organisations, groups and individuals in the field of social action, and to try to ensure that newly identified social needs are met by the most appropriate means, including the formation of new groups. Services available free to all voluntary bodies include information, legal, publishing, management and training.

The present tax reliefs

5. Charities are exempt from income tax, corporation tax (apart from certain trading income) and capital gains tax provided the income or gains are applied to charitable purposes only.

6. Individuals can deduct basic rate tax (thus effectively getting basic rate relief) from donations to charities which are made under deeds of covenant lasting for more than three years. In addition, individuals can claim relief from higher rate tax on covenanted payments up to £10,000 each year.

7. Companies can claim relief from corporation tax on the total amount of such covenanted payments and on payments (such as sponsorship payments) or gifts (made without a deed of covenant) which are wholly and exclusively for the purposes of the trade or business.

Known interests

8. Just over a year ago two representatives of CAF called here and left with us documents on the following subjects "for interest". Some of these were considered in the notes which we sent to you on 13 December.

Sealing of Deeds of Covenant

9. CAF sought concessionary tax relief for charities where deeds of covenant in favour of the charities had, for one

reason or another, no indication of sealing. Sealing is a requirement of general law, not tax law, in England and Wales, so an unsealed deed is not enforceable through the Courts. The Revenue cannot make repayments of tax on invalid deeds. This view has been upheld by the PCA.

Company giving

10. The literature related to a seminar on company giving held at Buckingham Palace on 1 November 1984. The objectives, very briefly, included encouraging companies to increase their charitable giving and to consider obtaining further tax and other incentives such as matching grants from Government. We do not know precisely what tax proposals were considered, but our note of 13 December covers our views on company giving and sets out various options for Ministers' consideration.

Close company apportionment

11. This subject was dealt with exhaustively in the correspondence with Sir Emmanuel Kaye, also covered in our note of 13 December (paragraphs 20 and 21).

Community Trusts

12. These were described as "a new mechanism which can make an organised contribution towards certain of the needs of any community" to which "the new contributor is neither 'state' nor 'private', but rather the Public and Private Sectors in Partnership". The aim of each Trust would be to help meet welfare and cultural needs of any coummunity. It was recognised that while neither Government nor Local Authorities can or should attempt to meet all such expenditure, it remains true that many individuals cannot and never will be able to meet their own needs. The CAF paper contained only one "fiscal consideration" - that company contributions (from a public company whose accounts are subject to shareholders' scrutiny) to a Community Trust could be free of tax on a single gift basis above, say £1,000. Relief for single company donations is covered at paragraphs 22 to 32 of our note of 13 December.

Once-for-all gifts

13. CAF may seek tax relief for once for all, or one-off, donations to charities (that is gifts made other than under a deed of covenant). They may be able to provide some idea of how far charities themselves would welcome such a change. We think there might be mixed views as different charities have different interests.

14. To allow tax relief for all one-off gifts would be extremely costly in terms of tax and staff. It would also increase the scope for abuse - tax avoidance through the use of charities is increasing - and our note of 13 December considers this, and the possible limitation of relief to public companies.

Increase or abolish the £10,000 limit for higher rate relief

15. This is linked to the apportionment of close company payments (see paragraph 11 above).

Payroll giving

16. This is covered in Appendix D to our note of 13 December and also in our note of 9 January to the Chancellor of the Exchequer.

Convenated Subscriptions to Charity

17. A deed of covenant is a promise to make payments for nothing in return. Where a convenant is used to pay membership subscriptions, and the member receives any benefit in return, eg free entry to the charity's premises when non-members have to pay, the payments cease to be "annual payments" for the purposes of the Taxes Acts and strictly speaking no tax refund can be made to the charity on the covenanted subscriptions. Case law has established that available benefits to members up to 25 per cent of their subscriptions can be ignored. A number of charities which provide benefits in excess of this amount have recently found their tax refunds on convenanted subscriptions refused. Speaking in a Radio 4 programme last year Michael Brophy of CAF acknowledged that the Revenue's practice in refusing these repayments was correct and he counselled charities to keep a low profile over this matter in case they finished up in a worse position than they are now.

Gifts by companies to universities etc

18. We have just seen a copy of Mr Prior's letter of 15 January to the Prime Minister proposing tax relief for one-off gifts by companies to universities eg to finance pieces of high technology equipment. This seems rather to ignore the existing provision (Section 133 of ICTA) which gives relief for payments by traders for the purpose of technical education related to the trade at any university, technical college or similar institution. If the point comes up, you might want to draw attention to this existing relief.

VAT

19. CAF and NCVO have not suggested that they wish to discuss VAT. But you may like to know that the Charities VAT Reform Group (CVRG) have made Budget Representations to the Chancellor. We understand from Customs and Excise that their shopping list includes the abolition of VAT on

i. purchases by social welfare charities

ii. building alterations for charities

iii. advertising

iv. drugs and medicines.

The Minister of State met representatives of CVRG in December to discuss these suggestions and we understand that a submission from Customs and Excise on 13 January is being considered by Treasury Ministers.

CHANCELLOR OF THE EXCHEQUER

Ch.

We obviously need to see this in the context of what is likely to happen to petrol prices (i.e. the RPI) as a result of the drop in oil prices. Perhaps unsurprisingly the Customs note is not very hot on the wider picture. Maybe someone here - ? PP - could do a proper note on the scope for raising oil duties in the Budget.

One or two relevant facts dotted through Bryce Knox's note e.g. petrol prices <u>were</u>

197.1 per gallon before
the last Budget and was
189.6p (after the latest 4 pence).

Simple revalorisation (+17.1%)
means a rise of 16p.

The EB boys tells us
that a 10% fall in pump
prices cuts the RPI by ½%.

All this will be better
considered when we have the
forecast & variants next
week. This can only be a
quick canter round the
course, to raise some of the
relevant questions.

RL.
24/11

copy no 1 of 30

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Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: B H KNOX

Date: 23 January 1986

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Pratt
Mr Cropper
Mr Lord
Mr H Davies
Sir L Airey - Inland Revenue
Mr Isaac - Inland Revenue
Mr Battishill - Inland Revenue

INDIRECT TAX OPTIONS

Introduction

At your first overview meeting on 20 January you asked for further work to be done in narrowing the indirect tax options available to take account of the RPI impact effect of what may occur on the direct tax side. This submission identifies what is possible, given the preferences expressed at your meeting. I am afraid the number of variables involved makes this rather heavy reading.

2. The starting point is the 0.5 per cent RPI effect which you are prepared to allow for over and above the forecast figure (also 0.5). Because the published figure is rounded

Internal circulation: CPS, Mr Jefferson Smith, Mr Wilmott, Mrs Hamill, Mr Bone

JCH

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to one place of decimals, the gross RPI effect of all the Budget changes can go as high as 1.04 per cent without breaching this ceiling. The three income tax options reduce that headroom by 0.07 per cent for each penny off the basic rate. This means that the overall impact effect of indirect tax changes (to include what is already in the forecast) can go as high as shown in table 1:

Table 1

	A	B	C
Change in basic rate	- 2p	- 2 1/2p	- 3p
RPI impact effect of:	%	%	%
direct tax change	+ 0.14	+ 0.17	+ 0.21
indirect tax change	+ 0.90	+ 0.87	+ 0.83

3. You indicated that the 2 preferred ways of reaching that RPI effect were:

Option I a 1 percent VAT increase and revalorisation of all excise duties except drinks; and

Option II no change in VAT, over-indexation of road fuel duties and cigarettes, and revalorisation of the other duties.

We also understand that you are looking for a PSBR effect of no less than £300 million to £400 million from these options. (I think this came from C.W.)

OPTION I

4. Table 2 summarises the possibilities (revenue yields, as elsewhere in this note, are shown net of revalorisation)

2p, 1/Item (1)

		594
		650
Opt	VAT 1	570
	2	620
	3	715
	non VAT 4	
	5	

Revenue effects of
Duty Unchanged

Drink	140
Tobacco	310
Petrol/Derv	450

PSBR > 400

or 2½ over
all now
or 156 over

0.26
0.275
0.535

Table 2 VAT, under-index drinks

	change	RPI impact effect (%)	Revenue 1986-87	Revenue 1987-88	Total PSBR effect 1986-87	Total PSBR effect 1987-88
VAT	1% point on standard rate	0.50	+ 705	+ 1040		
Petrol/derv) Tobacco) VED)	revalorise (+ 5.7%)	0.32	0	0		
Alcoholic drinks						
Income tax A (-2p)	0.6 x re-valorisation (3.25%)	0.08	- 70	- 70		
" " B (-2½p)	0.35 x re-valorisation (2%)	0.05	- 105	- 105		
" " C (-3p)	Nil	0	- 160	- 185		
TOTALS						
A		0.90	635	950	598	230 9
B		0.87	600	920	560	805
C		0.82	545	855	505	750

(no change in representative prices - see excursus in para 6)

The gross (ie revenue not scorecard) ? impact on business costs of the excise duty changes would be about £170 million. The PSBR effects accord with your criteria.

5. Alternatively drinks could be left alone and the leeway used to over-index either tobacco or petrol and derv. The effects are shown in tables 3 and 4

JCM

TABLE 3 VAT, no change drinks, overlander oil duties

		Change	RPI impact	Revenue 1986-87	Revenue 1987-88	Total PSBR effect 1986-87	Total PSBR effect 1987-88
VAT		1% point on standard rate	0.50	705	1040		
Alcoholic drinks		Nil	0	- 160	- 185		
VED		Revalorisation	0.05	0	0		
Tobacco		Revalorisation	0.14	0	0		
Petrol and derv							
Income tax	A	1.5 x re-valorisation (8.55%)	0.20	160	170		
	B	1.3 x re-valorisation (7.58%)	0.18	105	110		
	C	Revalorisation	0.13	0	0		
Totals							
	A		0.89	705	1025	650	885
	B		0.87	650	965	600	835
	C		0.82	545	855	505	755

The gross effect of duty changes on business costs would be between £170 million and £250 million. The PSBR effect is acceptable.

TABLE 4 VAT, no change in drinks, over-index Tobacco

	change	RPI impact effect (%)	Revenue 1986-87	Revenue 1987-88	PSBR effect 1986-87	PSBR effect 1987-88
VAT	1% point on standard rate	0.50	705	1040		
Alcoholic drinks	Nil	0	- 160	- 185		
VED	Revalorisation	0.05	0	0		
Petrol and derv	Revalorisation	0.13	0	0		
Tobacco						
Income tax A	1.5 x re-valorisation (8.55%)	0.20	65	70		
" " B	1.3 x re-valorisation (7.58%	0.18	40	45		
" " C	Revalorisation	0.14	0	0		
Totals					570	
A		0.88	610	925	750	805
B		0.86	585	900	545	780
C		0.82	545	855	505	750

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The gross effect of duty changes on business costs would be £170 million. The PSBR effect is acceptable.

6. We have not quoted illustrative overall price effects because these would vary with the factor cost of the product (because of the VAT rate change). Our conclusion is that seeking rounded price effects need not be a major presentational constraint if the VAT rate goes up.

OPTION II

7. There are two sub-options within this excise package, depending on whether the primary over-indexation is pinned to tobacco or road fuel duties. The constant factor in both is the RPI impact effect of revalorisation of the drinks duties and of VED, which amount to 0.19 per cent. The revalorisation is approximate in individual cases to take account of sensible rounding, but the overall effect on the RPI is the same. These constants are shown in Table 5.

TABLE 5

Duty	Change	Effect on prices	RPI Impact effect	Revenue £m 1986-87	Revenue £m 1987-88
Alcoholic drinks	Approx. revalorisation				
	Beer : 6.3%	1.3p/pint			
	Wine : 6.3%	5p/bottle table wine	0.14	5	5
	Spirits: 5.5%	30p/bottle spirits			
VED	Revalorisation	£5.70/cars	0.05	0	0

JCH

8. Option IIA takes as its focus triple revalorisation of tobacco duties and then a variable multiple (ranging from 2.25 to 1.75 for petrol and derv depending on the income tax option). The effects are shown in Table 6

have we done this before? (11.4% reval, 14p)

TABLE 6

Duty	Change	Effects on prices	RPI impact effect	Revenue 1986-87	Revenue 1987-88	Total PSBR 1986-1987	Total PSBR -88
Tobacco	3 x re-val (17.1%)	14p/pkt 20KS	0.41	265	270		
Petrol and derv		p/gal 4*					
Income tax A	2.25 x re-val (12.8%)	12.0	0.30	390	415		
" " B	2 x reval (11.4%)	10.7	0.26	310	330		
" " C	1.75 x reval (10.0%)	9.4	0.23	235	250		
TOTALS							
A			0.90	660	690	620	525
B			0.86	580	605	550	460
C			0.83	505	525	420	395

The gross effects of the duty changes on business costs be between £290 million and £360 million. The PSBR effects are acceptable.

9. Option IIB reverses the focus and starts with triple revalorisation of petrol and derv.

TABLE 7

Duty	Change	Effect on prices	RPI Impact effect	Revenue 1986-87	Revenue 1987-88	Total PSBR effect 1986-87	Total PSBR effect 1987-88
Petrol & derv	3 x revalorisation (17.1%)	16p/gal	0.40	620	660		
Tobacco		p/pkt 20 KS					
Income Tax A	2.1 x re-valorisation (12.25%)	10p	0.29	155	155		
" " B	1.9 x re-valorisation (11%)	9p	0.26	125	125		
" " C	1.7 x re-valorisation (9.8%)	8p	0.23	95	100		
TOTALS							
A			0.88	780	820	715	635
B			0.85	750	790	685	615
C			0.82	720	765	655	595

10. There is a very small (0.02 per cent) gap between the actual RPI impact effects of A and B and the ceiling. This is because of achieving rounded price increases for cigarettes. It would be possible to add a fractional increase to petrol and derv to take up this slack. The gross effect of the duty changes on business costs would be £470 million. The PSBR effect is acceptable.

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TABLE 8

SUMMARY : SCORECARD OF INDIRECT TAX OPTIONS

	IR options:		A	B	C	(Revenue, £m)
			−2p	−2½	−3	basic rate
OPTION I	VAT	86/7	635	600	545	
		87/8	950	920	855	
	VAT	86/8	705	650	545	
	Alternative A	87/8	1025	965	855	
	VAT	86/7	610	585	545	
	Alternative B	87/8	925	900	855	
OPTION II	EXCISE					
	VERSION A	86/7	660	580	505	
		87/8	690	605	525	
	VERSION B	86/7	780	750	720	
		87/8	820	790	765	

11. You will see that by using option IIB (excise, particularly petrol) you raise between £120 and £215 million more than by using option IIA (excise, particularly tobacco). This is because the road fuel duties are more RPI-efficient than the other excise duties. Both variants of option II raise more in 1986-87 than option I and its variants because of the lag in payment of VAT. (The position is reversed for 1987-88, when the full effect of the VAT change would be coming through.)

BUSINESS COSTS

12 You will wish to bear in mind the impact on business costs, which rise in proportion to the emphasis on increases in road fuel duties. Table 9 summarises the gross effects.

JC 14

TABLE 9

SUMMARY : INCREASES IN BUSINESS COSTS

		£m 1986-87
OPTION I	VAT	170*
	VAT Alternative A	170-250*
	VAT Alternative B	170*
OPTION II	EXCISE VERSION A	290-360
	VERSION B	470

*Excludes effect of increased VAT rate.

COMMENTS

discuss

13. Given the RPI constraints, option IIB (petrol and derv)is your best bet for raising revenue in 1986-87 (though if you are looking further ahead any of the VAT options is better). In a climate of falling petrol prices a large increase in petrol duty is likely to be less perceptible to the consumer than any other duty. Even triple revalorisation would bring the current price up only to roughly where it was after the last Budget. And if petrol prices should fall still further at the pumpthen there would be further slack which could be taken up by duty increases, either in the Budget or later by Regulator. If, later in the year, a large increase in indirect tax revenue was required then you could consider the use of the VAT regulator, which has the virtue of flexibility in raising large amounts of revenue.

JCH

14. Finally, Annex A provides, as a reference point, the effects of revalorisation. And I understand that you have asked for facts and figures on petrol. In the time available we have not been able to put together a special note, but I think that the relevant section from the excise options paper we were planning to submit before this present note overtook it will fit the bill. I attach it as Annex B.

Bryce Knox

B H KNOX

JCH

ANNEX A

REVALORISATION

Duties increased by 5.7%

		Price change including VAT on typical item[1]	First year yield (£m)	Full year yield (£m)	RPI impact effect (%)
Beer		1.2p per pint	90	100	0.07
Wine (all 70cl)	Table Sherry Port Sparkling	- 4.5p) - 8.3p) - 9.6p) - 7.5p)	30	30	0.03
Spirits		31.0p per 75cl bottle	35	40	0.04
Cider		0.6p per pint	5	5	negligible
Tobacco		4.7p per 20 king size cigarettes	135	150	0.14
Petrol		5.3p gallon	250	260	0.13
Derv		4.5p gallon	60	65	-
VED (cars & light vans)		£5.70	115	115	0.05
Minor duties[2]		-	40	40	-
TOTAL		-	760	805	0.46

(1) VAT is payable in addition to the duty except in the case of VED.

(2) Minor oils, matches and mechanical lighters and VED on heavy vehicles.

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ANNEX B

Petrol duty

	Typical price effect incl VAT	Duty increase	Revenue 1986/87	RPI impact effect
	(p per gallon)	(%)	(£ million)	(%)
Revalorisation	5.3	5.7	250	0.13
Alternatives	7.0	7.5	330	0.17
	8.0	8.5	375	0.20

Typical current price: 189.6 per gallon (price reductions of up to 4p a gallon have just been announced).

Recommendation

At least revalorisation. Could easily bear more. !!

Arguments

For

a) Relatively low impact on RPI (but mainly resulting from purchases by businesses - see Against (a)).

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b) Low price elasticity of demand - a buoyant revenue raiser.

c) Despite real increase since 1979, total tax in price (duty plus VAT) is still below June 1970 level.

d) UK price below average by EC standards (the 10 countries).

e) Energy conservation.

f) Falling prices would offset impact of Budget changes.

Against

a) About a third of increase falls on business costs (but includes unquantifiable element attributable to private motoring on business accounts).

b) Any increase significantly beyond revalorisation may provoke opposition from Conservative backbenchers representing rural constituencies. However, pump prices no longer marked by consistent urban/rural differentials, but vary depending on competitive conditions obtaining.

c) If petrol companies were to raise prices Budget changes of around 1.5 times revalorisation could push the typical price per gallon over £2.

Comments

a) Average price of a gallon of 4 star petrol now 189.6p compared to 197.1p just prior to the 1985 Budget. Prices vary around the country depending on competitive conditions rather than consistent urban/rural differentials.

Highest price currently recorded is 198.7p in Edinburgh and Glasgow.

b) Petrol consumption is buoyant - up 1.2% in first nine months of 1985 compared to the same period in 1984.

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Derv

	Typical price effect incl VAT	Duty increase	Revenue 1986/87	RPI impact effect
	(p per gallon)	(%)	(£ million)	(%)
Revalorisation	4.5	5.7	60	-
Alternatives	5.9	7.5	[ ]	-
	6.7	8.5	[ ]	-

Typical current retail price: 185.0p per gallon (but see Comments, item (a) below).

Recommendation

At least revalorisation. Could bear more.

Arguments

For

a) No impact on RPI (but see Against, item (a) below).

b) Low price elasticity of demand.

c) Despite the small (nearly 4%) real increase overall since 1979 the value of the duty in real terms has remained substantially below that of its June 1970 level.

d) Consumption has increased by 7.4% in the first 9 months of 1985 compared to the same period in 1984. The emerging diesel car industry [still forms a negligible part of the market].

e) Revalorisation, or more, would assist in avoiding adding to the burden of VED on lorries (if that is what is desired).

f) Energy conservation.

Against

a) Almost the whole burden of derv duty increase falls on businesses. Problem in attempting to justify real increase to business sector.

b) UK derv duty and pump prices still second highest in EC (the Ten), although some Member States impose a higher VED on diesel-engined vehicles to equalise the tax burden.

Comments

a) Typical retail pump prices have fallen to 185.0p per gallon from 194.6p per gallon just prior to the 1985 Budget, and further falls are being predicted. [Most derv (around 80%) is however, purchased at lower prices by contract (info re business purchases to be inserted - can RDD advise?) and the main benefit accrues to the larger users.] Business users can normally recover VAT on their purchases.

b) Derv currently carries a duty and VAT burden 14.6p per gallon less than petrol. The price advantage is not always carried over into pump prices. (Difference in typical price is currently less than 4p per gallon.) For that reason, and because of the increased incentive to evade duty, it is undesirable to widen the duty differential by too much more in real terms.

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E●R AA CN RIM319

171127 :-ECONOMIC SPOTLIGHT - U.K. BUDGET
By Janet Bush
LONDON, March 17 - Chancellor of the Exchequer Nigel Lawson will announce his 1986/87 Budget tomorrow in the knowledge that recent cuts in world interest rates provide a favourable climate for growth and take pressure off Britain to deliver substantial tax "give-aways", analysts said.
Financial markets are cheerfully resigned to a dull Budget because lower rates and collapsed oil prices will provide stimulus to growth at a time of declining inflation.
"Lawson is a lucky man. He can now be all things to all men", Chief Economist at Grieveson Grant Mike Osborne said.
MORE

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ECSS RIM321

171129 :ECONOMIC SPOTLIGHT =2 LONDON
U.K. financial markets are confident base rates will be cut soon after the Budget. Analysts see U.K. interest rates declining in 1986, possibly as low as nine pct by the year-end. Base rates are currently at 12-1/2 pct.
Hoare Govett economist Richard Jeffrey said, "The international round of interest rate cuts indicates that most, if not all, of the world's economic managers have decided that a burst of reflation can be achieved this year without inflationary consequences and it is unlikely the Chancellor will want to pass by the opportunity to advance a similar policy course in the U.K."
MORE

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ECST RIM322

171130 :ECONOMIC SPOTLIGHT =3 LONDON
Analysts agreed Lawson will want to pursue as expansionary a policy as possible to keep the economy growing ahead of a General Election, perhaps as early as summer, 1987.
Chief Economist at Simon and Coates, Gavyn Davies, said the Government should take full advantage of the crash in oil prices to maximise growth. He said a consensus now exists to aim for maximum short-term output and employment gains rather than long-term inflation gains.
Jeffrey said the Government must make progress on unemployment to have a good chance of winning the election and will try to do this through higher economic growth.
MORE

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ECSU RIM324

171131 :ECONOMIC SPOTLIGHT =4 LONDON

Davies said the downward adjustment in sterling since the oil price crash must continue so that Britain's traditional trading sectors can expand to fill the balance of payments gap left by the lower value of North Sea output. Thus, a tight monetary policy would be inappropriate, he said.

He said, "This will not be a Budget in which Mr Lawson can make a major splash as a tax-cutter or a tax-reformer. Much more interesting this year are the major strategic issues raised by the oil price crash and the financial markets should judge Mr Lawson mainly on whether his medium-term plans successfully come to grips with the new situation."

MORE

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ECSV RIM326

171133 :ECONOMIC SPOTLIGHT =5 LONDON

Analysts agree oil revenues will probably be around 5.5 billion stg lower than the 11.5 billion forecast in the Autumn Statement, effectively ruling out 3.5 billion stg in tax cuts planned in last year's Budget.

But favourable money supply and Public Sector Borrowing Requirement (PSBR) figures in January have tempered some City (of London) pessimism and revived hopes of small net tax cuts.

Acceptance of the Budget package by voters, as opposed to the markets, may depend on how much cash the Chancellor has conjured up and, crucially, on Lawson's presentation of his oil-induced stranglehold, analysts said.

MORE

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ECSW RIM327

171134 :ECONOMIC SPOTLIGHT =6 LONDON

Many analysts have upgraded their forecasts for GDP growth in 1986 to the Government's target of three pct, since the decline in oil prices.

Grieveson Grant's Osborne said it is possible Lawson may announce a forecast of three pct inflation at the end of the year, compared with 3.75 pct forecast in the autumn.

Osborne said such a forecast would ensure a favourable market response to the Budget. The Treasury has repeatedly stressed that lower inflation is the top priority. Osborne said the Government's only clear success has been inflation and it must go into an election with a lower rate.

MORE

EGSX RIM331

171135 :ECONOMIC SPOTLIGHT =7 LONDON

Analysts said any move to relax monetary policy to achieve maximum growth must be made within two constraints -- the inflationary risk of a lower exchange rate and the need to assure markets there is a coherent monetary policy.

Analysts said Lawson is unlikely to announce a 1986/87 PSBR much higher than his 7.5 billion stg target. Jeffrey said the U.K. Government Bond market would react badly to an explicit increase in the PSBR.

He said there has already been a significant drift in the PSBR, so far disguised by the sale of assets, but said markets have proved tolerant of this kind of "creative accounting".

MORE

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BC/3

Mick

on Tape

FROM: P WYNN OWEN

DATE 27 JANUARY 1986

MR H DAVIES

LETTER FROM MICHAEL LATHAM MP

The Chancellor would be grateful if you could draft a reply for him to send to the attached letter from Michael Latham MP.

Rus.

P WYNN OWEN

FINANCIAL SECRETARY TO THE TREASURY

MINUTES OF A MEETING IN THE FINANCIAL SECRETARY'S ROOM ON 21 JANUARY WITH THE CHARITIES AID FOUNDATION AND THE NATIONAL COUNCIL FOR VOLUNTARY ORGANISATIONS

Those present:	Sir Reay Geddes	Chairman CAF
	Michael Brophy	Director CAF
	Peter Jay	Chairman NCVO
	Mr Stewart	IR
	Mr Cropper	

1. Sir Reay Geddes said that the CAF and NCVO were taking a long term view of this subject. In response to the Financial Secretary's question on covenanting he said that they did not necessarily support a single jump to the US style system but they certainly had ideas about how to help the Government put money into the voluntary sector.

2. Mr Jay said that he saw this from two angles. Speaking from the NCVO and CAF viewpoint the day to day work of the CAF was very much built around giving through covenant schemes, but speaking personally he was attracted to the US way of giving and did not think that these two approaches were mutually incompatible. He suggested that what was vitally important was to open a channel of communication at working level between Revenue officials and the CAF, so that experience on specifics could be shared. The new Council for Charitable Support was an important step in co-ordinating the views of the various organisations in the charities field and it was important to open avenues of communication.

3. The Financial Secretary said that he could see the long term benefit of the Inland Revenue having access to the large amount of practical information the CAF could supply on this area, and at the same time it would be helpful to the CAF if they could see the practical constraints from the Revenue standpoint.

4. Mr Cropper agreed that in a field where changes were occurring at a fast pace it was desirable that both sides were as well-informed as possible.

5. Mr Brophy said that a recent meeting of the Council for Charitable Support had brought 8 organisations together and they had discussed in particular what they would like to see done with the present covenant system. He said that they had produced figures on the theoretical revenue loss of further concessions here (which could be discussed with the Revenue).

6. Mr Jay said that he thought that the limited personal tax concessions the Chancellor had made in this area in 1984 had been very sensible. Encouragement to charitable giving was different from more closely defined tax reliefs as the choice remained very much with the tax payer as to which charity should benefit from the tax relief he was given. He questioned the frequently made assertion that for a US style scheme for relief for single gifts it was actually essential to have self-assessment.

7. The Financial Secretary said that in the UK, unlike the US, only a minority of taxpayers had an end of year assessment, because in most cases PAYE collected the appropriate amount during the year. PAYE was in the process of being computerised and the charities should take this into account.

8. Mr Jay responded by saying that the real costs to the Exchequer of increased concessions were very speculative. If changes were made which acted as a powerful stimulant to charitable giving the total effect could actually be to reduce the PSBR.

9. The Financial Secretary commented that it was hard to substantiate this line of argument since increased charitable giving may not necessarily lead to a reduction in government spending.

10. In reply to the Financial Secretary's question on the relative importance of company giving as distinct from individual giving, Mr Brophy said that although individual giving was obviously of paramount importance the unanimous view had been reached at the recent CCS meeting that they would have no objections, to a relief confined to corporate giving. Such a relief would certainly be helpful, although in the US individual

giving was much larger than corporate giving. He suggested that any concessions could be for a period of ten years initially and could be added on to the existing covenant framework. ?

11. Mr Brophy said that concessions which were only aimed at public limited companies, and excluded close companies would still be welcomed.

12. Mr Jay added, however, that if this sort of concession was made he felt that Ministers would have to convince the charities world that good practical reasons were the sole motive for not offering further incentives to personal givers. He said that the Government needed to make it clear that when these practical difficulties had been overcome action would definitely be taken ie. there had to be a strong and convincing commitment to action in the long term.

13. Sir Reay Geddes briefly mentioned the ignorance that existed on the current opportunities for giving. He said that the CCS were starting work on the education process but there was much to be done. The Financial Secretary agreed that there was a need for this, and Mr Jay added that presentation was very important and the simpler this was the more people could become aware of what was available.

14. The Financial Secretary summed up by saying that he would write to the CAF/NCVO on the subject of opening up a channel of communication once he had spoken to the Chancellor and Mr Brophy confirmed that the CAF would look at the various other points that had been raised and would come back on them.

N Williams

NIGEL WILLIAMS
27.1.86

cc Those present
PS/Chancellor
PS/Chief Secretary
PS/Minister of State
PS/Economic Secretary
Mr Monger
Miss Sinclair
Mr Murray
Mr Woodall
Mr Cropper
Mr Lord
Mr Stewart IR
PS/IR

Jones & Shipman p.l.c.
Narborough Road South,
Leicester.
LE3 2LF

Telephone: 0533 896222
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BR

31 JAN 1986

FP

cc APS / CHX

FWB/SB.

The Rt. Hon. Nigel Lawson, M.P.,
Chancellor of the Exchequer,
House of Commons,
LONDON,
SW1A OAA.

CHX
11840/86

30th January, 1986.

~~To see letter from a constituent.~~

Dear Nigel

I am aware that, at this time of the year, you are bombarded with advice as to the income tax content of your next budget. Nevertheless, I feel I should express my views as Chairman of a comparatively small precision machine tool manufacturer employing 800 people and exporting 65% of our production overseas.

About 75% of our employees fall into a yearly salary bracket of between £5,000 to £7,500 and it is these valuable people who should get priority in any projected income tax reduction and this step would, I believe, assist us in our next negotiations on pay.

Fierce competition from rivals, particularly in West Germany, Japan and Switzerland, demands that we reduce our unit costs; at the same time, our employees need a sensible level of take home pay and here income tax is a significant item.

We have made an excellent recovery from the 1982/3 recession, but the demand from our home market, i.e. metal cutting organisations, is still at a relatively low level and whilst this situation appertains, we are very dependent on our success in exporting.

We are devoting considerable resources to our new product range which is technically highly competitive. Last year we introduced a share option scheme which if options are eventually taken up, will increase the ratio of employee shareholders from, currently, 40% to 85%.

I hope your are keeping well in spite of all the difficulties you have to contend with.

I am,

Yours sincerely,

Frank W. Brooks

F.W. BROOKS, OBE.

Registered Office: P.O. Box 89, Narborough Road South, Leicester, LE3 2LF. Registered No. 83479 England.

AIMS OF INDUSTRY

The free enterprise organisation

FREEDOM NEEDS FREE ENTERPRISE

BP

The Rt Hon Nigel Lawson MP,
Chancellor of the Exchequer,
Treasury,
Parliament Street,
London, SW1P 3AG.

30th January, 1986.

~~C. To note.~~

RS 31/1

Dear Nigel

I believe that we have sent you a copy of this study of ours "Towards a New Philosophy of Employment".

There is one particular point I would like to emphasise, namely the inadequate differential between a man in work and one receiving benefits. Our belief is that any reliefs in taxation should be directed at giving benefit to the lower paid by raising thresholds and/or reducing the first tax step from 30%. We also applaud the start you made last year in creating lower levels of employee National Insurance contributions for the lower income groups. We firmly believe that now is the time to increase the spending power of the employed lower paid and to provide motivation for those receiving benefit to find gainful employment.

Aims of Industry are beginning to think in terms of a General Election campaign and I am sure that you will find our efforts helpful. We do not believe that a campaign for lower wages is likely to be helpful; unlike the CBI, we believe the answer is in lower unit-costs - though that needs to be expressed in human and explicable language.

Congratulations on your splendid - and consistent - efforts.

Yours ever

Nigel

Nigel Mobbs
Chairman

BR.
HM TREASURY – MCU
31 JAN 1986
FP
cc IAE 3
cc APS/CHX

CHX
11788/86

40 Doughty Street, London WC1N 2LF Tel: 01-405 5195

NOTE OF A MEETING HELD IN HM TREASURY
ON FRIDAY 31 JANUARY 1986

Those Present:

Chancellor
Financial Secretary
Minister of State
Mr Kemp
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Isaac (IR)
Mr Corlett (IR)
Mr Stewart (IR)
Mr Beighton (IR)
Mr Jenkins (C&E)

CHARITABLE GIVING

VAT concessions for charities

The meeting discussed the Minister of State's minute of 30 January setting out a possible "caring package", based on the Charities VAT Reform Group's shopping list. Mr Jenkins said that the charities lobby should be extremely pleased with a package on these lines. There was one problem, over trying to draw a dividing line between "medicines" and "drugs", on which he would need to have discussions with DHSS. A final decision on the package would be needed about 3 weeks before Budget Day.

2. After discussion, it was agreed that the Minister of State's package (apart from the concession on medicines) which cost £10 million, should certainly form part of the Budget. A decision was deferred on medicines, but Mr Jenkins was authorised to hold discussions with DHSS.

Covenanted gifts by individuals

3. The Chancellor said he was very attracted to abolishing the £10,000 limit altogether, and thus removing the point which concerned Sir Emmanual Kaye (who had just won his High Court case against the Revenue); but at the same time to introduce measures to counteract abuse. The Financial Secretary said that although he had had reservations about the approach proposed by the Revenue, he was now content with this line. In discussion it was agreed that the form of the action against abuse should take the less draconian form put forward by the Revenue - relief only withdrawn to the extent that funds are not actually spent on charitable purposes.

4. Presentation would be important, and the Financial Secretary should ensure that a list of appropriate contacts was drawn up, with a view to ensuring the right reaction on Budget Day. The Financial Secretary said that, although some prominent people would not like the proposal, they would find it difficult to object publicly.

5. The Revenue were asked to work out the details of the proposal. Subject to any unforeseen stumbling blocks, it was agreed that this should form part of the Budget package.

Single gifts by companies

6. The Chancellor said he was worried by the substantial cost of this proposal. He asked whether there was any way of limiting it? Mr Isaac said that one possible way would be to impose a limit on donations, in terms of a percentage of profits. It was agreed that the relief could not, in any case, be extended to close companies. It might well be that this was better left in reserve until a future year.

7. There should be some offsetting saving from the introduction of measures against abuse. But this was an area of great uncertainty, and it was difficult to put a figure on it (although a speculative guess might be of the order of £25 million). The Revenue would do more work to try and quantify the offsetting saving.

8. In conclusion, the Chancellor asked the Revenue to refine their estimate of the cost of tax relief for single donations by charities, and in particular:-

(a) how it would build up year by year; and

(b) ways in which the cost could be contained.

Single gifts by individuals: payroll giving.

9. The Revenue stressed that they saw very great difficulties in this proposal - for employers as much as for themselves. The Chancellor agreed that, in order to make the scheme acceptable to employers, it was essential that it should be entirely voluntary - and that the precise form the scheme took should also be left to the employer. In any case, he would discuss this aspect privately with Lord Young.

10. On the other hand, the use of a "clearing house" should make life easier for both employer and the Revenue. Where the Government was the employer, it would also help to distance itself from the choice of charity. It should not be necessary to specify the use of clearing houses in legislation.

11. The Minister of State remained uneasy about the proposal, and it was recognised that it might be difficult to resist pressure to extend the scheme - to the self-employed, or to direct giving by

individuals. Nonetheless it was agreed that this should also form part of the 1986 Budget proposals, subject to the outcome of the Chancellor's discussions with Lord Young, and the shape of the overall charities package.

Other matters

12. It was agreed that exchange of information between the Revenue and the Charity Commissioners was desirable. It was also agreed that better publicity for tax incentives for charitable giving was needed.

A W KUCZYS

Distribution:

Those present
Sir P Middleton
PS/IR
PS/C&E

BUDGET CONFIDENTIAL

FROM: A W KUCZYS
DATE: 3 February 1986

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Monger
Mr Scholar
Mr Cropper
Mr H Davies
Mr Graham (OPC)
Mr Houghton (IR)
Mr Battersby (IR)
PS/IR

CTT LIFETIME CHARGE: TAPER RELIEF

The Chancellor has seen your minute of 21 January. He has commented that, if it is acceptable to have a taper which is less generous than the "present style" taper for gifts passing 3 to 4 years prior to death as is the case with Mr Houghton's suggested scale (80 per cent against 50 per cent), then a smoother and seemingly preferable variation of Mr Houghton's scale would be:

0-1	100
1-2	100
2-3	100
3-4	80
4-5	60
5-6	40
6-7	20

2. As the Chancellor understands it, given that a 100 per cent charge remains for 3 years prior to death, there is - as the Financial Secretary says - no need for transitional provisions.

AWK

A W KUCZYS

P.S. Subsequently discussed at Overview Meeting. AWK

Cabinet paper

CHANCELLOR'S PAPER ON ECONOMIC STRATEGY FOR CABINET

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

(86) 5 N4/46 B COPY NO 8

ebruary 1986

CABINET

ECONOMIC STRATEGY

Memorandum by the Chancellor of the Exchequer

The approach to the 1986 Budget is inevitably dominated by the dramatic changes taking place in the oil market. The large price fall that has already occurred means a sharp reduction in prospective oil tax revenues.

2. The current North Sea oil price of \$17-18 per barrel is some 40 per cent below the end-November level - a change almost as great as the price increases of 1973 and 1979. It is hard in current circumstances to make a reliable judgment about the new level at which oil prices may settle. We therefore have to consider the Budget against the prospect not merely of greatly reduced oil revenues but also considerable uncertainty about how large the reduction will be.

3. Our current estimates suggest that if oil prices settle at \$15 a barrel our revenues from the North Sea will be reduced to £6 billion for the next financial year. This compares with receipts of £12 billion in 1984-85. In last year's Medium Term Financial Strategy (MTFS) we expected revenues of £11½ billion for 1986-87.

4. There has inevitably been some turmoil in financial markets as they have responded to the oil price change. Sterling has fallen by about 7½ per cent and there has been persistent upward pressure on short term interest rates. So far we have weathered the collapse in oil prices and consequent financial market turbulence pretty well - though it may not be over yet. In so doing we are helped both by the underlying strength of the economy, in terms of growth, inflation and the external account; and above all by the reputation we have acquired for sound and prudent policies.

FISCAL POSITION

5. Faced with this background my judgment is that we must approach the Budget with considerable caution. We must avoid going above the £7½ billion Public Sector Borrowing Requirement figure set out in last year's MTFS. Indeed there is a strong case for going below it, bearing in mind the proceeds of privatisation, estimated at £4¾ billion next year.

6. Much may change between now and Budget Day. Because non-oil revenues are now projected to be higher than expected I hope to be able to avoid a

net increase in taxes in the Budget. But there looks like being little, if any, scope for a net reduction in taxation. We should just meet the public expenditure planning total set for the current financial year. The need to cope successfully with the unprecedented situation which the oil price fall has created for the public finances underlines the importance of holding public spending next year similarly within the planning total we have announced.

ECONOMIC PROSPECTS

7. But while lower oil prices have a profound impact on what is possible in the Budget, they should not greatly affect our overall economic performance, although there will be significant changes within the economy. For the world as a whole, lower oil (and commodity) prices will have beneficial effects in 1986 on the oil-consuming countries. The forecast for the major industrialised countries is for the output growth averaging 3 per cent - a little better than achieved last year. Inflation will stay low: indeed in Germany and Japan it is likely to approach zero.

8. For the United Kingdom, the oil price fall has not caused me to revise my view that [illegible] will be a further year of steady growth, at an annual rate of about [illegible] per cent, accompanied by declining inflation. Different parts of the economy will be affected in different ways by lower oil prices. While the oil sector will not do so well, manufacturing industry in particular should benefit considerably.

9. The United Kingdom economy is now in a stronger position to take advantage of the opportunities created by lower oil prices. The underlying improvement shows up in a number of indicators. Last year manufacturing productivity increased by a further 4 per cent. Since 1979 it has now grown at an average annual rate of $3^3/_4$ per cent. As the table below shows, our performance here compares very favourably with the recent past; and even with the majority of our principal overseas competitors.

Output per man hour in manufacturing
average annual growth rates, per cent

	1973-79	1979-85
United States	1½	2½
Japan	6½	6½
Germany	3	3
France	5	3½
United Kingdom	1	$3^3/_4$

10. Capital spending by business has generally been rising faster than output in recent years and further growth is expected in 1986, in response to higher profits and continued expansion in output. Exports performed well in 1985: indeed, United Kingdom exporters increased their

share of world trade. The prospect is for continued export growth, albeit at a slower pace. Even after the fall in oil prices, another sizeable current account surplus is in prospect for 1986, helped by rising earnings from our increasing stock of overseas assets. (Our net overseas asset position is now second only to that of Japan.)

11. This year is likely to see a significant rise in consumer spending. This reflects rapid growth in real disposable incomes - itself a result of the high level of wage settlements in 1984-85 and the reduction in inflation expected this year. Earnings are currently rising at or over 7½ per cent. With inflation likely to fall to 4 per cent this year, the average employee's pay may rise by some 4 per cent in real terms during 1986.

12. However, this excessive earnings growth remains the chief threat to jobs. Despite five years of continuous output growth, and a growth in the number of people in work of over 600,000 since the last election, which I expect to continue, unemployment is unlikely to show much of a reduction while wages rise so far ahead of prices. The plain fact is that, despite our very good productivity record, United Kingdom unit labour costs have been increasing much more rapidly than those of our competitors.

13. Annex 1 sets out key figures from the forecast. Annexes 2 and 3 set out the revenue effects of selected tax changes, together with a note on the tax burden.

SUMMARY AND CONCLUSIONS

14. The dramatic change in oil prices has had a major - and adverse - impact on the public finances; but I very much hope that, thanks to the sound financial policies we have been following, it will prove possible to avoid raising taxes overall in the Budget. The impact of lower oil prices on the United Kingdom economy as a whole is more neutral. I expect to see continuing steady growth for the sixth year in succession; and lower inflation. This is a measure of the strength of our underlying economic performance.

15. I seek colleagues' views on the appropriate shape of the Budget in the light of the circumstances I have outlined.

N L

Treasury Chambers

11 February 1986

SECRET

ANNEX 1

SELECTED ECONOMIC INDICATORS

	1979	1980	1981	1982	1983	1984	1985	1986 (1)
World GNP, (2) in major 7 economies (per cent change)	3½	1	1½	- ½	2½	4½	2½	3
UK GDP, (2) (per cent change)	2½	- 2½	- 1½	2	3½	2½	3½ (3½)	3
Domestic demand, (2) (per cent change)	4	- 3½	- 2	2½	4½	2½	2	3½
Retail prices Q4 (per cent change)	17½	15½	12	6	5	5	5½ (5)	4
Interest rates (average 3-month interbank)	13½	16½	14	12½	10	10	12	13 (3)
Current balance (£ billion)	- ½	3	6	4	3	1	3½ (3)	3½
Unemployment (UK, per cent excluding school leavers)	5	6	9½	11	12	12½	13	13 (4)
Sterling Index	87	96	95	90½	83	78½	78	74½ (3)
Oil prices, $, North Sea	20½	34½	37½	33	30	29½	27½	17½ (5)

(1) Provisional pre-Budget figures.

(2) At constant prices.

(3) February 7.

(4) Not a forecast. Figures based on assumptions in PEWP.

(5) Brent price for delivery in March, as of February 7.

ANNEX 2

REVENUE EFFECTS OF TAX CHANGES

A. Direct Taxes: Indexation

The RPI increased in the year to December 1985 by 5.7 per cent. With indexation by this amount and statutory rounding, the figures for the main allowances and other thresholds would be:

Personal allowances	1985-86 £	1986-87 £
Single and wife's earned income allowance	2205	2335
Married allowance	3455	3655
Bands eg		
30% rate	0-16200	0-17200
60%	over 40200	over 42700

The total revenue costs of indexation of income tax (reflected in the forecast) are £1140m in 1986-87, and £1490m in a full year, at forecast 1986-87 prices and incomes.

B Indirect Taxes: Indexation

The effects of 5.7 per cent revalorisation of the exercise duties (including VAT effects, price changes rounded) are as follows:

	Typical Price Change	Revenue effect (1986-87 prices) £m	RPI impact £m
Beer	1p/pint	100	0.07
Wine	5p/70cl light wine	20	0.02
Spirits	31p/bottle	45	0.04
Tobacco	5p/20 King size	150	0.14
Petrol	5p/gallon	260	0.13
Derv	5p/gallon	65	nil
VED	£5/car	100	0.05
Overall effect (reflected in forecast)		740	0.45

Note: First year and full year revenue effects are virtually identical.

C. Ready Reckoner: Illustrative Tax Changes

£ million at forecast 1986-87 income levels

INCOME TAX	1986-87	Full Year
Allowances and Thresholds		
1% above indexation on all statutory allowances	210	175
1% above indexation on all statutory allowances and thresholds	245	190
Rates		
Change basic rate by 1p	1175	975
CORPORATION TAX		
Change main rate by 1 percentage point	180	310
Change small companies' rate by 1 percentage point	16	30
OTHER TAXES		
Change VAT rate by 1 percentage point[1]	700[2]	925

(1) A 1% change in the VAT rate would change the RPI by 0.5%.

(2) Provisional forecast

ANNEX 3

THE TAX BURDEN

Since the Government came to power total taxes and NICs as a proportion of GDP at market has risen by about 5 percentage points, though the ratio has fallen slightly since 1981-82. The figures are as follows:

Table 1

Total taxation* as a % of GDP (market prices)	
1978-79	33.9
1979-80	35.2
1980-81	36.4
1981-82	39.3
1982-83	39.1
1983-84	38.6
1984-85	39.2
1985-86 (estimate)	38.7
1986-87 (assuming indexation)	38.6

* Including NICs and the local authority rates.

Personal sector

2. Despite reductions in income tax, total personal taxes (direct and indirect, including employees' NIC and domestic rates) in 1985-86 are about £15 billion higher in real terms (ie 1985-86 prices) than they were in 1978-79. For income tax and national insurance contributions the following table shows how the proportion of gross pay they represent has risen, particularly for the low paid:

Table 2

Income tax and NICs as a % of gross earnings*

	½ average earnings	Average earnings	2 average earnings
1978-79	16.0	27.8	31.4
1981-82	20.8	29.3	32.2
1982-83	20.8	29.8	32.3
1983-84	20.1	29.6	31.7
1984-85	19.3	29.2	31.5
1985-86 (estimate)	19.0	29.0	31.5
1986-87 (indexation)	19.3	29.1	31.7

* Adult male earnings (all occupations). Married couple, wife not working: the couple are assumed to have no children, to avoid distortion of the figures from the abolition of child tax allowances.

3. These figures reflect the rise in the standard employees' NIC rate from 6½% to 9%. The lower rates introduced in the 1985 Finance Act do not affect the cases shown. So far as income tax is concerned, personal allowances have increased by over 19% in real terms since 1978-79 and have increased slightly faster than earnings. The basic rate has been reduced from 33p to 30p, but the 25p reduced rate band has been abolished.

4. As the table shows, indexation of allowances in the Budget would lead to a very slight rise in the proportion of incomes taken in tax and NIC. This is because earnings are assumed to rise by 7% compared with the indexation percentage of 5.7%.

5. Since 1978-79 total taxes paid by businesses (outside the North Sea) have fallen slightly as a percentage of GDP. Within this total, the major change has been a fall in employers' NIC and NIS as a percentage of GDP, partially offset by an increase in business rates, and 'other' taxes as the following table shows:

Taxes paid by businesses £bn in 1985-86 prices

(figures in brackets are %s of GDP)

	Corporation tax[1]	Taxes on self employment incomes	Employers' NIC and NIS	Rates	Other[2]	Total
1978-79	7.1	2.4	9.9	4.7	3.7	27.7
	(2.2)	(0.7)	(3.1)	(1.4)	(1.1)	(8.6)
1985-86 (estimate)	8.2	3.1	8.0	5.9	4.8	30.0
	(2.3)	(0.9)	(2.2)	(1.7)	(1.4)	(8.4)

1. Excludes North Sea, but includes ACT
2. VED, car tax, road fuel duty, duty on rebated oils, capital taxes.

Pl type draft below as final letter for ~~LC~~'s sig'

FROM: **H J DAVIES**

DATE: **4 FEBRUARY 1986**

CHANCELLOR

cc: Mrs Case
Mr Perry
Mr P Davis
Mr Westhead
Mr Murray

LETTER FROM MICHAEL LATHAM MP

Mr Michael Latham MP wrote to you on 20 January attaching a booklet prepared by the Engineering Employers East Midlands Association for a meeting with Conservative Members of Parliament on 15 January. You asked for a reasonably substantial reply.

I attach a draft which has benefited from contributions from FP, IAE and AEF.

HJD

H J DAVIES

1257/12

DRAFT LETTER

Michael Latham MP
House of Commons
London SW1A OAA

Thank you for your letter of 20 January, together with the material from the Engineering Employers East Midlands Association, which I have looked at carefully. Could I say first how important I think it it for us to keep in close touch with employers, particularly in the regions, and how valuable I find it to receive such well presented material. Particularly, of course, when it concerns my own region.

You will appreciate that, with the Budget now only a few weeks off, I cannot comment on specific tax points raised in the EEF's Budget Submission. But I would like to pick up some of the points you raised in your letter.

You report that at your meeting there was concern about the support the Government gives to British exporters, and in particular the soft loan arrangements made by our competitors.

I hope that our new scheme, which is designed both to put UK companies on a footing equal to that of other OECD countries, and to meet the requirements of aid recipients who prefer soft loans to mixed credits, will meet this concern. We are not, of course, able to match the volume of Japan's aid programme and I know you will recognise the importance of balancing the many demands on our necessarily limited aid resources. Even so, the provision we have made should be enough to support more than £1 billion of new business for UK companies over the next five years. The form of our soft loans meets the requirements of China, and as you say we have already offered the facility of £100 million, which may in due course be increased. The Government is also examining the suitability of other countries for such loans, and Indonesia, where negotiations are already under way, is a high priority.

Your second point concerns Japanese investment in manufacturing and assembly plants in the UK. You pointed to the need to ensure a high level of local content.

I agree that in each case involving discretionary assistance we need to consider carefully the balance of advantage to the United Kingdom. A number of factors need to be considered. Japanese involvement in the UK has brought a number of benefits, such as higher product quality and different and often better management practices. But clearly a major factor is whether the investment will generate additional employment. In those cases where we want investment to come to the UK and discretionary assistance is being offered, the Government presses for as much local content as possible and 80% is frequently achieved. But at the end of the negotiations with a particular company a judgement has to be reached about the overall benefit of the investment to the UK economy. To insist on a minimum local content level would be likely to lead to valuable investments going elsewhere.

I note what you say about the employers views on joining the Exchange Rate Mechanism of the European monetary system. As you know, the Government's position, which Ian Stewart explained very fully in the House last week, is that the conditions are not now right for entry into the Exchange Rate Mechanism, but we acknowledge the benefits which membership might bring and keep the position under constant review.

I am glad that several of our colleagues referred to the danger of excessive wage settlements. The CBI has made a powerful case in recent months about the damage which excessive pay rises can do to our economy and trading prospects. It is important that we take every opportunity of pressing this message home.

Your final point concerned investment allowances. Without prejudice to my Budget decisions perhaps I can offer some general comments on the subject. We are indeed phasing out incentive allowances as part of the 1984 corporation tax reforms, retaining only writing down allowances which more closely reflect general rates of economic depreciation. But these changes were part of a balanced package of reforms which also included substantial reductions in the corporation tax rate. From this April the rate will be down to 35%, the lowest rate of any major industrialised country.

As to research and development, which is specifically mentioned in the EES Memorandum, we explicitly recognised the special high risk nature of this expenditure in the 1985 Budget, when I announced that a 100% scientific research allowances would exceptionally be retained within the reformed business tax system. I also announced the extension of the business expansion scheme to research and development companies, offering further encouragement to innovation.

I hope these comments are helpful in any further discussions you have with the employers.

NIGEL LAWSON

1257/12

cc Mrs Case
Mr Perry
Mr P Davis
Mr Westhead
Mr Murray
Mr Davies

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

Michael Latham MP
House of Commons
London
SW1A OAA

5 February 1986

Dear Michael

Thank you for your letter of 20 January, together with the material from the Engineering Employers East Midlands Association, which I have looked at carefully. Could I say first how important I think it it for us to keep in close touch with employers, particularly in the regions, and how valuable I find it to receive such well presented material. Particularly, of course, when it concerns my own region.

You will appreciate that, with the Budget now only a few weeks off, I cannot comment on specific tax points raised in the EEF's Budget Submission. But I would like to pick up some of the points you raised in your letter.

You report that at your meeting there was concern about the support the Government gives to British exporters, and in particular the soft loan arrangements made by our competitors.

I hope that our new scheme, which is designed both to put UK companies on a footing equal to that of other OECD countries, and to meet the requirements of aid recipients who prefer soft loans to mixed credits, will meet this concern. We are not, of course, able to match the volume of Japan's aid programme and I know you will recognise the importance of balancing the many demands on our necessarily limited aid resources. Even so, the provision we have made should be enough to support more than £1 billion of new business for UK companies over the next five years. The form of our soft loans meets the requirements of China, and as you say we have already offered the facility of £100 million, which may in due course be increased. The Government is also examining the suitability of other countries for such loans, and Indonesia, where negotiations are already under way, is a high priority.

Your second point concerns Japanese investment in manufacturing and assembly plants in the UK. You pointed to the need to ensure a high level of local content.

I agree that in each case involving discretionary assistance we need to consider carefully the balance of advantage to the United Kingdom. A number of factors need to be considered. Japanese involvement in the UK has brought a number of benefits, such as higher product quality and different and often better management practices. But clearly a major factor is whether the investment will generate additional employment. In those cases where we want investment to come to the UK and discretionary assistance is being offered, the Government presses for as much local content as possible and 80% is frequently achieved. But at the end of the negotiations with a particular company a judgement has to be reached about the overall benefit of the investment to the UK economy. To insist on a minimum local content level would be likely to lead to valuable investments going elsewhere.

I note what you say about the employers views on joining the Exchange Rate Mechanism of the European monetary system. As you know, the Government's position, which Ian Stewart explained very fully in the House last week, is that the conditions are not now right for entry into the Exchange Rate Mechanism, but we acknowledge the benefits which membership might bring and keep the position under constant review.

I am glad that several of our colleagues referred to the danger of excessive wage settlements. The CBI has made a powerful case in recent months about the damage which excessive pay rises can do to our economy and trading prospects. It is important that we take every opportunity of pressing the message home.

Your final point concerned investment allowances. Without prejudice to my Budget decisions perhaps I can offer some general comments on the subject. We are indeed phasing out incentive allowances as part of the 1984 corporation tax reforms, retaining only writing down allowances which more closely reflect general rates of economic depreciation. But these changes were part of a balanced package of reforms which also included substantial reductions in the corporation tax rate. From this April the rate will be down to 35%, the lowest rate of any major industrialised country.

As to research and development, which is specifically mentioned in the EES Memorandum, we explicitly recognised the special high risk nature of this expenditure in the 1985 Budget, when I announced that a 100% scientific research allowance would exceptionally be retained within the reformed business tax system. I also announced the extension of the business expansion scheme to research and development companies, offering further encouragement to innovation.

I hope these comments are helpful in any further discussions you have with the employers.

Yours
Nigel

NIGEL LAWSON

SECRET Personal Mrs Lomax

FROM: M C SCHOLAR
DATE: 5 February 1986

SIR P MIDDLETON

cc: Sir T Burns
Mr H P Evans
Mr Monger
Mr Odling-Smee
Mr Turnbull
Mr Pratt

CABINET 13 FEBRUARY: ECONOMIC STRATEGY PAPER

I have had a shot (with help from Mr Evans and others) at a draft Cabinet paper - attached with a copy of last year's for convenience (not to all). Annexes to follow.

2. If you and Sir T Burns are content, I will submit to the Chancellor tomorrow evening, ready for our discussion with him on Friday morning. That should just about leave us time to get a final version over to No 10 by Friday evening.

MCS

M C SCHOLAR

Should be more about ... ; ... ; market ... ... productivity. ...

SECRET

273/001

ECONOMIC STRATEGY

1. Our approach to the 1986 Budget comes at a time of considerable turbulence in the markets. We are weathering these storms. In so doing we are being greatly helped by the strong underlying performance of the economy, on growth, inflation and on external account; and by our sound and prudent policies.

Economic Prospects

2. After the strong growth during 1984 in world output and trade 1985 saw some slow-down in activity. But lower oil and commodity prices in 1986 will have beneficial effects on the oil-consuming countries, and the forecast for the major industrialised countries is for output growth averaging 3 per cent. Inflation will stay low: indeed there may be stable prices in the economies of Germany and Japan.

3. The UK economy grew rapidly in the second half of 1984 and first half of 1985, at an underlying annual rate of about 4 per cent. There was some slowing-down in the course of 1985. I expect growth of around 3 per cent in 1986, with the emphasis more on domestic demand.

4. Capital spending has generally been rising faster than output in recent years and further growth is expected in 1986,

As a response to higher profits and continued expansion in output. Exports performed well in 1985, responding to the rapid growth in world trade: indeed, UK exporters increased their share of world trade. The prospect is for continued growth, albeit at a slower pace. Notwithstanding the fall in oil prices, another substantial current account surplus is in prospect for 1986, helped by rising earnings from our increasing stock of overseas assets.

5. 1986 is likely to see a sizeable rise in consumer spending. This reflects rapid growth in real disposable incomes - itself the result of the high level of wage settlements in 1984-85 and the reduction in inflation this year. Earnings are currently rising at or above 7½ per cent. With inflation likely to fall below 4% this year, the average employee's pay may rise by 4-5% in real terms during 1986.

6. This excessive earnings growth remains the main domestic threat to employment. Despite five years of continuous output growth unemployment remains, at best, static, at an unacceptably high level. It is unlikely to fall substantially while wages rise well ahead of prices, and while our unit labour costs are increasing much more than those of our competitors. International competitive pressure should, it is true, restrict the ability of some employers to agree to large settlements, but it remains vital to press on with measures to improve the operation of the labour market and to secure lower pay increases.

productivity performance

internal comparisons

[illegible]. The main uncertainty at present is the oil price. Over the past few months spot prices have fallen from $30 to under $16 a barrel - almost back to pre-1979 levels - and prices could fall further still. Although there are, of course, beneficial effects for the UK economy in lower oil prices, more the markets are nervous, and are reacting unpredictably to news of OPEC and non-OPEC policies; and there are fears, too, about the effects of these changes on some major oil producers, and through them on the international financial system.

8. Annex 1 sets out key figures from the forecast.

Borrowing

9. The Public Sector Borrowing Requirement (PSBR) for the current financial year looks like turning out close to the £7 billion figure in the Budget (and below the £8 billion in the Autumn Statement). But there is still a considerable margin of error, and the outturn could be above or below the present forecast by £1 billion or more.

10. For 1986-87, the 1985 Financial Statement and Budget Report (FSBR) projected a PSBR of £7½ billion or 2% of GDP. But since then we have announced revised public expenditure plans, adding about £4 billion to public spending programmes. About half of that came from rolling forward the Reserve, but the rest was met by increased privatisation receipts.

although these additional receipts score in the accounts as negative expenditure their economic impact is much more akin to additional government borrowing than to lower public expenditure. Other things being equal, therefore, we would need to adopt a PSBR some way below £7½ billion in order to maintain a fiscal stance which is no looser than we have so far planned.

11. But other things are not, of course, equal. In particular, only a part of the very large fall in oil prices was allowed for in last year's projections. There is a case for taking part of the strain of lower oil revenues on temporarily higher borrowing. Nevertheless, with markets volatile and uncertain and further falls in the oil price - at least for a time - very much a possibility, my view is that we should aim to set a PSBR for 1986-87 a little below £7½ billion and perhaps just below close to the level of this year's estimated outturn, a little below.

Fiscal position

12. Last year's Autumn Statement gave, for the first time, no figure for the fiscal adjustment. Parliamentary and public comment, therefore, started from the £3½ billion fiscal adjustment figure projected in the 1985 FSBR, although informed opinion quickly guessed last autumn that the actual figure would inevitably turn out to be a good deal lower than this.

13. The fall in oil prices over the past few months has further limited the room for manoeuvre. Every $1 fall in the dollar

Effect of Dec exchange rate

oil price, assuming an unchanged sterling dollar exchange rate, reduces revenues by about £½ billion. The pressures for higher public expenditure remain intense: substantial claims on the 1986-87 Reserve are already in view, and the rise in domestic interest rates in January will increase the total of debt interest, already running at over £18 billion a year. Were it not for buoyant non-oil revenues we would be facing the need to increase rather than reduce taxes next year.

14. Much may change between now and Budget day. But, on present indications, I expect there to be no more than very modest scope for any new measures in the Budget, after providing for indexation. This makes it the more important to concentrate on measures which will improve the performance of the economy, to improve incentives, efficiency and the free operation of markets, as the best way to ensure growth of output and employment.

Summary and Conclusion

15. Our policies continue to deliver steady growth - now about to enter its sixth year - and declining inflation, although unemployment remains stubbornly high. The difficult financial conditions over the past month or so have underlined the importance of the sound financial policies we have adopted, which have allowed us to take a firm stand in the face of

strong and unwelcome pressures in the markets. We need to stick to these policies in the Budget, so as not to put at risk the good prospects for continuing growth, declining inflation, higher employment, [and, if employers are more successful in controlling their pay costs, a fall in unemployment].

16. I seek colleagues' views on the appropriate level of the PSBR for 1986-87 (paragraph 11), and on the broad shape of the Budget (paragraph 14).

(N.L.)

1 3326/85

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

John Browne Esq MP
House of Commons
LONDON
SW1A OAA

5 February 1986

Dear John

I am sorry you have not had an earlier reply to the supportive letter you wrote me just before Christmas.

I quite understand the difficulties and distractions you had to cope with towards the end of last year, and was glad to see you in good form when you came round to No 11 the other evening.

The TCSC was not wholly sensible in some of the things it said and wrote during the Autumn, and I was less than pleased to read, following a section dealing with my own appearance before them, that "All this represents a major change from the economic policy as it was originally explained to us when the present Government took office". That is simply not true. We still regard inflation as enemy number one, we are still concerned with sterling's purchasing power, with monetary discipline and with the creation of jobs. The details of policy do, of course, have to be varied. It makes a lot of difference if the price of oil is rising steeply or falling like a stone. It does make a difference if America is in a budgetary crisis or not.

All one can say is that the TCSC needs all the attention that its more sensible members can give to it, and I am delighted to know how seriously you take your membership. The pending Budget will give further opportunities for bringing a sound influence to bear in Parliament.

Yours ever

Nigel

NIGEL LAWSON

CAF

CHARITIES AID FOUNDATION
48 PEMBURY ROAD
TONBRIDGE, KENT TN9 2JD
TELEPHONE (0732) 356323

RWP

~~PPS pt~~

The Rt Hon John Moore MP
Financial Secretary
H M Treasury
Parliament Street
LONDON SW1P 3AG

Ref: X0710

6th February 1986

FINANCIAL SECRETARY
REC. 12 FEB 1986

Mr C. Stewart
PPS, CST, MST, EST,
Mr Monger, Mr Cropper
Mr Hall, Miss Sinclair
Mr S. Woodall, Mr A. Murray
PS/IR

Dear [handwritten]

Charities and Tax

Following our meeting I would like to record

a) We would be interested in attending the informal Treasury/Revenue meetings which you considered might be possible to arrange — after the Budget!

b) We would like Public Companies to be given a direct incentive to give.

c) This should be stated in the context of helping individuals in the future by either simplifying covenants and/or an incentive.

d) The so called covenant system should be left in place and impaired as little as possible.

e) On the question of "close companies" I note Sir Emmanuel Kaye's letter to you of 3rd February and rather agree with him that the right to apportion be maintained but not used in straight-forward cases.

Yours sincerely

Michael Brophy

Michael Brophy
Director

MB/JGC

BUDGET: CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

RJP

FROM: N WILLIAMS
DATE: 6 February 1986

M J G ELLIOTT IR

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Mr Monck
Mr Monger
Mr Shaw
Mr Cropper
Miss Sinclair
Mr Graham OPC
PS/IR

BUDGET STARTER 124A
SECONDMENT OF STAFF TO LOCAL ENTERPRISE AGENCIES

1. The Financial Secretary was grateful for your minute of 4 February.

2. He is content that Starter 124A should now be dropped.

3. The Financial Secretary however would like you to give careful consideration to publicising more widely the fact that an existing provision can be interpreted to give tax relief for the cost of seconding staff to local enterprise agencies.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

BUDGET: CONFIDENTIAL

BUDGET CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: M J G ELLIOTT
DATE: 4 February 1986

FINANCIAL SECRETARY

BUDGET STARTER 124A
SECONDMENT OF STAFF TO LOCAL ENTERPRISE AGENCIES

1. In his note to you of 30 January about the BES, Mr Beighton referred to our suggestion (which has become Starter 124A) that tax relief should be given for the cost of seconding staff to local enterprise agencies. He said that we now find that we can interpret an existing provision to achieve that effect.

2. The provision in question is Section 48 of the Finance Act 1982, which provides a relief for contributions to approved local enterprise agencies. This allows "any expenditure incurred . . . in making the contribution which would not otherwise be so deductible" to be deducted in computing profits for tax purposes. The contribution may be in cash or in kind; and we are now satisfied that the reference to contributions in kind is wide enough to cover the provision of services without charge, including the services of an employee seconded to an LEA.

3. We should accordingly be grateful for your confirmation that starter 124A may now be dropped.

MJE.

M J G ELLIOTT

---

c.	Chancellor	Mr Battishill
	Chief Secretary	Mr Beighton
	Economic Secretary	Mr Painter
	Minister of State	Mr Pattison
	Mr Monck	Mr Reed
	Mr Monger	Mr Elliott
	Mr Shaw	Miss Dyall
	Mr Cropper	PS/IR
	Miss Sinclair	
	Mr Graham (Parliamentary Counsel)	

SECRET

Copy 2 of 24

Inland Revenue

Policy Division
Somerset House

FROM : B O'CONNOR
7 February 1986

1. Mr Battishill AB 7/2.

2. Financial Secretary

MORTGAGE INTEREST RELIEF LIMIT : BUDGET STARTER 107

1. The mortgage interest relief limit, which applies to loans to purchase or improve the borrower's only or main residence needs to be renewed every year. At Chevening it was provisionally agreed that an increase in the ceiling should be resisted, not least because it would probably lead to higher mortgage rates. We should be grateful for confirmation and authority to instruct Parliamentary Counsel to draft on the basis that the limit for 1986/87 should be unchanged at £30,000.

2. It is likely that all the traditional arguments will be deployed during the passage of the Finance Bill and you might find it useful at this stage to have the following general background and current statistical information.

---

cc. Chancellor
Chief Secretary
Economic Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Mr Cropper
Miss Sinclair
Mr Hall
Mr Wood
Mr Graham (Parliamentary Counsel)

Mr Battishill
Mr Pollard
Mr Pitts
Mr Lewis
Mr Parker
Mr Davenport
Mr Eason
Mr P D Hall
Mr Gray
Mr O'Connor
PS/IR

BACKGROUND

3. The limit was introduced in 1974 by the then Labour government as one of the restrictions on relief for interest. It was set at £25,000 which was considered generous and capable of standing for some time. But the House decided that it should have to be reimposed annually. It remained £25,000 until 1983 when, following discussions with the Prime Minister, there was an increase to £30,000.

4. The 1983 Budget presented the increase as a help to home buyers and to the construction industry. During Committee Stage debates the then Financial Secretary (Mr Nicholas Ridley) justified the increase by reference to the rise in house prices since the limit was first introduced and because it would help encourage the growth of home ownership. In 1984 the then Minister of State (Mr Hayhoe) turned down an official Opposition amendment to increase the limit from £30,000 to £31,000 for basic rate taxpayers, referring to the 1983 increase and to the successive increases in the Stamp Duty threshold (raised from £15,000 to £30,000, over 1980-84).

5. In the 1985 Finance Bill the Financial Secretary said: "The limit was raised from £25,000 to £30,000 two years ago and we decided that it should remain unchanged this year. At £30,000, the limit is still sufficient to cover the great majority of borrowers. But we will of course be keeping the limit under review from year to year in framing the Budget". [Standing Committee B, 4 June 1985, Col.275.]

6. The Prime Minister has publicly reaffirmed her Government's commitment to the relief on several occasions, most recently in the House on 25 July 1985, when she said: "I am happy to repeat what I have frequently said from this Despatch Box and shall be saying many times in the future. So long as I am here, tax relief on mortgages will continue." (Hansard, 25

July 1985, Col.1301.) But her assurances have contained no specific commitment on the limit. More recently the subject was raised by Mr Jessel in an Oral Question to the Chancellor. The Chief Secretary answered that "The £30,000 limit is a matter for decision in each Finance Bill ..... The Government have made clear on many occasions that they have no intention of abolishing mortgage interest relief ....." For the Official Opposition Mr Hattersley said "There is no question of the next Labour Government ..... abolishing mortgage interest tax relief." In a supplementary question Mr Penhaligon implied that relief should be restricted to basic rate tax (Hansard, 16 January 1986, Cols 1199 and 1200).

Representations on the Limit

7. We can trace only two 1986 Budget submissions from representative bodies who have asked for an increase in the limit. These are the Building Employers' Confederation and the Managerial and Professional Staff Liaison Group who suggest a £40,000 and £65,000 limit respectively. Expressing contrary views several housing and tax studies published in the latter part of 1985 suggested phasing out, or at least reviewing the allowance of mortgage interest relief. These studies were notably the National Federation of Housing Associations' Enquiry (chaired by the Duke of Edinburgh and published in July), the Church of England Report on the Inner Cities (published in December) and the CBI Working Party Report on Tax Reform (published in December).

STATISTICAL INFORMATION

8. The Annex includes the latest figures on RPI and house price increases, average mortgages, numbers of loans above the present limit, and the costs of increasing that limit. If updated by reference to the RPI, the real value of the limit of £25,000 set in 1974 would be £97,000. Using 1983 as a base point when the present £30,000 limit was fixed the updated

figure would be £35,000. By reference to the House Price Index it would be £39,000.

9. The proportion of mortgages above £30,000 remains quite small. The numbers above the limit have been rising sharply in the last year or so but we estimate that by the end of March 1986 they will still only be around 500,000 out of a total of 8 million mortgages. In practice therefore the present limit fully covers the vast majority of people with mortgages.

10. But, taking new loans only, the position is rather different. 20% of all new building society loans are for £30,000 or more (13% over £30,000 plus 7.5% at £30,000). In the GLC area, this proportion rises to 55% (39% over £30,000 plus 16% at £30,000) and 38% in the South East (25% above £30,000 and 13% at £30,000). In the GLC area the average new building society loan to first-time buyers is now £29,850, and £31,000 for other buyers (the average home buyer in the South East was the main focus of the Opposition's concern in the 1985 Finance Bill debates). For banks the position is more marked, with 38% of all new loans being for more than £30,000 and a further 13% for £30,000.

11. The cost of a mortgage is also affected by changes in interest rates and a rise of 1 per cent would more than wipe out any saving to a borrower from an increase in the limit to £35,000. The net amount of interest payable by a basic rate taxpayer at present, assuming a £35,000 mortgage and an interest rate of 13 per cent is £3,380. This would reduce to £3,185 with a £35,000 limit but would increase to £3,430 if the increased limit was accompanied by a rise in the interest rate to 14 per cent.

Revenue cost

12. The total cost of mortgage interest relief for 1986/87 is estimated at around £5.5 billion, of which relief at the

higher rates will account for about £300m. Increases in the limit are difficult to cost with any certainty, because they depend partly on the amount of extra borrowing stimulated by the increase, and the effects may take several years to come through fully. But, an increase to £35,000 is estimated to cost £m80-120 in 1986/87 and £m120-150 in 1987/88; the eventual cost after 5 years or so could be between £m200-£300.

<u>Manpower Implications</u>

13. If there is no change in the limit an extra 55 Revenue staff, compared with 1985-86 staffing complement, will be required by April 1987 to deal with loans above the limit. By April 1988 it is expected that there will be no net additional Revenue manpower requirement on this account because the 1985 Finance Act measure, requiring lenders to bring new over the limit loans into MIRAS from April 1987, will have begun to take effect.

B O'CONNOR

ANNEX

1. Current Revenue cost of mortgage interest relief

1985/86 £4.75bn - of which £290m at excess over basic rate.

1986/87 £5.5bn - of which £300m* at excess over basic rate.

* assumes HR thresholds are increased only in line with RPI.

2. Revenue cost of an increase in the limit

	1986/87 cost	1987/88 cost≠	Eventual* cost at 1986/87 income levels≠
£35,000	£80m - £120m	£120m - £150m	£200m - £300m
£40,000	£100m - £150m	£150m - £200m	£250m - £300m

≠ Includes the effect of additional borrowing.

* This cost would build up over about 5 years.

3. What the limit would be if increased by reference to:

	RPI*	House Prices ≠
Since 1974	£97,000	£85,000
Since June 1979	£46,000	£55,000
Since last put up (Budget 1983 to Budget 1986)	£35,000	£39,000
12 months to Budget 1986	£32,000	£33,000

* December to December figures.

≠ Q3 figures.

4. Average House Prices

	UK	South East	GLC
Q3 1984	£30,300	£38,850	£39,800
Q3 1985	£31,450	£41,100	£45,000
Increase %	3.7%	5.8%	13.1%

5. Mortgage advances : new loans average : Q3 1984

Building Societies	First time buyers	Others
UK	£20,300	£23,200
South East	£25,300	£27,850
GLC	£29,850	£31,000
Banks (UK)	£26,400	£33,000

6. Number of mortgages qualifying for relief and number of loans above the £30,000 limit

(i) about 8m mortgages qualify for relief;
(ii) about 500,000 will be above the limit at 31.3.86.

7. Percentage of new advances at or above the £30,000 relief limit

	All	GLC	South East
Building Societes			
@ £30,000	7.5	16.5	13.0
above £30,000	13.0	39.0	25.0
Banks			
@ £30,000	13.0		
above £30,000	38.0		

BR/11

SECRET

CST
FST
MST
EST
Sir P Middleton
Sir G. Littler
Sir T. Burns
Mr F. Butler
Mr Cassell
Mr Scholar
Mr Odling-Smee
Mr H. Evans
Mr Cropper
Mr Lord
Mr H. Davies

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

7 February 1986

David Norgrove Esq
No 10 Downing Street

C/
Copy as sent to No 10 on Friday.
RO 11/2

Dear David,

PAPER FOR ECONOMIC CABINET

I attach a draft of the Chancellor's paper for the Cabinet discussion of economic strategy next Thursday. The Chancellor would like to know that the Prime Minister is content, before it is circulated to other Cabinet colleagues on Monday.

Yours ever
Rachel

RACHEL LOMAX
PRINCIPAL PRIVATE SECRETARY

BR/010

SECRET

ECONOMIC STRATEGY

Memorandum by the Chancellor of the Exchequer

1. The approach to the 1986 Budget is inevitably dominated by the dramatic changes taking place in the oil market. The large price fall that has already occurred means a sharp reduction in prospective oil tax revenues.

2. The current North Sea oil price of [$16-17] per barrel is some [45 per cent] below the end-November level - a change almost as great as the price increases of 1973 and 1979. It is hard in current circumstances to make a reliable judgement about the new level at which oil prices may settle. We therefore have to consider the Budget against the prospect not merely of greatly reduced oil revenues but also considerable uncertainty about how large the reduction will be.

3. Our current estimates suggests that if oil prices settle at $15 a barrel our revenues from the North Sea will be reduced to £6 billion for the next financial year. This compares with receipts of £12 billion in 1984-85. In last year's Medium Term Financial Strategy (MTFS) we expected revenues of £11½ billion for 1986-87.

4. There has inevitably been some turmoil in financial markets as they have responded to the oil price change. Sterling has fallen by about [7½] per cent and there has been persistent upward pressure on short term interest rates. So far we have weathered the collapse in oil prices and consequent financial market turbulence pretty well - though it may not be over yet. In so doing we are helped both by the underlying strength of the economy, in terms of growth, inflation and the external account; and above all by the reputation we have acquired for sound and prudent policies.

Fiscal position

5. Faced with this background my judgement is that we must approach the Budget with considerable caution. This means trying to avoid going above the £7½ billion Public Sector Borrowing Requirement (PSBR) figure set out in last year's MTFS. If anything there is a strong case for going somewhat below it.

6. Much may change between now and Budget Day. Because non-oil revenues are now projected to be higher than expected I hope to be able to avoid a net increase in taxes in the Budget. But there looks like being little, if any, scope for a net reduction in taxation. We should just meet the public expenditure planning total set for the current financial year. The need to cope successfully with the unprecedented situation which the oil price fall has created for the public finances underlines the importance of holding public spending next year similarly within the planning total we have announced.

Economic prospects

7. But while lower oil prices have a profound impact on what is possible in the Budget, they should not greatly affect our overall economic performance - although there will be significant changes within the economy. For the world as a whole, lower oil (and commodity) prices will have beneficial effects in 1986 on the oil-consuming countries. The forecast for the major industrialised countries is for output growth averaging 3 per cent - a little better than achieved last year. Inflation will stay low: indeed in Germany and Japan it is likely to approach zero.

8. For the UK, the oil price fall has not caused me to revise my view that 1986 will be a further year of steady growth, at an annual rate of about 3 per cent , accompanied by declining inflation. Different parts of the economy will be affected in different ways by lower oil prices. While the oil sector will not do so well, manufacturing industry in particular should benefit considerably.

9. The UK economy is now in a stronger position to take advantage of the opportunities created by lower oil prices. The underlying improvement shows up in a number of indicators. Last year manufacturing productivity increased by a further 4 per cent. Since 1979 it has now grown at an average annual rate of 3¼ per cent. As the table below shows, our performance here compares very favourably with the recent past; and even with the majority of our principal overseas competitors.

Output per man hour in manufacturing
annual average growth rates, per cent

	1973-79	1979-85
US	1½	2½
Japan	6½	6½
Germany	3	3
France	5	3½
UK	1	3¾

10. Capital spending by business has generally been rising faster than output in recent years and further growth is expected in 1986, as a response to higher profits and continued expansion in output. Exports performed well in 1985: indeed, UK exporters increased their share of world trade. The prospect is for continued export growth, albeit at a slower pace. Even after the fall in oil prices, another sizeable current account surplus is in prospect for 1986, helped by rising earnings from our increasing stock of overseas assets. (Our net overseas asset position is now second only to that of Japan).

11. This year is likely to see a significant rise in consumer spending. This reflects rapid growth in real disposable incomes - itself a result of the high level of wage settlements in 1984 and 1985 and the reduction in inflation expected this year. Earnings are currently rising at or over 7½ per cent. With inflation likely to fall to 4 per cent this year, the average employee's pay may rise by some 4 per cent in real terms during 1986.

12. However, this excessive earnings growth remains the chief threat to jobs. Despite five years of continuous output growth, and a growth in the number of people in work of over 600,000 since the last election, which I expect to continue, unemployment is unlikely to show much of a reduction while wages rise so far ahead of prices. The plain fact is that, despite our very good productivity record, UK unit labour costs have been increasing much more rapidly than those of our competitors.

13. Annex 1 sets out key figures from the forecast. Annexes 2 and 3 set out the revenue effects of selected tax changes, together with a note on the tax burden.

Summary and conclusions

14. The dramatic change in oil prices has had a major - and adverse - impact on the public finances; but I very much hope that, thanks to the sound financial policies we have been following, it will prove possible to avoid raising taxes overall in the Budget. The impact of lower oil prices on the UK economy as a whole is more neutral. I expect to see continuing steady growth for the sixth year in succession; and lower inflation. This is a measure of the strength of our underlying economic performance.

15. I seek colleagues' views on the appropriate shape of the Budget in the light of the circumstances I have outlined.

N.L

SECRET

ANNEX 1

SELECTED ECONOMIC INDICATORS

	1979	1980	1981	1982	1983	1984	1985	1986 (1)
World GNP, in major 7 economies (per cent change) (2)	3½	1	1½	- ½	2½	4½	2½	3
UK GDP (2) (per cent change)	2½	- 2½	- 1½	2	3½	2½	3½	3
Domestic demand (2), (per cent change)	4	- 3½	- 2	2½	4½	2½	2	3½
Retail prices Q4 (per cent change)	17½	15½	12	6	5	5	5½	4
Interest rates (average 3-month interbank)	13½	16½	14	12½	10	10	12	13 (3)
Current balance (£ billion)	- ½	3	6	4	3	1	3½	3½
Unemployment (UK, per cent excluding school leavers)	5	6	9½	11	12	12½	13	13 (4)
Sterling Index	87	96	95	90½	83	78½	78	74 (3)
Oil prices, $, North Sea	20½	34½	37½	33	30	29½	27½	17 (5)

(1) Provisional pre-Budget figures.

(2) At constant prices.

(3) February 7.

(4) Not a forecast. Figures based on assumptions in PEWP.

(5) Brent price for delivery in March, as of February 7.

ANNEX 2

REVENUE EFFECTS OF TAX CHANGES

A. Direct Taxes: Indexation

The RPI increased in the year to December 1985 by 5.7 per cent. With indexation by this amount and statutory rounding, the figures for the main allowances and other thresholds would be:

Personal allowances	1985-86 £	1986-87 £
Single and wife's earned income allowance	2205	2335
Married allowance	3455	3655
Bands eg		
30% rate	0-16200	0-17200
60%	over 40200	over 42700

The total revenue costs of indexation of income tax (reflected in the forecast) are £1140m in 1986-87, and £1490m in a full year, at forecast 1986-87 prices and incomes.

B Indirect Taxes: Indexation

The effects of 5.7 per cent revalorisation of the exercise duties (including VAT effects, price changes rounded) are as follows:

	Typical Price Change	Revenue effect (1986-87 prices) £m	RPI impact £m
Beer	1p/pint	100	0.07
Wine	5p/70cl light wine	20	0.02
Spirits	31p/bottle	45	0.04
Tobacco	5p/20 King size	150	0.14
Petrol	5p/gallon	260	0.13
Derv	5p/gallon	65	nil
VED	£5/car	100	0.05
Overall effect (reflected in forecast)		740	0.45

Note: First year and full year revenue effects are virtually identical.

C. Ready Reckoner: Illustrative Tax Changes

	£ million at forecast 1986-87 income levels	
INCOME TAX	1986-87	Full Year
Allowances and Thresholds		
1% above indexation on all statutory allowances	210	175
1% above indexation on all statutory allowances and thresholds	245	190
Rates		
Change basic rate by 1p	1175	975
CORPORATION TAX		
Change main rate by 1 percentage point	180	310
Change small companies' rate by 1 percentage point	16	30
OTHER TAXES		
Change VAT rate by 1 percentage point (1)	700 (2)	925

(1) A 1% change in the VAT rate would change the RPI by 0.5%.

(2) Provisional forecast

ANNEX 3

THE TAX BURDEN

Since the Government came to power total taxes and NICs as a proportion of GDP at market has risen by about 5 percentage points, though the ratio has fallen slightly since 1981-82. The figures are as follows:

Table 1

	Total taxation* as a % of GDP (market prices)
1978-79	33.9
1979-80	35.2
1980-81	36.4
1981-82	39.3
1982-83	39.1
1983-84	38.6
1984-85	39.2
1985-86 (estimate)	38.7
1986-87 (assuming indexation)	38.6

* Including NICs and the local authority rates.

Personal sector

2. Despite reductions in income tax, total personal taxes (direct and indirect, including employees' NIC and domestic rates) in 1985-86 are about £15 billion higher in real terms (ie 1985-86 prices) than they were in 1978-79. For income tax and national insurance contributions the following table shows how the proportion of gross pay they represent has risen, particularly for the low paid:

Table 2

Income tax and NICs as a % of gross earnings*

	½ average earnings	Average earnings	2 average earnings
1978-79	16.0	27.8	31.4
1981-82	20.8	29.3	32.2
1982-83	20.8	29.8	32.3
1983-84	20.1	29.6	31.7
1984-85	19.3	29.2	31.5
1985-86 (estimate)	19.0	29.0	31.5
1986-87 (indexation)	19.3	29.1	31.7

* Adult male earnings (all occupations). Married couple, wife not working: the couple are assumed to have no children, to avoid distortion of the figures from the abolition of child tax allowances.

3. These figures reflect the rise in the standard employees' NIC rate from 6¾% to 9%. The [illegible]er rates introduced in the 1985 Finance Act do not affect the cases shown. So far as income tax is concerned, personal allowances have increased by over 19% in real terms since 1978-79 and have increased slightly faster than earnings. The basic rate has been reduced from 33p to 30p, but the 25p reduced rate band has been abolished.

4. As the table shows, indexation of allowances in the Budget would lead to a very slight rise in the proportion of incomes taken in tax and NIC. This is because earnings are assumed to rise by 7% compared with the indexation percentage of 5.7%.

5. Since 1978-79 total taxes paid by businesses (outside the North Sea) have fallen slightly as a percentage of GDP. Within this total, the major change has been a fall in employers' NIC and NIS as a percentage of GDP, partially offset by an increase in business rates, and 'other' taxes as the following table shows:

Taxes paid by businesses £bn in 1985-86 prices
(figures in brackets are %s of GDP)

	Corporation tax[1]	Taxes on self employment incomes	Employers' NIC and NIS	Rates	Other[2]	Total
1978-79	7.1 (2.2)	2.4 (0.7)	9.9 (3.1)	4.7 (1.4)	3.7 (1.1)	27.7 (8.6)
1985-86 (estimate)	8.2 (2.3)	3.1 (0.9)	8.0 (2.2)	5.9 (1.7)	4.8 (1.4)	30.0 (8.4)

1. Excludes North Sea, but includes ACT
2. VED, car tax, road fuel duty, duty on rebated oils, capital taxes.

RR3.41 BUDGET - CONFIDENTIAL

FROM: MRS R LOMAX

DATE: 10 February 1986

MR SCHOLAR

cc Sir P Middleton
Sir T Burns
Mr Pratt

BRIEFING FOR THURSDAY CABINET

The Chancellor has seen the list of briefing which you have commissioned for Thursday's Cabinet. He thinks this covers the ground. He is particularly anxious for a very good brief on basic rates versus thresholds. He would like this to cover the arguments in the recent David Howell's speech; the points made by the IFS (John Kay; Fiscal Studies February 1984); the Fowler point, made by Sam Brittan today (this needs handling delicately); what has been achieved so far (including last year's NIC package, which reduced marginal rates for the very low paid); and factual material, in particular cross over points for single and married taxpayers, where the comparison is between the 2p reduction in the basic rate and equal cost increase in thresholds; and the point about unincorporated businesses, discussed at today's overview.

2. The only additional material he has asked for is a speaking note (on which you will need Sir Terence Burns' assistance). This should cover the outlook for 1987; how the fall in oil prices bears on the issue of what happens when the oil runs out - and the debate over the House of Lords report; the case for prudence (including why we should not raise the PSBR, in response to the fall in oil prices).

3. I have not yet fixed a briefing meeting; please let me know if and when you think one would be helpful.

RL.

RACHEL LOMAX

BUDGET - CONFIDENTIAL

FROM: A W KUCZYS

DATE: 10 February 1986

MR J H REED - INLAND REVENUE

cc PS/Chief Secretary
PS/Financial Secretary
Mr Monck
Mr Burgner
Mr Monger
Miss Sinclair
Mr Cropper
Mr H Davies
Mr Beighton - IR
PS/IR

BUSINESS EXPANSION SCHEME

The Chancellor was grateful for your minute of 6 February. He has commented that the evidence of the summary of public offers to date in 1985-86, attached to your submission, is that a £½ million ceiling would exclude some 80 per cent (by value) of the low asset-backed BES offers, which is not very attractive, when what we are seeking to do is to exclude excessively high asset backed offers from the scheme. He has also noted that property is more easily divisible than most businesses.

AWK

A W KUCZYS

RR3.41

BUDGET - CONFIDENTIAL

FROM: MRS R LOMAX
DATE: 10 February 1986

MR SCHOLAR

cc Sir P Middleton
Sir T Burns
Mr Pratt

BRIEFING FOR THURSDAY CABINET

The Chancellor has seen the list of briefing which you have commissioned for Thursday's Cabinet. He thinks this covers the ground. He is particularly anxious for a very good brief on basic rates versus thresholds. He would like this to cover the arguments in the recent David Howell's speech; the points made by the IFS (John Kay; Fiscal Studies February 1984); the Fowler point, made by Sam Brittan today (this needs handling delicately); what has been achieved so far (including last year's NIC package, which reduced marginal rates for the very low paid); and factual material, in particular cross over points for single and married taxpayers, where the comparison is between the 2p reduction in the basic rate and equal cost increase in thresholds; and the point about unincorporated businesses, discussed at today's overview.

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RL.

RACHEL LOMAX

BUDGET - CONFIDENTIAL

RT4.75 BUDGET CONFIDENTIAL

FROM: A W KUCZYS

DATE: 10 February 1986

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Byatt
Mr Monger
Mr Cropper
Mr Davies
Mr Graham - OPC
Mr Thompson - IR
Mr Houghton - IR
PS/IR

FINANCE BILL STARTER 140: CAPITAL GAINS TAX: DUAL RESIDENT TRUSTS

The Chancellor has seen your minute of 6 February. He is content with the Financial Secretary's recommendations.

AWK

A W KUCZYS

CHANCELLOR OF THE EXCHEQUER

Rachel

On re-reading my MS note of the overview meeting, I think what Ch may have said was the converse of what is recorded in the minutes, viz foreign shares should be held in reserve, and if necessary added to the package at Committee Stage. But I'm not sure now.

AWK
6/

Wo spoken

Ch.

Attached is a list of the

briefing being prepared for

Thursday's Cabinet

Is there anything else you

think you'll need?

In particular, do you

want a speaking note?

Chopping is in hand on this;

but you mentioned 2 points

you particularly wanted to

hole in the wall

preservation — 1987; and

the future oil price as the

[partial] answer to the

question as now "what happens

when the oil runs out" —

especially the House of Lords

mean-song.)

And is "somewhere

figures" enough on oil?

Or do you know it all?

Rh.

10/2.

1-26

FROM: R PRATT
DATE: 10 FEBRUARY 1986

MLS 10/2

1. **MR SCHOLAR**

2. **CHANCELLOR OF THE EXCHEQUER**

CABINET ON 13 FEBRUARY

We are currently preparing briefing for Thursday's Cabinet on the following topics:

(i) Financial markets - interest and exchange rates (on the usual lines).

(ii) Economic prospects - ie the basic points from the forecast and the fiscal prospect (including the impact of oil on forecast revenues).

(iii) Oil - some useful figures

(iv) MTFS - the underlying assumptions.

(v) The Green Paper on Personal Taxation - covering the timetable and the cost.

(vi) Defensive material on the arguments for income tax basic rate cut rather than threshold increases.

(vii) Defensive material on unemployment and employment measures.

3. We are aiming to submit this briefing (except (i)) to you by close tomorrow, Tuesday, 7 February.

Richard Pratt

RICHARD PRATT

From: **JOHN BROWNE,** MSc, MBA, MP.

Pl copy to Mr Cropper + return to me

HOUSE OF COMMONS
LONDON SW1A 0AA

Pmg

Rt Hon Nigel Lawson MP
HM Treasury
Treasury Chambers
Parliament Street
London SW1

10th February 1986

Dear Nigel,

Thank you for your letter of 5th February and for your kind remarks which I much appreciated.

I entirely agree with you about the maintenance of the aim with regard to economic policy i.e. anti inflation etc. I will try to work on this, particularly after the budget.

Yours ever,

John.

JOHN BROWNE

2153/10

SECRET

FROM: N WILLIAMS
DATE: 10 February 1986

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Monger
Mr Scholar
Mr Cropper
Miss Sinclair
Mr Hall
Mr Wood
Mr Graham OPC
Mr Battishill IR
Mr O'Connor IR
PS/IR

I agree

MORTGAGE INTEREST RELIEF LIMIT : BUDGET STARTER 107

1. The Financial Secretary has read Mr O'Connor's minute of 7 February. (below)

2. The Financial Secretary's view is that the Mortgage Interest Relief Limit for 1986/87 should remain unchanged at £30,000.

3. I should be grateful for confirmation that the Chancellor is content with this.

N Williams

NIGEL WILLIAMS
(Assistant Private Secretary)

SECRET

SCHOLAR
→ CH/EX
12/2

FROM: M C SCHOLAR
DATE: 12 February 1986

CHANCELLOR

cc: Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Monck
Mr H P Evans
Mr Pratt

BRIEFING FOR CABINET: 13 FEBRUARY

You asked for some additional information for tomorrow's Cabinet.

2. I attach:

(a) figures for general Government deficits in other major countries (Annex A)

(b) a note on main income tax rates in other major countries (Annex B)

(c) expected 1986 inflation rates elsewhere abroad (Annex C)

3. I also attach a copy of the IFS' Press Release, published today, on their Green Budget: it may be of some marginal assistance tomorrow.

MCS

M C SCHOLAR

Also now

1. Social Security and Tax since 1979

2. Monck on CBI letter.

273/018

ANNEX A

General Government Deficits

General Government Financial Balances as % of GNP	1980-84	1985	1986
US	-2½	-3¼	-3
Japan	-3½	-1¾	-1¼
Germany	-2½	-1¼	-1¼
France	-2	-3¼	-3¼
Italy	-11½	-13½	-13
Canada	-4½	-6½	-6¼
UK	-3¼	-3¼	-3
Major 7	-3½	-3½	-3¼

ANNEX B

INTERNATIONAL COMPARISONS OF 'MAIN' INCOME TAX RATES

There is generally no equivalent in the usual comparator countries for the long UK basic rate band (which implies a common marginal tax rate for over 90 per cent of UK tax payers). Typically, marginal rates increase in small steps at relatively narrow intervals through the whole range of taxable incomes (see Table 2 attached below). Table 1 shows marginal rates at earnings of the Average Production Worker (APW). This is an internationally-standardised measure; it is not (in the UK or elsewhere) equal to 'average earnings'. Rates are for 1985 except for France (1984) and UK (1985-86). Rates give total of national and local income tax rates. Rates for national tax alone, where lower, are shown in brackets.

ANNEX B INTER-NATIONAL COMPARISONS OF MAIN INCOME TAX RATES

Table 1

Marginal rate of -

(i) for a single person

	Tax %	Tax and Social Security %
Denmark	58 (29)	63 (34)
France	21	31
West Germany	41	59
Italy	27	33
Japan	16 (10)	24 (19)
Netherlands	32	54
USA	34 (26)	41 (33)
UK 1985-86	**30**	**39**

(ii) For a married couple without children

	Tax %	Tax and Social Security %
Denmark	58 (29)	63 (34)
France	10	22
West Germany	22	36
Italy	27	33
Japan	14 (8)	23 (18)
Netherlands	25	49
USA	22 (18)	29 (25)
UK 1985-86	**30**	**39**

UK higher

% MARGINAL RATE OF INCOME TAX (TAX AND SOCIAL SECURITY CONTRIBUTIONS)
MARRIED COUPLE WITH NO DEPENDENT CHILDREN

Purchasing power equivalent of £	Denmark	France	Germany	Italy	Japan	Netherlands	USA	UK
5,000	44(49)	10(22)	22(36)	18(25)	12(20)	16(51)	12(19)	30(39)
8,000	58(63)	14(25)	22(36)	27(33)	15(23)	25(59)	19(26)	30(39)
10,000	58(63)	17(24)	22(38)	27(33)	20(28)	32(53)	21(28)	30(39)
12,000	68(73)	21(27)	28(39)	27(33)	23(31)	32(53)	22(29)	30(39)
16,000	68(73)	30(36)	37(37)	35(40)	30(33)	42(42)	31(38)	30(30)
20,000	68(73)	30(35)	43(43)	37(42)	34(37)	52(52)	35(42)	40(40)
30,000	68(73)	33(39)	50(50)	41(46)	47(47)	67(67)	49(49)	50(50)
50,000	68(73)	62(64)	55(55)	47(51)	62(62)	70(70)	48(48)	60(60)
APW earnings	*29(34) 58(63)	10(22)	22(36)	27(33)	8(18) 14(23)	25(49)	18(25) 22(29)	30(39)
£10,000 converted at offical exchange rates	58(63)	17(24)	22(40)	27(33)	17(25)	32(54)	16(23)	30(39)

* national taxes

Table 2

16

TABLE 2

273/019

ANNEX C

Consumer price inflation in the Major 7 countries

% change in the consumer expenditure deflator on a year earlier	1984	1985	1986
US	4	3	2½
Canada	4	4	4
Japan	2	2	½
Germany	2½	2	½
France	7½	6	4
Italy	11½	9½	7
UK	5	5	4
Major 7	4½	3½	2½

ifs

PRESS RELEASE

B15

+ B12

EMBARGOED UNTIL NOON, WEDNESDAY 12 FEBRUARY 1986
10 FEBRUARY 1986
Contacts: John King, Mike Devereux, Robert Markless
(01-636 3784)

IFS GREEN BUDGET 1986

Although plummeting oil prices mean that there is now little scope for the Chancellor to make tax cuts in 1986 he could well find in excess of £4bn to give away in 1987. This is one of the major findings of an IFS analysis published today (Wednesday 12 February 1986). The Chancellor's options for his Budget on 18 March is presented in the fifth annual IFS 'Green Budget' together with a supplementary report Oil Prices and Budget Strategy' by Michael Devereux. This considers in detail the effects on the Government's financial position caused by the dramatic decline in oil prices in recent weeks.

IFS PRESS RELEASE 12/2

This year the conflicting pressures on the Chancellor will be more than usually difficult to reconcile. Only a few months ago it was widely expected that tax reductions of £3 billion or more could be made without jeopardising the Government's target of a £7.5 billion PSBR in 1986/7. But by mid-January, as IFS shows, most of that prospective 'fiscal adjustment' had been eliminated by falling dollar oil prices and a rise in the dollar value of sterling. With the further fall in oil prices that has since taken place, it would now be necessary to increase taxes in 1986 to keep the PSBR to its target level - even when full credit is taken for the £2 billion that the Government plans to raise during the year from additional asset sales.

So the Chancellor must either disappoint the strong political constituencies

THE INSTITUTE FOR FISCAL STUDIES
180/182 TOTTENHAM COURT ROAD, LONDON W1P 9LE

for reductions in income tax and measures aimed more directly at reducing unemployment, or he must revise his PSBR target. We expect that he will disappoint those expecting tax cuts in this Budget.

We do, however, believe he could promise and be able to deliver tax cuts in 1987. The decline in oil prices creates only a temporary hole in the Government's financial position while it eliminates the 1986 fiscal adjustment (with an unchanged PSBR target), and the IFS analysis shows that it actually increases the amount by which the Chancellor should be able to cut taxes in 1987 by over £4 bn.

The debate about the appropriate way to reduce tax levels therefore remains relevant. The 'Green Budget' discusses the merits of reducing rates of income tax or raising allowances and looks at other direct tax changes that could form part of another 'budget for jobs'.

- Ends -

Note to Editors

The IFS 'Green Budget' Conference will be held on Wednesday 12 February 1986.

IFS Report Series No.20 Budget Briefing 1986: The IFS "Green Budget" edited by John King.
IFS Report Series No.21 Oil Prices and Budget Strategy by Michael Devereux.

Further information on the conference and on the publications (price £10 each) are available from the Institute for Fiscal Studies, 180-182 Tottenham Court Road, London W1P 9LE.

121100 :INSTITUTE SEES NO SCOPE FOR U.K. TAX CUTS

LONDON, Feb 12 - Britain's Chancellor of the Exchequer Nigel Lawson will be unable to cut taxes in the 1986 budget, but should be able to make cuts of over 4.0 billion stg in 1987, the Institute for Fiscal Studies (IFS) said.

A,B,P,O,

In its forecast for the March 18 budget, the independent research group said plummeting oil prices had eaten away scope for tax cuts in fiscal 1986/87 which only a few months ago were expected to be in the region of 3.0 billion stg.

The government last March predicted a fiscal adjustment of 3.5 billion for 1986/87 and 3.0 billion for 1987/88.

MORE

121108 :INSTITUTE SEES =2 LONDON

IFS said that by mid-January the prospective fiscal adjustment had been eliminated by falling dollar oil prices and by sterling's strengthening against the dollar.

Given the further fall in oil prices since then, it would now be necessary to increase taxes in 1986 to keep the Public Sector Borrowing Requirement (PSBR) to its target level of 7.5 billion for 1986/87, even allowing for planned asset sales, it said.

Lawson must either disappoint the political calls for tax cuts and measures to boost employment, or must revise his PSBR target, IFS said.

MORE

NEWS REPORTS ON IFS

NNNN

£

AA CN RIM799

121109 :INSTITUTE SEES =3 LONDON

IFS said it expects Lawson to revise the PSBR, but forecast no new figure.

It said the decline in oil prices creates only a temporary hole in the government's financial position, while it eliminates the 1986 fiscal adjustment, if the PSBR is unchanged.

IFS analysis shows that the oil price decline actually increases the amount by which Lawson should be able to cut taxes the following year.

REUTER

NNNN

FROM: S D KING
DATE: 12 February 1986

1. MISS ~~S~~ O'MARA   MOM 12/2   ie revenues have risen half as fast as social security

2. MR SCHOLAR

cc PS/Chancellor

Not quite the point, I'm afraid, but see tax burden below.

I'll get better SS comparisons in the morning

ECONOMIC BRIEFING FOR CABINET 13 FEBRUARY

The Chancellor requested, through Mr Kuczys, the following information for tomorrow's Cabinet meeting.

2. Percentage change (in real terms) 1978/9-1985/6 in

a. Non-North Sea oil revenues	+15.7%
b. Social security spending	+33.7%*

3. Thus, over the period 1978/79-1985/6, revenues (including NICs and rates) and social security spending have risen by around one sixth and one third respectively.

*real GDP has grown about 10%

S D KING

Tax Burden
Non N Sea as % GDP

		excl rates
1978-79	33.7	(30.3)
1985-86	35.2	(31.4)

TAX & SOCIAL SECURITY

SCHOLAR → CH/EX 11/2

273/007

SECRET

FROM: M C SCHOLAR
DATE: 11 February 1985

CHANCELLOR

cc: Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Monck
Mr Pratt

BRIEFING FOR CABINET: 13 FEBRUARY

I attach, as requested by Mrs Lomax, the following briefs for Thursday's Cabinet:

BRIEF A	Economic Prospects
BRIEF B	Fiscal Prospects
BRIEF C	MTFS
BRIEF D	Oil fact sheet
	Other oil producers' response to oil price falls
BRIEF E	Basic rates v thresholds (followed by the one-page summary of salient points you asked for)
BRIEF F	Green Paper on Personal Taxation
BRIEF G	Employment (may need expanding: NM doing a piece on the Clarmarson letter)

2. I also attach (at Flag H) a speaking note on which you might base your opening remarks. I have, as you requested, prepared this in conjunction with Sir T Burns. As drafted, this follows the structure of the Cabinet paper; but there is a case for putting the fiscal section at the end rather than before the section on the economy, in order to end up with fiscal caution rather than with a bullish note on the economy.

Yes

3. A further brief on interest and exchange rates will follow, as usual, tomorrow evening.

4. I understand that you were asking about the oil price assumptions made in the 1983 Budget. I have done some quick

SECRET

research. It appears that in late February 1983 the Budget was being planned on the basis of an average world price for the rest of 1983 of $29 (corresponding to a Saudi marker price of $30) - a lower assumption than had been used earlier, following a fall of $4 a barrel at the beginning of the month. This price was based on the prevailing Saudi marker price (and was some way above the price in the very thin spot market of that time)*. Subsequently, in conditions of uncertainty there were expectations of a price cut; and, in early March, OPEC Ministers were in London. It was decided to reassess the Budget if the marker price fell below $27: but up to that point to take changes on the PSBR.

not obvious from table.

5. Later (8 March) it was decided to construct an alternative package against the possibility that the world oil price fell below $27. This was done, and included a PSBR £0.8 billion higher than the £0.5 billion increase which the fall to $27 was thought to produce; and a reduction in the fiscal adjustment from £1½ billion to £1 billion, achieved through abandoning the NIS reduction and increasing fuel duties. An alternative version of the FSBR was prepared; and abandoned only on the Saturday immediately preceding Budget Day, when it was clear that OPEC were going to defend a marker price of $29.

[illegible]

6. You will have today seen Sir J Cleminson's letter, which he has also sent to Cabinet colleague. Mr Monck is preparing some brief points to make, which we will let you have tomorrow. I have also suggested to Mrs Lomax that it might be useful if someone speaking early on on Thursday did a demolition job on this letter (better, I suggest, than yourself giving it prominence in your opening remarks).

Tebbit

MCS

* see Table (attached)

M C SCHOLAR

		Term		Spot	
		Arab Light	Brent	Arab Light	Brent
1982	December	34.0	33½	30.2	31.4
1983	January	34.0	33½	30.4	31.0
	February	30.0	30½	29.1	31.0
	March	29.5	30.0	28.1	28.7
	April	29.0	30.0	28.8	28.0

Monthly averages! V. volatile during Feb.

BRIEF A ECONOMIC PROSPECTS

ECONOMIC PROSPECTS

Factual

(i) GDP growth looks likely to have been 3½% in 1985, in line with the 1984 Autumn Statement, the 1985 FSBR, and 1985 Autumn Statement forecasts.

(ii) Quarterly path of GDP. In strike adjusted terms the level of GDP showed little change between 1985Q1 and Q3. But the path was distorted by the bringing forward of investment in the first quarter of the year and by the summer fall in North Sea production. Preliminary indications are that Q4 will see resumption of a satisfactory growth rate.

(iii) Current account surplus in 1985, at £3½ billion, slightly exceeded the 1985 FSBR and Autumn Statement forecasts of £3 billion.

(iv) Growth in RPI was 5.5 per cent in year to 1985Q4, in line with Autumn Statement forecast. Producer price indices for January show 5.2 per cent rise on year earlier in output prices, 7½ per cent fall in input prices.

(v) Retail sales were 4.2 per cent higher in real terms in 1985 than in 1984; consumers expenditure is provisionally estimated to have risen by 2½ per cent in 1984, with a 9 per cent rise in spending on durables between the second halves of 1984 and 1985.

(vi) With a further rise in profits during 1985, real rate of return of non-North Sea ICCs may have risen to around 8 per cent, compared with 3.3 per cent in 1981.

(vii) Unemployment (narrow, seasonally adjusted) rose by 5 thousand a month on average in 6 months to January. From 1983 to spring of 1985 trend rise in unemployment had been in the range 10,000 - 15,000 a month.

(viii) Autumn Statement forecast for 1986 compared with latest outside forecasts:

	Autumn Statement	Latest outside average
GDP growth	3	2.4
Current account (£bn)	4	2.6
RPI Q4	3¾	4.3
UK adult unemployment	-	3.10

Outside forecasters on average expect inflation to fall to about 3¾ per cent in Q2 before rising in the second half of the year. In spite of a slightly pessimistic (as usual) growth forecast, it is generally expected that adult unemployment will fall from its current level (around 3.2 million adult unemployed). (Outside forecasts covered were all made before January's bad unemployment figure.)

Check wed evening (under $17 below)

(ix) North Sea oil price has recently been around ? $[17.50] a barrel compared with an average in 1985 of $27 a barrel.

Positive

(i) The fall in inflation which is now generally forecast implies strong growth in personal income and consumption in 1986 - the pick up in consumer spending was already evident during 1985.

(ii) Total fixed investment expected to reach new record levels in both 1985 and 1986.

(iii) Autumn Statement forecasts for growth and inflation in 1986 still look about right: this means that 1986 should mark both the lowest yearly average inflation rate since 1967 and the longest sustained period of growth since the first oil shock.

(iv) Exports of manufactures (excluding erratics) were up by 8½ per cent in 1985. Manufacturing output now seems likely to have risen in 1985 by a little over 3 per cent, better than the Autumn Statement forecast of 2½ per cent. Manufacturing industry will be a prime beneficiary from lower oil prices.

Defensive

(i) **Unemployment rising again?** Too early to conclude that; but even including the disappointing December and January figures there has been a marked improvement in the unemployment trend since the spring of 1985. With the 1985 Budget expansion of the Community Programme still less than half completed, with little if any of the effects of NIC restructuring yet felt, and with labour force growth slowing down, prospects for further improvement in the unemployment trend are good. And they would be even better if pay settlements became more realistic.

(ii) **Latest CBI Trends Survey at odds with Treasury growth forecast?** Survey only covers manufacturing - 25 per cent of GDP - and anyway points to continuing if slower growth. Autumn Statement forecast in fact suggested some slow down in manufacturing output (to 2½ per cent) in 1986 compared with the 3 per cent plus increase now likely to be recorded for 1985. Trends Survey showed historically low level of firms expecting to raise prices.

(iii) **DTI Investment Intentions Survey disappointing, suggesting fall in manufacturing investment?** Always expected that 1984 Budget change in company taxes would mean a temporary weakness in investment in business investment after 1986 Q1. Overall 1986 should be a good year for investment, taking account of areas not covered by the DTI Survey (such as private residential investment).

(iv) **Fall in oil prices undermines Treasury forecast?** Treasury simulations, published well before recent developments, suggest that fall in oil prices may have little effect either way on inflation and output growth. Of course composition of growth in 1986 likely to be affected: somewhat more exports and less consumption.

(v) **Strong consumption growth forecast was dependent on tax cuts?** As the Autumn Statement made clear, it is the fall in inflation that is the main reason for the pick up in consumers' spending.

(vi) **High real interest rates will kill off growth?** The housing market, traditionally the most sensitive to interest rates, shows no sign of this: house prices are firm and housing starts buoyant. Stock market at record levels means that equity finance is an attractive alternative to firms put off by high interest rates.

sjdla

BRIEF B FISCAL PROSPECTS

FISCAL PROSPECTS

Factual

(i) 1985 Budget forecast of PSBR in **1985-86** was £7.1 billion, or 2% of GDP. Autumn Statement forecast was £8 billion, or 2¼% of GDP. Outturn in first 9 months was £7.8 billion, and latest forecast for year is close to 1985 Budget forecast, i.e. below Autumn Statement forecast.

(ii) For **1986-87, illustrative** PSBR path in 1985 MTFS showed PSBR at £7½ billion or 2% of GDP. Implied **fiscal adjustment** (ie scope for tax reductions) was **£3½ billion.**

(iii) But since then, fall in forecast oil revenues (could be £3½-5 bn), increases in public expenditure plans (£4 bn) and forecast debt interest (£½ bn), partly offset by increase in expected privatisation proceeds (£2½ bn), reduction in Reserve (£1½ bn) and increase in forecast non-oil revenues (possibly £2-3 bn).

(iv) **PSBR in 1986-87** will be decided in coming Budget. Because of changes at (iii) above, PSBR will probably be lower than 1985 MTFS projection, and **fiscal adjustment** is bound to be much **lower.**

Positive

(i) PSBR, as % of GDP, in **1985-86**, whether 2% or 2¼%, will be lowest for 14 years.

(ii) Buoyant non-oil revenues are reducing effect of lower oil revenues.

Defensive

(i) <u>1986-87 Fiscal Adjustment</u>

Scope for tax cuts in coming Budget depends critically on expected oil price, and on decision on PSBR. Bound to be modest.

(ii) <u>Effect of higher interest rates</u>

Interest rate rise in January is increasing debt interest and some other kinds of public expenditure (principally interest support costs for export and shipbuilding credit and housing subsidies). But have avoided further rise.

(iii) Why not have a PSBR in 1986-87 higher than £7½ billion?

In present uncertainties it would be imprudent to do so - a point the markets would be likely to take. Impossible to be sure that oil price will not fall further, either immediately before the Budget, or subsequently. If it were to do so it might be necessary to take the impact, in part at least, on the PSBR - so must keep room for manoeuvre. Unsound to respond to a fall in oil revenues which is not likely to be temporary by raising borrowing (unless as a short-term measure).

Wholly ?

BRIEF C MTFS

MTFS

Factual

1985 MTFS (published in 1985 FSBR) showed the following figures

	1984-85	1985-86	1986-87	1987-88	1988-89
MO	5½%	3%-7%	2%-6%	1%-5%	0%-4%
£M3	9½%	5%-9%	4%-8%	3%-7%	2%-6%
Money GDP	8¼%*	7%*	6½%	5¾%	5%
PSBR (% GDP)	£10½bn (3%)	£7bn (2%)	£7½bn (2%)	£7bn (1¾%)	£7½bn (1¾%)

*adjusted for coal strike

Underlying assumptions (adjusted for coal strike) were:

	1985-86	1986-87	1987-88	1988-89
GDP Deflator	5%	4½%	3½%	3%
Real GDP				
- non North Sea	2¼%	2½%	2½%	2½%
- total	2¼%	2%	2%	2%

These figures will be reviewed in this year's MTFS. Prospects for output improved by falling oil prices and rapid productivity growth.

(NOT FOR USE: Output and inflation assumptions to be revised up by ½% from 1987-88 onwards.)

Positive

A) **Fiscal Stance**

(i) Outturn for 1985-86 PSBR likely to be close to forecast figures of £7bn. Lowest borrowing (as a % of GDP) for 14 years. Return to planned path achieved after distortion of coal strike.

(ii) Continued reduction in PSBR necessary, perhaps below planned path and 1985-86 outturn

(a) To maintain reputation for prudence/sound finance

(b) To avoid further upward pressure on interest rates (already very high by historical and international standards) and increased debt interest payments

?

(c) No need for boost to consumers' expenditure or company finances at present. Both will gain from lower oil prices anyway.

?

(d) To take account of increased asset sales - which although valuable for efficiency gains, do not reduce demand for money in the way that expenditure cuts do.

B) **Monetary Stance**

(i) Money GDP growth has been broadly in line with previous MTFS - with improved inflation output split

	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
Money GDP							
- 1980 MTFS	17.5	17.1	12.0	9.6	10.7		
- 1983 MTFS				8.3	7.9	8.5	7.6
- latest estimate	19.9	13.8	10.1	9.3	7.9	8.4	7.9
GDP Deflator	16.9	18.6	10.0	7.0	4.4	4.6	5.5
Real GDP	2.7	-3.8	-0.1	2.3	3.3	3.7	2.5

(figures adjusted for coal strike)

(ii) All indicators of financial conditions taken into account - monetary aggregates and exchange rate. Mansion House speech announced intention to cease overfunding and to make no attempt to ensure £M3 brought within target range, given difficulties of interpretation.

Defensive

A) **Fiscal Stance**

(i) PSBR inappropriate fiscal indicator: PSBR available in timely fashion and not subject to significant revision, unlike other indicators. Composition of public sector accounts taken into account when judging appropriate path.

(ii) Should allow increased PSBR, (to compensate for lower oil revenues):

(a) There is a case for higher PSBR in response to lower oil revenues, but increased asset sales (of £2¼ billion in 1985 Survey) point to sharply lower PSBR.

(b) Given oil price uncertainties (and higher asset sales), higher PSBR would risk upsetting markets, putting pressure on exchange rates and interest rates.

(c) Cannot risk jeopardising inflation objectives. Stable prices would imply PSBR of 1% of GDP. Not appropriate to go so low too quickly - but for competitor countries, stable prices are clearly in prospect. UK cannot afford to let up.

(d) Growth is to continue. Easier to achieve PSBR reduction when economy is growing.

B) **Monetary Stance**

(i) Monetary targets is disarray, with £M3 suspended: Money GDP outturn has been as envisaged - with better output/prices split. Vindicates Government's approach - taking account of all indicators of financial conditions, including monetary aggregates and exchange rate.

(ii) Interest rates too high: Cannot take risks with inflation. Present stance led to best growth and output mix for two decades. Interest rates are high - this underlines need for prudent fiscal stance.

NORTH SEA OIL BRIEF

Factual

1. **Prices**: (l) per barrel of Brent crude for immediate delivery:

	$	£
average 1979	20.6	9.7
1980	34.7	14.9
1981	37.3	18.4
1982	32.9	18.8
1983	29.3	19.3
1984	28.8	21.3
1985	27.6	21.5
March 1985	28.0	24.9
November 1985	29.7	20.6
January 1986	22.1	15.6
Feb 10 1986	17.8	12.7

BRIEF D NORTH SEA OIL

(ii) Futures/forward prices $/bl 10 February

	Feb	March	April	May	Dec
Brent	17.8	16.9	16.3	16.1	-
West Texas Intermediate	n.a.	16.9	16.9	16.9	17.5

(iii) **Comparison**

Oil prices in $, £ and real terms currently at their lowest level since early 1979.

Oil price in 1974, after first oil price hike, just under $10. Real world price, taking 1980 as 100, now about 70 - lowest since early 1979 - compared with under 60 in 1974.

2. **Tax revenues**:

1984-85 - about £12 billion
- about 9 per cent of total revenues

1985-86 - about £11½ billion (A.S. projection)
- about 8½ per cent of total revenues
- largely determined by prices up to end 1985 so little affected by latest fall

1986-87 - estimate will be published at Budget time (but see also Defensive 2.)

3. **Contribution of oil to the economy in 1985**:

- 5-6 per cent of UK **national income**
- net oil exports 8 per cent of total UK **exports** (15½ per cent gross)
- 6 per cent of world oil **production**
- under ½ per cent of total UK employment
- 5 per cent of UK capital investment

4. **Contribution to GDP growth**

North Sea oil has contributed under ½ per cent a year to the average **growth** rate of economy of about 3 per cent a year during current upswing [1981H1-to date]. It contributed about 1 per cent a year in the upswing of 1975-79.

[NB has contributed ½ per cent a year since 1979, compared with annual growth of 1¼ per cent.]

5. **Petrol prices**

(i) Composition of petrol prices - December 1985

	p/gallon	**% of retail prices**
Tax excluded price	84.3	44
Duty	81.6	43
VAT	24.9	13
Retail price	190.8	100

n.b. VAT is levied at 15% of the tax excluded price plus duty.

2. Fall in petrol prices

(i) Pump prices fell 12p a gallon (about 5 per cent) between May peak and December 1985. [December 1985 prices were about 5½ p (3%) above their December 1984 level].

(ii) No official figures available for 1986 yet. Prices probably fell little between December and January. Cut of 3p per gallon announced by Esso, Shell and BP on 4 February. If this is reflected in corresponding fall in garages, petrol prices will be below the levels of February 1985.

3. RPI

A 10% fall in pump prices reduces the level of the RPI directly by about ½%.

4. Petrol prices and crude prices

(i) Margins (tax excluded price less costs of crude oil) increased substantially in 1985H1 and were still relatively high by the end of 1985. Fall in petrol prices (12p gallon) between May and December reflected both cuts in margins and falls in crude prices.

(ii) Since December crude oil prices have fallen by about 30% in sterling terms, but there has been a much smaller fall in petrol prices, implying a large increase in margins. (See Defensive 5).

5. Previous falls in oil prices

September 1982 - July 1983

Brent spot price <u>in dollars</u> fell $6/bl (17½%)
Brent spot price <u>in sterling</u> fell £1/bl (5½%)
Retail petrol price fell 6 pence a gallon (3½%)

Government line at the time

Implications of fall in price of oil

'...although the modest fall in the price of oil represents both gains and losses for this country, the overall effect is likely to be beneficial. It would however be in no one's interest if the price of oil were to fall too far too fast'. Chancellor at Question Time 27.1.83. Hansard col 1046.

6. Effect of oil price on industry

Companies stand to gain from lower oil prices through reductions in their raw materials and energy costs. Benefits enjoyed in the form of higher profits or passed on to consumers through lower prices.

Ready Reckoner

A sustained \$1/bl fall in crude oil prices reduces industry's costs by over £100 million a year, assuming the fall feeds through fully into oil product prices and assuming other things, including the exchange rate and other energy costs unchanged. (c.f. 1% cut in wages would save industry £1 billion, 1% cut in interest rates £250 million).

Positive

1. **Use made of North Sea revenue**

(i) Overseas debt of public sector accumulated in 1970s reduced; [illegible]

(ii) Revenues have helped reduce Government borrowing as a share of GDP and so helped bring inflation down. Lower inflation good for investment. Domestic fixed investment across whole economy expected to beat record levels in 1985;

(iii) Build-up in net overseas assets to estimated £73½ billion end-1984, post-1945 record. Overseas assets now bring us an annual income of some £3 billion a year and will continue to provide income in future, as oil production declines.

(2nd only to Japan)

2. **Better off with North Sea oil**

At today's prices, cost of extracting it below cost of buying oil on world market. And Exchequer shares in profits of North Sea.

3. **Beneficial effects of lower oil prices**

Consumers and industry will benefit from lower oil prices. And lower prices will encourage higher world trade and output, with lower world inflation. Overall effects on both output and inflation in the UK are expected to be broadly neutral - if anything, slightly beneficial.

Defensive

1. **Effect of lower prices on Autumn Statement 1985-86 revenue forecast**

Oil price falls come too late in financial year to have much effect on 1985-86 revenues.

2. **Effect on 1986-87 revenues of price fall**

FSBR forecast North Sea revenues of £11½ billion in 1986-87. For latest estimate wait for Budget. Sustained $1 fall in oil price, other things being equal, reduces North Sea revenues by £½bn in full year [NB oil price and exchange rate assumptions underlying FSBR forecast never made explicit.] But

- consumers and industry would benefit from lower oil prices;
- lower prices would permit higher world trade and output, with lower world inflation

3. **Ready reckoner**

A $1 a barrel lower oil price on average in 1986 would reduce North Sea revenues by £½ billion in 1986-87, other things including the exchange rate unchanged.

4. **Effect of lower prices on PSBR**

No decisions yet taken on appropriate level of PSBR for 1986-87. Government will persist with fiscal and monetary policies aimed at controlling inflation.

5. **Petrol Prices**

[Crude oil prices down over 30 per cent but much smaller fall in petrol prices. BP, Shell and Esso announced 3p-a-gallon cuts in the price of 4 star petrol on 4 February].

Matter for oil companies and their customers. Companies have made large windfall gains from recent fall in oil prices, but competition will make itself felt.

6. **Increase in petrol duty/windfall profits tax?**

[Press comment of increase in petrol duty/windfall profits tax because of large crude oil price falls].

Tax changes will be announced in Budget Statement. Wait for Budget.

7. **Effect of oil price falls on exchange rate**

Markets naturally disturbed by recent large falls in oil prices. But actual relationship complex.

- **on interest rates**

Feeble

Relationship complex. Monetary policy designed to put continuing downward pressure on inflation rate.

Done v. well to hold interest rates. Evidence of markets' belief in soundness of Govt's policies.

8. **Effect on North Sea activity**

Oil prices would have to fall very far - well into single figures - for there to be any significant effect on production from existing fields. Exploration and development depend on price expectations, often looking very far ahead, and most analysts expect real oil prices to rise in the 1990s.

9. **Government curbs on North Sea production to stabilise prices**

UK continues to maintain freest oil province in world: decisions on how much to produce are made not by Government but by oil companies. We can take lower oil prices in our stride - effect on UK if anything slightly beneficial. Most OPEC members (and Norway), heavily dependent on oil exports, will suffer much more. There is no way in which UK will become country member of OPEC.

10. **GDP growth since 1979 simply reflects higher oil output**

In upswing - 1981H1 to 1985H1 - oil has accounted for less than ½ per cent of annual growth of around 3 per cent (contributed around 1 per cent in previous recovery).

11. **UK should join OPEC**

It would not be in the UK's interest to join OPEC. Successful development of North Sea has taken place in a free market environment. Restrictions would damage confidence on which development has been based, and would damage our prospects for oil production in the 1990s and beyond.

G Hacche, EA2 (Ext 3871)

EFFECTS OF RECENT FALL IN OIL PRICES ON OIL PRODUCERS

Note by EF2

EFFECTS OF RECENT FALL IN OIL PRICES ON OIL PRODUCERS

1. The Norwegian government's revenues from oil taxes could be halved this year because of the oil price fall and its trade balance will also be severely hit. In recent years, strong output growth has been dependent on domestic demand growth buoyed up by oil revenues, but the government has still managed to maintain large financial surpluses. In 1985 the general government surplus was about 5 per cent of GDP. In 1986, this could be converted into a small deficit, in part because of the fall in oil prices and therefore oil revenues not being offset by expenditure cuts or increased revenue from other sources. The effect on the trade balance will also be large. In 1984 Norway had an overall surplus of NKr 43bn, which comprised an oil surplus of NKr 78bn and a non-oil deficit of NKr 35bn. The recent decline in oil prices could eliminate the trade surplus.

2. The government in the Netherlands are facing similar problems because revenues from taxes on gas have fallen recently. They have managed to avoid a significant increase in the general government financial deficit by cutting back on public expenditure, for example by freezing nominal social security benefit rates.

3. In most other countries the effects of lower oil prices on the current account are better detailed than the effects on the government's financial position.

4. Saudi Arabia built up a vast stock of reserves during the 1970s, but large current account deficits ($20 billion in 1985) are reducing this stock rapidly. It is now estimated to be down to $60 billion. The Saudis, therefore, need quickly to improve their current account position, and they are taking steps to cut drastically imports. The recent fall in oil prices will ease their problems so long as their production remains high enough to ensure increased export revenue. (Production has doubled since August, while oil prices have fallen by about one-third.)

5. Mexico will probably be hit the hardest by the oil price fall. It is the largest debtor among the net oil exporters and has already given notice that its borrowing requirement in 1986 will be considerably higher than it had earlier envisaged. Without further large cuts in imports, which would be politically difficult, or increased commercial borrowing, which may be difficult to find, Mexico will be looking to the IMF/IBRD and probably to Western governments for increased loans. The Baker debt initiative may be sufficient to alleviate these problems, although Mexico's requirements (up to $7 bn pa over the next three years) would take up perhaps half of the total suggested by Baker.

6. Oil makes up 95 per cent of Nigeria's exports, so the effect on its current balance of a sharp fall in oil prices is drastic. This may lead to a change in its opposition to an IMF loan, although the government appears unmoved by recent events. Its recent budget did not offer any measures to compensate for the oil price fall.

7. Egypt has been trying to avoid having to implement an IMF programme by seeking, without success, to reschedule debt payments. Like Nigeria the fall in oil prices might lead to a change of attitudes, but it may mean that Egypt has to be added to the list of major debtors.

8. The USSR is a major oil producer, and exporter. It will have to face cuts in its imports or resort to increased borrowing to counter losses as a result of lower oil prices.

(USA ?