PO-CH/N4/0192 PT D

Chex Lawson

PART D

CONFIDENTIAL

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PART D

CHANCELLOR'S 1988 PAPERS ON THE NATIONAL LOTTERY

PO -CH /NL/0192 PART D

Begins: 7/12/88

Ends: 22/12/88

DD: 25 years

6/9/95

APS pl to M. Peretz 2/12

CONFIDENTIAL

FROM: IAN RICH

DATE: 7 DECEMBER 1988

1. MR PERETZ 7/12

2. PS/ECONOMIC SECRETARY

cc PS/Chancellor
PS/Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Miss O'Mara
Mr Gieve
Mr Grice
Ms Ryding
Mrs Chaplin

Mr Patterson - DNS

NATIONAL SAVINGS RATES

Miss James' minute of 6 December records the Economic Secretary's agreement to an early announcement of increases in Income and Deposit Bonds, and Investment Account, interest rates.

2. I have discussed this with Mr Patterson. He has confirmed that the earliest practicable time for an announcement is Friday morning. I understand the EST is content, and I have asked DNS to prepare the usual draft Press Notice and briefing accordingly.

3. The announcement will follow very shortly on the heels of Thursday's announcement of the terms for the Ordinary Account in 1989. I attach a draft Private Secretary letter informing No. 10, so that it can be despatched this evening together with the draft already provided on the Ordinary Account.

Ian Rich

IAN RICH

DRAFT LETTER TO:

Paul Gray Esq
10 Downing Street
LONDON SW1

NATIONAL SAVINGS INTEREST RATES

I am writing to let you know that the Department for National Savings will be announcing at 10 a.m. on Friday 9 December increases of 3/4 per cent in the interest rates on National Savings Income and Deposit Bonds (from 10 3/4 per cent to 11 1/2 per cent) and the National Savings Bank Investment Account (from 10 per cent to 10 3/4 per cent). Deposit Bonds are no longer on sale, but we need to adjust the rate for existing bondholders.

These changes are a response to the recent increase in bank base rates, and anticipate the increase in retail rates we expect the banks and building societies to make shortly. The Income and Deposit Bond increases will take effect on 22 January, since six weeks' notice of change is required in the Regulations. The Investment Account increase will take effect on 23 December.

S M A JAMES

est.ld/james/Gray8.12

CONFIDENTIAL

cc PS/CHEX PS/SIR P MIDDLETON
SIR T BURNS SIR G LITTLER
MR SCHOLAR MISS O'MARA
MR GIEVE MR GRICE
MS RUDING MR RICH
MR CHAPLIN
MR PATTERSON DNS

Ch / just to remind you that this is planned for tomorrow

MPW

Paul Gray Esq
10 Downing Street
LONDON
SW1

8 December 1988

Dear Paul,

NATIONAL SAVINGS INTEREST RATES

I am writing to let you know that the Department for National Savings will be announcing at 10.00 a.m. on Friday 9 December increases of 3/4 per cent in the interest rates on National Savings Income and Deposit Bonds (from 10 3/4 per cent to 11 1/2 per cent) and the National Savings Bank Investment Account (from 10 per cent to 10 3/4 per cent). Deposit Bonds are no longer on sale, but we need to adjust the rate for existing bondholders.

These changes are a response to the recent increase in bank base rates, and anticipate the increase in retail rates we expect the banks and building societies to make shortly. The Income and Deposit Bond increases will take effect on 22 January, since six weeks' notice of change is required in the Regulations. The Investment Account increase will take effect on 23 December.

Yours,

S M A JAMES
PRIVATE SECRETARY

108g/mg1.pa docs(126) RESTRICTED

Is there any precedent for requiring tax to be paid before receipt of actually interest?

FROM: IAN RICH
DATE: 14 December 1988

1. MISS ~~O'MARA~~

2. ECONOMIC SECRETARY

Especially in the light of this afternoon's discussion on tax, I think it's important that we do include a reference to the annual statement in the prospectus.

cc: PS/Chancellor
Sir P Middleton*
Sir G Littler*
Mr Scholar*
Mr Peretz*
Mr Grice*
Miss Anderson*
Mrs Chaplin*
Mr Patterson* - DNS

File NSNL ET1

* without enclosures

Ch/ yes - cumulated unit trusts where "distributable" interest is taxable even if it is not distributed.

Mary 14/12

Thanks.

CAPITAL BOND PROSPECTUS

It is customary for Treasury Ministers to see the first prospectus when new National Savings products are introduced. The attached draft of the Capital Bond prospectus (not copied to all) has been prepared by DNS in consultation with the Treasury Solicitor.

2. The terms set out in the prospectus are in accordance with those announced on 13 October. The main additional points we should like to bring to your attention are:

a. Paragraph 4 limits purchases to individuals or trustees etc acting on behalf of sole individuals - in other words, corporate holdings of any kind are ruled out.

b. Paragraph 5 makes all applications subject to acceptance by the Director of Savings. This gives him a discretion to reject investments he thinks may be suspect - eg the proceeds of a crime, or money invested by an individual which in practice is a corporate investment.

c. No maximum holding limit is to be stipulated. But paragraph 8 gives the Treasury discretion to introduce one later on, and to vary holdings limits.

d. The interest rates shown in the tables in paragraphs 9 and 12 are purely illustrative at this stage. We shall be putting a separate submission to you shortly recommending actual rates.

These are all points for your information.

3. There is however one point of difference on tax treatment (paragraph 2) between the Treasury and DNS on which we should be grateful for your decision.

4. We should like to add to this paragraph a sentence explaining that investors will receive an annual statement of value, showing the amount of interest added. This we see as a natural corollary to the statement in the existing draft that interest must be included in tax returns for the year in which it is capitalised. We feel strongly that without such an explanation, the prospectus would be incomplete and open to criticism, since it would beg the question of how taxpayers would obtain information to help them complete their returns. We should also prefer to set the tax treatment paragraph in a separate section after the existing paragraph 8.

5. DNS argue against these suggestions. In their view, reference to annual statement of value and interest added is not appropriate for the prospectus, because such statements would not fully cover the complexity of the tax arrangements (assessment methods will vary over the 5 years' period). Their preference is to cover the point in the explanatory literature; they will do this in any event as follows:

> "After the first anniversary of purchase we will send you annual statements of value. These will show the amount of interest added to the value of your bond".

DNS also prefer to leave the tax treatment paragraph in its present position, on the grounds that it is an integral part of the description of the product.

6. We are not persuaded, and retain a strong preference for including in the prospectus a reference to annual statements of value.

7. When we have your views, DNS will finalise the text of the prospectus so that it can be printed immediately after you have taken the decision on interest rates (on which we plan to send you a separate submission for the weekend).

Ian Rich

IAN RICH

NATIONAL SAVINGS CAPITAL BONDS - SERIES A

PROSPECTUS

DESCRIPTION, TAX TREATMENT AND DEFINITIONS

1. National Savings Capital Bonds Series A ('Bonds') are a Government security issued by the Treasury under the National Loans Act 1968. They earn interest at fixed rates for five years from purchase and after this period no further interest will be earned. Bonds are registered on the National Savings Stock Register and are subject to the Statutory Regulations relating to the National Savings Stock Register for the time being in force, so far as these are applicable. The principal of, and interest on, Bonds are a charge on the National Loans Fund.

2. Interest on a Bond will be capitalised on each anniversary of the date of purchase without deduction of Income Tax, but interest is subject to Income Tax and must be included in any return of income made to the Inland Revenue in respect of the year in which it is capitalised.

3. In this prospectus "anniversary date" means an anniversary of the purchase date; "Anniversary Value" means the value of a Bond on an anniversary date; "maturity date" means the fifth anniversary date; and "redemption" means repayment on or after the maturity date.

WHO MAY PURCHASE AND HOLD BONDS

4. Bonds may be purchased and held by any individual who is not under a legal disability other than by reason of his age, or by two such individuals jointly. Bonds may also be purchased and held by not more than two trustees, either corporate or individual, where the beneficiary of the trust is a sole individual; or may be purchased by a receiver on behalf of and in the name of a mentally disordered person.

PURCHASING

5. Subject to a minimum purchase of £100, to any maximum holding limit (see paragraph 8) and to the acceptance of the application by the Director of Savings following its receipt at the Capital Bond Office a purchase may be made for any amount which is a multiple of £100. The date of purchase will be taken for all purposes to be the date payment is received, with a completed application form, at the Capital Bond Office, or, if earlier, at a post office transacting National Saving Bank business, or at such other place as the Director of Savings may specify.

6. An investment certificate, bearing the date of purchase, will be issued in respect of each purchase.

MINIMUM AND MAXIMUM HOLDING LIMITS

7. No person may hold, either solely or jointly with another person, less than £100 in any one Bond.

8. The Treasury may introduce a maximum holding limit and change this or the minimum holding or minimum purchase limits from time to time, upon giving notice, but such a change will not affect any right enjoyed by a Bondholder immediately before the change to retain any Bond he already holds. If the Treasury introduce a maximum holding limit they may, in the same notice, make such provision in relation to the treatment of capitalised interest, inherited bonds, bonds held by trustees and other consequential matters as they think fit.

AMOUNT DUE ON REPAYMENT

9. A Bond will grow in value up to its maturity date as follows:

PURCHASE PRICE	+ [1%] of Purchase Price	=	1st Anniversary Value
1st Anniversary Value	+ [2%] of 1st Anniversary Value	=	2nd Anniversary Value
2nd Anniversary Value	+ [3%] of 2nd Anniversary Value	=	3rd Anniversary Value
3rd Anniversary Value	+ [4%] of 3rd Anniversary Value	=	4th Anniversary Value
4th Anniversary Value	+ [5%] of 4th Anniversary Value	=	**5TH ANNIVERSARY VALUE**

This is equal to a compound rate over the 5 year period of [x%] pa where no part of the Bond is repaid before maturity.

10. Subject to paragraph 13 interest will begin to be earned on the date of purchase. No interest will be earned on and from the maturity date, or the date of repayment if earlier.

11. The value of a Bond repaid on an anniversary date will be the Anniversary Value for that date. Where part of a Bond is repaid on an anniversary date the Anniversary Value for that date will be reduced by the amount repaid.

12. The value of a Bond repaid between anniversary dates will be its most recent Anniversary Value, together with interest on that amount shown in the table at the end of this paragraph. Where part of a Bond is repaid between anniversary dates the most recent Anniversary Value will be reduced by the amount repaid; interest on the amount repaid will be earned at the rate set out in the following table and capitalised into the Anniversary Value on the next anniversary date (or, if the balance of the Bond is repaid before the next anniversary date, added to that repayment).

Date of repayment	**Interest earned from last anniversary date to date of repayment**
After 1st anniversary but before 2nd	[1%] pa
After 2nd anniversary but before 3rd	[2%] pa
After 3rd anniversary but before 4th	[3%] pa
After 4th anniversary but before 5th	[4%] pa

Interest under this paragraph will be earned for each day at 1/365 of the relevant rate (and 1/366 of the relevant rate for each day in a leap year).

13. No interest will be earned on a Bond or part of a Bond repaid before the first anniversary date.

14. The amount due on repayment will be rounded to the nearest penny and payment will be made by crossed warrant sent by post. For the purpose of determining the amount payable in respect of a Bond the date of repayment will be deemed to be the date on the warrant.

REDEMPTION OF BONDS

15. Bonds will be repayable on the maturity date upon application in writing by

the holder to the Capital Bond Office accompanied by the investment certificate. The Director of Savings will write to the holder before the maturity date to remind him of the need to apply for redemption. The Director of Savings will write to the last address notified by the holder to the Capital Bond Office.

16. If the holder is a child who is under the age of seven years the Director of Savings will write to the parent or guardian designated on the purchase application form.

REPAYMENT BEFORE THE MATURITY DATE

17. A holder may obtain repayment of a Bond before the maturity date on giving three calendar months' notice but no prior notice is required if application is made on the death of a sole bondholder. Any application for repayment of a Bond must be made in writing to the Capital Bond Office and be accompanied by the investment certificate. The period of notice will start on the date the application is received at the Capital Bond Office.

18. Application may be made in accordance with paragraph 17 for repayment of part of the capital value of a Bond, including capitalised interest, but the amount to be repaid must not be less than £100 or such other figure as the Treasury may determine from time to time upon giving notice. The balance of the Bond remaining after repayment, excluding interest which has not been capitalised, must be not less than the minimum holding limit which was in force at the date of application. Where part of a Bond has been repaid a replacement investment certificate, retaining the purchase date of the original Bond, will be issued.

MINORS UNDER SEVEN

19. Where a Bond is held by a child under the age of seven years the Director of Savings will normally repay a Bond which has reached its maturity date only to the parent or guardian designated at the time of purchase. However, the Director of Savings may, if he thinks fit, redeem the Bond on the application of any person who satisfies him that he is a proper person to receive payment. Repayment before the maturity date of a bond held by a child under the age of seven years will only be made with the consent of the Director of Savings.

TRANSFERS

20. Bonds will not be transferable except with the consent of the Director of Savings. The Director of Savings will, for example, normally give consent to a transfer which arises from the death of a holder but not to any proposed transfer which is by way of sale or for any consideration.

NOTICE

21. The Treasury will give any notice required under paragraphs 8 and 18 in the London, Edinburgh and Belfast Gazettes, or in any manner which they think fit.

If notice is given otherwise than in the Gazettes, it will as soon as reasonably possible thereafter be recorded in them.

CAPITAL BOND OFFICE
NATIONAL SAVINGS
GLASGOW G58 1SB

[date]

[The following note is for use on the purchase application form - "Please note: Your application to purchase National Savings Capital Bonds is subject to acceptance by the Director of Savings following its receipt at the Capital Bond Office. Bonds can be withdrawn from sale without notice. Your purchase application can only be accepted if the series of Bonds you want is on sale when your application is received at a post office, of if you apply direct by post, at the Capital Bond Office"] est.ld/james/Patt14.12

CONFIDENTIAL

FROM: S M A JAMES
DATE: 15 December 1988

MR PATTERSON - DNS

cc: PS/Chancellor
Mr Scholar
Mr Peretz
Mr Gieve
Miss O'Mara
Mr Grice
Mr Rich
Miss Anderson
Mrs Chaplin

Mr Wilson - DNS
Mrs Cullum - DNS

PS/IR

CAPITAL BOND PUBLICITY

The Economic Secretary was most grateful for the opportunity to see some of the publicity material and in particular the television advertisement you are planning to use for Capital Bond in January.

2. It was agreed that detailed information in the leaflets for Capital Bond should be kept to a minimum in line with the leaflets for existing DNS products. We should however need a full Q&A briefing package for use by DNS, IDT and the Revenue which would cover tax questions on capital bond in particular. We would not simply refer these queries to the Revenue. The briefing on how to declare taxable interest would stress that this was exactly the same procedure as for existing DNS products.

3. The general feeling of the meeting was that, barring any unforeseen developments, the press would have been short of financial news over the Christmas - New Year period and capital bond should therefore attract attention. On balance, the Economic Secretary thought that it would be best for him not to agree to interviews during the week capital bond goes on sale as this might

lead to awkward questions about interest rates and Budget measures to encourage personal saving. Mr Scholar thought the best spokesman would be someone who would be seen as an impartial outsider. The Economic Secretary would be grateful for **Mr Gieve's** advice (and for any views from **Mr Patterson**) on how we might identify and brief such a person.

4. Mr Peretz said he would shortly be putting up advice on the capital bond interest rate in order to take a final decision on this before Christmas.

S M A JAMES
PRIVATE SECRETARY

mg.ee/dlcp/15.12-dm

CONFIDENTIAL

PPS pl

From : D L C Peretz
Date : 15 December 1988

ECONOMIC SECRETARY

cc Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Miss O'Mara
Mr Gieve
Mr Grice
Mrs M Davies
Mr Rich
Mrs Ryding
Mrs Chaplin

Mr Patterson - DNS

looks like consensus — 11¾ ?

CAPITAL BOND : INTEREST RATE

My note of 12 December on national savings interest rates suggested (paragraphs 10-14), provisionally, a rate for the capital bond equivalent to 11½% compound interest, if held for 5 years. We need to take a final decision by Wednesday next week so that DNS can get the rate into the advertising material they are preparing. The decision however, is not totally straightforward, and we thought you might like a few days in which to consider it. 5 year gilt yields have remained at around 10¾% and that points to sticking at 11½%. But we think we should also consider the case for 12%.

Cost of Funding arguments

2. It is right to take the cost of a 5 year gilt as the starting point for comparison. The attached chart shows the movement in 5 year yields in recent weeks. There is no doubt the Bank of England could issue a new 5 year gilt now, if we wanted them to, at a yield close to current market yields. Because the interest is taxable in both cases, and indeed payable gross of tax for gilts held on the national savings stock register, the comparison between the two yields is fairly straightforward. As it happens, the yield today on a 5 year gilt is a shade under 10¾%. It might of course be higher or lower when the decision is announced on 3 January. All we can do is to take account of any further movements in market rates between now and when the decision has to be made, next week.

3. There are two adjustments to be made to get a direct comparison between the gilt rate and the capital bond rate. Administrative costs probably add around ¼% to the relative cost of the capital bond. To offset that, there will be a saving from the minority of holders who cash their bonds in early. Because of the rake (see table in paragraph 17) an investor will receive a much lower rate of interest if he cashes the bond in before the full 5 years are up. Experience with savings certificates suggests this factor means that the average rate paid will be at most ½% below the 5 year maximum rate, though of course it could in practice turn out to be more.

4. These factors point to a 5 year maximum rate of around 11%.

5. But there are other factors to be taken into account as well.

i) There are policy reasons for selling capital bonds rather than gilts. We are hoping the new instrument will help promote the savings habit, and increase the total of firmly held personal sector savings. Given the general economic background, there is a particular argument at present for seeking to produce a burst of personal savings. Looked at a different way the capital bond is intrinsically less liquid than a gilt, because it is not marketable, and therefore better "quality" funding.

ii) There are also quality of funding arguments for wishing to shift the stock of national savings away from the more liquid products such as Investment Account, and GER money, and into the less liquid capital bond. For this reason we pay slightly under the market on the former and should, arguably, be prepared to pay over the market for the latter.

iii) The tax treatment of the bond has pluses and minuses for the holder, and for the Exchequer. Payment gross of tax is an unambiguous benefit to the non-taxpaying investor; and on balance it is a benefit to the taxpaying investor, since in practice tax assessments lag a year behind the year in which interest is credited. The same points are true for gilts held on the NSSR. The difference is that a gilt provides a stream of income from which to pay tax (though the quoted yields assume complete reinvestment of interest), while holders of capital bonds will have to meet their tax liabilities in years 1 to 4 from other income. These factors do not affect the calculation of relative cost to the Exchequer of the two instruments. But the tax complication is nevertheless something to be taken into account in setting the interest rate, particularly at the launch and until the product and its tax treatment become more familiar.

A major disincentive

iv) There is a more general case for giving a particularly generous rate on the product initially, to help establish it. Like the initial advertising spending, this can be regarded as part of the launching cost for the new savings product.

6. Taking account of these factors, or at least (i), (ii) and (iv), would justify a higher rate than 11%. Given the marketing attractions of a relatively round number, we should probably consider this as a choice between 11½% and 12%. Are the factors listed in paragraph 5 worth ½%, or 1%?

Marketing Factors

7. We also need to consider what rate is needed to sell the new product. DNS think that either 11½% or 12% would make it a viable product, so long as they can get across the message of the guaranteed income. They would obviously prefer 12%, providing it did not provoke an embarrassing a flood of money, and would want to give it a higher profile in their advertising than if the rate is set at 11½%. But they are content with 11½%.

8. We need to remember that the average journalist writing about personal savings, and average investor, is quite likely to compare the rate with the going rates on building society and bank deposits - and be less interested in the sophistications of the yield curve. They will see the income guarantee as a plus; but the locking up of savings for 5 years as a distinct minus.

9. There has not yet been a general adjustment of retail interest rates to 13% base rates, and we now believe it to be likely (though this is not certain) that a general rise in retail deposit rates and mortgage rates will be delayed until after Christmas - probably taking effect from 1 February. Average building society instant access accounts thus remain at present at 8.4% net (11.2% gross). 90 day deposits for larger amounts, however, are in many cases already over 9.0% net (12% gross) and Abbey National have just announced a 10% net (13.3% gross) rate for deposits of over £25,000. It is also worth noting that although not widely marketed, guaranteed returns of over 12% gross are available on fixed term (up to 5 years) insurance company bonds, though in this case early withdrawals are not permitted.

10. By these standards, 11½% gross (worth 8.6% to a basic rate taxpayer) is probably sufficient - but risks appearing somewhat ungenerous as and when the building societies move. We must also take account of the risk of continued comment, however ill-informed, about alleged tax complications. We are preparing separately detailed Q and A briefing on the tax position, to get the message across that there are considerable tax benefits, and that the tax complications and drawbacks (such as they are) are not as great as has been suggested, and are in any event not new or unique to the capital bond. But we would certainly need to say, also, that the tax position had been fully taken into account in setting the interest rate.

11. 12% gross (worth 9% to a basic rate taxpayer) on the other hand, is a rate that would look competitive with building society rates even after a general rise. In the meantime it would risk looking rather over-generous.

12. If we went for 12% it would be easier to get across the message in general background briefing that it was to some extent an initial special offer intended to help launch the product, which might not be available for very long. But we do not in any case think we should do this by setting an <u>explicit</u> time limit on availability of "Series A".

Risks with 12%

13. The risks of going for a high rate are first that we might get an embarrassing flood of money (more embarrassing than it otherwise would be because of the PSDR); second, and probably linked to that, that we would be criticised for wasting taxpayers' money by paying too much in relation to the alternatives and third that it might be seen as a "signal" that we think interest rates are likely to remain high.

14. We could deal with the first, if it happened, by removing the initial series from sale and replacing it with a lower interest rate "Series B" bond. This would be easier if we had trailed that possibility in advance, as suggested above. Even so, we would not want to be forced to make such a change too soon.

15. On the second, we would have to say :-

a) the actual cost depends on how many investors stay the full 5 year course, which we cannot know in advance.

b) there are in any case policy reasons for paying a generous rate, as set out in paragraph 5(i) and (ii).

The question is whether these factors are sufficient to justify what would be seen as a 1¼% premium over gilts (or 1½%, making allowance for extra DNS costs).

16. As to signals, we doubt that 12% would be interpreted as a general signal on interest rates. But there is a possibility that when announced, and assuming they had not already moved, the building societies would say it was a factor in any subsequent decision to raise mortgage rates.

The rake

17. With either 11½% or 12% we are in favour of a steep rake, with an extra "bonus" of interest payable in the last year, on the following lines :-

Interest rate credited at the end of	11½% compound	12% compound
Year 1	5.3	5.5
Year 2	8.15	8.5
Year 3	11.0	11.5
Year 4	13.85	14.5
Year 5	19.75	20.6

Conclusion

18. The choice between 11½% and 12% really boils down to :-

i) How much of a premium over gilt rates can we justify; and

ii) What is needed to make the bond a success;

iii) With the added complication of whether or not the building societies are about to move.

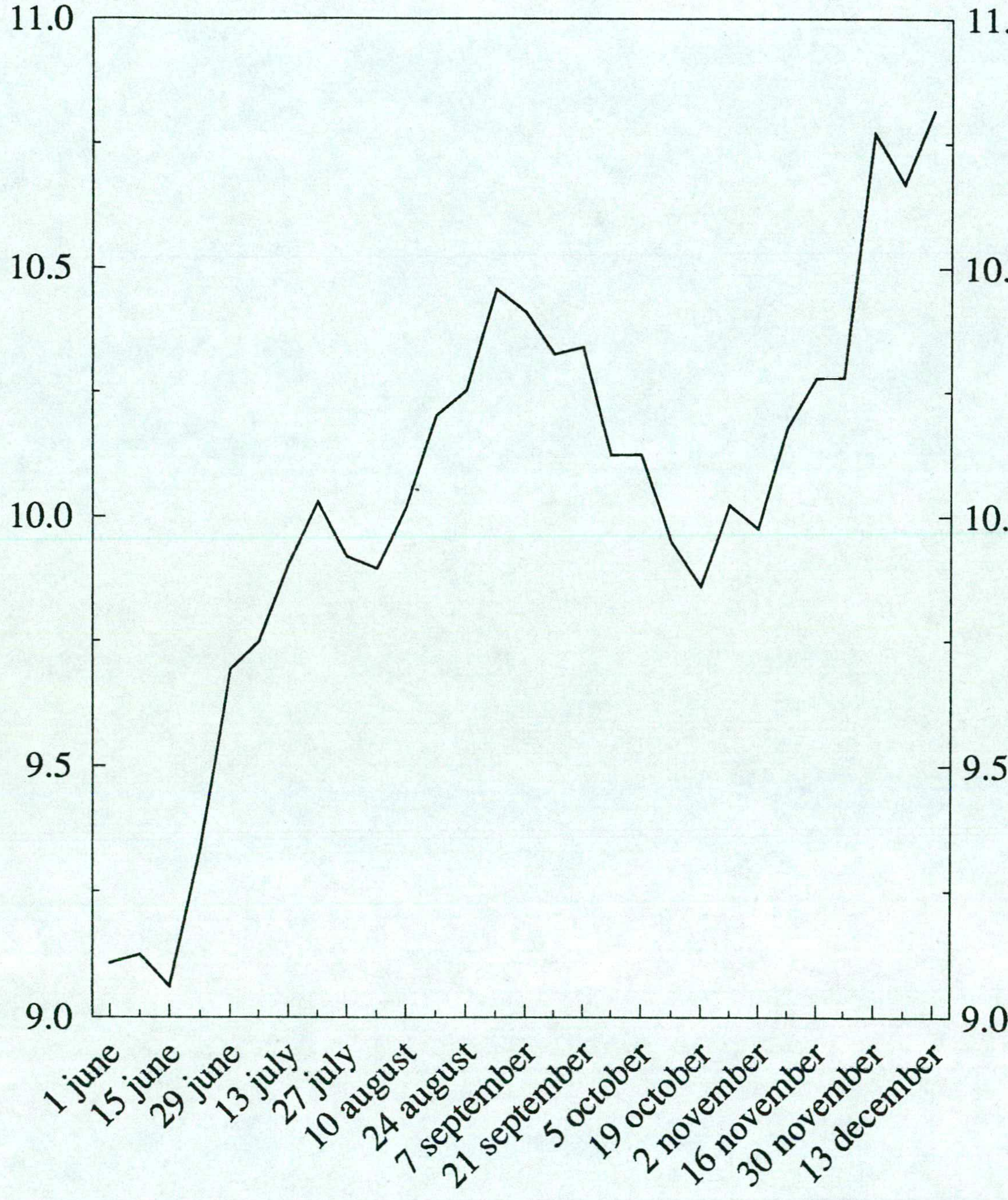
19. We can delay a final decision until Wednesday, by when we will know whether or not mortgage rates and building society deposit rates are going up on 1 January. In the meantime, you might like to discuss.

DLCP

D L C PERETZ

Chart: Par yields on 5 year gilts

wednesdays june - december 1988



LORD CHANCELLOR

CH/EXCHEQUER
REC. 19 DEC 1988 ✓ 19/12
FST
COPIES TO

HOUSE OF LORDS,
LONDON SW1A 0PW

16 December 1988

Jonathan

Dear Francis

Competition Initiative Action Programme

I have seen a copy of your letter of 2 December to the Chancellor of the Exchequer. The two entries for my Department listed in the Competition Initiative Action Programme which you circulated with your letter need revising in the light of the decisions we took at the E(CP) meeting in October. May I suggest that the two entries be revised to read as follows:-

Conveyancing (Page 1 of the Action Programme)

Action	Timing	Lead Department
Green Paper on the arrangements for Corporate Conveyancing to be issued.	Issue consultation paper in January 1989.	LCD.

.../continued

The Hon Francis Maude MP
The Parliamentary Under Secretary
of State for Corporate Affairs
Department of Trade & Industry
1-19 Victoria Street
London SW1H OET

Organisation of the Legal Profession (Page 2 of the Action Programme)

Action	Timing	Lead Department
Issue Green Papers on the future organisation of the legal profession and on contingency fees so as to ensure the best and most efficient administration of justice.	Green Papers to be issued in January 1989.	LCD.

I am copying this letter to Geofrey Howe, Nigel Lawson, Douglas Hurd, Malcolm Rifkind, Peter Walker, Tom King, members of E(CP) and Sir Robin Butler.

Yours ever,

James.

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB
Telephone 01-218 6621 (Direct Dialling)
01-218 9000 (Switchboard)

Minister of State
for Defence Procurement

20/12

D/MIN(DP)/DGT/4/5/1/1

16 December 1988

Dear Francis,

Thank you for copying to me your letter to Nigel Lawson on the Competition Initiative Action Programme.

The three actions for the Ministry of Defence are, of course, continuing ones and reports on all three are due to the Committee in January next year. In the meantime I attach some updates on these actions.

There are no new items for the Ministry of Defence

I am copying this letter and attachment to Geoffrey Howe, Nigel Lawson, James Mackay, Douglas Hurd, Malcolm Rifkind, Peter Walker, Tom King, members of E(CP) and Sir Robin Butler.

Yours

David

Lord Trefgarne

The Hon Francis Maude MP

Action	Timing
Extend competitive tendering and contracting out in defence support services	Action continues and a report is due to E(CP) in January 1989. In the meantime, during the first six months of this financial year, total personnel savings amounted to 114 Service and 937 civilian posts with an annual financial saving of £2.018M resulting from 54 competitive exercises. Of these 32 were first time letting and 22 remained in-house.
Increase range of defence contracting firms by small firms initiative and open tendering procedures	Action continues and a report is due to E(CP) in January 1989. During the twelve months to mid October 88 approximately 300 new small firms were added to the Defence Contractors List. A New Suppliers Service was launched in MOD on 30 November which coincided with the re-issue of the booklet "Selling to the MOD" in a much more comprehensive format. The MOD Contracts Bulletin has an increased circulation and French companies are being actively encouraged to bid for work.

Increase proportion of contracts placed by competitive procedures.

In the period April to October this financial year the percentage by value of contracts placed competitively or by reference to market forces was 51% compared with 49% in the same period last year. Figures are distorted by contracts which cannot be placed competitively - eg Trident submarines.

chex.md/mw/25 CONFIDENTIAL BF 21/12

FROM: MISS M P WALLACE

DATE: 19 December 1988

PS/ECONOMIC SECRETARY

cc Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Mr Peretz
Miss O'Mara
Mr Gieve
Mr Grice
Mrs M Davies
Mr Rich
Mrs Ryding
Mrs Chaplin

Mr Patterson DNS

CAPITAL BOND: INTEREST RATE

The Chancellor has seen Mr Peretz's note of 15 December. He has commented that it looks worth considering 11¼%.

MPW

MOIRA WALLACE

HOME SECRETARY

CH/EXCHEQUER
REC. 19 DEC 1988
ACTION FST
COPIES TO

QUEEN ANNE'S GATE LONDON SWIH 9AT

19 December 1988

Dear Mr Maude

Thank you for copying to me your letter of 2 December to Nigel Lawson.

I enclose progress reports on two Home Office entries in the action programme, broadcasting and remand prisoners. A revised entry has been offered on the former to reflect the completion of our first stage objective of publishing the White Paper. The entry on remand prisoners will also need updating once a decision has been reached on how to take this forward. I shall be receiving before Christmas a report on the outcome of the Green Paper consultation and expect to be putting proposals to H Committee in the New Year.

Progress reports on the other Home Office entries, on shop opening hours and police and fire service telecommunications, will come forward in March as previously agreed.

I have no new entries to propose for the action programme.

Yours sincerely

R C Sanderson
(approved by the Home Secretary and signed in his absence)

The Hon Francis Maude, MP.

Action

Examine scope for private sector provision or management of establishments, escorts and court manning for remand prisoners.

Timing

1988

Lead Department

HO

Progress

A Green Paper was published in July, requesting comments by the end of November. A firm of management consultants was appointed to examine feasibility, and their interim report was received in early December. The Home Secretary will report to H Committee shortly on the outcome of the consultation and consultancy exercises and on his proposals for future action, with a view to making an announcement in the New Year.

Action

(i) (Entry updated to reflect publication of Broadcasting White Paper.) In the light of comments on the Broadcasting White Paper prepare legislation on: competitive tendering for ITV contracts; possible reconstitution of Channel 4; implementation of 25% independent programme production target; subscription TV; new TV services; and new broadcast data services.

(ii) Legislation to deregulate non-BBC radio broadcasting.

Timing

1989/90

Lead Department

HO

Progress

White Paper (covering both (i) and (ii)) published on 7 November. Comments invited by 28 February 1989. Bid being made for major Broadcasting Bill in 1989/90 (covering both (i) and (ii)).

idt.sm.hjb.2.20

CONFIDENTIAL

FROM: H J BUSH
DATE: 20 December 1988

1. MR GIEVE

2. PS/ECONOMIC SECRETARY

cc PS/Chancellor
Mr Scholar
Mr Peretz
Miss O'Mara
Mr Grice
Mr Rich
Miss Anderson
Mrs Chaplin

Mr Patterson - DNS
Mr Wilson - DNS
Mrs Cullum - DNS

* Ridiculous. We know what publicity we want for this & EST must go on TV & radio. M.

CAPITAL BOND PUBLICITY

Your minute of 15 December to Mr Patterson asked IDT to consider the possibility of an 'impartial outsider' as 'spokesman' on the Capital Bond. Put in that way, we see no obvious candidates. Indeed, I am not sure that a designated spokesman as such was proposed. The important thing will be to ensure that from both here and DNS we brief the press fully. (An interested backbench MP might, of course, be pushed in the direction of the media, but questions would be likely to focus as much on the political - ie Budget - themes as the merits of the Capital Bond itself.)

2. There are two distinct press audiences: personal finance correspondents and economic journalists. The former will be dealt with by DNS and will be mainly interested in the attractiveness to the individual of the Capital Bond's terms. IDT will deal with its normal economics customers who will no doubt focus on the funding and (perhaps) interest rate implications. I doubt whether there will be much in the way of mass radio and TV interest (though in a thin news market you can never tell). But coverage on Money Box and the Financial World Tonight is to be expected. So it is important for DNS to take a pro-active line in carefully briefing these programmes (particularly Vincent Duggleby) and also

positive as ever! up to Mr B to interest people!

any financial journalists who may be called in as independent commentators - especially where (as in the case of Lorna Burke of the Independent) it is necessary to dispel misapprehensions on the tax position. IDT should also be able to assist from here with our contacts at City editor level (eg Peter Wilson-Smith).

Harry Bush

H J BUSH

mg.ee/dlcp/21.12-ir

CONFIDENTIAL

Ch
Draft press notice has v feeble start – needs sprucing up.
AA

From : I Rich
Date : 21 December 1988

1. MR PERETZ

2. ECONOMIC SECRETARY

cc PS/Chancellor
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Grice
Miss O'Mara
Mr Bush
Miss Anderson
Mrs Chaplin

Mr Patterson - DNS
Mr Corlett - IR
Mr Streeter - IR

File NSNLET1

I hope we can leave in the words in square brackets, but they are subject to views from the I.R. It is clearly important that all three departments speak with one voice on the tax aspects.
21/12

draft press notice v. feeble altogether, & needs complete whack (Less can do this)

CAPITAL BOND

I attach two pieces of draft briefing.

2. First, a note on tax treatment, prepared in consultation with Inland Revenue and DNS, designed for use by all three departments in handling questions from the media about the way in which income tax will be payable on the Capital Bond. You will recall that there was some criticism from Lorna Bourke (The Independent) and some others about this at the time of the October announcement, and we expect this to be pursued. The note explains that we are following normal practice, and defends it. Its use by all three departments is to help ensure that we all sing the same song. The sections in square brackets are subject to final confirmation from Inland Revenue.

3. Second, a draft Press Notice and Q and A briefing prepared by DNS. Treasury officials have suggested some amendments. These appear in manuscript, as there has not been time to get a clean version typed.

4. We should be grateful for your agreement to this material, subject to any further amendments you wish to make.

In addition to catchy opening, present draft (a) doesn't make sufficiently clear that interest is rolled up, (b) doesn't make clear that this is the 1st issue (18% for coll this) & can be withdrawn at X ~~weeks~~ weeks' notice (implies 'hurry while stocks last'). M.

5. We shall be submitting separately some draft defensive briefing on "why 12 %" etc.

Ian Rich

I RICH

CAPITAL BOND - TAX TREATMENT

(Note for dealing with questions from journalists, financial commentators etc).

FACTUAL

The interest on Capital Bonds will be taxed in exactly the same way as any other interest which is paid or credited gross, eg on National Savings Income and Deposit Bonds, Investment Account and Government stock held on the National Savings Stock Register. Investors are liable to tax each year on interest accruing, whether it is capitalised or paid to them.

In principle the tax on Capital Bonds (like other similar interest) becomes payable on 1 January in the year in which it is credited. In practice, for most taxpaying investors the Inland Revenue will be able to take it into account in fixing the investors' PAYE code, so that it is collected by instalments over the whole year, [normally a year in arrears].

Because no interest is credited until the first anniversary of purchase, no tax will be payable during the first year of holding. [Where PAYE coding is adjusted in arrears, tax will often not be paid until the third year of holding]. Moreover, because most of the interest will be credited in the last two years of life of the bond, most of the tax will be paid in those years [or later].

Covered in A3

~~[This tax treatment is normal practice. It applies to other existing investments of the same kind. National Savings Deposit Bonds, where interest is capitalised, are taxed in the same way. So is a range of fixed term investments available from private sector institutions eg building society term accounts and insurance company guaranteed bonds) where higher rate taxpayers have to settle annually their tax liabilities which have not already been covered by CRT.]~~

SPECIFIC QUESTIONS

Q1 How should investors notify the Inland Revenue?

A1 The interest should be entered on tax returns in the usual way.

[Q2 If pressed on what about taxpayers who do not receive tax returns?

[A2 As with all receipts of interest paid gross of tax, taxpayers should inform their Inspector of Taxes, on receipt of the annual statement from DNS that interest has been credited. Note this will not be until at least a year after purchase, since interest is not credited until the first anniversary of purchase].

Q3 Unfair to tax capitalised interest before it is paid out? Why not wait until maturity?

A3 Taxing interest only at maturity would be unfair. Many investors in Capital Bonds might be worse off if their interest were all taxed in a single year. It could, for example, push someone who did not normally pay tax into basic rate liability; and push a basic rate payer into higher rate liability. Moreover, investors subject to tax who are paid interest year by year and then re-invest it are in the same position.

The tax treatment is normal practice. It applies to other investments of the same kind, including National Savings Deposit Bonds where interest is capitalised in the same way; and to a range of fixed term investment available in the private sector (for example building society term accounts and insurance company guaranteed bonds) where higher rate taxpayers are liable annually for higher rate tax on capitalised interest.

Q4 Why different from bank and building society interest?

A4 Composite rate tax is deducted from bank and building society interest before it is paid to the investor or capitalised (by crediting it to his account). It is not repayable to the investor in any circumstances. So investors who are not normally liable to tax cannot get a repayment.

On the other hand, investors in Capital Bonds who are not otherwise liable to tax will not suffer any tax at all. So for these investors in capital bonds, the tax system works in their favour.

For higher rate taxpayers, there will be no difference between Capital Bonds and bank and building society interest. Higher rate tax will be payable each year in all cases.

Q5 When will holders get statements of value?

A5 DNS will normally send them to holders each April, showing the total value of holdings, and interest credited, at the latest anniversary of purchase.

Q6 Why not send statements on anniversary of purchase?

A6 This would mean multiple statements for people with multiple holdings - inconvenient for the saver and expensive for National Savings. Statements will show details of each separate Bond purchase, and resulting value of that Bonds on the anniversary of purchase.

~~RESTRICTED~~
Confidential until 3.1.88

DRAFT PRESS NOTICE

NATIONAL SAVINGS CAPITAL BONDS: DETAILS OF SERIES A

V feeble start! Needs spicing up, probably with interest rate first, then posting date

1. Postal applications for Capital Bonds, the new guaranteed growth product from National Savings, will be accepted from Wednesday 4 January. The bonds will go on sale at post offices on Monday 9 January.

2. The interest rate guaranteed over a full five years for Series A Capital Bonds is equivalent to a compound rate of XX.XX% p.a. The value of a £100 bond held for five years will be £XXX.

3. As with National Savings Certificates, ~~During the five year life of a bond~~ the interest rates ~~are higher~~ rise for each full year the bond is held over its five years' life~~, as with National Savings Certificates~~. At the end of five years the bond will be repaid. No further interest will then be earned.

4. No income tax will be deducted from the interest at source. ~~Taxpayers will need to pay the income tax which is due each year.~~ After bonds have been held for a year, the Capital Bond Office will send a Statement of Value once a year to the bondholder. This will record the amount of interest added to the value of their bonds in the previous year. Taxpayers will be liable to tax on this interest.

5. Capital Bonds give savers an absolute guarantee against falling interest rates for a full five years as well as complete security of capital backed by the Crown. They are the only non-risk savings product to offer ~~a guarantee of~~ five-year growth at a guaranteed rate with no tax deducted from the interest ~~before it is earned~~ at source. National Savings expect the new Capital Bond to be attractive both to taxpayers wanting capital

growth at fixed rates and to non-taxpayers wanting the additional benefit of gross interest.

6. The minimum purchase is £100 and bonds are sold in multiples of £100. There is no maximum. Capital Bonds may be held by personal savers of any age, ~~and~~ by two ~~trustees for~~ individuals jointly, and by trustees for individuals.

Notes to Editors

1. Prospectuses and application forms will be published in newspapers from 4 January. Savers will then be able to buy Capital Bonds by direct application to the Capital Bond Office, National Savings, Glasgow G58 1SB. From 9 January they can make their purchase at a post office counter or ask for an application form to send to the Capital Bond Office.

2. The fixed rates of interest for each year of a Series A Capital Bond's five year life are as follows:

Year 1 - ~~X.X%~~ 5.5%; Year 2 - ~~X.X%~~ 8.5%; Year 3 - ~~X.X%~~ 11.5%; Year 4 - ~~X.X%~~ 14.5%; Year 5 - ~~X.X%~~ 20.6%.

These figures produce the average compound rate of 12 p.a. over the full five years.

The steep ascent of the annual figures is designed to encourage savers to hold their bonds for the full five years, with a special bonus incorporated in the last year.

3. Capital Bonds may be repaid before maturity at three months' notice. Provided they have been held for a year or more, interest will be earned from the date of purchase to the date of repayment. The amount repaid will be the value at the latest anniversary of purchase, plus interest for the part of the year from that date until the date of repayment at the rates shown in Note 2 (eg the Year 1 rate would apply to repayments between the first and second anniversaries). Bonds repaid within a year of purchase will not earn any interest.

4. Capital Bonds were first announced by the Chancellor of the Exchequer on 13 October 1988 as a means of further encouraging savings.

Confidential until 3.1.88

~~RESTRICTED~~

CAPITAL BONDS: DRAFT Q & A

Q1. What is the guaranteed net return to a 25% taxpayer and to a 40% taxpayer on a Capital Bond held to maturity

A1. Equivalent to compound rates of 9% pa and 7.2% pa respectively

Q2. What are the interim rates?

A2. The gross rates are:

	%
Year 1:	5.5
Year 2:	8.5
Year 3:	11.5
Year 4:	14.5
Year 5:	20.6

Q3. Why such a steep rake?

A3. To give savers the maximum incentive to keep their money in Capital Bonds for the full five years. We do not want to attract money from savers who will cash in early, as that is poor quality funding for the government.

Q4. How did you determine the five-year return for Series A?

A4. We have set the five year return at a level which we think will be attractive to savers looking for capital growth with a cast iron guarantee that their savings will be protected against falling interest rates for a full five years after they buy their bonds.

Q5 Does the rate take account of the fact that interest is taxable?

A5 Yes. The EST said on 13 October that it would on this account be higher than the rate on savings certificates

Q~~5~~6. Why isn't the rate higher if you want to attract taxpayers?

6 ~~A5.~~ With the absolute guarantee for five years we think that the rate ~~should~~ will be attractive for taxpayers ~~(and very attractive indeed for~~ The Bond should appeal particularly to non-taxpayers). The Government is anxious to ensure that non-taxpayers continue to have homes for their savings at attractive rates. No other ~~No other~~ product combines the five-year guarantee with no upper limit on the amount which may be bought. ~~34th Issue has the same guarantee. The tax-free return is distinctly lower for basic rate taxpayers at 7.5%.~~

Q8 ~~Q6~~ Do you expect Capital Bonds to sell well at this rate?

A8 ~~A6~~ Yes, see A4. We set the rate to be attractive to both taxpayers and non-taxpayers wanting a five year guarantee against falling interest rates. ~~Non-taxpayers are being offered an exceptionally good deal.~~ Capital Bond brings these major benefits to savers for the first time without restriction.

Q9 ~~Q7~~ What makes you think non-taxpayers can afford to tie their money up for five years?

A9 ~~A7~~ ~~Not~~ Realise not all non-taxpayers can afford to do so, nor can all taxpayers for that matter. But ~~for any non-taxpayer wanting a cast iron five-year guarantee against falling interest rates,~~ Capital Bonds ~~offer an exceptional opportunity.~~ will certainly appeal to married women becoming entitled to their own tax allowance next year. They will also be a very attractive investment for children — eg gifts from grandparents.

Q10 ~~Q8.~~ Why is the net return for a ~~standard~~ basic rate taxpayer better than the return on 34th Issue Certificates?

A10 ~~A8.~~ ~~Because the Capital Bond is designed to encourage the saving habit without the tax break for taxpayers which is a special feature of Savings Certificates.~~ Reflects different tax treatment. 34th Issue is tax-exempt; Capital Bond is paid gross of tax, but taxpaying investors liable to tax on interest, as with Income and Deposit Bonds, Investment Account and gilts on National Savings Stock Register.

Q11 ~~Q9.~~ Have you made Series A especially generous?

11 ~~A9.~~ We certainly want to see Capital Bonds get off to a good start and we took this into account when we set the rate.

12 ~~Q10.~~ Are subsequent Series likely to be less ~~competitive~~ attractive?

12 ~~A10.~~ We never comment on future rates of interest.

Q7 What are competitors offering?

A7 No real comparisons can be made. Very little opportunity elsewhere for guaranteed rates, minimum entry of £100 and provision for early withdrawal — or for interest paid gross. Must beware of making comparisons between guaranteed return on Capital Bond and variable rates offered by banks and building societies, which can go down as well as up.

(there be a fixed relationship between the)

rate?

Q1~~1~~3. Will Capital Bonds ~~always level peg with~~ and Income Bonds? ~~[Question only applies if rate is the same]~~

(provides a monthly income and

A1~~1~~3. ~~There is No relationship between the two rates.~~ The Income Bond has a variable rate of interest. The guaranteed rate for any new Capital Bond Series ~~will be what we think is appropriate at the time, given that it guarantees a return for five full years ahead.~~ ~~set in the light of the economic circumstances~~ is a different kind of interest rate, and there will be no fixed relationship with variable rates.

Q1~~2~~4. How long will Series A be on sale for?

A~~12~~14. Impossible to say ~~in advance. But it is not likely to continue on sale as long as some of our more enduring Certificate Issues. Like 28th Issue it might be weeks rather than months.~~ But to some extent it is a relatively generous offer, designed to launch a product aimed at increasing the level of personal savings, so it might not be available for very long. And of course any Series can be taken off sale without notice, the same as ~~Certificate~~ Issues of Savings certificates.

Q~~13~~15. Why are you penalising people for early repayment and demanding three months' notice as well? [Banks and building societies don't do this.]

A~~13~~15. To give savers the maximum incentive to stay in for five years. Otherwise Capital Bonds won't ~~offer~~ provide the quality of funding the government is looking for. [Banks and building societies don't offer guaranteed rates for a full five years; building society guarantees are usually for a differential above one of their variable rates].

Q~~14~~16. Why can't you have Capital Bonds on sale at post offices from 4 January?

A~~14~~16. Because we wanted to get them on sale as soon as possible ~~after~~ in the New Year ~~but did not want to set the~~ after the interest rate ~~until shortly before the launch date~~ had been decided. As printing and despatch of prospectuses and leaflets takes longer over the Christmas/New Year period, it would not have been possible to have them in post offices by 4 January.

Q~~15~~17. Why not delay the launch until 9 January?

20 DEC '88 12:23 FROM DNS HQ LONDON PAGE.001

A~~15~~ 17. See A14. Wednesday 4 January is the first day of the New Year on which the whole country was back at work (3 January a Bank Holiday in Scotland).

NB: the following are taken from the original announcement Q & A.

Q~~16~~ 18. Who will buy Capital Bonds?

A~~16~~ 18. Taxpayers attracted by guaranteed rates and capital growth; non-taxpayers attracted by interest in full with no tax taken off before they get it. Probably especially appealing to those with a windfall they want to tuck away, people planning for retirement in a few years' time, and people who have recently retired and would like to see a lump sum grow steadily and securely for the next five years.

to be covered in funding briefing

~~Q17. Why launch a new product when the government want to repay public debt?~~

~~A17. Because the Government wants to improve the quality of its funding and to rearrange Government borrowing in a way that raises the level of ~~genuine~~ personal saving in the economy.~~

Q~~18~~ 19. How much do you expect to bring in from Series A?

A~~18~~ 19. We never make public forecasts of future sales. We expect the Capital Bond to develop into one of our major products.

Q~~19~~ 20. When did you last launch a new product?

A~~19~~ 20. Yearly Plan, in July 1984, of the products still on sale. We launched the Deposit Bond the previous autumn, and the Income Bond in August 1982. The Indexed-Income Bond was launched in November 1985 but it did not catch on and we withdrew it from sale in August 1987.

Q 21 Why limited to personal holders?

A 21 Because the aim is to attract personal saving.

means forgoing revenue from higher rate taxpayers.

Q~~20~~22. Why no holding limit?

A~~20~~22. Because we see no need for a holding limit. We need a limit on Savings Certificates because of the tax exemption. There is no such reason to restrict access to ~~the alternative~~ this product ~~with the five-year guarantee~~ because there is no tax exemption on the Capital Bond.

Tax Treatment (see separate brief).

These are questions we have asked Mr Rich, Treasury, to add to the list of questions on tax treatment he is going to clear with Inland Revenue. Treasury only want us to provide questions, not answers.

Q21. Why don't you tax on maturity?

Q22. Why are you making people pay tax before they get paid the interest?

Q23. When are you required to pay tax on the interest?
[should include detailed schedule year by year]

Q24. Why is the tax treatment different in different years?

Q25. Why will the second year's interest be assessed at the same amount as the first year's interest when the Revenue know just how much is guaranteed for the second year?

Q26. When will holders get their Statement of Value? [and why not on anniversary of purchase?]

Q27. How will someone who buys between the end of March and the end of December know how much interest to declare in order to pay the first year's tax by 1 January following the first anniversary?

[This question is for the benefit of anyone who notes the fact that an April-December purchaser will get the first Statement of Value after the tax on the first year's interest has become due. But we understand from Inland Revenue that savers will not be required to make a return until they have received the first Statement of Value. If this is confirmed, there is no problem.]

est.ld/james/PSCHX20.12

CONFIDENTIAL

ECONOMIC SECRETARY TO THE TREASURY

FROM: S M A JAMES
DATE: 21 December 1988

PS/CHANCELLOR

cc: Sir P Middleton
Sir T Burns
Mr Scholar
Mr Odling-Smee
Mr Peretz
Miss O'Mara
Mr Gieve
Mr Grice
Mrs M Davis
Mr Rich
Mrs Ryding
Mrs Chaplin

Mr Patterson - DNS

Ch/ I gather you have already discussed with EST. OK?

MPW.

OK – (but see phrasing below).

CAPITAL BOND - INTEREST RATES

The Economic Secretary has seen Miss Wallace's minute of 19 December recording the Chancellor's comments on Mr Peretz's submission of 15 December.

2. In the light of discussion with officials in MG and DNS, the Economic Secretary is minded to set the rate at 12%. He understands the arguments of cost and official caution but thinks that assessed on the balance of risks there is a good case for setting a generous rate. This should help ensure the successful launch of the capital bond and be taken as a sign of the Government's commitment to encourage personal saving. 11 1/2% may not be sufficiently high to ensure this and 11 3/4% is unattractive on marketing grounds (a round number is best).

3. The Economic Secretary agrees with Mr Peretz that we should present the 12% rate in background briefing as an initial special offer to help launch the product which might not be available very long (although we would not set an explicit time limit on the special offer period). If the initial rate proved to be over

generous and we were faced with embarrassingly high sales of capital bond, we could then more easily withdraw series A and replace it with a series B at a reduced rate.

4. A high initial rate might also help counter any press criticism about the tax position of capital bond.

Arguments against a rate as high as 12% are that

(i) we now know that most building society mortgage and retail deposit rates will not move on 1 January 1989 (however they may of course announce plans to do so on 1 February, shortly after the capital bond launch);

(ii) 5 year gilt yields are now 10 1/2% (a little lower than on 15 December when Mr Peretz minuted the Economic Secretary). A comparison with the capital bond rate could attract criticism in the financial press, and (in private) from the Bank.

(iii) this criticism on cost of funding grounds would be expressed the more strongly if the result of boosting capital bond sales were seen to be increased buying in of gilts. This could be countered on the grounds that we are trying to attract personal savers and increase the total of firmly held personal savings.

5. On balance the Economic Secretary thinks that the need to put the successful launch of the capital bond beyond doubt points to setting the initial rate at 12%. He would be grateful to know if the Chancellor is content.

SMAJ

S M A JAMES
PRIVATE SECRETARY

CH/EXCHEQUER
REC. 22 DEC 1988
ACTION FST ✓22/12
COPIES TO

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

MP

The Hon Francis Maude MP
Parliamentary Under Secretary
of State for Corporate Affairs
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

22 December 1988

Dear Francis

COMPETITION INITIATIVE ACTION PROGRAMME

Thankyou for copying to me your letter of 2 December to Nigel Lawson about the Competition Initiative Action Programme.

As you will appreciate there is limited scope for taking original initiatives in Northern Ireland. Indeed many of the proposals apply nationally (eg those relating to the European Single Market) and do not require separate action to secure implementation here. While I cannot at this stage put forward any new items you can be assured that I am fully committed to the initiative and that the revised Action Programme will be closely scrutinised with a view to implementation of any proposals which are relevant to Northern Ireland.

I am copying this letter to Nigel Lawson, Geoffrey Howe, James Mackay, Douglas Hurd, Malcolm Rifkind, Peter Walker, members of E(CP) and Sir Robin Butler.

Ever
Tom

TK

JB 18548

CONFIDENTIAL

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CH/EXCHEQUER
REC. 22 DEC 1988
ACTION FST
COPIES TO

✓ 22/12

Hon Francis Maude MP
Parliamentary Under Secretary of State
for Corporate and Consumer Affairs
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H OET

22nd December 1988

Dear Francis,

COMPETITION INITIATIVE

Your letter of 2 December to Nigel Lawson asked colleagues to consider whether the present Action Programme fully reflected all that we are doing under the Competition Initiative. As you know, my Department has undertaken major reviews which have been included in earlier stages of the programme or are currently in progress. I have carefully considered whether I have any new proposals for inclusion in the Programme but can offer nothing specific at this time.

Some revision is however necessary to the existing entries affecting my Department to reflect recent progress and our collective decisions. One entry, the National Consumer Council study of the CAP, can be removed as this exercise is now completed, and I have given the Government's response to the Council. For ease of reference I attach a revised entry for agriculture topics.

I am copying this letter to Nigel Lawson, Geoffrey Howe, James McKay, Douglas Hurd, Malcolm Rifkind, Peter Walker, Tom King, Members of E(CP) and Sir Robin Butler.

Yours ever,

JM

JOHN MacGREGOR

CONFIDENTIAL

ANNEX

COMPETITION INITIATIVE: CURRENT MAFF ENTRIES

Action	Timing	Lead Department
Review results of monitoring exercise on banana prices/margins	1990	MAFF/DTI/FCO
Monitor relationship between Dairy Crest and Milk Marketing Board following Touche Ross Report	Review 1988 Paper to E(CP) July 1988	MAFF
Review potato market support arrangements	By 1989. Paper to E(CP) July 1988	MAFF
NCC study of CAP commissioned 1986. Consider conclusions	By September 1988	MAFF
Review the role of the British Wool Marketing Board and its subsidiaries	Paper to E(CP) July 1988	MAFF
Transfer tuberculin production from Central Veterinary Laboratory to pharmaceutical industry	1988/89	MAFF
Transfer funding of "Food From Britain" to industry	1991/2 - report to E(CP) March 1989	MAFF

ANNEX TO MINISTER'S LETTER TO MR MAUDE

COMPETITION INITIATIVE

REVISED MAFF ENTRIES TO ACTION PROGRAMME

Action	Timing	Lead Department
Review results of monitoring exercise on banana prices/ margins	1990	MAFF/DTI/FCO
Review milk marketing arrangements	Paper to E(CP) in March 1989	MAFF
Review of potato marketing and support arrangements	In progress; paper to E(CP) in March 1989	MAFF
Removal of Wool guarantee	Place in 1989/90 legislative programme being sought	MAFF
Transfer tuberculin production from central veterinary laboratory to phamaceutical industry	1989	MAFF
Transfer funding of "Food From Britain" to industry	1991/2 - report to E(CP) March 1989	MAFF

chex.ul/jf/10.22.12mw

CONFIDENTIAL

MP

FROM: MISS M P WALLACE
DATE: 22 DECEMBER 1988

PS/ECONOMIC SECRETARY

cc; Sir P Middleton
Sir T Burns
Mr Odling-Smee
Mr Peretz
Miss O'Mara
Mr Gieve
Mr Grice
Mr M Davis
Mr Rich
Mrs Ryding
Mrs Chaplin

Mr Patterson - DNS

CAPITAL BOND - INTEREST RATES

The Chancellor has seen your minute of 21 December. He is content with the Economic Secretary's recommendation that we should opt for an initial rate of 12 per cent.

MPW

MOIRA WALLACE
Assistant Private Secretary

est.ld/james/Rich 22.12

MP

CONFIDENTIAL

Better, ~~[illegible]~~ this a great pity your rushing the word 'staying' in minute of 22/12 — which still needs to be taken on board.

FROM: S M A JAMES
DATE: 22 December 1988

MR RICH

cc: PS/Chancellor
Sir P Middleton
Sir T Burns
Mr Peretz
Mr Gieve
Miss O'Mara
Mrs Chaplin

Mr Patterson - DNS
Mr Corlett - IR
Mr Streeter - IR

Ch/ more on right lines now.

MP

*see also M O'M brief on wider issues. behind.

MP.

CAPITAL BOND - PRESS NOTICE AND BRIEFING

The Economic Secretary was grateful for your minute of 21 December attaching a draft press notice and briefing. He has also seen Miss O'Mara's minute to Mr Gieve of 22 December.

Press Notice

2. The Economic Secretary had some comments on the draft press notice:

(i) the Economic Secretary suggests an additional paragraph should be inserted before existing paragraph 1 as follows:

"National Savings announce the launch of their newest product - the Capital Bond. Peter Lilley MP, the Economic Secretary to the Treasury, said "the Capital Bond is designed to give a fresh stimulus to personal saving. I believe it will prove an attractive way for people to save and will tap additional longer term saving. The Capital Bond is a clear affirmation of the Government's commitment to encouraging personal saving;"

(ii) Paragraph 2. Redraft the second sentence to read "Annual interest is accumulated and paid out at redemption so the value, including accumulated interest, of £100 Bond held for the full five years will be £xxx;"

(iii) Insert a new paragraph between existing paragraphs 3 and 4: "The guaranteed 12% compound interest rate applies to the introductory series A of the Capital Bond. National Savings reserve the right to withdraw this series at any time";

(iv) Paragraph 5, last sentence, after "non-taxpayers" insert "including married women following the introduction of independent taxation in 1989";

(v) Notes to Editors, paragraph 4, insert "personal" before "savings".

Briefing

3. The Economic Secretary had a few comments on the briefing prepared by MG, DNS and Inland Revenue, which he thinks is very good. He is also aware of some changes to the factual brief Inland Revenue have made since you minuted him yesterday.

(i) **Tax treatment : Factual**

- Paragraph 2, second line insert "financial" before year;

- add a sentence to follow paragraph 2 : "[if asked, in practice PAYE adjustments will often be made a year in arrears]";

(ii) <u>Specific Questions</u>

- add a sentence to follow existing A2 : The annual statement of interest will contain a reminder to taxpaying investors about notifying the Inland Revenue";

(iii) <u>Capital Bonds : Q and A</u>

- A3, redraft second sentence as follows: "We do not want to attract money which savers can cash in early without penalty, as that is poor quality funding for the government";

- A18 first sentence, after "non-taxpayers" insert "including married women (with own allowances from 1989 onwards)".

Capital Bond Wider issues

4. "Why is Government concerned to increase personal saving in particular?" : The Economic Secretary is content with the reply as drafted but wishes to add the following after "consumption growth": "... and release finance for current investment boom".

S M A JAMES
PRIVATE SECRETARY

mom/pa.321

CONFIDENTIAL
UNTIL 3 JANUARY 1989

FROM: MISS M O'MARA
DATE: 22 December 1988

MR GIEVE

cc: PS/Chancellor
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Peretz
Mr Grice
Mr Bush
Mr Rich
Ms Ryding
Mrs Chaplin
Mr Patterson - DNS

CAPITAL BOND: WIDER ISSUES

As foreshadowed in Mr Rich's minute of 21 December, I attach some further briefing on the wider economic issues raised by the launch of the Capital Bond which is, of course, primarily for use by IDT rather than DNS.

MOM

MISS M O'MARA

Capital Bond represents expensive funding? Why pay 12 per cent when you could issue gilts for same term at [10½] per cent?

NB 12 per cent available only to those who hold Bond for five years. Steep interest rate rake means those who withdraw early receive considerably less. Experience with savings certificates is that there are some early withdrawals, reducing costs to Government.

Particular reasons for offering high return on this occasion:

- First issue of new product. Must remember can be withdrawn from sale at any time without notice.

- Higher personal savings bring benefits to economy as whole as well as to individuals concerned. Government is seeking to encourage longer term personal saving by providing attractive scheme.

What makes you think Capital Bond will increase saving?

Fills gap in savings market - no other product offers guaranteed return and interest payable gross, without upper limit on investment. Provides an attractive rate guaranteed for five years. Will stimulate new savings and also encourage people to turn existing short-term savings (eg bank or building society deposits) into longer term savings, more firmly held.

Why is Government concerned to increase personal saving in particular?

Demand has been growing too rapidly in 1988, partly reflecting excessive rise in consumption. An increase in personal savings will help to dampen consumption growth.

Capital Bond cannot increase net savings because of full-fund practice. If Government takes more money into Capital Bonds, has to pay back somebody else.

Capital Bond designed to improve quality of funding within full-fund rule and to increase level of personal savings. Capital Bond inflows represent very direct increase in personal savings (can only be bought by individuals). Any offsetting defunding likely to have either no direct impact on personal savings (eg extra gilt purchases from pension funds and insurance companies) or represent improvement in quality (eg if matched by lower net inflows into more liquid National Savings products).

Inconsistent with January's reverse auction?

No. (See above.) Reverse auction applies to stocks which will be bought largely from institutions. Capital Bond designed to lock-in personal funds for five years.

Does 12 per cent return over 5 years indicate Government expects interest rates to remain high for foreseeable future?

No such implication. Return on Capital Bond set in light of variety of factors (see above).

Government trying to engineer rise in building society rates through setting return on Capital Bond so high?

No. Rates set by building societies and banks are matter for them.

National Savings contribution to funding

In first 8 months of 1989-90 totalled £638.5 million, comprising

	£ million
Gross products	£1,158.5
Fixed interest products	-823.1
Index linked savings certificates	+205.0
Premium Bonds	+125.5
Other	- 27.4

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CONFIDENTIAL

FROM: MISS M P WALLACE
DATE: 22 DECEMBER 1988

PS/ECONOMIC SECRETARY

cc: Sir P Middleton
Sir T Burns
Mr Scholar
Mr Peretz
Mr Grice
Miss O'Mara
Mr Bush
Mr Rich
Miss Anderson
Mrs Chaplin

Mr Patterson - DNS
Mr Corlett - IR
Mr Streeter - IR

CAPITAL BOND

The Chancellor has seen Mr Rich's minute of 21 December, attaching Q&A briefing and a draft press notice.

2. The Chancellor would like the press notice "beefed up" slightly, and would be grateful if the Economic Secretary could consider this further. In particular, he thinks it could do with a more catchy opening. He also thinks it ought to bring out very clearly that interest is rolled up, and that this is the <u>first</u> issue (he thinks it ought to be called this explicitly) and could be withdrawn at quite short notice - with the implication "hurry while stocks last".

3. The Chancellor has also seen the papers on <u>capital bond publicity</u> - your minute of 15 December and Mr Bush's of 20 December. The Chancellor would hope that we could obtain maximum publicity for the launch, and he thinks it would be best if the Economic Secretary could appear on television and radio.

MOIRA WALLACE
Assistant Private Secretary