PO-CH/NL/0830
PART A

STARTS : 13-12-83
3.2.84

PO -CH /NL/ ~~0012~~ 0830

PART A

1984 BUDGET
REPRESENTATIONS
CONFEDERATION OF BRITISH
INDUSTRY

DDS 25 years NA 25/08/94

PO -CH /NL/ ~~0012~~ 0830
PART A

cc as per attached

12/1

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

13 December 1983

Ms Linda Turner
PA to the Director General
Confederation of British Industry
103 New Oxford Street
LONDON
WC1A 1DU

Dear Linda,

Thank you for your letter of 7 December.

NOW 4.30

The names of those attending the meeting on 12 January, from the Treasury, are as follows:-

- The Rt Hon Peter Rees, Chief Secretary
- John Moore, Financial Secretary
- Ian Stewart, Economic Secretary
- Barney Hayhoe, Minister of State
- Mr Middleton, Permanent Secretary
- Sir Terence Burns, Chief Economic Adviser
- ~~John Anson, CB, Industry Division~~ NICK Monck
- George Monger, Fiscal Policy Group
- Tony Battishill, Central Unit and Economic Briefing
- Peter Wilmott, Customs and Excise
- Terry Painter, Inland Revenue

CBI informed

Yours sincerely

Diana

MISS D YOUNG
Assistant Private Secretary

CHANCELLOR OF THE EXCHEQUER

12/1
4.00pm
HMT

CBI

CST
FST
EST
MST
Middleton
Burns
Anson
Monger
Battishill

2913
2106
Wilmott CtE

2541
7586
Painter? IR

~~Dom~~

We reckon ignore Norgrove!

We need CST, FST & prob MST.

EST to be limited if necessary.

Otherwise, ask

Middleton

Burns

~~Braithwaite if he wants~~

~~Lawrence [illegible] one substitute~~

Anson

Monger

Battishill

Mr Painter – IR – Check with Andrew Walker his the right one.

Mr Wilmott – C&E

Thanks

M.

CHANCELLOR OF THE EXCHEQUER

Wednesday

~~(1) Simon Webb, Alan [illegible]~~

Donna

The CBI will be ringing up about a Budget reps mtg in January. There's no way we'd refuse but you might check timing with David Norgrove first. I think they had in mind the week beginning 16 Jan which looks OK to me.

Thanks

M.

Margaret

Mr Norgrove agrees about timing but thinks the Treasury Team should be kept small & less heavy-weight i.e. only 1 other Minister & 1 Perm Sec plus other officials. Which should I line up plse?

21

CHANCELLOR OF THE EXCHEQUER

Ron.

urgent action on first folder

The rest can wait.

G

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Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI CONFEDERATION OF BRITISH INDUSTRY

cc CST
FST
EST
MST
Mr Middleton
Sir T. Burns
Mr Anson
Mr Monger
Mr Battishill
Mr Wilmott C&E
Mr Painter IR
Enquiry Rm X6

7th December, 1983

Dear Donna,

I now have a list of names for the meeting with the Chancellor on Thursday, 12th January, at 4 p.m. at the Treasury, on CBI Budget Representations:

Sir Campbell Fraser, President, CBI
Sir Terence Beckett, Director-General, CBI
Sir James Cleminson, Deputy President, CBI
~~Mr. Ken Durham, Chairman, CBI Economic & Financial Policy Cttee~~
Mr. Alan Willingale, Chairman, CBI Taxation Committee
Mr. Jeremy Pope, Chairman, CBI Smaller Firms Council
Sir Donald MacDougall, Chief Economic Adviser, CBI
Mr. Ken Edwards, Deputy Director-General, CBI
Mr. John Caff, Director Economic Affairs, CBI
Mr. Keith McDowall, Director Information, CBI
Mr. Douglas McWilliams, Deputy Director Economics, CBI
Mr. David Higham, Head of Economic Policy Department, CBI
Mr Mervin Woods, Head of Tax Dept.

If you could let me have the names of those attending from the Treasury some time, I should be most grateful.

Yours sincerely,

Linda.

(Personal Assistant to
the Director-General)

Miss Donna Young,
Diary Secretary,
Chancellor's Office,
H.M. Treasury,
Parliament Street,
London, S.W. 1.

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Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI

J Moore Esq
Financial Secretary
Her Majesty's Treasury
Parliament Street
LONDON SW1P 3AG

FINANCIAL SECRETARY	
REC.	-3 JAN 1984
ACTION	Mr Prescott - IR
COPIES TO	PPS CST MST EST
	Sir P Middleton
	Mr Cassell
	Mr Monger

Mr R I G Allen
Mr Chivers
Mr Lord PS/IR

29th December, 1983

Dear Mr. Moore,

As you will know there have been substantial developments in the extent and type of the provision of finance for smaller firms since I last discussed the idea of Small Firms Investment Companies (SFICs) in detail with your predecessor, Nicholas Ridley, and with officials at the Treasury. On taking up your new post I thought it would be useful to write setting out our latest thinking on this concept.

I attach a note setting out briefly the proposed role and structure of a SFIC as we see it.

Since the CBI first advocated the introduction of SFICs the Government has of course launched the Business Start-Up Scheme and subsequently the Business Expansion Scheme (BES) which have gone some way towards meeting the need to provide more equity investment in smaller firms and which the CBI welcomed. However I believe the need for simplicity has been sacrificed in favour of the somewhat illusory advantages of direct investment.

We still feel that the BES falls short - in means rather than aims - of what could be achieved in this area. Our 1984 Budget Representations will therefore argue that there is still a need for SFICs and that these could now be introduced as an extension of the BES. This could be achieved through the review of the BES which I know you are undertaking.

The drawbacks of the BES at present include :

- the difficulty of spreading risk; although Approved Investment Funds, however cumbersome, are of some assistance here

- uncertainty as to whether an investment will qualify and if so when any tax relief will actually arise;

- the inability of a person even indirectly to invest in the company that employs him;

- the uncertainty of ultimately selling the shares purchased and thereby realising the proceeds of the investment;

- the complexity for the investor and the Inland Revenue of working through Approved Investment Funds.

This has meant that so far the typical investor under the BES has probably had to be a fairly sophisticated person, perhaps with a marginal tax rate near the maximum of 75 per cent and with something near the limit of £40,000 to invest. We should like to see the appeal of the scheme spread much wider, both because this would make additional funds available for investment and because it would mean more people having a positive interest in the smaller enterprises which contribute significantly to the nation's wealth. We warmly welcome the concept of a capital owning democracy advocated by the former Secretary of State for Trade and Industry and by Mr Alex Fletcher in particular. However it is important to make this development as easy as possible.

For the ordinary member of the public who would like to have a financial stake in business, the only sensible and prudent way is through some intermediary which spreads the risk and administers the investment. Such people with relatively small amounts to invest cannot afford to spread the risk for themselves nor do they have the expertise to do so. It makes no sense to put all their savings directly in one or a few, by definition, risky businesses about which they may know little. However, the intermediary must be one which it is easy for them to understand, identify with and see the benefits of, if the take up is going to be significant.

If the intermediary was a fund operated by our proposed SFIC, spread of risk would be automatic (in contrast to the rigid and cumbersome method under BES' Approved Investment Funds); tax relief would arise earlier when shares in the fund were bought, providing greater certainty and therefore greater incentive; and it would be much easier to provide a market in shares in the fund than in each of the individual invested companies. Indeed the SFIC, as a PLC, could be quoted on the USM or Stock Exchange. This would mean that investors could be confident of realising any gains made on their investment. Invested Companies would not necessarily need to have a high chance of eventually becoming quoted before they could attract investment from a fund.

Furthermore, we envisage that SFICs would be relatively easy to set up on a local basis providing a fund with which local investors could readily identify and be involved. I know that one or two regionally-based funds have now been set up under the BES but we believe the idea would spread much wider and much faster if SFICs were available.

If you or your colleagues should wish to discuss these ideas any further we would of course be pleased to do so.

Because of his interest in the subject I am copying this to David Trippier MP at the DTI.

Yours sincerely

Jeremy Pope

Jeremy Pope
Chairman
Smaller Firms Council

enc

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Director-General
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Secretary
Denis Jackson

CBI

SMALL FIRMS INVESTMENT COMPANIES

A Small Firms Investment Company (SFIC) would specialise in taking equity in, and making long-term loans to new and established smaller companies. It would act as an intermediary between willing investors and companies in need of finance. Monies invested in a SFIC by individuals and financial institutions would be pooled and then invested in a portfolio of selected smaller companies.

The SFIC is a development of the Small Business Investment Company which has operated successfully in the USA since 1958.

A SFIC would operate with the approval of the Inland Revenue and would be permitted to invest in companies which meet the eligibility criteria specified in the Business Expansion Scheme (BES) by which an individual investor may obtain tax relief.

A SFIC would be exempted from CGT and tax on income in respect of its allowable investments in eligible companies, in a similar way to other investment institutions.

A SFIC itself might be a public or private company, listed or unlisted. It would be able to attract funds from individuals who would qualify for the tax incentives available under the BES when subscribing for new shares in a SFIC. A SFIC would also attract investment capital from financial institutions.

It is for consideration whether modest tax incentives should be provided for institutions supplying loan and/or equity finance to a SFIC.

In addition to the existing rules under the BES the following conditions would be put upon investments by a SFIC :-

- the ratio of a SFIC's loan to equity investment in a single company could not exceed 1:1;

- a SFIC could not raise loans in excess of twice the value of its own equity;

- money raised by a SFIC through an issue of shares could only be used for subscription for new shares in eligible companies within a two year period after the end of the tax year in which the shares were issued, and after this initial period an average of at least 80% of the SFIC's equity plus loan capital would have to be invested in or lent to eligible companies during any financial year;

- a SFIC should never hold more than 49% of the voting power in any company, nor should it invest more than 20% of its assets in any particular company;

- a SFIC's performance would obviously have to be monitored in some way to ensure that it complied with these conditions - if it failed to do so the Inland Revenue could be empowered to remove its tax privileged position and if appropriate claw back relief from investors.

A SFIC might specialise in a particular industrial sector or geographical area. SFICs would provide a readily identifiable source of equity and long-term loan finance and specialist advice for smaller companies, and collectively would cover a very wide range of such companies. They would go a long way to solving the problem of marketability which often deters people from buying private company shares since shares in a SFIC (which might be quoted) would in general be more easily sold than shares in a small private company.

SJCC/SAJ
14.11.83

FROM: H C GOODMAN
DATE: 11 JANUARY 1984

1. MR BATTISHILL 11/1

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Monck
Mr Monger
Mr Beighton - IR
Mr Painter - IR
Mr Wilmott - C&E

without attachments:

Mr Lovell
Mr Folger
Mr Hart
Mr Hall
Mr Shields
Mr Smee
Mr Halligan
Ms Rutter
Mr Norgrove
Mr S Davies
Mr S Webb
Ms S Walker
Mr Wynn Owen
Mr Ridley

MEETING WITH THE CBI

You are seeing the CBI tomorrow. Attached is the CBI cast list. On the Treasury side, with yourself, will be the Chief Secretary, the Financial Secretary, the Economic Secretary, the Minister of State, Sir Peter Middleton, Sir Terence Burns, Mr Battishill, Mr Monck, Mr Monger, Mr Beighton (IR), Mr Painter (IR) and Mr Wilmott (C&E).

2. You already have a copy of the representations and I am attaching other copies for those attending the meeting. These representations are still in draft. After your meeting the paper will go to the CBI Council for final approval on 18 January and will be released to the press on 25 January. The CBI plan to give no publicity to the meeting with you or to their Council meeting next week.

see note at end

3. You will not wish and the CBI will not expect you to reveal much of your own thinking about the Budget, but this will be an opportunity for you to comment on the representations and to influence them so far as you consider this to be right and

prudent. Nonetheless this should be a useful opportunity for hearing the CBI's views in more depth.

4. Attached are briefing notes on the main parts of the draft representations for which I am grateful to other divisions; the Revenue departments have prepared notes on each of the tax recommendations. The paragraphs below give a brief summary of the CBI proposals together with one or two possible points to make on each.

CBI PROPOSALS

5. We understand that in this discussion the CBI intend to put their representations in a medium term context. This is, at least in part, because they have revised upwards their view of prospects in 1984 and are now concerned more about 1985. The first section of the document summarises their representations.

SECTION II: MEDIUM TERM

Annex A 6. The CBI's projections of government receipts and expenditure to 1987-88 assume steady growth of 3 per cent pa, and public spending held constant in cost terms. The results allow tax cuts of £8 billion over the period. In part the CBI believe that tax cuts can be paid for by higher borrowing. They argue that this will not raise interest rates as their proposals to raise capital and lower current spending would improve the quality of the PSBR.

7. Looking further ahead, the CBI argue that once North Sea oil revenues have peaked in 1987-88, the need for improved competitiveness in the rest of the economy in order to sustain our balance of payments position, will become more urgent.

Comment

8. (1) Welcome this emphasis on the medium-term

(2) Very much agree with priority CBI attach to lower taxation, but not at the expense of higher borrowing.

SECTION III: ECONOMIC BACKGROUND

Annex B 9. They are more optimistic about prospects for 1984 than when you met them in the autumn, but are now concerned that the recovery may peter out in 1985. They argue that consumption growth will slow in 1984 and that current indications are that investment and exports will not pick up sufficiently to maintain GDP growth of 3 per cent per annum. They forecast an £8 billion PSBR in 1984-85 without need for a negative fiscal adjustment.

Comment

10. (1) CBI already more optimistic on 1984 than 3 months ago, but the fears have been pushed back a year.

(2) Consumption continuing to grow strongly, profits up, and investment and world trade rising, more than they suggest. Will be publishing with the Budget a forecast up to mid 1985, but take encouragement that present performance is not as gloomy as CBI had suggested.

1984 BUDGET

11. In order to overcome what they see as the short-term difficulties and the problems once the oil revenues have peaked, the CBI believe the immediate need is to improve competitiveness. The role they see for Government in this is to reduce "the costs it directly imposes on business". In particular they call for

Annex C

- the abolition of NIS
- 10 per cent partial business de-rating

and a one percentage point reduction in the rate of employers' NICs to take effect in 1985-86.

Comment

Annexes C, D and E

12. (1) Agree that there is a need further to reduce Government imposed burdens on business, though much has already been achieved. Committed to abolish NIS over the life of the present Parliament.

(2) Cannot have lower taxation <u>plus</u> higher borrowing <u>plus</u> lower interest rates.

(3) Welcome CBI's support for restraining LA expenditure and improving efficiency, particularly useful if CBI could re-iterate its support before Second Reading of Bill on 17 January.

You wanted to stress this

(4) 10 per cent business de-rating would cost £500 m; without expenditure reduction this would mean higher rates or taxes for others. Real solution is for local authorities to control their expenditure.

SECTION IV: TAXATION

13. In the 1984 Budget the CBI believe that the corporate sector should take priority over cuts in the burden of personal taxation and recommend that personal tax allowances are only increased in line with inflation. The CBI have also submitted detailed proposals on taxation; they are unlikely to raise many of these at the meeting.

Comment

14. You will not wish to commit yourself on tax changes for the Budget. You might draw on the detailed notes attached as necessary.

15. The CBI set out the revenue costs of their proposals for 1984-85 in table 1.1 (page 5). These figures are correct; however the 1985-86 cost of the tax proposals in the table would be much greater - of the order of £3.2 billion, as compared with £2.2 billion for 1984-85. Moreover it does not include the cost of reducing employers NICs by 1 percentage point, bringing the 1985-86 cost of the CBI's tax proposals to nearly £4½ billion, a little above the fiscal adjustment for 1985-86 shown in the 1983 FSBR (£4 billion).

Annex F **SECTION V: PUBLIC EXPENDITURE**

16. The CBI have not included public expenditure proposals in their Budget arithmetic and we do not expect them to raise this tomorrow. They are planning a separate submission on this in May timed to influence the new PES round. (They recognise that it is too late to have much effect on spending plans for 1984-85.) However, if they do raise this you may wish to turn to Annex F which contains short notes on their suggestions. You will notice that although they specify the increases in capital spending which they wish to see, their proposals for reducing current spending are limited to generalised improvements in efficiency and management.

SECTION VI: LOCAL AUTHORITY FINANCE

Annex E 17 The CBI support Government measures to restrain LA expenditure and measures to encourage efficiency. They believe that a first step towards longer term reforms would be made in this Budget with 10 per cent derating of businesses (see above).

HC Goodman.
H C GOODMAN

I would only emphasise two points:

(a) you may need to confirm that the CBI see this as a private meeting with no press statements: it is not unknown for this to go wrong;

(b) they do not really face up to the choice between lower taxes and lower interest rates, and may need to be pressed to face up to this.

[illegible initials]

We do not want a repeat of the IoD episode!
B.

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Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI
CONFEDERATION OF BRITISH INDUSTRY

FST
EST
MST
Mr Middleton
Sir T. Burns
Mr Ansen
Mr Monger
Mr Battishill

7th December, 1983

Mr Wilmott C&E
Mr Painter IR
Enquiry Rm X6

Dear Donna,

I now have a list of names for the meeting with the Chancellor on Thursday, 12th January, at 4 p.m. at the Treasury, on CBI Budget Representations:

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Mr. Keith McDowall, Director Information, CBI
Mr. Douglas McWilliams, Deputy Director Economics, CBI
Mr. David Higham, Head of Economic Policy Department, CBI
Mr. Mervyn Woods, Head of Tax Dept.

If you could let me have the names of those attending from the Treasury some time, I should be most grateful.

Yours sincerely,

Linda.

(Personal Assistant to
the Director-General)

Miss Donna Young,
Diary Secretary,
Chancellor's Office,
H.M. Treasury,
Parliament Street,
London, S.W. 1.

CC: MH, NP
DPS

NI5467 4 XXX 216
GROWTH 'CHANCELLOR'S ONLY CHOICE' - BECKETT

CHANCELLOR NIGEL LAWSON HAS NO ALTERNATIVE BUT TO TRY TO BOOST ECONOMIC GROWTH IN HIS MARCH BUDGET, CBI DIRECTOR GENERAL SIR TERENCE BECKETT SAID TODAY.

''LAWSON'S CHOICE IS HOBSON'S CHOICE,'' HE TOLD BRITISH LEATHER FEDERATION MEMBERS AT A LUNCH IN LONDON.

''THE THREE LARGEST ECONOMIES IN THE FREE WORLD, AMERICA, JAPAN AND GERMANY, ARE ALL SHOWING REAL GROWTH, AND THE WORLD ECONOMY AND WORLD TRADE IS REALLY STARTING TO MOVE.

''IF BRITAIN IS TO PARTICIPATE FULLY IN THIS GROWTH, IT MUST IMPROVE IN INDUSTRIAL COMPETITIVENESS. THIS NEXT BUDGET IS THE TIME TO ACT,'' HE SAID.

SIR TERENCE SAID THE MEASURES INDUSTRY EXPECTED FROM MR LAWSON WERE:

::ABOLISH THE JOBS TAX, THE 1P NATIONAL INSURANCE SURCHARGE ON THE PAYROLL OF EVERY BUSINESS, WHICH COSTS BRITISH BUSINESS £1 BILLION A YEAR.

::CUT BY 10 PER CENT THE £6 BILLION A YEAR RATES BURDEN IMPOSED ON COMMERCIAL ENTERPRISE.

::INCREASE CAPITAL INVESTMENT IN PUBLIC PROJECTS LIKE TRANSPORT AND COMMUNICATION. ''YOU ARE UNCOMPETITIVE IF YOU CAN'T DELIVER THE GOODS AT LESS COST AND ON TIME.''

::ENCOURAGE ENTERPRISE BY MEASURES TO ENABLE PEOPLE TO BUY A STAKE IN THE COMPANIES THEY WORK FOR - PARTICULARLY IN PROGRESSIVE SMALLER FIRMS WHICH WERE THE SEED-BED FROM WHICH BIG BUSINESS OF THE FUTURE MIGHT GROW.

--

261409 JAN 84

Standard PPS 12/2

SIR TERENCE BECKETT - INTERVIEW ON BUDGET REQUIREMENTS FOR BUSIESS

Trancript from: BBC Radio 4, Today, 13 January 1984

INTERVIEWER : (Brian Redhead) ... Sir Terence Beckett, the director general of the CBI, called upon the Chancellor of the Exchequer yesterday to tell him what the CBI would like to see in the Budget. Sir Terence is here and he will now tell us what he would like in the Budget. I imagine you want a Budget that will encourage recovery so what do you want?

BECKETT: Yes that's exactly what it is Brian, it's to encourage recovery by improving industry's competitiveness. And what we said to the Chancellor yesterday was that we wanted, as he's got a medium term financial strategy, we wanted in effect a medium term business strategy to match it. And the main things that we're after are a reduction in the National Insurance surcharge. Government has made a lot of progress on that. We want the thing now finally polished off. The Prime Minister has called it a pernicious tax on jobs. And we really do need to see the back of it. Rates are the single biggest burden we've got, costing us £6 billion, industry and commerce, this next year. And then thirdly we want an enterprise package to encourage small firms and also to get that real commitment of employees to their own companies and thir business.

INTERVIEWER : Well I hope the Chancellor though in hearing all that said to you but what are you going to do yourselves to make yourselves more competitive? I mean its dozy and inefficient managment that is the weakness in British industry?

BEKCETT: I don't fully agree with that. You might have been able to say that some years ago but there has been a radical change in management attitudes which, incidentally, we've recorded in a very recent survey. The Chancellor didn't say that to us

Standard.

SIR TERENCE BECKETT - INTERVIEW ON BUDGET REQUIREMENTS FOR BUSINESS

Transcript from: BBC Radio 4, Financial World Tonight, 12 Jan 1984

INTERVIEWER : (Rodney Smith) ... Getting in early, as it were, the CBI's most senior men spent an hour today with the Chancellor of the Exchequer outlining what they think would be most appropriate to help British companies in this year's Budget. The sterling rate is lower everywhere, but not quite low enough, inflation is down and there is some recovery in the economy. So what were they asking for this time? CBI director general, Sir Terence Beckett:

BECKETT: We asked the Chancellor , and the whole of the Treasury team, this afternoon to keep the present recovery going. The Chancellor, as you know, has a medium term financial strategy. What we were really describing to him was our medium term business strategy. The essential core idea behind it is that the only way we're going to get our share of this improving world business that we shall undoubtedly see in 1984 is if our competiveness is improved from present levels. So everything that we said to the Chancellor today is directed towards improving that competiveness. And we've got an enterprise package to improve our enterprise.

INTERVIEWER : Almost the only thing the Government can do about competiveness is to change the value of sterling, that's about all they can do?

BECKETT: No, I must disagree with you on that. They can of course reduce the burdens, the cost burdens, on industry. Incidentally, let me say that we in industry are absolutely convinced that most of this effort has got to come from us. But as far as Government's concerned there are two things they can do for us. One of them is finally to abolish what the

the Prime Minister has called a pernicious tax on jobs, the National Insurance surcharge. And then secondly, over and above this rate capping that the Government is proposing we do want a derating of industrial and commercial premises by about 10% in line with the reduction the domestic ratepayers get. If we could get those two off we would then be reducing the tax burden on industry and commerce, improve our competitiveness, we'd get a bigger share of world markets, more jobs, more prosperity.

INTERVIEWER : So broadly speaking, those things that you'd like the Government to do for you are much the same this year as they were last year?

BECKETT: Yes, and let me tell you that this thrust of competiveness is the thing we shall be asking for next year and the year after that as well because this is our medium term business package.

Standard PB Mr Bridgeman MR Saunders MR Pirie

JOHN CUMMING (WOOLWICH)
HERBERT WALDEN (BSA) - INTERVIEWS ON NEW CROSS FAILURE

Transcript from: BBC Radio 4, Today, 13 January 1984

PROGRAMME PRESENTER: .... Alinka Frankle talked to the chairman of the Buildng Societies Associaition, Herbert Walden, and the Woolwich chief executive, John Cumming. Mr Cumming told her the Wolwich had no choice but to freeze the New Cross funds:

CUMMING: This I'm sure seems hard to your listeners. It is a sadness to us but we felt that it was essential.

INTERVIEWER : So that means £150 million of investors funds are now frozen and can't be removed?

CUMMING: In broad and general terms yes, but we have said that we - with the management of the New Cross - will look at any and every case of hardship. If this should hurt any investors of the New Cross then do please write in, phone in, to the head office of the New Cross, and we will look at that.

INTERVIEWER : Mr Walden, as chairman of the Building Societies Association have you ever seen something like this happen before?

WALDEN: Exactly like this no. This is, I would like to emphasize this, it is an isolated and an unusual case. And as chairman of the Association I am more than grateful to the Woolwich for agreeing to accept the transfer of engagement to help the investors of the New Cross. And what I would like to do is emphasize that unfortunate as it is for those investors, it is a relatively small number of investors in building societies, 25,000 as against 25 million total investors in building societies. And I would like to reassure the investors in other building societies as to the safety of their funds. That is not in question at all.

INTERVIEWER : Does it suggest though that perhaps there ought to be stricter controls sooner on smallbuilding societies?

WALDEN: I think it is wrong to separate small, medium or large building socieites in this direction. The controls are there. You have a situation here, the Chief Registrar has exercised those controls. What he has done has been tested in two courts, the High court and then the Court of Appeal and the court of appeal have upheld him. And it is right that the Prudential supervisor should be able to take action when he thinks it to be necessary, and here he has done that very thing.

2—

yesterday in fact, because only on the previous day at the National Economic Development Council I gave him a paper on what industry is doing in terms of what we called non price competiveness. A couple of months ago we went into price competiveness. All the things we've got to do on costs, getting wage settlments at reasonable levels, improving our productivity and so on. But a couple of days ago what we described to him that what we've got to do as to; on product, on marketing, on quality on delivery, very detailed plans that all these little Neddy's will be working on. I beleive, Brian, we've got a combination now at the present time of new attitudes which, together with new technology over the whole spread of industry, really can begin to transform our position. That's what we're after.

INTERVIEWER : And did your pleas to the Chancellor fall on deaf ears, or did you get the feeling that he was in sympathy?

BECKETT: There's no way of course at this stage, as you know, that the Chancellor can indicate what his intentions are in the Budget. What I'm absolutely clear on from the Government's track record is the things that we are proposing in this Budget are the things that we and the Government want to do. How much they'll be able to do in this Budget and how much in the Budget after that and so is still a matter for decision. There is a risk, as you know, at the moment of interest rates going up unfortunately, largely because of the American position. So it isn't an entirely easy situation. I'm sure his intentions are the same as ours which are to get Britain going, get this economy moving, provide more jobs and better living standards.

Standard MR Saunders
PB MR Pure
M Bridgeman

REG ROLAND - INTERVIEW ON TREATMENT OF NEW CROSS SOCIETY

Transcript from: BBC Radio 4, Financial World Tonight, 12 Jan 1984

PROGRAMME PRESENTER: (Rodney Smith) .... Drams in the building society world are relatively few and far between. But we had one tonight, when, at a hastily summoned news conference, it was announced the the New Cross Building Society was going out of business. It's been rescued by the Woolwich. The Society, which has been noted for its rapid growth and for the high rate of interest paid to some 25,000 investors, has been locked in a legal battle with the Chief Registrar of Friendly Societies for the past 6 months. And, as Vincent Duggleby reports, this went on without the public knowing a thing:

DUGGLEBY: This is the first time that the Chief Registrar, who's responsible for the supervision of building societies, has exercised his powers to close one down in this way. And it's a decision that has been bitterly contested by the directors of the New Cross. In May last year the Registrar concluded that if the existing policies and present managment of the Society continued there was a distinct risk that the New Cross would not be able to pay investors in full. There was no allegation of fraud or dishonesty. He served an order under Section 48 of the Building Societies Act, which would have meant that the New Cross would no longer be able to take money from the public.. But following an appeal to the High Court in November the judge concluded that the chief registrar had exceeded his powers and had reached conclusions which no reasonable REgistrar could properly have reached. The Registrar in turn went to the Court of Appeal and they reversed the ruling last month. But not a hint of all this reached the public At this stage though the New Cross decided there was no alternative but to seek a merger, or transfer of engagements as it's called to another society.

And after a request from the Building Societies Association the Woolwich, which like the New Cross is based in south east London, and is the fifth largest in the country, came to the rescue. But as the New Cross closed the doors of its 10 suburban branches in London tonight investors are being told they'll have to wait, probably until early March, before they can get their money out. Borrowers are unaffected and will continue to make mortgage payments as usual. The end of the New Cross Society comes after 118 years but it was only in the last 8 years that they started to grow; from £6 million of assets in 1975 to £153 million at the end of last year, which put them among the top 50 societies. And it was this growth that worried the Registrar as well as their failure to meet certain regulations, including that for trustee status. Nonetheless, New Cross chairman, Reg Roland, feels the society has been treated very unjustly:

<u>ROLAND</u>: I think this has been borne out by the fact that the first time in history a Chief Registrar has been overuled by a High Court judge who said that he considered the registry's decision was unreasonable. And this is the first time, to my knowledge, in the the history of the building society movement it's ever happened.

<u>DUGGLEBY</u>: Nonetheless, the registrar did feel that investors mmight have been at risk. Are you saying they weren't?

<u>ROLAND</u>: They were at risk. They were less at risk with the New Cross than they are with many other societies. Because we have deliberately carried a high liquidity ratio at the New Cross in order that any of their members could have their money when they wanted it.

Annexes:-

A - The Medium Term Programme

B - Economic Background, including interest rates and monetary policy

C - Government Imposed Costs in UK and other countries

D - NIS and NICs

E - Local Authority Finance

F - Public Expenditure, including energy costs

G - Tax

Annex A

CBI BUDGET REPRESENTATIONS: SECTION 2

THE MEDIUM TERM PROGRAMME

The CBI provide projections of government receipts and expenditure in 1987/8 on the assumptions of:

(i) 3% p a steady growth from 1982/3 to 1987/8;

(ii) A small fall in the ratio of tax revenue to GDP even in the absence of any tax cuts;

(iii) Public spending held constant in cost terms, so falling as a share of GDP by 5½ percentage point in the next 4 years.

On these assumptions, an £8 billion reduction in taxes is possible by 1987/8, while still permitting a fall in the PSBR from 3¼% of GDP currently to 1½% of GDP. Comment There can be no disputing that if GDP grows as fast as projected and if expenditure does not grow at all there will eventually be room for large cuts in taxation. However

(i) it is completely fallacious to argue that if £8 billion is available sometime over the next 4 years, then a quarter of it (or rather more than a quarter) can be given away in the next budget. Whether any money at all is available for tax cuts now depends on the forecast for expenditure and taxes next year, not on the 1987/8 projection.

(ii) CBI have nothing but pious hopes to explain how the 3% growth rate can be achieved without risking some resurgence of inflation; exports are assumed to perform much better relative to world trade than in the past, pay settlements lower than in competitor countries, continued rapid increases in productivity.

Points to Make

While many features of the projection are in line with our own aspirations for the economy, current fiscal decisions cannot be based on this hypothetical outcome. The right time to cut taxes will be when public borrowing has already started to fall.

While we agree with the CBI that industrial competitiveness is a key element in sustained growth and hence a reduction in industrial costs is desirable, the good export performance that CBI forecast will not be possible if a higher PSBR leads to higher interest rates and a less competitive exchange rate.

If the economy actually does perform in line with CBI projections this would represent a transformation of economic performance compared with the last decade. The implication is that the policies pursued so far have been suceessful in changing the underlying behaviour of the economy and should not be undermined by relaxing fiscal policy.

The CBI note that high inflation is damaging to the economy and low inflation vital for sustained growth. We agree. Further reduction in inflation should be an important element of the medium term programme, and again this points to maintaining policies which have already succeeded in cutting inflation.

Annex B

CBI BUDGET REPRESENTATION: SECTION 3

Economic Background

(i) CBI Economic Forecast

The CBI's projections for the short term are very similar to other outside mainstream forecasting institutions. GDP growth is expected to slow down to 2 per cent or just under in 1984 and inflation to rise slightly (but still to be "under control"). Consumption growth is forecast to slow to $1\frac{3}{4}$ per cent in 1984 (no figures are given in this document). The CBI's recommendations are partly designed to bring GDP growth rate up to a "steady 3 per cent p.a.".

(ii) Points to make

(a) CBI forecast too gloomy about short-term prospects: consumers' expenditure still growing strongly ($3\frac{3}{4}$ per cent in year to 1983Q3) with real personal disposable income up by $2\frac{1}{2}$ per cent same period. DTI Investment Intentions Survey suggests, if anything, that Autumn Statement forecast for investment could be on the low side: manufacturing investment expected to rise by about 9 per cent cent in 1984; other business investment by 6 per cent. CBI also seem rather pessimistic about world recovery over next few years. (Paragraph II.20 suggests only 3 per cent p.a. growth between 1982-83 and 1987-88 in world trade).

(b) Recovery in private sector expenditure could be endangered by impact of higher PSBR on interest rates if CBI's recommendations are followed.

(c) Company incomes are now rising very fast: ICCs profits up by 25 per cent between first three quarters of 1982 and 1983. Latest data suggest ICCs achieved very large financial surpluses in 1983.

(d) There is a danger that, in this improved climate for companies, reductions in NIS and other business costs might be passed on as wage increases. And the higher PSBR brought about by such concessions would impede progress towards lower interest rates, thus implying higher company costs.

(e) Companies have shown in the past two years that the way to improve competitiveness and profitability is through higher productivity growth and holding firm on wage increases.

SECTION 3

CBI Views on Interest Rates and Monetary Policy

The CBI argue that

- though nominal interest rates have fallen, real rates are still high by historical standards.
- "the Government can influence interest rates and ... there is scope for further cuts"
- "we do not feel that monetary conditions necessitate keeping interest rates at their current high level given that inflation has fallen" (they point to MO's growth being slower than that of target aggregates as evidence of scope for interest rate cuts).

POINTS TO MAKE

(a) Nominal interest rates

- Base rates now back at their lowest level for 5½ years, 7 points below their peak in October 1981.

(b) Real interest rates

- Acknowledge CBI's point that real rates, especially tax element, are difficult to measure.

"

- Real rates high as economy adjusts to lower level of inflation, just as real rates were negative when inflation accelerated in the 1970s.

"

- UK real rates now comparable to those of 1950s and 1960s.

"

- Bank of England December bulletin stated:-
  "In the 1980s, real interest rates faced by tax-paying companies have been lower in the UK than in the United States and Germany. Non-tax paying companies in the UK also face lower real rates than non-tax paying German and US companies".

(c) Monetary growth

- Banking December figures suggest £M3 at top of target range, with PSL2 and M1 still outside.

"

- MO's growth could be expected to be below that of the current target aggregates over the target period since the upward trend in the velocity of MO, with its main components notes and coin, is much greater than the velocities of broader aggregates.

"

- Monetary growth under control, with six month annualised rates for all target aggregates at or slightly below the mid-point of their target range, but this does not necessarily feed through into immediate cuts in interest rates.

Annex C.

CBI BUDGET REPRESENTATIONS:

GOVERNMENT IMPOSED BUSINESS COSTS IN UK AND OTHER COUNTRIES

1. No evidence UK firms unduly burdened compared to those in other major western economies.

2. As percentage of GDP or total taxes, conventional business taxes (ie corporation tax, employer's NIC, NIS, non-domestic rates, stamp duty etc) put UK in about middle position.

3. CBI may argue conventional comparisons misleading: need to take account of occupational pension schemes in UK, which are counterpart of payroll-tax-financed state schemes abroad. Recent IFS study takes account of this: but UK still much in line with major competitors. Alternative definitions do not alter picture.

4. As percentage of profits, UK business taxes seem high. But comparison not very meaningful. Company profits struck after deduction of most of business taxes, which form part of costs of production.

5. CBI may also raise point of training costs. No comprehensive data available for other countries. But France and Germany impose more onerous legislation structure on employer training than UK.

Annex D

CBI BUDGET REPRESENTATIONS

CHAPTER IV: TAXATION

NATIONAL INSURANCE SURCHARGE AND CONTRIBUTIONS

The CBI propose immediate abolition of NIS, with clawback from central and local government but not public corporations (which are, of course, members of the Confederation). This would cost £900 million in 1984-85 and so is unlikely to be possible. But it may be possible in 1985-86 if the changes in company taxation currently under consideration (abolition of stock relief and reduction in the rate of some capital allowances) are implemented in the 1984 Budget. We assume, however, that you will not wish to raise this trade-off with the CBI at this stage. You might simply point out that the Government's stated aim is to abolish NIS over the lifetime of the present Parliament and that the substantial cost of immediate abolition poses obvious difficulties given the forecast fiscal prospect.

2. The CBI also propose an early announcement that employers' National Insurance contributions will be reduced by at least 1 percentage point in 1985-86 and that there should be a "temporary stabilisation" in the bands for NICS.

3. The gross full year cost to the National Insurance Fund of reducing employers' contributions by 1 per cent would be around £1,200 million (the CBI estimate much the same at around £1,150 million). The CBI propose that this shortfall in income to the Fund should be met by increasing the Treasury supplement. An increase in the Treasury supplement would, however, simply increase the burden on the taxpayer (though by somewhat less than £1,200 million since some part, around £400 million, would in any case have come from within the public sector). This would reverse the policy adopted by the Government in recent years to contain the burden on the general taxpayer of social security expenditure.

4. For 1984-85 the Government have decided to make no change in the rates of employer and employee contributions but to increase the Upper Earnings limit broadly in line with the expected movement in earnings - from £235 to £250. Overall the cash burden on employers rises by £700 million - but only £80 million of this arises from the change in the upper earnings limit - the rest is the effect of higher earnings, which emphasises the need for employers to contain pay increases. Also, when account is taken of the National Insurance Surcharge, the overall cash burden on all employers rises by only £330 million - less than 3 per cent - hence well below assumed increase in both prices and earnings.

5. In discussion you might point out that an increase in national insurance contributions over the last few years has been necessary, partly to meet the increased cost of benefits paid from the National Insurance Fund and also to contain the shift in the burden of social security benefit expenditure from the contributor to the taxpayer. Employers, however, have been largely protected from this increased burden; and the small rise in the employers' National Insurance contribution since 1979 has been much more than offset by the reduction in the National Insurance Surcharge in the same period. Employers' contracted-in contributions rose by 0.2 per cent (to 10.2 per cent) in 1980 and by 0.25 per cent (to 10.45 per cent) in 1983 - a total rise of 0.45 per cent. Employees' contributions, in contrast have risen by 2½ per cent. [Contracted-out contributions have risen by rather more (a total of 0.85 per cent for employers and 2.85 per cent for employees) but these higher contributions will be offset by the lower cost of providing for occupational pensions.] The National Insurance Surcharge during this time has been reduced from 3½ per cent to 1 per cent. So the combined burden on employers of both contributions and surcharge has fallen significantly - from 13.5 per cent to 11.45 per cent, saving private sector employers about £1½ billion a year.

Annex E

6. LOCAL AUTHORITY FINANCE

The need for control

Welcome the CBI's strong support for the measures taken by the Government to restrain LA expenditure and encourage greater efficiency. Would urge the CBI to voice its belief in the desirability in particular of rate capping. Particularly useful if CBI could reiterate its support for the legislation - as it does in the Budget representation document - before Second Reading of the Bill on 17 January.

10 per cent business/industrial derating

The CBI argue for a 10 per cent derating of all businesses in England and Wales, although they suggest that industry alone has a particularly strong case for relief. Local revenues would be reduced by £500 million by a 10 per cent derating of businesses, by £140 million if only industry is derated. In so far as expenditure was not reduced this would mean higher rates for all other ratepayers or, if the government sought to compensate local authorities, higher grant i.e taxes. The Inland Revenue Valuation Office would require extra staff and primary legislation would be required. The real remedy lies in local government controlling expenditure and that is where the Government's effort is directed.

Rate relief for partially used premises and plant: "Mothball Relief"

Although the Government has decided to suspend rates on empty industrial property, "mothballed" property is quite a different issue. It refers to industrial property which is only partly in use, where machinery etc remains in place in a section of a factory which is not (and probably cannot be) separately valued. Though there is a vocal lobby in favour of some form of "mothballing" relief, we believe that it would be technically impossible to operate.

Empty business property

The Government intends that local authorities' powers to levy rates on empty industrial property shall be suspended from 1 April 1984. Authorities will still retain discretion to levy at up to 50 per cent of full rates on empty commercial and other non-domestic property

- though fewer than half of the LAs actually do rate empty properties. Industrial ratepayers are being given particular protection because it is industrial property on which there is a surplus under prevailing market conditions which cannot be brought fully into use whereas there is reasonable demand for commercial property in many areas.

Annex F

PUBLIC EXPENDITURE - GENERAL

The CBI's general comments on expenditure are likely to concentrate on the case for more capital expenditure. In reply the Chancellor might say:-

a) The conventional definitions significantly understate public sector capital expenditure as it would be understood in any business. If the figures are adjusted for sales of council houses and to include defence capital spending and all nationalised industry capital expenditure, the total is around £24 billion,

b) Details will be given in the PEWP in mid-February (both the old and the new presentations will appear) but can say now that in real terms the level of this expenditure has been broadly the same - fluctuating only slightly from year to year - since 1978-79.

c) In 1979-80 (we have no corresponding figures for 1978-79), new construction other than dwellings amounted to 36% of public sector expenditure on capital goods and services. In 1983-84 it accounted for 38%.

d) The government is at one with the objectives stated by the CBI in para V(5) of their paper, which are unexceptionable to the point of being anodyne. Also share CBI's wish to reduce business costs. But must ensure that projects a) earn a satisfactory return and b) would not be better undertaken in the private sector.

Detailed Expenditure Proposals

INNOVATION SUPPORT

Points to make

(a) Expenditure has more than trebled since the Government took office.

(b) Further funds are being made available as a result of the recent Survey discussions. Details will be available in the White Paper.

ENERGY COSTS

Points to make

Electricity We will want to study your recent review of pricing in relation to continental competitors. Welcome acknowledgement of help given to large users in previous budgets (worth over £100 million). It is difficult to go further without running into either domestic or EC legislation on undue preference.

Fuel Oil Duty. The level of duty has not changed since March 1980 (ie a 20 per cent fall in real terms). Linkage to Trigg gas contracts means that reduction would give rise to disproportionate costs for industry elsewhere.

Background

Department of Energy are beginning to assess the CBI's review of electricity prices in comparison with continental users. Generally the report confirms that average prices to industry are in line but predictably it highlights a core of high-load factor high intensity users where there is a significant disadvantage.

SPECIAL EMPLOYMENT MEASURES

CBI say proposals would cost £100 million in 1984-85. Not clear whether this is gross or net (ie after social security flowbacks). Gross cost would be £250 million in 1984-85; net cost about half this. But spending would build up dramatically if proposed JRS changes were permanent, to almost £1 billion by the end of the decade.

Points to make

(a) Expenditure on JRS would reach £500 million by 1986-87 and almost £1 billion by end of decade. Cost effectiveness of this scheme would probably suffer.

(b) JSS has not taken off as hoped. Difficult to extend without subsidising part-time opportunities which might have existed anyway.

(c) Community programme. More sponsors welcome but MSC need to ensure community benefits outweigh private gain. More ambitious projects are more expensive.

MANPOWER

Points to make

(a) Welcome CBI support for improved efficiency and privatisation.

(b) Have already extended user charging in central and local Government.

(c) Civil Service manpower planned to fall to 593,000 by 1.4.88. Agree that LAs need to do more to reduce their manpower.

(d) Note CBI suggestion for legislation to require LAs to put more services to competitive tender.

PUBLIC SECTOR PAY

Points to make

The CBI urge continuation of trend for public sector settlements to be below private sector, and urge you to stick to the 3 per cent pay factor. There is no significant difference between Ministers and the CBI over the need for pay to continue downwards, and you need only say that you are well seized of the importance of these points. You might also ask about their views on the likely outcome for private sector pay in this round.

PUBLIC SERVICE PENSIONS

Points to make

(a) Government intends to continue to protect public service pensioners against rising prices, but will not give unopen-ended commitment to index-linking in all cases.

(b) Government committed to ensuring that public servants pay realistic contributions towards costs of their pensions.

Annex G

CBI BUDGET REPRESENTATIONS

DIRECT TAX POINTS

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Capital Allowances
DLT
Stamp Duty
Share Options
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CTT
Income Tax/IIS
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Wider share ownership
Unitary taxation
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B. Priority points from CBI's technical representations

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INDIRECT TAX POINTS

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Corporation Tax

The CBI's response to the Corporation Tax Green Paper contained over 60 detailed recommendations for changes to the structure of Corporation Tax. Many of these changes would involve very large Exchequer costs. But it was made quite clear in the Green Paper that the discussion of proposed changes would have to proceed on the basis of revenue-neutrality - ie that the changes would be financed from within the corporation sector. Furthermore, support for the CBI's proposals was by no means unanimous among others who responded to the Green Paper. In these circumstances it is not surprising that many of the CBI's suggestions have not been adopted. But Ministers have already made several useful changes, as the CBI acknowledge.

As to the CBI's request for a synopsis of representations to be published, some representations were submitted in confidence; but most major representative bodies released their representations publicly, and the CBI will doubtless be aware of these.

Advance Corporation Tax

The CBI "do not believe that the Select Committee debates in 1971 were intended forever to ossify the rules ...". Nor do Ministers. The changes announced in the 1983 Budget and due to be included in Finance Bill 1984, to extend to 6 years the carry-back period for surplus ACT and to reverse the order of set-off of ACT and double taxation relief, responded to representations made on the CT Green Paper by the CBI and will be of real help. Most of the other changes to ACT which the CBI now advocate would be very costly, running into several £m100s. How would the CBI propose financing them? And when Ministers considered the response to the Green Paper, they were not persuaded on the merits of these changes in principle, quite apart from the cost.

The CBI said that they supported the principle of the imputation system of corporation tax - but to implement the changes they propose would emasculate it.

Capital allowances

CBI propose new capital allowance for commercial buildings of 2% per year (straight line basis).

Points to make:

i. Accept the allowance right in principle - even if commercial buildings depreciate very slowly (or even appreciate in early years).

ii. But cost has always been the real difficulty. First year reasonably modest at £m25 - 30. But builds up to £bl.5 a year eventually.

iii. Nevertheless will bear in mind.

[Confidential Possibility of such an allowance - counterbalanced by withdrawal of first year allowances for plant in commercial buildings - one of the suggestions currently under consideration in context of longer term reform of capital allowance system.]

DEVELOPMENT LAND TAX

The future of this tax has been recently reviewed, and its abolition was not considered a runner (Miss O'Mara's 21 November minute to the FST). The CBI estimate the yield for 1983/84 at £50m, and suggest its immediate abolition would cost nothing significant. Better estimates are £80m yield, with an initial cost of £20m (1984/85) and £40m (1985/86). They suggest that its existence discourages commercial development, but the indications are that it is now generally accepted as a reasonable price to pay for continuity and stability in the property development field. To suspend its operation for 3 years as now suggested would create the very market instability that continuity of the tax avoids. And though such a tax holiday might lead to a flurry of apparent development activity, it is likely that this would be more concerned with establishing exemption by bogus starts to projects than by meaningful development, which will be supplied by the development industry in response to demand, not because of tax liability or otherwise.

STAMP DUTY

In their response to the Stamp Duty Consulative Document the CBI called for the abolition of:-

a. capital duty; and

b. stamp duty on equities.

As the CBI recognise, a duty (at a rate of 1 per cent) on the raising of capital by companies is mandatory on Member States of the European Community. The UK has had a form of capital duty since the 19th Century. The present duty is expected to yield £m75 this year. Although the Commission did tentatively suggest last year that the EC duty should be reviewed, nothing came of the idea. It is doubtful whether a majority of Member States would welcome any change.

The Chancellor is aware of the case for some reduction of the duty on equities. Reducing the rate to 1 per cent would cost £m175. More, if there was any leakage of tax from houses and land or if a reduction in stamp duty on equities led on to a revision of the rate scale for houses and land. The CBI in their stamp duty submission called for the introduction of a slice scale. With current rates this would cost £m350.

The responses to the Consultative Document are still being analysed.

Share Options

1. The Government's policies to encourage employee share ownership are reflected in the operation of three tax reliefs for employee shares -

a. No income tax is payable by an employee who retains for 7 years shares received as a gift under his company's approved profit-sharing scheme. Such schemes must be open to most full time employees. The limit on allocations to individual employees was raised to a maximum of £5000 in 1983.

b. No income tax is payable by an employee in respect of gains taken on SAYE-funded share options made available under his company's approved scheme. Such schemes must be open to all full time employees. SAYE contributions are limited to £50 a month (a 1983 Finance Bill proposal to increase this to £75 was lost).

c. Other share options, granted by employers on a discretionary basis, are normally the preserve of directors and senior managers. Gains made on exercise of such executive share options are subject to income tax, but a 1982 relief allows the tax payment to be spread over 3 yearly instalments (a 1983 Finance Bill proposal to increase this to 5 yearly instalments was lost).

Nearly 650 approved all-employee share schemes (a. and b.) have now been set up compared with just 30 when the new Government took office in 1979.

2. The CBI are keen to see more favourable tax treatment introduced for executive share options. Ministers are currently considering the case for providing a new tax relief in this area. Among the choices is replacement of the income tax charge with capital gains tax, which, subject to a range of conditions, is the regime introduced in the US in 1981 for "Incentive Stock Options".

CAPITAL GAINS TAX

General

Suggested line to take:

i. In longer term, it will be necessary to consider the future of CGT based on real gains and nominal losses.

Present yield - £m850 forecast for 1983/84 (including £m250 on companies gains) - will be progressively reduced by effect of indexation.

ii. Burden of tax has been significantly reduced in recent years: indexation allowance, increase in threshold for individuals to £5,300 and index-linked, reform of settled property provisions.

iii. Real gains which add to taxable capacity should not escape tax altogether. Without some charge on capital gains, the pressure to avoid income tax by conversion of income into capital would be increased.

Specific CBI proposals

i. Exemption for assets held for 6/7 years (to compensate for absence of indexation relief pre-1982).

This would not distinguish between real and inflationary gains. Administrative difficulty in applying such a rule to shares which, prior to 1982, were pooled - dates of acquisition will not therefore be known. The cost would be about £m300 in first full year.

ii. Overhaul of retirement relief.

Consultations about the relief were promised by the previous Chancellor in the 1983 Budget Speech. A consultative document is to be issued shortly. In the meantime, the Government has announced that it will be going ahead with the proposed doubling of the relief (from £50,000 to £100,000 in the 1984 Finance Bill).

iii. Simplify indexation provisions by (a) extending them to losses and (b) dropping the 12 months exclusion rule.

It is accepted that these restrictions add complexity. But they remain necessary (a) to preserve the current yield of the tax and to minimise the additional workload; and (b) to put a brake on the conversion of income to capital

iv. Removal of two tier charge on companies and their shareholders.

Gains realised by a company and by its shareholders are realised by different persons in respect of different assets usually over different periods of time. In most cases, it would be impractical to attempt to relate gains on shares to gains on particular assets by the companies in which the shares are held.

v. Carry forward of annual exempt amount.

At £5,300 (and index-linked) the threshold is very generous almost double the married mans allowance for income tax). If it were possible to carry forward unused part, the threshold itself might have to be lower. More important, administrative savings from not having to calculate small gains would be lost. Business assets are protected by special replacement and retirement reliefs.

CAPITAL TRANSFER TAX

It is suggested that the present business asset reliefs (currently either 50 per cent or 30 per cent) should be amalgamated and replaced by complete exemption. Present reliefs amount to £50m per annum, and the amalgamation and extension would cost some £50m. It would also set aside sound reasons for the two levels of relief, designed to ensure that roughly the same proportion of the value of the relevant estate is taxed, taking account of the different value levels of, say, minority shareholdings or tenanted agricultural land (now both enjoying 30 per cent relief) and the rate of tax then appropriate. CTT rates, for death or lifetime transfers, are due for review in the Budget, and it is for consideration what degree of incentive is though appropriate for lifetime gifts. The CBI is suggesting that transfers above £220,000 (where lifetime transfer rates begin to rise to somewhat more than half their death rate equivalent) should be reduced. This would mean reducing the top rate for lifetime transfers (applicable over £2,650,000) from the present 50 per cent to 37½ per cent, and it is thought this would cost some £5m for 1984/85. It may be thought appropriate to consider this possibility in the forthcoming paper on rates and threshold. With regard to the possibility of accumulating annual exemptions, for a limited period or for ever, the annual exemption of £3000 is presently a de minimis arrangement intended to free small gifts in any one tax year. To accumulate would be to effect an entirely different result: a small snip, but a large hole in the tax net.

INCOME TAX AND IIS

On income tax generally the Chancellor will presumably wish to do no more than note what the CBI have to say in relation to 1984/85 while sympathising with their longer term objective of reducing the overall burden of direct taxation. The Chancellor has made clear that increases in income tax thresholds have a very high priority, when resources are available. For 1984/85 the CBI proposals assume that income tax allowances and thresholds will be increased by no more than indexation. There is, however, a strong case for going further, in so far as available resources permit, to ensure, at the least, that the burden of income tax does not increase relative to average earnings.

On IIS the Chancellor may feel able to mention to the CBI his own view of the attractions in abolishing the surcharge and his personal wish to do something about it during his time in office - in line with what he told the Country Landowners Association on 4 October last year. He will, however, want to remind the CBI of the present very tight fiscal position; abolishing IIS would cost something over £300 million in a full year.

BUSINESS EXPANSION SCHEME

1. The CBI have resurrected their earlier proposal for a new kind of "small firms investment company" (SFIC). Individuals investing in a SFIC would qualify for BES relief. Short of introducing SIFCs, the CBI suggest changing the present rule so that an investor would get relief for the tax year in which he subscribed to a BES approved investment fund, even though his money might not be invested by the Fund in qualifying companies until the following year. The CBI also want an advance clearing system for investments and, in their Technical Representations, suggest a further seven changes.

2. None of these points is new. Some have been made by others as well, and all of them have been considered carefully by Ministers - most recently in a wide-ranging review of the Scheme by the Financial Secretary. His recommendation, which the Chancellor endorsed, was that while there might be merit in some of the suggested changes (others would definitely not be acceptable) the scheme should be given time to settle in and there should be no changes to it in the 1984 Finance Bill. (There is one possible exception; Ministers are reconsidering whether action is necessary to exclude farming.)

3. The case for SFICs was considered before the last Budget and, with the Prime Minister's agreement, BES was introduced instead. There were three main reasons. First, the main aim was to encourage individual investors to take a direct equity stake in companies; SFICs would break that direct link. Second, the existing approved investment funds have many of the same institutional advantages that are claimed for SFICs so it is doubtful whether a new kind of intermediary is needed anyhow. Third, to graft SFICs on to BES would in our view add a further layer of complexity to the scheme - we think the CBI are wrong to suppose it would allow simplification. The Chancellor deployed these arguments in resisting a suggestion last August from the Conservative Research Department for the introduction of SFICs, and in a speech to the British Venture Capital Association in September the then Financial Secretary again explained why the Government remained unpersuaded of the case for SFICs.

4. Of the CBI's other more detailed proposals, some (eg to extend the scheme to companies with overseas subsidiaries) are ones which Ministers might be prepared to accept if there were to be changes to the scheme in 1984. Others (eg to open up the scheme to employees;

to extend further the time limit during which a new company must start trading if it is to qualify) are incompatible with the fundamental aims of the scheme. Others again (eg consolidating the BES legislation - which is spread over four Finance Acts) are no doubt desirable, but not essential to the success of the scheme.

5. The CBI put the overall cost of their proposals tentatively at £200m in a full year. This is probably no more than a shot in the dark, and seems very high. It implies additional investment of around £400m a year, over and above money diverted from existing investment under the scheme. This is several times the current level of take-up. In the 1983 FSBR the full year cost was put at £75m (implying annual qualifying investment of about £150m) but it seems probable that even this figure will turn out to be on the high side.

<u>Line to take</u>

6. The Chancellor will probably not want to go into detail on the CBI's Technical Representations other than perhaps to note that whilst some may in principle have merit, others seem inconsistent with the fundamental aims of the scheme. On their point about advance clearances, local tax offices do already operate an informal clearance procedure for companies wishing to qualify under the scheme. On SFICs - about which the CBI will no doubt expect him to say more - he might draw on the arguments in paragraph 3 above. More generally, he might say that whilst the Government will be monitoring the scheme carefully, and welcomes suggestions for improving it, there is a good case for giving it time to settle in before considering any further changes.

Wider share ownership

1. The Government supports the aim of increasing wider share ownership, and entirely agrees with the view that employees should be encouraged to take a stakc in the enterprise they work for. Three of the past five Budgets have contained substantial - and welcomed - measures to increase the attraction of employee share ownership. Impressive results have already been achieved: over £m500 worth of shares have been allocated to employees or are subject to options held by employees. This is a healthy reversal of the trend towards institutional shareholding. The Government's 'privatization' programme has also opened up the chance of true financial participation for thousands of employees for whom it did not exist before. Other measures taken include BES and reduction in capital taxation.

2. Representation on BES, stamp duty, IIS and capital taxation have been noted.

UNITARY TAX

Background

After considerable prompting by both Treasury Ministers and officials, the CBI eventually got its act together on unitary taxation sufficient to submit a Note to Secretary Regan's Working Group. Largely because of the actual examples it contained, this was quite a powerful critique of the system. The CBI urges the UK Government (which submitted its own Note on 30 November), together with our European partners, to keep up the pressure on unitary tax.

Line to take

i. To welcome the CBI Note to the Working Group. This will complement the UK Government's own Note (which was prepared before the CBI had produced examples of actual damage).

ii. To urge them to provide their assessment of retaliatory measures and their consequences (ie the information requested in the Financial Secretary's 21 December letter). The need for this material is urgent.

iii. To stress the vigour with which the Government have pursued the issue, and our success in getting other Governments to respond vigorously. As well as the UK, the Governments of Australia, Canada, Germany the Netherlands and Switzerland have each submitted individual Notes to the Working Group. There has also been a joint Note from the 10 Member States of the EC. Liaison with European partners (and other countries) continues.

iv. In response to a request from Secretary Regan, UK officials gave oral evidence (11 January) to the Task Force on the UK's arm's length pricing rules.

CONTROLLED FOREIGN COMPANIES

Background

1. Legislation on "controlled foreign companies", designed to deal with the tax haven problem, was included in the original 1983 Finance Bill. This enabled a charge to UK tax to be imposed on certain UK resident companies with interests in tax haven companies. In the event these provisions were pruned from the 1983 Bill prior to the General Election and, with a view to legislating in 1984, revised draft clauses were issued last October. This revised draft incorporates the important changes Ministers had announced in response to the business community's criticisms of the proposals as included in the 1983 Finance Bill.

2. The CBI have played an active part in the three previous rounds of public consultation on tax havens. They have also been consulted informally, both by Treasury Ministers and officials, on this issue. The implication in their present representations that they have always been fundamentally opposed to the haven proposals is somewhat misleading. Hitherto they have accepted that it is right in principle to attack UK companies' use of tax havens to avoid UK tax: their concern has been that the legislation does not spill over to damage the "genuine" overseas activities of UK business. Unless they have had a significant change of heart, therefore, what the CBI are presumably now doing is taking up a fairly extreme negotiating posture in the hope of securing - yet further - relaxations of the legislation.

Line to take

i. To reaffirm the Government's commitment to tackle the tax haven problem, broadly on the lines of the existing proposals. They are however prepared to look at the detail of the provisions, and look forward to receiving the CBI's promised detailed comments on the revised draft clauses.

ii. To emphasise that the Government share the CBI's objective of preserving the competitive position of British business. That is why they have made such efforts to meet the business community's criticisms of the earlier proposals. In particular they have made a whole series of amendments to provide more certain safeguards for the "genuine" overseas operations of UK businesses.

iii. (If Section 482 is raised). To say that the Government recognise that Section 482 may no longer be appropriate in its present form. They already have the terms of the Section under review, and will be publishing proposals in due course.

Groups of companies

The CBI have now (two months late) submitted their representations for the review of the tax treatment of groups of companies. They had made numerous proposals and say they regard them all as a first priority for action in Finance Bill 1984.

Although the Chancellor has not ruled out action in 1984 on two particular points, both concerning consortium relief (and only one of which has been raised by the CBI), it seems unrealistic to expect action in 1984 on the review as a whole. This is a complex part of the tax code, and with 60 odd individual proposals to be considered, many of which would interact with each other, it will clearly take time to complete the review. Some further consultation may also be necessary and we have, for example, already arrange to discuss with the CBI and certain other bodies a more radical suggestion they have floated for an entirely different system to the present one for taxing groups of companies.

FOREIGN CURRENCY LOSSES

The exchange loss on foreign currency borrowings of a fixed capital nature is not allowable because it is a capital item (only expenditure of a revenue nature is deductible in arriving at taxable profits). Ministers have decided against action in the past. Reasons are the difficulty of determining precisely where the capital/revenue distinction was to be overidden (the case for relief is not universally strong), a fair and workable scheme would require long and complex legislation and the cost could be substantial. A recent adverse decision by the House of Lords may remove some of the pressure for relief for borrowings but it raises other problems. (The CBI representations were submitted before the judgment).

Line to take - Resist: We have recommended to Ministers that any change be ruled out for 1984 while we assess the significance of the judgment and what action, if any, may be needed.

COSTS OF EQUITY FINANCE

The 1980 legislation removed an anomaly by giving relief for the incidental costs of raising loan finance where the cost of maintaining the loan (the interest) was itself allowable. There is no corresponding anomaly in not allowing the costs of raising equity capital since the costs of maintaining equity (dividends) are not deductible from profits. There would also be practical problems in excluding the cost of share issues in, for example, contested takeover bids. Unlikely that a lack of tax relief for this once-and-for-all cost will affect a company's willingness to raise new equity capital having regard to the on-going costs of servicing that equity.

Line to take - Resist

Stock relief - six year cut off

The CBI oppose the rule in the 1981 scheme of stock relief under which losses attributable to relief under that scheme are cancelled if they remain unused for six years. The decision to introduce this rule was a budgetary one, to protect the flow of corporation tax revenue in the late 1980s and 1990s and to help stem the growth in the very large "overhang" of unused tax losses and allowances. And even with this rule, the UK is still more generous than most other countries, whose corporation tax systems generally place a restriction on carry-forward of all tax losses, not just those attributable to a particular relief.

Disincorporation

The CBI urge the removal of fiscal barriers to those who want to change from operating in a corporate to an unincorporated form e.g. as a partnership for sole trader. They particularly refer to the inhibiting effects of stock relief and capital gains tax.

Line to take

i. Accept that tax system should not inhibit the adoption of most desirable commercial form.

ii. At Ministers request, we have been examining this matter with the accountancy bodies (the CCAB) over recent months. Aim has been to remove fiscal obstacles on a revenue-neutral basis i.e. not to give any form of tax incentive. The CGT point has proved the most intractable - the present law imposes a charge on the company (in respect of assets) and on shareholders (in respect of gains on shares) - which can be met only by a specific relief.

iii. There does not appear to be any pressing need for action this year - the disincentive to corporate status arises primarily from the more stringent standards of auditing required by the Companies Act and the introduction of stricter requirement by the accountants own professional bodies. These will not bite until 1984 accounts are due.

iv. For your own information the Financial Secretary's preliminary view is that, against the background of pressure on the 1984 Finance Bill, the case for immediate action has not been made out, but that the matter should be kept under review as the Companies Act changes begin to take effect.

INDIRECT TAXATION ISSUES

PENSION FUNDS

1. Under the existing arrangements made in the light of counsels' advice, it is accepted that employers can recover VAT incurred in respect of administration services of funded pension schemes providing pension arrangements for employees. While the valuable work done by Pension Funds is fully recognised, it would be inequitable to make exceptional arrangements to provide special input tax relief to the funds or employers in respect of exempt supplies (eg of securities or property) made by pension funds. Any such measure would also be inconsistent with our international obligations and would lead to requests for similar treatment for other bodies undertaking worthwhile social functions such as charities.

2. A particular point the CBI is likely to raise is that the amount of VAT which pension funds are unable to recover may be increased by the proposed VAT partial exemption changes announced by MST in a written reply on 15 December. These changes are, of course, of general application, but their most significant impact will be on the financial sector. Pension funds have developed such a significant role in this sector and are so heavily engaged in investment activity that it would clearly be wrong to treat them more favourably than other businesses similarly engaged such as insurance companies, which share the burden of providing pensions.

PARTIAL EXEMPTION CHANGES

3. MST announced in Parliament on 15 December that he was satisfied that the present VAT partial exemption rules result in substantial losses of revenue. It is inevitable that the changes proposed to correct this situation will bring more businesses into the partial exemption net; but, generally speaking, they will be businesses with fairly sophisticated accounting systems which can cope with changes without difficulty. Some may wish to rearrange their VAT groupings.

Customs has agreed that the normal 90 days' notice required for such changes would be waived in this instance. Customs have also stressed in their meetings with trade bodies that they will be as cooperative as possible in agreeing special partial exemption methods to ensure that businesses affected by the proposed changes can recover all the input tax to which they are properly entitled. To the extent that the proposed changes are aimed at stemming revenue losses they will add to business costs, but the additional administrative burden associated with the proposed changes will be limited and has not, in fact, been a major source of complaint in Customs meetings with trade bodies and individual businesses.

DRAFT VAT 12TH DIRECTIVE

4. The draft Directive aims to harmonise rules for the deduction of input tax. The Commission's proposals, put forward in early 1983 would block a variety of business expenses (eg running costs of cars, expenditure on business travel) which is currently deductible in the UK. The European Parliament has recently suggested some amendments, but there has been no discussion between Member States either of the original proposal or the Parliament's views. The Directive could not come into effect without the agreement of all Member States.

5. Customs undertook a comprehensive consultation exercise on the original proposals and has also drawn the attention of interested bodies, including the CBI, to the views of the European Parliament. Subject to the MST's approval further consultations between Customs and the CBI and other bodies are likely (Mr Jefferson Smith's note to MST, 5 January).

6. The Minister of State announced the Government's line on the proposals in a Written Answer last July. The principle of blocking some input tax is something the UK Government accepted with the Sixth Directive in 1977 and has applied for cars and entertainment since the introduction of VAT. The purpose is to ensure expenditure of a private nature is not tax free. Ministers consider that blocking runs counter to normal VAT procedures and should only be used to prevent really significant abuse or administrative complications. Accordingly a Directive making blocking obligatory could only be accepted if it were restricted to the items already blocked in the UK. This line reflects fully the views of the CBI and others.

7. There has been no change in this position since the statement in July. In considering any revised proposals the interests of UK industry will be fully taken into account.

VAT REGISTRATION THRESHOLD

8. The VAT registration threshold has been increased in each of the past four years. It now stands at £18,000. An increase in 1984 to £19,000 would broadly maintain the real value of the limit at its 1973 level. However, the Commission has recently written to say that indexation back to 1973 is unacceptable under the EC Sixth VAT Directive, and that the UK should at least freeze the existing limit until it is effectively indexed from 1 January 1979. This would take about three years. (Mr Harris' note to MST, 15 December 1983).

For Chancellor's information only. Not to be revealed to CBI

9. The CBI will probably be aware that the Commission is unhappy with the level of the UK's VAT registration limit, but they will not know about the threatened infraction proceedings. No decision has yet been taken on the level of the limit for 1984. In view of the complications the Chancellor will no doubt wish to simply note the CBI's views on this point.

DERV

10. Derv has been favourably treated by the Government. The duty differential in favour of derv over petrol, which was introduced in July 1981, was widened slightly in the 1982 and 1983 Budgets. The derv duty is now about 12p a gallon less than petrol. The real value of the duty is well below its 1970 level.

11. Although the recommended retail selling price of derv is among the highest in Europe other factors mean that the effective price to businesses is not excessive by EC standards. Businesses in the UK are able to deduct VAT on derv whereas a number of Member States either completely or partially block deduction of VAT. Also some Member States (Denmark, Italy, Luxembourg and the Netherlands) which have a particularly low duty on derv, impose higher taxes on diesel-engined vehicles to equalise the tax burden. In the UK most derv is purchased by businesses under contractual arrangements which typically provide for discounts of up to 15p a gallon off the retail price.

12. Derv is an important revenue raiser - estimated at just over £1,000m in 1983-84. Any revenue foregone would have to be made up elsewhere.

Put with CBI brief

CHANCELLOR OF THE EXCHEQUER

HONI SOIT QUI MAL Y PENSE

C/

a late addition to your CBI briefing which arrived this morning.

MOM

12/1

P.S. We hear via Martin that CBI do want to tell the Press of the meeting. They claim their comments will be innocuous - and indeed, they can't be very forthcoming as they haven't cleared their reps through their own policy committees yet. They will clear the text of any press notice with Martin who will come to the meeting for that purpose.

A TECHNICAL FINANCE BILL?

The CBI have for some years been amongst those pressing for a "technical Finance Bill", to provide an opportunity to legislate on matters which they regard as primarily technical, but which do not find a place in normal Finance Bills. Many of the CBI's candidates for a technical Bill, however, would be unlikely to meet the criteria of the cautious approach floated by the previous Chancellor to the Procedure Committee.

Of the CBI's list of 11 candidates produced in 1981, only one met Sir Geoffrey Howe's criteria. The others had been considered and turned down by Ministers, or were controversial, or had a substantial revenue or staff cost. For example, one CBI proposal (concerning a Company which leases a Group) involved a motive test, which would have been staff intensive. Another, "sideways surrender" of losses between companies in a consortium, had been ruled out by Ministers in 1981. And another (concerned with ACT surrender to new subsidiaries) could only have been carried through by long and complicated legislation.

<u>Line to take</u> It is well-known that previous Chancellor took a particular interest in the idea of an occasional Ancillary Finance Bill for minor, technical and uncontroversial provisions. Not clear that CBI's candidates meet those requirements. But in any case cannot regard an Ancillary Finance Bill as a high priority - questionable whether more Parliamentary time should be devoted to discussion of technical tax matters.

Pup with CBI brief

CONFIDENTIAL

Draft

Speaking Brief for meeting with Chancellor: Sir Campbell Fraser

(After introducing the CBI team, thanking the Chancellor for seeing the team and giving him the proposed order of speaking).

First, Chancellor, I'd like to tell you about the exact status of the document which we sent you last Friday. Our Council has approved the broad themes of the Representations and has formally approved our coming here to talk to you before giving its final approval to the detail of the Representations. These Representations have been cleared by the relevant Committees and our Council will be asked to approve the details at its meeting next Wednesday. We don't expect that there will be any changes but if there are we will bring them to your attention immediately afterwards. We plan to release our full Representations at a Press Conference on the 25 January.

When you ended your Autumn Statement, you made what I thought was a very telling point. You said that we now had steady growth and low inflation and you called that a winning combination. I am sure that I speak for every one of our members when I say how much I agree with you on this and the need to keep it that way. We have drawn up our representations with the aim of helping you keep that winning combination going, not just for one year but for four or five years ahead.

We need to look this far ahead for two reasons. First, after the difficulties of the past ten years, what British business needs is to build up the momentum of steady and sustainable growth so that industrialists can feel that it is worthwhile making difficult decisions now to pay for better business prospects in the future. Secondly, our calculations (and, we believe, most other peoples') suggest that unless we have fairly strong growth through this period we run the risk of major tax and public expenditure problems towards the end of the decade when the oil revenues are falling.

What we have therefore tried to do is to identify the threats and opportunities affecting the medium term prospects and to see what can best be done now in the 1984 Budget to improve the prospects for sustaining the recovery.

So, to sustain the recovery we need first continued low inflation and secondly, further improvements in competitiveness. These in turn will lead to higher profitability and investment and hence, more jobs.

We also believe that the longer term prospects for growth combined with low inflation will be improved by action taken now to encourage enterprise. We have therefore put forward a package for enterprise which Alan Willingale and Jeremy Pope will speak to.

Obviously many of the things that need to be done to keep the recovery going are the responsibility of business. The CBI has spent a considerable amount of time and energy making the case for lower pay settlements, improved productivity and better employee involvement. But we need to aim to improve our competitiveness on all fronts and so in our Representations we ask you, Chancellor, to see what you can do to help.

You will not be particularly surprised by most of our Representations. There are two main themes: cuts in Government-imposed costs on business, which we believe is the best way in which the Government can help business keep its costs down and improve its competitiveness; and an enterprise package that concentrates particularly on measures that will encourage wider share ownership. These include the abolition of stamp duty on share transactions, improved stock options, amendments to the Business Expansion Scheme and the abolition of the Investment Income Surcharge. These measures will improve attitudes towards business as more and more people develop a direct interest in business prosperity.

Over the past four years there have been a massive expansion in home ownership. We ought from now to be getting an equivalent expansion of private ownership of shares in business.

Our package is a modest one but we feel that it will help improve the prospects of the sustained recovery with low inflation. Therefore we commend it to you Chancellor.

Now if I may I'd like Terry to go through the main points of the Representations, Alan Willingale to cover the more detailed tax points and Jeremy Pope to cover the representations that bear particularly on smaller firms.

CONFIDENTIAL

Speaking Brief for the Director-General on Budget Representations for the meeting with the Chancellor.

As Sir Campbell has said, our two main themes are cust in business costs and our enterprise package. I will cover the proposals for cutting business costs.

The most important of our representations is the immediate abolition of the National Insurance Surcharge, the tax on jobs. The Prime Minister has indeed called it "this pernicious tax on jobs" and has said that she hopes to abolish it in the life time of this Parliament. Getting rid of it for private sector and public corporations would cost £900 million this year and about £1 billion in a full year. There would however be a fairly considerable feed-back from increased revenue from other taxes.

Removing the tax would be the greatest single contribution the Government could make to helping industry improve its competitiveness.

NIS is a tax on jobs and raises the cost of employment. Our estimates suggest that most of it is passed on in higher prices. The rest is taken out of profits. Higher profits are essential if we are to get the economy going again and revive investment not only in fixed assets but in all the other areas that will help improve competitiveness further.

Our second main representation concerns business rates. Although the bill currently under discussion in Parliament does not do everything that we want, we have given and are giving Patrick Jenkin our steadfast support, particularly on rate capping, against his critics. But in the short-term this won't do very much to reduce the actual burden of rates paid by business which is likely to reach £6 billion next year.

We are therefore asking for business to be put on to the same basis as the domestic rate payer who at present receives a derating of 18½p in the pound which is worth about 10 per cent. To introduce this partial derating would require legislation, but the legislation is fairly simple. If the will is there it would be technically feasible to make the derating effective for this year by introducing legislation in the summer and making the rebate for the full year effective with the second rate payment. There are also a number of other provisions on rates set out in our representations.

Reducing rates would also help reduce business costs and improve competitiveness. Most of the benefits of lower rates would be similar to those of lower NIS but lower rates would help capital intensive industries.

We don't think that this is the time to cut income tax by raising income tax thresholds. We believe the income tax system is in need of reform to improve incentives but raising income tax thresholds will do very little to cope with the worst of the problems such as the poverty trap and unemployment trap.

If our strategy is implemented successfully, we estimate that there will be scope in later years, provided Britain is competitive, to pay for cuts in income tax. But first we need to be competitive.

CBI BUDGET REPS 1984

Let me just flag for you, Chancellor, those of our many other proposed tax changes that put in place now would most serve to cut business costs, encourage enterprise and give us a sporting chance against overseas competitors.

1. Stock Options (page 26)

   Favourable tax treatment would help employers to increase employee commitment in general and reduce the managerial equivalent of brain drain i.e. boss loss in particular.

2. Stamp Duty (page 26)

   Abolition of duty on share issues and transfers would help to widen share ownership (page 30) and win back to London a lot of transfers that have shifted to the New York market.

3. Corporation Tax (page 25)

   (a) ACT

   Treating ACT as what it says it is viz Advance Corporation Tax and not IT on distributions would open a tap for thirsty Capital Allowances and DTR to CT refund.

   (b) Commercial Buildings

   A two per cent per annum straight line writing down allowance on new commercial buildings would stimulate the construction industry and take a step forward greater equity for the commercial sector.

4. DLT (page 26)

   Abolition or failing that a three year suspension would rob you of a mole-hill of yield and rescue us from a mountain of compliance costs and misery.

5. VAT (page 30)

   Permitting full recovery of Imput tax on providing pensions would cut their cost to employers.

continued

6. Controlled Foreign Companies (page 31)

If you must issue the Revenue with a new weapon we would rather you make it a laser beam rifle than a sawn off shotgun. Too broadly targetted legislation of the sort still in draft will injure innocent bystanders and give advantage to our American competitors for whom Sub Part F holds much less terror. We are highly appreciative of the salvoes Ministers have loosed on the US Unitary Tax. Could you please redirect some of the thinking that went into that attack on foreign trespass on our bailliwick to avoiding damage at home to British companies that are legitimate invitees to other people's.

A. E. WILLINGALE

12th January 1984

SUGGESTED SPEAKING BRIEF FOR MR JEREMY POPE AT THE MEETING WITH THE CHANCELLOR OF THE EXCHEQUER ON THURSDAY 12 JANUARY 1984.

SMALLER FIRMS PRIORITIES IN BUDGET REPRESENTATIONS.

The Smaller Firms members of the CBI are solidly behind the main thrust of this year's Budget Representations. Their prime needs are for improved competitiveness - through their own effort and through a reduction of government-imposed burdens - and in particular a better environment for enterprise and investment.

We believe the introduction of the Business Expansion Scheme in last year's Budget was a very important step forward. It has been successful within the limits in which it operates but its potential is much greater. We have put forward proposals for a simpler, more flexible investment vehicle under the Scheme and for various improvements to the rules which would increase the uptake and broaden the range of people who become share-owners through the Scheme. This is just one facet of the development of a more entrepreneurial national culture which we wish to see.

Another key area is the taxation of capital and investment. "Investment income" should not be a dirty word any more than "profit" should and the time is now right to abolish the Investment Income Surcharge. We are especially concerned about the effects of IIS on people who have retired and are effectively using the proceeds of their life's work to provide a pension.

We are also seeking further changes to remove the worst effects of both Capital Gains Tax and Capital Transfer Tax.

On CGT the indexation rules - which we welcome as far as they go - leave a highly anomalous situation regarding assets held before April 1982 and exclude indexation relief both on losses and on assets held for less than a year. The retirement relief rules are in need of overhaul and there is a double charge to tax on gains when assets are held through a company.

On CTT we would like to see all classes of business assets exempted and lifetime rates reduced to half those on death throughout the scale. Here we are particularly concerned about the difficulties CTT causes when owners want to pass business on to the next generation of their family or to existing employees.

These fairly bold (but relatively inexpensive) measures at this stage in the life of the Parliament would convince investors, entrepreneurs and family businessmen that the taxman is not out to get them whichever way they turn, and that would greatly enhance the incentive to build businesses up and to be a share-owner.

SJCC/SAJ
10.1.84

CHANCELLOR OF THE EXCHEQUER

C

Alan Lillingale is, we believe, from BP, so it's just possible he may have caught a whiff of the capital allowance proposals.

You wanted to use this meeting as an opportunity to press the CBI to come out strongly in favour of the Rates Bill.

Mary

11/1

FROM: H C GOODMAN
DATE: 11 JANUARY 1984

1. MR BATTISHILL 11/1

2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Monck
Mr Monger
Mr Beighton - IR
Mr Painter - IR
Mr Wilmott - C&E

without attachments:

Mr Lovell
Mr Folger
Mr Hart
Mr Hall
Mr Shields
Mr Smee
Mr Halligan
Ms Rutter
Mr Norgrove
Mr S Davies
Mr S Webb
Ms S Walker
Mr Wynn Owen
Mr Ridley

MEETING WITH THE CBI

You are seeing the CBI tomorrow. Attached is the CBI cast list. On the Treasury side, with yourself, will be the Chief Secretary, the Financial Secretary, the Economic Secretary, the Minister of State, Sir Peter Middleton, Sir Terence Burns, Mr Battishill, Mr Monck, Mr Monger, Mr Beighton (IR), Mr Painter (IR) and Mr Wilmott (C&E).

2. You already have a copy of the representations and I am attaching other copies for those attending the meeting. These representations are still in draft. After your meeting the paper will go to the CBI Council for final approval on 18 January and will be released to the press on 25 January. The CBI plan to give no publicity to the meeting with you or to their Council meeting next week.

3. You will not wish and the CBI will not expect you to reveal much of your own thinking about the Budget, but this will be an opportunity for you to comment on the representations and to influence them so far as you consider this to be right and

prudent. Nonetheless this should be a useful opportunity for hearing the CBI's views in more depth.

4. Attached are briefing notes on the main parts of the draft representations for which I am grateful to other divisions; the Revenue departments have prepared notes on each of the tax recommendations. The paragraphs below give a brief summary of the CBI proposals together with one or two possible points to make on each.

CBI PROPOSALS

5. We understand that in this discussion the CBI intend to put their representations in a medium term context. This is, at least in part, because they have revised upwards their view of prospects in 1984 and are now concerned more about 1985. The first section of the document summarises their representations.

SECTION II: MEDIUM TERM

Annex A 6. The CBI's projections of government receipts and expenditure to 1987-88 assume steady growth of 3 per cent pa, and public spending held constant in cost terms. The results allow tax cuts of £8 billion over the period. In part the CBI believe that tax cuts can be paid for by higher borrowing. They argue that this will not raise interest rates as their proposals to raise capital and lower current spending would improve the quality of the PSBR.

7. Looking further ahead, the CBI argue that once North Sea oil revenues have peaked in 1987-88, the need for improved competitiveness in the rest of the economy in order to sustain our balance of payments position, will become more urgent.

Comment

8. (1) Welcome this emphasis on the medium-term

(2) Very much agree with priority CBI attach to lower taxation, but not at the expense of higher borrowing.

SECTION III: ECONOMIC BACKGROUND

Annex B 9. They are more optimistic about prospects for 1984 than when you met them in the autumn, but are now concerned that the recovery may peter out in 1985. They argue that consumption growth will slow in 1984 and that current indications are that investment and exports will not pick up sufficiently to maintain GDP growth of 3 per cent per annum. They forecast an £8 billion PSBR in 1984-85 without need for a negative fiscal adjustment.

Comment

10. (1) CBI already more optimistic on 1984 than 3 months ago, but the fears have been pushed back a year.

(2) Consumption continuing to grow strongly, profits up, and investment and world trade rising, more than they suggest. Will be publishing with the Budget a forecast up to mid 1985, but take encouragement that present performance is not as gloomy as CBI had suggested.

1984 BUDGET

11. In order to overcome what they see as the short-term difficulties and the problems once the oil revenues have peaked, the CBI believe the immediate need is to improve competitiveness. The role they see for Government in this is to reduce "the costs it directly imposes on business". In particular they call for

Annex C

- the abolition of NIS
- 10 per cent partial business de-rating

and a one percentage point reduction in the rate of employers' NICs to take effect in 1985-86.

Comment

nnexes C, D and E

12. (1) Agree that there is a need further to reduce Government imposed burdens on business, though much has already been achieved. Committed to abolish NIS over the life of the present Parliament.

(2) Cannot have lower taxation plus higher borrowing plus lower interest rates.

(3) Welcome CBI's support for restraining LA expenditure and improving efficiency, particularly useful if CBI could re-iterate its support before Second Reading of Bill on 17 January.

(4) 10 per cent business de-rating would cost £500 m; without expenditure reduction this would mean higher rates or taxes for others. Real solution is for local authorities to control their expenditure.

SECTION IV: TAXATION

13. In the 1984 Budget the CBI believe that the corporate sector should take priority over cuts in the burden of personal taxation and recommend that personal tax allowances are only increased in line with inflation. The CBI have also submitted detailed proposals on taxation; they are unlikely to raise many of these at the meeting.

Comment

14. You will not wish to commit yourself on tax changes for the Budget. You might draw on the detailed notes attached as necessary.

15. The CBI set out the revenue costs of their proposals for 1984-85 in table 1.1 (page 5). These figures are correct; however the 1985-86 cost of the tax proposals in the table would be much greater - of the order of £3.2 billion, as compared with £2.2 billion for 1984-85. Moreover it does not include the cost of reducing employers NICs by 1 percentage point, bringing the 1985-86 cost of the CBI's tax proposals to nearly £4½ billion, a little above the fiscal adjustment for 1985-86 shown in the 1983 FSBR (£4 billion).

Annex F

SECTION V: PUBLIC EXPENDITURE

16. The CBI have not included public expenditure proposals in their Budget arithmetic and we do not expect them to raise this tomorrow. They are planning a separate submission on this in May timed to influence the new PES round. (They recognise that it is too late to have much effect on spending plans for 1984-85.) However, if they do raise this you may wish to turn to Annex F which contains short notes on their suggestions. You will notice that although they specify the increases in capital spending which they wish to see, their proposals for reducing current spending are limited to generalised improvements in efficiency and management.

SECTION VI: LOCAL AUTHORITY FINANCE

Annex E

17 The CBI support Government measures to restrain LA expenditure and measures to encourage efficiency. They believe that a first step towards longer term reforms would be made in this Budget with 10 per cent derating of businesses (see above).

H C Goodman.

H C GOODMAN

I would only emphasize two points:

(a) you may need to confirm that the CBI see this as a private meeting with no press statements: it is not unknown for this to go wrong;

(b) they do not really face up to the choice between lower taxes and lower interest rates, and may need to be pressed to face up to this.

[illegible]

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Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI
CONFEDERATION OF BRITISH INDUSTRY

FST
EST
MST
Mr Middleton
Sir T. Burns
Mr Anson
Mr Monger
Mr Battishill

7th December, 1983

Mr Wilmott C&E
Mr Painter IR
Enquiry Rm X6

Dear Donna,

I now have a list of names for the meeting with the Chancellor on Thursday, 12th January, at 4 p.m. at the Treasury, on CBI Budget Representations:

Sir Campbell Fraser, President, CBI
Sir Terence Beckett, Director-General, CBI
Sir James Cleminson, Deputy President, CBI
~~Mr. Ken Durham, Chairman, CBI Economic & Financial Policy Cttee~~
Mr. Alan Willingale, Chairman, CBI Taxation Committee
Mr. Jeremy Pope, Chairman, CBI Smaller Firms Council
Sir Donald MacDougall, Chief Economic Adviser, CBI
Mr. Ken Edwards, Deputy Director-General, CBI
Mr. John Caff, Director Economic Affairs, CBI
Mr. Keith McDowall, Director Information, CBI
Mr. Douglas McWilliams, Deputy Director Economics, CBI
Mr. David Higham, Head of Economic Policy Department, CBI
Mr Mervyn Woods, Head of Tax Dept

If you could let me have the names of those attending from the Treasury some time, I should be most grateful.

Yours sincerely,

Linda.

(Personal Assistant to
the Director-General)

Miss Donna Young,
Diary Secretary,
Chancellor's Office,
H.M. Treasury,
Parliament Street,
London, S.W. 1.

Annexes:-

A - The Medium Term Programme

B - Economic Background, including interest rates and monetary policy

C - Government Imposed Costs in UK and other countries

D - NIS and NICs

E - Local Authority Finance

F - Public Expenditure, including energy costs

G - Tax

Annex A

CBI BUDGET REPRESENTATIONS: SECTION 2

THE MEDIUM TERM PROGRAMME

The CBI provide projections of government receipts and expenditure in 1987/8 on the assumptions of:

(i) 3% p a steady growth from 1982/3 to 1987/8;

(ii) A small fall in the ratio of tax revenue to GDP even in the absence of any tax cuts;

(iii) Public spending held constant in cost terms, so falling as a share of GDP by 5½ percentage point in the next 4 years.

On these assumptions, an £8 billion reduction in taxes is possible by 1987/8, while still permitting a fall in the PSBR from 3¼% of GDP currently to 1½% of GDP. Comment There can be no disputing that if GDP grows as fast as projected and if expenditure does not grow at all there will eventually be room for large cuts in taxation. However

(i) it is completely fallacious to argue that if £8 billion is available sometime over the next 4 years, then a quarter of it (or rather more than a quarter) can be given away in the next budget. Whether any money at all is available for tax cuts now depends on the forecast for expenditure and taxes next year, not on the 1987/8 projection.

(ii) CBI have nothing but pious hopes to explain how the 3% growth rate can be achieved without risking some resurgence of inflation; exports are assumed to perform much better relative to world trade than in the past, pay settlements lower than in competitor countries, continued rapid increases in productivity.

Points to Make

While many features of the projection are in line with our own aspirations for the economy, current fiscal decisions cannot be based on this hypothetical outcome. The right time to cut taxes will be when public borrowing has already started to fall.

While we agree with the CBI that industrial competitiveness is a key element in sustained growth and hence a reduction in industrial costs is desirable, the good export performance that CBI forecast will not be possible if a higher PSBR leads to higher interest rates and a less competitive exchange rate.

If the economy actually does perform in line with CBI projections this would represent a transformation of economic performance compared with the last decade. The implication is that the policies pursued so far have been successful in changing the underlying behaviour of the economy and should not be undermined by relaxing fiscal policy.

The CBI note that high inflation is damaging to the economy and low inflation vital for sustained growth. We agree. Further reduction in inflation should be an important element of the medium term programme, and again this points to maintaining policies which have already succeeded in cutting inflation.

Annex B

CBI BUDGET REPRESENTATION: SECTION 3

Economic Background

(i) CBI Economic Forecast

The CBI's projections for the short term are very similar to other outside mainstream forecasting institutions. GDP growth is expected to slow down to 2 per cent or just under in 1984 and inflation to rise slightly (but still to be "under control"). Consumption growth is forecast to slow to $1\frac{3}{4}$ per cent in 1984 (no figures are given in this document). The CBI's recommendations are partly designed to bring GDP growth rate up to a "steady 3 per cent p.a.".

(ii) Points to make

(a) CBI forecast too gloomy about short-term prospects: consumers' expenditure still growing strongly ($3\frac{3}{4}$ per cent in year to 1983Q3) with real personal disposable income up by $2\frac{1}{2}$ per cent same period. DTI Investment Intentions Survey suggests, if anything, that Autumn Statement forecast for investment could be on the low side: manufacturing investment expected to rise by about 9 per cent cent in 1984; other business investment by 6 per cent. CBI also seem rather pessimistic about world recovery over next few years. (Paragraph II.20 suggests only 3 per cent p.a. growth between 1982-83 and 1987-88 in world trade).

(b) Recovery in private sector expenditure could be endangered by impact of higher PSBR on interest rates if CBI's recommendations are followed.

(c) Company incomes are now rising very fast: ICCs profits up by 25 per cent between first three quarters of 1982 and 1983. Latest data suggest ICCs achieved very large financial surpluses in 1983.

(d) There is a danger that, in this improved climate for companies, reductions in NIS and other business costs might be passed on as wage increases. And the higher PSBR brought about by such concessions would impede progress towards lower interest rates, thus implying higher company costs.

(e) Companies have shown in the past two years that the way to improve competitiveness and profitability is through higher productivity growth and holding firm on wage increases.

SECTION 3

CBI Views on Interest Rates and Monetary Policy

The CBI argue that - though nominal interest rates have fallen, real rates are still high by historical standards.
- "the Government can influence interest rates and ... there is scope for further cuts"
- "we do not feel that monetary conditions necessitate keeping interest rates at their current high level given that inflation has fallen" (they point to MO's growth being slower than that of target aggregates as evidence of scope for interest rate cuts).

POINTS TO MAKE

(a) Nominal interest rates - Base rates now back at their lowest level for 5½ years, 7 points below their peak in October 1981.

(b) Real interest rates - Acknowledge CBI's point that real rates, especially tax element, are difficult to measure.

" - Real rates high as economy adjusts to lower level of inflation, just as real rates were negative when inflation accelerated in the 1970s.

" - UK real rates now comparable to those of 1950s and 1960s.

" - Bank of England December bulletin stated:- "In the 1980s, real interest rates faced by tax-paying companies have been lower in the UK than in the United States and Germany. Non-tax paying companies in the UK also face lower real rates than non-tax paying German and US companies".

(c) Monetary growth - Banking December figures suggest £M3 at top of target range, with PSL2 and M1 still outside.

" - MO's growth could be expected to be below that of the current target aggregates over the target period since the upward trend in the velocity of MO, with its main components notes and coin, is much greater than the velocities of broader aggregates.

" - Monetary growth under control, with six month annualised rates for all target aggregates at or slightly below the mid-point of their target range, but this does not necessarily feed through into immediate cuts in interest rates.

Annex C.

CBI BUDGET REPRESENTATIONS:

GOVERNMENT IMPOSED BUSINESS COSTS IN UK AND OTHER COUNTRIES

1. No evidence UK firms unduly burdened compared to those in other major western economies.

2. As percentage of GDP or total taxes, conventional business taxes (ie corporation tax, employer's NIC, NIS, non-domestic rates, stamp duty etc) put UK in about middle position.

3. CBI may argue conventional comparisons misleading: need to take account of occupational pension schemes in UK, which are counterpart of payroll-tax-financed state schemes abroad. Recent IFS study takes account of this: but UK still much in line with major competitors. Alternative definitions do not alter picture.

4. As percentage of profits, UK business taxes seem high. But comparison not very meaningful. Company profits struck after deduction of most of business taxes, which form part of costs of production.

5. CBI may also raise point of training costs. No comprehensive data available for other countries. But France and Germany impose more onerous legislation structure on employer training than UK.

Annex D

CBI BUDGET REPRESENTATIONS

CHAPTER IV: TAXATION

NATIONAL INSURANCE SURCHARGE AND CONTRIBUTIONS

The CBI propose immediate abolition of NIS, with clawback from central and local government but not public corporations (which are, of course, members of the Confederation). This would cost £900 million in 1984-85 and so is unlikely to be possible. But it may be possible in 1985-86 if the changes in company taxation currently under consideration (abolition of stock relief and reduction in the rate of some capital allowances) are implemented in the 1984 Budget. We assume, however, that you will not wish to raise this trade-off with the CBI at this stage. You might simply point out that the Government's stated aim is to abolish NIS over the lifetime of the present Parliament and that the substantial cost of immediate abolition poses obvious difficulties given the forecast fiscal prospect.

2. The CBI also propose an early announcement that employers' National Insurance contributions will be reduced by at least 1 percentage point in 1985-86 and that there should be a "temporary stabilisation" in the bands for NICS.

3. The gross full year cost to the National Insurance Fund of reducing employers' contributions by 1 per cent would be around £1,200 million (the CBI estimate much the same at around £1,150 million). The CBI propose that this shortfall in income to the Fund should be met by increasing the Treasury supplement. An increase in the Treasury supplement would, however, simply increase the burden on the taxpayer (though by somewhat less than £1,200 million since some part, around £400 million, would in any case have come from within the public sector). This would reverse the policy adopted by the Government in recent years to contain the burden on the general taxpayer of social security expenditure.

4. For 1984-85 the Government have decided to make no change in the rates of employer and employee contributions but to increase the Upper Earnings limit broadly in line with the expected movement in earnings - from £235 to £250. Overall the cash burden on employers rises by £700 million - but only £80 million of this arises from the change in the upper earnings limit - the rest is the effect of higher earnings, which emphasises the need for employers to contain pay increases. Also, when account is taken of the National Insurance Surcharge, the overall cash burden on all employers rises by only £330 million - less than 3 per cent - hence well below assumed increase in both prices and earnings.

In discussion you might point out that an increase in national insurance contributions over the last few years has been necessary, partly to meet the increased cost of benefits paid from the National Insurance Fund and also to contain the shift in the burden of social security benefit expenditure from the contributor to the taxpayer. Employers, however, have been largely protected from this increased burden; and the small rise in the employers' National Insurance contribution since 1979 has been much more than offset by the reduction in the National Insurance Surcharge in the same period. Employers' contracted-in contributions rose by 0.2 per cent (to 10.2 per cent) in 1980 and by 0.25 per cent (to 10.45 per cent) in 1983 - a total rise of 0.45 per cent. Employees' contributions, in contrast have risen by 2½ per cent. [Contracted-out contributions have risen by rather more (a total of 0.85 per cent for employers and 2.85 per cent for employees) but these higher contributions will be offset by the lower cost of providing for occupational pensions.] The National Insurance Surcharge during this time has been reduced from 3½ per cent to 1 per cent. So the combined burden on employers of both contributions and surcharge has fallen significantly - from 13.5 per cent to 11.45 per cent, saving private sector employers about £1½ billion a year.

Annex E

LOCAL AUTHORITY FINANCE

The need for control

Welcome the CBI's strong support for the measures taken by the Government to restrain LA expenditure and encourage greater efficiency. Would urge the CBI to voice its belief in the desirability in particular of rate capping. Particularly useful if CBI could reiterate its support for the legislation - as it does in the Budget representation document - before Second Reading of the Bill on 17 January.

10 per cent business/industrial derating

The CBI argue for a 10 per cent derating of all businesses in England and Wales, although they suggest that industry alone has a particularly strong case for relief. Local revenues would be reduced by £500 million by a 10 per cent derating of businesses, by £140 million if only industry is derated. In so far as expenditure was not reduced this would mean higher rates for all other ratepayers or, if the government sought to compensate local authorities, higher grant i.e taxes. The Inland Revenue Valuation Office would require extra staff and primary legislation would be required. The real remedy lies in local government controlling expenditure and that is where the Government's effort is directed.

Rate relief for partially used premises and plant: "Mothball Relief"

Although the Government has decided to suspend rates on empty industrial property, "mothballed" property is quite a different issue. It refers to industrial property which is only partly in use, where machinery etc remains in place in a section of a factory which is not (and probably cannot be) separately valued. Though there is a vocal lobby in favour of some form of "mothballing" relief, we believe that it would be technically impossible to operate.

Empty business property

The Government intends that local authorities' powers to levy rates on empty industrial property shall be suspended from 1 April 1984. Authorities will still retain discretion to levy at up to 50 per cent of full rates on empty commercial and other non-domestic property

- though fewer than half of the LAs actually do rate empty properties. Industrial ratepayers are being given particular protection because it is industrial property on which there is a surplus under prevailing market conditions which cannot be brought fully into use whereas there is reasonable demand for commercial property in many areas.

Annex F

PUBLIC EXPENDITURE - GENERAL

The CBI's general comments on expenditure are likely to concentrate on the case for more capital expenditure. In reply the Chancellor might say:-

a) The conventional definitions significantly understate public sector capital expenditure as it would be understood in any business. If the figures are adjusted for sales of council houses and to include defence capital spending and all nationalised industry capital expenditure, the total is around £24 billion,

b) Details will be given in the PEWP in mid-February (both the old and the new presentations will appear) but can say now that in real terms the level of this expenditure has been broadly the same - fluctuating only slightly from year to year - since 1978-79.

c) In 1979-80 (we have no corresponding figures for 1978-79), new construction other than dwellings amounted to 36% of public sector expenditure on capital goods and services. In 1983-84 it accounted for 38%.

d) The government is at one with the objectives stated by the CBI in para V(5) of their paper, which are unexceptionable to the point of being anodyne. Also share CBI's wish to reduce business costs. But must ensure that projects a) earn a satisfactory return and b) would not be better undertaken in the private sector.

Detailed Expenditure Proposals

INNOVATION SUPPORT

Points to make

(a) Expenditure has more than trebled since the Government took office.

(b) Further funds are being made available as a result of the recent Survey discussions. Details will be available in the White Paper.

ENERGY COSTS

Points to make

Electricity We will want to study your recent review of pricing in relation to continental competitors. Welcome acknowledgement of help given to large users in previous budgets (worth over £100 million). It is difficult to go further without running into either domestic or EC legislation on undue preference.

Fuel Oil Duty. The level of duty has not changed since March 1980 (ie a 20 per cent fall in real terms). Linkage to Trigg gas contracts means that reduction would give rise to disproportionate costs for industry elsewhere.

Background

Department of Energy are beginning to assess the CBI's review of electricity prices in comparison with continental users. Generally the report confirms that average prices to industry are in line but predictably it highlights a core of high-load factor high intensity users where there is a significant disadvantage.

SPECIAL EMPLOYMENT MEASURES

CBI say proposals would cost £100 million in 1984-85. Not clear whether this is gross or net (ie after social security flowbacks). Gross cost would be £250 million in 1984-85; net cost about half this. But spending would build up dramatically if proposed JRS changes were permanent, to almost £1 billion by the end of the decade.

Points to make

(a) Expenditure on JRS would reach £500 million by 1986-87 and almost £1 billion by end of decade. Cost effectiveness of this scheme would probably suffer.

(b) JSS has not taken off as hoped. Difficult to extend without subsidising part-time opportunities which might have existed anyway.

(c) Community programme. More sponsors welcome but MSC need to ensure community benefits outweigh private gain. More ambitious projects are more expensive.

MANPOWER

Points to make

(a) Welcome CBI support for improved efficiency and privatisation.

(b) Have already extended user charging in central and local Government.

(c) Civil Service manpower planned to fall to 593,000 by 1.4.88. Agree that LAs need to do more to reduce their manpower.

(d) Note CBI suggestion for legislation to require LAs to put more services to competitive tender.

PUBLIC SECTOR PAY

Points to make

The CBI urge continuation of trend for public sector settlements to be below private sector, and urge you to stick to the 3 per cent pay factor. There is no significant difference between Ministers and the CBI over the need for pay to continue downwards, and you need only say that you are well seized of the importance of these points. You might also ask about their views on the likely outcome for private sector pay in this round.

PUBLIC SERVICE PENSIONS

Points to make

(a) Government intends to continue to protect public service pensioners against rising prices, but will not give unopen-ended commitment to index-linking in all cases.

(b) Government committed to ensuring that public servants pay realistic contributions towards costs of their pensions.

CBI BUDGET REPRESENTATIONS

DIRECT TAX POINTS

Contents

A. Enterprise & Taxation

- Corporation Tax
- ACT
- Capital Allowances
- DLT
- Stamp Duty
- Share Options
- CGT
- CTT
- Income Tax/IIS
- Business Expansion Scheme
- Wider share ownership
- Unitary taxation
- Controlled foreign companies

B. Priority points from CBI's technical representations

- Groups of companies
- Foreign currency losses
- Costs of equity finance
- Stock relief
- Disincorporation

INDIRECT TAX POINTS

Contents

- Pension Funds
- Partial Exemption Changes
- Draft VAT 12th Directive
- VAT Registration Threshold
- DERV

Corporation Tax

The CBI's response to the Corporation Tax Green Paper contained over 60 detailed recommendations for changes to the structure of Corporation Tax. Many of these changes would involve very large Exchequer costs. But it was made quite clear in the Green Paper that the discussion of proposed changes would have to proceed on the basis of revenue-neutrality - ie that the changes would be financed from within the corporation sector. Furthermore, support for the CBI's proposals was by no means unanimous among others who responded to the Green Paper. In these circumstances it is not surprising that many of the CBI's suggestions have not been adopted. But Ministers have already made several useful changes, as the CBI acknowledge.

As to the CBI's request for a synopsis of representations to be published, some representations were submitted in confidence; but most major representative bodies released their representations publicly, and the CBI will doubtless be aware of these.

Advance Corporation Tax

The CBI "do not believe that the Select Committee debates in 1971 were intended forever to ossify the rules ...". Nor do Ministers. The changes announced in the 1983 Budget and due to be included in Finance Bill 1984, to extend to 6 years the carry-back period for surplus ACT and to reverse the order of set-off of ACT and double taxation relief, responded to representations made on the CT Green Paper by the CBI and will be of real help. Most of the other changes to ACT which the CBI now advocate would be very costly, running into several £m100s. How would the CBI propose financing them? And when Ministers considered the response to the Green Paper, they were not persuaded on the merits of these changes in principle, quite apart from the cost.

The CBI said that they supported the principle of the imputation system of corporation tax - but to implement the changes they propose would emasculate it.

Capital allowances

CBI propose new capital allowance for commercial buildings of 2% per year (straight line basis).

Points to make:

i. Accept the allowance right in principle - even if commercial buildings depreciate very slowly (or even appreciate in early years).

ii. But cost has always been the real difficulty. First year reasonably modest at £m25 - 30. But builds up to £bl.5 a year eventually.

iii. Nevertheless will bear in mind.

[Confidential Possibility of such an allowance - counterbalanced by withdrawal of first year allowances for plant in commercial buildings - one of the suggestions currently under consideration in context of longer term reform of capital allowance system.]

DEVELOPMENT LAND TAX

The future of this tax has been recently reviewed, and its abolition was not considered a runner (Miss O'Mara's 21 November minute to the FST). The CBI estimate the yield for 1983/84 at £50m, and suggest its immediate abolition would cost nothing significant. Better estimates are £80m yield, with an initial cost of £20m (1984/85) and £40m (1985/86). They suggest that its existence discourages commercial development, but the indications are that it is now generally accepted as a reasonable price to pay for continuity and stability in the property development field. To suspend its operation for 3 years as now suggested would create the very market instability that continuity of the tax avoids. And though such a tax holiday might lead to a flurry of apparent development activity, it is likely that this would be more concerned with establishing exemption by bogus starts to projects than by meaningful development, which will be supplied by the development industry in response to demand, not because of tax liability or otherwise.

STAMP DUTY

In their response to the Stamp Duty Consulative Document the CBI called for the abolition of:-

a. capital duty; and

b. stamp duty on equities.

As the CBI recognise, a duty (at a rate of 1 per cent) on the raising of capital by companies is mandatory on Member States of the European Community. The UK has had a form of capital duty since the 19th Century. The present duty is expected to yield £m75 this year. Although the Commission did tentatively suggest last year that the EC duty should be reviewed, nothing came of the idea. It is doubtful whether a majority of Member States would welcome any change.

The Chancellor is aware of the case for some reduction of the duty on equities. Reducing the rate to 1 per cent would cost £m175. More, if there was any leakage of tax from houses and land or if a reduction in stamp duty on equities led on to a revision of the rate scale for houses and land. The CBI in their stamp duty submission called for the introduction of a slice scale. With current rates this would cost £m350.

The responses to the Consultative Document are still being analysed.

Share Options

1. The Government's policies to encourage employee share ownership are reflected in the operation of three tax reliefs for employee shares -

a. No income tax is payable by an employee who retains for 7 years shares received as a gift under his company's approved profit-sharing scheme. Such schemes must be open to most full time employees. The limit on allocations to individual employees was raised to a maximum of £5000 in 1983.

b. No income tax is payable by an employee in respect of gains taken on SAYE-funded share options made available under his company's approved scheme. Such schemes must be open to all full time employees. SAYE contributions are limited to £50 a month (a 1983 Finance Bill proposal to increase this to £75 was lost).

c. Other share options, granted by employers on a discretionary basis, are normally the preserve of directors and senior managers. Gains made on exercise of such executive share options are subject to income tax, but a 1982 relief allows the tax payment to be spread over 3 yearly instalments (a 1983 Finance Bill proposal to increase this to 5 yearly instalments was lost).

Nearly 650 approved all-employee share schemes (a. and b.) have now been set up compared with just 30 when the new Government took office in 1979.

2. The CBI are keen to see more favourable tax treatment introduced for executive share options. Ministers are currently considering the case for providing a new tax relief in this area. Among the choices is replacement of the income tax charge with capital gains tax, which, subject to a range of conditions, is the regime introduced in the US in 1981 for "Incentive Stock Options".

CAPITAL GAINS TAX

General

Suggested line to take:

i. In longer term, it will be necessary to consider the future of CGT based on real gains and nominal losses.

   Present yield - £m850 forecast for 1983/84 (including £m250 on companies gains) - will be progressively reduced by effect of indexation.

ii. Burden of tax has been significantly reduced in recent years: indexation allowance, increase in threshold for individuals to £5,300 and index-linked, reform of settled property provisions.

iii. Real gains which add to taxable capacity should not escape tax altogether. Without some charge on capital gains, the pressure to avoid income tax by conversion of income into capital would be increased.

Specific CBI proposals

i. Exemption for assets held for 6/7 years (to compensate for absence of indexation relief pre-1982).

   This would not distinguish between real and inflationary gains. Administrative difficulty in applying such a rule to shares which, prior to 1982, were pooled - dates of acquisition will not therefore be known. The cost would be about £m300 in first full year.

ii. Overhaul of retirement relief.

   Consultations about the relief were promised by the previous Chancellor in the 1983 Budget Speech. A consultative document is to be issued shortly. In the meantime, the Government has announced that it will be going ahead with the proposed doubling of the relief (from £50,000 to £100,000 in the 1984 Finance Bill).

iii. Simplify indexation provisions by (a) extending them to losses and (b) dropping the 12 months exclusion rule.

   It is accepted that these restrictions add complexity. But they remain necessary (a) to preserve the current yield of the tax and to minimise the additional workload; and (b) to put a brake on the conversion of income to capital

iv. Removal of two tier charge on companies and their shareholders.

Gains realised by a company and by its shareholders are realised by different persons in respect of different assets usually over different periods of time. In most cases, it would be impractical to attempt to relate gains on shares to gains on particular assets by the companies in which the shares are held.

v. Carry forward of annual exempt amount.

At £5,300 (and index-linked) the threshold is very generous almost double the married mans allowance for income tax). If it were possible to carry forward unused part, the threshold itself might have to be lower. More important, administrative savings from not having to calculate small gains would be lost. Business assets are protected by special replacement and retirement reliefs.

CAPITAL TRANSFER TAX

It is suggested that the present business asset reliefs (currently either 50 per cent or 30 per cent) should be amalgamated and replaced by complete exemption. Present reliefs amount to £50m per annum, and the amalgamation and extension would cost some £50m. It would also set aside sound reasons for the two levels of relief, designed to ensure that roughly the same proportion of the value of the relevant estate is taxed, taking account of the different value levels of, say, minority shareholdings or tenanted agricultural land (now both enjoying 30 per cent relief) and the rate of tax then appropriate. CTT rates, for death or lifetime transfers, are due for review in the Budget, and it is for consideration what degree of incentive is though appropriate for lifetime gifts. The CBI is suggesting that transfers above £220,000 (where lifetime transfer rates begin to rise to somewhat more than half their death rate equivalent) should be reduced. This would mean reducing the top rate for lifetime transfers (applicable over £2,650,000) from the present 50 per cent to 37½ per cent, and it is thought this would cost some £5m for 1984/85. It may be thought appropriate to consider this possibility in the forthcoming paper on rates and threshold. With regard to the possibility of accumulating annual exemptions, for a limited period or for ever, the annual exemption of £3000 is presently a de minimis arrangement intended to free small gifts in any one tax year. To accumulate would be to effect an entirely different result: a small snip, but a large hole in the tax net.

INCOME TAX AND IIS

On income tax generally the Chancellor will presumably wish to do no more than note what the CBI have to say in relation to 1984/85 while sympathising with their longer term objective of reducing the overall burden of direct taxation. The Chancellor has made clear that increases in income tax thresholds have a very high priority, when resources are available. For 1984/85 the CBI proposals assume that income tax allowances and thresholds will be increased by no more than indexation. There is, however, a strong case for going further, in so far as available resources permit, to ensure, at the least, that the burden of income tax does not increase relative to average earnings.

On IIS the Chancellor may feel able to mention to the CBI his own view of the attractions in abolishing the surcharge and his personal wish to do something about it during his time in office - in line with what he told the Country Landowners Association on 4 October last year. He will, however, want to remind the CBI of the present very tight fiscal position; abolishing IIS would cost something over £300 million in a full year.

BUSINESS EXPANSION SCHEME

1. The CBI have resurrected their earlier proposal for a new kind of "small firms investment company" (SFIC). Individuals investing in a SFIC would qualify for BES relief. Short of introducing SIFCs, the CBI suggest changing the present rule so that an investor would get relief for the tax year in which he subscribed to a BES approved investment fund, even though his money might not be invested by the Fund in qualifying companies until the following year. The CBI also want an advance clearing system for investments and, in their Technical Representations, suggest a further seven changes.

2. None of these points is new. Some have been made by others as well, and all of them have been considered carefully by Ministers - most recently in a wide-ranging review of the Scheme by the Financial Secretary. His recommendation, which the Chancellor endorsed, was that while there might be merit in some of the suggested changes (others would definitely not be acceptable) the scheme should be given time to settle in and there should be no changes to it in the 1984 Finance Bill. (There is one possible exception; Ministers are reconsidering whether action is necessary to exclude farming.)

3. The case for SFICs was considered before the last Budget and, with the Prime Minister's agreement, BES was introduced instead. There were three main reasons. First, the main aim was to encourage individual investors to take a direct equity stake in companies; SFICs would break that direct link. Second, the existing approved investment funds have many of the same institutional advantages that are claimed for SFICs so it is doubtful whether a new kind of intermediary is needed anyhow. Third, to graft SFICs on to BES would in our view add a further layer of complexity to the scheme - we think the CBI are wrong to suppose it would allow simplification. The Chancellor deployed these arguments in resisting a suggestion last August from the Conservative Research Department for the introduction of SFICs, and in a speech to the British Venture Capital Association in September the then Financial Secretary again explained why the Government remained unpersuaded of the case for SFICs.

4. Of the CBI's other more detailed proposals, some (eg to extend the scheme to companies with overseas subsidiaries) are ones which Ministers might be prepared to accept if there were to be changes to the scheme in 1984. Others (eg to open up the scheme to employees;

to extend further the time limit during which a new company must start trading if it is to qualify) are incompatible with the fundamental aims of the scheme. Others again (eg consolidating the BES legislation - which is spread over four Finance Acts) are no doubt desirable, but not essential to the success of the scheme.

5. The CBI put the overall cost of their proposals tentatively at £200m in a full year. This is probably no more than a shot in the dark, and seems very high. It implies additional investment of around £400m a year, over and above money diverted from existing investment under the scheme. This is several times the current level of take-up. In the 1983 FSBR the full year cost was put at £75m (implying annual qualifying investment of about £150m) but it seems probable that even this figure will turn out to be on the high side.

Line to take

6. The Chancellor will probably not want to go into detail on the CBI's Technical Representations other than perhaps to note that whilst some may in principle have merit, others seem inconsistent with the fundamental aims of the scheme. On their point about advance clearances, local tax offices do already operate an informal clearance procedure for companies wishing to qualify under the scheme. On SFICs - about which the CBI will no doubt expect him to say more - he might draw on the arguments in paragraph 3 above. More generally, he might say that whilst the Government will be monitoring the scheme carefully, and welcomes suggestions for improving it, there is a good case for giving it time to settle in before considering any further changes.

Wider share ownership

1. The Government supports the aim of increasing wider share ownership, and entirely agrees with the view that employees should be encouraged to take a stake in the enterprise they work for. Three of the past five Budgets have contained substantial - and welcomed - measures to increase the attraction of employee share ownership. Impressive results have already been achieved: over £m500 worth of shares have been allocated to employees or are subject to options held by employees. This is a healthy reversal of the trend towards institutional shareholding. The Government's 'privatization' programme has also opened up the chance of true financial participation for thousands of employees for whom it did not exist before. Other measures taken include BES and reduction in capital taxation.

2. Representation on BES, stamp duty, IIS and capital taxation have been noted.

UNITARY TAX

Background

After considerable prompting by both Treasury Ministers and officials, the CBI eventually got its act together on unitary taxation sufficient to submit a Note to Secretary Regan's Working Group. Largely because of the actual examples it contained, this was quite a powerful critique of the system. The CBI urges the UK Government (which submitted its own Note on 30 November), together with our European partners, to keep up the pressure on unitary tax.

Line to take

i. To welcome the CBI Note to the Working Group. This will complement the UK Government's own Note (which was prepared before the CBI had produced examples of actual damage).

ii. To urge them to provide their assessment of retaliatory measures and their consequences (ie the information requested in the Financial Secretary's 21 December letter). The need for this material is urgent.

iii. To stress the vigour with which the Government have pursued the issue, and our success in getting other Governments to respond vigorously. As well as the UK, the Governments of Australia, Canada, Germany the Netherlands and Switzerland have each submitted individual Notes to the Working Group. There has also been a joint Note from the 10 Member States of the EC. Liaison with European partners (and other countries) continues.

iv. In response to a request from Secretary Regan, UK officials gave oral evidence (11 January) to the Task Force on the UK's arm's length pricing rules.

CONTROLLED FOREIGN COMPANIES

Background

1. Legislation on "controlled foreign companies", designed to deal with the tax haven problem, was included in the original 1983 Finance Bill. This enabled a charge to UK tax to be imposed on certain UK resident companies with interests in tax haven companies. In the event these provisions were pruned from the 1983 Bill prior to the General Election and, with a view to legislating in 1984, revised draft clauses were issued last October. This revised draft incorporates the important changes Ministers had announced in response to the business community's criticisms of the proposals as included in the 1983 Finance Bill.

2. The CBI have played an active part in the three previous rounds of public consultation on tax havens. They have also been consulted informally, both by Treasury Ministers and officials, on this issue. The implication in their present representations that they have always been fundamentally opposed to the haven proposals is somewhat misleading. Hitherto they have accepted that it is right in principle to attack UK companies' use of tax havens to avoid UK tax: their concern has been that the legislation does not spill over to damage the "genuine" overseas activities of UK business. Unless they have had a significant change of heart, therefore, what the CBI are presumably now doing is taking up a fairly extreme negotiating posture in the hope of securing - yet further - relaxations of the legislation.

Line to take

i. To reaffirm the Government's commitment to tackle the tax haven problem, broadly on the lines of the existing proposals. They are however prepared to look at the detail of the provisions, and look forward to receiving the CBI's promised detailed comments on the revised draft clauses.

ii. To emphasise that the Government share the CBI's objective of preserving the competitive position of British business. That is why they have made such efforts to meet the business community's criticisms of the earlier proposals. In particular they have made a whole series of amendments to provide more certain safeguards for the "genuine" overseas operations of UK businesses.

iii. (If Section 482 is raised). To say that the Government recognise that Section 482 may no longer be appropriate in its present form. They already have the terms of the Section under review, and will be publishing proposals in due course.

Customs has agreed that the normal 90 days' notice required for such changes would be waived in this instance. Customs have also stressed in their meetings with trade bodies that they will be as cooperative as possible in agreeing special partial exemption methods to ensure that businesses affected by the proposed changes can recover all the input tax to which they are properly entitled. To the extent that the proposed changes are aimed at stemming revenue losses they will add to business costs, but the additional administrative burden associated with the proposed changes will be limited and has not, in fact, been a major source of complaint in Customs meetings with trade bodies and individual businesses.

DRAFT VAT 12TH DIRECTIVE

4. The draft Directive aims to harmonise rules for the deduction of input tax. The Commission's proposals, put forward in early 1983 would block a variety of business expenses (eg running costs of cars, expenditure on business travel) which is currently deductible in the UK. The European Parliament has recently suggested some amendments, but there has been no discussion between Member States either of the original proposal or the Parliament's views. The Directive could not come into effect without the agreement of all Member States.

5. Customs undertook a comprehensive consultation exercise on the original proposals and has also drawn the attention of interested bodies, including the CBI, to the views of the European Parliament. Subject to the MST's approval further consultations between Customs and the CBI and other bodies are likely (Mr Jefferson Smith's note to MST, 5 January).

6. The Minister of State announced the Government's line on the proposals in a Written Answer last July. The principle of blocking some input tax is something the UK Government accepted with the Sixth Directive in 1977 and has applied for cars and entertainment since the introduction of VAT. The purpose is to ensure expenditure of a private nature is not tax free. Ministers consider that blocking runs counter to normal VAT procedures and should only be used to prevent really significant abuse or administrative complications. Accordingly a Directive making blocking obligatory could only be accepted if it were restricted to the items already blocked in the UK. This line reflects fully the views of the CBI and others.

7. There has been no change in this position since the statement in July. In considering any revised proposals the interests of UK industry will be fully taken into account.

Groups of companies

The CBI have now (two months late) submitted their representations for the review of the tax treatment of groups of companies. They had made numerous proposals and say they regard them all as a first priority for action in Finance Bill 1984.

Although the Chancellor has not ruled out action in 1984 on two particular points, both concerning consortium relief (and only one of which has been raised by the CBI), it seems unrealistic to expect action in 1984 on the review as a whole. This is a complex part of the tax code, and with 60 odd individual proposals to be considered, many of which would interact with each other, it will clearly take time to complete the review. Some further consultation may also be necessary and we have, for example, already arrange to discuss with the CBI and certain other bodies a more radical suggestion they have floated for an entirely different system to the present one for taxing groups of companies.

FOREIGN CURRENCY LOSSES

The exchange loss on foreign currency borrowings of a fixed capital nature is not allowable because it is a capital item (only expenditure of a revenue nature is deductible in arriving at taxable profits). Ministers have decided against action in the past. Reasons are the difficulty of determining precisely where the capital/revenue distinction was to be overidden (the case for relief is not universally strong), a fair and workable scheme would require long and complex legislation and the cost could be substantial. A recent adverse decision by the House of Lords may remove some of the pressure for relief for borrowings but it raises other problems. (The CBI representations were submitted before the judgment).

Line to take - Resist : We have recommended to Ministers that any change be ruled out for 1984 while we assess the significance of the judgment and what action, if any, may be needed.

COSTS OF EQUITY FINANCE

The 1980 legislation removed an anomaly by giving relief for the incidental costs of raising loan finance where the cost of maintaining the loan (the interest) was itself allowable. There is no corresponding anomaly in not allowing the costs of raising equity capital since the costs of maintaining equity (dividends) are not deductible from profits. There would also be practical problems in excluding the cost of share issues in, for example, contested takeover bids. Unlikely that a lack of tax relief for this once-and-for-all cost will affect a company's willingness to raise new equity capital having regard to the on-going costs of servicing that equity.

Line to take - Resist

Stock relief - six year cut off

The CBI oppose the rule in the 1981 scheme of stock relief under which losses attributable to relief under that scheme are cancelled if they remain unused for six years. The decision to introduce this rule was a budgetary one, to protect the flow of corporation tax revenue in the late 1980s and 1990s and to help stem the growth in the very large "overhang" of unused tax losses and allowances. And even with this rule, the UK is still more generous than most other countries, whose corporation tax systems generally place a restriction on carry-forward of all tax losses, not just those attributable to a particular relief.

Disincorporation

The CBI urge the removal of fiscal barriers to those who want to change from operating in a corporate to an unincorporated form e.g. as a partnership for sole trader. They particularly refer to the inhibiting effects of stock relief and capital gains tax.

Line to take

i. Accept that tax system should not inhibit the adoption of most desirable commercial form.

ii. At Ministers request, we have been examining this matter with the accountancy bodies (the CCAB) over recent months. Aim has been to remove fiscal obstacles on a revenue-neutral basis i.e. not to give any form of tax incentive. The CGT point has proved the most intractable - the present law imposes a charge on the company (in respect of assets) and on shareholders (in respect of gains on shares) - which can be met only by a specific relief.

iii. There does not appear to be any pressing need for action this year - the disincentive to corporate status arises primarily from the more stringent standards of auditing required by the Companies Act and the introduction of stricter requirement by the accountants own professional bodies. These will not bite until 1984 accounts are due.

iv. For your own information the Financial Secretary's preliminary view is that, against the background of pressure on the 1984 Finance Bill, the case for immediate action has not been made out, but that the matter should be kept under review as the Companies Act changes begin to take effect.

INDIRECT TAXATION ISSUES

PENSION FUNDS

1. Under the existing arrangements made in the light of counsels' advice, it is accepted that employers can recover VAT incurred in respect of administration services of funded pension schemes providing pension arrangements for employees. While the valuable work done by Pension Funds is fully recognised, it would be inequitable to make exceptional arrangements to provide special input tax relief to the funds or employers in respect of exempt supplies (eg of securities or property) made by pension funds. Any such measure would also be inconsistent with our international obligations and would lead to requests for similar treatment for other bodies undertaking worthwhile social functions such as charities.

2. A particular point the CBI is likely to raise is that the amount of VAT which pension funds are unable to recover may be increased by the proposed VAT partial exemption changes announced by MST in a written reply on 15 December. These changes are, of course, of general application, but their most significant impact will be on the financial sector. Pension funds have developed such a significant role in this sector and are so heavily engaged in investment activity that it would clearly be wrong to treat them more favourably than other businesses similarly engaged such as insurance companies, which share the burden of providing pensions.

PARTIAL EXEMPTION CHANGES

3. MST announced in Parliament on 15 December that he was satisfied that the present VAT partial exemption rules result in substantial losses of revenue. It is inevitable that the changes proposed to correct this situation will bring more businesses into the partial exemption net; but, generally speaking, they will be businesses with fairly sophisticated accounting systems which can cope with changes without difficulty. Some may wish to rearrange their VAT groupings.

Customs has agreed that the normal 90 days' notice required for such changes would be waived in this instance. Customs have also stressed in their meetings with trade bodies that they will be as cooperative as possible in agreeing special partial exemption methods to ensure that businesses affected by the proposed changes can recover all the input tax to which they are properly entitled. To the extent that the proposed changes are aimed at stemming revenue losses they will add to business costs, but the additional administrative burden associated with the proposed changes will be limited and has not, in fact, been a major source of complaint in Customs meetings with trade bodies and individual businesses.

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6. The Minister of State announced the Government's line on the proposals in a Written Answer last July. The principle of blocking some input tax is something the UK Government accepted with the Sixth Directive in 1977 and has applied for cars and entertainment since the introduction of VAT. The purpose is to ensure expenditure of a private nature is not tax free. Ministers consider that blocking runs counter to normal VAT procedures and should only be used to prevent really significant abuse or administrative complications. Accordingly a Directive making blocking obligatory could only be accepted if it were restricted to the items already blocked in the UK. This line reflects fully the views of the CBI and others.

7. There has been no change in this position since the statement in July. In considering any revised proposals the interests of UK industry will be fully taken into account.

VAT REGISTRATION THRESHOLD

For Chancellor's information only. Not to be revealed to CBI

8. The VAT registration threshold has been increased in each of the past four years. It now stands at £18,000. An increase in 1984 to £19,000 would broadly maintain the real value of the limit at its 1973 level. However, the Commission has recently written to say that indexation back to 1973 is unacceptable under the EC Sixth VAT Directive, and that the UK should at least freeze the existing limit until it is effectively indexed from 1 January 1979. This would take about three years. (Mr Harris' note to MST, 15 December 1983).

9. The CBI will probably be aware that the Commission is unhappy with the level of the UK's VAT registration limit, but they will not know about the threatened infraction proceedings. No decision has yet been taken on the level of the limit for 1984. In view of the complications the Chancellor will no doubt wish to simply note the CBI's views on this point.

DERV

10. Derv has been favourably treated by the Government. The duty differential in favour of derv over petrol, which was introduced in July 1981, was widened slightly in the 1982 and 1983 Budgets. The derv duty is now about 12p a gallon less than petrol. The real value of the duty is well below its 1970 level.

11. Although the recommended retail selling price of derv is among the highest in Europe other factors mean that the effective price to businesses is not excessive by EC standards. Businesses in the UK are able to deduct VAT on derv whereas a number of Member States either completely or partially block deduction of VAT. Also some Member States (Denmark, Italy, Luxembourg and the Netherlands) which have a particularly low duty on derv, impose higher taxes on diesel-engined vehicles to equalise the tax burden. In the UK most derv is purchased by businesses under contractual arrangements which typically provide for discounts of up to 15p a gallon off the retail price.

12. Derv is an important revenue raiser - estimated at just over £1,000m in 1983-84. Any revenue foregone would have to be made up elsewhere.

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CBI Budget Representations
to the Chancellor,
January 1984

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Executive Summary

1 Our task is to sustain the recovery without prejudicing the gains made in the fight against inflation.

2 The 1984 Budget must be prepared with this in mind.

3 With the prospect of lower North Sea oil production we cannot ignore the longer term. We therefore set out a five year programme of action by business and government, covering the period 1982/83 to 1987/88, which aims to sustain last year's 3 per cent rate of growth and keep inflation low. Improved competitiveness and encouragement of enterprise and investment are necessary to achieve this.

4 The overwhelming immediate need is to improve competitiveness. We are still more than 20 per cent less competitive against our main competitors than we were in the mid-1970s and the gap is still larger against our European rivals.

5 Unless we improve our competitive position increases in domestic demand will benefit foreign rather than domestic producers and lead to a further deterioration in the current account.

6 The 1984 Budget must concentrate on measures to reduce Government-imposed business costs - by the final abolition of the National Insurance Surcharge and 10 per cent business derating. Looking ahead, we need to reduce employers' National Insurance Contributions in 1985/86 and increase capital spending on the infrastructure.

7 We do not propose that income tax thresholds should be raised by more than inflation. If we reduce the burden of personal taxes in the 1984 Budget there is a serious danger that too much would be spent on imports and nothing done to help our competitiveness.

8 Only if we are successful in sustaining the present rate of growth in the economy will there be scope for cuts in personal taxation in future years.

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Chapter I

Main Representations

1 Our task must be to sustain the recovery. As the Chancellor has said, steady growth with low inflation is "a winning combination". Our Representations are drawn up with this in mind.

2 They are set in the context of a medium term programme of action by business and government, covering the period to 1987/8, with the following key features:

a Maintaining steady growth at around the 3 per cent rate achieved in 1983 and expected by the Chancellor for 1984;

b Keeping inflation low;

c Improving competitiveness in cost, price and non-price areas;

d Encouraging enterprise and investment.

The 1984 Budget

3 The overwhelming immediate need is to improve our competitiveness. We are still more than 20 per cent less competitive against our main competitors than we were in the mid-1970s and the gap is still larger against our European rivals. Our balance of payments current account has moved from a surplus of £6½ billion in 1981 to one of £1½ billion in 1983, despite a large improvement in the balance of trade in oil. In 1984, world trade growth should help exports and keep the current account in balance. But if the trend continued we could run into a balance of payments crisis in the second half of the decade especially if the world economy slows down, and if North Sea oil production starts to decline at about the same time. The brakes would then have to be put on which would stop growth; or the pound would fall excessively, causing renewed inflation; or, most probably, there would be a combination of both.

4 So, our priority has to be improved competitiveness. To this end, the first two lines in Table 1 propose cuts in Government-imposed business costs - the abolition of the National Insurance Surcharge and 10 per cent business derating to match domestic derating. Looking further ahead, we also recommend a reduction in employers' National Insurance Contributions, by one percentage point, to take effect in 1985/86.

5 The next Budget should also include further measures to help enterprise, investment and innovation. These will pay off in the longer term. We recommend improvements to the Business Expansion Scheme to make investments more marketable; improved tax treatment of employees' stock options; capital tax reliefs; abolition of the Investment Income Surcharge, of Development Land Tax and of Stamp Duty on share transactions; capital allowances for commercial buildings.

6 In addition, we want to see a higher level of capital spending, as soon as practicable, to improve the infrastructure. This will both help our competitiveness in the medium term and provide work for the sorely-pressed construction industry. We propose that this be financed by reducing Government current expenditure.

7 In addition, a reduction in the cost of borrowing, which remains high in relation to inflation, is a priority.

8 We do not propose that income tax thresholds and bands should be raised by more than inflation. Those in work have improved their real income after tax substantially since 1979, while company net income has fallen drastically. Increases in tax thresholds are an inefficient way of reducing the poverty trap and have little impact on the unemployment trap.

9 If personal tax were cut in the 1984 Budget, there is a serious danger that too much would be spent on imports and nothing done to help our competitiveness. In subsequent years, if we can improve our competitiveness, keep growth going, and the balance of payments under control - and if public spending is held down in real terms as the Government proposes - we should be able to make further substantial reductions in taxation, including personal tax, while reducing public borrowing as a percentage of GDP.

How our proposals can be financed

10 The cost of our proposals for the 1984 Budget are set out in Table I.1

11 They should not be financed by raising the burden of taxation elsewhere as this would, to a large extent, offset their beneficial effects and might add to inflation.

12 In the Government's medium term financial strategy, as set out in the Budget last March and in the Chancellor's Autumn Statement, there would appear to be little if any scope for tax reductions in the 1984 Budget but very much more in the Budget of 1985.

13 However, as the Chancellor pointed out in the House of Commons in November, these estimates "are subject to a wide margin of uncertainty at this stage and rest on a number of conventional assumptions. The Autumn Statement is not a time for decisions on appropriate levels of borrowing or taxation. By the time of the Budget I shall have much more, and much more up-to-date, information".

14 Our proposals imply a somewhat higher level of public borrowing in 1984/5 than the Chancellor has assumed in his Autumn Statement. They increase borrowing by ½ per cent of GDP, but leave it well within the Chancellor's target in the following year (1985/86). On present estimates, they would reduce the PSBR as a percentage of GDP from 3¼ per cent in 1983/4 to 3 per cent in 1984/85, and if our medium term programme were fulfilled the figure would fall to around 1½ per cent by 1987/88.

15 While the economy expanded at a rate of 3 per cent in 1983, we see a significant risk that it may slow down in the second half of 1984 if nothing is done. This would have a serious effect on business confidence and put the objective of steady growth at risk. On the other hand we do not think the risks of the economy overheating if our proposals are adopted are significant.

16 We believe that our proposals can be justified as a sound long-term investment in the future of this country. Also:

- they would still keep our public borrowing as a proportion of GDP lower than in any other important industrial nation.

- they should not add to inflation because they reduce costs.

- they should enable interest rates to be reduced as external factors permit.

TABLE I.1

CBI TAX RECOMMENDATIONS FOR 1984 BUDGET[1]

(£ billion)

Proposed Changes:

		1984/5 Cost
A	Lower Business Costs	
	Abolition of NIS	0.9
	Partial Business Derating and Other Measures	0.7
B	Measures to Encourage Enterprise and Investment	
	Improved Stock Options	-
	Stamp Duty Changes	0.5
	Capital Tax Changes	-
	Amendments to Business Expansion Scheme	-
	Abolition of Investment Income Surcharge	-
	Corporation Tax changes	0.1
	Abolition of Development Land Tax	-
	Feedback Effect	-0.4
	Net Effect on PSBR[2]	+1.8

1 Where no cost is indicated this is either because the cost of the proposal is insignificant, or would not become effective until 1985/86.

2 In comparison with unchanged policies using the same definition as the Treasury. The full year cost of these proposals is about £2½ billion.

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Chapter II

The Medium Term Programme

INTRODUCTION

1 This Chapter sets out the action which Government and business need to take to sustain steady growth and low inflation over the period to 1987/88. The economic arguments underlying our proposals for the 1984 Budget are set out in Chapter III and the details of these tax and expenditure proposals are set out in Chapters IV, V and VI.

THE NEED FOR A SUSTAINED RECOVERY

2 Over the past 10 years the British economy has grown only slowly, with much of the growth attributable to increased oil production.

3 In the next decade, oil production is likely to plateau and then fall. To avoid depressing the standard of living, it is essential to develop competitive businesses to compensate for this.

4 The recession has hit particularly those firms facing international competition and the investment goods industries. To survive they have had to cut expenditure and rationalise. We need now to build on the lessons learnt from this process to form the basis of a successful recovery.

5 Confidence is vital. Our Surveys show that the major constraint holding back investment is lack of certainty about growth and prospects (44 per cent of the respondents to the October 1983 CBI Industrial Trends Survey quoted 'uncertainty about demand' as the main factor holding back their investment). For confidence to invest in the future businessmen need to be convinced that the recovery will be sustained. In this way growth can create its own momentum.

6 Growth is also necessary to generate higher living standards and help create more jobs; with 3 million unemployed this is crucial.

7 Lack of growth in the economy increases the tension between the living standards we can afford and those to which we aspire. Slow growth leads to rising public spending on unemployment which can only be paid for by cutting benefits or public services, raising tax levels, or running the risk of excessive borrowing.

8 It has been argued that too rapid a rate of growth would lead to a deterioration in the quality of life or the environment. But stagnation or a rate of growth that is too slow can also damage the quality of life - through rising unemployment and the consequent loss of human skill, reduced growth in expenditure on education and health, and through deterioration of the infrastructure.

9 A rate of growth that is too rapid may lead to inflation. For this reason, holding down inflation is an essential element in our strategy for growth. Moreover, growth can hold down costs through spreading overheads and generating more funds for cost-cutting investment.

THE SPEED OF THE RECOVERY

10 During the 1970s GDP grew at an average rate of 1 - 1½ per cent per annum. But the trend during the 1950s and 1960s was much higher, close to 3 per cent. Given the dangers of shortages and inflation if growth is too fast, and of rising unemployment and higher taxes if growth is too slow, what rate should we aim for?

11 To answer this we need first to assess our starting point and then to consider the likely external environment.

Capacity

12 At first sight it would appear that we start from a position of considerable spare resources in the economy. An eighth of the labour force is unemployed. The different indicators of spare capacity in the manufacturing sector from the CBI Industrial Trends Survey, suggest that although capacity has been reduced, partly in response to low demand, there is still considerable scope for higher capacity utilisation.

13 This conclusion is backed up by most other researchers[1], though it has been argued that much of this capacity is not economically viable or is not in those particular sectors where it would be needed in a recovery.

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1 The OECD (Economic Survey of the United Kingdom, 1983) and J Taylor ("Unused Productive Capacity in the UK: 1950-82" Unpublished paper, University of Lancaster) both conclude, using different methodologies from the CBI Survey, that there is considerable unused capacity in the UK manufacturing sector. P W Robinson (LBS Economic Outlook, August 1981) has argued that there is in fact relatively little spare capacity. This conclusion is based, however, on the assumption that the total available capacity is equal to a 5 year moving average of output rather than using direct information about how much capacity is in existence.

14 Clearly as growth proceeds we should expect some shortages of capacity, labour and components. But temporary shortages can reflect a changing economic structure and investment in new capacity and production of components and training for skills is unlikely to take place without such market signals. The rate of growth that is sustainable without inflation, however, will depend on holding down such shortages to tolerable levels.

North Sea Oil

15 Another major factor that will affect the prospects for the economy in the coming years is North Sea Oil. We are now close to the likely peak level of production and over the period to 1987/8 production is likely to plateau or, possibly, decline. Assuming this profile for production, North Sea oil revenues, which have had beneficial effects on Government finances and greatly cushioned the impact of the recession on taxpayers are also likely to level out and may well decline towards the end of the decade. North Sea oil has also made a major contribution to the balance of payments and this increases the need for improved competitiveness as oil production declines.

The Achievable Rate of Growth

16 We propose that our Medium Term Programme should aim at an annual rate of growth of 3 per cent from 1982/3 to 1987/8. This is an optimistic figure by the standards of the last decade but we believe that it can be achieved.

17 A rate of growth slower than this would risk the difficulties described above; a faster rate may be achievable but might lead to difficulties, for example, for inflation and the balance of payments.

18 Our view that steady growth at around 3 per cent a year coupled with low inflation is a realistic objective over the five year period is based partly on the fact that it has been achieved in 1983 and is expected by the Chancellor to be achieved in 1984; and partly on past experience, coupled with the belief that we can improve on our past performance, particularly in the field of international competitiveness.

The External Environment

19 During the twenty years 1953-1973, before the first sharp rise in oil prices, GDP in this country grew at an average rate of 3 per cent a year (and faster during recovery periods), with retail price inflation averaging just over 4 per cent a year.

20 It is true that the volume of world trade in manufactures rose during this period at an annual rate of 9 per cent a year, and that we are assuming that it will rise by about 3 per cent a year during our five-year period.

21 On the other hand it must be remembered that from 1953 up to the devaluation of 1967, our competitiveness worsened very markedly - our unit labour costs in manufacturing rose something like 25 per cent more than the average of our main competitors. During the rest of the period up to 1973 our unit labour costs continued to rise somewhat faster than our competitors' in national currencies, and we were able to maintain our cost competitiveness - and indeed improve it - only by a fall in the value of the pound totalling around 25 per cent against a basket of currencies.

22 Over the period to 1987/8, we should not rely on a fall in sterling, but we do aim to avoid a deterioration in our cost competitiveness, through higher productivity, realistic pay settlements and cuts in government-imposed business costs; and indeed to improve it, as we have done over the past two years. We are also assuming some improvement in our non-price competitiveness through encouragement of enterprise, higher profitability leading to more investment in new equipment, new products, marketing, training,etc.

23 In these ways we believe we can achieve growth in our exports at around the same rate of world trade, instead of a much slower rate as in the past; and that even in an environment of considerably slower growth of world trade we can thus emulate our past performance of growth of the national economy at around 3 per cent a year, with low inflation, without running into balance of payments difficulties.

OUR PROGRAMME FOR SUSTAINING GROWTH

24 Achieving sustained growth with low inflation will require action by government and business to:

- encourage enterprise and investment;
- improve competitiveness; and
- hold down costs.

Encouragement of enterprise and investment

25 For the economy to grow and create jobs, enterpreneurs, investors and managers must be prepared to sacrifice leisure or short term rewards. To encourage this they must be allowed to keep for themselves a fair proportion of the returns created by their efforts or investment.

26 Enterprise is likely to be best encouraged when the public has a direct stake in the system through widespread share-ownership and when managers and employees have a direct stake in their own firms.

We therefore propose measures (see below and in Chapter IV) that will reduce tax disincentives to enterprise, investment and share-ownership.

27 The prospects for growth can also be improved by reforms aimed at greater flexibility in labour markets and by Government regulation of commerce and industry being kept to a miminum.

28 We intend to bring forward proposals in these areas and in industrial policy to improve the prospects for growth.

Competitiveness

29 To ensure that UK producers win a sufficient proportion of markets at home and abroad to sustain growth, improved competitiveness is essential. Improved competitiveness is also necessary to prevent the fall in the balance of payments current account surplus from £6½ billion in 1981 to about £1½ billion in 1983 becoming a trend that could halt the recovery in the medium term.

30 Our programme aims at improving both cost competitiveness and non-price competitiveness by:

- lower pay settlements than in competitor countries;
- continued rapid increases in productivity; and
- reductions in taxes on business that add to costs.

Chart II.1

31 The improvements in non-price competitiveness should result from increased profits and the confidence to plan for expansion leading to higher investment, not only in fixed assets, but also in:

- research and development;
- marketing; and
- training.

32 Many of the arguments about competitiveness are aimed at the manufacturing sector since this is the sector most directly exposed to international competition. If we look at our total exports of goods and services, about half the value added in the UK is in manufacturing industry. The other half is contributed by other sectors such as agriculture, energy, construction, communication, distribution and other services. These non-manufacturing sectors contribute in two ways, roughly equal in importance. First, they supply goods and services to manufacturers, help them get their exports to the ports and sell them abroad. Secondly, these sectors produce the invisible exports on which we rely so much. So improved competitiveness is also important for the non-manufacturing sectors.

Costs

33 We believe that high inflation is damaging to the economy and that for growth to be sustained low inflation is vital. For this reason we are not relying on a falling exchange rate to improve competitiveness, or a lax monetary policy to boost demand.

34 Our programme of pay moderation, rising productivity and reduced taxes on business will result in lower unit costs and help hold down inflation. The public sector must play its part by ensuring that it does not contribute to inflation by unjustified increases in its costs, prices and taxes.

Macroeconomic Policy

35 Macroeconomic policy also has an effect on the prospects for growth and inflation.

36 We support the aims of the Government's Medium Term Financial Strategy (MTFS). Such a strategy helps to create confidence in its aim of holding down inflation. However, we have consistently argued that the targets contained in it have to be interpreted flexibly and sometimes adjusted in the light of developments and prospects for the economy. The monetary targets should aim to allow sustained growth provided that this does not conflict with the objective of low inflation.

37 The medium term fiscal targets in the MTFS should be such as to hold down the ratio of public debt to GDP. In the short-term however, we would envisage deviations from that path where necessary in the light of economic circumstances for cyclical reasons, or if they specifically improve competitiveness.

38 Table II.3 in the Annex shows that if the present rate of growth is maintained and government spending is held to its present level, there would be scope for tax cuts of 2¼ per cent of GDP by 1987/8. This would be equivalent to about £2 billion (in 1984/85 prices) in each of the four Budgets before then. The proposals set out in Table I.1 would use up about £2½ billion by 1987/8 at 1984/5 prices. We would envisage (and have assumed in our calculations) that most of the rest of the sums available being used to reform and cut personal taxation on income and capital and to reduce payroll taxes on employers. The following ready reckoner gives the cost of possible options for tax changes.

Costs of Possible Options for Tax Changes

	Cost in full year 1984/85 prices £bn
Lower basic rate of income tax by 1 per cent	1.0
Reduce employers' NIC by 1 per cent	0.9
Reduce top income tax rate from 60 per cent to 50 per cent	0.2
Derate business by a further 10 per cent	0.5
Increase income tax thresholds and bands by 5 per cent more than inflation	0.8
Reduce corporation tax rate by 5 per cent	0.8

THE RISKS AND THE REWARDS

39 Our economic strategy might be driven off course by factors beyond our control. Further international disruption as occurred in the 1970s with sharp rises in oil prices, such as default by a major debtor nation, might require the strategy to be revised. We would have to face such circumstances as they occurred and make appropriate adjustments to the strategy.

40 The strategy could also be thrown off course as a result of factors that are under own control - we could allow inflation to pick up or our competitiveness may be insufficient to prevent a deterioration in the balance of payments. Either of these would reduce the achievable sustainable rate of growth.

41 If we steer away from these rocks, however, the benefits of success will be immense.

42 Further rises in living standards for those in work would be achievable while at the same time unemployment would start to fall.

43 If public spending were held roughly constant this would permit scope for substantial cuts in the burden of taxation as well as allowing public borrowing to fall substantially as a percentage of GDP (see Table II.3).

44 Perhaps most important, success would permit us to start to adjust our structure of industry and commerce to cope with the problems that may emerge in the 1990s and beyond, such as declining North Sea oil revenues, increasing technological demands for public services and demographic changes including the need to fund the pensions of an ageing population in the next century.

ANNEX II.1

HOW OUR PROGRAMME ADDS UP

1 This Annex gives illustrative figuring to show how the different elements in our programme fit together. The figures are not forecasts and their relative precision, without reference to the obvious margins of error involved, is merely intended to simplify the exposition.

Demand

2 Table II.1 shows the growth in the different components of demand which we expect to be consistent with our programme. The greatest absolute contribution to growth comes from consumers' expenditure rising in line with real incomes. The fastest growing components, however, are fixed investment, as profits recover, and exports, as world trade recovers and competitiveness improves.

Table II.1

Pattern of Growth[1] Consistent with CBI Programme
(Percentage annual change in volume)

	Estimated Growth so Far (1982/3 to 1983/4)	Projected Growth (1982/3 to 1987/8)
GDP (average measure)	2½	3
Consumers Expenditure	3	2
Fixed Investment	1½	6½
Government Current Expenditure on Goods and Services	2	0
Exports of goods & services	0	4
Imports of goods & services	5	5

1 Both between 1982/3 and 1983/4 and, to a lesser extent, between 1982/3 and 1987/8, there is some contribution to growth from a changing rate of stockbuilding.

Competitiveness

3 Our unit labour costs in manufacturing in the past two years have risen by about 2½ per cent per annum less than those in competitor countries. We have assumed over the next four years that, if our programme is implemented, this differential will be maintained. The improvement in our cost competitiveness indicated in Chart II.1 and improvements in our non-price competitiveness compared with our past performance are forecast to lead to annual export growth in manufactures over the period of about 3 per cent , the same as the growth in world trade in manufactures. Since the trend over a long period has been for total UK exports of goods and services to rise about 1 per cent per annum faster than our exports of manufactures, we have projected growth in the latter of 4 per cent.

4 Imports of goods and services are forecast to grow by 5 per cent per annum, slightly more slowly than the 7 per cent growth that would have been predicted without improved competitiveness.

Employment

5 Over the past two years, output per head in manufacturing has grown at an annual rate slightly faster than 7 per cent. Our projection for the next 4 years is that this will slow to about 5 per cent. Productivity in the economy as a whole only grows at slightly below half this speed however, with (by convention) little growth in productivity assumed for the public service sector and productivity in the private service sector forecast to grow by 2 per cent per annum. After taking account of changes in the labour force, the programme is forecast to start to reduce unemployment, bringing it down to under $2\frac{3}{4}$ million by the beginning of 1988. This calculation does not take account of further reductions that might result from special employment measures of the kind set out in Chapter V.

Chart II.2

6 The scenario set out above would imply manufacturing production growing faster than production in other sectors. However, the pattern of productivity improvements implies some further job losses in manufacturing while net increases in employment would be likely in the service sector. Table II.2 gives the projections for employment by sector and for unemployment.

Table II.2
Employment and Unemployment (millions)

	1983 1st Qtr.	1983 4th Qtr (est)	1988 1st Qtr.	Change 1983 Q1 to 1988 Q1
Manufacturing Employment	5.4	5.3	5.2	-0.2
Public Service Sector Employment	5.0	5.0	4.7	-0.3
Private Service Sector Employment[1]	13.1	13.2	13.9	+0.8
Total employment	23.5	23.5	23.8	+0.3
Labour Force	26.5	26.4	26.5	-
Unemployment	3.0	2.9	2.7	-0.3

1 Includes self-employed and employment in the non-manufacturing nationalised industries.

Monetary Policy

7 The projections assume growth remaining steady at an annual rate of about 3 per cent and the rate of increase in the GDP deflator falling from 7½ per cent during 1982/3 to about 4 per cent in 1987/8. The projections assume no trend change in the velocity of circulation for the wider monetary aggregates over this period and so these are forecast to rise in line with money GDP.

Government Revenue and Expenditure

Table II.3
Government Financial Accounts

	Percentages of GDP		
	1982/3	1983/4	1987/8 projected
Receipts[1]	43	42	39 (after 2¼ per cent net tax cuts)
Expenditure[1]	47	46	40½
PSBR	3¼	3¼	1½

1 General government receipts and expenditure; some adjustments to the difference between these figures are necessary to derive the PSBR.

8 Table II.3 shows how our proposals for taxes, expenditure and revenues add up.

9 Over the 5 year period to 1987/8 we propose that the level of public expenditure should be held constant in cost terms. This would reduce it from 47 per cent of GDP in 1982/3 to 40½ per cent of GDP in 1987/8. Provided that inflation remains low and economic growth continues, we would aim at a falling PSBR as a percentage of GDP to hold down the ratio of public debt to GDP and to prevent "crowding out" of the private sector in the medium term.

10 We estimate that at present rates of tax (after adjusting for inflation) there might be a slight fall in government revenue as a percentage of GDP and with some other accounting adjustments this might leave scope for net tax cuts, consistent with our estimates for borrowing and expenditure, of 2¼ per cent of GDP.

DRAFT 6.1.84

Chapter III

The Economic Background

1 This Chapter explains the economic reasoning behind the recommendations for the 1984 Budget. It explains why we believe that the Government must take immediate action to reduce business costs rather than the burden of personal taxation.

Recovery in Progress

2 A recovery is under way. The latest figures for GDP show that the trough of the recession was in the second quarter of 1981 and that the economy has been growing fairly steadily since then. It is, however, difficult to be precise about the extent of the recovery because of the unusually large discrepancy between the various measures of GDP. By the third quarter of 1983 the expenditure measure of GDP was nearly 5 per cent higher, the income measure 7 per cent higher, and the output measure 4½ per cent higher, than in the first half of 1981.

Chart III.1

3 Although the output measure is generally regarded as the best indicator of short-term movements in GDP because it is much less liable to revision than the expenditure and income based estimates, there is no reason to believe that it is more accurate than the other estimates over longer periods. In these circumstances, it is conventional to use the average of the expenditure, income and output measures. On this basis, GDP in the third quarter of 1983 was just over 5 per cent higher than in the first six months of 1981.

4 It is clear that the recovery is uneven and from a low base; for 1983 as a whole GDP (average measure) was only as high as in 1979. Moreover, North Sea oil has made an important contribution to growth; between the first halves of 1981 and 1983, oil and gas extraction rose by 23 per cent in volume terms and contributed nearly 1 percentage point to the growth of GDP (output measure) over the period. Manufacturing production, as a whole, remains depressed although there is growth in certain sectors. Output in manufacturing was about 2 per cent higher in the third quarter of 1983 than in the first half of 1981; by the third quarter of 1983, manufacturing production remained 14 per cent lower than in 1979. It should, however, be noted that the CSO's index of manufacturing production shows a considerably flatter picture during 1983 than would be expected on the basis of the results of the CBI Industrial Trends Survey.

Chart III.2

5 Inflation (as measured by the increase in the RPI over the previous twelve months) has dropped faster than expected from a peak of 21½ per cent in the second quarter of 1980 to under 4 per cent in the second quarter of 1983. Although inflation measured in this way has risen slightly since then this reflects the ending of certain special favourable factors and does not

indicate a resurgence of inflationary pressures. Other indicators confirm that inflation remains under control. The annual increase in the GDP deflator has fallen from over 20 per cent in the second quarter of 1980 to just over 5 per cent in the second quarter of 1983. The annual increase in unit labour costs in the second quarter of 1983 was 2.2 per cent for the whole economy and 2.4 per cent in manufacturing, compared with increases of 22.2 per cent and 24.9 per cent three years earlier.

6 There have been substantial gains in productivity during the last three years, particularly in manufacturing. In the first six months of 1983 output per head in the whole economy was nearly 9 per cent higher, and in manufacturing 13 per cent higher, than three years earlier. Nevertheless there remains a wide gap in levels of productivity between ourselves and our main competitors, particularly in manufacturing.

7 Profitability has also improved from the very low levels of the last few years. Industrial and commercial companies' (excluding North Sea activities) gross trading profits (net of stock appreciation) rose substantially in 1983 and we expect the real rate of return to have risen to around 6½ per cent. However this is still not only well below the level common in the 1960s but also less than in 1978, and remains below the rate of return of our major competitors. A recent study by the OECD[1] showed that in 1982 the real rate of return on capital in manufacturing in the UK was less than half of that in the United States, Germany and Canada, and only about one-fifth of that in Japan. We agree with the Bank of England[2] that the current rate of profitability is 'well below the level necessary for a healthy rate of investment'.

The Need to Sustain the Recovery

8 We fear that unless the Government implement our proposals and take further action to reduce business costs and improve competitiveness, the present recovery could falter later this year. Without such actions, our latest forecasts, published at the end of November, suggest that GDP, as measured by the average estimate, could rise by 1½-2 per cent between 1983 and 1984 as compared with an estimated increase of some 3 per cent between 1982 and 1983.

9 On the basis of existing economic policies, we expect the growth of consumers' expenditure to slow down in 1984. The strong increase in expenditure in 1983 was chiefly supported by a substantial fall in the savings ratio. Further falls are unlikely in 1984 bearing in mind that some of the fall which has occurred since the beginning of 1982 was due to special factors (such as the abolition of HP controls and the large increase in bank lending for mortgage purposes). The significant fall in inflation in recent years has also played a part but we expect only a modest further fall in 1984.

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1 OECD Economic Outlook July 1983 Table 23
2 Bank of England Quarterly Bulletin December 1983 p. 457

10 Nor do we expect any marked increase in stockbuilding during 1984; we believe that companies have learnt to live with lower levels of stocks in relation to turnover.

11 Our Surveys suggest a faster rate of growth of investment in 1984 helped by improved profitabilty. We also expect an improvement in net exports, following the improvement in competitiveness in 1983, but these are unlikely to be sufficient to compensate for the slower growth of consumption and moderate stockbuilding.

12 A slowdown in the rate of recovery next year is supported by other forecasting bodies. Given the margins of error involved in forecasting GDP, it is quite possible that growth next year could be faster than the 1½-2 per cent that was our central forecast last November. But it could also be slower. If the recovery were to falter the consequences for business confidence would be severe and put the objective of sustained growth at risk. Chapter II makes clear the dangers and we believe these far outweigh the risks of the economy overheating should growth be faster than our central forecast.

Competitiveness

13 Although the past year has seen a marked improvement, our unit labour costs in manufacturing are still more than 20 per cent higher when measured against our main competitors than they were in the mid-1970s and that gap is still larger against our European rivals. Our Trends results confirm that although price competitiveness is now better than during most of the period 1979-82 it still remains very poor in relation to earlier periods.

14 As a consequence import penetration in manufacturing remains very high and we have continued to lose our share of foreign markets in both goods and services. The sluggish response of manufacturing output to the recent rise in domestic demand, and the deterioration of the current account of the balance of payments,are further evidence of our weak competitive position.

15 Improving competitiveness requres action by both business and Government. Business must hold down unit labour costs by moderating pay increases and by improving productivity. Each year since the 1978/79 pay round, the CBI has engaged in an extensive series of conferences throughout the country underlining the vital links between holding down unit labour costs, competitiveness, profitability and jobs. The message has been accepted and for the last two years the growth of unit labour costs in manufacturing has been lower than the average for competitor countries. But there is still a long way to go. Important competitors like Germany and Japan continue to have very small increases in unit labour costs.

16 Business cannot do the job on its own. Government too must help by reducing the costs it directly imposes on business. Government-imposed costs on business in the form of National Insurance Surcharge, employers' National Insurance Contributions and business rates rose by 20 per cent in real terms between 1975 and 1979. Since 1979 there has been a decrease in the real burden but much still needs to be done, in the face of continued tough trading conditions.

Chart III.3

We regret the increase in the upper earnings limit for National Insurance Contributions announced in the Autumn Statement and urge the Government to take action in the Budget to reduce business costs by means of:

- the final abolition of NIS

- 10 per cent partial business derating.

We also urge that the Chancellor announce, as soon as possible, a one percentage point reduction in the rate of employers' National Insurance Contributions to take effect in 1985/86.

Business and Personal Taxation

17 Cuts in Government-imposed costs on business must take priority over cuts in the burden of personal taxation for the following reasons:

- the immediate and overwhelming need to improve competitiveness.

- if there were to be cuts in the burden of income tax, given our weak competitive position, a large part of the resulting increased consumption would go on imports.

- reducing business costs helps reduce inflation;

- whilst profits have improved lately, it has been from a very low level. By contrast, consumers have been doing relatively well in terms of real personal disposable income over the past years. They have become better off - at least those remaining in employment - while companies are much worse off.

Chart III.4

18 We therefore recommend that personal tax allowances are only increased in line with inflation. Increases in tax thresholds are an inefficient way of reducing the numbers caught in the poverty trap because they affect all taxpayers. Most of those taken out of tax by small increases in the thresholds are not the heads of households affected by the poverty trap. Because unemployment benefit is now taxable such increases also have little impact on the incentive to work.

Fiscal Policy

19 Our policy proposals are, if implemented, likely to raise the PSBR in 1984/85 by £1½-2bn (or ½ per cent of GDP) above the level it would otherwise have reached. We believe that our proposals are consistent with further falls in the trend rate of inflation and with reductions in interest rates.

20 Although our proposals involve raising the share of the PSBR in GDP above the level proposed for 1984/5 in the Autumn Statement, they still imply a reduction from the likely outturn for 1983/4 and remain consistent with the generally declining path for the PSBR as a percentage of GDP which is an important feature of the MTFS.

Chart III.5

21 Our proposals would also leave public borrowing in the UK (as a proportion of GDP) lower than in any other major OECD country including several with lower inflation rates than the UK.

Chart III.6

22 In previous Representations we have argued that the size of the PSBR can be a misleading guide to the stance of fiscal policy and that it is important not to give too much emphasis to setting or achieving a precise target for the PSBR in any one financial year.

23 The composition of the PSBR is of great importance. For any given PSBR, different combinations of taxes and government spending will have different effects on inflation, interest rates and economic activity. An increase resulting from increased government current spending could well raise inflation and interest rates. By way of contrast, the same increase brought about by measures to reduce business costs could actually reduce inflation and help keep down interest rates by reducing company borrowing.

24 The Government has managed to cut its borrowing significantly since first coming into office in 1979. In that year the general government deficit was equivalent to 3.2 per cent of GDP according to OECD figures. By 1982 this ratio had been reduced to 2.0 per cent. But the underlying improvement is even larger than this. The OECD calculate that the recession added 5.1 per cent to the ratio in that period as expenditure on social security payments rose and tax revenues fell. So the underlying fall in the deficit/GDP ratio between 1979 and 1982 is not 1.2 per cent but 6.3 per cent, this being larger than the size of the deficit itself. The conclusion must be that a very large part, if not all, of the present deficit is due to the recession and would disappear if recovery were sustained (this is shown in the annex to Chapter II). In these circumstances the concentration of policy on the simple PSBR/GDP ratio can be misleading.

Monetary Policy and Interest Rates

25 Although nominal interest rates have fallen from the high levels reached at the beginning of 1980, they remain, by historical standards, high in real terms.

Chart III.7

26 There are of course great difficulties involved in measuring real interest rates and it might be argued that the normal measure used overstates the real interest cost faced by companies by not allowing for interest relief from corporation tax. Post tax measures of the real interest cost faced by companies have to be treated with some care however. Insofar as companies are earning insufficient profits fully to offset interest payments, post-tax measures will underestimate the real interest rate being paid by these companies. The real interest rate faced by most companies will lie somewhere in between the normal and post-tax measures, with less profitable companies and those investing heavily with large capital allowance paying a higher net real rate.

27 Until 1980 profitability remained significantly above the level of real interest rates. More recently this has not been the case, as the Chart shows. This decline of profitability relative to real interest rates emphasises the need to lower interest rates.

28 A move towards lower interest rates would help considerably to sustain the recovery. While real interest rates are high firms will be encouraged to invest profits in financial rather than physical assets, but it is investment in the latter which is crucial to sustain growth and provide productive capacity.

29 We fully accept that interest rates are not under the Chancellor's control in the same way as public spending, National Insurance Contributions and other taxes, and that external influences can be an important constraint. Nevertheless, we believe that the Government can influence interest rates and that there is scope for further cuts.

30 Different monetary aggregates give conflicting accounts of the tightness of monetary policy. So far, in the current target period [to November 1983] annualised growth rates for monetary aggregates vary from [10.5] per cent for [£M3] to [12.1] per cent for [PSL2]. However, it seems likely that £M3, and possibly M1 also, will show growth inside the target range of 7-11 per cent at the end of the current target period and PSL2 growth is unlikely to be far above the top of the range. Furthermore M0, the new target aggregate which the Chancellor feels is especially useful in guiding official policy on short term interest rates, is currently growing at a much slower rate than the other aggregates. Thus we do not feel that present monetary conditions necessitate keeping interest rates at their current high level given that inflation has fallen.

31 Nor are UK interest rates solely determined by those in the US. Late 1983 saw a period when US interest rates rose without any significant response in the UK, and with the effective exchange rate for sterling remaining stronger than it had been earlier in the year. In addition, interest rates in Germany and Japan have been consistently far below US levels for some years. All this suggests that it would be possible to lower UK interest rates independently of US developments.

Chapter IV

Taxation

Introduction

1 In the tax field, our primary objective is a lower burden of taxation for private business in order to improve competitiveness and encourage enterprise.

2 Our main taxation proposals for the 1984 Budget, therefore, are:

- the abolition of the National Insurance Surcharge;

- 10 per cent business derating, to place business rates on the same basis as domestic rates (this is discussed below in Chapter VI);

- a package of measures to reduce the tax disincentives to enterprise

3 Tax priorities for subsequent years are outlined in Chapter II: the main emphasis being further reductions in taxes that hinder business competitiveness and later, as economic developments permit, reductions in income tax.

National Insurance Surcharge and Contributions

4 The most immediate way in which the Government can help business improve its competitiveness without adding to inflation is by abolishing the surcharge on employers' National Insurance contributions.

5 This surcharge holds back business competitiveness, squeezes profits and thus discourages provision for the future, adds to prices and discourages employment. The Prime Minister has described it as "a pernicious tax on jobs".

6 The CBI has welcomed the successive cuts in this surcharge from 3½ per cent to 1 per cent that have been made in the past two years. But employers' National Insurance contribution rates have risen and the contribution bands have widened in real terms in the past two years.

7 We must keep up the progress in reducing the burden of payroll taxes. We therefore recommend:

* The immediate abolition of the employers' National Insurance Surcharge;

* An early anouncement that employers' National Insurance contributions will be reduced by at least 1 percentage point in 1985/6;

* A temporary stabilisation in the bands for National Insurance contributions, which have risen in real terms in each of the past 5 years.

8 The cost for 1984/5 would be £900 million, assuming introduction on 1 April. The full year cost of the abolition of the surcharge would be £1,150 million assuming that the savings on the amount paid by central and local government on its own employees are clawed back. The cost of a 1 percentage point reduction in employers' national insurance contributions would be the same and we propose that such a reduction be, in the first instance, funded by an adjustment to the Government subvention to the National Insurance Fund. This would not affect public expenditure which is related to disbursements, rather than payments into the National Insurance Fund.

9 In the longer term National Insurance contributions need to be considered in the context of their interaction with the income tax and benefit systems, the future of state-funded pensions and their impact on the incentive to employ, particularly for low paid and part-time employees. However, changes in this latter area could be costly.

Enterprise and Taxation

10 We now we set out a number of measures for which we are seeking action to encourage enterprise and improve prospects for growth in the longer term. The main areas covered are:

- Corporation Tax
- Advance Corporation Tax
- Capital Allowances
- Development Land Tax
- Stamp Duty
- Share Options
- Capital Taxes
- Income Tax and the Investment Income Surcharge
- Business Expansion Scheme
- Wider Share Ownership
- Indirect Taxes
- International Aspects

Corporation Tax

11 In our response to the Government's Green Paper on Corporation Tax of October 1982 we emphasised the importance to business of stability in taxation. We concluded however that within the imputation system and present tax base there were a number of rigidities and anomalies where corrective action to remove or alleviate them would be helpful to business. (Annex IV.1 to this Chapter lists our detailed recommendations put to Government in 1982.)

12 Some of the recommendations have been taken up already, for instance on the incidental costs of loan finance and discounts on acceptance credits, others such as the tax treatment of groups of companies and mineral capital allowances are still under consideration. Nonetheless we have two main regrets. First, many of our recommendations have not been implemented nor has a promise of implementation been made. Secondly, to date no analysis or synopsis of all the responses to the Green Paper has been published. (This would be invaluable in future discussions.)

13 We have already submitted to Government our more detailed Technical Budget Representations with proposals for the 1984 Finance Bill (our priority items are listed in Annex IV.2).

14 Generally in this context and in the light of recent comments[1], we urge the Government to improve legislative procedures, to provide more time for a number of technical tax problems to be resolved and to provide an opportunity for fuller consideration of the legislation itself.

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1 eg. A Technical Taxation Bill - The CBI's Proposals, CBI October 1981

Advance Corporation Tax

15 Over the years we have made repeated attempts to improve the working of ACT, introduced in 1972. We do not believe it is necessary to be bound by any rigid theory of what ACT is or was intended to be and in particular that the Select Committee debates in 1971 should be regarded as forever ossifying the rules that were then under consideration. Practical experience of the system shows that:

- ACT payments to government should be set off against the next available mainstream corporation tax liability of the companies making the payments not deferred as at present.
- ACT set-off should not be restricted to 30 per cent of income.
- ACT set off should cease to be confined to mainstream corporation tax on income and should instead be available to set against corporation tax on all profits including chargeable gains.
- Capital allowances should be available against advance corporation tax and not just against mainstream corporation tax.
- Double taxation relief should be available against ACT.

Capital Allowances

16 The Green Paper on Corporation Tax[1] acknowledged that our major international competitors give relief for expenditure on commercial buildings. A small start has been made by giving relief to hotels, but this, at a 20 per cent initial allowance, is not as generous the 75 per cent available for other industrial buildings.

17 The lack of an allowance in this area was seen as an anomaly by the Sandilands Committee (Report of the Inflation Accounting Committee, September 1975) itself drawing on evidence from the Committee on the Taxation of Trading Profits (Cmd 8189 - 1952) and the Radcliffe Commission (Cmd 9474 - 1955). We have long and consistently urged remedial action.

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1 Cmd 8456 - para 15.33.

18 We believe that such a measure would lead to increased activity and hence jobs in the construction sector, and to a reduction of rental costs to industry and commerce.

19 We therefore recommend that the vital role of the commercial sector in the economy be clearly acknowledged and an immediate start be made by introducing a straight line writing down allowance at 2 per cent per annum on new commercial buildings.

Development Land Tax

20 This tax raises little revenue (approximately £50m for 1983/84) and has a discouraging effect on commercial decisions relating to surplus property. It should be abolished. Failing outright abolition of the tax we urge that it should be suspended for an experimental period of 3 years.

21 This would provide an incentive to business to initiate development projects free from the compliance costs and constraints which would otherwise apply even where at present the tax itself is deferred.

Stamp Duty

22 Our response to the recent Revenue consultations on Stamp Duty[1] drew government's attention to two particular areas of agreement with our colleagues in other European federations. We urged -

- First, the early abolition of the capital duty - a European tax - and invited the Inland Revenue to take the initiative in securing the necessary European reform.
- Second, the abolition of the tax on transactions in securities. The present rates of duty are such that dealings in quoted securities are being driven away to overseas markets where the tax costs are lower.

Share Options

23 The CBI believes that companies should be afforded the means to encourage employees in, and reward them for commitment to their endeavours. This can be done by providing them with opportunities to participate in their employers' capital growth on terms not rendered unattractive by taxation and as good as those available abroad. We shall in 1984 be looking at practical aspects of this on a broad front. Our priority for the 1984 Budget relates to Share Options.

24 Our attention has been drawn to recent changes in US law, under the Economic Recovery Tax Act of 1981, improving the share option schemes available there. Companies in the UK should be able to offer similar rewards on terms at least as favourable to ensure that key executives are not lost to overseas competitors.

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1 CBI - October 1983

Capital Taxes

25 Incentive can be inhibited by capital taxes where businessmen, particularly those in the unquoted sector, or non-corporate sector, are involved in family businesses. If taxation bites too hard the incentive to build businesses up and then hand them on is substantially diminished. Indeed, once a private family owned company has grown beyond a size sufficient to provide its owners with an adequate income, further growth generally brings with it unacceptable capital transfer tax liabilities and many businesses are therefore either sold on or artificially held back from further expansion. This is where the tax system affects economic performance

26 Since submission of our full and detailed memorandum to the then Chancellor of the Exchequer in 1979[1] we have continued to draw attention to difficulties in capital gains tax and capital transfer tax.

27 We shall not repeat previous representations here. So far as they have not been implemented they remain on the table. But we would single out certain major points for early action.

28 Capital Gains Tax

- Assets held at April 1982 which have been in continuous ownership for seven years should not be liable to CGT. This will remove from the tax net those assets held over a long time, for non-speculative reasons, which would otherwise carry in their taxable value a large measure of inflationary as opposed to real gain. The indexation rules introduced in 1982 cover only future inflation and make no allowance for past events. Our solution is fair and administratively simple and would cut significantly the cost of applying the tax for both the Revenue and the taxpayer.

- Overhaul of the retirement relief rules.

- Repeal of the rules restricting indexation relief both on losses and on assets held for less than twelve months to remove complexity and to provide more equal treatment for the effects of inflation.

- Action to relieve the double charge to tax on gains where assets are held through companies. Currently there is a charge on disposal of the asset by the company and a second charge on shareholders' disposals of shares, which in turn reflect the net gains on the company's disposals.

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1 CBI, 1979.

29 Capital Transfer Tax

- Improvement of business asset relief by amalgamation of all the existing classes of assets and giving relief at 100 per cent.
- Lifetime rates of CTT should be half those on death throughout the scale.

For both CTT and CGT we would like to explore with government the scope for providing a facility for accumulating annual exemptions either over a limited period or indefinitely.

The disincentive effect of these taxes is in marked contrast with the government's avowed aim of helping smaller businesses as in the business expansion scheme.

Income Tax and the Investment Income Surcharge

30 Our longer term objective remains to reduce the burden of direct taxes. For this year our priority is reduction in business taxation but in Chapter 2 we show how improved competitiveness and sustained growth will provide the scope for cuts in income tax in future years.

31 We are assuming that personal allowances and thresholds will be adjusted in line with inflation.

32 The Investment Income Surcharge is an additional tax applying selectively on certain savings and should be abolished as soon as possible. Its effect on retired businessmen living off the income produced by investment of the proceeds of sale of their businesses is unfair in that they suffer a surcharge on their income whereas those retiring from pensionable employment have their pensions treated as earned income.

Business Expansion Scheme

33 The CBI has welcomed the many initiatives introduced by the Government specifically targeted at encouraging small companies, especially the development of the Business Expansion Scheme. We would like to see this Scheme achieve its full potential in stimulating more equity investment in small firms, but this is still inhibited by:

- the difficulty of spreading risk;
- the uncertainty as to whether an investment will qualify and if so when any tax relief will arise;
- the difficulty of ultimately selling investments.

34 Funds designed along the lines of Small Firms Investment Companies (as proposed in detail in previous CBI representations) could be introduced within the framework of the existing Scheme with appropriate changes in the legislation, and would go a long way to solving these remaining difficulties. They would be simpler to operate than the current Approved Investment Funds and provide a greater incentive to the investor as tax relief would arise sooner and with more certainty.

35 Short of introducing Small Firms Investment Companies, the Business Expansion Scheme can be further improved in two important ways:

- An investor buying shares through an Approved Investment Fund should be able to obtain the tax relief in the year in which he subscribes to the fund even if it is not invested on until the following year. This would allow investors to plan better for their tax liabilities.
- An advance clearing system for investments could be introduced. If the Inland Revenue felt unable to allow formal prior clearance, their Inspectors should at least be encouraged to give a provisional opinion, as some have already been doing.

36 A number of more detailed points on the Scheme have been made in our Technical Representations.

Wider Share Ownership

37 The involvement of the personal sector in business through direct investment in companies has declined sharply in the past twenty years. Attitudes to enterprise would be greatly improved by wider share ownership, particularly by employees.

38 The proposals which we have set out for improving the business expansion scheme, improving capital taxation, abolishing the investment income surcharge and for abolishing stamp duty on equity transactions should contribute to this.

39 In the longer term, however, we envisage the extension of the tax advantages currently available on certain categories of savings to other categories, including savings directly invested in equities. This would encourage a closer identification of taxpayers with the role and functions of business.

Indirect Taxes

40 We remain concerned about a number of areas of VAT. On the domestic front:

- The treatment of pension funds. Pensions represent a cost to business and VAT incurred in the course of provision of pensions should therefore be recoverable just as it is on other business costs.

- Proposed revisions to the rules relating to partial exemption are likely to add to business costs and increase the administrative burden on businesses by drawing many of them into the partial exemption net. We are concerned about the pratical effects of these proposals on business. We have already registered our concern with Ministers.

- The threshold for VAT registration should continue to be moved upwards to help smaller firms and reduce costs. This movement should not however be allowed to prejudice the facility of voluntary registration for VAT.

41 On the European front we remain strongly opposed to the draft 12th VAT Directive the origins of which seem to lie in a disregard of the principle that VAT should not be an impost until transactions reach the stage of the ultimate non-business consumer. We urge government to maintain its opposition to this draft directive.

42 We continue to urge that the differential in the tax on DERV between the UK and other EEC countries should be phased out over time taking account of our motor industry's ability to meet shifts in demand, in order that British business should no longer be at a competitive disadvantage compared with our European partners. Car tax discriminates against a major industry and adds to business costs. There is therefore a strong case for planning to eliminate it.

International Aspects of Business Taxation

Unitary Tax

43 The unitary system of taxation is wholly inapropriate in the international field and damaging to free trade and investment.

44 We have submitted to the US Treasury Working Group a detailed critique of the worldwide combined reporting unitary tax applied by some US States to international companies and we were pleased to liaise with our sister Federations in Europe and elsewhere on this topic. We warmly welcome the Governments own submission against the use of unitary tax.

45 This tax is pernicious and its continued use or worse still its spread would have potentially far reaching consequences on international fiscal stability. Annex III gives the key salient points submitted to the US Working Group.

46 We trust that the Government will directly and via our European and other overseas allies keep up the pressure for suitable changes to the unitary tax rules as they affect our Members' interests.

Controlled Foreign Companies

47 New draft clauses on this topic were issued in October 1983. The case for such sweeping untargetted legislation still has not been made out. We urge that the Government, if it acts at all, should confine itself to specific cases. If legislation broadly on the basis of the draft proposals is introduced significant changes of principle as well as of a technical nature would be essential if the competitiveness of British business is not to be damaged.

48 We shall be making detailed criticisms of the draft proposals separately.

Foreign Currency Losses

49 The lack of tax relief for losses on foreign currency borrowings is an example of an area where UK tax law puts us at a competitive disadvantage compared with our trading rivals.

50 We therefore urge that early action be taken to alleviate this situation, and recognise at the same time that currency gains would fall within the tax net.

ANNEX IV.1

Extract from CBI Submission to the Green Paper on Corporation Tax

Section 7: Stock Relief

10 The possibility should be studied of allowing taxpayers to choose between stock relief and valuing stock on the "last in, first out" basis (7.1)

11 The concept of a credit restriction should be rejected (7.2).

12 In the interest of keeping stock relief simple, multiple indices should not be introduced in place of the present single all stock index (7.3).

13 Clawback should be abolished (7.4).

14 The six-year time limit should be removed (7.5).

15 Some form of relief should be introduced for financial businesses (7.6).

Section 8: Capital Allowances

16 Capital allowances should continue to provide an investment incentive and should not be reduced in value (8.3).

17 The existing system of capital allowances should be improved in preference to being completely changed (8.6).

18 Tax allowances are preferred to investment grants as the means of providing an investment incentive (8.7).

19 The CBI supports non-selectivity of allowances in principle and improvements should be made to the allowances for less-favoured sectors not at the expense of a reduction in the allowances for other sectors (8.8 and 8.11).

20 The present level of first-year allowance for plant and machinery investment should be retained (8.8).

21 Free depreciation should apply to expenditure on plant and machinery after the first year (8.9).

22 100 per cent first-year allowances should be introduced for industrial buildings and free depreciation should apply after the first year so as to obviate the present complex record-keeping (8.9).

23 A two per cent annum allowance for new commercial buildings should be introduced on a straight line writing down basis (8.10).

24 We believe that mining allowances are in need of update and simplification (8.11).

Section 9: Treatment of Interest

25 Interest payments should continue to be treated as an allowable cost for tax purposes.

Section 10: The Schedular System

26 Thought should be given to abolishing the schedular system and basing the assessment of taxable profits on audited accounts.

27 The schedular system should not be allowed to impose unjustified restriction on the way relief is given on losses.

28 The case should be examined for having consolidated tax returns for groups of companies.

Section 11: Disallowed Business Expenses

29 All expenditure deductible in computing commercial profits should be deductible for tax purposes. Instances where the law needs to be amended to give effect to this principle include:

- all incidental costs of raising finance (11.2)
- losses on foreign currency fluctuations (11.2)
- costs of raising share capital (11.2)
- discount and other expenses on acceptance credits (11.2)
- similar expenses on commercial paper (11.2)
- costs of issuing loan stocks, whether or not convertible into equity within three years (11.2)
- expenditure on abortive capital projects (11.3)
- post-trading expenses (11.3)

Section 12: Unutilised Tax Reliefs and Allowances

30 Companies should be enabled to make more immediate use of their reliefs (12.5).

31 Finance leasing should not be discouraged (12.5).

32 Further consideration should be given to allowing tax relief on interest to the lender where the borrower cannot use it and to removing the 1982 restrictions on loans under section 233 of the taxes Act 1970 (12.5).

33 Unutilised reliefs and allowances must not be cancelled or future reliefs time-limited or reduced in value (12.6).

Section 17: Reforms to Advance Corporation Tax (apart from Interaction with Double Taxation Relief)

37 Advance corporation tax to be offset against whole of mainstream tax (17.1(i)).

38 If the previous change is not introduced, the restricted offset of advance corporation tax should be applied to the company's taxable profits as a whole, and not as at present to each source separately (17.1(ii)).

39 Advance corporation tax to be offset against next payment of mainstream tax (17.1(iii)).

40 Carry-back period for advance corporation tax not to be time-limited (17.1(iv)).

41 Advance corporation tax to be deductible from corporation tax on capital gains (17.1(v)).

42 It should be possible to set capital allowances against advance corporation tax (17.2).

Section 18: Double Taxation Relief

43 Keep tax credit system as opposed to exempting foreign income (18.1).

44 Unused double taxation relief to be carried forward or carried back (18.2(i)).

45 Average all foreign tax over all foreign income for purpose of determining rate of foreign tax (18.2(ii)).

46 Double taxation relief to be available despite any timing differences between the two tax systems (18.2(iii)).

Section 19: Advance Corporation Tax and Double Taxation Relief

47 Allow double taxation relief in priority to advance corporation tax (19.2)

48 Allow foreign tax to reduce or extinguish advance corporation tax without a net UK rate restriction (19.2).

49 Foreign tax to be credited against advance corporation tax without reducing aggregate advance corporation tax below what is repaid (19.2(i)).
or
Advance corporation tax to be half present rate (19.2(ii)).
or
Re-adopt net UK rate system (19.2(iii)).

50 Dividends should be franked if they are paid out of current or past profits that have borne full UK tax (19.3).

Section 20: Groups of Companies

51 Group relief to be available for surrender in a later year than that in which the loss etc arises (20.2.(i)).

52 Partial use of group relief in different years to be permitted (20.2(ii)).

53 Surrender of relief other than loss not to be confined to the surplus not usable by the surrendering company (20.2(iii)).

54 Reliefs brought forward to be deducted from current year's income before calculating the amount of charges that can be surrendered to another company (20.2(iv)).

55 Similar changes when a company carries on several trades (20.2(iv)).

56 Surrender of part of a relief to consortium company and part to group company to be permitted (20.3(i)).

57 Surrender should be possible in either direction between a consortium company and group company (20.3(ii)).

Section 21: Capital Gains

58 Group relief for capital gains so that one company's losses can be offset against another's gains (21.1).

59 Double taxation of capital gains to be reduced, where company making capital gains pays dividend, by treating the dividend as a capital receipt or prevented by making the dividend not taxable (21.2).

60 Relief to be allowed on losses on intra-group loans (21.4).

61 Double taxation of capital gains to be prevented by making them not taxable on the company (21.5).

Section 22: Small Companies

62 Reduced rate to apply to first slice of all companies' income (22.1).

63 Small companies' rate and its upper and lower limits to be announced at the start of the year (22.2).

64 Reduced rate relief to be shared between associated companies as they wish (22.3).

65 Companies qualifying under business start-up scheme should not be treated as being associated with other companies for tax purposes so long as restraints on share disposal continue (22.4).

ANNEX IV.2

Extract from Technical Budget Representations 1984

B PRIORITY POINTS

1 Groups of Companies

The CBI is responding separately to the Inland Revenue's consultations on aspects of the taxation of groups of companies.

Nonetheless we consider that action on the points we are raising there is a first priority for 1984 and we are taking this opportunity to emphasise the importance we attach to them.

2 Foreign Currency Losses and Costs of Equity Finance

Our response to the Green Paper on Corporation Tax (CBI -October 1982) drew attention to the continuing anomalies concerning tax disallowed business expenditure or "nothings". We remain most anxious that all legitimate business expenditure should be allowed for tax purposes.

In particular we suggest that priority be given to the provision of tax relief for all losses on foreign currency borrowings.

In addition since the Finance Act 1980 introduced tax relief for the incidental costs of raising loan finance there seems to be no good case to continue to penalise equity finance by disallowing costs relating to raising it. The relevant fees are expenses of the companies concerned whether spent on raising equity or loan finance. In addition the fees are taxed in the hands of the recipients in each case. Encouragement could be given to the raising of equity finance by removing this penalty.

3 Stock Relief - Six Year Cut Off

We have, in previous representations, opposed the six year restriction on the carry forward of unused stock relief contained in Schedule 9 FA 1981. We continue to believe that this limit should be removed.

It is desirable to do this as soon as possible so that businesses can plan ahead successfully without being driven into complicated arrangements to prevent the neutralisation of stock relief brought forward. With the present six year limit and its restrictive rules governing the set off of available reliefs there is the danger that as the six year time bar draws nearer businesses will be forced to make investment decisions, which they otherwise would not, such as postponement of capital investment, to avoid a loss of stock relief.

4 Restrictions on ACT

In our Budget Representations last year we drew attention to some problems emanating from the rules on advance corporation tax as applied in the UK imputation system. We interpret the introduction of Clauses 41 and 42 in the original 1983 Finance Bill, to which we refer in greater detail later in this paper, as recognition of the existence of these problems.

In addition to the important question of double taxation relief to which Clause 42 applies there are restrictions on the utilisation of ACT which affect the timing of other corporation tax reliefs, such as capital allowances, and also the timing and amount of the ACT relief itself. We therefore urge that:

a Capital allowances should be capable of offset against advance corporation tax and not just against mainstream corporation tax.

b ACT payments to government should be set off against the next available mainstream corporation tax liability of the companies making the payments, instead of being deferred as at present.

c The current rule restricting ACT set-off to 30 per cent of income should be removed.

d ACT set-off should cease to be confined to mainstream corporation tax on income and should instead be available to corporation tax on all profits including chargeable gains.

We shall be referring to other ACT problems as they affect groups of companies in our separate submission.

5 Time Limits for Claims

The Taxes Acts at presentcontain no uniform time limits for making claims and seeking reliefs. We recommend that a time limit of six years should be introduced for making claims, seeking reliefs and exercising options. Not only would this ease the compliance burden in general, but it would also be of particular help to the proper running of the tax affairs of groups of companies.

6 Disincorporation

There are instances where it is commercially desirable for companies to be wound up and for their businesses to be continued as sole trades or partnerships. Unnecessary tax hurdles should not be placed in the way of those seeking to make these commercial changes.

We urge that where there are genuine business reasons for disincorporation ways should be examined to remove present fiscal barriers. Particular examples are the clawback of stock relief and the double charge to tax in relation to the capital gains of companies which are disincorporated. It might, for instance, be possible to provide some form of roll-over where a business currently carried on by a company is transferred to a partnership under the same management.

ANNEX IV.3

The Hon Donald T Regan
Secretary of the Treasury
Department of the Treasury
Washington DC
USA

2 December 1983

UNITARY TAXATION

The Confederation of British Industry welcomes the opportunity to express its views to the Working Group on Unitary Taxation. The CBI speaks for British business representing directly or indirectly well over 300,000 businesses and organisations with over 12 million employees. We have consistently opposed the application of worldwide unitary tax.

We are sending you a further paper which sets out detailed reasons why we so strongly oppose this system but endorse the separate accounting system based on the arm's length principle. Our paper also brings together previous evidence we have given in the United States on this issue. In this letter we summarise the main grounds for our opposition and the increasing concerns of British business.

Grounds for Opposition

1 Apportionment by factors of worldwide group profits is bound to produce an arbitrary and unfair result in an economically non-homogeneous world.

2 It will overallocate profit (or loss) to those jurisdictions with higher payroll, property and sales values.

3 Anomalous effects include conversion of a direct accounting loss into a unitary basis profit, apportionment of more than 100 per cent of the total world profits and unrelievable international double taxation.

4 The well tried domestically and internationally accepted arm's length basis produces a better evaluation of the true taxable profit (or loss) arising in a jurisdiction.

5 Uncertainty is so great as to undermine business confidence in investment.

6 Damage to free world trade could result from a worldwide tax war following emulation by other countries using factors modified to suit themselves.

7 Retaliation by trading partners among developed countries trying to protect their revenues would be even more damaging.

8 Compliance costs are very onerous and are bound to become increasingly so if more jurisdictions adopting the system require adjustments to local accounting, currency and tax rules and translation into local language.

Increasing Concerns

1 From a survey of our Members we learn that more State fiscal authorities are treating more UK headquartered groups of companies as single entities after demanding much information but paying little apparent regard to it. Several Members are still disputing the issue.

2 Instances have been brought to our attention of significant distortion of financial results in the USA even extending to the conversion of losses into profits.

3 Many businesses have not yet resolved their position and are still weighing up the potential tax and compliance costs. Compliance costs imposed on companies may well be out of all proportion to yield and there is therefore some inclination at present to settle.

4 Very strong unease remains as to what the future holds and British business is looking closely at operations in any State using or threatening a unitary system.

5 Some British businesses with operations in the USA have expressed considerable concern and disappointment about the lack of remedial action following the entry into force of the 1980 US/UK Double Tax Treaty. You will be aware that a number of Members of Parliament earlier this year sought to deny the refund of tax credit to companies headquartered, inter alia, in US States operating a unitary system.

6 Discussions with sister federations in Europe and elsewhere revealed similar awareness and concern about unitary tax, and its impact on and the future development of the international financial and commercial climate.

In the light of the fundamental importance of this matter both now and over the longer term we sincerely hope that our comments will be of assistance to you and your colleagues in successfully dealing with the situation and preventing the damage which could flow from the spread of this pernicious practice.

We would of course be pleased to try to assist you further, now or later in your deliberations, amplifying if necessary what has been said, in writing or orally, should your Group so wish.

DRAFT 6.1.84

Chapter V

Government Expenditure

1 CBI policy on government expenditure was set out in the paper submitted to the Chief Secretary to the Treasury[1] in July. Briefly, our priorities are:

i to reduce the public sector's share of GDP and enable the Government to finance tax cuts and reduce interest rates.

ii a shift within the total, away from current to capital expenditure.

iii greater efficiency in the public sector. The private sector has borne the brunt of the recession with significant cuts in manpower and substantial improvements in productivity; the public sector too must play its role.

2 The Autumn Statement held total expenditure to the total contained in the public expenditure White Paper of £126.4 billion in 1984/5 and the Chancellor has said it will be held in cost terms in later years. We welcome this.

3 Our proposals on government expenditure involve changes in the pattern of spending but no net increase in planned totals. We would like to see an increase in public sector capital expenditure and specific proposals will be set out in a study by the Federation of Civil Engineering Contractors and the CBI, in conjunction with other interested bodies. We also suggest increased expenditure on Special Employment Measures and measures to reduce energy costs to be financed by savings in expenditure elsewhere or from the Contingency Reserve.

The Case for Extra Capital Expenditure

4 The CBI has consistently argued for increased public sector investment financed by a reduction in government current expenditure.

5 We do not suggest that all capital spending is good and all current expenditure bad. Certain areas of current expenditure contribute to economic prosperity and future economic development, but we believe that there remains considerable scope for improved efficiency in the provision of services and that many services would be better performed by the private sector. We do not advocate capital expenditure for its own sake but because we believe that increased investment particularly in the infrastructure, would yield economic and social benefits, such as lower unemployment, reduced business costs and an improved environment.

6 We do not accept that it is simply the behaviour of total investment which is crucial. There are areas where private sector investment can, to a large extent, replace public sector investment - housing is an obvious example - but there are other areas - such as roads and sewers - where this is not the case. The reason is that a large proportion of the return to

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1 'Public Expenditure. Submission to Government', July 1983.

investment in these areas is social and does not accrue to those who provide the finance. The public sector still has a major role to play in investment and our study will identify specific capital expenditure projects which ought to be included in a longer term programme of public sector investment in the infrastructure.

7 Despite its importance, public sector investment has dropped dramatically both in absolute terms and as a proportion of total public expenditure. The fall has been particularly marked in general government capital spending. The result has been a deterioration in the infrastructure which is adding to business costs just when efforts are needed to improve our competitiveness.

Chart V.1

8 The Chancellor has argued recently that public sector investment has not fallen in real terms since 1978/79 once account is taken of capital expenditure in the area of defence and special sales of assets such as council houses.

9 We recognise that, by international convention, most defence expenditure is classed as current expenditure even when it is of a capital nature, and that defence spending has beneficial effects on employment. However, capital spending in the area of defence does little to improve the infrastructure and reduce business costs.

10 Sales of public sector assets have artificially depressed the investment figures for recent years, but even when the proceeds from these are allowed for government investment was still around 20 per cent lower in 1982 than in 1979. There is an urgent need to clarify statistics on public sector investment and we therefore welcome the Chancellor's announcement to Parliament that he hopes to improve the manner in which these matters are presented in the next White Paper to bring definitions closer to those used in business.

11 The CBI believes that public investment has been sacrificed as current spending and transfer payments have risen. It is easy to cut something the results of which will not be felt until the future; but this is a short sighted policy. A company adopting such an approach would soon go out of business.

12 In recent Representations we have asked for specific measures to remove administrative constraints on capital spending and are pleased to note that many of these have now been accepted, and that the problem of underspending has become much less important in the last year. We particularly welcome the introduction of end year flexibility for capital expenditure by both central and local government. We also welcome the extension of the arrangements introduced in the 1983 Budget to give local authorities assurances about their allocations for capital spending in future years.

13 There are three other specific areas of Government spending where changes are needed.

Innovation Support

14 The Government recognised the importance of support for innovation in the 1983 Budget by allocating an extra £85m over three years to cover extension of the existing schemes to the later stages of innovation. It also announced that existing resources would allow the grant rate to be maintained at the $33^1/3$ per cent rate for a further year and later, that it was ready to contribute up to £200m over five years to the "Alvey" programme in advanced information technology, in which the grant rate will be 50 per cent.

15 All these decisions were in accordance with CBI recommendations. But delays in obtaining EEC clearance for the £40m scheme of support for the later stages of innovation and setting up the proposed Marketing Advisory Scheme, mean that only a small proportion of the extra £85m will have been spent. Nor will the Alvey programme have as yet made many calls on expenditure during 1983/84. The schemes are important to the future of British industry but are demand-led. In the CBI's view the difference between 25 per cent and $33^1/3$ per cent is significant in determining the take-up of grants.

16 We therefore recommend for 1984 that:

- existing planned spending be at least maintained and if necessary increased in line with demand.

- the grant level be maintained at $33^1/3$ per cent for 1984-5, and

- the Alvey programme be regarded as a separate funding exercise additional to the general 'Support for Innovation' programme.

Energy Costs

17 The CBI and sectoral organisations have continued the campaign for the achievement and maintenance of competitive energy prices. We acknowledge that in certain respects over the last year to 18 months the UK's position has improved relative to the continent. Gas prices are now broadly competitive, as are electricity prices for general industrial users. However, we remain concerned at the level of electricity prices for intensive users who, despite the revised load management terms introduced over the last two years, still face a major price disadvantage compared with their continential competitors. UK prices for heavy fuel oil remain higher than those in the other major EEC countries, mainly because of the higher rate of duty levied in the UK. We have advocated for some time that the duty should be lowered or preferably abolished but have been informed that because of a contractual link with certain Norwegian gas supplies, the overall cost to the Exchequer would be disproportionately high compared with the cost benefit to industry.

18 We therefore recommend that:

- further relief should be provided for intensive electricity users

- the implications of lowering the fuel oil duty be re-examined and at the very least the duty remain at its present level.

We believe an allocation of £200m would be appropriate in 1984/5.

19 The CBI welcomed the Government's renewed drive for increased efficiency in energy use heralded by the formation of the Energy Efficiency Office and will be co-operating in the nationwide campaign to improve energy awareness. CBI also welcomed the extention of the Coal Firing Scheme announced at the end of 1983. However, industry still suffers from lack of funds inhibiting investment in energy saving equipment which would not only be to industry's advantage but to the national good as well. We therefore recommend that further consideration be given to additional financial assistance to encourage selected energy efficiency investment and the accelerated replication of new or novel technologies.

Special Employment Measures

20 Our proposals set out in Chapters 1-3 should, by helping to sustain a non-inflationary growth rate, result in a fall in unemployment in the medium term. However, additional measures are needed to create more job opportunities in the short-run. We therefore propose certain measures costing about £100m in 1984/5:

i the age threshold for men entering the Job Release Scheme should be lowered to 59, not raised to 64 from April 1984 as the Government proposes.

ii the age threshold for the Part-time Job Release Scheme should be lowered to 58 for both men and women and that employers should be entitled to a grant of £750 as under the Job-Splitting Scheme.

iii the Job-Splitting Scheme should be extended to cover newly created jobs, perhaps with some safeguards to show that they are jobs which would otherwise have been full-time. We believe the incremental cost of this would be negligible.

iv the Community Programme Scheme be amended to allow greater private sector involvement in both the sponsorship and management of the Scheme and to provide funding for more ambitious projects than can currently be undertaken.

Controlling Government Expenditure

21 In order to provide the resources to cover these additional costs, continued control of government spending at central and local level is crucial. This Section summarises and where necessary updates the proposal made in our recent submission to the Chief Secretary.

i Efficiency and Manpower

22 The CBI has welcomed steps taken in recent years to improve the efficiency of central and local government, such as the establishment of an Audit Commission for local authorities and the management changes proposed for the National Health Service in the Griffiths Report. The CBI has also welcomed the extension of the Management Information System for Ministers in the Civil Service.

23 The drive towards increased efficiency in the public sector must continue as a way of reducing the cost of providing existing levels of services. The CBI advocates the preparation of corporate plans for individual departments to clarify their objectives, and measures to follow up more aggressively the Rayner exercises. More attention must be paid to the effectiveness with which services are provided, and we urge departments to construct and publish performance indicators wherever appropriate to assist the management process.

24 It is essential to expose central and local government to the disciplines of market forces. We therefore welcome the Government's commitment to privatisation of certain public sector services, and to the further use of contracting out of both central and local government services and in the NHS. The existing legislation in respect of direct labour organisations in local government provides a model which can be built upon.

25 We have recommended an extension of the legislation to include, within local government, in the first instance, catering, refuse collection, cleaning and park services. The Government should introduce similar legislation to oblige competitive tendering for the provision of central government services where this is appropriate.

26 Increased charges and wider use of user-charging in certain areas, particularly local government, could help to reduce waste and to raise revenue.

27 We support the proposed legislation to restrain local authority rates and welcome the decision to abolish the Greater London Council and other metropolitan authorities in view of the savings that will ensue.

28 The CBI still believes there is scope for further cuts in public sector manpower which are consistent with maintaining the existing level of services and has on previous occasions put forward targets for manpower savings. We welcome the reductions in Civil Service manpower announced by the Chief Secretary in November and realise that steady progress has been made in this area. However, progress made by local authorities in reducing their manpower, the major component of public sector employment, has been very slow, and employment in the NHS has grown faster than planned.

29 Continued efforts are needed to achieve manpower reductions in local authorities and in the health service. We welcome the establishment of manpower targets for each regional health authority and the early introduction of performance indicators. We would urge local authorities to exercise more control over their manpower levels, perhaps by the introduction of cash limits for wages and salaries.

ii <u>Public Sector Pay</u>

30 The CBI has welcomed the fall in pay settlements in the public sector. Chart V.2 shows that settlements in the public services are now running at a level lower than those in private services and manufacturing. However, this came after a number of years when public sector settlements were higher than those in the private sector. The Government cannot afford to relax its vigilance.

Chart V.2

31 It is well understood that pay settlements in the public services not only affect the costs of provision, and therefore the private sector' competitiveness, but can also influence settlements elsewhere in the economy.The private sector is continuing to make great efforts to reduce the level of settlements and it is important that the public sector does the same.

We urge the Government to adhere firmly to its 3½ per cent guideline for public sector pay increases.

iii Pensions

32 The CBI has advocated as an eventual objective the abolition of inflation proof pensions in the public sector and has recommended that, in the interim, all public sector pension contributions be increased to the notional 8.5 per cent paid by the civil service. We welcomed increased contribution rates for the police force and the fire service, and recommend that similar action is taken in respect of other local authority workers, teachers and employees in the NHS.

Draft 6.1.84

Chapter VI

Local Authority Finance

1 In the current year, total gross spending by local authorities in England and Wales will be about £35 billion which is equivalent to about 14 per cent of GDP and between a quarter and a third of all public expenditure. It is therefore a significant proportion of total public spending and it is necessary for the Government to constrain it if total public expenditure is to be reduced.

Local Authority Expenditure

2 The Government has been attempting to reduce the real level of local authority current expenditure but with only limited success. Since the reorganisation of local government in 1974, total expenditure by local authorities has fallen by 16 per cent yet this has been achieved entirely by squeezing capital expenditure which is today only two-fifths of the level that it was in real terms in 1974/75. Current expenditure has not fallen at all.

Chart VI.1

3 Local authority gross current expenditure in England and Wales has risen in real terms between 1981/82 and 1983/84, despite a reduction in manpower on a full time equivalent basis of around 25,000 over the same period. And the latest manpower figures suggest that the downward trend of the last four years is in danger of being reversed.

4 The Government's objectives of seeking to improve value for money in local government is to be commended. Most authorities have made real efforts to achieve this, yet analysis of comparative performance indicators suggests that there is scope for further improvements in even the most efficient authorities. The Audit Commission has estimated that there are savings of £1-2bn which can be achieved by increased efficiency and effectiveness in the provision of services by local authorities in England and Wales.

5 The CBI strongly supports the efforts of the Government to encourage increased efficiency by local authorities through:

- expenditure guidelines or targets for local authorities.

- the allocation of rate support grant.

- the grant penalty system.

- the establishment of the Audit Commission for England and Wales.
- the direct labour organisation regulations.
- the general encouragement of contracting out.
- the proposals for limiting the rates of the highest spending authorities.
- the abolition of the metropolitan county councils and the GLC.

6 The CBI itself, at a series of meetings it has held with larger councils up and down the country, has urged local authorities to make every effort to provide improved value for money and most councils are striving to do just this. An irresponsible small minority do however appear determined to follow high-spending policies despite the adverse consequences high rates have on the ability and confidence of businesses to invest, expand, develop new products and services, and create or maintain employment.

<u>Rate Limitation</u>

7 In the absence of acceptable proposals to obtain restraint on rates achieved by increased accountability at the local level, we support the Government proposals for selective rate limitations which will only affect a tiny minority of authorities. We also favour reserve powers, which we hope would never have to be used, to impose general rate limitations. The argument that the selective rate limitation scheme represents a fundamental attack on the democratic rights of local authorities is questioned by the business community which provides councils with nearly half of their rate income with no accountability whatsoever.

<u>Rate Reform</u>

8 Over the last 4 years, the rates paid by business have risen by one and a half times the rate of inflation. In 1983/84 business will be paying not far short of £6 bn in rates. Rates are now the biggest tax burden on business excluding national insurance contributions. The White Paper "Rates: Proposals for Rate Limitation and Reform of the Rating System" (Cmnd 9008) and the Rates Bill currently before Parliament give evidence of Government recognition that action is needed to safeguard the business ratepayer in order to protect investment and jobs. However, we feel more action is needed than that proposed in the three areas of:

- partial business derating
- empty property rate
- rate relief for partially unutilised premises and plant

Chart VI.2

10 per cent Partial Business Derating

9 Our first recommendation is that 10 per cent partial business derating should be introduced in England and Wales in the rate year 1984/5. This is justified on grounds on reducing businss costs, improving competitiveness and restoring equity between the sectors. From 1929 up to 1963 industry benefited from partial derating; the CBI believes that, once again, industrial concerns have a particularly strong case for relief, but that it should be granted to the whole business sector to improve competitiveness. Where companies are seeing some sign of recovery, lower rate bills would give business more funds to invest for the future; and those companies whose existence is threatened would be helped to survive.

10 We also argue for the introduction of partial business derating on grounds of fairness. This measure would remove the inequity of the present rating system which results in domestic ratepayers in England and Wales being subsidised by the domestic rate relief of 18.5p per £ of rateable value. Business is also dealt with harshly compared with agriculture which is derated, yet the arguments for business being treated similarly are certainly as strong.

11 For the same reasons, we recommend business derating of 2 per cent in Scotland to bring business into line with the domestic sector which there enjoys relief of 3p per £ of rateable value. (Industry in Scotland is already derated by 50 per cent but this is in order to make rate payments on industrial property roughly equivalent between England and Scotland, and is not relevant to the present discussion).

12 Primary legislation would be needed to implement the measure. We propose that the Government should take steps at once to draft the necessary Bill and introduce it in time for it to be enacted by the end of July 1984. We recognise that this would put some pressure on the Parliamentary timetable but the enabling Bill could be relatively short. As the partial derating would apply to the rating year 1984/5 it would be necessary for rating authorities to reduce from September or October the monthly payment of rates where this was being done by instalment. Where six-monthly payments were made, a similar amendment would be needed for the second payment. Only in the case of those relatively few businesses who pay their total rates at the beginning of the rate year would refunds be necessary.

13 We estimate the cost of implementation at £600 million at 1984/85 prices. In the first year it should be paid for by the Government through an increase in the Rate Support Grant, but over a period of 3 or 4 years this would be phased out as local authorities improved their efficiency. In this context it is worth noting the point already made that the Audit Commission believes that between £1 and £2 billion per annum can be saved by local authorities in England and Wales alone, through increased efficiency and effectiveness in their spending.

Empty Property Rate

14 In the White Paper, the Government proposes the abolition of the rating of empty industrial premises. We welcome this proposal but believe that it should apply to all empty business properties. In principle rates are a tax on beneficial occupation and should not be levied on empty premises. At a time of recession the rating of empty commercial property, even at 50 per cent of the full rate, causes financial problems for many businesses. We feel it is unjust to penalise owners of empty property who have tried to let or sell but have been unable to do so because of the recession. We estimate that the additional cost of this proposal would be around £30-35 million at 1984/85 prices, and recommend that it should be implemented in 1984/85 by amendment to the relevant statutory instrument.

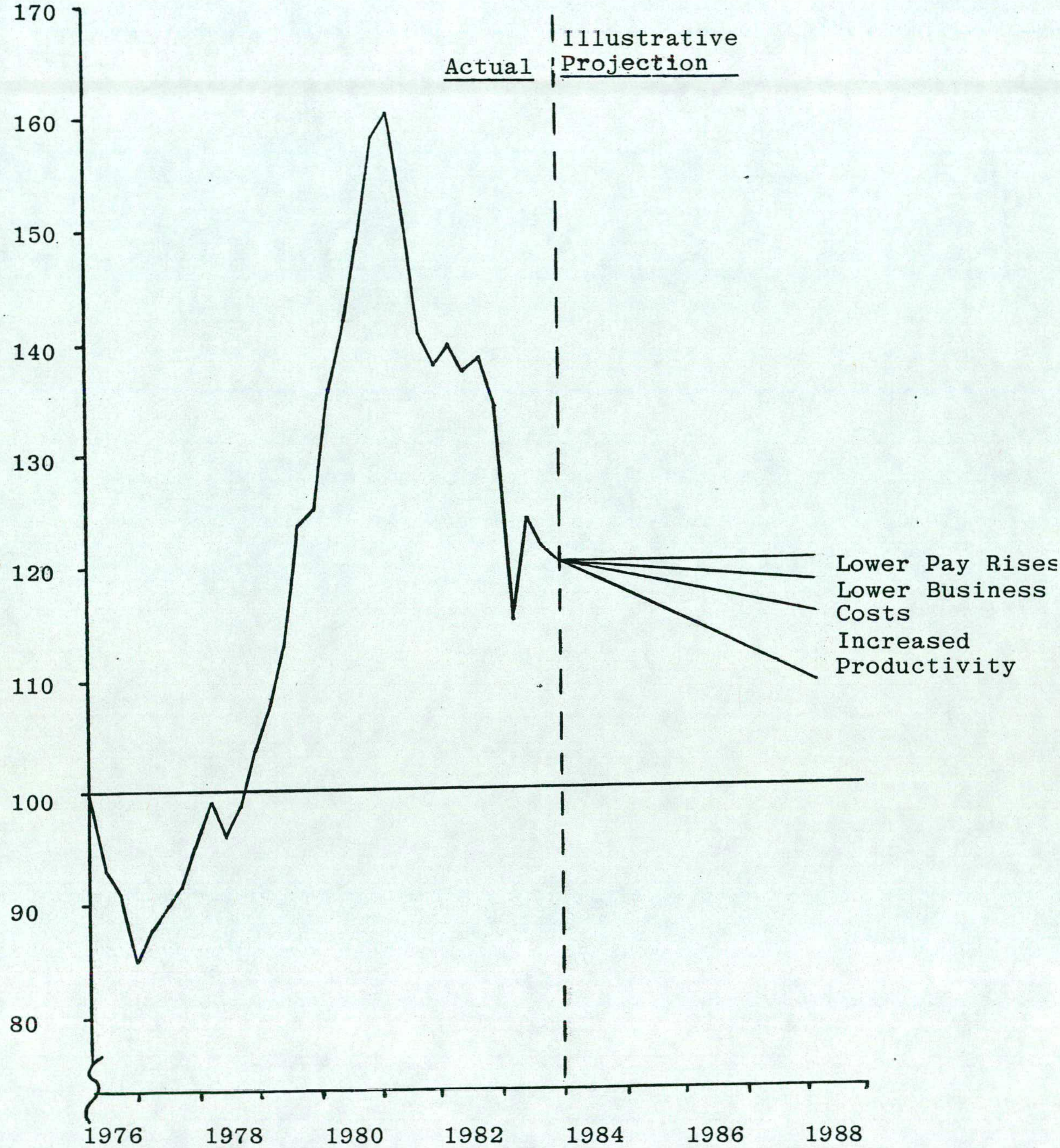
Rate Relief for Partially Unutilised Premises and Plant

15 In addition we advocate the introduction of "mothballing" rate relief for unutilised parts of premises and plant in order to alleviate the burden where these have been taken out of use but are being maintained with a view to eventual re-employment when economic circumstances allow. Legislation is needed but the measure should be effective in 1985/6.

CHARTS FOR BUDGET REPRESENTATIONS 1984

CHART II.1

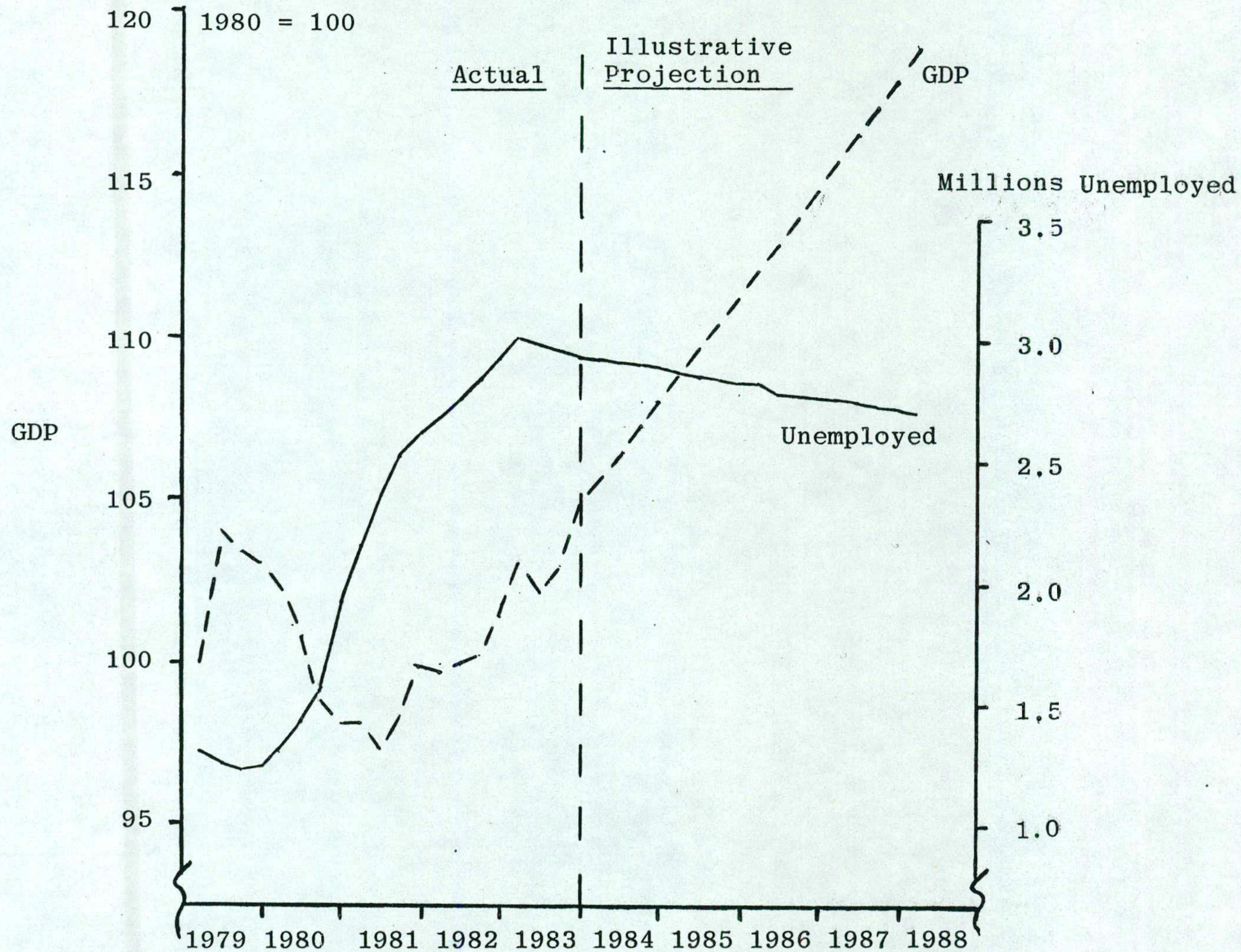
UK RELATIVE UNIT LABOUR COSTS IN MANUFACTURING 1975=100



Source : CBI estimates and illustrative projections.

CHART II.2

CBI PROGRAMME FOR GROWTH[1] AND UNEMPLOYMENT[2]



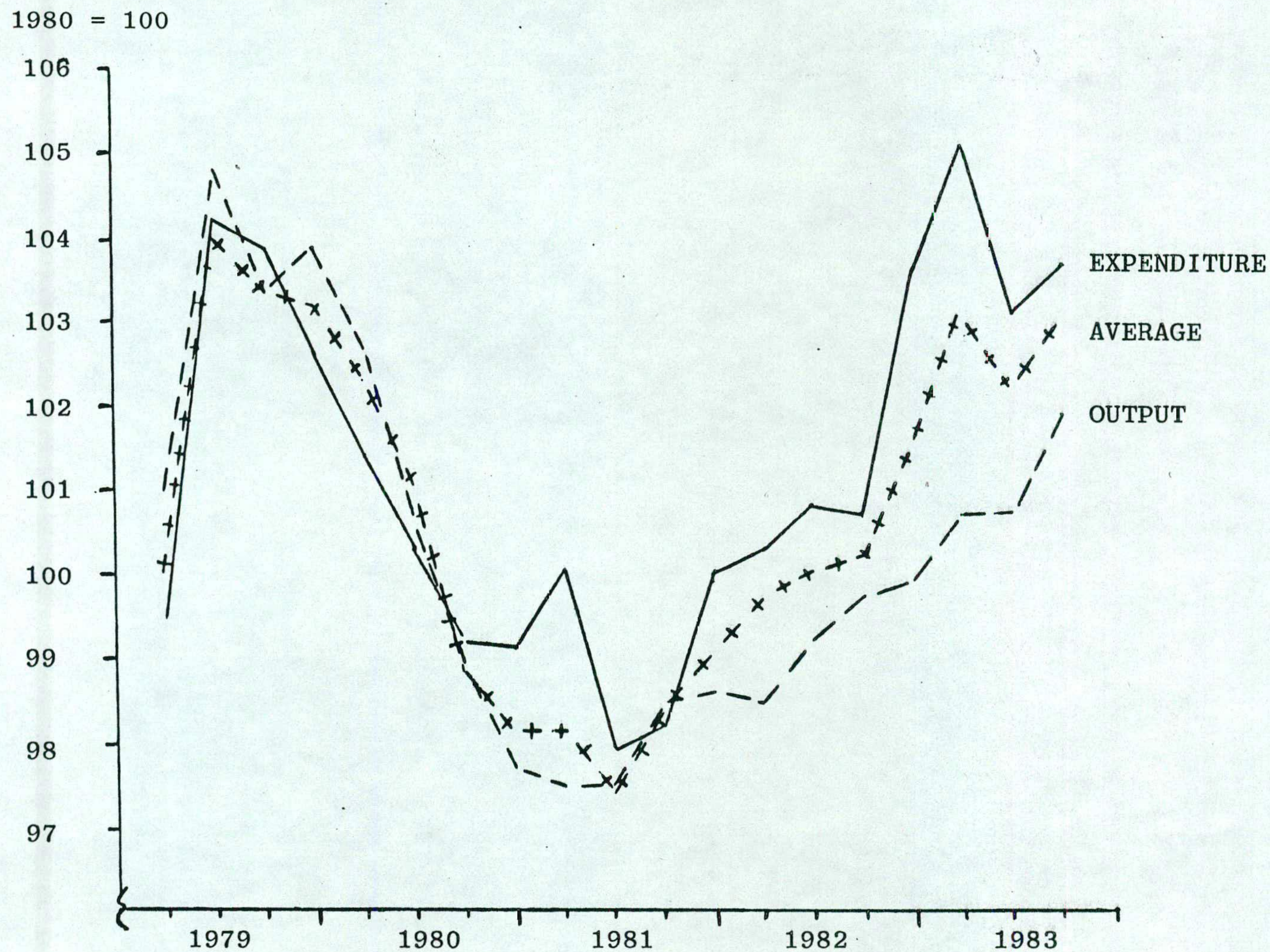
1. GDP average estimate

2. Excludes school leavers

Source GDP - CSO; CBI estimates and illustrative projections.
Unemployment - Department of Employment; CBI estimates and illustrative projections.

CHART III.1

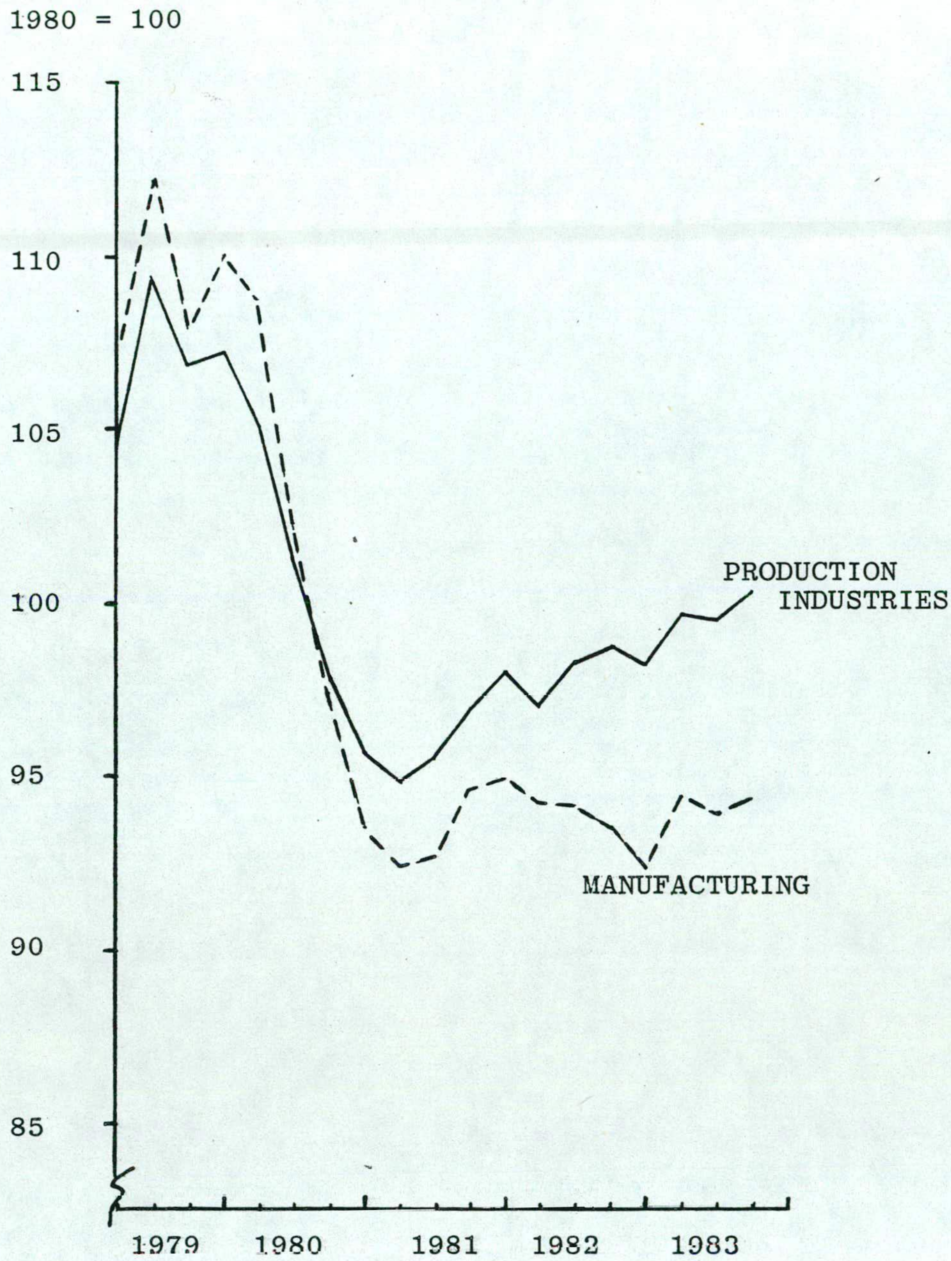
MEASURES OF REAL GDP



Source : CSO

CHART III.2

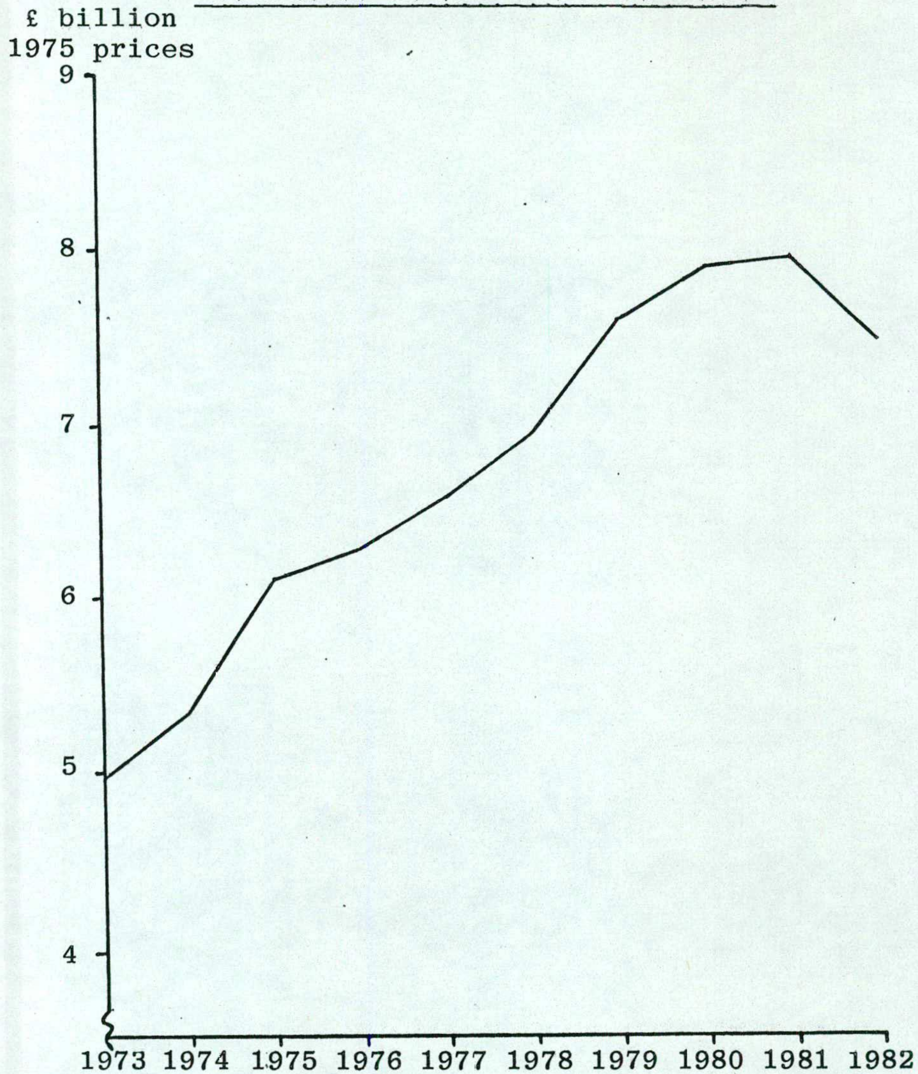
OUTPUT OF PRODUCTION INDUSTRIES AND MANUFACTURING



Source : CSO

CHART III.3

GOVERNMENT IMPOSED BUSINESS COSTS[1]

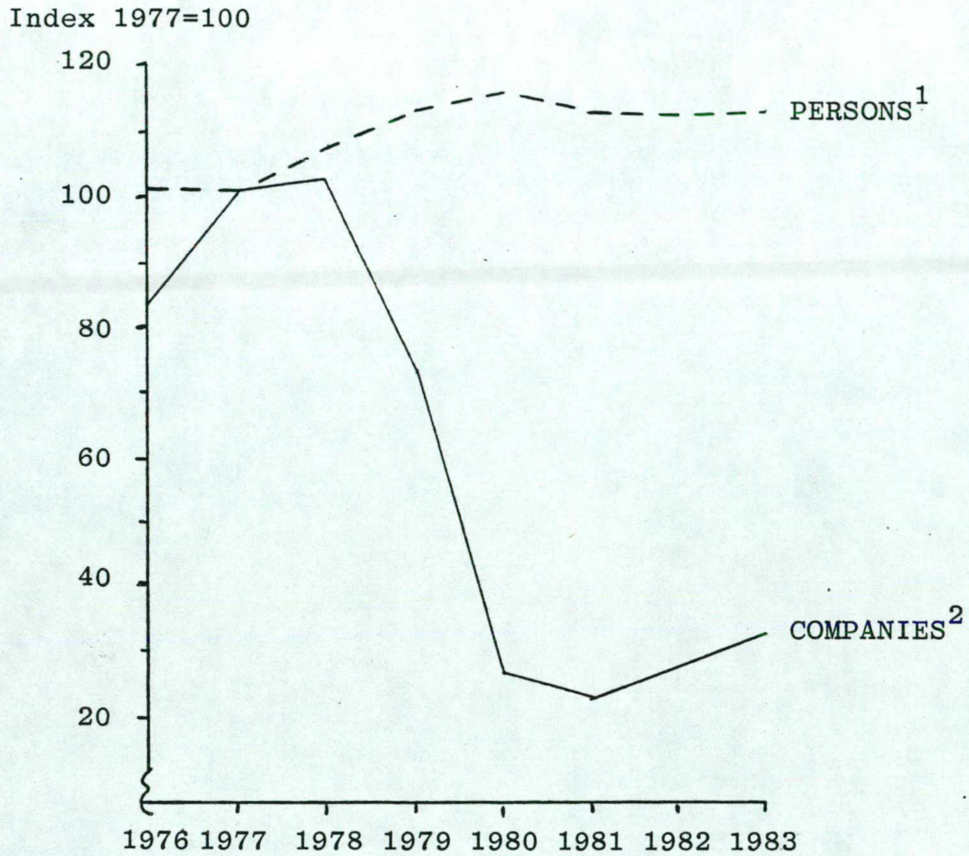


1 National Insurance Surcharge, Employer's National Insurance Contributions and Business Rates. Figures deflated by Wholesale Output Prices.

Source : NIS and NIC's - National Income and Expenditure 1983
Business Rates - For GB only. Based on Annual Abstract of Statistics and Scottish Annual Abstract figures.

CHART III.4

PERSONS' AND COMPANIES' REAL INCOME



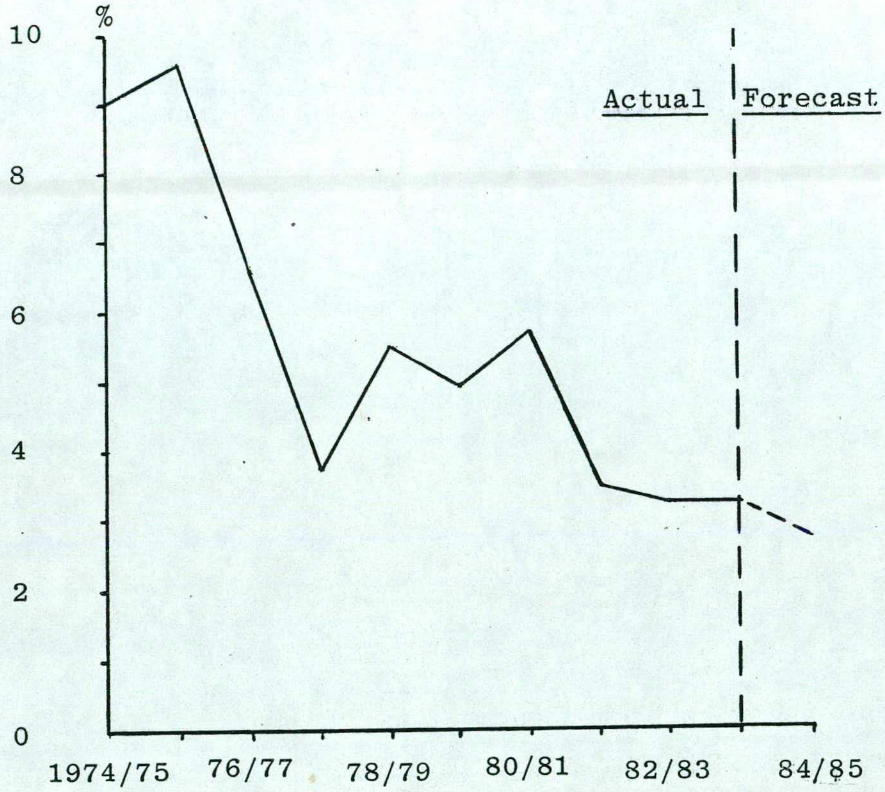
1 Real personal disposable income

2 Industrial and commercial companies' undistributed income plus dividends on ordinary shares after providing for depreciation, stock appreciation and additions to tax reserves. Deflated by Total Final Expenditure Deflator.

Sources: CSO and CBI estimates.

CHART III.5

PSBR AS A PERCENTAGE OF GDP[1]

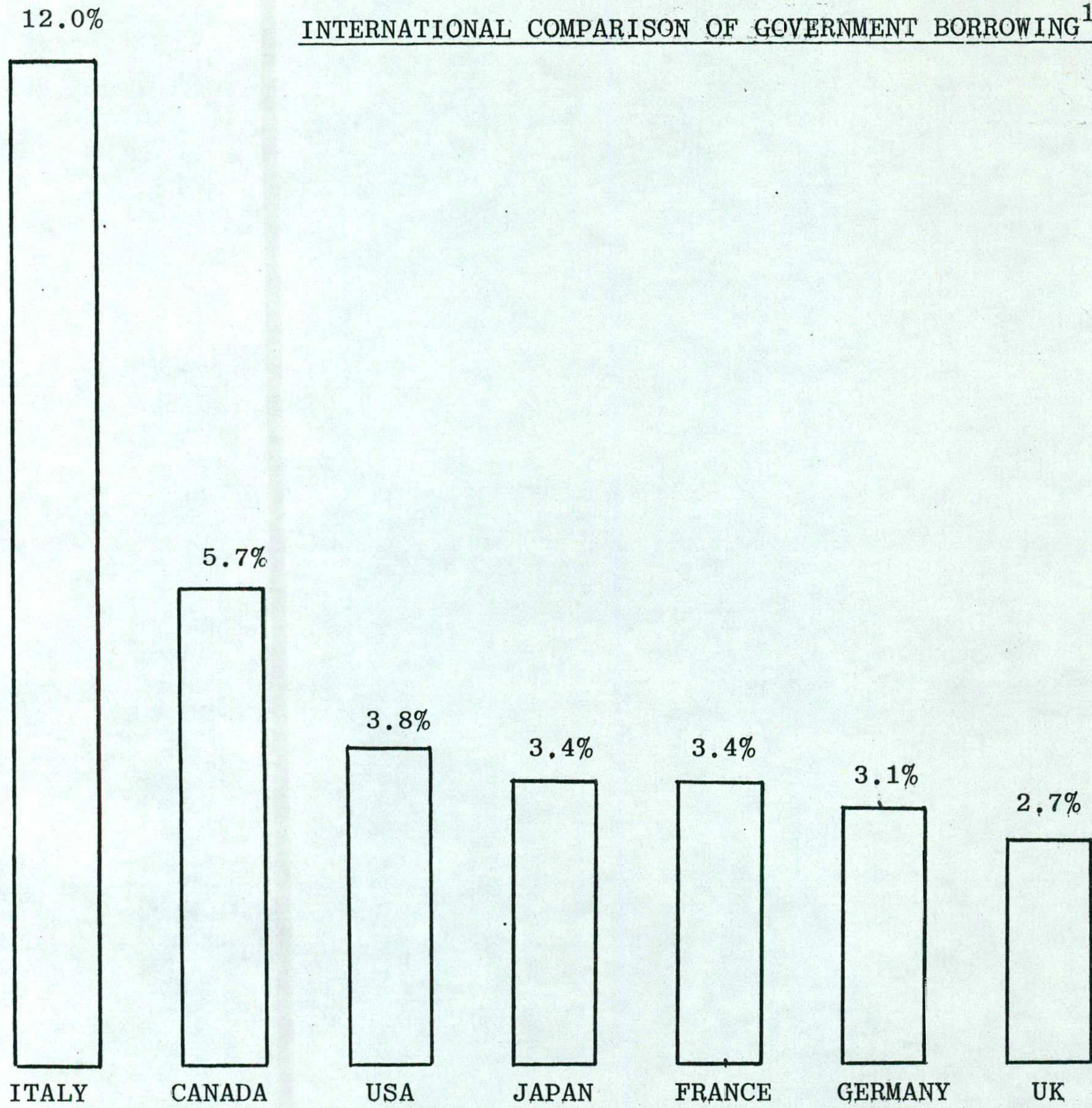


1 PSBR as percentage of GDP at market prices

Sources : 1974/75 to 1982/83, Financial Statistics and CSO; 1983/84 CBI estimate based on PSBR forecast contained in the Autumn Statement; 1984/85 CBI forecasts assuming implementation of CBI proposals.

CHART III.6

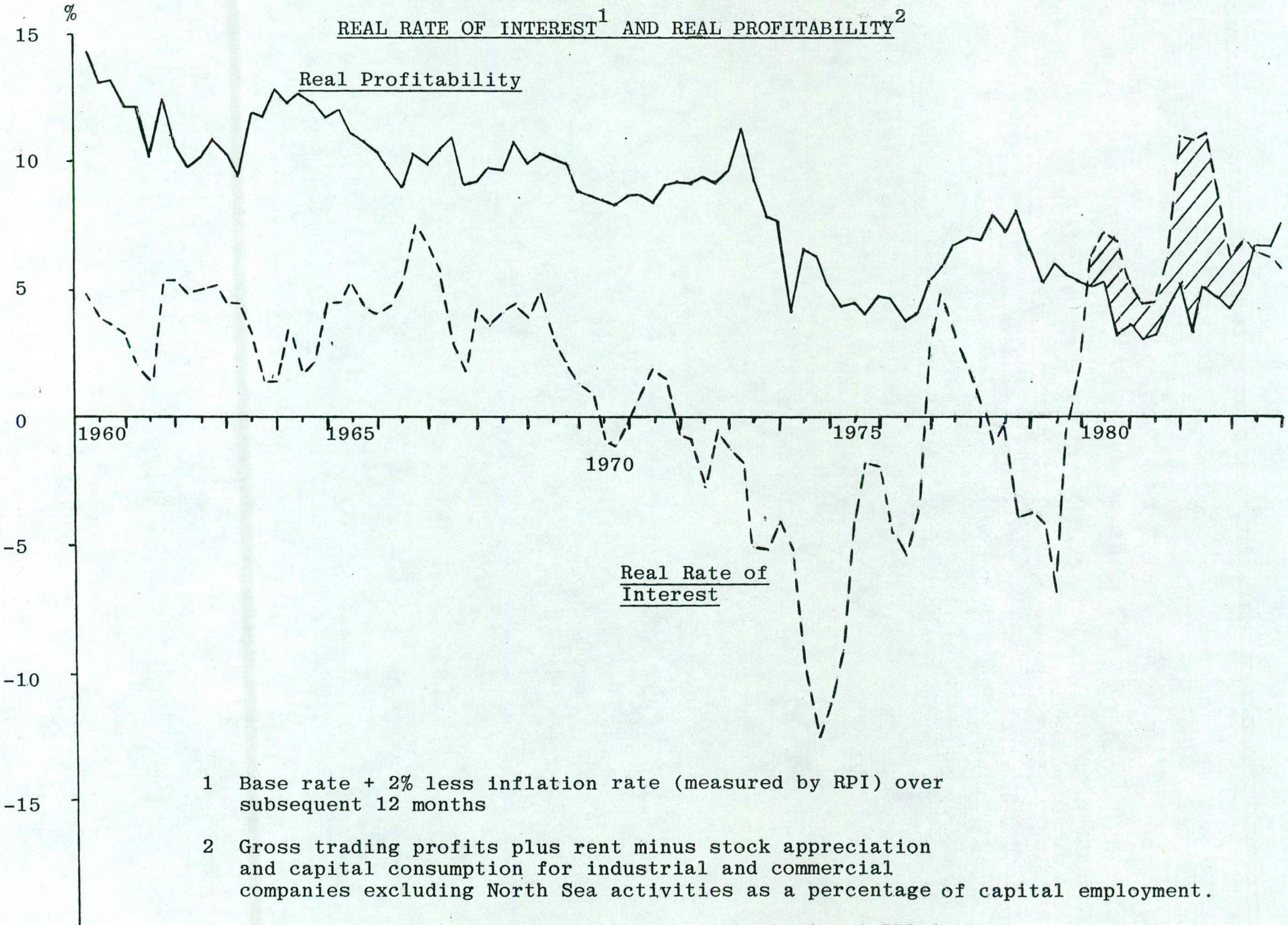
INTERNATIONAL COMPARISON OF GOVERNMENT BORROWING[1] IN 1983



1. General Government Deficit as a percentage of GDP/GNP at market prices. These figures refer to a somewhat narrower concept of public borrowing than our PSBR, but are on a comparable basis, and indeed they are more meaningful than would be a comparison of PSBR's, partly because of the differing degree of nationalisation in the various countries.
Source : OECD estimates, Economic Outlook, December 1983.

CHART III.7

REAL RATE OF INTEREST[1] AND REAL PROFITABILITY[2]



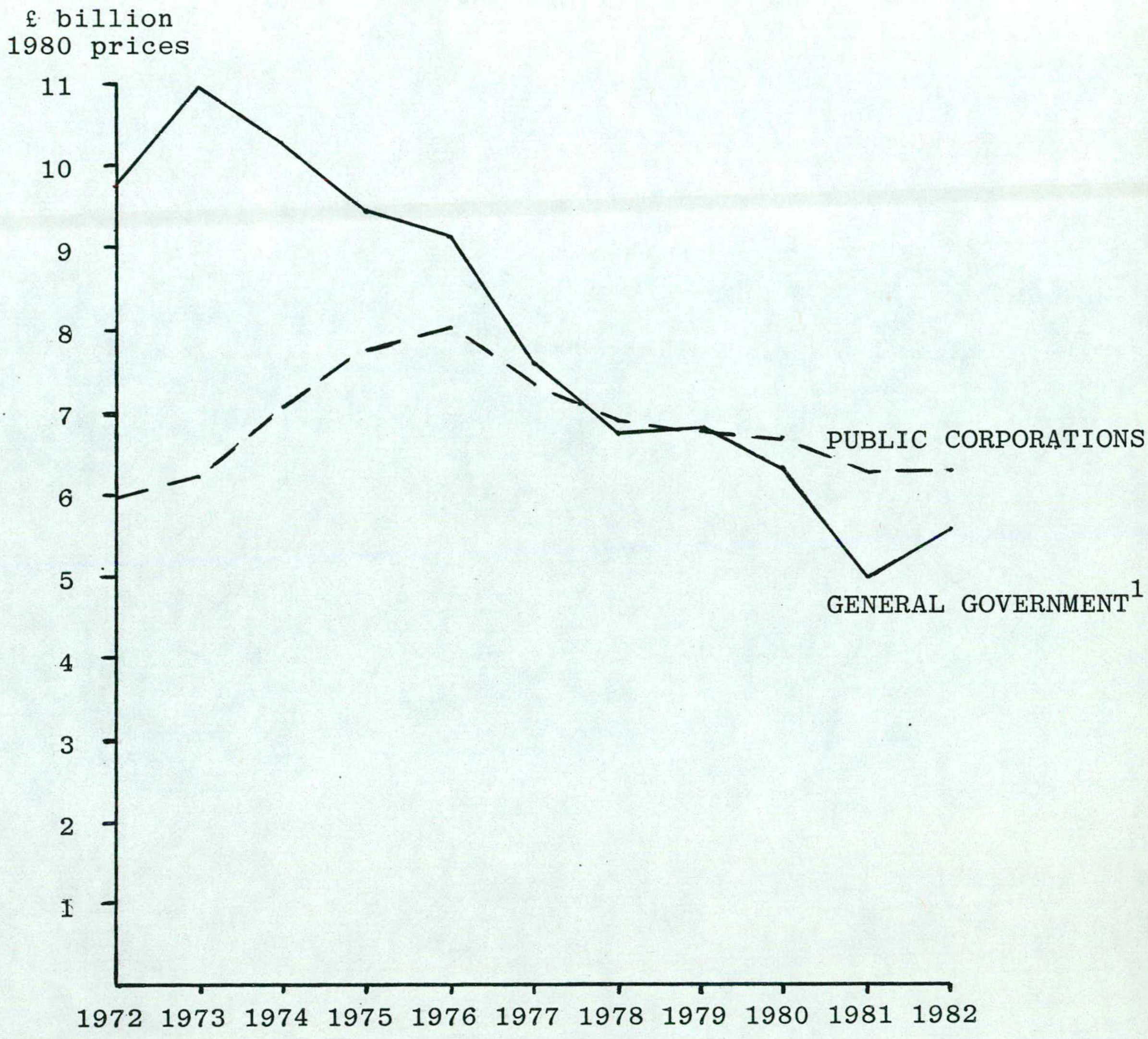
1 Base rate + 2% less inflation rate (measured by RPI) over subsequent 12 months

2 Gross trading profits plus rent minus stock appreciation and capital consumption for industrial and commercial companies excluding North Sea activities as a percentage of capital employment.

Source : CBI estimates based on Bank of England and CSO data.

CHART V.1

PUBLIC SECTOR INVESTMENT

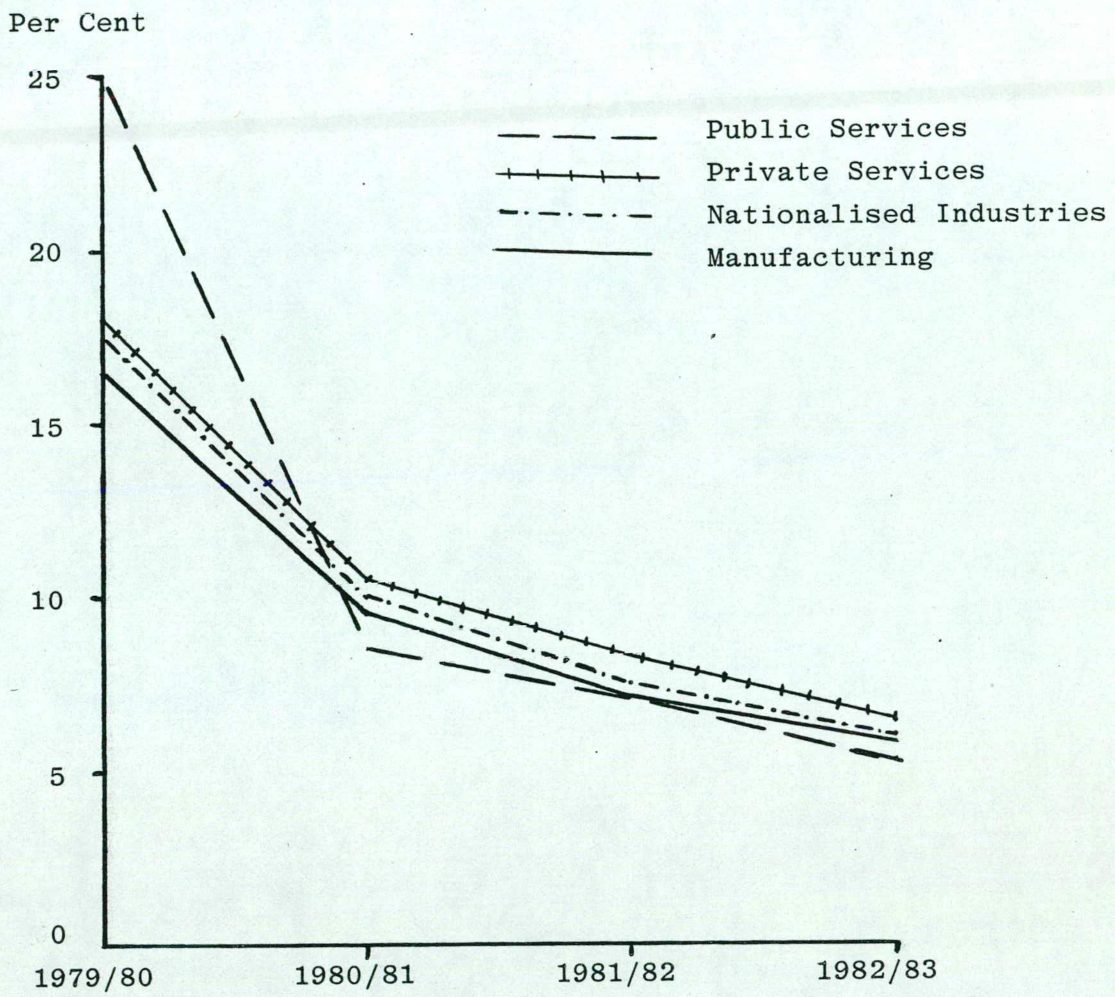


Source : National Income and Expenditure 1983

1 Figures adjusted for sales of council houses.

CHART V.2

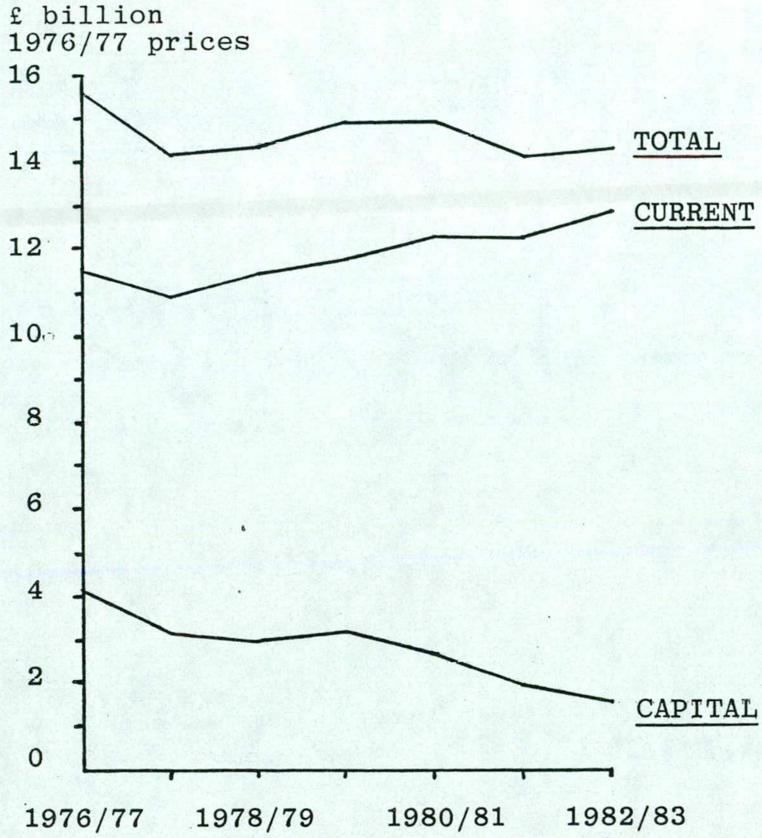
AVERAGE PAY SETTLEMENTS



Source : CBI Pay Databank

CHART VI.1

LEVELS OF LOCAL AUTHORITY EXPENDITURE[1]

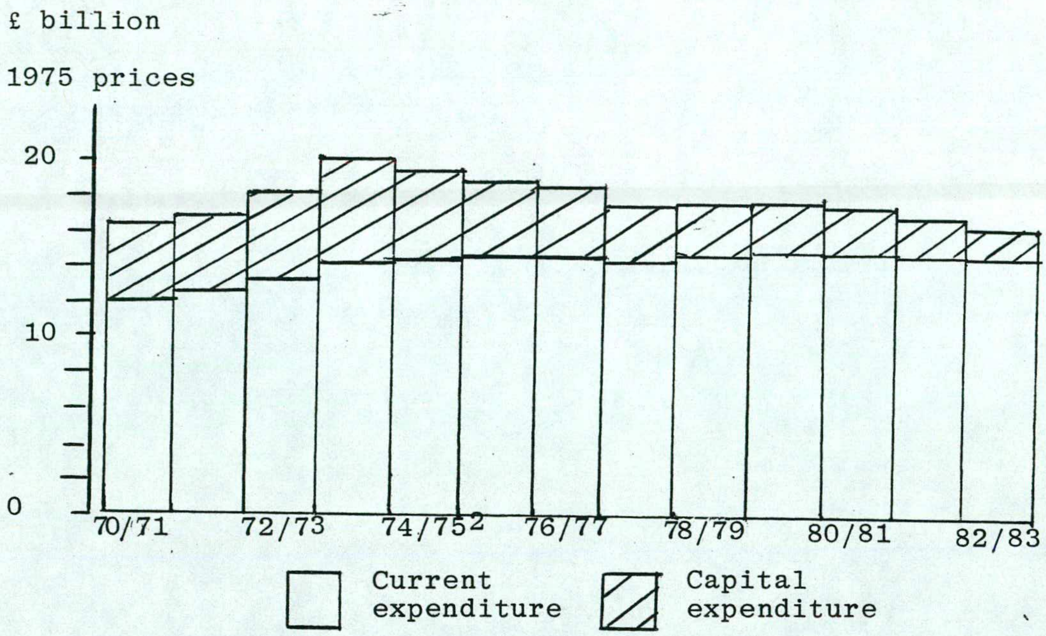


1 Great Britain only

Source: The Government's Expenditure Plans 1983-84 to 1985-86, (Cmnd 8789).

CHART VI.2

GROSS LOCAL AUTHORITY EXPENDITURE IN ENGLAND AND WALES[1]



1 Not corrected for double counting. This may account for up to 15 per cent of current expenditure.

2 Local authorities were reorganised in 1974, and some services were removed.

Source: Local Government Financial Statistics. 1970/1 - 1980/1. CBI estimates 1981/2, 1982/3.

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332

From
Sir Campbell Fraser
President

CBI CONFEDERATION OF BRITISH INDUSTRY

24 January 1984

Pl circulate top letter only & return.

Dear Nigel,

I enclose a copy of the CBI's Budget Representations which are to be published on 25 January, and of which you are well aware.

I very much commend them to you, modest or not.

A copy has gone to your Cabinet colleagues.

Yours,
Campbell.

CH/EXCHEQUER

REC.	26 JAN 1984 26/1
~~ACTION~~	Mr Battishill
COPIES TO	CST, FST, MST, EST
	Sir P. Middleton, Sir T Burns
	Mr Monck, Mr Monger
	Mr Lovell, Mr Folger, Mr Ridley

PS/IR, PS/C&E, Mr Goodman.

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

pl/

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

3 February 1984

Sir Campbell Fraser
President
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

Dear Campbell

Many thanks for your letter of 24 January, enclosing the final version of your Budget representations. I was pleased to see from this week's Industrial Trends Survey that you now take a rather brighter view of the prospects for growth over the next year or so!

Yours

Nigel

NIGEL LAWSON

Budget Representations
to the Chancellor
January 1984

CBI

KEEP IT GOING

TO SUSTAIN GROWTH, IMPROVE COMPETITIVENESS NOW

Budget Representations to the Chancellor January 1984

CBI

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103 New Oxford Street
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January 1984

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Executive Summary

1 Our task is to sustain the recovery without prejudicing the gains made in the fight against inflation.

2 The 1984 Budget must be prepared with this in mind.

3 With the prospect of lower North Sea oil production we cannot ignore the longer term. We therefore set out a five year programme of action by business and government, covering the period 1982/83 to 1987/88, which aims to sustain last year's 3 per cent rate of growth and keep inflation low. Improved competitiveness and encouragement of enterprise and investment are necessary to achieve this.

4 The overwhelming immediate need is to improve competitiveness. We are still over 20 per cent less competitive against our main competitors than we were in the mid-1970s and the gap is still larger against our European rivals.

5 Unless we improve our competitive position, increases in domestic demand will benefit foreign rather than domestic producers and lead to a further deterioration in the current account.

6 The 1984 Budget must concentrate on measures to reduce government-imposed business costs - by the final abolition of the National Insurance Surcharge and 10 per cent business derating. Looking ahead, we need to reduce employers' National Insurance Contributions in 1985/86 and increase capital spending on the infrastructure.

7 We do not propose that income tax thresholds should be raised by more than the rate of inflation. If we reduce the burden of personal taxes in the 1984 Budget there is a serious danger that too much would be spent on imports and nothing done to help our competitiveness.

8 Only if we are successful in sustaining the present rate of growth in the economy will there be scope for cuts in personal taxation in future years.

Chapter I

Main Representations

1 Our task must be to sustain the recovery. As the Chancellor has said, steady growth with low inflation is "a winning combination". Our Representations are drawn up with this in mind.

2 They are set in the context of a medium term programme of action by business and government, covering the period to 1987/88, with the following key features:

- maintaining steady growth at around the 3 per cent rate achieved in 1983 and expected by the Chancellor for 1984;
- keeping inflation low;
- improving competitiveness in cost, price and non-price areas;
- encouraging enterprise and investment.

The 1984 Budget

3 The overwhelming immediate need is to improve our competitiveness. We are still over 20 per cent less competitive against our main competitors than we were in the mid-1970s and the gap is still larger against our European rivals. Our balance of payments current account has moved from a surplus of £6½ billion in 1981 to one of £1½ billion in 1983, despite a large improvement in the balance of trade in oil. In 1984, world trade growth should help exports and keep the current account in balance. But we could run into a balance of payments crisis in the second half of the decade especially if the world economy slows down, and if North Sea oil production starts to decline at about the same time. The brakes would then have to be put on which would stop growth; or the pound would fall excessively, causing renewed inflation; or, most probably, there would be a combination of both.

4 So, our priority has to be improved competitiveness. To this end, the first two lines in Table I.1 propose cuts in government-imposed business costs - the abolition of the National Insurance Surcharge and 10 per cent business derating to match domestic derating. Looking further ahead, we also recommend a reduction in employers' National Insurance Contributions, by one percentage point, to take effect in 1985/86.

5 The next Budget should also include further measures to help enterprise, investment and innovation. These will pay off in the longer term. We recommend improvements to the Business Expansion Scheme to make investments more marketable; improved tax treatment of employees' stock options; capital tax reliefs; capital allowances for commercial buildings; and abolition of the Investment Income Surcharge, of Development Land Tax and of Stamp Duty on share transactions.

6 We must also see a higher level of capital spending to improve the infrastructure. This will both help our competitiveness in the medium term

and provide work for the sorely-pressed construction industry. We propose that this be financed by reducing government current expenditure.

7 In addition, a reduction in the cost of borrowing, which remains high in relation to inflation, is a priority.

8 We do not propose that income tax thresholds and bands should be raised by more than inflation. Those in work have improved their real income after tax substantially since 1979, while company net income has fallen drastically. Increases in tax thresholds are an inefficient way of reducing the poverty trap and have little impact on the unemployment trap.

9 If personal tax were cut in the 1984 Budget, there is a serious danger that too much would be spent on imports and nothing done to help our competitiveness. In subsequent years, if we can improve our competitiveness, keep growth going and the balance of payments under control - and if public spending is held down in real terms as the Government proposes - we should be able to make further substantial reductions in taxation, including personal tax, while reducing public borrowing as a percentage of GDP.

How Our Proposals Can Be Financed

10 The cost of our proposals for the 1984 Budget are set out in Table I.1

11 They should not be financed by raising the burden of taxation elsewhere as this would, to a large extent, offset their beneficial effects and might add to inflation.

12 In the Government's medium term financial strategy, as set out in the Budget last March and in the Chancellor's Autumn Statement, there would appear to be little if any scope for tax reductions in the 1984 Budget but very much more in the Budget of 1985.

13 However, as the Chancellor pointed out in the House of Commons in November, these estimates "are subject to a wide margin of uncertainty at this stage and rest on a number of conventional assumptions. The Autumn Statement is not a time for decisions on appropriate levels of borrowing or taxation. By the time of the Budget I shall have much more, and much more up-to-date, information."

14 Our proposals imply a somewhat higher level of public borrowing in 1984/85 than the Chancellor has assumed in his Autumn Statement. They increase borrowing by ½ per cent of GDP, but leave it well within the Chancellor's target in the following year (1985/86). On present estimates, they would reduce the PSBR as a percentage of GDP from 3¼ per cent in 1983/84 to 3 per cent in 1984/85, and if our medium term programme were fulfilled the figure would fall to around 1½ per cent by 1987/88.

15 While the economy expanded at a rate of 3 per cent in 1983, we see a significant risk that it may slow down in the second half of 1984 if nothing is done. This would have a serious effect on business confidence and put the objective of steady growth at risk. On the other hand we do not think the risks of the economy overheating if our proposals are adopted are significant.

16 We believe that our proposals can be justified as a sound long-term investment in the future of this country. Also:

- they would still keep our public borrowing as a proportion of GDP lower than in any other important industrial nation;

- they should not add to inflation because they reduce costs;

- they should enable interest rates to be reduced as external factors permit.

TABLE I.1

CBI TAX RECOMMENDATIONS FOR 1984 BUDGET[1]

(£ billion)

Proposed Changes:	1984/85 Cost
A Lower Business Costs	
Abolition of NIS	0.9
Partial Business Derating and Other Measures	0.7
B Measures to Encourage Enterprise and Investment	
Improved Stock Options	-
Stamp Duty Changes	0.5
Capital Tax Changes	-
Amendments to Business Expansion Scheme	-
Abolition of Investment Income Surcharge	-
Corporation Tax changes	0.1
Abolition of Development Land Tax	-
Feedback Effect	-0.4
Net Effect on PSBR[2]	+1.8

1 Where no cost is indicated this is either because the cost of the proposal is insignificant, or would not become effective until 1985/86.

2 In comparison with unchanged policies using the same definition as the Treasury. The full year cost of these proposals is about £2½ billion.

Chapter II

The Medium Term Programme

INTRODUCTION

1 This Chapter sets out the action which Government and business need to take to sustain steady growth and low inflation over the period to 1987/88. The economic arguments underlying our proposals for the 1984 Budget are set out in Chapter III and the details of these tax and expenditure proposals are set out in Chapters IV, V and VI.

THE NEED FOR A SUSTAINED RECOVERY

2 Over the past 10 years the British economy has grown only slowly, with much of the growth attributable to increased oil production.

3 In the next decade, oil production is likely to plateau and then fall. To avoid depressing the standard of living, it is essential to develop competitive businesses to compensate for this.

4 The recession has hit particularly the investment goods industries and those firms facing international competition. To survive they have had to cut expenditure and rationalise. We need now to build on the lessons learnt from this process to form the basis of a successful recovery.

5 Confidence is vital. Our Surveys show that the major constraint holding back investment is lack of certainty about growth and prospects (44 per cent of the respondents to the October 1983 CBI Industrial Trends Survey quoted 'uncertainty about demand' as the main factor holding back their investment). For confidence to invest in the future, businessmen need to be convinced that the recovery will be sustained. In this way growth can create its own momentum.

6 Growth is also necessary to generate higher living standards and help create more jobs; with 3 million unemployed this is crucial.

7 Lack of growth in the economy increases the tension between the living standards we can afford and those to which we aspire. Slow growth leads to rising public spending on unemployment which can only be paid for by cutting benefits or public services, raising tax levels, or running the risk of excessive borrowing.

8 It has been argued that too rapid a rate of growth would lead to a deterioration in the quality of life or the environment. But stagnation or a rate of growth that is too slow can also damage the quality of life - through rising unemployment and the consequent loss of human skill, reduced growth in expenditure on education and health, and through deterioration of the infrastructure.

9 A rate of growth that is too rapid may lead to inflation. For this reason, holding down inflation is an essential element in our strategy for growth. Moreover, growth can hold down costs through spreading overheads and generating more funds for cost-cutting investment.

THE SPEED OF THE RECOVERY

10 During the 1970s GDP grew at an average rate of 1 - 1½ per cent per annum. But the trend during the 1950s and 1960s was much higher, close to 3 per cent. Given the dangers of shortages and inflation if growth is too fast, and of rising unemployment and higher taxes if growth is too slow, what rate should we aim for?

11 To answer this we need first to assess our starting point and then to consider the likely external environment.

Capacity

12 At first sight it would appear that we start from a position of considerable spare resources in the economy. An eighth of the labour force is unemployed. The different indicators of spare capacity in the manufacturing sector from the CBI Industrial Trends Survey, suggest that although capacity has been reduced, partly in response to low demand, there is still considerable scope for higher capacity utilisation.

13 This conclusion is backed up by most other researchers[1], though it has been argued that much of this capacity is not economically viable or is not in those particular sectors where it would be needed in a recovery.

14 Clearly as growth proceeds we should expect some shortages of capacity, labour and components. But temporary shortages can reflect a changing economic structure, and investment in new capacity and production of components and training for skills is unlikely to take place without such market signals. The rate of growth that is sustainable without inflation, however, will depend on holding down such shortages to tolerable levels.

North Sea Oil

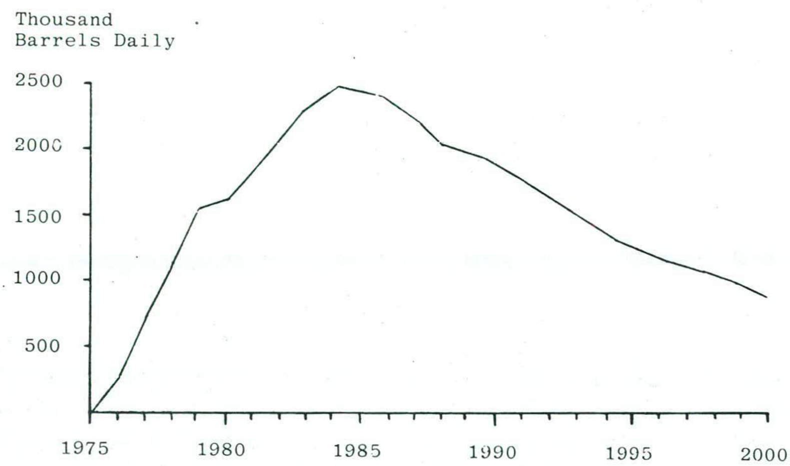
15 Another major factor that will affect the prospects for the economy in the coming years is North Sea Oil. We are now close to the likely peak level of production and over the period to 1987/88 production is likely to plateau or, possibly, decline. Assuming this profile for production, North Sea oil revenues, which have had beneficial effects on government finances and greatly cushioned the impact of the recession on taxpayers are also likely to level out and may well decline towards the end of the decade. North Sea oil has also made a major contribution to the balance of payments and this increases the need for improved competitiveness as oil production declines.

---

1 The OECD (Economic Survey of the United Kingdom, 1983) and J Taylor ("Unused Productive Capacity in the UK: 1950-82" Unpublished paper, University of Lancaster) both conclude, using different methodologies from the CBI Survey, that there is considerable unused capacity in the UK manufacturing sector. P W Robinson (LBS Economic Outlook, August 1981) has argued that there is in fact relatively little spare capacity. This conclusion is based, however, on the assumption that the total available capacity is equal to a 5 year moving average of output rather than using direct information about how much capacity is in existence.

CHART II.1

ESTIMATED UK NORTH SEA OIL PRODUCTION[1]



1. Source : BP - excludes possible future discoveries.

The Achievable Rate of Growth

16 We propose that our medium term programme should aim at an annual rate of growth of 3 per cent from 1982/83 to 1987/88. This is an optimistic figure by the standards of the last decade but we believe that it can be achieved.

17 A rate of growth slower than this would risk the difficulties described above; a faster rate may be achievable but might lead to difficulties for inflation and the balance of payments.

18 Our view that steady growth at around 3 per cent a year coupled with low inflation is a realistic objective over the five year period, is based partly on the fact that it has been achieved in 1983 and is expected by the Chancellor to be achieved in 1984; and partly on past experience, coupled with the belief that we can improve on our past performance, particularly in the field of international competitiveness.

The External Environment

19 During the twenty years 1953-1973, before the first sharp rise in oil prices, GDP in this country grew at an average rate of 3 per cent a year (and faster during recovery periods), with retail price inflation averaging just over 4 per cent a year.

20 It is true that the volume of world trade in manufactures rose during this period at an annual rate of 9 per cent a year, and that we are assuming that it will rise by about 3 per cent a year during our five-year period.

21 On the other hand, from 1953 up to the devaluation of 1967, our competitiveness worsened very markedly - our unit labour costs in

manufacturing rose something like 25 per cent more than the average of our main competitors. During the rest of the period up to 1973 our unit labour costs continued to rise faster than our competitors' in national currencies, and we were able to maintain our cost competitiveness only by a fall in the value of the pound totalling around 25 per cent against a basket of currencies.

22 Over the period to 1987/88, we should not rely on a fall in sterling, but we do aim to avoid a deterioration in our cost competitiveness, through higher productivity, realistic pay settlements and cuts in government-imposed business costs; and indeed to improve it, as we have done over the past two years. We are also assuming some improvement in our non-price competitiveness through encouragement of enterprise, higher profitability leading to more investment in new equipment, new products, marketing, training,etc.

23 In these ways, we believe we can achieve growth in our exports at around the same rate as world trade, instead of a much slower rate as in the past; and that even in an environment of considerably slower growth of world trade we can thus emulate our past performance of growth of the national economy at around 3 per cent a year, with low inflation, without running into balance of payments difficulties.

OUR PROGRAMME FOR SUSTAINING GROWTH

24 Achieving sustained growth with low inflation will require action by Government and business to:

- encourage enterprise and investment;
- improve competitiveness; and
- hold down costs.

Encouragement of Enterprise and Investment

25 For the economy to grow and create jobs, entrepreneurs, investors and managers must be prepared to sacrifice leisure or short term rewards. To encourage this they must be allowed to keep for themselves a fair proportion of the returns created by their efforts or investment.

26 Enterprise is likely to be best encouraged when the public has a direct stake in the system through widespread share-ownership and when managers and employees have a direct stake in their own firms. We therefore propose measures (see below and in Chapter IV) that will reduce tax disincentives to enterprise, investment and share-ownership.

27 The prospects for growth can also be improved by reforms aimed at greater flexibility in labour markets and by government regulation of commerce and industry being kept to a minimum.

28 We intend to bring forward proposals in these areas and in industrial policy to improve the prospects for growth.

Competitiveness

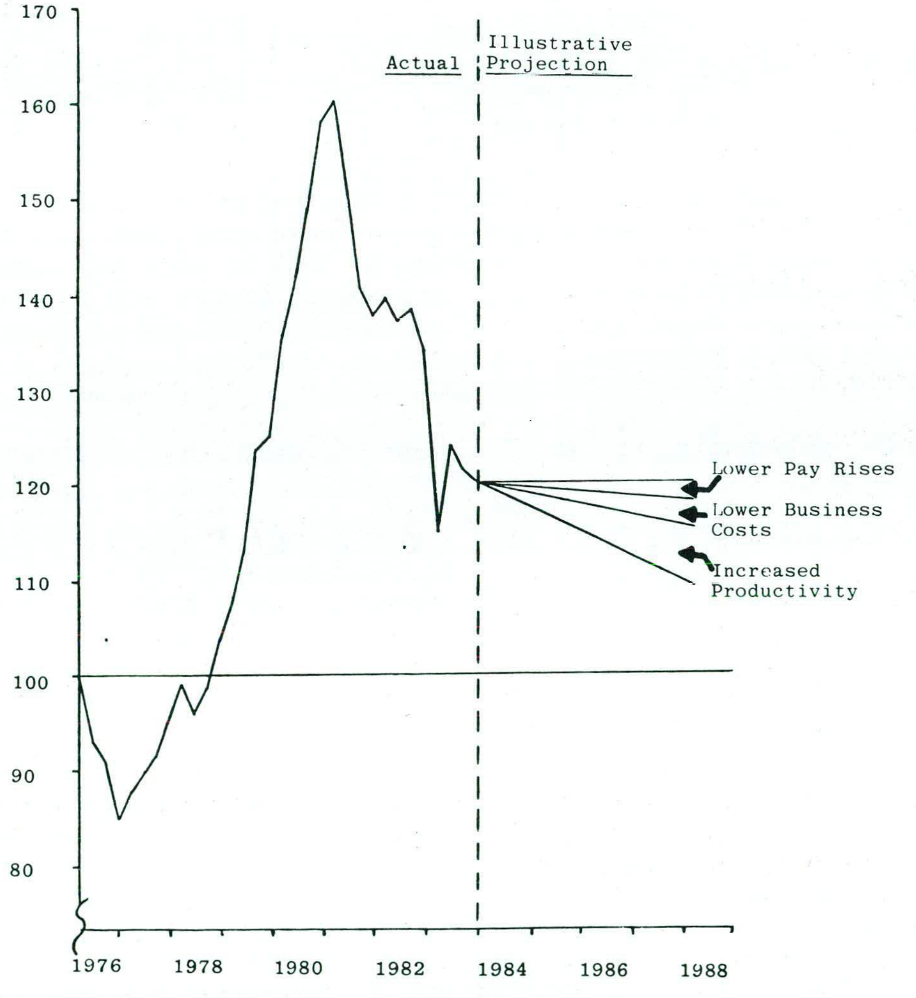
29 To ensure that UK producers win a sufficient proportion of markets at home and abroad to sustain growth, improved competitiveness is essential. Improved competitiveness is also necessary to prevent the fall in the balance of payments current account surplus from £6½ billion in 1981 to about £1½ billion in 1983 becoming a trend that could halt the recovery in the medium term.

30 Our programme aims at improving both cost competitiveness and non-price competitiveness by:

- lower pay settlements than in competitor countries;
- continued rapid increases in productivity; and
- reductions in taxes on business that add to costs.

CHART II.2

UK RELATIVE UNIT LABOUR COSTS IN MANUFACTURING 1975=100



Source : CBI estimates and illustrative projections.

31 The improvements in non-price competitiveness should result from increased profits and the confidence to plan for expansion leading to higher investment, not only in fixed assets, but also in:

- research and development;
- marketing; and
- training.

32 Many of the arguments about competitiveness are aimed at the manufacturing sector since this is the sector most directly exposed to international competition. If we look at our total exports of goods and services, about half the value added in the UK is in manufacturing industry. The other half is contributed by other sectors such as agriculture, energy, construction, communication, distribution and other services. These non-manufacturing sectors contribute in two ways, roughly equal in importance. First, they supply goods and services to manufacturers to help them get their exports to the ports and sell them abroad. Secondly, these sectors produce the invisible exports on which we rely so much. So improved competitiveness is also important for the non-manufacturing sectors.

Costs

33 We believe that high inflation is damaging to the economy and that for growth to be sustained low inflation is vital. For this reason we are not relying on a falling exchange rate to improve competitiveness, or a lax monetary policy to boost demand.

34 Our programme of pay moderation, rising productivity and reduced taxes on business will result in lower unit costs and help hold down inflation. The public sector must play its part by ensuring that it does not contribute to inflation by unjustified increases in its costs, prices and taxes.

Macroeconomic Policy

35 Macroeconomic policy also has an effect on the prospects for growth and inflation.

36 We support the aims of the Government's medium term financial strategy (MTFS). Such a strategy helps to create confidence in its aim of holding down inflation. However, we have consistently argued that the targets contained in it have to be interpreted flexibly and sometimes adjusted in the light of developments and prospects for the economy. The monetary targets should aim to allow sustained growth provided that this does not conflict with the objective of low inflation.

37 The medium term fiscal targets in the MTFS should be such as to hold down the ratio of public debt to GDP. In the short-term however, we would envisage deviations from that path where necessary in the light of economic circumstances for cyclical reasons, or if they specifically improve competitiveness.

38 Table II.3 in the Annex shows that if the present rate of growth is maintained and government spending is held to its present level, there would

be scope for tax cuts of 2¼ per cent of GDP by 1987/88. This would be equivalent to about £2 billion (in 1984/85 prices) in each of the four Budgets before then. The proposals set out in Table I.1 would use up about £2½ billion by 1987/88 at 1984/85 prices. We would envisage (and have assumed in our calculations) most of the rest of the sums available being used to reform and cut personal taxation on income and capital and to reduce payroll taxes on employers. The following ready reckoner will be helpful in costing possible options for tax changes.

Costs of Possible Tax Changes

	Cost in full year 1984/85 prices £bn
Lower basic rate of income tax by 1 per cent	1.0
Reduce employers' NIC by 1 per cent	0.9
Reduce top income tax rate from 60 per cent to 50 per cent	0.2
Derate business by a further 10 per cent	0.5
Increase income tax thresholds and bands by 5 per cent more than inflation	0.8
Reduce corporation tax rate by 5 per cent	0.8

THE RISKS AND THE REWARDS

39 Our economic strategy might be driven off course by factors beyond our control. Further international disruption as occurred in the 1970s with sharp rises in oil prices, such as default by a major debtor nation, might require the strategy to be revised. We would have to face such circumstances as they occurred and make appropriate adjustments to the strategy.

40 The strategy could also be thrown off course as a result of factors that are under own control - we could allow inflation to pick up or our competitiveness may be insufficient to prevent a deterioration in the balance of payments. Either of these would reduce the achievable sustainable rate of growth.

41 If we steer away from these rocks, however, the benefits of success will be immense.

42 Further rises in living standards for those in work would be achievable while at the same time unemployment would start to fall.

43 If public spending were held roughly constant this would permit scope for substantial cuts in the burden of taxation as well as allowing public borrowing to fall substantially as a percentage of GDP (see Table II.3).

44 Perhaps most important, success would permit us to start to adjust our structure of industry and commerce to cope with the problems that may emerge in the 1990s and beyond, such as declining North Sea oil revenues, increasing technological demands for public services and demographic changes including the need to fund the pensions of an ageing population in the next century.

ANNEX II.1

HOW OUR PROGRAMME ADDS UP

1 This Annex gives illustrative figuring to show how the different elements in our programme fit together. The figures are not forecasts and their relative precision, without reference to the obvious margins of error involved, is merely intended to simplify the exposition.

Demand

2 Table II.1 shows the growth in the different components of demand which we expect to be consistent with our programme. The greatest absolute contribution to growth comes from consumers' expenditure rising in line with real incomes. The fastest growing components, however, are fixed investment, as profits recover, and exports, as world trade recovers and competitiveness improves.

Table II.1

Pattern of Growth[1] Consistent with CBI Programme
(Percentage annual change in volume)

	Estimated Growth so Far (1982/83 to 1983/84)	Projected Growth (1982/83 to 1987/88)
GDP (average measure)	2½	3
Consumers Expenditure	3	2
Fixed Investment	1½	6½
Government Current Expenditure on Goods and Services	2	0
Exports of goods & services	0	4
Imports of goods & services	5	5

1 Both between 1982/83 and 1983/84 and, to a lesser extent, between 1982/83 and 1987/88, there is some contribution to growth from a changing rate of stockbuilding.

Competitiveness

3 Our unit labour costs in manufacturing in the past two years have risen by about 2½ per cent per annum less than those in competitor countries. We have assumed over the next four years that, if our programme is implemented, most of this differential will be maintained. The improvement in our cost competitiveness indicated in Chart II.3 and improvements in our non-price competitiveness compared with our past performance are forecast to lead to annual export growth in manufactures over the period of about 3 per cent , the same as the growth in world trade in manufactures. Since the trend over a long period has been for total UK exports of goods and services to rise about 1 per cent per annum faster than our exports of manufactures, we have projected growth in the former of 4 per cent.

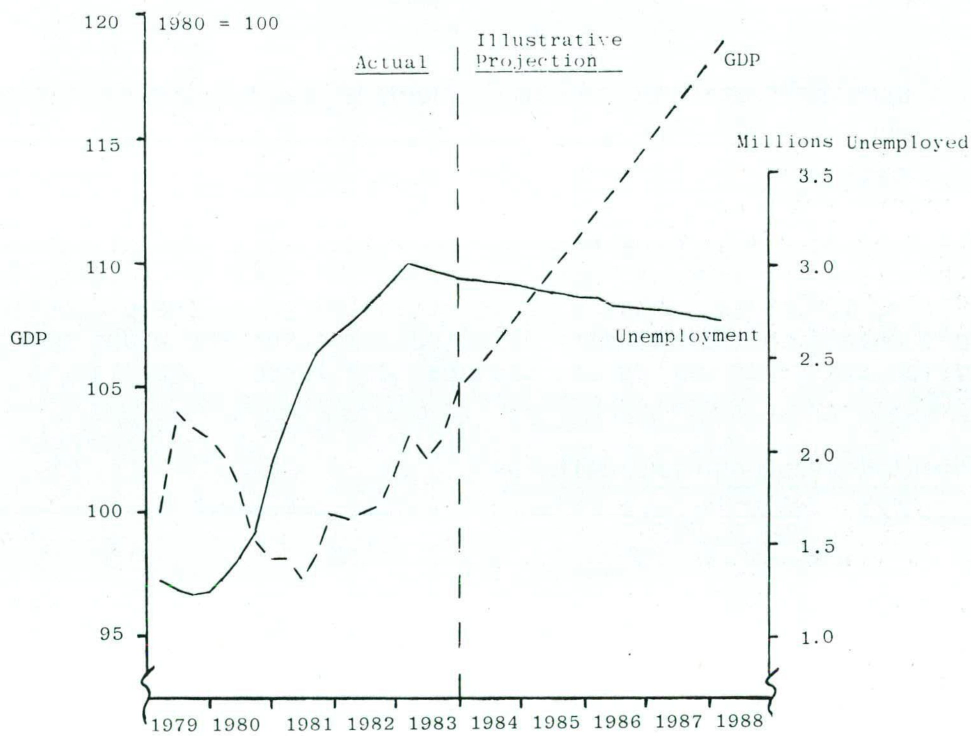
4 Imports of goods and services are forecast to grow by 5 per cent per annum, slightly more slowly than the 7 per cent growth that would have been predicted without improved competitiveness.

Employment

5 Over the past two years, output per head in manufacturing has grown at an annual rate slightly faster than 7 per cent. Our projection for the next 4 years is that this will slow to about 5 per cent. Productivity in the economy as a whole only grows at slightly below half this speed however, with (by convention) little growth in productivity assumed for the public service sector and productivity in the private service sector forecast to grow by 2 per cent per annum. After taking account of changes in the labour force, the programme is forecast to start to reduce unemployment, bringing it down to under 2¾ million by the beginning of 1988. This calculation does not take account of further reductions that might result from special employment measures of the kind set out in Chapter V.

CHART II.3

CBI PROGRAMME FOR GROWTH[1] AND UNEMPLOYMENT[2]



1. GDP, average estimate, at 1980 prices.

2. Excludes school leavers

Source GDP - CSO; CBI estimates and illustrative projections. Unemployment - Department of Employment; CBI estimates and illustrative projections.

6 The scenario set out above would imply manufacturing production growing faster than production in other sectors. However, the pattern of productivity improvements implies some further job losses in manufacturing while net increases in employment would be likely in the service sector. Table II.2 gives the projections for employment by sector and for unemployment.

Table II.2
Employment and Unemployment (millions)

	1983 1st Qtr.	1983 4th Qtr (est)	1988 1st Qtr.	Change 1983 Q1 to 1988 Q1
Manufacturing Employment	5.4	5.3	5.2	-0.2
Public Service Sector Employment	5.0	5.0	4.7	-0.3
Private Service Sector Employment[1]	13.1	13.2	13.9	+0.8
Total employment	23.5	23.5	23.8	+0.3
Labour Force	26.5	26.4	26.5	-
Unemployment	3.0	2.9	2.7	-0.3

1 Includes self-employed and employment in the non-manufacturing nationalised industries.

Monetary Policy

7 The projections assume growth remaining steady at an annual rate of about 3 per cent and the rate of increase in the GDP deflator falling from 7½ per cent during 1982/83 to about 4 per cent in 1987/88. The projections assume no trend change in the velocity of circulation for the wider monetary aggregates over this period and so these are forecast to rise in line with money GDP.

Government Revenue and Expenditure

Table II.3
Government Financial Accounts

Percentages of GDP

	1982/83	1983/84	1987/88 projected
Receipts[1]	43	42	39 (after net tax cuts equivalent to 2¼ per cent of GDP)
Expenditure[1]	47	46	40½
PSBR	3¼	3¼	1½

1 General government receipts and expenditure; some adjustments to the difference between these figures are necessary to derive the PSBR.

8 Table II.3 shows how our proposals for taxes, expenditure and revenues add up.

9 Over the 5 year period to 1987/88 we propose that the level of public expenditure should be held constant in cost terms. This would reduce it from 47 per cent of GDP in 1982/83 to 40½ per cent of GDP in 1987/88. Provided that inflation remains low and economic growth continues, we would aim at a falling PSBR as a percentage of GDP to hold down the ratio of public debt to GDP and to prevent "crowding out" of the private sector in the medium term.

10 We estimate that at present rates of tax (after adjusting for inflation) there might be a slight fall in government revenue as a percentage of GDP and with some other accounting adjustments this might leave scope for net tax cuts, consistent with our estimates for borrowing and expenditure, of 2¼ per cent of GDP.

Chapter III

The Economic Background

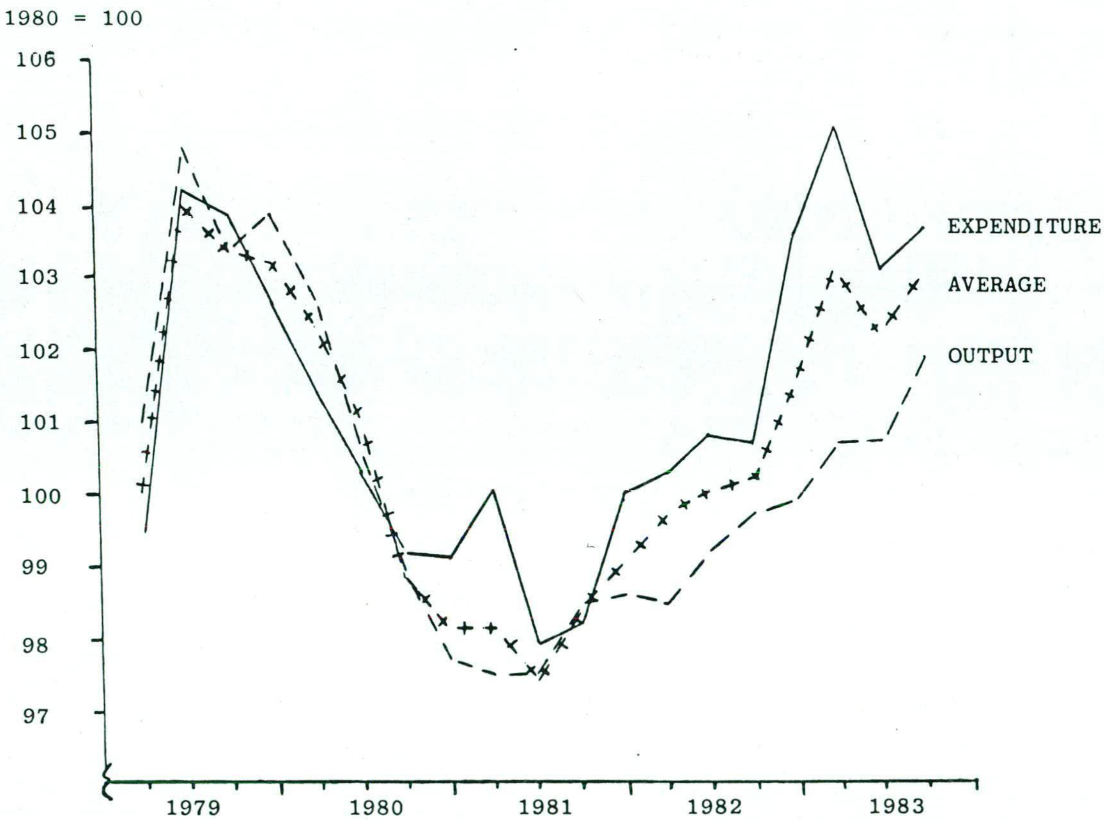
1 This Chapter explains the economic reasoning behind the recommendations for the 1984 Budget. It explains why we believe that the Government must take immediate action to reduce business costs rather than the burden of personal taxation.

Recovery in Progress

2 A recovery is under way. The latest figures for GDP show that the trough of the recession was in the second quarter of 1981 and that the economy has been growing fairly steadily since then. It is, however, difficult to be precise about the extent of the recovery because of the unusually large discrepancy between the various measures of GDP. By the third quarter of 1983 the expenditure measure of GDP was nearly 5 per cent higher, the income measure 7 per cent higher, and the output measure 4½ per cent higher, than in the first half of 1981.

CHART III.1

MEASURES OF REAL GDP



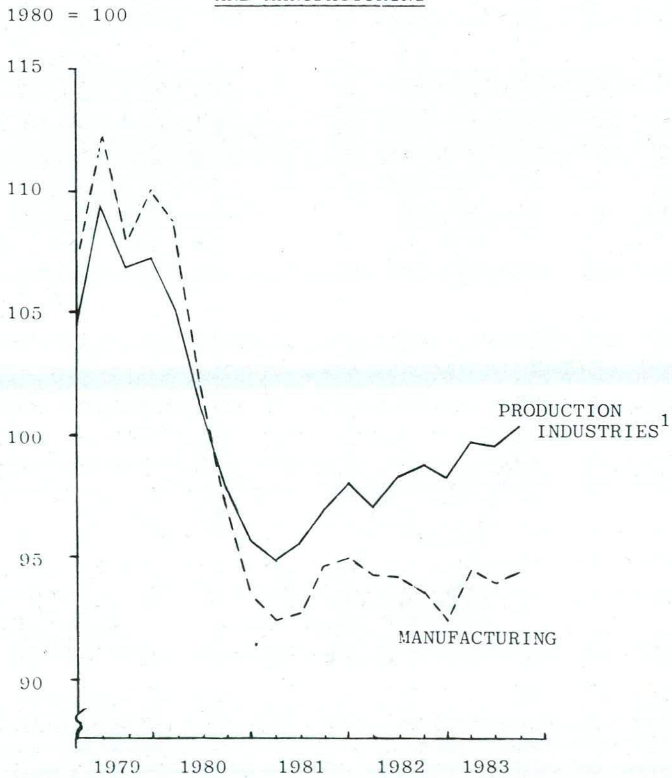
Source : CSO

3 Although the output measure is generally regarded as the best indicator of short-term movements in GDP because it is much less liable to revision than the expenditure and income based estimates, there is no reason to believe that it is more accurate than the other estimates over longer periods. In these circumstances, it is conventional to use the average of the expenditure, income and output measures. On this basis, GDP in the third quarter of 1983 was just over 5 per cent higher than in the first six months of 1981.

4 It is clear that the recovery is uneven and from a low base; for 1983 as a whole GDP (average measure) was only as high as in 1979. Moreover, North Sea oil has made an important contribution to growth; between the first halves of 1981 and 1983, oil and gas extraction rose by 23 per cent in volume terms and contributed nearly 1 percentage point to the growth of GDP (output measure) over the period. Manufacturing production, as a whole, remains depressed although there is growth in certain sectors. Output in manufacturing was about 2 per cent higher in the third quarter of 1983 than in the first half of 1981; by the third quarter of 1983, manufacturing production remained 14 per cent lower than in 1979. It should, however, be noted that the CSO's index of manufacturing production shows a considerably flatter picture during 1983 than would be expected on the basis of the results of the CBI Industrial Trends Survey.

CHART III.2

OUTPUT OF PRODUCTION INDUSTRIES[1]
AND MANUFACTURING



1. Includes energy sector.

Source : CSO

5 Inflation (as measured by the increase in the RPI over the previous twelve months) has dropped faster than expected from a peak of 21½ per cent in the second quarter of 1980 to under 4 per cent in the second quarter of 1983. Although inflation measured in this way has risen slightly since then this reflects the ending of certain special favourable factors and does not indicate a resurgence of inflationary pressures. Other indicators confirm that inflation remains under control. The annual increase in the GDP deflator has fallen from over 20 per cent in the second quarter of 1980 to just over 5 per cent in the second quarter of 1983. The annual increase in unit labour costs in the second quarter of 1983 was 2.2 per cent for the whole economy and 2.4 per cent in manufacturing, compared with increases of 22.2 per cent and 24.9 per cent three years earlier.

6 There have been substantial gains in productivity during the last three years, particularly in manufacturing. In the first six months of 1983 output per head in the whole economy was nearly 9 per cent higher, and in manufacturing 13 per cent higher, than three years earlier. Nevertheless there remains a wide gap in levels of productivity between ourselves and our main competitors, particularly in manufacturing.

7 Profitability has also improved from the very low levels of the last few years. Industrial and commercial companies' (excluding North Sea activities) gross trading profits (net of stock appreciation) rose substantially in 1983 and we expect the real rate of return to have risen to around 6½ per cent. However this is still not only well below the level common in the 1960s but also less than in 1978, and remains below the rate of return of our major competitors. A recent study by the OECD[1] showed that in 1982 the real rate of return on capital in manufacturing in the UK was less than half of that in the United States, Germany and Canada, and only about one-fifth of that in Japan. We agree with the Bank of England[2] that the current rate of profitability is 'well below the level necessary for a healthy rate of investment'.

Economic Prospects in 1984

8 We fear that unless the Government implement our proposals and take further action to reduce business costs and improve competitiveness, the present recovery could falter later this year. Without such actions, our latest forecasts, published at the end of November, suggest that GDP, as measured by the average estimate, could rise by 1½-2 per cent between 1983 and 1984 as compared with an estimated increase of some 3 per cent between 1982 and 1983.

9 On the basis of existing economic policies, we expect the growth of consumers' expenditure to slow down in 1984. The strong increase in expenditure in 1983 was chiefly supported by a substantial fall in the savings ratio. Further falls are unlikely in 1984 bearing in mind that some of the fall which has occurred since the beginning of 1982 was due to special factors (such as the abolition of HP controls and the large increase in bank lending for mortgage purposes). The significant fall in inflation in recent years has also played a part but we expect only a modest further fall in 1984.

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1 OECD Economic Outlook July 1983 Table 23
2 Bank of England Quarterly Bulletin December 1983 p. 457

10 Nor do we expect any marked increase in stockbuilding during 1984; we believe that companies have learnt to live with lower levels of stocks in relation to turnover.

11 Our Surveys suggest a faster rate of growth of investment in 1984 helped by improved profitabilty. We also expect an improvement in net exports following the improvement in competitiveness in 1983. But these are unlikely to be sufficient to compensate for the slower growth of consumption and moderate stockbuilding.

12 A slowdown in the rate of recovery next year is supported by other forecasting bodies. Given the margins of error involved in forecasting GDP, it is quite possible that growth next year could be faster than the 1½-2 per cent that was our central forecast last November. But it could also be slower. If the recovery were to falter the consequences for business confidence would be severe and put the objective of sustained growth at risk. Chapter II makes clear the dangers and we believe these far outweigh the risks of the economy overheating should growth be faster than our central forecast.

Competitiveness

13 Although the past year has seen a marked improvement, our unit labour costs in manufacturing are still more than 20 per cent higher when measured against our main competitors than they were in the mid-1970s and that gap is still larger against our European rivals. Our Trends results confirm that although price competitiveness is now better than during most of the period 1979-82 it still remains very poor in relation to earlier periods.

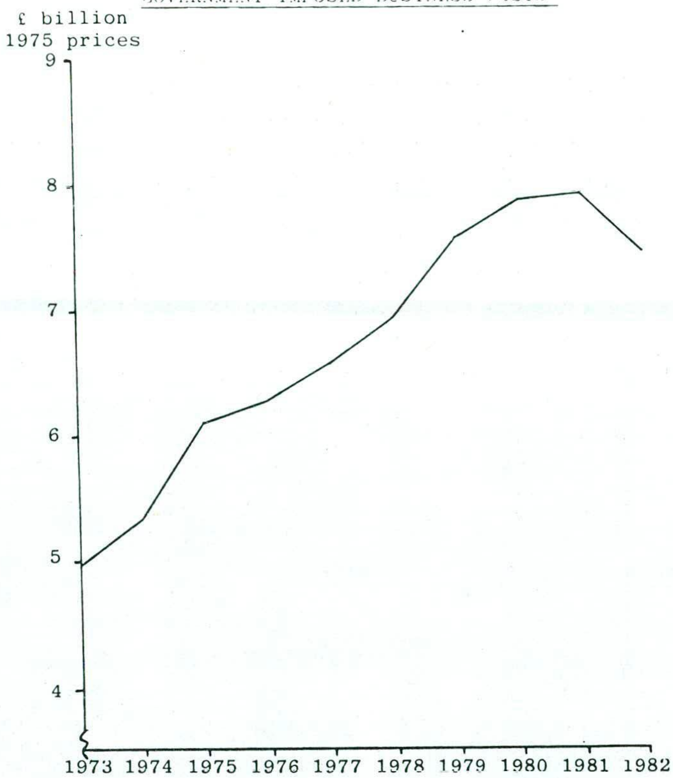
14 As a consequence import penetration in manufacturing remains very high and we have continued to lose our share of foreign markets in both goods and services. The sluggish response of manufacturing output to the recent rise in domestic demand, and the deterioration of the current account of the balance of payments, are further evidence of our weak competitive position.

15 Improving competitiveness requres action by both business and Government. Business must hold down unit labour costs by moderating pay increases and by improving productivity. Each year since the 1978/79 pay round, the CBI has engaged in an extensive series of conferences throughout the country underlining the vital links between holding down unit labour costs, competitiveness, profitability and jobs. The message has been accepted and for the last two years the growth of unit labour costs in manufacturing has been lower than the average for competitor countries. But there is still a long way to go. Important competitors like Germany and Japan continue to have very small increases in unit labour costs.

16 Business cannot do the job on its own. Government too must help by reducing the costs it directly imposes on business. Government-imposed costs on business in the form of National Insurance Surcharge, employers' National Insurance Contributions and business rates rose by 20 per cent in real terms between 1975 and 1979. Since 1979 there has been a decrease in the real burden but much still needs to be done, in the face of continued tough trading conditions.

CHART III.3

GOVERNMENT IMPOSED BUSINESS COSTS[1]



1 National Insurance Surcharge, Employers' National Insurance Contributions and Business Rates. Figures deflated by Wholesale Output Prices.

Source : NIS and NIC's - National Income and Expenditure 1983
Business Rates - For GB only. Based on Annual Abstract of Statistics and Scottish Annual Abstract figures.

We regret the increase in the upper earnings limit for National Insurance Contributions announced in the Autumn Statement and urge the Government to take action in the Budget to reduce business costs by means of:

- the final abolition of NIS; and
- 10 per cent partial business derating.

We also urge that the Chancellor announce, as soon as possible, a one percentage point reduction in the rate of employers' National Insurance Contributions to take effect in 1985/86.

Business and Personal Taxation

17 Cuts in government-imposed costs on business must take priority over cuts in the burden of personal taxation for the following reasons:

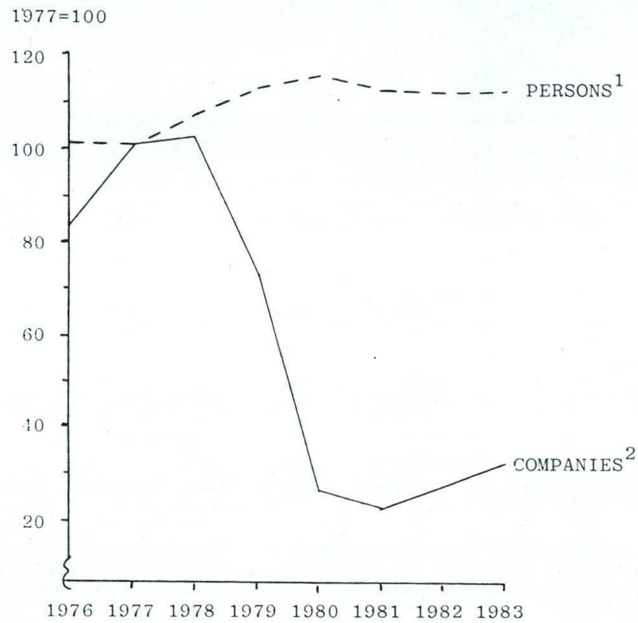
- the immediate and overwhelming need to improve competitiveness;
- if there were to be cuts in the burden of income tax, given our weak competitive position, a large part of the resulting increased consumption would go on imports;

- reducing business costs helps reduce inflation;

- whilst profits have improved lately, it has been from a very low level. By contrast, consumers have been doing relatively well in terms of real personal disposable income over the past years. They have become better off - at least those remaining in employment - while companies are much worse off.

CHART III.4

PERSONS' AND COMPANIES' REAL INCOME



1 Real personal disposable income

2 Industrial and commercial companies' undistributed income plus dividends on ordinary shares after providing for depreciation, stock appreciation and additions to tax reserves. Deflated by Total Final Expenditure Deflator.

Sources: CSO and CBI estimates

18 We therefore recommend that personal tax allowances are only increased in line with inflation. Increases in tax thresholds are an inefficient way of reducing the numbers caught in the poverty trap because they affect all taxpayers. Most of those taken out of tax by small increases in the thresholds are not the heads of households affected by the poverty trap. Because unemployment benefit is now taxable such increases also have little impact on the incentive to work.

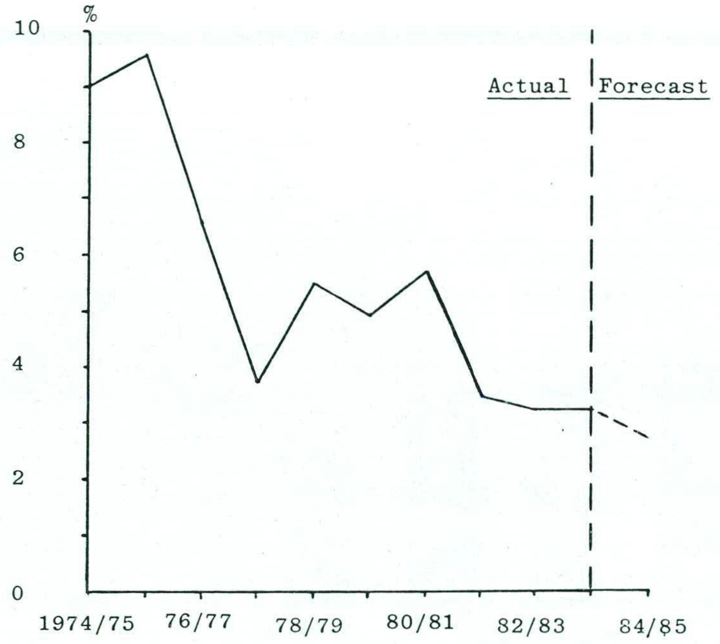
Fiscal Policy

19 Our policy proposals are, if implemented, likely to raise the PSBR in 1984/85 by £1½-2bn (or ½ per cent of GDP) above the level it would otherwise have reached. We believe that our proposals are consistent with further falls in the trend rate of inflation and with reductions in interest rates.

20 Although our proposals involve raising the share of the PSBR in GDP above the level proposed for 1984/85 in the Autumn Statement, they still imply a reduction from the likely outturn for 1983/84 and remain consistent with the generally declining path for the PSBR as a percentage of GDP which is an important feature of the MTFS.

CHART III.5

PSBR AS A PERCENTAGE OF GDP[1]



1 PSBR as percentage of GDP at market prices

Sources : 1974/75 to 1982/83, Financial Statistics and CSO; 1983/84 CBI estimate based on PSBR forecast contained in the Autumn Statement; 1984/85 CBI forecasts assuming implementation of CBI proposals.

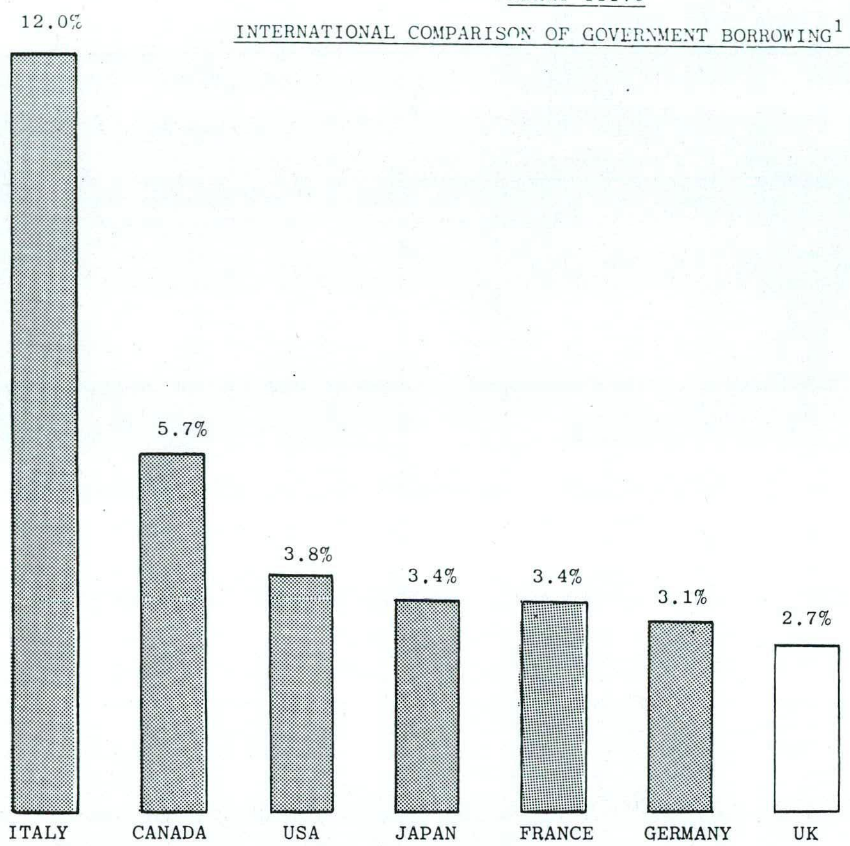
21 Our proposals would also leave public borrowing in the UK (as a proportion of GDP) lower than in any other major OECD country including several with lower inflation rates than the UK. (See Chart III.6).

22 In previous Representations we have argued that the size of the PSBR can be a misleading guide to the stance of fiscal policy and that it is important not to give too much emphasis to setting or achieving a precise target for the PSBR in any one financial year.

23 The composition of the PSBR is of great importance. For any given PSBR, different combinations of taxes and government spending will have different effects on inflation, interest rates and economic activity. An increase resulting from increased government current spending could well raise inflation and interest rates. By way of contrast, the same increase brought about by measures to reduce business costs could actually reduce inflation and help keep down interest rates by reducing company borrowing.

CHART III.6

INTERNATIONAL COMPARISON OF GOVERNMENT BORROWING[1] IN 1983



1. General Government Deficit as a percentage of GDP/GNP at market prices. These figures refer to a somewhat narrower concept of public borrowing than our PSBR, but are on a comparable basis, and indeed they are more meaningful than would be a comparison of PSBRs, partly because of the differing degree of nationalisation in the various countries.
Source : OECD estimates, Economic Outlook, December 1983.

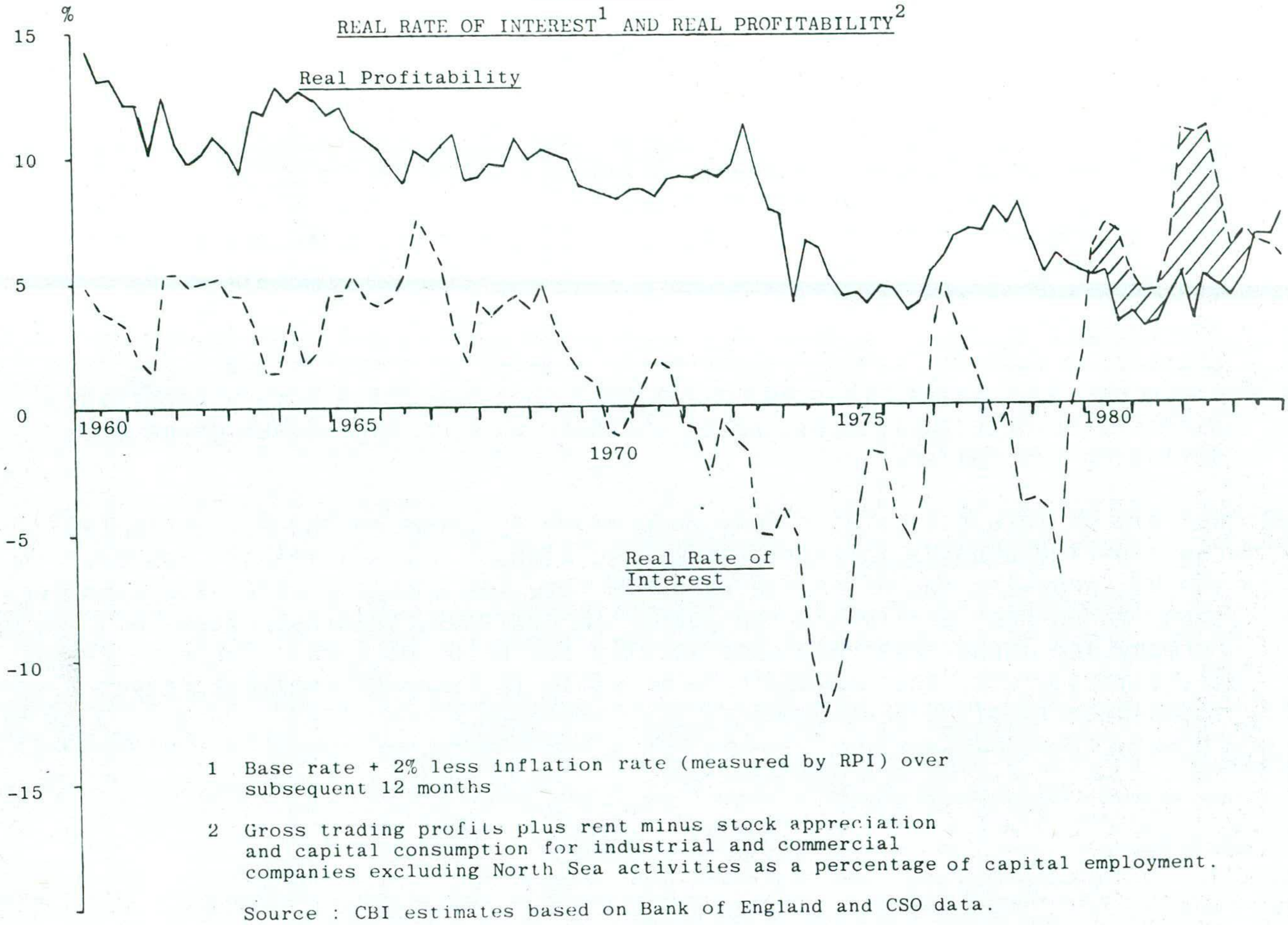
24 The Government has managed to cut its borrowing significantly since first coming into office in 1979. In that year the general government deficit was equivalent to 3.2 per cent of GDP according to OECD figures. By 1982 this ratio had been reduced to 2.0 per cent. But the underlying improvement is even larger than this. The OECD calculate that the recession added 5.1 per cent to the ratio in that period as expenditure on social security payments rose and tax revenues fell. So the underlying fall in the deficit/GDP ratio between 1979 and 1982 is not 1.2 per cent but 6.3 per cent, this being larger than the size of the deficit itself. The conclusion must be that a very large part, if not all, of the present deficit is due to the recession and would disappear if recovery were sustained (this is shown in the annex to Chapter II). In these circumstances the concentration of policy on the simple PSBR/GDP ratio can be misleading.

Monetary Policy and Interest Rates

25 Although nominal interest rates have fallen from the high levels reached at the beginning of 1980, they remain, by historical standards, high in real terms. (See Chart III.7).

CHART III.7

REAL RATE OF INTEREST[1] AND REAL PROFITABILITY[2]



1 Base rate + 2% less inflation rate (measured by RPI) over subsequent 12 months

2 Gross trading profits plus rent minus stock appreciation and capital consumption for industrial and commercial companies excluding North Sea activities as a percentage of capital employment.

Source : CBI estimates based on Bank of England and CSO data.

26 There are of course great difficulties involved in measuring real interest rates and it might be argued that the normal measure used overstates the real interest cost faced by companies by not allowing for interest relief from corporation tax. Post tax measures of the real interest cost faced by companies have to be treated with some care however. Insofar as companies are earning insufficient profits fully to offset interest payments, post-tax measures will underestimate the real interest rate being paid by these companies. The real interest rate faced by most companies will lie somewhere in between the normal and post-tax measures, with less profitable companies and those investing heavily with large capital allowances paying a higher net real rate.

27 Until 1980 profitability remained significantly above the level of real interest rates. More recently this has not been the case, as the Chart shows. This decline of profitability relative to real interest rates emphasises the need to lower interest rates.

28 A move towards lower interest rates would help considerably to sustain the recovery. While real interest rates are high firms will be encouraged to invest profits in financial rather than physical assets, but it is investment in the latter which is crucial to sustain growth and provide productive capacity.

29 We fully accept that interest rates are not under the Chancellor's control in the same way as public spending, National Insurance Contributions and other taxes, and that external influences can be an important constraint. Nevertheless, we believe that the Government can influence interest rates and that there is scope for further cuts.

30 Different monetary aggregates give conflicting accounts of the tightness of monetary policy. So far, in the current target period to December 1983 annualised growth rates for monetary aggregates vary from 11 per cent for £M3 to nearly 13 per cent for M1. However, it seems likely that £M3 will show growth inside the target range of 7-11 per cent at the end of the current target period and M1 and PSL2 growth rates are unlikely to be far from the top of the range. Furthermore M0, the new target aggregate which the Chancellor feels is especially useful in guiding official policy on short term interest rates, is currently growing at a much slower rate than the other aggregates. Thus we do not feel that present monetary conditions necessitate keeping interest rates at their current high level given that inflation has fallen.

31 Nor are UK interest rates solely determined by those in the US. Late 1983 saw a period when US interest rates rose without any significant response in the UK, and with the effective exchange rate for sterling remaining stronger than it had been earlier in the year. In addition, interest rates in Germany and Japan have been consistently far below US levels for some years. All this suggests that it would be possible to lower UK interest rates independently of US developments.

Chapter IV

Taxation

Introduction

1 In the tax field, our primary objective is a lower burden of taxation for private business in order to improve competitiveness and encourage enterprise.

2 Our main taxation proposals for the 1984 Budget, therefore, are:

- the abolition of the National Insurance Surcharge;

- 10 per cent business derating, to place business rates on the same basis as domestic rates (this is discussed below in Chapter VI);

- a package of measures to reduce the tax disincentives to enterprise

3 Tax priorities for subsequent years are outlined in Chapter II: the main emphasis being further reductions in taxes that hinder business competitiveness and later, as economic developments permit, reductions in income tax.

National Insurance Surcharge and Contributions

4 The most immediate way in which the Government can help business improve its competitiveness without adding to inflation is by abolishing the Surcharge on employers' National Insurance Contributions.

5 This Surcharge holds back business competitiveness, squeezes profits and thus discourages provision for the future, adds to prices and discourages employment. The Prime Minister has described it as "a pernicious tax on jobs".

6 The CBI has welcomed the successive cuts in this surcharge from 3½ per cent to 1 per cent that have been made in the past two years. But employers' National Insurance Contribution rates have risen and the contribution bands have widened in real terms in the past two years.

7 We must keep up the progress in reducing the burden of payroll taxes. We therefore recommend:

- the immediate abolition of the employers' National Insurance Surcharge;

- an early anouncement that employers' National Insurance Contributions will be reduced by at least 1 percentage point in 1985/86;

- a temporary stabilisation in the bands for National Insurance Contributions, which have risen in real terms in each of the past 5 years.

8 The cost for 1984/85 would be £900 million, assuming introduction on 1 April. The full year cost of the abolition of the Surcharge would be £1 billion assuming that the savings on the amount paid by central and local government on its own employees are clawed back. The cost of a 1 percentage point reduction in employers' National Insurance Contributions would be the same and we propose that such a reduction be, in the first instance, funded by an adjustment to the Government subvention to the National Insurance Fund. This would not affect public expenditure which is related to disbursements, rather than payments into the National Insurance Fund.

9 In the longer term National Insurance Contributions need to be considered in the context of their interaction with the income tax and benefit systems, the future of state-funded pensions and their impact on the incentive to employ, particularly for low paid and part-time employees. However, changes in this latter area could be costly.

Enterprise and Taxation

10 We now we set out a number of measures for which we are seeking action to encourage enterprise and improve prospects for growth in the longer term. The main areas covered are:

- Corporation Tax
- Advance Corporation Tax
- Capital Allowances
- Development Land Tax
- Stamp Duty
- Share Options
- Capital Taxes
- Income Tax and the Investment Income Surcharge
- Business Expansion Scheme
- Wider Share Ownership
- Indirect Taxes
- International Aspects

Corporation Tax

11 In our response to the Government's Green Paper on Corporation Tax of October 1982 we emphasised the importance to business of stability in taxation. We concluded however that within the imputation system and present tax base there were a number of rigidities and anomalies where corrective action to remove or alleviate them would be helpful to business. (Annex IV.1 to this Chapter lists some detailed recommendations put to Government in 1982.)

12 Some of the recommendations have been taken up already, for instance on the incidental costs of loan finance and discounts on acceptance credits, others such as the tax treatment of groups of companies and mineral capital allowances are still under consideration. Nonetheless we have two main regrets. First, many of our recommendations have not been implemented nor has a promise of implementation been made. Secondly, to date no analysis or synopsis of all the responses to the Green Paper has been published. (This would be invaluable in future discussions.)

13 We have already submitted to Government our more detailed Technical Budget Representations with proposals for the 1984 Finance Bill (our priority items are listed in Annex IV.2).

14 Generally in this context and in the light of recent comments[1], we urge the Government to improve legislative procedures, to provide more time for a number of technical tax problems to be resolved and to provide an opportunity for fuller consideration of the legislation itself.

Advance Corporation Tax

15 Over the years we have made repeated attempts to improve the working of ACT, introduced in 1972. We do not believe it is necessary to be bound by any rigid theory of what ACT is or was intended to be and in particular that the Select Committee debates in 1971 should be regarded as forever ossifying the rules that were then under consideration. Practical experience of the system shows that:

- ACT payments to government should be set off against the next available mainstream corporation tax liability of the companies making the payments not deferred as at present.

- ACT set-off should not be restricted to 30 per cent of income.

- ACT set off should cease to be confined to mainstream corporation tax on income and should instead be available to set against corporation tax on all profits including chargeable gains.

- Capital allowances should be available against advance corporation tax and not just against mainstream corporation tax.

- Double taxation relief should be available against ACT.

Capital Allowances

16 The Green Paper on Corporation Tax[2] acknowledged that our major international competitors give relief for expenditure on commercial buildings. A small start has been made by giving relief to hotels, but this, at a 20 per cent initial allowance, is not as generous as the 75 per cent available for other industrial buildings.

17 The lack of an allowance in this area was seen as an anomaly by the Sandilands Committee (Report of the Inflation Accounting Committee, September 1975) itself drawing on evidence from the Committee on the Taxation of Trading Profits (Cmd 8189 - 1952) and the Radcliffe Commission (Cmd 9474 - 1955). We have long and consistently urged remedial action.

18 We believe that such a measure would lead to increased activity and hence jobs in the construction sector, and to a reduction of rental costs to industry and commerce.

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1 eg. A Technical Taxation Bill - The CBI's Proposals, CBI October 1981

2 Cmnd 8456 - para 15.33.

19 We therefore recommend that the vital role of the commercial sector in the economy be clearly acknowledged and an immediate start be made by introducing a straight line writing down allowance at 2 per cent per annum on new commercial buildings.

Development Land Tax

20 This tax raises little revenue (approximately £50m for 1983/84) and has a discouraging effect on commercial decisions relating to surplus property. It should be abolished. Failing outright abolition of the tax we urge that it should be suspended for an experimental period of 3 years.

21 This would provide an incentive to business to initiate development projects free from the compliance costs and constraints which would otherwise apply even where at present the tax itself is deferred.

Stamp Duty

22 Our response to the recent Revenue consultations on Stamp Duty[1] drew government's attention to two particular areas of agreement with our colleagues in other European federations. We urged -

- First, the early abolition of the capital duty - a European tax - and invited the Inland Revenue to take the initiative in securing the necessary European reform.

- Second, the abolition of the tax on transactions in securities. The present rates of duty are such that dealings in quoted securities are being driven away to overseas markets where the tax costs are lower.

Share Options

23 The CBI believes that companies should be afforded the means to encourage employees in, and reward them for commitment to their endeavours. This can be done by providing them with opportunities to participate in their employers' capital growth on terms not rendered unattractive by taxation and as good as those available abroad. We shall in 1984 be looking at practical aspects of this on a broad front. Our priority for the 1984 Budget relates to Share Options.

24 Our attention has been drawn to recent changes in US law under the Economic Recovery Tax Act of 1981 improving the share option schemes available there. Companies in the UK should be able to offer similar rewards on terms at least as favourable to ensure that key employees are not lost to overseas competitors.

Capital Taxes

25 Incentive can be inhibited by capital taxes where businessmen, particularly those in the unquoted sector, or non-corporate sector, are involved in family businesses. If taxation bites too hard the incentive to build businesses up and then hand them on is substantially diminished. Indeed,

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1 CBI - October 1983

once a private family owned company has grown beyond a size sufficient to provide its owners with an adequate income, further growth generally brings with it unacceptable capital transfer tax liabilities and many businesses are therefore either sold on or artificially held back from further expansion. This is where the tax system affects economic performance.

26 Since submission of our full and detailed memorandum to the then Chancellor of the Exchequer in 1979[1] we have continued to draw attention to difficulties in capital gains tax and capital transfer tax.

27 We shall not repeat previous representations here. So far as they have not been implemented they remain on the table. But we would single out certain major points for early action.

28 Capital Gains Tax

- Assets held at April 1982 which have been in continuous ownership for seven years should not be liable to CGT. This will remove from the tax net those assets held over a long time, for non-speculative reasons, which would otherwise carry in their taxable value a large measure of inflationary as opposed to real gain. The indexation rules introduced in 1982 cover only future inflation and make no allowance for past events. Our solution is fair and administratively simple and would cut significantly the cost of applying the tax for both the Revenue and the taxpayer.

- Overhaul of the retirement relief rules.

- Repeal of the rules restricting indexation relief both on losses and on assets held for less than twelve months to remove complexity and to provide more equal treatment for the effects of inflation.

- Action to relieve the double charge to tax on gains where assets are held through companies. Currently there is a charge on disposal of the asset by the company and a second charge on shareholders' disposals of shares, which in turn reflect the net gains on the company's disposals.

29 Capital Transfer Tax

- Improvement of business asset relief by amalgamation of all the existing classes of assets and giving relief at 100 per cent.

- Lifetime rates of CTT should be half those on death throughout the scale.

For both CTT and CGT we would like to explore with government the scope for providing a facility for accumulating annual exemptions either over a limited period or indefinitely.

The disincentive effect of these taxes is in marked contrast with the government's avowed aim of helping smaller businesses as in the business expansion scheme.

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1 CBI, 1979.

Income Tax and the Investment Income Surcharge

30 Our longer term objective remains to reduce the burden of direct taxes. For this year our priority is reduction in business taxation but in Chapter II we show how improved competitiveness and sustained growth will provide the scope for cuts in income tax in future years.

31 We are assuming that personal allowances and thresholds will be adjusted in line with inflation.

32 The Investment Income Surcharge is an additional tax applying selectively on certain savings and should be abolished as soon as possible. Its effect on retired businessmen living off the income produced by investment of the proceeds of sale of their businesses is unfair in that they suffer a surcharge on their income whereas those retiring from pensionable employment have their pensions treated as earned income.

Taxation of Benefits in Kind

33 Concern has been expressed to us about the effect of the recent seemingly arbitrary increases in the scales of taxation of cars and fuel provided for employees and the consequences of these increases on employment costs. We shall continue to monitor the situation.

Business Expansion Scheme

34 The CBI has welcomed the many initiatives introduced by the Government specifically targeted at encouraging small companies, especially the development of the Business Expansion Scheme. We would like to see this Scheme achieve its full potential in stimulating more equity investment in small firms, but this is still inhibited by:

- the difficulty of spreading risk;
- the uncertainty as to whether an investment will qualify and if so when any tax relief will arise;
- the difficulty of ultimately selling investments.

35 Funds designed along the lines of Small Firms Investment Companies (as proposed in detail in previous CBI representations) could be introduced within the framework of the existing Scheme with appropriate changes in the legislation, and would go a long way to solving these remaining difficulties. They would be simpler to operate than the current Approved Investment Funds and provide a greater incentive to the investor as tax relief would arise sooner and with more certainty.

36 Short of introducing Small Firms Investment Companies, the Business Expansion Scheme can be further improved in two important ways:

- An investor buying shares through an Approved Investment Fund should be able to obtain the tax relief in the year in which he subscribes to the fund even if it is not invested on until the following year. This would allow investors to plan better for their tax liabilities.

- An advance clearing system for investments could be introduced. If the Inland Revenue felt unable to allow formal prior clearance, their Inspectors should at least be encouraged to give a provisional opinion, as some have already been doing.

37 A number of more detailed points on the Scheme have been made in our Technical Representations.

Wider Share Ownership

38 The involvement of the personal sector in business through direct investment in companies has declined sharply in the past twenty years. Attitudes to enterprise would be greatly improved by wider share ownership, particularly by employees.

39 The proposals which we have set out for improving the business expansion scheme, improving capital taxation, abolishing the investment income surcharge and for abolishing stamp duty on equity transactions should contribute to this.

40 In the longer term, however, we envisage the extension of the tax advantages currently available on certain categories of savings to other categories, including savings directly invested in equities. This would encourage a closer identification of taxpayers with the role and functions of business.

Indirect Taxes

41 We remain concerned about a number of areas of VAT. On the domestic front:

- The treatment of pension funds. Pensions represent a cost to business and VAT incurred in the course of provision of pensions should therefore be recoverable just as it is on other business costs.
- Proposed revisions to the rules relating to partial exemption are likely to add to business costs and increase the administrative burden on businesses by drawing many of them into the partial exemption net. We are concerned about the pratical effects of these proposals on business. We have already registered our concern with Ministers.
- The threshold for VAT registration should continue to be moved upwards to help smaller firms and reduce costs. This movement should not however be allowed to prejudice the facility of voluntary registration for VAT.

42 On the European front we remain strongly opposed to the draft 12th VAT Directive the origins of which seem to lie in a disregard of the principle that VAT should not be an impost until transactions reach the stage of the ultimate non-business consumer. We urge government to maintain its opposition to this draft directive.

43 We continue to urge that the differential in the tax on DERV between the UK and other EEC countries should be phased out over time taking account of our motor industry's ability to meet shifts in demand, in order that

British business should no longer be at a competitive disadvantage compared with our European partners. Car tax discriminates against a major industry and adds to business costs. There is therefore a strong case for planning to eliminate it.

International Aspects of Business Taxation

Unitary Tax

44 The unitary system of taxation is wholly inapropriate in the international field and damaging to free trade and investment.

45 We have submitted to the US Treasury Working Group a detailed critique of the worldwide combined reporting unitary tax applied by some US States to international companies and we were pleased to liaise with our sister Federations in Europe and elsewhere on this topic. We warmly welcome the Government's own submission against the use of unitary tax.

46 This tax is pernicious and its continued use or worse still its spread would have potentially far reaching consequences on international fiscal stability. Annex IV.3 gives the key salient points submitted to the US Working Group.

47 We trust that the Government will directly and via our European and other overseas allies keep up the pressure for suitable changes to the unitary tax rules as they affect our Members' interests.

Controlled Foreign Companies

48 New draft clauses on this topic were issued in October 1983. The case for such sweeping untargetted legislation still has not been made out. We urge that the Government, if it acts at all, should confine itself to specific cases. If legislation broadly on the basis of the draft proposals is introduced significant changes of principle as well as of a technical nature would be essential if the competitiveness of British business is not to be damaged.

49 We shall be making detailed criticisms of the draft proposals separately.

Foreign Currency Losses

50 The lack of tax relief for losses on foreign currency borrowings is an example of an area where UK tax law puts us at a competitive disadvantage compared with our trading rivals.

51 We therefore urge that early action be taken to alleviate this situation, and recognise at the same time that currency gains would fall within the tax net.

ANNEX IV.1

Extract from CBI Submission to the Green Paper on Corporation Tax

Section 7: Stock Relief

10 The possibility should be studied of allowing taxpayers to choose between stock relief and valuing stock on the "last in, first out" basis (7.1)

11 The concept of a credit restriction should be rejected (7.2).

12 In the interest of keeping stock relief simple, multiple indices should not be introduced in place of the present single all stock index (7.3).

13 Clawback should be abolished (7.4).

14 The six-year time limit should be removed (7.5).

15 Some form of relief should be introduced for financial businesses (7.6).

Section 8: Capital Allowances

16 Capital allowances should continue to provide an investment incentive and should not be reduced in value (8.3).

17 The existing system of capital allowances should be improved in preference to being completely changed (8.6).

18 Tax allowances are preferred to investment grants as the means of providing an investment incentive (8.7).

19 The CBI supports non-selectivity of allowances in principle and improvements should be made to the allowances for less-favoured sectors not at the expense of a reduction in the allowances for other sectors (8.8 and 8.11).

20 The present level of first-year allowance for plant and machinery investment should be retained (8.8).

21 Free depreciation should apply to expenditure on plant and machinery after the first year (8.9).

22 100 per cent first-year allowances should be introduced for industrial buildings and free depreciation should apply after the first year so as to obviate the present complex record-keeping (8.9).

23 A two per cent annum allowance for new commercial buildings should be introduced on a straight line writing down basis (8.10).

24 We believe that mining allowances are in need of update and simplification (8.11).

Section 9: Treatment of Interest

25 Interest payments should continue to be treated as an allowable cost for tax purposes.

Section 10: The Schedular System

26 Thought should be given to abolishing the schedular system and basing the assessment of taxable profits on audited accounts.

27 The schedular system should not be allowed to impose unjustified restriction on the way relief is given on losses.

28 The case should be examined for having consolidated tax returns for groups of companies.

Section 11: Disallowed Business Expenses

29 All expenditure deductible in computing commercial profits should be deductible for tax purposes. Instances where the law needs to be amended to give effect to this principle include:

- all incidental costs of raising finance (11.2)
- losses on foreign currency fluctuations (11.2)
- costs of raising share capital (11.2)
- discount and other expenses on acceptance credits (11.2)
- similar expenses on commercial paper (11.2)
- costs of issuing loan stocks, whether or not convertible into equity within three years (11.2)
- expenditure on abortive capital projects (11.3)
- post-trading expenses (11.3)

Section 12: Unutilised Tax Reliefs and Allowances

30 Companies should be enabled to make more immediate use of their reliefs (12.5).

31 Finance leasing should not be discouraged (12.5).

32 Further consideration should be given to allowing tax relief on interest to the lender where the borrower cannot use it and to removing the 1982 restrictions on loans under section 233 of the taxes Act 1970 (12.5).

33 Unutilised reliefs and allowances must not be cancelled or future reliefs time-limited or reduced in value (12.6).

Section 17: Reforms to Advance Corporation Tax (apart from Interaction with Double Taxation Relief)

37 Advance corporation tax to be offset against whole of mainstream tax (17.1(i)).

38 If the previous change is not introduced, the restricted offset of advance corporation tax should be applied to the company's taxable profits as a whole, and not as at present to each source separately (17.1(ii)).

39 Advance corporation tax to be offset against next payment of mainstream tax (17.1(iii)).

40 Carry-back period for advance corporation tax not to be time-limited (17.1(iv)).

41 Advance corporation tax to be deductible from corporation tax on capital gains (17.1(v)).

42 It should be possible to set capital allowances against advance corporation tax (17.2).

Section 18: Double Taxation Relief

43 Keep tax credit system as opposed to exempting foreign income (18.1).

44 Unused double taxation relief to be carried forward or carried back (18.2(i)).

45 Average all foreign tax over all foreign income for purpose of determining rate of foreign tax (18.2(ii)).

46 Double taxation relief to be available despite any timing differences between the two tax systems (18.2(iii)).

Section 19: Advance Corporation Tax and Double Taxation Relief

47 Allow double taxation relief in priority to advance corporation tax (19.2)

48 Allow foreign tax to reduce or extinguish advance corporation tax without a net UK rate restriction (19.2).

49 Foreign tax to be credited against advance corporation tax without reducing aggregate advance corporation tax below what is repaid (19.2(i)).
or
Advance corporation tax to be half present rate (19.2(ii)).
or
Re-adopt net UK rate system (19.2(iii)).

50 Dividends should be franked if they are paid out of current or past profits that have borne full UK tax (19.3).

Section 20: Groups of Companies

51 Group relief to be available for surrender in a later year than that in which the loss etc arises (20.2.(i)).

52 Partial use of group relief in different years to be permitted (20.2(ii)).

53 Surrender of relief other than loss not to be confined to the surplus not usable by the surrendering company (20.2(iii)).

54 Reliefs brought forward to be deducted from current year's income before calculating the amount of charges that can be surrendered to another company (20.2(iv)).

55 Similar changes when a company carries on several trades (20.2(iv)).

56 Surrender of part of a relief to consortium company and part to group company to be permitted (20.3(i)).

57 Surrender should be possible in either direction between a consortium company and group company (20.3(ii)).

Section 21: Capital Gains

58 Group relief for capital gains so that one company's losses can be offset against another's gains (21.1).

59 Double taxation of capital gains to be reduced, where company making capital gains pays dividend, by treating the dividend as a capital receipt or prevented by making the dividend not taxable (21.2).

60 Relief to be allowed on losses on intra-group loans (21.4).

61 Double taxation of capital gains to be prevented by making them not taxable on the company (21.5).

Section 22: Small Companies

62 Reduced rate to apply to first slice of all companies' income (22.1).

63 Small companies' rate and its upper and lower limits to be announced at the start of the year (22.2).

64 Reduced rate relief to be shared between associated companies as they wish (22.3).

65 Companies qualifying under business start-up scheme should not be treated as being associated with other companies for tax purposes so long as restraints on share disposal continue (22.4).

ANNEX IV.2

Extract from Technical Budget Representations 1984

B PRIORITY POINTS

1 Groups of Companies

The CBI is responding separately to the Inland Revenue's consultations on aspects of the taxation of groups of companies.

Nonetheless we consider that action on the points we are raising there is a first priority for 1984 and we are taking this opportunity to emphasise the importance we attach to them.

2 Foreign Currency Losses and Costs of Equity Finance

Our response to the Green Paper on Corporation Tax (CBI -October 1982) drew attention to the continuing anomalies concerning tax disallowed business expenditure or "nothings". We remain most anxious that all legitimate business expenditure should be allowed for tax purposes.

In particular we suggest that priority be given to the provision of tax relief for all losses on foreign currency borrowings.

In addition since the Finance Act 1980 introduced tax relief for the incidental costs of raising loan finance there seems to be no good case to continue to penalise equity finance by disallowing costs relating to raising it. The relevant fees are expenses of the companies concerned whether spent on raising equity or loan finance. In addition the fees are taxed in the hands of the recipients in each case. Encouragement could be given to the raising of equity finance by removing this penalty.

3 Stock Relief - Six Year Cut Off

We have, in previous representations, opposed the six year restriction on the carry forward of unused stock relief contained in Schedule 9 FA 1981. We continue to believe that this limit should be removed.

It is desirable to do this as soon as possible so that businesses can plan ahead successfully without being driven into complicated arrangements to prevent the neutralisation of stock relief brought forward. With the present six year limit and its restrictive rules governing the set off of available reliefs there is the danger that as the six year time bar draws nearer businesses will be forced to make investment decisions, which they otherwise would not, such as postponement of capital investment, to avoid a loss of stock relief.

4 Restrictions on ACT

In our Budget Representations last year we drew attention to some problems emanating from the rules on advance corporation tax as applied in the UK imputation system. We interpret the introduction of Clauses 41 and 42 in the original 1983 Finance Bill, to which we refer in greater detail later in this paper, as recognition of the existence of these problems.

In addition to the important question of double taxation relief to which Clause 42 applies there are restrictions on the utilisation of ACT which affect the timing of other corporation tax reliefs, such as capital allowances, and also the timing and amount of the ACT relief itself. We therefore urge that:

a Capital allowances should be capable of offset against advance corporation tax and not just against mainstream corporation tax.

b ACT payments to government should be set off against the next available mainstream corporation tax liability of the companies making the payments, instead of being deferred as at present.

c The current rule restricting ACT set-off to 30 per cent of income should be removed.

d ACT set-off should cease to be confined to mainstream corporation tax on income and should instead be available to corporation tax on all profits including chargeable gains.

We shall be referring to other ACT problems as they affect groups of companies in our separate submission.

5 Time Limits for Claims

The Taxes Acts at presentcontain no uniform time limits for making claims and seeking reliefs. We recommend that a time limit of six years should be introduced for making claims, seeking reliefs and exercising options. Not only would this ease the compliance burden in general, but it would also be of particular help to the proper running of the tax affairs of groups of companies.

6 Disincorporation

There are instances where it is commercially desirable for companies to be wound up and for their businesses to be continued as sole trades or partnerships. Unnecessary tax hurdles should not be placed in the way of those seeking to make these commercial changes.

We urge that where there are genuine business reasons for disincorporation ways should be examined to remove present fiscal barriers. Particular examples are the clawback of stock relief and the double charge to tax in relation to the capital gains of companies which are disincorporated. It might, for instance, be possible to provide some form of roll-over where a business currently carried on by a company is transferred to a partnership under the same management.

ANNEX IV.3

The Hon Donald T Regan
Secretary of the Treasury
Department of the Treasury
Washington DC
USA

2 December 1983

UNITARY TAXATION

The Confederation of British Industry welcomes the opportunity to express its views to the Working Group on Unitary Taxation. The CBI speaks for British business representing directly or indirectly well over 300,000 businesses and organisations with over 12 million employees. We have consistently opposed the application of worldwide unitary tax.

We are sending you a further paper which sets out detailed reasons why we so strongly oppose this system but endorse the separate accounting system based on the arm's length principle. Our paper also brings together previous evidence we have given in the United States on this issue. In this letter we summarise the main grounds for our opposition and the increasing concerns of British business.

Grounds for Opposition

1 Apportionment by factors of worldwide group profits is bound to produce an arbitrary and unfair result in an economically non-homogeneous world.

2 It will overallocate profit (or loss) to those jurisdictions with higher payroll, property and sales values.

3 Anomalous effects include conversion of a direct accounting loss into a unitary basis profit, apportionment of more than 100 per cent of the total world profits and unrelievable international double taxation.

4 The well tried domestically and internationally accepted arm's length basis produces a better evaluation of the true taxable profit (or loss) arising in a jurisdiction.

5 Uncertainty is so great as to undermine business confidence in investment.

6 Damage to free world trade could result from a worldwide tax war following emulation by other countries using factors modified to suit themselves.

7 Retaliation by trading partners among developed countries trying to protect their revenues would be even more damaging.

8 Compliance costs are very onerous and are bound to become increasingly so if more jurisdictions adopting the system require adjustments to local accounting, currency and tax rules and translation into local language.

Increasing Concerns

1 From a survey of our Members we learn that more State fiscal authorities are treating more UK headquartered groups of companies as single entities after demanding much information but paying little apparent regard to it. Several Members are still disputing the issue.

2 Instances have been brought to our attention of significant distortion of financial results in the USA even extending to the conversion of losses into profits.

3 Many businesses have not yet resolved their position and are still weighing up the potential tax and compliance costs. Compliance costs imposed on companies may well be out of all proportion to yield and there is therefore some inclination at present to settle.

4 Very strong unease remains as to what the future holds and British business is looking closely at operations in any State using or threatening a unitary system.

5 Some British businesses with operations in the USA have expressed considerable concern and disappointment about the lack of remedial action following the entry into force of the 1980 US/UK Double Tax Treaty. You will be aware that a number of Members of Parliament earlier this year sought to deny the refund of tax credit to companies headquartered, inter alia, in US States operating a unitary system.

6 Discussions with sister federations in Europe and elsewhere revealed similar awareness and concern about unitary tax, and its impact on and the future development of the international financial and commercial climate.

In the light of the fundamental importance of this matter both now and over the longer term we sincerely hope that our comments will be of assistance to you and your colleagues in successfully dealing with the situation and preventing the damage which could flow from the spread of this pernicious practice.

We would of course be pleased to try to assist you further, now or later in your deliberations, amplifying if necessary what has been said, in writing or orally, should your Group so wish.

Chapter V

Government Expenditure

1 CBI policy on government expenditure was set out in the paper submitted to the Chief Secretary to the Treasury[1] in July. Briefly, our priorities are:

- to reduce the public sector's share of GDP and enable the Government to finance tax cuts and reduce interest rates;

- a shift within the total, away from current to capital expenditure;

- greater efficiency in the public sector. The private sector has borne the brunt of the recession with significant cuts in manpower and substantial improvements in productivity; the public sector too must play its role.

2 The Autumn Statement held total expenditure to the total, contained in the public expenditure White Paper, of £126.4 billion in 1984/85 and the Chancellor has said it will be held in cost terms in later years. We welcome this.

3 Our proposals on government expenditure involve changes in the pattern of spending but no net increase in planned totals. We would like to see an increase in public sector capital expenditure and specific proposals will be set out in a study by the Federation of Civil Engineering Contractors and the CBI, in conjunction with other interested bodies. We also suggest increased expenditure on special employment measures and measures to reduce energy costs to be financed by savings in expenditure elsewhere or from the Contingency Reserve.

The Case for Extra Capital Expenditure

4 The CBI has consistently argued for increased public sector investment financed by a reduction in government current expenditure.

5 We do not suggest that all capital expenditure is good and all current expenditure bad. Certain areas of current expenditure contribute to economic prosperity and future economic development, but we believe that there remains considerable scope for improved efficiency in the provision of services and that many services would be better performed by the private sector. We do not advocate capital expenditure for its own sake but because we believe that increased investment, particularly in the infrastructure, would yield economic and social benefits, such as lower unemployment, reduced business costs and an improved environment.

6 We do not accept that it is simply the behaviour of total investment which is crucial. There are areas where private sector investment can, to a large extent, replace public sector investment - housing is an obvious example - but there are other areas - such as roads and sewers - where this is not the case. The reason is that a large proportion of the return to

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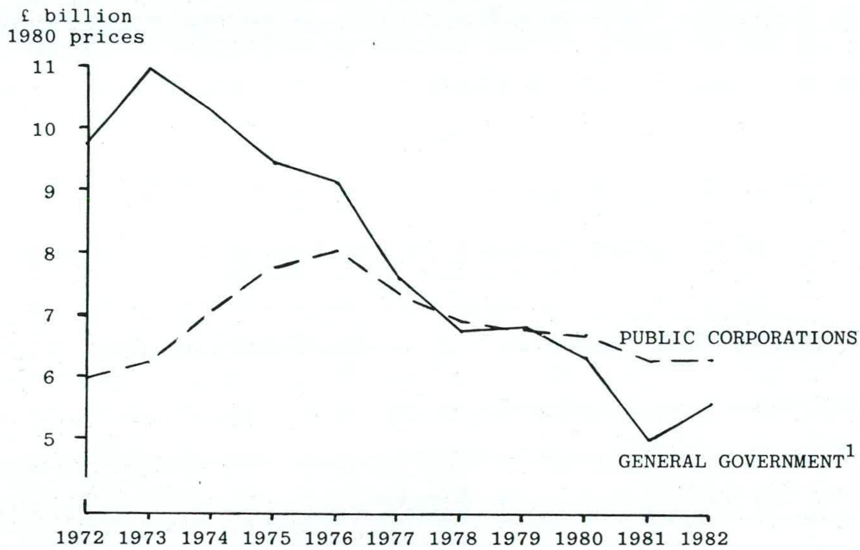
1 'Public Expenditure. Submission to Government', July 1983.

investment in these areas is social and does not accrue to those who provide the finance. The public sector still has a major role to play in investment and our study will identify specific capital expenditure projects which ought to be included in a longer term programme of public sector investment in the infrastructure.

7 Despite its importance, public sector investment has dropped dramatically both in absolute terms and as a proportion of total public expenditure. The fall has been particularly marked in general government capital spending. The result has been a deterioration in the infrastructure which is adding to business costs just when efforts are needed to improve our competitiveness.

CHART V.1

PUBLIC SECTOR INVESTMENT



Source : National Income and Expenditure 1983

1 Figures adjusted for sales of council houses.

8 The Chancellor has argued recently that public sector investment has not fallen in real terms since 1978/79 once account is taken of capital expenditure in the area of defence and special sales of assets such as council houses.

9 We recognise that, by international convention, most defence expenditure is classed as current expenditure even when it is of a capital nature, and that defence spending has beneficial effects on employment. However, capital spending in the area of defence does little to improve the infrastructure and reduce business costs.

10 Sales of public sector assets have artificially depressed the investment figures for recent years, but even when the proceeds from these are allowed for, general government investment was still around 20 per cent lower in 1982 than in 1979. There is an urgent need to clarify statistics on public

sector investment and we therefore welcome the Chancellor's announcement to Parliament that he hopes to improve the manner in which these matters are presented in the next White Paper to bring definitions closer to those used in business.

11 The CBI believes that public investment has been sacrificed as current spending and transfer payments have risen. It is easy to cut something the results of which will not be felt until the future; but this is a short sighted policy. A company adopting such an approach would soon go out of business.

12 In recent Representations we have asked for specific measures to remove administrative constraints on capital spending and are pleased to note that many of these have now been accepted, and that the problem of underspending has become much less important in the last year. We particularly welcome the introduction of end year flexibility for capital expenditure by both central and local government. We also welcome the extension of the arrangements introduced in the 1983 Budget to give local authorities assurances about their allocations for capital spending in future years.

13 There are three other specific areas of Government spending where changes are needed.

Innovation Support

14 The Government recognised the importance of support for innovation in the 1983 Budget by allocating an extra £85 million over three years to cover extension of the existing schemes to the later stages of innovation. It also announced that existing resources would allow the grant rate to be maintained at the $33^1/3$ per cent rate for a further year and later, that it was ready to contribute up to £200 million over five years to the "Alvey" programme in advanced information technology, in which the grant rate will be 50 per cent.

15 All these decisions were in accordance with CBI recommendations. But delays in obtaining EEC clearance for the £40 million scheme of support for the later stages of innovation and setting up the proposed Marketing Advisory Scheme, mean that only a small proportion of the extra £85 million will have been spent. Nor will the Alvey programme have as yet made many calls on expenditure during 1983/84. The schemes are important to the future of British industry but are demand-led. In the CBI's view the difference between 25 per cent and $33^1/3$ per cent is significant in determining the take-up of grants.

16 We therefore recommend for 1984 that:

- existing planned spending be at least maintained and if necessary increased in line with demand;
- the grant level be maintained at $33^1/3$ per cent for 1984/85; and
- the Alvey programme be regarded as a separate funding exercise additional to the general 'Support for Innovation' programme.

Energy Costs

17 The CBI and sectoral organisations have continued the campaign for the achievement and maintenance of competitive energy prices. We acknowledge that in certain respects over the last year to 18 months the UK's position has improved relative to the rest of Europe.Gas prices are now broadly competitive, as are electricity prices for general industrial users. However, we remain concerned at the level of electricity prices for intensive users who, despite the revised load management terms introduced over the last two years, still face a major price disadvantage compared with their continental competitors. UK prices for heavy fuel oil remain higher than those in the other major EEC countries, mainly because of the higher rate of duty levied in the UK. We have advocated for some time that the duty should be lowered or preferably abolished but have been informed that because of a contractual link with certain Norwegian gas supplies, the overall cost to the Exchequer would be disproportionately high compared with the cost benefit to industry.

18 We therefore recommend that:

- further relief should be provided for intensive electricity users; and

- the implications of lowering the fuel oil duty be re-examined and at the very least the duty remain at its present level.

We believe an allocation of £200 million would be appropriate in 1984/85.

19 The CBI welcomed the Government's renewed drive for increased efficiency in energy use heralded by the formation of the Energy Efficiency Office and will be co-operating in the nationwide campaign to improve energy awareness. CBI also welcomed the extension of the Coal Firing Scheme announced at the end of 1983. However, industry still suffers from lack of funds inhibiting investment in energy saving equipment which would not only be to industry's advantage but to the national good as well. We therefore recommend that further consideration be given to additional financial assistance to encourage selected energy efficiency investment and the accelerated replication of new or novel technologies.

Special Employment Measures

20 Our proposals set out in Chapters 1-3 should, by helping to sustain a non-inflationary growth rate, result in a fall in unemployment in the medium term. However, additional measures are needed to create more job opportunities in the short-run. We therefore propose certain measures costing about £100 million in 1984/85:

- the age threshold for men entering the Job Release Scheme should be lowered to 59, not raised to 64 from April 1984 as the Government proposes;

- the age threshold for the Part-time Job Release Scheme should be lowered to 58 for both men and women and that employers should be entitled to a grant of £750 as under the Job-Splitting Scheme;

- the Job-Splitting Scheme should be extended to cover newly created jobs, perhaps with some safeguards to show that they are jobs which would otherwise have been full-time. We believe the incremental cost of this would be negligible;

- the Community Programme Scheme be amended to allow greater private sector involvement in both the sponsorship and management of the Scheme and to provide funding for more ambitious projects than can currently be undertaken.

Controlling Government Expenditure

21 In order to provide the resources to cover these additional costs, continued control of government spending at central and local level is crucial. This Section summarises and where necessary updates the proposal made in our recent submission to the Chief Secretary.

i Efficiency and Manpower

22 The CBI has welcomed steps taken in recent years to improve the efficiency of central and local government, such as the establishment of an Audit Commission for local authorities and the management changes proposed for the National Health Service in the Griffiths Report. The CBI has also welcomed the extension of the Management Information System for Ministers in the Civil Service.

23 The drive towards increased efficiency in the public sector must continue as a way of reducing the cost of providing existing levels of services. The CBI advocates the preparation of corporate plans for individual departments to clarify their objectives, and measures to follow up more aggressively the Rayner exercises. More attention must be paid to the effectiveness with which services are provided, and we urge departments to construct and publish performance indicators wherever appropriate to assist the management process.

24 It is essential to expose central and local government to the disciplines of market forces. We therefore welcome the Government's commitment to privatisation of certain public sector services, and to the further use of contracting out of central and local government services and in the NHS. The existing legislation in respect of direct labour organisations in local government provides a model which can be built upon.

25 We have recommended an extension of the legislation to include, within local government, in the first instance, catering, refuse collection, cleaning and park services. The Government should introduce similar legislation to oblige competitive tendering for the provision of central government services where this is appropriate.

26 Increased charges and wider use of user-charging in certain areas, particularly local government, could help to reduce waste and to raise revenue.

27 We support the proposed legislation to restrain local authority rates and welcome the decision to abolish the Greater London Council and other metropolitan authorities in view of the savings that will ensue.

28 The CBI still believes there is scope for further cuts in public sector manpower which are consistent with maintaining the existing level of

services and has on previous occasions put forward targets for manpower savings. We welcome the reductions in Civil Service manpower announced by the Chief Secretary in November and realise that steady progress has been made in this area. However, progress made by local authorities in reducing their manpower, the major component of public sector employment, has been very slow, and employment in the NHS has grown faster than planned.

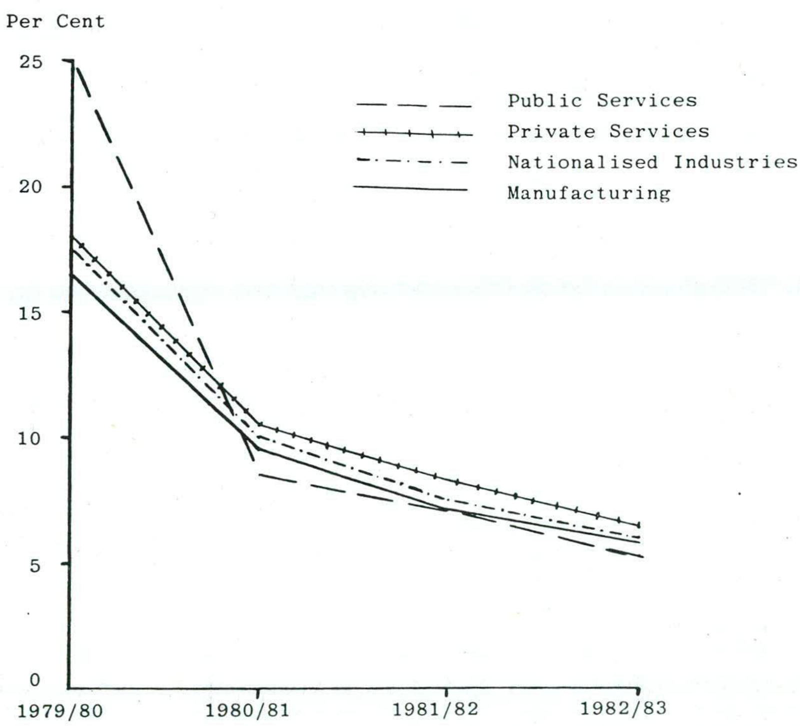
29 Continued efforts are needed to achieve manpower reductions in local authorities and in the health service. We welcome the establishment of manpower targets for each regional health authority and the early introduction of performance indicators. We would urge local authorities to exercise more control over their manpower levels, perhaps by the introduction of cash limits for wages and salaries.

ii Public Sector Pay

30 The CBI has welcomed the fall in pay settlements in the public sector. Chart V.2 shows that settlements in the public services are now running at a level lower than those in private services and manufacturing. However, this came after a number of years when public sector settlements were higher than those in the private sector. The Government cannot afford to relax its vigilance.

CHART V.2

AVERAGE PAY SETTLEMENTS



Source : CBI Pay Databank

31 It is well understood that pay settlements in the public services not only affect the costs of provision, and therefore the private sector's competitiveness, but can also influence settlements elsewhere in the economy.The private sector is continuing to make great efforts to reduce the level of settlements and it is important that the public sector does the same. We urge the Government to adhere firmly to its 3½ per cent guideline for public sector pay increases.

iii Pensions

32 The CBI has advocated as an eventual objective the abolition of inflation proof pensions in the public sector and has recommended that, in the interim, all public sector pension contributions be increased to the notional 8.5 per cent paid by the Civil Service. We welcomed increased contribution rates for the police force and the fire service, and recommend that similar action is taken in respect of other local authority workers, teachers and employees in the NHS.

Chapter VI

Local Authority Finance

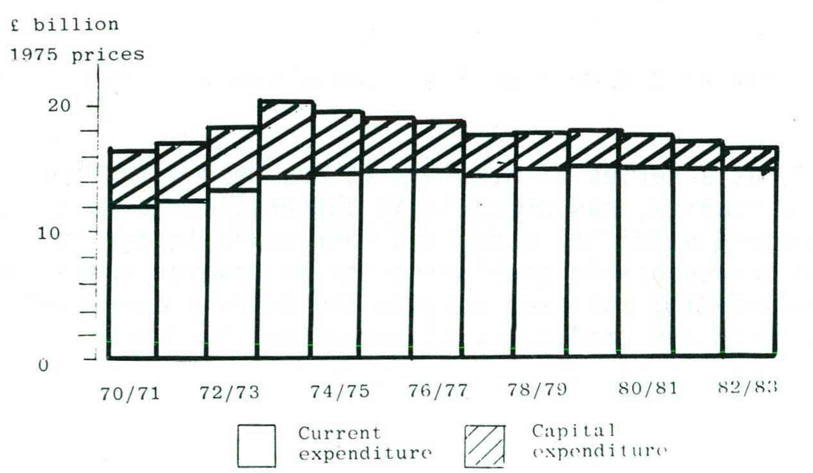
1 In the current year, total gross spending by local authorities in England and Wales will be about £35 billion which is equivalent to about 14 per cent of GDP and between a quarter and a third of all public expenditure. It is therefore a significant proportion of total public spending and it is necessary for the Government to control it if total public expenditure is to be reduced.

Local Authority Expenditure

2 The Government has been attempting to reduce the real level of local authority current expenditure but with only limited success. Since the reorganisation of local government in 1974, total expenditure by local authorities has fallen by 16 per cent yet this has been achieved entirely by squeezing capital expenditure which is today only two-fifths of the level that it was in real terms in 1974/75. Current expenditure has not fallen at all.

CHART VI.1

GROSS LOCAL AUTHORITY EXPENDITURE IN ENGLAND AND WALES[1,2]



1 Not corrected for double counting. This may account for up to 15 per cent of current expenditure.

2 Local authorities were reorganised in 1974, and some services were removed so that the figures are not fully comparable.

Source : Local Government Financial Statistics. 1970/1-1980/1. CBI estimates 1981/2, 1982/3.

3 Local authority gross current expenditure in England and Wales has risen in real terms between 1981/82 and 1983/84, despite a reduction in manpower on a full time equivalent basis of around 25,000 over the same period. And the latest manpower figures suggest that the downward trend of the last four years is in danger of being reversed.

4 The Government's objectives of seeking to improve value for money in local government is to be commended. Most authorities have made real efforts to achieve this, yet analysis of comparative performance indicators suggests that there is scope for further improvements in even the most efficient authorities. The Audit Commission has estimated that there are savings of £1-2bn which can be achieved by increased efficiency and effectiveness in the provision of services by local authorities in England and Wales.

5 The CBI strongly supports the efforts of the Government to encourage increased efficiency by local authorities through:

- expenditure guidelines or targets for local authorities;
- the allocation of Rate Support Grant;
- the grant penalty system;
- the establishment of the Audit Commission for England and Wales;
- the direct labour organisation regulations;
- the general encouragement of contracting out;
- the proposals for limiting the rates of the highest spending authorities;
- the abolition of the metropolitan county councils and the GLC.

6 The CBI itself, at a series of meetings it has held with larger councils up and down the country, has urged local authorities to make every effort to provide improved value for money and most councils are striving to do just this. An irresponsible small minority do however appear determined to follow high-spending policies despite the adverse consequences high rates have on the ability and confidence of businesses to invest, expand, develop new products and services, and create or maintain employment.

Rate Limitation

7 In the absence of acceptable proposals to obtain restraint on rates achieved by increased accountability at the local level, we support the Government proposals for selective rate limitations which will only affect a tiny minority of authorities. We also favour reserve powers, which we hope would never have to be used, to impose general rate limitations. The argument that the selective rate limitation scheme represents a fundamental attack on the democratic rights of local authorities is questioned by the business community which provides councils with nearly half of their rate income with no accountability whatsoever.

competitiveness and restoring equity between the sectors. From 1929 up to 1963 industry benefited from partial derating; the CBI believes that, once again, industrial concerns have a particularly strong case for relief, but that it should be granted to the whole business sector to improve competitiveness. Where companies are seeing some sign of recovery, lower rate bills would give business more funds to invest for the future; and those companies whose existence is threatened would be helped to survive.

10 We also argue for the introduction of partial business derating on grounds of fairness. This measure would remove the inequity of the present rating system which results in domestic ratepayers in England and Wales being subsidised by the domestic rate relief of 18.5p per £ of rateable value. Business is also dealt with harshly compared with agriculture which is derated, yet the arguments for business being treated similarly are certainly as strong.

11 For the same reasons, we recommend business derating of 2 per cent in Scotland to bring business into line with the domestic sector which there enjoys relief of 3p per £ of rateable value. (Industry in Scotland is already derated by 50 per cent but this is in order to make rate payments on industrial property roughly equivalent between England and Scotland, and is not relevant to the present discussion).

12 Primary legislation would be needed to implement the measure. We propose that the Government should take steps at once to draft the necessary Bill and introduce it in time for it to be enacted by the end of July 1984. We recognise that this would put some pressure on the Parliamentary timetable but the enabling Bill could be relatively short. As the partial derating would apply to the rating year 1984/85 it would be necessary for rating authorities to reduce from September or October the monthly payment of rates where this was being done by instalment. Where six-monthly payments were made, a similar amendment would be needed for the second payment. Only in the case of those relatively few businesses who pay their total rates at the beginning of the rate year would refunds be necessary.

13 We estimate the cost of implementation at £600 million at 1984/85 prices. In the first year it should be paid for by the Government through an increase in the Rate Support Grant, but over a period of 3 or 4 years this would be phased out as local authorities improved their efficiency. In this context it is worth noting the point already made that the Audit Commission believes that between £1 and £2 billion per annum can be saved by local authorities in England and Wales alone, through increased efficiency and effectiveness in their spending.

Empty Property Rate

14 In the White Paper, the Government proposes the abolition of the rating of empty industrial premises. We welcome this proposal but believe that it should apply to all empty business properties. In principle, rates are a tax on beneficial occupation and should not be levied on empty premises. At a time of recession the rating of empty commercial property, even at 50 per cent of the full rate, causes financial problems for many businesses. We feel it is unjust to penalise owners of empty property who have tried to let or sell but have been unable to do so because of the recession. We estimate that the additional cost of this proposal would be around £30-35 million at 1984/85 prices, and recommend that it should be implemented in 1984/85 by amendment to the relevant statutory instrument.

Rate Relief for Partially Unutilised Premises and Plant

15 In addition we advocate the introduction of "mothballing" rate relief for unutilised parts of premises and plant in order to alleviate the burden where these have been taken out of use but are being maintained with a view to eventual re-employment when economic circumstances allow. Legislation is needed but the measure should be effective in 1985/86.

CBI

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CBI Budget Representations
to the Chancellor,
January 1984

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Executive Summary

1 Our task is to sustain the recovery without prejudicing the gains made in the fight against inflation.

2 The 1984 Budget must be prepared with this in mind.

3 With the prospect of lower North Sea oil production we cannot ignore the longer term. We therefore set out a five year programme of action by business and government, covering the period 1982/83 to 1987/88, which aims to sustain last year's 3 per cent rate of growth and keep inflation low. Improved competitiveness and encouragement of enterprise and investment are necessary to achieve this.

4 The overwhelming immediate need is to improve competitiveness. We are still more than 20 per cent less competitive against our main competitors than we were in the mid-1970s and the gap is still larger against our European rivals.

5 Unless we improve our competitive position increases in domestic demand will benefit foreign rather than domestic producers and lead to a further deterioration in the current account.

6 The 1984 Budget must concentrate on measures to reduce Government-imposed business costs - by the final abolition of the National Insurance Surcharge and 10 per cent business derating. Looking ahead, we need to reduce employers' National Insurance Contributions in 1985/86 and increase capital spending on the infrastructure.

7 We do not propose that income tax thresholds should be raised by more than inflation. If we reduce the burden of personal taxes in the 1984 Budget there is a serious danger that too much would be spent on imports and nothing done to help our competitiveness.

8 Only if we are successful in sustaining the present rate of growth in the economy will there be scope for cuts in personal taxation in future years.

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Chapter I

Main Representations

1 Our task must be to sustain the recovery. As the Chancellor has said, steady growth with low inflation is "a winning combination". Our Representations are drawn up with this in mind.

2 They are set in the context of a medium term programme of action by business and government, covering the period to 1987/8, with the following key features:

a Maintaining steady growth at around the 3 per cent rate achieved in 1983 and expected by the Chancellor for 1984;

b Keeping inflation low;

c Improving competitiveness in cost, price and non-price areas;

d Encouraging enterprise and investment.

The 1984 Budget

3 The overwhelming immediate need is to improve our competitiveness. We are still more than 20 per cent less competitive against our main competitors than we were in the mid-1970s and the gap is still larger against our European rivals. Our balance of payments current account has moved from a surplus of £6½ billion in 1981 to one of £1½ billion in 1983, despite a large improvement in the balance of trade in oil. In 1984, world trade growth should help exports and keep the current account in balance. But if the trend continued we could run into a balance of payments crisis in the second half of the decade especially if the world economy slows down, and if North Sea oil production starts to decline at about the same time. The brakes would then have to be put on which would stop growth; or the pound would fall excessively, causing renewed inflation; or, most probably, there would be a combination of both.

4 So, our priority has to be improved competitiveness. To this end, the first two lines in Table 1 propose cuts in Government-imposed business costs - the abolition of the National Insurance Surcharge and 10 per cent business derating to match domestic derating. Looking further ahead, we also recommend a reduction in employers' National Insurance Contributions, by one percentage point, to take effect in 1985/86.

5 The next Budget should also include further measures to help enterprise, investment and innovation. These will pay off in the longer term. We recommend improvements to the Business Expansion Scheme to make investments more marketable; improved tax treatment of employees' stock options; capital tax reliefs; abolition of the Investment Income Surcharge, of Development Land Tax and of Stamp Duty on share transactions; capital allowances for commercial buildings.

6 In addition, we want to see a higher level of capital spending, as soon as practicable, to improve the infrastructure. This will both help our competitiveness in the medium term and provide work for the sorely-pressed construction industry. We propose that this be financed by reducing Government current expenditure.

7 In addition, a reduction in the cost of borrowing, which remains high in relation to inflation, is a priority.

8 We do not propose that income tax thresholds and bands should be raised by more than inflation. Those in work have improved their real income after tax substantially since 1979, while company net income has fallen drastically. Increases in tax thresholds are an inefficient way of reducing the poverty trap and have little impact on the unemployment trap.

9 If personal tax were cut in the 1984 Budget, there is a serious danger that too much would be spent on imports and nothing done to help our competitiveness. In subsequent years, if we can improve our competitiveness, keep growth going, and the balance of payments under control - and if public spending is held down in real terms as the Government proposes - we should be able to make further substantial reductions in taxation, including personal tax, while reducing public borrowing as a percentage of GDP.

How our proposals can be financed

10 The cost of our proposals for the 1984 Budget are set out in Table I.1

11 They should not be financed by raising the burden of taxation elsewhere as this would, to a large extent, offset their beneficial effects and might add to inflation.

12 In the Government's medium term financial strategy, as set out in the Budget last March and in the Chancellor's Autumn Statement, there would appear to be little if any scope for tax reductions in the 1984 Budget but very much more in the Budget of 1985.

13 However, as the Chancellor pointed out in the House of Commons in November, these estimates "are subject to a wide margin of uncertainty at this stage and rest on a number of conventional assumptions. The Autumn Statement is not a time for decisions on appropriate levels of borrowing or taxation. By the time of the Budget I shall have much more, and much more up-to-date, information".

14 Our proposals imply a somewhat higher level of public borrowing in 1984/5 than the Chancellor has assumed in his Autumn Statement. They increase borrowing by ½ per cent of GDP, but leave it well within the Chancellor's target in the following year (1985/86). On present estimates, they would reduce the PSBR as a percentage of GDP from 3¼ per cent in 1983/4 to 3 per cent in 1984/85, and if our medium term programme were fulfilled the figure would fall to around 1½ per cent by 1987/88.

15 While the economy expanded at a rate of 3 per cent in 1983, we see a significant risk that it may slow down in the second half of 1984 if nothing is done. This would have a serious effect on business confidence and put the objective of steady growth at risk. On the other hand we do not think the risks of the economy overheating if our proposals are adopted are significant.

16 We believe that our proposals can be justified as a sound long-term investment in the future of this country. Also:

- they would still keep our public borrowing as a proportion of GDP lower than in any other important industrial nation.

- they should not add to inflation because they reduce costs.

- they should enable interest rates to be reduced as external factors permit.

TABLE I.1

CBI TAX RECOMMENDATIONS FOR 1984 BUDGET[1]

(£ billion)

Proposed Changes:

	1984/5 Cost
A Lower Business Costs	
Abolition of NIS	0.9
Partial Business Derating and Other Measures	0.7
B Measures to Encourage Enterprise and Investment	
Improved Stock Options	-
Stamp Duty Changes	0.5
Capital Tax Changes	-
Amendments to Business Expansion Scheme	-
Abolition of Investment Income Surcharge	-
Corporation Tax changes	0.1
Abolition of Development Land Tax	-
Feedback Effect	-0.4
Net Effect on PSBR[2]	+1.8

1 Where no cost is indicated this is either because the cost of the proposal is insignificant, or would not become effective until 1985/86.

2 In comparison with unchanged policies using the same definition as the Treasury. The full year cost of these proposals is about £2½ billion.

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Chapter II

The Medium Term Programme

INTRODUCTION

1 This Chapter sets out the action which Government and business need to take to sustain steady growth and low inflation over the period to 1987/88. The economic arguments underlying our proposals for the 1984 Budget are set out in Chapter III and the details of these tax and expenditure proposals are set out in Chapters IV, V and VI.

THE NEED FOR A SUSTAINED RECOVERY

2 Over the past 10 years the British economy has grown only slowly, with much of the growth attributable to increased oil production.

3 In the next decade, oil production is likely to plateau and then fall. To avoid depressing the standard of living, it is essential to develop competitive businesses to compensate for this.

4 The recession has hit particularly those firms facing international competition and the investment goods industries. To survive they have had to cut expenditure and rationalise. We need now to build on the lessons learnt from this process to form the basis of a successful recovery.

5 Confidence is vital. Our Surveys show that the major constraint holding back investment is lack of certainty about growth and prospects (44 per cent of the respondents to the October 1983 CBI Industrial Trends Survey quoted 'uncertainty about demand' as the main factor holding back their investment). For confidence to invest in the future businessmen need to be convinced that the recovery will be sustained. In this way growth can create its own momentum.

6 Growth is also necessary to generate higher living standards and help create more jobs; with 3 million unemployed this is crucial.

7 Lack of growth in the economy increases the tension between the living standards we can afford and those to which we aspire. Slow growth leads to rising public spending on unemployment which can only be paid for by cutting benefits or public services, raising tax levels, or running the risk of excessive borrowing.

8 It has been argued that too rapid a rate of growth would lead to a deterioration in the quality of life or the environment. But stagnation or a rate of growth that is too slow can also damage the quality of life - through rising unemployment and the consequent loss of human skill, reduced growth in expenditure on education and health, and through deterioration of the infrastructure.

9 A rate of growth that is too rapid may lead to inflation. For this reason, holding down inflation is an essential element in our strategy for growth. Moreover, growth can hold down costs through spreading overheads and generating more funds for cost-cutting investment.

THE SPEED OF THE RECOVERY

10 During the 1970s GDP grew at an average rate of 1 - 1½ per cent per annum. But the trend during the 1950s and 1960s was much higher, close to 3 per cent. Given the dangers of shortages and inflation if growth is too fast, and of rising unemployment and higher taxes if growth is too slow, what rate should we aim for?

11 To answer this we need first to assess our starting point and then to consider the likely external environment.

Capacity

12 At first sight it would appear that we start from a position of considerable spare resources in the economy. An eighth of the labour force is unemployed. The different indicators of spare capacity in the manufacturing sector from the CBI Industrial Trends Survey, suggest that although capacity has been reduced, partly in response to low demand, there is still considerable scope for higher capacity utilisation.

13 This conclusion is backed up by most other researchers[1], though it has been argued that much of this capacity is not economically viable or is not in those particular sectors where it would be needed in a recovery.

---

1 The OECD (Economic Survey of the United Kingdom, 1983) and J Taylor ("Unused Productive Capacity in the UK: 1950-82" Unpublished paper, University of Lancaster) both conclude, using different methodologies from the CBI Survey, that there is considerable unused capacity in the UK manufacturing sector. P W Robinson (LBS Economic Outlook, August 1981) has argued that there is in fact relatively little spare capacity. This conclusion is based, however, on the assumption that the total available capacity is equal to a 5 year moving average of output rather than using direct information about how much capacity is in existence.

14 Clearly as growth proceeds we should expect some shortages of capacity, labour and components. But temporary shortages can reflect a changing economic structure and investment in new capacity and production of components and training for skills is unlikely to take place without such market signals. The rate of growth that is sustainable without inflation, however, will depend on holding down such shortages to tolerable levels.

North Sea Oil

15 Another major factor that will affect the prospects for the economy in the coming years is North Sea Oil. We are now close to the likely peak level of production and over the period to 1987/8 production is likely to plateau or, possibly, decline. Assuming this profile for production, North Sea oil revenues, which have had beneficial effects on Government finances and greatly cushioned the impact of the recession on taxpayers are also likely to level out and may well decline towards the end of the decade. North Sea oil has also made a major contribution to the balance of payments and this increases the need for improved competitiveness as oil production declines.

The Achievable Rate of Growth

16 We propose that our Medium Term Programme should aim at an annual rate of growth of 3 per cent from 1982/3 to 1987/8. This is an optimistic figure by the standards of the last decade but we believe that it can be achieved.

17 A rate of growth slower than this would risk the difficulties described above; a faster rate may be achievable but might lead to difficulties, for example, for inflation and the balance of payments.

18 Our view that steady growth at around 3 per cent a year coupled with low inflation is a realistic objective over the five year period is based partly on the fact that it has been achieved in 1983 and is expected by the Chancellor to be achieved in 1984; and partly on past experience, coupled with the belief that we can improve on our past performance, particularly in the field of international competitiveness.

The External Environment

19 During the twenty years 1953-1973, before the first sharp rise in oil prices, GDP in this country grew at an average rate of 3 per cent a year (and faster during recovery periods), with retail price inflation averaging just over 4 per cent a year.

20 It is true that the volume of world trade in manufactures rose during this period at an annual rate of 9 per cent a year, and that we are assuming that it will rise by about 3 per cent a year during our five-year period.

21 On the other hand it must be remembered that from 1953 up to the devaluation of 1967, our competitiveness worsened very markedly - our unit labour costs in manufacturing rose something like 25 per cent more than the average of our main competitors. During the rest of the period up to 1973 our unit labour costs continued to rise somewhat faster than our competitors' in national currencies, and we were able to maintain our cost competitiveness - and indeed improve it - only by a fall in the value of the pound totalling around 25 per cent against a basket of currencies.

22 Over the period to 1987/8, we should not rely on a fall in sterling, but we do aim to avoid a deterioration in our cost competitiveness, through higher productivity, realistic pay settlements and cuts in government-imposed business costs; and indeed to improve it, as we have done over the past two years. We are also assuming some improvement in our non-price competitiveness through encouragement of enterprise, higher profitability leading to more investment in new equipment, new products, marketing, training,etc.

23 In these ways we believe we can achieve growth in our exports at around the same rate of world trade, instead of a much slower rate as in the past; and that even in an environment of considerably slower growth of world trade we can thus emulate our past performance of growth of the national economy at around 3 per cent a year, with low inflation, without running into balance of payments difficulties.

OUR PROGRAMME FOR SUSTAINING GROWTH

24 Achieving sustained growth with low inflation will require action by government and business to:

- encourage enterprise and investment;
- improve competitiveness; and
- hold down costs.

Encouragement of enterprise and investment

25 For the economy to grow and create jobs, enterpreneurs, investors and managers must be prepared to sacrifice leisure or short term rewards. To encourage this they must be allowed to keep for themselves a fair proportion of the returns created by their efforts or investment.

26 Enterprise is likely to be best encouraged when the public has a direct stake in the system through widespread share-ownership and when managers and employees have a direct stake in their own firms.

We therefore propose measures (see below and in Chapter IV) that will reduce tax disincentives to enterprise, investment and share-ownership.

27 The prospects for growth can also be improved by reforms aimed at greater flexibility in labour markets and by Government regulation of commerce and industry being kept to a miminum.

28 We intend to bring forward proposals in these areas and in industrial policy to improve the prospects for growth.

Competitiveness

29 To ensure that UK producers win a sufficient proportion of markets at home and abroad to sustain growth, improved competitiveness is essential. Improved competitiveness is also necessary to prevent the fall in the balance of payments current account surplus from £6½ billion in 1981 to about £1½ billion in 1983 becoming a trend that could halt the recovery in the medium term.

30 Our programme aims at improving both cost competitiveness and non-price competitiveness by:

- lower pay settlements than in competitor countries;
- continued rapid increases in productivity; and
- reductions in taxes on business that add to costs.

Chart II.1

31 The improvements in non-price competitiveness should result from increased profits and the confidence to plan for expansion leading to higher investment, not only in fixed assets, but also in:

- research and development;
- marketing; and
- training.

32 Many of the arguments about competitiveness are aimed at the manufacturing sector since this is the sector most directly exposed to international competition. If we look at our total exports of goods and services, about half the value added in the UK is in manufacturing industry. The other half is contributed by other sectors such as agriculture, energy, construction, communication, distribution and other services. These non-manufacturing sectors contribute in two ways, roughly equal in importance. First, they supply goods and services to manufacturers, help them get their exports to the ports and sell them abroad. Secondly, these sectors produce the invisible exports on which we rely so much. So improved competitiveness is also important for the non-manufacturing sectors.

Costs

33 We believe that high inflation is damaging to the economy and that for growth to be sustained low inflation is vital. For this reason we are not relying on a falling exchange rate to improve competitiveness, or a lax monetary policy to boost demand.

34 Our programme of pay moderation, rising productivity and reduced taxes on business will result in lower unit costs and help hold down inflation. The public sector must play its part by ensuring that it does not contribute to inflation by unjustified increases in its costs, prices and taxes.

Macroeconomic Policy

35 Macroeconomic policy also has an effect on the prospects for growth and inflation.

36 We support the aims of the Government's Medium Term Financial Strategy (MTFS). Such a strategy helps to create confidence in its aim of holding down inflation. However, we have consistently argued that the targets contained in it have to be interpreted flexibly and sometimes adjusted in the light of developments and prospects for the economy. The monetary targets should aim to allow sustained growth provided that this does not conflict with the objective of low inflation.

37 The medium term fiscal targets in the MTFS should be such as to hold down the ratio of public debt to GDP. In the short-term however, we would envisage deviations from that path where necessary in the light of economic circumstances for cyclical reasons, or if they specifically improve competitiveness.

38 Table II.3 in the Annex shows that if the present rate of growth is maintained and government spending is held to its present level, there would be scope for tax cuts of 2¼ per cent of GDP by 1987/8. This would be equivalent to about £2 billion (in 1984/85 prices) in each of the four Budgets before then. The proposals set out in Table I.1 would use up about £2½ billion by 1987/8 at 1984/5 prices. We would envisage (and have assumed in our calculations) that most of the rest of the sums available being used to reform and cut personal taxation on income and capital and to reduce payroll taxes on employers. The following ready reckoner gives the cost of possible options for tax changes.

Costs of Possible Options for Tax Changes

	Cost in full year 1984/85 prices £bn
Lower basic rate of income tax by 1 per cent	1.0
Reduce employers' NIC by 1 per cent	0.9
Reduce top income tax rate from 60 per cent to 50 per cent	0.2
Derate business by a further 10 per cent	0.5
Increase income tax thresholds and bands by 5 per cent more than inflation	0.8
Reduce corporation tax rate by 5 per cent	0.8

THE RISKS AND THE REWARDS

39 Our economic strategy might be driven off course by factors beyond our control. Further international disruption as occurred in the 1970s with sharp rises in oil prices, such as default by a major debtor nation, might require the strategy to be revised. We would have to face such circumstances as they occurred and make appropriate adjustments to the strategy.

40 The strategy could also be thrown off course as a result of factors that are under own control - we could allow inflation to pick up or our competitiveness may be insufficient to prevent a deterioration in the balance of payments. Either of these would reduce the achievable sustainable rate of growth.

41 If we steer away from these rocks, however, the benefits of success will be immense.

42 Further rises in living standards for those in work would be achievable while at the same time unemployment would start to fall.

43 If public spending were held roughly constant this would permit scope for substantial cuts in the burden of taxation as well as allowing public borrowing to fall substantially as a percentage of GDP (see Table II.3).

44 Perhaps most important, success would permit us to start to adjust our structure of industry and commerce to cope with the problems that may emerge in the 1990s and beyond, such as declining North Sea oil revenues, increasing technological demands for public services and demographic changes including the need to fund the pensions of an ageing population in the next century.

ANNEX II.1

HOW OUR PROGRAMME ADDS UP

1 This Annex gives illustrative figuring to show how the different elements in our programme fit together. The figures are not forecasts and their relative precision, without reference to the obvious margins of error involved, is merely intended to simplify the exposition.

Demand

2 Table II.1 shows the growth in the different components of demand which we expect to be consistent with our programme. The greatest absolute contribution to growth comes from consumers' expenditure rising in line with real incomes. The fastest growing components, however, are fixed investment, as profits recover, and exports, as world trade recovers and competitiveness improves.

Table II.1

Pattern of Growth[1] Consistent with CBI Programme
(Percentage annual change in volume)

	Estimated Growth so Far (1982/3 to 1983/4)	Projected Growth (1982/3 to 1987/8)
GDP (average measure)	2½	3
Consumers Expenditure	3	2
Fixed Investment	1½	6½
Government Current Expenditure on Goods and Services	2	0
Exports of goods & services	0	4
Imports of goods & services	5	5

1 Both between 1982/3 and 1983/4 and, to a lesser extent, between 1982/3 and 1987/8, there is some contribution to growth from a changing rate of stockbuilding.

Competitiveness

3 Our unit labour costs in manufacturing in the past two years have risen by about 2½ per cent per annum less than those in competitor countries. We have assumed over the next four years that, if our programme is implemented, this differential will be maintained. The improvement in our cost competitiveness indicated in Chart II.1 and improvements in our non-price competitiveness compared with our past performance are forecast to lead to annual export growth in manufactures over the period of about 3 per cent , the same as the growth in world trade in manufactures. Since the trend over a long period has been for total UK exports of goods and services to rise about 1 per cent per annum faster than our exports of manufactures, we have projected growth in the latter of 4 per cent.

4 Imports of goods and services are forecast to grow by 5 per cent per annum, slightly more slowly than the 7 per cent growth that would have been predicted without improved competitiveness.

Employment

5 Over the past two years, output per head in manufacturing has grown at an annual rate slightly faster than 7 per cent. Our projection for the next 4 years is that this will slow to about 5 per cent. Productivity in the economy as a whole only grows at slightly below half this speed however, with (by convention) little growth in productivity assumed for the public service sector and productivity in the private service sector forecast to grow by 2 per cent per annum. After taking account of changes in the labour force, the programme is forecast to start to reduce unemployment, bringing it down to under $2\frac{3}{4}$ million by the beginning of 1988. This calculation does not take account of further reductions that might result from special employment measures of the kind set out in Chapter V.

Chart II. 2

6 The scenario set out above would imply manufacturing production growing faster than production in other sectors. However, the pattern of productivity improvements implies some further job losses in manufacturing while net increases in employment would be likely in the service sector. Table II.2 gives the projections for employment by sector and for unemployment.

Table II.2
Employment and Unemployment (millions)

	1983 1st Qtr.	1983 4th Qtr (est)	1988 1st Qtr.	Change 1983 Q1 to 1988 Q1
Manufacturing Employment	5.4	5.3	5.2	-0.2
Public Service Sector Employment	5.0	5.0	4.7	-0.3
Private Service Sector Employment[1]	13.1	13.2	13.9	+0.8
Total employment	23.5	23.5	23.8	+0.3
Labour Force	26.5	26.4	26.5	-
Unemployment	3.0	2.9	2.7	-0.3

1 Includes self-employed and employment in the non-manufacturing nationalised industries.

Monetary Policy

7 The projections assume growth remaining steady at an annual rate of about 3 per cent and the rate of increase in the GDP deflator falling from 7½ per cent during 1982/3 to about 4 per cent in 1987/8. The projections assume no trend change in the velocity of circulation for the wider monetary aggregates over this period and so these are forecast to rise in line with money GDP.

Government Revenue and Expenditure

Table II.3
Government Financial Accounts

Percentages of GDP

	1982/3	1983/4	1987/8 projected
Receipts[1]	43	42	39 (after 2¼ per cent net tax cuts)
Expenditure[1]	47	46	40½
PSBR	3¼	3¼	1½

1 General government receipts and expenditure; some adjustments to the difference between these figures are necessary to derive the PSBR.

8 Table II.3 shows how our proposals for taxes, expenditure and revenues add up.

9 Over the 5 year period to 1987/8 we propose that the level of public expenditure should be held constant in cost terms. This would reduce it from 47 per cent of GDP in 1982/3 to 40½ per cent of GDP in 1987/8. Provided that inflation remains low and economic growth continues, we would aim at a falling PSBR as a percentage of GDP to hold down the ratio of public debt to GDP and to prevent "crowding out" of the private sector in the medium term.

10 We estimate that at present rates of tax (after adjusting for inflation) there might be a slight fall in government revenue as a percentage of GDP and with some other accounting adjustments this might leave scope for net tax cuts, consistent with our estimates for borrowing and expenditure, of 2¼ per cent of GDP.

DRAFT 6.1.84

Chapter III

The Economic Background

1 This Chapter explains the economic reasoning behind the recommendations for the 1984 Budget. It explains why we believe that the Government must take immediate action to reduce business costs rather than the burden of personal taxation.

Recovery in Progress

2 A recovery is under way. The latest figures for GDP show that the trough of the recession was in the second quarter of 1981 and that the economy has been growing fairly steadily since then. It is, however, difficult to be precise about the extent of the recovery because of the unusually large discrepancy between the various measures of GDP. By the third quarter of 1983 the expenditure measure of GDP was nearly 5 per cent higher, the income measure 7 per cent higher, and the output measure 4½ per cent higher, than in the first half of 1981.

Chart III.1

3 Although the output measure is generally regarded as the best indicator of short-term movements in GDP because it is much less liable to revision than the expenditure and income based estimates, there is no reason to believe that it is more accurate than the other estimates over longer periods. In these circumstances, it is conventional to use the average of the expenditure, income and output measures. On this basis, GDP in the third quarter of 1983 was just over 5 per cent higher than in the first six months of 1981.

4 It is clear that the recovery is uneven and from a low base; for 1983 as a whole GDP (average measure) was only as high as in 1979. Moreover, North Sea oil has made an important contribution to growth; between the first halves of 1981 and 1983, oil and gas extraction rose by 23 per cent in volume terms and contributed nearly 1 percentage point to the growth of GDP (output measure) over the period. Manufacturing production, as a whole, remains depressed although there is growth in certain sectors. Output in manufacturing was about 2 per cent higher in the third quarter of 1983 than in the first half of 1981; by the third quarter of 1983, manufacturing production remained 14 per cent lower than in 1979. It should, however, be noted that the CSO's index of manufacturing production shows a considerably flatter picture during 1983 than would be expected on the basis of the results of the CBI Industrial Trends Survey.

Chart III.2

5 Inflation (as measured by the increase in the RPI over the previous twelve months) has dropped faster than expected from a peak of 21½ per cent in the second quarter of 1980 to under 4 per cent in the second quarter of 1983. Although inflation measured in this way has risen slightly since then this reflects the ending of certain special favourable factors and does not

indicate a resurgence of inflationary pressures. Other indicators confirm that inflation remains under control. The annual increase in the GDP deflator has fallen from over 20 per cent in the second quarter of 1980 to just over 5 per cent in the second quarter of 1983. The annual increase in unit labour costs in the second quarter of 1983 was 2.2 per cent for the whole economy and 2.4 per cent in manufacturing, compared with increases of 22.2 per cent and 24.9 per cent three years earlier.

6 There have been substantial gains in productivity during the last three years, particularly in manufacturing. In the first six months of 1983 output per head in the whole economy was nearly 9 per cent higher, and in manufacturing 13 per cent higher, than three years earlier. Nevertheless there remains a wide gap in levels of productivity between ourselves and our main competitors, particularly in manufacturing.

7 Profitability has also improved from the very low levels of the last few years. Industrial and commercial companies' (excluding North Sea activities) gross trading profits (net of stock appreciation) rose substantially in 1983 and we expect the real rate of return to have risen to around 6½ per cent. However this is still not only well below the level common in the 1960s but also less than in 1978, and remains below the rate of return of our major competitors. A recent study by the OECD[1] showed that in 1982 the real rate of return on capital in manufacturing in the UK was less than half of that in the United States, Germany and Canada, and only about one-fifth of that in Japan. We agree with the Bank of England[2] that the current rate of profitability is 'well below the level necessary for a healthy rate of investment'.

The Need to Sustain the Recovery

8 We fear that unless the Government implement our proposals and take further action to reduce business costs and improve competitiveness, the present recovery could falter later this year. Without such actions, our latest forecasts, published at the end of November, suggest that GDP, as measured by the average estimate, could rise by 1½-2 per cent between 1983 and 1984 as compared with an estimated increase of some 3 per cent between 1982 and 1983.

9 On the basis of existing economic policies, we expect the growth of consumers' expenditure to slow down in 1984. The strong increase in expenditure in 1983 was chiefly supported by a substantial fall in the savings ratio. Further falls are unlikely in 1984 bearing in mind that some of the fall which has occurred since the beginning of 1982 was due to special factors (such as the abolition of HP controls and the large increase in bank lending for mortgage purposes). The significant fall in inflation in recent years has also played a part but we expect only a modest further fall in 1984.

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1 OECD Economic Outlook July 1983 Table 23
2 Bank of England Quarterly Bulletin December 1983 p. 457

10 Nor do we expect any marked increase in stockbuilding during 1984; we believe that companies have learnt to live with lower levels of stocks in relation to turnover.

11 Our Surveys suggest a faster rate of growth of investment in 1984 helped by improved profitabilty. We also expect an improvement in net exports, following the improvement in competitiveness in 1983, but these are unlikely to be sufficient to compensate for the slower growth of consumption and moderate stockbuilding.

12 A slowdown in the rate of recovery next year is supported by other forecasting bodies. Given the margins of error involved in forecasting GDP, it is quite possible that growth next year could be faster than the 1½-2 per cent that was our central forecast last November. But it could also be slower. If the recovery were to falter the consequences for business confidence would be severe and put the objective of sustained growth at risk. Chapter II makes clear the dangers and we believe these far outweigh the risks of the economy overheating should growth be faster than our central forecast.

Competitiveness

13 Although the past year has seen a marked improvement, our unit labour costs in manufacturing are still more than 20 per cent higher when measured against our main competitors than they were in the mid-1970s and that gap is still larger against our European rivals. Our Trends results confirm that although price competitiveness is now better than during most of the period 1979-82 it still remains very poor in relation to earlier periods.

14 As a consequence import penetration in manufacturing remains very high and we have continued to lose our share of foreign markets in both goods and services. The sluggish response of manufacturing output to the recent rise in domestic demand, and the deterioration of the current account of the balance of payments,are further evidence of our weak competitive position.

15 Improving competitiveness requres action by both business and Government. Business must hold down unit labour costs by moderating pay increases and by improving productivity. Each year since the 1978/79 pay round, the CBI has engaged in an extensive series of conferences throughout the country underlining the vital links between holding down unit labour costs, competitiveness, profitability and jobs. The message has been accepted and for the last two years the growth of unit labour costs in manufacturing has been lower than the average for competitor countries. But there is still a long way to go. Important competitors like Germany and Japan continue to have very small increases in unit labour costs.

16 Business cannot do the job on its own. Government too must help by reducing the costs it directly imposes on business. Government-imposed costs on business in the form of National Insurance Surcharge, employers' National Insurance Contributions and business rates rose by 20 per cent in real terms between 1975 and 1979. Since 1979 there has been a decrease in the real burden but much still needs to be done, in the face of continued tough trading conditions.

Chart III.3

We regret the increase in the upper earnings limit for National Insurance Contributions announced in the Autumn Statement and urge the Government to take action in the Budget to reduce business costs by means of:

- the final abolition of NIS

- 10 per cent partial business derating.

We also urge that the Chancellor announce, as soon as possible, a one percentage point reduction in the rate of employers' National Insurance Contributions to take effect in 1985/86.

Business and Personal Taxation

17 Cuts in Government-imposed costs on business must take priority over cuts in the burden of personal taxation for the following reasons:

- the immediate and overwhelming need to improve competitiveness.

- if there were to be cuts in the burden of income tax, given our weak competitive position, a large part of the resulting increased consumption would go on imports.

- reducing business costs helps reduce inflation;

- whilst profits have improved lately, it has been from a very low level. By contrast, consumers have been doing relatively well in terms of real personal disposable income over the past years. They have become better off - at least those remaining in employment - while companies are much worse off.

Chart III.4

18 We therefore recommend that personal tax allowances are only increased in line with inflation. Increases in tax thresholds are an inefficient way of reducing the numbers caught in the poverty trap because they affect all taxpayers. Most of those taken out of tax by small increases in the thresholds are not the heads of households affected by the poverty trap. Because unemployment benefit is now taxable such increases also have little impact on the incentive to work.

Fiscal Policy

19 Our policy proposals are, if implemented, likely to raise the PSBR in 1984/85 by £1½-2bn (or ½ per cent of GDP) above the level it would otherwise have reached. We believe that our proposals are consistent with further falls in the trend rate of inflation and with reductions in interest rates.

20 Although our proposals involve raising the share of the PSBR in GDP above the level proposed for 1984/5 in the Autumn Statement, they still imply a reduction from the likely outturn for 1983/4 and remain consistent with the generally declining path for the PSBR as a percentage of GDP which is an important feature of the MTFS.

Chart III.5

21 Our proposals would also leave public borrowing in the UK (as a proportion of GDP) lower than in any other major OECD country including several with lower inflation rates than the UK.

Chart III.6

22 In previous Representations we have argued that the size of the PSBR can be a misleading guide to the stance of fiscal policy and that it is important not to give too much emphasis to setting or achieving a precise target for the PSBR in any one financial year.

23 The composition of the PSBR is of great importance. For any given PSBR, different combinations of taxes and government spending will have different effects on inflation, interest rates and economic activity. An increase resulting from increased government current spending could well raise inflation and interest rates. By way of contrast, the same increase brought about by measures to reduce business costs could actually reduce inflation and help keep down interest rates by reducing company borrowing.

24 The Government has managed to cut its borrowing significantly since first coming into office in 1979. In that year the general government deficit was equivalent to 3.2 per cent of GDP according to OECD figures. By 1982 this ratio had been reduced to 2.0 per cent. But the underlying improvement is even larger than this. The OECD calculate that the recession added 5.1 per cent to the ratio in that period as expenditure on social security payments rose and tax revenues fell. So the underlying fall in the deficit/GDP ratio between 1979 and 1982 is not 1.2 per cent but 6.3 per cent, this being larger than the size of the deficit itself. The conclusion must be that a very large part, if not all, of the present deficit is due to the recession and would disappear if recovery were sustained (this is shown in the annex to Chapter II). In these circumstances the concentration of policy on the simple PSBR/GDP ratio can be misleading.

Monetary Policy and Interest Rates

25 Although nominal interest rates have fallen from the high levels reached at the beginning of 1980, they remain, by historical standards, high in real terms.

Chart III.7

26 There are of course great difficulties involved in measuring real interest rates and it might be argued that the normal measure used overstates the real interest cost faced by companies by not allowing for interest relief from corporation tax. Post tax measures of the real interest cost faced by companies have to be treated with some care however. Insofar as companies are earning insufficient profits fully to offset interest payments, post-tax measures will underestimate the real interest rate being paid by these companies. The real interest rate faced by most companies will lie somewhere in between the normal and post-tax measures, with less profitable companies and those investing heavily with large capital allowance paying a higher net real rate.

27 Until 1980 profitability remained significantly above the level of real interest rates. More recently this has not been the case, as the Chart shows. This decline of profitability relative to real interest rates emphasises the need to lower interest rates.

28 A move towards lower interest rates would help considerably to sustain the recovery. While real interest rates are high firms will be encouraged to invest profits in financial rather than physical assets, but it is investment in the latter which is crucial to sustain growth and provide productive capacity.

29 We fully accept that interest rates are not under the Chancellor's control in the same way as public spending, National Insurance Contributions and other taxes, and that external influences can be an important constraint. Nevertheless, we believe that the Government can influence interest rates and that there is scope for further cuts.

30 Different monetary aggregates give conflicting accounts of the tightness of monetary policy. So far, in the current target period [to November 1983] annualised growth rates for monetary aggregates vary from [10.5] per cent for [£M3] to [12.1] per cent for [PSL2]. However, it seems likely that £M3, and possibly M1 also, will show growth inside the target range of 7-11 per cent at the end of the current target period and PSL2 growth is unlikely to be far above the top of the range. Furthermore M0, the new target aggregate which the Chancellor feels is especially useful in guiding official policy on short term interest rates, is currently growing at a much slower rate than the other aggregates. Thus we do not feel that present monetary conditions necessitate keeping interest rates at their current high level given that inflation has fallen.

31 Nor are UK interest rates solely determined by those in the US. Late 1983 saw a period when US interest rates rose without any significant response in the UK, and with the effective exchange rate for sterling remaining stronger than it had been earlier in the year. In addition, interest rates in Germany and Japan have been consistently far below US levels for some years. All this suggests that it would be possible to lower UK interest rates independently of US developments.

DRAFT 6.1.84

Chapter IV

Taxation

Introduction

1 In the tax field, our primary objective is a lower burden of taxation for private business in order to improve competitiveness and encourage enterprise.

2 Our main taxation proposals for the 1984 Budget, therefore, are:

- the abolition of the National Insurance Surcharge;
- 10 per cent business derating, to place business rates on the same basis as domestic rates (this is discussed below in Chapter VI);
- a package of measures to reduce the tax disincentives to enterprise

3 Tax priorities for subsequent years are outlined in Chapter II: the main emphasis being further reductions in taxes that hinder business competitiveness and later, as economic developments permit, reductions in income tax.

National Insurance Surcharge and Contributions

4 The most immediate way in which the Government can help business improve its competitiveness without adding to inflation is by abolishing the surcharge on employers' National Insurance contributions.

5 This surcharge holds back business competitiveness, squeezes profits and thus discourages provision for the future, adds to prices and discourages employment. The Prime Minister has described it as "a pernicious tax on jobs".

6 The CBI has welcomed the successive cuts in this surcharge from 3½ per cent to 1 per cent that have been made in the past two years. But employers' National Insurance contribution rates have risen and the contribution bands have widened in real terms in the past two years.

7 We must keep up the progress in reducing the burden of payroll taxes. We therefore recommend:

* The immediate abolition of the employers' National Insurance Surcharge;

* An early anouncement that employers' National Insurance contributions will be reduced by at least 1 percentage point in 1985/6;

* A temporary stabilisation in the bands for National Insurance contributions, which have risen in real terms in each of the past 5 years.

8 The cost for 1984/5 would be £900 million, assuming introduction on 1 April. The full year cost of the abolition of the surcharge would be £1,150 million assuming that the savings on the amount paid by central and local government on its own employees are clawed back. The cost of a 1 percentage point reduction in employers' national insurance contributions would be the same and we propose that such a reduction be, in the first instance, funded by an adjustment to the Government subvention to the National Insurance Fund. This would not affect public expenditure which is related to disbursements, rather than payments into the National Insurance Fund.

9 In the longer term National Insurance contributions need to be considered in the context of their interaction with the income tax and benefit systems, the future of state-funded pensions and their impact on the incentive to employ, particularly for low paid and part-time employees. However, changes in this latter area could be costly.

Enterprise and Taxation

10 We now we set out a number of measures for which we are seeking action to encourage enterprise and improve prospects for growth in the longer term. The main areas covered are:

- Corporation Tax
- Advance Corporation Tax
- Capital Allowances
- Development Land Tax
- Stamp Duty
- Share Options
- Capital Taxes
- Income Tax and the Investment Income Surcharge
- Business Expansion Scheme
- Wider Share Ownership
- Indirect Taxes
- International Aspects

Corporation Tax

11 In our response to the Government's Green Paper on Corporation Tax of October 1982 we emphasised the importance to business of stability in taxation. We concluded however that within the imputation system and present tax base there were a number of rigidities and anomalies where corrective action to remove or alleviate them would be helpful to business. (Annex IV.1 to this Chapter lists our detailed recommendations put to Government in 1982.)

12 Some of the recommendations have been taken up already, for instance on the incidental costs of loan finance and discounts on acceptance credits, others such as the tax treatment of groups of companies and mineral capital allowances are still under consideration. Nonetheless we have two main regrets. First, many of our recommendations have not been implemented nor has a promise of implementation been made. Secondly, to date no analysis or synopsis of all the responses to the Green Paper has been published. (This would be invaluable in future discussions.)

13 We have already submitted to Government our more detailed Technical Budget Representations with proposals for the 1984 Finance Bill (our priority items are listed in Annex IV.2).

14 Generally in this context and in the light of recent comments[1], we urge the Government to improve legislative procedures, to provide more time for a number of technical tax problems to be resolved and to provide an opportunity for fuller consideration of the legislation itself.

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1 eg. A Technical Taxation Bill - The CBI's Proposals, CBI October 1981

Advance Corporation Tax

15 Over the years we have made repeated attempts to improve the working of ACT, introduced in 1972. We do not believe it is necessary to be bound by any rigid theory of what ACT is or was intended to be and in particular that the Select Committee debates in 1971 should be regarded as forever ossifying the rules that were then under consideration. Practical experience of the system shows that:

- ACT payments to government should be set off against the next available mainstream corporation tax liability of the companies making the payments not deferred as at present.

- ACT set-off should not be restricted to 30 per cent of income.

- ACT set off should cease to be confined to mainstream corporation tax on income and should instead be available to set against corporation tax on all profits including chargeable gains.

- Capital allowances should be available against advance corporation tax and not just against mainstream corporation tax.

- Double taxation relief should be available against ACT.

Capital Allowances

16 The Green Paper on Corporation Tax[1] acknowledged that our major international competitors give relief for expenditure on commercial buildings. A small start has been made by giving relief to hotels, but this, at a 20 per cent initial allowance, is not as generous the 75 per cent available for other industrial buildings.

17 The lack of an allowance in this area was seen as an anomaly by the Sandilands Committee (Report of the Inflation Accounting Committee, September 1975) itself drawing on evidence from the Committee on the Taxation of Trading Profits (Cmd 8189 - 1952) and the Radcliffe Commission (Cmd 9474 - 1955). We have long and consistently urged remedial action.

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1 Cmd 8456 - para 15.33.

18 We believe that such a measure would lead to increased activity and hence jobs in the construction sector, and to a reduction of rental costs to industry and commerce.

19 We therefore recommend that the vital role of the commercial sector in the economy be clearly acknowledged and an immediate start be made by introducing a straight line writing down allowance at 2 per cent per annum on new commercial buildings.

Development Land Tax

20 This tax raises little revenue (approximately £50m for 1983/84) and has a discouraging effect on commercial decisions relating to surplus property. It should be abolished. Failing outright abolition of the tax we urge that it should be suspended for an experimental period of 3 years.

21 This would provide an incentive to business to initiate development projects free from the compliance costs and constraints which would otherwise apply even where at present the tax itself is deferred.

Stamp Duty

22 Our response to the recent Revenue consultations on Stamp Duty[1] drew government's attention to two particular areas of agreement with our colleagues in other European federations. We urged –

- First, the early abolition of the capital duty – a European tax – and invited the Inland Revenue to take the initiative in securing the necessary European reform.

- Second, the abolition of the tax on transactions in securities. The present rates of duty are such that dealings in quoted securities are being driven away to overseas markets where the tax costs are lower.

Share Options

23 The CBI believes that companies should be afforded the means to encourage employees in, and reward them for commitment to their endeavours. This can be done by providing them with opportunities to participate in their employers' capital growth on terms not rendered unattractive by taxation and as good as those available abroad. We shall in 1984 be looking at practical aspects of this on a broad front. Our priority for the 1984 Budget relates to Share Options.

24 Our attention has been drawn to recent changes in US law, under the Economic Recovery Tax Act of 1981, improving the share option schemes available there. Companies in the UK should be able to offer similar rewards on terms at least as favourable to ensure that key executives are not lost to overseas competitors.

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1 CBI – October 1983

Capital Taxes

25 Incentive can be inhibited by capital taxes where businessmen, particularly those in the unquoted sector, or non-corporate sector, are involved in family businesses. If taxation bites too hard the incentive to build businesses up and then hand them on is substantially diminished. Indeed, once a private family owned company has grown beyond a size sufficient to provide its owners with an adequate income, further growth generally brings with it unacceptable capital transfer tax liabilities and many businesses are therefore either sold on or artificially held back from further expansion. This is where the tax system affects economic performance

26 Since submission of our full and detailed memorandum to the then Chancellor of the Exchequer in 1979[1] we have continued to draw attention to difficulties in capital gains tax and capital transfer tax.

27 We shall not repeat previous representations here. So far as they have not been implemented they remain on the table. But we would single out certain major points for early action.

28 Capital Gains Tax

- Assets held at April 1982 which have been in continuous ownership for seven years should not be liable to CGT. This will remove from the tax net those assets held over a long time, for non-speculative reasons, which would otherwise carry in their taxable value a large measure of inflationary as opposed to real gain. The indexation rules introduced in 1982 cover only future inflation and make no allowance for past events. Our solution is fair and administratively simple and would cut significantly the cost of applying the tax for both the Revenue and the taxpayer.

- Overhaul of the retirement relief rules.

- Repeal of the rules restricting indexation relief both on losses and on assets held for less than twelve months to remove complexity and to provide more equal treatment for the effects of inflation.

- Action to relieve the double charge to tax on gains where assets are held through companies. Currently there is a charge on disposal of the asset by the company and a second charge on shareholders' disposals of shares, which in turn reflect the net gains on the company's disposals.

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1 CBI, 1979.

29 Capital Transfer Tax

- Improvement of business asset relief by amalgamation of all the existing classes of assets and giving relief at 100 per cent.

- Lifetime rates of CTT should be half those on death throughout the scale.

For both CTT and CGT we would like to explore with government the scope for providing a facility for accumulating annual exemptions either over a limited period or indefinitely.

The disincentive effect of these taxes is in marked contrast with the government's avowed aim of helping smaller businesses as in the business expansion scheme.

Income Tax and the Investment Income Surcharge

30 Our longer term objective remains to reduce the burden of direct taxes. For this year our priority is reduction in business taxation but in Chapter 2 we show how improved competitiveness and sustained growth will provide the scope for cuts in income tax in future years.

31 We are assuming that personal allowances and thresholds will be adjusted in line with inflation.

32 The Investment Income Surcharge is an additional tax applying selectively on certain savings and should be abolished as soon as possible. Its effect on retired businessmen living off the income produced by investment of the proceeds of sale of their businesses is unfair in that they suffer a surcharge on their income whereas those retiring from pensionable employment have their pensions treated as earned income.

Business Expansion Scheme

33 The CBI has welcomed the many initiatives introduced by the Government specifically targeted at encouraging small companies, especially the development of the Business Expansion Scheme. We would like to see this Scheme achieve its full potential in stimulating more equity investment in small firms, but this is still inhibited by:

- the difficulty of spreading risk;
- the uncertainty as to whether an investment will qualify and if so when any tax relief will arise;
- the difficulty of ultimately selling investments.

34 Funds designed along the lines of Small Firms Investment Companies (as proposed in detail in previous CBI representations) could be introduced within the framework of the existing Scheme with appropriate changes in the legislation, and would go a long way to solving these remaining difficulties. They would be simpler to operate than the current Approved Investment Funds and provide a greater incentive to the investor as tax relief would arise sooner and with more certainty.

35 Short of introducing Small Firms Investment Companies, the Business Expansion Scheme can be further improved in two important ways:

- An investor buying shares through an Approved Investment Fund should be able to obtain the tax relief in the year in which he subscribes to the fund even if it is not invested on until the following year. This would allow investors to plan better for their tax liabilities.
- An advance clearing system for investments could be introduced. If the Inland Revenue felt unable to allow formal prior clearance, their Inspectors should at least be encouraged to give a provisional opinion, as some have already been doing.

36 A number of more detailed points on the Scheme have been made in our Technical Representations.

Wider Share Ownership

37 The involvement of the personal sector in business through direct investment in companies has declined sharply in the past twenty years. Attitudes to enterprise would be greatly improved by wider share ownership, particularly by employees.

38 The proposals which we have set out for improving the business expansion scheme, improving capital taxation, abolishing the investment income surcharge and for abolishing stamp duty on equity transactions should contribute to this.

39 In the longer term, however, we envisage the extension of the tax advantages currently available on certain categories of savings to other categories, including savings directly invested in equities. This would encourage a closer identification of taxpayers with the role and functions of business.

Indirect Taxes

40 We remain concerned about a number of areas of VAT. On the domestic front:

- The treatment of pension funds. Pensions represent a cost to business and VAT incurred in the course of provision of pensions should therefore be recoverable just as it is on other business costs.

- Proposed revisions to the rules relating to partial exemption are likely to add to business costs and increase the administrative burden on businesses by drawing many of them into the partial exemption net. We are concerned about the pratical effects of these proposals on business. We have already registered our concern with Ministers.

- The threshold for VAT registration should continue to be moved upwards to help smaller firms and reduce costs. This movement should not however be allowed to prejudice the facility of voluntary registration for VAT.

41 On the European front we remain strongly opposed to the draft 12th VAT Directive the origins of which seem to lie in a disregard of the principle that VAT should not be an impost until transactions reach the stage of the ultimate non-business consumer. We urge government to maintain its opposition to this draft directive.

42 We continue to urge that the differential in the tax on DERV between the UK and other EEC countries should be phased out over time taking account of our motor industry's ability to meet shifts in demand, in order that British business should no longer be at a competitive disadvantage compared with our European partners. Car tax discriminates against a major industry and adds to business costs. There is therefore a strong case for planning to eliminate it.

International Aspects of Business Taxation

Unitary Tax

43 The unitary system of taxation is wholly inapropriate in the international field and damaging to free trade and investment.

44 We have submitted to the US Treasury Working Group a detailed critique of the worldwide combined reporting unitary tax applied by some US States to international companies and we were pleased to liaise with our sister Federations in Europe and elsewhere on this topic. We warmly welcome the Governments own submission against the use of unitary tax.

45 This tax is pernicious and its continued use or worse still its spread would have potentially far reaching consequences on international fiscal stability. Annex III gives the key salient points submitted to the US Working Group.

46 We trust that the Government will directly and via our European and other overseas allies keep up the pressure for suitable changes to the unitary tax rules as they affect our Members' interests.

Controlled Foreign Companies

47 New draft clauses on this topic were issued in October 1983. The case for such sweeping untargetted legislation still has not been made out. We urge that the Government, if it acts at all, should confine itself to specific cases. If legislation broadly on the basis of the draft proposals is introduced significant changes of principle as well as of a technical nature would be essential if the competitiveness of British business is not to be damaged.

48 We shall be making detailed criticisms of the draft proposals separately.

Foreign Currency Losses

49 The lack of tax relief for losses on foreign currency borrowings is an example of an area where UK tax law puts us at a competitive disadvantage compared with our trading rivals.

50 We therefore urge that early action be taken to alleviate this situation, and recognise at the same time that currency gains would fall within the tax net.

ANNEX IV.1

Extract from CBI Submission to the Green Paper on Corporation Tax

Section 7: Stock Relief

10 The possibility should be studied of allowing taxpayers to choose between stock relief and valuing stock on the "last in, first out" basis (7.1)

11 The concept of a credit restriction should be rejected (7.2).

12 In the interest of keeping stock relief simple, multiple indices should not be introduced in place of the present single all stock index (7.3).

13 Clawback should be abolished (7.4).

14 The six-year time limit should be removed (7.5).

15 Some form of relief should be introduced for financial businesses (7.6).

Section 8: Capital Allowances

16 Capital allowances should continue to provide an investment incentive and should not be reduced in value (8.3).

17 The existing system of capital allowances should be improved in preference to being completely changed (8.6).

18 Tax allowances are preferred to investment grants as the means of providing an investment incentive (8.7).

19 The CBI supports non-selectivity of allowances in principle and improvements should be made to the allowances for less-favoured sectors not at the expense of a reduction in the allowances for other sectors (8.8 and 8.11).

20 The present level of first-year allowance for plant and machinery investment should be retained (8.8).

21 Free depreciation should apply to expenditure on plant and machinery after the first year (8.9).

22 100 per cent first-year allowances should be introduced for industrial buildings and free depreciation should apply after the first year so as to obviate the present complex record-keeping (8.9).

23 A two per cent annum allowance for new commercial buildings should be introduced on a straight line writing down basis (8.10).

24 We believe that mining allowances are in need of update and simplification (8.11).

Section 9: Treatment of Interest

25 Interest payments should continue to be treated as an allowable cost for tax purposes.

Section 10: The Schedular System

26 Thought should be given to abolishing the schedular system and basing the assessment of taxable profits on audited accounts.

27 The schedular system should not be allowed to impose unjustified restriction on the way relief is given on losses.

28 The case should be examined for having consolidated tax returns for groups of companies.

Section 11: Disallowed Business Expenses

29 All expenditure deductible in computing commercial profits should be deductible for tax purposes. Instances where the law needs to be amended to give effect to this principle include:

- all incidental costs of raising finance (11.2)
- losses on foreign currency fluctuations (11.2)
- costs of raising share capital (11.2)
- discount and other expenses on acceptance credits (11.2)
- similar expenses on commercial paper (11.2)
- costs of issuing loan stocks, whether or not convertible into equity within three years (11.2)
- expenditure on abortive capital projects (11.3)
- post-trading expenses (11.3)

Section 12: Unutilised Tax Reliefs and Allowances

30 Companies should be enabled to make more immediate use of their reliefs (12.5).

31 Finance leasing should not be discouraged (12.5).

32 Further consideration should be given to allowing tax relief on interest to the lender where the borrower cannot use it and to removing the 1982 restrictions on loans under section 233 of the taxes Act 1970 (12.5).

33 Unutilised reliefs and allowances must not be cancelled or future reliefs time-limited or reduced in value (12.6).

Section 17: Reforms to Advance Corporation Tax (apart from Interaction with Double Taxation Relief)

37 Advance corporation tax to be offset against whole of mainstream tax (17.1(i)).

38 If the previous change is not introduced, the restricted offset of advance corporation tax should be applied to the company's taxable profits as a whole, and not as at present to each source separately (17.1(ii)).

39 Advance corporation tax to be offset against next payment of mainstream tax (17.1(iii)).

40 Carry-back period for advance corporation tax not to be time-limited (17.1(iv)).

41 Advance corporation tax to be deductible from corporation tax on capital gains (17.1(v)).

42 It should be possible to set capital allowances against advance corporation tax (17.2).

Section 18: Double Taxation Relief

43 Keep tax credit system as opposed to exempting foreign income (18.1).

44 Unused double taxation relief to be carried forward or carried back (18.2(i)).

45 Average all foreign tax over all foreign income for purpose of determining rate of foreign tax (18.2(ii)).

46 Double taxation relief to be available despite any timing differences between the two tax systems (18.2(iii)).

Section 19: Advance Corporation Tax and Double Taxation Relief

47 Allow double taxation relief in priority to advance corporation tax (19.2)

48 Allow foreign tax to reduce or extinguish advance corporation tax without a net UK rate restriction (19.2).

49 Foreign tax to be credited against advance corporation tax without reducing aggregate advance corporation tax below what is repaid (19.2(i)).
or
Advance corporation tax to be half present rate (19.2(ii)).
or
Re-adopt net UK rate system (19.2(iii)).

50 Dividends should be franked if they are paid out of current or past profits that have borne full UK tax (19.3).

Section 20: Groups of Companies

51 Group relief to be available for surrender in a later year than that in which the loss etc arises (20.2.(i)).

52 Partial use of group relief in different years to be permitted (20.2(ii)).

53 Surrender of relief other than loss not to be confined to the surplus not usable by the surrendering company (20.2(iii)).

54 Reliefs brought forward to be deducted from current year's income before calculating the amount of charges that can be surrendered to another company (20.2(iv)).

55 Similar changes when a company carries on several trades (20.2(iv)).

56 Surrender of part of a relief to consortium company and part to group company to be permitted (20.3(i)).

57 Surrender should be possible in either direction between a consortium company and group company (20.3(ii)).

Section 21: Capital Gains

58 Group relief for capital gains so that one company's losses can be offset against another's gains (21.1).

59 Double taxation of capital gains to be reduced, where company making capital gains pays dividend, by treating the dividend as a capital receipt or prevented by making the dividend not taxable (21.2).

60 Relief to be allowed on losses on intra-group loans (21.4).

61 Double taxation of capital gains to be prevented by making them not taxable on the company (21.5).

Section 22: Small Companies

62 Reduced rate to apply to first slice of all companies' income (22.1).

63 Small companies' rate and its upper and lower limits to be announced at the start of the year (22.2).

64 Reduced rate relief to be shared between associated companies as they wish (22.3).

65 Companies qualifying under business start-up scheme should not be treated as being associated with other companies for tax purposes so long as restraints on share disposal continue (22.4).

ANNEX IV.2

Extract from Technical Budget Representations 1984

B PRIORITY POINTS

1 Groups of Companies

The CBI is responding separately to the Inland Revenue's consultations on aspects of the taxation of groups of companies.

Nonetheless we consider that action on the points we are raising there is a first priority for 1984 and we are taking this opportunity to emphasise the importance we attach to them.

2 Foreign Currency Losses and Costs of Equity Finance

Our response to the Green Paper on Corporation Tax (CBI -October 1982) drew attention to the continuing anomalies concerning tax disallowed business expenditure or "nothings". We remain most anxious that all legitimate business expenditure should be allowed for tax purposes.

In particular we suggest that priority be given to the provision of tax relief for all losses on foreign currency borrowings.

In addition since the Finance Act 1980 introduced tax relief for the incidental costs of raising loan finance there seems to be no good case to continue to penalise equity finance by disallowing costs relating to raising it. The relevant fees are expenses of the companies concerned whether spent on raising equity or loan finance. In addition the fees are taxed in the hands of the recipients in each case. Encouragement could be given to the raising of equity finance by removing this penalty.

3 Stock Relief - Six Year Cut Off

We have, in previous representations, opposed the six year restriction on the carry forward of unused stock relief contained in Schedule 9 FA 1981. We continue to believe that this limit should be removed.

It is desirable to do this as soon as possible so that businesses can plan ahead successfully without being driven into complicated arrangements to prevent the neutralisation of stock relief brought forward. With the present six year limit and its restrictive rules governing the set off of available reliefs there is the danger that as the six year time bar draws nearer businesses will be forced to make investment decisions, which they otherwise would not, such as postponement of capital investment, to avoid a loss of stock relief.

4 Restrictions on ACT

In our Budget Representations last year we drew attention to some problems emanating from the rules on advance corporation tax as applied in the UK imputation system. We interpret the introduction of Clauses 41 and 42 in the original 1983 Finance Bill, to which we refer in greater detail later in this paper, as recognition of the existence of these problems.

In addition to the important question of double taxation relief to which Clause 42 applies there are restrictions on the utilisation of ACT which affect the timing of other corporation tax reliefs, such as capital allowances, and also the timing and amount of the ACT relief itself. We therefore urge that:

a Capital allowances should be capable of offset against advance corporation tax and not just against mainstream corporation tax.

b ACT payments to government should be set off against the next available mainstream corporation tax liability of the companies making the payments, instead of being deferred as at present.

c The current rule restricting ACT set-off to 30 per cent of income should be removed.

d ACT set-off should cease to be confined to mainstream corporation tax on income and should instead be available to corporation tax on all profits including chargeable gains.

We shall be referring to other ACT problems as they affect groups of companies in our separate submission.

5 Time Limits for Claims

The Taxes Acts at presentcontain no uniform time limits for making claims and seeking reliefs. We recommend that a time limit of six years should be introduced for making claims, seeking reliefs and exercising options. Not only would this ease the compliance burden in general, but it would also be of particular help to the proper running of the tax affairs of groups of companies.

6 Disincorporation

There are instances where it is commercially desirable for companies to be wound up and for their businesses to be continued as sole trades or partnerships. Unnecessary tax hurdles should not be placed in the way of those seeking to make these commercial changes.

We urge that where there are genuine business reasons for disincorporation ways should be examined to remove present fiscal barriers. Particular examples are the clawback of stock relief and the double charge to tax in relation to the capital gains of companies which are disincorporated. It might, for instance, be possible to provide some form of roll-over where a business currently carried on by a company is transferred to a partnership under the same management.

ANNEX IV.3

The Hon Donald T Regan
Secretary of the Treasury
Department of the Treasury
Washington DC
USA

2 December 1983

UNITARY TAXATION

The Confederation of British Industry welcomes the opportunity to express its views to the Working Group on Unitary Taxation. The CBI speaks for British business representing directly or indirectly well over 300,000 businesses and organisations with over 12 million employees. We have consistently opposed the application of worldwide unitary tax.

We are sending you a further paper which sets out detailed reasons why we so strongly oppose this system but endorse the separate accounting system based on the arm's length principle. Our paper also brings together previous evidence we have given in the United States on this issue. In this letter we summarise the main grounds for our opposition and the increasing concerns of British business.

Grounds for Opposition

1 Apportionment by factors of worldwide group profits is bound to produce an arbitrary and unfair result in an economically non-homogeneous world.

2 It will overallocate profit (or loss) to those jurisdictions with higher payroll, property and sales values.

3 Anomalous effects include conversion of a direct accounting loss into a unitary basis profit, apportionment of more than 100 per cent of the total world profits and unrelievable international double taxation.

4 The well tried domestically and internationally accepted arm's length basis produces a better evaluation of the true taxable profit (or loss) arising in a jurisdiction.

5 Uncertainty is so great as to undermine business confidence in investment.

6 Damage to free world trade could result from a worldwide tax war following emulation by other countries using factors modified to suit themselves.

7 Retaliation by trading partners among developed countries trying to protect their revenues would be even more damaging.

8 Compliance costs are very onerous and are bound to become increasingly so if more jurisdictions adopting the system require adjustments to local accounting, currency and tax rules and translation into local language.

Increasing Concerns

1 From a survey of our Members we learn that more State fiscal authorities are treating more UK headquartered groups of companies as single entities after demanding much information but paying little apparent regard to it. Several Members are still disputing the issue.

2 Instances have been brought to our attention of significant distortion of financial results in the USA even extending to the conversion of losses into profits.

3 Many businesses have not yet resolved their position and are still weighing up the potential tax and compliance costs. Compliance costs imposed on companies may well be out of all proportion to yield and there is therefore some inclination at present to settle.

4 Very strong unease remains as to what the future holds and British business is looking closely at operations in any State using or threatening a unitary system.

5 Some British businesses with operations in the USA have expressed considerable concern and disappointment about the lack of remedial action following the entry into force of the 1980 US/UK Double Tax Treaty. You will be aware that a number of Members of Parliament earlier this year sought to deny the refund of tax credit to companies headquartered, inter alia, in US States operating a unitary system.

6 Discussions with sister federations in Europe and elsewhere revealed similar awareness and concern about unitary tax, and its impact on and the future development of the international financial and commercial climate.

In the light of the fundamental importance of this matter both now and over the longer term we sincerely hope that our comments will be of assistance to you and your colleagues in successfully dealing with the situation and preventing the damage which could flow from the spread of this pernicious practice.

We would of course be pleased to try to assist you further, now or later in your deliberations, amplifying if necessary what has been said, in writing or orally, should your Group so wish.

DRAFT 6.1.84

Chapter V

Government Expenditure

1 CBI policy on government expenditure was set out in the paper submitted to the Chief Secretary to the Treasury[1] in July. Briefly, our priorities are:

i to reduce the public sector's share of GDP and enable the Government to finance tax cuts and reduce interest rates.

ii a shift within the total, away from current to capital expenditure.

iii greater efficiency in the public sector. The private sector has borne the brunt of the recession with significant cuts in manpower and substantial improvements in productivity; the public sector too must play its role.

2 The Autumn Statement held total expenditure to the total contained in the public expenditure White Paper of £126.4 billion in 1984/5 and the Chancellor has said it will be held in cost terms in later years. We welcome this.

3 Our proposals on government expenditure involve changes in the pattern of spending but no net increase in planned totals. We would like to see an increase in public sector capital expenditure and specific proposals will be set out in a study by the Federation of Civil Engineering Contractors and the CBI, in conjunction with other interested bodies. We also suggest increased expenditure on Special Employment Measures and measures to reduce energy costs to be financed by savings in expenditure elsewhere or from the Contingency Reserve.

The Case for Extra Capital Expenditure

4 The CBI has consistently argued for increased public sector investment financed by a reduction in government current expenditure.

5 We do not suggest that all capital spending is good and all current expenditure bad. Certain areas of current expenditure contribute to economic prosperity and future economic development, but we believe that there remains considerable scope for improved efficiency in the provision of services and that many services would be better performed by the private sector. We do not advocate capital expenditure for its own sake but because we believe that increased investment particularly in the infrastructure, would yield economic and social benefits, such as lower unemployment, reduced business costs and an improved environment.

6 We do not accept that it is simply the behaviour of total investment which is crucial. There are areas where private sector investment can, to a large extent, replace public sector investment - housing is an obvious example - but there are other areas - such as roads and sewers - where this is not the case. The reason is that a large proportion of the return to

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1 'Public Expenditure. Submission to Government', July 1983.

investment in these areas is social and does not accrue to those who provide the finance. The public sector still has a major role to play in investment and our study will identify specific capital expenditure projects which ought to be included in a longer term programme of public sector investment in the infrastructure.

7 Despite its importance, public sector investment has dropped dramatically both in absolute terms and as a proportion of total public expenditure. The fall has been particularly marked in general government capital spending. The result has been a deterioration in the infrastructure which is adding to business costs just when efforts are needed to improve our competitiveness.

Chart V.1

8 The Chancellor has argued recently that public sector investment has not fallen in real terms since 1978/79 once account is taken of capital expenditure in the area of defence and special sales of assets such as council houses.

9 We recognise that, by international convention, most defence expenditure is classed as current expenditure even when it is of a capital nature, and that defence spending has beneficial effects on employment. However, capital spending in the area of defence does little to improve the infrastructure and reduce business costs.

10 Sales of public sector assets have artificially depressed the investment figures for recent years, but even when the proceeds from these are allowed for government investment was still around 20 per cent lower in 1982 than in 1979. There is an urgent need to clarify statistics on public sector investment and we therefore welcome the Chancellor's announcement to Parliament that he hopes to improve the manner in which these matters are presented in the next White Paper to bring definitions closer to those used in business.

11 The CBI believes that public investment has been sacrificed as current spending and transfer payments have risen. It is easy to cut something the results of which will not be felt until the future; but this is a short sighted policy. A company adopting such an approach would soon go out of business.

12 In recent Representations we have asked for specific measures to remove administrative constraints on capital spending and are pleased to note that many of these have now been accepted, and that the problem of underspending has become much less important in the last year. We particularly welcome the introduction of end year flexibility for capital expenditure by both central and local government. We also welcome the extension of the arrangements introduced in the 1983 Budget to give local authorities assurances about their allocations for capital spending in future years.

13 There are three other specific areas of Government spending where changes are needed.

Innovation Support

14 The Government recognised the importance of support for innovation in the 1983 Budget by allocating an extra £85m over three years to cover extension of the existing schemes to the later stages of innovation. It also announced that existing resources would allow the grant rate to be maintained at the $33^1/3$ per cent rate for a further year and later, that it was ready to contribute up to £200m over five years to the "Alvey" programme in advanced information technology, in which the grant rate will be 50 per cent.

15 All these decisions were in accordance with CBI recommendations. But delays in obtaining EEC clearance for the £40m scheme of support for the later stages of innovation and setting up the proposed Marketing Advisory Scheme, mean that only a small proportion of the extra £85m will have been spent. Nor will the Alvey programme have as yet made many calls on expenditure during 1983/84. The schemes are important to the future of British industry but are demand-led. In the CBI's view the difference between 25 per cent and $33^1/3$ per cent is significant in determining the take-up of grants.

16 We therefore recommend for 1984 that:

- existing planned spending be at least maintained and if necessary increased in line with demand.
- the grant level be maintained at $33^1/3$ per cent for 1984-5, and
- the Alvey programme be regarded as a separate funding exercise additional to the general 'Support for Innovation' programme.

Energy Costs

17 The CBI and sectoral organisations have continued the campaign for the achievement and maintenance of competitive energy prices. We acknowledge that in certain respects over the last year to 18 months the UK's position has improved relative to the continent. Gas prices are now broadly competitive, as are electricity prices for general industrial users. However, we remain concerned at the level of electricity prices for intensive users who, despite the revised load management terms introduced over the last two years, still face a major price disadvantage compared with their continential competitors. UK prices for heavy fuel oil remain higher than those in the other major EEC countries, mainly because of the higher rate of duty levied in the UK. We have advocated for some time that the duty should be lowered or preferably abolished but have been informed that because of a contractual link with certain Norwegian gas supplies, the overall cost to the Exchequer would be disproportionately high compared with the cost benefit to industry.

18 We therefore recommend that:

- further relief should be provided for intensive electricity users
- the implications of lowering the fuel oil duty be re-examined and at the very least the duty remain at its present level.

We believe an allocation of £200m would be appropriate in 1984/5.

19 The CBI welcomed the Government's renewed drive for increased efficiency in energy use heralded by the formation of the Energy Efficiency Office and will be co-operating in the nationwide campaign to improve energy awareness. CBI also welcomed the extention of the Coal Firing Scheme announced at the end of 1983. However, industry still suffers from lack of funds inhibiting investment in energy saving equipment which would not only be to industry's advantage but to the national good as well. We therefore recommend that further consideration be given to additional financial assistance to encourage selected energy efficiency investment and the accelerated replication of new or novel technologies.

Special Employment Measures

20 Our proposals set out in Chapters 1-3 should, by helping to sustain a non-inflationary growth rate, result in a fall in unemployment in the medium term. However, additional measures are needed to create more job opportunities in the short-run. We therefore propose certain measures costing about £100m in 1984/5:

i the age threshold for men entering the Job Release Scheme should be lowered to 59, not raised to 64 from April 1984 as the Government proposes.

ii the age threshold for the Part-time Job Release Scheme should be lowered to 58 for both men and women and that employers should be entitled to a grant of £750 as under the Job-Splitting Scheme.

iii the Job-Splitting Scheme should be extended to cover newly created jobs, perhaps with some safeguards to show that they are jobs which would otherwise have been full-time. We believe the incremental cost of this would be negligible.

iv the Community Programme Scheme be amended to allow greater private sector involvement in both the sponsorship and management of the Scheme and to provide funding for more ambitious projects than can currently be undertaken.

Controlling Government Expenditure

21 In order to provide the resources to cover these additional costs, continued control of government spending at central and local level is crucial. This Section summarises and where necessary updates the proposal made in our recent submission to the Chief Secretary.

i Efficiency and Manpower

22 The CBI has welcomed steps taken in recent years to improve the efficiency of central and local government, such as the establishment of an Audit Commission for local authorities and the management changes proposed for the National Health Service in the Griffiths Report. The CBI has also welcomed the extension of the Management Information System for Ministers in the Civil Service.

23 The drive towards increased efficiency in the public sector must continue as a way of reducing the cost of providing existing levels of services. The CBI advocates the preparation of corporate plans for individual departments to clarify their objectives, and measures to follow up more aggressively the Rayner exercises. More attention must be paid to the effectiveness with which services are provided, and we urge departments to construct and publish performance indicators wherever appropriate to assist the management process.

24 It is essential to expose central and local government to the disciplines of market forces. We therefore welcome the Government's commitment to privatisation of certain public sector services, and to the further use of contracting out of both central and local government services and in the NHS. The existing legislation in respect of direct labour organisations in local government provides a model which can be built upon.

25 We have recommended an extension of the legislation to include, within local government, in the first instance, catering, refuse collection, cleaning and park services. The Government should introduce similar legislation to oblige competitive tendering for the provision of central government services where this is appropriate.

26 Increased charges and wider use of user-charging in certain areas, particularly local government, could help to reduce waste and to raise revenue.

27 We support the proposed legislation to restrain local authority rates and welcome the decision to abolish the Greater London Council and other metropolitan authorities in view of the savings that will ensue.

28 The CBI still believes there is scope for further cuts in public sector manpower which are consistent with maintaining the existing level of services and has on previous occasions put forward targets for manpower savings. We welcome the reductions in Civil Service manpower announced by the Chief Secretary in November and realise that steady progress has been made in this area. However, progress made by local authorities in reducing their manpower, the major component of public sector employment, has been very slow, and employment in the NHS has grown faster than planned.

29 Continued efforts are needed to achieve manpower reductions in local authorities and in the health service. We welcome the establishment of manpower targets for each regional health authority and the early introduction of performance indicators. We would urge local authorities to exercise more control over their manpower levels, perhaps by the introduction of cash limits for wages and salaries.

ii <u>Public Sector Pay</u>

30 The CBI has welcomed the fall in pay settlements in the public sector. Chart V.2 shows that settlements in the public services are now running at a level lower than those in private services and manufacturing. However, this came after a number of years when public sector settlements were higher than those in the private sector. The Government cannot afford to relax its vigilance.

Chart V.2

31 It is well understood that pay settlements in the public services not only affect the costs of provision, and therefore the private sector' competitiveness, but can also influence settlements elsewhere in the economy.The private sector is continuing to make great efforts to reduce the level of settlements and it is important that the public sector does the same.

We urge the Government to adhere firmly to its 3½ per cent guideline for public sector pay increases.

iii Pensions

32 The CBI has advocated as an eventual objective the abolition of inflation proof pensions in the public sector and has recommended that, in the interim, all public sector pension contributions be increased to the notional 8.5 per cent paid by the civil service. We welcomed increased contribution rates for the police force and the fire service, and recommend that similar action is taken in respect of other local authority workers, teachers and employees in the NHS.

Draft 6.1.84

Chapter VI

Local Authority Finance

1 In the current year, total gross spending by local authorities in England and Wales will be about £35 billion which is equivalent to about 14 per cent of GDP and between a quarter and a third of all public expenditure. It is therefore a significant proportion of total public spending and it is necessary for the Government to constrain it if total public expenditure is to be reduced.

Local Authority Expenditure

2 The Government has been attempting to reduce the real level of local authority current expenditure but with only limited success. Since the reorganisation of local government in 1974, total expenditure by local authorities has fallen by 16 per cent yet this has been achieved entirely by squeezing capital expenditure which is today only two-fifths of the level that it was in real terms in 1974/75. Current expenditure has not fallen at all.

Chart VI.1

3 Local authority gross current expenditure in England and Wales has risen in real terms between 1981/82 and 1983/84, despite a reduction in manpower on a full time equivalent basis of around 25,000 over the same period. And the latest manpower figures suggest that the downward trend of the last four years is in danger of being reversed.

4 The Government's objectives of seeking to improve value for money in local government is to be commended. Most authorities have made real efforts to achieve this, yet analysis of comparative performance indicators suggests that there is scope for further improvements in even the most efficient authorities. The Audit Commission has estimated that there are savings of £1-2bn which can be achieved by increased efficiency and effectiveness in the provision of services by local authorities in England and Wales.

5 The CBI strongly supports the efforts of the Government to encourage increased efficiency by local authorities through:

- expenditure guidelines or targets for local authorities.

- the allocation of rate support grant.

- the grant penalty system.

- the establishment of the Audit Commission for England and Wales.

- the direct labour organisation regulations.

- the general encouragement of contracting out.

- the proposals for limiting the rates of the highest spending authorities.

- the abolition of the metropolitan county councils and the GLC.

6 The CBI itself, at a series of meetings it has held with larger councils up and down the country, has urged local authorities to make every effort to provide improved value for money and most councils are striving to do just this. An irresponsible small minority do however appear determined to follow high-spending policies despite the adverse consequences high rates have on the ability and confidence of businesses to invest, expand, develop new products and services, and create or maintain employment.

Rate Limitation

7 In the absence of acceptable proposals to obtain restraint on rates achieved by increased accountability at the local level, we support the Government proposals for selective rate limitations which will only affect a tiny minority of authorities. We also favour reserve powers, which we hope would never have to be used, to impose general rate limitations. The argument that the selective rate limitation scheme represents a fundamental attack on the democratic rights of local authorities is questioned by the business community which provides councils with nearly half of their rate income with no accountability whatsoever.

Rate Reform

8 Over the last 4 years, the rates paid by business have risen by one and a half times the rate of inflation. In 1983/84 business will be paying not far short of £6 bn in rates. Rates are now the biggest tax burden on business excluding national insurance contributions. The White Paper "Rates: Proposals for Rate Limitation and Reform of the Rating System" (Cmnd 9008) and the Rates Bill currently before Parliament give evidence of Government recognition that action is needed to safeguard the business ratepayer in order to protect investment and jobs. However, we feel more action is needed than that proposed in the three areas of:

- partial business derating

- empty property rate

- rate relief for partially unutilised premises and plant

Chart VI.2

10 per cent Partial Business Derating

9 Our first recommendation is that 10 per cent partial business derating should be introduced in England and Wales in the rate year 1984/5. This is justified on grounds on reducing businss costs, improving competitiveness and restoring equity between the sectors. From 1929 up to 1963 industry benefited from partial derating; the CBI believes that, once again, industrial concerns have a particularly strong case for relief, but that it should be granted to the whole business sector to improve competitiveness. Where companies are seeing some sign of recovery, lower rate bills would give business more funds to invest for the future; and those companies whose existence is threatened would be helped to survive.

10 We also argue for the introduction of partial business derating on grounds of fairness. This measure would remove the inequity of the present rating system which results in domestic ratepayers in England and Wales being subsidised by the domestic rate relief of 18.5p per £ of rateable value. Business is also dealt with harshly compared with agriculture which is derated, yet the arguments for business being treated similarly are certainly as strong.

11 For the same reasons, we recommend business derating of 2 per cent in Scotland to bring business into line with the domestic sector which there enjoys relief of 3p per £ of rateable value. (Industry in Scotland is already derated by 50 per cent but this is in order to make rate payments on industrial property roughly equivalent between England and Scotland, and is not relevant to the present discussion).

12 Primary legislation would be needed to implement the measure. We propose that the Government should take steps at once to draft the necessary Bill and introduce it in time for it to be enacted by the end of July 1984. We recognise that this would put some pressure on the Parliamentary timetable but the enabling Bill could be relatively short. As the partial derating would apply to the rating year 1984/5 it would be necessary for rating authorities to reduce from September or October the monthly payment of rates where this was being done by instalment. Where six-monthly payments were made, a similar amendment would be needed for the second payment. Only in the case of those relatively few businesses who pay their total rates at the beginning of the rate year would refunds be necessary.

13 We estimate the cost of implementation at £600 million at 1984/85 prices. In the first year it should be paid for by the Government through an increase in the Rate Support Grant, but over a period of 3 or 4 years this would be phased out as local authorities improved their efficiency. In this context it is worth noting the point already made that the Audit Commission believes that between £1 and £2 billion per annum can be saved by local authorities in England and Wales alone, through increased efficiency and effectiveness in their spending.

Empty Property Rate

14 In the White Paper, the Government proposes the abolition of the rating of empty industrial premises. We welcome this proposal but believe that it should apply to all empty business properties. In principle rates are a tax on beneficial occupation and should not be levied on empty premises. At a time of recession the rating of empty commercial property, even at 50 per cent of the full rate, causes financial problems for many businesses. We feel it is unjust to penalise owners of empty property who have tried to let or sell but have been unable to do so because of the recession. We estimate that the additional cost of this proposal would be around £30-35 million at 1984/85 prices, and recommend that it should be implemented in 1984/85 by amendment to the relevant statutory instrument.

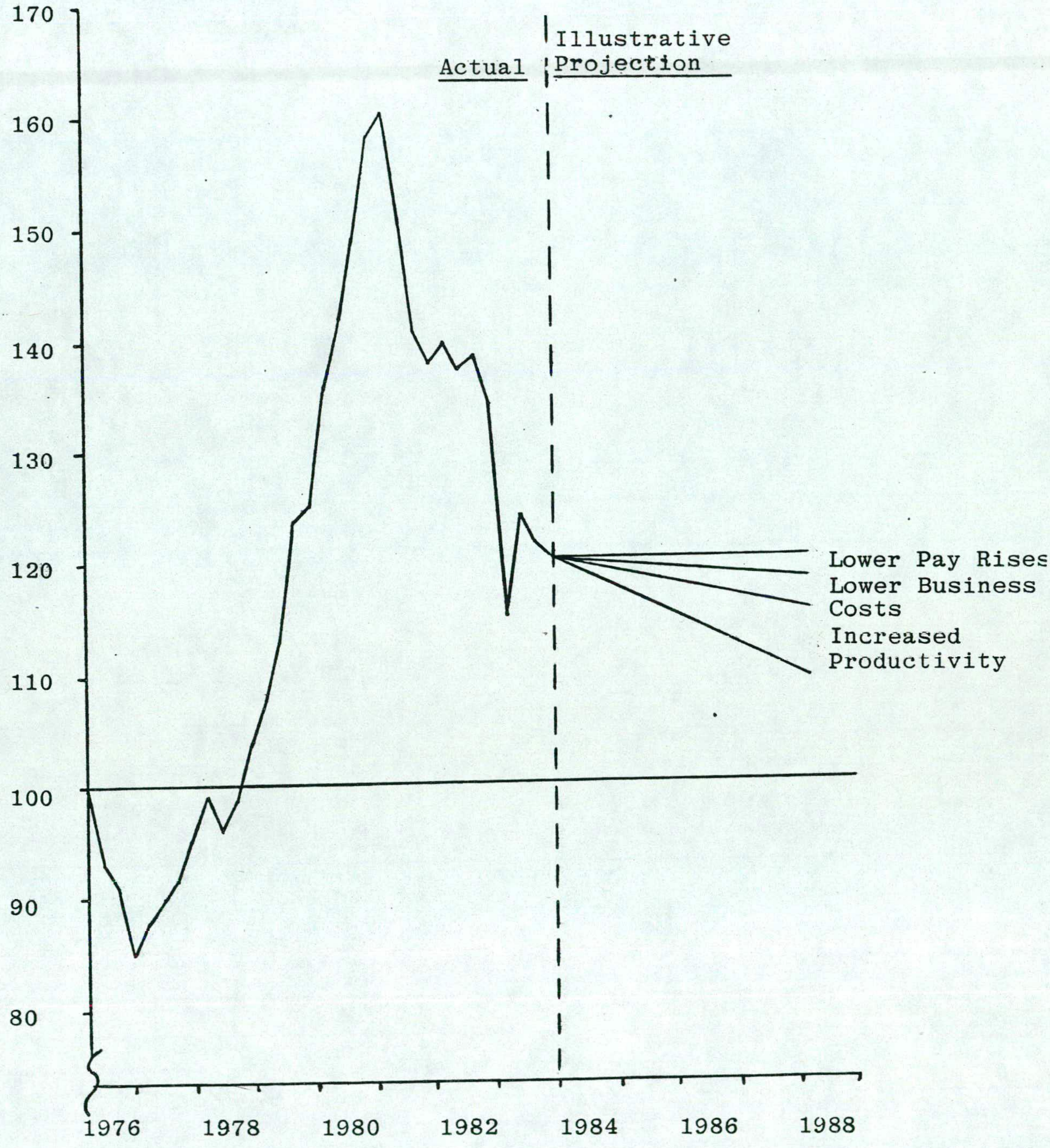
Rate Relief for Partially Unutilised Premises and Plant

15 In addition we advocate the introduction of "mothballing" rate relief for unutilised parts of premises and plant in order to alleviate the burden where these have been taken out of use but are being maintained with a view to eventual re-employment when economic circumstances allow. Legislation is needed but the measure should be effective in 1985/6.

CHARTS FOR BUDGET REPRESENTATIONS 1984

CHART II.1

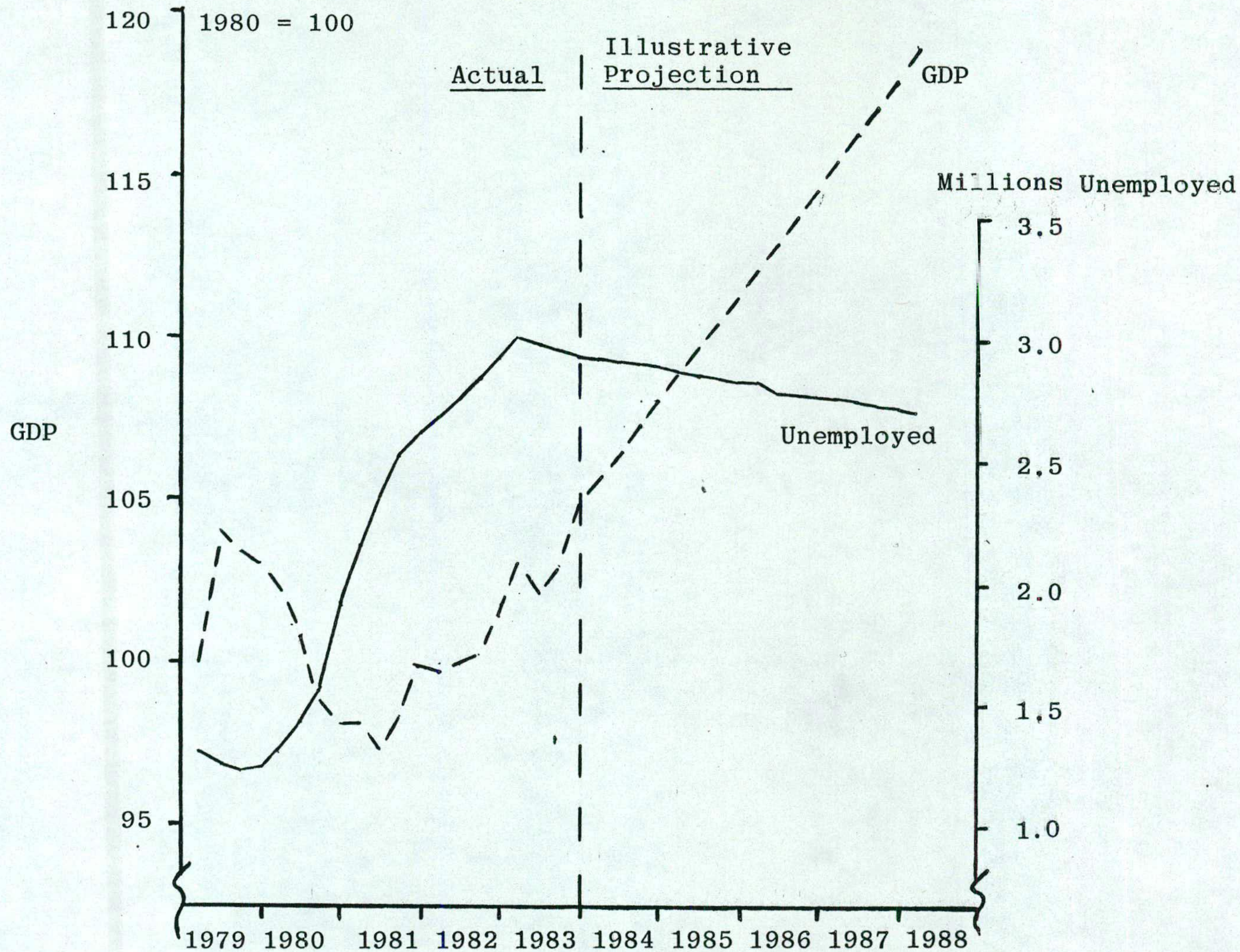
UK RELATIVE UNIT LABOUR COSTS IN MANUFACTURING 1975=100



Source : CBI estimates and illustrative projections.

CHART II.2

CBI PROGRAMME FOR GROWTH[1] AND UNEMPLOYMENT[2]



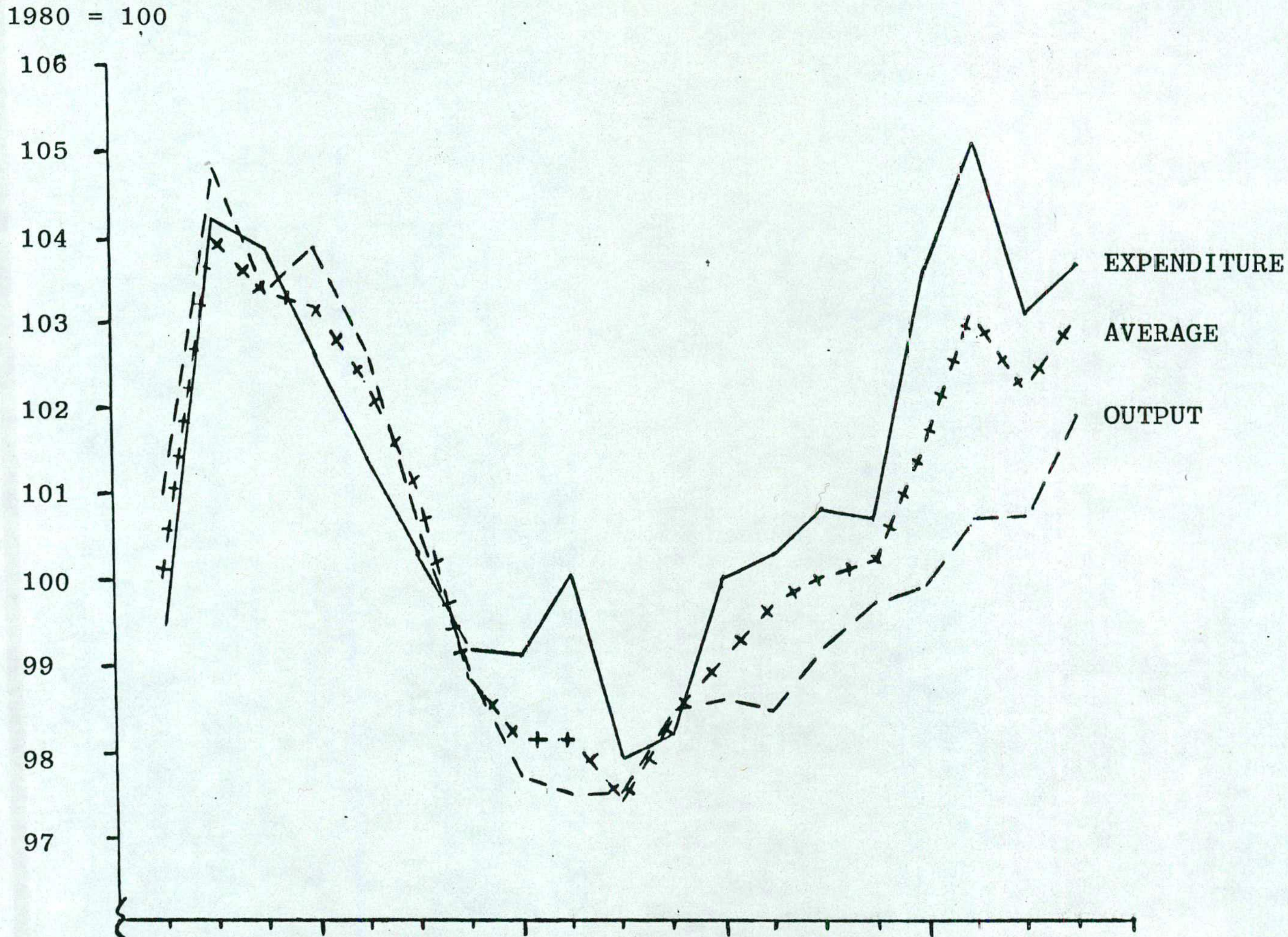
1. GDP average estimate

2. Excludes school leavers

Source GDP - CSO; CBI estimates and illustrative projections.
Unemployment - Department of Employment; CBI estimates and illustrative projections.

CHART III.1

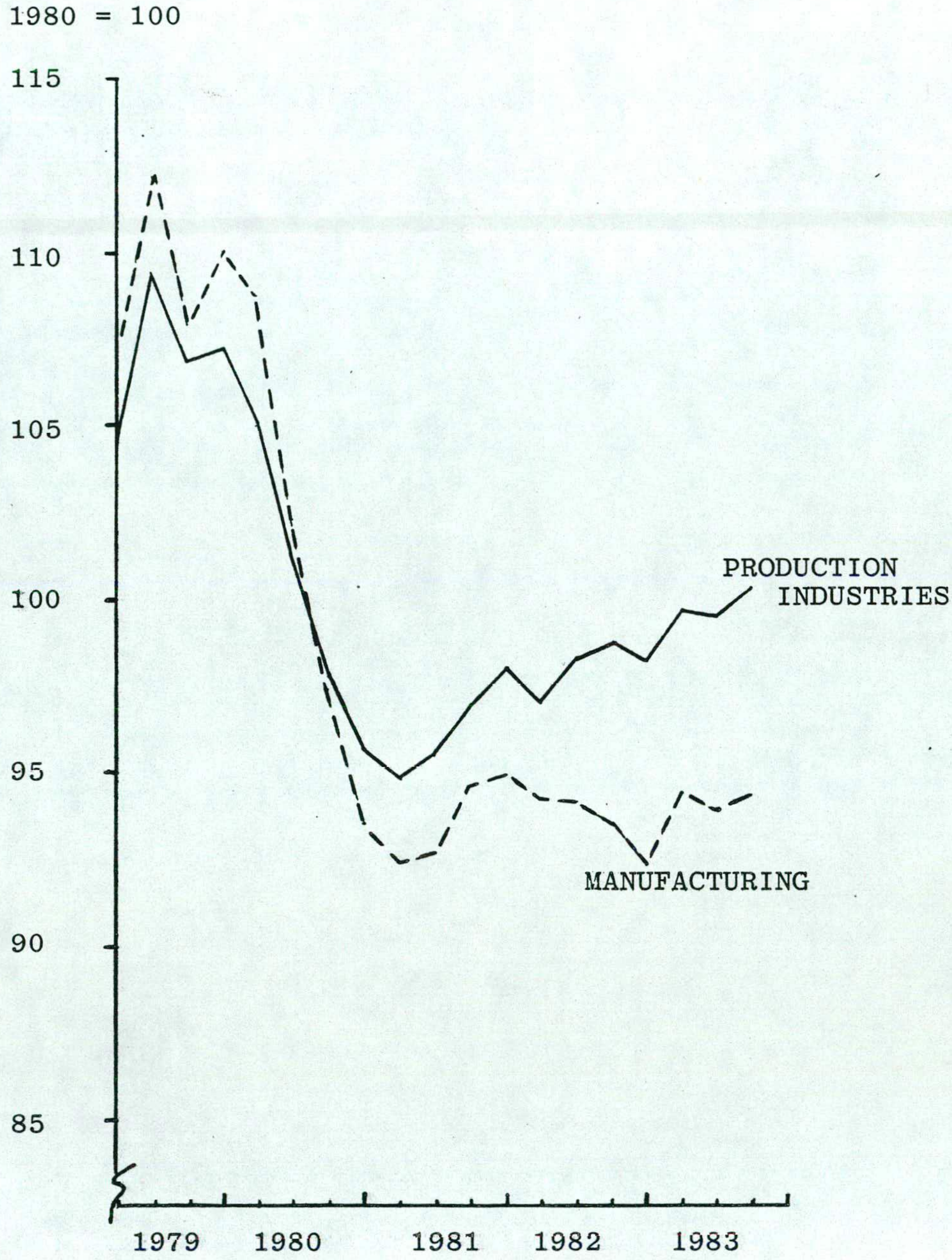
MEASURES OF REAL GDP



Source : CSO

CHART III.2

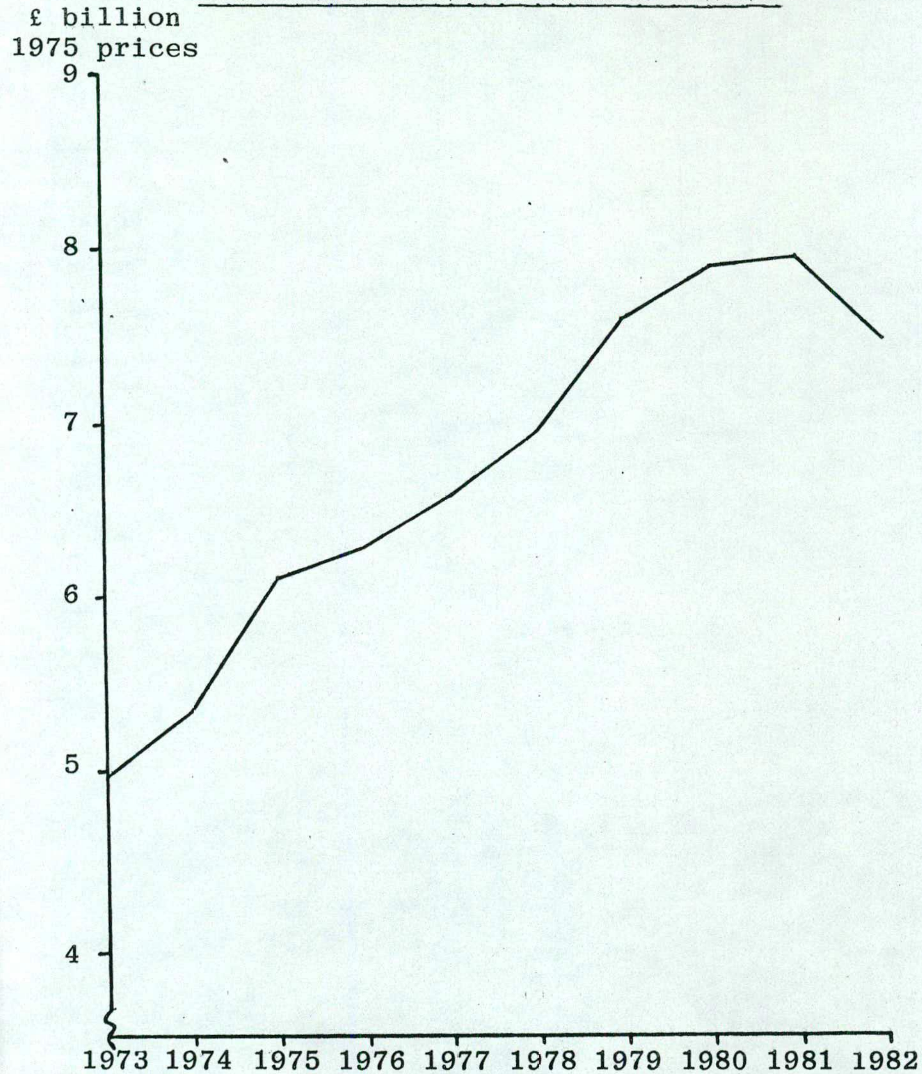
OUTPUT OF PRODUCTION INDUSTRIES AND MANUFACTURING



Source : CSO

CHART III.3

GOVERNMENT IMPOSED BUSINESS COSTS[1]

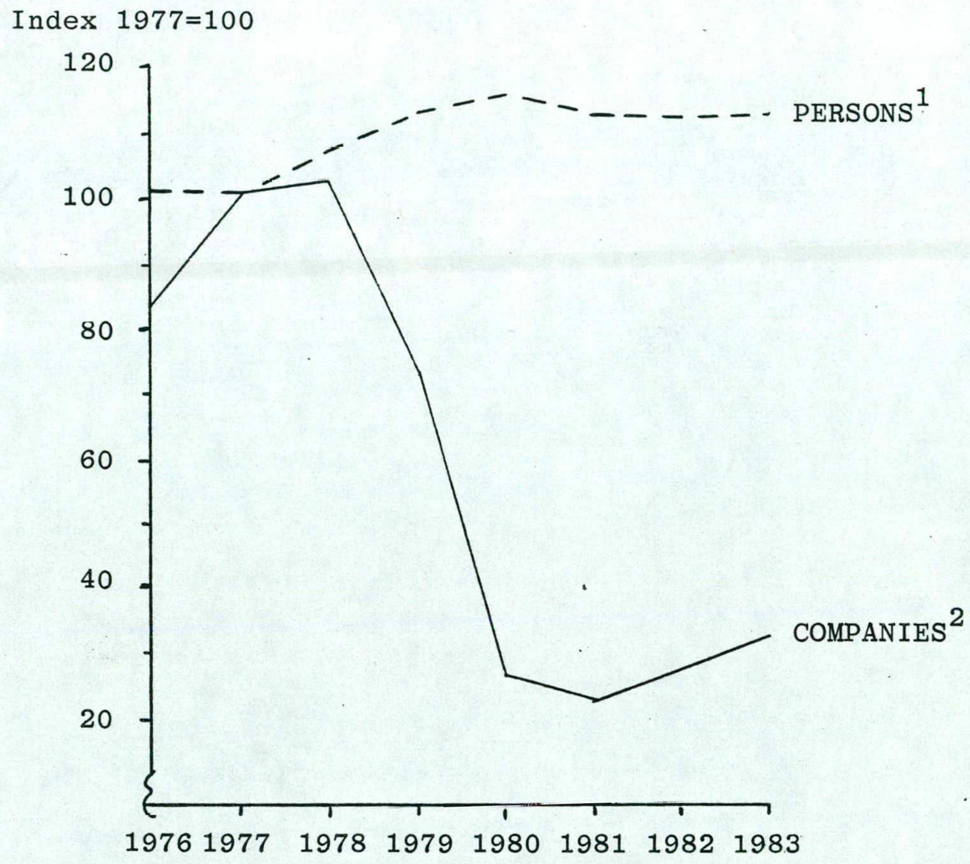


1 National Insurance Surcharge, Employer's National Insurance Contributions and Business Rates. Figures deflated by Wholesale Output Prices.

Source : NIS and NIC's - National Income and Expenditure 1983
Business Rates - For GB only. Based on Annual Abstract of Statistics and Scottish Annual Abstract figures.

CHART III.4

PERSONS' AND COMPANIES' REAL INCOME



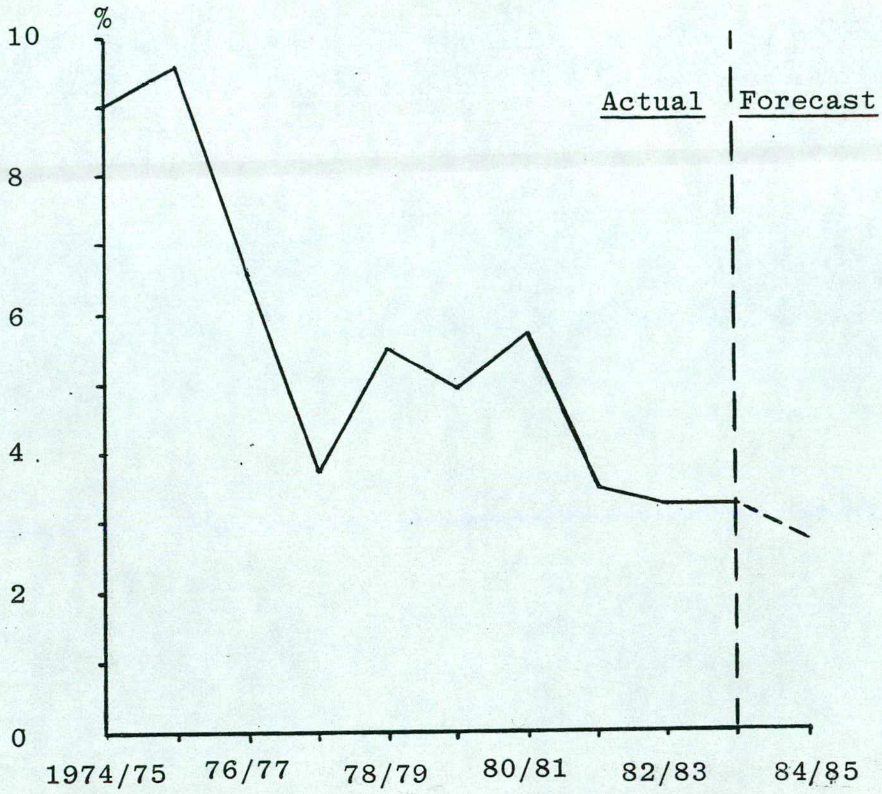
1 Real personal disposable income

2 Industrial and commercial companies' undistributed income plus dividends on ordinary shares after providing for depreciation, stock appreciation and additions to tax reserves. Deflated by Total Final Expenditure Deflator.

Sources: CSO and CBI estimates.

CHART III.5

PSBR AS A PERCENTAGE OF GDP[1]

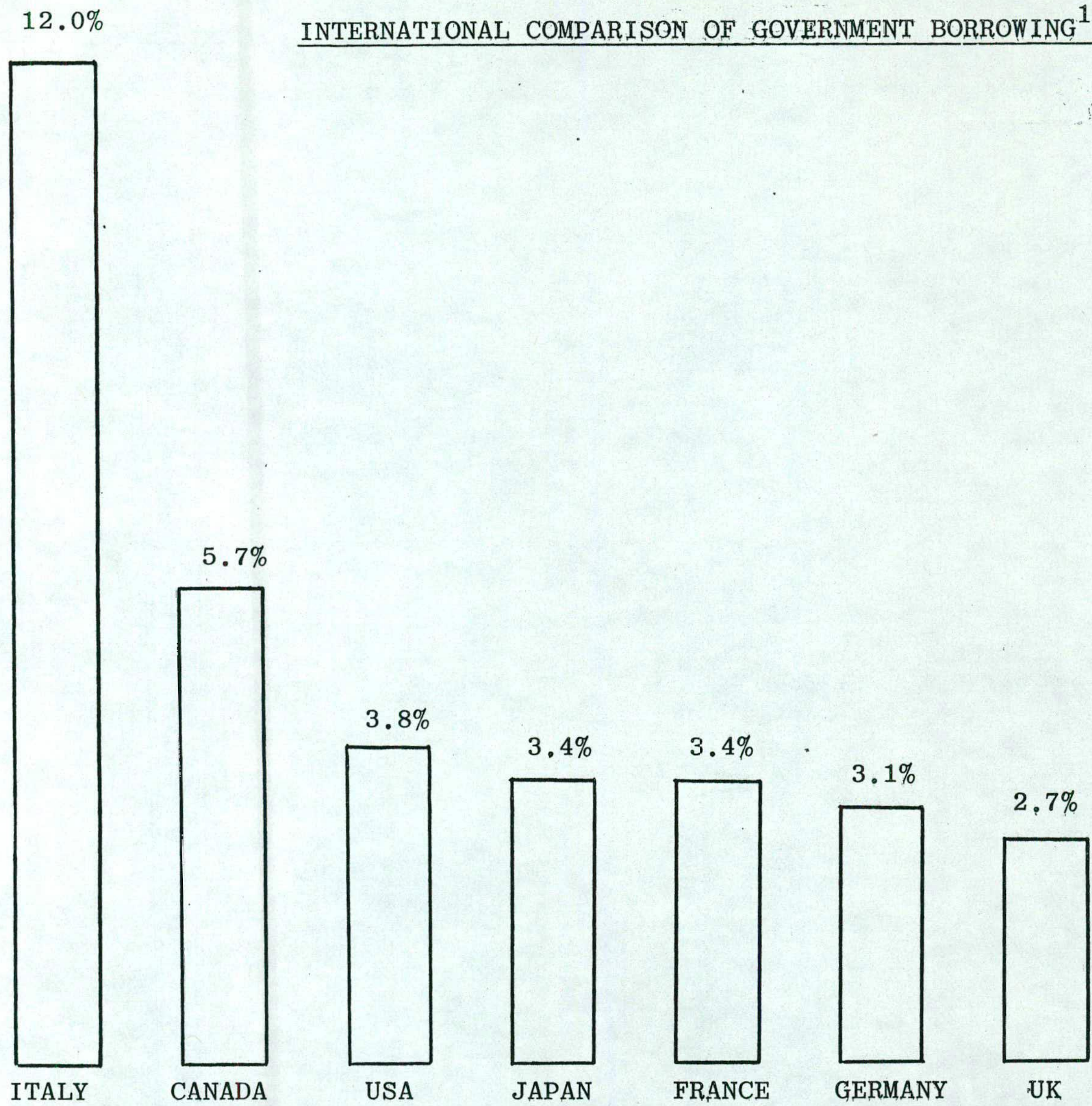


1 PSBR as percentage of GDP at market prices

<u>Sources</u> : 1974/75 to 1982/83, Financial Statistics and CSO; 1983/84 CBI estimate based on PSBR forecast contained in the Autumn Statement; 1984/85 CBI forecasts assuming implementation of CBI proposals.

CHART III.6

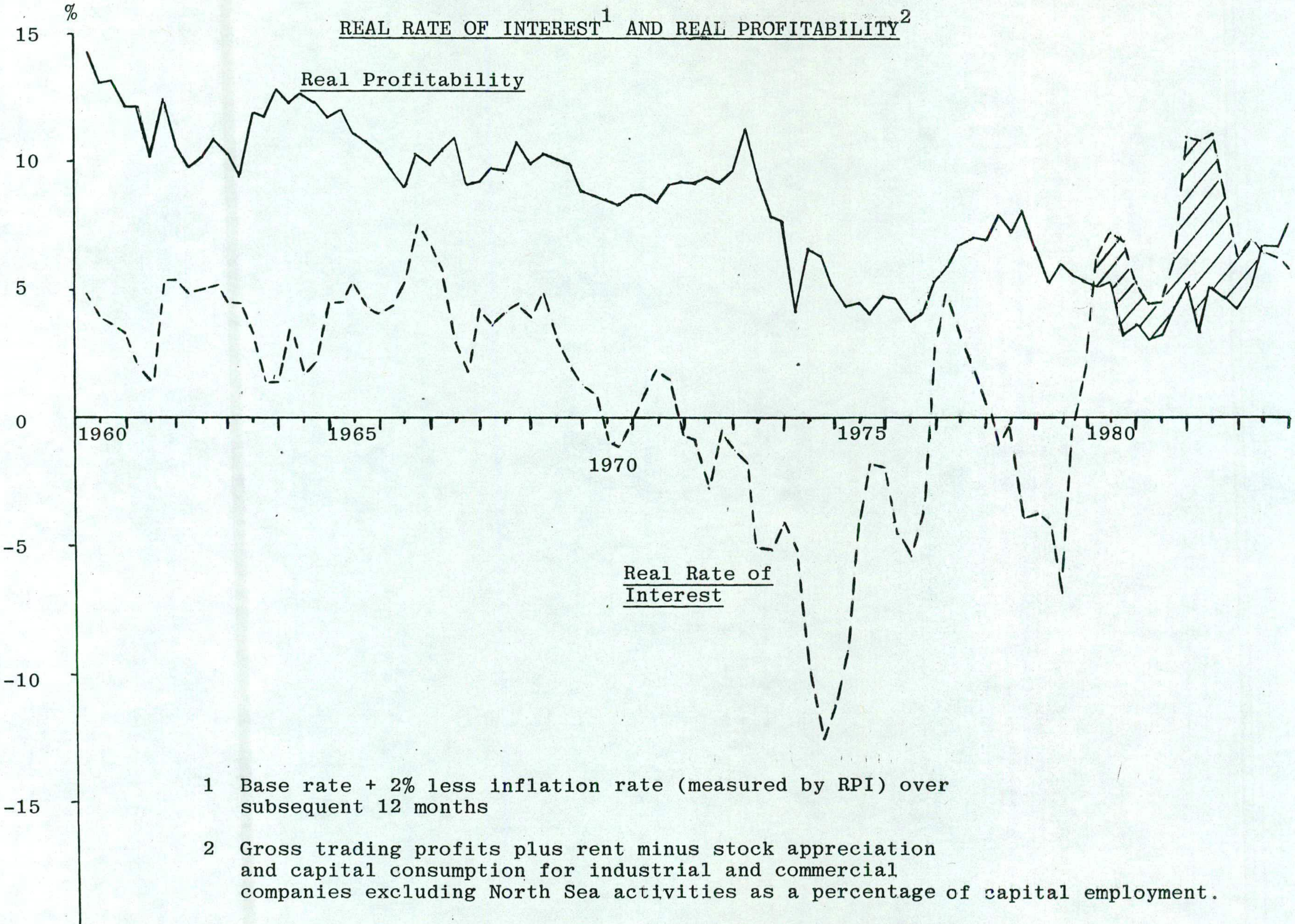
INTERNATIONAL COMPARISON OF GOVERNMENT BORROWING[1] IN 1983



1. General Government Deficit as a percentage of GDP/GNP at market prices. These figures refer to a somewhat narrower concept of public borrowing than our PSBR, but are on a comparable basis, and indeed they are more meaningful than would be a comparison of PSBR's, partly because of the differing degree of nationalisation in the various countries.
Source : OECD estimates, Economic Outlook, December 1983.

CHART III.7

REAL RATE OF INTEREST[1] AND REAL PROFITABILITY[2]



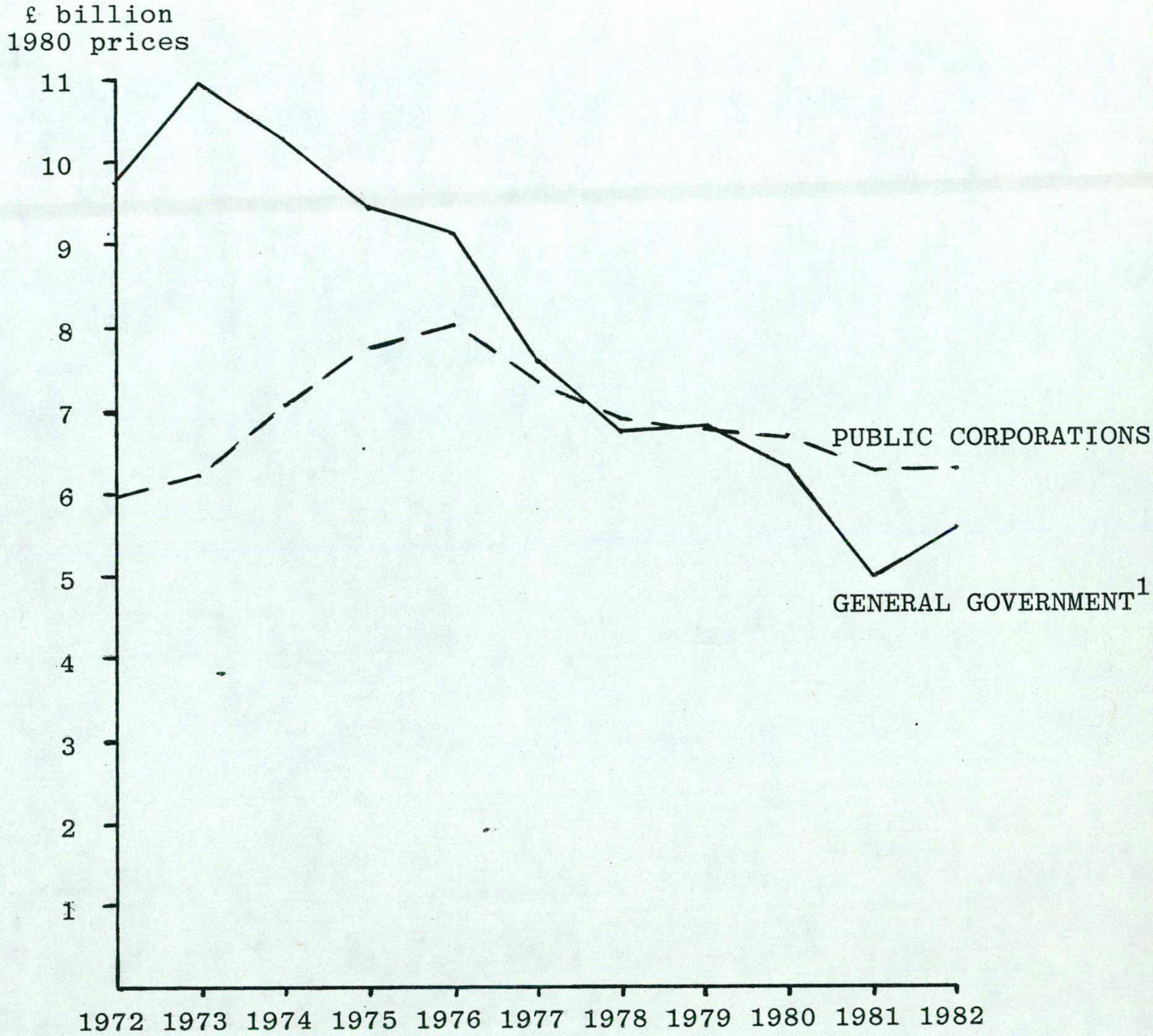
1 Base rate + 2% less inflation rate (measured by RPI) over subsequent 12 months

2 Gross trading profits plus rent minus stock appreciation and capital consumption for industrial and commercial companies excluding North Sea activities as a percentage of capital employment.

Source : CBI estimates based on Bank of England and CSO data.

CHART V.1

PUBLIC SECTOR INVESTMENT

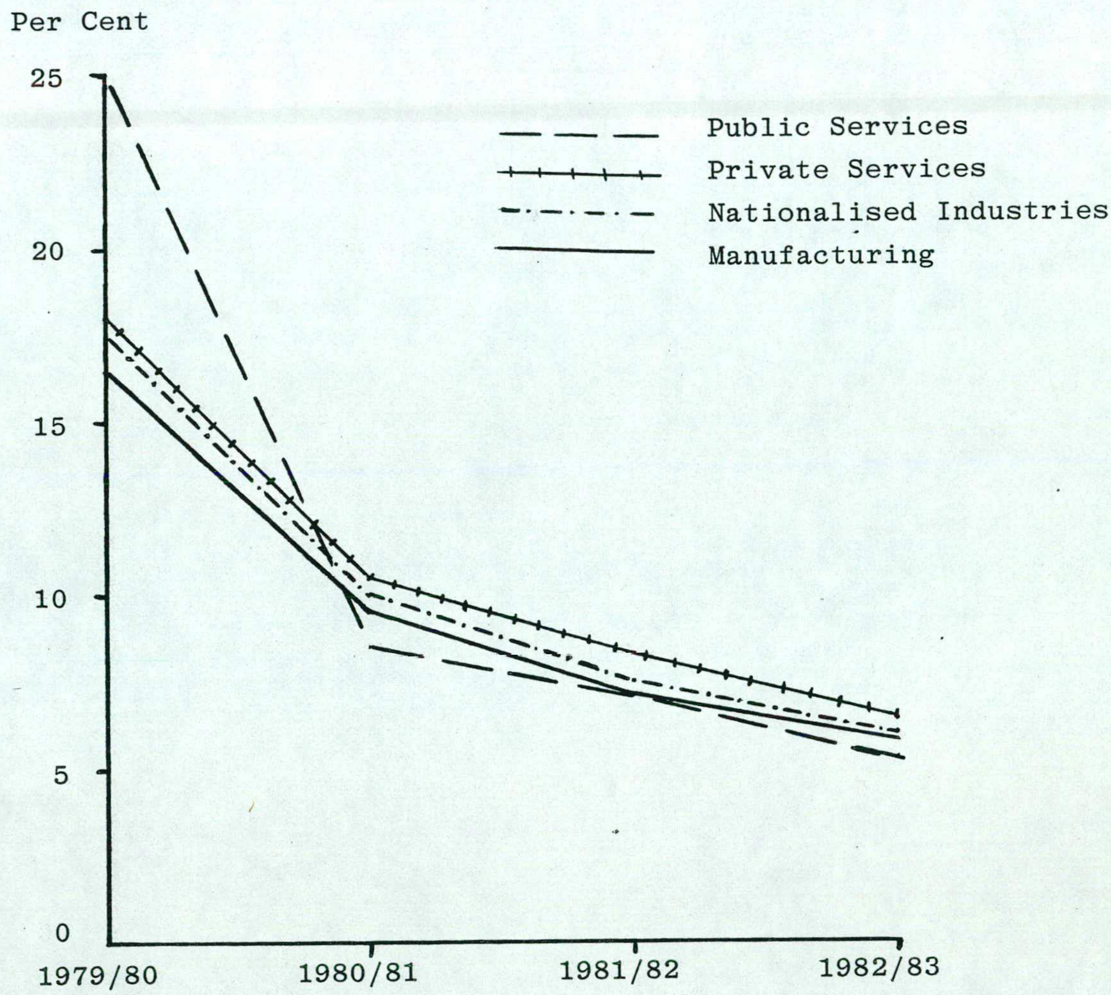


Source : National Income and Expenditure 1983

1 Figures adjusted for sales of council houses.

CHART V.2

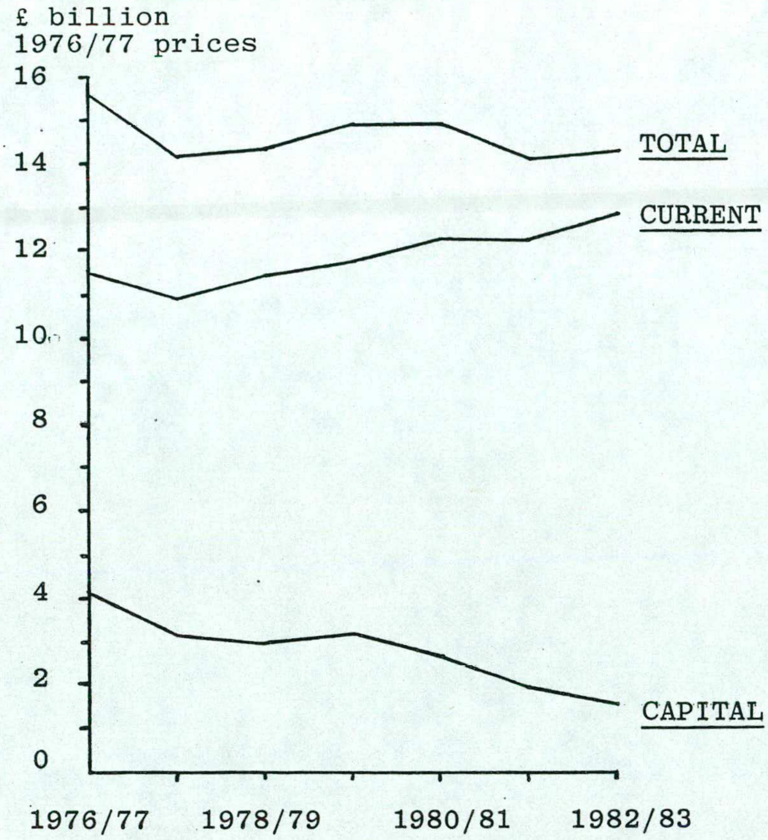
AVERAGE PAY SETTLEMENTS



Source : CBI Pay Databank

CHART VI.1

LEVELS OF LOCAL AUTHORITY EXPENDITURE[1]

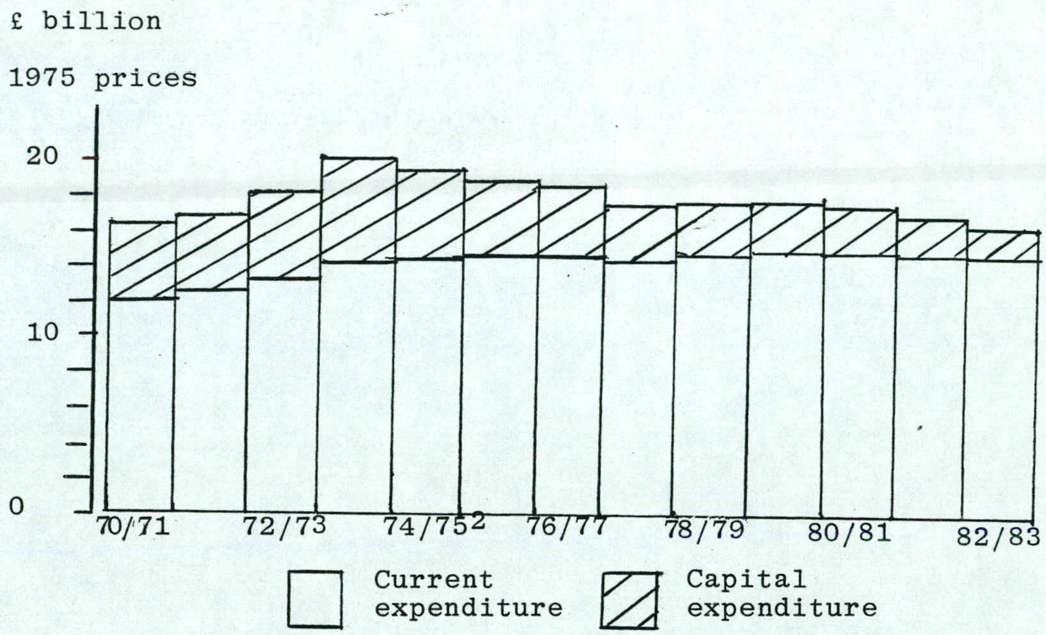


1 Great Britain only

Source: The Government's Expenditure Plans 1983-84 to 1985-86, (Cmnd 8789).

CHART VI.2

GROSS LOCAL AUTHORITY EXPENDITURE IN ENGLAND AND WALES[1]



1 Not corrected for double counting. This may account for up to 15 per cent of current expenditure.

2 Local authorities were reorganised in 1974, and some services were removed.

Source: Local Government Financial Statistics. 1970/1 - 1980/1. CBI estimates 1981/2, 1982/3.