PREM 19/194

Policy on Small Firms.
Enterprise proposals.

Part 1

ECONOMIC POLICY

JUNE 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~27.6.79~~		~~20.3.80.~~					
~~3.7.79.~~		~~25.3.80~~					
~~10.7.79~~		~~8.4.80~~					
~~18.7.79~~		~~30.4.80~~					
~~21.9.79~~		~~11.6.80~~					
~~26.9.79~~		20.6.80					
~~21-11-79~~		ENDS					
~~22.11.79~~							
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~~27.11.79~~							
~~5.12.79~~							
~~14.12.79~~							
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~~27.2.80~~							
~~5.3.80~~							
~~6.3.80~~							
~~18.3.80~~							

PREM 19/194

PART 1 ends:-

PM to Cockeram MP 20/6

PART 2 begins:-

CS to PM 8/7/80.

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(79) 13th Meeting, Item 2	23/10/79
E(79) 77	07/12/79
E(79) 82	10/12/79
E(79) 83	10/12/79
E(79) 19th Meeting, Item 2	12/12/79
E(80) 11	11/02/80
E(80) 5th Meeting, Item 3	13/02/80

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed *AWayland* Date *23 March 2010*

PREM Records Team

CF to note Original LKR

C. El Econ Pol Const.

10 DOWNING STREET

THE PRIME MINISTER

20 June 1980

Dear Eric,

Thank you for your letter of 3 June on behalf of your constituent, Mr. Brisbane of Brisbane Motorway Group Limited. I am grateful to you for bringing his views to my attention and I was pleased to note his support for our efforts in the task we have undertaken.

Mr. Brisbane suggests that we should be careful to listen at first hand to the views of those in smaller businesses and this is a valuable point. In my visits to various parts of the country I do in fact see businesses of all sizes and this is a practice which is followed by members of the Government generally. David Mitchell, Parliamentary Under-Secretary of State for Industry, with special responsibility for small firms, is naturally concerned to keep in touch with all parts of the sector and he maintains regular contacts with the organisations representing small businesses. Mr. Brisbane need have no fear, therefore, that the views of firms like his own are overlooked.

I hope you will tell Mr. Brisbane this and assure him that the Government remains firmly convinced of the valuable contribution small firms make to our economic and social life. We are acutely aware of the pressures facing many businesses at present and that smaller businesses are particularly vulnerable to these, with high interest rates only increasing their problems. There are, however, no quick and easy solutions to our deep-rooted economic problems.

/ Control

TWP

Control of inflation must remain our main economic and financial priority, and the high level of Minimum Lending Rate is playing a key role in bringing monetary growth under control. We cannot throw away the gains we have made in this direction by reducing interest rates prematurely.

However, in the relatively short time since we have been in office we have introduced many measures to help small firms. Our first budget made the largest ever reduction in income tax and is a major switch in favour of improving incentives and reward for effort and enterprise. The Government has continued that impetus by announcing in the last budget further measures of particular benefit to small firms. These include changes in income, corporation and capital taxation, with measures to encourage outside investment in small firms. Changes were also made in respect of Industrial Building Allowances for small workshop premises. In addition the Department of Industry has provided £5 million to help build 1,000 new nursery factory units in Assisted Areas in cooperation with the private sector.

The Government has also been examining the administrative and legislative burdens affecting small businesses and has already introduced changes in the Employment Protection Act. Further changes are incorporated in the Employment Bill now before Parliament.. Special arrangements with two large investment institutions have been launched to try and facilitate an increased flow of risk capital to small businesses. All Departments employing inspectors with statutory powers to enter business premises, have been asked to review the manner and extent of their requirements, and significant reductions have been made to the burden of statistical and other forms that small businesses have been required to complete.

/ I hope that

I hope that you will be able to persuade Mr. Brisbane that these measures demonstrate our determination to create a climate in which the birth and development of small firms will be encouraged.

Yours ever,

M

E. P. Cockeram, Esq., J.P., M.P.

C.F. to note

Original - CAR

cc HMT
trade
ind

ds

Econ Pol.

10 DOWNING STREET

THE PRIME MINISTER

11 June 1980

Dear Pam

Thank you for your letter of 22 May about the problems of small firms about which we spoke briefly.

I agree with you that the practice of some large companies of demanding extended credit from their small firm suppliers can cause them considerable difficulties. We are actively considering what we might do to help, though I doubt that public exhortation alone would have much effect. One possibility which I think you know we are looking at is the Law Commission's recommendation that there should be a statutory right to interest on delayed payments.

You also suggested that we should place more contracts with small firms. Although we are not aiming to place a specific percentage of Government contracts with small firms and although we must always have regard to best value for money, we are trying to ensure that small firms obtain more of them. The Department of Industry will shortly be publishing a booklet on contracting methods which will give small firms direct points of contact in purchasing Departments; and this should help. Government Departments

/ are

are also under instruction to pay their bills as quickly as possible; and their record on this is, I believe, good. For example, the Ministry of Defence - which is by far our largest Government purchaser - generally clears its bills within ten days of receipt.

Yours ever

MT

The Lady Sharples

Econ Pol

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

30 April 1980

The Rt Hon. Michael Heseltine MP
Secretary of State for Environment

P 2/5

Dear Michael

Thank you for your letter of 25 March about small factory premises. You mention that you are following up the ideas mooted in your letter of 5 July last to Keith Joseph.

I endorse your desire to see a closer private sector involvement in advance factory building for small firms. This was very much part of the new initiative in the English Assisted Areas which I announced in the Budget, after Keith Joseph had agreed to find the costs falling on the English Industrial Estates Corporation from within his allocations in Cmnd 7841. A large part of the cost of this initiative is to be found from private institutional finance, and Keith Joseph has sought wider powers in the Industry Bill to enable the English Industrial Estates Corporation to engage in partnerships with the private sector instead of relying exclusively on the taxpayer for finance, as in the past. It is also very much part of our new policy for factory building in the assisted areas to encourage disposals of publicly-funded premises to the private sector. The benefits to the PSBR are obvious.

You will no doubt wish to follow similar polices of encouraging the private sector and maximising disposals for the Vote-financed bodies within your responsibility (the Development Commission and COSIRA). I am however less happy about the specific proposal in your letter of 5 July last to Keith Joseph, and you will recall that John Biffen made some criticisms of it in his letter to Keith Joseph of 16 July last. He voiced our concern that your specific scheme seemed to involve a guarantee to private developers which absolved them of any risk, and he was also concerned that it might involve new powers to subsidise the private sector.

/I now

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

I now understand from my officials that you wish to launch an initiative not with the Vote-financed bodies but with the new towns, and that you intend to encourage Milton Keynes and Warrington to try out your proposal. I should welcome Keith Joseph's views on this, but I must say that I have grave doubts about it.

The first problem I see is that singling out Milton Keynes and Warrington for this sort of encouragement could be seen as going against our more selective approach to regional policy, which is of course designed not only to concentrate support on areas of greatest need, but also to reduce public expenditure. Government encouragement of new towns like Milton Keynes, which could be seen as competing very successfully with more difficult locations like Corby, could lead to considerable criticism.

The second problem I see is that you propose a right, or perhaps even an obligation, for the new town to buy out the private developer after three years. This implies a policy of acquiring new public assets, and goes right against our policy for disposals not only for new towns but for the Vote-financed bodies building advance factories, and more generally. This objection would stand even if you and the other Ministers with new town responsibilities were content not to single out individual new towns in the proposed approach.

I am sorry to see difficulties in your specific proposal, while welcoming your general objective of encouraging private sector involvement. But my impression is that some at least of the new towns have been very successful through leasing and other arrangements in building advance factories at no capital cost to public expenditure and the PSBR. I am content, if Keith Joseph, George Younger and Nick Edwards share your approach, that you should encourage new towns generally to use private sector rather than public funds to build advance factories. But I do not think that we should take individual initiatives with particular new towns to encourage specific forms of partnership. I would see particular difficulty in arrangements involving public purchase of factories after a period, since the new guidelines for the Vote-financed bodies aim to encourage disposal.

I am sending copies of this letter to the Prime Minister, to Keith Joseph, George Younger and Nicholas Edwards and also to Sir Robert Armstrong.

GEOFFREY HOWE

1 MAY 1980

Econ Pol VB
cc HMT

10 DOWNING STREET

THE PRIME MINISTER

8 April 1980

Dear Mr. Knighton,

Thank you for your letter of 20 March about Government measures to help small firms.

As you will now have seen from Sir Geoffrey Howe's Budget statement, we have been listening to the wide range of suggestions made in the past year or so for the strengthening of the small firms sector. Much the most important single step we have taken to help the enterprise sector generally was the cut in income tax rates put into effect last year. It has now been possible to add on measures more specifically aimed at small firms. To encourage the flow of equity finance, which you single out for priority, we have introduced:-

i. the Venture Capital Scheme - tax relief to reduce the risk of loss from direct equity investment;

ii. a lower charge and higher limit for corporation tax on small profits;

iii. reductions in taxes on capital;

iv. an end to apportionment of trading profits;

v. tax deductibility for some company formation expenses;

vi. stamp duty relief for dealers in unlisted shares.

/ We selected

We selected these measures because they were cost effective and feasible this year. I need hardly say that they are by no means the only ones we have considered, and will continue to consider others in the future.

I note in this context that you attach importance to the Wilson Committee's idea of "Small Firms Investment Companies" and to a Government-backed loan guarantee scheme. The first of these already seems to have borne some fruit in the increased interest on the part of banks and major institutions in equity investment in small firms; a number of subsidiaries specialising in the small firms sector have already been set up. The need for monetary restraint and the contingent public expenditure liability make it difficult for us to launch a government-backed loan guarantee scheme for the time being.

I hope you will not hesitate to keep the Government informed of your views and of the progress of your organisation.

Yours sincerely

Margaret Thatcher

B.A. Kingham, Esq.

CONFIDENTIAL

~~Prime Minister~~

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

2nd April 1980

T Lankester Esq
No 10 Downing Street
London SW1

Dear Tim,

You wrote to me on 24 March enclosing a copy of the letter of 20 March from the Association of Independent Businesses to the Prime Minister. You indicated that the Prime Minister would like to reply herself, and asked if we could supply a draft.

..... I enclose a letter for the Prime Minister to send to Mr Kingham of the AIB. You will want to be aware of how far officials have got in considering the case for small firms investment companies, as recommended by Wilson, and loan guarantee schemes. E Committee gave a remit to officials last December to study further the proposal for new institutions to bridge the equity gap. Officials have not yet completed their work. I think it is fair to say that the harder they look at this question, the less clear does it become that what is needed is a new institution.

Sir Keith Joseph and the Chancellor decided against ~~putting~~ pushing the proposal for a Government-backed loan guarantee scheme

..... in an exchange of letters last December (enclosed). It was left that the Government's decision not to proceed with a loan guarantee scheme for the time being should be announced in the context of whatever help the Chancellor was able to offer small firms in his Budget. The Chancellor wrote to Sir Keith Joseph on 26 March suggesting that the decision against a loan guarantee scheme should be included in a speech by a Treasury Minister in the debate on the Budget. We understand that Sir Keith Joseph wishes to think about the matter, so it is not clear at present when the Government's decision on the loan guarantee scheme will be made public.

/Against this

Against this background, and given that the Goverment has not responded officially to the Wilson Committee Report on the Financing of Small Firms (the Report recommends both a SFIC, with substantial tax concessions, and a Government backed loan guarantee scheme), it seemed to us that the Prime Minister's answer to Mr Kingham should be non-committal on both these points. We have assumed that the Prime Minister would wish to refer to the package of measures to help small firms introduced by the Chancellor in his Budget.

Yours,

Richard

R I TOLKIEN
Private Secretary

Gh - type pl.

DRAFT LETTER FOR THE PRIME MINISTER'S SIGNATURE

Write to: B A Kingham Esq
National Chairman
Association of Independent Businesses
Europe House
World Trade Centre
London E1 9AA

Thank you for your letter of 20 March about Government measures to help small firms.

As you will now have seen from Sir Geoffrey Howe's Budget statement, we have been listening to the wide range of suggestions made in the past year or so for the strengthening of the small firms sector. Much the most important single step we have taken to help the enterprise sector generally was the cut in income tax rates put into effect last year. It has now been possible to add on measures more specifically aimed at small firms. To encourage the flow of equity finance, which you single out for priority, we have introduced:-

i. the Venture Capital Scheme - tax relief to reduce the risk of loss from direct equity investment;

ii. a lower charge and higher limit for corporation tax on small profits;

iii. reductions in taxes on capital

iv. an end to apportionment of trading profits;

v. tax deductibility for some company formation expenses;

vi. stamp duty relief for dealers in unlisted shares.

We selected these measures ~~(among others with other objectives~~) because they were cost effective and feasible this year. I need hardly say that they are by no means the only ones we have considered, and will continue to consider others in the future.

I note in this context that you attach importance to the Wilson Committee's idea of "Small Firms Investment Companies" and to a Government-backed loan guarantee scheme. The first of these already seems to have borne some fruit in the increased interest on the part of banks and major institutions in equity investment in small firms; a number of subsidiaries specialising in the small firms sector have already been set up. The need for monetary restraint and the contingent public expenditure liability make it difficult for us to launch a government-backed loan guarantee scheme for the time being.

I hope you will not hesitate to keep the Government informed of your views and of the progress of your organisation.

(M.T.)

from Mr Parkinson PS 15/12

CONFIDENTIAL

Miss Sinclair 'Should we reply now?' FRH 14/12

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

CH/EXCHEQUER
REC. -7 DEC 1979
ACTION MR. BUTT
COPIES TO PS/CST, PS/FST, PS/MST(C), PS/MST(L), SIR D. WASS, SIR L. AIREY, MR. F. JONES, MR DIXON, MR RIDLEY, MR CARDONA

December 1979

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW 1

Mr MacAuslan For draft reply, pl. CA 17/12

Dear Geoffrey.

SMALL FIRMS - NON-FISCAL QUESTIONS

As you know, the interim report of the Wilson Committee recommended that a publicly underwritten loan guarantee scheme with a subsidy element should be set up on an experimental basis as soon as possible. There have also been proposals recently from the Union of Independent Companies and the Association of Independent Businesses for a somewhat different form of loan guarantee scheme with a Government subsidy.

I understand there has been inter-departmental official consideration of these proposals; and I have considered this proposal put by the Wilson Committee and the various representations by the small business organisations. A subsidised loan guarantee scheme would need to be sponsored by one department, and I imagine it would fall to the Department of Industry as the department responsible for small firms.

A subsidised loan guarantee scheme would have public expenditure implications and the issue is whether a new subsidy has sufficient priority. We must also bear in mind our limited scope for manoeuvre on PSBR grounds. I am quite sure that our first priority is to take action on the fiscal front to improve the climate within which small firms operate and to provide specific incentives for individuals to invest in small firms. Against this background I have concluded that we should not proceed with the idea of a loan guarantee scheme at present. But I think that, if we should find it necessary in future to supplement the fiscal measures on which I hope we shall shortly decide, we could look again at the question of a loan guarantee schem[e]

I shall be writing to you shortly on the subject of undue burdens on small firms.

I am sending copies of this letter to the Prime Minister and other members of E Committee, and to Sir Robert Armstrong.

Yours.

Keith

[illegible]
[illegible]
Sir D. Wass
Sir L. Airey
Mr F. Jones
Mr Dixon
Mr Ridley
Mr Cardona

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

31 December, 1979

Dear Keith

SMALL FIRMS - NON FISCAL QUESTIONS

Thank you for your letter of 5th December about the various proposals that have been made for a loan guarantee scheme. I have seen the proposals you mentioned, as well as a number of other representations in favour of a government backed loan guarantee scheme.

I agree that we must consider the merits of a loan guarantee scheme against the overall background, including possible fiscal measures to assist small firms. In addition to the factors you mention, we must not forget that there are considerable signs of movement by the clearing banks, even without any government incentive. The banks are already promoting their services for small firms, and branching out in new directions - long term lending and equity financing for instance. The provision by banks of equity and of advisory services will in a great many cases be more valuable than loans. A loan guarantee scheme would be intended to encourage more lending by the banks, and might lead to <u>less</u> intensive financial monitoring and intervention.

I think we also share doubts as to whether a loan guarantee scheme would actually alter the pattern of bank lending significantly. I have not yet seen an acceptable version of a scheme under which banks will not be tempted to use it (if at all) for loans which they would have made anyway rather than for truly additional loans.

In view of the points in your letter and above, I agree that we should not proceed with the idea of a loan guarantee scheme at present. Nevertheless, in view of the large amount of pressure which has built up for such a scheme, I suggest that we should not announce our decision on this until the Budget, when it can be seen against the background of whatever fiscal relief I am able to offer. Until then we could take

The Rt. Hon. Sir Keith Joseph, Bt. M.P.

the line that we are considering the various proposals put to us for a loan guarantee scheme, along with a number of other proposals for improving the flow of finance to small firms. As these must obviously be looked at in relation to one another, and as some of the proposals are relevant to the Budget, final decisions will not be taken until nearer the time of the Budget.

GEOFFREY HOWE

cc [illegible]
PS/CST
PS/FST
PS/MST C
PS/MST L
SIR D. WASS
SIR L. AIREY
MR F. JONES
MR DIXON
MR RIDLEY
MR CARDONA

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

31 December, 1979

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X

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The Rt. Hon. Sir Keith Joseph, Bt. M.P.

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GEOFFREY HOWE

Econ Pol

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

The Rt Hon Sir Keith Joseph Bt MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

25 March 1980

PREMISES FOR SMALL FIRMS

I have seen your letter of 18 March to Geoffrey Howe.

In principle I welcome your proposals for initiatives to increase the supply of premises for smaller firms, the more so as I understand that the Coopers & Lybrand report has demonstrated that the demand far exceeds the supply. At the same time I must have regard to my regional policy interest. I am aware that the Coopers & Lybrand findings suggest that private sector involvement in this area will bring particular benefits to the south east rather than to the assisted areas, where the response will be much slower.

I will therefore have to consider carefully the implications of your proposals for Scotland - and in particular for the SDA and the HIDB: I would also need to know how much of the external funding proposed might be available to Scotland. I would therefore be grateful if you could arrange for your officials to keep mine closely in touch with the development of your proposals for the EIEC.

In the meantime I think it would be important that any such reference to your proposals in Geoffrey Howe's budget speech should be sufficiently general to allow for the later accommodation of Scottish particularities.

I am copying this as before to the recipients of yours.

GEORGE YOUNGER

25 MAR 1980

11 12 1
10 2
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8 4
7 6 5

Econ Pol

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/11934/80

Your ref:

25 March 1980

Dear Geoffrey

R 25/3

As you know, Keith Joseph copied to me his letter of 27 February proposing that you announce in the budget statement an immediate initiative to provide 1,000 small factory units in the assisted areas. I have also just seen a copy of his further letter of 18 March.

Keith's proposal for selling off small factory estates to the private sector after they have been built and let is an interesting idea and one which should be explored further. I was disappointed that you did not fell able to support his funding proposal but I am glad to see from Keith's letter of 18 March that he himself hopes to be able to make some provision to launch the scheme. I share his belief in the need to offer the private sector every reasonable opportunity.

But the need for small premises, as Keith's letter acknowledges, is not confined to the assisted areas and I am following up in my own sphere the ideas mooted in my letter of 5 July 1979 to him. Our aim must be to explore as many ways as possible of clearing what seems to be a bottleneck in an important part of the industrial market.

I have responded separately to Keith about his proposal for a change in planning use classes in relation to nursery units.

I am copying this letter to those who received the earlier letters.

Yours ever

Michael

MICHAEL HESELTINE

The Rt Hon Sir Geoffrey Howe QC MP

25 MAR 1960

File

ds

Association of INDEPENDENT Businesses

Overdue

~~chase pse~~

Ringing back 1/4

24 March 1980

B.

The Prime Minister has received the enclosed letter about the possibility of a Government backed loan guarantee scheme. She would like to reply to this letter herself, and I would be grateful for a draft reply to reach us here by Monday, 31 March.

1/4

T P LANKESTER

Richard Tolkien, Esq.,
HM Treasury.

10 DOWNING STREET

Prime Minister

This letter from A.I.B. calls for a government-backed loan guarantee scheme to help small firms. Treasury and Bank are opposed because it would be expensive and because it wouldn't deal with the real problem – the equity gap. The Wilson Committee are not pressing the idea.

Since they have already seen Ld. Cockfield, I think you will have to reply. Agree?

Yes MT

TL. 20/3

Association of Independent Businesses

(formerly the Smaller Businesses Association)

Europe House, World Trade Centre, London E1 9AA
Telephone: 01-481 8669
01-481 0422

President: Patrick de Laszlo

R2113

The Rt. Hon. Margaret Thatcher MP,
The Prime Minister,
10, Downing Street,
London.

20th March 1980

Dear Prime Minister

In our Budget submission to the Chancellor and subsequent meeting with Lord Cockfield we put forward taxation proposals which we considered necessary to encourage the formation and growth of independent business by making equity finance more available. While there are necessary we recognise that this cannot be an easy Budget.

Therefore, in the light of our discussions with Lord Cockfield and a more recent meeting with Michael Shersby MP, we urge you to consider the fiscal arrangements required to promote the development of Small Firm Investment Companies as recommended by the Wilson Committee and the need to provide for a Government backed loan guarantee scheme which we see as a short term substitute for improving equity availability. The AIB's published proposals on the latter incorporate a mutual insurance element and do not, therefore, require a large Government commitment. Nevertheless a lead from the Government is required to promote such schemes, and to create 'gilt edged' paper to be created to attract institutional backing.

Since our submission the prospects of an early and rapid lowering of interest rates seem to have declined. Although we are aware of the current difficulties of many established firms, new and developing firms will suffer most from both high interest rates and the discriminating effects of the administrative procedures adopted by the banks to curb their lending.

The opportunity to assist these firms in the current difficult economic and financial climate by encouraging British Banks away from their excessive preoccupation with security (hardly justified by recently reported profit levels) and providing vehicles for institutional investment in small business should not be missed. The limited public expenditure commitment required should give rise to many times its level of real investment with the consequent benefits of employment and tax receipts.

While the AIB continues to support your Government's determination to reduce inflation and accepts that a difficult period lies ahead, we believe that positive action to increase the availability of equity capital to small businesses is required in next weeks Budget.

Yours sincerely

for [signature]

B.A. Kingham
National Chairman

Executive Committee: Brian Kingham (Chairman), Philip Bayliss, Peter Boneham, Lee Bushby, John Critchley, Patrick de Laszlo, Reuben Josephs, Simon Preston, Freddie Walker. Secretary: J. B. M. Donnellan.

The Association of Independent Businesses Ltd.
Company Limited by Guarantee Registered in London No. 850216

Econ Pol

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Sir Keith Joseph MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

R 2/3

20 March 1980

Dear Keith,

PREMISES FOR SMALL FIRMS

You wrote to Geoffrey Howe on 18 March in response to my letter of 6 March.

I have had a word with Geoffrey Howe about your suggestion for the budget speech, and you will be glad to know that he is willing to fit in a very brief reference to your initiative involving the English Industrial Estates Corporation and the private sector in providing more premises for small firms.

There are a number of specific public expenditure points which suggest to me that you should arrange a further announcement as soon as possible after the budget speech. The most important and immediate is to make it clear that the initial stake of £5 million is being found by making additional resources available for the EIEC <u>within</u> the Department of Industry programme totals for 1980-81 being published in the public expenditure White Paper. Any publicity material your Department are preparing should emphasise this point. You will no doubt also wish to emphasise that most of the £20 million will not involve public expenditure at all.

On this basis I am glad to agree with the expenditure aspects of your proposal, including the consequential increase in the cash limit and Summer Supplementary Estimate to which you refer. I think that you should also announce the increase in the cash limit as soon as possible.

I am sending copies of this letter to the Prime Minister, Jim Prior, Michael Heseltine, George Younger, Nick Edwards and Humphrey Atkins.

Yours
John Biffen

JOHN BIFFEN

20 MAR 1980

JH

Econ Pol.

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

18 March 1980

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

13/3

Dear Geoffrey,

PREMISES FOR SMALL FIRMS

John Biffen wrote on 6 March on the public expenditure aspects of my proposals for giving practical encouragement at the smallest end of the industrial property market. He explained the difficulties of making further calls on the contingency fund, and referred to the possibility of re-ordering Departmental priorities to accommodate this proposal.

I obviously cannot find £20m from within my own resources, but I am able to make £5m available from the Departmental "Wedge" during 1980/81 only; and whilst this will reduce the wedge to a very low level, I believe that the project is sufficiently important to warrant this. The arrangement will require an increase in the cash limit for the Vote which includes EIEC financing, and I should therefore be grateful for your agreement to such an increase, which could presumably be introduced in the Summer Supplementary Estimates.

However, £5m will provide for only 250 workshop units, which is unlikely to make any noticeable impact on the market. David Young has therefore been exploring what might be done to maximise the effect of this modest initial investment, and you will be glad to know that he has secured the interest of CIN Properties Ltd (the property investment subsidiary of the NCB Pension Fund) in putting up a further £15m. Details remain to be worked out, but I hope we may be in a position to announce their participation by the end of the month.

I believe, as you know, that the three interlocking proposals we have discussed - IBA changes, the Nursery Unit Planning Use we have proposed to Michael Heseltine, and my own proposal - will combine to produce a significant effect on industrial growth where it is most needed - from the bottom upwards. Assuming that we can agree

/on ...

on all three proposals, I think it would be of benefit to the Government if you could announce all of them briefly during your budget speech, as a package for the encouragement of enterprise at the base of our industrial pyramid. You could refer briefly to the fact that a survey commissioned by the Department of Industry had found a widespread national shortage of small premises, together with evidence to suggest that the availability of such premises does encourage company formation in the small firm sector; and that it proposed to publish this report shortly. In the meantime, the Government had decided to act in three areas - the new workshop tax allowance (about which I wrote to you on 10 March); changes in the planning use designation for nursery units to be announced by Michael Heseltine; and my own plan to encourage the construction of 1,000 new nursery units in the assisted areas over the next two years, in partnership with the private sector, by contributing an initial stake of £5m, through the EIEC. We would secure further publicity on the publication of the report, which we expect to be shortly after the budget debate, and by rapidly following up with the announcement of the involvement of the NCB Pension Fund.

I hope that we can agree on all three initiatives in time. I am copying this letter to the recipients of the earler correspondence.

Yours ever,

Keith

18 MAR 1960

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Ecn Pol

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Sir Keith Joseph MP
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
London SW1

6 March 1980

Dear Keith,

PREMISES FOR SMALL FIRMS

You wrote to Geoffrey Howe on 27 February about encouraging the provision of these premises through Government action of various kinds. He has asked me to reply on the public expenditure aspects. He plans to write to Michael Heseltine about the bad effects of past planning policies and the need to deal with this obstacle to the establishment of small businesses.

As for the provision of additional finance for this purpose, this would take you above the figures for your programmes to be published in the Public Expenditure White Paper later this month, and would imply a call on the contingency reserve. I cannot agree to this for reasons which I am sure you will recognise. The contingency reserve is dangerously low given the enormous uncertainties facing us in the coming financial year: we must maintain the reserve in case of developments where there is no option but to agree to its use. The fact that the units could be sold some years hence - perhaps at a profit - does not help us over this particular problem.

I would not of course have the same objection to proposals to change your priorities so as to give emphasis to providing small units in the assisted areas, either within the EIEC's planned financial provision or even by switches from other expenditures for which your Department is responsible. I suggest that your officials should get in touch with mine if you wish to re-shape your proposals on these lines. I agree with you that public provision by bodies like the EIEC must be confined to the assisted areas, in accordance with our selective approach to regional policy, and any special programme of small units should in my view be concentrated in the Development of Special Development Areas.

I am sending copies of this letter to the Prime Minister, Jim Prior Michael Heseltine, Nick Edwards, George Younger and Humphrey Atkins.

Yours
John Biffen

JOHN BIFFEN

-6 MAR 1950

Ecar Pol

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NA
Telephone Direct Line 01-213 6400
Switchboard 01-213 3000

NBPM

5/3

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

5 March 1980

Dear Geoffrey

PREMISES FOR SMALL FIRMS

27

I have seen a copy of Sir Keith Joseph's letter of 7 February to you suggesting a pump-priming exercise to help to accelerate private investment in smaller industrial units.

I have already expressed my concern at the fact that there appears to be a dearth of suitable premises for smaller firms and I am sure that a scheme on the lines suggested by Sir Keith would help to stimulate the formation and development of new enterprises, as well as demonstrating in a positive fashion our commitment to helping the small firms sector.

I am copying this letter to the Prime Minister, Sir Keith Joseph, Michael Heseltine, Nicholas Edwards, George Younger and Humphrey Atkins.

Yours
Jim

5 MAR 1960

Econ Pol

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

27 February 1980

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

Dear Geoffrey,

PREMISES FOR SMALL FIRMS

I have been thinking about further steps we might take to give significant encouragement to enterprise, without net cost to the Exchequer over the PESC period. These conditions are met by the following proposal in a crucial area relating to small firms.

We have much evidence to suggest that one of the reasons this country has relatively fewer small firms than any of our major international competitors is a dearth of suitable premises. We therefore commissioned an investigation by Coopers & Lybrand. Their report is almost ready and we now know that their main conclusions confirm that a shortage of small industrial premises persists throughout the country. They have not found any area where the supply situation could be said to be satisfactory. Another finding is that the provision of premises has stimulated the formation and development of small firms. It follows that the general shortage of premises must be having the opposite effect throughout the country.

The problem has arisen partly from misguided planning policies pursued over a long period, and partly by a failure of the property market to adapt to new circumstances. Urban renewal and derelict land clearance projects have literally planned many small premises out of existence; and whilst the major financial institutions, which nowadays account for virtually all private sector financing for industrial development, have been willing to invest in replacement of the larger ranges of industrial premises, they have taken no part in the provision of small units. Their reasons have been twofold; an unwillingness to accept that such investments will provide the same level of income growth as investment in larger industrial buildings; and an unwillingness to accept as tenants any companies which are not capable of taking on their standard 25 year lease. The prospect of dealing with a multiplicity of small, unknown, and potentially unreliable tenants who want only short-term rental agreements has hitherto proved a serious deterrent to institutions, whose prime concern has been assured, long-term rental growth with the least trouble and overhead cost. The consequence has been that wherever small

/premises ...

premises or areas of decayed mixed residential and industrial development have been swept away in the process of urban renewal, the private sector has in general replaced only the industrial units in the larger sizes; and the stock of the nursery of workshop unit has therefore been steadily eroded. It is significant that premises under 500 sq metres in area form only 4.8% of our national stock; and in the Northern Region, only 2%.

Local authorities have in some cases tried to fill the gap. Paradoxically, this has had the effect of introducing yet a further deterrent to private sector involvement, since despite the strong demand, the local authorities have often let their units at uncommercial rates of return. The problem is further compounded by over-rigid planning and building regulations.

Various steps are being taken to ease the planning difficulties, but this will do nothing to overcome the reluctance of the major financial institutions and property developers. One or two institutions, notably the NCB Pension Fund, have recently begun to take the temperature of the water. Their example and experiences may eventually tempt others to follow. The Coopers & Lybrand report, which I intend to publish, should dispel some of the prejudices prevalent among the institutions and help to persuade them that the commercial opportunities are worth their while. In particular it should be possible to demonstrate that the problems of multiple short-term tenancies can be satisfactorily overcome by new management systems. But changing the attitudes of the institutions will be a slow process - too slow to meet the large unsatisfied demand for small premises which now exists throughout the country and especially in the Assisted Areas, which will inevitably be the last to attract the private sector.

I therefore believe that it would be a significant contribution to the encouragement of enterprise, and to our potential for economic growth, if we could accelerate industrial property investment in this market sector by demonstrating in positive fashion that such investment is both practical and profitable. I believe we can do this without any net cost to public funds by undertaking a pump-priming exercise involving the provision of a tranche of these small units over a short period, specifically and solely for sale to investors as tenanted estates.

So far as the assisted areas in England are concerned, my officials and the EIEC are confident that there would be no difficulty in building and letting 1,000 small units by 1982, and selling all of them, perhaps even with a small profit, within a further two or three years at most. This is also the view of David Young who has been advising me on industrial property matters and has practical experience of building small units. 1,000 units would represent an expenditure of about £20m, which can be spread over 3 years (£6m in 1980/81, £10m in 1981/82 and £4m in 1982/83), and recovered over 4 years.

/I ...

I propose that although the shortage of small units is nation-wide, expenditure on this programme should be confined to the assisted areas. As you know, separate discussions are being held on the proposal for a workshop building allowance; if this idea goes ahead, as I hope it will, it should provide substantial encouragement to development in many non-assisted areas; and a successful scheme in the AAs will be just as valuable a catalyst for non-AA development as a successful scheme anywhere else, whereas the converse would not be true.

Obviously the initiative could not be confined to England, and we need to look to our colleagues in the territorial departments to say what would be appropriate in the other countries, having regard to basic criteria of prompt saleability. I would myself be inclined to suggest a maximum total outlay for Great Britain based perhaps largely on the relative numbers unemployed in the Assisted Areas and officials might be asked to agree a national target on this broad basis.

There remains the question of financing this proposal. Whilst I would normally have wanted to find the funds for such an important initiative from within my Department's overall provision, I am afraid I now find this impossible. I have, as you know, already made substantial efforts to find savings, and there are simply no more to be found. I hope you will therefore be able to find the additional provision required. The outlay required is modest, the rental yield potentially high and the whole expenditure recoverable in real terms.

The announcement of this programme could with advantage be made during your Budget Statement, together with the new workshop building allowance, and publication of the Coopers and Lybrand report could be timed accordingly. We could then not only claim to be making an immediate and significant contribution towards solving the serious problem the report has identified, but also taking steps at grass roots level to improve the nation's competitiveness and prosperity and strengthen the base of the industrial pyramid.

If you agree in principle with this proposal, I suggest officials should meet promptly to consider its detailed implementation.

I am copying this letter to the Prime Minister, Jim Prior, Michael Heseltine, Nicholas Edwards, George Younger and Humphrey Atkins.

Ever,

Keith

28 FEB 1980

Econ Pol. 2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

19 February 1980

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

Prime Minister
This seems a useful report - with valuable recommendations
MG
MG
Agree? TL 21/2

Dear Geoffrey

ELIMINATING UNDUE BURDENS ON SMALL FIRMS

You will recall that at the meeting of MISC 14 on 6 September 1979, it was agreed that I should submit a further paper on the elimination of burdens on small firms. Under cover of this letter, I attach a report and proposals, particularly identifying areas in which further progress needs to be made.

The cost of compliance by industry generally with the requirements of Government is now perceived to have been significantly under estimated in the past. A reduction in this burden on small firms and the elimination of other obstacles to their growth is an important objective in itself, but it has now assumed even greater importance because the stringency of the current financial situation is having a serious effect on the small firms sector.

I welcome the recommendations in the attached paper, and suggest we should monitor progress on all these topics with a view to making announcements at quarterly intervals, covering a small group of items, so as to make the maximum impact and underline our steady progress toward fulfilling our undertakings to the small business community. To this end, it would be helpful if a timetable could be provided by each Department responsible for the items in the progress report.

I am copying this to the other members of MISC 14 and to John Nott and Jim Prior.

Ever.

Keith

ELIMINATING UNDUE BURDENS ON SMALL FIRMS

Report and Proposals by The Department of Industry

1 Priority paper 10.1, which was considered by MISC 14 on 6 Sepember last, identified the principle burdens imposed on small firms. This paper reviews developments and draws attention to matters on which further action is outstanding.

The Burden of Legislation

2 Awareness of the problems facing small firms is permeating Whitehall, but tangible results so far are few and there is a real risk that they will be more than offset by new legislation, unless the implications for small firms can be kept continuously in the forefront of our minds. An example is the proposal for an Employers' Sick Pay Scheme; despite special arrangements being discussed for very small firms, the potential cost and administrative burden to be imposed on the rest of small businesses will be considerable. It was understood when the scheme was formulated that it would have this disadvantage, but it is an unwelcome facet of a desirable change.

3 We make two proposals of general application concerning future legislation:-

a Departments initiating legislation should be required to include in the explanatory memorandum an estimate of the compliance costs to industry. (We accept that in many cases only a broad estimate may be possible.)

b All legislation having a significant impact on industry should be accompanied by a simple explanatory guide for the small employer.

The Burden of Paper Work

4 This arises on the twin fronts of administrative forms and statistical ones. Administrative forms bring relatively few complaints. However, the Department of Trade's external inquiry into their forms may suggest some fresh initiatives.

5 Statistical questionnaires are percieved as a significant burden by small firms. As a result of the review, initiated by the previous Prime Minister and effected through PUSSs in each Department, 280,000 forms making statistical enquiries per annum have been stopped.

6 Under this Government some 750,000 statistical questionnaires have not gone out, but many of these were not annual returns. As a result of staff cuts, 50,000 enquiry forms per annum have had to be cut out. In addition, Sir Derek Rayner's first BSO exercise has suggested the saving of 50,000; half are in the process of being

implemented, the other 25,000 are subject to negotiation with the Treasury and the CSO. The Department of Employment are reviewing the frequency of their census of employment and the monthly employment return which involves substantial numbers.

7 The recent decision for Sir Derek Rayner to review the statistical services jointly with the CSO and CSD, particularly the Treasury's requirements as the largest user Department in Government, is particularly welcomed, since it is the demands of the user Department which inevitably dictate the number and frequency of enquiries. We are particularly anxious that they should not under-estimate the compliance costs involved for businesses of all sizes in supplying information, recognising that much the bigger burden falls on the small non-computerised company.

8 It is of overriding importance for Ministers and officials in all Departments to examine critically all proposals for seeking data from industry to ensure that only that which is absolutely essential is sought. More attention needs to be paid to the factor that some information will be readily available to the recipient. Where it is possible to delete sections of enquiries not applicable to the addressee, they should be removed. Forms should indicate on the front page to whom they apply and whether the return is compulsory, voluntary or to help the addressee.

Employment Protection Legislation

9 Important changes affecting small firms came into effect by order on 1 October, concerning the qualifying period for unfair dismissals and notification of redundancies. Further beneficial provisions are included in the current Employment Bill in relation to industrial tribunal procedures.

10 We particularly welcome the decision to amend the Employment Bill during its Committee Stage to extend the qualifying period for unfair dismissals to two years, not only for new businesses but in respect of new employees of all small firms (20 employees).

Health and Safety Legislation

11 A review of the work of the Health and Safety Executive is being conducted by the CPRS, who are due to report in March 1980.

Rating

12 The Planning and Land Bill will give small businesses the right to pay rates by instalment, and will provide for a more flexibile separation of the domestic and industrial proportion of rates for mixed hereditaments. A working party of officials is examining the scope for de-rating of empty properties and of properties in the process of conversion. It is desirable that recommendations should be with Ministers in time for the Committee Stage of the Bill.

Building and Fire Regulations

13 Building regulations are being reviewed with the objective of devolving responsibility for them from local authorities to the builders. A draft consultative document is in preparation. There appears to be a case for reviewing the appropriateness of some of the fire regulations applied to smaller firms.

Rights of Entry

14 A review of the rights of entry into business premises has recently begun and will be completed by June 1980. Revenue services are the subject of a separate review which is nearing completion.

Company Law

15 The Department of Trade published a Green Paper on company accounting and disclosure last September. In accordance with the EEC Fourth Directive, it proposes a new 3-tier structure for companies with different disclosure requirements for large, medium and small companies. Nevertheless, a vast number of very small businesses will still be required to file balance sheets annually etc etc. A 'de minimis' exemption from this requirement would ease the burden on both very small firms and on Company House.

Government Purchasing

16 We believe that without departing from the value for money principle, Purchasing Departments could place more contracts with small firms. To achieve this communication will have to be improved. In order to help small firms understand Government purchasing procedures, a booklet in the Small Firms Service series has been prepared and awaits approval by the Purchasing Departments. We recommend that each Purchasing Department should have a nominated 'Small Firms Officer' to act as a focal point for enquiries, since small firms are often deterred by the difficulty of making the appropriate contact. There may also be scope for publishing lists of contracts (below a certain size) through the Department of Industry's Small Firms Centres, and by other methods, to ensure that small firms know what contracts are available. These ideas are developed in a paper shortly to be discussed in the Official Committee on Public Procurement.

Planning

17 Action is being taken to enable the Secretary of State for the Environment to publish league tables showing the time taken by planning authorities to deal with applications. Measures to speed up the handling of appeals are to be covered in a consultation paper to be issued shortly. The general development Order (1977) is to be relaxed to permit the limit on industrial expansions to be raised from 10 to 20% subject to a maximum of 120 square metres. The Secretary of State for the Environment is currently considering a draft of a new circular on development control which will emphasise the importance of helping wealth and employment creating investment

to take place and of dealing with planning applications from small firms promptly, efficiently and sympathetically. Applications would be granted unless the purposes of the land allocation are damaged by reason of noise, smell, unsightliness, or traffic generation. i.e provided they do not offend against the purpose of the land allocation.

Conclusions and Recommendations

18 In summary, we think it can be fairly claimed that a good beginning has been made, but there is still much to do. The effort to eliminate burdens needs to be sustained, and taken much further. Specifically we recommend that:

(i) all Departments initiating legislation should be required to provide an estimate of the compliance cost to industry and to produce simple explanatory guides for the small employer;

(ii) Ministers and officials requiring statistical information should re-examine their use of statistics to ensure that the degree of accuracy required and the reliance to be placed upon the figures is known to the BSO or other collecting organisations, to ensure that neither in quantity nor in frequency are the statistics being collected in excess of the minimum needed;

(iii) forms should be redesigned so as to indicate clearly whether their return is voluntary, compulsory or to help the addressee and, if possible, a standard format should be achieved in this respect. Greater effort should be made to reduce the number of omnibus requests for information contained in the long standard forms;

(iv) a guide to Government purchasing procedures should be produced, each procurement agency should appoint a Small Firms Officer and lists of contracts that might be of interest to small firms should be published;

(v) reviews of the health and safety legislation, building and fire regulations, the Shops, Offices and Railway Premises Act should be undertaken and/or completed speedily, and if possible the results announced at the same time;

(vi) a further effort should be made to reduce the company law requirements falling on the smallest businesses.

20 FEB 1980

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10 DOWNING STREET

THE PRIME MINISTER

14 February 1980

Dear David,

Thank you for your letter of 17 January enclosing Mr. Anderson's letter of 3 January. Mr. Anderson attached his own letter of 1 January to me, which I read with interest. I am of course keenly aware of the problems of small businesses and very sympathetic towards them.

The question of manufacturers' discounts to retailers was made the subject of a general reference to the Monopolies and Mergers Commission by the former Secretary of State for Prices and Consumer Protection in July 1977. The Commission have completed their fact-finding operation and are now in the closing stages of their enquiry. They are expected to make their report this year and the Government will then decide whether any action is needed.

Mr. Anderson suggested that the Government should give some thought to removing price control for milk. Of course, we keep the need for this control under review but the reason for it lies in the structure of the dairy industry. The Milk Marketing Board are monopoly suppliers of milk in their areas and the processing and distribution of milk is increasingly concentrated in the hands of a few large companies. By setting both wholesale and retail prices the Government aims to ensure fair treatment for producer, distributor, and consumer alike.

The maximum retail milk prices set by the Government relate to milk in glass bottles. Mr. Anderson might like to know that

/for

PW

for sale of milk in non-returnable containers, retailers make a reasonable additional charge to cover the extra cost of the packaging involved.

Turning to butter prices, the statutory maximum retail prices of butter which were raised on 28 January had not been altered since February 1979. When setting statutory prices the Government takes into account changes in first hand prices which have occurred, or are due to do so, as well as allowing some headroom for unforeseen developments. More frequent changes, as Mr. Anderson suggests, would undoubtedly confuse and irritate both traders and the general public.

I enclose a copy of a Press Notice which sets out the reasons why the Government took the decision to abolish the Metrication Board. By the end of April there will be insufficient work to justify the Board's continuing as a separate entity and it will therefore make more sense for the Department of Trade to deal with metrication matters. As far as education is concerned, policy guidelines laid down by the Department of Education and Science advise schools to ensure the children should be kept reasonably familiar with both metric and the Imperial systems of measurements.

I hope that Mr. Anderson will find these comments helpful.

Yours ever

Rayarb

The Rt. Hon. David Howell, M.P.

Econ Pol

PRIME MINISTER

LOI MONORY

You asked about the Loi Monory, and whether this might be an alternative to some of the small firms schemes which the Treasury are considering.

The Loi Monory allows each French household to deduct against its tax bill up to 5,000 Francs of net new investment in the shares of any French company. People who take advantage of this have to hold the shares until 1983.

This is really a scheme to encourage equity investment generally, rather than in ~~any~~ small firms. It has not therefore been considered as a possible small firms scheme. However, it has been looked at, and will be reported on in the Report on Taxation and Savings which is coming to E Committee in a week or two. I am told that the Report will recommend against emulating the Loi Monory because -

i. it would be extremely expensive;

ii. it is unlikely we could get our banks to co-operate in administering the scheme. In France, in order to make sure people are not simply switching out of one share to another share in order to take advantage of the scheme, the banks play an important monitoring role. They are, of course, much more closely linked to the State than they are in this country.

R.

13 February 1980

Tim

As an economic agnostic I read the attached with some interest and put it in the Prime Minister's Box. In view of her remarks, I think it would be far more appropriate for you to take it over from here. Thank you

Richard.

12.2 ?.

THE FRENCH "LOI MONORY" :

ARE THERE LESSONS FOR THE UNITED KINGDOM?

by

STUART VALENTINE

Economic Adviser : The Stock Exchange

The French "Loi Monory" : are there lessons for the U.K.?

"Reconciling France with Industry" was how M. Rene Monory described the object of his tax incentives for share investment introduced in 1978. These measures, part of a wider package aimed at rejuvenating French industry, are now collectively known after the name of their sponsor as the "Loi Monory". But what are these measures, which, as I show, have had a substantial impact in France? They are, I believe, not widely known about in Britain, and to some degree misunderstood even by those who do know of them. The object of this paper is therefore quite simple. First to set out exactly what the Loi Monory measures are. Second, to discuss the reasons for their introduction in France. Third to assess the impact they have made and to attempt to analyse their success against their objectives. Finally to look at the scheme against a British background and to ask the question : should we introduce similar proposals in the United Kingdom as part of the review of capital taxation currently taking place?

The Tax Benefits of the "Loi Monory"

Tim - isnt this an alternative to some of the schemes Treasury is considering

Taking the first of these objectives : what is the "Loi Monory"? Essentially it is a series of measures introduced in France in July, 1978 the main object of which is to give tax relief for new investment in the shares of French companies. Each French household is allowed to deduct against its tax bill up to Fcs. 5,000 (around £550 at current rates of exchange) of net new investment in the shares of French companies. The "household" is defined as husband and wife, while an additional Fcs. 500 is available in respect of each of the first two children and a further Fcs. 1,000 a year for every additional child.

These tax benefits are generally available for the four years 1978 to 1981. The amounts invested each year go to reducing the household's tax bill in the following year. Thus the benefits will cease in 1982 and investors will be free to sell all their shares bought under the "Loi Monory" provisions from the beginning of 1983. There is, however, an important exception to the four-year limitation. For taxpayers over the age of 50, the tax benefits are granted for fifteen years, to allow such taxpayers to build up a capital fund for their retirement.

The Reasons for Introducing the "Loi Monory"

Before discussing the operation of the tax privileges, a prinlinary word on the general objectives of the law and the context in which it was introduced. The concessions offered under the "Loi Monory" are not an end in themselves designed to stimulate activity and prices on the Bourse to the benefit of French stockbrokers and unit trusts. They were a part of an economic package which - taken as a whole - was designed to improve the capital base and competitive position of French industry and commerce.

A major problem facing French industry was, as the Government saw it, that it was under-capitalised, both in relation to its total sales and to its bank and other borrowing. Examples quoted at the time of the introduction of the various reforms were that on average, French industry's borrowing / capital ratio was in general over 50%, rising to over 100% in some cases. Statistics showed that capital creation was increasing less slowly than value added, the wage bill, while interest charges on borrowing had risen very sharply. At the same time, internal sources of funds through non-distributed profit retention had fallen sharply.

The French Government therefore planned a two-pronged attack on this problem. First, to strengthen the internal flow of new capital resources, it lifted the price controls under which French industry and commerce had laboured since the end of the war, and stimulated French companies' demand for new capital. Interest and dividend payments on new capital raising exercises were to be fully tax-allowable against profits for seven years (compared with five previously), and on preference shares the period is ten years. (Preference share issues were not only allowed, but almost encouraged as a means of allowing companies to raise capital without altering the balance of voting control.

Other measures introduced around the same time, and all designed to stimulate industrial investment as part of a package, included tax deductions of up to the equivalent of 10% of the increase in investment during 1979 and 1980, and accelerated rates of amortisation for capital expenditure on scientific and technical research by small and medium sized companies. Selective aid was also given to investment in regions suffering as a result of a decline in major industries, such as steel and naval shipbuilding.

Secondly the Government sought to improve the willingness of investors to put up new external sources of capital by introducing the "Loi Monory". These measures must therefore be seen in the context of the Government's overall policy towards the financial health of the French corporate sector.

The French Government was also seeking to influence the personal sector in its choice of investments. As in the United Kingdom, the level of personal savings was high, but traditionally it flowed into short-term deposit saving with the banks. Not only did this help increase industry's dependence on borrowing from the banks, it also caused the French authorities problems in the field of monetary control. (The monetary authorities in this country will need no reminding of the difficulties of controlling monetary aggregates which can be volatile in the short-term).

The measures sought therefore to increase savers' willingness to commit long-term funds to French industry and trade, thus killing two birds with one stone - the undercapitalisation of French industry and the size of short-term deposit savings. (The interesting contrast with the United Kingdom is that here the authorities have sought to divert funds from short-term savings into long-term <u>government</u> debt.)

The final reason behind the particular scheme chosen was that the French government felt that it was highly desirable to involve the population as a whole with the success of French industry, to give them a financial stake in greater output, productivity and success. All this is summed up in the Monory quote at the beginning of this paper : "reconciling France with industry".

The "Loi Monory" and the Investor

Buying and Selling the Shares

The tax advantages are confined to direct investment in French company shares, or investment in SICAV (authorised unit trusts which have undertaken to invest at least 60% of their funds in such issues). Many of the SICAVs àre run by the banks, and I shall discuss the role of SICAVs later in the paper in analysing the success of the measures to date.

The tax benefits under the "Loi Monory" are granted on the net addition to investment during the year. The great advantage of this is that it does not lock an investor in to a particular share or portfolio. He is free to vary his investments as he likes, but he will be granted the tax benefits only on the net additions to his portfolio.

The Value of the Tax Saving

How much does a taxpayer save on his tax bill by taking advantage of the concessions? Any precise answers clearly depend upon his personal tax rate, the size of his family and how much he can afford to invest. The following examples, based on information given by Monsieur Bruno de Maulde, in a lecture soon to be published by The Stock Exchange*, give a useful indication (although the figures have been slightly amended).

Example 1

In the first case let us assume a taxpayer has a taxable income after allowances of Fcs. 100,000 a year (about £11,000). He has two dependent children, and he chooses to invest his full permitted amount under the scheme.

The full permitted amount in his case is Fcs. 6,000 (Fcs. 5,000 for the household, plus Fcs. 500 for each of his two children) and his total tax saving on an investment of Fcs. 6,000 will be almost Fcs. 2,100 roughly equivalent of £230.

Example 2

In the second case, we assume a man with three dependent children and taxable income of Fcs. 135,000. He, too, invests the full allowable amount, in this case Fcs. 7,000 (as in example 1, but with a further Fcs. 1,000 for his third child).

* Stock Exchange Chirman's Lecture, No.10., delivered 13th September, 1979.

Example 2 Cont'd

In these circumstances, his tax saving will be Fcs. 2,800, equivalent to a little over £300.

How valuable are these tax concessions? We can look at the question from two angles - apart from the unquantifiable delight of paying less tax anyway - those of income and capital.

On the income side first of all, if the taxpayer under example 1 invested in a security yielding 7% a year, his actual gross yield will be 10.8% since he has in effect paid only Fcs. 3,900 for shares to the value of Fcs. 6,000. Our taxpayer in example 2 benefits even more, since he acquired shares to the value of Fcs. 7,000 for Fcs. 4,200, so his 7% yield would rise to 11.7%.

Since the highest marginal income tax rate in France is 60%, the maximum saving for a household without children would therefore be Fcs. 3,000 or around £330. At this level, the yield on the above 7% example would rise to 17.5%. To date I have not been able to trace any figures which indicate the average tax saving, but again I am indebted to Monsieur de Maulde for an estimate that savings are likely to range from Fcs. 1,000 to Fcs. 2,500 per household.

Let us look now at the second way of assessing the benefit. Quite simply, each taxpayer by acquiring shares at a discount (represented by his tax relief) has a built-in protection against a fall in their value. In example 1 the shares could fall by anything up to 35% before the shareholder shows a loss, while on the second example his "cushion" is 40%. The main gainer, of course, would be the taxpayer on the highest marginal rate whose protection against a fall in value is 60% of the gross cost price.

The Lock - in Effect

An object of the scheme is, of course, to encourage the long-term nature of French personal savings. So to qualify for tax relief, there must be a "durable" investment. Shares bought under the scheme must be kept, or the proceeds of any sale re-invested in French company shares, for four years. Rules were also incorporated into the scheme to prevent existing investors simply switching old portfolios into "Monory" holdings just to qualify for the tax relief : there must be a net increase in the portfolio.

The penalty for selling the shares before the end of the four-year period is the immediate repayment of the tax benefit except in specified circumstances, which include death, retirement and divorce. But it is important to note that individual shares in the portfolio can be changed, and, provided that the proceeds are re-invested, the full relief claimed. If an investor is fortunate and his original shares rise substantially, there is no reclaiming of tax relief if he sells and re-invests the realised amount.

Testing the Claims of the Secondary Market

During the initial discussion period, a number of different ideas were put forward designed to achieve the desired overall objectives outlined above.

One of these would have given the tax concessions only to the contribution of "new capital". In other words, only new capital raised by companies and subscribed by the general public would qualify for tax relief, while investment in existing shares would not. The Government rejected this plan on the grounds that it would probably divert money into new shares and certainly do nothing for, and probably harm, the market in existing securities. In the long run this would have been counter-productive : a privileged class of shares would in effect have been created, but the scheme could easily have been undermined by a weak secondary market when these "privileged" investors chose to sell. Such a scheme would almost inevitably have led to distortions in the market, perhaps schemes designed to achieve no rational financial objective other than artificially to create "new" capital, and certainly a lot of administrative inconvenience.

In Monsieur de Maulde's words in the paper already referred to : "we thought we should believe in the stock market and in its smooth functioning, which would have been severely disrupted with a special advantage being reserved to the new issues".

So the French Government decided to test one of the stock market's major justifications for its system : the contention that an active and successful secondary market in which existing shares can be traded is an essential element of a successful primary or new issue market. In other words, investors who know that facilities exist for selling their shares at times of their own choosing in a liquid and competitive market-place will be all the more willing to invest their funds in the equity capital of industry in the first place, allowing industry to raise money more easily and more cheaply than if investors were locked in.

So the French Government in effect called upon the Bourse to justify this claim, justify indeed its very raison d'etre in respect of company finance. Create a sound trading market which will give confidence to savers to buy company shares : prices will rise, yields will fall, companies will tap the new issue market for new funds at these lower rates, which will help them both to reduce their dependence on borrowed funds and provide the necessary permanent capital for expansion. Was this argument valid? The Bourse was being put to the test.

The Results of the Scheme to Date

1. Investors' Reactions

Nor surprisingly, in view of the movements in the prices of French securities generally, French investors have taken considerable advantage of the "Loi Monory" provisions. Much of the success which has been achieved in wooing new shareholders into the market and reviving the interest of existing shareholders has been the great marketing effort put in by the French banks in selling SICAV investments to their customers.

It has been calculated by the French authorities that over one million households have taken advantage of the new law since July 1978, and that perhaps four-fifths of these were through SICAV

Twenty-one SICAVs having been formed to date to take advantage of the opportunities created by the "Loi Monory" In the first half of 1979 alone, SICAV registered price increases of between 5% and 12%.

In terms of money attracted into "Loi Monory" schemes, Fcs. 3,500m. came in during 1978 and Fcs. 4,000m. last year, a rise of some 18%. (In this context the fact that the scheme came into operation half way through 1978 is largely irrelevant, but it will be interesting to see if the success of the scheme carries through into 1980, especially if share prices do not maintain their present momentum.)

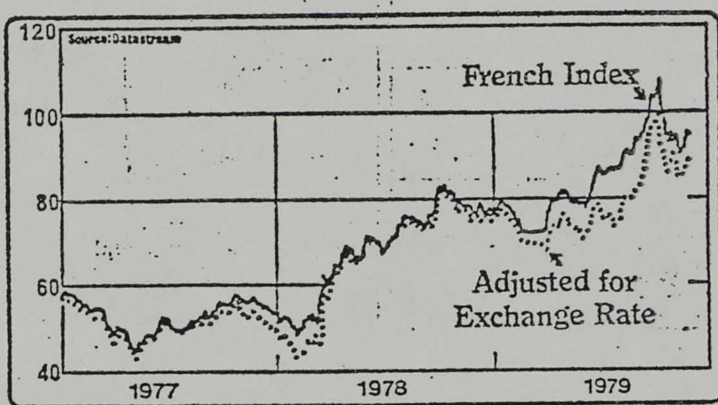
A further measure of the scheme's success in achieving its objective of associating the individual with French industry has been the fact that of the 1m. shareholdings under the scheme, it is estimated that approximately half of these are shareholders attracted into stock market

1. Investors' Reactions Cont'd.

investment for the first time. Probably an even higher percentage of new shareholders are to be found within the ranks of the SICAV unit holders.

2. The Stock Market's Reaction

Stock prices on the Bourse over the past eighteen months have risen by about 40%, with only minor reactions as may be seen from the chart.



Not all of this should be attributed to the effects of the "Loi Monory". Indeed it would be extremely dangerous if the rise were to be attributed wholly to it, given the temporary nature of the scheme. Following the French election early in 1978, share prices were historically low and politically were set fair for a rise following the unexpectedly heavy defeat of the left-wing parties in that election. As may be seen, the French share index rose from around 50 at the time of the election to around 70 by mid-1978 when the "Loi Monory" was introduced. Thus, the timing of the scheme's introduction was favourable. Nonetheless, the added weight of new investment funds coming to the market certainly helped maintain the momentum, and, of course, in a scheme like this nothing succeeds like success.

3. French Industry's Reaction

So the market index has been buoyant during the period of the "Loi Monory". But how have companies reacted? Has the stock market's claim that it could help industry raise money easily and cheaply been borne out?

In some ways it is far too early to tell. Certainly initial results were favourable. In 1978 French companies raised Fcs. 4,400m. of new capital mostly in the second half of the year, compared with only Fcs. 1,100m. during 1977. Last year, new capital of Fcs. 3,700m. was raised, and although this might indicate a slowing-down on the 1978 rate of growth, that figure may have included some catching up by French industry. The 1979 figure is, of course, still well in advance of the 1977 figure.

There is a curious, and perhaps co-incidental, similarity here between the amount of new funds thought to have been attracted into the market by the tax reforms and the new amounts raised by French companies through the new issue market mechanism. There is no particular reason why these two amounts should show such a similarity (Fcs. 7,500m. of new investment over two years compared with Fcs. 8,100m. of new capital raising by French industry), but the figures do argue quite strongly against any suggestion that stock market prices have simply been driven up by an excess demand over supply. They also bear out the confidence of the Government in trusting the mechanism of the stock market. The new money has been raised by industry without distortion to existing securities and on the back of a generally rising market.

3. French Industry's Reaction Cont'd

On the other side of the coin, what has been happening to capital investment by French companies? There has in fact been no obvious increase in new capital investment by French private sector companies. In fact it would seem that many French companies are doing what their British counterparts did in 1975 when stock market prices here began to rise sharply after the debacle of 1973-4; they have raised equity capital when the time is right in order to strengthen balance sheets and reduce short-term borrowing. This, indeed, is not only sensible, but in the French context, one of the major objectives of the "Monory" proposals. New investment will have to wait until the economic outlook improves, but by then companies having taken advantage of the capital-raising possibilities now, should be better placed to meet new investment and expansion plans.

An Interim Judgment

There can be little doubt that the effects of the "Loi Monory" in France have in the short-term been substantial.

It will be impossible until at least 1983 to give a complete assessment of the success of the French measures. As was noted earlier in the paper, the scheme is intended to be only a temporary one, with the tax benefits given in 1982 being, generally speaking, the last and investors free to sell their shares without penalty from 1983 onwards. The hope is that the tax concessions will be a pump-priming exercise, and that the enthusiasm for long-term investment in industry will be carried forward by its own momentum and without any further artificial aid after that.

Almost inevitably, unless other factors outweigh it, selling pressure in 1983 is likely to lead to a fall in stock prices, especially if substantial capital gains are there for the taking. If, however, the overall economic outlook is better by that tine, such selling pressure should prove containable. Indeed, this would provide the basis for a good two-way market of both buyers and sellers. (In the last resort the scheme could be renewed in the same or a modified form, although such an extension would in part be an admission that the pump-priming exercise had not been fully successful.

But in the short-term, the "Monory" proposals can be counted a success. The stock market has been boosted, and a wide spectrum of the French population has benefitted. Savings have been switched into longer-term holdings, while French companies have raised substantially larger amounts of new capital, to the benefit of their financial strength and long-term prospects.

Are there lessons for the United Kingdom?

In view of the French success, should the U.K. seek to strengthen investment in industry in the same, or a similar, way by means of tax concessions to direct shareholding?

I do not believe there is an obvious answer to this question. The French government introduced its proposals to suit the needs of French industry. So we should ask ourselves the question : what factors are there in the U.K. which would make a "Monory" type system as effective here as it has been in France?

It has been said, for instance, that a "Monory"-type scheme is not necessary here because British companies have not had the same difficulty in raising new capital as French companies. The City institutions made this point over and over again in evidence to the Wilson Committee and in general were supported in this view by industry itself.

A further point of difference is the much greater importance in the U.K. of funded pension schemes, which invest increasing amount of money in new and existing U.K. equities. Although full figures are not yet available, they probably invested around £1,500m. in them last year following figures of £1,473m. and £1,475m. in the two preceding years. Together with other institutional investors, notably the long-term insurance funds, they play a major role in the new issue market through the take-up of rights issues. The role of the pension funds is much smaller in France, where many schemes are not funded and operate on a pay-as-you-go basis. As a result the amount of new savings regularly becoming available for investment in French equities is much lower than in this country.

So from the point of view of company finance, there is probably not the same pressing need in the U.K. as there was in France. Nonetheless, there may well still be an argument for introducing a "Monory"-type law in this country as part of a package to encourage more direct participation in capital-ownership. The growing importance of institutional, especially pension fund, investment has been causing a lot of concern, and the volume of funds available for investment is bound to grow.

Taxation policy is still structured towards encouraging their growth, while inflation has added massively to their inflow of funds. The total number of pensioners receiving payments from them is relatively small compared with contributors, and the volume of money being paid out is around one-third of total income from contributions and investments.

Meanwhile, direct investment by individuals in equities is far from encouraged, and has certainly not been given tax benefits, except in the area of employee share-ownership. Yet such schemes, while they deserve strong support, are by their nature limited to particular groups of employees. The French, too, have employee-participation schemes, but clearly felt the need for a scheme which would have more general appeal.

The French stock market, prior to "Monory", had been hampered in its capital-raising role by a general lack of investment interest. Perhaps the U.K. stock market is being hampered by its increasing difficulty under the weight of institutional funds to make a steady and liquid two-way market. The weight of argument certainly indicates that the tax advantages which indirect investment enjoys over direct investment should be reduced, and if this cannot be done by reducing the institutions' advantages, then stimulation along the "Loi Monory" lines should be tried, because in the long-run, if institutions so dominate the market that The Stock Exchange cannot function effectively, British industry and the national prosperity will be the losers.

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Ref. A01403

PRIME MINISTER

Equity Investment Scheme - Tax Reliefs for Small Firms

(E(80) 11)

BACKGROUND

The Committee last considered this on 12th December (E(79) 17th Meeting, Item 2) when there were two options available, both designed 'to encourage enterprise and the growth of the small firms sector'. Two main schemes were:

(a) The 'losses' scheme, now retitled the 'risk sharing' scheme;

(b) the 'start-up' scheme.

2. There was a strong feeling in the Committee that the Chancellor should be more adventurous in the Budget, but in your summing up you left it that

> "the Committee could only give the Chancellor a broad indication of its views, and leave him to make the best judgment in the light of available resources nearer the time of the Budget. The Committee did not want to rule out the package of small measures to help small businesses, but it considered that, within the limits of available resources, there was much to be said for larger and more attractive schemes. Despite the difficulties, the Committee saw more attraction in the equity investment or 'start-up' scheme than in the so-called 'losses' scheme ....".

3. Since then, the Chancellor has reconsidered the proposal; but his letter of 21st January to the Secretary of State for Industry comes down firmly against any kind of 'start-up' scheme. (The paper attached to that letter is the best available account of the schemes themselves). This drew strong reactions from the Secretaries of State for Industry and for the Environment, and you asked (29th January) that the subject should go to E. The Chancellor demurred: and tried to persuade the two Secretaries of State to fall in line with his preference for the 'losses' scheme. They refused, returned to the charge, and you again ruled (Mr. Lankester's letter of 8th February) that the subject should go to E,

on the basis of a 'collective brief' from the CPRS. Even that did not dispose of the matter, because Mr. Heseltine has returned to the charge (minute dated 12th February) pressing the argument for a 'start-up' scheme, in almost exactly the form described in the Chancellor's note of 21st January. (The original start-up scheme actually began life in the Department of Industry).

4. The essential issue before the Committee comes out clearly from the CPRS paper. Is the package proposed by the Chancellor, including the 'losses' or 'risk sharing' scheme, good enough; or should the 'start-up' scheme be added to it?

5. The argument for the 'start-up' scheme is that it is much more positive and exciting than the rest of the package and will do more to encourage genuine new investment (not just expansion of existing small business). The argument against is the scope for abuse, the cost, and the poor return compared with other Budget options. To reduce the abuse means fencing the scheme round so much that the Chancellor does not think it worth the effort, still less the cost. Mr. Heseltine believes the Chancellor, and the CPRS paper, do insufficient justice to the merits of the start-up scheme, and believes that the Inland Revenue have over-emphasised the objections. Inland Revenue for their part do not think that Mr. Heseltine's minor modifications (advance certification by an accountant, etc.) make any practical difference.

HANDLING

6. I suggest you start by asking Sir Kenneth Berrill to introduce his 'background brief', and then ask the Committee whether they are satisfied with the rest of the Chancellor's package. If they are, the question comes down to a choice between the 'risk sharing' scheme, the 'start-up' scheme or a combination of the two. You might invite the Secretary of State for Industry to make the case for the start-up scheme; ask the Chancellor to rehearse the arguments against it; and then call the Secretary of State for the Environment to rebut some of the Inland Revenue arguments. Thereafter you can throw open the discussion more generally.

7. Tactics will be difficult. There is clearly a strong feeling among certain Ministers that the Chancellor is being too cautious. Equally, you will not wish to be seen to overrule the Chancellor on a Budgetary matter. I would imagine you will want to end up, as last time, with a 'take note' conclusion, inviting the Chancellor to do the best he can in the light of points made in this discussion, but noting the substantial difficulties in the way of a start-up scheme. You may also wish to add (as a genuine contribution, not just a consolation prize) the thought, in paragraph 11 of the CPRS paper, that there should be a study made of the start-up scheme, involving the use of outside tax consultants or tax counsel. Inland Revenue have suggested to us that the real need is not so much tax lawyers, but consultation with City interests: perhaps this could also be provided for.

CONCLUSIONS

8. The conclusions might be on the lines set out in the preceeding paragraph.

RA

(Robert Armstrong)

12th February, 1980

cc A. Duguid

SECRETARY OF STATE FOR THE ENVIRONMENT

Prime Minister

TAX RELIEFS FOR SMALL FIRMS

1. I would like to make a brief comment on the paper by the CPRS (E(80)11) which is to be discussed at E Committee tomorrow.

2. The economy is now entering the downswing of the investment cycle, and the prospects for new business formation and investment are much worse than we might have hoped during the election.

3. We have provided in income tax reductions as generous a set of incentives as are on offer in comparable economies. It is of overriding political and economic significance that these are seen to have worked in the lifetime of this Parliament.

4. I believe that we would be wrong to wait and hope that a more favourable climate will bring about a resurgence of the investment which we need. The lead time of investment also argues for accelerators in that once the climate does change it can be two years later before investment is to be seen on the ground.

5. The entrepreneurial climate in Britain has been so soured that we will not easily break out of the scepticism. The Chancellor's proposals are a start; but I remain totally convinced of the need to move more dramatically to give effective help to those who are prepared to take the risk of investing in new businesses. That is why I have discussed in some detail with

Inland Revenue officials the outline of my ideas for a start-up scheme. The CPRS paper fairly sets out the difficulties which Inland Revenue have explained to me; but it does not set out fully enough the advantages, nor does it seek to find ways of overcoming the difficulties.

6. Although it is narrowly drawn I believe that we should build on the scheme devised by the Inland Revenue that would provide to ex-employees starting in business for the first time, and others starting up in a new line of business, tax refunds or reliefs on up to £50,000 of income; provided the refunds or relief are used as equity invested in physical assets, and that the business is incorporated in addition to existing incentives. Working capital should also be eligible and could be defined in relation to a proportion of capital employed.

7. My wish would be for a scheme on the widest possible reasonable basis, against this objective. However, I can see that it may be necessary for there to be limitations in scope - I could, for example, envisage a limitation to investment in manufacturing industry, easily defined in relation to industrial classification.

8. It would be defensible, though regrettable, to exclude the existing business that wants to expand, the self-employed, the business man who wants to start a new venture in his present line, and the new business that wishes to put the bulk of its

SECRETARY OF STATE FOR THE ENVIRONMENT

investment in non-physical assets. This scheme cannot be extended to them unless and until ways can be found of doing so without risking major tax avoidance. I understand that it is agreed that the avoidance problem in what I propose is not major. But the principle limitation of risk is that a) no one can get more than £50,000; b) they have to invest most of that in physical resources to get anything at all.

9. I accept that there would be practical problems in administering such a scheme. However, I believe that most could be overcome: for example, the pre-registration of intending claims giving broad outline of the investment proposed and general purpose certified by a Chartered Accountant would deter the more obvious rackets.

10. The estimated cost for the scheme - up to £100m - is a guess, and any view on cost - effectiveness is speculation. All existing schemes can be so criticised.

11. I would only add one general point. If we are having to cope with the problems of £100m worth of new small businesses each investing on average about £25,000 each over the next year then we shall not be looking for ways of closing the scheme down but for ways of resisting the clamour to extend it.

SECRETARY OF STATE FOR THE ENVIRONMENT

12. I am copying this to colleagues in E Committee, Sir Robert Armstrong, Sir Kenneth Berrill and to John Hoskyns.

MH

12 February 1980

11 FEB 1980

Econ Policy B

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bc Duguid.

10 DOWNING STREET

From the Private Secretary 8 February 1980

Income Tax Reliefs for Equity Investment

The Prime Minister has now considered the Chancellor's latest minute on the above subject, and also the minute of 6 February from the Secretary of State for Industry and the minute of 7 February from the Secretary of State for the Environment. This is to confirm that, notwithstanding the arguments advanced by the Chancellor against even the "narrow" scheme, she would like the subject to be considered in E Committee once again.

I am sending copies of this letter to Ian Ellison (Department of Industry), Stuart Hampson (Department of Trade), David Edmonds (DOE), Gerry Spence (CPRS) and David Wright (Cabinet Office).

T. P. LANKESTER

R.I. Tolkien, Esq.,
H.M. Treasury.

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B

PRIME MINISTER

Income Tax Reliefs for Equity Investment - "Start-Up" Scheme

The Chancellor and Sir Keith continued to disagree on the "start-up" scheme. You have told colleagues that you want this considered once more in E. The Chancellor - for reasons set out in his minute at Flag A - wants to drop even the so-called "narrow" scheme from this year's Finance Bill, and does not want to take it back to E. Sir Keith wants one more try in E (Flag B); so does Mr. Heseltine (Flag C).

At the end of the day, I fear you will have to back the Chancellor on this one; but I do not think you should go back on your decision to have it reconsidered in E committee. Although the "narrow" scheme is not as good as it might be and although it would place a heavy burden on the Finance Bill (the Chancellor says it would require 20-25 pages of legislation), there are important political and economic gains to be won ~~on~~ from it.

Shall I say that you want this taken in E as previously planned?

No

TL

7 February 1980

LH

~~kc~~ to Brought (Co.)

SECRETARY OF STATE FOR THE ENVIRONMENT

Prime Minister

INCOME TAX RELIEFS FOR EQUITY INVESTMENT

I have seen Geoffrey Howe's minute to you about income tax reliefs for equity investment.

I very much hope that this matter can be brought back to E Committee before a decision is taken.

It seems to me that the circumstances arguing the need for such initiatives become most compelling as time passes. I appreciate that time has been devoted to exploring the technical problems and I am grateful to the Chancellor for making available to me the opportunity to explore with his officials my latest proposals in an attempt to find a way through.

I would hope therefore to have the opportunity of discussing the options with you and colleagues in E Committee.

I am copying this to the Chancellor of the Exchequer, the Secretaries of State for Trade and Industry, to Sir Kenneth Berrill and to John Hoskyns.

MH

M H

7 February 1980

7 FEB 1980

Not discussed
To Chancellor.

PRIME MINISTER

Meeting with the Chancellor, Thursday
7 February 1980

The Chancellor will want to discuss the timing of the announcement of last week's public expenditure decisions. He has sent you a minute on this (Flag A). He favours deferring the announcement of the aggregate cuts until they can be presented in the context of the budget. But he concedes that there are arguments the other way - notably the fact that some parts of the package will have to be announced earlier. In particular, the de-indexing of short-term benefits will have to be announced by 13 March if the timetable for the Social Security Bill is to remain in tact. In view of this, the Chancellor of the Duchy is in favour of an earlier announcement of the total package. Robert Armstrong however agrees with Geoffrey Howe that the announcement should be deferred until later.

now March 14

The Chancellor and Sir Keith continue to disagree on the "start-up" scheme. You have told colleagues that you want this considered once more in E. The Chancellor - for reasons set out in his minute (Flag B) wants to drop the scheme for this years Finance Bill, and does not want to take it back to E. Sir Keith wants one more try in E (Flag C)

At the end of the day, I fear you will have to back the Chancellor on this one; but I don't think you can really go back on your decision to take this to E once more. For all the difficulties of going ahead with the scheme, there are important political and economic benefits to be won from it. You might ask the Chancellor to think about these once again in the run up to E.

If there is time, you might discuss the latest monetary developments. The combination of substantial growth in the money supply in January, continuing very high short-term interest rates, and an excessively strong Pound are, of course, very worrying. What is the Chancellor's prognosis? The Chancellor's prime objective in the budget must surely be to get interest rates down.

TL

6 February 1980

JU

~~LC~~ Duguid.

~~cc~~ D. Wright CO

PRIME MINISTER

INCOME TAX RELIEFS FOR START-UPS

The Chancellor's minute to you, reporting the meeting he had with the Secretary of State for the Environment and me last Thursday, proposes to defer any tax reliefs for start-ups and restrict his "enterprise package" to the relatively minor and technical measures he had already described.

I think the meeting on Thursday made it quite plain that the Chancellor resists the start-up scheme not for technical reasons, but because:

(a) he thinks it will be less dramatic in its appearance and effect than I and our colleagues in the E Committee thought; and

(b) progress on working out the details has now been left so late that it could be accommodated in the Finance Bill only at the cost of deferring other desirable - but unspecified - provisions.

The Chancellor concedes, as I understand it, that the "narrow" scheme would not give rise to unacceptable avoidance and its cost is manageable. He does not agree, however, that it is politically acceptable. I dissent from him in that judgement, as did our colleagues in the E Committee.

/The ...

The Chancellor's objections to the narrow scheme are that it discriminates against existing businesses, against expansions (including "start-ups" by existing entrepreneurs in a similar field, which amount to expansions) and against the self-employed. The distinction between new and existing (or between new and expanding) is inherent in any incentive for start-ups: I believe that this discrimination is politically acceptable because of the importance, both real and symbolic, of increasing the number of start-ups. The distinction between the self-employed and incorporated is, as I think the Chancellor accepted, quite defensible - they operate under different regimes, and the self-employed already have some relevant advantages over the incorporated.

As to the value of the narrow scheme, I am in no doubt of it whatever. It would halve the equity capital the intending entrepreneur needs to find to set up in business (by allowing him to claw back income tax payments in the preceding three years or so), and thus double his rate of return, to make it possible to avoid the undercapitalisation which is the primary cause of early failure. Those are straight-forward, readily-understood and accurately-directed incentives and they will have an effect far greater than anything else in prospect.

Finally, there is an over-riding need to include some positive measure in the Budget which will stimulate enterprise at a dark moment. The Chancellor's suggestion that the contingent

/losses ...

losses scheme, the ending of apportionment of close companies' trading income, and a first move on demergers add up to "a very significant political dimension" is not a judgement that I share.

Notwithstanding the lateness of the hour, I believe there is still time to include this measure (perhaps if necessary introducing the actual clauses at Report stage); that it would be not only defensible but widely welcomed and dynamic in effect; and that we have an over-riding need to include such a measure in the Budget. I still hope, therefore, to take the matter to the E Committee next week.

I am sending copies of this minute to the Chancellor of the Exchequer, the Secretaries of State for Trade and the Environment, to Sir Kenneth Berrill and to John Hoskyns.

The Chancellor's arguments certainly have some weight but I really don't think that the scheme should be rejected without balancing the strong arguments still in favour.

KJ

K J

6 February 1980

Department of Industry
Ashdown House
123 Victoria Street

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K.B.

cc Duguid
cc D. Wright CO

C.S.
J.P.

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

PRIME MINISTER

S.I.E.L.S.

INCOME TAX RELIEFS FOR EQUITY INVESTMENT

I had a further talk last Thursday evening with the Secretaries of State for Industry and the Environment.

2. We all want, if we can, to find a workable scheme of income tax relief for equity investment. We spent a lot of time on this in Opposition and officials have put in a lot more effort over the past six months.

3. Sadly, however, no-one has yet produced a scheme which I could defend in the House of Commons.

4. We spent some time on Thursday discussing the so-called "narrow" scheme described by the Committee of officials which looked at fiscal aspects of the strategy exercise.

5. I do not believe that this is capable of doing the job for which it is billed, that is revitalising the small business sector. The form of the scheme would be complex. The relief itself would be restricted to a very small part of the business sector and would deny relief in several equally important cases - the man who wanted to develop his own business, using his own capital or capital from "Aunt Agatha"; the successful entrepreneur who wants to branch out into a new company, in the same broad line of business; and the self-employed. There are good economic and industrial arguments why the "narrow" scheme should not exclude these cases, but there turned out to be insuperable technical tax reasons for doing so. Such schemes would, for example,

/be open

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be open to easy abuse, through the circulation and re-circulation of money between the business and the investor. Put at its simplest, such schemes would encourage virtually every business to reconstitute itself as a "new" business so as to be able to take advantage of a new "tax avoidance charter". Nobody has yet been able to design a scheme which would be proof against this kind of thing.

6. Even in this narrow form the scheme would be expensive - officials' best guess is £100m - and on the most optimistic assumptions the Exchequer cost could be several times the net addition to investment. To breach the conditions proposed for the "narrow" scheme could make the thing unworkable, and could entail an Exchequer cost of several hundred millions of pounds.

7. An additional factor, which I find particularly tiresome, is that the scheme would probably require an incredible twenty to twenty-five pages of legislation. There would be all manner of technical problems, for example in monitoring the re-circulation of existing capital through new companies for the purpose of obtaining tax relief.

8. My conclusion is that I cannot include a scheme of income tax relief for equity investment in this year's Budget; but I have asked my officials to resume their efforts in the FASE group to devise a scheme that is reasonably workable and cost effective. The Secretary of State for the Environment brought forward some new ideas on Thursday evening. As I said on Thursday, I am not sure that these are an answer to our problems; but we have arranged for my officials to discuss these ideas direct with him.

/9. Meanwhile,

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CHANCELLOR OF THE EXCHEQUER

9. Meanwhile, I propose to press ahead with the enterprise package which I outlined in my letter to the Secretary of State for Industry of 21st January 1980. Some of these are minor in broad political terms, though they have been pressed on successive Governments for years by industry or the professions. I believe others will have a very significant political dimension - the ending of the apportionment of close companies' trading income, the scheme which has been known so far as the losses scheme, but which I propose we announce as the "venture capital" scheme, and a first move on demergers.

10. I feel sure that this is something which we ought to sort out between ourselves, and on which we should not need to trouble E Committee again.

11. I am sending copies of this minute to the Secretaries of State for Industry, Trade and the Environment, to Sir Kenneth Berrill and to John Hoskyns.

G.H.

(G.H.)

5 February, 1980

rec 6

BUDGET - CONFIDENTIAL

-6 FEB 1980

CONFIDENTIAL

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

6th February 1980

Dear Tim,

SMALL FIRMS

Your letter of 14 December asks whether rate remission for small firms might be a runner.

While the Chancellor sees the attraction of reducing local taxation as a means of encouraging business development, he agrees with the Secretary of State for the Environment's view, as set out in Jeff Jacobs' letter to you of 15 January, that a general concession of this kind for small businesses is not a feasible proposition at present. The Chancellor has in mind in particular the unwelcome fiscal implications of the loss of revenue involved, which might well fall on central government (since local authorities would inevitably press for grant compensation). He takes the view that it would be very difficult to contemplate such a concession - whether to all small firms or confined to new firms, which might represent a more satisfactory approach - while the future of domestic rates remains unresolved.

I am copying this letter to the recipients of yours.

Yours ever,

MH

M.A. HALL
(Private Secretary)

T. Lankester Esq.
10 Downing Street
SW1

CONFIDENTIAL

7 FEB 1980

FILE   VLG

CONFIDENTIAL

cc CO

SIR KENNETH BERRILL

Assistance to Small Firms

The Prime Minister was grateful for your note of 28 January. As you will see from my letter of today's date, she has asked that the "start-up" scheme should be taken in E Committee again. She would be grateful if you would put round a collective brief on the lines you suggested.

I am sending a copy of this minute to Sir Robert Armstrong.

T. P. LANKESTER

29 January 1980

CONFIDENTIAL

CONFIDENTIAL

VLB

Econ Pol

CC HO D/N
FCO CST
D/I DOE
LPO CO
D/M Sir K Berrill
MAFF
D/T

29 January 1980

Small Firms and New Enterprise

The Prime Minister has read the Chancellor's letter of 21 January on the above subject, and has noted that he does not feel able to proceed with an investment "start-up" scheme in this year's Finance Bill. She has also seen Sir Keith Joseph's letter of 24 January, however, which argues that even a narrowly drawn scheme would be worth while.

The Prime Minister would like this issue to be considered once more in E Committee. If further work can be done to resolve the outstanding difficulties in the present proposals in advance of the E discussion, that would of course be very welcome to the Prime Minister.

I am sending copies of this letter to the Private Secretaries to members of E Committee, to David Edmonds (Department of the Environment) and to David Wright (Cabinet Office).

T. P. LANKESTER

John Wiggins, Esq.,
H.M. Treasury.

CONFIDENTIAL

JS

3 PPS

Prime Minister

Sir Keith is still pressing hard for the start-up scheme, even in its restricted form. He wants another E discussion quickly. The Chancellor would prefer to look at the scheme with a view possibly to legislation in 1981. The Policy Unit and I think one more E discussion is worth having - we can fix it for the meeting on 6 Feb. Agree?

T 28/1.

CONFIDENTIAL

Qa 04414

To: MR LANKESTER

From: SIR KENNETH BERRILL

Yes MT

Assistance to Small Firms

Flag A

Flag B

1. We have seen the Chancellor's letter of 21 January to the Secretary of State for Industry, and Sir Keith Joseph's reply of 24 January.

2. The CPRS believes that the Chancellor's proposed package of measures for the forthcoming Budget, even though it does not include the 'start up' scheme to give tax relief for equity investment, is nevertheless a positive and worthwhile one, which goes a long way to meet the advocates (including the CPRS) of the case for special measures to stimulate small firms and new enterprises. It is considerably more than half a loaf and it would be a great pity to lose it.

3. In particular, we take the view that the scheme to give tax relief for capital losses is the most effective way, both generally and in cost terms, of stimulating new investment. The most powerful inhibition in setting up a new business is the risk and penalties of failure. The proposed scheme will act directly on this constraint. It is, however, important that the scheme should not suffer from a negative presentation and we support the proposal that it should be christened the 'risk sharing' scheme (a term used by the Chancellor), rather than the 'losses' scheme.

4. Sir Keith Joseph has asked that E should reconsider the 'start up' scheme. He argues for it on the grounds of 'imaginativeness' as well as effectiveness and on this point he may be right. So whether or not it is to be a runner for the Budget, we think the Prime Minister could endorse the need for further work on the lines proposed by the Chancellor. She might also propose that outside Counsel should be associated with this work (as he has been at the CPRS's suggestion with earlier work) to give an outside and independent view on the risks of avoidance (which is a critical issue in this scheme).

CONFIDENTIAL

5. If it is eventually decided that the 'start up' scheme should not, or cannot, be worked up in time for this Budget, we would strongly recommend against any mention of a study of such a scheme in the Budget speech or debates. This could have a perverse effect on new investment by making people hold off from investment pending its introduction. Moreover, until further work is completed, there can be no certainty that a viable scheme will emerge and it would be wrong to arouse expectations, only to disappoint them later.

6. In general, then, the CPRS view is that the Chancellor's package as it stands is well worth having. That if a start up scheme cannot be introduced in this Budget it should be further studied in conjunction with outside Counsel. If the Prime Minister decides to have further discussion in E, the CPRS could put round a collective brief on the above lines, if that would be helpful.

7. I am sending a copy of this minute to Sir Robert Armstrong.

X Shall I ask CPRS for a brief?
TL.

KB

28 January 1980

to Mr Ingmid

CONFIDENTIAL

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

24 January 1980

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

Dear Geoffrey.

SMALL FIRMS AND NEW ENTERPRISE

Thank you for your letter of 21 January, and for setting out the difficulties which have led you to the view that introduction of the start-up scheme for tax relief for equity investment in new small companies, which received strong support from our colleagues in E Committee, should be postponed until next year. I am grateful for your offer that your officials should explain the technicalities to David Mitchell, and he would like to take this offer up in due course.

I have to say, however, that I do not think this meets the imperatives of the situation. We face a series of measures, on public expenditure and other aspects of our central economic policy, whose impact - however essential - will be seen as negative, contractionary and unemployment-creating. Politically as well as economically, we have an over-riding need to show we believe in enterprise. We need a dramatic and imaginative gesture, and we need it now, not some time next year. Your "convincing enterprise package" consists primarily of a scheme for relief of losses, better pension provision for the self-employed, ending the apportionment of trading income of close companies, and something on "nothings". These technical measures are useful and worthwhile, but as an "enterprise package" I frankly do not see them calling forth the imaginative response we badly need.

The start-up scheme, on the other hand, is - for all its shortcomings - a striking and imaginative measure. It would halve the equity capital an intending entrepreneur would need to find to set up in business, and thus double his rate of return, or make it possible for him to avoid the under-capitalisation which is the primary cause of early failure. I do not at all accept your view that "it is drawn so narrowly as to be indefensible". Nor did our colleagues on the E Committee who gave it clear and strong support. I am quite sure that, given the right political priority, the scheme could be got into good enough shape to be announced in the Budget

/Statement ...

CONFIDENTIAL

Statement. The cost - £100m a year - is manageable.

I therefore propose, if the Prime Minister agrees, to bring the issue again before the E Committee at the earliest opportunity. I am sending copies of this letter to the Prime Minister and all members of the E Committee and to Sir Robert Armstrong.

Ever,

Keith

25 JAN 1950

File

Original in G/R

VB

cc HMT

Econ Pol

CF to note

24 January 1980

Thank you for your interesting letter of 7 December about the problems currently faced by small firms. The Government attaches the utmost importance to the role of small firms in the creation of wealth and employment. In this context, you will know of the continued efforts of Keith Joseph and David Mitchell to identify and diminish problems facing small firms (including the three measures introduced by the latter on 7 November to help with the provision of finance, advice and premises for small firms). Geoffrey Howe will be giving small firms the fullest consideration in forming his Budget. It is in this spirit that I am taking note of the specific proposals in your letter and drawing them to the attention of those more directly concerned.

The fact remains that the first of your suggestions, a Government-sponsored loan guarantee scheme, presents particular difficulties. Loan guarantee schemes have been advocated in the past to tilt the decision in favour of increased borrowing for projects where the risk of failure is too high to justify unaided lending. Your proposal, a guarantee scheme to ensure continuance of existing overdraft lending, would be invoked mainly where the bank took the view that the borrower is not generating enough cash to service the present level of interest charges. It is hard to believe that a partial guarantee at increased cost would be sufficient to satisfy the bank. You may like to obtain the views of bankers on this.

As far as other variants of loan guarantee schemes are concerned, we are watching with interest the initiative taken by the Welsh Development Agency and the clearing banks. But the

/ difference

difference in scale between a scheme of this type, and a Government-backed loan guarantee scheme at national level, will limit the extent to which the experience of the Welsh Development Agency scheme may be directly applicable. The general constraints on our public spending and manpower policies do not pre-dispose us to think automatically in terms of Government backing for loans to small businesses. Moreover, there are private sector schemes such as the Midland Bank Venture Capital Scheme which attack the problem of borrowing limits for small companies at the root by making equity available. I believe that some businessmen go too far in spurning the advantages that can be gained from an outside partner. There are financial institutions which are prepared to make minority investments while undertaking not to intervene in management. Moreover, John Nott intends to publish a consultative paper on the possibility of giving companies greater freedom to re-purchase their own shares.

You next discuss the incidence of Capital Transfer Tax on medium sized businesses owned by individuals. In our review of capital taxation we have been well aware of the problems you describe. Although it would not be right to leave Capital Transfers wholly untaxed, I am sure that Geoffrey Howe will see what can be done in the Budget in the light of his other priorities.

Finally, I am happy to endorse your view that we should explore ways of helping entrepreneurs (particularly those who can take advantage of special competence of qualifications) wishing to leave existing companies to start new ones. There are other possible means of encouraging them in addition to those you mentioned. I am sure we shall be able to make some progress here.

(Sgd) Margaret Thatcher

John Loveridge, Esq., M.P.

CONFIDENTIAL

2pp se below

cc PS/CST
PS/FST
PS/MST C
PS/MST L
SIR D WASS
MR RYRIE
MR LITTLER
MR LOVELL
MR UNWIN
MR DIXON
MRS HEATON
MR MORTIMER
MR SEEBOHM
MR CROPPER
PS/IR
MR ISAAC-IR
MR CORLETT

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

21 January 1980

Dear Keith

ASSISTANCE TO SMALL FIRMS AND THE EQUITY INVESTMENT "START-UPS" SCHEME

When we discussed, at E Committee on 12th December, possible fiscal measures to assist small firms, it was left that I would give further thought to the possibility of an enterprise package for the Budget in the light of the discussion. There was strong support from yourself and others for a scheme for encouraging the start up of new businesses through the provision of tax relief for individuals investing directly in them. You have emphasised the point in your letter to me of 15th January.

I entirely understand the enthusiasm there is among colleagues for an equity investment scheme, if we can only design one which will stand up. Since the meeting, I have examined the scheme as devised by officials in more depth. I am bound to say, however, that I have not yet been able to satisfy myself that we have a scheme which makes practical sense or which, if it were modified to look more sensible, I feel certain would be sufficiently tight to avoid unacceptable tax losses. There can be no doubt that a scheme much less restricted than in the FASE report would be wide open to abuse. We are not talking here of fringe manipulation - as my officials have emphasised from the outset, I am quite happy to live with that as a price for achieving a scheme with real impact - but about the certainty of really massive loss of tax through what could be the most easily concocted arrangements, and often resulting in no new genuine investment whatsoever. On the other hand, while the FASE scheme limits these avoidance opportunities, it is drawn so narrowly as to be indefensible.

"Fiscal Aspects of Strategy" Exercise

i.e. it excludes investment in working capital, investment in new business in same line of activity, and investment by self-employed. R.

I believe it might be fruitful, however, to put in hand further work to see whether there is any way of achieving

/our two

The Rt. Hon. Sir Keith Joseph, Bt., MP.

CONFIDENTIAL

our two aims - an effective and attractive incentive, with a reasonable cost to the Exchequer. The FASE proposals are a beginning at least, and I think take us nearer a possible solution than seemed possible in the past. It does mean, though, that it will not be possible to implement a scheme in the coming Finance Bill. A longer time-scale would have a number of advantages, not least in that it would allow us to consult rather more widely than we have done, even if it has to be on a confidential basis.

Some colleagues have asked me for a more detailed explanation of the problems of an unrestricted scheme - particularly the avoidance possibilities - and the attached note may be of some help. I have also included in it a reference to the sort of issues which I think need to be considered in the further work. If you and Michael Heseltine agree, I propose to ask the interdepartmental group of officials (FASE), who produced the previous report, to undertake this further examination and report to us in MISC 14. Your officials will, of course, be fully involved in the review. The work could be handled alongside the study, already under way, of ideas, such as the Small Firms Investment Company concept, which are designed to bring together potential investors and small businesses seeking venture capital.

I know that David Mitchell has taken a very close interest in all this, and I wonder whether it would be useful if, before the further work begins, he were to have a talk with one or two of my Treasury and Inland Revenue officials about the problems set out in the note. David may have some new ideas to inject. Indeed, you and Michael may feel that you would like to take part in this initial discussion.

Meanwhile I have in mind that the Budget could include a convincing enterprise package, made up of the following main elements. First, concessions on capital taxation, following the capital tax review. Second, I think we should go ahead with the risk-sharing scheme (the so-called "losses" scheme, but we must certainly find another name for it) under which income tax relief will be given for capital losses incurred in investing in unquoted companies. Third, I would like to include four of the five other measures which we looked at in E. The most important of these is clearly the abolition of the rules for apportioning the trading income of close companies. But I also see a worthwhile case for more generous tax reliefs for self-employed people who take out retirement annuities, extension of the relief for interest on loans taken out for the purpose of investing in family

/companies

companies and stamp duty relief to assist the marketing of unlisted companies. Fourth, I have it in mind to introduce a new relief - to which both industry and the accounting profession attach considerable importance - for the costs incurred by businesses in raising loan finance. Fifth, subject to the further discussion which I wish to have with you and John Nott, I hope I shall be in a position to make some positive move on easing de-mergers.

I will also see whether it might be possible to say something in my Budget Statement, in very broad terms, about the examination we are giving to the possibility of an equity investment scheme. But we shall need to think carefully about the wisdom of this. We must avoid running the risk of achieving exactly the opposite of what we intend, through people holding back from new ventures while they wait to see what may emerge.

I am copying this letter to Michael Heseltine, and also to the Prime Minister and colleagues on E Committee, and to Sir Robert Armstrong.

(GEOFFREY HOWE)

A SCHEME FOR TAX RELIEF FOR INDIVIDUALS INVESTING IN SMALL FIRMS

Objectives

1. The aim of the FASE report was to examine the feasibility of a scheme to encourage individuals to invest in small firms, by giving tax relief on the amounts invested. The concept of the scheme is simple enough. Individual A, say with a marginal tax rate of 60 per cent, invests £10,000 in small firm X; he finds £4,000 from his own resources, and the remaining £6,000 is provided by the Exchequer in the form of tax relief.

2. The scheme has to be geared to encouraging individuals to invest sums of the order of £10,000 to £50,000 - the sort of tranches which, according to the equity gap theory, are most required by small firms. This puts the scheme in an entirely different league from the French Loi Monory, where relief is restricted to £500 new equity investment per person per year.

3. FASE recommended that the relief should apply only to start-ups, and not to investment in existing small businesses. This was because, first, the cost needs to be kept within bounds, and second, Ministers themselves have tended to favour concentration on the encouragement of new businesses.

4. FASE envisaged that the relief would have to go wider than just Aunt Agatha (the outside investor), since it would be unreasonable to exclude individuals who wished to invest their own funds in their own new firms.

Problems

5. FASE has not gone so far as to design a possible scheme. What it has done is to identify the main constraints that would need to be built into any scheme.

6. One important problem is the sheer complexity of the necessary legislation, making the scheme expensive in skilled staff to administer, and perhaps unattractive to the ordinary businessman unused to seeking specialist advice.

7. More fundamental is the dilemma that:

i. a broadly-based scheme appears to be unmanageable, with a possible Exchequer cost of several hundred million pounds, with no guarantee that at the end of the day there would be a penny of new investment in small businesses; whereas

ii. a scheme capable of being contained within an Exchequer cost of, say, £100m would need to be so narrowly defined as in practice to be indefensible.

Cost effectiveness and avoidance

8. The problems centre round the difficulty of ensuring that the relief goes only to genuine investment by an individual which is channelled into a business, and retained there. This would have to be monitored without all the arrangements - for example an annual statement of a taxpayer's total assets and liabilities - on which the Revenue authorities would expect to draw under a fully-fledged expenditure tax. Even in its much more limited concept, the French Loi Monory in fact uses the institutional arrangements of the commercial banks to achieve just this.

9. Without this kind of defence, there are three main sources of easy abuse:

i. circulation and re-circulation of capital between the business and the investor;

ii. circulation and re-circulation of income between the business and the investor;

iii. the placing of all or part of the capital or profits of an existing business within a new one.

10. Circulation of capital. Firms can be used as a straight conduit for funds, so some way would have to be found to prevent the same tranche of investment capital being recycled and accumulating successive amounts of relief. To take the simplest possible example: individual A invests £10,000 in firm X, obtaining up to £6,000 tax relief. X then lends the money back to A, who makes a second investment in X (or a separate investment in Y), claiming a further £6,000 relief. And so on. Hence, a means must be found of ensuring that the initial investment is not financed by X, but remains in X. The necessary legislation would be complex, in particular in having to provide for clawback, and policing it would be a real problem.

11. Circulation of income. The directors or shareholders of a business could withdraw money in the form of directors' remuneration or dividends (attracting relief from corporation tax for the company), and could subsequently reinvest the same money in the company, attracting in the course of that simple transaction the new income tax relief. There is virtually no effective way of controlling that kind of arrangement. But it means that any company within the scheme could in effect enjoy a tax holiday from corporation tax on all its profits. It is one reason why FASE concluded that the scheme would have to be confined to start-ups (where companies would normally be making little taxable profit) rather than extended to small companies generally (where the amount of corporation tax at risk would be over £500 million).

12. Transfers of businesses. The more intractable problems arise from the fact that the creation of a "new company" does not necessarily imply the creation of a "new business". It would present no difficulty for the owners of an existing business to shift part or all of its assets, or indeed its profits, into a new company, and claim tax relief of up to (say) £30,000 per investor for nothing more than the placing of existing business assets under a new corporate label. Intensive work by the Inland Revenue, and subsequently in FASE, found no way of solving that problem, short of confining relief to the case where the new company is not in the same line of business as, and does not conduct a substantial amount of its business with, an existing business in which the investor has a significant interest.

13. But even with the start-up condition, the relief remains wide open to abuse. Hence, the FASE view that further restrictions would be required. For example:

i. A new business could be used simply as a haven for an investment portfolio. Thus, A sets up company X and lodges in it his personal holding of £10,000 of gilts, continuing to receive the benefit of the interest in the usual way. As a result of that simple manoeuvre, he obtains £6,000 relief. Hence, the proposal that only funds invested directly in physical assets - plant, machinery, stock, premises - should qualify for relief.

ii. The problems of distinguishing between personal and business funds in the case of an unincorporated business means that the scope for abuse would be even greater for the self-employed than for companies. Indeed, it would be open for anyone self-employed to claim a tax holiday on the whole of his income. Those who originally proposed the Aunt Agatha scheme recognised that the self-employed would have to be excluded.

Narrow scope of the scheme

14. FASE recognised that a scheme incorporating these sort of restrictions would end up drawn extremely narrowly. In particular:

i. There would be obvious political difficulties over having to exclude the self-employed.

ii. The crucial definition of a "new" business, while necessary to control tax avoidance in excluding firms started by businessmen already involved in the same line of activity, would, first, involve formidable practical problems and, second, look extraordinarily perverse by apparently withholding relief from anyone with previous practical experience in the business concerned.

iii. Limiting relief to investment in physical assets would exclude investment in working capital. That exclusion does not make a lot of sense in terms of practical business operations, and would look particularly unfair to those businesses, eg in the high technology field, whose main requirement for capital may be the purchase of expertise rather than the purchase of equipment. FASE recognised that the working capital exclusion might be dropped, but noted that it would add to the risk of abuse and, therefore, the cost of the scheme - although no estimate was possible of the likely size of this cost. The extent of possible exploitation is a matter of judgement, on which FASE was divided.

15. In the light of past experience, and indeed of what Ministers themselves have said in earlier Finance Bill debates on the self-employed, a scheme defined in these narrow terms could not in practice be defended. But the risk to the Exchequer if the scheme as it stands were extended - either intentionally or through irresistible pressure - would be unacceptable.

<u>Further work</u>

16. If further work is to be commissioned, with time to examine the problems and possibly to consult more widely, then the areas on which effort needs to be concentrated include:

i. Whether it is possible to construct a more acceptable and workable definition of a "new" firm - ie one which clearly identifies genuine start-ups involving completely fresh operations and entirely divorced from any existing business.

ii. Subject to the conclusions at i, consideration needs to be given to a whole range of technical problems. For example, consideration would need to be given to how far the relief - which would clearly be very considerable - could be available through carry back against previous years' tax. More difficult issues would be such things as clawback of past relief, definition of associated persons, changes in share ownership, definition of bona fide trading etc.

iii. A scheme as envisaged in the FASE report would apply to start-ups generally, whatever the purpose of the business. It would be worth considering whether there would be a case for restricting the relief to selected areas of activity - say manufacturing industry. This would have the advantage of confining the possible scope for tax loss, and arguably might be consistent with wider economic considerations.

H M Treasury
January 1980

LH

2

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

15 January 1980

Prime Minister

You asked whether small businesses could have their rates reduced or eliminated. Mr Heseltine in this letter argues pretty strongly against. The Chancellor (letter at Flag A) agrees with him.

7/2

Dear Tim

My Secretary of State has seen a copy of your letter of ~~14~~ December to Tony Battishill, asking what consideration had been given to the possibility of helping small firms by reducing or eliminating their rates.

So far as we know this particular proposition has not been examined by Departments before, but my Secretary of State's initial reaction is somewhat against the idea for three main reasons:

(i) Rate payments by the non-domestic sector amount to £4 bn annually. Whatever the definition of "small" small businesses will account for a substantial proportion of that amount. We are currently considering alternatives to domestic rates - which produce revenue totalling nearly £3 bn a year - and it is already clear that it will be extremely difficult to find an acceptable alternative form of revenue. The problem of alternative sources of revenue to offset income from domestic rates would be even greater if substantial relief from rates was given to small businesses.

(ii) There is no satisfactory definition of a "small" business, and there would be extreme difficulty in policing the boundary line between large and small, and avoiding artificial division of firms into qualifying parts. For this reason my Secretary of State concluded and colleagues agreed that in the enterprise zones the rating concession would have to extend to all firms, not just small ones.

(iii) Our economists and valuation advisers believe that much of the benefit of a rates concession would feed through to landlords and property owners in the form of higher rents and prices rather than being retained as a benefit by the firm in question. It is doubtful therefore whether it would do a great deal to assist small firms. Other forms of assistance through tax relief or grants are likely to be more cost-effective.

My Secretary of State considers that these are fairly conclusive objections to a general rates holiday for small businesses. There are however three other measures currently being developed in the rating field which will help small businesses:

(i) giving small businesses the right to pay rates by instalments, which is included in the Local Government Bill;

(ii) extending domestic rate relief to a wider range of mixed commercial and domestic properties, also contained in the Local Government Bill;

(iii) the rate concessions to be given to the non-domestic sector in the enterprise zones.

These proposals will provide significant assistance to small businesses in the rating field. My Secretary of State considers that the Government can reasonably rest on these proposals for the time being.

I am copying this letter to Tony Battishill (HM Treasury) Ian Ellison (Department of Industry) and Martin Vile (Cabinet Office).

Yours sincerely

Jill Jacobs

J JACOBS
Private Secretary

T P Lankester Esq

2F.

16 JAN 1980

MR LANKESTER   cc Mr Hoskyns

The E minutes for last Wednesday make it clear that the Committee favoured the "start-up" scheme to encourage equity investments. The Prime Minister said that the Chancellor should make his best judgment nearer the time of the Budget. My concern is that unless officials in the Inland Revenue (who are known to be hostile to the scheme) and Treasury officials (who seem indifferent) make very rapid progress in preparing a scheme in fuller detail, the Chancellor will not really have an option on the start-up scheme as the Budget approaches. I have heard that officials will be asking the Chancellor what priority to attach to work on the scheme within the next few days.

ADi.

ANDREW DUGUID
18 December 1979

CONFIDENTIAL

B/F 21.12.79.

FILE

Econ Pol

VLB

cc DOE
D/I
CO

14 December 1979

Small Firms

There has of course been much consideration given recently to possible ways of helping small firms. The Prime Minister has asked whether the possibility of substantially reducing the rates payable by small firms, or eliminating them altogether, has been considered.

I would be grateful for a note on whether this is a possible runner.

I am sending copies of this letter to David Edmonds (Department of the Environment), Ian Ellison (Department of Industry) and Martin Vile (Cabinet Office).

T P LANKESTER

A. M. W. Battishill, Esq.,
H.M. Treasury.

CONFIDENTIAL

E.R. Orig. Defence May 79 - Budget.

SECRET

PRIME MINISTER

MEETING WITH THE CHANCELLOR: THURSDAY 13 DECEMBER

The following issues are likely to be raised by the Chancellor:

(i) Public Expenditure

There is the note he sent you about defence expenditure (Flag A) on which Robert Armstrong commented at length. You will presumably want to persuade the Chancellor not to make a pitch in Cabinet against the defence spending volume figures. We are likely to have enough trouble getting Mr. Pym to agree the cash limits. There is also a note which came today (Flag B) on the other main options for spending cuts. (Robert Armstrong's note on handling of bilaterals or 'star chamber' is at Flag F).

(ii) Capital Taxation

There is a minute at Flag C in which the Chancellor sets out his provisional proposals - these involve abolishing the investment income surcharge altogether, and significantly reducing the burden of capital gains tax and capital transfer tax. You won't have time to discuss this in detail tomorrow. You might prefer to set up a meeting with one or two other Ministers - for example Mr. Nott and Sir Keith Joseph because of their interest in the industrial implications, and perhaps the Home Secretary to provide a political steer. The main issue will be whether the Chancellor can afford the whole package which will cost about £600 million. In the light of this afternoon's discussion on small firms, it might for example be better to spend rather less on CTT and spend £50 million on the small firms "start up" scheme.

(iii) Treasury Appointments

A meeting has been arranged for Friday morning with Ian Bancroft and others to discuss this, but the Chancellor wants a preliminary word. (Ian Bancroft's note at Flag E).

/Following your

Following your meetings today about the Local Government Bill, you may want to mention to the Chancellor the capital controls issue. Mr. Heseltine told you that his full package would be saleable, but that the aspects which the local authorities most wanted could not be announced until he and the Treasury (Mr. Lawson) had come to terms over the new arrangements to replace project controls. You told Mr. Heseltine that you would send a message to Mr. Lawson urging the fastest possible progress on this. In practice it might be best to do this by asking the Chancellor to see that work is expedited.

At E this afternoon, it was decided that the Chancellor should look again at the small firms "start up" scheme. But I think there was no suggestion that there should be any announcement before the Budget. I wonder whether the Chancellor should not be pressed to have something ready for an announcement earlier than the Budget. Although implementation would have to await the Finance Bill, this might bring forward decisions by potential investors. And it would be politically helpful. (We did write to the Treasury last month suggesting that an announcement before the Budget would be helpful - see Flag D.)

R.

12 December 1979

MR LANKESTER ✓ cc Mr Wolfson

Econ Pol.

ENTERPRISE PROPOSALS

1. The Policy Unit believes it would be a mistake to drop the "start-up" scheme to encourage investment in new companies. It could make all the difference between an imaginative package and a damp squib. Although some of the restrictions necessary to limit tax avoidance are unwelcome and complex, the principle is simple, novel and politically attractive: tax relief for investment in genuinely new start-up companies (up to £50,000 spread over several years). This would apply both to the entrepreneur proprietor and the outside investor. Against the background of cuts and necessary redundancies in nationalised industries, this would be a clear signal that the Government is willing to take positive measures to encourage the creation of new employment and to make investment more rewarding.

2. We agree with Sir Kenneth Berrill that it is essential to drop the restriction originally proposed by the Revenue which would exclude tax relief for investment in working capital. His brief says that even the Revenue have now reluctantly accepted this. It might prove possible to drop some of the other restrictions once experience of the scheme had been gained. We recognise that the cost (estimated to be a Revenue loss of up to £100m) is a serious inhibition, but there are few higher priorities than encouraging new companies. If necessary, some of the minor proposed measures like the tiny Corporation Tax cut from 42% to 40%, could be jettisoned. We support Sir Keith Joseph's wish to introduce the scheme - if necessary on an experimental basis - as quickly as possible.

AD

ANDREW DUGUID
12 December 1979

CONFIDENTIAL

Prime Minister
see also
CPRS brief

Ref. A0923

PRIME MINISTER

Enterprise Proposals

(E(79) 77, 82 and 83)

BACKGROUND

The Chancellor of the Exchequer's paper (E(79) 77) deals with 12 proposals for action "to encourage enterprise and the growth of the small firms sector" (these "enterprise proposals" are not related to "enterprise zones"). The Chancellor proposes to implement five of the schemes, accept another one in principle, and remit two more for further study. He rejects the remaining four. The CPRS (E(79) 82) suggests that one of the Chancellor's "favoured five" should be left out (a reduction in the "small firms rate" of Corporation Tax). Unlike the Chancellor, however, the CPRS does not want to turn down out of hand the "start-up scheme", although it involves further tax relief for individuals. The Secretary of State for Industry (E(79) 83) wants the "start-up scheme" introduced at once. The Secretary of State for the Environment has not circulated a separate paper, but can be expected to resist strongly the Chancellor's proposal to turn down his own two proposals ("Transfer of Investment Allowances" and "Investment Rebate Scheme"). There were signs in earlier discussions that his readiness to accept further cuts in his public expenditure programme would be conditional on his colleagues' acceptance of these proposals. !

2. It would have been helpful, time allowing, for the Ministers directly concerned to meet and sort out their differences. This may still be the best solution. We have left the paper on the agenda, so that the Committee can have a first run over the problems. If the Chancellor is right in his cautious approach, there is no need for immediate decisions: these matters can be left till the Budget. But I think you had hoped for at least "a small firms" package which could be announced very early. This would still be possible, but only if the first four (or five) bits of the package are announced in advance of the rest. An early decision on these items would be needed if there were to be an announcement in the New Year.

3. As with the earlier paper on profit sharing (E(79) 76, Item 2 on this agenda) everything turns on how much the Chancellor can afford in the next Budget. Assuming Cabinet approves the reopening of public expenditure totals, there could be a little room for manoeuvre: indeed, introduction of an "enterprise package" of some kind might make the expenditure cuts more palatable. It would also require them to be bigger. Ministers have therefore got a choice to make, and it will not be easy to take a final view until after the Cabinet discussion on public expenditure on Thursday.

4. The merits and demerits of the different schemes are set out in the various papers. The best course is probably to go through them one by one.

HANDLING

5. You might therefore call for an opening statement from the Chancellor of the Exchequer, and thereafter take the Committee through the various schemes, following the sequence in the Chancellor's covering paper (paragraph 4 onward):

(i) Abolish the rules for apportioning the trading income of "close" companies. No objections likely.

(ii) More generous tax relief for self-employed people who take out retirement annuities. No objections likely.

(iii) A reduction in the rate of Corporation Tax for small companies, from 42 per cent to 40 per cent. The Chancellor is prepared to recommend this: the CPRS argue that it is not cost-effective, although legislatively easy (even this is not certain: it will require a workable definition of a "small firm" which could be difficult to find). The Secretary of State for Industry is likely to support the Chancellor strongly.

(iv) Widening tax relief for interest on the loans for investment in closely controlled companies. No objections likely.

(v) A new relief from stamp duty to assist the marketing of unlisted companies. No objections likely.

(vi) The "Losses scheme". There is a full description of this in paragraphs 2.6-2.10 of the interdepartmental report. The Chancellor does not turn it down flat: he proposes it for further study. The Secretary of State for Industry argues against it, as less cost-effective, and psychologically more damaging, than his preferred option, the "Start-up scheme". The CPRS argues for the "Losses scheme" but draws attention to the administrative complications.

(vii) The Equity Investment or "Start-up" scheme. For the details, see the interdepartmental report on "Tax Relief for New Investment in the Equity of Small Firms". The scheme would work by giving individuals tax relief on income which they spend on buying shares in new ventures. There would be many problems of definition, and a very serious problem of evasion. The cost might therefore be high. But it is a gambler's risk: the pay-off could also be very large, if it led to new ventures on a substantial scale. It is much the biggest of the schemes. The CPRS paper goes into the problems in more detail (paragraphs 5-8). Its cost probably rules it out for the 1980 Budget anyway. Are Ministers content that it should be studied meanwhile?

(viii) Small Firms Investment Company. This is a proposal (paragraphs 2.16-2.18 in the official report) for filling the "Equity gap". There is no dissent from the Chancellor's proposal to study it further.

(ix) Relief from VAT on bad debts. Similarly, a review can be put in hand quickly: but there is no prospect of immediate action.

(x) A tax holiday for new businesses. This was Sir Keith Joseph's main proposal. It has analogies with the "enterprise zone" proposals which will be before the Committee next week, though it has proved impossible to find a way of introducing "tax holidays" on a geographically selective basis. The main difficulty, however, lies with the self-employed. The Secretary of State for Industry did not propose that they should be exempt: yet there is no easy way of keeping them out if they decide to incorporate themselves. The Chancellor recommends rejection. Does the Secretary of State, on reflection, agree?

(xi) An Investment Rebate Scheme. This, and the next one, are the two "accelerator" proposals for "encouraging winners" put forward by the Secretary of State for the Environment. He has never reduced them to writing, but has briefed his officials who have had several discussions with the Inland Revenue. Neither scheme seems a starter. Paragraphs 3.6-3.11 of the interdepartmental report explain why the Investment Rebate Scheme is not favoured. The original idea of tax rebates will not work anyway, because many taxpayers would not have the necessary liabilities against which to offset the very generous allowances. The scheme is therefore a "grants" scheme. As such, it is just another version of investment incentives, directed at companies which already have a proven track record. The Chancellor rejects it simply on its public expenditure cost. The CPRS have also studied the proposal (although it is not covered in their paper) and I believe that they too advise against it (Sir Kenneth Berrill to comment?).

(xii) Transfer of Investment Allowances. Paragraphs 3.2-3.5 of the interdepartmental report deal with the second of Mr. Heseltine's proposals. The Chancellor rejects it on grounds of principle. It involves making a company's additional tax allowances available to its shareholders. It is very much more open to tax avoidance than the "start-up" scheme. The Chancellor recommends rejection. Does the Secretary of State for the Environment acquiesce?

TIMING

6. At this point, you will want to consider whether there is enough of a package available to justify an early announcement. The Chancellor's proposals would cover only items (i)-(v) above (and the CPRS object to (iii)). He also suggests that (vi) could be considered for the 1980 Budget. Is he, therefore, ready to announce some or all of items (i)-(v) before then? Is this a sufficiently large package to be credible, or would it be better to wait for the Budget?

CONCLUSIONS

7. You will want to record a view for or against each of the 12 items listed above. You could then leave the Chancellor to decide which of the favoured items he could afford in the 1980 Budget - or alternatively which can be afforded and announced earlier in a separate package.

RTA

ROBERT ARMSTRONG

11th December, 1979

2

Prime Minister

TL 11/12

CONFIDENTIAL

Qa 04376

To: MR LANKESTER

From: SIR KENNETH BERRILL

Small Firms Package

1. You will have seen that the CPRS has circulated a note on this subject (E(79)82) which (a) recommends that Ministers should endorse a number of useful but limited measures but (b) takes a neutral approach on the major proposal, i.e. that individuals should be able to set off up to £10,000 or £20,000 invested in new small firms against their income tax liability. Sir Keith Joseph's paper, E(79)83, gives his support to (a) but pleads strongly for (b) also.

2. As the Prime Minister has expressed interest in this area, it might be helpful to spell out rather more fully:

(a) the economic pros and cons of the proposal;

(b) the administrative/avoidance considerations.

3. The scheme set out in the paper is a more limited version of a proposal put forward by Sir Keith Joseph which covered income tax relief for investment in both new and existing firms. I think the concentration on start-ups is justified as it is very much more difficult to find external risk capital for new comapnies than for existing companies with a few years' track record. The incentive (provided some of the restrictions were removed) would undoubtedly result in additional investment. It will also encourage people who would have invested in any case to invest more. All this should have a beneficial multiplier effect on the economy. On the other hand, the incentive is quite costly (say £100m.) at a time when the Chancellor is about to launch another exercise to cut back public expenditure. Such a sum might be used in alternative ways, e.g. to cut the investment income surcharge from 15 per cent to 10 per cent (£75m.) or to reduce the top rate of income tax from 60 per cent to 50 per cent (£105m.). There can be little doubt that most of the incentive will go to people who would have invested in any case (some 70,000 new companies are set up every year). Even if all the proposed Revenue restrictions are imposed (which in my view would make the scheme unviable) there is still likely to be a certain amount of avoidance.

4. In the light of the Prime Minister's earlier remarks in E about the need to temper the Revenue's natural anxiety to curb avoidance with the desirability of giving positive stimulus to the small firms sector, the CPRS has followed the discussions on the dangers of avoidance in great detail. Indeed, with the agreement of the Treasury and the Revenue we retained free of charge Tax Counsel (from Mr Peter Rees's Chambers) to advise on the problems to which the Revenue have drawn attention, which are spelt out fully in the report on tax relief for new investment in the equity of small firms attached to E(79)77.

5. Most of the restrictions which the Revenue propose are reasonable and defensible. They do not undermine the main political economic benefits of the scheme, although they inevitably lead to complicated legislation. Without them the scheme could be open to large-scale avoidance. There are, however, two restrictions which it would be essential to remove (or deal with in a different way) if Ministers wish to proceed with such a scheme, namely that the relief would not be available for

(a) working capital; or

(b) businessmen who set up new businesses in their existing line of business.

For the reasons explained in some detail in our paper the CPRS believes the restriction on working capital can be removed without danger of widespread avoidance. Tax Counsel strongly agrees with this view. The Revenue are now reluctantly willing to see this restriction dropped. If it is maintained the scheme is almost certainly not worth going ahead with.

6. Counsel also believes that ways could be found of dealing with the second problem, probably by putting the onus on such businessmen to prove, if necessary, that their new business is a genuine one. This is not wholly satisfactory and will be time-consuming for both investors and the Revenue. These points are not unnaturally emphasised by the Revenue. On the other hand, Ministers would find it impossible to defend an incentive which would benefit a widgets manufacturer who invested in, say, a new tobacconist, but would not benefit him if he set up a genuine new widgets factory.

7. If the Prime Minister considers it is worth doing further work on the scheme outlined by the Revenue with a view to omitting or altering some of the restrictions, she might consider proposing that outside Tax Counsel as well as other Departments should be associated with the work. While such an approach is unlikely to be welcome to the Revenue, it might help counterbalance their natural concern with avoidance.

8. I am sending a copy of this minute to Sir Robert Armstrong.

KB

11 December 1979

P.

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

11/12

11 December, 1979

Dear Keith

SMALL FIRMS

You wrote to me on 5th December about the suggestion for tax relief for individuals in respect of amounts which they invest in the equity of new businesses.

You will by now, I expect, have seen the report by the interdepartmental group of officials, which has been considering this and other possible measures to help small firms, and also my memorandum for E Committee. I am afraid that I have had to conclude that a relief of this sort is not a starter.

When you originally asked, in your letter of 3rd July to John Hoskyns, that this idea be considered in the strategy exercise, you said that the relief would involve considerable administrative difficulties and opportunities for avoidance, but that the potential advantages could outweigh those disadvantages. I, personally, and my officials have put in considerable time and effort to see if we can design a scheme to meet the objective of a measure which would be of real benefit to small firms, without incurring unacceptable costs and complications. I am convinced, however, that neither a narrowly-drawn relief - even if it were feasible in that form - nor an unrestricted one would give us good value for the very large amounts of revenue we should be giving up.

I am sorry not to be able to support you on this, but we need to adopt a reasonably rigorous approach to these sorts of proposals, and I have reluctantly come to the view that, while a capital losses scheme for investors can be justified in terms of its cost and likely benefits, the same cannot be said of an equity investment scheme.

I am copying this reply to the Prime Minister.

GEOFFREY HOWE

The Rt.Hon.Sir Keith Joseph, Bt. M.P.

11 DEC 1979

JU

CONFIDENTIAL

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

7 December 1979

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW 1

12 11/12

Dear Geoffrey.

SMALL FIRMS - NON-FISCAL QUESTIONS

As you know, the interim report of the Wilson Committee recommended that a publicly underwritten loan guarantee scheme with a subsidy element should be set up on an experimental basis as soon as possible. There have also been proposals recently from the Union of Independent Companies and the Association of Independent Businesses for a somewhat different form of loan guarantee scheme with a Government subsidy.

I understand there has been inter-departmental official consideration of these proposals; and I have considered this proposal put by the Wilson Committee and the various representations by the small business organisations. A subsidised loan guarantee scheme would need to be sponsored by one department, and I imagine it would fall to the Department of Industry as the department responsible for small firms.

A subsidised loan guarantee scheme would have public expenditure implications and the issue is whether a new subsidy has sufficient priority. We must also bear in mind our limited scope for manoeuvre on PSBR grounds. I am quite sure that our first priority is to take action on the fiscal front to improve the climate within which small firms operate and to provide specific incentives for individuals to invest in small firms. Against this background I have concluded that we should not proceed with the idea of a loan guarantee scheme at present. But I think that, if we should find it necessary in future to supplement the fiscal measures on which I hope we shall shortly decide, we could look again at the question of a loan guarantee scheme.

I shall be writing to you shortly on the subject of undue burdens on small firms.
I am sending copies of this letter to the Prime Minister and other members of E Committee, and to Sir Robert Armstrong.

Yours.

Keith

10 DEC 1979

CONFIDENTIAL

Econ Pol

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
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Secretary of State for Industry

5 December 1979

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

R 6/12

Dear Geoffrey.

SMALL FIRMS

We are to consider very shortly, in the E Committee, the various fiscal proposals in the small firms field.

I do understand the complexity of these matters, the risk of avoidance and the budgetary situation.

But I do think that we need to announce an imaginative step to encourage small firms and in particular start-ups. The principal scheme we shall be examining - a tax relief for individuals investing in genuine new start-ups (including proprietors as well as "Aunt Agathas") would be of quite major benefit both to us presentationally and to intending entrepreneurs and investors. I realise that a decision in favour of the scheme could delay other desirable tax reforms; but an imaginative and positive measure on start-ups and new enterprises must surely have a very high priority. I do hope that you will feel able to give it your backing.

I am copying this letter to the Prime Minister.

Ever,

Keith

M

5 DEC 1979

Econ Pol 2

cc Mr Hoskyns
Mr Wolfson

Prime Minister

To note: in response to my letter at Flag A which you said I should write to chase them up.

TL 27/11

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

27th November 1979

Dear Tim,

You wrote to me on 22 November about the Prime Minister's comments on the work which is being done on a package of tax measures to benefit small firms.

You can assure the Prime Minister that this work is being given the utmost priority in the Treasury and Inland Revenue. There are some difficult issues which are having to be resolved, but a good deal of progress has been made, and the Chancellor intends that the report shall be ready, if required, for a meeting of E Committee in the week beginning 10 December.

The question of an early announcement of Government action can be considered in the light of Ministers' decisions on the form of the package.

A copy of this letter goes to Martin Vile (Cabinet Office).

Yours ever,

Tony Battishill

(A.M.W. BATTISHILL)

Tim Lankester Esq.

27 NOV 1979

Original in G/R

Econ Pol.

JS

cc DI1

10 DOWNING STREET

THE PRIME MINISTER

26 November 1979

Dear Mr. Brindle,

Thank you for your letter of 16 November. I was sorry to learn of the problems which your company faces.

The Government recognise that high interest rates add to the difficulties faced by businesses. But we inherited a situation in which the money supply was growing too fast and the Chancellor has had to take immediate action, including increases in Minimum Lending Rate, to bring monetary growth under control. A premature reduction in interest rates would jeopardise the attainment of a lower rate of inflation, an objective which is essential for businesses of all sizes and for future investment and growth. As soon as the Government's monetary and fiscal policies take effect - in particular the planned reduction in public sector borrowing and spending - and it is clear that monetary growth is under control, it should be possible to lower interest rates.

This is a longer-term policy and the Government have never made any pretence that there are quick or easy answers to our deep-rooted economic problems or that industry does not face a very difficult period. However, there are measures which we can and are taking to encourage business and small firms in particular. The Budget, with its emphasis on

/improving

improving incentives and reward for effort and enterprise, was the first step in this direction. We are currently examining a number of other more specific financial and fiscal measures designed to help small businesses but I cannot be precise about these at this stage.

The other main strand of our policy to help small firms is the elimination of unnecessary constraints. The Secretary of State for Employment has already laid Orders to lengthen the qualifying period for unfair dismissals and reduce the period for small redundancies in advance of any changes which the current wider review of the legislation may suggest. The proposed changes in company law described in the recent Green Paper will considerably reduce the disclosure requirements on small firms. As a pilot exercise, the Department of Trade has commissioned a firm of consultants to review its administrative forms.

As I have said, these are first steps but, taken as they have been in the first few months of office, I hope you will agree that they are evidence of our future intentions.

So far as your immediate problem is concerned, I regret that I can make no promises but you might care to approach the Small Business Unit of the Welsh Development Agency at Treforest Industrial Estate, Pontypridd. The Small Business Unit offers a business guidance service and can help with modest amounts of finance in suitable cases.

I very much hope that you will find it possible to weather this difficult period, and I wish you every success in the future.

Yours sincerely

Margaret Thatcher

John Bridle, Esq.

Jrl VB
Econ Pol

10 DOWNING STREET

CONFIDENTIAL

From the Private Secretary

22 November 1979

At E Committee on 23 October there was some discussion of a possible package of tax measures to benefit small firms. The hope was expressed that such a package could be announced some time before the Budget. I understand that officials will be reporting back to the Chancellor shortly on the possibilities.

The Prime Minister has asked me to say that she regards this work as having added urgency in the light of the recent developments on the monetary front. Whilst she of course recognises that the increase in MLR and other measures announced last week were absolutely necessary, she feels that something needs to be done of a positive nature very soon to give industry - and particularly small firms - renewed confidence. She feels that the early announcement of tax measures to assist small firms would be very helpful - though she also realises that there are severe constraints imposed by the PSBR.

I am sending a copy of this letter to Martin Vile (Cabinet Office).

T. P. LANKESTER

A.M.W. Battishill, Esq.,
H.M. Treasury.

CF.

put on file
pls

R 27/1

Confidential

Tim

Small Firms

1. "E" will consider a report on 11 December a report on Fiscal Incentives to small firms. It will probably cover 3 major incentives:

(a) Investors in small firms will be able to offset any subsequent capital losses against their income tax liability. (Cost £20m - £25m).

This incentive has been advocated by numerous small businessmen, potential investors and financial advisers on the grounds that the major deterrent to investment in small firms is the high risk of loss. A similar incentive is provided in the U.S.A.

(b) Investors in new small firms will be able to invest, say, £10,000 p.a. to a total of £50,000, which they can set off against their income tax liability. (Cost. £100m +).

(c) Profitable small firms will be able to invest up to, say, £50,000 in other small firms out of pre-tax profits, i.e. without having to pay Corporation Tax. (Uncosted.)

(b) & (c) could be merged into one scheme.

2. Treasury officials are in principle prepared to accept all three schemes provided Revenue objections can be overcome. The Revenue say (a) is very difficult, but possible. They say (b) and (c) are impossible and have listed numerous objections, some of which are absurd.

3. I believe that all 3 schemes are possible and desirable. (a) and (c) are likely to be the most cost effective. A number of the Revenue objections do not stand up to scrutiny. There are solutions to other legitimate problems the Revenue have raised. What is need is for the P.M. + Sir G. Howe to tell the Revenue they must come up with workable schemes to be included in the 1980 Finance Act — the Treasury have already got this message. The general outline of scheme (a) and probably schemes (b) and (c) could be announced in the fairly near future, i.e. well in advance of the Budget.

4. The report also contains 5 agreed ~~recommendations~~ fiscal incentives for small firms. These are useful, but very small beer - and are rather technical. They would not represent a package by themselves..

John.

cc: Mr. Hoskyns

Econ Pol

MR. LANKESTER

P.

You asked about progress on measures to stimulate new enterprise and small firms. E Committee on 23 October emphasised the importance of this. Officials will be putting proposals to the Chancellor in the next week or so, and it would be possible to make an early announcement in principle - perhaps even before Christmas.

The best two ideas to come forward are:-

(a) Tax relief for investment by individuals in new companies. Although minimising the risk of tax avoidance causes lots of technical problems, this would be a radical and easily understood measure aimed at encouraging the foundation of new companies. It has been very crudely estimated to cost around £100 million per year in tax foregone. Of course, if it stimulated new economic activity, this would be offset.

(b) Tax relief for capital losses incurred by an individual investing in an unquoted company. At first sight this sounds a little less politically attractive because it is associated with losses. The aim, of course, is to alter the risk/reward ratio, inducing people with capital to consider putting it into companies (which is risky) rather than, say, property. It would probably cost £10-25 million a year in foregone revenue.

The same official group is about to recommend some extension of the schemes to encourage employee share ownership - which was a

/Manifesto

Manifesto commitment.

There are also several smaller fiscal reforms which would benefit small companies. Final conclusions have not been reached but two or three of these could probably be bundled up with the tax relief measures mentioned above.

AD.

21 November 1979

vk

CONFIDENTIAL

Ecn Pol

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

The Rt Hon Sir Keith Joseph MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

26 September 1979

Dear Keith

SMALL BUSINESSES AND THE EMPLOYMENT PROTECTION ACTS

We spoke on the telephone this afternoon about your letter to me of 21 September, and I explained why I felt it would be wrong to make any further change to our working paper on the lines of David Mitchell's proposal.

What weighs with me most is the unwisdom of discriminating in the statutory treatment of employees on a continuing basis simply by reason of the size of the firm employing them. Our aim must be to remove the impediment to the creation of new jobs and such evidence as there is indicates that new firms (not just small firms) are the main source of new employment. I feel strongly therefore that we can justify the proposed exemption for new firms, which is of a temporary nature in the firm's life, and that extending this to all small firms is not a satisfactory alternative.

This is not to decry the psychological importance of changes in the employment legislation to help small firms. I have had this very much in mind in framing the proposals which were approved by E(EA). I believe that the many changes now proposed in the working paper, taken together with the changes that have already been made by Order, constitute a package that should not only be of real practical benefit to small firms but also give the psychological boost desired, and do so without detriment to the basic employment protection which we need to preserve.

As I said to you, there is nothing to stop people putting forward proposals for further changes in the course of the consultations, as indeed has happened in the response to our earlier working papers. Indeed, our proposal on new firms seems bound to attract alternative suggestions of the kind David Mitchell suggests. And if sufficient evidence emerges from the consultations we shall be free to take this

SECRETARY OF STATE FOR EMPLOYMENT

into account in our final decisions on legislation. But I think it would be wrong for the Government to be advancing this idea.

It was with these considerations in mind that you kindly agreed not to press for inclusion of David Mitchell's additional proposal in the working paper. I am most grateful to you for your understanding over this, as it will enable me to keep to the timetable for publication of the working papers which I had planned.

I am copying this letter to members of E and E(EA) Committees.

Yours
Jim

26 SEP 1970

Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
Telephone Direct Line 01-212 3301
Switchboard 01-212 7676

21 September 1979

The Rt Hon James Prior Esq MP
Secretary of State for Employment
Department of Employment
St James's Square
SW1Y 4LL

Dear Secretary of State,

SMALL BUSINESSES AND THE EMPLOYMENT PROTECTION ACT

I have seen a copy of your letter to David Mitchell of 20 September.

He and I were pleased that you feel able to include as an option for consultation the proposal that small firms should be exempted from the requirement to re-instate following maternity leave. But I am returning once again to David's second proposal - for extending the qualifying period for unfair dismissal complaints for small firms - which we think is much more important.

I do not ask you to substitute this proposal for your own, but I do ask you to consider treating it the same as that on maternity provisions viz inclusion as an option for consideration and comment in what is after all a consultation paper.

Your own proposals to exempt new small firms already go a little way to discriminate between firms and I do not think that the proposals to exempt all small firms can be regarded as breaching a principle. Moreover your proposals invite some problems of definition (e.g what is the position of the firm which takes on the 21st employee in the first 2 years?), whereas ours are clear-cut - a firm either has or has not less than 20/25 employees at a given date.

John Biffen's objections also seem to me to lack practical force. If David Mitchell's proposal were adopted a firm with 20 employees might have only one or two employees at any time with between 52 and 104 weeks service - the rest would have been in employment for less than a year or for more than 2 years and so their position would be unaffected by our proposals. I do not myself believe that small firms would deliberately hold back growth merely to retain such an advantage vis-a-vis one or two employees and so I do not see the proposals as a barrier to growth in any way. David Mitchell was fully conscious of this point when he put his proposals to you.

/You ...

You may ask why if the advantage to employers is so small we regard the proposal as so important. But this is to overlook the tremendous psychological barrier to the development of small firms which we believe has been created by the Employment Protection Act and in particular the strong arguments which have already been put to you for aligning redundancy and unfair dismissal provisions, since they are inextricably linked in the minds of many small businessmen.

As you point out David Mitchell has been supported by Michael Heseltine, John Nott and George Younger who have added a number of cogent reasons for taking the steps proposed. I would therefore urge you at this late stage to consider the proposal again and to include it as an option in your consultation paper.

I am copying this letter to members of E and E(EA) committees.

Yours sincerely,
Peter Stredder

(approved by the Secretary of
State and signed in his absence)

24 SEP 1979

File

cc Stedder (D/Ind) DSG
Econ Pol

10 DOWNING STREET

From the Private Secretary

MR. HARTLEY

CPRS, CABINET OFFICE

ELIMINATING UNDUE BURDENS ON SMALL FIRMS

You kindly sent us a copy of a background attached note on "Eliminating Undue Burdens on Small Firms". I understand that firm proposals on this issue will be coming forward fairly soon.

I showed this note to the Prime Minister, and you will want to be aware that she is not much taken by options 8(a) and (c) - i.e. to set up independent Civil Service machinery to scrutinise departmental forms, or to appoint outside consultants.

I am sending a copy of this minute to Peter Mountfield (Cabinet Office).

T. P. LANKESTER

Pe

20 September 1979

CONFIDENTIAL

Prime Minister

You asked about "burdens on small firms". Sir K Joseph will bring forward proposals shortly. This paper gives some background (see last page on form filling)

TL 18/9

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6. 10.1 ELIMINATING UNDUE BURDENS ON SMALL FIRMS

1 The primary objective of the proprietors of most small firms is to be left alone to get on with the business in hand. This being so, their threshold of tolerance to the 'burdens' imposed by bureaucracies both central and local - and they do not often distinguish clearly between the two - tends to be low. 'Burdens' can broadly be taken to embrace anything that consumes either time or money and it is too much to expect of any government that it will be able to remove them to the satisfaction of all. Nevertheless, there are some areas of legislation and of central and local government activity that figure particularly prominently in letters to Ministers and MPs from small firms and their representatives bodies. The attached notes identify the principal irritants of these kinds under the following main headings:-

a the demands of new legislation; the burden of comprehension and the burden of implementation

b the demand for information

c the unpaid tax collector

2 The notes describe the action that government has taken, is taking or is contemplating taking to remove or alleviate such burdens. They do not deal in detail with the levels of VAT or other forms of taxation or with high interest rates; although both of these would be high on any list of complaints, they are being tackled separately.

3 Our general conclusions are as follows:-

So far as existing legislation is concerned the Small Firms Division of the Department of Industry has been discussing with responsible Departments possible changes aimed at easing the burden on small firms. This activity is reflected in the attached notes. More generally, we believe that an awareness of the special problems of small firms throughout Whitehall and of the impact that any proposed legislation or administrative requirement might have upon them should be our aim.

4 To this end, we offer the following suggestions:-

(i) Department initiating legislation might be required to assess/estimate the likely costs of the measures on industry where this is feasible. This could be included in the Memorandum along with the manpower and Civil Service costs.

(ii) Wide consultation with small firm representative bodies, including trade associations with a high percentage of small firms and Chambers of Commerce.

(iii) Consultative literature to be written so that it is simple and quick for small firms to grasp.

(iv) Preparation of a simple guide - and, in some cases, a special small firms edition - to be available soon after legislation receives the Royal Assent.

(v) Less legislation!

(vi) Administrative instructions etc to be written as simply as possible, with reporting requirements cut to a minimum. Forms to bear an indication of whether their completion is mandatory or voluntary; and (as is the case with many statistical surveys) clear guidance to be given to respondents about the parts that are, or are not, relevant to them.

Annex

GOVERNMENT-IMPOSED BURDENS ON SMALL FIRMS

The demand of government can perhaps be conveniently described under three headings:

i New or amended legislation; the need to be understood and honoured by small firms

ii Information (form filling)

iii The function of the businessman as unpaid tax collector

LEGISLATION

2 Small businesses are not lavishly endowed with management resources, and in the smallest the proprietor is chief engineer, legal adviser and administrator all rolled into one. Time is money to such people, and the burden of reading and understanding new legislation and regulations is a very real one.

3 Having struggled to understand what is required of him, the small businessman affected by legislation that does not recognise his special problems can be more severely affected than his larger counterpart, thus:

General

a Legislation requiring record-keeping can strike at the proprietor's dislike of, and (very often, since this is not what he is in business for) inability to cope with paperwork.

Specific Legislation

b Employment legislation has been a particular cause of complaint not only on account of its complexity but also as a result of the rigidity it is said to impose on the employment practices of small businesses employing only a few people in a close relationship with their employer.

c Similarly, some Health and Safety requirements impose burdens and especially costs that may be more appropriate to the large unit than the small.

d Planning legislation generates complaints on two scores. The first, which is not unique to small firms but hits then particularly hard, is the delay in obtaining decisions on planning applications. This complaint is of course directed at local authorities but can create severe difficulties for the small business whose success can depend on rapid adaptation to change. The second complaint conerns the planning restrictions on (for example) non-conforming but 'unobtrusive' use of residential schemes. There is pressure for a more flexible approach in recognition of the fact than many small businesses are and need to be situated close to the communities they serve and cannot always be as tidily disposed into industrial estates.

What Can be done?

4 In recognising and tackling the special problems of small firms it is

important to beware of the danger of creating two classes of business; the one affected by and the other exempt from major areas of regulation. If we go too far along this route we can create unacceptable penalties for those who cross the line dividing small from large, inhibit the very developments we want and, indeed, create a body of phoney small firms established for ~~regulation~~ evasion purposes alone. However, that is not to say that exemptions and modifications in the interests of small firms are to be ruled out, and in most cases cited in paragraph 3 above action (sometimes as part of a larger operation not confined to small firms) is already in train. Thus:

a Disclosure and Record Keeping. Implementation of the EEC Directive in Company Accountancy and Disclosure will make it possible to establish a new class of 'proprietary company' which should be helpful to smaller businesses as they will be required to disclose less information than at present; and the forthcoming consultation document will reflect this. The most common complaint concerns record-keeping necessitated by the Government's need for statistical information and for taxation purposes; see below.

b Employment Legislation. The qualifying period for complaints of unfair dismissal is being extended, as is the notification period for redundancies of under 100 people. Other possibilities - the exemption, for example, of firms in the first two years after they start to trade - are being explored. These are helpful, but on the other hand the current proposal to make employers responsible for sick pay will pose problems for small firms and is the subject of further discussion.

c Planning Legislation. The problems of balance between conflicting interests is clearly important. However, the Department of the Environment are now considering changes in the planning machinery - the elimination of overlapping functions and of minor cases and changes designed to accelerate appeals procedures - which are pointing very much in the right direction.

<u>What more needs to be done?</u>

5 It is the explicit function of the Department of Industry's Small Firms Division to scrutinise new legislation for its effects on small firms. The sheer volume of legislation makes this a fairly tall order, however, and (again, without wishing to create a second class category of industry) responsible Departments themselves should be invited to bear in mind the special needs and problems of small firms and to accommodate legislation to these as far as possible.

6 Nevertheless, new legislation <u>will</u> affect small firms, and guides to industry should either include special special sections drawing particular attention to those parts that affect small firms or should be supplemented by 'small firms editions', booklet series. Although it is a truism, comprehensibility of requirements and the avoidance of unnecessary ones are the key here as elsewhere.

INFORMATION (FORM FILLING)

7 In July last year the previous Administration initiated reviews of all Government statistical surveys and administrative forms with the aim of reducing the burden they impose on industry, particularly small firms. The results were disappointing - only a few forms were eliminated and certain administrative

procedures simplified. In general Departments managed to identify the range of their forms which affected small firms but claimed there was little scope for making significant reductions within the confines of statutory requirements and Departmental policy. Before further action could be considered by Ministers the Election intervened and the exercise was in effect aborted.

8 The following options for futher action have now been suggested to ministers:-

a To set up independent Civil Service machinery to scrutinise all Departmental forms; and perhaps reinforce its credibility by appointing someone from outside to head it; No

b To renew last year's review and require Parliamentary Secretaries of all Departments concerned to report results at the end of 6 months;

c To appoint outside consultants to work with Civil Servants on reviews of Departmental forms. No.

9 Option (C) has in effect already been adopted by the Department of Trade. A team consisting of 4 outside consultants and one DOT official will shortly begin work on DOT forms and a report is expected in the Autumn. We shall regard this exercise as a pilot scheme and decide later in the year whether or not to recommend a similar approach to other Departmental reviews.

10 Sir Derek Rayner proposed to mount in the Autumn a visual demonstration of the burden imposed on industry by governmental requests for statistical and administrative information. This might prompt further action on the issue.

STATISTICAL SURVEYS

11 Statistical inquiries account for only a small proportion of Government forms directed to businesses. The Government Statistical Service (GSS) endeavours to ensure that no greater burden is placed on businesses by statistical inquiries than is necessary in order to provide the information required. Particular attention is paid to small firms by eliminating them from surveys where possible and otherwise by simplyfying questionnaire design and introducing sampling where this would produce reasonable accurate results.

12 In addition to the continuing efforts of sponsoring Departments to reduce burdens, the Survey Control Unit of the CSO assesses each proposal for a new survey or for any change to an existing regular survey involving businesses with the aim of ensuring that the survey is efficiently designed, that the information could not be obtained from other sources and that the sample is no larger than is strictly necessary for the information required. The Unit pays particular attention to any burden on small firms.

13 For the purpose of the review initiated under the previous administration small firms were taken to be those with fewer than 200 employees. For each inquiry, the sponsoring Department considered whether it should be dropped or reduced in frequency, whether the sample size could be reduced and whether questions could be eliminated and forms simplified. The review is now nearing completion and the Director of the CSO is preparing a report for submission to Ministers in September. The review seems likely to achieve a reduction in the number of forms sent to small firms (as defined above) of about 12 per cent.

14 Two exercises are in hand which are also likely to affect the amount of data collected for statistical purposes from businesses. These are the Lord President's exercise, investigating options for achieving staff cuts by reducing or eliminating Departmental functions and Sir Derek Rayner's investigation of the statistical services of DIT.

TAXATION AND TAX COLLECTION

15 Collection of PAYE and National Insurance contributions is a perennial complaint of small firms. This is frequently expressed by suggestions that the firms should be paid some form of compensation for the work it does on behalf of HMG. Recognition of the cash flow benefit from holding money that does not belong to them is uncommon and many small firms are not sufficiently sophisticated in their accounting methods to take account of it. In all but the smallest concerns a cost will be involved, i.e. a book keeper will be engaged to look after this aspect. The other real cost involved is the size of the employers' contribution for National Insurance and here the surcharges have been particularly resented.

16 Despite the considerable effort devoted to explanation/training in the early days, the introduction of VAT has caused the greatest number of complaints about the tax system. Those who sell zero-rated goods complain about the free loan to HMG, and this is echoed by certain people engaged in highly seasonal trades. All complain about the volume of paperwork involved and although a single rate of tax does simplify matters, most small firms are too concerned about the effect of which the 15% rate will have on their sales to derive much comfort from this particular Budget change.

17 Capital Gains Tax and Capital Transfer Tax are seen as complicated in themselves, and inhibiting factors in transferring a business to the next generation. The difficulties involved and the inter-relationship of the 2 taxes have made it difficult for the small man to comprehend. Both the incidence and the complexity of these taxes are therefore seen by small business as inhibiting their desire to expand and develop.

Econ Pol.

THE SMALLER FIRM IN LONDON

Submission to The Greater London Council

on the Discussion Paper
Small Businesses in London

Submitted by
London & Southern Home
Counties Region
Association of Independent Businesses

Association of Independent Businesses

August 1979

World Trade Centre
London E1 99A
01-481 8669

INTRODUCTION.

Small Businesses in London rightly draws attention to the importance of small firms in London. The Association represents some 25,000 independent businesses, with approximately 5,000 in the Greater London area. It therefore has a considerable interest in the attitudes and policies of the GLC to our sector.

The bulk of the material in Small Businesses in London deals with the effects of national policies. So, indeed, the focus of the major representative bodies and most commentators has been on the national stage.

The Council has done a valuable service in reminding us all of the importance of local government policies.

Our members, of course, do not need reminding - the results of those policies are literally on their doorsteps - and in their balance books. As arbiters of planning policy, rates policy, and as providers of premises and services, local government has perhaps a more immediate impact on most small businesses than national government.

For these reasons, the London and Southern Home Counties Regional Council of the AIB welcomes the opportunity to comment on the discussion paper. It makes many suggestions for areas where the GLC could make a positive contribution to the well-being of our sector.

Although we welcome the fact that the GLC is looking at what it can do, we believe that it should limit its view to local government matters. We do not encourage the move of local authorities into the venture capital supply market or into the provision of services, such as information and counselling, which are adequately provided elsewhere. Nor are we seeking local government advocacy

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of our cause to national government. Nonetheless, that leaves a huge field for constructive action.

Should the GLC wish to discuss any of these recommendations, we would be delighted to assist. Further, we extend an invitation to officers and members of the Council to visit our members' firms, to see how local government policy works "on the ground."

ERNEST A. NAPTIN
Chairman,
London and Southern Home Counties,
Association of Independent Businesses.

PREFACE.

In developing policies concerning smaller businesses it is essential to understand how cities come to prosper. New trades and industries are almost always begun by small businesses run by entrepreneurs with foresight and initiative. If these trades and industries have an expanding market the businesses concerned will not only grow, they will also stimulate growth in related businesses supplying services and manufactures to themselves. This in turn is likely to attract to the same area entrepreneurs seeking to compete with the original businesses. What is more the climate which is seen to be favourable to small expanding businesses will attract others in unrelated trades.

Such developments are not planned, but happen. They happen in a general area which is geographically suited to trade and in a particular locality which allows for the development of new businesses. (Academic examination of this process is available. Recent work has been summarised in the study "Small Firms in Cities," Graham Bannock, Shell, 1978.).

There seems to be no reason for believing that London has ceased to be an area favourable to trade. The following comments will help, we hope, to make London a city which will be revitalised in the only real way, by allowing for the creation of new businesses, and with them the expanding commercial and industrial activities of the next generation.

RECOMMENDATIONS:

1. The basis of planning policy should be organic growth, rather than bulldozer re-development.

2. Greater use should be made of old premises - subdividing where necessary.

3. Zoning restrictions should be minimised and based on the criteria of actual disturbance, not on zoning by classification.

4. Small business start-ups are often in the individual's home or garage. This should be recognised and allowed for where possible.

5. "Reactive planning" is more relevant to London's needs than "creative" or "visionary" planning. Planning decisions must be made more quickly.

6. Local authorities ahould be discouraged from building up and retaining large "land-banks." Surplus or unused should be sold.

7. Local government should be discouraged from trying to finance business.

8. The Department of Industry already provides a very helpful Information and Counselling Service. We see no need for local authority initiatives in this area.

9. In providing land and premises for small businesses, local authorities should be aware of their frequent preference (for sound financial reasons) of freehold.

10. Direct labour departments are expensive, generally inefficient and offer unfair subsidised competition. If they are to exist, they must compete on an equal basis.

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11. Many municipalised services - such as catering - should be returned to the private sector - possibly in the form of co-operatives.

12. Failure to meet statutory duties in respect of services is one of the greatest damages local government does to our sector. There is increasing evidence that granting exclusive rights to union-controlled cartels is a less than perfect way of fulfilling these statutory duties. See 11 above. Services must be adequate and reliable.

13. The GLC should examine and report on the relationship between rates and commercial rents in the boroughs.

14. Commercial rates should be allowed to be paid monthly or quarterly.

15. Policy should be neutral as regards different types of business, for example, as between services and manufacturing.

16. Action is needed in the areas of parking, vehicle access and standing for delivery/collection.

17. Small business needs should be regularly monitored by an officer/councillor with an inter-departmental remit.

1. PLANNING.

Local authorities play a central role in the process of changing the pattern of urban land use: by broad policy, by influence and by the example of their own commercial activities. In too many cases they have embraced the viewpoint of the visionary professional planner, whose artform is best expressed on a large blank canvas. Planning by Compulsory Purchase Order, followed by the bulldozer, has become an unhealthy norm for Britain's inner cities. London contains some bad examples all of its own.

2. LAND USE.

If the alternative, which might perhaps be called "organic" regrowth is markedly less satisfying to the planner who wishes to see his idealised city rebuilt all in on go, it is nevertheless a necessary choice if city centres are to be restored commercially and socially. Planners should abandon their preference for all-at-once re-development, and the (at last disappearing) preference for zoning localities for single use - all housing, or all commercial, or all industrial. The answer is a constant mix, bits of which are at any one time being modernised alongside the middle-aged and the frankly old. Fortunately there are some recent examples of the more enlightened attitude creeping in: the way London preserved and re-used Covent Garden deserves credit, where the Parisian equivalent, Les Halles, does not.

3. It is not only tourists who enjoy the old-world charm of re-used buildings. Hard economic and commercial factors enter the question, even in the districts where the suffused glamour of tourism is absent. Old premises are cheap; preserving neighbourhoods does the minimum damage to the intricate web of workshops, services, catering premises and the rest which characterise the traditional urban commercial area. There are already signs that the "new"

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thinking of permitting organic growth has been widely accepted in principle: the task now is to ensure its dominance in practice often in the face of heavily-manned local authority planning departments steeped in the old thinking.

4. The most important single task is to break away from the habit of prescribing exact uses for buildings, or even whole neighbourhoods, in the absence of a user who fits the plan. Creative planning of that sort should give way to reactive planning, which builds change round those who actually want to live, trade, work or relax in the area: wait for them to come up with the proposals then, as far as possible, help them to implement their ideas. Obviously it is the duty of planning departments to ensure compliance with basic criteria - access, natural light, provision or services and utilities - and to plan ahead where roads are to be built. Their objective should be no more than a minimum list of such criteria, not the most comprehensive which professional planners can conceive.

5. BUILDING USE.

Planning is important, not only in the way it determines the use of land, but also in the way it governs the use of existing buildings. Many small businesses (and for that matter present-day large businesses whose origins trace back many decades), had the humblest of commercial beginnings. It is wrong to dismiss the significance of start-ups in a front sitting-room or garage: and it is short-sighted to prohibit such enterprise, however small the scale, on the grounds of planning preconceptions. Neighbourhood nuisance is one thing, anti-business prejudice is quite another and should be eradicated

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from the criteria used by planning officers, deciding whether to accept a small scale application for change of use.

6. Zoning should be based on practical results criteria, not on Standard Industrial Classification terms. For example, a bronze foundry (manufacturing) may be substantially less noisy and less disturbing than a metal drain pipes storage yard (warehousing), although the one may be permitted and not the other on grounds of industrial classification.

7. BUILDING OWNERSHIP.

The prolonged enthusiasm for "municipalisation" of inner urban land has endowed local authorities with a large and often ill-used land-bank. Moreover, local government financing methods permit them to become rich in idle assets, even when their income is low. The result is often wasteful. There is a strong case for selling of surplus (or simply currently unused) land owned by local authorities. A useful side-effect of this could be to ease the shortage of marketable land as freehold. Independent businesses very often prefer land which they own rather than rent. This is not a quirkish attitude of mind: a tangible asset such as a freehold provides security and so can be the key to raising loan finance for the operation of the business.

8. FLEXIBILITY IN COMMERCIAL USE.

Another consequence of the fashion for pre-determined, theoretical planning has been to hold up the natural expansion of existing businesses. An example from within the experience of an AIB member is typical: he sought premises for light industrial use in the Peckham area. Those he eventually found proved to be designated for "storage" use; he had to go elsewhere. The same

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Peckham premises are still vacant (and increasingly dilapidated) several years later. (See point 6 above).

9. Small businesses are speedy and flexible in their commercial activities; this can often run well ahead of formalised planning procedures. Most attempts at official level to anticipate which kinds of business are most likely to flourish seem doomed to failure. Even the most gifted entrepreneur cannot forsee business success stories on a regular basis; the chances that bureaucrats can do what he cannot are unlikely to say the least. Once again the conflict between visionary, "creative" planning and the more desirable "reactive" planning is highlighted. Planning procedures ought to be judged by their ability to accommodate surprises, not by their efforts to avoid them.

10. Direct access to decision-taking planning officers should be possible. Many members report frustrating delays during which they are only able to discuss the situation with low grade staff. Planning decisions should be made more quickly.

11. <u>LOCAL AUTHORITY INVOLVEMENT IN SMALL FIRMS</u>.

Recent enthusiasm for the small firms cause has tempted several local authorities to enter the business of small firms finance. Within the rarest of exceptions we consider this to be an ill-advised use for public funds and do so on four grounds:

a) the true source of such funds is not "government" but tax payers and rate payers - who include other successful businesses. Often such public funding is merely an inefficient "transfer payment" from one small business to another.

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b) there is considerable and growing doubt whether local authorities have the ability to "pick winners." In this respect their chances of success are certainly no greater, and probably much less than commercial institutions.

c) we view with concern the decided risk of growing competition between various levels of government to attract a finite number of businesses using evermore generous offers of public money.

d) there is a risk that, in selecting suitable recipients for public funds, local authorities may on occasion resort to political criteria which have nothing to do with the contribution which the business concerned can make to the prosperity of its community.

12. INFORMATION SERVICES.

A further tempting objective for local authorities has been to establish information services for small businesses. Again we consider that the wasting of public resources on duplicated provision of doubtful expertise more than out-weighs the potential for benefit to the community. There may be an argument in favour of local authority information services solely concerned with local authority activities, but it is likely such a service could be operated at least as efficiently through existing town hall agencies. In general the Small Firms Information services operated by the Department of Industry are better placed to assess those information requirements of small firms which can be met efficiently by official means.

13. DIRECT LABOUR DEPARTMENTS.

Direct labour departments which are allowed to compete with small firms and

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subsidised to do so inflict a double injury on the commercial community. Not only do they drive otherwise viable firms out of business, but the cost of financing the subsidy imposes a continuing burden on those which remain. There can be a place for "direct labour," for example on conventional maintenance work. But in the case of new contracts the system should be phased out in favour of the wise use of competitive tenders. Only that way can the rate payer be assured that he is getting value for money.

14. It would be imaginative to regard many services which are today municipalised as being, instead, the seedbed of small businesses. Catering services and refuse collection are good candidates for re-organisation as private enterprises quite possibly in the form of worker co-operatives.

15. PROVISION OF INFRASTRUCTURE.

The most basic task of local authorities is to ensure the uninterrrupted provision of utility services though this does not mean that they should necessarily undertake them directly - lighting, roads and parking, refuse collection. The last in particular has been subject to interruption through industrial action: in the case of many small businesses operating on tight turnrounds and margins such interruption can be most damaging. Where strikes are inevitable, small businesses should be free to contract for such services. Moreover, local authorities should be prepared to accept financial responsibility for failure to such statutory obligations. There is increasing evidence that granting exclusive rights to a union-controlled cartel is a less than perfect way of fulfilling those statutory duties.

16. Vehicle access, standing and parking are particular problems for small firms which usually do not have such facilities built into their premises. Despite

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election promises, progress in these areas has been slow despite the fact that this is probably the easiest area for reforms to be made.

17. RATING OF INDUSTRIAL AND COMMERCIAL PROPERTY.

Residential rate payers revolt against high rates through the ballot box. Small businesses, which are taxed yet have no representation, are obliged to vote with their feet. For too long the unenfranchised business community has been regarded as an easy source of rate income by local authorities seeking to make ends meet. The persistent tapping of their slim resources contrasts noticeably with the former concept of industrial de-rating: that formula was adopted with the specific objective of encouraging businesses to remain in a community and underpin its prosperity.

18. Throughout London rates vary widely in relation to rents which, because they are not regulated by law, usually give the most accurate picture of true commercial value. The GLC should examine the relationship between rates and rents and publish the average figure for each borough.

19. Commercial rates should be payable quarterly or monthly at the businesses' option.

20. POLICY NEUTRALITY.

In other ways local authorities have pursued policies, which, quite unneccessarily, reduce the yield they might expect from the rates. There remains still a groundless prejudice, especially in the inner London areas in favour of "manufacturing" and against office development. This cuts across the evident direction of business expansion in an era of increasingly scarce natural resources and third world industrialisation; it often places difficult burdens

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on roads and transport generally, given the need for easy access of most efficient manufacturing businesses; and it cuts across the job preferences of the local labour-force.

20. SMALL BUSINESS "MINISTER."

One way to ensure a better response by local government to small bsuiness needs would be to follow the national Government's example in appointing a "small business minister" to co-ordinate the work of the various relevant departments.

CONFIDENTIAL

Econ Pol

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

18 July 1979

Dear Keith

NBPM
12
18/7

<u>SMALL FIRMS</u>

Thank you for your letter of 3rd July. I agree with you that we need to make progress with removing obstacles to the starting up and expansion of small firms. I also agree that, in those cases where inter-departmental co-ordination is called for, this should take place through the mechanism of the group of officials under Treasury Chairmanship. This could, for instance, cover some of the small firms proposals put forward in the "Government strategy" exercise, if it is decided they are to be pursued.

In general, I am struck by the large number of "small firms" proposals now current. While I am sure we should make progress with as many as possible, we must be alive to the extent to which some may possibly be in conflict with others. For instance, I agree wholeheartedly with you that we need to encourage (or at least to remove some of the discouragements from) the <u>establishment</u> and <u>development</u> of small firms; but equally that means avoidance of proposals which could have the perverse effect of encouraging firms to stay small - where there are economic benefits in larger scale operation, we should not try to prevent it. So I think it would be helpful if the official Group, while reviewing the various proposals, could give thought to the criteria themselves.

So far as tax is concerned, I agree that the Group should consider proposals which specifically affect small firms and which require interdepartmental discussion. However, a number of the tax proposals (for instance, some of those relating to capital taxation) can now, as you imply, be taken as being subsumed in wider reviews. And there are others of a minor technical character which need not involve more than one or two Departments in the

/discussion.

The Rt. Hon. Sir Keith Joseph, MP

discussion. I will, of course, ensure that the industrial aspects are considered in all these reviews and will consult you specifically on this later.

At some stage the Treasury will need to make public a response to the Wilson Committee's report on small firms. That should be relatively straightforward when we have made more progress with the agenda generally. Meanwhile, I understand that your Department is still obtaining replies from interested organisations in response to the requests for comments on the Wilson Report.

I am copying this letter to the Prime Minister.

(GEOFFREY HOWE)

Ecn Pol

PRESS RELEASE

THE SMALL BUSINESS BUREAU

Release Time: 20.00 hours
Tuesday 10 July 1979

929/79

MINISTER FOR SMALL FIRMS SPELLS OUT IMPORTANCE OF FULL REPRESENTATION

David Mitchell MP, the Minister responsible for small businesses, addressed a Parliamentary Dinner of the Small Business Bureau in the House of Commons tonight. He welcomed the appointment of Michael Grylls, MP, as the new Chairman of the Small Business Bureau, and wished him luck in a job he had himself found, over the past three years, to be so challenging and rewarding.

Mr Mitchell went on to say; "A new era has opened in the relations between small businesses and the Government. Already most of the leading organisations representing small firms have been invited to the Department of Industry to put on record the problems of their members and their ideas for change, and an ongoing regular working relationship is now planned between myself, as Parliamentary Under Secretary of State in the Department of Industry, and the small business community.

"There are two major reasons why Britain has too few new businesses: the hurdles and barriers they have to climb are too high and the incentive to climb them has been too low. The Government's commitment is to bring down the barriers and to increase the incentives. The Budget is the first step on this road," he concluded.

END.

Further details contact Geoff Lace - 01 222 9000

32 Smith Square London SW1P 3HH Tel 01-222 9000

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DEPARTMENT OF INDUSTRY
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123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
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Secretary of State for Industry

2

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London SW1

3 July 1979

cc Mr Hoskyns

Prime Minister

To note x.

Dear Geoffrey.

Thatcher ms.

TL 3/7

SMALL FIRMS

Several of your proposals in the budget are of considerable benefit to small firms, for example, the general reductions in income tax, the stock relief measures (including the reduction in the profit restriction for unincorporated businesses), and the continuation of relief for pre-1974 loans all help small firms in one way or another.

We are deeply committed to the small firms sector; it forms an important part of my responsibilities; and it needs to thrive if we are to benefit from its contribution to the creation of new wealth. David Mitchell is actively reviewing all our policies in the small firms field, and we have a number of ideas. Inevitably tax measures are a principal method of ensuring they develop towards their potential and although the changes needed are clearly a matter for you to decide, I hope you will agree that it would be valuable if the Government were to produce a co-ordinated package.

As you will know, an interdepartmental group of officials under your Department's chairmanship, already exists to co-ordinate work on small firms, and this group will be considering the various external representations on the Wilson Committee Report. I would like to suggest, and I hope you would agree, that it would be worthwhile instructing the same group to prepare, for your early consideration, a positive package of measures in the tax field, which would reflect our political priorities and the importance we attach to encouraging the establishment and development of small firms, and investment in them. Without doubt, there will be other factors to consider - including administrative complication, liaison, etc.

x

Such an exercise will obviously be most fruitful if we can ensure

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that the official group approaches these questions positively. In some cases, the group's work on this would overlap with that of other reviews in the tax field which you have in hand (in particular, that on capital taxation), but I would hope that progress could be made in respect of small firms, without waiting for other more general conclusions. I have of course put forward several suggestions in my letter of 3 July to John Hoskyns which are closely related to this field. As the official group will be meeting on 9th July, I hope you will feel able to give them a positive steer in this direction by then.

I am sending a copy of this letter to the Prime Minister, in view of its importance for our wider economic programme.

Ever.

Keith

-3 JUL 1979

CONFIDENTIAL

RECEIVED IN
27 JUN 1979
SECRETARY OF STATE FOR INDUSTRY'S OFFICE

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:
Your ref:
27 June 1979

TO M. Mountfield
FOR ADVICE (AND DRAFT REPLY IF APPROPRIATE)
PLEASE BY: ~~4-7-79~~ 4-7-79

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M. Bunting
M. I Lightman
M. L Lightman
M. Battersby
M. Steel
M. Kendall

Dear Keith

We discussed the problems of stimulating the creation of small businesses during our recent meeting on regional policy and I agreed to set out my views for colleagues.

In order to keep the paper brief and without the benefit of a research machine let me first state a number of beliefs.

a. The small industrial sector is smaller in Britain than in other equivalent economies.

b. It is this sector that we need to encourage most enthusastically because it earns greater returns in productivity and output quicker than elsewhere and because as it has been more frustrated in Britain than other sectors as a result of high personal taxation it is the most fertile ground.

c. Its small scale makes it versatile and responsive in a way that larger industry may not be particularly as large industry has been able to develop more easily over recent years.

For as long as I can remember Governments have used either public sector or consumer expenditure to stimulate the economy. It has not been a happy experience and the conclusion of it for whatever reason left our industry in a parlous state.

I want to operate at one area of the economy where only in a very few exceptional cases have the Government sought to act - Winners.

If we ask ourselves who are the people - a crucial point of emphasis! - who are <u>most likely</u> to get a climate of wealth creation underway they have to be those people who have proved that they can make profits or earn large incomes. Not all those people can achieve what we want but there will be very few people outside this crude definition who can.

Broadly our strategy accepts this analysis. That is why we increase the real disposable income of those people and create a climate of incentives. At this point the car is pointing in the right direction and the engine is switched on.

But the driver has to put his foot on the accelerator and he has to choose which road to take.

Most economic forecasts are at the moment sober if not gloomy. The habit of innovation, entrepreneurial activity, risk is not well ingrained. We have become used to institutional thought.

And after the weary years the driver might decide to coast along the comfortable lanes of higher personal consumption rather than head off for the bumpy road of exhausting, risky innovation.

We have little time. We need to demonstrate success and results in a country that half expects governments to fail. And we need to enthuse everyone we can to change and articulate change.

Hence my proposals. We put to the winners an offer they can't refuse. We define the winners as those who have paid tax or would have paid tax if their capital allowances hadn't exhausted their liability. We offer a rebate of tax, Income Tax, Corporation Tax, Investment Income Surcharge to anyone who can show that he is undertaking defined investment this year over and above last year. Define the investment to pick up a wide range of industrial activity, accept that some people will get a grant for expenditure that they would have undertaken anyway, accept an accountant's certificate - with sanctions-to cut the red tape and choose an arbitrary figure for total rebate (personal £5000, companies geared to last year's investment plus say 10%) and fix a ceiling of £150m. Make it clear that only expenditure incurred by April 1980 counts.

The suggestion for this paper arose out of a discussion on regional policy. So make the rebates double in assisted areas. The public expenditure cost should come from economics in existing industrial support which is in my view far less effective than a scheme such as I suggest.

What is there to lose?

I am copying this to the Chancellor of the Exchequer, to Members of E(EA), the Secretary of State for Northern Ireland; and to Sir John Hunt. There is, of course, to be a discussion of regional policy at E(EA) tomorrow.

Yours ever

MICHAEL HESELTINE

The Rt Hon Sir Keith Joseph MP

29 JUN 1979