PREM 19/1062

PART 3

M-T

CONFIDENTIAL FILING

Meetings with the C.B.I. Correspondence on the Government's Economic Strategy

INDUSTRIAL POLICY

Pt. 1 MAY 1979

Pt 3 AUGUST 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~18.9.81~~							
~~21.9.81~~							
~~23.10.81~~							
~~2.11.81~~							
~~30.11.81~~							
~~4.12.81~~							
~~10.2.82~~							
~~7.7.82~~							
~~8.9.82~~							
~~26.10.82~~							
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~~26.11.82~~							
~~22.12.82~~							
~~27.6.83~~							
~~18.7.83~~							
~~22.9.83~~							
~~7.10.83~~							
20.10.83							
PART 3 ENDS							

PREM 19/1062

PART 3 ends:-

FERB to John Caff 20.10.83

PART 4 begins:-

Sir Terence Beckett + att Speeches to PM
8.11.83

HL

c. David Pascall

20 October 1983

Many thanks for your letter of 12 October. Mr. David Pascall of the No. 10 Policy Unit is hoping to attend, as an observer, the formal proceedings of the CBI Annual Conference from Monday 7 November onwards. Any arrangements can be made directly with him.

ROBIN BUTLER

John Caff, Esq.

JC

MR BUTLER

20 October 1983

CBI NATIONAL CONFERENCE - GLASGOW 6-8 November

I am planning to visit the conference for the formal proceedings, which start on Monday, 7 November. I am unable to be present for the opening reception and entertainment programme on the Sunday.

Would you like me to reply to the CBI accepting the invitation on behalf of No 10 or do you wish to do this?

DLP

DAVID PASCALL

1.TF for
2 CS.

Prime Minister
To note passage on real interest rates.
AT 17/10

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

17 October 1983

Andrew Turnbull Esq
10 Downing Street

Dear Andrew,

Following the Prime Minister's meeting with the CBI last week, you asked us for some information about international comparisons of interest rates in UK, Germany and Japan.

I attach a note prepared here by officials, which compares short-term prime rates charged by commercial banks on corporate loans, together with money market rates and inflation.

I hope this serves your purpose.

Yours
Judith

MISS J C SIMPSON
Private Secretary

INTERNATIONAL COMPARISONS OF INTEREST RATES

During a recent discussion with the Prime Minister, the CBI gave the impression that average interest rates for commercial borrowing in the UK were up to twice those in Germany and Japan.

2. The usual measure of corporate borrowing costs is the commercial bank's prime rate, which is the short-term interest rate charged to first-class borrowers. Prime rates are of course only a broad indication of the interest cost as the actual rates charged will depend on the lender's assessment of the borrower as regards risk, profitability, etc. Prime rates do not change as frequently as market rates. In Japan, for example, the administered interest rate structure has meant that the short-term prime rate, which is tied to the official discount rate, has not changed since the end of 1981. For both these reasons the comparison includes money market rates.

3. Nominal interest rates in the UK have been and are still higher than in Japan and Germany though the difference is more marked for short-term than for long-term rates. However, nominal rates say little about the real cost, that is after adjusting for inflation, to the borrowers. There are difficulties in deriving satisfactory estimates of real interest rates, particularly when making international comparisons.

4. Calculations of expected real interest rates, which are more relevant to a firm considering an investment, require an estimate of expected inflation or an inflation forecast. While short-term forecasts of inflation are readily available there are problems in obtaining a series on inflation expectations. Information from index-linked securities has been used to estimate the market's inflation expectations in the UK though there are no index-linked securities in either Germany or Japan.

5. The Bank of England produces a comparison of real short-term interest rates for the major countries (Table 2). These suggest that last year UK real rates were slightly higher though the difference has narrowed recently and UK rates are now not out of line with equivalent rates in Germany and Japan.

All these estimates are pre-tax. Different tax treatment of interest payments would of course affect the actual cost to the borrower. Use of consumer prices provides only a rough guide as borrowers will typically face different prices. Nor of course do these estimates take account of the relative size of external debt compared to other sources of finance, equity and retained earnings.

Table 1

Short-term interest rates (per cent pa)(1)

	Germany		Japan		UK	
	Prime	Interbank	Prime	Interbank	Prime	Interbank
1982 (av.)	11.5	8.9	6.0	6.9	12.9	12.3
1983 Q1	8.9	5.7	6.0	6.6	11.8	11.1
Q2	8.0	5.4	6.0	6.4	11.0	10.2
July	8.0	5.6	6.0	6.5	10.5	9.9
Aug	8.0	5.7	6.0	6.6	10.5	9.9
Sept	8.3	5.9	6.0	6.7	10.5	9.7
				now	10.0	9.5

Long-term interest rates (per cent pa)(2)

	Germany	Japan	UK
1982 (av.)	8.8	8.0	12.9
1983 Q1	7.4	7.6	11.4
Q2	8.0	7.5	10.5

Consumer price inflation (per cent pa)

	Germany	Japan	UK
1982 (av.)	5.3	2.7	8.6
1983 Q1	3.7	2.1	5.0
Q2	2.9	2.2	3.8
July	2.5	2.2	4.2
Aug	3.0	1.2	4.6
Sept	2.9	-	-

Notes

(1) For the UK prime rates are bank base rates plus 1 per cent. The Bank of England has provided nearest equivalent rates for Germany and Japan. The 'interbank' is a 3-month rate. UK banks cut base rates by ½ percentage point to 9 per cent with effect from Tuesday, 11 October.

(2) Long-term rates refer to the yields on long-term government bonds. For the UK it is the yield on 20-year government securities.

Table 2

Short-term real interest rates : International comparisons

		Germany	Japan	UK
1982 (average)		4.6	4.5	5.2
1983	Q1	2.6	5.1	4.8
	Q2	2.2	5.4	4.0
	Q3	2.6	4.8	3.3

Source: Bank of England.

The real interest rate is defined as the nominal interest rate less an estimate of expected or actual inflation. The nominal interest rates used are monthly averages of interbank rates. The rate of inflation is the recorded change in consumer prices between six months past and six months ahead where available and a Bank forecast for recent periods for which data are not yet available.

Short-term Real Interest Rates: International Comparisons

		Germany	Japan	UK
1982	(average)	4.6	4.5	5.2
1983	Q1	2.6	5.1	4.8
	Q2	2.2	5.4	4.0
	Q3	2.6	4.8	3.3

Source: Bank of England.

The real interest rate is defined as the nominal interest rate less an estimate of expected or actual inflation. The nominal interest rates used are monthly averages of interbank rates. The rate of inflation is the recorded change in consumer prices between six months past and six months ahead where available and a Bank forecast for recent periods for which data are not yet available.

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Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI

12 October 1983

BY HAND

RY
I think you said you might go
If so, I will tell FERB
PM 17/10

F E R Butler Esq
10 Downing Street
London SW1

Mr. Mount
Will anyone from Policy Unit be attending? (I am not urging that they should!)
FERB
14.10

Dear Robin,

CBI National Conference

I very much hope that it would be possible for someone from 10 Downing Street to come to the CBI National Conference in Glasgow from Sunday 6 November to Tuesday 8 November.

I attach copies of our programme and should be grateful if you could let me, or Tony Webb, my deputy, know who will be coming.

Yours ever,
John

John Caff
Director, Economic Affairs

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Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI

CBI NATIONAL CONFERENCE 1983 - 6-8 November in GLASGOW

The Outline Programme

Sunday 6 November

1500-2100 hrs - Delegate registration in City Hall, Glasgow.

1800-1945 hrs - Civic Reception and "Scotland at Home" Buffet Dinner in City Chambers.

2030-2215 hrs - 'Welcome to Strathclyde' - an evening's entertainment at Theatre Royal.

Monday 7 November

0925 - Opening address by Sir Terence Beckett, Director-General.
0945 - Session 1 - The Global Challenge.

. the economic outlook
. trade problems and opportunities
. making the Community work better

1400-1645 - Session 2 - A More Enterprising Britain.

. enterprise and the state
. patterns of work

Tuesday 8 November

0930 - Session 3 - Getting the Best Out of People

. industrial relations
. pay and productivity

1200 - Closing address by Sir Campbell Fraser, President.

1230 - Formal conference proceedings finish

N B Titles of conference sessions are only a rough guide. Resolutions for debate will be selected immediately prior to the Conference.

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From
Sir Terence Beckett CBE
Director-General

CF papers

CBI

Prime Minister

The comparison on the rates at which companies borrow is not quite as adverse as Sir Terry Beckett implied, but is still significant. Economist table attached.
AT 10/10

7th October, 1983

Dear Prime Minister,

At the presentation Campbell Fraser and I made to you on pay on Wednesday, you asked for more information on interest rates in Germany and Japan, and how they compared with those in the U.K. for prime borrowers.

Both in Germany and Japan there is no easy rule, such as there is in the U.K., for working out interest rates for business borrowers. Rates are negotiated on an individual firm by firm basis and may even vary for one firm depending on why the loan is being requested.

The Economist publish a table showing interest rates for prime borrowers in individual countries. Their figures are based on reports from local bank offices (primarily those of Chase Manhatten). According to the most recent of these tables (published today) prime borrowers may expect to pay around 8% in Germany and 6% in Japan. These figures agree with those we were able to obtain by calling German and Japanese banks in London today.

With U.K. bank base rates now at 9% and prime borrowers likely to pay 1 to 2% above base, it can be seen that although equivalent German and Japanese rates are greater than half of those here, they are still significantly below rates in the U.K.

Thank you for your interst in the Pay Presentation. We believe it will prove useful.

Yours sincerely,

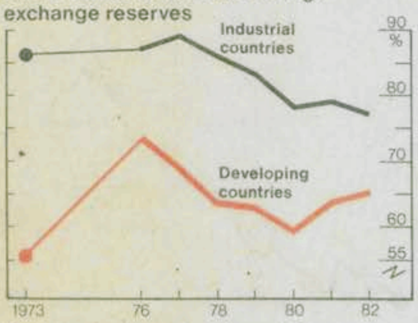
Terry Beckett

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister,
10 Downing Street,
London, S.W. 1.

ECONOMIC AND FINANCIAL INDICATORS 2

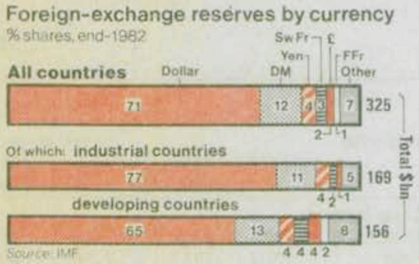
FOCUS: FOREIGN RESERVES The dollar is still the world's reserve currency. At the end of 1982, 71% of all countries' foreign-currency reserves were held in dollars, compared with 76% in 1973. The dollar's share shrank to 69% in 1980, largely because its exchange rate fell against currencies like the D-mark and the yen. Central banks want to hold reserves in a form that holds its value and can easily be used to finance trade. The dollar has scored on both counts while alternatives—principally the D-mark—have tended to resist a greater role as a reserve currency. Remember, though, that gold is still the most popular of all. In 1982 industrial countries held 60% of their foreign reserves in gold, only 30% in foreign currencies.

Dollar assets as % of total foreign-exchange reserves



Foreign-exchange reserves by currency

% shares, end-1982



WORLD BOURSES Hongkong had a drubbing, falling to its lowest point since December, 1982, and 37.5% below its 1983 high. Wall Street drifted down on profit-taking, while London perked up after a fall in interest rates. France rose, hovering around the record high it achieved this week.

Stock price indices	Oct 4	1983 high	1983 low	% Change on one week	one year	record high	31/12/82 in local currency	31/12/82 in $ terms
London	708.2	740.4	598.4	+2.0	+22.8	−4.3	+18.7	+8.2
New York	1236.7	1260.8	1027.0	−0.9	+36.3	−1.9	+18.2	+18.2
Canada	2474.0	2598.2	1949.8	−4.1	+56.3	−4.8	+26.4	+26.3
Australia	697.4	736.7	487.8	−2.9	+40.5	−6.5	+43.6	+31.9
Japan	690.5	694.4	574.5	−0.3	+32.4	−0.6	+16.3	+16.8
Hongkong	690.1	1102.6	690.1	−13.8	−21.8	−61.9	−12.0	−32.7
Belgium	130.9	134.4	100.5	−1.5	+28.2	−8.0	+27.2	+11.7
France	139.5	139.7	96.1	+0.2	+41.8	−0.1	+39.2	+17.1
Germany	941.5	986.3	727.9	+0.1	+32.4	−8.8	+23.3	+11.7
Holland	116.5	116.5	83.5	nil	+69.6	−17.1	+39.0	+24.2
Italy	192.1	214.9	160.5	−1.6	+19.9	−34.2	+15.8	−0.4
Singapore	953.4	992.6	712.3	−2.9	+46.1	−3.9	+30.2	+28.3
South Africa	934.7	968.7	740.9	−2.2	+36.4	−3.5	+26.6	+21.7
Sweden	1433.7	1528.6	896.2	−4.1	+118.0	−6.2	+58.8	+48.3
Switzerland	335.1	347.0	294.4	nil	+29.3	−28.6	+16.2	+10.3

MONEY AND INTEREST RATES All Japanese interest rates eased, as did West German bond yields—a ready response to the strength of the two countries' currencies. British banks cut their base lending rates by half a point to 9%, helped by expectations that some British money supply figures for September will show a fall.

	Money supply % rise on year ago Narrow (M1)	Broad‡	Interest rates % p.a. (Tuesday, except bonds which are previous Friday) Money market Overnight	3 months	Commercial banks Prime lending	Deposits 3 months	Bond yields Gov't long-term	Corporate	Eurocurrency Deposits 3 months	Bonds
Australia	+ 7.0	+12.6 (8)	11.50	11.45	14.00	10.07	14.30	15.30	10.50	14.36
Belgium	+ 3.3	+ 5.1 (3)	8.40	9.25	12.50	9.00	11.43	11.34	10.25	13.04
Canada	+16.1	+ 0.5 (8)	9.50	9.25	11.00	9.30	11.80	12.14	9.63	12.28
France	+10.5	+10.3 (5)	12.63	12.63	12.25	12.03	13.39	14.36	14.50	11.12
W Germany	+11.7	+ 6.8 (7)	5.55	6.20	8.00	5.64	8.38	8.35	5.81	8.16
Holland	+ 9.9	+10.0 (6)	5.88	6.38	8.00	6.38	8.63	8.78	6.06	11.53
Italy	+15.4	+15.0 (5)	17.63	17.69	18.75	11.50	17.64	17.32	17.75	12.87
Japan	+ 3.1	+ 7.1 (7)	6.75	5.38	6.00	3.75	7.57	7.68	6.69	6.91
Sweden	n.a.	+ 8.3 (6)	11.90	12.40	11.00	12.05	12.00	13.00	12.25	11.39
Switzerland	+ 6.8	+ 8.3 (6)	2.44	3.94	7.50	3.75	4.69	5.07	3.97	11.06
UK	+13.3	+11.0 (8)	8.44	9.44	10.00	9.31	10.85	11.89	9.44	12.24
USA	+12.7	+ 9.1 (8)	8.38	9.00	11.00	8.95	11.62	12.40	9.56	12.06

Other key rates in London 3 mth Treasury Bills 9.0%, 7-day Interbank 9.3%, clearing banks 7-day notice 5.5%. Eurodollar rates. (Libor): 3 mths 9.7%, 6 mths 9.9%.

‡ M2 except Australia, Canada, Switzerland, U.S.A., W. Germany, M3, Japan M2 + C.Ds, UK £M3, Definitions of interest rates quoted available on request. Sources: Chase Manhattan, Chase Econometrics, Banque de Commerce (Belgium), Nederlandse Credietbank, Credit Lyonnais, Svenska Handelsbanken, ANZ bank, Credit Suisse First Boston. These rates are indicative only and cannot be construed as offers by these banks.

TRADE, EXCHANGE RATES AND RESERVES Japan produced a current-account surplus of $2.1 billion in August, bringing its 12-month total to $15.5 billion. West Germany managed only $4.7 billion over the same 12 months, still enough to push the D-mark's trade-weighted value to its highest point since July. Australia's current-account deficit—$5.8 billion in the 12 months to August—was its smallest since 1980.

	Trade balance** $bn latest month	latest 12 months	current-account balance $bn latest12 mths	currency units per $ latest	year ago	3mth forward rate per $	Discount/ premium %pa	Trade-weighted‡ exchange rate latest	year ago	currency units per £	per SDR	foreign reserves†† $bn July	year ago
Australia	+0.01 (8)	− 0.3	− 5.8 (8)	1.10	1.06	1.11	Disc 3.16	82.3	84.7	1.64	1.17	6.3	4.1
Belgium	−0.14 (5)	− 3.5	− 2.5 (3)	53.5	49.5	53.5	Prem 0.11	90.7	93.4	78.9	56.6	5.5	3.7
Canada	+1.02 (7)	+14.0	+ 2.9 (6)	1.23	1.24	1.23	Prem 0.24	92.2	90.5	1.82	1.31	3.6	2.5
France	−0.05 (8)	−10.6	−10.6 (6)	8.01	7.20	8.10	Disc 4.78	67.4	72.5	11.8	8.47	20.4	15.4
W. Germany	+1.47 (8)	+19.0	+ 4.7 (8)	2.63	2.55	2.60	Prem 3.73	126.6	124.9	3.88	2.78	44.5	41.0
Holland	+0.47 (6)	+ 3.4	+ 3.6 (3)	2.94	2.79	2.92	Prem 3.37	116.5	117.1	4.34	3.11	10.7	8.3
Italy	+0.20 (5)	−10.3	− 3.3 (6)	1592	1434	1625	Disc 8.15	49.5	53.5	2348	1686	20.2	15.4
Japan	+3.13 (8)	+26.0	+15.5 (8)	234	273	232	Prem 2.90	153.0	126.1	345	248	25.4	25.6
Sweden	+0.24 (7)	− 0.2	− 3.2 (3)	7.83	6.29	7.88	Disc 2.66	67.1	80.9	11.5	8.27	3.6	3.2
Switzerland	−0.26 (7)	− 3.7	+ 3.5(12)	2.11	2.20	2.09	Prem 5.61	152.7	143.4	3.12	2.24	12.5	12.3
UK	−0.21 (8)	+ 0.5	+ 5.3 (8)	0.68	0.59	0.68	Prem 0.18	82.7	91.6	—	0.72	11.7	13.1
USA	−7.19 (8)	−57.5	−26.5 (6)	—	—	—	—	126.9	124.6	1.48	1.05	21.1	20.8

*‡Bank of England index 1975=100 ††excluding gold. **Canada, Australia, Japan, France and UK imports fob, exports fob. All others cif/fob.*

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JC JR

10 DOWNING STREET

THE PRIME MINISTER

6 October 1983

Dear Sir Campbell,

I was very grateful to you and Sir Terence for giving me an opportunity to see the CBI's presentation on Pay and Productivity. It was extremely well argued and illustrated and its message came across with great force.

It is very clear that though there are a number of positive signs in the economy there is still a long way to go to regain the ground lost over many years. It will be fatal to ease up in the control of costs at the first sign of improvement in the economic climate.

Yours sincerely

Margaret Thatcher

Sir Campbell Fraser

JC

10 DOWNING STREET

From the Private Secretary

Prime Minister

The purpose of the CBI visit is to show you their pay presentation and not to engage in a substantive discussion of the pay scene. But you could raise the following points.

(i) Is Vauxhall settlement likely to influence other settlements?

(ii) Private sector now clearly leading public sector (as it should be when former is expanding, latter contracting) but if gap is too great, difficult to hold line in public sector

(iii) Need to ensure companies don't fritter away increased profits (up 25 per cent on a year ago) on wage increases.

AT
5/10

Table handed to Prime Minister by Sir Terence Beckett on 5/10/83, as background to Vauxhall's 7.7% settlement

cc Mr Owen
Miss Simpson (Tsy)

	Public Services	NB Pay Factor	% Pay Increases Private Manufacturing	Vauxhalls
78/79 estimate[1]	11½		15½	na
79/80	25[2]	-	16½	11
80/81	8½	6.0	9½	7¾
81/82	7	4.0	7	5
82/83	4½-6	3.5	5¾	8
Total increase[3] 78/79 and years to 82/83	51½-53½		44	36

(1) From DE New Earnings Survey
(2) Including Clegg
(3) Cumulative Increase

10 DOWNING STREET

Prime Minister

Sir Terence Beckett and Sir Campbell Fraser are coming to give you the CBI's pay presentation. This is a slide show, lasting about 20 mins, which the CBI put on at the start of the wage round for their member companies. It has been seen by other Govt Ministers.

It has been agreed that there will be no publicity. Sir Terence and Sir Campbell will come in via Cabinet Office

AT

4/10

MR. INGHAM

cc Mr. Butler
Mr. Turnbull
Duty Clerks

CBI Pay Presentation

I had a word with Sir Terence Beckett this afternoon about the CBI's pay presentation to the Prime Minister next week.

Sir Terence readily agreed with me that it would be advantageous on all sides to keep the fact of the meeting confidential. He believed that from the CBI's point of view it would be counter-productive for them to be seen to be too close to the Government; and I thought that a public meeting with the CBI on pay might well stimulate an awkward request from the TUC for a similar meeting. Sir Terence Beckett, Sir Campbell Fraser, and Mr. Shiel (the projectionist) will, therefore, enter through the Cabinet Office door, and I would be grateful if the Duty Clerks would make the necessary arrangements.

M. C. SCHOLAR

30 September 1983

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Telephone 01-379 7400
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Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson

Tim Flesher o/R

To note

CBI CONFEDERATION OF BRITISH INDUSTRY

29th September, 1983

3/10

Dear Mr. Scholar,

I am writing to confirm arrangements for the Pay and Productivity Presentation to the Prime Minister on Wednesday, 5th October, at 3.45 p.m. at 10 Downing Street.

The President, Sir Campbell Fraser, and the Director-General, Sir Terence Beckett will be making the presentation. The equipment will be operated by Andrew Cheall of the CBI's Information Directorate. I have asked Mr. Cheall to contact your office to make the necessary arrangements for setting up the equipment.

Yours sincerely,

Linda Turner.

(Personal Assistant to
the Director-General)

Michael Scholar Esq.,
Private Secretary to the Prime Minister,
10 Downing Street,
London, S.W. 1.

Ind Pol CBI Pt 3

BF

10 DOWNING STREET

Now arranged for Wed 5/10 at 1545

4

Prime Minister

Sir Terence Beckett rang to ask if you could fit in 1/2 hour to see the CBI's pay presentation, which he, Campbell Fraser plus 2 would bring here for you – perhaps before the Party Conference.

Do you wish to see this?

Yes – if there is time

MCS 22/9

MT

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From
Sir Terence Beckett CBE
Director-General

CBI CONFEDERATION OF BRITISH INDUSTRY

4

Prime Minister

The Rt Hon Margaret Thatcher MP
10 Downing Street
LONDON SW1

Mes 12/7

12 July 1983

MT

Dear Prime Minister,

WORKING WITH POLITICIANS

As you know, the CBI attaches the greatest importance to good communication between businessmen and MPs and, indeed, politicians at all levels, locally and in the EEC.

To help foster this necessary dialogue from the business side, we have produced the above book as a guide for our members. We hope it will help them to understand better the pressures of the political life and facilitate easier communication.

I have taken the liberty of enclosing a copy so that you will be aware of its scope should any references be made to it in Parliamentary or political circles in general.

Yours sincerely,

Terry Beckett.

CONFIDENTIAL

SUBJECT

File

cc master

10 DOWNING STREET

From the Principal Private Secretary

27 June 1983

Dear John,

MEETING WITH THE CBI

Sir Campbell Fraser and Sir Terence Beckett called on the Prime Minister this morning. The Chancellor of the Exchequer and the Secretary of State for Trade and Industry were present.

Sir Campbell Fraser and Sir Terence Beckett, after referring to the CBI Trends Survey being published today, said that the recovery was still thin and patchy. They would describe the current state of the British economy as at "red/amber" and the current task was to turn it to "green". After discussion, it was agreed that this phraseology might be misunderstood if used publicly, since it might be taken as a description of a task for Government policy: a better way of putting it would be that the British economy was now in first gear, the immediate task was to get it into second gear and the longer-term task was to get it into top gear.

Sir Campbell Fraser and Sir Terence Beckett said that there were a number of matters which they would wish to raise under the heading of this general objective and the following points were covered in discussion:-

(i) The CBI representatives said that some energy-intensive industries were likely to contract further in the period ahead. To some extent this was inevitable, but it was also partly the result of excessive energy costs. The NUM's actions, designed to protect jobs in coal mining, were destroying them in other industries, and the recent report by the Monopolies and Mergers Commission had shown that the NCB was selling coal more cheaply - in some instances, at £10 a tonne less - in Europe than in the United Kingdom. The CBI were not so much asking for subsidies, but for the opportunity for British industry to compete on fair terms with Europe. The Prime Minister and the Chancellor of the Exchequer commented that action was being taken to make the coal industry more efficient.

/ (ii)

(ii) The CBI representatives said that they were absolutely in step with the Government on trade union reform. They would also deliver the 300,000 places under the Youth Training Scheme which they had promised two years ago, but they thought that it was essential that the YTS allowance should not be increased above £25 and that juvenile pay rates should be reduced as a proportion of adult rates. The Prime Minister said that the problem of the Wages Councils was one which would have to be addressed during the present Parliament.

(iii) The Prime Minister said that she was still worried about the general level of wage settlements, and had made the point that they had to be considered in relation to output and to wage costs of other countries. The CBI representatives said that they would be putting this message across to their members in a series of meetings on the coming pay round.

(iv) Ministers and CBI representatives agreed that an essential part of enabling British industry to take advantage of the recovery lay in getting costs down. The CBI welcomed what the Prime Minister had said about abolishing the National Insurance Surcharge during the present Parliament, and a further move in the same direction would be to reduce the burden of employers' National Insurance Contributions. They added that the essential condition for free enterprise to prosper was that Government spending and borrowing should be reduced. Sir Terence Beckett said that he had been encouraged by the discussion he had had with Permanent Secretaries at Sunningdale on this matter, but there was still a long way to go in achieving potential savings within Government.

(v) The CBI representatives also attached importance to achieving freer exchange of services within Europe to match the free movement of goods.

(vi) On interest rates, Sir Terence Beckett commented that the upward movement in the mortgage rate last week had to be set in the context of the very substantial reduction which had previously been achieved. However, real interest rates were still much higher than the real rate of return in British industry. Ministers commented that they shared the desire of the CBI for lower interest rates but, since these depended on market and international conditions, they were not solely within the Government's gift.

/ (vii)

(vii) The CBI representatives referred to the Williamsburg discussion of exchange rates and said that, while they would wish a somewhat lower sterling exchange rate with the European currencies, the main concern of industry was over exchange rate volatility. If a more stable regime could be achieved, this would be a great help to British industry. They complimented the Chancellor of the Exchequer on what had been done to stabilise the oil price.

Summing up the meeting, the Prime Minister said that it had been a very useful exchange, which had covered the medium term as well as the short term and revealed no major differences of opinion between the Government and the CBI. She would welcome further such exchanges with the leaders of the CBI, accompanied by less publicity than the present meeting.

I am copying this letter to Jonathan Spencer (Department of Industry), Barnaby Shaw (Department of Employment), Julian West (Department of Energy) and Richard Hatfield (Cabinet Office).

Yours ever,

Robin Butler

John Kerr, Esq.,
HM Treasury.

Mr. Scholar
Thank you.
FERS

→ Mr Butler
To see
MCS 23/6

1. MR SCHOLAR
MCS

(2)

2. PRIME MINISTER

Worth mentioning at meeting with CBI?

PAY PRESENTATION

I held a meeting of Chief Information Officers of the main economic Departments today on the question of pay policy. The meeting was unanimous on the need for the Government to influence opinion before the Recess, and for you to leave the CBI on Monday in no doubt about the importance of moderation in the private sector.

The Departments represented were: Treasury; Employment; Industry; Environment; Energy; Transport; DHSS; Scottish Office; Home Office. Nick Owen was also there.

Present Negotiating Round

First we looked at the present situation, with the negotiating round virtually complete. The main outstanding problems are:

- top salaries (crucial to the atmosphere);
- rail;
- health service (threat to re-open) linked with nurses' pay determination machinery.

Otherwise negotiations over the last 12 months had gone relatively successfully, though settlements remained well ahead of inflation.

Other Problems

Apart from nurses' pay machinery, we need in the foreseeable future to be aware of four factors if only from a timing point of view:

- Confederation of Shipbuilding and Engineering Union's conference (next week);
- NUM conference, Perth (first week in July);
- police pay - according to Edmund Davies' formula (late July);

- Trades Union Congress, though probably an agonised political event (first week of September).

Perspective

We concluded that you start your second term of Government in a very strong position:

- those in work have done very well out of it; they emerge from the depression not merely with their standard of living intact but improved, though they may not believe it;
- the average increase in earnings is well ahead of the rise in prices; the real post-tax income of a married man with two children rose 3% in year April 1983;
- the trade union movement is in no condition after 2 election defeats to mount a decisive challenge and is likely to be divisively preoccupied over the next few months with the Labour leadership;
- a greater awareness among the rank and file of the link between pay, productivity, prices and jobs;

On the other hand we see dangers in:

- the Government's stunning victory and the tendency, if not positively checked, to rest on its laurels when action is required;
- the natural tendency for people, whatever their heads may tell them, to try to make good what they feel is lost ground as the economy expands;
- a tendency for inflation to rise over the rest of this year instead of to fall, bringing fear of a return to higher inflation and the need to compensate for it;
- two institutional factors - a helpless (and hopeless) trade union movement which is incapable of pursuing its members' interests (as distinct from identifying them); and the incompetence of the generality of private sector companies in protecting their competitive trading interest;
- the worrying tendency in the Civil Service/public sector to come up with new and apparently flabby comparability formulae, regardless of market forces;

- a potential failure on the part of Government to realise the importance of influencing opinion now, immediately after its election, to meet hopes, expectations or predictions that it will relax the second time around.

Conclusion

We reached, unanimously, the following conclusions:

1. the Government must take seriously the urgent need to influence rank and file opinion, appealing to them over union heads, towards the next negotiating round;(we may wish to get away from annual rounds, but for the moment we are stuck with them);

2. its clear message should be:

   (i) large settlements are a thing of the past;

   (ii) there can be no let up in the drive to hold down wage settlements and to offset their cost with higher efficiency, output and productivity;

   (iii) those in work have done very well, falling inflation has provided real increases in the standard of living, even with declining settlements;

   (iv) those in work have an obligation to the unemployed:- low settlements, offset by productivity, create the means - a recovery in profitability and in competitiveness - to create new jobs;

   (v) there is no substitute for working our way steadily out of recession and behaving sensibly, responsibly and with moderation - the real message of the election;

3. the Government must lose no opportunity to get over its message at an early date; there is a risk that a sullen, demoralised and confused trade union movement could turn nasty unless it recognises the smack of firm Government; and

4. the place to start is with the CBI on Monday.

B. INGHAM
21 June 1983

5/1

Michael Scholar - on return

I said to Campbell Fraser that I heard it was good and he might suggest that the PM saw it. It might be useful if she saw it sometime before her speech at the CPRS dinner. Pl. would you discuss with Caroline and Fraser's secretary and see if we can work up a proposition to put to the PM.

ERB

24.12.

~~ROBIN~~

Sir Campbell Fraser's secretary rang to ask when the Prime Minister would like to see the Unemployment film.

Is this something you would wish to pass on to Caroline ?

I didn't take the message, so have not conveyed anything.

Perhaps someone would like to ring her back ?

A

20.12.82

Please file on CBI file — TUE 19 APRIL

ES

5/1

Overtaken.

MW

19/4/83

CONFIDENTIAL

c/c JV

NBPM
mr 29/11

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

26 November 1982

Ms Felicity Everiss,
Private Secretary to the Secretary of State
Department of Employment

Dear Felicity,

CBI REPORT ON UNEMPLOYMENT

Thank you for your letter of ~~17~~ 16 November suggesting that the Chancellor should chair the discussion on this report with the CBI.

The Chancellor is content to do so but feels that the meeting should be arranged for a date after Ministers have had time to consider the further proposals on selective employment measures now being prepared by your Secretary of State. Our offices have been in touch and I gather that the most convenient time is 3 p.m. on Tuesday, 14 December.

I am copying this letter to Tim Flesher (No.10), David Saunders (Industry) and to John Wilson (Scottish Office) and Carys Evans (Welsh Office) whose Secretaries of State have also been invited to the meeting.

Yours sincerely,

Margaret O'Mara

MISS M. O'MARA

Ind Pol
CEJV Ind. Pol

SECRETARY OF STATE FOR EMPLOYMENT

NBPM

MAS 16/11

Caxton House Tothill Street London SW1H 9NA F

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

Miss M O'Mara
Private Secretary
Treasury
Great George Street
LONDON
SW1

16 November 1982

Dear Margaret

CBI REPORT ON UNEMPLOYMENT

will repeat if required.

Thank you for your letter of 8 November about the handling of this report by Ministers.

As we see it, there is no question in this case of the Government making a detailed written response to the CBI. It is simply a question of whether Ministers respond to their request for a meeting separately or arrange a single meeting with all the Ministers concerned.

My Secretary of State is happy to see the CBI separately on the areas of the report which are his direct concern, but thinks there may be advantage in a single joint meeting (which seems to be what they have in mind). Such a meeting would normally fall to the Treasury to coordinate. My Secretary of State is of course prepared to take on that role if asked, but he does wonder whether the Chancellor would not in fact feel it right to chair such a meeting. The Report is very much concerned with the Government's general economic strategy and the Chancellor has, we understand, agreed to a TUC request to meet them soon to discuss the economic situation and unemployment.

I am sending a copy of this letter to the recipients of yours.

Yours sincerely

Felicity Everiss

MS F M EVERISS
Private Secretary

16 NOV 1982

cc JV

RECEIVED
- 9 NOV 1982
PRIVATE OFFICE
OF EMPLOYMENT

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

Prime Minister

MCS 17/4

Ms Felicity Everiss
Private Secretary
Department of Employment
Caxton House
Tothill St
London SW1

8 November 1982

MT

Dear Felicity,

We spoke on the telephone about the handling of the CBI's Report on Unemployment which Sir Campbell Fraser has sent to a number of Cabinet Ministers.

As I explained, the Chancellor had already sent a short personal acknowledgement to Sir Campbell before we received Tim Flesher's letter of 3 November. He did not respond specifically to Sir Campbell's request for a meeting, as he is in fairly frequent contact with the CBI on a range of issues. It would clearly be slightly embarrassing if the Chancellor were now to send a more substantive response on behalf of other Ministers and were to invite the CBI to a meeting to discuss the Report. He would therefore be grateful if your Secretary of State would coordinate the Government response.

I am sending a copy of this letter to Tim Flesher at No. 10 and to David Saunders in the Department of Industry.

Yours sincerely,

Margaret O'Mara

MISS M O'MARA

Ind Pol : Meetings with CBI Pt 3

HL

5 November 1982

I am writing on behalf of the Prime Minister to thank you for your letter of 5 November, with which you enclosed a copy of your CBI Conference speech.

I will place this before the Prime Minister at the earliest opportunity, and I am sure she will be interested to read it.

MICHAEL SCHOLAR

Sir Terence Beckett, C.B.E.

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Terence Beckett CBE
Director-General

CBI
CONFEDERATION OF BRITISH INDUSTRY

Prime Minister (2)

I have acknowledged on your behalf.

MCS 5/11

5th November, 1982

Dear Prime Minister,

see EPM.

I am enclosing a copy of the speech I made at the close of the C.B.I. Conference this year. I hope you will find it of interest.

Yours sincerely,

Terry Beckett.

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister,
10 Downing Street,
S.W. 1.

Enc.

Ind Pol Sup

Kay

Please return to me for retention

AJ 4/11

10 DOWNING STREET

From the Private Secretary 3 November 1982

I attach a copy of a letter the Prime Minister has received from Sir Campbell Fraser enclosing the CBI Report on Unemployment. As you will see, Sir Campbell says that he would welcome an opportunity to discuss the Report with members of the Government and I assume, therefore, that you have already received a copy. I should be grateful if whichever Minister replies to Sir Campbell's approach could do so on behalf of the Prime Minister; I assume that such a reply will cover the arrangements for the Ministers concerned to meet the CBI.

I am sending a copy of this to Felicity Everiss (Department of Employment) and David Saunders (Department of Industry).

(TIMOTHY FLESHER)

Miss Jill Rutter,
HM Treasury.

Tim

10 DOWNING STREET

Michael

Pity really - I think we could have simply acknowledged. I don't think he is looking for a substantive reply from us.

Ask ~~D/~~ Treasury for a draft reply, cleared with D/Emp + D/Ind, not dealing with substance but covering the arrangements being made for the Ministers concerned (excl. PM, I hope) to discuss with CBI

ERB

1.11.

MR. BUTLER

MR. SCHOLAR

How would you like to respond to the attached?

CS.

1 November 1982

HL

1 November 1982

I am writing on behalf of the Prime Minister to acknowledge receipt of your letter of 29 October and copy of the report "Unemployment - a challenge for us all".

Your letter is receiving attention and a reply will be sent to you as soon as possible.

CAROLINE STEPHENS

Sir Campbell Fraser

R/11/1

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Campbell Fraser
President

CBI CONFEDERATION OF BRITISH INDUSTRY

29 October 1982

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

Dear Prime Minister,

On Monday 1 November the CBI National Conference will receive the first report from the Steering Group on Unemployment which was set up under Sir Richard Cave's chairmanship as a result of our Conference last year.

A copy of the report - "Unemployment - a challenge for us all" - is enclosed. - filed on front cover

The report is consultative and we shall be seeking views and reactions during the next few months following the debate at our Conference. We have also prepared a 25 - minute film which will be shown to the Conference and which summarises and introduces the report.

We would very much welcome an opportunity to discuss the report with members of the Government and have sent copies to those directly concerned.

Yours sincerely,

Campbell Fraser.

Ind Pol

SUBJECT.

cc. Master set.

NOTE FOR THE RECORD

Sir Campbell Fraser, President of the CBI, called on the Prime Minister at 1700 hours on Monday 25 October. He had sent a copy of the draft of his President's Address for the CBI Conference a week later.

The Prime Minister congratulated Sir Campbell Fraser on some excellent phrases in his speech and said that she particularly liked the passage about the contribution which Britain had made to new technology. She referred to a passage saying that over the last two years Britain had become more competitive than other countries, and said that she would supply Sir Campbell Fraser with a graph showing that output per man in Britain was still well behind other countries. Sir Campbell Fraser handed the Prime Minister a copy of the Dunlop Magazine, containing the poem quoted in his speech.

Sir Campbell Fraser briefly outlined the programme for Eastbourne, starting with the Brain's Trust to be attended by the Chancellor of the Exchequer on Sunday evening. Seventy Members of Parliament were due to be attending the Monday session. Sir Campbell Fraser said that many at the Conference would be concerned about the outlook, which was very gloomy for the next four months: the Prime Minister pointed out, and Sir Campbell Fraser agreed, that retail trade was quite buoyant, but the problem was that too little of it was met from British production.

Sir Campbell Fraser said that he was much concerned about the level of imports from Spain. Tyres manufactured in Spain were being sold at very low prices in the UK, not only as a result of the low tariff, but also as a result of a Spanish export subsidy. The Prime Minister said that she was greatly concerned by the disparate tariff position between Britain and several countries, including Spain.

/ The Prime Minister

The Prime Minister referred to the CBI survey which was about to be published, which was the most pessimistic she had seen. Sir Campbell Fraser said that it was worrying that redundancies looked like continuing at such a high rate, and the high level of the exchange rate, particularly with Germany, was causing difficulties. He mentioned that Germany appeared to put obstacles in the way of imports by administrative delays in clearing specifications and operating instructions. Perhaps Britain could take a leaf out of their book in considering the new legislation on standards which was under consideration.

The Prime Minister asked Sir Campbell Fraser for his impression of the stance being taken by the trade unions. Sir Campbell Fraser said that the unions showed signs of being more aggressive than last year, but Dunlops were applying a zero norm for pay increases, which should really be negative. The aspect of the CBI survey which he found most worrying was the prospective fall in investment. The Prime Minister commented that local authorities and nationalised industries had reduced capital expenditure and used the money for increased current expenditure, including wages. In the last year earnings had risen by slightly more in the private sector than in the public sector.

The Prime Minister referred to the Order on heavy lorries about to be brought forward by the Minister for Transport. She hoped that the Government would not be beaten on it and that the CBI would speak up about the jobs at stake. Sir Campbell Fraser said that the CBI had made a big effort to help, but some Conservative MPs accepted the economic case and still disliked heavy lorries.

Sir Campbell Fraser referred to a visit he had paid over the weekend to the United States, where there had been mixed views about the prospects for recovery. A banker friend had expressed concern about the position in Mexico. The Prime Minister agreed that the position in Mexico was very difficult, especially since the outgoing President wanted to leave it to the new President to accept the IMF terms. She referred to falling international

/interest rates

interest rates, and Sir Campbell Fraser welcomed this development saying that all the help which could be given to companies' financial positions would be valuable during a time when they were struggling for survival. The Prime Minister noted that in his draft speech he had referred to rates in this context.

F.E.R.B.

26 October 1982

Prime Minister (ind Pol)

It will have to be Monday or after the Conference. Which do you prefer? Monday is light at the moment as I was keeping it free.
C.S.
4/9

PRIME MINISTER

CBI

1. Edward James, who is Deputy Director-General of the CBI, took me out to lunch yesterday.

2. He is a nice man, who had also been present at the Scottish CBI Dinner in Glasgow a week ago today, when I sat next to him.

3. The purpose of yesterday's lunch was for him to say that he and Terence Beckett were dismayed at the recent public dispute between the Government and the CBI and that Terence Beckett was anxious to "kiss and make-up".

4. He said that despite what had occurred Terence Beckett was a warm supporter of the Government's overall strategy and of you personally as Prime Minister.

Edward James acknowledged, of course, that there were differences on tactics, though not on strategy.

5. Terence Beckett would like to have half an hour's chat with you, for the purpose which I have described; I explained the enormous pressures on your time at the present ~~time~~, though I am bound to say that if you could squeeze him in, I do think that that would be time well spent. He would come on his own.

Agreed MT

Ian

8th September 1982

After the Falklands parade MT

cc Caroline Stephens

Note Told Chancellor of the Exchequer's and S/S Industry's offices about this mtg.

meeting was on 13/9

MCS 14/9.

CONFIDENTIAL

Hm

SUBJECT

File

cc: DOI
D/M

c. Master Set

10 DOWNING STREET

From the Private Secretary

7 July 1982

Dear Peter,

Sir Campbell Fraser

The President of the CBI, Sir Campbell Fraser, called upon the Prime Minister yesterday.

Sir Campbell said that the CBI had been giving much thought to the pay prospect. They had reached the conclusion that, in order to improve UK competitiveness - which, inspite of the dramatic productivity improvements of the past year, was still well below the level three years ago - there would ideally be no pay increases in the coming pay round. They, of course, recognised that in practice there would be pay increases, but they thought it most important that the general level of settlements should be lower next year than this. They had noted with concern some recent utterances by Lucas, which might begin to give rise to the impression that after several years of success in reducing the growth of earnings the country had now earned itself some relaxation. The Prime Minister agreed. There would be much to be said for getting away entirely from the annual pay round. Years of incomes policies had broken down the connection between earnings and product. Sir Campbell Fraser said that they had prepared a pay Presentation which lasted about 15 minutes and they would be grateful of the opportunity to make this Presentation to the Prime Minister. The Prime Minister said that she would be interested to hear it, perhaps at the beginning of next month.

Sir Campbell Fraser said that he thought that the Government should not take too gloomy a view of the economic prospect. Existing and prospective unemployment was at a disturbing level, but the other side of this coin was the great improvement in productivity, and the better prospect which many companies now faced as a result. But there must be some anxiety about seeing British companies through two further years in which there was little economic growth. The Prime Minister commented that the Government itself could not create growth; she would be looking to the CBI for some help in the campaign to improve the environment in which accelerated growth could take place: in particular in reducing the overheads on industry. The Prime Minister instanced the CBI's recent unhelpful role in the issue of whether supplementary benefit should be withdrawn from 16-year olds who did not participate in the Youth Training Scheme. Sir Campbell Fraser said that it had been necessary to take this stance in order to deliver a deal with

CONFIDENTIAL

/ the TUC.

DG

the TUC. The Prime Minister commented that she regretted that the point was always put this way round, and that the Government was never told that it was necessary to take a particular course of action in order to achieve a deal with the CBI. She hoped that industry would play a full part in the Youth Training Scheme, since it was much cheaper for companies to provide training places than for the MSC to do so. Sir Campbell Fraser said that he shared the Prime Minister's hope; but that once the scheme got under way he expected a volume of complaints from British industrialists about the costs which the scheme imposed upon them.

The Prime Minister said that another area in which she hoped for CBI support was in seeking improvements in the performance of the nationalised industries. These, she knew, figured prominently amongst the CBI's membership. The Nationalised Industry Investment Review was showing that, once again, these industries were posing a threat to the Government's economic strategy. The Review showed an over-run on the industries' EFL's of £1 billion for 1983/84, of which the National Coal Board was contributing almost £½ billion. They also posed a threat in their pay policies, and in the price increases which they imposed upon the rest of the community. Sir Campbell Fraser said that he believed that this was principally a problem for the industries' owner, the Government. On pay, he was not convinced that the industries were out of line with the general level of settlements in the economy. The Prime Minister said that she hoped that, notwithstanding these views, the CBI would assist the Government in the important task of maintaining proper control over these industries. She also hoped that, generally, the CBI would not be untowardly gloomy in their comments on the economy.. Some of their utterances in recent months had been quite unnecessarily discouraging.

I am sending a copy of this letter to Jonathan Spencer (Department of Industry) and Barnaby Shaw (Department of Employment).

Yours sincerely,

Michael Scholar

Peter Jenkins, Esq.,
H.M. Treasury.

cc. A.Duguid

cc Nasher

SUBJECT

10 DOWNING STREET

From the Private Secretary

10 February, 1982.

Sir Raymond Pennock and Sir Terence Beckett came in for a meeting with the Prime Minister yesterday evening.

Sir Raymond Pennock thanked the Prime Minister for finding time to see them. They wished to reiterate and to enlarge upon certain aspect of the budget representations which they had made to the Chancellor. The CBI's hope was that the budget would be a businessman's budget. The economy was undoubtedly picking up; they hoped that the budget would add some impetus to the increase in activity. The measures they had in mind would take some while to have an effect, and they thought i important that there should be a budget framed to help business this year rather than next when the election would be too close for the effects to have their maximum impact.

Sir Terence Beckett said that the industrial scene was in a much healthier state this year than when they had made their representations 12 months ago. There had been a spectacular growth in output per person. If industry could get its output back to a 1979 level there would be a very large increase in its profitability. The pay round was going well, with the vast majority of settlements in the 4-6% range. On exports, volume at the end of last year was 7% higher than 12 months earlier. Industry felt that it was doing its stuff; but it was still burdened by heavy costs from the public sector. Of these the National Insurance Surcharge was highly onerous. Sir Raymond said that this cost his company £9 million last year, some 10% of their profits. He assured the Prime Minister that if they were relieved of this burden, £9 million more would go into new investment and new technology. None of it would go into wages. Industry was still suffering very high local authority rates; and energy costs were still much too high, especially for electricity.

Sir Raymond Pennock said that they hoped that the Prime Minister would not take too much account of what the CBI had said in its budget representations about the size of the PSBR. Their economists had suggested this figure, and all concerned recognised the extent to which uncertainty clouded these matters. The CBI's concern was a practical one - that the budget should be good for business.

Sir Terence Beckett said that the CBI's proposal for an addition of £1.8 billion to the PSBR had been criticised by many of their members as being excessively modest. But he recognised that the take-off from the recession must be slow if we were to avoid bottlenecks and adding to inflationary pressures. At their meeting at the

/ Treasury

Treasury it had been argued that the CBI's proposals in relation to the NIS were too indiscriminate in their effect upon industry, and would leak into wages. They thought neither of these arguments was strong. It was their belief that companies would use this additional room for manoeuvre to improve their competitiveness and reduce their costs, and not to finance higher wage settlements. The effect on nationalised industries and local authorities could, they believed, be easily offset by corresponding reductions in EFLs and the RSG. They handed the Prime Minister a table to illustrate their contention that the benefit of the reduction they proposed would not be indiscriminate. Finally, they argued that the NIS is the reverse of an export subsidy: a reduction would improve the competitive position of our industries in relation to that of their overseas competitors.

The Prime Minister said that it was useful to hear the CBI's views at this stage. She reminded the CBI representatives of the savings to industry which had accrued from the shake-out of labour over the past two years. These costs, together with powerful political criticism, now fell upon the Government. The Prime Minister also noted that when the Government had announced increases in National Insurance contributions these had been framed asymmetrically, so as to minimise the additional burden upon industry. She pointed out that tax reliefs in the personal sector were also an important factor so far as the health of industry was concerned. This had been particularly important for management. She was concerned lest the CBI set their sights too high, so that there would be a risk that a good and fair budget would be criticised because it did not come up to excessive and pre-conceived benchmarks. The Prime Minister said that financial markets had in this recession rumbled governments: they were not this time round prepared to see negative real interest rates as they had done after the first major oil price rise. But it was vital, particularly for small businesses, to keep interest rates as low as possible. We must ensure that our emergence from a recession should occur in a sound and sensible way.

I am sending a copy of this letter to Jonathan Spencer (Department of Industry).

M. C. SCHOLAR

John Kerr, Esq.,
HM Treasury.

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Raymond Pennock
President

CBI CONFEDERATION OF BRITISH INDUSTRY

Econ Pol

PM has seen
MCS 5/2

3rd February 1982

Dear Caroline.

Further to Sir Raymond Pennock's letter of 26th January to the Prime Minister concerning the CBI Budget Representations, I now have pleasure in sending the final version of our Representations to the Chancellor.

Yours sincerely,
Beatrice Gilpin
Personal Assistant to
The President

Mrs. Caroline Ryder,
Personal Assistant to the Prime Minister,
10 Downing Street,
London, SW 1.

And many congratulations - and good wishes - on your marriage!

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 3 P.M. ON TUESDAY, 2ND FEBRUARY, 1982

Present:-

Chancellor of the Exchequer	Sir Raymond Pennock)
Financial Secretary	Sir Terence Beckett)
Mr. Ryrie	Sir Donald MacDougall) C.B.I.
Mr. Burns	Mr. D.R. Glynn)
Mr. Quinlan	Mr. R. Utiger)
Mr. Battishill	Mr. A. Willingdale)
Mr. Cassell	Mr. J. Pope)
	Mr. D. McWilliams)
Mr. Isaac) Inland	
Mr. Ware) Revenue	

C.B.I. BUDGET REPRESENTATIONS

Referring to the CBI document "A Winning Budget" due for publication on Wednesday, 10 February, Sir Raymond Pennock said that the CBI's basic message to the Chancellor did not claim to be original and he had heard it before. Above all what was needed was a Budget which cut business costs to reduce the disproportionate burden on the business sector. The aim should be to improve competitiveness and redress the imbalance of pressure in the economy which had borne less heavily on Government and consumption and much more heavily on production and investment. Since the last Budget the situation had changed significantly in a way which added validity to the CBI's basic case. This time last year the recession was still getting deeper; it was now clear with hindsight that it had reached bottom at the end of the second quarter of 1981, but the recovery had been so slow it had been difficult to discern. The second point was that the Government was a year nearer an Election which could be as little as 18 months away. British industry had done a great deal to make itself more competitive; and the CBI and Government were completely agreed that this was the key to recovery. The only way out of the recession would be by sustaining the improvement in productivity and reducing costs, particularly pay. Pay was a success story - the level of settlements had been halved last year, and in the present year they were running at 4 to 6 per cent in the private sector which represented a further halving of last year's level. On productivity, the CBI's figures showed that even with reduced output productivity in terms of output per man was up 10 per cent. The potential for improved productivity was even greater; in the case of his own company, BIC, if it were possible to return to the 1979 volume (i.e. 10 per cent up on present level) profitability would increase very substantially because the workforce was down by 25 per cent.

2. In the battle for competitiveness industry had therefore done what was required of it. But this contrasted markedly with what had happened in the public sector. When industry examined those costs over which it did not had control - and he had in mind particularly the NIS, rates, energy costs and other nationalised industry charges - it found they had all increased substantially. This had to be seen in the context of present levels of profitability which were around 2 per cent return on capital. A cut in NIS would be a sure and certain way of improving competitiveness or productivity or both. If the Government thought there was a danger than a NIS reduction would be passed on in higher wage settlements, then it was out of touch with reality. With 3 million unemployed and pre-tax profits at the present historically low level this simply would not happen. The CBI had demonstrated that at least 60 per cent of the benefit would go to manufacturing and distributive industry.

3. Sir Terence Beckett said that the CBI's quarterly trends survey was published that day. Its findings were consistent with the latest projections of 1 per cent growth in GDP and 3 per cent growth in manufacturing. The slight decline in confidence evident in the October survey had been reversed, but there was no significant improvement in demand or output. 93 per cent of respondents had said their output was constrained by lack of orders or sales. The position on competitiveness, and under-use of capacity were much the same, and it was clear that more job losses were in the pipe-line. There was also more de-stocking to be done on raw materials, work in

progress and finished goods. Trend profitability was improving; there was evidence that costs were under control and margins were hardening in both home and overseas markets. Investment intentions were rising for the 5th survey in a row, but it had to be remembered that there was a lag between intention and action of around 12 months, so that the spend would not occur until the second half of the year. On this evidence the case for help from Government to keep things moving in the right direction was compelling. But he had himself said quite clearly on radio and television that morning that reflation must be modest and restrained, since in the present state of the economy the risk of overheating and bottlenecks, and the renewed surge of inflation was very real.

4. Mr. Utiger commented in answer to a question from the Chancellor that although the CBI's representations only touched briefly on the question of excise duties, there was no doubt that last year's measures which did more than revalorise the duties had had a severe impact on the industries and there was therefore a strong case for restraint here. On income tax the CBI supported indexation of the thresholds on the Rooker-Wise formula. But they were convinced that an NIS cut should be preferred to a cut in income tax. It would be far more effective to act directly on business costs, than to try to help industry by increasing consumer purchasing which would tend to suck in imports.

5. The Chancellor commented that the Treasury's own analysis showed that the difference in the end between a cut in income tax, indirect taxes or the NIS on the level of activity were very slight. The Institute of Directors had argued in favour of an income tax cut mainly because of the helpful effect this would have on pay negotiations But he had noted the force of the CBI's argument on this point.

6. In answer to a question from the Financial Secretary about the case for cutting corporation tax, Sir Terence Beckett commented that he saw little point in this as few companies were making substantial profits. What was needed was a reduction in business costs generally, not a reduction in the tax burden on profits.

7. Mr. Utiger said that the CBI attached considerable importance to its proposals for local authority finance. In particular it considered that the present depressed state of the economy and the huge rise in business rates over the last two years fully justified the reintroduction of 15 per cent business de-rating - the recommendation was for 15 per cent. The abolition of rates on empty property, described in the document as "moth-balling" relief was also important.

8. In further discussion the CBI made the following main points:-

(i) The effect of its proposals on the level of the PSBR would be broadly in line with the level targetted for in the current year. In putting forward its package therefore it saw some scope for a reduction in interest rates. It did not feel that interest rate policy should be used to prop up the exchange rate.

(ii) It believed there was a strong need for additional investment in capital projects providing certain criteria were met, and it would like to see public sector projects financed by private capital.

(iii) On energy costs, a number of specific proposals had been put forward costing approximately £70 million in a full year. It was a little cynical about the likely outcome of the review of the CEGB's bulk supply tariff, and it hoped the Government would take early and positive action. The needs of the large users were too real and important to be put on one side too long, and the sums were comparatively modest. It realised the difficulties on fuel oil duty and had not made too much of this question in the document - but obviously any movement here would be very helpful.

(iv) On capital taxes, on which a very detailed submission had been made in October 1979, a number of changes had been made, but a great deal was still to be done. On CGT, where the most objectionable feature was the fact that it often proved to be a tax on inflationary rather than real gains, the CBI favoured the introduction of a 7 year cut-off in preference to the indexation of the threshold. On CTT it argued strongly for the extension of business relief, so that assets currently qualifying at 30 per cent should be merged with those currently relieved at 50 per cent, and the relief increased to 75 per cent for all of them (with assets now receiving 20 per cent relief being increased to 30 per cent). The CBI also attached importance to the review and overhaul of retirement relief rules for capital gains tax - this would be particularly helpful to small businesses.

(v) Development Land Tax, which only brought in some £25 million per year, should be scrapped.

9. The CBI would like to see further measures to help positively small firms, which suffered particular handicaps, and could not insulate themselves from prevailing economic conditions. It believed that the Business Start-Up reliefs should be made available to established companies, and particularly so in the case of management buy-outs. Individuals should be allowed the same tax relief as is now given for investing directly in eligible companies when they invested through the mechanism of a small firms investment company.

10. Summing up for the CBI, Sir Raymond Pennock said that the basic message was that the Budget should cut business costs significantly to improve competitiveness, even at the expense of the consumer. The direct effect on business costs of their recommendations were shown on page 5 - this showed a total reduction of £2590 million in 1982/83 and £3,000 million in 1983/84. The net addition to the PSBR on the CBI's calculations were shown on page 7 - £1840 million in 1982/83 and £1700 million in 1983/84. This meant a PSBR in money terms for 1982/83 of about £11 to £12 billion, which would represent about the

same percentage of GDP as the target for 1981/82 announced in the 1981 Budget. The CBI believed that the City had already discounted the effect of an increase in the PSBR of £1½ billion over the target of £9 billion. On page 6 of the document, the CBI had made some suggestions about how the proposals should be financed, and he wished to emphasise the importance of the second suggestion, reductions in Government current spending. This could be achieved by implementing the recommendations of the CBI working party on Government expenditure, from additional asset sales and lower interest payments. His general message would be for the Government not to believe anyone in the public sector who said they had already achieved as much as they could in this direction.

11. Finally, he would like to make a point on wages. He had already stressed that the CBI did not believe an NIS cut would feed through into higher wage settlements. This was partly because there had been a change in attitudes, away from a deterministic view of wages and the idea that there was an entitlement to wage levels above the level of inflation. There was now a much better appreciation of how overall costs could directly affect job security; and a realisation that profits were needed for investment.

12. The Chancellor thanked the CBI for their clear and full representation.

PJ

P.S. JENKINS
3rd February 1982

Circulation:

Ministers & officials present
Chief Secretary
Economic Secretary
Minister of State (L)
Minister of State (C)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Kenneth Couzens
Mr. Lavelle
Mr. Kitcatt
Mr. Evans

Mr. Barratt
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Mr. Buckley
Mr. Ridley
Mr. Harris
Mr. Burgner
Mr. Lovell
Mrs. Gilmore

PS/Inland Revenue
PS/Customs & Excise

FILE SW

Econ Pol.

29 Janu~~z~~ry, 1982

I am writing on behalf of the Prime Minister to thank you for your letter of 26 January which I am placing before the Prime Minister.

Yours sincerely,

M. C. SCHOLAR

Sir Raymond Pennock

B

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From
Sir Raymond Pennock
President

2

CBI CONFEDERATION OF BRITISH INDUSTRY

Prime Minister

The main points are
(i) reduction by 2 percentage points in NIS
(ii) 15% business derating
(iii) lower interest rates
(iv) more public sector capital investment.

MCS 29/1

26 January 1982

The Rt Hon Margaret Thatcher MP
The Prime Minister
10 Downing Street
London SW1

Dear Prime Minister,

Following the CBI Council meeting last week, we have now finalised our budget representations.

I am enclosing a copy of the leaflet "A Winning Budget", which briefly sets out our views overall. In addition, I am attaching the much more detailed "Budget Representations" which were given to our Council last week and will need some small amendments in the light of the discussion that took place then. Nevertheless, they do provide the full background for our proposals.

As soon as an amended copy is available, we will forward it to you.

Yours sincerely

Ray Pennock

D R A F T

STRICTLY CONFIDENTIAL

BUDGET REPRESENTATIONS TO THE CHANCELLOR

1982

A WINNING BUDGET:

Budget Representations to the Chancellor

February 1982

A Winning Budget

Business has made great strides in improving efficiency and reducing its cost increases. Despite this, the pressures on most firms remain severe and, if maintained, will hold back any recovery.

Now is the time to take advantage of the lessons we have all learned and build on our strengths. These Budget Representations to the Chancellor of the Exchequer show how he could best do this in the coming Budget.

British business has the will to win. We call on the Chancellor to back this with 'A Winning Budget'.

Confederation of British Industry
Centre Point
103 New Oxford Street
London
WC1A 1DU

February 1982

CONTENTS

BRSTART

I MAIN RECOMMENDATIONS

The priority for this Budget must be to reduce the disproportionate burden on the business sector. Business has made major adjustments at great cost-all in line with government policy. We now call on Government to reduce the costs which it imposes on business, improve competitiveness and redress the imbalance of pressure in the economy which has borne less heavily on government and consumption and much more heavily on production and investment.

The analysis in Annex I draws attention to two inter-related problems which the Budget must begin to solve if a sustained recovery is to be achieved: lack of competitiveness and the low level of activity. The Annex also shows how our proposals will affect the economy. The major effects are:

* no adverse effect on inflation. Our recommendations would reduce UK costs and raise, slightly, import costs. Net, after taking account of higher demand and the spreading of overheads, our estimates suggest that our package would not hold back the expected decline in inflation, and indeed may help reduce it further;

* a substantial improvement in competitiveness;

* more growth of production;

* improved profitablility; and as a result,

* more jobs. Our analysis shows that these proposals would lead to a quarter of a million extra jobs by the second half of 1983.

I.1 What We Recommend

There are four major elements in our recommended package:

i NATIONAL INSURANCE SURCHARGE SHOULD BE REDUCED IMMEDIATELY BY TWO PERCENTAGE POINTS AS THE FIRST STEP TO ABOLITION.

ii FIFTEEN PER CENT BUSINESS DERATING SHOULD BE INTRODUCED, FINANCED BY INCREASED CENTRAL GOVERNMENT GRANT. This would put business on an equal footing with the domestic sector.

iii THE BURDEN OF INTEREST COSTS WHICH IS BEARING HARD ON COMPANIES SHOULD BE REDUCED. Lower Interest Rates would help to bring the exchange rate down to a more competitive level. They are a major business cost, particularly for smaller firms, and their reduction would also help competitiveness, activity and investment. Both real interest rates and the real exchange rate are very high by historical standards. In addition, interest rates are high in relation to rates of return, and should not be kept up to hold up the exchange rate at its present level.

iv THE GOVERNMENT SHOULD MAKE AN IMMEDIATE START IN RAISING THE LEVEL OF PRODUCTIVE INVESTMENT IN THE PUBLIC SECTOR. This investment would strengthen competitiveness both by improving the economic infrastructure and by increasing industrial throughput. We envisage extra expenditure building up to £1 billion in 1983/84 (see Table I.2). As much as possible of this extra investment should be financed through the introduction of private capital, sharing any risk involved.

Our detailed proposals for Taxation, Local Authority Finance and Government Expenditure are contained in Sections III, IV and V. In addition to the measures above, these proposals include:

i Further measures to bring our industrial energy costs into line with those of our competitors.

ii The abolition of the empty property rate and the introduction of "mothballing" relief for industrial premises.

iii The continuation and extension of the measures taken by the Government which have been aimed at encouraging smaller firms. In particular, we believe that the development of Small Firms Investment Companies and an extension of the Business Start-Up Scheme would produce a significant increase in investment in such firms.

iv Further steps to reduce the harmful effects which Capital Gains Tax and Capital Transfer Tax have on enterprise and smaller businesses in particular.

v Abolition of the four months delay in payment of Regional Development Grants.

vi A number of technical tax changes which would improve the business climate, and remove anomalies at little revenue cost.

The direct effect on business costs of our recommendations is shown in Table I.1.

TABLE I.1

REDUCTIONS IN BUSINESS COSTS FROM CBI RECOMMENDATIONS

£m, 1982/83 prices

	In 1982/3	Full Year Effect
2 point reduction in NIS	1500*	1900
15 per cent business derating	850	850
'Mothball' relief, empty property rate relief and reduced energy costs	100	250
Abolition of 4 months delay in payment of RDGs	125	nil
Total reduction in business costs	2575	3000

Plus £250m (net) for every 1 percentage point reduction in interest rates.

* This assumes implementation 4 weeks after the start of the financial year. There is also an additional 6 week delay before the Government receipts are affected.

We are further recommending, and have assumed in our calculations, that personal income tax allowances and thresholds should be indexed in line with inflation and in addition that there should be no rise in excise duties. Although priority must be given to business there should be no increase in the overall burden of personal taxation in the coming Budget because of the expected weakness of consumer demand, particularly taking account of the higher National Insurance contributions to be paid from April 1982. The failure of the Chancellor to index personal allowances in 1981 and the substantial increase in excise duties in 1981 are further reasons for implementing these recommendations.

I.2 Financing These Proposals

In considering how the package of measures aimed at reducing business costs and raising investment should be financed, there are three main options open to the Government:

i There could be an increase in the burden of personal taxation, through not fully indexing personal income tax allowances and thresholds in line with prices, through increasing income tax rates or through raising indirect taxes. As made clear above, the CBI does not recommend any of these options.

ii There should be reductions in government current spending. The CBI has argued strongly that the Government should further reduce its current spending below planned levels. We believe that the Government could save at least £$\frac{3}{4}$ billion in 1982/83 from the levels announced by the Chancellor last December and considerably more in subsequent years by implementing the recommendations of the CBI Working Party on government expenditure, from additional asset sales and lower interest payments. Our detailed proposals for government expenditure are contained in Section V.

iii There could be an increase in public borrowing. The CBI has argued for a modest expansion of the economy, accepting a temporary increase in the public sector borrowing requirement. This would raise demand and, provided it were concentrated on the areas outlined above, it should lead to lower company borrowing and greater market confidence in a soundly based recovery and thus have little effect on monetary growth while still achieving our objective of lower interest rates. Our recommendations would leave the level of public borrowing below its level in some recent years in money terms and considerably lower than in most recent years once adjustment is made for inflation and the recession. More detailed discussion of fiscal and monetary policy and the effects of these proposals are contained in Section II and Annex I.

Table I.2 shows our preferred method of financing our recommendations. Although they result in a higher PSBR than expected on unchanged policies in 1982/83, the increase in the PSBR in 1983/84 is lower as a result of the higher level of economic activity. We consider that the proposals, taken together, are the best way of achieving our objectives of improved competitiveness and a sustainable recovery. If some of our recommendations for reductions in business costs were not implemented we would urge further reductions in other business costs. In addition, if personal taxes or taxes on consumption were to be increased or if for any other reason there were more scope than we have assumed, then any additional revenue should be used to finance additional reductions in business costs.

TABLE I.2

ADDITION TO PUBLIC BORROWING (PSBR)[1] FROM CBI RECOMMENDATIONS

	£m, 1982/83 prices	
	In 1982/3	In 1983/4
Cuts in business costs[2]	2575	3000
Extra public sector capital spending[3]	250	1000
Other measures[4]	small	400
Reduction in Government spending, and more asset sales (see Table V.1)	-800	-1500
Feedback Effect[5]	-200	-1200
Net Addition to PSBR	1825	1700

1 By comparison with the level assuming indexation of personal tax allowances and bands and no increases in excise duties.

2 See Table I.1 for further details. The estimates for 1982/83 are lower than for 1983/84 because of implementation and collection delays.

3 Some of this extra capital spending may be financed by private capital (eg British Telecom Bonds) and may not count towards the PSBR. The nationalised industries will gain from the reduction in NIS and business rates, which will enable them to increase their investment further and/or to reduce their prices and charges.

The extra capital spending allows for additional expenditure in support of industrial R and D.

4 Smaller firms, capital taxes, capital allowances, DLT and technical representations (see Section III).

5 Feedback effects reflect the estimated impact of these recommendations on the levels of prices and activity. This impact is mainly to reduce the PSBR as higher activity generates more tax revenue and reduces the number receiving unemploymment benefit in comparison with what otherwise would have happened.

II REDUCING INFLATION AND RECOVERING PROSPERITY

This section explains the economic reasoning underlying the recommendations set out in Section I. Further details on the economic situation and how our proposals would improve the economic prospects are contained in Annex 1.

II.1 Competitiveness

We show in Annex 1 how competitiveness has moved in recent years. Although the position now is substantially better than a year ago, UK unit labour cost competitiveness is still 30 to 35 per cent worse than in 1975, which was a typical year. Low levels of competitiveness and, resulting partly from that, low levels of profitability, have been important reasons for the large loss of output in recent years. At current levels of competitiveness, production in many sectors of the UK economy remains uneconomic. Therefore, competitiveness needs to improve for the recovery to be more than sluggish. These recommendations are designed to improve competitiveness directly by helping to reduce business costs.

II.2 The Need for Balance

The CBI has consistently given priority to the defeat of inflation. However this is not the only economic policy objective. Indeed, since a major reason for aiming to reduce inflation is to raise output and employment thereby, it would be perverse to follow a counter-inflation policy regardless of its consequence for these variables. To do so would risk the medicine proving more damaging than the disease. Moreover, for inflation to be kept low in the longer run, it is necessary for firms to have sufficient capacity in the widest sense for demand to be met without inflationary shortages. A fall in inflation in the short term bought at the expense of serious damage to the business sector's ability to supply its markets would thus be only a temporary victory. It is therefore important to balance the objective of a further reduction in the rate of inflation in the short run with that of preserving a healthy business sector.

A second area where a more balanced approach is needed is in ensuring that the pressure for improving efficiency and reducing inflation is spread more fairly between the Government sector and the business sector. Government consumption expenditure[1] was in mid-1981 over 20 per cent higher in cost terms than two years previously, whereas output in manufacturing fell by about 14 per cent in the same period. The imbalance of pressure that these figures demonstrate has greatly impeded the objective of reducing inflation. High public sector pay settlements, in conjunction with rising interest rates, taxes, local authority rates and public sector charges have added directly to inflation and have made pay moderation in the private sector more difficult to achieve. Had Government charges and taxes moved in line with the the costs directly under business control, price inflation by now would be well into single figures.

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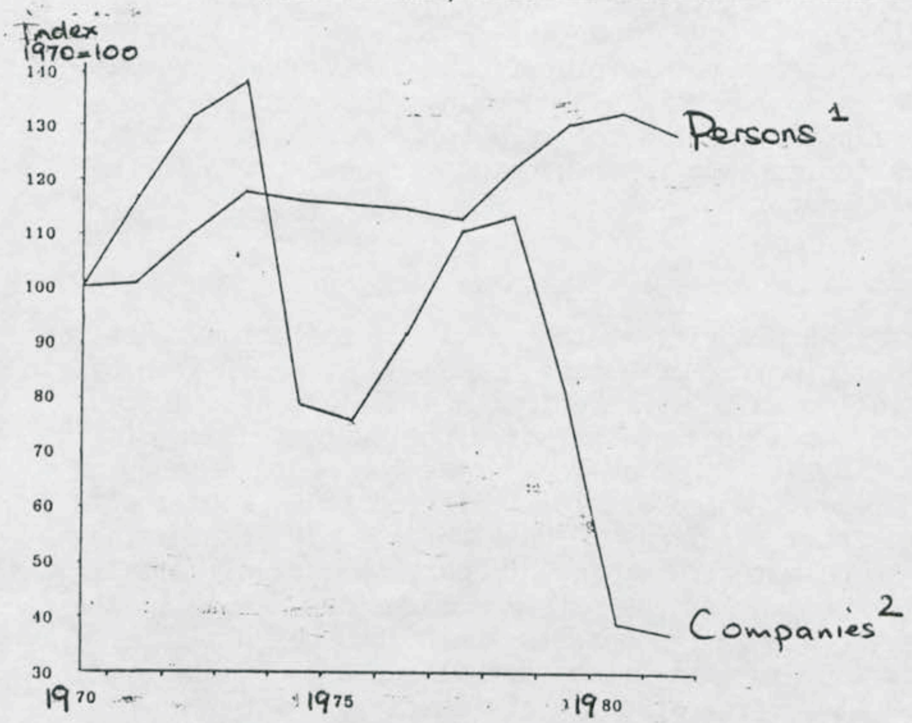
1 General government current expenditure on goods and services deflated by the GDP deflator. Much of this comprises pay and the extra costs of employment in the public sector.

A third imbalance is that between the incomes of persons in work and of companies. Although average earnings during 1981 rose by less than the cost of living, Chart II.1 shows that the real disposable incomes of those in work over the year as a whole were 13 per cent higher than four years earlier. Meanwhile real company post-tax profitability in 1981, despite a slight recovery during the year, is shown by the Chart to have fallen by nearly 70 per cent since 1977.

CHART II.1

Real Disposable Income for Companies and Persons



1. Real Personal Disposable Income
2. Gross trading profits plus rent net of stock appreciation, capital consumption and tax payments for industrial and commercial companies excluding North Sea activities

Sources: 1970-80 Central Statistical Office, 1981 CBI estimate

Our representations are designed to help correct these imbalances by improving profitability and competitiveness.

II.3 Reducing Inflation

Five years ago, in "Britain Means Business 1977", the CBI stated clearly that while sound fiscal and monetary policies were essential for reducing inflation, they should not be relied on solely. We pointed out that:

"Exclusive reliance on monetary policy could do serious damage to industry. In the absence of other measures, the more severe the cost pressures the more stringent the effects of monetary policy would be and hence the greater the fall in business activity, the greater the number of business failures and the greater the rise in unemployment."

This prediction has, unfortunately, been borne out by events. Our representations, therefore, include measures that support sound fiscal and monetary policies in helping to reduce inflation without crippling the business sector. We see a need for action in four areas.

First, the beneficial consequences for jobs and living standards of lower pay settlements and hence lower inflation should be made clear to all who work in industry. The CBI has taken the lead in this area: operating our own Employee Communication Unit, giving advice to individual companies, running conference and "workshops" on the communication of business realities, and providing briefing material for those involved in pay bargaining, including information on the economic background. The CBI has also carried out and published a major survey on current employee involvement practice among its members[1]. It remains essential for all concerned in industry and outside to communicate the true facts of the economic situation to all involved in negotiations on pay or productivity.

Secondly, the Government should ensure that the settlements which it can control, in the public sector, are at such levels that they do not raise pay expectations elsewhere in the economy. The Report of the CBI Working Party on Government Spending shows what can be done in this area and the CBI evidence to the Megaw Inquiry suggests ways in which the pay of Civil Servants can be more directly and effectively controlled by ministers.

Thirdly, the experience of the past two years has shown that while business has been very successful in holding down the increases in the costs it can control, rises in costs beyond its control, mainly imposed by government, have prevented this success from being fully reflected in lower inflation. The proposals in these Representations for reducing business costs and holding down indirect tax increases would enable measures taken by business to reduce costs to be more fully reflected in lower inflation.

Finally, although the need for sound fiscal and monetary policies is clear, this does not mean that these policies should be so restrictive as to do serious damage to the ability of the economy to produce. We give more detail on our recommendations for fiscal and monetary policy below.

The simulations reported in Annex 1 show that our recommendations will, if anything, reduce inflation. This is because we recommend that the attempts to reduce inflation by fiscal and monetary policy should be backed up by action in the areas outlined above. The direct effects on inflation of our recommendations would be to reduce UK business costs and raise, slightly, the costs of imported goods. The second round effects would be to put some upward pressure on prices from higher demand, but some downward pressure from the spreading of overheads over higher production. At present, with considerable spare capacity it is unlikely that higher demand would cause serious inflationary pressure. Our calculations show that the net effect of

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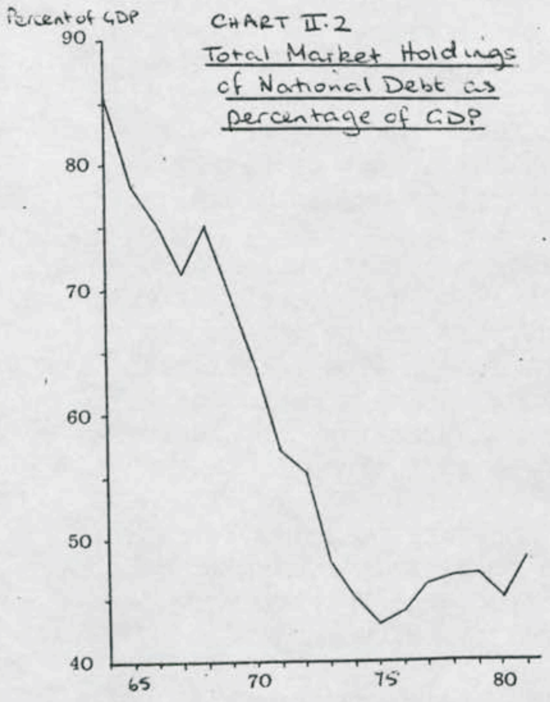
1 Current Employee Involvement Practice in British Business, CBI, November 1981.

all these influences is that they broadly offset each other or may reduce inflation slightly in the short run. In the longer run, by keeping capacity, in the widest sense, in existence where it might otherwise have been scrapped, our recommendations will make a further contribution to reducing inflation.

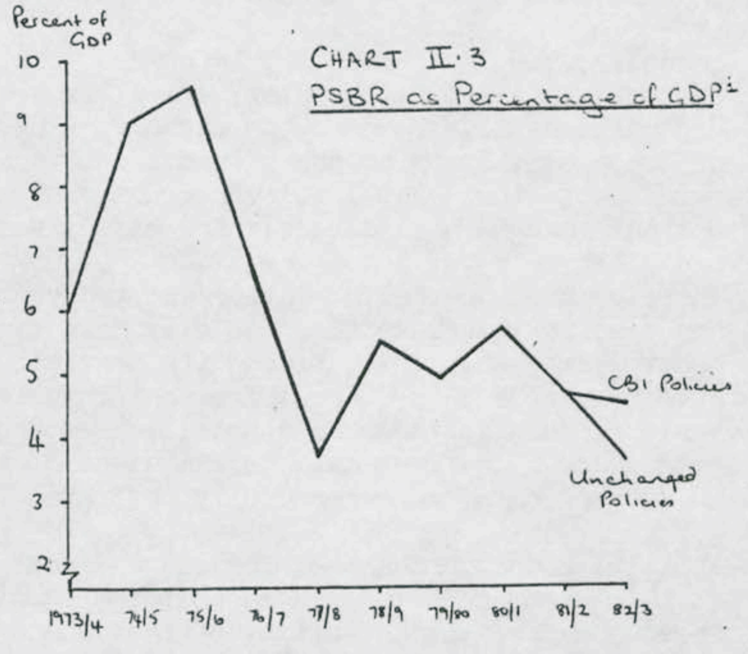
II.4 Fiscal Policy

The weakness of activity and employment, the low level of UK competitiveness and the depressed position of profitability together would, in isolation, lead us to recommend a very large expansion in the balance between spending and taxation. One objection to such an approach might be that a higher borrowing requirement might build up a burden for future generations.

In this context it is important to bear in mind that the burden of Government debt has fallen substantially since the mid 1960's, as Chart II.2 below demonstrates, while the PSBR as a percentage of GDP would on CBI proposals stay well below the levels of the mid-1970s (see Chart II.3). In addition, the Government is at present running a sizeable surplus on current account and would continue to do so if it were to follow our recommendations. Its borrowing, therefore, is less than its capital spending and is clearly not building up a burden for future generations of tax payers; quite the reverse.



Source: Bank of England



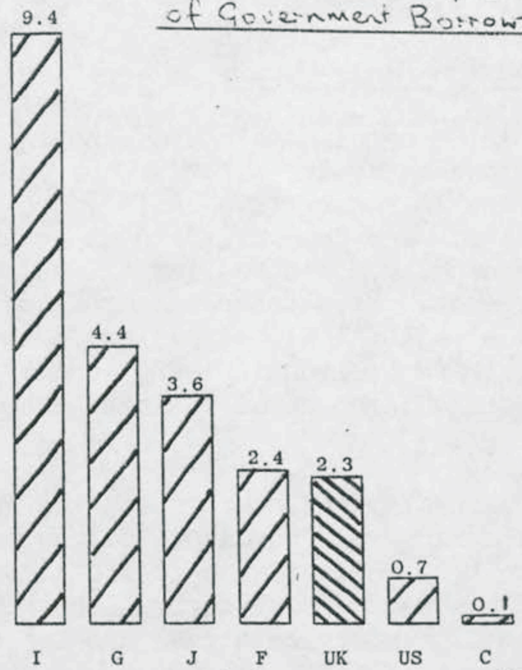
1 PSBR as percentage of GDP at market prices

Sources: 1973/4 to 1980/1, CSO; 1981/2, CBI estimate assuming PSBR is as announced in 1981 Budget; 1982/3 CBI estimates

Government borrowing in the UK is also lower than in many other major countries; Chart II.4 below shows government deficits on a comparable basis for the seven largest industrialised countries in 1981.

CHART II.4

International Comparison of Government Borrowing[1]



[1] General Government Deficit as percentage of GDP/GNP at market prices, 1981
Source: OECD Economic Outlook, December 1981

Recent experience has demonstrated that attempts to reduce public borrowing by imposing a restrictive fiscal stance on the economy during a recession may be counter-productive, intensifying the recessionary pressures, reducing Government revenues and forcing increased spending on unemployment and other benefits. A temporary modest increase in the PSBR should lead to economic growth which later reduces the burden of public borrowing by automatically increasing Government revenue and reducing expenditure.

The PSBR in 1980/81 was £13 billion and it looks likely that the outturn for 1981/82 will be close to the target of £10½ billion announced in the 1981 Budget. After taking account of inflation and the recession it is clear that a tightening of the fiscal stance has occurred between the two years. Estimates vary on the PSBR necessary for 1982/83 to prevent a further tightening but, on various different assumptions, figures of between £12 billion and £15 billion might be appropriate.

We believe that the 'quality' of the PSBR is important in affecting the ease with which it can be financed: raising the PSBR to cut business costs and, hence, business borrowing, is likely to impose less financing problems than doing so to cut personal taxes or raise Government spending. However, in our recommendations we have been constrained by concern about the potential impact on inflation and interest rates of a very large expansion of demand. It is indeed clear that the vast majority of CBI Members feel that they will be best able to take advantage of extra demand for their products if any expansion is not so rapid as to put at risk the success that they have achieved in controlling their own costs.

We are therefore recommending policies which would lead to a PSBR in money terms for 1982/83 of about £11-12 billion. Such a PSBR would represent about the same percentage of GDP as the target for 1981/82 which the Chancellor announced in the 1981 Budget.

Nevertheless our Recommendations would lead to more growth than on present policies and, through their effect on competitiveness and profitability, lead to a soundly based recovery.

II.5 Interest Rates and the Money Supply

The CBI has consistently pointed out that a sound monetary policy is an essential part of a policy to counter inflation. However, this does not mean that monetary policy should be so restrictive as to leave interest rates well above both the rate of inflation and the real rate of return of industrial and commercial companies (excluding North Sea activities) at a time of depressed activity as at present. High interest rates add to business costs (industry and commerce at the end of 1981 was paying £8 billion a year in interest charges compared with £4 billion in 1978) and to the RPI. Each 1 per cent reduction in interest rates saves business £250 million a year, net.

The Government has shown flexibility in interpreting the growth in the money supply, £M3, as only one of a range of indicators of the impact of their policies on the economy. We believe that such flexibility should be built upon. The behaviour of £M3 has been shown, through the effects of the abolition of the corset, the Civil Service strike and the movement of the banks into the market for housing finance amongst other distortions, to be an unreliable guide. Nor would any other single measure be without its own difficulties. The essential point is that it is necessary to go behind any set of figures and explain why they behave as they do, before using such figures for policy purposes.

Although the policies which we are recommending will add to the PSBR they will keep it at about its 1981/82 proportion of GDP and will reduce the need for company "distress" borrowing. It is thus by no means clear that they will lead to faster monetary growth. If they do however, since our analysis shows that they are likely to lead to higher output and not higher inflation (and might well reduce inflation in present circumstances), slightly faster monetary growth alone must not be a reason for rejecting our proposals for reducing interest rates and other business costs.

II.6 Exchange Rate Policy

Interest rates should also be reduced to help lower the exchange rate. It is important to take the need for a competitive exchange rate into account in formulating monetary policy. With the exchange rate at its present level, even with no rise at all in UK unit labour costs in manufacturing, it would take five years to bring our relative labour cost competitiveness back to its level in 1975, when it was close to its post-war average position. To achieve the necessary improvement in cost competitiveness the success of businesses in controlling their labour costs ought to be backed up by some further falls in the sterling exchange rate. The lower interest rates which we recommend should help bring this about.

Clearly the interest rate policy of the British Government cannot be completely isolated from the policies pursued in other countries. It is important, however, that any response to such international influences should not be such as to prevent our objective of improved competitiveness, particularly against our major European trading partners, from being achieved.

III TAXATION

This section of our Representations contains the details of the taxation measures which we are putting forward this year.

III.1 Personal and Business Taxation

In Section II we showed how personal incomes had risen over the past four years while corporate incomes had fallen sharply. Although this imbalance has been slightly reduced in the past year, there is still some distance to go. This alone would make a strong case for relief in the Budget being concentrated on the business sector rather than the personal sector.

The analysis in Annex 1 shows how the present low levels of output have reflected poor competitiveness and profitability. We believe that a soundly-based recovery will not occur until competitiveness and profitability improve by much more than is projected on unchanged policies.

Our projections indicate that cuts in business costs would provide many more jobs than similar sums used to cut personal taxes. Lower personal taxes would help demand but, with no direct impact on competitiveness or profitability, much of this extra demand would lead to higher imports. In comparison, our proposals would not only raise domestic demand but also exports. In the longer term a soundly-based business recovery would do more to raise living standards across the nation as a whole than any feasible cut in personal taxation.

It might be argued that personal tax cuts are likely to reduce inflationary pressures on wage negotiations. The experience of recent years suggests that while rises in indirect taxes have added to such pressures, it is by no means clear that cuts in income taxes have reduced them.

While our recommendation of indexed personal income tax allowances and no change in indirect taxes implies some slight reduction in the burden of personal taxation, we do not recommend any further reduction. CBI members, in our consultations, have shown overwhelming support for giving top priority to relief on taxes on business costs in our representations this year.

III.2 National Insurance Surcharge

Our priority taxation representation concerns the National Insurance Surcharge (NIS).

It is now five years since this damaging tax was introduced at a rate of 2 per cent on most of a company's wage and salary bill and more than three since it was increased to the present level of 3½ per cent. The CBI has consistently argued for its abolition, and in view of the importance of the issue it is appropriate to restate the arguments.

The total yield of NIS in 1982/83 is expected to be about £4 billion at present rates, but of this about a fifth is paid by government (as an employer) to itself. Total abolition would therefore cost about £3.3 billion in a full year or about £2.65 billion in the first year, assuming a 4 week implementation delay and a six week collection delay. A 2 per cent reduction would cost £1.9 billion in a full year and £1.5 billion in the first year.

We have said that it is a damaging tax. The damage is caused to four key factors in the economy:

* Competitiveness

UK relative unit labour costs in manufacturing are about 30 to 35 per cent higher than in 1975, a typical past year. The introduction of and increase in NIS have contributed to this rise in our relative costs. Goods produced in the UK are thus put at a disadvantage by NIS when they compete, here or abroad, with goods produced elsewhere.

* Inflation

NIS is a business cost, and like any business cost it influences output prices and inflation.

* Unemployment

NIS is a payroll tax, a tax on jobs. It can only add to the upward pressure on unemployment, which we feel is indefensible, particularly at the present time.

* Profitability

Real profitability in 1981 was at the lowest recorded level and only a small recovery is forecast for 1982. As a result many companies have had to close and others, with margins squeezed, have reduced investment plans and so damaged prospects for growth. By adding to business costs, NIS aggravates the downward pressure on profitability.

Cost Effectiveness

The benefit of reducing NIS would reach the whole business sector whereas many other measures to help business would only channel relief to some of the firms that need it. Apart from the proportion (about one fifth) of NIS paid by Central and Local Government, where we recommend that the planned expenditure totals are reduced to take account of reduced NIS, the remainder is paid mainly by manufacturing, construction and distributive industries and other sectors of great importance in the generation of UK growth and prosperity.

Some have suggested that the cost savings from lower NIS will be passed on in higher wages. At a time when competitiveness has been hit so hard, businesses are acutely aware of the need to make full use of any improvement in their cash flow. Where profitability is critically low, firms are seeking to increase output and margins. There is at present little room for gains to be passed on in higher wages, and we believe this would happen only to a very limited extent. The experience of when NIS was introduced and of past changes in payroll taxes provides little evidence to suggest that such taxes affect wages. In addition CBI members have argued strongly that a reduction in NIS would not be used to finance higher pay increases.

III.3 Income Tax

Last year we regretted that the Government considered itself unable to raise personal allowances and other thresholds and limits to allow for inflation. We recommend that there should be no similar increase in the real burden of income tax on individuals this year, particularly in the light of the higher National Insurance contributions to be paid from April, though we recognise that resources going beyond indexation for the last year's inflation may not be available. The tax burden should not be raised by stealth, through failure to index allowances, which would also worsen the poverty trap and increase the number paying tax. We therefore have assumed that the statutory indexation of personal tax allowances, the basic rate limit, the higher rate bands and the investment income thresholds will take place.

We remind Government that our longer term aim is for the basic rate of income tax to be reduced to 25 per cent, and the top rate to 50 per cent. We also look for the eventual abolition of the investment income surcharge, which bears particularly heavily on those who do not have normal pension rights and who have to pay the surcharge on investments made to provide for their retirement.

III.4 Indirect Taxes

We do not believe that this is an appropriate time for Government to raise indirect taxes. The long-term shifting of the balance from direct to indirect taxes should be achieved by cuts in direct taxes rather than, say, VAT increases.

We oppose increases in excise duties this year. These duties were raised by much more than inflation last year. Moreover any increases in these duties have a large effect on the Retail Prices Index in relation to the additional revenue they bring in.

III.5 Interest Rates and Tax Relief

We call in Section II for the authorities to take steps to reduce interest rates. Although tax measures are no substitute for direct action to lower interest rates themselves, we put forward in 1980 and again last year proposals permitting companies to disclaim tax relief on the interest on all or part of their borrowing from other companies and providing corresponding tax exemption on the interest in the hands of the recipients.

Interest rates remain high and, as a result of very low profitability, inability fully to utilise tax offsets against profits is still a major problem for companies. Indeed the Inland Revenue[1] estimate that the accumulated total of unused tax reliefs and allowances (excluding public corporations) is now £30 billion and increasing by £5 billion a year. This could be regarded as a massive interest free loan from business to the Exchequer. Since our proposals were put forward a number of other schemes have been proposed to reduce the cost of borrowing and the Government has announced a departmental working party set up to examine one such scheme. We urge that all the proposals are properly examined.

III.6 Smaller Firms

The CBI recognises the importance of smaller firms to the UK economy, and has therefore welcomed the measures taken by this Government designed specifically to stimulate the growth of the smaller firms sector.

However, smaller firms are not in a position to insulate or isolate themselves from prevailing economic conditions. No amount of consideration for the special problems that smaller firms face can fully compensate for an unfavourable economic background where high interest rates, low growth and

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1 Corporation Tax Green Paper Cmnd 8456 January 1982

continuing cost inflation afflict both smaller firms and their customers. This is why the CBI places so much emphasis in its representations for smaller firms on the need for Government to create an economic climate in which all businesses, whether large or small, can prosper and grow.

Apart from our general representations, which are of concern to all businesses, there are, we believe, two priority areas where the Government can and should take action which will be of direct benefit to the smaller firms sector. These are Small Firms Investment Companies and capital taxation. We also attach importance to the recommendations concerning smaller workshops in our section on Capital Allowances.

Small Firms Investment Companies

At the beginning of 1981 the CBI submitted to the Government detailed proposals for encouraging equity investment in new and established smaller companies through tax incentives and the development of Small Firms Investment Companies (SFICs)[1].

Many of the suggestions put forward by the CBI then, and subsequently in its detailed representations on the 1981 Finance Bill, were incorporated into the "Business Start-Up Scheme." The CBI has welcomed this scheme as an imaginative and important step towards improving the supply of equity finance to new companies but we believe that there is a need to encourage the flow of equity to existing as well as new companies.

Equity investment has the advantage over loan capital that it imposes no automatic servicing costs. This is particularly important when profits are low and interest rates high. Moreover, a sound capital base will also increase a small company's borrowing potential, making loans easier to raise and to service, so providing finance for cash-flow deficits or working capital. Encouraging equity investment by private individuals in new and smaller companies is also desirable as a means of ensuring that the ownership of business is spread across a wider cross-section of society and that entrepreneurial values within society become more deeply entrenched.

The Government has an opportunity to achieve these objectives by building on the start-up legislation, in a way that encourages greater long-term investment in the whole, and not just the new, small company sector and helps to generate new wealth and new jobs. We therefore recommend that the "Business Start-Up Scheme" is extended in two major respects.

a The legislation should be amended to provide a framework through which the development of SFICs can be encouraged. We believe that if individuals were allowed the same tax relief as is now given for investing directly in eligible companies when they invest through the mechanism of a SFIC, takeup under the scheme would be faster and the amount of money available for investment in smaller companies would be increased. SFICs would have the added advantages of being able to attract investment funds from companies and financial institutions, of providing a more marketable investment for the individual and of being able to complement their equity investments by providing additional finance in the form of loans.

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1 "A New Deal for Investment in New and Smaller Companies: Some CBI Proposals", CBI, January 1981. This paper is available from CBI Smaller Firms Directorate, and is also reproduced in "Smaller Firms in the Economy, 1981", available from CBI Publications Sales, price £5.00.

b Established small companies, as well as start-ups, should be eligible under the Scheme. Existing smaller companies which wish to expand often experience similar difficulties to start-up companies in raising equity capital. Moreover established small companies in many cases offer the best prospects for rapid growth and have the greatest potential for wealth and job creation.

Many of the detailed proposals for the structure and operation of SFICs put forward last year by the CBI are still relevant and could be incorporated into the "Business Start-Up Scheme" by amendment to the existing legislation.[1]

The implications of our proposals for tax revenue are difficult to assess, although the effect should largely be of postponement rather than absolute loss. We believe that whatever net revenue is given up in the short-run will be put to good use in wealth creation which will itself generate other tax revenue in the longer term. If, despite this, the Government is unable to extend the present Scheme beyond start-up companies, a strong case would still exist for introducing the concept of SFICs into the present legislation. Under these circumstances it would also be necessary for the Government specifically to extend eligibility under the Scheme to "management buy-outs" and/or, "rescues" as it has already indicated willingness to consider.

III.7 Capital Taxes

The CBI's views on the harmful effect that Capital Gains Tax (CGT) and Capital Transfer Tax (CTT) have on businesses - particularly on unquoted companies and smaller businesses - were set out in considerable detail in our submission to the Chancellor of the Exchequer in October 1979 in response to his announcement in relation to these taxes that the Government would ... "press ahead with a thorough study with a view to legislation ... at an early date."[2]

In the event the strategy adopted by the Government has been that of gradual reform, rather than a one-off major overhaul. We are encouraged that the Government has made a number of changes along the lines we advocated but we are disappointed that progress has proved to be less rapid than was envisaged in 1979.

We must therefore once again urge the Chancellor to implement the as yet unsatisfied proposals contained in our 1979 submission as soon as possible. Particularly striking is the absence of effective action, even by way of regular adjustment of the various thresholds and fixed sum exemptions, to cope with the most objectionable feature of Capital Gains Tax, that it is most often a tax on inflationary rather than real gains. As the Chancellor pointed out in his 1979 Budget Statement: ... "The tax is, therefore, a capricious and sometimes savage levy on the capital itself"...

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1 We think that the objective could be achieved by changes such as those listed in Annex 2.

2 See the Chancellor's 1979 Budget Statement (Hansard H C Debates, 12 June 1979, Vol. 968, col 255) where he also referred to the taxation of capital as ... " a matter of vital interest to business as well as to individuals" ... and indicated that the Government were ... "determined to make the taxation of capital simpler and less oppressive" ...

Whilst we wish to see all of our 1979 capital taxes package implemented we are particularly anxious to see action taken on items of importance to business.

Though we remain committed to our view that it is important to business that the inflationary element be taken out of chargeable gains we believe that the reform that presents the least administrative obstacles to Government action is the introduction of a seven year cut off for Capital Gains Tax. Such a cut off should be introduced this year, and because of the delay in payment would have negligible revenue cost in 1982/83. Costings of changes to capital taxes are difficult to produce but we estimate that the loss to the Revenue in 1983/4 could be of the order of £¼ billion.

Other areas where we recommend that action by Government this year should not be precluded by cost considerations are:

a the extension of business relief for CTT purposes. Assets currently qualifying for relief at 30 per cent should be merged with those currently relieved at 50 per cent and the relief for all of them increased to 75 per cent. Assets now receiving 20 per cent relief, should receive 30 per cent relief;

b the review and overhaul of the retirement relief rules for Capital Gains Tax including the tax treatment of businessmen who are forced to retire early because of ill health;

c the extension of the period for payment of CGT and CTT by instalments from eight years to twelve years and the abolition of the £250,000 limit on interest free payments for CGT. This limit creates an arbitrary anomaly while generating negligible revenue. In future the provisions for payments by instalments and interest thereon should be the same for CGT and CTT.

III.8 Corporation Tax

In considering our representations on corporation tax this year we faced the unusual constraint of the immonent publication of the long awaited Green Paper on Corporation Tax. Now that this paper has been published, we see it as an opportunity to examine in depth - perhaps helped by the appointment of a Select Committee as in 1971 - a number of issues which are very important to business. We are not repeating here all of the many representations on corporation tax which we have made over the years since the present system was introduced. A quick glance at some relevant items - the imputation system; ACT; mineral and other capital allowances; stock relief; double taxation relief; current cost accounting; groups of companies; the treatment of smaller companies - indicates the scope for discussion.

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1 Very broadly the 50 per cent relief at present covers transfers of all or part of an unincorporated business and shares on securities in a company where the transferor has control; the 30 per cent relief applies to land, buildings, machinery or plant used for business purposes by a company controlled by the transferor or by a partnership in which he is a partner; the 20 per cent relief applies to minority interests in unquoted shares. Certain trust assets also qualify for the 30 per cent relief.

III.9 Capital Allowances

We have consistently urged Government to introduce a scheme of capital allowances for commercial buildings. We recommend that a start is made now, even if limited to straight line writing down allowances at a very low rate, say 2 per cent, and even if confined to new building work. This would provide a boost to the construction industry and employment and at last give some recognition to the value to the economy, in terms of invisible earnings and the provision of essential services to both industry and consumers, that commercial businesses contribute.

Smaller Workshops

The 1980 Finance Act introduced 100 per cent initial allowances in respect of expenditure incurred on the building of small workshops of 2500 square feet floor space or less. However, the type of use to which a workshop may be put in order to qualify for allowances as an "industrial building" is strictly limited. We suggest that the restrictions as to qualifying use should be substantially relaxed.

III.10 Stock Relief

When considering, last year, the new system of stock relief suggested by the Government we pressed hard for the removal of the credit restriction. We are pleased that our arguments were heeded when the new system finally came into operation. The case for allowing businesses to use indices more closely reflecting their own circumstances should now be more fully examined, and we are hopeful that publication of the Green Paper will provide further opportunity.

III.11 Development Land Tax

The yield from this tax is only £25 million. Nevertheless, its effect on the release of land for development or redevelopment is damaging. It is a constraint on commercial activity which should be removed at once.

III.12 Heavy Oil Duty

The CBI continues to urge that the Government bring energy costs for industry into line with those in competitor countries. As stated in the second NEDC Energy Task Force report released in November 1981, the remaining disparity between the level of UK heavy fuel oil prices and the average level prevailing on the Continent can to a very large extent be attributed to the high rate of duty in the UK. We therefore ask the Government to find a way of abolishing this duty or offsetting its effects.

III.13 Technical Representations

In our Budget Representations of 1980 and 1981 we referred to the need for changes in the legislative procedure to begin to tidy up the host of technical anomalies that have crept into our taxation system.

The particular change that we highlighted was the introduction of a Technical Taxation Bill separate from the ordinary Finance Bill. The case for such legislative change was pointed out by the Chancellor in speeches to the Addington Society in 1977 and to the Institute of Chartered Accountants in 1980, as well as being referred to in the report of the Armstrong Committee set up by the Institute for Fiscal Studies.

Fulfilling the pledge which we made last year we have now published a paper[1] setting out a sample of items of a technical nature for inclusion in a Technical Taxation Bill. We have sent our proposals to the Chancellor and to the Revenue Departments.

In putting forward our Technical Taxation Bill proposals we were aware of the difficulty the Government faces in fitting all that it would like to do into a crowded legislative programme. If a bill along the lines which we propose is not introduced this year, the Chancellor can still deal with some or all of our technical points in the ordinary Finance Bill and indeed, in his response to our paper, he alluded to the possibility of making further progress in this way. We accordingly repeat here the list of eleven headings from our Taxation Bill proposals. Our detailed proposals are set out in the document itself.

The eleven points are:

- Grouping of Capital Losses
- Quantification of Capital Losses
- Capital Gains Tax - Rollover relief for groups of companies
- Capital Gains Tax - Rollover relief - Wasting Assets
- Groups - Company ceasing to be a member
- Groups - Case V Income - Charges on income and management expenses
- Group Relief - Anti-avoidance - Section 29 Finance Act 1973
- Consortia - Sideways surrender of losses
- Disallowed Business Expenses (Nothings) - Costs of equity finance
- Capital Allowances - Abortive Expenditure
- Advance Corporation Tax - New Subsidiaries

In singling out these first eleven topics for a Technical Taxation Bill we were anxious to keep our selection of items relatively simple to facilitate the birth of such a new type of legislation. We were also aware of the likely appearance of the Government's Green Paper on Corporation Tax. However, our list of technical representations has expanded over the years, and continues to expand each year as many more points are added than are dealt with by legislative action in the crowded Budget-Finance Bill programme.

In view of our proposals for a Technical Taxation Bill we are not repeating here all our outstanding technical representations from previous years. They remain on the table for action by Government and we shall return to them in future years as appropriate if the relevant problems still exist.

We have however, as last year, already written to the Revenue Departments reminding them that these points remain outstanding and have also drawn their attention to a number of fresh points some of which arise from changes made in the Finance Act 1981. These technical representations are included as Annex 3.

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1 "A Technical Taxation Bill - The CBI's Proposals" - available from CBI Publications Sales, price £2.00.

IV LOCAL AUTHORITY FINANCE

IV.1 The Need for Lower Business Rates

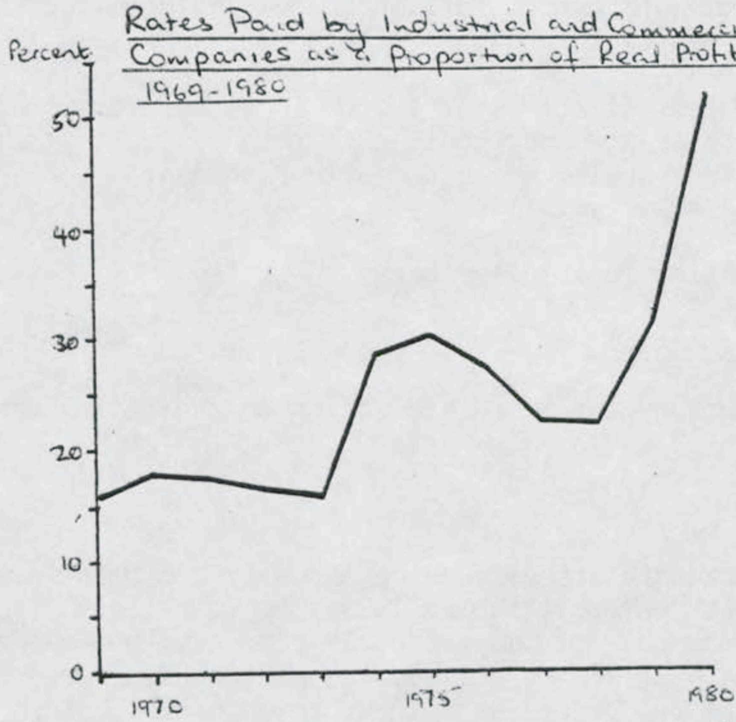
In last year's Budget Representations we emphasised that the rapid increase in business rates was a major cause of concern and called for a low average rate increase for 1981/82. This could have been achieved, in spite of the reduction in rate support grant, if local authorities had followed the Government's spending and pay guidelines, in which case some authorities benefiting from the revised distribution of money through the new block grant system would even have been in a position to cut their rates.

However, the average rate increase for 1981/82 has been 17 per cent, and over the years 1980/81 and 1981/82 business rates will have risen by over 40 per cent whereas between April 1980 and April 1982 the general price level will have risen by under 25 per cent. In Scotland business rates have risen by around 80 per cent over the last two years. Restraint in rate increases to the extent envisaged by the Government and the CBI has tended to be the exception and many businesses have suffered severely from the burden of rising costs, including rates.

We estimate that in 1981/82 business will have paid in the order of £5bn in rates which represents nearly half of the total revenue local authorities obtain from rates. Rates have now overtaken corporation tax to become the heaviest single impost on business[1] and they have risen extremely sharply in real terms while profitability has fallen to disastrously low levels. as Chart IV.1 illustrates.

CHART IV.1

Rates Paid by Industrial and Commercial Companies as a Proportion of Real Profits 1969-1980



Sources: Rates: Derived from DOE & Scottish Office data

Profits: Derived from National Income & Expenditure 1980

1 Excluding National Insurance Contributions.

It is important that local authorities' rate increases for 1982/83 are very low. We estimate that if local authorities were to keep strictly within the Government's spending guidelines, including the pay and price assumptions, it should be possible for local authorities to keep business rate increases on average [well below double figures].

The CBI has supported the Government in its campaign to restrain local authority expenditure as an effective way of keeping business costs down. For our part, we have set up local rates groups to try to influence spending and rating decisions by councils at local level. We have supported the introduction of the block grant system by the Government and it has undoubtedly contributed to restraining the level of local authority expenditure. However, one adverse effect has been to encourage some high-spending authorities to levy excessive rate increases rather than to cut back spending. The CBI deeply regrets the fact that the Government appears to have decided not to provide any protection for the business ratepayers in England and Wales in the Local Government Finance (No 2) Bill. In Scotland the powers being taken in the Local Government and Planning (Scotland) Bill will enable the Secretary of State in certain circumstances to force an authority to reduce rates by a specified amount. This increase will give some protection to all ratepayers against excessive rate increases.

We also regret that the Government Green Paper on 'Alternatives to Domestic Rates' (Cmnd 8449) failed to consider alternatives to business rates as well as domestic rates, as the case against the former is much stronger than the latter. Whatever the reaction to the Green Paper it is clear that the burden of rates on business is excessive and should be reduced. Our reasons for maintaining that business should be relieved of the present excessive rate burden and protected from further rate increases are:

- business rates are a cost which adversely affects competitiveness and jobs;

- business has no vote and cannot influence local authority spending decisions through the ballot box;

- business receives less direct benefit from local services than domestic ratepayers in spite of its contribution to rate revenue; the inequity is compounded by the subsidy which domestic ratepayers receive through the domestic rate relief grant;

- rates bear no relation to ability to pay.

IV.2 Priorities for Action

Our specific recommendations for immediate action on the rating system are as follows:

i Business Derating

The present recession in its effects on industry has been far more severe compared with the position in 1929 when 75 per cent industrial derating was introduced. It was gradually decreased but was completely withdrawn only in 1963, and we believe the present depressed state of the economy and the huge rise in business rates over the last two years fully justify the re-introduction of partial business derating.

The domestic sector is currently subsidised by central government at the cost of £720m. There is a much stronger case for helping the business ratepayer. If business were to be put on an equal footing with the domestic sector this would permit approximately 15 per cent business derating in England and Wales. The case is particularly strong for industrial concerns. Agricultural land is exempt from rating and the same principle should apply to all wealth-creating sectors.

The introduction, or extension in the case of Scotland and Northern Ireland, of partial business derating would help to maintain the industrial base and would contribute to improving competitiveness and employment prospects in the economic upturn. We regard action on business derating as being a main priority for 1982/83 and recommend that 15 per cent business derating is introduced. It would cost in the order of [£850m] at 1982/83 prices. We appreciate that the introduction of business derating would require separate legislation from the Finance Bill; nevertheless such legislation could be enacted by the summer, if there is sufficient will to reduce the burden of rates on business.

The introduction of partial business or industrial derating to have effect in 1982/83 would cause some administrative problems for rating authorities. For those small businesses which pay rates by instalment, the size of the instalment will need to be amended, and so would the second six-monthly rates payment made by most other businesses. In some cases refunds would need to be made. The administrative work involved, however, should not be all that costly, and would be small relative to the significant benefits that would arise for business.

ii <u>Ceiling on Business Rate Increases</u>

As already mentioned, we are disappointed that the Local Government Finance Bill does not include a ceiling on business rate increases and we believe that there are no valid reasons why it should not still be incorporated in the legislation. It would limit business cost increases, restrain local authority spending and increase local accountability, which are all objectives of Government policy. It would cost Government nothing as the local authorities would have to make up any shortfall from the domestic sector or cut spending. It is still not too late for such protection for business to be incorporated in the Bill.

iii <u>Introduction of 'Mothballing' Relief</u>

This measure means that no rates would be payable on parts of properties which are taken out of use during the recession but are maintained in good order for re-use when the business climate improves. We advocate 'mothballing' relief for all businesses, but the case is particularly strong for industrial premises, especially where the unused parts contain plant and cannot be let or put to another use at the moment but could contribute towards providing the greater capacity needed in the economic upturn.

The administrative problem which it has been alleged would arise from the introduction of 'mothballing' relief for business could be overcome without all that much difficulty and we have already suggested to the Government ways and means of doing so.

We recommend that legislation is introduced to permit 'mothball' relief to be given for business in 1983/84. We propose that relief totalling £150m at 1982/83 prices is given.

iv **Abolition of Business Rate on Empty Property**

The rate payable on empty business property was reduced to 50 per cent of the full rate following the passage of the Local Government Planning and Land Act 1980 and we welcomed this relief in response to our representations. But we remain of the view that payment of rates on empty property goes against the principle of taxing beneficial occupation and continue to urge that the rate should be abolished. It is a discretionary levy and we estimate that about half local authorities raise it. The loss of revenue from abolition would amount to about [£35m] at 1982/83 prices. In order to reduce costs, businesses are cutting down on premises where possible, but during a recession it is often difficult to sell or let them. The arguments presented for introducing 'mothballing' relief are relevant also to empty property rate and, once again, we would advocate this relief for industry if it could not be granted immediately to the whole of the business sector.

V GOVERNMENT EXPENDITURE

In September 1981 the Report of the CBI Working Party on government expenditure[1] was published and, with CBI Council's endorsement, the main recommendations in the Report were submitted to the Chancellor and other Ministers. The Report showed how substantial savings in the cost of government expenditure could be obtained even if levels of service were to be kept at planned levels. This section brings the recommendations of the Report up-to-date in the light of more recent information[2] and, in addition, shows the policy changes which the CBI recommends.

V.1 Recommended Changes to Planned Levels of Spending

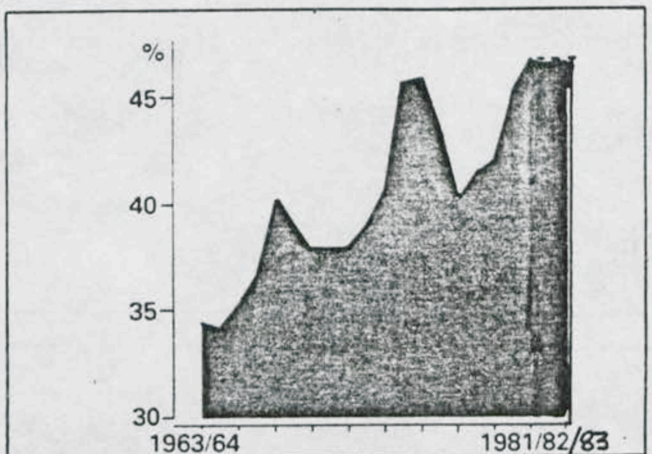
The latest Government announcement on the planned level of expenditure (excluding debt interest) for 1982/83 shows that this is now likely to amount to £115 billion in cash terms whereas at the time of the March 1981 Budget, expenditure in 1982/83 equivalent to about £110 billion[3] was planned.

Some of the £5 billion extra expenditure is due to the recession and increases in expenditure in areas where we have previously recommended increases, notably special employment measures. However, in other areas, such as local authority expenditure and defence, there still appear to be problems in bringing expenditure under control.

Chart V.1 shows that the share of government expenditure in GDP is now likely to stabilise between 1981/82 and 1982/83. This is better than a further increase but we feel that more cuts in current expenditure could be achieved. We also recommend increased capital expenditure and measures to reduce business costs generally.

CHART V.1

Share of Government spending in GDP



Source: CSO; 1981/82 and 1982/83 CBI estimates and forecasts on unchanged policies.

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1 Report of the CBI Working Party on government expenditure, CBI, September 1981.

2 On 2 December 1981 the Chancellor made an announcement on government expenditure for 1982/83. We have taken account of this announcement, although full details of the Government's proposals have not been given, particularly concerning asset sales, debt interest, the contingency reserve, and the allowance for shortfall.

3 The Government estimates that £77.9 billion in 1980 survey prices revalued to 'cash' assuming increases of four per cent for average earnings and nine per cent for prices, would be equivalent to about £110 billion for 1982/83.

Although the main benefit of action taken in our recommended areas such as improved efficiency and higher public service employee contributions for the benefit of their index linked pensions may not accrue until 1983/84, we are anxious that the changes are announced as soon as possible.

In addition we recommend further savings in 1982/83 from lower interest payments, and a reduced net impact on spending from the total of the contingency reserve, sales of assets and 'shortfall' or underspending. We recommend higher levels of capital spending than are presently planned, although as with the economies in current spending, the main benefits of action in this area are unlikely to appear before 1983/84. We estimate that the net impact of our recommendations would be to hold government spending slightly below the levels presently planned but, at the same time, to give the taxpayer better value for money and generate much needed investment.

Table V.1 (below) summarises our recommendations on government expenditure.

TABLE V.1

CBI Recommendations on Government Expenditure[1]

£ million (1982/83 prices)

		1982/83	1983/84
Savings from manpower cost economies[2]	-	100	-1500
Savings from reduced total for contingency reserve, shortfall, asset sales and from lower interest payments	-	700	nil
Savings from lower unemployment levels and from other, 'demand effects'[3]	-	100	- 300
Extra capital expenditure[4] and industrial support	+	250	+1000
Eliminating the 4 month delay in the payment of RDGs	+	125	nil
Extra expenditure on reducing energy costs, (approx)	+	70	+ 70
TOTAL, (rounded)	-	430	- 730

1 In comparison with totals announced on 2 December 1981 for 1982/83, and in comparison with totals given in the March 1981 White Paper (with some adjustment for changed assumptions about economic conditions and policy changes announced since then) for 1983/84.

2 This does not include the extra savings arising from our recommendation that spending totals for central and local government be reduced by the amounts saved from lower NIS, etc.

3 See footnote 5, Table I.2.

4 See footnote 3, Table I.2.

V.2 Manpower Cost Economies

i Manpower

The CBI's Report on government expenditure identified significant scope for and recommended cuts in manpower in the Civil Service, the NHS, and the local authorities, over and above those which the Government appeared to be planning. Overall, allowing for savings in costs associated with employment, accommodation, etc., we identified savings of £2 billion at 1981/82 prices by 1984/85.

We also suggested that economies should be sought in non-front line manpower, particularly in the local authorities and the NHS. We argued that many of these economies were possible without significant damage to service levels, given the large increases that have occurred in public service manpower, (over 20 per cent in the last ten years); the significant reductions which have been made within the business sector in the last two years; the examples of savings of 20 per cent and sometimes much more that have been made where services are contracted out; the large savings revealed by LAMSAC[1] studies of manning levels in certain local authority services; the apparently large regional and area differences in manning levels per head of population in the NHS and the local authorities revealed by comparative statistics; and international comparisons which suggest that on a broadly comparable basis public service employment appears to be up to 25 per cent larger in the UK than in other European countries.

Since this Report was published, further evidence has come to light which confirms our conclusion. A recent report from the Comptroller and Auditor General has identified serious weakness in manpower controls in the NHS. After considering his report the Public Accounts Committee concluded:

> "We doubt whether the present largely devolved system of control in England has ensured that numbers of staff employed have been limited to those strictly necessary to meet the objectives of the NHS."[2]

A Department of Education report has revealed substantial differences in cost per pupil in local authority run polytechnics.[3] After allowing for differing composition of arts and science courses, costs in 1979/80 ranged from £1500 per pupil per year at Trent Polytechnic (Nottingham), to £2500 per pupil per year at the North East London Polytechnic (Barking).

There has been nothing in the response from the Government or the local authorities to our report to suggest that the economies which we recommended could not be made. However, we note that the Government announced on 2 December 1981 reductions in administration expenditure and other efficiency gains contributing to a saving of an additional £0.5 billion for 1982/83.

We believe that significant additional economies are possible from this source in 1983/84, and our recommendations for current expenditure economies in that year reflects this belief.

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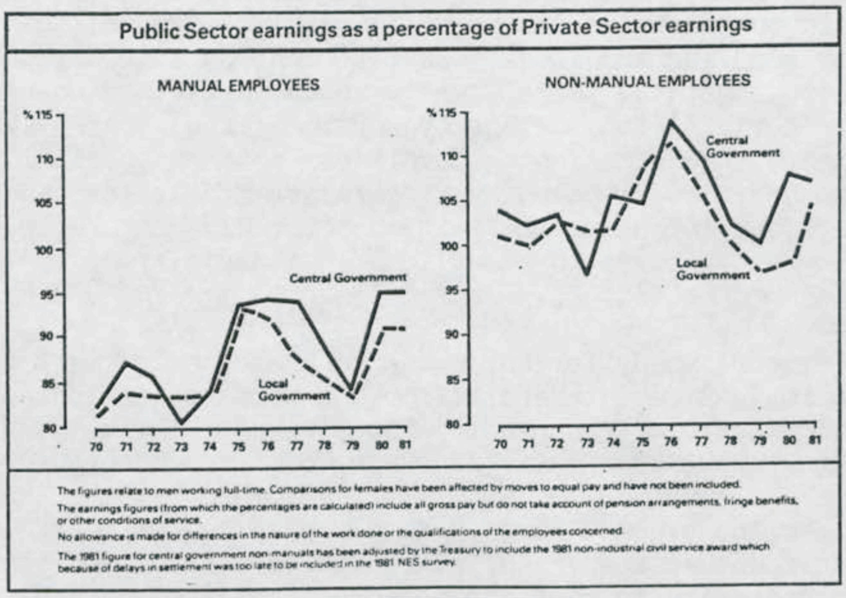
1 Local Authorities Management Services and Computer Committee.
2 <u>Financial Control and Accountability in the National Health Service,</u> Seventeenth Report from the Committee of Public Accounts, Session 1980/81, September 1981.
3 The Times, 1 October 1981.

ii Pay

The CBI's Report on government expenditure showed that pay in the public service has increased considerably more than in the private sector over the decade 1970-1980.

Chart V.2 is an updated version of the chart in this Report showing pay in the public service relative to pay in the private sector for male manual and non manual workers in central and local government. The latest data for 1981 indicate that the relativities that existed in 1980 have been broadly maintained, and the recent large improvements in the position of the public services which occurred during the 1979/80 pay round when 'Clegg' type awards had their main effect have not yet been eroded.

CHART V.2



Looking at the whole period the Treasury have concluded:

> "In all cases the recent position of the public sector can be seen to be better than in the first few years of the 1970's. This is especially true of manual workers where relative improvements of around 10 per cent have been recorded. The improvement for non-manual workers is smaller, but still of the order of five per cent."[1]

The assumption of 4 per cent for the rise in average earnings from due settlement dates for the 1982/83 pay cash limits was in line with the top end of the range included in our recommendations. We welcome this but it is important that firm action is taken to ensure that settlements that have yet to be made are no higher than this, and that similar restraint is shown in 1983/84.

iii Pensions

In its evidence to the Scott Committee the CBI recommended that fully indexed

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1 Economic Progress Report No. 140, December 1981, The Treasury.

pensions in the public service sector be discontinued. Our Report on government expenditure also proposed an increase in employee contributions of 2-2½ per cent for those public service workers outside the Civil Service, unless and until full indexation ceases.

Table V.2 shows the pension contributions paid by different groups of workers in the public service sector.

TABLE V.2

Public Service Sector[1] Employee Contributions for the Benefit of Index Linking in 1980/81[2]

Employment Group	No of Employees in Pension Scheme '000s	Employee Contribution as a Percentage of Salary (approximate)
Civil Servants	690	8-8.5
Local Authority Workers	1025	
i Manuals		5
ii Non Manuals		6
Teachers	600	6
National Health Service	760	
i Manuals		5
ii Non Manuals		6
Armed Forces	310	11
Police	135	
i Men		7
ii Women		5

Source: Public Sector Pensions: Note by the Civil Service Department. Submitted as Evidence to the Scott Committee of Enquiry into the Value of Pensions, 1980.

1 Includes main groups only.

2 All available information suggests that the percentage contributions for the benefit of index linking have remained unchanged since 1980/81, although number of members of particular schemes may have changed marginally.

Raising employee contributions for those workers outside the Civil Service until they pay only as much as Civil Servants notionally currently pay would, unless and until pensions are de-indexed, result in considerable saving - over £500 million in a full year. To do this would require an alteration to the Pensions (Increase) Act and a commitment to introducing this legislation should be announced in the near future.

V.3 Controlling Government Spending

The revisions to the public expenditure planning and control system announced in the March 1981 Budget imply a tighter control on the costs of government spending. However, it is clear that some government departments still need to stick much more firmly to cash limits.[1]

Although under the new system of planning the contingency reserve is intended to cover unanticipated inflation as well as volume changes, the total apparently allowed for 1982/83 is very large[2], and we recommend that some of this should, in the current circumstances, remain unspent.

There is a need for more value for money studies and an improvement in both internal and external auditing in central and local government. The CBI has welcomed the Government's intention to set up an Audit Commission for the local authorities as we recommended in our last Budget Representations. We earnestly urge such a Commission to initiate more value for money and comparative performance studies throughout the local authorities and make their results public so that ratepayers can be assured that efforts are being made to improve efficiency in expenditure. We also urge that a Commission be considered to perform similar tasks for the Regional and District Health Authorities.

V.4 Contracting Out

The recently published Coopers and Lybrand Report on contracting out[3] identified more examples of areas where contracting out has produced a significant saving, adding weight to the arguments put forward in the Report on government expenditure for more contracting out. Examples of contracting out have shown savings generally in excess of 20 per cent. Contracting out and competitive tendering should be extended wherever possible to secure continuing pressure for cost reductions.

V.5 Sale of Assets/Privatisation

We do not know at this stage what the Government is currently planning on asset sales for 1982/83 and 1983/84. In addition, there is some uncertainty about the amount to be raised from and the timing of the proposed sale of BNOC and other assets. However, as a general case the CBI is in favour of increasing market sector provision, particularly at a time of extreme pressure on public sector resources. We therefore welcome asset sales in principle, provided that they take account of commercial considerations.

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1 Section 9 proposes a limited scheme to allow some carry over of capital expenditure on certain capital projects.

2 The announcement on 2 December 1981 gave only a combined total for planned expenditure on the contingency reserve minus savings from asset sales and shortfall. If the totals allowed for asset sales and shortfall remain unchanged from those planned in March 1981, the amount allowed for the contingency reserve in the December 1981 plan is £4.8 billion. This is nearly twice as large as the contingency reserve allowed for in the March 1981 plans and is very much larger than sums previously allowed for, 'contingencies'.

3 Service Provision and Pricing in Local Government, Studies in Local Environmental Services, Coopers and Lybrand Associates Ltd., September 1981, HMSO.

More local authority land could be released for private sector use. Local authorities have now extended land registers to cover all England. To date some 35 districts and London Boroughs have completed registers of unused land often in the heart of cities. The first 33 registers alone revealed over 20,000 acres of underused land, on more than 2,000 sites owned by local authorities and other public bodies. Much of this land is in urban areas and nearly half is identified by the Department of the Environment as having potential for development. All registers for England are expected to be published in April 1982.

V.6 Charges

We estimate that much of the avoidable overspending by the authorities in 1981/82 and the increases in planned expenditure for 1982/83 is due to increases in local authority transport subsidies. The CBI has often argued that these subsidies are wasteful of resources and that they should be reduced.

There appears to be substantial scope for raising other fees and charges in the local authorities, not to exploit monopoly positions but to ensure that the prices paid for services reflect the cost of their provision more closely. Such scope was identified in the Report on government expenditure. For example, in recreation services local authorities cover only one-sixth of total costs of £600 million. There is ample room for net expenditure to be reduced by this means, although we recognise that this may add to the Retail Price Index, and these increases may take time to implement.

V.7 Debt Interest

Reductions in debt interest will arise out of reductions in interest rates, which are a result of our overall policy recommendations.

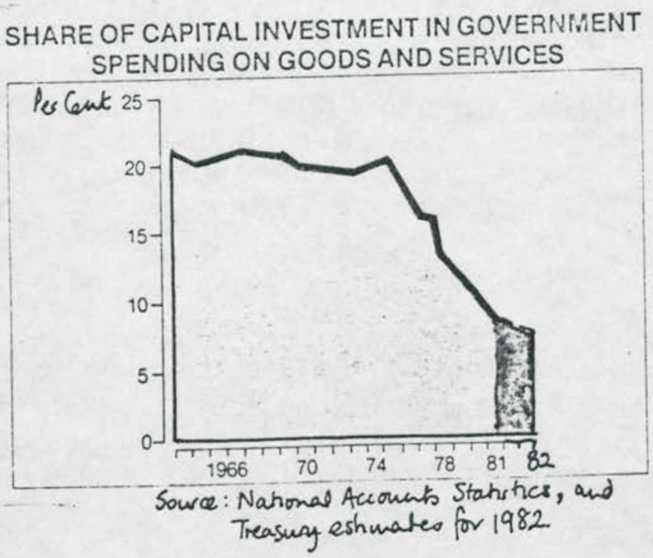
V.8 Special Employment Measures and Unemployment Benefit

The CBI has welcomed the Government's latest proposals on training and youth employment. Much of this increased expenditure was recommended in "The Will to Win". However, we must contrast the large expense incurred on special employment measures and unemployment benefit with the limited relief given to the business sector for creating sustainable employment. The effect of our recommendations would be to create more jobs and as a result there would be savings in expenditure on special employment measures and unemployment benefit.

V.9 Capital Expenditure and Industrial Support

The share of capital expenditure in total government spending continues to fall as Chart V.3 shows. We disapprove of the way that past exercises to contain cost of government expenditure have resulted in excessive cut backs or delays to capital spending, whilst current expenditure has been maintained or increased.

Chart V.3



We note that the Treasury and Civil Service Select Committee[1] have urged the Government to raise significantly the proportion of public investment in public expenditure, and this has been a persistant feature of the CBI's recommendations on macro-economic policy for many years.

We very much regret the further cut in the general government cash allowance for capital spending by the local authorities, water authorities and for motorway and trunk roads announced by the Chancellor on 2 December 1981, and in particular that element which is not mitigated by keener construction prices working through. The Government's 2 December announcement and the accompanying Treasury Press Release indicate that no allowance has been made for any increase in capital investment by the nationalised industries above that planned for in the March 1981 White Paper, despite bids from the nationalised industries for extra capital expenditure in excess of £1 billion for 1982/83. In addition there have also been disturbing amounts of underspending by local authorities on capital projects expected for 1981/82.[2]

We recommend that the Treasury again consider introducing a limited scheme which allows underspending on capital programmes to be carried forward into the next financial year, where a clear need for such expenditure has been identified. Allowing some carry-forward of underspending on capital expenditure would help to avoid the danger of unnecessary spending to use up the limit at the year end, or of further unintended reductions in the level of capital spending where substantial shortfall appears to have occurred. Such a scheme may also be used to encourage improved financial control within Departments.

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1 "The 1981 Budget and the Government's Expenditure Plans, 1981/82 to 1983/84". Treasury and Civil Service Select Committee, 1980/81 Session, March 1981.

2 Financial Times, 8 January 1982. This report suggested underspending of almost £1 billion or 23 per cent of total local authority capital expenditure for 1981/82.

We recommend that there should be an increase in planned capital expenditure by both general government and the nationalised industries of about £250 million in 1982/83, and of £1 billion by 1983/84. These figures are net of any additional capital expenditure by the nationalised industries financed from reductions in business costs recommended elsewhere.

"The Will to Win", and "Agenda for Recovery" outlined certain areas where capital expenditure could usefully be increased; roads (particularly local roads), construction, railways and sewer and drainage systems in addition to telecommunications and other nationalised industry investment projects.

The recent report by the Group of Eight[1] indicated that preparation work is being suspended on major road schemes worth over £1 billion, and total expenditure on roads appears to have stabilised at about half of the 1975 level.

The Government controls the total level of capital expenditure by councils and provides assistance through the Transport Supplementary Grant to local road building. We suggest that central government could provide funds to encourage an increase in road building and maintenance by local authorities. In other areas, such as capital expenditure on water industry assets, on school buildings, and in housing various commentators have identified a need for increased capital expenditure to maintain and improve the nation's vital infra-structure. Lead times on work can mean that it may take 2-3 years to incur significant expenditure.

A recent report by Cambridge Econometrics commissioned by five construction industry organisations[2] demonstrates the beneficial economic effects of extra capital expenditure on house building and civil engineering works. Extra expenditure of £500 million per annum (at 1981 prices) is estimated to generate 60,000 extra jobs on average in the three years following the increase in expenditure with much of the cost of this extra expenditure offset by increased government revenue and reduced expenditure on such items as unemployment benefit. Another report, prepared by the Economic Intelligence Unit and commissioned by the Federation of Civil Engineering Contractors,[3] showed estimates of the effect of a very much larger increase in capital expenditure, (leading to a doubling in three years). These effects are also shown to be substantially beneficial - leading to up to four per cent more output and 550,000 extra jobs although the scale of the impact on output and employment depends on the way in which the expenditure is financed.

The four month imposed delay in the payment of Regional Development Grants should be removed. We estimate that the once and for all cost of this measure would be £125 million in the first year, 1982/83, with no cost thereafter. Such a measure would bring immediate relief to many manufacturing companies in depressed regions of the UK.

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1 Group of Eight Parliamentary Brief on Construction, July 1981.

2 Policies for Recovery: An evaluation of alternatives, by Cambridge Eonometrics Limited, December 1981.

3 Capital Spending and the UK Economy: A computer study by the Economist Intelligence Unit Limited. Commissioned by the Federation of Civil Engineering Contractors, November 1981.

In addition, we recommend that some additional expenditure is allowed for research and development programmes, particularly in advanced electronics and robotics. Such expenditure could greatly enhance the UK's future economic performance.

The expenditure implications of these proposals on capital expenditure is difficult to estimate because of long and often variable lead times and, for example, administrative delays. Thus the figures given in Table V.1 for these items are intended only as a broad indication.

V.10 **Energy Costs and Industrial Support**

The CBI recommends that the Government maintains and extends its measures to bring our industrial energy costs more in line with those of our European competitors.

The Electricity Council has undertaken a review of the CEGB's Bulk Supply Tariff, and we hope that this will lead to early measures to reduce the cost of electricity to certain large industrial users. While the second NEDC Energy Task Force report confirmed that for the vast majority of industrial users, UK electricity prices were broadly comparable with Contintental levels, significant disparities remained for some large and electricity intensive users. We recommend that the Government adjusts the Electricity Council's EFL for 1982/83 to permit them to reduce the costs of these large industrial users.

We also recommend that the £10 per tonne concession on the list price of foundry coke introduced by National Smokeless Fuels should be continued beyond its intended expiry date of March 1982.

These proposals on energy prices would a cost approximately £10 million in a full year, and we have taken account of this in our costings.

BRSECTV.

ANNEX I

THE ECONOMIC SITUATION AND PROSPECTS

Introduction

In this annex we outline the main elements of the current economic situation, look at the prospects on unchanged policies and at how our recommendations will improve these prospects.

Our unchanged policies forecast a year ago was that the UK economy would continue to suffer from low levels of activity and lack of competitiveness. Events since then have proved these predictions correct although British business has done much to bring down cost inflation and improve efficiency.

We expect only a very sluggish recovery in production, with some fall in price inflation in the the next year on present policies. This assessment is in line with the latest published official forecast[1]. If the proposals outlined in this document were implemented we estimate that they would improve the prospect for growth, profits and jobs without adding to inflation.

Demand and Output

The sharp fall in output that had taken place in 1980 continued into early 1981 before production started to stabilise or, possibly, rise slightly from the middle of the year. Although both output in the economy as a whole (measured by GDP) and in the manufacturing sector fell by large amounts by historic standards, the fall was very much greater in the manufacturing sector than in the economy as a whole.

Chart A.1 shows the CBI Staff projections for GDP on optimistic and pessimistic paths[2] and indicates how, even on the optimistic path, growth over the next two years on present policies is unlikely to be sufficiently strong to recover more than a fairly small proportion of the falls in production that took place in the last two years. Meanwhile the projections on pessimistic assumptions show that there remains a considerable possibility that production could fall further in the next two years.

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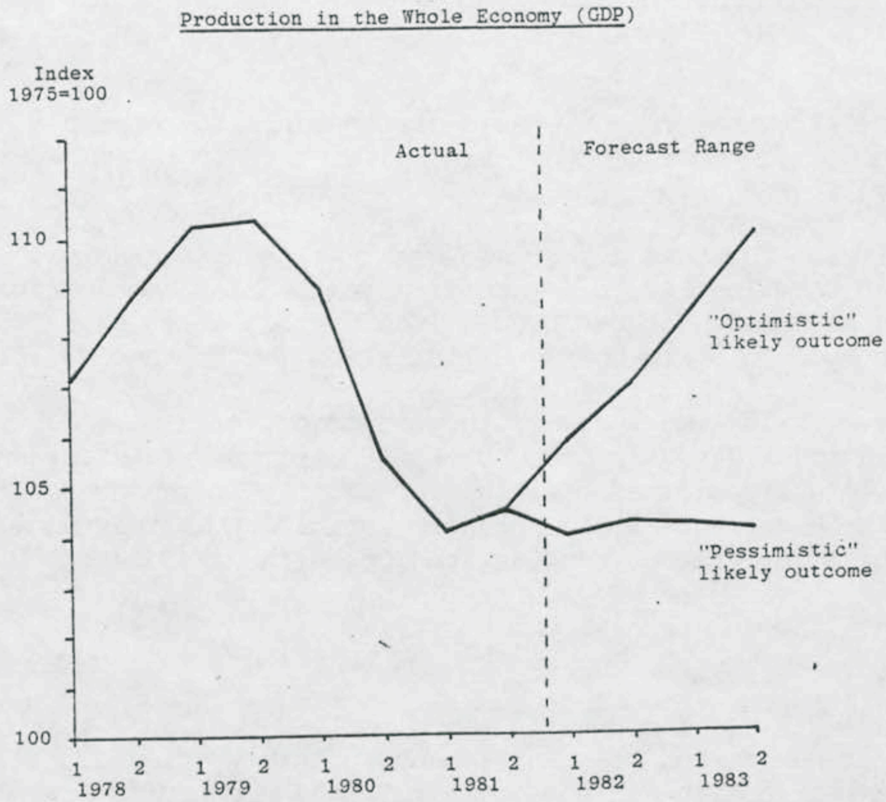
1 H M Treasury Economic Progress Report Supplement, December 1981

2 It is important to bear in mind the likely margin of error in forecasts. We have increased our central GDP projections by the average error estimated in this way from past Treasury forecasts between June 1965 and October 1979 (see Economic Progress Report Supplement, December 1981) to give the "optimistic likely outcome" shown in Chart A.1. The "pessimistic likely outcome" shown in Chart A.1 was obtained by subtracting the average error from our central forecasts. There is a 58 per cent chance of the outturn falling within the range of one average error above or below the central forecast if the forecast errors are normally distributed. The Charts showing RPI, unemployment and real rate of return were derived in the same way using data on average errors in Treasury, NIESR or CBI Staff forecasts.

Chart A.1



Source: CSO and CBI estimates

During 1980 the fall in production reflected particularly a massive turnaround from stockbuilding to heavy destocking and sharp falls in exports. By contrast, during 1981 some of these factors were partly reversed but the weakness of the other components of demand, consumers' expenditure, investment and Government expenditure, together with rising imports, held output down.

Our central forecast suggests that in 1982 and 1983 the slowing down of destocking and the growth of exports are likely to be the main upward influences on demand; consumers' expenditure and investment are likely to remain close to their present levels while government expenditure on goods and services is likely to fall slightly and imports are predicted to continue to rise. These forecasts, however, are particularly uncertain in three major areas: consumers' expenditure, where the rise in borrowing that has so far compensated for falls in real personal disposable income may not be sustained; the world economy; and stocks. Taking the four years from 1979 to 1983, together our forecasts suggest a fall in output of between 1 and 7 per cent in total, with falls in stockbuilding, fixed investment and export shares, together with rising import penetration, responsible for most of the predicted decline. We believe that much of this reflects the impact of the worsening of competitiveness and low levels of profitability on business. These problems, in turn, largely reflect the effects of high interest and exchange rates combined with severe inflationary pressures on business costs from high pay settlements and rising Government charges. We look in more detail at competitiveness and profitability below.

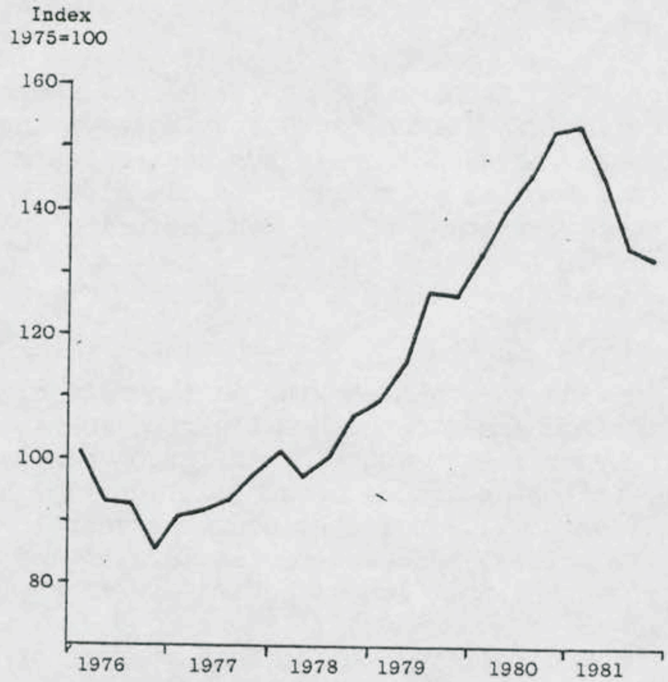
Competitiveness

We pointed out last year that there had been a severe deterioration in the cost competitiveness of British industry compared to overseas producers. Since then the position has improved but remains bad in comparison with historical trends as Chart A.2 shows.

These movements in competitiveness partly reflect changes in the value of Sterling. Its effective exchange rate was on an upward trend from the end of 1976 until the beginning of this year. Since then it has fallen back somewhat and recently seems to have stabilised close to 90 per cent of its 1975 value. Among the wide variety of factors likely to influence Sterling's exchange rate over the next two years, there could be some upward pressure if oil prices rise from their present depressed levels in response to the predicted ending of world oil destocking and higher industrial production levels, while increases in interest rates overseas could imply some downward pressure. Our central economic assessment is based on the assumption that Sterling's effective rate is likely to decline by a small amount over the next two years.

CHART A.2

Unit Labour Cost Competitiveness[1]



1 Labour costs per unit of output in UK manufacturing divided by the equivalent costs in competitor countries on a trade-weighted basis, expressed in common currencies.

Source: CBI estimates

Competitiveness has also been strongly influenced by rises in UK manufacturing average earnings greatly in excess of those in competitor countries. From 1970 to 1980 average earnings in UK manufacturing rose by 346 per cent in comparison with increases of 190 per cent in our main overseas competitors. In the two years to mid-1980 average earnings in UK manufacturing increased by more than twice as much as the average of our major competitors. Since then, the position has improved somewhat, with a rise of over 11 per cent in the year to mid-1981, similar to our competitors, and there is evidence of some further slowing since then. There is some hope that this downward trend will continue but this would be despite the influence of settlements in many parts of the public sector over the last 2½ years well above the average private sector level (see Section V for further details).

Another factor contributing to the recent movements in competitiveness shown in Chart A.2 was the large decline in manufacturing output per employee over the eighteen months to the end of 1980, followed by a sharp reversal of this trend resulting in an estimated 10 per cent improvement up to the end of 1981. Part of this sharp change reflects movements in hours worked but even adjusting for this, the recovery in productivity is most unusual over a period when output changed little.

Some of this recovery reflects exceptional factors which cannot be repeated, such as closure of least efficient factories and concentration of output in the remaining plants. In part it may be due to cutbacks in training research and development which firms have reluctantly been obliged to implement, and other factors which might be reversed when demand picks up. However, some of the rise in productivity reflects improvements in working practices and attitudes which could occur more widely in future. Many CBI Members have reported that if demand were to increase, substantial further increases in productivity could be achieved.

The competitiveness figures shown in Chart A.2 are based on labour costs and therefore do not reflect the impact of Local Authority rates, energy changes, interest rates and other costs. Local Authority business rates have risen by over 40 per cent in past two financial years and this has clearly had a significant effect on the competitiveness of our manufacturing and service businesses.

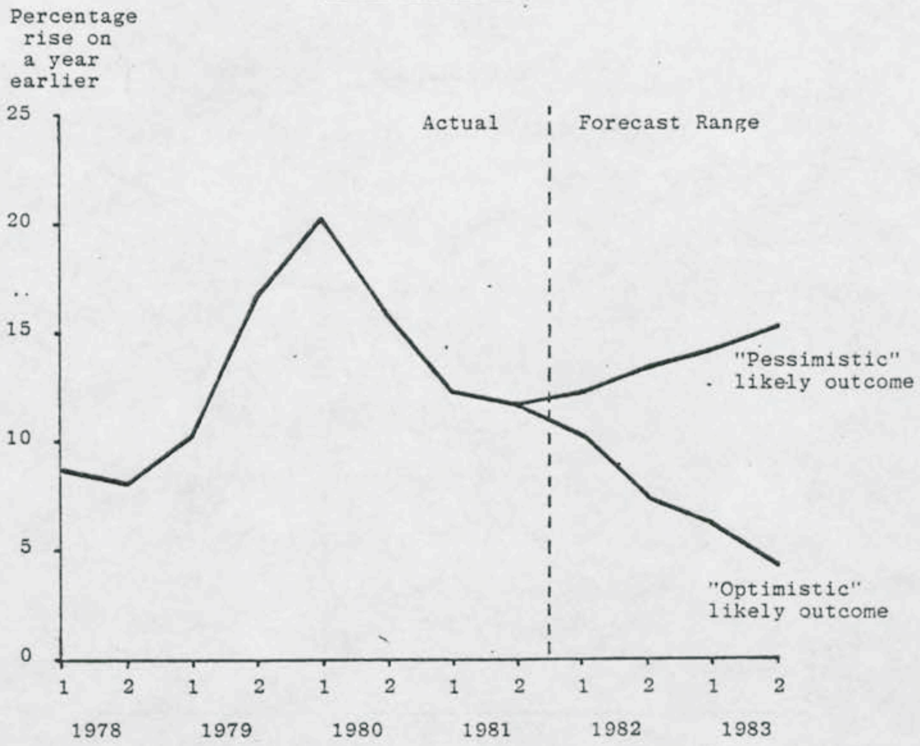
Price Inflation

1981 witnessed a slow decline and then a steadying in the rate of inflation as measured by the twelve month change in the Retail Price Index. Chart A.3 shows that by the end of the year this measure of inflation was running at 12 per cent. This decline, following a more marked fall during the second half of 1980 from the peak rate of 21.9 per cent over the year to May 1980, reflects weak world commodity prices, squeezed profit margins and more recently a slower rate of growth of unit labour costs.

Our central forecast on unchanged policies is for this measure of inflation to show little change until the Spring, with possibly some slow decline to around 10 per cent by the end of the year. This would reflect our assumptions of a small decline in Sterling's exchange rate and further moderation in labour cost increases. The chart shows that the optimistic end of the range of likely outcomes would be a marked fall in this measure of inflation, while the pessimistic end shows it remaining around present levels in the coming year and rising in 1983.

CHART A3

Price Inflation[1]



1 Index of Retail Prices

Source: Department of Employment and CBI forecasts

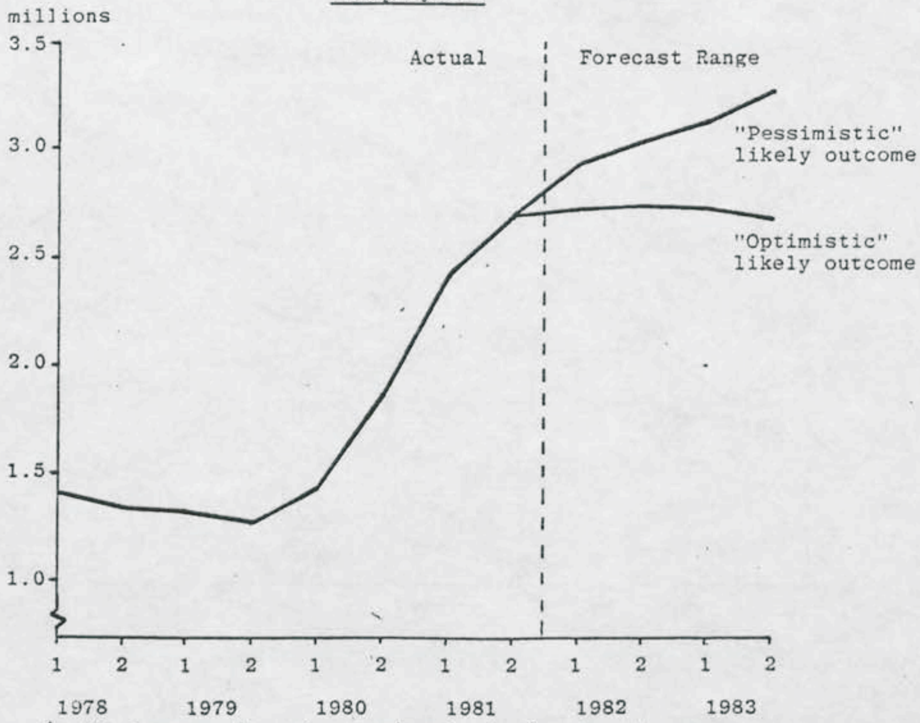
Unemployment

Chart A.4 shows that the fall in output was reflected in a very rapid rise in unemployment from the end of 1979 and throughout 1980. Unemployment continued to rise throughout 1981 but at a declining rate. By the final quarter of 1981, the total number unemployed was only marginally below three million.

We expect the trend in unemployment to continue upwards until the middle of this year. In the second half of the year, the trend in registered unemployment (seasonally adjusted, excluding school leavers) could more or less stabilise, reflecting our estimate of the impact of various government special employment measures which are likely to take increasing numbers off the unemployment register. However, the impact of these measures is still somewhat uncertain and the Chart shows that a continuation of the upward trend is within the likely range of outcomes. During 1983, registered unemployment is likely to resume an upward trend on present policies unless the new training scheme proposed by the Government takes very large numbers out of the labour force.

CHART A4

Unemployment[1]



1 UK seasonally adjusted excluding school leavers
Source: Department of Employment and CBI estimates

Company Profitability and Provision for the Future

In 1981 the real pre-tax, pre-interest rate of return for non-North Sea Industrial and Commercial companies fell to just over 2 per cent, the lowest ever recorded in this country, and almost certainly much lower than in any of our overseas competitors[1]. Although some recovery appears to have begun in the second half of the year and is expected to be sustained throughout 1982, real profitability this year is likely to be around 3 per cent. Chart A.5 shows that this would still be extremely low by historic standards. Chart A.5 shows profitability before tax and interest. The magnitude of the squeeze on company finances is pointed out even more graphically in Chart A.6 which shows real profitability for industrial and commercial companies (excluding North Sea activities) minus payments of tax and interest. In 1980, for the first time on record, this total was negative. We estimate that it remained negative in 1981 and on our central forecast will continue to be negative on unchanged policies this year. The Chart also shows that the proposals in this document would make real profits after tax and interest positive.

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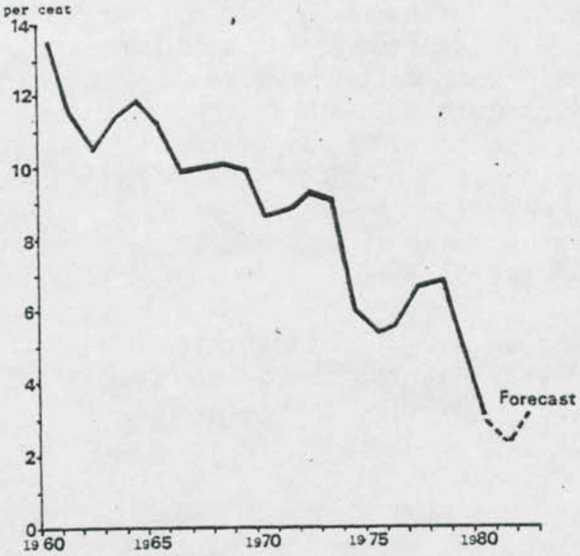
1 An article in British Business, 4 September 1981, indicates that real profitability in the UK appears to be considerably lower than in all of a group of comparable industrialised countries.

CHART A5

Real Profitability[1]

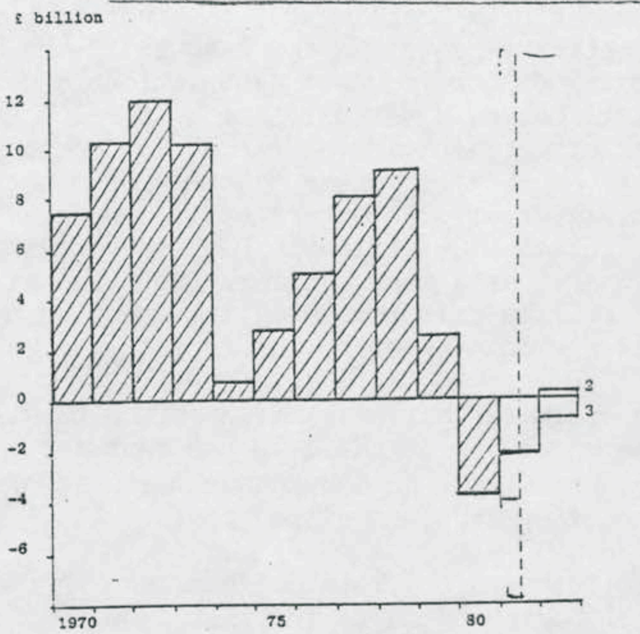


1 Gross Trading Profits plus rent minus stock appreciation and capital consumption as a percentage of capital employed for industrial and commercial companies excluding North Sea activities.

Source: CSO and CBI estimates.

CHART A6

Real Profits after Tax and Interest[1]



3 On unchanged policies

2 After the implementation of our package

1 Gross Trading profits plus rent minus stock appreciation, capital consumption, net tax payments on income and net interest payments revalued to 1982 prices for industrial and commercial companies excluding North Sea activities

Source: CBI estimates

Investment and other provision for the future has been cut sharply in the past two years. Manufacturing industry investment (even after adjusting for leasing) is estimated to have fallen nearly 20 per cent between 1979 and 1981 and a further small fall in 1982 is likely. In addition to cutbacks in new investment, companies have reacted to the recession by widespread plant closures. The number of affirmative responses to the CBI Industrial Trends Survey question 'is your present level of output below capacity?' has been declining much more rapidly than can be accounted for by increases in output, implying substantial reductions in capacity. The number of new engineering apprenticeships in 1981/82 is estimated by the Training Services Division of the MSC to have fallen by 20 per cent from 2 years earlier, even more sharply than earlier forecasts had suggested and there is considerable anecdotal evidence of reductions in training.

Because of the low levels of profitability, particularly after tax interest, achieved in the recent past and expected in the near future, company expenditure on investment and provision for the future is likely to be constrained in the coming years. In addition we expect on unchanged policies that there will be continued closures of plants and firms caused by production in many parts of the economy remaining uneconomic.

Despite low profitability, industrial and commercialcompanies accumulated more liquid assets than liabilities and hence recorded a negative net borrowing requirement in the first three quarters of 1981, instead of recording a positive net borrowing requirement as is usual. This reflected both substantial destocking and the delay in collection of tax revenues caused by the Civil Servants' dispute. From the fourth quarter of last year, companies seem to have been increasing their borrowing substantially as destocking slowed down and the delayed payments of tax were made.

In the coming year we estimate that the impact on company borrowing of lower destocking will be more than enough to offset the small projected rise in profits.

Monetary Situation and Outlook

Movements in Sterling M3, the indicator used to define the Government's monetary targets, in the past two years have been strongly affected by the ending of the 'corset' restrictions and in the 1981/82 financial year by the Civil Servants' dispute and by the substitution of bank lending for building society lending in the market for housing finance, among other factors. However, several major features of monetary developments in 1981/82 are fairly clear. The Government's borrowing is likely to be close to its PSBR target of £10½ billion. Despite this interest rates at the end of 1981 were higher than a year earlier. The personal sector has offset much of the effect of falling real income on its spending by a sharp increase in its borrowing and new company borrowing from the banks has been fairly high.

We estimate that overall, Sterling M3 will have grown slightly faster than the upper end of the 6-10 per cent per annum target range for the 14 months to April 1982. However other measures of the money supply are likely to indicate much less rapid growth.

Preliminary forecasts suggest that in the 1982/83 financial year the PSBR will be around £9 to 10 billion on present policies.[1] Company borrowing is likely to rise as destocking ends. The outlook for personal borrowing is highly uncertain but if people are to maintain current spending levels they will probably have to cut back on saving or continue raising their borrowing at around the rate recorded during the 1981/82 financial year. Monetary forecasts are inevitably uncertain but, in the absence of further special factors, there is a strong possibility that monetary growth on unchanged fiscal policies and assuming a small fall in interest rates would be close to the top of the target range of 5 to 9 per cent for 1982/83.

How the prospects would be improved by implementation of CBI policies

i Effect on Output

We describe above our forecast for GDP assuming a continuation of present policies.[2] In this section we consider the likely outlook if the CBI recommendations were implemented in the Spring 1982 Budget. Our estimates are based on our econometric model but we also checked them with the Economist Intelligence Unit version of the Treasury model and obtained essentially similar results.

The projections show how our proposals would increase output compared to the outlook on unchanged policies. They do this through two main routes. First, competitiveness would be markedly improved by the reductions in business costs that we are proposing: lower NIS, business rates, interest rates and energy costs. This improvement in competitiveness should lead to higher exports and lower import penetration thus increasing GDP. Second, our measures represent an increase in the overall level of demand because the Government would have increased the balance between its expenditure and its revenue and reduced interest rates.

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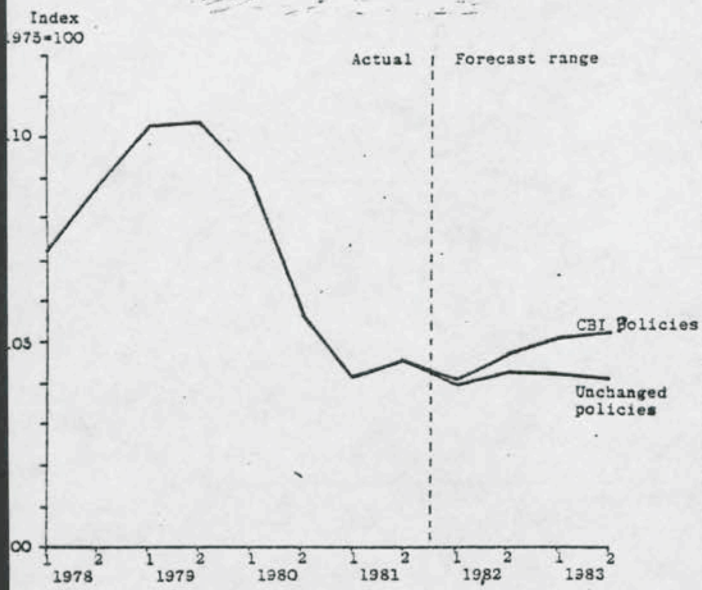
1 "present policies" including indexation of personal income tax allowances system and not indexing specific duties; indexing the latter would reduce the PSBR forecast by roughly £1 billion.

2 For further details see CBI Economic Situation Reports, annual subscription £110, (£90 for CBI Members).

HOW CBI POLICIES AFFECT GDP

CHART A8

Chart A.7
"Pessimistic" likely outcome



"Optimistic" Likely Outcome

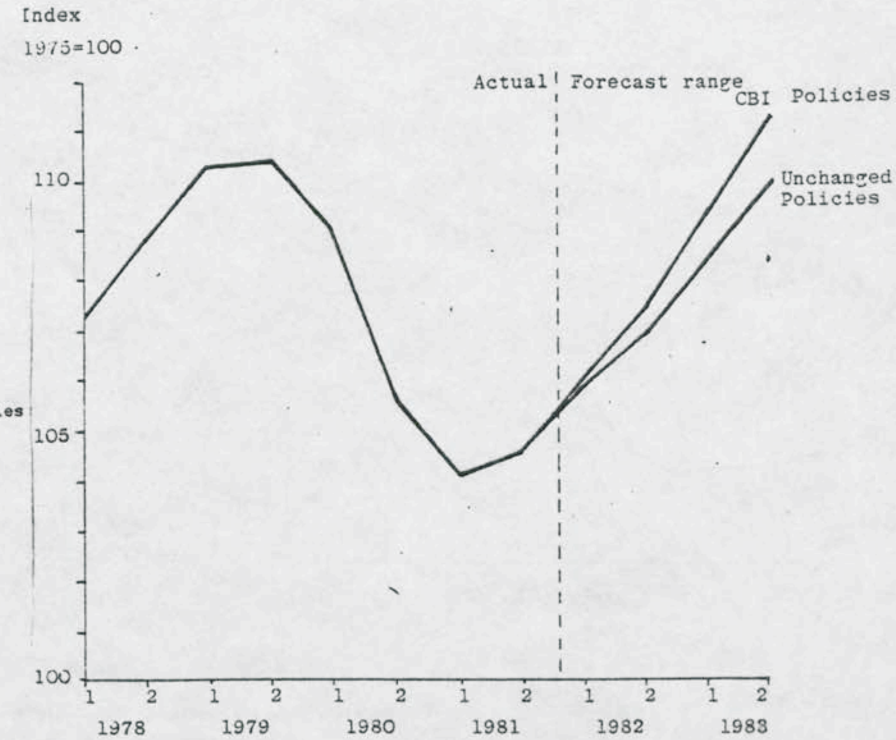


Chart A.7 shows that on present policies, if developments were at the pessimistic end of the range of likely possibilities, output would resume falling in the course of 1982, continuing to decline in 1983. This would destroy the present hopes that unemployment could more or less stabilise in the second half of next year and it would eliminate the small recovery in profitability that we are currently hoping for. We would regard such an outcome for the UK economy as extremely unsatisfactory. This Chart also shows that were our policies implemented, developments at the pessimistic end of the range of likely possibilities would imply that output more or less stabilised. This, would still be far from satisfactory but it would be markedly better than a decline in output.

Chart A.8 shows that if the outcome were at the optimistic end of the likely range, then even on present policies output would be likely to grow by about 2½ per cent in the course of 1982. Chart A.8 also shows that if our policies were implemented, an outturn at the optimistic end of the range would imply that GDP growth of nearly 4 per cent was likely over the year to early 1983, by when it would still be 2 per cent lower than in 1979. Our estimates suggest that because of the large margin of spare capacity existing at present, growth at this rate would be unlikely to lead to significant shortages.

ii Effect on unemployment

Charts A.9 and A.10 show the likely impact of our policies on unemployment. If unemployment turned out to be at the pessimistic end of the likely range suggested by our forecasts, then on current policies it would continue rising fairly markedly throughout the period to end-1983, while on our policies it would be more or less stabilised. At the optimistic end of the likely range of possibilities, on current policies the trend in unemployment would decline slightly but on our policies it would fall by rather more.

HOW CBI POLICIES AFFECT UNEMPLOYMENT[1]

CHART A9

"Pessimistic" Likely Outcome

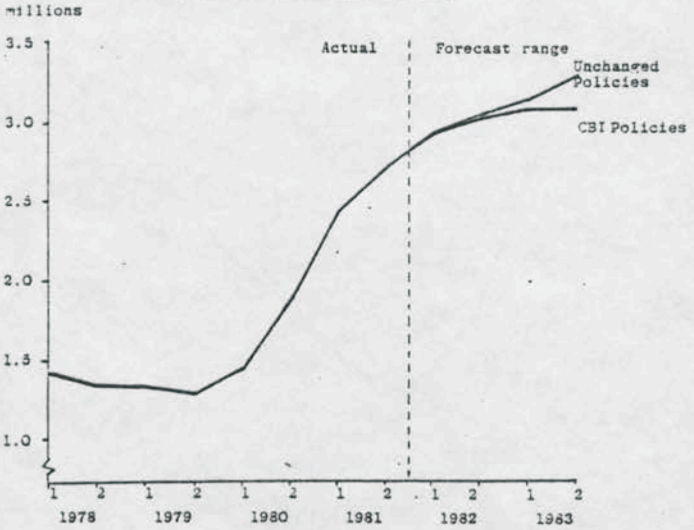
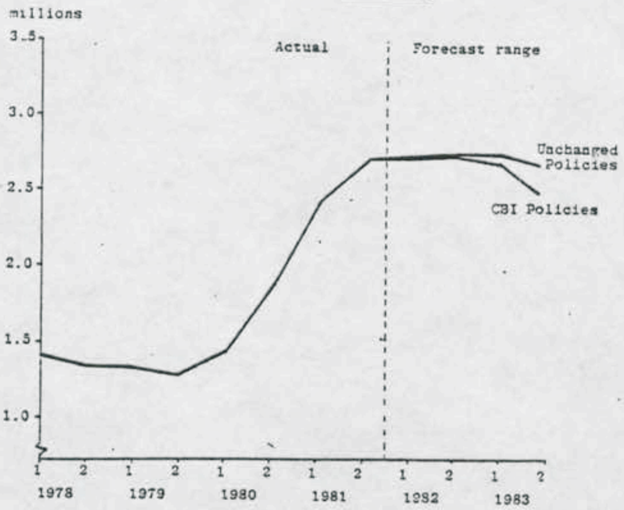


CHART A10

"Optimistic" Likely Outcome



1 UK, Seasonally adjusted, excluding school leavers

iii Effect on profitability

Chart A.11 shows that on current policies, pre-tax, pre-interest profitability (defined on chart) would fall slightly from the record low levels last year if developments turn out at the pessimistic end of the likely range of outcomes. If our policies were implemented, a pessimistic outcome would give a slight rise in profitability. If events turned out at the favourable extreme of probable forecasts, profitability on present policies would rise only to around five per cent by end-1983 - still very low by historic standards - whereas on our policies it would reach nearly six per cent. Chart A.6 shows that the effects of our proposals on real profits after tax and interest is to turn a negative total predicted for 1982 on unchanged policies into a positive one.

HOW CBI POLICIES AFFECT PROFITABILITY[1]

CHART A11

"Pessimistic" Likely Outcome

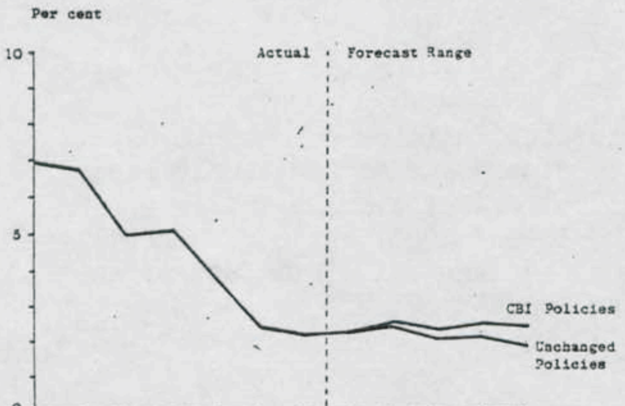
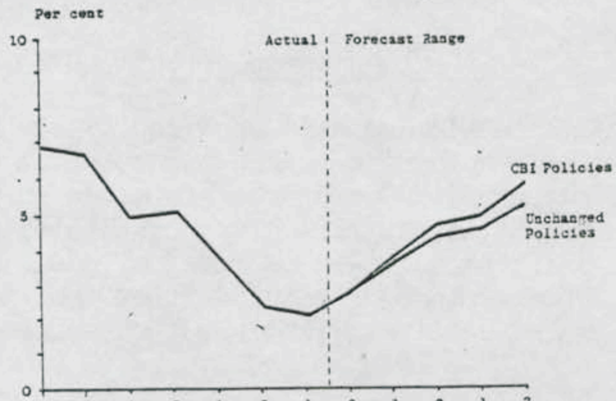


CHART A12

"Optimistic" Likely Outcome



1 Gross Trading Profits plus rent minus stock appreciation and capital consumption as a percentage of capital employed for industrial and commercial companies excluding North Sea activities.

Effect on inflation

We described above our central projection for twelve monthly retail price inflation, which showed a slight slowdown from the present rate, assuming continuation of current policies. Hence the optimistic end of the forecast range in Chart A.13 shows a marked fall on present policies.

HOW CBI POLICIES AFFECT INFLATION[1]

Chart A.13
"Pessimistic likely outcome"

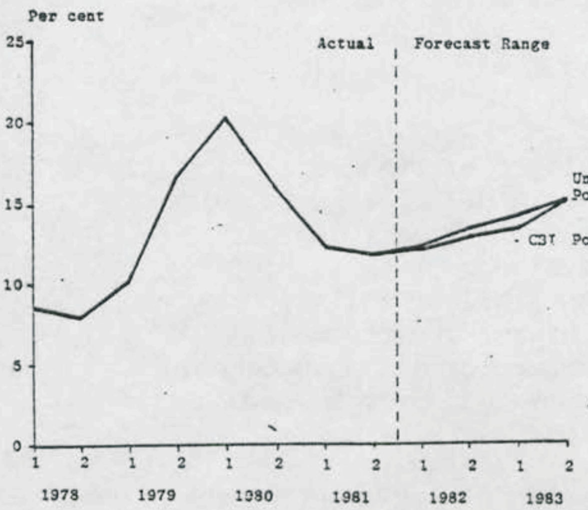
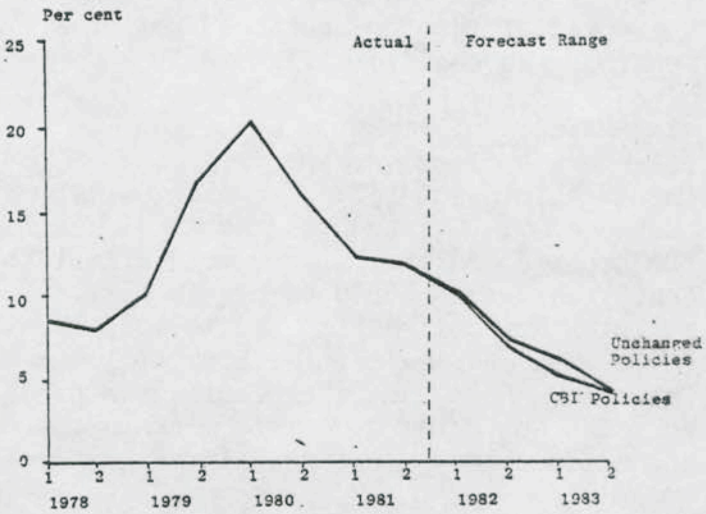


Chart A.14
"Optimistic likely outcome"



1 RPI, percentage rise over past year

Our proposals for lower business costs (see Table I.1) would reduce business costs by £3000 million at 1982/83 prices in a full year. If there were a fall in the Sterling effective exchange rate in comparison with what otherwise would have happened of, say, 3 per cent, the addition to the costs for UK businesses and consumers of imported goods is unlikely to be as much as £1000 million annually. The net effect on retail prices of the lower UK business costs and the higher import costs, together with the impact of higher demand and profitability, the spreading of overheads from increased throughput and lower interest rates is unlikely to be upwards given the large amount of unutilised capacity shown by CBI Industrial Trends Surveys.

The evidence of movements in pay when NIS was introduced and of the effects of various other changes in payroll taxes does not suggest that our package of recommended cuts in business costs would lead to higher pay. We have checked this conclusion in very extensive discussion with CBI Members with particular knowledge and experience of factors influencing pay negotiations at the present time. This discussions have shown overwhelming support for the view that there would be no direct effect on pay from our proposed reductions in business costs.

Charts A.12 and A.13 show that, if anything, our proposals are likely to reduce inflation.

v Effect on PSBR

The higher output which we expect to be generated by our measures would, after a while, boost Government tax revenue and reduce unemployment pay below what it would be on present policies. This would tend to offset the effect on the PSBR of the net reduction in revenue relative to expenditure that we are proposing, although the initial effect would probably be small. Table I.2 summarises our estimates of these "feedback" effects. The PSBR would be increasd by about £1.8 billion in 1982/83 from the £9 to £10 billion figure we expect on current policies and, therefore, remain about the same percentage of GDP as the target for 1981/82 announced by the Chancellor in the March 1981 Budget. In 1983/84 the PSBR would be increased by about £1.7 billion at 1982/83 prices and incomes by our recommendations.

We show in II.4 and II.5 why, although the PSBR after our proposals is likely to be higher than on unchanged policies, lower interest rates would be feasible and beneficial.

vi Balance of risks

Charts A.7 to A.14 give a clear indication of the balance of risks affecting the economy. Charts A.13 and A.14 show the large margin of error surrounding the prospect for inflation, with a fall to 4 per cent or a rise to 15 per cent within the bounds of possibility. These charts also show that CBI policies are unlikely to add to inflation. The risk of higher inflation has to be balanced against the risk of lower output and higher unemployment. Chart A.9 shows that the pessimistic projection for unemployment on unchanged policies would leave unemployment in the second half of 1983 over 500,000 higher than in the second half of last year.

Given the range of possibilities we judge that the risks of implementing the proposals contained in this document are less serious than those of continuing to follow unchanged policies. Moreover these charts overstate the danger of an excessive boost to demand since they are based on the assumption that there is no change in fiscal stance between the 1982/83 and 1983/4 financial years.

In fact it would be possible to restrain the economy, for example in the Spring 1983 Budget, if signs emerged that the economy was growing too fast and leading to a risk of inflationary shortages.

ANNEX 2

PROPOSALS FOR INCORPORATING SFICs INTO THE BUSINESS START-UP SCHEME

a Individuals would get tax relief for investing in SFICs just as they do for investing directly in smaller companies under the present Scheme. We believe that this would require only minor amendment to the existing legislation and is already permitted under the Scheme when an individual invests in a start-up company through an approved investment fund.

b Institutions and other companies should be able to invest in SFICs (although they would not receive the same tax relief as individuals) and this would require amendment of the 1981 Act.

c SFICs and individuals should be able to invest in existing companies as well as new ones. Accordingly the restriction in the 1981 Act to new trades (and the consequential restriction to new companies) should not apply. This departure from the Act would require omission or amendment of the sections that impose the restrictions.

d The kinds of trade that qualify under the 1981 Act would also be those qualifying for investment by SFICs.

e Since a SFIC should be able to lend to an investee company as well as acquire equity and be able to acquire securities in qualifying companies and not be confined to subscribing for new securities, there would have to be departures in these respects from the 1981 Act.

f Institutional investors should be able to deduct, when calculating taxable income, any realised or unrealised losses on investment they had made in a SFIC. This would be a departure from the 1981 Act.

g The income and capital gains derived from qualifying investments made by SFICs should be free from tax. This would require legislation.

h The SFIC would have to comply in its constitution and conduct of its business with general company law and, in particular, with the Prevention of Fraud (Investments) Act 1958. We do not believe that this would require new legislation. However, it would probably be necessary to provide for the withdrawal of relief for investors, and of benefits for the SFIC, if a SFIC failed to make investments in qualifying companies, or did not comply with its rules and conditions. This could probably be achieved by amendment to the existing legislation.

BRANNEX2.

ANNEX 3

TECHNICAL TAX REPRESENTATIONS

This Annex contains the more detailed technical representations which we have sent to the Revenue Departments. They reflect the existing law and they should not be seen as affecting the position expressed in Section III.

A REPRESENTATIONS ARISING OUT OF THE FINANCE ACT 1981

Consortium Relief

Section 40 FA 1981 extended consortium relief and now allows consortium members to surrender losses down to a consortium company to be used against its profits. The impediment to the free and full use of ordinary group relief and consortium relief which Section 263(5) ICTA presents is now more significant. Section 263 should be amended so that part of a loss can be set off by way of group relief without prejudice to using all or part of the rest of that loss by way of consortium relief.

Stock Relief

a Six Year Cut-off

The six years restriction on the carry forward of unused relief should be abolished.

b Payments on Account

If a business makes a payment on account of stock in advance of obtaining ownership, it should get stock relief on the payment. This is a reasonable corollary of the rule that the supplier of the stock has his claim cut down as a result of receiving the payment on account.

c Amount of Tax on Clawback

The tax on the clawback should not exceed the tax reduction obtained in the past on the relief.

The tax on the clawback may be at 52% whereas the previous relief may have been at 40% (small companies rate), 22% (mainstream tax partly covered by ACT) or some rate less than the usual because of DTR.

Relief for Interest

The extension of relief for interest paid on loans taken out for investment in a partnership or co-operative which was provided by Section 25FA 1981 should be further extended by removing the exclusion of limited partners.

Development Land Tax

The increase in exempt cubic content provided by Section 133FA 1981 should apply to rebuilding as well as enlargement.

B OTHER TECHNICAL REPRESENTATIONS

Capital Allowances

Plant and Machinery - Transfers between related persons

The taxpayer should have the right to elect for plant and machinery to be transferred at its tax written-down value in all cases where it passes between related persons.

Group Relief

a Extension to accumulated losses

The group rules in Part XI ICTA should be amended so that a company may surrender accumulated as well as current year losses.

b Time limits for surrender

Section 512(2) ICTA recognises that it can take a considerable time for foreign tax assessments to become final and therefore extends the normal time limits for claims and assessments.

However, if a member of a UK group with foreign taxed income has covered its remaining UK liability after double tax relief with group relief and subsequently the double tax relief is increased by an adjustment to the overseas tax, the group relief claim cannot be revised if the double tax relief adjustment occurs outside the two year time limit for group relief purposes.

The additional double tax relief may be lost and the purpose of Section 512(2) frustrated.

Without prejudice to our long-standing representation that time limits for group relief and other claims should be six years, the time limit for revisions of group relief claims should be extended to meet this case.

c Surrender of excess charges on income - effect of Section 13 Oil Taxation Act 1975

Section 13 Oil Taxation Act 1975, which treats oil extraction activities etc carried on as part of a trade as constituting a separate "trade" for corporation tax purposes, causes a restriction on relief for charges on income in certain circumstances.

Section 248(1) ICTA allows a company's charges against total profits and if the charges exceed total profits the excess may be surrendered as group relief (Section 259(6) ICTA).

Unfortunately where a company carries on two or more trades, one of which is a Section 13 OTA 1975 "trade", relief is restricted where:

i the charges other than those relating to the Section 13 trade (Section 15 OTA 1975) exceed trading income arising outside the ring fence, but

ii total charges do not exceed total profits.

here the excess must be carried forward since it cannot either be offset against ring fence trading profits (Section 15 OTA 1975) or surrendered as group relief (Section 259(6) ICTA).

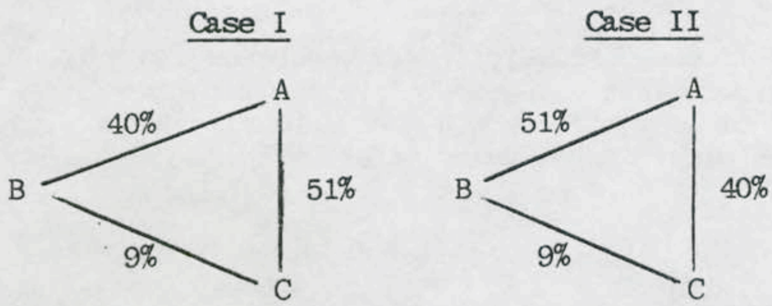
Section 259(6) ICTA should be amended to permit such excess to be surrendered as group relief.

Capital Gains - Transfers within a group

Difficulties can arise in some cases in relation to the availability of rollover relief due to the combined effect of Section 273 ICTA and Section 115 Capital Gains Tax Act 1979. To avoid this problem Section 273 should be amended to allow the transferor company to elect that the provisions of subsection (1) shall not apply to a particular transfer where the market value of the relevant asset at the time of transfer is greater than the value at which it would otherwise have been deemed to have been transferred.

Double Taxation Relief

Section 508 ICTA can operate in an anomalously restrictive manner as illustrated below:



A is a UK company
B and C are overseas companies.

In Case II Section 508 gives relief to A on underlying tax on dividends from C to B, because B is a subsidiary of A which controls directly or indirectly 10% of C.

In Case I underlying tax relief is not given to A on dividends from C to B, because B is not a subsidiary of A.

Section 508 should be amended to give underlying tax relief to A in Case I on the basis that C is deemed to be related to B provided that B is related to A and C is a subsidiary of A.

Advance Corporation Tax

a Change of Rate

Where there is change of ACT rate at 5 April there is a new deemed accounting period with the result that ACT payable in respect of a distribution made before that date cannot be set off against franked investment income received after 5 April but within the normal accounting period.

Section 103 FA 1972 should be amended to remove this restriction.

b Surrendered ACT

Section 92(4) Finance Act 1972 can create a trap in relation to bona fide reorganisations of the structure of groups of companies where there have been surrenders of ACT, as is illustrated below:

Parent Company	A	
	|	100% shareholding
Intermediate company	B	
	|	100% shareholding
Trading subsidiary	C	

B surrenders ACT to C. Subsequently B transfers its shares in C to A. As C is no longer a subsidiary of the surrendering company B, the ACT surrendered to it is lost.

Section 92 should be amended to allow such reorganisations to take place without the company which received the surrendered ACT losing the right to carry it forward.

Pre-trading expenditure

The 1980 Finance Act introduced relief for certain expenditure incurred by a prospective trader not more than one year before the time the trade is commenced. This is unduly restrictive and should be extended to cover items of expenditure incurred within three years before trading commences.

VAT

a Business Gifts - Limits

The limit under paragraph 5(2) Schedule 2 FA 1972 should be raised from £10 to £30.

b Relief for Bad Debts

The limited relief granted under Section 12 FA 1978 should be extended to equate with the rules applying for income and corporation tax purposes.

c Input Tax where no Invoices

Input tax should be allowed on a percentage of total expenditure on items such as hotels, travelling and the like as an alternative to the present invoice basis, which is administratively costly.

SUBJECT

cc Master
Ind Pol

NOTE FOR THE RECORD

Sir Ray Pennock called on Wednesday, 2 December, at 5.30 for a short general discussion with the Prime Minister.

Sir Ray gave an account of the CBI Conference last month. It had been much the best Conference they had had for a number of years, although it had not received much publicity, because it had been overshadowed in the Press by the events at that time at BL.

There was a general discussion of the economy.

The meeting ended at 6 o'clock.

MCS

4 December, 1981.

BRACKEN HOUSE, CANNON STREET, LONDON EC4P 4BY
Telegrams: Finantimo, London PS4. Telex: 8954871
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Monday November 30 1981

FT LEADER
Monday 30 November 1981

Management by consent

SIR RAYMOND PENNOCK, president of the Confederation of British Industry, was right last week to stress the need for companies to increase employee involvement and to warn them not to rely too much on changes in labour law. It is a message which needs to be repeated frequently in the coming months when companies slowly begin to emerge from the bottom of the recession. At this time they will need the co-operation of their workforces for smooth, efficient production—otherwise they may find many of the gains they have made by slimming down and modernising their operations in the past year or two are lost.

Docile

During the recession many companies have increased their communications with employees—either to prepare them for possible cuts and closures—or to pave the way for low pay rises. For the first time for many years employees have also become more aware of the commercial facts on which their jobs depend.

Managements should not believe, however, that employees' more docile attitudes, which have been bred mainly by fear of unemployment, automatically indicate a permanent acceptance of economic realities or a permanent willingness to co-operate with management decisions. Equally, companies should not suppose a few exercises in communication carried out in the past year will have a lasting effect.

Sir Raymond made his remarks to accompany publication of a CBI survey which showed that companies have engaged in far more communication and consultation in the past two or three years. The survey findings could easily be exaggerated, however, and Sir Raymond stressed the real message is that far too little is still being done in most companies.

The survey was answered by fewer than half the 1,000 companies contacted. Only a tiny proportion of chief executives and managers involved thought there had been a definite improvement in practices. In more than half the cases, however, companies had impressed their employees with a more participative and more open approach. There was a general acceptance by senior executives of the importance of communication and consultation.

Between 80 per cent and 90 per cent of the managers felt increased employee involvement had led to tangible gains in performance. Most of this improvement was on labour-related matters, such as more realistic pay-bargaining and improved morale. It also extended (with lower percentages), however, to acceptance of new technology, improved quality and consumer service, reduced energy usage and lower scrap rates. It is when a company can measure the success of its approach to employee involvement in these practical terms that it can be sure it is making permanent progress.

One is not arguing here soft management, nor creation of endless committ which can slow down decis making. The reassertion of managerial authority in the past couple of years has in many ways been a healthy development; it has enabled tough and necessary decisions to be implemented. An insensitive use of management power, however, is certain to breed resentment among employees—a resentment which will be exploited by trade unions when the recession ends.

Usurp

There are also political and social dimensions to this subject. The tide that swept the Bullock proposals on industrial democracy into a major issue has not receded forever. The Trades Union Congress intends to reopen the debate. Proposals now being processed by the European Parliament will also soon reactivate arguments about the role and content of legislation on the issue of participation.

Employees, whether they are shop-floor workers or highly-paid professional staff, are slowly demanding a greater say in the affairs of their companies. Most of them do not want to usurp their managers' authority; but they do want their views to be heard and taken into account, sometimes by the boards of holding companies as well as by their nearest line managers.

The remarkable increase in management buy-outs, sometimes involving workers as well as managers, reflects the desire for people to have more influence over the decisions which affect their working lives. The challenge now is for companies to find ways of basing their new found managerial authority on the involvement and support of their employees.

10 DOWNING STREET

Prime Minister

You may like to look at the summary on inside front cover p 1 and, if you have time, at the economic assessment on pp 2-4. (You are seeing Ray Pennock on Wednesday)

Not too bad.

MCS 27/11

lnd Pol

MR HOSKYNS

cc:- Mr Scholar
Mr Ingham
Mr Duguid
Mr Walters

CBI Conference: Pay, Unemployment and Industrial Relations

The first day's debate at the CBI Conference yesterday was unimpressive. The discussion was almost entirely unstructured; speeches were kept too short for arguments to be properly developed; resolutions, always uncosted and sometimes contradictory, were introduced from the floor without warning; and voting was shambolic.

Ray Pennock's opening statement set three priorities for the CBI for the coming year. First, pay: nothing very original here, - he expressed the objective as no more than our German rivals, and nothing unless backed by productivity increases. Second, unemployment: a national system of training and work experience was needed to help the young, but in the long term jobs would be created only by growth without inflation. Third, public expenditure: £3 billion could be saved from the pay, manning and pensions of the public service - "not a man in this room would not know how to do it" - but he failed to mention that even Sir Derek Rayner had only managed £80 million.

The pay debate was notable for a consensus on the need for better communication by management with employees, although no-one seemed surprised or ashamed that this very obvious point still needed stating. Management communication was such a widespread theme at the Conference that I think there is a case for the Prime Minister coming back to it herself, perhaps in her speech to the EGCI later this month. Speakers were split on the extent to which there had been a permanent change in attitudes on pay - on the one hand, it was pointed out, even if pay moderation was resulting from fear, at least that showed that some people (obviously not BL employees) could see the link with job security; on the other hand, it was noted that the unrealistic nature of claims still being put in showed that we were merely enjoying an uneasy truce. There was virtually no interest in pay determination machinery, national fora, or incomes policies.

/The debate

The debate on unemployment was a little livelier, with delegates falling over each other to show their concern. Unfortunately the underlying attitudes occasionally showed: one speaker referred to the need "to feel more comfortable about unemployment", and Ray Pennock himself said at one point "a subject of this importance requires at least three resolutions." Ian MacGregor made the best speech of the day: he said that 3 million people were paying the penalty of a decade in which the British people had indulged themselves in rewards they had not earned. Government and the trade unions had been less than helpful, but managers had to accept responsibility. They had been willing to accept low performance standards, over-manning and poor yields. They delegated communication to subordinates. And they neglected training - clearly unskilled labour earning £2 an hour could not compete with countries where it was paid 10p a day.

The surprise on industrial relations was the absence of interest in legislation. Again and again delegates returned to the theme of communication and employee involvement. Frodsham from the EEF said that the law was unquestionably a factor in the balance of power between employers and unions, but it could not be changed in a hurry. There was no mention of immunities, and little of the closed shop.

This was the first CBI conference I have attended, and I was left wondering why it took place at all. Despite the slick physical arrangements, the substance was dealt with as if the participants themselves did not think what they were doing was important. And the tone of too many of the speakers, as well as the very existence of separate management and union conferences at opposite ends of the country, was a constant reminder of how wide is the gulf in British industry.

J. M. M. VEREKER

3 November, 1981

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CBI CONFEDERATION OF BRITISH INDUSTRY

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P.139.81

CBI FIFTH NATIONAL CONFERENCE

EASTBOURNE, 1-3 NOVEMBER 1981

TEXT OF OPENING SPEECH BY SIR RAYMOND PENNOCK, PRESIDENT OF THE CBI

Good morning, Ladies and Gentlemen. Welcome to Eastbourne, and welcome to the fifth CBI National Conference. Botham, you will recall, was fifth wicket down when he pulverised the Australians at Headingley and five was the number which gave Beethoven his place with posterity. By the time you reach five you should be really getting into your stride. Old enough to have learnt plenty of lessons and still young enough not to be set in your ways. You should still be ready for change and this year we are trying to introduce it. There are changes to the format of our Conference. Changes to procedure, and I hope you will agree that with really first class background papers, which are changed in both content and presentation, we are well set for a Conference to produce action and change ourselves.

One unfortunate change is that today our Director-General is not present. Terry Beckett is progressing well and is getting stronger every day. I talk to him regularly on the 'phone. He is keenly interested in the Conference and will be watching its proceedings avidly. His medical expert has advised that he will be back in the office in good health by the end of November and we look forward to that. I know you would want me to send a message of good wishes and I can assure you that will speed him still further on his return.

This is the last in the annual round of conferences and the way they have all unfolded this year, and especially this year, leaves me in no doubt that ours is different, has always been different and different we always will be. Our Conference differs in its purpose, in its objective, in the things we expect to happen from it and, not surprisingly, in the style of our debates and the priorities contained within them. The purpose of other conferences is political - in fact party political - and regretfully I include the TUC Conference in this category also. We are not political. We are not here to tell the Government of the day how to run the country or how we would run it we were in their place.

We are not here to advance our own personal position by the speeches we make. Our personal ambitions are usually concerned with running our own business successfully.

We have no political infighting and jockeying for position, and if you asked us to send out coded messages in our speeches most of us wouldn't know where to begin.

We are here to decide, as we were here to decide twelve months ago, what we in business should have as our priorities for action in the next twelve months to get business moving, and we only involve ourselves with Government to the extent that Government helps or hinders us in that process.

We are here to decide our actions and every one of them must pass the litmus test of competitiveness. That is why competitiveness is imprinted on every background paper distributed to you, and that is why I hope competitiveness will be the most frequently used word in our Conference over the next two days.

Now we won't produce action if we have a conference of moaning and groaning and even of droning. But we will produce action if we have a conference that is bright, constructive and shows our mettle. By tomorrow lunchtime above all else we must know where we are going for the next twelve months, and the action we propose to get there. That, as I see it, is the purpose of this conference.

After the last conference there was a good deal of talk about what it had and had not achieved and since then, as we all know, nowhere in the world has life been easy.

Let me try and tell you some of the things we in the CBI have achieved since last we met a year ago in that vast, daunting auditorium at Brighton. The CBI's ten commandments, for 1981, if you like.

One: as we said we would, we have led business and industry successfully in the battle to bring down inflation by moderate wage settlements. Last year we halved them and this year our objective is not dissimilar. Last year we said it had to be single figure wage settlements, and we didn't mean 9 per cent. This year we say some can afford nothing and most of us not much more. For several years now, we have held pay conferences for chairmen and those in charge of company negotiations. Last year about 1,000 people attended the pay conferences we held up and down the country. This year the figure has almost doubled. And there is no-one who attends them who will not testify to the value and help that they give.

Two: although we continue to support the Government in fundamentals, we have continually pressed for much tighter control of public revenue expenditure with some significant effect in central government departments already. More recently we have produced a report on what more should be done which has been widely approved and well received, even from those within Government itself. We now wait for this approval to be translated into further action.

Three: as the chief contributor to local government expenditure through our 5 billion pound rate bill, we have fought long and furiously against massive and unjustified increases, we are subjected in business to taxation without representation. So we've created our own representation through over 40 local authority liaison committees which we have set up, and we also represent direct to a minister who recognises the justice of our cause. Michael Heseltine has now committed the Government to a ceiling on industrial rates levied by the big spending authorities, we will be pressing to extend this ceiling over much wider areas. To other local authorities whether they are big spenders or not.

Four: we thought that certain energy charges in 1980 were not competitive, so it was we in the CBI who initiated a working party in the NEDC which successfully sought agreement on the facts. This group continues to operate actively. The Budget brought a £170 million package of relief on energy costs which was welcome, but nothing like enough so we have insisted on a review of the up-to-date situation on the table for discussion at the NEDC meeting next week.

Five: a year ago we were a lone voice on the inequity and indeed the iniquity of NIS, as a tax on exports, and a tax on jobs. We now have a chorus of support which extends into the Cabinet itself. It is stated that the Chancellor fears a reduction of NIS might be absorbed in higher wage rates. Let me here and now disabuse him.

In my company, the abolition of NIS would increase my UK profits by no less than 20 per cent of the total earned in the UK and I give him my guarantee here and now that that money would be spent <u>not</u> on higher wages, but on investment to create new jobs and to preserve those already in existence. And I'm sure all of you in this hall will give the Chancellor the same guarantee.

Six: interest rates. The timing of the four per cent rise in the last month is tragic. We should not forget for many months in this year we have enjoyed interest rates which compared favourably with our competitors. And the Prime Minister herself has reminded me more than once that they came down 2 per cent in the month after last year's CBI Conference, a further 2 per cent at the Budget, and 5 per cent during the year overall. I know that Government understands the gravity of this reversal and has publicly affirmed the continued reduction of interest rates is part of its avowed policy. We will see this affirmation remains at the forefront of their thinking.

Seven: our Smaller Firms Council has carried the entrepreneurs' case into every corner of Whitehall and Westminster. It has made proposals for a new deal for investment in new and smaller companies, which the Government has gone a long way to meet in the 1981 Finance Act.

It has made recommendations for improving Government services to and promotion of the smaller firms sector, and these are already being reflected in government action.

It has worked to ensure the improvement of many sections of the 1981 Companies Bill to meet the special problems and needs of small firms. All this and more is detailed in the new edition of "Smaller Firms in the Economy" which the CBI published last week - a unique collection of vital information about a vital sector of the economy.

Eight: the payment of sickness benefit. We have worked on this problem for most of the last year and have been supported by evidence from many sector organisations. We have pressed our case at all levels including an exchange of letters with the Prime Minister. We heard two weeks ago that a 100 per cent reimbursement of the cost of transferring to employers the payment of sickness benefit in the first 8 weeks of sickness, is now accepted. We are happy to co-operate in a system which will put into practice the principle of less government bureaucracy on which we are all agreed.

Nine: we have worked hard to stem and then reverse the escalating imbalance of our trade with Japan. The deficit is now running at an annual rate which is more than 30 per cent up on last year's £1.1 billion, and last year was 25% up on the year before. Japanese imports in the narrow sectors of motorcars, electronics and machine tools are a particular problem. But it doesn't stop there. Other sectors such as shipbuilding are also affected and access to the Japanese domestic market needs to be dramatically improved. This battle continues and we shall not be found wanting.

Ten: we are making every effort, and this Conference will help us, to educate the nation on the stupidity and futility of even contemplating secession from the EEC. To believe we can replace nearly half of our exports, which is about one sixth of all we make, to a market on our doorstep with no tariff barriers, by distant, deepsea markets with expensive lines of distribution and often high tariff and non-tariff barriers, is an arrant nonsense which could affect up to two million jobs. To those who wish to secede because of the bureaucracy of Brussels, I say what we said to the half-dozen CBI members who left us after the last Conference. If you have a disagreement with an organisation to which you belong, don't walk out and achieve nothing, but get stuck in and do something about it.

I believe this record is a tribute to all those who work for and in the CBI and it is also a tribute in many ways to a Government which is often accused of not recognising the problems of industry.

And so we turn to the next two days and with it our actions for the next twelve months. "People" this morning - pay, unemployment and the law - "Trade", when we look outwards this afternoon, and "The Economy" tomorrow, when we come to the culmination and the climax of nine months debate and gestation which began with "The Will to Win", the strategy put forward at the beginning of this year.

You will have to decide the priorities for action.

In our forthcoming debates there are three priorities which I would like to bring to your notice.

First pay. Pay is at the very root of this word competitiveness. I said in the summer that if I take my own company's extra costs of increased local rates, increased energy costs, and higher interest rates and add them all together, they amount to about 10 per cent of my total wage bill for the year. The fact is that for most of us, pay is paramount... and in an age of low growth and high competition the level of settlements will make or break many businesses.

Pay is also the very root of inflation. Now I am not in the camp of forecasters and commentators who say that now inflation is down to about 11 per cent it cannot go lower and may even return to between 12 and 14 per cent. Why should it? If we faced reality, with the real profit position of British industry at between two and three per cent before tax and interest we would pay either nothing or close to it. If we continued as we should in this way for the next three years, our inflation rates would be down to those of the Japanese and Germans and we would be nearer to being competitive than ever before. It is our job, and above all else our job, to make the twenty odd million people in jobs really understand that the major cause of having three million not in jobs is because for five years they have been paid more for less and less output. The quickest way back to competitiveness, prosperity, and the reduction of that three million out of work, is for the 20 million in work to receive increases, if not nothing at least not more than those of our German and Japanese rivals and positively no pay increases unless backed by increased productivity.

And we can only make this message stick if we get comprehension. Whether we get comprehension depends on involving our employees in understanding the performance of businesses - above all else on the people in this room.

Second, unemployment. One cannot over-estimate the deep despair and misery, not only of young people, but of men and women in their prime who have got up and gone to work each morning for 30 years and are now not able to do so. This is a deep, social, divisive issue. But it can't be solved by social solutions. It can only be solved, again, by competitiveness and economic performance. As I have said before, three times in the post-war world we have had a three to four per cent growth in production for three to four years with no more than three to four per cent inflation and each time nearly a million new jobs have been created. Growth without inflation is the answer and how we begin to achieve this is what must be debated, turned over and contested at this Conference over the next thirty-six hours.

Turning to the young people, adversity could give us, if we siezed it, an opportunity for radical reform and the creation of a new national system of training and work experience for all school leavers for varying periods according to their skill. To succeed, this must incorporate the best features of present apprenticeship training and this must in turn mean full blooded, unconditional involvement of the trade union movement. The unions cannot be outraged at youth unemployment and then back off support of this new initiative because they don't agree with the economic policies of the Government. I appeal to them to rise above party politics, to back this new initiative of the Manpower Services Commission. We back it here and now in this Conference in the interests of all young people in every part of the community regardless of their political persuasion or indeed of ours.

Finally, public expenditure. The Cabinet is in the throes of its annual trauma over the control of public expenditure and once again, because of overspending sometimes for reasons beyond their control, they are wrestling to find reductions. And again they centre on policies instead of doing what businessmen would do instinctively, which is to ask whether the money is being spent efficiently in the first place. Their debate should not be on how can we reduce defence, can we abandon the indexation of unemployment benefit, and even, can we make people pay for state education. It should be to recognise that we employ 4¼ million people in central and local government - as a percentage of all people in work about 25% higher than the average of other industrial countries.

We have a national expenditure bill of about £120 billion, and over £34 billion is on the cost of people whom Government employs. The debate, and indeed the action, should not just be on policies but to do with people, their pay, which Government is tackling, and manning levels and pensions, which by and large, they are not. We have said, and will continue to say, you have forced us to become more efficient and some of us have even exceeded our own expectations. One of my directors assures me that following the changes which have been achieved in the last few years, a fifteen per cent increase in his UK volume back to the level of 1979 would give him 50 per cent more profit and that profit would mean more investment and more jobs. I find that vastly encouraging.

But it also encourages me to say to Government you have forced us to put our house in order, will you please now do the same with your own. If over four years you were to replace only one in two of your support staff, not the doctors, not the dentists, the soldiers, the sailors, the nurses, the teachers, the ambulancemen, but the support staff. If you replaced, without any enforced redundancy, only one in two of those who retire or leave voluntarily and make all public servants pay a fair price for their pensions, you would have at your disposal £3 billion to cut business costs and or transfer revneue expenditure to capital - a policy which the Chancellor himself endorsed at the Conservative Conference one month ago.

We say to the spending Ministers in the Cabinet, to the Permanent Secretaries who are already achieving results in this direction, and most of all to those who manage the National Health Service, and Local Government offices, we have done our stuff, please now get on and do yours, and please hurry up because it is we who locally and centrally more than any other sector of the community are having to pay for it.

And so to our debate. Last week's Press called us little grey men in appalling suits who bound up to the rostrum for a brief moment of electronic glory. They got it wrong, you know. It is the electronic glory which frightens the life out of most of us. We don't even measure men by their Savile row suiting. We don't even measure them by whether they can sway this Conference. We measure them by their track record and what they achieve. We also measure this Conference by its track record and what it achieves and we measure the CBI by its track record and what it achieves. We know in

SUBJECT

CONFIDENTIAL

file AB

10 DOWNING STREET

cc Master

From the Private Secretary

2 November 1981

Sir Ray Pennock called in to see the Prime Minister during the afternoon of 30 October, to outline the main points of the address he will be making to the CBI Annual Conference; and for a general discussion.

He said that the main thrust of his speech would be concerned with pay. He continued to believe that moderation in pay increases in the forthcoming round was the key to the defeat of inflation. He was considering floating the idea that employers and employees should by agreement decide to forego any pay increases for the next 12 or 24 months. He intended to reiterate his earlier calls for a reduction in the totality of public expenditure and, within the global figure, for a shift from current revenue expenditure to capital expenditure. He would also urge cuts in public sector manpower, and a cut in the National Insurance Surcharge. He intended to argue that 1½-2 million jobs would be at stake if we withdrew from the EEC. He also felt strongly that this was a particularly good moment for the Government to push ahead with trade union reforms - on the abolition of the closed shop and on the removal of immunities where unions are involved in strike action in breach of contract.

In the discussion on trade, which was to take place on Monday afternoon, he expected that there would be a good deal of pressure to take action against Japanese imports. He himself had a good deal of sympathy with this.

Sir Ray asked the Prime Minister's advice on how he should deal with the pressure he expected to face for an addition to the borrowing requirement of £1-1½ billion - the effect of abolishing the National Insurance Surcharge, and also of mounting increased capital projects of various kinds (like the Channel Tunnel and rail electrification). The Prime Minister answered by reference to the upward pressure which this would bring to bear on domestic interest rates.

I am sending copies of this letter to Ian Ellison (Department of Industry) and John Rhodes (Department of Trade).

M. C. SCHOLAR

J. O. Kerr, Esq.,
H.M. Treasury.

AB

CONFIDENTIAL

1.

PRIME MINISTER

SIR RAY PENNOCK

Sir Ray Pennock saw me earlier this week to outline the main points of the address he will be making to the CBI's annual conference which begins on Sunday 1 November.

He will, as before, say that the first priority must be the defeat of inflation. As a key part of that battle pay increases in the forthcoming round will have to be very low. He will stress that many companies in the private sector will not be able to increase the pay of their employees at all in the next twelve months, and he will therefore go on to emphasise the need for no more than small increases in the public sector and to welcome the Government's pay factor of 4 per cent.

He will also reiterate his earlier calls for a reduction in the totality of public expenditure and, within the global figure, for a shift from current revenue expenditure to capital expenditure. Again, repeating a familiar theme of his, he will urge cuts in public sector manpower, drawing comparisons with the much steeper run down in the private sector.

He will also return to the charge about a cut in the national insurance surcharge.

There was one particular point about his speech over which he was hesitating. The economists at the CBI are arguing that the PSBR should be put up by one to one and a half billion pounds. These extra resources should go into capital projects (like the Channel tunnel and rail eletrification). They claim that because some 15 per cent of the capacity of manufacturing industry is at present unused, a sum of this size could be absorbed without any inflationary effect: since existing capacity would be used, there would be no question of paying higher wages or raising prices. Sir Ray said that his people were urging him strongly to develop this proposal in his speech. He had discussed it with the Chancellor who had told him that the Treasury economists took a different view from their CBI colleagues and thought that such a step would be inflationary.

/the

I said to Sir Ray that it seemed to me that/most obvious risk of this proposal was that if the extra money was not to be found by additional taxation - and plainly that would not be something the CBI would recommend - , it would have to come from increased borrowing and this would be very likely to push up interest rates higher than they would otherwise have been - and that presumably was the last thing the CBI would want.

Sir Ray acknowledged my objection and said that in the light of our conversation he would mention the idea in neutral, non-committal terms as an idea with advantages and disadvantages, if he touched upon it at all in his speech.

Finally, he said that he would include a passage arguing strongly against the Labour Party's line on withdrawal from the Community, particularly because of the employment effects of withdrawal and what would be the very great difficulty of trying to find alternative markets; and a warning that if the Japanese did not very soon begin to match their words about restraint in their exports with deeds, Community governments would have to impose import controls.

At the end of all this Sir Ray said that he would find it very helpful if he could see you for half an hour before he goes to his conference (there is no doubt in my mind that it helps him enormously with his membership if he can tell them that he sees you regularly). I have therefore provisionally arranged for him to come in at 1615 on Friday 30 October. May I confirm this time please ?

Yes mt

AAW.

23 October 1981

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Raymond Pennock
President

CONFEDERATION OF BRITISH INDUSTRY

22nd October 1981

Dear Clive,

In view of the date which you have kindly arranged on Friday 30th October at 4.15 p.m., I thought it worth while to send you a copy of the background papers to the nine debate sessions we are having at Eastbourne. It is early days but they have, so far, had a very good reception.

You will see from them that Conference discussion splits itself into People (issues 1-3) on the Monday morning; Trade (issues 4-6) on the Monday afternoon; and the Economy (issues 7-9) on the final Tuesday morning. I would propose to give the Prime Minister the highlights of each of these sessions at our meeting.

Best wishes,

Yours sincerely,

Ray.

C.A. Whitmore Esq.,
Principal Private Secretary to the Prime Minister,
10 Downing Street,
London, SW 1.

PRIME MINISTER

After reading John Sparrow's latest letter, you asked whether the CBI analysis on public spending had been drawn to the attention of Departments and whether they are taking heed.

The Chancellor has already written in about this and has confirmed that the Chief Secretary will be having discussions with the main public spending Departments on the CBI's proposals. I have particularly asked the Chief Secretary to bear in mind what the CBI have to say about manpower.

21 September 1981

cc Mr. Wolfson
Mr. Walters
Mr. Hoskyns - O

MR. DUGUID

Thank you for your note of 16 September about the CBI Report on Government expenditure. I do not think that the Prime Minister can really get into questioning Government departments on the CBI proposals: we have to leave this to the Treasury. As you will see from the Chancellor minute (copy attached), this is what the Treasury will be doing - and the Prime Minister has asked the Chief Secretary to look particularly at manning levels.

I. P. LANKESTER

18 September 1981

cc CDL
DOE
D/M
DHSS

HL

10 DOWNING STREET

From the Private Secretary 18 September 1981

Returned for retention to Policy Unit. 23/9/81

The Prime Minister was grateful for the Chancellor's minute of 17 September on the CBI Report on Government expenditure. She has noted that the Chief Secretary is arranging to examine the Report in detail over the next few weeks with colleagues primarily concerned: she hopes that he will look especially at what the Report has to say about manning levels.

I am copying this letter to Jim Buckley (Chancellor of the Duchy of Lancaster's Office), David Edmonds (Department of the Environment), Richard Dykes (Department of Employment) and Don Brereton (Department of Health and Social Security).

T. P. LANKESTER

Peter Jenkins, Esq.,
H.M. Treasury.

Prime Minister

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R

17/9

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

PRIME MINISTER

CBI REPORT ON GOVERNMENT EXPENDITURE

Sir Raymond Pennock invited me to pass on to you the CBI's Report (published yesterday) on ways of reducing Government current expenditure. My office sent yours a copy yesterday.

2. The recommendations are ambitious, with a target of some £3 billion savings on public service manpower costs, from a range of suggestions totalling £4-5 billion. Rather over half the total arises on pay, on which the CBI expound their judgement that public service pay levels, far from having fallen behind the private sector, have over the last decade as a whole gone ahead, and on pensions, where they seek both limitation of inflation-proofing and higher employee contributions. The remaining savings would come from manpower economies, primarily in the local authorities and National Health Service.

3. Much of the material in the Report is not new, and some of the recommendations are already being adopted, attempted or considered. But the CBI have put a good deal of effort into the supporting evidence and arguments for their recommendations, and I believe we should study the material seriously and make the maximum use of it.

4. The Chief Secretary is arranging, with colleagues primarily concerned, to examine the Report in detail over the next few weeks.

— Especially the manning levels.

MS

/I am copying this

5. I am copying this minute to the Chancellor of the Duchy of Lancaster, and the Secretaries of State for the Environment, Employment and Social Services.

G.

(G.H.)

17 September 1981

cc Mr. Wolfson
Mr. Walters
Mr. Hoskyns O/R

MR. LANKESTER

CBI REPORT ON GOVERNMENT EXPENDITURE

1. On the whole, the CBI's report is a welcome source of outside pressure and publicity for the case for tighter control over the public sector. Of course, as the report acknowledges, the Government does not directly control large chunks of the public services where the CBI would like to see manpower reductions. CBI highlight some interesting comparisons of costs and manning between areas in the health service, the library service, local authority planning departments, etc.

2. It seems to me that the report provides an opportunity for the Prime Minister to ask relevant departments - principally CSD, Environment, DHSS, DES - for a response to the CBI proposals. Do you think this would be worth while?

(Copy enclosed for reference.)

AD

16 September 1981

ANDREW DUGUID

UK NEWS

CBI calls for £3bn to £5bn public services cuts

John Elliott on industry's look at government spending

SAVINGS of between £3bn and £5bn a year in Government expenditure should be made by cuts in public service manpower, pay and pensions, according to a report published yesterday by the Confederation of British Industry.

Further savings should be made by examining 25 other areas for economies including rationalising the work of the Employment Department and its a gencies, cutting Defence Ministry bureaucracy, and rationalising regional industrial development agencies.

Part of the major savings would come from a 10 per cent cut in the 4.2m-strong workforce of public services such as local authorities, the national health service, and other agencies. This would be done by recruiting only one person for every two employees leaving "non front line jobs." It would save £3.5bn in 1984-85, or about £2bn more than is implied by present Government plans.

A further £2.25bn to £3bn should be saved by adopting "more sensible arrangements for public service pensions and by correcting the substantial excess of public sector pay relative to that of the private sector." This would include cutting index-linked pensions and reviewing incremental pay scales.

The report says that further considerable savings are possible by making more use of commercial charging for services, and introducing other economies.

An initial target of £3bn savings should be set to allow for "unforeseen difficulties" that would emerge as the cuts programme swung into action.

The CBI wants the money saved to be used for capital projects such as the Channel tunnel, road building and sewer replacement. It estimates that the empolyment generated in productive industry would more than compensate for the 100,000 administrative jobs which would be lost.

Sir Ray Pennock, CBI president, said yesterday when he launched the report: "We are not just outsiders commenting — we pay the ruddy money."

The CBI which believes the Prime Minister has not pushed hard enough for cuts is calling on the Government to adopt a business-like approach to its spending. It says that private sector companies have been forced to adopt such an approach in order to survive the recession.

"The CBI and its member companies did not think 18 months ago that the sorts of cuts they have had to make in their organisations could be done without disrupting the service they provide," said Mr Malcolm MacAlpine, a director of Sir Robert MacAlpine and Son, who headed the working party which produced the report. But they had discovered that it was possible, and the Government should now do the same.

"The experience of private business shows that blunt instrument approaches are the only way in which the necessary rapid reductions in manpower and improvements in efficiency can be effected," says the report.

The report has been sent to the Prime Minister and Cabinet members. CBI members will be urged to discuss with their local councils how it can be implemented. It will also be examined by 45 regional liaison groups set up in the past few years by the CBI with local authorities.

Only two events clouded the launch of the report yesterday. The first was the resignation two months ago of Sir Leo Pliatzky, former senior civil servant, from the job of advisor to the CBI working party. He said he did not believe the CBI's approach to cutting Government spending was practical.

The second was a note of reservation added by Mr Terence Higgins, Conservative MP for Worthing, and a member of the working party. He said he believed that "further work" should be done before pension benefits were cut. He also wanted the CBI to develop more specific policy proposals.

On general economies the CBI wants: more services contracted to outside companies; more competitive tendering for contracts; a clear deliniation longer-term of locally and nationally determined local council spending; more management cost information and management auditing; more detailed scrutiny of expenditure; and the encouragement of zero-based budgeting.

In an appendix to the report, 25 ideas are listed for savings put forward by its individual members which the CBI believes should be considered.

They include rationalising the employment, manpower and training services of the Employment Department, the Manpower Services Commission, industrial training boards, the careers service, and the Office of Manpower Economics.

There should also be "reduced bureaucracy in Ministry of Defence procurement." Procedures and contracts could be simpified according to several CBI members.

Merger or rationalisation of regional departments and development agencies—particularly in Scotland, Wales and Northern Ireland was also proposed.

Another idea is to charge "hotel fees" of £20 a week in hospitals to generate £250m a year.

"The CBI will offer its services to the Government or to any local authority to help find businessmen who can offer their experience to assist in achieving economies that will result in greater efficiency," says the report.

Report of the CBI Working Party on Government Expenditure. CBI, Centre Point, London, WC1. Price £5.

file MFS 11/9
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President's Dinner of CBI

10 DOWNING STREET

THE PRIME MINISTER

10 September 1981

I am very grateful to you for arranging yesterday evening's dinner.

I found it most valuable to hear at first hand how you and your colleagues see the major economic and industrial problems we are all facing, and I was encouraged by the support you expressed for the policies which the Government is pursuing in seeking solutions to those problems.

I am grateful to you too for making the occasion so relaxed and informal. I am sure that this contributed in no small way to making our discussion so open and constructive.

Sir Ray Pennock.

BK

Confederation of British Industry
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Telex 21332
Telegrams Cobustry London WC1

From
Sir Raymond Pennock
President

R 11

CBI
CONFEDERATION OF BRITISH INDUSTRY

10th September 1981

Box

Dear Prime Minister,

Thank you very much for taking the time to dine with us yesterday evening in the middle of an especially busy week. We greatly appreciated the opportunity of having such a frank and open discussion.

All of us were tremendously impressed with your grasp and in-depth knowledge of every subject which was raised and it was also encouraging to hear you spell out the areas where we can give you support in achieving the objectives which we all share. My colleagues found the occasion enjoyable and rewarding and all of them asked me to convey their appreciation to you.

Yours sincerely,

Ray Pennock

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister,
10 Downing Street,
London, SW 1.

MT

DINNER PARTY GIVEN BY SIR RAYMOND PENNOCK, PRESIDENT OF THE CONFEDERATION OF BRITISH INDUSTRY IN HONOUR OF THE PRIME MINISTER, ON WEDNESDAY 9TH SEPTEMBER 1981 AT 7.30 for 8.00 P.M., AT 8 SMITH SQUARE, LONDON SW 1

Sir Raymond Pennock (Host)	President, CBI Chairman, BICC Limited
The Rt. Hon. Margaret Thatcher, MP	Prime Minister
Mr. C.A. Whitmore	Principal Private Secretary to The Prime Minister
Sir Adrian Cadbury	Chairman, Cadbury Schweppes Limited.
Mr. J.A.S. Cleminson	Chairman, CBI Economic Situation Committee Chairman, Reckitt & Colman Limited.
Sir Campbell Fraser	Deputy President, CBI Chairman, CBI Industrial Policy Committee Chairman, Dunlop Holdings Limited.
Sir David Orr	Chairman, Unilever Limited.
Mr. R.E. Utiger	Chairman, CBI Economic & Financial Policy Committee Managing Director, Tube Investments Limited.
Mr. P.I. Walters	Deputy Chairman, The British Petroleum Company Limited.

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From
Sir Raymond Pennock
President

CBI CONFEDERATION OF BRITISH INDUSTRY

Private and Confidential

2nd September 1981

Mr Whitmore

Dear Caroline,

Further to my letter of 21st August, I am writing to let you know that unfortunately Sir Terence Beckett is at present unwell and will not now be able to attend the dinner party on Wednesday 9th September.

Sir Raymond Pennock has invited Mr. James Cleminson to attend. Mr. Cleminson is Chairman of Reckitt & Colman Limited, and Chairman of the CBI Economic Situation Committee.

Yours sincerely,

Beatrice Gilpin

Personal Assistant to
The President

Miss C.M. Stephens,
Personal Assistant to The Prime Minister,
10 DowningStreet,
London, SW 1.

PS I am attaching a list of those who will be present.

~~MR. RICKETT~~ Mr Whitmore
X is attached: PM has seen.
WR 28/8

Dinner with CBI: Wednesday, 9 September

This engagement is confidential, and should not appear in the diary. They will be X/ sending you a guest list over the weekend. There will be only 9 people in total, including the Prime Minister and Clive. I have arranged for dinner for the detective and driver, and should you wish to speak to anyone at the CBI about this engagement, please ring Linda Turner. No one else at the CBI knows that the dinner is taking place.

C.S.

21 August, 1981.

Confederation of British Industry
Centre Point
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Telephone 01-379 7400
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Telegrams Cobustry London WC1

From
Sir Raymond Pennock
President

CBI CONFEDERATION OF BRITISH INDUSTRY

Prime Minister 2
for information.
WM 20/8

Private and Confidential

21st August 1981

Dear Caroline,

I am writing to confirm the arrangements for the private dinner party which Sir Raymond Pennock is giving on Wednesday 9th September. The dinner party will be held at 8, Smith Square, London, SW1. at 7.30 for 8.00 pm.

Sir Raymond will be accompanied by Sir Terence Beckett, and the other guests will be:

Sir Adrian Cadbury	Chairman, Cadbury Schweppes Limited
Sir Campbell Fraser	Deputy President, CBI Chairman, Dunlop Holdings Limited.
Sir David Orr	Chairman, Unilever Limited.
Mr. R.E. Utiger	Chairman, CBI Economic & Financial Policy Committee; Managing Director, Tube Investments Limited.
Mr. P.I. Walters	Deputy Chairman, The British Petroleum Co. Ltd.

I understand that the Prime Minister will be accompanied by Mr. Clive Whitmore, and I have arranged for her Private Detective and Driver also to have dinner at Smith Square.

Yours sincerely,

Beatrice

Personal Assistant to The President

Miss Caroline Stephens,
Personal Assistant to the Prime Minister,
10, Downing Street,
London, SW 1.

P.S. This confirms our telephone conversation this morning - no reply expected to this letter.

week 9/9
19.30 hrs

Please file
cl. 518

Mr Stephens.

I have spoken to Sir R. Pennock. The names below are those who will be at the dinner. I have mentioned them to the Prime Minister. She is content.

[initials]
4 viii

MR WHITMORE

Sir Raymond Pennock telephoned (11.15): he would like a few minutes with you on the telephone, preferably before 1.00 pm since you are going on leave at the end of today.

If you cannot ring him before 1.00, he will try to ring you again later this afternoon - he sees Lord Carrington at 4.00 pm, so will try from about 5 onwards.

He just wants to talk about the meeting arranged for early September - those attending etc. etc.

AH

4 August

Orr - Unilever

Walters - BP

Fraser - President CBI - designate

Cadbury - Cadbury Schweppes.

Utiger - Tube Investments.

Beckett.

Pennock

CBI

1979

9 July	Delegation President, Chairmen of Committees	PUBLIC
14 December	Sir J Methven	PRIVATE

1980

9 January	NEDC	PUBLIC
5 February	Sir J Methven	PRIVATE
2 June	Sir R Pennock and Sir J Greenborough	PRIVATE
4 July	Sir R Pennock	PRIVATE
[illegible] September	Sir R Pennock	PRIVATE
12 November	Sir T Beckett and Sir R Pennock	PUBLIC

1981

2 February	Sir T Beckett and Sir R Pennock	PRIVATE
4 February	NEDC	PUBLIC
13 March	Sir R Pennock and Sir T Beckett	PUBLIC
12 May	Sir R Pennock and Sir T Beckett	PRIVATE
16 June	Annual Dinner CBI	PUBLIC
[illegible] September	Informal dinner with CBI	PRIVATE
30 October	Sir R Pennock	PRIVATE
2 December	Sir R Pennock	PRIVATE

1982

3 February	NEDC	PUBLIC
9 February	Sir R Pennock and Sir T Beckett	PRIVATE
6 July	Sir Campbell Frazer	PRIVATE
25 October	Sir Cambell Frazer	

PUBLIC MEETINGS 7 (Including NEDC)

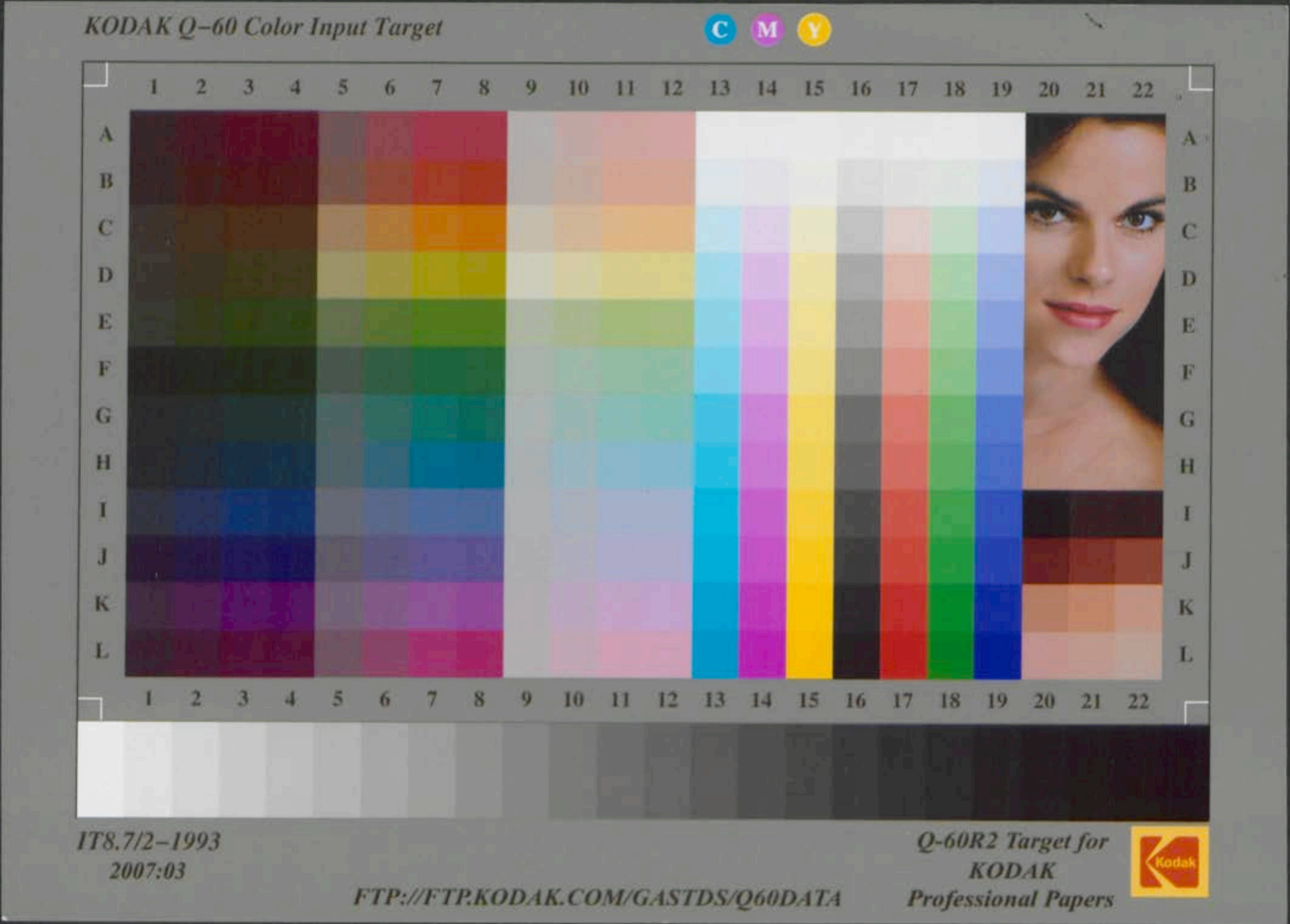
PRIVATE MEETINGS 14

PART 2 ends:-

WR to Linda Turner 7/7

PART 3 begins:-

A. Walters to CAW.


KODAK Q-60 Color Input Target
C M Y
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22
A B C D E F G H I J K L
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