



2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

14 August 1980

Mr. Sen

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Dear Chancellor

14/15

It was agreed at Cabinet on 10 July that after consultation with colleagues you would circulate a paper setting out options for further measures of industrial support. I have been giving some thought to what we might do to give support to the construction industry. All the forecasts are pointing to a drop in construction industry output over the next two years. Anything which we can do to provide a boost which is compatible with our overall approach to economic and industrial issues would help to maintain a healthy industry and to ease unemployment. I see three main possibilities.

INDUSTRIAL BUILDING ALLOWANCES

We could raise allowances for industrial buildings from 50% to 100% in the initial year, giving parity of treatment with plant and machinery. This is an issue on which, as you know, the industry has campaigned for a long time. We are now making 100% initial allowances available for both industrial and commercial buildings in enterprise zones, and there is a good case for extending this, at least for industrial buildings, to the country generally. The attraction of the measure seems to me that it would have a positive effect early on, without any loss of revenue in the long-term. I believe that officials have estimated the take up of such a scheme as costing virtually nothing in the first year of operation, £140 million in the second year, reaching a peak of £250 million in the fourth year and then tapering back to nothing in the mid-90s. Such a step would assist manufacturing industry by providing an added inducement to improved efficiency through investment in new buildings. (This was well demonstrated in the report "Construction for Industrial Recovery" by the Building and Civil Engineering EDCs). And it would assist the construction industry, who would welcome this as a major opportunity to sell their services to the manufacturing sector.

VAT ON REPAIR AND MAINTENANCE

New building work is zero-rated, but repair and maintenance is liable to the standard rate of VAT. This has produced endless anomalies in tax treatment and has encouraged evasion. It has

created resentment and a heavy burden of paperwork, particularly amongst the smaller firms at the lower end of the market, not to mention a thriving commerce in methods of avoidance. To zero-rate repair and maintenance work, though not materials, would have an annual revenue cost of about £120m. This is less than 1% of the net take of VAT, and it seems to me that we would have a good case for arguing in the context of European Community obligations, that this is not a significant extension of the existing situation. Such a step would also give a welcome boost to our policies of encouraging responsible homeownership and promoting the rehabilitation of old housing. It would also directly assist manufacturing industry, as well as helping the very small firms in the construction industry (around 90% have less than 14 employees) and relieving them of unnecessary paperwork.

STOCK RELIEF

Perhaps we could also consider again the stock relief provisions. I realise that these arrangements have been revised in the last two Budgets, and have implications beyond the construction industry itself. But a reduction in the clawback period from six years to four years would directly assist building material producers and suppliers, especially small firms and would involve a tax cost of no more than £25-50 million.

I am copying this to members of the Cabinet and Sir Robert Armstrong.

Yours sincerely
Paul Bunsell
(Private Secretary)

MICHAEL HESELTINE
(agreed by the Secretary of
State and signed in his absence)



15 AUG 1980



2 PAM
PRIME MINISTER

2 MARSHAM STREET
LONDON SW1P 3EB

To see both

letters: further

My ref:

Your ref:

Suggestions for
softening the impact
of the squeeze

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MS
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Dear Chancellor

I have sent to you today a letter about help for the construction industry in connection with the exercise you are doing on industrial support about which you wrote to me on 22 July. It says sensible things that come from my departmental standpoint.

I have also read Keith Joseph's letter of 8 August, which contains many ideas that are designed to help.

I felt however that I must come back to the basic starting point which I have pursued now for 2½ years. Profits of business are bearing the brunt of our monetary policies - and no early relief is in prospect. In that climate, retrenchment is bound to be the order of the day. Only exceptional measures have any chance of persuading business to do what all the economic conditions make extremely difficult.

The general palliatives now being considered will in the main go to bolster cash flows and prevent even further retrenchment. They will be spread too thinly fundamentally to alter the business outlook. The more specific may help lop the peak off unemployment, but only by the direct use of more public expenditure.

I have come to the conclusion that the only way to secure the kind of long-term profitable investment we want in advance of the market's improvement is to devise schemes that are quite precisely directed at the target - the risk-takers in society who are in a position to make that kind of investment. So I continue to attach overriding priority to the ideas now being worked out by FASE which effectively rebate taxation to those that will undertake investment.

I do recognise that you have already in your two budgets done much that will improve conditions for entrepreneurs once the economy is moving again. I hope that you will apply whatever resources we decide to commit to this area to schemes involving direct tax rebate with time limits to ensure that they operate in advance of the upturn.

Copies go to the recipients of Keith's letter.

Yours sincerely
Paul Bonsor
(Private Secretary)

MICHAEL HESELTINE
(dictated by the Secretary of State and signed in his absence)

15 AUG 1980

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