



Secretary of State for Industry

Prime Minister

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See para 5 10/11.
Mus 19/2
PA Mus 24/2

18 February 1982

The Rt Hon Sir Geoffrey Howe QC, MP
Chancellor of the Exchequer
Parliament Street
LONDON
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Dear Chancellor

1982 BUDGET

Forgive me for raising two further Budget issues with you further to my letters of 11 December and 26 January, but I think they are important.

2. First the Loan Guarantee Scheme. John MacGregor has only just begun his first, inevitably very interim, review with the banks. In the course of this we have considered the suggestion put forward by the Parliamentary Industry Committee's Study Group on bank lending and raised again at the Prime Minister's meeting last week with Michael Grylls and others of the Industry Committee that the present ceiling of £75,000 on individual loans should be raised substantially, say to £250,000 or £500,000 as they advocate. I do not think that the case for this is made out. The average size of loan guaranteed under the Scheme is only £34,000. Less than 20 percent of loans have been at the £75,000 limit and many of these form part of a larger package comprising commercial loans, equity and overdrafts.

3. The £75,000 ceiling was aimed to cover the small end of the market where we saw a specific need for Government support. Most of the private sector organisations such as the Venture and Development Capital Companies are only interested in larger investments where their administration costs are proportionately less. We would therefore be changing the whole nature of the Scheme and opening it up to many larger businesses, possibly to the detriment of the smaller ones that have benefitted hitherto. Moreover there is already very considerable demand for the Scheme as it stands, so enlarging the scope could mean a very considerable increase of its size or, if we were not prepared to contemplate such a pro rata increase, a possible need for rationing. There are also some aspects of the present Scheme which may in the light of further experience be shown to need



alteration. It would be better to await a more considered review before simply extending the Scheme in its present form by such an increase in ceiling.

4. However I do feel that we will have to take decisions soon about the present ceiling of £150m, which was originally announced for a 3 year pilot scheme. By the end of January, 2,325 guarantees had been issued in respect of £80.1m of bank lending, 80 percent covered by guarantee. In October last year you agreed that the ceiling for the first year of the Scheme should be raised to £100m. At the present rate this will be exhausted before the end of March. If the remaining £50m were to be made available then, it also would have run out by the end of July on present trends. I do not believe that we should wind up this Scheme after only 14 months. I think that now is the time to consider the financial provision necessary for the second year of the Scheme, ie to the end of May 1983.

5. I believe that we have sufficient evidence on the Scheme for you to announce in your Budget Statement that guarantees will be issued at the current rate for another year. The rate of lending has been increasing and I consider that an additional £150m of bank lending (£120m of which would be guaranteed) should be the figure you announce. Unless the economy picks up rapidly, this should be sufficient to cover the greater part of the second year.

6. We must, of course, satisfy ourselves that the objectives of the Scheme are being met and that it is not being mis-used. As I said in my letter to you of 30 September 1981, some important aspects of the Scheme (eg the loss rate) are not susceptible to early review, and will in any case be influenced over time by movements in the economy and in interest rates. John MacGregor has put in hand arrangements for monitoring the Scheme, in conjunction with the London and Scottish Clearing Banks and ICFC. My officials have discussed these with yours. The monitoring exercise is to include a continuing analysis of the statistics and of cohort samples of individual loans, involving contact with the borrower and his bank. John MacGregor has held a meeting with the banks to secure their cooperation. I hope to have the result of the initial survey by early June. At that stage I shall want to consider with you and other colleagues how the Scheme has been shown to have been operating and what changes in its terms and conditions might be desirable.

7. John MacGregor has also had a preliminary discussion with the banks about their views on the Scheme. There was general agreement that the Scheme was on the whole working well and the



banks declared themselves satisfied that the vast majority of loans under the Scheme were genuinely additional to that they might have done in any case. Clearly we will need to test this as part of the monitoring exercise.

8. I suggest that any announcement should therefore be confined to the increase in the ceiling ^{of} £300m and should state at the same time that we are keeping open the possibility that, as the result of the current review, we might see the need to change some features of the Scheme when the first tranche is used up. Our current agreements with the banks relate to a pilot Scheme of £150m, and I think that if we wish, we could change some of the terms before issuing any further guarantees, although it has to be recognised that this would require fresh negotiations with the Clearing Banks. The question of raising the £75,000 ceiling could be considered again then.

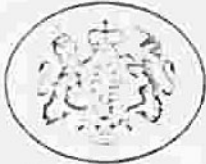
9. An increase of this size in the ceiling for the Scheme would mean that we should need to seek an increase in the overall limit for assistance under Section 8 of the Industry Act 1972. This would require further legislation, but an announcement in the Budget about the Loan Guarantee Scheme would provide a good opportunity for stating our intention to raise the Section 8 limit. We hope to put a paper to E(EA) shortly on this point.

10. The second issue is the Business Start-Up Scheme. I have already suggested to you that the individual investment limit should be raised perhaps to £20,000. I also suggested that further consideration be given to reducing the restrictions which surround the Scheme.

11. Since then there have been two further developments; first, the Parliamentary Industry Committee at the same meeting with the Prime Minister argued strongly that the Scheme needed revision if there was to be substantial take-up, and the Prime Minister responded positively to them; second, we are now beginning to get firmer feedback from major accountancy firms, financial institutions and so on about the extent of the take-up of the Scheme so far, and this tends to confirm the view that it will be very limited indeed this year. In view of the substantial political capital which you and many of us have invested in the Scheme, this is disturbing and I now believe that more needs to be done in the Budget to redress this position.

12. I have the following suggestions to make:-

a. I believe that consideration should be given to raising the limit to £25,000 or even possibly £50,000. This may be necessary to attract sufficient individual investors investing directly; without an incentive on this scale they may not be willing to contemplate the considerable



administrative and legal work in setting up a scheme, as well as the risk; and I have had it argued to me that once a major individual investor comes in others would be prepared to top-up on his assessment. A higher level might also attract in more intermediaries to act as "brokers"; at present there seems to be insufficient scope for them within the Scheme to cover the administrative and other costs of setting up individual arrangements.

b. There have been some criticisms that the Inland Revenue are reluctant to advise on "hypothetical" marginal situations and that this may again deter potential investors. I am sure that inspectors have been instructed to cooperate fully in answering queries and I appreciate, and understand, the reluctance of officials to give categorical advice in advance of an established set of facts. However I do feel that a complex new relief of this nature deserves a rather special approach and I would urge that inspectors be asked to refer any difficult questions to the appropriate technical division and that the clearest possible advice should be given speedily to potential applicants for the relief.

c. Quite apart from the complications and uncertainties, there are particular difficulties in relation to getting schemes off the ground in this current financial year. Effectively the Scheme only came into operation almost half way through the year, and with the inevitable time it takes to locate suitable start-ups and arrange matters, many potential investors are likely to find that they will be unable to claim relief in 1981/2. This is also a particular difficulty for the approved funds, and on present evidence it is likely that only a small proportion of their funds already invested will be eligible for tax relief by the end of the year. This could produce unfavourable publicity at that time, and thus create a further disincentive to potential investors. In order to overcome this, I would like to suggest a facility to carry forward unused relief. This could either be for one year or alternatively it seems to me entirely within the spirit of our intentions that an investor who has not previously had relief should be able to claim the combined relief for all three years of the Scheme in the third year. Should we later decide to extend the Scheme beyond three years, you might wish to consider applying some form of cut-off to the carry-forward facility. But in the meantime I believe it would significantly improve both the effectiveness and reputation of the Scheme.



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13. I have set out some rather specific proposals here, but I would also like to reiterate the general point which I made in my letter of 26 January - that British companies are in a weak position to face a difficult future. The latest index of production statistics, which show declining output in the last two months of 1981 indicate how fragile any recovery is. It is, in my view, of the greatest importance that the Budget should as far as possible concentrate on measures which help and strengthen industry, most of all by cutting their costs.

14. I am copying this letter to the Prime Minister, the Lord President, the Secretaries of State for the Environment, Scotland, Wales, Trade, Social Services, Energy and Employment and to Sir Robert Armstrong.

Yours sincerely,

Jonathan Spencer

MP

PATRICK JENKIN
(Approved by the Secretary
of State and signed
in his absence)