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See meeting notice 8 1 81

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, HM TREASURY AT 4.15 PM ON THURSDAY, 8TH JANUARY, 1981

Present:

Chancellor of the Exchequer (in the chair)
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Mr. Ryrie
Mr. Middleton
Mr. Battishill
Mr. Monck
Mr. Unwin
Mr. Griffiths
Mr. Pirie
Mr. Cropper

Deputy Governor (Bank/England)
Mr. Walker (Bank/England)
Sir Lawrence Airey) Inland Revenue
Mr. J. Isaac)
Mr. A. Phelps (Customs & Excise)

The meeting was held to consider whether to tax the windfall profits accruing to the banks as a result of high interest rates and the possibility of taxing financial services. The background to these issues was set out in the two notes by officials attached to Mr. Middleton's minute of 19 December. Minutes from Lord Cockfield of 6 and 8 January were also relevant.

TAXING BANK WINDFALL PROFITS

2. The Chancellor noted that there was a need for additional revenue in 1981-82, and if some of this was to be raised by imposing a levy on the endowment profits of the banks which arose from high nominal interest rates, a decision would be needed very soon so that the enabling legislation might be prepared. The rationale for such a levy was that it would enable the economic rent represented by the difference between current levels of interest rates and the cost to the banks of running current accounts to be shared more widely. The Government taxed other rents in the economy, e.g. those arising from oil and planning consents, and it was legitimate to consider taxing the rent accruing to the banks.

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3. The Financial Secretary, reporting on his discussions with Sir Jeremy Morse, said that Sir Jeremy had clearly argued that the banks would prefer an overt levy to taking over from the Government some of the cost of fixed rate export credit. He had not denied the existence of further taxable capacity. The Chancellor said that it was his impression, from informal conversations with other clearing bank chairmen, that some of the clearers, recognising the considerable pressures which the Government faced, would prefer a more positive response to the Government's suggestion that the banks share in the cost of subsidising export credit. Sir Douglas Wass said that he had formed the same impression from a conversation he had had with the Chairman of the National Westminster Bank, Mr. Leigh-Pemberton. It was noted that Sir Jeremy Morse had argued, in effect, in a letter to the Chancellor, that if the Government were to draw attention to the additional taxable capacity of the banks, this would make the banks' wage negotiations more difficult. Against this, it was highly unlikely that the banks' staff sides were not unaware of the banks' financial position and, per contra, a reduction in the banks' profits, whether as a result of a levy or of cost sharing of export finance, might strengthen the banks' hand in wage negotiations.

4. The case against seeking to raise further revenue from the banks in 1981-82 was that profits, in terms of current cost accounting, would be reduced; that the banks' provisions for bad and doubtful debts would be larger; and that the Government might well want the banks to extend help to companies in difficulty where, on commercial considerations alone, the banks might judge this inappropriate. The Deputy Governor said that the Bank would not want HMG to under-estimate the possible extent of companies in difficulty in 1981-82. The Bank estimated that the additional provision which the banks would be making for reserves this year would amount to about £500 million out of profits of about

£1½ billion. Against this background, a levy of the order of £500 million might, in their view, be a mistake. The Financial Secretary thought that, whilst the pressure on the corporate sector might well, in the event, be intense, it was not possible at this stage to tell and a number of measures, in addition to resiling from seeking further revenues from the banks, could be used to assist the corporate sector. Whilst he agreed with this as a macro-economic point, the Deputy Governor said that the Bank's concern was that a large levy might, both because of a shortage of funds and coolness towards Government, limit the extent to which the banks would be prepared to assist companies where commercial considerations would not justify this. Mr. Walker thought that it was important to bear in mind the need to leave room for the banks to do things which might not in the short term earn them a return, for example taking on variable rate medium-term debt, which would help to improve monetary control. The Chancellor thought that it was important not to be too beguiled by possible developments which might not occur any way. The Financial Secretary thought that whilst the banks' CCA profits would be down, they had rebuilt the ratios of their free reserves to deposits and were therefore in a stronger position this year than last.

5. The Chancellor noted that, in addition to the various schemes for a levy which had been identified in the paper by officials, Lord Cockfield had put forward alternative proposals of denying the banks the relief on net monetary assets (RMA) for tax purposes which SSAP 16 might suggest they be granted, or doubling the rate of the National Insurance Surcharge (NIS) paid by the banks. Whilst threatening to withhold relief on net monetary assets to the banks might have some value, it suffered from a number of disadvantages. It would bring in no revenue in 1981-82; it would be difficult to present convincingly to Parliament and in so doing it would almost certainly be necessary to make reference to the

promised Green Paper on Corporation Tax which, at the time of the Budget Speech, would still be some way in the future; it would almost certainly prompt others to ask whether they would be granted such relief; and, finally, it was not at all clear that giving such relief to the banks would be seriously considered anyway.

6. An alternative to denying the banks RMA might be to hold out to them, on a confidential basis, the prospect of such relief, in order to encourage them to take over some of the cost of fixed rate export credit. Such a measure could however give rise to a net budgetary cost over time, whilst the banks would not be able to present to their shareholders the reason for their initiative on export credit.

7. There were a number of arguments against a discriminatory rate of NIS. In particular, it would only raise about £40 million and would, officials advised, raise considerable administrative and definitional problems.

8. The meeting then considered the various options for a levy identified in the paper by officials. These ranged from a larger, one-off levy, probably retrospective, yielding about £500 million, to a continuing levy related more closely to the notional windfall profits received by the banks as a result of high interest rates and yielding a smaller return. Ideally, any levy should reflect both in timing and magnitude the source of the banks' windfall profits. This pointed towards a smaller continuing levy. There were, however, a number of other considerations which made this unattractive. Schemes involving a continuing levy would be administratively more complex than a one-off levy, and would yield much less in 1981-82, when the need for additional revenue was greatest. A continuing scheme which involved a substantial levy could make it worthwhile to the banks to incur the cost of changing their present policies, for example paying interest on current accounts, in order to avoid continuing to pay the

levy. A continuing levy would reduce the attractiveness of banking based in the UK and would tend to increase the amount of banking carried out in the euro-sterling markets. Larger euro-sterling markets could substantially complicate the task of monetary control. The Deputy Governor said that the US and West Germany had had particular difficulties of this sort and that the Bank attached considerable importance to the need to avoid pushing funds overseas. Mr. Middleton thought that a continuing scheme would not fit easily with developments towards monetary base control. These considerations pointed towards a larger one-off levy on a retrospective basis.

9. The Chancellor noted that the prospective yield from such a levy - about £500 million - was much larger than the saving to public expenditure which would result from the banks assuming some of the cost of fixed rate export credit. The Financial Secretary thought a larger sum could be raised by law than by persuasion and, in political terms, by a one-off than by a continuing levy. Sir Lawrence Airey thought that Sir Jeremy Morse, in rejecting the suggestion that the banks assume responsibility for some fixed rate export credit, might have thought that the Government would feel politically constrained from going for a much larger one-off levy. On the other hand, there continued to be calls from all sections of the House of Commons for some action on bank profits.

10. Having announced a one-off levy, there might be pressure on the Government, particularly if bank profits continued at a high level, to extend the levy. The question arose of how to avoid this. Moreover, the banks would want some reassurance that a one-off levy would indeed be one-off. Sir Douglas Wass noted that on all three previous occasions when one-off levies had been imposed - under Chancellors Dalton, Jenkins and Barber - the levies had been for one year only. There would be advantage in making the enabling power run for one year only.

11. The Chancellor noted that the practical arguments reduced the options to a one-off retrospective levy or securing a voluntary agreement with the banks under which they would assume responsibility for some of the cost of fixed rate export credit. He said, concluding the discussion, that work on legislation to enable Scheme A in the note by officials to be implemented to yield revenue in 1981-82 should be set in hand. The rate of levy and the precise sum to be raised would be decided later, though the latter would be more than £150 million and less than £500 million. If, in the meantime, the banks should decide to adopt the Government's suggestion about export credit the one-off levy could be dropped. He recognised Sir Lawrence Airey's concern that if the banks were to adopt the Government's suggestion they should be encouraged to do this at the earliest possible date, in order that Parliamentary Counsel's time, which was very scarce, could be devoted to the drafting of other legislation. With this in mind, he said he would put the alternatives to the banks at an early date. He further agreed with the Financial Secretary's suggestion that in discussing the issues with the banks, he should meet with a full representation of clearing bank chairmen, present cost sharing of export credit as an alternative to a levy and indicate that the levy would be of the order of two to three times as large as the cost to the banks of sharing in the costs of export credit.

FINANCIAL SERVICES

12. The meeting then considered the taxation of financial services. Mr. Battishill said that a group under his chairmanship had produced an initial report on the possibilities and officials would welcome guidance as to what further work should be done. After a short discussion, it was decided that no further work should be done on the scope for extending VAT in the financial sector, imposing a tax on loans or taxing money transmission. Further work should be undertaken into the possibility of a tax on consumer credit. It was noted that, once the yield of such a tax had built up, its rate could be used to regulate the growth of new consumer credit. Ministers also agreed that the possibility of a tax on non-life

insurance premiums should be examined further.

R.I.T.

R.I. TOLKIEN
12 January 1981

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CHANCELLOR OF THE EXCHEQUER

CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

See note of mtg 12 1 81

SUBJECT	TAXATION OF THE BANKS AND FINANCIAL SERVICES
DATE AND TIME	THURSDAY 8TH JANUARY 4.00pm
VENUE	Chancellor's Room, Treasury/~~No.11/Conference Room/House of Commons~~
PAPERS	Mr Wiggins to Mr Ryrie 29/12 Mr Middleton to Mr Ryrie 19/12 & attached notes.
THOSF ATTENDING	Chancellor CST FST MST(C) MST(L) Sir Douglas Wass Mr Ryrie Mr Middleton Mr Monck Mr Unwin. Deputy Governor ~~Mr Fforde~~ Walker Sir Lawrence Airey Mr Isaac