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Prime Minister (2)

My ref:

Your ref:

5 February 1982

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Dear Chancellor of the Exchequer

I have been considering what measures, if taken now, could be expected to provide a decisive boost to the construction industry, particularly to private sector house-building. I shall be setting out in my paper to E Committee the reasons why I believe priority should be given to these sectors, and I was pleased to note the widespread view of colleagues at last Thursday's Cabinet discussion that some early direct stimulation was needed in this area.

The purpose of this letter is to urge you, as strongly as I am able, to see that any resources that are available in the context of the forthcoming budget are used wherever possible directly to stimulate construction. I would like to see special impetus given to industrial development, to housebuilding and to home improvements, including insulation measures. The latter activities in particular are highly labour intensive and attract a good measure of private finance. If we could find a fixed additional sum for private sector improvement and insulation grants I have ascertained that I could allocate the sums in such a way that they would be used specifically and exclusively by local authorities for these programmes under the aegis of a scheme of national importance. I accept, of course, that this would be an additional public expenditure bid for 1982/3 but one that I think is well worth promoting.

The second initiative I would press for is the proposal which Tom King wrote to you about on 29 December, namely encouragement to the intensive efforts that I and other colleagues have been making over the last few years to get enterprise agencies off the ground. There are now over 50 enterprise agencies operating throughout the country, and another 50 in the process of being set up. They are one of the few examples of genuine partnership between the various sides of industry, local authorities, and central government. I believe that we could significantly develop this creative activity if you were able to allow contributions by larger companies to the enterprise agencies to be tax-deductible. This would greatly reinforce the enterprise agencies' drive to start up new firms and expand existing companies.

The third area where early progress could be made is with the introduction of more generous capital allowances for industrial buildings. I believe that such a scheme should operate on a time-limited basis so as to being investment forward. Given the timelag in the building process a 2-year concession would seem appropriate. Last year you increased the allowance for industrial building from 50% to 75%. I should now like to see a full 100% allowance. The cost of so doing would be negligible in the first year and would rise to about £60m in year two. It also seems inequitable to give no allowance for ware-

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housing, servicing and repair and commercial activity which are equally important in generating employment. I imagine that to extend the 100% industrial building allowance to warehousing and so on would cost very little in year one and perhaps £200m in year two. Similarly a 20% allowance for all commercial building would cost around the same amount (£200m). I am also of the view that we should do all we can to encourage industry to modernise its building and I strongly support the case which the construction industry itself has been making for industrial building allowances to be extended to cover refurbishment.

Fourth, and I suspect that this does not require specific action but rather a whole-hearted commendation in the budget speech, I would like to see far more emphasis given to the benefits of high-gearing public sector programmes for the private sector. I have already launched a new initiative with the 1982/3 derelict land programme and intend to do so shortly with the urban programme; it would be most helpful if you could announce a firm Government commitment to give priority to the promotion of such schemes throughout the public sector. We could invite local authorities and other public bodies to bid for capital allocations on this basis, and give early notice that schemes bid for in this way would begin in 1983/4, which would allow for the further preparation which would be necessary. We could, for example, without in itself prejudicing our public expenditure ceiling, find room to offer (subject to the outcome of our experience in 1982/3) up to £20m of derelict land grant and perhaps £50m of urban programme resources on this basis, which should bring forward significant enhancement from the private sector which up until now has added little to either programme. I shall hope to return to this point in the paper being prepared for E Committee.

Fifth, though not specifically related to housing or construction, I would advocate again the introduction of a tax refund scheme for people setting up their own small businesses. This would operate by way of cash grant which would effectively repay personal tax previously paid by those people who showed they were investing in small business.

Sixth, I also commend for your consideration the attached paper by Michael Grylls' Sub-Group advocating the establishment of a system whereby interest payments of loans for defined industrial projects should be payable net of the corporation tax ultimately deductible in the hands of the borrower.

Seventh, I believe that the scheme recently announced by Chancellor Schmidt, to stimulate capital investment in industry by means of a 110% tax allowance to companies which maintain, or increase by a given percentage, their past level of capital investment, could and should be introduced here. It is very much on the lines that I have discussed with you in the past. Again, a time limit would ensure that investment was brought forward rather than deferred.

Next I turn to housebuilding where I have a number of specific proposals.

#### Stamp Duty

I have no doubt that you will be looking at the various representations made to you about stamp duty. There is a very considerable body of opinion in the private housebuilding industry which would prefer a significant reduction. If you were considering a wider and significant package for housing and construction, stamp duty changes could play a part. But I do not consider that this should be the major priority, as I believe the more incentive-directed proposals I have made would have more effect in stimulating the capital investment which we all want to see.

If you are thinking of taking action on this measure, my preference would be to concentrate any reduction in the incidence of duty at the lower end of the housing market. It might be sensible to adopt an arrangement whereby successive rates of duty are payable only on that proportion of the purchase price which exceeds the relevant threshold - a "slice" rather than "slab" system.

### DLT

I was interested to see the proposals in the Joint Taxation Committee's submission of 26 January for further changes in the incidence and administration of DLT. My officials are consulting the Revenue on the particular points made. I do, however, have particular sympathy with the argument that deemed disposal assessments at the start of new housing projects lead to considerable administrative work both for housebuilders and for the Government, while producing very little revenue.

### New housebuilding for rent

There is also an urgent need to stimulate new building for rent. I am persuaded by the very helpful study which your officials and mine have recently made of the private rented sector that we should now take prompt action to provide private landlords, especially the major property and development companies, with an incentive to take advantage of the assured tenancy provisions. The study examined the case for both grants and capital allowances, but I hope we can agree that the latter will be simpler and more effective. It is also the approach which the British Property Federation advocated (in their letter to you of 17 July 1981) as being the most effective means of stimulating building for rent. The BPF sought a 100% first-year allowance, but on the basis of the study I consider a 75% first-year allowance sufficient, with the remaining 25% being spread over the following 5 years. The allowances would need to apply to all income - not just rental income - and also to both corporation taxpayers and income taxpayers. The volume of new building for rent is at present negligible, so an estimate of costs has to rely on assumptions about the likely impact of the incentive. In the first full year it seems probable that no more than 1,000 new homes would be built, rising gradually thereafter - with say, 2,000 in the second year. On this basis, the first year cost would be about £7½ million, and the second year about £15 million.

### Home improvement and repair

It is also crucial that we should provide a new impetus to the labour-intensive activities of house improvement and repair. Apart from my proposal about private sector grants for improvement and insulation set out in paragraph 2 above, I do not believe we can, or should, do more at present to assist owner-occupiers. But the private rented sector, which still contains much of our most run-down housing, would greatly benefit from extra investment by landlords in the upkeep of their property.

I therefore further propose that the 75% capital allowance for new build, set against both income and corporation tax, should apply also to conversions and improvements to dwellings that are or will be let. It would not, of course, apply to any grant-aided element of expenditure. The cost would depend on the extent of improvement and conversions done, and on the tax position of the landlords concerned, which will vary greatly. On the basis that half of such work is anyway met by grant, our best estimate of the cost of a 75% capital allowance would be £75-100 million per annum, relating to about £750 million work done.

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In addition, I would again propose that costs of repairs and maintenance by landlords should be offset against all income and not only rental income as at present: this would particularly help landlords faced with major repairs and could be achieved at very little extra cost.

You will appreciate that in the time available I have not been able to assess the public expenditure cost of all the schemes I have put forward, or the tax losses which would result. In any event, I believe that the judgements of these orders of magnitude must be for you. But all these proposals could be controlled in a manner that would ensure that progress was made within a given allocation. It must be for you to decide the limit we can afford.

None of the proposals made in this letter need await the longer-term proposals I shall be making in the E paper, a first draft of which should be with you within the next few days.

I am copying this to the Prime Minister, the Secretary of State for Industry, and to the Chief Secretary.

*John Major*

*DMF*

For MICHAEL HESELTINE

*(letter drafted by the Secy of State  
and signed in his absence)*