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	C.B.I.
Financial Secretary	Sir Terence Beckett	
Mr. Ryrie	Sir Donald MacDougall	
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 negotiation 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 recommendatio 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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