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NOTE OF A MEETING HELD AT NO.11 DOWNING STREET: 5.00 P.M., FRIDAY, 16TH MAY, 1980

Present:

Chancellor of the Exchequer	Sir John Hedley Greenborough
Mr. Ryrie	Sir Raymond Pennock
Mr. Middleton	Sir Adrian Cadbury
Mr. Battishill	Mr. Alan Lord
Mr. Dixon	Sir Donald MacDougall
	Mr. D.R. Glynn

The Chancellor invited Sir John Greenborough to expand on the arguments set out in his letter of 6th May.

2. Sir John Greenborough said that in their Budget representations, the CBI had expressed concern about the liquidity of the corporate sector, and the declining profitability of manufacturing industry. They had argued that a PSBT somewhat larger than the Government's target was acceptable, and had put forward the case for abolishing the NIS, though they had not at that time thought it essential. They had also expressed concern about interest rates, but would not want the Government to compromise their monetary policies. By March, however, the CBI had concluded that an early reduction in MLR was unlikely. This lay behind the proposals in Sir John Methven's letter of 14th March, putting forward the "Lord scheme" of special relief for interest payments by companies that have exhausted their normal corporation tax liability.

3. In the intervening weeks, the CBI's concerns had heightened. Pressure from members led them to press the Lord proposals more strongly. They also considered

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that there was now a strong case for an early reduction of MLR, and that the arguments for abolishing the NIS were much stronger than before. The CBI believed that these measures were possible within the Government's target for this year's PSBR. Room would be made by settlement of the dispute over the British net contribution to the EEC Budget, and, if necessary, further reductions in public expenditure. The CBI had been particularly disappointed at what they saw as a heavy concentration of cuts on capital expenditure, and insufficiently vigorous action on the current side. Finally, the CBI were most concerned about the excessive burden of rates on industry.

4. The CBI saw the Lord proposals as well worth implementing in themselves; but if there was no early movement in MLR they became vitally important. Sir John invited Sir Adrian Cadbury to amplify his opening remarks.

5. Sir Adrian Cadbury said that the CBI well understood that inflation had to be brought down. But it was essential that when the Government's policies begain to show results, industry should not be too weak to take advantage of them. The CBI's April survey showed that many firms were now reducing stocks and cutting back investment plans. The number still seeking to borrow from the banks was now falling. The level of income gearing was high, and companies were now finding it very difficult to borrow more. Action to help industry over the next few months was becoming urgent. He could understand the Government's caution in not wishing to lower MLR if there was a real risk of having to put it up again. But he regarded this risk as low, and worth taking. He also commended the Lord proposal.

6. The Chancellor said he had recently made several regional visits, and had received very much the same message. Manufacturing companies showed great concern over the strength of the exchange rate; but there was little that the Government could do to bring it down. But the success of the Government's monetary

policies would lead to a fall in interest rates, which should in turn remove one of the more important factors pushing the exchange rate up. The rate of growth of the money supply was certainly falling; but bank lending was still high. He remained reluctant to lower MLR whilst bank lending remained so high and there was a risk that the rate would have to be raised again. The de-stocking which was now taking place should reduce companies need to borrow. Sir John Greenborough said that the CBI membership would not necessarily be averse to rapid changes in direction of interest rate movements. Mr. Ryrie observed that the effect of such fluctuations on the gilts market would certainly be adverse.

7. Mr. Lord said that the Government's present fiscal policies had upset the established balance between the access of manufacturing industry to bank borrowing and that of the rest of the commercial sector. Within a given quantum of bank borrowing, a manufacturing company had less capacity to borrow than a profitable commercial company. He construed the Inland Revenue's "fundamental objection" as simply opposition to new ideas. The effect of his proposal would be to redress this balance, so that manufacturing companies could, so to speak, sell their notional interest ~~national stock~~ relief to the banks, thus reducing the rate of interest they had to pay. If this relief could be given, many potentially worthwhile investment projects would be saved. If not, investment would be seriously cut back, and manufacturing industry would emerge in 1981-82 in even poorer shape than before the Government's policies were introduced. He believed in any case that companies would find a way of reducing the cost of their borrowing. It was better to do this directly and transparently than by off balance sheet techniques.

8. Mr. Isaac said that the cost of Mr. Lord's proposals could be as high as £700 million. There was just insufficient fiscal headroom to accommodate it. Furthermore, for the scheme to be successful depended on the banks having substantial taxable profits. The high level of their leasing activities severely curtailed the scope for the scheme. Mr. Lord thought that

these two objections were on the face of it inconsistent. Mr. Middleton said that tax relief on short term interest payments was one of the reasons why bank lending was not responding to the high level of interest rates. If the fiscal position permitted assistance to companies, it should arguably be applied to longer term borrowing. Mr. Battishill observed that if the Lord scheme were to be successful, the implication was that other sectors would suffer, e.g. by a reduction in the banks' leasing activity.

9. Mr. Lord said he was confident that the scheme would be helpful to manufacturing industry, and that if something like it were not introduced, the companies would find their own ways, e.g. by stock adjustments and more leasing, to reduce the cost of their borrowing. He did not think it would be right to follow up the Chancellor's own suggestion that this scheme be examined in the context of the Government's review of corporate taxation. It was a two-year temporary relief which the CBI were seeking. Mr. Glynn commented that an advantage of the scheme was that it would show up in next year's PSBR rather than this year's. Sir Greenborough urged the Chancellor to reconsider the scheme, would would be immensely valuable to manufacturing companies. The CBI were under great pressure from their members to say what they were doing to press the Government to reduce the cost of borrowing. They had not yet revealed these particular proposals to their members. They would be pressed very hard at the next Council meeting. The Chancellor undertook to re-examine the proposals in the light of this discussion.

Pay

10. The Chancellor said it was extremely important to get across to employers and unions the message that the general level of pay settlements had to be substantially reduced. The CBI could help in this by publicly keeping the Government as an employer up to the mark.

Employee Participation

11. Sir Raymond Pennock said he saw further discussion of "employee participation" as one of the ways of involving the TUC in a wider dialogue. At this stage, however, he thought that this discussion was more profitably pursued as a dialogue between the CBI and TUC, rather than with Government involvement Sir John Greenborough said that the dialogue was proceeding at two levels, centrally between the national organisations, and regionally between regional TUC and CBI officials. In many ways, the regional dialogue was more fruitful. The TUC's regional officers felt isolated both from the shopfloor and from the General Council in London. The ~~Chancellor~~ said that there was no doubt that an accurate perception of economic realities did exist at various levels in the trade unions and industrial management. The closer to the coalface, the more realistic the perception. Sir Raymond Pennock commented that when faced with a crisis, liaison between the TUC and CBI worked well, but it was difficult in normal circumstances to overcome the TUC's negative attitude. The NEDC 6 were quite unable to deliver any kind of agreement on pay; they themselves realised this, and were concerned about it.

(M.A. HALL)
20th May, 1980

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5.00 PM MEETING WITH CBI, FRIDAY 16 MAY: AMENDMENT

I am sorry to circulate a further amendment to this ill-fated record. I am however content that the revision suggestion in Mr Isaac's letter below be substituted for the present version.

MAH

M A HALL
30 May 1980

CH/EXCHEQUER
REC. 27 MAY 1980
ACTION
COPIES TO

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

23 May 1980

M A Hall Esq
HM Treasury
Treasury Chambers
Parliament Street
SW1

Dear Hall

MEETING WITH CBI ON FRIDAY 16 MAY

Paragraph 8 of your note does not quite get right the discussion of the Lord scheme - I recognise that it was an elliptical discussion on some rather complex issues. I do not ordinarily like to suggest corrections of minutes. However, given that the CBI is likely to revert to the scheme, and that there are points factually wrong, as well as important omissions, I wonder if you would consider revising the beginning of this paragraph on the following lines -

> "Mr Isaac said that the cost of Mr Lord's proposals could be several hundred million £s. The prior question was whether there was sufficient fiscal headroom to accommodate that. Furthermore, and even leaving aside the questions of fiscal principle which Mr Lord had mentioned, officials had doubts about the effects of the scheme on bank lending; and in some of its possible forms the scheme's success would depend on the banks having substantial taxable profits. In practice, bank profits were at present substantially sheltered by leasing. Mr Lord thought that these two objections were on the face of it inconsistent. In the following dicussion, Mr Lord said that the CBI did not propose (as had been suggested in earlier discussions) that the bank should be able to claim repayment of the income tax notionally "deducted" by companies under the Lord scheme. Mr Middleton said ... ".

I am sending a copy of this letter to Peter Middleton and Tony Battishill.

Yours sincerely

A J G ISAAC

IMPORT PROTECTION

Recent press reports suggest a renewed interest by the CBI in the question of selective import controls, though there was no mention of this in Sir John Greenborough's speech to the CBI Dinner. But at a speech on 29 May to the Export Houses Association Sir John did say that "selective import controls may provide temporary respite for hard pressed industries here at home who can make out a case". He went on to say, however, that selective controls would not tackle the "fundamental and probably self-inflicted" problems of high wage rises and inflation and that the main emphasis with regard to trade policy should be to "establish the principle and practice of fair trade to a greater extent than it is at the present time".

2. It is not clear whether the CBI intend to touch on this subject at their meeting with the Prime Minister, but there is nothing in what the CBI has said so far which would suggest a fundamental difference between them and the Government. The Government (like the CBI) does not regard general import controls as likely to help resolve our economic problems; such controls would put up domestic prices, reduce the freedom of choice to the consumer and would undermine the competitiveness of UK industry. It is moreover likely that if the UK were to restrict imports in this way other countries would follow suit, and this could not fail to have adverse consequences for our exporting industries and for the employment which depends on them.

3. This is not to deny that imports, particularly low cost imports, may cause serious problems for certain sectors of industry. It is for this reason for example that the Government supports the Multi Fibre Arrangement which is designed to ensure the orderly growth of trade in textiles. The Government has also stated its willingness to consider the imposition of temporary controls where sudden surges of imports threaten disruption and loss of jobs. Moreover, imports from a number of sources are already subject to restrictions and understandings at industry or Community level (see annex) and these cover sensitive sectors such as cutlery, footwear, TVs and audio equipment, vehicles and steel.

4. The Government's policy on trade restrictions was set out in the Secretary of State for Trade's open letter to the TUC dated 3 April (copy attached). A major theme was the Government's belief that the main emphasis should be on persuading other countries to bring down their barriers to trade, rather than in erecting fresh ones of our own. This, again, seems entirely in accord with the views expressed by Sir John Greenborough.