

CONFIDENTIAL



10 DOWNING STREET

*From the Private Secretary*

13 November 1980

Cost Sharing with the Banks on Fixed  
Rate Lending

The Prime Minister read the Chancellor's recent minute on the above subject, and has agreed his proposals.

I am copying this letter to the Private Secretaries to the Secretaries of State for Industry and Trade and the Governor.

J. P. LANKESTER

A.J. Wiggins, Esq.,  
HM Treasury.

CS

Prime Minister

told JWiggins MI  
Agreed  
mt.



This proposal would be  
instead of a levy on  
bank profits. The Treasury

Treasury Chambers, Parliament Street, SW1P 3AG need a decision  
01-233 3000

PRIME MINISTER

to Mr Hodgson  
Mr Wilson

by tomorrow (or at  
a push by Friday  
morning) so that  
this can put it  
to the members on  
Friday - with  
a view to

COST SHARING WITH THE BANKS ON FIXED RATE LENDING

Earlier in the year I considered imposing a levy based on the banks' non-interest bearing deposits as a way of obtaining for the Exchequer some of the profits accruing to banks when interest rates are high. We have not publicly ruled out this idea, but there are, as you know, considerable political disadvantages. I therefore now plan to pursue an alternative approach.

announcement  
in the Chancellor's  
end-Nov  
statement.

2. The interest subsidy on fixed rate export credit and home shipbuilding lending is expensive when interest rates are high. Interest support on fixed rate export credit is costing us about £500 million a year at present. Since some of this money is paid to the banks, the idea naturally arises of persuading them to take over part of these costs. The general proposal would be that the banks would meet part of the interest subsidy costs above a certain threshold level of interest rates.

It would be  
less contentious  
than a levy,  
but has the  
same effect -  
and I  
think should  
be accepted.  
Content?

3. Of course, the banks will not welcome this. I should need to assure them that the idea of a levy would be dropped if they were prepared to acquiesce

W

R  
12/11

/in this arrangement.



in this arrangement. They would need that assurance if they were to be able to defend to their shareholders their contribution to interest subsidy costs.

4. A straightforward cost-sharing arrangement could well threaten the flow of new finance for exports and home shipbuilding since it would reduce the return on this lending considerably below market levels. The scheme that I propose to put to the banks would seek to avoid this difficulty by relating each bank's contribution not to its fixed rate lending but to its non-interest bearing deposits. John Nott and Keith Joseph, who are directly responsible for the export credit and home shipbuilding schemes, are prepared to accept the idea on that basis. It should largely eliminate the disincentive effect.

5. I have it in mind also to propose to the banks a reduction in the margin which they charge on short term ECGD-backed credit. This would benefit exporters rather than HMG since this credit is not subsidised, and it would only cost the banks about £5 million. It should be helpful in presenting the package at a later stage.

6. The PSBR savings arising from a cost sharing arrangement of this kind would depend on the level of interest rates and the precise parameters of the scheme negotiated with the banks. We would hope to secure cash savings of around £100 million in 1981-82 on the basis of current interest rate expectations.

7. There is a danger of a rebuff from the banks.

/They may judge

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They may judge that it would be more in their interests to risk the levy itself than to accept this cost-sharing arrangement. This was one of the factors that led the Governor to advise against proceeding with the idea. But notwithstanding the risks I think that it would be well worthwhile for us to try this approach given the pressing need to reduce public expenditure to meet our targets and our difficulty in finding ways of doing this.

8. It is important to move quickly if we are to stand any chance of securing savings this year. Subject to your concurrence, I therefore propose to raise the idea with Sir Jeremy Morse (the Chairman of the Committee of London Clearing Banks) on ~~Thursday~~ Friday.

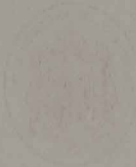
9. I am copying this minute to John Nott, Keith Joseph and the Governor.

PSJ

(G.H.)

12 November 1980

(Approved by the Chancellor and signed in his absence).



12 NOV 1981



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