



Prime Minister 2

For a Journal

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RECORD OF A MEETING HELD IN THE TREASURY
AT 4.30 P.M. ON WEDNESDAY, 23RD MAY, 1979

Present:

Chancellor of the Exchequer	Mr. H.P. Greenborough
Minister of State (Commons)	Sir Raymond Pennock
Minister of State (Lords)	Sir John Methven
Sir Anthony Rawlinson	Sir Adrian Cadbury
Sir Lawrence Airey	Mr. A. Lord
Mr. Littler	Sir Donald MacDougall
Mr. Lovell	Mr. D.R. Glynn
Mr. P.G. Davies	Mr. E.A.J. Rayner
Mr. Cropper	
Mr. Gracey, Inland Revenue	
Mr. Ian Stewart, M.P.	

CONFEDERATION OF BRITISH INDUSTRY:
BUDGET REPRESENTATIONS

Mr. Greenborough introduced the CBI's Budget representations; they were summarised in the enclosure to Sir John Methven's letter to the Chancellor of the Exchequer of 11th May, which brought up to date the representations the CBI had made in February. Mr. Greenborough said the CBI welcomed the general thrust of the Chancellor's speech on 22 May. He had been right to emphasise the sombre prospects for the world economy. The CBI still recommended a "broadly neutral" Budget. In their view, the risks of accelerating inflation ruled out any stimulus to demand; equally, the already poor growth prospects argued strongly against a deflationary Budget. As a general strategy, the CBI favoured cuts in direct taxation, financed by reductions in public expenditure. If strictly necessary, indirect taxes could be increased by up to £1 billion. The construction industry would be badly affected by further cuts in the Government's plans for capital expenditure. The CBI had not taken account in their calculations of the possible



sale of Government assets. As a preliminary view, they saw merit in some of the Government's proposals, e.g. disposal of some of the NEBs holdings and of land.

2. The CBI welcomed the Government's intention to abolish the Price Commission. Their recommended medium term strategy proposed further measures aimed at restoring competitiveness and adequate levels of profitability. The main elements of this were:- no further real increase in public expenditure; further reductions in direct taxation on companies and individuals, reform of the structure for determining pay, abolition of exchange controls and dividend controls, and, of course, no increase in the national insurance surcharge. Mr. Greenborough thought annual growth of 3½-4 per cent was a desirable target, but recognised that the CBI's Budget proposals would not help significantly in the short term to achieve it. But the CBI welcomed the Government's intention to create the conditions for responsible risk taking by businessmen, and recognised that the forthcoming Budget would be an important signal to businessmen generally.

3. The Chancellor of the Exchequer said that he had studied carefully the CBI's written representations. He felt however that he must emphasise the necessarily packed Budget timetable. The lateness of the date also meant that the Finance Bill would have to be comparatively brief, and the revenue benefit from increases in indirect taxation much less than for a full year. He thought the phrase "broadly neutral" was ambiguous. Whilst the first round demand effects might be strictly neutral, a shift in the pattern of taxation could have a sharply stimulatory effect, whatever the strict Budget arithmetic. Sir John Methven took the Chancellor's point on "neutrality"; but the CBI meant by this a Budget which neither raised nor lowered the level of aggregate demand in the first instance. The Government's task must be to establish the right climate; it would then be for managers to respond. In the CBI's view, reductions in direct



taxation were the most important element. But the poor prospects for growth and the high and increasing level of inflation made it difficult to make a really significant impact in this year's Budget. The CBI's emphasis was therefore on a strategy for the medium term, but it was psychologically very important, particularly for small businesses, that the top maximum income tax rate should be cut at once to 60 per cent, not in a smaller step to 75 per cent. In the longer term, personal taxation should be reduced by some 30 per cent. On an inflation adjusted basis, the CBI calculated that profitability had been some $4\frac{1}{2}$ per cent on average in 1978. They expected it to be only $3\frac{1}{2}$ per cent this year, and also estimated that unit cost competitiveness had worsened by some 15 to 20 per cent over the last two years. This underlined the merit of abolishing the Price Commission, and the argument for not increasing the NIS. Inflation was a serious worry. An increase in VAT to a 10 per cent unified rate would add 1 to $1\frac{1}{2}$ per cent to the RPI this would bring the RPI to 12 to 13 per cent by the end of the year. If VAT went to $12\frac{1}{2}$ per cent, a further $1\frac{1}{4}$ per cent would be added to the RPI. The rise in oil prices was having an equally serious effect. If the inflation rate rose above 15 per cent, it would be extremely difficult to keep earnings down to an acceptable level in the next pay round. This was why the CBI regarded increases in indirect taxes to pay for direct tax cuts as a last resort; and in any event not to be invoked beyond a total increase of £1 billion. The determination of earnings was a continuing problem, which the CBI would like to discuss with the Government at an early opportunity.

4. Sir Adrian Cadbury added that the exchange rate was one of the factors which had been affecting competitiveness. Sterling had appreciated by 5.3 per cent in effective terms this year. He also emphasised the importance of continuity in the Government's policies and the need to pursue consistently medium term objectives. He would add BP shares to the list of assets which the



Government might usefully dispose of. He wished to emphasise two points from earlier discussion; dividend controls should be removed, and cuts in public expenditure should take full account of the precarious state of the construction industry. He also considered that there was no longer a case for maintaining exchange controls.

5. The Chancellor of the Exchequer said that the Government wished to consider carefully its future role in the determination of pay. They would be glad to take up the CBI's offer of discussions "fairly shortly". As for dividend controls, he would say only that they were not immortal. The CBI had said that their own Budget scenario suggested a PSBR of £8½ billion. What would be the impact of this on interest rates?

Sir Adrian Cadbury said that if adherence to strict monetary targets implied higher interest rates, business would accept this. Sir John Methven commented that the figure of £8½ billion took no account of the sale of assets. Sir Lawrence Airey pointed out that such sales would reduce the PSBR, but would not necessarily relieve the pressure on monetary targets.

6. The Chancellor of the Exchequer said that the Government was considering its policy on exchange controls. The shape and timing of any package required careful thought. He detected two strands of thoughts in the CBI's view on the exchange rate - varying degrees of stress were placed on the benefits to competitiveness of a weak exchange rate, and the benefits on the prices front of a strong rate. Sir Adrian Cadbury referred to a recent survey by Peter Oppenheimer; 67 per cent of those who replied said that the relative prices of their products compared with overseas competitors were an important consideration. In his view, the relaxation of exchange control would be the best means of achieving the right exchange rate. Sir John Methven commented that views on the exchange rate varied from sector to sector of industry. The Chancellor of the Exchequer said there was a need to work for wider understanding



of the benefits of relaxing exchange controls on the part of the TUC. Sir Adrian Cadbury thought that on the theoretical plane the TUC now accepted the arguments for relaxation. But there was a political block. Sir John Methven said that there was now significantly less pressure from the TUC for generalised import controls. Sir Raymond Pennock added that, whilst ICI's export volume had increased by 7 per cent, the value had fallen by 1 per cent.

7. The Chancellor of the Exchequer said that he well understood the need for a powerful signal in the Budget on the top rates of income tax. But it was politically very difficult to make such a gesture towards the higher paid, without offering something to the rest of those who paid income tax. He also took the point that public expenditure must be the quarry of first resort to finance cuts in direct taxation. But the more capital expenditure was left alone, the more difficult it was to find sufficient savings. There was an inherent problem in switching from direct to indirect taxes. Even in a period of low or very low inflation, a shift from direct to indirect taxes would cause the RPI to increase. If attention continued to focus on pre-tax wages, this increase would tend to be reflected in the next pay round. Unless the Government were bold, anxiety about the RPI effects could be a permanent obstacle to change. Clearly radical change in this area carried a price tag. But the solution was surely to concentrate on net post tax earnings. Sir John Methven said that in his view, expectations about inflation were the prime influence on pay bargaining. In his experience, at the lower levels of earnings, tax cuts had had no significant effect on bargaining. But a start in cutting direct taxation had to be made somewhere. It was the managers who were the engines of change; and in any case, the cost of cutting the top rates of income tax would be negligible. Such a policy could even increase revenue. It would cut sharply the amount of time and effort

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spent on tax avoidance. The Chancellor of the Exchequer said he thought that even at the lower end of the earnings scale, there was a learning curve, and that it was increasingly take-home pay with which pay bargainers were concerned. Mr. Alan Lord still felt, however, that the less the cut in direct taxation had to be carried on indirect taxes, and hence by the RPI, the better. It was therefore helpful to sell assets in this first year as a once and for all measure. The Chancellor said there were two aspects to asset sales; the PSBR effect was obviously important, but such sales were also useful in themselves, to the extent that they restored competition and balance in the market.

8. Before bringing the meeting to a close, the Chancellor asked the CBI if they had any clear view on why unemployment was falling. Sir Donald MacDougall said that this trend was not clearly understood. Various factors might be at work - output higher than recorded, movement of married women out of employment, but no on to the unemployment register, further erosion of productivity; the CBI would welcome a continuing exchange of ideas on this.



M.A.H.

(M.A. HALL)

29th May, 1979

31 MAY 1979

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