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If the Chancellor does not agree - we must have an urgent meeting. I agree with DTI

MB

PRIME MINISTER

BUDGET: NISSAN

You will have seen my letter to the Chancellor of 16 February, and his reply of 22 February. The Chancellor's view is that nothing can be done to mitigate the affects of the corporation tax package on Nissan: and he also takes a rather different view from me on what the consequences of that package will be on Nissan.

I agree

2 To me the position looks extremely serious. I cannot, of course, state categorically that Nissan will pull out unless we can find a solution. But I have to say that it is my judgement, and that of those closest to the negotiations, that there is a very high probability that they would do so - not only because of the additional cost to them, but because of the peculiarly central part your private leasing proposal to Mr Kawamata played in converting him to support the project. Without this, the deal would not have been reached.

3 It may help if I set out where Nigel and I are in agreement, and where we differ. There is no difference of the analysis of the cost to Nissan of the proposed budget package. At minimum, Nissan will face an additional cost of over £30m; it could be as high as £45m. Virtually all these costs fall on Phase II of the

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project. Where I differ from the Chancellor is in his separation of the project into two clear and distinct phases. I do not believe that this is realistic. Instead, it is necessary to consider the project as one, not two. Quite simply, it would not make sense for Nissan to invest in Phase I unless at the time they made the decision so to do they firmly intended to proceed to Phase II. On Nissan's own figures, Phase I will make a loss of £12m a year; and the production of 24,000 units a year is a quite uneconomic quantity in the context of the motor industry. I do not believe that Nissan will pay £12m a year in order to come to a view on whether to exercise an option in 1986. Rather, if Nissan know before they take the final decision on Phase I that they will not get the terms they expected on Phase II, they may well decide not to go ahead with either Phase I or Phase II. Whatever decision we come to, I do believe it must be based on looking at the cost to Nissan of the project as a whole.

4 If Nissan does indeed pull out, it would clearly be a pity in terms of the project itself; and, of greater importance, would be harmful in terms of our policy of attracting further inward investment from Japan. There would also be a danger, which I discuss in paragraph 5 below, of your being accused of a breach of faith. More central to our economic policy, there is also the risk that withdrawal by Nissan could endanger the case for the budget package itself. That package rests to a large extent on our being able to assert that it will not damage investment.

Such a claim would be hard to sustain if an early, and highly visible, effect of the package was the cancellation, as a direct consequence of the package, of a peculiarly prominent investment for which we have claimed considerable political credit. I fear that were this to happen it would be used by our opponents as a proven, as opposed to a theoretical, case against the Chancellor's reform.

5 There is the further point, which must be for you to judge, of the political consequences in the light of your own personal and crucial involvement in the negotiations. There is a danger that Nissan might interpret the fact that the agreement with them was signed in full knowledge of impending taxation changes which would seriously affect the project as a breach of faith, and that in particular they will regard the undertakings which you made on leasing as having been vitiated. We can, of course, make something of the Chancellor's argument that you offered leasing arrangements, not continuity of capital allowances, but must recognize that the leasing offer becomes significantly reduced in value without the capital allowances. The Japanese might choose to represent this as a direct breach of faith.

So do I

6 Because of these difficulties, I continue to see this as a greater problem than the Chancellor suggests. I therefore believe we should investigate, as a matter of urgency, whether there is a means of avoiding the difficulties that will occur if Nissan choose not to proceed.

7 I am clear that the sums involved are too large to compensate Nissan through additional selective financial assistance (SFA). This would raise difficult presentational issues and in any case we are limited by EC rules governing the amount of financial assistance that can be given. This leaves some form of "transitional" arrangements which would allow Nissan to continue to benefit from the current levels of first year allowances on the project's capital expenditure. What we could do would be to mirror on the tax side exactly what has been done for Nissan (and other companies) on RDGs, where any firm that has negotiated selective assistance prior to announcement of the new regime is assured of the current benefits on the assisted project. The logic for our existing policy for RDGs is that the negotiated level of SFA takes account of other benefits available to the company, such as RDGs. Equally, it can be argued that the level of SFA negotiated has taken account of the tax regime which made leasing attractive. I believe that transitional arrangements on this basis could be offered without driving a coach and horses through the package: there will be few companies which are in the position of Nissan, in terms of both having an offer of SFA, and being heavily affected by the proposed changes in capital allowances. SFA is offered on only a very small proportion of total investment and for many of the projects qualifying for this transitional treatment most of the capital expenditure will have been incurred by the time the full force of the package comes into effect.

8 I hope that transitional arrangements on these lines would prove acceptable. I very much support the Chancellor's proposals to restructure the corporation tax system. I fear, however, that unless we can find a satisfactory solution to the Nissan problem we may incur criticism which could set the whole package at risk. The transitional arrangements I propose seem to me a reasonable price to pay for avoidance of this risk.

9 I am copying this minute to the Chancellor.

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27 February 1984

Department of Trade & Industry