PRIME MINISTER

Lunch with British Invisible Exports Council

The following briefing has been prepared:-

(i) Key facts on services - Flag A

(ii) A letter from Mr. Mackworth-Young suggesting an agenda for the discussion - Flag B

(iii) Briefing from Department of Trade and Industry - Flag C - which includes:-

(a) Notes on those attending the lunch

(b) Notes on the agenda items

(c) Q and A briefing on likely issues. at C2.

(iv) Notes from the Treasury (Flag D) on controversial items arising from the Budget, in particular the impact of the change in capital allowances on ships, films and leasing; and the removal of relief on foreign emoluments.

(v) Sir William Clarke may suggest amending the criteria for The Queen's Awards for Exports in order to improve the prospects for services - Flag E. The Queen's Awards Office are neutral on the idea of a review, though point out that it would cost £50,000. You could offer to consider the idea, while pointing out that services do quite well at present. Services account for 24% of total exports of goods and services, and they get 24% of the awards for exports from only 18% of the applications.

AT

29 March, 1984.

A

A

SERVICES IN THE UK: KEY FACTS

(i) Share of manufacturing and services in employment

(GB except 1961 which is UK)

	1961	1979	1983 (Sept)
Manufacturing	38.4	31.1	26.6
Services	46.7	58.7	63.9

(ii) Growth of jobs in services (GB)

Between September 1979 and September 1983 employees in employment in services fell slightly, from 13.26 million to 13.19 million, but numbers rose by 170,000 in first nine months of 1983. For details of individual sectors see attached table.

(iii) UK Exports of services

Total UK exports of services in 1983 were £19 million, against £60 million for goods. The balance of trade in services was positive at £4.4 billion.

	Exports	Trade balance (£ million 1983)
Shipping - dry cargo	2.0	-1.1
Shipping - tankers	1.2	+0.3
Civil aviation	2.7	+0.4
Travel	3.7	-0.4
Financial services	2.6	+2.6
Other (incl. Govt.)	5.9	-2.5
Total:-	19.0	+4.4

(iv) Changes in Government policies

Government has made substantial changes in policy to eliminate tax/grant bias in favour of manufacturing and against services

/where

where nearly two-thirds of jobs are now found.

(i) Restructuring Regional Assistance.

(ii) New Corporation Tax regime

(iii) Abolition of NIS.

AP

The processes of change operate first and foremost at the company level. Observed employment shifts are the result of the balance between a multitude of small changes. New jobs are continuously created throughout the economy - in firms operating in sectors seen to be in decline, as well as in those which are expected to grow. But analysis has to be conducted at the industry, not the company level. Table 1 below shows the industries which today have 10,000 more employees than they did 10 years ago.

TABLE 1

INDUSTRIES WITH OVER 10,000 MORE EMPLOYEES IN 1983 THAN IN 1973

Production industries	Increase (000s)	Service industries	Increase (000s)
Radio, radar and electronic goods	25	Medical and dental services	291
Petroleum and natural gas	24	"Other" miscellaneous services (includes photography, welfare and charitable services, trade associations, window cleaning)	212
Water supply	23	Educational services	120
Electronic computers	12	"Other" business services (includes typewriting, copying, employment agencies, computer services)	106
		Banking and bill discounting	88
		"Other" professional and scientific services (including accountancy and legal services)	61
		Sport and other recreations	50
		Miscellaneous transport services and storage	48
		Property owning and managing, etc	42
		Clubs	37
		Dealing in industrial materials and machinery (other than fuels, builders materials and agricultural supplies)	37
		"Other" financial institutions (includes building societies, stockbrokers)	31
		Insurance	28
		Hotels and other residential establishments	28
		Public houses	26
		Restaurants, cafes, snack bars	15
		Catering contractors	14
		Advertising and market research	11

Source: Annex Tables A3-A6

Notes: 1. The categories are those used in the 1968 Standard Industrial Classification

2. The two years do not represent equivalent points in the economic cycle (1973 was a cyclical peak). Tables A3 and A5 in the Annex show growth between comparable years.

B

cc ~~BI~~

~~Ray Parker~~

BRITISH INVISIBLE EXPORTS COUNCIL

15th March 1984

David Barclay, Esq.,
Private Secretary to the Prime Minister,
10 Downing Street,
London. SW1.

Dear Mr Barclay,

We spoke. This is to confirm the arrangements for the luncheon for the Prime Minister on Friday the 30th of March 1984 and to let you have a list of guests. This is attached.

Mr. Mackworth-Young suggests the following topics for discussion over lunch:-

1. World Invisible markets.
2. UK Services' foreign earnings.
3. Employment in Services.
4. Barriers to international trade in Services.

Luncheon will be at 1.00p.m. at the offices of Morgan Grenfell in 23 Great Winchester Street.

I mentioned to you that prolonged and extensive roadworks are taking place outside the Bank and you said that the Police would be making their dispositions beforehand.

Yours sincerely

Desmond Harney

DESMOND HARNEY
General Assistant to the Chairman

C/

C1

JF6145

BRIEFING NOTE FOR THE PRIME MINISTER'S LUNCH WITH THE BRITISH INVISIBLE EXPORTS COUNCIL ON 30 MARCH 1984

The British Invisible Exports Council (known by the initials BIE) has written (15 March to David Barclay) to say that they would expect certain topics to come up in the course of discussion with the Prime Minister. Notes on each topic are at Annexes 2 - 5.

LINE TO TAKE

1. The ~~DTI~~ Government attaches importance to the continued growth of the services sector.

2. Seek the Council's views on what will happen to world and UK trade in services as world economic recovery strengthens.

3. Recognise the important role BIE and its LOTIS (Liberalisation of Trade in Services) Sub-Committee has in the promotion of freedom of trade in services.

4. Welcome BIE's co-operation with DTI on the UK's contribution to current international work.

5. Invite views on which are the most important obstacles Council members face in overseas trading; and, in any negotiation to remove them, what practices might the UK be asked to relax?

1 BACKGROUND TO BIE

The Committee on Invisible Exports (COIE) was established by the Bank of England in 1968 to advance measures for the encouragement of invisible earnings and for the promotion of international trade in services. In December 1983 the Committee changed its title to the British Invisible Exports Council (BIE) to emphasize its connection with the UK in its activities abroad. The Council is privately funded and represents all aspects of the invisibles sector: e.g banking, insurance and other City interests, tourism, civil aviation and consultancy. Government Departments and the Bank of England are also represented on the Council, which meets formally about three times a year.

A list of those attending the lunch is at Annex 1.

2 BIE's EXPORT ACTIVITY

The Council promotes the invisibles sector overseas mainly through missions and seminars (about three each year) which it organises with assistance from the BOTB and the commercial Posts overseas. Its 1984 programme includes missions and presentations in the USA, Italy, Malaysia and India. The Council has also organized a number of successful missions into the UK.

3 CONTACT WITH THE DTI

The BIE has many contacts within the Department at senior level. The Chief Executive of the BOTB, Mr Christopher Robers, until recently represented DTI interests on the Council. Mr David Dell, who has in his charge Divisions with responsibility for the financial services and insurance sectors, will in future attend the Council's meetings following changes in departmental organisation introduced by the Secretary of State. The BIE is aware that the new arrangement reflects Mr Tebbit's wish to extend the role of service industry sponsoring divisions into the export work of the Department and it has been welcomed by the Council.

4 REVIEW OF EXPORT ASSISTANCE FRO THE SERVICES SECTOR

As part of wider Ministerial consideration of our trade policy, the Department is examining whether the various measures of export help provided by the BOTB fully meet the needs of the services sector. Consultation is taking place with the various representational organisations and a selection of service companies to establish their perception of the help currently available and how they believe this might be developed or improved. The Department is in close contact with BIE on this and members of the BIE will be meeting the Minister for Trade (Mr Channon) on the subject on 28 March.

OT3/4 (PCU)
March 1984

Annex 2

WORLD INVISIBLES MARKETS

Up-to-date information on world markets for services is not available but in the early 1980s, world imports of services (debits on invisible trade, excluding - mainly - payment of interest profits and dividends) amounted to between a fifth and a quarter of the value of world trade in goods. Of world imports of services, around 40% consists of transport services and some 25% of expenditure on travel abroad. The remainder includes financial services, consultancy earnings, royalties etc.

2. If trade between EC countries is included, over 70% of imports of services is taken by the industrial countries. West Germany is the largest importer (on the above definition) and is much more dependent on service imports (relative to merchandise imports) than any other EC country apart from Denmark. This is especially marked in overseas travel. Service imports of the EC as a whole make up over 40% of the world total. Other major importers are Japan and the USA, each taking in the region of 8% of the total. Aggregate imports of the oil exporting countries are similar, with approaching half of the value taken by Saudi Arabia.

3. The growth of the total value of world service imports since the mid 1970s appears to have been about the same as that of imports of goods. Imports of shipping services have grown more slowly in value than imports of goods. Travel and 'other services' (financial, consultancy etc.) have grown faster.

Ec2B
20.3.84

Annex 3

UK SERVICES FOREIGN EARNINGS

UK exports of services in 1983 amounted to some £19bn compared with exports of goods worth £60bn. In volume terms, exports of services peaked in 1978-79 but then declined as a result of world recession and, for a time, the strength of sterling. The level fell by 13% between 1979 and the latter part of 1982. Since then there has been some recovery in all the major categories except shipping, with an overall increase in volume of 1% in 1983 compared with 1982. With the likely widening of world economic recovery this year it seems likely that the volume of UK service exports will grow more rapidly than in 1983.

2. Service exports involve, of course, value added of other industries just as exports of manufactures incorporate value added of service industries. Moreover part of (direct) exports of services, such as insurance and shipping earnings, is associated with exports of goods.

3. The main broad categories of service exports are shipping (17%), civil aviation (14%), travel (19%) and financial services (14%). Identified areas of strong growth in recent years have been financial services (especially insurance), earnings from construction work overseas, other consultancy earnings and earnings from telecommunication services. Earnings from shipping continue to decline, even in value terms, and this shift in their relative importance is indicated by the fall in their share of UK exports of services from nearly 50% in 1960. Earnings from tourism are especially sensitive to the sterling exchange rate. While there was some recovery last year the level remains well below the peak in 1977.

Ec2B
20.3.84

Annex 4

EMPLOYMENT IN SERVICES

In general, high income countries have tended to experience an increasing proportion of service activities, reflecting the development of consumer choice and perhaps the comparative advantage of these countries, not least the UK, in international trade. In the UK, service industries, including public administration, accounted for 63% of total employment in 1982 as against 54% in 1972. The total of some 13mn service workers in employment (GB) included 2mn in retail distribution, 1¾mn in public administration, a similar number in banking insurance and finance, 1½mn in education, 1¼mn in medical and other health services and about 1mn in each of wholesale distribution and repairs, hotels and catering, and transport. Between September 1979 and September 1983 employees in employment in the service industries changed very little. In contrast total employment fell by some 9%. Among service industries, financial and medical/health services increased employment by 4% and 7% respectively. Transport services showed a fall of 15%.

2. Between 1972 and 1982 the output of the service industries rose by 14%, a little less than the growth of GDP, though the latter is appreciably affected by the growth of oil output. The rise in the proportion of employment in the service industries reflects the slower growth of productivity in the service sector - where measurement of output is well known to be difficult.

Ec2B
20.3.84

Annex 5

BARRIERS TO INTERNATIONAL TRADE IN SERVICES

LIBERALISATION OF TRADE IN SERVICES (LOTIS)

As a leading services exporter the UK has a long standing interest in the liberalisation of international trade in services. At present there is no international framework of rights and obligations for services trade along the lines the GATT provides for trade in goods.

Work on the structure of and obstacles to services is now going on in OECD, UNCTAD and GATT. In particular the GATT Ministerial meeting in November 1982 recommended that GATT Contracting Parties undertake studies of services issues for review at their meeting in November 1984. DTI is preparing the UK national study (expected to be ready in April) in close cooperation with the British Invisible Exports Council through its sub-Committee LOTIS.

The US are the prime movers in international work to liberalise trade in services. Developing countries have been generally hostile to the idea of GATT work on services, which they regard as unlikely to be beneficial to them; and some developed countries such as France are reluctant. Current international work is likely to produce results only in the long term. Negotiations (if any) are still a long way off.

The LOTIS Committee is in the forefront of UK private sector lobbying for liberalisation. It is expected that LOTIS will shortly meet the Minister for Trade to discuss the final draft of the UK study for GATT. While liberalisation is the aim,

/difficult

difficult factors to be faced in eventual negotiation would include what the UK itself could be asked to liberalise and what advantages liberalisation would give to our competitors in markets where UK companies are already established despite local obstacles.

ITP/DTI
March 1984

G W MACKWORTH-YOUNG

Bill Mackworth-Young was appointed Chairman of the Committee on Invisible Exports, now the British Invisible Export Council, in April 1983. Since 1980 he has also been Chairman of Morgan Grenfell & Co Ltd., the City of London merchant bank and twice winners of the Queen's Award for Export Achievement.

Mr Mackworth-Young began his career as a merchant banker with Baring Brothers & Co in 1950, spending some time in the Sydney office before joining Rowe & Pitman, one of the leading London stockbrokers in 1952. He became a partner the following year and also a member of the London Stock Exchange. He joined Morgan Grefell in 1974 as a Director and Vice Chairman of Morgan Grenfell Holdings.

Mr Mackworth-Young holds numerous outside directorships including Lloyds Bank, Willis Faber and Charter Consolidated. He is also Chairman of the Industrial Development Advisory Board.

OT3/4 (PCU)

March 1984

WILLIAM M CLARKE, CBE

Mr Clarke has been involved with the Committee on Invisible Exports since it was formed in 1968, and is the present Director General and Deputy Chairman of the BIE.

He was the Financial Editor of The Times from 1956-1966. He is the author of several books on the City and its institutions - The City's Invisible Earnings, The City in the World Economy, Britain's Invisible Earnings, The World's Money, Private Enterprise in Developing Countries and Inside the City.

In additon to his literary interests Mr Clarke is a Director of Grindlays Bank, United Kingdom Provident Institution, Trade Indemnity Company, Romney Investment Trust, Euromoney Publications and Swiss Re-insurance.

OT3/4 (PCU)
March 1984

C2

C2

PRIME MINISTER'S LUNCH WITH THE BRITISH INVISIBLE EXPORTS COUNCIL: 30 MARCH 1984

Supplementary notes on international trade in services

UK service sectors involved in international trade include:

Accountancy
Advertising agencies
Banking
Civil aviation
Commodity trading and other merchanting
Computer services
Construction and consultancy services
Distribution services
Educational services
Films and television
Franchising and royalties
Insurance
Legal services
Medical services
Shipping
Stock Exchange
Telecommunications and Postal services
Travel and Tourism.

Trade in goods is largely liberalised through the GATT (though exceptions are permitted for the developing countries): but the GATT does not cover services.

What are the chances of a multilateral agreement on services?

- We are pressing for liberalisation of trade in services. So are other countries, including the Americans. We would prefer to do this through the GATT. But many developing countries want to protect their service industries. As well as a steel mill, they want their own airline, insurance company, Intourist etc.
- We believe that more wealth will be created by freer trade in goods and services. Some developing countries do not see things this way. They believe liberalisation works only for the benefit of the strong. And, on services, some developed countries take a similar view. So it will take a good deal of persuading to get what we want in the GATT.

What exactly are we doing in the GATT at the moment?

- We shall shortly be submitting a UK national study on trade in services. Comparable studies have already been presented by the US and Canada. We are not engaging in polemics - but seeking to focus the minds of GATT members on the importance of services in international trade today. LOTIS have given us valuable assistance in the preparation of this study.

Within what timescale can we hope for services liberalisation?

- The chances of quick and useful progress are greatest within the Community: we hope to see real progress here in the next year or two. Work in the GATT will be for the longer term: it has taken 30 years to achieve the current degree of liberalisation of trade in goods within GATT. Unrealistic to expect work on services to bear fruit before the 1990s - although we have to recognise that much of modern industry involves long lead times.

What services should be included/excluded?

- We start from the position that liberalisation is desirable for all service sectors. Exceptions for particular sectors would encourage vested interest to protect their corners. But individual sectors may have special characteristics (like safety in aviation or consumer protection needs) which will have to be borne in mind.

Will it be possible to define what "services" are as against "investment" or "information technology" issues?

- The dividing line between "investment" and "trade" issues is more difficult to draw for services than for goods. Some services are traded across frontiers: in other cases it is necessary to establish oneself in a country to serve that domestic market. Information technology is an important vehicle for liberalisation (eg through consulting computerised facilities located in another country): one of our ~~objections~~ objectives will be to reduce current barriers to cross-border use of new technologies.

What will the role of the Community be in international discussions on services?

- Community competence on services should logically be related to the Community's success in achieving liberalisation of the internal market.

Do we envisage one broad general agreement or individual sectoral agreements?

- We are attracted in principle to the idea, which the Americans share, of an umbrella framework of principles within which detailed agreements for individual sectors (reflecting special factors like safety requirements etc) could be negotiated.

What is the progess on liberalisation of insurance services in the EC?

- A liberal non-life services Directive continues to be a major objective. We are working hard in Brussels on the just-introduced proposals for a services Directive limited to business risks, but too soon to be sanguine about the prospects for success. We back the Commission's view that European Court cases on insurance should not be withdrawn if there is no agreement on insurance services liberalisation.

ITP Division
Department of Trade and Industry
29 March 1984

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CCWO
D

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

27 March 1984

Andrew Turnbull Esq
10 Downing Street

Dear Andrew,

BRITISH INVISIBLE EXPORTS COUNCIL

You wrote to me on 19 March asking me for briefing for the lunch which the Prime Minister is having with the Council on Friday 30 March. You particularly asked for material on the impact of the corporation tax changes on leasing, shipping and films; on the removal of reliefs on foreign emoluments; and on the banking aspects of liberalisation of trade in services. Notes on all these are attached, together with a further note on the business expansion scheme.

We understand that the DTI have provided a general brief on "barriers to international trade in the services" and there are no points which the Treasury is particularly anxious for the Prime Minister to raise, so our brief on this item contains only a few ball points for use in discussion.

Yours ever,

Judith

MISS J C SIMPSON
Private Secretary

BUSINESS TAX CHANGES

The Budget changes - phased reduction in rates of Corporation Tax to 35% (30% for small companies), phased withdrawal of first year and initial capital allowances, abolition of stock relief, abolition of NIS, postponed accounting for VAT on imports - should be of overall benefit to the service and financial sectors, both in the short and long term. However, even within sectors which will be overall gainers, there are bound to be individual businesses or types of business which will be disadvantaged; British Airways and other transport undertakings, which tend to be very capital intensive, may well be in this position.

Shipping and Airlines

Ships and aircraft qualify for machinery or plant capital allowances - 100% in the first year until the Budget. In addition, new ships qualify for a special relief under which the ship owner can take his first year allowances when he wishes (sometimes known as "free depreciation"). Under the Budget changes, the rate of first year allowance for ships and aircraft will be phased out (as for machinery and plant generally), leaving only annual writing down allowances of 25% (reducing balance basis) from 1986. "Free depreciation" will continue to provide some (though smaller) benefit until then, but will thereafter become redundant.

The shipping and airline industries are unlikely to be gainers from the Budget, and will probably be among the leading objectors to the changes. The shippers will strongly run the war contingencies argument.

Line to take The Budget changes must be seen as part of a whole reform package, which will have a dynamic effect on efficiency and profitability generally throughout the economy. Inevitably, however, there will be some sectors and companies which will not do so well or may even be disadvantaged, and ship owners and airlines may be amongst them.

But the extent of this disadvantage should not be exaggerated,

i. Cuts in corporation tax rates will help.

ii. The impact of capital allowance reductions will be more muted in the case of assets with long lives - like ships and aircraft - than for those with short lives.

iii. Neither shippers nor airlines qualified for stock relief - so have nothing to lose on that score.

iv. The Chancellor is proposing altering the timing of writing-down allowances in a way which will help long-lead assets where stage payments are normally made in advance of delivery.

v. The changes are being staged to give companies time to adjust to the new system.

Films

In 1979, the Revenue received legal advice that a film was "machinery or plant" and therefore qualified under existing law for capital allowances. Banks and other lessors buying up films (from producers) could claim 100% first year allowances on the entire cost, and thereby use the incentive (acceleration) element in the allowance to lease the films out to distributors at rates subsidised by the Exchequer.

i. The UK became the focus of an international trade in "washing" foreign (particularly American) films through the British tax system via UK and other London-based banks. Some of these films had a UK content (eg, filmed at Pinewood or made with British directors or actors); others had very little or none at all. None of them were actually financed at risk in the UK, so no profits ended up here.

ii. A small recovery started to take place in the UK film industry as genuine British films (television as well as feature) were washed through the same process.

The rush to London under i. above and estimates of £b½ worth of capital allowances being at risk in relation to Hollywood productions alone (ie, the UK incentives being entirely "exported"), led the Government to take action in 1982 to withdraw capital allowances from films generally. To assist the UK industry to adjust, however, there was a transitional provision providing for the capital allowances to run on for two years for British films. This transitional relief was extended last year for a further three years, until 1987.

The Budget changes mean that the rate of capital allowances for films (as for all other forms of machinery or plant) will be reduced. But the Chancellor is doing two things for the British film industry. First, he is abolishing the 1987 termination date; so that capital allowances (at the going rate) will run on permanently. Second, he is allowing investors in British films to have an option, either to take the capital allowances or to switch to the alternative 1982 system for non-British films, if they prefer it.

The industry has already expressed publicly its opposition to the changes. The impression is given that the reduction in allowances is aimed specifically at films. In fact, many people find it difficult to understand how a film can be "machinery or plant" in the first instance. And, despite being restricted to British films, the capital allowances are still being used in many cases for blatant tax avoidance purposes rather than for true investment in the creative arts. Opinion in the City tends to be divided: some see film leasing as largely an abuse (and some major lessor banks will not touch it), while others view it as a legitimate tax shelter with the advantage of providing help for a precarious flagship industry.

Line to take Films are only being treated as machinery and plant generally. Difficulty of justifying making exception for films, when all other industries - many of which far more vital to the economy - would not get similar treatment. Film industry asking for the ha'penny and the bun - ie the old 100% first year allowance and the cut in corporation tax. What do those round the table think - should the tax system be used this way to provide hidden subsidy to the film industry as a whole?

[Confidential. DTI and Treasury Ministers are in touch about how to handle the film industry representations]

Leasing

Leasing is the mechanism which allows tax exhausted companies effectively to transfer their capital allowances to banks (or other lessors) and reap the benefit in terms of lower rental payments. Lessors "cash" these allowances by using them to shelter from corporation tax their profits from other activities. The phased reduction in the first year (accelerated) allowances will reduce the amount of benefit which bank lessors are able to pass through to lessees, in the same way as it will reduce the incentive element in the allowances claimed directly by businesses purchasing assets directly themselves. About 17% of investment by manufacturing industry is arranged through leasing.

The effect of the corporation tax rate and capital allowance reductions on leasing are likely to be as follows:

i. In 1984-85, leasing should expand (because the reduction in the first year allowance to 75% will be more than compensated for by the much lower corporation tax on the rental income towards the back-end of the lease).

ii. In subsequent years, the incentive effect will be reduced, and total leasing business will fall - probably by between 25% and 50% from present levels.

Reductions in leasing business will affect the banks, but it is not yet clear to what extent. As their ability to shelter profits from tax is reduced, their corporation tax liability is likely to rise and they will need to make greater "provisions" for future tax in their accounts.

Line to take Effect of Budget changes on leased assets will be similar to that on assets purchased directly by companies.

No case for shielding tax-exhausted businesses from general thrust of measures to reduce subsidisation of certain favoured types investments. Banks will need to re-assess their position in the light of new circumstances, and may need to make more provision for tax than previously; but phasing-in changes over 2 years gives time for adjustment. The Equipment Leasing Association themselves have said that they do not believe that a high level of first year allowances is essential to leasing; and that leasing flourishes in other countries without a generous system of accelerated depreciation.

FOREIGN EMOLUMENTS

"Foreign emoluments" are the earnings of employees who are not domiciled in the UK from employments with concerns not resident in the UK. Until 1974, such employees were liable to UK tax only on amounts actually paid in or remitted to the UK (the remittance basis). Since 1974 they have been liable to tax on all their foreign emoluments subject to a 50 per cent deduction (reducing to 25 per cent after nine years' residence in the UK). About 65,000 people get this relief at a 1983/84 cost of about £m80. A fairly high proportion (perhaps 40 per cent) work in banking and finance - particularly for American and Japanese concerns.

It is proposed to withdraw the relief from new cases from Budget Day with transitional provisions protecting people who have not yet completed nine years' residence in the UK. The 25 per cent relief therefore ceases with effect from 6 April 1984 and the 50 per cent relief is to be phased out over the five years to 1988/89.

Some Press reports have suggested that withdrawal of the relief will lead to an exodus of foreign executives and to a loss of business for London. This view is not shared by others - notably the Wall Street Journal (22 March), The Economist (24 March) or The Financial Times which pointed out (15 March) that the changes will bring London into line with overseas centres.

Line to take

When the relief was introduced in 1974 the top marginal rate of income tax was 83 per cent - far higher than in competing countries. Since 1979, UK top and average tax rates have been brought more into line with other European countries and special reliefs of this sort are no longer needed. London can surely compete with Brussels, Zurich and Paris without such special reliefs. Any tax disadvantages that remain are compensated for in other directions e.g. highly developed markets and financial institutions, extensive travel and telecommuncations, educational, recreational and cultural facilities, etc.

Removal of the relief reflects success to date in bringing down the tax rates and the Chancellor's determination to eliminate as far as possible distortions and anomalies in the tax system.

Like the similar relief for foreign earnings of UK residents working and trading abroad, also to be phased out (over two years) the foreign emoluments deduction may be said to have outlived its usefulness. Its withdrawal is in no sense an "anti-foreigner" move nor, more particularly, is it anti-American. There is no connection with the "unitary tax" controversy.

The generous transitional provisions demonstrate our concern to "soften the blow" for those affected.

BUSINESS EXPANSION SCHEME

The BES was introduced in 1983 and greatly extended and improved the previous Business Start-up Scheme. It offers income tax relief at full marginal rates for individuals investing up to £40,000 in new, full-risk ordinary shares of unquoted UK companies with which the investor is not otherwise connected. Two issues concerning the scheme may be mentioned:

(a) Exports

The Scheme is to benefit activity, including jobs in the UK so, to qualify, a company and any subsidiaries must be incorporated and resident in the UK. It has been argued that this is too restrictive - companies which export often need for sound commercial and non-fiscal reasons to have an overseas subsidiary - and that in certain cases the scheme should be extended to companies with overseas subsidiaries.

Line to take Under present rules a company can still qualify if it exports some or all of its products etc, or if it carries on some activities overseas, provided more than half of its activities as a whole are carried on in the UK. Treasury Ministers not unsympathetic to letting in a company with overseas subsidiaries in certain circumstances, but in his Budget Statement Chancellor said Scheme needs time to settle down before considering any changes.

(b) Shipping

The Scheme is for investment in high-risk trades so certain activities are excluded. Among these are leasing and letting assets on hire including ship chartering. The shipping industry has been pressing hard for certain kinds of - more risky - ship chartering to be included.

Line to take Treasury Ministers have considered this carefully but see considerable difficulties. It would open up the Scheme to leasing and letting assets on hire generally. It might result in little direct additional economic activity in UK - eg ship might be built abroad, be engaged wholly in third country trade and not necessarily (apart from the officers) manned by a UK crew. Also, whilst there is no limitation in the legislation on the size of company, scheme is aimed at encouraging investment in small and medium sized companies rather than the larger companies such as there generally found in the shipping industry.

Liberalisation of trade in banking services

There are no particular points on liberalisation of trade in banking services which it is necessary for you to raise. Banking is included in the service sectors on which studies on obstacles to trade are being carried out in OECD, GATT and UNCTAD (Annex 5 of DTI brief). The UK has of course a particularly strong interest in liberalisation in this sector, and the BIEC has been active in the past in promoting UK banking services abroad. In discussion you might wish to make use of the following bull points on banking services generally:

(i) In 1982 (latest figures) UK banks contributed credits of over £4 billion to the balance of payments. Banking sector debits were £2½ billion, making a surplus of £1½ billion.

(ii) Growth in these earnings has been extremely rapid over the past 10 years; the 1982 figure was 12 times the size of the 1972 figure.

(iii) In 1981 (latest world data), the UK produced the largest world surplus in the BIEC's "other services" category, which includes financial services.

(iv) In 1982 London's share of all international banking transactions rose to almost 27 per cent - some $642 billion - with the USA in second place with 14½ per cent.

The main reasons for not having a Review were given as:-

(a) The Scheme is working smoothly and continues to attract support from industry and commerce.

(b) It would cost (then) some £36,000, mainly staff costs.

(c) The Government was seeking to curb public expenditure.

(d) The question of a Review could be re-considered from year-to-year if support declined.

Although the number of applications for the export Award has dropped since 1979 (the technology ones holding up quite well), I think that this is more a reflection of the economic situation rather than a decline of interest in the Scheme itself. A rough re-estimate of the costs of a Review show these to be in the order of £50,000; again, mostly staff costs. Apart from these direct costs, a Review would occupy some of Sir Robert's time as well as that of Sir Brian Hayes and Sir Anthony Rawlinson since, on past precedents, they would be members of the Review Committee.

There have been a number of proposals to extend the scope of the Scheme, many of which have been considered, and rejected, by previous Review Committees. A list of the major suggestions is attached.

The invisibles sector has done quite well in the number of the Awards it has gained when compared with its proportion of the total applications from both the visibles and invisibles. For example, last year, the invisibles represented 18% of the total export applications yet gained 24% of the 90 export Awards granted.

The Office view on the question of a Review is neutral. My only purpose in writing now is so that you may be aware of the past history in case the BIEC does raise the matter with the Prime Minister.

I am copying this letter to Robin Butler, Peter Bunn in Sir Brian Hayes' office and Paul Smee in Sir Anthony Rawlinson's office.

Yours sincerely

Leslie Quilter

L H QUILTER

1. PROPOSALS FOR EXTENSIONS TO THE SCHEME

Suggestions for extending the Scheme have included claims for special recognition of:-

Aid for Commonwealth development

Consistent exporters

Employment - job creation

Employment - for disabled

Energy conservation

Import savings

Indirect exports

Industrial relations

Investment strategy

Holding companies (as parents)

Labour unit-cost improvements

Pollution control

Profitability

Quality

Race relations

Reclamation

Services to exporters

Staff training

In addition, the Committee on Invisible Exports (COIE) has been pressing for the rules to be changed so as to allow inclusion of:-

Profit on direct investments overseas

Interest received on loans and credits made overseas

Profit on portfolio investments made abroad

Estimate of earnings from tourism

Receipts from UK residents by shipping and aviation carriers

The COIE proposals, and some of the others, have been considered - and rejected - by previous Review Committees.

The Queen's Awards Office
~~April 1983~~
February 1984

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R P Hatfield Esq
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22 February 1984

pps in 'Honours'

Dear Richard

THE QUEEN'S AWARDS FOR EXPORT AND TECHNOLOGY

At its meeting last March, the Prime Minister's Advisory Committee set up an informal Working Group, which I chair, to look at the application of the rules of the Scheme to the invisibles sector.

The British Invisible Exports Council is represented by its Director General, Mr William Clarke. On a number of points raised by the BIEC, which would involve significant changes in the present rules, I have commented that these would probably have to wait until there is another full-scale review of the Scheme (and none is planned at present).

In his latest letter, Mr Clarke has stated that the BIEC will be meeting the Prime Minister next month and may take the opportunity of raising the matter of a review with her. This was mentioned again at one of the regular meetings of the Working Group held last week.

The Scheme was set up in 1965 (originally as The Queen's Award to Industry) following the recommendations of a Committee chaired by The Duke of Edinburgh. One of the recommendations of that Committee was that the Scheme should be reviewed after five years. The first review took place in 1970 (by a Committee under Lord McFadzean, in the absence overseas of The Duke of Edinburgh) and recommended that the invisibles sector, hitherto excluded, be brought into the Scheme; another recommendation was that there should be a further review in 1975. This second review took place under The Duke of Edinburgh and recommended a further review in 1980. (The recommendations of these three Committees provide the rules under which the Scheme is operated).

When the 1980 review became due, the then Secretary, Department of Industry and Secretary, Department of Trade, with the concurrence of their Secretaries of State recommended that the review should not take place and The Queen, on the advice of the Prime Minister, agreed (July 1979). We were told that the Prime Minister preferred that we should deal with any questions on a future review on the lines:

> "The Queen's Awards for Export and Technology will continue as at present, without Quinquennial Review".