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DEPARTMENT OF TRANSPORT
2 MARSHAM STREET LONDON SW1P 3EB

Prime Minister (2)

MCS 21/7

The Rt Hon Leon Brittan QC, MP
Chief Secretary to the Treasury
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

20 July 1982

Dear Leon

BRITISH RAIL'S TEMPORARY BORROWING FROM THE NLF

Thank you for your letter of 8 July proposing the immediate introduction of new arrangements for BR to take short-term finance from the NLF and to cease drawing on its established banking sources.

I understand that though there are unlikely to be significant practical difficulties in establishing an NLF facility, the substantive issues about arrangements for nationalised industries generally to have access to an NLF "overdraft" are still under discussion in the NICG on the basis that any changes would be voluntary.

I see considerable disadvantages in making fresh arrangements with BR in advance of the outcome of those discussions. I am not clear why this step is necessary now. The amounts involved for BR are relatively small since the great majority of their temporary borrowing is taken not from the banks but from various public sector sources, principally local authorities.

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One special step which we might take, if the Board are willing, would be to ask them to use the NLF as an additional facility particularly for temporary borrowings in excess of £150m. This would be on a voluntary basis, and subject to the Board's being satisfied about the terms. That is, in my view, all we can ask them to do at present, and I believe that the Board would agree.

I would be concerned if there were a firm proposal that BRB should only borrow temporarily from the public sector. In present circumstances we should not want to take any steps which could cast doubt on their credit, both with suppliers and the City.

Yours ever

David

DAVID HOWELL

Prime Minister (2)

This somewhat weakens our public position that we are not giving BRB any more money - but for good monetary policy reasons.

MCS 8/7

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon David Howell MP
Secretary of State
Department of Transport
2 Marsham Street
London SW1P 3EB

8 July 1982

Dear Secretary of State,

BRITISH RAIL'S TEMPORARY BORROWING FROM THE NLF

It is now public knowledge that the Government has agreed that, in the absence of the Public Service Obligation grant, British Rail should be able to borrow against its temporary borrowing limit of £150 million and that if necessary the limit can be raised.

Under current arrangements the Board would borrow from banks or from other public sector bodies with the existing Government guarantee. The purpose of this letter is to propose that from now on the temporary borrowing from banks which the Board would otherwise have made should come from the National Loans Fund. I understand that the Board would be willing to do this, though they might well want to retain a limited overdraft facility with their present clearing bank. This has emerged from the consultations which the Treasury has been having with the Nationalised Industries about displacing temporary borrowing from the banks by NLF lending. The context of the consultations, which are not yet complete, was set out in the Chancellor's Parliamentary Answer of 25 June (a copy is enclosed). But in brief, for a given level of funding required for monetary control, displacing bank borrowing by Nationalised Industries with NLF lending reduces the extent of money market shortage and of any NLF surplus that we might accumulate. It raises the CGBR but leaves the PSBR unchanged and should produce some savings in the public sector's interest burden.

From the presentational point of view there is little to choose between the Board borrowing from banks with an explicit Government guarantee and borrowing from the NLF. The amount of borrowing would of course be unaffected.

I understand that practical arrangements should not be difficult to sort out and, if you agree, I hope that temporary borrowing from the NLF can begin on Monday, 12 July.

I am sending copies of this letter to the Prime Minister and Sir Robert Armstrong.

Yours sincerely

T. Mattews

for LEON BRITTAN

Approved by the Chief Secretary
and signed in his absence

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
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25 June 1982

ARRANGEMENTS GOVERNING BORROWING BY THE CORPORATE AND PUBLIC SECTORS

In answer to a Written Question from Sir Brandon Rhys Williams Bt, MP, the Chancellor of the Exchequer, the Rt Hon Sir Geoffrey Howe, QC, MP, today gave the attached answer about arrangements governing borrowing by the corporate and public sectors.

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HM TREASURY
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SIR BRANDON RHYS WILLIAMS:

To ask the Chancellor of the Exchequer if he will make a statement about arrangements governing borrowing by the corporate and public sectors.

CHANCELLOR:

Yes. I have decided that some further steps should be taken which I believe may help industry to raise long term finance, to reduce the dependence of the local authorities on bank borrowing, and to remove possible obstacles to funding the borrowing requirement.

Funding has been an important instrument of monetary policy under successive governments. Sales of central government debt such as gilts and National Savings to the non-bank public have been used to contain the growth of £M3 and to reduce liquidity in the economy.

The level of funding needed to achieve satisfactory monetary conditions would be lower if companies derived more of their finance from the capital market and less from banks than they have done for many years. There was a revival in equity issues last year. But there has, so far, been little improvement in company stock issues. This should come with further reduction in inflation and interest rates. But there is one obstacle which I can remove immediately. This is the effective embargo on the issue of zero and low coupon stock by companies. The Inland Revenue are issuing a statement today, which will be available in the Vote Office, to clarify the tax treatment of such stock and also of different forms of indexed borrowing by companies, together with the safeguards necessary to prevent tax avoidance.

Companies, including small companies, will now be free to issue such stock, as they have in the past been free to issue indexed stock, subject to the normal arrangements for obtaining timing consent from the Bank of England for issues of £3 m or above.

The Government are separately examining the possibility of providing for the taxation on an "accruals" basis of the discount on zero and low coupon stocks. Under such a regime the discount would be treated for tax purposes, both for the lender and for the borrower, as interest arising over the life of the stock, rather than as rolled-up interest paid at redemption. Such arrangements, if they were considered appropriate, would require legislation in next year's Finance Bill and would not apply to stock already in issue at that time.

The appropriate level of funding has, of course, to be decided in the light of all the monetary indicators. That level may sometimes be higher and sometimes lower than the Public Sector Borrowing Requirement. But as a result of the cumulative effect of funding policy in recent years it may not be possible to fund the borrowing requirement without a risk of producing balances in the National Loans Fund (NLF) larger than the working levels permitted under the 1968 National Loans Act.

I have therefore decided that it would be right to amend Section 12 of the Act to allow the Treasury to borrow for monetary policy purposes when this is not needed to meet the NLF's outgoings. If use of this power leads to NLF balances with the Banking Department at the Bank of England, these sums would be available to relieve shortages in the money market, which are a corollary of debt sales.

I shall also be proposing amendments to Section 5 of the Act. This will provide an explicit power for the NLF to make variable rate loans. This will enable us to meet the request for such a facility from the local authorities, which in recent years have increasingly borrowed in this form from the banks. Higher lending to the local authorities from the NLF will raise the CGBR but not the PSBR. For a given level of debt sales it will reduce any balance in the NLF and the scale of money market shortages. A similar effect will be achieved if more of the temporary finance needed by Nationalised Industries is provided from the NLF. The possibility is now being discussed with them.

The necessary new Clauses and Ways and Means Resolution are being tabled today.