MO

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 3 P.M. ON TUESDAY, 2ND FEBRUARY, 1982

Present:-

Chancellor of the Exchequer	Sir Raymond Pennock	)
Financial Secretary	Sir Terence Beckett	)
Mr. Ryrie	Sir Donald MacDougall	) C.B.I.
Mr. Burns	Mr. D.R. Glynn	)
Mr. Quinlan	Mr. R. Utiger	)
Mr. Battishill	Mr. A. Willingdale	)
Mr. Cassell	Mr. J. Pope	)
	Mr. D. McWilliams	)
Mr. Isaac) Inland		
Mr. Ware) Revenue		

C.B.I. BUDGET REPRESENTATIONS

Referring to the CBI document "A Winning Budget" due for publication on Wednesday, 10 February, Sir Raymond Pennock said that the CBI's basic message to the Chancellor did not claim to be original and he had heard it before. Above all what was needed was a Budget which cut business costs to reduce the disproportionate burden on the business sector. The aim should be to improve competitiveness and redress the imbalance of pressure in the economy which had borne less heavily on Government and consumption and much more heavily on production and investment. Since the last Budget the situation had changed significantly in a way which added validity to the CBI's basic case. This time last year the recession was still getting deeper; it was now clear with hindsight that it had reached bottom at the end of the second quarter of 1981, but the recovery had been so slow it had been difficult to discern. The second point was that the Government was a year nearer an Election which could be as little as 18 months away. British industry had done a great deal to make itself more competitive; and the CBI and Government were completely agreed that this was the key to recovery. The only way out of the recession would be by sustaining the improvement in productivity and reducing costs, particularly pay. Pay was a success story - the level of settlements had been halved last year, and in the present year they were running at 4 to 6 per cent in the private sector which represented a further halving of last year's level. On productivity, the CBI's figures showed that even with reduced output productivity in terms of output per man was up 10 per cent. The potential for improved productivity was even greater; in the case of his own company, BIC, if it were possible to return to the 1979 volume (i.e. 10 per cent up on present level) profitability would increase very substantially because the workforce was down by 25 per cent.

2. In the battle for competitiveness industry had therefore done what was required of it. But this contrasted markedly with what had happened in the public sector. When industry examined those costs over which it did not had control - and he had in mind particularly the NIS, rates, energy costs and other nationalised industry charges - it found they had all increased substantially. This had to be seen in the context of present levels of profitability which were around 2 per cent return on capital. A cut in NIS would be a sure and certain way of improving competitiveness or productivity or both. If the Government thought there was a danger than a NIS reduction would be passed on in higher wage settlements, then it was out of touch with reality. With 3 million unemployed and pre-tax profits at the present historically low level this simply would not happen. The CBI had demonstrated that at least 60 per cent of the benefit would go to manufacturing and distributive industry.

3. Sir Terence Beckett said that the CBI's quarterly trends survey was published that day. Its findings were consistent with the latest projections of 1 per cent growth in GDP and 3 per cent growth in manufacturing. The slight decline in confidence evident in the October survey had been reversed, but there was no significant improvement in demand or output. 93 per cent of respondents had said their output was constrained by lack of orders or sales. The position on competitiveness, and under-use of capacity were much the same, and it was clear that more job losses were in the pipe-line. There was also more de-stocking to be done on raw materials, work in

progress and finished goods. Trend profitability was improving; there was evidence that costs were under control and margins were hardening in both home and overseas markets. Investment intentions were rising for the 5th survey in a row, but it had to be remembered that there was a lag between intention and action of around 12 months, so that the spend would not occur until the second half of the year. On this evidence the case for help from Government to keep things moving in the right direction was compelling. But he had himself said quite clearly on radio and television that morning that reflation must be modest and restrained, since in the present state of the economy the risk of overheating and bottlenecks, and the renewed surge of inflation was very real.

4. Mr. Utiger commented in answer to a question from the Chancellor that although the CBI's representations only touched briefly on the question of excise duties, there was no doubt that last year's measures which did more than revalorise the duties had had a severe impact on the industries and there was therefore a strong case for restraint here. On income tax the CBI supported indexation of the thresholds on the Rooker-Wise formula. But they were convinced that an NIS cut should be preferred to a cut in income tax. It would be far more effective to act directly on business costs, than to try to help industry by increasing consumer purchasing which would tend to suck in imports.

5. The Chancellor commented that the Treasury's own analysis showed that the difference in the end between a cut in income tax, indirect taxes or the NIS on the level of activity were very slight. The Institute of Directors had argued in favour of an income tax cut mainly because of the helpful effect this would have on pay negotiations But he had noted the force of the CBI's argument on this point.

6. In answer to a question from the Financial Secretary about the case for cutting corporation tax, Sir Terence Beckett commented that he saw little point in this as few companies were making substantial profits. What was needed was a reduction in business costs generally, not a reduction in the tax burden on profits.

7. Mr. Utiger said that the CBI attached considerable importance to its proposals for local authority finance. In particular it considered that the present depressed state of the economy and the huge rise in business rates over the last two years fully justified the reintroduction of 15 per cent business de-rating - the recommendation was for 15 per cent. The abolition of rates on empty property, described in the document as "moth-balling" relief was also important.

8. In further discussion the CBI made the following main points:-

(i) The effect of its proposals on the level of the PSBR would be broadly in line with the level targetted for in the current year. In putting forward its package therefore it saw some scope for a reduction in interest rates. It did not feel that interest rate policy should be used to prop up the exchange rate.

(ii) It believed there was a strong need for additional investment in capital projects providing certain criteria were met, and it would like to see public sector projects financed by private capital.

(iii) On energy costs, a number of specific proposals had been put forward costing approximately £70 million in a full year. It was a little cynical about the likely outcome of the review of the CEGB's bulk supply tariff, and it hoped the Government would take early and positive action. The needs of the large users were too real and important to be put on one side too long, and the sums were comparatively modest. It realised the difficulties on fuel oil duty and had not made too much of this question in the document - but obviously any movement here would be very helpful.

(iv) On capital taxes, on which a very detailed submission had been made in October 1979, a number of changes had been made, but a great deal was still to be done. On CGT, where the most objectionable feature was the fact that it often proved to be a tax on inflationary rather than real gains, the CBI favoured the introduction of a 7 year cut-off in preference to the indexation of the threshold. On CTT it argued strongly for the extension of business relief, so that assets currently qualifying at 30 per cent should be merged with those currently relieved at 50 per cent, and the relief increased to 75 per cent for all of them (with assets now receiving 20 per cent relief being increased to 30 per cent). The CBI also attached importance to the review and overhaul of retirement relief rules for capital gains tax - this would be particularly helpful to small businesses.

(v) Development Land Tax, which only brought in some £25 million per year, should be scrapped.

9. The CBI would like to see further measures to help positively small firms, which suffered particular handicaps, and could not insulate themselves from prevailing economic conditions. It believed that the Business Start-Up reliefs should be made available to established companies, and particularly so in the case of management buy-outs. Individuals should be allowed the same tax relief as is now given for investing directly in eligible companies when they invested through the mechanism of a small firms investment company.

10. Summing up for the CBI, Sir Raymond Pennock said that the basic message was that the Budget should cut business costs significantly to improve competitiveness, even at the expense of the consumer. The direct effect on business costs of their recommendations were shown on page 5 - this showed a total reduction of £2590 million in 1982/83 and £3,000 million in 1983/84. The net addition to the PSBR on the CBI's calculations were shown on page 7 - £1840 million in 1982/83 and £1700 million in 1983/84. This meant a PSBR in money terms for 1982/83 of about £11 to £12 billion, which would represent about the

same percentage of GDP as the target for 1981/82 announced in the 1981 Budget. The CBI believed that the City had already discounted the effect of an increase in the PSBR of £1½ billion over the target of £9 billion. On page 6 of the document, the CBI had made some suggestions about how the proposals should be financed, and he wished to emphasise the importance of the second suggestion, reductions in Government current spending. This could be achieved by implementing the recommendations of the CBI working party on Government expenditure, from additional asset sales and lower interest payments. His general message would be for the Government not to believe anyone in the public sector who said they had already achieved as much as they could in this direction.

11. Finally, he would like to make a point on wages. He had already stressed that the CBI did not believe an NIS cut would feed through into higher wage settlements. This was partly because there had been a change in attitudes, away from a deterministic view of wages and the idea that there was an entitlement to wage levels above the level of inflation. There was now a much better appreciation of how overall costs could directly affect job security; and a realisation that profits were needed for investment.

12. <u>The Chancellor</u> thanked the CBI for their clear and full representation.

PJ

P.S. JENKINS
3rd February 1982

Circulation:

Ministers & officials present
Chief Secretary
Economic Secretary
Minister of State (L)
Minister of State (C)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Kenneth Couzens
Mr. Lavelle
Mr. Kitcatt
Mr. Evans

Mr. Barratt
Mr. Middleton
Mr. Kemp
Mr. Griffiths
Mr. Robson
Mr. Norgrove
Mr. Mountfield
Mr. R.I.G. Allen
Mr. Christie
Mr Monck

Mr. Dixon
Mr. Gordon
Mr. Buckley
Mr. Ridley
Mr. Harris
Mr. Burgner
Mr. Lovell
Mrs. Gilmore

PS/Inland Revenue
PS/Customs & Excise

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Raymond Pennock
President

CBI CONFEDERATION OF BRITISH INDUSTRY

Econ Pol

PM has seen
MLS 5/2

3rd February 1982

Dear Caroline.

Further to Sir Raymond Pennock's letter of 26th January to the Prime Minister concerning the CBI Budget Representations, I now have pleasure in sending the final version of our Representations to the Chancellor.

Yours sincerely,
Beatrice Gilpin
Personal Assistant to
The President

Mrs. Caroline Ryder,
Personal Assistant to the Prime Minister,
10 Downing Street,
London, SW 1.

And many congratulations - and good wishes - on your marriage!

FILE SW

Econ Pol.

29 Janumry, 1982

I am writing on behalf of the Prime Minister to thank you for your letter of 26 January which I am placing before the Prime Minister.

Yours sincerely,

M. C. SCHOLAR

Sir Raymond Pennock

B

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From
Sir Raymond Pennock
President

2

CBI CONFEDERATION OF BRITISH INDUSTRY

Prime Minister

The main points are

(i) reduction by 2 percentage points in NIS

(ii) 15% business derating

(iii) lower interest rates

(iv) more public sector capital investment.

MLS 29/1

26 January 1982

The Rt Hon Margaret Thatcher MP
The Prime Minister
10 Downing Street
London SW1

Dear Prime Minister,

Following the CBI Council meeting last week, we have now finalised our budget representations.

I am enclosing a copy of the leaflet "A Winning Budget", which briefly sets out our views overall. In addition, I am attaching the much more detailed "Budget Representations" which were given to our Council last week and will need some small amendments in the light of the discussion that took place then. Nevertheless, they do provide the full background for our proposals.

As soon as an amended copy is available, we will forward it to you.

Yours sincerely

Ray Pennock

D R A F T

STRICTLY CONFIDENTIAL

BUDGET REPRESENTATIONS TO THE CHANCELLOR

1982

A WINNING BUDGET:

Budget Representations to the Chancellor

February 1982

A Winning Budget

Business has made great strides in improving efficiency and reducing its cost increases. Despite this, the pressures on most firms remain severe and, if maintained, will hold back any recovery.

Now is the time to take advantage of the lessons we have all learned and build on our strengths. These Budget Representations to the Chancellor of the Exchequer show how he could best do this in the coming Budget.

British business has the will to win. We call on the Chancellor to back this with 'A Winning Budget'.

Confederation of British Industry
Centre Point
103 New Oxford Street
London
WC1A 1DU

February 1982

CONTENTS

BRSTART

I MAIN RECOMMENDATIONS

The priority for this Budget must be to reduce the disproportionate burden on the business sector. Business has made major adjustments at great cost-all in line with government policy. We now call on Government to reduce the costs which it imposes on business, improve competitiveness and redress the imbalance of pressure in the economy which has borne less heavily on government and consumption and much more heavily on production and investment.

The analysis in Annex I draws attention to two inter-related problems which the Budget must begin to solve if a sustained recovery is to be achieved: lack of competitiveness and the low level of activity. The Annex also shows how our proposals will affect the economy. The major effects are:

* no adverse effect on inflation. Our recommendations would reduce UK costs and raise, slightly, import costs. Net, after taking account of higher demand and the spreading of overheads, our estimates suggest that our package would not hold back the expected decline in inflation, and indeed may help reduce it further;

* a substantial improvement in competitiveness;

* more growth of production;

* improved profitablility; and as a result,

* more jobs. Our analysis shows that these proposals would lead to a quarter of a million extra jobs by the second half of 1983.

I.1 What We Recommend

There are four major elements in our recommended package:

i NATIONAL INSURANCE SURCHARGE SHOULD BE REDUCED IMMEDIATELY BY TWO PERCENTAGE POINTS AS THE FIRST STEP TO ABOLITION.

ii FIFTEEN PER CENT BUSINESS DERATING SHOULD BE INTRODUCED, FINANCED BY INCREASED CENTRAL GOVERNMENT GRANT. This would put business on an equal footing with the domestic sector.

iii THE BURDEN OF INTEREST COSTS WHICH IS BEARING HARD ON COMPANIES SHOULD BE REDUCED. Lower Interest Rates would help to bring the exchange rate down to a more competitive level. They are a major business cost, particularly for smaller firms, and their reduction would also help competitiveness, activity and investment. Both real interest rates and the real exchange rate are very high by historical standards. In addition, interest rates are high in relation to rates of return, and should not be kept up to hold up the exchange rate at its present level.

iv THE GOVERNMENT SHOULD MAKE AN IMMEDIATE START IN RAISING THE LEVEL OF PRODUCTIVE INVESTMENT IN THE PUBLIC SECTOR. This investment would strengthen competitiveness both by improving the economic infrastructure and by increasing industrial throughput. We envisage extra expenditure building up to £1 billion in 1983/84 (see Table I.2). As much as possible of this extra investment should be financed through the introduction of private capital, sharing any risk involved.

Our detailed proposals for Taxation, Local Authority Finance and Government Expenditure are contained in Sections III, IV and V. In addition to the measures above, these proposals include:

i Further measures to bring our industrial energy costs into line with those of our competitors.

ii The abolition of the empty property rate and the introduction of "mothballing" relief for industrial premises.

iii The continuation and extension of the measures taken by the Government which have been aimed at encouraging smaller firms. In particular, we believe that the development of Small Firms Investment Companies and an extension of the Business Start-Up Scheme would produce a significant increase in investment in such firms.

iv Further steps to reduce the harmful effects which Capital Gains Tax and Capital Transfer Tax have on enterprise and smaller businesses in particular.

v Abolition of the four months delay in payment of Regional Development Grants.

vi A number of technical tax changes which would improve the business climate, and remove anomalies at little revenue cost.

The direct effect on business costs of our recommendations is shown in Table I.1.

TABLE I.1

REDUCTIONS IN BUSINESS COSTS FROM CBI RECOMMENDATIONS

£m, 1982/83 prices

	In 1982/3	Full Year Effect
2 point reduction in NIS	1500*	1900
15 per cent business derating	850	850
'Mothball' relief, empty property rate relief and reduced energy costs	100	250
Abolition of 4 months delay in payment of RDGs	125	nil
Total reduction in business costs	2575	3000

Plus £250m (net) for every 1 percentage point reduction in interest rates.

* This assumes implementation 4 weeks after the start of the financial year. There is also an additional 6 week delay before the Government receipts are affected.

We are further recommending, and have assumed in our calculations, that personal income tax allowances and thresholds should be indexed in line with inflation and in addition that there should be no rise in excise duties. Although priority must be given to business there should be no increase in the overall burden of personal taxation in the coming Budget because of the expected weakness of consumer demand, particularly taking account of the higher National Insurance contributions to be paid from April 1982. The failure of the Chancellor to index personal allowances in 1981 and the substantial increase in excise duties in 1981 are further reasons for implementing these recommendations.

I.2 Financing These Proposals

In considering how the package of measures aimed at reducing business costs and raising investment should be financed, there are three main options open to the Government:

i There could be an increase in the burden of personal taxation, through not fully indexing personal income tax allowances and thresholds in line with prices, through increasing income tax rates or through raising indirect taxes. As made clear above, the CBI does not recommend any of these options.

ii There should be reductions in government current spending. The CBI has argued strongly that the Government should further reduce its current spending below planned levels. We believe that the Government could save at least £¾ billion in 1982/83 from the levels announced by the Chancellor last December and considerably more in subsequent years by implementing the recommendations of the CBI Working Party on government expenditure, from additional asset sales and lower interest payments. Our detailed proposals for government expenditure are contained in Section V.

iii There could be an increase in public borrowing. The CBI has argued for a modest expansion of the economy, accepting a temporary increase in the public sector borrowing requirement. This would raise demand and, provided it were concentrated on the areas outlined above, it should lead to lower company borrowing and greater market confidence in a soundly based recovery and thus have little effect on monetary growth while still achieving our objective of lower interest rates. Our recommendations would leave the level of public borrowing below its level in some recent years in money terms and considerably lower than in most recent years once adjustment is made for inflation and the recession. More detailed discussion of fiscal and monetary policy and the effects of these proposals are contained in Section II and Annex I.

Table I.2 shows our preferred method of financing our recommendations. Although they result in a higher PSBR than expected on unchanged policies in 1982/83, the increase in the PSBR in 1983/84 is lower as a result of the higher level of economic activity. We consider that the proposals, taken together, are the best way of achieving our objectives of improved competitiveness and a sustainable recovery. If some of our recommendations for reductions in business costs were not implemented we would urge further reductions in other business costs. In addition, if personal taxes or taxes on consumption were to be increased or if for any other reason there were more scope than we have assumed, then any additional revenue should be used to finance additional reductions in business costs.

TABLE I.2

ADDITION TO PUBLIC BORROWING (PSBR)[1] FROM CBI RECOMMENDATIONS

	£m, 1982/83 prices	
	In 1982/3	In 1983/4
Cuts in business costs[2]	2575	3000
Extra public sector capital spending[3]	250	1000
Other measures[4]	small	400
Reduction in Government spending, and more asset sales (see Table V.1)	-800	-1500
Feedback Effect[5]	-200	-1200
Net Addition to PSBR	1825	1700

1 By comparison with the level assuming indexation of personal tax allowances and bands and no increases in excise duties.

2 See Table I.1 for further details. The estimates for 1982/83 are lower than for 1983/84 because of implementation and collection delays.

3 Some of this extra capital spending may be financed by private capital (eg British Telecom Bonds) and may not count towards the PSBR. The nationalised industries will gain from the reduction in NIS and business rates, which will enable them to increase their investment further and/or to reduce their prices and charges.

The extra capital spending allows for additional expenditure in support of industrial R and D.

4 Smaller firms, capital taxes, capital allowances, DLT and technical representations (see Section III).

5 Feedback effects reflect the estimated impact of these recommendations on the levels of prices and activity. This impact is mainly to reduce the PSBR as higher activity generates more tax revenue and reduces the number receiving unemploymment benefit in comparison with what otherwise would have happened.

II REDUCING INFLATION AND RECOVERING PROSPERITY

This section explains the economic reasoning underlying the recommendations set out in Section I. Further details on the economic situation and how our proposals would improve the economic prospects are contained in Annex 1.

II.1 Competitiveness

We show in Annex 1 how competitiveness has moved in recent years. Although the position now is substantially better than a year ago, UK unit labour cost competitiveness is still 30 to 35 per cent worse than in 1975, which was a typical year. Low levels of competitiveness and, resulting partly from that, low levels of profitability, have been important reasons for the large loss of output in recent years. At current levels of competitiveness, production in many sectors of the UK economy remains uneconomic. Therefore, competitiveness needs to improve for the recovery to be more than sluggish. These recommendations are designed to improve competitiveness directly by helping to reduce business costs.

II.2 The Need for Balance

The CBI has consistently given priority to the defeat of inflation. However this is not the only economic policy objective. Indeed, since a major reason for aiming to reduce inflation is to raise output and employment thereby, it would be perverse to follow a counter-inflation policy regardless of its consequence for these variables. To do so would risk the medicine proving more damaging than the disease. Moreover, for inflation to be kept low in the longer run, it is necessary for firms to have sufficient capacity in the widest sense for demand to be met without inflationary shortages. A fall in inflation in the short term bought at the expense of serious damage to the business sector's ability to supply its markets would thus be only a temporary victory. It is therefore important to balance the objective of a further reduction in the rate of inflation in the short run with that of preserving a healthy business sector.

A second area where a more balanced approach is needed is in ensuring that the pressure for improving efficiency and reducing inflation is spread more fairly between the Government sector and the business sector. Government consumption expenditure[1] was in mid-1981 over 20 per cent higher in cost terms than two years previously, whereas output in manufacturing fell by about 14 per cent in the same period. The imbalance of pressure that these figures demonstrate has greatly impeded the objective of reducing inflation. High public sector pay settlements, in conjunction with rising interest rates, taxes, local authority rates and public sector charges have added directly to inflation and have made pay moderation in the private sector more difficult to achieve. Had Government charges and taxes moved in line with the the costs directly under business control, price inflation by now would be well into single figures.

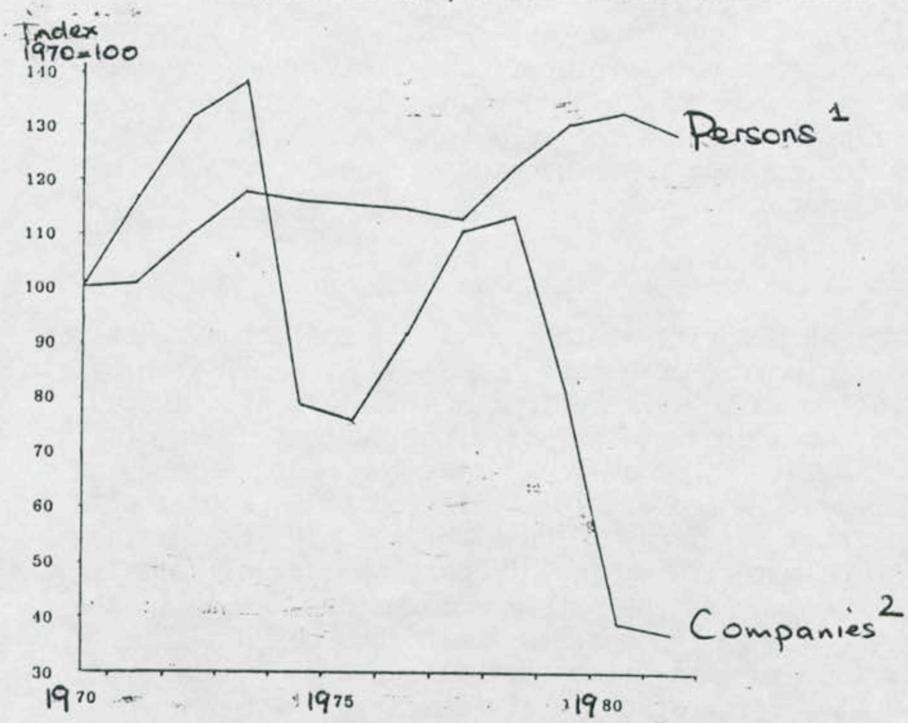
---

1 General government current expenditure on goods and services deflated by the GDP deflator. Much of this comprises pay and the extra costs of employment in the public sector.

A third imbalance is that between the incomes of persons in work and of companies. Although average earnings during 1981 rose by less than the cost of living, Chart II.1 shows that the real disposable incomes of those in work over the year as a whole were 13 per cent higher than four years earlier. Meanwhile real company post-tax profitability in 1981, despite a slight recovery during the year, is shown by the Chart to have fallen by nearly 70 per cent since 1977.

CHART II.1

Real Disposable Income for Companies and Persons



1 Real Personal Disposable Income

2 Gross trading profits plus rent net of stock appreciation, capital consumption and tax payments for industrial and commercial companies excluding North Sea activities

Sources: 1970-80 Central Statistical Office, 1981 CBI estimate

Our representations are designed to help correct these imbalances by improving profitability and competitiveness.

II.3 Reducing Inflation

Five years ago, in "Britain Means Business 1977", the CBI stated clearly that while sound fiscal and monetary policies were essential for reducing inflation, they should not be relied on solely. We pointed out that:

"Exclusive reliance on monetary policy could do serious damage to industry. In the absence of other measures, the more severe the cost pressures the more stringent the effects of monetary policy would be and hence the greater the fall in business activity, the greater the number of business failures and the greater the rise in unemployment."

This prediction has, unfortunately, been borne out by events. Our representations, therefore, include measures that support sound fiscal and monetary policies in helping to reduce inflation without crippling the business sector. We see a need for action in four areas.

First, the beneficial consequences for jobs and living standards of lower pay settlements and hence lower inflation should be made clear to all who work in industry. The CBI has taken the lead in this area: operating our own Employee Communication Unit, giving advice to individual companies, running conference and "workshops" on the communication of business realities, and providing briefing material for those involved in pay bargaining, including information on the economic background. The CBI has also carried out and published a major survey on current employee involvement practice among its members[1]. It remains essential for all concerned in industry and outside to communicate the true facts of the economic situation to all involved in negotiations on pay or productivity.

Secondly, the Government should ensure that the settlements which it can control, in the public sector, are at such levels that they do not raise pay expectations elsewhere in the economy. The Report of the CBI Working Party on Government Spending shows what can be done in this area and the CBI evidence to the Megaw Inquiry suggests ways in which the pay of Civil Servants can be more directly and effectively controlled by ministers.

Thirdly, the experience of the past two years has shown that while business has been very successful in holding down the increases in the costs it can control, rises in costs beyond its control, mainly imposed by government, have prevented this success from being fully reflected in lower inflation. The proposals in these Representations for reducing business costs and holding down indirect tax increases would enable measures taken by business to reduce costs to be more fully reflected in lower inflation.

Finally, although the need for sound fiscal and monetary policies is clear, this does not mean that these policies should be so restrictive as to do serious damage to the ability of the economy to produce. We give more detail on our recommendations for fiscal and monetary policy below.

The simulations reported in Annex 1 show that our recommendations will, if anything, reduce inflation. This is because we recommend that the attempts to reduce inflation by fiscal and monetary policy should be backed up by action in the areas outlined above. The direct effects on inflation of our recommendations would be to reduce UK business costs and raise, slightly, the costs of imported goods. The second round effects would be to put some upward pressure on prices from higher demand, but some downward pressure from the spreading of overheads over higher production. At present, with considerable spare capacity it is unlikely that higher demand would cause serious inflationary pressure. Our calculations show that the net effect of

---

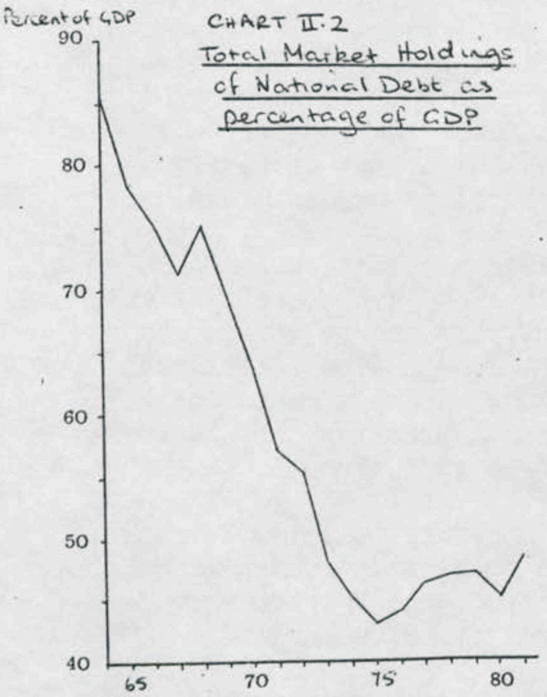
1 Current Employee Involvement Practice in British Business, CBI, November 1981.

all these influences is that they broadly offset each other or may reduce inflation slightly in the short run. In the longer run, by keeping capacity, in the widest sense, in existence where it might otherwise have been scrapped, our recommendations will make a further contribution to reducing inflation.

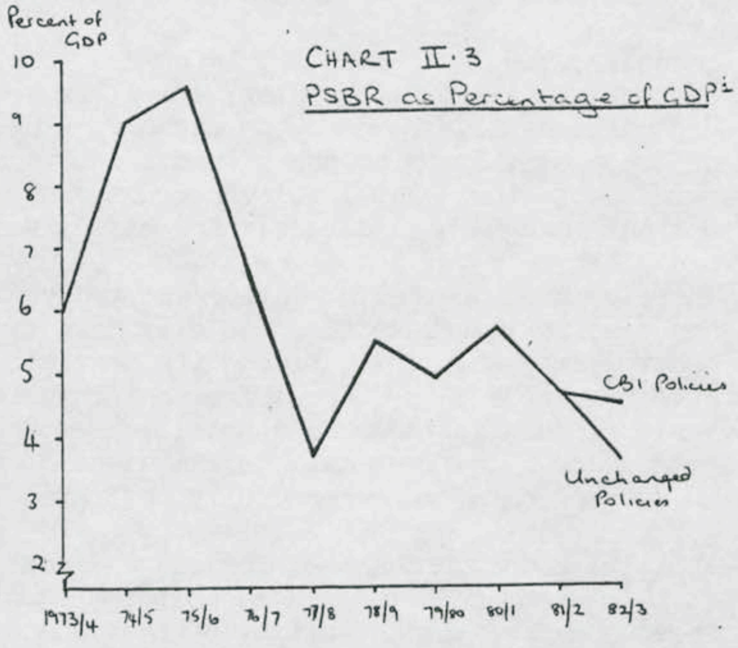
II.4 Fiscal Policy

The weakness of activity and employment, the low level of UK competitiveness and the depressed position of profitability together would, in isolation, lead us to recommend a very large expansion in the balance between spending and taxation. One objection to such an approach might be that a higher borrowing requirement might build up a burden for future generations.

In this context it is important to bear in mind that the burden of Government debt has fallen substantially since the mid 1960's, as Chart II.2 below demonstrates, while the PSBR as a percentage of GDP would on CBI proposals stay well below the levels of the mid-1970s (see Chart II.3). In addition, the Government is at present running a sizeable surplus on current account and would continue to do so if it were to follow our recommendations. Its borrowing, therefore, is less than its capital spending and is clearly not building up a burden for future generations of tax payers; quite the reverse.



Source: Bank of England



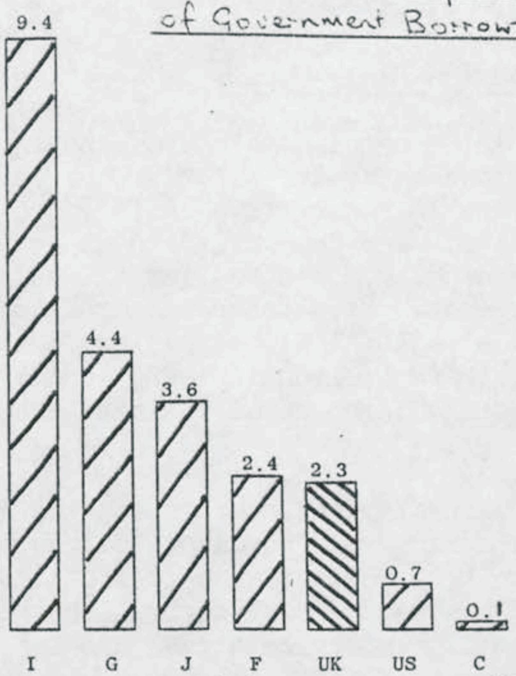
1 PSBR as percentage of GDP at market prices

Sources: 1973/4 to 1980/1, CSO; 1981/2, CBI estimate assuming PSBR is as announced in 1981 Budget; 1982/3 CBI estimates

Government borrowing in the UK is also lower than in many other major countries; Chart II.4 below shows government deficits on a comparable basis for the seven largest industrialised countries in 1981.

CHART II.4

International Comparison of Government Borrowing[1]



[1] General Government Deficit as percentage of GDP/GNP at market prices, 1981

Source: OECD Economic Outlook, December 1981

Recent experience has demonstrated that attempts to reduce public borrowing by imposing a restrictive fiscal stance on the economy during a recession may be counter-productive, intensifying the recessionary pressures, reducing Government revenues and forcing increased spending on unemployment and other benefits. A temporary modest increase in the PSBR should lead to economic growth which later reduces the burden of public borrowing by automatically increasing Government revenue and reducing expenditure.

The PSBR in 1980/81 was £13 billion and it looks likely that the outturn for 1981/82 will be close to the target of £10½ billion announced in the 1981 Budget. After taking account of inflation and the recession it is clear that a tightening of the fiscal stance has occurred between the two years. Estimates vary on the PSBR necessary for 1982/83 to prevent a further tightening but, on various different assumptions, figures of between £12 billion and £15 billion might be appropriate.

We believe that the 'quality' of the PSBR is important in affecting the ease with which it can be financed: raising the PSBR to cut business costs and, hence, business borrowing, is likely to impose less financing problems than doing so to cut personal taxes or raise Government spending. However, in our recommendations we have been constrained by concern about the potential impact on inflation and interest rates of a very large expansion of demand. It is indeed clear that the vast majority of CBI Members feel that they will be best able to take advantage of extra demand for their products if any expansion is not so rapid as to put at risk the success that they have achieved in controlling their own costs.

We are therefore recommending policies which would lead to a PSBR in money terms for 1982/83 of about £11-12 billion. Such a PSBR would represent about the same percentage of GDP as the target for 1981/82 which the Chancellor announced in the 1981 Budget.

Nevertheless our Recommendations would lead to more growth than on present policies and, through their effect on competitiveness and profitability, lead to a soundly based recovery.

II.5 Interest Rates and the Money Supply

The CBI has consistently pointed out that a sound monetary policy is an essential part of a policy to counter inflation. However, this does not mean that monetary policy should be so restrictive as to leave interest rates well above both the rate of inflation and the real rate of return of industrial and commercial companies (excluding North Sea activities) at a time of depressed activity as at present. High interest rates add to business costs (industry and commerce at the end of 1981 was paying £8 billion a year in interest charges compared with £4 billion in 1978) and to the RPI. Each 1 per cent reduction in interest rates saves business £250 million a year, net.

The Government has shown flexibility in interpreting the growth in the money supply, £M3, as only one of a range of indicators of the impact of their policies on the economy. We believe that such flexibility should be built upon. The behaviour of £M3 has been shown, through the effects of the abolition of the corset, the Civil Service strike and the movement of the banks into the market for housing finance amongst other distortions, to be an unreliable guide. Nor would any other single measure be without its own difficulties. The essential point is that it is necessary to go behind any set of figures and explain why they behave as they do, before using such figures for policy purposes.

Although the policies which we are recommending will add to the PSBR they will keep it at about its 1981/82 proportion of GDP and will reduce the need for company "distress" borrowing. It is thus by no means clear that they will lead to faster monetary growth. If they do however, since our analysis shows that they are likely to lead to higher output and not higher inflation (and might well reduce inflation in present circumstances), slightly faster monetary growth alone must not be a reason for rejecting our proposals for reducing interest rates and other business costs.

II.6 Exchange Rate Policy

Interest rates should also be reduced to help lower the exchange rate. It is important to take the need for a competitive exchange rate into account in formulating monetary policy. With the exchange rate at its present level, even with no rise at all in UK unit labour costs in manufacturing, it would take five years to bring our relative labour cost competitiveness back to its level in 1975, when it was close to its post-war average position. To achieve the necessary improvement in cost competitiveness the success of businesses in controlling their labour costs ought to be backed up by some further falls in the sterling exchange rate. The lower interest rates which we recommend should help bring this about.

Clearly the interest rate policy of the British Government cannot be completely isolated from the policies pursued in other countries. It is important, however, that any response to such international influences should not be such as to prevent our objective of improved competitiveness, particularly against our major European trading partners, from being achieved.

III TAXATION

This section of our Representations contains the details of the taxation measures which we are putting forward this year.

III.1 Personal and Business Taxation

In Section II we showed how personal incomes had risen over the past four years while corporate incomes had fallen sharply. Although this imbalance has been slightly reduced in the past year, there is still some distance to go. This alone would make a strong case for relief in the Budget being concentrated on the business sector rather than the personal sector.

The analysis in Annex 1 shows how the present low levels of output have reflected poor competitiveness and profitability. We believe that a soundly-based recovery will not occur until competitiveness and profitability improve by much more than is projected on unchanged policies.

Our projections indicate that cuts in business costs would provide many more jobs than similar sums used to cut personal taxes. Lower personal taxes would help demand but, with no direct impact on competitiveness or profitability, much of this extra demand would lead to higher imports. In comparison, our proposals would not only raise domestic demand but also exports. In the longer term a soundly-based business recovery would do more to raise living standards across the nation as a whole than any feasible cut in personal taxation.

It might be argued that personal tax cuts are likely to reduce inflationary pressures on wage negotiations. The experience of recent years suggests that while rises in indirect taxes have added to such pressures, it is by no means clear that cuts in income taxes have reduced them.

While our recommendation of indexed personal income tax allowances and no change in indirect taxes implies some slight reduction in the burden of personal taxation, we do not recommend any further reduction. CBI members, in our consultations, have shown overwhelming support for giving top priority to relief on taxes on business costs in our representations this year.

III.2 National Insurance Surcharge

Our priority taxation representation concerns the National Insurance Surcharge (NIS).

It is now five years since this damaging tax was introduced at a rate of 2 per cent on most of a company's wage and salary bill and more than three since it was increased to the present level of 3½ per cent. The CBI has consistently argued for its abolition, and in view of the importance of the issue it is appropriate to restate the arguments.

The total yield of NIS in 1982/83 is expected to be about £4 billion at present rates, but of this about a fifth is paid by government (as an employer) to itself. Total abolition would therefore cost about £3.3 billion in a full year or about £2.65 billion in the first year, assuming a 4 week implementation delay and a six week collection delay. A 2 per cent reduction would cost £1.9 billion in a full year and £1.5 billion in the first year.

We have said that it is a damaging tax. The damage is caused to four key factors in the economy:

* <u>Competitiveness</u>

UK relative unit labour costs in manufacturing are about 30 to 35 per cent higher than in 1975, a typical past year. The introduction of and increase in NIS have contributed to this rise in our relative costs. Goods produced in the UK are thus put at a disadvantage by NIS when they compete, here or abroad, with goods produced elsewhere.

* <u>Inflation</u>

NIS is a business cost, and like any business cost it influences output prices and inflation.

* <u>Unemployment</u>

NIS is a payroll tax, a tax on jobs. It can only add to the upward pressure on unemployment, which we feel is indefensible, particularly at the present time.

* <u>Profitability</u>

Real profitability in 1981 was at the lowest recorded level and only a small recovery is forecast for 1982. As a result many companies have had to close and others, with margins squeezed, have reduced investment plans and so damaged prospects for growth. By adding to business costs, NIS aggravates the downward pressure on profitability.

Cost Effectiveness

The benefit of reducing NIS would reach the whole business sector whereas many other measures to help business would only channel relief to some of the firms that need it. Apart from the proportion (about one fifth) of NIS paid by Central and Local Government, where we recommend that the planned expenditure totals are reduced to take account of reduced NIS, the remainder is paid mainly by manufacturing, construction and distributive industries and other sectors of great importance in the generation of UK growth and prosperity.

Some have suggested that the cost savings from lower NIS will be passed on in higher wages. At a time when competitiveness has been hit so hard, businesses are acutely aware of the need to make full use of any improvement in their cash flow. Where profitability is critically low, firms are seeking to increase output and margins. There is at present little room for gains to be passed on in higher wages, and we believe this would happen only to a very limited extent. The experience of when NIS was introduced and of past changes in payroll taxes provides little evidence to suggest that such taxes affect wages. In addition CBI members have argued strongly that a reduction in NIS would not be used to finance higher pay increases.

III.3 Income Tax

Last year we regretted that the Government considered itself unable to raise personal allowances and other thresholds and limits to allow for inflation. We recommend that there should be no similar increase in the real burden of income tax on individuals this year, particularly in the light of the higher National Insurance contributions to be paid from April, though we recognise that resources going beyond indexation for the last year's inflation may not be available. The tax burden should not be raised by stealth, through failure to index allowances, which would also worsen the poverty trap and increase the number paying tax. We therefore have assumed that the statutory indexation of personal tax allowances, the basic rate limit, the higher rate bands and the investment income thresholds will take place.

We remind Government that our longer term aim is for the basic rate of income tax to be reduced to 25 per cent, and the top rate to 50 per cent. We also look for the eventual abolition of the investment income surcharge, which bears particularly heavily on those who do not have normal pension rights and who have to pay the surcharge on investments made to provide for their retirement.

III.4 Indirect Taxes

We do not believe that this is an appropriate time for Government to raise indirect taxes. The long-term shifting of the balance from direct to indirect taxes should be achieved by cuts in direct taxes rather than, say, VAT increases.

We oppose increases in excise duties this year. These duties were raised by much more than inflation last year. Moreover any increases in these duties have a large effect on the Retail Prices Index in relation to the additional revenue they bring in.

III.5 Interest Rates and Tax Relief

We call in Section II for the authorities to take steps to reduce interest rates. Although tax measures are no substitute for direct action to lower interest rates themselves, we put forward in 1980 and again last year proposals permitting companies to disclaim tax relief on the interest on all or part of their borrowing from other companies and providing corresponding tax exemption on the interest in the hands of the recipients.

Interest rates remain high and, as a result of very low profitability, inability fully to utilise tax offsets against profits is still a major problem for companies. Indeed the Inland Revenue[1] estimate that the accumulated total of unused tax reliefs and allowances (excluding public corporations) is now £30 billion and increasing by £5 billion a year. This could be regarded as a massive interest free loan from business to the Exchequer. Since our proposals were put forward a number of other schemes have been proposed to reduce the cost of borrowing and the Government has announced a departmental working party set up to examine one such scheme. We urge that all the proposals are properly examined.

III.6 Smaller Firms

The CBI recognises the importance of smaller firms to the UK economy, and has therefore welcomed the measures taken by this Government designed specifically to stimulate the growth of the smaller firms sector.

However, smaller firms are not in a position to insulate or isolate themselves from prevailing economic conditions. No amount of consideration for the special problems that smaller firms face can fully compensate for an unfavourable economic background where high interest rates, low growth and

---

1 Corporation Tax Green Paper Cmnd 8456 January 1982

continuing cost inflation afflict both smaller firms and their customers. This is why the CBI places so much emphasis in its representations for smaller firms on the need for Government to create an economic climate in which all businesses, whether large or small, can prosper and grow.

Apart from our general representations, which are of concern to all businesses, there are, we believe, two priority areas where the Government can and should take action which will be of direct benefit to the smaller firms sector. These are Small Firms Investment Companies and capital taxation. We also attach importance to the recommendations concerning smaller workshops in our section on Capital Allowances.

Small Firms Investment Companies

At the beginning of 1981 the CBI submitted to the Government detailed proposals for encouraging equity investment in new and established smaller companies through tax incentives and the development of Small Firms Investment Companies (SFICs)[1].

Many of the suggestions put forward by the CBI then, and subsequently in its detailed representations on the 1981 Finance Bill, were incorporated into the "Business Start-Up Scheme." The CBI has welcomed this scheme as an imaginative and important step towards improving the supply of equity finance to new companies but we believe that there is a need to encourage the flow of equity to existing as well as new companies.

Equity investment has the advantage over loan capital that it imposes no automatic servicing costs. This is particularly important when profits are low and interest rates high. Moreover, a sound capital base will also increase a small company's borrowing potential, making loans easier to raise and to service, so providing finance for cash-flow deficits or working capital. Encouraging equity investment by private individuals in new and smaller companies is also desirable as a means of ensuring that the ownership of business is spread across a wider cross-section of society and that entrepreneurial values within society become more deeply entrenched.

The Government has an opportunity to achieve these objectives by building on the start-up legislation, in a way that encourages greater long-term investment in the whole, and not just the new, small company sector and helps to generate new wealth and new jobs. We therefore recommend that the "Business Start-Up Scheme" is extended in two major respects.

a The legislation should be amended to provide a framework through which the development of SFICs can be encouraged. We believe that if individuals were allowed the same tax relief as is now given for investing directly in eligible companies when they invest through the mechanism of a SFIC, takeup under the scheme would be faster and the amount of money available for investment in smaller companies would be increased. SFICs would have the added advantages of being able to attract investment funds from companies and financial institutions, of providing a more marketable investment for the individual and of being able to complement their equity investments by providing additional finance in the form of loans.

---

1 "A New Deal for Investment in New and Smaller Companies: Some CBI Proposals", CBI, January 1981. This paper is available from CBI Smaller Firms Directorate, and is also reproduced in "Smaller Firms in the Economy, 1981", available from CBI Publications Sales, price £5.00.

b Established small companies, as well as start-ups, should be eligible under the Scheme. Existing smaller companies which wish to expand often experience similar difficulties to start-up companies in raising equity capital. Moreover established small companies in many cases offer the best prospects for rapid growth and have the greatest potential for wealth and job creation.

Many of the detailed proposals for the structure and operation of SFICs put forward last year by the CBI are still relevant and could be incorporated into the "Business Start-Up Scheme" by amendment to the existing legislation.[1]

The implications of our proposals for tax revenue are difficult to assess, although the effect should largely be of postponement rather than absolute loss. We believe that whatever net revenue is given up in the short-run will be put to good use in wealth creation which will itself generate other tax revenue in the longer term. If, despite this, the Government is unable to extend the present Scheme beyond start-up companies, a strong case would still exist for introducing the concept of SFICs into the present legislation. Under these circumstances it would also be necessary for the Government specifically to extend eligibility under the Scheme to "management buy-outs" and/or, "rescues" as it has already indicated willingness to consider.

III.7 Capital Taxes

The CBI's views on the harmful effect that Capital Gains Tax (CGT) and Capital Transfer Tax (CTT) have on businesses - particularly on unquoted companies and smaller businesses - were set out in considerable detail in our submission to the Chancellor of the Exchequer in October 1979 in response to his announcement in relation to these taxes that the Government would ... "press ahead with a thorough study with a view to legislation ... at an early date."[2]

In the event the strategy adopted by the Government has been that of gradual reform, rather than a one-off major overhaul. We are encouraged that the Government has made a number of changes along the lines we advocated but we are disappointed that progress has proved to be less rapid than was envisaged in 1979.

We must therefore once again urge the Chancellor to implement the as yet unsatisfied proposals contained in our 1979 submission as soon as possible. Particularly striking is the absence of effective action, even by way of regular adjustment of the various thresholds and fixed sum exemptions, to cope with the most objectionable feature of Capital Gains Tax, that it is most often a tax on inflationary rather than real gains. As the Chancellor pointed out in his 1979 Budget Statement: ... "The tax is, therefore, a capricious and sometimes savage levy on the capital itself"...

---

1 We think that the objective could be achieved by changes such as those listed in Annex 2.

2 See the Chancellor's 1979 Budget Statement (Hansard H C Debates, 12 June 1979, Vol. 968, col 255) where he also referred to the taxation of capital as ... " a matter of vital interest to business as well as to individuals" ... and indicated that the Government were ... "determined to make the taxation of capital simpler and less oppressive" ...

Whilst we wish to see all of our 1979 capital taxes package implemented we are particularly anxious to see action taken on items of importance to business.

Though we remain committed to our view that it is important to business that the inflationary element be taken out of chargeable gains we believe that the reform that presents the least administrative obstacles to Government action is the introduction of a seven year cut off for Capital Gains Tax. Such a cut off should be introduced this year, and because of the delay in payment would have negligible revenue cost in 1982/83. Costings of changes to capital taxes are difficult to produce but we estimate that the loss to the Revenue in 1983/4 could be of the order of £¼ billion.

Other areas where we recommend that action by Government this year should not be precluded by cost considerations are:

a the extension of business relief for CTT purposes. Assets currently qualifying for relief at 30 per cent should be merged with those currently relieved at 50 per cent and the relief for all of them increased to 75 per cent. Assets now receiving 20 per cent relief, should receive 30 per cent relief;

b the review and overhaul of the retirement relief rules for Capital Gains Tax including the tax treatment of businessmen who are forced to retire early because of ill health;

c the extension of the period for payment of CGT and CTT by instalments from eight years to twelve years and the abolition of the £250,000 limit on interest free payments for CGT. This limit creates an arbitrary anomaly while generating negligible revenue. In future the provisions for payments by instalments and interest thereon should be the same for CGT and CTT.

III.8 Corporation Tax

In considering our representations on corporation tax this year we faced the unusual constraint of the immonent publication of the long awaited Green Paper on Corporation Tax. Now that this paper has been published, we see it as an opportunity to examine in depth - perhaps helped by the appointment of a Select Committee as in 1971 - a number of issues which are very important to business. We are not repeating here all of the many representations on corporation tax which we have made over the years since the present system was introduced. A quick glance at some relevant items - the imputation system; ACT; mineral and other capital allowances; stock relief; double taxation relief; current cost accounting; groups of companies; the treatment of smaller companies - indicates the scope for discussion.

---

1 Very broadly the 50 per cent relief at present covers transfers of all or part of an unincorporated business and shares on securities in a company where the transferor has control; the 30 per cent relief applies to land, buildings, machinery or plant used for business purposes by a company controlled by the transferor or by a partnership in which he is a partner; the 20 per cent relief applies to minority interests in unquoted shares. Certain trust assets also qualify for the 30 per cent relief.

III.9 Capital Allowances

We have consistently urged Government to introduce a scheme of capital allowances for commercial buildings. We recommend that a start is made now, even if limited to straight line writing down allowances at a very low rate, say 2 per cent, and even if confined to new building work. This would provide a boost to the construction industry and employment and at last give some recognition to the value to the economy, in terms of invisible earnings and the provision of essential services to both industry and consumers, that commercial businesses contribute.

Smaller Workshops

The 1980 Finance Act introduced 100 per cent initial allowances in respect of expenditure incurred on the building of small workshops of 2500 square feet floor space or less. However, the type of use to which a workshop may be put in order to qualify for allowances as an "industrial building" is strictly limited. We suggest that the restrictions as to qualifying use should be substantially relaxed.

III.10 Stock Relief

When considering, last year, the new system of stock relief suggested by the Government we pressed hard for the removal of the credit restriction. We are pleased that our arguments were heeded when the new system finally came into operation. The case for allowing businesses to use indices more closely reflecting their own circumstances should now be more fully examined, and we are hopeful that publication of the Green Paper will provide further opportunity.

III.11 Development Land Tax

The yield from this tax is only £25 million. Nevertheless, its effect on the release of land for development or redevelopment is damaging. It is a constraint on commercial activity which should be removed at once.

III.12 Heavy Oil Duty

The CBI continues to urge that the Government bring energy costs for industry into line with those in competitor countries. As stated in the second NEDC Energy Task Force report released in November 1981, the remaining disparity between the level of UK heavy fuel oil prices and the average level prevailing on the Continent can to a very large extent be attributed to the high rate of duty in the UK. We therefore ask the Government to find a way of abolishing this duty or offsetting its effects.

III.13 Technical Representations

In our Budget Representations of 1980 and 1981 we referred to the need for changes in the legislative procedure to begin to tidy up the host of technical anomalies that have crept into our taxation system.

The particular change that we highlighted was the introduction of a Technical Taxation Bill separate from the ordinary Finance Bill. The case for such legislative change was pointed out by the Chancellor in speeches to the Addington Society in 1977 and to the Institute of Chartered Accountants in 1980, as well as being referred to in the report of the Armstrong Committee set up by the Institute for Fiscal Studies.

Fulfilling the pledge which we made last year we have now published a paper[1] setting out a sample of items of a technical nature for inclusion in a Technical Taxation Bill. We have sent our proposals to the Chancellor and to the Revenue Departments.

In putting forward our Technical Taxation Bill proposals we were aware of the difficulty the Government faces in fitting all that it would like to do into a crowded legislative programme. If a bill along the lines which we propose is not introduced this year, the Chancellor can still deal with some or all of our technical points in the ordinary Finance Bill and indeed, in his response to our paper, he alluded to the possibility of making further progress in this way. We accordingly repeat here the list of eleven headings from our Taxation Bill proposals. Our detailed proposals are set out in the document itself.

The eleven points are:

- Grouping of Capital Losses
- Quantification of Capital Losses
- Capital Gains Tax - Rollover relief for groups of companies
- Capital Gains Tax - Rollover relief - Wasting Assets
- Groups - Company ceasing to be a member
- Groups - Case V Income - Charges on income and management expenses
- Group Relief - Anti-avoidance - Section 29 Finance Act 1973
- Consortia - Sideways surrender of losses
- Disallowed Business Expenses (Nothings) - Costs of equity finance
- Capital Allowances - Abortive Expenditure
- Advance Corporation Tax - New Subsidiaries

In singling out these first eleven topics for a Technical Taxation Bill we were anxious to keep our selection of items relatively simple to facilitate the birth of such a new type of legislation. We were also aware of the likely appearance of the Government's Green Paper on Corporation Tax. However, our list of technical representations has expanded over the years, and continues to expand each year as many more points are added than are dealt with by legislative action in the crowded Budget-Finance Bill programme.

In view of our proposals for a Technical Taxation Bill we are not repeating here all our outstanding technical representations from previous years. They remain on the table for action by Government and we shall return to them in future years as appropriate if the relevant problems still exist.

We have however, as last year, already written to the Revenue Departments reminding them that these points remain outstanding and have also drawn their attention to a number of fresh points some of which arise from changes made in the Finance Act 1981. These technical representations are included as Annex 3.

---

1 "A Technical Taxation Bill - The CBI's Proposals" - available from CBI Publications Sales, price £2.00.

IV LOCAL AUTHORITY FINANCE

IV.1 The Need for Lower Business Rates

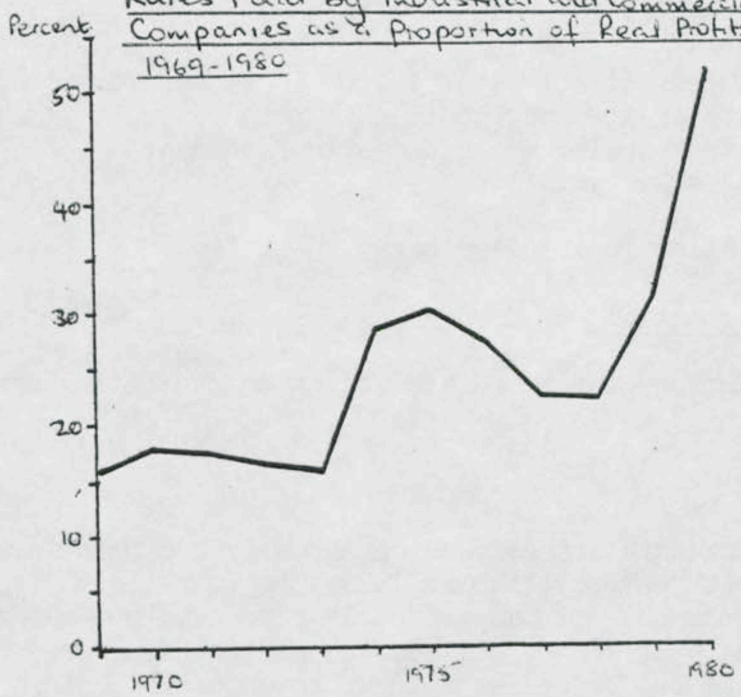
In last year's Budget Representations we emphasised that the rapid increase in business rates was a major cause of concern and called for a low average rate increase for 1981/82. This could have been achieved, in spite of the reduction in rate support grant, if local authorities had followed the Government's spending and pay guidelines, in which case some authorities benefiting from the revised distribution of money through the new block grant system would even have been in a position to cut their rates.

However, the average rate increase for 1981/82 has been 17 per cent, and over the years 1980/81 and 1981/82 business rates will have risen by over 40 per cent whereas between April 1980 and April 1982 the general price level will have risen by under 25 per cent. In Scotland business rates have risen by around 80 per cent over the last two years. Restraint in rate increases to the extent envisaged by the Government and the CBI has tended to be the exception and many businesses have suffered severely from the burden of rising costs, including rates.

We estimate that in 1981/82 business will have paid in the order of £5bn in rates which represents nearly half of the total revenue local authorities obtain from rates. Rates have now overtaken corporation tax to become the heaviest single impost on business[1] and they have risen extremely sharply in real terms while profitability has fallen to disastrously low levels. as Chart IV.1 illustrates.

CHART IV.1

Rates Paid by Industrial and Commercial Companies as a Proportion of Real Profits 1969-1980



Sources: Rates: Derived from DOE & Scottish Office data

Profits: Derived from National Income & Expenditure 1980

1 Excluding National Insurance Contributions.

It is important that local authorities' rate increases for 1982/83 are very low. We estimate that if local authorities were to keep strictly within the Government's spending guidelines, including the pay and price assumptions, it should be possible for local authorities to keep business rate increases on average [well below double figures].

The CBI has supported the Government in its campaign to restrain local authority expenditure as an effective way of keeping business costs down. For our part, we have set up local rates groups to try to influence spending and rating decisions by councils at local level. We have supported the introduction of the block grant system by the Government and it has undoubtedly contributed to restraining the level of local authority expenditure. However, one adverse effect has been to encourage some high-spending authorities to levy excessive rate increases rather than to cut back spending. The CBI deeply regrets the fact that the Government appears to have decided not to provide any protection for the business ratepayers in England and Wales in the Local Government Finance (No 2) Bill. In Scotland the powers being taken in the Local Government and Planning (Scotland) Bill will enable the Secretary of State in certain circumstances to force an authority to reduce rates by a specified amount. This increase will give some protection to all ratepayers against excessive rate increases.

We also regret that the Government Green Paper on 'Alternatives to Domestic Rates' (Cmnd 8449) failed to consider alternatives to business rates as well as domestic rates, as the case against the former is much stronger than the latter. Whatever the reaction to the Green Paper it is clear that the burden of rates on business is excessive and should be reduced. Our reasons for maintaining that business should be relieved of the present excessive rate burden and protected from further rate increases are:

- business rates are a cost which adversely affects competitiveness and jobs;

- business has no vote and cannot influence local authority spending decisions through the ballot box;

- business receives less direct benefit from local services than domestic ratepayers in spite of its contribution to rate revenue; the inequity is compounded by the subsidy which domestic ratepayers receive through the domestic rate relief grant;

- rates bear no relation to ability to pay.

IV.2 Priorities for Action

Our specific recommendations for immediate action on the rating system are as follows:

i Business Derating

The present recession in its effects on industry has been far more severe compared with the position in 1929 when 75 per cent industrial derating was introduced. It was gradually decreased but was completely withdrawn only in 1963, and we believe the present depressed state of the economy and the huge rise in business rates over the last two years fully justify the re-introduction of partial business derating.

The domestic sector is currently subsidised by central government at the cost of £720m. There is a much stronger case for helping the business ratepayer. If business were to be put on an equal footing with the domestic sector this would permit approximately 15 per cent business derating in England and Wales. The case is particularly strong for industrial concerns. Agricultural land is exempt from rating and the same principle should apply to all wealth-creating sectors.

The introduction, or extension in the case of Scotland and Northern Ireland, of partial business derating would help to maintain the industrial base and would contribute to improving competitiveness and employment prospects in the economic upturn. We regard action on business derating as being a main priority for 1982/83 and recommend that 15 per cent business derating is introduced. It would cost in the order of [£850m] at 1982/83 prices. We appreciate that the introduction of business derating would require separate legislation from the Finance Bill; nevertheless such legislation could be enacted by the summer, if there is sufficient will to reduce the burden of rates on business.

The introduction of partial business or industrial derating to have effect in 1982/83 would cause some administrative problems for rating authorities. For those small businesses which pay rates by instalment, the size of the instalment will need to be amended, and so would the second six-monthly rates payment made by most other businesses. In some cases refunds would need to be made. The administrative work involved, however, should not be all that costly, and would be small relative to the significant benefits that would arise for business.

ii <u>Ceiling on Business Rate Increases</u>

As already mentioned, we are disappointed that the Local Government Finance Bill does not include a ceiling on business rate increases and we believe that there are no valid reasons why it should not still be incorporated in the legislation. It would limit business cost increases, restrain local authority spending and increase local accountability, which are all objectives of Government policy. It would cost Government nothing as the local authorities would have to make up any shortfall from the domestic sector or cut spending. It is still not too late for such protection for business to be incorporated in the Bill.

iii <u>Introduction of 'Mothballing' Relief</u>

This measure means that no rates would be payable on parts of properties which are taken out of use during the recession but are maintained in good order for re-use when the business climate improves. We advocate 'mothballing' relief for all businesses, but the case is particularly strong for industrial premises, especially where the unused parts contain plant and cannot be let or put to another use at the moment but could contribute towards providing the greater capacity needed in the economic upturn.

The administrative problem which it has been alleged would arise from the introduction of 'mothballing' relief for business could be overcome without all that much difficulty and we have already suggested to the Government ways and means of doing so.

We recommend that legislation is introduced to permit 'mothball' relief to be given for business in 1983/84. We propose that relief totalling £150m at 1982/83 prices is given.

iv Abolition of Business Rate on Empty Property

The rate payable on empty business property was reduced to 50 per cent of the full rate following the passage of the Local Government Planning and Land Act 1980 and we welcomed this relief in response to our representations. But we remain of the view that payment of rates on empty property goes against the principle of taxing beneficial occupation and continue to urge that the rate should be abolished. It is a discretionary levy and we estimate that about half local authorities raise it. The loss of revenue from abolition would amount to about [£35m] at 1982/83 prices. In order to reduce costs, businesses are cutting down on premises where possible, but during a recession it is often difficult to sell or let them. The arguments presented for introducing 'mothballing' relief are relevant also to empty property rate and, once again, we would advocate this relief for industry if it could not be granted immediately to the whole of the business sector.

V GOVERNMENT EXPENDITURE

In September 1981 the Report of the CBI Working Party on government expenditure[1] was published and, with CBI Council's endorsement, the main recommendations in the Report were submitted to the Chancellor and other Ministers. The Report showed how substantial savings in the cost of government expenditure could be obtained even if levels of service were to be kept at planned levels. This section brings the recommendations of the Report up-to-date in the light of more recent information[2] and, in addition, shows the policy changes which the CBI recommends.

V.1 Recommended Changes to Planned Levels of Spending

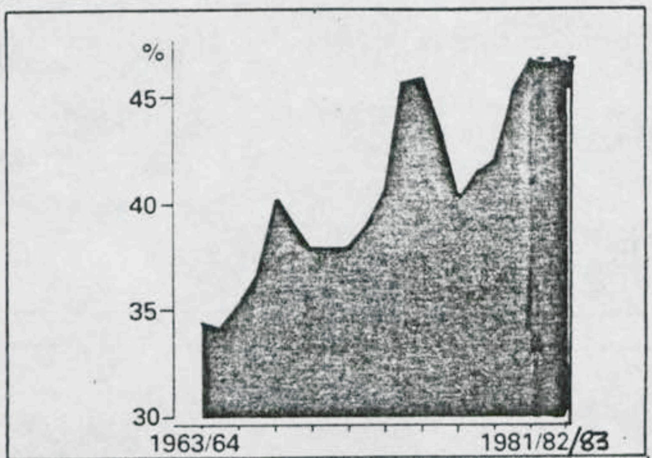
The latest Government announcement on the planned level of expenditure (excluding debt interest) for 1982/83 shows that this is now likely to amount to £115 billion in cash terms whereas at the time of the March 1981 Budget, expenditure in 1982/83 equivalent to about £110 billion[3] was planned.

Some of the £5 billion extra expenditure is due to the recession and increases in expenditure in areas where we have previously recommended increases, notably special employment measures. However, in other areas, such as local authority expenditure and defence, there still appear to be problems in bringing expenditure under control.

Chart V.1 shows that the share of government expenditure in GDP is now likely to stabilise between 1981/82 and 1982/83. This is better than a further increase but we feel that more cuts in current expenditure could be achieved. We also recommend increased capital expenditure and measures to reduce business costs generally.

CHART V.1

Share of Government spending in GDP



Source: CSO; 1981/82 and 1982/83 CBI estimates and forecasts on unchanged policies.

---

1 Report of the CBI Working Party on government expenditure, CBI, September 1981.

2 On 2 December 1981 the Chancellor made an announcement on government expenditure for 1982/83. We have taken account of this announcement, although full details of the Government's proposals have not been given, particularly concerning asset sales, debt interest, the contingency reserve, and the allowance for shortfall.

3 The Government estimates that £77.9 billion in 1980 survey prices revalued to 'cash' assuming increases of four per cent for average earnings and nine per cent for prices, would be equivalent to about £110 billion for 1982/83.

Although the main benefit of action taken in our recommended areas such as improved efficiency and higher public service employee contributions for the benefit of their index linked pensions may not accrue until 1983/84, we are anxious that the changes are announced as soon as possible.

In addition we recommend further savings in 1982/83 from lower interest payments, and a reduced net impact on spending from the total of the contingency reserve, sales of assets and 'shortfall' or underspending. We recommend higher levels of capital spending than are presently planned, although as with the economies in current spending, the main benefits of action in this area are unlikely to appear before 1983/84. We estimate that the net impact of our recommendations would be to hold government spending slightly below the levels presently planned but, at the same time, to give the taxpayer better value for money and generate much needed investment.

Table V.1 (below) summarises our recommendations on government expenditure.

TABLE V.1

CBI Recommendations on Government Expenditure[1]

£ million (1982/83 prices)

		1982/83	1983/84
Savings from manpower cost economies[2]	-	100	-1500
Savings from reduced total for contingency reserve, shortfall, asset sales and from lower interest payments	-	700	nil
Savings from lower unemployment levels and from other, 'demand effects'[3]	-	100	- 300
Extra capital expenditure[4] and industrial support	+	250	+1000
Eliminating the 4 month delay in the payment of RDGs	+	125	nil
Extra expenditure on reducing energy costs, (approx)	+	70	+ 70
TOTAL, (rounded)	-	430	- 730

1 In comparison with totals announced on 2 December 1981 for 1982/83, and in comparison with totals given in the March 1981 White Paper (with some adjustment for changed assumptions about economic conditions and policy changes announced since then) for 1983/84.

2 This does not include the extra savings arising from our recommendation that spending totals for central and local government be reduced by the amounts saved from lower NIS, etc.

3 See footnote 5, Table I.2.

4 See footnote 3, Table I.2.

V.2 Manpower Cost Economies

i Manpower

The CBI's Report on government expenditure identified significant scope for and recommended cuts in manpower in the Civil Service, the NHS, and the local authorities, over and above those which the Government appeared to be planning. Overall, allowing for savings in costs associated with employment, accommodation, etc., we identified savings of £2 billion at 1981/82 prices by 1984/85.

We also suggested that economies should be sought in non-front line manpower, particularly in the local authorities and the NHS. We argued that many of these economies were possible without significant damage to service levels, given the large increases that have occurred in public service manpower, (over 20 per cent in the last ten years); the significant reductions which have been made within the business sector in the last two years; the examples of savings of 20 per cent and sometimes much more that have been made where services are contracted out; the large savings revealed by LAMSAC[1] studies of manning levels in certain local authority services; the apparently large regional and area differences in manning levels per head of population in the NHS and the local authorities revealed by comparative statistics; and international comparisons which suggest that on a broadly comparable basis public service employment appears to be up to 25 per cent larger in the UK than in other European countries.

Since this Report was published, further evidence has come to light which confirms our conclusion. A recent report from the Comptroller and Auditor General has identified serious weakness in manpower controls in the NHS. After considering his report the Public Accounts Committee concluded:

> "We doubt whether the present largely devolved system of control in England has ensured that numbers of staff employed have been limited to those strictly necessary to meet the objectives of the NHS."[2]

A Department of Education report has revealed substantial differences in cost per pupil in local authority run polytechnics.[3] After allowing for differing composition of arts and science courses, costs in 1979/80 ranged from £1500 per pupil per year at Trent Polytechnic (Nottingham), to £2500 per pupil per year at the North East London Polytechnic (Barking).

There has been nothing in the response from the Government or the local authorities to our report to suggest that the economies which we recommended could not be made. However, we note that the Government announced on 2 December 1981 reductions in administration expenditure and other efficiency gains contributing to a saving of an additional £0.5 billion for 1982/83.

We believe that significant additional economies are possible from this source in 1983/84, and our recommendations for current expenditure economies in that year reflects this belief.

---

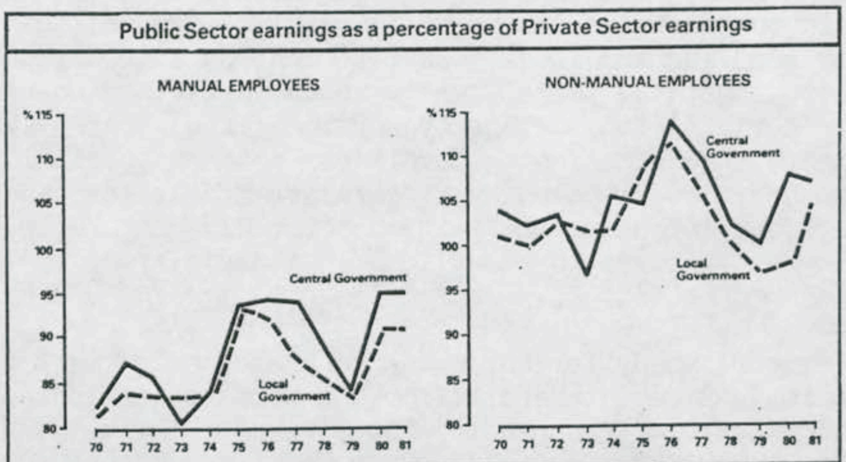
1 Local Authorities Management Services and Computer Committee.
2 Financial Control and Accountability in the National Health Service, Seventeenth Report from the Committee of Public Accounts, Session 1980/81, September 1981.
3 The Times, 1 October 1981.

ii Pay

The CBI's Report on government expenditure showed that pay in the public service has increased considerably more than in the private sector over the decade 1970-1980.

Chart V.2 is an updated version of the chart in this Report showing pay in the public service relative to pay in the private sector for male manual and non manual workers in central and local government. The latest data for 1981 indicate that the relativities that existed in 1980 have been broadly maintained, and the recent large improvements in the position of the public services which occurred during the 1979/80 pay round when 'Clegg' type awards had their main effect have not yet been eroded.

CHART V.2



The figures relate to men working full-time. Comparisons for females have been affected by moves to equal pay and have not been included.

The earnings figures (from which the percentages are calculated) include all gross pay but do not take account of pension arrangements, fringe benefits, or other conditions of service.

No allowance is made for differences in the nature of the work done or the qualifications of the employees concerned.

The 1981 figure for central government non-manuals has been adjusted by the Treasury to include the 1981 non-industrial civil service award which because of delays in settlement was too late to be included in the 1981 NES survey.

Looking at the whole period the Treasury have concluded:

> "In all cases the recent position of the public sector can be seen to be better than in the first few years of the 1970's. This is especially true of manual workers where relative improvements of around 10 per cent have been recorded. The improvement for non-manual workers is smaller, but still of the order of five per cent."[1]

The assumption of 4 per cent for the rise in average earnings from due settlement dates for the 1982/83 pay cash limits was in line with the top end of the range included in our recommendations. We welcome this but it is important that firm action is taken to ensure that settlements that have yet to be made are no higher than this, and that similar restraint is shown in 1983/84.

iii Pensions

In its evidence to the Scott Committee the CBI recommended that fully indexed

---

1 Economic Progress Report No. 140, December 1981, The Treasury.

pensions in the public service sector be discontinued. Our Report on government expenditure also proposed an increase in employee contributions of 2-2½ per cent for those public service workers outside the Civil Service, unless and until full indexation ceases.

Table V.2 shows the pension contributions paid by different groups of workers in the public service sector.

TABLE V.2

Public Service Sector[1] Employee Contributions for the Benefit of Index Linking in 1980/81[2]

Employment Group	No of Employees in Pension Scheme '000s	Employee Contribution as a Percentage of Salary (approximate)
Civil Servants	690	8-8.5
Local Authority Workers	1025	
i Manuals		5
ii Non Manuals		6
Teachers	600	6
National Health Service	760	
i Manuals		5
ii Non Manuals		6
Armed Forces	310	11
Police	135	
i Men		7
ii Women		5

Source: Public Sector Pensions: Note by the Civil Service Department. Submitted as Evidence to the Scott Committee of Enquiry into the Value of Pensions, 1980.

1 Includes main groups only.

2 All available information suggests that the percentage contributions for the benefit of index linking have remained unchanged since 1980/81, although number of members of particular schemes may have changed marginally.

Raising employee contributions for those workers outside the Civil Service until they pay only as much as Civil Servants notionally currently pay would, unless and until pensions are de-indexed, result in considerable saving - over £500 million in a full year. To do this would require an alteration to the Pensions (Increase) Act and a commitment to introducing this legislation should be announced in the near future.

V.3 Controlling Government Spending

The revisions to the public expenditure planning and control system announced in the March 1981 Budget imply a tighter control on the costs of government spending. However, it is clear that some government departments still need to stick much more firmly to cash limits.[1]

Although under the new system of planning the contingency reserve is intended to cover unanticipated inflation as well as volume changes, the total apparently allowed for 1982/83 is very large[2], and we recommend that some of this should, in the current circumstances, remain unspent.

There is a need for more value for money studies and an improvement in both internal and external auditing in central and local government. The CBI has welcomed the Government's intention to set up an Audit Commission for the local authorities as we recommended in our last Budget Representations. We earnestly urge such a Commission to initiate more value for money and comparative performance studies throughout the local authorities and make their results public so that ratepayers can be assured that efforts are being made to improve efficiency in expenditure. We also urge that a Commission be considered to perform similar tasks for the Regional and District Health Authorities.

V.4 Contracting Out

The recently published Coopers and Lybrand Report on contracting out[3] identified more examples of areas where contracting out has produced a significant saving, adding weight to the arguments put forward in the Report on government expenditure for more contracting out. Examples of contracting out have shown savings generally in excess of 20 per cent. Contracting out and competitive tendering should be extended wherever possible to secure continuing pressure for cost reductions.

V.5 Sale of Assets/Privatisation

We do not know at this stage what the Government is currently planning on asset sales for 1982/83 and 1983/84. In addition, there is some uncertainty about the amount to be raised from and the timing of the proposed sale of BNOC and other assets. However, as a general case the CBI is in favour of increasing market sector provision, particularly at a time of extreme pressure on public sector resources. We therefore welcome asset sales in principle, provided that they take account of commercial considerations.

---

1 Section 9 proposes a limited scheme to allow some carry over of capital expenditure on certain capital projects.

2 The announcement on 2 December 1981 gave only a combined total for planned expenditure on the contingency reserve minus savings from asset sales and shortfall. If the totals allowed for asset sales and shortfall remain unchanged from those planned in March 1981, the amount allowed for the contingency reserve in the December 1981 plan is £4.8 billion. This is nearly twice as large as the contingency reserve allowed for in the March 1981 plans and is very much larger than sums previously allowed for, 'contingencies'.

3 Service Provision and Pricing in Local Government, Studies in Local Environmental Services, Coopers and Lybrand Associates Ltd., September 1981, HMSO.

More local authority land could be released for private sector use. Local authorities have now extended land registers to cover all England. To date some 35 districts and London Boroughs have completed registers of unused land often in the heart of cities. The first 33 registers alone revealed over 20,000 acres of underused land, on more than 2,000 sites owned by local authorities and other public bodies. Much of this land is in urban areas and nearly half is identified by the Department of the Environment as having potential for development. All registers for England are expected to be published in April 1982.

V.6 Charges

We estimate that much of the avoidable overspending by the authorities in 1981/82 and the increases in planned expenditure for 1982/83 is due to increases in local authority transport subsidies. The CBI has often argued that these subsidies are wasteful of resources and that they should be reduced.

There appears to be substantial scope for raising other fees and charges in the local authorities, not to exploit monopoly positions but to ensure that the prices paid for services reflect the cost of their provision more closely. Such scope was identified in the Report on government expenditure. For example, in recreation services local authorities cover only one-sixth of total costs of £600 million. There is ample room for net expenditure to be reduced by this means, although we recognise that this may add to the Retail Price Index, and these increases may take time to implement.

V.7 Debt Interest

Reductions in debt interest will arise out of reductions in interest rates, which are a result of our overall policy recommendations.

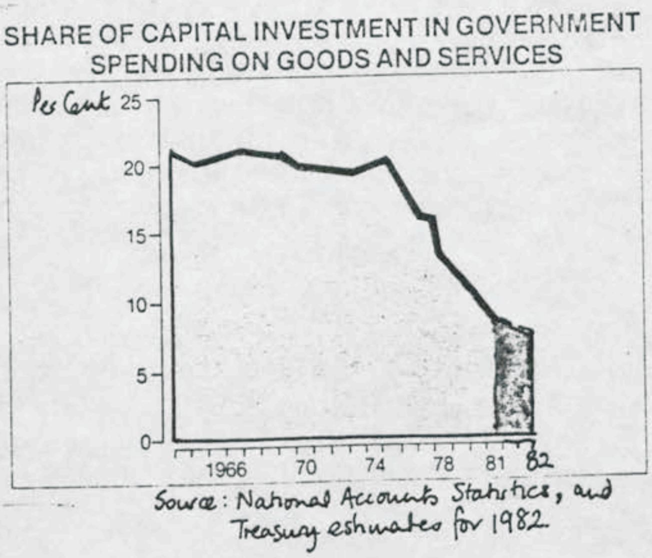
V.8 Special Employment Measures and Unemployment Benefit

The CBI has welcomed the Government's latest proposals on training and youth employment. Much of this increased expenditure was recommended in "The Will to Win". However, we must contrast the large expense incurred on special employment measures and unemployment benefit with the limited relief given to the business sector for creating sustainable employment. The effect of our recommendations would be to create more jobs and as a result there would be savings in expenditure on special employment measures and unemployment benefit.

V.9 Capital Expenditure and Industrial Support

The share of capital expenditure in total government spending continues to fall as Chart V.3 shows. We disapprove of the way that past exercises to contain cost of government expenditure have resulted in excessive cut backs or delays to capital spending, whilst current expenditure has been maintained or increased.

Chart V.3



We note that the Treasury and Civil Service Select Committee[1] have urged the Government to raise significantly the proportion of public investment in public expenditure, and this has been a persistant feature of the CBI's recommendations on macro-economic policy for many years.

We very much regret the further cut in the general government cash allowance for capital spending by the local authorities, water authorities and for motorway and trunk roads announced by the Chancellor on 2 December 1981, and in particular that element which is not mitigated by keener construction prices working through. The Government's 2 December announcement and the accompanying Treasury Press Release indicate that no allowance has been made for any increase in capital investment by the nationalised industries above that planned for in the March 1981 White Paper, despite bids from the nationalised industries for extra capital expenditure in excess of £1 billion for 1982/83. In addition there have also been disturbing amounts of underspending by local authorities on capital projects expected for 1981/82.[2]

We recommend that the Treasury again consider introducing a limited scheme which allows underspending on capital programmes to be carried forward into the next financial year, where a clear need for such expenditure has been identified. Allowing some carry-forward of underspending on capital expenditure would help to avoid the danger of unnecessary spending to use up the limit at the year end, or of further unintended reductions in the level of capital spending where substantial shortfall appears to have occurred. Such a scheme may also be used to encourage improved financial control within Departments.

---

1 "The 1981 Budget and the Government's Expenditure Plans, 1981/82 to 1983/84". Treasury and Civil Service Select Committee, 1980/81 Session, March 1981.

2 Financial Times, 8 January 1982. This report suggested underspending of almost £1 billion or 23 per cent of total local authority capital expenditure for 1981/82.

We recommend that there should be an increase in planned capital expenditure by both general government and the nationalised industries of about £250 million in 1982/83, and of £1 billion by 1983/84. These figures are net of any additional capital expenditure by the nationalised industries financed from reductions in business costs recommended elsewhere.

"The Will to Win", and "Agenda for Recovery" outlined certain areas where capital expenditure could usefully be increased; roads (particularly local roads), construction, railways and sewer and drainage systems in addition to telecommunications and other nationalised industry investment projects.

The recent report by the Group of Eight[1] indicated that preparation work is being suspended on major road schemes worth over £1 billion, and total expenditure on roads appears to have stabilised at about half of the 1975 level.

The Government controls the total level of capital expenditure by councils and provides assistance through the Transport Supplementary Grant to local road building. We suggest that central government could provide funds to encourage an increase in road building and maintenance by local authorities. In other areas, such as capital expenditure on water industry assets, on school buildings, and in housing various commentators have identified a need for increased capital expenditure to maintain and improve the nation's vital infra-structure. Lead times on work can mean that it may take 2-3 years to incur significant expenditure.

A recent report by Cambridge Econometrics commissioned by five construction industry organisations[2] demonstrates the beneficial economic effects of extra capital expenditure on house building and civil engineering works. Extra expenditure of £500 million per annum (at 1981 prices) is estimated to generate 60,000 extra jobs on average in the three years following the increase in expenditure with much of the cost of this extra expenditure offset by increased government revenue and reduced expenditure on such items as unemployment benefit. Another report, prepared by the Economic Intelligence Unit and commissioned by the Federation of Civil Engineering Contractors,[3] showed estimates of the effect of a very much larger increase in capital expenditure, (leading to a doubling in three years). These effects are also shown to be substantially beneficial - leading to up to four per cent more output and 550,000 extra jobs although the scale of the impact on output and employment depends on the way in which the expenditure is financed.

The four month imposed delay in the payment of Regional Development Grants should be removed. We estimate that the once and for all cost of this measure would be £125 million in the first year, 1982/83, with no cost thereafter. Such a measure would bring immediate relief to many manufacturing companies in depressed regions of the UK.

---

1 Group of Eight Parliamentary Brief on Construction, July 1981.

2 Policies for Recovery: An evaluation of alternatives, by Cambridge Eonometrics Limited, December 1981.

3 Capital Spending and the UK Economy: A computer study by the Economist Intelligence Unit Limited. Commissioned by the Federation of Civil Engineering Contractors, November 1981.

In addition, we recommend that some additional expenditure is allowed for research and development programmes, particularly in advanced electronics and robotics. Such expenditure could greatly enhance the UK's future economic performance.

The expenditure implications of these proposals on capital expenditure is difficult to estimate because of long and often variable lead times and, for example, administrative delays. Thus the figures given in Table V.1 for these items are intended only as a broad indication.

V.10 Energy Costs and Industrial Support

The CBI recommends that the Government maintains and extends its measures to bring our industrial energy costs more in line with those of our European competitors.

The Electricity Council has undertaken a review of the CEGB's Bulk Supply Tariff, and we hope that this will lead to early measures to reduce the cost of electricity to certain large industrial users. While the second NEDC Energy Task Force report confirmed that for the vast majority of industrial users, UK electricity prices were broadly comparable with Contintental levels, significant disparities remained for some large and electricity intensive users. We recommend that the Government adjusts the Electricity Council's EFL for 1982/83 to permit them to reduce the costs of these large industrial users.

We also recommend that the £10 per tonne concession on the list price of foundry coke introduced by National Smokeless Fuels should be continued beyond its intended expiry date of March 1982.

These proposals on energy prices would a cost approximately £10 million in a full year, and we have taken account of this in our costings.

ANNEX I

THE ECONOMIC SITUATION AND PROSPECTS

Introduction

In this annex we outline the main elements of the current economic situation, look at the prospects on unchanged policies and at how our recommendations will improve these prospects.

Our unchanged policies forecast a year ago was that the UK economy would continue to suffer from low levels of activity and lack of competitiveness. Events since then have proved these predictions correct although British business has done much to bring down cost inflation and improve efficiency.

We expect only a very sluggish recovery in production, with some fall in price inflation in the the next year on present policies. This assessment is in line with the latest published official forecast[1]. If the proposals outlined in this document were implemented we estimate that they would improve the prospect for growth, profits and jobs without adding to inflation.

Demand and Output

The sharp fall in output that had taken place in 1980 continued into early 1981 before production started to stabilise or, possibly, rise slightly from the middle of the year. Although both output in the economy as a whole (measured by GDP) and in the manufacturing sector fell by large amounts by historic standards, the fall was very much greater in the manufacturing sector than in the economy as a whole.

Chart A.1 shows the CBI Staff projections for GDP on optimistic and pessimistic paths[2] and indicates how, even on the optimistic path, growth over the next two years on present policies is unlikely to be sufficiently strong to recover more than a fairly small proportion of the falls in production that took place in the last two years. Meanwhile the projections on pessimistic assumptions show that there remains a considerable possibility that production could fall further in the next two years.

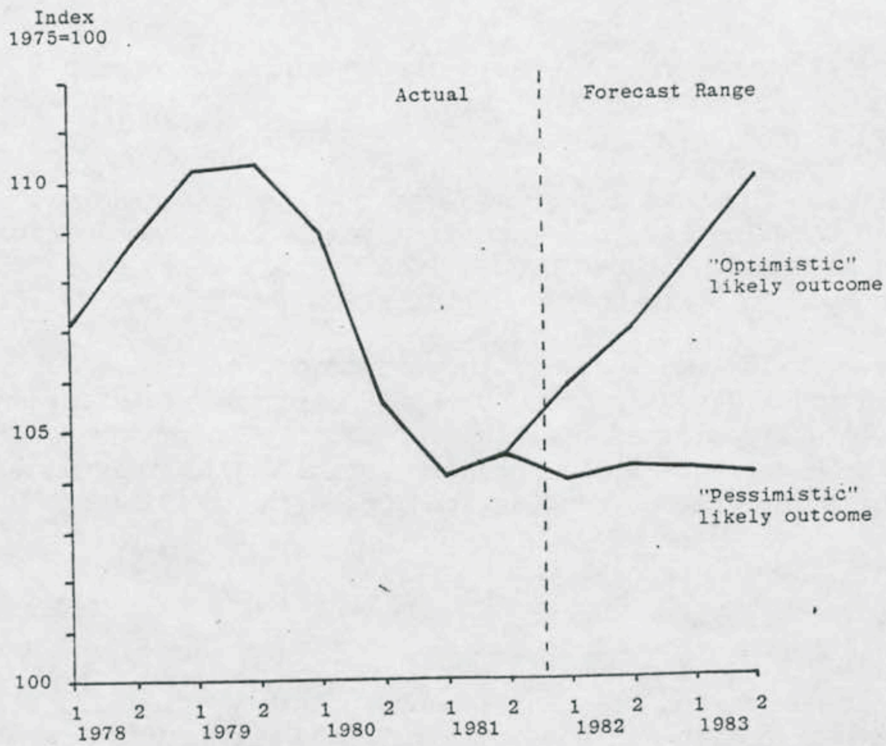
---

1 H M Treasury Economic Progress Report Supplement, December 1981

2 It is important to bear in mind the likely margin of error in forecasts. We have increased our central GDP projections by the average error estimated in this way from past Treasury forecasts between June 1965 and October 1979 (see Economic Progress Report Supplement, December 1981) to give the "optimistic likely outcome" shown in Chart A.1. The "pessimistic likely outcome", shown in Chart A.1 was obtained by subtracting the average error from our central forecasts. There is a 58 per cent chance of the outturn falling within the range of one average error above or below the central forecast if the forecast errors are normally distributed. The Charts showing RPI, unemployment and real rate of return were derived in the same way using data on average errors in Treasury, NIESR or CBI Staff forecasts.

Chart A.1

Production in the Whole Economy (GDP)



Source: CSO and CBI estimates

During 1980 the fall in production reflected particularly a massive turnaround from stockbuilding to heavy destocking and sharp falls in exports. By contrast, during 1981 some of these factors were partly reversed but the weakness of the other components of demand, consumers' expenditure, investment and Government expenditure, together with rising imports, held output down.

Our central forecast suggests that in 1982 and 1983 the slowing down of destocking and the growth of exports are likely to be the main upward influences on demand; consumers' expenditure and investment are likely to remain close to their present levels while government expenditure on goods and services is likely to fall slightly and imports are predicted to continue to rise. These forecasts, however, are particularly uncertain in three major areas: consumers' expenditure, where the rise in borrowing that has so far compensated for falls in real personal disposable income may not be sustained; the world economy; and stocks. Taking the four years from 1979 to 1983, together our forecasts suggest a fall in output of between 1 and 7 per cent in total, with falls in stockbuilding, fixed investment and export shares, together with rising import penetration, responsible for most of the predicted decline. We believe that much of this reflects the impact of the worsening of competitiveness and low levels of profitability on business. These problems, in turn, largely reflect the effects of high interest and exchange rates combined with severe inflationary pressures on business costs from high pay settlements and rising Government charges. We look in more detail at competitiveness and profitability below.

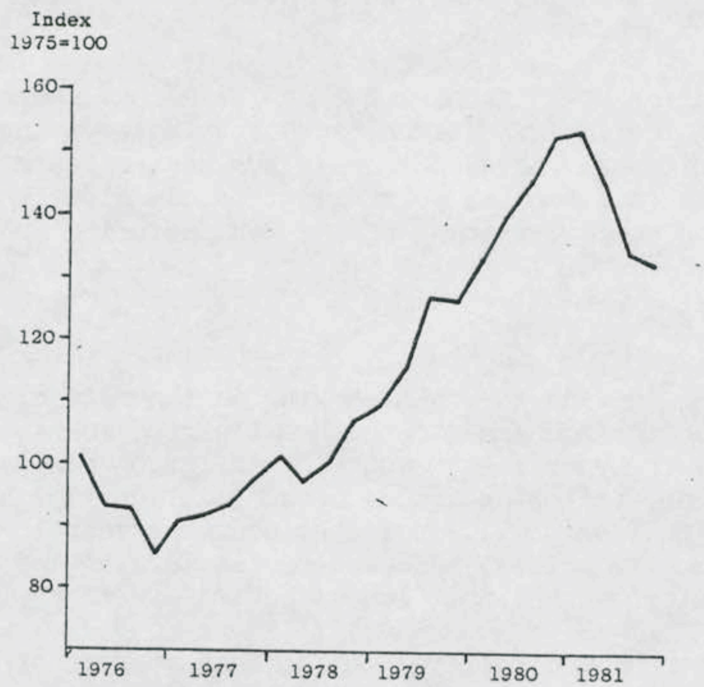
Competitiveness

We pointed out last year that there had been a severe deterioration in the cost competitiveness of British industry compared to overseas producers. Since then the position has improved but remains bad in comparison with historical trends as Chart A.2 shows.

These movements in competitiveness partly reflect changes in the value of Sterling. Its effective exchange rate was on an upward trend from the end of 1976 until the beginning of this year. Since then it has fallen back somewhat and recently seems to have stabilised close to 90 per cent of its 1975 value. Among the wide variety of factors likely to influence Sterling's exchange rate over the next two years, there could be some upward pressure if oil prices rise from their present depressed levels in response to the predicted ending of world oil destocking and higher industrial production levels, while increases in interest rates overseas could imply some downward pressure. Our central economic assessment is based on the assumption that Sterling's effective rate is likely to decline by a small amount over the next two years.

CHART A.2

Unit Labour Cost Competitiveness[1]



1 Labour costs per unit of output in UK manufacturing divided by the equivalent costs in competitor countries on a trade-weighted basis, expressed in common currencies.

Source: CBI estimates

Competitiveness has also been strongly influenced by rises in UK manufacturing average earnings greatly in excess of those in competitor countries. From 1970 to 1980 average earnings in UK manufacturing rose by 346 per cent in comparison with increases of 190 per cent in our main overseas competitors. In the two years to mid-1980 average earnings in UK manufacturing increased by more than twice as much as the average of our major competitors. Since then, the position has improved somewhat, with a rise of over 11 per cent in the year to mid-1981, similar to our competitors, and there is evidence of some further slowing since then. There is some hope that this downward trend will continue but this would be despite the influence of settlements in many parts of the public sector over the last 2½ years well above the average private sector level (see Section V for further details).

Another factor contributing to the recent movements in competitiveness shown in Chart A.2 was the large decline in manufacturing output per employee over the eighteen months to the end of 1980, followed by a sharp reversal of this trend resulting in an estimated 10 per cent improvement up to the end of 1981. Part of this sharp change reflects movements in hours worked but even adjusting for this, the recovery in productivity is most unusual over a period when output changed little.

Some of this recovery reflects exceptional factors which cannot be repeated, such as closure of least efficient factories and concentration of output in the remaining plants. In part it may be due to cutbacks in training research and development which firms have reluctantly been obliged to implement, and other factors which might be reversed when demand picks up. However, some of the rise in productivity reflects improvements in working practices and attitudes which could occur more widely in future. Many CBI Members have reported that if demand were to increase, substantial further increases in productivity could be achieved.

The competitiveness figures shown in Chart A.2 are based on labour costs and therefore do not reflect the impact of Local Authority rates, energy changes, interest rates and other costs. Local Authority business rates have risen by over 40 per cent in past two financial years and this has clearly had a significant effect on the competitiveness of our manufacturing and service businesses.

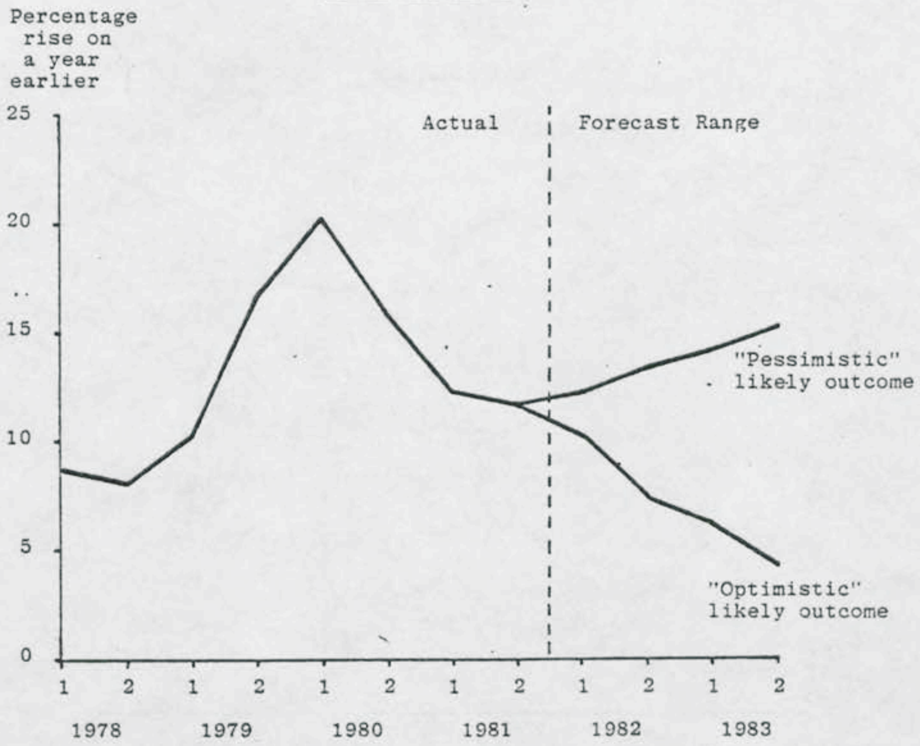
Price Inflation

1981 witnessed a slow decline and then a steadying in the rate of inflation as measured by the twelve month change in the Retail Price Index. Chart A.3 shows that by the end of the year this measure of inflation was running at 12 per cent. This decline, following a more marked fall during the second half of 1980 from the peak rate of 21.9 per cent over the year to May 1980, reflects weak world commodity prices, squeezed profit margins and more recently a slower rate of growth of unit labour costs.

Our central forecast on unchanged policies is for this measure of inflation to show little change until the Spring, with possibly some slow decline to around 10 per cent by the end of the year. This would reflect our assumptions of a small decline in Sterling's exchange rate and further moderation in labour cost increases. The chart shows that the optimistic end of the range of likely outcomes would be a marked fall in this measure of inflation, while the pessimistic end shows it remaining around present levels in the coming year and rising in 1983.

CHART A3

Price Inflation[1]



1 Index of Retail Prices

Source: Department of Employment and CBI forecasts

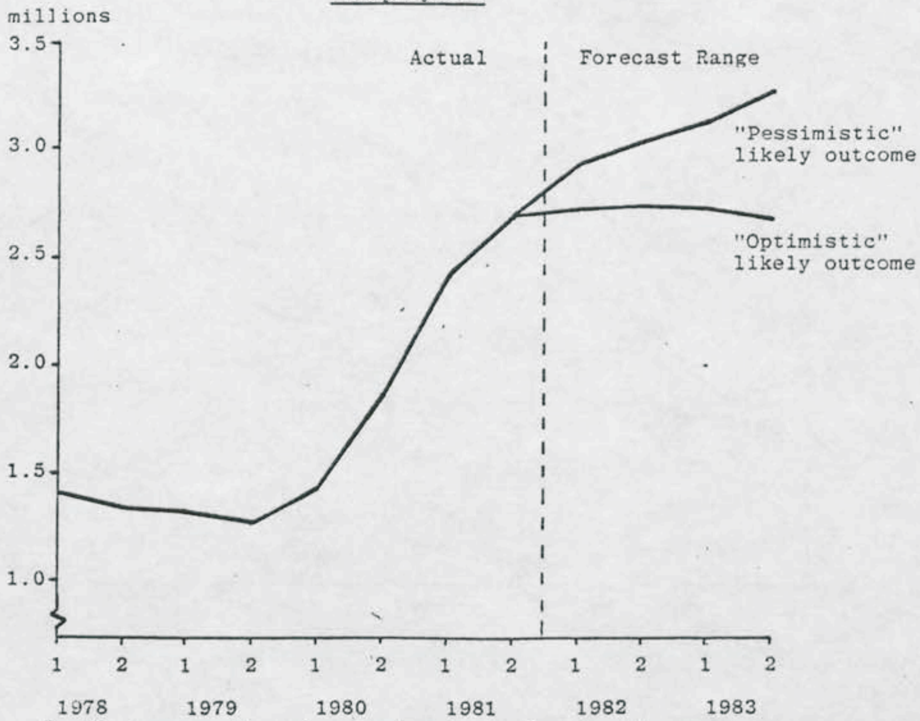
Unemployment

Chart A.4 shows that the fall in output was reflected in a very rapid rise in unemployment from the end of 1979 and throughout 1980. Unemployment continued to rise throughout 1981 but at a declining rate. By the final quarter of 1981, the total number unemployed was only marginally below three million.

We expect the trend in unemployment to continue upwards until the middle of this year. In the second half of the year, the trend in registered unemployment (seasonally adjusted, excluding school leavers) could more or less stabilise, reflecting our estimate of the impact of various government special employment measures which are likely to take increasing numbers off the unemployment register. However, the impact of these measures is still somewhat uncertain and the Chart shows that a continuation of the upward trend is within the likely range of outcomes. During 1983, registered unemployment is likely to resume an upward trend on present policies unless the new training scheme proposed by the Government takes very large numbers out of the labour force.

CHART A4

Unemployment[1]



1 UK seasonally adjusted excluding school leavers
Source: Department of Employment and CBI estimates

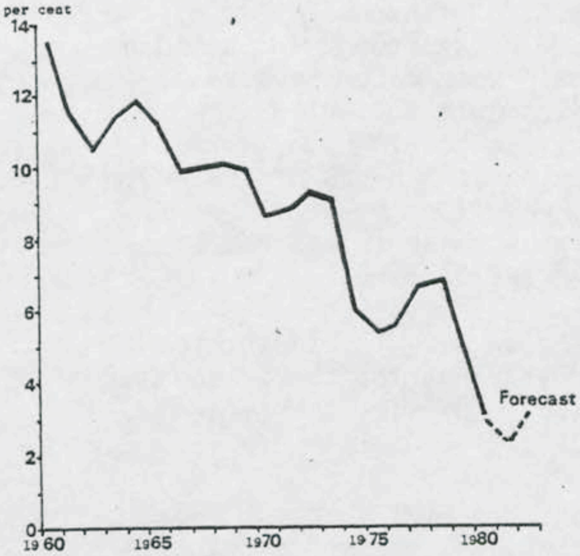
Company Profitability and Provision for the Future

In 1981 the real pre-tax, pre-interest rate of return for non-North Sea Industrial and Commercial companies fell to just over 2 per cent, the lowest ever recorded in this country, and almost certainly much lower than in any of our overseas competitors[1]. Although some recovery appears to have begun in the second half of the year and is expected to be sustained throughout 1982, real profitability this year is likely to be around 3 per cent. Chart A.5 shows that this would still be extremely low by historic standards. Chart A.5 shows profitability before tax and interest. The magnitude of the squeeze on company finances is pointed out even more graphically in Chart A.6 which shows real profitability for industrial and commercial companies (excluding North Sea activities) minus payments of tax and interest. In 1980, for the first time on record, this total was negative. We estimate that it remained negative in 1981 and on our central forecast will continue to be negative on unchanged policies this year. The Chart also shows that the proposals in this document would make real profits after tax and interest positive.

---

1 An article in British Business, 4 September 1981, indicates that real profitability in the UK appears to be considerably lower than in all of a group of comparable industrialised countries.

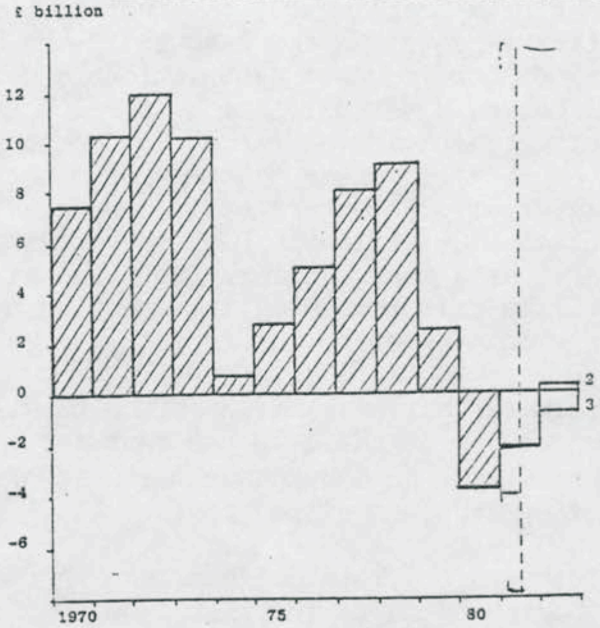
CHART A5
Real Profitability[1]



1 Gross Trading Profits plus rent minus stock appreciation and capital consumption as a percentage of capital employed for industrial and commercial companies excluding North Sea activities.

Source: CSO and CBI estimates.

CHART A6
Real Profits after Tax and Interest[1]



3 On unchanged policies

2 After the implementation of our package

1 Gross Trading profits plus rent minus stock appreciation, capital consumption, net tax payments on income and net interest payments revalued to 1982 prices for industrial and commercial companies excluding North Sea activities

Source: CBI estimates

Investment and other provision for the future has been cut sharply in the past two years. Manufacturing industry investment (even after adjusting for leasing) is estimated to have fallen nearly 20 per cent between 1979 and 1981 and a further small fall in 1982 is likely. In addition to cutbacks in new investment, companies have reacted to the recession by widespread plant closures. The number of affirmative responses to the CBI Industrial Trends Survey question 'is your present level of output below capacity?' has been declining much more rapidly than can be accounted for by increases in output, implying substantial reductions in capacity. The number of new engineering apprenticeships in 1981/82 is estimated by the Training Services Division of the MSC to have fallen by 20 per cent from 2 years earlier, even more sharply than earlier forecasts had suggested and there is considerable anecdotal evidence of reductions in training.

Because of the low levels of profitability, particularly after tax interest, achieved in the recent past and expected in the near future, company expenditure on investment and provision for the future is likely to be constrained in the coming years. In addition we expect on unchanged policies that there will be continued closures of plants and firms caused by production in many parts of the economy remaining uneconomic.

Despite low profitability, industrial and commercialcompanies accumulated more liquid assets than liabilities and hence recorded a negative net borrowing requirement in the first three quarters of 1981, instead of recording a positive net borrowing requirement as is usual. This reflected both substantial destocking and the delay in collection of tax revenues caused by the Civil Servants' dispute. From the fourth quarter of last year, companies seem to have been increasing their borrowing substantially as destocking slowed down and the delayed payments of tax were made.

In the coming year we estimate that the impact on company borrowing of lower destocking will be more than enough to offset the small projected rise in profits.

Monetary Situation and Outlook

Movements in Sterling M3, the indicator used to define the Government's monetary targets, in the past two years have been strongly affected by the ending of the 'corset' restrictions and in the 1981/82 financial year by the Civil Servants' dispute and by the substitution of bank lending for building society lending in the market for housing finance, among other factors. However, several major features of monetary developments in 1981/82 are fairly clear. The Government's borrowing is likely to be close to its PSBR target of £10½ billion. Despite this interest rates at the end of 1981 were higher than a year earlier. The personal sector has offset much of the effect of falling real income on its spending by a sharp increase in its borrowing and new company borrowing from the banks has been fairly high.

We estimate that overall, Sterling M3 will have grown slightly faster than the upper end of the 6-10 per cent per annum target range for the 14 months to April 1982. However other measures of the money supply are likely to indicate much less rapid growth.

Preliminary forecasts suggest that in the 1982/83 financial year the PSBR will be around £9 to 10 billion on present policies.[1] Company borrowing is likely to rise as destocking ends. The outlook for personal borrowing is highly uncertain but if people are to maintain current spending levels they will probably have to cut back on saving or continue raising their borrowing at around the rate recorded during the 1981/82 financial year. Monetary forecasts are inevitably uncertain but, in the absence of further special factors, there is a strong possibility that monetary growth on unchanged fiscal policies and assuming a small fall in interest rates would be close to the top of the target range of 5 to 9 per cent for 1982/83.

How the prospects would be improved by implementation of CBI policies

i Effect on Output

We describe above our forecast for GDP assuming a continuation of present policies.[2] In this section we consider the likely outlook if the CBI recommendations were implemented in the Spring 1982 Budget. Our estimates are based on our econometric model but we also checked them with the Economist Intelligence Unit version of the Treasury model and obtained essentially similar results.

The projections show how our proposals would increase output compared to the outlook on unchanged policies. They do this through two main routes. First, competitiveness would be markedly improved by the reductions in business costs that we are proposing: lower NIS, business rates, interest rates and energy costs. This improvement in competitiveness should lead to higher exports and lower import penetration thus increasing GDP. Second, our measures represent an increase in the overall level of demand because the Government would have increased the balance between its expenditure and its revenue and reduced interest rates.

---

1 "present policies" including indexation of personal income tax allowances system and not indexing specific duties; indexing the latter would reduce the PSBR forecast by roughly £1 billion.

2 For further details see CBI Economic Situation Reports, annual subscription £110, (£90 for CBI Members).

HOW CBI POLICIES AFFECT GDP

Chart A.7
"Pessimistic" likely outcome

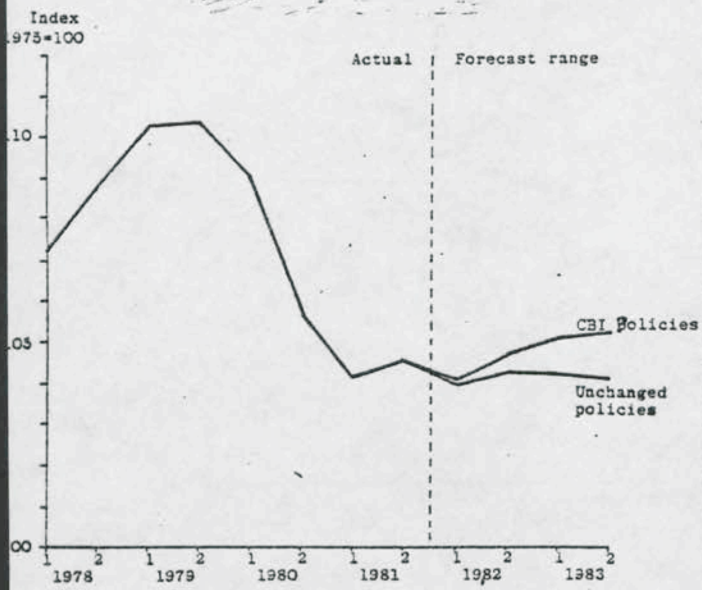


CHART A8

"Optimistic" Likely Outcome

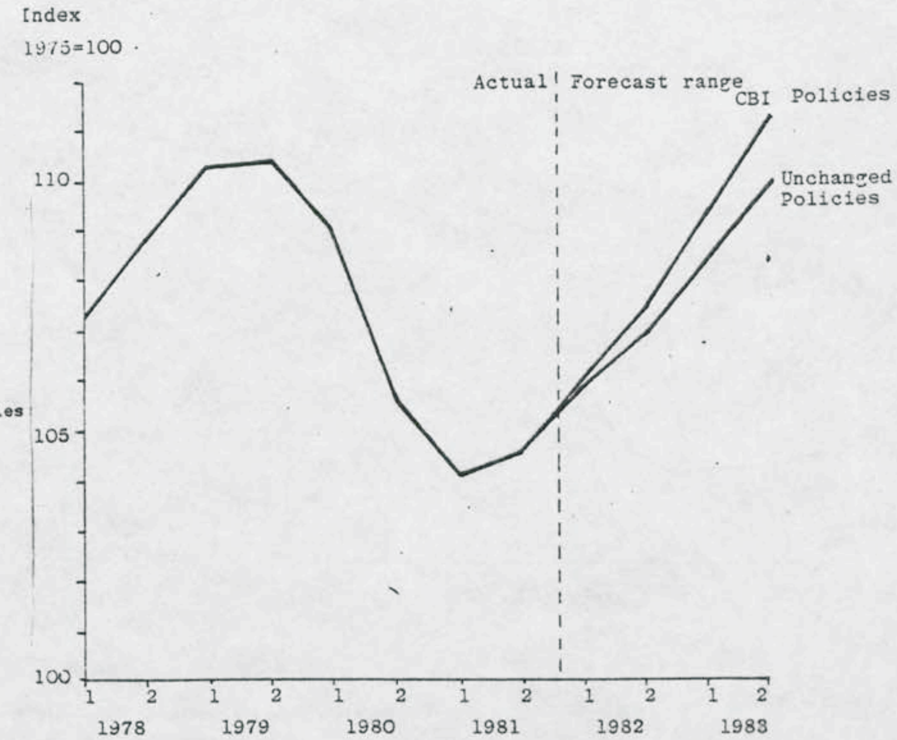


Chart A.7 shows that on present policies, if developments were at the pessimistic end of the range of likely possibilities, output would resume falling in the course of 1982, continuing to decline in 1983. This would destroy the present hopes that unemployment could more or less stabilise in the second half of next year and it would eliminate the small recovery in profitability that we are currently hoping for. We would regard such an outcome for the UK economy as extremely unsatisfactory. This Chart also shows that were our policies implemented, developments at the pessimistic end of the range of likely possibilities would imply that output more or less stabilised. This, would still be far from satisfactory but it would be markedly better than a decline in output.

Chart A.8 shows that if the outcome were at the optimistic end of the likely range, then even on present policies output would be likely to grow by about 2½ per cent in the course of 1982. Chart A.8 also shows that if our policies were implemented, an outturn at the optimistic end of the range would imply that GDP growth of nearly 4 per cent was likely over the year to early 1983, by when it would still be 2 per cent lower than in 1979. Our estimates suggest that because of the large margin of spare capacity existing at present, growth at this rate would be unlikely to lead to significant shortages.

ii Effect on unemployment

Charts A.9 and A.10 show the likely impact of our policies on unemployment. If unemployment turned out to be at the pessimistic end of the likely range suggested by our forecasts, then on current policies it would continue rising fairly markedly throughout the period to end-1983, while on our policies it would be more or less stabilised. At the optimistic end of the likely range of possibilities, on current policies the trend in unemployment would decline slightly but on our policies it would fall by rather more.

HOW CBI POLICIES AFFECT UNEMPLOYMENT[1]

CHART A9

"Pessimistic" Likely Outcome

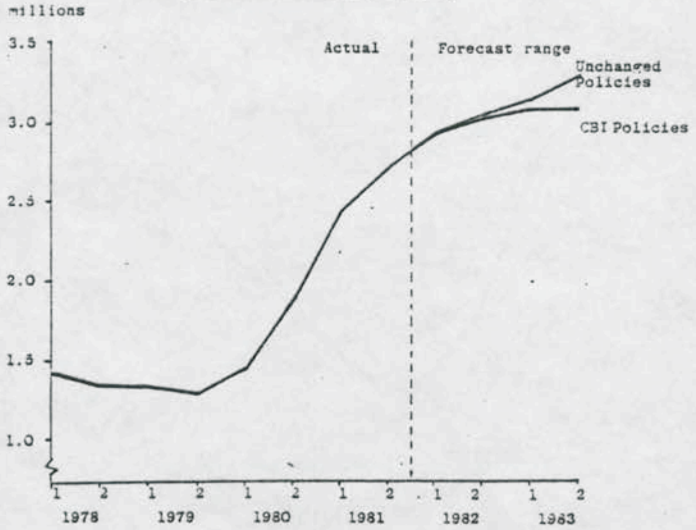
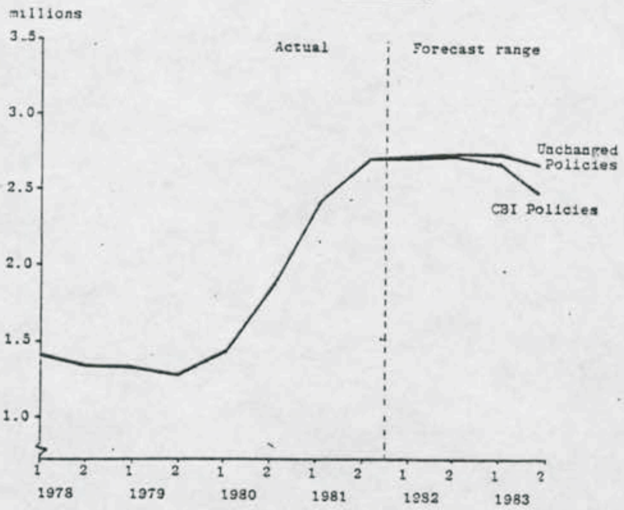


CHART A10

"Optimistic" Likely Outcome



1 UK, Seasonally adjusted, excluding school leavers

iii Effect on profitability

Chart A.11 shows that on current policies,pre-tax, pre-interest profitability (defined on chart) would fall slightly from the record low levels last year if developments turn out at the pessimistic end of the likely range of outcomes. If our policies were implemented, a pessimistic outcome would give a slight rise in profitability. If events turned out at the favourable extreme of probable forecasts, profitability on present policies would rise only to around five per cent by end-1983 - still very low by historic standards - whereas on our policies it would reach nearly six per cent. Chart A.6 shows that the effects of our proposals on real profits after tax and interest is to turn a negative total predicted for 1982 on unchanged policies into a positive one.

HOW CBI POLICIES AFFECT PROFITABILITY[1]

CHART A11

"Pessimistic" Likely Outcome

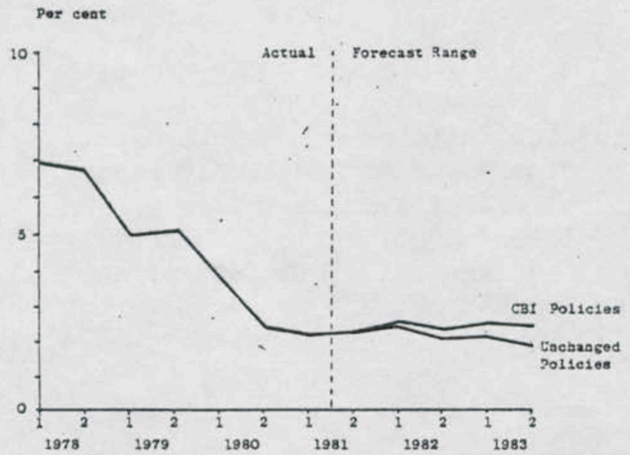
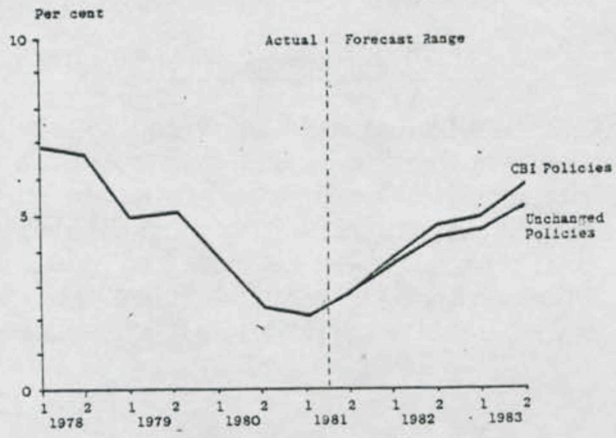


CHART A12

"Optimistic" Likely Outcome



1 Gross Trading Profits plus rent minus stock appreciation and capital consumption as a percentage of capital employed for industrial and commercial companies excluding North Sea activities.

Effect on inflation

We described above our central projection for twelve monthly retail price inflation, which showed a slight slowdown from the present rate, assuming continuation of current policies. Hence the optimistic end of the forecast range in Chart A.13 shows a marked fall on present policies.

HOW CBI POLICIES AFFECT INFLATION [1]

Chart A.13
"Pessimistic likely outcome"

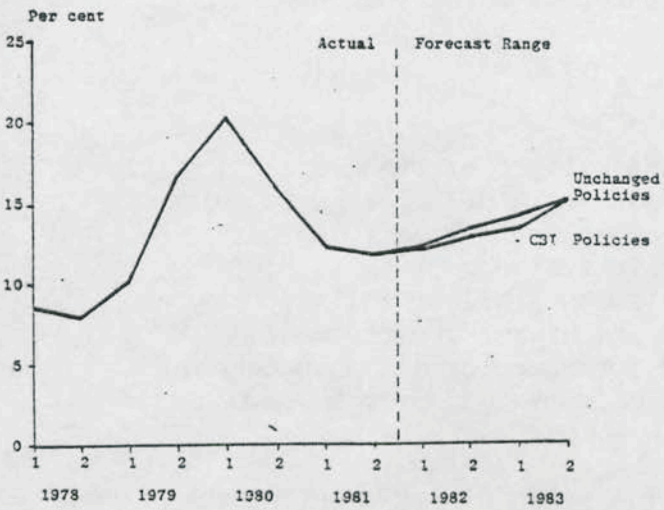
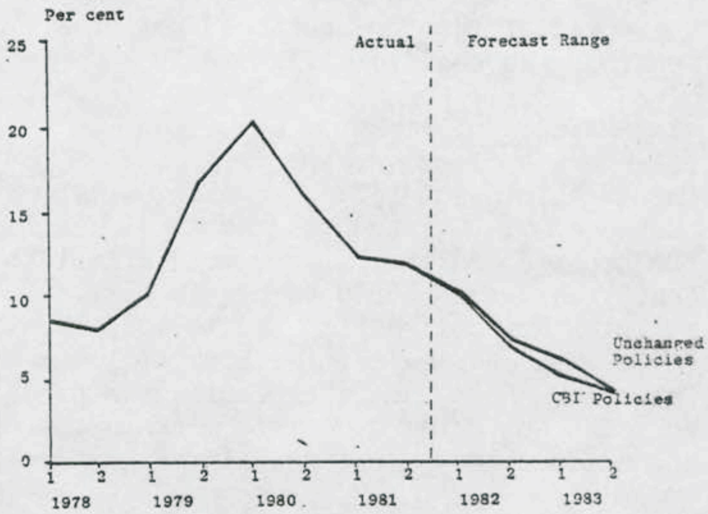


Chart A.14
"Optimistic likely outcome"



1 RPI, percentage rise over past year

Our proposals for lower business costs (see Table I.1) would reduce business costs by £3000 million at 1982/83 prices in a full year. If there were a fall in the Sterling effective exchange rate in comparison with what otherwise would have happened of, say, 3 per cent, the addition to the costs for UK businesses and consumers of imported goods is unlikely to be as much as £1000 million annually. The net effect on retail prices of the lower UK business costs and the higher import costs, together with the impact of higher demand and profitability, the spreading of overheads from increased throughput and lower interest rates is unlikely to be upwards given the large amount of unutilised capacity shown by CBI Industrial Trends Surveys.

The evidence of movements in pay when NIS was introduced and of the effects of various other changes in payroll taxes does not suggest that our package of recommended cuts in business costs would lead to higher pay. We have checked this conclusion in very extensive discussion with CBI Members with particular knowledge and experience of factors influencing pay negotiations at the present time. This discussions have shown overwhelming support for the view that there would be no direct effect on pay from our proposed reductions in business costs.

Charts A.12 and A.13 show that, if anything, our proposals are likely to reduce inflation.

v Effect on PSBR

The higher output which we expect to be generated by our measures would, after a while, boost Government tax revenue and reduce unemployment pay below what it would be on present policies. This would tend to offset the effect on the PSBR of the net reduction in revenue relative to expenditure that we are proposing, although the initial effect would probably be small. Table I.2 summarises our estimates of these "feedback" effects. The PSBR would be increasd by about £1.8 billion in 1982/83 from the £9 to £10 billion figure we expect on current policies and, therefore, remain about the same percentage of GDP as the target for 1981/82 announced by the Chancellor in the March 1981 Budget. In 1983/84 the PSBR would be increased by about £1.7 billion at 1982/83 prices and incomes by our recommendations.

We show in II.4 and II.5 why, although the PSBR after our proposals is likely to be higher than on unchanged policies, lower interest rates would be feasible and beneficial.

vi Balance of risks

Charts A.7 to A.14 give a clear indication of the balance of risks affecting the economy. Charts A.13 and A.14 show the large margin of error surrounding the prospect for inflation, with a fall to 4 per cent or a rise to 15 per cent within the bounds of possibility. These charts also show that CBI policies are unlikely to add to inflation. The risk of higher inflation has to be balanced against the risk of lower output and higher unemployment. Chart A.9 shows that the pessimistic projection for unemployment on unchanged policies would leave unemployment in the second half of 1983 over 500,000 higher than in the second half of last year.

Given the range of possibilities we judge that the risks of implementing the proposals contained in this document are less serious than those of continuing to follow unchanged policies. Moreover these charts overstate the danger of an excessive boost to demand since they are based on the assumption that there is no change in fiscal stance between the 1982/83 and 1983/4 financial years.

In fact it would be possible to restrain the economy, for example in the Spring 1983 Budget, if signs emerged that the economy was growing too fast and leading to a risk of inflationary shortages.

ANNEX 2

PROPOSALS FOR INCORPORATING SFICs INTO THE BUSINESS START-UP SCHEME

a Individuals would get tax relief for investing in SFICs just as they do for investing directly in smaller companies under the present Scheme. We believe that this would require only minor amendment to the existing legislation and is already permitted under the Scheme when an individual invests in a start-up company through an approved investment fund.

b Institutions and other companies should be able to invest in SFICs (although they would not receive the same tax relief as individuals) and this would require amendment of the 1981 Act.

c SFICs and individuals should be able to invest in existing companies as well as new ones. Accordingly the restriction in the 1981 Act to new trades (and the consequential restriction to new companies) should not apply. This departure from the Act would require omission or amendment of the sections that impose the restrictions.

d The kinds of trade that qualify under the 1981 Act would also be those qualifying for investment by SFICs.

e Since a SFIC should be able to lend to an investee company as well as acquire equity and be able to acquire securities in qualifying companies and not be confined to subscribing for new securities, there would have to be departures in these respects from the 1981 Act.

f Institutional investors should be able to deduct, when calculating taxable income, any realised or unrealised losses on investment they had made in a SFIC. This would be a departure from the 1981 Act.

g The income and capital gains derived from qualifying investments made by SFICs should be free from tax. This would require legislation.

h The SFIC would have to comply in its constitution and conduct of its business with general company law and, in particular, with the Prevention of Fraud (Investments) Act 1958. We do not believe that this would require new legislation. However, it would probably be necessary to provide for the withdrawal of relief for investors, and of benefits for the SFIC, if a SFIC failed to make investments in qualifying companies, or did not comply with its rules and conditions. This could probably be achieved by amendment to the existing legislation.

ANNEX 3

TECHNICAL TAX REPRESENTATIONS

This Annex contains the more detailed technical representations which we have sent to the Revenue Departments. They reflect the existing law and they should not be seen as affecting the position expressed in Section III.

A REPRESENTATIONS ARISING OUT OF THE FINANCE ACT 1981

Consortium Relief

Section 40 FA 1981 extended consortium relief and now allows consortium members to surrender losses down to a consortium company to be used against its profits. The impediment to the free and full use of ordinary group relief and consortium relief which Section 263(5) ICTA presents is now more significant. Section 263 should be amended so that part of a loss can be set off by way of group relief without prejudice to using all or part of the rest of that loss by way of consortium relief.

Stock Relief

a Six Year Cut-off

The six years restriction on the carry forward of unused relief should be abolished.

b Payments on Account

If a business makes a payment on account of stock in advance of obtaining ownership, it should get stock relief on the payment. This is a reasonable corollary of the rule that the supplier of the stock has his claim cut down as a result of receiving the payment on account.

c Amount of Tax on Clawback

The tax on the clawback should not exceed the tax reduction obtained in the past on the relief.

The tax on the clawback may be at 52% whereas the previous relief may have been at 40% (small companies rate), 22% (mainstream tax partly covered by ACT) or some rate less than the usual because of DTR.

Relief for Interest

The extension of relief for interest paid on loans taken out for investment in a partnership or co-operative which was provided by Section 25FA 1981 should be further extended by removing the exclusion of limited partners.

Development Land Tax

The increase in exempt cubic content provided by Section 133FA 1981 should apply to rebuilding as well as enlargement.

B OTHER TECHNICAL REPRESENTATIONS

Capital Allowances

Plant and Machinery - Transfers between related persons

The taxpayer should have the right to elect for plant and machinery to be transferred at its tax written-down value in all cases where it passes between related persons.

Group Relief

a Extension to accumulated losses

The group rules in Part XI ICTA should be amended so that a company may surrender accumulated as well as current year losses.

b Time limits for surrender

Section 512(2) ICTA recognises that it can take a considerable time for foreign tax assessments to become final and therefore extends the normal time limits for claims and assessments.

However, if a member of a UK group with foreign taxed income has covered its remaining UK liability after double tax relief with group relief and subsequently the double tax relief is increased by an adjustment to the overseas tax, the group relief claim cannot be revised if the double tax relief adjustment occurs outside the two year time limit for group relief purposes.

The additional double tax relief may be lost and the purpose of Section 512(2) frustrated.

Without prejudice to our long-standing representation that time limits for group relief and other claims should be six years, the time limit for revisions of group relief claims should be extended to meet this case.

c Surrender of excess charges on income - effect of Section 13 Oil Taxation Act 1975

Section 13 Oil Taxation Act 1975, which treats oil extraction activities etc carried on as part of a trade as constituting a separate "trade" for corporation tax purposes, causes a restriction on relief for charges on income in certain circumstances.

Section 248(1) ICTA allows a company's charges against total profits and if the charges exceed total profits the excess may be surrendered as group relief (Section 259(6) ICTA).

Unfortunately where a company carries on two or more trades, one of which is a Section 13 OTA 1975 "trade", relief is restricted where:

i the charges other than those relating to the Section 13 trade (Section 15 OTA 1975) exceed trading income arising outside the ring fence, but

ii total charges do not exceed total profits.

here the excess must be carried forward since it cannot either be offset against ring fence trading profits (Section 15 OTA 1975) or surrendered as group relief (Section 259(6) ICTA).

Section 259(6) ICTA should be amended to permit such excess to be surrendered as group relief.

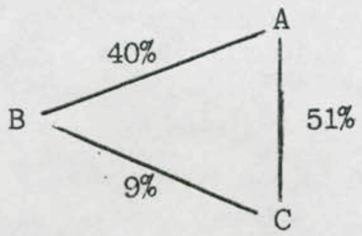
Capital Gains - Transfers within a group

Difficulties can arise in some cases in relation to the availability of rollover relief due to the combined effect of Section 273 ICTA and Section 115 Capital Gains Tax Act 1979. To avoid this problem Section 273 should be amended to allow the transferor company to elect that the provisions of subsection (1) shall not apply to a particular transfer where the market value of the relevant asset at the time of transfer is greater than the value at which it would otherwise have been deemed to have been transferred.

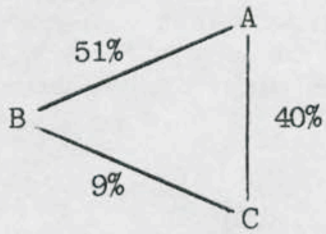
Double Taxation Relief

Section 508 ICTA can operate in an anomalously restrictive manner as illustrated below:

Case I



Case II



A is a UK company
B and C are overseas companies.

In Case II Section 508 gives relief to A on underlying tax on dividends from C to B, because B is a subsidiary of A which controls directly or indirectly 10% of C.

In Case I underlying tax relief is not given to A on dividends from C to B, because B is not a subsidiary of A.

Section 508 should be amended to give underlying tax relief to A in Case I on the basis that C is deemed to be related to B provided that B is related to A and C is a subsidiary of A.

Advance Corporation Tax

a Change of Rate

Where there is change of ACT rate at 5 April there is a new deemed accounting period with the result that ACT payable in respect of a distribution made before that date cannot be set off against franked investment income received after 5 April but within the normal accounting period.

Section 103 FA 1972 should be amended to remove this restriction.

b Surrendered ACT

Section 92(4) Finance Act 1972 can create a trap in relation to bona fide reorganisations of the structure of groups of companies where there have been surrenders of ACT, as is illustrated below:

Parent Company	A	
	|	100% shareholding
Intermediate company	B	
	|	100% shareholding
Trading subsidiary	C	

B surrenders ACT to C. Subsequently B transfers its shares in C to A. As C is no longer a subsidiary of the surrendering company B, the ACT surrendered to it is lost.

Section 92 should be amended to allow such reorganisations to take place without the company which received the surrendered ACT losing the right to carry it forward.

Pre-trading expenditure

The 1980 Finance Act introduced relief for certain expenditure incurred by a prospective trader not more than one year before the time the trade is commenced. This is unduly restrictive and should be extended to cover items of expenditure incurred within three years before trading commences.

VAT

a Business Gifts - Limits

The limit under paragraph 5(2) Schedule 2 FA 1972 should be raised from £10 to £30.

b Relief for Bad Debts

The limited relief granted under Section 12 FA 1978 should be extended to equate with the rules applying for income and corporation tax purposes.

c Input Tax where no Invoices

Input tax should be allowed on a percentage of total expenditure on items such as hotels, travelling and the like as an alternative to the present invoice basis, which is administratively costly.