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Secretary of State for Trade and Industry

PS/

6 April 1984

Robin Butler Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1

Dear Robin,

MEETING BETWEEN THE PRIME MINISTER AND SIR TERENCE BECKETT ON 11 ARPIL 1984

... I attach to this letter briefs dealing with:

i) the Budget and business: a general line on the points which the CBI may wish to raise in relation to the Budget, where the most likely points of contention are the changes in the capital allowance and corporation tax package, and the changes in the treatment of VAT on imports;

ii) electricity prices (long standing bone of contention with the CBI, which I am sure the Prime Minister would not wish to raise); and

iii) the background note on the effect of the coal miners' strike: clearly this is in extremely general terms, but the meetings of MISC 101 next week will no doubt keep the Prime Minister much better in touch with events.

2 As for the suggestion that the Prime Minister should attend the first evening of the CBI Conference on Sunday 4 November and either make a speech or answer questions, we should have no objection whatsoever. The Conference is a suitably prestigious affair for the Prime Minister to address, and the CBI would no doubt be delighted. If the Prime Minister decides to accept the offer, my Secretary of State would be pleased to accept the CBI invitation to speak at their dinner next April.

3 I am copying this letter and attachments to David Peretz (Treasury) and to David Normington (Department of Employment).

Yours ever

Callum McCarthy

M C McCARTHY
Private Secretary

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THE BUDGET AND BUSINESS

As background, an aide memoire which was sent to the CBI by the Treasury, is attached.

2. Broadly speaking the CBI have welcomed the industrial aspects of the Budget package, displaying less concern than had been anticipated on the phasing - out of high first-year capital allowances.

3. Particular points and criticisms which have been made by Sir Terence Beckett and the CBI are as follows:

(i) Capital allowance/corporation tax package

In spite of having previously expressed a wish to retain high first-year capital allowances, criticism of their phasing-out has been muted. But the CBI have called for a longer transitional period, to ease the difficulties of those firms heavily committed to an investment programme. The CBI have also said that the package will adversely affect small, fast growing, capital intensive companies while recognising that it will be beneficial to industry as a whole because it will encourage profitable investment.

LINE TO TAKE

It is gratifying that the CBI have recognised the overall benefit of the package in encouraging profitable investment. After-tax returns will be increased as a result of the sharp cut in corporation tax; and marginal projects, undertaken largely for tax reasons, will be discouraged. Distortion in the tax system - between capital and labour, between equity and debt and between one industry and another - will be reduced. Deciding the length of the transitional period is a matter of fine judgement. Some have suggested the change should have been sudden, with no transitional period. On balance, phasing over 3 years seems right. It is in business' own interest to move as soon as possible to the much lower rate of corporation tax.

(ii) Postponed accounting system for VAT on imports

The ending of this system with effect from 1 October has also been broadly welcomed, on the grounds that this removes a bias in favour of imports. But industry also imports large quantities of goods - raw materials, semi-manufactures and finished products - and the CBI have suggested, arguing by analogy with practice is the Republic of Ireland, that the postponed accounting system should be retained for raw materials to ease the adverse effects of withdrawal of PAS on industry's cash flow.

LINE TO TAKE

Many CBI members will welcome this change which has followed representations from various sectors of British manufacturing industry about the discriminatory effect of the present system in favour of imports. The possibility of retaining the postponed accounting system for raw materials has been examined carefully but we are advised that such discrimination would be illegal under the Treaty of Rome and we would be challenged by the EC Commission. It is true that the Irish system under which postponed VAT accounting applies to raw materials and components imported by companies exporting 75% or more of their production is a discriminatory measure; we will have to see what action the Commission takes. Moreover, to draw such a distinction would require additional staff resources and would lead to disputes as to where the line was to be drawn. Industry imports considerable quantities of semi-finished and finished manufactures; so special treatment for raw materials would be difficult to defend.

(iii) Extension of VAT base to include building alterations and hot takeaway food

The CBI have said that broadening the VAT base is preferable to increasing the rate of tax. On the other hand, some reservations, though fairly muted, have been expressed about the effect on the building and takeaway food industries.

LINE TO TAKE

Agree with CBI that broadening the base is preferable to raising tax rate (which would have had to be raised to 16% to yield the same revenue on the old base). Naturally those industries directly affected will object. But the extension to building alterations removes a major source of confusion and litigation; and the extension to hot takeaway food extends the same VAT treatment as to other forms of catering.

(iv) National insurance surcharge

The CBI have warmly welcomed the abolition of this tax, for which they have always campaigned vigorously. One criticism is that it has been very slow in coming.

LINE TO TAKE

The Government are pleased to have been able to abolish this tax on jobs. Abolition came more slowly than would have been wished, but this demonstrates the Government's responsible attitude to financial policies. Earlier abolition could well have meant higher interest rates. Our stated objective was to abolish NIS within the lifetime of this Parliament: we have done it right at the beginning. Compared with the 3½% NIS we inherited, abolition means that we have given back to industry £3 billion a year to reduce costs and encourage employment. It is essential that the benefits of abolition are used to reduce costs and do not feed through into higher wages.

(v) Investment income surcharge

The abolition of this additional charge on investment income has been warmly welcomed.

LINE TO TAKE

The Government are pleased to have been able to abolish this additional charge. This removes discrimination against investment and will be particularly helpful to retired smaller business people who are living off the interest income from investment of the proceeds from the disposal of their business. This is often the way the self-employed provide for their retirement - rather than through pension arrangements. Abolition of the surcharge will further encourage small firm enterprise.

(vi) Share options

The CBI feel the introduction of a new and benign tax regime for shares acquired under employee options (capital gains tax rather than income tax, payable on disposal of shares rather than on exercising the option) will affect only a small number of people but that it is nevertheless a very important step in encouraging enterprise and good management.

LINE TO TAKE

The new tax treatment of share options illustrates the Government's commitment to enterprise. It will give companies a valuable new incentive to motivate and link the rewards of key executives and employees to the success of their companies. They could be a powerful incentive to attract top quality management which industry so badly needs. The changes will assist small and growing companies to attract key personnel; assist ailing companies to attract new management; assist large and established companies to retain and motivate staff. They will also give employees the chance to accumulate capital to start their own business and will encourage wider share ownership. This measure could have a larger and longer lasting effect on industrial performance than the direct reduction of costs on industry through measures such as abolition of NIS.

(vii) Business expansion scheme

The CBI have welcomed the exclusion of farming from the scheme, which was diverting funds away from industrial investment. They feel a corporate investment vehicle - 'small firms investment company' would be preferable to the present approved funds system.

LINE TO TAKE

There was only one change to the scheme this year - the exclusion of farming. The scheme needs a period of consolidation to show how it is developing. Small firms investment companies would not necessarily represent a simplification - at least so far as the legislation is concerned, would not necessarily be more marketable, and would run counter to the object of the scheme which is to encourage individual investment and direct shareholdings in the individual small companies.

(viii) Stamp duty

The CBI have welcomed the changes - broadly, a reduction in the duty from 2% to 1% on both real property and share transfers - but would have preferred to see abolition.

LINE TO TAKE

This change will encourage labour mobility, wider share ownership and help to restore the competitiveness of the Stock Exchange. Stamp duty is an important revenue raiser and it would have been too expensive to abolish the tax completely.

GP1 (DTI)

6 April 1984

THE BUDGET AND BUSINESS: AN AIDE MEMOIRE

The Budget set the Government's course for this Parliament. The MTFS has been extended to cover 5 years. The Budget has two themes: to reduce inflation and improve the prospects for jobs; and to reform and simplify the tax system in a way that improves economic performance.

The PSBR and Interest Rates

2. For 1984/85 the Budget is broadly revenue neutral, compared with an indexed base. It will reduce the PSBR sharply as a percentage of GDP and this should allow progress to lower interest rates to be resumed. For 1985/86 the measures will reduce taxation by well over £1¾ billion. There are no public expenditure measures.

Business Tax Burden Cut Over Next Two Years

3. The Budget measures directly affecting business will reduce its tax burden over the next two years taken together by about £900 million, compared with an indexed base. In 1984/85 alone, within a neutral Budget, business will pay up to £500 million more tax (solely as a result of the once and for all impact of earlier payment of VAT on imports) but this will be outweighed by the gain to business in 1985/86 of about £1400 million. In the longer term the reduction in corporation tax rates to 35% should give a lasting cut in the tax burden on business.

Major Business Tax Measures

4. The major measures include:

a. corporation tax reform: abolition of stock relief; phasing out first year capital allowances; and reducing the CT rate by stages from 52% to 35%. The CT rate for "small companies" comes down immediately from 38% to 30%. The result will be broadly that UK capital allowances will be more in line with those in most other countries and corporation tax rates will be lower;

b. earlier payment (for most imports about a month after entry) of VAT on imports from 1 October, which will improve the competitiveness of UK producers against imports;

c. abolition of NIS from 1 October;

d. halving the main rates of Stamp Duty from 2% to 1%;

e. changes affecting the North Sea.

The Finance Bill will embody all these changes so that business ..... will be able to plan ahead with confidence. The attached Press notice explains the purpose and effects of a. and c. in more detail. In brief, the measures will raise profits after tax by lightening the tax burden and reduce the distortions entrenched in the present system. Businesses will be able to spend more on innovation of all kinds; and investment will bring a higher pre-tax return to the economy.

Business and the Capital Market

5. The halving of Stamp Duty on share transfers should lead to increased trading in equities and to more purchases by individuals. This should make it easier and cheaper for companies to raise new equity.

6. The Budget also contains several measures which will benefit company stock issues: in particular the new arrangements for deep discount stock and reliefs for companies issuing euro-bonds and convertible loan stock announced last year will go ahead; and most new corporate fixed interest securities held for more than a year will now be exempt from CGT.

Indirect Taxes

7. As part of a switch from taxes on earnings to taxes on spending, VAT will be extended to 2 areas at present zero-rated - alterations to buildings, and hot take-away food and drink - and tobacco duty is being increased by 15%.

8. Most other excise duties, and vehicle excise duty, will go up roughly in line with prices. Heavy oil duty will not be raised, and kerosene duty will be abolished.

9. The VAT registration threshold is raised to £18,700, as much as the EC directive allows.

Direct Personal Taxes

10. The relief for the foreign earnings of residents who spend at least 30 and less than 365 days abroad will be withdrawn from 1985/86. For 1984/85 a reduced relief 12½% will apply. The 100% relief for 365 days continuous absence is not affected.

11. Benefit scales for cars and for fuel provided by employers will be raised by 10% with effect from April 1985, a smaller increase than last year.

12. There will be a number of changes in capital taxes, which will be of particular help to owners of family businesses. The highest rate of Capital Transfer Tax will be cut from 75% to 60%. For lifetime gifts the rate will be half the rate on death over the whole scale. The limit for retirement relief for CGT will be doubled. The DLT threshold will be raised from £50,000 to £75,000.

13. The Investment Income Surcharge will be abolished.

14. There will be no change in income tax rates. Most allowances and tax thresholds will go up broadly in line with prices. But in order to ease the poverty and unemployment traps, the married man's and single person's thresholds will rise by 12½%, well over double the rise in prices. Every tax paying married couple of working age will have a tax cut of at least £2 a week.

15. Two changes will encourage share options. The contribution ceiling for savings-related share option schemes will be doubled from £50 to £100 a month. Secondly in order to do more to make top quality company management mobile and to increase the incentives to existing executives, share options generally, subject to certain limits and conditions, will be taken out of income tax altogether. Any gain will be subject to CGT on ultimate disposal.

Conclusion

16. The Budget will bring business substantial benefits. The effect of the tax changes, particularly of the CT reforms and

early payment of VAT on imports, on individual companies will of course vary widely. But the overall tax burden on business will be lightened over the next two years by nearly £1 billion. In the longer term the cut in the Corporation Tax rate by a third to 35%, which will be in this year's Finance Bill, will mean a lasting reduction in the tax burden. The abolition of NIS will benefit all employers, improving competitiveness and the prospect for jobs. The lower PSBR should help to bring down interest rates and tax changes will make companies' access to capital markets cheaper. The more generous provision for stock options will help to improve the mobility of key managers and also to reward those who do not change jobs for good results. More generally the tax reform will help to improve the UK's economic performance.

17. Small businesses will gain from the capital tax changes; and in particular from the immediate reduction in the "small companies" CT rate from 38% to 30%, well below the rate in most other countries.

HM Treasury
13 March 1984

ELECTRICITY PRICES

BRIEF

Background

The CBI have been pressing for a reduction in electricity prices for a number of industries for which electricity is a major element in their costs - chemicals, steel, paper, man-made fibres, glass and refractory products - particularly high load factor users.

2. Electricity prices to users at a load factor of 70% are about 10% above the average of Continental prices; the gap widens at higher load factor. This differential is a significant factor in the competitiveness of the electricity intensive industries. It is argued that the international competition faced by these industries and the risk to UK jobs and investment justifies a reduction in prices to the small minority of high load factor customers.

3. Removing the gap would cost about £60m in revenue foregone from intensive users. Basically there are three ways in which the gap could be removed:

a) 'tilt' the tariff structure so that intensive electricity users pay less and other customers (including domestic customers) pay more;

b) reduce tariffs to intensive users only and meet the cost by further cost savings by the electricity supply industry (esi);

c) relax the esi's EFL by £60m.

4. A number of specific measures have been suggested (by the CBI and others) to reduce tariffs to intensive users. The esi and DEnergy consider that all of these would breach the principles of economic pricing (tariffs should reflect long run marginal costs of supply). There is also a statutory obligation on the esi not to show 'undue preference' between different customers.

5. The Treasury would have to be consulted on any proposal to amend the esi's EFL.

6. Proposals on the options set out in para 3 above have yet to be put to Ministers.

LINE TO TAKE

- Much has already been done for industrial electricity customers by the general standstill on industrial prices since 1983;

- It is accepted that prices to a minority of high load factor customers are higher than the prices paid by some of their Continental competitors, although the comparisons are affected by exchange rate changes and will narrow if Continental prices rise faster than in the UK;

- Some measures costing over £100 million have been introduced since 1981 to help these customers. The introduction of a larger number of charging periods should be of some further help;

- Other possibilities are being looked into but there is the perennial problem of the obligation not to show 'undue preference' between different customers, and of how to finance any reduction that might be made to high load factor customers;

- The issue has to be considered in the wider context of efficient pricing of alternative forms of energy and the financing of the electricity supply industry;

IF RAISED :

Too early to say what are the implications of the present miners' dispute for electricity costs. In the first instance this will be a question for Electricity Boards. Electricity industry and industry generally can only stand to benefit from efforts to create an efficient coal industry.

GP2 (DTI)
5 April 1984

cc. Michael Reidy
D-Energy

PRIME MINISTER'S MEETING WITH SIR TERENCE BECKETT
DIRECTOR GENERAL OF CBI ON WEDNESDAY, 11 APRIL 1984

EFFECT OF COAL MINERS' STRIKE ON INDUSTRY

Sir Terence Beckett may wish to discuss the effect of the coal strike on industry.

2. Coal firing represents only 20% of the total energy needs of industry, some 13.4 million tonnes a year, of which 10.0 million tonnes are used by the iron and steel sectors, cement, and engineering and other metal trades. Some industries use coal to generate their own electricity.

3. So far the effect of the strike on industrial production has been minimal.

4. The steel industry has had problems mainly with coking coal. But by using stocks and imported coal BSC have been able to maintain production at all their sites except Scunthorpe where production was cut by half at the end of last month. The private sector mainly uses electric arc furnaces.

5. Iron foundries, particularly in the Midlands have experienced difficulties as a result of the cessation of supplies of coke from National Smokeless Fuels. Concessions are however being negotiated with the NUM for supplies to be delivered from existing stockpiles to foundries threatened with closure.

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6. The situation could however deteriorate rapidly by Easter when companies who are not receiving supplies will be running out of stocks. Paper mills and leather processors are examples of industries whose stocks are dwindling fast. Once industries run out of coal stocks the knock-on effect will be tremendous. Car manufacturers are major customers of BSC and of iron foundries for castings.

7. If industries have to close because of shortage of coal, some claim they will lo~~o~~se their markets permanently.

GP
6 April 1984

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Secretary of State for Trade and Industry

4 April 1984

Robin Butler Esq
No 10
London SW1

Dear Robin,

CBI

We shall be sending you briefing for the meeting between Sir Terence Beckett and the Prime Minister to take place next Wednesday. You may like to see in the meantime the minutes of the meeting between the Conservative Backbench Trade & Industry Committee and Sir Terence Beckett which took place on Tuesday 20 ... March, a copy of which I attach to this letter.

Yours ever

Callum McCarthy

M C McCARTHY
Private Secretary

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Conservative Research Department

32 Smith Square Westminster SW1P 3HH   Telephone 01-222 9511

Director: PETER CROPPER

PRIVATE & CONFIDENTIAL

Meeting of the Backbench Trade & Industry Committee at 5.00 pm on Tuesday 20th March 1984.

Sir Terence Beckett, Director - General of the C.B.I. addressed the Committee.

Summary

Sir Terence said that the CBI viewed the Budget favourably and pointed out that it should be judged as a whole and for its overall effect rather than by weighing up the relative merits of each item within it . He then answered Members questions on specific points arising out of the CBI's post-Budget appraisal.

Minutes

Sir Terence said that 1984 offered a window of opportunity: the US economy would expand rapidly until the Presidential election when action might be taken to curtail the Budget deficit. The West German and Japanese economies were in better shape this year than last. The prospects for world trade in 1984 were good, while doubts existed on the outlook for 1985. CBI industrial trends surveys had registered gradual improvements in the state of British industry since January 1983; the Budget priority was to maintain this trend. He particularly welcomed the fact that the Chancellor had "set out his stall" for the next four or five years; this gave industry the confidence to plan ahead.

Commenting on individual elements in the Budget, Sir Terence said that
- the derating of empty industrial premises was very useful
- those affected by the alteration to stock options were small but important for the whole economy.
- action on Stamp Duty went only half-way to meeting what the CBI were looking for
- the abolition of investment income surcharge would help small firms
- the changes in corporation tax/capital allowance would as a whole adversely affect the small, faster growing companies who were investing heavily.

But Sir Terence made it clear that these changes were beneficial to industry as a whole as they offered a challenge to achieve greater profitability.
- the CBI had suggested to the Chancellor that raw materials should be exempted from the accelerated VAT payments on imports. The Government had thought this to be contrary to commission rules even though Ireland engaged in this practise.
- the CBI were sympathetic to the extension of the VAT base rather than raising the rate.

Answering Members questions

- He said while he thought there were specifics on which the Budget might be improved, he was not going to indulge in special pleading that undermined the base on which the Budget was built; the VAT change had provided the key to many of the other changes which industry had welcomed.

He did not think that the abolition of the NIS would be reflected in higher wages; wages were falling at the time that NIS was being gradually cut. He warned that wage rates were rising again with earnings in manufacturing rising even more. He pointed out that in the last year threehad been a 3 per cent rise in manufacturing costs in the UK at the time when costs in Japan and the USA had been falling by up to 3 per cent. He did not have the solution to this worsening in our relative position, although the increase in overtime was a contributory factor.

He said representations regarding the phased reductions in capital allowances had come mainly from fast growing high technology companies and engineering firms who were regretting that they would not be receiving what they had had in the past. Sir Terence said that it was important to point out that investment was only a means to an end; better returns on capital are what is important and the new regime will assist that objective.

He said that zero inflation was not a priority for the CBI as he felt the restraint required to achieve it would not be socially acceptable. He did feel however that inflation could be brought down further from its present level and must certainly not be allowed to rise again.

He did not think the Budget would have much impact on unemployment; that would depend on the level of growth. , but he felt industry itself and world conditions would have a greater effect.

He acknowledged that the technology gap between Europe and Japan and the USA was large and widening; there was a need to encourage a new spirit of enterprise in this area.

Sir Terence said that he thought industry displayed certain signs of "sloppiness".

- The assumption that pay awards should always equal the cost of living was wrong. The definition of what contributed a realistic pay settlement was not as stringent in the UK as that understood by our main competitors.

- Greatereffortscould be made by companies in reducing their overheads; a better structuring of companies was required as too many were top heavy. He noted that although many new jobs were being created, these would offset by the need to make economies in other areas.

He agreed that the Employment Protection Act did make employers cautious about taking new people on.

In conclusion Sir Terence said that he did not believe that it was possible to take any single action against restrictive international trade practises; it was a case of being vigilant and urging the Commission to move quicker. He said that retaliation would only foster greater protectionism in trade which would not help the UK.

ANDREW DUNLOP

AD/CE
28.3.84

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