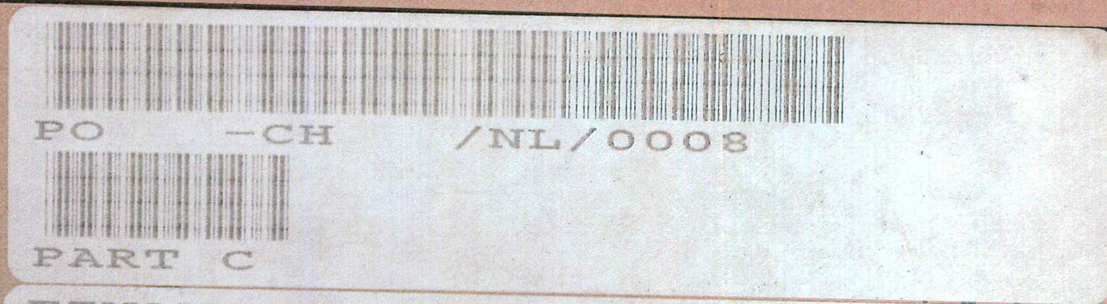
TREASURY

FILE BEGINS 21/4/87 ENDS 22/4/87


PO -CH /NL/0008

PART C

FINANCE BILL 1987

FOR DISPOSAL ADVICE SEE INSIDE COVER

DISPOSAL DIRECTIONS	SIGNATURE	DATE
DESTROY AFTER 25 YEARS	[signature]	8/11/93
PRESERVE		

PO -CH /NL/0008 PART C

...ATION USE ONLY	REFER TO	DATE	REFER TO	DATE
	PA(22/4/87) PAR	8/11/93		

001/2767

FROM: JILL RUTTER

DATE: 21 April 1987

PRINCIPAL PRIVATE SECRETARY

cc:
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Miss C Evans
Mr Walters
Mr Haigh
Ms Goodman
Mr Romanski
Mr Cropper
Mr Tyrie
Mr Ross Goobey

PS/IR
PS/C & E

Mr Graham - Parliamentary Counsel
Mr Neubert MP
Mr MacLean - Chief Whip's Office

Ch
Other papers on Prayer's folder, (but may not now need to discuss these?)
AA

FINANCE BILL: COMMITTEE OF THE WHOLE HOUSE: ALLOCATION OF CLAUSES

The Chief Secretary has discussed with the Chancellor the allocation of clauses between Ministers for the two days of Committee of the Whole House. He proposes the following allocation:

29 April

Clauses 20 and 23 - Chancellor to open; CST to wind.

Clauses - 21 and 22 - Financial Secretary

30 April

Clause 11 - Minister of State

Clause - 147 - Chief Secretary

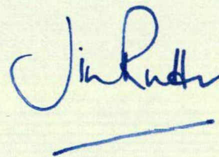
Clause 160 - Chancellor

Clause 18 - Economic Secretary

Clause 33 - and Schedule 4 - Economic Secretary

Clause 45 - Economic Secretary.

2 The Chief Secretary proposes to discuss with Mr Gould tomorrow whether he thinks there is sufficient business for the 29 April, or whether he thinks that the order should be amended.



JILL RUTTER
Private Secretary

Inland Revenue

Policy Division
Somerset House

Andrew

PWP

FROM: P A MICHAEL
21 APRIL 1987

1. MR HOUGHTON

2. FINANCIAL SECRETARY

FINANCE BILL SECOND READING DEBATE: LIFE ASSURANCE COMPANIES

1. You asked us to provide some defensive material in summary form dealing with

   a. the impact of the capital gains changes generally; and

   b. the impact on endowment mortgages.

This is at Section I of the attached note.

2. You also asked for secondary material which you could use if pressed on

   i. the comparison with unit trusts, and

---

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Miss Sinclair
Miss C Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Isaac
Mr Painter
Mr Houghton
Mr McGivern
Mr Spence
Mr Cayley
Mr Michael
PS/IR
(Mr Beighton)

ii. general assertions that the industry is heavily taxed already.

This is at Section II of the note. We have also as requested put in a short background piece on historical comparisons, making the point that the industry's current overall tax bill seems low by comparison with the tax it paid in the early 1970s. However, it was agreed at our meeting that this sort of comparison would strike the industry as provocative and that it would probably be desirable not to use it in the debate.

PAM
P A MICHAEL

LIFE ASSURANCE COMPANIES

SECTION I

Impact of the change on capital gains

Had the change been operative in 1985, the extra tax on policyholders' gains might well have been under £m20 for the whole sector. Later data is not available, but the ABI allege the figure would have been higher in 1986. They may well be right, because of the buoyancy of the stock market, and because from July 1986 life companies can no longer set short-term losses on gilts against gains. (The rules on gilts losses were changed in the 1985 Finance Act). But it would still have been very small in relation to the assets and profits reserved for policyholders. (Assets in policyholders' funds stood at around £bn70 in 1985 and could now well be approaching £bn90.) The impact will vary from company to company depending on

- the pattern of investments and gains and
- how far gains are sheltered from tax (management expenses - around £bn4 in 1985 - and captive unit trusts etc).

But even for the companies most affected it should not be substantial compared with their financial capacity.

Changes will hit low-cost endowment mortgages?

No, the effect on endowment mortgages - like other policies - should be marginal. In recent years, as a result of the buoyancy of market activity and the high level of reversionary and terminal bonuses, anticipated returns may have been running well ahead of original expectations.

(NOTE. An endowment mortgage usually consists of an endowment policy coupled with decreasing term assurance. The with profits endowment policy is designed to pay off the mortgage at the expiration of the fixed period (usually 25 years in the case of a

first-time buyer) and the decreasing term assurance provides cover in the event of the mortgagor's prior death).

SECTION II

Comparison with unit trusts

It is true that the capital gains of life companies are taxed whereas those of unit trusts are not. But there are advantages the other way. For example, income reserved for policyholders on qualifying policies is taxed at the 35% corporation tax rate, whereas investors in unit trusts pay tax on their income year by year at income tax marginal rates up to 60%: even for non-qualifying life policies (eg single premium bonds) any higher rate liability is deferred until redemption (with top-slicing relief) - a major advantage. There are other advantages as well: holders of unit-linked bonds have the option of switching between different funds free of capital gains liability: equivalent switches in unit trusts are taxable disposals for CGT purposes. And the important issue is how much tax is actually paid on the life companies' capital gains.

Life companies are overtaxed already (35% CT on income and now 35% on gains)

The availability of management expenses, and a number of other facilities, mean that the tax actually paid by life companies is considerably lower than it would be if all their income and gains were taxed at 35%. On the industry's own figures for tax provisions, the effective rate of tax on the gross income and gains attributable to non-pension ordinary life business was in the order of 5.5% for 1984 and 7.5% for 1985.

Historical comparisons

Whilst incomings of all sorts increased by factors of 11 to 12 over the period 1968-1985 and dividends to shareholders increased by a factor of 12, tax provisions increased by a factor of less than 6. Put another way the value of tax provisions as a proportion of investment income plus gains fell from 19% in 1968 to 7.5% in 1985. None of this would suggest that the life assurance sector as a whole is over-taxed or that the effect of the present changes is likely to be substantial.

CE45

Passed on comments marked to C. Evans. Being revised. AHH

P recd 10AM 22/4 PW4 Andrew

FROM: MISS C EVANS
DATE: 21 APRIL 1987

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Scholar
Mr Odling-Smee
Mr Sedgwick
Mr Riley
Mr Mowl
Miss Sinclair
Mr G P Smith
Mr Culpin
Miss O'Mara
Mr Scotter
Mr Cropper
Mr Ross Goobey
Mr Tyrie
FAX { PS/IR
Mr Mace
Mr Eason
Mr Walker
Mr Hudson
Mr Gibson
FAX { PS/C&E
Miss French

SECOND READING DEBATE 22 APRIL: WIND-UP: BURDEN OF TAX

... I attach a revised version of the speaking note on the burden of tax as discussed at your meeting today. Could comments reach me by 12 tomorrow ps.

I have just seen Mr Hudson's minute of today recording the Chancellor's comments on the draft. I will submit a further revise taking account of these as soon as possible tomorrow morning.

CE

MISS C EVANS

21 April revise

SECOND READING DEBATE - WIND-UP SPEECH

BURDEN OF TAX

Mr Speaker many hon Members will be as surprised as I was by the Labour Party's decision to choose the burden of tax as a theme to attack the Government in this debate. Bereft of all other arguments they cling to this although a dispassionate observer might think this approach was something of an own goal for a party committed to creating a high spending, high borrowing, high tax economy. Their position is riddled with contradictions. On the one hand they intend to vote against the income tax reductions contained in the Finance Bill and they are committed to reversing them if they came to power. They accuse us of seeking to bribe people by cutting taxes. Then in the same breath they argue that taxes are too high and they revert to their latest favourite theme - the burden of tax. They really must be desperate.

2. We have cut the basic rate from 33p to 27p. We have increased personal allowances by 22 per cent in real terms, bringing the married man's allowance to its highest real level since the war and taking 1.4 million people out of tax compared with simply indexing the regime we inherited from Labour. During the last Labour Government the basic rate went up as high as 35p and personal allowances actually fell in real terms.

3. The tax burden concept can be measured in various different ways. But what really matters to ordinary people is whether or not they are better off ie what happens to their real take home pay after taking account of inflation. The record is absolutely clear and it demolishes the opposition's case. At all levels of earnings real take home pay has increased substantially under this Government. Under the last Labour Government living standards hardly rose at all for many people and actually fell for single people at all multiples of average earnings. For a man on average earnings with 2 children real take home pay has gone up by over 21 per cent since 1978-79. For the same man real take home pay went up by less than 1 per cent between 1973-74 and 1978-79 -hardly any increase at all. And the comparison holds for lower earners as well. For the man with

2 children on half average earnings between 1978-79 and 1987-88 real take home pay went up by 17.5 per cent. This compares with only 4 per cent under Labour. But what about the people at the bottom - those whom Labour claim to defend? For this group too, the bottom decile of the earnings distribution, real take home pay has increased by more under this Government than under Labour.

(if challenged on the bottom decile)

4. [We obviously do not yet have [estimates the figures] for the growth of carnings of people at the bottom decile to 1987-88. On cautious assumptions we estimate that the increase will be 6.5 per cent between 1978-79 and 1987-88 which compares with 4.1 per cent between 1973-74 and 1978-79. This is an annual rate of increase of 0.8 per cent under Labour and 0.7 per cent under this Government. Thus, taking the annual rate of increase, our record for the people at the bottom bears comparison with the last Labour government, notwithstanding the fact that their policies were deliberately skewed towards the lower paid which had the effect of distorting the labour market, compressing differentials [and increasing unemployment]. While it is undoubtedly true that the ending of incomes policy has meant that the increase in incomes for people at the bottom has been less than the average, the Government has recognised this [by raising income related benefits by [ ]* per cent in real terms]. [The figure of 2 per cent for the increase in [real take home pay earnings] at the bottom decile since 1978-79 quoted by the hon Gentleman/Lady opposite is out of date, it relates only to the period to April 1986, and thus leaves out the effects of 1986 and 1987 Budgets. As I have said, on cautious assumptions, we estimate the increase in real take home pay for married man with two children at the bottom decile between 1978-79 and 1987-88 at 6.5 per cent.] Whatever comparisons the Opposition may draw about the rates of increase in real earnings at the bottom decile under this Government and under Labour one fact is inescapable. Under this Government real take home pay has increased for everyone, at all levels of income. This was not the case under Labour, when real incomes actually fell for many people.]

× Bit provocative.

True of FIS, but HB?

5. Ordinary people understand that they are better off under this Government. Let me take just one example, the nurse. [The Hon Member opposite points out that] the nurse is now paying a higher proportion of her income in tax than she was in 1978-79. This is not surprising

* & ST to supply

given that the nurse will have seen her real take home pay go up by over [33] per cent between 1978-79 and 1986-87 [1987-88] (forecast based on earnings 1986-87 - no assumption made about review body award), compared with only 14 per cent between 1973-74 and 1978-79.

I think that's dangerous.

6. Faced with the facts on real take home pay Labour seek to divert attention to the burden of tax. This Government has reduced taxes in every Budget since 1981. We are committed to continuing to reduce taxes. I ask the House to consider what the position would be without the reductions we have made. The burden of income tax and national insurance contributions today is lower for all family types, at all levels of income, than it would be if we had simply indexed Labour's regime. For a married man on average earnings with 2 children an indexed Labour regime would mean paying £4.85 a week more in income tax and national insurance contributions.

7. One thing is absolutely clear. Whatever Labour may say about the burden of tax under this Government - it would be much, much higher if they were in office. Their spending commitments amount to £34 billion - to raise this from income tax would mean at least doubling the basic rate.

8. I could go on at length about the contradictions in Labour's position. But I turn now to the impact of this year's Finance Bill, which is the subject of this debate. The overall impact of the Bill is to reduce taxes in 1987-88 by £2.6 billion. As a result of the implementation of the Bill we estimate that the percentage of earnings taken in income tax, NICs and indirect taxes will fall for virtually everyone, except the very highest paid. This is a Budget designed to reduce the burden of tax. As a result of the income tax changes alone a married man on average earnings will be £3.87 a week better off. A primary school teacher married to a nurse will be better off as a couple by £7.59 a week. People whose mortgage rates come down next month will gain a further benefit. A married man with no children on average earnings with an average mortgage will be £5.37 a week better off as a result of the Budget changes and the fall in mortgage interest rates. The cut in the basic rate to be effected by Clause 20 will benefit all taxpayers.

9. [Members opposite have seen cause for criticism in the fact that the lowest 34 per cent of taxpayers received only 12 per cent of the total reduction in income tax. The explanation for this is simple. The bottom 34 per cent contributed only 9 per cent of the total income tax take in 1986-87 - in other words they have received a share of the reduction which is greater than their contribution to the total.]

10. Mr Speaker, the Government welcomes the Labour Party's conversion to the cause of those who seek to reduce the burden of tax. We agree that the tax burden is still too high and we intend to continue to reduce it when prudent to do so. Tax reduction is a cardinal element of the Government's policy. We believe that cutting taxes is the single most effective measure available to us to encourage enterprise and improve the prospect for output and jobs. As my rt hon Friend the Chancellor said in his Budget speech there is now a worldwide consensus on the economic desirability of tax reform and tax reduction, and in particular, the reduction of income tax. We are reducing income tax without any increases in indirect tax rates and the Red Book indicates scope for further reductions in taxation in each of the next three years. The Government remains committed to the prudent reduction of the overall burden of taxation. We are the only party with such a commitment; and we are the only party with a track record of tax reductions.

006/2767

Pu

FROM: **ANTHONY DIGHT**
DATE: **21 April 1987**

MR HUTSON

cc:
PS/Chancellor 2nd
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Mr Scholar
Miss O'Mara
Mr C W Kelly
Mr Pickering
Miss Sinclair
Miss C Evans
Mr Haigh
Mr Romanski
Miss Goodman
Mr Dyer
Mr Walters

Mr Eason - IR
Dr G Keenay - IR
Mr Walker - IR
Ms French - C & E
Mr Bone - C & E
PS/IR
PS/ C & E

2ND READING FINANCE BILL: OFFICIAL BOX

Could you please let the House authorities know that the following people will be occupying the Official Box at various times during the 2nd Reading of the Finance Bill Debate on Wednesday, 22 April.

2 I should be grateful if officials could ensure that the Box is covered at all times.

Anthony Dight

ANTHONY DIGHT
Diary Secretary

INDLAND REVENUE

Mr Eason

Dr G Keenay

Mr Walker

CUSTOMS & EXCISE

Ms French

Mr Bone

FP

Mr Scholar

Miss Sinclair

Miss Evans

Mr Haigh

Mr Romanski

EB

Miss O'Mara

Mr Pickering

MG 1

Mr C W Kelly

Miss Goodman

ps4/12H

UNCLASSIFIED

PWP

FROM: A P HUDSON
DATE: 21 April 1987

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Scholar
Mr Odling-Smee
Mr Sedgwick
Mr Riley
Mr Mowl
Miss Sinclair
Mr G P Smith
Mr M Williams
Mr Culpin
Miss O'Mara
Mr Scotter
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Miss C. Evans
PS/IR
Mr Mace - IR
Mr Eason - IR
Mr Walker - IR
PS/C&E
Miss French - C&E

SECOND READING DEBATE, 22 APRIL: WIND-UP

The Chancellor has seen the material attached to Miss Evans' 16 April minute.

2. On the speaking note on the burden of tax, he would delete the first sentence of paragraph 5. It is dangerous, given that the overall tax burden, as a percentage of GDP, has gone up.

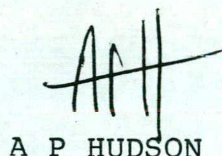
3. In the briefing on burden of tax as percent of GDP, he would replace "more or less stabilised" in lines 6-7 with "been reduced". The original formulation sounds like a euphemism for "gone up more slowly" which is not the case.

4. He would redraft the second paragraph on Real Take Home Pay so as to say more about jobs and the advantages of performance-related pay, eg PRP.

5. More generally on the burden of tax, the Chancellor notes that we have always conceded that we were obliged to put taxes up initially, because Labour had left us a massive and unsustainable PSBR. There is no need to resile from this line. Also, we have frequently talked (see eg 1984 Green Paper on Long-Term Public Expenditure) about the burden of tax in terms of non-North Sea taxes. This may be a more helpful presentation.

6. The Chancellor thinks the section on VAT plans is inadequate. It should not go into the EC dimension, where each answer leads to a new question, but should simply add to the general brush-off: we will reduce taxes, they would put them up, and this is just a smokescreen. It should also remind the House that we heard all these "secret agenda" allegations in 1983, too, and there is nothing new in them.

7. The Chancellor is not happy with the third paragraph on the oil package. Not only is $18 the new OPEC price, and we would therefore look very foolish if we talked of it going higher, but there will be plenty of investment with a price of $18. The immediate problem is not a price of $18 but the sharp adjustment, and the uncertainty. Having seen it go to $9, people are not yet confident it will stay at $18.



A P HUDSON

40/2

pug

FROM: PETER PATTERSON
DATE: 21 April 1987

1. MISS O'MARA MOM 21/4
2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Miss Evans
File

SPEAKING NOTES FOR SECOND READING DEBATE

I attach the speaking notes you requested on unemployment and manufacturing, on which Mr Gould seems likely to focus tomorrow.

2. I also attach a note by Mr Gunton on jobs vacant advertising in Northern newspapers, mentioned at your meeting this afternoon, together with the use Mr Baldry made of similar material in the Budget debate on 19 March. (The Paymaster General drew on newspaper advertising in much the same way in pre-Budget debate.)

Peter Patterson
P L PATTERSON

SPEAKING NOTES FOR FST: SECOND READING DEBATE, 22 APRIL

UNEMPLOYMENT

I was not surprised the hg made such heavy weather of discussing the unemployment situation. For however much he tries to obscure the truth, nothing can disguise the fact that unemployment is now firmly established on a downward trend. The seasonally adjusted adult figure has fallen for eight successive months by 180,000 in total. The fall in the past six months, averaging 25,000 a month, is larger than over any similar period for fourteen years. This improvement covers all areas of the labour market - youth unemployment is already below the average for the EC, both youth and long-term unemployment are lower than a year ago and both are still falling. The picture is similar throughout Great Britain. Unemployment has fallen in every region over the last six months and over the last year has fallen fastest in Wales and the North, giving the lie to the Opposition's claims that a 'North/South' divide is splitting the country in two. And long-term unemployment is falling fastest in the same areas. Even in Scotland, faced with the consequences for the oil sector of last year's collapse in oil prices, unemployment has now started to fall. Vacancies have risen strongly in all regions over the past year.

The prospects are just as good for further cuts in the numbers of unemployed. The conditions that we have established during our period of government are now yielding the results that we promised - a lengthy period not only of continuous growth in output but also of employment, which has risen in fifteen successive quarters, the longest period of sustained employment growth for almost 30 years. The number of new jobs has increased by over one million since June 1983, and through 1986 we have seen renewed acceleration in employment growth.

We expect these employment gains to continue and, with the growth in the labour force projected to slow further, the downward trend in unemployment should be maintained.

EMPLOYMENT MEASURES

But despite the rapid fall in unemployment, we are far from complacement. We recognise that the jobless total is still too high and we are doing all we can to bring it down. Over the past year we have devoted substantial additional resources on employment and training measures. The continued expansion of these schemes has encouraged enterprise and helped the young and long-term unemployed to find real jobs through the aquisition of new skills. We are planning to spend over £3 billion on employment and training programmes in 1987-88 and nearly £3½ billion by 1989-90. In real terms this is more than double the level of expenditure in 1978-79. No other country can match this achievement. But there can be no substitute for flexibility in labour markets, for pay moderation, and for a spirit of vigour and enterprise in the economy. This is why my Rt. Hon. Friend, the Chancellor of the Exchequer, improved incentives still further by the tax measures he put forward in his March Budget.

FIDDLING THE FIGURES?

There are some, including hon members on the benches opposite, who only have the poverty of imagination to decry our achievements in reducing the number of unemployed people. They suggest that the only way we have been able to reduce the unemployment count is by fiddling the unemployment figures and pushing people off benefits. This is manifestly untrue. The latest Labour Force Survey, taken in Spring 1986, showed that the numbers of unemployed, defined as those without a job and seeking work, was (at 2.83 million) actually lower (by 340,000) than the claimant count at the same time. I would not deny that Restart and availability testing are having some effect in reducing the unemployment count. But 90 per cent of those interviewed get positive offers towards getting back into jobs and there

is widerspread satisfaction with the interviews. If some fraudulent claimants cease to claim benefits, then that can only be a beneficial side effect.

No, what the members opposite have to accept is that the reduction in unemployment reflects this Government's sound financial and economic policies.

MANUFACTURING INDUSTRY

Manufacturing industry has shared in the economic benefits from this Government's policies. I fail to see why members opposite should take on so at our our forecast, published in the Red Book last month, of an £8 billion deficit in manufacturing trade. The trade balance is only one indicator of many, and certainly not the best measure of our manufacturing performance. Look at the volume of our manufactured exports which have grown at least as fast as those of other developed countries since 1981, and that after decades of relative decline; or the 4 per cent rise in manufacturing output over the past year and the 4 per cent forecast for 1987; the significant and continuing improvement in manufacturing productivity, which has grown faster than in any other major country since 1980; and manufacturing profitability, at its highest level since 1973. These figures bear eloquent testimony to the strength of recovery of the manufacturing sector; and to its ability to compete more effectively after years of overmanning and inefficiency.

FROM: MICHAEL GUNTON

DATE: 23 MARCH 1987

ANDREW HUDSON

cc Mr Culpin

Mr Pickford

THE GOOD NEWS ON JOBS

Further to your request on the situations vacant situation in Northern newspapers.

The Birmingham Evening Mail which in January reported an increase of between 23 and 40 per cent over the previous Januarynow reports a maintained 22 - 27 pages a week - still up around 30 per cent.
Wolverhampton Express and Star maintains a steady 20-25 per cent increase over last year with an average 10 pages on situants vacant day.
Nottingham Evening Post with an average of 10 pages (750 jobs a week) also maintains its higher average. You will remember that in January it was boasting that it has 10 pages on Thursdays, the usual day for job ads.

THE NORTH WEST

Manchester Evening News says that in the first 10 weeks of 1986 they carried 17,298 sits vac ads. Inb the first 10 weeks mof this year the figure is 18,861 - up 9 per cent.
Liverpool Echo reports that in the first 10 weeks of 1986 they carried 5,037 sits vac adds. In thje first 10 weeks of this year the figure is 5,409 - up 7.3 per cent.

Both newspapers point out that a situations vacant ad need not necessarily be for one job. Some ads advertise as many as 20 vacancies.

THE NORTH EAST

Newcastle Evening Chronicle In January 1986 they carried 406 col ins of sits vac ads - in January this year it was 441 col inches.

In February 1986 they carried 401 col inches - in February this year there was a 12 per cent increase to 480 col inches.

YORKSHIRE

The Sheffield Star which reported a 50 per cent increase in January compared to the same month the previous year says that increase is certainly being maintained and is probably now larger. They used to carry one page a week - now they carry two pages on one day and ½ page every other day.

NOTE (Not really my business) The Opposition are making great play over opinion polls which say that people would rather the money spent on hospitals than on a tax cut. I have'nt heard a Government spokesman ask whether the same people would also forego a pay rise so that British goods were more competitive and inflation reduced even further so that more money could be spent on hospitals etec.

MICHAEL GUNTON

in September 1986 it was 638,000, a decrease of just over 34 per cent. What an appalling record that is. The Minister indicated that there were one or two qualifications on that and I have to say, in all fairness, that there will be some qualifications that he does not mention in the other direction; but time prevents me from going into the detail of them.

I accept that some of the changes have come about as a result of new technology. As a shop steward in industry before being elected to this House, I accepted that if we wanted to continue in business and to carry on employing people we would have to accept change. But we have to get our manufacturing industry into surplus, and the Government should be doing something about rectifying the appalling present situation.

The north-west spokesman for the Confederation of British Industry, the regional director, Mr. Andrew Toop, speaking at a meeting just before the Budget on interest rates, said that he welcomed the previous week's reduction of 0·5 per cent. which he said would save industry and commerce about £125 million a year. He went on to say:

"It is the level of interest rates against our competitors which is the biggest single factor that prevents our business climate improving more quickly and at the same time restrains investment and overseas sales."

He also said that in the previous year the United Kingdom's real interest rate was 7·2 per cent., compared with 4·9 per cent. in West Germany, 4·8 per cent. in the United States and 4 per cent. in Japan. He went on:

"In a medium-sized manufacturing firm employing 300 people this could mean an extra £150,000 on their costs every year, which could make all the difference when competing for contracts."

That is important. I recognise that there has been a further reduction following the Budget but we still have a long way to go.

We have to accept that manufacturing output is still lower than in 1979. I acknowledge that productivity is higher but output is still lower and investment in manufacturing is also still lower than in that year. Those figures must give concern to all hon. Members. I hope that hon. Members on the Government Benches will not dismiss this fact.

My final point is a plea for north-east Lancashire. We have been trying to persuade the Government to give us an extension to our enterprise zone. Enterprise zones have many faults but ours has been extremely successful. We have applied for an extension and have been told that the Government have put all these applications on ice. If they were to give us that, it would be one small move in the right direction. If they were also to connect us to the main motorway network it would, at least in one small part of the country, be a good move. But the Government have many lessons to learn, and I believe that the Paymaster General was completely wrong to describe this as a Budget for jobs.

7.45 pm

Mr. Tony Baldry (Banbury): This debate takes place against a further monthly fall in unemployment of some 71,000, the biggest monthly fall since records started in 1971. This is the seventh consecutive month of a consistent downward trend in unemployment which has fallen by 150,000 in the past seven months, an average fall of some 20,000 every month. This substantial fall has occurred without any change whatsoever in the methodology by which the unemployment statistics are compiled. This month's fall, in particular, is all the more noteworthy because the 71,000 do not involve any extra places on training schemes.

But this is not the only consistent fall in unemployment figures that demonstrates the real and steady improvement on the jobs front. Unfilled vacancies are standing at their highest level this decade. One does not have to look simply at the official statistics to see this. A glance at the jobs page of every major local and provincial newspaper tells the same story. In the west midlands, the *Birmingham Evening Mail* has seen recruitment advertising rise by 40 per cent. in a year. In the north-east, the Newcastle *Evening Chronicle* has seen a 30 per cent. increase in advertising revenue. In Wales, the Cardiff *Evening Echo* has seen a 16 per cent. increase and in the north-west, the *Manchester Evening News* has seen an annual increase in recruitment advertising of 11 per cent. No wonder the CBI suggests that there is three times more work available than official figures suggest. The CBI puts the figure of unfilled vacancies at well over 600,000, and probably nearer 750,000—three-quarters of a million jobs waiting to be filled.

That there has been this degree of recovery should not be a matter for surprise. In the past three years our growth has averaged around 3 per cent. We have had high growth combined with low inflation, a combination that has not been achieved for a generation and a combination certainly never achieved under a Labour Government. Investment is at record levels; company profitability is at its highest for over 20 years; productivity is up by more than 30 per cent. since the end of 1980; and manufacturing output is at its highest since 1980. Throughout the 1980s Britain has had the highest growth rate in the European Community. Manufacturing and productivity during this period have been growing at the highest rate of any leading industrial nation. Britain is the only major country whose export volume is rising, the only economy in the European Community for which forecasters are now more optimistic than they were this time last year.

This is the background for this year's Budget. There seems to be some confusion in the minds of some of the media and the Opposition parties as to what the Budget is all about. It is not about how much the Chancellor should give away in public spending. That is determined in the autumn statement. Let us not forget that last autumn the Chancellor gave away £4·75 billion in public spending, including £1·25 billion for local government spending, much of it for extra pay for teachers and extra resources in our schools, £600 million more on health and personal social services, £450 million more on housing investment and £65 million more for new roads. So massive amounts of money are being spent on the infrastructure, on new roads, new schools, new hospitals and new housing. In my area alone we see work starting this year on the M4 motorway extension from Oxford to Birmingham and £12 million being spent on new buildings at Horton hospital.

Nor is the Budget about how much personal benefits such as pensions should be increased. That will come at the next benefit uprating. But let us not forget that pensions have gone ahead faster than price increases. Between 1979 and 1985, the average weekly net income of pensioners has risen by 18 per cent. in real terms, more than twice the increase for the population as a whole. Under Labour the

RA3.22 UNCLASSIFIED pup

FROM: A C S ALLAN
DATE: 21 April 1987

MISS C EVANS

cc Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Miss O'Mara

TCSC REPORT ON THE 1987 BUDGET

As you may have noticed, the TCSC report does <u>not</u> take on board all the amendments to the quotations from the Chancellor's evidence which Mr Scholar attached to his letter of 6 April to the Clerk. But they have been taken on board in the transcript of the evidence itself: so the cross references do not match. The most obvious example is the quote from Q184 in paragraph 16 of the report. (The TCSC also managed to introduce a new mistake: "ration" for "ratio" in the quotation in paragraph 24.)

2. I complained about these to the Clerk, who apologised profusely and accepted that the fault lay at their end. They would draw it to Mr Higgins' attention, but there was no scope at this stage for doing any more.

ACSA

A C ~~S~~ ALLAN

ps4/14H

UNCLASSIFIED

APH TO RGoobey 21/4

FROM: A P HUDSON
DATE: 21 April 1987

MR ROSS GOOBEY

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Cropper
Mr Tyrie

Mr Neubert MP H/C
Mr Lilley MP H/C

Mr Cayley - IR
Mr Shepherd - IR
Mr McGivern - IR
Mr Munro - IR

POST-BUDGET LOBBYING - COUNTER BRIEFS

The Chancellor was very grateful for your 7 April minute.

2. We shall be fixing a meeting prior to Committee stage to review the state of play on these points.

APH

A P HUDSON

GOODMAN → PS/CH 22/4
FB: CLAUSE 160

3885/019

FROM: H C GOODMAN

DATE: 22 April 1987

1. MR KELLY

2. PS/CHANCELLOR

These notes still need some work done on them. But we thought it would be helpful to get them to you in their present form before your meeting tomorrow.

CWK 22.4

C.

I think these are basically fine, with the important rider that we will need a bit more on the positive benefits of abolishing exchange controls but if the debate is on Cl. stand part & not on a Labour amendment.

AHH

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr G Littler
Mr Cassell
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr S Matthews
Mr A Bottrill
Ms M O'Mara
Miss Sinclair
Mr Tyrie
Mr Ross Goobey
Mr Dyer
Mr Norman
Mr Hyett - T/Sol
Mr Michael - IR
PS/C&E
PS/IR
Mr K P Sedgwick
Mr P Graham
Miss Hughes
Mr Kowalski
Mr Flitton

Mr Hudson

FINANCE BILL: CLAUSE 160 - PART 2 NOTES ON CLAUSES

The Chancellor will, on present plans, himself be taking Clause 160 in Committee of the Whole House on 30 April. Mr Hattersley has said he wants it to be a mini-debate on the Labour Party's proposals.

in his lengthy speech in the Bgt debate.

2. We have already circulated the factual Part I of Notes on Clauses for Clause 160 and Clause 161. Attached are draft speaking notes (Part II of Notes on Clauses) on the various aspects of Clause 160. These cover:-

(i) Speaking Note A: A general speaking note on the repeal of the Exchange Control Act and Labour's scheme, prepared by Mr Peretz, on the assumption that the Chancellor will be speaking after Mr Hattersley.

(ii) Speaking Note B: on retention of power to validate, retrospectively, pre-1979 transactions carried out without permission.

(iii) Speaking Note C: on the CGT aspects.

(iv) Speaking Note D: on the Isle of Man and Channel Islands.

3. I also attach:-

ANNEX I: Some defensive notes on repeal, on the CGT aspect and on Labour's scheme.

ANNEX II: Background notes on the tax aspects.

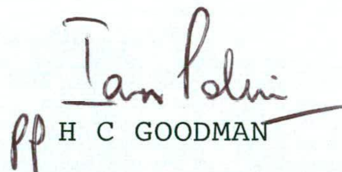
ANNEX III: Background note on the Labour Party proposal (prepared by Howard Davies in October 1985, but still broadly up-to-date except for the renaming of the British Investment Bank).

ANNEX IV: A note on the IFS study of Labour's proposals.

ANNEX V: An extract from Mr Hattersley's September 1986 New York speech.

4. Part II speaking notes on Clause 161, which will not be taken until later in Committe, will be circulated in due course.

5. I am grateful to Mr Michael for his help on the CGT sections.



pp H C GOODMAN

Distribution:
(i) Speaking Note A - to all copy recipients.
(ii) All speaking notes, Annexes I and II to Messrs Dyer, Norman, Hyett, Michael, PS/C&E, PS/IR, Miss Wallis, Mr Graham, Miss Hughes.
(iii) Whole set - Top copy + MG only.

3885/020[15/3070D]

SPEAKING NOTE A

Exchange Controls and Labour's Policy

The decision taken in 1979 to abolish exchange controls has proved wholly beneficial to the British economy. The controls which the government inherited in 1979 were inappropriate to our circumstances, inefficient, and increasingly ineffective. Throughout Europe, from Denmark to Spain, other countries are following our lead in lifting controls and moving towards full liberalisation of capital movements. I am glad that the party opposite has now come to accept that the Exchange Control Act is archaic and should be repealed.

2. But it is clear from what the RHG has said [today] that he still does not understand the economic arguments.

3. The first point to recognise is that our net investment abroad in recent years represents an important part of the way in which, as a nation, we have been investing the return from North Sea oil.

4. Abolition of exchange controls allowed this overseas investment to take place without restraints, in a way that will produce the best return for the future. At the same time it helped smooth the economy's adjustment to the fact of North Sea oil.

5. We have now built up a valuable nest egg of net overseas assets - amounting at the end of 1986 to £110 billion, a level second only to Japan. These assets will continue to produce a flow of overseas earnings for the future, as North Sea production declines. In 1986 they generated a net income of more than £4 billion.

6. The Labour Party's proposals are aimed at destroying that national asset, by seeking to persuade institutions to repatriate overseas investments. The RHG also seems to think that the

result would be to prop the £ up - an attempt to stave off the sterling crisis that he, quite rightly, recognises would come if he were ever given a chance to hold office. But here too he is mistaken in his analysis. Introducing a scheme of this kind would not help the £; it would be far more likely to frighten off foreign investors. The way to maintain confidence in the currency, as every Government discovers sooner or later, is to follow sensible and prudent policies, not to dream up [ramshackle] schemes of this kind.

7. Next, he suggests that his proposals would increase funds available for UK investment. There are two fallacies here. The first is the idea that there is a shortage of funds for investment. Official enquiry after official enquiry has shown this not to be the case [possible Wilson Committee reference?]. The way to encourage investment is to create an environment of steady and sustained growth in which businesses can invest profitably, and with confidence. That is what we have achieved. That is why business investment is now at a record level.

8. The second fallacy is the idea that if less is invested abroad more will be invested at home. I will spare the House a lecture on balance of payments arithmetic. But let me refer to the analysis of the Labour Party proposals carried out by the Institute of Fiscal Studies - a body not always sympathetic to the Government. In their analysis they say, and I quote, that they "reject the view that each £ invested abroad means a £ less invested in job creating enterprises in Britain".

9. The real losers from the scheme would be pensioners and savers. The Opposition likes to pretend that the British Investment Bank is a new idea, but of course it is not. [Possible joke. The initials BIB suggest that somewhere deep in his subconscious the RHG accepts that it is an infantile idea.] The history of the 1960s and 70s shows time and again that Governments are not successful at picking winners. [Even the RHG has recognised this in the past. In an interview in Marxism Today in October 1985 he said "I think its almost impossible for government to pick winners". But the BIB is designed to do just that]. Whatever fine motives it might start out with,

the BIB would invest in loss making projects chosen for political reasons - ending up with a portfolio of lame ducks and half-baked experiments. The returns earned by pension funds forced to invest in the BIB would no doubt be correspondingly low, and pensioners and savers would lose.

10. On top of this the scheme would impose other important costs on the economy. More tax inspectors would be needed to run it; and the more accountants would be employed to run round it.

11. The scheme is a nonsensical compromise designed to paper over conflicts within the Labour Party, and prevent a sterling crisis. The RHG knows there would be a run on the £ if he were ever allowed near the Treasury and he hopes that a scheme of this kind would bail him out. Fortunately it will never be necessary to put this to the test.

SPEAKING NOTE B

Certificates of Validation

The power is being retained to validate retrospectively certain transactions made without permission before 1979. If permission was not given or if there is no proof that the transfer was valid, the holder of an asset may be unable to realise its value if he wishes to do so. In some cases, of course, transfers will have been illegal. Where serious misdemeanours are discovered people will continue to be prosecuted. But equally it is right to retain the power to issue certificates of validation in other cases, where for example there is some doubt about whether or not Exchange Control permission should have been sought; or where a genuine mistake was made.

SPEAKING NOTE C

Capital gains tax

Under the Exchange Control Act 1947, the sale of some assets was subject to restrictions which prevented the seller from keeping all of the proceeds of sale. For example, there was a compulsory requirement that 25 per cent of any non-sterling currency obtained on the disposal of foreign securities had to be encashed at the official rate of exchange. In these cases, section 150(5) of the Capital Gains Tax Act 1979 makes an appropriate adjustment to the valuation of such assets for capital gains tax purposes. This provision will continue to be required to the extent that valuations prior to the abolition of exchange controls are still needed. Now that the 1947 Act is to be repealed it is therefore necessary, as a technical matter, to ensure that section 150(5) remains operative for such valuations. This is achieved by subsection (3) of the clause.

3885/020

SPEAKING NOTE D

Isle of Man and Channel Islands

Under section 43(2), as modified by an Order in Council the Exchange Control Act applied to the Isle of Man. By powers conferred by Section 43(3) the Act was also extended, in a modified form, by Orders in Council to cover the Channel Islands. It is necessary now to extend the repeal to both.

ANNEX I

DEFENSIVE NOTES. A EXCHANGE CONTROL

(i) **Why not repeal the Act before?** Because not appropriate to do so. Since then circumstances have moved on. Acting now to remove uncertainty.

(ii) **Isn't this simply a pre-election gimmick?** It is a sensible piece of housekeeping, which removes an uncertainty which could be damaging. Mr Hattersley has said Labour Party has no use for the Act either.

(iii) **Don't most other industries countries have similar powers available for use in emegencies? Why is the UK different?** Experience shows that exchange controls do not work, except in very extreme circumstances such as war. But in extreme circumstances it is usually possible to introduce legislation very quickly. Predecessor to the Exchange Control Act went through Parliament in 1939 in a single day. If necessary, new legislation can be tailored to the precise circumstances at the time, not those of the 1940s.

For use only if asked

(iv) **Isn't there a Community obligation?** This is a complicated and technical area of Community law. But the move is fully in line with the spirit of moves under way within the Community for further dismantling of exchange controls.

For use only if pressed further

(v) **What about the 1972 directive/1980 written answer?** Circumstances have changed a lot since 1972. In particular, dismantling of exchange controls is now an agreed priority within the Community programme for completing the internal market by 1992. Directive is currently under review in that context. We will look again at the best way of meeting any Community obligation when precise nature of future requirement becomes clear. Exchange Control Act is designed for the circumstances of the Second World War, not the 1980s.

(vi) **Why not keep the Act until future of the directive is clear? Aren't you jumping the gun?** Have concluded that continued existence of Act in the Statute Book creates undesirable uncertainties that could be damaging. No point in keeping redundant legislation any longer than necessary.

(vii) **If you felt this way, why take steps as recently as 1981 to strengthen the contingent powers available to you?** Because we felt that if we were going to keep these powers on the Statute Book we ought to ensure that they were technically as sound as we could make them, and to make it clear that there should be no presumption that if the powers ever were used they were any more likely to be used to counter outflows than inflows.

(viii) **Have you consulted the Commission?** Informed President Delors of his intentions.

(ix) **Effect of repeal on implementation of sanctions against other countries?** International measures could, if necessary, be enforced by other means. [Action against Argentina, Libya, Syria and South Africa has not relied on this Act].

B CGT

Why not simply repeal the CGT provision?

(x) The effect of section 150(5) for valuations before 1979 needs to be preserved for three reasons. First, to deal with old cases which may come to light where the normal time limit for the making of an assessment does not apply (for example, where there is fraud or wilful default on the part of the taxpayer). Secondly, for existing cases which are open and working as at the date on which the 1947 Act ceases to have effect. Thirdly, for future disposals where it is necessary to establish the market value on acquisition of the asset disposed of and there is an exchange control aspect in that context.

If CGT provision still required for valuations before 1979 why tinker with it?

(xi) Our legal advice is that section 150(5) cannot remain on the statute book after repeal of the 1947 Act. So we are doing this to cover valuations on transactions made before controls were lifted.

C LABOUR'S PROPOSALS

(xii) **Hasn't NEDC come out in favour of a new, state-funded credit institution?** The Committee for Finance in Industry, which reported to the NEDC, did some work on what such a body would look like, but the Council did not accept that there is a need for it. The Government regarded this as a misconceived enterprise and have made it clear that they see no need for a financial intermediary. The Committee's work was in any case on quite different lines from the BIB. There is no question of forced repatriation of funds. [NB The Committee for Finance in Industry (now replaced by the Committee on Industry and Finance) also produced a paper on "Financial Aspects of Industrial Restructuring, published in June 1986. Government members saw no case, on the basis of evidence available, for setting up a new publicly funded body, to deal with financial restructuring].

HANSARD WRITTEN ANSWERS 16/5/80

vol: 984 col: 672

Exchange Control Act 1947

Mr. Cockeram asked the Chancellor of the Exchequer if he has completed his review of the future of the Exchange Control Act 1947; and whether he will make a statement.

Sir Geoffrey Howe: Yes. The House was told on 6 November last that, following my decision, announced in October, to abolish exchange controls, I would be reviewing the future of the Exchange Control Act 1947. I have now decided that, at least for the time being, the present Act should be retained.

I regard the 1947 Act as unsatisfactory in a number of ways, notably in the wide extent of its powers and in its bias, natural enough when it was introduced, towards the control of outflows. I see no prospect of time being made available in the legislative programme for the early replacement or substantive amendment of the Act; and simple repeal would not be compatible with our Treaty obligations.

I do however envisage that ultimately, and probably most conveniently in several stages, changes in the law will be sought with the objectives of making the powers available in this area less draconian and more symmetrical as between control of outflows and of inflows.

In the meantime, the Act needs to be kept in being because the United Kingdom Government are required, under the European Community Council Directive 72/156 of 21 March 1972, to have available certain instruments for effective regulation of international capital flows and for neutralising those effects of such flows on domestic liquidity which are considered undesirable. The directive also requires that these instruments may be able, where necessary, to be put into operation without further enabling measures. The Exchange Control Act 1947 is the only current legislative authority in the United Kingdom under which the Government could take such action.

ANNEX II

BACKGROUND NOTE ON THE TAX ASPECTS

1. The Repeals Schedule 22 contains a part (XII) covering the repeals consequential on the repeal of the Exchange Control Act as well as the Act itself. Apart from the Capitals Gains Tax points which are dealt with separately below these are are technical changes.

2. Clause 141 of the Finance Bill redefines foreign currency for the purpose of Section 30 of the Finance Act 1967 which exempts some instruments from stamp duty. It has the effect of broadening the exemption from duty in respect of issues/transfers of bearer stock; stock expressed in Irish Punts would be exempt. For further details see the Note on Clause 141.

3. The current definition of securities in the VAT exemption of securities (Item 6 of G5 of Schedule 6 for 1983 VAT Act) depends on the definition in Section 42 of the Exchange Control Act. Customs and Excise are in any case reviewing this taking into account more recent developments in the financial markets. They will issue a suitable order before Royal Assent, when the Exchange Control Act repeal comes into effect. For further details see the background note to clause 18.

Capital gains tax and exchange control

4. The Exchange Control Act 1947 effectively divided the world into two separate groups of countries. One group, listed in the First Schedule to the Act, comprised the UK, the Channel Islands, the Isle of Man, the Republic of Ireland and Gibraltar - the "Scheduled Territories". The second group comprised the rest of the world. The splitting of the world into these two groups was fundamental to the application of UK exchange control as, save in a few instances, the provisions of the Act did not apply to transactions between residents of the Scheduled Territories.

5. Before the abolition of exchange control on 24 October 1979, except for the restrictions on transactions in Rhodesia, the general rule - to which there were some exceptions - was that investment

currency was required by UK residents for the purchase of either foreign currency securities for portfolio purposes or private property abroad. The need for investment currency arose because the Treasury was not prepared to release foreign currency from the official reserves for such purposes. Invariably, the demand for investment currency exceeded supply with the result that it traded at a premium (the so called "Dollar premium" since it was expressed by reference to the sterling/US dollar exchange rate) and the amount of the premium fluctuated considerably over the years reaching a peak of 92% in April 1975.

6. The corollary of this was that the premium could be recovered, at the prevailing rate, if the proceeds of premium worthy assets were subsequently repatriated. However, between 7 April 1965 and 31 December 1977 there was a requirement - to which there were again some exceptions - that 25% of the sale proceeds had to be surrendered at the official rate of exchange with the result that the premium could only be recovered as to 75% of the sale proceeds.

7. For CGT purposes, the payment of the premium on the acquisition of a foreign asset counted towards the base cost. On a subsequent disposal of that asset for foreign currency - which is in effect an exchange of one asset for another for CGT purposes - it is necessary to arrive at the market value of the currency received in exchange. In the absence of Section 150(5), CGTA this would be given by the premium rate of exchange quoted on the market. Section 150(5) remedies the position by adjusting the market value of the currency where, owing to exchange control regulations, the seller was prevented from keeping part of the currency given by the purchaser.

8. We need to retain the effect of section 150(5) for the reasons given in the speaking notes. However, because the section is not expressly limited to valuations prior to the abolition of exchange controls, our legal advice is that it cannot remain on the statute book from the date on which the 1947 Act itself ceases to have legal effect. Subsection 3 of the clause therefore repeals section 150(5) except in relation to valuations before controls were lifted.

9. There are three other provisions in the CGT legislation with an exchange control dimension. These are contained in Schedule 6, CGTA 1979, (which consists entirely of transitory rules) and all three provisions, unlike section 150(5), are already expressed to apply only to past acquisitions. There is, therefore, no need to repeal them. First, paragraph 2(5) provides the equivalent of section 150(5) where the market value of an asset before the commencement of the 1979 Act is material. Secondly, paragraph 17 grants a measure of relief where a financial institution obtained permission for a foreign currency loan for the acquisition of foreign securities prior to the devaluation of sterling on 18 November 1967 and subsequently disposed of the securities repaying the loan from the proceeds. In the absence of such relief, a gain would arise on the increase in the sterling value of the security without any corresponding allowable loss on the increased sterling liability on the loan (which is not an asset in the hands of the borrower). Thirdly, paragraph 18 applies a similar provision to certain foreign insurance funds.

Annex III

THE NATIONAL INVESTMENT BANK

1. **The Proposal**

"Pooled investment schemes" - pension funds, insurance companies, unit trusts etc. - are to be induced, by the withdrawal of "fiscal privileges", to repatriate funds held overseas and invest them in securities issued by the National Investment Bank. The Bank would, in turn, invest that money in UK companies. Though the two sides of the proposal are linked, they are in principle separable.

a) Repatriation of Funds

An incoming Labour Government would set a percentage cut-off for overseas investment by pooled investment schemes. If they held overseas assets above this percentage they would lose tax concessions. Pension funds, for example, would be liable to Capital Gains Tax, and employers contributions to pension schemes would not be tax deductible. The cut-off figure has not yet been set, but illustrative calculations have mentioned 5%. At the end of 1984 pension and insurance funds held around 13% of their funds (of over £250 billion) overseas.

Schemes which reduced their overseas investment to this level over an unspecified period would retain their tax concessions. If not, the Labour Party estimates that an additional £4 billion of tax revenue would be raised.

b) The National Investment Bank

Pooled investment schemes would not be free to invest these repatriated funds where they wished in the UK. They would still lose tax concessions unless a proportion of their funds were invested in loan stock issued by the National Investment Bank. This proportion has also not been fixed, but it would be set to ensure that the NIB mopped up most

if not all of the repatriated money.

The NIB itself would be based on an existing credit institution taken over by the Government (probably Investors in Industry). Its securities would be guaranteed by the Bank of England and would offer market rates of interest. It would provide equity and term loans - some at discounted rates - to businesses in the UK, giving priority to small and medium-sized companies. Investments would be supported by a business plan agreed by the NIB, management and shareholders, and the workforce. The NIB would also be required by Parliament to take account of a range of other economic and social objectives, for example import substitution, regional development and the promotion of social ownership. Subject to these overriding aims, it would judge investments "on a commercial basis."

2. **Uncertainties**

It will be seen from the above brief description that considerable uncertainties remain, in four areas

a) the coverage of the scheme
b) the quantity of assets repatriated
c) the tax concessions withdrawn and
d) the investment policy of the NIB.

a) Coverage

It is clear that pension funds, life assurance companies investment and unit trusts are covered. Charities, too, would almost certainly be included. In the case of individuals, it seems likely that they would have to be covered in some way. The policy document refers in the analysis of overseas investment to the fact that "wealthy individuals have taken advantage of their freedom to buy villas in the Algarve" though Mr Kinnock has said that holiday homes would not be affected.

If individuals were not included then the scope for evasion

would be immense, either simply in direct investment in overseas assets, or through portable pensions. To be effective, therefore, the scheme would need to cover persons, and it would make no sense to exclude property from the calculation of overseas assets.

b) Quantity of Assets Repatriated

One illustrative calculation shows occupational pension funds with 9.2 per cent of assets overseas (as opposed to 19% in 1984). Elsewhere a worked example uses 5 per cent. This latter figure appears more prominently in the papers, and seems likely to be the planned percentage. If this were to be the number, then we estimate on the basis of 1984 accounts that the total sums repatriated would be of the order of £30 billion. This compares with an annual average of outward capital flows since 1979 of £3.7 billion.

It is impossible to estimate with any precision the implications of extending the scheme to individuals. (The Annex shows the basis of calculation of these figures, and the way in which overseas asset holdings changed from 1979 to 1984).

Mr Hattersley recognises that in the early years the bank would have more money than it could use. He says that the surplus will be used on infrastructural repairs if industrial ventures cannot be found.

c) Tax concessions withdrawn

Here the published documents are very vague. It seems clear that the tax concessions attaching to the funds themselves, and to employers contributions to them, would be withdrawn in each case. The more radical option - which is evidently under consideration - would be to withdraw tax concessions also from the beneficiaries of funds which did not meet the scheme criteria. This would mean, for example, that employees' pension contributions, and lump sum payments,

ould also attract tax.

d) Investment Policy of the NIB

The extent to which the NIB would act as a commercial bank is unclear. This depends on the guidelines set by Parliament in enabling legislation. They are couched in very vague terms in the policy documents. The extent of interest subsidies (and perhaps grants) which the NIB could disburse is not revealed. But it would be an interventionist operation, with control over the "investment and other decisions" made by companies receiving funds. It would therefore be an industrial strategy arm of government, rather than a credit institution.

3. **Analysis**

The scheme is based on three false premises

a) That there is a shortage of funds for domestic investment and the increase in overseas investment has been at the expense of domestic investment.

b) That repatriation of funds will increase investment and output without offsetting effects elsewhere

c) That the Government can second-guess the market and "pick winners."

a) No shortage of funds

There is no shortage of funds for domestic investment. Repeated inquiries - the Wilson Committee Report was perhaps the most comprehensive - have failed to identify a large-scale financial market failure. And private sector investment has in fact been rising particularly rapidly - up by 15

per cent last year to a record level. The analysis behind the NIB also implies that the stock of investment funding is fixed, and that a pound invested abroad is a pound less invested at home. This is false. The rate of domestic saving, which creates funds for investment, varies with interest rates. And internationally funds are generated and flow towards higher expected returns.

There is no evidence that the increase in overseas investment has been at the expense of domestic investment.
In fact in the period after exchange controls were abolished, 1980-82, the proportion of institutional investment going into UK companies securities increased. The rise in overseas investment was largely at the expense of gilts.

b) Repatriation increases net investment

This is false. Forced repatriation may temporarily increase the supply of investment funds. These will be channelled through the NIB. The NIB will, in search of viable projects and in pursuit of its other objectives, lend at lower than market rates. This will create subsidised competition for previously viable companies and projects, forcing them out of business.

The capital outflow observed since 1979 has been the counterpart of current account surpluses. Capital inflows mean current account deficits. So that an increase in investment demand will be offset by the loss of demand for exports. It is evident that repatriation on the scale envisaged would exert significant upward pressure on the exchange rate, forcing British companies out of export markets. Also, the scheme will not in itself reduce interest rates in the UK. The increase in investment funds seeking a home would be matched by increased demand for finance to coverthe current account deficit.

c) The Government cannot secondguess the market

All the evidence shows that Governments cannot "pick winners". The National Enterprise Board was a failure. Subsidised investment implies that projects would not otherwise be viable. Few projects or companies initiated with subsidies graduate to the free marketplace. There is no incentive for them to do so. Mr Hattersley appeared to recognise the point in his recent interview with Marxism Today. He said "I think it's almost impossible for government to pick winners." But the NIB is designed to do just that.

With a mix of social, political and economic objectives the NIB is unlikely to fulfil any of its aims. The most important net effect of the scheme will be to reduce the return to savers, and particularly pension savings. If pension funds did not fulfil the scheme's requirements, and paid tax instead, then the overall net income of pension funds might be reduced by around £3 billion. To offset the effect of this on benefits, contribution rates would have to rise by about a third.

If the funds did meet the criteria then returns to savers would still be lowered, and the value of pensions reduced. The Labour Party published figures which purported to show that the return to funds would have been lowered by only 0.2 per cent had they invested in gilts rather than overseas equities over the last 5 years. But these calculations are wrong. They include the impact of the ending of exchange controls in 1979 and the consequent loss of the investment dollar premium. This is quite irrelevant to the calculation of long-term yields on overseas investment. Before 1979 overseas investments were valued including the effect of the premium: thus between 1979 and 1980 they showed a (purely paper) loss. From 1980-1984 (removing this distortion) pension fund returns would have been reduced by 0.86 per cent. A reduction on this scale would have a significant impact on actuarial calculations, requiring increased contributions from beneficiaries, or reducing benefits. The Labour claim that pensioners would not have suffered from this change over the last five years is quite false.

0

But the overall economic impact of the scheme should be seen in the context of the rest of Labour's economic policy. Their stated aim of massive increases in public spending would put pressure on sterling and interest rates. The Government would be faced with a run on sterling, and the need to lift interest rates to fund a massive increase in borrowing. The NIB scheme has been devised to address these problems. In effect pensioners and other savers will be forced to lend to the Government and to prop up the pound. The value and security of their savings would be reduced as a result. It is wrong to compare, as the Labour Party does, returns which have been earned on gilts over the past six years, with returns overseas. Savers have earned positive real returns because the Government has brought down inflation and maintained sound financial conditions. Under Labour in the seventies yields on gilts were consistently negative. That would happen again as inflation rose, and the real value of savings and pensions would be eroded.

£ billion

	1979			1984		
	(1) Overseas assets	(2) Total balance sheet[a]	(1) as % of (2)	(1) Overseas assets	(2) Total balance sheet[a]	(1) as % of (2)
Institutions						
Pension funds	2.0	34.4	5.9	19.3	125.2	15.4
Insurance companies: long-term funds	1.3	42.3	3.0	13(b)	130(b)	10.0
Insurance companies: general funds	0.8	10.5	7.9			
Unit trusts	0.7	3.5	18.8	5.2	14.0	36.9
Investment trusts	2.2	5.8	39.0	8.1	15.3	52.9
Total other financial institutions	7.1	96.4	7.3	45.6	284.5	16.0

5% of 284.5 = 14.2, so amount to be repatriated = 45.6 - 14.2 = 31.4

Notes: (a) Some figures represent total balance sheet, others total investments.

(b) CSO estimate

Annex IV

IFS STUDY

The Labour Party proposes to restrict the share of overseas capital in the portfolio holdings of British residents, and particularly of UK financial institutions. It is intended that institutions should return to roughly their 1979 position, involving the repatriation of around £35bn of funds.

2. In the IFS Study two main macro-economic arguments have been cited in favour of Labour's proposal:

(i) The effect on investment - It has been suggested that the repatriation of OPC will stimulate real domestic investment. However, uncontrolled OPC does not restrict industry's access to finance for real investment. Any benefit would depend on the effect on the cost, rather than the availability, of finance - in particular, the government might respond to any upward pressure on the exchange rate by reducing interest rates.

(ii) The effect on the exchange rate -

(a) It has been claimed that introducing restrictions on OPC would reduce the volatility of the exchange rate. However, IFS argue that restrictions would not affect the speculative flows which are the principal cause of instability. It is extremely unlikely that this would have any effect on the volatility of sterling.

(b) IFS show that introducing restrictions on OPC, ceteris paribus, will lead to an appreciation of the exchange rate. They accept that a higher exchange rate might provide scope for either a reduction in interest rates or for a non-inflationary fiscal expansion. However, they stress that the size of the exchange rate appreciation is very uncertain, and suggest that the behaviour of sterling in 1979-80 after the abolition of exchange controls implies that it is likely to be small. This would limit any

non-inflationary benefits from looser policy. However, IFS question the long-run sustainability of using restrictions to achieve a higher exchange rate because of the implication for competitiveness and, hence, for the current account.

3. IFS also report some simulation work intended to quantify the effects of restrictions on OPC using the London Business School model. However, they were unable to simulate the effects of the proposal directly, and their results should be interpreted only as the effects on the economy of 'imposing' a higher exchange rate, not of introducing restrictions on OPC.

4. Apart from their simulation work, IFS's analysis generally seems to be sound. The most important point that we would add is that the general efficiency of the economy may be harmed if institutions are forced to invest in projects that earn a rate of return below that which could be achieved by overseas investment.

ıpanies — overseas securities constituted
cent of [illegible]r total portfolios respectively.
ıs have grown rapidly, as the abolition of
profitable diversification abroad. Table
he composition of the holdings of these
ınd 1985. By the end of 1985, pension
securities had increased to 14.4 per cent
gure for insurance companies being 10.7
ımount invested in overseas securities by
und £36 billion. Also unit trusts and
almost £15 billion invested overseas.

re the subject of the Labour Party's
ır intends that the majority of this capital
ıverseas assets into UK assets, so that the
to their 1979 position. There are two
ɔeen advanced in support of this policy.
anies have been starved of investment
y has gone abroad. We have already
overseas portfolio investment on real
come through the cost, rather than the
finance. The second argument is that
upward pressure on the exchange rate,
ressure likely to result from Labour's
ıis argument has rather more force, and
apter 5.

ır bringing about this repatriation is the
penalties if institutions, and possibly
o limits on the proportion of their funds
se tax penalties would be supported by
failed to conform as an 'overseas' asset
vestors who put funds in it.

roach with the exchange control regime
.abour's scheme would directly affect the
ıe current account of the balance of
vould apply to the portfolio investments
s, but not to direct corporate investment
rected at whole portfolios, not just new
ıgh based on the tax system, the
orm. The role of the tax penalties in the
of the quotas. Once the quota boundary
ıes would affect all investments, not just
e scheme would not involve an effective

TABLE 3.1

The Changing Composition of Institutions' Portfolio Holdings

End of year

	1979 £m	1979 (%)	1985 £m	1985 (%)
Pension Funds				
UK company securities	15 160	(44.1)	80 799	(51.4)
UK government securities[1]	7 664	(22.3)	27 601	(17.6)
UK property[2]	6 651	(19.3)	15 447	(9.8)
Overseas company securities	1 850	(5.4)	21 579	(13.7)
Overseas government securities	43	(0.1)	1 030	(0.7)
Unit trust units	107	(0.3)	1 235	(0.8)
Other	2 899	(8.4)	9 578	(6.1)
Total overseas securities	1 893	(5.5)	22 609	(14.4)
Total holdings	34 374	(100.0)	157 269	(100.0)
Long-Term Insurance Funds				
UK company securities	12 723	(29.8)	47 355	(36.1)
UK government securities[1]	11 893	(27.9)	31 112	(23.7)
UK property	10 330	(24.2)	20 162	(15.3)
Overseas company securities	1 155	(2.7)	12 278	(9.3)
Overseas government securities	112	(0.3)	1 803	(1.4)
Unit trust units	1 097	(2.6)	7 960	(6.1)
Other	5 367	(12.6)	10 688	(8.1)
Total overseas securities	1 267	(3.0)	14 081	(10.7)
Total holdings	42 677	(100.0)	131 358	(100.0)
Unit Trusts[3]				
UK company securities	2 578	(78.2)	11 668	(62.5)
UK government securities	46	(1.4)	525	(2.8)
Overseas company securities	654	(19.8)	6 357	(34.1)
Other overseas	3	(0.1)	73	(0.4)
Other	16	(0.5)	31	(0.2)
Total overseas securities	657	(19.9)	6 430	(34.5)
Total holdings	3 297	(100.0)	18 654	(100.0)
Investment Trusts				
UK company securities	3 516	(61.1)	7 928	(46.2)
UK government securities	262	(4.6)	445	(2.6)
Overseas company securities	1 829	(31.8)	7 926	(46.1)
Other overseas	27	(0.5)	373	(2.2)
Other	118	(2.1)	503	(2.9)
Total overseas securities	1 856	(32.3)	8 299	(48.3)
Total holdings	5 752	(100.0)	17 175	(100.0)

Sources: CSO *Financial Statistics* (November 1981, October 1986); Department of Trade and Industry.

1. Includes local authority securities.
2. Includes property unit trusts.
3. Excludes property unit trusts.

Annex V

Mr Hattersley's speech in New York 11/4/86

EXCHANGE RATE POLICY

For Labour's plans to succeed we have to work in proper partnership with the world outside Great Britain - a world which I know will in general will not be governed by socialist parties nor committed, as we will be committed, to a policy of economic expansion. Because of Britain's special position as a world financial centre, that requires us to take a specific and realistic view on the future of sterling.

The Labour Party has no intention of reintroducing statutory exchange controls. There will be no legal prohibition on the export of capital from the United Kingdom economy. We have taken that decision for four reasons. First, the reintroduction of old style exchange controls is literally impossible - indeed either to attempt it or to predict it would have quite the opposite effect from that which its supporters claim. Money would leave the United Kingdom not simply during the early weeks of a Labour Government but during the campaign in which the election of a Labour Government became more certain. Since old style exchange control is impossible it is hardly worthwhile discussing its disadvantages. But there were two subsidiary reasons for deciding not even to consider such a policy which I mention in passing. There would be formidable technical problems involved in reintroducing statutory controls and reintroduction might severely damage the status of the City as

a world financial centre - with a consequent reduction in our invisible earnings. The fourth reason is worth a more detailed explanation. We have thought of something better.

Our intention is to deter - rather than to prohibit - the investment overseas of the monies held in the portfolios of UK collective investment schemes - unit trusts, insurance companies and pension funds. All those institutions at present receive considerable tax concessions on their investments. Those fiscal privileges will be withdrawn from United Kingdom institutions if they do not repatriate a specified proportion of their foreign investment. Before the aboliton of statutory exchange control, on average, about 5% of institutional funds were invested abroad. This now amounts to over 16%. Our general objective will be to reduce the percentage to something like the 1979 figure, though there would clearly be a transitional period and we would not intend to treat every institution according to the same rigid formula. Our proposals neither affect direct overseas investment by British companies, nor holiday makers and businessmen wanting to take small sums out of the country. Nor do they affect inward investment flows whether direct or portfolio. You may be able best to understand our proposals if you think of them as similar to those which were introduced by President Kennedy in 1963 and to schemes which operate today in some Canadian provinces.

Exchange control was removed in 1979, partly for ideological reasons, but partly to allow an outflow of capital and thus ensure that sterling did not become even more overvalued. Our proposals are the mirror image of that intention. The repatriation of a percentage of institutional overseas portfolios will exert some upward pressure on sterling values. And it will help to avert any over-depreciation which would undermine our efforts to rebuild British industry. A recent assessment by Greenwell Montagu made the point exactly "This plan would undoubtedly be a significant inducement to bring back funds into the country, particularly for the institutions. The prospect of a Labour election victory might even induce some repatriation to start before the election, on the following calculation. If Labour were to win and repatriation were to start on a large scale, the exchange rate would, on that ground alone, be expected to rise. In these circumstances, it might be better to anticipate that rise than be forced to buy sterling later at a higher price. No doubt there would be a lot of money going the other way, foreigners' money for example, so the net effect is by no means guaranteed. But the possibility of large scale repatriation could, for a period, hold sterling up a lot higher than might otherwise be expected." That upward pressure will assist us in our endeavours to hold down interest rates without risking an unacceptable sterling depreciation. Its effects will be intensified in that they will influence exchange rate expectations - even in advance of the General Election. We

are, I think, the first Labour Opposition which has ever been accused of first, risking the overvaluation of sterling and second, producing a rush of sterling into the United Kingdom.

Of course I am not suggesting for a moment that this one device will, in itself, be enough to secure our desired exchange rate level. Whichever way sterling moves in the short term a new Labour Government will respond with the available mechanisms and techniques open to us including, if necessary, intervention policy backed by adjustments in interest rates. And, of course, in some circumstances it would be right for the currency itself to take some of the strain. The new tax based incentive for the repatriation of overseas portfolio investments would be an added weapon in our armoury. It also has one other crucial advantage. It is a demonstration that we accept the realities of the world in which we shall become the government of Britain and that we are already preparing to overcome some of the difficulties which previous Labour Governments did not always anticipate.

Exchange rate policy is, of course, important, because of its potential effect on the rate of inflation. I do not hold the view that the inflation rate can be sacrificed for other objectives. Indeed, I do not believe that the other objectives can be achieved if inflation is allowed to get out of hand. There is agreement in the British Labour movement - the trade unions no less than the Party - that a sudden

increase in money wages, which was produced as a misguided response to our decisions to stimulate the economy, would be bound to result in the slowing down of our employment and investment programmes. It is our clear and unequivocal view that to pursue expansion as if consequent increases in inflation were of no importance, is just as foolish as to follow the policy which has damaged the British economy over the last seven years. That policy is the apparent belief that if inflation is held down, everything else will automatically and inevitably fall into place. Experience proves that to be wrong. The control of inflation is essential. But it is only one campaign in the battle for an expanding economy.

PUBLIC OWNERSHIP

The last seven years have been unique in recent British history in one, perhaps surprising, way. We have been governed by the most ideologically committed Cabinet which has ever presided over British fortunes. Because of the ideological obsessions of the present administration, decisions have been taken that no practical businessman would contemplate - amongst them selling off capital assets at knock-down prices and the consequent long term loss of government revenue. The All-Party Public Accounts Committee severely reprimanded the government for under-pricing the sale of British Telecom assets. Some estimates suggest that undervaluation was as much as £1.3 bn. The most recent

3885/019

FROM: H C GOODMAN

DATE: 22 April 1987

1. MR KELLY

2. PS/CHANCELLOR

These notes still need some work done on them. But we thought it would be helpful to get them to you in their present form before your meeting tomorrow.

CWK 22.4

cc PS/Chief Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr G Littler
Mr Cassell
Mr Odling-Smee
Mr Peretz
Mr Scholar
Mr S Matthews
Mr A Bottrill
Ms M O'Mara
Miss Sinclair
Mr Tyrie
Mr Watson
Mr Ross Goobey
Mr Dyer
Mr Norman
Mr Hyett - T/Sol
Mr Michael - IR
PS/C&E
PS/IR
Mr K P Sedgwick
Mr P Graham
Miss Hughes
Mr Kowalski
Mr Flitton

FINANCE BILL: CLAUSE 160 - PART 2 NOTES ON CLAUSES

The Chancellor will, on present plans, himself be taking Clause 160 in Committee of the Whole House on 30 April. Mr Hattersley has said he wants it to be a mini-debate on the Labour Party's proposals.

2. We have already circulated the factual Part I of Notes on Clauses for Clause 160 and Clause 161. Attached are draft speaking notes (Part II of Notes on Clauses) on the various aspects of Clause 160. These cover:-

(i) Speaking Note A: A general speaking note on the repeal of the Exchange Control Act and Labour's scheme, prepared by Mr Peretz, on the assumption that the Chancellor will be speaking after Mr Hattersley.

(ii) <u>Speaking Note B</u>: on retention of power to validate, retrospectively, pre-1979 transactions carried out without permission.

(iii) <u>Speaking Note C</u>: on the CGT aspects.

(iv) <u>Speaking Note D</u>: on the Isle of Man and Channel Islands.

3. I also attach:-

ANNEX I: Some defensive notes on repeal, on the CGT aspect and on Labour's scheme.

ANNEX II: Background notes on the tax aspects.

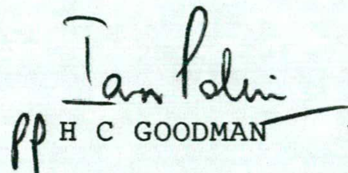
ANNEX III: Background note on the Labour Party proposal (prepared by Howard Davies in October 1985, but still broadly up-to-date except for the renaming of the British Investment Bank).

ANNEX IV: A note on the IFS study of Labour's proposals.

ANNEX V: An extract from Mr Hattersley's September 1986 New York speech.

4. Part II speaking notes on Clause 161, which will not be taken until later in Committe, will be circulated in due course.

5. I am grateful to Mr Michael for his help on the CGT sections.



pp H C GOODMAN

Distribution:

(i) Speaking Note A - to all copy recipients.

(ii) All speaking notes, Annexes I and II to Messrs Dyer, Norman, Hyett, Michael, PS/C&E, PS/IR, Miss Wallis, Mr Graham, Miss Hughes.

(iii) Whole set - Top copy + MG only.

SPEAKING NOTE A

Exchange Controls and Labour's Policy

The decision taken in 1979 to abolish exchange controls has proved wholly beneficial to the British economy. The controls which the government inherited in 1979 were inappropriate to our circumstances, inefficient, and increasingly ineffective. Throughout Europe, from Denmark to Spain, other countries are following our lead in lifting controls and moving towards full liberalisation of capital movements. I am glad that the party opposite has now come to accept that the Exchange Control Act is archaic and should be repealed.

2. But it is clear from what the RHG has said [today] that he still does not understand the economic arguments.

3. The first point to recognise is that our net investment abroad in recent years represents an important part of the way in which, as a nation, we have been investing the return from North Sea oil.

4. Abolition of exchange controls allowed this overseas investment to take place without restraints, in a way that will produce the best return for the future. At the same time it helped smooth the economy's adjustment to the fact of North Sea oil.

5. We have now built up a valuable nest egg of net overseas assets - amounting at the end of 1986 to £110 billion, a level second only to Japan. These assets will continue to produce a flow of overseas earnings for the future, as North Sea production declines. In 1986 they generated a net income of more than £4 billion.

6. The Labour Party's proposals are aimed at destroying that national asset, by seeking to persuade institutions to repatriate overseas investments. The RHG also seems to think that the

result would be to prop the £ up - an attempt to stave off the sterling crisis that he, quite rightly, recognises would come if he were ever given a chance to hold office. But here too he is mistaken in his analysis. Introducing a scheme of this kind would not help the £; it would be far more likely to frighten off foreign investors. The way to maintain confidence in the currency, as every Government discovers sooner or later, is to follow sensible and prudent policies, not to dream up [ramshackle] schemes of this kind.

7. Next, he suggests that his proposals would increase funds available for UK investment. There are two fallacies here. The first is the idea that there is a shortage of funds for investment. Official enquiry after official enquiry has shown this not to be the case [possible Wilson Committee reference?]. The way to encourage investment is to create an environment of steady and sustained growth in which businesses can invest profitably, and with confidence. That is what we have achieved. That is why business investment is now at a record level.

8. The second fallacy is the idea that if less is invested abroad more will be invested at home. I will spare the House a lecture on balance of payments arithmetic. But let me refer to the analysis of the Labour Party proposals carried out by the Institute of Fiscal Studies - a body not always sympathetic to the Government. In their analysis they say, and I quote, that they "reject the view that each £ invested abroad means a £ less invested in job creating enterprises in Britain".

9. The real losers from the scheme would be pensioners and savers. The Opposition likes to pretend that the British Investment Bank is a new idea, but of course it is not. [Possible joke. The initials BIB suggest that somewhere deep in his subconscious the RHG accepts that it is an infantile idea.] The history of the 1960s and 70s shows time and again that Governments are not successful at picking winners. [Even the RHG has recognised this in the past. In an interview in Marxism Today in October 1985 he said "I think its almost impossible for government to pick winners". But the BIB is designed to do just that]. Whatever fine motives it might start out with,

the BIB would invest in loss making projects chosen for political reasons - ending up with a portfolio of lame ducks and half-baked experiments. The returns earned by pension funds forced to invest in the BIB would no doubt be correspondingly low, and pensioners and savers would lose.

10. On top of this the scheme would impose other important costs on the economy. More tax inspectors would be needed to run it; and the more accountants would be employed to run round it.

11. The scheme is a nonsensical compromise designed to paper over conflicts within the Labour Party, and prevent a sterling crisis. The RHG knows there would be a run on the £ if he were ever allowed near the Treasury and he hopes that a scheme of this kind would bail him out. Fortunately it will never be necessary to put this to the test.

SPEAKING NOTE B

Certificates of Validation

The power is being retained to validate retrospectively certain transactions made without permission before 1979. If permission was not given or if there is no proof that the transfer was valid, the holder of an asset may be unable to realise its value if he wishes to do so. In some cases, of course, transfers will have been illegal. Where serious misdemeanours are discovered people will continue to be prosecuted. But equally it is right to retain the power to issue certificates of validation in other cases, where for example there is some doubt about whether or not Exchange Control permission should have been sought; or where a genuine mistake was made.

SPEAKING NOTE C

Capital gains tax

Under the Exchange Control Act 1947, the sale of some assets was subject to restrictions which prevented the seller from keeping all of the proceeds of sale. For example, there was a compulsory requirement that 25 per cent of any non-sterling currency obtained on the disposal of foreign securities had to be encashed at the official rate of exchange. In these cases, section 150(5) of the Capital Gains Tax Act 1979 makes an appropriate adjustment to the valuation of such assets for capital gains tax purposes. This provision will continue to be required to the extent that valuations prior to the abolition of exchange controls are still needed. Now that the 1947 Act is to be repealed it is therefore necessary, as a technical matter, to ensure that section 150(5) remains operative for such valuations. This is achieved by subsection (3) of the clause.

SPEAKING NOTE D

Isle of Man and Channel Islands

Under section 43(2), as modified by an Order in Council the Exchange Control Act applied to the Isle of Man. By powers conferred by Section 43(3) the Act was also extended, in a modified form, by Orders in Council to cover the Channel Islands. It is necessary now to extend the repeal to both.

ANNEX I

DEFENSIVE NOTES. A EXCHANGE CONTROL

(i) **Why not repeal the Act before?** Because not appropriate to do so. Since then circumstances have moved on. Acting now to remove uncertainty.

(ii) **Isn't this simply a pre-election gimmick?** It is a sensible piece of housekeeping, which removes an uncertainty which could be damaging. Mr Hattersley has said Labour Party has no use for the Act either.

(iii) **Don't most other industries countries have similar powers available for use in emegencies? Why is the UK different?** Experience shows that exchange controls do not work, except in very extreme circumstances such as war. But in extreme circumstances it is usually possible to introduce legislation very quickly. Predecessor to the Exchange Control Act went through Parliament in 1939 in a single day. If necessary, new legislation can be tailored to the precise circumstances at the time, not those of the 1940s.

For use only if asked

(iv) **Isn't there a Community obligation?** This is a complicated and technical area of Community law. But the move is fully in line with the spirit of moves under way within the Community for further dismantling of exchange controls.

For use only if pressed further

(v) **What about the 1972 directive/1980 written answer?** Circumstances have changed a lot since 1972. In particular, dismantling of exchange controls is now an agreed priority within the Community programme for completing the internal market by 1992. Directive is currently under review in that context. We will look again at the best way of meeting any Community obligation when precise nature of future requirement becomes clear. Exchange Control Act is designed for the circumstances of the Second World War, not the 1980s.

(vi) **Why not keep the Act until future of the directive is clear? Aren't you jumping the gun?** Have concluded that continued existence of Act in the Statute Book creates undesirable uncertainties that could be damaging. No point in keeping redundant legislation any longer than necessary.

(vii) **If you felt this way, why take steps as recently as 1981 to strengthen the contingent powers available to you?** Because we felt that if we were going to keep these powers on the Statute Book we ought to ensure that they were technically as sound as we could make them, and to make it clear that there should be no presumption that if the powers ever were used they were any more likely to be used to counter outflows than inflows.

(viii) **Have you consulted the Commission?** Informed President Delors of his intentions.

(ix) **Effect of repeal on implementation of sanctions against other countries?** International measures could, if necessary, be enforced by other means. [Action against Argentina, Libya, Syria and South Africa has not relied on this Act].

B CGT

Why not simply repeal the CGT provision?

(x) The effect of section 150(5) for valuations before 1979 needs to be preserved for three reasons. First, to deal with old cases which may come to light where the normal time limit for the making of an assessment does not apply (for example, where there is fraud or wilful default on the part of the taxpayer). Secondly, for existing cases which are open and working as at the date on which the 1947 Act ceases to have effect. Thirdly, for future disposals where it is necessary to establish the market value on acquisition of the asset disposed of and there is an exchange control aspect in that context.

If CGT provision still required for valuations before 1979 why tinker with it?

(xi) Our legal advice is that section 150(5) cannot remain on the statute book after repeal of the 1947 Act. So we are doing this to cover valuations on transactions made before controls were lifted.

C LABOUR'S PROPOSALS

(xii) **Hasn't NEDC come out in favour of a new, state-funded credit institution?** The Committee for Finance in Industry, which reported to the NEDC, did some work on what such a body would look like, but the Council did not accept that there is a need for it. The Government regarded this as a misconceived enterprise and have made it clear that they see no need for a financial intermediary. The Committee's work was in any case on quite different lines from the BIB. There is no question of forced repatriation of funds. [NB The Committee for Finance in Industry (now replaced by the Committee on Industry and Finance) also produced a paper on "Financial Aspects of Industrial Restructuring, published in June 1986. Government members saw no case, on the basis of evidence available, for setting up a new publicly funded body, to deal with financial restructuring].

HANSARD WRITTEN ANSWERS 16/5/80

vol: 984 col: 672

Exchange Control Act 1947

Mr. Cockeram asked the Chancellor of the Exchequer if he has completed his review of the future of the Exchange Control Act 1947; and whether he will make a statement.

Sir Geoffrey Howe: Yes. The House was told on 6 November last that, following my decision, announced in October, to abolish exchange controls, I would be reviewing the future of the Exchange Control Act 1947. I have now decided that, at least for the time being, the present Act should be retained.

I regard the 1947 Act as unsatisfactory in a number of ways, notably in the wide extent of its powers and in its bias, natural enough when it was introduced, towards the control of outflows. I see no prospect of time being made available in the legislative programme for the early replacement or substantive amendment of the Act; and simple repeal would not be compatible with our Treaty obligations.

I do however envisage that ultimately, and probably most conveniently in several stages, changes in the law will be sought with the objectives of making the powers available in this area less draconian and more symmetrical as between control of outflows and of inflows.

In the meantime, the Act needs to be kept in being because the United Kingdom Government are required, under the European Community Council Directive 72/156 of 21 March 1972, to have available certain instruments for effective regulation of international capital flows and for neutralising those effects of such flows on domestic liquidity which are considered undesirable. The directive also requires that these instruments may be able, where necessary, to be put into operation without further enabling measures. The Exchange Control Act 1947 is the only current legislative authority in the United Kingdom under which the Government could take such action.

ANNEX II

BACKGROUND NOTE ON THE TAX ASPECTS

1. The Repeals Schedule 22 contains a part (XII) covering the repeals consequential on the repeal of the Exchange Control Act as well as the Act itself. Apart from the Capitals Gains Tax points which are dealt with separately below these are are technical changes.

2. Clause 141 of the Finance Bill redefines foreign currency for the purpose of Section 30 of the Finance Act 1967 which exempts some instruments from stamp duty. It has the effect of broadening the exemption from duty in respect of issues/transfers of bearer stock; stock expressed in Irish Punts would be exempt. For further details see the Note on Clause 141.

3. The current definition of securities in the VAT exemption of securities (Item 6 of G5 of Schedule 6 for 1983 VAT Act) depends on the definition in Section 42 of the Exchange Control Act. Customs and Excise are in any case reviewing this taking into account more recent developments in the financial markets. They will issue a suitable order before Royal Assent, when the Exchange Control Act repeal comes into effect. For further details see the background note to clause 18.

Capital gains tax and exchange control

4. The Exchange Control Act 1947 effectively divided the world into two separate groups of countries. One group, listed in the First Schedule to the Act, comprised the UK, the Channel Islands, the Isle of Man, the Republic of Ireland and Gibraltar - the "Scheduled Territories". The second group comprised the rest of the world. The splitting of the world into these two groups was fundamental to the application of UK exchange control as, save in a few instances, the provisions of the Act did not apply to transactions between residents of the Scheduled Territories.

5. Before the abolition of exchange control on 24 October 1979, except for the restrictions on transactions in Rhodesia, the general rule - to which there were some exceptions - was that investment

currency was required by UK residents for the purchase of either foreign currency securities for portfolio purposes or private property abroad. The need for investment currency arose because the Treasury was not prepared to release foreign currency from the official reserves for such purposes. Invariably, the demand for investment currency exceeded supply with the result that it traded at a premium (the so called "Dollar premium" since it was expressed by reference to the sterling/US dollar exchange rate) and the amount of the premium fluctuated considerably over the years reaching a peak of 92% in April 1975.

6. The corollary of this was that the premium could be recovered, at the prevailing rate, if the proceeds of premium worthy assets were subsequently repatriated. However, between 7 April 1965 and 31 December 1977 there was a requirement - to which there were again some exceptions - that 25% of the sale proceeds had to be surrendered at the official rate of exchange with the result that the premium could only be recovered as to 75% of the sale proceeds.

7. For CGT purposes, the payment of the premium on the acquisition of a foreign asset counted towards the base cost. On a subsequent disposal of that asset for foreign currency - which is in effect an exchange of one asset for another for CGT purposes - it is necessary to arrive at the market value of the currency received in exchange. In the absence of Section 150(5), CGTA this would be given by the premium rate of exchange quoted on the market. Section 150(5) remedies the position by adjusting the market value of the currency where, owing to exchange control regulations, the seller was prevented from keeping part of the currency given by the purchaser.

8. We need to retain the effect of section 150(5) for the reasons given in the speaking notes. However, because the section is not expressly limited to valuations prior to the abolition of exchange controls, our legal advice is that it cannot remain on the statute book from the date on which the 1947 Act itself ceases to have legal effect. Subsection 3 of the clause therefore repeals section 150(5) except in relation to valuations before controls were lifted.

9. There are three other provisions in the CGT legislation with an exchange control dimension. These are contained in Schedule 6, CGTA 1979, (which consists entirely of transitory rules) and all three provisions, unlike section 150(5), are already expressed to apply only to past acquisitions. There is, therefore, no need to repeal them. First, paragraph 2(5) provides the equivalent of section 150(5) where the market value of an asset before the commencement of the 1979 Act is material. Secondly, paragraph 17 grants a measure of relief where a financial institution obtained permission for a foreign currency loan for the acquisition of foreign securities prior to the devaluation of sterling on 18 November 1967 and subsequently disposed of the securities repaying the loan from the proceeds. In the absence of such relief, a gain would arise on the increase in the sterling value of the security without any corresponding allowable loss on the increased sterling liability on the loan (which is not an asset in the hands of the borrower). Thirdly, paragraph 18 applies a similar provision to certain foreign insurance funds.

Annex III

THE NATIONAL INVESTMENT BANK

1. The Proposal

"Pooled investment schemes" - pension funds, insurance companies, unit trusts etc. - are to be induced, by the withdrawal of "fiscal privileges", to repatriate funds held overseas and invest them in securities issued by the National Investment Bank. The Bank would, in turn, invest that money in UK companies. Though the two sides of the proposal are linked, they are in principle separable.

a) Repatriation of Funds

An incoming Labour Government would set a percentage cut-off for overseas investment by pooled investment schemes. If they held overseas assets above this percentage they would lose tax concessions. Pension funds, for example, would be liable to Capital Gains Tax, and employers contributions to pension schemes would not be tax deductible. The cut-off figure has not yet been set, but illustrative calculations have mentioned 5%. At the end of 1984 pension and insurance funds held around 13% of their funds (of over £250 billion) overseas.

Schemes which reduced their overseas investment to this level over an unspecified period would retain their tax concessions. If not, the Labour Party estimates that an additional £4 billion of tax revenue would be raised.

b) The National Investment Bank

Pooled investment schemes would not be free to invest these repatriated funds where they wished in the UK. They would still lose tax concessions unless a proportion of their funds were invested in loan stock issued by the National Investment Bank. This proportion has also not been fixed, but it would be set to ensure that the NIB mopped up most

if not all of the repatriated money.

The NIB itself would be based on an existing credit institution taken over by the Government (probably Investors in Industry). Its securities would be guaranteed by the Bank of England and would offer market rates of interest. It would provide equity and term loans - some at discounted rates - to businesses in the UK, giving priority to small and medium-sized companies. Investments would be supported by a business plan agreed by the NIB, management and shareholders, and the workforce. The NIB would also be required by Parliament to take account of a range of other economic and social objectives, for example import substitution, regional development and the promotion of social ownership. Subject to these overriding aims, it would judge investments "on a commercial basis."

2. Uncertainties

It will be seen from the above brief description that considerable uncertainties remain, in four areas

a) the coverage of the scheme
b) the quantity of assets repatriated
c) the tax concessions withdrawn and
d) the investment policy of the NIB.

a) Coverage

It is clear that pension funds, life assurance companies investment and unit trusts are covered. Charities, too, would almost certainly be included. In the case of individuals, it seems likely that they would have to be covered in some way. The policy document refers in the analysis of overseas investment to the fact that "wealthy individuals have taken advantage of their freedom to buy villas in the Algarve" though Mr Kinnock has said that holiday homes would not be affected.

If individuals were not included then the scope for evasion

would be immense, either simply in direct investment in overseas assets, or through portable pensions. To be effective, therefore, the scheme would need to cover persons, and it would make no sense to exclude property from the calculation of overseas assets.

b) Quantity of Assets Repatriated

One illustrative calculation shows occupational pension funds with 9.2 per cent of assets overseas (as opposed to 19% in 1984). Elsewhere a worked example uses 5 per cent. This latter figure appears more prominently in the papers, and seems likely to be the planned percentage. If this were to be the number, then we estimate on the basis of 1984 accounts that the total sums repatriated would be of the order of £30 billion. This compares with an annual average of outward capital flows since 1979 of £3.7 billion.

It is impossible to estimate with any precision the implications of extending the scheme to individuals. (The Annex shows the basis of calculation of these figures, and the way in which overseas asset holdings changed from 1979 to 1984).

Mr Hattersley recognises that in the early years the bank would have more money than it could use. He says that the surplus will be used on infrastructural repairs if industrial ventures cannot be found.

c) Tax concessions withdrawn

Here the published documents are very vague. It seems clear that the tax concessions attaching to the funds themselves, and to employers contributions to them, would be withdrawn in each case. The more radical option - which is evidently under consideration - would be to withdraw tax concessions also from the beneficiaries of funds which did not meet the scheme criteria. This would mean, for example, that employees' pension contributions, and lump sum payments,

ould also attract tax.

d) Investment Policy of the NIB

The extent to which the NIB would act as a commercial bank is unclear. This depends on the guidelines set by Parliament in enabling legislation. They are couched in very vague terms in the policy documents. The extent of interest subsidies (and perhaps grants) which the NIB could disburse is not revealed. But it would be an interventionist operation, with control over the "investment and other decisions" made by companies receiving funds. It would therefore be an industrial strategy arm of government, rather than a credit institution.

3. **Analysis**

The scheme is based on three false premises

a) That there is a shortage of funds for domestic investment and the increase in overseas investment has been at the expense of domestic investment.

b) That repatriation of funds will increase investment and output without offsetting effects elsewhere

c) That the Government can second-guess the market and "pick winners."

a) No shortage of funds

There is no shortage of funds for domestic investment. Repeated inquiries - the Wilson Committee Report was perhaps the most comprehensive - have failed to identify a large-scale financial market failure. And private sector investment has in fact been rising particularly rapidly - up by 15

per cent last year to a record level. The analysis behind the NIB also implies that the stock of investment funding is fixed, and that a pound invested abroad is a pound less invested at home. This is false. The rate of domestic saving, which creates funds for investment, varies with interest rates. And internationally funds are generated and flow towards higher expected returns.

There is no evidence that the increase in overseas investment has been at the expense of domestic investment.
In fact in the period after exchange controls were abolished, 1980-82, the proportion of institutional investment going into UK companies securities increased. The rise in overseas investment was largely at the expense of gilts.

b) Repatriation increases net investment

This is false. Forced repatriation may temporarily increase the supply of investment funds. These will be channelled through the NIB. The NIB will, in search of viable projects and in pursuit of its other objectives, lend at lower than market rates. This will create subsidised competition for previously viable companies and projects, forcing them out of business.

The capital outflow observed since 1979 has been the counterpart of current account surpluses. Capital inflows mean current account deficits. So that an increase in investment demand will be offset by the loss of demand for exports. It is evident that repatriation on the scale envisaged would exert significant upward pressure on the exchange rate, forcing British companies out of export markets. Also, the scheme will not in itself reduce interest rates in the UK. The increase in investment funds seeking a home would be matched by increased demand for finance to coverthe current account deficit.

c) The Government cannot secondguess the market

All the evidence shows that Governments cannot "pick winners". The National Enterprise Board was a failure. Subsidised investment implies that projects would not otherwise be viable. Few projects or companies initiated with subsidies graduate to the free marketplace. There is no incentive for them to do so. Mr Hattersley appeared to recognise the point in his recent interview with Marxism Today. He said "I think it's almost impossible for government to pick winners." But the NIB is designed to do just that.

With a mix of social, political and economic objectives the NIB is unlikely to fulfil any of its aims. The most important net effect of the scheme will be to reduce the return to savers, and particularly pension savings. If pension funds did not fulfil the scheme's requirements, and paid tax instead, then the overall net income of pension funds might be reduced by around £3 billion. To offset the effect of this on benefits, contribution rates would have to rise by about a third.

If the funds did meet the criteria then returns to savers would still be lowered, and the value of pensions reduced. The Labour Party published figures which purported to show that the return to funds would have been lowered by only 0.2 per cent had they invested in gilts rather than overseas equities over the last 5 years. But these calculations are wrong. They include the impact of the ending of exchange controls in 1979 and the consequent loss of the investment dollar premium. This is quite irrelevant to the calculation of long-term yields on overseas investment. Before 1979 overseas investments were valued including the effect of the premium: thus between 1979 and 1980 they showed a (purely paper) loss. From 1980-1984 (removing this distortion) pension fund returns would have been reduced by 0.86 per cent. A reduction on this scale would have a significant impact on actuarial calculations, requiring increased contributions from beneficiaries, or reducing benefits. The Labour claim that pensioners would not have suffered from this change over the last five years is quite false.

But the overall economic impact of the scheme should be seen in the context of the rest of Labour's economic policy. Their stated aim of massive increases in public spending would put pressure on sterling and interest rates. The Government would be faced with a run on sterling, and the need to lift interest rates to fund a massive increase in borrowing. The NIB scheme has been devised to address these problems. In effect pensioners and other savers will be forced to lend to the Government and to prop up the pound. The value and security of their savings would be reduced as a result. It is wrong to compare, as the Labour Party does, returns which have been earned on gilts over the past six years, with returns overseas. Savers have earned positive real returns because the Government has brought down inflation and maintained sound financial conditions. Under Labour in the seventies yields on gilts were consistently negative. That would happen again as inflation rose, and the real value of savings and pensions would be eroded.

£ billion

	1979			1984		
	(1) **Overseas assets**	(2) **Total balance sheet**[a]	(1) as % of (2)	(1) **Overseas assets**	(2) **Total balance sheet**[a]	(1) as % of (2)
Institutions						
Pension funds	2.0	34.4	5.9	19.3	125.2	15.4
Insurance companies: long-term funds	1.3	42.3	3.0	13(b)	130(b)	10.0
Insurance companies: general funds	0.8	10.5	7.9			
Unit trusts	0.7	3.5	18.8	5.2	14.0	36.9
Investment trusts	2.2	5.8	39.0	8.1	15.3	52.9
Total other financial institutions	7.1	96.4	7.3	45.6	284.5	16.0

5% of 284.5 = 14.2, so amount to be repatriated = 45.6 - 14.2 = 31 .4

Notes: (a) Some figures represent total balance sheet, others total investments.

(b) CSO estimate

Annex IV

IFS STUDY

The Labour Party proposes to restrict the share of overseas capital in the portfolio holdings of British residents, and particularly of UK financial institutions. It is intended that institutions should return to roughly their 1979 position, involving the repatriation of around £35bn of funds.

2. In the IFS Study two main macro-economic arguments have been cited in favour of Labour's proposal:

(i) The effect on investment - It has been suggested that the repatriation of OPC will stimulate real domestic investment. However, uncontrolled OPC does not restrict industry's access to finance for real investment. Any benefit would depend on the effect on the cost, rather than the availability, of finance - in particular, the government might respond to any upward pressure on the exchange rate by reducing interest rates.

(ii) The effect on the exchange rate -

(a) It has been claimed that introducing restrictions on OPC would reduce the volatility of the exchange rate. However, IFS argue that restrictions would not affect the speculative flows which are the principal cause of instability. It is extremely unlikely that this would have any effect on the volatility of sterling.

(b) IFS show that introducing restrictions on OPC, ceteris paribus, will lead to an appreciation of the exchange rate. They accept that a higher exchange rate might provide scope for either a reduction in interest rates or for a non-inflationary fiscal expansion. However, they stress that the size of the exchange rate appreciation is very uncertain, and suggest that the behaviour of sterling in 1979-80 after the abolition of exchange controls implies that it is likely to be small. This would limit any

non-inflationary benefits from looser policy. However, IFS question the long-run sustainability of using restrictions to achieve a higher exchange rate because of the implication for competitiveness and, hence, for the current account.

3. IFS also report some simulation work intended to quantify the effects of restrictions on OPC using the London Business School model. However, they were unable to simulate the effects of the proposal directly, and their results should be interpreted only as the effects on the economy of 'imposing' a higher exchange rate, not of introducing restrictions on OPC.

4. Apart from their simulation work, IFS's analysis generally seems to be sound. The most important point that we would add is that the general efficiency of the economy may be harmed if institutions are forced to invest in projects that earn a rate of return below that which could be achieved by overseas investment.

npanies [illegible]overseas securities constituted
cent of t[illegible]r total portfolios respectively.
s have grown rapidly, as the abolition of
profitable diversification abroad. Table
he composition of the holdings of these
and 1985. By the end of 1985, pension
securities had increased to 14.4 per cent
gure for insurance companies being 10.7
amount invested in overseas securities by
und £36 billion. Also unit trusts and
almost £15 billion invested overseas.

re the subject of the Labour Party's
ır intends that the majority of this capital
overseas assets into UK assets, so that the
to their 1979 position. There are two
been advanced in support of this policy.
anies have been starved of investment
y has gone abroad. We have already
overseas portfolio investment on real
come through the cost, rather than the
finance. The second argument is that
upward pressure on the exchange rate,
ressure likely to result from Labour's
his argument has rather more force, and
apter 5.

or bringing about this repatriation is the
penalties if institutions, and possibly
o limits on the proportion of their funds
se tax penalties would be supported by
failed to conform as an 'overseas' asset
vestors who put funds in it.

roach with the exchange control regime
Labour's scheme would directly affect the
e current account of the balance of
vould apply to the portfolio investments
s, but not to direct corporate investment
rected at whole portfolios, not just new
igh based on the tax system, the
orm. The role of the tax penalties in the
of the quotas. Once the quota boundary
ies would affect all investments, not just
e scheme would not involve an effective

TABLE 3.1
The Changing Composition of Institutions' Portfolio Holdings

End of year

	1979 £m	1979 (%)	1985 £m	1985 (%)
Pension Funds				
UK company securities	15 160	(44.1)	80 799	(51.4)
UK government securities[1]	7 664	(22.3)	27 601	(17.6)
UK property[2]	6 651	(19.3)	15 447	(9.8)
Overseas company securities	1 830	(5.4)	21 579	(13.7)
Overseas government securities	43	(0.1)	1 030	(0.7)
Unit trust units	107	(0.3)	1 235	(0.8)
Other	2 899	(8.4)	9 578	(6.1)
Total overseas securities	1 893	(5.5)	22 609	(14.4)
Total holdings	34 374	(100.0)	157 269	(100.0)
Long-Term Insurance Funds				
UK company securities	12 723	(29.8)	47 355	(36.1)
UK government securities[1]	11 893	(27.9)	31 112	(23.7)
UK property	10 330	(24.2)	20 162	(15.3)
Overseas company securities	1 155	(2.7)	12 278	(9.3)
Overseas government securities	112	(0.3)	1 803	(1.4)
Unit trust units	1 097	(2.6)	7 960	(6.1)
Other	5 367	(12.6)	10 688	(8.1)
Total overseas securities	1 267	(3.0)	14 081	(10.7)
Total holdings	42 677	(100.0)	131 358	(100.0)
Unit Trusts[3]				
UK company securities	2 578	(78.2)	11 668	(62.5)
UK government securities	46	(1.4)	525	(2.8)
Overseas company securities	654	(19.8)	6 357	(34.1)
Other overseas	3	(0.1)	73	(0.4)
Other	16	(0.5)	31	(0.2)
Total overseas securities	657	(19.9)	6 430	(34.5)
Total holdings	3 297	(100.0)	18 654	(100.0)
Investment Trusts				
UK company securities	3 516	(61.1)	7 928	(46.2)
UK government securities	262	(4.6)	445	(2.6)
Overseas company securities	1 829	(31.8)	7 926	(46.1)
Other overseas	27	(0.5)	373	(2.2)
Other	118	(2.1)	503	(2.9)
Total overseas securities	1 856	(32.3)	8 299	(48.3)
Total holdings	5 752	(100.0)	17 175	(100.0)

Sources: CSO *Financial Statistics* (November 1981, October 1986); Department of Trade and Industry.

1. Includes local authority securities.
2. Includes property unit trusts.
3. Excludes property unit trusts.

Annex V

Mr Hattersley's speech in New York 11/4/86

EXCHANGE RATE POLICY

For Labour's plans to succeed we have to work in proper partnership with the world outside Great Britain - a world which I know will in general will not be governed by socialist parties nor committed, as we will be committed, to a policy of economic expansion. Because of Britain's special position as a world financial centre, that requires us to take a specific and realistic view on the future of sterling.

The Labour Party has no intention of reintroducing statutory exchange controls. There will be no legal prohibition on the export of capital from the United Kingdom economy. We have taken that decision for four reasons. First, the reintroduction of old style exchange controls is literally impossible - indeed either to attempt it or to predict it would have quite the opposite effect from that which its supporters claim. Money would leave the United Kingdom not simply during the early weeks of a Labour Government but during the campaign in which the election of a Labour Government became more certain. Since old style exchange control is impossible it is hardly worthwhile discussing its disadvantages. But there were two subsidiary reasons for deciding not even to consider such a policy which I mention in passing. There would be formidable technical problems involved in reintroducing statutory controls and reintroduction might severely damage the status of the City as

a world financial centre - with a consequent reduction in our invisible earnings. The fourth reason is worth a more detailed explanation. We have thought of something better.

Our intention is to deter - rather than to prohibit - the investment overseas of the monies held in the portfolios of UK collective investment schemes - unit trusts, insurance companies and pension funds. All those institutions at present receive considerable tax concessions on their investments. Those fiscal privileges will be withdrawn from United Kingdom institutions if they do not repatriate a specified proportion of their foreign investment. Before the aboliton of statutory exchange control, on average, about 5% of institutional funds were invested abroad. This now amounts to over 16%. Our general objective will be to reduce the percentage to something like the 1979 figure, though there would clearly be a transitional period and we would not intend to treat every institution according to the same rigid formula. Our proposals neither affect direct overseas investment by British companies, nor holiday makers and businessmen wanting to take small sums out of the country. Nor do they affect inward investment flows whether direct or portfolio. You may be able best to understand our proposals if you think of them as similar to those which were introduced by President Kennedy in 1963 and to schemes which operate today in some Canadian provinces.

Exchange control was removed in 1979, partly for ideological reasons, but partly to allow an outflow of capital and thus ensure that sterling did not become even more overvalued. Our proposals are the mirror image of that intention. The repatriation of a percentage of institutional overseas portfolios will exert some upward pressure on sterling values. And it will help to avert any over-depreciation which would undermine our efforts to rebuild British industry. A recent assessment by Greenwell Montagu made the point exactly "This plan would undoubtedly be a significant inducement to bring back funds into the country, particularly for the institutions. The prospect of a Labour election victory might even induce some repatriation to start before the election, on the following calculation. If Labour were to win and repatriation were to start on a large scale, the exchange rate would, on that ground alone, be expected to rise. In these circumstances, it might be better to anticipate that rise than be forced to buy sterling later at a higher price. No doubt there would be a lot of money going the other way, foreigners' money for example, so the net effect is by no means guaranteed. But the possibility of large scale repatriation could, for a period, hold sterling up a lot higher than might otherwise be expected." That upward pressure will assist us in our endeavours to hold down interest rates without risking an unacceptable sterling depreciation. Its effects will be intensified in that they will influence exchange rate expectations - even in advance of the General Election. We

are, I think, the first Labour Opposition which has ever been accused of first, risking the overvaluation of sterling and second, producing a rush of sterling into the United Kingdom.

Of course I am not suggesting for a moment that this one device will, in itself, be enough to secure our desired exchange rate level. Whichever way sterling moves in the short term a new Labour Government will respond with the available mechanisms and techniques open to us including, if necessary, intervention policy backed by adjustments in interest rates. And, of course, in some circumstances it would be right for the currency itself to take some of the strain. The new tax based incentive for the repatriation of overseas portfolio investments would be an added weapon in our armoury. It also has one other crucial advantage. It is a demonstration that we accept the realities of the world in which we shall become the government of Britain and that we are already preparing to overcome some of the difficulties which previous Labour Governments did not always anticipate.

Exchange rate policy is, of course, important, because of its potential effect on the rate of inflation. I do not hold the view that the inflation rate can be sacrificed for other objectives. Indeed, I do not believe that the other objectives can be achieved if inflation is allowed to get out of hand. There is agreement in the British Labour movement - the trade unions no less than the Party - that a sudden

increase in money wages, which was produced as a misguided response to our decisions to stimulate the economy, would be bound to result in the slowing down of our employment and investment programmes. It is our clear and unequivocal view that to pursue expansion as if consequent increases in inflation were of no importance, is just as foolish as to follow the policy which has damaged the British economy over the last seven years. That policy is the apparent belief that if inflation is held down, everything else will automatically and inevitably fall into place. Experience proves that to be wrong. The control of inflation is essential. But it is only one campaign in the battle for an expanding economy.

PUBLIC OWNERSHIP

The last seven years have been unique in recent British history in one, perhaps surprising, way. We have been governed by the most ideologically committed Cabinet which has ever presided over British fortunes. Because of the ideological obsessions of the present administration, decisions have been taken that no practical businessman would contemplate - amongst them selling off capital assets at knock-down prices and the consequent long term loss of government revenue. The All-Party Public Accounts Committee severely reprimanded the government for under-pricing the sale of British Telecom assets. Some estimates suggest that undervaluation was as much as £1.3 bn. The most recent

1757/004

FROM: S P B WALKER

DATE: 22 APRIL 1987

1. MR LUCE

2. FINANCIAL SECRETARY

cc: Chancellor of the Exchequer
Economic Secretary
Minister of State
Sir Peter Middleton
Mr Kemp
Mr Scholar
Miss Sinclair Mr Dixon o/R
Mr Culpin Miss Evans
Mr Cropper
Mr Ross Goobey
Mr Tyrie

FINANCE BILL SECOND READING

Miss Evans' minute of 16 April submitted briefing on the pensions measures in the Finance Bill. This briefing referred to the advantages of personal pensions in assisting job mobility. You should be aware, in this context, of the attached correspondence between the Lord Privy Seal and Mr Michael Stern MP, in which Mr Biffen explains for the first time that the Government do not intend to make contributions to MPs' personal pensions beyond the minimum required by the 1986 Social Security Act. It is the Government's policy (agreed at the time of the White Paper which preceded the Act) that this line should be taken in all the public service schemes, because of the PSBR implications of making substantial employers contributions to personal pensions in respect of employees who leave unfunded pension schemes (where no employer's contribution is paid while the employee is in service).

2. MPs may claim that this polcy makes a nonsense of the claim that personal pensions will aid job mobility (at least for public service employees) since only a 'financial loon' (in Mr Michael Stern's words) would take one out in preference to a public service occupational scheme. The answer is that the Government does not intend to encourage members of good occupational schemes to leave them for personal pensions, and it is up to individual employers to decide whether to offer additional contributions to personal pensions. The main target for personal pensions is the millions of employees who are currently not covered by an occupational scheme.

S P B Walker
Superannuation Division

PRIVY COUNCIL OFFICE
WHITEHALL. LONDON SWIA 2AT

MINISTER OF STATE
REC. 21 APR 1987
ACTION
INFO mr Lamp
Mr Love
ms Noble
mr Dixon
mr Pair

Ms Walker 55/9
on Bristow
MST

21 April 1987

Dear Michael,

PARLIAMENTARY AND OTHER PENSIONS BILL

Thank you for your letter of 6 April about the Bill.

You are right to point out the increased flexibility for improving benefits by additional voluntary contributions which the Government is introducing. As you say, from next April Members will be able to pay extra contributions to improve the level of cover for death in service under the scheme and I am sure this will be welcome.

You also ask about Exchequer contributions towards personal pensions. The arrangements introduced by the Social Security Act 1986 will of course require a contribution from the employer (or, in the case of Members, the Exchequer) in the form of the higher standard rate National Insurance contributions to be paid in respect of those who opt out of a contracted-out scheme. This extra amount will be passed on by the DHSS to the personal pension provider. There is, as you say, no obligation on the employer to make any further contribution, and I do not intend to offer any. Those who opt out of the Parliamentary scheme will do so voluntarily in the knowledge that they are giving up the benefits of the scheme; the option of continuing to participate in the scheme will still be open to all Members.

This is not inconsistent with the Government's general policy towards personal pensions: Norman Fowler has said on several occasions that the Government see personal pensions as an important new opportunity for certain groups of employees, particularly those who are not now members of occupational schemes. It is not the Government's intention to encourage members of good occupational schemes, particularly those with good arrangements for early leavers, to opt instead for personal pensions.

I am copying this letter to Norman Fowler and Peter Brooke.

Yours
John

JOHN BIFFEN

Michael Stern Esq MP
House of Commons

Michael Stern MP.

F/8

HOUSE OF COMMONS
LONDON SW1A 0AA

The Rt Hon John Biffen MP
Leader of the House of Commons
Privy Council Office
Whitehall
London
SW1A 2AT

MINISTER OF STATE
REC. 17 APR 1987
ACTION Miss Walker
Mr Kemp
Mr Dixon
Mr Luce
~~Mr Hayden~~ SS/S
Mr Dyer
Mr Muttukumaru T.S
MST

REFERENCE:

06 Apr 87

PARLIAMENTARY AND OTHER PENSIONS BILL.

Since I am precluded from speaking on the Bill, I am writing to you on two matters of concern.

I hope that, in introducing the Bill, you will have the opportunity of making it clear to Members the very much greater flexibility which will be available under the parliamentary pension scheme as a result of the 1986 Social Security Act. I am not thinking specifically of the opportunity to opt for a personal pension, which is dealt with below, but more the opportunity to provide additional death in service benefits by means of AVCs. As I am sure you are aware, one of the principal criticisms of the present scheme was the provision of wholly inadequate life cover for Members and I think the Government should take credit for now allowing Members to improve this postion.

An area of great concern to me is that Clause 3 of the Bill, while providing for the continuation of Exchequer contribution to the fund, makes no provision to give power to the Exchequer to make any contribution whatsoever to a personal pension plan. As I am sure you are aware, no requirement for employer contribution to a personal plan could be written into the 1986 Social Security Act because it would have been inequitable to do so, but there was a general expectation that employers in the private sector would very quickly find themselves in a position of having to make some contribution, probably at a lower rate, to those employees who relied on personal pensions to create some equity between such employees and those remaining within the company's own pension fund. Indeed, from conversations with employers in the private sector, I believe that there is a general expectation that a position where some employees received a substantial contribution

/to their......

to their pensions while others receive no contribution at all from the same employer would be wholly untenable.

As the Bill stands, the Exchequer contribution of 20.7% of Members' salaries will only be payable if the Member stays within the fund and clearly this will ensure that only a financial loon would opt for a personal pension. It seems a pity, given the Government's commitment to the growth of personal pensions, that the opportunity has not been taken for the Exchequer to make a lower contribution, of an amount to be decided by the Exchequer in the circumstances, to a Member's personal pension since such a power would not only enable Members to look more closely at the possibility of personal pensions, it would also save the Exchequer money.

I should be interested in your thoughts on the above.

cc The Hon P Brooke MP
Minister of State
HM Treasury.

CE45

PWP

FROM: MISS C EVANS
DATE: 22 APRIL 1987

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
Mr Houghton
Mr Walker

SECOND READING DEBATE 22 APRIL: WIND-UP: CGT AND LIFE ASSURANCE COMPANIES

... I attach a revised version of the speaking note on the impact of the Finance Bill on life assurance companies which takes on board the amendments suggested by Mr Houghton at ~~today~~ yesterday's meeting.

CE

MISS C EVANS

21 April revise

FINANCE BILL SECOND READING DEBATE: WIND-UP SPEECH

IMPACT ON LIFE ASSURANCE COMPANIES

I have listened carefully to the points made in this debate about the implications for life assurance of the new arrangements we propose for the taxation of companies' capital gains.

The Government did consider very carefully whether the change proposed in Clause 62 should extend to capital gains earned for holders of life assurance policies. In the end, we concluded that it would not be appropriate to make such gains an exception. I believe that was the right decision. There will of course be an opportunity for full debate in Finance Bill Committee but I am able to deal with the key points in this debate.

The main point at issue is the impact of the tax payable on policyholders' gains. The impact may well be less than has been suggested. There are two main reasons for this. First, a sizeable proportion of policyholders' funds is invested in gilts and other assets outside the CGT net. Second, gains earned for policyholders are largely - in some cases wholly - sheltered from tax by deductions, in particular for management expenses. Much of such tax as the life companies pay on their gains is on profits earned for shareholders and does not affect policyholders' funds. The Inland Revenue cannot, for reasons of confidentiality, give me figures for individual companies, but they have told me that a number of major companies' computations show for 1985 no tax liability on policyholders' gains, and the first indications from the 1986 figures now beginning to be submitted suggest that the same may be true for 1986. Thus I believe that fears about the change have been exaggerated, as some in the industry already recognise.

Accordingly we see no reason why the changes should undermine the competitiveness of life assurance in the way some Members have suggested. Some companies have, I know, increased the provision they set aside for possible future tax on gains, and as a result reduced somewhat the returns to policyholders. The extent to which companies

make such provision varies widely. A few make none on the basis that they expect no tax liability on policyholders' gains in the foreseeable future. Many set aside a provision that is heavily discounted to reflect the fact that any liability will in general not arise for some years and then be heavily offset by management expenses. It is entirely a matter for each company to determine what effect the new regime will have on the level of provision they make for possible future tax. But, as I have said, in practice the impact of the change on life companies' tax liabilities should be relatively marginal.

We have received a number of representations on this issue and I have discussed it with the Association of British Insurers. I have taken careful note of the points made in this debate which we can consider further in Committee.

CE45

PWP

FROM: MISS C EVANS
DATE: 22 APRIL 1987

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Scholar
Mr Sedgwick
Mr M Williams
Mr Culpin
Miss O'Mara
Mr Cropper
Mr Ross Goobey
Mr Tyrie

PS/IR
Mr Pitts
Mr Walker

SECOND READING DEBATE 22 APRIL: WIND-UP: OIL

... I attach a revised draft of the oil section which takes account of the Chancellor's comments recorded in Mr Hudson's minute of yesterday.

MISS C EVANS

22 April revise

OIL PACKAGE

My rt Hon Friend has outlined the Clauses designed to ease the taxation of oil production, development and research.

The House will need no reminding of the collapse of the oil price at the beginning of last year. But those who prophesied doom then overreacted. The oil price has come back - from the lowest point of $8½ to around $ 18 today. The industry, with admirable resilience, has more than survived. Production from existing sources has continued at a high level. The search for new sources has gone on.

But there has been a cutback in new activity. This is having a harmful effect, not least on jobs in the offshore supplies industry. It is not within the Government's power to alter the economics of new activity in the oil industry in its new, changed, circumstances. Nevertheless we recognise that there is a problem due to the present uncertainty. Having seen the price drop so dramatically, companies are not yet confident of the level at which it will stabilise. Decisions on some new developments are being delayed and this is likely to result in a loss of capacity which will be needed again when activity picks up.

One reason for the delay in new developments could have been cash-flow difficulties of the smaller partners in possible new projects. As early as last autumn, we took action on this with a carefully targetted measure. We brought forward the repayment of some £300 million of Advance Petroleum Revenue Tax. This has now been paid back to the companies.

But there is another reason why a decision to go ahead with a project might be delayed. It may no longer be clear that the project is going to be sufficiently profitable. We do not of course wish to introduce fiscal incentives for companies to go ahead with uneconomic projects. But we think it would be right however to give some help in the present situation to increase the post-tax profitability of new

developments. We propose that for the purposes of Petroleum Revenue Tax a participator in a new offshore oil-field outside the Southern Basin should be allowed, if it wishes, to set up to 10 per cent of qualifying development expenditure in that new field against its profits in another field. The expenditure is that which would qualify for 'uplift' if relieved in its own field.

The aim has been to set this relief at a level which will give a useful benefit without making fields economic after tax which would not be so pre-tax.

The industry had given us a number of suggestions for ways in which they might be helped in the present difficulty, and [while they would have liked more] they have generally welcomed this cross-field allowance.

But this is not an industry which just sits back and hopes for Government help. It has already been acting vigorously to reduce costs. It is these cost reductions which are so important in securing new development work. Our own contribution here is to remedy a gap in the rules for giving Petroleum Revenue Tax relief for research related to oil extraction activities.

(use if needed) [The potential impact of these proposals is far greater than the cost figures shown in the Financial Statement for 1987-88 and 1988-89. The figures there can only be estimates: the actual cost will depend on how companies respond. But more important, much of the incurring of the expenditure and the impact of this on tax receipts comes later; but the measures themselves will enable early decisions to be taken and so orders to be advanced. The cost will build up, and in due course could benefit the industry by over £100 million in a year. The value of orders advanced will of course be much greater than that.]

RH12.51

UNCLASSIFIED

PwP

FROM: A P HUDSON

DATE: 22 April 1987

CHANCELLOR

cc Mr Peretz
Mr Scholar
Mr C W Kelly
Mr Allan
Mr Cropper
Mr Ross Goobey
Mr Mace - IR

FINANCE BILL

At tomorrow's meeting, we can discuss the handling of next week's debate, and how best to organise our material. I attach brief notes of the main points.

2. On income tax, I have included a suggested outline for an opening speech. This can draw extensively on Mr Mace's note on Clause (below).

3. On exchange controls, Ms Goodman's minute covers a lot of material. For tomorrow it might be best to focus on Speaking Note A, at the front, which covers the key arguments.

APH

A P HUDSON

INCOME TAX

Likely form of debate

Difficult for Opposition to amend Bill, but they may put down amendment in favour of Reduced Rate Band.

- If so, Labour will open, with Chancellor to respond.
- If not, or following debate on amendment, debate on Clause stand part, with Chancellor opening and Labour responding.

Positive points to get across

2. Cut in income tax improves incentives.

3. Builds on previous reductions since 1979. Committed to more.

4. Labour Government would mean higher income tax for everybody.

Possible outline of speech

5. Clause 20 very important - not just in itself; but because goes to the heart of difference between parties.

6. Clause itself reduces basic rate by 2p. Means [over £3 a week to man on average earnings etc.] Builds on previous income tax reductions. (Examples.)

7. Real take-home pay up for all. Cf Labour record.

8. Committed to going further. Other parties committed to increase taxes.

9. Difference much more than a matter of bookkeeping: different approach to the economy and society. Government believes in improving incentives to succeed; other parties don't. Government believes low-tax free enterprise economy works better; other parties don't. Government believes in leaving people free to spend their own money; other parties don't.

10. Government approach in van of gathering world consensus (examples); other parties out of step.

Likely Labour arguments

11. Tax burden still higher than 1979.
Needed to get borrowing down to sort out economic mess. Reduced tax burden consistently since 1981. Committed to go further.

12. Tax cuts not sustainable. Will be reversed/VAT increased after election.
Strength of economy means cuts are sustainable. Allegations on VAT merely a smokescreen to try to hide Labour plans.

13. Income tax cuts wrong social choice.
Part of "hat-trick", alongside increase in priority spending.

14. Income tax cuts wrong economic choice.

- Jobs. Income tax reductions stimulate enterprise and hence create more jobs.
- Fuel consumer boom. Growth of consumers' expenditure expected to be lower in 1987 than 1986.
- Suck in imports. Effect same as wage increase. Why assume British firms unable to respond to extra demand? Forecast shows no increase in rate of growth of imports in 1987.

15. Rich have done much better than poor under this Government.
Real take-home pay up for all - unlike under Labour. This Budget restricts benefit at top levels. But no apology for necessary cuts in top rates in 1979. Yield of higher rate tax gone up, and top 5 per cent pay higher share of burden, in spite of cuts since 1979.

16. Should have reintroduced Reduced Rate Band.
Reduced Rate Band very costly, and has less impact on incentives than basic rate cut. Complicated for employers and the Revenue.

EXCHANGE CONTROLS

Likely form of Debate

1. The Opposition may put down an amendment which would introduce their own scheme of tax penalties on investment overseas.

   - If so, Labour will open and the Chancellor responds.
   - If not, or following that debate, Chancellor will open on Clause stand part.

Positive points to get across

2. Abolition of controls wholly beneficial to economy.

3. Controls inefficient and damaging at any time. Now unlikely to be technically viable.

4. Abolition facilitated build up of net overseas assets.

Likely Labour arguments

5. Tax penalty on overseas investment a better approach

   - Against interests of pensioners/investors.
   - Difficult to operate.
   - No shortage of funds for investment. Labour's National Investment Bank unnecessary, and previous similar bodies failed disastrously.

CE45

RWP

FROM: MISS C EVANS
DATE: 22 APRIL 1987

12/2

FINANCIAL SECRETARY

cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Minister of State
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Kemp
Mr Monck
Mr Scholar
Mr Odling-Smee
Mr Sedgwick
Mr Riley
Mr Mowl
Mr G P Smith
Mr Culpin
Miss O'Mara
Mr Short
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Hudson
Mr Gibson

PS/IR
Mr Mace
Mr Eason
Mr Walker

PS/C&E
Miss French

SECOND READING DEBATE 22 APRIL: WIND-UP: BURDEN OF TAX

... I attach a revised version of the speech and defensive material which takes account of the Chancellor's comments.

CE

MISS C EVANS

CE37

22 April revise

SECOND READING DEBATE - WIND-UP SPEECH

BURDEN OF TAX

Mr Speaker many hon Members will be as surprised as I was by the Labour Party's decision to choose the burden of tax as a theme to attack the Government in this debate. Bereft of all other arguments they cling to this although a dispassionate observer might think this approach was something of an own goal for a party committed to creating a high spending, high borrowing, high tax economy. Their position is riddled with contradictions. On the one hand they intend to vote against the income tax reductions contained in the Finance Bill and they are committed to reversing them if they came to power. They accuse us of seeking to bribe people by cutting taxes. Then in the same breath they argue that taxes are too high and they revert to their latest favourite theme - the burden of tax. They really must be desperate.

2. We have cut the basic rate from 33p to 27p. We have increased personal allowances by 22 per cent in real terms, bringing the married man's allowance to its highest real level since the war and taking 1.4 million people out of tax compared with simply indexing the regime we inherited from Labour. During the last Labour Government the basic rate went up as high as 35p and personal allowances actually fell in real terms.

3. The tax burden concept can be measured in various different ways. But what really matters to ordinary people is whether or not they are better off ie what happens to their real take home pay after taking account of inflation. The record is absolutely clear and it demolishes the opposition's case. At all levels of earnings real take home pay has increased substantially under this Government. Under the last Labour Government living standards hardly rose at all for many people and actually fell for single people at all multiples of average earnings. For a man on average earnings with 2 children real take home pay has gone up by over 21 per cent since 1978-79. For the same man real take home pay went up by less than 1 per cent between 1973-74 and 1978-79 -hardly any increase at all. And the

comparison holds for lower earners as well. For the man with 2 children on half average earnings between 1978-79 and 1987-88 real take home pay went up by 17.5 per cent. This compares with only 4 per cent under Labour. But what about the people at the bottom - those whom Labour claim to defend? For this group too, the bottom decile of the earnings distribution, real take home pay has increased by more under this Government than under Labour.

NEXT PARA IF CHALLENGED ON BOTTOM DECILE

4. [We do not yet have the figures for the growth of earnings of people at the bottom decile to 1987-88. On cautious assumptions we estimate that the increase will be 6.5 per cent between 1978-79 and 1987-88 which compares with 4.1 per cent between 1973-74 and 1978-79. if pressed [This is an annual rate of increase of 0.8 per cent under Labour and 0.7 per cent under this Government.] Our record for the people at the bottom bears comparison with the last Labour government, [notwithstanding the fact that their policies were deliberately skewed towards the lower paid which had the effect of distorting the labour market, compressing differentials and adding to the difficulties of the economy.] possibly omit to shorten While it is undoubtedly true that the ending of incomes policy has meant that the increase in incomes for people at the bottom has been less than the average, Family Income Supplement, which is available to low income families in work, has been increased by between 13 and 25 per cent in real terms depending on the age of the children. [The figure of 2 per cent for the increase in earnings at the bottom decile since 1978-79 quoted by the hon Gentleman/Lady opposite is out of date, it relates only to the period to April 1986, and thus leaves out the effects of 1986 and 1987 Budgets. As I have said, on cautious assumptions, we estimate the increase in real take home pay for married man with two children at the bottom decile between 1978-79 and 1987-88 at 6.5 per cent.] Whatever comparisons the Opposition may draw about the rates of increase in real earnings at the bottom decile under this Government and under Labour, one fact is inescapable. Under this Government real take home pay has increased for everyone, at all levels of income. This was not the case under Labour, when real incomes actually fell for many people.]

5. Ordinary people understand that they are better off under this Government. Let me take just one example, the nurse. [The Hon Member opposite points out that] the nurse is now paying a higher proportion of her income in tax and NIC than she was in 1978-79. But the nurse will have seen her real take home pay go up by over 33 per cent between 1978-79 and 1986-87 compared with only 14 per cent between 1973-74 and 1978-79.

6. Faced with these facts on real take home pay Labour seek to divert attention to the burden of tax. This Government has reduced taxes in every Budget since 1981. We are committed to continuing to reduce taxes. I ask the House to consider what the position would be without the reductions we have made. The burden of income tax and national insurance contributions today is lower for all family types, at all levels of income, than it would be if we had simply indexed Labour's regime. For a married man on average earnings with 2 children an indexed Labour regime would mean paying £4.85 a week more in income tax and national insurance contributions.

7. One thing is absolutely clear. Whatever Labour may say about the burden of tax under this Government - it would be much, much higher if they were in office. Their spending commitments amount to £34 billion - to raise this from income tax would mean at least doubling the basic rate.

8. I could go on at length about the contradictions in Labour's position. But I turn now to the impact of this year's Finance Bill, which is the subject of this debate. The overall impact of the Bill is to reduce taxes in 1987-88 by £2.6 billion. As a result of the implementation of the Bill we estimate that the percentage of earnings taken in income tax, NICs and indirect taxes will fall for virtually everyone, except the very highest paid. This is a Budget designed to reduce the burden of tax. As a result of the income tax changes alone a married man on average earnings will be £3.87 a week better off. A primary school teacher married to a nurse will be better off as a couple by £7.59 a week. People whose mortgage rates come down next month will gain a further benefit. A married man with no children on average earnings with an average mortgage will be

£5.37 a week better off as a result of the Budget changes and the fall in mortgage interest rates. The cut in the basic rate to be effected by Clause 20 will benefit all taxpayers.

9. [Members opposite have seen cause for criticism in the fact that the lowest 34 per cent of taxpayers received only 12 per cent of the total reduction in income tax. The explanation for this is simple. The bottom 34 per cent contributed only 9 per cent of the total income tax take in 1986-87 - in other words they have received a share of the reduction which is greater than their contribution to the total.]

10. Mr Speaker, the Government welcomes the Labour Party's conversion to the cause of those who seek to reduce the burden of tax. We agree that the tax burden is still too high and we intend to continue to reduce it when prudent to do so. Tax reduction is a cardinal element of the Government's policy. We believe that cutting taxes is the single most effective measure available to us to encourage enterprise and improve the prospect for output and jobs. As my rt hon Friend the Chancellor said in his Budget speech there is now a worldwide consensus on the economic desirability of tax reform and tax reduction, and in particular, the reduction of income tax. We are reducing income tax without any increases in indirect tax rates and the Red Book indicates scope for further reductions in taxation in each of the next three years. The Government remains committed to the prudent reduction of the overall burden of taxation. We are the only party with such a commitment; and we are the only party with a track record of tax reductions.

BURDEN OF TAX: DEFENSIVE BRIEFING

TAX AS PER CENT OF GDP

Burden of tax as per cent of GDP increased since 1978-79 (from 33.8 to 38.0 - FSBR estimate for 1987-88)?

When we came to power we recognised that we had to put taxes up initially in order to reduce the massive and unsustainable PSBR which we inherited from Labour. Since 1981-82 the burden has been reduced. We are committed to reducing it further when prudent to do so. Now that we have brought borrowing down to 1 per cent of GDP, and with continued restraint in public spending, the Red Book shows a clear prospect of reductions in the tax burden in each of the next three years.

REAL TAKE HOME PAY

The Government is taking credit for high real take home pay - how is this consistent with calls for pay restraint?

We are not arguing that those in work should take pay cuts in real terms. In a strong healthy economy, real wages and living standards can continue to rise. But we are saying that lower rises in average real pay would mean more jobs in the long run. We have stressed the need for more flexibility in relating pay and performance - that is why the Finance Bill contains the new Profit Related Pay scheme.

VAT PLANS

Government planning VAT increases to fund direct tax cuts?

These allegations are purely fanciful. My rt Hon Friends the Prime Minister and the Chancellor have denied them repeatedly, firmly and publicly. These scare stories show how desperate the opposition must be to distract attention from their own high tax policies. The House will remember that we have heard all these 'secret agenda' allegations before in 1983. They were wrong then and they are wrong now. The Finance Bill provides for cuts in income tax without

increasing in indirect taxation. The Red Book fiscal adjustment projections show that, with continued restraint in public spending, reductions in the burden of tax will be possible in each of the next three years, and these do not depend on increases in indirect taxes.

The Labour Party is clearly desperate to put up a smokescreen to hide the fact that we are the party of lower taxation and they are the party of higher taxation.

RH12.51

UNCLASSIFIED

PWP

FROM: A P HUDSON
DATE: 22 April 1987

CHANCELLOR

cc Mr Peretz
Mr Scholar
Mr C W Kelly
Mr Allan
Mr Cropper
Mr Ross Goobey
Mr Mace - IR

FINANCE BILL

At tomorrow's meeting, we can discuss the handling of next week's debate, and how best to organise our material. I attach brief notes of the main points.

2. On income tax, I have included a suggested outline for an opening speech. This can draw extensively on Mr Mace's note on Clause (below).

3. On exchange controls, Ms Goodman's minute covers a lot of material. For tomorrow it might be best to focus on Speaking Note A, at the front, which covers the key arguments.

APH

A P HUDSON

INCOME TAX

Likely form of debate

Difficult for Opposition to amend Bill, but they may put down amendment in favour of Reduced Rate Band.

- If so, Labour will open, with Chancellor to respond.
- If not, or following debate on amendment, debate on Clause stand part, with Chancellor opening and Labour responding.

Positive points to get across

2. Cut in income tax improves incentives.

3. Builds on previous reductions since 1979. Committed to more.

4. Labour Government would mean higher income tax for everybody.

Possible outline of speech

5. Clause 20 very important - not just in itself; but because goes to the heart of difference between parties.

6. Clause itself reduces basic rate by 2p. Means [over £3 a week to man on average earnings etc.] Builds on previous income tax reductions. (Examples.)

7. Real take-home pay up for all. Cf Labour record.

8. Committed to going further. Other parties committed to increase taxes.

9. Difference much more than a matter of bookkeeping: different approach to the economy and society. Government believes in improving incentives to succeed; other parties don't. Government believes low-tax free enterprise economy works better; other parties don't. Government believes in leaving people free to spend their own money; other parties don't.

10. Government approach in van of gathering world consensus (examples); other parties out of step.

Likely Labour arguments

11. Tax burden still higher than 1979.
Needed to get borrowing down to sort out economic mess. Reduced tax burden consistently since 1981. Committed to go further.

12. Tax cuts not sustainable. Will be reversed/VAT increased after election.
Strength of economy means cuts are sustainable. Allegations on VAT merely a smokescreen to try to hide Labour plans.

13. Income tax cuts wrong social choice.
Part of "hat-trick", alongside increase in priority spending.

14. Income tax cuts wrong economic choice.
- Jobs. Income tax reductions stimulate enterprise and hence create more jobs.
- Fuel consumer boom. Growth of consumers' expenditure expected to be lower in 1987 than 1986.
- Suck in imports. Effect same as wage increase. Why assume British firms unable to respond to extra demand? Forecast shows no increase in rate of growth of imports in 1987.

15. Rich have done much better than poor under this Government.
Real take-home pay up for all - unlike under Labour. This Budget restricts benefit at top levels. But no apology for necessary cuts in top rates in 1979. Yield of higher rate tax gone up, and top 5 per cent pay higher share of burden, in spite of cuts since 1979.

16. Should have reintroduced Reduced Rate Band.
Reduced Rate Band very costly, and has less impact on incentives than basic rate cut. Complicated for employers and the Revenue.

EXCHANGE CONTROLS

Likely form of Debate

1. The Opposition may put down an amendment which would introduce their own scheme of tax penalties on investment overseas.

   - If so, Labour will open and the Chancellor responds.
   - If not, or following that debate, Chancellor will open on Clause stand part.

Positive points to get across

2. Abolition of controls wholly beneficial to economy.

3. Controls inefficient and damaging at any time. Now unlikely to be technically viable.

4. Abolition facilitated build up of net overseas assets.

Likely Labour arguments

5. Tax penalty on overseas investment a better approach

   - Against interests of pensioners/investors.
   - Difficult to operate.
   - No shortage of funds for investment. Labour's National Investment Bank unnecessary, and previous similar bodies failed disastrously.

1779/20

FROM: I POLIN

DATE: 22 April 1987

1. MR KELLY
2. PARLIAMENTARY CLERK

cc: PS/Chancellor
PS/EST
Sir P Middleton
Sir G Littler
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Board
Mr Neilson
Mr Hyett - T Sol
Mr Norman - B/E
Mr Michael - IR
Miss S Wallis
Mr P Graham - Parliamentary Counsel
Miss Hughes - Legislative Draftsman's Office
Mr G Kowalski - Lord Advocate's Dept

NOTES ON CLAUSES

I attach your 19 copies of a revised Part I of the Note on Clause 161. CRU are making a further 45 copies which they will let you have directly.

I POLIN

encs

1779/005

Finance Bill 1987
Clause 161

CLAUSE 161: REGULATION OF FINANCIAL DEALINGS

Summary

1. This clause provides definitions of gold and foreign currency to replace the references to the definitions in the Exchange Control Act used in the Banking and Financial Dealings Act 1971.

2. Section 2 of the 1971 Act enables the Treasury to suspend financial dealings if necessary to do so in the national interest. Subsection (1) enables the Treasury to give a direction that no person shall deal in foreign currency of such kind as may be specified (paragraph (b)) or in any gold (paragraph (c)). By subsection (6) "foreign currency" and "gold" have the same meanings as in the 1947 Act.

3. Paragraph (a) amends paragraph (c) of section 2(1) of the 1971 Act which enables the Treasury to give directions in respect of gold. It is being amended so that the direction may prohibit dealings in particular types of gold or gold generally.

4. Paragraph (b) replaces the definition of foreign currency and gold in Section 2(6) of the 1971 Act which refers to the Exchange Control Act. The definition of foreign currency is being extended to cover units of account defined by reference to more than one currency. This brings it into line with the definition used in section 113 of the Finance Act 1986. It means that the directions may cover for example dealings in European Currency Units and Special Drawing Rights. The existing definition of gold covers only coin and bullion. There are a number of types of gold other than coin and bullion. The definition is being amended so that all types of gold are covered; gold wafers are specifically mentioned as well as gold coin and gold bullion.

pup

FROM: A BOTTRILL

DATE: 22 April 1987

MR CULPIN

cc: PS/Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Mr Cassell
Mr Peretz
Mr Sedgwick
Ms O'Mara
Mr Owen
Mr Cropper
Mr Ross Goobey
Mr Tyrie

TCSC REPORT ON THE BUDGET

Mr Sedgwick asked me to let you have comments on paras 42-43 on the balance of payments. The TCSC suggests that the FSBR forecast of a £2½ billion current deficit in 1987 may be too pessimistic. We would be reluctant, however, to put a new forecast into circulation even implicitly by commenting too fully on the Committee's projection at this stage. I suggest, therefore, something along the following lines:

> 'It is true that the out-turn for the balance of payments so far this year has been encouraging. The trade figures for January and February were particularly good suggesting that the current balance was in surplus. It is too early, however, to revise the forecast for the year as a whole. [If necessary: The average of projections by outside commentators is still for a current deficit of £2¾ billion in 1987.]'

2. You will be aware already that publication of the March trade figures - due on 28 April - is to be delayed as a result of industrial action at Customs. The putative revised publication date is 1 May, but DTI is waiting to confirm that this can be met. Their present intention is to announce the delay and the revised date this Friday, 24 April.

ABottrill

A BOTTRILL

Reference ....

pry

Mr. Allan

Press office are not under any pressure on this issue, but I'll put round the attached note if you think the Cx would be content with the line it takes.

CJR

22/4

Ch

This was never used. Are you content for possible future use?

AA

CODE 18.78

FROM: C J RILEY
DATE: 22 APRIL 1987

MR PICKFORD

cc PPS
PS/Financial Secretary
Sir P Middleton
Sir T Burns (o/r)
Mr Odling-Smee (o/r)
Mr Peretz
Mr Sedgwick
Mr Scholar
Mr Turnbull
Mr Culpin (o/r)
Miss O'Mara
Mr Ross Goobey

TCSC REPORT ON THE BUDGET: THE PSBR

There is essentially one main problem area in the section of the Report on fiscal policy.

2. The Report complains that the Chancellor has offered no arguments on the appropriate ratio of public sector debt to GDP. He has justified the 1% PSBR figure on the grounds that it would prevent the debt ratio rising (in line with the arguments in the Lombard speech), but then for example so would a budget surplus. The implication is that a more precise objective for the debt ratio is required.

3. I think our line on this particular issue is:

- that there is no uniquely correct ratio of debt to GDP which the Government should aim for, and a precise target is thus not appropriate. (Balance sheet data do not help, not least because the measurement problems are so great.)

- the key requirement is that borrowing and debt positions should be sustainable. This means avoiding sustained movements in the debt ratio over time, particularly upwards. (The Report acknowledges this in paragraph 27).

- if we stick to the 1% PSBR objective, the debt ratio will fall over the next few years. This is no bad thing since it is currently higher than in most other major economies.

- to go for a Budget surplus, a possibility the Report raises in paragraph 27, would be unnecessarily restrictive.

3. The Report also urges the Treasury to address this issue more fully in future versions of the MTFS. I imagine that if the Chancellor wished to set out his thinking in more detail he would prefer to do so in a speech rather than in the text of the MTFS.

C J RILEY