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PART B

Part B.

SECRET

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Begins: 23/5/84
Ends: 22/10/84

PO -CH /NL/0076



PART B

Chancellor's (Lawson) Papers:

**ENTERPRISE INITIATIVES
FOR INDUSTRY AND
EMPLOYMENT**

PO -CH /NL/0076
PART B

Disposal Directions: 25 years

Dr. Lawson

25/7/95



10 DOWNING STREET

From the Private Secretary

23 May 1984

Re David

SEMINAR ON INDUSTRY AND EMPLOYMENT

N.B. // In my letter of 19 May I promised circulation of a DTI paper on export promotion. The Secretary of State for Trade and Industry will be unable to attend the meeting and will not therefore be circulating his paper for discussion at this time.

I attach a further annex on measures to encourage wider share ownership which should be attached to the Policy Unit paper you have already received.

I am copying this letter to David Normington (Department of Employment), Michael Reidy (Department of Energy), John Ballard (Department of the Environment), Elizabeth Hodgkinson (Department of Education and Science), Callum McCarthy (Department of Trade and Industry), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Young (Manpower Services Commission) and Richard Hatfield (Cabinet Office).

*Your sincerely
Andrew*

Andrew Turnbull

David Peretz, Esq.,
H.M. Treasury.

VSCABS

TAX AND OTHER LEGISLATION DESIGNED TO ENCOURAGE
EMPLOYEE SHARE OWNERSHIP AND WIDER
SHARE OWNERSHIP MORE GENERALLY

A. EMPLOYEE SHARE OWNERSHIP

(Annex A gives figures)

1. Profit Sharing

The reliefs available under the Finance Act 1978 for approved all-employee schemes were made more generous in 1980, 1982 and 1983. Annual limit on value of share allocation per employee is now £1250 or 10 per cent of salary (subject to a ceiling of £5000) compared to £500 in 1979. Minimum retention period for employee shareholdings to attract most favourable tax treatment is now 7 years compared to 10 years.

2. Share Option Reliefs

A new relief was introduced in 1980 for approved all-employee SAYE-linked share option schemes. In 1982 a 3-year instalment relief was provided to spread payment of income tax arising on share options exercised outside these approved schemes - typically by senior managers.

The 1984 Finance Bill:

- (a) increases the monthly savings limit under the SAYE-linked schemes from £50 to £100;
- (b) extends to 5 years the instalment relief for unapproved options granted before 6 April 1984; and
- (c) introduces from 6 April 1984 a new relief for share options granted under schemes satisfying various conditions to qualify for Inland Revenue approval, the usual income tax charge on exercise of the option being replaced by CGT liability on disposal of shares.

3. Employment Act 1982

Companies with over 250 employees required to make an annual statement about employee involvement arrangements, including financial participation.

4 Interest Relief

Section 24 Finance Act 1983 provides relief for interest paid on loans taken out by employees to buy shares in their employee - controlled company as part of an employee buy-out. Other measures have been introduced to improve the relief available to people investing in their business: close companies (1982), co-operatives (1981) and partnerships (1981).

B. MEASURES ENCOURAGING WIDER EQUITY INVESTMENT GENERALLY

5. Stamp Duty

The cut in the rate of stamp duty to 1 per cent, announced in the 1984 Budget from the 2 per cent rate imposed by the Labour Government in 1974 removes an important disincentive to investment in equities. The reduction in the rate of duty on share transfers should encourage direct share ownership by individuals as well as institutions.

6. Capital Taxation Generally

Capital taxation has been reduced to encourage investment and enterprise. Since 1979:

- (a) the CGT threshold has been increased from £1,000 to £5,600;
- (b) the CTT threshold stands at more than double its 1979 level, (£64,000 rather than £25,000) and the cumulation period has been cut to 10 years. This is of particular value to family firms;
- (c) the 1984 Budget cut the top rates of CTT from 75 per cent to 60 per cent (transfers on death) and from 50 per cent to 30 per cent (lifetime transfers). Again this helps family firms;
- (d) an indexation allowance has been introduced for CGT, and CTT rate-bands index-linked.

7. Investment Income Surcharge

The investment income surcharge (chargeable for 1983-84 at 15 per cent on an individual's investment income in excess of £7,100) has been abolished with effect from 1984-85. The surcharge was a factor in discouraging individuals from saving or investing directly, in particular in equities, and abolition therefore removes one element of discrimination against direct investment. A total of some 280,000 taxpayers will benefit, at a cost of about £360 million in a full year.

8. Abolition of Life Assurance Premium Relief (LAPR)

The 1984 Finance Bill proposes to abolish LAPR on life assurance contracts made after 13 March 1984 (and existing ones, if subsequently enhanced). This will reduce the fiscal distortions which favoured investment in life assurance and, together with other tax reform measures, should remove biases which encouraged individuals to invest in institutions rather than directly in equities.

9. Venture Capital Scheme

This was introduced in 1980 to encourage the flow of risk capital into small businesses. It enables investment companies, as well as individuals, to set losses from investments in unquoted shares against income instead of capital gains, thereby enhancing the value of the loss for tax purposes. Thus the relief offers reassurance to those who provide risk capital by sharing with them any loss on the failure of their investment.

10. Business Expansion Scheme

The BES was introduced in 1983 and greatly extended the 1981 Business Start-Up Scheme. It is an unprecedented measure, more closely targeted but also far more generous than, for example, the Loi Monory. It offers income tax relief at full marginal rates on up to £40,000 a year to encourage individual outsiders to invest in the full-risk ordinary shares of new and expanding unquoted trading companies.

11. Purchase of Own Shares

The 1982 Finance Act eased the tax charge when unquoted companies buy back their own shares to the benefit of their trade. This encourages more equity investment because owners and investors are often understandably concerned about finding a way out. Thus, for example small companies should be encouraged to set up employee share schemes since with a buy-back provision their shares are more readily marketable. The measure can also assist "management buy-outs" - the managers purchasing a small number of shares and the company buying back (and cancelling) the balance held by existing shareholders.

TAKE-UP OF EMPLOYEE SHARE SCHEMES

1. By 30 April 1984 the total number of schemes qualifying for tax relief was 689 (397 Finance Act 1978 profit sharing and 292 Finance Act 1980 savings-related share option schemes). Compares with less than 30 approved schemes in 1979 when Government took office. No reliable figures for unapproved share option schemes but estimated there may be around 1000.
2. Number of approved schemes considerably understates number of companies since many schemes cover group of companies. No precise figures of total numbers but estimated that there are currently approaching 2000 companies participating in profit sharing schemes and over 45000 in SAYE-linked share option schemes; figures cannot be cumulated as some companies will participate in both but total must certainly be in excess of 5000.
3. Estimated that nearly $\frac{1}{2}$ million employees have benefited under approved schemes since 1979 (ie have been allotted shares or given options to buy shares). A 1981 commercial survey estimated that companies employing total of over $1\frac{1}{2}$ million employees had some form of scheme, approved or unapproved.
4. In money terms (on basis of estimated figures up to March 1983) employees have been allocated fml95 worth of shares under profit sharing schemes and been granted options under SAYE-linked schemes to value of £350m. No figures available for unapproved schemes.

23 May 1984

CHANCELLOR

cc Sir P Middleton

WIDER OWNERSHIP: PAPER BY POLICY UNIT

This paper deals with the virtues of wider ownership and ways of extending it further. It concentrates on ownership of homes and of shares, particularly by employees.

2. You will agree with its general thrust but some of the specific proposals have public expenditure or revenue costs. Even when they are desirable, you will want to resist any commitment on whether or when they should be done.

3. The biggest proposal is a further reduction in stamp duty, relevant both to housing and to shares of course. You might be able to use this proposal to win support for getting revenue and tax changes on pension schemes, which is helpfully mentioned on page 6 and covered by the conclusion in favour of "fiscal neutrality between savings mechanisms".

Housing

4. The proposals which would or could raise public expenditure are: a(iii), b(ii) and (iii), c(iii) and c(v).

5. On the first of these 74% of land is already registered. The Chief Secretary has recently agreed to an extra 400 staff spread over 2 years which will raise the registered proportion by 5% a year. It will reach 85% by the end of 1986-87 and, with the help of computers, be complete within 10 years.

6. b(ii) would reduce the negative public expenditure scored by sales of council houses, unless the change was offset by the increase in the number of sales.

7. b(iii) has already been agreed in principle by the Chief Secretary. This like some of the other proposals would help mobility of labour.

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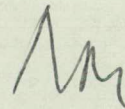
8. c(iii) is odd. There seems no case for encouraging building by local authorities when the private sector can do it cheaper. There is already a programme of improvement for sale by local authorities which involves public expenditure on start up costs, though it is recovered in the end. c(v) would also raise public expenditure.

Wider shareholding

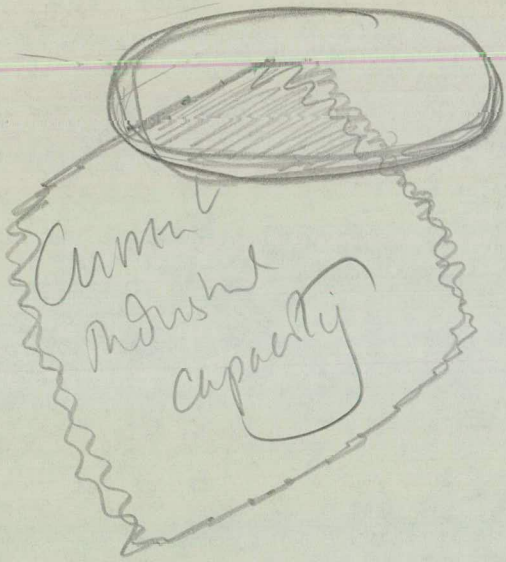
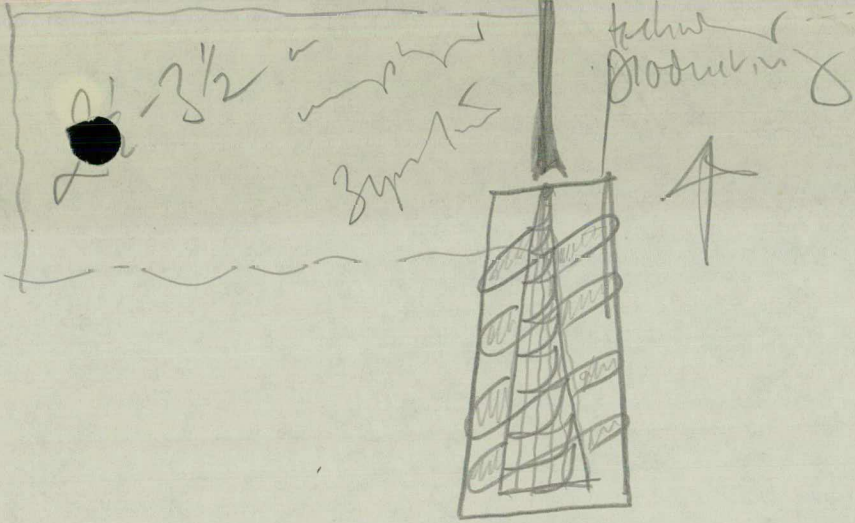
9. The enterprise allowance proposal on page 4 is dealt with elsewhere. Incentives to employees for privatised nationalised industries are familiar ground. The "DTI paper" at Annex A consists largely of material prepared in the Treasury for No 10.

10. Apart from fiscal neutrality between savings instruments, most of the other disincentives to shareholding by individuals should, as the paper says, be reduced by the reform of the stock exchange provided nothing is done to restrict the development of retailing.

11. On tax measures ^{already taken} to help share ownership you will want to have by you the Inland Revenue note which was attached to Mr Folger's submission of 15 May.



N MONCK



23 May 1984

CHANCELLOR OF THE EXCHEQUER

cc Sir P Middleton
Sir T Burns

INDUSTRY AND EMPLOYMENT

The agenda was set out in Mr Turnbull's letter of 9 May. It has been widened by the inclusion of 2 papers by the No 10 policy unit on Wider Ownership and Entrepreneurship in the Regions and the DTI's paper on export promotion. But the main papers are the two by Mr King on:

↑ not now coming as Mr Tebbit can't attend

- (a) Employment Prospects and
- (b) Policies Affecting the Labour Market and Employment.

This brief is concerned with these 2 papers, though in view of the classification I have not consulted on the detail in the normal way.

2. The origin of the papers was a Cabinet discussion on 1 March of the bad unemployment figures which Mr King was about to announce. So there will presumably be a report back to Cabinet at some stage on employment prospects and possible Government action.

Employment prospects

3. This paper sets the scene - a prospect that adult unemployment in three year's time might be somewhere in the range of 2½-3½ million. A separate brief on this paper, which was discussed with Sir T Burns, is at Annex 1. Annex 2 gives OECD standardised unemployment from 1981 onwards. You might also like to have Mr Evans' note of 18 May on "Activity in the Labour Market" by you.

Policies Affecting the Labour Market and Employment

4. Mr King focusses on the next three years. He thinks that unemployment needs to be falling significantly by 1986 if the Government is to win the next election.

Diaper

MONCK
BRIEF

4A. He is personally hopeful that the existing economic strategy will produce an adequate fall in unemployment. But he makes two proposals:

- a. An "early initiative" - partly a campaign of speeches by Ministers (including you and Mr Tebbit); partly a package of measures. The package would include a voluntary version of Lord Cockfield's "Passport for a Job" and opening the Enterprise Allowance scheme to all comers (paras 6-9); and
- b. work on further contingency measures which could be taken in early 1986 if unemployment had not clearly turned down by then. This work would cover i) the scope for more special employment measures and ii) additional labour intensive public expenditure, presented as substituting for expenditure with a lower job content but in practice largely net increases (Paras 10-12).

5. In general, given the scope for these subject to generate challenges either to the MTFs or, via additional public expenditure, to your tax commitments, these proposals do not look too alarming, apart from the signs that Mr King may be coming out as a supporter of the reflationist infrastructure lobby. But there are still a lot of points you will want to make, particularly on public expenditure in the current year.

An early initiative - Line to take

6. The content of the speech campaign on the scope for jobs created by Government steps to improve the labour market is most clearly described in paragraph 4. ^{for the paper}

You will want to consider the possible impact of such a campaign on the "confrontationist" element in the TUC, particularly if it were mounted before the TUC's September Congress. But subject to that, you might say:

- a. The campaign is a good idea but it will take time to work up its main themes and to ensure they can be attractively expressed. (The material on labour markets ought also to be linked to policies on

✓✓
product markets, competition and the phasing out of trade distortions and subsidies.) The campaign's content ought to be good enough to stand by itself without the support of new special employment measures and should not depend on them. Despite their potential illustrative value, their quantitative net effect on unemployment is not big enough to be decisive;

- ✓✓
b. if, however, new measures are eventually agreed (see below), there are serious risks in an announcement before the summer break. It would look panicky about unemployment. Financial markets might be alarmed by additional expenditure announced in isolation from wider announcements later in the year after the public expenditure decisions are complete. There seems no need to run these risks, especially as it will in any case take time to work up the campaign.

7. On possible new measures (listed in Annex 1 of the paper) you might:

- c. ask what purely legislative ie costless changes affecting the labour market Mr King proposes (eg abolition of wages councils), or the repeal or modification of protection against dismissal generally, and opposed to the young who would be exempted by the passport (para A14-16 in Annex 1 of the paper).

More detailed briefing below prepared with Lord Colclough first floated the idea
There are some attractions in the passport idea. Young people accepting jobs with pay up to say £45 a week would be exempted from employee and employer National Insurance contributions and income tax. (See A.8-11 in Annex 1 of the paper). But you will want to:

- d. ensure that any remit for further work on special employment measures should be about whether Mr King's proposals are desirable as well as about how they should be carried out; this is not an occasion for firm decisions without proper examination;

- ✓✓
- e. although you welcome Mr King's suggestion in his para 8) that he could contain the cost of his proposals within existing PES provision by hypothecating estimating savings from, for example, the Youth Training Scheme, you should point out that it is not at all safe for Mr King to assume that estimating savings can be spent on new discretionary expenditure.

NB

For the current year, in view of the state of the Contingency reserve any estimating savings will certainly have to be surrendered. It may also be necessary for future years. For example Mr King himself has some estimating changes which are additional bids, notably on redundancy payments and salaries. Costs, whether public expenditure or revenue loss, clearly need to be looked at thoroughly. So do the benefits, which will be reduced by the high - perhaps 80% - expected "dead weight" (see Para A.9 of Annex 1 of the paper) and borderline cases. The Inland Revenue are concerned that the scheme would break the principle that earnings above the threshold (now equivalent to £39 a week) create a tax liability.

8. Mr King quotes costs of £36m a year in lost revenue for the passport scheme and up to £78m for the enterprise allowance scheme. There has been some preliminary official work but the figures are not yet firm. What is clear is that any costs whether lost revenue or public expenditure must as a minimum be matched by net savings on Mr King's programmes for future years. For the current year savings must be surrendered.

Further action - Line to take

9. The phrase about "replacing" less labour intensive with more labour intensive public expenditure has little practical meaning. So the apparent proposal is almost certainly a large net addition to public expenditure which means higher taxes and/or interest rates unless a departure from the MTFs is being proposed. I advise you to:

- ✓✓
- f. resist any further work on boosting labour intensive expenditure. It could be damaging if it leaks, as would certainly be likely if concrete contingency

plans were wanted, and the public works proposals could look like a U turn. We already know that special employment measures can be increased quickly and have a quick effect on unemployment, as Mr King says in para 11(i). By contrast to assist as many as 150 to 200,000 people would take very roughly £5 billion of public construction investment on the assumption of fixed money supply. (The figure would be lower if monetary policy were accommodating or if the unemployment effect were achieved by current expenditure on public service jobs).

10. If, however, Ministers decide they want some work done, preferably confined to comparing the effects of additional expenditure on public works and official employment measures, the remit should be given to you since it goes beyond the competence of any other department (and also as damage limitation).

Other points

11. Annex 2 to Mr King's paper contains a summary of what has already been done to free the labour market. Annex 1 lists possibilities for future action. I draw attention to a few of these in Annex III to this brief either because they are likely to be raised or because they are your responsibility.

Conclusion

12. The main issues at this meeting arise on Mr King's proposals for an early initiative - part words part deeds - and for contingency work on labour intensive public expenditure. I recommend you to take the line set out in points a. to f. in paragraphs 6 to 9 above, and in paragraph 10.

N MONCK

SECRET

LABOUR MARKET TRENDS AND PROSPECTS

1. This paper has been discussed with Sir Terence Burns who is broadly in agreement with it.

2. The section on the past year points to the rise in total employment following a continuous fall since 1979. But unemployment did not fall, because of the rise in the labour force, itself partly due to higher activity rates.

3. Although unemployment (seasonally adjusted, excluding school leavers) fell by 1,000 in April, the underlying trend is still upwards. There is no reason yet to doubt the Budget forecast of continuing growth in employment and a flattening out of unemployment during 1984.

4. The section on the prospects for the next three years is consistent with the assumptions underlying the MTF5 and with the discussion in Annex 3 of the Green Paper about output, productivity and employment growth. This concluded that:

"Overall output growth of $2\frac{1}{4}$ per cent a year to 1988-89 and $1\frac{1}{2}$ to 2 per cent a year after that should be consistent with a steady decline in unemployment. Higher output growth would of course imply a greater decline in unemployment."

Actually our underlying projections showed little change in unemployment over the period to 1988, and then some fall, partly reflecting the slowdown in labour force growth expected after about 1988.

5. Although we would not wish to quarrel with the central assumption of a stable path for unemployment, the paper perhaps underestimates the likelihood of a wide variation around the central view. We were surprised by how much unemployment rose in the early 1980s, and similarly large changes could occur - in either direction - again.

6. Unfortunately an unexpectedly large fall in unemployment would probably not be a pure gain. To the extent that it was associated with unexpectedly slow productivity growth, perhaps because people were pricing themselves back into jobs or labour hoarding was building up again, there would be unfavourable implications for our level of productivity relative to other countries and hence perhaps for our competitiveness (both price and non-price) and, in the long run, our relative living standards. To the extent that it was associated with unexpectedly fast output growth, there could be worries about the inflationary implications.

7. The paper is correct to identify slower earnings growth as an important route which might lead to a larger fall in unemployment. It does not discuss how this might come about. The policies that are likely to be most conducive to slower earnings growth and to other factors contributing to lower unemployment are

those that encourage flexibility, competition and efficiency in both labour and goods markets, including: openness to international competition, privatisation, reduction in subsidies and other industrial support, reduction in labour restrictive practices, etc.

8. The role of macro-economic policies is to provide a stable environment with declining inflation. It would not be consistent to attempt to lower unemployment by easing the pressure on companies or by being deliberately expansionary whether through a massive infrastructure investment programme or any other fiscal relaxation. The right route is to make markets work better (supply side) in the ways listed in the previous paragraph. This is the way to improve the prospects for sustainable growth and a reduction in unemployment within the macro-economic framework of the MTFS.

OECD STANDARDIZED UNEMPLOYMENT; PER CENT OF TOTAL LABOUR FORCE; SEASONALLY ADJUSTED

	1983			1984				1983				1984			
	1981	1982	1983	Q1	Q2	Q3	Q4	Q1	Oct	Nov	Dec	Jan	Feb	Mar	Apr
CANADA	7.5	10.9	11.8	12.4	12.2	11.5	11.1	11.3	11.1	11.1	11.1	11.2	11.3	11.3	..
UNITED STATES*	7.5	9.5	9.5	10.2	10.0	9.3	8.4	7.8	8.7	8.3	8.1	7.9	7.7	7.7	..
JAPAN	2.2	2.4	2.6	2.6	2.6	2.7	2.6	2.7	2.6	2.7	2.6	2.7	2.7	2.7	..
AUSTRALIA	5.7	7.1	9.8	9.5	10.2	10.3	9.5	..	9.9	9.6	9.0	9.3	9.3	..	..
AUSTRIA	2.5	3.5	4.2	4.4	4.3	4.2	..	..	..	..	..	..	..	..	..
BELGIUM	11.1	13.1	14.5	14.2	14.6	14.6	14.9	15.0	14.9	14.9	14.8	14.9	15.0	15.1	15.0
FINLAND	5.1	5.8	6.1	5.9	6.3	5.8	6.2	..	6.1	6.3	6.2	..	..	..	..
FRANCE	7.3	8.0	8.1	8.0	8.1	8.0	8.2	8.7	8.0	8.3	8.4	8.5	8.7	8.9	..
GERMANY	4.4	6.1	7.5	7.1	7.8	7.9	7.6	7.3	7.7	7.6	7.4	7.1	7.3	7.5	..
ITALY	8.3	8.9	9.7	9.6	10.0	9.4	10.0	..	9.9	..	..	..	..	..	..
NETHERLANDS	8.6	11.4	13.7	12.9	13.8	13.9	14.0	14.0	14.0	14.1	14.0	13.8	14.1	14.2	..
NORWAY	2.0	2.6	3.3	3.8	3.6	3.1	2.8	3.1	..	2.7	..	..	3.1	..	..
SPAIN	14.0	15.9	17.4	17.3	16.8	17.3	18.0	..	..	..	18.0	..	..	..	..
SWEDEN	2.5	3.1	3.5	3.3	3.5	3.6	3.4	3.2	3.4	3.3	3.4	3.2	3.0	3.2	..
UNITED KINGDOM	10.6	12.3	13.2	13.0	13.2	13.3	13.1	13.3	13.1	13.1	13.1	13.2	13.3	13.4	13.3
BIG 7(1)	6.5	7.9	8.2	8.5	8.5	8.2	7.8	..	7.9	7.8	7.7	7.7	7.6	7.7	..
EEC(2)	7.8	9.1	10.1	9.9	10.2	10.1	10.2	..	10.2	10.2	10.2	10.2	10.4	10.5	..
OECD TOTAL(3)	6.7	8.2	8.7	8.9	8.9	8.6	8.3	..	8.4	8.3	8.2	8.2	8.2	8.3	..

(1) BIG7 - Canada, United States, Japan, France, Germany, Italy and the United Kingdom

(2) EEC - Total Countries shown only - Belgium, France, Germany, Italy, the Netherlands and the United Kingdom

(3) OECD - Total Countries shown only

SELECTED POINTS IN ANNEX I OF THE PAPER ON LABOUR MARKET POLICIES

Annex 1 references

- A. Labour costs. You may want to stress the good effects on employment of the fall in real wages in the US and of the fall in relative wages paid in services compared with manufacturing.
- A.4 Pay and central government employees. Example-setting here is difficult.
- A.5 Wages councils. Ministers need to consider whether to denounce these before the deadline in 1985/86.
- A12.- Tax and benefits. The Policy Unit want to legitimise the
13. black economy work done by some people who receive benefits as unemployed. The argument for this is that the number of registered unemployed would be reduced. On the other hand some who now do, for example, part-time work in the white economy might try to get benefits. If so, there would be an additional cost. Doubtful value, but it can be looked at.
- B. On raising tax thresholds, the last sentence of para A.13 makes the point about cost and the link with sustained public expenditure control. A 5% increase in thresholds costs nearly £1 billion.
- C.7-8 deal with the long term unemployed. Strong case for action here but costly. For example the CBI scheme for a £30 "jobs bounty" for firms employing people of 18-24 who have been unemployed for 6 months

SECRET AND PERSONAL

and older people unemployed for a year could in the extreme case cost £2¹/₄ billion if all 1.4 million people were taken on. The realistic cost is of course much lower.

D. Labour mobility. The policy unit's paper on wider ownership is relevant here - see separate brief. D3(b) refers to the building societies Green Paper.

D.3(f) mentions reducing the disincentive effect of CGT on resident landlords. The idea is that landlords should be exempt from CGT on gains from disposals of housing that has been wholly or partly rented. Although ideally we would get rid of CGT relief for owner-occupied housing, it probably cannot be done. If so, there may be an argument for giving a similar relief for rented housing. You would agree to look at this if it is raised.

You looked at this earlier - more detailed notes below

M

D.6 Regional policy. The last sentence proposes we should try to renegotiate the EEC ceiling of about £3,000 per job. Although we would be doing that to help jobs against capital, the proposal would be seen in the EEC as an increase in State aid. We are unlikely to make any headway.

E.1-E.4 Work sharing. The key point on this - ie the need for pay-sharing - is made in paragraph E.2

E.7 Discrimination by tax or national insurance system against the self-employed. You are aware of the possibility of giving tax relief on the proportion of self-employed national insurance contributions corresponding to the employer's contribution to employees NIC. You have decided not to offer it unless overwhelming pressure develops for it. The paper notes that self-employed contributions are already too low.



SECRET AND PERSONAL: CMO

24/5/84.

(2)

PRIME MINISTER

Plot
24/5

EMPLOYMENT PROSPECTS AND POLICIES AFFECTING THE LABOUR
MARKET AND EMPLOYMENT

I am sorry not to be able to participate in the discussion on 25 May on the two important and excellent papers by the Secretary of State for Employment. I thought it would be helpful if I were to let you have in writing the main points which I would have wanted to make in the discussion.

2 The paper sets out the difficult prospects over the next few years and I have no basis for challenging them. There will be concern that after nearly a decade of our economic strategy adult unemployment will still be regrettably high. We must be able to develop further the understanding of the reasons for high unemployment - not least that the price of too much of our labour force is too high in relation to its past levels of productivity.

3 I agree with the broad approach outlined by the

JH2AMW



Deputy Secretary to the Treasury

PPS

This is helpful especially
on reflection (34), wages
Committee (5a), and
shorter working week (5d).

5c on the private rented
sector may highlight CST
on resident landlords - see
D 3(f) in Annex III to the
brief on the King papers.

NM

24/5



SECRET AND PERSONAL: CMO

Secretary of State for Employment in the Policies paper. Both the campaign and the specific measures identified should help create conditions in which employers would be less reluctant to take on new labour. Regrettably past labour problems and the difficulty of adjusting labour forces to demand lead to cases where firms would rather let demand for their products leak into imports than meet that demand by expanding employment.

4 These considerations would prompt me to suggest that we should not only look at radical measures like the passport for jobs (though I have reservations about that) but also a selection from the menu in annex 1 to the Policies paper, but above all to the continuance of the education programme *1.2-Speeder* which both Government and Party undertook between 1981 and 1983. That, rather than demand stimulus measures which seem to be implied in para 11.2 of the paper, would seem to offer the best prospects of success in both improving the situation and living with what cannot be cured.

5 Turning to points of specific DTI interest I have the following comments:

JH2AMW



a) Labour costs - I see increased earnings as a major threat to job prospects. The recovery led to softness in resisting wage demands and the downward pressure has been halted. It is long overdue that we resolve to scrap the Wages Councils as a further signal of our determination.

b) Labour quality - my Department would wish to continue to help bring industry and education into closer contact in getting schools to be more industry and technology oriented and ridding them of anti-industry and wealth creation bias.

c) Labour mobility - I fully support the measures to encourage labour mobility. Steps to improve and simplify house purchase, which incidentally are also desirable aims of competition policy, are relevant here, as are improved pension transfer arrangements, but the most important single step would be the restoration of the privately rented

EGT read across sector.

*John
Purman
both*



- d) Labour mobility (Regional Policy) - whilst I will certainly look to see whether there is more we could do to increase the job creation scope of the new scheme, I would not want to set aside the aims of cost effectiveness and sound investment and there are EC problems.
- e) Patterns of Work - We need to avoid giving credibility to the soft option of shorter working weeks without shorter pay. On more detailed points within this Section - I would hope that other Departments will help us on easing burdens on small firms. We have done almost all we can within the DTI. The Small Firms Loan Guarantee Scheme has been a useful job creation measure and we have announced an extension until the end of the year. Provision beyond that will depend on decisions in the PES round. On Insolvency Law Reform I am certainly willing to look a the balance of the measures in the White Paper proposals. I do not want to frighten off good management for new businesses but equally I must be careful about providing a charter for those who are ready to abuse the scope of limited liability.



SECRET AND PERSONAL: CMO

6 I am sending copies of this minute to the Chancellor, the Secretaries of State for Education and Science, Energy, Environment and Employment, to the Chancellor of the Duchy of Lancaster, to David Young and to Sir Robert Armstrong.

I would be grateful if all copy recipients would ensure that this minute is treated in the same way as other papers circulated for this meeting.

NT

N T

24 May 1984

Department of Trade and Industry

JH2AMW

FROM: N MONCK
DATE: 24 May 1984

CONFIDENTIAL

CHANCELLOR

cc Sir P Middleton
Sir T Burns

JOB'S AND REGIONAL VISITS: NOTE BY POLICY UNIT

The covering note goes beyond the regional remit the Unit were given and makes some general remarks on page 1 about what has been done and what remains to be done to make markets work better.

2. It offers five general conclusions on the regional visits. Although none are very novel, most of them are reasonable.

3. Subsidising people rather than companies is both cheaper in cost per job terms and does less damage in terms of distorting the pattern of output and maintaining "unreal" jobs.

4. It is interesting that the Unit seems to regard an effective public agency - either a local authority or a specially created one - as a necessary element in successful regional policy. They are however critical of the Scottish Development Agency which has in the past been admired eg by the Economist and by official visitors.

5. It is easy to agree with conclusions 3 and 4 that subsidies should not be scattered without clear targets and that monitoring should be tightened up with the aim of using them as a temporary support for jobs that become self-sustaining. But I am not sure the ideas about clear targets have really been thought through.

6. This remark is prompted by the first two of the Policy Unit's conclusions in the appendix on their six visits (which are interesting in a somewhat anecdotal way, particularly the one on Liverpool). The Unit say "Not all areas are equally suitable for rescue". That is surely right. But the logic of this implies that the Government would, as it were, "pick winners" from the list of unemployment black spots. In some it would spend with the intention of producing self-sustaining growth of business and employment. In others it would concentrate on what the Liverpool note calls "the task of humanely managing the contraction", an important part

of which is "to prevent the insidious growth of physical dereliction". It would be necessary to explain and justify different patterns of public expenditure in the two categories of development areas on the one hand and what would effectively be "contraction areas" on the other. The Government would have to come clean on the existence of the two categories and to develop criteria for deciding which category different places with plainful problems belong to.

7. This approach in principle has some appeal in economic terms, though the task of defining and applying such criteria would be extremely difficult. The political problems would obviously be immense.

8. None of this removes the case for defining targets and monitoring so far as possible. But there are limits and my guess is that there is in practice bound to remain a wide disparity in cost-effectiveness between different regions.

Regional Policy and Public Expenditure

9. As you know, it has been agreed to make net savings of £150-200 million through changes in the Regional Development Grants Scheme and the Assisted Area Map. The DTI will be putting papers to Ministers next month.

10. We are also taking up a Policy Unit suggestion that there is scope for cutting back the building^{of}/advance factories by the regional agencies which currently costs about £150 million a year. The annexed table showing vacancy rates suggest there is scope for this, though cuts will no doubt be resisted by the responsible Secretaries of State.

11. We are also looking at the scope for the agencies selling off more factories at a discount, for which a scheme already exists, and for selling their equity holdings. The latter is normally done quickly in the case of very successful firms. ^{But} where a firm is small and only marginally profitable there is no incentive for the other shareholders to buy out the agency hold.

N MONCK

VACANCY RATES (PREMISES VACANT AS A PERCENTAGE OF TOTAL STOCK)

ANNEX

end March:	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
- EIEC ¹	14.7	19	23	19	16
SDA ²	8.8	2.9	5.3	8.8	12.3
WDA ²	2	6.5	15.2	14.8	13.5
- HIDE ²	4	11.4	8.7	12.9	21.5
DBRW	0.1 ¹	8.0 ¹	7.5 ¹	10.6 ²	10.6 ²
DC ¹	N/A	N/A	N/A	16.8	16.1

¹All vacancies

²Only premises readily available for let (ie excludes premises in need of renovation and under construction)

31/5/84.

AGRICULTURAL SUPPORT
Note by IAE 1 Division

This paper describes CAP and national arrangements for agricultural support and discusses the scope for action to reduce its cost in the foreseeable future.

COMMON AGRICULTURAL POLICY (CAP)

2. The CAP is the main source of support for agriculture within the United Kingdom, as in the rest of the European Community.

Market support takes the following forms:

- (a) 'classical' market support regimes (for example those for milk and cereals) in which producer prices are maintained above world market levels by import levies and, for products in surplus, export and consumption subsidies and intervention buying;
- (b) deficiency payments (in the United Kingdom, for sheepmeat and beef);
- (c) production subsidies (such as those for oilseed rape, olive oil and durum wheat).

In addition the Community Budget provides partial reimbursement of Member States' 'structural' expenditure on agriculture, most of which is intended to encourage investment and or to support production in 'less favoured areas' of the Community.

Effects of the CAP

3. CAP market support arrangements have three broad economic consequences for the United Kingdom:-

- (a) We have to make a direct transfer of resources across the exchanges to the benefit of agricultural producers in other Member States. Through the Community Budget we are substantial net contributors to the budgetary costs of the

CAP. We are also obliged to carry on trade in agricultural products with other Member States at CAP rather than world prices. These costs arise from the fact that the CAP is a common policy, with budgetary costs borne through the Community Budget and with preferential pricing for Community producers: they are a measure of the cost of providing the CAP level and system of support within the Community rather than nationally.

(b) In addition the CAP leads to larger distortion of consumption and production patterns within the United Kingdom economy than a purely national agricultural policy would be likely to produce: Ministers are agreed that CAP support levels are too high; and if agricultural policy were a national responsibility it is likely that we would place greater reliance on deficiency payments than does the CAP.

(c) The CAP gives a correspondingly large measure of support and protection to United Kingdom agriculture.

4. Annex A illustrates diagrammatically how these effects arise in respect of a 'classic' CAP market regime and outlines some of the difficulties of quantifying them. The broad orders of magnitude (based on 1982 data) are as follows:

- a. budgetary cost of the CAP: £1 billion;
- b. net cost of intra Community trade: £0.2 billion;
- c. costs arising from resource misallocation within the UK economy: £0.7 billion to £ 1.1 billion (so that the total resource cost of the CAP is between £1.9 billion and £2.3 billion);
- d. producer gain to UK agriculture: between £2.3 billion and £3.6 billion;
- e. loss to UK consumers: between £2.9 billion and £4.7 billion.

Policy towards the CAP

5. Reducing the cost of the CAP to the United Kingdom is one of the main objectives of the Government's policy towards the EC. But to do so will be an uphill battle.

6. There is political resistance from other Member States to any major reduction in the level of support for agriculture. Agriculture constitutes a larger share of GDP, and those employed in agriculture a higher proportion of the population in almost all other Member States than in the United Kingdom. There is also a readier acceptance in continental Europe of protectionist policies for agriculture - a dear food policy - than in the United Kingdom. It is widely accepted within the Community that the increasing budgetary costs of the CAP (Annex B) and crude physical surpluses constitute a problem: but there is far less support for the obvious conclusion that CAP support levels must be reduced.

7. Even comparatively modest targets such as preventing further increases in surpluses are likely to require substantial reductions in prices in real terms: Annex C illustrates the way in which production of some CAP products has increased more rapidly than consumption in recent years.

8. Moreover, the Community's decision-making procedure does not assist in securing sensible changes in the CAP: agricultural decisions are taken, if necessary by qualified majority voting, by the Council of Agriculture Ministers, each of whom (including our own Minister of Agriculture) has special interests to defend, and all of whom are under a temptation to agree to expensive 'package deals' which benefit producer interests. And, as Annex D shows, a substantial proportion of increases in agricultural prices comes not from agreed changes in common prices but from devaluation of green rates, where in practice Member States have a good deal of discretion.

9. Against this background, what approach can the Government adopt towards the CAP? Generalised calls for CAP reform are of

little use; nor should we support the idea of moving from market support to direct income aids (espoused by the FCO and the Labour Party): we would end up with both and contribute disproportionately to the net costs of income support because of our shortage of poor farmers.

10. There are four main areas on which we shall need to concentrate.

(a) Moderation in annual price fixings - price freezes or minimal increases. This will always be the most important element in trying to reduce CAP costs: it is the level of support even more than the system which is at fault.

(b) Introduction of 'guarantee thresholds' for products in or almost in surplus, on which expenditure is rising fast or for which production is increasing more rapidly than consumption, which would buttress and institutionalise pressure for restraining support levels by providing for action to reduce support levels if production exceeds a given level.

(c) Other detailed changes in support regimes (for example discontinuance of certain special aids for some production).

(d) Operation of a financial guideline for CAP market support expenditure, for which the United Kingdom has pressed in the post-Stuttgart negotiations, and which would relate the permitted rate of growth of agricultural expenditure to the rate of growth of the Community's Own Resources.

Recent Negotiations

11. Some progress has been made on these fronts in the recent round of post-Stuttgart and CAP price fixing negotiations, but our success should not be exaggerated.

(a) The Council of Ministers agreed on an average reduction of just over $\frac{1}{2}\%$ in CAP common prices this year; but when 'green exchange rate' changes agreed on in this price fixing are taken into account, the average level of CAP support prices will rise by between 2% and 3%.

reached in March
(b) The Agriculture Council/agreement/on the need for the more widespread introduction of guarantee thresholds; but the problem will be to ensure that the Commission brings forward, and the Council adopts, proposals which are sufficiently strict in detail to have a significant effect on support levels.

(c) The milk superlevy scheme should reduce significantly the net budgetary costs of supporting the milk market (by over £1 billion in a full year according to Commission estimates), but the superlevy aims to stabilise milk production at a level which is still some 15-20% above Community consumption.

(d) To counterbalance progress on milk, we have a new and expensive CAP folly in the form of revised arrangements for green exchange rates and monetary compensatory amounts.

(e) Provisional agreement has been reached on a financial guideline; but the agreement is less strict than we would have liked, the details remain to be worked out and it is not clear whether we can obtain an arrangement which is juridically binding. Moreover we face a major problem in containing FEOGA expenditure to the level provided in the Community Budget this year and restraining its rate of growth next year.

DOMESTIC SUPPORT FOR AGRICULTURE

12. Annex E sets out the level of public expenditure on agricultural support for the period 1980-81 to 1986-87. Total public expenditure on agriculture in 1984-85 is expected to be some £2245 million. Over 60% of that total represents public expenditure on CAP market support and is thus determined by decisions on CAP support levels, world market conditions and decisions on the management on agricultural markets taken by the European Commission: this expenditure is a consequence of the CAP price support and protection discussed in paragraphs 3 and 4 above.

13. The main constituents of 'domestic' public expenditure support for agriculture are as follows:

a. Capital Grants (£190 million in 1984-85). These grants are available as of right for any qualifying expenditure. The weighted average grant rate (including supplements paid in less favoured areas) is about 30% of eligible expenditure over the United Kingdom as a whole.

b. Research and Development (£175 million - including the DES grant-in-aid to the Agriculture and Food Research Council). Agricultural research depends far more heavily on public support (which represents about $2\frac{1}{2}\%$ of agriculture's contribution to GDP) than does research in other areas.

c. Administration (£135 million).

d. Livestock Subsidies (£100 million). These payments - headage payments for sheep and cattle are intended to provide income support to farmers in 'less favoured areas'.

e. Rural Drainage (£60 million). On average about 75% of the cost of investment in this land drainage work is met by Central Government, although the benefits accrue mainly to agriculture in the areas concerned.

f. Supplementary assistance to agriculture in Northern Ireland (£60 million).

g. Expenditure on animal health (£45 million).

h. Advice and Promotion (30 million). Expenditure by the Agricultural Development and Advisory Services (ADAS) is the main area of expenditure. Agriculture is uniquely favoured in having free technical advice 'tailormade' to the requirements of particular producers.

14. The total level of support for agriculture, taking domestic public expenditure programmes and CAP market support levels together, far exceeds that provided for other comparable sectors of the economy. The value of CAP and national price and other support for

agriculture is estimated to be between 70% and 110% of value added in agriculture; for manufacturing industry the equivalent figures are 11% to 15%. Agriculture also benefits from a range of tax reliefs but, in general, they mirror the tax reliefs available to other sectors of the economy. Ministers have said that they have no plans to change the one major anomaly in the tax treatment of agriculture: the derating of agricultural land and buildings.

15. The agricultural departments seek to justify the provision of national support for agriculture on the grounds:

- (a) that it 'promotes efficiency' (not properly distinguished from increasing output);
- (b) that it helps British agriculture to compete with producers in other parts of the Community;
- (c) that agricultural support, especially livestock subsidies and other grants paid in 'less favoured areas' stems rural depopulation;
- (d) that it helps to make the UK self-sufficient in agricultural products. (But whether for balance of payments reasons or for strategic/defence reasons is not specified).

Treasury officials would argue, on the other hand, that:

- (a) Farming benefits from a highly protected market and even with changes in the CAP this will continue;
- (b) Domestic agriculture policy should be framed against this background. In particular it should reflect the same considerations regarding the efficient use of resources as those which guide policy towards the rest of the economy;
- (c) Taken together these two points imply there is no good economic case for public expenditure on agriculture of the scale at present planned;
- (d) that there may in some cases be social arguments for agricultural support, but that considerations of social policy do not apply to the greater part of existing national support for agriculture;

- (e) there is therefore scope for substantial reductions in public expenditure on agriculture, in particular on capital grants, R and D and advisory services.

CONCLUSIONS

16. The Treasury's objectives so far as agricultural policy are concerned are: to restrain the level and cost of support provided through the Common Agricultural Policy; and to reduce the additional national support provided by UK public expenditure on agricultural. But agriculture is likely to continue for the foreseeable future to be more heavily protected and supported than any other comparable area of the economy.

COSTS OF THE COMMON AGRICULTURAL POLICY (CAP)

The simplest estimate of the costs of the CAP is that of the EC budgetary flows arising from it. In addition there are wider trade costs which arise because the UK imports food from other Member States at CAP rather than world prices. The budgetary and trade costs, when added together, show the effect of the CAP on the balance of payments of the Member States, and hence the scale of the resource transfers between them. They are a measure of the cost of providing the CAP level and system of support within the Community rather than nationally.

2. A more comprehensive estimate of the cost of the CAP is the total resource cost. This involves extending the analysis of resource flows to include estimates of the mis-allocation of national resources resulting from agricultural support above world market prices.
3. Figure 1 illustrates the resource costs of the CAP for a country like the UK which is a food importer and for a commodity for which there is a 'classical' CAP support regime. Consumers lose both because of the higher price they pay for the amount of the commodity they purchase and as a result of consuming less. The rectangle $A + B + C$ represents the loss to consumers from the higher price paid and triangle D the loss from lower consumption. Producers however benefit from operating at CAP rather than world prices: area A represents the additional producer surplus which, from the point of view of the economy as a whole, partially offsets the losses to consumers. The resource cost of the CAP is thus area $B + C + D$.
4. If the same level of support were provided on a national basis, the Exchequer would gain by area C (which would represent the proceeds of import duties or levies): the resource cost of the policy would then be limited to the sum of triangles B and D , the welfare losses resulting from distortion of production and consumption patterns within the national economy.

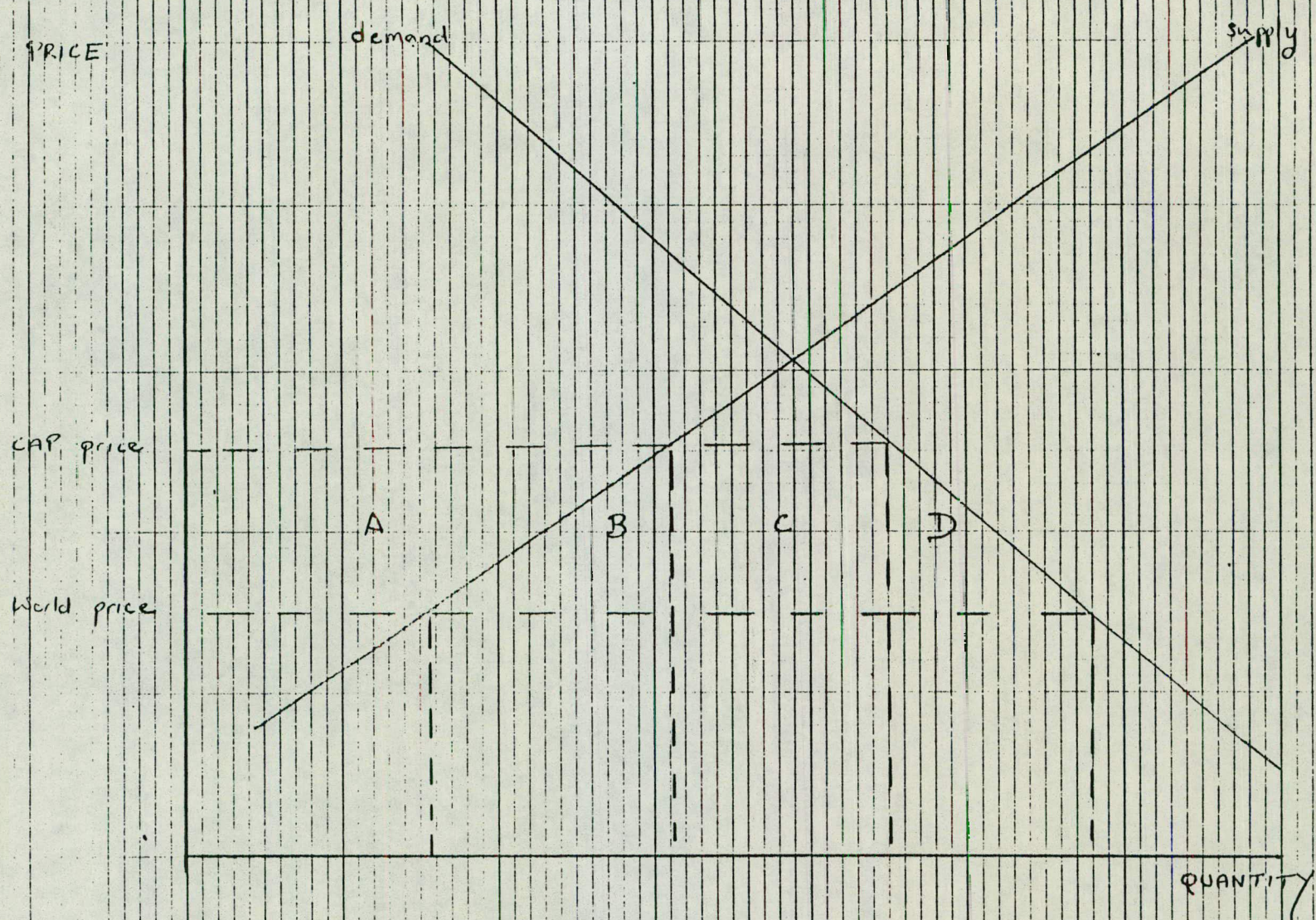
5. Figure 1 does not capture some of the transactions which must be included in the costs of the CAP: notably United Kingdom receipts from deficiency payments and that part of our customs duties and VAT contribution to the EC Budget which can be regarded as being spent on agricultural support.

6. It is important to realise the limitations of, and difficulties inherent in, any analysis and estimate of the costs of the CAP. The analysis normally proceeds by comparison with the assumption of free trade, and does not allow either for the difficulty of adjustment or for the political fact that we would still choose to support agriculture even if we were not obliged to do so by the CAP. Quantified estimates depend on uncertain assumptions about supply and demand elasticities, and the effects on world prices of EC surpluses. A particular empirical difficulty is choosing an appropriate measure of the difference between CAP and world prices. Information on 'world prices' is difficult to obtain directly, and estimates tend to use either EC import levies or export refunds. Neither measure gives a 'true' picture. Import levies are frequently set at a level which is overprotective and thus overstate the difference between CAP and 'world' prices; export refunds often understate the average gap between Community and world prices.

7. Depending on the measure used, however, and subject to the limitations above, estimates for 1982 (the last year for which full data available) suggest the following orders of magnitude:

- a. budgetary cost of the CAP: £1 billion;
- b. net cost of intra Community trade: £0.2 billion;
- c. costs arising from resource misallocation within the UK economy: £0.7 billion to £1.1 billion (so that the total resource cost of the CAP was between £1.9 billion and £2.3 billion);
- d. producer gain to UK agriculture: between £2.3 billion and £3.6 billion;
- d. loss to UK consumers: between £2.9 billion and £4.7 billion.

FIGURE 1



TREND OF FEOGA GUARANTEE EXPENDITURE SINCE 1973

m. ECU

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983 ⁽¹⁾	1984 ⁽²⁾
Main Sectors	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Cereals	1051.4	383	589.9	655.9	629.9	1112.5	1563.8	1669.3	1921.4	1824.5	2474	2590
Sugar & Isoglucose	141.2	106.1	271.2	229.3	598.4	878	939.8	575.2	767.5	1241.8	1433	1417
Olive Oil	246.2	109.5	158.7	143.4	177.1	182.1	388.2	317.9	442.7	493.1	676	773.
Oilseeds	84.3	10.6	29.1	103.7	91.4	142.7	217.8	369.4	582.7	720.7	968	1100
Fruit & vegetables	31.7	58.5	72.6	185.1	178.2	100.7	442.8	687.3	641.1	914.3	1089	1045
Wine	11.1	41.0	141.3	133.8	89.9	63.7	61.9	299.5	459.4	570.6	638	583
Tobacco	124.5	166.4	200.5	185.4	205.2	216.1	225.4	309.3	361.8	622.6	668	745
Milk and milk products	1583.6	1257.9	1193.7	2277.7	2924.1	4014.7	4527.5	4752.0	3342.8	3327.7	4723	5006
(gross) (.. .. .)					2948.2	4170.8	4621.6	4974.9	3821.3	3865.0	5242	5556)
.....												
TOTAL	3927	3094	4513	5576	6822	8657	10424	11292	10952	12372	15861	16500
% increase		-21.2%	+45.9%	+23.6%	+22.3%	+26.9%	+20.4%	+8.3%	-3.0%	+13.0%	+28.2%	+4.0%
(1) forecast outturn												
(2) budget provision												
% increase in Own Resources Base		+11.1%	+10.2%	+19.8%	+16.2%	+ 6.3%	+ 11.7%	+ 1.3%	+ 6.6%	+12.2%	+ 9.6%	+ 6.1%

SELECTED
PRODUCTION AND CONSUMPTION OF/MAJOR AGRICULTURAL COMMODITIES IN EC

	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82 prov.	1982/83 est.
Common Wheat											
Production	37517	37945	41545	33482	35319	35869	43576	42624	50232	49728	55595
Consumption	37538	35594	35798	33260	33629	35309	36706	37587	39142	40653	39877
Barley											
Production	33402	34130	34479	32160	29751	37336	39219	28937	41352	39442	40963
Consumption	31164	33167	32183	31302	31806	33400	34829	34901	36225	34348	33900
Milk fats ⁽¹⁾											
Production	3527	3525	3546	3630	3734	3925	4001	4062	4152	na	na
Consumption	3413	3494	3489	3436	3470	3507	3549	3517	3615	na	na
% self sufficiency				106	109	113	114	118	119	121	[124]

(1) MAFF regard these as the best available statistics to illustrate total milk production/consumption. The figures are for calendar years 1973 - 1983.

CAP PRICE CHANGES

Annex D

	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	Cumulative
EC												
(a) Common prices	+ 7.0	+ 13.8	+ 9.8	+ 6.6	+ 3.6	+ 2.1	- 1.1	+ 4.6	+ 9.1	++ 10.2	+ 4.1	99.5
(b) National prices (including Green rate changes)	+ 7.0	+ 21.0	+ 11.6	+ 8.4	+ 8.5	+ 8.1	- 5.9	+ 9.4	+ 10.6	++ 12.0	+ 7.0	182.1
GDP deflator	+ 8.3	+ 12.5	+ 14.8	+ 10.5	+ 9.7	+ 8.5	- 9.4	+ 10.8	+ 9.1	++ 9.1	+ 6.3	182.1
UK												
(a) Common prices	+ 7.3	+ 12.9	+ 9.6	+ 6.4	+ 3.6	+ 2.0	+ 1.0	+ 4.4	+ 8.7	++ 10.1	+ 3.8	95.5
(b) national prices	+ 7.3	+ 21.9	+ 12.1	+ 18.9	+ 6.2	+ 10.8	+ 11.9	+ 11.1	+ 8.7	++ 10.1	+ 3.8	216.8
GDP deflator	+ 7.1	+ 15.1	+ 26.9	+ 14.8	+ 14.0	+ 10.9	+ 15.1	+ 19.2	+ 12.1	++ 12.1	+ 7.8	295.2

DOMESTIC PUBLIC EXPENDITURE ON AGRICULTURE

Year	£M						
	80/81	81/82	82/83	83/84	84/85	85/86	85/87
<u>Capital Grants</u>							
- including LFA supplements	210	185	230	215	190	185	180
<u>Livestock Subsidies</u>							
- in less favoured areas	95	85	90	95	100	100	100
<u>Other National Support</u>							
- potatoes, wool	55	25	15	20	15	15	15
<u>R & D</u>	125	140	155	170	175	180	185
<u>Advice & Promotion</u>	20	20	20	30	30	30	30
<u>Animal Health</u>	35	35	35	45	45	45	45
<u>Rural Drainage and Flood Protection</u>	50	50	65	65	60	60	65
<u>Other Agriculture & Food Expenditure</u>	10	15	20	25	35	35	35
<u>Northern Ireland Supplements</u>	45	40	50	50	60	65	70
<u>Administration</u>	95	100	100	140	135	140	140
SUB TOTAL	740	695	780	855	845	855	870
<u>CAP market Regulation and Support</u>	650	670	1095	1345	1380	1265	1275
<u>IBAP Administration</u>	10	15	15	20	20	20	20
GRAND TOTAL	1400	1380	1890	2220	2245	2140	2155

8/15/84.

INDUSTRIAL SUBSIDIES AND TRADE DISTORTIONS

Note by the Treasury

Subsidies and trade distortions are still widespread in the UK economy. The subsidies do not all serve the same purpose and the trade distortions are not all the result of actions by the UK Government. But many of them are inconsistent with the Government's general policy that the free operation of market forces and competition should decide the scale of output, trade and employment in different activities; and that this is the best way of ensuring that the economy is efficient, flexible and responds rapidly to a continuously changing environment. This policy implies support for an open world trading system (recently re-affirmed by ES), and a presumption that subsidies and protection in various forms for public or private industry should be progressively reduced.

2. Such progress is an essential complement to the macro-economic framework set by the medium term financial strategy. Without it there may be inadequate stimulus both to keep inflation coming down and to improve supply side performance. In other words progress in freeing markets is vital to getting a better split, within the MTFs, between output and prices.

Scale of Distortions

3. The scale of subsidies and trade distortions is large in terms of public expenditure cost and of the share of tradeable activities which receives subsidy or other forms of protection.

4. The total cost of the subsidies depends on the precise definition which is debateable. The table below shows the wide range of sectors and items that could be included and gives several total with varying coverage. The expenditure at the top of the table is directed at individual sectors or firms and the lines at the bottom have a more generalised target, though business benefits from most of them. Not all the expenditure shown is strictly subsidies but most of it is. Annex A gives more details. For 1984/85 a minimum figure would be about £2½ billion. The totals for public expenditure in the White Paper take credit for rapid rundowns in the next two years, but there are a number of additional bids.

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Industrial Support: Public Expenditure

	1983-84	1984-85	1985-86
	£m	£m	£m
1. Nationalised Industries external finance (steel, shipbuilding, coal)	2037	1595	996
2. Publicly owned companies	129	37	33
3. Agriculture (excluding forestry and fishing)	2220	2245	2140
4. Launch Aid for British Aerospace, Rolls Royce and Westlands	92	100	111
5. Science and Technology (mainly grants to private industry)	330	378	39
6. Industry Act Section 8	128	107	111
7. Tourism	45	49	51
8. Export Credit	350	196	67
9. Regional	662	658	654
10. Adult Training	242	280	278
11. Employment measures	<u>1564</u>	<u>1929</u>	<u>1997</u>
TOTAL	7799	7574	6828
Total excluding 10 and 11	5993	5365	4553
Total excluding 9-11	5331	4707	3899
Total excluding 3 and 9-11	3111	2462	1759

5. The sectors which receive heavy subsidies or import protection include agriculture and coal. Manufacturing industries benefitting in this way account for about 25% of the output index. A large proportion of these subsidies goes to steel and shipbuilding, but considerable sums also go to producers of air frames and aero engines and to electronics/information and other high technology industries. So both old and new industries appear to qualify for subsidies. The

beneficiaries of protection against imports include vehicles, consumer electronics, textiles, clothing and footwear.

6. About 8% of manufactured exports are supported by credit arrangements involving subsidies. The main subsidies are the provision of fixed rate export credits (often at a rate below the market rate and the Aid and Trade Provision (ATP) of the aid programme, which involves a mixture of grants and export credits. The projected fall in expenditure on export credit reflects assumptions of falling interest rates which may not now be fulfilled. Additional bids of some £130 million per annum have been made in the PES round to reflect changes in the past year and updated interest rate assumptions.

7. Estimates of the share of visible imports affected by non-tariff trade restraints in recent years range from the DTI's 7% (or 22% if tariffs are included) to the National Institute's 18%. Voluntary export restraint agreements have increased further in recent years and now cover more than a dozen major products. Many restraints do not merely make exporting to the UK more difficult, they effectively ban imports once a certain quantity (eg 250,000 Japanese colour TVs is reached. About 20% of manufactured imports are subject to tariffs or other barriers (Annex B). The benefit to domestic producers of import protection is roughly equal to 5-10% of value added in manufacturing. Some benefit also goes to foreign producers who receive higher prices than they would get without VRAs. The counterpart is a heavy consumer cost, which probably adds about 2% to the RPI.

Economic Effects

8. Unless they can be shown to yield clear profits to productive potential, after allowing for offsets such as the effect of higher taxation, subsidies or other forms of protection will, ^{short run, bring about a reallocation} other than in the/ of resources in the economy as a whole rather than increase the overall level of resource use. Given the Government's approach to macro-economic policy, measures of assistance that involve public expenditure will require either offsetting cuts elsewhere and/or a rise in taxes, or, if public borrowing is increased, higher interest rates than there would otherwise have been. Furthermore, any measure of subsidy or

protection that (other things being equal) improves the balance of payments will tend to make the exchange rate higher than it would otherwise have been and thus render other parts of the tradeable goods and services sector less competitive. The main result of efforts to protect individual industries will therefore be - through some combination of lower public expenditure elsewhere, higher taxes, higher interest rates, and a higher exchange rate - that output and employment are greater than would otherwise have been the case in the protected sector and lower in the other sectors. This analysis applies both to trade measures and to industrial subsidies.

9. Since it is often in declining and uncompetitive sectors that the strongest pressures emerge, subsidy or protection will often slow down the process of structural adjustment in the economy, delaying the movement of resources into more competitive and expanding industries. Employment may be greater in the assisted sector, but it may be no greater in aggregate; indeed by reinforcing rather than reducing labour market rigidities, protection can reduce the sustainable level of aggregate employment. Recognition of these factors is one reason why OECD countries have sought to promote "positive adjustment" policies in recent years, ie policies to facilitate necessary structural adjustment rather than slow it down.

Industrial and Political Aspects

10. The strength of industrial and political lobbies which press for subsidies and protection reflects the visible effects of such measures on individual industries which gain from them (or would lose from their withdrawal). The diffused damage the measures do to other parts of the economy is hard to discern and so does not give rise to countervailing pressures. Moreover representatives of particular industries can often point to subsidies and other forms of protection enjoyed by their competitors in other countries. They argue that UK industries are entitled to a comparable degree of support and that if it is not forthcoming, jobs will be lost in their own industries without any offsetting gains in the rest of the economy.

11. There is something in these arguments. Withdrawing subsidies or protection will in most cases mean that some jobs will be lost,

it is typically uncertain how long or where new jobs will be created, and the benefits of withdrawal will be widely spread and hard to identify. In certain cases there may be special arguments or a risk of losing permanently a firm or industry that might later become both competitive and profitable without Government support. However it is extremely difficult to distinguish good cases from bad and, as the Chancellor has said publicly, the industries which expand "when the oil runs out" will not be the same ones which enjoy or seek support now. So in general, on the analysis in paragraphs 8-9 above, the presumption must be against new forms of support and in favour of phasing out existing ones so that barriers to change and flexibility are removed. This is the only route to a lasting reduction in unemployment and a rise in living standards over the medium term.

IMPLICATIONS FOR POLICY

12. The conflict between the Government's general policy commitments and the disproportionate political force of narrowly based industrial lobbies calls for a coherent response sustained over this Parliament, if progress is to be made in strengthening the supply side. The phasing out of subsidies and trade distortions could be treated - both publicly and within Government - as a major part of the programme of action for promoting competition.

(a) General

13. The first key point is that the general economic analysis in paragraphs 8-9 above, which underlies the Government's policy commitments, should be applied rigorously to all proposals to introduce subsidies and trade distortions for individual industries and to reviews of existing measures. Such reviews should be carried out regularly and comprehensively with the object of unwinding barriers to market forces. This will ensure that cases are not looked at on an ad hoc basis in terms of an individual industry and reduce the risk that an accretion of new "special cases" will build up.

14. Industrial subsidies should be progressively reduced in the course of public expenditure rounds, except where there is a

rationale consistent with the Government's general reliance on market forces and where there is clear evidence that the specified purpose is being achieved or is likely to be achieved without offsetting disadvantages elsewhere in the economy.

15. As already agreed by Ministers collectively, the UK should initiate and pursue coherent proposals in international bodies designed to achieve progressive multilateral reduction in trade distortions. Openness to international trade is the most effective competitive pressure that is available in a medium sized trading economy.

16. These general points fit in well with the statement which the Union of European Industries, backed by the CBI has sent to all candidates in the European elections. An extract is reproduced in Annex C.

(b) Operational

17. To some extent these general principles are already being applied in various piecemeal ways. But there is plenty of scope for extending and organising this more thoroughly, doing so over a number of years, and taking stock once a year in a comprehensive way of the progress being made in trade and on industrial subsidies.

18. Over the next 18 months issues to do with trade and subsidies are due to come up at the following international meetings:

- a. London Summit - 8-10 June 1984;
- b. OECD Export Credit Consensus meeting - September 1984 - will discuss mixed credits;
- c. OECD Development Assistance Committee (DAC) at Ministerial level. End November/early December 1984;

- d. GATT Ministerial - November 1985. This would be the occasion of the formal decision to start a new GATT round, if this is agreed on.

There are also regular EC meetings dealing with export credit issues.

19. In these international meetings the UK:

- a. should be ready to take the lead in order to get things moving. Although the general aim should be multilateral reduction in subsidies and trade distortions, it is not practicable to insist in all cases on precisely matched multilateral deals, partly because national methods of protection vary so widely. In any case the analysis in paragraphs 8-9 suggests that the UK could gain from individual as well as multilateral action, despite the obvious political difficulties;
- b. should welcome greater transparency of subsidies and other distortions despite potential embarrassments for us in specific areas, since other countries are at present more opaque than we are, as well as (in some cases) more protective;
- c. needs to ensure that the economic departments and their representatives take a common line on subsidies and trade distortions in international bodies.

20. So far as domestic action is concerned:

- a. the general presumption that subsidies should be phased out should be applied firmly in the 1984 public expenditure round;
- b. in particular this should be done in the review of DTI's expenditure on support for private industry proposed in the Chief Secretary's letter to

Mr Tebbit of 4 May. The review would cover the questions whether there is a rationale for each category of expenditure compatible with the Government's general reliance on market forces; whether there is clear evidence that the expenditure has contributed (or is likely to do so) to the specific purpose proposed; and whether the procedures for assessing performance and proposals and for settling individual expenditure issues can be improved. The review should be started soon.

21. Periodic meetings, say at least annually, should be held between the Treasury and DTI, which is involved both in its general economic role and through specific responsibilities for some subsidies and trade policy, to consider comprehensively progress and plans on the whole range of trade and subsidy issues. (Departments responsible for subsidies etc outside the DTI's field can be brought in as necessary.) This is bound to be a time consuming process. But it is necessary because a general policy of "market forces with [many] exceptions" is in effect collectively agreed already. The only way to make progress is on specific issues. Reports to Ministers or perhaps to the Ministerial Committee on Competition Policy can be made as necessary.

(c) Presentational

22. Ministers should be advised to put across in speeches and in press briefing the general arguments for reducing subsidies and trade distortions for individual industries. This might include the following points:

- i. the present extent and level of subsidies and trade distortions and the damage done to other parts of the economy by selective protection;
- ii. the cost of subsidies can be expressed vividly in terms of cost per job and also of the effect on income tax thresholds or rates;
- iii. the cost to consumers of VRAs etc;

- iv. when the problem is protection in other countries, the solution is to build on the successes that have been achieved through persistent international negotiation eg GATT and the Export Credit consensus;
- v. poor performance in-home or overseas markets is too often blamed by UK producers on unfair and/or subsidised competition. Failures within UK industry are often the root cause and the way to remedy these is not to provide a feather bed on demand;
- vi. public presentation of reducing trade distortions and subsidies as part of the Government's "competition initiative" (as well as a contribution to its tax objectives).

Conclusion

23. The Treasury and DTI have a common interest in implementing the policy implications set out in paragraphs 19-22.

HM Treasury

31 May 1984

	Public Expenditure		
	1983-84	1984-85	1985-86
	£m	£m	£m
<u>NI EFLs</u>	2037	1595	996
Coal	1409	1103	741
BSC	321	275	140
BS	307	217	115
<u>Publicly Owned Companies</u>	129	37	33
BL	90	-	-
RR	(9)	(9)	(9)
Harland & Wolf	40	38	42
Short Bros.	8	7	-
<u>Agriculture (excluding fish and forestry)</u>	2220	2245	2140
CAP - market support	1365	1400	1285
Domestic	855	845	855
<u>Launch Aid</u>	92	100	111
BAe (A 320)	-	62	73
RR	76	20	25
Westlands	16	18	13
<u>Science & Technology Assistance</u>	330	378	390
Government R & D Establishments	34	42	47
+ R & D Grants to Private Industry	254	297	304
+ Advisory Services	35	36	36
Rest	7	3	3
<u>Industry Act Section 8</u>	128	107	111
+ Support for specific industries	55	40	60
+ General investment support facilities	44	43	44
Small Firm Loan Guarantee Scheme	25	20	12
Stockpile of Strategic Minerals	4	4	4
<u>Export Credit</u>	350	196	67
Fixed rate export credits	322	130	1
ATP grant element	28	66	66

* illustrative of scope and cost rather than definitive. The public expenditure sums shown are largely but not entirely subsidies.

+ includes support for information technology programmes.

	<u>1983-84</u> £m	<u>1984-85</u> £m	<u>1985-86</u> £m
<u>Tourism Support</u>	45	49	51
Promotion	35	35	35
Investment	10	14	16
<u>Regional</u>	662	658	654
Section 7	102	112	106
Other	560	546	548
<u>Adult Training</u>	242	280	278
Training Opportunities Scheme	140	208	216
Other	102	72	62
<u>Special and Other Employment Measures</u>	1564	1929	1997
Youth Training Scheme	760	880	1010
Community Programmes	427	597	628
Job Release Scheme	266	315	266
Other	111	137	93

Notes

1983-84 figures = Current Outturn Estimate

1984-85 figures = Current Estimates adjusted for known changes not yet incorporated in Estimates

1985-86 figures = Current PES position plus known changes. These are tentative until PES round when totals and components may change

ESTIMATES OF THE EXTENT OF DISTORTIONS TO UK TRADE

Import Restrictions

The DTI estimate that in 1980 about £3½ billion of UK imports of goods - 7% of the total - were subject to some form of non-tariff restraint, mostly quantitative restrictions. This figure is made up as follows:

	£m
Levyable CAP products	1700
Other agriculture	27
Steel products (mainly ECSC)	280
Textiles and clothing (including Multi-Fibre Arrangement)	921
Voluntary restraint agreements (VRAs)	421
Miscellaneous restraints (mainly quotas)	65

	3415

2. These figures are likely to understate the size of the distortion, for various reasons:

- a. they relate to the ex post value of imports: the value of goods imported despite the existence of an import restraint. But what should in principle be measured is the amount of imports that would have taken place without the restraint. To take an extreme case, a complete ban on imports of a certain good from a certain country would not show up in this measure at all;
- b. the existence of a restraint on one commodity may lead foreign producers to be cautious in their export strategy for a related product, to lessen the risk that it too will be subjected to restraint;
- c. in the case of VRAs the figures relate only to imports from the country with whom the restraint is agreed. But

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the effect of a VRA on the lowest cost producer (who is the one most likely to be singled out) will be to raise the import price of the product and worsen the terms of trade. This effect will carry over to imports from other countries. In such a case total imports of the commodity in question should be regarded as "distorted";

- d. the figures exclude imports from other EC countries. But markets in steel and agriculture products are so distorted by EC arrangements that intra-EC imports of these commodities could reasonably be included in the total;
- e. Government procurement decisions in favour of the home producer, eg defence, are excluded.

3. It is thus possible to arrive at a much higher figure, as in the estimate by Mrs Page of NIESR. Her figure is 24% if 1980 weights are used. If intra-EC trade in food and iron and steel is included (2d above), and if all textiles and steel products are included (on the argument of 2b) the proportion of imports subject to non-tariff restraint in 1980 was about 18%.

4. Since 1980, more VRAs have been agreed. Examples are footwear from Taiwan; coal from countries outside the EC; and on an EC-wide basis there are VRAs for light commercial vehicles, forklift trucks, motorcycles, quartz watches, video tape-recorders, loud-speakers and turntables. The value of Japanese video recorder imports alone was nearly £500 million in 1983 and the total for goods covered by new restraints is probably about £800 million (a little over 1% of 1983 imports). Pressure to maintain and extend VRAs is likely to continue, since total imports of the sort of goods covered by VRAs are still increasing. For example, about 25% more cars were imported in 1983 than in 1980 and over 60% more television sets.

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-3-

5. The import restrictions impose considerable costs on consumers, which are the counterprt of the benefits of protection for domestic producers and of higher prices for foreign producers which quantitative restrictions produce.

6. Approximate estimates can be made of the consumer costs, though these cannot be precise because they depend among other things on assumptions about supply and demand elasticities. For manufactured goods the costs imposed on consumers by tariff and non-tariff measures together are probably in the range £6-11 billion (1982 prices). Consumer prices are raised as a result of this protection.

Estimated effect of production in price of selected goods

Textiles and clothes	+ 10-15%
Footwear	+ 10%
Consumer electronics	+ 10%
Cars	+ 10-25%

The combined effect of these and other restrictions on the RPI is roughly 2 %.

Exports

7. The main subsidies to UK exports are the provision of fixed rate export credits (often at a rate below the market rate) and through the Aid and Trade provision (ATP) of the Aid programme, which involves a mixture of grants and export credits. Expenditure on these items is as follows:

	1983-4	1984-5	1985-6
Fixed rate export credits*	322	130	1
ATP grant element	28	66	66

* The fall in expenditure on export credit reflects assumptions of falling interest rates which recent events suggest may not be fulfilled. To the extent that happens expenditure will be higher than the figures in the table.

8. The exports supported in these ways account for about 5% of UK visible exports and about 8% of manufactured exports.

**Enough of central control at national or
Community level**

The European Community is founded on market economy principles.

The Community has been the champion of these principles, which are enshrined in the Treaty of Rome. The free movement of goods, services and capital is central to the Treaty.

State or Community intervention in business often interferes with the smooth running of the market system.

To push ahead and contribute to revival, firms need more elbow room, without, however, harming the legitimate interests of others; yet their initiative is often curbed by a mass of laws and regulations.

Through state aids and subsidies, considerable resources are poured into industrial sectors that have little prospect of growth.

Free enterprise needs a united, integrated Europe. It wants to see a speedy end to the "every nation for itself" mentality, and freedom for firms to react individually to the new demands of international competition.

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From: SIR PETER MIDDLETON

Date: 8 June 1984

c/
 You'd suggested earlier
 in standard L&S'd been
 from knocking the faxes

CHANCELLOR

mom
876
 cc Chief Secretary
 Economic Secretary
 Mr Bailey
 Mr Littler
 Mr Monck
 Mr Unwin
 Mr Lovell
 Mr Bostock

SUBSIDIES TO INDUSTRY AND AGRICULTURE

... I attach a copy of the paper which I have today sent to Sir Brian Hayes. I will report back on our discussions in due course.

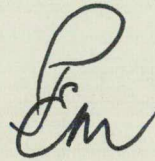
2. The table on page 2 of that paper shows that taking a comprehensive view of industrial support, agriculture is the largest single item. You might therefore like to have the attached paper which analyses agricultural spending. I realise that this is delicate territory and that levels of subsidy are high throughout Europe. Nonetheless there is a massive misallocation of resources taking place.

3. We make resource transfers equivalent to about $\frac{1}{2}\%$ of our GDP to other European countries on account of the CAP. This aspect of policy has certainly received its due share of attention. But because the difficulties of making progress are so great, we ought to turn our attention to those areas of purely domestic expenditure which amount to 40% of the £2 $\frac{1}{4}$ bn of public money which goes to agriculture support. The list in paragraph 11 constitutes a description of a highly interventionist regime. If we apply the same tests to this expenditure as we are seeking to do on the rest of industrial support, it is difficult

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to imagine that there are not substantial savings to be found.

4. The agriculture paper has not been seen outside the Treasury.

A handwritten signature in black ink, consisting of a large, stylized 'P' followed by 'E' and 'M' in a cursive script.

P E MIDDLETON

NOTES FOR THE CHANCELLOR SPEAKING TO THE BASIL FELDMAN
DINNER ON 26 JUNE

"ENTERPRISE ON COURSE"

The Government has been in office five years and for all of that time it has followed a consistent economic policy. That has amazed and confounded our critics. In the early days of our term they were wondering whether the U turn would come after 6 months or 12. The smart money was on 6, they tell me. But the bets were lost.

When the U turn did not come, our critics said our policies might be consistent but they could not work. In spring 1981, 364 economists came together to write to the Times saying that recovery could not result from our policies. Remarkable since never before had 364 economists agreed on anything. And the one time they did agree, they were wrong. The irony is that the recovery began when the ink on their letter was not yet dry: in the spring of 1981.

When our critics saw that our policies were working on inflation, they said: "Ah yes, but these policies can never produce growth". When our policies have succeeded both in bringing down inflation and in bringing about growth, our critics said: "Ah yes, but now inflation will start to rise again". Well, that has proved incorrect too. We have at the moment that winning combination that has eluded us in the past of both low inflation and vigorous growth at the same time.

But still not content with all the evidence, our critics then alleged that it was not our policies that had brought success, but the fact that we had clandestinely and unobserved, dumped our policies somewhere along the way. So then began a veritable hunt of the snark to try to discover in what way we had abandoned our policy in favour of secret reflation. Our critics have, therefore, cast a very suspicious eye over the government

convinced that its performance can only be explained by some hole and corner reflationary tipling.

Not so. Indeed our recovery dates from about the time of Sir Geoffrey Howe's budget of 1981, from the time when we most firmly tightened our fiscal stance.

So after five years of consistent economic policies, people obviously have a pretty good idea of what the Government is about. Ask anybody and they will probably be able to tell you that the Government aims to reduce inflation still further, and is therefore pursuing a tight monetary policy, maintaining firm control on Government spending and driving down the proportion of our national income taken up by Government borrowing.

And all of these things are of course true. But they are only part of what we are doing. Low inflation is the necessary foundation for everything else. Without low inflation it is almost impossible for enterprise to flourish. Inflation makes it difficult for businesses to plan for the future. It impairs their ability to compete in foreign markets, or with foreign products in home markets. Inflation undermines industrial relations as workers struggle to stay ahead of rising prices.

But much more is needed to create a really healthy climate for enterprise.

It's possible to imagine having low inflation, but a series of obstacles and controls standing in the way of enterprise. You could have low inflation, and yet still maintain a tax system which penalised success and mitigated the impact of failure. And just because there is low inflation, it doesn't follow that the climate of opinion will be right. A climate to encourage the young to go into business or a climate in which the importance of a dynamic business sector is appreciated and its need to produce profits is acknowledged.

No, low inflation is not enough, as the government is well aware. That is why, although the defeat of inflation has always been our primary aim, we have also set about making the economy work better, sweeping away controls and scrapping or reforming those policies that inhibit the free movement of people, goods and services. And though this aspect of our policy receives less attention than the more visible fight against inflation, although it involves a wider range of apparently disparate policies, nonetheless it has always been clearly in our minds and the progress that we have made has been remarkable.

First and most obviously, we have done away with that range of controls that took responsibility away from managers. Dividend control, price control, wage control - all gone. The responsibility for all these matters is back where it belongs in the boardroom.

Then we scrapped exchange controls. We did so overnight, in one fell swoop. It was in a sense an act of faith, an expression of our real confidence in the benefits of freely-functioning markets. At the time, there were many who predicted that we would have to reimpose them, that there would be a run on sterling and that we should have to reverse our policy. In the event, of course, we were criticised because sterling rose too high. The result has been to allow the free movement of capital, a freedom enjoyed by the citizens of very few other countries. Britain has returned to something of her traditional role of building up a highly valuable portfolio of investments across the world. Frequently, those investments lead to new trade opportunities, and so to jobs at home. Taken together, these investments represent a valuable nest-egg which will provide a stream of income to this country for many years to come.

Our policies have also aimed to remove the barriers

to competition at home. Where companies or industries are owned by the state, there can be no fully satisfactory proxy for the full effects of competition. That is why, wherever possible, we have moved those industries and companies back into the private sector, and allowed them the freedom to compete and allowed others the freedom to compete with them. We have a long list of successes in this field ranging from the enormous privatisation exercise in which I was involved - Britoil - to the smaller companies like the National Freight Company and Amersham International. Now we are embarked upon privatisation of British Telecom, the biggest privatisation yet. British Telecom will operate under a stringent regulatory regime to ensure that it does not exploit its position in the market. But in the longer term, it is competition in this field too that will guarantee the best deal for the customer, and provide us with a dynamic telecommunications sector. In that sense, we are privatising British Telecom and allowing others freely to enter the field in the nick of time, so that the widest range of British companies can be involved in and take advantage of the very rapid pace of development in this field.

Where we cannot for the moment privatise nationalised industries, we are nonetheless improving competition and obliging them to operate on commercial lines. This process of change can be immensely painful for those involved, but I do not think I need dwell on that today.

We are exposing one area of activity after another to the beneficent forces of competition. Perhaps our approach is most dramatically symbolised by the changes which we have set in motion at the Stock Exchange. The fact of the matter is that financial markets are changing fast, and becoming far more international and competitive. Unless our own institutions are exposed to greater internal competition, and to competition from abroad also, they will never adapt or develop the necessary resilience. Unless they learn to compete, they will wither.

A range of other professional bodies are feeling the

winds of competition too, such as opticians and solicitors.

Some of you will complain quite rightly that while markets in Britain are clearly being thrown open, many markets abroad are still heavily restricted. It is one of the things to which we have particularly turned our attention in our discussions with our Common Market partners. For example, some of our highly successful service industries, banking and insurance, are not given free access to European markets. This is one of our substantial and legitimate grievances. Equally, our airlines which amply demonstrate that the British spirit of enterprise is alive and well, are denied access to international routes and refused permission to fix their prices freely by other community governments. But in this area we can now see that the forces of change are busily at work.

Our approach to trade union reform has followed logically from our concept of competition. It is our aim to weaken senseless and outdated restrictive practices. It is our policy to strengthen the voice of the many within trade unions against the power of the few, and greatly to improve the remedies available to them. And it has been our achievement to reinstate a reasonable balance between unions and employers.

I said before that low inflation was not enough. But let us be clear too that removing controls, breaking down restrictive practices, smashing monopolies, breaking into cartels, and changing laws - all that is still not enough to provide us with an enterprise economy. We need also to alter attitudes.

Looking back over British history since the war, there are many causes for sadness. Opportunities foregone, mistakes made. But perhaps nothing is more regrettable, perhaps nothing has been more damaging, than the growth and dominance of hostility to enterprise. By contrast with, say, Germany or America where the businessman

is king, here he has too often been sneered at or denounced as a profiteer. The universities have turned out able people and pointed them in the direction of government or towards the professions and discouraged them from entering business. For many years, the very word "profits" has been used by many as though it were a dirty word, or a term of abuse.

In the five years that we have been in office, we have struggled to change this perception, to teach the simple lesson that wealth must be created before it can be spent. We have tried to show that those who create the wealth are deserving both of the rewards of their labour, and of our respect. We are now engaged, quite consciously, in the process of reinstating the word "profits" to its rightful place in the English language.

That was one of the sub-themes of my budget. The tax changes that I made for companies are designed to improve profitability. The changes to capital allowances will steer companies towards putting their money into projects that are genuinely profitable, not merely ones that are apparently profitable after tax. And for those companies that are successful, their profits will be taxed at much lower rates, at only 30% for small companies and 35% for larger companies, once all the changes are in place. It is from the profits of successful companies that our economic expansion will chiefly flow, and out of those profits that the new jobs in this country will be created.

But the real change in attitudes comes when people can participate directly in ownership. It is no use singing the praises of capitalism, unless we can all be capitalists, and feel the benefits at first hand.

We have approached this challenge in three stages. The first is to encourage and enable more and more people to own real property, bricks and mortar, their homes.

Now 60% of families own their own homes, and since 1979 there has been a flood of buyers, many of whom have never owned anything of enduring value before, many of whom had never dreamt of it.

Stage 2 has been to create hundreds of thousands of new shareholders. That is an opportunity that has arisen as a by-product of the privatisation programme. When shares have been on offer, the employees have rightly seized the opportunity with both hands. And the difference that this has wrought in attitudes is remarkable. For the first time, employees perceive fully the identity of interest between the enterprise and all who work in it, and they now receive a tangible benefit directly linked to their own performance.

The third stage will be to spread share ownership far and wide. The denationalisation of BT will help, because each of the 18 million subscribers has good reason to want to buy a piece of the action. But there must be a wide-ranging effort too to break down the mystique of share ownership, and make the opportunity to participate in ownership available to all, certainly in the high street, and perhaps thanks to modern technology, all the way through to the living room.

There are those who have put up determined resistance to economic reality and the enterprise spirit. You can see one expression of that resistance most evenings on the television news. And yet I believe that the climate has changed, and continues to change. But in one important respect, attitudes have changed disappointingly slowly. Our expectations on pay remain far too high. The result of that is that the benefits of economic recovery are

felt principally by those in work whose real earnings rise year by year, instead of being spread to an increasing number through the growth of new jobs. In the United States, those in work have seen their real wages decline. As a result, unemployment in the United States is falling, and employment is on the increase. Over the last ten years, the USA has created 15 million new jobs. In Britain, however, because real wages are still rising, unemployment has not yet begun to fall. Over the last ten years in Europe, the total number of people in work has fallen. There is a clear lesson here.

I cannot speak to you tonight of a job completed. I am not sure if I can tell you that we are even halfway. There is such a backlog of anti-competitive prices and institutional obstacles in the way of enterprise to be cleared away, that we shall be busy with our brooms for many years.

But already the evidence of success is very great. Last year our economy grew faster than any other in the European community. This year we are at or near the top of that league again. This after many years when our natural place seemed to be in the relegation zone. Inflation is low, and set to fall further. Public expenditure has been falling as a percentage of GDP and we are determined to keep it firmly in check. Our productivity is up by 23% on the trough of three years ago. Investment is running very strongly. And profits rose by a quarter last year.

As Captain Kirk might have said to Mr Spock, "Enterprise is on course".

MP

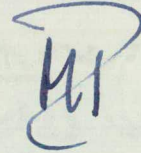
FROM: M D X PORTILLO
DATE: 2 JULY 1984

CHANCELLOR

cc Mr Robson

ENTERPRISE OIL

I attach a draft which Mr Robson and I can discuss
with you at 2pm.



M D X PORTILLO

ENTERPRISE OIL

There has been a lot of hot air talked about the Enterprise Oil share issue. Most commentators have missed these essential points.

First, the aim of privatisation is to transfer businesses to the private sector. Enterprise made that transition last Wednesday. Whether shares were left with the underwriters or not, they are all now held by private investors. Those underwriters who took shares and have yet to sell them on, are doing the job for which they are paid.

Second, we aim to get value for the taxpayer. The sale raised £380 million which is a fair price.

Since the sale achieved these two objectives - privatisation and a fair price - it is absurd to call it a flop.

The Government stated that Enterprise was to be a new independent British oil company. We made that policy very clear. Had we wanted to sell it to an existing oil company, we had ample opportunity to do so. Companies would have had to tender for it, and they would probably have had to pay more for it. [One of our reasons for rejecting that route, was that we preferred to see a new British company in existence, and not risk seeing it pass into

foreign ownership.]

Having chosen to float Enterprise, it would have been quite wrong to allow RTZ to buy a controlling interest. It would have been unfair on other investors who had the assurance in the prospectus that they were subscribing to an independent oil company. And to other oil companies who, rightly, felt excluded from bidding. And to the taxpayer, since purchase by a company with RTZ's tax position would have greatly diminished the value of the sale to the PSBR.

If any oil company now wishes to increase its stake in Enterprise it is free to do so - within the normal rules of the Take Over Panel. That is as things should be.

Doubtless, once a company's interest in building up its holding is known, that will be reflected in the market in the higher price that they will have to pay.

Enterprise Oil can make a valuable contribution to the further development of our oil and gas resources - as a new private sector company under autonomous management. It will be protected until the end of 1988 by the fact that the government retains a single special share. This so-called "golden" share gives the government a special voting majority where a change in the ownership or control of the company is proposed.

New companies which have never faced the pressures of genuine private sector competition need time to establish themselves. In particular, they need time to build up their defences against foreign takeover. The "golden" share mechanism has applied successfully in the cases of Amersham and Britoil, where in fact it has never needed to be invoked. It is a valuable device which the market has readily accepted, and the government will certainly consider its use in future privatisations.

*1 do not agree with
of this.
A 2-tier system, with improved
treatment for start-ups, is clearly
indicated. But this is to achieve
the central tax relief.
No central tax relief,
but by which some
of the other
conditions -
by the
Mr Prescott's
para 20.
PSR on 17/10
PSR to Lord
MS see that
Mr*

FROM: R A L LORD
DATE: 6 AUGUST 1984

cc.
PS/Financial Secretary
Mr Monck
Mr Lovell
Mr Monger
PS/IR
Mr Beighton IR
Mr Prescott IR

CHANCELLOR

SMALL FIRMS: BUSINESS EXPANSION SCHEME

You asked for views on the future of BES (Miss O'Mara, 17 July).

2. The Business Start-Up Scheme was extended to established companies on the view that these were often as much in need of outside capital and at least as worthy as start-ups. If the tax system is to be used to favour investment in small business at all, and our general prejudice against special reliefs overridden, then this view still has some force.

3. It is certainly possible that investment in existing businesses is crowding out investment in start-ups. The Inland Revenue survey now under way - which I understand should be yielding results by end-October - may provide more information. But assuming the established companies need the equity injection, is this undesirable ?

4. There is, I think, a feeling abroad that BES money is not necessarily going where it is most needed and we need to beware of the scheme getting a bad name. But it was to meet similar pressure from the small business lobbies that BSS was turned into BES. I think Mr Prescott is probably right in his analysis that any changes will have to involve a selective reduction in the scale of relief rather than an increase. If that is so I cannot see any political advantage in moving to a 2-tier system, and there is some possible disadvantage in taking away part of what was formerly conceded. Partially reversing the extension beyond start-ups

within a couple of years also makes the Government look slightly incompetent.

5. A 2-tier BES would be very difficult to square with our aim of simplifying the tax system.

6. Subject to further and better information on the extent of any crowding out of start-ups I think my view is that it would be better to leave BES as it is. If, however, the balance of advantage were thought to lie with a 2-tier system then the proposed higher-rate package would probably provide the best vehicle politically, by restricting tax relief on non-start-ups to the basic rate.

RL

R A L LORD

Mem
to
let.



David

- Done

C

Despite X
may I show this -
on a strictly personal basis -
to Sir P. E. M.?

yes

✓ Y is already in hand.

Z needs to be
commissioned, perhaps
(but you may have
discussed with Sir T. B.)

I have, ^{but} ~~not~~ ^{not} ~~not~~
per confirm. N.B.

N.B

Later papers with D. Baillie
- ^{site} on a less restricted
basis. M.P.



pmf

10 DOWNING STREET

From the Private Secretary

17 September, 1984

Dec Davis,

SEMINAR ON INDUSTRY AND EMPLOYMENT

I attach a checklist of conclusions and matters to be followed up arising from the meeting at Downing Street last Thursday.

The Prime Minister would be grateful if the Ministers indicated could take the action attributed to them in the note, consulting with other colleagues as required (though in such cases no reference to the origin of the remit should be made). As proposals are developed they should be brought to the Cabinet or its Committees as appropriate. Alternatively, papers can be circulated to ad hoc groups of Ministers. This office will be happy to advise on the appropriate channels.

The Prime Minister expects to hold a further meeting, probably in November, when work on the possible discussion document and the measures which could give substance to it is more advanced.

X/ This letter and the checklist are for the sight and use of Ministers only and their Principal Private Secretaries. The Prime Minister has asked for no circulation of this letter or the list; that no copies should be made of them and that action should be initiated by means of separate instructions and not by means of the list itself. In putting action in hand, no indication should be given as to the origin of the remit.

I am sending a copy of this letter and enclosure to Elizabeth Hodkinson (Department of Education and Science),

Michael Reidy (Department of Energy), John Ballard (Department of the Environment), David Normington (Department of Employment), Callum McCarthy (Department of Trade and Industry), Steve Godber (Department of Health and Social Security), Lee Lewis (Office of the Minister without Portfolio); and to Richard Hatfield and Peter Gregson (Cabinet Office).

*Your sincerely
Andrew*

(Andrew Turnbull)

D. Peretz, Esq.,
HM Treasury.

SEMINAR ON INDUSTRY AND EMPLOYMENT: CHECK LIST AND CONCLUSIONS

Developments in the Labour Market

(i) The Secretary of State for Employment to produce an analysis of the impact of YTS, covering the take-up, the impact it had had on youth unemployment, the extent to which "graduates" of YTS were finding employment or were moving on to YWS, and the extent to which young workers might be displacing older workers.

Expenditure programmes relevant to employment

(ii) The Group took note of the report of the working group and broadly endorsed its conclusions. It was agreed that no major re-allocation between expenditure programmes was needed.

(iii) It was agreed that the inter-departmental Manpower Group, under Department of Employment chairmanship, should evaluate on a regular basis both the special employment measures and other programmes with similar aims.

(iv) It was agreed that when putting forward proposals for expenditure, primarily directed towards cutting unemployment or increasing employment, including support for industries in financial difficulties, Departments should support the proposal with figures for the net exchequer cost per person taken off the unemployment count or per net job. At the same time, adequate weight should be given to longer term supply side benefits.

Link between wages and unemployment

(v) The group endorsed the Chancellor's paper discussing the link between wages and unemployment. It found particularly helpful the counter arguments to the claims which had been made to deny the existence of this link. The Chancellor of the Exchequer agreed to circulate an addendum countering the TUC arguments that the link was disproved by the existence of sectors with high wages and increasing employment such as electronics and sectors with low wages and declining employment such as textiles.

(vi) The Secretary of State for Education and Science in conjunction with the Chancellor of the Exchequer and the Secretary of State for Employment and Trade and Industry to meet Sir Christopher Lawson to carry forward work on a privately financed programme of public education on the economic facts of life. This should make use of the

material included in the Chancellor's paper.

2 | (vii) The Treasury to continue work to establish econometrically the relationship between wages and unemployment.

Passport for a job

(viii) The Group considered the Secretary of State for Employment's report on the Passport for a Job proposal. His preferred option was to provide a certificate to young people falling between eligibility for YTS and age 20 removing them from the scope of PAYE, employment protection and wages councils and granting a credit for National Insurance contributions.

(ix) The Group felt it was necessary to consider whether in practice the scheme would reduce bureaucracy when allowance was made for the machinery that was needed to issue and monitor the use of certificates of exemption; whether it was equitable to exempt one group of workers from tax when others on lower incomes might still be paying tax (this could only be solved by pitching the net wage near the tax threshold though which could make the scheme unattractive); whether workers should be given a credit for NI contributions which would entail the keeping of records or whether like students they should be deemed not to have paid.

(x) The Secretary of State for Employment to continue work on various options for the scheme, ie. different age groups, the size of firm to be eligible and the net wage to be offered taking account of the points made in the discussion. The costings should be agreed with the Treasury. The Secretary of State for Employment in consultation with the Secretary of State for Social Services should consider the inter-relationship between the net wage under the scheme and the social security benefits available to young people.

(xi) The Secretary of State for Employment to continue work on the remits which emerged from the meeting of 24 July on the reduction of administrative and legislative burdens, in particular the case for reducing the scope of employment protection legislation. How far it was possible to make progress generally in this area would be relevant to whether a scheme targetted on young people should be introduced.

Getting across the Government's approach on employment

(xii) The Group discussed the case for a discussion document setting out the Government's approach on employment questions. It was agreed that it would be easier to secure

public acceptance of individual measures where protections were being removed if the measures could be seen as part of a wider picture.

(xiii) The Group agreed to keep open the question of whether to publish a discussion document. It was noted that for this to be successful, the Government would need to have developed a number of measures, eg. on wages councils, employment protection, shop hours, etc., which would form an adequate Government response to the problem of unemployment. Such a document should also contain a section on how jobs had been created. Care should be taken not to jeopardise the Government's success in securing public acceptance that the problem of unemployment could not be laid entirely at the Government's door.

(xiv) The Secretary of State for Employment, the Secretary of State for Trade and Industry and the Minister without Portfolio should work together on ways in which the Government's case could be better presented. They should assemble material for speeches; should carry forward work on a possible discussion document which might be issued early in 1985; and should consider what might be the elements of a package of measures which could give substance to such a document. The Chancellor should be kept closely in touch with this work. The Prime Minister would convene a further meeting, probably in November, to review progress.

Planning

(xv) The Secretary of State for the Environment to bring forward a paper on the improvements which could be made to the planning system to remove obstacles to enterprise and the creation of jobs.

Surplus land and developments in the public sector

(xvi) The Secretary of State for the Environment to bring the papers circulated to the group to E(DL) for discussion and action.

AT

1719



3/10/84

MO 21/8/5

CH/EXCHEQUER	
REC.	4 OCT 1984
ACTION	Mr Mowat
COPIES TO	CS, EST, MJ, EST
	Mr D. Middleton
	Mr Dainton, Mr Burrell
	Mr Mercer, Mr Scholar

5/10

Sec of State Defence 3 Oct.

Mr Vickers, Mr Gordon, Mr Conn, Mr Kelly, Mr Lord.
 Sir T. Dunn, Mr Faulkner, Mr Lovell.

PRIME MINISTER

ENTERPRISE

attached

I have read David Young's minute to Cabinet colleagues about Enterprise; I am sure that there is total agreement on the need for us to pursue policies that encourage Enterprise. There are two areas in particular that seem to me worth further thought and development.

2. The first requires an examination of the centralised investment of so much of the nation's savings through the institutions. These institutions are largely centred in the City of London, and are broadly organised in order to invest huge sums of money in large packets and understandably the institutions go for those areas of investment where the profits are most secure and most substantial. The fiduciary responsibilities of the institutions understandably encourage such an approach. But equally, I suspect this has the effect of drawing the savings of the nation from the small to the large and from the outlying parts of Britain to the South. It is not that it is impossible to make profits in the former; it is simply easier to invest in office blocks with first class contents than it is to deal with the more complicated activity of supporting or innovating small businesses. There must be a very substantial consequence to the level of innovation in our economy flowing from this concentration in the use of funds, and one that would not be so evident if more people had a greater influence at the local level on the investment of their own savings.



3. The second idea that I believe is capable of significant development is essentially that of the sponsored industrial estate. I spent some time trying to develop this on Merseyside with the help of Plesseys. The idea is very simple. The public sector provides through English Industrial Estates, the urban programme and the derelict land grant scheme very sophisticated machinery for the recovery of despoiled areas, often in our less prosperous areas. The present practice is to expect the market to produce the tenants for the reclaimed land and the advanced factories. My concept was to develop industrial sponsorship for a new estate from a significant industrial or commercial company. Very little is actually required by way of resources from the sponsor company - in practice little more than one or two people and the Chairman's goodwill. It would be quite wrong in my view to expect major companies to divert top class managers or scarce resources to such activities, but in practice most companies have a number of senior people who are not keeping up with the frontline and who often are shunted sideways or made redundant. An alternative is to use one such person and see if within the sponsor company there are any opportunities that could be developed on the sponsor's estate. There are many classes of such opportunities - in-house activities that can be hived off, unexploited spin-off from Research and Development, import substitution, suppliers that can be persuaded to relocate nearer the procuring company - to name but four. But the essence of the idea is that a large commercially experienced company puts its weight behind a significant local industrial estate. In no way does it expect the sponsor to provide any financial underwriting against its judgement. The idea has many variations - British American Tobacco for example made a conspicuous contribution to Liverpool's docks by converting old warehouses to starter units that were rapidly taken up.

4. If a significant number of large organisations could be persuaded to back such a concept then the opportunity to establish industrial estates along these lines in relatively less prosperous areas could be considerable. Moreover, it would be seen to be being achieved by the private sector.



5. I am sending a copy of this minute to Cabinet colleagues and to Sir Robert Armstrong.

Wright

Ministry of Defence
3rd October 1984



10 DOWNING STREET

From the Private Secretary

CH/EXCHEQUER	
REG.	- 5 OCT 1984
ACTION	MR MONCK
COPIES TO	CST, FST, MST, EST
	Sir P. Middleton
	Sir F. Burns, Mr Bailey
5 October 1984 Mr Burgess	

PS/No 10
5 Oct.

✓ 51

Mr Faulkner, Mr Merew
 Mr Scholar, Mr Lovell,
 Mr Kittrutt, Mr Gordon
 Ms Lann, Mr Ridley,
 Mr Lord.

ENTERPRISE

The Prime Minister has seen the Minister Without Portfolio's minute of 2 October and the minute from the Secretary of State for Defence of 3 October.

The Prime Minister wishes the Minister Without Portfolio to give special attention to policies for the promotion of enterprise and the creation of jobs. She agrees with his proposals to establish an Enterprise Unit, and is content with the areas which he has identified as his immediate priorities. She hopes that in due course the Minister Without Portfolio will be able to take up the issues suggested by the Secretary of State for Defence.

The Prime Minister understands that the Minister Without Portfolio will shortly be discussing with Sir Robert Armstrong the machinery required to carry forward this work. She is content that the Minister Without Portfolio should publicise his initiative as soon as these arrangements have been agreed and the details of presentation have been sorted out.

I am copying this letter to the Private Secretaries to the members of Cabinet and to Richard Hatfield (Cabinet Office).

ANDREW TURNBULL

Leigh Lewis, Esq.,
Office of the Minister Without Portfolio.

CONFIDENTIAL

Sc 070

PP



10 DOWNING STREET

From the Private Secretary

CIVIL SERVICE	
REC.	- 8 OCT 1984
ACTION	FST.
COPIES TO	

8 October 1984

✓ 8/10

Dear David,

Self-Employment

The Prime Minister has seen and noted the Chancellor's minute of 28 September and the papers attached to it.

Yours sincerely

Andrew

Andrew Turnbull

David Peretz Esq
HM Treasury.

CONFIDENTIAL
STAFF IN CONFIDENCEFROM: DAVID PERETZ
DATE: 8 October 1984

MR MONCK

cc Sir P Middleton

ENTERPRISE

As you know, the Chancellor discussed Mr Young's minute to the Prime Minister of 2 October with him in draft before it was sent. The Chancellor says the final version takes on board the key points he made to Mr Young.

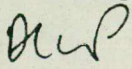
2. The Chancellor also explained to Mr Young the need for him:-

(a) to propose nothing that increased expenditure, and indeed to look for proposals that reduced it; and

(b) to work through E(CP), and not in competition with it.

Both points, he believes, Mr Young accepts.

3. Finally, Mr Young told the Chancellor when they met that he wanted a Treasury official seconded to the Enterprise Unit, and we have now had this confirmed from Mr Young's office. The Chancellor believes we should provide an official, and that it is clearly in our interest to do so. He would like to talk to Peter Middleton about possible names. (I understand Mr Young is looking for an economist, but has no strong views about grade.)


D L C PERETZ

CONFIDENTIAL



CH/EXCHEQUER	
REC.	10 OCT 1984
ACTION	Mr Monck
COPIES TO	CST, FST, MST, EST
	Sir P. Middleton
	Sir T. Burgess, Mr Bailey
	Mr Burgner, Mr Faulkner

10/10

9/10/84

Mr Mercer, Mr Scholar, Mr Howell, Mr Kittratt
Mr Gordon, Ms Conn, Mr Ridley, Mr Lord.

PRIME MINISTER

ENTERPRISE

I have seen David Young's minute to you of 2 October, and I will, of course, ensure that my Department contributes in every way possible to the work that he proposes to put in hand.

Our main contribution to this field is through the Urban Programme and the Development Commission. One of the Urban Programme's main objectives is to help foster local enterprise and business confidence in the inner cities, and I deal with this in the papers that I am circulating for discussion in MISC 104. The Urban Development Grant and Derelict Land Grant give high priority to the provision of sites for industrial development, including factories and workshops for small firms, usually provided by private developers on reclaimed sites or in refurbished buildings. Michael Heseltine in his note of 3 October refers to the Wavertree Technology Park, where Plessey have taken the lead and which you saw on your visit to Liverpool, and for which Derelict Land Grant was made available. He also mentions the BAT workshops to which the Merseyside Urban Development Corporation contributed. There are many more good examples, and I agree with Michael that there is great potential for further schemes of this kind and that major companies could make a striking contribution in this way to urban renewal and the regeneration of the local economy in the inner cities.

In rural areas the development Commission undertake similar schemes to help small firms, both by providing small factories and workshops, and through the advisory services provided by COSIRA.

We should not overlook the fact that competent local authorities can help to create an environment conducive to local enterprise, not least

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CONFIDENTIAL



by keeping the rates down and by using their statutory powers in ways that help rather than hinder local businesses. Many local authorities have shown themselves willing and able to work constructively with private developers and industry in facilitating new development. We should not underrate this contribution just because a few local authorities operate in ways that positively deter private enterprise: we should make the point that such authorities are damaging their own area's chances of attracting jobs and investment.

My Department is already fully involved in the interdepartmental scrutiny that Robin Ibbs has initiated of the administrative and legislative burdens on firms.

I am sure that we will find that there are other ways in which my department and its sponsored bodies can contribute to this work, and I welcome the stimulus that David Young's initiative will provide.

I am copying this minute to Cabinet colleagues and to Sir Robert Armstrong.

PJ

PJ

9 October 1984

CONFIDENTIAL

11/10/84.
Early dip
from top posts
à la Française
looks much
attractive.
Has to manage
with or strikes?
cc Sir P Middlebrook
(Personal)

Ref. A084/2712
PRIME MINISTER

The Secretary of State for Defence mentioned in Cabinet the other day his concern about the implications for the efficiency of the public service of the fact that the level of pay increases for management staff in the private sector has recently greatly exceeded the level of pay increases for the "comparable" people in the public service, so that the Civil Service is seen to have fallen even further behind the private sector than before.

2. The Ministry of Defence lost three of their best young Principals in August and September. You may like to see the attached copies of two letters which they have sent to explain their decisions to leave the public service: the deterioration of promotion prospects, the earnings disparities, and the loss of esteem of the Civil Service in the public eye all feature in these letters.

3. The wastage is not confined to bright young administrators and scarcity groups like computer programmers. The Ministry of Defence are also losing an alarming number of scientists.

4. If these trends continue unchecked, the implications for the efficiency and morale of the Civil Service in ten years' time could be extremely serious.

5. As you know, we are doing something to encourage early retirement and to introduce merit pay on an experimental basis. These measures may slightly improve promotion prospects and motivation, but I fear that, because the measures themselves are relatively modest (and in the case of merit pay experimental) their effects will not be very great. The problem of the earnings gap is something which will have to be thought about in connection with next year's pay settlement and Top Salaries Review Body review. I hope that we may be able to persuade Ministers to use whatever opportunities are open to them publicly to commend the work of the Civil Service and the management changes which are in train: that would do much to reassure

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feeling in the Civil Service, though it would no doubt be difficult to persuade the media that there was much general news value in such speeches.

6. I am sending copies of this minute and of the two letters to the Chancellor of the Exchequer and the Chancellor of the Duchy of Lancaster.

ROBERT ARMSTRONG

11 October 1984



4/9/84

MINISTRY OF DEFENCE
S. 15/84

MINISTRY OF DEFENCE

Main Building, Whitehall, London SW1A 2HB

Telephone (Direct Dialling) 01-218 -2837

(Switchboard) 01-218 9000

S. 15/84
S/K

4th September 1984

J L L Imrie Esq
Head of CM(A)1

Dear Sir,

Following our discussion on 3 September, I am now writing formally to advise you that I propose to take up an offer of employment from the merchant bank Lazard Brothers and Company Ltd and, therefore, that I wish to leave the Ministry of Defence. You kindly offered me the option of a six months' 'lifeline' by releasing me initially on special unpaid leave, and I wish to accept this. I have not yet sorted out either the fine points of my terms and conditions or the proposed transfer date with Lazards, although I am confident that there should be no last-minute hitches: I assume, however, that the six months' 'lifeline' begins on the day I start at Lazards.

I said that I would let you know in some detail why I have decided to leave the MOD. First, I should say that I go with a heavy heart: I have enjoyed enormously my work in the MOD - variously in the Private Office, Defence Sales and DS12 - and, both intellectually, and in terms of working relationships with my civilian and military colleagues, I could not have wished for a finer place to work. But three factors have eroded my confidence in the Civil Service and the Department: first, the significant loss of senior posts in the MOD following an from re-organisation must mean (even if PVR provides some slight once-and-for-all relief) that the promotion prospects to one, two - and three-star posts will now be significantly worse for junior Principals. My career prospects therefore are deteriorating, and, most depressingly of all, there is little or nothing I can do to improve my lot within the Civil Service. Secondly, Civil Service pay has fallen woefully behind that in the private sector, and I judge that, for example, my peers (lawyers, bankers, accountants etc) outside Government Service will be earning very significantly more - as much as 50-100% - than I earn, quite apart from a whole raft of additional fringe benefits. Thirdly, I feel that the status and esteem of the Civil Service in the public eye has been diminished to such an extent that it is now almost an embarrassment to admit to being a Civil Servant. Government pronouncements on, and attitude to, the Public Service give no cause for comfort - indeed, I expect the climate to get colder still.

Given that these three factors are unlikely to change - save perhaps for the worse - my analysis led me, sadly, towards the inescapable conclusion that, in order to be assured of better career and pay

prospects, and to be able to take greater public pride in my work, I would have to leave. Lazards have offered me a job which - assuming I make the grade - will satisfy these criteria. I should add that initially my pay at Lazards will be only marginally more than my current salary - I am not therefore being seduced by a fast buck - but I feel that Lazards offers career and pay prospects which far exceed those I could possibly hope for in the MOD however efficient my performance.

I hope you will find this a useful explanation of my reason for leaving. I would like to hope that the problems could be rectified so that fast streamers would not be so tempted to leave, but I see little or no prospect of this, and I regret, for the sake of the Civil Service, that more will reach the same inexorable conclusions that I have reached.

I have already mentioned that no date has yet been fixed for my arrival at Lazards. Clearly, though, I would like to press on as fast as possible, and I imagine you would wish to appoint someone to this key job in DS12 fairly soon. I should like to aim to join Lazards at the beginning of November - but perhaps we could discuss timings in detail when you have considered the 'staff plot' implication: I am of course anxious that the least possible disruption takes place within DS12, and I believe my successor should be in post a good month before the early December Ministerials in Brussels - hence the proposal for the beginning of November. I understand from CM(Conduct) that no special permission is required to take up an appointment with Lazards, as they are not in any contractual relationship with the MOD.

Would you please regard this letter as the formal notification of my intended transfer?

Yours sincerely
Jonathan Dawson
J D S DAWSON



MINISTER OF STATE FOR
THE ARMED FORCES

MINISTRY OF DEFENCE
MAIN BUILDING WHITEHALL LONDON SW1A 2HB

Telephone 01-218 2216 (Direct Dialling)
01-218 9000 (Switchboard)

10 August 1984

D.
A.L.
28

Dear Mr Hasha-Smith

When we met yesterday, I informed you that I had decided to accept an offer of employment with the Orion Royal Bank and to resign from the Civil Service. You asked me to confirm this in writing and I am now doing so.

M.H.L. 10/8

As I said yesterday, I have had an immensely varied and interesting career in the Civil Service - first as an Administration Trainee in the ROF organisation, DS8 and IP2; then as a HEO(A) on loan to the FCO, based for part of the time in Geneva and New York as a member of the UK Disarmament Delegation to the United Nations; and more recently as a Principal in DS17, ESW(Army), DS11 and, for the past year, as the Private Secretary to Minister(AF). I could not have hoped for a better start to my career; and I can say without hesitation that I have the greatest admiration for my colleagues and that I have been enormously impressed with the quality of their work.

Much as I have enjoyed my career in the Ministry of Defence, however, I have over the past two years increasingly felt that my future does not lie in the Civil Service. The experience of the past year in particular has contributed to this process but it has not been the main cause. (I do not deny that it has placed a very considerable strain on my wife and our young family.) More important factors, as I told you yesterday, have been the steady erosion of the position of the Civil Service in the earnings league; the low regard in which I find the Civil Service is held by many of my private sector contemporaries; and, with the squeeze on Civil Service numbers, the increasingly difficult promotion prospects.

I do not see any significant improvement in the future. I admire many of the achievements of this Government and I am personally in sympathy with many of its objectives. But there is a world of difference between its performance as a Government and its record as an employer. As a line manager, I have found it increasingly difficult to justify its actions to my staff. And as an employee, I am not surprised that so many should feel demoralised and disenchanted.

my own case, however, these are not the principal reasons for resignation. In general, I regard myself as having been extraordinarily fortunate in the positions I have occupied and I shall always be grateful for the way in which my own career has been planned and managed. In my own case, the apprehension I feel for a future career in the Civil Service has come at a time when I have become increasingly interested in the operation of the international economy and in the role of the key financial institutions (this was also a particular interest in my Economics degree). I have become increasingly interested in pursuing a career in the City and the offer of employment I have received from the Orion Royal Bank will allow me to work in this field. After careful thought, I have decided to accept their offer.

When we spoke yesterday, you suggested that I might inform Minister (AF) of this decision on his return from overseas in mid-September with a view to leaving my post in mid-October. On reflection, I believe it would be in the interests of all concerned if I informed Mr Stanley as soon as possible, with a view to leaving the Civil Service at the end of September. I would not want him to learn of my resignation from a third party: not only would this be greatly discourteous on my part but it could well put you and my colleagues in a most difficult position. He has also just told me of his intention to come into the office for part of the week commencing 27 August. I therefore propose to inform him in writing early next week and to explain my decision to him in more detail when I see him at the end of August.

Finally, may I take this opportunity to thank you for all you personally have done to make my career in the MOD such an interesting and demanding one and for the interest you have shown in my progress.

Yours ever

P M W Francis

P M W FRANCIS
Private Secretary

R M Hastie-Smith Esq CB

SPEECH PROGRAMME

b/f for next Supply bilateral

PEM 11/10

From: SIR PETER MIDDLETON
Date: 11 October 1984

(Handwritten initials)

CHANCELLOR

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Minister of State
- PS/Economic Secretary
- Mr Monck
- Mr Battishill
- Mr Folger
- Mr Culpin
- Miss Young
- Mr Ridley
- Mr Lord
- Mr Portillo
- Mr Makeham

SPEECHES

The speech programme attached to Mr Makeham's minute of 8 October makes me wonder whether you and your colleagues would think it wise to consider the programme as a whole and what you hope to get out of it. There are 26 speeches before Christmas excluding Parliamentary occasions such as the debate on the Queen's Speech and the Autumn Statement. This represents quite a load on the Department, and Ministers will wish to be sure that it is planned so as to produce the best value for money.

C
 To discuss with
 PEM at a bilateral. *(taken at Prayers?)*
 16 of the 25 are the
 FST — I don't
 think that put's a huge
 burden on officials, since
 he tends to speak off the
 cuff. * *NSP*

(Handwritten signature)

P E MIDDLETON

ENTERPRISE

1. I have seen David Young's minute of 2 October and Michael Heseltine's of 3 October. I agree strongly with the areas David proposes to work in.

2. What ought to be one of our most important concerns is highlighted in Michael Heseltine's minute - the provision of capital for new businesses. Two natural sources of this are redundancy payments and small individual savings. Even though the Enterprise Allowance scheme has been a success we ought to be able to go further and find a way to ensure that those who dedicate their capital or redundancy pay to setting up a business could automatically have it discounted for the purpose of social security benefit. We need also to improve the provision of advice to those who have no previous experience of business.

3. There is a good deal of scope for an extended partnership between job centres and local CBIs, Chambers of Commerce and other business groups to promote the concept of self-employment as something easier of achievement among people and in areas (such as the North East) where this is not a normal expectation. The Conservative imperative to seek to extend enterprise among groups who are traditionally organised and educated to ignore its possibilities makes this a very important area of policy.

4. I am sending a copy of this minute to members of the Cabinet and to Sir Robert Armstrong.

JSG

Cabinet Office

16 October 1984

SECRETARY
16 OCT 1984
Ms Cann.
FST MST
EST.
Sir P Middleton
Mr Bailey

Mr Manck
Mr Burgner

Mr Faulkner
Mr Mercer
Mr Scholar
Mr Carell
Mr Latcatt
Mr Ridley
Mr Lord
Mr Gordon

DAVID YOUNG'S
ENTERPRISE UNIT

fyep



CABINET OFFICE

CH/EXCHEQUER	
REC.	16 OCT 1984
ACTION	Mr Manck ✓ 16/10
COPIES TO	Sir P. Middleton
	Sir T. Bucks
70 Whitehall	
London SW1A 2AS	
Telephone 233-3299	

Mr. A. BAILEY

LORD
YOUNG
16/10

From the Minister without Portfolio

The Rt. Hon. Lord Young of Graffham

The Rt. Hon. Nigel Lawson Q.C., M.P.,
Chancellor of the Exchequer,
H M Treasury,
Parliament Street,
London, S.W.1.

16th October, 1984

✓

For Nigel,

ENTERPRISE UNIT

I mentioned to you when we met on 2nd October that I should very much like to include someone from the Treasury in the inter-departmental team of officials which I am assembling in the Cabinet Office to support me in my work on enterprise. An economist, especially one at Principal level, would fit particularly well into the structure now being planned. I do hope that you will be able to make a suitable person available.

I attach a copy of the terms of reference now established for the Enterprise Unit. As I told you, the overall aim of its work will be to secure better use of existing resources and I would see this as providing support for the Treasury's work in many areas. I would certainly want the Unit to work closely with your officials at all times.

Lawson
David

ENTERPRISE UNIT

The role of the Enterprise Unit is to work with and for Departments in order to encourage and develop enterprise in society and the economy.

In particular, it will assist in identifying, analysing and proposing solutions to problems, especially where the effectiveness of enterprise policies or programmes is being held back.

The Enterprise Unit will work closely with the No. 10 Policy Unit and with the Efficiency Unit. It will report to the Minister without Portfolio.



CABINET OFFICE

From the Minister without Portfolio

The Rt. Hon. Lord Young of Graffham

70 Whitehall
London SW1A 2AS
Telephone 233 3299

David Peretz, Esq.,
Private Secretary to the
Chancellor of the Exchequer,
H M Treasury,
Parliament Street,
London, S.W.1.

16th October, 1984

to then further... my impression... in letter... etc & an... 23k-arr... com... work... possible... small... had some... (Mr Heseltine) says on... Affairs... X ?

Dear David

to for... 23k-arr... com... work... possible... small... had some... fruits.

CH/EXCHEQUER	
REC.	17 OCT 1984
ACTION	Mr Monck
COPIES TO	CST, FST, MJT, EST SIF Middlton SIF Brown, Mr Barkley, Mr Bagnall, Mr Furler, Mr Mercer, Mr Schuler, Mr Lovell, Mr Kitchin, Mr Gordon, Miss Lane, Mr Ridley Mr Lord.

ENTERPRISE UNIT

Andrew Turnbull's letter to me of 5th October recorded the Prime Minister's agreement to Lord Young's proposals to establish an Enterprise Unit.

I now attach for your information the terms of reference for the Unit which is being set up within the Cabinet Office. The Unit is headed by Robin Lingard, an Under Secretary on secondment from DTI, whose office is Room 050 in the Cabinet Office (233 7266/7750). Other staff will be joining the Unit over the coming weeks.

I am copying this letter to the Private Secretaries to the members of the Cabinet and to Andrew Turnbull (No. 10), Richard Hatfield (Cabinet Office), John Redwood (Policy Unit) and Ian Beesley (Efficiency Unit).

Leigh Lewis
Private Secretary

of... have... I... can... a... via... it... greater... m...

LEWIS
PERETZ
16/10

ENTERPRISE UNIT

The role of the Enterprise Unit is to work with and for Departments in order to encourage and develop enterprise in society and the economy.

In particular, it will assist in identifying, analysing and proposing solutions to problems, especially where the effectiveness of enterprise policies or programmes is being held back.

The Enterprise Unit will work closely with the No. 10 Policy Unit and with the Efficiency Unit. It will report to the Minister without Portfolio.



10 DOWNING STREET

From the Private Secretary

17 October 1984

PPS/PJ
✓

CH/F
18 OCT 1984
Action Mr Morck
COPIES TO CST, FST, MST, EST
Sir P. Middleton
Sir T. Evans, Mr Bailey
Mr Burgner, Mr Faulkner
Mr Mercer, Mr Schobor
Mr Kitcatt, Mr Gordon, Ms Conn, Mr Lovell
Mr Ridley
Mr Lord.

✓ 18/10

Dear David,

ENTERPRISE

The Prime Minister has seen the Paymaster General's minute of 16 October. She would be grateful if the Secretary of State for Employment, in consultation with the Secretary of State for Social Services could consider his suggestion that those who dedicate their capital or redundancy pay to setting up a business could automatically have it discounted for the purposes of social security benefits.

I am sending a copy of this letter to David Peretz (HM Treasury), Steve Godber (Department of Health and Social Security), Leigh Lewis (Minister without Portfolio's Office), Alex Galloway (Paymaster General's Office) and Richard Hatfield (Cabinet Office).

Yours sincerely

Andrew Turnbull

Andrew Turnbull

David Normington, Esq.,
Department of Employment

CONFIDENTIAL

purp



NORTHERN IRELAND OFFICE
WHITEHALL
LONDON SW1A 2AZ

SECRETARY OF STATE
FOR
NORTHERN IRELAND

The Rt Hon Lord Young of Graffham
Cabinet Office
70 Whitehall
LONDON
SW1A 2AS

18th October 1984

CH/EXCHEQUER	
REC.	<i>18</i> 18 OCT 1984
ACTION	<i>Mr Manck</i>
COPIES TO	<i>CST, FST, MST, EST Sir P. Middleton Sir T. Burns, Mr. Bailey Mr. Burgess, Mr. Faulkner Mr. Mercer, Mr. Scholar, Mr. Lovell Mr. Kitcott, Mr. Gordon, Mr. Conn, Mr. Ridley Mr. Lord</i>

Dear Minister,

ENTERPRISE

I was most interested to see your minute of 2 October to the Prime Minister about the way in which you propose to carry forward your work to encourage enterprise. Since many of the economic and social problems of the nation as a whole are seen in their most extreme form in regions such as Northern Ireland, there is I think a very important regional dimension of your work. Clearly the Enterprise Unit which is to support you will be a small, compact organisation, but I would suggest that its effectiveness might be reinforced by the presence within it of one or two officials with direct experience of regional problems, and if you thought well of it I would be very happy to identify a suitable Northern Ireland official for a period of secondment to the Unit.

I would also like to register with you the thought that Northern Ireland, with its own extremely compact and well co-ordinated administrative system, could in some circumstances be a useful "test bed" for the development of new ideas and policies. As you know, we were able to get the local equivalent of the YTS (which is in some respects more comprehensive) off the ground here a year earlier than the rest of the United Kingdom, and because many of the powers deployed in Great Britain by local authorities or public bodies such as the MSC are direct government functions in Northern Ireland, we can on occasions launch initiatives in a relatively straightforward way.

I would/....

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CONFIDENTIAL

I would like to be kept in close touch with the development of each of the subject areas you have identified in your minute. In particular, we have been giving some consideration to a local study at the 14-25 age cohort which would inevitably have to address the question which you identify of keeping young people under 18 out of unemployment. The motivation here for considering an extension of the age cohort to be studied to 25 was that this would allow some consideration of the effectiveness of education, training and other measures in equipping young adults (amongst whom unemployment here, as elsewhere, is depressingly high) for the realities of the labour market and of society. In view of what you now have in mind at the national level, it is obviously important that any work we carry out here should be genuinely complementary. I would want to consult you about this when we have carried our ideas a little further forward.

On present information, I think it would be useful for us to receive the papers of all four groups you have in mind, and to be directly represented on the groups dealing with Small Firms and the 14-18 Age Group, although I realise that you will be anxious to keep the groups as small as possible.

I would very much welcome an opportunity for an early discussion with you about the way in which NIO could best be associated with your programme of work, and indeed you might think it worthwhile at some stage to pay a visit to Northern Ireland.

I am copying this letter to the Prime Minister, to Cabinet colleagues and to Sir Robert Armstrong.

Yours sincerely
N Howard

for D H

(Approved by the Secretary of State
and signed in his absence in Belfast)

LORD YOUNG'S
TWO WORKING
GROUPS

MONCK
19/10

CONFIDENTIAL

FROM: N MONCK
DATE: 19 October 1984

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Anson
Mr Byatt
Mr Lovell
Miss Kelley
Mr Watson
Ms Seammes
Mr Faulkner
Mr Mercer

Handwritten notes in red ink:
I am not happy with the suggestions for the 14-18 group. I would like to see a group for small firms. I have an alternative suggestion. Who is the Minister? (and you're letter of 16/10).
letter to issue?
R.P.

LORD YOUNG'S TWO WORKING GROUPS

Lord Young's letter of 15 October (copy attached) asked you to nominate a Minister and a senior official to two new working groups. One would be on the 14-18 age group and one will be on small firms.

2. The first group seems likely to be considering proposals which would have a public expenditure cost which we guess to be up to about £250 million. The second group has "within existing resources" built into the terms of reference.

3. The attached draft letter proposes the Chief Secretary and Financial Secretary as ministerial members of the groups, supported respectively by me and Mr Lovell. *I understand the Chief Secy as Financial Secy are involved with this*

4. I understand that DHSS and DES have also been asked to name representatives for the first group and suggest that the draft letter, with its warning about public expenditure, should be copied to those departments.

yes ✓

N MONCK

CONFIDENTIAL

DRAFT LETTER FOR THE CHANCELLOR TO SEND TO LORD YOUNG

Thank you for your letter of 15 October about the two working groups you will be setting up on the 14-18 year age group and small firms. ^{Bonney Hayhoe} (Peter Rees) will represent the Treasury on the first group and ^{John Stewart} (John Moore) will do so on the second. The official representatives will be Nick Monck and ^{Mike Prescott,} (Arnold Lovell) ^{from the Inland Revenue,} respectively.

2. I was glad to see that the terms of reference of the small firms group included "within existing resources". As you know from our earlier talk about the work of your unit, I attach great importance to this proviso across the board and this applies equally to the work on the 14-18 age group.

3. I am sending copies of this letter to Norman Tebbit, Tom King, Keith Joseph and Norman Fowler, and also to Sir Robert Armstrong.



CONFIDENTIAL

CABINET OFFICE

From the Minister without Portfolio

70 Whitehall
London SW1A 2AS
Telephone 233 3299

The Rt. Hon. Lord Young of Graffham

Young
15/10

The Rt. Hon. Nigel Lawson Q.C., M.P.,
Chancellor of the Exchequer,
H M Treasury,
Parliament Street,
London, S.W.1.

15th October, 1984

C
FST +
Nick Mouch?
MP

Dear Nigel,

CH/EXCHEQUE	
REC.	16 OCT 1984
ACTION	Mr Mack
COPIES TO	Sir P. Middleton
	Mr A. Bailey

16/10
Sir P. Burns

As you know, the Prime Minister has identified a number of areas to which she has asked me to give immediate attention in pursuing my remit to promote policies for the growth of enterprise and the creation of jobs. Accordingly, and after discussion with the Secretary of the Cabinet, it has been agreed that I should chair a working group for each of the areas concerned consisting of a junior Minister and a senior official nominated by the Ministers in charge of the departments concerned. The groups will report with conclusions and recommendations to the appropriate Cabinet Committee, by whom decisions will be taken.

The two areas to which I intend to give immediate priority are the 14 - 18 year age group and small firms. The terms of reference which I have in mind for the groups are as follows:

14 - 18 Age Group

To review policy towards the 14 - 18 year age group with a view to creating a comprehensive, employment-oriented programme that is broad, balanced, relevant and differentiated for the ability range; and to make recommendations to the Ministerial Sub-Committee on Economic Affairs (E(A)).

Small Firms

To review the range of Government support and assistance available to small firms and to consider what scope there may be for making this support and assistance more cost-effective and for further financial and non-financial measures, within existing resources, to encourage the establishment and growth of small firms; and to make recommendations to the Ministerial Sub-Committee on Economic Affairs (E(A)).

CONFIDENTIAL

.... /Cont.

CONFIDENTIAL

- 2 -

I very much hope that you will agree that your Department should be represented on these groups. If so, perhaps you could be kind enough to let me know who will represent you on each group at Ministerial and senior official levels.

I am sending copies of this letter to Norman Tebbit and Tom King, with a similar request, and to Sir Robert Armstrong.

*Yours
luc,
David*

CONFIDENTIAL



CABINET OFFICE

H

From the Minister without Portfolio

70 Whitehall
London SW1A 2AS
Telephone 233 3299

The Rt. Hon. Lord Young of Graffham

Andrew Turnbull, Esq.,
Private Secretary,
10 Downing Street,
London, S.W.1.

22nd October, 1984

Dear Andrew

CH/EXCHEQUER	
REC.	24 OCT 1984
ACTION	Mr Monek
COPIES TO	CSI, FSI, MSI, EST
	Sir P. Middleton
	Sir T. Burns, Mr Bailey
	Mr Bussner, Mr Faulkner

✓ 24/10

ENTERPRISE

Lord Young has seen the Paymaster General's minute of 16th October and your letter to David Normington of 17th October.

Mr Gordon
Mr Conry
Mr Riolley
Mr Lord

The Paymaster General raised a second point in his minute - namely the provision of advice to those who may wish to set up as self-employed but who have no previous experience of business. The Minister without Portfolio has asked me to say that, if the Prime Minister agrees, he would intend to follow this up within the group which he is establishing on the small firms area.

I am copying this letter to the recipients of yours of 17th October and to Callum McCarthy (DTI).

Yours ever

Leigh

Leigh Lewis
Private Secretary