ANNEX II

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The Rt Hon Margaret Thatcher MP
Prime Minister & First Lord of the Treasury
10 Downing Street
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Dear Prime Minister.

I am writing to express the Institute of Directors' views on the priority that should be accorded to various aspects of national policy during the next session of Parliament. They largely relate to the economy both because of the nature of the Institute's membership and because the present state of the national economy overrides all other considerations.

The Institute, representing 30,000 senior business leaders responsible between them for the livelihoods of over 5 million employees, remains firmly convinced that the three main strands of this Government's economic strategy are correct:

- the reduction of inflation by controlling the money supply,
- the reintroduction of disciplines of the market place,
- and, the stimulation of individual responsibility and enterprise.

In order to pursue these policies, there are certain areas which require early legislative attention. The two to which the Institute accords the highest priority are the reform of capital taxation and the regulation of the relationship between trade unions and the rest of society.

Capital Taxation

The present system of capital taxation imposes an inefficiently high cost of collection, is unfair in that it taxes the unreal gains of inflation, and arbitrary in its incidence as between individuals and types of assets.

Quite apart from the promises which have been made, both before and after the election, we are at a loss to understand why your Government persists in maintaining the fundamental fiscal bias against saving and investment. Capital taxes inhibit saving and, in particular, the accumulation of private capital for productive purposes, and fail in their redistributive aim by hampering the normal process of distribution of wealth from richer to poorer through gift and bequest. Their removal would entail a comparatively small loss of revenue of some £1 billion, little of which would fall in the next fiscal year. At the same time the Government would secure major increases in the flexibility and responsiveness of the economy, and a substantial saving in its own unproductive expenditure.

Industrial Relations

The same economic considerations support the case for the reform of trade union law. Most public criticism of trade unions' legal privileges stems from their undesirable constitutional and political side effects. The economic role of these privileges is equally important in reinforcing the public sector's continued involvement in the economy, and in obstructing changes in the private sector which are essential to increase its productivity. Monopolizing tendencies are just as dangerous in the hands of labour as in the hands of capital, and we should regard the reduction of the one as an essential corollary of the reduction of the other and of the power of the state. This is the best justification for further action to reduce trade unions' immunities, and without such action much of the Government's other policies will be placed seriously at risk.

The Public Sector

But in addition to the reform of capital taxation and trade union reform we cannot stress too highly the urgent need for government action in the general context of the economy. We are concerned that the Government has so far lacked the confidence to take the steps which lie within its own power, and has not been vigorous enough in reducing both the present and the prospective proportion of national production pre-empted by the public sector.

In consequence, the chosen instrument for the reduction of inflation - monetary control - is rendered ineffective by the Government's own financial deficit, and the distortions to a competitive and self regulating economy caused by a public presence on which 48% of the population depend for their primary source of income persist. Not only has this left little room for further reductions in individual taxation, but commerce and industry themselves - and those who work in them or increasingly are not working in them - have borne virtually the whole burden of the Government's policies. Some 6.8% of the private sector workforce is at present unemployed; the corresponding figure for the public sector is 3.8%. It is ironic that the Government should have incurred so much odium from the Left for cuts which it has not made.

The Institute has never sought special favours for commerce and industry from government; it has never sought protection from external competition, nor subsidies to cushion internal decline. But it cannot acquiesce in additional burdens in the shape of high interest rates and the reduction of Government deficits by raising nationalised industry prices and taxes, such as rates, in a manner which designedly adds to industry's burdens at the expense of other sectors. Other, and more radical methods need to be found if Government policies are to succeed.

Although comparisons between business and Government can be misleading they can also enlighten. The public sector's total position today is in many respects similar to that of a business whose costs have exceeded its income over a number of years, which has run through its liquid assets, and whose credit is rapidly approaching exhaustion.

In these circumstances a business can do only four things if it is to survive. It can cut its costs - especially those it has regarded as fixed costs; it can raise the volume of its sales; it can put up its prices until it meets diminished returns from disillusioned customers; and it can search the balance sheet for dispensable and preferably undervalued fixed assets. There are no other choices.

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Cutting current costs is invariably a long term and difficult process; it must be prosecuted with vigour and continued when all the easy cuts have been made. It is an essential element in stabilizing the situation but it cannot of itself effect an immediate cure.

Government does not have the option of increasing sales volume - we need less Government activity not more - and government has already reached the limit of customer resistance to price rises in the shape of increased taxation. This leaves only the balance sheet as a possible source of immediate salvation.

Here the prospects are immeasurably brighter. The Government has substantial undervalued assets devoted to the provision of private, as opposed to public, goods.

It is to this area therefore that we must look to solve the present financial problem, and, by good fortune, it is in this area that action can also best promote the Government's long term strategy of disengagement from the economy.

Sales of public assets have generally hitherto been envisaged as flotations of shares in a minority of the equity of a few profitable public undertakings. This is a reasonable approach, but one of limited scope. A wider and more radical approach seems necessary.

Public assets cover a wide spectrum ranging from those such as the aviation activities which operate in a market controlled by home and foreign competition, industrial failures such as British Steel, British Leyland and British Rail, state monopolies subject to little real competition such as the energy corporations and post and telecomunications, and the 'social' services such as health, education and welfare. There is no divine pronouncement which says that any of these services need be a state monopoly, and plenty of evidence from other countries of their success in the private sector.

We suggest therefore that the Government should review this portfolio carefully, starting with those activities which are closest to normal commercial operations. Its approach should be to consider how best to allow financial institutions, which manage the savings of over half the population, and individuals to participate directly in the financing of the provision of these services. This divestment would however be only the first step in a process of creating the maximum possible number of independent concerns with the widest degree of freedom to compete among themselves.

In some cases, where competiton is already a reality, simple flotation of the shares of newly created independent companies would be appropriate. The Government should however be considering how to deal with the long deferred consequences of doing what has always been necessary among the industrial failures - the separation and subsequent flotation or sale of the viable or potentially viable pieces. In their present environment these activities are starved of the investment they can use effectively by its diversion to their unprofitable but dominant stablemates.

Whilst it might be possible to float off the state monopolies by the issue of shares - and there are many examples in other countries of the effective provision of public utilities by private concerns - a halfway stage might be to arrange for the transfer of their assets to the private sector on a'sale and lease-back'basis at rentals which would reflect the prospect of the ultimate transfer of their operations to independent companies; although it would mean an even greater effort of popular imagination the same process could be applied to social services. These services, which at present have little or no independent sources of revenue, would acquire them over a transitional period through the introduction of an insurance based fees system.

The finance for their operation would come from those savings, which are at present diverted to government's direct control by the issue of public sector securities. The great virtue of direct financing would be that the market would at last begin to be able to signal consumer choice and that the investment and development programmes of the services concerned would at last begin to reflect it.

Raiding the balance sheet could be construed as a counsel of desperation - but in the present situation it is not. It directly promotes the Government's long term aim of promoting a free competitive and productive economy. At the same time it is a reasonable and sensible method of solving the short term problems of the imbalance between Government activity and public unwillingness to pay for it, which creates inflation. As such I think it merits the most careful consideration by you and your colleagues.

Yours sincerely