10 DOWNING STREET

THE PRIME MINISTER

18 November 1980

Dear Mr. Goldsmith

Thank you for your letter of 7 October. I value highly your endorsement of our economic strategy, and much appreciate the time you spent sending me your advice.

I know that many see a strong case for the complete removal of capital taxation in this country. However, the Conservative Party has taken the view that it would be wrong to remove all restraints on the aggregation and transmission of substantial wealth. We do not want to see the concentration of the country's assets in fewer and fewer hands. On the contrary, we are concerned to enable many more people to acquire and transmit property. This certainly means that there has to be a substantial reduction in both the burden and the complexity of capital taxation; indeed, it was our Manifesto commitment to deal with the most damaging features of capital taxation and to propose a simpler and less oppressive system in the long run. But I cannot - certainly at this moment - share your view that £1 billion would represent a "comparatively small loss of revenue".

In our first full year in office we managed to make a substantial start on redeeming our Manifesto pledge. In the 1979 Budget we considerably raised the threshold for the investment income surcharge and we reduced and simplified the development land tax. This year we introduced a sizeable measure of relief from capital gains tax and dealt with the much criticised double charge to CTT and CGT. We doubled the threshold to capital transfer tax, so that it is higher in real terms than at any time since the introduction of estate duty in 1894, and provided some

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relief from stamp duties. By these measures we removed from Capital Transfer Tax at least two-thirds of the estates which would otherwise have been liable; in the case of Capital Gains Tax we removed from tax half the cases formerly liable.

Despite all this, I know that we have so far done less than we should have liked. Indeed, Geoffrey Howe and his colleagues at the Treasury have stressed that what we have done is only a start and that there are more far-reaching changes to come. This year we simply took the view that it would not be acceptable to the country, or to the Conservative Party, to have brought forward the full range of CTT reforms at a time when a number of very unpalatable decisions are being forced on us in other areas. But I should be disappointed if by the end of this Parliament we have not done a great deal towards changing the structure of capital taxation we inherited into one which we can all accept.

You say that the Institute accords high priority to the need to regulate the relationship between trade unions and the rest of society. This is something to which we also attach considerable importance and on which we have already taken action. We are committed to restoring the balance of power in industrial relations and the Employment Act has given industry a legal framework which will assist it in this task. Amongst the Act's most important measures are the provision of funds for secret ballots for trade union votes; extra protection for individual employees where a closed shop is established; and the limiting of lawful picketing and other forms of secondary action.

I fully recognise the valuable contribution that improved industrial relations can make in assisting our economic recovery. However, I am of course, aware that the changes introduced by the Employment Act have yet to be tested. We are therefore keeping the question of immunities under review and it is intended that a Green Paper on the subject should be published before the end of the year. This will provide a good basis for discussion of any further changes that may be needed.

As regards the public sector, I think that we can claim to have taken vigorous action to restrain the level of public spending. As you say, cutting costs is difficult and is not merely a short-term matter. At the time of the Budget last March we announced a reduction of £5 billion off planned spending for 1980-81, with substantially larger reductions in the subsequent years. We have also given special attention to civil service manpower, and aim to secure a reduction of some 100,000 by April 1984 from the level of 732,000 which we inherited on taking office. This would mean the smallest civil service since the war. Already the numbers have been reduced to under 700,000.

Although in the absence of nationalised industry price increases public sector borrowing and consequently the level of interest rates would almost certainly have been higher, it is not true that the level and structure of nationalised industry prices has been set with the aim of achieving a particular reduction in the public sector deficit. The principles guiding nationalised industry pricing are broadly those set out in the 1978 White Paper on the Nationalised Industries (Cmnd 7131). In general, the industries are expected to set prices at a level which will enable them to meet their financial targets: these in turn are set by the Government at levels designed to ensure that the industries earn a rate of return on their investment at least equivalent to that which the capital would have earned if it had been put to use in the private sector. This principle must be applied if national resources are not to be wasted through misallocation, and is independent of the size of the public sector deficit. Applying it has produced some sharp rises in prices where prices had been held back at uneconomic levels in the mid-70s, but our expectation is that the differential between nationalised industry price rises and movements in the RPI will fall back significantly over the coming year.

I read with interest your comments on the different forms which disposal of public sector assets could take. I was pleased to note your view that where competition is already a reality, it might be appropriate to sell shares in newly created independent companies. As I am sure you know, the Government is developing

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proposals for the sale of newly independent companies. The National Freight Corporation has recently been vested as a Companies Act company as the first step towards an offer for sale of shares. Plans are also in hand for sales in other areas including, for example, British Airways and British Aerospace.

Your second suggestion - that public utilities assets might be transferred to financial institutions on a sale and lease-back basis to provide them with a private source of finance - is under discussion.

Yours sincerely

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Walter Goldsmith, Esq.