

DOE COPY No 1
2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

5 February 1981

~~to the leaders~~
to the leaders
to the leaders
to the leaders

1981 BUDGET

As you are thinking about possible Budget measures to boost industry, I would like you to give serious consideration to what can be done to help the construction industries which, together with materials manufacture, form over one fifth of industrial production. Output in this sector is now some 10% lower than when we took office and new order figures suggest a further decline of similar magnitude in 1981.

Unemployment has risen to over 280,000 unskilled men and craftsmen. So far I understand that much of the residual manufacturing capacity has been retained; but once closed, this cannot easily be reinstated. Recent statements of business intentions concerning buildings investment suggest a halt to the steady decline since mid-1979 but this is as yet too short lived to be regarded as evidence of the beginnings of an upturn for construction.

The features of the industry which would make it an essential contributor to renewed growth in the economy are well known to you. Construction has a very small import content and labour represents the bulk of its value added, while the materials capacity remains, it can swing into action as quickly as the orders come forward. This would trigger off an upswing for other industries - construction plant heating ventilating equipment, carpet manufacture to name a few.

The most valuable fiscal stimulus which could be directed primarily to construction would be to extend 100% capital allowances to those businesses investing in industrial building, placing these allowances on a similar basis to that for plant and machinery. There would be a revenue cost of some £600 m spread over four years, though none of this would fall in the first year and in the long run there would be no loss of revenue. With my encouragement the industry is directing more attention to this particular market in the private sector; and a change in the tax arrangements now would strongly complement such efforts.

This would of course bring wider benefits to industry as a whole. Much of our efforts in Government to date have been directed to raising industrial performance! As you know, so much of our industry - even the innovative engineering sectors - is conducted in hopelessly antiquated premises which hamper efficient production and undermine the morale of management and workforce. As the

recent NEDO Study Construction for Industry Recovery' reported, investment in new premises has resulted in improvements and profitability for most firms on a scale which was unexpected. Efficient buildings can reduce the time and cost of production, improve delivery services, and reduce capital 'tied up' in work in progress. A reduction in cost for a new facility of this kind would be of significant help to small and medium sized companies considering new investment.

I have thought about your suggestion that Development Land Tax should be exempted for a period. I strongly support this. It seems to me that there are powerful arguments for doing this for a short period in the first instance. Perhaps only for one year subject to review. I think we want the maximum galvanising effect.

I would strongly support any change to reduce the costs of new house purchase and hence provide a stimulus to the housebuilding industry at a time when private sector output is some 30% lower than in the previous year. Given that the average price of a new house substantially exceeds the exemption limit of £20,000 there is a strong case for raising it to £25,000 or even £30,000. You might also consider the proposal for a reform of the structure of the tax so that only the top slice exceeding the limit attracts the tax rather than the whole house price.

I should also like to emphasise the concern that I expressed when I wrote to you in August about the different treatment for VAP purposes of new build and repair and maintenance. The existing rules are so blurred round the edges that they have produced endless anomalies in tax treatment and have encouraged evasion. The construction industry has expressed justifiable disquiet at the resulting growth of the black economy. It seems to me that we could argue that, in the context of EEC obligations, zero rating of repair and maintenance would not be a significant extension of the existing situation. It would also give a welcome boost to our policies of encouraging responsible home ownership and promoting the rehabilitation of older housing. Moreover this kind of building work is labour intensive and would provide welcome relief for the unemployed. If you are unable to agree to zero rating repairs generally, I hope you will consider making this relaxation for repairs to historic buildings. It would remove a major disincentive to conservation work.

I hope you will be able to accommodate some or all of these changes. I should be happy to discuss further with you.

I am copying this to the Prime Minister, and to those to whom Keith Joseph's letter of 30 January 1981 was copied.

*Yours in
sincere
faith*
MICHAEL HERSHKOVITZ

-5 FEB 1981

1
2
3
4
5
6
7
8
9
10

Enlight
cc to letters
A letter
A demand
See briefing



DOE COPY No 1
2 MARSHAM STREET
LONDON SW1P 3EE

My ref:
Your ref:
5 February 1981

1981 BUDGET

I was interested to see Sir Keith Joseph's letter of 20 January. I agree very strongly with him that helping industry, even at the expense of the domestic taxpayer, must be our main priority. (I am writing to you separately today with some ideas of my own).

For me, the top priority remains the early introduction of a 'stimulus' or 'start-up' package, on the lines of which FASE has been working. I think your forthcoming budget is the last occasion on which something can be introduced which will make a significant contribution in this Parliament. We must be prepared to take risks here.

I hope also that you will be able to look sympathetically at Keith's suggestions for some more discretionary expenditure. Even if, as we all hope, output has reached the bottom, a quick recovery in investment will not happen without some stimulus. The proposal to cancel the deferment of RDG looks attractive as a means of helping relieve the financial pressures on the big investors.

I have thought deeply about his main suggestion that the NIS surcharge should be cut. A selective cut would be attractive - particularly if it could include the construction industry, which is also suffering badly from the heavy cut-backs to investment. But if that is not possible, my own feeling is that it would be better not to give this across-the-board relief. Similar, probably rather greater problems would apply to industrial leasing. I have already mentioned to you my concern about the adequacy of building society funds to support the revival of private housebuilding, particularly as your proposals to finance more of the PSBR from domestic savings and less from the long-term capital markets could make their task harder. But I feel that both Keith and I should be wary of making proposals that relieve the current costs of industry or construction. They must make it harder for you to reduce your need to borrow and put off the time when interest rates (and the exchange rate) can fall and so help the revival of private investment, whether in industry or in housebuilding.

I would also like to offer strong support for Keith's suggestion on capital allowances for small industrial workshops. An extension of the arrangements to enable the tax advantages to

SECRET

flow through to a large number of individual investors has considerable merit. If we are to get these developments off the ground successfully then we must be seeking to tap all sections of the market, not simply the Pension Funds, who initially are inclined to adopt a more cautious line.

I am copying this to the Prime Minister and to those to whom Keith Joseph's letter of 30 January was copied.

Yours truly



MICHAEL HESELTINE

-5 FEB 1988

