

PART 8

Confidential Filip

ECONOMIC
POLICY

Part 1: May 1979

Part 8: June 1982

The 1982 Budget

PREM 19/702

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
14-6-82							
17-6-82							
5-7-82							
8-7-82							
12-7-82							
13-7-82							
20-7-82							
31-8-82							
6-9-82							
1-10-82							

PART 8 ends:-

MCS to HMT of 1/10/82.

PART 9 begins:-

ch of Ex to PM + act of 19/10/82



Even Post.

10 DOWNING STREET

From the Private Secretary

1 October 1982

Dear John,

The Prime Minister was grateful for the Chancellor's minute of 27 September. I confirm that Mrs. Thatcher is content with 15 March as the planning date for the Budget.

Yours sincerely,

Michael Scholar

John Kerr Esq
HM Treasury.

CONFIDENTIAL

RM

PERSONAL AND CONFIDENTIAL

PRIME MINISTER

It may be useful to you as you fly home to have a short account of current preoccupations on the economic front.

My talks in Washington - about which I shall let you have a separate note - left me with the strong impression that the US recovery will be slow to come through. The international banking situation looks a little less dicey than it did when you left though Mexico still causes continuing concern. Domestically I hope we shall get another half point off base rates during the next week or so. The August output figures were bad but the inflation outlook continues to improve: we now expect to be down to 6½% by the turn of the year. (In order to maximise the pay round effect I made something of a splash of this in a speech in New York last week). We are to discuss in Cabinet on Thursday the pay factor in next year's cash limits: the choice is I think between 3% and 4%. Leon Brittan is in the thick of public expenditure survey bilateral discussions: the greatest problem is as usual likely to be defence but the improved inflation prospect may make his overall task rather easier than it was last year.

Two pieces of press speculation are proving hard to kill. First, as you feared, the CPRS' ideas on changes in the public expenditure pattern in the long term have leaked and attracted a good deal of publicity which has ignored the long term nature of the exercise and has concentrated on contentious possible prescriptions rather than the diagnosis on which all should agree. Secondly, Fleet Street buzzes with rumours - not of Treasury origin! - that I plan to devote three or four billion pounds in the budget to raising personal tax thresholds. Some variants of the story have me making an announcement to this effect in November and some papers link the two stories suggesting that massive tax cuts will be paid for by an onslaught on the NHS. All this is irritating and efforts to kill it will be stepped up.

It is of course far too soon to judge what room we shall have at budget time for tax reductions or the form such reductions might take. Action on the personal tax thresholds is certainly / desirable

- 2 -

desirable but we need also to consider - as this year - more direct ways of assisting industry. The CBI are already planning their campaign and I am in touch with Terry Beckett and will have an early private meeting with him.

Within the next fortnight I shall have the Autumn forecast which will give the first broad indication of the scope for further action. But we shall not by November be in a position to make any substantial commitments for a March budget. What we will have to do in November - or early December - is as usual to publish the outline public expenditure plans and proposed national insurance changes for the year ahead and the forecast required under the Industry Act. I favour adding to these announcements some presentationally attractive boosters for enterprise and I am already in touch with Patrick Jenkin about this. If our improved monitoring of this year's PSBR were to reveal the likelihood of an under-shot it might be possible to add more substantive measures to take immediate effect - e.g. the abolition of deferment on regional development grant and there may be more directly employment-related measures which we could take: I look forward to discussing the CPRS and Minford ideas with you. But we cannot yet say how much room for adjustment we shall have in the late Autumn still less at budget time and must beware e.g. in what we say at Brighton next week of raising expectations unduly. What matters most if we are to sustain the downward movement of interest rates is of course that our determination to hold borrowing down should be seen to be undiminished.

Incidentally, we have yet to formally agree on the date of the next budget though I have mentioned to you that I am at present planning on 15 March. This is about a week later than in the past two years but still earlier than has often been the practice. 8 March would also be possible though I would prefer the extra week: 22 March is ruled out by a European Council. No final decisions are needed until the New Year but it would be helpful if you could confirm that you are content with a planning date of 15 March.

28 September 1982

CHANCELLOR OF THE EXCHEQUER

cc. A.W.

PERSONAL AND CONFIDENTIAL



Delayed a
braking to
H Kapan
28/9

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister (2)

You have, I believe,

already seen this
your progress report.

MCS 27/9

PRIME MINISTER

It may be useful to you as you fly home to have a short account of current preoccupations on the economic front.

2. My talks in Washington - about which I shall let you have a separate note - left me with the strong impression that the US recovery will beslow to come through. The international banking situation looks a little less dicey than it did when you left, though Mexico still causes continuing concern. Domestically, I hope we shall get another half point off base rates during the next week or so. The August output figures were bad, but the inflation outlook continues to improve: we now expect to be down to 6½ per cent by the turn of the year. (In order to maximise the pay round effects, I made something of a splash of this in a speech in New York last week.) We are to discuss in Cabinet on Thursday the pay factor in next year's cash limits: the choice is, I think, between 3 per cent and 4 per cent. Leon Brittan is in the thick of public expenditure survey bilateral discussions: the greatest problem is, as usual, likely to be defence, but the improved inflation prospect may make his overall task rather easier than it was last year.

3. Two pieces of press speculation are proving hard to kill. First, as you feared, the CPRS ideas on changes in the public expenditure pattern in the long term have leaked, and attracted a good deal of publicity, which has ignored the long-term nature of the exercise, and has concentrated on contentious possible prescriptions rather than the diagnosis on which all should agree. Secondly, Fleet Street buzzes with rumours - not of Treasury origin! - that I plan to devote £3 or £4 billion in the Budget to

PERSONAL AND CONFIDENTIAL



raising personal tax thresholds. Some variants of the story have me making an announcement to this effect in November. And some papers link the two stories, suggesting that massive tax cuts will be paid for by an onslaught on the NHS. All this is irritating, and efforts to kill it will be stepped up.

4. It is of course far too soon to judge what room we shall have at Budget-time for tax reductions, or the form such reductions might take. Action on the personal tax thresholds is certainly desirable, but we need also to consider - as this year - more direct ways of assisting industry. The CBI are already planning their campaign, and I am in touch with Terry Beckett, and will have an early private meeting with him.

5. Within the next fortnight, I shall have the autumn forecast, which will give the first broad indication of the scope for future action. But we shall not by November be in a position to make any substantial commitments for a March Budget. What we will have to do in November - or early December - is, as usual, to publish the outline public expenditure plans and proposed National Insurance changes for the year ahead, and the forecast required under the Industry Act. I favour adding to these announcements some presentationally attractive boosters for enterprise, and I am already in touch with Patrick Jenkin about this. If our improved monitoring of this year's PSBR were to reveal the likelihood of an undershoot, it might be possible to add more substantive measures to take immediate effect - e.g. the abolition of the deferment on regional development grants. And there may be more directly employment-related measures which we could take: I look forward to discussing the CPRS and Minford ideas with you. But we cannot yet say how much room for adjustment we shall have in the late autumn, still less at Budget-time, and must beware - e.g. in what we say at Brighton next week - of raising expectations unduly. What matters most, if we are to sustain the downward movement of interest rates, is



of course that our determination to hold borrowing down should be seen to be undiminished.

6. Incidentally, we have yet to formally agree on the date of the next Budget, though I have mentioned to you that I am at present planning on 15 March. This is about a week later than in the past two years, but still earlier than has often been the practice. 8 March would also be possible, though I would prefer the extra week: 22 March is ruled out by a European Council. No final decisions are needed until the New Year, but it would be helpful if you could confirm that you are content with a planning date of 15 March.

(G.H.)

27 September 1982

22 September 1962

- Budget
Exec Pol*
1. MR KEMP *not below
Kerr.*
2. CHANCELLOR OF THE EXCHEQUER cc As on attached list

TIMETABLE TO THE BUDGET

Attached is an updated timetable, which has been discussed with interested divisions. The two high spots are of course the date of the Budget and the timing of the autumn announcements.

The Budget Date

2. First, the Budget. Mr Kerr's minute of 14 June conveyed your preliminary endorsement of the timetable up to a 15 March Budget. We have since checked over the other possibilities again, consulting the Lord President's Office, the Chief Whip's Office and the No 10 diary keeper, and this still seems to be front runner. 8 March is possible but a little early, especially since more now has to be crammed into the timetable, including particularly the pre-Budget Cabinet. 22 March is ruled out by a European Council. 29 March would be awkward in relation to Easter. Dates in April risk congesting the Parliamentary timetable and lose revenue. 19 April is anyway probably ruled out by the fact that the Prime Minister is addressing the CBI annual dinner that day and it would be difficult for her to make an economic speech on the same day as the Budget.

3. 15 March is also slightly awkward since industrial production figures are due to be published that day. However we should have a first CSO forecast of them in February and the actual figures on the Friday before the Budget, so they could be taken into account as necessary in the speech and in briefing. A similar point has arisen in the past (and would arise again for a Budget on 8 March next year) in relation to the provisional money numbers.

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4. If you agree that we should continue to plan on 15 March I attach a draft minute which you might send to the Prime Minister to consult her formally.

Autumn Announcements

5. There was last year some discussion about the possibility of trickling out the usual autumn announcements (IAF, public expenditure, NIC etc) rather than putting them together for a single day. The Prime Minister has shown an inclination to see if that can be achieved this year.

6. There are familiar advantages and disadvantages to a trickle approach. The Government has though said in its reply to the TCSC report on Budgetary reform that it would publish an Autumn Statement bringing together the IAF, the expenditure proposals, NIC, ready reckoners and any proposed tax changes which can then be announced. On this basis there is a presumption that a document will be published bringing these things together, even if the reply to the TCSC does not require a single oral statement to the House. It is for example possible, though perhaps unlikely, that an Autumn Statement (AS) could be drawn to the attention of the House by means of a written PQ. A particular question is the timing of an announcement of any NIS change. A note is being submitted separately on this, and another is in hand on the content and presentation of the AS. For present purposes however it is assumed simply that a single document will be published.

7. The suggested timetable is set out in detail on the attached sheet. In outline it is as follows:

October 7	Autumn forecast circulated
October 21	Economic and public expenditure papers circulated to Cabinet
October 22	Paper circulated on main questions arising in relation to IAF and assumptions for GAD

October 26 Final assumptions to GAD
October 28 Economic Cabinet
November 4 Possible spill-over Cabinet
November 24 Autumn Statement published

There is however already a possibility that the first economic Cabinet could slip back to November 4 with a spill-over on November 11 if necessary.

8. Publication on 24 November would be earlier than we had suggested in June (when the reply to the TCSC had not been finalised). But this earlier timetable would among other advantages give earlier notice to the spenders of public money, it would allow a more relaxed Parliamentary timetable for any necessary legislation, and it would keep the announcements clear of the IMF Article IV consultations.

9. The gap envisaged here between final public spending decisions on 4 November and announcements on 24 November is in some ways a comfortable one, perhaps too comfortable. You will recall that last year there was strong pressure to publish within a day or so of the final decisions, and in the event your statement was made six days after the final decisions.

10. The need to print the AS this year, rather than putting out the announcements in press notices, adds some 4-5 days to the timetable, assuming that a good part of the material has gone to the printers in advance. There is to some extent a trade-off here between comprehensiveness and beauty on the one hand and speed on the other. It may be possible to produce the AS within say 10 days of the final decisions if not too much further analysis of the expenditure figures is to be included in the AS, and the charts are not too elaborate. At the other end, publication in December should allow full analysis and the AS could be a thing of beauty.

11. The date suggested of November 24 lies on the prudent side:

some of the expenditure decisions may slip as noted above, and there are also this year some new features in the content of the announcements (eg a PSBR figure for the coming year) which could lead to protracted discussion. But if things go according to plan publication date might be brought forward.

12. You might like to note, finally, that the "window" for the Britoil flotation is 8 November to 3 December. We shall need to co-ordinate the timing so that if at all possible there is a reasonable gap between the AS and the announcement about the flotation.

Conclusion

13. As always we are unlikely to be able to stick rigidly to any particular timetable, but it would be helpful to have your preliminary agreement to what is proposed here, and for you formally to seek the Prime Minister's agreement to a Budget date of 15 March.

D R Norgrove

D R NORGROVE

I think we should try to plan now for a 15 March Budget. For the Autumn there are two questions (a) what goes into the Autumn Statement and what emerges separately? and (b) when is the Autumn Statement itself to be published? On (a) we have told the TCSC that certain things will be in the AS - see paragraph 6 above. Whether any "extraordinary" items go into it or come out separately can perhaps be best decided case by case (and the separate submission on NIS (para 6 above) was attached to my brief for your meeting tomorrow with Mr Jenkin - a further copy is attached for convenience). On (b) my inclination is to have the shortest possible gap between Ministers taking final decisions and publication of the AS, even if this leaves the AS with some rough edges at least this year. This may mean that a date of 24 November could be bettered or it may not. But other factors may have a bearing on its date of publication (and indeed possibly content); Britoil (paragraph 12 above) is one and the miners' pay negotiation may be another. You may wish to discuss this with us.

EPK

EPK

DRAFT MINUTE FROM THE CHANCELLOR TO THE
PRIME MINISTER

I have been giving some thought to the timing of the 1983 Budget in the light of the decisions that will need to be taken in the coming months.

I am asking my Departments provisionally to plan for Budget day on March 15. This is about a week later than in the past two years, but it is still earlier than has often been the practice. The slight easing would, I think, be helpful as the timetable in the run-up to the Budget becomes increasingly crowded. A date of 15 March may be slightly awkward if the industrial production figures due to be announced that day turned out to be poor. However we shall know what they are to be on the Friday before the Budget so they could be taken into account in the speech and in briefing.

Other dates also have disadvantages. March 8 is I believe possible though a little too soon. March 22, is ruled out by a European Council, and dates in April (April 12 or 19) among other things risk creating difficulties for the Parliamentary timetable and would lose revenue.

You are I understand in any case down to address the
CBI annual dinner on April 19.

No final decisions are needed until the New Year,
and unforeseen circumstances may change the balance
of advantage. But it would be helpful to know that
you are content with a planning date of 15 March.

/GH/

Circulation:

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
PCC
MEG
Mr Monger
Mr Burgner
Mr Ridley
Mr French
Mr Harris

PS/Inland Revenue
PS/Customs and Excise

	October					November					December		
	4	11	18	25	28-29	1	8	15	22	29	6	13	20
Relevant events		Part 1 review	18 ↑ Planning France	28-29 Paragotia		3 ↑ State opening					6-13 Article IV consultations		
Ch/Ex major commitments not in London	5-8 Party conference		18 ↑ Exfin	28-29 Germany		4-5 ↑ A French summit		15-16 ↑ Exfin and Jember Council				17 ↑ Exfin	
Economic strategy and spending totals	30 ↑ Cabinet report on public spending			28 ↑ Economic and public expenditure Cabinet		4 ↑ Possible spill-over Cabinet	11 ↑ Further possible spill-over			24 ↑ Public Autumn Statement			
Forecasts etc	7 ↑ Autumn forecast to THs	15 ↑ Prelim. assumptions to GAD	22 ↑ Paper on IAF, ↑ assumptions for GAD	24-26 ↑ Final assumptions to GAD		3 ↑ Report on IAF	5 ↑ Draft IAF			24 ↑ Publish IAF			
Tax						8-15 ↑ Donors NIS related to NIC etc				24 ↑ NIS change announced (final)			
Social Security						8-15 ↑ Towards decision on NCC				24 ↑ NIS rates announced Order/bill laid/introduced			
Local authorities and waterworks in dispute				21 ↑ Cabinet w. A decides RSG and EFLs	28 ↑					24 ↑ Finance EFLs Provide RSG announcement November 25			
Economic statistics announced	5 ↑ Money (prev)	13 ↑ RPI ↑ Industrial production	15 ↑ RPI	21 ↑ PSBR	26 ↑ Unemployment	9 ↑ Money (prev)	12 ↑ RPI ↑ Industrial production			7 ↑ Money (prev)	13 ↑ Ind prod	17 ↑ RPI	

Note: from November timing of unemployment figures is uncertain - possibly around first Tuesday of each month.

	January					February				March			
	3	10	17	24	31	7	14	21	28	7	14	21	28
			15/16/17 ↑ Exfin Chewing			7 ↑ Exfin				7 ↑ Exfin			
							28 ↑ Publish P&D	3 ↑ Excal				15 ↑ Budget day	
	6/7 ↑ Update IAF to THs			24 ↑ Pre-budget forecast								15 ↑ F&S published	
						18 ↑ VATT specific duties structure	25 ↑ NIS and other tax rates					15 ↑ Finance tax changes	31 ↑ Probable date for handing Finance Bill to House authorities
												15 ↑ Upstream announced	
	4 ↑ Money (prev)		18 ↑ Ind. RPI prod. PSBR	21 ↑ RPI		8 ↑ Money (prev)	11 ↑ RPI	15 ↑ Ind prod		8 ↑ Money (prev)	11 ↑ PSBR	15 ↑ Ind prod.	18 ↑ RPI

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CONFIDENTIAL



PRIVY COUNCIL OFFICE
WHITEHALL LONDON SW1A 7AT

6 September 1982

*Please file
C1.*

Dear Mr. Norgrove

DATE OF 1983 BUDGET

Thank you for your letter of 27 August.
The Lord President is content with the
timing that you propose.

I am copying this letter to the recipients
of yours.

Yours sincerely
D C R Heyhoe

D C R HEYHOE
Private Secretary

D R Norgrove Esq
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

CONFIDENTIAL

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Econ Pol.

Sub

31 August 1982

1983 BUDGET

Following your letter to David Heyhoe, I have had a look at the Prime Minister's diary and Tuesday, 15 March will suit her. 8 March and 12 April will also be convenient, but 19 April would not as Mrs. Thatcher is addressing the Annual Dinner of the CBI.

CAROLINE STEPHENS

D.R. Norgrove, Esq.,
HM Treasury.

PN

CONFIDENTIAL



Treasury Chambers
Parliament Street London SW1P 3AG

Telex 262405

Telephone Direct Line 01-233 }
GTN 233 }

Switchboard 01-233 3000

D Heyhoe Esq
PS/Leader of the House of Commons
Privy Council Office
London SW1

Your reference

Our reference

Date 27 August 1982

Dear Heyhoe,

DATE OF 1983 BUDGET

As part of our planning of the sequence of economic decisions and other announcements over the period up to April next year we have been looking at possible dates for the 1983 Budget. The aim of this letter is, as far as is possible at this early stage, to obtain clearance from yourself and those to whom I am copying this letter, for possible dates, bearing in mind the requirements of the Parliamentary timetable and the management of Government business (including the Budget debates); the Prime Minister's diary on Budget day and during the Budget debates; and any functions that may require Ministerial attendance.

The Chancellor has provisionally marked 15 March as front runner. However, as we are checking this date it might be wise to check on other possibilities as well: these dates are 8 March, 12 April and 19 April. The latter two seem unattractive because of the way they would constrict the Finance Bill timetable, however.

I should be grateful for comments by September 13 if possible. We shall then suggest that the Chancellor minute the Prime Minister and other colleagues most closely concerned.

I am copying this letter to Murdo Maclean (Chief Whip's Office), Miss C M Stephens (No 10), Terry Painter (Inland Revenue) and David Howard (Customs & Excise).

Yours sincerely

David Norgrove

D R NORGROVE

27 AUG 1962

11 12 1 2 3 4
5 6 7 8 9

M. Scholar Esq.



AW (P?)

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

13 July 1982

The Rt. Hon. Lord Cockfield,
Secretary of State for Trade

De AM

HIRE PURCHASE CONTROLS

- all report of approved

You wrote to me on 28 June about HP controls, and I have discussed your letter with the Governor. I agree with you that the climate of opinion on monetary affairs is now more favourable to abolition than it was at the time of the Budget. It is of course always possible that there will be unforeseen difficulties. But, subject to that, I think we should now set in hand the preparations for announcing abolition of the controls before the Parliamentary recess. My officials will be arranging this in consultation with your Department and Patrick Jenkin and, of course, with the Bank.

As I said in March, the presentation will need particular care. There is some conflict between the arguments that the controls are ineffective in macro-economic terms and inequitable, and the arguments advanced by for example, the motor industry, that relaxation would make a substantial difference to car sales, particularly in August. I think the broad presentation should be that the removal of these discriminatory controls will help to strengthen competition and benefit some specific sectors, but that abolition is fully compatible overall with maintaining non-inflationary monetary conditions. We shall also need to think through possible implications for the terms of the Bank of England's guidance to the banks on lending to persons.

I am copying this letter to Patrick Jenkin, and to the Governor of the Bank of England.

[Handwritten signature]

GEOFFREY HOWE

✓ PA

C. N. C. HASLAM

TELEPHONE:
01-438 2792

SHELL-MEX HOUSE
STRAND
LONDON WC2R ODX

13th July, 1982.

P.E. Middleton, Esq.,
H.M. Treasury,
Parliament Street,
London SW1P 3AG.

Dear Mr. Middleton,

CLAUSE 129 - FINANCE BILL

I refer to our telephone conversation of yesterday's date and now enclose a copy of a note giving some background to the views of Shell U.K. Ltd. on the issues behind Clause 129.

I hope you will find this helpful. If you have any further queries could you ring me (tel. no. as indicated above) or Mr. Beck on 01-438 2573.

Yours sincerely,

Nigel Haslam

143AJA

gill

TAXATION OF PETROCHEMICAL FEEDSTOCK

It is understood that the Labour Party have tabled an amendment for today's debate on the Finance Bill proposing deletion of Clause 129. In the light of this, this note provides some background behind the view stated in Mr. Raisman's letter to the Financial Times of 8th July (copy attached) regarding the essential nature of this Clause.

1. The Mossmorran Ethane Cracker project was developed in the period 1975 - 1979 when, on the one side, Shell and Esso as developers of the Brent Field had to find a secure outlet for ethane from that field and, on the other, these companies were under very substantial pressure from the Government of the day to utilise such ethane for petrochemical manufacture. At the time ICI and BP showed little interest in taking this feedstock, so that the only way of using it for petrochemical purposes was for Esso and Shell to develop their own project.
2. Security of feedstock availability and a long term basis of pricing are clearly essential ingredients whenever companies decide on major petrochemical investment projects, since these take up to five years to build and often a further five years before they are running at capacity. Where a project utilises special feedstock, such as ethane, for which there is no readily available market price, this problem is covered by agreeing long term feedstock contracts on an arm's length basis between independent sellers and buyers with appropriate escalation clauses.
3. In the particular circumstances of Mossmorran, however, the feedstock necessary for the establishment of the project was not going to be bought from an independent supplier but was to be provided by an affiliated company. A transfer price has nevertheless to be established against which PRT and corporation tax would be calculated. Under the 1975 Oil Taxation Act it is not possible for tax purposes to establish a long term pricing formula between two associated companies. The law provides that the basis for taxation will be the market value established monthly in the light of the competitive environment. Because of the existence of PRT and the resulting high rates of tax on the transfer price of ethane, there was very considerable concern as to how monthly pricing for ethane might develop over the period during which the plant was in operation, since this would clearly be critical to the economics of the project.
4. Shell and Esso, therefore, felt it essential to have some assurance regarding the valuation of the feedstock for taxation purposes before launching such a major project. In the light of these approaches, H.M. Government decided that the best way of dealing with this problem was to amend the current legislation to allow long term contracts between affiliates to be recognised in these limited circumstances for tax purposes in the same way as they would be between independent third parties, provided that the agreement

could be examined in detail by the Inland Revenue and that the Inland Revenue were satisfied that the proposed pricing basis and its escalation formulae was indeed in line with those which would be agreed on an arm's length approach.

5. The removal of this anomaly from the 1975 Oil Taxation Act was necessary to enable chemical affiliates of oil companies to invest in the utilisation of potential petrochemical feedstocks from the North Sea.

The matter was seen as urgent as any agreement on pricing has to be entered into at the time major capital investment is about to be committed - not when it comes on stream. In view of the time scale mentioned in paragraph 2 above, limited review of the basis of valuation is also essential and the period of 5 years mentioned in Clause 129 is the very minimum for this type of contract within the Chemical Industry.

6. On the strength of assurance from H.M. Government that they would propose such amending legislation in the 1982 Finance Bill - this being the earliest time any such amendment could be put through the Parliamentary timetable - and on the strength of an acceptance by the Inland Revenue of the contractual basis to establish the value of the ethane between the associated companies being akin to an arm's length arrangement which fully took into account the best possible forecast of the alternative use value of the ethane, Shell and Esso agreed to proceed with this major investment. The viability of the Mossmorran project and the continuation of the jobs associated with it are thus dependent upon the assurances provided by Clause 129.
7. The above explanation should make clear that under Clause 129 there is no question of any "taxation concession". It merely enables us to establish on a long term basis to the satisfaction of the Inland Revenue that the proposed forward estimate of the value of the ethane being transferred into the petrochemical plant does equate with the sort of pricing formula that one would expect to see between two independent companies.

UKPL

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5571

7th July 1982

The Editor,
Financial Times Ltd.,
Bracken House,
Cannon Street,
London, EC4P 4BY

Sir,

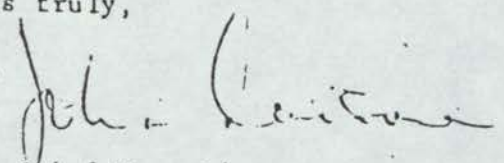
In your leading article 'A Tax Regime for North Sea Gas' of July 2nd, and in your story 'Norway likely to react to North Sea gas tax move' (July 7th) you state that Shell and Esso have been given special tax concessions because they threatened to cancel the Mossmorran petrochemical project. This is not so.

The fact is that the 1975 Oil Taxation Act was found to be inadequate when dealing with transfers between affiliated companies of petrochemical feedstock such as ethane, since the Act stipulates monthly valuation as the pricing basis for such transfers, whereas any such deals between independent companies would undoubtedly be based on long term price formulae. Had this anomaly not been corrected it would have been impossible for integrated oil/chemical companies to develop petrochemical schemes based on such feedstock.

The change now proposed makes it possible for such companies to use a contract price for taxation purposes, provided this price is accepted by the Inland Revenue as equating to one which would be charged in a long term, arms's length transaction between an independent buyer and an independent seller. Anyone who knows how the Revenue operates to protect the national interest must find the idea that such a clause gives some kind of special concession rather strange.

Your leading article also refers to the gas gathering pipeline, for which you appear to have a lingering sympathy. I do not share your confidence that the scheme was the right one either for bringing gas ashore in the most economical way or for providing a firmer footing for the UK petrochemical industry. To my mind projects such as the FLAGS and FRIGG systems now being developed by the oil industry offer a better means of achieving these objectives.

Yours truly,



Chairman and Chief Executive
Shell U.K. Limited

CONFIDENTIAL

FILE

1745



10 DOWNING STREET

From the Private Secretary

13 July 1982

Dear Jill,

Mossmorran; ICI/Wilton

The Prime Minister had a brief discussion with the Chancellor this morning about Clause 129 in the Finance Bill, and its effect on the ICI plant at Wilton. Mr. Middleton was also present.

The Prime Minister said that the Government should continue in the course upon which it was now embarked. But, with hindsight, it had been a mistake to take last autumn's action in regard to Mossmorran without any assessment of the likely impact on ICI. It was surprising that ICI had not at that point made strong representations to the Government. It would be necessary to watch events at Wilton carefully: there would be a strong temptation for ICI to blame the Government for any reduction in capacity there, even where such reduction was likely to take place in any event because of the poor condition of the petrochemical market. The Prime Minister commented that it might prove necessary to consider some form of assistance to ICI, if events so developed.

Yours sincerely,

Michael Scholar

Miss Jill Rutter
HM Treasury.

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Eym Pol

msb

10 DOWNING STREET

(1)

Prime Minister

Mossman /ICI-Wilton

Here is the Attorney-General's
view. It doesn't take us very
far. For discussion with the
Chancellor tomorrow morning.

PLS 12/7

Please see, too, a new letter from
BP, supporting Clause 129! (page A)

CONFIDENTIAL

01-405 7641 Ext. 3020

Communications on this subject should
be addressed to
The Legal Secretary
Attorney General's Chambers

ATTORNEY GENERAL'S CHAMBERS
LAW OFFICERS' DEPARTMENT
ROYAL COURTS OF JUSTICE
LONDON, W.C.2

12 July 1982

M Scholar Esq
10 Downing Street
LONDON S W 1

Dear Scholar

ICI AND NORTH SEA TAXATION

As arranged, I attach a note
setting out the views expressed by
the Attorney General at his conference
earlier today.

Yours sincerely
A. M. Susman

A M SUSMAN

CONFIDENTIAL



I.C.I. AND NORTH SEA TAXATION

Advice of the Attorney General given in conference on 12 July 1982.

The Attorney General was asked to advise whether Clause 129 of the Finance Bill 1982 was vulnerable to successful challenge under Article 92 of the EEC Treaty.

The Attorney General advised that if the formula for valuation laid down in Clause 129 was the best that could be done to achieve an arm's-length, market valuation, a court would not say that the Clause itself was contrary to Article 92 just because of the possibility that decisions thereunder might be more favourable to the taxpayer than they could otherwise be.

He said that following the expert advice which had been given to the Inland Revenue, the Bill provided fairly for valuation on the basis of arms'-length transactions. The question in the action brought by ICI arose out of commitments given to Shell and BP, the existence of which was already suspected by ICI and some components of which would become known in the course of the litigation. ICI contended that these commitments amounted to more favourable treatment than under arms'-length transactions. This question was so complex that the Government could only accept the expert advice that had been given to the effect that the purpose of the legislation would be effected, and if this advice were correct there would be no breach of Article 92. The Attorney General added that he always approached with caution any tax legislation which was designed to assist one or a small number of taxpayers.



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

12 July 1982

Michael Scholar Esq
No.10 Downing Street

Dear Michael,

ICI: CLAUSE 129 OF THE FINANCE BILL

The Chancellor thought that the Prime Minister might be interested to see the attached comments from BP on the ICI demarche about Clause 129.

*Yours ever,
J O Kerr*

J O KERR

R. B. Horton
Chairman and
Managing Director

CHECK CHEQUE	
DATE	- 9 JUL 1982
ACTION	MR CRAWLEY ^{BP} ^{IRM 9/7}
COPIES TO	EST, FET, EST, MST(R) Sir D. Wass, Sir W. Rynie, Mr Middleton Mr Dixon, Mr Moore, Mr Wicks PS/IR

BP Chemicals Limited

Belgrave House
76 Buckingham Palace Road
London SW1W 0SU
Telephone 01-581 6210 ✓

8th July, 1982.

Dear Chancellor,

I have been concerned at some of the comment that has been generated in the media and elsewhere on Clause 129 of the Finance Bill, and have now heard that I.C.I. have applied to the High Court for a declaration that, if enacted, Clause 129 would be contrary to Article 92 of the Treaty of Rome.

Although Mr. Wakeham made quite clear the Government's position during the Committee Debate on 24th June, with which we agree, I would like to record our position on certain assertions which have been made.

If we look at our cracking operations at the present time, as you may know, our Baglan Bay cracker will continue to operate on naphtha feedstock. We will continue to have a share in the Teesside cracker with I.C.I., which is capable of taking a wide range of feedstocks including naphtha and, even after conversion of the Grangemouth Plant, we will continue to utilise as much naphtha in the U.K. as, for example, I.C.I. We therefore have every interest in securing the future viability of naphtha based crackers in the United Kingdom.

This, however, is not at issue when considering Grangemouth. If we compare cracker downstream products of BP Chemicals with those of I.C.I. in the United Kingdom, there is virtually no overlap and it is difficult to see how I.C.I. could be directly affected by Clause 129 and Schedule 13. Ethane is a convenient alternative to naphtha as a feedstock at Grangemouth since our operations there are predominantly ethylene-based - high and low density polyethylenes and ethanol. In contrast, I.C.I.'s operations at Wilton are largely derived from other cracker products and other raw materials. I imagine that much the same arguments would apply to Mossmorran.

.....2

The material which has been the subject of the recent amendments is an impure ethane stream derived from our Forties Field which is uneconomic to separate into its constituent parts because of the relatively small quantities involved. This stream will be used as a straight feed into our Grangemouth cracker with the methane component passing through unchanged, with a consequential increase in that plant's costs.

It was essential to have the legislation now so that the modifications to the plant could begin at end 1983 and, without which, these valuable raw materials could not be used effectively.

The envisaged amendments merely place our internal purchases of ethane and mixed dry gases on a similar basis to some of our other bought in raw materials. It introduces a measure of stability and certainty into the tax treatment, without which substantial investment becomes very difficult, if not impossible. Because of the necessary escalation clauses, we are still probably in a worse position than, say, the long-running I.C.I. methane purchase contract with BGC.

In our tax price discussions to date with the Inland Revenue, and as foreseen in the proposed legislation, alternative fuel value is very much taken into account. Alternative fuel users at present and for the foreseeable future, however, will not pay anything approaching Fuel Oil Equivalent for the relevant ethane/mixed dry gases. We see no evidence in any of our dealings with the Revenue that any subsidy, direct or implied, will be forthcoming, nor has it been asked. The target figure of 26p./therm which, I believe, has been stated by I.C.I., in comparison with 33p. for naphtha, ignores the valuable by-products from the latter. The net result of I.C.I.'s proposal would therefore be a disadvantage for ethane cracking as against naphtha.

I apologise for writing at such length but it seemed important that we set on record our view of the position, which I believe reflects the dialogue with Government over recent months.

Obviously, the uncertainty which I.C.I.'s action induces will not diminish the problems of the U.K. petrochemical industry. We therefore look forward with more than usual anxiety to the placing of Clause 129 on the Statute Book.

I am copying this letter to the Secretaries of State for Industry and for Scotland.

Yours sincerely,

Robert Horton

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London, SW1P 3AG



785





10 DOWNING STREET

Prime Minister

(1)

Clause 129 is reached on Tuesday.
Law Department officials believe the
government's case is sound. The
Attorney-General's view will be
available on Monday.

Do you wish to intervene? If
so I suggest we get John Wakeham
and Peter Middleton in on Monday
(the Chancellor is in Brussels until
7-7.30 pm). Agree?

MUS 9/7

Will see A-G's views
first. - but I think we
are in for trouble now

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

9 July 1982

Michael Scholar Esq
No.10 Downing Street

Dear Michael,

ICI AND NORTH SEA TAXATION

I wrote on 1 July and 6 July giving the background on ~~Clause~~ Clause 129 of the Finance Bill and the latest developments. I said we would report back following the Chancellor's further meeting with ICI this morning, which was intended as a last attempt to dissuade ICI from legal action.

ICI (led by Sir Robin Ibbs and Dr Harvey) once more expressed concern about additional capacity in ethylene going forward at Mossmorran in a situation of general over-capacity. They accepted that ethane had natural advantages as a feedstock. Wilton 6 was an efficient cracker, but in a glut those who survived were not always the most efficient but those with the deepest purse (including cross-subsidisation within companies or Government subsidy). They made it clear that the principle of the legislation was acceptable, but in practice, the range of possible prices was so wide, that they were concerned that it might enable the Inland Revenue to make valuations (in particular with Shell/Esso on Mossmorran) which would in ICI's view be unduly favourable. The only changes in the legislation which could therefore satisfy them would be either the insertion of a specific valuation 'floor' set at approximately heavy fuel oil value (which ICI agreed would depart from the arm's length principle), or the deferral of the Clause until some formula with similar effect could be worked out.

The Chancellor said that the Government had considered all ICI's representations very fully and carefully, but continued to believe that it would be right to legislate to remove an anomaly which discriminated against non-arm's length transactions. It was based on the arm's length principle. It was not a subsidy. The idea of a 'floor' was unacceptable;

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it would involve a clear breach of the arm's length principle. Deferment would put other projects (BP's cracker conversion at Grangemough) at risk, quite apart from Mossmorran; there seemed no principle on which it could be justified.

On legal action under Article 92 of the Treaty of Rome, he made it clear that the Government, having taken legal advice, believed its own case was sound. He could hold out no prospect that Ministers would do other than press on with the Clause as proposed. What ICI did was for them to decide, but he urged them to reflect carefully before taking the matter to court on the implications of provoking Commission interest in the UK petrochemical industry with results which might prove unwelcome for ICI.

ICI have since taken out an originating summons. We are taking further legal advice on the next steps and are briefing the press. We shall keep you informed.

Yours sincerely,

Jill Rutter

JILL RUTTER

Cabinet / Cabinet Committee Document

The following document, which was enclosed on this file, has been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate CAB (CABINET OFFICE) CLASSES.

Reference: CC(82) 37th Conclusions, Minute 1

Date: 8 July 1982

Signed A Wayland Date 16 August 2012

PREM Records Team

CONFIDENTIAL



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Updated version
of this in
box on 9/7

kan pd

8 July 1982

Michael Scholar, Esq.,
10, Downing Street

Dear Michael,

ICI AND NORTH SEA TAXATION

I wrote on 1 July and 6 July giving the background on Clause 129 of the Finance Bill and the latest developments. I said we would report back following the Chancellor's further meeting with ICI this morning, which was intended as a last attempt to dissuade ICI from legal action.

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The Chancellor said that the Government had considered all ICI's representations very fully and carefully, but continued to believe that it would be right to legislate to remove an anomaly which discriminated against non-arm's length transactions. It was based on the arm's length principle. It was not a subsidy. The idea of a 'floor' was unacceptable; it would involve a clear breach of the arm's length principle. Deferment would put other projects (BP's cracker conversion at Grangemouth) at risk, quite apart from Mossmorran; there seemed no principle on which it could be justified.

/On legal

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ICI have since taken out an originating summons. We are taking further legal advice on the next steps and are briefing the press. We shall keep you informed.

Yours sincerely,

Jill Rutter

JILL RUTTER



1963 JUN 11

1963 JUN 11

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From Budget

1. I think I.C.I.

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Prime Minister ①



Have a red point and that unless we find some alternative help to Wilton - it will close -

No final decision is required by this confusing letter (the earlier letter - attached - is much clearer).

Treasury Chambers, Parliament Street, SW1P 3AG

But the Treasury are

01-233 3000

*Clive and I

6 July 1982

clearly moving towards

a conclusion not to help

Michael Scholar, Esq., happened to No.10 Downing Street

lunch with Robin

ICI. ICI ^{*}believe their

lobs on Monday. He is Wilton plant will be threatened.

Dear Michael, very concerned.

If it will help I will brief you orally on your return.

ICI AND NORTH SEA TAXATION/MS

MCS 6/7

In view of the Prime Minister's considerable interest in the discussions of the Mossmorran project last year which led to the introduction of Clause 129 (formerly Clause 119) of the Finance Bill, the Chancellor thought that she might welcome a report on the latest developments involving ICI, who are claiming that the Clause could jeopardise their operations at Wilton, putting some 9,000 jobs at risk.

The Prime Minister will remember that Clause 129 is intended to remove a tax anomaly to enable non-arm's length deals in ethane and mixed gas streams of which ethane is the largest single component to be valued for tax purposes by reference to a long-term price formula, comparable to what would be agreed in an arm's length deal. Ministers committed themselves to legislate in this year's Finance Bill and authorised the Revenue to agree valuations with Shell and Esso, subject of course to legislation being enacted.

ICI fears that the valuations under Clause 129 (and in particular the valuation of ethane for the Shell/Esso Mossmorran cracker) will be set at an unreasonably low level and that they will suffer a major competitive disadvantage which could put the long-term future of Wilton at risk.

In representations to the Finance Bill Standing Committee, ICI asked for three changes in the clause. The first of these (on taking fuel use into account in setting the price) was already implied in the legislation but has now been made explicit by an amendment at Committee stage. The second and third (to shorten the period for which a valuation would run and to limit the extension to mixed streams) would be contrary to the undertakings to Shell/Esso and BP, described in my earlier letter.

Further attempts have been made to convince ICI that the arm's length principle was being properly followed. But ICI's position has hardened meanwhile. They now argue that there is so much uncertainty in what arm's length parties would agree for ethane that the legislation should depart from the normal arm's length principle and instead place a floor on the valuation which would be linked to the price of some other fuel, such as heavy fuel oil. ICI's aim

/clearly

Perhaps we can
dis miss
BK. ^{not}
Disowned with
PM's await
former Tm
letter.
MS 9/7



clearly is to ensure that Mossmorran does not go ahead. To make this change would leave inter-affiliate deals worse off than arm's length deals and go against Ministerial commitments.

Last Thursday, ICI told the Minister of State that they proposed to take out an originating summons in the High Court for a declaration that Clause 129 in principle or its implementation would be a state aid distorting competition contrary to Article 92 of the Treaty of Rome. Preliminary advice from the Law Officers' Department is that while there is a risk that ICI's case might succeed, on balance the Government was more likely to win. In particular it seemed unlikely that the argument that Clause 129 constituted a 'state aid' would succeed, (though it had to be agreed that ICI would be able to give it a run).

In the light of this threat from ICI Ministers have been considering what action to take. Ministers had looked earlier at possible forms of help for ICI to counterbalance what ICI see as an advantage for Shell, Esso and BP. ICI themselves suggested a scheme for rebating PRT paid by an oil producer to a petrochemical firm buying North Sea crude oil or naphtha made from it. But this, throws up a host of problems: it would not be a genuine tax rebate - it would be paid to someone other than the taxpayer concerned; there would have to be price controls to make sure that the benefit did not flow back to the oil company, and it would effectively be an operating subsidy. This would be very costly and would be likely to be much more vulnerable to EC objections than the current Finance Bill clause. None of the alternatives canvassed (public expenditure, administrative action and trade measures) proved attractive.

The Minister of State (Revenue) discussed next steps yesterday with the Minister of State, Department of Industry (Mr Kenneth Baker) and the Minister of State, Department of Energy (Mr Hamish Gray). They concluded that there could be no going back on the undertakings given to Shell/Esso and BP and that if ICI could not be persuaded to withdraw their threat it would be necessary to fight the action in the Courts. After consulting the Chancellor, Mr Wakeham reported this conclusion to Sir Robin Ibbs of ICI yesterday afternoon. He drew Sir Robin's attention to the fact that if ICI proceeded with litigation, the Government would have to stop further consideration of measures to help the petrochemical industry while action was proceeding. ICI asked about the benefits which were likely to flow from a further review. Treasury Ministers are now exploring with Department of Industry whether anything can be said about the likely outcome of a further review. Mr Wakeham promised to go back to ICI on this

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and invited them to talk to the Chancellor later this week (on Thursday). ICI have now indicated they are willing to defer legal action to Thursday, but they have said they see nothing

in the Government's response so far that will dissuade them from going ahead then. Ministers have tried and will continue to try to find a way of dissuading ICI from taking this action. But this will be difficult. (The Chancellor is to have a further meeting with Sir Robin Ibbs on Thursday morning. We will report the outcome to you.) Substantial changes or withdrawal would breach undertakings to other companies, and would risk the cancellation of Mossmorran and closure of Grangemouth. The Clause will be discussed in Report Stage of the Finance Bill in the middle of next week. While there may be strong criticism, Ministers do not believe there is serious risk of defeat.

There is one final point on ICI's claim that the Clause 129 will cause operations at Wilton to cease. The inter-departmental working group concluded that Wilton should still remain reasonably viable since ethane-based capacity is unlikely to take over completely from naphtha-based capacity. Although the European petrochemical industry is suffering from over-capacity and threat of competition from the Middle East, there are many European naphtha crackers less efficient than ICI's which ought to be more vulnerable. It is of course impossible to be certain and the Minister of State, Department of Industry (Mr. Kenneth Baker) has expressed the view that official advice may be over-sanguine on this point. But it is important to recognise that Mossmorran did not create this problem. It is expected to contribute less than 5 per cent of Western European capacity in 1985 (although a much larger proportion of UK capacity). If Wilton was unable to withstand competition from ethane and continuation of the tax anomaly had prevented Mossmorran from going ahead the UK petrochemical industry would be much the weaker in the long term.

I am copying this to the Private Secretaries of the Secretaries of State for Industry, Energy, Scotland and to the Attorney General.

Yours sincerely,

Jill Rutter

JILL RUTTER



Handing a further matter
they have said they are holding

USA JUL 1962

NEW YORK
JUL 19 1962

CONFIDENTIAL



10 DOWNING STREET

~~Prime Minister~~

ICI : Wilton - 9,000 jobs

Threatened

May come up at Questions.

This is a revised note - I suggest
you look at the background note.

The Chancellor is minuting you
tomorrow.

My judgement is that the Inland
Revenue have acted fairly but
that in dealing with one anomaly
they really are threatening ICI Wilton.

ICI are for the time being
holding back their summons
against the Revenue - but will
issue it unless the government
indicates that it will act.

MCS 5/7



Keon Pol

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

July 1982

M Scholar Esq
No.10 Downing Street

Dear Michael,

ICI AND NORTH SEA TAXATION: PRIME MINISTER'S QUESTIONS

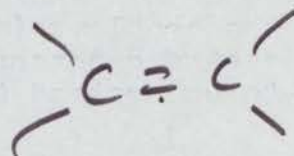
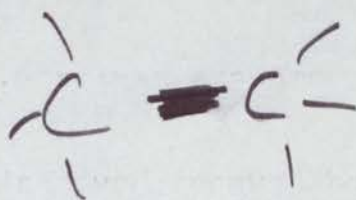
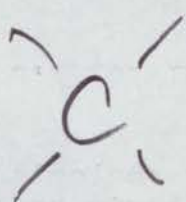
The Inland Revenue have asked me to apologise for the fact that the Prime Minister found their briefing difficult to follow. I enclose a revised version. The background note is longer (this reflects the highly technical nature of the point ICI are raising), but the 'line to take' has been simplified. We have marked the background note 'Confidential' in view of its reference to the circumstances of Ministerial commitments to Esso and Shell last year (and BP this year), and to internal work done in Whitehall on the problems (and ICI's representations in particular). It seemed necessary to explain this if the Prime Minister is to understand the relevant constraints.

and everyone
see 1.

Yours,

Jill Rutter

JILL RUTTER
Private Secretary



Line to Take

Q. Are 9000 jobs at Wilton being put at risk by tax changes?

A. Tax changes are being introduced to put the valuation of inter-affiliate deals of ethane on all fours with arm's length deals. These do not artificially subsidise ethane. I am aware of the worries about jobs at Wilton but I believe that despite the undoubted pressures on the petrochemical industry from depressed demand and newly available ethane feedstocks there is a good future for efficient naphtha crackers like the Wilton cracker. It would be wrong to keep a tax anomaly and put jobs elsewhere at risk to provide some added protection for naphtha crackers.

A. Is not a hidden subsidy being given to Mossmorran by ignoring fuel value?

A. Under the new provisions for valuing ethane for tax purposes, the price for fuel is not ignored. They allow non-arm's length deals to use long-term price formulae just as arm's length deals do. This is not a subsidy.

Q. Is the Government ignoring ICI's representations?

A. The Minister of State (Treasury) promised at Committee State of the Finance Bill to have further talks with ICI. This follows up a series of meetings and discussions with ICI - Ministers have listened very carefully to their representations but there are other considerations to be taken into account.

BACKGROUND NOTE

1. Where oil and gas produced in the North Sea are sold in an arm's length deal, the actual price is brought into the tax calculation. Where it is not an arm's length deal, for example where oil or gas is sold to an affiliate of the producing company, it is valued for tax purposes at the price it would fetch in a comparable genuine arm's length deal (to prevent tax being depressed by artificial transfer pricing). The legislation has to lay down the detailed provisions for determining what form a comparable arm's length deal would take.

2. The original 1975 oil tax legislation required oil and gas to be valued on the assumption that it would be sold at arm's length in a contract for one month's delivery at a time in isolation. This is appropriate for oil where prices are re-negotiated frequently. But light gases like ethane and mixtures with a significant ethane component are sold in arm's length deals under long-term contracts lasting up to 20 years, where the price is set in advance by a formula, typically a base price escalating according to some index of price movements.

3. Shell and Esso are constructing a petrochemical cracker at Mossmorran to make ethylene from ethane from the North sea. Last year they approached Ministers threatening that they might have to abandon the Mossmorran project without undertakings from Government on a number of issues including tax. They argued that they were faced with a major uncertainty on tax which a comparable arm's length purchaser would not face since an arm's length deal would have a fixed price formula. Ministers accepted that this anomaly was not justified and therefore promised Shell/Esso that legislation would be introduced to allow inter-affiliate deals in ethane to be valued on the basis of a long-term price formula provided it was comparable with what would be agreed in arm's length deals. Ministers also authorised

the Inland Revenue to enter into discussions with Shell/Esso on the formula they would be prepared to accept if the legislation were passed. On the basis of these assurances and the outcome of the discussions between Shell/Esso and the Revenue Shell/Esso decided to proceed with the cracker. The Minister for Industry and Education at the Scottish Office (Mr Fletcher) informed the Prime Minister of this outcome on 10 August and the Prime Minister's Private Secretary minuted on 17 August that she was pleased at this news.

4. The original undertaking to Shell/Esso was in terms of pure ethane for petrochemical use only and the Government's proposal to legislate on this was announced last October. BP represented to Ministers in the autumn that it ought also to be extended to mixed streams with a significant ethane component since these would also be sold in arm's length deals under terms including a long-term price formula. BP were anxious to convert their Grangemouth cracker from using naphtha (an expensive feedstock) to such a mixture of gases but, like Shell/Esso, felt the tax uncertainties put the viability of the necessary investment in doubt. They argued that without such a conversion they might have to close Grangemouth. This risk was mentioned in a minute by the Secretary of State for Scotland to the Prime Minister on 12 February.//At about the same time ICI, who have no access to ethane, argued that the proposal gave ethane users an unfair advantage over naphtha users who had to buy in naphtha in the open market since they had no such long-term certainty on the price of their feedstock. The asked either for withdrawal of the proposals or the introduction of some counter-balancing financial benefit for naphtha users.
5. Scotland to the Prime Minister on 12 February.//At about the same time ICI, who have no access to ethane, argued that the proposal gave ethane users an unfair advantage over naphtha users who had to buy in naphtha in the open market since they had no such long-term certainty on the price of their feedstock. The asked either for withdrawal of the proposals or the introduction of some counter-balancing financial benefit for naphtha users.
6. An inter-departmental Working Group under Treasury chairmanship considered these representations and recommended that the proposed new valuation rules should be extended to all light gases which would in arm's length deals be sold under long-term pricing formulae. This would include mixed streams such as those to be used by BP and also methane. The Group

recommended against ICI's proposals for naphtha since these effectively called for an expensive operating subsidy. Allowing light gas users to adopt long-term price formulae while naphtha users continued to face regular price re-negotiations reflected the position in the market where light gases were sold on a long-term basis and crude oil and heavier oil fractions were sold under contracts with regular re-negotiations. (This difference in market practice reflects the transportation and handling difficulties for light gases.)

7. Ministers accepted the Working Group's recommendations except that the extension was limited to mixed streams and did not cover methane as well since there was no immediate need for such an extension and ICI made strong representations against any wider extension.

8. ICI and BP have recently announced a restructuring agreement under which ICI will be reducing its polyethylene interests and increasing its PVC commitment (and vice versa for BP). ICI are nevertheless now threatening that Mossmorran and Grangemouth may undermine their competitiveness and thus imperil the future of their Wilton site (with 9,000 or 10,000 jobs). If their future is at risk this is not because of the tax change. This just puts inter-affiliate deals in ethane on all fours with what independent parties would agree in a market. There is no hidden subsidy to Shell/Esso or BP. There are real pressures on the European naphtha based petrochemical industry arising from the depressed outlook for demand and from competition from the new ethane feedstock becoming available not just in the North Sea but also in the Middle East. However, ethane is very unlikely to eliminate naphtha altogether as a feedstock and ICI's Wilton cracker is a very modern and efficient naphtha cracker which should have a good future. Unless there is effective subsidy or protection abroad, some less efficient European naphtha crackers should be much more

vulnerable to competition from Mossmorran and the Middle East. Mossmorran alone only adds about 3% to Western European ethylene capacity. But it is proposed to keep the position under review and the Working Group will be reconvened in the autumn.

9. ICI have criticised a number of details of the legislation, in particular suggesting it allows the ethane to be valued below its value for fuel use. The Minister of State, Treasury explained to the Finance Bill Standing Committee on 24 June that this was not so - the price which could be got for fuel is fully taken account of. But he agreed to continue discussions with ICI about the details of the legislation before Report Stage of the Bill. These discussions are continuing but ^{there seems} no scope for any significant further concessions or changes in the legislation in a direction which ICI would find helpful which would be consistent with the firm Ministerial undertakings made to Shell/Esso and BP. The legislation does no more than allow tax valuations for ethane and mixed gas streams to reflect the form of contracts which could be agreed between independent parties. They are not a subsidy.

30 JUN 1982



Gran Pd

Imperial Chemical Industries PLC

Imperial Chemical House
Millbank London SW1P 3JF
Telephone 01-834 4444



From J. R. Ibbs

PERSONAL

17 June 1982

Clive Whitmore, Esq.
10 Downing Street
London, SW1

Dear Clive,

I was sorry to learn that you and Michael cannot manage lunch tomorrow but I quite understand. I am sure another date can be found. Even if that is frustrated I am certain that by perseverance we shall finally make it.

As you can imagine, there are many topics on which I was looking forward to talking to you. Nevertheless, however, impatient I may be, all but one can wait. The exception is the legislative arrangements currently envisaged for taxation of Ethane as a petrochemical feedstock - Section 119 of the Finance Bill which will shortly be reached in Committee.

I dare say this is a matter which will not come to the Prime Minister's attention but just in case it does I wanted you to know that I believe the current proposals pose a serious threat to ICI, and through ICI to a major sector of the UK petrochemical industry. Not to put too fine a point on it, if the natural advantage of Ethane as a feedstock (with which we must of course live) is to be supplemented by special long term valuation for tax purposes on interaffiliate sales, far more jobs will be at risk than will ever be created at Mossmorran and much of petrochemicals in this country may well sink into an unprofitable mess similar to that which we have experienced in textiles, steel and cars. If the worst comes to the worst and present legislative proposals go ahead I believe, on Counsel's advice, that ICI should be able under the Treaty of Rome to get the situation corrected but this seems a poor way of trying to sort it out.

I have talked at length to Douglas Wass and Peter Carey about this. I believe they recognise the force of my arguments and that I am not just indulging in special pleading on behalf of ICI. As things stand, I believe that John Harvey-Jones and I may well need urgently to seek an opportunity to put our concerns to Geoffrey Howe.

I am of course well aware of the real hook that Ministers are on, and that it seems easier to risk sacrificing ICI's operations at Wilton than to go back on moral commitments made to oil companies. However, taking a longer view, I believe postponement of the immediate legislative proposals, so as to allow informed assessment of the alternatives would be prudent.

-continued-

I apologise for going on about this, which I intended only to mention en passant at lunch, but in all the circumstances just in case it should come your way, it seems wrong not to write about it (if Michael should want more detail from me, I shall of course be glad to provide it). Please look indulgently on this blatant ear-bashing.

I look forward to our lunch when that can be fixed, and to discussion then of subjects on which I shall maintain my normal detachment.

This letter is personal to you and I shall not be copying it to others.

yours ever,

RR-

CONFIDENTIAL

file

BK

Can Rd

14 June 1982

NORTH SEA FISCAL REGIME

The Prime Minister was grateful for the Chancellor's minute of 7 June, which she has read without comment.

I am sending a copy of this letter to Julian West (Department of Energy).

MICHAEL SCHOLAR

John Kerr, Esq.,
HM Treasury

SA

CONFIDENTIAL

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- 1 MR KEMP *11/6/82*
- 2 CHANCELLOR

PA

Mr Scholar

You might like to see this on a personal basis. A letter should be coming to you soon from Mr Kerr.

*David Noyane
21/6.*

- cc Chief Secretary
- Financial Secretary
- Economic Secretary
- Minister of State (C)
- Minister of State (R)
- PCC
- MEG
- Mr Monger
- Mr Ridley
- Mr French
- Mr Harris
- PS/Inland Revenue
- PS/Customs & Excise

TIMETABLE TO THE BUDGET

With the help of Divisions we have put together the timetable which is attached. Inevitably much of it is provisional at this stage.

2. The main dates around which the timetable is built are the ones chosen for autumn announcements and for the Budget.
3. The real key to the timetable is the timing of the autumn announcements, pencilled in for December 7. There are perhaps two points to note about this. First, it leaves out of account the option of announcing the various decisions piecemeal, some of them coming from people other than Treasury Ministers. Attractive as it may be in principle, this does not seem to be a feasible option in the light of the failure of the attempts to keep it alive last year, and the expectations created by the TCSC enquiry into Budgetary Reform.
4. Secondly, it assumes that you will not wish us to try to produce a full "Green Book" along the lines proposed in the draft report on Budget Reform from the TCSC. This question is discussed in a separate submission by Mr Kemp. However, it is clear that to publish a full version of Part I of the PEWP as the Committee wishes would mean delaying the announcements until well into December, and they might not be possible even then.

5. The timetable assumes, however, that you will go this year for a form of Green Book and on this basis it writes in final decisions by November 23 to allow for preparation of more detail on the public expenditure side than was given last year, for working out the other things envisaged in Mr Kemp's draft reply to the Report and for printing a more formal document to incorporate all the detailed announcements under one cover. (This is likely to prove in some ways more difficult in terms of timing than the FSBR: the contents of the FSBR are under Treasury control, whereas a major part of the Green Book depends on agreement with Cabinet colleagues.) On this basis, the timetable is quite ambitious if the pattern of last year's negotiations were to be repeated.

6. If things begin to slip the main constraint could become the need to allow two weekends between publication of any NIC or NIS Bill and its second reading. That would be a binding constraint, and so slippage in decisions would tend to squeeze out the time available for preparing material for a Green Book.

7. The Budget is pencilled in for March 15. The slight delay compared with the past two years would have two main advantages. It would, first, allow a few more days to take into account the early January update of the forecast in putting together papers for another "Chevening" if there is to be one. This year they had to be written over the Christmas period in parallel with the forecast. Secondly, the pre-Budget economic Cabinet might be allowed to move back a little to give more time for the results of the pre-Budget forecast to be taken into account, whether in briefing or in your paper to Cabinet.

8. Clearly there is plenty of time to think further about this, and a Budget on March 8 would be feasible if that seems better. (March 22 on the other hand is ruled out by a European Council.) We shall make the usual full submission in the autumn; there is no need to take a view now.

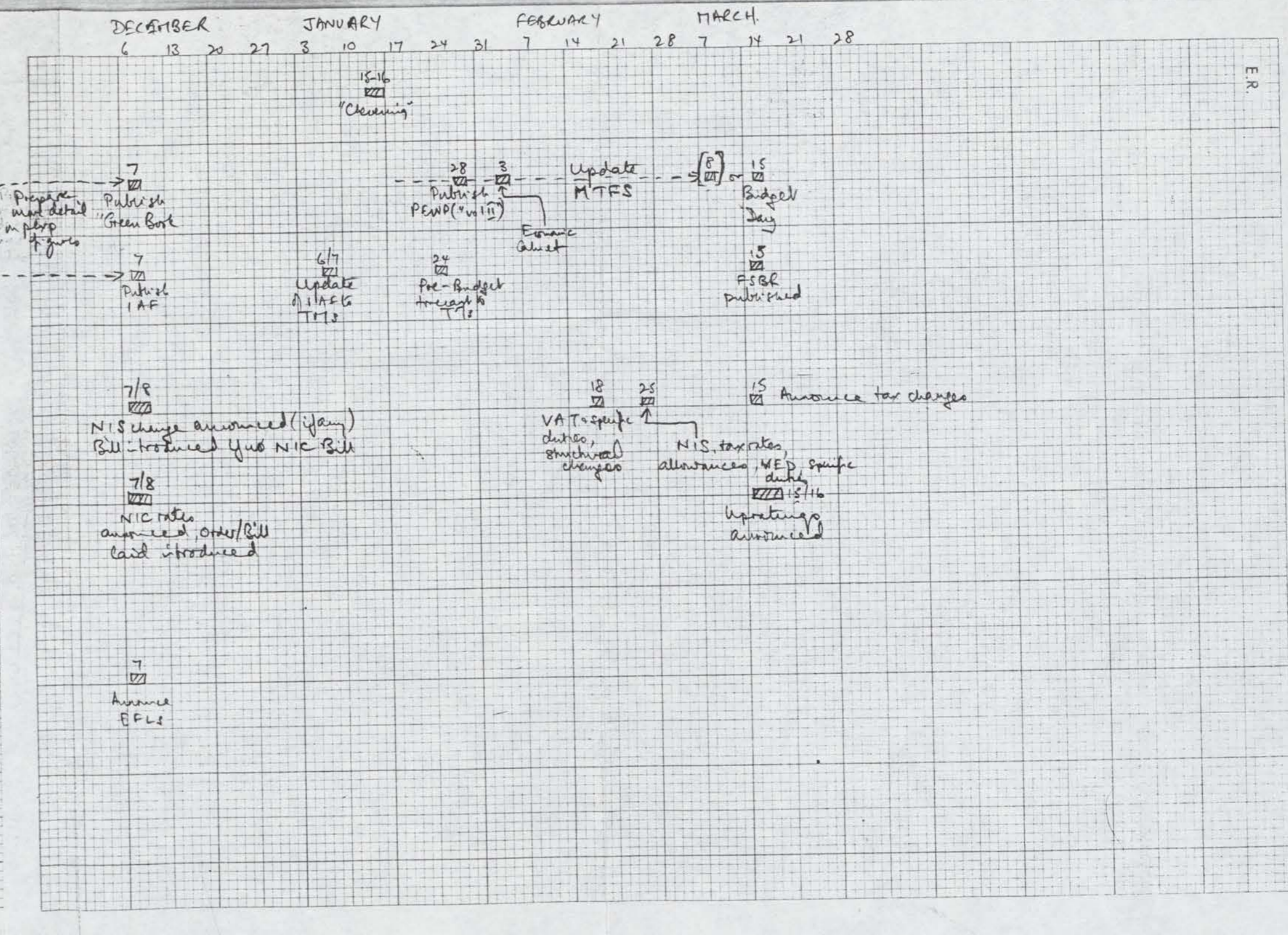
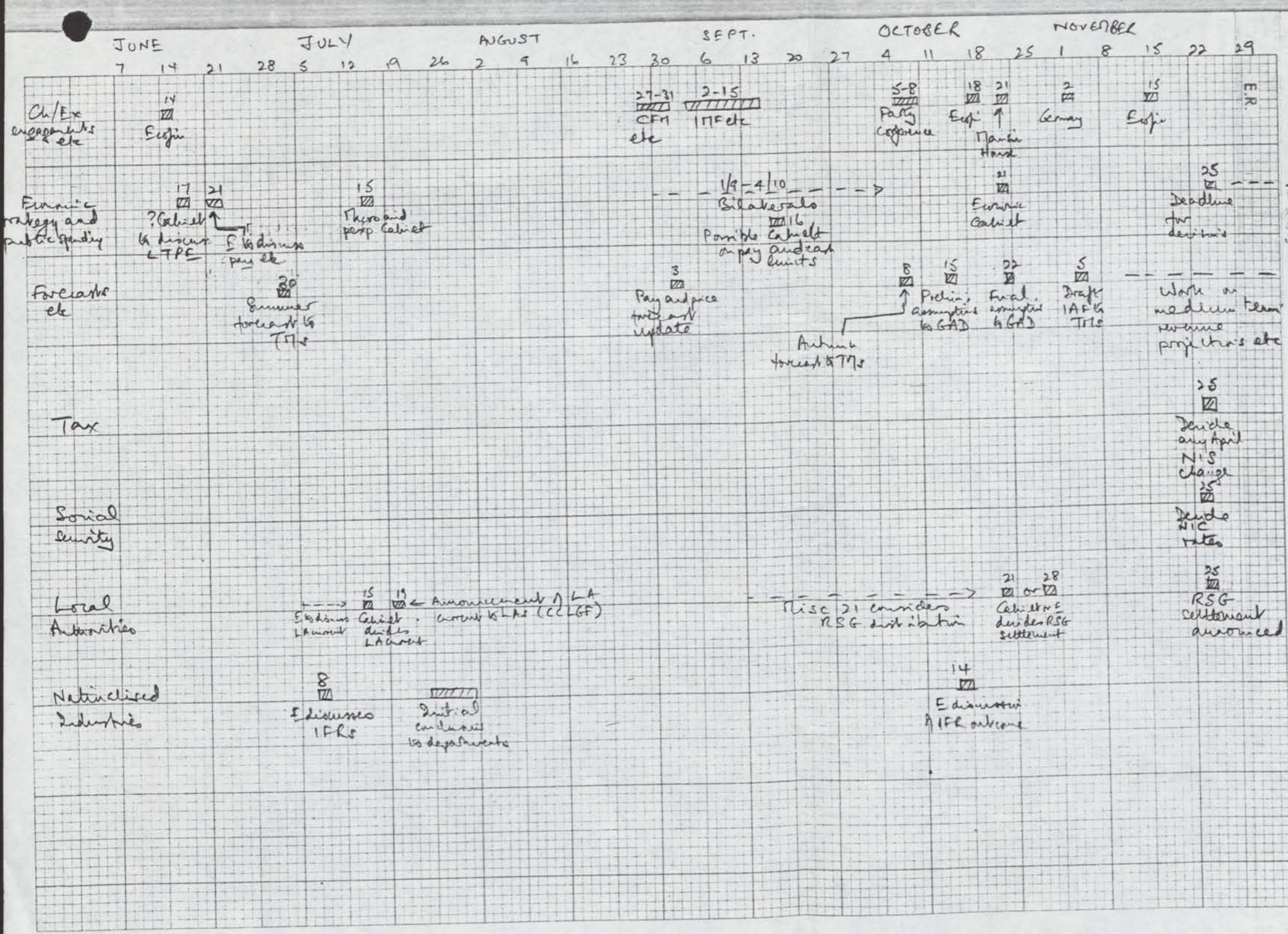
9. On a more detailed point, the timetable has the Cabinet to start off the hard public expenditure negotiations on the same day as the Mansion House speech. That would be a particularly wearing day for you, and the coincidence increases the pressure on those in

the office concerned in preparing for both events. However, there is bound to be some coincidence, and the alternative date for the Cabinet would be October 14. The timing of the Conservative Party Conference would then conflict with the preparation of yours and the Chief Secretary's papers. From that point of view October 21 would be preferable.

10. For the rest, the timetable speaks for itself and, indeed, the year has begun to settle into quite a regular rhythm, having absorbed the programme of economic Cabinets. The main uncertainty for later years will be how far and how quickly the pressures for Budgetary reform will lead to change, particularly to the timetable for taking public expenditure decisions.

11. I have consulted the Cabinet Office and Mr Scholar informally about the timetable and they see no objection at first sight. As last year, it might be wise to consult No 10 formally. We shall, if you agree, let you have a draft minute or Private Secretary letter when we have your reactions to the timetable and your preliminary views on whether you want to agree to a Green Book and if so what its contents might be. If you approve the timetable we shall send a copy of the timetable itself to the Cabinet Office.

D. R. Norgrove
D R NORGROVE



E.R.

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fc AW (2)
Prime Minister

Treasury Chambers, Parliament Street, SW1P 3AG
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MUS 2/6

PRIME MINISTER

MB

NORTH SEA FISCAL REGIME

Since the Budget I have been carrying out a further review, in close consultation with the Secretary of State for Energy, of my proposals for changes in the North Sea Fiscal Regime (on which I minuted you on 26 February, and on which your Private Secretary reported your comments in his letter of 1 March). The review has taken into account both the uncertain current state of the oil markets, the representations of the industry on the regime generally and my Budget proposals in particular, and your own concern that the regime might be too onerous and inhibit desirable exploration and development. I thought it right to tell you our conclusions.

2. Both Nigel Lawson and I believe that the level of development that is likely to be achieved at the present time is not likely to be sensitive to the kind of tax changes that we could sensibly make. There has been some hardening of the oil market since the Budget but there is still of course considerable uncertainty about the future of oil prices in both the short and long term. We have therefore looked at the profitability of both existing fields and likely future developments again against a wide range of oil price scenarios including a fall as steep and steeper than any that has yet occurred. The results still look generally attractive and robust.

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3. It is true that there has been recent publicity given to company decisions to defer particular projects. But the companies admit, and our own evidence suggests, that other factors - such as uncertainty on oil prices or technical problems - have been as or more important than the tax regime. The Department of Energy is actively discussing with the companies concerned some projects which are expected to proceed before long. Tax concessions sufficient to produce a marked change in the pace of development would have to be very large indeed.

4. In Mr Scholar's note of 1 March it was suggested that without larger reductions in tax, companies might be encouraged to boost their production in order to maintain profits. In practice, the need to recover capital costs as quickly as possible leads companies generally to produce as fast as they can regardless of tax. Department of Energy's development controls prevent companies producing faster than good oil field practice would permit and they are already producing up to that level. So we do not fear distortions on that account.

5. We have therefore concentrated our attention, not on ways of reducing the overall level of take, but on ways of reducing the impact of APRT on some of the less profitable fields. Small fields, which are likely to predominate among the marginal fields of the future, already pay a much lower level of tax than large fields, because of the protection given to them by the PRT and APRT oil allowances. The average rate of tax on small fields is generally only about 60-65 per cent compared with 85-90 per cent for the large fields. I would propose to add to these benefits

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by the following concessions:

- a) APRT to be repaid after 5 years (rather than at end of field life) if it has not by then been set off against ordinary PRT.
- b) No further liability to APRT for a field once 5 years have elapsed since first APRT payment.
- c) APRT to be allowed as a deduction in computing "payback" for PRT (so slightly prolonging availability of certain reliefs in some circumstances).
- d) A transitional provision to ease the effects of my proposals for 'smoothing' payments of PRT: this will ease cash flow problems for companies (BP in particular) in the second half of 1983.
- e) Accepting the principle of an amendment put down by Sir William Clark for Finance Bill Standing Committee to make one of the technical relieving clauses (which cures an anomaly in ring fence corporation tax) retrospective for two years. The industry (including Shell and ICI) has pressed for this.

6. The overall cost of these concessions would be around £100m over the period up to 1986-87. Repayments of APRT would not arise before 1988, and the cost (perhaps around £100m in that year) will depend on oil prices between now and then.



7. We have also agreed to continue discussions at working level with the industry to explore their concerns on incremental investment and marginal fields. This will allow us to have a closer look at the analytical basis for some of their assertions, but I hope also to convince them that stability on the basis of the latest structural proposals is preferable to any further review of the tax structure as a whole. Nigel Lawson is in the meantime looking further at possible schemes for using royalty refunds to assist marginal fields.

8. I propose to make these changes by way of amendment at Committee Stage. I shall announce the proposed changes as a package later this week so that their overall effect is not lost. The whole package should help to meet some of the industry's main concerns.

9. I am copying this minute to Nigel Lawson.

gh

(G.H.)
7 June 1982

PART 7 ends:-

25-4-82

PART 8 begins:-

7-6-82

