PREM 19/1465

MT.

PART 3

Confidential Filing

MEETINGS OF THE NEDC
THE QUESTION OF MINISTERIAL MEMBERSHIP

ECONOMIC POLICY

Part 1 May 1979
Part 2 Dec 1979
Part 3 Jan 1982.

PREM 19/1465

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~6-1-82~~							
~~2-2-82~~							
~~16-2-82~~							
~~22-10-82~~							
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~~24-1-85~~							
~~29.3.85~~							
~~29.3.85~~							
~~25/7/85~~							
10.9.85							
Part Ends							

PART 3 ends:-

DN to HMT 10/5/85

PART 4 begins:-

HMT to NW 14/4/86

~~DN to HMT 29.4.86~~

SRW

10 September 1985

NEDC MEMBERSHIP

The Prime Minister has seen your letter to me of 5 September. She is content for the Chancellor to invite Mr. Kenneth Baker to join the Council in order to fill the vacant Ministerial seat.

(DAVID NORGROVE)

Philip Wynn Owen, Esq.,
HM Treasury.

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

Practical Aspects of a New Financial Intermediary: A Discussion Paper. Published by the National Economic Development Council, July 1985. ISBN 0 7292 07315

Programme for Recovery: TUC Economic Review 1982. Published in February 1982 by Trades Union Congress, London WC1B 3LS.

Signed J. Gray Date 22/1/2014

PREM Records Team

Prime Minister
NEDC is usually a pain. But if the Govt. is going to be in it the Chancellor needs to be supported properly by his colleagues. There is already absenteeism and DoE are important particularly on the infrastructure arguments with CBI & TUC, which won't go away. Agree to the Chancellor's proposal?
Yes MT
DRN 6/9.

(1)

CONFIDENTIAL

MR NORGROVE

6 September 1985

NEDC MEMBERSHIP

The Chancellor proposes to invite Kenneth Baker to fill the vacant Ministerial seat on the NEDC.

The Policy Unit urged the Prime Minister to consider abolishing the NEDC in 1983. It is not merely a waste of time; it is actively damaging in that it provides selected industrial interest groups with opportunities to attack the Government for spending too little in infrastructure, industrial support, R&D, training, or whatever. Press coverage invariably gives more space to the attacks than to the Government's replies.

Meetings occupy 10 half days a year. Surely Mr Baker has more pressing priorities than this? Could I suggest, therefore, that, in reply, the Prime Minister questions whether it is necessary for Environment to resume this seat, in view of the time which these meetings absorb and the predominantly industrial content of the agendas. Perhaps Kenneth Baker could attend by invitation, when the agenda features items of specific concern to the Department of the Environment?

Nicholas Owen

NICHOLAS OWEN

CONFIDENTIAL

006/045

010

cc NO

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

D R Norgrove Esq
10 Downing Street
London SW1

5 September 1985

Dear David,

NEDC MEMBERSHIP

The Prime Minister will be aware that there are normally six Ministers on the NEDC, to match the six representatives of the CBI and the six representatives of the TUC. However, the integration of the Enterprise Unit within the Department of Employment has reduced the Government team to five: the Chancellor, Mr Brittan (who replaces Mr Tebbit), Sir Keith Joseph, Mr Walker and Lord Young.

The Chancellor would like to invite Mr Kenneth Baker to join the Council in order to fill the vacant Ministerial seat. The Prime Minister will be aware that the Secretary of State for the Environment has always been a member of the Council until Mr Jenkin stepped down last year in order to accommodate Lord Young. Provided the Prime Minister is content, he would like to write to Mr Baker, inviting him to join the Government team on the Council in time for the next NEDC meeting on 25 September.

Yours sincerely,

Philip Wynn Owen

P WYNN OWEN

VP56

NBPM
AT
25/7

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

25 July 1985

Andrew Turnbull Esq
10 Downing Street
London SW1

Dear Andrew,

NEDO PUBLICATION "PRACTICAL ASPECTS OF A NEW FINANCIAL INTERMEDIARY"

This letter is to forewarn you that the attached document is being published by NEDO today. We were told this yesterday afternoon, although NEDO had undertaken to let CFI members know several days in advance. This paper is the result of work started some years ago into the practical aspects of a national financial intermediary, if one were to be set up. The Government has made it clear from the start that it regards this as a misconceived enterprise and that it sees no need for a new intermediary.

The foreword to the document makes clear that the paper is dealing with the practical aspects of what a body might look like and is "not directed to the question of need itself" which is a "separate question". The foreword makes clear that the paper does not commit the Committee's Members or the bodies they represent, to any particular view as to the need for an institution of this kind. Having failed to prevent the existence of the paper, Government Departments have assisted in its drafting as a means of damage limitation.

It is likely that the TUC will want to give this document a high profile because of their support for the idea of a national investment bank. Attached are some speaking notes which cover both the published document and the issue of the need for such a national financial intermediary. These notes may be useful if the possibility of such a body is raised in PM's Questions this afternoon.

I am sending a copy to Andrew Lansley (DTI).

Yours sincerely,

Philip Wynn Owen.

P WYNN OWEN
Assistant Private Secretary

ANNEX A

OUTLINE OF THE NEDO PAPER ON THE PRACTICAL ASPECTS OF A FINANCIAL INTERMEDIARY

The paper uses as an assumption that the institution would consist of a parent company with a number of operating subsidiaries. The parent company would be largely owned by the major banks and financial institutions, with the Government holding a significant minority stake.

2. The main board would decide the body's financial objectives and investment policies. Representation on the main board would be broadly in line with shareholdings which suggests that the banks and financial institutions would be dominant voice. "Wider interests in the economy" might also be represented.

Investment activities

3. The intermediary would have two principle operating divisions. The first would provide private finance for general industrial purposes with the emphasis being on projects involving a high degree of risk, on innovative projects and on the restructuring of ailing companies with potential for recovery. This division would be concerned with both equity and loan investments and would have flexibility in the timing of interest and repayment obligations in certain cases.

4. The other principle division would be concerned with the provision of private funds for large scale projects. It would co-ordinate the raising of finance for long-term, major infrastructure projects and could get involved in project evaluation and the issue of tenders.

Sources of finance

5. The paper suggests that the intermediary would raise most of its funds to finance its investment by issuing bonds to the public. The paper identifies that a problem would be to maintain a flow of cash to service its debt and cover operating expenses, while absorbing the risks from its investments and lending at

longer maturities than it would usually borrow at.

Role of Government

6. Because of the nature of its lending (long term and/or to high risk projects) the paper says that the financial intermediary could need government backing probably in the form of explicit or implicit guarantees for its borrowing. The paper acknowledges that this would raise questions of accountability to Parliament.

An Expanded Role

7. The NEDO document also envisages that two further divisions might be established in due course. The first would be a division to intermediate in public financial support for industry and the second to make specific investments at the Government's request.

ANNEX B

NEDO PUBLICATION: PRACTICAL ASPECTS OF A NEW FINANCIAL INTERMEDIARY

SPEAKING NOTES

1.1 The Government regard this as a misconceived enterprise, and has made it clear from the start that it sees no need for a new intermediary.

1.2 The foreword therefore makes clear that the paper which presents the result of work started some years ago into the practical aspects of a new financial intermediary, is "not directed to the question of need itself" and states that the issue of whether or not there is a need for such a body is a "separate question".

1.3 The foreword makes clear that the paper does not go into the practical aspects in equal detail. It is not a blueprint for action.

1.4 The foreword acknowledges that other European countries have over time developed public investment corporations, but makes clear that circumstances are different in this country. It identifies that there is a more highly developed capital market in this country compared to elsewhere in the European Community and points to the array and adaptability of funding sources.

1.5 The foreword makes clear that the paper does not commit the Committee's members, or the bodies they represent, to any particular view as to the need for an institution of this kind. Nor does it commit them to a view on how such an institution would work, if one were established.

If the need for such an intermediary is argued:

2.1 The case has not been demonstrated that a new publicly supported national body is needed to promote investment in industry. Investment across the whole economy is now running at its highest ever level. April 1985 CBI forecast suggests an 8 per cent rise in manufacturing investment this year. Recovery in company profits means more internal funds available for investment.

2.2 Not impressed by argument that we must have a national financial intermediary or a national investment bank because other countries do. No correlation between such institutions and economic success. UK growth topped EC growth league in 1983 and according to OECD forecast should achieve faster growth than any other major EC country in 1985.

2.3 Lending from any new financial intermediary would almost certainly displace finance which would have been raised anyway. Any element of subsidy would therefore be a waste of taxpayers' money. Danger that truly additional lending would go to projects which the generality of lenders were not prepared to finance because they would not pass normal tests of commercal viability.

2.4 Experience of NEB a reminder of how commercial criteria can be bent to meet political ends, eg by propping up lame ducks.

2.5 This Government believes in leaving decisions on allocation of resources to those with keenest appreciation of risks and rewards - namely individual enterprise and investors.

2.6 Most important contribution a government can make to help business is to improve the general environment in which it operates by pursuing prudent financial policies, encouraging enterprise and risk taking, and removing obstacles to the free functioning of markets.

file (34)

10 DOWNING STREET

From the Principal Private Secretary

29 March 1985

NEDC

The Prime Minister had a word with the Chancellor of the Exchequer yesterday evening about the suggestion that she might give a dinner for members of NEDC.

The Prime Minister and the Chancellor agreed that the original purpose of the dinner - to welcome the TUC members back to NEDC - had passed. The Chancellor suggested that as an alternative the Prime Minister might like to Chair the meeting of NEDC later in the year. But the Prime Minister was disinclined to do this since this might encourage the TUC to make political capital out of the occasion. The Prime Minister and the Chancellor concluded that the best occasion for the Prime Minister to be associated with the NEDC again might be to mark NEDC's Jubilee.

I am copying this letter to David Normington (Department of Employment).

Robin

Mrs Rachel Lomax,
H M Treasury

PERSONAL AND CONFIDENTIAL

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Restricted

→ File

AT

National Economic Development Council

25/1

NEDC(85)9
24 January 1985

SECURITY OF NEDC PAPERS

Note by the Secretary to the Council

At the meeting of the Council held on 9 January, members expressed concern at the prior leaking to the press of papers about to be discussed. The Chairman emphasised - and the Council accepted - that it was for the Council to decide what should be published.

Recipients of copies of Council papers are therefore reminded that they should take all reasonable steps to prevent unauthorised disclosure.

P V Dixon

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

National Economic Development Council

NEDC(85)7
23 January 1985

SMALL FIRMS AND ENTERPRISE

A Memorandum by the CBI

INTRODUCTION

1. The CBI is convinced that smaller and new firms are essential to the health of the economy, and that they provide a significant source of new jobs. It believes there is a need for a constant supply of new, which in general means small, firms to maintain the "water table" within the economy, and that it is no coincidence that the traditionally successful economies of the USA, Japan, and Germany have maintained a higher population of such firms than the UK.

2. In February 1982 the Council discussed the CBI's paper "Smaller Firms in the Economy" NEDC (82)8. That stressed the interdependence of small firms with the rest of the economy and the fact that they should not be regarded as providing an instant solution to unemployment. Since then further work has been done on the role of small firms. This paper reviews the available evidence on the impact which they have had upon job creation and considers measures designed to promote these enterprises.

3. The action programme at the end is divided between specific measures which can be followed through either by the Council or individual parties, and further research which will improve the understanding of the sector and help further towards the creation of jobs.

4. As stressed in the 1982 paper, the CBI does not seek privileged status for small firms. But they can on occasions be faced with special problems. It is therefore important to remove discrimination against them.

THE ROLE OF THE SMALL FIRM

5. Statistical evidence suggests that the number of small firms has been increasing in recent years and that these firms in themselves have been providing new jobs at a faster rate than larger firms. The annex gives greater detail.

6. Small, localised firms are important to regional employment regeneration. They tend to develop local linkages and base their often employment-intensive management functions within the region more often than do branch plants of larger firms. Small firms are necessary and important sub-contractors to larger firms and therefore play an essential role in the improvement of the large firms' competitiveness.

7. New firms play a vital role in the acceleration of much needed structural change within the economy, and are important sources of innovation and invention. A high proportion of new and small firms thus helps an economy to respond rapidly to technological change and promotes competition.

STATISTICS

8. Sufficient research evidence is now building up to confirm the view that the contribution made by small firms to the competitive process is fundamental; but there is still room for improvement in the statistics. The CBI monitors through its monthly Trends and Distributive Trades Surveys the state of optimism, output and employment prospects for small firms. But Government statistics on small firms are weak; some of the revision to official output and employment statistics has been due to lack of information about small firms when early estimates are made. The CBI is discussing this problem with the Business Statistics Office.

POLICY FORMULATION AND EVALUATION

9. The identification of appropriate policies to encourage new enterprises requires knowledge of what makes successful firms. In this context it is useful to think in terms of five building blocks:

i) Product or Service - The entrepreneur will have his ideas. He would not be in business if he did not think "he could do it better". But in order to stay in business he needs not only a continuous stream of ideas but also to ensure that his products can move quickly from the research through the development stage to the market.

ii) The Market - Small firms often lack market information and knowledge of marketing techniques, particularly in the export markets, which can affect their growth and therefore job creation prospects. The Economic Development Committees and the BOTB have a specially valuable part to play in assisting small firms to identify and exploit new markets, and in promoting co-operative export marketing and closer maker/user relationships which have been the centre of much work within the EDCs. The Government can also ensure that small firms are given a chance to compete for public contracts.

iii) Premises - Most firms when starting up are content with very basic premises, possibly even a garage. Inflexible application of planning law can stifle new ventures, and hence the creation of jobs, at source. Efforts are required to broaden horizons and perceptions among certain town planners, developers and architects of the actual needs of small firms. Here again the EDCs and the various business organisations have a role.

Co-operative ventures through such bodies as CoSIRA, and the stimulus of the Government's small workshops scheme have been helpful.

Rent subsidy is not a solution. This can be an open-ended commitment: it distorts competition, and can prevent firms from recognising their true financial circumstances.

iv) Funding and Finance - The major banks have taken an increasingly positive and understanding attitude towards small firms in recent years and this must continue. Over-reliance on loan finance remains a cause of unnecessary small business failure. This can be tackled:

a) Partly through making equity finance more available. The Business Expansion Scheme (BES) has had a positive impact here and been immensely popular, although rather costly to administer and relatively inflexible. A simpler, more flexible version could be developed.

b) The recent Small Engineering Firms' Investment Scheme (SEFIS) provides an acceptable model for the specific purpose of helping small firms . Here the proposals were administratively straightforward and assisted firms in gearing themselves up for growth and employment expansion.

c) The tax structure needs to take account of the pressures on small firms. This is covered separately in the CBI Budget proposals.

v) Organisation and Management - Many small firms do not have the resources or perceive the need for technical business skills in areas such as:
- financial management and controls
- compliance with legislation
- marketing.

One approach is through management training. Many initiatives in this field have been funded by both public and private sectors and in some cases jointly. It will be helpful to collate the experiences of many organisations in this field such as enterprise trusts and agencies in order to examine the relative success and failure rate, together with any geographical or sectoral differences.

Further it is essential to free management resources by reducing the burdens of legislation. The Government's own scrutiny aimed at identifying unnecessary administrative and legislative burdens should be vigorously followed through. The CBI has made specific proposals to Government. Legislation needs to take account of small firms in terms of the threshold levels for taxation, VAT, and legislative requirements. Since small firms are so vital to job creation, it is important to be particularly sensitive to the impact which employment protection legislation can have on small firms' recruitment decisions. The CBI's Gallup survey on attitudes to employment (October 1984) found that although most firms were uncertain about the impact of this legislation, a significant minority of small firms thought that unfair dismissal arrangements might be an impediment to higher employment.

MANAGEMENT BUY-OUT

10. Flexibility and responsiveness to change has to be the key. Management buy-out has a useful and positive role which has been increasing in the last few years.

11. Ownership and control of a firm's resources and rewards can become unambiguously placed in the hands of a group of individuals, thereby stimulating greater managerial motivation in "their" firm, and, provided the environment is right, a spur to enterprise. Buy-outs can also be a useful means for floating off under-utilised or under-managed parts of a larger firm.

ACTION POINTS

(i) The Government must follow through its scrutiny of administrative and legislative burdens and ease those which inhibit enterprise. The CBI looks for an early Government response to its proposals.

(ii) There are still questions about finance and funding for small and new firms. The Committee on Finance for Industry and in particular its Working Party on Small Firms might look at the issue and specifically at the possibilities of a development of the BES, perhaps along the lines of a Small Firms Investment Company, and further grants based on the SEFIS model.

(iii) The Government together with the CBI should look at ways in which the agencies operating in the small and new firms area might better co-ordinate their activities. Here we would look to the output of EDCs, the MSC, DTI and BOTB in particular to help to improve the overall performance of small firms and enhance job creation in that area.

(iv) In the longer term we need to consider ways in which the flow of information to firms can be improved and published statistics on smaller firms can be geared more closely to the necessary policy decisions. This is an issue which the CBI will be pursuing separately with Government but would be grateful for views.

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU

ANNEX

INFORMATION ON SMALL FIRMS

The basic background book on small firms is the "Bolton Report" (1971).

Gallagher and Stewart [1] show that in the period 1971-81, 31% of all new jobs created by "births" and "expansions" were in firms of less than 20 employees (although these firms consisted of only 13% of all employment in the sample in 1971[2]).

Over half (52%) of the new jobs came from firms with less than 100 employees (29% of employment sample). Thus these firms created a significantly higher proportion of new jobs than their contribution to total employment would have suggested.

The contribution which small firms have made to employment in the economy is made clearer when net figures in the same period are considered (that is, after subtracting employment losses resulting from "deaths" and"contractions"). Firms employing less than 100 employees provided 1.82 million net new jobs compared to a net loss of 1.17 million jobs in firms employing more than 100 employees.

American experience[3] is similar to this.

There is no comprehensive data on "births" and "deaths" of firms in the UK. Pom Ganguly[4], drawing upon VAT data, has calculated that in the period 1980-83 there were 111,924 more new businesses started up than closed down and these were predominantly firms with a turnover of less than £500,000. Moreover, an excess occurred in each of the UK regions which he studied.

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1. "The Jobs and the Business Life Cycle in the UK" by CC Gallagher and H Stewart (Research Report 2, University of Newcastle-upon-Tyne, 1984)

2. Their sample covered 50% of all manufacturing firms.

3. "The Jobs Generation Process" by D Birch, MIT Programme on Neighbourhood and Regional Change (1979).

4. "Business starts and stops: regional analyses by turnover, size and sector 1980-83" in British Business 2/11/84

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National Economic Development Council

NEDC(85)6
23 January 1985

CLOTHING

Memorandum by Sir Basil Feldman
Chairman of the Clothing Economic Development Committee (1978-1985)
Chairman of the Better Made in Britain Exhibition Committee 1983 and 1984

INTRODUCTION

1. The importance of the clothing industry as a chief customer of the textile industry, main supplier of the retailing industry, major employer and exporter is well known and the current position and recent trends on the industry are described in Annex 1. The industry faces a difficult challenge from the unique combination in this country of dominant retailers and the threat of continually increasing imports from low cost countries. These factors have depressed clothing retail prices and been mainly responsible for low levels of profitability and investment. Between 1978 and 1983 clothing imports rose by 70% and 100,000 jobs were lost. Yet the industry, encouraged by low inflation, the level of the exchange rate and a favourable productivity record, now finds itself in an environment where individual firms can take advantage of more promising market conditions.

THE OBJECTIVES AND WORK OF THE EDC

2. The EDC has seen as its role to act as a catalyst in encouraging change and its work has been increasingly directed at the following areas:-

a) Design, marketing and branding
b) Import substitution
c) Promotional Activities - Development of a Trade Centre
d) Initiation of the Clothing, Footwear and Textiles Scheme
e) Encouraging Export Performance
f) Communications

a) Design, marketing and branding

3. Since the late 1970's and particularly through the recession the EDC has brought to the attention of firms the need to focus on design, marketing and branding in place of a former production based outlook. The "St. Neddy" project launched by the EDC in 1979 was a campaign directed at boosting the sales of quality British Clothing in the UK and export markets which aimed to increase their attractiveness and suitability by promoting a collective trade name - "HERITAGE". An industry wide marketing campaign was developed to increase consumer awareness of British Clothing. The EDC has also devoted some time in 1984 to promoting the Design Advisory Service Funded Consultancy Scheme.

4. The change taking place in the High Street in display of merchandise led by the success of "Next Ltd", the womenswear retail chain, and now followed by many other retailers has helped create a demand for co-ordinated ranges of stylish and fashionable garments. This has led to a requirement for shorter production runs and greater flexibility where the UK manufacturers now have a potential advantage over Far Eastern producers who have longer supply lines.

5. During 1984 a meeting was held at NEDO between designers and retailers in order to bring the brand name of British designers into medium price clothes and win back orders to the UK, thus creating British jobs.

b) Import Substitution

6. The EDC has tackled import substitution in several different ways. In 1978 the publication 'Increasing your Sales in the UK market' concluded that a professional approach to marketing was an essential pre-requisite. In December 1979 a set of proposals were sent to the Secretary of State for Trade on Import Substitution. The Clothing EDC discussed in 1981 a co-ordinated design, marketing and brand image campaign "Have More Fun With Your Clothes On - Wear Something New" to make consumers more interested in buying British and to give retailers sound commercial reasons for stocking British made clothing.

7. The Manufacturer/Retailer Panels first set up in 1979, aim to identify future retail requirements and areas of opportunity for UK manufacturers. In 1980 a "Pilot Study of Garment Buying and Sourcing" was initiated which provided an insight into how retailers formulated their purchasing policies. Such efforts in building up closer links between manufacturers and retailers provided a foundation for launching the highly successful and innovative 'Better Made in Britain' Exhibitions which have formed the cornerstone of the EDC's import substitution drive for the last two years. Better Made in Britain I with its recapture of £20m of new business for UK manufacturers and II are described more fully in Annex 2.

c) Promotional Activities - Development of a Trade Centre

8. The EDC brought proposals to the industry on the establishment of a British Fashion Centre in Central London to act as a focal point for both home and overseas buyers. Such a centre would be of particular benefit to the medium to smaller companies who would be able to lease offices/showrooms in Central London and make it easier to buy British merchandise.

9. Fashion marketing centres are established in many cities in Europe and the Chairman of the EDC invited Mr Norman Lamont, Minister of State for Industry, to accompany him to the Confectiecentrum in Amsterdam, a Clothing Centre, which opened in 1968 spurred on by the initiative of a few manufacturers with support from the Amsterdam City Council, and which now extends to a complex of 72,500 square metres housing 350 manufacturers. A further complex of 75,000 square metres is planned.

10. A research study among 400 leading clothing and knitwear manufacturers, undertaken by Kurt Salmon Associates in 1983 for the EDC indicated that there was strong potential support from the industry for a British Fashion Centre, but in the event it has not yet attracted sufficient financial backing.

d) Initiation of the CLOFT Scheme

11. In 1983, following the successful launch of the DTI's Small Engineering Firms Investment scheme (SEFIS), the Clothing EDC initiated a series of proposals for a similar scheme. The government responded in March 1984 by announcing the provision of £20 million for a scheme to assist the textiles, knitted goods, footwear and clothing sectors and also to provide additional government funds to encourage the more effective use of designers. The scheme is still under review in Brussels.

e) Encouraging Export Performance

12. The Export Market Research Group set up in October 1982 decided to concentrate on more difficult but potentially high growth markets. In September 1983 a seminar and exhibition of military clothing was arranged for a top level delegation from the Federal Procurement Office of the West German Ministry of Defence (BWB). At the invitation of the BWB the British Knitting and Clothing Export Council is organising a two day exhibition of apparel items in Koblenz in March 1985.

13. The main thrust of the EDC's export effort has however been directed to Saudi Arabia. "Export Spotlight - Saudi Arabia" reporting on opportunities for specialised clothing, workwear and uniforms was prepared following a visit by export group members in April 1984. Further investigation is currently being undertaken on the retail sector in the Kingdom in order to identify the key buyers and best marketing channels for UK manufacturers.

f) Communications

14. Industry leaders have been involved with a number of informal dinners hosted by the Chairman of the Clothing EDC. Topics discussed have included banking services, design, the unions' view of the industry, import substitution, the MFA III negotiations and support for smaller firms. Guests of honour have included leaders of financial institutions, Sir John Nott, then Secretary of State for Trade, Mr Cecil Parkinson, then Minister for Trade, Viscount Davignon, Commissioner for Industry and Vice President of the EEC, and Mr John McGregor who was responsible for small firms at the Department of Industry. These dinners have provided a useful means to discuss strengthening the industry in difficult times and included members of the industry not on the EDC.

15. The work programme and recommendations of the EDC have through mailings, conferences and in-company visits been communicated to those who work in the industry. Since 1978 the EDC Ambassadors have held 80 meetings in companies involving management and workforce. Such meetings are partly aimed at improving communications within companies and the EDC is about to launch "Effective Communication in Companies" which is based upon the experience of firms in the industry and provides a simple yet practical step by step illustration of how companies can introduce or strengthen communication arrangements.

EXPLOITING THE CHALLENGES OF THE 1980's

16. The industry is fortunate in having three organisations which provide a wide range of services to help firms improve their competitive position in The British Clothing Industry Association, the British Knitting and Clothing Export Council and the British Clothing Industry Productivity and Technology Centre. Taking account of the activities of the organisations the EDC, which is currently being reconstituted, is likely to focus on the following areas:

- maximising the industry's performance in marketing and promoting a "quality" image in both home and oveseas markets. The government may wish to consider some form of promotional campaign along the lines of 'Food from Britain', which seeks to maximise opportunities in existing and potential markets. With the rapid changes which are occurring in High Street store layout particular emphasis will need to be given to packaging and presentation in addition to design, marketing and branding.

- the Export Market Research Group will continue to research those priority markets where there are significant potential opportunities for UK manufacturers.

- a flexible manufacturing sewing system employing robotics is being developed in Japan in a co-ordinated research effort between 3 Research Associations and 27 major companies with funding from the Ministry of International Trade and Industry (MITI). The EDC will be watching these developments closely.

- to pursue actively work on import substitution in all ways including a further look at the feasibility of a Trade Centre.

- the practical guide on "Effective Communications in Companies" will be promoted widely within the industry through mailings and regional meetings. The need for training workshops in communication skills will be considered.

17. With productivity improvement aided by good labour relations, a creditable export performance, low inflation and a favourable exchange rate, the industry is in a position of potential strength where, provided the product design and marketing effort are right, firms can seize opportunities in both home and overseas markets. This will increase sales, reduce import levels and consequently increase employment opportunities .

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

ANNEX 1 TO NEDC (85)6

THE INDUSTRY'S POSITION AND RECENT TRENDS

1. When the textiles and knitting sectors are combined with clothing the value added is nearly twice that of each of the motor vehicles and aerospace sectors.

2. It is as a major employer, however, that the industry can make the greatest contribution to the economy. Chart 1b illustrates the position of the clothing industry as an employer compared with several major industries. Moreover much of the industry is located in regions of high unemployment and about 80% of its labour force are women.

3. The industry is spread across 7 sectors (chart 2) which encompass a varied and exciting product mix from high quality fashion garments to specialised work clothing. Total output has increased from £1724 million in 1975 to £3164 million in 1983 in current prices. Output rose rapidly in the later part of the 1970's and despite a downturn in 1981 is now showing an upward trend, although the trend is initially flat when looked at in terms of constant 1980 prices (chart 3).

4. Total net capital investment (new building work plus acquisitions of land, plant and machinery, and vehicles less disposals of those items) rose sharply between 1975 and 1979 from £28.4 million to £66.9 million spurred on by the 1975 Clothing Industry Scheme but has fallen back in the early part of the 1980's.

5. The export performance of the industry has been a considerable success story with exports increasing in current prices from £175 million in 1975 to £561 million in 1983. (chart 4) As a proportion of total production exports have risen from 10% to 18% in the same period. The same chart shows imports rising from £388 million to £1121 million over the same period with over 40% of imports coming from OECD countries.

6. Export efforts are directed worldwide (Chart 5) with Saudi Arabia for example now being the 7th largest overseas market for clothing. Amongst the other countries the Soviet Union is becoming a growth market with 1.8% of total exports. From 1976-1981 the clothing industry had a positive balance with EEC countries and, although UK exports to the EEC have not grown as fast as might be expected, especially as the UK accounts for 17% of Community production, exports to the EEC have become increasingly important and now account for around 50% of total exports.

7. Considerable strides have also been made in productivity improvements and the rate of increase in clothing productivity has been similar to the average for all manufacturing industry since 1980 after exceeding it in the late 1970's (Chart 6).

8. The greatest threat to the industry as a major employer, however, comes from the rising imports of the high volume low cost producers. Although import penetration (the ratio between imports and home demand) for the industry is currently about 33% by value, in volume terms it is much higher and it has increased significantly in many sectors since 1978 (Chart 7). For example between 1978 and 1983 import penetration for men's and boys suits, has increased from 39% to 64%, for jackets and waistcoats from 45% to 65% and for women's and girl's woven costumes and suits from 56% to 95%. Import penetration for men's shirts and women's blouses has remained high throughout at around 65% and 56% respectively.

9. Large volume sales in the UK are concentrated in the hands of a relatively small number of retailers which combined with low cost imports has resulted in retail price levels in the clothing industry rising substantially less than those for all retail goods over a long period (chart 8). For example, between 1975 and 1984, retail prices (all items) increased by 161% whilst retail clothing prices rose by only 67%. In 1984 it is estimated the clothing retail prices have fallen slightly.

10. In 1982 there were 5800 enterprises in the industry with about 95% of firms employing less than 100 and accounting for 35% of total output. At the other end of the scale 59 firms employing over 500 people accounted for nearly 40% of total output. This compares with 7000 establishments in 1978, with a similar proportion of firms employing less than 100 people and 87 firms employing more than 500 with output shares of 31% and 44% respectively.

11. The impact of risng low cost imports on employment levels however causes the greatest concern. Employment in the clothing industry which was 326,000 in 1975 had fallen to 211,000 by June 1984. Since 1978 almost 100,000 jobs have been lost (chart 9).

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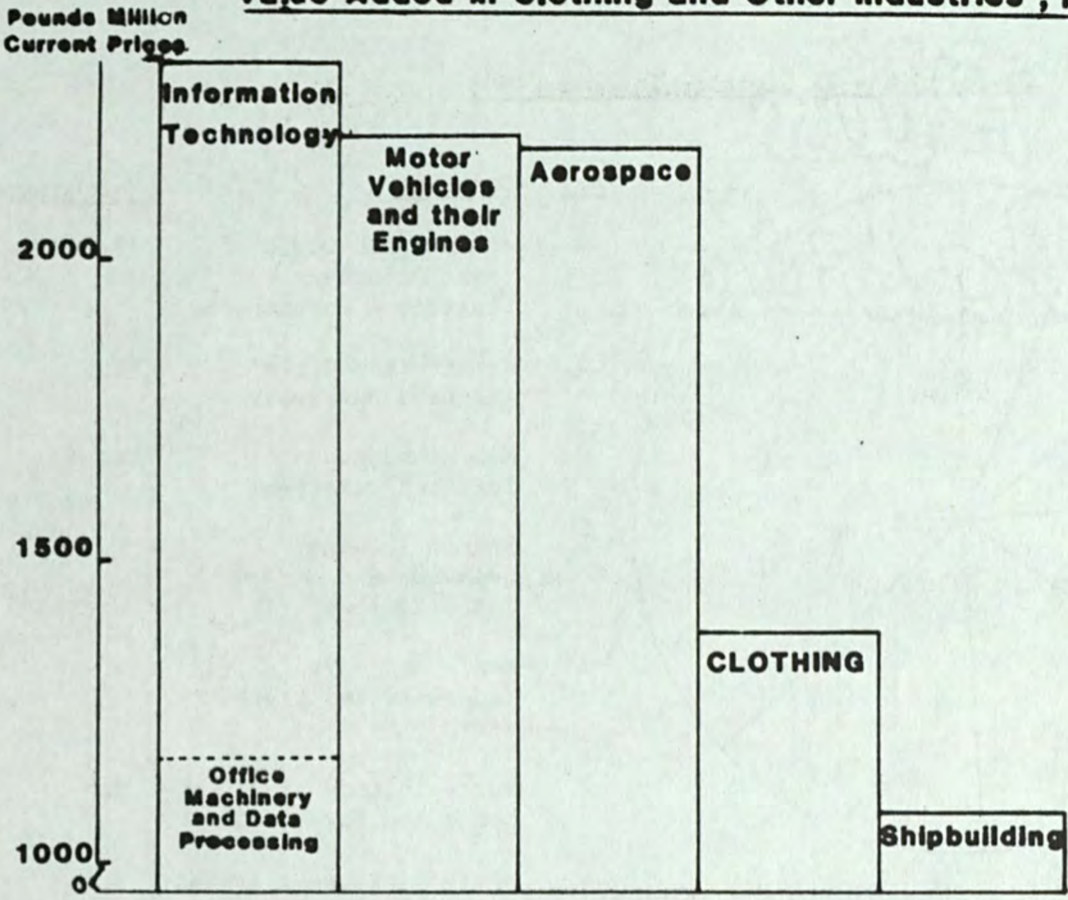
Value Added in Clothing and Other Industries, 1983

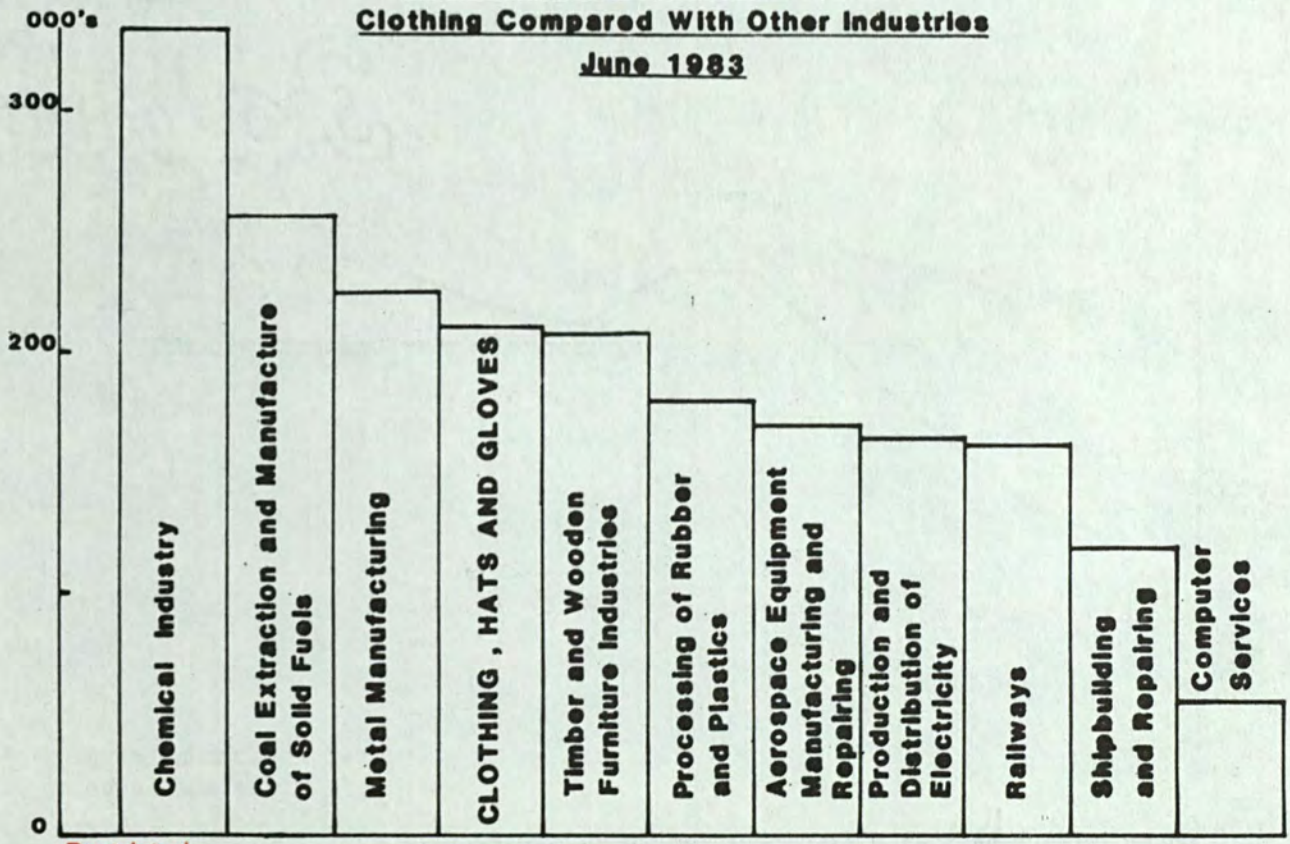
Chart 1a



Source : Department of Trade and Industry

UK Employees in Employment
Clothing Compared With Other Industries
June 1983

Chart 1b



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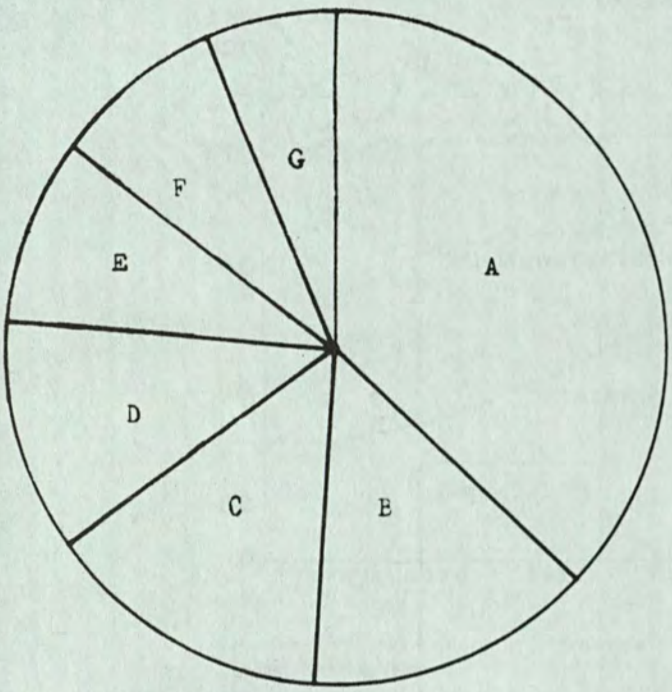
Source : Department of Employment

Chart 2

Shape of the UK Clothing Industry 1983



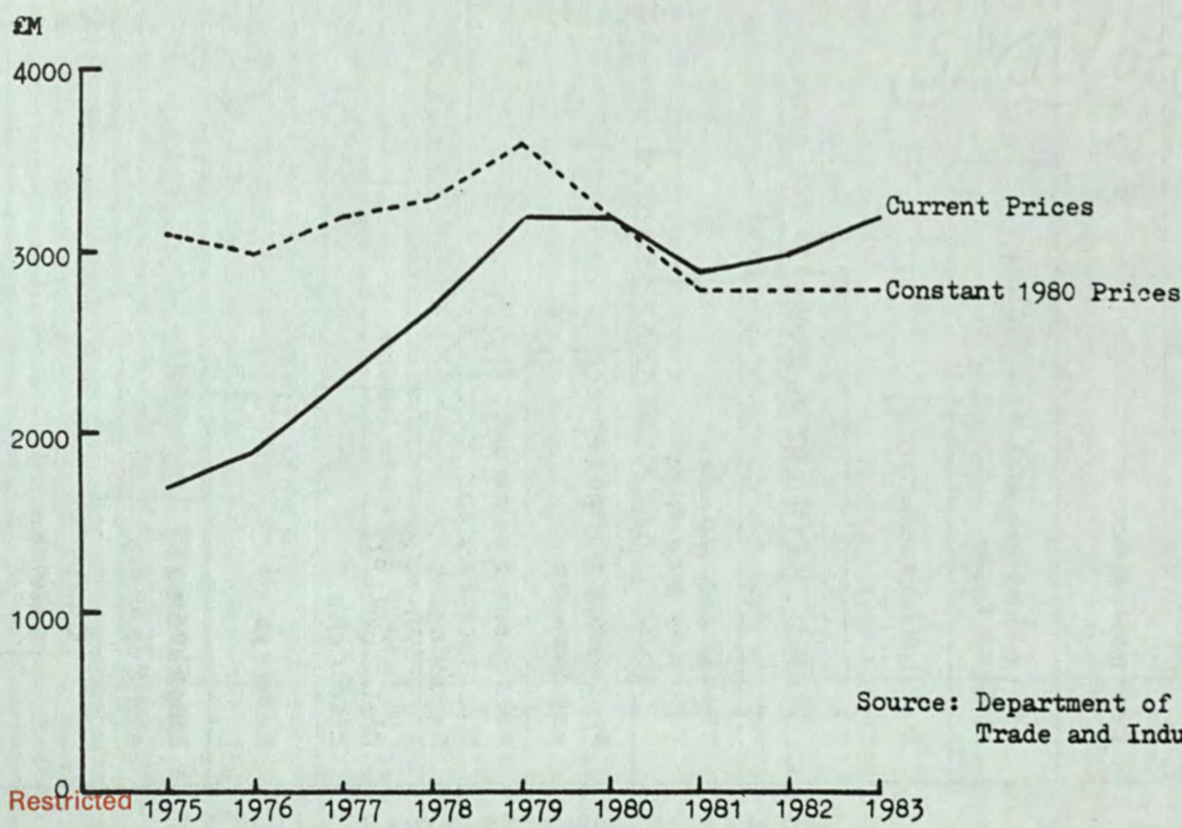
Key	Category	Percentage
A	Women's and Girls light Outerwear Lingerie & Infantswear	37.0
B	Women's and Girls' Tailored Outerwear	14.3
C	Men's and Boys' Tailored Outerwear	14.2
D	Foundationwear, Swimwear and miscellaneous	11.3
E	Men's and Boys' Shirts Underwear and Night-wear	9.1
F	Work-clothing and Men's and Boys' Jeans	8.3
G	Weather-proof Outerwear	5.8

Source: Department of Trade and Industry

Output £3164 million

Chart 3

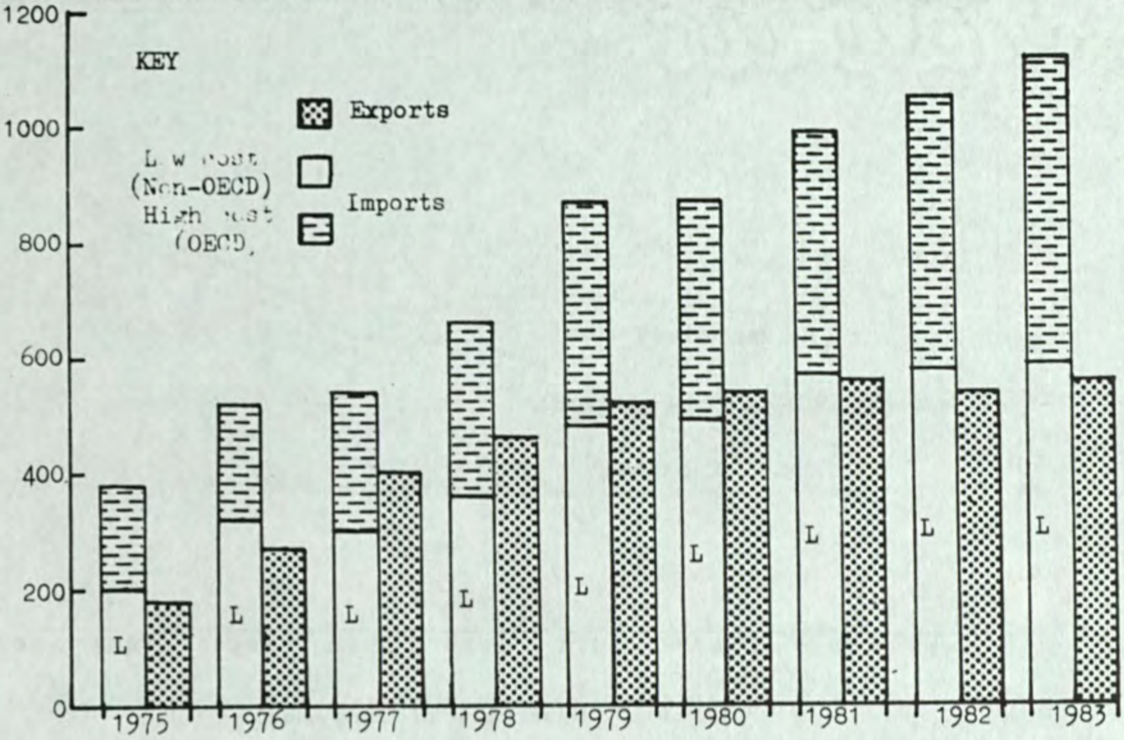
UK Production of Clothing



Source: Department of Trade and Industry

Chart 4

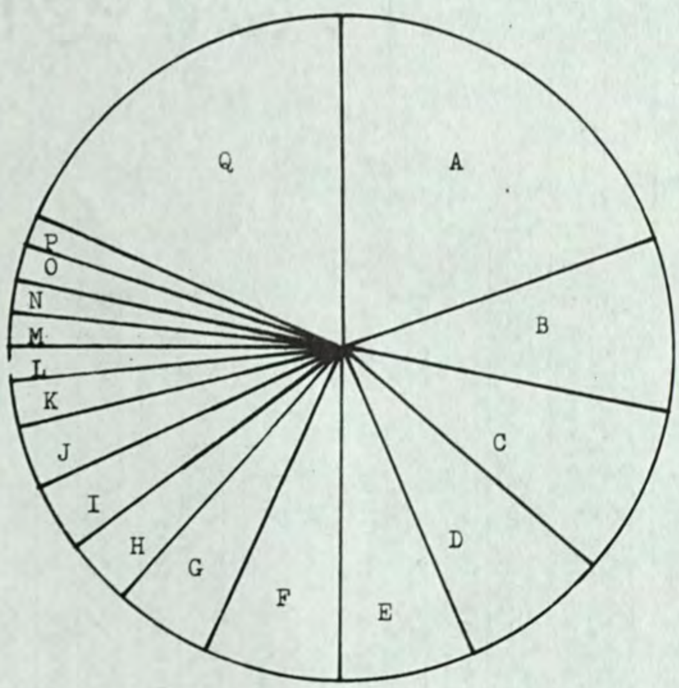
UK Clothing Industry: Exports and Imports



Sources Dept of Trade and Industry and O.E.C.D

Chart 5

UK Exports of Clothing 1983



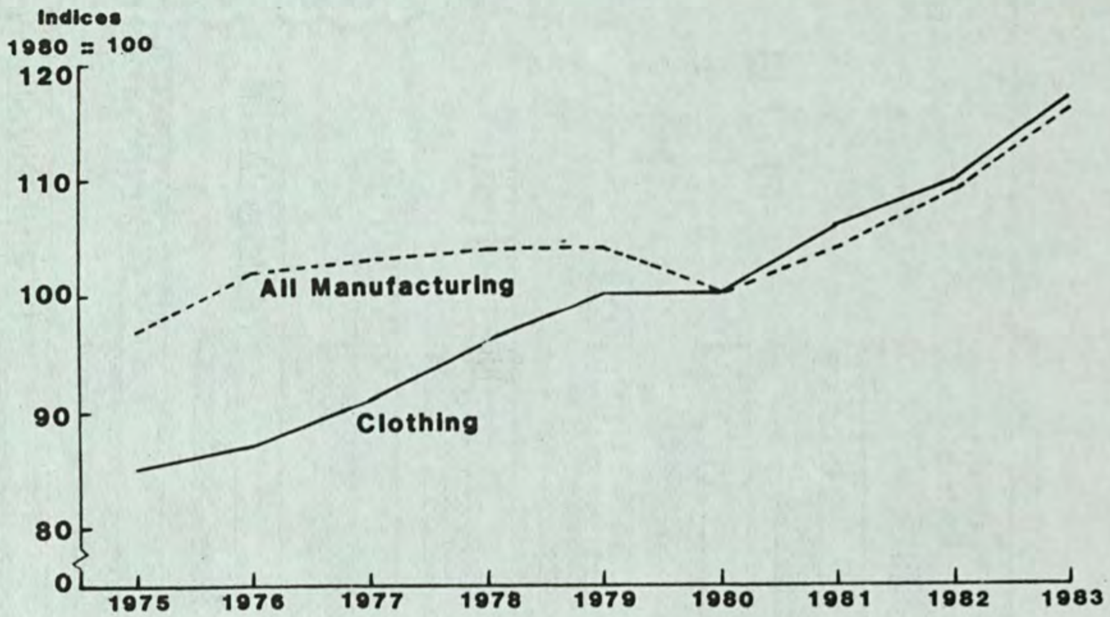
Key		% of Exports
A	IRELAND	19.8
B	FRANCE	8.7
C	W GERMANY	8.3
D	SWEDEN	7.2
E	NETHERLANDS	6.8
F	USA	6.7
G	S ARABIA	4.8
H	BELGIUM/LUX	3.3
I	SWITZERLAND	3.2
J	NORWAY	3.0
K	DENMARK	2.3
L	JAPAN	1.8
M	SOVIET UNION	1.8
N	ITALY	1.7
O	NIGERIA	1.6
P	AUSTRIA	1.5
Q	ALL OTHERS	17.5

Total UK Clothing Exports 1983 $ 822M

Source: OECD

Chart 6

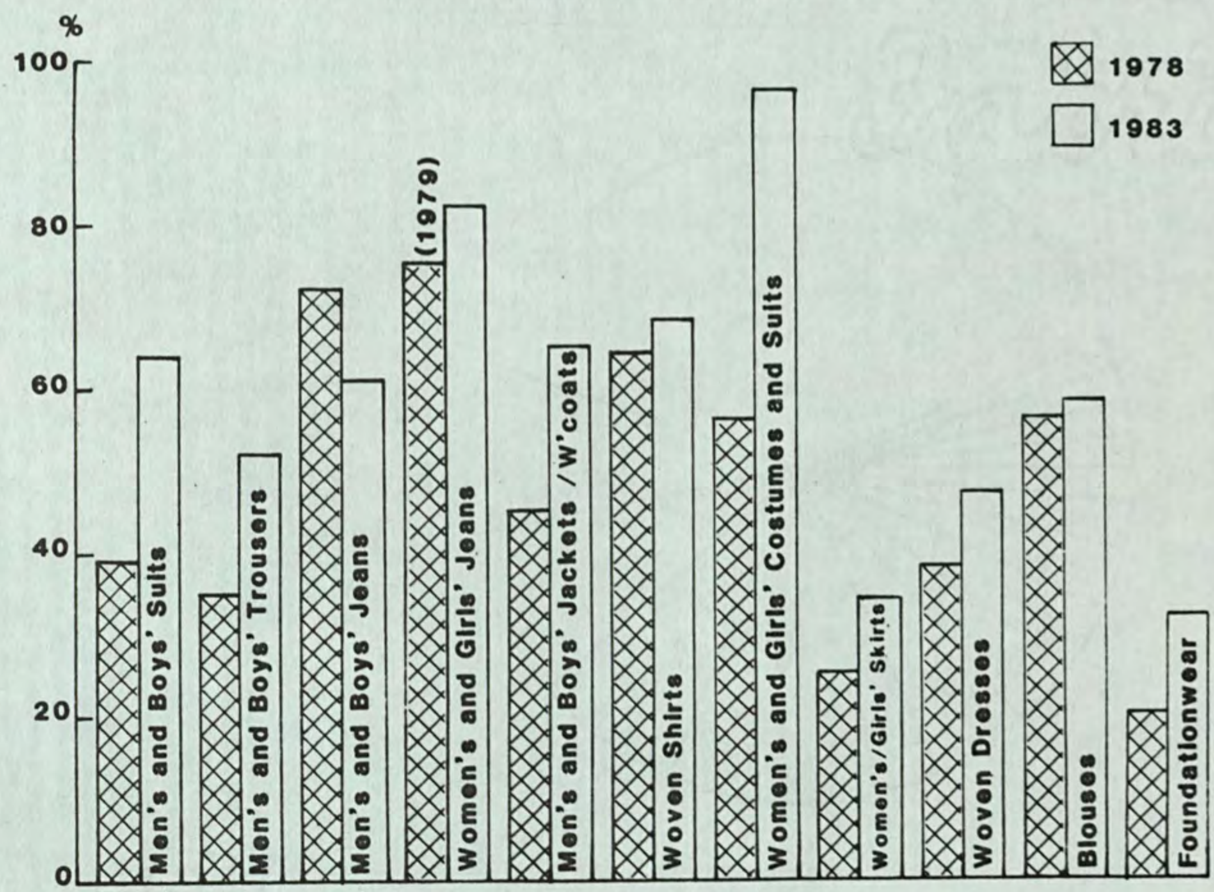
Output per Head in Clothing and All Manufacturing Industries



Source : Department of Employment

Chart 7

UK Clothing Market : Import Penetration by Volume



Source : Department of Trade and Industry

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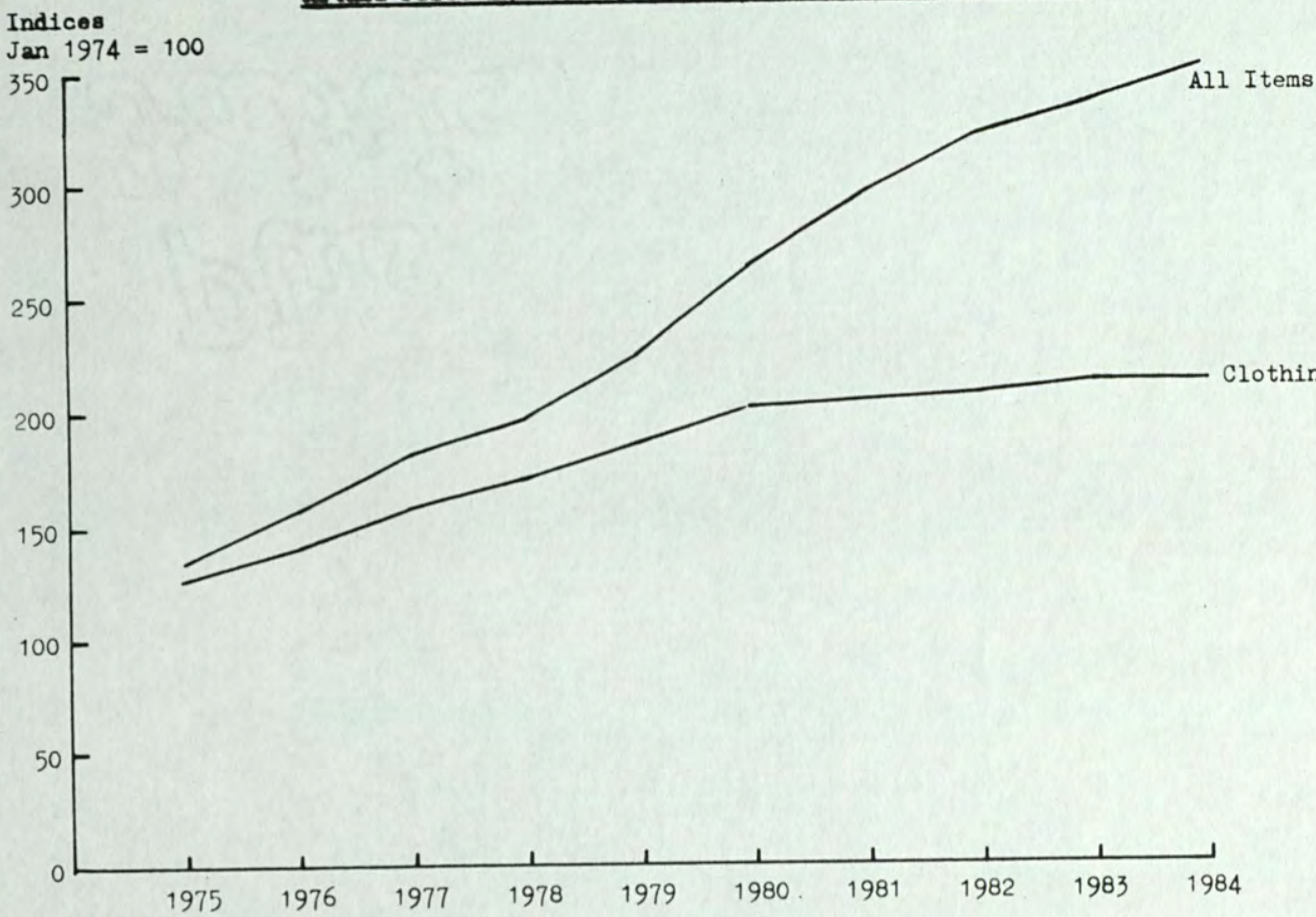
Chart 8

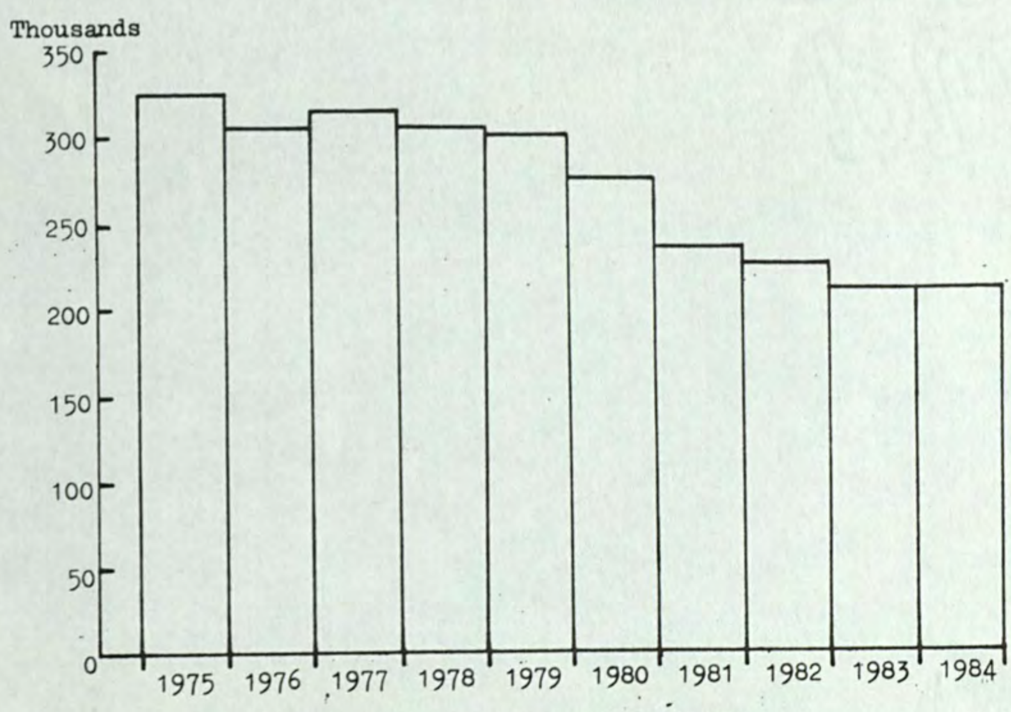
Retail Price Inflation, all items compared with Clothing



Source: Central Statistical Office

Chart 9

Employment in the UK Clothing Industry



Figures relate to June of each year
Source: Department of Employment

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ANNEX 2 TO NEDC (85)6

BETTER MADE IN BRITAIN

1 The first Better made in Britain exhibition held in March 1983 is estimated to have won back £20 million of new business for UK manufacturers and created or saved, either directly and indirectly, 2000 jobs. The second exhibition which was held in October 1984 and broadened the clothing (and knitting) look by including both the footwear and textile sectors, is targeted to win back £100 million of new orders to the UK and create or save 10,000 jobs.

Concept and objectives of the Exhibition

2 The first Better Made in Britain broke new ground for the British clothing and knitting industries by seeking through a unique 'back to front' exhibition to establish widespread contact between manufacturers and UK retailers by bringing them together across a whole product area under one roof. The objective was to strengthen the domestic producer by providing an opportunity for him to talk to major retailers about the merchandise they were currently importing. This it was hoped would lead to an opportunity to match it in quality, price, availability and design for future seasons.

3 It was to consolidate the new business generated by the first exhibition and to build on the success of the experiment that in response to many requests from both manufacturers and retailers the second exhibition was launched in October 1984. The successful formula of retailers exhibiting imported items which they would rather buy in the UK, given a fully commercially acceptable source, was reconfirmed.

Facts and Figures

4 Total sales of the four industries covered by the Better Made in Britain Exhibition amounted to £8844 million in 1983. Imports from these industries have risen from £2754 million in 1978 to £4103 million in 1983 (33%) whereas the size of the home market increased only from £9958 million to £10,882 million (8%). This has resulted in import penetration rising from 27.6% to 37.7%. Over the same period 350,000 jobs have been lost with employment falling from 889,000 in 1978 to 516,000 in 1983. In the first three quarters of 1984 provisional estimates show imports amounting to £3692 million with import penetration reaching 40% and the loss of a further 16,000 jobs by June 1984.

5 The Better Made in Britain Exhibition is aimed at reversing the trend of job losses and creating employment by promoting the cause of import substitution provided UK manufacturers can be competitive with imported merchandise on the basis of price, design, quality and delivery. Most retailers also indicated that they were prepared to Buy British rather than import. It is a concept which can be adapted to other industries whether between retailers and manufacturers or manufacturers and their component suppliers.

6 The second exhibition was held on 24 and 25 October 1984 at the Kensington Exhibition Centre in London. 40 major retailers including 1 major overseas retailer and 4 overseas mail order companies covering some 70 brand names displayed over 3000 items of imported merchandise. For the clothing sector alone it is estimated that this represents an opportunity for UK manufacturers of 8 million garments. About 400 retail buyers and merchandisers were present over the two days of the exhibition. A total of 2004 tickets were sold to 1117 UK companies, 90% of which were represented at Director or Managing Director level. Both retailers and manufacturers showed considerable commitment to the exhibition - the participating retailers contributed £750-£1000 towards the cost of the stands in addition to the expenditure of dressing each stand and manufacturers paid £25 per ticket for admission. Council will be interested to know that total income and expenditure are estimated at £105,000 and £115,000 respectively.

7 The exhibition was a high profile event and the increase in participating retailers, from 28 to 40 at the second exhibition, who were prepared to put considerable time and money into identifying their companies with the initiative, demonstrated a genuine and growing desire to support the domestic industry. The exhibition was to have been opened by the Rt Hon Norman Tebbit MP, Secretary of State for Trade and Industry, but in the event the ceremony was performed by Viscount Whitelaw. Many other members of Government visited the exhibition together with key figures from the CBI, and Trades Unions. A highlight of the two days was a reception at 11, Downing Street, made available by the Chancellor of the Exchequer at which both the Chancellor and Prime Minister spoke.

Reaction

8 The event itself proved to be highly successful. Retailers were impressed with the calibre of manufacturers who approached them and commented on a noticeably more professional management attitude. A number of retailers registered interest from 200-300 manufacturers and most considered their involvement as being justified. Manufacturers found it better planned and more useful in a number of ways than the first occasion; they were pleased at the switch away from the lowest cost imports and found the retailers more helpful. The second event clearly helped both sides maximise the opportunity. There were many favourable comments on the atmosphere of the exhibition and high level of presentation adopted by the stand holders.

Media Coverage

9 Although it might have been imagined that press coverage for a second exhibition would be less easy to generate than for the first there were articles or features in 8 national and 13 regional newspapers and 35 trade journals or periodicals. The various Trade Association and Trade Union bulletins also gave strong support to the event.

The Industries Stand

10 Clearly a positive response needed to be made by manufacturers and this year the footwear, clothing and knitting industries shared a stand which demonstrated the wide ranging commercial, technical, education and training services aimed at strengthening the competitiveness of these industries into the 90's. New technological developments were also on view on the stand.

Surveys of imported merchandise

11 The aim of the surveys, undertaken on behalf of the Clothing, Knitting and Footwear EDC's by the BCC, Zina Roworth & SATRA respectively, was to establish a record of a proportion of the items exhibited both in terms of a factual analysis and to provide an assessment of the implications for UK manufacturers.

12 The reports provide much very interesting detail on the content of the exhibition. Every item examined was logged as per the basic information displayed on its ticket so a clear picture has emerged of what was on show, where it came from, the likely order sizes and delivery requirements, and usually its selling price if not the cost price. Also given is a good idea of why the item is being imported and whether it is viable for manufacture in the UK in the opinion of the researchers.

13 These surveys indicated that the bulk of the merchandise on display could be technically made in the UK. Moreover for the knitting and footwear sectors it was estimated that 75% and 50% respectively of the products could be made commercially. For the clothing sector the profitability for UK manufacturers is to be further researched by the British Clothing Industry Association.

Spreading the Message

14 The Office has commissioned a film on the exhibition with the objective of persuading other industries to consider a similar approach to strengthen the links between manufacturers and their purchasers. The concept of the exhibition is strongly supported by Government and opposition spokesmen, CBI and TUC, together with senior representatives of the Furniture, Printing, Hardware and Housewares and Cutlery industries who attended the exhibition. Over 70 leaders of other industries sent letters of support to the "Better Made in Britain" Exhibition and the Prime Minister in a letter to Sir Basil Feldman strongly supported the exhibition and hoped that such initiatives would set an example to other industries.

15 Based upon the experiences of the Better Made in Britain Exhibitions success can be measured at two levels. First there is the impact of the exhibition itself and secondly the later commercial success which in the case of the first exhibition brought £20 million of new orders for UK manufacturers.

16 The Better Made in Britain video identifies 7 key pointers for a successful exhibition. Firstly the event was pioneered by Sir Basil Feldman, Chairman of the Exhibition Committee, which included senior retail, management, government and Trade Union representatives. Secondly the product range was limited and targetted to specific areas with a reasonable chance that a high proportion of the merchandise on display could be manufactured profitably in the UK, so as to provide significant opportunities for substitution by the visiting manufacturers. Thirdly the commitment of the key buyers (the retailers on this occasion) was a essential pre-requisite and fourthly it was clearly important for the manufacturers from the various industries to support the exhibition. The friendly ambience of the Kensington Exhibition Centre was the fifth factor and helped to provide a lively and congenial atmosphere conducive to detailed but relaxed discussions. Sixth the whole event was given a high profile by the support received at top level from government, opposition, both sides of industry and TV and sports personalities. And, seventh, NEDO with its neutral stance, regular contact with manufacturers and retailers and sector committee structure was the ideal catalyst to organise such an exhibition.

File

Rev

c.c. Sue Goodchild

10 DOWNING STREET

From the Private Secretary

7 January, 1985

NEDC DINNER

The Prime Minister understands that the idea of a dinner in No.10 for NEDC members was put to Norman Willis and, though he did not wish to turn down the idea, he felt that he could not get his team together in time for January. The Prime Minister has agreed to keep the idea in play. Could we, therefore, have a further word in early March to see whether the climate is right for resurrecting the idea.

BF

I am sending a copy of this letter to David Normington (Department of Employment).

(A. Turnbull)

Miss M. O'Mara
HM Treasury

File

(1)

PRIME MINISTER

NEDC Dinner

Following your meeting with Sir Terence Beckett in November, it was suggested that you might host a dinner at No. 10 for the members of NEDDY Council. The purpose would be to acknowledge the return of the TUC. The evening of 8 January, immediately before the 9 January meeting of NEDC, was considered.

This was put to Norman Willis by Sir Peter Middleton who, together with Mr. Cassels and Sir Terence Beckett, form the Group of Four who meet to arrange NECD business. After some delay, Norman Willis has returned to say that he favours the idea in principle but feels that he cannot get his team together for January. In any case, he feels uneasy about such an occasion while the mining strike is on. He is anxious not to be seen to be spurning your offer and has suggested that the idea might be reconsidered in, say, March or April.

Content?

AT

Yes
MT

ANDREW TURNBULL

4 January, 1985

File

MR TURNBULL (o.r.)

cc Mrs Ryder

NEDC Dinner

Margaret O'Mara 'phoned to tell me that the TUC, who have now been sounded out about the possibility of a dinner for the NEDC, say they are happy in principle but January is too soon to get all their chaps together. March would be better.

27 December 1984

OIP

Restricted

File

AJ

National Economic Development Council

NEDC(84)47
Cover note
22 November 1984

INVESTMENT IN THE PUBLIC SECTOR BUILT INFRASTRUCTURE

The attached paper provides a factual and analytical contribution towards consideration of investment in the infrastructure by the Council early in the New Year. The paper for discussion by the Council will be circulated at the normal time in advance of the meeting.

P V Dixon

Secretary to the Council

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

Restricted

NEDC(84)47
20 November 1984

INVESTMENT IN THE PUBLIC SECTOR BUILT INFRASTRUCTURE

CONTENTS

* Circulated to advisers only

NEDC(84)47
20 November 1984

INVESTMENT IN THE PUBLIC SECTOR BUILT INFRASTRUCTURE

Memorandum by Director General

PART I SUMMARY

Introduction

At its meeting in August 1983, the Council considered the question of investment in the built infrastructure and the prospects to the end of the decade for the construction sectors. NEDO was commissioned to examine the criteria used in practice by public bodies responsible for investment in the renewal, improvement and maintenance of major parts of the nation's infrastructure. The terms of reference agreed with the Council parties are at Annex 1.

2 Six main categories of infrastructure were selected for study:

- Roads and bridges
- Water supplies and sewerage
- Public sector housing
- School buildings
- Health service properties
- Central government's civil estate administered by the Property Services Agency (PSA).

3 In 1983 the total flow of capital funds invested in new assets in these six categories, which together account for perhaps half of total infrastructure investment, exceeded £5bn (the exact figure cannot be established from existing procedures). There was also a very large total of current expenditure on maintenance and renewal, which cannot be separately distinguished from the other current expenditures in these fields, but is estimated to be of the same order of magnitude. The value of the assets in England alone is in excess of £200 bn.

4 The study carried out by NEDO staff investigated the extent of the information on which capital and current expenditure decisions are at present based, and the objectives, criteria, methods of allocating priorities and the procedures and funding systems used. An assessment was also made of the implications for the quality and condition of the built infrastructure of each service, so far as this could be ascertained. The study deals with the systems and practices followed in England, and with those followed in other parts of the UK insofar as they are similar.

5 Such existing data as are available were collected and used as the basis for a series of some 100 structured interviews with sponsor Departments, regional and local spending authorities and other relevant organisations (listed in Annex 2). They were visited over the period February to July 1984.

6 The study considers the main categories of funding arrangements:

- Direct central government funding: PSA civil estate, NHS hospitals, and the national trunk road network, including motorways.

- Local government rate provision with central government funding through the rate support grant system : county roads, education buildings, public sector housing (partly funded by rents).

- Utility funded by charging for its services and by borrowing within central government limits : water and sewerage.

Summaries of the reports on the six areas studied are attached; the full reports are enclosed as an annex.

Theme of the Report

7 Well-run public and private sector companies provide for the maintenance of their assets, and for depreciation to replace those which they expect to be able to employ profitably in the future. They are subject to the disciplines of the market and they can test and compare the performance of specific investment programmes by the rate of return which they earn. The cash flows generated are invested provided they are judged capable of earning the anticipated return.

8 This calls for the assets to be quantified and valued both in terms of the initial investment and also according to their condition and value in use. It also calls for criteria to determine the investment to generate the anticipated return in the light of information on existing assets and assessments of future demand, both for new projects (taking account of lifetime costs) and also for cost effective planned maintenance and replacement.

9 Market forces alone cannot provide the same discipline on expenditure for the provision, maintenance and renewal of the infrastructure. Here, the interpretation of need provides the relevant criterion, except to a limited extent in the case of water and sewerage, and housing (through rents). If the very large sums spent on both capital and current account are to secure both value for money and a level of provision acceptable to the user, decisions and expenditure procedures need to take account of clearly defined objectives for each service; and to be based on:

- properly substantiated assessments of the forward demand for, and (where appropriate) economic and social benefits from, the service both locally and nationally;

- detailed information on the value, extent, nature, condition and level of use of the present stock of assets, on maintenance levels and costs and on expenditure on capital and current account;

- criteria and systems to determine priorities for capital and current expenditure both locally and nationally, and for making the best use of available resources;

- financial disciplines which enable the long-run costs and benefits of alternative maintenance regimes to be assessed and compared, including the assessment of the whole life cost of particular assets, and of particular maintenance and replacement regimes;

- consistent arrangements for allocating available funds at both national and local level to meet the requirements, criteria and priorities identified.

10 The findings are related to these requirements.

Findings

Provision for depreciation

11 Except for the Water Authorities, assets are not formally valued in financial terms, and no formal provision for annual depreciation is therefore possible. Water Authorities, which depreciate their assets on a current cost accounting basis, are dealt with at paragraph 36. For all five other sectors, the analysis in paragraph 9 is alone relevant.

Objectives of the services

12 The objectives, whether set nationally by government or by the local authority, are usually too vague and generalised to be of practical use as benchmarks of performance, or as indicators of investment needs.

Extent, value and condition of the stock

13 The available information on the value, extent, quality, condition and performance of the stock and of the amount spent on it is extremely variable. It ranges from being quite comprehensive in certain fields (eg motorways and trunk roads) through inadequate (eg housing in relation to quality and performance characteristics) to poor (hospitals). A new information system is being introduced for the NHS hospital stock which has many good features, and is potentially applicable in other fields.

Investment criteria

14 Criteria are drawn up for investment in new stock or assets and are generally though by no means universally well developed. Except for some new projects, life cycle costs have not on the whole been taken into formal consideration. Criteria for expenditure on the maintenance and renewal of the assets are usually much less formalised than for new developments and range from standardised condition assessments (eg in motorways) to largely reactive "firefighting" on an ad hoc crisis management basis. Additionally, the system used generally fails to take account of the fact that the maintenance requirements of complex modern structures (eg hospitals) are often greater than those of the older, less technically sophisticated buildings that are replaced. Criteria will of course need to vary, and in a few cases could conceivably include even 'firefighting', but in many cases it appears that the criteria fail to provide the basis for efficient use of resources.

15 Typically, at the time of construction some of those assets referred to in paragraph 3 have very long lives attached to them. They have often deteriorated prematurely either because they have been subject to far greater use and wear and tear than originally assumed, or because methods of design and construction or materials used were unsatisfactory. At the

aggregate level, to base necessary expenditure on those assets on some theoretical rate of depreciation may lead to serious underestimates of required expenditure.

Assessments of demand and setting of priorities

16 The setting of priorities at local level, both as between viable new construction projects and the maintenance or replacement of existing assets, and as between individual projects, is made annually against assessments of forward requirements and of the condition of the stock. The priorities reflect these procedures, which are usually very imperfect, given the inadequate information base, as well as an element of choice based on spending authorities' own assessments of need. Local Authorities' Transport Policy and Plans (TPPs) and Housing Investment Programmes (HIPs) - submitted in mid year for the subsequent financial year - provide the clearest examples of an attempt at a formal statement in relation to needs.

17 Within certain infrastructural areas, at both national and local level, there is evidence that maintenance/repair has been put to the end of the queue for funds in order to keep pace with current expenditure essential to maintain the standards of the services provided - eg for medical staff and equipment in the hospital service or for teachers and equipment in schools.

18 Though local spending plans are submitted through the regional offices of sponsor Departments, they do not determine the total national allocation of funds. Nor is the national level of funds to those services which are provided directly by central government based on such formal assessments of requirements.

Allocation of funds by central government

19 Allocation of funds to each service is negotiated simultaneously with the preparation of the annual bids at local and central government level. Centrally, the allocation is made through the collective decision of the Cabinet after bilateral discussions between the sponsor department and the Treasury. The plans of spending authorities do not appear to influence the outcome of the negotiations with the Treasury, which take the level of the existing provision as the starting point. It is spending authorities' perception that next year's allocation by government is based on last year's spend and on the one-year financing cycle, although the expenditure plans themselves cover a three year period.

20 Generally there appears to be no attempt at the appropriate level within central government to base the case for annual allocations of funds on strategic assessments of requirements and priorities. Such assessments do come into play, however, in the subsequent process of allocating available resources as between capital and current expenditure.

21 Further, the allocation of funds as between categories of infrastructure at national level does not seem to be based on a review of strategic assessments of requirements and priorities. Also there is no adequate mechanism for achieving a balanced spend in relation to need as between each category of service within a Region. Such a mechanism may be hard to set up but the need for it was raised by some spending authorities.

Allocation of funds by local authorities

22 The allocation of funds by local authorities to those services which they provide is not simply based on need criteria and priority assessments. The starting point is the current year's proposed spend in each service. It is then related, so far as possible, to authorities' assessment of local needs and priorities and includes an element of "horse-trading" between different services. It does not have to correspond to the net government provision, which is partially based on assessments of need.

23 In the past three years, local authorities' receipts through the sale of assets have given them some degree of flexibility to allocate the resulting funds either to the service concerned (mainly housing) or for distribution over the full range of local authority funded services.

The one-year funding cycle

24 Most services provided by local authorities, and some of those provided by central government direct, are subject to acute problems caused by the one year funding cycle. Insufficient indication is given of the resources likely to be available beyond the allocation year concerned; allocations must be used in the year for which they are made and after allowing for virement (switching of expenditure) between services and a 10% carry over to the next year any unused portion is lost. Many instances were found in the study where the lead time, eg for housing renovation programmes or local road investment, is such that the most cost effective projects cannot be undertaken within the time scale available. In order to fit within the one-year cycle or to accommodate unexpected changes in allocation, expenditure is at times undertaken which does not give good value for money.

25 Some authorities, especially those responsible for housing, argued that a 5-year planning/funding cycle is their greatest single need and that this would be more effective and more helpful than a one-off increase in funds. An increase spread over a number of years is, nevertheless, needed by nearly all of them to overcome the situation that has built up.

Backlogs of maintenance, repair and renewal work

26 The report shows that in many areas the present criteria, systems and levels of resource allocation have led to backlogs of maintenance, repair and renewal because they do not allow spending decisions to be based on value for money. These backlogs are neither trivial nor cosmetic items, though of course deterioration on its own does not prove the need for further expenditure unless the outcome will provide value for money. The examples encountered include many which arise from delays in maintenance which so sharply increase necessary expenditures in subsequent periods that no rational discounting process can justify them. In many areas, present systems and levels of resource allocation have led to failures to maintain the fabric of buildings and structures, to remedy structural faults, to renew worn out components and to remove obsolescent features. In some areas, which are specified and quantified so far as possible in the report, delayed and insufficient expenditures have led to accumulating and accelerating backlogs of work as the deterioration of the stock and the costs of crisis repairs increase. It is claimed that there are many instances where the quality of service provided has fallen below statutory or minimum acceptable standards.

27 The extent of the backlogs is often concealed by inadequacy of information. Once these backlogs have been cleared, planned maintenance and replacement to keep the stock in good condition could be funded by the allocation of sums not very different from those currently being disbursed. In one particular area - local roads - several county surveyors reported that without expenditure of around 2 to 3 times the current annual maintenance provision, spread over several years, far greater expenditure would be required later to prevent further deterioration, and to remedy the situation.

28 In the case of hospitals, a Government report based on a sample survey has estimated a maintenance backlog of the magnitude of £2bn; the judgement offered to the study team is that although some surplus property may be included in this estimate, the magnitude of the backlog is indeed of this order. A number of the Health Authorities visited indicated that they would need to spend at least twice their existing maintenance budgets to clear their backlogs.

29 In some education authorities, and in several PSA regions, it is evident that maintenance expenditure falls short, in some cases by as much as 40%, of the amount required even to deal with the most urgently justified tasks.

30 Quite apart from the backlog of repairs which have accumulated due to wear and tear and to neglect, there is mounting evidence of defects in much of the stock of housing and school buildings erected in the 1960s, which is giving rise to growing concern. The cost of overcoming those defects in the public housing sector alone is currently estimated at £5bn by the Association of Metropolitan Authorities. This estimate is widely supported and has not been challenged.

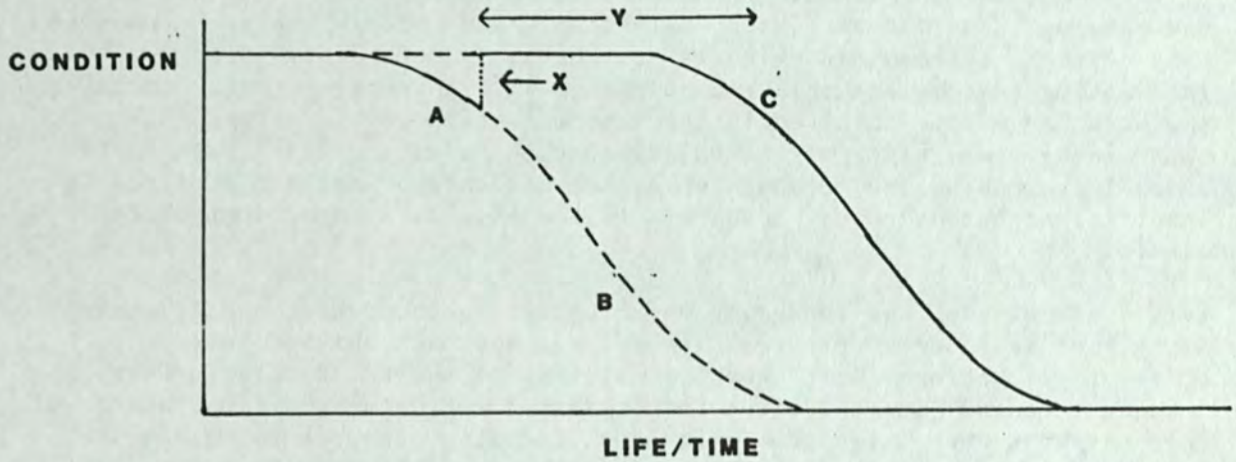
31 The report thus paints a sombre picture. Assessment of the backlogs has been based on the more conservative and well substantiated estimates in the areas under review; in many of the areas it is now evident that the situation has been deteriorating progressively over a number of years, and is not of relatively recent origin.

Consequences of delayed maintenance and renewal

32 The consequences of delaying required maintenance work can be well illustrated for roads. An average life for a road's surface dressing may be 4-8 years. A failure to renew this dressing (the minimum treatment) at the appropriate time can lead to the need for complete resurface at a cost per square metre some ten times greater than that for surface dressing. If resurfacing is also delayed so that the foundations of the road are affected, the cost of restoration can be fifty times that for surface dressing. One typical shire county estimates that at present even its principal roads are only being surface-dressed every 10-12 years.

33 The problem is expressed diagramatically below. The illustration is adapted from one prepared for roads but it epitomises the argument for effective maintenance for all infrastructural services buildings and structures. A highway should never be allowed to deteriorate below point A on the diagram which is the level at which a modest amount of regular maintenance (X) will produce a significant increase in the useful life of the road (Y). Warning levels need to be established to represent point A. In practice, many county roads - and other items of built infrastructure -

have deteriorated to condition B, so that a considerable expenditure is needed to restore the road to its original condition. The spending of only a small amount on maintenance at condition B is likely to prove of little benefit.



34 In school buildings and public sector housing dealt with in the survey, there are catalogues of deteriorating components such as rotting lintels and window frames, and a recurring theme is how only temporary, but frequent, repairs to initially cheap roofs can be afforded. Health authorities speak of painting for hygiene reasons being unreasonably delayed.

35 One health district is spending only one-third of the amount indicated by officially laid-down replacement norms for its mechanical and electrical equipment. A PSA region is replacing only around one-fifth of those lifts which annually reach the end of their normal working life.

Water and sewerage

36 The Government requires each of the Water Authorities to achieve a rate of return on the net current cost value of its assets. However, the value of underground assets is understated by the often inadequate records of their extent, capacity and condition. Each Authority provides for depreciation of mains and sewers sufficient to write off the book amount of each asset over an estimated useful life of 80 to 125 years. However, historically low levels of investment against undervalued assets and the way they have been managed have resulted in a backlog of renewal and maintenance work in both water and sewerage networks in certain regions.

CONCLUSIONS

(i) In some areas of the six categories of infrastructure examined, there are effective systems of information and priority allocation, and of criteria for new construction, notably for national trunk roads and water and sewerage. As far as repair, maintenance and improvement are concerned many of these systems and criteria are seriously deficient. Poor information systems and criteria cannot provide a sound basis for spending the very large sums involved in the most effective way. Further, maintaining the quality of the building stock is an ancillary part of the overall responsibility of some infrastructure categories, and as a result insufficient attention has been paid to the effective management of the estate.

(ii) Furthermore, the foregoing deficiencies in procedures and criteria imply that in a number of areas the current approach has led to the build-up of backlogs which are accumulating as the stock deteriorates. Because the study was selective rather than comprehensive, illustrations of this situation are given from individual spending authorities rather than a total quantified report of backlogs in each area. Nevertheless, the coverage and range of the enquiries clearly suggest that the backlogs identified are widespread. The procedures and systems adopted both help to create the situation and prevent its being effectively dealt with - especially where crisis management, which is seldom appropriate, is adopted, rather than planned maintenance and replacement over a substantial period.

(iii) Whilst it thus appears that current criteria and procedures do not result in the best value for money being obtained, this does not mean that the backlogs and defects identified could be met simply by reallocating existing funds and by improving the system, even though the benefits from enabling professional management to function effectively would be very substantial. All the evidence collected for the report suggests that the major problems identified need to be tackled on a once-for-all basis, involving a defined though delimited requirement for additional funds over a period of time.

(iv) Well developed or not, the systems described do not link in with but are detached from the central government allocation of funds. Does this matter? If not, it is reasonable to ask whether the time spent currently in setting up and operating better information, criteria and procedural systems is being wasted. In fact, several authorities reported that they have deliberately decided not to improve their information bases, criteria and systems because this would take resources they can ill spare, to little purpose.

(v) The conclusion must be that it does matter, because the very large sums involved are being spent in ways which are demonstrably not cost effective or giving best value for money. New projects are often selected to fit in with the pattern of funding available and at lowest first cost, and maintenance and renewal tends to be carried out on a reactive crisis management basis which can be considerably more expensive than a planned approach. The present situation militates against efficient management of the very large resources involved, and can only frustrate the increasing professionalism in the services examined from achieving cost effective operations.

(vi) It is therefore essential to develop the appropriate information data bases, criteria, allocation and funding systems at central and local level to provide the basis for efficient management of the resources under review and to link the allocation of funds to them. This would be an appropriate area for detailed investigation, for example by Rayner teams. Arrangements for dissemination of the best practices developed by individual authorities, for example the NHS estate assessment system now under development, are currently lacking and should also be improved. The degree and scale of deficiencies set out in the report point to the need for early and comprehensive action to improve the effectiveness of the present systems and criteria and to tackle the shortcomings identified.

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Annex 1

INVESTMENT IN THE PUBLIC SECTOR BUILT INFRASTRUCTURE

TERMS OF REFERENCE

- to examine the basis on which expenditure on maintaining and improving the quality of the built infrastructure through new investment and through renewal, maintenance and repair, is accounted for, and how it relates to the value of the national assets involved in each activity;

- to include the road infrastructure, water and sewerage, public sector buildings, public housing, education and health, in the scope of the work;

- to report back to NEDC in mid 1984.

For each of these fields of expenditure, it is proposed to investigate:

- the criteria used to justify and authorise expenditure, the assessment of benefit to the economy in general, and how the lowest lifetime cost is established in evaluating alternative proposals;

- the nature of the capital resources register, the basis on which the assets are valued and recorded, and the provision for depreciation and how the sums set aside for this purpose are used;

- how the decisions to allocate funds are initiated and taken in each field, and how future renewal, maintenance and repair requirements are assessed and budgetted;

- what lessons can be learnt by comparing the public sector practices with those used in the private sector.

ORGANISATIONS VISITED/CONSULTED

Annex 2

ROADS

Shire Counties

Kent
Lancashire
North Yorkshire
East Sussex
Hertfordshire
Northamptonshire
Staffordshire

Metropolitan Counties

West Yorkshire
West Midlands

Department of Transport

Headquarters Divisions
Regional Offices -
Yorkshire and Humberside Region
West Midlands Region
South East Region

Other Organisations

Scottish Development Department

HOUSING

Metropolitan Councils

Birmingham
Bolton
Brent
Calderdale
Greenwich
Hackney
Hammersmith and Fulham
Hounslow
Kirklees
Sandwell
South Tyneside
Trafford
Walsall
Wirral

District Councils

Ashford
Basildon
Blackburn
Brighton
Bristol
Gloucester
Great Grimsby
Harlow
Ipswich
Newport
Northampton
Nottingham
Plymouth
Redditch
Rochester upon Medway
Sedgefield
Southampton
Taunton Deane
Test Valley
Woodspring

Other Organisations

Association Of District Authorities
Association of Metropolitan Authorities
Department of the Environment
Institute of Housing
Northern Counties Housing Association
Glasgow City Council
The Housing Corporation (Scotland)
Scottish Development Department
Scottish Special Housing Association

EDUCATION

Non-metropolitan Counties

Cambridgeshire
Cheshire
Hereford and Worcester
Lancashire
Suffolk

London Boroughs

ILEA
Ealing
Hounslow
Waltham Forest

Metropolitan Boroughs

Birmingham (City)
Doncaster
Gateshead
South Tyneside
Trafford

Other Organisations

Department of Education and Science

WATER MAINS AND SEWERS

Water Authorities

Anglian
North West
Severn Trent
Thames
Wessex

Other Organisations

Water Directorate, Department of the Environment

HEALTH

Department of Health and Social Security

Headquarters Divisions

Regional Authorities

Oxford Region
East Anglian Region
S W Thames Region

District Authorities

East Surrey
Preston
Gateshead
South Tees

Other Organisations

Scottish Home and Health Department
Nuffield Nursing Homes Trust

PSA

Headquarters Division plus UKTO offices in Edinburgh, Manchester and London

Restricted

National Economic Development Council

NEDC(84)47
20 November 1984

INVESTMENT IN THE PUBLIC SECTOR BUILT INFRASTRUCTURE

PART 2

INDIVIDUAL SUMMARIES AND CONCLUSIONS

National Economic Development Office
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Restricted

ROADS AND BRIDGES

Responsibilities

1 The English road network falls into two categories which are considered separately below. The motorways and the national trunk road system are provided, financed and maintained by the Department of Transport, with the shire and metropolitan counties and some London boroughs acting as the Department's agents locally. All the other roads are provided and funded by the county councils, the Greater London Council, London boroughs and the City of London. There is some central government support from the rate support grant system and the Transport Supplementary Grant.

Overall expenditure and loading

2 Total expenditure in 1983/4 both on new construction and on maintenance and repair of the network was £2.1bn. Of this, £710m was spent on the motorways and trunk roads, with a total length of 6200 miles (4% of the total mileage) in 1982/3. The remaining £1.4bn was spent by the Counties on 157,000 miles of 'A', 'B' and unclassified roads.

3 The road network has been growing at around ½% pa over the last two decades, the development of the motorway system being a major feature. There has also been an increasing programme of by-passes for towns and villages lying on the national road network. The number of vehicles per mile of road nearly doubled over the period 1958-65, from 34 to 64, and is now in excess of 90. Most significant is the growth in multi-axle heavy goods vehicles (HGVs), which account for virtually all of the traffic induced deterioration in the structure of the carriageways, though all vehicles contribute to the wear of the road surface.

MOTORWAYS AND TRUNK ROADS

Extent and condition

4 In April 1983 there were 6238 miles of trunk roads in England which included 1413 miles of motorway.

5 Information on the trunk and motorway network is kept within the Department of Transport and its regional offices and is comprehensive. The location of roads, the individual specification of roads built within the last thirty years, major maintenance over the same period and all maintenance carried out more recently are recorded, together with inventories of major road furniture and fittings.

6 The qualitative condition of the network is reported by the agent authorities, using both detailed visual inspection and equipment to measure residual life, pavement deflection, skid resistance, riding quality etc. Their reports are now processed by a computerised system which indicates the type of treatment needed and its priority for defined defects. The quality of the trunk road network is also assessed through the National Road Maintenance Condition Survey (NRMCS), drawing on the County agents' reports.

7 Motorways are generally designed for an initial life of 20 years and strengthening and renewal requirements are normally identifiable well in advance, subject to the accuracy of the traffic forecasts. However, the older motorways attracted far more traffic than they were originally

designed for and a backlog of structural repairs built up. In response the Department of Transport has introduced a 5-year rolling programme of major works. The current 5-year programme provides for strengthening and renewing 25% of the network.

8 25% of trunk road mileage has a residual life of less than ten years before renewal and strengthening are required, according to the NRMCS. This implies a medium to longer term need for 2½% of the trunk road system to be renewed and strengthened each year, which is lower than the proportion actually strengthened in 1981-82 and 1982-83. There is increasing engineering evidence that a backlog also exists on the all-purpose trunk road network, and DTp is about to set up a 5-year programe similar to the one for motorways.

Policy objectives

9 The objectives of the current English motorway and trunk road expenditure programme as stated in the 1983 White Paper (Cmnd 9059) are to:

- provide roads which aid economic recovery and development;
- provide roads which bring environmental benefits;
- preserve the investment already made;
- secure improved road safety.

Funding

10 Estimates of work required during the subsequent financial year are put forward by the County agent authorities in July of the preceding year to the DTp's regional offices, and are sent forward to the Department with an overall regional appraisal in September. Meanwhile, in parallel, the road budget is separately negotiated bilaterally between the DTp and the Treasury through the PESC system, taking the current year's overall level of expenditure as the starting point rather than a fundamental debate of the national case for road expenditure against other public expenditure and of the detailed options for allocation of the road 'spend'. Whilst the DTp deploy separate arguments about the desirable levels of new build/improvement, as opposed to repair/structural maintenance etc, the full division of the allocated overall roads budget is a subsequent matter of judgement by the Department. This process of allocation, within the given overall total budget, takes account of the regional reviews and of the priorities arising from the severity of the defects identified. County agent authorities normally have a firm indication of the major works they are to carry out on the Department's behalf by the end of the calendar year preceding the start of the financial year in April.

11 In 1983/84 DTp spent £710m on English trunk roads/motorways. £517m went to new roads and improvements, and £126m on structural renewal (both classified as capital expenditure), and £67m on current maintenance. The DTp takes the view that much structural maintenance amounts to the renewal of capital assets, and should be classified as capital expenditure. Into this category fall not only complete carriageway reconstruction, but also less fundamental repairs,

resurfacing and surface dressing. Inclusion of structural maintenance within the Department's capital provision means that any underspend on new construction can be diverted to structural maintenance, and vice versa. Current expenditure includes cyclical and preventative maintenance (lighting, renewing markings, sweeping etc) and winter maintenance such as gritting and snow clearing. The size of individual structural renewal schemes is frequently compromised against the cost of traffic delays caused.

Criteria

12 Potential new road schemes are identified by local authorities and DTp regional offices. If a prima facie case can be made on economic and/or environmental grounds, with Ministerial approval they enter the programme. Road pre-construction procedures are lengthy (typically 10 years or more), complex and difficult to forecast, but it is the policy of DTp to ensure that the volume of schemes coming forward for construction in a given year broadly matches the funds which it is expected will be available. Adjustment to any larger programme might take some time.

13 The design of a road scheme is subject to very detailed cost-benefit analysis, and a range of environmental factors is also taken into account. Both the line of the road and the proposed details of construction are tested at public inquiry. DTp consider that road schemes promoted by them, and approved by the Treasury, show a satisfactory return on the investment of public money. Technical standards of road construction are now being refined to ensure that increasd account is taken of whole-life costing, with relatively less emphasis on initial construction costs.

14 Deterioration and wear in the carriageways and footways of the DTp roads are assessed either visually or with the equipment mentioned earlier by the County agent authorities: defects are investigated and assessed according to their severity and relative importance, and overall priorities for allocating structural maintenance resources to specific road lengths determined accordingly. A code of practice is being developed for routine maintenance which will prescribe levels of intervention more formally.

Principal findings

15 Information about the extent and condition of the trunk-road/motorway system is extensive and accessible.

16 At present and expected levels of expenditure, there are enough new road schemes with strongly positive economic and environmental benefits coming through the long pre-construction processes to fill the programme for a number of years. Pre-construction procedures may however, with modifications, in due course be capable of accommodating to increased throughput (though the study has not examined suggested alternative capital programmes).

17 The current relatively stable rolling 5-year programme of structural renewal of the motorway system should in the medium-term bring English motorways back to an adequate condition, though it will take some years to clear the backlogs which have arisen over the past few years because of higher than expected heavy traffic growth and

earlier inadequate spending levels. But possible structural problems now under investigation on the Severn bridge the Midlands motorway links and in a number of concrete bridges could call for additional resources if the programme is to be maintained.

18 Some county surveyors and other professionals argue that in the past quite small increases, of the order of 5% on first costs, would have led to considerably reduced strengthening and maintenance costs now. There is also a widely held view that until recently too much emphasis has been placed on extending lengths of the motorway system as quickly as possible, without enough regard to subsequent maintenance implications. In 1978, however, the DTp issued a technical memorandum to improve the foundation construction for new roads and to base designs for both new construction and the reconstruction of existing roads on increased vehicle damage factors.

19 There is a general professional view that the concentration on motorway repair and renewal means that other trunk roads are being inadequately funded. A backlog has already been identified on these roads and fresh funds will be required if it is not to mount rapidly.

20 Some county surveyors do not expect the proposed routine maintenance code of practice to improve on their expert judgment, and new mandatory standards could lead to increased litigation and claims from the public arising from alleged surface imperfections.

LOCAL ROADS

Extent and condition of the network

21 About 96% (157,000 miles) of English roads are the responsibility of the county councils in which they lie: 15,000 miles of classified principal roads, 49,000 miles of classified non-principal, and 92,000 miles of unclassified roads. Most counties place an arbitrary financial value on their road stock.

22 Knowledge of the physical location of the roads and associated structures is fairly complete, but information on minor street furnishings and fittings appears more variable, being fuller in urban than rural areas. Data are normally in documentary form and readily accessible; a few counties are moving to considerably more sophisticated methods of recording.

23 Few counties had as full a knowledge of the condition of their roads as they wished. In the case of minor roads (especially rural) knowledge tended to be slight, and based entirely on visual checks; mechanical methods of checking were normally inappropriate. On the other hand most counties carried out complete and systematic condition checks of their principal roads on an annual or biennial basis, using visual methods backed up by mechanical devices, coring, etc. Between these extremes there is a wide range of practices followed on secondary roads, within the constraints of local availability of funds.

24 The National Road Maintenance Condition Survey (NRMCS) reviews year-to-year changes in the condition of all classes of local roads (except motorways and unsurfaced roads) on a county-by-county basis, against the 1977 datum. The NRMCS embodies no absolute standards:

little is known of the basic specification of most local roads, whose origins are lost. The NRMCS suggests that for urban principal roads, after marked deterioration in 1981 and 1982, there was little further change in 1983. The condition of urban classified roads has remained stable since 1977. Rural principal roads deteriorated between 1980 and 1982, but there was no further change in 1983. Rural classified roads have shown little change since 1979; for rural unclassified there was a small improvement in 1983, following some earlier deterioration. 24% of urban principal roads are estimated as having a residual life of less than 5 years, and 11% of rural principal roads.

25 The statistical base for individual county results in the NRMCS is limited, and counties also conduct their own more detailed investigations of the condition of the roads, using similar professionally agreed objective methods to those of the NRMCS, as well as wider-ranging visual checks.

Policy objectives

26 Counties' formal transport objectives vary, but typically will include such aims as:

- to maintain the county roads in a safe and adequate state;

- to provide new and improved roads to assist economic activity, and improve safety and the environment.

Funding

27 About £1400m was spent by local authorities on roads in England in 1983-4. Rather more than half of this went on repairs, renewal and maintenance of the existing stock, all of which is current expenditure. The amount spent on maintenance was severely cut back in the mid 1970s, but there have been some small real increases from that level more recently. The proportion of the local authorities' road budget going to maintenance is now at its highest level since the 1950s. Local authority road expenditure is funded by rates, supported by Government block grant and Transport Supplementary Grant (TSG). (From 1985/86 TSG will be payable for capital schemes only, and not for maintenance.) The overall size of the TSG is determined annually between DTp, DoE and Treasury. Its distribution takes account of bids from the counties and local authorities' likely total revenue spending. Once funds are allocated to counties they may be spent at their discretion. The level of the counties' rates are also determined annually.

28 Counties have rolling programmes, generally of 3-5 year horizon, for capital schemes, but generally find the adoption of other than short-term revenue expenditure programmes difficult.

Criteria

29 New build schemes, which are usually less extensive than national road schemes, are appraised according to similar criteria to those used for national roads (see above), though they may not be applied as intensively for smaller schemes.

30 Measurement of structural deterioration on local classified roads also follows similar practices and criteria to those for trunk roads, and a variety of computer programs and other methods are used to refine needs and allocate priorities. There is an extensive and widely used (though non-mandatory) code of practice for determining warning and intervention levels, both for structural maintenance and for reactive and preventive maintenance. Routine maintenance regimes have by general admission been pared to absolute minima, to permit as great a volume of funds as possible to go to repairs and preventive work. Elsewhere criteria appear to have been developed on the basis of best practice.

Principal findings

31 The extent of information about local roads systems varies considerably between counties.

32 Most counties have lengthy and long-standing programmes for .iable capital schemes, and at current levels of expenditure see little likelihood of these being fulfilled even in the longer term.

33 Criteria on repairs and maintenance are broadly consistent across the country.

34 There was a strong measure of agreement among those consulted that the condition of roads in the counties was unsatisfactory, and that this resulted directly from the levels of funding, rather than a failure of the system to identify what needed to be done. Rural minor roads might be an exception; arguably, until the early 1970s these had been maintained at a needlessly high standard.

35 Counties point to substantial backlogs of structural maintenance work. Only about 2% by length of principal roads have received strengthening annually over the past several years. At best the backlog is being held, often by non cost-effective expedients, eg. continual patching rather than a thorough resurface. In a third range of cases the treatment was post-critical - ie full reconstruction of a stretch of road was required, whereas timely, pre-critical, treatment could have saved substantial funds.

36 Most counties had quantified their maintenance backlogs/shortfalls. In some cases, expenditure two or three times greater than that now being undertaken, spread over a number of years, would be needed to bring the condition of local roads up to a satisfactory standard, though in other counties present expenditure levels would suffice if roads were already up to standard.

BRIDGES

37 There are some 150,000 road bridges in the UK, with over half in England. The majority are associated with local authority roads.

38 A new code of assessment has been introduced for bridges with increased traffic loading to accommodate modern heavy traffic needs. This new code will entail a substantial additional inspection programme likely to cost several hundred thousand pounds in each county. At the end of this, county officials expect that a programme

of partial strengthening and repair, and partial weight limitation and diversion, will be required. They say that the cost cannot be anticipated, but that it appears from DTp statements that no additional funds will be forthcoming to pay for it.

WATER MAINS AND SEWERS

Responsibility

1 Nine English regional water authorities, together with the Welsh Water Authority, are responsible for the provision in England and Wales of most water services including sewerage. For all but 5 per cent of the population, local authorities act as agents for the regional water authorities in the provision of sewerage.

2 The Secretary of State for the Environment and the Minister for Agriculture, Fisheries and Food exercise a number of controlling functions in England, and share with the Secretary for Wales overall responsibility for water policy in England and Wales.

Capital expenditure

3 Capital expenditure on water services is expected to be £686 million in 1984/85 and to increase to £769 million in 1985/86. The expenditure to be met from water authorities' internal finance is planned to increase from £422 million to £586 million.

Size, age and condition of the stock

4 The bulk of water authorities' assets are underground, some have reached a venerable age, and records of their location are in many cases incomplete. For example, one authority recently "discovered" 3,000 kms of sewers, increasing the known length within its responsibility from 8,000 to 11,000 kms. The best estimate by the water authorities is that there are approximately 258,000 kms of water mains and 196,000 kms of public sewers in England. New technology for inspecting sewers is enabling information on their condition to be gradually improved, but it remains the general view that the necessary knowledge is still inadequate.

Water mains

5 Almost one-third of water put into the system is unaccounted for. Estimates of water leakage range from 20 to 40 per cent of total supply. This is both an indication of the condition of the water mains and the fact that water remains a cheap commodity; leakage may be located but it is not necessarily cost-effective to repair the leak unless it is to prevent further damage.

6 The chief factor contributing to water mains failure is corrosion, which can also lead to structural failure, hydraulic inefficiency and poor water quality. Fifty per cent of UK water supplies are corrosive, as are 10 per cent of the soils surrounding the water mains. There are also millions of joints within the system which can often be points of weakness.

7 Early water mains had relatively thick walls, capable of providing a working life of 75 to 100 years even under corrosive conditions. Improved manufacturing methods have allowed a progressive reduction in wall thickness, with a corresponding reduction in working life under corrosive conditions. Without the necessary remedial action, it is estimated that half of the active length of iron mains could fail in a period of 20 years.

Sewers

8 Age, ground subsidence, disturbance by traffic, excavation for other utilities and blockage are blamed as being the main causes of faults in

sewers. It is estimated that there are about 5,000 sewer failures each year, including 3,500 collapses and 1,500 blockages, requiring excavation at a total cost of £100 million.

9 As with the water mains, the condition of sewers varies regionally and locally. The most severe sewerage problems occur in the North West region, which in 1982/83 had one quarter of all the sewer collapses reported by water authorities, and one half of all unsatisfactory storm sewage overflows. In 1982/83, the North West region experienced one significant sewer collapse for every 43 kms of sewers.

Repair, maintenance and improvement

10 In the water authorities the distinction between repair, maintenance and improvement tends to be based on the costs of particular types of work. An arbitrary cut-off point between £5,000 and £6,000 tends to be the upper limit for work defined as repair and maintenance, although in practice much of the work above this limit is also in this category.

11 Water mains' corrosion can be reduced, and renovation techniques are now sufficiently advanced to enable the life of a water main to be extended by up to 50 years. At present about 60 per cent of new iron pipes are lined and some, for use in corrosive soils, are PVC sheathed. There is however a danger that present financial constraints could force an undertaker to leave out the more expensive linings and sheathings, so bequeathing a legacy of trouble for their successors.

12 Repairs to sewers have in the past been carried out primarily in response to a failure in the system. Some preventive maintenance is now also being undertaken, although this only amounted to £8 million in 1981/82, out of a total spend on sewerage of £205 million. Authorities visited claimed that, on the basis of present levels of expenditure, the average age of the system must inevitably rise. They recognise, however, that older sewers may have a longer life than some more recently installed and that it is difficult to estimate life-expectancy with any accuracy since many of the older sewers are still in good condition.

13 Several of the water authorities report that capital expenditure is required to make good deficiencies in the distribution system that have arisen as a result of inadequate investment in the past. Such a backlog of renewal, added to the inevitable ageing of assets and increased demand in many areas from new developments and from existing customers, means that even with expanded capital programmes the authorities can offer no real improvement in the services they provide. In many cases they claim that they can only aim to maintain a standstill to prevent services deteriorating further. Reference was also made to the need for increased expenditure on sea defences.

Funding arrangements

14 Regional water authorities have two main sources of funds: internal finance (generated from charges to customers) and external borrowing. As public monopoly suppliers of essential services their charges cannot be determined simply through the market and they do not come under competitive pressure to improve their efficiency. Instead, they are subject to comprehensive and effective controls by central government, in the form of External Financing Limits (EFLs), performance aims, and financial targets.

15 Water authorities produce annual corporate plans which look five years ahead. At government request, their plans include an options exercise for an investment programme 10 per cent below their preferred level.

16 If EFLs are too low to enable proposed capital expenditure to be carried out, the only alternative is to increase charges. It is the aim of most authorities to keep the rise in charges below the RPI, but the government recognises that water charges are likely to rise faster than the general rate of inflation in the next financial year, as a result of revised financial targets.

Criteria

17 All water authorities already have elaborate priority ranking systems for expenditure programmes but improved knowledge of the stock may over time alter the degree of urgency of some of those programmes. The Water Research Centre's Sewerage Rehabilitation Manual which sets out in detail the steps needed to ensure an adequate level of service marks an important step forward. Its main recommendation is to implement a policy of crisis maintenance for 80 per cent of the existing sewer network. The remaining stock, crucial to the functioning of the system as a whole, should be monitored and maintained in good condition.

Principal findings

18 Any organisation wishing to develop a disciplined and cost effective approach to maintaining and renewing its assets requires adequate information on their condition and on the demands likely to be placed on them. However, the bulk of the water authorities' assets are underground, their condition is hard to assess, and maintenance has largely been carried out in response to failure. Without adequate and extensive surveys of location, capacity and condition of the underground assets, the necessary investment levels are difficult to quantify, and hard to justify.

19 Sudden and unexpected changes in the level of available financial resources lead to inefficiency in the water and sewerage industries. Many investment programmes are of the type which require long gestation periods. Once projects are under way, any holdups are costly and wasteful of resources. It would be beneficial to all authorities if greater flexibility were introduced into the system of controls, while at the same time maintaining the degree of stability necessary to efficient planning.

20 Water authorities have to operate within a system of tight centrally-imposed financial constraints. At the same time the need for crisis maintenance requires a flexibility in the availability and use of resources. Such flexibility could be provided by the creation of an emergency reserve fund to be drawn on for unexpected expenditure, over and above the levels required to enable planned capital programmes to go ahead.

21 In this area as in others, the financial system encourages 'make and mend and occasionally extend' solutions, rather than the choice of more expensive investments with a good rate of return but a longer payback period, such as would take place in the private sector. Statutory requirements also impose on water authorities distortions in their investment programmes which have become more acute as overall levels of investment have shrunk.

HOUSING

Responsibility

1 Local authorities are responsible for all housing within their boundaries. In addition to their role as providers of rented accommodation for those who require it, they also engage in a range of activities aimed at improving the stock of owner occupied and private rented dwellings. They include the provision of home improvement and repair grants and support for housing associations. To the extent that such support involves ranking of priorities in terms of allocation of resources, it is relevant to the scope of this report.

Expenditure

2 The latest White Paper shows that the estimated out-turn for housing expenditure for 1983/84 is £2,760 million, and indicates a planned 9.6% reduction in cash terms to £2,496 million for 1984/85. This represents a 16.5% reduction on the previous plans for that year. In cash terms local authority capital expenditure on new dwellings fell from £1,263 million in 1977/78 (37% of the total programme) to £695 million in 1982/83 (26% of the total programme), while that on improvements rose from £374 million to £934 million over the same period. At the same time receipts from sales of dwellings and repayment of loans increased from £386 million to £1,725 million. Expenditure on public housing repair and maintenance is not separately indentified in government statistics.

Size and nature of the stock

3 Since the 1920s there has been a major shift from the private to the public sector in the provision of dwellings for rent, with the public sector share of the rented stock rising from 14% in 1938 to 60% in 1971 and 70% by 1982. By 1982, public rented accommodation accounted for 27% of the total stock of over 18 million dwellings in England. There are considerable regional variations in this figure - for example, it is 37% in the North and 20% in the South West.

4 Programmes to increase the stock of public rented dwellings thus dominated much of the post-war period, but diminished in size during the 1970s for a variety of reasons. The current emphasis is on the maintenance and improvement of the existing stock. To achieve these aims in a cost effective way requires considerably more information on the condition of the existing stock and on present and future housing needs than when the aim was the speedy implementation of public housebuilding programmes to meet urgent need.

Objectives

5 The main aims of present government policy are to increase the opportunity for people to buy their homes, to improve the condition of the existing stock and to provide homes only for those in special need. Those objectives are translated into specific programmes at the local level in the light of local circumstances and locally determined priorities. However, assessment of those priorities and judgements on which of them are most pressing, cannot be wholly consistent as between authorities facing widely different circumstances.

Funding

6 The financing of local authority housing expenditure is extremely complicated and subject to close central government control. On the capital side there are two major influences on spending. The first is the Housing Improvement Programme (HIP) system whereby DoE sets borrowing limits for local authorities' housing programmes. The second is capital receipts, the use of which has varied according to the financial situation of individual authorities and of their perceived needs, and to the government's macro-economic policy.

7 Repair and maintenance expenditure is generally funded from the Housing Revenue Account. It is limited by the size of the revenue which consists mainly of rents and contributions from the General Rate Fund (GRF).

8 For most authorities an important objective is at least to maintain total expenditure at a reasonably stable level and at best to increase it to a level where it does not impair efficiency. This is reflected in their unanimous dislike of 'stops' and 'goes'.

Condition of the public housing stock

9 The information held by local authorities on the public housing for which they are responsible includes the number of dwellings and their age, location and type, together with a breakdown in broad terms by type of construction. Information on the quality of the stock at local level is usually much less detailed. The main national sources of information on this aspect are the English and Welsh House Condition Surveys, which are carried out at 5-yearly intervals by the Building Research Establishment on behalf of the Department of the Environment.

10 The 1981 English House Condition Survey (EHCS) found that almost 84% of public dwellings were in a satisfactory condition but it pre-dates the awareness of many major defects. However, many local authorities point out that the results of the EHCS can be misleading: a tower block, for example, might be in a satisfactory state of repair, but be quite unsuitable for current accommodation needs. In many instances local authority dwellings lack central heating; a surprising number still have an outside lavatory; some do not have ring main wiring; and a very large number have out-dated bathrooms and kitchens.

11 There is widespread evidence of inadequate preventive maintenance and of a considerable backlog of such work. Programmes are now needed for the refurbishment of post-war stock, and many authorities face the added large burden of remedying defective system built housing. Furthermore, the external environment of many estates remains depressing and run down, and they lack facilities such as play areas.

12 Many local authorities have now recognised the need to build an effective data base on the condition and maintenance record of their housing stock, and some are well on their way to its achievement. There are still some who either do not accept the need for more information, or who are taking little action to obtain it. The reasons advanced include: the adequate and indeed obvious evidence of the problems of ageing and defective stock; the fact that resources to carry out the necessary investigations across the whole of the local stock are not available from central government and cannot otherwise be spared; and the inadequacy of resources available to deal even with known problems

Repair and maintenance

13 Day-to-day repairs are carried out by local authorities in response to requests from tenants. Maintenance work is more formally organised and nowadays most local authorities have planned maintenance programmes which range from external pre-painting and painting programmes at their most modest, to comprehensive ones aimed at dealing systematically with the fabric of their estates.

14 Local authority officials point out that the current system of financial controls prevents the adoption of a cost effective approach to the upkeep of the housing stock, and does not permit the achievement of a level of quality satisfactory by modern standards, nor of a level of maintenance which might lower the need for, and hence the cost of, day-to-day repairs.

15 Many local authorities visited expect the existing backlog of maintenance work will grow and quality levels decline as the deterioration of the system-built estates of the late 1960s accelerates and as the early 'bulge' of post-war properties comes up for major refurbishment, despite an overall increase in spending. The implementation of disciplined, planned, and cost effective maintenance programmes will inevitably become still harder to achieve than at present.

Improvement

16 Improvement programmes now make up the larger part of local authorities' capital budgets as a result of the emphasis put on raising the quality of the housing stock by both central and local policies. There are a considerable number of post-1945 dwellings due, if not overdue, for their first major refurbishment. In many cases it will not be until towards the end of this decade that a start will be made on such work for these properties.

Newbuild

17 Current policy is to concentrate newbuild on provision for 'special needs', which in the majority of cases are those of elderly people. Except for a few instances, where population increases or existing shortages call for the construction of family-type dwellings, authorities are concentrating on the provision of sheltered homes. Current government policy, shortage of suitable sites and awareness of the growing pressure for housing suitable for the elderly have all encouraged the bias towards the development of sheltered homes.

Criteria

18 All authorities have developed criteria for maintenance of the fabric of dwellings (eg frequency of painting cycles) which, if applied, would ensure satisfactory standards. Few have been able to make sure that the programmes required to meet these criteria are carried out. Criteria of quality are a more elusive concept. They can be more precisely determined, but are subject to perceptions of the general quality of the total local stock and of the level of local expectations. Improvement expenditure for similar dwellings can therefore range widely between housing authorities.

19 Life cycle costs are not used as a foundation for decision-making; the concept is interpreted as ensuring that 'value for money' is obtained or low maintenance components are used to replace worn out or defective ones.

Principal findings

20 Of the authorities which we visited only a few claim to be able to do more than hold the stock in its present often unsatisfactory condition at current levels of expenditure. In many instances, authorities are aware of a faster rate of deterioration than current resources enable them to overcome. For example, the high cost of remedies to dwellings erected in the 1960s have already forced some authorities to relinquish programmes which they would otherwise have undertaken in the rest of the stock.

21 There is a rising backlog of expenditure for most authorities visited, coupled with further additional large commitments in authorities with a high proportion of 1960s system-built estates or other defective housing. These authorities are especially concerned at the expenditure which will be required on those dwellings, including the repurchase of properties which they will have to put right. By the time repairs and modernisation of the pre-war and system-built dwellings have been completed, authorities will run into the modernisation programmes of the early bulge of post-war properties; these properties will by then be more than 50 years old. Housing authorities therefore do not at present see any possible reduction in their level of expenditure and on the whole they claim that a higher level of expenditure is required over a number of years before the general condition of their stock can be regarded as satisfactory.

22 Many spending decisions are still based on inadequate information, so that priorities cannot be correctly decided. A proper data base, which could be required of authorities within a specified period, would provide an essential input to the central assessment of the conditions of the local housing stock and its requirements. It would also improve the guidelines for the allocation of resources to meet local needs.

23 An increase in planned maintenance, in preventive repairs and timely replacement (eg for external woodwork) would reduce costs over the longer run and also lead to an overall improvement in quality. However, a number of local authorities find that they cannot adopt this approach, partly because detailed knowledge of the present condition of their housing stock is insufficient, partly because it involves an initial large increase in expenditure, but mainly because of the short time horizon and uncertainties of the financial system within which they operate.

24 Changes in national housing policy almost invariably require some action by local authorities. Frequent small alterations add to the administrative burden. Major changes, such as 'stops' and 'goes', create major difficulties in the execution of programmes. For instance, all authorities said that they would prefer to have a limited annual increase in spending power spread over several years rather than a one-off larger increase, because this would enable them to plan and control the proposed expenditure in a more efficient manner. Anticipation by government of the lengthy period required to adjust to changes of policy direction in the use of public resources is a sine qua non for their efficient application.

25 A firmer and longer term financial framework is seen as a pre-requisite to improved performance, so as to permit a more explicit, detailed and ordered assessment of priorities than is possible under the "one year plus two" of the HIP system. Any such change to the system depends crucially on the willingness of government to provide reasonably firm estimates of future financial allocations. Both local authorities and the construction industry would benefit from the recognition by government that capital programmes require a longer term firm horizon, of say three to five years. All authorities consider such a change to the existing central system of controls to be the most essential requirement in order to raise the overall level of efficiency and performance in all aspects of public housing.

THE NHS ESTATE

Responsibilities

1 National policy and funding of the NHS are determined by the DHSS. Hospital and community health services in England are organised by 14 regional and 192 district health authorities, and 8 special health authorities administer postgraduate teaching hospitals. The regions provide the first level of executive and planning control for most purposes but the districts actually provide the services.

Size and nature of the stock

2 The English NHS estate now comprises nearly 2,000 hospitals of various sizes, other buildings such as health centres, clinics, offices, residential accommodation, laundries etc., and some 50,000 acres of land. The replacement value of the stock is estimated at more than £20bn. Around 50% of the buildings are pre-1918 and not much more than a quarter are post-1948. Since the mid-1970s, there has been a shift from large greenfield projects towards piecemeal improvements to existing hospitals, and where new hospitals are built they are smaller overall, or are built in stages.

3 The total number of hospitals has fallen from 2,441 in 1959 to 1,984 in 1980. Over the same period there was a marked reduction in large hospitals, from 81 with over 1000 beds in 1959 to 36 in 1980, but a substantial increase in smaller hospitals. Whilst the overall number of beds has fallen from 455,000 to 363,000 the patient "throughput" has increased and the average stay by patients in hospital fell from 25.6 days in 1970 to 18.6 days in 1980.

Condition of the stock

4 Until very recently the information available nationally on the extent and condition of the stock has been generally inadequate. A major exercise is now under way to rectify this, following the 1982 'Davies report' into means to ensure that health authorities identify under-used land and property and dispose of it in ways to create the maximum benefit for the NHS. The report commented that findings relating to those terms of reference could not be sustained without parallel improvements in the way the NHS estate is managed, and recommended a survey of existing stock of buildings, a continuing record of the condition and changes in the stock, functional suitability, and effective utilisation.

5 The surge of new building in the 1960s encouraged an "emergency cover only" attitude to the maintenance of older buildings, partly to conserve scarce resources for much needed medical staff and equipment, but also because of a belief that these buildings would probably be replaced in the foreseeable future. In consequence a large backlog of maintenance work has built up, and many districts report that it is still growing. The cost of the work required to bring properties in England up to the level regarded by health authorities as the minimum acceptable standard has been estimated as of the order of £2bn, though this includes work on buildings which may be surplus to current requirements.

Policy objectives

6 The main factors determining recent DHSS policy which have had an impact on the need for and use of buildings have been:

- the need to provide services for an increasing number of old and very old people;

- the need to develop services to make greater use of new technology;

- the improvement in standards of care for the mentally ill, mentally handicapped and long stay geriatric patients, and the shift in resources for such care from hospitals to community based facilities;

- the distribution of NHS resources across the country on a more equitable basis.

Funding

7 Of the total Government programme for health and personal social services, 85% is central government expenditure on health; the remaining 15% of the total DHSS programme is for personal social service expenditure, which is almost wholly undertaken by local authorities financed in part by the Rate Support Grant. Of the central government health expenditure, about 80% goes through the health authorities and is subject to cash limits and budgets, and the remainder is spent through the family practitioner committees, which are not subject to the same constraints.

8 Capital spending was some £700mn in 1983/4, and some part of this went to major renewal projects. In real terms, capital spending fell during the later 1970s but since then it has gradually increased. Most maintenance spending comes, however, from the £8,000mn revenue allocation, and cannot be separately identified, though some have suggested that it could be in the range £500mn-£1,000mn. Principal discrete elements of NHS expenditure are determined in annual negotiation between DHSS and Treasury; previous years' allocations form the starting point, with arguments for small changes being supported by evidence on the differences between forecast construction prices and general inflation, special developments such as large-scale computer projects, or evidence of deteriorating maintenance standards.

9 There are complex formulae for allocating funds between Regions, and into districts. The formulae are largely based on demographic considerations rather than the size and condition of the estate.

10 Every five years the Regions produce strategic plans which provide the structure for their subsequent expenditure. The plans look forward ten years, though in detail only over the first part of the period. Within the context of their plans, Regions are responsible for the detailed allocation of funds to capital and revenue.

11 Major capital schemes are generally managed at the Regional level. A block allocation is usually made to Districts including sums for plant and machinery maintenance, maintenance of small buildings, and some delegated authority for less expensive capital work. The majority of routine maintenance is however carried out by Districts from their revenue

provisions, which are allocated by the Regions according to population-related formulae. The majority of funds in the revenue category inevitably go to wages and salaries, and the maintenance provision is one of the claims competing at the margin for the small amount (typically 20%+) remaining. On a once-and-for-all basis, substantial funds for use by Districts (normally to spend on capital) will come forward from property disposals, and these will often have significant revenue implications.

Criteria

12 The methods for appraising the case for capital expenditure on new-build or extension of existing stock are laid down and approved by DHSS and Treasury, and rigorously applied. Sanction for larger schemes is referred upwards. Option appraisal including the use of discounted cash flow techniques are taken into account. While staff cost implications are now more fully taken into account than in the past, there is criticism that whole-life costing in proposed new structures is not always effective. For smaller capital schemes, the option appraisal processes are in practice less rigorous. So far as new projects are concerned, there is a continuing supply of economically viable capital schemes coming forward.

13 For maintenance, inspection schedules to be carried out by professionally qualified staff at the District level are laid down and generally followed. Determination of need for work to be done is judgemental, but computer programs are widely used to help in allocating priorities.

14 There are a number of priority calls on maintenance funds - equipment at the medical/patient interface; fire, health and safety needs, etc; and the requirement to keep buildings in use weatherproof - which take precedence over routine maintenance.

Private sector comparisons

15 NHS has a National Property Advisory Group, which enables private sector property practices to be taken into account where relevant. The private sector hospital estate is too small in total, and the individual hospitals in it too small and new, to permit valid comparisons.

Principal findings

16 There is an enhanced awareness within the NHS of the importance of the estate as a major resource.

17 Formulae for disbursing funds are based primarily on local demographic considerations, rather than the condition of the estate.

18 New systems for cataloguing the NHS estate are in the process of introduction. If successful, there will for the first time be a full understanding of the scope and condition of the estate.

19 There is nevertheless now a feeling within the Service that the determination of officials to manage all their assets more efficiently is being frustrated in the case of maintenance of the physical stock by a level of funding quite disproportionate to the task identified. As a result of the level of funding, non cost-effective methods of reactive maintenance are in many cases the norm.

20 Both capital and current spending on the building stock have had a relatively low priority in competing for funds and management attention with the staff and equipment directly concerned with providing medical services to the patient. In consequence, while new buildings continue to come into use, many patients experience a rising standard of medical care but within ageing, out-dated, and deteriorating buildings. There is a national maintenance backlog estimated as of the order of £2bn, and many districts have evidence that their backlogs are still growing.

21 A further reason for the backlog is a failure in some quarters to appreciate that the maintenance requirements of new and complex structures and hardware are often much more expensive than those of their older predecessors. Examples quoted of this latter factor were costs twice as high for modern mechanical and electrical hardware, and three/four times as high for buildings.

22 Typical estimates of backlogs included a need for 10% of a District revenue budget rather than the 7% received; and in a Region that, if best professional practices were followed, maintenance expenditure should be five times its existing level. In other Districts officials said they would need at least to double maintenance spending to begin to cut into their backlogs.

SCHOOL BUILDINGS

Responsibility

1 The day-to-day running of the publicly maintained education service in England and Wales is the responsibility of the 105 Local Education Authorities (LEAs), which have a duty to provide schools and colleges in their areas and to administer them.

Capital expenditure

2 In 1982/83, capital expenditure by local authorities on schools amounted to £264 million, compared with a total current spend of £6,729 million. The larger part of capital expenditure is estimated to be earmarked to construction work. Between 1982/83 and 1986/87 total capital spend on schools by local authorities is projected to fall by 23 per cent. There are no data available on the share of current expenditure earmarked to repair and maintenance of school buildings.

Size of the national stock

3 In 1981/82 there were 22,523 maintained primary schools in England and Wales and 4,863 secondary schools. From 1946 to 1981/82 over eight million new places were created in all schools, of which 884,000 were provided in new schools. By January 1984 the stock had decreased to 21,822 primary and 4,680 secondary schools, as a result of closures brought about by the fall in the school population.

Policy and objectives

4 Post-war school building has been dominated by the basic need for new places. The need arose because of:

- very little new building during the Second World War;
- war damage: 5,000 schools (approximately 17 per cent of total stock) were affected;
- raising the school leaving age to 15 in 1947;
- raising the school leaving age to 16 in 1973;
- an increase in the birth rate in the late 1940s, and again between 1955 and 1964;
- growth of new communities on the periphery of old towns, and the growth of new towns.

Later developments have on the whole been aimed at improving facilities, replacing inadequate primary schools and increasing the level of minor improvements.

Age and condition of the national stock

5 As a result of the large post-war school building programmes, less than 10 per cent of secondary and 20 per cent of primary schools today consist entirely of pre-1945 accommodation. However, the age of the stock is not an indication of its structural condition and the more recently

erected stock is already of some concern to LEAs. Even where older schools are structurally sound, they may have inadequate lighting, heating, plumbing and wiring systems and lack the space or facility requirements of modern teaching. There are also still a considerable number of temporary places in use.

6 Since regular surveys are insisted upon by most authorities, knowledge of the condition of the stock is reasonably up-to-date. This does not mean that schools are well-maintained. The primacy of providing the service tends to eclipse the needs of the stock when budgetary allocations are made. As a result, there is evidence of increasing neglect of those problems which fall outside statutory requirements. A number of authorities categorise work required as essential, necessary or desirable. They claim that not all work in the first category is carried out, due to financial constraints and to the low priority given to maintenance of buildings.

Repair and maintenance

7 Because of the poor condition of the woodwork and of many of the flat roofs, which together account for the worst of the fabric problems, it is difficult to separate repair and maintenance activity. For instance, because external painting cycles have to be delayed, more repairs are called for in the interim and more windows replaced instead of repainted. Regular maintenance programmes are, however, observed for heating systems.

Improvement and newbuild

8 The fall in school populations has created an opportunity for an assessment of the need for places and of the gap between the present level of standards and amenities and that required by modern curricula and teaching methods. The reduction in school places has been reflected in a considerable fall in newbuild programmes and an increasing emphasis on improving the general standard of the existing stock.

Funding arrangements

9 Local education is financed largely through the General Rate Fund, and salaries and wages account for the bulk of revenue expenditure. Repair and maintenance work can either be earmarked to revenue budgets or capitalised. Its treatment depends on the financial situation of individual authorities.

10 Sales of buildings or land now surplus to requirements do not necessarily fully benefit the LEAs' capital budgets since in most authorities such windfalls are pooled and allocated across the whole range of bids from the various services.

Criteria

11 The only relevant criteria for repair and maintenance are weather-tightness and health and safety precautions. Those which relate to improving the quality of the environment, either physical or educational and often poor, are of little relevance to many authorities since the necessary resources to go beyond essential work are not forthcoming.

12 The importance of the condition of the buildings and of developing the criteria to ensure a satisfactory state of repair is dependent upon where the responsibility for such decisions is lodged within LEAs. Where

responsibility for maintenance expenditure rests with the education committee itself, the main emphasis is likely to be on the quality of the service rather than with the needs of the building fabric.

13 DES sanctions major projects, including improvement programmes, which require capital expenditure above a certain amount fixed by DES and occasionally adjusted for inflation.

Principal findings

14 The various decision-making processes used by local education authorities to allocate resources fail to ensure that levels of repair and maintenance will be adequate to maintain the stock of buildings in reasonable condition. Indeed the main conclusion which must be drawn from interviews with education officers is that much of the stock is of poor quality and deteriorating. At the local level, other issues appear to predominate.

15 Repair and maintenance of education buildings is a small item in local authorities' budgets which tend to be dominated by education salaries and wages on the revenue side of expenditure. However small, this expenditure still does not escape when economies are sought. The standard approach is for one year's expenditure to provide the basis for the following one, adjusted for expected inflation, and then to be trimmed as centrally dictated financial exigencies and local political views require.

16 DES regulations stipulating higher standards of amenities which should be reached by 1991 cannot be met with the current level of resources.

17 Present practice flies in the face of good property management and means must be found to ensure that the physical assets of the education service do not suffer from even worse neglect than other parts of the infrastructure. The most urgent need is to raise the quality of school buildings and then to provide the necessary resources to maintain that quality. Unless expenditure is permitted to rise in real terms in the near future, disrepair will increase and the scale of unpostponable expenditure will rise considerably.

18 Some system of control within central or local decision-making structures, or external to them, needs to be established. One solution might be to introduce some form of regular independent survey and assessment of the condition of the stock and of work required to reach some agreed standard of quality. The responsible organisation must have mandatory powers to ensure proper upkeep of property. It could be modelled on the existing factory inspectorate or the NHS system now under development could perhaps be adopted here.

19 DES uses a three year planning period, which includes a firm allocation to LEAs for the first year and provisional indications of the committed expenditure element of allocations for the following two years. That is, although LEAs themselves plan spending programmes three years ahead, DES forward indications do not accommodate any projects due to begin beyond the first year. The scale of many newbuild programmes is such that they can usually be fitted within a three year horizon and the same is true of major improvement programmes. According to LEAs, allocation of resources would be improved if DES gave firm allocations for a full three year period, including new work starting in the second and third years.

20 Earlier notification of capital allocations would also lead to better use of resources since it would ensure that design costs are only incurred for projects guaranteed of implementation.

21 A first step towards a better appreciation by relevant government departments of the current state of school buildings would be for DoE/DES to require all LEAs to submit a detailed strategy statement for education buildings similar to that currently provided for housing.

22 Whilst this report has been mainly concerned with the physical condition of buildings, there is a growing need to alter structurally sound buildings which fail to provide the environment required for today's curricula. The strategy should ensure that the educational quality of buildings, which is a crucial aspect of the teaching environment, is fully taken into account.

CENTRAL GOVERNMENT'S CIVIL ESTATE

Responsibilities and objectives

1 The Property Services Agency (PSA) has the task of providing, managing, and maintaining as economically as possible, the property used by central government throughout the UK. The civil estate consists of office accommodation, storage, and specialised buildings such as courts, museums and art galleries. (This report is not concerned with the defence estate).

2 The PSA is responsible for the day-to-day estate and property management of the specialised buildings, but the decisions on the scale and nature of the new building projects, and in some cases the maintenance, are taken by the particular departments concerned, who also fund the work out of their public expenditure programme budgets. The PSA has sole responsibility for the remainder of the civil estate and exercises this responsibility through 8 English regional headquarters, separate local headquarters for Scotland and Wales, 34 area works offices, 31 area estate offices and 156 district works offices.

Extent and condition of the estate

3 The central government's civil estate in the UK consists of 9,000 separate buildings, very approximately valued in total at £2.8bn, and amounting to some 12 million square metres in all. Office accommodation, of which 60% is leasehold, accounts for 7 million square metres, and the remainder is fairly evenly divided between storage and specialised buildings such as courts, museums and art galleries.

4 No private sector landlord in the UK has an estate approaching the size and diversity of that administered by the PSA, which includes many historic and listed buildings requiring particular attention.

5 Full information on every building occupied by a public sector client is recorded initially, following a survey before occupation, and it is kept up-dated on a regular basis through periodic inspections. Detailed information is also held on the repairs and maintenance carried out on a building, and on changes in its physical condition.

6 However, these records are manual, and are held locally. While some changes are now in hand, at present information is only available in a summary form at regional level, and officials reported that in consequence there was a major deficiency in the management information available to them. In contrast, many private sector landlords now have computerised information systems on which to base their estate management programmes.

Funding

7 Expenditure on the civil estate in the UK in 1982/83 was £122mn on new works and £242mn on maintenance, though not all of this latter is spending which directly contributes to upkeep of the estate. Freehold office accommodation is now rarely acquired except where there are no leasehold alternatives.

8 Under the Property Repayment Scheme (PRS) introduced in April 1983, departments pay rent to the PSA. They also pay an accommodation charge to cover PSA expenditure on larger maintenance and minor new works and have an allocation for minor maintenance works (up to £1000) which they can carry

out themselves. There is no direct link between PRS payments and the sums allocated by the Treasury to PSA for repairs, renewals and maintenance.

9 Although PSA headquarters assemble information from the regions on requirements for maintenance, minor new work, and refurbishment opportunities, the starting point for the annual budget negotiation is the existing public expenditure provision (which reflects the amount to be recovered from departments via the accommodation charge). Maintenance funds are divided between regions roughly pro-rata to the level of their 'minimum' bids, with some regard to special requirements such as listed or unusual buildings and also to the area of their holdings. Around £9/square metre is currently allocated to maintenance nationally, with the London allocation somewhat greater than this.

10 The same PRS rent per square metre is paid by occupants of office, storage or specialised accommodation throughout a region (except in London, where there is further 'zoning'), irrespective of the location or the condition of the buildings. In 1986 it is expected that rents will be individually assessed. The current rent is assessed at near to 'market' averages in the region, but also reflects the PSA's buying power as a large and - at least until recently - attractive customer for leasehold accommodation. However, since many of the PSA's current leasehold agreements are long-standing, the actual rent paid to the landlord may be below the charge levied by the PSA on the client. In one region visited, rental paid to the landlords averaged around £2/square foot, while 'rents' levied on tenants by PSA were £2.40.

Criteria

11 PSA will normally endeavour to meet client departments' requirements for new accommodation with leasehold or rented property. This is because of shortage of funds, particularly on PSA's own office public expenditure programme provision. Capital expenditure on freehold office property is mainly confined to work on existing sites or buildings and cases where it is not possible to lease suitable accommodation. Specialised buildings are not normally available for lease, and are provided according to the needs of the departments concerned and how far these can be accommodated in their public expenditure programmes which fund the work.

12 For repairs and maintenance expenditure, all buildings in the PSA estate are classified in terms of the standard of maintenance required. Apart from "normal", the classification extends upwards to "exceptional" - impeccable at all times for operational, public importance, or other reasons; and downwards to "limited life" - maintained to allow not more than 5 years life - "wind and weatherproof" and "demolition pending". Buildings are given a full routine inspection every 2 years (although this period can vary between 1 and 6 years in exceptional circumstances) during which the maintenance work required is identified and its cost roughly estimated. A more limited annual inspection is also carried out which will pick up indications of rapid or unexpected deterioration.

13 In the light of the maintenance standard set for the building, the work required is classified in one of three categories, broadly indicating that it is vital, essential or desirable. The top grading effectively indicates that the work should be carried out in the next financial year, if not earlier.

14 The inspection and routine maintenance of mechanical and electrical equipment generally follows the schedules laid down by the manufacturers, although these schedules are sometimes relaxed somewhat when experience has shown that it is safe to do so.

Private sector comparisons

15 The PSA participates in the Building Cost Maintenance Service, which allows limited comparisons between maintenance spending in the public and private sectors. It shows, for example, that the major banks' spending per square metre is about twice that of the PSA. The PSA also has an Advisory Board of 13 members, 11 of whom come from the private sector. The Board commented in the PSA's 1982/83 annual report, 'The Advisory Board also remains concerned by some of the constraints under which the PSA has to operate and particularly when these inhibit the attainment of value for money. The standards applied to the maintenance of civil properties remain a major cause for concern'.

Principal findings

16 In many aspects of its work PSA is offering a service which is comparable to that offered by private sector property companies. However, it is by no means clear that in the areas considered in this report the Agency's service reaches normal private sector standards.

17 The amount of information about the civil estate is nominally extensive. However, the system of information collection, storage and retrieval leaves much scope for the improvement which in some areas is now in hand.

18 There is only a limited link between the rents paid by a government department occupant of a building and the overall standard of accommodation and service which the occupant may receive.

19 The criteria for repairs and maintenance in the civil estate follow professional best practices and allow priorities to be effectively identified.

20 Senior officials report that effective stewardship of the estate is made more difficult through problems in recruiting and retaining technical staff: private sector salaries and conditions are considerably more attractive.

21 It is reported that allocation of funds for repair and maintenance now covers only about two-thirds of bids for essential work and that bids for non-vital work are now barely met at all. In at least two instances the validity of the list of essential projects has been fully confirmed by independent consultants.

22 The effects of budget stringency on maintenance were clear throughout the regions visited. A number of non-discretionary claims on funds had to be met first. These included obligations arising from premises where public sector clients were only part-tenants, and where the private sector landlord would therefore carry out work to his own (usually higher) standards and costs, or premises where the landlord closely specified the regime to be followed (such as the frequency of interior and exterior painting).

23 The limited amount of 'discretionary' funds remaining bore no relationship to the work needed on the structure of the civil estate or the mechanical and electrical equipment in it. Officials reported that the clients were not getting a good deal because the conditions in which public servants had to operate were often very poor, and full utilisation of premises was sometimes impossible.

24 Professional opinion is emphatic that the condition of the PSA office stock is deteriorating, and is likely to continue doing so until the provision for repair and maintenance work is considerably increased. More specifically, it was said, far too little preventive maintenance was carried out; there had to be a disproportionate emphasis on reactive repair work, which was less cost effective. Furthermore, much of this reactive work was not carried out to best advantage: recurring cheap-at-the-time palliative measures, rather than more expensive but lasting full repairs, often had to be the rule. There were examples of structures which had become dangerous and where repairs could not be afforded; all that could be done was to take steps to prevent eg loose coping stones from falling on to passers-by.

25 Painting for protective purposes, let alone decorative, could rarely be given adequate priority. Much mechanical and electrical equipment was well beyond its economic life, and required frequent attention either to prevent breakdown or following it. An example was given in the case of lifts, which have a working life of some 25-30 years. One PSA region estimated that on this basis they should be replacing around 50 lifts per year: in practice only about 10 were replaced.

National Economic Development Council

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ELECTRONIC COMPONENTS

Memorandum by Mr Eric Hammond OBE,
Chairman of the Electronic Components Economic Development Committee.

KEY ISSUES

1. The manufacture of electronics is one of Britain's fastest growing industries and within it, electronic components is one of the fastest growing sectors. The Electronic Components Economic Development Committee is, however, concerned about the future and, whilst the EDC has engaged in a wide range of issues in many product areas, this report concentrates on the strategically significant sub-sector of integrated circuits. The key issues are:

* the integrated circuit (IC) is now the fundamental component for much of the electronics industry. Competitive equipment makers need access to the latest component technology. This can be assured only if the UK IC suppliers remain at the forefront of that technology;

* a positive trade balance in ICs, whilst desirable, is not the most important reason for the UK making a substantial commitment to this industry. More fundamental is that the IC is now the key ingredient in electronics;

* enormous changes are taking place in the way ICs are made and how they are used. The next generation of ICs will be 'intelligent', performing complex tasks in equipments essential for the competitive success of many of the UK's manufacturing and commercial businesses. It is vital for the UK to be fully competitive in this technology;

* at the forefront of each IC technology there are only a small number of companies worldwide. Britain needs an indigenous expertise in each area. Market forces alone will be insufficient to ensure this, as the governments of our major competitors recognise;

* IC companies in the UK have, overall, been lagging behind our competitors. In 1983 only one British company appeared in the list of the top ten companies selling ICs in UK;

* the industry is constrained by a severe shortage of skilled engineers, scientists and technicians.

2. These considerations pose fundamental questions for 'UK plc": do we intend to compete fully in world markets in both the development and the applications of the new technology, or not? The EDC's view is that we should and its work has been directed at finding ways to ensure success.

3. The Annexe (attached) outlines the work of the EDC, and sets out the major factors that the EDC believes will determine how successful the components and therefore equipment industries will be in the future.

CONCLUSIONS AND RECOMMENDATIONS

4. The analysis in the Annexe shows that the UK based IC supply industry is faced with a formidable set of challenges:

i) to keep abreast of a rapidly developing technology that is at the leading edge of applied science;

ii) to stimulate and serve the needs of the electronic equipment industries who need to exploit these technologies for their own competitive advantage; and

ii) to expand its manufacturing output at a rate at least as fast as the market. This is forecast to be some 30% per annum to the end of the decade.

5. The UK manufacturing base in ICs is a mixture of UK and foreign owned companies. Although the overall balance of trade position in ICs is strongly adverse there are changes in the market requirements due to technological advance with an increasing trend towards ICs which are more 'tailor made' for applications in equipments and systems. These changes could well be to the advantage of British IC manufacturers who are better able to work closely with the equipment companies (where necessary on a European scale) to exploit the fruits of innovation to mutual advantage. In this, UK based manufacturers are advantaged over those foreign suppliers whose strength lies in commodity products.

6. The challenges are formidable, but the opportunities are real. To achieve the desired transformation of the industry across a broad front will require a concentrated dedication of will and commitment to the future from the IC supply industry, Government and the equipment industry whose interests are increasingly inter-related to those of the IC suppliers.

7. The work of the EDC has been directed towards:-

* establishing what are the key issues for the development of a stronger UK base in IC manufacture;

* promoting an informed debate in the industry and in Government about what needs to be done to support and nurture this critically important sector; and

* finding ways to bring about a stronger and more effective dialogue between component suppliers and equipment manufacturers. The EDC has established a supplier user task force to this end.

8. <u>In summary</u>, the main recommendations which the EDC now invites the NEDC to support are:-

<u>i) Recommendation to British based IC companies</u>

* carry out a review of medium and long term business plans with the objective of growing at least as fast as the market and recognising the high rate of capital and other investment this is likely to require;

* draw maximum advantage from pre-competitive collaboration between companies and where appropriate extend this into joint agreements to exploit the market on a European and/or world scale;

* liaise effectively with equipment companies to derive joint benefit from the advantages of application-specific integrated circuits;

* develop stronger links with schools, universities and other colleges to help solve critical skill shortages;

ii) Recommendation to electronic equipment companies

* respond to the need for closer working with component suppliers at the product design stage to exploit fully the capability of advanced components and where appropriate to acquire for themselves the tools and know how for IC design;

iii) Recommendation to Government

* review the support schemes related to the IC industry and augment them to be sufficiently effective in assisting the IC manufacturers in their expansion plans - it is likely that the total investment to be generated will need to be approximately £400m per annum until the end of the decade which is at least a threefold increase over current investment levels. A higher level of grant is needed to concentrate resources in key areas. The need to augment support arrangements is partly a consequence of the impact on the IC industry in particular of the 1984 Budget withdrawal of 100% capital allowance;

* give early consideration to the best way of ensuring that there is commercial exploitation of the output expected from the collaborative research being done under Alvey and Esprit, so as to produce marketable products with the associated support infrastructure in components and softare. Also, ensure that smaller innovative companies are more fully participative in the Alvey programme;

* implement the expected recommendations from the Butcher Information Technology Skills Committee and whatever other measures may be necessary to tackle the problem of shortages in critical skills. Also, provide additional funding to SERC to enable them to maintain their essential activities in post graduate funding and providing valuable "hands on" experience in microelectronics.

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ANNEXE TO NEDC(84)53

INTRODUCTION

1. The role of the components industry has traditionally been to serve the electronic equipment industries of telecommunications, computers, consumer and industrial goods, etc. by supplying them with components to assemble into their products.

2. In the UK, the components industry is diverse both from the marketing and manufacturing points of view. Definitions of what should be included vary and there is no satisfactory way of handling the sub-assembly business. This paper adopts a fairly restricted product range and, because of compatibility problems, sub-assemblies are largely omitted (Appendix 1 contains a reconciliation to the Business Monitor). Included are valves, integrated circuits, discrete semiconductors, printed circuit boards, capacitors, connectors, resistors, and a range of other passive components. Total output in 1983 was more than £1 billion. Details of markets, output, exports and imports of some broad product ranges are shown in Appendix 1, but the following table demonstrates the total industry position over the last few years, with annual growth rates inserted between the years:

TOTAL ELECTRONIC COMPONENTS

£M	1980	%	1981	%	1982	%	1983	%	1984*
UK Market	991	2	1009	15	1163	28	1491	31	1951
Production	875	(6)	823	11	913	18	1077	30	1397
Exports	285	(5)	271	18	321	22	391	36	531
Imports	401	14	457	25	571	41	805	35	1086
Trade Balance	(116)		(186)		(250)		(414)		(555)
Export%	33		33		35		36		38
Import%	40		45		49		54		56

Source: Business Monitor and NEDO estimates. (see Appendix 1)
*1984 derived from half year figures

3. In addition to this wide variety of products, the structure of the industry is diverse and contains many different types of companies:

- some 25 substantial and independent UK companies, encompassing about 70 maufacturing sites;
- subsidiaries of larger and diversified UK groups which are usually based in the electronic equipment sector - in some 30 manufacturing sites;
- manufacturing subsidiaries of large foreign groups which are either in electronic components or equipment;
- a myriad of smaller independent companies.

It is estimated that this adds up to more than 700 manufacturing sites, although part of this is explained by the large number of printed circuit board companies which total more than 400.

4. The UK has traditionally had a strong capability in a wide range of the more specialised types of components, maintaining a comparative advantage in discrete semiconductors particularly at the power end of the range, in vacuum technology and passives, particularly associated with the defence and aerospace industries. This has been a reflection of the structure of the UK equipment industries into which the components industry is selling. However that structure is changing and the UK components industry is not adapting fast enough. Figures are not available on a market outlet basis, but the tables in Appendix 1 demonstrate that more and more of the UK market, even in passives, is unfortunately being satisfied from imports.

NATURE OF THE BUSINESS

5. In many ways the term 'Components Industry' is now a misnomer. It implies the manufacture of products for a main industry, such as the headlamp or seat-belt producers, which serve the motor industry. If a classification remains necessary in the electronics industry today, it should be between components and applications. The design and manufacture of components can no longer be regarded as an ancillary activity - a handmaiden to those with a more important purpose in life. Its role is now central and its success crucial to all electronics applications. A strong components industry will stimulate many of Britain's other industries - from process control to motor vehicles themselves.

6. As a result, the core engineering skill in the design of a piece of equipment no longer resides solely, as it used to, in the ability of the equipment designer to combine components, through the sub-assembly method, to achieve the desired result. Increasingly the function is being realised directly in the IC. The traditional sub-assembly is, through changes in technology, becoming a component in its own right.

7. The cause of this shift in the centre of gravity of the electronics industry from the equipment industries to the components industry is that the IC is now <u>the</u> fundamental ingredient of the applications industries. The reason that electronics, and ICs in particular, have become so pervasive is that very complex systems are now relatively cheap, use little power, and do not demand special environmental conditions. Moreover, it is likely that the speed of developments in the past decade will be more than matched by developments in the next decade. This leads to two fundamental points:

* first, the importance of Britain developing an advanced IC industry for the benefit of the equipment industries;

* second, that the components industry needs an advanced equipment industry which applies the latest technologies effectively.

THE STRATEGIC SIGNIFICANCE OF INTEGRATED CIRCUITS

8. Although ICs currently comprise only 25% of the UK's output of electronic components, they hold the key to the future of not only the components industry, but, more widely, the future of all industries employing advanced electronics. This means - or should mean - almost every aspect of Britain's industrial base, and much of its service sector. On a

worldwide basis, the electronic equipment industries are forecast to grow at 13% per annum to 1990, whilst ICs will grow at 22% pa. For this reason this paper concentrates on ICs and how they will change the interface between the component and equipment industries. (Supplementary information on other active and passive components can be found in the Appendices.)

9. A new generation of electronic components is revolutionising the way ICs are made, what they do and how they can be used. This revolution concerns the capacity to put not just memory, logic and control on a circuit, but to programme it to be intelligent, and thus to make "intelligent" machines. The key to this will be the capacity of the new generation of ICs to perform complex tasks not only in parallel, but also for these separate operations to interact.

10. Increasingly ICs can be distinguished between commodity circuits and application-specific ICs (ASICs).

* Commodity ICs are manufactured and sold worldwide by all the major semiconductor companies. They provide memory, logic and other facilities required in complex circuits.

* However, these attributes frequently need to be tailored to the requirements of the end user. The term ASIC is used to cover all ICs that are customisable to meet a particular application, and it includes gate arrays, standard cells, full custom circuits, and programmable logic arrays. By 1990 ASICs will account for 30-50% of the world IC market. Production and use are related. In theory, equipment makers could import all the ICs they need. In practice, they will suffer if they do, because they will lose out in world markets to those equipment makers that work closely with ASIC makers to produce the most suitable components and hence the best products.

11. The importance of an advanced industrial country like Britain staying at the forefront of component technology is hard to overstate. Increasingly the crucial skills needed to make world competitive products and supply world beating services will be those skills used to design and apply the ICs themselves, rather than assembling commodity ICs in conventional equipment.

12. From this it follows that while it would be desirable for the UK to have a positive trade balance in both commodity ICs and ASICs, it is of more strategic significance to have a strong capability in ASICs to provide the user industries with more optimisable designs.

13. Related to this is another, more directly commercial point. An increasing share of the value-added in electronic equipment will be in the ICs themselves. Any attempt to assess Britain's prospects in equipment manufacture and use of the most advanced ICs must, therefore, start with an assessment of the significance of the current IC revolution.

14. Moreover, if Britain is to succeed in developing a competitive IC industry, IC companies will need to employ more designers and the most advanced computer-aided design (CAD) techniques in order to achieve the lowest possible price-per-function. The user industries will also need to acquire their own advanced CAD capabilities.

CAD does two things for ICs. First, it allows ICs to be designed far more quickly and to a far greater degree of complexity, than was possible before. Second, it also allows fundamentally new kinds of IC to be developed - the 'intelligent chip', in which sub-systems communicate directly with each other. This quality will greatly expand the potential applications of ICs - for example in advanced manufacturing systems using robotics and office and other systems using speech input-output.

THE CHIP BUSINESS IS UNLIKE ANY OTHER

15. The rate of technical change in ICs is greater than in any other major industry; the market it serves is growing faster than any other major market; the number of products made by the IC industry is growing as fast as any in the UK; the dramatic fall in price-per-function in this industry is greater than in any other industry. This is a capital-hungry industry investing typically more than 35% of turnover on research and development, and capital investment. Smaller companies, and those in the ASICs, are investing at an even higher rate.

16. In many industries the best results are obtained through competition among a variety of companies, each with broadly equal levels of technology and each trying to secure an advantage through price and/or quality and/or productive efficiency. The IC business, however, is unlike any other:

* Close links between ASIC manufacturers and equipment companies are essential.

* In any given area at the forefront of any IC technology there are only a limited number of companies worldwide.

* High-tech IC manufacture is highly specialised: customers of the most advanced chips cannot readily take their business elsewhere.

* Defence needs. Independent defence capabilities are important for strategic reasons; otherwise we are, in practice, dependent on imported technology in key areas where an early supply of critical and innovative components is essential.

17. For all these reasons, it is important to ensure that Britain has a capability in each key technology. If a small community of business executives make only a few 'wrong' decisions (as far as 'UK plc' is concerned), Britain will find itself relegated from the second division of high-tech countries (assuming US and Japan comprise the first division). Should we fall further behind and fail to maintain a presence in high-tech IC developments, it will be impossible to recover.

COMPETITIVE POSITION

18. Between 1980 and 1983 the UK market for ICs grew by 95% to £458 million; however output only grew by 70% to £272 million. During the same period exports grew by 62%, while imports grew by 100%. The table below shows a deteriorating trade balance.

TOTAL INTEGRATED CIRCUITS

£M	1980	%	1981	%	1982	%	1983	%	1984
UK Market	235	6	249	28	318	44	458	42	652
Production	160	5	168	23	206	42	272	44	393
Trade Balance	(75)		(81)		(112)		(186)		(259)

% are growth between years
Source: Business Monitor and NEDO Estimates - see Appendix 1
*1984 derived from half year figures

19. However, components trade figures do not provide a good indicator of the industry's performance, as they mix two separate factors: the success of British component makers in selling to the world, and the demand by UK equipment makers for components. The 'best' component trade figures would result from an excellent components industry but a weak equipment industry - this pattern would, in theory, generate considerable exports, but little demand for imports.

Instead, the way to assess the components industry is, in general, to examine its growth in output and exports; and specifically - though more subjectively - examining whether we are succeeding in establishing an effective British presence in particular areas.

20. In 1983 the main companies selling in the UK were:

1983	$M UK Sales	$M World Sales
Texas Instruments (US)	80	1540
Motorola (US)	70	1060
Mullard (Philips) (Dutch)	50	250
Intel (US)	50	780
National Semiconductors (US)	50	790
Ferranti (UK)	30	70
Hitachi (Japanese)	30	910
NEC (Japanese)	30	1090
Siemens (German)	30	180
Fairchild (US/French)	30	370

Source: Dataquest

[NB: Dollar figures have been given as this is the currency in which the international IC trade is conducted, and prices are set. Figures in £s would tend to be misleading, especially at a time of fluctuating exchange rates.]

It is encouraging that most of these companies have a presence in the UK, but disturbing that only four manufacture in the UK, and only one of those - Ferranti - is UK owned. The top five companies, all foreign owned, accounted for half the UK market in 1983.

21. Worldwide sales of the five main British based IC companies in 1983 were:

Ferranti	\$68m
Inmos	\$60m
Plessey	\$58m
STC	\$30m
MEDL (GEC)	\$23m

Source: Dataquest and NEDO Estimates

These figures show how relatively small the UK companies are compared with their American, Japanese and European rivals; and how urgent it is for them to grow rapidly if they are to be at all credible in world markets.

However, these figures also conceal some rapid growth rates in recent years, particularly by Ferranti, Plessey and STC in (semi) custom ICs, and Inmos and STC in the commodity market.

22. Two main conclusions emerge from this analysis:

* that the UK's indigenous IC companies are small compared with our competitors and, overall, not growing fast enough to hold their share of either the British or international markets;

* that the UK's IC output figures are substantially enhanced by the output of multinational companies located in this country; without them our output and trade figures would be extremely disturbing.

23. However, it is worth noting the findings of the US market research group ICE (Integrated Circuit Engineering), which ranks all IC companies worldwide with sales of more than \$25 million a year. In both 1982 and 1983 British companies came top in growth rate - Ferranti in 1982 and Inmos in 1983.

24. The position of Inmos deserves special comment. This is a company whose formation and development was encouraged by the EDC and supported by Government, in the face of widespread predictions of its failure. It is now thriving and remains British (now owned by Thorn-EMI). In particular Inmos' highly innovative transputer will make a significant contribution to the UK's ASIC capability. Inmos' transputer is potentially one of the most powerful ASIC in the world. The Japanese government funded programme to develop 5th generation technology, ICOT (Japanese Research Institution on 5th Generation Computer Technology), and several major American computer companies, believe Inmos will be their major source of supply.

25. The area in which UK companies have tended to specialise - the manufacture of applications specific or customised ICs for local electronic equipment industry - will provide many of the fastest growing market opportunities during the coming decade. UK indigenous companies are therefore now well placed to improve their performance and to fulfil the ASIC needs of the equipment industries; they have a sound technical base from which they must be encouraged to expand faster.

THE KEY ISSUES FOR THE FUTURE

26. It is evident that urgent steps must be taken to restore Britain's place in the international IC industry.

i) The IC Industry itself

Clearly there is much that the IC industry can do itself to exploit more effectively the changing markets and technologies, to promote closer contact with the equipment companies and to build on stable industrial relations. The foregoing analysis has shown that the investments required in research, development, design facilities and capital plant for manufacture are large by any standards. The UK market is currently growing at about 30% per annum; to increase output at this rate will require managerial and financial commitment of a long term nature. The necessary requirement for greater use of CAD will itself impose a strain on human skills and company resources.

Therefore, the EDC recommends that IC companies:-

* review their medium and long term business plans for ICs with the objective of growing at least as fast as the market. The list of current investment programmes is impressive, but is inadequate to fulfil UK equipment demand; it is estimated that an annual investment rate of £400m will be required;

* draw what advantage they can from pre-competitive collaboration between companies to maximise the advantages of scale, the pooling of development and advanced manufacturing techniques. Through building on the experience of working with the (British) Alvey and (European) Esprit projects to emulate the recent example of collaboration between Philips and Siemens to develop and manufacture advanced ICs; this is the most ambitious attempt yet to reverse the European semiconductor industry's decline in world markets;

* in recognition of the increasing importance of ASICs companies will need to establish close working relationships with equipment companies to liaise effectively at the design stage of new products;

* in view of the current and impending shortages of critical higher level skills companies should develop stronger links with schools, universities and other colleges of education for example by sponsoring students and lectureships and through the provision of equipments.

27. ii) The Equipment Companies

This paper has argued that the fortunes of the electronic equipment manufacturing companies are inextricably entwined with the components industry and that they are mutually interdependent. To be competitive in international markets the equipment companies will need to exploit effectively all the benefits that advanced ICs offer. The EDC has established a supplier/user task force to promote the necessary collaboration and it is recommended that:-

* companies review their plans for new products to ensure that full advantage is taken of changing component technology. More particularly, equipment companies should respond to the need for closer working with component suppliers at the design stage where for example to exploit fully the capability of ASICs they will need to consider acquiring themselves the tools and know-how for IC design.

28. iii) Government

There is much that Government has done and is doing to assist in the development of the components industry generally and the IC industry in particular. The package of inter-related schemes of support for innovation, including the MISP 2 programme and the Alvey project are noteworthy. But our major competitor nations also recognise that market forces alone are insufficient to create an effective IC capability and their Governments are more generally involved in underpinning their indigenous industries either indirectly or directly through state support for R & D and capital investment. For example, the German and Dutch governments are prepared to spend more than £110 million to support the joint Philips/Siemens project during the next four years - that is approximately equal to the total British MISP 2 scheme.

The EDC considers that Government has an essential role to play to assist the IC industry in realising its full potential. Specifically it is recommended that Government should:-

29. Investment

* review the current package of schemes related to the IC industry to ensure that an adequate level of encouragement and support is available to the companies to underpin the necessary rate of technological development and business growth. Consideration should be given to augmenting the MISP 2 scheme to reflect the continuing need for substantial additional capital investment; (overall it is estimated that the IC industry needs to invest at a rate of £400m per annum) and to provide a higher level of grant to enable a concentration of resources in key areas. An additional reason for augmenting support in this way is to counteract the adverse effect on the IC industry of the withdrawal of 100% capital allowances in

the 1984 Budget. With its high level of capital investment, short write-off period (because of advancing technology) and relatively low profitability the IC industry is particularly badly effected by this measure. Note: In the financial years 1981-84 Government support (excluding regional development grants) totalled more than £2 billion to the steel industry, almost £650 million to shipbuilding, but only £126 million for the whole of microelectronics;

* consideration should be given to widening the scope of support so that related areas are included eg the supply of equipment and materials to the IC industry; and the development and use of more efficient IC packaging technology etc;

30. Research exploitation

* examine the role that Government could play to assist in the exploitation of the fruits of collaborative research from the Alvey and Esprit programmes. The Alvey project is a rare and welcome example of the UK providing funds on a sufficient scale to match, and even overtake, our competitors, but thought needs to be given now on how to make best use of this mechanism and to exploit it. Urgent consideration should be given to the following points:-

a) bring together the work of the Alvey Directorate's four sections in order to develop marketable 'intelligent' machines and the necessary infrastructure in components and software to support them;

b) ensure, in accordance with the Directorate's original plans, that smaller companies, both in production technology and software, are fully participative and are able to exploit leading edge technologies;

31. Education and skills

* address the problem of shortages of critical skills by implementing the recommendations that are likely to emerge from the Butcher Information Technology Skills Committee and whatever other measures are necessary to remedy these now well documented deficiencies;

* provide additional funds to the SERC to enable it to maintain its support for post graduate studentships and conversion courses and more particularly, to keep in existence the specialist facilities doing practical work in microelectronics.

MANPOWER AND SKILL REQUIREMENTS

32. Employment in the overall component industry (total of PQ3444 & 3453) has declined sharply since 1980, but within that decline there have been considerable skill shifts, as follows:

	1980	1981	1982	1983	%change 80-83
Scientists and Technologists	3420	3534	3773	3995	+17
Technicians (inc draughtsmen)	6159	5476	5304	5542	-10
Operators	45736	37025	32955	33280	-27
All Other Employees	32996	29402	27278	26159	-21
Total	88311	75437	69310	68976	-22

Source: EITB Statutory returns

33. In three years, total employment has declined by 22%, although total output has risen substantially. This decrease in overall levels is a reflection of two moves within the industry. Firstly there is the shift towards more capital intensive products. For example a relative decline in professional tubes which have been comparatively labour intensive, against large increases in integrated circuits which are capital intensive. Secondly, there have been increases in the capital intensity within most products.

34. This paper has made extensive reference to the need for considerable investment in the components industry, not only to increase output, but to improve effectiveness. It is therefore likely that there will be a continuation of this trend of increasing output per head. Recent increases have been nearly 20% per annum and output would need to expand at that rate, just to hold the employment level steady.

35. Despite an overall decline of 22%, the number of scientists and technologists has risen in absolute terms. This trend to higher skills will continue and the shortages of skilled engineers is already a severe constraint on the industry. To overcome this, action is required in two related areas:

- The 1982 UGC cuts effectively froze the undergraduate intake for courses in electrical and electronic engineering and related subjects. The position is even more serious than this implies, because although the total numbers have been held, up to one third of places available in British universities are now reserved for foreign students paying full commercial fees. There has therefore been a decline in the number of UK students being trained in these subjects. The recent interim report from the Butcher Committee estimates a reuired increase of about 25% by 1990 in the number of trained electronic engineers available to UK industry. Industry estimates suggest that the additional numbers required may be as high as 40% for the IC industry.

- The Science and Engineering Research Council (SERC) provides an essential service to the industry by providing funds for post-graduate work and, specifically in microelectronics, by supporting the six specialist facilities doing practical work - Edinburgh (silicon); Sheffield (III-V compounds); Surrey (Ion Beam); Southampton (Silicon); Rutherford Appleton Laboratory (Electron beam lithography and CAD software). Recent decisions to reduce the SERC's funds put at least one of these facitilities at risk. The SERC IT Directorate should have sufficient funds to finance the requirements of industry adequately and these should not be at the expense of other programmes.

THE WORK OF THE EDC

36. Much of this paper has been devoted to the central role of ICs in electronic components. ICs, however, form only part of the EDC's work programme. For example, in recent years the EDC's work has included:

* Quality: The EDC co-operated with the Electronics Consumer Goods EDC in its work to make the UK TV manufacturing industry competitive with Far Eastern sources. The Parts per Million approach to quality has resulted in dramatic reductions in the level of rejects and has enhanced the manufacturing base of components as well as sets. The Electronic Consumer Goods EDC has highlighted the importance of recent improvements in component quality in its "FACT" booklet. This work on components quality has complemented the main thrust on quality and standards by BS/CECC.

* Printed Circuit Boards: The EDC investigated the important sub-sector of printed circuit boards, organised a maker/user seminar and produced a report which made recommendations about various aspects of the sector.

* Productivity: The EDC published and widely distributed a report which was based on a series of case studies of the way that companies had increased productivity and improve their competitiveness. The report encouraged other companies to follow these examples and placed emphasis on the early involvement of the workforce.

* Applications: The EDC brought together manufacturers, academics, members of research establishments and users of VLSI integrated circuits in a workshop to discuss the problems and opportunities provided by the new technology and to define better the future requirements of the user sectors.

* Government Support Schemes: The EDC has influenced the Government to continue and expand its support schemes in microelectronics. The establishment of MISP 1 & 2, MAP, CADMAT and the Alvey directorate will ensure considerable government assistance for research, production and applications. The EDC proposed a specific Government scheme for fibre-optics. This was introduced and the Fibre Optic Support Scheme (FOS) has been very successful. It has been supplemented by the Joint Optoelectronic Research Scheme (JOERS). This meant that the UK was well placed in this key technology. However, recent developments in other countries - the USA, Japan, Korea etc - make our relative position in world markets in the future, more questionable.

* Inward Investment: The EDC prepared a list of specific guidelines for inward investment projects and presented this to Government to ensure that foreign owned companies are only encouraged to invest in the UK in a manner which enhances the UK manufacturing base.

* Tariffs: The EDC has secured the agreement of the UK's semiconductor and Printed Circuit Board (PCB) industries to a rationalisation of the tariff structure for components imported into the EEC. Imported semiconductors currently attract a duty of 17% while populated PC Boards only attract an import duty of approximately 5-7%. This is an incentive to import semiconductors already on PCBs. The PCB industry and manufacturers of equipment, such as the computer industry, sought a reduction in the tariff on semiconductors in order to increase the proportion of indigenous components used and the amount of assembly work carried out in the UK. The semiconductor industry has now agreed to this, and the matter is currently being considered by the European Commission.

37. The EDC functions at two levels: a formal level, represented by papers to the EDC and meetings of members; and an informal level, represented by the work of staff co-operating with members of the industry on specific issues. For example, the EDC staff has added an educational and marketing dimension to the industry's major annual Semi-Custom Conference.

38. One of the most useful features of the EDC is that its existence - quite apart from its formal meetings - enables contacts to be made and information to be circulated to the benefit of the whole industry. This information is often of a delicate nature but the Office, which has no commercial axe of its own to grind, is able to perform a vital intermediary role as it is trusted by all parties.

National Economic Development Council

NEDC(84)54
20 November 1984

TAX POLICY AND THE JOBS EXERCISE: SUMMARY

Memorandum by the Chancellor of the Exchequer

The principal contribution that the Government can make to job creation is to conquer inflation and restore financial stability and business confidence. The Government's macro-economic policy framework is set out in the Medium - Term Financial Strategy. Consistent with this strategy, the Government's prime tax objective is to reduce the overall level of taxation. A second objective is to reform the tax structure to reduce economic distortions and simplify the system.

2. Reducing taxation depends upon controlling public expenditure. The recent Autumn Statement, which set out the Government's public expenditure plans for 1985-86, confirms the public expenditure planning total that was provisionally announced in the Public Expenditure White Paper in February. The Green Paper on Long-Term Public Expenditure discussed the upward pressures on public expenditure and outlined the scope for future tax reductions if these pressures can be successfully resisted. The scope for tax reductions, and the pace at which they can be achieved, depends upon future economic growth and control of public expenditure.

3. Given success in these areas there should be scope for tax reductions over the remainder of the MTFS period. At the time of the Budget, the MTFS indicated scope for tax reductions building up to £13½ billion by 1988-89 on certain assumptions about revenue and expenditure. The Autumn Statement slightly modified the projected fiscal adjustment for 1985-86 but there is no reason to alter substantially the picture for the entire MTFS period detailed in the 1984 Financial Statement and Budget Report (the "Red Book").

4. Tax reductions will improve incentives to work, risk-taking, and enterprise. They will contribute to the release of market forces, which will improve the "supply - side" of the economy, thus increasing output and generating more job opportunities. Tax measures cannot produce these results overnight or by themselves and are only one component of the Government's general policy of reforming institutions and changing attitudes. But, tax reductions should contribute to a more dynamic and adaptable economy, in which choices are more market determined and less influenced by the State.

5. Historical and international evidence points strongly to a link between low taxation and good economic performance.

6. Tax reform is a second objective of Government policy. A broader tax base with fewer special exemptions will reduce tax created distortions and allow marginal tax rates to be reduced and resources to be allocated more efficiently. Tax reform is no substitute for tax reductions but, with a given level of revenue, it can increase the influence of the market and reduce that of the State on resource allocation and thereby minimise the damage that taxation does to economic performance.

7. Since taking office the Government has moved towards tax reduction and reform. The burden of income tax has been reduced through reduction in rates and increases in the real value of thresholds. The latter concentrate the greatest proportionate benefits of tax reductions on those on average earnings and below and helps to mitigate the effects of the unemployment and poverty "traps". It is difficult effectively to relieve poverty without accepting the existence of some degree of poverty trap: this is inherent in the very concept of selective assistance.

8. Company taxation has been reduced and reformed since the Government took office. Measures to encourage business in recent Budgets through the Enterprise packages were augmented by the 1984 Budget changes to the company tax structure. These will provide immediate benefits to companies and reduce the tax burden on companies in the long - term. In particular UK companies will face one of the lowest rates of corporation tax in the OECD. The package will also improve the allocation of resources by reducing previous tax induced distortions between different types of investments and between capital and labour. The net effect of the package should provide a boost to employment prospects.

9. The tax treatment of savings has also been reformed. The abolition of the Investment Income Surcharge has provided encouragement to savings. Various changes to the tax treatment of savings instruments will increase competition between financial institutions and improve the workings of the capital market.

10. The tax burden in the UK remains excessive and the structure needs further reform. Reducing tax is costly and, if it is to be achieved, the additional resources created by a growing economy must not be siphoned off into higher public spending. Ultimately the extent to which taxes can be reduced will depend upon our success in controlling public spending.

TAX POLICY AND THE JOBS EXERCISE

Memorandum by the Chancellor of the Exchequer

This paper considers tax policy and its role in creating conditions conducive to economic growth and the creation of new jobs. The note is organised as follows:

Section A discusses the Government's taxation objectives and the contribution that their achievement can make to job creation.

Section B reviews progress to date.

Section C considers the areas where further progress needs to be made and the conditions that need to be fulfilled in order to make it possible.

A. TAXATION OBJECTIVES

The Macro-Economic Framework

2. The Government's macro-economic policy is set out in the Medium-Term Financial Strategy which provides the framework within which other policies operate. The prime objective of the strategy is control of inflation. This is the main contribution that macro-economic policy can make to increasing employment.

3. Each year the Financial Statement and Budget Report (the "Red Book") sets out the monetary growth rates and associated PSBR levels that are compatible with the objective of controlling inflation. In the Government's first term the priority was to reduce the PSBR as a proportion of GDP so that inflation could be reduced at an acceptable level of real interest rates. The table below sets out the progress that has been made.

Table 1 Public Sector Borrowing

	1974-5 to 1978-9	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
PSBR as a proportion of GDP (%)	6.7	4.8	5.4	3.3	3.1	3.2	2.5

4. The PSBR as a proportion of GDP is now half the level of the late 1970s and declining, inflation has been reduced to 5 per cent, and real interest rates are declining. With public sector borrowing and inflation under control and reasonable prospects for falls in real interest rates there should now be scope for reducing the tax burden.

5. The 1984 Red Book set out the room that there should be for tax cuts over the period to 1988-89, provided that there is reasonable economic growth and that public

expenditure is kept under control. The Autumn Statement (published on November 12) further demonstrates the Government's success in controlling public expenditure. The public expenditure planning total has been held to the level set in previous plans, notwithstanding the pressures for higher spending. As a result there should be scope for tax cuts in 1985-86. The Statement amended slightly the fiscal adjustment for 1985-86, but the overall prospects for tax cuts in the 1985-86 to 1988-89 period are broadly unchanged from prospects at the time of the last Budget.

Table 2 Fiscal Adjustment: 1985-86-1988-89

	1985-86*	1986-87	1987-88	1988-89
Annual Fiscal Adjustment (£bn)	2	4½	3½	3½
Cumulative Fiscal Adjustment (£bn)	2	6½	10	13½

* Autumn Statement revised 1985-86 fiscal adjustment to £1.5 billion

6. The £1.5 billion fiscal adjustment for 1985-86 is in addition to the carry-over effect of the 1984 Budget measures, which will reduce taxes by £1.8 billion compared with an indexed base. Thus there is a prospect of a £3.3 billion real reduction in the 1985-86 tax burden.

The Micro-Economic Framework

7. The macro-economic strategy must be complemented by policies which will benefit the micro-economic performance of the economy - improving the supply-side of the economy. This means mobilising resources to undertake productive activity, augmenting the quality of those resources, and increasing the efficiency with which they are deployed. Market forces have the central role here and micro-economic policies are accordingly directed at making market forces work better. Such policies will increase output and generate more employment.

8. Tax reductions have a role to play in this process, along with other supply-side measures, which the Government is pursuing. The process of improving the supply-side is a gradual one, which depends on changing both institutions and attitudes. It would be a mistake to expect tax reductions and reforms to have an overnight effect or to carry the whole burden of improving economic performance.

9. As part of a policy of improving the supply - side reducing taxation is important: taxation distorts the pattern of incentives and can misdirect resources away from efficient activities towards inefficient ones. The higher the level of taxation the greater the potential distortion which can arise. Reduction of the total tax burden - in a way consistent with the Government's overall macro-economic policy - is therefore an

integral part of the policy of revitalising the economy by making it more receptive to market pressures and less influenced by the State.

10. All taxation distorts economic activity to some degree by driving a wedge between pre and post-tax returns. For example income tax drives a wedge between the pre and post-tax return of working and so may reduce the supply of labour. This discouragement relates to both the quantity supplied eg the disincentive connected with an extra hour of overtime compared with going home, and to the quality of labour eg the discouragement to train for a more skilled job or take on more responsibility. High tax rates are especially detrimental to risk - taking activity where the entrepreneur stands to lose something if his enterprise fails and requires the prospect of a reasonable reward to compensate for the risk.

Taxation and Incentives

11. It is never possible to "prove" unequivocally a relationship between two economic variables exists. However, there is historical and international evidence which points strongly to a relationship between low taxation and high output and employment.

12. The overall burden of taxation in the UK is considerably higher now than 20 years ago. (Details of the increase and the background to it are set out in the Green Paper on Long Term Public Expenditure, published earlier this year.) The proportion of non-North Sea tax to non-North Sea GDP was 38 per cent in 1983-84 compared with 29 per cent in 1963-64. In the 1963-64 financial year a married man with no children receiving no allowances except married mans allowance, started to pay tax at an income level of 45 per cent of average earnings. By the 1984-85 financial year a man in similar circumstances started to pay tax at 33 per cent of average earnings. The percentage of earnings paid in income tax by a married man receiving just the personal married man's allowance rose from 13 per cent in 1963-64 to 20 per cent in 1984-85. There is little doubt that our poor economic performance over the last 20 years is at least partly related to the growing burden of tax.

International Evidence

13. This is provided from a recent OECD comparison of tax revenue as a proportion of GDP in the 18 major OECD economies. While the UK was 9th highest out of 18 with a tax burden equivalent to 39.6 per cent of GDP in 1982 it is notable that, Japan and USA, the two economies with the most dynamic economic performance and best job creation records in recent years, have substantially lower tax burdens. The USA is 15th out of 18 with a ratio of 30.5 per cent and Japan is 16th with a ratio of 27.0 per cent.

14. These countries have low tax burdens because public expenditure is also relatively low as a proportion of GDP. According to OECD data, public expenditure as a proportion of GDP in 1981 (defining public expenditure in National Account terms), was 35.4 per cent in the USA and 34.0 per cent in Japan compared with 47.3* per cent in the UK. Since then the UK proportion has fallen to 45.4* per cent but further reductions will be needed if tax is to be reduced to a more sensible level.

15. Income tax starts in the UK at a lower level of earnings than in most of our major international competitors. The table below sets out the starting level at which income tax is charged in the UK for single people and married people without children compared with the four largest OECD economies:

Table 3 Income Tax Thresholds

Country	Single Person (£)	Married without children (£)
France	3840	4250
Germany	1980	3455
Japan	3210	4410
USA (Fed)	2580	4220
UK	2005	3155

Notes (a) November 13 1984 exchange rates.

Long-Term Tax and Public Expenditure

16. Lower taxation is crucially important if incentives to work, risk-taking and enterprise are to be improved. The 1984 FSBR details the scope for such reductions over the period to 1988-89. In the longer-term the potential for tax cutting is discussed in the Green Paper on Long-Term Public Expenditure, published earlier this year. It shows the importance of both controlling public expenditure and economic growth if the tax burden is to be further reduced. The table below [Table 5 from the Green Paper] sets out the burden of Non-North Sea taxation on differing public expenditure and growth assumptions.

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* OECD series compare public expenditure, defined in National Accounts terms, as a proportion of GDP. UK public expenditure on this basis is higher than the planning total. A reconciliation between National Accounts Terms and the Planning Total is given in Table 1.7 of the Autumn Statement.

Table 4 The Burden of Non-North Sea Taxation in 1993-94

(per cent of non-North Sea GDP at market prices)

	Public Expenditure growth after 1988-89	
GDP growth after 1988-89	Zero	1%
1½%	32½%	34%
2%	31½%	33½%

17. Over the longer-term there is a two way relationship between economic growth and lower taxation. Economic growth, by increasing the size of the tax base, will allow a given borrowng requirement to be achieved with lower rates of taxation. However lower taxation, by improving incentives and resource allocation, will create conditions in which faster economic growth is more likely to occur. The Government's objective is to break into a virtous circle in which lower taxation encourages economic growth which in turn, makes room for further reductions in the rate of taxation.

Tax Reform

18. The Government's objective is not only to reduce the total amount of taxation but also to ensure that revenues are raised in a manner which imposes a minimum distortion to markets. This means moving towards a broadly based tax system with lower rates of tax. Broadening the tax base requires that special concessions and exemptions should be minimised. This does not mean that it is an aim of policy to abolish them all. Some are justified in order to correct market imperfections elsewhere in the economy or because of accompanying social benefits. However, each concession must be justified, not only on its individual merits but also taking into account the repercussions for the rest of the economy. Every concession, no matter how deserving individually, means a higher tax burden on those activities which are not the subject of concessionary treatment and increases the associated disincentive effects.

19. The mixture of incentives and disincentives that results from a tax system with numerous concessions and exemptions distorts activity. Resources in the economy are allocated, not according to the pattern of pre-tax returns, but after the tax system has distorted this patten towards some activities and away from others. Sometimes this is the consequence of a clear decision that particular activities should be favoured for reasons which remain valid today.

20. However, some exemptions and concessions are no longer justified and have misallocated resources. The Government examines existing exemptions and concessions against this background and its policy is to retain only those that can be justified on wider economic or social grounds.

21. Eliminating distortions will also contribute towards a clearer and simpler tax system. Much effort and expertise is currently devoted to artificial activities and devices, which have no economic benefit and whose sole purpose is to save tax by taking advantage of the small print of the system.

22. The Government has also changed the balance of taxation somewhat by shifting the burden from taxes on earnings to taxes on spending. Since 1978-79 income tax as a share of the total tax take has fallen from 32.7 per cent to 26.6 per cent, while taxes on final spending have risen as a share from 27.6 per cent to 30.5 per cent. As the next section points out the Government has given priority to improving incentives to work, save and take risks. Income tax has been cut and this has partly been financed by increasing taxes on spending.

B. PROGRESS TO DATE

23. This section reviews the progress that the Government has made to date in accomplishing its objectives of tax reduction and tax reforms. Action has been taken in three main areas:

(a) personal taxation and reform of benefit;

(b) company taxation;

(c) taxation of savings and investment instruments.

Personal Taxation and Reform of Benefits

24. The Government's reforms have been directed at improving the incentive to work and also to develop skills and to assume responsibility. The following specific measures have been taken:

(a) Reduction of income tax rates. The basic rate of tax has been cut from 33 per cent to 30 per cent and the highest rate from 83 per cent to 60 per cent. The marginal rate of tax - which is an important determinant of the incentive to work - has fallen for nearly all tax payers.

(b) Personal tax thresholds have been increased by 16 per cent in real terms since 1978-79. Earnings have risen almost as much in real terms and so the percentage of average earnings at which people start to pay tax has risen only slightly. For a single person (with no other allowances) the rise has been from 20 per cent of average earnings in 1978-79 to 21 per cent in 1984-85 and for a married person (with no other allowances) from 31 per cent in 1978-79 to 33 per cent in 1984-85. These figures are still too low and it is a high priority to raise thresholds further.

(c) Employee share schemes have been encouraged. The tax regime for profit sharing and savings related share option schemes has been improved and from this year gains under a new form of approved share option will be treated as capital gains rather than income. These measures are intended to encourage the spread of such schemes which directly link rewards to performance.

25. This Government has given special attention to raising tax thresholds. As a result of increases in tax thresholds introduced by this Government there are 850,000 fewer taxpayers than there would have been if taxes had merely been indexed. Increases in thresholds havethe dual advantages of taking many of the poorest people out of tax altogether and of concentrating the greatest relative benefits on those of up to average earnings. Increases in tax thresholds also help alleviate the unemployment and poverty traps. These anomalies in the tax and benefit system have been the focus of several recent studies and are described below.

The "Unemployment Trap"

26. The first of the traps concerns the incentive to the unemployed to take work. One measure of this is the ratio between net income when out of work and net income when working - the "replacement ratio". In some - rare - cases this ratio may be so high that it is scarcely worthwhile for the unemployed person to take a job.

27. However, the Government has made some progress in improving incentives by cuts in taxation for those in work combined with bringing unemployment benefits into tax and the abolition of earnings related unemployment benefit. The table below compares replacement ratios of a sample of men who became unemployed in 1978 with the ratios that they would have faced had they become unemployed in 1982.

Table 5 Replacement Ratios for the Unemployed

Percentage with Replacement Ratios		Under 50%	50%-80%	Over 80%
All	1978	30	46	25
	1982	39	40	21
Single	1978	47	46	6
	1982	62	35	3
Married	1978	16	48	36
	1982	22	55	23
Married + 1/2 child	1978	10	50	40
	1982	13	44	43
Married 3+ children	1978	7	29	64
	1982	7	31	62

Source: GES Working Paper No 69. DHSS June 1984

<u>note</u> taxation of unemployment benefit excluded. Allowing for it would tend to reduce further short-term replacement ratios in 1982.

28. Another approach has been through a range of policies designed to encourage the unemployed to set up their own businesses. Around 45,000 have done so under the Enterprise Allowance Scheme, since it was introduced in January 1982. Overall, self-employment grew by 400,000 between mid-1979 and mid-1983.

The "Poverty Trap"

29. The poverty trap concerns the disincentive to work harder or to get a better job. Some lower paid workers with children find that a combination of deductions from pay and loss of means-tested benefits leaves them with little or no increase in net income from an increase in gross income. The problem partly arises because workers start to become liable for income tax at income levels which are far too low. The Government's general policy of increasing the real value of the personal allowances will therefore help to alleviate the poverty trap.

30. The various aspects of the unemployment and poverty traps are complicated. The complexity of means tested benefits, particularly where they overlap with tax, is such that people are often confused about the circumstances in which they would be better off. Measures which improve one trap may worsen the other; for instance, Family Income Supplement alleviates the unemployment trap by increasing in-work income, but is a major cause of the poverty trap because it is withdrawn at the rate of 50 pence for each £1 increase in income.

31. No-one has so far been able to provide a solution to the traps, which is not either unacceptably expensive or creates wider and perhaps more important effects on

incentives. The recent scheme put forward by the Institute of Fiscal Studies would have eliminated the worst part of the poverty trap, but at the price of a combined marginal rate of tax and benefit withdrawal of 84 per cent for about one-fifth of the working population. The difficulty of reconciling the effective relief of poverty with giving reasonable work incentives arises because of the selective nature of assistance to the poor and is central to the dilemma of dealing with the traps.

Company Taxation

32. Major changes in company taxation were made in the 1984 Budget and earlier Budgets which have reduced the burden on industry and reformed its structure. Earlier Budgets encouraged new businesses and projects though for example the Business Start-up and Expansion Schemes. Enterprise Zones, incorporating tax advantages for companies have also been introduced, and various tax changes have made it easier for businesses to raise money and operate. The changes in the 1984 Budget will reduce, substantially, the tax burden faced by the company sector in 1984-85 and 1985-86. In the longer-term companies will benefit from one of the lowest rates of corporation tax in the developed world. This will increase the company's sector resources, benefitting employment in existing businesses and also attracting inwards investment to the UK. The "reform" element of the package will also encourage employment, by removing distortions against employment compared with certain kinds of investment, and by improving the rate of return on the UK capital stock.

33. The main elements of the company tax package were:

(a) a phased reduction in the main rate of corporation tax from 52 per cent to 35 per cent by 1986-87;

(b) phased withdrawal of first year and initial allowances for plant and machinery and industrial buildings respectively but retention of annual writing down allowances;

(c) abolition of the National Insurance Surcharge;

(d) abolition of stock relief.

Reduction in Burden

34. The total effect of the above package is to reduce taxes on business by about £2 billion in 1984-85 and 1985-86. In 1985-86 the changes to corporation tax, capital allowances and stock relief will produce a net reduction in the tax bills of companies of £450m. The final abolition of NIS is worth another £925m and this is a continuing benefit to industry. [Abolition saves companies £3 billion per year compared with the peak rate of 3½ per cent.]

Company Taxation: International Comparisons

35. As a result of these changes the UK rate of corporation tax will be well below existing levels of corporation tax in our major competitors as the table below demonstrates. In the longer-term this will bring substantial and lasting benefits to companies and increase employment prospects.

Table 6 Comparitive Corporation Tax Rates

UK	Ireland	France	West Germany	Neths	USA	Japan
35	50 (a)	50 (b)	64.5 (c)	40 (d)(f)	46 (f)	54 (e)

Notes

(a) 10 per cent rate for manufacturing

(b) for industrial firms less than 5 years old, profits exempt for tax for first three years and reduced by half before charging to tax in next 2 years.

(c) Includes typical 8½ per cent local profits tax.

(d) Proposed 1985 rate.

(e) Includes typical 12 per cent local profits tax.

(f) These countries have classical, rather than imputation systems. Effective rates about - 10 per cent higher than in the table.

36. The Government has reduced the share of total taxation borne by the non-North Sea company sector since it took office. The table below sets out business taxes as a proportion of total taxation since 1978-79.

Table 7 Business Taxes as % of Total Taxation

	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84	1984-85
North Sea	0.9	3.1	4.5	6.1	6.8	7.1	7.1
non-North Sea	28.4	27.0	25.9	24.9	23.8	23.7	24.9

Notes (1) non-North Sea includes public corporations

(2) Taxes include all identifiable taxation of businesses.

37. The table below sets out business taxes as a proportion of GDP in the biggest five OECD economies.

Table 8 Business Taxes as % of GDP at market prices (1982)

	Taxes on Corporate Income	Employers Social Security Payments	Payroll Taxes	Total
France	2.2	12.6	1.0	15.8
Germany	1.9	7.3	-	9.2
Japan	5.4	4.2	-	9.6
USA	2.1	4.9	-	7.0
UK	3.8	3.6	1.3*	8.7

* NIS - since abolished

Source: OECD.

38. Even in 1982 the UK imposed a relatively low tax burden on business by international standards. Abolition of NIS subsequently made an important contribution towards reducing the burden still further. In paticular, the UK raises the lowest contribution from employer social security payments as a share of total taxation and of GDP in the Big Five OECD economies. Thus, it is relatively cheap for employers to take on labour in the UK.

Structural Reform

39. The 1984 Budget also reformed the structure of corporation tax. For many years the tax regime subsidised heavily certain types of investment and ways of financing it. At the same time it discriminated against other types of business expenditure, including the employment of labour.

40. The effect of this year's changes has been to reduce the distortions caused by the tax system. Under the old system it sometimes paid businesses to go ahead with investment projects which were intrinsically unprofitable. As a result the average (pre-tax) rate of return from investment projects was held down, and some projects with a higher pre-tax return never went ahead because of their less favourable tax treatment. The effect of the reform will be to encourage the more profitable and successful projects, raise the average rate of return on investment, and avoid the waste of resources on unprofitable ventures.

41. A better distribution of the capital stock between projects will be matched by an improved allocation of business expenditure between investment in capital and investment in jobs. The previous tax system simultaneously subsidised investment by companies by companies but penalised employment through the National Insurance

Surcharge. Its removal saved business £3 billion per year compared with its costs at its peak rate of 3½ per cent and provided an immediate cashflow benefit to business and reduced the bias against employing labour. Furthermore the switch in emphasis towards profitable investment projects will mean a sounder base for new and lasting jobs.

42. Concern has been expressed that the changes will adversely affect cash flows in later years as past tax losses are run off and that investment will be discouraged. Clearly the effects will vary between different firms; some will lose and others gain. While the cost of capital will rise at the margin because of the reduction in allowances, the new arrangements will still represent a generous average rate of depreciation taking the full spread of a typical business's capital stock, comparing well with rates in other countries. Some highly profitable projects will do better under the new system because of the reduction in the rate of corporation tax. When all the transitional effects have worked through, the lower marginal tax rates will encourage higher quality investment with a higher pre-tax rate of return. This will also result in higher after-tax profitability which in turn will leave room for additional expenditure on employment and innovatory expenditure eg product development.

Taxation of Savings Instruments

43. Finally, the tax treatment of some savings instruments has been reformed. The strategy here has been to reduce tax generated distortions, which encourage savers to direct their money towards institutions rather than undertake direct investments, and towards some institutions rather than others.

44. The 1984 Budget:

(a) Withdrew Life Assurance Premium Relief for new policies.

(b) Abolished the Investment Income Surcharge, which removed a disincentive against direct savings and investment, in particular for equities.

(c) Announced the introduction of a composite rate for bank interest, to parallel that for building societies.

(d) Halved stamp duty on stock exchange transactions to 1 per cent. This should encourage a more efficient capital market.

(e) Exempted the holding of certain company bonds from capital gains tax, bringing their treatment into line with that for comparable Government Securities.

45. As a result market forces will be more important in determining where investors put their money and the tax system less so. The financial sector will be more efficient and better able to market its services overseas.

C THE FUTURE

46. The Government attaches great importance to reducing the burden of tax in a way consistent with the Government's overall macro-economic objectives. In the initial years of the Government priority had to be given to reducing the PSBR as a proportion of GDP to restore financial stability to the economy. Now that the PSBR has been reduced to more manageable levels and inflation is under control there should be scope for tax reductions. The 1984 FSBR, and the Autumn Statement, have set out the scope for future reductions. Their achievement depends upon reasonable economic growth and keeping public expenditure under control. The Green Paper on Long-Term Public Expenditure discussed the pressures for additional spending. If these are resisted there should be room for a gradual reduction in the overall tax burden and the prospect of eventually getting back to the more reasonable levels of tax that prevailed in the mid-1960s.

47. The Government's second aim is to reform the tax system to help markets to work more effectively and allocate resources in the most efficient manner.

48. The last Budget involved a major overhaul of the company tax system with a substantial reduction in the amount of tax paid by the business sector and the introduction of a rate of corporation tax that will be amongst the lowest in the developed world. The taxation of certain savings instruments was also reformed.

49. A course has been set in the company tax field and no further major structural changes are contemplated in the lifetime of this Parliament. A priority in the area of personal taxation will be to raise the real value of allowances. This has the advantage of concentrating the greatest relative benefits on people with lower earnings whilst also helping to alleviate the poverty and unemployment traps.

50. There is no doubt that the level of taxation in this country is too high and that its incidence needs further reform. Reducing the level and reforming the structure are costly in revenue terms. So it is imperative that we devote the additional revenues generated from a growing economy to these ends, and not to financing a rising volume of public expenditure. For this reason, the Government attaches the utmost importance to holding public expenditure to current plans.

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File

National Economic Development Council

NEDC(84)
7th Meeting

MEETING to be held at the
National Economic Development Office on
Wednesday, 5 December at 10.00 am
(Luncheon will be available in the Office)

A G E N D A

1. FUTURE WORKING METHODS OF THE NEDC

   Paper submitted jointly by the TUC and CBI
   (NEDC(84)51, circulated herewith)

2. SECTORAL REPORT: ELECTRONIC COMPONENTS

   Report by Mr E A Hammond, OBE, Chairman of the Electronic Components Economic Development Committee
   (NEDC(84)53, circulated herewith)

3. THE CHANCELLOR OF THE EXCHEQUER'S AUTUMN STATEMENT

   (NEDC(84)52, circulated herewith to non-government Council Members and principal advisers only)

4. TAX POLICY AND THE JOBS EXERCISE
   Memorandum by the Chancellor of the Exchequer
   (NEDC(84)54, circulated herewith)

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5. *EFFECTS OF NEW TECHNOLOGY UPON EMPLOYMENT

   Paper by the Department of Employment
   (NEDC(84)46, circulated on 6 August 1984)

   * This item is put forward for noting and release without discussion.

6. ANY OTHER BUSINESS

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

20 November 1984

Restricted

National Economic Development Council

NEDC(84)51
19 November 1984

FUTURE WORKING METHODS OF NEDC: TUC/CBI PAPER

Note by the Director General

I circulate herewith, as agreed, the paper on this subject submitted jointly by the TUC and CBI for the meeting of the Council on 5th December.

National Economic Development Office
Millbank Tower
Millbank
London
SW1P 4QX

FUTURE WORKING METHODS OF NEDC

Joint paper by TUC/CBI

The TUC and CBI have agreed that reform of the working methods of NEDC along the lines set out below will reinvigorate the Council and its programme of work, making it a more effective instrument to promote national economic growth.

1. Need to improve connection between Council agendas and TUC and CBI work; where an issue is given priority by the two organisations, the Council agenda should reflect it.

2. TUC and CBI to increase their contribution of papers to the Council.

3. Arrangements for compiling the agenda including the role of the Group of Four and the Co-ordinating Committee to be reviewed.

4. Where there is a clear annual timetable for Government decision-making (eg on PESC, Budget) there should be a clear "slot" allocated for NEDC discussion well in advance of the Government decision. This should fit within a pattern of quarterly discussions on economic strategy, as opposed to irregular ad hoc exchanges with inadequate preparation.

5. Need for sharper focus on promoting conditions favourable to faster economic growth - this will centre on the "new jobs" exercise, capital investment, infrastructure and other major factors in Britain's economic development.

6. All major economic questions should be open for prior Council discussion and influence (example - timely discussion on regional policy was helpful to all sides).

7. Discussion should be permitted at short notice (48 hours) on items of topical interest within the remit of the Council.

8. Council papers should be shorter, more precise, carefully and crisply drafted, including "action" points.

9. Papers must be submitted to the Council on time.

10. Follow up required from Council should be clearly specified.

11. Where follow up is not achieved (after monitoring) a report should be made and explanation given.

12. By use of Sub-Groups, involving members and senior officials, carry out thorough preparatory work, to make Council discussion more effective.

13. Council meetings could then be bi-monthly for Council but holding other dates in diary. One possibility would be Plenary sessions with meetings of the smaller groups on other available dates.

14. Consideration could also be given to the number of officials attending each type of meeting.

15. In this context the role of Ministers arises. Their use of substitutes has become too frequent.

16. Revitalise and relaunch "Action at Company and Plant Level" to improve links between Council and EDCs, EDCs and their sectors and companies, and in the regions.

17. Keep coverage and scope of sectoral committees under review, and ensure a proper valuation is placed on their work.

18. The number of copies of Council papers prior to discussion should be strictly limited. All parties should honour the understanding that no briefings or comment be given to the media prior to Council discussion.

19. Following the Council meeting all parties should be free to comment if they so choose.

20. The Council should consider an external review of the public presentation of the NEDC and EDC work.

27 September 1984

NEDC file

No. 3 TIM RENTON ON NEDC

SUPPLEMENTARY

"WOULD MY RHF REMIND THE TUC OF CLEM ATLEE'S ADVICE - NEVER WALK OUT BECAUSE YOU WILL HAVE TO WALK BACK. BUT WILL SHE MAKE USE OF THE INTERVAL TO SEE IF THE WORK OF NEDC CAN BE MADE MORE PRODUCTIVE BY STUDYING THOSE INDUSTRIES AND SERVICES IN WHICH BRITAIN CAN BE PRE-EMINENT IN THE 1990S AND HOW THIS CAN BEST BE ACHIEVED."

ANSWER

I very much endorse the views of my hon Friend. It is extremely sad that the TUC have walked out on the major exercise which NEDC is conducting into the industries of the 1990's - the exercise which the TUC themselves initially took up with great enthusiasm.

MASTER

National Economic Development Council

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NEDC(84) 4th Meeting

MINUTES of a Meeting at the NATIONAL ECONOMIC DEVELOPMENT OFFICE
Millbank Tower, Millbank, London SW1, on Wednesday, 4 April 1984

PRESENT:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
(in the Chair)

Sir Donald Barron	Sir Terence Beckett CBE
Mr J S Cassels CB	Sir Campbell Fraser
Sir George Jefferson CBE	The Rt Hon Sir Keith Joseph Bt, MP Secretary of State for Education and Science
The Rt Hon Tom King MP Secretary of State for Employment	Dr J S McFarlane
Sir Walter Marshall CBE FRS	Mr J J R Pope
The Rt Hon Norman Tebbit MP Secretary of State for Trade and Industry	Mrs R E Waterhouse CBE

The following were also present:

The Rt Hon Alick Buchanan-Smith MP, Minister of State for Energy

The Hon William Waldegrave MP, Parliamentary Under Secretary of State for Employment

Mr N J Atkinson Manpower Services Commission	Mr U J Baker Department of Trade and Industry
Mr J Ball Department of Employment	Mrs P Birdseye Confederation of British Industry
Sir Terence Burns HM Treasury	Mr J Caines Department of Trade and Industry

Miss R Crockett
Confederation of British Industry

Mr L Dicks-Mireaux
Bank of England

Mr C J Farrow
Bank of England

Mr M T Folger
HM Treasury

Mr M A Hall
HM Treasury

Mr J R S Homan
National Economic Development Office

Mrs Z Hornstein
Department of Employment

Mr B S Kalen
HM Treasury

Mr A Kilpatrick
National Economic Development Office
(for item 2)

Mr P Landymore
National Economic Development Office
(for item 2)

Mr C Leach
National Economic Development Office

Dr M A Loudon
Nationalised Industries' Chairmen's Group

Mr K McDowell
Confederation of British Industry

Mr P McGregor
National Economic Development Office

Mr N J Monck
HM Treasury

Dr D Morris
National Economic Development Office

Miss M O'Mara
HM Treasury

Mr E Pash
Department of Energy

Mr T Rickett
National Economic Development Office

Mr S Ryder-Smith
National Economic Development Office
(for item 3)

Mr T Sparrow
National Economic Development Office

Mr I Urquhart
Department of the Environment

Mr A Whiting
Department of Trade and Industry

Secretariat:

Mr P V Dixon

Mr D A Truman

1. INTRODUCTION

The CHANCELLOR OF THE EXCHEQUER said that apologies for absence had been received from the Secretary of State for the Environment, who would be represented by the Parliamentary Under Secretary of State for the Environment; the Secretary of State for Energy would be represented by the Minister of State for Energy. Apologies had also been received from the Governor of the Bank of England, from Dr Main and from Mr Young.

2. ECONOMIC STRATEGY AND THE 1984 BUDGET

The CHANCELLOR OF THE EXCHEQUER made a slide presentation (full text circulated at the meeting and copies of slides to be made available). He said that inflation, after its sharp fall between 1980 and 1983, was expected to continue at a low level. Output, especially of oil and the service industries, had been increasing since mid-1981 and was forecast to rise by 3 per cent in 1984 and at a rate of 2½ per cent into 1985. As inflation and cost performance improved, there would be room for more output within a decelerating growth of nominal GDP. Although unemployment was still rising, there had been a heartening turnround in employment; the prospect could be improved by lower pay rises, as in competitor countries. The Medium Term Financial Strategy continued the downward path for both monetary growth and the PSBR; this was aimed at reducing inflation and interest rates. If public expenditure were held steady in real terms, as assumed in the Green Paper, both the PSBR and non-North Sea taxes should be able to be reduced as a proportion of GDP. The projections were consistent with the achievement of stable prices.

Turning to the Budget itself, the CHANCELLOR picked out four changes as improving the business environment: abolition of the National Insurance Surcharge (NIS); the reforms in Corporation Tax (CT); the arrangements for share options to reward enterprise; the measures to assist company finance, such as the reduction in Stamp Duty on equities and exemption of corporate bonds from Capital Gains Tax. Concentrating on the CT package, he said that the old system was inconsistent in its treatment of different assets, of debt as compared to equity, and of capital as compared with labour; as a result, investment in the UK was of low quality and profitability by comparison with that in other countries. The reforms would improve the profitability after tax of projects with a high pre-tax rate of return and, taken together with the abolition of NIS, the bias against jobs would be reduced. The treatment of investment by the tax system would remain comparable with that overseas, while the taxation of profits would be less; this should leave room for higher current expenditure on innovation.

SIR CAMPBELL FRASER welcomed this placing of the Budget in a longer context, the emphasis on competitiveness and the need for profits. He was grateful for the abolition of NIS; but it was necessary to ensure that wage settlements, public and private, were decently restrained; he was concerned that the projections might not be achieved if current trends continued.

The PSBR was lower than that advocated by the CBI, but higher growth would give room for manoeuvre. He welcomed the change in CT, though he hoped the period over which the allowances were to be phased out might be reconsidered. Bringing forward payments of VAT on imports would help some firms and make things more difficult for others; he wondered if an exception could be made for raw materials. The CBI were working on a strategy for the improvement of competitiveness and profitability over the medium term - this would involve the tax system and public expenditure; more would have to be spent on the infrastructure.

MR POPE favoured the changes in CT. He accepted also the changes in the Business Expansion Scheme; too much had been siphoned off into agriculture, which was not what was intended; there remained mechanical difficulties which could be eased by permitting investment through Small Firms Investment Companies and which he wished to discuss with the Secretary of State for Trade and Industry.

SIR GEORGE JEFFERSON thought that the combined effect of the CT changes would be adverse in the short term and might put pressure on prices; apart from that, he welcomed the Budget.

DR McFARLANE suggested a longer bridge between the old and the new systems for CT and a straight line basis, rather than declining balance, for the new allowances. Unless inflation came down to 2½ per cent or less, the loss of stock relief and of the allowances would outweigh the benefit of the lower rate of tax. One should be aware of the effects of the changes on important industries with low rates of return.

SIR TERENCE BECKETT commented that unit labour costs were a better indicator than wage costs. This was where things were going wrong, and he had written to the chief executives of companies about it. Regarding the aim of keeping public expenditure constant, he thought that it would be wise to carry out a sensitivity analysis on the implications of some of the aims not being achieved and what would have to be done to safeguard the overall position; this would be useful in public debate. If the aims were achieved, and growth took place, Government should consider using the extra room for measures to reform personal tax to provide more incentives as well as to relieve the poverty trap. More needed to be spent on infrastructure, particularly to link British industry with its European markets. The CBI had in mind the need for further study of possible future shifts from direct to indirect taxation.

SIR DONALD BARRON welcomed the general thrust of the Budget; it was right to discard the assumption that capital expenditure was all that was needed; but it had yet to be proved that the changes would be enough to stimulate adequate marketing, research and product development. A particular worry for the banks was whether the investment stimulated by the prospect of the allowances disappearing would coincide with a period when the tax changes reduced the resources available to companies.

MRS WATERHOUSE welcomed the changes in Stamp Duty and the Investment Income Surcharge, but would have preferred the removal of the "composite rate" arrangements from the building societies rather than their extension to the banks - non-tax-payers subsidised tax-payers as a result. She had some concern about the effect of the change in VAT on contruction work already in the pipeline; and about the effect of the abolition of life assurance relief.

The DIRECTOR GENERAL said that it was gratifying that the proposal of the Knitting EDC relating to VAT on imports had been accepted and concurred with the CBI that the treatment of raw materials might be studied further. He was also glad that proposals from several EDCs for grants to help particular types of investment had been reflected in the announcement by the Secretary of State for Trade and Industry during the Budget debate. He supported the change in the balance of the tax system, which would put current expenditure on innovation on a level with capital investment; but how it would work in practice would need to be watched. He raised a question about the possibility of any dent in unemployment, and especially long-term unemployment, given the prospective increase of over 450,000 in the labour force between 1984 and 1989 and productivity probably not growing significantly less than the 2¼ per cent assumed for the growth in the economy. The Green Paper was more interesting than the Press had implied; it was reassuring that oil and gas would still be contributing £5½ billion in tax in 1993-94; but the projections implied that the trade surplus in oil would disappear about the end of the present decade. The Green Paper rightly drew attention to the "poverty trap" and "unemployment trap"; if downward flexibility in wages were seen as a means of reducing unemployment, this might make the unemployment trap worse; larger Child Benefits financed out of the married man's tax allowance, as suggested by the Financial Times, might be a way out. On public expenditure, there remained the question of principle as to how to deal with services for which one would expect there to be growing demand if they happened to be those (such as health) for which the public sector was responsible; a greater degree of private financing was referred to as a possibility in the Green Paper and this should be considered for infrastructure also.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY said it was a radical and reforming Budget which had been successful because the Chancellor had been forthcoming in consultation with his colleagues and had thus been able to deal in advance with problems which would otherwise have occurred.

The MINISTER OF STATE FOR ENERGY said that for the second year running the Budget had been an encouraging one for the offshore oil industry and more might be done in future to stimulate incremental production; there was a need to ensure that our supplying industries responded to the opportunities.

The SECRETARY OF STATE FOR EDUCATION expressed interest in whether, on the basis of other countries' experience, it was possible to construct a relationship between low unit labour costs and more jobs. SIR DONALD BARRON mentioned the influence of volume on labour costs. SIR TERENCE BECKETT said that one needed to look especially at three components: pay settlements, earnings and productivity; taking all factors into account, our competitiveness had worsened by 6 per cent in the last year by comparison with the rest of OECD; only half of the earnings "drift" represented overtime, the remainder being bonuses, upgrading and incremental systems which were a product of past incomes policies.

SIR WALTER MARSHALL welcomed the change of emphasis relating to investment. All a Government could do was to set the climate and it had now done so in two important ways. The main reason why companies had not given attention to innovation in the past was because they had been absorbed in industrial relations problems, but that element in the climate had been changed drastically during the Government's previous term. The other preoccupation at board level was how to minimise taxation, but the effect of this Budget was to turn the attention of management to its real business. Beside these two simple points, the detail was unimportant.

The CHANCELLOR OF THE EXCHEQUER, responding to the discussion, said that the projection of public expenditure in real terms in the Green Paper was ambitious but realistic. The possibility of higher productivity growth than he had assumed need not be bad news for unemployment if it meant that output also was higher. He agreed that the CBI had been right to point to the damage done by previous incomes policies. It was difficult to isolate any single factor as influencing employment but the difference between the United States and the UK as regards the pattern of earnings and job creation, discussed in his paper on "jobs" for the Council meeting in December, pointed a clear moral which the complications did not vitiate. The possibility of exempting imports of raw materials from the earlier payment of VAT had been studied and was illegal under Community law. On infrastructure there would doubtless be further discussions, but about £5 billion of current expenditure was going on repairs and maintenance which might be more cost-effective than new construction. The length of time over which the CT allowances were phased out was a matter of judgement; if it were longer, it would take longer also to get the rate down to 35 per cent. Although the changes were neutral in overall effect during the change-over period as a whole, they were favourable to industry in the longer run, since the allowances affected timing whereas the reduction in the rate (and also the abolition of NIS) had continuing effects. He agreed with Sir Terence Beckett that one should not at this stage pre-judge the pattern of future tax reduction; an assumption had been used in the Green Paper only for illustration. In response to a suggestion from SIR CAMPBELL FRASER that the presence of the TUC would have introduced more balance if less unanimity into the discussion, the CHANCELLOR agreed that the Council regretted their absence, although it had not prevented a worthwhile discussion.

The COUNCIL:

(i) Took note of NEDC(84)28, covering the Financial Statement and Budget Report 1984-85 ("Red Book"); and the Green Paper (CMND 9189) on Public Expenditure and Taxation into the 1990s;

(ii) requested that copies of the slides shown should be circulated.

3. THE UK LABOUR MARKET

THE SECRETARY OF STATE FOR EMPLOYMENT, introducing NEDC(84)29, noted that the labour force had grown by over 1 million in each of the last two decades and that the same was to be expected in the eighties. The increase in the female activity rates might be a factor in the growth of jobs, many of which were part-time, without apparent effect on unemployment. Hours worked during a lifetime had declined and the proportion of employment in smaller firms was increasing although this trend might not be significant. He hoped this background paper would be useful in the context of the jobs exercise.

SIR TERENCE BECKETT expressed concern about the widespread assumption that the working week would be reduced, particularly when the assumption did not involve a corresponding reduction in pay. We should not think of a general trend but of the emergence of kaleidoscopic changes in patterns of work. SIR WALTER MARSHALL asked for clarification whether the paper referred to reduction in the number of hours actually worked or in the nominal working week; pressure for a shorter week reflected wishes to reclassify work as overtime. The SECRETARY OF STATE FOR EMPLOYMENT said that the paper referred to hours worked in a lifetime.

The PARLIAMENTARY UNDER SECRETARY OF STATE FOR THE ENVIRONMENT said that the overall figure for service employment included that for local authorities; if employment there were to decline it should not affect views about the prospects for employment elsewhere in the services sector.

MR POPE thought that the comments on the size of employing firms would benefit from further research, particularly since the Director General's paper (NEDC(84)27) showed large reductions in employment in some of the biggest industries. He hoped to bring a paper to the Council about the role of small firms in employment, but they were not the only source of jobs; was the increasing proportion of employment in small firms reflecting the demise of large ones or was it new growth?

MRS WATERHOUSE noted that the rise in female activity had flattened out possibly because females gave up more readily in a period of recession, the "discouraged worker effect". But women might not wish to go back to their traditional caring role; she believed that the Beveridge concept of men as the breadwinners had changed and we now had a structure which involved two people in work. SIR DONALD BARRON suggested, instead, that there was research evidence that relatively small payments might persuade many women to stay at home. The SECRETARY OF STATE FOR EMPLOYMENT said that in Europe measures were needed to tackle female unemployment, which was a less serious problem in the United Kingdom. The SECRETARY OF STATE FOR TRADE AND INDUSTRY thought that, in the United Kingdom, the wages of industrial workers were too low, because of abysmal productivity, to provide a decent standard of living and women worked to raise family incomes to an acceptable level. SIR TERENCE BECKETT thought that women provided a more tractable labour force and were therefore in demand by employers.

The DIRECTOR GENERAL said that the increasing proportion of part-time jobs for women in the services sector was not a substitute for full-time jobs. American experience suggested that a high proportion of extra jobs in the service sector would be in public services, education and health. In the UK, service sector jobs tended to be concentrated in the South-east where unemployment was already lower than elsewhere. Warwick University believed that we would need 82,000 more engineers and scientists by the end of the decade and even more technicians, while semi-skilled and unskilled jobs would decline by nearly a million. The need for education and training continued to increase. In the United States, Germany and Japan, unemployment among 16 and 17 year olds was less common than in Britain because such people were in full-time education or training. Despite 290,000 young people in the YTS, there were still 200,000 unemployed 16 and 17 year olds; it would be better if they were taken out of the regular work force to acquire skills and competence for the future. We should not be complacent about overtime, which had remained at about 8½ hours per week for each operative working overtime in manufacturing, and was equivalent in the case of all men manual workers to about half a million full-time jobs; often this was inflexible and a source of inefficiency; other countries managed with much less.

The CHANCELLOR OF THE EXCHEQUER commented that these last remarks reinforced Sir Terence Beckett's point that cuts in working hours should not be allowed to increase costs. There had been a useful discussion.

The COUNCIL:

(iii) noted NEDC(84)29.

4. REVIEW OF THE SECTOR ASSESSMENTS

The DIRECTOR GENERAL said that NEDC(84)27 rounded off the 1982 exercise in which the sector committees assessed the prospects for their industries to the end of the decade. Most of the reports had been published and accepted as authoritative. They had given impetus to the work of the EDCs and the Council might wish to pass on to them its appreciation. The paper analysed the competitive performance of 30 of the EDC sectors together with some others. The charts, indicating change, not the absolute position of sectors, showed how these had fared in home markets and in international trade over the period 1975 to 1981/2. They revealed declining competitiveness, reflected also in the move of the balance of trade in manufactures into deficit in 1983. Some industries with advanced technological content had done well but others, including electronic consumer goods and information technology, were among the weakest sectors; although the UK electronics industry was expanding by around 6 per cent a year in real terms, this was only half the world-wide rate. More work needed to be done to follow up the assessments before there was thought of repeating the exercise.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY agreed that the Office was to be congratulated on bringing to conclusion a difficult piece of work which was helpful in structuring the work programme of EDCs and in examining some common problems. The emphasis on improving efficiency and technological change was reflected in his aims for his own Department. There was an interesting list of initiatives to which might be added quality and design. He noted the wide range of success, with some companies in poor sectors doing well while there were laggards in good sectors; the aim should be to raise the general level to that of the best. The momentum needed to be maintained and the discussion taken to the company and plant level; some of the work was also relevant to the Council's exercise on jobs. It might be possible to repeat the exercise in due course, but it would not be a good use of resources to do so in the near future.

SIR TERENCE BECKETT expressed concern about the picture shown by the charts. Most of the EDCs covered older industries and their findings might be unrepresentative of Great Britain as a whole. The high-volume, low-cost industries had performed badly; one had to think of the implications of their decline - high quality boutiques could not substitute for them. Perhaps it was that the British were not adept at large-scale activities. The Budget and changes in regional policy might make the climate more difficult for capital-intensive industry. In response to a question from the Chancellor, he suggested that the paper might be confined to internal use.

In further discussion, other points about the charts included the following:

(a) Firms and industries which continued to lose market share would eventually become endangered even if they managed to to be profitable in the interim.

(b) The lower right hand quadrant, which showed industries subject to increasing international specialisation, was not necessarily an indicator of danger.

(c) The great increase in oil, both as an import substitute and as an export, even though some of the counterpart was to be seen in the capital account, made it inevitable that other industries would perform relatively poorly for a time.

(d) Declines in export market shares simply meant that the UK economy was growing less quickly than world trade, which had been the case for a long time.

(e) Since the period covered was 1975-82, the lessons to be drawn were not necessarily current ones.

MRS WATERHOUSE referred to the work of the Distributive Trades EDC and the tendency, mentioned in the paper, for the margins of suppliers to be squeezed by the actions of distributors; this was the opposite of what was apparently intended and should be further examined.

The CHANCELLOR OF THE EXCHEQUER, summing up, said that the paper and discussion were a useful conclusion to the exercise on Sector Assessments. The EDCs had done good work, which still needed to be followed up before a further exercise was initiated. Publication of the paper should be considered when it had been revised in the light of points made in the discussion. It should be brought back to the Council, though it might not be necessary to discuss it again.

The COUNCIL:

(iv) Took note of the summing up by the Chancellor of the Exchequer;

(v) invited the Director General to revise NEDC(84)27 in the light of the discussion and re-submit it to the Council.

5. RELEASE OF DOCUMENTS

It was agreed that NEDC(84)29 could be released.

6. CORRIGENDUM

Minutes of MARCH Meeting: page 1, item 2, paragraph 1, line 11. This should read : ".......from about 10,000 to between 14,000 and 16,000......"

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

10 April 1984

MASTER

Private and confidential

File

National Economic Development Council

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NEDC(84) 3rd Meeting

MINUTES of a Meeting at the NATIONAL ECONOMIC DEVELOPMENT OFFICE
Millbank Tower, Millbank, London SW1, on Wednesday, 7 March 1984

Present:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
(in the Chair)

Sir Terence Beckett CBE

Sir Campbell Fraser

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment

The Rt Hon Tom King MP
Secretary of State for Employment

Dr J S McFarlane

Sir Walter Marshall

The Rt Hon Norman Tebbit MP
Secretary of State for Trade and Industry

Mr D Young

Mr J S Cassels CB

Sir George Jefferson CBE

The Rt Hon Sir Keith Joseph, Bt, MP
Secretary of State for Education and Science

Mr R Leigh-Pemberton

Dr P T Main ERD

Mr J J R Pope

Mrs R E Waterhouse CBE

The following were also present:

The Rt Hon Alick Buchanan-Smith MP, Minister of State for Energy

Mr Stuart Hollander, Chairman of the Cotton and Allied Textiles Economic Development Committee

Mr D B Andren
HM Treasury

Mr M Brech
National Economic Development Office
(for item 4)

Mr B Armstrong
Department of Trade and Industry

Mr V Brown
Department of Trade and Industry

Private and confidential

Mr J Caines
Department of Trade and Industry

Mr M Cannell
National Economic Development Office
(for item 2)

Miss R Crockett
Confederation of British Industry

Mr L Dicks-Mireaux
Bank of England

Mr C J Farrow
Bank of England

Mr M J Faulkner
HM Treasury

Mr A G R Gater
National Economic Development Office
(for item 2)

Mr M A Hall
HM Treasury

Mr J R S Homan
National Economic Development Office

Mrs Z Hornstein
Department of Employment

Mr A Johnson
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Mr B Kalen
HM Treasury

Mr P Landymore
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Mr C Leach
National Economic Development Office

Mr K McDowell
Confederation of British Industry

Sir Donald MacDougall CBE
Confederation of British Industry

Mr P McGregor
National Economic Development Office

Mr N J Monck
HM Treasury

Dr D Morris
National Economic Development Office

Miss M O'Mara
HM Treasury

Mr G Reid
Manpower Services Commission

Mr T Rickett
National Economic Development Office

Mr M Roberts
Confederation of British Industry

Mr T Sparrow
National Economic Development Office

Mr J Stevens
National Economic Development Office

Mr R Trotman
Nationalised Industries' Chairmen's Group

Mr I Urquhart
Department of the Environment

Mr J R Wakely
Department of Energy

Mr R Walker
Department of Education and Science

Mr E Wright
Department of Trade and Industry

Secretariat:

Mr P V Dixon

Mr D A Truman

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1. INTRODUCTION

The CHANCELLOR OF THE EXCHEQUER paid a tribute to Sir Donald MacDougall, the first Economic Director of the NEDO, who was present at a meeting of the Council for the last time. He said that apologies for absence had been received from the Secretary of State for Energy, who would be represented by the Minister of State, and from Sir Donald Barron. Members of the Council would also be aware that representatives of the TUC had withdrawn from attendance for the time being; the TUC's decision did not apply to the EDCs. He regretted the TUC's absence, but thought the right thing was to go ahead with Council business as usual, since there was much work to do. He hoped that all present would agree.

The DIRECTOR GENERAL also regretted the absence of the TUC. The NEDC existed to promote dialogue between Government, employers and trades unions, and it was part of its strength that this role was not affected by changes in the balance of power at Westminster. When the dialogue worked well, it influenced prosperity and jobs for the better so that, when it broke down, all were losers. Continued absence would put at risk the whole of the 'Neddy' operation, and he hoped the TUC would make a speedy return.

2. HIGHER EDUCATION AND THE NEEDS OF THE ECONOMY

The SECRETARY OF STATE FOR EDUCATION AND SCIENCE, introducing NEDC(84)19, said that, although Governments were not qualified for manpower planning, he was forced into it because the University Grants Committee and the National Advisory Body for Local Authority Higher Education (NAB), in deciding numbers of places, were doing so at taxpayers' expense. Students also were supported by the taxpayer, thus blunting approaches based on the market. Nevertheless, the trends were modestly healthy, with larger numbers of students interesting themelves in engineering and related subjects. He had given guidance to the UGC and the NAB involving a 2 per cent switch of places (and a bigger switch of finance). This should increase the throughput of engineers from about 10,000 to between 15,000 and 16,000 by the end of the decade; the division between types of technology might still not match the needs of the market; as to whether the scale was sufficient, opinions were still divided and consultation, including with the Engineering Council, was continuing. There were many difficulties in producing such a programme: employers were not good at signalling their needs in advance; pay levels might not seem attractive; and lead times were long.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY, referring to NEDC(84)17, stressed the need not only for vocational skills, but also for technically literate managers. But the signals from the market were out of phase with the underlying needs; better links were needed, and industry should take the initiative in offering careers which were more attractive than those derived from the redistributive activities of Government. Sponsorship at a realistically generous level would be one means of attracting the ablest youngsters into the disciplines which industry and commerce wanted.

MR YOUNG, referring to NEDC(84)25, said that initial education and training should not be too detailed, because the direction of technological development was not known; further courses and conversion training were essential. The Technical and Vocational Educational Initiative (TVEI) was one way of bringing people back into higher education; but there might be a tendency for employers to look for academic success instead of TVEI performance; similarly the universities ought to be prepared to accept qualifications other than O and A levels. The preoccupation with examinations was damaging to education. A particular problem was the shortage of teachers of technology and design.

SIR CAMPBELL FRASER was surprised at the suggestion that the market did not work - as it seemed to for more glamorous professions. He welcomed the thrust of the Secretary of State in favour of technological education, recognising that the views expressed by employers were often conflicting and relating to the short term. A broad base was necessary - specialisms could be acquired later at the postgraduate level and in career progression; in Japan the education of engineers was often highly theoretical, with specialist knowledge being acquired in companies. He supported the Secretary of State's switch and argued for an increased swing from arts to sciences; there was an unforeseen pay-off in advancing the intellectual frontiers. Employers accepted the need for rewards to be sufficient to attract and retain well-trained people. He was surprised at the lack of references to women.

DR McFARLANE also approved the general direction shown by the Secretary of State for Education. The needs could not be quantified precisely and, rather than passing this problem round various authorities, one could override the difficulty by agreeing that a 50 per cent increase in throughput was as much as could reasonably be planned within a three or four year timespan. Engineers had a difficult and challenging discipline in which any mistakes were obvious. Incentives needed to be effective towards the end of schooling - they depended on the facilities available and financial inducement, but jobs could not be guaranteed. He referred to the scheme for national engineering scholarships, which needed freshening up if it still existed.

SIR TERENCE BECKETT thought that signals were coming through more strongly than the market was being given credit for; electronic engineers were an example. But (in answer to the Secretary of State for Trade and Industry) the message was not necessarily getting through to universities. Furthermore, manufacturing had been through a bad patch, and this inevitably was part of the picture in young people's minds. Levels of pay were not sufficient to attract the most able - "express lifts" needed to be visible - but for many the level of pay was already too high. The trained engineer was not always capable of taking on jobs in general management; this led to ossification and fewer engineers on the boards of companies than in the USA, Germany and Japan. One need was to improve the (usually poor) careers advice in schools, which depended partly on the initiative and responsibility of local employers. It was necessary also to remedy the lop-sided culture of engineers, who were numerate but were sometimes unable to argue with accountants or handle customers; a wider spectrum of talent was needed. Although the climate had changed radically for the better already, a change in many of its elements was thus still needed.

The GOVERNOR OF THE BANK OF ENGLAND said that on his visit to Glasgow the previous day it had been impressed on him that there were not enough qualified people to man the new semi-conductor plant which had just been announced. We had failed to give priority to investment in people, rather than in the physical infrastructure. In his view the market signals had worked only too well - the standing of those who led in industry was low, and parents who were engineers recommended their children not to follow them. It would help if the prospects and profitability of industry improved. Technological qualifications were more difficult to acquire than financial ones (requiring higher mathematics and not just the ability to add); engineering was as valuable and mind-stretching an education as the humanities. Degrees or National Certificates were necessary now for operatives as well as managers, and links between industry and universities were important.

DR MAIN thought that the shift in the climate in favour of technology might even be too strong; he suggested also that the technical aspects of engineering training were the important ones and that general managerial and financial skills could be added later.

The SECRETARY OF STATE FOR EMPLOYMENT thought that market signals were flashing strongly and included the number of young millionaires who had started their own electronics businesses. The shortage of electronics specialists was acknowledged in his own practice of issuing work permits freely for overseas recruits. But the need for other sorts of engineer was not equally clear. It was necessary also to change the practices which made it difficult for graduates to move into factory management; this tended still to be reserved for those who had gone through craft apprenticeships for which (more able) graduates would be likely to be ineligible on grounds of age, putting Britain at a competitive disadvantage by comparison with Japan.

SIR WALTER MARSHALL thought that the present direction was right, that the signals were in place and that it was important to persevere. He agreed that society attracted the people with brains into the "glamour professions" and that technological education was pre-empted by physics and chemistry, where Nobel prizes were to be won. Engineering had to be seen in its broadest sense, including activities such as software engineering. The expansion of the universities had been a social disaster, because a pool of people of abilities which were used productively in Europe and Japan had been diverted into social sciences, where their output was negative. He did not agree with Mr Young that the examination system was in a mess and that an alternative would be better. He was sceptical about the pursuit of fundamental science in "stand-alone" institutions, since they always recommended more of it, regardless of the overall needs. By contrast, there needed to be more movement between disciplines. Although the restriction of funds for universities was a blunt instrument, and in the short term resulted in the movement of those whom the universities could least afford to lose, it was one way of bringing about a better balance in the long run. He also drew attention to the value of bringing women into technological careers (including the Royal Navy). There had, however, been progress: one shipyard now employed more graduates than the whole industry had done a decade ago.

The SECRETARY OF STATE FOR THE ENVIRONMENT said that his grandfather had been the first Professor of Engineering at Oxford, and had commented on the hostility to the "rude mechanicals"; that problem had not disappeared. But it needed to be recognised that some areas of engineering, for instance to do with construction, were no longer offering adequate careers because of the drop in work-load.

MRS WATERHOUSE said that career choices were often determined before O level and the educational system needed to be more flexible. The availability of suitable courses (eg a "thick sandwich") influenced decisions, as did the culture which directed women away from line management in manufacturing. She did not agree with Dr Main that management could safely be left to be learned on the job; there were possibilities for combining it with engineering, and we should consider Japanese practice; but there was a regrettable tendency for it to be an option for the least able.

SIR GEORGE JEFFERSON said that it would be wrong to concentrate too much on engineers themselves rather than on making the populace as a whole more conscious of engineering and of how an important part of our economic system worked. This meant starting with schools where the essential components were not just arts and sciences, but also technology. The long-standing shortage of software engineers, despite the high rewards received by some, showed how slowly the system responded to new needs and ways had to be found of increasing the response. Even within engineering, the problem was to persuade people to put specialist knowledge into useful directions, for instance linking design with production engineering; the microchip (requiring many different technologies in its design and production) was an example of how engineering was permeating into other areas and itself being permeated - a broadening of technology was taking place.

The MINISTER OF STATE FOR ENERGY said that, while the market signals might be visible in the high-technology industries, this was not yet sufficiently the case in areas employing basic engineering skills, such as fabrication for the off-shore industry. Secondly, he stressed the need to bring the demand and supply of technologists together, and referred to science parks as a way of doing this by linking companies with universities.

The DIRECTOR GENERAL said that there was an excessive assumption that engineers should be employed in jobs reserved for them. But the trend of the discussion had been different - that engineering was a general education valid for all. He agreed with this approach, the extra expense of which would have to be faced. Secondly, there needed to be greater emphasis on opportunities for further learning during working life; he supported the case for more conversion courses. Third, there was the problem of inadequate provision of training for graduates on entry to industry and for sandwich students; the Engineering Council's proposed solution - Government funding - was not necessarily the right one; it should be possible for employers to organise better support.

The SECRETARY OF STATE FOR EDUCATION AND SCIENCE, replying to points made, said that it had been one of the most constructive and perceptive discussions in the Council; he would study carefully the record of what had been said and follow up the various points.

The CHANCELLOR OF THE EXCHEQUER, in conclusion, said that the discussion had revealed that market signals were still being muffled by cultural ones; progress was, however, being made.

The Council:

(i) took note of NEDC(84)17, NEDC(84)19, and NEDC(84)25.

3. SECTORAL REPORT: COTTON AND ALLIED TEXTILES (NEDC(84)18)

MR HOLLANDER, Chairman of the Cotton and Allied Textiles EDC, giving an illustrated presentation, said that the recession, the high value of sterling and the strategies pursued by some major groups had meant the demise of many firms between 1979 and 1982. The very diverse industry was now recovering, but it was highly capital intensive and employment was unlikely to increase. Basic commodity textiles such as grey unfinished cloth were now mainly sourced in the Far East. The industry now had to make distinctive products and to specialise in particular market areas. Innovative design capability and technological leadership to the best international standards were also needed. Imports from the Far East and Western Europe were increasing, in the latter case mainly as a result of an over-valued pound and the state aids that distorted competition in Europe. The EDC had completed an analysis of the apparel fabric market which showed the industry's need to get closer to its retail customers. A study of the finishing sector had highlighted the complex role of the merchant converter, a barrier between many finishers and the purchaser of finished fabrics which was hard to remove. The EDC had stimulated cooperative activity in exports and investigated public purchasing of cotton textiles. A future report would compare the design approaches of leading European companies with those in the UK; a project had been started to help firms with strategic planning; and the EDC intended to study the structure and prospects of the weaving sector. The EDC believed that they had helped to achieve closer relationships between the industry and its customers and that more retailers and apparel manufacturers now accepted the need for a sound home base for fabric supplies. They were making good progress in developing closer links with the merchant converters. Much effort was devoted to communicating the EDC's work to the industry, helped by an ambassador who had been instrumental in the early development of the Factory Development Committees. They hoped that Government would accept the need for help with new investment and strongly supported the British Textile Confederation's proposals - made 12 months ago - for an interest stabilisation and abatement scheme for approved capital projects. They urged continuance of the MFA and hoped Government would deal promptly with non-MFA disruption and seek improvements in the EEC's ability to respond to such threats. The UK's state aid packages should be structured sectorally more than regionally and should be comparable with others in the EEC. Purchasing by public authorities concentrated too much on achieving the lowest initial price, rather than on long-run value for money; they should adopt the Marks and Spencer philosophy of protecting their UK base while making it competitive with overseas alternatives. In time of national emergency there would need to be access to the whole chain of textile processes; a Government-funded study should evaluate this requirement.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY acknowledged the contribution of the industry to the economy, with (according to his data) output of £950m, exports of £335m and employment 45,000. The industry had been through difficult times, but now had shown some recovery. He welcomed the studies of commercial structures and marketing, but regretted that it was necessary to use public funds to demonstrate that companies needed to look after their customers. The sector was benefiting from the reduction of inflation and interest rates; exchange rates were beyond the control of the Government and one should beware of seeking to reduce them by action which might offset the short-term benefits. As for financial assistance, other sectors had also asked for help, and he would consider these together in the light of constraints on public expenditure. As for the state aids provided by other EEC countries, he understood that the French scheme was not continuing (MR HOLLANDER dissented). He was accustomed to argue forcefully about such schemes with the Commission; but they also wanted an assurance about the policies of the UK; the DTI was currently working on a re-packaging of aid schemes. He agreed that public purchasers should look beyond initial cost in seeking value for money and referred to the guidelines circulated by the Health Service Supply Council. Textiles would be covered by review of policies for national emergencies. Quotas under the MFA could not be exceeded; other quotas were more difficult to enforce. The MFA had been helpful, but no form of protection was without costs.

SIR TERENCE BECKETT said that the EDC was doing a useful job; it would be a pity, with reference to the Chairman's earlier remarks, if this sort of work were lost. The bounce in the pound in 1980/81 had done damage, and there were still problems in relation to Europe. He agreed that the only long-term solution was to make the shift up-market by improving non-price competitiveness. He commended the flexible and admirable approach to employee communications. He sympathised with the Secretary of State and the Chancellor of the Exchequer on the difficulty of acceding to the EDC's proposals for financial assistance; this put the emphasis on the need for investment generally and on current interest rates. Some of the equipment installed in the early 1970s would probably not be replaced, because of its poor financial return.

MR POPE asked whether there was a problem of public sector contracts not being broken down into a size which smaller firms could digest.

Responding, MR HOLLANDER said that there was no problem about access; the problem was the failure to build up relationships. Profitability was still not nearly sufficient to generate the capital-intensive investment needed. The assistance provided to the French industry had continued for several years after the Commission's ruling, and he believed it was still persisting in a "more acceptable" form. Regarding the exchange rate, it was stability rather than a particular level which the EDC thought important.

The CHANCELLOR OF THE EXCHEQUER said that the industry had contracted painfully; but it was now highly competitive and had its future in its own hands. It was easy for it to see only the advantages of a lower exchange rate. The EDC was doing much to help and he asked for the Council's appreciation to be passed on.

The COUNCIL:

(ii) noted NEDC(84)18 and the Chancellor of the Exchequer's summing up.

4. EMPLOYMENT TRENDS IN THE US, EUROPE AND JAPAN (NEDC(84)24)

The SECRETARY OF STATE FOR EMPLOYMENT said that his paper was the first in the programme of work agreed by the Council on where the new jobs would be coming from; it provided factual background for the work on the UK which was to follow.

SIR TERENCE BECKETT said that there were gaps in the paper which he hoped could be filled after discussion at a technical level.

The CHANCELLOR OF THE EXCHEQUER said that time precluded substantive discussion at present; there would be future occasions to discuss underlying issues.

The COUNCIL:

(iii) invited the Secretary of State for Employment to consider comments on NEDC(84)24 to be submitted by the CBI;

(iv) agreed to take up substantive discussion at a later date.

5. TRADE PATTERNS AND INDUSTRIAL CHANGE

The DIRECTOR GENERAL said that NEDC(84)21 described broad patterns in Britain's trade performance, leading into two issues of great importance: innovation, and the consequences of North Sea oil. The background work, referred to as Annexes, had been circulated to advisers. Most sectors of manufacturing had improved their investment record during the 1970s, though during the last three years net investment in manufacturing had been negative. Much recent investment had been directed to cost-cutting rather than to innovation. This might have been essential to survival, but had been at the expense of new products and markets based on new design, advanced technology, and higher value-added. Suggestions for dealing with this problem had been made in the paper on the engineering and components industries considered at the February meeting. We would derive benefit from the North Sea for many years; but, as production declined from its current peak, it would be necessary to return to a surplus in the balance of trade on manufacturing; the gap could not be filled by services alone. As the CBI had pointed out in their paper on non-price competitiveness in January, innovation required investment in product development as well as plant. It might be possible for the Office to produce a "company use of resources" package to help companies to analyse their own situations and get the issues at stake understood by all concerned. Secondly, while noting the trend of DTI support already in favour of innovation, he suggested that it might be reinforced by looking again at the case for increasing private funds available for innovation. He referred again to his suggestion, made earlier, that there might be grants for a period, perhaps three years, to cover say 50 per cent of the cost of employing R&D staff in medium-sized and small firms. The Technical Change Centre had recently pointed out that the improved tax treatment of investment in plant and equipment had shifted the balance away from R&D, and this needed to be restored.

The SECRETARY OF STATE FOR TRADE AND INDUSTRY said that NEDC(84)21 was most interesting and realistically recognised the contribution of services to the economy; the opportunities in all sectors, even those in overall decline; the importance of new technology, even in old industries; and the significance of better working practices and new products and processes. The paper was right to point out that there was no unique relationship between investment and performance, and that it was the quality and use of investment which mattered; it was also right that investment in hardware could be less important than that in the various aspects of non-price competitiveness. He welcomed the apparent endorsement of a non-sectoral approach, but he believed that grants for R&D staff were unlikely to be as cost-effective as broader support for innovation generally. Caution was also necessary about providing advice to companies on how to manage themselves better.

SIR CAMPBELL FRASER said the paper matched closely the views of the CBI. It rightly referred to the association between manufacturing and services, and stressed the importance of innovation. But the fit between innovation and performance was not perfect and the case for Government assistance was greater when the activity was further away from the market. The responsibility should be with companies, and he did not think that the Government should pick out R&D for new types of support to the exclusion of other essential elements.

MR POPE said that small companies had difficulty with innovation, because banks might call in loans just when benefits were beginning. He thought the DTI's advisory services ought to be developed - small firms would be willing to pay a fair share for what they could not afford individually. Such advice might provide ideas for introducing technology without excessive financial"front-end loading".

DR McFARLANE also noted the investment in cost cutting. We were unlikely to make the transition to services quickly enough and, when people were a fixed cost in the nation, it was wrong to use so much of the oil to buy foreign manufactures which we could make ourselves. He doubted that the problem was a shortage of expenditure on R&D - we were not short of ideas, but lacked the confidence to invest in them. What was necessary was to make investment in output more attractive, as against retention of piles of money. The paper on textiles had referred to the relationship between Marks and Spencer and its suppliers; it was effective because of assurance of demand, which was also why farmers had invested.

SIR WALTER MARSHALL said that it was important that we did not think that manufacturing was finished. He was concerned about the old-fashioned British view of research and development, which was to create a department under a director and hope that this would yield products. It was important that top management looked for innovation and decided what R&D was necessary. The UK was prone to make the mistake of adopting technology-led rather than market-led development.

MR YOUNG said that we must look to the small firms for increased employment; the Enterprise Allowance Scheme was assisting people to start up their own businesses and attracting 1000 applications a week. People were more flexible than was supposed, and there were examples of those who were leaders in high technology even though they had no formal education.

The SECRETARY OF STATE FOR EMPLOYMENT agreed with Sir Walter Marshall on the importance of customer-led research and development. Getting products developed on time was a problem; computer-aided design could help with this, and computer-controlled production could shorten the length of production runs and reduce lead times.

MRS WATERHOUSE wondered whether R&D sufficiently covered design. The reliability of domestic products and of cars had improved; but manufacturers were slow to go for the new designs (and designers) which customers wanted.

The DIRECTOR GENERAL agreed that the whole process of product development and innovation was important, but R&D was a component in it and our private investment in R&D was less than that of our competitors. He took Dr McFarlane's point on the need for confidence to invest; perhaps this was something the CFI might consider. The difficulty was how to generate confidence. Regarding the 'use of resources package', this would reflect good practice coming out of the EDCs which could assist companies in communicating about the issues before them.

The CHANCELLOR OF THE EXCHEQUER thought it unnecessary to argue over innovation versus cost-cutting; both were vital, and he was grateful to the Director General for tabling the paper.

The Council:

(vi) took note of NEDC(84)21.

6. NEDO BUDGET 1984/85: ACTIVITIES, FINANCE AND STAFF (NEDC(84)20)

The Council:

(vii) took note of NEDC(84)20.

7. The Council agreed to the release of NEDC(84)17, 19, and 25; NEDC(84)18; NEDC(84)24; and NEDC(84)21.

National Economic Development Office,
Millbank Tower,
Millbank,
London SW1P 4QX

14 March 1984

10 DOWNING STREET

From the Private Secretary

②

Prime Minister

You may like to know that the Chancellor and the other Ministers who attend NEDC have decided to carry on despite the empty TUC chairs

AT
2/3

Good
MT

Told Treasury of this reaction

AT
5/3

Action

National Economic Development Council

(2)

Prime Minister
To see pages 3 + 4
and Chancellor's summing up
AT 15/12

1

NEDC(83)10th Meeting

MINUTES of a Meeting at the NATIONAL ECONOMIC DEVELOPMENT OFFICE, Millbank Tower, Millbank, London SW1P 4QX
on Wednesday, 7 December 1983, at 10.00 am

Present:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer

Sir Donald Barron

Mr R Bickerstaffe

Mr T Duffy

Sir Campbell Fraser

The Rt Hon Patrick Jenkin MP
Secretary of State for the Environment

The Rt Hon Sir Keith Joseph Bt, MP
Secretary of State for Education and Science

Mr R Leigh-Pemberton

The Rt Hon Lionel Murray OBE

The Rt Hon Peter Walker MP
Secretary of State for Energy

Mr D Young

Sir Terence Beckett CBE

Mr J S Cassels CB

Mr A M Evans

Sir George Jefferson CBE

Mr C Jenkins

The Rt Hon Tom King MP
Secretary of State for Employment

Dr J S McFarlane

Mr J J R Pope

Mrs R E Waterhouse CBE

The following were also present:

Mr Norman Lamont MP, Minister of State for Trade and Industry

Mr Harry Kleeman, Chairman of the Plastics Processing Economic Development Committee

Mr J Anson
HM Treasury

Mr B Barber
Trades Union Congress

Sir Terence Burns
HM Treasury

Mr W Callaghan
Trades Union Congress

Mr A Dawson
Confederation of British Industry

Mr J Driscoll
Nationalised Industries' Chairmen's Group

Mr C J Farrow
Bank of England

Mr I Helps
National Economic Development Office (for item 4)

Mr J R S Homan
National Economic Development Office

Dr M Howe
Department of Trade and Industry

Mr B Kalen
HM Treasury

Mr D Lea OBE
Trades Union Congress

Mr K McDowell
Confederation of British Industry

Mr P E Middleton
HM Treasury

Mr B Naisbitt
National Economic Development Office (for item 2)

Mr S Pride
Department of Trade and Industry

Mr T Rickett
National Economic Development Office

Mr N Attenborough
Department of Trade and Industry

Mr S Beach
National Economic Development Office
(for item 4)

Mr J Caff
Confederation of British Industry

Mr J Chapman
Department of Trade and Industry

Mr L Dicks-Mireaux
Bank of England

Mr C Driver
National Economic Development Office
(for item 2)

Mr M Hall
HM Treasury

Dr D Higham
Confederation of British Industry

Mr A G Johnson
Department of Employment

Mr R Hudson
National Economic Development Office

Mr P Kane
Trades Union Congress

Mr C Leach
National Economic Development Office

Mr P McGregor
National Economic Development Office

Dr D Morris
National Economic Development Office

Miss M O'Mara
HM Treasury

Mr G Reid
Manpower Services Commission

Mr C Smee
HM Treasury

Mr T Sparrow
National Economic Development Office

Mr P Street
Department of Trade and Industry

Mr I Urquhart
Department of the Environment

Mr J R Wakeley
Department of Energy

Mr E Wright
Department of Trade and Industry

Secretariat:

Mr P V Dixon

Mr D A Truman

CONTENTS

1. INTRODUCTION

The CHANCELLOR OF THE EXCHEQUER said that apologies had been received from the Secretary of State for Trade and Industry, who would be represented by the Minister of State; from Mr Basnett and from Mr Utiger.

2. CHANCELLOR OF THE EXCHEQUER'S SPEECH OF 17 NOVEMBER AND AUTUMN STATEMENT (NEDC(83)60)

The CHANCELLOR OF THE EXCHEQUER said that, since the turning point in early 1981, output had grown by 5 per cent, faster than predicted by most forecasts (including the Treasury's), and in 1983 was expected to be 3 per cent higher than in 1982. Inflation at 5 per cent was lower than most had predicted, and the profitability of many companies had improved, admittedly from a very low base. The supply side factors suggested that growth in output could be sustained in 1984. Fears had been expressed that consumer demand might fall back, but overstimulation had been a mistake in past cycles and experience showed that recovery was often led by the consumer. Continuing recovery in the USA and better performance in Europe should assist exports, as should developments in productivity and competitiveness. The Treasury expected higher investment, as did the CBI. A recovery was now beginning in employment, with unemployment levelling off. The Treasury's forecast for 1984, a shade under 3 per cent, was towards the upper end of the narrow range of forecasts reported by the Financial Times, averaging 2.4 per cent. The PSBR in 1983/84 looked like being £2 billion above the forecast in spite of the July measures. On the assumption that the figure of £8 billion projected for 1984/85 was to be held, a small increase in taxation, perhaps £0.5 billion, might be needed. But there was a considerable margin for error. Overall there was a hopeful prospect of growth in output without resurgence of inflation.

MR MURRAY said that it was valuable to have the Statement and he looked forward to the day when it was put to the Council with options for discussion. Both optimists and pessimists could be wrong and he would like to think the Treasury's forecasts were right, except on unemployment where there appeared no prospect of a substantial fall. The success of exports was critical, and the TUC was less optimistic. If, as stated, the picture was of faster growth than expected, but with higher PSBR and less inflation, it appeared not to match the Government's views of the inter-relationship of these factors. There could be room for more growth, on which the TUC would be submitting ideas to the Chancellor.

SIR TERENCE BECKETT said that the Chancellor was already aware of the CBI's views. They would like to see growth sustained, but their estimate for 1984 was lower, because of lower consumer demand. He was worried about imports since we were still at least 20 per cent uncompetitive. Investment, though growing, was dependent on the level of profitability, which was below that in competitor countries. He was concerned about the second half of 1984. The priority should be to reduce the costs of industry; this involved a role for the CBI on pay; there was also a need to reduce the burdens imposed by the Government. It was disappointing that the National Insurance Surcharge had not been abolished. Raising the National Insurance contribution of the higher-paid would cost industry £90m a year; it was to be hoped that the reduction in the External Financing Limits of the nationalised industries would not result in higher energy prices, on which we already compared unfavourably with Europe. For choice, business costs should be reduced rather than the real level of income tax.

The SECRETARY OF STATE FOR THE ENVIRONMENT said that the forecasts for the construction industry were encouraging, with orders 16 per cent up compared with 1982 and public sector construction being sustained at a high level; following an intervention from DR McFARLANE about the obfuscation of the split between current and capital expenditure in public accounts, he added that the shift from rebuilding to rehabilitation - including so-called "enveloping" schemes - could make definitions misleading.

The CHANCELLOR OF THE EXCHEQUER said that the next Public Expenditure White Paper would give figures for capital and current expenditure. But it was not self-evident that capital was preferable to current; for instance, that education would be improved if more were spent on buildings and less on teachers. The SECRETARY OF STATE FOR EMPLOYMENT made a similar point relating to the construction and maintenance of motorways. He added that there were indications of a higher level of Christmas spending. Import content was a worry: if British industry had not lost market share in the last ten years, there would have been one and a quarter million fewer unemployed.

SIR DONALD BARRON suggested the need for new accounting conventions in the energy field to prevent undesirable repercussions on targets and prices.

MR DUFFY urged the need to restore the purchasing power of the unemployed. For the sake of jobs, trade unions had accepted low wage increases. There was a danger of being lulled into a sense of false security. The Government should respond positively to the CBI's request for the abolition of the NIS; to the view that German and Japanese industry received subsidies not open to the British; and to the need for world markets to be open to British exporters.

In drawing the discussion to a conclusion, the CHANCELLOR OF THE EXCHEQUER replied to MR JENKINS that the Government was not conducting contingency planning for import controls.

The Council:

(i) noted the Chancellor's Autumn Statement as circulated with NEDC(83)60.

3. "WHERE WILL THE NEW JOBS BE?"

The CHANCELLOR OF THE EXCHEQUER said that NEDC(83)58 and NEDC(83)59, in spite of differences, revealed a wide area of common ground. Both papers rejected counsels of despair and recognised that economic change led to rising prosperity. The common ground included the importance of productivity growth; the long-term decline in employment in manufacturing and increase in services; the reduction in hours of work but increase in part-time working and participation rates; lack of success in past attempts to predict the nature of new jobs; the rejection of explanations blaming technical change for unemployment; the importance of performance on the supply side of the economy. On the other hand, there were differences of view on the treatment of demand; and he was sceptical about predictions of a medium-term "jobs gap". He suggested that there should now be further work onthe implications of new technology; the respective roles of services and manufacturing; education and training; impediments to the creation of jobs.

MR MURRAY welcomed the Treasury paper's attention to the main issues, though he took exception to some of the obiter dicta. Sustained growth was a condition for success in the aim of using resources fully; but he agreed that studies in the present context should avoid macroeconomic futurology. The TUC believed there had been a break in trends: until recently, jobs lost in manufacturing had been balanced by gains elsewhere but they now saw a five million job shortage by 1990. The Chancellor had given only a vague answer on whether this was reversible. The continued decline of manufacturing was not inevitable. It would be wrong to suggest that incomes in the UK were too high, since some countries with higher incomes grew more quickly; and the growth of the incomes and expenditure of consumers might still be insufficient to stop employment falling. If more jobs developed in the (mainly non-tradeable) low-wage services sector, it raised the question whether the high-wage tradeable part of the economy would be big enough. The Government's insistence on job growth being in the private sector appeared to be based on no more than faith. Both papers emphasised the need for adjustment, but there should be a clear idea of what we were adjusting towards. The US was interesting, but not a model. In the UK there was the problem of creating confidence and also of reducing the cost to those on whom the burden of adjustment fell. Discussion of the "supply side" involved the contentious areas of the size of the public sector, wages and so on: he had never been averse from looking at the supply side, provided that the demand side was covered also, but the arguments should be conducted on the basis of joint and fuller analysis than in the past. A group of senior officials should therefore identify the areas for discussion.

SIR CAMPBELL FRASER thought that the papers had more in common than Mr Murray suggested. The CBI wanted to be positive on reducing unemployment, but not by means of massive reflation. The TUC's paper had been researched and argued well, but he did not endorse the "jobs gap" of five million. Unemployment was in part cyclical but also in part structural. The rise of employment in services might not continue in the face of rising productivity in information-using industries. The distinction between manufacturing and services no longer made sense because of the interdependence of the two, and could lead to policy mistakes. Further work was needed on changing patterns of work, training, impediments to labour mobility, the role of profits in job creation, competitiveness, and the encouragement of technology. The Group of Four should provide a programme.

The SECRETARY OF STATE FOR EMPLOYMENT welcomed the initiative, which he saw as a test of the Council on its central concern. The further work should avoid the trap of politically-charged areas such as the "jobs gap". He congratulated the TUC on their research, but would wish to challenge some aspects of the paper, such as its dismissiveness of small firms and the Enterprise Allowance. Follow-up work should include lessons from other countries, education and training, mobility and impediments to new jobs. The statistical classifications needed to be looked at, for instance concerning the information sector; but he did not favour a total upheaval.

MR DUFFY said that the subject raised difficulties for both sides, but it was essential to deliver a successful outcome. He was ready to discuss any area, including that of wages; but in a democracy change depended on discussion. Some companies were showing that technical change could be accepted and could provide jobs. He raised the question of import controls and suggested that the UK should be as nationalistic as competitors. Unions would be more inclined to look beyond the immediate pay packet if managers also went without big increases for the sake of ploughing profits back into their companies. A continuing dialogue was needed to remove the cancer of unemployment.

THE DIRECTOR GENERAL said he said he was encouraged by the start of the discussion. North Sea oil was an omission from both papers - through its effect on the exchange rate, part of the economy had been weakened; the rate of exploitation would remain an important, though indirect, influence. In view of the range of questions in the papers, he suggested that the material should be divided into manageable pieces of work which could be discussed in greater depth by the Council. The overall context was set by the question of what needed to be done which in total would match the task facing the country. He identified four possible areas for further work: (a) complementing the study of the US with work on other countries; (b) a study of the balance between sectors (services/manufacturing/oil); (c) obstacles to the creation of jobs, including the influence of tax and social security on employment and investment; (d) the role of profits and investment and their relationship with technology productivity and unit labour costs. A working group of the three parties and himself might be able to suggest an agreed programme of work to the Council in February.

The SECRETARY OF STATE FOR ENERGY said that peak production of oil might continue for two to three years. The capacity which had been developed for off-shore supplies could be used in the development of new export markets. We had expertise also in other areas of energy technology. In general it would be necessary to identify markets where there would be growth in the future, influenced by changing patterns of world monetary flows, together with developments in competition.

SIR TERENCE BECKETT mentioned Germany and Japan as countries worth studying. The US was a strange mixture of high technology but poor growth in productivity. He agreed that the split between manufacturing and services was artificial; and looking to the services for growth was dangerous, since, directly or indirectly, most services were dependent on manufacturing.

MRS WATERHOUSE stressed the interdependence of manufacturing and services as a result of new products (eg home freezers or micro-computers) creating a demand for many associated goods and services. The changes in patterns of work which were occurring (for instance, through flexible hours and the introduction of new technology) could profoundly affect the conventions of employment as between men and women.

The SECRETARY OF STATE FOR EDUCATION AND SCIENCE said that neither paper paid enough attention to the entrepreneur - the market hunter and job creator - who might be a minnow or a giant. There was also the business re-starter, who applied drive to regeneration as exemplified in the management buy-out. Cooperatives, if not subsidised, were group entrepreneurs.

MR JENKINS criticised the absence of projections in the Treasury paper. The reason for the success of the off-shore supplies industries was Government policy; a comparable steer might be needed today. He agreed that mobility was important and welcomed the Fowler Committee on pensions, which currently were sustained by the abandoned money of those who dropped out. The prospects for the service industries were not encouraging, because education and health, where much of the growth had been, were the subject of Government reductions and new technology might cause reductions in employment also in banking and insurance. The UK would not revive on Koreanisation of its already low wages; it needed more expenditure on infrastructure.

The GOVERNOR OF THE BANK OF ENGLAND said that more competitiveness would lead to faster expansion and more jobs. There had been a rapid deterioration in the current account of the balance of payments, which implied a substantial loss of jobs; earnings since 1980 had risen 7½ per cent faster than the average of other countries. It remained essential to have a strong manufacturing base, though the appropriate measure was output rather than employment. The impediments to the creation of jobs should be investigated, including the financial ones. He mentioned that desirable rationalisation might sometimes be inhibited by its adverse effect on a company's balance sheet.

The MINISTER OF STATE FOR TRADE AND INDUSTRY said that a higher proportion of the workforce was in manufacturing in the UK than in Japan, but the contribution of manufacturing to output was higher in Japan. Leisure industries had been growing in the US and could do so in the UK - service employment had been growing even in the recent past. In the long run, small firms had a potential contribution, inadequately acknowledged by the TUC.

MR EVANS questioned how the changes recommended by the Chancellor could be actually brought about. He saw the need for bilateral discussions at the top to cover market prospects, competitiveness, training, technology. This could provide guidance reflected in institutions at company level. Whether unemployment was "structural" or not made no difference to the person who was unemployed. The phrase "waiting for work" might carry less stigma; the level of benefits was not just a political problem.

MR POPE stressed the importance of rapid exploitation of new technologies and saw hopeful signs in the spread of computers in homes and in schools. Skills were crucial for employment prospects, and those who had entered the labour market without much training presented a particular problem.

DR McFARLANE, stressing the importance of the discussion, saw conditioned reflexes in both papers. The Treasury regarded change as the norm but thought all change could be left to the market; the TUC thought that the "disjuncture" was reversible and that the Government should therefore reflate. Neither was radical enough. Insufficient attention was given to skill-saving technology, the newly-industrialising countries (NICs), the North Sea, or the capacity of economies to change in sudden leaps. The present problem was because the world recession, new technology and the impact of NICs coincided. Solutions would depend on new and radical thinking.

SIR DONALD BARRON mentioned the correlation, established by the Clare Group, of profitability with value-added and employment. Referring to mobility, he stressed the importance of looking at the taxation of the privately rented sector; the SECRETARY OF STATE FOR THE ENVIRONMENT commented that the decline of that sector, where mobility was greatest, had been a disaster, with improvement stymied by threats to repeal the shorthold legislation - the subject was under active review and tripartite study would be helpful.

MR BICKERSTAFFE suggested that if the references to pay in paragraphs 3.21 and 3.22 of NEDC(83)58 were intended to mean "lower" pay, they should have said so. The CHANCELLOR OF THE EXCHEQUER referred to the need for lower unit labour costs.

MR YOUNG urged the need to heal the schism between training and education, with the modern equivalent of "the 3-Rs" in schools. Contrary to criticisms, the Enterprise Allowance was going well; and, if demand on the Youth Training Scheme was less than expected, this was because more young people were going into jobs - the Christmas undertaking would probably be met. The need for mobility was illustrated by placement rates of close to 100 per cent on the part of Skillcentres in the south, while there were unplaced trainees and queues for jobs 150 miles away. The US had lessons to offer on adult training (paid for by the individual).

MR MURRAY described the discussion so far as having been the easiest part of the exercise, which would now have to move carefully forward on thin ice. Many ideas needed to be put into the pot, including those of the CBI, whose interest in competitiveness was shared by all. He still saw value in trying to predict the broad size of the problem. It should be tackled in a step-by-step approach, first where there was most prospect of agreement and facing more contentious issues later. A programme should be proposed by senior officials. The TUC and CBI might be able to do some work jointly.

The CHANCELLOR OF THE EXCHEQUER, summing up, said that it had been one of the most important discussions at the NEDC and was right at the heart of Britain's economic problem; but it was only a starting point. There was overlap on some of the approaches, though not on the "five million jobs gap"; he regarded the forecast on which that was based as pessimistic, and it would be interesting to look at others. The Council had shown a clear desire to follow up with further studies, in which some ingredients - though the list was not exhaustive - were as follows:

(a) the experience of other countries, for instance covering flexibility in patterns of work and the split between services and manufacturing;

(b) implications of new technology;

(c) the TUC's discussion of an information sector;

(d) the CBI's thoughts on profitability in relation to jobs;

(e) education and training - to be followed up in January;

(f) the impediments to the creation of jobs, involving topics such as pensions, housing, competition and labour market issues.

The Group of Four should refine the material and report to the Council.

The COUNCIL:

(ii) noted NEDC(83)58 and NEDC(83)59 and the summing up by the Chancellor of the Exchequer;

(iii) agreed that the Director General, in consultation with Sir Terence Beckett, Mr Murray and the Permanent Secretary to the Treasury, should supervise the preparation of a programme of work and report to the Council;

(iv) agreed that in public discussion of the meeting there should be emphasis on the points of agreement and the joint desire to carry the studies forward in a positive spirit.

4. SECTORAL REPORT: PLASTICS PROCESSING

MR KLEEMAN, introducing NEDC(83)61, said that the raw material was the only common factor linking the industry. There were two broad categories of processor - those with their own final products and those, including many small firms, who provided a components service. Packaging accounted for a third of plastics usage and building for about 17 per cent. Employment in the industry had dropped to 200,000 and automation was likely to reduce it further. The EDC had identified a need for a clearing house for information on plastics and with financial assistance from the DTI, the British Plastics Federation (BPF) now operated the Plastics Advisory Service (PAS). An investigation undertaken with the Electronics Consumer Goods EDC on the quality of plastics components supplied to television set makers had opened the way to huge improvements in both industries. The results of an inter-firm comparison survey were now being distributed, including a "self-analysis kit". The biggest problem was communication; the EDC was using newsletters, working on guidelines on communications within companies and had organised a conference on "British plastics - the next ten years". Competitiveness was the chief current topic, covering scheduling and costing methods, the use of robots and, together with the Gauge and Tool EDC, moulds. The EDC supported the Plastics Industry Training Board and would welcome greater emphasis on plastics in the curricula for engineering students. The EDC would like to see more emphasis on research and in particular that the Polymer Engineering Directorate (PED) should receive more funds. Investigation had shown that the average age of machinery used by the industry compared unfavourably with continental competitors and the EDC supported the approach made by the BPF that the Government should give plastics processors the same help that metal processors received under the Small Engineering Firms' Investment Scheme (SCFIS).

The MINISTER OF STATE FOR THE DEPARTMENT OF TRADE AND INDUSTRY congratulated Mr Kleeman and the EDC on its self-help initiatives, in particular the self-analysis kit. The industry was in the forefront of technology and had the potential for growth. The DTI had supported R&D and innovation, as was evidenced by their help for the PAS. MR MURRAY supported the retention of the Plastics Processing ITB; but members of the EDC were anxious that the PED should retain financial support. He shared the view that it was anomalous to confine SEFIS to metal working. The MINISTER OF STATE confirmed continuing financial support for the PED and noted the representations on SEFIS, which the Government was considering.

SECRETARY OF STATE FOR EMPLOYMENT added his support to the Plastics Processing ITB. The use of plastics could transform whole processes; for instance, there was a huge potential market for liners for renovating sewers, but this required new systems and engineering and even the largest of the firms interested were too small to take on the risk of development.

The SECRETARY OF STATE FOR THE ENVIRONMENT referred to initiatives by the DTI on quality assurance. The PSA also were trying to raise the industry's performance, but might not have had enough contact with the EDC.

SIR DONALD BARRON noted that the importance of financial services as users of plastics. Electronic funds transfers at point of sale would be a large new development.

In response to a question from MR EVANS about recycling, MR KLEEMAN said that work was under way on PET bottles. Continental legislation on returnable containers was a cause for concern. The EDC hoped to do more work in future on maker/user techniques; they were currently working with the Gauge and Tool EDC and with the Electronic Consumer Goods EDC.

The CHANCELLOR OF THE EXCHEQUER thanked Mr Kleeman for his presentation; the work of this successful EDC had aroused the interest of the Council.

The COUNCIL noted:

(v) NEDC(83)61.

CORRIGENDA

Minutes of NEDC(83) 9th Meeting

Page 5, paragraph 2, line 3: after "exchange" insert "buildings".

Page 7, paragraph 1: add "The extent to which ex-YTS trainees got jobs should be reviewed after the first year".

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

December 1983

Sub

10 DOWNING STREET

From the Private Secretary 22 November 1983

NEDO

We had provisionally arranged for the Prime Minister to Chair NEDO on the morning of 2 May, 1984. I am afraid that this date now proves not to be possible because of a clash with the next Anglo/German Summit (which has not yet been announced). Could you please arrange for us to have the dates of NEDO meetings in the latter half of 1984 as soon as they are available so that the Prime Minister can consider alternatives?

MR. D. BARCLAY

Miss Judith Simpson,
HM Treasury.

10 DOWNING STREET

①

Prime Minister

I consulted you about chairing NEDC. You were content in principle but not happy with February date suggested. An alternative would be Wednesday 2 May, which is free in the diary.

Agree?

Yes

AT

19/10

COVERING RESTRICTED ~~Mr Ingham~~ FO

FROM: MRS C A RYDING
DATE: 17 OCTOBER 1983

File

MR TURNBULL

NEDC SIMULATIONS

Further to your telephone conversation with Sir Terence Burns on Thursday, 13 October, I attach a copy of NEDC(83)47 - Report * on the Treasury Simulations presented to the Council in April 1982 which became available to the press that day.

2. Sir Terence thought that you might also find it helpful to see copies of NEDC(83)46 - The Role of Demand in the Economy, * Comparison of Models - a background paper by NEDO staff on NEDC(83)46 and NEDC(83)47, and a note by John Odling-Smee to Sir Terence Burns. I understand that NEDC(83)46 and the paper on Comparison of Models are also available to the press on request.

C.A. Ryding
C A RYDING

* Papers filed with other NEDC papers in C/F.

17 OCT 1983

cc Mr Ingham.

AT 17/10 K9

FROM: J ODLING-SMEE
DATE: 29 SEPTEMBER 1982

SIR T BURNS
(NEDO Papers attached to top copy only)

cc Mr Middleton
Mr Anson
Mr Byatt
Mr Cassell
Mr Battishill
Mr Evans
Mr Lovell
Mrs Lomax
Mr Riley
Mr Mortimer
Mr Ritchie
Mr Hall

NEDC SIMULATIONS

Two of the papers that the NEDO Director-General has tabled to be noted but not discussed at the NEDC meeting on 29 September report simulations on the Treasury model. One fulfils a remit from the Council at the April 1982 meeting to examine in more detail some of the characteristics of the Treasury model. The other, on the role of demand, arose out of the discussion of competitiveness at the August 1982 Council meeting.*

Report on Treasury simulations presented to Council in April 1982

2. You will recall that the TUC accused the Treasury of rigging the simulations by choosing policy assumptions and a version of the model that maximised the "crowding-out" that resulted from a fiscal expansion. The NEDO paper investigates this charge indirectly (and without mentioning it explicitly) by:

(a) examining the various stages that the Treasury model went through before and after the version used for the NEDC simulations;

(b) commentating on the reasons for and consequences of changes in a few important equations (earnings, exchange rate, monetary sector, and corporate liquidity);

* There is also a background paper for advisers on comparisons between the Treasury model and those of NIESR, CEPG, LBS and Liverpool; and a fuller version of it which we have not yet seen. This may be useful to us for occasional reference.

(c) discussing the effects of different assumptions for monetary policy and cash limits.

3. The paper does not come up with anything that is new to us, although it is quite interesting to see some of the results set out like this since we do not often trace changes in model properties over a number of vintages. (More detail is presented in a Technical Annex that NEDO has made available to advisers, and in Professor Artis' report, which we have not yet seen.) The discussion is fair and balanced, and, as far as we can tell, correct. (They took our comments on earlier drafts.)

4. The conclusions are generally helpful to us. They confirm that the version of the Treasury model used for the NEDC simulations was the regular version used at the time, and not a specially "fixed" one. They do, however, point out that it happens to be the model with the most crowding-out of all variants of recent years (including the present one). But there is no suggestion that this was deliberate. And there is still significant crowding-out on the latest version of the model examined. They argue persuasively that models are bound to change all the time, and that this means that simulation results should be interpreted cautiously and their limitations recognised. It does not make them entirely useless for policy analysis.

The role of demand

5. The NEDO paper on this is relatively modest. After an introductory section in which nominal demand is distinguished from real demand, the rest of the paper reports simulations on the Treasury model of higher domestic demand (public investment), higher external demand (world trade), various types of better supply-side performance (better exports, better productivity and lower imports, and lower earnings growth), and combinations of these. Although we would not necessarily have done the simulations exactly like this - for instance, they do not seem to have included any announcement effects and their non-accommodating monetary policy is fixed £M3 - the broad results are not surprising. They show that demand expansions, whether domestic or external in origin, raise output for a few years but this is crowded out in time, and inflation also rises. There are, however,

combinations of demand expansion and supply-side improvements that avoid crowding out of the higher output and also avoid higher inflation.

6. The paper draws the conclusion for policy that a fiscal expansion might be useful if supply-side improvements could be made. But it recognises that this is exactly the problem the Council is trying to tackle, as yet without finding radically different solutions. If supply-side improvements cannot be made, a large-scale expansion of demand cannot reduce unemployment permanently unless the inflationary consequence of such action can be tackled successfully. This last phrase may be a reference to incomes policy.

Comments and line to take

7. These papers seem to have come out fairly well from the point of view of the Chancellor and the Treasury. In particular they:

(a) support the Government's position on the effects of fiscal expansion;

(b) emphasise the benefits of supply-side improvements (including slower earnings growth);

(c) discuss the role of model simulations in policy analysis in a balanced way;

(d) explain clearly why the Treasury model has changed and why that is an inevitable process given the uncertainties;

(e) do all this in a low-key and unprovocative style.

8. I suggest that the line to take, if any is necessary (the papers are not to be discussed, after all), should be that these are helpful papers and that they have successfully cleared up some of the questions left unresolved at the April 1982 and August 1982 Council meetings. If any further points need to be made, they can be drawn from paragraph 7 above.

JO-S

J ODLING-SMEE

CONFIDENTIAL

FILE 8H

10 DOWNING STREET

From the Private Secretary 17 October, 1983

NEDC

In your letter of 6 October you asked whether the Prime Minister would be interested in chairing the February meeting of NEDC. In principle, she is prepared to chair an NEDC meeting but thinks that February tends to be a difficult time in the Government calendar. She would be grateful, therefore, if you could consider other possible dates.

ANDREW TURNBULL

John Kerr, Esq.,
H.M. Treasury

CONFIDENTIAL

See VC

MR. INGHAM

Simulations on Treasury Model

The history of this case is as follows:

(i) In April 1982 the Treasury produced simulations using its model to show the effect of additional public expenditure, particularly on investment. The results were very adverse for the reflationist case. Output and unemployment were shown to be worse by the fourth year. This result came about following modifications which had been made to the model since 1979. (Under the Industry Act the Treasury is required to publish the model manual.)

(ii) These results caused a row, with the TUC accusing the Treasury of fiddling.

(iii) NEDO undertook to investigate and it has just published its report. This was taken note of at the September meeting of NEDC without comment which may indicate that the TUC has finally lost interest in this controversy.

(iv) NEDO's report shows that the latest version of the HMT model produces weaker correcting out effects than the version used for the original simulations.

Comment

(i) True that recent modifications of the model have reduced ~~correcting~~ crowding out effects but these are still strong. The initial increase in output is not sustained and unemployment is still shown to be higher at the end of a 5 year period. Too much emphasis is being placed on the differences in the two simulations and not enough in the new results themselves. These still do not validate the reflationist case.

(ii) The changes in the model do not stem from TUC or NEDO criticisms. The process of re-estimating equations goes on more or less continuously and the results are thus incorporated into the model.

(iii)

(iii) Danger of emphasising the role of the model in policy making - only one input. Other factors, eg expectations, are very difficult and cannot be given full weight in the model.

(iv) Relatively minor changes in the model do not imply any change in the views of Ministers.

(v) New simulations validate Ministers' views that most powerful force for reflation would be lower pay.

(vi) Treasury do not accept that it would be appropriate to combine looser monetary policy with higher public expenditure. Simulations show that this adds significantly to impact on inflation.

AT

13 October 1983

Prime Minister

Do you want to chair NEDC or let tradition lapse?

AT 13/10

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

13 October 1983

Andrew Turnbull Esq
10 Downing Street
LONDON SW1

Not as soon as February – it will be a difficult time. MT

Dear Andrew,

NEDC

At their meeting on 6 October the Prime Minister and the Chancellor talked about NEDC. The Chancellor has since asked me to find out, via you, whether the Prime Minister would be interested in chairing the NEDC meeting at 10.00 am on Wednesday 1 February, when her diary is, I understand, free at present.

The Prime Minister will recall chairing such meetings on three previous occasions - in January 1980, February 1981 and February 1982. She was unable to chair this year's February meeting, but planned to chair one this summer. No date was however fixed, and the Election intervened. The Chancellor's view is that, while it is certainly not essential to fix a date now, it would be a pity if the tradition were to lapse altogether. Choosing a date early in the calendar year has worked well in the past,and the February meeting is probably best, given that the January one comes very shortly after the Christmas break, and the March one will be rather close to the Budget.

Could you let me know the Prime Minister's views?

Yours ever,

John Kerr.

J O KERR

CONFIDENTIAL

File

MR. MOUNT

Future of NEDO

This was discussed at the Prime Minister's meeting with the Chancellor of the Exchequer today. There was no real conviction that NEDO was particularly helpful but it was felt that there might be some small public relations value in retaining it and that the row in disbanding it would not be worthwhile. Its activities have been cut back and the CBI continues to attach value to it. The Chancellor said that some changes had been made to make it slightly less tri-partite. A small businesses' representative now sat on the Council and he would be proposing to the CBI that they include a representative of the Retail Consortium within their team.

The Prime Minister said that she might consult you further to see if there were any other small changes which could be made to its structure.

AT

6 October 1983

CONFIDENTIAL

CONFIDENTIAL AND PERSONAL FILE

SA

10 DOWNING STREET

From the Private Secretary

3 October, 1983

Future of NEDO/NEDC

As I mentioned on the phone, the Prime Minister has received from the Policy Unit a note questioning the future role of NEDO/NEDC. The Prime Minister may well raise this at their next meeting on Wednesday. You may therefore like to have a copy of the original Policy Unit note. I would be grateful if this were not circulated through the Treasury.

A.T.

J. Kerr, Esq.,
H.M. Treasury

CONFIDENTIAL AND PERSONAL

SH

30 September 1983
Policy Unit

PRIME MINISTER

Prime Minister ①
For Wednesday's meeting with the Chancellor?
AT 30/9

THE FUTURE OF NEDO/NEDC

Should we have another look at NEDO?

It continues to be a source of political embarrassment and nasty headlines. It sustains tripartite attitudes and habits of thought which are damaging to growth and which the Government has sought in other contexts to break. Among the illusions fostered by NEDO are:

- that economic problems can invariably be resolved by seeking "consensus" among the "social partners". The Government knows that decisive and often divisive action is what is normally required on matters such as spending, pay, restructuring industries;
- that industries should look towards Government to solve their problems, rather than standing on their own feet;
- that the TUC has a valuable contribution to make to the formation of economic policy.

Despite this manifest inconsistency of aims, the Government has maintained NEDO because:

(i) NEDC is the only "forum in which it can talk to the unions".

(ii) NEDO and its Sector Working Parties are thought to do some "useful work".

Neither argument is convincing. Talking to the unions about economic policy in general accords them an unwarranted importance. They have no mandate from their members to discuss these general issues; the subjects on which they could claim some authority to speak - pay and industrial relations - are excluded from NEDC discussions as "too difficult". The appropriate context for such discussions is, of course, the consultations which Mr Tebbit is conducting.

The "useful work" is extremely sketchy and could hardly justify the public expenditure of £4 million annually, not to mention the cost of the time of 1,000 or so industrialists involved in the NEDO machinery. The truth is that Sector Working Parties find it far easier to formulate requests to Government - for protection, or subsidy, or additional orders, or a stimulus to demand - than to diagnose their own industries' weaknesses. So long as such committees are institutionalised, the Government invites industries to think in this way. Industries have alternative channels, notably their own trade associations.

The presentational advantages of talking to the unions are illusory. The TUC make no secret of the fact that they regard NEDC "as a foundation in its contact with a future Labour Government" (Len Murray, 9 September 1982). The converse is that the TUC regards NEDC as a platform for launching attacks on a Conservative Government, using the poorly argued papers prepared by the NEDO secretariat as ammunition. The Government is in no position to retaliate: as "host" and Chairman, the Chancellor is obliged to behave moderately, whereas the TUC has a licence to behave as it likes.

Options

1. Abolition

This is the logical answer, but it would mean a reopening of our quarrel with the CBI and would promote the illusion, even among some of our own supporters, that we were not interested in co-operation with industry.

2. Reform

I think we could achieve most of our aims by the following changes:

(a) Breaking down the corporatist tripartism of NEDC. At present, those attending NEDC sit in three big blocks with their acolytes behind them, and only a pitiful handful of "independent" members facing them (Governor of the Bank of England, the consumers' representative, and the nationalised industry representative). We could reform the Council to broaden and individualise its membership as follows: one representative only from each of the following: CBI, Institute of Directors, Retailers' Assocation, small business, TUC, self-employed, academic world. In addition, the Chancellor could invite a selection of leading businessmen and trade union leaders, but as individuals and not as representatives. He could also invite one or two "resident gadflies" who would question the received wisdom of the producer lobbies. These could be people like John Vaizey or Douglas Hague.

(b) Absorbing the NEDO Sector Working Parties into the relevant Ministries. This would sweep away the expensive and pretentious Neddy bureaucracy. It would save money and shorten the lines of communication between the producer lobbies and the Ministries. The Agriculture Working Party would be talking straight to MAFF, and the Information Technology Working Party would be dealing direct with Kenneth Baker. Much of this work is already done under the auspices of Departments and we would merely be wiping out duplication of effort.

A streamlined, individualised Council of this sort, with no supporting bureaucracy, would be much more straightforward, and could operate as a genuine discussion group under the Chancellor's direction.

Would you like to discuss this question with Nigel Lawson at one of your weekly meetings?

Yes MT

FM

FERDINAND MOUNT

E. R.

Econ Pol.

PRIME MINISTER

NEDC Meeting

Do you wish, as in previous years, to chair a meeting of NEDC at the beginning of next year - say in February? This has a pretty limited usefulness, and nobody is strongly urging you to do so.

MCS

I would rather not do it in Feb - perhaps later in the summer

MT

22 October 1982

Told Sir D Wass' office. If they see fit they will phone about a possible summer 83 occasion.

MCS 25/10

Econ Pol

MLS 16/2

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OUR REF. JP/JL YOUR REF.

REGISTERED OFFICE
DORCHESTER BREWERY
P.O. BOX NO. 2, DORCHESTER
DORSET, ENGLAND
DT1 1QT

15th February, 1982

Michael Scholar, Esq.,
Private Secretary to the Prime Minister,
10 Downing Street,
London, S.W.1.

Dear Mr. Scholar,

Thank you for your letter of the 8th February, the contents of which I note.

Yours sincerely,

Jeremy Pope

JEREMY POPE

80

PRIME MINISTER

Do you have a paper in the flat by Lord Caldecote entitled "Capital Structure of Industry in Europe"? Please do not spend any time looking for it. It is simply missing from the files downstairs.

CAROLINE STEPHENS

11 February, 1982.

BK

Kay
Please return for file
filing in CF
AJ 12/2

8 February 1982

I am writing on the Prime Minister's behalf to thank you for your letter of 4 February, which I will place before the Prime Minister.

I do not think that the Prime Minister received any impression from your remarks at NEDC last week that the CBI is not enthusiastic about the measures taken already by the Government to assist the small firms sector. I am sure the Prime Minister will be interested to read the extracts from Sir Terence Beckett's speech last June; as you say, many commentators at that time were still claiming that the Government's package was little more than window-dressing.

MICHAEL SCHOLAR

Jeremy Pope, Esq.

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OUR REF. JP/JL YOUR REF.

REGISTERED OFFICE
DORCHESTER BREWERY
P.O. BOX NO. 2, DORCHESTER
DORSET, ENGLAND
DT1 1QT

4th February, 1982

The Rt. Hon. Margaret Thatcher, M.P.,
The Prime Minister,
10 Downing Street,
London, S.W.1.

Pb

Dear Prime Minister,

I am concerned lest the shortage of time and thus the fleeting nature of my introduction to our paper on Smaller Firms at yesterday's meeting of the N.E.D.C., may have left you with the impression that the C.B.I., is not enthusiastic about the measures taken already by the Government to assist the small firms sector.

For the record we were foremost of the few who actively supported the arrangements after the Chancellor's Budget Speech last year and, as I am certain staff at the Inland Revenue under Mr. John Isaac can vouch for, it was the help and advice of several members of the Smaller Firms Council and Sonia Elkin in particular, which moulded the original ideas into the more dynamic creature contained in the Finance Act. Incidentally both John MacGregor and John Isaac took the trouble to write and thank Sonia Elkin for our support and assistance.

As to public utterances in support of these proposals I enclose extracts from a speech delivered by Sir Terence Beckett in June at a time when many commentators were still claiming that the package was little more than window dressing. I also enclose an extract from the Business Opportunities supplement to the October issue of British Business following a winding-up speech I made at the first B.O.P. Conference in September.

If I may pursue my horticultural analogy of yesterday we are keenly in favour of the seedbed being tended and fertilised. However until the macro-economic climate rises above 45°F. that investment will not bear fruit because the germination and growth will not have occurred. That is not to say the husbandry and preparation should stop. On the contrary we believe it to be of such importance that the excellent foundations laid last year should be extended.

Contd./..........

ELDRIDGE, POPE & Co
LIMITED

The Rt. Hon. Margaret Thatcher, M.P. 4th February, 1982

The concept of broadening the equity base of smaller companies, whether new or established, is evidently one which finds favour in the sight of Patrick Jenkin and his Department. We, of course, appreciate that in these difficult times the further extension of the Scheme may be regarded as unaffordable by Government. However, any extension of a scheme, which is designed essentially to help the enterprising help themselves, would be invaluable and in particular the creation of the concept of the Smaller Firms Investment Company. We are acutely aware that extensions might lead to abuse and tax evasion. That is an area where we are in close touch with the Inland Revenue but subject to proper safeguards is no reason for stifling initiative. As the distinction between A.I.F's, such as Electra House, and S.F.I.C's is frequently misunderstood I enclose a brief synopsis of their different attributes.

We are still strongly supportive of the initiatives taken by the Government and are greatly encouraged that apart from some differences in emphasis, which I highlighted yesterday, our perception of the place and contribution of the sector coincides so closely with that of the Government. Neither the Smaller Firms Council nor the C.B.I., are seeking to act irresponsibly by pressing for these extensions. In the case of the Smaller Firms parts of our Budget Representations we have said what we would like to see (as has the D.O.I. in its paper to N.E.D.C.) but the Chancellor and the Cabinet must naturally be the final arbiter in the matter.

Yours sincerely,

Jeremy Pope

JEREMY POPE

Encs.

There can be no doubt that the importance of smaller firms are well recognised by the present Government. The launching of the Business Opportunities Programme last month provides firm evidence, and goes far beyond mere words and political rhetoric, heralding, as it does, constructive measures to help.

The CBI believes that the Business Start-up Scheme announced in the Budget is one of the most important contributions any Government has made towards encouraging the starting of new firms since the war. It has, as you will know, attracted considerable criticism in the Press and elsewhere because of certain restrictions attached to it. No one, least of all the CBI wants to see the scope of the scheme and thus its impact on job and wealth-creation so hedged about with conditions that it becomes impotent. But we believe it has some real potential and have therefore worked <u>with</u> the Government to prepare the amendments to the Finance Bill which, it is generally agreed are necessary if the Government's concept is to achieve the desired result, but recognising that there must be some protection against blatent abuse which would discredit the scheme.

Unfortunately, the other measures which the Chancellor took in his recent Budget to help smaller firms have been largely overlooked in all the controversy there has been on the Business Start-up Scheme. I have heard it said that small firms are never satisfied. Whatever they are given, they ask for more. That from having had all the characteristics of Oliver Twist, begging for affection and recognition from a basis of deprivation and starvation, they are now becoming Billy Bunters - overfed and greedy.

But that, as you all know, is very far from being the true picture, and those who allow the impression to arise do small firms no service. It has been necessary to be very straight with this and previous Governments about the real day to day problems facing the man or woman trying to set up a new business or run an existing one. The CBI has devoted considerable resources to doing just this. But when the Government does something positive for business then for God's sake, let's welcome it.

Take the loan guarantee scheme. We have had doubts about the potential of any such scheme for creating additional lending to small businesses. We were concerned on the one hand that the Government should not simply subsidise the bank's risk and on the other that the scheme did not result in pushing the frontiers of lending beyond projects that have the potential for commercial viability.

However, we have been surprised by the hostile reaction to the scheme from some groups which ought to know better and have lobbied so vigorously for its introduction. It has been condemned by them as being too expensive. But surely this is to miss the intention and object of the scheme. This is to push the risk forward so that projects where there is a short-fall in security or track record may be able to obtain funds. If the critics of the scheme feel it will fail to achieve this objective, they have grounds for concern, but it is not reasonable to criticise it because it does not provide cheap loans.

The banks have to decide if they want this business and then compete for it on commercial terms. Whether the level of the Government premium is too high must be tested. If it is set too low and the exchequer loses, this will add to Government borrowing. If it is too high people will not be prepared to pay.

So, I believe there must be a period of experiment in order to see whether a loan guarantee scheme is a cost effective way of stimulating new and small businesses and whether its terms are right. We must give it a try.

Small firms are not different from the rest

MacGregor: We are now determined to refocus on small firms.

Jeremy Pope, finance and planning director of the small but thriving Dorchester brewers Eldridge, Pope & Co, talks to Alan Williams about the problems of small businesses and firmly dispels the belief that small firms are in some way different from others.

Jeremy Pope knows all about brewing new business because in addition to being the chairman of the Confederation of British Industry's small firms council, he is finance and planning director of Dorchester brewers Eldridge, Pope & Co, a company he describes as a 'big small business' with some 250 employees in the brewery itself. The company has just finished overseeing a thorough modernisation and rationalisation of the works, which is still very much a local brewery, having avoided the rash of takeovers and mergers in the 1950s and 1960s, and although he confesses that it couldn't have been done at a more difficult time, he is confident that his major investment in new equipment was right and that as a result the company will be much better placed to take advantage of the upturn when it comes. He admits to being worried about the trading situation but is not pessimistic and shuns price cutting to gain a marginally larger slice of the market as a short-term expedient, preferring in difficult times simply to remain competitive and to instead emphasise quality and service.

Pope is dismissive of those who argue that small firms are somehow different from others and insists that, at the end of the day, what is good for business in general is good for small businesses in particular. However, he has great sympathy for the entrepreneur with an idea but little else who finds himself faced with a plethora of organisations and well-meaning advisors all bombarding him with information but in the end serving only to further confuse. He is openly enthusiastic about the business opportunities programme, which he sees quite simply as a package for the small firm which is without parallel in recent history. He acknowledges that, as with existing industries, no amount of government aid or assistance will make a basically weak company strong, but he thinks industry has been far too slow to recognise the enormous psychological barrier which has been broken down by getting a scheme under way which actually attracts individual investors into new businesses.

He feels that people already in business have an important role to play in the generation of new enterprise, and that projects like the young enterprise scheme, where teenage school children are actually encouraged to run their own little enterprises under guidance, deserve much more support from the business fraternity than they usually get. He readily admits that, if it hadn't been for his family business interests, he would probably not have gone into industry himself after his legal training because the general feeling among his peers was that industry was somehow boring and not particularly respectable compared to a career in the professions.

He is keen to get more professionalism into industry now for he feels that the typical small business is characterised by a surfeit of enthusiasm – which he adds wryly is probably no bad thing, given some of the frustrations – but also by a compensating lack of professionalism.

Far too many people, he feels, when they start a business begin with no more than a vague pipedream. They seem to feel that they need to do no more than pour their heart out to their bank manager and then get upset when he fails to come up with the cash.

He is adamant that before anybody starts out in business they need to know precisely what they want to do and how they hope to do it. And they have got to be prepared to pull round them a workable team of people of like mind.

But doesn't that advice clash with his views about industry and the professions? Not at all, it seems. He is all in favour of getting as much advice as possible, particularly from an accountant, before presenting a case to the bank, but insists that in the end the real test of the competence of an embryonic management is its ability to assimilate and use the advice it is given. It seems that to succeed, the principal of a small company has got to be prepared to throw aside the mantle of the production manager and look further afield. He feels that too many of the people he meets who are setting up companies, although great experts in their own field, are so blinkered and mesmerised by that activity that they haven't been prepared to look further afield until forced to do so by external factors. And for that reason, he says, they tend to regard any new government legislation or taxation proposals as by definition an irritant deliberately introduced by government simply to frustrate their particular activity, whereas in fact in most cases the fault is simply that they haven't organised themselves adequately so as to be able to deal with the normal burden of administering a company which of course includes ensuring an adequate flow of management information. Surprisingly, many smaller firms still turn their face against the accountancy skills which are in fact crucially important to the survival of any company, large or small. Jeremy Pope is quite adamant on this point. However good a technologist or salesman a principal may be, unless he has the skeleton of an efficient management and accounting system behind him, he is almost bound to fail, says Pope, particularly in an inflationary environment where costs and prices need to be constantly monitored.

What then, does he think are the prerequisites for a successful entrepreneur? First, it seems, it is no good going into business nowadays unless you are prepared to be totally dedicated and committed to hard work.

Secondly, even if it has to be imported, some professional experience in law or accountancy, banking or finance, is a must so as to establish a regime which considers developments carefully rather than one that lives from day to day and is characterised by instant decisions.

Thirdly, a realisation that, whether one likes it or not, it is government that makes rules about Vat, taxation and so on and that it really is a waste of time and totally counter-productive to be constantly complaining about the rules of the game. Pope thinks that, instead of regarding the Vat inspector as the enemy, progressive management should realise that a basic Vat system, for example, can also be a very useful management tool if used properly because it measures the value that is added and therefore can be made to provide information that might not otherwise be produced.

And finally, a warning that complacency is apparently the killer of all invention. Too many companies, says Pope firmly, stop thinking about the future when they are reasonably successful and subconsciously begin to rest on their laurels. And that in his book is the beginning of the end. 'Clogs to clogs in three generations.' Now there's a thought. I wonder if there's a market for plastic clogs . . .

MAIN DIFFERENCES BETWEEN SMALL FIRMS INVESTMENT COMPANIES (SFICs) AND APPROVED INVESTMENT FUNDS (AIFs)

AIFs exist under the Government's "Business Start-Up Scheme" to bring together the funds of a number of investors and spread them over a number of separate business starts. Effectively AIFs act as the agents or nominees for the individual investor.

SFICs, as proposed by the CBI, would act as intermediaries between investors and smaller companies. Individual investors would buy shares in the SFIC and obtain tax relief on their investment. The SFIC itself would then invest in a portfolio of eligible small companies.

Although there are similarities between SFICs and AIFs the important differences are as follows:

	AIF	SFIC
1.	Can accept investment only from individuals.	Can accept investments from funds and institutions as well as individuals.
2.	Invests as a nominee of the investor.	The investor takes shares in the SFIC which itself takes shares in the company.
3.	Investment is confined to equity in "new" businesses.	A SFIC may make loans or take equity in existing as well as new businesses.
4.	Because the individual has title to the shares in the new business, at the end of the qualifying period he has to find his own purchaser if he wishes to realise the shares. If the business has not gone public this can present difficulties.	As the investor purchases shares in the SFIC, the SFIC itself provides some sort of a market for shares as new investors come in. Further, it is quite possible that the SFIC itself might go public and will market its shares, although its investments may all be in private companies. This would make the realising of shares in the SFIC very straightforward.
5.	Funds require the specific and individual approval of the Revenue to allow the managers to act on behalf of individuals to spread their investments over a broad range of <u>new</u> business start ups.	SFICs would be governed by their own constitutions, general company law and specific existing legislation (such as the Prevention of Fraud Investments Act) which protects investors. They would be a great deal less complex and more flexible.

RESTRICTED

Econ M

Prime Minister

MCS 2/2

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

2 February

M. Scholar, Esq.,
Private Secretary,
10, Downing Street

Dear Michael.

OVERSEAS INVESTMENT AND CAPITAL FLOWS: NEDC(82)9

At this morning's meeting with the Chancellor the Prime Minister asked for a further explanatory note on why it is that a current account surplus brings with it an increase in our net overseas assets (a net capital outflow); and why the abolition of exchange controls reduced the exchange rate even though, after the event, it will not directly have increased the total net capital outflow. This note ... is now attached.

Yours ever
Peter

P.S. JENKINS

Michael ~~Told Peretz OK.~~

Following our word yesterday, the Chancellor has approved a

~~Your Ref~~ version of this paper for the February EPR – revised to take account of the PM's comments and also to give it a more definite message. He did not want to trouble the PM. But you might like to have a copy as it has gone to the printers. (Message as agreed with J Kerr!)

David Peretz

with compliments

Treasury Chambers
Parliament Street
London SW1P 3AG
Tel: Direct Line 01-233
Switchboard 01-233-3000

OVERSEAS INVESTMENT AND CAPITAL FLOWS

There was a discussion of inward and outward investment and capital flows at the meeting of the National Economic Development Council on 3 February. This article is based on the paper submitted to that meeting by the Chancellor of the Exchequer and sets out some of the facts and arguments.

2. It is clear in retrospect that abolition of exchange controls in 1979 not only removed a large unnecessary administrative burden on industry; but also that it was very timely. There was bound to be a sharp increase in outflows of investment by people and companies resident in the UK, as UK investors sought to build up the overseas element of their portfolios to a desired level ~~by residents as UK investors made the adjustment~~ following 40 years of controls. But in the event this came at a time, in 1980 and early 1981, when oil factors would otherwise have carried the exchange rate to even higher levels. Because the exchange rate was thus lower than it would otherwise have been, exports, production, employment and investment have all been helped by the abolition of exchange controls. At the same time, as set out more fully in an article in the January Economic Progress Report, ~~we have~~ Britain has been building up a stock of profitable overseas assets ~~that~~ which will provide a flow of overseas income for the future after the value of North Sea production has begun to decline; and which, in the meantime, will help to balance the outflow of interest and profit from the substantial overseas investments in the North Sea.

Relationship between capital flows and the current account

3. Concern is sometimes expressed about the size of capital outflows in recent years. While the abolition of exchange controls will have affected the composition of these flows and the exchange rate, it will not, directly, have affected their total size. The size of the total net capital outflow is not a cause for concern; on the contrary. Just as when countries run current account deficits they have to draw on their reserves or borrow, so when they are in surplus they necessarily build up their net overseas assets or reduce their overseas debts, in one ~~form~~ way or another. The net capital outflow for 1981 shown in table 1 below reflects the substantial current account surplus the UK has been running - perhaps £6 billion in 1981 alone - helped by North Sea oil, and

means that as a nation we are increasing our net overseas wealth and paying off debts. Table 3 shows the figures in more detail.

Table 1

£ billion

	Investment and other capital transactions	Official financing transactions	Current account balance	Balancing item
1970-4 (annual average)	+0.7	-0.2	-0.4	-0.1
1975	+0.1	+1.5	-1.5	0.0
1976	-3.1	+3.6	-0.9	+0.3
1977	+4.2	-7.4	0.0	+3.2
1978	-4.2	+1.1	0.9	+2.2
1979	+2.2	-1.7	-0.9	+0.4
1980	-1.4	-1.2	+3.1	-0.5
1981 (first 3 quarters only)	-6.2	+0.7	na	na

Note: minus sign means capital outflow, current account deficit.

~~Relationship between capital and current accounts~~

~~3.~~4 This is a point that is not always fully appreciated. ~~is that the nature of these flows requires~~ The first three columns in Table 1 should ~~to~~ add to zero; and the fact that they do not do so, and that a "balancing item" is needed, simply indicates that not all transactions have been correctly identified and measured. If as a country we export more than we import, then we necessarily acquire claims on foreigners - either in the form of credit extended to them, or by buying ~~capital~~ assets ~~from them either abroad (overseas investment or a reduction in overseas debt) or in the UK~~ - or by reducing our overseas debts. A net capital outflow and increase in the nation's overseas wealth is thus the automatic counter-part to a current account surplus. ~~Such an outflow increases~~ This increase in the UK's holdings of net external assets will ~~and either~~ reduce~~s~~ future current account payments on servicing overseas debts, or add~~s~~ to the future flow of interest, profits and dividends from abroad.

~~3.~~5 If exchange controls inhibit certain forms of capital outflow such as overseas portfolio investment, then the exchange rate will be forced up to the point where it induces different kinds of outflow (eg withdrawal of non-resident funds), or a lower level of exports and reduced current account surplus. When official intervention was used to limit the rise in the exchange rate, then the outflow took the form of an addition to the ~~assets~~ portfolio of overseas securities held in the o/f foreign currency reserves rather than private sector overseas investment. Abolishing exchange controls has not therefore affected the total net capital outflow, except to the extent that a higher exchange rate ~~would have meant~~ might in due course have lead to a smaller current account surplus, but the composition of the capital account outflow will have been changed.

Direct investment abroad

6 Direct investment abroad means investment by UK companies in the operations of their overseas branches, subsidiaries and associates. One effect of exchange controls was to require most of such investment to be financed by foreign currency borrowing (or retained foreign earnings). This rule was not designed to discourage investment, but to protect the exchange rate and the official foreign currency reserves. An early effect of exchange control abolition was that many companies were able to repay foreign currency loans previously raised to finance overseas investment. But, as expected, there has probably been little impact on the level of overseas direct investment itself, (with the figures for 1980 and 1981 showing only a fairly modest rise from the 1978-79 level) (See ~~Annex~~ Table 3, column 2).

~~8~~7 ~~There are reasons to suppose that~~ This continuing flow of direct investment overseas brings benefits to industry and UK employment in addition to the expected flow of future profits and dividends from abroad. Most ~~of our major trading partners~~ other developed countries have reached a similar conclusion. Much of such investment will complement rather than substitute for UK production. In some cases it helps promote UK exports by establishing sales and distribution networks and providing personnel links with UK firms and also by bringing orders for UK machinery and components. In some cases countries require exporters seeking export orders to invest in their country, particularly if large projects are at stake. And in other cases the alternative to investment by UK firms in overseas manufacturing capacity, where there is a profitable opportunity, will be similar investment by one of our overseas competitors, with a consequential loss of export markets to the UK.

Other capital outflows

~~4~~8. Most other capital outflows on the part of UK residents were tightly controlled before 1979, although non-resident flows were not controlled and large changes in leads and lags on trade payments were possible. Overseas portfolio investment had to be financed either by foreign currency borrowing or through the investment currency market, and it was illegal for UK residents to hold foreign currency bank notes or deposits (or to engage in forward exchange market transactions) without permission. These controls, which had been in existence since the start of the last war, were used to help defend the fixed exchange rate for sterling in the period up to the early 1970's.

~~8~~9. The removal of exchange controls allowed residents (including financial institutions) to increase the proportion of net foreign currency assets in their portfolios. In principle there might be both temporary and continuing effects on the flow of new investment abroad: a temporary (or stock-shift) effect as investors make up for a low level of investment in the past; and a continuing (or flow) effect thereafter as a larger porportion of new saving is invested overseas. The continuing flow effect is likely to be much smaller than the initial stock-shift effect. For this reason, the early impact of abolishing controls on overseas investment flows is unlikely to be a good guide to the flows that will continue into the longer term.

9. In the event perhaps the most obvious effect on the balance of payments of relaxing exchange controls has been the large outflow of portfolio investment (see Annex, column 1). This appears to have taken some time to build up, perhaps as institutions adjusted to the new freedom, but was running at the rate of over £4 billions a year during the second half of 1980 and the first half of 1981. Although there remains a great deal of uncertainty about the scale of future portfolio outflows, these figures are probably mainly the result of a once-and-for-all adjustment, following 40 years of control. Net UK bank lending overseas (Annex , columns 4 and 5) has also increased, although the increased sterling lending overseas has been partly matched by a related growth in overseas sterling deposits in the UK, as the euro-sterling and domestic sterling markets have become more integrated. This reflects continued development of London's business as an international banking and financial centre.

Effect of outflows on the domestic economy

(a) The exchange rate

10. These developments meant that the exchange rate was lower than it would otherwise have been in 1980 and in 1981. For much of the period, of course, other upwards pressures on the rate more than offset this effect: but without it, the rate would have risen higher than it did. The UK current account has been in massive surplus over the last two years, helped by the build up of North Sea oil production. There had to be a corresponding capital outflow as the counterpart to such a surplus. Removing controls on private capital outflows facilitated this adjustment, reducing the upward pressure on the exchange rate.

10. In the event perhaps the most obvious effect on the balance of payments of relaxing exchange controls has been the large outflow of portfolio investment (see Table 3, column 1). This appears to have taken some time to build up, perhaps as institutions adjusted to the new freedom, but was running at the rate of over £4 billions a year during the second half of 1980 and the first half of 1981. These large figures reflected a once-and-for-all adjustment, following 40 years of control, as financial institutions sought to reach a desired spread of investments round the world. There will be a natural ~~national~~ limit to this adjustment process, which is of course to the benefit of the pensioners and others who invest through these institutions. Table 2 below shows the proportions of new investment flows by the major investing institutions - insurance companies and pension funds - going abroad, into UK company securities and into British government securities during 1979, 1980, and the first three quarters ~~half~~ of 1981. In practice the increase in proportion of funds going abroad even during the 1980-1981 period of once and for all adjustment in portfolios ~~balance~~ ~~seems to have~~ has had little impact on ~~either~~ the ~~level or~~ proportion of funds going into British shares ~~UK equities.~~

Table 2 →

11. Net UK bank lending overseas (Table 3, columns 4 and 5) has also increased, although the increased sterling lending overseas has been partly matched by a related growth in overseas sterling deposits in the UK, as the euro-sterling and domestic sterling markets have become more integrated. This reflects continued development of London's business as an international banking and financial centre.

Effect of outflows on the domestic economy

(a) The exchange rate

12. Although as noted above the total net capital outflow will not have been directly affected by the abolition of exchange controls, it will have had a different composition. The outflow of resident funds, pent up for 40 years, will have taken place at

Table 2

% of new net investment going to:-

	Overseas investment	UK company shares	British Government securities
Insurance companies (long term funds)			
1979	2.0	14.9	55.1
1980	11.3	14.9	39.5
1981 (first 3 quarters)	14.5	13.8	40.2
Superannuation funds			
1979	8.2	26.8	41.0
1980	21.6	32.1	32.2
1981 (first 3 quarters)	23.5	26.9	31.8

a lower exchange rate than would have been required to induce a corresponding withdrawal of non-resident funds had exchange controls not been abolished. So, the exchange rate was lower than it would otherwise have been in 1980 and in 1981. For much of the period, of course, other upwards pressures on the rate more than offset this effect: but without it, the rate would have risen higher than it did. The UK current account has been in massive surplus over the last two years, helped by the build up of North Sea oil production. There had to be a corresponding capital outflow as the counterpart to such a surplus. Removing controls on private capital outflows facilitated this adjustment, reducing the upward pressure on the exchange rate.

13. Although the ending of exchange controls has thus had the effect of smoothing the impact of current account influences on the exchange rate, it is sometimes argued that it may have made the rate more sensitive to financial influences such as international interest rate differentials, and hence more volatile. The evidence is inconclusive. There has been an

increase in volatility in most major currencies in the period since mid-1979 compared with the immediately preceding period. This is no doubt associated with the worldwide growth in internationall mobile funds after the 1979 oil price rises. As to the impact in the UK of abolishing exchange controls, it is important to remember that even when tight exchange controls were in place, small changes in the timing of payments for imports and exports and changes in non-residents' investments in sterling could make the exchange rate extremely volatile, as they did during 1976 and 1977. Moreover the flows which were liberalised - notably portfolio outflows - seem in practice to have been stable, and also to have had a stabilising influence, (since they have tended to be largest in the quarters when sterling has been strongest).

(b) Interest Rates

14. Exchange controls restricted access to overseas securities by UK residents and for this reason may have allowed UK interest rates to be marginally lower (and security prices higher), relative to those abroad, than they would otherwise have been. Removing the controls will have reduced the demand of UK residents for UK assets, but it is likely that the net effect on interest rates has been small, for two main reasons:

(i) Non residents have always been able to move their funds freely between UK and overseas assets; this will have tended to keep expected returns in the UK in line with those overseas, even when exchange controls were in force.

(ii) The UK monetary authorities need to sell a lesser quantity of public sector debt to maintain any given degree of domestic monetary stringency. Thus the supply of UK public sector debt is reduced as well as the demand for it.

(c) Domestic activity and investment

15. Although it is difficult to be certain, the net effect of removing exchange controls has probably been beneficial for domestic activity. The exchange rate will have been lower and the international competitiveness better than otherwise, tending to sustain the level of activity. On the other hand interest rates may have been a little higher, tending to work in the opposite direction. But for the internationally exposed sectors of the economy, including manufacturing industry, the effect has almost certainly been beneficial, ~~helping these~~ coming at just the right time to help industries to adjust to the impact of North Sea oil at a time of rising world oil prices by moderating the associated rise in the exchange rate.

with the major once and for all outflows following the abolition of controls

16. The lower exchange rate will have helped, increasing the profitability of industry, especially in the internationally exposed sectors; and thus will certainly have helped rather than hindered domestic investment.

Investment in the UK was not helped by 40 years of rigid exchange controls, and will not have been damaged by their abolition. Increased investment depends on increased profitability. In this respect.

Conclusion

15. Most direct investment overseas probably helps complement UK exports and investment. Such investment was little inhibited by exchange controls, nor, following their abolition, has its level ~~significantly~~ greatly increased.

16. Abolishing exchange controls will not have increased total net capital outflows, except to the extent that by reducing the exchange rate it may have increased the current account surplus. But it will have changed the composition of these flows; outward portfolio investment has increased in particular. The net effect of this on the economy is hard to assess. But the results have been:-

(a) A smaller rise in the sterling exchange rate in 1980-81 than we would otherwise have experienced, at a time when oil factors in particular were carrying the rate to high levels.

(b) Perhaps some marginal upwards impact on interest rates.

(c) As a net result of (a) and (b), levels of output, investment and employment which are probably higher than they would otherwise have been, particularly in internationally exposed sectors of industry.

17. At the same time, by increasing profitable investment abroad through the private sector, the nation is building up an important source of overseas earnings that will continue to produce benefits beyond the period of peak North Sea production.

H M Treasury
22 January 1982

Table 3 ~~ANNEX~~

BALANCE OF PAYMENTS FLOWS

£ billion

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	UK Private Investment Overseas			UK banks external sterling lending (net of repayments)	UK banks external foreign currency borrowing or lending	Overseas investment in UK private sector	Other	TOTAL investment and other capital transactions	Official financing including allocation of SDR's	Current account balance
	Portfolio	Direct	Oil & Misc.							
Average 1970-74	0.0	-1.0	-0.2	0.0	+0.3	+1.1	+0.4	+0.7	-0.2	-0.4
1975	-0.1	-1.1	-0.1	+0.1	+0.3	+1.5	-0.4	+0.1	+1.5	-1.[illegible]
1976	+0.1	-2.1	-0.2	-0.3	-1.0	+1.9	-2.3	-3.1	+3.6	-0.9
1977	0.0	-1.9	-0.5	+0.1	+0.4	+3.0	+3.1	+4.2	-7.4	0.0
1978	-1.1	-2.7	-0.8	-0.5	-0.4	+2.0	-0.7	-4.2	+1.1	+0.9
1979	-0.9	-2.8	-2.9	+0.2	+1.6	+3.4	+3.5	+2.2	-1.7	-0.9
1980	-3.1	-2.6	-1.4	-2.5	+2.0	+4.2	+1.9	-1.4	-1.2	+3.1
1981 Q1	-1.3	-1.0	-0.4	-1.2	-0.6	+0.6	+0.7	-3.3	-0.2	na
Q2	-1.0	-1.0	-0.4	-0.4	-0.8	+1.3	+0.4	-1.9	+0.2	
Q3	-0.8	-1.0	-0.3	-0.8	+0.1	+0.9	+0.9	-0.9	+0.7	

NB. If all transactions are correctly and comprehensively recorded the current account balance necessarily equals total investment and other capital flows plus official financing.

5 FEB 1982

PM has seen MLS 5/2

Prime Minister

Just arrived this p.m.
MLS 2/2

Econ Pol

National Economic Development Council

NEDC(82)13
(For information)

FEBRUARY 1982 COUNCIL: TUC ECONOMIC REVIEW 1982

The TUC's Economic Review for 1982, 'Programme for Recovery', is circulated herewith - to members of the Council only - for information.

P G Davies

Secretary to the Council

National Economic Development Office
Millbank Tower
Millbank
London SW1P 4QX

2 February 1982

NATIONAL ECONOMIC DEVELOPMENT COUNCIL: WEDNESDAY 3 FEBRUARY

CHAIRMAN'S BRIEF

THE COUNCIL: BACKGROUND

The Council was set up by Ministerial decision in 1962 with broad terms of reference to examine the economic performance of the nation. Over the years, a wide range of economic and industrial issues have been considered. When you last chaired a Council meeting in February 1981, the main items on the agenda were industrial trends and prospects, and the UK's performance in the market for large overseas capital projects. A list of current Council members is attached at Annex A.

2. The Council has no executive powers. Its role (and its strength) is as a forum in which the Government, management and the trade unions can exchange views. Whilst it provides an opportunity for each of the parties to explain its policies, its success depends on the willingness of Council members to listen, and to respond constructively, to the views put forward by others.

3. You will recall from your previous visits that the tone of the meetings tends to be informal and loosely structured. The practice has been for the Chairman to concentrate on inviting contributions from others and on drawing out, and summing up, on each item, any areas of agreement and points which need to be followed up by one or more of the parties. He normally leaves it to the responsible member of the Ministerial team to take the lead in replying for the Government on individual items of substance.

4. The meetings are held in private but the normal practice is for papers to be released to the press, if the Council agree, and for the Director General to hold a press conference immediately after the meeting at which he gives an objective account of the proceedings.

5. The last Council meeting was at the beginning of January when the main item on the agenda was a paper by the Chancellor on macro-economic policy. The paper argued that wage and price inflation had to be reduced further, and the recent rapid increase in industrial productivity maintained if we were to create the conditions in which

a sustained economic recovery could take place. The TUC said that the Chancellor's paper should have examined alternative policy options - including a reflationary package of increased public expenditure and a reduction in VAT. The CBI called for action to reduce business costs.

AGENDA

Item		Suggested length of discussion
1.	The outcome of the Cancun Summit	½ hour
2.	Inward and outward investment	1 hour
3.	The electronics industry: Government action check list	¾ hour
4.	The small firms sector	½ hour

6. Both Mr Baker, Minister for Information Technology, and Sir Henry Chilver will join the Council for the discussion on the electronics industry. Sir Henry is Chairman of the Electronics EDC.

7. This will be Mr Astley Whittall's last Council meeting. He has been a member of the CBI team on the Council for the last four years. You may wish to express to Mr Whittall the thanks of the whole Council for his contribution over this period. This will also be Sir George Jefferson's first Council. Sir George is Chairman of British Telecom and will represent the nationalised industries. You may wish to welcome him.

OPENING REMARKS

8. You may care to open by thanking Council for inviting you to chair the meeting. You could say that you found the discussion at the meeting you attended a year ago most valuable. It confirmed your belief that the Council had an important part to play in improving our understanding of the UK's economic problems.

ITEM 1: CANCUN

9. You will wish to introduce the discussion. A speaking note (prepared by the FCO) follows:

"The Summit was designed to promote greater understanding between the participants and to give a lead in seeking solutions to various problems. It was never intended to negotiate or to make precise commitments, since we could not bind countries that were absent.

In the view of all the participants, the Summit was reasonably successful. Constructive discussion among developed and developing countries at highest level.

Pleased that rhetoric and confrontational atmosphere avoided. Common interests underlined.

Valuable practical discussion on specific issues, particularly on food and energy. On food, it was agreed that, while food aid was needed for temporary shortages, the main priority must be for developing countries to grow more food for their own people. This means giving farmers the right incentives and technical support. Aid should be designed to reinforce these objectives.

The discussion on energy focussed on increasing investment in developing countries, to enable them to build up their own resources. I joined a number of other participants in supporting the idea of an energy affiliate of the World Bank, provided that this would attract additional finance for energy investment, especially from OPEC surplus countries.

The Summit fulfilled its main objectives. The task now is to build on this - to ensure momentum generated at Cancun is maintained.

I hoped we could go on from Cancun to reach agreement in New York on launching Global Negotiations on international economic co-operation for development. Useful progress made in preparing for these negotiations. Full agreement not reached, but no doors closed. Remain willing to help where we can.

Meanwhile, Brandt Commissioners remind us that developing countries face persistent problems which cannot wait. Fully support call by Mr Trudeau and President Lopez-Portillo for renewed efforts to achieve consensus on launching Global Negotiations.

Noted with interest meeting of Brandt Commissioners in Kuwait in January. Also watching sympathetically meeting of developing countries convened by Mrs Gandhi in New York later this month".

10. Handling. When you have finished your introduction, you will wish to invite the TUC and the CBI to comment. The TUC will argue that the Cancun Summit did not go far enough in implementing the recommendations of the Brandt report. The CBI are unlikely to have anything to say. You will wish to keep the discussion short, and perhaps use the summing up to reply to particular TUC points.

11. Cancun has been discussed on two previous occasions in the NEDC. The TUC, however, want to raise it again because they wish to express their concerns to you personally. Mr Murray outlined the TUC views in a recent letter to Lord Carrington (letter plus Mr Hurd's reply attached at Annex B). The TUC want a massive transfer of resources to the developing countries, and are disappointed at the Government's failure to commit itself to an 0.7 per cent of GNP aid target. They do not believe that private investment flows are an adequate substitute. They would also like to see the reform of the IMF and the IBRD to reflect the interests of borrowers as well as lenders, the establishment of an IBRD energy affiliate, more aid for energy technology, further progress on the problems of trade and adjustment, agreement on a UN code of conduct on trans-national corporations, and a resumption of the Global Negotiations in the UN.

12. If the TUC raise any of these points, you could argue:

(i) reform of the World Bank and the IMF. Both the Bank and the Fund have, with our active support, substantially adapted their activities recently to meet the needs of developing countries. Greatly expanded resources are now available, on terms which increasingly reflect the economic needs of ldcs;

(ii) <u>establishment of energy affiliate</u>. We have made clear our support for an affiliate which would attract additional funds for energy development, particularly from oil surplus countries;

(iii) <u>special aid for energy</u>. 25 per cent of our bilateral aid programme now goes to energy development projects. We have specially earmarked resources in the aid programme for assistance with energy planning in developing countries;

(iv) <u>the problems of trade and industrial adjustment</u>. We recognise the importance of helping developing countries, particularly the poorest and least developed, to industrialise and of giving them greater access to our market. The Community's generalised scheme of preferences is an important means of advancing this objective;

(v) <u>the importance of private investment flows</u>. I quote the words of Herr Brandt himself, "in our report we emphasise that official development assistance has always played a marginal and a subsidiary role in financing investment in developing countries" (Economist, 28 November);

(vi) <u>UN code of conduct on trans-national corporations</u>. We fully endorse non-mandatory codes of conduct such as the OECD guidelines and the UNCTAD restrictive business practices code which contribute to a general framework within which TNCs can work. We are actively involved in negotiations on the TNC code and hope that agreement can be reached that will satisfy the aspirations of all the interested parties;

(vii) <u>big increase in aid required</u>. The UK's net aid programme is over £1 billion; a substantial sum by any standards; and the fifth largest of OECD countries (after the US, France, Germany and Japan). We accept the 0.7 per cent of GNP as a target, but, like previous governments, we are unable to commit ourselves to a specific time for reaching it;

(viii) <u>need to press on with Global Negotiations.</u> Preparations for the negotiations havenot resumed in New York since the Christmas adjournment. Unfortunately, it has been difficult to get agreement between the US, the EC and G77 on a text to form the basis for launching the negotiations. Without a text, no further progress is possible.

ITEM 2: INWARD AND OUTWARD INVESTMENT (NEDC(82)7,9 and 11)

13. There are three papers for discussion: two on outward investment; and one on inward investment. You will wish to invite the Chancellor, the TUC and Mr Jenkin to introduce their papers in that order and without any intervening discussion. A speaking note for the Chancellor' use is at Annex C . Mr Jenkin's brief is at Annex D .

14. The idea is that there should be one general discussion on both inward and outward investment. Since, however, the two topics raise somewhat different issues, the rest of this part of the brief is divided into two sections - Part A dealing with outward investment, and Part B dealing with inward investment.

<u>A. Outward investment</u>

15. <u>Aims</u>. The main objective is to get Council to view the abolition of exchange controls in its proper perspective: it was a timely move that helped reduce upward pressures on sterling at a time when they were particularly strong, not least for oil-related reasons, and has thereby on balance helped rather than hindered employment and investment. It is also a good example of a change that has produced indirect benefits through the removal of unnecessary bureaucracy.

16. <u>Background</u>. Overseas investment is on the agenda at the request of the TUC who feel that the abolition of exchange controls has led to a sharp increase in overseas investment, with adverse effects on domestic interest rates, employment and activity.

17. The <u>Chancellor's paper</u> points out that a current account surplus must be offset by a net capital outflow. Abolition of exchange controls has thus not, directly, increased the <u>net</u> outflow; but has altered the composition. Direct investment overseas has not increased significantly since exchange controls were abolished. But other outflows, notably portfolio investment and bank lending overseas,

have done so. The initial effects of abolition included a once and for all stock adjustment and are likely to be larger than the continuing effects. The outflows eased pressure on the exchange rate when oil factors were pushing the rate upwards. The outflows will continue to produce balance of payments benefits after the period of North Sea production.

18. The TUC paper accepts that some direct overseas investment helps UK exports and that inward investment to the UK should be encouraged. Nonetheless, the paper calls for a Foreign Investment Review Body to monitor inward and outward direct investment. The TUC draw attention to the increase in portfolio investment overseas and say that money is being diverted overseas that would otherwise be invested in UK shares or gilts leading to lower interest rates. The paper suggests that although abolition of exchange controls has led to a lower exchange rate it needs to be still lower and suggests that this could be achieved if monetary policy was relaxed. It is suggested that financial institutions should invest more in the UK and the TUC invite NEDC to consider how investment in the UK can be increased and whether exchange controls can help maintain stability in international financial markets.

19. Points for you or the Chancellor to make. It is for consideration to what extent you, as Chairman, should intervene in the discussion. You may wish to make one or two of the following points yourself. Alternatively, you could leave it to the Chancellor (and other Ministers) to express the Government's point of view:

(i) abolishing exchange controls facilitated some types of outflow and helped keep the exchange rate lower than it would otherwise have been. There was no direct impact on the net capital outflow, which must necessarily balance the current account surplus;

(ii) in retrospect it is clear that the timing of abolition was as good as it could be. The largest outflows came when the exchange rate was under considerable upward pressure due to oil factors;

(iii) abolishing exchange controls is a good example of reducing bureaucracy (around 750 public sector jobs were saved) while helping the productive parts of the economy;

(iv) overseas investment will provide balance of payments benefits for the economy in future, after North Sea production has begun to decline.

20. Defensive points on TUC paper:

(i) any impact on securities prices and interest rates of the abolition of exchange controls will have been small. Non-residents were always free to switch between UK and overseas assets. Moreover, resident outflows reduce the need to sell gilts to maintain any degree of monetary stringency;

(ii) the Bank and Treasury agree that the net exchange rate and interest rate effect of abolishing exchange control will have helped exporters, employment and domestic investment;

(iii) all agree on the need to encourage profitable investment in the UK, that will benefit the current account. But there is no benefit to anyone in trying to force institutions to invest in unprofitable projects. The main precondition for such investment is further improvements in working practices and productivity to match our overseas competitors;

(iv) a Foreign Investment Review Body would add to the bureaucratic burden on industry without helping it to improve profitability or increase UK investment. The private sector is best placed to judge the profitability of a project and if the project is profitable the private sector will find the money;

(v) exchange rate stability: the dramatic fall in sterling in 1976 and the subsequent recovery occurred when tight exchange controls were in place. There is no evidence that sterling is less stable than it was then;

(vi) seeking to reduce the exchange rate by relaxing monetary conditions leads to higher inflation and further loss of competitiveness. We have been down this road too many times in the past.

B. Inward investment

21. Aims. The important thing is to get Council to recognise the important contribution which inward investment already makes to the UK economy. Attracting more investment to the UK will depend on our continuing commitment to membership of the EC and on our maintaining a liberal trading regime.

22. Mr Jenkin's paper argues that inward investment is to be welcomed not just for its effects on UK employment (and these are sizeable: over 1 million people are employed in overseas-controlled establishments) but also for introducing new technology, new working practices and new managerial expertise. The paper also points out that with the UK's heavy dependence on overseas trade it is vital that we continue to provide an attractive base for internationally mobile investment projects.

23. In discussion, it might be worth bringing out the point that the UK has a very successful record in attracting inward investment. In 1980 we attracted nearly 60 per cent of all the US direct investment in EC countries, and half of Japanese investment (though that is much smaller). So long as the UK continues to be seen as an attractive location for international investment (and our membership of the EC is important here) we should continue to derive benefits in terms of employment, technology and management skills.

24. The CBI are likely to welcome the general stance of encouraging inward investment, but to argue for a more selective approach, particularly where Government grants are concerned. They feel that it is important that foreign firms setting up in the UK should purchase a large proportion of their components from UK firms. The Government agrees with this objective in principle: offers of selective financial assistance do take account of the long term impact of a project on the UK economy. But it is not easy to put across a message of qualified welcome without putting off some investors altogether.

25. The CBI may also criticise the proliferation of Government agencies promoting inward investment. This can lead to wasteful competition. The Government has accordingly set up machinery for co-ordinating the work of the various bodies involved.

26. The main TUC point is likely to concern the dangers of companies setting up peripheral plants in the UK, with no long term commitment to their future and with inadequate R&D effort; this can mean that these plants are the first to get closed if the company runs into difficulty. There is really very little evidence on this either way - but certainly none to support the view that manufacturing employment in foreign aid companies has declined sharper than the average over the last few years.

Summing up on inward and outward investment

27. You will wish to record as much agreement as possible on the following points:

(i) inward investment should be encouraged:it can provide additional jobs and constitutes a mechanism for introducing new technology;

(ii) the abolition of exchange controls has reduced the bureaucratic burden on the economy and means that the exchange rate was lower than it would otherwise have been when oil prices were forcing it upwards.

(iii) on balance, the abolition of exchange controls has helped rather than hindered employment and investment;

(iv) overseas investment will provide a valuable balance of payments benefit after the value of North Sea production has begun to decline.

ITEM 3: THE ELECTRONICS INDUSTRY (NEDC(82)12)

28. You will wish to invite Mr Baker to introduce his paper (NEDC(82)12). Before opening up the discussion, you might ask Sir Henry Chilver for his reaction. Mr Baker's brief is at Annex E.

29. Aims. These are to:

(i) impress on Council the importance of the information technology (IT) sector;

(ii) explain what the Government is doing to help;

(iii) emphasise that the UK supply industry must improve its competitive position and increase its share of world markets.

30. Background. Mr Baker's paper is a response to a presentation given to Council last November by Sir Henry Chilver. Sir Henry emphasised in particular that the UK had to be internationally competitive in IT markets, and that a selective approach to the industry was required. Most of Sir Henry's recommendations were aimed at Government:

(i) over the next 12-months, the major firms in the UK and

Government, through the EDC and SWPs, should collaborate to identify selective business strategies;

(ii) industrial priorities should be identified across the public sector; and

(iii) the role and objectives of public sector bodies should be examined so that investment assistance of R&D spending is best used to promote these priorities.

31. Mr Baker's response emphasises that the UK IT industry can have no real future without establishing a competitive international position It accepts the concept of selectivity in this sector and shows how this is already reflected in the Government's current action programme. The response points to action already being taken in the broad areas identified by the Electronics EDC (IT systems, viewdata/teletext, radio communications, civil spin-off from defence R&D, and core technologies such as fibre optics) and refers to a number of other key areas, including cable and satellite systems and computing research. While accepting that the Government has a role to play, the response stresses that the UK's success will depend ultimately on the efforts which the IT industry and the private sector make to remedy the weaknesses identified and to capitalise on the strengths.

32. Points for you or the Chancellor to make:

(i) consideration of possible Government initiatives should not mask or delay the need for private sector initiatives. Two areas where this is particularly relevant are (a) the commercial application of defence technology and (b) public procurement, where the performance and flexibility of UK suppliers are as important as the attitude of purchasers;

(ii) training: half of the training of programmers and analysts in IT is funded by the MSC and 34,000 training places have been privided by grants from the Microprocessor Applications Project. What are managements and unions doing to increase training opportunities and to encourage acceptance of the new technologies?

(iii) private sector investment: a policy of selective support in key areas must depend upon the willingness of the financial world to invest in the identified new technologies and business opportunities offered by IT systems, cable and satellite communications etc. It will also be necessary for them to take the longer view of their investment which is essential if a high world market share and competitive pricing policy is to be achieved;

(iv) IT Year: the aim is to promote an awareness of IT by the public at large and by businesses. Can industry and the unions do more to help? Kenneth Baker has written to all Government Departments asking for them to make a special effort in IT Year;

(v) selectivity: the constraints on the Government's resources must be remembered if the discussion of selectivity is to have any practical relevance. Would the Council wish the Government to give greater priority to IT within its overall budget and how might this best be achieved? In the competition for limited resources should the fast growing new technology industries be given priority over the traditional industrial sectors?

(vi) international competition: the UK industry by world standards is small, fragmented and over-dependent upon the domestic market. It has only a tiny share (1.5 per cent) of the non-UK market; current trends are discouraging and must be reversed. UK industry must establish itself in world markets, and particularly in the USA and Europe.

Summing up

33. You will wish to thank Sir Henry Chilver for the valuable work of his EDC in concentrating the attention of the Council on this subject which is of such fundamental importance to the UK's economic future. You may also wish to mention IT Year: it provides a good framework for the Council to register its recognition of the importance of IT and of the need for all parties to work together to get this message across. Finally, you could emphasise the Government's willingness to discuss directly with the IT industry ways in which the efforts of all sides could most usefully be concentrated on selected key areas. But success can only come from commitment from all of those involved in the IT industry and is ultimately dependent upon the industry itself.

TECHNOLOGY AGREEMENT IN THE CIVIL SERVICE

34. The TUC have indicated that, if no new technology agreement has been reached between the Government and the Civil Service unions

before the NEDC meeting takes place, they propose to raise the matter in the course of the debate on the electronics industry. They will argue that the Government, by refusing to conclude the draft agreement, is obstructing the introduction of new technology. The MPO will be supplying a separate brief on this during the next few days.

ITEM 4: SMALL FIRMS (NEDC(82)8 and 10)

35. There are two papers on this subject, one by the DOI and another by the CBI. You will wish to invite Mr Jenkin to introduce his paper first, and Mr Pope, Chairman of the CBI Smaller Firms Council, to introduce his second. Mr Jenkin's brief is at Annex F.

36. The DOI paper first describes the size and recent growth of the small firms sector and identifies certain small-firms characteristics which contribute to the health of the economy - their flexibility, their record on innovation, and their spirit of enterprise. It then describes what the Government has done to provide help for small firms - including tax changes, measures to provide easier access to capital (the Business Start-Up and Loan Guarantee Schemes) and the Small Workshop Scheme. Finally, the paper considers future policy, and notes the pressure for further cuts in taxes and the NIS, as well as improvements in the Business Start-Up and Loan Guarantee Schemes.

37. The CBI paper covers largely the same ground. But it contains a useful additional section outlining the particular problems of small firms (eg the narrower product range and thus greater exposure to market changes and their limited financial and human resources). The paper rightly argues that it is the need for policy measures to overcome the natural drawbacks of size which constitutes the rationale for Government intervention.

38. Aims. These are to get Council to:

(i) recognise /that the small firms sector can and does make an important contribution to the economy;

(ii) endorse the various measures the Government has taken to provide help for this sector;

(iii) suggest what other forms of assistance might be required.

39. Points for you or the Chancellor to make:

(i) over the 1970s, small firms did better in terms of employment than medium or large firms. Faster growth in services vis-a-vis manufacturing industry combined with developments in fields such as information technology are expected to lead to a greater expansion of small firms in the future. The focus on small firms is thus an excellent example of the Government promoting positive adjustment in the economy, seeking to move with market developments and facilitating change and growth, rather than shoring up obsolete sectors;

(ii) no Government has done more for small firms. Since taking office, over seventy-five measures of help have been introduced. Some of these - particularly the Business Start-Up Scheme - are radical in scope. Moreover, such innovations have helped change attitudes in the banks and other financial institutions and made them more receptive to the needs of small firms. The banks also introduced valuable new financial packages for small companies of their own. Easier access to finance combined with the various tax changes have transformed the whole environment facing small firms;

(iii) in general, small firms appear to benefit from good working relationships between employer and employee. One reason for this might be the low degree of unionisation in small companies. Another factor might be that employees find it easier to identify with small firms. What do the TUC and the CBI think?

40. The TUC are unlikely to have much to say on small firms. They may, however, argue that small firms contribute a significant part of the black economy. They may also complain about the special dispensations for small firms from certain employment legislation (eg employees cannot bring claims for unfair dismissal to industrial tribunals unless they had been employed for two years rather than one). In reply, the two problems could be takentogether: deregulation and greater flexibility are necessary to encourage people to set up small firms.

Closer or tighter regulation might encourage more small firms into the black economy. The main rights of employees in small firms are in any case still protected.

41. Summing up. You will wish to record agreement on as many as possible of the following points:

(i) small firms have a vital part to play. Their flexibility, spirit of enterprise and approach to innovation make a significant contribution to the overall health of the economy;

(ii) it is right that small firms should be helped to overcome the natural obstacle of their size. The Government's record in providing help is second to none;

(iii) but this is not to say there is no scope for further action. The discussion has produced a number of proposals which deserve, and will receive, careful consideration.

NEDC MEMBERSHIP

Government

Chancellor of the Exchequer
Secretary of State - Industry
Secretary of State - Trade
Secretary of State - Employment
Secretary of State - Energy
Secretary of State - Environment

TUC

Len Murray
Frank Chapple
Geoffrey Drain
Moss Evans
Terry Duffy
David Basnett

CBI

Astley Whitall
Ronald Utiger
Sir Terence Beckett
Sir Ray Pennock
Jeremy Pope
Robin Leigh-Pemberton

Nationalised Industries

Sir Peter Parker
Sir George Jefferson

Independent Members

Gordon Richardson
Rachel Waterhouse
Sir Richard O'Brien

Director General NEDO

Geoffrey Chandler

ANNEX B

TRADES UNION CONGRESS

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Po. mT

Rt Hon Lord Carrington
Secretary of State for Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street West
LONDON
SW1A 2AL

YOUR REFERENCE

OUR REFERENCE LM/BC/SMcC/EK

DEPARTMENT Economic

January 4 1982

Dear Lord Carrington

The Mexico Summit: International Meeting for Co-operation and Development

At their recent meeting the General Council considered the outcome of the Mexico Summit held at Cancun in October. The TUC's view was expressed at the November meeting of the National Economic Development Council when the Secretary of State for Industry gave a short report on the Summit. I am taking this opportunity to elaborate on the views expressed at that time, and also to enclose a statement issued by the Executive Board of the International Confederation of Free Trade Unions.

The General Council welcomed the fact that the Summit meeting took place, but expressed strong disappointment over the failure of the Government to make any commitments as a result. The central message of the Brandt Report - that interdependence creates a mutual interest in Third World development - seems to have been acknowledged and then ignored by the Summit participants. Indeed, the Government has failed to respond positively to the Brandt Report's urgent recommendations. It was imperative that the Government should have committed itself in Mexico to a 0.7% of GNP aid target and announced a timetable for achieving this target. A worrying feature is the Government's emphasis on the importance of private investment flows to the Third World as if this is a suitable or acceptable alternative to official development assistance. On many of the other major items on the agenda of the Summit meeting there was an apparent inability by the UK Government to take the initiative.

However, the 'success' or 'failure' of the Summit meeting will depend on rapid progress across a whole range of subjects within the North-South dialogue at the United Nations. Follow-up action by the Government must include tangible progress towards reform of the World Bank and International Monetary Fund to reflect more closely the interests of these institutions' 'consumers' as well as of their lenders. Also, every effort needs to be made towards the establishment of an IBRD energy affiliate to promote investments in Third World energy projects as a means of reducing their oil-induced balance of payments difficulties. A start could be made by the UK Government announcing a special package of aid in energy technology. Another important area where little was achieved at Cancun but which requires urgent solution is the problem of international trade and industrial adjustment. The stress on private investment flows as part of the transfer of resources to the Third World reinforces the arguments put forward by trade unions and Third World countries for the speedy and successful conclusion to negotiations on a UN code of conduct on transnational corporations. This code would be a means of guaranteeing TNC activities respond to the needs and aspirations of the communities in which they operate. These are a few of the outstanding issues on which quick progress should be possible.

The TUC, in looking forward to Government action to follow-up the conclusions of the Summit, calls for a massive transfer of resources to increase the effective demand of Third World countries to meet the basic needs of their populations. It is crucially important that the deadlock in the 'global negotiations' is broken since action, both to reduce unemployment and initiate industrialisation, is urgently required. The UK Government has an important role in ensuring the constructive resumption of these negotiations at the United Nations.

Yours sincerely

Lionel Murray

General Secretary

encl.

INTERNATIONAL CONFEDERATION OF FREE TRADE UNIONS

CANCUN: BRAVE WORDS BUT NOT MUCH ACTION

The Cancun Summit could have given a major new impetus to the stagnated North-South dialogue. Unfortunately, the 22 leaders present seem to have missed the opportunity. World-wide poverty and unemployment have worsened to crisis proportions and the people of North and South are looking for concerted international action. Although the meeting was not expected to solve all the problems of the world economy, it could have given its backing to positive proposals which would force the pace of global negotiations within the UN framework. The summary of the meeting given by the co-chairmen is short on specific proposals, and the ICFTU can only conclude that at least some of the leaders present do not yet appreciate the urgency of the problems facing working people all over the world.

On food and agricultural development some proposals to eliminate hunger by increased food production and by emergency food aid were discussed and received support. The Summit participants also seem to have established agreement on the importance of activating the Common Fund on Commodities and new commodity agreements. In contrast differences are more acute on trade, industrialisation, energy and monetary and financial issues. The failure to make progress on the vital issues of the financing needs of developing countries, the role and functioning of the IMF and the World Bank, reducing the damaging high level of interest rates and creating a more stable exchange rate and reserve asset regime, is particularly disappointing. The Summit only briefly touched upon the need to reduce expenditure on armaments. It did not go into the vital question of defining development strategies which meet the Basic Needs of working people. This was a major gap in the agenda at Cancun.

Many of the political leaders present at Cancun believe a better understanding of different points of view was established. We sincerely hope that this will bear fruit in the resumed discussions of the UN General Assembly. However, a considerable amount of work still needs to be done before a successful agreement on a new international economic and social order can be achieved. The ICFTU and its affiliates mounted a big effort to make the Cancun Summit a positive step in the North-South dialogue, including sending a special high-level delegation to meet President Lopéz Portillo. We will continue our efforts and intend to publish a programme for balanced world development in the 1982 World Economic Review. This programme is part of the follow-up to the ICFTU's New Delhi Conference on the Trade Union Role in Development and links up directly with our affiliated organisations' own representations to governments.

President Lopéz Portillo and Prime Minister Pierre Trudeau, the co-chairmen at the Summit, said that the meeting had "made clear the political will of all participants at Cancun to move forward and take action". These are brave words. The task of the ICFTU and its affiliates in the future will be to ensure that political leaders live up to them.

Foreign and Commonwealth Office

London SW1A 2AH

25 January 1982

From The Minister of State

Douglas Hurd CBE MP

Dear Len Murray,

CANCUN SUMMIT : INTERNATIONAL MEETING FOR COOPERATION AND DEVELOPMENT

You wrote on 4 January to Peter Carrington about the Cancun Summit, amplifying the TUC's views as expressed at the National Economic Development Council and enclosing a statement by the ICFTU. He has asked me to thank you and to reply.

You will know that Peter Carrington was always concerned that too much would be expected from the Cancun Summit. Too much was expected; and this has inevitably meant some disappointment with the result. But this disappointment was not shared by the Summit participants, from either the developed or the developing countries. All the leaders who attended found the meeting valuable and welcomed the practical and constructive discussions and the friendly and informal atmosphere in which they took place. For example, Mrs Gandhi made this point to me in Delhi a few days ago.

Your letter suggests that Britain took a passive role at the Summit and was unable to take the initiative on any subject. This is not the case. The discussion on food and agriculture, as reflected in the Chairman's summary, followed clearly the line first set out in the Prime Minister's speech. This stressed the need for developing countries to grow more food for their own population and warned against an undue reliance on food aid. In the energy debate we stated our support for a World Bank energy affiliate, provided this would attract additional funds particularly from the surplus oil producers. I am glad to see that you too endorse this measure. On trade, we announced our intention to ratify the Common Fund Agreement and have since done so. I note that the ICFTU gave a special welcome to what the Summit said on this.

I agree that we much now follow up the Summit by seeking progress across the whole range of subjects of concern to developing and developed countries. We announced before the Summit extra British aid for energy resource planning, as well as in the fields of water supply, agricultural research and population. We are

/taking

The Rt Hon Lionel Murray OBE
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taking a full part in the review of quotas in progress in the International Monetary Fund and in the current negotiations for the UN Code of Conduct on Trans-national Corporations; we hope that agreements acceptable to all can be achieved. In this context, I should make clear that we do not regard private investment as an alternative to official development assistance, as you suggest. There is a place for both. But we think it important that developing countries in a position to do so should make every effort to attract private investment, so that official aid can be concentrated more on those poor countries which need it most.

Both your letter and the ICFTU statement attach much weight to starting the Global Negotiations at the UN. We share the same objective. As holders of the Presidency of the Community up to the end of last year, we were active at the General Assembly in seeking ways of launching Global Negotiations, early in 1982, on a basis which all could endorse. We came close to agreement last year and shall continue to do what we can to keep up the momentum.

We are all aware that the developing countries face daunting problems and that great efforts are needed to move things forward. There are no quick solutions and agreement is not easily achieved in these complex economic matters. But I believe that the better understanding of problems of general concern which was achieved at Cancun will help us all in the future.

Yours ever,

Douglas Hurd.

ANNEX C

OVERSEAS INVESTMENT AND CAPITAL FLOWS

SPEAKING NOTE FOR CHANCELLOR

To help the discussion today, I have circulated a paper that both sets out the facts about capital outflows in recent years, and assesses what the implications have been. The overall picture and the ways that the different flows interact are not, I think, as widely understood as they might be, so I welcome this opportunity for a discussion in NEDC.

2. By way of introduction let me stress the main points that the paper brings out.

3. First, the current account of the balance of payments has been in very substantial surplus (perhaps £6-7 billion in 1981 alone). Everyone understands that when we are running a deficit we have to rundown our reserves or borrow. Similarly when the current account is in surplus we necessarily build up our net overseas assets, by increasing the reserves, reducing past borrowing or by investing overseas. The net capital outflow is thus not a cause for concern: on the contrary, it reflects the current account surplus; and means that as a nation we are increasing our net overseas wealth.

4. Secondly, it follows that abolishing exchange controls will have made no difference, directly at least, to the net capital outflow. The main effect of allowing new forms of outflow will have been an exchange rate lower than it would otherwise

have been. At the same time any fall in UK securities prices consequential upwards impact on <u>interest rates</u> is likely to have been small. Particularly for the internationally exposed sectors of industry the net effect will certainly have been helpful to employment, output and investment.

5. In retrospect it is clear that we got the timing of abolition almost precisely right. Certainly we did well not to delay. The main stock adjustment, as domestic investors sought to make up for 40 years of control, came at a time when oil factors in particular would otherwise have carried the exchange rate to even higher levels. I would commend the episode as a good example of the indirect as well as direct benefits to the economy of abolishing outdated bureaucracy and control.

6. <u>Finally</u>, it is worth recalling that North Sea production has now built up to near its maximum level. The overseas assets we are acquiring will provide a flow of overseas income in future after the value of North Sea production has begun to decline. [I do not pretend these assets are a substitute for the greater profitable investment we need at home. But I hope that by the end of today's discussion we might be able to agree that they are a useful complement].

ANNEX D

Extracts from Mr Jenkin's Brief on Inward Investment

NEDC MEETING 3 FEBRUARY 1982: INWARD INVESTMENT

BRIEF FOR SECRETARY OF STATE

Objectives

Although we do not expect any positive outcome from the meeting in respect of inward investment, it will provide an opportunity to emphasise publicly our belief in freedom of international investment and to stress the important contribution that such investment makes to the UK economy.

2. In addition the Secretary of State will be able to:-

(a) rebut claims that inward investment has an adverse effect on indigenous companies, explain the difficulties that would be involved in operating a more selective approach to inward investment, while explaining what is already done to monitor the performance of inward investors who receive Government aid;

(b) emphasise the relatively small part that investment by Japanese companies plays in the overall context of foreign investment, and the benefits that such investment has brought;

(c) acknowledge the concern expressed by the CBI and others about the apparently large number of competing promotional agencies in the UK and explain what is being done to co-ordinate their efforts.

Line to Take/Points to Make

1. A liberal approach to inward investment is part of our belief in free market economic policies: freedom of investment has benefitted the UK economy and will continue to do so. We want to make sure that whatever new investment by multinational companies is now being made comes here rather than elsewhere. Our policy on non-discrimination in taxation, on promotion and financial assistance is designed to achieve this.

2. Britain's membership of the EC has been an important factor in attracting US and Japanese investors in particular. The UK's share of US direct investment in Europe has been rising rapidly since our accession to the Community. In 1980 we attracted nearly 60%* of all the US direct investment in the EC countries. A survey published in a technical magazine recently showed the UK in top place as a location for overseas investment by US electronics companies and that Britain's

* the paper, para.5, says 40% - this was an under-estimate

FLAG A presence within the EC is a major attraction (Annex2- Flag A)

3. Unemployment black spots such as Northern Ireland and Scotland have benefitted noticeably from the employment brought by inward investors. In Northern Ireland 22% of employment in manufacturing is in US firms and in Scotland such companies have provided 70,000 jobs. Overall, foreign firms currently employ over a million people, equivalent to 14% of the workforce in manufacturing. The IBB expects more than 37,000 jobs to be created in the UK as a result of manufacturing projects firmly decided upon by overseas companies during 1980 and 1981 (see table and examples of recent inward investment successes

FLAG B at Annex 1 - Flag B).

4. Although the UK accounts for about half of the Japanese investment in the EC, the volume of such investment in terms both of projects established and numbers of jobs is still small. At the moment there are only 22 fully fledged manufacturing enterprises in the UK with Japanese owners, with a further 3 about to start. We believe that suitable inward investment from Japan can play an important part in reducing balance of trade deficits, through import substitution, and in introducing modern, highly efficient production units.

5. By and large, foreign owned manufacturing plants perform better than average in terms of investment and exports as well as employment. In 1977, foreign ownership accounted for less than 3% of all manufacturing establishments but provided 14% of employment, 16% of wages and salaries, 19% of capital expenditure. In 1979, foreign controlled enterprises accounted for 29% of all UK exports (excluding diamonds), compared with 23% in 1977.

6. There are therefore plenty of good reasons why we should aim to attract as big a share as possible of international investment. We do so by the vigorous promotion of the UK carried out by the Invest in Britain Bureau, our diplomatic Posts overseas, the various territorial and regional agencies. But most of all, as the paper says, it is this country's economic performance - lower inflation, higher productivity, a more realistic approach to industrial relations - plus our membership of the European Community which will attract the growing high technology companies we want to site their new projects in Britain.

C Sladen
Invest in Britain Bureau
212 5873 January 1982

(Background)

INWARD INVESTMENT

In 1977, the latest year for which figures are available from the census of production, overseas controlled establishments (ie establishments more than 50% of whose ownership lies outside the UK) accounted for 2.5% of all manufacturing establishments in the UK, 14% of employment in manufacturing; 16% of wages and salaries; 19% of net capital expenditure.

2. Between 1973 and 1977 employment in foreign owned establishments increased by 192,000 compared with an overall decrease of 385,000 in manufacturing employment in general. While much of the growth was due to the acquisition of existing UK companies, some came from the creation of jobs in new projects and expansions.

FLAG B Attached at Annex 1 are tables showing manufacturing project investment decisions by foreign owned companies, known to IBB in 1980/81, some examples of recent inward investment successes and the most recently published figures on inward direct investment in the UK.

Inward investment from Japan

3. It is only in the last ten years that there has been any significant Japanese interest in investing in manufacturing in Europe and the volume of actual investment is still very small with only 25 Japanese manufacturing subsidiaries here compared to about 1000 US and 180 German companies. The number of people currently employed in Japanese factories in Britain is under 7000 and is thus too tiny to have any major effect on current levels of unemployment. The significance of Japanese investment so far seems to lie more in the introduction of modern, highly efficient production units, which increase competition, usually within sectors which have been particularly vulnerable to imports. Most also contribute to British exports by seeking markets throughout Europe and sometimes beyond, for their products. As a result of this success, Sony were awarded a Queen's Award for Exports Achievement in 1980.

4. Japanese manufacturing investment in the UK has so far been concentrated on consumer electronics, in particular on TV and audio equipment - and it has been located mainly in the assisted areas of South Wales, the North West and Scotland. Most of these factories are very new, but as they expand, they build up exports, encourage our component manufacturers to improve their standards and, we hope, will use their UK factories as the basis for making, and eventually designing new products for the European market.

Sourcing of components

5. The CBI argue that the government should maintain firm control over Japanese investment projects in particular by establishing guidelines that require the company (inter alia) to maintain high levels of local sourcing of components and services, to be monitored by the DoI. Where such undertakings form part of an offer of selective financial assistance the mechanism for formal monitoring already exists though we are criticised in OECD for attaching performance requirements to offers of this kind.

Nissan

6. Concern has been expressed by UK motor manufacturers and automobile component manufacturers that the arrival of Nissan could herald a new form of attack on the UK industry. Discussions with Nissan on their proposed project to manufacture motor cars in this country are continuing. If the project does go ahead, Nissan will aim to achieve a high level of local content. This has been a key consideration in the government's welcome for the project, and will continue to be so in future discussions with the company.

Recent Inward Investment Successes

Hewlett Packard, (U.S.A), Bristol

New project. Initially 450 jobs, long term 1,300. Manufacture of Disc Memory equipment.

Mitel Telecommunications Ltd (Canada) Caldicot

New project. Initially 870 jobs, long term 1,700. Manufacture of telecommunication equipment.

Yuasa Batteries Ltd, (Japan) Ebbw Vale

New project. Initially 140 jobs, long term 270. Manufacture of Sealed lead acid batteries.

Sanyo Ltd, (Japan) Lowestoft

New project, in old Pye T.V. factory. Initially 400. Manufacture of colour T.V's.

Harris Corporation Ltd (U.S.A) Glenrothes

New project. Initially 150 long term 1,700. Manufacture of high technology communication and information processing systems equipment and components.

U.I.E. Shipbuilding (France) Clydebank

Expansion. Extra 225 jobs on top of current 750. Manufacture of jack up drilling rigs.

(This company was formerly Marathon Shipyards, taken over in 1980 by U.I.E, saving 750 jobs).

IBB
January 1982

INWARD DIRECT INVESTMENT IN THE UK

	Annual Flows of Direct Investment excluding oil					Book Value of Level of Direct Investment excluding insurance including oil at end 1978
	1960-67	1967-74	1975-77	1978	1979	
	£m	£m	£m	£m	£m	£m
Value of Inward Direct Investment	173	486	913	1292	1818	17754
	Distribution of Direct Investment as Percentage of Total					
	%	%	%	%	%	%
Western Europe	18	21	33	34	29	31
European Community	10	11	20	24	15	23
France	2	2	7	12	3	
West Germany	1	3	3	5	4	
Netherlands	5	3	2	1	5	
Other EC	2	3	7	6	4	
Rest of Western Europe	9	10	13	10	14	8
North America	78	63	54	65	61	63
USA	71	59	55	62	55	60
Canada	7	4	-1	3	7	3
Other Developed Countries	1	6	8	1	3	3
Japan	-	1	-3	-2	2	0.3
Other Countries	1	6	11	2	1	3
Rest of World	3	10	5	-	7	2
Total	100	100	100	100	100	100
of which manufacturing	77	65	66	71	58	46

(a) EC consists in all years of original six plus Denmark and Irish Republic. Greece is included in 'Rest of Western Europe'

(b) Complete figures are not available of the book value of investment by individual EC countries but at the end of 1978 of the total inward direct investment France held 3%, West Germany 1%, and the Netherlands 3% before including their investment in oil and banking.

ANNEX F

Mr Jenkin's Brief on Small Firms

NATIONAL ECONOMIC DEVELOPMENT COUNCIL - 3 FEBRUARY

Secretary of State's Memorandum on Small Firms

1 The objective of the meeting should be:

a) to reach a rounded consensus with both sides of industry on the importance of small firms' contribution to the economy, taking account of their direct contribution to employment but also their capacity to innovate, to provide competition and react flexibly to changes in demand, to improve the structure of local economies away from over-dependence on large firms, and the part they can play in improving labour relations.

Memorandum Paras 6-10

b) To seek endorsement of:

Memorandum Paras 13 to 22

i) Government policy - with the control of inflation the main priority for small firms, as well as the economy as a whole, at the same time acting to remove particular obstacles to growth of the small firms sector.

Memorandum Paras 23 to 27

ii) The areas for further development of policy.

CBI Memorandum

2 The CBI will also submit a memorandum (flag A) which is broadly consistent with the Secretary of State's memorandum. They recognise a large degree of common interest between large and small firms in which improvement of general economic conditions and the control of inflation are the main priorities. They also recognise that small firms have special needs and that objectives should be to remove or reduce their inherent disadvantages without positive discrimination.

Particular Issues

3 The following issues may arise:

- Finance

a) The CBI argue for more emphasis on improving small firms' equity base. Relevant background is in a minute of 7 January from Mr Green - IC(A) Division (flag B) about related arguments expressed in the FFI document "The Capital Structure of Industry in Europe."

Line to take

The Secretary of State can refer to the Business Start up Scheme and the Loan Guarantee Scheme as measures which stimulate provision of both equity (for new business) and loan finance.

b) The CBI have argued for extension of the Business Start up Scheme to facilitate Small Firms Investment companies and investments in existing small companies; and for relaxation of Capital Gains and Capital Transfer Taxes.

Line to take

These are questions for the Chancellor of the Exchequer but the Secretary of State will be aware that it has been decided to include re-examination of some restrictions in the Business Start up Scheme in final Budget representations to the Chancellor.

On capital taxation the Secretary of State made representations to the Chancellor in his letter of 11 December (flag C).

- Company Law

c) Commenting on future scope for easing the burdens of legislation the CBI have commented that consolidation of company law gives the Government the opportunity to make life simpler for the smaller company by clearly distinguishing which rules apply to public companies and which to private companies.

Line to take

A consultative document on consolidation of company law was issued in 1981 and specifically raised the question of a split up of the law for public and private companies. No decision on this will be made until the consultations are concluded.

- Public Purchasing

d) The CBI have pointed to the major impact of public purchasing on the structure of industry and the fortunes of firms and ask Government purchasers to be especially aware of what small firms can do and to treat them flexibly as far as commercially possible.

Line to take

Small firms should have equal opportunity to compete for public contracts where their competitiveness and flexibility will stand them in good stead. A booklet has been published (a year ago) by Department of Industry to give the sort of information small firms need to gain easier access to Purchasing Departments. Possible needs for further action to improve their access are under review by this Department.

- Information and Advisory Services

e) The CBI urge that Government measures of benefit to small firms and other sources of help for them should be organised and publicised as simply as possible for best effect.

Line to take

The Small Firms Service serves the information and advisory function and now employs 170 counsellors. The Service readily cooperates with other sources of information and advice which serve important needs. There is plenty of scope for help to come from different sources (public and private sectors) but the scope for greater cooperation is being examined. As an example the Small Firms Service and the Council for Small Industries in Rural Areas are operating an experimental arrangement in a few parts of the country to bring together the information and advisory functions of the two services.

The Secretary of State can also point to the success of the Business Opportunities Programme in publicising Government measures.

B C Rayner

B C Rayner
Small Firms Division
28 January 1982

CONFIDENTIAL

Prime Minister

MLS 2/2

PRIME MINISTER

c. Mr. Hoskyns
Mr. Ingham

NEDC: ASLEF DISPUTE

It seems likely that the latest developments in the ASLEF dispute will crop up in conversation with Len Murray tomorrow, in the margins of the NEDC meeting, although it should not of course be a topic for discussion in the meeting itself. You may therefore wish to have this background note of where we are as of 6.00 pm this evening, and what you might say to Len Murray.

As the news agencies are reporting, ACAS has announced that they are using their powers to appoint a Committee of Inquiry into the rail dispute, chaired by Lord McCarthy to report as a matter of urgency. The terms of reference as reported would be:

> "To consider the terms of the 1981 pay and productivity understandings ratified as agreements by the Railway Staff National Council, and taking into account the agreement to introduce a 39-hour week, to make recommendations to resolve the differences over the payment of the further 3% pay increase to footplate grades, and over productivity understanding on flexible rostering and related matters."

You will see that this would meet BR's insistence that any Inquiry should cover both pay and productivity.

Ray Buckton has apparently told the media that ASLEF will not cooperate with the Inquiry, although Mr. Howell's Office have told me that ASLEF have not yet passed that decision on to ACAS. I am told that ACAS will proceed regardless with their meeting tomorrow, without ASLEF; and that McCarthy may then issue an appeal to ASLEF to participate, after which he will adjourn the Inquiry until they do.

Even if ASLEF had attended the Inquiry, there would have been no question of their calling off the industrial action; any Inquiry would take a week to ten days; and there would be a

/ period of

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.E.R.

period of further negotiation after the enquiry reported.

The background to these latest developments is that Pat Lowry, Chairman of ACAS, Len Murray and Peter Parker have all more or less independently concluded that there is no other way out of the present log jam, even though a non-binding Inquiry carries no guarantee of success. I am told that Len Murray, perhaps conscious of the unhelpful nature of his first intervention - in which he said that BR should pay the 3% - met the ASLEF Executive last night and warned them that if they did not agree to participate in the Inquiry, they would further alienate public opinion, and perhaps also incur the TUC's condemnation.

Nonetheless, Douglas Smith suggests that it would be wrong to indicate any form of appreciation to Len Murray for his recent efforts, because he might see that as an intrusion into a squabble within the union family. You could say, if there is still any prospect of the Inquiry going ahead, that you hope it will provide a sensible resolution of this issue of principle; and that a lot of change is needed on the railways, including getting the unions to work together.

J.M.M. VEREKER

2 February 1982

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Ray Pennock → Len Murray
Terry Beckett Terry Duffy
Alex Whittall Frank Chapple

Restricted

National Economic Development Council

Ronny Utiger → David Basnett
Leny Pyke Geoffrey Drain
Robin Leigh-Pemberton Moss Evans.

NEDC(82) 1
2nd Meeting

MEETING to be held at the
National Economic Development Office
on WEDNESDAY, 3 FEBRUARY, at 10.00 am

Ch. Richardson

(Luncheon will be available in the Office)

Peter Parker

A G E N D A

1. THE OUTCOME OF THE CANCUN SUMMIT 30 mins?

Oral report by the Prime Minister

2. INWARD AND OUTWARD INVESTMENT 1 hr.

OVERSEAS INVESTMENT AND CAPITAL FLOWS

Memorandum by the Chancellor of the Exchequer
(NEDC(82)9, already circulated)

T.U.C. will do - 1st?

OVERSEAS INVESTMENT

Memorandum by the TUC (NEDC(82)11, already circulated)

DIRECT INWARD INVESTMENT

Memorandum by the Secretary of State for Industry
(NEDC(82)7, already circulated)

3. RESPONSE TO ELECTRONICS EDC PAPER ON POLICY FOR UK ELECTRONICS INDUSTRY: A PROGRAMME OF ACTION

35 mins. Follow-up. Intro of new technology in civil service..

Memorandum by the Minister for Industry and Information
Technology (NEDC(82)12, circulated herewith)

Sir Henry Chilver,

4. THE SMALL FIRMS SECTOR

1/2 hour

SMALL FIRMS

Memorandum by the Secretary of State for Industry
(NEDC(82)10, already circulated)

SMALLER FIRMS IN THE ECONOMY: POSITION, PROBLEMS AND POLICY

Memorandum by the Confederation of British Industry
(NEDC(82)8, already circulated)

5. ANY OTHER BUSINESS - ? Energy Prices -

NB. The TUC's Annual Economic Review for 1982, 'Programme for Recovery', will be circulated shortly (Council members only) for information.

National Economic Development Office
Millbank Tower, Millbank.
London SW1P 4QX

27 January 1982

Restricted

1

PRIME MINISTER

NEDC, 3 February

You are chairing NEDC on 3 February.

The agenda is:

1. The outcome of the Cancun Summit
2. Inward and outward investment
3. The electronics industry
4. The small firms sector.

I am attaching briefing which the Treasury has provided. We have set up two preliminary briefing meetings for you: one on 2 February at 1645 at which Geoffrey Howe, Patrick Jenkin and Kenneth Baker will be present. There will be an audio-visual presentation at this meeting on the electronics industry paper. I have also pencilled in your diary a short meeting with Geoffrey Chandler. Both of these briefing meetings are set up on a provisional basis. Are you content?

John Hoskyns and Bernard Ingham have both asked whether they can accompany you. Content?

Yes. MT

MCS

29 January 1982

2

Prime Minister

MCS 29/1

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

29 January 1982

M.C. Scholar, Esq.,
Private Secretary,
10, Downing Street

Dear Michael,

NEDC, 3 FEBRUARY: STEERING BRIEF

... I attach 3 copies of the Chairman's steering brief for the February NEDC. Some of the annexes are not yet available and will be sent over next week.

I understand that you have fixed a briefing meeting for 4.45 on 2 February.

You will see that the Prime Minister's report on the outcome of the Cancun Summit is to be taken at the beginning of the Council meeting. We will arrange for an FCO official (Nicholas Bayne) to be present for the discussion on this item.

Yours,

Jill

JILL RUTTER

29 JAN 1982

NATIONAL ECONOMIC DEVELOPMENT COUNCIL: WEDNESDAY 3 FEBRUARY

CHAIRMAN'S BRIEF

THE COUNCIL: BACKGROUND

The Council was set up by Ministerial decision in 1962 with broad terms of reference to examine the economic performance of the nation. Over the years, a wide range of economic and industrial issues have been considered. When you last chaired a Council meeting in February 1981, the main items on the agenda were industrial trends and prospects, and the UK's performance in the market for large overseas capital projects. A list of current Council members is attached at Annex A.

2. The Council has no executive powers. Its role (and its strength) is as a forum in which the Government, management and the trade unions can exchange views. Whilst it provides an opportunity for each of the parties to explain its policies, its success depends on the willingness of Council members to listen, and to respond constructively, to the views put forward by others.

3. You will recall from your previous visits that the tone of the meetings tends to be informal and loosely structured. The practice has been for the Chairman to concentrate on inviting contributions from others and on drawing out, and summing up, on each item, any areas of agreement and points which need to be followed up by one or more of the parties. He normally leaves it to the responsible member of the Ministerial team to take the lead in replying for the Government on individual items of substance.

4. The meetings are held in private but the normal practice is for papers to be released to the press, if the Council agree, and for the Director General to hold a press conference immediately after the meeting at which he gives an objective account of the proceedings.

5. The last Council meeting was at the beginning of January when the main item on the agenda was a paper by the Chancellor on macro-economic policy. The paper argued that wage and price inflation had to be reduced further, and the recent rapid increase in industrial productivity maintained if we were to create the conditions in which

a sustained economic recovery could take place. The TUC said that the Chancellor's paper should have examined alternative policy options - including a reflationary package of increased public expenditure and a reduction in VAT. The CBI called for action to reduce business costs.

AGENDA

Item		Suggested length of discussion
1.	The outcome of the Cancun Summit	½ hour
2.	Inward and outward investment	1 hour
3.	The electronics industry: Government action check list	¾ hour
4.	The small firms sector	½ hour

6. Both Mr Baker, Minister for Information Technology, and Sir Henry Chilver will join the Council for the discussion on the electronics industry. Sir Henry is Chairman of the Electronics EDC.

7. This will be Mr Astley Whittall's last Council meeting. He has been a member of the CBI team on the Council for the last four years. You may wish to express to Mr Whittall the thanks of the whole Council for his contribution over this period. This will also be Sir George Jefferson's first Council. Sir George is Chairman of British Telecom and will represent the nationalised industries. You may wish to welcome him.

OPENING REMARKS

8. You may care to open by thanking Council for inviting you to chair the meeting. You could say that you found the discussion at the meeting you attended a year ago most valuable. It confirmed your belief that the Council had an important part to play in improving our understanding of the UK's economic problems.

ITEM 1: CANCUN

9. You will wish to introduce the discussion. A speaking note (prepared by the FCO) follows:

"The Summit was designed to promote greater understanding between the participants and to give a lead in seeking solutions to various problems. It was never intended to negotiate or to make precise commitments, since we could not bind countries that were absent.

In the view of all the participants, the Summit was reasonably successful. Constructive discussion among developed and developing countries at highest level.

Pleased that rhetoric and confrontational atmosphere avoided. Common interests underlined.

Valuable practical discussion on specific issues, particularly on food and energy. On food, it was agreed that, while food aid was needed for temporary shortages, the main priority must be for developing countries to grow more food for their own people. This means giving farmers the right incentives and technical support. Aid should be designed to reinforce these objectives.

The discussion on energy focussed on increasing investment in developing countries, to enable them to build up their own resources. I joined a number of other participants in supporting the idea of an energy affiliate of the World Bank, provided that this would attract additional finance for energy investment, especially from OPEC surplus countries.

Trade

The Summit fulfilled its main objectives. The task now is to build on this - to ensure momentum generated at Cancun is maintained.

I hoped we could go on from Cancun to reach agreement in New York on launching Global Negotiations on international economic co-operation for development. Useful progress made in preparing for these negotiations. Full agreement not reached but no doors closed. Remain willing to help where we can.

Meanwhile, Brandt Commissioners remind us that developing countries face persistent problems which cannot wait. Fully support call by Mr Trudeau and President Lopez-Portillo for renewed efforts to achieve consensus on launching Global Negotiations.

Noted with interest meeting of Brandt Commissioners in Kuwait in January. Also watching sympathetically meeting of developing countries convened by Mrs Gandhi in New York later this month".

10. Handling. When you have finished your introduction, you will wish to invite the TUC and the CBI to comment. The TUC will argue that the Cancun Summit did not go far enough in implementing the recommendations of the Brandt report. The CBI are unlikely to have anything to say. You will wish to keep the discussion short, and perhaps use the summing up to reply to particular TUC points.

11. Cancun has been discussed on two previous occasions in the NEDC. The TUC, however, want to raise it again because they wish to express their concerns to you personally. Mr Murray outlined the TUC views in a recent letter to Lord Carrington (letter plus Mr Hurd's reply attached at Annex B). The TUC want a massive transfer of resources to the developing countries, and are disappointed at the Government's failure to commit itself to an 0.7 per cent of GNP aid target. They do not believe that private investment flows are an adequate substitute. They would also like to see the reform of the IMF and the IBRD to reflect the interests of borrowers as well as lenders, the establishment of an IBRD energy affiliate, more aid for energy technology, further progress on the problems of trade and adjustment, agreement on a UN code of conduct on trans-national corporations, and a resumption of the Global Negotiations in the UN.

12. If the TUC raise any of these points, you could argue:

(i) reform of the World Bank and the IMF. Both the Bank and the Fund have, with our active support, substantially adapted their activities recently to meet the needs of developing countries. Greatly expanded resources are now available, on terms which increasingly reflect the economic needs of ldcs;

(ii) establishment of energy affiliate. We have made clear our support for an affiliate which would attract additional funds for energy development, particularly from oil surplus countries;

(iii) special aid for energy. 25 per cent of our bilateral aid programme now goes to energy development projects. We have specially earmarked resources in the aid programme for assistance with energy planning in developing countries;

(iv) the problems of trade and industrial adjustment. We recognise the importance of helping developing countries, particularly the poorest and least developed, to industrialise and of giving them greater access to our market. The Community's generalised scheme of preferences is an important means of advancing this objective;

(v) the importance of private investment flows. I quote the words of Herr Brandt himself, "in our report we emphasise that official development assistance has always played a marginal and a subsidiary role in financing investment in developing countries" (Economist, 28 November);

(vi) UN code of conduct on trans-national corporations. We fully endorse non-mandatory codes of conduct such as the OECD guidelines and the UNCTAD restrictive business practices code which contribute to a general framework within which TNCs can work. We are actively involved in negotiations on the TNC code and hope that agreement can be reached that will satisfy the aspirations of all the interested parties;

(vii) big increase in aid required. The UK's net aid programme is over £1 billion; a substantial sum by any standards; and the fifth largest of OECD countries (after the US, France, Germany and Japan). We accept the 0.7 per cent of GNP as a target, but, like previous governments, we are unable to commit ourselves to a specific time for reaching it;

(viii) need to press on with Global Negotiations. Preparations for the negotiations havenot resumed in New York since the Christmas adjournment. Unfortunately, it has been difficult to get agreement between the US, the EC and G77 on a text to form the basis for launching the negotiations. Without a text, no further progress is possible.

ITEM 2: INWARD AND OUTWARD INVESTMENT (NEDC(82)7,9 and 11)

13. There are three papers for discussion: two on outward investment; and one on inward investment. You will wish to invite the Chancellor, the TUC and Mr Jenkin to introduce their papers in that order and without any intervening discussion. A speaking note for the Chancellor' use is at Annex C . Mr Jenkin's brief is at Annex D .

14. The idea is that there should be one general discussion on both inward and outward investment. Since, however, the two topics raise somewhat different issues, the rest of this part of the brief is divided into two sections - Part A dealing with outward investment, and Part B dealing with inward investment.

A. Outward investment

15. Aims. The main objective is to get Council to view the abolition of exchange controls in its proper perspective: it was a timely move that helped reduce upward pressures on sterling at a time when they were particularly strong, not least for oil-related reasons, and has thereby on balance helped rather than hindered employment and investment. It is also a good example of a change that has produced indirect benefits through the removal of unnecessary bureaucracy.

16. Background. Overseas investment is on the agenda at the request of the TUC who feel that the abolition of exchange controls has led to a sharp increase in overseas investment, with adverse effects on domestic interest rates, employment and activity.

17. The Chancellor's paper points out that a current account surplus must be offset by a net capital outflow. Abolition of exchange controls has thus not, directly, increased the net outflow; but has altered the composition. Direct investment overseas has not increased significantly since exchange controls were abolished. But other outflows, notably portfolio investment and bank lending overseas,

have done so. The initial effects of abolition included a once and for all stock adjustment and are likely to be larger than the continuing effects. The outflows eased pressure on the exchange rate when oil factors were pushing the rate upwards. The outflows will continue to produce balance of payments benefits after the period of North Sea production.

18. The TUC paper accepts that some direct overseas investment helps UK exports and that inward investment to the UK should be encouraged. Nonetheless, the paper calls for a Foreign Investment Review Body to monitor inward and outward direct investment. The TUC draw attention to the increase in portfolio investment overseas and say that money is being diverted overseas that would otherwise be invested in UK shares or gilts leading to lower interest rates. The paper suggests that although abolition of exchange controls has led to a lower exchange rate it needs to be still lower and suggests that this could be achieved if monetary policy was relaxed. It is suggested that financial institutions should invest more in the UK and the TUC invite NEDC to consider how investment in the UK can be increased and whether exchange controls can help maintain stability in international financial markets.

19. Points for you or the Chancellor to make. It is for consideration to what extent you, as Chairman, should intervene in the discussion. You may wish to make one or two of the following points yourself. Alternatively, you could leave it to the Chancellor (and other Ministers) to express the Government's point of view:

(i) abolishing exchange controls facilitated some types of outflow and helped keep the exchange rate lower than it would otherwise have been. There was no direct impact on the net capital outflow, which must necessarily balance the current account surplus;

(ii) in retrospect it is clear that the timing of abolition was as good as it could be. The largest outflows came when the exchange rate was under considerable upward pressure due to oil factors;

(iii) abolishing exchange controls is a good example of reducing bureaucracy (around 750 public sector jobs were saved) while helping the productive parts of the economy;

(iv) overseas investment will provide balance of payments benefits for the economy in future, after North Sea production has begun to decline.

20. Defensive points on TUC paper:

(i) any impact on securities prices and interest rates of the abolition of exchange controls will have been small. Non-residents were always free to switch between UK and overseas assets. Moreover, resident outflows reduce the need to sell gilts to maintain any degree of monetary stringency;

(ii) the Bank and Treasury agree that the net exchange rate and interest rate effect of abolishing exchange control will have helped exporters, employment and domestic investment;

(iii) all agree on the need to encourage profitable investment in the UK, that will benefit the current account. But there is no benefit to anyone in trying to force institutions to invest in unprofitable projects. The main precondition for such investment is further improvements in working practices and productivity to match our overseas competitors;

(iv) a Foreign Investment Review Body would add to the bureaucratic burden on industry without helping it to improve profitability or increase UK investment. The private sector is best placed to judge the profitability of a project and if the project is profitable the private sector will find the money;

(v) exchange rate stability: the dramatic fall in sterling in 1976 and the subsequent recovery occurred when tight exchange controls were in place. There is no evidence that sterling is less stable than it was then;

(vi) seeking to reduce the exchange rate by relaxing monetary conditions leads to higher inflation and further loss of competitiveness. We have been down this road too many times in the past.

B. Inward investment

21. Aims. The important thing is to get Council to recognise the important contribution which inward investment already makes to the UK economy. Attracting more investment to the UK will depend on our continuing commitment to membership of the EC and on our maintaining a liberal trading regime.

22. Mr Jenkin's paper argues that inward investment is to be welcomed not just for its effects on UK employment (and these are sizeable: over 1 million people are employed in overseas-controlled establishments) but also for introducing new technology, new working practices and new managerial expertise. The paper also points out that with the UK's heavy dependence on overseas trade it is vital that we continue to provide an attractive base for internationally mobile investment projects.

23. In discussion, it might be worth bringing out the point that the UK has a very successful record in attracting inward investment. In 1980 we attracted nearly 60 per cent of all the US direct investment in EC countries, and half of Japanese investment (though that is much smaller). So long as the UK continues to be seen as an attractive location for international investment (and our membership of the EC is important here) we should continue to derive benefits in terms of employment, technology and management skills.

24. The CBI are likely to welcome the general stance of encouraging inward investment, but to argue for a more selective approach, particularly where Government grants are concerned. They feel that it is important that foreign firms setting up in the UK should purchase a large proportion of their components from UK firms. The Government agrees with this objective in principle: offers of selective financial assistance do take account of the long term impact of a project on the UK economy. But it is not easy to put across a message of qualified welcome without putting off some investors altogether.

25. The CBI may also criticise the proliferation of Government agencies promoting inward investment. This can lead to wasteful competition. The Government has accordingly set up machinery for co-ordinating the work of the various bodies involved.

26. The main TUC point is likely to concern the dangers of companies setting up peripheral plants in the UK, with no long term commitment to their future and with inadequate R&D effort; this can mean that these plants are the first to get closed if the company runs into difficulty. There is really very little evidence on this either way - but certainly none to support the view that manufacturing employment in foreign aid companies has declined sharper than the average over the last few years.

Summing up on inward and outward investment

27. You will wish to record as much agreement as possible on the following points:

(i) inward investment should be encouraged:it can provide additional jobs and constitutes a mechanism for introducing new technology;

(ii) the abolition of exchange controls has reduced the bureaucratic burden on the economy and means that the exchange rate was lower than it would otherwise have been when oil prices were forcing it upwards.

(iii) on balance, the abolition of exchange controls has helped rather than hindered employment and investment;

(iv) overseas investment will provide a valuable balance of payments benefit after the value of North Sea production has begun to decline.

ITEM 3: THE ELECTRONICS INDUSTRY (NEDC(82)12)

28. You will wish to invite Mr Baker to introduce his paper (NEDC(82)12). Before opening up the discussion, you might ask Sir Henry Chilver for his reaction. Mr Baker's brief is at Annex E.

29. Aims. These are to:

(i) impress on Council the importance of the information technology (IT) sector;

(ii) explain what the Government is doing to help;

(iii) emphasise that the UK supply industry must improve its competitive position and increase its share of world markets.

30. Background. Mr Baker's paper is a response to a presentation given to Council last November by Sir Henry Chilver. Sir Henry emphasised in particular that the UK had to be internationally competitive in IT markets, and that a selective approach to the industry was required. Most of Sir Henry's recommendations were aimed at Government:

(i) over the next 12-months, the major firms in the UK and

Government, through the EDC and SWPs, should collaborate to identify selective business strategies;

(ii) industrial priorities should be identified across the public sector; and

(iii) the role and objectives of public sector bodies should be examined so that investment assistance of R&D spending is best used to promote these priorities.

31. Mr Baker's response emphasises that the UK IT industry can have no real future without establishing a competitive international position It accepts the concept of selectivity in this sector and shows how this is already reflected in the Government's current action programme. The response points to action already being taken in the broad areas identified by the Electronics EDC (IT systems, viewdata/teletext, radio communications, civil spin-off from defence R&D, and core technologies such as fibre optics) and refers to a number of other key areas, including cable and satellite systems and computing research. While accepting that the Government has a role to play, the response stresses that the UK's success will depend ultimately on the efforts which the IT industry and the private sector make to remedy the weaknesses identified and to capitalise on the strengths.

32. Points for you or the Chancellor to make:

(i) consideration of possible Government initiatives should not mask or delay the need for private sector initiatives. Two areas where this is particularly relevant are (a) the commercial application of defence technology and (b) public procurement, where the performance and flexibility of UK suppliers are as important as the attitude of purchasers;

50% basic computer training

(ii) training: half of the training of programmers and analysts in IT is funded by the MSC and 34,000 training places have been privided by grants from the Microprocessor Applications Project. What are managements and unions doing to increase training opportunities and to encourage acceptance of the new technologies?

(iii) private sector investment: a policy of selective support in key areas must depend upon the willingness of the financial world to invest in the identified new technologies and business opportunities offered by IT systems, cable and satellite communications etc. It will also be necessary for them to take the longer view of their investment which is essential if a high world market share and competitive pricing policy is to be achieved;

(iv) IT Year: the aim is to promote an awareness of IT by the public at large and by businesses. Can industry and the unions do more to help? Kenneth Baker has written to all Government Departments asking for them to make a special effort in IT Year;

(v) selectivity: the constraints on the Government's resources must be remembered if the discussion of selectivity is to have any practical relevance. Would the Council wish the Government to give greater priority to IT within its overall budget and how might this best be achieved? In the competition for limited resources should the fast growing new technology industries be given priority over the traditional industrial sectors?

(vi) international competition: the UK industry by world standards is small, fragmented and over-dependent upon the domestic market. It has only a tiny share (1.5 per cent) of the non-UK market; current trends are discouraging and must be reversed. UK industry must establish itself in world markets, and particularly in the USA and Europe.

Summing up

33. You will wish to thank Sir Henry Chilver for the valuable work of his EDC in concentrating the attention of the Council on this subject which is of such fundamental importance to the UK's economic future. You may also wish to mention IT Year: it provides a good framework for the Council to register its recognition of the importance of IT and of the need for all parties to work together to get this message across. Finally, you could emphasise the Government's willingness to discuss directly with the IT industry ways in which the efforts of all sides could most usefully be concentrated on selected key areas. But success can only come from commitment from all of those involved in the IT industry and is ultimately dependent upon the industry itself.

TECHNOLOGY AGREEMENT IN THE CIVIL SERVICE

34. The TUC have indicated that, if no new technology agreement has been reached between the Government and the Civil Service unions

before the NEDC meeting takes place, they propose to raise the matter in the course of the debate on the electronics industry. They will argue that the Government, by refusing to conclude the draft agreement, is obstructing the introduction of new technology. The MPO will be supplying a separate brief on this during the next few days.

ITEM 4: SMALL FIRMS (NEDC(82)8 and 10)

35. There are two papers on this subject, one by the DOI and another by the CBI. You will wisn to invite Mr Jenkin to introduce his paper first, and Mr Pope, Chairman of the CBI Smaller Firms Council, to introduce his second. Mr Jenkin's brief is at Annex F.

36. The DOI paper first describes the size and recent growth of the small firms sector and identifies certain small-firms characteristics which contribute to the health of the economy - their flexibility, their record on innovation, and their spirit of enterprise. It then describes what the Government has done to provide help for small firms - including tax changes, measures to provide easier access to capital (the Business Start-Up and Loan Guarantee Schemes) and the Small Workshop Scheme. Finally, the paper considers future policy, and notes the pressure for further cuts in taxes and the NIS, as well as improvements in the Business Start-Up and Loan Guarantee Schemes.

37. The CBI paper covers largely the same ground. But it contains a useful additional section outlining the particular problems of small firms (eg the narrower product range and thus greater exposure to market changes and their limited financial and human resources). The paper rightly argues that it is the need for policy measures to overcome the natural drawbacks of size which constitutes the rationale for Government intervention.

38. Aims. These are to get Council to:

(i) recognise that the small firms sector can and does make an important contribution to the economy;

(ii) endorse the various measures the Government has taken to provide help for this sector;

(iii) suggest what other forms of assistance might be required.

39. Points for you or the Chancellor to make:

(i) over the 1970s, small firms did better in terms of employment than medium or large firms. Faster growth in services vis-a-vis manufacturing industry combined with developments in fields such as information technology are expected to lead to a greater expansion of small firms in the future. The focus on small firms is thus an excellent example of the Government promoting positive adjustment in the economy, seeking to move with market developments and facilitating change and growth, rather than shoring up obsolete sectors;

(ii) no Government has done more for small firms. Since taking office, over seventy-five measures of help have been introduced. Some of these - particularly the Business Start-Up Scheme - are radical in scope. Moreover, such innovations have helped change attitudes in the banks and other financial institutions and made them more receptive to the needs of small firms. The banks also introduced valuable new financial packages for small companies of their own. Easier access to finance combined with the various tax changes have transformed the whole environment facing small firms;

(iii) in general, small firms appear to benefit from good working relationships between employer and employee. One reason for this might be the low degree of unionisation in small companies. Another factor might be that employees find it easier to identify with small firms. What do the TUC and the CBI think?

40. The TUC are unlikely to have much to say on small firms. They may, however, argue that small firms contribute a significant part of the black economy. They may also complain about the special dispensations for small firms from certain employment legislation (eg employees cannot bring claims for unfair dismissal to industrial tribunals unless they had been employed for two years rather than one). In reply, the two problems could be takentogether: deregulation and greater flexibility are necessary to encourage people to set up small firms.

Closer or tighter regulation might encourage more small firms into the black economy. The main rights of employees in small firms are in any case still protected.

41. <u>Summing up</u>. You will wish to record agreement on as many as possible of the following points:

(i) small firms have a vital part to play. Their flexibility, spirit of enterprise and approach to innovation make a significant contribution to the overall health of the economy;

(ii) it is right that small firms should be helped to overcome the natural obstacle of their size. The Government's record in providing help is second to none;

(iii) but this is not to say there is no scope for further action. The discussion has produced a number of proposals which deserve, and will receive, careful consideration.

NEDC MEMBERSHIP

Government

Chancellor of the Exchequer
Secretary of State - Industry
Secretary of State - Trade
Secretary of State - Employment
Secretary of State - Energy
Secretary of State - Environment

TUC

Len Murray
Frank Chapple
Geoffrey Drain
Moss Evans
Terry Duffy
David Basnett

CBI

Astley Whitall
Ronald Utiger
Sir Terence Beckett
Sir Ray Pennock
Jeremy Pope
Robin Leigh-Pemberton

Nationalised Industries

Sir Peter Parker
Sir George Jefferson

Independent Members

Gordon Richardson
Rachel Waterhouse
Sir Richard O'Brien

Director General NEDO

Geoffrey Chandler

ANNEX B

TRADES UNION CONGI

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Po. mF

YOUR REFERENCE

OUR REFERENCE LM/BC/SMcC/EK

DEPARTMENT Economic

Rt Hon Lord Carrington
Secretary of State for Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street West
LONDON
SW1A 2AL

January 4 1982

Dear Lord Carrington

The Mexico Summit: International Meeting for Co-operation and Development

At their recent meeting the General Council considered the outcome of the Mexico Summit held at Cancun in October. The TUC's view was expressed at the November meeting of the National Economic Development Council when the Secretary of State for Industry gave a short report on the Summit. I am taking this opportunity to elaborate on the views expressed at that time, and also to enclose a statement issued by the Executive Board of the International Confederation of Free Trade Unions.

The General Council welcomed the fact that the Summit meeting took place, but expressed strong disappointment over the failure of the Government to make any commitments as a result. The central message of the Brandt Report - that interdependence creates a mutual interest in Third World development - seems to have been acknowledged and then ignored by the Summit participants. Indeed, the Government has failed to respond positively to the Brandt Report's urgent recommendations. It was imperative that the Government should have committed itself in Mexico to a 0.7% of GNP aid target and announced a timetable for achieving this target. A worrying feature is the Government's emphasis on the importance of private investment flows to the Third World as if this is a suitable or acceptable alternative to official development assistance. On many of the other major items on the agenda of the Summit meeting there was an apparent inability by the UK Government to take the initiative.

However, the 'success' or 'failure' of the Summit meeting will depend on rapid progress across a whole range of subjects within the North-South dialogue at the United Nations. Follow-up action by the Government must include tangible progress towards reform of the World Bank and International Monetary Fund to reflect more closely the interests of these institutions' 'consumers' as well as of their lenders. Also, every effort needs to be made towards the establishment of an IBRD energy affiliate to promote investments in Third World energy projects as a means of reducing their oil-induced balance of payments difficulties. A start could be made by the UK Government announcing a special package of aid in energy technology. Another important area where little was achieved at Cancun but which requires urgent solution is the problem of international trade and industrial adjustment. The stress on private investment flows as part of the transfer of resources to the Third World reinforces the arguments put forward by trade unions and Third World countries for the speedy and successful conclusion to negotiations on a UN code of conduct on transnational corporations. This code would be a means of guaranteeing TNC activities respond to the needs and aspirations of the communities in which they operate. These are a few of the outstanding issues on which quick progress should be possible.

The TUC, in looking forward to Government action to follow-up the conclusions of the Summit, calls for a massive transfer of resources to increase the effective demand of Third World countries to meet the basic needs of their populations. It is crucially important that the deadlock in the 'global negotiations' is broken since action, both to reduce unemployment and initiate industrialisation, is urgently required. The UK Government has an important role in ensuring the constructive resumption of these negotiations at the United Nations.

Yours sincerely

General Secretary

encl.

INTERNATIONAL CONFEDERATION OF FREE TRADE UNIONS

CANCUN: BRAVE WORDS BUT NOT MUCH ACTION

The Cancun Summit could have given a major new impetus to the stagnated North-South dialogue. Unfortunately, the 22 leaders present seem to have missed the opportunity. World-wide poverty and unemployment have worsened to crisis proportions and the people of North and South are looking for concerted international action. Although the meeting was not expected to solve all the problems of the world economy, it could have given its backing to positive proposals which would force the pace of global negotiations within the UN framework. The summary of the meeting given by the co-chairmen is short on specific proposals, and the ICFTU can only conclude that at least some of the leaders present do not yet appreciate the urgency of the problems facing working people all over the world.

On food and agricultural development some proposals to eliminate hunger by increased food production and by emergency food aid were discussed and received support. The Summit participants also seem to have established agreement on the importance of activating the Common Fund on Commodities and new commodity agreements. In contrast differences are more acute on trade, industrialisation, energy and monetary and financial issues. The failure to make progress on the vital issues of the financing needs of developing countries, the role and functioning of the IMF and the World Bank, reducing the damaging high level of interest rates and creating a more stable exchange rate and reserve asset regime, is particularly disappointing. The Summit only briefly touched upon the need to reduce expenditure on armaments. It did not go into the vital question of defining development strategies which meet the Basic Needs of working people. This was a major gap in the agenda at Cancun.

Many of the political leaders present at Cancun believe a better understanding of different points of view was established. We sincerely hope that this will bear fruit in the resumed discussions of the UN General Assembly. However, a considerable amount of work still needs to be done

before a successful agreement on a new international economic and social ord
can be achieved. The ICFTU and its affiliates mounted a big effort to make the Cancun Summit a positive step in the North-South dialogue, including sending a special high-level delegation to meet President Lopéz Portillo. We will continue our efforts and intend to publish a programme for balanced world development in the 1982 World Economic Review. This programme is part of the follow-up to the ICFTU's New Delhi Conference on the Trade Union Role in Development and links up directly with our affiliated organisations' own representations to governments.

President Lopéz Portillo and Prime Minister Pierre Trudeau, the co-chairmen at the Summit, said that the meeting had "made clear the political will of all participants at Cancun to move forward and take action". These are brave words. The task of the ICFTU and its affiliates in the future will be to ensure that political leaders live up to them.

Foreign and Commonwealth Office

London SW1A 2AH

25 January 1982

From The Minister of State

Douglas Hurd CBE MP

Dear Len Murray,

CANCUN SUMMIT : INTERNATIONAL MEETING FOR COOPERATION AND DEVELOPMENT

You wrote on 4 January to Peter Carrington about the Cancun Summit, amplifying the TUC's views as expressed at the National Economic Development Council and enclosing a statement by the ICFTU. He has asked me to thank you and to reply.

You will know that Peter Carrington was always concerned that too much would be expected from the Cancun Summit. Too much was expected; and this has inevitably meant some disappointment with the result. But this disappointment was not shared by the Summit participants, from either the developed or the developing countries. All the leaders who attended found the meeting valuable and welcomed the practical and constructive discussions and the friendly and informal atmosphere in which they took place. For example, Mrs Gandhi made this point to me in Delhi a few days ago.

Your letter suggests that Britain took a passive role at the Summit and was unable to take the initiative on any subject. This is not the case. The discussion on food and agriculture, as reflected in the Chairman's summary, followed clearly the line first set out in the Prime Minister's speech. This stressed the need for developing countries to grow more food for their own population and warned against an undue reliance on food aid. In the energy debate we stated our support for a World Bank energy affiliate, provided this would attract additional funds particularly from the surplus oil producers. I am glad to see that you too endorse this measure. On trade, we announced our intention to ratify the Common Fund Agreement and have since done so. I note that the ICFTU gave a special welcome to what the Summit said on this.

I agree that we much now follow up the Summit by seeking progress across the whole range of subjects of concern to developing and developed countries. We announced before the Summit extra British aid for energy resource planning, as well as in the fields of water supply, agricultural research and population. We are

/taking

The Rt Hon Lionel Murray OBE
General Secretary
The Trade Union Congress
Congress House
Great Russell Street
LONDON WC1B 3LS

taking a full part in the review of quotas in progress in the International Monetary Fund and in the current negotiations for the UN Code of Conduct on Trans-national Corporations; we hope that agreements acceptable to all can be achieved. In this context, I should make clear that we do not regard private investment as an alternative to official development assistance, as you suggest. There is a place for both. But we think it important that developing countries in a position to do so should make every effort to attract private investment, so that official aid can be concentrated more on those poor countries which need it most.

Both your letter and the ICFTU statement attach much weight to starting the Global Negotiations at the UN. We share the same objective. As holders of the Presidency of the Community up to the end of last year, we were active at the General Assembly in seeking ways of launching Global Negotiations, early in 1982, on a basis which all could endorse. We came close to agreement last year and shall continue to do what we can to keep up the momentum.

We are all aware that the developing countries face daunting problems and that great efforts are needed to move things forward. There are no quick solutions and agreement is not easily achieved in these complex economic matters. But I believe that the better understanding of problems of general concern which was achieved at Cancun will help us all in the future.

Yours ever,

Douglas Hurd.

ANNEX C

OVERSEAS INVESTMENT AND CAPITAL FLOWS

SPEAKING NOTE FOR CHANCELLOR

To help the discussion today, I have circulated a paper that both sets out the facts about capital outflows in recent years, and assesses what the implications have been. The overall picture and the ways that the different flows interact are not, I think, as widely understood as they might be, so I welcome this opportunity for a discussion in NEDC.

2. By way of introduction let me stress the main points that the paper brings out.

3. First, the current account of the balance of payments has been in very substantial surplus (perhaps £6-7 billion in 1981 alone). Everyone understands that when we are running a deficit we have to rundown our reserves or borrow. Similarly when the current account is in surplus we necessarily build up our net overseas assets, by increasing the reserves, reducing past borrowing or by investing overseas. The net capital outflow is thus not a cause for concern: on the contrary, it reflects the current account surplus; and means that as a nation we are increasing our net overseas wealth.

4. Secondly, it follows that abolishing exchange controls will have made no difference, directly at least, to the net capital outflow. The main effect of allowing new forms of outflow will have been an exchange rate lower than it would otherwise

have been. At the same time any fall in UK securities prices or consequential upwards impact on interest rates is likely to have been small. Particularly for the internationally exposed sectors of industry the net effect will certainly have been helpful to employment, output and investment.

5. In retrospect it is clear that we got the timing of abolition almost precisely right. Certainly we did well not to delay. The main stock adjustment, as domestic investors sought to make up for 40 years of control, came at a time when oil factors in particular would otherwise have carried the exchange rate to even higher levels. I would commend the episode as a good example of the indirect as well as direct benefits to the economy of abolishing outdated bureaucracy and control.

6. Finally, it is worth recalling that North Sea production has now built up to near its maximum level. The overseas assets we are acquiring will provide a flow of overseas income in future after the value of North Sea production has begun to decline. [I do not pretend these assets are a substitute for the greater profitable investment we need at home. But I hope that by the end of today's discussion we might be able to agree that they are a useful complement].

ANNEX D

Extracts from Mr Jenkin's Brief on Inward Investment

NEDC MEETING 3 FEBRUARY 1982: INWARD INVESTMENT

BRIEF FOR SECRETARY OF STATE

Objectives

Although we do not expect any positive outcome from the meeting in respect of inward investment, it will provide an opportunity to emphasise publicly our belief in freedom of international investment and to stress the important contribution that such investment makes to the UK economy.

2. In addition the Secretary of State will be able to:-

(a) rebut claims that inward investment has an adverse effect on indigenous companies, explain the difficulties that would be involved in operating a more selective approach to inward investment, while explaining what is already done to monitor the performance of inward investors who receive Government aid;

(b) emphasise the relatively small part that investment by Japanese companies plays in the overall context of foreign investment, and the benefits that such investment has brought;

(c) acknowledge the concern expressed by the CBI and others about the apparently large number of competing promotional agencies in the UK and explain what is being done to co-ordinate their efforts.

Line to Take/Points to Make

1. A liberal approach to inward investment is part of our belief in free market economic policies: freedom of investment has benefitted the UK economy and will continue to do so. We want to make sure that whatever new investment by multinational companies is now being made comes here rather than elsewhere. Our policy on non-discrimination in taxation, on promotion and financial assistance is designed to achieve this.

2. Britain's membership of the EC has been an important factor in attracting US and Japanese investors in particular. The UK's share of US direct investment in Europe has been rising rapidly since our accession to the Community. In 1980 we attracted nearly 60%* of all the US direct investment in the EC countries. A survey published in a technical magazine recently showed the UK in top place as a location for overseas investment by US electronics companies and that Britain's

* the paper, para.5, says 40% - this was an under-estimate

FLAG A presence within the EC is a major attraction (Annex 1 - Flag A)

3. Unemployment black spots such as Northern Ireland and Scotland have benefitted noticeably from the employment brought by inward investors. In Northern Ireland 22% of employment in manufacturing is in US firms and in Scotland such companies have provided 70,000 jobs. Overall, foreign firms currently employ over a million people, equivalent to 14% of the workforce in manufacturing. The IBB expects more than 37,000 jobs to be created in the UK as a result of manufacturing projects firmly decided upon by overseas companies during 1980 and 1981 (see table and examples of recent inward investment successes

FLAG B at Annex 1 - Flag B).

4. Although the UK accounts for about half of the Japanese investment in the EC, the volume of such investment in terms both of projects established and numbers of jobs is still small. At the moment there are only 22 fully fledged manufacturing enterprises in the UK with Japanese owners, with a further 3 about to start. We believe that suitable inward investment from Japan can play an important part in reducing balance of trade deficits, through import substitution, and in introducing modern, highly efficient production units.

5. By and large, foreign owned manufacturing plants perform better than average in terms of investment and exports as well as employment. In 1977, foreign ownership accounted for less than 3% of all manufacturing establishments but provided 14% of employment, 16% of wages and salaries, 19% of capital expenditure. In 1979, foreign controlled enterprises accounted for 29% of all UK exports (excluding diamonds), compared with 23% in 1977.

6. There are therefore plenty of good reasons why we should aim to attract as big a share as possible of international investment. We do so by the vigorous promotion of the UK carried out by the Invest in Britain Bureau, our diplomatic Posts overseas, the various territorial and regional agencies. But most of all, as the paper says, it is this country's economic performance - lower inflation, higher productivity, a more realistic approach to industrial relations - plus our membership of the European Community which will attract the growing high technology companies we want to site their new projects in Britain.

C Sladen
Invest in Britain Bureau
212 5873 January 1982

(Background)

INWARD INVESTMENT

In 1977, the latest year for which figures are available from the census of production, overseas controlled establishments (ie establishments more than 50% of whose ownership lies outside the UK) accounted for 2.5% of all manufacturing establishments in the UK, 14% of employment in manufacturing; 16% of wages and salaries; 19% of net capital expenditure.

2. Between 1973 and 1977 employment in foreign owned establishments increased by 192,000 compared with an overall decrease of 385,000 in manufacturing employment in general. While much of the growth was due to the acquisition of existing UK companies, some came from the creation of jobs in new projects and expansions.

FLAG B Attached at Annex 1 are tables showing manufacturing project investment decisions by foreign owned companies, known to IBB in 1980/81, some examples of recent inward investment successes and the most recently published figures on inward direct investment in the UK.

Inward investment from Japan

3. It is only in the last ten years that there has been any significant Japanese interest in investing in manufacturing in Europe and the volume of actual investment is still very small with only 25 Japanese manufacturing subsidiaries here compared to about 1000 US and 180 German companies. The number of people currently employed in Japanese factories in Britain is under 7000 and is thus too tiny to have any major effect on current levels of unemployment. The significance of Japanese investment so far seems to lie more in the introduction of modern, highly efficient production units, which increase competition, usually within sectors which have been particularly vulnerable to imports. Most also contribute to British exports by seeking markets throughout Europe and sometimes beyond, for their products. As a result of this success, Sony were awarded a Queen's Award for Exports Achievement in 1980.

4. Japanese manufacturing investment in the UK has so far been concentrated on consumer electronics, in particular on TV and audio equipment - and it has been located mainly in the assisted areas of South Wales, the North West and Scotland. Most of these factories are very new, but as they expand, they build up exports, encourage our component manufacturers to improve their standards and, we hope, will use their UK factories as the basis for making, and eventually designing new products for the European market.

Sourcing of components

5. The CBI argue that the government should maintain firm control over Japanese investment projects in particular by establishing guidelines that require the company (inter alia) to maintain high levels of local sourcing of components and services, to be monitored by the DoI. Where such undertakings form part of an offer of selective financial assistance the mechanism for formal monitoring already exists though we are criticised in OECD for attaching performance requirements to offers of this kind.

Nissan

6. Concern has been expressed by UK motor manufacturers and automobile component manufacturers that the arrival of Nissan could herald a new form of attack on the UK industry. Discussions with Nissan on their proposed project to manufacture motor cars in this country are continuing. If the project does go ahead, Nissan will aim to achieve a high level of local content. This has been a key consideration in the government's welcome for the project, and will continue to be so in future discussions with the company.

Recent Inward Investment Successes

Hewlett Packard, (U.S.A), Bristol

New project. Initially 450 jobs, long term 1,300. Manufacture of Disc Memory equipment.

Mitel Telecommunications Ltd (Canada) Caldicot

New project. Initially 870 jobs, long term 1,700. Manufacture of telecommunication equipment.

Yuasa Batteries Ltd, (Japan) Ebbw Vale

New project. Initially 140 jobs, long term 270. Manufacture of Sealed lead acid batteries.

Sanyo Ltd, (Japan) Lowestoft

New project, in old Pye T.V. factory. Initially 400. Manufacture of colour T.V's.

Harris Corporation Ltd (U.S.A) Glenrothes

New project. Initially 150 long term 1,700. Manufacture of high technology communication and information processing systems equipment and components.

U.I.E. Shipbuilding (France) Clydebank

Expansion. Extra 225 jobs on top of current 750. Manufacture of jack up drilling rigs.

(This company was formerly Marathon Shipyards, taken over in 1980 by U.I.E, saving 750 jobs).

IBB
January 1982

INWARD DIRECT INVESTMENT IN THE UK

	Annual Flows of Direct Investment excluding oil					Book Value of Level of Direct Investment excluding insurance including oil at end 1978
	1960-67	1967-74	1975-77	1978	1979	
	£m	£m	£m	£m	£m	£m
Value of Inward Direct Investment	173	486	913	1292	1818	17754
	Distribution of Direct Investment as Percentage of Total					
	%	%	%	%	%	%
Western Europe	18	21	33	34	29	31
European Community	10	11	20	24	15	23
France	2	2	7	12	3	
West Germany	1	3	3	5	4	
Netherlands	5	3	2	1	5	
Other EC	2	3	7	6	4	
Rest of Western Europe	9	10	13	10	14	8
North America	78	63	54	65	61	63
USA	71	59	55	62	55	60
Canada	7	4	-1	3	7	3
Other Developed Countries	1	6	8	1	3	3
Japan	-	1	-3	-2	2	0.3
Other Countries	1	6	11	2	1	3
Rest of World	3	10	5	-	7	2
Total	100	100	100	100	100	100
of which manufacturing	77	65	66	71	58	46

(a) EC consists in all years of original six plus Denmark and Irish Republic. Greece is included in 'Rest of Western Europe'

(b) Complete figures are not available of the book value of investment by individual EC countries but at the end of 1978 of the total inward direct investment France held 3%, West Germany 1%, and the Netherlands 3% before including their investment in oil and banking.

ANNEX E

EXTRACTS FROM MR BAKER'S BRIEF ON THE ELECTRONICS INDUSTRY

BRIEF FOR MR BAKER

GOVERNMENT RESPONSE TO EEDC PAPER

The Prime Minister will be chairing the meeting. Mr Baker will be invited to present the Government response: a speaking note is attached. (Not attached).

Sir Henry Chilver will be attending for this item. The Prime Minister will wish to draw him into the discussion following the presentation.

1 Aims

The aim of the discussion on this item is to get:-

(a) general agreement on the fundamental importance of information technology to the UK economy and on the commitment of the Council to tackle the difficult problems inherent in increasing the use and application of information technology in the UK; and

(b) acceptance of the necessity for the UK supply industry to improve its competitive position and increase its share of world IT markets.

2 Background

The Electronics EDC paper has two themes:-

(a) the need for the UK to be internationally competitive in the IT markets, in order to benefit employment and profitability; and

(b) the need for a selective approach in order to achieve this.

The emphasis in the EEDC paper however is on the way in which Government can act to promote a more selective approach within the industry. There are few recommendations aimed solely at industry initiatives and none at the unions. The EEDC's main recommendations are:-

(i) over the next year, the major firms in the UK and Government should collaborate through the EDC and SWPs to identify selective business strategies;

(ii) the identification and co-ordination of industrial priorities across the public sectors; and

(iii) examination of the roles and objectives of public sector bodies so that investment assistance, public purchasing and R & D spending are best used to promote these priorities.

The EEDC paper was discussed by the Council on 11 November. Mr Baker will recall that it was well received and Mr Murray, Mr Utiger and Sir P Parker in particular welcomed it as an important paper which raised difficult problems which needed to be faced. Mr Baker was invited to prepare a "checklist for action" to be discussed at the Council's February meeting. This is attached.

3 The response which has been submitted to the Council is not a bare checklist for action: it presents Government policy on IT and the programme of action based on that policy. It stresses that international competitiveness is vital and accepts the concept of selectivity. It points out how action

is already being taken in the broad 'selected areas' identified by the EEDC (teletext/viewdata, IT systems, radio communications, civil applications of defence technology) as well as putting forward a number of other key areas (cable and satellite systems, computing research, databases). The response also stresses that the UK's success will depend ultimately on the efforts which the IT industry and the private sector make to remedy the weaknesses identified and capitalise on the strengths.

Briefing notes follow on some of the main issues raised in the EEDC paper and the Government response. Notes on issues raised in the EEDC paper to which no specific reference is made in the response are appended at Annex A. (Not attached)

4 Government Policy

The EEDC paper calls for better co-ordination and communication of Government policy, with adequate provision for consultation with industry. Council members may take up this point, citing Citizen's Band radio as an example where Government could have given a clearer and speedier policy lead. CB radio is a complex issue. A fair response would be to comment that there is no room for complacency on either side: the private sector too has to take stock of developments with long-term implications. Cable and satellite systems are a case in point: the Government is ready to listen to industry's and investors' views on the 'broad band into the home.'

Government Programme of Action

5 Awareness

The EEDC paper gave very little place to awareness, although it is an integral part of Government policy. It would be useful to make the point that:-

(a) awareness campaigns are the way to make sure that everyone - and not just the suppliers - benefits from the increased efficiency that IT can offer;

(b) awareness is not just the responsibility of Government. IT Year is a joint initiative, a partnership between Government and all branches of the private sector. We all need to devote effort, resources, patience and imagination to make IT Year a success;

(c) awareness campaigns do not just use shotgun tactics: the Government's awareness campaigns are directed at specific sectors (teletext and viewdata, telecoms liberalisation, CAD/CAM, robotics). The IT Year activities will help focus the minds of suppliers and users on specific and new uses for IT - IT and the disabled, IT in the home and so on.

Infrastructure

6(a) Liberalisation

The EEDC paper expressed worries about the effect of telecoms liberalisation. Yet here there is an adequate 'mechanism' for consultation with the industry, through the Consultative Committee on Telecommunications (CCT). The Department is maintaining continual pressure in the CCT and the British Standards Institution to progress and resolve outstanding issues as quickly as possible.

(b) Education, training and employment

On employment: it is impossible to predict what effect the advent of IT will have on employment, independent of all other factors affecting employment. Two things seem clear however: first, the employment consequences of not utilising the technology as quickly as possible are ~~greater~~ worse than the negative consequences of doing so; second, there will be an increased need for manpower trained in IT skills. MSC training initiatives and IT Centres are practical responses to this: what are management and trade unions doing to ensure that more people are trained in the skills they need?

Support Measures and Public Purchasing

7(a) Support measures

The Minister can offer to take note of any comments the Council has regarding the level of funding provided for specific areas such as robotics or fibre optics.

(b) Public purchasing

The EEDC paper argues that the Government should carry further the principles of the public purchasing initiative, placing greater weight on the longer term interests of the indigenous supply industry.

The paper underestimates the degree to which a longer term view of "value for money" has already been adopted by public sector organisations. The Treasury guidance issued in March 1981 clearly states that value for money is not to be interpreted as "lowest initial cost", but is to take into account the broader issues of industrial viability and competitiveness. Maintaining a close dialogue with the supply industry in order to build up a long term picture of product development and requirements is a basic element of the new public purchasing initiative.

However both sides have to bear in mind (a) the necessary constraints on public expenditure and (b) our international obligations under GATT and EEC regulations, with which UK policy must comply.

The success of the initiative will also depend on renewed efforts by the supply industry: it is not a one-way process.

Selectivity

8 Discussion of the concept and application of selectivity should not lose sight of the following:

(i) the constraints on public expenditure, essential to the overall economic framework needed to encourage business enterprise. This implies deciding priorities for support on two levels: the priority given to IT compared with the traditional industries; and the priority given to different products and services within the IT sector;

/is (ii) the existing support measure/in the Government's programme of action;

(iii) selectivity implies acceptance that the UK cannot maintain an across the broad presence in IT. This leads to the conclusion that some products made by some company(ies) will be selectively supported; others will not. There are difficult employment and company profitability aspects to this concept which cannot be avoided.

Government is prepared to consider with industry this question. But a positive response from industry is essential if the exercise is to be a serious one.

9 BT

With an annual investment programme of £2000M and its R & D spend on telecommunications of £150M, BT is placed to have potentially a massive influence on the rate and direction of development of the UK's information technology industry. It would be misleading however to imply that Government itself can play the "BT procurement fiddle" to extract whatever tune it wished. Clearly the right to discuss BT's research and investment programme enables Government to exercise an influence over broad areas of development but the exercise of this influence in the 'selected' areas called for by the EEDC would inevitably be an indirect and uncertain one.

Role of BT

BT's investment constitutes the largest single civilian investment programme in the country. The way it is deployed and exploited has an important role to play in developing the UK IT industries. Competition will make BT a more competitive buyer and a more cost effective developer. Suppliers will have to adjust, and in adjusting become more competitive themselves. Since the passing of the BT Act, BT has taken many initiatives conducive toe providing a spur to British industry -- the Britsat programme, the TXE enhancement, System orders, the Monarch cost reductions, the Herald, new fibre optics orders, new microwave orders, new telephones, Viewdata mailbox etc. I also welcome the establishment of Martlesham enterprises, a BT joint venture with the City to translate some of

Martlesham's inventions into marketable products. At the same time, our liberalisation programme has created opportunities for new market entrants bringing new jobs - ICL/Mitel, GTE/Ferranti - and new export prospects."

Key areas identified by the EEDC

10(a) IT Systems

The areas chosen by the EEDC are so broad as to exclude almost nothing in the IT field: "IT Systems" in particular embraces peripherals and mainframe (as well as micro) computers which are two areas of weakness as far as the UK supply industry is concerned. Further definition is needed: office systems - with the emphasis on local area networks and the linking of processes which is at the heart of IT - and software products are the areas singled out in the Government response.

(b) Teletext/Viewdata

This is a useful illustration of the way in which selectivity can also mean the careful choice of the most appropriate business strategy and support measures. Marketing is a key issue in this area: manufacturers have got together to identify their marketing problems and solutions, and Government is supporting their efforts through awareness measures. Capital allowances to boost teletext set sales are also being considered.

(c) Radio Communications

This is an area where there is rapidly developing market potential - for example in the civilian use of mobile radio. There is an opportunity for transfer of defence technology to commercial products here.

(d) Transfer of defence technology

The response outlines measures which MoD is taking to increase the potential for commercial application of the results of defence-related research and for higher export sales of equipment developed with MoD funds.

The EEDC has agreed to appoint Sir Iuan Maddock to conduct a study of the ways in which the commercial potential of defence technology could be more fully exploited. He has undertaken to report back to the EEDC in April.

Locked in Marconi, Plessey, Thorn-EMI, etc are storehouses of advanced technology, much of which is capable of being applied in non-military sectors. This is not being done. And while it is not being done the technology is becoming out-dated. Industry must do more to use this already-funded technology. Government is willing to discuss what might be done to promote greater use of this technology but it is really a matter for industry.

Further key areas (not exhaustive) suggested by Government

11(a) Cable and satellite systems

The ITAP paper on cable systems is to be produced and may be circulated for discussion within the next few weeks. Key issues will be the availability of private sector finance - the Advisers believe that this should be forthcoming - and the choice between co-axial and fibre optic cables.

(b) Fifth Generation Computers

Fifth Generation computing is perhaps best explained in terms of the identification of each successive 'generation' with a technological change eg valves, transisters, integrated circuits, large scale integrated circuits. The key features of the fifth-generation of computers which will come into use in the late 1980s will include:

(i) in hardware: distributed intelligence, VLSI, use of non-silicon technologies;

(ii) in software: improved productivity, simplified user programming;

(iii) in applications: artificial intelligence applications, CA., robotics, interpreting/translation.

A UK mission attended a seminar in Japan in October 1981 which outlined Japanese plans for an ambitious and major programme for the development of fifth generation computers. The UK team reported that for the UK to maintain a presence in this technology, more effective organisation of the national effort was required and resources concentrated on key areas. A seminar to discuss the findings of the mission is being held 29/30 January when ideas about a national and collaborative effort in certain project areas is to be discussed.

(c) Databases/Information systems

This is an area where the UK has great potential. What is lacking is the entrepreneurial approach to identify and grasp the opportunities available. The finance sector can help by looking favourably on good proposals to develop databases. Support can be found within existing DoI measures to help in the establishment of new databases.

Implementation

12 The response suggests as further action that Government is prepared to discuss with major UK electronics companies the areas proposed and their implications for the use of public sector resources.

Council members may argue that Government should involve fully in these discussions the EDCs and SWPs/the CBI/ the Trades Unions, and it should use a clearly defined method, such as report/ regularly to the EEDC, to do so.

/ing

Our discussions suggest that there is little enthusiasm in the industry for continued recourse to the EEDC. It remains even to be seen what level of commitment there is from industry to explore further the issues raised in this exchange. In reply the Minister could suggest that the first step is for Government to see what level of response there is from the industry by talking directly to companies: this is a sine qua non of further action. Where there is scope for direct action by the EEDC - such as the commissioning of a study on defence spin-offs - this is already in hand.

Conclusion

Discussion of this subject at Council is not intended to be a detailed examination of the ways to apply a selective approach to each of the 'key areas': this is something which can only be done over a longer time span, and in direct consultation with industry. What is needed at this stage is an indication of the level of interest and commitment from bodies other than Government on a selective approach to the IT industry. More broadly, the discussion should serve to highlight the fundamental importance of IT to the UK economy.

ANNEX F

Mr Jenkin's Brief on Small Firms

NATIONAL ECONOMIC DEVELOPMENT COUNCIL - 3 FEBRUARY

Secretary of State's Memorandum on Small Firms

1 The objective of the meeting should be:

Memorandum Paras 6-10

a) to reach a rounded consensus with both sides of industry on the importance of small firms' contribution to the economy, taking account of their direct contribution to employment but also their capacity to innovate, to provide competition and react flexibly to changes in demand, to improve the structure of local economies away from over-dependence on large firms, and the part they can play in improving labour relations.

b) To seek endorsement of:

Memorandum Paras 18 to 22

i) Government policy - with the control of inflation the main priority for small firms, as well as the economy as a whole, at the same time acting to remove particular obstacles to growth of the small firms sector.

Memorandum Paras 23 to 27

ii) The areas for further development of policy.

CBI Memorandum

2 The CBI will also submit a memorandum (flag A) which is broadly consistent with the Secretary of State's memorandum. They recognise a large degree of common interest between large and small firms in which improvement of general economic conditions and the control of inflation are the main priorities. They also recognise that small firms have special needs and that objectives should be to remove or reduce their inherent disadvantages without positive discrimination.

Particular Issues

3 The following issues may arise:

- Finance

a) The CBI argue for more emphasis on improving small firms' equity base. Relevant background is in a minute of 7 January from Mr Green - IC(A) Division (flag B) about related arguments expressed in the FFI document "The Capital Structure of Industry in Europe."

Line to take

The Secretary of State can refer to the Business Start up Scheme and the Loan Guarantee Scheme as measures which stimulate provision of both equity (for new business) and loan finance.

b) The CBI have argued for extension of the Business Start up Scheme to facilitate Small Firms Investment companies and investments in existing small companies; and for relaxation of Capital Gains and Capital Transfer Taxes.

Line to take

These are questions for the Chancellor of the Exchequer but the Secretary of State will be aware that it has been decided to include re-examination of some restrictions in the Business Start up Scheme in final Budget representations to the Chancellor.

On capital taxation the Secretary of State made representations to the Chancellor in his letter of 11 December (flag C).

- Company Law

c) Commenting on future scope for easing the burdens of legislation the CBI have commented that consolidation of company law gives the Government the opportunity to make life simpler for the smaller company by clearly distinguishing which rules apply to public companies and which to private companies.

Line to take

A consultative document on consolidation of company law was issued in 1981 and specifically raised the question of a split up of the law for public and private companies. No decision on this will be made until the consultations are concluded.

- Public Purchasing

d) The CBI have pointed to the major impact of public purchasing on the structure of industry and the fortunes of firms and ask Government purchasers to be especially aware of what small firms can do and to treat them flexibly as far as commercially possible.

Line to take

Small firms should have equal opportunity to compete for public contracts where their competitiveness and flexibility will stand them in good stead. A booklet has been published (a year ago) by Department of Industry to give the sort of information small firms need to gain easier access to Purchasing Departments. Possible needs for further action to improve their access are under review by this Department.

- Information and Advisory Services

e) The CBI urge that Government measures of benefit to small firms and other sources of help for them should be organised and publicised as simply as possible for best effect.

Line to take

The Small Firms Service serves the information and advisory function and now employs 170 counsellors. The Service readily cooperates with other sources of information and advice which serve important needs. There is plenty of scope for help to come from different sources (public and private sectors) but the scope for greater cooperation is being examined. As an example the Small Firms Service and the Council for Small Industries in Rural Areas are operating an experimental arrangement in a few parts of the country to bring together the information and advisory functions of the two services.

The Secretary of State can also point to the success of the Business Opportunities Programme in publicising Government measures.

B C Rayner

B C Rayner
Small Firms Division
28 January 1982

JH 209

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①

Secretary of State for Industry

22 January 1982

rec'd 25/1

Michael Scholar Esq
Private Secretary to the
Prime Minister
10 Downing Street
London SW1A 0AA

Prime Minister

You earlier asked for an audio-visual presentation at your briefing meeting for the NEDC discussion on the electronics industry / IT. Is the attached an adequate substitute? (We would have a non-audio-visual briefing meeting anyway). MCS 27/1

No

not

Dear Michael

You will be aware that the Government's response to the Electronics EDC paper is to be discussed by the National Economic Development Council at a meeting on 3 February chaired by the Prime Minister.

2 Discussion in the Council is likely to centre on ways in which the UK information technology industry might be best assisted to develop an internationally competitive position. This particular industry is so wide ranging in its products and services offered and technologies used that a very broad based strategy of support is likely to be ruled out if only on limited resource grounds. Accordingly there will be a need to focus discussion in the Council on the IT sectors where the Council's attention is likely to be concentrated. This aspect will be addressed in the briefing which will be submitted for the meeting. It might however be helpful to the Prime Minister in advance of receiving that briefing to glance through the attached paper which presents a view of the UK information technology industry and its strengths and weaknesses in some of the key market sectors.

3 It may be that having seen the attached material the Prime Minister will consider that an audio-visual presentation is no longer necessary for the 2 February briefing meeting. I am, however, making the appropriate ~~arrangements but~~ would be grateful for your advice on this point as soon as possible.

4 I am copying this letter to PS/Chancellor.

Yours ever
Richard

RICHARD RILEY
Private Secretary

THE UK INFORMATION TECHNOLOGY INDUSTRY

Introduction

1 Through the use of modern technology and, in particular, microelectronics, the previously separate technologies of computing and telecommunications are being brought together to create new products and services, in the office and elsewhere, and to enable existing services to be provided in new ways (see Figure 1). The result of this convergence is known as information technology, and the processing and transmission of information and its use in product manufacture and services will account for a steadily larger portion of the GDP of advanced nations.

2 Two main factors underlie current interest in information technology. The first is that accurate and adequate information is a major component of industrial and commercial operations and an increasing proportion of the labour force is employed in information handling: in the USA the proportion is ca 50%. The second factor is technical: the development of fast, reliable and cheap microelectronic devices for use in computing and telecommunications.

3 In a sense this new technology has all the virtues: it causes no pollution; it exhausts no natural resources (there is an abundance of silicon); 'chips' carry no health or safety dangers and consume only minute quantities of energy both in their manufacture and operation.

4 The world market for IT products - in banks, shops, offices, factories, houses etc - is vast, currently £50 billion, and expanding rapidly. A competitive UK share in this market could be a major factor in our future industrial success.

Equally important however is the use and application of IT in this country to improve the efficiency of industry, commerce and public services.

The World Market

5 Geographic trends 1980/85 are shown in Figure 2. US suppliers dominate globally with 75% of the world data processing market and 50% of the telecommunications market. Japanese and US competition can be expected to intensify in Europe - a market which accounts for 25% of the world data processing sales and 35% of the telecommunications market and yet which imports 80% of its integrated circuits requirements.

6 Unlike the US, Japan and Germany the UK is a net IT importer and the trade gap is widening: trends indicate the gap will increase from £300M to £1000M over the 1980s.

UK Position

7 Despite the crucial importance of IT to the UK's economic future, there are serious weaknesses in the country's IT industry although a large range of products and technologies are offered. In world terms it is small (see Figure 3) with only one wholly-owned UK company in the top thirty; it is fragmented and its activities are largely concentrated on the domestic market. The penetration of the domestic market by foreign-owned companies can be gauged from the fact that 40 out of the UK's 100 IT companies are UK-owned. These have only a 1.5% share of the non-UK market and even this is decreasing. The UK has no industrial giant like Siemens or Philips; Hitachi is bigger than the seven top UK IT companies combined.

8 Most of the world's top ten IT companies are strong in both telecommunications and computers. The larger UK companies however tend to be strong in telecommunications with their

second in defence electronics. Only ICL has real strength in computers.

9 The key to competitivity in the IT sector is volume production and market share. Figure 2 shows that the UK market is too small itself to sustain a viable IT industry. UK companies must therefore pursue business on an international scale; there is really no other option.

10 Apart from Rank-Xerox which is 51% US-owned, the major UK IT companies are GEC, ICL, Plessey, Thorn-EMI, Racal-Decca and Ferranti. Unlike the US where some two-thirds of all new jobs have been created by small companies not older than 5 years, in the UK there is a scarcity of dynamic small and medium size high growth companies, Racal being the outstanding exception. With this in mind and since in the UK 15% of the IT companies are responsible for ca 85% of IT sales, then for the next few years it is probably realistic to look mainly to the existing medium/large UK companies for the establishment of an internationally-competitive industry and substantial bridgeheads in the main IT markets.

11 The scale of the problem of turning these particular companies from their over-absorption in the home market can be seen from Figure 4; only Racal is truly internationally oriented. And further analysis of the domestic portfolios of GEC and Plessey would show a high dependence upon the traditional government markets such as defence and public telecommunications equipment.

Key IT Sectors

12 Some of the more important IT sectors are:

Telecommunications

Office systems
General computer systems
Special systems
Services
Information systems including Teletext and Prestel

How do we stand in these?

Telecommunications

13 The UK is suffering from a long term decline in the competitiveness of its supply industry, its world market share having fallen from 24% to 6% over the past 15 years. We have three substantial companies in the public switching sector, GEC, Plessey and STC, and System X is nearing the stage where it can be offered in world markets. Potentially it could capture a significant share of these markets. Given however the intense competition in this sector and the necessity of high volume production for competitive pricing, it is difficult to resist the logic that at least one of the three UK companies will not survive in the public switching business beyond the 1980s.

14 In the telecommunications attachments sector liberalisation of the monopoly will provide new opportunities for the traditional telecommunications companies and the younger innovative companies. But they will face intense international competition and one cannot be entirely confident of the outcome.

Office Systems

15 This market includes a wide range of data, text, image processing, storage, display and communications equipment. UK companies include GEC, Plessey, ICL, Rediffusion, Rank, Gestetner, Nexos, CTL, Muirhead. It is in a state of flux

and uncertainty, in terms of products and services supplied, users' attitudes and the evolution of competition. This uncertainty, caused by the overlapping of previously separate products (in telecommunications, data processing and office products) and by the potentially massive impact of new office technologies, creates a market rich in both opportunities and risks.

16 To date the UK effort has been piecemeal at home and largely non-existent elsewhere. It is however a high growth and dynamic market (word processing growth is 35% per year) and successful entry into it is still possible via a variety of individual products and through the use of 'local area networks' (such as Xerox's Ethernet and Logica's Cambridge Ring) which can interconnect a range of disparate office products. But the supply industry cannot wait much longer before committing itself whole-heartedly to this sector, if it is to have real prospects of supplying other than specialised sectors of the market.

General Computer Systems

17 Trends indicate major growth in small business machines, including small computers, intelligent work stations and terminals, and software products. The influence of IBM is all-pervasive; Japan, where they have adopted a very long range strategy in IT, is also strong and Fujitsu in particular is poised to expand its world market share and bids fair to rival IBM over the 1980s.

18 The UK does not have a powerful base from which to develop a strategy for this sector. Its relevance to other IT markets means however that its abandonment would be unwise. ICL clearly failed to develop a product range to match the growth areas for the 1980s but under its present management it is focussing on the smaller (and faster growing) end of the computer market. Its linking with demonstrably successful

international companies such as Fujitsu and Mitel is enabling the company to widen its product base and make a serious bid for the small business system market.

19 Indicators in the US point to opportunities for the UK industry, particularly in the services and software area and in small computers. It is in these particular sectors where the smaller, more innovative UK companies with clear perspectives on technology needs may be expected to capitalise; the larger, more established companies are likely to be slower to react.

Special Systems

20 These systems are based on combinations of high performance communications and computing and are frequently defence oriented eg mobile networks for military tactical communications, industrial process simulators. UK companies active in this area include Plessey, Ferranti, Marconi, ICL, Rediffusion, Racal, Data Logic, Scicon, SDL and Software Sciences. The industry derives considerable revenue from special systems but its market penetration can and should be increased. If the UK is to keep abreast of leading edge technologies a continued presence in special systems (where there is a large export potential) is vital.

21 The creative use of procurement by Government in enhancing the competitiveness of the UK industry and in establishing larger, more effective groups is apparent.

Services

22 The UK software services industry is in a moderately good starting position, occupying second place in Europe (to France). It has several major service bureaux backed by large international groups (such as BOC Datasolve and BP's Scicon) and is in a good position to attack the US market

because of close contacts and the common language. But this position could be eroded by further takeovers of UK companies by US and French firms and by continued aggressive pursuit of the UK computer bureau market by overseas companies. Nevertheless the services sector is well placed to adopt a central role in the IT sector and help overcome the major weaknesses in other sectors by developing effective and attractive combinations of UK hardware and software.

23 The aim should also be to establish several 'critical mass' service companies capable of competing with the large US and French companies on advanced, complex projects.

Information Systems including Teletext and Prestel (viewdata)

24 The markets and opportunities for information systems and services based on the electronic storage, transfer and dissemination of information is substantial and characterised by a high growth rate. Included in this are public and closed user group Prestel based viewdata services, specialised financial and economic information services (such as provided by Reuters, Extel etc) and scientific and other kinds of database material.

25 A complex variety of participants is involved including publishers, computer operators, and hardware and software suppliers, telecommunications companies as well as large information users. The scope of the market and the diverse nature of skill requirements makes it a likely sector for new entrepreneurial activity, particularly in the exploitation of the national/international information sources based in the UK.

26 The strengths of the UK include: a number of organisations skilled in the packaging and delivery of information

(eg Reuters, BBC, Extel, Pergamon); the widespread acceptability of English; the increasingly liberal telecommunications environment; design and manufacturing skills for Teletext/ Prestel systems. Weaknesses: the information management software needed to create electronic information services; the much slower than anticipated take-off of Prestel (though Teletext usage is now building up acceptably); too many companies chasing too little demand.

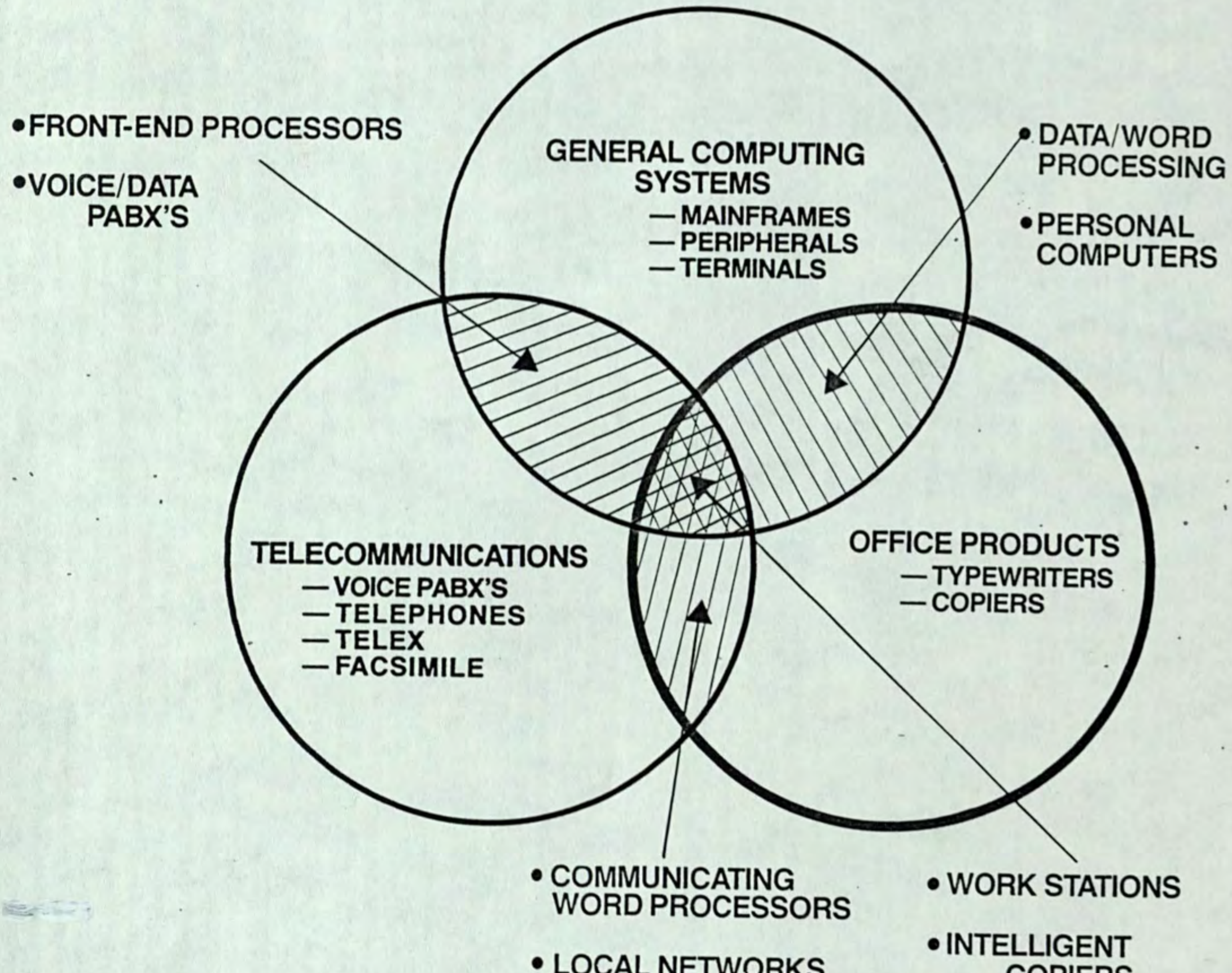
Government Influence and Support

27 The opportunities presented by the burgeoning IT industry have been recognised by the leading IT nations and there have been significant but markedly different support programmes. Figure 6 shows the relative size of the UK IT industry and some other traditional industries as against the support the UK Government has given to these sectors. Figure 5 also shows the comparative development support given to IT by the British, French and German governments: in the UK in the past support has tended not to be in the faster growing IT areas but in the more traditional areas, including main frame computers but this pattern is changing quite quickly.

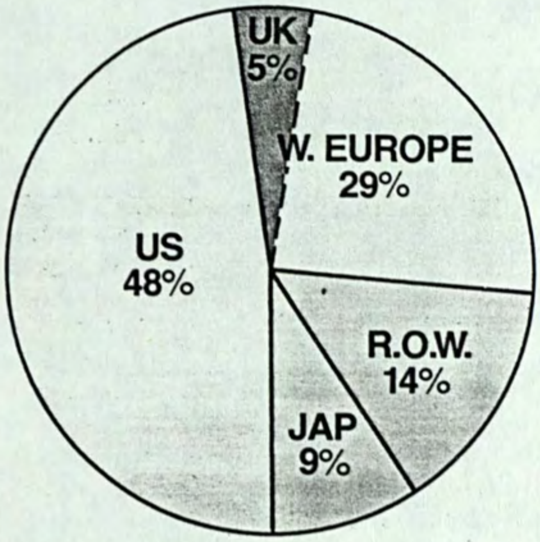
Department of Industry
21 January 1982

FIGURE 1

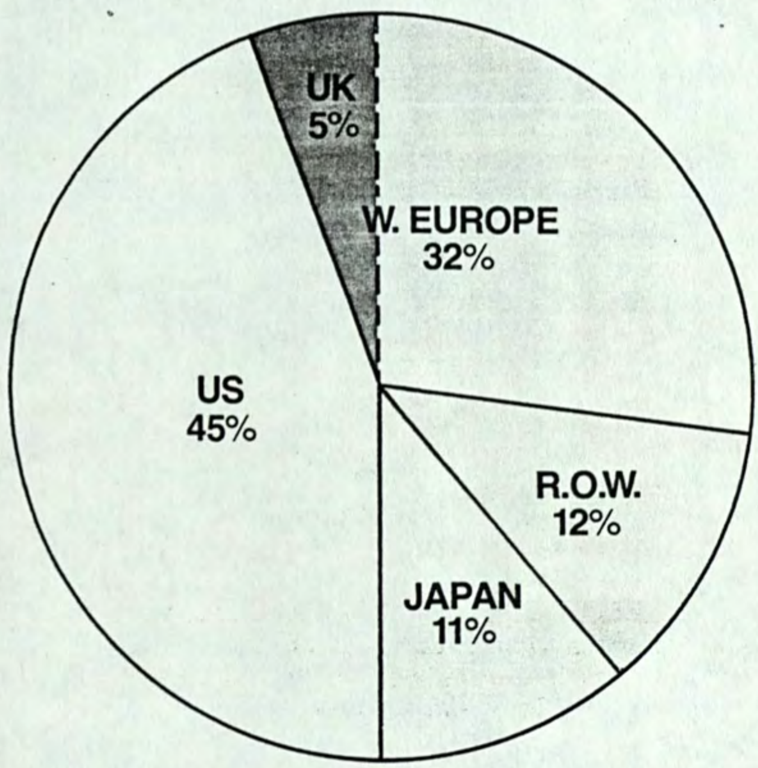
ELECTRONIC OFFICE SYSTEMS: CONVERGENCE



GROWTH OF INFORMATION TECHNOLOGY MARKET



1980 WORLD MARKET £54.4 B



1985 WORLD MARKET £104.7 B

FIGURE 3

WORLD TOP 50 IT COMPANIES

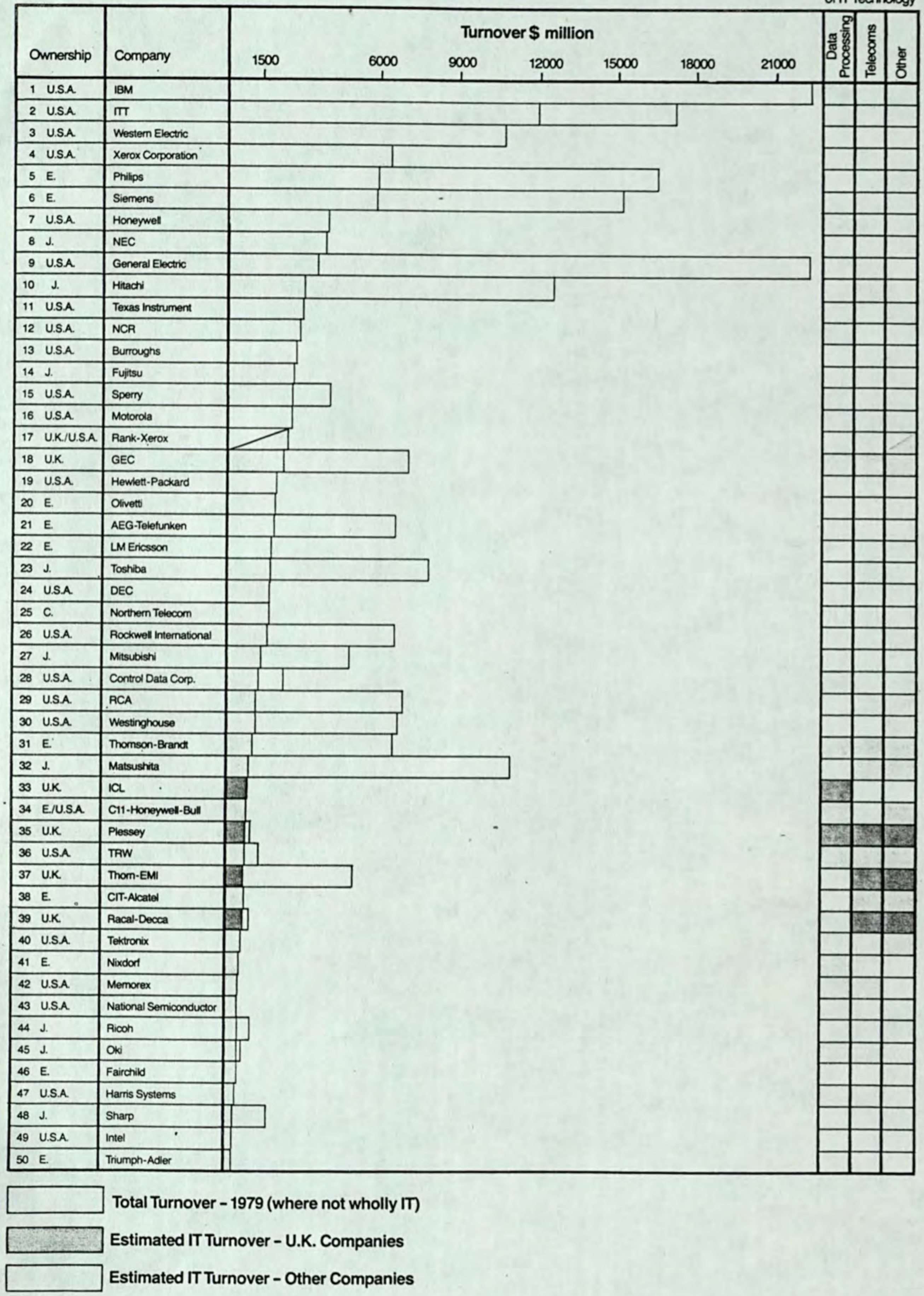


FIGURE 4

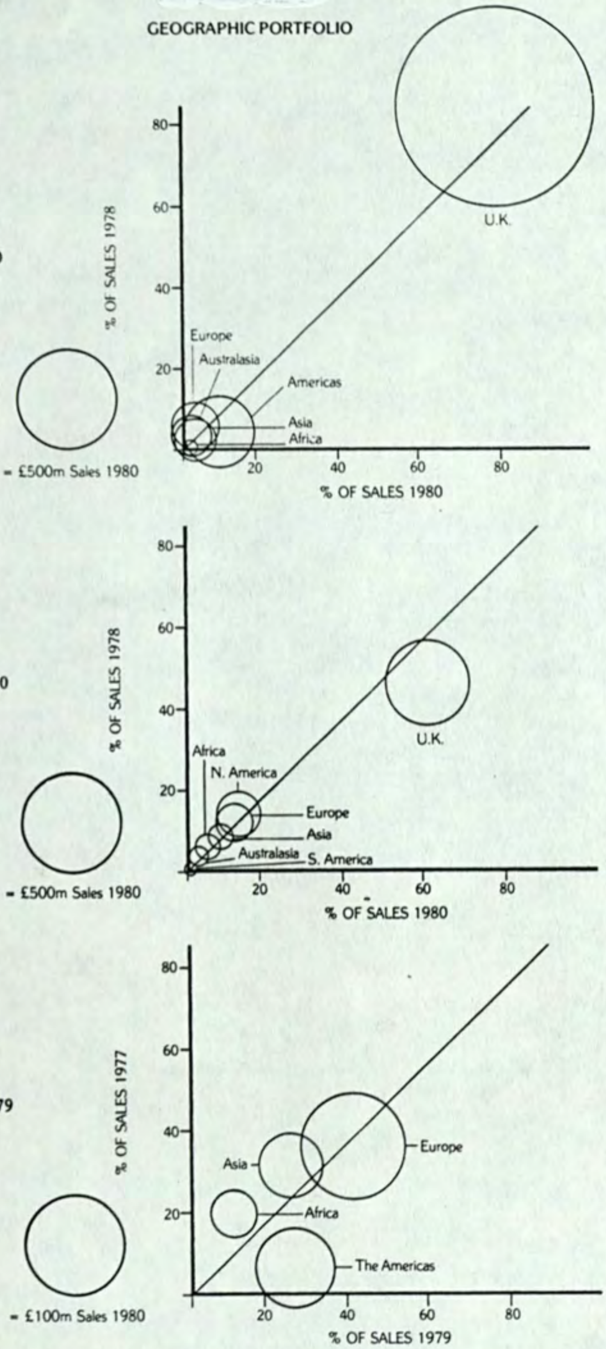
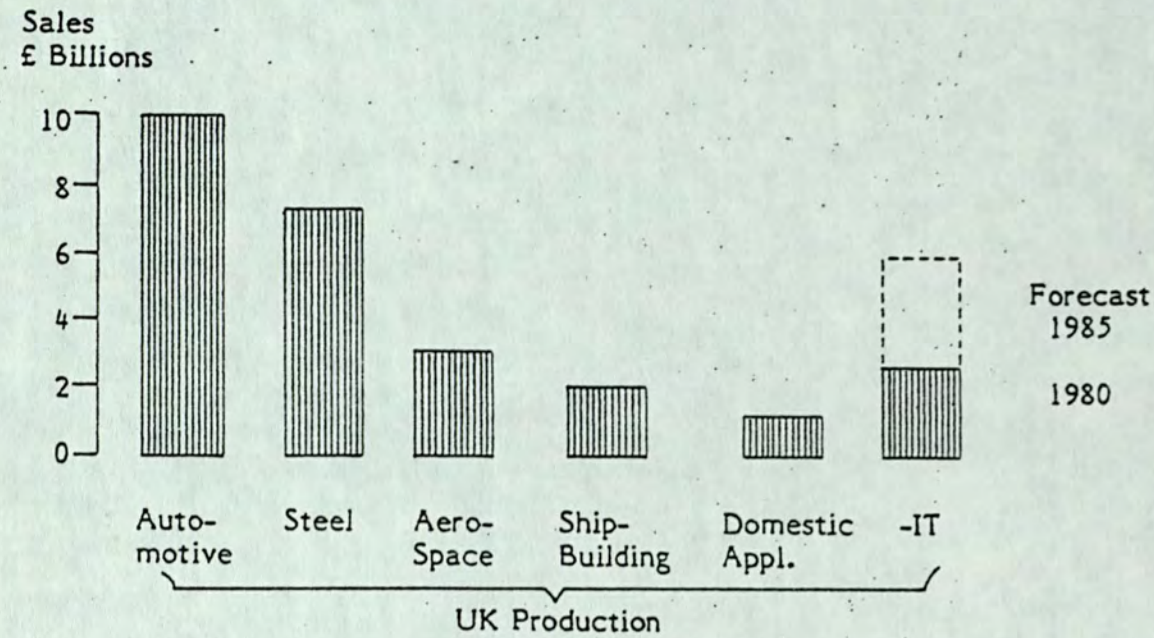
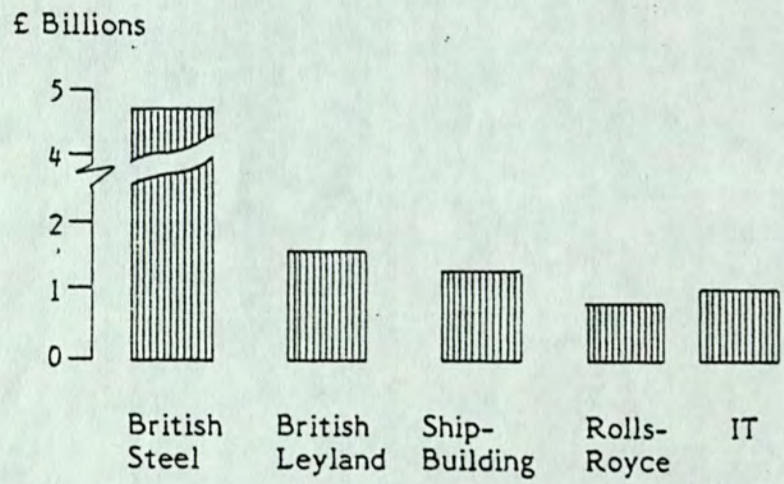

GEOGRAPHIC PORTFOLIO
G.E.C.
1978 – 1980
% OF SALES 1978
% OF SALES 1980
U.K.
Europe
Australasia
Americas
Asia
Africa
= £500m Sales 1980
PLESSEY
1978 – 1980
% OF SALES 1978
% OF SALES 1980
U.K.
Africa
N. America
Europe
Asia
Australasia
S. America
= £500m Sales 1980
RACAL
1977 – 1979
% OF SALES 1977
% OF SALES 1979
Europe
Asia
Africa
The Americas
= £100m Sales 1980

FIGURE 5

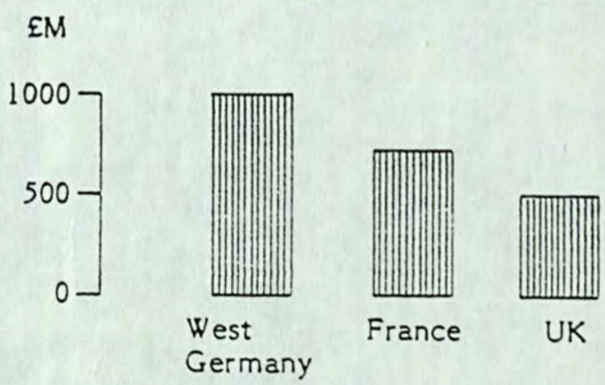
Relative Size of IT in UK 1979/1980



UK Government Financial Support IT and Other Industries 1970-1980



Comparative Government Support for IT Industry 1970-1980



Prime Minister

You should be aware of this,

MLS 6/1

2

NOTE FOR THE RECORD

cc Mr Scholar

NEDC

John Monaghan telephoned me this afternoon with a message about the discussion of the Chancellor's paper at the NEDC this morning.

He said that they had a useful and constructive discussion on macro-economic matters, which was not limited to pay, and it produced general agreement on the need to work the battle against inflation.

Unfortunately, however, towards the end of the discussion of the Chancellor's paper, Len Murray asked if the Treasury could produce a paper for the February meeting, over which the Prime Minister is to preside, looking at the trade-off on growth, productivity, investment, unemployment etc. based on different assumptions fed into the Treasury computer.

The background to Mr Murray's request is that the TUC consider the 1% growth provided for in the Industry Act forecasts as unacceptable. Mr Murray is particularly anxious to know the effect of a 2.5% cut in VAT and a £2bn boost for public sector investment.

The Chancellor, who was clearly put in a difficult position, pointed out that Treasury forecasts were not the mechanical product of a computer operation but reflected a range of assumptions and a great deal of judgement. He agreed, however, to produce a paper on assumptions and options but not for the February meeting and certainly not before the budget.

The Treasury in briefing (and see notes attached) will seek to highlight the constructive part of the discussion but they recognise that Geoffrey Chandler, Director General, will refer to Mr Murray's request of a paper for February and the Chancellor's agreement in principle to produce one, but not at the meeting over which the Prime Minister presides. It is likely that the TUC will also add their own heavy briefing, bearing in mind that they may well feel that Mr Murray's request may well have embarrassed us.
Press Officers should draw on the attached note if they are approached.

B. INGHAM 6 January 1982

MR INGHAM

FROM: J J MONAGHAN
6 January 1982

PRESS OFFICE NOTE

NEDC MEETING

1. The Chancellor's paper on the macro-economy was discussed by NEDC at their meeting this morning. During the course of the discussion some disagreement arose between Len Murray and the Chancellor as a result of a request from Mr Murray that the Treasury should produce a paper for NEDC's February meeting which would look at different options and different possible outcomes, and to what extent there was a trade-off between growth, productivity, employment, investment, etc.

2. The TUC view was that the 1 percent growth envisaged in the Industry Act forecast for 1982 was unacceptable, and Mr Murray asked specifically what would be the effect of a 2½ per cent cut in VAT and an increase of £2 billion in capital expenditure in the public sector. He claimed that all he was aksing for was a set of simulations off the Treasury model which could be produced in 30 minutes.

3. The Chancellor pointed out that Treasury forecasts are not mechanistic things on which we can run simulations. There is a strong judgemental input at various stages of the Treasury's forecasting exercise. Simulating variants, without changing the policy and other assumptions (monetary, exchange rate, etc) underlying the forecast, would not tell you anything meaningful. However, the Chancellor agreed to produce for a future NEDC meeting (but not February) a paper which would look at possible outcomes on the basis of different options and different assumptions. This might well include changes in those assumptions over which the TUC and others might have more influence than the Government (for example, earnings).

4. Geoffrey Chandler will be meeting the press at 3 o'clock this afternoon for the customary briefing. The Chancellor's paper is being issued to the press by NEDO. At his briefing, Mr Chandler will disclose that there was a disagreement, albeit on a rather narrow point. Nevertheless, the TUC are likely to do some heavy briefing on their own behalf and we can expect the Chancellor to come in for some press criticism for refusing to provide a paper for discussion at the February NEDC. In our press briefing, we must strive to get a more balanced presentation of what happened at today's NEDC.

5. Points we can make are the following:

(a) The February meeting of NEDC will be chaired by the Prime Minister and the agenda for the meeting was decided some weeks ago. It would be difficult to add something to the agenda at this stage.

(b) There was a useful and constructive discussion at NEDC this morning on the macro-economy. The discussion was not limited to pay.

(c) The importance of improvements in productivity and of the need to win the battle against inflation was recognised by all. There was widespread agreement.

(d) The TUC request for a further paper is going to be met (though not in February). The reasons for not meeting the request by February should be given as set out in para. 3 and 5 (a) above. Any NEDC discussion of such a paper, even if it is after the Budget, could still be a meaningful step in the ongoing discussion on the Government's long-term strategy.

(e) In view of the useful and constructive discussion that took place and the widespread agreement reached, the extent of the disagreement should be played down as much as possible.

(f) Presentation should take a low profile. The Chancellor will not want to give any interviews and has already turned down the request from Douglas Moffat of IRN.

J J M

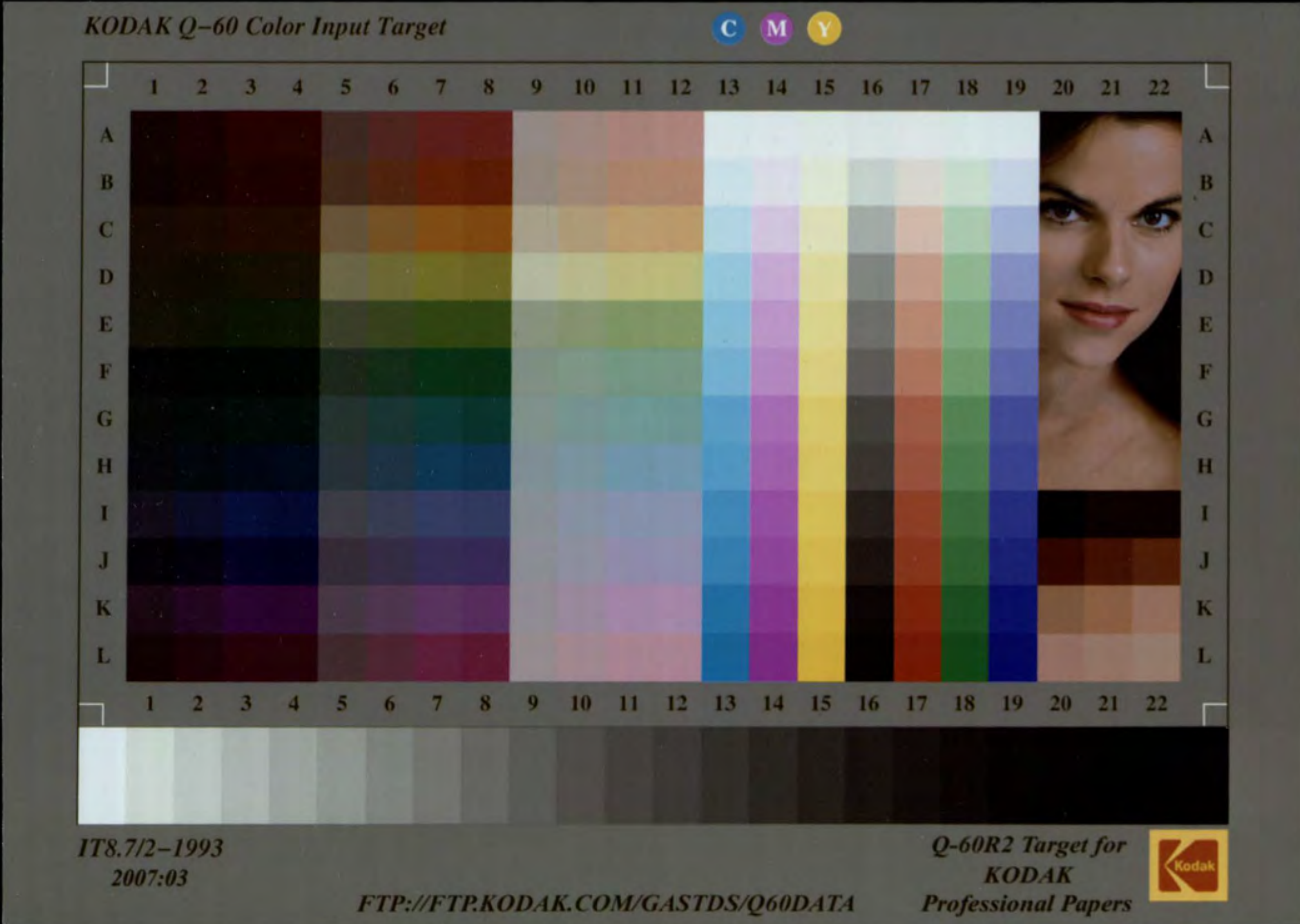
J J MONAGHAN

PART 2 ends:-

PM to Finance for Ind Ltd ~~to PM~~ 24/12/81
(Lord Caldecote)

PART 3 begins:-

Press notice of NEDC meeting (by JJ Monaghan)
6.1.82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