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Secretary of State for Industry

13 July 1982

Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Prime Minister (1)

Mr Jenkin argues for an autumn package for industry of £1billion!

MLS 13/7

Dear Geoffrey,

THE OUTLOOK FOR INDUSTRY

We are to have a discussion in Cabinet on Thursday about the economy, and it may be helpful to you and colleagues to have some advance indication of my views on the outlook for industry.

2 It is already clear that industrial performance has not picked up in the way we expected at the time of the Budget. So far this year neither total output nor manufacturing output has registered any increase on the low levels of the second half of 1981.* Mainly because of the flatness in manufacturing industry, output growth in 1982 is likely to be well below the Budget and MTFS forecast. More recent assessments, notably by the OECD, emphasise the deteriorating prospects for British industry in both home and especially export markets. The latest CBI survey shows no sign of a recovery in output and in certain respects eg export order books, the situation appears to have been worsening over the past few months. This is consistent with reports reaching me that some of the largest companies are considering further cuts in investment and employment.

3 Of course, there are some encouraging features for industry - an improvement in profitability, some recovery in competitiveness and above all the falling rate of inflation. The leading indicators and the forecasters without exception still predict a modest recovery next year.

4 However, the adjectives most commonly used by industrialists to describe their prospects are 'flat' and 'sluggish', and a delayed upturn is the picture that emerges, at best. I am concerned that the delay will have serious consequences for industry and employment. Moreover, any ground lost this year seems unlikely to be made good next year. I am also concerned about the considerable downside risks in the present situation which may delay the upturn even longer; particularly the risk of deteriorating prospects in export markets and our continuing vulnerability to import penetration. The basic cause for concern is that despite recent progress, industry's competitiveness is still 40% worse than 4 years ago.

*though I have just seen that the May figures are a little more encouraging.

5 Against this background we ought to consider seriously what further steps should be taken in the near future, primarily to reduce industry's costs and so improve its competitiveness, thereby enhancing the prospects for more secure jobs. The main objective should be to help UK manufacturers to secure a larger share of both their home and overseas markets.

6 Further reductions in interest rates would be welcome for this purpose. As well as having a significant direct effect on costs - 1% is worth £250m to industry - lower interest rates would also exert downward pressure on the exchange rate which has been responsible for about one quarter of industry's loss of competitiveness since 1979. I understand that interest rates were expected to drift downwards after the Falklands crisis, and I think it is important not to stand in the way of market forces which might help to bring about such a movement, accompanied by a modest depreciation in the effective exchange rate. However, as interest rates and exchange rates are subject to so many external forces, notably in the USA, I see a need for other, and more certain, ways of improving industry's competitive power.

7 My own judgement is that a carefully chosen package of measures to assist industry totalling at least £1 billion announced or implemented soon after the recess, would give a useful boost to industry without undue risk to our monetary strategy. I also note that some respectable commentators (eg Sam Brittan) are calling for a bigger stimulation to the economy as a whole. So far as industry is concerned, you will not be surprised that my first priority is a further reduction in the National Insurance Surcharge. The gloomier outlook for industry and employment strengthens the case for phasing out this tax on jobs and exports as quickly as possible. But this year's Budget arrangements mean that the rate will in fact increase from 2% to 2½% next April unless a decision to the contrary is taken by the autumn. Just to maintain the rate at 2% from next April would reduce industry's costs by some £400m in 1983/84 and at the very least an early announcement of this decision would help to raise industry's confidence in the meantime. However, I believe there is a sound case for a full percentage point reduction next April and I would like to urge that upon you. We must also look carefully at the related question of the size of next year's National Insurance Contributions by employers and employees, especially at the combined cash flow effect on industry.

8 Particularly because it would not take effect for 9 months, I do not consider a ½% reduction in the NIS rate would be a sufficient response to the present situation. We also need to take some action that will have a quicker effect. There are several possibilities.

9 A revival of the small engineering firms investment scheme (SEFIS) would make an almost immediate impact. This scheme is a most effective way of encouraging small firms to become more competitive through the acquisition of technologically advanced and

more productive equipment, and it also provides much needed additional orders for the vital machine tool sector. (Over 60% of orders under the scheme have been for British equipment). It has been an outstanding political and industrial success and the fact that the £30m allocated to the scheme was exhausted within a matter of weeks indicates that it has considerable further potential. I therefore recommend that we consider reviving this scheme, after reviewing its scope and coverage, with an allocation of £100m for this purpose.

10 Ending the 4 month deferment in the payment of Regional Development Grants is another measure which would give an immediate financial boost to industry in the Assisted Areas at a once for all cost of £140 million. This proposal was a late casualty in the run-up to this year's budget, and I strongly urge that it should now be implemented. It would also have the incidental but important benefit of saving Departmental manpower. A more modest alternative would be to end the deferment only for small firms employing up to 100, which would reduce the cost to £25 million.

11 More specifically related to our export performance, I would advocate more generous Aid/Trade Provisions under the aid programme. The terms of the international consensus governing officially supported export credit are hardening in ways which are bound to be detrimental to our exporters of heavy capital goods, and we must be ready to face an increasing resort to aid/trade mixtures if we are to gain a fair share of the available business. Such orders tend quickly to be reflected in jobs at home. Certainly I hope we can avoid the extraordinary agonising over marginal concessions of the kind involved in the current Klang Power Station case in Malaysia.

12 Finally, I think we should consider the scope for a stimulus to the civil engineering side of the construction industry. The Budget measures are having a beneficial effect on housing but the rest of the industry is being hit very hard by the recession. As you know, the CBI attach high priority to some help from Government in this quarter where there is very little import penetration. They claim that a quick and widespread effect on activity and employment with a useful spin off to other parts of industry could be achieved by a programme of infrastructure maintenance and repair eg on roads and sewers. So far as roads are concerned, a targeted programme could be helpful in promoting our proposals for implementing the Armitage report on heavy lorries thus reducing industrial transport costs. Altogether there would be direct and indirect benefit for industry here and I should be interested to hear the views of Michael Heseltine and David Howell on whether action on these lines might be feasible.

HP Controls

13 In addition to this package, I should also like to support

the idea of a relaxation of hire purchase controls. The Society of Motor Manufacturers and Traders have recently written to you renewing their request for a relaxation of the controls as they affect motor vehicles and I support their suggestion as a minimum step that we might take. Arthur Cockfield, in his letter of 28 June, has gone further and proposed total abolition of controls. He has put forward good reasons for taking this more radical course and I do not wish to argue against him. However, we do need to be careful that industry is not taken unawares by a major change of this sort with a possibly damaging influx of imports. Although I am in favour of abolition there is therefore something to be said for moving one step at a time.

14 In sum, what I am seeking is an autumn package of measures and announcements which will mitigate the heavy downside risk which now seriously threatens even the very modest growth forecasts following the budget. Measures worth about £1 billion to industry's cash flow ought to be feasible without undue risk to expectations about inflation, and would indeed serve to fend off a further round of cuts in manpower and investment and output which would be highly damaging to our longer term industrial prospects.

15 I am copying this to the Prime Minister and other Members of the Cabinet, to the Chief Whip, and to Sir Robert Armstrong.

Yours ever

Patrick

13 JUL 1982