SUBJECT

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cc Mr. Duguid
Mr. Lankester

Industrial Policy

NOTE OF A MEETING BETWEEN THE PRIME MINISTER AND LORD TRENCHARD HELD AT 10 DOWNING STREET AT 1715 HOURS ON TUESDAY 13 JANUARY 1981

Lord Trenchard said that he was grateful for an opportunity to report to the Prime Minister at the end of his assignment at the Department of Industry. There was no room for dispute about the good news - on inflation and on much improved management throughout industry, with the possible exception of Ford. Taking his 30 year experience of manufacturing industry with his 18 months as Minister, he was asking himself about the seriousness of current problems. The strength of the pound was at the top of his list. Lord Trenchard knew of the CBI President's discussions with the Prime Minister. His company benefited from special products where markets were buoyant, and some other major manufacturers were in relatively good shape. But he estimated that half of the private sector companies covered by his part of DOI would not be able to cope if current circumstances persisted over time. About half British exports were already undertaken at a loss. The underlying problem was a backlog of non-competitiveness - perhaps 40% against major competitors - which could not be handled with an unrealistic exchange rate. He personally believed that, given the new realism, we could hope to improve productivity at up to 5% per annum if we could stabilize our volume of output. But if volume continued to fall, it would be extremely difficult to retrieve this backlog. The problem could not be handled by any sort of crash programme over a one, two or three year timescale. We needed to use every available trick to protect existing markets. We needed to consider carefully, for instance, non-tariff barriers elsewhere. An upturn in world trade might help some industries, but such growth would be unlikely to disguise our relative decline, as had happened in the past. The best assumption might be that our volume held whilst our share declined in growing markets. In 1979, productivity had risen 2% over the previous year, but this had been lost again in 1980.

Lord Trenchard had invited officials in DOI and elsewhere to fault his analysis, but no-one had yet successfully done so. He concluded that exports must fall sometime within the next couple

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of years, given the negative margins in many areas. This would inevitably weaken our balance of payments by comparison with competitors. In turn, the enormous external confidence in our prospects could collapse, with a result that the pound would fall far too fast. It was to avoid this scenario that he was still keen to impress on the Prime Minister the advantages of taking steps to weaken the pound now, against our current balance of payments strength. It should be possible to prevent the process going too far. He had been frequently told that it was impossible to bring down or talk down the pound but he felt the search for methods was still worthwhile. If we could not tackle this at present, there was a real risk of sterling falling out of control in the run up to the next election.

The Prime Minister asked how much our loss of competitiveness related to pay rather than currency movements. Lord Trenchard said that this was wholly true in relation to Japan, but in relation to the United States, the pound was responsible for about half the change. The Prime Minister asked how Lord Trenchard saw the prospects for regenerating the volume of manufacturing output. Lord Trenchard said that Government would have to help create the conditions to stabilize output before it could start to improve. Productivity was crucial. Government would need to make some contribution, whether through energy pricing, NIS, or reform of local authority financing.

Turning to his new responsibilities, Lord Trenchard noted that the UK's world market share had dropped from 20% in 1960 to 8% in 1980. We now tended to be small in all spheres instead of being large in all spheres. We had to identify areas where we still had a lead, so that we could select and concentrate. Internal MOD advice suggested that we could no longer see ourselves as innovators, except, in part, in electronics and chemicals. The advice was particularly gloomy about Rolls Royce (and its management) and the aircraft side of British Aerospace.

Lord Trenchard was questioning whether MOD's present commitment timescale was necessary. There were enormous staffs involved in forward procurement. If the size and timescale of the operation could be cut back, there might be more scope for discussing with industry what they should be producing in the future.

Touching on nationalised industries, Lord Trenchard commented that if the pound had not passed $2.20, there would have been only a minor requirement for Government funding of BL. But some of the more reliable parts of the group had major long term problems. The Land Rover premium over the Toyota competitor ranged from 70-90% depending on the market. Land Rover had some product pluses, but they could not sustain such premiums beyond a year or two. BL must have a Chairman and a Board who would wind it up if it was not moving in the right direction. He would strongly advise that early steps be taken to retain Michael Edwardes for a further three years.

Returning to the general industrial picture, Lord Trenchard said that there was quite a close correlation between the industries with highest energy costs and those hardest hit by current circumstances. The UK tended to support its capital goods sector more than other manufacturing areas. In his assessment, over half our service industries depended on manufacturing, and would shrink as the manufacturing base did. The Prime Minister said she had never seen the future in terms of service industry replacing manufacturing.

Lord Trenchard said that he would be visiting Malaysia and Indonesia soon, and he undertook to let the Prime Minister have a note of the sales prospects that he would be following up. He commented that the new textile arrangements with Indonesia would set a precedent with 20 or 30 other developing countries. The United States applied the MFA ruthlessly, and never attracted retaliation. The exporters knew that they would achieve nothing. The UK was different. We would need to make it clear that we were not a pushover and it might be necessary to take a loss of exports to one country to demonstrate this. He added that ICI now found their US textile wage costs 82% of those prevailing in the UK.

MAP

14 January 1981

Jan 8th

HOUSE OF LORDS

Arranged for Tuesday 13th January at 15.30 HC [illegible]

Dear Prime Minister

Thankyou for giving me the M.O.D. job which provides a challenge and I will look urgently for opportunities in the overlapping areas of defence sales and procurement costs.

We had a hurried conversation on industry, exchange rates and competitivity and I asked you whether you could spare another ¼ hour.

I would like to do this and to give you my outgoing views and rough quantifications of the future trends of exports and imports for manufacturing industry as a whole.

I know you are well informed but contact with private industry was my full time job since you appointed me and I would welcome such an opportunity.

I dont think that I shall waste your very precious time.

Thankyou again for giving me the opportunity to continue to try to help the cause

Yours

Tom Stenchard