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Prime Minister

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PRIME MINISTER

... In response to your personal minute of 4 February I attach notes covering forward projections of Department of Industry programme expenditure and of the financing requirements of nationalised industries sponsored by my Department. I have consulted Treasury colleagues.

2 Forecasting future industrial support is difficult while profits are still at a historically low level. It is our common experience, in discussions with both representative bodies and individual firms that many still do not have the resources to undertake new investment or the modernisation of their capacity and products which is necessary if they are to become more competitive. It is impossible to deny with any degree of conviction that the Government's policy of a tight control on money and high interest rates has led to a significant squeeze on profit margins - as has been consistently pointed out by the CBI at NEDC. I believe that the Treasury has been absolutely right it recognising this in recent budgets in allowing us to expand our programmes for innovation and new technology. It is right to point out that this growth has been considerably less than the substantial reductions over the years in the sums provided for the 'casualties of the past', thus allowing a significant reduction in the Department's overall spending.

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3 The current forecasts for my programme support in 1985/86 assume no further support for such "casualties", and the further expansion for innovation and new technology that may be needed must imply increases in total expenditure even after allowing for reductions in regional support. My original forecasts of expenditure to 1990/91 were based on such premises, but I do recognise that if and when industrial profitability improves to more normal levels, we could expect to be able to phase down and eventually eliminate many of the special schemes of assistance which present circumstances make necessary. My agreement to this must only be conditional; the position is one of great uncertainty though as we come out of the recession and as the benefits of past rationalisation and improved productivity really begin to be felt, I would very much hope that this is the picture which will emerge.

4 For the present therefore, because I am fully appreciative of the difficulties which the Treasury face, I am prepared to hold my future total programme support at the 1985/86 level, thereby consolidating the 35% decrease in total support expected between 1982/83 and 1985/86. These forecasts should still allow for a significant switch of resources to priority areas. Of course if economic conditions and levels of company profitability improve significantly I would be prepared to accept reductions in this overall support.

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5 I am copying this minute and the attached notes to the Chancellor of the Exchequer, the Chief Secretary and the Secretaries of State for Scotland and Wales.

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31 March 1983

Department of Industry
Ashdown House
123 Victoria Street

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LONG TERM PUBLIC EXPENDITURE - DEPARTMENT OF INDUSTRY

BACKGROUND - PES PROVISIONS

The PES provisions which form the basis of Cmnd 8789, with adjustments for the Innovation Package, imply a sharp reduction in my Department's total programme expenditure - from £1.8 billion in 1982/83 to £1.2 billion in 1985/86.

2 The principle factors in this fall are reductions in finance for BL and Rolls Royce, in shipbuilding support, in the costs of the support scheme for redundant steelworkers, and in RDGs (this latter reduction being "technical" - RDG costs in 1982/83 being abnormally high with the ending of the deferment of payments). These various savings dominate an increase of over £100 million in Science and Technology Act support between 1982/83 and 1985/86 and a smaller increase in Section 8 support.

THE FIVE YEAR FORWARD LOOK

3 My report drew attention to particular initiatives including the Alvey programme of collaborative research in Advanced Information Technology, support for more professional management and a major revision of regional policy. High priority would be given to maintaining a steady expansion of our programmes for research and its applications and for management support. These increases might be accommodated within present levels of total Departmental spending provided that expenditure on the public bodies could be reduced and that savings in regional policy would result from the present review. The Department would be "doing its utmost to switch resources" between its activities.

DOI EXPENDITURE IN THE LONGER TERM

4 In the longer term the success of our macro-economic policies in providing the conditions for growth and the restoration of higher levels of profitability should have significant influences over my Department's total expenditure. Initially higher growth might lead to an increase in the demand for support for R&D projects and investment projects. Indeed it is important that we should have the funds to meet such a demand thus enabling as many companies as possible to take early advantage of an upturn towards continued higher growth. However, with the maintenenance of improved economic conditions and significantly higher company profitability, it would be my intention to seek reductions typically in our project support, perhaps by reducing the levels of incentives available or even withdrawing some measures. A further consideration is that in such favourable economic conditions the financing calls of our public bodies should be much reduced.

5 On the assumption of a more modest economic recovery, forecasts of forward spend are as shown in the Annex. The principal features of this forecast are:

- a substantial reduction (nearly 30%) in regional policy support by 1990/91;

- a downturn in Section 8 investment support - this includes SEFIS-type schemes, innovation-linked investment support, follow-on support for major new technology initiatives like Alvey, expansion of small firms support, public purchasing initiatives, etc;

- maintenance of the momentum of R&D project support, spread over a wide range of industries and technologies, and including collaborative research projects;

- increased support for Advisory Services and Educationrelated developments, ranging from consultancy support under particular schemes to services like the Manufacturing Advisory Service and the Small Business Service, to the extension of the "Micros in Schools" approach to other advanced equipment in Higher and Further Education, and to encouragement of university/industry links;

- holding steady Aerospace support under the Science and Technology Act 1965 (i.e Aircraft and Aeroengine R&D support and support for Space Technology) but with some allowance for new launch aid projects where outgoings should be offset by receipts;

- no calls for finance relating to public bodies, except for some shipbuilding support.

6 As shown in the Annex total expenditure has been kept down to the 1985/86 figure of £1.17 billion in both 1987/88 and 1990/91 (with no allowance for inflation after 1985/86). It may be unrealistic however to assume such few calls from public bodies. In 1982/83 the combined calls from BL, Rolls Royce, shipbuilding and the scheme for benefits for redundant steelworkers totalled over £600 million. While our aim must be that future financing of these bodies should be small and infrequent, experience suggests that a fall from £600 million to much lower levels is unlikely to be achieved quickly. Accordingly it would seem sensible to follow the practice used last year and allow for some contingency element - perhaps initially taking the figure of £200 million used last year but reducing this figure to £100 million by 1990/91. (Our aim is that Rolls Royce should be returned to the private sector by 1988 and that equity in certain BL companies - Jaguar, possibly Unipart and Land Rover - should be put on offer to private investors by 1985).

7 On the above basis the Department would make considerable progress in the directions indicated in the Five Year Foward Look, with the expansion of support for priority areas and a "switching of resources" from other areas. Forecasts of total expenditure to 1990/91 would be in line with the forecast spend for 1985/86, and considerably below the current (1982/83) levels of support. Moreover, if the macro-economic conditions turned out to be more favourable and company profits moved to higher levels there would be sound prospects of some further savings as the need for particular levels of support or even some support measures became less justifiable.

ANNEX

POSSIBLE FORWARD EXPENDITURE ON THE DOI PROGRAMME

	1982/83	1985/6	1987/88	1990/91
Regional Support	660	550	450	400
Section 8 (investment support, etc)	120	150	150	130
S&T Act support, etc				
- R&D projects	140	240	280	330
- Advisory/Education	50	60	80	90
- Aerospace	100	100	100	100
Launch Aid, Other Air Support	75	(15)	25	35
Rolls Royce Financing	50	-	-	-
BL	360	-	-	-
Shipbuilding/Steel Redundancy Scheme	210	15	15	15
	1,765	1,100	1,100	1,100
Administration	50	70	70	70
Total	1,815	1,170	1,170	1,170
Possible Contingency		200	150	100

Notes

(i) No allowance for inflation has been made after 1985/86.

(ii) 1985/86 figures are as in Cmnd 8789 plus £80 million (in Section 8 and S&T Act support) from the Innovation Package.

(iii) The "possible contingency" would provide cover for any further financing calls from BL or Rolls Royce, any outgoings related to privatisation, as in the 1982 look at long-term public expenditure.

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LONG TERM PUBLIC EXPENDITURE - DOI NATIONALISED INDUSTRIES

BACKGROUND - FORECAST EFLs

The current forecasts of External Financing requirements of DOI nationalised industries in 1982/83 and 1985/86 are shown in the first two columns below. The privatisation of BT will of course remove the possibility of further negative EFLs, but there could well be substantial dividends accruing to the Government in 1985/86.

(£m)

	EFLs 1982/83	EFLs 1985/86	1987/88	1990/91
BSC	575	85*	Some contingency?	Some contingency?
BS	152	70	35	25
BT	(258)	Dividends?	Dividends?	Dividends?
PO/Giro	(56)	(37)	(35)	(35)

(* - a figure of £185 million is in the BSC's latest Corporate Plan which is still being examined)

FIVE YEAR FORWARD LOOK

2 Apart from the privatisation of BT this report sets out proposals for the progressive sale of BSC (peripherals businesses by 1984, joint ventures by 1984; privatisation of major steel making businesses when viable - probably after 1984), and of BS (privatisation of ship repair in 1983/84 and warship builders after the election).

EXPENDITURE IN THE LONGER TERM

3 The longer term performances of BSC and BS are particularly uncertain. The state of the economy and of world trade could have a marked influence on those performances, the size of the industries and the financing requirements. The steps towards privatisation could also affect financing requirements significantly. In such circumstances it would be sensible to allow for some contingency cover, perhaps £50-£100 million a year for BSC. For BS the financing needs might decline gradually over the period. Such possible outgoings could well be substantially offset by returns through dividends from a privatised BT.