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PRIME MINISTER

17 January 1986

MISC 119 REPORT ON GOVERNMENT R&D

MISC 110 recommended reductions in defence R&D. Michael Heseltine disagreed, so MISC 119 was commissioned to review all Departments' R&D programmes in an effort, as Michael Heseltine put it, "to consider their long-term effects on our industrial base".

Michael Heseltine escaped in the summer by securing a wider review. George Younger may escape, too, because his colleagues have discovered that they have little or no information on which to answer the exam question they allowed themselves to be set, namely: how do their programmes contribute to the economy? It will be even harder to show that these programmes contribute more, at the margin, than defence R&D. MoD can at least claim that it generates products, exports and jobs in a direct way. In contrast, DTI's support for R&D, whether for technological applications or for new products, is less decisive in its effects.

MISC 119's Report recommends that a DTI-chaired committee be established to carry its work forward. Before accepting that recommendation, you should consider where this will lead us; whether it will actually resolve the defence R&D question; and is DTI the appropriate department to chair such a committee?

Committee machinery cannot succeed unless there is first some clear thinking on policy.

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First, is it good government to press departments to pursue objectives which are irrelevant to their main purpose? Surely DHSS's research priority is to develop better medical techniques and establish which types of treatment are most effective. Why distract DHSS with the concerns of medical equipment suppliers? Should MoD be charged with promoting civilian spin-off, if this distracts them from their task - defending us, within their budget?

Second, is it realistic to try to agree a smaller defence R&D budget? A more promising line of attack on defence R&D might be to address the policy issues and agree an approach which will reduce defence R&D. Neither MoD nor DTI are consistent in their approach. Defence Ministers have sought more defence for less money, but they also pursue an industrial policy which sometimes cuts across this objective. DTI talks with two voices. Their scientific staff argue that MoD should not pre-empt the country's best brains, but whenever an individual procurement is discussed in MoD's Central Equipment Policy Committee the DTI representative, from a "sponsoring division", invariably supports the development of a British solution to the threat, "in order to sustain or develop a radar/tank/terminal guidance or whatever capability in this country". Unless we can agree on a procurement policy which leaves more development work to our Allies and takes more advantage of the American weapons supermarket, we will jeopardise our security and pay excessive defence costs. We should have bought, and will eventually have to buy, an American airborne early warning system.

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Third, if we are to have a new Ministerial Committee, should it be chaired by the DTI? DTI's credentials for assessing other departments' effectiveness in research must be doubtful. They have a long history of supporting uncommercial projects, principally in aerospace. Westlands' W30 is only the latest. Much of their R&D support is taken by companies as their first source of funds, for projects which would have gone ahead anyway. Could the Lord President be persuaded to continue?

Britain's Innovative Performance

It is generally agreed that industry invests too little in research and that our performance (in terms of patents, for example) is slipping. MISC 119 commissioned a perceptive analysis of the complex reasons why we innovate badly, including:

- the fragmentation of Community markets;
- the difficulties which small firms encounter when entering public procurement markets, dominated by large suppliers;
- easy pickings in defence;
- poor management, particularly the use of qualified engineers;
- an under-developed and uninformed venture capital market;

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- weak competition, due in part to the growth of industrial concentration in the 1960s and 1970s;
- weak links between universities and industry;
- a low rate of new firm formation.

The policy dilemma which this conclusion poses is: should Government compensate for this deficiency in expenditure on innovation, or should it try to remedy the root causes of the deficiency? Major industrial countries have taken very different approaches. Very broadly, the USA and Japan rely on private sector initiative, encouraged by competition. In Europe, there is little competition; governments don't trust industry to do enough research, and subsidise it.

The drawback with the Europeans' dirigiste approach is that it often backs losers. Indeed it is bound to do so. Can one expect civil servants, whose entrepreneurial experience can be limited to buying a house, be expected to make good, entrepreneurial judgements? Drawing on advice from industry may not be the answer, either. If we don't trust industry to do enough, or to fully exploit our excellent science base, as foreigners do, can we rely on their advice? The alternative is to make the market work better.

You could suggest that the new Committee should consider the following possible remedies to the problems identified above:

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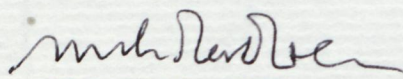
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1. Adopting a tougher competition policy, along American lines; companies will then have to spend more on research, in order to survive. Ask Leon Brittan to consider.
2. "Breaking out" public procurement contracts into smaller chunks to give small firms and new firms a better chance to compete; ask major purchasing departments (MoD, DoE, DHSS) to consider.
3. Offering specific financial incentives to universities which attract industrial funding (eg an additional £1 of extra public funding for every £3 raised from industry); ask Keith Joseph to consider.
4. Intensifying efforts to deregulate in order to encourage new company formation; David Young to report.

Recommendations

We recommend that:

1. If E(A) cannot agree to reduce defence R&D, you call a separate meeting to resolve the underlying policy issues.
2. Consider the chairmanship of the new Committee.
3. Direct the new Committee to consider the four points above.


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