



Prime Minister

MUS 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,

JR

JILL RUTTER

29 JAN 1982



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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

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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

<u>Item</u>	<u>Suggested length of discussion</u>
1. The outcome of the Cancun Summit	$\frac{1}{2}$ hour
2. Inward and outward investment	1 hour
3. The electronics industry: Government action check list	$\frac{3}{4}$ hour
4. The small firms sector	$\frac{1}{2}$ 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 <u>Mr Astley Whittall's</u> 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 <u>Sir George Jefferson's</u> 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

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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

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now available, on terms which increasingly reflect the economic needs of ldc's;

- (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} 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's 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,

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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.

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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

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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 provided 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

SDY to be
considered
training



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

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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 taken together: deregulation and greater flexibility are necessary to encourage people to set up small firms.

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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