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Andrew Turnbull Esq
10 Downing Street
London SW1

Dear Andrew,

NEDO PUBLICATION "PRACTICAL ASPECTS OF A NEW FINANCIAL INTERMEDIARY"

This letter is to forewarn you that the attached document is being published by NEDO today. We were told this yesterday afternoon, although NEDO had undertaken to let CFI members know several days in advance. This paper is the result of work started some years ago into the practical aspects of a national financial intermediary, if one were to be set up. The Government has made it clear from the start that it regards this as a misconceived enterprise and that it sees no need for a new intermediary.

The foreword to the document makes clear that the paper is dealing with the practical aspects of what a body might look like and is "not directed to the question of need itself" which is a "separate question". The foreword makes clear that the paper does not commit the Committee's Members or the bodies they represent, to any particular view as to the need for an institution of this kind. Having failed to prevent the existence of the paper, Government Departments have assisted in its drafting as a means of damage limitation.

It is likely that the TUC will want to give this document a high profile because of their support for the idea of a national investment bank. Attached are some speaking notes which cover both the published document and the issue of the need for such a national financial intermediary. These notes may be useful if the possibility of such a body is raised in PM's Questions this afternoon.

I am sending a copy to Andrew Lansley (DTI).

Yours sincerely,

Philip Wynn Owen

P WYNN OWEN
Assistant Private Secretary

OUTLINE OF THE NEDO PAPER ON THE PRACTICAL ASPECTS OF A FINANCIAL INTERMEDIARY

The paper uses as an assumption that the institution would consist of a parent company with a number of operating subsidiaries. The parent company would be largely owned by the major banks and financial institutions, with the Government holding a significant minority stake.

2. The main board would decide the body's financial objectives and investment policies. Representation on the main board would be broadly in line with shareholdings which suggests that the banks and financial institutions would be dominant voice. "Wider interests in the economy" might also be represented.

Investment activities

3. The intermediary would have two principle operating divisions. The first would provide private finance for general industrial purposes with the emphasis being on projects involving a high degree of risk, on innovative projects and on the restructuring of ailing companies with potential for recovery. This division would be concerned with both equity and loan investments and would have flexibility in the timing of interest and repayment obligations in certain cases.

4. The other principle division would be concerned with the provision of private funds for large scale projects. It would co-ordinate the raising of finance for long-term, major infrastructure projects and could get involved in project evaluation and the issue of tenders.

Sources of finance

5. The paper suggests that the intermediary would raise most of its funds to finance its investment by issuing bonds to the public. The paper identifies that a problem would be to maintain a flow of cash to service its debt and cover operating expenses, while absorbing the risks from its investments and lending at

longer maturities than it would usually borrow at.

Role of Government

6. Because of the nature of its lending (long term and/or to high risk projects) the paper says that the financial intermediary could need government backing probably in the form of explicit or implicit guarantees for its borrowing. The paper acknowledges that this would raise questions of accountability to Parliament.

An Expanded Role

7. The NEDO document also envisages that two further divisions might be established in due course. The first would be a division to intermediate in public financial support for industry and the second to make specific investments at the Government's request.

NEDO PUBLICATION: PRACTICAL ASPECTS OF A NEW FINANCIAL INTERMEDIARY**SPEAKING NOTES**

- 1.1 The Government regard this as a misconceived enterprise, and has made it clear from the start that it sees no need for a new intermediary.
- 1.2 The foreword therefore makes clear that the paper which presents the result of work started some years ago into the practical aspects of a new financial intermediary, is "not directed to the question of need itself" and states that the issue of whether or not there is a need for such a body is a "separate question".
- 1.3 The foreword makes clear that the paper does not go into the practical aspects in equal detail. It is not a blueprint for action.
- 1.4 The foreword acknowledges that other European countries have over time developed public investment corporations, but makes clear that circumstances are different in this country. It identifies that there is a more highly developed capital market in this country compared to elsewhere in the European Community and points to the array and adaptability of funding sources.
- 1.5 The foreword makes clear that the paper does not commit the Committee's members, or the bodies they represent, to any particular view as to the need for an institution of this kind. Nor does it commit them to a view on how such an institution would work, if one were established.

If the need for such an intermediary is argued:

- 2.1 The case has not been demonstrated that a new publicly supported national body is needed to promote investment in industry. Investment across the whole economy is now running at its highest ever level. April 1985 CBI forecast suggests an 8 per cent rise in manufacturing investment this year. Recovery in company profits means more internal funds available for investment.
- 2.2 Not impressed by argument that we must have a national financial intermediary or a national investment bank because other countries do. No correlation between such institutions and economic success. UK growth topped EC growth league in 1983 and according to OECD forecast should achieve faster growth than any other major EC country in 1985.

2.3 Lending from any new financial intermediary would almost certainly displace finance which would have been raised anyway. Any element of subsidy would therefore be a waste of taxpayers' money. Danger that truly additional lending would go to projects which the generality of lenders were not prepared to finance because they would not pass normal tests of commercial viability.

2.4 Experience of NEB a reminder of how commercial criteria can be bent to meet political ends, eg by propping up lame ducks.

2.5 This Government believes in leaving decisions on allocation of resources to those with keenest appreciation of risks and rewards - namely individual enterprise and investors.

2.6 Most important contribution a government can make to help business is to improve the general environment in which it operates by pursuing prudent financial policies, encouraging enterprise and risk taking, and removing obstacles to the free functioning of markets.