E(80)109
8 October 1980

COPY NO. 55

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

INDUSTRIAL SUPPORT MEASURES

Memorandum by the Chancellor of the Exchequer

At its meeting on 10 July Cabinet invited me to consider options for additional measures of industrial support. Cabinet also endorsed the Cmnd 7841 aggregate expenditure totals, so that any additional spending in favour of industry would call for a re-ordering of expenditure priorities. However, the public expenditure prospect looks more difficult than was foreseen in July, and it may not be feasible to accommodate even a modest package of measures. This paper considers the basis for selecting such a package on the assumption that in the event it will prove possible to find room for them within the agreed totals.

Background

2. I share colleagues' concern about the worsening position of manufacturing and some other industries, as reflected in loss of industrial capacity, dwindling investment programmes and the squeeze on liquidity and profit margins. But I am mindful too that these difficulties are part of the painful process of adjustment to a more competitive and inflation-free economy. Some companies have often brought these difficulties on themselves

by failing to recognise the implications of our policies and our determination to see them through. There can be no question of a relaxation now, especially at this critical moment for the coming pay round. Moreover, the best way to help industry is to establish conditions which would help to bring interest rates down. Our policies on public expenditure and the PSBR are aimed to make this possible.

3. I recognise, however, that colleagues would welcome the opportunity to discuss the economic prospects and the outlook for the company sector and I will be circulating material on the macro-economic background, based on the latest Treasury forecast, as part of the general review of public expenditure schedules for the end of the month.

Liquidity measures

4. Many of the measures suggested to me by colleagues would be intended to ease the liquidity pressures falling on companies. But apart from the conflict with the general thrust of our policies, such measures would be costly in terms of public spending or loss of tax revenue. As regards taxation it would be premature to consider such specific tax changes at this stage - they are a matter for next year's Budget. I will, of course, be prepared to discuss with colleagues their tax proposals at the appropriate time.

5. In the meantime, there is one public expenditure measure which some colleagues have said would improve the liquidity of firms investing in assisted areas. This would be to remove the four month deferment on payment of regional development grants. I have considered this very carefully but I am not convinced that in current circumstances it would give good value for money. The cost - around £140 million - would be difficult to absorb and would certainly rule out any other measures. The benefits would be widely difused offering marginal, but hardly decisive, help to the companies concerned. I do see a case, however, for directing attention to the administrative delays which add

to the deferment. If there are inefficiencies in the payments system we should consider how these might be eliminated to avoid penalising the recipients.

"Seed Corn" measures

6. The Secretary of State for Industry has stessed the case for protecting "seed corn" expenditure which firms, despite the need to strengthen their future competitive position, may neglect or cut back in the next year or two as cash flow pressures force a reappraisal of spending priorities. I can see that there may be a case for injecting Government funds where such assistance would increase the competitiveness strength of British firms. Selective help in the area of research and development with the emphasis on development, should be the key note of any such measures.

7. The central aim, therefore, would be to help our more competitive firms to develop their product range. Amongst these firms a number are operating in the high technology area. If they can be encouraged to continue their investment and development programmes it would help to improve our prospects for winning procurement contracts at home and for increasing exports. A further possibility in this "seed corn" area would be some improvement in our export arrangements, e.g. in the Market Entry Guarantee Scheme to encourage firms to break into export markets. A number of measures relating to energy conservation have also been brought to my attention. One possibility falling within the concept I have in mind would be a modest increase in funding for the Energy Conservation Demonstration Project which is designed to support projects incorporating new or adapted technology directed towards energy saving.

8. The Secretary of State for Industry's first priority is to increase the current provisions for expenditure on research and development with the emphasis on developing and applying new technology in private industry. There are a number of instruments which might be used for this purpose; a scheme to encourage

product development is operated by the Department of Industry under the Science and Technology Act 1965, for example. Assistance towards development contracts for new products or processes which could help the firm concerned to secure public purchasing contracts in the future, or which might strengthen a firm's capacity to gain overseas contracts, might also qualify. There may be scope too for more use of selective assistance under Sections 7 & 8 of the 1972 Industry Act to encourage viable investment projects which might otherwise fall victim to the recession.

9. If room could be found for limited support for these kind of activities I envisage the cost should fall within £60 million in any year over the next 3 years. At the same time, the possibility cannot be dismissed that it may not be possible to go as far as this. Indeed, even the additional bid for support for research and development which is the Secretary of State for Industry's first priority may not be possible to accommodate. We cannot reach a view on this until the Chief Secretary reports to Cabinet at the end of October on the outcome of his bilateral discussions with spending Ministers.

<u>Other measures</u>

10. The Secretary of State for the Environment has put forward ideas directed at environmental improvement, pollution control and re-cycling of waste. But given our current stringencies I am not convinced that these proposals can be regarded as deserving special priority. If they are to be pursued I think there will need to be some re-ordering of priorities within environmental programmes.

11. Regional interests would be helped by the "seed corn" use of Section 7 assistance. Private sector firms' investment in the assisted areas can also benefit by borrowing from the European Invest ment Bank and the European Coal and Steel Community with the exchange risk covered by a Guarantee Scheme. The scheme is due to terminate in December 1981 and this uncertainty about its

future may be causing difficulties for some firms. We could end this uncertainty by an early decision on whether to continue the scheme beyond 1981.

12. I attach an Annex, prepared by officials, on the relevant instruments.

13. To sum up, I invite colleagues to agree:

(i) There is no room for expenditure measures designed to relieve corporate liquidity.

(ii) Any options for industrial support should be confined to the "seed corn" items described in paragraphs 6 to 9. Essentially the emphasis would be on development and investment where because of current pressures on companies, these activities might fall victim to retrenchment and financial economies.

(iii) Additional spending even on a modest scale for these items would need to fall within the Cmnd 7841 totals.

14. If this is agreed, I recommend that the Chief Secretary should be invited to consider the prospects for adjusting public expenditure priorities in favour of these items in his report to Cabinet at the end of October.

H.M. Treasury (G.H.)

ANNEX

INSTRUMENTS FOR INDUSTRIAL SUPPORT

1. This annex summarises the instruments for industrial support in Great Britain of particular relevance for the options considered in the main paper. There are equivalent arrangements in Northern Ireland. It is a common feature of these instruments that assistance is only provided to vaible firms and that they must provide most of the finance themselves.

Science and Technology Act 1965

Product and Process Development Scheme (PPDS)

2. This scheme is a major element in the Department of Industry R & D budget. Its aim is to support firms to develop new products and processes by pump-priming grants. The Secretary of State for Industry has sought additional resources to stimulate development of new technologies such as fibre optics, telematics, computer-aided development and manufacture and robotics, and the application of technological advances to improve industrial performance.

Industry Act 1972: selective assistance

3. The instruments for selective assistance come under sections 7 and 8 of this Act.

National selective assistance is operated by the Department of Industry under section 8. It aims to support new investment by manufacturing firms which would not go ahead without some assistance. The firm must put forward an investment project, and it would only receive support to the minimum extent needed and if this was judged to be in the national interest. Projects supported could range from expansion schemes to rationalisation of production methods. New schemes to support sectors of industry or to accelerate investment generally are not envisaged.

Regional selective assistance is operated by the Scottish and Welsh Offices as well as the Department of Industry under section 7. It also aims to support additional investment by manufacturing industry, but only in assisted areas. (In Development and Special Development Areas investment would also attract regional development grants.) Though section 7 assistance can be used to maintain employment the criteria adopted by the present Government insist that it should be used to secure more productive investment, not simply for job protection.

Procurement and Export Objectives

4. Both the product and process development scheme and selective assistance could give a greater emphasis to encouraging exports and could be used with the Government's procurement policies to make firms more competitive. Financial assistance would be provided direct to companies not to agencies procuring their products. Such assistance may be needed to permit a UK firm to establish a product in national and international markets (eg television and radio transmitters, hospital equipment). In other cases, eg electric powered vehicles, there may be clear future potential in international markets. The problem is to show the product in a working environment. At a time of cut-throat competition in world markets during the recession there is a particular risk that UK firms competing in world markets may be unable to maintain their investment in expert work teams which they have built up over the years.

5. If markets including overseas markets are lost it may be very difficult to win them back. In other cases (eg System X telephone exchanges; 'combined cycle' gas/steam power stations) the need is to break into the market.

6. Grants towards development and investment costs, shared-cost contracts and pre-production orders would be the methods of assisting UK firms to win new procurement contracts and to win overseas business.

Export Promotion and the Market Entry Guarantee Scheme

7. To reinforce the use of the Science and Technology Act and Industry Act it would be feasible to give a higher priority to export promotion work eg by improvements in the market entry guarantee scheme. This scheme is a Department of Trade/British Overseas Trade Board scheme, designed to encourage firms, especially smaller firms, to break into new export markets by meeting some of their initial costs.

Energy Conservation Demonstration Project

8. Development work in the priority area of energy conservation is supported under the joint Department of Energy/Department of Industry scheme for demonstrating the energy saving potential of new or specially adapted technology. Firms with development projects may receive capital grants for part of the cost and the scheme pays the full cost of monitoring projects to demonstrate the benefit to other firms.