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Secretary of State for Industry

12 January 1983

Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear Geoffrey,

1983 BUDGET

In your reply of 10 December to my letter of 6 December, in which I set out my views on industrial measures for the Budget, you invited me to let you have early in the New Year my further thoughts on major taxation measures and my proposals for items that might be included in an expenditure package to encourage innovation.

Taxation Measures

2 So far as taxation measures are concerned there is in fact little that I want to add to my earlier letter at this stage. Developments in the economic situation since early December have not I imagine made it easier for you to judge what room for manoeuvre there will be at budget time, nor have they encouraged me to think that the prospects for industry have improved, despite the recent fall in sterling.

3 I need not go over the domestic and international grounds for concern which are all very familiar to you, but I thought the CBI presentation at NEDC on Wednesday brought out starkly the serious implications for the corporate sector of persistently inadequate profitability and liquidity. Terence Beckett's point that the liquidity ratio for the corporate sector as a whole in the third quarter of 1982 was far below what an individual company would regard as the danger point serves to confirm indications we are getting that a further surge in closures and redundancies could be in the offing.

4 Against this still sombre economic background it remains my view that further help to industry should remain our highest priority. And I would place the emphasis emphatically on providing that help by reducing industry's costs rather than on stimulating consumer demand. You are aware of my continuing concern about energy costs and non-domestic rates, but unfortunately there seems little realistic prospect of major



changes here in industry's favour in the near future. This makes it the more important that the Budget should include at least one major measure that will bring significant benefit to industry.

5 In my view abolition of the NIS is far and away the best of the taxation possibilities. It would be generally welcomed by industry, as have been the successive reductions you have already been able to make. Equivalent concessions through reductions in Corporation Tax would be less well received and they would be of less help to many of the manufacturing sectors in greatest difficulty.

6 Presumably a reduction in personal income tax is the main alternative you will be considering. I appreciate that this too would benefit industry, but the benefit would be less direct and less certain. The main effect would be to increase consumers' expenditure, which would mean that a significant part of the benefit would be lost to imports. Abolition of NIS, by contrast, would directly and immediately improve industry's cash flow, competitiveness and profitability.

Innovation

7 I very much hope that, as last year, it will be possible to include some expenditure measures in an innovation package, and I welcome your willingness to look at our further proposals. These are shown in the annexed list.

8 My main priorities are SEFIS (and I am pleased that you recognise this as something of a special case), the "Alvey" programme of support for research in advanced Information Technology, and holding the level of grant support for our "Support for Innovation" programme at 33 $\frac{1}{3}$ % beyond the one year period ending in May this year.

9 You are familiar with the SEFIS concept: the annex describes some adjustments to its terms we should wish to propose. Despite my high priority for the Alvey programme, funding it - or any major new measure - is difficult for the DoI programme. Even after assuming a lower build-up of spend than in the Alvey Report we cannot provide all the DoI contributions we consider necessary without cutting other innovation support programmes. It would make little sense to cut, for example, our programme of support for Space - an important form of Information Technology - in order to finance Alvey. Indeed we see scope for usefully increasing support for Space, for example, through "demonstration projects". Over the past two years or so our Support for Innovation programme has achieved a considerable momentum. In order to maintain that we believe that it is very necessary to hold the level of our grant support at 33 $\frac{1}{3}$ % beyond the one year period ending in May this year. Certainly industry would welcome an announcement to that effect.



10 The remaining items in the Annex (items 4 - 12) are listed in no particular order of priority. They are all proposals to stimulate innovation and, given the general state of industry, and the priority this Government has given to the stimulation of innovation as a means of helping industry to become more competitive, I believe that further help along these lines could not but have a beneficial impact. I have included, as item 4, a possible investment support facility for "pulling through" the development of new products and processes that have successfully completed the R&D stages but need further help to surmount the investment stage. Again, the need for something on these lines arises primarily because of the very low levels of profitability which we discussed at NEDC on Wednesday. Unlike the R&D support, I would not see this as permanent but as something aimed at a carefully defined target for a limited period of time.

11 Estimates of possible costs are shown against each of the dozen measures listed but of course these give only orders of magnitude. Some of our proposals will need further working up, at which point I should be happy for your officials to be associated with mine; but I believe the list contains the ingredients for a very effective and presentable package of expenditure support.

Loan Guarantee Scheme

12 I should also like to take this opportunity of mentioning the desirability of raising the limit on loans supported under the Small Firms Loan Guarantee Scheme. The current £300m limit may well be reached in the next month or two, and an increase by another £250-300m would provide the assurance necessary to take us over the three years to May 1984. Of course, any extra expenditure arising from such an extension would be very much smaller, as premia will largely offset any calls on our guarantees. We shall have an opportunity to discuss this scheme at our Health of Industry meeting on Tuesday 11 January.

13 I am sending copies of this letter to the Prime Minister, Sir Robert Armstrong and John Sparrow.

Yours ever
Patrick

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BUDGET INNOVATION PACKAGE - POSSIBLE EXPENDITURE MEASURES

<u>Measure</u>	<u>Proposal</u>	Possible Spend (£m)
		(1983/84, 1984/85, 1985/86)
1 Small Engineering Firms Industry Scheme	Reintroduction of 1982 SEFIS scheme with shorter time-scale and possible minor modifications, eg increase size limit to community figure of 500 employees for small and medium-sized firms, and extension to cover use of similar machinery in wood-working industries.	30/40/30
2 Alvey - a programme of pre-competitive research in advanced IT	About half of the desirable DoI contribution consistent with the likely build-up in Alvey spend could be provided from existing DoI PES provisions, without cutting other innovation support programmes. But extra funds are needed to make the full DoI contribution likely to be needed if other support is not to be foregone.	0/10/15
3 Support for Innovation guidelines	First, the level of SFI grant should be maintained at 33 $\frac{1}{3}$ % beyond May 1983. It would be a significant blow for our promotion of Innovation if the grant were now reduced. Our PES forecasts were partly based on the presumption of holding the present level, so the cost would not be large. Secondly, there would be advantage in introducing a new element of innovation support - ie for market assessments prior to the undertaking of R&D.	3/10/15

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<u>Measure</u>	<u>Proposal</u>	<u>Possible Spend (£m)</u> (1983/84, 1984/85, 1985/86)
4 A new facility for supporting innovation-linked investment	Support would be available at 20-25% of project costs for investment resulting from the development of new products and processes with significant innovation. This would fill a gap in our array of support measures and enable successful R&D projects to be "pulled-through" the investment stage. Support would also be available for the initial marketing of the new products.	6/16/20
5 Advisory Services	Existing advisory services, including the Manufacturing and Design Advisory Services and the Small Firms Technical Enquiry Service, would be extended, and a new Marketing Advisory Service introduced.	7/8/9
6 Advanced equipment for education centres	The "micros in schools" approach would be followed with micros and computer numerically controlled equipment and computer-aided design and manufacture equipment in higher education and further education.	5/6/8
7 Computer-Aided Equipment in Industry	The existing support scheme for computer-aided design and testing would be extended; a new scheme for computer-aided production management, possibly leading to linked business schemes, would also be introduced.	4/12/19
8 Robots for Small Firms	A possible development from the machine tools in SEFIS to robots.	2/6/2
9 Electronics	The existing Software Products Scheme would be extended, and support provided for the stimulation of the medical instrument area.	5/6/9

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<u>Measure</u>	<u>Proposal</u>	<u>Possible Spend (£m)</u> (1983/84, 1984/85, 1985/86)
10 Quality Assurance	A new scheme to help small companies to implement QA systems, thus improving the quality of UK manufactured products as recommended in the White Paper "Standards, Quality and International Competitiveness".	1/6/8
11 Space	Support for "demonstration projects" for remote-sensing receivers for Third World markets, satellite business ground stations and mobile terminals, etc.	2/5/5
12 Science Parks	Support for equipment facilitating the support for the development of science parks and innovation centres, and for the creation of "incubator units" enabling several small firms to tackle high technology projects with minimum overheads.	2/3/5

Theoretical Total 67/128/155

= £350m overall

10 JUL 1968

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