

DEPARTMENTAL INVESTMENT STRATEGY 2005-2008

1. Strategic Overview

1.1 The Department of Trade & Industry is responsible for investing over £1 billion each year to support it in delivering its objectives. Only a very small part of this is direct capital expenditure by the Department and its Agencies. The majority of capital expenditure is undertaken by non-Departmental public bodies that are funded by the Department. The Department also operates a number of capital grant programmes that enable investment to be targeted to key parts of the economy. These capital grants are funded from Resource DEL.

Summary of Investment for SR2004

| Objective | 2005-2006 | 2006-2007 | 2007-2008 |
|-------------------------------------|-----------|-----------|-----------|
| | £ million | £ million | £ million |
| Science & Engineering | 638.7 | 671.7 | 694.7 |
| Assets & Liabilities | 249.9 | 336.9 | 303.0 |
| Strengthening Regional Economies | 152.5 | 142.5 | 132.5 |
| Sustainability & the Environment | 102.0 | 42.0 | 42.0 |
| Finance for Investment | -141.3 | -106.3 | -97.3 |
| Knowledge Transfer & Innovation | 5.1 | 26.1 | 15.1 |
| Improving Business Performance | 8.0 | 8.0 | 8.0 |
| Excellent Corporate Services | 7.0 | 7.0 | 7.0 |
| Maximise Potential in the Workplace | 2.8 | 2.8 | 2.8 |
| Enterprise for All | 3.0 | 0.0 | 0.0 |
| Consumers & Competition | 0.9 | 0.9 | 0.9 |
| Corporate Activity Framework | 0.1 | 0.1 | 0.1 |
| Unattributed | -22.1 | 6.3 | 5.2 |
| Total Capital Investment | 1,006.6 | 1,138.0 | 1,114.0 |
| Of which: | | | |
| Capital DEL | 300.6 | 477.0 | 472.0 |
| Capital Grants | 706.0 | 661.0 | 642.0 |

1.2 Investment over the SR2004 period is closely aligned to the priorities the Department has identified, to enable it to most effectively achieve its objectives. In particular these are:

- commencing the 10 year Investment Strategy for Science & Innovation
- establishing the Nuclear Decommissioning Authority
- improved working with the regions
- introduction of Enterprise Capital Funds
- implementing the Efficiency Programme

- introduction of the Technology Strategy

1.3 The Department's plans for investment have been developed directly out of its Public Service Agreement (PSA) against which it reports progress regularly. The main investment programmes and how they fit into the PSA and objectives are outlined below. All figures are £ million.

PSA 2: Improve the relative international performance of the UK research base and increase the overall innovation performance of the UK economy making continued progress to 2008, including through effective knowledge transfer amongst universities, research institutions and business.

Objective 1: Science and Engineering

| | 2005-06 | 2006-07 | 2007-08 |
|---|---------|---------|---------|
| Research Councils own capital expenditure | 204.5 | 234.5 | 254.5 |
| Research Councils grants for large facilities | 129.2 | 132.2 | 135.2 |
| Higher Education Institutes – sustainability grants | 305.0 | 305.0 | 305.0 |

Objective 2: Knowledge Transfer and Innovation

| | 2005-06 | 2006-07 | 2007-08 |
|---|---------|---------|---------|
| National Physics Laboratory capital expenditure | 5.1 | 5.1 | 5.1 |
| Technology Strategy grants | 0.0 | 21.0 | 10.0 |

PSA 11: Reduce the civil nuclear liability by 10% by 2010 and establish a safe, innovative and dynamic market for nuclear cleanup by delivering annual 2% efficiency gains from 2006-07. Ensure successful competitions have been completed for the management of at least 50% of UK nuclear sites by end 2008.

Objective 11: Assets and Liabilities

| | 2005-06 | 2006-07 | 2007-08 |
|---|---------|---------|---------|
| Nuclear Decommissioning Authority own capital expenditure | 249.9 | 336.9 | 303.0 |

PSA 7: Make sustainable improvements in the economic performance of all English regions by 2008 and over the long term reduce the persistent gap in growth rates between the regions, demonstrating progress by 2006.

Objective 7: Strengthening Regional Economies

| | 2005-06 | 2006-07 | 2007-08 |
|--|---------|---------|---------|
| Regional Development Agencies single pot capital grants | 96.0 | 96.0 | 96.0 |
| Selective Finance for Investment in England capital grants | 55.0 | 45.0 | 35.0 |
| Structural Funds capital expenditure | 1.5 | 1.5 | 1.5 |

PSA 4: Lead work to deliver the goals of energy policy:

- To reduce greenhouse gas emissions by 12.5% from 1990 levels in line with our Kyoto commitment and to move towards a 20% reduction in carbon dioxide emissions below 1990 levels by 2010, through measures including energy efficiency and renewables.
- Maintain the reliability of energy supplies.
- Eliminate fuel poverty in vulnerable households in England by 2010 in line with the Government's Fuel Poverty Strategy objective.
- Ensure the UK remains in the top three most competitive energy markets in the EU and G7.

Objective 5: Sustainability & the Environment

| | 2005-06 | 2006-07 | 2007-08 |
|------------------------------------|---------|---------|---------|
| Non-Fossil Fuel Obligation | 60.0 | 0.0 | 0.0 |
| Sustainable energy research grants | 38.0 | 38.0 | 38.0 |
| Photovoltaic cells research grants | 4.0 | 4.0 | 4.0 |

PSA 6: Build an enterprise society in which small firms of all kinds thrive and achieve their potential, with:

- an increase in the number of people considering going into business.
- an improvement in the overall productivity of small firms.
- more enterprise in disadvantaged communities.

Objective 6: Enterprise and Business Investment

| | 2005-06 | 2006-07 | 2007-08 |
|---|---------|---------|---------|
| Enterprise Fund venture capital | 17.0 | 17.0 | 17.0 |
| Enterprise Capital Fund venture capital | 0.0 | 35.0 | 44.0 |
| Launch Investment capital receipts | -158.3 | -158.3 | -158.3 |
| Gateway capital grants | 8.0 | 8.0 | 8.0 |

Efficiency Programme

Objective 16: Excellent Corporate Services

| | 2005-06 | 2006-07 | 2007-08 |
|--|---------|---------|---------|
| IT / Accommodation capital expenditure | 1.8 | 1.8 | 1.8 |
| IT / Accommodation capital grants | 5.2 | 5.2 | 5.2 |

2. Managing the Existing Asset Base

2.1 Coal Industry Pensions

2.1.1 The Department maintains an interest in the two former British Coal Corporation pension schemes – the Mineworkers Pension Scheme and the British Coal Staff Superannuation Scheme. When the Government privatised British Coal in 1994, they agreed to guarantee the benefits of these two pension schemes, in return for a half share in any future investment surpluses of these schemes. The Department is now responsible for managing these liabilities on behalf of the Government. The coal pensions therefore form part of the Department's Assets & Liabilities objective.

Valuation of Assets at 31 March 2004

| | |
|------------------------------|------------------|
| Combined Investment Reserves | £1,277.4 million |
| Combined Guarantors Funds | £1,506.0 million |

2.1.2 Money owed to the Department at the time of privatisation has been left in the form of an Investment Reserve in each scheme. The Department agreed to use these Reserves to ensure that the pension benefits of scheme members is maintained in the event of deficits arising in the Guaranteed Fund of the pension schemes. The Guaranteed Fund is the fund from which the former mineworkers pensions are paid. Any money in the Investment Reserves not used in this way is being steadily returned to the Department over a 25 year period.

2.1.3 Both pension schemes are subject to 3-yearly actuarial valuations. Where the Government Actuary's Department (GAD) identifies surpluses, due to high growth in the investments, half of the surplus is transferred to the Guarantors Fund. The other half is transferred to the Bonus Augmentation Fund. This latter fund is used to further improve the benefits to scheme members. The money in the Guarantors Fund is paid over to HM Treasury in equal instalments over 10 years from the surplus arising.

2.2 Launch Investment Portfolio

2.2.1 Launch Investment is the means by which the Department provides risk-sharing capital for the design and development of major new civil aircraft and aero-engine projects in the UK. The basis for this investment stems from the provisions of the Civil Aviation Act 1982 and is only available to the aerospace sector. It is designed to allow the UK to compete on equivalent terms with other major aerospace centres around the world that enjoy similar forms of state support.

2.2.2 The existing portfolio of projects contributes to the Finance for Investment objective. The provision of Launch Investment is entirely discretionary. There is no formal scheme or budget. Each application is considered on its merits against a range of established criteria. These investments are repaid and are expected to provide a return to the Department in the form of a levy on sales when the developed products are sold commercially. The valuation of the assets on the balance sheet is derived from the future levy income that is forecast to be achieved.

2.2.3 The valuation of the Launch Investment portfolio at 31 March 2004 was £2,127.8 million.

2.3 Loans and Public Dividend Capital

2.3.1 The Department is responsible for Royal Mail Holdings plc, a company wholly owned by government, which took over the property, rights and liabilities of the Post Office. This contributes to the Assets and Liabilities objective. The Department holds Ordinary Shares in Royal Mail Holdings plc. The Royal Mail is currently implementing a major restructuring plan, which is responsible for incurring exceptional costs over a 3-year period. The Department has agreed a financing package for the Royal Mail to support it through this restructuring exercise. This includes the purchase of 2 bond issues totalling £500 million that is repayable by March 2009. Royal Mail pays interest on the loan, but the Department is not currently drawing any dividends from Royal Mail for the shares.

2.3.2 British Shipbuilders is a public corporation that has ceased all of its trading activities. The Department now manages its residual affairs, which consists principally in dealing with the liabilities arising from former employees health claims. The Department has a public dividend capital (PDC) holding in the corporation, but no longer draws any dividends from it. This programme forms part of the Assets and Liabilities objective.

2.3.3 The Patent Office and Companies House are both trading funds of the Department. The Patent Office contributes to the Knowledge Transfer and Innovation objective. Companies House forms part of the Corporate Activity Framework objective. The Department holds PDC and loans with both of these bodies. The Department earns dividends and interest from each of these holdings.

2.3.4 The Office of Communications (Ofcom) was established, in December 2003, as the regulator of the UK communications industries, which includes television, radio and telecommunications. The Department's own Radiocommunications Agency was closed and merged with four other regulators to form Ofcom. As part of the Department's support for this restructuring process, under the Consumers and Competition objective, it provided loan funding to Ofcom that is repayable with interest by March 2008.

Value of Loans and Public Dividend Capital (PDC) at 31 March 2004

| | |
|----------------------------|----------------|
| Royal Mail Ordinary Shares | £0.05 million |
| Royal Mail Loan | £500.0 million |
| British Shipbuilders PDC | £21.0 million |
| Patent Office PDC | £6.3 million |
| Patent Office Loan | £2.3 million |
| Companies House PDC | £15.9 million |
| Companies House Loan | £1.2 million |
| OfCom Loan | £48.0 million |

2.4 Tangible Fixed Assets

2.4.1 The Department, together with its Agencies, has a relatively small amount of tangible fixed assets, consisting primarily of the office buildings, furniture, IT and other office equipment that is necessary for the 10,000 strong workforce to operate effectively. More than 95% of the Department's asset base consists of fixed asset investments, which are detailed in previous sections.

2.4.2 The Department also has responsibility for a number of Non-Departmental Public Bodies (NDPBs) that own in total a much larger tangible fixed asset base. The Research Councils and the UKAEA are the primary members of this group and their assets are summarised in later sections.

Tangible Fixed Assets of the Department and its Agencies at 31 March 2004

| | Land & Buildings | Furniture, Fixtures & Fittings | Equipment, Vehicles & Machinery | Assets Under Construction | TOTAL |
|----------------|------------------|--------------------------------|---------------------------------|---------------------------|--------------|
| | £ million | £ million | £ million | £ million | £ million |
| Value | | | | | |
| Core Dept | 119.9 | 13.2 | 6.1 | 11.4 | 150.6 |
| ETS | 9.9 | 6.2 | 1.1 | | 17.2 |
| INSS | 0.7 | | 2.2 | | 2.9 |
| NWML | | 0.2 | 2.2 | | 2.4 |
| ACAS | 6.6 | 2.2 | 3.0 | | 11.8 |
| TOTAL | 137.1 | 21.8 | 14.6 | 11.4 | 184.9 |
| Depreciation | | | | | |
| Core Dept | 11.4 | 5.9 | 3.1 | | 20.4 |
| ETS | 2.7 | 4.5 | 0.9 | | 8.1 |
| INSS | 0.1 | | 1.3 | | 1.4 |
| NWML | | 0.1 | 1.4 | | 1.5 |
| ACAS | 2.1 | 1.5 | 2.6 | | 6.2 |
| TOTAL | 16.3 | 12.0 | 9.3 | | 37.6 |
| Net Book Value | | | | | |
| Core Dept | 108.5 | 7.3 | 3.0 | 11.4 | 130.2 |
| ETS | 7.2 | 1.7 | 0.2 | | 9.1 |
| INSS | 0.6 | | 0.9 | | 1.5 |
| NWML | | 0.1 | 0.8 | | 0.9 |
| ACAS | 4.5 | 0.7 | 0.4 | | 5.6 |
| TOTAL | 120.8 | 9.8 | 5.3 | 11.4 | 147.3 |

2.5 Efficiency Project

£ 11.3m / 7.4m / 0.4m

2.5.1 As part of the Department's determination to maximise value for money on its administration costs, a programme is now underway to rationalise the central London estate from six buildings to two. This is part of the Department's strategic drive to

minimise the cost of accommodation against a background of rising rates and rents. It will achieve these savings, together with moving towards a leaner, more highly skilled and flexible Department.

2.5.2 The Department will invest capital to cover the costs of fitting out the remaining two buildings with flexible telephone technology, greater use of open plan offices and more flexible structuring of office space generally. Within this framework, old inefficient furniture will be replaced with smaller, more ergonomic furniture to help improve the space density within the retained buildings. Further savings will be realised by the Department's move to hot-desking, where there will be desks provided at the rate of 80% of staff numbers, and space allocated at 10 square metres per desk. This places the Department at the vanguard of such reorganisations across Whitehall.

2.6 Enterprise Fund

2.6.1 The Enterprise Fund is a partnership with the private sector to develop and deliver risk capital programmes that support small and medium size enterprises in a number of ways. The provision of small-scale equity finance is achieved through the UK High Technology Funds, the Regional Venture Capital Funds and the Early Growth Funds. These programmes all contribute to the Finance for Investment objective.

Value of Enterprise Funds at 31 March 2004

| | |
|--------------------------------|---------------|
| UK High Technology Fund | £16.6 million |
| Regional Venture Capital Funds | £10.1 million |
| Early Growth Fund | £3.6 million |

2.6.2 Departmental funding into the UK High Technology Fund of £20 million has secured a further £106 million of private sector investment. This fund focuses on early stage investment in technology-based businesses. Investments have been made in companies operating in areas as diverse as software, pharmaceuticals, communications, internet technology and biosciences. The UK High Technology Fund is managed by Westport Private Equity.

2.6.3 A network of 9 Regional Venture Capital Funds has been established to address the equity gap encountered by small and medium size enterprises seeking venture capital investment of up to £500,000. These are commercial funds, managed by experienced venture capital fund managers providing finance to small, high-growth companies. The funds had made over 70 investments by November 2003, and together with private sector funding, a total of £250 million will be invested by the end of the programme.

2.6.4 The Early Growth Funds provide risk capital to businesses in early stages of growth to enable them to achieve their full potential. Professional fund managers are making investments of risk capital, against commercial criteria, of between £50,000 and £100,000. The funds operate by co-investing with business angels to keep due diligence costs down and to offer higher levels of post-investment support.

2.7 World Class Science & Innovation

2.7.1 More than half of the Department's capital expenditure is targeted on the Science & Innovation objective. Much of this expenditure is Research Council funding, allowing them to invest in scientific laboratories and equipment. Also access to many major world-class research facilities is provided through the UK's membership of international organisations, including:

- European Organisation for Nuclear Research (CERN)
- European Space Agency (ESA)
- European Southern Observatory (ESO)
- European Molecular Biology Laboratory

2.7.2 During the last two spending reviews significant capital investment has been undertaken in a determined effort to address the issue of under-funding of the science base. A modern and well maintained capital infrastructure in universities and research institutes is important to the health of scientific research in the UK because:

- The quality and age of the facilities and equipment increasingly determine the quality of science that an institute can do. Failure to invest will progressively put the UK at a competitive disadvantage, given the increasing importance of infrastructure to modern science;
- Universities and institutes with older laboratories and outdated equipment will find it increasingly difficult to attract and retain the best research talent in what is now a global market for science research.

2.7.3 Much has been achieved over recent years due to the increased investment in science from consecutive spending reviews. Some of the achievements have been:

- UK Stem Cell Bank opened in May 2004 - the first of its kind in the world. It will store and supply ethically approved quality controlled stem cell lines for research, and ultimately for treatment;
- Investment in the Diamond Synchrotron – this is the largest UK scientific facility to be built for 30 years, providing facilities for many disciplines and directions of research.

2.7.4 The Department funds the seven UK Research Councils through grant-in-aid and they ensure the continued excellence of the science and engineering base by providing high quality scientific research, training and world-class facilities. The capital assets of the Research Councils are set out in the table below. The Research Councils are:

| | |
|---|-------|
| Biotechnology and Biological Sciences Research Council | BBSRC |
| Council for the Central Laboratory of the Research Councils | CCLRC |
| Engineering and Physical Sciences Research Council | EPSRC |
| Economic and Social Research Council | ESRC |
| Medical Research Council | MRC |
| Natural Environment Research Council | NERC |
| Particle Physics and Astronomy Research Council | PPARC |

Tangible Fixed Assets of the Research Councils at 31 March 2004

| | Land & Buildings | Equipment | Vehicles, Plant & Machinery | Assets under Construction | Total |
|----------------------|------------------|-----------|-----------------------------|---------------------------|-----------|
| | £ million | £ million | £ million | £ million | £ million |
| Value | | | | | |
| BBSRC | 291.2 | 3.9 | | 2.3 | 297.4 |
| CCLRC | 168.1 | 428.3 | | 84.9 | 681.3 |
| EPSRC | 6.5 | 7.1 | | | 13.6 |
| ESRC | 2.5 | 4.2 | | | 6.7 |
| MRC | 255.2 | 167.4 | | 9.0 | 431.6 |
| NERC | 233.2 | 67.2 | 137.3 | | 437.7 |
| PPARC | 78.1 | 1.3 | 75.5 | 11.4 | 166.3 |
| Total Value | 1,034.8 | 679.4 | 212.8 | 107.6 | 2,034.6 |
| Depreciation | | | | | |
| BBSRC | 99.1 | 2.2 | | | 101.3 |
| CCLRC | 0.1 | 321.0 | | | 321.1 |
| EPSRC | 2.2 | 5.4 | | | 7.6 |
| ESRC | | 2.7 | | | 2.7 |
| MRC | 126.4 | 118.5 | | | 244.9 |
| NERC | 90.7 | 42.0 | 81.5 | | 214.2 |
| PPARC | 44.8 | 0.9 | 59.1 | | 104.8 |
| Total Depreciation | 363.3 | 492.7 | 140.6 | | 996.6 |
| Net Book Value | | | | | |
| BBSRC | | | | | |
| CCLRC | | | | | |
| EPSRC | | | | | |
| ESRC | | | | | |
| MRC | | | | | |
| NERC | | | | | |
| PPARC | | | | | |
| Total Net Book Value | 671.5 | 186.7 | 72.2 | 107.6 | 1038 |

2.8 Regional Development Agencies

- 2.8.1 The Department has an objective to improve the performance of regional economies by strengthening regional leadership and empowering the regions to generate their own solutions dependent on their particular strengths and weaknesses. The prime vehicle for delivering this objective is the Regional Development Agencies.
- 2.8.2 The network of Regional Development Agencies have statutory responsibility for economic development and regeneration, promoting business efficiency, investment and competitiveness. As such many of the Department's business development programmes are now administered through them. This enables the national schemes to be delivered more effectively because they are being managed locally and tailored to

best fit the business needs of the region. The tangible fixed assets of the Regional Development Agencies is summarised below.

Tangible Fixed Assets of the Regional Development Agencies at 31 March 2004

| | Land & Buildings | Furniture, Fixtures & Equipment | Information Technology | Total |
|-------------------------|------------------|---------------------------------|------------------------|-----------|
| | £ million | £ million | £ million | £ million |
| Value | | | | |
| Advantage West Midlands | | 1.5 | 1.4 | 2.9 |
| East England DA | | 1.8 | | 1.8 |
| East Midlands DA | 0.1 | 2.2 | | 2.3 |
| North West DA | | | | |
| One North East | 7.7 | 3.6 | | 11.3 |
| South East England DA | 1.3 | | | 1.3 |
| South West England DA | 1.1 | 1.0 | 1.6 | 3.7 |
| Yorkshire Forward | 0.3 | 0.3 | 1.4 | 2.0 |
| Total | 10.5 | 10.4 | 4.4 | 25.3 |
| Depreciation | | | | |
| Advantage West Midlands | | 0.8 | 1.0 | 1.8 |
| East England DA | | 1.1 | | 1.1 |
| East Midlands DA | | 1.3 | | 1.3 |
| North West DA | | | | |
| One North East | | 1.7 | | 1.7 |
| South East England DA | | | | |
| South West England DA | 0.4 | 0.8 | 1.5 | 2.7 |
| Yorkshire Forward | 0.1 | 0.3 | 1.3 | 1.7 |
| Total | 0.5 | 6.0 | 3.8 | 10.3 |
| Net Book Value | | | | |
| Advantage West Midlands | | | | |
| East England DA | | | | |
| East Midlands DA | | | | |
| North West DA | | | | |
| One North East | | | | |
| South East England DA | | | | |
| South West England DA | | | | |
| Yorkshire Forward | | | | |
| Total | | | | |
| Net Book Value | 10.0 | 4.4 | 0.6 | 15.0 |

2.8 Resource Budgeting Consequences

2.8.1 The Department recognises the resource costs that arise from retaining assets that support it in the delivery of its objectives. The opportunity cost of tying up capital

funds in assets of the Department is reflected in the cost of capital charge. Falls in the gross value of the assets due to their wearing out, or a reduction in their useful life, is reflected in the depreciation charge. Both of these costs are charged to the Resource budget of the Department and are reflected in the table below.

Resource Costs Arising from the Holding of Fixed Assets

| | 2004 / 2005 | 2005 / 2006 | 2006 / 2007 | 2007 / 2008 |
|--------------------------------------|-------------|-------------|-------------|-------------|
| Cost of Capital | £ million | £ million | £ million | £ million |
| Departmental Assets | 95.3 | 96.8 | 77.8 | 68.8 |
| Science Research Councils Assets | 43.0 | 43.0 | 46.0 | 48.0 |
| Regional Development Agencies Assets | 26.0 | 25.4 | 26.0 | 26.8 |
| Other NDPBs Assets | 3.7 | 3.7 | 3.7 | 3.7 |
| Total Cost of Capital | 168.0 | 168.9 | 153.5 | 147.3 |
| | | | | |
| Depreciation | | | | |
| Departmental Assets | 20.8 | 20.8 | 37.5 | 42.8 |
| Science Research Councils Assets | 90.1 | 90.1 | 85.7 | 85.7 |
| Regional Development Agencies Assets | 2.3 | 2.2 | 2.3 | 2.3 |
| Other NDPBs Assets | 6.1 | 9.1 | 9.4 | 9.1 |
| Total Depreciation | 119.3 | 122.2 | 134.9 | 139.9 |

3. NEW INVESTMENT PLANS

3.1 Investment Strategy for Science and Engineering £ 638.7m / 671.7m / 694.7m

3.1.1 The UK economy must invest more strongly in the knowledge base, and translate this knowledge more effectively into business and public service innovation if it is to achieve economic growth through increased productivity over the next decade. This was the conclusion of the Science & Innovation Investment Framework for 2004-2014, which was published in July 2004.

3.1.2 At the core of the UK's knowledge base is its research and development capacity, which enables it to create, absorb and deploy new ideas rapidly. Working with partners in the business and not-for-profit sectors, the Department aims to build the UK science, research and innovation system by ensuring sustainability in research funding in return for robust financial management by universities and public laboratories across the UK to achieve sustainable levels of research activity and investment.

3.1.3 The last two Spending Reviews have allocated significant funding increases to science research spending, averaging 10% growth above inflation each year between 2002-2003 and 2005-2006. However the increased volume of research activity has not been funded to cover the full economic costs of this work. The Government recognises this is not sustainable in the longer term as this results in under investment in the asset base of universities and public sector research establishments. Sustainability will only be achieved when institutions are properly aware of, and recover, the full costs of the research they undertake, and avoid running down investment in the institutions.

3.1.4 To tackle past under-investment in higher education research capital, the Department has established a dedicated capital fund, the Science Research Investment Fund (SRIF), and through this the Department will continue to channel £305 million each year across the Spending Review period. The SRIF has been found to achieve the following benefits:

- funding is being spent on projects which address infrastructure backlogs;
- the maintenance of 'well-found' laboratories to a standard where universities can compete globally for projects;
- better research capital strategies, including plans to make estates more flexible, multi-disciplinary and improve utilisation of space.

3.1.5 The Research Councils collectively represent a world-class resource and face similar challenges to universities in maintaining their capital base. A report commissioned by the Office of Science & Technology found that there is a need for:

- improved capital investment, linked to forward looking, science-driven investment strategies;
- recognition and recovery of the full economic cost of the research undertaken;
- greater clarity of responsibilities within, and between, the Research Councils and their parent bodies.

- 3.1.6 To address the capital infrastructure backlog the Department has increased the dedicated capital funding stream for the Research Councils Institutes from £205 million in 2004-05 to £255 million by 2007-08. This funding will be allocated by the Research Councils, based on agreed investment strategies.
- 3.1.7 There are circumstances when it is in the national strategic interest to build major facilities in the UK on a national basis, or to host major facilities on an international basis, with the UK taking a lead. Annual funding for large facilities has reached a level of £129 million and this level will be maintained in real terms until 2007-08. This allows the implementation of the long-term plan for investment in large facilities, which has been derived from the Large Facilities Road Map.
- 3.1.8 The Large Facilities Road Map sets out the Research Councils priorities for the UK, looking strategically across all scientific disciplines, over a 15-year planning horizon. Projects currently underway include:
- the Diamond Synchrotron (a joint venture between Government 86% and the Wellcome Trust 14%) – a new third generation synchrotron facility due to open in January 2007. By 2013 it will be populated with 22 beamlines;
 - the Second Target Station for the ISIS Neutron source and a new instrument suite, due to be completed in 2008;
 - the worlds most powerful particle accelerator for high energy physics, the Large Hadron Collider at CERN, Geneva, will begin operations in 2007;
 - a replacement marine research vessel to replace the RRS Charles Darwin, to be delivered in 2007.
- 3.2 Establishing the Nuclear Decommissioning Authority £ 249.9m / 336.9m / 303.0m
- 3.2.1 The Energy Act 2004 provides the framework for the Department's strategy to manage the decommissioning of the UK's civil nuclear legacy. This will tackle the nuclear clean-up programme head-on, in a way that is designed to be safe, secure, environmentally-friendly and will deliver the best value for money. It will cost in the region of £50bn over the next century.
- 3.2.2 The cornerstone of the strategy is the establishment of the Nuclear Decommissioning Authority (NDA), a statutory Non Departmental Public Body (NDPB), which will be responsible to the Department. Its remit is to provide strategic direction to the management of nuclear decommissioning and clean up in the UK. The Department's target is for the NDA to become operational in April 2005.
- 3.2.3 The NDA will be responsible for the twenty civil nuclear sites currently owned by British Nuclear Fuels Ltd (BNFL) and the United Kingdom Atomic Energy Authority (UKAEA). All of these sites require major programmes of expenditure (largely civil engineering in high risk environments) first to stabilise them (i.e. ensure that all nuclear waste material is adequately dealt with) and then to prepare the sites for alternative use. The cost of this activity will be met by the NDA, with the current financial liabilities being removed from the balance sheets of BNFL and UKAEA respectively.

- 3.2.4 The NDA will operate through letting site management contracts to third party contractors and will not manage the operations directly. Initially, contracts will be let to BNFL and UKAEA, which will be reorganised into management companies focused on delivering clean up. But subsequent contracts will be let on a competitive basis to ensure cost reductions and gains in efficiency. The level of savings is difficult to quantify at this stage, but the US experience suggests that costs savings of 20% are potentially achievable and the time taken to complete the work is capable of reduction.
- 3.2.5 Capital investments are planned largely for new nuclear waste management treatment and storage facilities required for NDA to deliver on its statutory responsibilities. The forecasts have been derived from the existing plans of BNFL and UKAEA. The investments are currently subject to NDA's own investment review and approval process.
- 3.2.6 The bulk of the capital expenditure programme for 2005-2006 will be at Sellafield and Dounreay where a number of new construction projects will be performed. These will include the design and construction of safe storage facilities for spent nuclear materials and also the construction of various facilities to enhance the commercial reprocessing operations at the site. The first Annual Plan of the NDA, covering 2005/06, will be published in draft for public consultation in early October 2004 and submitted to Ministers by 31 December. This consolidates individual site clean-up and operational plans, and the roll-up costs the NDA will oversee in the first year of its operation.

3.3 Strengthening Regional Economies £ 152.5m / 142.5m / 132.5m

- 3.3.1 Selective Finance for Investment in England (SFIE) is the main programme of capital grant expenditure under this objective. It is discretionary and is available to domestic and international investors. The key changes the new product is aiming to secure are:
- **Growth in productivity** - measured by Gross Value Added per Full Time Equivalent employee, compared to the sector and national averages;
 - **Higher skills** - with the majority of jobs required to be at NVQ level 2 and above.
- 3.3.2 Scope remains to continue support for a small proportion of projects which do not meet the new criteria but which are judged to be of value because of their gains for regional employment, but this will be limited.
- 3.3.3 With effect from 1 April 2004, SFIE has replaced both Regional Selective Assistance (RSA) and Enterprise Grants (EG) in England. Both of these schemes closed to new applications on 31 March 2004. This new product replaced RSA and EG in the English Assisted Areas and offers a more limited form of assistance in "Tier 3" areas. In future the SFIE grants will be delivered by the Regional Development Agencies, except for the very few largest applications that continue to be appraised by the Department directly.
- 3.3.4 There will be a minimum threshold for grant applications of £10,000. The grant maximum in Tier 3 areas is being increased from £75,000 to £100,000. Applications of less than £100,000, in both the Assisted Areas and Tier 3, will not require job creation or safeguarding to be eligible for support.

3.3.5 The Department also provides capital grants to the Regional Development Agencies (RDA's) to support investment in economic development, promoting employment and regeneration. These grants are provided along with funding from other government departments as a single pot. This funding mechanism allows the RDA's flexibility to meet their own regional priorities so long as these are consistent with implementing the Corporate Plans agreed with the Department.

3.4 Sustainable Energy £ 102.0m / 42.0m / 42.0m

3.4.1 The Energy White Paper, published in March 2004, sets out the Department's objective to promote sustainability of the UK energy supply. A key element to achieving sustainability is through reducing the carbon emissions caused by burning fossil fuels, by increasing the proportion of energy supply produced from renewable sources. There is a target to ensure renewable energy will supply 10% of electricity, at acceptable cost by 2010, and a goal to supply 20% of electricity from renewable sources by 2020.

3.4.2 During 2003 the Renewables Innovation Review looked at how to encourage innovation in the new and renewable energy industry, to facilitate delivery of the White Paper targets. The Review identified key technology priorities that would reduce carbon dioxide emissions most cost effectively and contribute benefits to the UK economy. The Review also identified a major gap in demonstration funding for projects, which is required to prepare for commercialisation of renewable technologies.

3.4.3 In response, the Department has established capital grant programmes to support investment in a number of demonstration projects for offshore wind, wave and tidal, biomass, photovoltaic cell and environmentally efficient buildings. The capital grants will help reduce the costs and risks involved in these projects.

3.4.4 The Department has now given consent to begin construction of 12 wind farms. In November 2003 North Hoyle wind farm became the first to begin producing electricity. It has the capacity to provide electricity to 50,000 homes.

3.5 Technology Strategy & Innovation £ 5.1m / 26.1m / 15.1m

3.5.1 The Innovation Report, published in December 2003, concluded that the Department should take a lead role in supporting innovation in business through developing a Technology Strategy. The Technology Strategy Board, made up predominantly of senior business representatives, will identify the priority technology areas that are critical to the growth of the UK economy.

3.5.2 Government investment in research & development programmes will then be focused on these areas and will allow businesses to benefit from this targeted scientific research. The main funds will be available for collaborative research grants that link businesses with universities, which further encourages the commercial exploitation of scientific knowledge.

- 3.5.3 The National Physics Laboratory which consists of an array of facilities at a site in Teddington, requires an ongoing capital programme to maintain and develop the facilities to serve today's exacting scientific standards. The PFI project with the LASER consortium was terminated earlier this year. Phased occupation of the 16 laboratories has commenced as the completion of the laboratories is achieved. Also the installation of a new linear accelerator (LINAC) is required urgently to meet the needs of the health sector for radiotherapy services. New specialist laboratories are also required to enable development research in biotechnology, a new and fast developing field of science.
- 3.6 Launch of the Enterprise Capital Funds £ 0.0m / 35.0m / 44.0m
- 3.6.1 Enterprise Capital Funds (ECFs) are venture capital funds designed to stimulate increased investment in the 'equity gap' that exists between £250,000 and £2 million. This is where a shortage of private capital currently poses a barrier for small businesses seeking to raise modest sums of risk capital to finance innovation, capital expenditure and growth. ECFs will therefore contribute to the Department's objective to support enterprise and productivity growth by improving access to finance.
- 3.6.2 The majority of finance provided to small and medium sized businesses takes the form of loans. Lenders face uncertainty when assessing credit risk of small businesses and often rely on the borrower being able to offer assets as security. This is not appropriate in all circumstances, as entrepreneurs may not be in a position to offer suitable assets and in particular, equity finance may be more appropriate where a business is seeking risk capital, to generate rapid growth. In the UK the private equity markets, although well developed, have concentrated on larger investments of normally not less than £2 million.
- 3.6.3 The announcement of a 'pathfinder' round of ECFs, to examine the scope and likely level of demand for a longer-term programme, followed the extensive Bridging the finance gap consultation carried out during 2003. Each ECF will be a privately-managed fund, investing a combination of public and private capital in businesses affected by the equity gap. It is envisaged that the pathfinder round will comprise between three and five ECFs, with the government investing a maximum of £25 million in each Fund. The pathfinder bidding process will be managed within the Small Business Service, as the scale of the pathfinder will not be sufficiently large to justify the costs of establishing and operating a separate delivery body.

4. Systems and Procedures

4.1 Coal Industry Pensions

4.1.1 The pension schemes are managed by a Board of Trustees. Half of each Board are elected and the remainder, including the chairman, are appointed by the Department. The appointees include a Departmental official, the rest being senior pensions professionals or have been senior British Coal Corporation managers.

4.1.2 The investment strategy is the responsibility of the Trustees, but must be approved by the Department. The strategy determines the financial performance of the scheme's investments and also the risk that the Department bears that the schemes will run into deficit.

4.1.3 The Department takes advice from the Government Actuary's Department on the liabilities, and from Hewitt, Bacon and Woodrow on the investments. Department officials participate in Trustees management meetings and the Investment sub-committee meetings. The Department also maintains close working relations with the Chief Executive of each scheme.

4.2 Launch Investment

4.2.1 The Department closely monitors the progress of each supported aerospace programme. The release of investment funds is linked to actual expenditure by the aerospace company and to the achievement of specific technical milestones.

4.2.2 The Department receives, as a provisional record, monthly statements of engine/aircraft sales and the levy due from each of the aerospace companies. These statements are independently audited each year, which provides the Department with confirmation of the actual sales. Also independent data sources are used to track the company sales of supported products.

4.3 Loans and Public Dividend Capital

4.3.1 The Department holds a Special Share in Royal Mail that confers rights that enable it to retain certain controls over the company. These controls include the appointment of the Chairman, borrowing limits and the disposal of subsidiaries or substantial assets.

4.4 Science & Innovation

4.4.1 All large capital investments included in the large facilities road map which have secured funding will be managed as discrete projects and be subject to independent review at key stages in their lifecycle. This is designed to be compatible with the Office of Government Commerce guidelines for major capital projects embodied in their Gateway Process. In order to secure funding a project proposal must progress successfully through the first two key stage reviews – the science case and the business

case. The Research Councils Executive Group will make funding recommendations based on the strategic priorities for the available budget.

4.4.2 Strategic areas currently highly prioritised in the road map are:

- Synchrotron radiation
- Neutron beams
- High powered lasers
- Radioactive particle beams
- Particle accelerators
- Astronomy facilities
- Fusion research facilities
- Oceanographic research vessels

4.4.3 Medium term projects currently under construction are:

- The Diamond Synchrotron and a research complex for the associated infrastructure;
- Second target station on the ISIS neutron spallation source at the Rutherford Appleton Laboratory;
- Muon Ionisation Cooling Experiment – attached to the ISIS neutron source;
- Major rebuild programme for the Institute of Animal Health Pirbright Laboratory;
- HECTOR – a new high performance computing facility;
- Replacement of the Halley Research Station in Antarctica;
- Replacement building for the Laboratory of N-molecular Biology.

4.14 The Management Statements and Financial Memoranda combined with set objectives for each of the Chief Executives and specific measures for the Research Councils together require that the Chief Executive is responsible for:

- ensuring that proper project management systems are in place and regularly reviewed to reflect best practice;
- ensuring that the development and installation of all business critical systems are subject to proper project management disciplines and that sound contingency plans are in place.

4.15 Audit Committees are responsible for paying particular attention to risks and contingency plans on all business critical projects and report to the Council where procedures for plans or progress are such to prejudice Councils' operations.

4.16 OST maintains an overview plan of Research Council capital investment. Research Councils produce detailed Capital Investment Strategies every two years.

NDA

3.1.3 Current estimates indicate that the NDA will employ around 220 staff with its headquarters in West Cumbria. Annual running costs for the NDA will be about £ 30-40 million. Like any other NDPB, the NDA will be subject to monitoring and administration costs oversight by the Department. But its principal task will be to minimise programme costs through more efficient and effective clean up.

- 3.1.4 The Department is working closely with the companies and the nuclear regulators to ensure that work plans for each site are prioritised within the available budget to most efficient use. To underline the Department's determination to deliver the most effective and efficient clean up programme achievable, it has set out in Public Service Agreement 11, the objectives to be achieved through the NDA.
- 3.1.5 The Department is also working with the Office of Government Commerce in planning for the facilities and IT systems that the NDA will require and is subject to a Gateway Review process. It is envisaged that the NDA will utilise existing Government arrangements, SCAT and GCAT, for its initial IT requirements. Non-core functions, such as payroll, will be outsourced to organisations in either Government or the private sector. The NDA Board will be encouraged to evaluate use of shared support and services throughout the Agency.
- 3.3.2 The launch of ECFs is subject to achieving European state aids clearance, which it is anticipated the Department will receive during early 2005. Once clearance is obtained, government funding will be allocated to specific Funds by means of a competitive bidding process, designed to ensure that support is directed towards ECF proposals that will offer best value for money. Applications will be subject to a rigorous 'due diligence' assessment to help protect public funds, bringing in the necessary commercial expertise from the private sector (including members of the Small Business Investment Taskforce).
- 3.3.3 If the pathfinder round is successful, the Department intends to implement a longer-term ECF programme, which would be administered by an organisation operating at arm's length from the government. Such a body would be set up with appropriate incentives to achieve acceptable financial returns for the government, while also achieving the government's non-financial objectives for the programme.

Appraisal/ monitoring

Case papers for grant applications of £250k or more are presented to the local Regional Industrial Development Advisory Board for examination. (For the East of England Board the grant level is £100k or more). Cases of £2m+ are appraised in London and presented to the Industrial Development Advisory Board. These Boards are made up of senior people from the business community. Cases of £2m+ are also considered by the DTI's Individual Programmes Committee for recommendation before going to Ministers for decision.

RDA officials monitor all projects. Claims for payment of grant are paid when trigger points relating to project expenditure, GVA levels and/or jobs achieved, as set out under the terms of the offer letter, have been met and certified by an independent accountant. Following final payment of grant, projects continue to be monitored for a set period of time to ensure that assets and jobs remain in place. Recovery of some or all of the grant is likely if assets and jobs are not maintained.

SFIE/ RSA Grants

SFIE contributes to the Regional Economic Performance PSA target: “To make sustainable improvements in the economic performance of all English regions by 2008”. The RDAs deliver SFIE and will continue to monitor existing RSA projects. Projects supported must be viable and will include new plant and modernisation of existing plant covering a wide range of activities depending on sector and processes involved. In the four years ending 31 March 2004, offers made under the former Regional Selective Assistance scheme (the best features of which have now been migrated into SFIE) totalled about £540 million and are expected to lever in total investment of £5,000 million and about 95,000 new and safeguarded jobs into the most deprived areas of England. Companies helped include those in the pharmaceutical, automotive, electrical, chemical, and service sectors. Approximately 85% goes to support manufacturing industries with 15% going to the service sector. Around 50% of the grants offered by value goes to companies located in the North East and North West regions but all English regions have some eligible areas and receive support.