

dti

the department for Enterprise

CEPU

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*John,*

*See attached  
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1988 PUBLIC EXPENDITURE SURVEY

In my bidding letter of 25 May, I said that I would make further proposals to you on a number of programmes. This letter fulfils that commitment, and also updates the position on other bids as necessary. It does not deal with the points raised in your letter of 21 July, which I have not yet had time to consider in any detail.

Estimating Changes

2. I have no changes to make to the forecasts for Regional Development Grant contained in my 25 May letter. As foreshadowed in that letter, we shall need to review the forecasts nearer the time of the bilateral: my officials will send yours the revised figures in early September. I should however repeat that these forecasts assume that the waiting period for payments under RDGII is lifted. If it is not, I shall have to increase my bid by £15m - on the latest view - over the three years. I do not accept that the extra cost in the current year if the waiting period is lifted could only be met from my Department's budget, and I will want to return to this subject in our bilateral.



3. The revised economic assumptions now in force mean a revised bid for the Home Shipbuilding Credit Guarantee Scheme. The costs of this scheme are determined by interest rates, and the latest Treasury interest rate assumptions have turned the reduced requirements forecast earlier into a bid of:

£m	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
	+ 3.6	+ 0.2	- 2.9

This is an estimating change, which I trust you will accept as a technical bid, in accordance with past practice.

### Discretionary Bids

4. In my letter of 25 May, I said that I was looking for ways of bringing the bid for Regional Selective Assistance back to baseline. Kenneth Clarke and I have now completed our review of the position. In particular, we have carried out a thorough review of the forecast, taking account of the latest information. I now estimate a significantly lower spend over the PES period than the previous one. This reduction is attributable to a number of factors. The most important is the impact of the more stringent application of the additionality criterion: we now have the first full quarter's experience since Kenneth Clarke's guidance was issued in March. As a result, I need only bid for year 3, as follows:

£m	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
	0	0	+10.0

5. Given that the year 3 baseline would have an immediate effect on the commitment profile under the commitment limiting system, this bid for year 3 cannot in my view be avoided. Combined provision for DTI expenditure on regional incentives - RDG, RSA and Regional Enterprise Grants - would still be some £30m down on the previous year, with the prospect of further reductions to follow as residual spend on RDG disappears. I therefore hope you will agree to accept this bid.

6. I also wish to propose a change in the wording of the additionality criterion in the internal RSA guidelines. The key sentence says "The judgement to be made is not whether the project could or should go ahead in the same manner without



assistance but whether it will go ahead if no assistance is provided". This is unsatisfactory because it implies that assistance should be offered even if an applicant's expectations are unreasonable; it also places too much weight on the applicant's claims. What is needed is a more objective test, on the lines that "The judgement to be made is whether assistance should be necessary to enable the project to go ahead ... taking account of whether it would accord with normal business practice for the applicant to proceed without assistance".

This change would not affect our PES bid, since we have already adopted it in substance. It would however make the guidelines more consistent with our philosophy on this issue, and it is obviously desirable that differences in the way the scheme operates as between England, Scotland and Wales should be kept to a minimum: I therefore hope that Malcolm Rifkind and Peter Walker, to whom I am copying this part of my letter, will be able to agree to this change.

7. My letter of 25 May gave warning that the initial estimates of the costs of a new building for the Patent Office in Newport were in the process of being revised upwards. The total cost of the move is now estimated at £28m, including a new building cost of £21m against the original PSA estimate of £15m. I therefore need to increase my bid for major works and relocation to:

£m	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
	+21.4	+13.3	+ 1.6

The costings for the Patent Office building have been checked by independent consultants and I am satisfied that they are a realistic estimate for a minimum space building with low maintenance costs. It is unfortunate that the estimated costs have risen so much but the move will still bring significant savings in the longer term. I should also note that the figures incorporate extra costs of some £2.5m arising from the imposition of VAT on the construction of non-domestic building and civil works as a result of the recent European Court decision, which could not be foreseen: the Economic Secretary has, of course, announced that public sector construction programmes will be protected from the effects of this decision by allowing, where necessary, compensating adjustments to the relevant expenditure provision.



8. I noted in my letter of 25 May the uncertainties about the requirements over the PES period for the private sector shipbuilding intervention fund (IF). These requirements remain very difficult to predict. It is however now almost certain that Govan will be sold to Kvaerner, which will give rise to forecast payments of £13m a year under the IF over the PES period. If the other remaining BS yards are sold, they will almost certainly require IF support. As a result, I must now bid for:

£m	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
	+31.0	+31.0	+31.0

These are large sums. They follow unavoidably from the decision to offer IF to privatised yards, but they are of course dependent on the extent to which yards are in the event closed or sold. This is still unpredictable. Moreover, these costs will be more than offset by reductions in BS's IFR costs: when all the current BS merchant yards are privatised or closed, BS's need for IFR finance, forecast at £90m in each of the next two years, will reduce to a very low level.

9. I feel very strongly that we should not be prepared to see the complete closure of the yards at Sunderland, which employ 2,800, without adopting a package of remedial measures. The same goes for the Appledore yard in Devon. Even if both yards are sold, there will be redundancies on a sufficiently substantial scale to warrant such a package. On the other hand, complete or substantial closure of the yards would reduce the IF assumptions built into the bid above in which case I might wish to propose that some of my present bid for IF should be converted to a bid for a remedial package.

### Programme Reviews

10. When I wrote to you on 25 May, I indicated that I had reviews at different stages in several expenditure areas, and entered bids for these areas at baseline in the interim. I am now able to provide further information on these reviews.

#### a) Research Establishments

11. As you know, I have announced the outcome of this review. I concluded that the REs should concentrate on research required by Government, whether for statutory, regulating or policy reasons. I also concluded that NPL, LGC, and WSL



should be considered for agency status, and that proposals should be invited for the development of NEL within the private sector. NEL apart, these conclusions do not lead to any savings which can be offered at present. I will be writing to you separately about NEL when I have considered proposals for its acquisition. I must therefore continue to bid at baseline, except for the extra costs of:

£m	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
	+ 1.3	+ 1.4	+ 1.5

resulting from the European Court decision imposing VAT on the construction of non-domestic buildings and civil works. These costs were unforeseeable and as before, I hope you will allow compensating adjustments.

#### b) Export Services

12. As you know I am sympathetic to the view which you expressed that more of the costs in this area could be recovered from customers. Officials in my Central Unit have made proposals to this end and for the delivery of the Export Services by a "Next Steps" agency. These are set out in a report which your officials have seen and proposals are now being worked up with a view to decisions early in 1989. As part of this Geoffrey Howe and I are planning to run a number of pilot studies: but the result of these and hence detailed proposals will not be ready for our bilaterals. I cannot therefore anticipate in my bid how much they might realise. However I had already been looking at other ways in which new or restructured services might bring in new revenue, and approximately £1m of such revenue is already allowed for in the Baseline although the form which it will take may vary depending on the decisions which Sir Geoffrey Howe and I make. I must therefore continue to keep this bid at baseline.

#### c) Aircraft and Aeroengine R&D

13. I have concluded that there are a number of ways in which we can obtain better value for money from this area of expenditure, together with greater consistency with the Department's innovation policy, including the end of near-market R&D support. I believe however that the industry continues to justify special support measures while it operates in a market which is very open to international competition but at the same highly distorted, particularly as a result of US Government support for US industry. I therefore wish to continue to bid at baseline, though I note your remarks on this.



d) Invest in Britain Bureau

14. This review began only recently, and I am not yet able to put proposals to you. I hope however to be in a position to do so in advance of our bilateral discussion.

EIEC

15. I expect to receive the EIEC's Corporate Plan at the end of August. Until I have had time to consider this, I wish to continue to bid at baseline.

Other pressures

16. My letter of 25 May indicated that Rolls Royce were considering making an application for launch aid for a large aeroengine development. An application for £107m has now been received, and it must therefore be given proper consideration. Officials are now studying the application but more work needs to be done. Notwithstanding what you say in your letter of 21 July, it seems unlikely that a full paper will be ready for Ministerial consideration before the end of September. There is of course no baseline for new launch aid proposals in any case, and any funding that might be agreed would have to be found from the Reserve.

17. I also mentioned in my earlier letter the possibility that the Government might be requested to give further support to BAe for Airbus. I understand that BAe are in fact now likely to put a proposal to me next week on this. Again, it is unlikely that a full paper will be ready for Ministerial consideration before the end of September.

Running Costs

18. I am glad to say that I am now in a position to reduce my bid for running costs. It now appears that a rent review affecting Companies House in City Road will not flow through to my Department's running costs till 1991/92. My bid for accommodation running costs for the first two years of the Survey can therefore be reduced by £4.5m in both years. My revised running costs profile is as follows:

£m	<u>1989/90</u>	<u>1990/91</u>	<u>1991/92</u>
	317.8	331.1	345.0

## Conclusion

19. Leaving aside bids arising from estimating changes, and the bid for Intervention Fund support, which will be more than matched by a reduction in BS's IFR finance, these changes lead to programme expenditure bids against baseline totalling +£42.9m; +£18.9m and -£61.9m; in other words, within baseline taking the three years together. In view of this, I hope that you will reconsider the reductions proposed in your letter of 21 July; if so, I see no reason why we should not agree the Department's figures for the 1988 Survey without the need of a formal bilateral.

20. I am sending a copy of this letter to the Prime Minister. Copies of the passages dealing with regional expenditure also go to Malcolm Rifkind and Peter Walker.

*Y. L. H. H. H.*



ECON PDR: Public Exp.

