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The Rt Hon John Major MP
Chief Secretary
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

25 May 1989

Dear John,

PES 1989

This letter sets out, as requested in the Survey guidelines, my proposals for the resources required for my programmes outside the arrangements for the operation of the Scottish block.

My bids, which are all of equal and high priority, are summarised below and more detail for the Industry and the Agriculture and Fisheries programmes is given in the Annex. As is customary, John MacGregor will deal separately with a number of AFF issues in which I have an interest although I have not yet seen the detail of John's proposals. The table in this letter shows a number of particular Scottish bids within the AFF programme, the purpose of which is described in the relevant part of the Annex.

	£m		
	1990-91	1991-92	1992-93
Agriculture and Fisheries	5.8	13.2	15.5
Industry	28.5	33.0	28.0
Housing subsidies (revised economic assumptions)	- 2.617	- 5.044	-
Water services (capital)	30.0	60.0	100.0

I should comment in particular on the bid for water services capital. Both north and south of the Border we face major demand for capital expenditure on water and sewerage services in order to bring them up to scratch, in the light especially of EC requirements. It is not yet clear how this problem will be tackled in England and Wales - although provision will have to be made one way or another - but I have no option but to address this issue in the PES round. As indicated in my letter of 16 May 1989 to Nigel Lawson on the EC drinking water directive, following privatisation of the water services in England and Wales, there

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is no programme south of the border with which capital expenditure on water services in Scotland is comparable. My officials have been in touch with yours about how bids for this service should be handled outside the present block and formula arrangements and they are currently assessing the requirements in Scotland both in the short term and the longer term; I will wish to return to the longer-term situation in next year's Survey. The bids I have entered in this Survey will allow a reasonable start to be made on the outstanding problems.

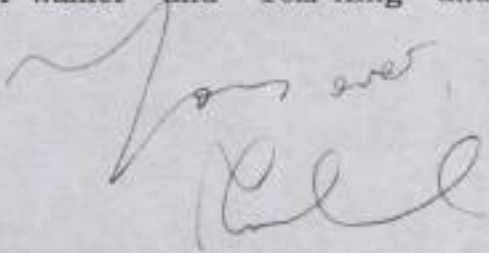
We are making good progress on privatisation of both the two Scottish Electricity Boards and the bus companies in the Scottish Transport Group. But we have not yet set the final timetable. Until we do we cannot be certain when the receipts will be available, although in both cases I hope that these will start to come in in 1990-91. Even if they do not, I will still be faced with expenditure on expenses in 1990-91. In the case of the Transport Group, these will be modest, about £0.4m, but those for the Electricity Boards will include flotation expenses. We cannot be precise about these; we still have to decide on factors, such as customer and staff inducements, which will affect them, but we are working on the basis of £77m, in addition to the existing provision of £5m, in 1990-91. These expenses, and the receipts, are not part of my programmes although they are met from my Departments' Votes, and the prospect that receipts in 1990-91 will more than meet the additional expenditure remains good. In the meantime, provision for the additional expenses will require to be made.

I also expect, as last year, to make a bid for any PES transfers to DHSS for housing benefit. I am not yet in a position to quantify my assessment of these issues and will write again with the information as soon as possible.

This year the Survey guidelines request the notification of contingent liabilities likely to arise or to increase during the Survey period. My officials will be supplying yours with details of a number of such contingent liabilities relating to block programmes.

Finally, as usual, departmental running costs are the subject of a separate letter.

Copies of this letter go to the Prime Minister, John MacGregor, David Young, John Moore, Norman Fowler, Nicholas Ridley, Paul Channon, Cecil Parkinson, Peter Walker and Tom King and to Sir Robin Butler.



MALCOLM RIFKIND

AGRICULTURE AND FISHERIES

Rural Enterprise Programme (REP)

Against the background of the reform of the EC structural funds my officials have discussed with yours our proposals for action in the Highlands and Islands in terms of Objective (b) of the new framework Regulation. While I am determined that the introduction of the new EC arrangements should not give rise to unrealistic expectations in the Highlands and Islands, I am convinced that the circumstances of those farming in extremely marginal conditions very much at the periphery of the Community are such as to justify the introduction of a limited and targeted programme.

The Rural Enterprise Programme bid envisages the introduction of measures to be targeted on specific localities within the Highlands and Islands where objective indicators show that the agricultural sector is especially fragile and least able to adjust to the effects of CAP reform. The REP would promote special measures to assist with diversification and measures to improve the quality and marketing of produce. The aim would be to stimulate viable self-supporting alternatives to traditional agricultural production and broaden the income base of those involved in agriculture. We propose a gradual build up of expenditure to ensure that there is adequate assessment of the emphasis of measures in specific localities before funding assistance.

Much work remains to be done in firming up the details of our proposals. However, if the Commission keeps to its current timetable, I shall be under a great deal of pressure domestically later this year to announce the extent of the Government's proposed actions under Objective (b). I think it essential that we keep the initiative and that we should be ready to set out our proposals. What I have in mind is a 5-year REP averaging £5m a year from 1991-92. Before then I would wish to see the establishment (in 1990-91) of a project team whose main task would be to assess and test the feasibility of the range of measures which might be put in place in the selected areas. The cost of the project team in 1990-91 is likely to be about £0.5m and I propose to meet this cost from savings that year on fisheries protection (current) expenditure. The first grant expenditure in targeted areas would occur in 1991-92 with full costs in 1992-93. Accordingly I make the following bid:

		£m
1990-91	1991-92	1992-93
-	3.0	5.0

Scottish Agricultural Colleges (SAC) and Scottish Agricultural Research Institutes (SARI) Capital

A significant aspect of the process of rationalisation following reductions in funding of R & D expenditure was our decision, in 1986, to reduce the

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number of SARIs grant-aided by DAFS by merging the Hill Farming Research Organisation (HFRO), based at Edinburgh and the Macaulay Research Institute, based at Aberdeen. A new body the Macaulay Land Use Research Institute (MLURI) was created and the decision taken to transfer to the new institute at Aberdeen former HFRO staff from Edinburgh.

We had hoped to carry out the capital works at MLURI necessary to accommodate the staff of the joint body and to schedule the transfer of staff to Aberdeen in such a way as to accommodate the costs within the existing baseline provision for SARI capital. However, the former HFRO facilities at Edinburgh were destroyed by fire at the end of March and, while we have made temporary arrangements for the staff at Edinburgh, I believe we must speed up the necessary development at MLURI and the transfer of staff from Edinburgh if we are to avoid nugatory expenditure following the fire. My officials recently sought Treasury approval in principle for the development option we have chosen. The total cost of the project is £8.6m but, because of the need to proceed quickly I am not able to contain all of this cost within existing provision.

The second element of the bid relates to the additional capital expenditure which will be necessary to improve the physical security of the SAC/SARI buildings throughout Scotland. We are now reviewing security arrangements following the loss of MLURI facilities at Edinburgh due to arson. We must take all reasonable steps to deter or prevent similar attacks on other buildings and I propose a 3-year programme of capital works to cope with the more sensitive areas. My SAC/SARI capital bid is therefore:-

	£m		
	1990-91	1991-92	1992-93
SAC/SARI security	0.5	0.5	0.5
MLURI	2.7	1.8	-
Total	3.2	2.3	0.5

I should say that the preferred option for the MLURI development, when completed, will release land outside the PES period for disposal currently estimated at £2.7m in value.

Scottish Agricultural Colleges (SAC)/SARI Redundancies

The reduction in funding of near-market R&D agreed in 1988 PES and the squeeze on the advisory services are posing very real problems for the Scottish Agricultural Research Institutes and Colleges. Despite the provision of additional funding for strategic research from 1991-92 and an encouraging increase in revenue from non-DAFS sources, there will still be a significant and increasing net reduction in total funding over the PES period. These organisations are manpower intensive, and staffing reductions will be necessary in order to help expenditure within cash limits. This year we expect to lose about 30 posts through voluntary/compulsory redundancies, and the costs of which we shall accommodate within present cash limits. This will not be possible over

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the remaining years of the PES period. My additional bid to meet staff early severance costs is therefore:

	£m		
	1990-91	1991-92	1992-93
	2.5	4.6	5.9

Fisheries Protection

In the last two PES rounds I have entered a bid for the costs of replacing the DAFS inshore fisheries surveillance aircraft (a Cessna Titan). On both occasions the bid was withdrawn after bilateral discussions. The aircraft is now virtually at the end of its useful life and I make the following bid:

	£m		
	1990-91	1991-92	1992-93
	-	2.0	-

Harbours

My bid in respect of harbours concerns DAFS grants for Local Authority and Independent Trusts projects and ERDF receipts for projects carried out by independent harbour bodies. The bids are:

	£m		
	1990-91	1991-92	1992-93
DAFS Grant (LAs)	-0.129	0.472	0.423
LA Net Capital Allocation	-0.558	0.016	-0.156
Net LA Harbours	-0.687	0.488	0.267
DAFS Grant (Independents)	-	-	3.000
ERDF (Independents)	0.849	0.849	0.849

The bid in years 2 and 3 in respect of DAFS grant (LAs) arises essentially from significantly increased costs on a project for which we now have a revised investment appraisal. We are still to consider the appraisal and only if it proves wholly satisfactory will I press the bid. The bid for the Independent Trusts relates to proposed developments at Eyemouth and Scrabster.

Accordingly, my total bid (including harbours) is:

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	1990-91	1991-92	£m 1992-93
Independent Harbours	5.7	11.9	11.4
LA Harbours	0.8	0.8	3.8
	- 0.7	0.5	0.3
	5.8	13.2	15.5

In addition I have a number of small bids for SAC/SARI superannuation, Marine Laboratory equipment, Farm Woodlands Scheme and animal health. I propose to meet these (together with the first year costs of the REP) from savings on fisheries protection and capital grants.

INDUSTRY

The objectives to my proposals are to take full advantage of the opportunities presented by the Single European Market; to maintain and increase the momentum of encouraging private sector investment in inner cities and peripheral estates; and to give a credible response to the potentially politically very difficult situation in Caithness. At the same time, the continuing run down in payments of regional development grant means reduced requirements. My initiative for an evaluation of the options for disposal of the SDA's properties and investments is making good progress but it is still too early to estimate the proceeds or their timing.

Scottish Enterprise

My proposals take no account of needs specific to Scottish Enterprise. That will be discussed in detail in the next Survey. Necessary funds, for example, for the setting up of pathfinder agencies, will be found from the relevant existing programmes (in my case, from the SDA) as appropriate.

Regional Selective Assistance

With the ending of regional development grant, regional selective assistance is our major vehicle for securing new investment in assisted areas. It is particularly important in attracting inward investment, where we are experiencing tough competition from our European partners. In the run-up to the creation of the Single European Market in 1992 there will be an opportunity to attract to the UK in general and the assisted areas in particular investment which will be locating in the Community.

If we are to do so, we must ensure that we can compete. Recently we have lost a number of desirable projects because we are unable to approach the levels of assistance offered by our competitors. We are, of course already seeking through the Commission to curb excessive assistance levels offered by our partners. But that will not be enough despite Britain's attractions for business. We have to be more flexible, particularly on cost per job rules. Cost per job is an incomplete indicator of the value for money offered by an individual project; we have also to take into account the type of jobs, the technology transfer

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aspects, fresh management ideas, the expanded market for indigenous suppliers and other factors. A sensible amendment of the guidelines, backed by the additional resources I have proposed, will allow us to capture projects that would otherwise be lost.

Bid

	£m		
	1990-91	1991-92	1992-93
Regional Selective Assistance	4.0	7.0	15.0

Scottish Development Agency (SDA)

There are two elements to my proposals for additional resources for the SDA. First, I want the Agency specifically to address itself to the implications of the creation of the Single European Market. We know from experience that the ability to offer custom-built factories quickly can be an important feature of the package that will attract inwards investment. From our point of view these are good investments, which I want to continue as a key priority within the SDA's continuing role in premises provision following the disposal of the bulk of its existing property portfolio.

Secondly, there is an increasing need to deal with accumulated problems of urban dereliction, to maintain the momentum of our peripheral estates initiatives, and to keep up the effort to improve the environment more generally in order to complement the efforts going into the attraction of inwards investment and ensure that Scotland continues to be seen as an attractive location for companies to establish and develop. I am therefore proposing an increase in the resources available for these activities for use by the Agency with leverage from the private sector.

Bid

	£m		
	1990-91	1991-92	1992-93
Scottish Development Agency	20.0	20.0	20.0

Highlands and Islands Development Board (HIDB)

Despite the improvement our policies have brought to the economy generally, the position in the Highlands and Islands is worrying. Unemployment there is higher than in Scotland as a whole; and the differential is rising. Within that, there are areas, especially in the rural parts and on the periphery, where unemployment is at particularly high levels. The area as a whole has generally suffered disproportionately from the downturn on oil-related construction.

We must aim towards the sustained and lasting improvement in employment in the Highlands and Islands; and this, of course, means real jobs stemming from private sector enterprise. We can help in creating the

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conditions in which enterprise can flourish in an area suffering from distance and communication difficulties. This cannot be done, of course, through blanket subsidies; but sensible selective intervention through limited financial assistance and factory provision does provide results. The potential is there and I believe we can obtain additional private sector investments, and the jobs and other economic improvements they bring, far in excess of the increased expenditure I am proposing.

Bid

	£m		
	1990-91	1991-92	1992-93
Highlands and Islands Development Board	3.5	3.0	3.0

HIDB Caithness initiative

We have a particular problem in Caithness, where the rundown of the Dounreay establishment, the only major employer in the area, will be traumatic. I believe it is important politically that we act, and are seen to be acting, in response. Of course, HIDB will have to reorganise their priorities on account of Dounreay; and they will do just that. But there is a limit to what they can do with existing resources. The rundown at Dounreay heralds a major change in the economic and social circumstances of the far north of mainland Britain. I believe that the further resources I propose are required. They will allow us to announce a £30m initiative, comprising the new resources and diversion of existing HIDB resources, over five years. I do not believe that anything less will be acceptable.

Bid

	£m		
	1990-91	1991-92	1992-93
HIDB Caithness initiative	1.0	3.0	5.0

Regional Development Grant

The above bids are offset by the following savings:-

Savings

	£m		
	1990-91	1991-92	1992-93
Regional Development Grant	-	-	15.0

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