PO-CH/NL/0258
PART A

Part A.

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Begins: 27/3/87.
Ends: 23/8/88.

PO -CH /NL/0258
PART A

Chancellor's (Lawson) Papers:

ACCOUNTING FOR RESEARCH
AND DEVELOPMENT

Disposal Directions: 25 Years

D Anderson
28/9/95.

PO -CH /NL/0258
PART A

9/5 27 MAR 1987 - 15

I'm taking this to Prayers.
PB 28/iii

FROM: I C R BYATT
DATE: 27 MARCH 1987

MINISTER OF STATE

c Sir P Middleton
Sir T Burns
Mr C D Butler
Mr Odling-Smee
Mr Spackman
Mr Melliss
Mrs Pugh

MST
You may like to give this to CST when you raise this issue on Monday! More seriously, I suggest you have a meeting to discuss how planning is done, & you fit into it. P10-14 are most interesting: the 6 reports attached are flagged in a self-explanatory way! Do you have any comments on the individual projects? I have made some marginal comments in the reports. [initials] 27/3

TREASURY RESEARCH BUDGET

This is the first of a series of regular submissions to you on the Treasury's expenditure on contracted out research. The expenditure itself is relatively small - less than ½% of total Treasury expenditure - and it contains a number of small items as well as a few big ones. Hence there is rather a lot of paper attached to this note. Some of the projects can be - and are - politically sensitive.

2. Each year, following the Planning Board's decision in the autumn on the scale of resources available for such work in the following year, we plan to submit to you:-

- a list of the activities planned for the following financial year;

- a report on the research carried out during the previous financial year;

- a progress report on the research being carried out in the current financial year.

3. We will also submit all new projects to you as and when they arise. You may then want to consult the Chancellor, who has asked that all new projects should be cleared with him.

4. The research programme is managed, on behalf of the whole central Treasury, by two responsibility centres - EA/MP (Mr Odling-Smee) for the macro economic elements and

PXE (Mr Spackman) for the micro economic elements. The budget is divided broadly two-thirds/one third respectively into these two areas. But we allow virement between them.

5. This submission relates to research planned for 1987-88, which falls within the ceiling of £370,000 laid down by the Planning Board last autumn. In future years it will come earlier in the financial year. It consists of separate papers, which are attached, on both the macro and micro economic research budgets, each covering the three items in paragraph 2 above. This note draws together the work in these sub-budgets.

This seems inconsistent.

6. The work which is funded by the research budget falls into three broad categories:-

But it means this submission covers 85-86 report, 86-7 progress report + 87-88 plans.

- our share of expenditure in research consortia;

- bread and butter activities in direct support of our internal analytic capability;

- projects designed to answer particular questions about specific policies or areas of policy.

Research Consortia

7. This will account for £k208 in 1987-88, 56% of the budget:-

- £k196 is for our contribution to the macro economic consortia funded jointly with the ESRC, which you will remember from your DES days. (There is also a small contribution from the Bank of England.) Our contribution, which is not to exceed £k200 in 1985-86 prices, will run for four years from autumn 1987. It continues a similar contribution over the four years from autumn 1983 to autumn 1987. The extension was agreed by the Chancellor during the course of last summer on the basis of papers submitted by Sir T Burns;

- £k12 is for our contribution to the tail end of the Public Finance Consortium, funded jointly with the Revenue Departments and the ESRC. The consortium was initially planned to run for four years from 1982-83 to 1986-87, but a small amount of work on indirect taxes and on the compliance costs of taxation remained to be financed, so we agreed to spend a further £k12 in 1987-88 and 1988-89. We have not envisaged a full scale extension, although there is a case for one, because we preferred to garner our resources for some research on the consequences of the reform of business taxation in 1984.

<u>Continuing and essentially technical activities supporting our internal analysis</u>

8. We need to allocate up to about £k50 (under 15% of the budget) to this in 1987-88. It consists of a range of activities, such as the cost of the academic panel, purchase of data, software, payment for methodological advice, membership subscriptions to organisations such as the International Institute of Public Finance, the Public Finance Foundation and the Strategic Planning Society, cost of attending research conferences, etc. Some of the items are scarcely worth itemising; but we thought that you would like to see some of the bigger ones. They are therefore set out and marked with an asterisk in the attached papers. We need to be pretty flexible about this category.

<u>Policy related research projects</u>

9. Projects in this category are either studies of changes in policy, such as the reform of corporation tax in 1984, or inquiries into areas where results can appear to have implications for policy. They sometimes last for more than one year. While we always reserve our rights over publication, when the work is carried out by academics, which is much cheaper than using consultants, there is an expectation that our consent

would not be unreasonably withheld. This is the area where political sensitivity can arise - as we saw in the case of the work commissioned from Professor Brown on taxation and labour supply.

10. The biggest item in this category is the proposed research on the effects of the changes in the structure of corporation tax in 1984. This could be costly and politically sensitive. We have made provision for this in the budget but there is not yet a decision to go ahead.

11. A year ago, I put a proposal to the Chancellor, suggesting that we should monitor the effect of the 1984 changes. It is the declared wish of the government to evaluate policy changes; the Chief Secretary has urged this on spending departments. The Chancellor felt, however, that the time was not then ripe for a research project. He was content that we should do more methodological work and put a proposal back to him in a year's time.

12. We asked National Economic Research Associates Ltd (NERA) to carry out some preliminary work for us under conditions of strict confidence. This will be available shortly. When we have examined this report, we will send you a submission, which you will want to discuss with the Chancellor.

13. The NERA report will, inter alia, advise us on costs. In the meantime, we have set aside £k85 in 1987-88 - £k75 from the micro and £k10 from the macro economic budgets. If the project went ahead, we would get a comparable contribution from the Inland Revenue and lower contributions from the DTI and the Bank of England. We envisage a 2-year project, with expenditure spread fairly evenly over 1987-88 and 1988-89. The total cost to the Treasury cannot exceed 2 x £k85 = £k170. We might be able to do the work for less.

14. The other projects fall into main categories:-

- the labour market, where we have commissioned projects on the duration of unemployment and "insiders and outsiders". Both are directed to getting more illumination on important policy issues. They are budgeted at £k7½ each;

- a survey of manpower budgeting in some very large organisations (contingent on the results of the survey of the state of the art). This work, which is relevant to our management of departmental manpower and running costs, would cost about £k17;

- consultations and research on the valuation of labour costs. We want to tighten up our position on the valuations we put into investment appraisals. This work might cost £k2. Ministers would be consulted before it went ahead;

- the public utilities, where we want to collect information on the financial performance, especially return to capital, of utilities in other countries. We need to know, for policy purposes, whether the targets we agree with nationalised industries are more or less onerous than in other countries. The consequences of different pricing policies based on different returns on capital, especially when, as in the case of electricity, there are implications for industrial costs and competitiveness, are important. We think we could get a useful piece of work done for about £k15, but have still to approach research contractors;

- the flexibility of product markets, where we need to know more about what underlies our apparent inflexibility compared with other countries. We have set aside £k7 for this in 1987-88, but would want to proceed cautiously with a first stage costing about £k1;

- barriers to trade. There has been considerable growth in non-tariff barriers in recent years and we need to analyse their impact on macro economic variables; we are planning a project which would cost about £k4;

- the working of land markets, where we (and DOE) want to look at what evidence there is of the apparent failure of urban land markets to develop vacant or under-used sites. Our contribution would be about £k2;

- a survey of practice in leading industrial countries on the financing of large infrastructure projects. This would cost about £k3.

15. If we carried out all these projects, they would cost about £k150 in 1987-88. Together with £k208 on consortia and £k50 on direct support for our analysis, this would rather more than exhaust the budget. We must not exceed our cash limit. But there is usually some slippage in commissioning and carrying out research projects. Even if we were to go ahead with all the projects in 1987-88, we could well underspend. If the Treasury decides not to go ahead on the corporation tax project, we will think again about the balance of the work - in particular we may want to examine the scope for work on taxation, savings and share ownership, possibly in the context of a consortium, together with Inland Revenue and the ESRC.

pace EC budget.

16. I am afraid that this submission and the supporting documents are rather bulky. The research budget is a mixture of small nuts and bolts and a few big issues. I presume you will want to concentrate on the latter. You may want to discuss the issue with us, and Messrs Odling-Smee, Spackman and I would welcome this. In particular, it would help us to know how you would like us to handle things in the future.

IB

MACRO-ECONOMIC RESEARCH EXPENDITURE 1985-86

1. Expenditure under the macroeconomic research budget in 1985-86 amounted to £210,400, of which £191,000 was accounted for by the ESRC Macroeconomic Modelling Consortium. The remaining £19,400 was largely devoted to research on company sector behaviour and expenditure on the Academic Panel, consultants and conferences, with smaller expenditure on support of other macro-economic models, the purchase of data and work on trade barriers. The detailed allocation of the expenditure is shown in the table attached.

ESRC Macro-Economic Modelling Consortium

2. The Treasury contribution to Consortium expenditure in 1985-86 amounted to £191,000, 20 per cent of the total. A small contribution was made by the Bank, with the ESRC itself providing the bulk of funds.

3. The end of 1985-86 marked the half way stage in the Consortium's first four year programme of funding. Consortium funded work carried out in 1985-86 which has been of particular interest to Treasury economists included:-

(i) The investigation of stochastic simulation methods by the Warwick Bureau (P. Fisher and M. Salmon) and, in the context of model simulations, the work at the National Institute of Economic and Social Research (S. Hall). The NIESR work had also been supported directly by the Treasury in 1984-85.

(ii) Empirical work on international policy co-ordination questions carried out using the Liverpool world and UK models (P. Minford) and the Treasury's WEP model (E. Karakitsos at Imperial College).

(iii) The systematic investigation of the reliability and accuracy of forecasts. The Warwick Bureau do annual comparisons of the forecast records of the various teams. The National Institute (S. Hall and B. Henry) have also investigated the improvement in accuracy which the judgemental element of the NIESR forecasts provides.

(iv) There is continuing research interest in the role of expectations, both at the individual equation level where work on the exchange rate and company sector is dominated by this issue, and in methods of running models under consistent expectations. LBS, Liverpool, NIESR and Warwick have all contributed to this work.

(v) Issues of policy design, including policy credibility and time consistency are beginning to be addressed by modellers, following on from largely theoretical work. LBS (D. Currie and P. Levine) has been active in this area, which is of considerable relevance to the Treasury. We ourselves have investigated the use of feedback rules to control nominal GDP, and are currently engaged in devising methods of running the Treasury model under the assumption that policy is time consistent.

More generally, the Consortium system has fostered a diversity of approach and the maintenance of best practices by the modelling teams. Some evidence for this could be seen in the large number of high quality applications for funds for the period 1987-91 which were elicited by the Consortium.

Other Macroeconomic Models

4. The final Treasury contribution to the LSE supply-side model (C. Bean) was made in 1985-86. This model has produced some interesting research results, particularly in the field of investment behaviour where some of the results challenged long-accepted views. The LSE model is now operational, and it was

recently used to investigate questions relating to the structural impact of N. Sea oil and the effect of changes in real oil prices (C. Bean, 'The Macroeconomic Consequences of North Sea Oil', paper given to CLE Conference of British Economy, May 1986). It has been our intention to mount this model on the Treasury computer, where it will make an interesting companion to the small supply-side model being developed internally.

? Cooperative Award in Social Sciences?

5. This was the second year in which we made a contribution to the cost of the CASS student, Andrew Blake, who is jointly supported by Queen Mary College and ourselves. He continued his work, as part of his PhD, on the linearization of the Treasury model. He will be shortly reporting results to us at the Academic Panel. The software used by him is being made available to the Treasury, and we expect that it will be helpful in policy analysis work, particularly the issue of how policy rules are affected by different expectational assumptions.

Wd you like to go.

Company Sector Behaviour

6. Two projects were concerned with the estimation of relationships for company sector, especially the stockbuilding, price and output equations. The larger of the two, carried out by Professor Wickens and Dr Thomas at Southampton University, involved the empirical estimation of a theoretical model devised within the Treasury. The project showed that it was possible to estimate successfully relationships in which future expected values of the endogenous variables appeared (the Euler equations) and which were consistent with a tightly specified theoretical model based on maximizing behaviour. This represents further evidence of the importance of forward looking expectations in modelling the company sector. The report also provides us with a good guide to the methods and difficulties involved in estimating this class of model. A methodological paper, which has recently appeared in the Centre for Economic Policy Research working papers series, has resulted from this research. We aim to produce a paper which draws together the theoretical and empirical work that has been done.

7. The small project carried out by Dr Wadhwani at the LSE was concerned chiefly with the econometric methodology of an alternative method of estimation in using a full information method and taking account of the appropriate cross-equation restrictions.

Other projects

8. A project was done by Roy Batchelor at City University to examine the role of consumer expectations data derived from a regular survey conducted by Gallup Poll for the EC. This work showed that it was possible to translate qualitative data of this type into a form suitable for inclusion in the consumers' expenditure relationships of the Treasury model. The work showed that the inclusion of series representing perceptions and expectations of consumers' financial position led to a significant improvement in explanatory power of the consumer durables, but not the non-durables, equation. However, in the light of the interim report, it was thought that further work would not be worthwhile. Mr Batchelor was therefore paid an appropriate proportion of the sum due under the contract.

Does this mean they got enough info. from Stage 1, or the work was poor?

9. Data relating to the means of payment were collected from AGB Index and NOP data. As on previous occasions, the Treasury shared the cost with the Bank.

10. The project on expectations data was carried out in 1984-85 by S. Wren Lewis and discussed in the report on research expenditure in 1984-85.

11. As part of their work on the possible effects of liberalizing trade in textiles and clothing and motor vehicles, Treasury and DTI economists commissioned a simulation study from Cambridge Econometrics. The simulations were designed to show, using the disaggregated CGP model, the effects on the industries concerned of trade liberalization measures which were interpreted for this exercise as a reduction in import prices. The results have been discussed with Cambridge Econometrics, and a better understanding of possible quantitative effects has been obtained.

Academic Panel and Conferences

12. There were 6 meetings of the Academic Panel in 1985-86, implying an average cost per meeting of £700. The Panel gave helpful guidance on a number of topics, including labour supply and working population, modelling expectations and feedback rules.

13. Among the conferences attended by Treasury economists were the macroeconomic seminars arranged by Warwick Bureau, the AUTE conference, a CLE conference on unemployment, a conference organized by Brookings Institution on Empirical Macroeconomics for Interdependent Economies, and Conferences organised by the National Institute on public sector debt and the National Institute model 8.

Macro-Economic Research Expenditure 1985-86

ESRC Macro-economic Modelling Consortium	191,000.00
Other macro-economic models:	
CASS studentship (Blake)	1,000.00
LSE model (Bean)	1,500.00
Purchase of forecast for Warwick Bureau	10(1)
TOTAL	2,510.00
Academic Panel, consultants and conferences:	
Panel fees and expenses	4,099.05
Consultants' fees and expenses	620.20
Conference fees and expenses	2,161.94
TOTAL	6,881.19
Company sector behaviour:	
Estimation of prices and outputs (Wickens)	5,000.00
Econometric methodology (Wadhwani)	750.00
Effects of inflation (Wadhwani)	-
TOTAL	5,750.00
Data:	
AGB Index	523.25
NOP Data	143.75
Permanent Income measurement	1,000.00
Expectations data	1,050.00
TOTAL	2,717.00
Trade barriers and tariffs	1,500.00
TOTAL	210,358.19

(1)Payment to National Institute for their model documentation

MACRO-ECONOMIC RESEARCH EXPENDITURE 1986-87; PROGRESS REPORT

Up to 14th March, £232,750 had been spent, and an additional £8,350 is expected to be spent before the end of March, making a total expenditure of £241,100. The attached table shows the breakdown. The rest of this note describes projects which are not discussed in either the report on expenditure in 1985-86 or the plans for expenditure in 1987-88.

Macro-economic Research Expenditure, 1986-87: Projected Outturn

		£ thousands
Macro-economic Modelling Consortium		198.0
Academic Panel, consultants and conferences		
Panel fees and expenses	6.3	
Consultants' fees and expenses	0.2	
Conference fees and expenses	3.0	
TOTAL		9.5
Data		
Measurement of capital stock	2.0	
NOP data	0.3	
Pension fund survey	3.0	
TOTAL		5.3
Effects of CT changes		20.0
CASS studentship (Blake)		0.5
NIC restructuring		5.8
Duration of unemployment		2.0
TOTAL		241.1

Measurement of the Capital Stock

2. This is a small project being carried out by Tony Smith of the National Institute. He is using current cost information from company accounts in the early 1980s to obtain estimates of the capital stock for comparison with the CSO's estimates published in the Blue Book. The first stage of his work, which we did not finance, showed that this approach could shed some light on the

likely orders of magnitude of the errors in the CSO series. We therefore decided to finance a continuation so that he could extend his analysis for a single year from manufacturing to non-manufacturing companies

3. Our interest in this is to improve our modelling and understanding of the growth of productive potential. The capital stock series produced by the CSO have been constructed artificially, and it would be helpful to assess them against the information from this project with a view to improving their accuracy.

Pension Fund Survey

4. Following the provisions in the Finance Act 1986, we have been investigating the methods that pension funds use for valuing assets and liabilities in order to assess the appropriateness of the 5% surplus above which pension funds become exposed to the new tax charges.

5. There is very little systematic information about pension fund valuation methods. However, a consulting actuary at the City University (Bernstein) has conducted a survey of pension funds which collected a considerable amount of relevant information. Unfortunately, he was unable to analyse all his data, and the purpose of this expenditure (a maximum of £3,000) is to buy some information from the survey. We expect to receive the results in March 1987.

NIC Restructuring

6. It was agreed within the Treasury, DE and DTI that an evaluation should be done of the effects of the 1985 restructuring of National Insurance contributions. An interview study was commissioned to appraise its effects at the level of the individual firm. The survey, entitled "Employers' Costs and Practices", aimed to establish (a) the degree of awareness of the 1985 NIC changes and (b) employment and other responses to changes in non-wage labour costs such as NICs.

7. The survey was carried out by IFF Research Ltd in Autumn 1986 and involved 500 short telephone interviews with a sample of private sector firms followed by longer face-to-face interviews with 100 of the original sample. The total cost of the project was £34,845 (including VAT) of which the Treasury share was £5,800. A first draft of the report by IFF was received in December 1986 and the final draft is expected shortly. The data from the survey will be further analysed by DE along with data from other sources eg the New Earnings Survey.

MACRO-ECONOMIC RESEARCH EXPENDITURE 1987-88

It is proposed that macro-economic research expenditure in 1987-88 should be £241,000. The great bulk of this (£196,000) is earmarked for the Macro-economic Modelling Consortium. The remaining £45,000 is to be spread over a number of small projects and activities.

Table 1

Macro-economic Research Expenditure, 1983-87

£ thousands

	Consortium	Other	Total
1983-84	128	36	164
1984-85	185	52½	237½
1985-86	191	19	210
1986-87 (projected outturn)	198	43	241
1987-88 (plans)	196	45	241

2. Total expenditure will be about the same in cash terms as the projected outturn for 1986-87 (Table 1). The real decline reflects the temporary lull in expenditure on the Consortium, as the first round comes to an end and the second round gets under way.

3. Since 1985-86, the broad aim in forward planning has been to keep expenditure within a ceiling of about £240,000 at 1985-86 prices, corresponding to £250,000 in 1986-87 prices and £260,000 in 1987-88 prices.

4. Expenditure plans for 1987-88 can be seen in relation to total expenditure on the same projects and activities in all years (Table 2). The two main multi-year projects are the Consortium and the study of the effects of the 1984 corporation tax change. Expenditure on the duration of unemployment is being incurred in 1986-87 as well as 1987-88. There is also continuing expenditure on the Academic Panel, consultants and conferences.

Table 2

Macro-economic Research Expenditure Plans, 1987-88

	Expenditure in 1987-88	Expenditure in all years
		£ thousands
Macro-economic Modelling Consortium	196	892 (1)
Academic Panel, consultants and conferences*	13½	(2)
Data*	1	(3)
Investment behaviour and stock market valuations*	8	8
Modelling the gradual adjustment of expectations*	5	5
Duration of unemployment	2¾	4¾ (4)
Insiders and Outsiders	3¾	3¾ (4)
Effects of 1984 Corporation Tax change	10	10 (5)
Barriers to trade	4	4 (6)
TOTAL	244	

(1) This is the maximum expenditure in the second round, which runs from 1987-88 to 1991-92 inclusive. Some of the planned expenditure in 1987-88 comes under the first round, in which total HMT expenditure over five years is expected to be £817,000. The ESRC and the Bank also contribute to the Consortium.

(2) This is recurrent expenditure which has been continuing for many years.

(3) One component of this, costing about £250 a year, is recurrent and has been continuing for many years.

(4) These projects are also being financed from the micro-economic research budget. Total Treasury expenditure is:

Duration of unemployment	7½
Insiders and outsiders	7½

(5) This project will also be financed from the micro-economic research budget, and there will be contributions from the Inland Revenue, DTI and the Bank.

(6) A contribution from DTI towards the cost of this project will be sought, so that the total cost will probably be greater than £4,000.

*Continuing or essentially technical activities supporting our internal analysis

5. The sum of expenditure on individual projects shown in Table 2 is higher, by £3,000, than the planned total, shown in Table 1. This is because experience suggests that one or two projects under consideration will not take place or will go ahead on a reduced scale.

Macro-economic Modelling Consortium

6. The first four-year round comes to an end in September 1987. Treasury expenditure in this round is expected to amount to a total of £817,000 (Table 3). The second four-year round will begin in academic year 1987-88. The Consortium has not yet decided how to spend all its money, and so there is some uncertainty about expenditure in 1988-89 and later years, and perhaps even 1987-88. However, it has been agreed (Burns to Chancellor 20th May 1986, Lomax to Burns 22nd May 1986) that the Treasury's contribution should not exceed £200,000 a year at 1985-86 prices. This would imply maximum expenditure as shown in Table 3, amounting to £892,000 over the second round of the Consortium. However, the experience of the first round was that the Consortium tended to under-spend slightly.

Table 3

HMT Contribution to Macro-economic Modelling Consortium

		£ thousands
	First Round	**Second Round**
1983-84	128	
1984-85	185	
1985-86	191	
1986-87	198	
1987-88	115	81
1988-89		223*
1989-90		230*
1990-91		236*
1991-92		122*
TOTAL	817	892

*Maximum. Corresponds to £200,000 at 1985-86 prices. Expenditure in 1991-92 is assumed to be half expenditure in a full year.

How much of this wd you like to see? 85-86 report gives more detail of what Consortium did in that yr but I can't find corresponding detail in later years.

7. The Treasury's interest in the Consortium and discussion of what we obtain from it is fully set out in the papers attached to the minute from Sir Terence Burns to the Chancellor of 20th May 1986. After that the Consortium made its main decisions about allocating the bulk of its available funds to the main macro-economic modelling teams. These decisions are summarised in the minute from Mr Melliss to Sir Peter Middleton of 27th August 1986.

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8. The Consortium is currently engaged in an assessment of proposals for research into "micro to macro" modelling, which will probably account for most of the rest of the unused funds. This is a relatively new concept, which attempts to integrate models that take account of micro-economic determinants of, for example, firms' behaviour into macro-economic models. Success in this direction could greatly improve our understanding of the macro-economic significance of micro-economic policy initiatives, and vice versa, with benefits for policy analysis among both micro and macro economists in the Treasury.

Academic Panel, Consultants and Conferences

9. The plans for 1987-88 allow for 10 meetings of the Academic Panel, at £1,000 per meeting. This is the maximum, since we usually cancel one or two meetings, but we have to allow for the possibility that we shall have enough issues which we want to discuss with the Panel.

10. Most of the rest of the money under this heading will be devoted to conferences. Most conferences, especially those in London, are inexpensive, but occasionally it is necessary to spend a few hundred pounds, for example for travel expenses or the fee for private sector conferences.

Data

11. Part of the £1,000 under this heading is for the usual purchase of data on the means of payment. The rest is notional at this stage: the opportunity to purchase data often arises at short notice during the course of the year.

Investment Behaviour and Stock Market Valuations

12. The equations for business investment in the Treasury Model are based on backward-looking information, mainly the past behaviour of output (ie an accelerator model) and recent factor prices. We would like to incorporate more of a forward-looking element into the equations, since the investment decision is very much one about the future. One way in which economists have suggested that this could be done is to use share prices as a measure of expectations about future profitability. More formally, Tobin has suggested that the ratio of the market value of companies to the replacement cost of their real capital assets, a ratio he calls Q, should theoretically be a determinant of investment. What do you think, as an ex-businessman?!

13. Some recent empirical work in the UK has produced plausible equations for investment based on Tobin's Q. Some of this work has been done by Dinenis who is at the LBS, and who has given papers on it at the Treasury. We are now discussing with the LBS the possibility of their estimating equations which could be used in the Treasury Model.

Modelling the Gradual Adjustment of Expectations

14. The way in which expectations are formed, especially in financial markets, is extremely important for the quantitative assessment of policy and other changes. In the last year or two we have experimented with a variety of techniques for simulating the Treasury Model under different assumptions about expectations formation. These include not only the usual backward-looking expectations formation assumptions (eg adaptive expectations), but also forward-looking mechanisms which involve economic agents in correctly anticipating the course of policy and its effects on the economy. Where policy changes are thought to be unsustainable, we have imposed assumptions about how economic agents expect that the policies will be reversed at some point in the future.

15. Some of the assumptions that we have to make about expectations formation are rather arbitrary. In addition it is unsatisfactory to have to choose between one extreme assumption that

I like this choice. ✓!

expectations are entirely backward-looking, and another that they are fully consistent with future events. A more realistic scenario might be one in which economic agents gradually adjust their expectations about, for example, the sustainability or otherwise of policy or other changes.

16. As far as we know, very little empirical work based on this kind of model has been done. However, it is of considerable importance to our quantitative results that we should adopt realistic assumptions about expectations formation. We therefore intend to seek advice about what could be done in this area. The first stage will be a discussion at the Academic Panel in April, on the basis of a paper which we are preparing. Arising out of that we hope that there will be suggestions for further work, some of which could probably be done in-house, but for some we might wish to engage an academic expert in the field. The £5,000 in the plans is a provision for this eventuality.

Duration of Unemployment

17. Considerable attention has recently been focused on the duration of unemployment, especially the relative sizes and flows into and out of the stocks of short-term and long-term unemployment. However, our understanding of the dynamics of the unemployment stock is poor, and attempts that we have made in the Treasury to explain the behaviour of long-term unemployment given the path of total unemployment have not been successful.

a good name.

18. The purpose of this project, which is being conducted by Pissarides at the Centre for Labour Economics (LSE), is to specify and estimate time series models of the transitional probabilities of staying on (or leaving) the unemployment count, for each duration of unemployment. These probabilities are assumed to depend not only on total (current and lagged) unemployment, but also on other relevant economic variables, such as output and the structure of output.

19. The project began in the Autumn of 1986, and a progress report is expected in March 1987. If progress is satisfactory, we may make an interim payment in 1986-87, and the final payment on receipt of a satisfactory final report in 1987-88.

Insiders and Outsiders

20. The failure of wages to adjust more rapidly to the high level of unemployment has focused attention on theories which may help to explain why the unemployed have so little influence on the wage bargaining process. Some of these theories are grouped under the heading of Insiders and Outsiders, and it would be desirable to quantify the implications of these theories. However, this is very difficult because there is no commonly agreed way of defining outsiders and the barriers to outsiders are not easy to measure. It seems unlikely that aggregate time series research would reveal very much. We have therefore commissioned a study by the Centre for Labour Economics (LSE) which will use the cross-section information which they have been collecting to test some of the relevant hypotheses.

21. The work will be conducted mainly by Wadhwani under the supervision of Nickell, and will try to distinguish between firm-specific and external influences on wage determination by individual firms. Some of the firm-specific influences, such as the degree of unionisation, could be held to signify a greater degree of insider power relative to outsiders. The research will therefore provide an indirect measure of the extent to which insider/outsider theories, as opposed to economy-wide influences, affect wage determination.

Effects of the 1984 Corporation Tax Changes

see 10-13 of cover note.

22. This is the subject of separate submissions from Mr Byatt. We shall shortly be assessing the feasibility study based on a pilot survey carried out in 1986, before considering whether to go ahead with the main study. The £10,000 provided for in the macro-economic research budget would be only part of the cost of this. Additional finance is expected to be forthcoming, should the work proceed, from the micro-economic research budget, the Inland Revenue, DTI and the Bank.

Barriers to Trade

23. A good deal of theoretical and empirical work has been done over the last twenty years in analysing and quantifying the effects

of <u>tariff</u> barriers, which until recently have been the main instruments of protection in the developed world. Over the last decade there has been a significant increase in the use of non-tariff measures that are largely outside the framework of the GATT and pose a threat to both GATT itself and to the world trading system. Such measures include quotas, voluntary restraint agreements, import licensing schemes, variable levies, local content regulations and other administrative barriers to trade. There is also growing pressure, particularly in the US, for the use of import and export competing subsidies to domestic firms.

24. Existing models for analysing the impact of such measures on consumers, output, national welfare and trade have been extremely theoretical, and so the focus of this project will be on exploring more pragmatic approaches. It is intended that the project would be commissioned and funded jointly with the DTI, a short list of academics would be invited to submit proposals and selection would be on the basis of informal competitive tendering. Clear objectives and a detailed outline would be agreed before a contract was finalised. An interdepartmental group would ensure close monitoring and control of the project.

Looks interesting.

5/5
(3/6)(4118/27/CER)

MICRO-ECONOMIC RESEARCH BUDGET: FINAL REPORT FOR 1985-86

1. The micro-economic research budget for 1985-86 was £112,000. Outturn expenditure on microeconomic projects was £115,770, the excess over budget being funded from the macroeconomic research budget. This expenditure was allocated as follows.

Micro-economic research expenditure, 1985-86

		£ cash
Taxation (£72,130)		
(i)	Public Finance Consortium	44,000
(ii)	Taxation and Labour Supply	23,980
(iii)	Taxation and benefit modelling	4,150
Public Enterprises (£7,822)		
(iv)	Accounting for changing prices	7,822
Public Services (£32,164)		
(v)	Comparison of cost and performance in public services	32,164
Other expenditure (£3,654)		
(vi)	Conferences and subscriptions	3,654

2. The achievements of these expenditures were as follows.

(i) Public Finance Consortium

3. The following two research groups were supported by the Public Finance Consortium:

(a) **IFS** - Research on personal sector has included the continuing development of tax benefit models and their integration with models of labour supply. They have produced computer programmes which have been used in policy analysis.

On the expenditure side IFS are developing dynamic demand systems with the aim of incorporating behavioural responses into the tax benefit model. We are in close touch with this work and hope to benefit from it in our own modelling of indirect taxes. A number of technical/methodological papers have been published.

Research on the corporate sector has involved setting up a database of industrial and commercial companies and continued development of their corporation tax modelling including extension to the UK of the OEC 'model firm' methodology. Besides empirical work eg on dividend policy, IFS have produced a number of policy relevant theoretical papers.

(b) **LSE** - The Taxation and Incentive programme under Professor Atkinson, King and Stern continues to produce a stream of useful working papers. A report on low income families interviewed in the Family Finance Survey and reinterviewed a year later in the Family Resources Survey will be published later this year. The Surveys were commissioned by DHSS and the analysis carried out by Ruth Hancock, on secondment from DHSS. This shows how family circumstances change significantly even over short periods. The work also provides some evidence on the poverty trap and possible disincentive effects.

(ii) Taxation and the Labour Supply

4. This was the continuation of a project designed to:

(i) develop and estimate an econometric model of short run labour supply;

(ii) provide a DIY simulation package for analysing the effects of tax changes;

(iii) provide descriptive papers on relevant aspects of labour market behaviour.

The project ended in September 1986 and a separate report has been made to Sir Peter Middleton. Wd you like to see it?

(iii) Taxation and benefit-modelling

5. £3000 was paid to Ian Walker (Manchester) to develop his model for simulating the effects of tax and benefit changes on household labour supply, in particular to allow for post-Fowler social security benefits and transferable income tax allowances. He provided us with a program which runs on our IBM AT and which we have used in analysing the labour supply effects of a wide range of policy options.

£1000 was paid to the IFS for provision of a version of their tax-benefit model which can run on our IBV AT. This has been used mainly as a cross-check on our own work in developing a tax-benefit model.

(iv) Accounting for changing prices

6. This is the direct cost of the work of an advisory group of experts asked to report on how published accounts in nationalised industries could be adapted to identify the economic costs of supply (notably the costs of capital). This information is important, particularly to the Treasury, in setting financial targets for nationalised industries. Problems in applying the recommendations are now being discussed with individual industries. The work is also relevant to the design of regulatory procedures for privatised industries. The final report has been published and is being used to support CCA in the private sector generally. the expenditure includes £2000 spent on a conference with the advisory group.

(v) Comparison of cost and performance in public services

7. This was further funding of the research programme carried out by Malcolm Levitt (NIESR) and his assistant. The research has studied the methodology (including regression analysis and data envelope analysis) for comparing costs and performance of the public services, and empirical work has been carried out for education, health, law and order, and defence. Results on the relationship between inputs and outputs and on the comparative efficiency of individual agencies such as local education and police authorities are of direct use in policy analysis (eg police manpower and defence

briefing). Several working papers have been published and the work will be brought together in a book, 'The Growth and Efficiency of Public Spending' to be published in late 1987. — Political aspects?

Eh!

(vi) Comparison of cost and performance in public services

Conferences + subscriptions

8. Conferences attended include IFS seminars on the Fowler Reviews, airport policy, taxation and savings and local government; Public Finance Foundation seminars on defence and on the water industry; the Operation Research Society conference; and the AUTE.

9. Subscriptions included those to the International Institute of Public Finance, the IFS, the Institute for Strategic Studies and the Public Finance Foundation. Benefits include information about the institutes and reductions in charges for journals and conference attendances.

MICRO-ECONOMIC RESEARCH BUDGET: PROGRESS REPORT FOR 1986-87

The 1986-87 budget of £117,000 is expected to be fully spent. The excess will be met by a transfer from the macro budget. The expected expenditure on microeconomic projects is as follows. All these projects will be started and completed within the year, except for number (i) to (iv), for which the total expenditures are recorded in a footnote.

Micro-economic research expenditure expected in 1986-87

		£ cash
Taxation (£83,720)		
(i)	Public Finance Consortium	45,400
(ii)	Compliance costs and indirect taxation	12,000
(iii)	Taxation and the Labour Supply	14,600
(iv)	Business tax research	10,720
(v)	Other taxation research	1,000
Public Enterprises (£12,450)		
(vi)	Regulation of private sector utilities in Western Europe	10,400
(vii)	Economics of wider share ownership	2,050
Public Services (£10,550)		
(viii)	Comparison of costs and performance in the public services	5,000
(ix)	Modelling the birth rate	3,550
(x)	Critique of road appraisal methodology	1,000
(xi)	CASS studentship	1,000
Industry (£8,260)		
(xii)	Survey on Profit Related Pay	8,260
Other expenditure (£4,000)		
(xiii)	Conferences and subscriptions	4,000
		118,980

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these projects, only items (i) to (iv) extend over more than one year. Total expenditure on these projects is as follows:

(i) Previous Treasury contributions to the Public Finance Consortium:

1983-84	£33,700
1984-85	£43,000
1985-86	£44,000

Total for the four years 1983-84 to 1986-87 is £166,100.

(ii) Total Treasury contribution to these projects is £24,000 (£12,000 in 1986-87, £12,000 in 1987-88).

(iii) Total cash cost of project, 1979 to 1986-87, is £599,280 of which the OPCS survey cost £388,800, Treasury expenditure £210,480.

(iv) Total cost of stage one of project (to be completed in 1986-87) is £36,225, £19,505 will be funded from the macro research budget, DTI and Bank of England will contribute £6,000. A submission has not yet been made for stage two.

2. Items (i), (iii) and (viii) are the continuation of commitments described in the final report for 1985-86. The other items are progressing as follows.

(ii) <u>Compliance costs and indirect taxation</u>

3. An additional contribution to the Public Finance consortium, tied to four research projects. Three of these are examining the effects of indirect tax changes and have just started: one by Professor Ulph (Bristol) is looking at aggregate equations for forecasting VAT revenue; one by Dr Posnett (York) is studying demand and supply responses to changes in alcohol and tobacco taxation; and one by Professor Blundell (UCL) is examining the household response to indirect tax changes using FES data. The other project is research by Professor Sandford (Bath) on the compliance costs of tax. He has recently produced results on personal income tax and CGT and is currently working on a book on compliance costs generally.

(iv) Business Tax Research

4. The pilot stage of a possible larger project to monitor the impact of the 1984 business tax changes on company behaviour (including investment). The pilot is being carried out by National Economic Research Associates (NERA) and is exploring the methodology and likely costs of a main-stage survey. The consultants have produced two progress reports and undertaken six pilot interviews with business (of widely differing types). NERA will submit a feasibility study for a main stage project this Easter, though there is no commitment that the project will go ahead, nor if it does that NERA will do it.

(v) Other taxation research

5. Payment to the IFS for provision of an updated version of their tax-benefit model and the associated data base.

(vi) Regulation of private sector utilities in Western Europe

6. A study by IFS on the effectiveness of different institutional arrangements and regulating regimes for those utilities in other countries which in the UK are, or were recently, in public ownership. The research has involved overseas visits as well as the review of written material. The report was received in February 1987.

(vii) The Economics of wider share ownership

7. A survey paper on the existing theoretical and empirical work on wider share ownership written by Professor Grout (Bristol). The paper examined the relevance of the capital asset pricing model, the unanimity rule and the Modigliani-Miller theorem. A subsequent seminar on the paper yielded useful insights for wider and employee share ownership and privatisation policies.

Not one I know!

(ix) Modelling the birth rate

8. Extension of work by Dr Ermisch (NIESR) on economic modelling of the birth rate previously carried out by himself and others with Treasury financial support. The parameter estimates resulting from

the research will be used to simulate past changes in births and project future changes under different economic assumptions on a program developed with financial support from OPCS.

(x) Critique of road appraisal methodology

9. A short critique by Mr Plowden (ex Policy Studies Institute) of selected aspects of the method used by DTp to appraise trunk road schemes. This proposal has been agreed with DTp economists and the Treasury is seeking to secure some independent research which would otherwise not be supported. A report is due in March 1987.

(xi) CASS studentship

10. Sponsorship of a PhD student from Queen Mary College, working on the analytical problems of measuring public sector output, and in particular, the application of data envelope analysis to schools and prisons.

(xii) Survey on Profit Related Pay

11. A survey carried out by IFF Research Ltd on the nature of existing cash-based profit sharing schemes in private sector companies. This was a follow up to an earlier DE sponsored survey of profit sharing schemes in general and is of direct use for estimating the impact of policies on profit related pay.

Um. I wonder!

MICROECONOMIC RESEARCH BUDGET: PROPOSALS FOR 1987-88

1. The microeconomic research budget for 1987-88 is £121,000. The research proposed is listed in the table below. As in previous years, the projects listed would in total cost more than this. Precedence will be given to those which are considered during the year to merit the highest priority.

5/3
(3359/28)

Microeconomic Research Proposals 1987-88

		Expenditure	Comment
A.	**Taxation** (£97,000)	£cash	
(i)	Monitoring the impact of the 1984 business tax changes.	75,000	Commissioning depends on the outcome of the feasibility study funded from 1986-87 budget. A separate submission will be made to Treasury management.
(ii)	Joint research with Revenue Departments on compliance costs and indirect taxation.	12,000	Completion of three projects (at UCL, Bristol and York) on aspects of indirect tax forecasting and modelling of importance to Customs and ourselves. The compliance cost work will enable Professor Sandford to complete and bring up to date his work covering a wide range of taxes; total proposed Treasury expenditure on these projects is £24,000.
(iii)	Tax and benefit modelling	10,000*	Possible extension of Professor Blundell's UCL project above (due to end in September 87) to incorporate an indirect tax module into our own (IGOTM) tax-benefit model.
B.	**Public Enterprises** (£15,000)		
(iv)	Performance of overseas utilities	15,000	Collection and analysis of data on the financial performance of utilities in OECD countries. Objective is to assess whether an RRR of 5 per cent is an unusually demanding target for UK utilities with particular emphasis on the competitive position of major industrial users of electricity.

* Continuing or essentially technical activities supporting our internal analysis.

C. **Labour markets and industry** (£15,000)

(v)	Product market flexibility	7,000	Research on the responsiveness and flexibility of UK industrial output prices to cost and demand changes as compared with other countries (notably the US, Japan, EC countries such as Germany and France, and Sweden). The first stage (which might cost £1,000) would review existing evidence and determine whether a second stage of empirical work on selected countries and sectors was warranted.
(vi)	Valuation of labour costs	2,000	An internal Treasury paper to be prepared setting out the case for generally valuing labour at the wage rate but raising questions about special categories of labour market for which special treatment might be justified. This to be followed by limited interdepartmental discussion and, subject to consultatio with Ministers, the commissioning of short critiques by a range of academic economists.
(vii)	Duration of unemployment	2,750	Project conducted by Dr Pissarides at the Centre for Labour Economics (LSE) on the factors (such as total unemployment and the structure of output) affecting the duration of unemployment. Project began in autumn of 1986 and is expected to be completed in 1987-88. Total cost expected to be £7,500, £4,750 will be funded from the macro research budget.

(viii)	Insiders and Outsiders	3,750	A study by Professor Nickell and Dr Wadhwani at the Centre for Labour Economics on the relative importance of firm-specific and external influences on wage determination. Total cost expected to be £7,500, £3,750 will be funded by the macro research budget.

D. **Public Services** (£10,000)

(ix)	Joint research with DOE on inner city land markets	2,000	At the Treasury's instigation DOE recently commissioned a review of available evidence on the apparent failure of urban land markets to develop vacant or under-utilised sites. The review will be completed in March/April and will suggest what empirical work should follow. It has been provisionally agreed with DOE that the Treasury will contribute to this second stage. The work is relevant to urban policy and the costing of land in investment appraisals.
(x)	Interest rates and lenders' preferences	3,000*	Work on the relationship between market interest rates and lenders' preferences, aimed in particular at why the interest rate on indexed gilts is lower than most plausible rates of personal time preference. The work is relevant to the conceptual basis of the Test Discount Rate used for comparing public expenditures over time.

(ix)	Financing major infrastructure projects	3,000	Survey of available evidence on the ways in which leading industrial countries (USA, France, Germany, Japan) finance major infrastructure projects. The study will look in particular at the use of private finance and its effects on overall costs and quality. The aim is to provide more information on how best to use private enterprise in infrastructure development.
(x)	Risk and financial institutions	2,000*	A review of evidence on criteria used by financial institutions for lending on risky investments. The work will contribute to the development of Treasury guidance on the appraisal of financing costs.

E. <u>Manpower planning</u> (£20,000)

(xi)		3,000*	A survey of the current state of the art in bringing together manpower supply projections, traditionally based on wastage, retirement, promotion and current manpower stocks, with the forecasting of manpower demand to meet future workloads; including a proposal for a survey of practice in some large organisations.
(xii)		17,000	A survey of manpower budgeting following from the proposal above, including work on the analysis of wastage.

F. **Conferences etc**

4,000*

TOTAL **£161,500**

RESEARCH BUDGET

BF 9/6

FROM: S P Judge

DATE: 28 April 1987

MR BYATT

cc PPS
Sir Peter Middleton
Sir Terence Burns
Mr C D Butler
Mr Odling-Smee
Mr Spackman
Mr Scholar
Mr Melliss
Mrs Pugh

TREASURY RESEARCH BUDGET

The Minister of State discussed your submission of 27 March yesterday with you, Mr Butler, Mr Spackman, Mr Scholar and Mr Melliss.

2. You explained how the budget had been created in 1975, to bring various activities together. Proposals were put each year to the Planning Board; within this envelope were some continuing projects and some new ones. Projects varied widely in size; indeed it was difficult to define what exactly a project is.

3. The Minister thought he should read the papers leading up to the decision to extend the macro-economic modelling consortium for a further 4 years - mentioned in paragraph 7 of your submission. I would be grateful if **Mr Melliss** could supply copies of these papers.

4. The Minister enquired about the market for contract research. You explained how Treasury economists decided what needed to be done, and used their knowledge of who would be able to do it to seek tenders. You were looking for people with strong analytic skills who could apply themselves to practical problems; they are a rarity in British Universities. Given that the Government could not pay universities consultancy fees (as this would involve paying UGC-funded staff twice) it was often possible to get expert involvement from research supervisors practically for nothing. Good ideas were scarce but could often be got

cheaply, while surveys etc were very expensive, as people were not prepared to do them for love.

5. Mr Melliss explained that the slippage in the budget was sometimes caused by Treasury staff making more progress than they expected in the time between the preparation of the budget and the letting of the contract. Conversely, they might decide in that period that the problem was too hard to be solved. Mr Butler said that EOG were hoping to be able to give more information to those running the budget towards the end of each financial year, to ensure that the cash limit was hit; Mr Spackman added that they had their own internal commitment monitoring arrangements that backed up EOG's MAISY payment monitoring system. In addition, each project was the responsibility of a project officer, who alerted others if spending was diverging from plans.

6. The Minister asked how much involvement Ministers had had in individual projects in the past. You explained that before 1979 research had been considered as very much an "official Treasury" activity. The project on Corporation Tax forecasting had been submitted to the Chancellor a year ago, and you now understood that Ministers wished to see all new proposals. The Minister said he would discuss this further with the Chancellor, and agree a procedure for handling proposals for new projects. The Minister agreed that he did not need to see details of methodological projects, unless they were very expensive. But he thought Ministers should see all new "public policy" projects as they arrived, with a summary each year of the existing projects. He did <u>not</u> wish to see a report on the outcome of each project.

X

7. Mr Melliss explained how the macro-economic modelling consortium allocated its funds. Nearly 20 groups had replied to the competition invitation; after a two-day conference they had decided (with the benefit of advice from two overseas academics) how to allocate the money, and divided it between four-year and two-year grants. Cambridge and the City of London Business School had featured in the first round, but their applications had not been successful in the new round. The ESRC

involvement was necessary because of the increasing importance of computing and data handling in research.

8. The Minister mentioned the Brown project (labour market) and the various VAT forecasting projects (paragraph 3 of your 1986-87 micro-economic progress report). The Opposition were saying that work was being done in the Treasury on the VAT base; they might be assuming that the existence of the Blundell et al projects implied backup in the Treasury. The Minister thought this link was only of interest near to an election. You agreed that Research could get controversial, especially when quasi-philosophical aspects came into play. You felt the Public Finance Consortium was a good way of separating such research from the Government. The fact that VAT was being investigated did not mean that the Treasury were interested in making changes to it: indeed Labour would also have policies on VAT. To advise Ministers it was necessary to be able to predict the response to various tax changes; such research takes a long time.

9. Mr Scholar said that the Chancellor was considering answering an arranged PQ on the Research Budget, announcing in a matter-of-fact way the projects that are being financed; this could then be referred to during CWH on Wednesday. (Mr G P Smith's submission of 27 April refers.)

10. Mr Melliss said that the academic panel of twelve good men and true met seven or eight times a year, and contained no foreigners. Treasury economists attended as appropriate, depending on the subject under discussion. You said that the group was becoming very technical, and concentrated very much on modelling - now even micro-modelling.

SPJ

S P JUDGE
Private Secretary

CONFIDENTIAL

Chancellor of the Duchy of Lancaster

Nbl m v..

CH/EXCHEQUER

REC.	29 APR 1987 29/4
ACTION	CST
COPIES TO	

PRIME MINISTER

EC R&D FRAMEWORK PROGRAMME

Amédée Turner, the EDG spokesman on research and technology, came to see me yesterday. He is much concerned at the political impact of the continued lack of agreement over the research framework programme.

I made it clear to him that, while we recognised the improvements in the balance of the research and development programme, the so-called Presidency compromise remained too high and that we could not agree to a programme which would contribute to a breach of the budgetary discipline of the 1.4% VAT ceiling, nor one which broke the limits of the Chancellor's White Paper on expenditure.

The discussion has, however, left me uneasy. I would be the first to advise continued resistance to agreement if that were also likely to be of benefit in the wider context of EC Budget reform and control of agricultural spending. But I fear it will not; it is beginning to look to be more a weapon against us within the Community than a prop to budgetary discipline, allowing opponents to construe our position as one born solely of intransigence rather than of principle.

Amédée Turner drew attention to the next European Parliament Plenary Session beginning on 11 May, and the increasingly difficult position (as he sees it) in which he and his colleagues are placed. I would not overstate the importance of this, but this suggests the lack of time available before we must expect further political difficulty.

If, as it increasingly looks, agreement must come sooner or later, there are strong reasons for reaching it sooner rather than later. In the absence of agreement, we must expect some awkward political point-scoring against us. In particular this, in combination with other scare stories about the "brain drain" and domestic R&D effort, will be natural grist to the "alliance" mill, especially if, as time goes on, further projects are curtailed or halted pending agreement to the framework programme.

This underlines the need to reach an accommodation between Departments over PES provision which will allow us to accede to the Presidency compromise without a call on the contingency reserve.

I'm sure you would not wish this issue to overhang the June Summit ? European Council wasting discussion time and negotiating goodwill.

I am sending a copy of this minute to Willie Whitelaw, Geoffrey Howe, Nigel Lawson, John MacGregor, Paul Channon and to Sir Robert Armstrong.

NORMAN TEBBIT

29 April 1987

RT4.9 UNCLASSIFIED

bf with PWP advice

FROM: A W KUCZYS

DATE: 11 May 1987

MR CULPIN

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Monck
Mr Burgner
Mr Scholar
Mr Cropper
Mr Ross Goobey

RESEARCH AND DEVELOPMENT: INTERNATIONAL SURVEY

... Please see the attached note of 31 March from Mr Driscoll in the Inland Revenue. The Chancellor would be grateful if you could let him and the Financial Secretary have your views on publication, etc.

AWK

A W KUCZYS

GRS 1000

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FRAME INDUSTRY

EC R AND D FRAMEWORK PROGRAMME : MY TELNOS 1193 AND 1616

SUMMARY

1. CALLING OF THE GENERAL ELECTION HAS TO SOME EXTENT TAKEN THE HEAT OFF US HERE. BUT FRUSTRATION, AND CONCERN OVER DAMAGE PROGRAMMES, CAUSED BY THE DELAY ARE RISING AND WILL SPILL OVER INTO THE JUNE EUROPEAN COUNCIL IF DECISIONS HAVE NOT BEEN TAKEN BY THEN.

DETAIL

2. THE CONCERN EXPRESSED BY THE PRESIDENCY AT LAST WEEK'S COREPER OVER THE CONTINUED DELAY IN OUR RESPONSE TO THE PRESIDENCY COMPROMISE ON THE R AND D FRAMEWORK PROGRAMME WAS, TOGETHER WITH TINDEMANS' RECENT LETTER TO YOU, A FIRST SIGN OF MOUNTING FRUSTRATION AND IRRITATION. IT WILL NOT BE THE LAST. THE IMPLICATIONS OF THE ELECTION ARE DAMPENING DOWN THE CRITICISM IN THE SHORT TERM. BUT BY THE TIME OF THE EUROPEAN COUNCIL WE MUST EXPECT TO BE THE OBJECT OF STRONG PUBLIC CRITICISM IF WE HAVE NOT BY THEN DEFINED OUR POSITION.

3. PARTICULAR EMPHASIS IS NOW BEING GIVEN TO THE DAMAGE THE DELAY IS DOING TO SPECIFIC RESEARCH ACTIVITIES, EITHER EXISTING OR PROJECTED. THIS THEME IS BECOMING AN INCREASINGLY PROMINENT FEATURE OF PRESS AND PARLIAMENTARY COMMENT. WHILE SOME OF THE COMMENT IS EXAGGERATED - MUCH OF THE COMMUNITY'S R AND D ACTIVITIES WILL CONTINUE UNAFFECTED DURING THIS YEAR AND BEYOND - THERE IS LITTLE DOUBT THAT DAMAGE TO CERTAIN RESEARCH ACTIVITIES IS INCREASING.

4. IN MY TELNO 1193, I GAVE AN ASSESMENT OF THE POSITION AT THE BEGINNING OF APRIL. THIS IS STILL LARGELY VALID, BUT, WITH THE PASSAGE OF TIME, THE SITUATION ON THE GROUND IS BECOMING MORE ACUTE. THERE IS INCREASING LIKELIHOOD THAT THE 900 OR SO RESEARCHES PREVIOUSLY INVOLVED IN THE RACE (TELECOMMUNICATIONS) AND SCIENCE AND TECHNOLOGY FOR DEVELOPMENT PROGRAMMES WILL BE DEPLOYED ON OTHER RESEARCH ACTIVITIES AND MAY BE LOST TO THE TWO PROGRAMMES ONCE THEY ARE RESTARTED. THE POSITION ON ESPRIT ALSO IS WORSENING. THE COMMISSION ESTIMATE THAT FROM JULY ONWARDS APPROXIMATELY 60 RESEARCHERS PER MONTH WILL HAVE TO BE FOUND NEW ACTIVITIES AS PROJECTS UNDER ESPRIT I COME TO AN END AND CANNOT BE RENEWED OWING TO THE LACK OF FUNDING FOR ESPRIT II. IN THE CASE OF THE MEDICAL AN

TELE 18/5

Confidential

HEALTH RESEARCH PROGRAMME, WHICH IS LARGELY CONCERNED WITH COORDINATING MEMBER STATES ACTIVITIES, THE DIRECT EFFECTS ARE MORE LIMITED, BUT THERE IS GREAT POLITICAL SENSITIVITY IN THE CASE OF THE PROPOSED WORK ON AIDS AND CANCER. ON AIDS THE COMMISSION IS UNABLE TO INITIATE WORK TO INCREASE COOPERATION BETWEEN THE BEST RESEARCH TEAMS IN THE COMMUNITY. ON CANCER, THE MOST SIGNIFICANT DAMAGE WILL BE DONE TO THE WORK OF THE EUROPEAN ORGANISATION FOR THE RESEARCH AND TREATMENT OF CANCER (EORTC) (PRESIDENT - THE DUKE OF EDINBURGH) WHICH WILL HAVE DIFFICULTY IN FINANCING THE DATA CENTRE COORDINATING CLINICAL TRIALS ON CANCER ONCE THE PRESENT COMMUNITY FUNDING RUNS OUT IN JUNE. UNDER THE COMMISSION'S PROPOSAL FOR A NEW PROGRAMME APPROX 500,000 ECU PER ANNUM WOULD GO TO THE EORTC.

5. EVEN IF THE FRAMEWORK PROGRAMME WERE TO BE AGREED IN THE NEXT FEW WEEKS, IT WOULD BE LATE THIS YEAR OR EARLY IN 1988 BEFORE RESEACH CONTRACTS UNDER NEW PROGRAMMES COULD BE LET. THE DAMAGE TO SPECIFIC RESEARCH ACTIVITIES AND THE CONSEQUENTIAL LOSS OF MOMENTUM WILL BECOME MORE SERIOUS OVER THE COMING MONTHS. THE LOSS OF MOMENTUM WILL BE PARTICULARLY DAMAGING FOR ESPRIT WHERE THE PROGRAMME IS SHOWING SOME EVIDENCE OF THE COMMUNITY CATCHING UP WITH THE US AND JAPAN: AND FOR RACE WHERE THE BENEFITS OF COMMUNITY-WIDE COOPERATION INVOLVING ALL THE MAJOR PARTICIPANTS IN THE TELECOMMUNICATIONS FIELD ACHEIVED THROUGH THE RACE DEFINITION PHASE ARE GRADUALLY BEING DISSIPATED. THERE ARE ALSO LIKELY TO BE KNOCK-ON EFFECTS FOR OTHER MAJOR PROGRAMMES WHICH (BECAUSE OF THE DELAY IN AGREEING THE FRAMEWORK PROGRAMME) THE COMMISSION HAVE NOT YET PUT TO THE COUNCIL, MOST NOTABLY, BRITE, BIOTECHNOLOGY, STIMULATION, RADIATION PROTECTION (INCLUDING POST-CHERNOBYL WORK) AND FUSION (WHERE URGENT DECISIONS ARE NEEDED ABOUT THE LONGER TERM DEVELOPMENT OF JET AND OTHER FUSION ACTIVITIES).

6. NOTERDAEME'S REACTION TO MY REMARK THAT NOTHING WAS PREVENTING PREPARATORY WORK CONTINUING IN THE MEANTIME ON THE SPECIFIC RESEARCH PROGRAMMES SHOWS HOW SENSITIVE PEOPLE HERE ARE LIKELY TO BE TO ANY EFFORT TO TO BY-PASS THE FRAMEWORK PROGRAMME. THE STRUCTURE OF THE RELEVANT ARTICLES OF THE SINGLE EUROPEAN ACT IN ANY CASE MAKES THIS DIFFICULT TO ACHIEVE IN LEGAL TERMS. OUR OWN INTEREST MUST BE AGAINST BY-PASSING, SINCE A SERIES OF SPECIFIC PROGRAMMES ADOPTED BY QUALIFIED MAJORITY UNDER THE PROVISIONS OF THE SEA AND UNCONSTRAINED BY AN OVERALL FRAMEWORK FIGURE WILL ALMOST CERTAINLY END UP MORE /COSTLY

COSTLY OVER A FIVE YEAR PERIOD THAN THE PROPOSED FRAMEWORK. IT CERTAINLY WILL NOT END UP LESS COSTLY SINCE THE OTHER ELEVEN MEMBER STATES ARE NOW COMMITTED TO THE FIGURES IN THE PRESIDENCY COMPROMISE AND ARE IN THIS WAY ALSO COMMITTED TO VOTING THROUGH SPECIFIC PROGRAMMES AT THE LEVEL OF FUNDING SPECIFIED IN THE ANNEX TO THE FRAMEWORK PROGRAMME.

HANNAY

YYYY
ADVANCE
KERR FCO
WALL FCO
WETTON FCO
WILLIAMSON CAB
FAIRCLOUGH CAB
DONNELLY CAB
BUDD CAB
WILLIAMS RTP DTI
MOGG DTI
KEDDIE RTP DTI
HIRD ALVEY DTI
MILLS TP DTI
WINTER ODA
LAVELLE TSY
CRABBIE TSY
ROBSON DOE
FREMANTLE D/EN
AGRELL D/EN
METTERS DHSS
MAIN
FRAME INDUSTRY
ECO(I)

(ADVANCED AS REQUESTED)

COPIES TO ADVANCE ADDRESSEES.

UCLNAN 8334

NNNN

Confidential

28/5/87.

Ch
John Kerr still pressing v hard!
Shall I copy to CST?
AA

Yes.

N. Tebbit 'structures' is a non-starter: depts will not give up [illegible]

FCS/87/125

CHANCELLOR OF THE EXCHEQUER

EC R & D

1. We spoke last week about this wretched loose end, and the damage it will do us if it remains unsettled in the run-up to the European Council. I have since been brooding about it, in the course of campaign journeys, in the light of last Monday's Foreign Affairs Council in Brussels, when Delors attacked us pretty sharply.

2. He argued, understandably enough, that the research framework had been held up for eighteen months; the delay was now doing serious damage to important research programmes (ESPRIT/RACE/BRITE); over 200 contracts were blocked; 30 ESPRIT projects would end this year, with some 500 staff paid off, if no replacements could start; 400 RACE staff, having completed their project definition work, would have to go if the projects themselves had to stay on ice; and some cancer research work would have to end.

3. I was mainly concerned, of course, to get across our main points on the ex novo review and our opposition to the oils and fats tax, so that on this point I responded only by saying that we were still considering our attitude to the Presidency 5.6 becu compromise, and that the problems of the R & D framework were a good illustration of the damage done to other programmes by the chronic failure to control agricultural spending. But I naturally got no support.

HOME TO CH/EX 28/5

/4.

4. I can't confirm the precise facts as quoted by Delors: but UKRep telegram number 1699 (copy attached) shows that he wasn't exaggerating much, if at all. So we must expect increasing publicity for delays and redundancies, and consequent public and political criticism.

5. I wouldn't mind the isolation in the Community, or the criticism here, if I thought that we stood to gain anything by refusing to budge. But we don't: as soon as the Germans moved up to 5.6 becu, a programme at 4.2 became unachievable. Getting the post-'91 commitments firmly held back until post-'91 is of course essential, but only achievable when we too move to 5.6. And the wider argument that a move would make our European Council aims - on future financing, the abatement, budgetary control, and agriculture - harder to achieve is, I am convinced, totally wrong: the R & D factor is much more likely to weaken sympathy for our wider aims from our natural allies, eg in France and Germany, and to increase pressure for higher own resources and a lower abatement. Delors' remarks on Monday reinforce me in that judgement.

6. I should accordingly be most grateful if you could look at this problem again so that we can try to find another chance to discuss it together (you might like to glance at the attached note, which is FCO officials' latest statement of the facts, and which I enclose on a strictly personal basis). I confess that I still am attracted by Norman Tebbit's solution - his minute of 29 April - which strikes me as having considerable attractions, not least for the Treasury!

/7.

7. I am not, of course, copying this minute to anyone.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

28 May 1987

R & D FRAMEWORK PROGRAMME

Negotiating History

1. The Comission launched the discussion in early 1986 on the basis of a 10.3 billion ecu (£7.2 billion) Framework Programme over 5 years. In July 1986 they put forward formal proposals for a 7.735 becu (£5.4 billion) programme. The UK suggested a programme at 4.2 becu (£2.96). At the 24 March 1987 Research Council the Belgian Presidency put forward a compromise proposal of 5.6 becu (£3.9 billion) plus a tail of 860 mecu which would not be committed before 1992. The compromise was accepted at the Council by 10 Member States and subsequently by the Germans. The programme now proposed meets the UK objective of greater concentration on industrially oriented research (57% compared to 28%) of current Community;funded research).

UK Contribution/Receipts

2. On the basis of a 5.6 becu programme the UK financing share would be about 200 mecu (£140 million) a year. In 1986 the UK received 24% of total EC R&D expenditure. If this rate of return is maintained the benefit to the UK from the Framework would be about 270 mecu (£189 million) a year. Taking into account the consequences of the Fontainebleau abatement we would still be net beneficiaries by about £16 million a year.

UK Financing Costs

3. The financing costs (above the EUROPES baseline) of a 4.2 becu programme would be £69 million over 5 years. The financing cost of a 5.6 becu programme would be £206 million. The Chief Secretary has already negotiated EUROPES baseline adjustments to cope with our contribution to a 4.2 becu programme; the additional cost of a 5.6 becu programme would be £137 million, or £27 million a year (rising from £9.2 million in 1987 to £45.7 million in 1991). Only two Departments (DTI £11.7 million a year, D/En £7.4 million a year) would incur a cost above £1 million a year from moving to a programme at 5.6 becu compared with 4.2 becu. In earlier discussions DTI indicated they could absorb £8 million a

year. D/En have also given some indications that they might get by without a call on the contingency reserve because of their public sector receipts.

Relationship to other EC spending

4. A 5.6 becu programme would result in no increase in real terms in EC expenditure on R&D. The 1987 budget contains provision for 1040 mecu commitments for R&D. An annual rate of increase of 4% would result in expenditure over the five years 1987-1991 of over 5.6 becu. The "maximum rate" which governs non-obligatory expenditure has been over 7% in recent years and is 7.4% for 1988, although it is expected to fall in future years. So the rate of increase for R&D will be less than for other non-obligatory spending.

Legal implications of not agreeing a Framework Programme

5. Research programmes are currently agreed under Article 235 of the EEC Treaty which allows the Council to take action where the Treaty "has not provided the necessary powers." Once the SEA comes into force this Article will no longer be available. Under the SEA the Framework Programme has to be adopted by unanimity before any individual programmes can be adopted (by qualified majority). Without a Framework EC research will gradually grind to a halt. Our legal advice is that the Commission/the other Member States could not legally get around this problem. However, they would certainly combine to say that they were not prepared to see EC R&D held to ransom by the UK and they would try to find ways of undermining our veto. For example, the European Parliament, with the connivance of other Member States, might refuse to adopt a budget containing provision for our abatement unless it also contained provision for R&D on the basis of an agreed framework.

Implications for research in the UK

6. The implications of delay on current EC research programmes were discussed in UKRep telno 1699 (below). The key programmes concerned are:

MA2AIU

- RACE (advance telecommunications) The Definition phase of RACE (RDP) has been completed and the Main Phase (RMP), which was due to start at the beginning of the year, is being delayed. The Commission believe that researchers involved in the RDP will be reassigned to other work. The UK received 32% of the 20 mecu funding under the RDP. 52 UK research institutes and companies, including BT, GEC, Plessey and BICC were among the 192 participants involved in 32 contracts. The UK was in the lead in 14 of these contracts: there was a British presence in all but 6.

- ESPRIT (Information technology) The Commission say they will have to start laying off researchers involved in ESPRIT at the end of the month and that about 60 researchers a month will be laid off as projects under ESPRIT I come to an end. Over 50 UK firms, including ICL, Barr & Stroud of Glasgow and Mari International of Newcastle, plus 40 research institutes; are involved in ESPRIT I.

ps3/47K

PERSONAL AND CONFIDENTIAL

CP

FROM: A W KUCZYS

DATE: 29 May 1987

PS/CHIEF SECRETARY

... The Chancellor has asked me to copy the enclosed papers to the Chief Secretary. He has commented that Mr Tebbit's "solution" is a non-starter: Departments will not give up good research for bad; and why should they?

2. There was a helpful article in The Spectator last month, which I am sending separately to the Foreign Secretary's office.

AWK

A W KUCZYS

ps3/46K

cc PS/CST
Ms Lavelle

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

29 May 1987

Lyn Parker Esq
Private Secretary to the
Secretary of State
Foreign and Commonwealth Office
Downing Street
LONDON SW1A 2AL

Dear Lyn

EC R&D

The Chancellor has seen your Secretary of State's personal and confidential minute of 28 May. Like the Foreign Secretary, he is away from the office until after the Election. Meanwhile, he has asked me to send the Foreign Secretary the enclosed article from The Spectator of 18 April.

Yours ever,

Tony

A W KUCZYS

ANK
TO
PS/FCO
29/5

HOW THE EEC RUINS RESEARCH

Terence Kealey argues that Britain is right to stop the EEC spending more on scientific research

BRITAIN'S foreign policy seems, for the present, to have been delegated to junior ministers at the Department of Trade and Industry. While Michael Howard has been sent to fight for the traders in Tokyo, his colleague Geoffrey Pattie has been holding the line against our EEC partners in Brussels. Michael Howard's job has been, perhaps, the more straightforward, because people are prepared for a trade war against the Japanese. For Geoffrey Pattie, Minister for Information Technology, life has been rather lonelier.

The EEC, as everybody knows, finances the Common Agricultural Policy. Less well known is the fact that the EEC also finances a programme of support for research and development into technology called 'Framework'. This not inconsiderable programme had a budget for the years 1983–1987 of approximately £2,100 million (approximately, because EEC budgeting is so imprecise that individual officials quote figures that differ by millions of pounds). M. Guy Verkosaft, the Belgian research minister and president of the EEC Research Council, has wished nearly to triple this to £5,900 million for the years 1987–1991. He argues that this expansion is crucial to Europe's competition with the US and Japan.

France and Germany originally joined us in opposing this increase, but they have since agreed to a compromise budget of £4,000 million. Only Britain is now holding out, for a ceiling of £2,940 million, and because all council decisions have to be unanimous, we have completely blocked the expansion.

Our isolation has been acute. Under strong headlines ('Research Funds Fury at EEC', 'Britain Odd Man Out') the *Times* has reported the anger that now consumes Brussels. 'If Mr Pattie forces a political crisis,' one official is reported to have said bitterly, 'the research programme will collapse and cause the loss of 3,000 jobs.'

Is Mr Pattie a luddite? Can he not see that Europe must build up its technological base if we are to compete?

Curiously, it can be shown that Britain, and Britain alone, is right on this issue. The evidence is various but it should first, perhaps, be noted that we are not so isolated as we appear. Privately, many officials will acknowledge that Germany and France share our doubts, but they are happy to nurture their reputations as *bons communautaires* under the umbrella of our now famous obduracy. This shared doubt is very important. The only three countries in the EEC who actually understand science are Britain, Germany and France. The others are either too small or too uninterested to make significant contributions. It would be ridiculous if our judgment were to be overruled by nations with the scientific traditions of Ireland, Portugal, Spain and Greece.

The British Government's major worry over Framework is pragmatic. Is the money being spent properly? This concern first surfaced during our chairmanship last year of the EEC Research Council, when Mr Pattie found that the officials simply could not tell him how much money was being spent on particular projects. Eventually, in the face of much-publicised resentment, Pattie commissioned an independent report under the chairmanship of Mr Harry Becker, research director of Shell. Becker and his panel were asked to examine the workings of the Joint Research Centres. These technical establishments, which study aspects of nuclear reactor safety and radioactive waste disposal, consume a quarter of the Framework budget. Becker's report was damning — so much so that the EEC Commission itself acknowledged publicly on 6 April that the research centres were over-bureaucratic, out of touch with industry's needs and inflexibly managed. In short, millions and millions of pounds had been wasted.

None of which has dampened the Research Council's desire for gross expansion. The bulk of Framework's money goes on 'shared contracts' through schemes like Esprit. Officials in Brussels will define areas of technology they wish to see developed — improved silicon chips, for example — and they will invite industrialists and researchers to form consortia and to bid for funds. Should a proposal be found satisfactory, Framework will bear half the cost of the R and D. These gifts of money average up to £10 million spread over four years.

Such a scheme is obviously open to abuse. Is the money being spent as promised? Is it being spent efficiently? Are early findings being evaluated so as to justify continued funding?

The responsibility for answering these questions devolves on the monitoring officers. Under Framework they have a hopeless task. Each officer is made responsible for four or five separate projects, each of which, because this is an EEC programme, has to be split between at least two different countries. Each officer, therefore, finds himself trying to scrutinise a budget of tens of millions of pounds, divided internationally between many separate factories and universities. It has become notorious that the Framework monitoring programme is inadequate. Site visits rarely occur and the only regular audit is made on the companies' own monthly reports and the six-monthly reviews. This is unacceptable. In the absence of proper evaluation there is, sadly, no reason to believe that the EEC shared-cost contracts are any more efficently run than joint research centres.

There is, however, a more fundamental objection to Framework. The EEC maintains that member states cannot conduct efficient national research programmes against the might of Japan and the US. This is a complete misunderstanding of the nature of much advance in technology. In rapidly advancing fields like information technology, experience has shown that crucial developments are often the work of new, small, entrepreneurial companies. This can be illustrated by the American electronic experience. Electronics were dominated until the early 1950s by the vacuum tube. It was the discovery of the transistor that revolutionised the field and has led to the current explosion in semiconductors. Of the ten leading American producers of vacuum tubes in 1955, only two were among America's largest semiconductor producers in 1977. Of the top ten semiconductor producers, four did not even exist in 1955. This shows that efficient development in information technology is not promoted by gargantuan, bureaucratic, centralised planning agencies, but by innovative entrepreneurialism.

Unfortunately, it is precisely the small entrepreneurs who experience the greatest difficulties in raising EEC funding. That generally goes to the big boys who can afford to employ full-time experts in making applications to the Brussels bureaucracy. One of the problems with Brussels is that Europe is too big for the officials to know the qualities of the companies applying. Success in winning grants, therefore, depends as much on the appearance of the application forms as on the track records of the applicants themselves.

Framework and Esprit have obviously not been entirely useless. Within the narrow niche of promoting European cross-fertilisation of technology, some good work has been done. But until Esprit can provide evidence that its activities have helped dent foreign penetration of our markets, and it is noteworthy that no such study has been commissioned, there can be no case for further expansion. Indeed, expansion carries the danger that research funding would become so subsidised in the areas that Brussels approves, that companies would become inhibited from paying for research in other, unsubsidised fields — a worrying vulnerability.

The trouble with EEC funding is that it is not accountable. Instead, it is controlled by enthusiasts who regard European collaboration as an end rather than a means. Before Esprit receives even more money, its supporters should, perhaps, explain how it is that Japan can thrive with so much smaller a proportion of its R and D being publicly funded than is the case in Europe. The worry is that the EEC is doing for technology what it has done for farming. The experience of countries like the US and Japan indicates that the most important requirement for technological innovation is an entrepreneurial environment. The EEC Commission does not promote such an enviroment; it destroys it.

BLOODSTAINED WHITEWASH

***Dhiren Bhagat** finds the new report on a massacre of Sikhs inferior to the 1919 version*

New Delhi

IT IS useful when reading the official report on the massacre of Sikhs following the assassination of Mrs Gandhi to remind oneself that Rajiv Gandhi's government is not the first to have resisted ordering an inquiry into a terrible massacre, or, having ordered it, tried to obtain a result more favourable to themselves. Mr Justice Mishra's report was submitted last July and was tabled before the Indian government in February. On 13 April 1919 the massacre of Jallianwallah Bagh took place; as late as 22 May, the Secretary of State for India, Edwin Montagu, under pressure in the House of Commons, said in the Budget speech, 'Let us talk of the inquiry when we have put the fire out.' A week later, the war in Afghanistan was over and the Punjab became peaceful. Now there was no reason to delay the inquiry.

The telegraph wires connecting Delhi to London buzzed with communications between Montagu and the Viceroy, Lord Chelmsford, who expressed real reluctance. So we find Montagu imploring Lord Chelmsford not to adopt the view that the Government of India had to defend whatever had been done or that the inquiry had to whitewash everything. 'In that case we shall have achieved nothing and we shall have done more to embitter feelings than anything.'

If only this sound advice had been wired to *our* government of India. In time, the Disorders Inquiry Committee 1919 was appointed with Lord Hunter, the Solicitor-General for Scotland, as its president and seven other members: three British civilians, one British general and three Indians. Historians aside, few today bother to read the Hunter Committee report; certainly it does not appear Mr Justice Mishra has.

The most horrendous evidence in the Hunter Committee report is contained in the cross-examination of General Dyer.

'When you got into the bagh [park], what did you do?'

'I opened fire.'

'At once?'

'Immediately. I had thought about the matter and don't imagine it took me more than 30 seconds.' Since the general had admitted that a good many people in the bagh would not have heard the proclamation made earlier that day prohibiting processions or gatherings, Lord Hunter asked, 'Did it not occur to you that it was a proper measure to ask the crowd to disperse before you took that step of actually firing?'

'No, at that time it did not. I merely felt that my orders had not been obeyed . . . .'

'Before you dispersed the crowd, had the crowd taken any action at all?'

'No sir, they had run away, a few of them.'

And later:

'Did the crowd at once start to disperse as soon as you fired?'

'Immediately.'

'Did you continue firing.'

'Yes.'

'After the crowd indicated that it was going to disperse why did you not stop?'

'I thought it was my duty to go on until it dispersed.'

In reply to a question from Justice Rankin. Dyer went so far as to say, 'I had made up my mind I would do all men to death if they were going to continue the meeting.' But it was Sir Chimanlal Setalvad's cross-examination that really tripped up Dyer, who was rash enough to volunteer replies to hypothetical questions.

'Supposing the passage [into the bagh] was sufficient to allow armoured cars to go in, would you have opened fire with the machine guns?'

'I think probably yes.'

When it came to preparing a report, unanimity proved difficult and the committee split on racial lines. Even so, both the majority report and the minority report were published under the same covers. There was no ground to believe that Hunter had headed a cover-up operation. Even the report of the Punjab Subcommittee of the Indian National Congress drew freely on testimony given to the Hunter Committee by Dyer and others.

Mr Justice Mishra, alas, was too busy to cross-examine any of the prominent Congressmen against whom grave allegations have been made in the depositions: allegations that they instigated and organised the massacres. He had better things to do. When not making trenchant observations about the viewing habits of children ('They are more punctual than adults in viewing television programmes') he is busy quoting Mueller's eulogies about the spiritual wealth of India. When he has finished exhorting 'everyone in society . . . to put in great efforts in the right line, first to stop the downward trend and then, raise the same up' he busies himself with insisting that 'every Indian must feel proud to have been born in India'.

Must we? Certainly there is little in Mr Justice Mishra's report to justify such pride. Take the case of H.K.L. Bhagat, the only member of the cabinet to have been implicated in depositions before the Mishra Commission. The Mishra Commission had no intention 'of separately dealing with the case of Shri Bhagat'.

According to affidavits filed by at least five people, Mr Bhagat held a meeting at the home of a Congress (I) worker, Shyam Singh Tyagi, in Shakharpur on the night of 31 October 1984 during which he directed those present to kill Sikhs. Mr Justice Mishra waves away these affidavits with a single sentence: 'The evidence regarding what transpired is scanty.' It will not do.

Inland Revenue

Policy Division
Somerset House

PBT circulate to [illegible] & let me know (or FST) have his views on publication etc.

FROM: P J A DRISCOLL
EXT: 6287

31 March 1987

1. MR McGIVERN A very helpful report which I believe Ministers should consider publishing after we have had DTI's reactions.

2. FINANCIAL SECRETARY

31/3

RESEARCH AND DEVELOPMENT: INTERNATIONAL SURVEY

1. You may recall that following an ACARD report last autumn we undertook (my note of 14 November 1986) to carry out a survey of the tax treatment of R&D expenditure in a number of overseas countries. The Chief Secretary referred to this work at the meeting of the Ministerial Committee E(RD) on 19 November 1986. But we have succeeded, so far as we know, in avoiding any public reference to this report as such, as distinct from references to our continuous monitoring of the position in other countries.

2. I now enclose a copy of our report (not attached) which is the product of work carried out jointly by Inland Revenue and Treasury officials. We have met officials of the French, West German and United States Governments and of the OECD; and have corresponded with officials in Australia, Canada and Switzerland.

3. We have shown parts of the report and of the Appendices to DTI officials.

---

cc. Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Mr Gilmore
Mr Monck
Mr Burgner
Mr Scholar
Mr White
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Mr Isaac
Mr Painter
Mr Taylor Thompson
Mr McGivern
Mr Beighton
Mr Lawrance
Mr Calder
Mr Weeden
Mr King
Mr Rodway
Mr Greenslade
Mr Elmer
Mr Driscoll
PS/IR

. The report covers the ground described in the synopsis attached to my note of 14 November 1986 but for ease of presentation much of the factual material for the ten study countries is given in appendices. Appendix A gives details of the treatment of R & D expenditure in the ten countries.

5. In order to do justice to the wide range of material and the issues involved the report is a lengthy one. However, our conclusions are given in an Executive Summary (pages (ii) and (iii)) which reproduces the final section 4.

Key findings

6. Very briefly, our key findings can be stated as follows:

- Australia and Canada offer significant subsidies to R&D investments, France and the USA a very small one, while in the other survey countries, including the UK, the position is broadly neutral;

- there is not a worldwide trend to increase tax subsidies. Some countries have been pulling back recently;

- best estimates suggest that only about half of the tax revenue forgone under tax subsidy schemes is spent on additional R&D (which is even worse than the evidence on public expenditure grants).

Lessons for the UK

7. In our view the report does not present any compelling evidence for increased tax relief for R & D in the UK. On the contrary, as noted, the evidence suggests that the reliefs represent very poor value for money, with perhaps 50% of the revenue forgone finding its way into company coffers or distributions. And the UK is not out of step with the rest of the world.

number of our competitors either have no special reliefs or are letting schemes expire. Other schemes are under review. Moreover, there is nothing in this report to question the broad thrust of the 1984 reforms which removed the distortions to investment decisions which can result from reliefs of this kind.

Handling inside and outside Government

8. We think that you (FST) will probably want to hold a meeting to discuss the report with us and with Treasury officials before the Chief Secretary reports back to E(RD). We shall, in due course, provide a covering paper and a brief for the Chief Secretary's E(RD) meeting.

9. No particular time limit has been fixed for this item to reappear on the E(RD) Agenda although in February Ministers were told that the survey would be ready "in the Spring" of 1987. Subject to other pressures, Treasury Ministers may think it a good idea to retain the initiative in this area by arranging for it to be discussed at the Committee's first meeting after Easter (date to be arranged - possibly mid-May).

10. Treasury Ministers will also want to consider the uses to which the report should be put. We shall be drawing heavily on it for Finance Bill briefing and using it for the NEDC discussion of Innovation on 1 April.

11. It is for consideration whether and, if so, how the report should be published. There are arguments both ways here. On the one hand, it has since 1977 been policy under both Governments to "publish as much as possible of the factual and analytical material used as the background to major studies". And it shows the sort of work that is done when Treasury Ministers are considering major tax changes. On the other hand, publication could stimulate yet further debate on this subject and lead to time-consuming correspondence and discussion on detailed points and to calls for an annual updating of the report to be published

each year <u>ahead</u> of the Budget. (In any event, now that the data have been assembled we propose to up-date them annually as part of our monitoring of other countries' treatment of R & D expenditure). Before a final decision is taken on publication it will be helpful to have DTI's reaction to the report - which they have not yet seen in its entirety. This is something you may want to discuss.

12. And even if the report itself is not published it could, we suggest, form a useful quarry for articles/papers for external purposes on particular aspects of the subject.

P J A DRISCOLL

Inland Revenue

Policy Division
Somerset House

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P J A DRISCOLL

28

Foreign and Commonwealth Office

London SW1A 2AH

H/EXCHEQUER
REG. 03 JUN 1987 3/6
ACTION CST
COPIES TO Mr Lavelle.

3 June 1987

Dear Tony,

EC R & D

With your letter to Lyn Parker to 29 May you enclosed a copy of Kealey's piece in the Spectator of 18 April.

The Foreign Secretary, who had seen it at the time, has commented that:

- Kealey's thesis is not generally shared in the serious UK press;

- his point about the misdirection of EC research funds is overtaken by our success in securing greater concentration on industrial-related projects designed to improve competitiveness; but

- he does however have one good point - the need for improved evaluation. Securing this should be a condition of our agreement to the 5.6 becu framework programme. But we can't of course secure anything while we remain stuck, as at present.

Yours ever,

Tony Galsworthy

(A C Galsworthy)
Private Secretary

PS/FCO TO ANK 3/6

A W Kuczys Esq
APS/Chancellor of the Exchequer

Pps (6)

2786/15

FROM: C D CRABBIE
DATE: 9 JUNE 1987

PS/Chief Secretary

cc: PS/Chancellor
Mr Lavelle
Mr Edwards
Mr Evans o/r
Mrs Meason
Mr Burgner

CRABBIE TO PS/CST 9/6

EC R&D

The Chief Secretary asked for advice on some points in the note attached to the Foreign Secretary's minute of 28 May to the Chancellor (copy attached).

2. In paragraph 2, the paper overstates the likely net benefit (i[n] cash, not scientific terms) to the UK. We will not obtain 24% o[f] receipts under the new Framework: according to DTI and the Scienc[e] and Technology Secretariat in the Cabinet Office, it is likely t[o] be 18% at the most. So it is nonsense to assert that we may well be net beneficiaries to the tune of £16m a year: in reality we would be lucky to break even in cash terms. And however many receipts we obtained, the real effect would be an increase in public expenditure to finance low priority research at the expense of national scientific objectives.

3. In paragraph 3, the presentation of UK financing costs is a slanted interpretation of tables we have already circulated. It illustrates the extra costs **above** the 4.2 becu programme to whose financing cost we managed (with great difficulty) to commit Departments. Thus while it is true if misleading to note that the additional cost of the Presidency "compromise" over and above a 4.2 becu programme would be £137m, the additional cost over **actual** EUROPES baselines would be £206m. The total offsetting savings required from Departments of a 5.6 becu programme are illustrated in the attached table, which assumes redistribution. You will note that the figures are substantially larger than those indicated in the Foreign Office's piece. DTI would have to find an average of £15.5m p.a, Department of Energy £13.4m p.a and DOE £1.5m p.a. Although Mr Channon has indicated privately to the Foreign Secretary that his Department could produce up to £8m a year savings, I know of no evidence (and plenty

the contrary) to support the Foreign Office's claim that the Department of Energy could live with their offsetting savings unless they were allowed a category of public sector receipts which we do not regard as admissible.

4. In paragraph 4 of the paper it is asserted that a 5.6 becu programme constitutes no real increase in R&D. This is simply untrue. As E(A) was informed last November, 4.2 becu constituted level spending: 5.6 becu is a real increase of c.30%.

5. In paragraph 5, the Foreign Office paper maintains that acceptance of the Presidency "compromise" would protect our abatement from attack by other Member States and/or the European Parliament. This is tantamount to saying that unless we give up our legal right to object to a profligate programme, our partners will act illegally against us. The Foreign Office might argue that we should surrender in face of such a threat (whose existence we actually doubt): I am sure the Prime Minister and HMT would not.

6. To summarise, the Foreign Office paper gives the impression that the problems are smaller and the advantages greater than they really are. Given the difficulties we had in negotiating an interdepartmental agreement of 4.2 becu, I see no chance of getting them to agree to a 5.6 becu programme unless the Exchequer bears most of the extra cost. This we must oppose. At present at least a third of EC R&D funds are wasted: we should not encourage this with an injection of Exchequer cash any more than we should oblige Departments to make offsetting savings from their own R&D programmes unless they choose to do so on the intrinsic merits of the European framework.

7. The Foreign Secretary's own covering note is less than accurate. The figures he gives for staff lay offs are, by his own admission, those provided by Delors. The best advice in London is that these are wild exaggerations: almost the only redundancies are likely to be of Eurocrats who have been engaged on temporary contracts to do project definition.

8. This will come to the boil between the Election and the European Council on 28/29 June. Although it must surely be for E(A) to consider

If any change in our existing policy is needed, the Foreign Office will try to slip a decision through OD(E) on 16 June, when Ministers are due to discuss our approach to the future financing issue at the Council. We will obviously need to be on our guard to avoid a decision to accept the compromise in principle with an instruction to the Chief Secretary to sort out the financing issue later.

C D CRABBIE

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	1987	1988	1989	1990	1991	TOTAL	AVERAGE
	£m						
DTp	[-0.27]	[-0.06]	0.21	0.45	0.61	0.9	0.18
DOE	1.32	2.02	1.46	1.22	1.58	7.6	1.52
DHSS	0.03	0.62	1.14	0.52	0.4	2.7	0.54
DTI	[-12.94]	[-2.22]	14.55	30.57	42.54	72.5	14.5
+JRC(non-staff)	**[-11.89]**	**[-1.08]**	**15.44**	**31.49**	**43.47**	**77.4**	**15.5**
MAFF	[-1.4]	[-0.004]	0.84	1.68	2.18	3.7	0.74
DEn	18.31	17.67	8.5	4.5	4.22	53.2	10.64
+JRC(non-staff)	**21.25**	**20.86**	**11.0**	**7.08**	**6.82**	**67.0**	**13.4**
DES	[-1.0]	[-0.23]	0.72	1.64	2.2	3.3	0.66
Unsponsored	[-3.72]	[-0.14]	2.94	6.02	7.87	13.0	2.6
JRC	10.51	11.37	8.93	9.22	9.29	49.3	9.86
of which staff costs	**6.31**	**6.82**	**5.36**	**5.53**	**5.57**	**29.59**	**5.92**
TOTAL	11.2	29	39.3	55.8	70.9	206	41.2

RT4.32

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PP

FROM: A W KUCZYS

DATE: 10 June 1987

MR CRABBIE

cc PS/Chief Secretary
Mr Lavelle
Mr A Edwards
Mr H P Evans
Mr Burgner
Mrs Meason

FINK TO CRABBIE 10/6

EC R&D

Your (unclassified) minute of 9 June to the Chief Secretary referred to the Foreign Secretary's personal and confidential minute of 28 May to the Chancellor. Sir G Howe did not copy his minute to anyone. Please could you and copy recipients ensure that it does not get back to the Foreign Office that Treasury officials are widely aware of the Foreign Secretary's minute?

A W KUCZYS

003/3292

FROM: JILL RUTTER
DATE: 11 June 1987

PS/CHANCELLOR

PS/CST TO PS/CH 11/6

cc:
Mr F E R Butler
Mr Lavelle
Mr A J Edwards
Mr Burgner
Mr Crabbie
Mr Evans
Mrs Meason

EC R & D

The Chief Secretary has seen Mr Crabbie's minute of 9 June.

2 He found this very helpful.

3 The Chief Secretary has some comments on the points made in Mr Crabbie's minute. He thinks we should make clear to the Foreign Office the point about our being unlikely to be net beneficiaries even in cash terms. The Chief Secretary believes we must also challenge the Foreign Office's claim that the Department of Energy could live with their offsetting savings, but a 5.6 becu programme represents no real increase in R & D and that the figures for staff layoffs are an exaggeration.

4 The Chief Secretary's view is that the Treasury should be prepared to circulate a note in advance of any Ministerial discussion covering the points I have highlighted in this minute.

JILL RUTTER
Private Secretary

CONFIDENTIAL

CRABBIE
TO
PS/CH
12/6

2786/43

PS/Chancellor

FROM: C D CRABBIE
DATE: 12 JUNE 1987

cc: PS/Chief Secretary
PS/Minister of State
Mr Lavelle
Mr Burgner
Mr Edwards
Mr Gieve
Mr Mortimer
Mr Donnelly
Mr Evans o.r
Miss Bogan
Mrs Meason o.r

OD(E) 16 JUNE - EC RESEARCH AND DEVELOPMENT

I attach briefing for the above meeting. Although future financing is the primary agenda item, I understand that the Foreign Secretary will raise EC R&D in an effort to reopen E(A)'s decision to aim for a 4.2 becu framework. There is no realistic prospect that spending Departments would be prepared to make the major diversion of resources from domestic to EC R&D implicit in the 5.6 programme currently being touted: acceptance of a framework of that size would therefore place us under pressure to fill the gap with extra public expenditure (c.£150 million). So any meeting which OD(E) might mandate the Chief Secretary to hold to "sort out the financing arrangements" is bound to prove unproductive. It should be discouraged.

2. With one exception, the brief takes account of the Chief Secretary's helpful comments recorded in Miss Rutter's minute of 11 June. The exception is his wish that we should challenge the Foreign Secretary's assertion in his letter to the Chancellor that he has evidence that the Department of Energy could bear the financing costs of a 5.6 becu programme. Given that this point was made privately to the Chancellor, it seems best not to address it in an open meeting. However the Chancellor might care to take an opportunity to mention privately to Sir G Howe that the only way in which Energy would accept such financing costs would be if we allowed them to take credit for certain public sector receipts relating to the Atomic Energy Authority which cannot be allowable if EUROPES is to be a properly effective discipline.

Christopher Crabbie

C D CRABBIE

CONFIDENTIAL

2786/32

OD(E) 16 JUNE - EC RESEARCH AND DEVELOPMENT

OD(E) is to discuss our policy on the future financing negotiations which will begin in earnest at the European Council on 28/29 June. However the Foreign Secretary believes that attainment of our objectives in those major negotiations may be hampered if, in another part of the woods, we continue to hold out against the 5.6 becu R&D framework programme which all other member states are prepared to accept. R&D is therefore certain to be raised as an issue pertaining to our overall strategy at the European Council. Cabinet Office have not prepared a detailed paper.

Objective

To prevent the meeting from taking a substantive decision on whether or not to acquiesce in the 5.6 becu framework. This is for E(A), which took the original decision that the UK should aim for a maximum figure of 4.2 becu. To discourage Sir G Howe from calling on an ad hoc group of Ministers simply to sort out the domestic financing problems necessary to allow UK acceptance of the proposed framework: this would inevitably be unproductive.

Points to make

1) **UK negotiating objectives.** The 5.6 becu proposal is still much too high. No convincing case has been made that a programme of this size is scientifically justified (E(A) was advised last November that a 5 becu framework was just about justifiable). Acknowledge that the shape is better, but this has been achieved by massively boosting industrial research rather than cutting wasteful programmes. Do not accept that we cannot bring about further reductions if we are determined enough to maintain our right to say 'no' to profligate spending. Nonsense to plan major (30%) expansion of activity before we have sorted out the budget mess. Particularly bad precedent to agree on something which the Commission has specifically proposed should be outside the constraints of the maximum rate. We should argue (as the Prime Minister did at the London European Council) that we cannot consider any increase in R&D until we have a clearer picture of the overall level of resources available. This would be consistent with our general approach to the future financing negotiations;

2) **Linkage to future financing.** No evidence that the firm UK attitude on R&D might be 'punished' with hostility in the future financing negotiations. Our alliances on the latter will be built on common interests, not out of gratitude or resentment over UK policy on R&D. Surrender on the latter could, indeed, be interpreted as a sign that we were not serious about bringing Community spending under proper control;

3) **Decision making.** E(A) decided our original policy. Wrong for OD(E) to try to amend it when a number of those involved are unrepresented. Could not accept an 'orientation' from OD(E) to E(A) or a remit to an ad hoc group simply to resolve the financing consequences arising from a decision in principle to accept a 5.6 becu framework. The E(A) decision was that we must resist any increase in public expenditure as the result of the R&D proposals. At the last ad hoc meeting on 11 March the spending Departments concerned chose not to divert resources from domestic to an EC programme of more than 4.2 becu. 5.6 becu is a different ball park. Our objective must be to withhold agreement until the framework **is** acceptable and the overall budget position is brought under control.

[If necessary]

Defensive

Many scientists will be thrown out of work. No proof at all. One can hardly throw out of work people whose jobs have not begun. Some officials working on project definition might find that their temporary contracts expired. But most scientists would be redeployed on other projects, many of which are likely to be scientifically better. Plenty of projects and resources (over 1 becu) to keep things going until this is resolved. R&D will not stop because of a UK veto. It may wind down, but probably not by much in the immediate future. Note that Commission are already finding ways of funding a new medical health programme (including cancer and Aids).

Europe's competitive edge v US/Japan will be blunted. EC R&D is about 2% of Europe's overall research effort. Much of the existing programme is incontrovertibly bad. Not at all optimistic that new one will be much better.

Our abatement may be attacked in retaliation. Tantamount to saying that if we exert our legal right to resist an extravagant proposal, our partners will act illegally against us. This Government has not made it a practice of succumbing to such threats (whose existence is doubtful anyway).

We've already done well in almost halving the Commission's original proposal (10 becu+). No guarantee that 5.6 becu ceiling would hold. On present formulation, "Commitments overhang" unlikely to stay outside the 5 year period: **actual** level more likely to be about 6.4 becu, ie over £1.5 billion more than E(A) decided as our objective last November. UK would have to pay nearly £300 million of that increase: even if we did negotiate a satisfactory guarantee against that, our total contribution to a 5.6 becu programme would still be over £700 million. A poor bargain involving massive diversion of national resources.

Unrealistic to achieve further reduction. We can only discover if this is true by holding firm, at least until we see how effectively the overall budget can be controlled.

UK would be handsome net beneficiary: we got 24% of the last Framework. Our advice is that we might just manage to break even this time. Enlargement and the general decline in our receipts share in all areas suggest this is the most we can expect. And even if we obtain that, the real effect would be increased public expenditure and/or diversion of resources to finance low quality EC research at the expense of national science.

BACKGROUND

Having been predictably deserted by the French and Germans, we are on our own in opposing a framework of 5.2 becu over 5 years. Since we have a rare veto, we can hold things up fairly effectively. This is unpopular with our partners and the scientific lobby in the UK, and FCO are mounting an intense campaign to overturn E(A)'s decision last November that we should aim to negotiate a 4.2 becu R&D framework. They claim that our abatement may be attacked or that we will suffer other retaliation in the important future financing negotiations if we do not cave in.

2. The proposed framework is grossly inflated by the usual Community process whereby compromise is achieved through offering everyone a prize. Admittedly the proposed 5.6 becu framework is better shaped than the existing programme since there is more emphasis than before on industrially-related R&D. But this improvement is obtained by massive increases in possibly worthwhile programmes rather than by reductions in the existing bad ones. It is the same technique that the Commission has applied to the ex novo review, whereby better shape is achieved by proposing increases in the allegedly good Structural Funds rather than through reductions in the reputedly bad Agricultural sector.

3. The EUROPES system has played a major role in shaping our negotiating position. The Chief Secretary managed (with great difficulty) to persuade Departments to accept the offsetting savings implicit in a 4.2 becu programme on the basis of a redistribution of baseline provision to reflect the shape of a new framework. It is most improbable that he could repeat the trick at 5.6 becu, with the result that the Exchequer would be under intense pressure to fill the financing gap by allowing extra bids. In such circumstances, public expenditure could rise by some £150 million over 5 years. E(A) agreed in November that any increase in public expenditure should be resisted.

4. The financing costs to Departments (ie the offsetting savings required) of a 5.6 becu programme are as follows:

REDISTRIBUTED

£m

	1987	1988	1989	1990	1991	TOTAL	AVERAGE
DTp	[-0.27]	[-0.06]	0.21	0.45	0.61	0.9	0.18
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DTI	[-12.94]	[-2.22]	14.55	30.57	42.54	72.5	14.5
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DEn	18.31	17.67	8.5	4.5	4.22	53.2	10.64
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TOTAL	11.2	29	39.3	55.8	70.9	206	41.2

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FUTURE FINANCING OF THE COMMUNITY

1. YOU, THE CHANCELLOR AND THE PRIME MINISTER MIGHT BE FORGIVEN FOR FEELING A SENSE OF DEJA VU AS YOU FACE A FLURRY OF COMMUNITY MEETINGS IN THE NEXT FEW DAYS. AS IN 1983 A BRITISH GENERAL ELECTION IS TO BE FOLLOWED IMMEDIATELY BY MEETINGS OF FINANCE AND FOREIGN MINISTERS (THE LATTER TWICE ON THIS OCCASION) AND WITHIN TWO WEEKS BY A EUROPEAN COUNCIL AT WHICH THE PARLOUS STATE OF THE COMMUNITY'S FINANCES WILL BE THE CENTREPIECE. AS IN 1983 THE COMMUNITY IS OUT OF MONEY, THE AGRICULTURAL POLICY IS COSTING TOO MUCH, THE POORER MEMBER STATES WANT MORE SOCIAL AND REGIONAL SPENDING, AND THE COMMISSION, CAST IN THE ROLE OF THE SPENDING DEPARTMENT THROUGH THE AGES, WANTS MORE THAN THE COUNCIL WANTS TO GIVE IT.

2. SO WHAT IS NEW? QUITE A LOT, I WOULD SUGGEST. THE MAIN DIFFERENCES SINCE 1983 ARE:
(I) THE PROBLEMS OF AGRICULTURE ARE IN SOME WAYS BETTER AND IN SOME WAYS WORSE. BETTER BECAUSE, WHEREAS IN 1983 THERE WAS ONLY A VAGUELY DAWNING AND UNWELCOME REALISATION THAT SOMETHING WOULD HAVE TO BE DONE ABOUT SURPLUSES AND THEIR COST (THE FIRST DECISIONS ON MILK QUOTAS DID NOT COME UNTIL THE SPRING OF 1984), THE NEED FOR REFORM, ENDORSED AT THE OECD MINISTERIAL AND THE VENICE SUMMIT, IS NOW SEEN TO BE INELUCTABLE AND SIGNIFICANT STEPS TO BRING IT ABOUT HAVE EITHER BEEN TAKEN (ON BEEF AND FURTHER MILK RESTRICTIONS IN DECEMBER 1986) OR ARE ON THE COUNCIL TABLE (CEREALS AND OILSEEDS). BETTER TOO
[illegible] COMMITTED TO REFORM THAN

EITHER BEEN TAKEN (ON BEEF AND FURTHER MILK RESTRICTIONS IN DECEMBER 1986) OR ARE ON THE COUNCIL TABLE (CEREALS AND OILSEEDS). BETTER TOO BECAUSE THE COMMISSION IS MORE FIRMLY COMMITTED TO REFORM THAN BEFORE AND HAS PROPOSED BUILDING STABILISERS INTO EACH REGIME TO PREVENT PRODUCTION AND COST OVERRUNS IN THE FUTURE. WORSE BECAUSE THE TIME IT HAS TAKEN TO GET REFORM MEASURES DECIDED HAS PERMITTED A MASSIVE BUILD-UP OF UNDER-BUDGETISED STOCKS AND BECAUSE THE FALL OF THE DOLLAR HAS RESULTED AND IS STILL RESULTING IN VERY LARGE COST OVERRUNS. WORSE BECAUSE AT LEAST ONE OF THE COMMISSION'S IDEAS FOR REFORM, AN OILS AND FATS TAX, OBJECTIONABLE ON A WIDE RANGE OF GROUNDS, NOW HAS MORE SUPPORT IN THE COUNCIL THAN EVER BEFORE. WORSE ABOVE ALL BECAUSE THE COMMUNITY IS NO NEARER TO GETTING ROUND THE SINGLE FACTOR WHICH HAS DONE MOST TO DAMAGE THE CAP SINCE ITS ESTABLISHMENT IN THE 1960S: THE GERMAN INSISTENCE ON HIGH PRICES.

(II) THE DEMANDS OF THE POORER MEMBER STATES FOR HIGHER REGIONAL AND SOCIAL SPENDING IN THE BACKWARD REGIONS ARE MORE INSISTENT AND BETTER ORCHESTRATED THAN BEFORE. IT WAS NOT TOO DIFFICULT IN 1983/4 TO BRUSH ASIDE PAPENDREOU AND BUY HIM OFF (ALBEIT RATHER EXPENSIVELY) WITH THE INTEGRATED MEDITERRANEAN PROGRAMMES: IT WILL BE MORE DIFFICULT IN 1987 TO HANDLE THE NEW ENLARGED CHORUS OF FIVE (SPAIN, PORTUGAL, ITALY, GREECE AND IRELAND) CHANTING THE TUNE THAT THE COMMUNITY CANNOT HAVE A SINGLE INTERNAL MARKET WITHOUT SPENDING MORE TO MODERNISE THE PERIPHERY. BUT IN THE LAST RESORT, WHEN THEY HAVE TO CHOSE BETWEEN GETTING LESS THAN THEY WANT OR GETTING NOTHING AT ALL, THEIR LEVERAGE IS NOT AS GREAT AS THEY THINK. THIS TRUTH MAY TAKE SOME TIME TO DAWN.

(III) THE UK'S POSITION IS A GOOD DEAL MORE COMFORTABLE THAN IT WAS IN 1983. THEN WE WERE FIGHTING FOR A LASTING ABATEMENT MECHANISM AND MEANWHILE HAVING TO MAKE DO WITH INADEQUATE SHORT TERM FIXES. NOW WE HAVE THE FONTAINEBLEAU MECHANISM EMBEDDED IN THE COMMUNITY'S BASIC FINANCING ARRANGEMENTS IN SUCH A WAY THAT IT, AND THEY, CAN ONLY BE CHANGED WITH OUR AGREEMENT. ATTEMPTS WILL BE MADE IN THIS NEGOTIATION (ALREADY ARE BEING MADE BY THE DUTCH AND THE GERMANS) TO REDUCE THE ABATEMENT, BUT THE RANK INCONCEIVABILITY OF OUR AGREEING IN ONE BREATH TO AN INCREASE IN COMMUNITY RESOURCES AND A WEAKENING OF THE ABATEMENT IS WELL UNDERSTOOD, IF NOT YET ACCEPTED.

(IV) OUR POSITION IS ALSO STRENGTHENED BY THE MUCH BETTER WORKING RELATIONSHIP WE HAVE NOW WITH FRANCE AND GERMANY, WHO IN 1983 WERE THE CHIEF OBSTACLES AND ADVERSARIES TO THE ATTAINMENT OF OUR OBJECTIVES. BUT THIS CRUCIAL TRIANGULAR RELATIONSHIP IS ALREADY COMING UNDER STRAIN FROM UNRESOLVED CONFLICTS OF INTEREST (OVER MCA'S AND THE OILS AND FATS TAX BETWEEN FRANCE AND GERMANY, OVER CAP REFORM AND THE ABATEMENT BETWEEN US AND GERMANY, OVER THE OILS AND FATS TAX BETWEEN US AND FRANCE AND OVER RESEARCH AND DEVELOPMENT BETWEEN US AND ALL THE OTHERS. THE STRAINS RISK GETTING WORSE AS THE FRENCH PRESIDENTIAL ELECTIONS CAST AN INCREASINGLY HEAVY SHADOW.

3. IF THAT IS THE BACKGROUND, WHAT THEN ARE THE PROSPECTS FOR THE JUNE EUROPEAN COUNCIL? EVEN IF THE AGRICULTURE MINISTERS DO NOT GET COMPLETELY STUCK THIS WEEK OVER THE RESUMED PRICE FIXING NEGOTIATIONS OR, ALTERNATIVELY, UNLOAD ONE OR BOTH OF THE OILS AND FATS TAX AND THE MCA PROBLEM ON THE HEADS OF GOVERNMENT, THE PROSPECTS FOR SWEETNESS AND LIGHT ARE NOT VERY GOOD. AT BEST THERE COULD BE AGREEMENT ON CONCLUSIONS AS AT STUTTGART IN 1983, WHICH, WITHOUT COMMITTING ANYONE VERY FAR ON SPECIFICS, WOULD RING UP THE CURTAIN ON THE REAL NEGOTIATION LATER IN THE YEAR. BUT ANY OR ALL OF EXCESSIVE MEDITERRANEAN APPETITES, COMMISSION CRISIS-MONGERING OVER THE 1987 BUDGET DEFICIT, DIFFERENCES OVER MCA'S OR THE OILS AND FATS TAX, TACTICAL POSTURING ON OUR ABATEMENT OR AN ATTEMPT TO PUSH TOO FAR FOR US ON AGREEING TO NEW RESOURCES COULD RESULT IN OPEN DISAGREEMENT. I BELIEVE WE COULD LIVE WITH EITHER OUTCOME BUT THAT AN AGREED APPROACH A LA STUTTGART WOULD ON BALANCE HELP US TO REACH

TOO FAR FOR US ON AGREEING TO NEW RESOURCES COULD RESULT IN OPEN DISAGREEMENT. I BELIEVE WE COULD LIVE WITH EITHER OUTCOME BUT THAT AN AGREED APPROACH A LA STUTTGART WOULD ON BALANCE HELP US TO REACH OUR OBJECTIVES IN THE AUTUMN NEGOTIATIONS SINCE WE SHALL CERTAINLY BE ABLE TO GET SOME FIRM REFERENCES TO CAP REFORM AND BUDGET DISCIPLINE.

4. WHAT SHOULD OUR MAIN OBJECTIVES BE OVER THE NEXT TWO WEEKS? SEEN FROM HERE, THE FOLLOWING:

(I) TO PUSH AS HARD AS WE CAN FOR FURTHER CAP REFORM MEASURES, BOTH IN THE 1987/8 PRICE FIXING AND IN AUTUMN NEGOTIATIONS OVER STABLILSING MECHANISM, MAKING IT CLEAR THAT THE LATTER WILL BE A CRUCIAL PART OF ANY DECISION ON OWN RESOURCES.

(II) TO WORK, IF POSSIBLE IN CONCERT WITH THE FRENCH, GERMANS AND DUTCH, FOR STRENGTHENED EXPENDITURE CONTROL MECHANISMS AFFECTING BOTH AGRICULTURAL AND NON-AGRICULTURAL EXPENDITURE.

(III) TO RESIST EXCESSIVE EXPANSION OF THE SOCIAL AND REGIONAL FUNDS, IN PARTICULAR THE COMMISSION PROPOSAL FOR DOUBLING THEM OVER THE NEXT FIVE YEARS.

(IV) WHILE STANDING BY OUR FONTAINEBLEAU ENGAGEMENT - OWN RESOURCES MAY (NOT WILL) INCREASE TO 1.6 PER CENT ON 1 JANUARY 1988 - TO MAKE IT CLEAR THAT THIS QUESTION CAN ONLY BE ANSWERED AT THE END OF THE NEGOTIATION IN THE LIGHT IN PARTICULAR OF THE PROGRESS MADE ON (I) AND (II) ABOVE, THE COMMISSION PROPOSALS BEING IN ANY CASE OVER-AMBITIOUS.

(V) TO SET OUT SUCCINTLY THE ENHANCED JUSTIFICATION FOR THE UK ABATEMENT JUSTIFYING THE PROPOSITION THAT ANY CHANGE MUST BE IN THE DIRECTION OF GREATER EQUITY FOR THE UK AND TO MAKE CLEAR THAT THE COMMISSION PROPOSALS DO NOT MEASURE UP TO THAT YARDSTICK.

(VI) TO ARGUE THAT THE PROBLEMS OF THE 1987 BUDGET CAN AND SHOULD BE SOLVED WITHOUT AN IGA BY A SWITCH FROM AGRICULTURAL ADVANCES TO RE-IMBURSEMENTS.

(VII) TO WORK THROUGH BILATERAL CONTACTS WITH THE FRENCH AND GERMANS BEFORE THE EUROPEAN COUNCIL TO MINIMISE OPEN DISAGREEMENT BETWEEN US AND TO MAXIMISE JOINT PRESSURE ON THOSE POINTS WHERE WE HAVE COMMON GROUND.

5. THERE IS ONE JOKER IN THE PACK, RESEARCH AND DEVELOPMENT. AS THE ONLY MEMBER STATE WHICH HAS NOT ACCEPTED THE BELGIAN PRESIDENCY'S MARCH COMPROMISE PROPOSAL, WE EXPECT TO BE PUT UNDER CONSIDERABLE PRESSURE TO DO SO EITHER BEFORE OR AT THE EUROPEAN COUNCIL. THE FIGURES ON THE TABLE ARE SO FAR BELOW THE ORIGINAL AMBITIONS OF THE COMMISSION AND THE MAJORITY OF STATES THAT I DO NOT BELIEVE THEY CAN BE GOT DOWN FURTHER. THE FRENCH AND GERMANS, EARLIER OUR ALLIES IN FIGHTING MORE GRANDIOSE SCHEMES, ARE NOW CLEAR THAT THE PRESENT FIGURES ARE ACCEPTABLE. THE BALANCE BETWEEN THE DIFFERENT PARTS OF THE PROGRAMME IS CLOSE TO OUR ORIGINAL OBJECTIVE. WOULD WE INCREASE OUR LEVERAGE IN THE NEGOTIATIONS ON FUTURE FINANCING BY CONTINUING TO RESIST THE PRESIDENCY PROPOSAL? I FEAR THE CONTRARY WOULD BE THE CASE. THE DAMAGE TO PROGRAMMES WOULD GROW AS THE THE YEAR GOES ON, INCREASING THE IRRITIATION WE WOULD BE CAUSING AND SPILLING OVER INTO MAIN NEGOTIATIONS. BY GOING ON TRYING TO BLOCK THE ONLY AREA OF COMMUNITY SPENDING IN WHICH THE UK IS A NET BENEFACIARY WE WOULD BAFFLE OUR FRIENDS, AND DELIGHT OUR FOES WHO LIKE TO MAINTAIN THAT, THANKS TO THE FONTAINEBLEAU MECHANISM, WE OPPOSE ALL SPENDING PLANS IRRESPECTIVE OF THEIR MERITS. THIS WOULD REDUCE OUR CHANCES OF ACHIEVING STAISFACTORY RESULTS ON CAP REFORM AND EXPENDITURE CONTROL.

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HANNAY

YYYY
ADVANCE
PS FCO
PS/MINISTER OF STATE FCO
PS/PUS FCO
BRAITHWAITE FCO
KERR FCO
WALL FCO
WILLIAMSON CAB
HOLROYD CAB
BUDD CAB
PS/ S OF S DTI
MOGG DTI
ROBERTS DTI
PS/ S OF S MAFF
ANDREWS MAFF
HADLEY MAFF
PS/CHANCELLOR TSY
PS/MST TSY
LAVELLE TSY
CRABBIE TSY
MAIN
FRAME GENERAL

UCLNAN 8790

NNNN

[redacted]786/48

FROM: C D CRABBIE
DATE: 15 JUNE 1987

PS/Chancellor

cc: PS/Chief Secretary
PS/Minister of State
Mr Lavelle
Mr Burgner
Mr Edwards
Mr Gieve
Mr Mortimer
Mr Donnelly
Mr Evans
Miss Bogan
Mrs Meason

OD(E), 16 JUNE: EC R&D

Paragraph 5 of the attached telegram* confirms the warning in my minute of 12 June that the Foreign Secretary is likely to make a big effort tomorrow to reverse E(A)'s decision that we should not agree to an R&D programme of more than 4.2 becu.

*the one Sir D Hannay mentioned on the 'plane AWK

2. I hope that my brief for OD(E) answers the assertions in Sir D Hannay's telegram. The key points are:

a) In spite of what he says, the issue is peripheral to the future financing negotiation. Our alliances in the latter will be based on shared interests in that context, not by any sense of annoyance or gratitude about our policy on research and development;

b) The proposed framework is not very good science. Its structure is marginally better than that of its predecessor, but the improvement is obtained by increasing overall size, not by cutting back on bad R&D;

c) There is no evidence that we will be major net beneficiaries (as FCO assert) of the new framework. In this, as in virtually all other programmes, the trend is towards declining UK receipt shares. And whatever the size of our receipts, they effectively involve government funding of private R&D;

d) I am certain that if Ministers agreed to the proposed 5.6 becu framework, we would **not** be able to obtain from Departments the offsetting savings necessary to prevent an increase in public expenditure. In short, the Exchequer would end up paying for the lion's share of the increase.

Christopher Crabbie

C D CRABBIE

747/77

PWP

FROM: ROBERT CULPIN
DATE: 15 JUNE 1987

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Burgner
Mr Scholar
Miss O'Mara
Mr Pickford
Mr Hudson

RESEARCH AND DEVELOPMENT: INTERNATIONAL SURVEY

Mr Kuczys' note of 11 May asked for my views on publication of a survey submitted by Mr Driscoll. My views are these:

a. The survey should certainly be published. It pulls together interesting material which there is no good reason to keep private.

b. It could help by showing two main things:

(i) tax distortions in favour of R&D are neither the international flavour of the month nor cost-effective;

(ii) the distinguishing feature of the most successful economies (as I read Table 1) is that industry, not the government, spends a higher proportion of output on R&D.

c. Before the survey is published, either the preface or the summary should be pointed up to highlight these conclusions (suitably modified if the authors think that necessary).

d. It should be released without special fanfare as a working paper - part of the normal routine, like Government Economic Service papers or the Treasury's guide to "The Management of Public Spending".

e. We should advertise its existence in the EPR, as we do for other such reports.

f. Once it is on the record, you and other Ministers should refer to it in speeches if, when and in whatever terms it suits us.

RC

ROBERT CULPIN

2787/8

PS/Chief Secretary

FROM: C D CRABBIE
DATE: 16 JUNE 1987

TC

cc: PS/Chancellor
Mr Lavelle
Mr Edwards
Mr Burgner
Mr Evans
Mr Donnelly
Miss Bogan
Mrs Meason

EC FRAMEWORK PROGRAMME FOR RESEARCH AND DEVELOPMENT

Mr Amedee Turner has written to the Chief Secretary about the EC R&D framework agreement. Background is contained in my minutes of 12 and 15 June, copies of which are attached for ease of reference.

2. Mr Turner has been an energetic lobbyist on behalf of a compromise proposal which the other 11 member states are now willing to support. Among others, he has recently seen Mr Tebbit and the former Secretary of State for Trade and Industry. The compromise involves commitments of 5.6 becu (£4 billion) over 5 years: the UK's existing position is to aim for a programme of no more than 4.2 becu (£3 billion). The proposed framework comprises fairly low quality science. It is also manifestly profligate, which is one reason why the European Parliament, ever in favour of more spending, supports it.

3. It has been our policy to minimise any dialogue with Mr Turner, notwithstanding the falsity of many of his arguments. (In particular he is wrong to claim that we are bound to be net beneficiaries of the proposed framework, that we are using our tough stance as a lever in wider negotiations about the future financing of the Community budget, that the item will formally be on the agenda of the forthcoming European Council or that any valuable research is presently being held up). Throughout this saga, Treasury Ministers have deliberately kept a low public profile to avoid fuelling the myth that the Treasury is holding out against the wishes of enthusiastic spending departments. In reality, existing public expenditure rules enshrined in EUROPES mean that

spending Departments are as opposed as we are to extravagant proposals since they would have to make offsetting savings on their domestic programmes in order to accommodate the UK contribution to an enlarged European research programme. This they want to do as little as we want to fill the financing gap with extra public expenditure. The framework's only real supporters are the Foreign Office, whose interest has less to do with its intrinsic scientific value than their traditional nervousness about being criticised abroad.

4. I therefore recommend that the Chief Secretary should send a reply which discourages the idea of a meeting, notes that the question of the UK policy is still under consideration, and refers to the visit by Lord Plumb (President of the European Parliament) this week to lobby on behalf of the programme.

Christopher Crabbie

C D CRABBIE

013

DRAFT LETTER

Amedee Turner Esq MEP

EC FRAMEWORK PROGRAMME FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 15 June about the framework proposal. I should make it abundantly clear that our policy on this issue is nothing to do with leverage in other negotiations. We are simply concerned about ~~the unwisdom of~~ agreeing to a major expansion of Community research and development at a time when the overall Community budget is under such pressure.

As you know, the Government have not yet replied substantively to the Presidency's proposal. We are considering the matter at the moment. You have of course put your arguments across to a number of my colleagues in the past month or so, and these have been given due weight. They will doubtless be supplemented by Lord Plumb when he visits London later this week. So I do not think it would be useful for you and ~~I~~ me to go over the ground again.

BACK GROUND PAPERS

2787/20

FROM: C D CRABBIE
DATE: 17 JUNE 1987

PS/Chancellor

cc: PS/Chief Secretary
PS/Paymaster General
Mr Lavelle
Mr Edwards
Mr Burgner
Mr Gieve
Mr Waller
Mr Mortimer
Mr Evans
Mr Donnelly
Miss Bogan
Mrs Meason

CRABBIE TO PS/CH 17/6

CABINET, 18 JUNE: EC RESEARCH AND DEVELOPMENT

The Foreign Secretary is not briefed to raise this in full Cabinet. However I gather that he intends to have a word in the margins with Mr Clarke and Mr Parkinson. His aim is to bring the newcomers round to his view that we should accept the 5.6 becu (£4 billion) proposed framework. Inter alia, he may point out that although agreement to the framework would in theory require spending Departments to make large offsetting savings, they still have the right to seek extra provision under EUROPES rules.

2. He may sow the seed that the Treasury would find it difficult to resist such extra bids. This is of course exactly why we should oppose the Foreign Office strategem, which would effectively mean an increase in public expenditure of at least £150 million to support a profligate programme. Compare this with E(A)'s view last November that "[with regard to EC R&D], it was essential that pressures to increase public expenditure should be resisted" (E(A)86 27th meeting).

Christopher Crabbie

C D CRABBIE

PMG x + any other papers pse

J Russell: Mr transfer + EST:

FROM: S P JUDGE
DATE: 17 June 1987

PAYMASTER GENERAL

APS/CHANCELLOR OF THE EXCHEQUER

cc PS/Sir Peter Middleton
PS/Sir Terence Burns
Mr Byatt

TREASURY RESEARCH BUDGET

I think there is an outstanding loose end arising from my minute of 28 April to Mr Byatt.

Paragraph 6 records the tentative decision the then Minister of State reached. Details of "methodological" projects would not be shown to Ministers, but any proposals for new projects with "public policy" implications should be put to him in future. He would then consult with the Chancellor on particularly controversial projects.

Officials would provide a summary each year of the projects in progress, but the Minister did not wish to see a report on the outcome of every individual project.

The Paymaster would like to check that the Chancellor is content with these arrangements. Subject to your views, it might be convenient for them to have a word in the margin of Prayers on Friday.

SPJ

S P JUDGE
Private Secretary

Ch

PMG wants a word in the margin at Prayers.

AA

(need to be careful about what "methodological" projects are!)

ps3/64K

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 23 June 1987

MR LAVELLE

cc PS/Chief Secretary
PS/Paymaster General
Mr F E R Butler
Mr A Edwards
Mr Crabbie
Mr Cropper

AWK to LAVELLE 23/6

EC R&D

The Foreign Secretary spoke to the Chancellor this morning. He said he thought it would be helpful to hold a meeting of Ministers in the very near future, to discuss EC R&D. Sir G Howe's idea seems to be that at such a meeting he could persuade the relevant spending colleagues to "cough up" the necessary savings. Please could you supply briefing for the Chancellor? (Miss Long will let you know as soon as a time has been fixed for the Foreign Secretary's meeting.)

6.45 Thurs

AWK

A W KUCZYS

3873/7

CHANCELLOR

1987/88 }
1988/89 } DTI can accommodate
no surplus.

JRC

FROM : R G LAVELLE
23 June 1987

cc PS/Chief Secretary
PS/Paymaster General
Mr Burgner
Mr Edwards
Mr Gieve
Mr Crabbie o/r
Mr Mortimer
Mr Donnelly
Miss Bogan
Mrs Meason

EC RESEARCH AND DEVELOPMENT

Briefing is attached for your meeting on Thursday.

EUROPES

2. The Foreign Secretary is said, in the light of calls to DTI and D/En, to believe that Departments may be readier now to pay for a 5.6 becu programme. This is not my impression from official contacts.

3. At the time of the previous Chief Secretary's general meeting on redistribution in March, all present wanted to stick to 4.2 becu. My understanding is that above such a figure (which costs them nothing because of allowable receipts) D/Energy remain unwilling to cut national programmes to make way for European research - though if we changed the agreed definition of admissable public sector receipts, so that no costs would fall on them, they would not positively object to a 5.6 becu programme. DTI have been colonised rather more thoroughly. They would like the issue to be settled. In the past, they were prepared to pay up for a 5 becu programme. But they would still "look for Treasury help" for a 5.6 becu programme (which would cost them some £20 million more over the period).

4. The overall difference between the financing cost of a 4.2 becu programme and a 5.6 becu one is £137 million. Maybe the DTI would pay a little towards this. But we are talking of a possible addition to public expenditure well in excess, for example, of our estimate of the total extra cost to the UK annually of a 1.6 per cent ceiling, after abatement.

5. The Departments' attitude to the money expresses, in effect, their attitude to the science involved.

The politics

6. The FCO line has been (at various times) that standing out will lose us friends in the general future financing exercise; will make us look foolish because ways will be found to circumvent the veto or because scientists who would be employed on research in the UK will be laid off (the latter arguments do not run together too easily); or is fruitless because in the end, we will have to settle for 5.6 becu and anyway we can always be out-voted in the annual budget discussions.

7. When we were in the 5 becu game, I saw some force in the point about the annual budget vote. But at 5.6 becu, we would be building in pretty big annual numbers for R&D, while saying we are not prepared to do any such thing on (say) structural funds. The headline "Mrs Thatcher relents on R&D" from the European Council would not get the general exercise off to too good a start.

The public line

8. The line sometimes suggested by the FCO to go with a change of front varies between bluster and kidology. The bluster line is: we will insist on conditions on the tail, on evaluation of projects, and on a reform of the JRC. (Fine: but the cost is still 5.6 becu.) The kidology line is: we agree but of course we will have to see later if the money is there. It is partly by chance that this issue has remained unresolved. But at this point, a public line that we will want to come back to this when we see how the reforms on budgetary control are going sounds more coherent: and more in line with what the Prime Minister said yesterday to Mr Martens. (see separate blue folder)

R G LAVELLE

3873/5

1. MR C EVANS USE/24/6/87

2. MR LAVELLE M.

FROM : MRS K S MEASON

24 June 1987

cc PS/Chief Secretary
PS/Paymaster General
Mr Burgner
Mr Edwards
Mr Gieve
Mr Crabbie o/r
Mr Mortimer
Mr Donnelly
Miss Bogan

AD HOC MEETING, THURSDAY 25 JUNE : EC RESEARCH AND DEVELOPMENT

I understand that there is to be an ad hoc meeting of Ministers (chaired by the Foreign Secretary) at 6.45 pm on Thursday, 25 June. Departments with a major interest will be represented (ie HMT, DTI, D/En).

2. I gather that the Foreign Secretary believes he can persuade Departments to accept financing costs for a 5.6 becu programme, but that he also considers it 'unresolved' until the Treasury is converted. So we do effectively have a veto in Whitehall which we should use if we have to.

3. Our aim must be to prevent the meeting from agreeing to go along with the 5.6 becu Presidency compromise at the European Council at the end of this month.

4. I attach briefing for the Chancellor which should cover all the points that are likely to be raised.

KSMeason

MRS K S MEASON

AD HOC MEETING - 25 JUNE : EC RESEARCH AND DEVELOPMENT

Ministers with a major interest (FCO, HMT, DTI, D/En) are to discuss the 5.6 becu R&D framework programme at 6.45 pm on Thursday, 25 June.

Objective

To prevent the meeting from agreeing to the 5.6 becu proposal. This is for E(A), which took the original decision that the UK should aim for a maximum figure of 4.2 becu. The Foreign Secretary believes that he can persuade Departments to accept the financing costs of a 5.6 becu programme. He also considers that, until the Treasury is converted, the matter is unresolved. Effectively, therefore, we have a veto in Whitehall, as in Brussels, which we should use if necessary.

Points to make

1. UK negotiating objectives. The 5.6 becu proposals is still much too high. No convincing case has been made that a programme of this size is scientifically justified. (E(A) was advised last November that a 5 becu framework was just about justifiable.) Acknowledge that the shape is better, but this has been achieved by massively boosting industrial research rather than cutting wasteful programmes. Do not accept that we cannot bring about further reductions if we are determined enough to maintain our right to say 'no' to profligate spending. Nonsense to plan major (30 per cent) expansion of activity before we have sorted out the budget mess. Particularly bad precedent to agree on something which the Commission has specifically proposed should be outside the constraints of the maximum rate. We should argue (as the Prime Minister did at the London European Council) that we cannot consider any increase in R&D until we have a clearer picture of the overall level of resources available. This would be consistent with our general approach to the future financing negotiations.

2. Linkage to future financing. No evidence that the firm UK attitude on R&D might be 'punished' with hostility in the future financing negotiations. Our alliances on the latter will be built on common interests, not out of gratitude or resentment over UK policy on R&D. Surrender on the latter could, indeed, be interpreted as a sign that we were not serious about bringing Community spending under proper control.

3. Decision making. E(A) decided our original policy. Wrong for an ad hoc meeting to amend it when a number of those involved (albeit to a lesser extent) are unrepresented. Could not accept a decision from an ad hoc group simply to resolve the financing consequences arising from a decision in principle to accept a 5.6 becu framework. The E(A) decision was that we must resist any increase in public expenditure as the result of the R&D proposals. Our objective must be to withhold agreement until the framework is acceptable and the overall budget position is brought under control.

[IF NECESSARY]

Defensive

Many scientists will be thrown out of work (see attached Press cuttings). No proof at all. One can hardly throw out of work people whose jobs have not begun. Some officials working on project definition might find that their temporary contracts expired. But most scientists would be redeployed on other projects, many of which are likely to be scientifically better. Plenty of projects and resources (over 1 becu) to keep things going until this is resolved. R&D will not stop because of a UK veto. It may wind down, but probably not by much in the immediate future. Note that Commission are already finding ways of funding a new medical health programme (including cancer and Aids).

Europe's competitive edge v US/Japan will be blunted. EC R&D is about 2 per cent of Europe's overall research effort. Much of the existing programme is incontrovertibly bad. Not at all optimistic that new one will be much better.

Our abatement may be attacked in retaliation. Tantamount to saying that if we exert our legal right to resist an extravagant proposal, our partners will act illegally against us. This Government has not made a practice of succumbing to such threats (whose existence is doubtful anyway).

We've already done well in almost halving the Commission's original proposal (10 becu plus). No guarantee that 5.6 becu ceiling would hold. On present formulation, "commitments overhang" unlikely to stay outside the five-year period: actual level more likely to be about 6.4 becu, ie over £1.5 billion more than E(A) decided as our objective last November. UK would have to pay nearly £300 million of that increase: even if we did negotiate a satisfactory guarantee against that, our total contribution to a 5.6 becu programme would still be over £700 million. A poor bargain involving massive diversion of national resources.

Unrealistic to achieve further reduction. We can only discover if this is true by holding firm, at least until we see how effectively the overall budget can be controlled.

UK would be handsome net beneficiary: we got 24 per cent of the last framework. Our advice is that we might just manage to break even this time. Enlargement and the general decline in our receipts share in all areas suggest this is the most we can expect. And even if we obtain that, the real effect would be increased public expenditure and/or diversion of resources to finance low quality EC research at the expense of national science.

Departments will agree to abide by EUROPES rules. Mr Tebbit, pre-Election, suggested that the UK should agree to the compromise and that Departments should accept the consequences for their own expenditure imposed by the EUROPES rules: looks superficially attractive outcome. In reality, however, would involve us in having to allow a host of extra bids. This would increase public expenditure in support of EC R&D, which is of course something E(A) decided should not happen.

[IF RAISED]
UKAEA receipts to offset D/En overspend. The Chief Secretary agreed in March with the then Secretary of State for Energy that, for the purposes of EUROPES, receipts under the EURATOM Contracts of Association (on present plans, around £5 million per annum) should count as public sector receipts capable of being offset against financing costs. D/En may also ask for receipts for work done by UKAEA at Culham on the JET project to be treated as public sector receipts (about £13 million). These are, in effect, contract receipts relating to the cost of the establishment rather than the cost of research, and existed before EUROPES was in operation.

Line to take on D/En/UKAEA receipts point

This is an issue which has already been discussed and agreed. D/En cannot simply change the rules just because it is convenient to them to do so.

UK line if R&D raised at European Council

Our advice is to take the line that there has been full discussion of the R&D area on many occasions. We do not think it is sensible to take it further until we have seen genuine progress in total future financing area. Prepared to look again at (say) the end of the year but now is not the right moment. Best to carry on existing programmes and discuss new areas when the complete picture is clearer.

BACKGROUND

Having been predictably deserted by the French and Germans, we are on our own in opposing a framework of 5.6 becu over five years. Since we have a rare veto, we can hold things up fairly effectively. This is unpopular with our partners and the scientific lobby in the UK, and FCO are mounting an intense campaign to overturn E(A)'s decision last November that we should aim to negotiate a 4.2 becu R&D framework. They claim that our abatement may be attacked or that we will suffer other retaliation in the important future financing negotiations if we do not cave in.

The proposed framework is grossly inflated by the usual Community process whereby compromise is achieved through offering everyone a prize. Admittedly, the proposed 5.6 becu framework is better shaped than the existing programme, since there is more emphasis than before on industrially-related R&D. But this improvement is obtained by massive increases in possibly worthwhile programmes rather than by reductions in the existing bad ones. It is the same technique that the Commission has applied to the ex novo review, whereby better shape is achieved by proposing increases in the allegedly good structural funds rather than through reductions in the reputedly bad agricultural sector.

The EUROPES system has played a major role in shaping our negotiating position. The Chief Secretary managed (with great difficulty) to persuade Departments to accept the offsetting savings implicit in a 4.2 becu programme on the basis of a redistribution of baseline provision to reflect the shape of a new framework. It is most improbable that he could repeat the trick at 5.6 becu, with the result that the Exchequer would be under intense pressure to fill the financing gap by allowing extra bids. In such circumstances, public expenditure could rise by some £150 million over five years. E(A) agreed in November that any increase in public expenditure should be resisted.

The financing cost to Departments (ie the offsetting savings required) of a 5.6 becu programme are as follows:

REDISTRIBUTED

£m

	1987	1988	1989	1990	1991	TOTAL	AVERAGE
DTp	[-0.27]	[-0.06]	0.21	0.45	0.61	0.9	0.18
DOE	1.32	2.02	1.46	1.22	1.58	7.6	1.52
DHSS	0.03	0.62	1.14	0.52	0.4	2.7	0.54
DTI	[-12.94]	[-2.22]	14.55	30.57	42.54	72.5	14.5
+JRC(non-staff)	**[-11.89]**	**[-1.08]**	**15.44**	**31.49**	**43.47**	**77.4**	**15.5**
MAFF	[-1.4]	[-0.004]	0.84	1.68	2.18	3.7	0.74
DEn	18.31	17.67	8.5	4.5	4.22	53.2	10.64
+JRC(non-staff)	**21.25**	**20.86**	**11.0**	**7.08**	**6.82**	**67.0**	**13.4**
DES	[-1.0]	[-0.23]	0.72	1.64	2.2	3.3	0.66
Unsponsored	[-3.72]	[-0.14]	2.94	6.02	7.87	13.0	2.6
JRC	10.51	11.37	8.93	9.22	9.29	49.3	9.86
of which staff costs	**6.31**	**6.82**	**5.36**	**5.53**	**5.57**	**29.59**	**5.92**
TOTAL	11.2	29	39.3	55.8	70.9	206	41.2

FINANCIAL TIMES 24vi87

UK close to decision on EC research proposals

BY WILLIAM DAWKINS IN BRUSSELS

THE British Government is understood to be close to a final decision on whether to lift its lone opposition to the EC's planned research budget.

Community officials said yesterday they expected Britain to make up its mind over the veto before, or in time for, next week's European summit. Britain since April has been the only member state to refuse to accept the Ecu 6.48bn (£4.5bn) scheme for research spending over the next five years. It has argued that parts of the proposal duplicate national efforts and that its budget should be cut back to Ecu 4.2bn, a sum which none of the other member states can accept.

The European Commission warned yesterday that the block risks doing irreparable damage to some joint research projects in need of new funding, notably the Esprit study into information technology. The programme also covers biotechnology, research into Aids and cancer, nuclear energy and industrial automation.

What Britain will do is unclear. However, it is understood that Lord Young, the new Trade and Industry Secretary, and Mr Kenneth Clarke, the Minister responsible for EC research, do not wish to block the programme — a significant change from the implacable opposition of Mr Geoffrey Pattie, the former Minister for Information Technology, who was dropped from his post after the recent general election.

Mrs Margaret Thatcher told the Belgian Prime Minister, Mr Wilfried Martens, yesterday that Britain opposed extra funds for the EC until it brought its agricultural budget under control, Reuter reports. A British official said after the meeting there was no question of Britain agreeing to extra money until the Community agreed on enforceable financial discipline.

The only real block to the plan now remaining in the UK Government is the Treasury, which faces a growing feeling among other departments that it is hard to justify holding out against one of the very few EC policies of which Britain is a net beneficiary, especially when it has the support of all 11 other member states.

If Britain does allow the programme through — and officials stress that its decision could go either way — it is likely to insist on tougher evaluation of practical benefits and a reorganisation of the Joint Research Centre in northern Italy, recently criticised in an independent report for being out of touch with commercial needs.

Even if the research budget is approved next week, the Commission estimates that the second phase of Esprit—the largest project, accounting for a quarter of the total budget—would not be able to start until next spring, more than a year after the end of the first phase.

That means 600 of the 2,900 Esprit research workers will be temporarily out of work, the Commission said yesterday. Many of them already have other jobs at their existing research establishments, but the delay opens the risk of some projects being ended or taken over by national bodies, it warned.

In a separate move, the Commission yesterday proposed that the second phase of Esprit should include an Ecu 50m scheme to encourage research co-operation between universities, companies and official research centres.

Hope seen for cheaper flights

BY TIM DICKSON IN BRUSSELS

THE EC Transport Commissioner, Mr Stanley Clinton Davis, will claim in Luxembourg today that the Community's latest proposals for airline reform will offer significant new opportunities to travellers.

Transport ministers from the 12 member states will make a last ditch effort to agree a controversial package on air liberalisation put forward by the Belgian presidency. This is broadly based on the European Commission's ideas put forward more than a year ago but they have been significantly watered down in an effort to secure the necessary agreement from the more conservative countries, such as Greece and Italy.

Mr Clinton Davis insists that the Commission's blessing will depend on the exact shape of basis of the latest Belgian compromise he believes that the effect on the European air transport industry will be significant.

"The package now before the Council will bring considerable changes to European civil aviation," he said last night. "It will allow existing cheap fares to be reduced further. About two thirds of the discount fares which are currently available on flights between member countries could be cut by an extra 10 or 20 per cent."

An important innovation, he added, would be cheap fares on off-peak flights without further qualitative criteria but with a 20 per cent or 50 per cent cancellation charge. "The criteria are a substantial improvement on those worked ... duce the possibility of new kinds of fares on many Community routes."

Referring to the proposed arrangements to reduce capacity sharing between airlines, Mr Clinton Davis claims that on the 30 busiest routes in the Community — those largely shared by France, Britain and West Germany—carriers would be free to lay on an additional 170 return flights a week in the first two years.

"This measure could affect more than half the routes in the Community and especially the busier ones, where the capacity sharing rules are currently applied most strictly," he said. His remarks are likely to irritate those in the Commission who feel that the latest proposals represent a "sell out."

One vote could save Haughey today

By Hugh Carnegy in Dublin

MR CHARLES Haughey's minority Fianna Fail Government may have to depend on the support of an independent deputy to avoid a potentially fatal defeat in the Irish parliament today.

Despite its minority position, Fianna Fail has enjoyed a clear run since it came to power in March because the two main opposition groups, Fine Gael and the Progressive Democrats, agree on the need for its tough measures to curb the excessive national debt.

But just as encouraging signs have begun to appear in the economy, all but one independent on the opposition benches have pledged to vote against the government's spending cuts in the health service, threatening Mr Haughey.

Assuming all available opposition deputies vote, the outcome will turn on Mr Neil Blaney, a former Fianna Fail minister. Mr Haughey needs him to vote with Fianna Fail to win on the casting vote of the speaker.

The Government said last night it would call an immediate general election if it were defeated.

The irony is that no party wants an election, least of all Fine Gael, the biggest opposition party, which is still recovering from a bad beating in the February election.

Mr Alan Dukes, the new leader, appears to have decided to vote against the health cuts to mollify concern within Fine Gael at the way a near unspoken coalition with Fianna Fail has operated.

A government defeat and the resulting instability would upset calculations based on Fianna Fail's hardline approach on the public finances.

Yesterday, stockbrokers Goodbody James Capel predicted Fianna Fail would achieve its targetted sharp reduction in borrowing and the current budget deficit this year, with interest rates shading downwards, annual inflation down to 3.5 per cent, the current balance of payments deficit remaining small and GNP growing by up to 1.5

"GUARDIAN" WED 24 JUNE 1987

tential, the sale abroad of its expertise in managing the entire water cycle in complete river basin. Thames believes its overseas business, currently worth £1 million a year, will grow rapidly under private ownership, accounting for up to a third of its business and spinning off orders for British construction firms and equipment suppliers.

It also believes that an NRA, responsible for water conservation and resource planning, pollution control, fisheries, land drainage, flood protection and navigation will add £40 million a year to net costs and make the day to day operation of water supply and sewerage less efficient.

Roy Watts

Inevitable conflicts of interest in the management of rivers, removed by the 1973 creation of the regional water authorities able to take optimum decisions, will reappear, it claims.

The government's promised green paper on the proposals, announced in the Tory manifesto, will be pointless if it discusses only the form of an NRA rather than whether there should be one, Thames

speak out based on Thames' undiminished enthusiasm for privatisation and its performance, including a 1986-87 profit of £190 million (up £40 million) confirmed yesterday and a projected '87-88 profit of £212 million.

Thames accepted the case for public sector regulation of the industry and suggested that the Environment Department act as the "competent authority" required by the EEC for pollution control and water quality, receive costed statements of aims and objectives on community and environmental activities, licence abstractions and discharges, and oversee performance against objectives and statutory obligations.

Sunday trading call for garden centres

By James Erlichman, Consumer Affairs Correspondent

DIY shops and garden centres should be added to the list of retail outlets that are allowed to trade on Sunday, the Consumers' Association said yesterday.

After its humiliating defeat on Sunday trading, the government is not expected to re-introduce a new Bill in the Queen's Speech on Thursday. But longer pub opening times are expected to be introduced and a Bill to liberalise Sunday trading could be included in the next session of Parliament.

In the meantime Mr Peter Goldman, the Consumers' Association director, believes that DIY shops and garden centres should be allowed to open on Sundays. In a letter to the Prime Minister he urged yesterday that they could be added to the list of exempted shops, like newsagents and food outlets, which are allowed to trade.

Surveys show that DIY shops and garden centres are high on the list of retail outlets that consumers would like to use on Sunday and Mr Goldman said that their exemption could attract a majority of support in Parliament.

A coalition of churches, trade unions and small shopkeepers, under the "Keep Sunday Special" banner, helped to defeat the last Sunday trading Bill which collapsed after an unexpected revolt by Tory backbenchers. The Bill also received its final vote on the night that the United States used British bases to make air strikes on Libya — a factor which may have distracted government support for it in the chamber.

Threat to 'Esprit'

From Alex Scott in Brussels

The government's continued refusal to agree to the Common Market's £4 billion research and development programme is threatening the next stage of the EEC's key "Esprit" information technology programme, it emerged in Brussels yesterday.

Britain's veto on the R&D package is almost certain to be raised at next week's European summit, where the other 11 EEC member states will be hoping that changes in the UK Cabinet will result in the government dropping its opposition.

EEC's Industry Commissioner, Karl-Heinz Narjes, warned that, if no agreement is reached before the end of June, up to 1,000 researchers in the Esprit programme could be lost for good.

Toyota trucks into Europe

Toyota Motor Corporation, Japan's top car manufacturer, and the German motor giant Volswagen have reached agreement on the joint production of a light truck in West Germany.

The link up comes at a time that European production is becoming increasingly critical for Toyota because of growing protectionist pressure on Japanese motor vehicle exports. Motor industry analysts in Japan speculate that the Toyota-VW venture may lead to joint passenger

Toyota would help complement its own range of commercial vehicles. VW makes a light truck, the Golf-Caddy with a capacity roughly half that of the Hi-Lux. VW said demand for one-tonne trucks was growing in Western Europe, with the market now dominated by Japanese suppliers.

After an initial period, more than half the components of the Hanover-produced truck would come from local sources, according to the VW-Toyota statement.

becomes the third Japanese motor manufacturer to begin production in Europe. Honda has been manufacturing cars with Austin Rover since 1981 while Nissan has been manufacturing in Britain since the middle of last year.

The Toyota spokeswoman said that eventual joint production of cars could not be ruled out, although she stressed it had not been discussed in the latest talks.

"We have been concentrating on the Hi-Lux," she said.

VW's link up with T...

and bullish presentation from the company to peg themselves to profit forecasts of around £150 million for the current year. The shares leapt up by 17p to 268p, leaving Racal carrying a market value of £1.67 billion.

The reaction came despite Racal turning in a lower than forecast increase in profits for the year to the end of March. Profits were up by 11 per cent to just over £100 million on sales up by only 2 per cent to £1.29 billion.

But deputy chief executive, Mr David Elsbury, yesterday put last year's disappointing performance behind him and promised that the group had entered "another period of sustained growth," based on a thriving telecommunications and a solid security business.

He backed his confidence by predicting that the combined operating profits of these two businesses would climb to £65 million in the current period and £105 million and £145 million in the following two years.

The message was received loud and clear in the City where Racal is perceived to have freed itself from a dependency on the fluctuating US data communications market and from the uncertain Middle East defence market.

Last year's slump in oil prices—described by Mr Elsbury as "the worst oil crisis on record"—strangled Middle East defence budgets and gave the group's radio communications business an "extremely black" year.

Profits plunged by over £30 million to £6.7 million and a slowdown in UK defence spending also conspired to lop 27 per cent off sales, he said.

The marine and energy division had a rough ride too with profits of just over £4.5 million last time transformed into losses of nearly £5 million. Both the radio and marine and energy divisions have been put on a surer footing but at a cost of heavy staff reductions and Mr Elsbury warned of further rationalisations this year.

But the rest of the group's businesses pushed ahead with security, data communications and telecommunications all recording increased sales and profits.

The group's Vodafone

26/6/87.

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Qz.05889

MR PARKER, APS/FOREIGN AND COMMONWEALTH SECRETARY

European Community: Research and Development Framework Programme

At last night's meeting of Ministers on this subject it was agreed that officials should look again at the public expenditure implications of a 5.6 becu programme. I held separate meetings today with Department of Trade and Industry and Department of Energy officials, both attended by H M Treasury, to ensure a common understanding of the present position. The paragraphs below represent the agreed outcome of these meetings.

Department of Trade and Industry expenditure

It was recognised that the DTI and the Treasury reached their 1986 PES settlement on the assumption of a 5 becu European Community research and development framework programme with a redistributed baseline. The main EuroPES financing problem for DTI within the coming PES period is now expected to arise in 1990-1. The DTI accordingly reserved its normal right - which the Treasury acknowledged - to address the additional costs of a 5.6 becu programme, by comparison with a 5 becu programme, in the coming PES round.

Department of Energy expenditure

The Department of Energy considered:

a. that they should not be expected to re-order their domestic public expenditure priorities in order to offset the additional financing costs which would arise (with a redistributed baseline) from a framework programme of 5.6 becu as compared with one of 4.2 becu;

b. that the Department would be able to meet their attributed share of the additional cost of a 5.6 becu

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programme if they were allowed to use as offsets the public sector receipts of some £10-12 million a year which were paid to the United Kingdom Atomic Energy Authority (AEA) as an agency fee in connection with the JET project.

The Treasury considered that:

a. there was a distinction between the AEA's receipts in connection with JET and the Authority's receipts in connection with "contracts of association". It had been agreed that the latter could be deducted from the gross financing cost of the programme;

b. on the basis of existing accounting conventions, the framework programme would add more than otherwise to public expenditure (ie there would be an increase in the United Kingdom's net contribution to the Community budget in programme 2.7) if the AEA's receipts in connection with JET were to be allowed as offsets to the gross financing cost.

The remaining annual financing cost of about £8 million which would result from a programme of 5.6 becu by comparison with a 4.2 becu programme would be spread among a number of Departments or would add to unsponsored and JRC staff cost totals. No individual Department would have a financing cost exceeding £1 million a year over the period 1987-91.

I am copying this minute to the Private Secretaries to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Chancellor of the Duchy of Lancaster, the Secretary of State for Energy and to Sir Robert Armstrong and John Fairclough.

D F Williamson

D F WILLIAMSON

26 June 1987

CONFIDENTIAL

Qz.05886

NOTE FOR THE RECORD

European Community research and development: ad hoc meeting of Ministers, 25 June

Present: Foreign and Commonwealth Secretary
Chancellor of the Exchequer
Secretary of State for Energy
Chancellor of the Duchy of Lancaster

The Chief Scientific Adviser and Mr Williamson, Cabinet Office, were also present.

1. The Foreign and Commonwealth Secretary said that he was convinced of the need to bring this question to a conclusion soon. There was no prospect of further reducing the 5.6 becu proposal now on the table. In return for agreement, we should be able to extract important conditions to improve the future quality of Community research and development and limit future expenditure. He saw no negotiating advantage for the United Kingdom in holding out any further. It should be possible to find a way of accepting the 5.6 becu framework on suitable conditions and in a manner consistent with the Euro-PES system.

2. In discussion the following points were made:

- for the United Kingdom to back down from the position it had staked out without gaining anything in return would give a bad signal to our partners in the wider context of the negotiations on future financing. The domestic public expenditure considerations were also important. It was far from clear that all interested Departments were able to give cast iron assurances that the increase to 5.6 becu would be absorbed through a re-ordering of their priorities, so that no extra public expenditure (or future PES bids) would be involved;

- it was argued that the United Kingdom had already secured substantial changes and reductions in the size of the Commission's proposal: in particular, we had secured a significant shift from general science to programmes of an industrial and commercial character. This shift was very much to our advantage: British firms took a disproportionate share of such programmes. The question now was whether agreement would extract some negotiating advantage;

- if we continued to block the framework, other member states and the Commission would seek - and find - ways to circumvent the blockage. They would agree programmes on terms which suited them, and undermine the shift we had achieved. The United Kingdom would lose out, particularly on IT and electronics. Scientific advice was that programmes re-assembled in this way would be likely to be less advantageous to the United Kingdom;

- a recent meeting with the Belgian President of the Council had confirmed that in return for agreement we stood a good chance of extracting useful conditions relating to the "tail"; evaluation; and reforms at the Joint Research Centre;

- the Department of Energy would be able to agree to a 5.6 becu framework provided that the additional financing cost of £7.4 million could be offset against public sector receipts of £10-12 million from the Community in respect of JET. There was a provision for such offsets in the Euro-PES rules. On the other hand it was argued that the Department of Energy's proposal was not a proper application of the Euro-PES rules and that the net effect would be additional public expenditure;

- it was suggested that the additional cost to the Department of Trade and Industry would for the first few years be covered by a surplus on the programme as a whole. Only in 1990-91 would larger financing problems arise.

3. The Chancellor of the Exchequer said that he would ask his officials to look carefully again at the figures in relation to public expenditure.

Cabinet Office

26 June 1987

Circulation:

Mr Parker (FCO)
Mr Allan (Treasury)
Mr Dart (Dept of Energy)
Mr Smith (DTI)

3873/13

CHANCELLOR

FROM : R G LAVELLE

26 June 1987

cc Chief Secretary
Paymaster General
MR F E R Butler
Mr Burgner
Mr Edwards
Mr Gieve
Mr Crabbie o/r
Mr Mortimer
Mrs Meason o/r

Thanks. Re X, OK.

EC R&D

As agreed at the end of the ad hoc Ministerial meeting last evening, officials have looked again at the public expenditure implications of a 5.6 becu programme. The attached Cabinet Office note records the position.

2. This is as anticipated in an earlier briefing. Equally, it confirms your view that, in contrast to the Foreign Secretary's expectation, we can in no way look for cast-iron assurances from Departments that the costs of a 5.6 becu programme would be absorbed. DTI confirmed that they would absorb the cost of a 5 becu programme but still reserved the right to bid to cover the extra costs of a 5.6 becu one. The Department of Energy remain unwilling to cover any of the costs of a move from a 4.2 becu to a 5.6 becu programme by genuine offsetting savings: they continue to pray in aid JET receipts, which we do not regard as admissable.

3. It seems not impossible that the Foreign Secretary will telephone you about all this at some point over the weekend. As I see it, you would be bound to say to him that, in these circumstances, you cannot agree that any indication should be given at the European Council that the UK would remove its veto. You also remain of the view that to do so would convey a wrong signal: indeed, in the wide context, it would seem quixotic to make a concession at this stage without any evidence of getting something in return.

4. It is of course possible that the Prime Minister may herself come under strong pressure to concede on the spot, or, perhaps more probably, give an indication that a decision will be reached within a relatively short further period. If she judged it essential to give some such a commitment, it would be helpful if it did not indicate a precise date. This is because, as you know, action is in train to establish a new Committee structure to oversee the whole R&D area and reach decisions about priorities. The terms of reference and mode of work of the new Committee are not yet established. But it might be possible to take some account of any possible concession on a 5.6 becu programme in that context. If the new Committee structure did not settle down in that way, and a concession were made, GE are considering the possibility of postponing the process of bringing additional costs to account for a year (on the grounds that the actual pattern of expenditure will not be very clear in advance). This, too, might make it possible to strike rather better bargains. You might wish to make some reference to the first possibility.

[illegible] 5. To sum up, you will, I think, wish to argue against any concession. If one is in the wind (which I fear is not impossible) it should, in any event, not be conceded on the spot. It would be preferable to take the line that we understand the Community is itself giving further thought, which we welcome, to how to tighten up the R&D framework. We do not think the time has come to reach new decisions. We want first to see more progress in the move to get a grip on EC finance. If the Prime Minister were to judge that she needed to take some more forthcoming position, it would be preferable if this did not indicate a precise timetable, and so allow a decision to be reached in the context of the proposed new R&D Committee arrangements. If you agree, I will take this general line in stocktaking sessions during the European Council.

R G LAVELLE

28/6/87.

CH/EXCHEQUER
REC. 29 JUN 1987
ACTION MR CRABBIE
COPIES TO CST PMG
SIR P. MIDDLETON
MR LAVELLE
MR BURGNER
MR EDWARDS
MR GIEVE
MR MORTIMER

PM/87/034

PRIME MINISTER

European Community Research and Development

1. We need to give some thought to the handling of European Community R&D in the European Council tomorrow. This minute is intended to bring you up to date. I had further discussions last week with David Young and with Nigel Lawson, Kenneth Clarke and Cecil Parkinson about our response on the European Community framework programme. There was also, as was to be expected, a strong request in the Foreign Ministers' conclave this weekend that we should now give an answer to the Presidency's April proposal, and do so favourably.

2. With Cabinet colleagues I found much common ground that:

(i) because of changes we have negotiated in slanting the effort towards programmes related to industrial competitiveness eg in telecommunications and information technology, the content of the framework programme is much more closely aligned with United Kingdom objectives, and is basically satisfactory;

(ii) we are confident that the financial benefit to UK research and development will continue to exceed the UK's financial contribution;

(iii) if deadlock persists, research institutes and industrial companies - in particular those in the United Kingdom since they have a large share of existing contracts and are showing a disproportionately large interest in the future work - will have to lay

/off

off or transfer specialist staff. In the case of continuing programmes such as ESPRIT there will be at the least be a loss of efficiency in using our resources and skills;

(iv) in due course the Community will no doubt try to minimise damage to the research and industrial effort by continuing or expanding some existing work; but we are sure that a reassembled programme of that kind will be much less favourable to the United Kingdom.

3. There are two basic questions which we have to confront: the effect on public expenditure and any link with our overall approach to future financing of the Community.

4. The framework programme does no more than set a limit on expenditure commitments over five years: actual expenditure within the limit being determined by later decisions on specific programmes, by the budget provision to be made for them, and by the availability of finance within the own resources ceiling. Last year we took the view that in terms of our research and development priorities a 5 becu programme would be appropriate. On public expenditure grounds, however, we decided to go in the negotiation for 4.2 becu. If the framework commitments were to be fully taken up, we estimate that the additional UK financing cost of the framework programme now proposed, by comparison with a programme of 4.2 becu, would be about £27 m a year. This breaks down into £11.7m for the Department of Trade and Industry (a large part of which they have already indicated their willingness to absorb), £7.4m for the Department of Energy, and the rest spread out among a number of Departments with smaller interests and the unsponsored and JRC staff costs. I understand that the Secretary of State for Trade and Industry would have no difficulty in 1987/88

/and

and 1988/89; any possible problems in 1989/90 and 1990/91 would be for consideration in the normal PES process. The Secretary of State for Energy has said that he could manage his budget with no PES bid; for this purpose he would need to use some of his UK Atomic Energy Authority receipts the framework programme. Although this would involve an increase in net public expenditure I think that we should keep the order of this expenditure in perspective. No other Department would have a financial cost exceeding £1m a year.

5. On the relationship with our objectives on future financing we need to keep in mind the importance of the other issues at stake in the wider negotiation. It is my judgement that, if we decide to reject the Presidency proposal, we shall reduce rather than increase our leverage over future financing. The way ahead must surely be to set out new conditions on research and development which would be of real benefit to us in return for agreeing to the framework programme. These conditions should be:

(i) there must be an absolute guarantee that commitments falling beyond 1991 cannot be drawn back into the period of this programme;

(ii) there must be an improved system for effective evaluation of work undertaken in the programme;

(iii) clear targets must be established for reducing the annual cost of expenditure on the Community's Joint Research Centre (JRC) in the framework programme by earning income from outside sources, and taking full account of the savings when the JRC budget is agreed each year.

/7.

7. It also must go without saying that financing of individual programmes to be taken under the framework programme must depend on the availability of Community resources and the existence of budget provision at the time, which in turn implies necessary reforms in the pattern of Community expenditure.

8. If pressed on this at the European Council, I believe we must make our conditions plain.

9. I am sending copies of this minute to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, Chancellor of the Duchy of Lancaster, the Secretary of State for Energy, and Sir Robert Armstrong.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
28 June 1987

MR 2/87

UNCLASSIFIED

8

FROM: A W KUCZYS

DATE: 29 June 1987

MR LAVELLE

cc: CST
Paymaster General
Mr F E R Butler
Mr Edwards
Mr Gieve
Mr Crabbie
Mr Mortimer
Mrs Meason

EC R&D

The Chancellor was grateful for your note of 26 June. As you say, he would wish to argue against any concession. He is content with the general line you propose to take in stocktaking sessions during the European Council.

A W KUCZYS

Andrew

Inland Revenue

Policy Division
Somerset House

C.
The point we must get across is Robert's b(ii), which seems to be lost altogether, followed by the fact that high industry-financed R&D countries have low tax incentives, which comes at the end. Ask Robert to look at drafting? Don't know where FST's got to, I'm afraid.

D 10/7.

FROM: P J A DRISCOLL
EXT: 6287

10 July 1987

1. MR PAINTER

2. PS/FINANCIAL SECRETARY

IR/HMT INTERNATIONAL SURVEY OF FISCAL INCENTIVES FOR R&D SPENDING

Below.

1. Mr Kuczys sent me a copy of Mr Culpin's minute of 15 June 1987.

2. As you know, E(ST) agreed on 1 July that the survey should be published at the same time as the Government's response to the House of Lords Select Committee Report - scheduled for the afternoon of Monday 20 July.

3. I have discussed the handling with Messrs Pickford and Waller and our proposals are now as follows:

a. Since E(ST) has approved publication of the text that it saw it would be inappropriate to alter it at this late stage. We therefore propose to publish the survey as it stands. The points Mr Culpin makes at his paragraph b. could be brought out in the Press Release which we agree will be necessary to tell people how to get hold of copies. A draft of that Press Release is attached for the Financial Secretary's approval, please.

They are not, that's the whole trouble. ✓

Yes pse. As per 28 June from the Lords. This is a subject on which the [illegible] for [illegible] [illegible]: [illegible] the press release summary needs to make the key points in clear terms.

cc. Principal Private Secretary
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Monck
Mr Burgner
Mr Culpin
Mr Gilmore
Mr G White
Ms Roberts
Ms Carrington
Parliamentary Clerk
Mr Painter
Mr McGivern
Mr Beighton
Mr Weeden
Mr Elliott
Mr Dawson
Mr Rodway
Mr Elmer
Mr Driscoll
Miss McFarlane
PS/IR

b. The Revenue Press Office will contact the "serious" newspapers making a very small number (say 6) of complimentary copies available to selected journalists. Other copies will be distributed by the Inland Revenue [and the Treasury], price £15.

c. The Report will be a source of material for Ministerial speeches and for other briefing.

d. I attach a copy of a Q & A brief we are supplying to the Press Offices.

4. Perhaps you will let me know if the Financial Secretary is content with these arrangements?

P J A DRISCOLL

DRAFT PRESS RELEASE

FISCAL INCENTIVES FOR RESEARCH & DEVELOPMENT SPENDING: PUBLICATION OF AN INTERNATIONAL SURVEY

1. The Inland Revenue and HM Treasury have today published a study undertaken by their officials of international fiscal incentives for Research & Development spending.

2. Earlier this year the House of Lords Select Committee on Civil Research and Development recommended, among other things, that the Government should examine tax incentives in other countries. The study now published surveys R&D tax incentives available in the UK and nine other OECD countries. Its main conclusion is that, on the best available evidence, special fiscal incentives increase industrial R&D by roughly one-half of the revenue forgone by government. The study found no evidence of a general trend towards the greater use of fiscal incentives for R&D. In the UK's main competitor countries, including those where industry-financed R&D is highest, the fiscal incentives to invest in R&D were at best small.

Could be better put.

3. Publication of the overall Government response to the House of Lords Select Committee Report (Cmnd) was announced by the Prime Minister [earlier today] in reply to a Parliamentary Question.

4. Copies of the survey are available from the Inland Revenue Reference Room, New Wing, Somerset House, Strand, London WC2R 1LB, price £15 post free.

INLAND REVENUE/HMT INTERNATIONAL SURVEY OF FISCAL INCENTIVES FOR R & D SPENDING

DRAFT Q & A BRIEF

Q. What is background to survey?

A. R & D has been the subject of considerable interest in recent years, in particular relatively poor performance of UK industry. Sometimes suggested that further tax incentives needed. Study set in hand late 1986 to review published evidence on experience elsewhere.

Q. Why publish?

A. Work completed in March 1987. Response to H of L Select Committee Report gives opportunity to publish. Demonstrates sort of background work done by IR and Treasury as basis for Ministerial decisions on tax policy issues. Publication ~~will raise level of~~ makes important contribution to debate on this issue.

Q. What does survey cover?

A. Covers arrangements in 10 major OECD countries including UK and reviews economic literature on effectiveness of incentives offered. Countries selected to represent main international competitors and to include countries with special fiscal incentives. Does not in general cover grants.

Q. Do other countries offer more incentives than UK?

A. Of the countries studied only Australia and Canada offer strong incentives to invest in R & D. In each case, industry funded R & D is extremely low. Elsewhere incentive to invest in R & D small or at best neutral. Some countries eg USA, Germany are reducing (value of) incentives.

Q. What are main conclusions of survey?

A. On the best available evidence, special fiscal incentives increase industrial R & D by roughly one half of the revenue forgone by Government. Study found no evidence of general trend to greater use of fiscal incentives for R & D. In UK's main competitor countries, including those where industry financed R & D is highest, the fiscal incentives to invest in R & D were at best small.

Q. What are implications for UK tax policy?

A. R & D expenditure already favourably treated. Over 90% allowed against tax in year incurred either as revenue expenditure or under special scientific research allowance. Nothing in Report suggests that UK is out of line with main competitors or that a more generous tax regime would stimulate R & D in cost-effective way.

2788/30

FROM: C D CRABBIE
DATE: 16 JULY 1987

PS/Chancellor

I agree with most of
this esp (a) the most
drain @ X → (b)
no current negotiation
getting into
Burgner
N.

cc: PS/Chief Secretary
PS/Paymaster General
Sir G Littler
Mr F E R Butler
Mr Lavelle
Mr Monck
Mr Edwards
Mr Burgner
Mr Gilmore
Mr Gieve
Mr Waller
Mr M Williams
Mr Mortimer
Mr Evans
Mr Donnelly
Miss Simpson
Miss Bogan
Mrs Meason

EC RESEARCH AND DEVELOPMENT

The Budget Council should formally approve a framework for EC Research and Development on 23 July. Shorn of its chronic Eurojargon (Annex A) and important technicalities relating to the so-called commitments overhang, the agreement is for a five year programme of 5.2 becu (£3.8 billion) with an increase to 5.6 becu (£4.1 billion) subject to successful conclusion of the future financing negotiations. Unanimous agreement would be necessary for that increase to be made.

2. Although agreement is at a pretty high level (E(A) wanted no more than 4.2 becu), the outcome nonetheless vindicates the line which the Treasury and above all the Prime Minister have taken throughout a long and difficult negotiation. In its course we became progressively isolated by the profligacy of all the other member states, defeatism in the Foreign Office and elsewhere in Whitehall and hostility from the media and, for what it is worth, the Alliance, which included a specific reference to the issue in its election manifesto. Only two weeks ago we were assured by UKREP that there was no chance of bringing the figure down to the level now agreed, and warned of the damage that the UK's approach would inflict on the maintenance of a common stance with the French and Germans on wider issues. This episode perhaps

illustrates the problems we may face within Whitehall in the final stages of the ex novo review. It is also a rare example of us getting our way in the Community, or at least as much of our way as theirs. The Commission originally sought a programme of over 10 becu (£7.6 billion) and most member states would have settled for above 7 becu (£5.1 billion). All this at a time when the Community budget is, for all intents and purposes, bankrupt. X

3. The best working assumption on the eventual outcome is probably a 5.6 becu framework. The other 11 member states and the Commission are certainly working on that basis. However we have a reasonably tight linkage of the increase from 5.2 becu to the satisfactory conclusion of the future financing negotiations, which is consistent with the Prime Minister's insistence at the European Council that we cannot go on pouring more water into the bath as long as the plug is removed. It remains to be seen if our partners will accept the insertion of a plug in the form of effective budgetary controls.

4. A key determinant in the UK position has been the Treasury's insistence that Departments, not the Exchequer, should bear the extra cost of increased EC R&D, much of which is not particularly worthwhile anyway. EUROPES has come under intense strain, not least over the question of redistribution of baseline provision, which transfers a large part of the bill from DTI to Department of Energy. That issue is still not fully resolved. However the Department of Energy has accepted the principle of redistribution at the level of 4.2 becu, and we should be able to exploit that later. We also have to expect that when we seek offsetting savings from next year's Survey onwards (the Chief Secretary has agreed that we should suspend the EUROPES system this year) we will receive a number of extra bids to cover a significant proportion of the extra financing costs of an enlarged framework. Some of these we will successfully resist in future bilaterals. So if public expenditure increases as the result of the new framework, we can console ourselves that it should do so by less than it would otherwise have done. And, in all events, we can be reasonably satisfied that the draconian effects of EUROPES have served as a useful disincentive to Departments from acquiescing in the wilder excesses originally proposed.

S J Smith

pp. C D CRABBIE

ANNEX A

Brussels, 15 July 1987

P.l fax to Mr Wall ECD(I), FCO
(+ 2 copies for me)

15/7

FINAL COMPROMISE TEXT
AFTER COREPER DISCUSSIONS OF 14.7.87

Article 1, paragraph 3

Without prejudice to the amount of 1084 MECU deemed necessary in respect of research programmes already decided or under way, the total amount deemed necessary for Community participation in the achievement of the scientific and technical objectives set out in Annex II, and therefore the sum to be allocated to specific programmes to be decided on during that period, is 5396 MECU, of which no more than 4533 MECU are deemed necessary to be committed for the execution of specific programmes before the end of 1991.

Of the amount of 5396 MECU mentioned above, the amount deemed necessary for specific programmes to be decided on during 1987-1991 is provisionally, and pending the Council Decision referred to in subparagraph 3, fixed at 4979 MECU.

The Council, acting unanimously, will subsequently decide on the addition of the remaining amount of 417 MECU to the amount of 4979 MECU.

STATEMENTS FOR THE COUNCIL MINUTES

- Ad Article 1, Paragraph 3:

(a) The UK-delegation considers that the Council can only decide on the 417 MECU referred to in subparagraph 3 when the decisions set out on Page 12 of the conclusions circulated by the Presidency after the European Council meeting of 29/30 June 1987 (doc. SN 2279/3/87) have been taken.

On the assumption that the abovementioned decisions are taken at the Copenhagen meeting of the European Council (4/5 December 1987), the UK-delegation will agree to a decision adding the amount of 417 MECU not later than 31.12.1987.

Without prejudice to their positions set out in the conclusions circulated by the Presidency after the European Council (doc. SN 2279/3/87), 11 delegations and the Commission consider that the decision on the addition of the 417 MECU must in all circumstances be taken no later than 31 December 1987.

The Council and the Commission note that in any case the implementation of the Framework Programme will respect the equilibria as set out in Annex 1.

(b) Taking into account the normal time-lag between the reference period for the Framework programme and the actual duration of specific programmes, the Commission agrees that an amount deemed necessary corresponding to 863 MECU of the amount deemed necessary for the Framework Programme under sub-paragraphs 1 & 2 of Article 1 §3 will have to be committed in the budget after 1991 and the contribution to this amount will be identified in specific programmes when they are brought forward.

.../...

This must not prevent the balanced start and development of the new programme within a reasonable period.

The Council takes note of this statement and finds that there is unanimous agreement within the Council to act accordingly.

- Ad Article 2, Paragraph 2 (Evaluation of Programmes):

(c) The Council and the Commission, welcoming the agreement that all specific programmes to be agreed under this Framework Programme will be evaluated in relation to their precise objectives, agree that the specific programmes, when they are brought forward for adoption, will set out the procedures to be followed and identify the estimated resources to be made available for carrying out these evaluations.

(d) Joint Research Centre

The Council and the Commission reaffirm the Community character of the JRC.

The Commission states its intention to reflect the main recommendations of the Panel of Senior Industrialists and the opinions of the JRC Board of Governors in its formal proposals for the future programme of the JRC; these will take into account inter alia activities to be carried out for Commission Services as well as outside customers.

The Council and Commission agree that such proposals should be finalized within a short time.

745/103

FROM: S J PICKFORD
DATE: 17 JULY 1987

Yes rather. Min Statement OK.

1. MR CULPIN

2. CHANCELLOR

This is much better. It's a pity the report itself doesn't have a ministerial preface. RC 17/7

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Cassell
Mr Monck
Mr Burger
Mr Scholar
Miss O'Mara
Mr Waller
Mr Hudson

Mr Driscoll IR

INTERNATIONAL SURVEY OF FISCAL INCENTIVES FOR R&D

You asked for the press release to be re-drafted to emphasise the key points stemming from the survey.

I attach a draft which tries to do that. It seems to me that the best way to make the point that it is important for industry, not the Government, to spend more money on R&D is to include a Ministerial statement to that effect.

You also asked that the summary of the Working Paper should be amended to make these points. Unfortunately it is now too late to make any changes to the paper itself. The Financial Secretary approved the paper earlier this week, and it is now too late to reprint it, since it is being published on Monday.

Are you content with the revised draft press notice, given that we will have to rely on that to put across the main points?

Stephen Pickford

S J PICKFORD

Encs

745/99

DRAFT PRESS RELEASE

FISCAL INCENTIVES FOR RESEARCH AND DEVELOPMENT SPENDING: PUBLICATION OF AN INTERNATIONAL SURVEY

The Inland Revenue and HM Treasury have today published a study undertaken by their officials of international fiscal incentives for Research & Development spending.

This study looks at R&D tax incentives in the UK and nine other OECD countries. A major conclusion is that, on the best available evidence, special fiscal incentives are not cost-effective: the value of additional R&D spending by industry generated by the incentives only amounts to roughly one-half of their cost to Government in revenue foregone. The study found no evidence of a general trend towards the greater use of fiscal incentives for R&D. In the UK's main competitor countries, including those where industry-financed R&D is highest, the fiscal incentives to invest in R&D were at best small.

Commenting on the study, the Financial Secretary to the Treasury, the Rt Hon Norman Lamont MP, said:

> "Now that industry is making record profits and the Government's policies have ensured stable non-inflationary growth, the prime need is for industry to make its own investment in the future by spending more on R&D. The figures show that this is a distinguishing feature of the most successful economies."

NOTES TO EDITORS

1. Earlier this year one of the recommendations made by the House of Lords Select Committee on Civil Research and Development was that the Government should examine tax incentives in other countries.

2. Publication of the overall Government response to the House of Lords Select Committee Report (Cm 185) was announced by the Prime Minister earlier today in reply to a Parliamentary Question.

3. Copies of the survey are available from the Inland Revenue Reference Room, New Wing, Somerset House, Strand, London WC2R 1LB, price £15 post free.

FROM: A W KUCZYS
DATE: 20 July 1987

MR DRISCOLL - INLAND REVENUE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Cassell
Mr Monck
Mr Burgner
Mr Scholar
Mr Culpin
Miss O'Mara
Mr Waller
Mr Hudson

INTERNATIONAL SURVEY OF FISCAL INCENTIVES FOR R&D

As I have already told you by 'phone, the Chancellor was content with Mr Pickford's revised version of the Press Release. He is most grateful to Mr Pickford. Apologies for disrupting production of your Press Release.

A W KUCZYS

ps3/16K

UNCLASSIFIED

FROM: A W KUCZYS
DATE: 20 July 1987

MR C D CRABBIE

cc PS/Chief Secretary
PS/Paymaster General
Sir G Littler
Mr F. E R Butler
Mr Lavelle
Mr Monck
Mr Edwards
Mr Burgner
Mr Gilmore
Mr Gieve
Mr Waller
Mr M Williams
Mr Mortimer
Mr Evans
Mr Donnelly
Miss Simpson
Miss Bogan
Mrs Meason

EC RESEARCH AND DEVELOPMENT

The Chancellor has seen your note of 16 July. He agrees with most of it, especially:

(a) the moral drawn at the top of the second page ("This episode perhaps illustrates the problems we may face within Whitehall in the final stages of the ex novo review."); and

(b) the crucial importance of clinging on to EUROPES.

A W K

A W KUCZYS

dti

the department for Enterprise

pl ring CST's Done
to check that
~~they~~ copy to
Sir A Wilson + other
accountancy people
M

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

BF 19/5

EXCHEQUER
04 MAY 1988
ACTION CST.
COPIES TO

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref PS5APQ
Your ref
Date 3 May 1988

Dear Nigel,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Over the past year the Accounting Standards Committee (ASC) has been consulting on a draft revised Standard on the measurement and disclosure of expenditure on research and development (R&D). The Government's main interest has been to support the draft Standard's proposed requirement that R&D expenditure written off against the profit or loss account and any development costs amortised in the balance sheet are to be disclosed as separate items in the annual report and accounts of companies. The ASC consultative period ended on 30 November and the ASC meeting on 25 May is likely to be asked to agree the new text, perhaps with some detailed amendments to meet various concerns.

A requirement to disclose R&D expenditure in company accounts was recommended by the 1986 Report of the House of Lords Select Committee on Civil R&D. My Department's Technology Requirements Board is also strongly in favour of disclosure. The White Paper in July 1987 replying to the House of Lords Report (CM 185 "Civil Research and Development") accepted the need for more industrially-funded R&D. However, among the range of measures taken or announced in the White Paper to encourage more R&D there was no proposal to legislate to make disclosure of R&D expenditure compulsory, in view of the progress being made by the ASC. Nevertheless, on other occasions we have made clear our readiness to consider legislation if the parts of the revised Standard requiring disclosure were not agreed.

In fact the overwhelming majority of all those consulted by ASC have supported disclosure in the manner suggested by the draft Standard. However, there are a few dissentients which carry weight. These include the Institute of Chartered Accountants in England and Wales (ICAEW), which is not convinced that disclosure is necessary for the purpose of ensuring that accounts give a "true and fair" view. The ASC is not a Government body, although DTI and the Treasury each has a non-voting observer who attends meetings, and for Standards to be adopted a two-thirds majority in the Committee and unanimous support by the six major professional accounting bodies is required. Unless the ICAEW changes its views the likelihood is that the revised Standard will be agreed but with the disclosure requirements deleted.

I have been looking again at our commitment in the light of our objectives on deregulation. The principal purpose of requiring disclosure of R&D spending is, of course, to enable investors to judge the company's performance and, if necessary, bring pressure on the company to step up its R&D investment. But this argument is relevant only to public companies, especially those whose shares are quoted on the Stock Exchange or those that are growing to a size at which a quotation could become desirable. The case for extending this requirement to independent private companies is weak: such a requirement would impose an unnecessary and unjustifiable burden. I have therefore concluded that our aim should be to secure disclosure of R&D spending in the reports and accounts of only public limited companies (PLCs), including their consolidated accounts where they have subsidiaries. Drawing the line at the PLC or PLC-headed group would provide a simple definition and, I believe, capture the preponderance of R&D spending.

I recognise that adopting this proposal would represent something of a change in the line we have previously taken. It may be argued that by restricting the disclosure requirement we should be losing the opportunity to obtain information about the R&D activities of small firms. My Department's statisticians however tell me that they do not regard disclosure of R&D expenditure in company accounts as a useful source of statistical data. I am also not attracted to the idea of imposing on companies disclosure requirements directed at providing the Government with information. My proposal seeks to limit the requirement as far as possible only to the purpose for which disclosure is required. Moreover, as the requirement to disclose is for economic, not

dti

the department for Enterprise

accounting, purposes, it ought to be a requirement imposed by law, not by Accounting Standard. I therefore propose that a suitable amendment be included in the detailed revision of the accounting Schedules to the Companies Act which are already agreed for the forthcoming Companies Bill.

So far as the ASC is concerned it would be unfortunate if the ASC were to adopt the Standard in its present form, which applies the disclosure requirement to all companies. If the ASC decides in favour of a disclosure requirement, it may resist the idea of restricting it in the way we might wish, although it might be persuaded to exclude small companies. I suggest that the Government observers should take such action as may be necessary to steer the ASC away from reaching a conclusion that conflicted with our present objectives. In doing so the observers will almost certainly be obliged to reveal our legislative intentions. I therefore suggest that we prepare an arranged Question, for answer shortly after the ASC meeting, announcing our intention to include provision in future legislation.

I would be grateful to know by 13 May if you and copy recipients are content for us to proceed on the above basis so that the DTI observer may inform the ASC Chairman in advance of the meeting of our views and take whatever other steps are necessary to secure a satisfactory outcome.

I am copying this letter to the Prime Minister, members of E(ST) and to Sir Robin Butler.

Yours,

David

iae.cr/docs/R&D2

CONFIDENTIAL

BPS for (BF?)

FROM: T U BURGNER
DATE: 9 MAY 1988

CHANCELLOR

OK ...

Ch/ content to write as drafted?
mpw 9/5

cc Chief Secretary
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Monck
Mrs Case
Mr Turnbull
Mr Waller
Mr Inglis
Mr MacAuslan
Mr Call

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

1. Lord Young's letter of 3 May reports on the likely outcome of ASC consultations about a revised accounting Standard on the measurement and disclosure of expenditure on R&D. Although a large majority of those consulted by the ASC have supported disclosure, there are some dissentients including the influential Institute of Chartered Accountants in England and Wales. If their opposition is maintained, an adequate disclosure requirement is unlikely to be agreed as part of the revised Standard. Lord Young therefore proposes that following the forthcoming meeting of the ASC on 25 May, when the revised draft Standard will be discussed the Government should announce its intention to legislate so as to require adequate disclosure for R&D issued by all public limited companies, including their consolidated accounts where they have subsidiaries. Legislation would take the form of an amendment to one of the accounting schedules to the Companies Act in the forthcoming Companies Bill.

2. Lord Young's letter marks an important and welcome step forward on this issue. The Treasury have for a considerable time advocated disclosure of R&D in company accounts as an indirect means of putting pressure on companies that do comparatively little R&D to do more. (Comparative statistics show that it is in company financed R&D that Britain lags behind its competitors.) Disclosure has the support, among others, of the House of Lords Committee on Civil R&D and, more recently, of ACOST. The DTI have

hitherto favoured a "wait and see" policy, pinning their hopes on ASC agreeing to a revised Standard which would include adequate disclosure requirements. But their judgement is now that this is unlikely, given the opposition of the influential ICAEW. We agree with this assessment.

3. Lord Young's proposal for limiting disclosure to PLC's is, as he acknowledges, a change. Hitherto we have assumed disclosure would apply to all companies. Whilst agreeing that a requirement to disclose R&D expenditure would be burdensome on the smallest companies, the limit proposed by Lord Young is high and would not, for example, require disclosure of R&D expenditure by UK subsidiaries of foreign owned companies. The 1985 Companies Act already recognises a category of medium sized companies (those with an average of less than 250 employees, turnover below £5.75m and net assets of less than £2.8m). If disclosure were required for all companies above this size, it is likely to ensure that disclosure is made of all significant R&D expenditure without imposing a burden on small companies. We therefore recommend that you accept the reformulated proposal.

4. On handling, Lord Young suggests an arranged PQ shortly after the ASC meeting announcing the Government's intention for future legislation. He proposes that the Government observers on the ASC, (there is one from DTI and also Sir Anthony Wilson representing the Treasury), should try to steer the ASC away from conclusions that conflicted with his proposal, even though this would reveal to the ASC the Government's legislative intentions. This seems inevitable and we would support the proposed method of handling.

5. I attach a draft letter for you to send to Lord Young. He has asked for views by 13 May, but No.10 have asked for your comments by 11 May.

TB

T U BURGNER

iae.cr/docs/R&D

CONFIDENTIAL

pse type please Porch

DRAFT LETTER FROM CHANCELLOR THE EXCHEQUER

TO LORD YOUNG

cc Prime Minister
E(ST) Members
Sir Robin Butler

ACCOUNT FOR RESEARCH AND DEVELOPMENT

1. Thank you for your letter of 3 May. It is disappointing that the attitude of some bodies, including the influential ICAEW, is likely to prevent the ASC from agreeing an adequate disclosure requirement as part of a revised Standard on R&D. It would ~~be preferable,~~ have been desirable, as the Government said in ~~its~~ reply to the House of Lords Committee on Civil R&D, for disclosure to be implemented without legislation. However we have always made clear that we do not rule out the statutory route and, in view of the likely outcome of the ASC meeting, it ~~seems~~ is clearly right to make our intentions clear as soon as possible thereafter. The debate on this issue has already gone on too long.

2. I therefore welcome in principle your intention to take the initiative on this issue. And I agree with your proposal to exclude ~~the smallest~~ small companies from the burden of disclosure. ~~is in principle reasonable.~~ I would however prefer to see the limit set at a lower level than you suggest, requiring disclosure for all companies which are too large to qualify as 'medium sized' under the 1985 Companies Act. Such a level would be likely to include all companies carrying on significant R&D programmes and would, for example, ensure that large UK subsidiaries of foreign owned companies were included, as they should be, while not adding to the burdens on generally small companies.

3. I agree with your proposal for handling by means of an arranged Question (no doubt you will clear the terms of this) and for dealing with the ASC. Sir Anthony Wilson, the Treasury observer on the ASC, will be in touch with your department so as to ensure a common approach.

4. I am copying this letter to the recipients of yours.

N L

mjd 3/159m

CONFIDENTIAL

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

10 May 1988

The Rt Hon Lord Young of Graffham
Secretary of State
Department of Trade and Industry
1-19 Victoria Street
London SW1

cc: Chief Secretary
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Monck
Mrs Case
Mr Turnbull
Mr Waller
Mr Inglis
Mr MacAuslan
Mr Call

Dear David

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 3 May. It is disappointing that the attitude of some bodies, including the influential ICAEW, is likely to prevent the ASC from agreeing an adequate disclosure requirement as part of a revised Standard on R&D. It would have been desirable, as the Government said in reply to the House of Lords Committee on Civil R&D, for disclosure to be implemented without legislation. However we have always made clear that we do not rule out the statutory route and, in view of the likely outcome of the ASC meeting, it is clearly right to make our intentions clear as soon as possible thereafter. The debate on this issue has already gone on too long.

I therefore welcome your intention to take the initiative on this issue. And I agree in principle with your proposal to exclude small companies from the burden of disclosure. I would however prefer to see the limit set at a lower level than you suggest, requiring disclosure for all companies which are too large to qualify as 'medium sized' under the 1985 Companies Act. Such a level would be likely to include all companies carrying on significant R&D programmes and would, for example, ensure that large UK subsidiaries of foreign owned companies were included, as they should be, while not adding to the burdens on genuinely small companies.

I agree with your proposal for handling by means of an arranged Question (no doubt you will clear the terms of this) and for dealing with the ASC. Sir Anthony Wilson, the Treasury observer on the ASC, will be in touch with your department so as to ensure a common approach.

I am copying this letter to the recipients of yours.

Yours
Nigel

NIGEL LAWSON

SECRETARY OF STATE FOR EDUCATION AND SCIENCE

ELIZABETH HOUSE
YORK ROAD
LONDON SE1 7PH
01-934 9000

BF 12/5

CH/EXCHEQUER
REC. 11 MAY 1988
ACTION CST
COPIES TO

The Rt Hon Nigel Lawson MP
Chancellor or the Exchequer
H M Treasury
Parliament Street
LONDON SW1P 3AG

11 May 1988

Dear Nigel,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

David Young copied to me his letter to you of 3rd May on this subject. Like him, I attach great importance to maintaining our steady encouragement to the private sector to increase its expenditure on R & D and thereby to complement the Government's policies for publicly funding R & D and for the progressive transfer of near-market research to industry. I therefore welcome his proposal to make an early announcement declaring our intention to include provision in future legislation, covering PLCs and their subsidiaries. I quite understand his reasons for excluding other companies but I think it important that we should continue to make it clear that our policy of wishing to see more R & D undertaken and paid for by the private sector applies across the whole of industry including small firms. And I think we should continue to endeavour by whatever means we can to ensure that our information about private sector R & D expenditure is as complete as possible.

As David knows I have myself argued this line in the House on occasions and should therefore be grateful to have the opportunity to see his proposed answer in draft.

I am copying this letter to the Prime Minister, to other members of E(ST) and to Sir Robin Butler.

Yours ever,

Kenneth

SPARE

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
Department for Trade and Industry
1-19 Victoria Street
London SW1H OET

CH/EXCHEQUER

REC.	13 MAY 1988
ACTION	MR BURGNER
COPIES TO	C STEVENSON
	MR MONCK MRS CASE
	MR TURNBULL
	MR ROBSON MR WALLER
	MR CALL

11 May 1988 V 13/5

Dear Secretary of State,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for copying to me your letter of 3 May to Nigel Lawson.

As you know, I am very anxious that we should secure increased industry funding of R & D in agriculture, fisheries and food. My own view is that disclosure would help in this not only by enabling investors to judge the performance of companies, but perhaps also by allowing other interested groups - such as levy funding bodies and producer organisations - to have an accurate picture of the total private sector effort. This is more than simply providing Government with information. But without some kind of formal requirement - either in law or as an accounting standard - there will always be scope for argument about the true extent of such contributions.

I take your points about drawing the line at the PLC or PLC-headed group and not imposing unnecessary burdens on small companies, and therefore agree to the line you are proposing.

I am copying this letter to the Prime Minister, members of E(ST), Nigel Lawson and to Sir Robin Butler.

Yours sincerely

Jane

JOHN MacGREGOR

(Approved by the Minister and signed in his absence)

CONFIDENTIAL

PMP

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER

REC.	17 MAY 1988
ACTION	MR BURGNER
COPIES TO	CST MR ANSON
	MR MONCK MRS CASE
	MR TURNBULL
	MR ROBSON
	MR WALLER
	MR CALL

From the Private Secretary

16 May 1988

Dear Stephen

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

The Prime Minister has seen your Secretary of State's letter of 3 May to the Chancellor of the Exchequer, and the Chancellor's reply of 10 May.

The Prime Minister is concerned about the implications of the proposed disclosure requirement for the Government's objectives on deregulation. She also wonders whether a requirement would lead to time-consuming arguments about the precise definition of R & D. She is, therefore, doubtful whether the arguments in favour of disclosure justify this step; and in any event, she thinks the coverage of companies affected by any such requirement should be kept to a minimum.

I am sending copies of this letter to the Private Secretaries to the members of E(ST) and to Sir Robin Butler.

Yours,

Paul

Paul Gray

Stephen Ratcliffe, Esq.,
Department of Trade and Industry.

CH/EXCHEQUER
REC. 17 MAY 1988
ACTION MR BURGNER
COPIES TO CST MR RANSON
MR MONCK MR SCASE
MR TURNBULL
MR ROBSON
MR WALLER
MR CALL

17/5/88.

FCS/88/100

SECRETARY OF STATE FOR TRADE AND INDUSTRY

Accounting for Research and Development

1. Thank you for copying to me your letter of 3 May to Nigel Lawson.

2. I welcome these moves towards greater transparency of R & D activities by British companies. Although I would not argue that the disclosure requirements should be introduced solely for the purpose of providing Government with information, this is nevertheless an important aspect when it comes to comparing our national R & D performance with that of our major competitors, and seeing what conclusions we can draw for our priorities in the future. For this purpose also it should be sufficient to concentrate, as you suggest, on the public limited companies.

3. Given the potential difficulties you see with the introduction of a revised Standard by the Accounting Standards Committee, I agree that it would be preferable now to aim for a legislative amendment instead.

4. I am copying this minute to the recipients of your letter.

(GEOFFREY HOWE)

Foreign and Commonwealth Office

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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01-215 7877

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CHEQUER
20 MAY 1988
29/5
MR BURGNER
CST SIR P. MIDDLETON
MR ANSON SIR A WILSON
MR MONCK MR SCASE
MR TURNBULL MR WALLER
MR INGLIS
MR MACAUSLAN
MR CALL

Direct line 215 5422
Our ref PS4AQD
Your ref
Date 19 May 1988

Dear Nigel,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT (R&D)

Thank you for your letter of 10 May welcoming my proposal to exclude smaller companies from any requirement to disclose expenditure on R&D in their annual accounts. I have also received comments from the Prime Minister, and other colleagues.

Colleagues generally have supported my proposal, but the Prime Minister has expressed concern that the additional burden it would impose would outweigh the benefits, even for larger companies, and you have suggested that the requirement should apply to all large companies, irrespective of whether or not they are PLCs.

I share very much the Prime Minister's concern about the implications of a disclosure requirement for our deregulatory objectives. This was why I concluded that the requirement should not apply to private companies but only to the 0.5 per cent of companies which are PLCs. Most such companies are large. I would not expect the disclosure requirement to be a burden to them.

the enterprise initiative

There is already an accounting standard which defines expenditure on R&D and lays down how it is to be treated in accounts. The proposed new standard will make some changes to the required treatment but the consultation on the proposed standard has not suggested that there is any fundamental problem in identifying what is R&D expenditure, although there are inevitably some difficulties at the margin. The additional burden involved in disclosing total expenditure will therefore be slight.

There is widespread public support for requiring at least large companies to disclose their R&D expenditure and we are publicly committed to backing such a requirement. I do not think that the potential burden is such as should cause us to reverse our position.

I remain of the view that the right distinction in any statutory requirement on this point is between PLCs and private companies rather than large companies and others. My objective is to encourage shareholders and potential investors to take an interest in company R&D expenditure, and for them to bring pressure on a company in appropriate cases. This argument applies much less strongly to private companies than to PLCs as the shareholders of the former are already well placed to influence the management. Moreover, to apply the requirement to all companies which are not defined as "medium" or "small" in the Companies Act would increase the number of companies affected from about 5,000 to 13,000. I am not convinced that this would be justified.

I hope therefore that we can agree to go ahead as I have proposed. I would be grateful to have a reply by Monday 23 May, as the ASC meets on Wednesday morning and preliminary discussions with the ASC chairman will be necessary.

I am copying this letter to the Prime Minister and members of E(ST) and to Sir Robin Butler.

Yours ever,
David

DRAFT PARLIAMENTARY QUESTION AND ANSWER

To ask Her Majesty's Government/the Chancellor of the Duchy of Lancaster whether they/he will require the annual accounts of companies to disclose expenditure on research and development.

DRAFT REPLY

As the Government's White Paper "Civil Research and Development" (Cm 185 published in July 1987) made clear, we accept that there is a need to emphasise to shareholders and managers the value of research and development (R&D). It is for companies to ensure that their bankers and major shareholders understand the advantages of R&D. The reporting of R&D expenditure in annual accounts will promote this understanding. The case for disclosure is, however, mainly relevant to public companies and the case for making disclosure mandatory on private companies is much weaker in relation to the burdens that disclosure is likely to involve for them. We/I have therefore decided that future legislation should amend the Companies Act 1985 so as to require disclosure of R&D expenditure in the annual accounts of public limited companies. We/I believe that limiting disclosure in this way represents the best balance between encouraging R&D in companies and the need to avoid burdensome legislation.

45/B.rj.2191/003

FROM: T U BURGNER

DATE: 20 May 1988

CHANCELLOR OF THE EXCHEQUER

Ch/ content to write as drafted? APM 27/5

cc Chief Secretary
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Monck — Burgner.
Mrs Case
Mr Turnbull
Mr Waller
Mr Inglis
Mr MacAuslan
Mr Call

OK as drafted.

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Your letter of 10 May welcomed Lord Young's intention to legislate to secure disclosure of R & D spending in the report and accounts of plcs, but proposed that this should cover all companies which are too large to qualify as "medium sized" under the 1985 Companies Act. Lord Young's reply reaffirms his view that the requirement should be limited to companies which are plcs.

2. Lord Young's reply explicitly takes account of the Prime Minister's scepticism (No 10 minute of 16 May) about whether a disclosure requirement is worthwhile in itself, particularly given the Government's objectives on deregulation. Her view was that the coverage should in any event be kept to a minimum. The Prime Minister's intervention virtually rules out any chance of widening Lord Young's proposal in the way suggested in your previous letter (the number of companies affected would have increased from 5,000 to 13,000); and we think the right course now is to support Lord Young's proposal as it stands. This will still cover the overwhelming proportion of R & D carried out in the UK. The only significant omission will be the UK subsidiaries of foreign owned companies, some of which will disclose voluntarily in any case.

3. The latest CA advice, contrary to what DTI indicated earlier, is that the ASC at their meeting on Wednesday next week may voluntarily agree an accounting standard for R & D; if so the coverage might well be wider than the 5,000 plcs. One possibility would therefore be to await the outcome of the ASC meeting. On balance we think there are good arguments for sticking with the legislative change that Lord Young proposes. First, we cannot be sure how the ASC will behave - in the event they may continue to prevaricate and such momentum as the DTI have now mustered

ould be lost. Second, even with an agreed accounting standard individual companies may choose not to comply; this could quickly erode its usefulness. Third, ACOST (on which private sector companies are heavily represented) has come out in favour of a disclosure requirement. And last, it would be a very odd piece of role reversal of the Treasury to urge delay now that DTI have made up their mind to act.

4. We think therefore you should write in support of Lord Young. He has asked for a reply on Monday. I attach a draft.

TB

T U BURGNER

20 May 1988

45/B.rj.2192/004

pl type final for Ch

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO THE SECRETARY OF STATE FOR TRADE AND INDUSTRY

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 19 May. I fully recognise the need to avoid a disclosure requirement that appears to conflict with our objectives for deregulation. The proposal in my earlier letter would have ~~of course have exempted~~ had the advantage of including UK subsidiaries of foreign-owned companies, while still exempting the large mass of medium sized and small firms. ~~Nevertheless I~~ But I do not feel strongly about this, and am willing to agree that the requirement should be restricted even further to companies which are PLCs, since this will still cover the bulk of R & D carried out in the UK while limiting the requirement to a much smaller group of companies. I am therefore content with the proposal in your letter.

2. I am copying this letter to the recipients of yours.

[NL]

RCST OF PPS IN?

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

CH/EXCHEQUER	
REC.	23 MAY 1988
ACTION	MR BURGNER
COPIES TO	CST MR ANSON
	MR MONCK
	MRS CASE
	MR TURNBULL
	MR ROBSON
	MR WALLER
	MR CALL.

23/5

The Rt Hon Lord Young of Graffham
Secretary of State for Trade & Industry
Department of Trade of Industry
1-19 Victoria Street
London SW1H OET

23 May 1988

Dear David,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT (R&D)

Thank you for copying to me your letter of 19 May to Nigel Lawson.

I am writing to confirm that I am in agreement with the course of action you propose.

I am copying this letter to the Prime Minister and members of E(ST) and to Sir Robin Butler and Nigel Lawson.

Yours ever,

JOHN MacGREGOR

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

The Rt Hon Lord Young of Graffham
Secretary of State for Trade
and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON SW1H 0ET

cc Chief Secretary
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Monck
Mr Burgner
Mrs Case
Mr Turnbull
Mr Waller
Mr Inglis
Mr MacAuslan
Mr Call

23 May 1988

Dear David

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 19 May. I fully recognise the need to avoid a disclosure requirement that appears to conflict with our objectives for deregulation. The proposal in my earlier letter would have had the advantage of including UK subsidiaries of foreign-owned companies, while still exempting the large mass of medium sized and small firms. But I do not feel strongly about thus, and am willing to agree that the requirement should be restricted even further to companies which are PLCs, since this will still cover the bulk of R & D carried out in the UK while limiting the requirement to a much smaller group of companies. I am therefore content with the proposal in your letter.

I am copying this letter to the recipients of yours.

Yours

Nigel

NIGEL LAWSON

MP

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

23 May 1988

Dear Stephen,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

The Prime Minister has seen your Secretary of State's further letter of 19 May to the Chancellor of the Exchequer. In the light of his further comments, she is content for an announcement to be made along the lines proposed.

I am copying this letter to the Private Secretaries to members of E(ST) and Sir Robin Butler.

CH/EXCHEQUER	
REC.	24 MAY 1988
ACTION	MR BURGNER
COPIES TO	CST, MR ANSON MR MONCK MRS CASE MR TURNBULL MR ROBSON MR WALLER MR CALL

✓ 24/5

Yours,
Paul

PAUL GRAY

CHIEF SECRETARY	
REC.	23 MAY 1988
ACTION	CX
COPIES TO	

Stephen Ratcliffe, Esq.
Department of Trade and Industry

Bf 316.

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament St
London SW1

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard 01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

CH/EXCHEQUER
REC. 02 JUN1988 2/6
ACTION MR BURGNER
COPIES TO CST SIR P. MIDDLETON MR ANSON SIR A WILSON MR MONCK MRS CASE MR TURNBULL MR WALLER MR INGLIS MR MACAUSLAN MR CALL

Direct line 215 5422
Our ref DW1ADN
Your ref
Date 2 June 1988

Dear Chancellor

ACCOUNTING FOR RESEARCH AND DEVELOPMENT (R&D)

Thank you for your quick response to my letter of 19 May on this subject. In the event, the discussion at the Accounting Standards Committee (ASC) went better than expected. The ASC agreed to recommend the adoption of a standard which requires the disclosure of expenditure on R&D but exempts smaller companies from this obligation. The Committee provisionally concluded that the most appropriate distinction was between plcs and private companies but intends to consider this decision further at the next meeting at the end of June as it will create a precedent for those future standards which are not of universal application. Quite rightly, the ASC wishes to avoid having a multiplicity of different distinctions. However, the discussion at yesterday's meeting makes it very probable that the ASC will confirm its provisional decision.

This is a most satisfactory outcome. It has always been our preference to achieve the disclosure of R&D expenditure through an accounting standard rather than through legislation. There is, of course, still the major hurdle to be overcome of obtaining the endorsement of the proposed standard by each of the individual members of the CCAB. This cannot be taken for granted, especially in view of the opposition of the Institute of Chartered Accountants in England and Wales to the disclosure requirement. Nevertheless, I do not think that it would now be appropriate to announce that the Government intend to legislate on this subject. We do not want to risk undermining the ASC's position when it has just taken the positive decision we want. Instead, I propose that we should welcome the ASC's initiative while hinting at the likelihood of legislation if the CCAB bodies do not endorse the proposed standard. I attach a revised draft answer to the PQ on these lines.

As the PQ has already been put down, I would like to reply to it as soon as possible after Parliament resumes. Please may I therefore ask for any comments by Monday 6 June.

Yours sincerely

Jeremy Godfrey
(approved by the Secretary of State and signed on his behalf in his absence)

DRAFT PARLIAMENTARY QUESTION AND ANSWER

To ask the Chancellor of the Duchy of Lancaster whether he will require the annual accounts of companies to disclose expenditure on research and development.

Draft reply

As the Government's White Paper "Civil Research and Development" (Cm 185 published in July 1987) made clear, we accept that there is a need to emphasise to shareholders and managers the value of research and development (R&D). It is for companies to ensure that their bankers and major shareholders understand the advantages of R&D. The reporting of R&D expenditure in annual accounts will promote this understanding. The case for disclosure is, however, mainly relevant to public companies. I therefore very much welcome the decision of the Accounting Standards Committee to recommend the adoption of a standard which would require such companies to disclose expenditure on R&D. Such a standard would be preferable to legislation on this subject and I hope that the ASC's recommendation will be acted on.

DW1ADO

5/B.rj.2192/020

FROM: N MONCK
DATE: 3 June 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Paymaster General
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Burgner o/r
Mrs Case
Mr Burr
Mr Waller
Mr Inglis
Mr Call

Ch/ content to write as drafted?

OK -

8/6

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

In his letter of 2 June Lord Young reports that, as foreshadowed in Mr Burgner's minute of 20 May, the ASC agreed to recommend a standard requiring disclosure of expenditure on R & D. He now wants to drop the idea of announcing an intention to legislate. Instead he wants to welcome the ASC's initiative while hinting at legislation if the accounting bodies do not endorse the proposed standard.

2. There remains some doubt about whether and when the institutes will do this and also about the willingness of PLCs to follow the standard. But Sir Anthony Wilson and I judge that there is little chance of getting Lord Young to re-reverse himself and the attached draft reply does not attempt that. It says that you would agree to Lord Young's proposal provided he accepts that legislation would also be needed if companies fail to follow the standard uniformly and that the draft reply to the PQ is amended to cover that point.

3. There is unlikely to be much difference in timing between the standard and legislation taking effect. It seems probably that the standard would apply to financial years starting after the beginning of 1989 and so affect accounts appearing in 1990.

4. Lord Young's letter does not appear to have been copied, unlike the earlier correspondence to the Prime Minister and members of E(ST). Your office might check with Lord Young to see that your letter gets the same circulation as his has had.

will do!

done. No other copies.

N M

N MONCK

45/B.rj.2192/019

DRAFT REPLY FOR THE CHANCELLOR TO SEND TO LORD YOUNG

pl type final for Ch.

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 2 June. I understand your preference for a voluntary approach and the reasons which have led you to revise your proposal. But, given the prolonged history of this subject, I agree that we cannot be sure that the standard alone will prove to be effective. I therefore continue to see a good deal of force in your earlier view that:

> "as the requirement to disclose is for economic, not accounting, purposes, it ought to be a requirement imposed by law, not by accounting standard."

2. I agree with you that in welcoming the ASC's initiative, you would need to hint at the likelihood of legislation if the CCAB bodies do not endorse the proposed standard. I hope you would also accept that legislation would be needed if the standard is endorsed by the other institutions but not uniformly followed by PLCs. To meet that point the last sentence of the draft reply attached to your letter would need to be amended on the lines of:

> "Provided such a standard is endorsed by the accountancy bodies and voluntarily applied by PLCs, it would be preferable to legislation on this subject. I therefore hope that the ASC's recommendation will now be acted on."

I understand there would be no practical problems about legislating if that proved to be necessary.

3. On this basis I would go along with your new proposal.

[NL]

mjd 3/153m

pl copy also to Mr Monck

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

6 June 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade and Industry
1-19 Victoria Street
London SW1H 0ET

cc: Chief Secretary
Paymaster General
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Burgner o/r
Mrs Case
Mr Burr
Mr Waller
Mr Inglis
Mr Call

Dear David

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

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I understand there would be no practical problem about legislating if that proved to be necessary.

On this basis I would go along with your new proposal.

Yours ever
Nigel

NIGEL LAWSON

MF

FROM: P D P BARNES
DATE: 13 June 1988

MR RILEY

cc PS/Chancellor
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Mr Byatt
Mr Scholar
Mr C D Butler
Mr Culpin
Mr Odling Smee
Mr Spackman
Mr I Wilson
Mrs Pugh
Mr Scotter
Mr Toller

DEVELOPMENT OF THE IGOTM MODEL

The Economic Secretary was grateful for submission of 10 June.

2. The Economic Secretary thinks that it would be very desirable to enhance the facilities offered by the IGOTM model. He is content that the Treasury's share of the development costs (£20,000) should be financed from the Research Budget.

PB

P D P BARNES
Private Secretary

dti

the department for Enterprise

~~BF~~ 15/6

Mr B

pl ask if this is OK

(I expect it is)

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

14/6

Direct line 215 5422
Our ref DW5AGM
Your ref
Date 13 ~~May~~ JUNE 1988

Dear Nigel,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 6 June. I am content to accept the changes which you propose to the draft answer, subject to minor alterations to reflect the facts that it is for the CCAB bodies to adopt the standard and that they cannot act immediately as the ASC recommendation has not yet been formally made to them as the ASC still has to review its decision on the plc/private company distinction at its meeting later this month.

I attach a copy of the final version of the answer which we aim to give next week.

I am sending copies of this letter to recipients of my earlier letters.

Y.e.

David

DRAFT PARLIAMENTARY QUESTION AND ANSWER

To ask the Chancellor of the Duchy of Lancaster whether he will require the annual accounts of companies to disclose expenditure on research and development.

Draft reply

As the Government's White Paper "Civil Research and Development" (Cm 185 published in July 1987) made clear, we accept that there is a need to emphasise to shareholders and managers the value of research and development (R&D). It is for companies to ensure that their bankers and major shareholders understand the advantages of R&D. The reporting of R&D expenditure in annual accounts will promote this understanding. The case for disclosure is, however, mainly relevant to public companies. I therefore very much welcome the decision of the Accounting Standards Committee to recommend a standard which would require such companies to disclose expenditure on R&D. Such a standard, if adopted by the accountancy bodies and complied with by public companies, would be preferable to legislation on this subject. I therefore hope that the ASC's recommendation will be acted on promptly.

iae.cr/docs/Acct

CONFIDENTIAL

FROM: T U BURGNER
DATE: 15 JUNE 1988

CHANCELLOR

cc Chief Secretary
Paymaster General
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Monck
Mrs Case
Mr Waller
Mr Inglis
Mr Call

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

1. Lord Young's latest letter effectively accepts the amendment proposed in your letter to him of 6 June. This emphasised the need - if legislation is to be avoided - not only for the Accountancy Bodies to accept the ASC's decision in favour of a standard for disclosing R&D in company accounts but also for PLCs to comply with it. Lord Young's draft has minor alterations to allow for the face t that the ASC recommendation will not be made to the Accountancy Bodies until the ASC has considered the decision on limiting the standard to PLCs at a meeting later this month.

2. You might like to reply briefly to Lord Young's signifying acceptance of the latest draft Parliamentary Q&A.

TB

T U BURGNER

iae.cr/docs/Acct

CONFIDENTIAL

pl type final

DRAFT LETTER FROM CHANCELLOR OF THE EXCHEQUER

TO LORD YOUNG

Copied to: Members of E(ST)
Sir Robin Butler

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 13 June enclosing a revised Parliamentary Answer. I am entirely content with this version.

I am sending copies of this letter to the recipients of yours.

dti
the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CH/EXCHEQUER
REC. 13 JUN1988 1/6 G
ACTION MR BURGNER
COPIES TO CST PMG SIR P. MIDDLETON MR ANSON SIR A WILSON MR MONCK MRS CASE MR BURR MR WALLER MR INGALLS MR CALL

Direct line 215 5422
Our ref DW5AGM
Your ref
Date 13 ~~May~~ June 1988

Dear Nigel,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

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David

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ps2/49M

CONFIDENTIAL

cc Chief Secretary
Paymaster General
Sir P Middleton
Mr Anson
Sir A Wilson
Mr Monck
Mrs Case
Mr Waller
Mr Inglis
Mr Call
Mr Burgner

Treasury Chambers, Parliament Street, SW1P 3A(
01-270 3000

15 June 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade
and Industry
Department of Trade and Industry
1-19 Victoria Street
LONDON
SW1H 0ET

Dear David

ACCOUNTING FOR RESEARCH AND DEVELOPMENT

Thank you for your letter of 13 June enclosing a revised Parliamentary Answer. I am entirely content with this version.

I am sending copies of this letter to the recipients of yours.

Yours
Nigel

NIGEL LAWSON

PWP

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

Jonathon Taylor Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 24 JUN 1988
ACTION
COPIES TO

Department of Trade and Industry
1-19 Victoria Street
London SW1H 0ET
Switchboard
01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

Direct line 215 5422
Our ref PS4AUD
Your ref
Date 23 June 1988

Dear Mr Taylor,

ACCOUNTING FOR RESEARCH AND DEVELOPMENT (R&D)

My Secretary of State wrote to the Chancellor on 2 June concerning the above but unfortunately this was not copied to E(ST) Colleagues. I apologise for this error and I am circulating the original letter to members of E(ST) under cover of this letter.

Yours sincerely,
Ian Bendelow

IAN BENDELOW
Assistant Private Secretary

the enterprise initiative

Thursday, July 28, 1988

NANCIAL TIMES

dustry lifts the R and D baton

Fishlock reports on trends shown in the latest survey

5

THE LATEST annual survey of Britain's research and development shows significant shifts in public expenditure, which the Government's scientific advisers have been seeking for several years.

They include a fall in defence expenditure to less than 50 per cent of government R and D spending for the current year. It was expected to approach 55 per cent.

Agriculture and environment R and D are other casualties of diminishing public expenditure.

Government policy is to shed spending it identifies as the responsibility of industry, to free funds for science initiatives such as interdisciplinary research centres at leading universities.

Government expenditure on R and D in 1986-87 totalled £4.59bn, 4.4 per cent of total spending by central government, compared with 4.7 per cent the previous year. It is expected to increase to £5.02bn by 1990-91, reflecting a 12 per cent rise in civil R and D and a 7 per cent rise in defence R and D over the five-year period.

X R and D carried out by British industry totalled £5.56bn in 1986, a rise of more than 13 per cent in real terms from 1981, but this included £1.3bn of government money.

The report, produced by the Cabinet Office's science secretariat headed by Mr John Fairclough, chief scientific adviser, is a neutral document designed to provide statistical guidance to government departments for the annual public expenditure survey.

However, its trends have been highlighted by recent government decisions to cut expenditure on nuclear and space R and D, notably for the fast reactor and the Hotol launch project.

Civil R and D in the public sector increased by 4 per cent in 1986-87, against the previous year, while defence R and D fell by 3 per cent.

R and D in support of higher education, known as the science budget, is expected to grow by 15 per cent over the five years to 1990-91. But that carried out by other government departments is predicted to fall by 7 per cent over the same period, with the £3.5m Welsh Office budget halved.

The departments of industry, energy and agriculture all forecast big cuts in their R and D spending over this period, although in the case of energy, this reflects the transfer of the UK Atomic Energy Authority to a quasi-commercial, trading fund basis.

The research budget of the Ministry of Defence is expected to fall from £408m in 1986-87 to £357m by 1990-91, with the development budget falling from £1.93bn to £1.66bn in the same period. With government money to help early retirement, the total defence R and D budget is expected to be £2.08bn in 1990-91, compared with £2.4bn in 1985-86.

The summary of R and D done in British industry is based on a survey carried out for 1985, updated by sample surveys, the latest of which was published in British Business last February.

The estimate of £5.67bn for 1986 is made up of £3.62bn considered to be industry's "mainly own" funds, £714m of overseas income, and £1.31bn of government R and D contracts. More than £500m counted as capital expenditure, and £2.37bn went into wages and salaries.

Some of the R and D was commissioned from universities, but the 1986 total of £25m was down from £30.9m the previous year. The University Grants Committee's statistics, however, suggest that university work for industry is a growth area and the survey explains this discrepancy as due partly to the fact that it covers only companies which do their own R and D, and those that employ more than 200 people.

The breakdown by industrial sector suggests that electronics with an R and D investment of £1.94bn is the biggest spender, followed by chemicals (£1.04bn), aerospace (£958m) and motor vehicles (£394m). Non-manufactured products invested £477m.

The authors of the survey acknowledge discrepancies between the public and private sector figures, which they say arise because the Government – in common with other OECD governments – has standardised its criteria according to the rules of the Frascati Manual (1981), where industry has not.

R&D 1988: annual review of government funded research and development. HMSO. £10.95.

Re X, do we have a status, year-by-year from (say) 1978? And when will we get an estimate for 1987?

The Guardian

State spending on R&D still falling

Peter Large
Technology Editor

9

GOVERNMENT spending on research and development is programmed to continue dropping until 1991. The projected total three years ahead is £4.274 billion, nearly 10 per cent less in real terms than in 1985 6.

The Cabinet Office's annual review of R & D, published yesterday, shows a total of £4.59 billion of public money invested last year, representing 4.4 per cent of all central government spending and 1.2 per cent of the nation's gross domestic product.

The defence share of this dipped below 50 per cent for the first time since 1983. This year it is rising again from 49.3 per cent to 50.4, but is forecast to fall to 47.8 in the coming year.

The review illustrates again the disparity in priorities between Britain and the rest of Europe. France is nearest to us in defence commitment — 33 per cent of R & D. In real science — "the advancement of knowledge" — France, West Germany, Italy, and Sweden spend around twice as much in percentage terms as we do. The same applies to space, industrial, and energy R & D.

Government R & D investment overall used to be high in GDP terms, but since 1981 we have fallen below the levels of Sweden and France. The United States, with its even heavier defence proportion, has overtaken us in GDP terms since 1981 — and spends three times more on health.

Last year the biggest share of the civil R & D budget (35 per cent) went to the Department of Trade and Industry. The amount of R & D undertaken in industry rose by 7 per cent between 1985 and 1986, but the percentage of that funding provided by industry fell from 66 to 64 per cent.

The government employs 14,745 graduates on R & D and, surprisingly, the Ministry of Defence has only 4,968 of them.

615

mjd 2/36Jn

UNCLASSIFIED

FROM: J M G TAYLOR
DATE: 29 July 1988

MS ROBERTS

cc Mr Waller
Mr Fray

b7 6/8

R AND D

... The Chancellor has seen the attached report in the FT about the annual review of Government funded research and development.

2. He has noted that it says that R and D carried out by British industry totalled £5.56 billion in 1986. He has asked whether we have a series, year by year from (say) 1978, and when we will get an estimate for 1987. I should be grateful for advice.

J M G TAYLOR

Thursday, July 28, 1988

NANCIAL TIMES

ıdustry lifts the R and D baton

ı Fishlock reports on trends shown in the latest survey

5

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R&D 1988: annual review of government funded research and development. HMSO. £10.95.

The Guardian

State spending on R&D still falling

Peter Large
Technology Editor

9

GOVERNMENT spending on research and development is programmed to continue dropping until 1991. The projected total three years ahead is £4.274 billion, nearly 10 per cent less in real terms than in 1985 6.

The Cabinet Office's annual review of R & D, published yesterday, shows a total of £4.59 billion of public money invested last year, representing 4.4 per cent of all central government spending and 1.2 per cent of the nation's gross domestic product.

The defence share of this dipped below 50 per cent for the first time since 1983. This year it is rising again from 49.3 per cent to 50.4, but is forecast to fall to 47.8 in the coming year.

The review illustrates again the disparity in priorities between Britain and the rest of Europe. France is nearest to us in defence commitment — 33 per cent of R & D. In real science — "the advancement of knowledge" — France, West Germany, Italy, and Sweden spend around twice as much in percentage terms as we do. The same applies to space, industrial, and energy R & D.

Government R & D investment overall used to be high in GDP terms, but since 1981 we have fallen below the levels of Sweden and France. The United States, with its even heavier defence proportion, has overtaken us in GDP terms since 1981 — and spends three times more on health.

Last year the biggest share of the civil R & D budget (35 per cent) went to the Department of Trade and Industry. The amount of R & D undertaken in industry rose by 7 per cent between 1985 and 1986, but the percentage of that funding provided by industry fell from 66 to 64 per cent.

The government employs 14,745 graduates on R & D and, surprisingly, the Ministry of Defence has only 4,968 of them.

615

iae.st/Rob/083

FROM: H M ROBERTS
DATE: 3 August 1988

MR TAYLOR

cc Mr Burgner
Mr Waller or

R AND D

Your minute of 29 July asked for some background information on the £5.56bn R&D carried out by British industry and published last week in the Annual Review of Government Funded R&D 1988.

2. DTI conducts a survey of total intramural R&D conducted by industry which addresses enterprises of 200 or more employees. The Survey covers only expenditure on R&D within the enterprise itself. Not all this expenditure is funded by industry since the total includes Government and overseas funding. The attached table (taken from figures published in the 1988 Annual Review) shows the trend in intramural industrial R&D since 1967. It shows expenditure of £2.3 billion in 1978 compared with £5.7bn for 1986, the latest year. Since 1978 the percentage of Government funding has fallen significantly from 30 to 23 per cent. In real terms, the table shows that intramural industrial R&D has consistently increased since 1975, rising by nearly 17 percentage points between 1978 and 1986.

3. The DTI full industrial survey is conducted every 4 years, updated by smaller surveys in the intervening years. Figures for 1987 are expected to be available from February 1989.

MS H M ROBERTS

iae.st/Rob/084

Industrial R&D 1967-1986

	REAL TERMS (1981 prices)		CASH							
			Total intramural R&D		Government funds		Overseas funds		Mainly own funds	
	£m	index	£ million	%	£ million	%	£ million	%	£ million	%
1967			611.5	100	178.0	29	23.3	4	410.2	67
1968			647.6	100	191.5	30	29.1	4	427.0	66
1969			693.3	100	216.5	31	32.6	5	444.8	64
1972			838.5	100	277.3	33	54.0	6	507.2	60
1975	3065.7	71.2	1352.2	100	414.1	31	84.9	6	853.3	63
1978	3581.4	83.2	2341.0	100	679.7	29	185.6	8	1475.7	63
1981	3792.5	88	3792.5	100	1137.2	30	331.3	9	2324.0	61
1983	3574.8	83	4163.3	100	1257.6	30	283.2	7	2622.5	63
1985	4004.7	93	5145.8	100	1193.5	23	575.2	11	3377.0	66
1986	4304.0	100	5672.7	100	1309.4	23	742.3	13	3621.0	64

chex.ps/mw/24 **UNCLASSIFIED**

MP

FROM: MISS M P WALLACE

DATE: 23 August 1988

MISS H M ROBERTS

cc Mr Burgner
Mr Waller
Mr Pickford*
Mr Bush*

(*with copy of Miss Roberts' minute of 3 August)

R AND D

The Chancellor has seen your minute of 3 August to Jonathan Taylor. He has noted in particular that the increase in intramural industrial R&D (your paragraph 2) is a useful and usable fact.

MPW.

MOIRA WALLACE