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PART C

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CHANCELLOR'S PAPERS ON COMPETITION POLICY

DD: 25 years

29/9/95

Begins: 27/1/88

Ends: 1/7/88 (CONTINUED)

PO -CH /NL/0261

PART C

27/1/88

CONFIDENTIAL

Reference No: E 0500

CHANCELLOR OF THE EXCHEQUER

COMPETITION IN THE LEGAL PROFESSION: RESTRICTIONS ON PRACTICE AND EFFICIENCY

E(CP)(88)1

(Also relevant are E(CP)(87)8, prepared by the previous Lord Chancellor, and the letter of 10 December from the Secretary of State for Scotland).

BACKGROUND

In June 1986, in the context of discussion in E(A) on remuneration of barristers engaged in prosecution work for the Crown Prosecution Service, Mr Channon, then Trade and Industry Secretary, proposed that a report on competition and restrictive practices in legal services be made to E(A) or E(CP) in six months to a year's time. The Prime Minister agreed that such a paper would be useful. After considerable delay, a paper (E(CP)(87)8) was submitted by the previous Lord Chancellor, Lord Havers, last autumn to fulfil this remit. However, Lord Havers had resigned by the time the paper came to be discussed, and so on 19 November (E(CP)(87)2nd meeting) you asked Lord Mackay of Clashfern to review his predecessor's proposals and prepare a further paper for the New Year.

2. E(CP)(88)1 is the result. It appears to show a greater willingness to consider reform than the previous paper, but does not promise much in the way of rapid action. The following brief takes the subjects in the order in which they appear in the paper.

ISSUES

Paragraph 5. Competition between lawyers and laymen

3. The paper mentions first the prohibition on non-solicitors applying for grants of probate even in non-contentious cases, and says it is time it was reviewed. How and when the review should take place is not indicated. This is a long-standing question and Mr Rifkind suggested in the consultation paper on Scottish

solicitors that their exclusive rights in this area should be abolished. You may wish to ask the Lord Chancellor about the timing and further work and, if appropriate, suggest a deadline for receipt of substantive proposals.

4. Next is the question of multi-disciplinary practices. The Lord Chancellor says he will 'consider favourably' the possibility of removing the statutory restriction on mixed partnerships, 'depending on the outcome', presumably of the current review by the Law Society. This question also has a long history. In 1986 the Director General of Fair Trading recommended there should be no bar on solicitors forming multi-disciplinary practices to provide solicitors' and other professional services. The Law Society is consulting its members on this question and opinion is fairly equally divided. Recent press speculation suggests that the Law Society may reject this proposal, and that its Council could put off any decision until April or July. The Young Solicitors Group of the Law Society is, however, strongly in favour. Mr Rifkind's consultation document said he favoured permitting mixed partnerships. Subject to discussion, you may want to place on record in summing up the strong view of E(CP) that mixed partnerships should be encouraged, and to invite the Lord Chancellor to bring forward proposals on mixed partnerships in the light of the Marre report.

Paragraph 6. The legal profession's monopoly on the provision of legal advice and assistance.

5. The Lord Chancellor intends to ask for urgent advice from the Legal Aid Board on whether legal aid costs could be reduced by contracting out legal aid work on issues such as welfare, housing, employment and immigration law from solicitors to other advisory agencies. These are detailed areas on which it could be difficult for the Sub-Committee to have a substantive discussion. But you could ask the Lord Chancellor to expand on the possibilities

identified in the paper, encourage him to give the Legal Aid Board the fullest remit to investigate the scope for competition, and ask him to report the Board's advice to the Sub-Committee.

Paragraph 8. Advertising by barristers

6. Barristers are now prohibited from advertising their services, but the Bar Council are considering whether some form of advertising (directories and brochures) might be allowed. They are now expected to permit some advertising, and incorporate their decision in a revised Code of Conduct for barristers due out in the summer. The Lord Chancellor does not say how he will pursue this question. You may wish to ask him for a progress report on barristers' advertising when he returns to the Sub-Committee on the substantive issues.

Paragraph 9. Price competition

7. This paragraph apparently rejects the idea of price competition between barristers for legal aid work but 'hopes' that it will be possible to introduce some price competition between solicitors employed in this work. The Lord Chancellor also says that he is 'considering whether to seek the legal Aid Board's advice' on the possibility of more competition. Further work on this might be covered by the remit suggested above in the brief on paragraph 6 of the paper.

Paragraphs 11-13. Fusion

8. This is perhaps the most important question in the paper. It would be a massive undertaking to change the Government view that fusion is undesirable. The 1979 Royal Commission report concluded that the balance of argument was against it. The Government accepted this view in its White Paper on the Legal Profession in November 1983. The Attorney General reaffirmed this in the House on 17 July last year. The Lord Chancellor gives no hint of a

change in the line on this. It may be that instead of challenging the orthodoxy on fusion head-on it would be better to concentrate on those other questions on which the Lord Chancellor has shown some willingness to move.

Paragraphs 14-18. Rights of audience

9. On rights of audience, the present position is that, in criminal proceedings, solicitors have limited rights of audience in the Crown Court, but unlimited rights of audience in magistrates' courts. The Lord Chancellor has powers to extend solicitors' rights of audience, having regard to any shortage of counsel in a particular area. The Law Society have pressed for increased rights of audience generally, but any enlargement would be opposed by the Bar.

10. The paper suggests that if general rights of audience were granted to solicitors, the larger firms of solicitors would recruit the most capable barristers, who would then not be available for other litigants. The underlying assumption here is that these activities, unlike most others in our economic life, cannot be entrusted to the operation of the market. Nevertheless, the Lord Chancellor says that there may be a case for some relaxation, although he will not come to a final view until the report of the Marre Committee, which has been set up by the profession themselves to examine all these questions. You might take up this hint and invite the Lord Chancellor to report his conclusions to the Sub-Committee in the light of the Marre Committee's report, before the summer recess if possible.

Paragraph 19. Double manning

11. There are two questions here: whether there need be two Counsel in a case, and whether barristers need be supported by a solicitor's representative. On the first, even the previous paper

admitted that 'there is some ground for supposing that silks are appearing in some cases with a junior where there is no real need for the latter'. The Lord Chancellor now says that 'there is scope to move further', although it is not clear whether he has both cases of double manning in mind, or how and when he proposes to make any move. You might ask for a report to the Sub-Committee when he has reached his conclusion on both varieties of overmanning.

Paragraph 20. Direct access

12. The Lord Chancellor opposes any general relaxation of the rule that a barrister may accept professional work only if instructed by a solicitor. This is a pretty clear example of a restrictive practice. The only argument given against it is that the public would lose the advantage of lower barristers' costs, presumably because the barristers would have to undertake more routine office work now undertaken by solicitors. But litigants would no longer have to pay two sets of fees, and even Lord Havers' paper said that relaxation 'might produce savings and reduce delays' and that these were matters currently being considered by the profession, on which Ministers need not reach a considered view now. In this case, the cause of reform is helped by the fact that the Bar would like some relaxation. The Lord Chancellor says there may be scope for some limited relaxation and you might take this up and invite him to return to the Sub-Committee with his conclusion.

CONCLUSIONS

13. The Lord Chancellor offers to consider, in the light of Marre:

i. Prohibition on non-solicitors applying for grants of non-contentious probate (para 5 of paper).

ii. Statutory prohibition of Solicitors forming mixed partnerships (para 5).

iii. Solicitors' rights of audience and whether they should be extended (paras 14-18).

iv. Rule requiring barristers to be accompanied in court by a solicitor's representative (para 19). Subject to the discussion, this might also cover the two Counsel rule.

This brief also suggests that you might ask him to report back on:

v. Advice from Legal Aid Board on contracting out, and getting more competition in, legal aid work (paras 6 and 9).

[vi. Advertising by barristers (para 8).]

vii. Relaxation of rule that barristers can accept work only if instructed by a solicitor (para 20).

There may however be some doubt about the timing of the Marre report. It was intended to appear at Easter, but the paper now refers to 'spring or summer'. Nevertheless, you will probably want to ask for the reports before the summer recess if possible.

G W MONGER

Cabinet Office
27 January 1988

ANNEX HM

E(CP)(88)1: COMPETITION IN THE LEGAL PROFESSIONS: RESTRICTIONS ON PRACTICE AND EFFICIENCY

While the paper is sharper and somewhat less defensive than its predecessor - E(CP)(87)8 - and even acknowledges the relevance of public funds in its reference to legal aid as one of the Lord Chancellor's prime concerns, nevertheless it does not offer any great prospect of dramatic changes in the near future.

Proposals

2. The paper only invites agreement from colleagues that the Lord Chancellor should consider, in the light of the Report of the Marre Committee (due Spring or Summer):

(i) the current prohibition on non-solicitors applying for grants of probate;

(ii) the present statutory prohibition on solicitors forming partnerships with other professions;

(iii) solicitors' rights of audience; and

(iv) the need for barristers to be accompanied by a solicitor's representative.

Objective

3. The Treasury's objective is to use the E(CP) discussion to maintain pressure on the Lord Chancellor, and through him on the legal profession, to deliver efficient working methods within the legal profession as a whole, and so to offer better value for money to the Government as its principal customer.

Line to take

4. You should welcome the Lord Chancellor's offer but seek to put a time limit to his consideration by requiring him to report back to E(CP) before the summer recess. You should also invite the Lord

Chancellor to ensure that the Marre Committee is fully aware of the Government's concerns about efficiency and cost, and also ensure that they consider the specific points raised (paragraph 8 below) about rights of audience. Finally, you should press for better results from the Efficiency Commission.

Discussion

The Marre Committee

5. It is hardly satisfactory that further progress is delayed by having to wait for the Marre Committee to report. The Committee was set up by the two branches of the profession and is dominated by lawyers. The Lord Chancellor should be asked if he (or his Department) has represented Government views to the Committee, and to circulate these to members of E(CP).

Fusion

6. The fusion of the two branches of the profession is a subject on which it is not easy for the layman to comment. The interest of the Government is that continued separation should not be allowed to impair the efficiency (and therefore the costs) of the courts and also add to the considerable legal aid bill, and the Lord Chancellor should be ready to examine any aspect of fusion that has such an effect (in the spirit of paragraph 3 of his paper). The desirability of specialist advocacy skills can be over-stated. Barristers being generally cheaper than solicitors is a more germane point though the ability of certain members of the Bar to earn vast sums is an embarrassment since these tend to be quoted against the Government in the contexts of fees paid for publicy-funded work and difficulties in recruiting judges.

7. The benefits of distancing barristers from their clients are not apparent. It can work against the legally-aided client who sees the barrister only an hour before entering the court, too late to contact a witness whom the barrister may consider crucial. The well-heeled client, on the other hand, has no such problem and it is extremely doubtful whether in such cases the duty to the court

does over-ride the duty to the client. Otherwise, it would not be necessary for the Government to be contemplating legislation against the right of silence in order to overcome the "ambush" defence.

Rights of audience

8. Again the adversarial system is prayed in aid, but not altogether convincingly. The effect of the current restrictions is to leave curious gaps. For instance, CPS lawyers are unable to prosecute in the Crown court even though a considerable percentage of cases (by volume) is relatively undemanding. Other Government lawyers (eg from HM Customs) are unable to present cases in their special fields. Even the Lord Chancellor's Official Solicitor is unable to appear in certain of the Lord Chancellor's courts. At a lower level, confining rights of audience in the magistrates' courts to the legal profession can deny the inarticulate (who may have been refused legal aid) from any hope of defending themselves adequately, even though they might have access to someone who could speak effectively on their behalf. The Lord Chancellor should raise all these points with the Marre Committee.

The Efficiency Commission

9. This is an informal assembly of representatives from the Bar, the Law Society and the Lord Chancellor's Department. It was set up as a quid pro quo for the 1986 remuneration settlement when the profession sought judicial review of the Lord Chancellor's decision. But in practice it has delivered very little other than some reduction in double-manning and, it would seem, very little in the way of allowing greater direct access to barristers. Relaxation of the rule requiring barristers to be accompanied in court by a solicitor's representative is something which could and should have been dealt with by the Commission.

Reference No: E 0504

CHANCELLOR OF THE EXCHEQUER

COMPETITION AND EMPLOYMENT LAW

(E(CP)(88)5)

DECISIONS

You may wish the Sub-Committee -

i. to agree that future MMC studies of nationalised industries should be asked to cover the scope for improvements in the efficient use of manpower and, where appropriate, to make recommendations on restrictive labour practices; and

ii. to welcome Mr Hurd's agreement to officials' working up the terms of a possible MMC reference on restrictive labour practices in broadcasting (including the activities of Equity and the Musicians Union).

BACKGROUND

2. At E(CP) last July (E(CP)(87)1st Meeting) Mr Fowler was invited to consider with colleagues whether any restrictive labour practices should be referred to the MMC. Such a reference would be under the hitherto-unused powers of section 79 of the Fair Trading Act 1973. Lord Young, Mr Fowler and Mr Lamont favour a reference of broadcasting, which would be fairly widely drafted but primarily focussed on the restrictive practices in television programme making. Such a reference could sweep up an outstanding remit from E(A) to consider the activities of Equity and the Musicians Union. During the autumn Mr Hurd resisted such a reference on the grounds that the independent TV companies are at long last starting to tackle these practices and would not welcome an external scrutiny by the MMC. However, his approach has softened slightly in his letter of 22 January to Mr Fowler (copy attached). In this he

agrees to officials considering what the detailed terms of such a reference might consist of, without prejudice to a decision on the principle. It will not be appropriate to take the substantive decision at this meeting of E(CP) in advance of receiving the detailed draft terms of reference from officials, but you may wish to give the proposal as fair a wind as possible.

ISSUES

Addition to terms of MMC section 11 nationalised industry references

3. This is unlikely to be controversial. Mr Fowler's paper proposes that the regular MMC scrutinies of nationalised industries should include a look at the scope for improving the efficiency of manpower use and investigate any restrictive labour practices. Lord Young may suggest that this extension of MMC references should be interpreted flexibly, to take account of the particular circumstances of each industry at the time of the reference. You may wish to invite the Sub-Committee to agree to Mr Fowler's recommendation, subject to an appropriate reference to flexibility if needed.

Section 79 MMC reference of broadcasting

4. A brief discussion of the case for referring broadcasting labour practices to the MMC may be helpful, by conveying to Mr Hurd the strength of feeling of his colleagues that such a reference is desirable. His willingness to contemplate a reference, by agreeing without commitment to the terms being considered, could be welcomed. You may wish to indicate that if Mr Fowler and Mr Hurd can agree on a reference there is no need for a further discussion in E(CP), but that if there is disagreement E(CP) will have to resolve it, preferably at its meeting in March.

E(A) remit

5. At E(A) on 21 September the Prime Minister asked Lord Young, in consultation with Mr Fowler, to 'explore what might be done to reduce the restrictive trade practices of Equity and the Musicians' Union in the broadcasting industry and elsewhere'. If an MMC reference can be agreed, it should also, subject to the Prime Minister's agreement, meet that remit. If it cannot, Lord Young and Mr Fowler will have to consider other ways of meeting the remit. There seems no need for E(CP) to be concerned with this question now.

Other candidates for section 79 references

6. You may wish to express some disappointment that members of the Sub-Committee were not willing to come up with more suggestions for section 79 references of restrictive labour practices. It would probably be a vain hope to expect any volunteers now. Clearly the situation has improved very considerably since 1979.

7. Last October Mr Lamont proposed that British Rail's Network South East might be a suitable candidate. Mr Channon expressed his opposition on the grounds that Network South East had twice been referred ordinarily to the MMC. In the light of E(NI)'s decision last week to refer BR Provincial in the 1988 MMC programme, we understand that Mr Lamont is unlikely to pursue his suggestion.

HANDLING

8. You will wish to invite Secretary of State for Employment to introduce his paper. The Secretary of State for Trade and Industry and the Financial Secretary, Treasury could be asked for their views. The Home Secretary's invitation to this meeting has been extended to this item because of his responsibility for broadcasting, and he will wish to speak. Other Ministers may wish to contribute.

G W MONGER

Cabinet Office
27 January 1988

Ch.

Mr Moore cannot attend, and sends his apologies. He has asked that Mr Newton attends in his place.

2. Mr Rifkind (who we thought it would be helpful to invite for item 1) cannot attend — he is sending Mr Lang instead.

27/1

MINISTRY OF DEFENCE
WHITEHALL LONDON SW1A 2HB

Telephone 01-218 6621 (Direct Dialling)
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Minister of State
for Defence Procurement

D/MIN(DP)/DGT/12/7

27th January 1988

Dear Nigel,

I regret that I shall be unable to attend the meeting of E(CP) on Thursday, 28th January, and that the Department will not be represented. The meeting unfortunately coincides with the publication of a report on the health of our nuclear test veterans, and I must hold myself available for interviews if these are required.

I have seen the papers for the meeting and am satisfied that there is nothing of vital import to the Ministry of Defence. But I will, of course, study the Minutes carefully.

Yours,

David.

Lord Trefgarne

The Rt Hon Nigel Lawson MP

100/G/IEP/815/10

CONFIDENTIAL

From: S J FLANAGAN
Date: 27 January 1988

1 MR MACAULSAN

2 CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Mr Monck
Mr Burgner
Mr C W Kelly
Mr Mountfield
Mr Burr
Mr Davis
Mr Gilhooly
Mr Revolta
Mr Saunders
Mr Waller
Mr Bolt
Mr DeBerker
Mr Guy
Mr Molan
Ms Roberts
Mr Russell
Mr J Stevens
Mr Symes
Mr Wynn Owen

Chairman's briefs are in the appropriate sections.

E(CP), THURSDAY 28 JANUARY 1988, 4.00pm

You are chairing E(CP) tomorrow afternoon. The Financial Secretary will be representing the Treasury.

2. I attach briefing as follows:

(i) **Competition in the legal profession:** brief by HE1 division at **Annex A.** The Lord Chancellor, the Attorney General, and the Home Secretary are attending for this item, which has been deferred from the last meeting of E(CP) on 19 November 1987 (when the Lord Chancellor was unable to attend);

(ii) **Competition and Employment Law:** brief at **Annex B.** The Home Secretary will also be attending for this item, which covers inter alia an MMC reference on broadcasting;

(iii) **Local authority national pay agreements:** brief by Pay 1 division at **Annex C;**

(iv) **Voluntary restraint arrangements on imports:** brief by AEF 1 division at **Annex D.**

(v) **Action programme and future work of sub-committee:** brief at **Annex E.** It will be important to avoid this item being squeezed, as it is important to maintain the momentum of work on competition.

Steven Flanagan

S J FLANAGAN

Reference No: E 0501

CHANCELLOR OF THE EXCHEQUER

LOCAL AUTHORITY NATIONAL PAY AGREEMENTS

[E(CP)(88)4]

DECISIONS

The Sub-Committee need to decide whether to take action to change the present national arrangements for setting local authority pay. The aim would be to introduce more local variation in pay levels. The options identified by officials are -

i. To encourage action already in train on a voluntary basis.

ii. To consult local authorities on legislation which would enable them to opt out of the national pay bargaining arrangements without facing claims for unfair dismissal from their staff.

iii. To consult all employers (including those in the private sector) about a universal change of the same sort.

2. Mr Ridley and Mr Fowler see great difficulties in the two legislative options, since they would involve removing employees rights under employment protection legislation (and possibly under common law as well). They therefore favour option i., based on encouraging voluntary action by local authorities, both collectively and individually.

BACKGROUND

3. The present Memorandum fulfills a remit from E(CP) on 20 July 1987 (E(CP)(87)1st Meeting, Item 2). The Sub-Committee noted that several local authorities wished to be free to negotiate their own pay settlements with their own employees, and not be tied by national pay agreements. They could not do this because their employees' contract of employments specified pay rates agreed under the national negotiating arrangements. The Employment and Environment Secretaries were asked to consider whether further action by the Government was desirable.

4. There are now special pay arrangements for employees who account for about 40 per cent of the local authority pay bill, including teachers, the police and firemen. However the remainder are covered by unconstrained national collective bargaining arrangements. Recent years have seen an acceleration in pay settlements for this group. The 1987 award for local authority manual workers was no less than 10.6 per cent and set a damaging precedent for the 1987-8 pay round. Although the employers originally intended to secure substantial management benefits in return for this settlement, they eventually conceded nearly all these points during the negotiations. A number of authorities have again pressed to be allowed to opt out of the present pay arrangements.

MAIN ISSUES

A voluntary approach

5. Mr Ridley and Mr Fowler recommend encouraging voluntary moves by local authorities collectively (through LACSAB) to introduce more local variability into the present national negotiating arrangements, and by individual authorities to negotiate their way out of the national framework. This approach may indeed be the best. But there must be doubts about whether it will deliver worthwhile results. The experience of the 1987 manuals' settlement does not suggest that the employers collectively are prepared to take on the unions over the issue of local arrangements for setting

bonuses or productivity arrangements, much less basic pay levels. Equally staff seem unlikely to concede local bargaining by negotiation, unless they believe it will lead to higher pay levels (which might well be the case in London for example). You may therefore want to press Mr Ridley and Mr Fowler about how much can realistically be expected from a voluntary approach.

6. There are two possible additions to the voluntary approach which are not mentioned in the paper:

a. The threat of legislation if local authorities cannot agree a satisfactory change in the arrangements. Do Mr Fowler and Mr Ridley think that this would help to get some movement?

b. A move by a local authority to test the law. According to the paper, the great objection to withdrawal from the national machinery by an individual authority is that it would affect contracts of employment and so lead to claims for unfair dismissal. But it also says that the law has not been tested. Would a local authority be willing to test it?

Possible Alternative Action

7. The only legislative option considered by the paper is one to amend the statutory definition of 'dismissal' so that it does not cover action by an employer to terminate one contract and offer another, if the only difference between the two is the system of pay determination. It was suggested by Westminster City Council, as a way of removing the main constraint on decisions by local authorities to withdraw from the national machinery. It would however breach what the paper calls the 'sanctity' of the individual employment contract. The paper says, perhaps rightly, that would be extremely controversial.

8. Would an alternative be to legislate directly to change the negotiating arrangements themselves? Such legislation could for example provide that negotiations on bonus and productivity arrangements should be local rather than national. At the extreme, the whole machinery could be changed, as happened with the legislation on the teachers. It is not clear whether legislation on contracts of employment or the definition of unfair dismissal would be required; at least the difficulty was successfully overcome in the legislation on teachers' negotiations. If in discussion this idea looked at all promising, you could ask Mr Ridley and Mr Fowler to study it further.

HANDLING

9. You will want to ask the Environment Secretary and the Employment Secretary to speak to their joint Memorandum. The Chief Secretary, Treasury will wish to comment, as may Ministers responsible for individual local authority services.

G W MONGER

Cabinet Office
27 January 1988

ANNEX

E(CP)(88)5: COMPETITION AND EMPLOYMENT LAW

Note by the Secretary of State for Employment

Proposal

1. Mr Fowler proposes:

- that future **MMC studies of nationalised industries** should explicitly cover manpower and restrictive labour practices

- that officials in relevant departments should prepare an MMC reference (under **Section 79** of the 1973 Fair Trading Act) on restrictive labour practices in **broadcasting.** This would include the activities of **Equity** and the **Musicians Union**

- that there should not be a Section 79 reference on British Rail Network South-East

Line to Take

2. **Agree** that it is sensible to include **manpower** and restrictive labour practices in MMC studies of nationalised industries.

3. Accept that there should not be a Section 79 reference on **BR Network South-East,** at least for the time being. The MMC will be conducting a study on the provincial network, which will allow the issue to be taken up again, if necessary.

4. **Support** the proposal to remit officials to prepare an MMC reference on **broadcasting** restrictive practices. Home Office are likely to press for them to consider only whether there should be a reference.

5. Keep **options open on Equity and the Musicians Union.** It may be that this would fit with the broadcasting reference, but that is intended to centre on technicians' practices. The Home Secretary is also resisting the idea of a broadcasting MMC reference. Officials should consider how the two might fit together, but the option of referring Equity and the Musicians Unions separately should remain.

6. The aim should be to ensure that the **precedent of using Section 79** is set, even if the area studied is not of particular economic interest.

Background

7. E(CP) on 20 July 1987 invited Mr Fowler to bring forward a paper on labour market restrictive practices which might be referred to the Monopolies and Megers Commission (MMC). Accordingly, his letter of 28 July to Lord Young, copied to E(CP) members, asked for suggestions of appropriate groups to refer.

8. Section 79 of the Fair Trading Act 1973 allows the following questions to be referred to the MMC:

(1) whether a practice of a description specified in the reference exists and, if so, whether it is a **restrictive practice**

(2) if it is such a practice, whether it operates or may be expected to operate against the **public interest** and, if so, what particular effects adverse to the public interest it has or may be expected to have.

9. This section of the legislation has never been used, so a reference now would not only be of use in its own right if it uncovered undesirable practices, but it would set a precedent for using the legislation this way, and would be a useful public signal of the Government attitude towards restrictive labour practices. What would follow is unclear, though, as the legislation does not give the Secretary of State powers to make the restrictive practices illegal thereafter.

10. The results of Mr Fowler's trawl were disappointing. The three possibilities suggested were:

- British Rail Network South-East
- Broadcasting
- Equity and the Musicians Union

11. Network South-East's labour practices were criticised in a recent MMC report, which prompted the Financial Secretary to suggest them as a possible candidate for a Section 79 reference. The Secretary of State for Transport has resisted this. Since there will be an MMC study on provincial services later this year, which will provide an opportunity to return to the issue, we would not press it now.

12. On Broadcasting, the Home Secretary believes that a Section 79 reference would be unnecessary because of his other initiatives in this area. Both Lord Young and the Financial Secretary have, however, pressed for a reference, and believe it would complement Mr Hurd's other measures. It appears that Mr Fowler agrees. The Prime Minister has called broadcasting "the last bastion of restrictive practices" and the current industrial dispute at TV-AM makes a reference timely.

13. Lord Young also suggested a reference of Equity and the Musicians Union. Mr Fowler is worried about the defence the unions would mount, and does not believe they are economically particularly significant. He therefore suggests that this aspect be included in the scope of the broadcasting reference. This would be acceptable (although it might move the focus of the broadcasting reference away from the practices of technicians) provided the broadcasting reference goes ahead. If it does not, the option should still be available of referring Equity and the Musicians Union as a separate case.

Reference No E 0502

CHANCELLOR OF THE EXCHEQUER

VOLUNTARY RESTRAINT ARRANGEMENTS ON IMPORTS (VRAs)
(E(CP)(88)2)

DECISIONS

You may wish the Sub-Committee -

i. to note the new deadlines for the VRA reviews which were due to have been completed by the end of last year but have slipped;

ii. to ask for prior discussion of the sensitive decision on termination of the VRA on Japanese cars;

iii. (if the point is raised in discussion) to investigate whether certain industries are seeking to perpetuate VRAs on which Government support has been withdrawn; and

iv. (again if the point is raised in discussion) to decide that officials should agree the methodology of future reviews of VRAs before they are undertaken.

BACKGROUND

2. Lord Young was given a remit at E(CP) last July (E(CP)(87)1st Meeting) to arrange for a review of all Voluntary Restraint Arrangements on Imports (VRAs), without a definite termination date, by the end of the last year. Some progress has been made, in that before the end of last year Lord Young decided to conclude the VRAs on cutlery with Japan and South Korea and the pottery VRA with Japan. The only VRAs on which a final decision to discontinue has not been made are:

- Japanese machine tools.

- Footwear, from South Korea, Czechoslovakia, Poland and Romania.

- Japanese cars, light commercial vehicles and trucks.

ISSUES

VRAs on machine tools and footwear

3. Of remaining VRAs that on Japanese machine tools was extended for one year last autumn. Reviews of the 4 VRAs on footware are currently under way, and Lord Young has promised to let E(CP) know the outcome in March. The normal procedure for E(CP)'s scrutiny of VRAs has been to leave the decision on terminating ~~on~~ individual agreements to the discretion of the Secretary of State for Trade and Industry. If he decides to extend the 4 footwear agreements and the reasons appear weak, this can be challenged at E(CP)'s March meeting. No substantive discussions of these VRAs seems necessary now.

VRA on Japanese cars

4. This is by far the most important VRA and the slippage in dealing with it is disappointing. Given the sensitivity of the VRA on Japanese cars, and the potential impact of its termination of the Rover Group, there seems a strong case for collective discussion of the decision on termination of this VRA. You could therefore ask Lord Young to submit his recommendation on the Japanese VRA to E(CP), instead of reporting his decision as has happened previously. He says he will report the outcome on cars 'as soon as possible', and you might set the target of the meeting planned for March. The VRAs on Japanese light commercial trucks and vehicles can follow later.

Cessation of VRAs after withdrawal of Government support

5. Treasury officials understand that certain UK industries are seeking to continue VRAs with their industrial counterparts in other countries, after we have terminated our support. DTI have not made a major policy statement on withdrawal of support of VRAs whilst some agreements are still continuing, so it is possible that some foreign Governments and industries are unaware of our revised policy. If the Financial Secretary raises this point, and some significant continuation of spent VRAs becomes apparent during discussion, you may wish to ask Lord Young for a report on this for consideration at E(CP)'s next meeting in March.

Methodology of future VRA reviews

6. Treasury officials have expressed concern at DTI's methodology in conducting some of the recent VRA reviews. They point to the fact that the framework for the machine tool reference was agreed with the relevant trade association, and are therefore concerned that the review concentrated on the costs and benefits to that industry of continuing its VRA. They suggest, instead, that a full analysis of the national costs and benefits should be undertaken. This should not give rise to substantive discussion between Ministers. If the point is raised you could suggest further discussion beween DTI and the Treasury on the point.

HANDLING

7. You will wish the Secretary of State for Trade and Industry to introduce his paper. The Financial Secretary, Treasury will wish to respond. The Secretary of State for Transport may have views on the Japanese vehicles VRAs. Other Ministers may wish to contribute to the discussion.

G W MONGER

Cabinet Office
27 January 1988

ANNJHMT-

CONFIDENTIAL

E(CP)(84)4 LOCAL AUTHORITY NATIONAL PAY AGREEMENTS

The Paper

The paper stems from a remit from the meeting of E(CP) in July to Mr Fowler and Mr Ridley.

2. It considers the possibility of amending legislation **to allow local authorities (LAs) to unilaterally introduce local pay agreements** in place of the nationally negotiated arrangements which are written into their employees' contracts of employment. At the moment they cannot do this unilaterally, because it would breach the contracts and trigger claims for unfair dismissal. **The conclusion is that there should be no legislation, but that the possibility should be kept in reserve.** We do not think that the discussion will take long because the conclusion is not contentious.

Line to take

- **agree to voluntary approach (understand other Ministers are content)**

- **point out that continued pressure on LA finance through firm RSG settlements best way to ensure moderate pay increases and local flexibility.**

Background

4. **The Present System:** there are about 2.9m LA employees with a pay bill of £20bn. Since 1985, most of the negotiating groups have been Labour controlled, and they have conceded substantial rises.

5. Paragraph 5 of the paper says that the pay arrangements for teachers, firemen and police are out of LAs' hands. This

is only true for teachers. Mr Hurd may point out that the Official side arrangements for fire and police are dominated by LA representatives.

6. **The Scope for Local Variations:** the national agreements already allow some flexibility for local variations, and there were hopes that the 1986 LA manual workers' pay settlement would increase it. In the end there was an excessive pay settlement (10.6 per cent), but virtually no additional flexibility.

7. **Government Influence over Local Authority Pay:** Ministers can only influence pay through the Rate Support Grant (RSG), but it is difficult to avoid validating previous pay increases. If Aggregate Exchequer Grant is not set at a level which allows modest rate increases for responsible LAs, it is difficult to argue that rate increases follow from irresponsible behaviour in the year ahead. You may wish to point out that this is a matter of political will. If the RSG was not increased to take account of past pay awards, the financial effects on LAs might make them more cautious. The difficulty is that until later, lower, pay awards came through all LAs would be penalised for the consequences of excessive national pay awards. The Chief Secretary has drawn attention to the dangers of financing all pay settlements retrospectively through a "fixed grant percentage".

8. The introduction of Community Charge should increase the pressure for modest pay settlements (although the point about political will still applies) as will the proposals in the Local Government Bill to extend competitive tendering. LAs and unions are becoming aware that high settlements could make their labour forces uncompetitive.

9. **Government Pressure for Local Pay Bargaining:** a few Conservative LAs have responded enthusiastically to Ministers' views about the need to tie pay rates to local market conditions. And

the Local Authority Conditions of Service Advisory Board (LACSAB) have produced a consultative document which recognises the need for greater local discretion and flexibility within national agreements. If a greater degree of flexibility could be incorporated into the national agreements, and the provisions were actually used, the agreements would be acceptable provided they did not set minimum increases which were excessive to start with.

10. **Difficulties in Moving to Local Bargaining:** the paper points out difficulties LA's face in moving to local agreements and the necessity of doing this by negotiation in the absence of legislation. It also airs the possibilities of a two tier wage system where recruits are given different, and less favourable, pay and conditions than the existing labour force. This has been tried by some firms in the US but it has not been successful. The paper implicitly rejects such a solution for LA's.

11. **Legislative Possibilities, Contract and Public Law aspects of Legislative Changes:** Westminister City Council have suggested that the contract problem could be dealt with by amending the definition of dismissal in the 1978 Employment Protection Act to exclude situations where an employer terminates one contract and immediately offers another - the only difference being in the system for pay determination. It is pointed out that this would not be sufficient. There would also have to be legislation to prevent employees suing for breach of contract under common law, and to prevent such actions being challenged under public law eg the 1972 Local Government Act.

12. Passing the necessary legislation would be controversial. It would be difficult to restrict it just to LA employees (so all employees might feel threatened), and LAs taking advantage of such legislation would probably face substantial industrial disruption when they actually used it. So there is considerable doubt how many LA's would take up the opportunity.

13. But the most important reason for not introducing legislation is not properly explained. Trade Union reform has been based on the application of the civil law to contracts between an employee and his employer. The 1984 Trade Union Act ensures that the ballot paper for a strike ballot makes it clear to the employee, that if he goes on strike, he will be breaching his contract with his employer. The Employment bill before the House contains a clause to ensure that, for the purposes of current Trade Union legislation, civil servants are deemed to have a contract to break should they go on strike. Legislation which allows employers to escape the consequence of breaking their side of the contract of employment does not fit well with this approach.

14 **Conclusions:** The paper identifies 3 approaches:

(A) continue with the voluntary approach

(B) consult LAs on legislative changes

(C) consult employers more widely about legislative changes for national agreements generally.

The paper comes down firmly in favour of the voluntary approach (A) with the suggestion that the possibility of legislation is kept on reserve. We think you will want to agree to this, but you may wish to point out that if there is no legislation at this stage it could be much more difficult to do it later. You may also want to emphasise that the problem is not national agreements in themselves, but excessive pay increases setting an unnecessarily high floor and lack of local flexibility. The solution is to maintain the pressure on LAs to ensure that they behave as required. There is no need to abolish national agreements provied they are appropriately drafted.

15. LG and IRD are content.

Reference No E 0503

CHANCELLOR OF THE EXCHEQUER

Action Programme and Future Work of the Sub-Committee

DECISIONS

You will wish the Sub-Committee -

i. to endorse the revised Action Programme attached to Mr Maude's paper;

ii. to agree the agenda for a meeting after the Budget in March; and

iii. to note that further proposals for action may be forthcoming after Mr Maude's discussions with MAFF, Home Office and DHSS Ministers.

BACKGROUND

2. The Action Programme has been a regular feature of E(CP) meetings since the Competition Initiative was launched in 1984. It has been revised in accordance with a remit from the Sub-Committee last July (E(CP)(87)1st Meeting).

ISSUES

Action Programme

3. This should not give rise to substantive discussion. It has been considerably revised in the last six months and incorporates the contributions from all departments represented on E(CP).

Agenda for March Meeting

4. The provisional agenda is described in paragraph 4 of Mr Maude's paper. There should not need to be any discussion of the timing of the DTI papers on management of the Radio Frequency Spectrum and on EC Car Price differentials, although you might like

to chide DTI on the time it has taken them to produce these papers (the remit on radio frequency spectrum management dates back to July 1986, and that on EC car price differentials to December 1986). The amount of business on VRAs will depend on discussion of the previous item. Mr Newton may suggest that E(CP) is no longer a suitable forum for a general paper on Competition in Health Care Services, and that this should be considered by whatever new arrangements the Prime Minister establishes for discussing NHS policy. This may be true, although you may wish to keep options open for the time being. The remit given by E(CP)(87)2nd Meeting in November to consider the NHS Pharmacy contract should not however be affected. Mr MacGregor may point out that the minutes of E(CP)(87)1st Meeting only require him to submit a paper on his detailed review of the case for retaining the British Wool Marketing Board some time in 1988. However, the Forward Look submitted by his Ministry to the Cabinet Office last December volunteered that this paper might be ready before Easter. If Mr MacGregor indicates slippage from this, you could press him about the progress of his review.

5. Lord Young has indicated in a letter from his private secretary of 6 January that he may wish to persuade E(CP) to amend its decision on the break up of the Phonographic Performance Limited cartel (E(CP)(87)2nd Meeting). At present he has a remit to bring forward with Mr Hurd detailed proposals for a breakup by early 1988, so the issue could well need to be on E(CP)'s March agenda in any event.

HANDLING

6. You may wish to invite the Parliamentary Under-Secretary of State for Corporate and Consumer Affairs to introduce his paper. Other Ministers may wish to comment, particularly on the agenda for the March meeting of E(CP).

G W MONGER

Cabinet Office
27 January 1988

ANNEX D HMT-

CONFIDENTIAL

E(CP)(88)2: VOLUNTARY RESTRAINT ARRANGEMENTS (VRAs) ON IMPORTS

THE PAPER

Lord Young reports that support for 4 VRAs ceased at the end of 1987 leaving 8 out of the original 35 subject to review. Of these, support will be withdrawn from 2 (fork lift trucks with Japan and special steels with Spain) at the end of 1988 and 6 remain without termination dates but are subject to annual reviews. (One of the 6, covering special steels with Japan, has in fact lapsed as the EC has not renewed the umbrella VRA for the community.)

2. The latest review of four the VRA on Japanese machine tools is said to have found that while the UK industry is making efforts to improve its international competitiveness, performance varies between the machining centres sector, where progress is encouraging, and the computer numerically controlled (CNC) lathes sector where further investment is needed to increase competitiveness which remains poor. The results of the review have led Lord Young to decide that support for this VRA should continue subject to a further review next Autumn focussing in particular on the case for protecting CNC manufacturers.

3. The review of the four VRAs on footwear with South Korea, Poland, Czechoslavakia and Romania is underway and Lord Young hopes to report the outcome to E(CP) in March.

4. There are three further VRAs to be reviewed which were excluded from the original 35: these are the VRAs with Japan on cars, trucks and light commercial vechicles. Lord Young undertakes to provide a report on the outcome of the review of the politically sensitive car VRA as soon as possible with reports to follow on the remaining two.

5. LINE TO TAKE

i. Aim must be to remove support from remaining VRAs as soon as possible. Does the withdrawal of Government support

mean that a VRA automatically terminates? Are steps always taken by DTI to ensure that industry and Government in exporting country are aware of decision? If not, danger that protection will simply run on.

ii. All remaining VRAs need termination dates. Need to demonstrate against fixed timetable that they are committing sufficient resources to restructuring. Otherwise a danger that the onus of proof for retaining VRA will move back to DTI. Inconsistency with GATT 'safeguards' proposals recently put to Chancellor which seek to impose time-limits on all such measures.

iii. In view of political sensitivity, Committee should consider review of cars VRA before a decision is taken as to whether support should continue. Full economic cost/benefits analysis should be included in report to Committee.

iv. Criteria for reviewing VRAs requires economy-wide costs to be weighed in the balance. No reference to such costs in summary of review of machine tools VRA. Was this aspect covered, at least in qualitative terms?

v. Agree that machine tool VRA should be further reviewed in Autumn. Should also look closely at case for retaining protection for machining centre producers given improvements reported in industry's competitiveness.

vi. Will next review of machine tool VRA be conducted in framework agreed with industry? Loss of industrial sponsorship role by DTI surely implies such working methods will no longer be used. Consumers as well as suppliers need to be consulted.

vii. Beneficial if my officials could be closely involved in annual reviews. Treasury has particular interest in economy-wide costs of VRAs.

BACKGROUND

6. The paper is intended to meet a remit given last July to Lord Young's predecessor to report back on the reviews of outstanding VRAs.

7. Like all barriers to imports, VRAs involve costs to domestic consumer and the economy as a whole. VRAs do not formally involve governments but they could not work without implicit Government support (though see below.) The absence of overt Government involvement means that such arrangements do not put the UK in breach of our GATT obligations. However, the worldwide proliferation of these and other "grey area" measures which undermine the GATT framework is causing concern and the matter will have to be addressed in the current GATT Round. In December Lord Young put proposals to the Chancellor for subjecting such measures to GATT disciplines. These envisaged that, subject to certain criteria being met, protection ("safeguards" in GATT terminology) would be available for a specified period of time only to provide an incentive for the necessary adjustment to take place. (The Chancellor replied to the effect that he considered that further work was needed on the proposals).

8. A review of VRAs was set in hand by Mr Tebbitt in 1985. The review proceeded on the assumption that support would be withdrawn unless the industry concerned could make a strong case for retention of its VRA. DTI was then to analyse the costs and benefits in term of the overall national interest. Continued protection would only be contemplated where it was necessary for industrial restructuring and the attainment of international competitiveness within a reasonable period of time.

9. As the paper shows, a fair amount of progress has been made since the review began. However, DTI's performance could still be better. Full economic assessments have been carried out on those VRAs remaining and subsequent annual reviews are scheduled to take place. But reviews have been subject to delay and the background work on which the Secretary of State's decisions have been based has sometimes been poor. Thus, there are grounds

for maintaining the pressure on DTI. Termination dates are needed and annual reviews should be conducted on time. Co-operation between HMT and DTI at official level over the work of these reviews is important as this will enable us to keep an eye on progress, evaluate the work done and attempt to influence the outcome of reviews. Endorsement by Ministers of such a working relationship would assist here.

10. One aspect which the paper does not cover is whether the withdrawal of Government support means that a VRA automatically ends. Unless the exporting industry and its Government is told of such a decision the UK industry may let the arrangement run on. It is worth probing on this point.

11. On the specific VRA's referred to in the paper, we have seen the report of the review of the Japanese machine tools VRA. This concentrates solely on the effects the VRA have on the industry. We have not seen the policy assessment of the case for retaining the VRA put to Lord Young but past experience suggests that this is unlikely to have taken account of the economy-wide costs arising, which should be weighed against the purported gains to UK machine tool manufacturers. That being the case, the criteria for retention is not being strictly applied. Also, the review of this VRA was conducted within "a framework agreed with the UK Machine Tools Trade Association", ie with the beneficiaries of the arrangement. Now that DTI no longer "sponsors" industries but is concerned about the functioning of markets, such unsatisfactory working methods should give way to strictly objective investigations. Consumer interests should also be considered.

12. In the case of motor vehicles, DTI have been very slow to bring these VRAs within the scope of the exercise. Because of the political sensitivities, eg implications for the Rover Group, and our doubts about the rigour of DTI's assessment there is a strong case for a collective discussion to take place on the cars VRA before Lord Young decides whether to continue support for it. A full economic cost/benefit analysis should be made available which allows the costs to be weighed against the relevant

political factors. Lord Young may resist this suggestion as the paper implies that, in line with past practice, the Committee will be presented with a fait accompli.

ANNEX E

E(CP)(88)3: ACTION PROGRAMME AND FUTURE WORK OF THE SUB-COMMITTEE

Memorandum by the Parliamentary Under Secretary of State for Corporate and Consumer Affairs

Proposal

1. Mr Maude seeks endorsement of the **revised Action Programme** he has drawn up from inter-Departmental correspondence. He will be discussing further measures with various Ministers.

2. Mr Maude also proposes specific **items for a future meeting** of the Committee in March, namely:

- Competition in the Health Care Services (DHSS)
- Review of NHS Pharmacy contract - main issues (DHSS)
- Future of the British Wool Marketing Board (MAFF)
- Management of the Radio Frequency Spectrum (DTI)
- EC car price differentials (DTI)

A sixth item, Voluntary Restraint Arrangements on Imports, has been brought forward to this meeting.

Line to Take

3. You can **endorse the Action Programme,** which is largely descriptive of initiatives currently underway, and the proposed items for the next meeting.

4. You might also look forward to seeing the results of Mr Maude's **discussions with colleagues** on health (noting that the Prime Minister is now taking a personal interest), agriculture and home affairs.

5. You ~~might~~ should ask what is being done in the area of **Telecommunications** raised by the Financial Secretary in his letter of 9 November to Lord Young, and what could usefully be discussed in E(CP).

6. Finally, you might **invite suggestions** for items E(CP) might usefully discuss in future.

Background

7. E(CP) in July 1987 noted that the existing Action Programme was out of date. Lord Young accordingly wrote to you on 31 July 1987, copying to colleagues, seeking amendments to the Action Programme. The Annex to Mr Maude's note is the outcome.

8. On 17 November 1987, Mr Maude wrote to appropriate colleagues suggesting discussions on the following items:

- the Forestry Commission (MAFF)
- agricultural Development Councils (MAFF)
- prison management and ancillary services (Home Office)
- the Tote and the horse-race betting levy (Home Office)

In addition, he may be holding meetings on taxis and hire cars (DTp) and food aid (FCO). It is not now clear whether the planned meeting with DHSS Ministers will take place.

9. In his letter of 9 November, the Financial Secretary suggested four areas where E(CP) papers might be useful. The supply of building land will now be taken in a paper for MISC 133 and postal services have been discussed in E(A). There has not, however, been a reply to the Financial Secretary's suggestions of a paper on telecommunications.

10. The fourth item suggested by the Financial Secretary was health. It will still be useful for E(CP) to review the NHS pharmacy contract and the Pharmaceutical Price Regulations Scheme (PPRS). These would usefully supplement the more general NHS review launched by the Prime Minister. But you might like to consider whether or not a paper on "Competition in the Heath Care Service" generally, as proposed for the next meeting, would be a duplication of effort.

dti

press notice

Chancellor

.88/83

4 February 1988

Press Office
Tel 01-215 4471
Out of Hours
Tel 01-215 7877

CLEARANCE OF MERGER PROPOSAL

The Secretary of State for Trade and Industry has decided, on the information at present before him, and in accordance with the recommendation of the Director General of Fair Trading, not to refer the proposed acquisition by the British Petroleum Company p.l.c. of Britoil plc to the Monopolies and Mergers Commission under the provisions of the Fair Trading Act 1973.

ENDS

declassified 4/2/88 BAA.

CONFIDENTIAL AND MARKET SENSITIVE
UNTIL 9 ~~AM~~ ON 4 FEBRUARY

BP/BRITOIL

NOTES FOR ATTRIBUTABLE PRESS BRIEFING

Q DID THE SECRETARY OF STATE DECIDE NOT TO REFER BECAUSE THE CHANCELLOR HAS MADE IT CLEAR THAT HE WILL USE THE SPECIAL SHARE TO PREVENT ANY BIDDER FROM GAINING CONTROL OF THE BP BOARD?

A. The decision not to refer was not dependent on the existence of the special share. The use of the special share is a matter for the Chancellor of the Exchequer and I cannot add to his statement to the House of 1 February (attached).

Q WHAT ABOUT THE IMPLICATIONS FOR SCOTLAND OF A TAKEOVER BY BP?

A. The Secretary of State considered concerns expressed about Scotland (possible loss of Britoil's headquarters functions) but did not consider that they justified a reference.

SLBAAR

~~CONFIDENTIAL~~ AND MARKET ~~SENSITIVE~~
Declassified 4/2/88 BAA.

CONFIDENTIAL

Ch/
Agree
(i) to scrap the 23/3 meeting, and rearrange for April;
(ii) to write to Lord Young as proposed?
Agreed - 25 11/3

Reference No: E 0523

CHANCELLOR OF THE EXCHEQUER

E(CP) 23 March

We have provisionally arranged an E(CP) for 23 March. It was to discuss papers on:

- EC car price differentials.

- VRAs on imports, especially Japanese cars.

- Radio frequency spectrum management.

2. The meeting could also have provided the opportunity to discuss, if necessary:

- Needletime. You and the Home Secretary have accepted Lord Young's proposal that there should be an MMC enquiry, lasting six months, into breaking up the PPL monopoly. The only outstanding question is whether the draft terms of reference attached to Lord Young's letter of 8 March are acceptable, and in particular whether the enquiry should consider the case for breaking the monopoly as well as the arrangements to be made if it were broken.

- Potato marketing. Mr McGregor proposed in his letter of 22 February to publish a consultative document on the future of potato support in Great Britain. He suggested that one of the three options to be mentioned was abolition of the Marketing Board and the creation of a free market. The Chief Secretary, Lord Young and Mr

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Ridley all argued that the paper should make it clear that this was the Government's preferred option. MAFF tell us that they expect to reach agreement on this, and accept that if there were continuing disagreement it could be resolved at an April meeting.

3. Of the three main papers, that on EC car price differentials has now come round. But DTI now tell us that the paper on the radio frequency spectrum could not be round until the day before the meeting at the earliest, and that the paper on Japanese cars will certainly not be available.

4. I would suggest that, unless you want to discuss the terms of reference for the MMC enquiry on the needletime monopoly it would be better to put off the meeting until next month. We could then be sure of having the radio frequency spectrum paper in good time, and could meanwhile bring further pressure to have a paper on Japanese cars ready as well. The paper on EC car differentials would not be worth a meeting by itself.

5. DTI have not done well on their papers. The remit on radio frequency spectrum goes back originally to July 1986. Last year you asked for it to be ready first for a meeting in September 1987 and then for a meeting very early this year. As to Japanese cars, the remit on VRAs generally goes back to 1985. Last year Lord Young was given a remit to report on it by the end of 1987 and at the last meeting of the Committee in January you said you hoped it could be discussed in March. And of course DTI have also tried to stall on the E(CP) decision on needletime.

6. DTI now say that the radio frequency spectrum paper should be circulated soon, but the paper on Japanese cars may not be ready until June, becaue of the pressure of work on the Rover Group sale. You might like to consider sending a minute to Lord Young to try to get the Japanese cars ready for a meeting next month. I attach a draft accordingly.

7. If you agree, therefore, we shall cancel next Wednesday's meeting and find a time in mid to late April for a meeting to discuss at least EC car price differentials and radio frequency spectrum management and also, we hope, the VRA on Japanese cars.

G W MONGER

Cabinet Office
16 March, 1988

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Re type for Ch to sign

Draft letter for Chancellor of the Exchequer
to send to Secretary of State for
Trade and Industry

As you know, a meeting of E(CP) had been arranged for next Wednesday, 23 March, but has had to be cancelled because insufficient papers were ready. We hope to rearrange it for mid to late April.

I understand that the paper on radio frequency spectrum management will be available for an April meeting. I am sure that the Committee would welcome the chance to discuss it then. I very much hope that the paper on the VRA on Japanese cars could also be ready for such a meeting. The remit is a long standing one and it would now be helpful to dispose of it quickly.

CONFIDENTIAL

mjd 2/22Jn

CONFIDENTIAL

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

17 March 1988

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

As you know, a meeting of E(CP) had been arranged for next Wednesday 23 March, but has had to be cancelled because insufficient papers were ready. We hope to rearrange it for mid to late April.

I understand that the paper on radio frequency spectrum management will be available for an April meeting. I am sure that the Committee would welcome the chance to discuss it then. I very much hope that the paper on the VRA on Japanese cars could also be ready for such a meeting. The remit is a long standing one and it would now be helpful to dispose of it quickly.

NIGEL LAWSON

ps3/37T

CONFIDENTIAL

FW?

FROM: J M G TAYLOR
DATE: 18 March 1988

MR MONGER

E(CP) 23 MARCH

The Chancellor has seen your minute of 16 March, and agrees that we should put off the meeting provisionally arranged for 23 March until next month. He has written to Lord Young on the lines you propose: a copy of that letter is enclosed.

J M G TAYLOR

1. Jonathan
2 Prep

FROM: S P JUDGE
DATE: 21 March 1988

MR EDWARDS

cc PS/Chancellor
PS/Sir Peter Middleton
Sir Geoffrey Littler
Mr Lankester
Mr Odling-Smee
Mr Bonney
Mr Mercer
Mr Mortimer

TREASURY AND CIVIL SERVICE COMMITTEE

The Paymaster General has now read the transcript of the evidence you gave to the TCSC on 2 March.

2. The Paymaster very much enjoyed and admired your performance, the more so in the latter case when contemplating the further supplementary questions submitted by the Committee.

S P JUDGE
Private Secretary

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

Direct line 215 5422
Our ref DW5CRK
Your ref
Date 21 March 1988

Dear Nigel,

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

I have now considered the first annual review of the footwear VRAs on which I was invited to report to E(CP) this month.

Footwear is a complex area with very different product types and quality ranges. The UK industry is also fragmented with many small and medium sized firms alongside a few major companies. This makes it difficult to draw simple conclusions from a monitoring exercise. In general however the review shows that in respect of leather, plastic and rubber footwear there are good prospects of an improvement in the industry's competitive position as recent investment in new technology and changes in manufacturing practice begin to pay off. There is however still quite a way to go. On the other hand there is little likelihood that the industry can become fully competitive with imports of textile uppered footwear from the Far East except possibly in a limited way by importing uppers from low cost sources.

I have therefore concluded that there is a case for continuing to support the inter-industry VRA with Korea if it is successfully re-negotiated. We would however suggest to the British Footwear Manufacturers Federation that we see no case on the information available to us, for it to cover textile uppered footwear. I considered whether to make continuing support subject to a further review in 12 months' time, leaving our attitude to anything beyond that open. I decided however that there would be greater advantage in continuing support for the VRA without further monitoring but subject to a firm cut-off date of mid-1990. This would signal clearly to

the industry that the pressures for adjustment must be faced while allowing a reasonable breathing space of just over 2 years for current modernisation programmes to take effect. This matches the period the Commission have allowed the Italian footwear industry for adjustment in the recent safeguards case against South Korea and Taiwan. I would expect restraint levels in the VRA to be progressively increased over its lifetime.

It is of course possible that the Koreans may refuse to renew the agreement. In that event the VRA would lapse as the footwear VRA with Taiwan lapsed in the past.

By the way, while we might in any case expect Korea to offer strong competition in simple footwear, their exchange rate policy may well have been a factor in the upsurge of Korean exports and therefore in generating pressure for protection.

The VRAs negotiated on our behalf by the Commission with the Governments of Poland, Czechoslovakia and Romania to restrict imports of leather footwear are virtually indistinguishable in their effect from quota restrictions and are seen by the industry as protecting them from possible surges of unfairly traded imports in a sector where effective anti-dumping action is not easy.

I have decided they should in principle continue subject to annual re-examination and to any adjustments in particular limits that may be appropriate.

I am copying to others members of E(CP) and to Sir Robin Butler.

FROM: ROSIE CHADWICK
DATE: 21 March 1988

MR ILETT

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mrs Lomax
Mr Neilson

TAKEOVER PANEL RECEPTION - 27 APRIL 1988

The Paymaster General has received the following invitation, which he is minded to accept.

We understand that Mr Maude is also planning to attend, & if you are content, we plan to obtain a copy of his briefing for use by the Paymaster. Perhaps when you have seen it you could add any Treasury gloss?

REC

ROSIE CHADWICK
Assistant Private Secretary

NB

The Takeover Panel

14th March 1988

Hon Peter Brooke MP
The Paymaster General
HM Treasury
Parliament Street
London
SW1P 3AG

Dear Mr Brooke

Reception on Wednesday, 27th April 1988

Since the Takeover Panel was first established, twenty years ago, it has investigated over 5,000 takeover bids. Occasionally, these have been controversial and the subject of intense media scrutiny and public and Parliamentary debate.

We wonder if you would be free to join us for a drink on Wednesday, 27th April in Dining Room A of the House of Commons from 5.00pm to 6.30pm. Mr John Butterfill MP has very kindly agreed to sponsor the reception.

Both Robert Alexander QC, Chairman of the Panel, and I will be present along with other members of the Panel and its Executive and we very much hope you will be able to come along. Perhaps you could let me know.

I look forward to hearing from you.

Yours sincerely

Antony Beevor
Director General

The Panel on Takeovers and Mergers
P.O. Box No. 226
The Stock Exchange Building
London EC2P 2JX
Tel. 01-382 9026 Fax. 01-638 1554

4369/66

FINANCIAL SECRETARY TO THE TREASURY

PMP

MR MOLAN

FROM: J J HEYWOOD
DATE: 22 March 1988

cc PS/Chancellor
Mr Burgner
Mr Mountfield
Mr MacAuslan
Mr Call
Mr Tyrie

VRAs ON FOOTWEAR

The Financial Secretary has seen Lord Young's minute of 21 March to the Chancellor.

2. He has questioned why there is a case for continuing to support the VRA with Korea. He thinks we should challenge this letter strongly.

J.H.

JEREMY HEYWOOD
Private Secretary

dti
the department for Enterprise

copy no 3 of 7

CH/EXCHEQUER	
REC.	24 MAR 1988
ACTION	Mr WALLER
COPIES TO	C ST. PMG
	Mr ANSON
	Mr MONCK
	Mr BURGNER

SECRET

PRIME MINISTER

ROVER GROUP : REVIEW OF CARS VRA WITH JAPAN

Paragraphs 6-10 of the attached note by officials highlight the implications of the review for the BAe negotiations. In light of that analysis, I should be grateful for urgent agreement that we stand down the VRA review for the forseeable future.

I have made clear to BAe that we will not give them any warranties. But the letter BAe wrote to me on the day we announced negotiations states that they needed to be satisfied that Rover Group would "continue to be eligible to receive any benefits, subsidies and other assistance available from HM Government in support of the motor industry or like business". This arguably means that a failure to disclose the existence of the review would not fall within the 'caveat emptor' principle. BAe could well argue that we should already have disclosed the review and I believe that unless we agree to defer it for the forseeable future, we will have no option but to disclose it. I believe that this could well precipitate BAe's withdrawal.

I am copying this minute to Geoffrey Howe and Nigel Lawson.

D Y

24 March 1988

Department of Trade and Industry

the Enterprise initiative

DC4AIV

dti
the department for Enterprise

SECRET
COMMERCIAL IN CONFIDENCE

BAe/RG NEGOTIATIONS: E(CP) REVIEW OF THE CARS VRA WITH JAPAN

Note by the Department of Trade and Industry

INTRODUCTION

1 Officials from the DTI, the Treasury and the No 10 Policy Unit have agreed the following advice as background to Lord Young's recommendation that the review of the cars VRA should be abandoned for the foreseeable future.

PROGRESS OF THE REVIEW

2 DTI's work to date, and studies by outside academics, have been dogged by uncertainties and problems in estimating the cost of protection to UK consumers and the economy. Estimates range widely, from £100-£700 million a year (in a car market where turnover attributable to private buyers - those most affected by the VRA - is some £6 billion). The VRA clearly imposes some additional cost, especially on private buyers, and this is not compatible with the Government's general competition policy and objectives.

OTHER FACTORS AFFECTING THE VRA'S FUTURE

3 Developments in three areas may eventually make the VRA untenable, or change its nature sharply:

(i) in the GATT Uruguay round, "grey area measures" like VRAs are under scrutiny and may later this decade fall foul of the rollback commitment;

(ii) in the EC, the Commission have long said that they will react to pressure from the European Parliament and the industry by proposing an EC-wide system of import restraint against Japanese cars: they are being very slow in tabling proposals but they may be encouraged to move by their own wish, for single market reasons, to replace the current patchwork of open and closed markets with a coherent and harmonised external policy in the cars sector in time for 1992;

(iii) domestically, under the likely successor to the Restrictive Trade Practices Act in the early 1990s, VRAs will fall within the general prohibition on agreements restricting competition.

IMPLICATIONS OF EARLY, UNILATERAL ENDING OF THE VRA

4 Although for these reasons the VRA may not have a long or secure future, its early ending by unilateral Government action would be likely to have serious effects on the UK market in general and on RG in particular. Precision is impossible, but the Japanese have secured 15-16% of the unprotected German market - despite the presence of particularly strong domestic competitors like VW, GM-Opel and Ford - so penetration of the UK market could reach at least 20%. (One recent estimate by the Economist Intelligence Unit talked of 25%).

5 As regards RG - demonstrably not the strongest UK producer - the resulting market turbulence, including price-cutting in the short term and direct loss of sales, would take it quickly into the critical zone where sustaining the company in its present configuration could be very costly indeed. (Mr Day has long made clear that significantly reduced prices, or loss of even one or two market-share points, would have this effect.)

IMPLICATIONS FOR BAe/RG NEGOTIATIONS

6 In the draft sale and purchase Agreement put to DTI, BAe sought two general provisions which, if they eventually had to be conceded, would target the VRA review precisely:

- first, that the Agreement is conditional on no government or international agency having taken any action which carries a risk that RG will be "materially and adversely affected";

- secondly, that pending completion the SOS should not himself "take or agree to take any actions likely to be detrimental to the interests of RG".

7 In line with our position on undertakings and warranties, we are pressing to have these provisions struck out. But we cannot be certain that, to clinch a final settlement, we shall not be forced some way down this road at the last moment. If so, we would have either to reveal the VRA review - with the clear risk of aborting the negotiations or at least much worsening the terms of the deal - or else follow the patently unacceptable course of failing to disclose the review and risk continuing legal liability for not having done so.

8 But even if we can avoid legal commitments, we do not see how the review can be continued. BAe may well ask about the future of the VRA as part of due diligence or otherwise and we would of course have to answer truthfully. While we cannot guarantee that EC, GATT or other international developments will not erode or alter it over time, it would be quite another matter for us to admit that we were unilaterally reviewing the VRA with a view to withdrawing Government support and so engineering its early collapse.

9 Nor can we in good faith just continue with the negotiations and hope that BAe will not ask the question. This would perhaps be justified in narrow legal terms of "caveat emptor", but as a matter of wider policy HMG could clearly not act in this way.

10 Our advisers, Barings and Slaughter and May, take the firm view that, in the absence of other very compelling policy pressures, the review should be deferred and not reactivated until such time as we can be advised that the risk of liability no longer exists - which means for the foreseeable future.

ALTERNATIVE STRATEGY ON CAR IMPORT RESTRAINTS

11 While this may look regrettable on competition policy grounds, there was anyway emerging doubt whether it would in fact be sensible for the UK to decide unilaterally now to open our market to Japanese imports. To do so would infuriate the French, Italians, Spanish and Portuguese (who themselves virtually exclude such imports) in a

major area of EC external policy. Worse, it would leave the UK as the single focus for extra imports into the EC with no attempt to spread the pain of liberalisation amongst the other member states with restrictions.

12 An alternative strategy might instead be based on what will be needed for completion of the EC single market in 1992 and also to meet the Uruguay round commitments on roll-back and "grey area measures". This might suggest working for an EC regime which would first harmonise national restraints - so spreading the pain to France, Italy etc - but with a view to eventual and progressive liberalisation depending on Japan's own trade performance, the outcome of the Uruguay round and so on.

13 All this plainly needs more thought. But for present purposes the point is that abandonment of the VRA review need not mean a permanent end to developing a medium to longer term strategy on import restraints which fits better with EC and GATT considerations.

CONCLUSIONS

14 In the short term, abandonment of the VRA review will perpetuate some loss to UK consumers. But the elements of an alternative strategy on import restraint, with genuine merit, can be identified. And officials anyway confirm that, for BAe/RG reasons, the review must be abandoned for the foreseeable future.

Vehicles Market Division
Branch 1
DTI

24 March 1988

SECRET

BF 30/3 BF 31/3

From : D L C Peretz
Date : 25 March 1988

ECONOMIC SECRETARY

cc Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Scholar
Mr Odling-Smee
Mr Sedgwick
Mr Grice
Miss O'Mara
Mr Cropper
Mr Tyrie

Mr Patterson - DNS

Mr George) B/E
Mr Plenderleith)

Ch: These are for discussion at EST's funding meeting on 30/3. No need to read the (voluminous) background ppr., but you may like to glance over this covering ppr. by Mr P. JG 25/3

FUNDING STRATEGY : 1988-89

The prospects for 1988-89 set out in the budget forecast raise some interesting issues and opportunities for the Government's borrowing programme. I am attaching a set of papers covering most of the questions that arise :

1: The Prospective Funding Arithmetic

2: Funding Guidelines for 1988-89

3: Review of the Guidelines for 1987-88

4: Certificates of Tax Deposit

5: Implications of the Funding Requirement for the Gilts Market.

I hope we can have a first discussion of the issues at your Funding Meeting on 30 March.

Funding Arithmetic

2. On the figures underlying the MTFS, set out in **Paper 1** attached, funding will be needed to cover £8.2 billion of maturing

gilts and a £1 billion carry over from 1987-88, less a £3 billion contribution from the PSDR and a £3 billion contribution from unwinding of past intervention. This could be covered, roughly, by a £1 billion contribution from national savings, and **gross gilt sales of £2 billion.** There could be more funding to do than this, if for example there is less intervention to support sterling than the £3 billion assumed. And the PSBR for next year could of course be different from forecast. The prospect is uncertain, and we need to remember we thought we were in a similar position a year ago : but in the event had a large amount of intervention to fund. But on any of the more likely scenarios the 1988-89 funding requirement will be significantly less, even in nominal cash terms, than any year since the early 1970s. Average annual gross gilt sales since 1979-80 have been around £12 billion.

3. Our borrowing needs in later years, even with a balanced budget, will normally be larger than this. So we do not want to allow the Government's borrowing machinery, either in the gilts market or Department for National Savings, to fall into disrepair next year. More importantly, a year of low borrowing gives us an opportunity to tackle a variety of debt management objectives.

General strategy for 1988-89

4. In general we suggest we take the opportunity to achieve some restructuring in the current outstanding stock of funding instruments (see attached chart for figures of current stock) :-

a) We should take the opportunity to run down some of the forms of borrowing that are so liquid as scarcely to count as proper funding at all : for example the more liquid forms of national savings, and money held in certificates of tax deposit.

b) We may be able to reduce debt servicing costs by redeeming expensive debt and replacing it with debt we

expect to be cheaper (at present yields this means selling IGs and short conventionals and buying in longs).

c) It may be worth seeking to achieve some smoothing of future humps in the maturity profile by buying in.

National Savings

5. We have not set an annual target for National Savings since 1985-86. We have, rather, followed an approach of making decisions on rates during the year alongside other funding decisions, and in the light of the latest assessment of funding needs, the relative servicing cost of National Savings products and their funding "quality".

6. For 1988-89 we think we should stick to the same approach. We also have to bear in mind other factors. Any sharp change in National Savings can cause acute management problems; it is better to make gradual changes over a period within an agreed overall strategy. There is an outstanding stock of £36 billion held in National Savings, much of which could be withdrawn at fairly short notice; so we need to avoid moves that could create an avalanche of withdrawals, with all the administrative problems that would pose. We also need to watch National Savings' longer-term image. It would take some time to re-establish its reputation as a good place to put personal savings, if that were lost by setting too uncompetitive rates for a period.

7. **Paper 2** discusses guidelines for National Savings strategy for next year against this background. Its main conclusions are :

a) **variable rate gross of tax products.** These are all fairly liquid : capital certain and encashable at short notice and low cost. Although they score technically as "funding" on the present definition, arguably they should not do so. They are however less liquid than most bank and building society deposits. Money on Investment Account is withdrawable at one month's

notice; for income and deposit bonds three months' notice of withdrawal is required and there is a loss of half the interest on amounts repaid in the first year. Moreover, there is some advantage in terms of the cost and mix of Government borrowing in having some significant amount of debt on floating rate terms - and these products are less liquid than alternatives such as Treasury Bills or variable rate gilts. As important, these gross of tax products serve an extra purpose : as the one home for non-taxpayers' savings that is not subject to CRT. Our conclusion is that for the future the rates on these products should be kept just a shade below the competition. The aim would be to give a reasonable deal to non-taxpaying investors, while avoiding abnormally large net inflows or outflows.

b) **matured certificates held on general extension (GER) terms.** These are very liquid and can be repaid within 8 days. Our conclusion is that the tax-free GER should be reduced further in relation to other interest rates, with the aim of shaking out around £2 billion. However, this will be quite an achievement. Maturities in 1988-89 will be around £1.7 billion and until the most recent cut in GER, repayment at maturity accounted for only about 10 per cent of maturing stock. If we reduce the rate substantially and significant outflows still do not occur, then perhaps we should conclude that this money is less liquid than we thought : but at least we would be saving money on the interest (every 1 per cent off the rate saves £75 million a year on the present stock).

c) **five-year certificates,** in contrast, do represent quality funding. Their cost at present is comparable with that of short gilts, and therefore substantially less, on our interest rate expectations, than long gilts. They have the unattractive feature of giving a particular benefit to high rate taxpayers and for that reason we have imposed a maximum £1,000 new purchase

limit. Tax changes in the Budget make the certificates less attractive to higher rate taxpayers. Because of this we think we should consider again, in due course, whether the maximum purchase limit should be raised. But for the time being, the conclusion is that we should keep the maximum purchase limit and aim to continue to keep the servicing cost roughly in line with the cost of 5-year gilts.

8. It is not easy to assess the results of this strategy in terms of net flows to DNS over the year. We could, of course, affect the outcome by making marginal adjustments to rates during the year within the overall strategy. Our best guess is that it might produce a net contribution of £½ billion over the year - ie £½ billion less than assumed in the forecast.

9. We would however like to investigate whether a five year taxable fixed rate bond could be developed, offering no special attraction to high rate taxpayers but with sufficient distinguishing features from gilts. Interest might be paid gross of tax, and a possibility would be to substitute this product for the variable rate deposit bond. If such a product could be sold successfully it might provide a cheaper form of borrowing than conventional gilts - in which case it would be sensible to switch more funding away from gilts and into national savings. We would need to think about the presentation of a new gross of tax product at a time when the change in taxation of husband and wife might make competitors more sensitive on this score : but it would be a rather different product from those offered by banks and building societies. There are a number of other questions both of practicability and of presentation that need to be considered further.

CTDs

10. There is an outstanding stock of some £2½ billion of certificates of tax deposit with the non-bank private sector. Some companies no doubt use these as a genuine convenience, to put money aside for later payment of tax. But there is plenty of

evidence that a high proportion of purchases of CTDs, by value, are of a more speculative nature : hundreds of millions are occasionally bought on single days when market rates fall below the rates offered on CTDs, and round-tripping is possible by borrowing from banks to buy CTDs. This happens when market rates fall very sharply, since for administrative reasons we have to give a day's notice of changes in CTD rates.

11. Although sales of CTDs score as funding on the current definition, there is only quite modest justification for this. This is particularly true of speculative purchases financed by bank borrowing. Also, although CTDs are not marketable, the fact that they may be used against any tax liability means in effect that they are quite liquid in the hands of large companies.

12. Our conclusion is that we should in future set interest rates for CTDs at a level significantly (perhaps about 1%) below LIBID. With a gap of this size there would be little risk of speculative inflows when market rates fall unexpectedly. A gap of this size might cause some complaints from CTD users. But if we went for a smaller gap we would have to investigate ways of adjusting rates more quickly. The Budget forecast assumes net outflows out of CTDs of £250 million over the next financial year. If we keep rates as low as proposed we think we might produce a much larger outflow - perhaps around £1 billion. (As the stock of CTDs turns over about once a year, and most are redeemed in January, there is scope for a still larger rundown but uncertainty over success in achieving any target until late in the financial year).

Gilts

14. Following these recommendations on national savings and CTDs might leave us with a gross gilt sales requirement of a little over £3 billion over the year, rather than the £2 billion assumed in the forecast. The figure will be bigger if there is less negative intervention than assumed; smaller if the PSDR turns out to be larger. But it seems most unlikely to be anything other an a very low figure by the standards of recent years.

15. It would of course be wrong to allow concern about the impact of this on the markets to be a significant factor in our thinking - especially since we would expect issues of corporate and overseas fixed interest debt to some degree to fill the gap. But we do have an interest in retaining a respectably healthy gilts market, against greater gross borrowing needs in future years. **Paper 5** discusses these issues.

16. The low gross sales requirement, however, gives us a management opportunity. Much of the total required sales for the year could probably be tied up in the two further experimental auctions which we want to hold. But we would like to go beyond that, in two ways :

i) Although the "hump" of maturities in 1989-90 looks less worrying than it did, given the much reduced borrowing needs, we should consider a programme of buying in stock from particular maturity "humps" in future years.

ii) At current yields we could somewhat reduce our prospective debt service costs by buying in longer dated stock and issuing a combination of IGs and short dated stock, reducing the average maturity of debt outstanding. At higher yields it would be worth making faster progress in this direction; at significantly lower yields we might want to go into reverse. Our recommendation is that at each month's funding meeting over the year ahead we should agree for the following month not just a net gilt sales target, but also an objective, in numerical terms, for seeking to buy in some kinds of stock and replace them with others, using the guidelines developed in Paper 2 as a basis for these decisions.

Guidelines

17. 1987-88 was the first year for which we have adopted guidelines, to inform decisions about new gilt issues over the year. We think this has proved useful, and would like to adopt

guidelines for 1988-89 on the lines suggested in the Annex to Paper 2. Given the funding position, these clearly need to give greater weight to debt restructuring objectives than the 1987-88 version, and this has involved some changes. We also suggest, for the first time, adopting guidelines to steer decisions on National Savings over the year, and again a draft is annexed to Paper 2.

Views of DNS and Bank of England

18. We have discussed the papers in draft with DNS, and the Bank have seen them. I think we have incorporated most of DNS' comments. The Bank however have some more general reservations, and will be putting in a paper of their own. When that arrives I will let you have any further comments that occur to us. If the Bank's concerns mainly relate to the way the guideline for conventional gilts is expressed, as I think they may, I would hope that after a general discussion at the Funding Meeting it might be possible to achieve subsequent agreement on a version we could both accept. We do not have hard and fast views on how the guideline is expressed : but what we do believe, strongly, is that we should be giving some weight in our funding and debt restructuring decisions to the Government's own expectations about the future course of interest rates and inflation, where these differ from market expectations.

19. I believe the Bank also have a number of detailed points on the papers, which would best be discussed outside the Funding Meeting.

Summary and Conclusion

20. After the adjustments suggested above we would be looking for a £½ billion contribution from National Savings in 1988-89 and gross gilt sales of a little over £3 billion (net sales of -£5 billion). There are large uncertainties. And if we can get a larger contribution (or can only get a smaller contribution) from sales of cheap, quality, National Savings instruments, we should be prepared to adjust the balance.

21. I suggest we do not try to reach agreement on the detailed guidelines suggested in Paper 2 at the Funding Meeting, though I hope we can have some discussion before remitting them for further detailed Treasury/Bank consideration. But I hope we might reach agreement on the following :-

National Savings

i) Rates on gross variable rate products to be kept if anything a shade below the competition.

ii) Further steps down in GER to achieve a shakeout (or to establish that remaining funds not liquid), and cost savings.

iii) Investigation of a new taxable fixed rate product.

CTDs

iv) Set rates in future around 1% below LIBID to achieve shakeout/protect against round tripping and sudden inflows.

Gilts

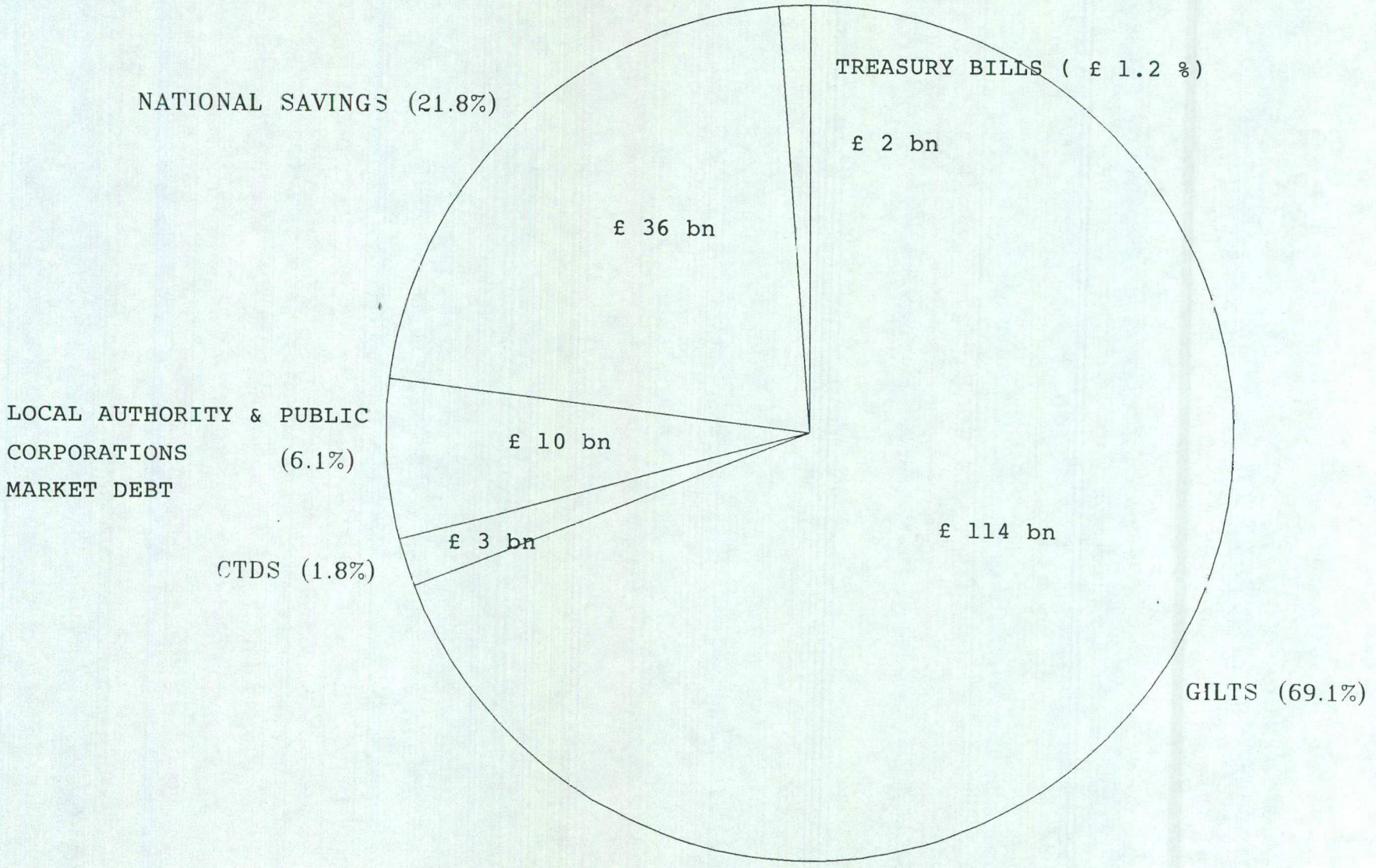
v) A year to pursue restructuring objectives, and in particular to seek to reduce expected debt servicing costs by giving some weight to our own expectations about future inflation and interest rates.

DLCP

D L C PERETZ

GOVERNMENT STERLING FUNDING

AMOUNT OUTSTANDING FEBRUARY 1988



SECRET

cc Chief Secretary
Paymaster General
Mr Anson
Mr Monck
Mr Burgner
Mr Waller

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

25 March 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

ROVER GROUP: REVIEW OF CARS' VRA WITH JAPAN

Thank you for copying to me your minute of 24 March to the Prime Minister. I am content to defer the review of this VRA, for the reasons which you set out.

I am copying this letter to the Prime Minister and Geoffrey Howe.

NIGEL LAWSON

91G.SCB.4318.43

CONFIDENTIAL

~~BE~~ Mup.

FROM: IAN RICH
DATE: 8 April 1988

1. MISS O'~~MARA~~ MoM 8/4
2. ECONOMIC SECRETARY

cc: Chancellor
Sir P Middleton
Sir G Littler
Mr Scholar
Mr Peretz
Mr Grice
Mr Bush
Miss Anderson
Mr Cropper

Mr Patterson) DNS
Mr Ward)

File NSNL R2

NATIONAL SAVINGS: GENERAL EXTENSION RATE (GER)

1. We discussed the GER at the last funding meeting, when you agreed that a further reduction of ¾ per cent from 5.76 per cent to 5.01 per cent should be made on 1 May. This submission, which has been agreed in broad terms with DNS, summarises the background and suggests how the announcement might be timed and presented.

2. GER is paid to holders of savings certificates not cashed at the 5 year maturity point. It is tax free and variable. In theory the GER stock (at present about £7.3 billion) is liquid and not good quality funding. It is capital certain and repayment is available at about 8 days' notice, though mistiming of a repayment application can entail up to 3 months' loss of interest.

3. Our approach since April 1987 has been to encourage withdrawals from the GER stock by a series of reductions in the rate. It fell to 7.5 per cent on 1 April 1987; to 7.02 per cent on 1 May 1987; to 6.51 per cent on 1 October 1987; and to 5.76 per cent on 1 March 1988. The reductions made in 1987 had little impact. There are signs that the reduction on 1 March had more. In March about £70 million appears to have been reinvested and about

£120 million repaid. DNS calculate that if outflows at the peak levels in March were sustained there would be a gross outflow from the GER stock of over £3 billion in 1988-89. However, past experience suggests that in practice such an outflow will not be sustained. Indeed it is already tailing off. Hence the decision at the funding meeting to make another reduction.

4. We also have to take inflows into account. The GER stock increases as certificates come to maturity. In 1988-89, such maturities will be about £1.7 billion, of which up to £1.5 billion might, if last year's experience is repeated, move on to GER. The series of reductions in GER since April 1987 to encourage withdrawals from the GER stock (see paragraph 3) also aimed to divert some of the withdrawals into current issue certificates by providing an additional holdings limit of £5000 for GER reinvestments. An aim of the funding strategy for 1988-89 is to reduce the outstanding GER stock by £2-3 billion, so we expect still further cuts will be needed over the year to bring this aim within reach.

5. Both we and the DNS would like to announce the reduction well in advance. DNS suggest noon on Wednesday 13 April. A draft Press Notice is attached. An announcement fairly early in the month would make it easier to associate the reduction with other national savings rate reductions announced recently - in particular the 1½% a year reduction in the rate payable on Income and Deposit Bonds which takes effect on 1 May. We therefore support the DNS proposal on timing.

6. At the funding meeting, Mr Patterson mentioned his intention to do some modest press advertising (something under £200,000) after the decision had been announced. This would be designed to encourage some outflow of GER money by publicising the cut, but underpin the explanations to be given in the press briefing; help secure some better quality funding by drawing attention to the reinvestment option: and get across the message that National Savings remains a credible and viable savings institution - a continuing need recognised in the funding strategy papers. This would be financed as part of the normal DNS advertising budget.

7. We should be grateful for your agreement to the draft Press Notice and its timing. If you are content, we shall need to send the customary Private Secretary letter to No 10. I attach a draft. We will submit draft Q and A briefing separately.

Ian Rich

IAN RICH

DRAFT

PRESS RELEASE

NEW GENERAL EXTENSION RATE

National Savings announce that the tax-free General Extension Rate applying to many earlier Issues of Savings Certificates will go down from 5·76% p.a. to 5.01% p.a. from 1 May 1988.

Note to Editors

1. The General Extension Rate is a variable rate which now applies to Certificates of the 7th to 14th, 16th, 18th, 19th, 21st, 23rd, 24th and 25th Issues when they have completed their fixed period terms.

2. The current 33rd Issue of National Savings Certificates offers a rate of 7% p.a. tax-free guaranteed for savers who hold their certificates for five full years. Holders of mature Issues may re-invest up to £5000 in the current Issue as well as purchasing the maximum holding of £1,000.

3. Savers who switch from matured Certificates into 33rd Issue will earn interest for each complete period of three months if they have to cash in during the first year. Other savers will only earn interest for the first year if they cash in on or after the first anniversary of purchase.

4. Savers who need to cash in their 33rd Issue certificates before completing the five full years earn returns rising from 5.5% p.a. from date of purchase for a minimum period of 1 year to 6.5% p.a. for a minimum period of 4 years.

NATIONAL SAVINGS

Department for National Savings, Charles House, 375 Kensington High Street, London W14 8SD
Telephone 01-605 9437

91G.SCB.4318.45

DRAFT LETTER TO:

Paul Gray Esq
10 Downing Street
LONDON SW1

NATIONAL SAVINGS: GENERAL EXTENSION RATE

This is to let you know that we have decided to reduce this interest rate, which is paid to holders of matured savings certificates, from 5.76% to 5.01% from 1 May. The Department for National Savings will be announcing this reduction at noon on Wednesday 13 April.

Matured certificates earning the GER can be repaid at about 8 days' notice. Unlike unmatured certificates, there is no disincentive to early repayment through a raked interest rate structure. In the light of this, and our much lower borrowing needs,we aim to reduce the total GER stock (at present about £7.3 billion) by some £2-3 billion by the end of 1988-89. We are therefore making a series of reductions in GER, to encourage repayments and to divert some of these into the current issue certificate which offers a guaranteed tax free return if held to maturity (5 years).

The last reduction in this rate was from 6.51% to 5.76% on 1 March 1988. We expect further reductions over the year will be necessary to bring our aim for the GER stock within reach.

42/2.BTW.4375/37

CONFIDENTIAL

PMP

CC: PPS, CST, PMG, EST
Sir. P. Middleton
Mr. Monck
Mr. Lankester
Mr. Burgner
Mr. P.G.F. Davis
Mr. MacAuslan
Mr. Mountfield
Mr. L. Nolan
Mr. Hughes

Treasury Chambers, Parliament Street, SW1P 3AG

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 OET

18 April 1988

Ms. Symes O/K
Miss. Preston
Mr. Tyrie.
Mr. Call.

Dear David

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

Nigel Lawson has asked me to reply to your letter of 21 March.

I am pleased to learn that you have decided to withdraw support for that part of the Korean VRA relating to textile uppered footwear. But I see no case for support to continue for the rest of the VRA. There is no evidence that the existence of the VRA has had the required beneficial effect on the UK industry which as you say, still has quite a way to go before a significant improvement in its competitive position is likely to emerge. As support for a VRA should only continue if justification for it can be demonstrated, it seems clear to me that we ought not to acquiesce in a further two years' protection over and above the tariff protection. I do not see how we could justify the consequential cost of the VRA to the rest of the economy, which will inevitably arise, running on any longer. Thus, I think that support should be withdrawn forthwith and the industry be left with full incentive to adjust by pursuing as quickly as possible the modernisation programme you refer to. I must therefore ask you to reconsider your decision to continue support for the arrangement until mid-1990, if it is renegotiated. In asking you to do this, I am not disputing the general principle that a firm cut-off date should be set for VRAs. But in this case it seems indisputable that protection has been in place long enough already.

I note your comment that the UK industry sees a need to be protected from imports from Poland, Czechoslovakia and Romania. Can I take it that, on the basis of the information available, you too are fully satisfied that the industry's view is justified? If so, I would be interested to know the basis upon which the annual examinations of these VRAs will be conducted. Given the rationale for these arrangements, this would presumably not be done on the basis of a cost/benefit analysis. Clearly a proper balance needs to be struck between the industry's desire to be protected from unfair competition and the costs of protection falling on the consumer.

As you rightly say in your letter, VRAs are virtually indistinguishable in their effect from quota restrictions. I understand that a number of quota restrictions exist in relation to footwear imports from state trading countries and these were also considered in the review. Although these may not technically fall within the scope of the E(CP) VRA review, they are clearly relevant to the review's objectives of removing trade restrictions which inhibit competition. Thus, I would be interested to know whether you are content that these restrictions and the levels of protection they impose are justified bearing in mind the costs they too must impose on the rest of the UK economy.

I am copying this letter to other members of E(CP) and to Sir Robin Butler.

Yours ever

Norman

NORMAN LAMONT

PWP
(E(CP) plans
for next week)

Ch.

E(CP): 3 May (passim)

The FST will not be able to come to this, ∴ of C.W.H.
EST to "lead" for the Treasury in his place?

OK -

27/4

Ch.

E(CP): 3 May

The Home Office had asked that Mr Renton might accompany Mr Hurd to this meeting. You agreed. They have now asked me if Mr Hurd might be excused.

Content? OK

HR
27/4

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

21 MAR 1988

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

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Direct line 215 5422
Our ref DW5CRK
Your ref
Date 21 March 1988

CHANCELLOR OF THE EXCHEQUER
REC. 21 MAR 1988

FINANCIAL SECRETARY
REC. 21 MAR 1988
ACTION Mr. Nolan
COPIES TO PPS: EST Sir P. Middleton CST Mr. Anson, Mr. Monck, Mr. Lankester Mr. Burgner, Mr. Northfield Mr. Macfarlane Mr. Flanagan, Mr. Gill

Dear Nigel,

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

I have now considered the first annual review of the footwear VRAs on which I was invited to report to E(CP) this month.

Footwear is a complex area with very different product types and quality ranges. The UK industry is also fragmented with many small and medium sized firms alongside a few major companies. This makes it difficult to draw simple conclusions from a monitoring exercise. In general however the review shows that in respect of leather, plastic and rubber footwear there are good prospects of an improvement in the industry's competitive position as recent investment in new technology and changes in manufacturing practice begin to pay off. There is however still quite a way to go. On the other hand there is little likelihood that the industry can become fully competitive with imports of textile uppered footwear from the Far East except possibly in a limited way by importing uppers from low cost sources.

I have therefore concluded that there is a case for continuing to support the inter-industry VRA with Korea if it is successfully re-negotiated. We would however suggest to the British Footwear Manufacturers Federation that we see no case on the information available to us, for it to cover textile uppered footwear. I considered whether to make continuing support subject to a further review in 12 months' time, leaving our attitude to anything beyond that open. I decided however that there would be greater advantage in continuing support for the VRA without further monitoring but subject to a firm cut-off date of mid-1990. This would signal clearly to

the industry that the pressures for adjustment must be faced while allowing a reasonable breathing space of just over 2 years for current modernisation programmes to take effect. This matches the period the Commission have allowed the Italian footwear industry for adjustment in the recent safeguards case against South Korea and Taiwan. I would expect restraint levels in the VRA to be progressively increased over its lifetime.

It is of course possible that the Koreans may refuse to renew the agreement. In that event the VRA would lapse as the footwear VRA with Taiwan lapsed in the past.

By the way, while we might in any case expect Korea to offer strong competition in simple footwear, their exchange rate policy may well have been a factor in the upsurge of Korean exports and therefore in generating pressure for protection.

The VRAs negotiated on our behalf by the Commission with the Governments of Poland, Czechoslovakia and Romania to restrict imports of leather footwear are virtually indistinguishable in their effect from quota restrictions and are seen by the industry as protecting them from possible surges of unfairly traded imports in a sector where effective anti-dumping action is not easy.

I have decided they should in principle continue subject to annual re-examination and to any adjustments in particular limits that may be appropriate.

I am copying to others members of E(CP) and to Sir Robin Butler.

CONFIDENTIAL

Reference No E0550

CHANCELLOR OF THE EXCHEQUER

Motor Vehicles: price differentials in the EC

E(CP)(88)6

DECISIONS

The Secretary of State's paper argues that the differentials between car prices in the UK and in other member States have narrowed recently and that complaints from consumers trying to import cars from other member States have fallen off. He concludes, although he does not say so explicitly, that no special action is needed to improve the working of the market or to safeguard the position of UK car buyers. It is for E(CP) to decide whether they agree with this.

BACKGROUND

2. For many years, there have been complaints that car prices in the UK are much higher than those in some other member States. Belgium and Denmark are the countries most often quoted. People trying to import cars from such countries have also complained of obstruction and delay from suppliers there.

3. One reason for the failure of the market to work properly might be the exemption of car selective distribution systems from the prohibition on restrictive agreements under EC rules. Following pressure on the point, the Commission introduced a new regulation in 1985. This maintained the exemption but required manufacturers, on pain of losing it, to provide the car buyer with certain safeguards, mainly aimed at making it easier for him to import from other member States. One question to consider in the current review is what effect the 1985 Regulation has had.

4. E(CP) last considered the matter in December 1986. Then also the Secretary of State argued that car price differentials were falling and that fewer complaints were being received from car buyers. He said however that he would pursue with the Commission

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the possible issue of further guidelines covering delivery delays, servicing under guarantee, and 'certain remaining distortions, particularly in respect of Denmark and Belgium'. E(CP) decided that these developments were encouraging but that they wanted to keep the matter under review. The Secretary of State was asked to put forward a further paper in the second half of 1987 and meanwhile invite the Commission to issue the further guidelines he had described.

MAIN ISSUES

Car price differentials

5. The table in paragraph 7 of the paper aims to show that differentials have narrowed over the past few years. But, as the paper itself says, (paragraph 6) a major reason for this has been the depreciation of the pound against European currencies. The latest price comparison in the paper is for July 1987 and since then sterling has appreciated against European currencies. It has risen by 6-7 % against both the Belgian franc and the Danish Krone. You might ask if there is any information about price differentials more recent than July 1987.

Position of Denmark and Belgium

6. The paper tries to brush aside the much lower prices which still exist in Denmark and Belgium. For example, paragraph 9 ays that, leaving aside these two countries, price differentials are within the 12% regarded by the Commission as tolerable. By paragraph 12 this has become a statement that the 'general' level is within the Commission tolerance.

7. The position of Denmark and Belgium may be worth probing. At the last E(CP) the then Secretary of State said he would pursue with the Commission the case for further guidelines covering certain remaining distortions 'particularly in respect of Denmark and Belgium'. His paper now says (paragraph 4) that the Commission's publicly-declared intention is to investigate with possible withdrawal of the exemptions in mind only where price

differentials persist above 12%. This condition is satisfied for Denmark and Belgium. Have the Commission carried out their declared policy in respect of those two countries? What progress have DTI made in pressing them on the issue?

Obstacles to personal imports

8. The paper argues (paragraph 10) that complaints about obstacles to personal imports have fallen away recently. You might check that this statement is based on up-to-date information, given the possibility that recent exchange rate movements will have increased the incentive to import. You might also ask for the latest information about the volume of imports. The differential shown in the paper for Belgium, which is conveniently near, would mean a saving of around £1,000 on a comparatively cheap car. Is there a significant level of imports from Belgium? If not, why not?

Rover Group

9. You might ask the Secretary of State how the likely sale of the Rover Group to British Aerospace affects the arguments. He will probably argue that it increases the case against taking any action, at least for the time being. Normal bank!!

Remits from 1986

10. At the last E(CP) meeting on the subject the Secretary of State was asked to invite the Commission to issue further guidelines on these aspects of the Regulation where there were still difficulties. Paragraph 12 of his new paper is probably meant to show what came of this, but you might ask if he is now satisfied that the Commission have taken effective action on the difficulties. (The other remit, on Denmark and Belgium, is mentioned above, in paragraph 7).

11. The 1986 meeting also discussed a paper by the then Secretary of State for Transport on the issue whether consumers' freedom to import should be more tightly controlled to ensure that UK type approval standards were enforced, for example in the interests of

safety. E(CP) decided not to curtail the freedom to import and you will probably not want to reopen that. But it also said that 'it was for consideration whether more should be done to align [UK type approval standards] more closely with those in force elsewhere in the EC'. You might ask the Transport Secretary whether any progress has been made on this since the last meeting. Apparently car component standards are reasonably closely aligned in the Community but whole car standards are not, and Commission attempts to harmonise them have so far made little progress.

Next steps

12. The paper takes for granted the exemption of car distribution systems from EC competition rules. On the face of it, this is the origin of the problem. If you wished E(CP) to take a fundamental look at the problem, you could ask the Secretary of State to prepare a paper on the case for the exemption. This would no doubt dismay DTI, who might be able to argue that there is no prospect of agreement inside the Community on removing the exemption. Or you could simply ask the Secretary of State to circulate another paper giving price information for 1988 as soon as it was available. This need not be for discussion, depending what the new figures showed.

HANDLING

13. The Secretary of State for Trade and Industry will want to introduce his paper and the Economic Secretary Treasury to comment. The only other Minister with a Departmental interest is the Secretary of State for Transport, although that is largely confined to the question of type approval and its effect on imports.

G W MONGER

Cabinet Office
28 April 1988

CONFIDENTIAL

Reference No E 0551

CHANCELLOR OF THE EXCHEQUER

VOLUNTARY RESTRAINT ARRANGEMENTS ON IMPORTS (VRAs)

E(CP)(88)2

(Letter from Lord Young to yourself of 21 March; reply by the Financial Secretary, Treasury to Lord Young of 18 April)

DECISIONS

You may wish the Sub-Committee -

i. to consider whether the VRA on Korean footwear should be terminated now or in two years time;

ii. to consider the case for continuing the VRAs on East European footwear, subject to annual review; and how to deal with quota restrictions, both for these products and more generally;

iii. to ask Lord Young for a report by the next meeting in July about the reported continuation by trade associations of VRAs for which Government support has ended;

iv. to ask Lord Young for a report in the autumn on the annual review of the VRA covering Japanese machine tools.

v. to ask Lord Young whether Rover considerations allow a review of the VRA on Japanese light commercial vehicles and trucks.

BACKGROUND

2. At the last discussion of VRAs in E(CP), in July 1987 (E(CP)(87)1st Meeting), Lord Young proposed that all outstanding VRAs should henceforth be reviewed annually to establish whether their continuation remained in the national interest. Last autumn Government support was withdrawn for VRAs on cutlery with Japan and South Korea, on pottery with Japan, on fork lift trucks with Japan

and on special steels with Spain, and the special steels VRA with Japan lapsed. Lord Young reported the latest position on VRAs in January in E(CP)(88)2, but this paper was not discussed at E(CP)'s last meeting due to lack of time. Recently there has been some backbench and press interest in VRAs. An article appeared in the Economist on 22 April strongly critical of the continuing existence of VRAs (copy attached). A number of parliamentary questions on VRAs have recently been tabled.

3. The only VRAs for which Government support continues are:

- Japanese machine tools (E(CP)(88)2 reported that Lord Young had decided to give this a one year extension to autumn 1988);

- Footwear from South Korea (Lord Young suggested in his letter of 21 March that this should be terminated in mid-1990; replying, Mr Lamont felt support should be withdrawn immediately);

- Footwear from Poland, Czechoslovakia and Romania (Lord Young proposed on 21 March that these VRAs should continue subject to annual review).

- Japanese cars, light commercial vehicle and trucks (it was agreed with the Prime Minister at the end of March that the current review of the Japanese cars VRA should not be pursued).

ISSUES

Korean footwear

4. After reviews of the 4 footwear VRAs were completed in March, Lord Young proposed that support should be withdrawn from the textile uppered part of the Korean VRA, since there seemed little prospect of the UK industry becoming competitive in this market. But he also proposed a 2 year extension of the remainder of the VRA before it was also terminated in mid-1990. He argued that recent investment in new technology and changes in working practices offered the prospect of improved international competitiveness for

the UK industry in the leather, plastic and rubber footwear markets, if some VRA protection was extended for a limited period. In his letter of 18 April, Mr Lamont suggested that the previous existence of this VRA did not appear to have had any noticeable beneficial effect on the UK industry, and that support should be withdrawn forthwith so that the economy as a whole could benefit from cheaper footwear. The debate may be a hypothetical one, for any continuation of this VRA depends on Korean agreement, and this has not yet been forthcoming. We understand that Lord Young is on the point of replying to Mr Lamont. You may wish to begin, therefore, by asking Lord Young for his latest views on the Korean VRA. The Economic Secretary will wish to comment.

5. A possible compromise would be to extend the VRA for a year only, either as a final extension or with the possibility, subject to review, of one further year.

Polish, Czechoslovakian and Romanian footwear

6. Following DTI's review, Lord Young proposed in March that these 3 VRAs should continue subject to annual review. He suggested that these VRAs were akin to quota restrictions and were viewed by the UK industry as protecting them against possible surges of imports in a sector where effective anti-dumping action is difficult to enforce. Mr Lamont asked for greater justification of the benefits of such restrictions, and for an assurance that future reviews would be conducted on an overall national interest basis and would not simply consider what was in the interests of the UK manufacturers involved. You may wish to ask Lord Young to respond to Mr Lamont's comments The Economic Secretary may wish to reply.

7. Mr Lamont also asked for an assessment of the case for the quota restrictions on the same products. It is not clear how Lord Young deals with these. Would there be a case for annual reviews, if they do not already happen, of these quota restrictions, with annual reports also to E(CP)? Are there any other important quota restrictions? Would it be useful for Lord Young to prepare a paper on quota restrictions generally?

Cessation of VRAs for which Government support has been withdrawn

8. Support has been withdrawn from some 30 VRAs over the last 3 years. There is increasing evidence that some manufacturers and trade associations have been seeking to continue their VRAs nevertheless, and that some have not told overseas manufacturers about the Government's decision (examples are quoted in the Economist article). Until recently DTI had refrained from making public announcements about withdrawing support for VRAs, to avoid a build up of lobbying against termination of VRAs which were still under review. The end result may, however, have been somewhat unsatisfactory, with little notice being taken of Government decisions to end support. You may wish to ask Lord Young for a report for E(CP)'s next meeting in July on how many VRAs are continuing without Government support, and describing what action he proposes to take on these.

Japanese machine tools

9. Lord Young decided to extend this VRA for a year last autumn. The Economic Secretary may ask that Treasury officials be consulted about the methodology of the next review of this VRA, due this autumn. E(CP)(88)2 reports that the framework for the last review was agreed with the relevant trade association, which suggests it may have been more concerned with the costs and benefits to the industry of continuing the VRA, rather than the national costs and benefits. You may wish to ask Lord Young to report the recommendations of the forthcoming review to E(CP) in the autumn. The aim is that he should report to E(CP) before reaching the decision not (as has usually been the case) afterwards.

Japanese vehicles

10. In March it was agreed that, in view of Rover Group sensitivities, work should not continue on the Japanese cars VRA. There are, however, also VRAs covering Japanese light commercial vehicles and trucks. These did not appear to be covered by the March decision. You may therefore wish to ask Lord Young whether Rover Group considerations also rule out a review of these VRAs.

HANDLING

11. You will wish the Secretary of State for Trade and Industry to introduce the discussion. The Economic Secretary, Treasury may wish to respond on a number of the issues raised. The Secretary of State for Transport may wish to comment on the VRAs on Japanese light commercial vehicles and trucks. Other Ministers may wish to contribute to the discussion.

G W MONGER

Cabinet Office
29 April 1988

British trade

Economist 22/4/88

Grey areas

JAPANESE carmakers are in London to discuss "prudent" marketing policies in Britain for 1988-89. On May 10th South Korean shoemakers will visit the British Footwear Manufacturers' Federation to discuss how many pairs of shoes they should export to Britain. Both visits are about voluntary restraint arrangements (VRAs): deals in which foreign firms agree to keep down their exports to Britain. A month ago, a junior trade minister told Parliament that "government pressure has resulted in the termination of no fewer than a dozen" VRAs. Yet the government tolerates VRAs on six groups of products. It disapproves of VRAs covering another five—but nobody takes much notice.

VRAs have all the economic disadvantages of import tariffs, and three more besides. First, a VRA lets the foreign supplier collect the value that is being denied the consumer—for while a tariff diverts that value to government, a VRA lets the supplier put his prices up to keep his sales down. Second, VRAs divert trade away from the low-cost foreign suppliers which sign them to higher-cost ones which do not. Third, VRAs are not open for all to see.

This is why protectionist industries like them. Consumers, being ignorant of VRAs, do not object. Politicians can disclaim responsibility, arguing that they are a business-to-business affair. And VRAs are in the grey areas outside the General Agreement on Tariffs and Trade (GATT).

Why does Britain's government, so preachy about free markets, tolerate VRAs? In some cases, it does not have the evidence to quantify the damage they do. (Several British trade associations say that their VRAs have not in fact restricted imports at all: odd, then, that they should want them.) More often, as with the deal which has limited imports of Japanese cars to 11% of the British market since 1977, the political cost is too high. Although a study from the Trade Policy Research Centre argued in 1985 that this car deal has cost British consumers up to £500m a year, its abolition might raise the market share of imported Japanese cars to above 20%, cutting British carmaking capacity by 100,000 a year. That would make Rover less attractive to British Aerospace.

On March 30th, the Department of Trade and Industry named the products which it no longer wants covered by a VRA. On the list: monochrome and colour TVs, music centres, stainless steel cutlery and pottery.

The British Ceramic Manufacturers' Federation, which has operated for 15 years a tight VRA with Japanese pottery firms, has kept quiet in the hope that the Japanese will disregard the government statement. The Cutlery and Silverware Association, whose deals (first signed in 1966) now limit exports of spoons and forks from Japan to 2.5m dozen and from Korea to 4.05m dozen, says that the government's change of mind has had no effect on its arrangement. Equally unworried is the British Radio and Electronic Equipment Manufacturers' Association, which for at least 12 years has talked regularly with Japan, South Korea, Singapore, Taiwan, Hongkong and once even with Thailand.

In short, exporting firms in Asia are themselves happy with covert deals that assure them a market slice with high profits and little political trouble. To change things, Britain must be more assertive. One hope: the Uruguay round of world trade talks is already discussing how to prevent "grey-area" protectionist arrangements, although there is little chance that VRAs will be outlawed.

If the EEC's plans for a single market are ripe by the end of 1992, national VRAs will have to be replaced by Community-wide arrangements. That is no guarantee of rationality; it might even make things worse. The EEC already has communal non-tariff barriers in steel and in textiles. If the example of cars is anything to go by, most other European countries are more protectionist than Britain. The share of the British market cornered by imported Japanese cars is, at 11%, almost two percentage points higher than the average for the EEC. Portugal allows each Japanese firm to export only 15 cars to it a year.

Restricted

dti

the department for Enterprise

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

The Rt Hon Norman Lamont MP
Financial Secretary to the Treasury
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CH/EXCHEQUER
REC. 29 APR 1988
ACTION FST
COPIES TO

V 29/4

Direct line 215 5422
Our ref PS5AQF
Your ref
Date 29 April 1988

Dear Mr Lamont,

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

I have carefully considered the arguments in your letter of 18 April, in favour of withdrawing support immediately for the inter-industry voluntary restraint agreement with South Korea on footwear.

While I accept that there are some parts of the footwear industry that will find it difficult to become fully competitive the review does identify action by a number of companies to invest in new technology and new approaches which will take some time to work through. In these circumstances I would not wish to deprive them of a further period of consolidation before they are exposed to full competition from low cost imports. By giving the industry a clear terminal date now we make very clear the need to use this additional breathing space productively.

The review does not point conclusively to a cut-off date of mid 1990 and I may want to reconsider the position before taking a final decision. We also need to consider the implications of the Single European Market. I am therefore arranging for an internal review to be carried out in a years time to see whether any variation is justified. I do not, however, intend to reveal this to the industry.

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dti
the department for Enterprise

I am satisfied the VRAs with Poland, Czechoslavakia and Romania are justified. These agreements are renewed each year at the same time as the quota arrangements with other Eastern European states. At that time we consider whether an increase or removal is appropriate, taking into account the views of industry and interests of consumers as well as our trading relationship with the country concerned and wider trade policy interests. We also look to see whether a relaxation could achieve better market opening (in footwear or other products).

In making the point that these VRAs are virtually indistinguishable from the quota arrangements, I have in mind that the three Eastern European states involved preferred such "voluntary" arrangements to quotas, although they are in effect the same. Indeed, we apply the same criteria when reviewing the annual quotas. Such quota arrangements are, as you say, outside the scope of the E(CP) VRA review since it was recognised their future was principally a trade policy matter.

I am copying this letter to other members of E(CP) and to Sir Robin Butler.

Yours sincerely,

Stephen Ratcliffe

STEPHEN RATCLIFFE
Private Secretary

Approved by the Secretary of State
and signed in his absence.

315

E(CP)

Ch.

This was fixed for 3.30 pm next Tuesday, 3 May. I told Mr Monger that I thought you (+ the FST) might wish to be in the House then, for the opening of CWH. We ∴ postponed the meeting. Mr Monger has now asked me whether it might nonetheless be possible to hold it at 3.30 pm on 3 May. Would it?

OK – dr

26/4

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Reference No: E 0553

CHANCELLOR OF THE EXCHEQUER

E(CP): 3 May 1988

I attach briefs for the three items to be discussed at E(CP) on Tuesday.

2. We envisage a further meeting of E(CP) in July, to consider the papers on competition in the legal profession from the Lord Chancellor and Mr Rifkind which were commissioned in January. I understand that the Marre Committee is currently expected to report at the end of May.

3. Other possible subjects for the July meeting are:

i. The Future of the British Wool Marketing Board, from Mr MacGregor. It was agreed at E(CP) in July 1987 that Mr MacGregor should submit proposals on the future of this Board and its subsidiaries in 1988, following a far-reaching review of the Board's activities and the associated wool guarantee arrangements. MAFF's forward look of business submitted to the Cabinet Office at Easter said this paper would be ready before the summer recess.

ii. The Future of the Potato Marketing Board, also from Mr MacGregor. Mr MacGregor circulated a draft consultation document on the future of potato support operations after the present arrangements expire in 1990. The Chief Secretary, Lord Young and Mr Ridley have all suggested that the support arrangements should not be continued and that the Board should be wound up. Mr MacGregor is considering the position further. If he does not

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agree with his colleagues, it could be useful to discuss his alternative proposals in July.

4. During the meeting you may also have commissioned papers from Lord Young on:

i. A procedure for auctioning radio frequency bands.

ii. Continuation of VRAs from which Government support has been withdrawn.

5. Finally, a July meeting could also take a paper from Lord Young on an action programme for the future work of the Sub-Committee.

6. If you wished, you could briefly mention these possibilities at the end of the meeting. If necessary, either of the papers from MAFF could slip until the autumn. But it may be worth mentioning them now as possible candidates for July so as to avoid excessive delay on the part of MAFF.

G W MONGER

Cabinet Office
29 April 1988

CONFIDENTIAL

Reference No E 0552

CHANCELLOR OF THE EXCHEQUER

MANAGEMENT OF THE RADIO SPECTRUM

E(CP)(88)7

DECISIONS

Lord Young's paper describes a variety of approaches to introducing competition into the management of the radio spectrum. No consensus appears to have emerged yet about the right way forward. Lord Young will be conscious that the Government should not be too prescriptive in an area of rapidly developing technology. He therefore proposes that feasibility work should be commissioned on a range of options. As there is unlikely to be legislative time available before November 1989 for proposals in this area, the Sub-Committee may agree that this is a sensible approach for the present.

2. You may wish the Sub-Committee to decide -

i. whether proposals should be worked up for direct auctions of specific bands of spectrum, for consideration by E(CP) before public consultation and legislation;

ii. whether feasibility work on limited trials of Frequency Planning Organistions (FPOs) should proceed, and whether the trials should be more extended that Lord Young proposes; and

iii. the timetable for further reports on this subject to E(CP).

BACKGROUND

3. DTI have been very slow in producing this paper. You first asked for a paper on spectrum management in July 1986 (E(ST)(86)1st meeting), envisaging a discussion in early autumn of that year. In 1985, DTI employed consultants ~~CPS~~ CSP International to review the case

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for introducing market forces into spectrum management, to develop a proposal which gave market forces a greater role, and to examine the economic impact of market-orientated allocation of spectrum. Last year CSPI reported that their main recommendation was that competing FPOs should be created to sell the right to use spectrum. E(CP)(88)7 contains Lord Young's recommendations on CSPI's report and subsequent work by officials. He favours further work on direct auctions of spectrum and a gradual build-up in private-sector involvement in frequency planning and assignment, rather than adoption of the complete FPO approach at this stage.

ISSUES

Direct auctions

4. There is likely to be general endorsement of the proposal to work up a scheme for direct auction of specific spectrum bands. The main issues which may be raised in discussion are -

i. Extent of auctioning. The proposal that auctions should initially be for limited ranges of spectrum, in the mobile bands, should not be controversial. The Economic Secretary may suggest that auctions by Lord Young's department should be a short term objective, the longer term aim being to move to fully private sector assignments by FPOs.

ii. Size of bands auctioned. Lord Young may favour auctioning spectrum in fairly sizeable blocks, to meet concerns that the private sector will wish to be technology neutral and preserve its flexibility to use spectrum in different ways. But such an approach will favour large companies at the expense of small users, and will give those successful in auctions some potential monopoly power in sub-licensing parts of their block to smaller users. DTI intend the auctions to be conducted primarily on a national basis, but for similar reasons it may be desirable to auction spectrum also on a regional and local basis. These issues can be

considered further as proposals are worked up, if the Sub-Committee is content with the broad principle of auctioning.

iii. Public Service Users. Some Ministers with sponsorship responsibilities may suggest that bands allocated to public service users (eg: emergency services, police, defence etc) should not be included in auctions. The Economic Secretary may however suggest that, even if such spectrum remain allocated to public service users, they should be made to bear the economic cost of denying those allocations to other users, in order to maximise the efficiency with which they use the spectrum. He may also note that the public expenditure implications of public service users bearing the economic costs of their use of spectrum will need to be considered further. You may wish to encourage Ministers to show flexibility in considering their public service requirements for spectrum.

iv. Extension to spectrum used for TV broadcasting. It is not proposed to auction spectrum used for TV broadcasting in the first instance. But you may wish to note the relationship of this subject with the work of MISC 128. It may be appropriate at some future date to test through an auction whether certain bands of spectrum are more valuable to TV broadcasters or mobile users (the most immediate need to do this has disappeared with MISC 128's decision not to pursue the proposal to use VHF frequencies for a new TV channel). Mr Renton is expected to put down a marker that auctioning of spectrum for TV broadcasting at some future date could undermine the justification for the Government's levy on the advertising revenue of commercial TV.

5. Given the lengthy delay in producing this paper, it would seen advisable to set a tight timetable for any further consideration of spectrum management. Lord Young's paper suggests that worked up proposals on direct auctions should be ready for E(CP) in June, but we understand DTI's officials will be briefing him to say that this will have to slip to September. We recommend that, if appropriate, Lord Young be given a clear remit to report back to E(CP)'s next meeting - planned for July. Another argument for pressing ahead quickly is that, according to Annex D (paragraph 6) room might be found in one of next Sessions's Bills for legislation on auctions. Given the pressure on next year's programme, it is unlikely that the business managers would welcome adding these provisions. Nevertheless, working out a detailed scheme quickly will maximise what chance there is that legislation will be possible.

Frequency Planning Organisations

6. Despite the cautious conclusion to E(CP)(88)7, Lord Young is not seeking to rule out the option of FPOs. Indeed, he proposes two ways of carrying forward work on FPOs:

i. the employment of external consultants to advise on the feasibility of a trial of the FPO model, using the 13 and 14 GHz bands which have few fixed users at present; and

ii. exploration with private mobile radio users of the proposals they produced in February for delegating to the private sector the planning and assignment of spectrum in the mobile bands.

7. Lord Young notes a full switch to FPOs would be highly disruptive and unpopular with existing spectrum users. He also expresses concern that the operation of FPOs might not be sufficiently profitable. This problem might however be eased if the BT/Mercury duopoly was reviewed and abolished after the deadline in 1990. The Economic Secretary will suggest that

feasibility trials of the FPO model should be more extensive and include more heavily used bands, as recommended by CSPI. This would provide a full test of the effect of market forces on spectrum users. You will wish to decide, in the light of the discussion, whether to press Lord Young to instigate feasibility studies for a trial setting up of an FPO in a more heavily used part of the spectrum.

8. Lord Young's paper offers to report back to E(CP) on items (i) and (ii) by the end of the year. You may wish to emphasise the importance of keeping to this timetable, and of providing worked up proposals for legislation on the same timescale, if he is to be successful at QL for the 1989-90 Session.

Private Sector Access to DTI's Fixed Link Database

9. Lord Young wishes to allow private sector access to his Radiocommunication Division (RD's) fixed link database, subject to certain safeguards. You will wish to welcome this. He also describes a second and third stage for increasing private sector involvement in this database, but provides no indication of how long these stages might take to achieve. You may wish to suggest that feasibility work be commissioned on the practicability of these stages, in order to open up access to the database along US lines.

Radiocommunications Division as a "Next Steps" Agency

10. Lord Young's paper suggests that he is actively considering turning RD into a "Next Steps" agency within Government. The Economic Secretary will agree with Lord Young's judgement that RD should not be privatised in its present monopolistic form, but will be cautious about movement to an agency basis because this could entrench RD's present executive role in allocating and assigning spectrum rights. If Lord Young seeks E(CP)'s endorsement to an agency approach for RD, you may wish to suggest that this would be better considered in conjunction with the Treasury and in accordance with the normal 'Next Steps' procedures

HANDLING

12. You will wish the Secretary of State for Trade and Industry to introduce his paper. The Economic Secretary, Treasury and the Minister of State, Home Office (Mr Renton), who has been invited for this item, will wish to respond. Other Ministers may wish to comment.

G W MONGER

Cabinet Office
29 April 1988

Flan/047

FROM: S J FLANAGAN
DATE: 29 April 1988

1. MR MACAUSLAN

2. ECONOMIC SECRETARY

cc

Chancellor	Mr Bonney
Chief Secretary	(para 4)
Financial Secretary	Mr P G F Davis
Paymaster General	Mr Meyrick
Sir P Middleton	Mr Revolta
Mr Monck	(para 4)
Mr Burgner	Ms Seammen
Mrs Case	Mr Walker
Mr Mountfield	Mr Bolt
Mr Odling-Smee	Mrs Pugh
Mr Spackman	Ms Roberts
	Mr Sly
	Mr J Stevens
	Mr Wynn Owen or
	Mr Leniston
	Mr Kerley
	Mr Picard
	Mr Wanless
	(para 4)

E(CP): TUESDAY 3 MAY 1988

You are attending E(CP), the Ministerial sub-committee on competition policy, on Tuesday 3 May at 3.30 pm, in the large Ministerial Conference Room, at the House of Commons. **The Chancellor** will be in the chair.

2. All the items on the agenda are based on papers by **Lord Young**. He should be present at the meeting. I understand that **Mr Maude** will not be there in support.

3. I attach briefing as follows:

i. **Management of the Radio Spectrum**: brief by IAE, HE, DM and PXE attached at **Annex A**.

ii. **Motor Vehicles: Price Differentials In The EC**: brief by IAE2 at **Annex B**.

iii. **Voluntary Restraint Agreements on Imports**: brief by AEF1 at **Annex C**.

Next meeting

4. I understand that the Cabinet Office Chairman's brief will suggest that the Chancellor should ask for the following papers for the next meeting of E(CP), which will probably be in July:

- **Competition in the Legal Profession** - at E(CP) on 28 January, the Chancellor asked the Lord Chancellor to report back after the Marre Committee (an independent committee of the legal profession) had reported, and preferably before the summer recess. Lady Marre is due to report at the end of May (it is conceivable, though, that this timing will slip);

- **Radio frequency auctioning: consultation and legislation** - a follow-up to the radio spectrum item on today's agenda. Lord Young's paper says "we should aim to put firm proposals for consultation and legislation on recommendation a [auctioning] to the Committee by June". His officials have intimated this might slip, which should be avoided if at all possible;

- **Potato support:** Mr MacGregor circulated a consultation paper on the future of the Potato marketing Board on 22 February 1988. He has not so far responded to the comments sent to him, and the stimulus of a report to E(CP) might be useful. At the least, he could usefully be prompted to produce the finished consultation paper;

- **British Wool Marketing Board:** a paper to E(CP) this year was promised in the action plan agreed on 28 January. It would seem sensible to take this at the same meeting as discussion of the Potato Marketing Board;

- **Future Work Programme:** Mr Maude has been holding bilateral talks with several Departments about the Competition Initiative, and it would be worth getting a report on what items for future E(CP) discussion have been thrown up.

Steven Flan

S J FLANAGAN

ANNEX A

E(CP)(88)7: MANAGEMENT OF THE RADIO SPECTRUM

Memorandum by the Secretary of State for Trade and Industry

Proposals

This paper considers proposals for changing the way in which the radio spectrum is managed with the objective of improving the economic benefits thus derived. The committee is asked to endorse Lord Young's proposals for further work on the possibility of auctioning specific bands of the spectrum and encouraging private sector involvement in frequency planning. A background note also covering the economics of spectrum pricing is at Annex A.

Objective

To secure further consideration of more radical options than those proposed by Lord Young. Fallback accept proposals on the understanding that they are only a first step towards the objective of introducing market forces into spectrum management.

Line to take

- Welcome DTI's proposals as a step in right direction, but too cautious. Recognise it is a technically complex area, needs some minimal regulation (interference; international treaties). But spectrum rights and the selling of spectrum rights are not "natural monopolies". They can both be opened up to competition.

- Best way of introducing market forces appears to be competing Frequency Planning Organisations (FPOs). Welcome proposal to examine feasibility of commercial trial of FPOs in 13 and 14 GHz bands. But this should be more ambitious and extend to cover trials also in other, more heavily used band, as recommended in the CSPI report (paragraphs 3-6).

- Welcome direct auctions to users as a way of allocating spectrum not allotted to FPOs. However direct auctions cover only small part of spectrum and retain the selling of spectrum in the hands of government.

They are a poor relation of FPOs, which privatise, and introduce competition to the selling of spectrum. There should be as few as possible restrictions on types of use of auctioned spectrum (paragraphs 7-10).

- Paper says nothing about public service users (e.g. defence, emergency services). Exposure to market forces would encourage these services to use spectrum efficiently, but would have implications for public expenditure (and receipts). Officials should be asked to examine how the economic cost of spectrum use might be brought home to the public services.

- Avoid Treasury commitment to Agency status for RD division. This could confirm DTI's executive role in allocating and assigning spectrum rights to users.

- Gently welcome private sector access to frequency planning information, for bands which for some reason cannot be auctioned (or allotted to FPOs).

- Press for a firm timetable on decisions about which bands can be opened up to direct auction or possibly FPOs.

Treasury Interest

1. The Treasury has an interest in improving the supply side by increasing the extent to which use of spectrum is determined by competitive market forces. There is a link with the aim of a more competitive broadcasting market which we are pursuing in MISC 128. There are also implications for the 1990 review of telecommunications policy and for large public sector users of spectrum such as MOD.

2. Full deregulation of the radio spectrum would also have implications for public expenditure, since government departments (e.g. MOD, who currently occupy 35% of the spectrum) would have to compete in the market place for the frequencies they require. These potential costs, and receipts from sales of

spectrum rights or marketing rights, cannot be assessed at this stage. (Purely administrative solutions to the problem of allocating frequencies to government departments do not necessarily provide incentives to departments to make the most efficient of scarce frequencies.) Allocating frequencies to public service users is a complex topic and should be the subject of a further study by officials. It is important that this study should be directed clearly to the aim of determining how public sector spectrum use should take account of the spectrum's opportunity cost. Otherwise the study will be dominated by user Departments' efforts to defend their existing rights.

Options

Frequency Planning Organisations

3. DTI's paper acknowledges that if it worked, the FPO model would offer the greatest economic benefits. Private sector FPO's would be allotted blocks of spectrum (probably by competitive tender or auction) and would then sell rights to use particular frequencies to individual users. Allotments would be made such that users could buy rights from at least two competing FPO's. Major users (such as British Telecom) would also be allowed to sub-license on commercial terms.

4. The major advantage of FPO's would be the market incentives to respond to different users demands and to plan and assign frequencies efficiently. There is no obvious alternative way of introducing market forces into the allocation and assignment of spectrum among large numbers of small users (as in mobile radio and some fixed links).

5. The objections raised by DTI are less than convincing. The legal problems of defining rights to use spectrum will have to be faced at some time if spectrum is to be marketed. It is not at all clear why allotments to FPO's could not accommodate international treaties as easily as direct

auctions. FPO allotments could include sitting tenants who would be protected for a limited period. The expected objections from users are very much those to be expected when any market is opened up for the first time to competition.

6. Thus the FPO model appears sufficiently attractive to warrant a more extensive experiment than simply the 13 and 14 GHz bands. Moreover, since these bands are presently largely unused, there is a risk that the FPO model would be discarded simply because it had only been attempted in unprofitable parts of the spectrum.

Direct auctions

7. In principle auctions could be very similar to FPO's; the winner would on-sell specific frequencies to end-users. Indeed, the expectation would probably be that FPO's would be chosen by competitive tender or by auction.

8. However, the DTI proposal differs from FPO's in that spectrum would be sold in small blocks and the winner would normally be an end user. Bidders would not be restricted to any particular use, but the licence once issued would specify the type of use. This proposal, in contrast to FPOs, would not open up the management of spectrum rights to competition.

9. The main advantage over FPO's appears to be that the licence would be for equipment, as at present, and would thus avoid the legal difficulties of defining a right to use spectrum (as with FPO's). DTI also suggest (although give little reason) that international obligations would be easier to accommodate under such arrangements.

10. The main disadvantage of this option is simply that it does not go far enough. A few presumably largely unused, frequencies would be sold competitively rather than allocated administratively. Beyond that, there would be no market in the use of spectrum and changes in allocation would be prohibited (by the terms of the licence). To the extent that there are few auctions, winners who do sub-license would have monopolies.

Other private sector involvement in frequency planning

11. DTI propose that RD should continue with plans to give private sector access to their fixed-link database (Annex E of E(CP)(88)7). Thus some planning of assignments would effectively be contracted out to users or their agents. This is sensible for bands not allocated to FPOs and would avoid unnecessary duplication whereby users plan systems in ignorance of the possible impact on other users.

12. DTI suggest (Annex E) that private sector involvement in frequency planning would evolve to a stage where users and planners would make fixed-link assignments themselves, without the intervention of RD. This would be similar to FPO's in that planning and licensing would be privatised to competing agencies. However their planners would not have exclusive rights to particular channels and thus it would appear inefficient and expensive (users would have to defend their interests against newcomers and negotiate over conflicts in requirements). It is also not clear how this option would introduce market forces into the allocation to different classes of user, as opposed to assignment to users within the same class. This is, therefore, not satisfactory as a first step to FPOs. It is a stop-gap, pending confirmation that the FPO solution is feasible.

Privatise RD

13. As a privatised body RD would plan, assign and license for a fee. We recommend that you agree with Lord Young's rejection of this option which would create one monopoly supplier of spectrum and involve regulatory problems.

Other issues

14. The DTI paper does not discuss major users such as broadcasters and British Telecom, or public service users such as MOD and emergency services. No action can probably be taken on British Telecom and Mercury until the duopoly review in 1990

15. Similarly there can probably be little action on MOD's and emergency services use of spectrum until market prices are established. But subsequently, there is a case for charging public services for their use of spectrum and, where appropriate, requiring that they buy their spectrum from FPO's or other selling agencies in competition with other users.

16. MISC 128 is presently considering the case for new UHF television channels and MVDS (multi point video distribution system) television in the 11 and 12 GHz bands, which could both displace and be displaced by other spectrum users. A longer term issue is whether new and existing broadcasters should, for example, bid against potential FPO's or other major users for blocks of spectrum. But that will partly depend on MISC 128's decisions on the kind of services which should be provided for, and the degree of commercial interest in providing them.

Conclusions

17. DTI proposals are welcome as a first step towards deregulating management of the radio spectrum. But they do not go far enough, particularly with regard to FPO's which could be applied to more spectrum than simply the 13 and 14 GHZ bands. The 'three stage' approach of contracting out frequency planning and the proposal for direct auctions would bring only limited benefits and may slow down further change rather than progress towards a market of competing buyers and sellers. They should be accepted as temporary measures only, not as satisfactory long term solutions. There should be a commitment to review the policy after 3 years.

APPENDIX TO
ANNEX A

Background

1. At present responsibility for radio regulation is spread across a number of Government Departments. Civil use of radio spectrum requires a licence under the Wireless and Telegraphy Acts. With the exception of the broadcasting authorities, which are licensed by the Home Office, licences are issued by the Radio Regulatory Division of the Department of Trade and Industry. RD is the main source of professional expertise in radio frequency planning and has wide responsibilities for spectrum planning and international aspects of radio regulation; in addition it is also responsible for policing licensing and investigating complaints about interference. Crown use of radio spectrum is exempt from the licensing and the MOD has a major involvement in spectrum management for the armed forces. The present basis of charging for the assignment of radio frequencies is through licence fees which are designed to fully cover RD's administrative costs of some £13m a year.

2. Spectrum management was reviewed by Dr J H H Merriman in 1983. His 'Report of the Independent Review of the Radio Spectrum', did not reach any firm conclusion on the case for spectrum pricing, but recommended commissioning a feasibility study. In 1985 DTI commissioned CSP International to review the case for introducing market forces into spectrum management, to develop a proposal which gave market forces a greater role, and to examine the economic impact of market-oriented allocation.

3. CSPI concluded that the present administrative system of spectrum management had considerable weaknesses. Allocation (designation of a frequency band to one or more classes of user) has not responded to changes in users' demands, and assignment (designation of specific frequencies for use by specified persons, for specified types of use in specified locations) has been inefficient.

4. CSPI's main recommendation was that competing Frequency Planning Organisations (FPO's) should be created to sell the right to use spectrum. 'Major users' (eg British Telecom) would also be allowed to sell the use of their allotment of frequencies. Annex B of E(CP)(88)7 describes the CSPI proposals in more detail.

5. An interdepartmental working group of officials, chaired by DTI, and with Treasury representatives, was set up in September 1987 to look at ways of introducing market forces in the light of the CSPI report. The working group discussed various options including FPO's, direct auctions and an 'evolutionary approach' whereby Radiocommunications division contracted out frequency planning. It was a discussion group only and produced no final report.

Economics of spectrum pricing

6. Management of the radio spectrum is technically complicated. Spectrum differs from many other resources in that supply is limited and there are potential problems from interference among users. International treaties govern some broad allocations; a large share of spectrum is used for security purposes and emergency services where it is particularly difficult to introduce market forces.

7. Nonetheless, with minimal regulation to protect against illegal use, interference and monopolies it would be possible to introduce market competition in the buying and selling of the right to use spectrum. This should make decisions on allocation and assignment of spectrum more responsive to the relative needs of different users. Markets would also improve decisions on investment in new technology to increase the supply of spectrum. (At present such decisions are largely taken by DTI Radiocommunications division).

8. One objection to deregulation of spectrum and rapid introduction of markets is protection of existing users. Sitting tenants could not be immediately evicted; there would have to be some phasing in of market prices for existing licensees.

9. There will be objections from users if they face higher charges, but there should be longer term gains of a more efficient service from sellers of spectrum rights. Some users will be priced out of the market but, as with the allocation of any scarce resource, there will always be losers as well as gainers. It is for the market not the government to decide who these should be, the market is generally more efficient. There may also be concern that individual users and small businesses will face 'unfair' competition from large businesses. But if some users can pay more because they have monopoly power in the market for their output then this is an issue to be dealt with by competition policy, not policy on spectrum management.

ANNEX B

Introduction

The paper for this item is:

E(CP)(88)6 by Secretary of Trade and Industry - "Motor Vehicles: Price Differentials in the EC".

Proposals

The Committee is being asked to note:

- a continued narrowing of price differentials between the UK and other Member States of the EC.

- a further reduction in the level of complaint from UK consumers about obstacles to the purchase of vehicles in other Member States ("personal imports").

Line to take

- **Welcome trend** towards lower price differentials

- Note trend continued despite stabilisation of exchange rates by end of 1986.

- Nevertheless price differentials should **continue to be monitored.**

Background

At E(CP) meeting of 11 December 1986 to which the present E(CP) paper relates, the Chancellor of the Exchequer suggested that, while the narrowing of differentials evident at that time was encouraging, the Sub Committee would wish to keep developments under review. The committee, inter alia, invited the Secretary of State for Trade and Industry to prepare a further paper reviewing trends in the UK car market in the light of further experiences of the operation of the EC Block Exemption Regulation.

The Secretary of State's paper notes declining price differentials between UK and other Member States, notes that while obstacles to personal importing still arise the level of consumer complaint is low and that a rise in personal importing activity is evident in certain other Member States. The Secretary sees these as encouraging signs of an increasing open market for motor vehicles.

The price differentials being examined are, to a large extent, differentials between markets which are, themselves, subjects of varying levels of protectionism from wider international competition by means of, for example, VRAs. Consequently, there will continue to be costs to the consumer and to the economy generally in the continuation of motor vehicle VRAs.

There are, however, serious implications for the Government's agreement with BAe over the sale of Rover Group if a review of VRAs proceeds in the relatively near future. These arise from the condition of the agreement that no Government action which will materially affect Rover Group is planned and undisclosed. DTI's advisers, Barings and Slaughter and May, took the firm view that, in the absence of other very compelling policy pressures the review of cars VRA with Japan should be deferred and not reactivated until such time as the risk of liability no longer exists. The principles in respect of Europe are the same. Given the commercially sensitive nature of this issue substantive discussion in E(CP) is best avoided pro tem.

The Chancellor reluctantly endorsed the advice as part of the overall Rover Group/BAe deal.

Nevertheless the Secretary of State should continue to monitor trends and report to E(CP).

ANNEX C

CONFIDENTIAL

E(CP)(88)2: VOLUNTARY RESTRAINT ARRANGEMENTS (VRAS) ON IMPORTS

THE PAPER

Lord Young reports that support for 7 VRAs ceased at the end of 198 leaving 8 out of the original 35 subject to review carrying DTI support Of these 8, support will be withdrawn for 2 (forklift trucks wit Japan and special steels with Spain) at the end of 1988 and the on covering special steels with Japan has in fact lapsed as the Commissio has not renewed the umbrella VRA for the Community.

2. Turning to the remaining 5, the review of the VRA on Japanese Machine Tools is reported to have found that while the UK industry is making efforts to improve its international competitiveness, performance varies between the machining centre sector, were progress is encouraging, and the computer numerically controlled (CNC) lathes sector where further investment is needed to increase competitiveness which remains poor. The results of the review have led Lord Young to decide that support for this VRA should continue subject to a further review next Autumn focusing in particular on the case for protecting CNC manufacturers.

3. Lord Young has written since the paper was tabled on the review of the 4 VRAs on footwear with South Korea, Poland, Czechoslovakia and Romania (see background section).

4. Three further VRAs remain to be reviewed which were excluded from the original 35: these are the VRAs with Japan on cars, trucks and light commercial vehicles. Because of the legal reasons connected with the sale of the Rover Group, these arrangements cannot be reviewed by Ministers for about 18 months.

Line to Take

i. Very concerned at economy-wide costs of VRAs. Aim must be to remove support from remaining VRAs as soon as possible. Important to keep up pressure on industries to adjust. Otherwise risk of weakening incentive to improve competitiveness.

ii. Agree that machine tool VRA should be further reviewed in Autumn. Must not let this slip. Unsatisfactory that no termination date has been set for this arrangement so reducing incentive for necessary adjustments to be made. Unless next review can demonstrate that economy wide costs arising are fully justified, by reference to gains to industry flowing from VRA, support should be withdrawn. Costs of protection in this case will particularly affect other manufacturing sectors: such wider costs must be covered in review.

iii. Concerned by recent reports that certain arrangements (cutlery, pottery and consumer electronics) are running on despite withdrawal of support: we will be writing [see para 9 below].

You could also follow up 3 points raised by Financial Secretary in his letter of 18 April to Lord Young at Appendix B (to which Lord Young has not yet replied): viz:

iv. Review of Korean footwear VRA produced no evidence of industry benefitting from existence of arrangement. Without this evidence, inevitable costs falling to rest of economy cannot be justified for further 2 years. Support for complete arrangement should now be withdrawn.

v. Concern with East European footwear VRAs is that basis of future reviews is not clear.

vi. Quota restrictions on footwear are clearly relevant given that all restrictions on competition are E(CP)'s concern.

BACKGROUND

5. Paper is intended to meet a remit given last July to Lord Young's predecessor to report back on the reviews of outstanding VRAs. Like

all barriers to imports, VRAs involve costs to the domestic consumer and the economy as a whole. VRAs do not formally involve governments but they generally cannot operate without implicit goverment support (though see paragraph 10). The Government's lack of direct involvement means that such arrangements do not put the UK in breach of our GATT obligations. However, the world wide proliferation of these and other "grey area" measures which undermine the GATT framework is causing concern and is being addressed in the Uruguay Round.

6. A review of VRAs was set in hand by Mr Tebbit in 1985. The review proceeded on the assumption that support would be withdrawn unless the industry concerned could make a strong case for retention of its VRAs. DTI were to analyse the costs and benefits in terms of the overall national interest. Continued protection could only be contemplated where it was necessary for industrial restructuring and the attainment of international competitiveness within a reasonable period of time.

7. On the specific VRA discussed in the paper (Japanese machine tools) we have seen the full report of the review. This concentrates solely on the performance of the industry and does not take account of the economy-wide costs arising. Unless the next review in the Autumn can demonstrate that the VRA has assisted the industry to adjust and the benefits are not outweighed by the costs falling to consumers, support should end.

8. Since this paper was tabled, Lord Young has written reporting his conclusions on the review of the 4 arrangements relating to footwear. (Appendix A) His intention was to continue to support the for most parts of the Korean arrangement until mid-1990, if it is renegotiated by the industry. In the case of the arrangements negotiated by the EC on behalf of the UK with Poland, Czechoslovakia and Romania his intention was to review these on an annual basis. (The UK industry alleged imports from these 3 countries were effectively being dumped but rather than pursue an anti-dumping action asked for a VRA). The Financial Secretary replied on 18 April (Appendix B) arguing that support should be withdrawn now from the Korean arrangement. Further, he asked what the basis would be for the reviews of the East European arrangements (the usual cost/benefit analysis not being

appropriate) and whether Lord Young was content that the further restrictions imposed on footwear imports from Eastern Europe by means of quota restrictions imposed under EC law were justified. (These are technically outside the scope of the VRA review but their economic effects are basically the same). Lord Young has not yet replied to this letter.

9. Last month Mr Michael Fallon MP tabled a question in the House about those VRAs which have been terminated as a result of government pressure. (Appendix C) Mr Maude's reply has stimulated some interest and an article in the recent edition of "The Economist" (Annex D) commenting on it claimed that a number of the arrangements (namely those affecting cutlery, pottery and consumer electronics) remain intact despite the withdrawal of DTI's support. This story confirmed information which we had received. It would be worth recording some unease with the fact that the outcome of DTI's reviews is in some cases apparently only having a cosmetic effect. (We will be commenting shortly on the issue of how such arrangements might be tackled directly in a submission to the Chancellor on the subject of import restrictions in general.)

FROM: J W STEVENS

DATE: 3 May 1988

ECONOMIC SECRETARY

cc. Chancellor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Mr Monck
Mr Burgner
Mrs Case
Mr Spackman
Mr Meyrick
Ms Seammen
Mr Bolt
Mrs Pugh
Mr Flanagan
Mr Leniston

E(CP): TUESDAY 3 MAY 1988

1. At your briefing meeting this morning you asked for a supplementary note on the four points raised at the end of paragraph 11 of the E(CP)(88)7 about the possible adverse effects of the introduction of FPOs. A short speaking note on each of these points is attached.

2. You also ask on E(CP)(88)6 about motor vehicle price differential in the EC, whether the Commission had investigated cases where it is suspected that high price differentials were being sustained by restrictive dealership arrangements. We understand that there are no cases of the Commission initiating a formal investigation or threatening withdrawal of block exemption regulation benefits. The only action taken has been informal enquiries in response to a limited number of specific complaints; primarily about delivery delays and servicing problems.

3. In the time available DTI have been unable to provide examples of the licenses which are currently issued by RD.

J W STEVENS

SPEAKING NOTE

Disruption of existing services

No fixed structure for FPOs. No reason why they should not be set up in such a way that existing users can be accommodated with protected rights for a specified period. Blocks of spectrum on offer to potential FPOs could reflects this and it would be a factor taken into account by bidders when formulating their bid.

Fragmentation of the equipment market

Point needs to be explored further. By no means certain that existing equipment would not be suitable in most cases. Also no reason to suppose that equipment manufacturers would not meet any change which was required with flexible response.

Higher prices for spectrum

Purpose of deregulation is to open spectrum allocation to market forces in place of existing administrative system. Users may be prepared to pay more for specific parts of spectrum, but FPOs would have incentive to develop new services for those parts of the spectrum currently under utilised. Price mechanism would ensure that allocation of spectrum between users is efficient.

Less encouragement of new technology

May have the reverse effect. FPOs will have the incentive to develop new uses for under utilised parts of the spectrum so they derive the maximum benefit from their allocation. This could have the effect of encouraging new technology, for example by developing new methods of suppressing interference between narrowly separated bands or between operators using the same frequency in different areas.

4441/042

FROM: R MOLAN
DATE: 3 May 1988

ECONOMIC SECRETARY

cc PS/Chancellor
PS/Financial Secretary
Mr Mountfield
Mr P G F Davis
Mr MacAuslan
Ms Symes
Mr Tyrie (with brief) + letter

E(CP): VOLUNTARY RESTRAINT ARRANGEMENTS

Since the brief went forward for today's meeting of E(CP) Lord Young has replied (29 April) to the Financial Secretary's letter of 18 April on the footwear VRAs.

on the folder

2. Having previously discussed this matter with the Financial Secretary, we will need to consider the terms in which he may wish to reply. He may be prepared to accept Lord Young's undertaking that a further (internal) review be carried out in a year's time of the Korean VRA provided that this includes a rigorous analysis of the benefits (if any) of the VRA to the UK industry and the cost to consumers. But in order to preserve the Financial Secretary's room for manoeuvre, we suggest that you pass no comment at today's meeting.

R MOLAN

FROM: J W STEVENS

DATE: 3 May 1988

ECONOMIC SECRETARY

cc. Chancellor 2nd Floor
Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Mr Monck
Mr Burgner
Mrs Case
Mr Spackman
Mr Meyrick
Ms Seammen
Mr Bolt
Mrs Pugh
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Mr Leniston

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dti

the department for Enterprise

The Hon. Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs

The Hon Douglas Hogg MP
Parliamentary Under Secretary
of State
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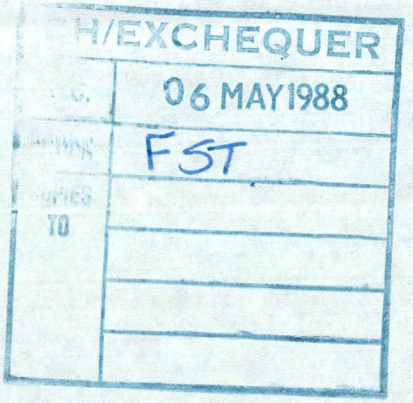


V6/5

Dear Douglas

NOT RECIEVED

COMPETITION INITIATIVE

Thank you for your letter of 20 April about Home Office policy on private sector involvement in prison management and ancillary services.

I agree that there is a considerable programme of work in this area. The Green Paper and consultancy which is to come, will be a valuable contribution to the debate and I welcome your request to your officials to keep mine informed. I am glad to see that nothing is being ruled out at this stage beyond the experimental scheme.

Members of E(CP) will no doubt wish to have the opportunity to comment on the draft of the Green Paper and I assume that E(CP) will examine the outcome of both the Green Paper and consultancy study.

I am copying this letter to Nigel Lawson.

Yours

FRANCIS MAUDE

JA2DKK

the enterprise initiative

4443/001

RESTRICTED

FROM: R MOLAN
DATE: 10 May 1988

1. MR P G F DAVIS
2. FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Economic Secretary
Paymaster General
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Monck
Mr Burgner
Mr Mountfield o/r
Mr MacAuslan
Ms Symes ← Mr Edmonds
Mr Flanagan
Miss Preston
Mr Call
Mr Tyrie

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

Lord Young's letter of 29 April is in response to your letter of 18 April commenting on DTI support for these VRAs.

Background

2. Lord Young wrote on 21 March to the Chancellor advising that he intended to continue to support the inter-industry VRA with Korea, in almost its entirety, until mid-1990. He argued that the provision of this additional breathing space could provide an opportunity and an incentive for the industry to speedily implement various modernisation programmes which they were reported to be pursuing. He also indicated that in his view the VRAs negotiated on the UK's behalf by the European Commission with the governments of Poland, Czechoslovakia and Romania should continue subject to annual re-examination.

3. You replied on 18 April to the effect that there was no case for support to continue for the Korean VRA as there was no evidence that its existence had had any beneficial effect on the UK industry. You considered that the costs falling to the rest of the economy could

not be justified any longer in view of the absence of such evidence. In the case of the East European VRAs, you asked Lord Young whether he, as well as the industry, was satisfied that these arrangements were justified and if so on what basis would the future reviews be conducted. You went on to ask Lord Young whether he was content that the further restrictions on footwear imports from Eastern Europe effected through the imposition of quota restrictions under EC law were justified.

Lord Young's reply

4. Lord Young accepts that some part of the UK industry will find it difficult to become fully competitive but considers that those parts which will be able to benefit from investment in new technology etc should be give a further period of protection to reap such benefits. However, he indicates that he may wish to reconsider the position before mid-1990 and is arranging for an internal review to be carried out in a year's time to see whether any variation is justified. He also comments that it will be necessary to consider the implications of the Single European Market. (It is not clear what the intended significance of this last remark is in this context.)

5. He goes on to say that the VRAs with Poland, Czechoslovakia and Romania are justified in his view. These are renewed each year in parallel with the quota restrictions applying to other Eastern European states and at that time consideration is given to the case for their retention, taking into account the views of UK industry and the interests of consumers as well as wider policy interests. The possibility of relaxation bringing about an increase in recripocal access to East European markets is also examined.

6. Lord Young acknowledges that the East European VRAs are virtually indistinguishable in economic terms from the quota arrangements and so the same criteria is applied when each of these categories is being reviewed. But he comments that quota arrangements are rightfully outside the scope of the E(CP) review since these are a matter of "trade policy".

Analysis

7. Lord Young's reply adds nothing to the case for continued protection set out in his earlier letter. He is persisting in the view that a further breathing space should be given following an open ended period of protection. Thus, there are grounds for pursuing the argument that support should end forthwith. However, this may not be a productive path to follow. The decision by Lord Young to arrange for a further review to be carried out in 1989 presents itself as a useful compromise that you could agree to provided that, unlike the recent review, the next review attempts to establish the direct effects of the VRA on the industry and estimates the cost of the arrangement to consumers, and further that these costs can be shown to be justified by any benefits to the industry. DTI should be in a good position to evaluate these costs and benefits, as they are giving financial support to a study of the market which has been underway for over a year.

8. Lord Young does not state the reasons why he believes the VRAs with the Eastern European states are justified but we presume that he accepts that these countries are probably dumping their footwear on the UK market, as the UK industry alleges they are. While it sounds reassuring that, when these arrangements come up for renewal, DTI consider the interest of consumers in their assessment, the recent review of the footwear VRAs did not acknowledge any costs to consumers. In order to ensure that these interests are given proper weight it would be desirable if, when Lord Young reports his conclusions of the next review to E(CP), he fully explains the factors bearing on his decision.

9. We suggested that you raise the question of quota arrangements (QRs) with Lord Young as although their status is different from VRAs, the economic effects they have in terms of inhibiting competition and raising the prices paid by consumers are the same. In effect, Lord Young is arguing that these are restrictions not a proper subject for E(CP) to consider as trade policy, the heading which they come under, is somehow quite distinct from competition policy. This illogical distinction is drawn purely to stop collective consideration in this E(CP) review of a wider range of DTI activities on the trade front. It need not be substantially challenged here as we will shortly be putting a

submission to the Chancellor suggesting that Lord Young should put a paper to E(CP) providing an overview and analysis of all import restrictions (including quotas) into the UK. A passing reference would suffice to remove any appearance of inconsistency between your reply and the letter the Chancellor might send. We can, in that context, remind Lord Young of the close inter-relationship between trade and competition policy.

10. I attach a draft reply to Lord Young.

R MOLAN

RESTRICTED

DRAFT LETTER TO:

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

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

Thank you for you letter of 29 April.

2. For the reasons set out in my letter of 18 April, I am still not persuaded that the case has been made for an additional breathing space to be provided to this industry. I am disappointed that you appear to place little weight on the fact that the costs of the VRA to the rest of the economy have already run on for some time. However, I welcome your intention to commission an internal review in a year's time to see whether any change is justified. But it is essential that if this review is to be meaningful it must assess the effect of the VRA on the industry's performance and make some estimate of the costs to consumers. Unless these costs can be shown to be justified by benefits accruing to the industry, support should then be ended.

3. I am grateful for your comments on the VRAs with Poland, Czechoslovakia and Romania. I am reassured by the fact that the interests of consumers are taken into account when these come up for renewal. It will be helpful if, when you report to E(CP) on the decisions reached following the next set of reviews, you fully explain the factors leading to your conclusions.

4. I note what you say about the quota arrangements which I referred to in my letter though I am unclear about the logic behind the distinction you appear to draw in this context between trade and competition policy.

5. I am copying this letter to other members of E(CP) and to Sir Robin Butler.

NORMAN LAMONT

6/3653

CONFIDENTIAL

FROM: A G TYRIE
DATE: 18 MAY 1988

FINANCIAL SECRETARY

cc Chancellor
Chief Secretary
Paymaster General
Economic Secretary
Mr Molan
Mr Cropper
Mr Call

VOLUNTARY EXPORT RESTRAINTS

I saw E(CP)'s minutes on this which were heartening and reflected our appropriately robust line. I also saw today's FT report that the VRA on Taiwanese footwear, which had just lapsed, has now been renewed - a step backwards.

A few thoughts:

i. We will need to press hard to get a clear answer on what in practice the Government should do to make sure VRAs disappear. Merely removing support from them is probably not enough: should we consider making them illegal?

ii. There is also the EEC aspect: 1992 could bring an internal market but external protection. EEC wide VRAs on footwear are just what we can expect Spain, Portugal and Italy to lobby for in the run up to 1992. I gather from Mr Molan that the Commission are already planning something for Japanese car imports. I think we should ask the DTI to give us all the information they have on

Commission plans to introduce EEC wide VRAs.

iii. Four years ago Professor Silberston wrote an excellent and damning report on the Multi-Fibres Arrangement showing what a rip off it is for consumers. I gather that Alan Clarke has been resisting a suggestion to ask Professor Silberton to update the report. Clearly he would prefer a quiet life with the textile lobby. That's a pity, I think we should prod him.

A final word on the DTI: what we want from them is less public expenditure and more supply side/free trade action. What we seem to be getting these days is the reverse!

M. Moy

pp A G TYRIE

42/2.BTW.4376/42

RESTRICTED

CC: PPS, CST, PMG, EST, Mr Molan, Mr Tyrie, Mr Cropper, Mr Call.

Treasury Chambers, Parliament Street, SW1P 3AG

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 OET

23 May 1988

Dear David

VOLUNTARY RESTRAINT ARRANGEMENTS ON FOOTWEAR

Thank you for your letter of 29 April.

For the reasons set out in my letter of 18 April, I am still not persuaded that the case has been made for an additional breathing space to be provided to this industry. I am disappointed that you appear to place little weight on the fact that the costs of the VRA to the rest of the economy have already run on for some time. However, I welcome your intention to commission an internal review in a year's time to see whether any change is justified. But it is essential that if this review is to be meaningful it must assess the effect of the VRA on the industry's performance and set out the costs to consumers in detail. Unless these costs can be shown to be justified by benefits accruing to the industry, support should then be ended.

I am grateful for your comments on the VRAs with Poland, Czechoslovakia and Romania. I am reassured by the fact that the interests of consumers are taken into account when these come up for renewal. It will be helpful if, when you report to E(CP) on the decision reached following the next set of reviews, you fully explain the factors leading to your conclusions.

I note what you say about the quota arrangements which I referred to in my letter though I am unclear about the logic behind the distinction you appear to draw in this context between trade and competition policy.

I am copying this letter to other members of E(CP) and to Sir Robin Butler.

NORMAN LAMONT

NH8/72Jo

RESTRICTED

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

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

1 June 1988

E(CP): QUANTITATIVE RESTRICTIONS ON IMPORTS INTO UK

As you know E(CP) has been considering from time to time over the past three years progress in the review of voluntary restraint arrangements (VRAs). On the whole, this has been a very useful exercise and the fact that it has been done within the umbrella of E(CP) underlines the close inter-relationship between competition and trade policy. International trade serves to sharpen competition in the domestic market place in terms of price, quality, variety and incentives to innovate new products. Trade barriers which shelter particular domestic industries can bring anti-competitive effects on the domestic market and, in certain circumstances, can induce collusive behaviour by exporting and/or importing enterprises. You yourself recently reiterated the Government's determination to tackle anti-competitive practices in your recent Green Paper on restrictive trade practices. E(CP) can provide a forum within which the interface between competition and trade policy can be considered, but I do not think it can adequately do this if it confines its consideration to VRAs and takes no account of other forms of restriction with similar and equally important effects.

With these points in mind, I believe that it would desirable for E(CP) to be given the opportunity to consider the nature and extent of all restrictions on the import of non-agricultural goods into the UK. This would enable the Committee to consider the cumulative effect of such restrictions on competition in the UK and also to focus on particular industries where such protection is in place. To facilitate such a discussion it would be helpful for your department to produce a paper providing an overview of all such restrictions on imports and explaining the justification for each measure and the arrangements for reviewing their continuation. It would be useful if the paper could give some assessment of the percentage of total UK imports affected by such measures and the total cost to consumers arising.

Once an initial discussion has taken place the Committee could later return to the general picture or focus on specific areas of protection. A regular updating of the paper would be particularly helpful. Apart from giving the Committee an opportunity to consider the general competition implications of trade barriers, the paper would also provide the basis for discussion of the implications that UK restrictions have in the context of Uruguay Round, the external trade implications of the Internal Market, the extent to which consumer interests are taken into account in trade policy decisions and the possible impact of any new restrictive trade practices legislation.

It would be useful if you could table such a paper in the early Autumn. I envisage that it would cover, inter alia, industry-to-industry VRAs which continue to carry DTI support and those which no longer have DTI support but remain in existence, EC VRAs negotiated on the UK's behalf, VRAs built into the various technical and co-operation agreements between the EC and Mediterranean countries, EC quota arrangements applying to the UK and of course the Multi-Fibre Agreement. (The ongoing review of VRAs could be subsumed within the exercise).

I am copying this letter to other members of E(CP) and Sir Robin Butler.

NIGEL LAWSON

dti

the department for Enterprise

EXCHEQUER
15 JUN 1988
R NOLAN
CST, FST, PMG, EST
SIR P MIDDLETON,
SIR G LITTLER, MR BYATT
MR LANKESTER, MR MOIOCK
MR H EVANS, MR MOUNTFIELD
MR PGF DAVIS,
MR MACAULAY,
MS SINES, MR LO-NN-OLOEN
MISS PRESTON,
MR CROPPER, MR TYRIE
MR CALL

101/7

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
Switchboard 01-215 7877
Telex 8811074/5 DTHQ G
Fax 01-222 2629

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

FINANCIAL SECRETARY
REC. 15 JUN 1988
ACTION RPS
COPIES TO

Direct line 215 5422
Our ref DW2AHJ
Your ref
Date 15 June 1988

Dear Nigel,

E(CP) : QUANTITATIVE RESTRICTIONS ON IMPORTS INTO THE UK

Thank you for your letter of 1 June.

I agree that other forms of import restriction can have much the same effect on the economy as VRAs. At the same time there is an important distinction. VRAs particularly those negotiated industry to industry, were developed informally outside the normal trade policy framework and can be dealt with through unilateral domestic action. The other restraints we maintain reflect specific UK or Community trade policy decisions and their future will, in most cases, involve Community procedures as well as multilateral or bilateral negotiations. As such they have tended also to be examined by Cabinet Committees with a Community or overseas focus.

The remaining restrictions on non-agricultural imports fall into three broad categories: steel, textiles and a fairly small number of residual quotas on imports from state-trading countries. The steel and textile measures are Community-wide (with some supporting national restrictions) and are designed to meet internationally-recognised structural problems. The residual quotas against state traders on the other hand generally reflect the particular problems caused by the trading practices of these centrally managed non-market economies. Most of the latter are likely to be extremely limited in their impact on consumers, unlike VRAs consumer goods from highly competitive sources.

the Enterprise

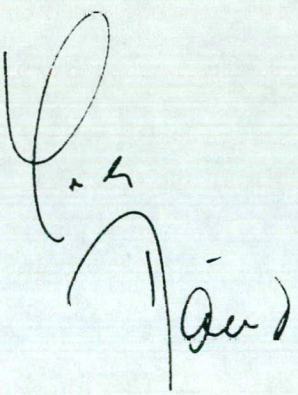
dti

the department for Enterprise

I am happy to circulate a paper in the autumn identifying these restrictions more fully and informing E(CP) of the work on them already carried out or planned for the future. I agree that, to provide a complete overview, the paper could also usefully cover VRAs continuing at that time.

Our priorities in reviewing the remaining restrictions are largely determined by external factors, such as the Uruguay Round or the completion of the single market - all will be covered in one way or another. Those national quotas on imports from state trading countries not already considered in the course of assessment of VRAs in the same sector and not forming part of the EC's rollback offer in the Uruguay Round are to be reviewed systematically in the context of the completion of the single market. The future of our steel and textile restraints will need to be considered in the light of the Community's objectives in the Uruguay Round and proposals emerging in the course of the negotiations. The form and timing of these reviews will depend on the timetable set by the negotiations. And in all these cases, the Community will wish to give due weight to negotiating aspects such as the price to be demanded for liberalisation and the achievement of other Uruguay Round objectives. These points will be brought out in the paper.

I am copying this letter to the other members of E(CP) and to Sir Robin Butler.



4366/9

CONFIDENTIAL

MR P DAVIES

FROM: J J HEYWOOD
DATE: 20 June 1988

cc PS/Chancellor
Mr Molan
Mr Tyrie

E(CP) RESTRICTIONS ON IMPORTS

The Financial Secretary has seen Mr Tyrie's minute of 16 June. He strongly agrees with the idea of getting Silberston to update his report on the Multi Fibre Arrangement.

JEREMY HEYWOOD
Private Secretary

35/3 lb.21.20.6

FL

-RESTRICTED-

FROM: P EDMONDS
DATE: 22 June 1988

MISS PRESTON

cc Mr P G F Davis
Mr Matthews
Mr Molan o/r
Ms Symes o/r

PROPOSED VRA ON SOUTH KOREAN ELECTRONIC GOODS

1. Susie Symes was grateful for your minute of 16 June, and has asked me - in her absence at OECD - to comment on the Commission's paper which argues that a Community VRA is needed. The Commission's paper does not make an adequate case for the proposed VRA and totally ignores the costs it would impose on consumers.

2. The protectionist attitude the Commission shows in its paper has implications for the E(CP) review of UK trade barriers being carried out by the DTI at the request of the Chancellor. Lord Young's letter to the Chancellor of 15 June notes that the Commission will be forming policy on the VRAs with state trading countries, and an approach to the Uruguay Round that will affect our textiles and steel restraints. If the Commission's paper on Korean electronic goods shows how it thinks , the UK may find that the protection it has dismantled will be replaced by a more protective set of trade policy measures.

3. The Commission's arguments for a VRA owe more to xenophobia than to economics, but some economic issues are raised: the undervalued Korean currency, Korean protection, possible Korean dumping, and the relationship between economies of scale and market penetration.

4. The Commission rightly argues that the won is undervalued; South Korea has a current account surplus of almost 9% of GDP. But a VRA is <u>not</u> an appropriate response. It would impose costs on European consumers - households <u>and</u> firms - and is a long-term measure while the undervaluation may be only temporary. We should respond by calling for Korea to allow its currency to appreciate,

not by calling for protectionist measures.

5. On Korean protection, our response should be to call for the acceleration of the process of liberalisation of Korean markets. South Korea is a full member of the GATT, so pressure can be applied by demanding that the country fulfils its GATT obligations. Once again, a VRA is not an appropriate policy response, due to the costs it imposes and the distortions of resource use it causes.

6. The Commission's paper does not give any evidence of Korean dumping of electronic goods. If dumping is shown to be occurring, the correct response is a short-term and specific anti-dumping measure, not a long-term VRA covering a whole sector of manufactured trade, which may outlast any dumping and cover more products.

7. The argument that large production runs reduce unit costs in the production of electronic goods, and help fund product development, may well be true, but this does not justify a VRA. The forecast in Section 3 - kindly provided by "one of the major EC producers" - predicts a large rise in the European market from 2 billion ecu in 1985 (although this may be wrong as the hi-fi/TV figure seems too low) to nearly 8 billion ecu in 1990. This growth would allow both increasing Korean exports to Europe and a large increase in EC domestic production. The potential overseas market for EC electronic goods is also rising.

8. The Commission invokes the fear of a 'surge' of imports from Korea redirected from the USA. The issue of 'safeguards' is still under negotiation in the GATT, and the EC does not accept that action must be non-discriminatory. Mr Lawson wrote to Lord Young (13 Jan 1988) that there must be an economic rationale for any protections granted, and the Commission should surely have to prove injury, rather than just say it may happen, to justify protection. Christopher Roberts' reply to Mr Loeff, dated 15 June, makes this point strongly, and asks the Commission to provide further information. If that information arrives—and Mr Roberts demands are rigorous - we will want to examine the evidence for injury. GATT does not allow discrimination in

safeguard measures, and any protection against a 'surge' should be only short-term. Both of these arguments would lead to the rejection of a VRA against Korean electronic goods, even if injury was proved. It is very odd for the Commission to write " ... no-one should think of developing non-economic European production behind the walk of grey-zone measures" when they are proposing just such walls.

9. The tables on page 5 are not helpful. Does "market share" refer to the Korean share of the total EC(?) market, or of imports into the EC, or the share of imports in the EC market? The bottom table does not say what year the figures are for, and this makes its significance difficult to establish.

10. The Commission's paper does not mention that a VRA would impose costs on consumers - both firms and households - from higher prices and reduced choice. Mr Roberts' letter to Mr Loeff does mention costs to the consumer and implies that the UK will want them to be estimated and discussed in any further material the Commission presents in pursuit of its case. It will be important to emphasise costs to consumers in any letter to the DTI, to ensure that the Department gives them full weight when it considers further Commission papers on this VRA. It may also be useful to remind the DTI of the helpful checklist developed by the OECD to ensure that governments took consumers' interests into account when formulating trade policy.

11. To conclude: the Commission's paper does not justify the VRA it proposes, and it fails to consider the costs such a policy would impose on consumers. Given DTI's past ambivalence on these issues, would it be worth putting down an early marker with DTI officials, so that they have a clear idea of our concerns, and asking them for a response?

P. Edmonds

P EDMONDS

040/3653

RESTRICTED

→ Jarlath

FROM: A G TYRIE
DATE: 24 JUNE 1988

MR P DAVIS

Thanks. Pop (with other VRA papers)

cc PS/Chancellor
Mr Lankester
Mr Edmonds
Miss Preston
Mr Matthews
Mr Molan
Ms Symes

PROPOSED VRA ON SOUTH KOREAN ELECTRONIC GOODS

You very kindly passed me the papers on this.

I entirely agree with Mr Edmonds' note of 22 June. We should not allow the DTI to give the Commission any succour. My instinct is also not to offer the suggestion of using the anti-dumping code in preference to a VRA (paragraph 6). If the Koreans want to subsidise microwaves in British kitchens, let them!

I also entirely agree with paragraph 5, that our response should be to call for the full liberalisation of the Korean market.

A G TYRIE

BF with briefing on 6/7

HOUSE OF LORDS,
LONDON SW1A 0PW

29 June 1988

DL 10/236/01

CH/EXCHEQUER
REC. 29 JUN1988 ✓29/6
ACTION MR WYNN OWEN
FST
SIR P MIDDLETON
MR MONCK
MR BURGNER
MRS CASE
MR BURR

Dear Nigel,

E(CP)

When I presented my paper to E(CP) last January I agreed to report back on the issues listed below, having taken account of the conclusions of the Marre Committee, before the summer recess if possible.

The current position on these matters is as follows:

(i) Non-Contentious Probate: I have opened discussions with the President of the Law Society, but no conclusions have yet been reached.

(ii) Multi-Disciplinary Practices: The Law Society are already seriously considering these. I am pressing them on their timetable for reaching a conclusion.

(iii) Attendance on Counsel: Discussions between my Department and the Bar and the Law Society are now at an advanced stage. They look to be capable of resolution over the summer.

(iv) Extending Competition in Legal Aid Work: The Legal Aid Bill is due to receive Royal Assent by the end of July. The Act will give the Legal Aid Board power to contract out work to both lawyers and non-lawyers after it takes over the administration of legal aid.

The Rt Hon Nigel Lawson MP
HM Treasury
Parliament Street
London SW1

.../continued

CONFIDENTIAL

(v) Recognised Institution Rules: Work on the draft Rules is proceeding. It cannot, however, be completed until the current review of our policy on holdings by lending institutions in subsidiary companies is completed. As you will know, The Treasury offered to prepare a paper on this subject for Ministerial consideration. They have recently let my officials have a draft of this; and I hope we will be able shortly to consider a paper which has been agreed at official level.

(vi) Direct access to the Bar.

(vii) Extension of rights of audience for solicitors.

These last two items are obviously the major and most contentious ones. Both are central to the Marre Committee's deliberations. I clearly cannot reach a settled view on either of them in advance of studying what Lady Marre has to say in her Report. As I expect you know, the timetable for publication of this Report has slipped. When E(CP) considered this subject in January, I expected the Report to be published around Easter. I now understand that the publication date will be 13 July. Lady Marre has recently told my officials that the earliest possible date that a draft of the report can be made available to them is Friday 8 July. As you know, the Marre Committee was set up jointly by the Bar and the Law Society and will report directly to the Chairman of the Bar and the President of the Law Society. I am not a party to the Committee's deliberations and I do not know what conclusions it has reached. I expect, moreover, that it will be a weighty document. As I am sure you will appreciate, since I will not see the Marre report until 8 July, I will not have sufficient time to formulate detailed and well-thought out policy proposals in the light of it before the summer recess, particularly as it concerns such important issues as rights of audience and direct access to the Bar.

In these circumstances, I think it would be more sensible for me to aim instead to put a paper to E(CP) in the autumn (presumably October) which can cover these matters fully. We might also perhaps then be able to reach substantive conclusions on some of the other matters listed above, for example the Recognised Institution Rules, where progress looks to be capable of achievement over the next 2 or 3 months.

I am sending copies of this letter to other members of E(CP) and Sir Robin Butler.

Yours ever,

James.

CONFIDENTIAL

JW/D/47

4 JUL 1988

RESTRICTED

Caxton House Tothill Street London SW1H 9NF
5803

Telephone Direct Line 01-273 .....
Switchboard 01-273 3000 Telex 915564
GTN Code 273 Facsimile 01-273 5124

FINANCIAL SECRETARY
- 4 JUL 1988
ACTION CX
COPIES TO

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

June 30

Dear Nigel.

E(CP): QUANTATIVE RESTRICTIONS ON IMPORTS INTO UK

I have seen your letter of 1 June to David Young and his reply of 15 June.

I agree that international trade serves to sharpen product competition in the domestic market and that trade barriers can produce anti-competitive effects. Moreover, I believe these effects apply in the labour market as well as in the product market. International trade can be an important means of encouraging the development of labour market flexibility, and the removal of unnecessary barriers.

I therefore support your proposal that E(CP) be given the opportunity to consider the nature and extent of all restrictions on the import of non-agricultural goods into the UK, and would hope that the labour market implications would be one of the aspects we would consider.

I am sending copies of this letter to other members of E(CP) and Sir Robin Butler.

Yours

NORMAN FOWLER

RESTRICTED

Yes, they have been told.

CHANCELLOR OF THE EXCHEQUER

Ch.

E(CP)

Wool etc.

I attach a copy of the minutes of the last meeting. You will see that the last para. explicitly calls for pps. on wool (+ potatoes) for the July meeting.

2. The problem seems to be that the last page was omitted from MAFFs copy. They are trying to do their best to get pps. circulated, but these may be a bit later than usual.

11/7

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

From the Minister

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

1 July 1988

Dear Nigel,

MILK MARKETING ARRANGEMENTS

A meeting of E(CP) on 16 July 1986 discussed our milk marketing arrangements in the light of the Touche Ross report on the England and Wales Milk Marketing Board's commercial arm, Dairy Crest. Your summing up endorsed Michael Jopling's proposals to redefine the relationship between the Milk Marketing Board (MMB) and Dairy Crest. Michael was therefore able to announce, on 25 July 1986, an agreed package of measures to ensure fair competition between all buyers of milk, to clarify the separation of Dairy Crest from the MMB and to reinforce the Government's supervisory role provided for under Community law. These measures included not only the incorporatation of Dairy Crest but also a system to monitor the Company's performance on the basis of reports to be submitted to my officials at regular intervals. Copies of the announcement of 25 July 1986 and of the memorandum of agreement are attached at Annex I.

Your summing up also suggested that the Sub-Committee should review the operation of the arrangements in two years' time. Colleagues will, therefore, wish to know that significant progress has been made. In particular, Dairy Crest was incorporated on 23 September 1987, despite a number of unexpected difficulties including problems over the capital structure of the company and a legal obstacle to incorporation which necessitated an amendment to the Milk Marketing Scheme. The Board is submitting confidential reports at the prescribed intervals on Dairy Crest's financing, financial performance, management arrangements and market position so that my Department - with continuing advice from Touche Ross - can fulfil its monitoring role.

/All the evidence ...

All the evidence suggests that the new arrangements are having the desired effect and that Dairy Crest Limited is now thinking and operating as an independent Company with fully commercial objectives. It has, for example, introduced major rationalisation programmes for its cheese, butter and skimmed milk powder operations. As a result, the Dairy Trade Federation's complaints about Dairy Crest have been largely silenced and they are even contemplating admitting the company to one of their constituent bodies, the Creamery Proprietors' Association. A detailed Schedule of progress in monitoring the new arrangements is attached at Annex II.

The European Commission also appear content. They were given details of the July 1986 agreement but did not express any particular interest and they have not enquired about the results of our monitoring. Their attitude on this and on other MMB matters has been significantly more relaxed since the conclusion of our European Court litigation.

As regards the situation in Scotland, I note that Malcolm Rifkind has now published a document on Scottish Pride (the commercial arm of the Scottish Milk Marketing Board) which is analogous to the original Touche Ross report on Dairy Crest and DAFS are now discussing its implications with their industry. In Northern Ireland, I understand that the Northern Milk Marketing Board have reached agreement on how the Board's commercial division should operate and DANI, with advice from Deloitte Haskins and Sells, is monitoring the situation. The consultants and the Department's legal advisers are content that implementation of the industry agreement will ensure separation and equalfootedness in the operation of the Northern Ireland Board's commercial activities.

I conclude that the approach which E(CP) approved in 1986 remains valid. I invite my colleagues to endorse this assessment and to agree that we should review the position again in 1990.

† I am sending copies of this letter to other members of E(CP), to the Secretaries of State for Wales, Northern Ireland and Scotland and to Sir Robin Butler.

Yours ever,

JOHN MacGREGOR

Ministry of Agriculture, Fisheries and Food

ANNEX I

MAFF

PRESS RELEASE

July 25, 1986

MICHAEL JOPLING ANNOUNCES RESPONSE TO TOUCHE ROSS REPORT

The Rt Hon Michael Jopling MP, Minister of Agriculture, Fisheries and Food, today announced his response to the Touche Ross Report on the Milk Marketing Board and Dairy Crest.

In a written answer to a Parliamentary question by Sir Adam Butler MP, Jopling said:

"My Rt Hon friend the Secretary of State for Wales and I received the report on December 23, 1985. Touche Ross concluded that in most respects separation between the Milk Marketing Board and Dairy Crest Foods had been achieved, as required by Community and domestic legislation. However, they considered that Dairy Crest's strategy could be constrained by the Board's interests in maintaining and increasing markets for milk, and that Dairy Crest Foods' rate of return might not have been acceptable to a commercial company.

"The report required careful consideration and consultation with the industry. Agreement has now been reached between the Government, the Milk Marketing Board and the Dairy Trade Federation on arrangements designed to strengthen competition in the dairy industry, to ensure fair competition between all buyers of milk, to clarify the separation of Dairy Crest Foods from the Milk Marketing Board and to reinforce the Government's supervision of the industry.

"Under the existing umbrella of the Milk Marketing Scheme, Dairy Crest Foods will become a body legally distinct from the Milk Marketing Board and will work to clearly stated commercial objectives. In the Joint Committee, which will remain the essential vehicle for negotiations on prices and supplies, the Milk Marketing Board and the Dairy Trade Federation will continue to negotiate on an equal footing and to respect the requirements of UK and

Community law. The National Farmers' Union of England and Wales and the Farmers' Union of Wales have been consulted and have endorsed the proposed arrangements.

"I am arranging for the text of the agreemnt to be placed in the Library."

NOTES FOR EDITORS

1. The Minister announced his intention of commissioning a study of Dairy Crest on December 5, 1984. Press Release No 426 contains his statement and the terms of reference for the study.

2. The Minister announced on January 28, 1986 (Press Release No 26) that the report had been received.

MEMORANDUM OF AGREEMENT

MILK MARKETING ARRANGEMENTS FOLLOWING THE TOUCHE ROSS REPORT

INTRODUCTION

1. This memorandum sets out the arrangements agreed between Government, the Milk Marketing Board of England and Wales (MMB), and the Dairy Trade Federation (DTF), following the study of the relationship between the MMB's producer activities and Dairy Crest Foods by the management consultants, Touche Ross, and associated discussions on other issues. The purpose of the arrangements is to strengthen competition in the dairy industry, to ensure fair competition between all buyers of milk, to clarify the separation of Dairy Crest Foods from the MMB and to reinforce the Government's supervisory role. Under the existing umbrella of the Milk Marketing Scheme, Dairy Crest Foods will become a body legally distinct from the MMB and work to clearly stated commercial objectives. In the Joint Committee, which will remain the essential vehicle for negotiations on prices and supplies, the MMB and DTF will continue to negotiate on an equal footing and to respect the requirements of UK and Community law. The National Farmers' Union of England and Wales and the Farmers' Union of Wales have been consulted, and have endorsed the proposed arrangements.

A. DAIRY CREST FOODS

LEGAL STATUS

2. Dairy Crest Foods will be incorporated and will become a wholly owned subsidiary of the Milk Marketing Board.

OBJECTIVES OF DAIRY CREST FOODS

3. As a company, Dairy Crest Foods will have its own Memorandum and Articles of Association. These will reflect the commercial nature of the organisation. They will be agreed with the Ministry of Agriculture, Fisheries and Food (MAFF) who will have consultations with the DTF.

4. Dairy Crest Foods will adopt a Statement of Business Purpose (see Annex A). This will be published. It will not be changed without the consent of MAFF following consultation with the DTF. The main objective is (and will remain) a commercial one which might

be expected of any independent dairy organisation. The MMB will not ask Dairy Crest Foods to depart in any way from this commercial objective.

BOARD MEMBERSHIP

5. The Board of Dairy Crest Foods will be appointed by the MMB. The majority of the Board of Dairy Crest Foods will not be members of the Milk Marketing Board; the Chairman will not be an elected member of the Milk Marketing Board. The number of independent non-executive directors, whose terms of reference will be defined in the Articles of Association, will not be less than the number of directors who are elected members of the Milk Marketing Board.

FINANCE

6. The MMB will set Dairy Crest Foods a target return on total assets in line with its Business Purpose in Annex A. Every six months, it will review Dairy Crest Foods' success in achieving this target return, take expeditious remedial measures where necessary in the same way as an independent company and inform MAFF on a strictly confidential basis. It will also set clear commercial criteria for the acceptance of proposals for new investments and product development.

7. When Dairy Crest Foods is incorporated, the aim will be to establish a capital structure reflecting normal commercial practice as closely as possible. Producer levies will not be used to increase the equity capital of Dairy Crest Foods save with the agreement of MAFF.

8. The MMB will lend to Dairy Crest Foods only at fully commercial rates of interest. Dairy Crest Foods will not be able to obtain funds from the MMB in circumstances where its financial returns and prospects would not justify borrowing by a commercial firm.

NEGOTIATIONS ON PRICES AND SUPPLIES

9. Dairy Crest Foods and the DTF will be free to discuss on the initiative of either party matters of mutual interest which are to be the subject of negotiations in the Joint Committee framework.

10. The Arbitrator will be free, with the agreement of the MMB and the DTF to request information from Dairy Crest Foods about the likely effect upon its financial position of any proposals put to him. Apart from this, Dairy Crest Foods will not communicate with the Arbitrator.

11. It is the intention of the MMB, the DTF and Dairy Crest Foods to develop these arrangements towards a situation in which Dairy Crest Foods can become a member of the Creamery Proprietors' Association.

MANAGEMENT ARRANGEMENTS

12. More formal procedures will be established to prevent confidential information being passed from Milk Marketing Department to Dairy Crest Foods and vice versa.

13. The MMB recently abolished the post of common Chief Executive for the producer activities and Dairy Crest Foods. Separation at all levels will be maintained so far as is practicable within a normal holding company/subsidiary relationship. New contracts of employment for senior staff in certain sensitive positions in Milk Marketing Department where they have had access to commercially sensitive information as a result of their contact with buyers will provide that moves to dairy companies (including Dairy Crest Foods) will not take place without an appropriate time break.

14. Dairy Crest Foods has its own Finance Division and Personnel Department. Its reliance upon MMB corporate services will be minimised.

INTERNAL TRANSACTIONS

15. It is the policy of Dairy Crest Foods to move its staff to separate premises. So long as Dairy Crest Foods occupies any premises owned by the MMB, it will pay a full commercial rent to the MMB. Such rent will be assessed initially by an independent firm of valuers.

INVESTMENT APPRAISALS

16. Investment appraisals presented to the Board of Dairy Crest Foods will be assessed in terms of the net benefits to Dairy Crest Foods alone.

MILK HAULAGE

17. In its annual reports to MAFF (Annex B) Dairy Crest Foods will show the profits attributable to its haulage activities and the return on capital employed, together with its share of ex-farm haulage.

18. Arrangements will be made for Dairy Crest Foods to take part in negotiations in the Associated Transport Committee.

PRODUCT DEVELOPMENT AND PROMOTION

19. Dairy Crest Foods will not exploit its link to the MMB to gain a promotion or product development advantage over the independent dairy companies.

MONITORING

20. The MMB and Dairy Crest Foods will provide MAFF with information on the lines set out in Annex B. MAFF will seek the advice of independent consultants and obtain such comparative data as may be necessary. The independent consultants will in particular advise on any circumstances where producer influence has disadvantaged Dairy Crest Foods commercially. MAFF will discuss the report with the MMB and Dairy Crest Foods and will subsequently inform the DTF of the conclusions of the monitoring in paragraph 6 and in Annex B.

21. The MMB and Dairy Crest Foods will make available to MAFF minutes of Board meetings on a strictly confidential basis.

INFORMATION FOR PRODUCERS

22. The MMB and Dairy Crest Foods will provide producers with information on the lines set out in Annex C.

B. MILK MARKETING BOARD AND DAIRY TRADE FEDERATION

BALANCING SUPPLIES

23. The MMB will identify the measures needed to deal with supply fluctuations due to seasonal and other factors. It is the responsibility of Milk Marketing Department to consult the DTF on the principles to be applied and agree them in the framework of the Joint Committee. In an emergency the MMB will be free to take appropriate action and report it to the Joint Committee.

ARRANGEMENTS FOR MAKING MILK AVAILABLE TO BUYERS

24. In order to ensure that the rules are widely understood, Milk Marketing Department and the DTF will finalise the agreement currently under discussion and make sure that it is widely available. The Joint Committee will inform MAFF of the rules (and any changes in them) and of the methods used to implement the rules, including which costs are in practice taken into account.

MILK HAULAGE

25. The MMB is responsible for the co-ordination of movements of ex-farm milk. It will agree the contractual basis for such movements with the DTF and the Road Haulage Association (RHA) and will keep MAFF informed of any such agreements.

26. Milk Marketing Department will state its policy on the disposal of vehicles bought back when hauliers' contracts are terminated.

MONITORING

27. The Joint Committee will inform MAFF of agreements reached about the systems of milk pricing and allocation and any changes in those systems. It will also send MAFF copies of any decisions by the Arbitrator.

28. The Joint Committee will inform MAFF of any measures required to deal with supply peaks or troughs.

IMPLEMENTATION

29. Dairy Crest Foods will be incorporated in April 1987. The half-yearly reviews of Dairy Crest Foods' financial performance will start in January 1987 and the confidential annual reports to MAFF in July 1987.

Ministry of Agriculture, Fisheries and Food

Welsh Office

25 July 1986

ANNEX A

THE DAIRY CREST FOODS' BUSINESS PURPOSE

The Dairy Crest Foods' business is a commercial enterprise whose owner is the Milk Marketing Board for England and Wales. Its purpose is to make a commercial return on assets at least equivalent to the best of its competitors while developing and exploiting the dairy products markets. Additionally, it provides as necessary, as a commercial service to the Milk Marketing Board, manufacturing capacity able to accommodate the imbalances in milk supply created by seasonal and other factors, within the framework of the Joint Committee procedures.

In seeking to achieve its purpose, Dairy Crest Foods is committed to:-

1. A continuing emphasis on product and production process innovation and development to meet the challenges and opportunities presented in a changing technical and economic environment.

2. Ensuring the highest standards of quality in the products and services it provides.

3. A continuing improvement in the levels of efficiency in all areas of activity in order to achieve a "lowest cost" operation.

4. Sustaining the priority of the customer in the development of the business.

5. Ensuring that the requisite staff are available, motivated and committed to the long-term success of the business and work in the closest possible collaboration.

INFORMATION FOR MAFF

1. MMB should provide a supplementary report covering the following material, which MAFF would treat as strictly confidential.

MANAGEMENT ARRANGEMENTS

2. The report should set out:-

(a) the organisation structure of the MMB and of Dairy Crest;

(b) the membership of the statutory boards and of executive boards and committees together with their terms of reference;

(c) transfers of senior staff between Dairy Crest Foods and the producer side of the MMB;

(d) arrangements made by the MMB and Dairy Crest Foods to ensure that commercially sensitive material is not passed from one to the other.

FINANCIAL TRANSACTIONS

3. The report should include a statement by the auditors of MMB and Dairy Crest Foods, qualified if necessary, to the effect that the bases used for calculating charges for goods and services provided by the MMB to Dairy Crest Foods or vice versa are reasonable. The report will include a list of such goods and services by broad headings.

FINANCING

4. The report should contain a statement of:-

(a) Dairy Crest Foods flow of funds, identifying separately:-

(i) the movement on current account;

(ii) external borrowing by Dairy Crest Foods, any borrowing by Dairy Crest Foods from the MMB and external borrowing by

the MMB for Dairy Crest Foods; and the terms of any guarantee given by the MMB;

(iii) movements on reserves;

(b) any conditions imposed on Dairy Crest Foods in respect of funds provided, including the method of calculating interest rates;

(c) the Dairy Crest Foods board decisions governing movements in its reserves and the reasons for those decisions;

(d) dividends payable by Dairy Crest Foods to the MMB;

(e) the total value of finance leases disclosable under the terms of SSAP 21 when that standard becomes mandatory.

FINANCIAL PERFORMANCE

5. The report should include:-

(a) a statement of the overall financial objective set for Dairy Crest Foods by the MMB, relating the objective to the need to earn a normal commercial return;

(b) a statement of the criteria for the acceptance of new investment and product development;

(c) a comparison of Dairy Crest Foods' actual financial results with its financial objectives;

(d) the profit performance including the return on capital employed of Dairy Crest Foods analysed by product group, division or profit centre, identifying in particular the performance of the hualage operations.

SPECIAL ARRANGEMENTS AFFECTING DAIRY CREST FOODS

6. The report should set out:-

(a) Dairy Crest Foods' Statement of Business Purpose and any other objectives;

(b) any requirements imposed on Dairy Crest Foods by the MMB that would not be expected of an independent dairy;

(c) the financial implications for Dairy Crest Foods of those requirements.

MILK PRICING AND RULES FOR BUYING MILK

7. The report should describe:-

(a) any arrangements made for Dairy Crest Foods to participate in, or contribute to, the industry's negotiations and arbitrations on milk pricing and the rules for buying milk and the extent to which these arrangements were used;

(b) any measures agreed to deal with supply fluctuations and the extent to which they have involved Dairy Crest Foods as compared with independent dairies.

MILK HAULAGE

8. The report should set out:-

(a) the methods used by the MMB to allocate haulage contracts and to determine the remuneration of hauliers;

(b) the effects of any termination by the MMB of hauliers' contracts, including the disposal of vehicles bought back.

MARKET POSITION

9. The report should state:-

(a) milk sales to Dairy Crest Foods compared with the total for other purchasers, broken down by product group;

(b) the volume of milk hauled by Dairy Crest Foods as against independent hauliers.

INFORMATION FOR PRODUCERS

1. As a company, Dairy Crest would have its own annual Directors' Report and audited Accounts, which would be sent to all registered producers.

2. In the report to producers the following should be specifically identified:-

(a) Dairy Crest's net profits for the year and its return on capital employed;

(b) the net flow of funds between the MMB and Dairy Crest, excluding payments for goods and services;

(c) the movement in the net worth of Dairy Crest to producers.

JULY 1986 AGREEMENT ON DAIRY CREST (DC)

PROGRESS REPORT

Paragraph No	Action Required	Position at June 1988
1.	This paragraph is not operational	-
2.	DC to be incorporated as wholly owned subsidiary of MMB	DC incorporated
3.	DC to have Memorandum and Articles agreed with MAFF, who will consult DTF	DC Memorandum and Articles established in accordance with this paragraph
4.	DC's statement of business purpose to be published and not to be changed without consent of MAFF	Statement of business purpose was published as annex to the agreement. MMB are considering publication in Milk Producer. The question of amendment has not arisen.
	MMB not to ask DC to depart from commercial objective.	This is covered by monitoring: no evidence of any such request.
5.	Composition of DC's Board to comply with criteria laid down in this paragraph	Composition of DC Board now finalised and complies with this paragraph.

Paragraph No	Action Required	Position at June 1988
6.	MMB to set DC a target return in line with statement of business purpose. MMB to review DC's performance against target, take expeditious remedial measures and inform MAFF on a strictly confidential basis. MMB to set clear commercial criteria for investment and product development.	The provisions on target setting need clarificatio in the light of the monitoring experience so far obtained. This is currently under discussion with the Board.
7.	DC's capital structure should reflect normal commercial practice. Producer levies not to be used without MAFF's consent.	MAFF satisfied that DC's capital structure complies: the question of producer levies has not arisen.
8.	MMB to lend to DC only at commercial rates: DC not to obtain funds from MMB if borrowing by a commercial firm would not be justified.	This is covered by monitoring: no evidence of non-compliance.
9.	DC and DTF free to discuss "matters of mutual interest" prior to Joint Committee negotiation.	MAFF's understanding is that such contacts are taking place.
10.	Arbitrator to be free to approach DC if MMB and DTF agree.	MAFF is not aware of any such approach: no evidence that MMB or DTF agreement has been withheld.

Paragraph No	Action required	Position at June 1988
11.	Possible DC membership of CPA.	Discussions between the Board and the CPA on Dairy Crest membership proceeding.
12.	MMB/DC to ensure that confidential information is not exchanged.	The MMB has reported on new arrangements in accordance with paragraph 2 of annex B.
13.	MMB/DC to ensure staff separation.	The MMB has reported new arrangements in accordance with paragraph 2 of annex B.
14.	DC to have separate finance division and personnel department and to minimise reliance on MMB corporate services.	The MMB reports on this in accordance with paragraph 2 of annex B: separation is progressing well.
15.	DC to pay full commercial rent on any premises owned by MMB.	MMB reports on this in accordance with paragraph 3 of annex B.
16.	DC investment appraisals to be assessed in terms of benefit to DC only.	MMB reports on this in accordance paragraph 5 of annex B.

Paragraph No	Action required	Position at June 1988
17.	MMB reports to MAFF to show profit and return on haulage and DC share of the market.	MMB is reporting accordingly.
18.	DC to take part in ATC negotiations.	Dairy Products Transport attending MMB/ATC discussions.
19.	DC not to exploit links with MMB to gain promotion or product development advantages.	No evidence that this paragraph is not being observed.
20.	MMB/DC to report to MAFF in July/August every year along lines of Annex B.	Board reported on time.
	MAFF to seek advice from consultants.	Touche Ross appointed.
	MAFF to discuss reports with MMB/DC and to inform DTF of the conclusions of: (a) the monitoring in paragraph 6 (ie the six monthly review) (b) the monitoring in annex B (ie the annual exercise).	MAFF has informed the DTF of conclusions in relation to the period April - September 1986, and also for the 12 month period from April 1986 to March 1987. The report for the period April to September 1987 is currently under discussion with the MMB.

Paragraph No.	Action required	Position at June 1988
21.	MMB/DC to provide MAFF with Board minutes.	MMB/DC complying.
22.	MMB/DC to provide information for producers.	The first report will be included with the Board's 1988 Annual Report.
23.	MMB/DTF to agree arrangements on balancing supplies.	Agreement now reached.
24.	MMB/DTF to finalise arrangements document.	Agreement now reached by MMB/DTF. Document seen by MAFF and agreed subject to minor clarification.
25.	MMB to agree contractual basis for movement of ex-farm milk with DTF and RHA and to inform MAFF.	MAFF provided with copy of contract.
26.	MMB to state policy on disposal of vehicles when contracts terminated.	No contracts terminated in period covered by latest report.
27.	Joint Committee to inform MAFF of agreements on pricing and allocation, and to provide copies of arbitration decisions.	No Problem.

Paragraph	Action required	Position at June 1988
28.	Joint Committee to inform MAFF of measures required to deal with supply peaks or troughs.	A copy of the document setting out the measures agreed by the Joint Committee to deal with supply peaks and troughs was received in February 1988.
29.	This paragraph deals with timing.	