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MR BLACKWELL

European Regional Development Fund

I attach your note together with my comments, both of which the Prime Minister has seen over the weekend.

I understand from the Prime Minister that she would prefer not to ask the Trade and Industry Secretary to develop proposals at present but wants to wait and see what emerges from the discussion of various aspects of the ERDF in E(A) which she understands is likely to be held fairly soon.

C D POWELL

27 October 1986

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PRIME MINISTER

24 October 1986

EUROPEAN REGIONAL DEVELOPMENT FUND

The publicity over the ERDF submission has, amongst other things, highlighted the absurdity of this particular scheme for transferring control of UK public expenditure to the European Commission. It could be timely to rethink our approach.

The original rationale for UK support of the ERDF was to provide a mechanism by which the UK could obtain a greater share of EEC expenditure to offset our net contributions to CAP. Under current budgetary arrangements, however, we have now become a net contributor to the ERDF as well! The maximum share of ERDF expenditure we are allowed is 19.3% and officials believe we are unlikely to achieve more than 17%. Against this, our share of the EEC budget is about 18%.

We are hence paying for the privilege of handing over £350 million to Brussels, only to have them lay down rules on how we can then spend that part which they give us back. And, since one of the rules is that expenditure should be additional to planned UK public sector expenditure, we have to construct elaborate mirrors to convince the Commission that this condition is being met while, at the same time, ensuring that it does not actually add to public spending. (Our success in doing this might lead us to question how well the

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Government can police a similar additionality condition imposed on DTI investment grants to industry!)

As long as the scheme exists, there is clear pressure on officials to search around to find suitable investments for submission from industry, local councils and central government departments - a task made difficult by the lack of incentives if non-additionality is strictly applied. As well as the inefficiencies of the whole administrative charade, there is a significant danger that at the end of the day some UK public expenditure gets diverted into marginal projects that happen to meet ERDF rules instead of other more deserving domestic priorities. Indeed, since the Commission is increasingly developing proposals for ERDF investment in its own pet projects - such as the development of a community-wide telecommunications network - it will be increasingly difficult for the UK Government to retain control of expenditure.

We would clearly be better off without ERDF, but the scheme - although started at our behest - has now acquired its own life and bureaucracy. Furthermore, in the context of the forthcoming 'Ex Novo' negotiations on the future shape of the EEC budget, some departments are arguing perversely that we should increase the size of the ERDF and ESF budgets as a way of decreasing the importance of agriculture. The most likely outcome of that approach would be a higher total budget!

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Possible Approach

We should use our Presidency of the EEC to set the tone for future discussions on EEC funding. But we need to clarify the Government's own approach first. With current budget pressures, the time may be ripe to develop an alliance aimed at either phasing out the current ERDF régime or imposing stricter eligibility requirements that effectively limit take-up throughout the community. You may therefore wish to ask Paul Channon to develop proposals along these lines.

Norman Blackwell

NORMAN BLACKWELL

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PRIME MINISTER

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EUROPEAN REGIONAL DEVELOPMENT FUND

The Policy Unit have written you the attached note.

When you have read it, I would ask you also to consider the following comments.

There are three reasons why we are becoming net contributors to the ERDF:

- (i) enlargement of the Community has meant that the cake has to be cut into smaller pieces;
- (ii) under the Fontainebleau mechanism, any receipts have the effect of diminishing our abatement. This diminishes the incentive to seek receipts;
- (iii) the incentive is further diminished by our position on additionality. Departments have to find off-setting savings from their programmes to match receipts which, as privatisation proceeds, increasingly go to the private sector. There are, of course, good public expenditure reasons for this.

The conclusion to be drawn from this is that we have a stronger interest than ever in keeping down total Community expenditure. But there is nothing to be gained from attacking the Regional Fund as such because:

- (i) we shall not succeed in getting rid of it. With the Single European Act, the ERDF is now in the Treaty. You went to some trouble to ensure that "areas of industrial decline" should be able to benefit from it, to ensure that we continued to derive some benefit, and it didn't all go to Portugal, Greece, etc;

(ii) other member states will conclude that we are attacking the structural Funds because we no longer have an interest in receipts, only in abatements. This will focus their attention on attacking the Fontainebleau mechanism in the review of the Community's finances next year. We can't avoid that, but we don't want to encourage it.

These issues are due to come to E(A) soon. I recommend that you hold back on launching the exercise proposed by Mr. Blackwell at least until after that.

EDP

Charles Powell

24 October 1986

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