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PRIME MINISTER

*for the first item
at E(A) tomorrow.*

19 November 1986

*DRS
19/11*

ERDF RECEIPTS FOR PRIVATISED INDUSTRIES

This is a straightforward issue where the commonsense solution has been muddled by arguments over principles. We recommend that you confirm the existing Treasury policy but recognise that Mr Ridley may wish to request special funding to continue Government grants for the Mersey clean-up.

The Arguments

Our aim is to use ERDF to get some money back from Europe. To prevent overspending, current rules state that ERDF grants should be put towards programmes, including Nationalised Industry investment, which have been agreed within public expenditure totals.

Once an industry is privatised, however, a continuation of ERDF grants would represent additional public expenditure rather than an offset. The Treasury are right to argue that departments should only seek new ERDF grants for privatised industries if they are prepared to include this aid within their agreed expenditure plans. To abandon this principle would mean treating ERDF as if it was a free, extra bucket of funds outside of normal PES controls and priorities.

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The spending departments have put forward two arguments for changing this general principle, neither of which is convincing.

1. They argue that we will be unable to take up our full quota of ERDF money if applications from privatised industries are disallowed.

However, while the industries which have been or are scheduled to be privatised since 1983/84 still account for 31% of total ERDF receipts (reflecting prior year commitments), in 1985 they represented only 10.5% of new commitments.

	<u>1983/4</u>	<u>1984/5</u>	<u>1985/6</u>	<u>1986/7</u> <u>forecast</u>
% of receipts from privatisation candidates	25.6%	18.5%	31%	31%
	<u>1983</u>	<u>1984</u>	<u>1985</u>	
% of UK commitments from privatisation candidates	36%	29%	10.5%	
UK share of ERDF commitments	21.2%	27%	24%	

We have already filled most of the gap, and both the Welsh and Scottish offices are prepared to take up more if required.

In any case, we should not spend money on programmes we would not otherwise undertake just to fill our quota. Under the Fontainebleau arithmetic, every extra £1 of ERDF grant we receive costs the UK exchequer 66p in lost rebate.

2. They argue that a decision to stop applications for ERDF grants could lead to the privatised industry curtailing programmes to which the Government has been committed.

The key example is the North West Water Authority and the Mersey clean-up project. The DoE case is that:

- a. The proposed level of investment to meet quality standards exceeds what could be justified commercially.
- b. The current EFL projections, based on forward investment plans, therefore implicitly include a hidden element of Government spending against environmental objectives which should be maintained (on top of other programmes) when the EFL disappears.
- c. It would be politically embarrassing for the ERDF grant to be withdrawn as a result of privatisation, endangering environmental objectives.

But this one case - however well justified - does not make the case for a wholesale change in general rules. We cannot presume that the existence of ERDF funding justifies a continued Government grant after privatisation. In the BT situation, for example, the ERDF commitments were for normal commercial investment which the company could fund itself.

Mr Ridley's memorandum proposes that public expenditure plans should include a separate line for ERDF grants which departments would then bid for. What is the logic for this? Surely it would simply reinforce the notion of a hand-out on top of other programmes?

If Mr Ridley believes that there is a special case for maintaining Government support for the Mersey clean-up project, he should put forward a specific proposition. The Treasury have already agreed that existing ERDF commitments should be kept and any new commitments would probably not affect expenditure until 1989. However, the current E(A) paper does not provide a basis on which that decision can be made.

Conclusion

The argument for a general abandonment of the non-additionality rule on ERDF receipts is a back door way of getting an easy source of new funds. We recommend that you

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support the Treasury line and request that special cases are dealt with in the normal way.

You might also use this opportunity to squash proposals from some departments that we should argue in the ex-Novo review for the ERDF fund to be increased as a proportion of the EEC budget - ostensibly to help put further pressure on CAP. The only consequence would be a higher total budget - and since we are now likely to be net contributors to ERDF, we have nothing to gain. The discussion on privatised industry receipts only goes to prove once again how pointless it is to have to go through the exercise of cycling our money through a European Bureaucracy. We should argue consistently to put a limit on all EEC budgets.

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