

PRIME MINISTER

Norman Tebbit's letter to Nigel concerning the Loan Guarantee Scheme reveals another story of how the best of intentions can miscarry when you set out to rig markets.

The Loan Guarantee Scheme was set up with the intention of breaking even on the lending to small firms, not with the intention of offering a relatively cheap job-creation scheme based on Government subsidy. The origins of the idea were that the banks were failing to lend money to a range of entrepreneurs who could use it profitably, but who were denied access to the money through a surfeit of banking caution.

The figures on the Loan Guarantee Scheme show that the banks were right to be cautious. It also shows that they have been sloppy in their appraisal as soon as Government guarantee and money is involved. People are only cautious in the way they spend their own money.

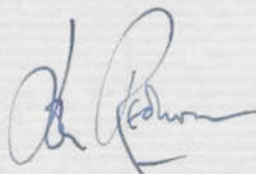
Many small businesses do not need access to more, possibly subsidised, borrowing. They need equity capital. In the early years of a small business setting up, there is quite enough risk in the operation without overburdening it with high interest charges. For this reason, we should be much keener to see the Business Expansion Scheme succeed in channelling monies to small businesses, than in extending or protecting the Loan Guarantee Scheme.

Nonetheless, small business is a central part of this Government's aspirations for the growth of the economy and the creation of new jobs. The small business lobbies are powerful and have become important allies. Axeing the scheme entirely would therefore be a dangerous and inappropriate response.

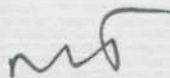
Of the options set out in Norman Tebbit's letter, the most attractive is the one which not only increases the amount of risk the banks are going to carry, but also increases the premium. The aim should be to get back nearer to the original intention that the scheme should break even.

I am sure the Treasury will argue some such case, and will also correctly argue that any additional costs of the Loan Guarantee

Scheme should be met from within DTI's budget. Taking Norman Tebbit's argument about the cost per job, and viewing this as yet another Job-Creation Scheme, there is an argument for persevering with it in a scaled-down version, but it should be financed at the expense of some of the very costly job-preservation measures the DTI are undertaking through the nationalised industries under their sponsorship.



JOHN REDWOOD





10 DOWNING STREET

Prime Minister ^(C)

No decisions are needed
as Treasury and DTI are
still considering modifications.

But you might want to record

(i) your disappointment at
high cost

(ii) your disappointment at
poor response by banks

(iii) you hope that changes
will be made to put more
risk on banks and to
bring ^{2clene} nearer to break-even.

Agree?

Yes - Charles ^{AT} 30/3

MB



10 DOWNING STREET

From the Private Secretary

2 April 1984

Review of Loan Guarantee Scheme

The Prime Minister has seen your Secretary of State's letter to the Chancellor of 29 March setting out experience to date with the Loan Guarantee Scheme and the changes which could be made to it. The Prime Minister has expressed disappointment at the high cost of the scheme and at the inadequate response from banks and other professional advisers. She accepts that the Scheme should continue but hopes that changes will be made to put more of the risk onto the banks and to bring the cost of the Scheme nearer to break-even.

I am sending copies of this letter to David Peretz (HM Treasury), Derek Hill (Northern Ireland Office), John Graham (Scottish Office), Colin Jones (Welsh Office), John Ballard (Department of the Environment), David Normington (Department of Employment), and to John Bartlett (Governor of the Bank of England's office).

(Andrew Turnbull)

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