SECRET

Prime Minister ①

This is the note the Treasury promised. I suggest that at the 2.30pm meeting you concentrate on general philosophy and turn to figures after E(NI)

AT 2/10

5

PUBLIC EXPENDITURE SURVEY 1984: TRADE AND INDUSTRY

The purpose of the meeting is to settle Mr Tebbit's expenditure programmes on a basis that enables him to serve as a member of the Star Chamber.

2 The main aim is to secure large savings in DTI's mainline programme of industrial support. These are needed not only to help secure the overall planning totals agreed by Cabinet but also to enhance the Star Chamber's authority to demand savings from others - particularly on agricultural subsidies. While large reductions in agricultural and industrial subsidies might be thought to involve a change in policy, they would not breach pledges in the manifesto or elsewhere.

3 Mr Tebbit's proposals on regional policy are to be discussed by E(A) earlier in the day. The savings he proposes fall short of these sought by Treasury Ministers by about £80 million in a full year. This underlines the need for savings in his non-regional spending.

4 The outstanding points on the provision for Mr Tebbit's nationalised industries concern the Post Office and British Steel and should be capable of settlement in bilateral correspondence.

5 The agenda for the Prime Minister's meeting is, therefore:

i DTI mainline programme excluding regional policy - see Annex A

ii ECGD - see Annex B

iii Redundancy Fund (Where we understand that Mr Tebbit is being advised to oppose a change which would produce savings in the Department of Employment's programme) - see Annex C.

108 157 169

Annex A

DTI's MAINLINE PROGRAMME (excluding regional policy)

80 143 -73

	£m		
	1985-86	1986-87	1987-88
1. Baseline	783	752	773
Secretary of State's proposal	D 1227.5	1184.2	1215.2
	N 1307.5	1327.2	1165.2
2. Reduced requirements	- 14	- 25	- 37
	1297	1284	[illegible]
3. Further savings offered at bilateral	- 27	- 29	- 15
4. Bids conceded by Chief Secretary	143	139	49
5. Bids not conceded by Chief Secretary	13	25	24
6. Net addition to baseline	+ 115	+110	+ 21
Further changes sought by Chief Secretary (see letter of 27 September)			
7. Bids not conceded	- 13	- 25	- 24
8. Further reductions in programmes or increased charges	- 20	-122	-225
9. Net changes from baseline	+ 82	- 37	-228
10. Gap between Secretary of State and CST	33	147	249
		100	200

1. Mr Tebbit maintaines that the modest reduced requirements and savings he has offered (lines 2 & 3 above) are the most that are "practicable and realistic".

2. The Chief Secretary has conceded that large savings are not practicable for 1985/86 and has reduced his bid for savings to £20 million. But for later years large savings <u>are</u> practicable from "uncommitted" industrial support - estimated at £243m and £370m in 1986/87 and 1987/88 (see table attached). Higher revenue from charges could also contribute. Both kinds of savings fit in well with the Government's general policies. The Chief Secretary would leave it to Mr Tebbit to decide how to achieve the savings.

1052. 123 1215

1384 123 1261

£168m [Spain]. 267

3. Industrial subsidies <u>may</u> be justified in certain particular cases where it can be shown that market forces cannot operate effectively, eg the Alvey programme. But the Treasury believes that much DTI spending is on intervention in industry which has little effect on what companies actually do and is inconsistent with the broad aims of the Government's economic policy. The Chief Secretary proposed a joint review of the DTI's industrial support schemes in the summer. This would be designed to clarify objectives and test the evidence that actual or expected benefits exceed the cost of the subsidies. Mr Tebbit has not yet agreed and Permanent Secretaries are to discuss it after the survey. Such a review should of course ideally precede not follow further commitments. But the PES timing makes this difficult. The dilemma might be resolved if Mr Tebbit could be persuaded to withdraw his additional bids and offer savings of at least £20m in 1985-86, £75 million in 1986/87 and £150 million in in 1987/88. These figures would still leave two-thirds of DTI's uncommitted current provision to fund this type of spending if the review demonstrated a case.

4. In addition the DTI could increase resources available to them by charging. There may be a case for free or subsidised services to "first time exporters", and a few other cases. But in general the full costs of export promotion and of DTI's regulatory functions could and should be recovered. This is already the policy in other areas (eg prudential supervision and the nuclear inspectorates). Nor is it right, as DTI seem to assume, to charge only "what the market will bear". If firms, eg exporters, will not pay the full cost for DTI services, it generally means:

either that the service is not worth providing;

or that it is being provided inefficiently.

Full-cost charging brings this out and allows the private sector to compete .

POINTS TO MAKE

Mainline DTI Expenditure

5. a. The DTI should contribute adequate savings on its non-regional expenditure, especially as its programme will be over baseline in 1985/86. DTI's good progress on parts of BL and privatisation needs to be followed now by reducing and tightening up interventionist subsidies to the private sector even though they may now be directed at "innovation". Policy changes are involved but not a breach of pledges.

b. The savings Mr Tebbit has offered so far on non-regional expenditure are inadequate: less than his aggregate bids and small (up to £30 million a year) on a non-regional baseline of nearly £800 million.The savings are of course needed as contribution to overall Cabinet objectives. But also to ensure Mr Tebbit can serve on Star Chamber without weakening its authority in relation to other subsidies, particularly agriculture (which Mr Tebbit himself is believed to favour cutting).

c. Ask Mr Tebbit for proposals and look for the following:

i. drop additional bids (see paragraph 4 a. above);

ii. savings of £20m in 1985/86 and, not less than £75m and £150m in 1986/87 and 1987/88 by a combination of reductions in industrial support and charging;

iii. seek Mr Tebbit's undertaking to support a sensible formulation of a joint review of his industrial support which Permanent Secretaries are to discuss after the survey. The review would be "without prejudice"and it could be taken into accout in the 1985 Survey.

CONFIDENTIAL

GRANT GIVING SUB-PROGRAMMES WHERE REDUCTIONS ARE BEING SOUGHT: BASELINE AND COMMITMENTS

£ million

	1985-86 in June 1984	1985-86 in Sept 1984	1986-87	1987-88
1. Selective Assistance to Individual Industries				
- Baseline	94.7	94.7	80.9	82.9
- Commitments	81.7	91.8	59.9	43.9
- Committed: (%) of Baseline	(86)	(97)	(74)	(53)
2. General Industrial R & D				
- Baseline	295.3	295.3	304.4	312.0
- Commitments	225.3	279.2	136.0	45.0
- Committed: (%) of Baseline	(76)	(95)	(45)	(15)
3. Aircraft & Aeroengine General R & D				
- Baseline	35.4	35.4	36.3	37.2
- Commitments	3.4	35.7	3.3	4.2
- Committed: (%) of Baseline	(10)	(100)	(9)	(11)
4. Space				
- Baseline	67.7	67.7	69.0	70.7
- Commitments	68.5	67.1	49.0	40.6
- Committed: (%) of Baseline	(101)	(99)	(71)	(57)
5. Future Industrial Support				
- Baseline	2.7	2.7	1.0	1.0
- Commitments	0	0	0	0
- Committed: (%) of baseline	-	-	-	-
6. Total - Baseline	495.8	495.8	491.6	503.8
- Commitments	378.9	473.8	248.2	133.7
- Uncommitted	116.9	22.0	243.4	370.1
- Committed (%) of Baseline	(76)	(96)	(50)	(27)

Annex B

ECGD

£m

	1985-86	1986-87	1987-88
Expenditure baseline	29.9	-159.3	-163.2
Reduced requirements	-21.0	-	- 0.2
Additional bids (conceded by CST)	+307.4	+319.4	+187.1
Savings agreed in bilateral (transfer of refinance)	- 76.5	- 19.7	- 18.1
Net addition to baseline	209.9	299.7	168.8
Further saving sought by CST (switch from $ finance)	- 1.8	-12.5	-33.9
CST net change from baseline	208.1	287.2	134.9

Export subsidies (interest make-up) are paid to the banks to bridge the gap between their current cost of funds and the fixed Consensus interest rates charged to the buyer of UK capital goods. The cost of these subsidies rises rapidly over the Survey period (by some £800 million in total) reflecting higher forecast sterling and, especially, US dollar interest rates. There is thus a strong case for discouraging the use of US dollar finance. Loading the interest rate for new US dollar loans to give the same subsidies as on sterling loans would produce savings without completely withdrawing support for a major trading currency. The size of the saving would vary with relative interest rates. On present forecasts it would save £34 million in 1987-88. The loading could be regularly reviewed in the light of prevailing market rates. This is the only way of controlling rising costs under the present arrangements (since Consensus rates reflect international agreements. Mr Tebbit has offered no other real savings on ECGD's programme). The saving from the transfer of refinance is entirely painless.

Points to make

(i) Ask Mr Tebbit to accept the loading of interest rates for new US dollar loans sufficient to provide savings equivalent to a 100 per cent switch out of dollar finance whilst interest rates remain high. Subsidies to exporters cannot continue on an open-ended basis regardless of cost. The Treasury proposal (the use of loading) is not equivalent to total withdrawal of support for US dollar loans.

(ii) The reduction of subsidies on dollar finance to levels equivalent to those available on sterling finance may lose exports in some markets but the overall effect will be small.

(iii) Experience with less direct methods of controlling the cost eg encouragement to use currencies with lower interest rates has not in practice provided savings. A mandatory change is essential if savings are to be secured.

ANNEX C

REDUNDANCY FUND

	1985-86	1986-87	1987-88
Baseline	254	261	268
Estimating increase	90	87	89
Option for Savings	- 37	- 36	- 37

Bid reflects higher forecasts (agreed by Treasury) of the number of payments and unit costs. The option entails cutting Redundancy Fund rebate to employers from 41 to 35 per cent of their statutory payments.

Mr King has agreed with the Chief Secretary to make the savings but has consulted Mr Tebbit because of the industrial implications. Securing the savings should allow the Employment programme to be settled outside the Star Chamber.

Line to take

(a) Company finances are improving, shedding of labour has slowed and perennial arguments against cutting rebate are now much weaker.

(b) Sums involved are tiny compared with benefits to companies from 1984 Budget (£1000m or so); and even smaller as a proportion of total redundancy costs (firms typically pay out more than their statutory requirement).

(c) Companies will eventually benefit from a lower rate of contribution to balance the Fund.

Note: A cut to anything other than 35 per cent would need main legislation as would exemption for small firms.