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Qz 05932

MR POWELL, 10 Downing Street

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Industrial subsidies in the Federal Republic of Germany

In your minute of 6 August you asked for further information on the provision for industrial subsidies in the Federal German draft budget for 1988 referred to in Bonn telegram no 11 Saving of 31 July.

2. Full details of the Federal German draft 1988 budget for individual Ministries will be published on 8 September but, on the basis of information already available to our Embassy in Bonn and the Department of Trade and Industry, we expect that

- the budget of the Federal Economics Ministry will increase by DM 840 million (£284 million) to DM 6,437 million (£2175 million). The increase will be about 15 per cent (but 10 per cent if compared with the original approved budget). Some expenditure on radioactive waste storage and on shipbuilding will be an interdepartmental budget transfer and will not therefore be a net increase;
- the largest single increase, of about DM 380 million (about £128 million) is in aid to the aircraft industry, primarily to fund Airbus development costs;
- an increase of DM 100 million (£34 million) is provided for additional subsidisation of coking coal prices down to world market levels;
- there is an extra DM 80 million (£27 million) on the Economics Ministry budget for assistance to the shipbuilding industry but overall support is down;

- an extra DM 70 million (£24 million) is for the purchase of a deep burial site for the storage of radioactive waste;
- an extra DM 60 million (£20 million) is to be made available under the regional development programme for new job creation and infrastructure investment projects in areas hit by the contraction of traditional industries.

3. Subsidies in which there are no significant increases but which are nonetheless important are DM 528 million (£178 million) for research, development and innovation (mainly a scheme, which is due to expire, for subsidising the cost of research staff in small and medium-sized enterprises); DM 273 million (£92 million) under a scheme, also due to expire, for interest free loans and other assistance to small and medium-sized enterprises; and DM 114 million (£38 million) for trade fairs and other export related activities.

4. We need to be vigilant in protecting the competitive position of our own industries. Our current assessment of the application of Community rules to some of the major elements in the proposed Federal German Economics Ministry's budget is -

(a) Airbus

The United Kingdom's position is that aid for the Airbus project is not notifiable to the Commission, given that it is recoverable. We understand that the Federal Republic of Germany is notifying its aid, probably because it contains an element of writing off old losses. We shall ensure that this does not give rise to difficulties for us. Article 92.3 of the Treaty of Rome states that aid intended to promote the execution of an important project of common European interest may be considered to be compatible with the common market.

(b) Coal

German subsidisation of the coal industry is massive - DM 2800 million (£946 million) in 1987, of which the principal element is the subsidisation of coking coal prices down to world market levels. Proposals for coal subsidies are submitted to the Commission which recently gave its approval to the German programme for 1987.

(c) Shipbuilding

The Federal Republic of Germany opposes direct operating aid to shipbuilders and the 1988 draft budget will reduce by DM 20 million the direct subsidisation of interest payments. German shipbuilding does benefit from indirect forms of assistance, eg fiscal incentives. The recent Community directive on shipbuilding should bring these under better control. The Federal Republic of Germany has notified its current aid schemes in accordance with that directive but the Commission has not yet approved them.

(d) Radioactive waste

This money is repayable from the proceeds of the operating company which is being established and is thus not a notifiable state aid.

(e) Regional development

This is an increase in provision for job creation and infrastructure in areas hit by the contraction of traditional industry. The Commission can authorise such regional aid programmes under article 92 of the Treaty and is responsible for vetting their compatibility with the Treaty. It will be examining these German proposals. There has been a recent agreement between the German authorities and the Commission under

which the population covered by assisted areas provisions would be reduced from 45 per cent to 38 per cent. Over a period of time this may lead to a reduction in expenditure.

5. Some of the increases, therefore, are already known (Airbus), one-off (radioactive waste) or more apparent than real (shipbuilding). We believe that the Federal German government does try to respect the Treaty rules on state aids and is seeking to restrain industrial subsidisation, although in some respects it may not be making a very good fist of the latter in the draft 1988 budget. The overall level of subsidisation has to take account also of the activities of the Länder. Thus in the steel sector, while German Ministers in successive Industry Councils have vehemently attacked subsidies paid by other member states to state owned steel companies, the Commission is currently investigating attempts by the State of Bavaria to rescue the bankrupt Maxhuettenwerke, and there have been similar inconsistencies in the past. The Department of Trade and Industry and our representatives in Bonn and Brussels monitor significant cases if they are thought to affect the competitive position of our industry or our negotiating position in Brussels. The Commission's inventory of state aids on which they are working may illuminate some of these murkier areas.

6. I am sending copies to Lyn Parker (FCO), Alex Allan (Treasury), Timothy Walker (DTI) and to Sir Robert Armstrong.

*DF Williamson*

D F WILLIAMSON

21 August 1987



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*From the Private Secretary*

MR. WILLIAMSON  
Cabinet Office

The Prime Minister has seen your minute Qx 05925 of 19 August to Charles Powell. She has commented that the argument must be defeated.

P. A. BEARPARK  
21 August 1987

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