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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP
Secretary of State for Trade and Industry
Department of Trade and Industry
1 - 19 Victoria Street
London
SW1E 6RB

7 July 1986

*Dear Paul,***REGIONAL ASSISTANCE**

I have seen Malcolm Rifkind's letter to you of 27 May and your reply of 6 June. I have also seen Nicholas Edwards' letters of 9 and 19 June.

As suggested in your letter of 6 June, officials of our Departments have met to discuss forecasting methodologies and to clarify the figures. On the forecasting techniques, I understand that our officials have agreed on the need to remove inconsistencies in some of the key, underlying assumptions. Important differences, however, remain over the adjustments to the models required to predict territorial spend under the new regional assistance map accurately. This is something which is only likely to be settled by experience in running the models.

Nonetheless, I must underline my great concern at the figures emerging as a result of the meeting. They present a serious threat to our ability to control expenditure on regional assistance. Against the current expenditure background for both this year and the Survey period, I must stress that I can offer no prospect of increasing the provision for regional assistance for 1986-87 or beyond unless deliverable off-setting savings are offered up on the cash limited provisions of the Departments concerned.

The possible scale of projected overspends underlines the need for effective monitoring and control mechanisms for these programmes. Apart from the possibility of raising thresholds of eligibility for assistance or extending moratoria, I think there are three areas which need addressing. First,

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we need to be sure that RSA cases are scrutinised with equal rigour and consistency in the three countries. I attach importance to this being investigated thoroughly and the results reported to Ministers. This suggests that it should be part of the review of the administration of regional policy, which the three Departments will be conducting in the next few weeks. I would wish my officials to be fully involved in the work.

Second, I would also wish to improve control and monitoring mechanisms; this means pursuing commitment limiting for RSA, on which our officials did some work last year, and developing commitment monitoring for RDG.

Third, it appears that effective control under the new territorial administration of regional assistance will remain elusive while the notion of a common pool persists. We must either have one Department responsible for the overall provision in all three countries, or, subject to a review of the distribution of the current provision (see below), totally separate funds for the three Departments.

In his letter to you Malcolm presses for a review of the division of the existing provision as a basis for seeking agreement for redistribution between the three Departments. I understand that you and Nicholas accept that there should be a review, though differences remain between the three Departments on the appropriate timing. As I said in my letter to you of 27 March, I have been prepared to contemplate inter-departmental transfers, subject to a firm undertaking that the Department transferring out regional assistance provision would be able to offset any overspending in other areas by savings elsewhere in its programme. I would be prepared to agree to a review, provided the outcome was accepted as binding by all three Departments; there was no increase in the overall provision; and there was no question of further redistribution thereafter. It would be for you to agree on the timing of the review between yourselves. From my point of view, I would see merit in this taking place soon as to remove uncertainty. Any resulting transfer would ideally need to be effected in the context of the appropriate Survey to avoid compromising in-year control totals. Until, however, a review takes place and any changes are agreed, my position on redistribution remains as set out in my letter of 27 March.

Finally, I note what you and Nick Edwards have to say about postponing the moratorium on RDG2 payments. I do not see how we can set aside a decision agreed only last October in the Survey discussions, particularly in the light of the very difficult expenditure prospects. Whatever the political considerations, I could only begin to contemplate a postponement if I was satisfied that the costs (for all three Departments) could be absorbed within the existing baselines for each of the three departments.

I am sending copies of this letter to Malcolm Rifkind and Nicholas Edwards.

John MacGregor
JOHN MacGREGOR

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Secretary of State for Trade and Industry

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4 August 1986

The Rt Hon John MacGregor OBE MP
Chief Secretary to the Treasury
HM Treasury
Treasury Chambers
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SW1P 3AG

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Dear John.

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REGIONAL ASSISTANCE

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Thank you for your letter of 7 July.

It is important to keep a proper perspective in looking at the present situation. While all three Departments are forecasting overspends in the current year, this is largely due to payments under the old Regional Development Grant Scheme. This is a temporary phenomenon and needs to be addressed as such. Forecast overspends for the PES years are very much smaller and provide no justification for introducing fundamental changes in our regional policy - put in place less than two years ago - which would be damaging both in terms of cost-effectiveness and political impact.

As far as the current year is concerned the DTI's latest "technical" forecast is for an overspend of £45 million net, which is more than fully accounted for by an expected excess of £47 million in payments of old RDG. While the forecast for old RDG is fairly robust, however, the figures for new RDG and for Regional Selective Assistance are much less so. Given the uncertainties of the forecast I do not intend to call for a supplementary estimate on the basis of current figures but I shall be reviewing the position in September/October - taking account also of progress on other elements in the same Vote - and if it proves to be necessary I will make my case for a Winter Supplementary at that time.

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The fact that provision is proving inadequate is not particularly surprising. We always knew that expenditure would be difficult to forecast during the period of transition from the old policy to the new. There is little that can be done to avoid the overspend. We already have a four-month moratorium on payments of old RDG and lengthening the period would not have much effect on spending this year. To call for offsetting savings seems to me simply unrealistic: it is precisely to cater for such unforeseeable and temporary contingencies that the reserve exists.

Turning to other aspects of your letter, as I have said I do not think the prospects in future years are nearly as serious as you imply. I am prepared for my officials to discuss with yours possible improvements in the monitoring of commitments so that we have the best available information on likely future spending patterns. But I would be opposed to any system which would lead to moratoria on offers or applications of RSA, which has always been regarded as a demand-led scheme. The uncertainty introduced by moratoria or even the threat of them would seriously damage the effectiveness of the scheme in influencing companies' investment decisions.

On the question of a common pool I again find your position unrealistic. I see no prospect of reversing the process whereby administration of regional assistance has been transferred to the Scottish and Welsh Offices. Yet equally there can be no possibility of a once-for-all review of the distribution of provision when we are in the middle of a transitional period. The distribution will have to be kept under review until the new policy settles down into a consistent pattern and we have a sound basis on which to forecast future needs. I have agreed with Malcolm Rifkind and Wyn Roberts that our officials will take a look at the distribution issue now in the light of experience since November 1984, albeit that experience is distorted to an unknown degree by the transitional arrangements. The results of these exchanges will be reported to the Treasury. The discussions will include the question of the consistency of administration of RSA which you also mention and which I agree needs to be examined.

Finally I note your comments on the question of a moratorium on new RDG. In the PES context I shall press strongly for my proposal to meet the cost of deferring the moratorium from savings which I have identified in other demand-led programmes. This would effectively reverse the process which took place last year when Leon Brittan reluctantly went along with the idea of a moratorium in order to meet higher expenditure than foreseen on other programmes.

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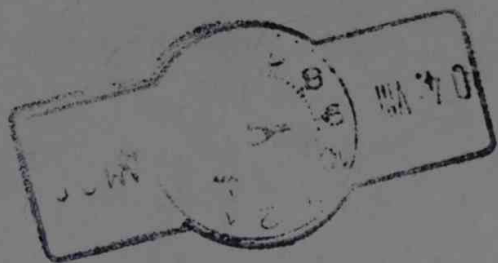
Your position that savings must be found from cash-limited budgets is thus entirely inconsistent with what was decided last year. However I accept that the moratorium will have to be deferred in all three countries if it is to be deferred at all. This is therefore another matter on which my officials will be talking to the Scottish and Welsh Offices before we discuss it in the bilaterals.

I am sending copies of this letter to Malcolm Rifkind, Nicholas Edwards, the other members of E(A) and Sir Robert Armstrong.

ms,
Paul

PAUL CHANNON

JF6AHN





CC/SA

SCOTTISH OFFICE
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The Rt Hon John MacGregor OBE MP
Treasury Chambers
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4 August 1986

Dear Chief Secretary

REGIONAL ASSISTANCE

Thank you for copying to me your letter of 7 July to Paul Channon.

I think there is a danger of over-reacting to a short term problem. Spending on regional assistance for Britain as a whole was close to provision last year. In the forward years, the forecast of aggregate additional requirements is as low as £12 million in 1988-89 and even in the other years, when the forecast additional requirements are higher, they still represent only about 7% of baseline provision.

1986-87 is an exception to this pattern for readily identifiable reasons, which will not apply in future years. The high additional requirements arise largely from the cost of the last stage of the transitional arrangements to phase out RDG I. It is inherent in the terms of those transitional arrangements that the expenditure will not continue on anything like the same scale.

I think this leads to two conclusions.

First, there is no case for changes either to regional policy or to monitoring and control arrangements. The one-off problem of 1986-87 would be unaffected by such changes. In any case, changes in regional policy would require discussion in E(A). Moreover, I do not accept that monitoring and control have been deficient. All three Departments were able to tell you of this year's problem and its probable scale after only two months of the financial year. I think that is a standard of early monitoring which must stand comparison with the majority of spending programmes.

Second, this year's forecast overspends are a classic example of the type of uncontrollable demand which the Reserve exists to cater for. We have legal commitments to make the payments. There is no option about making provision. It is true that one could, in theory, shuffle some of the additional costs into next year. However, we surely do not wish to arouse major hostility in the business community, and add to the

difficulties faced by individual businesses which have responded to our exhortations to invest, merely for the sake of moving expenditure across the boundary of the financial year. The normal rules on access to the Reserve must apply. I will examine the scope for offsetting reductions and I will keep the forecast of additional requirements under review, since there is still the possibility that they will come down. However, the balance between the additional requirements and any offsetting reductions must be met from the Reserve.

You also mentioned the review of the division between Departments of existing baseline provision and Paul Channon's proposal to postpone the introduction of the moratorium on RDG II.

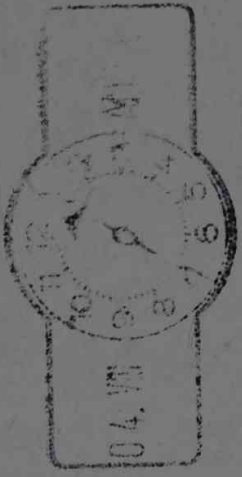
The three Departments have agreed that the review should begin now and produce some findings within the timetable of Survey discussions. Officials are having preliminary discussions and will be in touch with your officials in due course. We have agreed that the review process, which is in a sense a continuous activity, cannot be artificially curtailed. Agreement to transfer provision for regional assistance between Departments in future Surveys must be a matter for the Departments concerned. Any need for provision above baseline is, of course, a different matter and would have to be discussed with you in the normal way. This simply points to the desirability of any inter-Departmental discussions about the distribution of baseline being concluded in advance of final Survey decisions, so that the relationship of baseline to individual Departments' requirements is clear.

This latter point is relevant to my position on the postponement of the RDG II moratorium. I wholly agree with Paul Channon about the political undesirability of introduction on 1 April 1987. However, I cannot set that consideration in the context of other priorities within my very narrow industry programme while the redistribution of baseline for regional assistance remains unresolved.

I am copying this letter to Paul Channon, Nicholas Edwards, other members of E(A) and Sir Robert Armstrong.

Yours sincerely
Malcolm Rifkind

H MALCOLM RIFKIND
Approved by the Secretary of
State and signed in his
absence



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From The Parliamentary Under-Secretary

4 August 1986

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REGIONAL ASSISTANCE

I am responding to your letter of 7 July to Paul Channon in Nicholas Edwards' absence.

Nick wrote to you on 19 June about the problem with 1986/87 expenditure which, as he explained, became evident in Wales following the receipt in May of claims for old-style RDG. While I would be content for my officials to participate in discussions to look at ways of improving the monitoring system I think it is particularly important that we should all keep in mind the one off nature of this problem during a transitional period and the fact that the present monitoring system has sounded such an early warning.

The latest information available to me shows a forecast overspend in this financial year on RDG of about £48m in Wales. As Nick made clear in his letter, the only offset that we can identify is from our RSA programme and this is estimated at present at £5.5m. In these circumstances we will have no alternative but to call on the reserve which surely is wholly appropriate in a situation such as this. We will be keeping the position under review and will be seeking a Winter Supplementary in due course on the basis of the latest information then available.

More generally, I have also agreed that my officials' together with those of the Scottish Office and DTI should review the present distribution of resources. And I am, as I have said, content for my officials to join in discussions to see if monitoring can be further improved; but I am bound to say that I am wholly unsympathetic to a system which would go beyond that with its implications for a demand led programme and its effect on industry's investment plans and decision making. There would also be considerable political repercussions of introducing such a system.

/You are ...

The Rt Hon John MacGregor MP
Chief Secretary



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You are already aware of Nick's views on the suggestion that the moratorium on RDGII be deferred. We cannot find the resources required from within our existing baseline; and clearly it is common ground between all of us that any deferment would have to take place in England, Scotland and Wales or not at all.

I am sending copies of this letter to Paul Channon and Malcolm Rifkind.

A. C. [Signature]

Approved by Mr Wyn Roberts
and signed in his absence

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP
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 Department of Trade and Industry
 1 - 19 Victoria Street
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9 September 1986

Dear Paul,

REGIONAL ASSISTANCE

Thank you for your letter of 4 August. I was also grateful to receive Malcolm Rifkind and Wynn Roberts' letters of the same date. As you will be aware, the main issues have since been discussed by officials from all four Departments.

WILL REQUEST IF REQUIRED

I understand that work is now in hand on developing reliable forecasting and monitoring systems. This should clearly go ahead quickly. I also understand that the three Departments have done some work on the distribution of regional assistance, and the rigour and consistency of administration of RSA; and that the results of this work will be reported to you (and to Malcolm Rifkind and Nicholas Edwards) in time for our Survey discussions. It is a pity that it has not so far proved possible to involve Treasury officials - but I hope that they can now be brought in straightaway. Indeed I believe that consideration by all four departments of the results of this analysis is an essential prerequisite of any discussion between us on regional assistance.

You will be aware, from my letter of 7 July, of the importance I attach to a thorough scrutiny of the way in which we appraise projects. If, as I understand is likely to be the case, the results of the work done last month are inconclusive, more in depth analysis by all four departments will be necessary.

The nature of the work done on distribution and the rigour and consistency of administration underlines the extent to which the interests of the three Departments are involved in any discussion of regional assistance. Your own bid to postpone the moratorium on RDG 2 has expenditure implications

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for Malcolm and Nicholas' programmes as well as for your own. Against this background, I think it would be sensible for us to discuss Regional Assistance at a separate quadripartite meeting (with Malcolm and Nicholas) and not, as currently envisaged, in the bilateral discussion which can focus on DTI matters. This separate meeting will give us an opportunity to consider, in addition to the issues of monitoring and the rigour of appraisals:

- The level of provision. I am not persuaded that overspending on regional assistance as a whole is a short term problem. I do not regard forecast overspend of 7 per cent above baseline provision (some £30 million for 1987-88 and 1989-90) as negligible;
- The distribution of provision. I accept that the current review (before the transitional period is complete) should not be regarded as a once-for-all exercise, and would be prepared to accept a second, and final, review in, say, 2 years time when the new policy has settled down. But stability and certainty of financial provision are essential for effective financial management and control; and I am not prepared to accept that the review process should be an annual event.
- Commitment limiting. The E(A) remit on this is still outstanding. It is deplorable that my request that work on this should be pursued has met with such negative response. It is essential as a minimum first step that we should have effective machinery in place for 1987-88 to alert us when commitments are likely to breach agreed PES provision so that we can decide how to deal with the problem.
- Any action we do take will depend in part on the nature of RSA. I understand that some Departments at least take the view that they could not accept any limit on their ability to offer RSA to eligible projects. I cannot accept such an open-ended commitment for a selective programme and cannot see the justification for it in either statutory or policy terms.

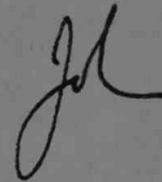
Finally, though not part of the Survey discussions, I should touch, in this letter, on the forecast overspend in 1986-87. I note Malcolm's undertaking to examine the scope for offsetting savings to meet the forecast overspend, but I cannot accept the assumption in all three Departments that the overspend - or at least the greater part of it - will automatically be met from the Reserve. As you know, the position on this year's Reserve is very tight and expenditure control has to be pursued rigorously. The prospective total overspend of £157 million on RDG and RSA is unacceptable and I must ask each of you to consider urgently every means of containing expenditure and finding offsets. Unless progress

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is made here, we may need to look seriously at the question of moratoria going beyond those already agreed. As I stressed in my letter of 7 July, I can offer no prospect of increasing the provision for regional assistance for 1986-87 (or beyond) unless deliverable offsetting savings are offered up on the cash limited provisions of the Department concerned. It is therefore vital that every effort is made to minimise the overspend.

I am copying this letter to Malcolm Rifkind, and Nicholas Edwards, other Members of E(A) and to Sir Robert Armstrong.

Yours ever,



JOHN MacGREGOR

