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CHIEF SECRETARY TO THE TREASURY

1986 PUBLIC EXPENDITURE SURVEY: TRADE AND INDUSTRY

Note of a meeting in the Chief Secretary's Office at 9.45 am on Thursday 11 September 1986

Present

The Chief Secretary	The Secretary of State for Trade & Industry	
Mr F E R Butler		
	Sir B Hayes	DTI
Mr Monck	Mr Knighton	DTI
Mr Burgner	Mr Russell	DTI
Mr Moore	Mr P Smith	DTI
Mr Mountfield	Mr Priddle	DTI
Mr Gray	Mr Warman	DTI
Mr Waller		
Mr Bush	Sir G Borrie	
Mr Hood	Director General	
Mr Hoare	of Fair Trading	
Mr Stevens		
Mr Ross-Goobey	Mr J Gill	ECGD

1. **The Chief Secretary** said that the background to the current round of bilateral discussions with spending Ministers was the decision taken at Cabinet in July to limit growth in public expenditure to the plans in the Public Expenditure White Paper; he noted that the Secretary of State had supported this decision. The position was particularly difficult this year because of a large number of irresistible demand-led bids and the decisions already made in E(LA) about local authority current expenditure. The policy of limiting growth in public expenditure and restraining the PSBR yielded great cash-flow benefits to industry.

2. **The Secretary of State** said that he accepted the importance of containing growth in public expenditure. His programmes had already made a major contribution toward the restraint of public expenditure - in large part because of the turn around in the fortunes of DTI's nationalised industries. But he was worried about the overall industrial picture: manufacturing investment was still 17% below the 1979 level. Trends were not encouraging

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- in particular he was concerned about the trade figures. The sectors which DTI programmes tended to support, for example, electronics had not shown a significant growth in profitability since 1982-3. The bids he had put forward had been carefully scrutinised and represented areas, notably support for R&D, where he was satisfied that additional expenditure was justified on merit.

3. **The Chief Secretary** indicated that there were two major areas of the Secretary of State's programme, space and launch aid where further bids were likely. He invited the Secretary of State to say what the latest position on these was and to give some indication of the timescale in which they might be expected to come forward.

4. **The Secretary of State** said that on space, a final plan from the BNSC had not yet been received, but was expected within the next few weeks. On launch aid, the timing depended very much on BAe. It was likely that both bids would be large. Recent information suggested that BAe's deadline for a final decision had been put back, probably to next March. **The Chief Secretary** noted that further collective consideration of these items would be needed, but they were a factor which he would have to bear in mind when considering the bids currently under discussion.

EXPORT CREDIT GUARANTEE DEPARTMENT

5. The **Secretary of State** said that ECGD's interest make-up requirements were considerably reduced. Although this was in large part the result of interest rate estimating changes, the figures also reflected genuine cost reductions on account of changes in Consensus terms and also reduced margins and capital market financing which were currently the subject of negotiation with the banks. The **Chief Secretary** asked that progress should be made in studying how FREF might be made more selective. The **Secretary of State** agreed that ECGD and Treasury officials should continue their work on the subject: there was a PAC remit anyway to look at cost effectiveness. However, he believed that the quest for greater FREF selectivity would not bear fruit and, in view of the general lack of project business and the fierce international competition for what there was, changes in the

direction sought would cause a considerable row.

6. The **Secretary of State** said that the £2m per annum additional bid for TTC reflected his judgement that the facxility provided a usesful service to exporters but was unsuited to ECGD's trading account. The figure of £2m needed to be seen in the context of the much larger reduced requirements on ECGD's programmes generally. The **Chief Secretary** responded that estimating changes could not be used as offsetting reductions. Account needed to be taken of the growth of private sector facilities and the fact that a good deal of the assistance went to large companies who should be prepared to bear the burden themselves. He asked the Secretary of State to consider what priority he really attached to this additional bid.

7. The **Secretary of State** offered compensating savings from the Mixed Credit Matching Facility (MCMF). However, it was pointed out that £1m per annum had already been offered up, and that the spare resources left within the facility were insufficient to compensate for TTC. Moreover, unless the facility was closed down there was a risk that future business would be a call on the Reserve. It was agreed, however, that officials would examine the scope for offsetting savings from the MCMF, though the results would need to be assessed in the light of the outcome of the bilateral as a whole.

8. The **Chief Secretary** raised the likelihood of a shortfall in the savings from discussions with the banks on the FREF structure and remuneration. He recognised the uncertainties as the negotiations were still going on, but would have to bear the problem in mind in considering the overall DTI position.

OFFICE OF FAIR TRADING

9. **The Director General of Fair Trading** said that the main element of this bid was £1m in 1987-88 for the computerisation of OFT's licensing branch. More than £2m had already been spent on the project, but work had been delayed because of problems with a contractor.

10. **The Chief Secretary** noted that money had been made available from the Reserve for this in 1985-86, but had not been spent for the reasons outlined by the Secretary of State and said that he could not accept this bid. If the Secretary of State attached a high priority to it he would have to find offsetting savings from within the cash limited expenditure of his other departments. **The Secretary of State** said that he did not accept that he should be required to find savings on DTI programmes to fund an increase for the Office of Fair Trading. It would be absurd if this project had to be cancelled. **The Chief Secretary** noted that in the 1985 Survey the then Secretary of State had agreed to scale down one of his bids for DTI in 1986-87 to make room for this item. The **Director General** pointed out that the OFT was constitutionally independent from DTI.

11. The **Chief Secretary** refused to accept that this was a technical bid as the Secretary of State suggested. If it were to be accepted he would look more toughly at other DTI programmes. He noted that the Secretary of State clearly thought that the bid was justified.

NATIONALISED INDUSTRIES

12. The **Chief Secretary** recalled the agreement at Cabinet on 17 July that the provision for nationalised industries should be held to baseline and where possible below that.

British Steel Corporation

13. The **Chief Secretary** recognised the uncertainty underlying the figures. There was a timing problem because the BSC's full Corporate Plan assessment would not be available before the IFR figures were finalised. Nevertheless, he saw scope for savings below baseline. In particular, the contingency provisions were large with an erratic profile.

14. It was pointed out that not all the likely influences on BSC were unfavourable, and factors such as lower energy prices and more favourable exchange rates would have a positive effect on BSC's finances.

15. The **Secretary of State** said that the figures in the bid had already been scaled down compared with BSC's original proposals. **Sir Brian Hayes** pointed out that the contingency provision was a residual. In the light of present uncertainties he did not believe that a cut below baseline could be justified. The size of the contingency reflected a foreseeable event - the liberalisation of the European steel market at the end of 1987. BSC estimated that this would reduce the sterling prices of steel products by 5 per cent. Some EC countries would undoubtedly subsidise their industries and an assumption of stable prices was therefore optimistic. It was pointed out that it was by no means certain that steel prices would fall following liberalisation of the EC steel market. Even if they did, the effect would be muted in the first year.

16. The **Chief Secretary** saw possibilities for savings on the purchase of overseas stockholding facilities, working capital and asset sales. The **Secretary of State** said that the purchase of overseas stockholding facilities was clearly in the commercial interests of BSC, and there were no powers to prevent it. However, some savings might be possible through economies on working capital, and asset sales might be increased to £5 million a year, but large overall savings were not possible without a major new policy decision. His objective was to prepare BSC for privatisation post-election. He did not wish to prejudice that. But he would be prepared to make some small change in the bid for BSC.

<u>Post Office</u>

17. The **Chief Secretary** asked about the position on HAL/CON. The **Secretary of State** noted that the HAL/CON project had not yet been approved. If approved the project would allow the Post Office to compete in the profitable end of the parcels market. The **Chief Secretary** asked what had happened over the past year to justify a major increase in the remaining capital expenditure bid. In reply, it was pointed out that the Post Office was under capitalised: it had now reappraised its capital requirement. A large proportion of the projects included in the bid were designed to improve efficiency (such as computerisation) and quality of service. However, it was also noted that some projects were generalised improvements in offices without any direct financial benefit.

19. The **Chief Secretary** suggested that there was some scope for savings in working capital. Although overall the Post Office had a growing surplus of working capital, the MMC had indicated that the average duration of stocks held could be reduced from 9 months to 3 months which would save £5 million at one depot alone. Also, the Post Office had been consistently conservative in its assessment of asset sales.

20. The **Secretary of State** said that he would consider the point on working capital. He accepted that the Post Office had a record of badly underestimating the value of buildings for sale recently.

National Girobank

21. The **Secretary of State** said that either the Girobank could be starved of funds or it could be given funds to allow it to develop. The **Chief Secretary** noted that there was no adequate appriasal of the forecast capital requirements. It was agreed that discussion of the National Girobank should be deferred pending discussions by officials on the detail of the bid.

British Shipbuilders

22. The **Secretary of State** said that BS were in severe difficulties over the longer term because of worldwide excess capacity. However, in the short term the order situation was relatively favourable. He agreed that the savings which the Treasury sought on working capital could be found, with some difficulty, by BS.

Conclusion

23. The **Chief Secretary** said that, in order to reach agreement, he would be prepared to look for about half of his original demand in the first year, and somewhat more in the later years. He asked the Secretary of State to consider savings under baseline for his industries as a whole of £30 million in 1987-88, £35 million in 1988-89 and £60 million in 1989-90. The **Secretary of State** said that he foresaw considerable difficulties in a move of that extent.

DEPARTMENT OF TRADE AND INDUSTRY

24. It was agreed that the items would be considered in the order

they were set out in the (revised) table attached to the Chief Secretary's letter of 24 July. It was agreed that regional support would be considered at a separate meeting with the Scottish and Welsh Secretaries and would not therefore be discussed at the bilateral.

B1-3: Agreed additions/reductions

25. **The Secretary of State** noted that his agreement to find offsetting savings to cover part of the cost to the MoD of advancing the order for AOR02 depended on a decision being taken during the current Survey to place a firm order with Swan Hunter for this vessel.

C1, C2: ERDF (non-quota) payments and BT flotation expenses

26. **The Chief Secretary** said that he was prepared to accept these bids.

C3: Eureka

27. **The Secretary of State** said that Eureka was regarded as a successful scheme for promoting international collaborative R&D and the UK had played a leading role in its development. Savings had been found from within the DTI programme to fund the first 10 projects. Further funds were now needed if the scheme was to develop; the bid represented the minimum which he considered necessary.

28. **The Chief Secretary** said that it was accepted policy that Eureka should be funded from within agreed provision; if the Secretary of State wanted to increase spending on this scheme he should do so by reordering priorities on domestic R&D. Work undertaken by DTI last year to assess the impact of industrial support schemes on Large and Regular Users had cast doubt about the level of additionality which was being generated. It was possible to argue about the precise level, but on the department's own interpretation additional spending did no more than match £ for £ the funds which had been made available. This was disappointing. If the schemes represented good value for money

some leverage should be expected. It was also important that programme effectiveness was properly assessed and that positive benefits were seen to flow from these schemes. The level of corporate profitability ought also to be an important factor in determining companies attitudes to investing their own resources in R&D. As corporate profitability rose, the need for Government funding to support R&D should decline. There was some evidence of increased corporate investment in R&D since 1983.

29. **The Secretary of State** said that projects were subjected to an extensive and careful appraisal before they were accepted for support. He agreed that it was disappointing that the level of additionality had not been greater; but he did not accept this was an argument for not continuing to provide support. Evidence suggested that if the level of funding provided by the department was reduced industry would not itself move to fill the gap. Corporate profitability/liquidity did not seem to be a major factor in determining industry's attitude to investing funds in R&D.

<u>C4: Pull Through</u>

30. **The Secretary of State** said that he was prepared to withdraw this bid.

<u>C5: EC R&D</u>

31. **The Secretary of State** said that decisions on the new R&D framework would not be taken before the December Research Council and that it would be necessary for further collective discussion of this before then. The bid which he had put forward largely reflected imbalances in the distribution of the EUROPES baseline, which had been set on the basis of programmes as they existed in 1984 and had not been amended since. The new framework envisaged a considerable shift in the balance of the programme away from energy R&D in favour of industrial R&D. Some redistribution of the baseline was, therefore, necessary. It was noted that even if the baseline was reallocated this might not in itself cover the full cost of the framework if a large (6 BECU) programme was agreed. **The Secretary of State** accepted this, and said that he would be pressing for a small (4½ BECU) programme, but that it might not be possible to achieve this.

32. **The Chief Secretary** agreed that further attention should be given to the question of redistributing the EUROPES baseline. It was agreed that officials would consider this, without commitment.

C7-8: PSA Services

33. **The Chief Secretary** said that the decision to transfer responsibility to departments for certain PSA services was taken because departments were in the best position to assess the relative priority they attached to this expenditure compared with other items in their programme. The PSA had not transferred money for new works out of its baseline and in consequence he was faced with a large number of bids from departments. He would have to look to the Secretary of State to make offsetting savings. **The Secretary of State** indicated that this was likely to cause problems but agreed to reflect on the Chief Secretary's comments.

C9: Companies Registration Office

34. It was agreed that there should be further discussion of this item between officials.

D(i)1: Strategic Mineral Stockpile/D(i)2-4 Other Savings

35. The **Chief Secretary** queried the realism of the savings offered on the mineral stockpile. The **Secretary of State** said that this was a very low priority for the DTI. If colleagues took a different view he believed they should provide some resources to cover the savings. It was agreed that officials should look further at this. The **Chief Secretary** said he regarded the further savings offered by the Secretary of State which were linked to the discussion on regional assistance, as estimating not policy savings.

D(ii)2-5: Chief Secretary's proposals for reductions

36. These would be discussed at a further meeting.

Conclusions

37. Summing up the **Chief Secretary** said that he had made an offer on the nationalised industries. Items B1-3 were agreed and C1

and 2 were accepted. Taken together these represented a small net addition to the DTI programme. The Secretary of State had withdrawn C4. It was agreed that officials should look at C5, C9 and D(i)1. D(i)2-4 were linked to the further discussion on regional assistance. There would be a further meeting after the quadrilateral meeting on regional assistance.

JILL RUTTER
Private Secretary

Distribution:
Those present
Principal Private Secretary
PS/Sir Peter Middleton

HM TREASURY
17 September 1986