



PRIME MINISTER

PUBLIC EXPENDITURE AND THE EUROPEAN REGIONAL DEVELOPMENT FUND

We are to discuss the treatment of ERDF receipts by privatised industries at E(A) on Thursday.

I am deeply concerned about this issue. I believe that strict adherence to narrow definitions is obscuring the wider issues which we must address. Nicholas Ridley's minute of 17 November has highlighted some of these issues particularly as they affect the water industry. My own Departmental concern is British Gas. Although its past ERDF receipts are small compared with those in the water industry it remains politically important for them to continue post privatisation. But it will be impossible to find the compensating savings from my Department's other programmes. Thus even if the Commission agree, as I understand they may well do, to private sector utilities remaining eligible for grant we shall be unable to forward any further applications for gas projects.

The choice colleagues face is whether we pass ERDF grants to privatised industries, without compensating savings from Departmental budgets (at a cost of 66% through reduced abatement), or under existing rules risk the loss of the nation's entitlement to the available funds and its consequences on balance of payments, regional development policy and our privatisation programme.

Under the Fontainebleau mechanism receipts from ERDF reduce our abatement by 66% irrespective of whether they go towards public or private sector projects. Whilst I accept that receipts in respect of existing public sector projects benefit public expenditure, there is as Nicholas Ridley made clear, a real risk of there not being sufficient suitable public sector projects within existing plans to attract aid.

If privatised industries are discouraged from applying for aid we therefore risk losing our entitlements. The grants foregone less



abatment, will count against our balance of payments and will simply go to subsidise other Member States. That is surely undesirable.

As the privatisation programme proceeds the infrastructure projects eligible for grant, eg telecommunications, gas, water etc, will increasingly be in the privatised industries. We understand that the Commission are likely to decide that such projects will only be regarded as eligible for grant if they cannot otherwise be undertaken. Hence, in the absence of ERDF aid these projects will not go ahead and lack of this infrastructure will compound the difficulties of attracting other industries to the Assisted Areas which need all the help they can get to stimulate the local economies.

Through our privatisation policy we are already reducing the size of the public sector (including public expenditure in the Assisted Areas). Furthermore public expenditure derives a substantial one-off benefit from flotation proceeds, which in certain circumstances would be even higher if it was known at the time of flotation that ERDF would continue to be available to the privatisation candidate. In addition the gross investment by the industries in projects attracting aid is likely to benefit the Exchequer in other ways, eg higher PAYE and National Insurance Receipts, reduced unemployment benefits, higher Corporation Tax Receipts. To argue that passing grants to the privatised industries increases public expenditure therefore is an over simplification.

I am copying this to Geoffrey Howe, Members of E(A) and Sir Robert Armstrong.

SECRETARY OF STATE FOR ENERGY

19 November 1986

AT THE DIVISION OF

