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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
London  
SW1P 3EB

10 August 1987

*Dear Secretary of State,*

**GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF  
CURRENT EXPENDITURE BY LOCAL AUTHORITIES**

You will recall that John MacGregor agreed that the Treasury should take over this issue because of the difficulty which the Department of the Environment was having in handling it. My officials have now prepared the attached paper in consultation with officials from your Department and those of the other Departments concerned. Shorn of its complexity, it invites us to decide between maintaining or relaxing Government policy effectively to control the public expenditure consequences of Community receipts, specifically in respect of Article 15 grants.

We need to sort out the way in which Article 15 receipts should be handled as soon as possible. As the paper makes clear, we cannot indefinitely hold up applications for Article 15 grants, not only given growing pressure from local authorities and members of Parliament, but also because of the risk that continued delay may affect our ability to draw fully on European Regional Development Fund funding as a whole.

The paper is long since it has been necessary to explore an extensive range of options. Of the five considered, only two seem workable in present circumstances, and I agree with officials that it is between these alternatives that we should choose. They are:

- i) to make offsetting changes to central Government programmes in order to reflect Article 15 receipts;
- ii) to disregard the receipts on a de minimis basis.

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As you will expect, I very much prefer the first of the alternatives. Our general policy on Community receipts is to handle them in such a way as to prevent increases in domestic public expenditure wherever possible. This is particularly important at a time when the Commission has pretensions greatly to expand the Structural Funds: if we do not maintain proper control now, especially in the area of local government expenditure, then we run the risk of allowing the Commission an ever-increasing say in the setting of our priorities and even the level of UK public expenditure. This is something which we must clearly avoid. The natural way of doing so is that set out in option 2 i.e. that the level of planned expenditure of relevant Departments should be reduced in the Public Expenditure Survey by an amount corresponding to Article 15 grants.

I note that your own officials opposed this option on the grounds that such a mechanism could result in consequent reductions of expenditure programmes to which Departments attach greater significance: however failure to make any offsetting savings would simply pre-empt public expenditure within planned totals from areas quite unrelated to the Article 15 grants themselves. So the preferred option is intended to tie the expenditure consequences of Article 15 grants as tightly as possible to analogous national activities. Where there are difficulties in finding activities comparable to those covered by individual Article 15 grants, I would be prepared to discuss where savings should be made on a case by case basis. I appreciate that the finding of appropriate offsetting savings may not always be easy: but this arrangement is by far the most effective means of ensuring that our agreed policy on Community receipts is respected, and it is therefore the one which I propose to adopt.

I note your officials' preference for the alternative which would simply disregard Article 15 receipts on the basis that the sums involved are relatively small. This seems to risk setting a dangerous precedent. Admittedly the numbers are not large at the moment, but as we have found with the European Social Fund, in Community matters small beginnings tend to lead to very large programmes later on. The Department of Environment estimate that notwithstanding the low level of anticipated receipts at the moment, Article 15 receipts might rise to between £5 million and £10 million between 1989 and 1990. This seems on the face of it to be a low estimate, particularly since in theory receipts in 1986 could have been as high as £30 million. I could not agree simply to ignore such sums on the grounds that they were "de minimis": clearly they may not be. If we got the handling of the question wrong now, then we would open the way to all sorts of exemptions later which, when added together, would lead to a very large loophole in effective public expenditure control. Naturally I could not accept that.

I therefore hope you will agree that we should maintain proper expenditure control in regard to Article 15 receipts by requiring Departments to make appropriate offsetting savings.

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Given the length of time which it has taken to consider this, I should like to establish our policy by correspondence as soon as possible. However I would, if necessary, be prepared to chair a small ad hoc meeting of the Ministers concerned. I trust it will not prove necessary to take the matter to E(A).

I am copying this letter to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and to Sir Robert Armstrong.

*Yours sincerely*  
*John Major*

*JJ* JOHN MAJOR

*(Approved by the Chief  
Secretary and signed in  
his absence.)*

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GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT  
EXPENDITURE BY LOCAL AUTHORITIES

## Note by Officials

## INTRODUCTION

This note, which has been prepared by officials from HM Treasury, the Departments of the Environment, Employment, Trade and Industry, and the Scottish and Welsh Offices, considers how the Government's policy on the public expenditure treatment of European Community (EC) receipts should be applied in respect of grants from the EC which help finance current expenditure by local authorities. Such grants can be made from the European Regional Development Fund (ERDF), under Article 15 of the new ERDF regulation 1787/84 (copy attached at Annex A). An early decision on the treatment of such grants is needed so that applications can be forwarded to the European Commission: there is growing pressure from potential applicants for this to be done. The situation does not apply in Northern Ireland where there is no local authority expenditure of a relevant type.

## THE GOVERNMENT'S POLICY ON COMMUNITY RECEIPTS

2. The Government's general policy on receipts from the Community Budget has two principal objectives:

- (a) maximising the UK share of receipts without compromising our posture on budget discipline and the control of Community expenditure;
- (b) using the receipts, as far as possible, to finance the Government's planned programmes of public expenditure (which are set at levels which reflect the existence of these receipts) rather than as additions to programmes.

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This paper considers the options available for achieving these objectives in the case of local authority current expenditure.

3. In accordance with the Government's policy at 2(b) above, public expenditure programmes are set at levels that take account of the expectation of Community receipts. If receipts then become available for purposes other than financing the planned public expenditure programmes, then possible approaches include:

- i) to reject or forgo the receipts;
- ii) to accept them on the basis that sponsor departments would find savings to offset the extra expenditure which they finance;
- iii) in cases where the Government does not receive the Community money directly but provides the recipient body itself with part or all of its funding (eg local authorities), to accept the receipts whilst making offsetting adjustments in that funding.

4. Local authority receipts from the Community budget for current expenditure may, in the absence of countervailing action, lead to increased spending by local authorities since the Government has less control over local authority spending than its own spending. In the past such receipts have been almost entirely limited to receipts from the European Social Fund (ESF). The Government's policy has been to pass these receipts on to local authorities subject to an undertaking that they will be used to increase balances or relieve rates and not to finance additional public expenditure.

**ARTICLE 15 GRANTS**

5. Article 15 of the ERDF Regulation 1787/84 provides for grants to promote 'greater exploitation of the potential for internally generated development of regions...' primarily by assisting small and medium sized firms to start up or expand their activities, and to obtain access to capital markets, new technology, advice on management and organisational matters etc. It is also intended to encourage the promotion and management of tourism and

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accommodation. These objectives accord well with current UK policies.

6. The Regulation provides that payments under Article 15 may not exceed 10 per cent of a member state's ERDF minimum quota share. In the UK's case, this would have implied a limit of £30 million in 1986. In practice, the Department of the Environment estimates that receipts in 1986/87 were about £0.12 million and are likely to rise to £5-10 million by 1989/90.

7. While discussion has been continuing on possible ways of treating Article 15 receipts, the Department of Trade and Industry has been obliged to put a moratorium on forwarding applications specifically related to Article 15 to the Commission. This policy is now provoking increasing complaints from members of Parliament and from the local authorities, of whom many have excellent contacts in Brussels and have lost no opportunity to blame the Government for the delay.

8. There are more general reasons why increasing difficulties are expected from a continued moratorium on grant applications for Article 15 activities. The Commission is hardening its attitude on the distribution of ERDF funds by laying increasing stress on the submission of programme rather than project applications. It has also made it clear that it expects these programmes (such as National Programmes of Community Interest (NPCIs), in which a block grant is awarded for both capital and revenue purposes, to be disbursed by the member state in accordance with the objectives of the programme) to include grant related expenditure on Article 15 activities. Five of the six NPCIs approved for the UK have included an Article 15 element, although in only one case (Shildon) has money so far been passed to the local authority. This was done on the understanding that the public expenditure treatment finally agreed for Article 15 receipts should also be applied retrospectively in that case.

**OPTIONS**

9. Officials originally identified five ways of dealing with Article 15 receipts. Departments' views on them are set out below.

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Option 1 - forward no applications for Article 15 receipts

10. Under this option, the UK would refuse to transmit to the Commission applications for Article 15 grants from local authorities. This would guarantee that public expenditure arising from such applications would not increase. Under this option, the UK would refuse to transmit to the Commission applications for Article 15 grants from local authorities. This would guarantee that public expenditure arising from such applications would not increase. However, the Commission has made it clear that failure to reflect Article 15 projects in UK programmes (namely ERDF NPCIs and Integrated Operations Programmes (IOs) - which combine funding from a number of Community instruments, including the ERDF) will jeopardise the chances of such programmes securing Commission approval. Given the increasing emphasis on programmes - which under the Commission's structural fund review proposals would become the predominant form of assistance - this could seriously affect the UK's ability to draw fully on ERDF funding. Although the Article 15 sums in such cases are small, the overall funding involved is substantial, and a number of programme submissions over the next 12 months could be affected (eg steel closure integrated operations). For this reason, as well as the problems of relations with the local authorities, the danger of well-publicised criticism (however misguided) of the Government's general policy on Community receipts and possible legal difficulties, it would in the view of officials be difficult to justify or sustain a policy of not forwarding any Article 15 applications.

Option 2 - make offsetting changes to central Government programmes

11. Depending on the nature or location of the particular project, the Department(s) concerned would make an estimate of expected ERDF Article 15 grants. In the Public Expenditure Survey there would be a corresponding reduction in the level of planned expenditure by the Department(s). Wherever possible this should

be concentrated on activities analogous to those covered in the project. The particular programmes concerned would need to be identified on a case-by-case basis, depending on the ERDF project concerned, in discussions between the relevant Departments and the Treasury. In accordance with the normal operation of the policy, if receipts exceeded the level allowed for in the public expenditure plans, the Department(s) concerned would be expected to provide offsetting savings.

12. A variant on this approach would be to bring Article 15 receipts within the EUROPES system. Under EUROPES, Departments must find offsetting savings to compensate for the net cost of certain EC programmes or put in additional bids in the following UK financial year (eg any overspends in 1988 will be taken into account in the PES round for 1989/90). The system applies in general to areas where UK receipts are mainly in the private sector - principally R&D. It does not currently apply to any ERDF receipts. In the view of officials, extension of EUROPES to embrace the structural funds as a whole is something that could be considered, but the details would take some time to work out and it is suggested that any consideration of this is best left until more experience has been gained of the current EUROPES arrangements.

13. The Treasury considers that the arrangements proposed in paragraph 11 are by far the most effective method of ensuring that the Government's agreed policy on Community receipts is respected, as the offsetting savings would fall on expenditure programmes over which the Government has direct control. Because there would be no direct reduction in grant recipients' funds from the Government, it would not attract adverse notice from the Commission.

14. Other Departments consider that they would not on the whole have associated programme expenditure against which to offset EC receipts, and that the consequence of this approach would therefore be that cuts would have to fall on other departmental



expenditures unrelated to local authority spending. The allocation of money to local government by the EC would result in offsets in expenditure programmes to which Departments attach greater significance. Hence spending priorities would no longer necessarily be determined by Departments but would be affected by EC decisions. Departments further noted that this option would not operate directly on the programme of local authority current expenditure concerned, so that there would be an impetus for the quantum of local authority current expenditure to increase.

Option 3 - pass grants to local authorities in return for undertaking that they will be used to reduce rates, not finance extra spending

15. This is the policy applied at present to grants to local authorities under the European Social Fund (ESF). It is difficult to police or enforce. These difficulties were recognised, but accepted on de minimis grounds, when the policy was introduced because of the low level of such receipts at that stage.

16. The Treasury's view is that this is the least reliable of the techniques used to give effect to the Government's policy on Community receipts and would therefore be an unfortunate precedent on which to build for Article 15 receipts. Although Article 15 receipts totalled only £0.12 million in 1986/87 (because of the moratorium on applications), they are expected to reach £5-10 million a year by 1989/90 on present policy (and might be higher if the Commission is successful in its attempts significantly to expand the structural funds). Extension of the existing policy on ESF receipts would also increase the pressure to disregard other receipts from the EC on de minimis grounds, and the cumulative effect of such concessions could be a significant increase in public expenditure.

17. Other Departments accept that this option lacks a formal control mechanism and cannot therefore be properly policed. They are also concerned that the attempt to impose it, even nominally, could be deemed to be inconsistent with the joint declaration of the Council and Commission in 1984 that ERDF receipts would

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be, in general, an additional source of finance in the areas concerned.

18. In view of the problems outlined above with the current arrangements for local authority receipts from the ESF, Ministers may wish in due course to consider whether those arrangements should be changed - especially if they decide on a different system for Article 15 receipts. Officials recommend, however, that priority be given to reaching a decision in the first instance on the treatment of Article 15 receipts, for which no arrangements at all are in place.

Option 4 - Commensurate reductions in Aggregate Exchequer Grant to local authorities

19. Officials have also explored the possibility of reducing Aggregate Exchequer Grant (AEG) so as to offset expected Community receipts. On this approach, policy on grants in support of current spending would be broadly similar to that already operated on grants in support of capital spending (under which the borrowing permission given to local authorities is reduced by the amount of ERDF receipts received; so the receipts substitute for borrowing within the agreed capital spending limit, and do not fund additional projects).

20. The Law Officers advised towards the end of last year that ERDF (and ESF) receipts could not be regarded under local government legislation as 'moneys provided by Parliament' and therefore treated as a specific grant within the total of AEG determined by Ministers. Pending further instructions, they left open the question of whether such receipts could nevertheless be taken into account in determining the total of AEG. Following Ministerial correspondence earlier this year, extensive effort was put into the preparation of a further case to the Law Officers on this point. In the course of this, however, it has become clear that there would be a considerable risk of legal challenge to a declared policy of taking EC receipts into account in determining AEG, whatever the Law Officers might advise as to the likely outcome of the case. Such a challenge would be embarrassing to the Government, and might well encourage similar challenges in other areas of the Government's policy on Community receipts.

21. A further point is that reductions in AEG may in any case not lead to equal reductions in expenditure. Local Authority spending relevant for the calculation of AEG already excludes spending financed by EC receipts. If Ministers decide to determine AEG in any year as a percentage of relevant expenditure, and to the extent that EC-financed spending is not additional to other LA expenditure, AEG is therefore anyway reduced because of EC receipts. DOE consider that AEG is thereby reduced by about 46% of EC receipts for 1988-89.

22. In view of the points above, in particular the risk of a legal challenge, officials recommend that this option should not be pursued, for the time being at least.

Option 5 - Explicitly disregard Article 15 receipts on a 'de minimis' basis

23. The Treasury regard this option as unsatisfactory for similar reasons to Option 3: ultimately it may lead to an increase in public expenditure; would be inconsistent with the Government's wider policy on Community receipts generally; and could also set an undesirable precedent.

24. Other departments see this option as preferable to Option 2 on the grounds that it would avoid the objections referred to in paragraph 14. Such an option would, they argue, accept the practical outcome of the policy without running the risk of attracting unfavourable attention from the Commission. They argue that there is a finite limit to the level of receipts involved, so that this would not be an open-ended concession; and that the sums involved are insignificant when measured against total local authority current expenditure (the planned total for which in 1987/88 is nearly £30 billion). The Department of Environment also maintains that Article 15 receipts may to some extent be offset by the way in which the level of AEG is set (see paragraph 21 above).

CONCLUSION

25. Officials considered five possible methods for the handling of grants under Article 15 of the ERDF. Three of these were judged impractical. They were:

- Option 1 (paragraph 10) - forward no applications for Article 15 receipts;
- Option 3 (paragraphs 15-18) - seek undertakings from local authorities that grants will be used to reduce rates, not finance extra spending;
- Option 4 (paragraphs 19-20) - make commensurate reductions in AEG.

Should Ministers agree that these options should not be considered further for the time being, they are invited to consider which of the following two procedures should be applied to Article 15 grants;

- Option 2 (paragraphs 11-14) - make offsetting changes to control Government programmes; or
- Option 5 (paragraphs 21-22) - explicitly disregard these receipts on a de minimis basis.



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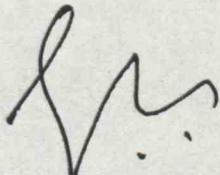
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Chief Secretary

Grants from the European Community in respect of  
Current Expenditure by Local Authorities

1. I was interested to see your letter of 3 November to Nicholas Ridley about ERDF Article 15 applications.
2. When Labour Members of the European Parliament raised this subject at Strasbourg on 27 October, Commissioner Schmidhuber confirmed, and regretted that the UK was still only making limited use of Article 15. There is evidence that the Commission may in fact try to force the issue by refusing to accept applications for Integrated Operations unless they include Article 15 components. Since we currently have four such applications outstanding, worth in all nearly £700 million in terms of ERDF and Social Fund grants, we would do well to conclude our internal debate on Article 15 receipts very quickly.
3. I therefore welcome your latest proposal. I assume that your cumulative £5 million limit would apply only to new receipts; and hope that Nicholas Ridley and others will agree to settle the matter on that basis.
4. I am copying this minute to the Prime Minister, Nicholas Ridley, David Young, Kenneth Clarke, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler and to Sir Robert Armstrong.

Foreign and Commonwealth Office  
22 November 1987

  
(GEOFFREY HOWE)

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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Nicholas Ridley AMICE MP  
Secretary of State for the Environment  
Department of the Environment  
2 Marsham Street  
London  
SW1P 3EB

3 November 1987

*Dear Nick,*

**GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT  
OF CURRENT EXPENDITURE BY LOCAL AUTHORITIES**

*FIG WITH BIUP*

Thank you for your letter of ~~7~~ September in reply to mine of 10 August. I am also grateful for Peter Walker's letter of 27 August, Norman Fowler's of 11 September, Kenneth Clarke's of 17 September, Tom King's of 18 September and Ian Lang's of 30 September.

I remain of the view that neither the scale nor the character of receipts under Article 15 of the ERDF regulation is such as to justify, in principle, their exemption from the Government's agreed policy of ensuring, as far as possible, that receipts from the Community budget do not increase domestic public expenditure.

I do, however, recognise that there may be a transitional problem in identifying the savings that are required fully to offset the additional local authority spending which the Article 15 receipts finance. Although this is far from being a unique problem as regards either EC-related or purely domestic public expenditure, I am conscious that the continuing uncertainty over our treatment of these receipts is beginning to create difficulties for ERDF applications involving quite large amounts of money.

In these circumstances, I am prepared to make a suggestion with the aim of facilitating early resolution of the issue without undermining our policy on Community receipts. The suggestion is that we disregard Article 15 receipts until the end of 1988-89 - subject to a cumulative upper limit of £5 million - on the understanding that the normal additionality rules would apply in subsequent years. That is to say, Departments would be expected to identify savings within their own programmes to offset these receipts unless they could convince the Treasury and colleagues collectively to the contrary in the annual survey procedure.

I very much hope that you and other colleagues whose programmes are affected by Article 15 receipts will agree to proceed on this basis. Our officials could discuss the detailed arrangements.

I am copying this letter to the Prime Minister, David Young, Kenneth Clarke, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and to Sir Robert Armstrong.

Yours Ever,  
John

JOHN MAJOR





SECRETARY OF STATE  
FOR  
NORTHERN IRELAND

NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

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CM

Rt Hon John Major MP  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AT

18 September 1987

*Dear Chief Secretary*

**GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT  
EXPENDITURE BY LOCAL AUTHORITIES**

Thank you for sending me a copy of your letter of 10 August to Nicholas Ridley on the above subject. The Treasury paper circulated with it contains a fresh option which opens up a direct Northern Ireland interest in the outcome of this issue.

The key point is that while, as my officials have previously indicated, Northern Ireland has at present no local authority expenditure of a relevant type, other bodies, some outside the public sector, have applied for Article 15 aid. Therefore, if we decide, as I think we should, to implement option 5 - which involves explicitly disregarding these receipts on a de minimis basis - I would want to have your agreement that such treatment would also apply to Northern Ireland Article 15 receipts going to the private sector. Option 2 in the paper is unacceptable to me since it would require PE offsets on programmes not associated with the sectors being aided and which have a higher priority in overall public expenditure terms. A realistic assessment of the bids made to the European Commission on behalf of Northern Ireland agencies suggests that about £1m will be earned over the 3 years 1987/88 to 1989/90 by private sector bodies such as Queens University, Belfast and the Northern Ireland Small Business Institute.

I recognise fully the importance of public expenditure considerations, and I understand your preference for option 2. However the situation in this case is not unlike some of the other instances in which colleagues have agreed to treat ERDF aid as de minimis, and on balance, I favour a pragmatic approach - implementation of option 5.



My officials will brief yours on some detailed aspects of the Northern Ireland position but I would appreciate having your agreement that a decision to treat this class of receipts as de minimis will apply to Northern Ireland.

Copies of this letter go to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Norman Fowler, Geoffrey Howe, Nicholas Ridley and to Sir Robert Armstrong.

Yours sincerely  
G. H. H. Smith

TK  
(Approved by the Secretary  
of State and signed in his  
absence)

LOCAL GOVT

RELATIONS

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From the Chancellor of the Duchy of Lancaster  
and Minister of Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET  
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215)  
GTN 215) 5147  
(Switchboard) 01-215 7877

cc B.G.

THE RT HON KENNETH CLARKE QC MP

Rt Hon John Major MP  
Chief Secretary to the  
Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1P 3AG

CAP

17 September 1987

Dear John,

You wrote on 10 August to Nicholas Ridley about grants from the European Community in respect of current expenditure by local authorities.

I agree with you that an early resolution of this problem is essential but I do not think you have put forward the best answer. The problem is to reconcile local political pressure with public expenditure considerations, while avoiding exposing any further to the European Commission the embarrassment of our position. I suggest we agree to treat a maximum of say £10 million (net of the saving in Exchequer grant) as "de minimis", and resolve to reconsider the matter if and when that amount has been fully committed, possibly in 1990.

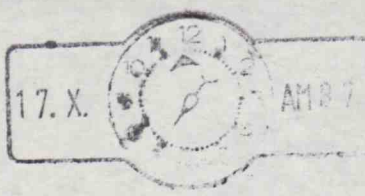
If a meeting proves necessary, I will be ready to join it.

I am copying this letter to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler and Geoffrey Howe; and to Sir Robert Armstrong.

KENNETH CLARKE

SE2ADE

Local Court



Relations

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Caxton House Tothill Street London SW1H 9NF  
6460

Telephone Direct Line 01-213.....

Switchboard 01-213 3000 GTN Code 213  
Facsimile 01-213 5465 Telex 915564

The Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1

*LCSP*

*N* September 1987

*Dear John*

**GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT  
EXPENDITURE BY LOCAL AUTHORITIES**

I have seen your letter of 10 August about Article 15 of the European Regional Development Fund and Nicholas Ridley's reply of 7 September.

I agree with Nicholas Ridley that local authorities should now be allowed to claim under Article 15. To make off-setting savings from Central Government programmes seems to be cutting off our noses to spite our faces. Local authorities' spending would not be directly controlled, and we would take the impact on Government spending programmes that we probably value more. If we are really concerned about this small gap in our public spending control, we should be willing to contemplate taking powers to act directly on local authority current expenditure - if need be, as Nicholas Ridley suggests, in the reform of the Local Government finance system.

I would be happy to join in a meeting if necessary.

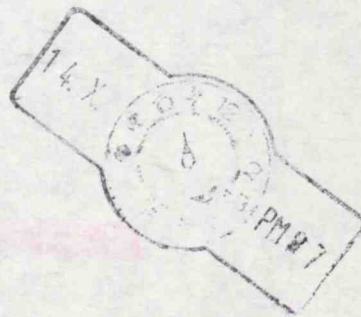
I am copying this to the recipients of your letter.

*Yours* *Norman Fowler*

NORMAN FOWLER

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LOCAL GOVT: relations pt 33



cc B4



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

The Rt Hon John Major Esq MP  
Chief Secretary  
HM Treasury  
Parliament Street  
LONDON  
SW1

My ref:

Your ref:

*CDF*  
*000 8/9*

7 September 1987

Dear Chief Secretary,

GRANTS FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT  
EXPENDITURE BY LOCAL AUTHORITIES

Thank you for your letter dated 10 August, covering a note prepared by officials specifically concentrating on receipts from the ERDF for Article 15 activities.

The public expenditure treatment of these receipts has remained undecided for more than two years, a situation increasingly difficult for the Government to defend. Further, Article 15 grants are now seen by the Commission as a necessary trigger for the granting of much larger ERDF sums for capital works. If we do not begin to accept Article 15 applications, certain ERDF programmes which draw down very substantial amounts of infrastructure grant are most unlikely to receive Commission approval. We need to remove this threat to the United Kingdom's ability to secure ERDF grants. For both these reasons I support your suggestion that, if at all possible, we should resolve this matter quickly on the lines of the alternatives mentioned in your letter.

While I share your concern with public spending levels, as the paper notes there are two principal objectives to be secured - maximising receipts and as far as possible financing planned expenditure programmes with those receipts. I feel that the option you propose fails on both counts. There is a disincentive for the Departments concerned to handle Article 15 applications and planned Government programmes would be cut back at the expense of unrelated local authority spending. What is needed is an approach that balances the achievement of the two objectives.

The sums involved in Article 15 receipts are small in comparison to other receipts from ERDF and minute in comparison to the totality of local authority expenditure. Receipts are also effectively limited by the ERDF regulation itself. In view of this my feeling is that we should treat Article 15 receipts as "de minimis" for the present. I estimate that receipts in 1989/90 will be in the range of £5m to £10m for the UK as a whole. The suggestion that receipts could have been as high as £30m in 1986 misconstrues the ERDF Regulation, the relationship between applications and receipts and the ability of the Departments concerned to influence the flow of both.

Moreover a substantial part of Article 15 receipts will be offset by the consequential reduction in Aggregate Exchequer Grant. Since AEG is determined in relation to relevant expenditure which is calculated net of EC receipts, Article 15 grants of, for example, £10m would reduce relevant expenditure by the same amount. Therefore AEG would itself be reduced by £46m, assuming 1987/88 grant percentage of 46%. The remaining amount hardly seem to constitute a very large loophole in public expenditure controls. Rather, this sort of relaxation would be beneficial in permitting this country to receive the much larger ERDF grants available for capital works. The domestic policy implications of failure to attract funding will become of greater relevance when the ERDF becomes more slanted towards inner city areas as currently proposed by the Commission (after British lobbying).

In view of the amounts involved, particularly after their effect on AEG has been taken into account, I feel that your suggestion that Departments find offsetting savings from elsewhere in their own programmes is neither necessary nor appropriate. This would only be possible if you were to provide us with a notional sum of say £10m, from which we would "save" each time an ERDF grant was made, and hand it back to the Treasury!

I fully share your other concern that we must minimise the Commission attempts to influence domestic spending priorities. We would not achieve this by the offsetting savings option, rather the reverse. Such a policy would oblige spending Departments to make reductions in their own programmes which have an agreed domestic priority, in order to cover grant awards made by the Commission. This hardly meets the agreed policy objective of using Commission resources to finance planned programme expenditures.

Moreover, as the paper notes, there are few if any analogous domestic programmes which could be raided in this way. Departments would be forced to make arbitrary cuts in unrelated areas. It is not at all clear which programmes in which Departments would be affected by your proposal and requests to your officials to identify such programmes have failed to elicit a practical response. I really do not think it either reasonable or responsible for me to assent to such a vague proposal without knowing its consequences.

It appears that your concern with the "de minimis" option is less a matter of the level of receipts anticipated by 1989/90, but rather the possibility of a substantial further growth thereafter. As you know the future of the EC's Structural Funds (including ERDF) is under review, although my present reading of the expansion of resources proposed does not suggest any significant increase in the UK's receipts. By next year we should know what role measures of the Article 15 type will have in the recast Fund.

Equally, we are reforming local government finance. We can wait to see if the level of Article 15 receipts eventually merits enough concern to be built into the new system. A case by case approach



probably involving retrospective PES adjustments between Departments would be costly to administer. As is so often the case when EC and domestic expenditures interact, I feel that the approach you advocate risks becoming an administratively difficult sledge hammer to crack a small and time-limited nut.

I would hope that on the above basis you can agree to our treating these receipts as de minimis for the present, while officials keep the situation under review. In two years time, if it is required, we will have a much more factual base - both about the level of Article 15 receipts and the activities the grants are supporting - to devise a system of reducing the public expenditure implications, linked to both a changed ERDF regulation and local government finance system.

If you would like to discuss further, I would be happy to attend a meeting with other interested colleagues. I understand that some of these colleagues share my concern over your proposals and I am copying this letter to the Prime Minister, David Young, Peter Walker, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and Sir Robert Armstrong.

*Yours sincerely,*

*Deborah Lamb*

PP. NICHOLAS RIDLEY  
(approved by the Secretary of State  
in draft & signed in his absence.)

LOCAL GOVT

RELATIONS

PT 33

Y SWYDDFA GYMREIG

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-270 3000 (Switsfwrdd)  
01-270 0538 (Llinell Union)

Oddi wrth Ysgrifennydd Gwladol Cymru



The Rt Hon Peter Walker MBE MP

WELSH OFFICE

GWYDYR HOUSE

WHITEHALL LONDON SW1A 2ER

Tel. 01-270 3000 (Switchboard)  
01-270 0538 (Direct Line)

From The Secretary of State for Wales

CONFIDENTIAL

27 August 1987

NORM  
CDD  
25/8

GRANT FROM THE EUROPEAN COMMUNITY IN RESPECT OF CURRENT EXPENDITURE  
BY LOCAL AUTHORITIES

Thank you for copying to me your letter of 10 August to Nicholas Ridley on the treatment of receipts under Article 15 of the European Regional Development Fund (ERDF).

I agree that we need to reach decisions on this with some urgency given that the issue is a longstanding one on which local authorities, other sponsors and the Commission are getting increasingly restive.

The absence of decisions is also adding to the difficulties of drafting and negotiating EC programmes which are likely to become the main channel for EC aid whether we like it or not. The omission of an Article 15 element in such programmes also, of course, means that we are running the risk of, at the very least, delaying decisions on some millions of pounds of prospective grant through our apparent unwillingness to take on board Article 15 expenditure of comparatively modest proportions. In the case of the Dyfed, Gwynedd, Powys Integrated Operations Programme for example some £108m in grant is at stake.

Your letter poses two options for dealing with this situation one of which, namely making offsetting changes to central government programmes, would present me with some difficulty since I have no analogous programmes against which to make such savings. The net result of pursuing that route in Wales would, therefore, in effect amount to an arbitrary offset against other unrelated expenditure programmes, covering say health, education or economic development in order to compensate for EC grants to local authorities which would in turn support private sector developments. This would clearly be difficult to justify even if it were possible. Because of the difficulty in forecasting accurately the level of EC receipts likely in any one financial year it would also result in an inefficient use of departmental resources, particularly if adjustments were sought in subsequent years.

The Rt Hon John Major MP  
Chief Secretary to the Treasury

/For my ...



For my part, therefore, the de minimis route seems to me to be the only practical solution, the more so since the sums involved are likely in the immediate term to be insignificant when viewed against the totality of local authority expenditure and are anyway already in part taken into account when relevant expenditure is being determined.

If and when this ceases to be the case then we might, of course, need to look at the situation again. A reconsideration of our arrangements for the treatment of EC receipts may anyway well turn out to be necessary as the effects of the changes introduced by the Single European Act and the ongoing Structural Funds review work their way through with possible effect on our levels of EC receipts across the board. For the present, however, I hope that you will agree that the balance of interest lies in the early resolution of this issue and that this will indeed prove possible on the basis of the present correspondence.

If, however you feel that a discussion would be useful - either at an ad hoc meeting or at E(A) - then I would be ready to participate. Copies of this letter go to the Prime Minister, David Young, Malcolm Rifkind, Tom King, Norman Fowler, Geoffrey Howe and to Sir Robert Armstrong.

A handwritten signature in black ink, appearing to be 'J. Lee', written in a cursive style.

LOCAL ROUT: Relations PT33

