PRIME MINISTER

cc. Peter Warry

LOAN GUARANTEE SCHEME

Difficult choices have arisen over the future of the Loan Guarantee Scheme. Last May it was extended to December 1984 with tighter conditions, a lower guaranteed proportion (70 per cent), and a higher premium (5 per cent). No PESC provision exists afater December 1984.

Mr. Trippier has written to the Chancellor - Flag A - proposing that the Scheme run for a further three years but (i) with the premium being put back down to 3 per cent and (ii) the conditions being further tightened. He has sought additional funding from the Contingency Reserve. Para 8 of his letter shows the cost with a take up of £100 million a year and a range of failure rates. I am told that if finance is not made available from the Treasury, Mr. Tebbit would allow the Scheme to lapse rather than cut back some of his other programmes.

A large number of colleagues have written to support the continuation of the Scheme on these terms. These include, Mr. Jenkin, Mr. Walker, Mr. Hurd, Mr. Younger, Mr. Edwards and Lords Young and Gowrie. The Chief Secretary - Flag B - has written to say that he would prefer to extend the Scheme for one further year but that he cannot offer any additional finance for it. He is therefore asking that DTI find the money or let the Scheme lapse.

This presents a difficult choice. Neither DTI nor the Treasury regard the Scheme sufficiently highly to provide finance for it but numerous colleagues see political difficulties in killing it off. You could:

(i) Conclude that the Scheme has been a disappointment; that it has been a long way from self-financing and is unlikely ever to be; that it has encouraged debt rather than equity financing; and that it has been misused by the banks. The logical course would be to let it lapse.

(ii) Recognise that killing the Scheme off would cause a major political row and weaken the Government's case on small firms.

The Policy Unit's view is that any scheme whose terms are sufficiently strict to keep expenditure within bounds will wither away in time and that it would be foolish for the Government to take on responsibility for ending it. You could press the Treasury to make available some additional money, perhaps £5 million, with DTI finding the rest.

On the terms of the Scheme itself, it seems odd to reduce the premium until it comes nearer to being self-financing. It would make more sense to tighten the administration, reduce the guaranteed share to two-thirds, as David Young suggests, and to keep the premium at 5 per cent until there is evidence that the costs are being significantly reduced. The Policy Unit note - Flag C - suggests some further tightening up which could be made.

DTI calculate that a scheme run for three years at £100 million a year, with a 5 per cent premium and a 1 in 5 failure rate and 70 per cent guaranteed by the Government, would have a whole life cost of £8 million. In fact, at the present 5 per cent premium, the annual take up is only £50 million and the total cost over three years could fall within the £5 million suggested as a contribution from the Treasury.

Do you:

(i) believe the Scheme should be allowed to lapse; or

(ii) want to press Treasury and DTI to share the cost;

(iii) agree that the premium should be held at 5 per cent until it is clearer that the cost is being brought down;

(iv) want to keep the guaranteed proportion at 70 per cent or reduce it to two thirds;

(v) agree that the Policy Unit suggestions for tightening up be pursued?

You might like to discuss this with David Young tomorrow.

AT

8 November 1984

JKRALL

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RAMAGK

B/C Mr. Warry

E(A): HMT DOE
NIO LPS
Energy DTI
SO CDL
WL Emp
MAFF
Chief Sec
D.Trans
CO
Paymaster Gen.

10 DOWNING STREET

9 November, 1984

From the Private Secretary

MIN/W/PORTFOLIO 14/11

LOAN GUARANTEE SCHEME

The Prime Minister has seen Mr. Trippier's letter of 18 October to the Chancellor and replies from the Chancellor, the Secretaries of State for Energy, Environment, Scotland and Wales, the Chancellor the Duchy of Lancaster and the Minister without Portfolio.

She recognises that the Government's stance in relation to the small firms sector would be damaged if the scheme were allowed to lapse at the end of December. She believes, however, that given the pressures on public expenditure it would not be right to seek finance for the continuation of the scheme through a claim on the contingency reserve.

She thinks the right way to proceed is for the administration of the scheme to be substantially tightened in order to reduce the failure rate and to prevent the banks taking advantage of the scheme. Until there is evidence that the failure rate is improving the premium should be kept at 5 per cent.

The Prime Minister believes that if the cost of the scheme is limited in this way it should be possible to find the necessary finance from within DTI's existing programmes.

I am sending a copy of this letter to the Private Secretaries to members of E(A) and to Richard Hatfield (Cabinet Office).

(A.Turnbull)

P Madden, Esq.,
Department of Trade & Industry.

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MR TURNBULL | 8 November 1984

SMALL FIRMS LOAN GUARANTEE SCHEME

As an example of what you can buy, the DTI calculate that a scheme run for three years at £100 million per year, with a 5% premium, with a one in five failure rate and 70% guaranteed by the Government would have a whole life cost of £8 million in total.

In fact, at the present 5% rate, the annual take-up is only £50 million and therefore the outcome if we continued the scheme for a further three years could fall within the £5 million that we have suggested.

Peter Warry

PETER WARRY

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C

MR TURNBULL 7 November 1984

SMALL FIRMS LOAN GUARANTEE SCHEME

Should the loan guarantee scheme continue and if so in what form? If it does who should pay?

DTI claim they have no money and without Treasury support they will abandon the scheme which would be politically damaging. Treasury say that any continuation must be at DTI's expense.

The scheme could be cash limited and conditions made tougher. Treasury recommend continuation of the 5% premium rate which we support. There is general agreement on improving the information provided for loan applications and for subsequent monitoring.

The scheme could be further tightened by restricting it solely to new starters (at present it's roughly a 50/50 split between new and existing businesses), or not permitting loans where there is existing bank lending (banks originally used the loan guarantee scheme to substitute for existing bad loans and when this was stopped, to help fund their way out of trouble). We could also withdraw the guarantee from banks who have acted recklessly or not conducted proper monitoring.

We recommend that a small sum, say £5 million, be provided above DTI's budget but imposing very tight conditions to get the scheme nearer the original idea of being self-financing. If DTI want more generous conditions or if it exceeds the target then they must fund it. This compromise should call DTI's bluff about abandoning the scheme for little political or actual cost.

Peter Warry

PETER WARRY

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