CONFIDENTIAL

Econ P57

Ref. A05853

PRIME MINISTER

Regional Development Grants

(E(81) 101 and 107)

BACKGROUND

In E(81) 101 the Secretary of State for Industry proposes reductions in public expenditure on Regional Development Grant (RDG); these savings would be less than those recommended by the Chief Secretary in C(81) 51. In E(81) 107, the Secretary of State for Scotland argues for letting the present arrangements stand. Discussion of these papers by E Committee has been planned for some time and it would not be feasible to divert them to the Home Secretary's MISC 62 Group, since three of the four members of MISC 62 have very firm but very different views on the solution.

2. The decisions fall into three main groups: whether RDGs should be paid for the Sullom Voe and Flotta oil pipeline terminals; the rates of RDG; and the period of deferment of payment of grants. The figures are summarised in Annex 2 of the Secretary of State for Industry's paper E(81) 101.

Sullom Voe and Flotta

3. The Secretary of State for Industry and the Chief Secretary recommend savings of £122 million in 1982-83 and of £9 million in 1983-84 by denying RDGs to the oil companies who have built these two terminals. The Secretary of State points out that the payments would be a poor use of public money, since the prospect of them did not influence the choice of location and the number of jobs provided is only 800 or 900; and that the oil companies are already able to reduce their tax payments by the full cost of the assets and maybe by more. Although the oil companies are expecting the payments under present procedures, the Attorney General, and the Lord Advocate, have advised that the Secretary of State could properly exercise his discretion to refuse them payments and that it is unlikely that his decision could be challenged successfully in the courts.



CONFIDENTIAL

4. The Secretary of State for Scotland agrees that payment in these cases would be an ineffective use of public money and that there should be no risk of successful legal challenge (the doubts to which he refers in his paragraph 2 have now been cleared up following further discussions with the Lord Advocate). He has, however, grave misgivings on the grounds that refusal would be a breach of good faith on the part of the Government which could be damaging to the confidence of the oil companies investing in the North Sea.

Rates of Grant

5. The present rates of RDG are 22 per cent in the Special Development Areas (SDAs) and 15 per cent in the Development Areas (DAs). The Secretary of State for Industry proposes that these rates should be cut by 2 per cent and the Chief Secretary, Treasury, proposed, in C(81) 51, that the cuts should be of 3 per cent for the SDAs and 4 per cent for the DAs. The prospective public expenditure savings from these alternatives are:-

£ million

| | 1982-83 | 1983-84 | 1984-85 |
|---|---|---|---|
| Industry | 20 | 53 | 51 |
| Treasury | 36 | 90 | 90 |

The Secretary of State for Industry judges that his option is the most that could be done consistently with the statement made by his predecessor in July 1979 after the Government's review of regional policy, and repeated since, that:-

"Our objective is to maintain reasonable stability in the framework of regional investment incentives and to avoid abrupt changes".

6. The Secretaries of State for Scotland and for Wales will both argue strongly against making any reductions, on the grounds that it is mistaken to reduce incentives during a recession and that reductions could cause some companies, including overseas companies, to decide against going ahead with projects. The counter-argument is that it is questionable whether a small cut would really tip the balance. A company receiving tax allowances and RDGs in an SDA would at present only have to find 48 per cent of the capital costs of a new investment and it seems doubtful whether such projects would be withdrawn if, in future, they had to find 2 or 3 per cent more. It may also be argued that

some tapering of the RDG percentage now is in line with the thinking of some Ministers that in due course the whole RDG system should be fundamentally changed; the CPRS are preparing a paper on this for the Chancellor of the Exchequer's MISC 14 Group.

7. In political terms, however, industry is looking for more help from Government, not less - particularly at a time when they are beginning to be conscious of the need to invest against the prospects of economic recovery. It would be easier to justify the proposed reduction to industry, if it could be presented as part of a package which also included more cost-effective, and perhaps more selective, measures to encourage industrial investment, not necessarily on a regional basis.

8. The Secretary of State for Industry recommends against withdrawing RDGs from capital intensive industries (other than future oil terminal projects) since this could lose major inward investments, and the Chief Secretary is not proposing this. The Secretary of State for Scotland would be prepared to accept such cuts, as the less of two evils, only as an alternative to the Chief Secretary's proposed deeper cuts in RDG percentages.

Period of Deferment of Grant Payment

9. Under present procedures, once an application has been approved payment is deferred from that date for four months. The Secretary of State for Industry recommends that, to make the proposed reduction in the RDG percentage more palatable, this deferment should be reduced to two months. If this were approved, the other savings would then be reduced by £70 million in 1982-83 and by £4 million and £11 million in the two following years. This would halve the total potential saving in the key year 1982-83. Not surprisingly the Chief Secretary is opposed to it, and the Secretary of State for Scotland does not regard it as a consolation he would want to accept in return for concessions on the other points.

Summary of Expenditure Implications

10. The Chief Secretary is looking for the following savings:

| | £ million | |
|---|---|---|
| | 1982-83 | 1983-84 |
| Sullom Voe/Flotta | 122 | 9 |
| Reduction in RDG rates by 3 per cent in SDAs and 4 per cent in DAs | 36 | 90 |
| | 158 | 99 |

The Secretary of State for Scotland is opposed to both these proposals. The Secretary of State for Industry would be prepared to offer Sullom Voe/Flotta and a 2 per cent reduction in RDG rates (saving £20 million in 1982-83 and £53 million in 1983-84) but offset by reduction in deferment of payment (increase £70 million in 1982-83 and £4 million in 1983-84) so that the net savings would be only £72 million in 1982-83 and £58 million in 1983-84.

??

11. If the overriding priority is to get as near as possible to the Chancellor's proposed public expenditure totals for 1982-83 and 1983-84, it is difficult to see how they can avoid going for the Sullom Voe/Flotta proposal and some reduction in RDG rates (e.g. perhaps the 2 per cent reduction favoured by the Secretary of State for Industry), and dropping the deferment reduction proposal. This would give savings of £142 million in 1982-83 (as against the £158 million sought) and £62 million in 1983-84 (as against the £99 million sought). But there are formidable objections: of breach of faith on Sullom Voe and Flotta, and of appearing to run counter to the need to encourage industrial investment in the case of the grant percentages.

HANDLING

12. After the Secretary of State for Industry has introduced his proposals, you might suggest that the Committee deals with them in turn, with the Chief Secretary, Treasury, and the Secretaries of State for Scotland and for Wales commenting on each. The Secretary of State for Energy should be invited to advise on the reactions of the oil companies to the proposals on Sullom Voe and Flotta.

CONCLUSIONS

13. You will wish to reach conclusions on the following issues:

(i) Should RDGs for Sullom Voe and Flotta be refused?

(ii) Should the rates of RDGs be reduced and, if so, should it be by 2 per cent as proposed by the Secretary of State for Industry, or, as proposed by the Chief Secretary, Treasury, by 3 per cent in the SDAs and by 4 per cent in the DAs?

(iii) Should RDGs continue to be paid for capital intensive projects other than oil terminals?

(iv) Should payment of RDGs continue to be deferred for four months, or should the deferment be reduced to two months as proposed by the Secretary of State for Industry?

RtA

ROBERT ARMSTRONG

30th October, 1981