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P.0846

PRIME MINISTER

Northern Ireland: New Economic Initiative

E(82)62 and 63

BACKGROUND

FLAGA
FLAG B
In E(82)62 the Secretary of State for Northern Ireland puts forward proposals for a new economic initiative in Northern Ireland based on the report by officials circulated as E(82)63.

2. The Secretary of State's main proposals are:

(a) that the National Insurance Surcharge (NIS) should be at least one percentage point lower in Northern Ireland than in Great Britain;

(b) that the Northern Ireland Department of Commerce should be empowered to pay a Corporation Tax Relief Grant which would repay probably 80 per cent of the Corporation Tax levied on profits earned in Northern Ireland.

The Secretary of State makes it clear that he is not asking for additional resources: the effects of the proposals on public expenditure and the PSBR would be offset by reductions in the Northern Ireland programme. This is in accordance with your summing up of the E(NI) discussion which led to the setting up of the studies in E(82)63.

3. The Secretary of State says that he wishes to consider further the third major proposal in the report by officials: ie, that the Government should attempt to reduce wages in Northern Ireland relative to those in Great Britain, for example by directing assistance only to private sector firms which restrain wages and by trying more directly to break the link between Northern Irish and mainland pay rates in the public sector.

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4. The Secretary of State wishes to announce the establishment of a lower Northern Ireland NIS and of a Corporation Tax Relief Grant in the near future together with other proposals made in the report by officials (which involve rationalising or changing the emphasis of the existing arrangements for assistance in Northern Ireland, and should not need discussion).

5. The Ministerial Steering Group on Government Strategy (MISC 14) has commissioned a study by officials of regional economic policy which is due to be available around the end of this year. The Secretary of State accepts that the Northern Ireland position will need to be reviewed in the light of its conclusions, but argues in effect, that action on the lines he recommends cannot and need not await them. The precise timing which Mr Prior has in mind is not clear. He refers to the fact that the elections for the new Assembly will take place on 20 October. For various reasons which are explained below it would be difficult to announce the two main proposals before then, even if they are eventually found to be acceptable. It may be however that Mr Prior would still see political advantage in announcing a new economic initiative for Northern Ireland in the late autumn after the Election.

MAIN ISSUES

6. You will want the discussion to cover the following points:

a. The case for some improvement, now, in the incentives to business in Northern Ireland.

b. The specific proposals for a differential NIS and a Corporation Tax Relief Grant.

c. Possible action to hold down wages in Northern Ireland relative to those in Great Britain.

General case for improved incentives

7. The Secretary of State puts forward two arguments for new economic measures in Northern Ireland:



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a. economic: Northern Ireland suffers higher unemployment than any other part of the United Kingdom; the disparity is likely to increase unless new action is taken;

b. political: the Government needs to show its continuing commitment to Northern Ireland.

8. The main general arguments against further measures appear to be as follows:

i. Northern Ireland already has more generous investment incentives than anywhere else in the United Kingdom (for example 30 per cent capital grants, compared with 22 per cent in mainland Special Development Areas); it is not clear that further improvements will bring much benefit.

ii. It may be difficult to justify yet further preferential treatment for Northern Ireland: while the average level of unemployment is higher than in any mainland region there are comparable 'black spots' throughout much of Great Britain; further special measures for Northern Ireland might therefore lead to calls for similar changes in Great Britain.

iii. It is premature to change the arrangements for industrial assistance in Northern Ireland before the Review of Regional Economic Policy is completed.

9. There are also particular difficulties about the two main proposals - for a differential NIS and a Corporation Tax relief grant. Although Mr Prior's proposals are based on the report (circulated as E(82)63) of an Official Working Party, on which the Treasury was represented, we understand that the Treasury consider that important issues, both of principle and of administration, affecting these proposals need to be more fully examined.

Differential NIS

10. The NIS, previously at 3.5 per cent, was reduced to 2 per cent from August this year to next April when it will rise to 2.5 per cent. This follows the decision announced in the last Budget. The lower rate from August 1982 to April 1983 was designed to compensate for the fact that, for administrative reasons, the reduction announced in the Budget could not take effect until several months later; there was



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thus a reduction of 1.5 per cent for two-thirds of a year in 1982-83 and a reduction of 1 per cent for the full year 1983-84. Any further reduction in the NIS generally to take effect from next April would need to be announced in early November following this year's public expenditure discussions.

11. The Secretary of State for Northern Ireland argues that a rate of NIS at least one percentage point lower than in Great Britain would reduce the level of taxation on labour and would thus be particularly well suited to the circumstances of Northern Ireland where there is a need to shift the emphasis of the incentives away from fixed investment and towards employment.

12. There are however considerable difficulties about the proposal:

i. It would break new ground in charging a different rate of national tax in one part of the United Kingdom.

ii. As has been seen, in discussion of proposals to reduce the NIS generally, some are sceptical of the industrial benefits and believe that some or most of the reduction may leak into higher wages.

iii. Others who see merits in the reduction or abolition of NIS are likely to argue that such action should be taken generally and not confined to Northern Ireland; the announcement of a differential lower rate of NIS for Northern Ireland as part of a package of economic incentives would be seen as implying the continuance of NIS for the United Kingdom generally for some considerable time.

iv. The DHSS are likely to see administrative problems in charging two different rates of NIS on companies which have activities in both Northern Ireland and Great Britain.

v. It would be awkward to announce a differential lower rate of NIS for Northern Ireland until the Government has taken decisions about the rate of NIS generally in the context of the public expenditure discussions. (The report argues that if the NIS were abolished or if its rates were significantly changed, the impact on Northern Ireland's incentives would need to be reviewed; this implies some readiness to substitute a new incentive for the differential



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lower NIS at a later stage; it is not clear however what this might be and the Government would lack credibility if it announced a differential NIS for Northern Ireland but had to compensate for an erosion of its value soon afterwards).

Corporation Tax Relief Grant

13. The Secretary of State for Northern Ireland argues that a Corporation Tax relief grant at the rate of 80 per cent would be particularly helpful in enabling Northern Ireland to compete for inward investment with the Republic of Ireland where there is a 10 per cent corporation tax for incoming firms.

14. This proposal is however open to one of the same objections as that to a differential rate of NIS. In effect, although not in form, it would mean that a lower rate of national tax would be levied in one part of the United Kingdom.

15. The Chief Secretary, Treasury, is likely to argue that Mr Prior seriously underestimates the administrative difficulty of introducing a Corporation Tax Relief Grant. Mr Prior argues that a grants scheme, administered by the Northern Irish Department of Commerce as part of a selective financial assistance package, would avoid the complex legislation and major administrative difficulties that would be required for an explicit reduction of corporation tax in Northern Ireland. But a tax relief grant would still require difficult judgements about the proportion of a company's profits which were deemed to be earned in Northern Ireland. It would also seem difficult to justify selective tax reductions - and the more selective the scheme is the less well it will look by comparison with the Irish Republic's 10 per cent rate of corporation tax.

16. The Chief Secretary may also argue that the tax relief grant would represent an undesirable public expenditure commitment in the longer term. For the proposed differential NIS which it has been possible to cost at £12.5 million a year, Mr Prior would find offsetting savings from his other expenditure. He considers however that any estimates of the cost of a Corporation Tax relief grant are too arbitrary and uncertain to justify offsetting cuts in the existing incentives package, although he makes it clear in paragraph 15 of his paper that he is not seeking agreement to an automatic addition to his programme total for the Corporation Tax relief grant, for the differential NIS or for any other proposal in the report now or in the future.



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European Community

17. The proposals would almost certainly require notification to the European Commission as regional aids; and it is unlikely that the Commission would decide before 20 October whether they should be authorised. Any early announcement would therefore have to be conditional on Commission authorisation. If the Committee supports the proposals, it would therefore be best to instruct officials urgently to consider the question of notification, to sound out the Commission informally, and to advise Ministers in the light of the Commission's reaction whether an early announcement should be made.

Northern Irish wage levels

18. Although there are obviously limits to the extent to which the Government can influence private sector wage levels in Northern Ireland, it would be fully in accordance with Government policy to advocate lower relative wages in an area of high unemployment and low productivity (see, for example, paragraph 1.13 and Annex IV of the note by officials circulated with E(82)63); and many industries and institutions in Northern Ireland have, or easily could have, separate wage-bargaining arrangements from those in Great Britain. Mr Prior says (paragraph 7 of his paper) that he supports this recommendation particularly where companies are in difficulty and seeking Government assistance or where they are in public ownership, but that it will be a highly sensitive issue and that he will need to consider it further. You may therefore wish to press him to come forward with positive proposals in this area.

HANDLING

19. The Secretary of State for Northern Ireland will want to introduce his proposals. The Chief Secretary, Treasury, will wish to comment generally on his proposals, as will other Ministers with responsibilities for economically depressed parts of the United Kingdom - the Secretary of State for Industry and the representatives of the Secretaries of State for Scotland and Wales. The Secretary of State for Social Services will probably want to comment on the proposal for a differential NIS; and the Foreign and Commonwealth Secretary on the European Community aspects of Mr Prior's proposals. Mr Sparrow will also wish to contribute to the discussion.

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CONCLUSIONS

20. You will want the Committee to reach conclusions on the following points:

i. whether a new package of economic incentives for Northern Ireland should be announced this autumn in advance of the conclusions of the review of regional economic policy;

ii. in respect of the proposal for a lower rate of National Insurance Surcharge for Northern Ireland whether this:

a. is acceptable in principle, subject to further detailed work by officials;

b. should be ruled out now; or

c. should be examined further, for later consideration by the Committee;

iii. in respect of the proposal for a Corporation Tax relief grant whether this:


a. is acceptable in principle, subject to further detailed work by officials;

b. should be ruled out now; or

c. should be examined further, for later consideration by the Committee;

iv. whether the timing of any announcement should be considered further, bearing in mind any further work which may need to be done on ii. and iii. above and the need to consult the European Commission;

v. whether the Secretary of State for Northern Ireland should be invited to bring forward proposals to promote a reduction in wage levels in Northern Ireland relative to those in Great Britain.


P L GREGSON

7 September 1982

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