13 January 1983
Policy Unit

PRIME MINISTER

REGIONAL ECONOMIC POLICY

This report ends up facing in the right direction, but its arguments lack incisiveness and leave out several vital points which would have pushed the conclusions further in the right direction.

1. It does not clearly answer the fundamental question: what makes a declining area decline? It cannot be "infrastructure". West Lancashire and West Central Scotland are criss-crossed by motorways. It cannot be "geographical remoteness". Eastern Scotland, East Midlands, and East Anglia are scarcely less remote than their Western counterparts. If it is "declining industry", we have to ask what makes those industries decline? Why should Liverpool decline, and not Rotterdam? Why do British car plants decline and Belgian car plants increase production - within a country as badly hit by recession as the UK?

   By elimination, we are driven to accept one single answer to which the report only fleetingly refers: unionisation and union behaviour.

   Decline is most marked in heavily-unionised regsions where restrictive practices are widespread and notorious and can be reversed only by reducing the degree of unionisation or by the trade unions themselves behaving sensibly. US experience suggested that supposedly declining industries could revive in a remarkable way, when transported to the "Sunbelt" where union penetration was much weaker.

2. Existing REP has tended to operate in exactly the wrong direction. It has concentrated help on large mass-production manufacturing plants in which the unions are almost invariably strong.

   There has been very little help for small firms, especially in the service sector - where the unions tend to be weak or non-existent. We spend over £900m on REP. Less than 10% of that goes to service projects - and only a fraction of that is job-related, rather than plant-related.

   Thus, again and again REP has rewarded trade union militancy, or at least attempted to mitigate the damage caused by that militancy. And we are financing those rewards by taxing primarily the non-unionised and non-militant sector.

3. The report does say (paragraphs 81 and 109):

". . . there is no general reason why investment assistance in the AAs should be closely confined to the manufacturing sector. The objective of expanding employment opportunities is at least as likely to be met by increasing service-sector jobs."

This is an understatement, considering that in a developed economy we may expect about three-quarters of new jobs to be in the service sector.

But the report goes on to miss the point:

"It makes little sense to subsidise setting up a new garage or retail shop if the only effect is to put existing ones nearby out of business. This problem of 'displacement' is more severe for services than for manufacturing, since most serve only a narrow geographical area whereas most manufacturing projects can in principle supply a wide market in the UK and overseas."

On the contrary, manufacturing projects are more likely to be displaced, while service projects are more likely to be additional. The alternative to building a chemical plant in the North-East is often to build a chemical plant in Southampton. The alternative to starting up a beauty parlour or a window-cleaning business on Merseyside is not to start up at all. Declining areas tend to be impoverished, both in small firms and in the service sector. And large service firms often serve the whole country in any case - eg mail order firms and Littlewood Pools. There are also "sunrise" service industries - such as computer software - where we enjoy a relative advantage internationally (which we do not have with many of the manufacturing projects currently subsidised by REP) and which therefore offer a more lasting foundation for the regional economy.

4. The report does attempt to steer the system more in the direction of services, and in paragraph 114 suggests a scheme for grant of £2,000 per job created beyond a certain threshold, but this is only to be additional to a grant for capital expenditure, and "The aim would be that most projects would qualify only" for the latter.

Most of the money would thus continue to go to investment in large capital projects where there would be substitution of capital for labour, although more of these would be in the service sector than before (the building of shops, offices and warehouses, for instance).

Most of the money would still be flowing into the heavily unionised sector. Paragraph 110 makes it clear that "because of the displacement problem most of this assistance (to service firms) should, as now, be selective, and this will make it unlikely that expenditure need or would go very high".

5. The report rejects general wage subsidies like the old Regional Employment Premium as carrying too much deadweight and being contrary to Community rules (paragraphs 99-101).

But labour subsidies to service-sector jobs are not limited by Community rules, and nor are temporary subsidies. It would be quite possible to have a time-limited subsidy for new jobs in Assisted Areas - a kind of temporary regional devaluation, which might give new small firms, whether in services or manufacture, a good start and encourage existing firms to take on an extra person or expand their activities. The point is that this would offer far less temptation to inefficiency than subsidies to jobs in highly unionised large-scale manufacturing, where an extra man, once taken on, is hard to get rid of.

The report does not explore this type of possibility. Yet without it, many small firms would not qualify for help - as the report itself admits in paragraph 116 - because their expansion is not a clear-cut "investment project" as envisaged in paragraph 108.

6. The whole report is still too oriented towards manufacture and large firms. And it gives no comparative costing of job-creation as between manufacture and services, and between large firms and small firms.

We conclude:

(i) That the conclusions of the review do not go far enough to justify the upheaval required to implement them.

(ii) That further work should be done urgently on how to encourage small non-unionised and labour-intensive firms in Assisted Areas. As a guide, it might be assumed that not less than one-third of all REP expenditure would be devoted to such firms.

(iii) That Ministerial discussion of regional economic policy, either in MISC 14 or another group, should not start until this work is finished.

FERDINAND MOUNT FM

AW ALAN WALTERS

cc Mr. Mount
Mr. Scholar

MR. VEREKER

REGIONAL ECONOMIC POLICY

Your note of 11 January quite correctly reflects my views. But of course, I go a little further.

If the purpose of regional economic policy is, as Quinlan expects, to subsidise labour in the development areas, then my analysis suggests that what we are doing is rewarding union militancy, and financing those rewards by taxing primarily the non-unionised and non-militant sector. We encourage thereby militancy and penalise the generally lower income earners in the non-unionised sector. Not a good thing.

A further point which I did not discuss with you, but should have done, is that the regions which suffer high unemployment are often characterised by spendthrift public authorities. This increases the local rates, and usually in Labour dominated areas, is accompanied by various anti-business and pro-Labour practices. Rates bulk very large in taxes on business. Again, a regional economic policy would reward the profligate Left wing local authorities at the expense of the more responsible local electorates. Again, not the sort of thing we want to see.

I think the other point I made was that it is quite impossible for anyone to predict when an area is going to decline on the one hand, or take off on the other. For years everyone predicted that the Southern States of the United States were doomed for ever to be depressed areas, whereas the North East and the Mid-West would for ever grow. But because of high unionisation in North East and the Mid West, combined with spendthrift state and local authorities, business shifted rapidly to the South. Interestingly enough the traditional industries which died in New England, such as textiles and light engineering, set up again in the Southern and South Western States. There they flourish.

11 January 1983

ALAN WALTERS

ec JV

Prime Minister ②

To be aware. I will resubmit this to you with briefing and advice - I suspect that it is more politically sensitive than this minute suggests.

MCS 6/1

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PRIME MINISTER

REVIEW OF REGIONAL ECONOMIC POLICY

Your Private Secretary's letter of 4 May conveyed your agreement that an inter-departmental working group of officials, under Treasury chairmanship and MISC 14 supervision, should undertake a review of regional economic policy. The group was to aim to produce a substantive report by the end of December.

in folder attached to file.

2. The group has now produced its report and I attach a copy. You may like to glance at Part VII (pages 73-78) which gives the main conclusions and poses some basic questions about the next steps.

3. The report is unexciting and there is a good deal more work to be done if specific changes are eventually to be made on the lines suggested. But I regard it as a workmanlike effort, and a broadly acceptable basis for taking matters forward. The next step might be to circulate it to MISC 14 (augmented as necessary) and to carry discussion forward there.

4. Before that is done, however, I should be glad to know whether you have views on procedure or forum. You might think it useful for us to have a word together about how we see the substance and timing of all this fitting into our general political strategy - paragraphs 199-202 of the report are relevant.

5. I am sending a copy of this minute to Sir Robert Armstrong.

G.H.

(G.H.)

30 December 1982

H M Treasury Document

Description REGIONAL ECONOMIC POLICY, DECEMBER 1982: Report by Interdepartmental Group of Officials.

Reference RREP(83)1

Date 6 January 1983

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Signed CWayland

Date 23 April 2013

PREM Records Team