P.01114

PRIME MINISTER

Review of Regional Economic Policy

(E(A)(83)11 and 12)

Flags A + B

BACKGROUND

E
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In February and March this year the Ministerial Steering Group on Government Strategy considered a report by officials (the "Quinlan Report") on regional economic policy (MISC 14(83)1st and 2nd Meetings). Ministers instructed officials to prepare a successor to Regional Development Grants (RDGs) which would:

Views of S/S Wales and S/S Emp at C + D

- place greater emphasis on job creation rather than capital investment;
- involve a substantial degree of automaticity;
- assume no significantly greater resources;
- maximise receipts from the EC;
- encourage sensible modernisation programmes.

Officials were also asked to examine other matters, including measures to encourage innovation in the regions. They were not, however, to consider possible changes in the map of Assisted Areas.

Proposals

Attached to A

2. The latest report by officials (the "Anson Report") carries out these instructions. It recommends that the successor scheme to RDGs should take the form of an automatic grant system, with eligible investment receiving the higher of:

- a fixed percentage on capital investment (subject to a cost per job ceiling); or
- a fixed amount per job created.

Five such schemes are exemplified; but no preference is stated for any particular level of grant. The report also suggests that the new scheme should be project based in order to reduce "deadweight" expenditure on replacement investment; that modernisation projects should qualify for regional selective assistance (RSA), to help safeguard employment in the assisted areas; that a wider range of activities, particularly more service industries, should qualify for assistance: and that there should be a simplified administration for small firms.

3. The other main recommendations in the report are:

a. officials should review the map of assisted areas, using up-to-date indicators of need following the 1981 census;

b. a White or Green Paper on the general approach to regional policy should be published and a short enabling Bill introduced, if possible, in the 1983-84 Session;

c. regional differentiation in the level of grants under the support for innovation schemes, and other specific measures to encourage innovation and the formation of new firms, should be considered;

d. measures to improve coordination between Government departments and further analyses of regional policy effectiveness should be undertaken.

4. The Chief Secretary in E(A)(83)11 and the Secretary of State for Trade and Industry in E(A)(83)12 both broadly endorse these recommendations and propose a White Paper later this year, with a short Bill in the current session. The main points of difference are however:

- how far the new grant should be job-related rather than capital-related;
  (the Chief Secretary thinks that the options to be considered should include not just those in the report but also an option proposed by Mr Sparrow in his letter of 19 July - copy at Annex A, and the option of a grant related to jobs alone; the Secretary of State for Trade and Industry rejects the option of a simple job grant and argues against making the grant too job-related)

- what savings should be sought;
  (the Chief Secretary argues for £200 million a year; the Secretary of State for Trade and Industry for £150 million a year)

- the approach to assisted area coverage;
  (the Chief Secretary proposes that this should be decided along with decisions on the form and level of grant within the objective of £200 million a year savings; the Secretary of State for Trade and Industry says that officials should be told to aim at the same percentage coverage of the working population as now, ie 27 per cent).

MAIN ISSUES

5. The main issues before the Sub-Committee are as follows:

i. the type of successor scheme to RDGs;

ii. the review of the assisted areas map;

iii. the scope for savings and the introduction of measures to help innovation and new firms in the regions;

iv. the publication of a White Paper and the timing and form of legislation.

Successor scheme to RDGs

6. The present RDG scheme provides an automatic grant towards capital expenditure. It is common ground that it is wasteful to provide large public subsidies to highly capital intensive projects like Sullum Voe. Arguably the need is to subsidise jobs not capital invesmtent in areas of high unemployment. But, as Mr Parkinson will argue, there are some important objections to a grant related to jobs only, or a grant which is related too much to jobs rather than capital investment, ie:

- encouragement to overmanning, and thus uncompetitiveness in the longer term

- EC rules limit the amount of job subsidy, so that a simple job grant or a grant mainly related to jobs would be small, and perhaps ineffective in attracting international projects

- job-related grants are less predictable for companies and may thus be ignored in location decisions

- job subsidies may leak into higher wages

- checking the number of jobs created greatly increases costs of administration.

7. At this stage it is a question of deciding on the range of options for officials to consider. It would be helpful if Ministers could decide:

- whether to rule out a grant related to jobs alone

- whether the options for a mixed jobs/capital grant should be confined to those in the officials' report or extended to include Mr Sparrow's option.

Assisted Areas map

8. There are two main questions here:

i. should officials be instructed to review the map of assisted areas?

ii. if so, should they be given any general guidance at this stage?

Should the map be reviewed?

9. As the Anson Report brings out, there are good reasons for reviewing the map. Certainly, if the map were being drawn "from scratch" it would be unlikely to take its present shape. Moreover, information from the 1981 census should soon be available; it would be difficult to appear to ignore it. On the other hand, changes in the map are bound to raise political difficulties; and the results of the previous review were announced as recently as the middle of 1982.

Guidance

10. If the map is to be reviewed, Ministers may wish to give officials guidance on, in particular, coverage and the number of

tiers. The present map covers about 27 per cent of the working population. Should officials assume that this percentage should stay broadly unchanged, as Mr Parkinson proposes? Or that it may be somewhat increased? (Presumably Ministers would not favour a substantial increase, since that would bring the percentage fairly close to the 44 per cent coverage under the last Labour administration, which it was a prime aim of the previous review to reduce). A relevant question here is access to EC resources: the larger the area classified as assisted, the greater the potential receipts - but at the cost of higher domestic public expenditure on regional policy.

11. It is possible to deal, as now, with different assisted areas in different ways by having more than one tier. Different tiers will be eligible for different assistance: for example, the rate of grant may vary, or some types of grant may be available in one tier but not another. The effective choice is probably between a three-tier and a two-tier approach. The latter, which Mr Parkinson favours, is administratively simpler and allows resources to be concentrated on areas of greatest need. But a three-tier approach, as at present, could have presentational and political advantages in dealing with sensitive areas, for example as a means of helping the West Midlands without giving it full assisted area status.

Resources and new measures

12. The Chief Secretary proposes that the aim should be net savings of £200 million a year (current annual spending on RDGs is about £450 million a year). The Secretary of State for Trade and Industry suggests somewhat smaller savings of about £150 million a year. Some Ministers may argue that it is better to leave this issue open for the time being. It is however crucial to the further work by officials on the form and level of

grant and on assisted area coverage. If the majority of the Sub-Committee are satisfied that fewer resources should be devoted to regional industrial policy, leaving more room to help the economy in other ways, a target for savings should now be set.

13. A related question is how far any savings should be devoted to various schemes discussed in the Anson Report for stimulating innovation and the formation of new firms in the assisted areas. The Chief Secretary estimates that if all the schemes were adopted they would cost £60-£70 million a year. If the Sub-Committee are able to agree on a target for savings, it would be helpful if they were also able to say in broad terms how far they wished the savings to be available for helping the economy generally through lower taxation and how much should be devoted to the new schemes.

White Paper and legislation

14. Both Mr Rees and Mr Parkinson favour early publication of a White Paper and a short enabling Bill in this Parliamentary session. There are obvious attractions in early and comprehensive action in preference to the alternatives discussed in the Anson Report (legislation postponed to 1984-85, or making only those changes to RDGs not requiring primary legislation.) In particular it would enable savings to be realised quickly; and it would minimise the period of transition to a new grants scheme, and the uncertainties during that period.

15. But Mr Parkinson's specific proposal (using the Cooperative Development Agency (CDA) Bill) entails a White Paper and legislation at a time when the Government will not be able to give crucial details of new grant schemes or the assisted area map (unless Ministers decide that the map should not be reviewed). Will Parliament be willing to pass general enabling legislation, with no firm indication of how it will be used?

16. If the difficulties of such early action seem too great, it would be possible to explore a slightly different approach: early publication of a consultative document, with legislation in, say, the early new year, either as a separate Bill or in a deferred CDA Bill. No doubt the business managers would not welcome this, but its feasibility may need to be examined.

Minor recommendations

17. Finally, paragraph 16 of E(A)(83) 11 mentions a large number of relatively minor and detailed recommendations in the Anson Report. It does not seem necessary to go through these at the meeting: it should be enough to ask whether any member of the Sub-Committee wishes to object to any of them.

HANDLING

18. You will wish to invite the Chief Secretary, Treasury and the Secretary of State for Trade and Industry to introduce their memoranda. The Chancellor of the Exchequer may wish to comment from the general economic standpoint. The Secretaries of State for Northern Ireland, Scotland and Wales will wish to discuss the implications for the parts of the United Kingdom for which they are responsible; and the Secretary of State for the Environment may have comments from the standpoint of the English regions. The Foreign and Commonwealth Secretary can advise on the EC aspects, and the Lord Privy Seal on the timetable and the implications for the legislative programme.

CONCLUSIONS

19. You will wish the Sub-Committee to reach conclusions on the following:

i. whether the successor scheme to RDGs should be a grant partly related to capital and partly to jobs on the lines proposed in the Anson Report and endorsed by the Secretary of State for Trade and Industry;

ii. whether the variants of such a scheme to be considered by officials should be as proposed in the Anson Report or should include the "Sparrow" option;

iii. whether officials should be instructed to review the map of assisted areas; and if so, whether they should be given any guidance at this stage, particularly on

- coverage;
- the number of tiers;

iv. whether Ministers should aim at a particular figure of net savings; and if so, what it should be;

v. whether Ministers wish to express any view at this stage on the measures to promote innovation and the formation of small firms in the assisted areas outlined in chapter 3 of the Anson Report and the scale of resources to be devoted to them;

vi. the nature and timing of any White Paper or other consultative document;

vii. the timing and nature of legislation;

viii. the minor recommendations mentioned in paragraph 16 of E(A)(83)11.

PLG

P L GREGSON

5 October 1983

10 DOWNING STREET

Prime Minister

① Nick Owen has represented No 10 on the Anson group. It would be of great value if he could sit in on the E(A) meeting

Agree?

Yes mt

(2) The figure of £5,000 mentioned in para 5 is not in the CST's paper. It is a figure which Treasury may propose for inclusion in options for further study if their preferred job grant is rejected. It would provide an even more labour intensive option even than Mr Sparrow's £7,000

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ANNEX A

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Qa 06420

From: John Sparrow
CONFIDENTIAL

19 July 1983

The Rt Hon Nigel Lawson MP
HM Treasury
S W 1

Dear Nigel,

Review of Regional Economic Policy - Anson Report

I have seen a copy of this Report which, I understand, is very unlikely to be discussed before the Recess and the closure of the CPRS. I offer this letter as a kind of posthumous CPRS Collective Brief. It concentrates on the most important element in the Report - the new scheme for Regional Development Grants (RDGs). Points on three other issues are in an Annex.

As the Quinlan Report concluded, Government expenditure on regional policy is a means of achieving political and social objectives rather than economic objectives. RDGs are subsidies financed by the taxpayer which divert economic activity, often at a high exchequer cost-per-job, to regions of high unemployment. They may thus be seen as one of a number of instruments for redistributing a part of national income towards the needy and disadvantaged.

The present RDG Scheme is not cost-effective; nor does it minimise interference with the operation of market forces. It encourages excessive labour saving investment and the growth of capital intensive firms at the expense of labour intensive firms.

The proposed new arrangements for RDGs go some way towards reducing these disadvantages. Helpful in this context are the proposals to exclude replacement and modernisation investment (categories of investment prone to high deadweight), to introduce a cost-per-job ceiling and to extend in a limited way the coverage of qualifying activities to include some services. I do not, however, believe that the Scheme goes far enough.

As regards cost-effectiveness, material in the Report (e.g. paragraph 2.28 where it can be inferred that £1m. of extra grant expenditure will increase regional investment by slightly over £1m.) suggests that the once-off exchequer cost-per-job will be high. Although precise quantification is not possible, we guess that cost could be in excess of £40,000.

As regards capital bias (which contributes to high cost-per-job) the Report suggests that out of £260m. of automatic grant expenditure a year under Option B, only £35m. would be in the form of job grant. Our own calculations suggest that the job grant benefits would be paid to projects accounting for less than 10 per cent of the investment eligible for the scheme envisaged under Option B.

I recognise that EC constraints on grant levels make it impossible to devise a scheme fully neutral as between capital and labour. But I do believe that we could move further towards neutrality and at the same time secure substantial public expenditure savings - a prize worth considering in the general public expenditure context.

In preference to the Anson proposal I would advocate a single tier automatic assistance scheme with a cost-per-job ceiling of £7,000, a capital grant rate of 10 per cent and a job grant of £3,000. The report inclines to the view that a 10 per cent rate of capital grant would be 'ineffective' (paragraph 2.25(a)). Fortified by the views of its 'industrial members' the CPRS does not agree; a 10 per cent rate associated with a higher job grant and with the possibility of 'topping up' through selective assistance in particular cases should work. The other argument advanced against such a package is that job grant is unpredictable (2.25(c)). Surely job grant is unpredictable only in the sense that its size will depend on the success of the project - such an incentive is positively desirable! Moreover, would the CBI have pressed so forcefully for a reduction in the National Insurance Surcharge had it felt that the 'jobs tax' (tantamount to the converse of a job grant) was unpredictable?

I would also advocate:

(a) A firm prior commitment to full annual indexation of the cost-per-job ceiling and the job grant (albeit with the facility for

Ministers to over-ride these arrangements in special circumstances). Investors need to be able to predict that the full value of job grant will not be allowed to erode over time if they are to be encouraged to switch to less capital intensive methods of production. This indexation procedure may lead to a few more instances where total grant payments are constrained by EC limits. But I do not believe the difficulties thereby incurred can be that great (cf. paragraph 2.25(b)). Even under Option B - which is regarded as practicable - grant payments to some projects will be constrained by the higher of the EC limits (see graph in Appendix B).

(b) Renegotiationg the EC limits to permit higher job grants thus enabling the RDG scheme to be moved nearer neutrality. Even if a general increase in limits is not negotiable in the foreseeable future it would be worth renegotiating the structure of the limits with a view to obtaining a higher limit expressed in eua per job. This could be combined with a reduction in the current maximum grant of 30 per cent of capital costs (paragraph 2.4(d)).

Unless an automatic RDG scheme can be shifted nearer to a position of neutrality than the Anson proposal envisages it will not serve the central objective of increasing job opportunities cost-effectively in the areas of high unemployment. If the objections to any further significant move towards neutrality are seen to be overwhelming then I would suggest that Ministers should reconsider the importance they have hitherto given to the retention of an automatic system with the 'deadweight' disadvantage that it inevitably has. The primary objective of regional policy may be better and more economically served by relying exclusively on selective assistance (always assuming that such assistance is administered professionally and subjected to tight budgetary control).

I am sending copies of this letter to the Prime Minister, the Lord President and the Lord Privy Seal, the Secretaries of State for Scotland, Wales, Northern Ireland, Environment, Employment and Trade and Industry, and to Sir Robert Armstrong.

Yours sincerely,
John.

John Sparrow

CONFIDENTIAL

Other CPRS Comments

1. Innovation: We support the aim of improving the climate for innovation in the Assisted Areas. But encouraging profitable innovation through state intervention is difficult enough without importing a regional bias into the subsidy arrangements. The risk that the national economy could thereby suffer seems particularly high. We do not therefore favour a regional differential on such grants (paras 3.3 - 3.4).

2. Co-ordination: We welcome the modest steps taken to co-ordinate the activities of Departments of the Environment and Trade and Industry (paras 3.11 - 3.15). The arrangements described in para 3.15 could be strengthened by developing a process of annual stock-taking of the problems and prospects of each region and the impact on them of Government policies generally.

3. Rural Programme: It is disturbing that there is little evidence available to assess the effectiveness of rural economic assistance and we question whether 2 years is not too long a time to allow for a research study. A shorter investigation, perhaps by independent consultants, might be preferable. More importantly the effect of agricultural policy on rural population and employment requires study. The suspicion must be that rural economic assistance is to a large extent merely coping with the adverse consequences of the Common Agricultural Policy on rural life.