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PRIME MINISTER 28 September 1984

REVIEW OF REGIONAL INDUSTRIAL POLICY

E(A) ON 3 OCTOBER

1. The right way of judging Mr Tebbit's recommendations is to test them against questions which refuse to lie down:

i. What has the money spent on regional aid - £20 billion at 1982 prices over 20 years - actually bought? The appalling fact is that we don't know because we have no adequate monitoring mechanisms. (The 1983 White Paper estimated, cautiously, that about half a million jobs had been 'created' in the Assisted Areas. But it added that many of these would have arisen in the non-assisted areas anyway, so we have paid about £40,000 to transfer each job).

£40,000

ii. Does regional aid square with the government's intentions to free up markets, to withdraw from industrial intervention, and to spread and lower the burden of taxation?

iii. If (as the White Paper said) the aim is to even up regional inequalities in employment opportunities, are grants to companies the right way of going about it? Don't regional handouts tend to reinforce labour market rigidities? The worst areas remain virulently anti-capitalist.

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iv. Because Regional Development Grants are automatic, the taxpayer chips in more as industry is able to invest more. What is the point of that?

v. Do grants really influence where companies invest, or are they just a handy contribution?

vi. We promote regional aid in order to compete for 'mobile' overseas investment. How far should we be engaging in subsidy war? If we have to, do our efforts undermine established UK companies?

2. Mr Tebbit's recommendations address only some of these questions.

We strongly support:

i. The reduction of bias towards capital investment in manufacturing; the inclusion of service industries; job grants as an alternative to capital grants; and limitations on capital grants if they do not yield a given level of jobs.

ii. Reducing the present three tiers of assistance to two.

iii. The intended reduction of public expenditure (but see 'debit' below).

On the 'debit' side

iv. There is nothing about monitoring or controlling the expenditure. This is really a very serious omission.

v. In the short term, expenditure actually rises.

vi. The recommendations for a new Assisted Area map look costly and would be difficult to defend in public.

vii. By leaving in place the essentials of the old policy, the new proposals ignore the philosophical weaknesses of its foundations.

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You should remind spending Ministers of these deeper doubts. You could also remind them that regional aid comes on top of many more billions handed out through Rate Support Grant and naionalised industry funding. If Ministers put all this on one side (and they probably will) E(A) has to decide:

- how to set and control levels of expenditure.

- how to draw the map.

3. Setting and Controlling Expenditure

Officials found genuine difficulty with E(A)'s earlier remit to 'find savings of £150 - 200 million' because it was not clear from what levels they should count.

We recommend that, this time round, E(A) should set levels of expenditure, not of savings. Pressures on public spending and the unsoundness of regional policy dictate that the expenditure should be set low.

We suggest £250 - 300 million cash per annum for each of the next three years, ie £200 - 250 million less than the current year's provision.

Controlling the expenditure is another matter. We cannot have the kind of open ended obligations on the taxpayer which Mr Tebbit's recommendations would perpetuate.

He favours a 15% rate of Regional Development Grant in the inner tier, topped up with Regional Selective Assistance; and Regional Selective Assistance alone in a much larger outer tier.

We do not see the need for Regional Selective Assistance, either as a top up or on its own. It should be abolished. We like the proposal for 15% RDG in the inner tier, but suggest 10% RDG for the outer, provided that both tiers are more tightly drawn (see 'Map Coverage' below).

If RDG itself is to remain automatic, it should be cash limited. There will be some queueing, but we do not see that as serious. Alternatively, you could make the approval of RDG (but not the rates) discretionary. Either way, you have control.

We agree with Mr Tebbit's proposal for a £3,000 job grant as an alternative to capital grant, but suggest it be paid over three years. Some of the jobs 'created' in the regions do not last long.

Finally, you should insist on proper monitoring - not just a record of what has been paid out, but what it has bought. No private sector company ventures millions of pounds on a risky project without keeping close watch on the results. Yet Government does with regional aid. It is a scandal.

4. <u>The Map</u>

We dislike Mr Tebbit's proposal for extending the Assisted Areas coverage from its present 27.5% of working population to over 37%. It will be costly and, as proposed, is a fudge. He is reluctant to see much in the way of area downgrading - yet if Regional Policy 'works' at all that is precisely what should happen. We just cannot afford a ratchet.

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Worse, larger coverage conflicts with the need to save money, so we then have to play games between inner and outer tiers, and between outer tiers and non assisted areas. For instance, on objective unemployment criteria, parts of the West Midlands should qualify as inner tier areas, yet Mr Tebbit recommends no more than outer tier status. Similarly, parts of the South West and Scotland should drop down or out, yet he finds 'potential' reasons for keeping them in.

It is specious to argue that larger map coverage enables us to maximise our take from European regional funds. So it may, but it will still cost us more in nett terms.

When questions in Parliament and in the country arise as to how the new map was drawn, Mr Tebbit's recommendations will not be defensible. So on cost and presentation grounds we argue for an Assisted Area map which is drawn up strictly objectively, and covers no more than the present proportion of the working population. We suggest an inner tier of 10% and an outer tier covering 15%.

5. Summary

We recommend:

1. A two tier map, with 10% of working population in the inner tier and 15% in the outer.

2. The abolition of Regional Selective Assistance; and Regional Development Grant Rates set at 15% for the inner tier and 10% for the outer.

3. As an alternative to capital grant, a job grant of £3,000 maximum for the inner tier (pro rated to £2,000 for the outer) payable over three years.

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4. Limiting capital grants to the equivalent of £10,000 per job in the inner tier, pro rated to £6,700 in the outer.

5. Cash limits to be applied to RDG, set at £250 million per annum for each of the next three years.

6. An effective monitoring mechanism.

R.Y.

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