

P. 01401

PRIME MINISTER

Review of Regional Policy:
New Structure for Regional Industrial Incentives
 (E(A)(84)53, 55 and 56)

BACKGROUND

Flag A

The Sub-Committee decided in October last year (E(A)(83)5th Meeting) that the Regional Development Grant (RDG) scheme should be replaced by a new scheme under which grant would be paid against approved capital expenditure, subject to a grant-per-job ceiling, with an alternative job grant for the most labour intensive projects. They also agreed that the Assisted Areas (AA) map should be revised, and that officials should prepare alternative regional incentive packages to achieve net savings in public expenditure of £150 to £200 million a year.

ProposalsFlag B

2. The officials' report, which is attached to the Secretary of State for Trade and Industry's paper (E(A)(84)53) examines a range of grant and map options. The particular combination favoured by Mr Tebbit is:

- a. two tiers of assistance, together covering 37.3 per cent of the working population:
 - an inner tier of Development Areas (DAs), covering 14.8 per cent of the working population, and eligible for both RDGs and Regional Selective Assistance (RSA);
 - an outer tier of Intermediate Areas (IAs), covering 22.5 per cent, and eligible for RSA only;

- b. geographical coverage as illustrated in Annex A and listed in Annex B of E(A)(84)53;
- c. an RDG scheme involving:
 - a 15 per cent capital grant;
 - a grant-per-job ceiling of £10,000;
 - a £3000 job grant for labour intensive projects;
- d. the inclusion of the service industries listed in Annex C to E(A)(84)53 in the new RDG scheme.

Mr Tebbit also proposes a revised savings target of £280-300 million for 1987/88, with £20 million of the savings to be used to finance a new scheme to promote innovation and new firm formation in the AAs. This would be announced at the same time as the revised RDG scheme, although it would not begin until 1987/88 and officials would need to study the details further.

Flag C

3. The Secretary of State for Scotland's paper (E(A)(84)55) concentrates on the AA map in Scotland. The effect of his proposals as compared to Mr Tebbit's would be a slight increase both in total Scottish AA coverage and in the proportion within the inner tier. The effect would be to increase the proportion of the GB working population covered by the inner tier from 14.8 per cent to 15.18 per cent, and coverage of inner and outer tiers combined from 37.3 per cent to 37.6 per cent. The additional cost would be about £6 million in 1987/88.

Flag D

4. The Minister of State, Welsh Office's paper (E(A)(84)56) argues that Mr Tebbit's proposals create disparity between Wales and Scotland, and proposes additions to the inner tier in Wales. The cost is not quantified in the paper; but Welsh Office officials estimate that the proposals would add about 0.5 per cent to the proportion of the GB working population covered by the inner tier, and cost about £8-10 million a year.

MAIN ISSUES

5. The main issues are:
- i. the level of savings to be sought;
 - ii. the extent of the geographical coverage of AAs, and the split between inner and outer tiers;
 - iii. the particular areas to be included in the AA map;
 - iv. the rates of grant for the new RDG scheme;
 - v. the service industries to be eligible for RDG;
 - vi. the Commission's attitude and any implications for timing;
 - vii. whether to decide now that further measures to encourage innovation and new firms in AAs are needed, and, if so, the cost and the timing of any announcement.

Target savings

6. This is the key issue. Decisions on the desired total cost of the regional industrial incentives will limit the room for manoeuvre on geographical coverage, rate of grant, qualifying activities, and any new scheme to encourage innovation and new firm formation. There is a dispute between the Chancellor of the Exchequer and Mr Tebbit.

7. The Chancellor (in his letter of 16 August) has suggested that the savings target should be £350 million rather than the aim of £150-200 million adopted by the Sub-Committee last October. His argument is that economic assumptions at that time suggested that expenditure would be about £300 million a year; now that the economic assumptions suggest higher capital spending, the right course is to increase the target savings.

8. Mr Tebbit has gone some considerable way to meet this argument, recognising that the case for regional incentives diminishes as the economic climate improves. He now suggests savings (on the latest

forecast expenditure) of £280-300 million (before expenditure of £20 million on innovation and new firm formation).

9. This difference in views is illustrated in the annexed table, which shows the position in 1987/88. The following points are relevant:

a. On the one hand, if it is accepted that RDGs are demand-led it is not possible to hold to a fixed annual level of expenditure on them. The Sub-Committee's discussion in October 1983 did not envisage that expenditure should be held at £300 million a year, or any other specific figure.

b. On the other hand, the general structure of the new scheme will need to take account of what can be afforded. Mr Tebbit tacitly recognises this, at least to some extent, by offering significant reductions below the baseline. The Sub-Committee will need to consider whether these go far enough.

Map coverage

10. As noted above, decisions on target savings, map coverage and the rate of grant are interdependent; the wider the map coverage, the greater the cost of regional incentives for a given rate of grant. The greatest impact on expenditure is made by decisions on the size of the inner tier, since DAs qualify for both RDGs and RSA.

11. There are two main policy decisions to be taken:

i. whether Assisted Area coverage as a whole should be increased from 27.5 per cent of the working population at present to over 37 per cent;

(37.3 per cent on Mr Tebbit's proposals; 37.6 per cent on Mr Younger's)

ii. how large the inner tier coverage should be.

12. On i., although an increase in AA coverage looks at first sight like a step backwards towards the 44 per cent coverage under the last Labour Government, it may ease the political acceptability of the changes at a time of high unemployment and it will help the UK to maximise take-up from the European Regional Development Fund.

13. On ii., Mr Tebbit proposes inner tier coverage of 14.8 per cent. If the proposals of both Mr Younger and Mr Stradling Thomas were accepted the inner tier coverage would be increased to some 15.7 per cent at an extra cost of around £15 million. The Chancellor, on the other hand, may argue for a smaller inner tier - say covering 10 per cent with a saving of some £60 million.

Details of the map

14. I understand that Mr Tebbit intends to illustrate some of the detailed options on the map with slides. If decisions have been taken on the public expenditure savings to be achieved and on the percentage of the working population to be covered by the inner and outer tiers, it may not be necessary to take final decisions on all the details of the map. The outstanding points might be remitted to the Secretary of State for Trade and Industry in consultation with the Secretaries of State for Scotland and Wales and Treasury Ministers.

15. There are however two points which should be borne in mind:

i. The more Ministers move away from the objective criteria employed in the officials' report, the more difficult it will be to resist further special pleading, to avoid increasing assisted area coverage still more, and to secure EC clearance.

ii. Negotiating with the Commission about the new map will require careful handling. It is for consideration whether the 28 November date for announcement is realistic and, in particular, whether to avoid commitment to this date in advance of Mr Tebbit's informal discussions with the Commission. He might be asked to keep in close touch with the Foreign and Commonwealth Secretary on the EC aspects.

Details of the new RDG scheme

16. The main considerations in setting the rate of capital

grant are the level of public expenditure savings sought, the desired impact on employment in the AAs, and judgements on the cost-effectiveness of different rates. A 15 per cent capital grant is consistent with Mr Tebbit's proposals on savings and the map, and officials' findings that a rate below 10 per cent might not influence investment decisions, while a grant rate above 20 per cent would not be cost-effective. A 10 per cent rate might save £25-30 million.

17. The grant-per-job ceiling limits grant payments for projects that create few jobs relative to total capital expenditure. Setting the ceiling so low that many cases hit it would reduce the effectiveness of the scheme, because the uncertainty affecting the employment consequences of many projects will complicate the inclusion of RDG in companies' investment appraisals. Too high a ceiling would increase total RDG expenditure. The £10,000 ceiling proposed by Mr Tebbit is about double the average capital-intensity and would limit the grant paid for about $\frac{1}{6}$ of projects comprising 25 per cent of eligible investment. The ceiling would not apply to small firms (employing less than 200).

18. EC rules set a £3,200 maximum for the alternative job grant for labour intensive projects. There is unlikely to be disagreement with Mr Tebbit's proposal for a £3000 grant.

Service Industries

19. The White Paper proposed the extension of RDGs to service industries. It also set out criteria for selection, the most important being that the availability of grant should increase the overall level of economic activity in the AA. Mr Tebbit's list (Annex C to E(A)(84)53) adds cable television to officials' proposals. The Sub-Committee may wish to consider further candidates such as tourism.



If so you may find it helpful to draw on Table 3 of Annex B to the officials' report, which sets out the arguments against including various other activities.

20. The cost of extending RDGs to the proposed activities is uncertain, but might be of the order of £10-30 million a year. Obviously the more activities made eligible, the greater the cost.

Innovation and Firm Formation

21. The Sub-Committee took no view on this last October. Mr Tebbit's proposal, for a scheme costing £20 million a year, is modest compared to the full range of schemes discussed in the earlier Anson report, which might have cost £60-70 million a year. Discussion is likely to concentrate on whether the cost should be contained within the overall regional spend, rather than reducing savings.

22. There are two reasons for making and announcing decisions now. First the presentational advantages of the scheme as a counter-weight to the cut-back in RDGs. Second, it will clarify the PES position. But there is no overriding need to reach firm decisions now, in advance of necessary further work by officials, and the Sub-Committee might prefer to return to this later.

Timing

23. Once finalised, the new arrangements should be introduced quickly in order to avoid unnecessary speculation, minimise lobbying and secure the savings as early as possible. Mr Tebbit proposes introduction on 28 November. This is an ambitious timetable, particularly in view of the EC difficulties, and it is unlikely to be met if the Sub-Committee do not settle most of the issues at this meeting.

HANDLING

24. You will wish to ask the Secretary of State for Trade and Industry to introduce his memorandum. Thereafter it will probably be convenient to divide discussion between two broad areas:

- i. the level of savings to be achieved; which sets the parameters for
- ii. the details of the new arrangements.

The Secretary of State for Trade and Industry should have set the context for discussion of i.. The Chancellor of the Exchequer, the Secretary of State for Scotland and the Minister of State, Welsh Office are likely to be the main other contributors.

25. On ii., the Secretary of State for Scotland and the Minister of State, Welsh Office should be asked to speak to their memoranda, which are mainly concerned with map coverage. The Minister for Local Government (Mr Baker) and the Minister of State Northern Ireland Office (Mr Boyson) may have views on the implications for the English regions and for Northern Ireland.

CONCLUSIONS

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

- i. the target level of savings in 1987/88;
- ii. the overall geographical coverage of the new AA map, and the split between inner and outer tiers;



- iii. the areas to be included in the new AA map, if necessary leaving the position of marginal TTWAs to a small group of interested Ministers;
- iv. the rates of grant for the new RDG scheme;
- v. the service industries to be eligible for RDG;
- vi. whether the Secretary of State for Trade and Industry should, after discussion with the Foreign Secretary, consult the Commission informally about the new arrangements, and the timing of the announcement relative to such consultation and to formal submission of UK proposals to the EC;
- vii. whether Ministers wish to decide now to introduce new measures to encourage innovation and new firms in the AAs from 1987/88 and the scale of resources to be devoted to them; if so, the timing of any announcement and further work by officials.

PLG

P L GREGSON

2 October 1984

£ million

Expenditure

PES baseline:

- RDG (old scheme)	380
- RSA	<u>109</u>
Total	489

PES baseline with
latest economic
assumptions:

- RDG (old scheme)	548
- RSA	<u>131</u>
Total	679

Savings

		(a) on PES baseline	(b) on latest forecast
Mr Tebbit's proposals			
- RDG (old scheme)	47		
(new scheme)	153	180	348
- RSA	<u>178</u>	<u>(69)</u>	<u>(47)</u>
Sub-total	378	111	301
- New firms	<u>20</u>	<u>(20)</u>	<u>(20)</u>
Total	398	91	281

Mr Lawson's proposals

(RDG + RSA total;
assumes new firms scheme
not additional)

300	189	379
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Andrew Turnbull
The Chief Whip wanted you
to see in confidence the advice
he has given to the Lord Privy Seal

LORD PRIVY SEAL

NEW STRUCTURE OF REGIONAL INDUSTRIAL INCENTIVES

FERB
2.90

~~Points~~ points to make on behalf of the Chief Whip -

1. Sure ~~the~~ broad thrust of policy is right and Secretary of State must be supported in his objectives.
2. There are bound to be some difficulties with back benchers who will be under pressure in their constituencies and who will not stand firm.
Very important to begin a back bench operation shortly before policy made public. It would be helpful if the Chief Whip and the Secretary of State could be invited to work out a detailed programme of action in terms of regions and individuals.
3. The South West will be without a doubt the most difficult area. Coming on top of their perceived grievances over agricultural policy, they may well become very disgruntled over regional policy if they think they are being yet further disadvantaged. It will be extremely important to secure a soundly based group early on who will stand firm.
4. Whilst the report seeks to strike a balance between regions, difficulties could arise over any change in this balance, ie if it is thought, for example, that there are substantial improvements proposed for Wales, this could well affect the attitude of back benchers in the West Midlands. Extremely important to minimise these difficulties. Changes must therefore be viewed in this context.

2nd October 1984