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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

REGIONAL DEVELOPMENT GRANTS: POSSIBLE CHANGES

MEMORANDUM BY THE SECRETARY OF STATE FOR INDUSTRY

INTRODUCTION

I have been considering a range of options for reducing expenditure in order to offset additional bids by the Department and to provide possible PES option cuts. Although a cut at this time in the aid given to manufacturing industry in areas of high unemployment presents difficulties, the Regional Development Grant (RDG) scheme is one programme in the Department where substantial savings could be made.

2 There are two issues: whether RDG should be denied to the two North Sea oil pipeline terminals at Sullom Voe and Flotta to provide savings to offset additional bids; and whether a change in the level or scope of RDGs should be considered as a potential source for PES option cuts. These matters affect other Departments' interests and this paper therefore sets out my options, so that colleagues can give me their views before final decisions are taken.

SULLOM VOE AND FLOTTA

3 Annex 1 sets out the background to the grant claims on these oil terminals. The issue is fairly clear. On the one hand payment of grant to Sullom Voe and Flotta (about £150 million in all) is not an effective use of public money. The two projects had no effective choice of location and the number of long-term jobs provided is only 800 or 900. Moreover, the oil companies are already able to reduce their tax payments by the full cost of the assets and maybe even more.

4 Against this our dealings with the oil companies have left them with expectations that normal rules were satisfied. As all of the incurred some time ago, they can therefore that a refusal to pay grant amounts to a and a breach of public faith.

5 Having weighed these conflicting considerations that the over-riding need to reduce public disappointing the oil companies' expectations should not be paid on Sullom Voe and Flotta. General advises that this would be a proper discretion within the Industry Act 1972 and challenged successfully in the courts. I provides a defence again any charge of avoid appearing arbitrary I would also future oil terminal projects from RDGs.

PES OPTION CUTS

EXCLUSION OF CAPITAL INTENSIVE INDUSTRIES

6 One option, which could be seen as a companion to refusing grant to Sullom Voe and Flotta, would be to highly capital intensive sectors of industry, say refining and general chemicals. This might lead to a saving of up to a further £50 million in 1983/4 and £60 million in 1984/5.

7 I believe, however, that the effect on the sectors would be unacceptable. Some large projects affected may be internationally mobile. If we cannot offer assistance to that available in other countries, major new investments in the chemical sector could be lost from the UK along with the employment benefits of downstream developments associated with major projects. It could also hinder our objectives of maximising the benefits from North Sea oil and ensuring that natural gas liquids are used for productive added value purposes. This option could be contemplated only if substantial additional selective assistance were made available for these projects (especially Mossmorran where commitments have already been given). As well as creating difficulties with the EC Commission this would maybe halve the potential savings.

REDUCTION IN RATES OF GRANT

8 The other main change that I have considered is a small reduction in the rates of RDG. This would affect all grant recipients and I believe that a cut of 2% in each of the rates (to 20% in SDAs and 13% in DAs) is as far as I can realistically consider going in view of earlier commitments to stability.

9 The effect of such a cut on any particular project would be relatively small and industrialists are accustomed to planning to coping with variations in some of the parameters. The reduction could therefore be put into effect at once and the estimate of the savings which this would produce is as follows:

1982/3	1983/4	1984/5
20	53	51

DEFERMENT

10 Any change in the rate of grant, coming only one year after the previous change was implemented, may be seen by industry as a sign that grant rates will be liable to frequent change in the future. This would weaken the effectiveness of the RDG scheme. This risk would be reduced if the change was accompanied by other measures of benefit to industry and one possibility would be to reduce the four months period of deferment of RDG payments. Its continuation for two years has been resented by industry and the delay in receipt of RDG payments both imposes additional interest costs on industry and weakens the incentive effect. We could therefore consider reducing deferment in 1982/3 to two months. The estimated cost would be around £70 million for 1982/3 and maybe £4 million and £11 million in the following two years.

CONCLUSION

1 I seek the agreement of my colleagues to my conclusions concerning Sullom Voe and Flotta and on possible option cuts within the RDG field. The overall effect of these proposals year by year during the proposed is shown in Annex 2.

P J

Department of Industry

16 October 1981

Much of the oil from North Sea production wells is brought ashore by pipeline to three terminals at Seal Sands (Reeside), Flotta (Orkney) and Sullom Voe (Shetlands). After dewatering and degassing the oil is transferred by tanker to refineries. During the passage of the Industry Act 1972 it was decided that these processes would be regarded as the first stage of refining and therefore qualifying activities for RDG purposes. On this basis RDG (about £55 million) has been paid on Seal Sands (Phillips Petroleum). The premises at Flotta were provisionally accepted as qualifying, but after payment of £4 million (to Occidental Oil) further payments were postponed so that a final view could be taken on the activities with greater confidence once the premises were fully operational. Provision decision has ever been taken on Sullom Voe (where to head a consortium of some 30 American and British oil firms including BNOCC).

2 Whether or not the Flotta and/or Sullom Voe premises qualify for grant is a technical question, which depends on the exact mix of the activities carried on there. The decision would be a borderline one, and it might be up to another two years before all of the information was available to permit a final view to be taken. But even if the premises did qualify there would be no automatic entitlement to RDG. Although in practice grant has always been paid according to published criteria, payment of grant in any particular case is at the Secretary of State's discretion, which is not limited in the Act.

3 Although much of the expenditure on the terminals was effectively excluded from RDG as a result of the downgrading of the areas in which they are located in 1979, the amounts of grant at stake are still very large - a further £26 million for Flotta and £122 million for Sullom Voe, all of which would be payable within the PES period. But the long term jobs related to this investment are few - about 380 at Flotta and 400/500 at Sullom Voe - so the cost per job of our assistance would be nearly £100,000 at Flotta to maybe £300,000 at Sullom Voe. (Unlike Seal Sands) there is no reason to believe that the availability of RDG had any influence whatever on the timing, location or scale of these projects. Payment of grant on such projects has already been the subject of some criticism by the PAC in 1976/77. The Department's response rested on the automatic and predictable nature of the RDG scheme, but nevertheless there remains a case for making assistance for projects more closely related to the jobs provided.

4 A further consideration, which has only recently been appreciated, is that this expenditure has already led to a reduction in Corporation Tax and Petroleum Revenue Tax at rates in excess of 90 or even 100 per cent. This is because for many taxes capital allowances are based on the gross cost before allowances and allowances for PRT can reach as high as 175 per cent of the cost of the assets. Even though allowances have been reduced in this way since PRT was introduced, to pay an additional 20 per cent RDG on top of this now would invite criticism as being a waste of public money. (This does not apply at Seal Sands which processes only Norwegian oil and is not subject to PRT).

5 During the long period that they have been supplying the Department with information for RDG purposes the oil companies have been given no indication that they would not receive RDG, provided they met the usual criteria. The Department's rejection of PAC criticism on this subject in 1978, the knowledge that grant has been paid to Seal Sands, the provisional qualification of Flotta and the fact that virtually all of the expenditure on which grant is claimed was incurred in 1979 or earlier (before the previous policy changes) will undoubtedly have raised their expectations of receiving grant. They can therefore be expected to claim that a refusal to pay grant amounts to a retrospective decision and a breach of public faith.

6 The views of the Attorney General have therefore been sought and his view is clear. In deciding whether to pay grant, any relevant considerations may be taken into account, including public expenditure policy. And, whilst the factors referred to in paragraph 5 above should be taken into account, they in no way fetter the discretion which is provided in the Industry Act. He advises therefore that a refusal to pay grant on public expenditure grounds would be unlikely to be challenged successfully in the Courts, although he advises strongly against any attempt to strike a deal with the oil companies for payment of a lesser sum than the amount claimed. The Department believes that if the decision can be shown to fall properly within the discretion provided by the Industry Act (as the Attorney has advised), this would provide also a defence to any charge of maladministration.

EFFECT OF PROPOSED CHANGES IN RDG

	1982/3	1983/4	£M cash 1984/5
a - Refusal to pay grant on Sullom Voe and Flotta	122	9	--
b - Exclusion of future oil terminal projects (N/A)		N/A	N/A)
c - 2 per cent reduction in grant rates	20	53	51
d - Reduction in deferment to 2 months	(70)	(4)	(11)
Net saving	72	58	40

- Notes - 1 - The estimates currently contain no provision for RDG on future oil terminal projects;
- 2 - The effect at 'c' is subject to fluctuation in the timing of grant applications (especially the first year).