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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

NORTHERN IRELAND: A NEW ECONOMIC INITIATIVE

Memorandum by the Secretary of State for Northern Ireland

Introduction

1. In the course of a consideration of the future of Harland and Wolff on 8 March last (E(NI)(82)2nd Meeting, item 1) there was some discussion of the wider economic problems of the Province; and as a result I was invited to arrange for officials to consider the scope for changing the structure of the assistance given to investment through the tax system and grants. This work has now been completed, and the official report has been circulated for information under cover of E(82)63. I summarise its main features in para 3 below.

2. I would remind my colleagues that we are approaching a politically sensitive period in Northern Ireland. The elections to the Assembly set up under this year's Northern Ireland Act will take place on October 20th; and thereafter that elected body will, I hope, concern itself actively with the economic and social affairs of the Province. Given the very serious economic situation to which this agreed report draws attention, there is a strong case for early action by the Government to demonstrate our continuing commitment to the welfare of the people of Ulster.

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The Official Report

3. Officials (my own and those of the Treasury, the Central Policy Review Staff and the Department of Industry) have agreed that:

(i) Northern Ireland is experiencing a greater degree of economic disadvantage than any other UK region because of weaknesses (including a serious decline in indigenous industry) internal to the Province. Unless policy action is taken by the Government the disparity between Northern Ireland and the rest of the UK will increase; and unemployment will be well over 20% for most of the 1980s.

(ii) The objective should be, not to increase total public expenditure, but to secure the most effective use of available resources.

(iii) The Government's strategy should be aimed at maximising secure and productive employment through the development of viable and competitive industry. To this end the position of existing industry should be strengthened, the small firms and services sectors encouraged, new inward investment (from GB as well as overseas) attracted, assistance focussed as far as possible on labour rather than on capital, and labour costs eased.

(iv) The composition of the existing incentives is no longer sufficient to attract inward investment to Northern Ireland.

(v) To meet this situation a wide spread of measures should be taken. (These are summarised in para 7.9 of the officials' report and most of them are matters which require no reference to my colleagues. I shall pursue these urgently. Three recommendations, however, raise issues which require collective consideration; viz a reduction in the National Insurance Surcharge; the application of a policy of wage restraint in Northern Ireland; and the introduction of a Corporation Tax Relief Grant.)

My Proposals

4. In the light of this Report, and in particular of its agreement on the extremely serious economic prospects, I am convinced that we must take early action to reverse the disastrous decline in economic activity now in progress - a decline exacerbated, but not caused, by the current recession, and unlikely to be abated even when the national or world economy picks up. I appreciate that there is an inter-departmental exercise in progress (the review of regional economic policy under Mr Quinlan of the Treasury) which will not come to fruition until early 1983; but that is a longer-term exercise more concerned with the general principles of regional policy in GB, and while no doubt the Northern Ireland position will need to be reviewed in the light of its conclusions, the present analysis of Northern Ireland's plight will remain valid, as well as the need for an urgent and positive response by the Government.

5. It is clear that there is no single proposal which will correct Northern Ireland's deep-seated economic malaise. The existing incentives must in general be maintained, and in various ways they need to be intensified so as to enhance our ability to compete for new investment and to promote competitiveness by improving the management and raising the productivity of existing industry. From early September a new administrative structure is in position in Belfast - a new Industrial Development Board with a strong private sector element on it and a new integrated Department of Economic Development - and I shall use this machinery to follow up vigorously those proposals in the report which in many cases amount to development of existing effort. The present incentives include an employment grant used to top up selective financial assistance packages; and I shall certainly press the Industrial Development Board, as officials have proposed, to make greater use of these at the expense of capital grants in future, so as to put the weight of assistance on labour rather than capital. I am convinced, however, that minor tinkering with the present incentives will not be sufficient and that we must also announce some new and imaginative move if we are to have any hope of overcoming the present alarming trend.

National Insurance Surcharge

6. Northern Ireland's most serious problem, present and prospective, is an imbalance in the labour market, with over 21% unemployment (over 25% male unemployment) and every reason to believe that those figures will worsen over the next few years despite recovery at national level. Northern Ireland's special difficulties need to be recognised by a reduction in labour taxes which would be of benefit to all firms in the Province, whether

they receive assistance or not. Much the simplest way of achieving this would be to reduce the National Insurance Surcharge (itself a source of distortion in the labour market), paid by the private sector, a move which would have an immediate effect and which would directly improve competitiveness. If it were reduced by one point below the national rate it would cost about £12.5 million per annum, a cost which I should be prepared to accommodate within my Northern Ireland total.

Wage Levels

7. The report recommends action to impose downward pressure on wage levels in the Province, a move which could attract new projects and improve competitiveness. I support this recommendation particularly where companies are in difficulty and seeking Government assistance or where they are in public ownership. But I have to recognise that it will be a highly sensitive issue, both because it would involve discriminatory treatment of one part of the UK, and because income per head in Northern Ireland is already lower than it is in other regions of the country. I shall therefore need to consider this question further.

Corporation Tax Relief Grant

8. In addition the Report makes clear that it will remain vitally necessary to attract new investment from outside. In the last two years only 5 new overseas investment projects, and only 2 projects from Great Britain, have been set up in Northern Ireland - but investment has been pouring into the Republic, a significant element of it from Great Britain. No doubt part of the reason for this is Northern Ireland's bad (and not wholly justified) security image, and we are actively seeking to combat this. But if we are

to tap mobile investment on the scale needed, some new device is needed to act as a lure.

9. Officials considered, and rejected, the possibility of a differentially lower rate of Corporation Tax for Northern Ireland. Apart from objections of principle, such a scheme would run into a whole nexus of serious administrative difficulties which, even if they could be overcome, would make the scheme so complex and unattractive as to defeat its purpose. By contrast, a scheme under which projects qualifying for selective financial assistance were eligible for a refund of, say, 80% of the previous year's Corporation Tax would be feasible and almost as attractive as the 10% Corporation Tax arrangements in the Republic which are widely recognised as the key factor in its continuing industrial development success.

10. Both a lower rate of tax and a relief grant would require the assessment of the relevant profits arising in Northern Ireland. But whereas for a tax reduction the full details of the scheme - including all the safeguards against abuse - would need to be set in the concrete of statute and be justiciable in the courts, for a relief grant scheme the arrangements would be part of a selective financial assistance package negotiated with each firm individually, and would thus be at the discretion of the Department, whose ability to monitor the firm's continuing performance over time would greatly reduce the scope for abuse.

11. Since some companies would proceed with less front-ended assistance than might otherwise have been the case, the proportion of the initial investment coming from private sector sources should in these cases be increased. Furthermore, since the relief grant

would only come into payment if and when a firm achieved profits, it would be a reward for success. This is exactly the kind of motivation we are seeking to achieve.

12. Because theirs is a national measure the Republic of Ireland can operate a low rate of Corporation Tax without running into difficulties with the European Community's regional policy. A regionally differentiated rate of tax for one part of the UK might fare less well. But the proposal for a Relief Grant is more likely to prove acceptable, especially as the Commission takes a sympathetic view of some of our existing incentives because of Northern Ireland's acute socio-economic difficulties. I would not expect, therefore, to run into any serious EC problems.

13. I therefore recommend to my colleagues that officials should be asked to draw up a detailed proposal for the introduction of a Corporation Tax Relief Grant on the basis described in para 9.

Public Expenditure

14. No firm estimate can be made of the cost of a Corporation Tax Relief Grant because of course it is dependent critically on (i) the quantity and nature of the investment attracted by the scheme, and (ii) the extent to which, and the time-profile over which, profits are built up. Neither of these can be forecast in any reliable way. Some illustrative costings have, at the request of the Treasury, been done, and these are attached at Annex A; but I would emphasise that these figures of cost are worth little more than the (somewhat arbitrary) assumptions which have to be fed into them.

15. The payments of Relief Grant will build up only slowly, however successful the scheme may be - few new projects show an appreciable profit before their third or fourth year. Officials are agreed that the proposals will not create public expenditure difficulties in the short to medium term. The Treasury representatives were, however, concerned that increased requirements could give rise to public expenditure pressures in the longer term and were inclined to think that it was necessary to identify new offsetting cuts in elements in the existing package. The Report indicates that my own officials were satisfied that such public expenditure issues as would arise could be effectively handled in the context of the successive annual public expenditure surveys (para 7.15b of the Report in particular illustrates the approach). I strongly support this view; indeed, given the uncertainties about the public expenditure total for the UK as a whole in the later 1980s, and within that for Northern Ireland, I do not see any other realistic way of proceeding. I am seeking ways of redistributing my expenditure to make it more effective, not to increase it. There is certainly no justification for making reductions now to offset public expenditure requirements which (a) may or may not arise in the late 1980s and beyond and (b) if they did, might be perfectly capable of being handled. I want to make it clear, however, that I am not seeking agreement to an automatic addition to my programme total for the Corporation Tax Relief Grant or for the National Insurance Surcharge proposal or any other aspect of the report now or in the future.

Conclusion

16. I seek my colleagues' agreement to:

(i) the establishment of a differential of at least one percentage point in the National Insurance Surcharge between GB and Northern Ireland;

(ii) the introduction of a Corporation Tax Relief Grant in NI subject to the preparation by officials of a detailed scheme;

(iii) an early announcement of these changes as the central features of an economic initiative which will also include the non-financial proposals in the officials' report.

JP

Northern Ireland Office
31 August 1982

ANNEX A

PUBLIC EXPENDITURE IMPLICATIONS OF A CORPORATION TAX RELIEF GRANT

1. Introduction

This paper has been produced to provide some indication of the possible expenditure implications arising from the introduction of a Corporation Tax Relief Grant. It does not purport to be a definitive statement of the putative costs since it is based on judgemental factors involving the subjective assessment of a number of variables, including the anticipated level of job promotions arising from the introduction of this grant and the other measures proposed in the Report of the Working Party and the level and pattern of profitability which might be achieved in the new projects.

The calculations have been made on the basis of the assumptions set out below, which have been drawn as far as possible from extant material on the factors concerned and which seek to provide a range of possible costings from fairly marginal improvement in current performance to a fairly exceptional improvement. The figures thus seek to indicate the likely upper boundary to potential expenditure.

2. Assumptions

(a) The level of job promotions in Northern Ireland varies from a pessimistic scenario, reflecting only marginal improvement over current performance, of 5,000 new jobs (including LEDU-assisted jobs) promoted per annum up to an upper limit of 10,000 new job promotions per annum.

(b) The pattern in which these job promotions are converted into actual jobs as the project comes on stream over the four year period following promotion is 25% in Year 1, 50% by Year 2, 66% by Year 3 and 75% by Year 4. (These are rather optimistic in relation to recent experience but are close to the levels achieved in new projects over the decade of the sixties.)

(c) Annual profit per employee is assumed to be in the range £1,000-£4,000. Calculations are provided for both the lower and upper limits. (The National Accounts suggest average gross profit figures of approximately £1,500 for employees in manufacturing and services in 1980; the reports of a selection of quoted PLCs show wide variation but average around £2,000 per employee; projections by recent applicants for industrial development assistance in Northern Ireland indicate a range of between £1,000-£18,000 per employee, with an average of about £6,000 if extreme cases are omitted - experience shows, however, that these projections are overly optimistic. The assumed range of £1,000-£4,000 is therefore intended to provide a reasonably realistic illustration.)

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(d) It is assumed that the pattern of profitability of projects is that they do not break even until year 3, that profits are 50% of their plateau level by year 4 and that they reach plateau level in year 5 and are maintained at that level thereafter.

(e) It is assumed that the effective rate of Corporation Tax paid by companies is 18%, that the Corporation Tax Relief Grant is equivalent to 80% of tax liability and that the Tax and Grant are paid one year in arrears.

3. Results

Table 1 indicates the potential Tax Grant commitment on these assumptions for a ten year period following its introduction.

Table 1: Potential Tax Grant Commitment (Gross Figures)

(£M)

	5,000 jobs promoted per annum		10,000 jobs promoted per annum	
	£1,000 profit per worker	£4,000 profit per worker	£1,000 profit per worker	£4,000 profit per worker
1	-			
2	-	-		
3	-	-		
4	-	-		
5	-	-		
6	0.238	0.952	0.475	1.900
7	0.778	3.112	1.556	6.224
8	1.318	5.272	2.635	10.540
9	1.858	7.432	3.715	14.860
10	2.398	9.592	4.795	19.180
	2.938	11.752	5.875	23.500

Some amendment of these gross figures is required, however, to take account of the fact that not all of the jobs which are created survive over the period. Attrition of projects has been fairly high in recent years and if the attrition rates which have been experienced in the past decade were applied the estimates of profit would need to be substantially reduced. It is assumed for the purposes of this paper, however, that the introduction of the Tax Grant and the other recommended measures would encourage the establishment of more durable and successful projects and that attrition rates reflecting the longer term historical experience would apply. It is therefore assumed that after the initial 4 year build-up period jobs become subject to an annual attrition rate of 3 % and that profits are reduced correspondingly. Table 2 indicates the potential Tax Grant commitment on the basis of this attrition rate.

Table 2: Potential Tax Grant Commitment (incorporating 3% attrition rate per annum)

(£M)

	5,000 jobs promoted per annum		10,000 jobs promoted per annum	
	£1,000 profit per worker	£4,000 profit per worker	£1,000 profit per worker	£4,000 profit per worker
Year 1	-	-	-	-
Year 2	-	-	-	-
Year 3	-	-	-	-
Year 4	-	-	-	-
Year 5	-	-	-	-
Year 6	0.238	0.952	0.476	1.906
Year 7	0.778	3.112	1.556	6.224
Year 8	1.302	5.208	2.604	10.416
Year 9	1.809	7.239	3.618	14.472
Year 10	2.302	9.209	4.604	18.416
	2.781	11.123	5.562	22.248

4. Conclusions

On the basis of the assumptions embodied in this paper it is estimated that the introduction of a Corporation Tax Relief Grant, on the terms envisaged in the Report of the Working Party, would incur a potential grant commitment after 10 years within the range £2.781 million to £22.248 million. There would be no grant commitment within the first 3 years of the introduction of the grant and the commitment would increase steadily thereafter.

31 August 1982