

CONFIDENTIAL

THIS DOCUMENT IS THE PROPERTY OF HER BRITANIC MAJESTY'S GOVERNMENT

E(83)6

COPY NO

67

1 March 1983

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

NORTHERN IRELAND: A NEW ECONOMIC INITIATIVE

Memorandum by the Secretary of State for Northern Ireland

Introduction

1 Last September the Committee agreed (E(82)20th meeting) that urgent action was needed to stem the alarming rate of economic decline in Northern Ireland, but had reservations about the specific measures proposed. In the light of our discussion I have substantially revised the proposal for a Corporation Tax Relief Grant (CTRG) and I have reviewed the scope for introducing new measures of local relevance to assist the Northern Ireland economy.

Economic and Political Background

2 The situation has worsened since our September discussion. The unemployment rate was 20.6% in February (with some horrific unemployment black spots such as Strabane with 38.9%); closures and cutbacks have already reduced the industrial workforce almost to the 96000 projected for 1986.* The recently announced closure of the Michelin plant will eliminate at a stroke over 2% of manufacturing employment. Northern Ireland continues to face a combination of difficulties unique in the United Kingdom, and the gap between it and the rest of the country is widening. Annex A shows that Northern Ireland is losing manufacturing employment faster than the rest of the United Kingdom, and faster than the Republic of Ireland.

3 The continuing drain of manufacturing employment and the lack of any prospect of enough new jobs being created are leading to a

* See Annex V para 2(ii) of the Officials Report to the September E Committee (E(82)(63)).

CONFIDENTIAL

CONFIDENTIAL

growing sense of hopelessness, and a widespread concern that the Government is not doing enough to turn the tide of deindustrialisation. We cannot ignore either the pressures generated by the close attention which the Northern Ireland Assembly is paying to the economy or the very strong advice from the recently established Industrial Development Board (IDB) that, without radical measures, the situation will continue to deteriorate. Although Northern Ireland already has a generous range of industrial incentives it is simply not proving adequate to the task.

4 This is an economic climate in which political extremism thrives. If we do not adopt new and imaginative measures to encourage further new investment and to arrest the decline in the existing industrial base, we will face an atmosphere of unrest in the Province which would be very difficult for Government to handle. The political realities of Northern Ireland add a further dimension to the already exceptional economic problems we face in the Province.

Measures already in hand

5 Steps are being taken to maximise the effect of existing incentives. The action in hand on a number of the subsidiary recommendations in the officials' September report is described in Annex B. At our meeting in September I was invited to do what was possible to reduce the level of wages in Northern Ireland. The unions at Harland and Wolff have been pressed, and have agreed, to accept minimal wage increases in the context of the proposed Blue Star order. Similar developments may be occurring in the private sector - Hyster's recent action to reduce wage rates at their Scottish factory brought them more into line with the substantially lower rates paid at their Northern Ireland plant. Any general attempt to depress wage levels in Northern Ireland, except as part of a United Kingdom wide policy, is not a realistic option; but I shall take any opportunity that offers to improve Northern Ireland's competitiveness on wage levels.

The Way Forward

6 Fresh action as set out below is needed to create new jobs, and this must be coupled with firm measures to sustain and improve existing industry.

CONFIDENTIAL

7 The creation of new employment is particularly difficult to achieve since Northern Ireland is in direct competition with the Republic of Ireland for new jobs. The Select Committee on Industry and Trade singled out the Republic's 10% rate of Corporation Tax for manufacturing companies as a central element in its success in attracting new projects. A separate rate of Corporation Tax is out of the question for Northern Ireland. I am, however, wholly persuaded that if we are to create new jobs, Northern Ireland's armoury of investment incentives must be reinforced with a radical measure which will enable it to match the strong competition provided by the Republic of Ireland. The new measure must be one with sufficient "shop-window" impact to restart the momentum of inward investment promotion, which has come to an almost complete halt in the last 18 months. Only the proposed Corporation Tax Relief Grant (CTRG) offers a realistic prospect of achieving this. Following their independent review of the position, the IDB have strongly recommended the introduction of CTRG as a new incentive.

8 Officials, in consultation with the Inland Revenue and the Treasury, have revised and expanded the earlier proposals for CTRG. A description of the scheme now proposed is at Annex C. Essentially, the proposed grant will be attractive to profit making industry because it will reimburse companies 80% of the Corporation Tax paid on profits arising from the new venture. The grant will be simple to introduce - it could be paid under Northern Ireland's existing Industrial Development legislation, although a Finance Bill provision would be required to make it non-taxable - and it would be administered as part of the existing arrangements for giving selective financial assistance. The relatively small number of cases would lessen the procedural burden. Since the grant would only be given as a discretionary element in a selective assistance agreement, it could be tailored to maximize the safeguards and streamline the administration in each individual case.

9 The revised scheme seeks to take account of the comments made during our September discussion; more material on these is at Annex D.

CONFIDENTIAL

CONFIDENTIAL

10 The CTRG scheme aims to build in the principles of selectivity and value for money. Of course it will require skill and insight from the Industrial Development Board's negotiating and monitoring teams. It will be for the IDB (or in the case of small firms, the Local Enterprise Development Unit (LEDU)) to decide in each case whether to agree to make CTRG available. Existing incentives allow a generous volume of assistance to be offered: I see the main impact of CTRG lying in its power to catch the eye of potential investors and persuade them to consider Northern Ireland seriously as a location. Some of them might not in the end ask for its inclusion in the assistance package they agree with the IDB - but a radical measure is clearly needed to counter the Province's image problem and competition from the Republic.

Measures of Local Relevance

11 The measures of local relevance which colleagues suggested in September as possible ways of helping the Northern Ireland economy have been carefully examined; Annex E gives the details. In my view we would not get best value for money from commercial derating, a transport subsidy or assistance to the construction industry. A strategy to assist small firms is already in operation (see annex B (iii)). The importance of maximising the development of small businesses and of providing advice and support to companies of all sizes on improving their competitiveness (eg in marketing) is fully appreciated: both LEDU and the IDB have increased their efforts in this direction. Consideration is also being given to the promotion of the service sector.

12 The measures in this category which I would wish to recommend are therefore the extension of industrial derating to 100% and the introduction of an energy conservation scheme. Rates on industrial premises could be reduced from 25% to zero at an annual cost of some £6.4 million. This would be a cost effective way of supporting existing employment - the second element in our overall strategy - especially as rates (unlike CT) are payable whether or not the firm makes a profit and can therefore often be the last straw which pushes it into insolvency. This measure would help to maintain manufacturing jobs which would otherwise be lost. The energy conservation scheme proposed in paragraph 12 of Annex E would contribute to efficiency, to cost cutting and (to a small extent) to extra employment. It is well worth pursuing as a supplement to more far-reaching measures.

4
CONFIDENTIAL

CONFIDENTIAL

13 Of course the measures I propose will not bring an immediate answer to Northern Ireland's difficulties; there is evidence enough to show that the Province's image of violence and instability will continue to inhibit potential inward investors. In most respects the image is substantially worse than the actuality and colleagues will be as concerned as I am to find further ways of overcoming this. It is partly to overcome the reluctance of managers to settle in Northern Ireland that the IDB have proposed that our incentives package should include inducements for individual managers, as distinct from their companies. I can also see a strong wider case for enabling the IDB to help companies to identify weaknesses in management, and to remedy them, and I hope to be able to make arrangements for this within the existing range of incentives.

Public Expenditure

14 The measures which I now recommend are not directed towards increasing public expenditure in Northern Ireland but rather to securing the more effective use of the resources which I have allocated for purposes of industrial development within the Northern Ireland block. I have agreed with the Chief Secretary that in the shorter term, and certainly within the current Public Expenditure Survey (PES) period, there will be no additional pressures on public expenditure; and that in the longer term any pressure which does arise can be handled in the context of PES arrangements including those applying to the NI block. A fuller discussion of this issue is in Annex F.

Regional Economic Policy

15 Although the Quinlan Review of Regional Economic Policy* did not of course cover Northern Ireland, whose problems we have been examining separately, none of my proposals is inconsistent with the line we are taking on that review. The review refers briefly to CTRG, noting that in the light of the special circumstances of Northern Ireland the introduction of such a scheme in the Province would not necessarily create a case for giving equivalent grants in Great Britain.

EC Implications

16 Any addition to the incentives in Northern Ireland would need to be reported to the Commission. It is likely that the CTRG and ^{and} industrial derating proposals would be seen as operating subsidies/careful

CONFIDENTIAL

presentation would be needed to enable the Commission, which has been sympathetic to Northern Ireland, to conclude that the new incentives would not provide an unfair distortion of ^{the} principles of competition.

Conclusion

17 I seek my colleagues' agreement to:

- (i) the introduction of a CTRG in Northern Ireland on the lines of the scheme in Annex C;
- (ii) the reduction of rates on industrial premises in Northern Ireland from 25% to zero;
- (iii) the introduction of an energy conservation scheme in the Province.

JP

Northern Ireland Office

1 March 1983

CONFIDENTIAL

CONFIDENTIAL

ANNEXES

- ANNEX A EMPLOYMENT IN MANUFACTURING INDUSTRY IN NORTHERN IRELAND, THE IRISH REPUBLIC AND GREAT BRITAIN.
- ANNEX B ACTION IN HAND.
- ANNEX C CORPORATION TAX RELIEF GRANT - OUTLINE OF PROPOSED SCHEME.
- APPENDIX A Main criteria for eligibility for
Selective Financial Assistance.
- APPENDIX B Calculation of Amount of Grant payable.
- ANNEX D CTRG: POINTS RAISED AT E(82) 20TH MEETING.
- ANNEX E POSSIBLE MEASURES TO ASSIST NORTHERN IRELAND INDUSTRY.
- ANNEX F PUBLIC EXPENDITURE ASPECTS.

CONFIDENTIAL

EMPLOYMENT IN MANUFACTURING INDUSTRY IN NORTHERN IRELAND, THE IRISH REPUBLIC, AND GREAT BRITAIN

YEAR	EMPLOYEES IN NI	EMPLOYEES IN ROI	EMPLOYEES IN ALL IRELAND (NI & REPUBLIC)	% OF ALL IRELAND MANUF. EMPLOYMENT IN NI	EMPLOYEES IN GB	EMPLOYEES IN UK	% OF UK MANUF. EMPLOYMENT IN NI
1971	171,636	195,900	367,536	46.7	7886,000	8057,636	2.13
1972	166,146	196,900	363,046	45.8	7613,000	7779,146	2.14
1973	165,734	206,300	372,034	44.5	7604,000	7769,734	2.13
1974	167,515	211,700	379,215	44.2	8052,000	8219,515	2.04
1975	155,793	197,200	352,993	44.1	7333,000	7488,793	2.08
1976	147,200	195,600	342,800	42.9	7136,000	7283,200	2.02
1977	142,028	202,000	344,028	41.3	7205,000	7347,028	1.93
1978	140,157	205,800	345,957	40.5	7161,000	7301,157	1.92
1979	140,100	214,300	354,400	39.5	7015,000	7155,100	1.96
1980	128,550	214,300	342,850	37.5	6679,000	6807,550	1.89
1981	112,500	205,400	317,900	35.4	5926,000	6038,500	1.86
1982	97,700	199,900	297,600	32.8	5599,000	5696,700	1.72

ACTION IN HAND

The following action is in hand on some of the subsidiary recommendations in the official report (circulated as E(82)(63)):

- (i) the IDB and LEDU are both giving considerable emphasis to the importance of competitiveness in the production and marketing of goods and services by Northern Ireland companies, and are promoting the availability of schemes of assistance and support;
- (ii) the Department of Economic Development's new management development programme is a major initiative to assist companies to up-rate their management quality; and the IDB has put forward proposals, which are currently being studied by the Department of Economic Development, for encouraging companies to recruit better management, and to bring better quality managers to the Province;
- (iii) Adam Butler has recently approved the new LEDU strategy (recommended by officials) to boost employment in the small firms sectors. The LEDU Strategy includes a wide range of innovative measures designed to stimulate the creation and growth of small businesses. These measures cover initiatives in marketing, business start-up, promotion, efficiency and development within the small business sector. LEDU have already embarked on the implementation of this strategy and have markedly increased their job promotion figures. In the period from 1 April 1982 to 31 January 1983 LEDU have promoted over 1,600 jobs which significantly exceeds their job promotion figures for the whole of the previous financial year;
- (iv) the Department of Economic Development is currently considering ^{the} scope for extending the range of incentives available to the service sector, while the IDB is reviewing the application to this sector of the present selective assistance package.

L.R.

CORPORATION TAX RELIEF GRANT - OUTLINE OF PROPOSED SCHEME

1. This note describes the main features of the Corporation Tax Relief Grant (CTRG) Scheme which is proposed for Northern Ireland as an additional incentive within the Selective Financial Assistance (SFA) package available, subject to negotiation, to new and expanding industry in Northern Ireland.

Aim

2. CTRG is designed to encourage the expansion of employment in profitable businesses in Northern Ireland by offering an attractive and competitive incentive to companies with sound expectations of profitability to set up or expand their operations in the Province. The scheme would operate by offering, in effect, a significant reduction in the Corporation Tax (CT) burden on selected companies in relation to their Northern Ireland profits. (It is proposed that the grant should itself be free of tax). Such an incentive would have considerable "shop window" appeal to companies considering investment and would make Northern Ireland more competitive in seeking to secure such investment against other possible locations, notably the Republic of Ireland.

Administration

3. The grant would be payable only to those companies with which the Industrial Development Board for Northern Ireland (IDB) or the Local Enterprise Development Unit (LEDU) had concluded a SFA agreement, based on the creation of additional employment, in which the IDB or LEDU had agreed that CTRG should be included. (The main criteria for eligibility for SFA are described in Appendix A). It would be for the IDB or LEDU to determine whether the grant should be part of the agreement and to strike the balance between this grant and the other possible components of aid in negotiating the SFA package.

4. To simplify administration the grant would only be available to companies registered in Northern Ireland. Many British and foreign

.... /

CONFIDENTIAL

companies wishing to invest in Northern Ireland already choose to establish a Northern Ireland subsidiary for the purpose, and local investors wishing to develop an enterprise in the Province also form distinct Northern Ireland companies. In future any enterprise investing in Northern Ireland would be required to establish a Northern Ireland registered company if it wished to have CTRG included in the package of assistance.

Assessment

5. The starting point in determining the amount of grant payable would be the Inland Revenue's normal assessment of that Company's CT liability, and an Inland Revenue certificate that such tax had been paid.
6. The grant would be related to CT actually paid by the company in respect of any given year. Grant would only be paid in respect of payments actually received by the Inland Revenue. Any ensuing adjustments of tax paid (including repayments) would be taken into account by IDB/LEDU at the relevant time in assessing the grant to be paid. (The most convenient mechanism in most cases might be to make an annual payment of grant, related to CT paid in the current year, plus or minus any recent adjustments to CT paid in previous years). In determining what amounts of CT had been paid, IDB/LEDU would treat any formal statement by the Inland Revenue as conclusive.
7. Grant would be paid only in respect of CT paid on profits arising from the company's new trading activities in Northern Ireland - that is those trading activities which are the subject of the SFA agreement. Where a company had both new trading activities (in respect of which CTRG has been promised) and existing trading activities it would be necessary for IDB/LEDU to apportion the company's trading income in order to assess the grant payable. Tax payable on other income, on capital gains etc would not be eligible for grant.
8. Grant would be payable only in respect of relevant mainstream CT payments; payments of Advance Corporation Tax would not qualify.

CONFIDENTIAL

9. Trading losses accepted by the Inland Revenue as counting against taxable income (including losses or charges carried forward, or back) would be taken into account. Since these could not normally be identified with particular items in the Company's taxable profits, and it would not be possible to determine which losses should be set off against the profits of new trading activities, IDB/LEDU would, for the purpose of calculating the grant, apportion losses pro rata between all the company's taxable profits in the relevant year.
10. An estimated CT assessment would not draw any distinction between income derived from trading profits and other income or taxable gains, and would not identify any offsetting charges or losses. IDB/LEDU would not therefore be able to make any precise assessment of the grant due until a full tax assessment had been prepared. Since this could take an appreciable time IDB/LEDU would make an interim payment of grant once tax had been paid on the estimated assessment, representing a proportion of the grant believed to be due. When a full tax assessment was available and tax paid upon it, the balance of the grant due to the company would be paid.
11. It would be for the IDB/LEDU, on the basis of the information supplied by the Inland Revenue, to assess what proportion of a company's CT payment was eligible for grant. As a condition of eligibility for CTRG a company would be required, in the SFA agreement, to authorise the Inland Revenue to disclose to the IDB/LEDU the company's assessments (including any amended assessment) for CT, and information about tax actually paid (or repaid). (Precisely what information is required will be considered in detail by IDB/LEDU and the Inland Revenue and their legal advisers). Similarly, in accordance with present practice the company would be required to supply IDB/LEDU with its accounts, or any other relevant information.
12. In keeping with the present practice in Northern Ireland in relation to existing selective incentives all companies wishing to benefit from CTRG would be required to agree a target for the number

CONFIDENTIAL

of jobs to be provided. The calculation of grant payable to a company would then be governed by the basic proposition that the effective (as distinct from the nominal) rate of CTRG should depend on the extent to which the agreed job target is actually achieved. The proposed methodology for making this calculation is given at Appendix B. Employment for the purposes of the grant scheme would be defined as all persons engaged on a full time basis in the company's business and residing in Northern Ireland. Part time employees and Directors would be excluded.

Policing

13. Group membership would pose additional problems. Any company which was, or later became, a member of a group might see advantage in shunting profits; if the intention in shunting profits into the Northern Ireland economy was not to boost the company's CTRG, this could still be the effect. It would be impractical to seek to control the intra-group transfers, but three steps would be taken to control the effect of such transfers on CTRG. First, a company seeking to include CTRG in the package of financial assistance would be required to undertake that its dealings with other companies would be at arm's length and the IDB/LEDU would be permitted to require the company to demonstrate that this condition was being observed; the number of companies entitled to CTRG would be relatively small, and by placing the burden of proof on the company, the scheme should enable IDB/LEDU to identify any particularly serious profit shunting. The SFA agreement would enable IDB/LEDU to withhold CTRG until it was satisfied that the condition was being met.

14. The second step would reinforce the first, and would also improve financial control. Every company seeking to include CTRG in the SFA agreement would be required to agree profit forecasts with IDB/LEDU. These forecasts would be in the upper limit of profits in relation to which CTRG would be paid. There would be a strong incentive for the company to make the forecasts realistic; there would be a trade-off between the initial capital assistance offered by IDB/LEDU and the forecast level of CTRG payments. Companies which

CONFIDENTIAL

Q.R. sought to maximise the scope for CTRG through unrealistic inflation of profit projections could be penalized in the amount of initial capital assistance they were offered. Unrealistically low forecasts would by definition reduce the CTRG payable. Provision would be made within the scheme to allow the forecasts to be revised, perhaps every 5 years, with the proviso that the original forecasts would remain operative until any new ones had been agreed. Such revision would be dependent upon IDB/LEDU being satisfied that the new forecasts were soundly based and were not the result of profit shunting or other manipulation of profit levels.

15. The third step would deal with the surrender of losses (including investment allowances) for group relief purposes. Under present tax legislation eligible losses for tax purposes incurred by an applicant company which is part of a group can be carried forward or back - in which case grant repayments might be due - in the company's books or surrendered as group relief to other companies in the group. For CTRG purposes, however, IDB/LEDU would assume that a loss surrendered as group relief had instead been retained by the company and carried forward (or back if the company so elected); IDB/LEDU would then adjust the company's actual taxable profits accordingly, in order to calculate the CTRG.

16. In dealing with cases involving expansion by existing companies in Northern Ireland, the IDB/LEDU would take steps to ensure that the expansion was soundly based and was not a device to secure the payment of CTRG. Once IDB/LEDU had decided that the payment of CTRG to the company would be justified, the amount of CTRG payable would normally be determined, as indicated in paragraph 7, on the basis of the profits (and hence CT paid) attributable to the new trading activity into which the company had expanded. In cases where this apportionment could not realistically be made, because for example the company was simply expanding an existing activity which could not be separately identified, it would be open to IDB/LEDU to make an apportionment of the profits according to the distribution of employment between the new and old elements of its activity. In expansion cases, as with other cases where CTRG was claimed, the company would be required to agree both employment targets and profit forecasts for its expansion activity.

CONFIDENTIAL

The IDB/LEDU would take steps to ensure that the payment of CTRG was based upon realistic profit levels and the achievement of the employment targets in the qualifying activity. As already indicated above, IDB/LEDU would examine the company's performance to determine the appropriate level of profits attributable to the new activity and would also ensure that the achievement of the employment target was directly related to the qualifying activity and was not partially due to increased employment in other of the company's activities.

17. Once the go-ahead is given to the CTRG scheme, IDB/LEDU will take the necessary measures to ensure that sufficient experienced staff are available to undertake and monitor the apportionment arrangements.

18. IDB/LEDU would have the right to claw back any CTRG paid, as they have the right at present to claw back any other SFA payments if any of the conditions of payments are shown not^{to} have been met. In the case of CTRG, however, clawback is less likely to be required than with other elements of SFA, since CTRG is paid only after the relevant conditions have been met; but the clawback provided would still be needed to cover the case where a company failed to maintain the investment or employment targets which underpinned the SFA agreement; or where there was some subsequent evidence of impropriety in the formulation of the profit levels against which the CT assessment was made, or where the company ceased to trade.

19. Initially the rate of grant operable in the scheme would be 80% of the relevant CT payments; this rate could be reduced in future years, but it is envisaged that the rate for an individual company would always remain at the level fixed in the SFA agreement. In the circumstances of particular negotiations it may be necessary, however, to negotiate a lower rate of grant at the outset.

CONFIDENTIAL

20. The SFA agreement would provide for CTRG to be payable in respect of CT payments arising during a period of 20 years from the date of the agreement. (The agreement would not be revocable by IDB, but provision could be included for IDB/LEDU to buy out the right to receive CTRG). Payment of grant would only be made following an application for payment from the company, and it would be open to the company not to claim grant in respect of particular CT payments if it wished (eg because it could not at that time fulfil one of the conditions, such as the 'arm's length' provision).

21. In a case in which a CTRG payment had been made and there was subsequent refund of CT by Inland Revenue to a company, there would be provision within the terms of the SFA agreement for the company to authorise the payment of the refund to IDB/LEDU.

22. While the grant could not be unilaterally withdrawn from a company that had signed an agreement (unless the company had been guilty of some malpractice), the continued availability of the grant as an element in the SFA package would need to be reviewed at regular intervals. There could be no presumption that the grant would remain on offer for a particular number of years. (Apart from other considerations, it is of course conceivable that CT itself will be abolished). Similarly, the possibility of revising the grant would be kept open; for instance, it might be desirable in due course to amend the rate of grant, or it might be necessary to change some of the conditions to take account of experience in operating the grant. The scheme proposed in this note would allow any such changes (including ending the availability of the grant to new customers) to be accomplished at once, since entitlement to the grant would stem only from an SFA agreement and it would be administratively simple to insert the relevant changes into all future agreements.

Legislation

23. The grant could be paid under Northern Ireland's existing Industrial Development legislation; no new legislative powers would

Q.R.

CONFIDENTIAL

be needed to allow payment. But it would be desirable for the grant itself to be non-taxable in the hands of the company, and legislation would be needed to achieve this and (possibly) to permit disclosure to IDB of the company's tax assessment and payments.

CAM

-8-
CONFIDENTIAL

70

CONFIDENTIAL

APPENDIX A

The grant would only be available to those companies with whom the Industrial Development Board for Northern Ireland and LEDU agreed to include the grant in a selective financial assistance package. Selective financial assistance is available in Northern Ireland under the Province's industrial development legislation for investment which creates or maintains employment in the Province. The assistance package is put together to match the individual need of each project. Assistance can take the form of grants, loans, share capital or loan guarantees, the central elements being Selective Capital Grants and Employment Grants. A thorough appraisal is made of the technical, commercial and financial aspects of the project, and if the project is viable, a judgement is made as to how much might be offered in all the circumstances of the project, and on what terms. The precise amount of assistance is governed by the "additionality" criterion, ie it is the minimum amount necessary to ensure that the project goes ahead as originally planned. Account is also taken of the contribution the project will make to the regional and national economy and whether it will lead to more productive and more secure jobs (the "efficiency criterion").

CONFIDENTIAL

CONFIDENTIAL

APPENDIX B: CALCULATION OF AMOUNT OF GRANT PAYABLE

To achieve consistent treatment across the different possible scenarios - new projects, expansions and subsequent expansions - the following methodology has been devised to calculate the amount of grant payable in any given case. Five pieces of information are required for the calculation, which involves seven steps.

Information required

- (1) The base level of employment at the time of the agreement. In the case of a new project, this would be zero. In the case of an expansion, it would, unless otherwise agreed, be the actual employment prior to the expansion. In some expansion cases a previous agreement may exist - if so, the base level of employment now agreed should not be less than the target total employment in the previous agreement. This is to ensure that employment is correctly attributed between successive projects undertaken by one company, without the risk of double-counting.
- (2) The agreed total employment target to be achieved under the agreement. ie including any base employment as defined at (1) above.
- (3) The actual total employment in the Company in the year of assessment. This would be calculated as an average over the course of the relevant financial year.
- (4) The agreed nominal rate of CTRG.
- (5) The agreed qualifying tax payments in the year of assessment.

Calculation

- (6) Additional employment to be created = $(2) - (1)$.
- (7) Additional employment actually existing in the year of assessment = $(3) - (1)$. where (3) is less than (1), this result would be taken as zero; where (3) is greater than (2), the result at (6) would be taken.
- (8) Proportion of target additional employment actually achieved = $(7) \div (6)$.
- (9) Proportion of actual total employment in the assisted project = $(7) \div (3)$.
- (10) Effective rate of CTRG = $(4) \times (8)$.
- (11) Qualifying tax payments eligible for grant = $(5) \times (9)$.
- (12) Amount of CTRG = $(10) \times (11)$. This is subject to any upper limit which may have been agreed with the company.

Illustrative examples are provided on the next page to show how the method of calculation would be applied to new, expansion and subsequent expansion cases.

CONFIDENTIAL

II

I

- (1) base employment
(2) total employment target
(3) actual total employment
(4) nominal rate of CTRG
(5) qualifying tax payments [Note (*i*)]

0
50
25
80%
£0.5m

100
150
125
80%
£2.5m

Calculation

- (6) additional employment target = (2) - (1)
(7) actual additional employment = (3) - (1)
[subject to min 0, max (6)]
(8) proportion of additional target achieved
= (7) ÷ (6)
(9) proportion of actual total employment assisted
= (7) ÷ (3)

50
25
0.5
1.0

50
25
0.5
0.2

- (10) effective rate of CTRG = (4) x (8)
(11) tax payments eligible for grant = (5) x (9)

80% x 0.5 = 40%
£0.5m x 1.0 = £0.5m

80% x 0.5 = 40%
£2.5m x 0.2 = £0.5m

80% x 1.0 = 80%
£2.5m x 0.8 = £2.0m
80% x 0.5 = 40%
£2.5m x 0.2 = £0.5m

- (12) AMOUNT OF GRANT PAYABLE = (10) x (11)

40% x £0.5m = £0.2m

40% x £0.5m = £0.2m

80% x £2.0m = £1.6m
40% x £0.5m = £0.2m

TOTAL = £1.8m

Notes: (i) to assist comparison between the above examples, each case assumes the generation of a constant amount of tax liability per worker of £20,000;

(ii) calculated in two stages: the original project and then the subsequent project. The base employment for the subsequent project is the total target employment from the original project.

(iii) new projects are defined as separately identifiable new production/trading activities undertaken by new companies starting up or existing companies expanding.

(iv) expansion projects are defined as simple expansion of existing production/trading activities undertaken by existing companies.

CONFIDENTIAL

CTRG: POINTS RAISED AT E(82) 20TH MEETING

1 The fears which Ministers expressed last September were that a CTRG might:-

- (i) amount to selective taxation and damage the tax unity of the United Kingdom;
- (ii) provoke demands for similar preferential treatment from other regions;
- (iii) require elaborate policing to prevent the artificial inflation of taxable profits;
- (iv) have a random effect in view of the often tenuous relationship between employment and taxable profits.

2 On (i), the integrity of the tax system would not in my view be damaged by the addition to the existing package of incentives in the Province of what is in effect a highly selective grant. Although CTRG would be calculated by reference to the tax payments of the companies receiving it, the rules for the scheme would be entirely outside tax regulations and the taxation system would remain exactly the same in Northern Ireland as elsewhere in the United Kingdom. The Inland Revenue do not expect that a scheme on the lines proposed would cause them any significant operational difficulty.

3 On (ii) I believe that it is perfectly defensible to argue that Northern Ireland needs this special incentive because of the quite exceptional scale and intractability of its combination of economic difficulties.

4 On (iii), the scheme I now propose would incorporate a number of safeguards to prevent profit-shunting. First, a company in receipt of CTRG would be required to undertake (and to demonstrate if required to do so by IDB/LEDU) that all its dealings with other

CONFIDENTIAL

companies were at arm's length. Second, the company would have to agree profit forecasts with IDB/LEDU which would determine the ceiling on grant payable in any particular year. The company would need to make these forecasts realistic, since they would not be accepted (and CTRG would therefore not be available) if they were clearly out of line with the returns which might reasonably be expected from the project. Moreover there would be a trade-off between the initial capital assistance offered by IDB/LEDU and the forecast level of CTRG payments. Companies which sought to maximise the scope for CTRG through unrealistic inflation of profit projections could be penalized in the amount of initial capital assistance they were offered. The objective of the IDB/LEDU negotiators would continue to be to obtain every project at the cheapest possible price. Once the negotiators had done their work, the Department of Finance and Personnel in the Province (in consultation with HM Treasury in major cases) would need as now to be satisfied that value for money had been obtained.

5 In the case of expansion projects by an existing Northern Ireland enterprise, the company would normally be required to apportion taxable profits between its new qualifying activity and its other activities which would not earn grant. The operation of these safeguards is spelt out in more detail in paragraphs 13-21 of Annex C.

6 On the final point, there are of course firms where the level of employment bears little relation to taxable profits. However in linking employment expansion to profitability in the CTRG scheme, I am deliberately aiming to attract those dynamic, growth-oriented companies which are confident of their capacity both to create viable jobs and to profit from expanded output. The extent to which firms in fact benefit from CTRG will depend crucially on their progress in achieving the specified employment targets, as well as on their profit level. Even with successful firms which avoid CT liabilities, the "shop-window" impact of CTRG could have a beneficial effect in prompting them to think about location in Northern Ireland for the first time.

CONFIDENTIAL

7 It should also be noted that as a profit-related grant, CTRG would be broadly neutral in its impact as between capital and labour intensity, and would indeed probably back-out some capital-biased selective assistance. The overall effect could therefore be to encourage efficient labour intensive development, which is very much in the spirit of the RREP recommendations discussed in MISC14 (83) 1st meeting on 21 February.

CONFIDENTIAL

POSSIBLE MEASURES TO ASSIST NORTHERN IRELAND INDUSTRY.

1. This annex appraises the following measures which might benefit Northern Ireland industry, including some suggested at E(82)20th meeting on 8 September 1982:

- (i) 100% industrial derating
- (ii) Commercial derating
- (iii) Energy subsidy
- (iv) Energy conservation scheme
- (v) Transport subsidy
- (vi) Assistance to the construction industry

100% Industrial Derating

2. 75% derating on industrial premises has applied in Northern Ireland for many years. It is estimated that the cost of moving from 75% to 100% industrial derating would at present be £6.4m per year.

3. Arguments for:

- (a) Rates are a tax on the space occupied by a firm. Unlike corporation tax, they are payable whether or not the firm makes a profit, and can therefore turn the balance between bankruptcy and solvency. 100% industrial derating could therefore contribute to maintaining employment by helping to keep in business marginal and loss-making firms.
- (b) When the relationship between share of manufacturing workforce and distribution of subsidy is calculated for the rates, energy and transport costs of industry, derating emerges as offering the best value for money in terms of channeling support to firms employing the most labour.
- (c) 100% derating would mean that the Province was the only area of the British Isles with no local property taxes on industrial premises. It should be possible to develop this as a selling-point with potential investors, although the existing 75% derating has not hitherto proved to have much "shop-window" appeal.

CONFIDENTIAL

- (d) The introduction of 100% industrial derating could be readily accomplished.

4. Against:

Total industrial derating would undoubtedly provoke complaints of discrimination from the commercial sector (where there is no provision for derating). A possible commercial derating scheme is discussed below.

Commercial Derating

5. The introduction of 100% derating for commercial properties would at present cost some £66.5 million per year. To minimize deadweight costs, it would be desirable to target derating at "mobile" commercial sectors which are capable of generating employment, as opposed to operations like retailing where employment is mainly determined by local demand. (As a hypothetical example, if it was judged that 40% of the private service sector was "mobile" and should be offered the incentive of 25% derating, the resulting scheme would cost £6.65 million per year.)

6. In practice, however, considerable problems arise in trying to define "mobile" sectors (eg business support services) for the purposes of targetted derating. The sectors posing fewest problems of definition tend to be those which we would not wish to assist: eg retailing, hotels (which already benefit from specific tourism development schemes). (It might be possible to devise a scheme providing for rate relief grant for certain classes of enterprise, and this will be studied by DED/IDB.) At present the only feasible option would be a blanket derating for commercial properties - a 25% derating across the board would cost some £16.6 million per year. (Anything less than 25% would not be regarded as meaningful.)

7. Arguments for:

- (a) If coupled with a move to 100% industrial derating, the introduction of 25% commercial derating would blunt criticism from the commercial lobby.
- (b) The reduction in rates costs would strengthen the financial position of the commercial sector (although the effect on employment is not clear).
- (c) Administratively the derating could be accomplished with few problems.

8. Against

- (a) The cost of introducing 25% commercial derating - £16.6m per year - is high compared to the other measures we have examined.

CONFIDENTIAL

- (c) A subsidy scheme by itself could not be justified on energy policy grounds; and (insofar as it modified the incentive for industry to reduce its dependence on oil - currently 82% of total industrial energy consumption) would be detrimental.
- (d) Although the presentational impact of an energy subsidy within the Province is clear enough (para 10(a) above) it is doubtful whether it would have much "shop-window" impact on likely inward investors. In a recent attitude survey of potential investors energy costs were rated only 20th out of 26 in the list of priorities affecting investment decisions.

Energy conservation scheme

12. This proposal was initially considered as a possible adjunct to an energy subsidy scheme; but it later emerged as an independent option. An industrial energy conservation scheme would offer grants in the 25-30% range for the net cost of approved energy conservation projects - eg insulation schemes, improvements in processes and techniques, waste-heat recovery schemes. (Most industrial projects of this nature would also qualify for standard capital grant making a total rate of assistance of some 50%). It is estimated that expenditure of some £3m per year could be sustained on grants for conservation projects, with perhaps an additional £1m per year for the conversion of oil-fired boilers to coal (this would attract a 50% grant rate).

13. Arguments for:

- (a) A conservation scheme would be consistent with national, and would strongly reinforce regional energy policy, particularly if it provided incentives for Northern Ireland industry to reduce its excessive dependence on oil.
- (b) It would help to give local industry a continuing competitive edge, based on real efficiency improvements, and would therefore have the incidental effect of safeguarding employment.
- (c) Since most conservation projects would entail structural alterations to factories, etc a conservation scheme would increase activity and employment in the construction industry and among the suppliers of professional services. It is estimated that a conservation and oil conversion scheme costing £4m per year in grants could generate annual expenditure on construction and professional services of over £2m per year, as well as leading to a recurring reduction in the industrial energy bill of some £3m per year.

14 Against:

- (a) Although its virtues are evident, an energy conservation scheme would at best have only a modest impact on the Province's economic problems. It is a makeweight measure which would be unsuitable as the vehicle for any major injection of funds into the economy.
- (b) A conservation scheme would have no "shop-window" appeal for potential investors.

Transport Subsidy

15 While no precise figures are available, the Chamber of Commerce and Industry has expressed the view that the cost disadvantage imposed on manufacturers by the sea crossing from Northern Ireland to Great Britain is in the range of 4-10% of total transport costs. With transport costs estimated at around £200 million per year, the annual disadvantage may therefore lie in the range of £10-20 million (a figure supported by other estimates). A scheme aimed at compensating Northern Ireland manufacturing industry for this extra cost would probably apply only to exports and would need to cover both the exported goods carried in containers or flats, and the much smaller proportion carried as bulk cargo. In respect of the container traffic, the average sea transport cost of shipping a container to GB would need to be established. A subsidy rate could then be struck and grant paid (on the basis of the number of containers shipped, not the actual cost incurred) to firms submitting audited applications. The use of standard rather than actual costs would be necessary to keep the paperwork within manageable proportions. For exports not travelling in standard containers, however, the subsidy would have to be paid on the actual costs incurred by the manufacturer.

16 Arguments for:

- (a) The sea barrier is widely perceived as, and is, a special disadvantage faced by Northern Ireland industry although it has a differential effect on different sectors. A subsidy scheme which compensated for this physical separation could have some psychological (as well as financial) value for manufacturers.

- (b) While a standard transport subsidy would not be uniformly attractive or helpful to all companies, a targetted scheme could be a more cost-effective way of assisting employment in sectors which face a high transport cost disadvantage.

17. Against:

- (a) The operation of any transport subsidy scheme would be administratively complex and would have significant staffing implications. Moreover, to limit potential abuse of the scheme, considerable staff resources would need to be devoted to it.
- (b) Whatever the staffing level, however, the scope for abuse could not be eliminated. There would for example be considerable difficulties in ensuring that goods originating in the Irish Republic did not benefit from the scheme.
- (c) The introduction of a subsidy on exports could well raise a clamour for similar aid from importing companies. But a transport subsidy on the import side would be impractical to administer and would be unacceptable on policy grounds, since a high proportion of imports are consumer goods and any measure which reduced the cost of imports would in effect be a subsidy on consumer expenditure.
- (d) Although it is difficult to quantify the employment/subsidy match for a standard (as opposed to selective) transport subsidy it is clear that this approach (less good than derating but better than an energy subsidy) would be an expensive way of assisting employment. There would in practice be severe difficulties in attempting to devise a targetting scheme given the diversity of the industrial sector.
- (e) The "shop-window" effect of a transport subsidy might not be substantial. (In the attitude survey of potential investors mentioned above, transport and proximity to markets rated ninth and tenth in the order of priority). Indeed, a transport subsidy scheme might be counter-productive in drawing attention to a problem which had not previously been seen as significant.
- (f) Once introduced, a subsidy on transport costs would be exceptionally difficult to discontinue, given that the facts of Northern Ireland's geographical separation would not change.

Assistance to the Construction Industry

18. Government could stimulate activity through the allocation of funds for new construction projects.

19. Arguments for:

Employment could be created fairly rapidly.

20. Against:

- (a) Jobs created in this manner would be expensive and would last only as long as the public expenditure injections which created them. By contrast our aim is to create secure and viable jobs.
- (b) Increased construction activity would not necessarily strengthen the industrial base or increase the resilience of the manufacturing sector.

PUBLIC EXPENDITURE ASPECTS

1 The cost of an extension of industrial derating to 100% and the introduction of an energy conservation scheme is estimated at about £10m for a full year and I am prepared to cover those costs from within the resources presently allocated to the industry, energy, trade and employment programmes in Northern Ireland.

2 The Corporation Tax Relief Grant should not give rise to any significant cost in the first few years, since it is proposed to limit it to new cases qualifying for selective assistance and it would inevitably be some time before profits are generated. It is not possible to form a quantified view of the number of additional projects which the scheme would attract nor the profits qualifying for grant which, over a period of years, such projects would make. In addition while there could be some trade-off between CTRG and other elements of the NI incentives package it is impracticable in advance of the detailed negotiations which would be involved to balance this accurately. However there is little doubt that in the shorter term, and certainly within the period of the Public Expenditure Survey, there will be no pressure on public expenditure.

3 In the longer term it is not possible to put a precise figure on the cost of the proposed Corporation Tax Relief Grant. Illustrative costings discussed with HMT suggest, however, that by year 10 the cost of selective assistance in Northern Ireland with CTRG added to the armoury of incentives would be (on "worst case" assumptions for public expenditure purposes) of the order of £68.7m. I believe the figure on more realistic assumptions to be likely to be nearer £61.8m. In arriving at the public expenditure costs it is assumed that in both the "worst case" and the "realistic case" half of the CTRG commitment would be additional to and half in substitution for the existing range of incentives; and also that the introduction of CTRG will have an incentive effect on the number of cases which come. The estimate for the "worst case" assumption subsumes a figure of £18.2m for the total effect of CTRG of which £9.1m is in substitution for the existing range of incentives. The estimate for the "realistic case" assumption subsumes a figure of £4.4m for the total effect of CTRG of which £2.2m is in substitution for the

CONFIDENTIAL

existing range. In view of the difficulty about forecasting inflation, all estimates are expressed in terms of 1983 prices. Accordingly the public expenditure implications of CTRG would be manageable in the foreseeable future within the block arrangements under which I manage the NI public expenditure total. That total is currently of the order of £3.8 billion and within that successive Secretaries of State have always been prepared to attach priority to the industrial development programme - I have no doubt that they will continue to do so. The allocation for selective assistance for the 1983/84 year is in fact £74m.

4 I appreciate that on any assumption the cost of a CTRG scheme would still be rising at year 10 and would, if left unchanged, not reach a plateau until year 22. The 22 year peak in the "worst case" would be £87m in terms of total public expenditure commitment (subsuming a £54.8m total for CTRG of which £27.4m is in substitution for existing incentives) and in the "realistic case" would be £65m in terms of total public expenditure commitment (subsuming a £10.6m total for CTRG of which £5.3m is in substitution for existing incentives).

5 Therefore given the estimates of total costs involved on "worst" or "realistic" assumptions (for the short term or the 10 or 22 year points) compared with the existing selective assistance budget of £74m for 1983/84 (which, even if carried forward unchanged, becomes increasingly uncommitted year by year and which on present trends, without the incentive of CTRG, is unlikely to become committed for industrial development), and given the size of the NI public expenditure block which I manage, I am satisfied that even in the longer term the existing public expenditure survey arrangements can cope with such pressures on public expenditure as may arise. Even in the "worst case" 22 year peak it will be possible, when rolling forward public expenditure surveys to take account of existing commitments to projects arising from CTRG, and of potential new commitments, in time for the Departments concerned (including HM Treasury where appropriate) to consider any necessary adjustments in light of all the relevant factors. The options open would include reducing the generosity of the Relief Grant or abolishing it for

CONFIDENTIAL

CONFIDENTIAL

future years, reducing or abolishing some other forms of industrial support, or according some other Northern Ireland expenditure a lower priority to enable industrial assistance to have a larger share of the Northern Ireland block. The central point is that I am not seeking a public expenditure addition now or a commitment to one in the future.

CONFIDENTIAL