Briefing Paper

"REGIONAL INDUSTRIAL DEVELOPMENT" (CMND 9111, DECEMBER 1983)

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The reports of the death of regional policy were premature. Regional policy is alive, if not well, under the present Government. This is clear following the publication of the Governments long-awaited White Paper on regional policy: **Regional Industrial Development (Cmnd 9111, December 1983.)**

The White Paper was expected to be the culmination of a review of regional policy which began in July 1979 under Sir Keith Joseph. Introduced several changes in the detail but maintained the broad philosophy which has underpinned British regional policy since at least the Industry Act of 1972. Surprisingly, the expected radical changes have not materialised. Instead we have a White Paper with "green edges" suggesting perhaps uncertainty and/or a lack of consensus within Government on how best to approach the regional problem in times of severe, if self-imposed, financial stringency.

In broad terms, the Government is proposing to concentrate resources more closely on areas and communities in need. In addition, the present structure of regional incentives, particularly regional development grants, is to be altered in an attempt to make it more cost-effective. Specifically, the White Paper heralds a move to a more discretionary and less automatic incentive structure; greater emphasis on job creation and less on capital investment **per se**; less discrimination against service industries and emphasis on local job creation rather than job diversion.

The Government hopes to achieve these objectives and at the same time reduce public expenditures on the policy. However, it is evident that the Government has yet to discover the philosophers' stone because the White Paper extends an invitation to the public to submit their views on detailed aspects of the policy. These include: the criteria for and coverage of the Assisted Areas; the balance between automatic and discretionary assistance; the role of incentives in creating new firms and local jobs and the activities qualifying for and the rates of, regional development grant. After consultation the Government hopes to take the final decisions in the autumn of this year.

This perspective examines in greater detail the present Government's approach to regional policy, the rationale for change, the specific proposals and the likely outcome for Scotland.

The case for regional policy

The White Paper, not unreasonably, considers the essence of the regional problem to be "imbalances between areas in employment opportunities." (p3) The imbalances remain because institutional and cultural rigidities in the form of geographical wage-stickiness and immobility of labour prevent the otherwise "natural adjustment of labour markets." (p3). Accordingly, the case for regional policy is seen principally as "a social one" (p4), presumably to mitigate the effects of higher unemployment in depressed areas and the consequences to family life of the "forced" migration of those workers who do seek work elsewhere.

The implied view of market efficiency in the absence of institutional rigidities accords well with what has come to be expected from the present Government in the pronouncements of Ministers in other areas of economic policy. Yet, paradoxically, the White Paper does concede an economic case for regional policy but denies its current relevance. The argument that a regional policy diversion of labour demand will raise in some proportion to the jobs diverted, **national** employment and output is held to be inapplicable in conditions of general unemployment. However, to draw such a conclusion is to oversimplify a complex problem and ignores the academic work which suggests that an economic case for regional policy **can** still be made when unemployment exists in all areas. Moreover, it is faintly absurd for the Government to argue on the one hand that freely-functioning labour markets adjust naturally, while on the other conceding an economic case for regional policy when the national pressure of demand is high. In these circumstances, when production in the prosperous areas of the UK is constrained by labour shortages, regional incentives are only necessary to overcome the myopia of entrepreneurs who would other-wise ignore the more profitable production opportunities due to plentiful labour supplies in the Assisted Areas. This is hardly "natural" adjustment. It is most unfortunate that the Government appears to place the responsibility for the failure of labour markets to adjust spatially on the labour force, while ignoring the role played by the inertia of companies. There is no evidence that the South of Britain is an absolutely more efficient location for given production activities, so there is no reason why workers and unions should be held solely responsible for the loss of output due to the failure of the labour market to adjust.

Whatever the intellectual arguments, the fact remains that the Government currently perceives the rationale for regional policy to be purely social. In these circumstances the gross regional policy expenditures are viewed as being equal to the net cost to the Exchequer. The net cost would normally be lower when regional policy creates jobs in the nation, because the average new job increases tax revenues and lowers transfer payments. The pressure on Government to reduce the outlays on regional policy can be expected to increase when these savings in net outlays are absent. Table 1 shows the **gross** outlays to be £917 million at outturn prices in fiscal year 82-83 and the Government is forecasting a figure of £643 million on current policies in fiscal year 83-84.

The policy proposals and the rationale for change

The White Paper's proposals do not stem simply from a perceived increase in the net Exchequer cost of regional policy. The present structure of incentives is biased in favour of an automatic investment grant: the Regional Development Grant (RDG), payable for the provision of new assets for use on qualifying premises. To qualify for assistance the premises must be used for manufacturing and located in either Special Development Areas (SDAs) or simply Development Areas (DAs). The areas taken together cover 27.5% of the working population in Great Britain and approximately 70% of the working population in Scotland. RDG is payable at a rate of 22% in SDAs and 15% in DAs. Table 1 shows that on average expenditure on RDGs accounted for about 72% of total outlays in GB over the period 77/8 to 82/3.

Table 1 : Regional Industrial Assistance, Great Britain and Scotland; Outturn Prices £m

Fiscal Year		77-78	78-79	79-80	80-81	81-82	82-83
1. Regional Development Grants :	Scotland	105	107	70	113	143	287
	Great Britain	393	417	331	491	617	690
2. Selective Financial Assistance:	Scotland	12	12	15	22	19	20
	Great Britain	44	104	78	74	76	90
3. Land and Factory Building:	Scotland	19	30	42	52	60	53
	Great Britain	52	85	110	141	161	137
Totals:	Scotland	136	149	127	187	222	360
	Great Britain	489	606	519	706	854	917
	Scotland as % of Great Britain	28	25	24	26	26	39

Source: Cmnd 9111 and Scottish Economic Bulletin, No 28 December 1983

The main criticism of the RDG is that once the above criteria have been satisfied it is automatic, and payment is not directly related to job creation. Since the Government sees the regional problem to be a relative lack of employment opportunities, a grant which is paid irrespective of job creation and whether the investment would have occurred anyway, can reasonably be considered to be a less than adequate policy instrument.

This is brought home with some force by the scale of RDG payments in fiscal year 82/83 (Table 1). Total RDG expenditures rose from £617 m to £690 m but perhaps more interestingly, the Scottish share of RDG expenditure jumped from 23% in 81/82 to 42% in 82/83. This jump can largely be accounted for by payments to large capital-intensive investments which probably would have occurred in the same locations anyway: £92 m to BP for the oil terminal at Sullom Voe and £19 m to Occidental of Britain Incorporated for oil-related developments in the Orkneys. Moreover, any expenditures that might result following the increased cash flow made possible by the grant would, in these and many other similar cases, be unlikely to benefit the specific local areas designated as being in need of assistance. Apart from these extreme cases, the estimated Exchequer cost of job creation under the present system has been running at about £35-£40,000 per job. A figure which the Government evidently feels to be too high.

It was to be expected that the White Paper's main proposals would seek to tackle this particular problem. However, rather than following the obvious route of scrapping RDG and replacing it with a marginal labour subsidy, the White Paper proposes to retain the RDG but to alter the conditions under which the grant is given. Specifically, RDG Mark II would be an automatic grant payable on **projects** rather than assets, located on qualifying premises which either create new productive capacity or effect a change in a product, process or service. The areas in which the grant would be paid are subject to revision and the activities likely to be in receipt of the grant would be defined more broadly to include possibly 'mobile' services as well as manufacturing. Firms would receive a grant which would be the **higher** of either (a) a fixed amount £x for each new job created, or (b) a percentage of the investment outlays subject to an, as yet unspecified, £Y cost-per-job limit, where £y >£x.

The move away from automaticity to greater selectivity is to be achieved by raising the proportion of expenditures on the present Selective Financial Assistance (SFA): a project-related grant paid with discretion subject to job creation and viability conditions. It is expected that the RDG Mark II will still constitute the main instrument of regional policy, even though the share of SFA expenditures will rise.

Implications for Scotland

One cannot of course predict the effects of the proposals on Scotland with any certainty given that many aspects of the new policy are still to be decided. Yet, the broad lines of policy are clear and it is evident that there will be several effects on Scotland and, to confound the prophets of doom, not all of them harmful.

It is important to be clear that regional policy does work. The most recent estimate of gross job creation quoted by the White paper is of approximately 500,000 manufacturing jobs in the Assisted Areas of the UK over the period 1961-1981. Scotland managed to obtain about one fifth of these jobs that would not otherwise have been located in the Assisted Areas. Two fifths of the jobs created in Scotland can be classified as indigenous; that is jobs created which were not directly associated with inward firm movement. It would, however, be a mistake to attribute these effects solely to the regional incentive structure, for two reasons. First, the pressure of demand in the national economy is important. It is estimated that regional policy was creating about seven to eight thousand jobs in manufacturing per year in the late 1960's, but only about two and a half thousand jobs per annum in the late 1970's. Most of the difference can be accounted for by differences in the national pressure of demand in the later period which was reinforced by the second reason: an active policy of IDC control in the late 1960's which was **de facto** abandoned in the late 1970's because the 'costs' of possible lost investments were less easy to bear during a period of recession. The implication is that Scotland will benefit much more from regional policy once the national economy begins to climb out of recession. The proposed changes in the regional incentive structure will, in contrast, have a relatively marginal effect.

The Government plan to try and reduce the scale of regional policy expenditures while at the same time providing some assistance to currently non-assisted areas, for example, the West Midlands which have suffered relative decline. Expenditures in Scotland are, other things equal, likely to be lower. There will be several capital-intensive projects that will run up against the cost-per-job constraint but the investment will go ahead anyway, because a suitable alternative location will be absent. For these cases the loss of regional policy expenditures is largely immaterial. However, there will be other capital-intensive projects of perhaps a more marginal nature that might not occur at all following the imposition of the cost-per-job constraint. The loss of these expenditures will materially affect the Scottish economy. The difficulty is in assessing the relative proportions of the two categories and estimating if there will be any. relatively labour-intensive projects that might not be viable under the present incentive structure but would be likely to go ahead under the new proposals. The likely result is that there will be a decline in the number of jobs created by the RDG in Scotland but at a smaller rate than the decline in RDG expenditures. The final position on job creation will depend on how effectively the Scottish Office deploys its relatively greater control over regional policy now that it is proposed that the SFA should constitute a greater proportion of overall expenditures. There is some hope here, given the limited evidence on the effectiveness of SFA, that the Scottish Office might be able to use its increased discretion more to the benefit of Scotland, pound for pound, than would otherwise be the case with the RDG. It is, however, an open question, which ignores the extra costs of administering a more discretionary policy.

It is to be expected that the desire to reduce expenditures and concentrate aid will be to the detriment of several areas in Scotland. No decisions have been taken, but the areas most at risk are those DAs with relatively low unemployment rates eg. Dunoon, Oban, Lochgilpead, Falkirk, Kirkcaldy and Dunfermline. It should be noted that removal of Assisted Area status also precludes access to EEC regional aid as well as UK regional aid. However, some areas in Scotland might benefit compared with elsewhere because the White Paper proposes to place a greater weight on criteria other than unemployment to designate Assisted Areas. These include in particular remoteness from an economic centre and emigration.

The abolition of RDG payments to replacement investment which is necessary to bring Britain into line with the requirements of the European Commission, could be especially damaging for the Assisted Areas and Scotland in particular. Many of the projects aided by regional policy in the late 1960s and early 1970s are now coming to the end of their economic life. Without the subsidy to unit costs provided by RDGs for replacement investment, many of these companies may choose to relocate plants back to the parent establishment abroad or in the South of England. One cannot predict the scale of this effect but it could very well be great. This is not necessarily to suggest that Scotland will be perceived to be an economically less efficient location. Rather, when there is little difference in unit costs between areas the cultural attractions of proximity to the metropolis are difficult to resist. Moreover, in a recession the heavy costs of producing in more central locations during periods of expansion and boom are often forgotten.

Finally, Scotland may gain some benefit from a greater emphasis on services, especially if tourism is included. However the Government is surely misguided in seeking to restrict the new incentive structure to those services which do not serve local markets and which are likely to be more mobile. Local services do not necessarily depend on a given level of spending from income earned outside the area by other local sectors such as manufacturing. Spending can be increased and local jobs created by reductions in imports and savings. Moreover, the local service job will itself add to local income and spending. Many manufacturing activities serve local markets e.g. breweries and bakeries, and the Government does not deny RDG payments to those activities on the grounds that it expects jobs to be displaced elsewhere in the local economy. They should adopt the same stance towards services.