P.0592

PRIME MINISTER

Regional Development Grants
(E(81)115 & 116)

BACKGROUND

At their meeting on 10 November (E(81)33rd Meeting, Item 2) the Committee agreed that Ministerial discretion should not be exercised so as to deny Regional Development Grants (RDGs) to the Sullom Voe and Flotta oil pipeline terminals; if the applications, which have yet to be examined, satisfy present criteria the grants will be paid. The Committee did not decide whether to reduce the present RDG percentage rate but asked the Secretary of State for Industry to consider with the Chief Secretary and the Secretaries of State for Scotland and for Wales the possibility of selective changes in the present RDG system.

2. The Secretary of State for Industry reports in E(81)115 that in his view such selective changes are not practicable and that the only sensible option is to reduce the rate by 2 per cent. The Secretaries of State for Wales and for Scotland, in E(81)116, are opposed to such an across-the-board cut and recommend legislation leading to selective changes taking effect from 1983-84. The Chief Secretary, Treasury recommended in C(81)51 cuts of 4 per cent in the RDGs for the Special Development Areas (SDAs) and of 3 per cent for the Development Areas (DAs). The object of the meeting will be to reach a firm decision on the amount and form of any changes in RDGs so that the outcome can be taken into account when the Cabinet looks at the overall public expenditure totals on Thursday.

3. The savings which would flow from the 3 main proposals now before the Committee are:

	£ million 1982-83	1983-84	1984-85	
Secretary of State for Industry	20	53	51	2% off RDG rate
Chief Secretary	36	90	90	3% off DA rate; 4% off SDA rate
Scotland/Wales	0	?	?	Legislation leading to selective changes

MAIN ISSUES

4. The Secretary of State for Industry advises in E(81)115 against selective cuts. In his view, to limit grants by reference to the numbers employed, or by a monetary limit on the grant to be paid on an individual asset, would create uncertainty and so deter potential investment, including inward investment, and might be challenged in the courts as an arbitrary exercise of the Secretary of State's discretion in the payment of grants. He also advises against the exclusion of capital intensive sectors on the grounds that this would deter internationally mobile investment unless selective financial assistance were to be offered, so reducing the savings in prospect.

5. Because of these doubts, the Secretary of State for Industry advises that the only sensible option is to reduce by 2 percentage points the present RDG rates of 22 per cent in the SDAs and of 15 per cent in the DAs. He is opposed to the Chief Secretary's proposals for larger percentage cuts because he judges that 2 per cent is the most that could be done consistently with the statement made by his predecessor in July 1979 after the Government's review of regional policy, and repeated since, that:

> "Our objective is to maintain reasonable stability in the framework of regional investment incentives and to avoid abrupt changes."

6. In the previous discussion, the Secretary of State made clear that he would be willing to support a 2 per cent cut in RDGs only if this were in the wider context of a package helpful to industry. In particular he had in mind a reduction in the National Insurance Surcharge; now that he knows that the Chancellor of the Exchequer cannot accept this for the time being, he may be reluctant to go along with an RDG cut. One possibility is that he might revert to his proposal, which he did not press at the last meeting, that the present deferment of payment of grant by 4 months from approval should be reduced to 2 months. Unless the costs could be brought forward into 1981-82 this would be highly unattractive because there would be additional payments of £70 million in 1982-83 and of £4 million and £11 million in the 2 following years; since it is no longer proposed to deny grants for Sullom Voe and Flotta, which might have saved £122 million in 1982-83, there would be a net increase in expenditure next year.

7. The Chief Secretary will probably continue to argue for the higher savings for which he bid in his public expenditure paper C(81)51. We understand that he may, later today, send you a minute suggesting that an alternative would be to remove, perhaps, five industrial sectors from eligibility for the scheme. This would seem to be wholly inconsistent with the present pledge and not to be a runner.

8. The Secretary of State for Wales, who took the lead in preparing E(81)116, and the Secretary of State for Scotland are strongly opposed to a general cut of even 2 per cent. They believe that it would create uncertainty which would deter inward investment; would perhaps lose some finely balanced projects; and would be an untimely blow to the cash flow of firms in the Development and Special Development Areas. They suggest instead that there should be legislation to remedy the present deficiencies of the RDG scheme by providing for tapering rates of grant above defined thresholds or lower rates of grant for capital intensive industries. They accept that new legislation could not be introduced in the present Session.

9. There are two strong objections to this proposal: there would be no public expenditure savings in the key year of 1982-83, negligible savings in the following year, and an unquantified amount in 1984-85; such changes, in the lifetime of the present Parliament, would not sit easily with present pledges. The better course would be to take these ideas on board in the general review of RDGs which is to be undertaken with a view to fundamental changes in the next Parliament; the CPRS will shortly be putting a paper on this to the Chancellor of the Exchequer's MISC 14 Group.

10. Given the need to have regard to the Government's pledges on RDGs, to make public expenditure savings as soon as possible, and to avoid further legislation, you might wish to consider steering the Committee to a conclusion in favour of a cut of at least the 2 per cent suggested by the Secretary of State for Industry. Since this is a relatively modest cut, the Secretaries of State for Wales and for Scotland might be persuaded that their fears about the effect on industrial cash flow and on inward investment are exaggerated. Treasury Ministers will no doubt argue that no strings should be attached to this saving; the main benefit to industry will be in helping to keep down the overall total of public expenditure and so reducing the pressure on interest rates.

HANDLING

11. After the Secretary of State for Industry has introduced his paper you might ask the Secretaries of State for Wales and for Scotland to speak to E(81)116 and then invite the Chief Secretary to state his position. The Secretary of State for Energy may want to comment on the selective options, which could affect in particular oil refining projects. You will wish to guide the meeting to reaching a firm decision which can be taken into the public expenditure arithmetic which the Cabinet is to consider on Thursday.

CONCLUSIONS

12. In the light of the discussion you will wish to record conclusions on which of the three main options before the Committee is to be adopted:

i. a general 2 per cent cut in the RDG rate as proposed by the Secretary of State for Industry;

or ii. a cut of 4 per cent in the rate in the SDAs and of 3 per cent in the DAs, as proposed by the Chief Secretary;

or iii. no savings in 1982-83 but legislation next Session to provide for unspecified savings in the later years, as proposed by the Secretaries of State for Wales and for Scotland.

PLG

P L GREGSON

23 November 1981